

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 230 OF 2020

**CENTRAL RIFT VALLEY WATER
DEVELOPMENT AGENCY.....APPELLANT**

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

A. INTRODUCTION

1. The Appellant is a State Corporation under the Ministry of Environment, Water and National Resources and is registered as a tax payer.
2. The Respondent is a principal officer of the Kenya Revenue Authority (KRA), a public body duly established under the Kenya Revenue Authority Act (Cap 469) of the Laws of Kenya whose primary mandate is the assessment and collection of revenue on behalf of the Government of Kenya.

B. BACKGROUND

3. The Appellant was identified as an employer of the Itare Dam Water supply project which was implemented by CMC Di Ravenna of Italy and Sabor Iten Tambach Water supply project (Phase 2) that was implemented by Aspen International SPRL of Belgium.

4. On 7th February 2020 the Respondent through the International Tax Office audit team requested for evidence of withholding tax on payments made to the contractors pursuant to the contracts for the two projects.
5. The Respondent issued the Appellant with an assessment for withholding tax amounting to Kshs. 643,394,426.00 on 28th February 2020. The Appellant vide a letter dated 19th March 2020 objected to the assessment.
6. The Respondent held a meeting with the Appellant on 8th April 2020 during which the Appellant was requested to avail the contract documents and exemption letter for value added tax (VAT) and Income tax.
7. Vide a letter dated 20th April 2020 the Appellant wrote to the Respondent explaining its grounds of objection. The Respondent responded by rendering its objection decision on 14th May 2020 confirming the assessment of withholding tax amounting to Kshs. 643,394,426.00, inclusive of interest and penalties. Dissatisfied with the objection decision the Appellant filed the Appeal herein with the Tribunal.

C. APPEAL

8. The Appellant herein filed its Memorandum of Appeal with the Tribunal on 12th June 2020, on the following grounds;
 - a. That the Commissioner of Domestic Taxes erred in fact in finding that the Appellant had not proffered a sufficient explanation in the objection lodged.

- b. That the Commissioner of Domestic Taxes erred in fact and in law in denying the Appellant the chance to challenge an illegal assessment for a colossal sum of Kshs. 643,394,426.00 by the Respondent thus condemning it unheard.
 - c. That the impugned decision of 14th May 2020 was made and/or delivered without establishing facts.
 - d. That the Commissioner of Domestic Taxes erred in fact and in law in making an illegal decision.
9. In line with the foregoing grounds of appeal the Appellant prayed for orders THAT;
- a. This Tribunal be and is hereby pleased to set aside the Respondent's decision delivered on 14th May 2020.
 - b. This Tribunal be and is hereby pleased to declare the Respondent's demand for Kshs. 643,394,426.00 contained in the letter dated 7th February 2020 and 28th February 2020 to be null and void.

D. RESPONSE TO THE APPEAL

10. In response to the above grounds of appeal, the Respondent avers as follows;
- a. The Respondent states that the exemption from tax in the Financing agreement at clause 14.2 (c) is limited to repayment of money borrowed by the Government of Kenya to BNP Paribas Fortis S.A /N.V and Intesa San Paolo SPA dated 15th July 2015.

- b. The Respondent further state that the Appellant entered into a separate contract with CMC Di Ravenna for the execution of the Itare Dam Water supply project as buyer and supplier respectively on 15th May 2015. This contract between the Appellant and CMC Di Ravenna was signed before the financing agreement and did not exempt the Appellant from paying withholding tax.
- c. The Respondent affirms that the Contractor CMC Di Ravenna was not exempt from income tax in Kenya. This position is confirmed by the National Treasury in the value added tax master exemption letter dated 30th May 2016 which expressly states as follows; “please note that withholding tax on income is payable.” The exemption on income was further clarified by the National Treasury through Technical Circular No. 15/2019 issued on 11th December 2019.
- d. The Respondent states that the exemption that were granted for the project related to customs duty and Value added tax (VAT) on goods and services as per the exemption letter from the National Treasury dated 30th May 2016.
- e. The Respondent further states that the Appellant has failed to avail the exemption letters for income tax for the project either at the time of the objection the assessment or in this appeal before this Honorable.
- f. The Respondent states that the exemption from tax in the financing agreement between Belfius Bank SA/NV of 4th October 2013 at clause 10.1 and in the legal opinion by the Attorney General is limited to repayment of money borrowed by the Republic of Kenya to Belfius Bank SA/NV.

- g. The Respondent confirms that the contract between the Appellant and ASPAC International (sprl) was signed in December 2012 while the financing agreement was signed on 4th October 2013. The Appellant was already aware of its tax obligation before the financing agreement was signed.
- h. The Respondent also states that the contract the Appellant signed did not exempt the Appellant from deducting and paying withholding tax. The Appellant has not provided income tax exemption for the project as provided for under Section 13 of the Income Tax Act.
- i. The Respondent states that the exemption letters presented by the Appellant only related to customs duty and vat. The Appellant did not seek and obtain income tax exemptions for the project and was therefore liable to pay withholding tax.
- j. The Respondent avers that the services offered under the contracts for the two projects were in the nature of management and professional services as defined under the income tax act and the payment made was in the nature of management of professional fee subject to withholding tax under Section 35 (1) (a) of the Income Tax act.
- k. The Respondent affirms that the Appellant was responsible for preparation of payment certificates which it failed to do and therefore in contravention of Section 35 (5) of the Income Tax Act.

- l. The Respondent reiterates that had the Appellant deducted withholding tax in the payment certificates, the payment of the withholding tax would have made to the Respondent as per the payment certificates issued by the Appellant.
- m. The Appellant's allegation that it was condemned unheard is baseless as the Respondent have annexed evidence that a meeting was held on 8th April 2020 which is confirmed by the Appellant in paragraph 15 of its statement facts.
11. In light of the above response, the Respondent prays that the Appellant's appeal be dismissed with costs, the objection decision be upheld and the Appellant to pay the assessed amount of Kshs. 562,463,472 together with interests, penalties and costs of this appeal.

E. ISSUE FOR DETERMINATION

12. The Appeal raises the following single issue for our determination;

Whether the two projects under assessment are exempt from withholding tax, and if not, who bears the burden of deduction

F. ANALYSIS

Whether the two projects under assessment are exempt from withholding tax, and if not, who bears the burden of deduction?

13. The Appellant has not made any direct submissions on the question whether the payments for the two projects, Itare Dam Water Supply Project, and Sabor- Iten Tambach Water Supply Project, were exempt from withholding tax. However, the focus of its submission was that, while it understood the obligations under Section 35 of the Income Tax Act as read together with 4 (1) of the Act, the Respondent ought to have first established who was making the payments to the Contractors. In its submissions, the Appellant averred that the burden of deduction fell on the entity making the payments to contractors for the works done.
14. It was the Appellant's submission that the Respondent's assessment was inconsistent with the provisions of Section 35 (5) of the Income Tax Act for a number of reasons chief among them that the Appellant was not responsible for the preparation of payment vouchers. As such, the Appellant would have nothing to return to the Respondent since it was not in control of the funds. By requiring it to withhold tax without filing returns, the Appellant would have committed an offence.
15. The Appellant submitted that the Respondent in his demand and on various meetings has alluded to analyzing the ledgers of the Appellant on the amount of payment made to the contractors. The Appellant refutes this assertion and avers that the accounts for the payment of the contractors were not domiciled with the Appellant. The Appellant was responsible for the certification of the

works which would then translate to the interim payment certificates. This in itself does not amount to payment since the interim payment certificate as raised is not conclusive. As such, the claims by the Respondent that it examined the Appellant's ledgers is without any evidence, unfounded and baseless. In this regard the Appellant placed reliance on the principles of taxation as set forth in ***Keroche Industries Limited versus Kenya Revenue Authority & 5 Other (2007) eKLR*** and ***R v Commissioner of Domestic Taxes ex parte Barclays Bank of Kenya Ltd.***

16. On the issue of who was to make payment and deduct the taxes, the Appellant placed reliance on Sections 2 and 35 (1) of the Income Act. The Appellant submitted that the Respondent's case is hinged on the assertion that the Appellant had an obligation to deduct the taxes even if they were not in control of the payments. The Appellant counter this averment by asserting that it was not the payer as provided by the law in order to incur deduction obligations.
17. In dissuading the Tribunal from relying on ***Kenya Electricity Generating Company Limited v Commissioner of Domestic Taxes, Appeal No 6 of 2010*** the Appellant submitted that the Commissioner's demand is erroneous for failing to identify the payer, the source of the payment and at what stage the deductions were to be entered.
18. On his part the Respondent submitted that Appellant entered into a contract with CMC Di Ravenna for the Itare Dam Water Supply Project on 15th May 2015. The said Contract described the Appellant as the Employer and CMC Di Ravenna as the Contractor. Further, on the basis of this contract, the Government of Kenya entered into a facility agreement with BNP Paribas Fortis S.A. /N.V and Intesa San Paolo S.PA on 15th July 2015. The Facility agreement described the

Government of Kenya as the Borrower, BNP Paribas Fortis S.A. /N.V as the arranger, financial institution in schedule 1 of the agreement as the original lenders, the Appellant as the buyer and CMC Di Ravenna as the Italian exporter.

19. It was submitted for the Respondent that clause 14.2 of the Finance Agreement is express that it refers to payments made by the Borrower (the Government of Kenya) to the Lender and not payments made by the buyer (the Appellant) to the contractor. It was the Respondent's argument that had the finance Agreement intended to extend the exemption to the Appellant and CMC Di Ravenna, it would have expressly stated so since parties are expressly defined in the Agreement. Clause 14.2 of the Finance agreement therefore is applicable in respect of the Borrower and not the Appellant.
20. The Respondent further submitted the Itare project was granted exemptions for services in respect to VAT by the National Treasury in a letter dated 30th May 2016. The letter was specific that it did not include exemptions of goods, a separate application for exemption for goods for use in the project must be made in accordance with the 'procedure for processing exemptions from duties and VAT for official aid funded projects and withholding tax on income is payable. Further, the exemptions granted in the letter were specific to customs and vat on goods and services. The exemptions did not cover withholding tax under the Income Tax Act. The Respondent's assessment on withholding tax is therefore sound and should be upheld by the Tribunal.
21. It was submitted for the Respondent that the income earned by CMC Di Ravenna as a contractor of the Appellant was not specified in part I of the First Schedule to the Income Tax Act as exempt. The income was not exempt by any notice in the Gazette and therefore the Appellant was duty bound to withhold

income under the law. The Commissioner relied on Section 35 (1) of the Income Tax Act and point out that Section required every person to deduct tax upon payment of any amount to any non-resident person not having a permanent established in respect of management or professional fees.

22. The Respondent submitted that the Appellant was responsible for preparation of payment certificates which were forwarded to the State department of Water for processing of payment. It is the Respondent's argument that the Appellant failed to account for withholding tax as it was preparing the payment certificates and therefore failed to discharge its obligations as the employer of the contractor.
23. On the Sabor – Iten Tambach Water supply project the Respondent further submitted that the Appellant herein was described as the employer and Aspac Intl (SPRL) and the contractor. The works undertaken by the contractor similarly attracted professional and management fees which is subject to withholding tax under Section 35 (1) on account of the Appellant. The Respondent's submissions and logic assessing withholding in this regard are similar to the above arguments in respect of the Itare Dam Water Supply Project.
24. In addition to foregoing arguments, the Respondent further averred that the Appellant cannot seek to rely on the opinion granted by the Attorney General to avoid contractual obligation to pay withholding tax. It is clear, in clause H of the Opinion that the legal opinion was in respect of the credit agreement dated 4th October 2013 relating to the buyer credit facility granted by Belfius Bank SA/NV to the Republic of Kenya. The Commissioner placed reliance on ***Kenya Electricity Generating Company Limited v Commissioner of Domestic Taxes (2015) eKLR***.

25. We have carefully addressed our minds to the pleadings, evidence, submissions and the authorities in support thereof tendered by both parties to this appeal. The first issue to determine concerns whether the projects undertaken by the Appellant were withholding tax exempt. This will require us to look at the respective agreement for the projects. In case of the Itare Water Supply Project, the Appellant entered into agreement with CMC DI Ravenna as contractors on 15th May 2015. To finance the Agreement, the Government entered into a financing agreement with BNP Paribas Fortis S.A/N.A and Intesa San Paolo S.P.A on 15th July 2015. Of particular interest clause 14.2 of this finance agreement, which provided as follows;

“a. The borrower (being the Government of Kenya) shall make all payments to be made by it without any tax deduction, unless tax deduction is required in law.

b. The Borrower shall promptly upon becoming aware that it must make a deduction (or that there is any change in the rate or the basis of a tax deduction) notify the agent accordingly. Similarly, a lender shall notify the agent on becoming so aware in respect of a payment payable to that lender. If the agent receives such notification from a lender it shall notify the borrower.

c. If a tax deduction is required by law to be made by the borrower, the amount of the payment due from the borrower shall be increased to an amount which (after making any tax deduction) leaves an amount equal to the payment which would have been due if no tax deduction had been required.

- d. If the borrower is required to make tax deduction, it shall make that tax deduction and any payment required in connection with that tax deduction within the time allowed and in the minimum amount required by law.*
- e. Within thirty business days of making either a tax deduction or any payment required in connection with that tax deduction, the borrower making that tax deduction shall deliver to the agent for the finance party entitled to the payment evidence reasonably satisfactorily to that finance party that the tax deduction has been made or (as applicable) any appropriate payment paid to the relevant taxing authority or a certification issued by the taxing authority indicating that any such payment to the agent for the finance party is tax exempted.”*

26. In respect of Sabor-Iten Project, the Appellant signed an agreement with its contractor, Aspac Intl on 19th December 2012. By a facility agreement dated 4th October 2013, the National Treasury executed an agreement with Belfius Bank of Belgium for the implementation of the project. Clause 10.1 & 2 of the said agreement provided as follows;

“The Borrower shall make all payments to be made by it under this Agreement without any deduction or withholding for or on account of any tax, levy, impost, duty or other charges or withholding of a similar nature.

In any case, the Lender must receive from the Borrower an amount equal to the amount which the Lender would have received if no deduction or withholding of any kind had been required.

If a deduction or withholding for or on account of any tax, levy, impost, duty or other charges or withholding of a similar nature is required from a payment due under this Agreement, the Borrower shall immediately pay to the Lender an additional amount equal to the amount of the deduction or withholding.”

27. Our understanding of the foregoing clauses of these agreements is in line with the interpretation adopted by the Respondent in this case. The import of the foregoing clauses is that the Government of Kenya entered into these agreements with the lenders on the understanding when the time for repayment of the loan facilities came, it will pay the lenders the amounts due under agreements without being affected by tax deduction requirements. Both agreements went on at length to underscore that if the laws of the Borrowers (being the Government of Kenya) required tax deduction such deduction should be made within the time allowed and in the minimum amount required by law. The Agreements also required evidence of such deduction be delivered to the Lenders agents. None of these clauses indicate a state where the Contractors undertaking the work would be exempt from withholding or deduction of the relevant taxes. To the contrary, the agreements were drafted in such an anticipatory manner in order to account situations, such as the current one, where the law requires deductions on fees due to the contractors implementing the project.
28. Our resolve in this regard is further buttressed by the letter dated 30th May 2016 from the National Treasury to the Respondent herein and the State Department of National Water Services. In the said letter the National Treasury confirmed that the services to the project are exempt in accordance with the provisions of Part II Item 20 of the 1st Schedule to the VAT Act 2013. The letter was categorical that it did not include the exemption of goods. A separate application for the exemption of goods for use in the project must be made in accordance with the

Procedure for processing exemption from duties and VAT for official aid funded projects. In clear terms the letter also states the withholding tax on income was payable.

29. Accordingly, we find that the argument by the Appellant that project was exempt from withholding tax is baseless and unfounded as the only exemptions granted from the evidence before us are in respect of valued added tax and customs duty.
30. Having so determined, we now turn our attention who bore the burden or obligation of deducting withholding taxes from the amounts due to the contractors under the two projects undertaken for the Appellant herein. In this regard, the Respondent submitted that the Appellant bore the burden of deducting withholding taxes as it prepared the certificates of payment. The Appellant on its part averred that it could not deduct the taxes due since it was not in control of the funds i.e. it was not the payer, who in law bears the burden of such deduction.
31. We have looked at the sample payment certificate availed to us in this appeal. For instance, on 22nd July 2016 the Appellant prepared payment certificate number 2 under vote 1103102700 in the amount of Kshs. 2,007,3398,109.35 due to its contractor CMC Di Ravenna. The certificate was addressed to the Principal Secretary State Department of Water. In the late paragraph, the Appellant states as follows;

“Please forward the certificates to the principal secretary, National Treasury for his further necessary action.”

32. Starkly missing from payment certificate number 2, prepared by the Appellant herein, is the amount to be withheld from the contractors as management or professional fees. In failing to include the amount to be withheld in the payment certificate the Appellant herein was in violation of Section 35 (1) of the Income Tax Act, Cap 470 of the Laws of Kenya as well as facility agreements for the projects, both of which required such deduction. As we can discern it from the its submissions, the Appellant is under the assumption, misguided though it may, that by indicating in the payment certificate the withholding taxes due, it would have to immediately remit the taxes so deducted from its pockets hence the arguments that it did not have access to the funds for the project or that it had no budget to settle the withholding taxes. Nothing could be further from the truth.
33. As reading of Section 35 (1) & (5) of the Income Tax Act leads us to the inevitable conclusion that the Appellant was bound to withhold taxes due on account of the contractor even if the contractor had not been paid as at that time because the obligation to make payment had arisen. In this regard, we associate ourselves on the finding in ***Kenya Revenue Authority v Republic (Ex Parte Fintel Ltd) [2019] EKL.R.***
34. The Appellant has also argued that making this deduction would mean that violating facility agreements and the burden of the deduction would be visited upon the Lenders under the agreement. This is an argument we are persuaded by and shall underscore our rationale by explaining the nature and process of payments in official aid funded projects such as those of the Appellant herein. Ideally, the contractor would invoice the agency that contracted it for the works, in this case the Appellant.

35. The Appellant upon being invoiced will begin processing the payment by preparing payment certificates, which should include as we have said the amounts due to the contractor and the amount to be withheld. This is sent to the parent Ministry or Department, in this case the State Department of Water, who then sent the payment certificate to the National Treasury.
36. Upon receipt, the National Treasury has two options; one, settlement of the amounts in question while deducting the withholding tax amount due, in the event the official aid project lender disbursed the funds to the National Treasury of the borrower. In such a scenario, after paying the contractor, the National treasury will remit the withheld amount to the parent Ministry or the Department concerned; who in turn remit it to the project implementing entity, in case the Appellant, who finally remits the withheld taxes to the Commissioner herein.
37. The second scenario is where the lender, as in this case of the Appellant, decides to disburse the finance directly to the suppliers of the project. We note from the Attorney General's letter dated 9th March 2016 addressed to the National Treasury, that the lender had amended the disbursement mechanisms for the proceeds of the loan so as to allow for direct payments to the suppliers of the project. In such a case, the National Treasury would pass on the payment certificate to the lender from in order to pay the contractors. If the project is income tax exempt, the process ends at the point. However, where the project is not income tax exempt as in this case, and the Lender does not bear the burden of deduction, then the National Treasury would have to budget to provide the Appellant with the funds to settle withholding taxes due; after all this is bargain made by the Government in order to fund the development projects.

38. In any event, by failing to include the withholding taxes due the Appellant herein fell into error. The Respondent is therefore well within its rights as the assessor tax obligation in his assessment against the Appellant; that the Appellant was supposed to withhold tax from the management and professional fees to the contractors.

F. CONCLUSION

39. The upshot of the foregoing analysis is that we find the Respondent assessment was proper in law and the Appeal lacks in merit. Accordingly, we make the following Orders;

- i) The Appeal be and is hereby dismissed.
- ii) The Respondent's objection decision dated 14th May 2020 confirming an assessment for the sum of Kshs. 643,394,426.00 be and is hereby upheld in its entirety.
- iii) Each party to bear its own costs.

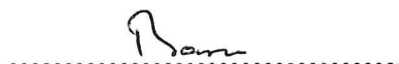
40. It is so ordered.

DATED and DELIVERED at NAIROBI this 4th day of June, 2021.


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MAHAT SOMANE
CHAIRPERSON


.....
WILFRED GICHUKI
MEMBER


.....
JOHN KINYUA WANGARI
MEMBER


.....
ROSE WAMBUI NAMU
MEMBER


.....
TIMOTHY CHESIRE
MEMBER

