REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 14 OF 2020

PERFORMERS RIGHTS SOCIETY OF KENYA..........................APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES..........................RESPONDENT

JUDGEMENT

A. INTRODUCTION

1. The Appellant is a non-profit company limited by guarantee duly registered under the Companies Act 2015 within the Republic of Kenya and licensed by Kenya Copyright Board to operate as a collective management organization to collect license fees and fairly distribute royalties to performers enabling them to benefit and make economic gains from their intellectual property and investment.

2. The Respondent is a principal officer appointed under and in accordance with Section 13 of Kenya Revenue Authority Act, and is charged with the responsibility of among others, assessment, collection, accounting and the general administration of tax revenue on behalf of the Government of Kenya.

B. BACKGROUND

3. The genesis of this Appeal emanated from a service made to the Appellant with a compliance check findings in the Respondent’s letter dated 21st April
2019 notifying the Appellant of underpaid taxes amounting to Kshs. 43,650,842.00 including a demand for payment of the same.

4. The Appellant in a letter dated 18th March 2019 disagreed with the calculations made by the Respondent and the categorization of the amounts received by the Appellant as taxable income.

5. On 9th August 2019, the Appellant filed a late objection and sought extension of time from the Commissioner for filing of the same, which was granted by the Respondent vide a letter dated 8th October 2019. The Respondent also requested for additional documents from the Appellant to allow the Respondent to review and consider the Appellant’s objection.

6. In the Respondent’s letter of 24th April 2019, the Respondent addressed issues raised by the Appellant in its objection, including issues raised during meetings and engagements held between the parties. Vide email correspondence dated 15th October 2019 the Appellant forwarded to the Respondent documents required to consider and review the objection lodged.

7. On 13th December 2019, the Respondent communicated his objection decision to the Appellant rejecting the Appellant’s objection and thus confirming the initial assessment.

8. The Appellant being aggrieved by the decision of the Respondent filed a notice of appeal with the Tribunal against the entire assessment on 7th January 2020.

C. APPEAL

9. The Appellant’s Appeal as elaborated in its Memorandum of Appeal dated 14th January 2020, is premised on the following grounds:
a. That the Respondent erred in fact and law in its demand for Income Tax of Kshs 5,614,523.00 and Value Added Tax of Kshs 38,036,319.00 for the year of income 2016 as the said demand is not based on any material facts that have been provided by the Respondent.

b. That Respondent erred in law and fact it its demand by alleging that the funds in the Appellant’s account should be subjected to Income Tax and VAT.

c. That the Respondent erred in fact and law by alleging that the Appellant is a business generating income, while in fact the Appellant is a trade association involved in collection of License fees and distribution of royalties to its members.

d. That the Appellant is not subjected to Part II of First Schedule of the Income Tax Act.

e. That the Respondent erred in fact and law as it out rightly contravened the doctrine of legitimate expectation that rests on a presumption on the Commissioner to follow certain procedures in arriving at the tax liability and the benefits that accrue from it.

f. That the Respondent failed to consider the provisions of Section 21(2) of the Income Tax Act that a trade association can choose or elect by notice in writing to the Commissioner of Domestic Taxes to be considered to be carrying out business chargeable to tax in respect to any year of income. The Appellant has not made such an election and therefore cannot be subjected to Income Tax and VAT.
g. That the Appellant is established under Section 46 of the Copyright Act as a no-profit entity charged with the responsibility to collectively administer the rights of its members by collecting license fees and distribution of royalties without making any profit and therefore the Respondent's treatment of the Appellant's transaction for taxes is misconstrued.

D. RESPONSE TO THE APPEAL

10. The Respondent responded to the grounds appeal in a Statement of Facts dated 13th May 2021 as follows;

a. The Respondent acknowledged that some of the Withholding Tax in the Appellant's ledger did not belong to Appellant and that the same would not be considered in tabulations related to the Appellant. The Respondent also recognized that the Appellant's business did not have trade debtors and the Respondent thus conceded that it could not determine income using Withholding Tax. The Respondent then made an Income Tax computation for year of income 2016 which put the Appellant in a credit position amounting to Kshs 279,907.00.

b. On VAT, the Respondent referenced the Appellant's letter of 18th March 2019 where the Appellant had indicated that it was a social welfare group qualifying for exemption under First Schedule Part II Paragraph 11 (b) and that they neither charged or claimed input VAT on the basis that it was exempt. While the Appellant may be performing welfare activities to its members and operating only on royalties collected on behalf of members without making any profits or keeping any revenue in reserve the import of the above provision is clear that the Appellant ought to have sought the necessary exemption as required in law.
c. That the Appellant also relied on the provisions of Section 21(1) of the Income Tax Act to justify that it was exempt from Income Tax on the basis that it was a members' club, reliant on revenue coming from members' contributions. However, a reading of Section 21 (1) of the Income Tax Act show that the Appellant's gross receipt actually come from licensees who are consumers of art work and entertainment produced by the Appellant’s members and not the members themselves. These royalties are what is then distributed to the Appellant’s members after deduction of administrative costs.

d. The Respondent found that the proviso of Section 21 (1) of the ITA negates the Appellant’s argument as it refers to receipt from members and not those from consumers of members' products as is the case in this Appeal.

e. The Respondent averred that the services provided by the Appellant did not fall under the conditions set out in the First Schedule Part II Paragraph 11 (b) as the services offered were of a business nature.

f. That Section 13 of the Income Tax Act envisages an exemption authorized as such by the Cabinet Secretary. Indeed, the Appellant does not fall within this category and no evidence to that effect has been provided.

11. The Respondent prays that the Appeal be dismissed with costs to the Respondent and the confirmed assessment be upheld.

E. ISSUE FOR DETERMINATION

12. The Appeal herein raises a single issue for determination by this Tribunal, namely:

a. Whether the Appellant is liable to Income Tax and Value Added Tax
F. ANALYSIS

13. It is the Appellant's contention that the Respondent misdirected himself by treating the Appellant as an income generating business entity when in reality the Appellant is a trade association created to administer its members' rights by collecting and distributing royalties to the said members without keeping any profits. The services rendered by the Appellant are purely for the welfare and protection of its members, which rights have been abused time and again, leading to widespread misery and suffering of artistes and performers in Kenya.

14. It was submitted for the Appellant that the Respondent's findings in his objection decision was erroneous especially in light of Section 46 of the Copyright Act, 2001. The Appellant argued that it is established under Section 46 of the Copyright Act as non-profit entity to collectively administer the rights of their members such as composers, performers, authors, artists, book publishers among others. This is done by licensing users through the collection of license fees which are then distributed as royalties. Its principle role therefore is to collect and distribute royalties on behalf of its members.

15. It was the Appellant's further averment that generally trade associations are not considered to be carrying out trading activities and therefore exempted from tax both under the VAT Act and the Income Tax Act (ITA) Cap 470 of the Laws of Kenya. However, the members of the association are allowed to deduct the subscriptions in their income computation. Further, under Section 21 (2) of the Income Tax Act, a trade association can choose or elect by notice in writing to the Commissioner of Domestic Taxes to be considered to be carrying out business chargeable to tax in respect to any year of income. The Appellant has not made any such application under Section 21 (2) of the ITA and therefore it cannot be subjected to Income Tax.
16. Further, that nowhere in the VAT Act is it contemplated that member clubs and trade associations will be subject to the provisions of the Act. Trade associations are not in business in the manner implied by the Commissioner and, in fact the definition of ‘business’ in the Act purposely excludes such entities from its scope of application in order to impose Value Added Tax.

17. On his part, it was submitted for the Commissioner that on the Value Added Tax assessment the Appellant does not qualify to seek refuge under the provisions of Paragraph 11 (b) of the Part 11 of the First Schedule to the VAT Act 2013. That while the Appellant may be performing welfare activities to its members and operating only royalties collected on behalf of its members without making any profits or keeping any revenue in reserves, the import of Paragraph 11 (b) Part II of the First Schedule to the VAT Act is clear that the Appellant ought to have sought the necessary exemptions as required in law.

18. It was submitted for the Respondent that the Appellant does not qualify to be placed within the ambit of Section 21 (1) of the Income Tax Act. That a reading of the Section reveals that the Appellant’s gross receipts actually come from licensees, who are consumers of art work and entertainment produced by the Appellant’s members and not the members themselves. These royalties are what is then distributed to the Appellant’s members after deduction of administrative costs. Particularly the proviso of the section, which refers to receipts from members and not those from consumers of members’ products as is the case in this Appeal.

19. It was submitted for the Respondent that the services provided by the Appellant do not fall within the parameters of Section 21 of the ITA nor within paragraph 11 (b) of the First Schedule to the VAT Act. This is because the
services rendered by the Appellant as offered are of a business nature hence the levy of Income Tax and Value Added Tax.

20. We have reviewed the rival submissions and shall begin our analysis with a restatement and examination of Sections of the law relied upon by the Appellant. In this regard, Section 21 of the ITA espouses as follows;

“(1) A body of persons which carries on a members’ club shall be deemed to be carrying on a business and the gross receipts on revenue account (including entrance fees and subscriptions) shall be deemed to be income from a business:

Provided that where not less than three-quarters of such gross receipts, other than gross investment receipts, are received from the members of such club, such body of persons shall not be deemed to be carrying on a business and no part of such gross receipts, other than gross investment receipts, shall be income.

(2) A trade association may elect, by notice in writing to the Commissioner, in respect of any year of income to be deemed to carry on a business charged to tax, whereupon its gross receipts on revenue account from transactions with its members (including entrance fees and annual subscriptions) and with other persons shall be deemed to be income from business for that and succeeding years of income.”
21. Paragraphs 10 and 11 (b) of the First Schedule to the Income Tax Act and First Schedule Part II of the VAT Act, respectively, stipulate as follows;

PARAGRAPH 10 FIRST SCHEDULE, ITA

"Subject to section 26, the income of an institution, body of persons or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education—

(a) Established in Kenya; or

(b) Whose regional headquarters is situated in Kenya,

In so far as the Commissioner is satisfied that the income is to be expended either in Kenya or in circumstances in which the expenditure of that income is for the purposes which result in the benefit of the residents of Kenya:

Provided that any such income which consists of gains or profits from a business shall not be exempt from tax unless such gains or profits are applied solely to such purposes and either—

(i) Such business is carried on in the course of the actual execution of such purposes;

(ii) The work in connexion with such business is mainly carried on by beneficiaries under such purposes; or

(iii) such gains or profits consist of rents (including premiums or any similar consideration in the nature of rent) received from the leasing or letting of land and any chattels leased or let
therewith; and provided further that an exemption under this paragraph—

(A) Shall be valid for a period of five years but may be revoked by the Commissioner for any just cause; and

(B) Shall, where an applicant has complied with all the requirements of this paragraph, be issued within sixty days of the lodging of the application.”

PARAGRAPH 11 (B) PART II, FIRST SCHEDULE VAT ACT 2013

“The supply of the following services shall be exempt supplies—

(11) The supply of—

(a) Services rendered by educational, political, religious, welfare and other philanthropic associations to their members, or

(b) social welfare services provided by charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act (Cap. 108), or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organization Coordination Act, (No. 19 of 1990) and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act (Cap. 470), and approved by the Commissioner of Social Services:

Provided that this paragraph shall not apply where any such services are rendered by way of business.”
22. From the records before us, the Appellant objects to Income Tax and Value Added Tax assessment on the basis that it is exempt from both obligations in line with the above mentioned provision of the ITA and VAT Act. In our understanding, the foregoing provision of the law, provide avenues for entities that deal in social welfare activities to be exempt from both Income Tax and Value Added Tax obligations. However, for the exemption to apply the entity must be based in Kenya and is either established solely for the purposes of the relief of the poverty or distress of the public or for the advancement of religion or education, or supplies services rendered by educational, political, religious, welfare and other philanthropic associations to its members.

23. In respect of Income Tax obligation, Section 21 (2) of the ITA provides such entities with the option of electing by notice in writing to the Commissioner in order that the income of a particular year be deemed to be chargeable to tax. In such instances, the entity’s gross receipts on revenue account from transactions with its members (including entrance fees and annual subscriptions) and with other persons shall be deemed to be income from business for that and succeeding years of income. Noteworthy, in the Appeal before the Tribunal the Appellant out rightly denies making such an election neither has the Commissioner availed evidence of such an election.

24. That being said, we must answer the question whether the Appellant qualifies to benefit from exemptions in the above quoted Sections of the ITA and the VAT Act. Our answer to this is resoundingly in the affirmative. The Commissioner is solely opposed to the Appellant benefiting from this exemption on the basis that the Appellant has not sought the exemption in line with Paragraph 11 (b) of Part II of the First Schedule to the VAT Act. We find this to be a misguided construction of the Paragraph 11 (b) of the Part II of the First Schedule to the VAT Act.
25. In our humble view, Paragraph 11 (b) of the Part II of the First Schedule to the VAT Act affords the exempt status to either social welfare services provided by charitable organizations registered as such, or which are exempted from registration under the provisions of Section 10 of the Societies Act (Cap. 108), and the Non-Governmental Organization Coordination Act, (No. 19 of 1990). The Appellant herein does not fall within the later ground. The Appellant is a registered collecting society under the provisions of Section 46 of the Copyright Act, 2001. Section 46 of the Copyright Act provides as follows;

"The Board may approve a collecting society if it is satisfied that—
(a) The body is a company limited by guarantee and incorporated under the Companies Act (Cap. 486);
(b) It is a non-profit making entity;
(c) Its rules and regulations contain such other provisions as are prescribed, being provisions necessary to ensure that the interests of members of the collecting society are adequately protected;
(d) Its principal objectives are the collection and distribution of royalties; and
(e) Its accounts are regularly audited by independent external auditors elected by the society."

26. As we held in Kenya Association of Music Producers vs Commissioner of Domestic Taxes TAT No. 13 of 2020 Section 46 empowers the Copyright Board to issue certificates to collecting societies if satisfied that the society, and we use this term loosely, has met the cumulative conditions listed in Section 46 (4) (a) to (e) of the Copyright Acts. These conditions are that the body is a company limited by guarantee and incorporate under the Companies Act (Cap 486) (now repealed), is a non-profit making entity, its rules prescribe provisions necessary to ensure that the interests of members of the collecting
society are adequately protected, its principal objectives are the collection and distribution of royalties; and its accounts are regularly audited by independent external auditors elected by the society. It is because the Appellant fulfilled these conditions that the Copyright Board issued the Appellant with a certificate of renewal of registration of a collective management society. As such, the Respondent cannot be heard to claim that the services rendered by the Appellant were rendered by way of business. Had this been true, then the Appellant would not be holding the certificate of a collective management society.

27. From the totality of the evidence before us, the Tribunal finds that the services offered by the Appellant places it within the parameter of exemption from Income Tax and Value Added Tax in line with Paragraphs 10 and 11 (b) of the First Schedule to the Income Tax Act and First Schedule Part II of the VAT Act, respectively. The Respondent therefore erred in assessing Income Tax and VAT on the Appellant.

G. CONCLUSION

28. In light of the foregoing analysis, the Tribunal makes the following Orders:

a. The Appeal herein is merited.

   a. The Respondent’s assessment dated 24th April 2019 and confirmed on 22nd November 2019 be and is hereby vacated.

   b. Each party to bear its own costs.

29. It is so ordered.
DATED and DELIVERED at NAIROBI on this 23rd day of July, 2021.

MAHAT SOMANE
CHAIRPERSON

WILFRED GICHUKI
MEMBER

ROSE WAMBUI NAMU
MEMBER

JOHN KINYUA WANGARI
MEMBER

TIMOTHY CHESIRE
MEMBER