

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL AT NAIROBI
TAX APPEALS NOS. 17 OF 2017 & 405 OF 2018

MENNONITE BOARD OF EAST AFRICA T/A
ROSSLYN ACADEMY..... APPELLANT
VERSUS
THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

INTRODUCTION

1. The Appellant, (hereinafter referred to as “the Appellant or the Tax Payer”), is an International Christian School affiliated to the Mennonite Board in East Africa that largely provides education for children of missionaries and staff of Christian mission agencies based in Kenya.
2. The Respondent, Kenya Revenue Authority (hereinafter referred to as “the Respondent or KRA”) is a creature of Section 3 of the Kenya Revenue Authority (Cap 469) and its core mandate is to assess, collect and account for all revenues in accordance with the various tax statutes.

BACKGROUND

Appeal No. 17 of 2017

3. The Respondent commenced a tax audit in October 2011 covering corporation tax and Pay as You Earn(PAYE) for the period July 2006 to June 2011. The audit findings were communicated to the Appellant vide a letter dated 15th April 2013.
4. The Audit established that children of the staff/teachers of the school did not pay school fees like the rest of the children. The benefit was not brought to tax as required under Section 5 of the Income Tax Act, Cap 470 of the Laws of Kenya. Accordingly, the Respondent raised an assessment of Kes.51,950,058 and Kes. 53,616,128 for corporation tax and PAYE respectively.

5. The Appellant objected to the assessment vide a letter dated 25th July 2013. The same was acknowledged by the Respondent on 19th August 2013. Consequently, the parties engaged in deliberations which culminated in a meeting on 28th April 2014 and as a result the Appellant paid an amount of Kes.13,861,948.
6. On further consideration, the Respondent through a letter dated 15th December 2016 rejected the payment proposal and went ahead and confirmed the assessment of PAYE. This led to the Appellant filing the Appeal herein

Appeal No. 405 of 2018

7. The Appellant was selected for audit with regards to PAYE computation for compliance purposes. The audit revealed that staff of the Appellant enjoyed a school fees benefit for their children. This benefit to the employees was not accounted for in accordance with Section 5 of the Income Tax Act. As such, the Respondent issued an assessment on 7th August 2018 for Kes.21,064,899 for PAYE inclusive of interest.
8. The Appellant raised an objection to the Assessment on 6th September 2018 contending that the Christian Mission rate should be used for computing the Appellant's PAYE liability. Further, that the assessment was contrary to Section 51(11) of the Tax Procedures Act, 2015.

APPEAL

Appeal No. 17 of 2017

9. The Appeal is premised on the following grounds;
 - a) That the Respondent erred in finding that the private tuition rate charged by the Appellant constitutes the fair market value for purposes of computing the School fees benefit for its members of staff.
 - b) That the Respondent erred in failing to find that the rate charged to Christian missionaries was the fair market value and consequently arrived at an erroneous assessment.
 - c) That the Respondent erred in failing to take into consideration the tuition rates charged by other schools that are similar to the Appellant in determining the fair market value of the school fees benefit and thereby arrived at a disproportionate and unjustified assessment.

- d) That the Respondent erred in raising an additional assessment whereas it had received a proposal from the Appellant and accepted payment on terms thereof.
 - e) That the Respondent's erred in purporting to raise the assessment in respect of a matter already closed more than two years earlier and for which the Respondent was estopped from reopening or otherwise charging.
 - f) That the Assessment is contrary to the provisions of Section 51(11) of the Tax Procedures Act.
 - g) That the Assessment by the Respondent violates the principles of fair administrative action and national values and principles of governance as set out in Articles 10 and 47 of the Constitution of Kenya(2010).
 - 1. The Appellant prays that this Tribunal do set aside and annul the Assessment by the Respondent and order that the Respondent pay the costs of this Appeal.
10. The Respondent proceeded to submit on these issues as hereunder; -
- a) The Respondent states that, there was no error in finding that the private tuition rate charged by the Appellant constitutes the fair market value for purposes of computing the school fees benefit for its members of staff.
 - b) The Respondent states that there is a difference between "market value" and "fair market value".
The Respondent states that Fair market value is defined by Treasury Regulations S1.170A-
"...the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts."
"market value is an opinion of the most probable buy-sell price. It reflects the probable amount of money a buyer would pay and a seller would accept for an item of property under specific conditions."
 - c) The Respondent states that the private sponsored category which applies to students who are neither missionary children or whose families get a school fee benefit from their employers of less than 50% was deemed to be the "fair market value" in the instant case based on the fact that this would be the typical cost that a student would pay to attend the school.
 - d) Section 5(5)(b) of the Income Tax Act states that:

“Notwithstanding any other provisions of this Act, the value of the benefit (excluding the value of premises as determined under subsection (3) and the value of benefit determined under subsection(2B) for the purposes of this section shall be higher of cost to the employer or the fair market value of the benefit.”

- e) This section allows the Respondent to exercise discretion in determining the value of benefit applicable and at all times the Respondent categorically communicated to the Appellant their decision to charge the benefit based on the higher of the cost to the employer.
- f) The Respondent did not err in finding that the rate charged to Christian missionaries was not the fair market value and consequently arriving at an assessment.
- g) The Respondent has the discretion under Section 5(5) of the Income Tax Act in determining the value benefit applicable to use either the higher of the cost to the employer or the fair market value of the benefit.
- h) The Respondent states that in exercise of this discretion, the Assessment was arrived at, and thus it cannot be erroneous.
- i) The Respondent did not at any one time accept the payment proposed by the Appellant.
- j) The Respondent in its letter dated 15th December 2016 communicated clearly to the Appellant that the proposal was rejected. There was no earlier communication to the Appellant indicating acceptance of the payment proposal.
- k) The Respondent at all times indicated that the taxes due with regard to PAYE were Kes.27,956,457.
- l) The Respondent states that the assessment is not contrary to Section 51(11) of the Tax Procedures, 2015.
- m) The Respondent states that the Assessment was raised on 28th June, 2013 and the objection filed on 28th July,2013 a period which the applicable law was the Income Tax Act, Cap 470 Laws of Kenya.
- n) Under the Income Tax Act, Section 85 the Commissioner was not time barred as to when to respond to an objection notice by a taxpayer/Appellant.

- o) The Respondent in this case considered the objection notice and further proposal made by the Appellant and notified the Appellant of its decision on 15th December ,2016.
- p) The Respondent was thus acting within the law when responding to the objection by the Appellant.
- q) Furthermore, the parties engaged in negotiations with a view to coming up with a favourable settlement which meant the time within which the Respondent is expected to respond to an objection notice had stopped running.
- r) The Respondent thus responded to the objection notice within reasonable time.
- s) The Respondent states that the Appellant was accorded fair administrative as provided for under Article 47of the Constitution.
- t) The Appellant was given a chance to be heard and consultations made between the parties. The eventuality of the consultations was the striking out of the corporation tax and reduction in the PAYE amount claimed.
- u) The Respondent considered the settlement proposal by the Appellant and rejected the same.
- v) The Appellant was also heard in the meeting held on 28th April, 2014 and further meetings thereafter. It was upon further consideration of the proposal, that the Respondent confirmed the assessments and demanded taxes.
- w) The Respondent states that the Appellant has not proved unfairness, arbitrariness, inconsistency, and any capricious acts of the Respondents. The Respondents acted within the law in the manner it dealt with the Appellant.
- x) The Appellant's right to fair administrative action has not been infringed by the Respondent. There is no evidence that the Respondent has abused its powers or discretion or that the Decision arrived at is so absurd that it lacks logic.

11. Consequently, The Respondent humbly prays that this Tribunal dismisses the Appellant's Appeal and upholds the assessment with interest and penalty amounting to Kes.14,094,509/- on account of PAYE.
12. The Respondent undertook to adduce any other or further oral and/or documentary evidence at the hearing in support thereof.

Appeal No.405 Of 2018

The Appeal is premised on the following grounds;

13. That the Respondent erred in adopting a restrictive and narrow interpretation of “fair market value” as used in the Income Tax Act (ITA).
14. That the Respondent erred in failing to recognize that where there is an ambiguity or lack of clarity in the meaning of a tax provision subject to more than one interpretation of that provision, then it is trite law that the interpretation to be applied is the one which favors the taxpayer.
15. That the Respondent erred in finding that only the private tuition rate charged by the Appellant constitutes the fair market value for purpose of computing the school fees benefit for its members of staff.
16. That the Respondent erred in failing to find that the rate charged by the Appellant constitutes the fair market value for purposes of computing the school fees benefit for its member of staff.
17. That the Respondent erred in failing to find that the rate charged to independent Christian missionaries constitutes the fair market value to be applied for the Appellant’s members of staff and consequently arrived at an erroneous assessment.
18. That the Respondent erred in failing to take into consideration the tuition rates charged by other schools that are similar to the Appellant’s School, in determining the fair market value of school fees benefit and thereby arrived at an unjustified assessment.
19. That without prejudice to the foregoing, the Respondent failed to take into consideration an advance payment of Kes.13,861,948 which was paid on account on 9 June 2014 which meant that in any event there would be no outstanding tax liability by the Appellant.
20. The Appellant prays that this Tribunal do set aside and annul the Objection Decision by the Respondent and order that the Respondent pay cost of this Appeal.

21. From the Appellant's grounds of Appeal, the following issues arise for determination according to the Respondent; -
- a) Whether the Arm's length Principle was the correct principle is calculating the taxes due by the Appellant.
 - b) Whether the Respondent's Objection Decision dated 3/10/2018 was proper.
22. The Arm's length principle is the description of an agreement made by two parties freely and independently of each other and without some special relationship such as being a relative, having another deal on the side or one party having complete control of other.
23. The concept of arm's length ensures that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other party. It also assures third parties that there is no collusion between the buyer and seller.
24. The arm's length principle is the condition or the fact that the parties to a transaction are independent and on an equal footing.
25. That the transactions between affiliated firms must be made purely on commercial basis both firms trying to maximize their advantage and neither firm accommodating or favouring the other in any way.
26. That the arm's length transaction occurs between a buyer and a seller on the open market. Both parties act according to their own self-interest with buyer wanting the lowest possible price and the seller wanting the maximum price.
27. That the fee charged under Christian Mission Sponsor category relates to the children of the families of independent Christian missionaries with no ties to the Appellant.
28. That the Appellant opened the School in Kenya in order to cater to the educational needs of the Christian missionaries who came to Kenya.
29. That this category recognizes special relationship i.e. fellow missionaries. Though there are no ties with the Appellant and that the fee charged is cognizance of the fact that these are Christian Missionaries with similar missionary objectives in the Country.

30. That the Private Sponsor category relates to children from families with no ties to the Appellant and is not affiliated to any Christian mission.
31. That the transactions between Rosslyn and private sponsor categories is made purely on commercial basis with both parties trying to maximize their advantage, and neither firm accommodating or favouring the other in any way.
32. The Parties under the private sponsor category are totally independent and on an equal footing and thus fits well within the definition of an arm's length transaction.
33. That the fee payable under private sponsor reflects the fair market value which is the best comparable in determining the arm's length price.
34. The Respondent Prays that this Honorable Tribunal to find:
 - a. That the Objection Decision dated 3rd November 2018 claiming the Principal Income Tax of Kes.21,064,899 for the years between 2013 to 2015 together with the stipulated penalties and interest for the financial year 2015 was proper in law and in conformity with the provisions of the income Tax Act, CAP 470;
 - b. That the additional tax of Kes.21,064,899 is due and payable by the Appellant to the Respondent; and
 - c. That this Appeal be dismissed with costs to the Respondent as the same is without merit.

PARTIES' SUBMISSIONS

1. APPELLANT

35. Counsel for the Appellant submitted that Appeal No.17 of 2017 is entirely a PAYE assessment. That the Appellant herein runs a school under the name Rosslyn Academy. In 2012 the Respondent commenced a tax audit which covered both PAYE and corporation tax and issued an assessment for Kes. 53,000,000 million for purposes of PAYE. Accordingly, the Appellant argued that it was taxed and the taxes which had been paid had not been factored in.

36. It was further submitted that the Respondent issued a letter following a meeting which took place on 28th April 2014 in which the Respondent gave credit for the taxes that had been paid in respect of the benefit. Therefore, it is not the case that the benefit was not taxed. It was actually being taxed but it had not been recorded in the initial assessment.
37. Subsequent to a meeting held in June 2014 a settlement was entered into and a formulae was proposed whereby the various rates were to be summed up and halved so as to arrive at an acceptable fair market value. Accordingly, an amount of Kes.13,861,948 was paid.
38. It was further argued that it was only after two and a half years in 2016 that the Appellant received a letter confirming the initial assessment. The Respondent further sought an additional Kes.14,000,000 on the basis that the private sponsor rate was the fair market value.
39. Counsel for the Appellant relied on Section 5(5) of the Income Tax Act, Cap 470 of the Laws of Kenya which provides that the value of employment benefit is the higher of the cost to the employer or the fair market value. The challenge however is that there is no definition of fair market value in the Act. The Appellant adopted the definition of fair market value in the Black's Law Dictionary. That fair market value is the price to which the property would change hands between a willing buyer and a willing seller where the former is not under any compulsion to buy and the later is not under any compulsion to sell.
40. Further, the Appellant submitted from the above definition of fair market value, a few issues become apparent;
 - a. That the price must be arm's length between a willing buyer and a willing seller.
 - b. That the fair market value is relative, it is not an absolute number.
 - c. It depends on a variety of factors through the existence of comparable transactions.
 - d. There will be a difference in opinion on what constitutes fair market value.

41. Counsel further contended that the Christian sponsor rate qualifies as the fair market value in this case. In support of this, the Appellant made reference to a number of independent missions that enjoy the Christian sponsor rate. Further, it was submitted that Rosslyn Academy is not required to enroll any of these students. This is because the Appellant's admission policy is to first admit its own students and if there are vacancies, they admit any other student. The Appellant was not under any compulsion to accept its employees' children. By way of comparison the Appellant compared its transactions to other schools in the jurisdiction that offer similar education curriculum. Additionally, the Appellant requested the Tribunal to adopt the foregoing submissions in respect of Appeal No. 405 of 2018.

2. RESPONDENT

42. The Respondent submitted it interrogated the employment contracts of the Appellant during the audit. The only requirement in the contracts of employment was to profess the Christian faith. Section (5)(b) provision of the Income Tax Act says that the value of the benefit shall be the higher of the cost to the employer or the fair market value. The Appellant failed to disclose the cost of the benefit. Consequently, Respondent moved to apply the fair market value of the benefit. The Respondent applied the private sponsor rate because the children of the members of staff are not affiliated to the Mennonite Board, they are not children of Christian missionaries.
43. It was further submitted that the Appellant applied the owner agency sponsor rate, which is the lowest of the school fees that is charged. The rate is charged on members that are affiliated to the Mennonite Board. The result was the PAYE liability of Kes.13,800,000/=. The Respondent, on the other hand applied the private sponsor rate which in its view is the most appropriate and constituted the fair market value because it applied to members who are not affiliated to the Mennonite Board and children who are not children of Christian missionaries. The result was the PAYE liability of Kes.27,900,000/=. Out of this, the Appellant settled Kes.13,800,000/= and the Respondent is claiming the balance as a result of applying the private sponsor rate.
44. The Respondent further averred that Income Tax Act is silent on the definition of the fair market value but Black's Law Dictionary provides that it is the price that the seller is willing to accept and the buyer is willing to pay

on the open market and in an arm's length transaction. That the Appellant failed to consider the aspect of arm's length transaction. Arm's length transaction in the sense that this is what the buyer is willing to pay and the seller is willing to accept based on the fact that there is no special relationship between the parties.

45. It was submitted that the private sponsor rate is the most appropriate to constitute the fair market value. This is for members of staff who are not affiliated to the umbrella body of the Mennonite board, are not children of Christian missionaries, are not children of diplomats and they do not belong to the agency corporate sponsor.
46. With regards to the issue that the objection decision was issued out of time, the Respondent sought refuge under the provisions of Article 159(2)(d) of the Constitution. It was argued that the Respondent will be prejudiced and suffer loss of revenue should the Tribunal decide this in favor of the Appellant.

ISSUES FOR DETERMINATION

47. The foregoing Appeals have one issue in common, namely;

Whether the school fees benefit should be computed on the basis of the Christian Sponsor rate or the Private Sponsor rate

ANALYSIS

Whether the school fees benefit should be computed on the basis of the Christian sponsor or the private sponsor rate

48. We have heard the rival contentions and perused the record. This Tribunal will render a single judgment for both Appeals considering they raised the same point of law. The main issue in both appeals is which of the various school fee categories represents the fair market value as envisaged in Section 5 of the Income Tax Act, Cap 470 of the Laws of Kenya. According to the Appellant, the Christian Sponsor rate qualifies as the fair market value in this circumstance. To the Respondent avers the private sponsor rate represents the fair market value.

49. Given the antecedent adversary contentions, it is important to reproduce the impugned Section of the Act, viz. Section 5(5) of the Income Tax Act which provides thus;

Notwithstanding any other provision of this Act, the value of the benefit (excluding the value of premises as determined under subsection (3) and the value of benefit determined under subsection (2B) for the purposes of this section, shall be the higher of the cost to the employer or the fair market value of the benefit:

50. In the Appeals before us, the key question is which of the school fees rates represents the fair market value. More particularly, between the Christian sponsor rate and the Private sponsor rate. And true to both parties' submissions, while the Income Tax Act does provide for the "fair market value" as way of bringing to charge benefits to employees, it does not go so far as to define fair market value or how to determine it. In the circumstance, we have to make reference to and borrow the definition assigned to the concept from other jurisdictions. To begin with, Black's law Dictionary defines fair market value as;

The price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's-length transaction; the point at which supply and demand intersect.

51. Additionally, the Internal Revenue Service, Publication 561 defines fair market value as follows;

Fair market value (FMV) is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts. If you put a restriction on the use of property you donate, the FMV must reflect that restriction.

...

A determination of fair market value, being a question of fact, will depend upon the circumstance in each case. No formula can be devised that will be generally applicable to the multitude of different valuations issues...Often, an appraiser will find wide differences of opinion as the fair market value...In resolving such differences, he should maintain a reasonable attitude in recognition of the fact that valuations is not an exact science. A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into

the process of weighing those facts and determining their aggregate significance.

52. From the foregoing definitions of the concept of fair market value, a number of factors must be considered in determining the fair market value in any given circumstance, namely;
- a. The price must be an arm's length price between a willing buyer and a willing seller.*
 - b. Neither the buyer nor the seller is compelled to act.*
 - c. The existence of comparable transactions.*
53. The children of the Appellant's employees are certainly not under any compulsion to attend the school. The parties are free and independent of each other. This means that the transaction herein easily qualifies as an arm's length transaction between a willing buyer and a willing seller. Additionally, there are comparable transactions of similar nature. The Appellant has provided the Tribunal with evidence of other Christian schools that offer an American based curriculum at a similar rate at page 41 of it's submissions. Consequently, applying this test to the facts of this case has led us to the conclusion that the Christian mission rate, in all character, constitutes the fair market value. This is the rate that should be applied in order to bring to charge the benefits accorded to the employees while taking into account the amounts already paid.
54. The Respondent adopts the same test to determine what constitutes the fair market value but arrives at a different school fees rate i.e. the private sponsor rate, as the fair market value. To the Commissioner, the Christian mission rate is not at arm's length. Interestingly, at paragraph 16 of it's submissions, the Respondent contends that it considered the "uniqueness of services and products offered by Rosslyn Academy and other schools which provide K-12 Christian oriented education." Indeed, if this were true the Respondent would have concluded the Christian mission rate represents the fair market value.
55. In so holding, we are further persuaded by the apparent lacuna in the Act in defining and laying down the determinants of what amounts to fair market value. The Tribunal is alive to the dictates of principles of interpretation of statutes, especially in matters tax. Accordingly, we must adopt a rate that favors the taxpayer. We must ensure that the effects of this lacuna do not

visit undue burden and hardship upon the taxpayer. In the premise, we cite with approval the High Court holding in ***Kenya Bankers Association vs Kenya Revenue Authority, Miscellaneous Civil Case No. 510 of 2017***;

From a consideration of the relevant authorities it is clear that whereas under the principles of interpretation of statutes, the general rule is that the court should lean in favor of an interpretation which makes it effective and operative, in tax legislation the court ought not to strain the language with intention of bringing tax payers within an otherwise vague and ambiguous legislation. Where the legislation is vague and ambiguous the courts ought to adopt an interpretation which best favors the taxpayer.

56. That aside, the Respondent issued the initial assessment on 28th June 2013. The Appellant raised an objection in this regard on the 25th July 2013. This culminated in discussions between the parties, thereby settling the PAYE tax of Kes.13,861,948. However, vide a letter dated 6th September 2018 the Respondent purported to issue an Objection Decision. Noteworthy, this was close to two and half years later. As such, the Appellant contends that this purported objection decision violated the provisions of Section 51(11) of the Tax Procedures Act, 2015.

57. The impugned section provides thus;

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.

58. The section allows the Commissioner to render an objection decision to a taxpayer within sixty days. Before us is a case where the Commissioner has issued an objection decision close to two and a half years later. Thus, we find the Commissioner's conduct in this matter not only grossly violates the provisions of Section 51 (11) of the Tax procedures Act but also the Appellant's legitimate expectation.

59. It has become almost habitual for the Respondent to make representations to the taxpayers and later change its mind under the guise of tax re-computations or generally revisiting its previous decisions. The Tribunal is concerned the Respondent is not alive to the effects its actions have on the general public. It is almost as though its mandate is to collect taxes by any

means necessary, without the slightest regard for its duties under Article 47 of the Constitution or the legitimate expectations flowing from its conduct.

60. We find that by holding discussions with the Appellant on settling the PAYE taxes and the actual payment of those taxes, an expectation was created. That the said taxes, were for all intents and purposes settled. To our minds, legitimate expectation would arise when an institution has sowed the seeds of expectation within its powers to fulfil. And for the expectation to be legitimate, it must be founded upon a promise or practice by a public authority such as the Respondent herein, that is expected to fulfil the expectation. The Respondent in this case created this expectation and thwarted it by issuing the Objection Decision on 6th September 2018. It has not provided us with sufficient reasons to override this expectation. In the premise, we find the said objection decision has no basis in law.
61. To buttress the foregoing, we rely on the Courts holding in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others Nairobi [2007] eKLR**, which reads;

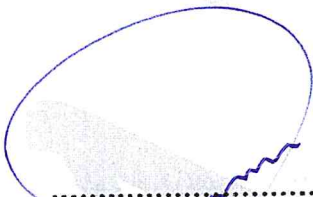
“...legitimate expectation is based not only on ensuring that legitimate expectations by the parties are not thwarted, but on a higher public interest beneficial to all including the Respondents, which is, the value or the need of holding authorities to promises and practices they have made and acted on and by so doing upholding responsible public administration. This in turn enables people affected to plan their lives with a sense of certainty, trust, reasonableness and reasonable expectation. An abrupt change as was intended in this case, targeted at a particular company or industry is certainly abuse of power. Stated simply legitimate expectation arises for example where a member of the public as a result of a promise or other conduct expects that he will be treated in one way and the public body wishes to treat him or her in a different way... Public authorities must be held to their practices and promises by the courts and the only exception is where a public authority has a sufficient overriding interest to justify a departure from what has been previously promised.

DETERMINATION

62. The Tribunal makes the following orders;

- a. The Appeal herein is merited.
- b. The Christian mission rates constitutes the fair market value.
- c. The Respondent's Objection Decision dated 8th September 2018 is hereby dismissed.
- d. Each party shall bear its Costs.

DATED and DELIVERED at NAIROBI this 27th day of March 2020.



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MOSES B. OBONYO
CHAIRMAN



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MAHAT SOMANE
MEMBER



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PATRICIA MAGIRI - ANAMPIU
MEMBER



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TIMOTHY K. CHESIRE
MEMBER