REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 72 of 2017

I & M BANK KENYA LIMITED.....APPELLANT
VERSUS
COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant is a limited liability company incorporated in Kenya and licensed under the Banking Act whose principal activity is banking and provision of financial services.

2. The Respondent, the Commissioner of Domestic Taxes, is an agent of the Kenya Revenue Authority and appointed under Section 13 of the Kenya Revenue Authority Act (Cap 469) with the mandate to collect various taxes on behalf of the Government of Kenya.

3. The Respondent carried out an audit of the Appellant's tax affairs for the years of income 2011 and 2012 in relation to Income Tax and years of income 2012 to 2013 for agency taxes.

4. Based on the above audit exercise, the Respondent assessed and demanded additional tax amounting to **Kshs 434,247,169.00** in respect of the years 2011-2013 as per the additional tax assessment letter dated 29 May 2015.

5. The grounds for additional tax assessment were:

   (i) That the Appellant erroneously claimed provisions of bad and doubtful debts as tax deductible contrary to Section 15(2)(a) of the Income Tax Act ("ITA") and the *Guidelines on Allowability of Bad Debts* (Legal Notice No. 37 of 2011);
   (ii) That the Appellant incorrectly claimed a deduction on unrealised forex losses;

(iii) That the Appellant should not have claimed a deduction in respect of certain provisions; and
(iv) That the Appellant failed to account for withholding tax and VAT on certain fees.

6. The Appellant objected to the additional tax assessment in a letter dated 26th June 2015. The objection was raised under the then Section 84(1) of the Income Tax Act (repealed by Act no. 29 of 2015).

7. The Respondent acknowledged the Appellant's objection through a letter dated 15th July 2015. The letter observed that the Respondent had taken note of the Appellant's objection to the additional tax assessment and requested for additional information to enable it undertake a review in order to finalise the matter. The Respondent also issued the Forms IT 13 to confirm receipt and acknowledgement of the objection.

8. Various meetings and e-mail correspondence took place in August and September 2015 between the parties and more information was exchanged.

9. On 25th January 2017, the Appellant wrote to the Respondent and pointed out that since an Objection Decision had not been issued by the Respondent, it was the Appellant's view that its objection was deemed to have been allowed in line with Section 51(11) of the Tax Procedures Act (TPA). Section 51(11) provides that:

> ***Where the Commissioner has not made an objection decision within sixty days from the date that the taxpayer lodged a notice of the objection, the objection shall be allowed.***

10. The Respondent, in response to the Appellant's above-mentioned letter, issued an Objection Decision vide a letter dated 13th March 2017. The Objection Decision partly allowed the Appellant's objection and revised downwards the additional tax assessed to **KShs 238,811,243.00**.

11. Aggrieved by the Respondent's decision, the Appellant instituted judicial review proceedings in the High Court on 3rd April 2017 to quash the Respondent's Objection Decision on the basis that the decision was time-barred and illegal (JR Application No. 138 of 2017).

12. The High Court, in a ruling dated 5th December 2017, referred the matter to the Tax Appeals Tribunal ('TAT') for determination, and further directed

the Appellant to amend its Memorandum of Appeal and Statement of Facts accordingly to include its arguments that the Respondent's Objection Decision was time-barred.

13. When the matter came up for hearing before the Tribunal, the Appellant raised a preliminary objection that the Respondent's Amended Statement of Facts had been filed out of time, and without seeking and obtaining leave from the Tribunal prior to filing the same. The Respondent had earlier been directed by the Tribunal Chair to file its Amended Statement of Facts within 14 days of being served with the Appellant's Amended Memorandum of Appeal and Statement of Facts.

14. The Respondent however argued that the Amended Statement caused no prejudice to the Appellant and prayed that it be allowed in the interest of justice and with due regard to Article 159 of the Constitution.

15. The Tribunal concurred with the Appellant and directed that the Respondent's Amended Statement of Facts be expunged from record. The Tribunal observed that the Respondent had failed to avail itself the opportunity to seek leave and had not placed any material before the Tribunal to justify why the Amended Statement of Facts was filed out of time. The Tribunal therefore upheld the Appellant's objection.

THE APPELLANT'S CASE

16. The Appellant, through a letter dated 26th June 2015, objected to the Respondent's assessment letter of 29th May 2015. The Appellant's Notice of Objection was filed within the stipulated time and in accordance with the then Section 84 of the Income Tax Act which provided as follows:

> ***(1) A person who disputes an assessment made upon him under this Act may, by notice in writing to the Commissioner, object to the assessment.***
>
> ***(2) A notice given under subsection (1) shall not be a valid notice of objection unless it states precisely the grounds of objection to the assessment and is received by the Commissioner within sixty days after the date of service of the notice of assessment; but if the Commissioner is satisfied that owing to absence from Kenya, sickness or other reasonable cause, the person objecting to the assessment was prevented from giving the notice within that period and there has***

been no unreasonable delay on his part, the Commissioner may, upon application by the person objecting, and after deposit by him with the Commissioner of so much of the tax as is due under the assessment under section 92, or such part thereof as the Commissioner may require, and the payment of any interest due under section 94, admit the notice after the expiry of that period and the admitted notice shall be a valid notice of objection:

Provided that the objection made within the sixty days shall not be valid unless it is accompanied by a return of income together with all the supporting documents, where applicable.

(3) A person aggrieved by the refusal of the Commissioner to admit a notice of objection under subsection (2) may, on depositing with the Commissioner if he so requires, the whole or such part as the Commissioner may require of the amount of tax assessed under the assessment to which objection is made and on paying any interest due under section 94, appeal against the refusal to a local committee, whose decision shall be final.

(4) All the provisions of this Act relating to appeals against assessments shall, so far as they are applicable and subject to the finality of the decision of the local committee, have effect with respect to an appeal under subsection (3), and the local committee hearing the appeal may confirm the decision of the Commissioner or may direct that the notice concerned shall be a valid notice of objection.

17. The Appellant submitted that its Notice of Objection complied with the requirements of the foregoing section in all aspects and that the Respondent acknowledged the Notice of Objection in its letter dated 15th July 2015.

18. Upon receipt of the Appellant's objection, the Respondent proceeded to issue the Appellant with Forms IT 13 which set out the undisputed tax to be paid, which the Appellant settled.

19. After receipt of the Appellant's Notice of Objection, the Respondent further requested for additional documents which the Appellant claims to have provided.

20. Upon commencement of the TPA on 19th January 2016, the Appellant's expectation was that the Respondent would issue an Objection Decision within 60 days of the TPA coming into force in accordance with Sections 51(8) and 51(11) which provide as follows:-

> ***51(8) - Where a notice of objection has been validly lodged within time, the Commissioner shall consider the objection and decide either to allow the objection in whole or in part, or disallow it, and Commissioner's decision shall be referred to has an "Objection Decision".***

21. In the Appellant's view, the Respondent was required by the TPA to issue an Objection Decision by 19th March 2016, i.e. 60 days after the TPA coming into effect, and it failed to so.

22. The Appellant wrote to the Respondent on 25th January 2017, about one year after TPA came into effect, and drew the Respondent's attention to the fact that since no Objection Decision had been issued within the time period stipulated in the Act, the Appellant deemed its Notice of Objection to have been allowed in accordance with Section 51(11) of the TPA.

23. However, the Respondent, upon receiving the Appellant's letter, issued an Objection Decision in a letter dated 13th March 2017.

24. Since the Respondent did not issue an Objection Decision within 60 days after the coming into effect of the TPA, the Appellant contends that its Notice of Objection should be deemed to have been allowed in accordance with Section 51(11) of the TPA.

THE RESPONDENT'S CASE

25. The Respondent avers that it held a meeting with the Appellant on 3rd March 2015 at the Respondent's office to discuss the status of the audit exercise. In the meeting, the Respondent alleges that the Appellant promised to provide the necessary documentation the Respondent needed to conclude the exercise, but failed to do so.

26. Due to the Appellant's failure to produce the required documents, the Respondent proceeded to raise the tax assessment vide its additional tax assessment letter dated 29th May 2015.

27. The Respondent contends that in response to its assessment, the Appellant raised an open-ended objection dated 26th June 2015. In the objection letter, the Appellant is alleged to have indicated that it will provide the Respondent with additional information and also conduct a review of any outstanding information before issuing a final response to the Respondent. This, according to the Respondent, is demonstrated by paragraphs 1, 2, 3, 4 & 10 of the Appellant's objection letter.

28. The Respondent submits that it acknowledged the Appellant's letter on 15th July 2015 and requested the Appellant to provide the necessary information to enable the Respondent review the tax assessment.

29. A follow-up meeting was held between the Respondent and the Appellant in the Respondent's office on 11th August 2015 to discuss the tax issues raised in the objection letter. Again, the Appellant is alleged to have promised that it will provide additional information and reconciliations to enable conclusion of the matter.

30. On the 25th August 2015, the Appellant issued a further notice of objection to the Respondent, and on 17th September 2015 confirmed by e-mail the action points of the meeting held on 11th August 2015 and undertook to provide the required information.

31 The Respondent contends that the Appellant further acknowledged that the review exercise was still ongoing through the Appellant's e-mail dated 12th January 2017 to the Respondent.

32. However, the Respondent claims that the Appellant retreated from the above position and invoked Section 51(11) of the TPA vide a letter dated 25th January 2017. As a result, the Respondent communicated its Objection Decision in a letter dated 13th March 2017.

33. The Appellant, aggrieved by the Respondent's decision, filed an application for judicial review at the High Court on 24th March 2017 challenging the validity of the Respondent's Objection Decision. It also filed an appeal with the TAT on 25th April 2017.

34. The High Court directed that the matter regarding the validity of the Objection Decision should also be determined by the Tax Appeals Tribunal together with the Appellant's appeal.

SUBMISSIONS BY THE PARTIES

A. Legality of Respondent's Objection Decision

35. The Appellant submits that the Respondent's Objection Decision was time-barred as it was not rendered within the time period specified in Section 51(11) of the TPA.

36. Section 51(11) requires that the Commissioner renders a Decision to an Objection within 60 days after the taxpayer has submitted its objection. The Appellant bases its argument on the following grounds:
    (i) The Respondent issued its assessment on 29th May 2015;
    (ii) The Appellant duly lodged its objection to the assessment on 26th June 2015;
    (iii) The Respondent acknowledged the Appellant's objection on 15th July 2015;
    (iv) The Appellant wrote to the Respondent on 25th January 2017 and pointed out that no Objection Decision had been issued within the 60-day period stipulated in the TPA;
    (v) After receiving the Appellant's letter, the Respondent issued an Objection Decision on 13th March 2017 which partially allowed the Appellant's objection and reduced the additional tax demanded from **KShs 434,247,169.00** to **KShs 238,811,243.00**, being principal tax plus penalties and interest;
    (vi) That the TPA came into effect on 19th January 2016 and therefore the Respondent was bound to issue a decision within 60 days from that date, i.e. on or before 19th March 2016;
    (vii) Section 51(11) provides that where the Commissioner has not made an Objection Decision within 60 days from the date the Objection Notice was lodged, then the objection shall be deemed to have been allowed; and
    (viii) The Appellant provided the Respondent with all the information it requested for in order to make a decision on the Appellant's objection, but the Respondent still failed to communicate its decision on the Appellant's objection within the mandatory 60 days provided for in the TPA.

37. The Appellant relied on **REPUBLIC-VS- KENYA REVENUE AUTHORITY ex-parte M-KOPA KENYA LIMITED (JR APPLICATION NO. 599 OF 2017) eKLR,** the High Court addressed the issue regarding the time-period within

which an Objection Decision should be rendered and held as follows in paragraph 106:

> ***"...the Respondent was required to make a decision in respect thereof within sixty (60) days under section 51(11) of the said Act. As the Respondent defaulted in making a determination thereon within the prescribed time, the said objection was deemed to have been allowed."***

38. The Appellant has pointed out that the requirement to render a decision within a stipulated time period is not unique to the TPA. Section 229(5) of the East African Community Customs Management Act (EACCMA) requires the Commissioner to make a decision within 30 days failure to which the Application for Review is deemed to have been allowed. S. 229(5) -

> ***"Where the Commissioner has not communicated a decision to the person lodging the application for review within the time specified in subsection (4) the Commissioner shall be deemed to have made a decision to allow the application."***

39. That the High Court affirmed the position with respect to S.229(5) of EACCMA in the case of **REPUBLIC-VS- COMMISSIONER OF CUSTOMS SERVICES ex-parte UNILEVER KENYA LIMITED (2012) eKLR** where Korir J. held that:

> ***"If the respondent does not communicate a decision within 30 days, then the respondent "shall be deemed to have made a decision to allow the application." The law is so clear that it can only be interpreted in one way.***
>
> ***The ex-parte applicant lodged an application for review on 8th March, 2011 and provided further information on 16th March, 2011 when samples for laboratory tests were taken by the respondent. The 30 days therefore started running from 16th March, 2011. The respondent communicated the decision to the ex-parte applicant on 18th July, 2011. By communicating the decision four months from 16th March, 2011 the respondent was clearly in breach of the provisions of Section 229 EACCMA.***
>
> ***The respondent's letter dated 18th July, 2011 means nothing since the respondent's failure to communicate a decision to the ex-parte***

applicant by 16th April, 2011 meant that the respondent had accepted the ex-parte applicant's application for review. The implication of the respondent's non-communication within the statutory period of 30 days is that the ex-parte applicant did not owe the taxes demanded by the demand notice of 9th February, 2011. The respondent's decision in the letter dated 18th July, 2011 which revised the tax demand downwards from Kshs. 102,254,601.00 to Kshs. 65,335,378.00 was therefore void from the beginning. The law as it is presumes that by failing to communicate a decision by 16th April, 2011 the respondent was telling the ex-parte applicant that its appeal against the tax demand contained in the notice dated 9th February, 2011 had been allowed and the ex-parte applicant did not owe the respondent any tax in respect of that particular demand. It is clear that the respondent is barred by the law from ever recovering the tax demanded in the letter dated 9th February, 2011 and revised by the letter dated 18th July, 2011."

40. The Appellant is of the view that the Respondent was bound by Section 51(11) of the TPA to communicate its decision within 60 days of the TPA coming into effect, and failure to do so should be taken to mean that the Appellant's objection had been allowed. Thus the Respondent has no legal right to demand the amount stated in its letter dated 13th March 2017.

41 Even though its objection was made prior to the TPA coming into effect, the Appellant submits that the provisions of the Act apply to this case by virtue of Section 113(1) which states:

> ***Subject to this section, this Act shall apply to any act or omission that occurred or is occurring for which no prosecution has been commenced, or any assessment made against which no appeal has been made, before the commencement date.***

42. Since the Appellant had not filed an appeal at the commencement of the TPA, it submits that Section 113(1) applies to this case in so far as the time limit applicable for issuing an Objection Decision by the Respondent.

43. The Appellant has relied on the case of **TRANSACTION PAYMENT SOLUTIONS (K) LIMITED-VS.-KENYA REVENUE AUTHORITY (TAT No. 51 of 2016)** on late notification of an Objection Decision. In this case, the Tribunal examined the arguments placed before it by the parties and made the following observations:

(i) The TPA came into effect after the Appellant had already filed its objection against the assessment;
(ii) The Tribunal found that no Appeal and no prosecution had been commenced before the effective date of the TPA, as the Appellant was still awaiting the Commissioner's decision on its objection; and
(iii) Therefore the Appeal could not be handled under the repealed sections of the ITA.

44. The Respondent in reply to the Appellants submissions contends that the Appellant's objection was not valid and did not comply with Section 51(3) of the TPA to warrant an appeal. Section 51(3) states:

> ***A Notice of Objection shall be treated as validly lodged by a taxpayer under subsection (2) if—***
> ***(a) the notice of objection states precisely the grounds of objection, the amendments required to be made to correct the decision, and the reasons for the amendments; and***
> ***(b) in relation to an objection to an assessment, the taxpayer has paid the entire amount of tax due under the assessment that is not in dispute.***

45. The Respondent also states that the Appellant did not provide it with the necessary information in good time to enable it amend the assessment, and that the Appellant continuously engaged it with meetings, letters and e-mails on the outstanding issues to the assessment for a period of more than 60 days from the date of assessment. As a result, the Respondent avers that it was left with no choice but to facilitate the Appellant on resolving tax issues at hand.

46. The Respondent further submits that the Appellant's letter of objection lacked finality and left room for engagement with the Respondent who was constrained to facilitate the Appellant to conclusively deal with outstanding issues in good faith. For instance, paragraph two of the letter states;

> *"we are currently undertaking a further review of 2012 and 2011 and will provide additional details shortly".*

The Appellant is also alleged not to have provided necessary information on issue no. 2(11) on withholding tax on interest on foreign bank deposits and had stated;

"we are continuing review of the source of the differences for years of income 2011 and 2012 and will revert in a short while".

47. The Respondent avers that from the various correspondence between its representatives and the Appellant, it is clear that deliberations took place and the Appellant had in its letter expressed willingness to discuss the assessment with a view to reaching a settlement on the matter. The slow pace of the review exercise of the matter in dispute was as a result of unavailability of information that was to be provided by the Appellant.

48. The Respondent submits that it acted in good faith by giving the Appellant a window to provide additional information on pending issues. In its view, the Appellant's action to invoke the provisions of Section 51(11) after a period of two years demonstrates bad faith and is also untenable in the circumstances.

49. Without prejudice to its challenge of the legality of the Respondent's Objection Decision, the Appellant nevertheless submits as follows on the specific issues raised in the Respondent's assessment.

B. <u>On the validity of the Appellant's Notice of Objection</u>

50. The Respondent, in its Statement of Facts, has argued that the Appellant's objection dated 26th June 2015 was not valid. The Appellant submits that the Respondent should be estopped from denying the validity of the Notice of Objection dated 26th June 2015 for the following reasons:

    (i) After receipt of the objection, the Respondent did not at any time raise any issue regarding its validity; and
    (ii) The Respondent proceeded to issue an Objection Decision. Under the provisions of Section 51(8) of the TPA, this can only be issued in the case of a valid objection.

51. The Appellant avers that Section 51(4) gave the Respondent an opportunity to determine whether an objection has been validly lodged and to immediately inform the Appellant in case it was of the view that the objection had not been validly lodged. However, it did not do so.

Section 51(4) - Where the Commissioner has determined that a notice of objection lodged by a taxpayer has not been validly lodged, the

Commissioner shall immediately notify the taxpayer in writing that the objection has not been validly lodged.

52. The Appellant further submits that the Respondent, in its letter dated 15th July 2015, acknowledged the Appellant's objection. The letter partially read;

> *"By a copy of this letter, we acknowledge your objection to additional assessment for the following tax heads..."*
>
> The letter's heading read:
>
> *"Re: I & M Bank Limited: Acknowledgement of Objection, Years of Income 2011 to 2013."*

53. In the Appellant's view, there is no doubt that the Respondent received the Notice of Objection, acknowledged and considered it as such. This is further demonstrated by the Respondent's issuance of Forms IT13 indicating the amount of undisputed tax to be settled by the Appellant.

54. The Respondent in disputing the validity of the Appellant's objection letter dated 26th June 2015 avers that the letter was open-ended and lacking in precision. Whereas the said letter stated the grounds of objection, it did not conclusively specify the amendments the Respondent was required to make in order to correct its decision.

55. The Appellant, on the other hand, submits that the TPA did not exist at the time it lodged its objection. At that time, the appeal was governed by the ITA, and Section 84(1) of the ITA at that time only required the Appellant to state the grounds for the objection. The requirement for specifying the nature of amendments that the Respondent should make to the assessment was introduced by the TPA.

56. Nonetheless, the Appellant argues that in its objection, it had in fact requested the Respondent to amend its assessment.

- The second last line of page two of the Notice of Objection (page 15 of the Appellant's Amended Statement of Facts) reads;

> *"in light of the above explanation, we consider that no additional tax is payable and request that this item be dropped".*

Similarly, on page 18 of the Amended Statement of Facts, the second paragraph states;

> *"the additional assessment raised under this item is therefore erroneous and should be dropped".*

- On page 19 of the Amended Statement of Facts, in the last line of paragraph one, the Appellant states;

> *"we have re-worked the correct position per Appendix 7 herewith. The additional amount payable is KShs 54, 810.00. We therefore object to the additional assessment of KShs 970,076.00".*

- Lastly, at page 22 of the Amended Statement of Facts, the Appellant states;

> *"we shall be grateful if you would amend the assessment accordingly."*

The foregoing suggestions, in the Appellant's view, are evidence of its requests to the Respondent to amend its assessment accordingly.

57. The Appellant argues that the **M-KOPA CASE** set out the parameters of what constitutes a valid objection by stating as follows:

> ***"..there is no format for making an objection, what is required is the substance rather than the form. What the law frowns at is an objection that is framed in such an ambiguous manner as not to be certain whether the tax payer is seeking further particulars or indulgence to enable it pay the taxes demanded. In this case the applicant had clearly made what was in substance an objection as envisioned under section 51 of the Tax procedures Act, 2015. Accordingly, the Respondent was required to make a decision in respect thereof within sixty (60) days under section 51(11) of the said Act. As the Respondent defaulted in making a termination thereon within the prescribed time, the said objection was deemed to have been allowed."***

58. The Respondent, on the other hand, maintains that an effective objection as prescribed by statute must be a clear counter-offer as understood in the law of contract or a clear and complete answer to the assessment. The Respondent makes reference to the case of **ARROW HI-FI (E.A.) Ltd-VS-THE COMMISSIONER GENERAL OF KENYA REVENUE AUTHORITY & TWO OTHERS** where the Applicant submitted that it inter alia objected to an assessment and also requested for a meeting with KRA officials in order to come to a proper resolution on the disputed customs values within the

stipulated time, but no response was received within 30 days as provided by Section 229(4) of EACCMA. The Applicant therefore deemed its objection had been allowed. The court however held that:

> ***"...an objection that does not unconditionally state a clear and unambiguous position of the taxpayer and which suggests a discussion or a meeting is an application under s. 229(5). For it to be effective it must unequivocally deal with all aspects of the assessment and specify the taxpayer's position on each with clear answers and figures admitted or not admitted. Both letters sought meetings and discussions and the meetings took place and the discussions were held and some tentative arrangements concerning payments were agreed upon. ..***
>
> ***I find and hold that the 'application' did not take effect and was not capable of taking effect under s. 229(5). For an application to take effect it must satisfy the description of a counter offer as understood in the law of contract or constitute a clear and complete answer to the assessment in a manner that can bind the KRA."***

59. Going by the above ruling, the Respondent submits that the Appellant's letter of 26th June 2015 does not qualify as an objection letter since it was suggesting meetings and requested for time to carry out review on their records. In the Respondent's eyes it lacked finality in dealing with issues in dispute.

60. The Respondent further contends that the objection letter dated 26th June 2015 did not meet the threshold set by Section 51(3)(b) of the TPA which also requires the taxpayer to pay the entire tax not in dispute before lodging an objection. Whereas the Appellant conceded to principal tax amounting to **KShs.6,563,885.00** in its letter of 26th June 2015, it only paid **KShs 2,796,044.00** leaving a balance of **KShs 3,767,841.00**. The balance was paid later in July 2015 since the parties were in constant communication. The Appellant has neither paid outstanding interest and penalties on the principal tax nor applied for waiver of interest and penalties.

61. The Appellant, on the other hand, argues this case should be distinguished from the **ARROW HI-FI CASE** which has been relied on by the Respondent on the basis that in that case, the taxpayer completely failed to point out

the tax claims that it wanted the Commissioner to drop or vacate or the tax claims it had admitted. In this matter, the Appellant contends that it clearly admitted to the claims it was not challenging and also requested the Respondent to drop the claims not admitted.

62. The Appellant submits that its Notice of Objection complied with the requirements of the foregoing section in all aspects, i.e., the letter clearly specified that it is a Notice of Objection, it set out the grounds of the objection and also proposed amendments to be made to the assessment.

63. The Appellant further argues that had its claim been vague as alleged by the Respondent then the latter would not have proceeded to issue Forms IT 13 to enable the Appellant to make payment of the admitted taxes.

64. On the claim that it did not pay the admitted taxes before filing the Notice of Objection, the Appellant reiterates this was not a requirement under the repealed Section 84(1) and (2) of the ITA. Payment of admitted taxes prior to lodgment of an objection is a requirement of the TPA under Section 51(3). The Appellant avers that payments were made on 2nd March 2015 and 17th July 2015, which was before the coming into effect of the TPA.

65. With regard to failure to pay penalties and interest, the Appellant contends that it paid the principal tax based on the amount computed and advised by the Respondent in Forms IT 13 issued, i.e., **KShs 2,238,693.00** and **KShs 3,994,789.00** respectively. The Respondent computed only the principal tax not disputed because it was aware that the Appellant had a right to apply for a waiver of penalties and interest under Section 94(5) of the ITA, a right which the Appellant had indicated in its objection that it would exercise.

66. On the allegations of failing to produce the necessary information in good time to allow the Respondent effect the amendment to the assessment, the Appellant contends that it had already provided the documentation requested by the Respondent by 19th January 2016, when the TPA became effective. This is evidenced by the e-mail correspondence exchanged between the two parties, and specifically the e-mail from the Appellant to the Respondent dated 17th July 2015 and the Respondent's response dated 22nd September 2015 in which the latter acknowledged receipt and indicated it would review and revert. The Appellant did not hear from the Respondent thereafter until it wrote to the Respondent on 25th January

2017 pointing out its failure to deliver the Objection Decision within the time-period specified by the Law.

67. The Appellant disputes the Respondent's argument that the parties engaged in meetings, letters and e-mails on the outstanding issues for a period of more than 60 days from the date of assessment leaving the Respondent with no choice but to engage the Appellant in resolving the issues. According to the Appellant, all discussions had taken place and concluded by the time the TPA became effective and the 60-day period runs from the date the TPA became effective. The Appellant has also pointed out that even if it had continued to engage the Respondent after the commencement of the TPA, this would not have stopped time running based on the decision of the **UNILEVER CASE,** where it was held:

> ***"There is evidence that the parties kept on communicating even after the 30 days had lapsed and one can say that ex-parte applicant had consented to the delay by continuing to communicate over the issue with the respondent. One can say the ex-parte applicant was being a wily fox by giving the respondent the impression that the awaited decision was going to be lawful. The ex-parte applicant was however being clever within the law and the law allows such cleverness. The law is however clear and even if the ex-parte applicant had consented to the delay, that would still not have made the respondent's demand valid."***

C. On the deductibility of the provisions for bad debts made by the Appellant

68. The Appellant avers that it makes two types of provisions, namely; specific impairment losses and portfolio impairment losses. Portfolio impairment is considered a general provision since it is not related to any particular debt and hence is not deductible for tax purposes. However, the movement of portfolio balances from one year to the other has explicit tax implication. This implies the marginal increase from one year to another is tax deductible and similarly a marginal decrease from one year to another is chargeable to tax.

69. The amounts in dispute are specific impairment provisions made on a case by case basis depending on the recovery efforts and collateral available.

70. The Appellant contends that Section 15(2)(a) of the ITA allows deductibility of (i) bad debts; and (ii) doubtful debts. The section states:

(2) Without prejudice to sub-section (1) of this section, in computing for a year of income the gains or profits chargeable to tax under section 3(2)(a) of this Act, the following amounts shall be deducted:

(a) bad debts incurred in the production of such gains or profits which the Commissioner considers to have become bad, and doubtful debts so incurred to the extent that they are estimated to the satisfaction of the Commissioner to have become bad, during such year of income and the Commissioner may prescribe such guidelines as may be appropriate for the purposes of determining bad debts under this subparagraph;

71. Section 15(2) empowers the Commissioner to prescribe guidelines on allowability of bad debts. The Commissioner vide Legal Notice No. 37 of 2011 published guidelines outlining the said conditions, i.e.:

1. *A debt shall be considered to have become bad if it is proved to the satisfaction of the Commissioner to have become uncollectable after all reasonable steps have been taken to collect it.*

2. *A debt shall be deemed to have become uncollectable under paragraph (1) where*
   (a) the creditor loses the contractual right that comprises the debt through a court order;
   (b) no form of security or collateral is realisable whether partially or in full;
   (c) the securities or collateral have been realized but the proceeds fail to cover the entire debt;
   (d) the debtor is adjudged insolvent or bankrupt by a court of law;
   (e) the costs of recovering the debt exceeds the debt itself; or
   (f) efforts to collect the debt are abandoned for another reasonable cause.

3. *A bad debt shall be a deductible expense only if it is wholly and exclusively incurred in the normal course of business.*

4. For the purposes of these guidelines, a bad debt which is of a capital nature shall not be an allowable expense.

72. The Appellant's contention is that the above guidelines do not apply to both bad and doubtful debts, and that these two terms are completely different. The Appellant breaks down the accounting definitions of the two terms below:

Bad debt: is an account receivable that has been clearly identified as not being collectible. From an accounting perspective, this implies that you remove that specific account receivable from accounts receivable account by writing it off. (www.accountingtools.com)

Doubtful debts: As per the International Accounting Standard ("IAS") No. 37, this is an account receivable that might become a bad debt at some point in the future. In this case, one is required to determine accounts receivable that may eventually become bad debts and create an account that is known as allowance/provision for doubtful accounts/debts.

73. Based on the above definitions, a bad debt relates to a debt write off where there is certainty of the debt being uncollectable whereas a doubtful debt is a provision where there is a probability of a debt becoming uncollectable. Provisions are estimated since they are not yet certain.

74. In the Appellant's view, Section 15(2) recognizes that doubtful debts are estimated and this section does not give the Commissioner any powers to prescribe guidelines for deductibility of doubtful debts. The Commissioner's Guidelines only apply to bad debts.

75. The Appellant submits that the Respondent is attempting to extend the scope of the guidelines beyond that which it was intended to address and that Section 15(2) only requires that the Commissioner be satisfied with respect to the estimation of doubtful debts.

76. The Appellant further contends that there is no loss of revenue for the Respondent since where the provisions for doubtful debts recognized in the financial statements in one year are recovered in subsequent periods, they are brought to charge for tax in the year of recovery as per Section 4(d) of the Income Tax Act. Thus disallowing these provisions in the year the provision is made would amount to double taxation, contrary to the requirements of Section 4(d) which states:

"where in computing gains or profits for any year of income any expenditure or loss has been deducted, or a deduction in respect of any reserve or provision to meet any liability has been made, and in a later year of income the whole or part of such expenditure or loss is recovered, or the whole or part of that liability is released, or the retention in whole or in part of such reserve or provision has become unnecessary, then any sum so recovered or released or no longer required as a reserve or provision shall be deemed to be gains or profits of the year of income in which it is recovered or released or no longer required:

Provided that if the person so chargeable with tax in respect of any such sum requests the Commissioner in writing to exercise his power under this proviso, the Commissioner may divide the sum into so many equal portions, not exceeding six, as he may consider fit, and one such portion shall be taken into account in computing the gains or profits of such person for the year of income in respect of which such sum is so deemed to be gains or profits and for each of the previous years of income corresponding to the number of portions"

77. The Appellant further contends that there is no loss of revenue for the Respondent since where the provisions for doubtful debts recognized in the financial statements in one year are recovered in subsequent periods, they are subjected to tax in the year of recovery as per Section 4(d) of the ITA. Disallowing these provisions in the year the provision is made would thus amount to double taxation.

78. The Appellant has relied on IAS 39 that forms the basis of preparation of Financial Statements that are acceptable for tax purposes. IAS 39, which is IFRS (International Financial Reporting Standards) standard that deals with impairment losses on receivables, requires that an impairment on a financial asset or a group of financial assets should only be recognized if there is evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that the event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets.

79. The Appellant submits that in compliance with IAS 39 it has put in place internal monitoring mechanisms to determine when a debt is considered non-performing and impaired, i.e.:

a. *A customer is in default of principal or interest payments (where full payment of principal and interest becomes questionable or as soon as payment of interest or principal is 90 days or more overdue);*
b. *A customer files for bankruptcy protection and this would avoid or delay the customer's obligations to the Appellant;*
c. *The Appellant files to have a customer declared bankrupt;*
d. *The customer consents to a restructuring of a loan that results in a diminished financial obligation that can be demonstrated by material forgiveness of the debt or postponement of scheduled payments;*
e. *The Appellant sells the loan at a material credit-related economic loss; or*
f. *There is observable data indicating that there is a measurable decrease in the estimated future cash flows from a loan.*

80. The Appellant has created a specific provision in respect of specific receivables which are known to be facing serious financial problems or have trade dispute with the entity. Specific allowance may not be created for the entire amount of the doubtful receivable but only a portion of it. On the contrary, a general provision is made based on the fact that the past history of a business may show that a portion of receivable balances is not recovered due to unforeseen circumstances. As a result, it is prudent to create a general provision for doubtful debts in addition to the specific allowance. This general provision is however disallowed in the tax computation since it does not relate to specific occurrence of a default.

81. The Appellant avers that it is regularly audited by the Central Bank of Kenya ("CBK") to ensure compliance with IFRS and CBK Prudential Guidelines with regard to provisioning. The CBK has to date not highlighted or pointed out any non-compliance on the Appellant's part.

82. In view of the fact that there are no specific rules for computing provisions, the Appellant has relied on IFRS which is the basis upon which financial statements are prepared in Kenya. As such, the Appellant contends that it acted within the applicable legal requirements to claim the provisions as a tax deduction.

83. Below is the Appellant's analysis of doubtful debts in contention and a summary of the recovery measures it claims to have taken towards recovery of the same.

Provisions for Year 2011

(i) **Lamsons Industries Limited**

The Appellant made a provision amounting to KShs 50,000,000.00 with respect to this borrower. The facility was secured by, inter alia, a charge over two Nakuru properties owned by a related company, Lams Investments Limited.

The Appellant sent a demand notice for immediate repayment on 29th October 2009. The Appellant's legal counsel later issued a 30 day demand notice on 18th June 2010 and a further 90 days demand notice on 20th July 2010.

The borrower did not respond or act on either of the demand notices, and the Appellant's legal counsel engaged an auctioneering firm, Sportlight Intercepts, who upon expiry of the their notice period issued a 45-day mandatory public auction notice to Lams Investments Limited on 10th February 2011.

The borrower filed a law suit requiring the Appellant to attend a hearing on the 31st March 2011 regarding the outstanding debt. However, on 21st March 2011, the Appellant was served with a temporary injunction dated 18th March 2011 stopping the sale of the properties pending the hearing and determination of the case. On 30th June 2011, the court adjourned the injunction ruling to 2nd December 2011 and on 24th April **2012?**, the court found that the borrower had a *prima facie* case and therefore the matter would proceed for a full hearing hence extending the injunction. Since the value of the security is not realizable by the bank, partially or fully, the Appellant provided for the debt.

(ii) **Virchand Virpal & Sons Limited**

The Appellant made a provision of KShs 34,500,000.00 for this debt. The debt was secured by a charge on residential property in Mombasa. Additional security was pledged in the form of shares trading in the Nairobi Securities Exchange.

Sometime in 2009, the Appellant commenced realization of security by disposing the shares held. However, on 27 April 2010 the Appellant was served with an injunctive order stopping the sale of the shares until the case filed by the borrower is heard and determined by the court.

Whilst the court dismissed the borrower's case on 3rd June 2011, the borrower obtained an injunction preventing the sale of property which was still in force as at 31st December 2011. The Appellant, being unable to realise the security, made a provision for the amount owed.

(iii) **Benir Investments Limited**

The provision amounted to KShs 14,500,000.00 and the facility was secured by *inter alia* a charge over a property in Nyari Estate, Nairobi. The Appellant wrote to the borrower on 15th July 2008, 10th August 2008 and 8th January 2009 requesting that it regularizes its account which was in arrears.

The borrower's managing director wrote to the Appellant on 15th October 2008 informing them of their intention to sell the property Nairobi/Block94/170 in order to regularize the account, and on 6th January 2009, the firm of T.K. Rutto & Co. Advocates wrote to the Appellant and advised that sale process was at an advanced stage. However, in the course of the sale, a third party filed an injunction stopping the transfer of the property and also lodged a caution on the property. The third party raised allegations of fraud and filed a complaint with the Criminal Investigations Department ('CID') and the Land Registry.

On 29th January 2010, the court issued a ruling lifting the caution pending the hearing and determination of the suit. The Appellant's advocates issued demand notices for immediate repayment on 15th April 2010 and 3rd June 2010 respectively.

On 25th March 2011, the court ruled that the original titles held by the Appellant and the third party should be analysed by the Lands registry to determine their authenticity. The court had not ruled on the matter as at 31st December 2011. However, the Chief Land Registrar had indicated the ownership documents furnished by the

borrower are likely to be fraudulent. For the above reasons, the Appellant opted to provide for the outstanding amount.

(iv) **Timothy Njoroge Kimani**

The amount provided for is KShs 600,000.00 in respect of a Hire Purchase facility. The Appellant's legal officer wrote to the borrower on 23rd June 2011 informing him that the facility was in default and therefore it had been terminated and the vehicle would be repossessed.

The Appellant instructed the auctioneering firm of Sportlight Intercepts Kenya Limited to repossess the vehicle. As at 14th December 2011, the auctioneers had been unable to trace both the vehicle and the debtor. A search at the Registrar of Motor Vehicles also established that the vehicle was registered solely in the borrower's name which was inconsistent with the details of the copy of the logbook held by the Appellant.

Provisions for Year 2012

(v) **Cosmos Plastics Limited**

The amount provided for is KShs 25,245,555.00 and arises from a KShs 125 million overdraft facility granted to the borrower in 1996 and which became non-performing in December 2004. The facility was unsecured and the Appellant only held a Corporate Guarantee from Kenya Millers Limited and Cosmos Millers Limited (companies related to the borrower) and personal guarantees of the three directors.

The Appellant's legal counsel sent demand letters to the borrower and guarantors on 11th July 2005. The Appellant later filed a civil suit against the debtor and guarantors on 9th August 2005. The hearing of the suit had not commenced as at 31 December 2012.

Since the Appellant did not hold any tangible security for realization it entered into discussions with the borrower's directors who agreed to pay KShs 48 million against an outstanding amount of Kshs 73 million. A consent letter was executed on 25th March 2013 by the parties and the court declared the suit fully settled on 8th November 2013 on the basis of the consent letter.

The Appellant is of the view that it took all reasonable steps to recover the debt and circumstances beyond its control prevented the hearing of the civil **suit** from taking place.

(vi) **Limobco Exporters Limited**

The provision amounts to KShs 9,000,000.00 and relates to a Hire Purchase facility which was secured by 6 trailers and 6 prime movers. The Appellant sent a demand letter on 24th May 2012 demanding payment within 14 days for the outstanding amount. On 4th June 2012, the Appellant terminated the facility and repossessed the vehicles in July 2012. The borrower obtained a court order stopping the sale of vehicles.

The order was later lifted whereupon the Appellant engaged auctioneers to determine the realizable value of the vehicles based on market rates. As at 31 December 2012, the auctioneers advised that the realizable value was estimated to be approximately KShs 27 million against an exposure of KShs 39.2 million and therefore there was a deficit of KShs 12.2 million. The Appellant made a decision to provide for KShs 9 million against the expected exposure.

(vii) **Caroline Wanjihia**

The amount provided for is KShs 3,000,000.00. The Appellant wrote to the borrower on 13th June 2012 and demanded repayment of the entire outstanding amount **in** respect of a Hire Purchase facility. On 13th June 2012, the Appellant ordered that the vehicle be repossessed.

On 20th July 2012, the Appellant obtained a court order directing the Officer Commanding Muthangari Police Station ("OCS-Muthangari") to assist in the repossession of the vehicle. The vehicle was repossessed and detained at the police station but not released to the Appellant. However, the vehicle was released to, and later sold by, a third party against another debt under unclear circumstances. The Appellant wrote to the CID requesting investigations be undertaken to determine the manner in which the motor vehicle registration was transferred **to** the third party and the authenticity of the auction. Since the security was not available despite the Appellant making its best effort to repossess and auction the vehicle, it made a provision for the debt.

(viii) **Helios Energy Limited**

The provision amounts to KShs 1,500,000.00. The Appellant's legal counsel issued a demand letter to the borrower on 10th September 2012. The debt was unsecured and the Appellant therefore provided for the same.

(ix) **Mr. Chandulal Vichand Shah**

The provision amounts to KShs 870,000.00 and relates to an overdraft for the purposes of trading in shares in the Nairobi Securities Exchange. The facility was secured by a pledge of shares and personal guarantees of Sunil Chandulal Shah, Atul Chandulal Shah and Hasmukhal Virchand Shah through a letter of Guarantee and Indemnity.

The debtor failed to honour the obligations and the Appellant sold all the security pledged. However, it did not recover the entire amount owed and therefore sent out demand letters informing the guarantors of its intention to call up the guarantees.

Upon continued default, the Appellant invoked a clause in the letter of Guarantee and Indemnity that entitled it to exercise the right of set off and appropriation of funds held by any of the debtors/guarantors. This was however challenged in court and the matter went for a full hearing. As at December 2011, the debtors were still indebted to the Appellant and the matter had been fixed for mention on 27th January 2012.

(x) **Ricon Associates (Kenya) Limited**

The provision is for KShs 690,000.00 and the key collateral was a Jeep Cherokee registration number KBK 874K valued at KShs 3,900,000.00 which had been imported by the borrower. The Appellant issued a demand letter on 13th March 2012.

The borrower's majority shareholder and Managing Director, John William Hawley, passed on 3rd April 2012. At that time the vehicle's log book had not been issued and therefore there was no security to enforce towards recovering the outstanding amount.

(xi) **Keval R. Patel & Ajeshkumar V Agravat**

The provision amounts to KShs 600,000.00. The borrowers had been granted an overdraft facility to undertake share trading. The

Appellant wrote a letter on 14th January 2009 informing the borrowers that the amount outstanding was beyond the pledged value of securities and requested that they regularize the account. On 23rd April 2019, the Appellant instructed its legal counsel to demand repayment. The Appellant followed up with another demand letter dated 19th October 2020.

On 26th April 2012, the Appellant instructed its legal counsel to pursue recovery of the debt. The legal counsel sent a demand letter on 14th May 2012 seeking immediate repayment. The Appellant realized the pledged securities and provided for the amount not covered.

(xii) **Caroline Wanjihia & Company Advocates**

The provision is for KShs 500,000.00 and arises from various enhanced facilities granted to the borrower in 2011. The Appellant sent a demand letter on 25th September 2011 demanding immediate repayment.

The facility was secured by a property in Lavington, Nairobi valued at KShs 11.5 million. The security held did not adequately cover the debt and in view of no response from the borrower, the Appellant provided for the difference.

(xiii) **Annways Heritage Limited**

The provision is for KShs 466,307.00. The debtor was granted Hire Purchase facility of KShs 5,600,000.00 and KShs 7,500,000.00 for purchasing a Prime Mover and Trailer respectively. The vehicles also served as security for the facility.

The Appellant issued a demand letter on 14th October 2009 demanding payment of the outstanding amount. On 18th March 2011, the Appellant instructed Mater Quick Col Services, an investigation firm, to trace the whereabouts of the vehicles and guarantors, and also ascertain the vehicles' ownership. On 23rd June 2011, the trailer was recovered.

On 23rd June 2011, the Appellant also instructed Sportlight Intercepts to repossess and sell the vehicles by auction. The Trailer received a bid of KShs 1 million according to a letter from the auctioneers dated 20th July 2011 while the Prime Mover had not been traced as at 23rd

March 2012. The Appellant therefore provided for the amount not covered by the security.

(xiv) **Kaka Wholesalers**

The provision is KShs 418,000.00. The borrower filed a winding up petition in November 2008. In a Kenya Gazette notice dated 11th December 2009, the hearing of the winding-up petition was scheduled to be held on 22nd January 2010. The Appellant sold the vehicles held as security in March – May 2009 and realized proceeds amounting to approximately KShs 6 million which was used to offset part of the outstanding debt.

Since the company was no longer a going concern and being unable to meet its obligations, the Appellant made a provision since it also did not have additional security against which to recover the outstanding amount.

(xv) **Samson Keengu Nyamweya**

The amount provided for is KShs 350,000.00 which arises from overdraft facilities granted between May and October 2007. The Appellant sent a demand letter to the borrower on 7th January 2008. The Appellant's legal counsel wrote to the borrower on 8th November 2012 and notified him of intention to file a Bankruptcy Petition within 14 days. The Appellant filed bankruptcy petition and provided for the amount.

(vi) **Provision for other various debtors**

These are provisions for 14 debtors totaling KShs 1,611,217.00 and are for years 2011 and 2012. The amounts range between KShs 17,000.00 and KShs 268,664.00. The Appellant submits these debts are unsecured and cost of recovery would exceed the amounts owed.

84. The Respondent meanwhile argues that according to Black's Law Dictionary (8th edition), for a bad debt to be considered bad, it must be uncollectable. Hence doubtful debts not proven uncollectable are not bad and therefore allowable deductions within the provision of Section 15(1) and (2). To be allowable they must observe the following characteristics:

(i) Be bad or have become bad.
(ii) Have been incurred in the production of gains or profit.
(iii) Must be estimated to the satisfaction of the Commissioner to have been bad.

85. The Respondent submits that this issue was ably dealt with in **KENYA POSTEL DIRECTORIES LIMITED-VS-COMMISSIONER OF DOMESTIC TAXES (TAX APPEAL NO. 05 OF 2016)**. The Tribunal held:

> ***59. There is a divergent of approach to the above issue by the Appellant and the Respondent. The Appellant takes the position that the provisions of Section 15 (2) (a) of ITA and the guidelines contained in Legal Notice No. 37 of 2011 which confer upon the Respondent the powers on allowability of bad debts is inapplicable to the present Appeal as they only deal with issue of bad debts. According to it the facts of this Appeal relate to "doubtful debts" which according to its reading of Section 15 (2)(a) of ITA are doubtful and can only be estimated to the satisfaction of the Respondent as they have not become bad.***
>
> ***60. The Appellant contends that the said Legal Notice is inapplicable as it only gives guidelines in bad debts and not doubtful debts. In the absence of those guidelines therefore, the Appellant seeks reliance on the Guidelines contained in IAS 39 of the IFRS which essentially means that these debts need only be estimated and a provision made to this effect in its books of accounts.***
>
> ***61. The Respondent on the other hand insists that this Appeal is in respect to bad debts pure and simple under this heading. This being the case therefore the said provision of the ITA and the said guidelines apply with full force effect-and tenor.***
>
> ***62. In order to resolve the contradictory approaches by both parties the Tribunal addressed itself to the issue as to whether there is in reality a distinction between bad and doubtful debts. According to the Black's Law dictionary "Z" edition a bad debt is defined as; "Accounts receivable that will likely remain uncollectable and will be written off. Bad debts appear as an expense on the company's income statement, thus reducing net income. In general, companies make an estimate of bad debt expenses that might be incurred in the current time period based on past records as part of the process of estimating earnings. Most companies make a bad debt allowance since it is unlikely that all of their debtors will pay them in full.***
>
> ***63. Whilst it defines doubtful debts as; the amount of money that a business does not expect to collect from its clients. A bad or doubtful***

debt is an operating expense that can be reported on a financial statement when a customer is experiencing financial troubles or has filed for bankruptcy.

64. Arising out of the above the defining feature of a Bad or Doubtful Debt is that they are irrecoverable and or uncollectable. Therefor for all intents and purposes there is no distinction between a Bad and Doubtful Debts as these words can be used interchangeably.

65. Having resolved the above divergence of approach by the parties the Tribunal makes a finding that the so called "Doubtful Debts" by the Appellant are indeed Bad Debts which must then be tested against the said provision of the ITA and the said guidelines to determine whether they are indeed Bad or Doubtful Debts.

86. The Respondent asserts that according to Section 15(2)(a) of the ITA and the Commissioner's Guidelines, the Commissioner must be satisfied that the debt has become bad in line with the Commissioner's Guidelines (Legal Notice No. 37 of 2011).

87. In the Respondent's view, for debt to be considered bad, it must not be merely doubtful. A debt will not be considered bad merely because the period of time usually set for payment has elapsed and neither payment nor contact has been made by the creditor.

88. That the import of Legal Notice No. 37 of 2011 was emphasized in **COMMISSIONER OF DOMESTIC TAXES-VS-KENYA MALTINGS LTD (COMMERCIAL CIVIL CASE 2 OF 2010).** The court stated at paragraph 25:

"The import of the Legal Notice No 37 of 2011 is that the Commissioner of Income Tax must be satisfied that that all efforts have been made to collect a debt. He must be convinced that the same has become uncollectable for him to declare it a bad debt."

89. In **REPUBLIC-VS-COMMISSIONER FOR INCOME TAX & ANOTHER ex-parte STOCKMAN ROZEN KENYA LIMITED eKLR (2015),** the Judge stated in paragraph 63 that:

"It is clear from the foregoing provision that the decision as to which of the gains or profits that have become bad and doubtful debts so as to be deducted in computing for a year of income the gains or profits

chargeable to tax under section 3(2)(a) is purely the discretion of the Commissioner."

90. That at the time of making the provisions for tax, the Appellant had entered into agreements with some debtors and repayments were being made on the loans.

91. That the Respondent analysed the Appellant's debtors taking into consideration the circumstance of each debt to determine whether the provisions made on non-performing loans were bad or merely doubtful.

92. The Respondent submits that it carried out a detailed analysis of the provisions made by the Appellant and disallowed those that did not comply with the requirements of Legal Notice No. 37. The Respondent's explanations for disallowing them are as follows:

(i) **Lamsons Industries Limited**
The Respondent contends that the court order was a temporary injunction pending determination of the case and therefore there was still an opportunity to realise the security in the future.

(ii) **Virchand Vipal & Sons**
The Respondent contends that the court injunction on the residential property used to secure facility was temporary pending determination of the case. The Appellant is therefore not prevented from realizing the security in future.

(iii) **Benir Investments**
The Appellant holds a charge on a property in Nyari Estate, Nairobi. A third party had filed a case claiming that the property had been fraudulently acquired by the borrower and therefore preventing its sale and transfer.

The Respondent however is of the view that there has been no court ruling that the property cannot be disposed in future to offset the debt.

(iv) **Timothy Njoroge Kimani**
The Respondent has not exhausted all measures for recovery of the debt since no criminal or civil proceedings have been instituted against the debtor in order to try and recover the debt.

(v) **Cosmos Plastics Limited**

The Respondent's contention is that the Appellant did not exhaust all necessary measures available to recover the debt in full. It held corporate guarantees from Kenya Millers Limited and Cosmos Millers Limited, and personal guarantees from the company's three directors from whom the debt could still be recovered.

(vi) **Limobco Exporters Limited**

The Respondent contends that the Appellant should have made the provision after the disposal in line with paragraph (c) of the *Commissioner's Guidelines* which stipulate;

"The securities or collateral have been realized but the proceeds fail to cover the entire debt."

(vii) **Caroline Wanjihia**

The Respondent contends that the Appellant has not exhausted all efforts to recover the debt such as instituting legal proceedings to recover the debt.

(viii) **Helios Energy Limited**

The Respondent is of the view that the Appellant has not demonstrated that it has exhausted all efforts to recover the debt in accordance with LN 37.

(ix) **Chandulal Virchand Shah**

An ongoing case prevented the Appellant from exercising the right to set off and appropriate any funds held in the debtors account towards settlement of the debt. The Respondent avers that since no ruling of the case had been made there was still a chance that the Appellant would recover the outstanding amounts in full.

(x) **Ricon Associates (Kenya) Limited**

The Respondent contends that the Appellant has not demonstrated that the debt is uncollectable by having taken all reasonable steps envisaged in the *Commissioner's Guidelines.*

(xi) **Keval R. Patel and Ajeshkumar V. Agravat**

The Respondent submits that the fact that the Appellant did not hold any security in relation to the debt is not satisfactory because it had

not demonstrated that all measures to recover the debt have been exhausted.

(xii) **Caroline Wanjihia and Company Advocates**
The Respondent position is that the Appellant should have realized the security held before making provision for the outstanding amount. Furthermore, the Appellant had not demonstrated that it had exhausted all available measures to recover the debt.

(xiii) **Annways Heritage Limited**
The Respondent contends that the provisions for the amounts not covered by security was an estimate and that Appellant had not demonstrated that all efforts to recover the amount had been exhausted.

(xiv) **Kaka Wholesalers**
The Respondent argues that all recovery measures have not been exhausted since the company has not been wound up. Any proceeds that are available after the winding up can be utilized to offset the debt.

(xv) **Samson Keengu Nyamweya**
The Respondent contends that no ruling has been made with respect to the bankruptcy petition.

(xvi) **Provision for various debtors**
The Respondent argues that the Appellant has not demonstrated that the cost of recovery would surpass the debt amounts and hence the provisions are disallowed for tax purposes.

D. <u>On deductibility of foreign exchange Losses</u>

93. The Appellant avers that the profitability of financial institutions depends on their exposure/mismatch to various market risks items. Exposure or a mismatch is an imbalance that occurs when the bank's assets do not match its liabilities, i.e. the tendency of a bank possessing more liabilities than assets or vice versa. The controlled matching and mis-matching of assets

and liabilities denominated in foreign currency is the key driver/determinant of a bank's level of profitability with regard to forex income.

94. The Appellant submits that the Respondent has made an erroneous conclusion that the amounts described as revaluation are unrealized foreign exchange gains/losses. The Respondent further went ahead and adjusted for the foreign exchange differences described as revaluation forex.

95. That, for instance, if a bank teller buys USD 500.00 from a customer at KShs125.00 whereas the trading rate is KShs 130.00, the teller makes a profit of KShs 2,500.00 (500 * 5). This amount is referred to as trading profit in the ledger which is an interdepartmental profit / Management Information System (MIS) return criteria used internally to motivate the branch/sales staff.

96. That a bank operates on a concept called End of Day ("EOD"), a controlled system to ensure all entries in the system are committed/approved and the books of account are balanced and the final closing rates for the translation of all foreign currency balances to KShs are determined from the market rate determined.

97. That the actual gain at the end of the day on the transaction above, assuming an EOD rate of KShs 400.00, would therefore be KShs 137,500.00 (i.e. 500 *(400-125)). The additional gain booked in the ledger would hence be KShs 135,500.00 (i.e. 137,500-2,500) which is booked a revaluation gain in order to differentiate it from the initial gain of KShs 2,500.00 recognised at the point of selling or buying the USD.

98. That the EOD recognition of the actual gain based on the existing rate is what the system labels as *revaluation,* but is actually the determination of the true profit or loss of the day. Whilst the bank cannot ignore the EOD rate, the intra-day rate is not compulsory being an MIS rate.

99. That for purposes of external reporting and taxation, the total gain/losses of KShs 137,500.00 is reported as foreign exchange income and taxed. This amount comprises revaluation (Kshs 135,000.00) and trading profit (Kshs 2,500.00).

100. The terminology "*revaluation*" is merely used to differentiate between additional gains/losses at the end of the day and those recognized when the initial trading took place.

101. That where there is a net gain from the summation of the revaluation and trading gain/loss as detailed above, tax is paid on the forex income. The Commissioner should therefore not be allowed to disallow the forex amount where the same is a loss since the overall gain at the end of the day is a combination of the two.

102. The Respondent avers that the Appellant claimed unrealized foreign exchange losses arising from revaluation for the years 2011 and 2012 contrary to Section 4A of the ITA. In its letter of 26th June 2015, the Appellant admitted not to have added back the entire amount of unrealized exchange losses in 2011 and 2012 but introduced forex issues relating to years 2010 and 2013 to show that they are in a recoverable position. The audit exercise covered years 2011 and 2012 and therefore the two years are outside the scope of the review. Section 4A of the ITA provides:

> ***(1) A foreign exchange gain or loss realized on or after the 1st January, 1989 in a business carried on in Kenya shall be taken into account as a trading receipt or deductible expenses in computing the gains and profits of that business for the year of income in which that gain or loss was realized:***
> ***Provided that—***
>
> > ***(i) no foreign exchange gain or loss shall be taken into account to the extent that taking that foreign exchange gain or loss into account would duplicate the amounts of gain or loss accrued in any prior year of income; and***
> > ***(ii) the foreign exchange loss shall be deferred (and not taken into account)—***
> > ***(a) where the foreign exchange loss is realized by a company with respect to a loan from a person who, alone or together with four or fewer other persons, is in control of that company and the highest amount of all loans by that company outstanding at any time during the year of income is more than three times the sum of the revenue reserves retained earnings and the issued and paid up capital of all classes of shares of the company; or***
> > ***(b) to the extent of any foreign exchange gain that would be realized if all foreign currency assets and liabilities of the business were disposed of or satisfied on the last day of the year***

of income and any foreign exchange loss so deferred shall be deemed realized in the next succeeding year of income.

(1A) For the avoidance of doubt accumulated losses shall be taken into account in computing the amount of revenue reserves.

(2) The amount of foreign exchange gain or loss shall be calculated in accordance with the difference between (a times r1) and (a times r2) where—
a is the amount of foreign currency received, paid or otherwise computed with respect to a foreign currency asset or liability in the transaction in which the foreign exchange gain or loss is realized;
r1 is the applicable rate of exchange for that foreign currency ("a") at the date of the transaction in which the foreign exchange gain or loss is realized;
r2 is the applicable rate of exchange for that foreign currency ("a") at the date on which the foreign currency asset or liability was obtained or established or on the 30th December, 1988, whichever date is the later.

(3) For the purposes of this section, no foreign exchange loss shall be deemed to be realized where a foreign currency asset or liability is disposed of or satisfied and within a period of sixty days a substantially similar foreign currency asset or liability is obtained or established.

(4) For the purposes of this section—
"control" shall have the meaning ascribed to it in paragraph 32(1) of the Second Schedule;
"company" does not include a bank or a financial institution licensed under the Banking Act (Cap. 488);
"all loans" shall have the meaning assigned in section 16(3);
"foreign currency asset or liability" means an asset or liability denominated in, or the amount of which is otherwise determined by reference to, a currency other than the Kenya Shilling.

E. <u>On unexplained differences disallowed by the Respondent</u>

103. That the Respondent has disallowed other non-specified provisions amounting to KShs 7,909,547.00 without corresponding explanation relating to the amount being given.

104. The Appellant submits that amounts adjusted were not explained at the time of issuing the Objection Decision and therefore it is unable to respond. This, in the Appellant's view, is contrary to Section 51(10) of the TPA which requires that an Objection Decision includes a statement of findings on the material facts and reasons for the decision.

105. The Respondent stated that the unexplained differences added back refer to other provisions not specifically identified in the year 2012 made by the Appellant and which could not be supported at the time of issuing the Objection Decision.

ISSUES FOR DETERMINATION

106. The Tribunal has framed the following issues for determination, i.e.:

a. Whether the Respondent's Objection Decision was time-barred.

b. Whether the Appellant's Notice of Objection was valid in Law.

c. Whether the provisions for bad debts made by the Appellant meet the requirements of Section 15(2)(a) of the ITA and the Legal Notice No. 37 of 2011.

d. Whether foreign exchange losses are allowable.

e. Whether the unexplained differences disallowed by the Respondent without corresponding explanations are allowable.

ANALYSIS AND FINDINGS

Issue no. 1: Whether the Respondent's Objection Decision was time-barred.

107. The Tribunal in considering whether the Respondent's Objection Decision was time-barred makes the following observations, i.e.

f. The TPA was assented to on 15th December 2015 and came into effect on 19th January 2016;
g. That where an objection has been validly lodged, the Commissioner is required to consider the objection and communicate its decision on the same ("Objection Decision") under Section 51(8) of the TPA.;
h. That Section 51(11) prescribes a mandatory time period (i.e. 60 days) within which the Commissioner must issue an Objection Decision. In the event the Commissioner fails to communicate

its decision within the stipulated period then objection is deemed allowed; and

i. That the Respondent's Objection Decision which was issued on 13th March 2017 was outside the 60 days envisaged by the TPA.

108. The Tribunal has also taken into account that the Appellant and Respondent were in communication with each other between 2015 and 2017. Whereas the Appellant avers that its expectation was that the Respondent would communicate its decision soon after the TPA came into force on 19th January 2015, it still continued engaging with **the** Respondent beyond that date. The Tribunal, in particular, takes note of specific e-mails sent by the Appellant to the Respondent on 19th August 2016 and 12th January 2017. The Appellant's Representative, Ms. Lucy Thegeya, while expressing its frustration over the inordinate delay the matter had taken, sought to know whether the Respondent had made a decision. The Respondent's representative, Ms. Doreen Mbingi, acknowledged the Appellant's earlier e-mail and indicated that it was reviewing the matter and would revert in due course. In the later e-mail of 12th January 2017, the Appellant is still following up on the matter and signs off with the wording, *"I look forward to your early response."*

109. In **the** Tribunal's view, the Appellant's communication lacked finality on its engagement with Respondent, and therefore finds that its letter of 25th January 2017 and decision to trigger Section 51(11) of the TPA to be an ambush on the Respondent by the Appellant. The Tribunal is faced with the difficulty of when to draw a line, i.e. when do the sixty days start to run in a situation where the parties are engaging each other with a view to resolving a dispute.

110. It is the Tribunal's view that the Appellant needed to state in a clear and unambiguous manner in its communication that it had provided all the information sought by the Respondent and its final position on the matter. In such an event, the Appellant would have been justified to argue that an Objection Decision was time-barred if delivered thereafter. By writing to the Respondent and advising that it looked forward to an early response, the Appellant had the effect of allowing the Respondent more time to deliberate the matter and make a decision.

Issue no. 2: Whether the Appellant's Notice of Objection was valid in Law.

111. The Tribunal's finds that the Appellant's Notice of Objection was valid for the reasons stated below:-

i) The objection complied with the requirements of the repealed Section 84 of the ITA which was the applicable statute at the time it was lodged. The section only required an aggrieved taxpayer to specify the reasons for the objection and did not require the taxpayer to either settle admitted taxes or indicate amendments that **the** Respondent was to make in the assessment.

ii) The Appellant's objection letter clearly states on the third last paragraph of the last page as follows; *"Please treat this letter as on objection for Corporate Tax, Withholding Tax and VAT assessed in your letter dated 29th May 2015."*

iii) The Respondent acknowledged the objection on 15th July 2015 and went ahead to issue Forms IT13 wherein it indicated the amount of tax not in dispute that was due for payment by the Appellant.

iv) The Respondent issued an Objection Decision in response to the Appellant's Notice of Objection, which could only have happened if the Respondent considered the Appellant's objection to have been validly lodged.

Issue No. 3: Whether the provisions for bad debts made by the Appellant meet the requirements of Section 15(2)(a) of the ITA and the Legal Notice No. 37 of 2011.

112. The Appellant contends that Section 15(2)(a) of the ITA allows deductibility of both bad debts and doubtful debts and that the Commissioner's Guidelines do not apply to both bad and doubtful debts. In the Appellant's view, these two terms are completely different.

113. In the Appellant's view, a bad debt refers to an account receivable that has become uncollectable while a doubtful debt is defined by IAS 37 as an account receivable that might become a bad debt at some point in the future.

114. The Respondent submits that this issue was ably dealt with in **KENYA POSTEL DIRECTORIES LIMITED-VS-COMMISSIONER OF DOMESTIC TAXES (TAX APPEAL NO. 05 OF 2016)** where the Tribunal held that a bad or doubtful debt is that they are irrecoverable and or uncollectable. Therefore for all intents and purposes there is no distinction between Bad and Doubtful Debts as these words can be used interchangeably.

115. In the Respondent's view, for **a** debt to be considered bad, it must not be merely doubtful. A debt will not be considered bad merely because the period of time usually set for payment has elapsed and neither payment nor contact has been made by the creditor.

Section 15(2)(b) of the ITA states:

> *i. "Without prejudice to sub-section (1) of this section, in computing for a year of income the gains or profits chargeable to tax under section 3(2)(a) of this Act, the following amounts shall be deducted:*
>
> *(a) bad debts incurred in the production of such gains or profits which the Commissioner considers to have become bad, and doubtful debts so incurred to the extent that they are estimated to the satisfaction of the Commissioner to have become bad, during such year of income and the Commissioner may prescribe such guidelines as may be appropriate for the purposes of determining bad debts under this subparagraph"*

116. In the Tribunal's view, Section 15(2)(a) allows doubtful debts to be deductible only ***to the extent that they are estimated to the satisfaction of the Commissioner to have become bad.*** For doubtful debts to be allowable, they must therefore be deemed to have become bad by the Commissioner, i.e. uncollectible.

117. The Act therefore considers bad and doubtful to be one and the same. Thus it is the Tribunal's view that the Commissioner's Guidelines applies in so far as determining whether or not a doubtful debt can be deemed to be uncollectible.

118. On the basis of the foregoing, the Tribunal has taken into account the Commissioner's Guidelines in determining whether the various provisions made by the Appellant are allowable for deduction or not.

119. The Tribunal is bound by other tribunal decisions rendered and the findings in the **KENYA POSTEL DIRECTORY CASE (SUPRA);** and **COMMISSIONER OF DOMESTIC TAXES VS KENYA MALTINGS LTD** and **REPUBLIC-VS-**

COMMISSIONER FOR INCOME TAX & ANOTHER ex-parte STOCKMAN ROZEN KENYA LIMITED eKLR (2015).

(i) Lamsons Industries Limited

a. The Appellant avers it made efforts to collect the debt from October 2009 by way of sending demand letters themselves and through their legal advisors. It further engaged an auctioneering firm to advertise and dispose the properties charged to the Appellant as security for the debt. However, the High Court, on 24th April 2012 held that the borrower had established a *prima facie case* and therefore extended the injunction preventing the realization of the security.

b. It is the Tribunal's view that there still existed an opportunity to recover the debt upon full hearing and determination of the matter. This debt cannot be deemed to have become bad until the matter has fully been determined in court.

(ii) Virchand Virpal & Sons Limited

a. Whilst there was an injunction preventing the Appellant disposing and realizing the property in order to settle the debt the matter is heard and determined by the Court, it is the Tribunal's view that the debt **can only be** deemed to have become upon conclusion of the case. This provision is therefore not allowed.

(iii) Benir Investments Limited

a. The borrower wrote to the Appellant on 15th October 2008 informing them of their intention to sell the property Nairobi/Block94/170 in order to regularize its non-performing account and took steps to effect the sale. However, a third party raised allegations of fraud and obtained a court injunction stopping the sale in addition to file a complaint with the CID.

b. The court ruled that the original titles held by the Appellant and the third party should be analysed by the Lands registry to determine their authenticity.

c. The court case should be allowed to proceed to its logical conclusion and a decision be rendered.

d. This provision is therefore disallowed.

(iv) Timothy Njoroge Kimani

a. The debt was in respect of a Hire Purchase facility. The Appellant wrote to the borrower on 23rd June 2011 informing him that the facility was in default and therefore terminating and seeking repossession of the vehicle.

b. As at 14th December 2011, the Appellant's auctioneers had been unable to trace both the vehicle and the debtor. A search at the Registrar of Motor Vehicles also established that the vehicle was registered solely in the borrower's name which was inconsistent with the details of the copy of the logbook held by the Appellant.

c. Since the debtor or collateral cannot be traced despite the Appellant having taken reasonable steps towards recovery of the debt, it is the Tribunal's view that the provision be allowed for deduction. There is no form of security to be realized in order to recover the debt.

.(v) Cosmos Plastics Limited

a. The provision arises from a KShs 125 million overdraft facility granted to the borrower in 1996 and which became non-performing in December 2004. The Appellant, through its legal counsel, sent demand letters to the borrower and guarantors on 11th July 2005. The Appellant later filed a civil suit against the debtor and guarantors on 9th August 2005. The hearing of the suit had not commenced as at 31 December 2012.

b. The matter had dragged in court for more than seven years and the Tribunal is of the view that the Appellant was justified in entering into a consent with the borrower's Directors. This provision is therefore allowed.

c. The Tribunal's view is further persuaded by the following facts:
d. The Appellant did not hold any realizable security; and
e. The Appellant had taken reasonable steps to recover the debt by filing a civil suit against the debtors and its guarantors.

(vi) Limobco Exporters Limited

a. The provision is in respect of a Hire Purchase facility which was secured by 6 trailers and 6 prime movers. Upon the debtor's default and expiry of the period stipulated in the demand letter, the Appellant repossessed the vehicles.

b. The Appellant's auctioneers later advised that the realizable value was approximately KShs 27 million against an exposure of KShs 39.2 million. The Appellant therefore made a decision to provide for KShs 9 million against the estimated deficit of KShs 12.2 million.

c. The Tribunal concurs with **the** Respondent. This provision ought to have been made after disposal of the vehicles and the proceeds realized had failed to cover the entire debt. It has therefore been disallowed for deduction.

(vii) Caroline Wanjihia

a. The provision is in respect of a Hire Purchase facility granted to the borrower. On 20th July 2012, the Appellant obtained sought and obtained a court order directing the OCS Muthangari to assist it in repossessing the vehicle.

b. The vehicle was repossessed and detained at the police station but not released to the Appellant. However, the vehicle was released to, and later sold by, a third party against another debt under unclear circumstances. The Appellant wrote to the CID requesting investigations be undertaken to determine the manner in which the motor vehicle registration was transferred the third party and the authenticity of the auction.

c. The Tribunal finds in favour of the Appellant. **There** was no security to realise and the Appellant made reasonable steps to recover the debt including obtaining a court order to compel the OCS Muthangari to assist it in recovery and repossession of the vehicle. It is not as a result of Appellant's fault or negligence that the vehicle was released to another party and later disposed in suspicious circumstances.

(viii) Helios Energy Limited

a. The Appellant contends that having issued a demand letter to the borrower on 10th September 2012 through its legal counsel.

However, the debt was unsecured and the Appellant opted to make a provision.

b. The Tribunal is of the view that the bank should have made some effort to recover the debt from the borrower's guarantors before making a provision. Consequently, the Tribunal finds in favour of the Respondent.

(ix) Mr. Chandulal Virchand Shah

a. The provision is in respect of an overdraft granted to the borrower for the purposes of trading in shares in the Nairobi Securities Exchange. The facility was secured by a pledge of shares and personal guarantees of Sunil Chandulal Shah, Atul Chandulal Shah and Hasmukhal Virchand Shah through a letter of Guarantee and Indemnity.

b. Upon continued default, the Appellant sold all the security pledged to it, but failed to recover the entire amount owed. The Appellant thereafter invoked a clause in the letter of Guarantee and Indemnity that entitled it to exercise the right of set off and appropriation of funds held by any of the debtors or guarantors. This was however challenged in court and the matter went for a full hearing. As at December 2011, the debtors were still indebted to the Appellant and the matter had been fixed for mention on 27th January 2012.

c. The Tribunal is of the view that there was still an opportunity to recover the debt and therefore it could not be considered bad until the Court had made its determination. This provision is not allowed for deduction.

(x) Ricon Associates (Kenya) Limited

a. The facility had been secured against a motor vehicle whose logbook had not been issued at the time of the demise of the borrower's Managing Director and majority shareholder.

b. The Tribunal however noted that a letter from K.H. Osmond, the borrower's lawyer, dated 31st October 2012 had indicated that the vehicle was available for disposal upon completion of police investigations and the funds realized therefrom would be available to offset the Appellant's debt.

c. The Appellant has not given an update on the outcome of this initiative. The Tribunal is therefore not convinced that the Appellant had exhausted all the avenues for recovering the debt. The Tribunal finds for the Respondent and disallows this provision.

(xi) Keval R. Patel & Ajeshkumar V Agravat

a. The debt arises from an overdraft facility granted to the borrower for purposes of share trading. The Appellant wrote a letter on 14th January 2009 informing the borrowers that the amount outstanding was beyond the pledged value of securities and requested that they regularize the account. The Appellant disposed the pledged security upon expiry of the demand notices issued. The funds realized were not adequate to offset the debt.

b. The Tribunal noted that the facility had been guaranteed by Mr. Shital Rameshbhai Patel and the Appellant has not indicated whether it made any effort towards recovering the amount owed from the guarantor. In the absence of taking any such measures, the Tribunal finds that the Appellant did not exhaust all reasonable steps available to it to recover the debt and therefore disallows this provision.

(xii) Caroline Wanjihia & Company Advocates

a. The facility was secured by a property in Lavington, Nairobi, valued at KShs 11.5 million. The security held did not adequately cover the debt and in view of no response from the borrower, the Appellant provided for the difference.

b. The Tribunal concurs with the Respondent that Appellant should have realized the security and only provided for the debt after the outcome of the disposal. This provision is therefore disallowed.

(xiii) Annways Heritage Limited

a. The provision arose from a Hire Purchase facility granted for purchase of motor vehicles which also served as security. The security did not cover the entire debt and the Appellant provided for the outstanding amount.

b. The Tribunal concurs with the Respondent that the Appellant has not exhausted all efforts to recover the debt. Though the Appellant indicated that the facility was guaranteed by the borrower's directors

it has not demonstrated whether any effort was made to recover the outstanding amount from the guarantors. The provision is disallowed for deduction.

(xiv) Kaka Wholesalers

a. The borrower filed a winding up petition in November 2008. In a Kenya Gazette notice dated 11th December 2009, the hearing of the winding-up petition was scheduled to take place on 22nd January 2010. The Appellant had already sold the vehicles held as security around March – May 2009 but proceeds realized from the sale were used offset part of the outstanding debt.

b. The Tribunal agrees with the Appellant and allows the provision. The borrower having filed a petition to wind itself up and no longer being a going concern, there are no further reasonable steps the Appellant could have taken to recover the debt.

(xv) Samson Keengu Nyamweya

a. The borrower had been granted an unsecured overdraft facility and he defaulted. The Appellant filed a bankruptcy petition against the borrower.

b. The bankruptcy proceedings have not been concluded and should be allowed to proceed until final orders are made. This provision is disallowed.

(xvi) Provision for other various debtors

a. In the Appellant's estimation, the cost of recovering the individual debts would exceed the amount owed in each case. The Appellant's view is based on the Instruction and Appearance Fees paid to lawyers and has referred to the Advocates Remuneration Order, 2014, to support its arguments.

b. Whilst the Tribunal is persuaded by the Appellant's contention and which is line with the Commissioner's Guidelines, no evidence has been provided that the Appellant made other efforts towards recovering these debts from the borrowers. For example, the Tribunal has not seen any demand letters by the Appellant to the borrowers. For this reason, the Tribunal disallows these provisions.

120. Without prejudice to the foregoing, the Tribunal is cognizant of the fact that the assessments in this appeal relate to the years of income 2011, 2012 and **2013**. It is therefore likely that subsequent events since the submission of this Appeal have resulted in some of the above debts maturing into bad debts that have been disallowed. The Tribunal therefore directs that in the interest of justice such debts be allowed.

Issue no. 4: Whether foreign exchange losses are allowable for tax

121. Section 4A(1) of the ITA provides that foreign exchange gains or losses realized by a business carried shall be taken into account as a trading receipt or deductible expenses in computing the gains and profits of that business for the year of income in which that gain or loss was realized. The ITA however does not define "realized" or when describe how or when "realization" takes place or deemed to have taken place.

122. The dispute herein appears to be essentially the rate of exchange to be used in accounting for losses or gains in forex transactions. Whereas the Appellant contends that the EOD or market rate is the correct rate to apply, the Respondent appears to be of the view that the trading rate should be used instead.

123. Exchange rates are dynamic and tend to be subject to changes in the course of the day. There is a possibility that an exchange rate will be different from the time when a transaction takes place and when it is actually converted to the local currency. It is an established practice by banks and financial institutions therefore to account for foreign currency at the closing rate or end of day rate.

124. The Tribunal is therefore of the view the gains or losses arising from the transactions accounted using the EOD or market rate are realized gains or losses and hence taxable or allowable as the case may be.

125. The Tribunal therefore finds in favour of the Appellant and allows the deduction of the forex losses.

Issue No. 5: Whether the unexplained differences disallowed by the Respondent without corresponding explanations are allowable.

126. The Respondent contends that the unexplained differences refer to other provisions not specifically identified in the year 2012 made by the Appellant and which were unsupported. The Appellant meanwhile avers that there is

no corresponding explanation given for the two amounts and therefore is unable to give a response on this item.

127. The Tribunal having perused the Respondent's letter of assessment, the Appellant's Objection Letter and other communication exchanged between the parties, notes that this matter was not among matters in dispute in the earlier correspondence between the Appellant and Respondent. It appeared for the first time in the Respondent's Objection Decision.

128. Having so observed and in the absence of corresponding explanation by the Respondent, the Tribunal finds in favour of the Appellant.

FINAL DETERMINATION

The Tribunal partially allows the Appeal and makes the following final orders:

a) The Respondent's Objection Decision was validly issued.
b) The provisions for bad debts with respect to Timothy Njoroge Kimani, Cosmos Plastics Limited, Caroline Wanjihia and Kaka Wholesalers be allowed.
c) **The provisions for bad debts in respect of Lamsons Industries Limited, Virchand Vipal & Sons, Benir Investments Limited, Limobco Exporters Limited, Helios Energy Limited, Mr. Chandulal Virchand Shah, Ricon Associates (Kenya) Limited, Keval R. Patel & Ajeshkumar V Agravat , Caroline Wanjihia & Company Advocates, Annways Heritage Limited, Samson Keengu Nyamweya and Provision for other various debtors be disallowed.**
d) The forex losses are not unrealized and therefore allowed for deduction.
e) The assessment on the Respondent's unexplained differences be and is hereby disallowed.
f) Each party to bear its own costs.

DATED and DELIVERED at NAIROBI this 30th day of March, 2020

.....
PATRICK LUTTA
CHAIRPERSON

.....
HELEN BILA
MEMBER

.....
MWAI MBUTHIA
MEMBER

.....
ELI NJERU
MEMBER