HAZINA SACCO SOCIETY LIMITED..................................APPELLANT
VERSUS
THE COMMISSIONER OF DOMESTIC TAXES.................RESPONDENT

INTRODUCTION
1. The Appellant is a Savings and Credit Co-operative Society established and duly registered under the Co-operatives Societies Act, Cap. 490, Laws of Kenya.

2. The Respondent is established under the Kenya Revenue Authority Act, Cap 469 of the Laws of Kenya, charged with the mandate among others of assessment, collection and receipt of taxes on behalf of the Government of Kenya.

BACKGROUND
3. On 27/1/2014, the Respondent served the Appellant with notice under the provisions of the Income Tax Act, Cap 470, hereinafter referred to as ITA and Value Added Tax Cap 476, laws of Kenya, (repealed), hereinafter referred to as VAT, with their intention to carry out an audit for the period 2008 - 2012.

4. Subsequently, there were several meetings and correspondence exchanged between the parties herein in respect of the subject dispute culminating in the Appellant making a payment of undisputed taxes of Ksh:11,664,131. in respect of various tax heads namely, P.A.Y.E, Withholding Tax and Corporation Tax together with penalties.
5. On 31/5/2015 the parties held a meeting in which they failed to resolve the disputed taxes on the various tax heads referred to above. Consequently, the Respondent served the Appellant with a letter dated 7/6/2015 on the basis that the Audit carried out by the Respondent revealed instances of non-compliance resulting into issuing of additional assessments vide their letter of 10/6/2015 in respect of Corporation Tax and Excise Duty for the years 2008 – 2012.

6. The Respondent demanded additional tax for Corporation Tax amounting to Ksh:50,415,678. and Excise Duty amounting to Ksh:4,179,732. This was objected to by the Appellant vide their letter of 26/6/2015 on the ground that the assessment of income was excessive.

7. The Appellant did not get a response to the objection and sent a reminder on 9/10/2015 asking for an acknowledgment of their objection and for the Respondent to make a determination under Section 85 of the Income Tax Act.

8. The Appellant, being aggrieved lodged this appeal on 5/7/2016.

THE APPELLANT'S ARGUMENTS

9. According to the Appellant, the Respondent's assessment of its income was excessive on the grounds set out in the Memorandum of Appeal, namely:

(i) The 20% commission on top up loans should be exempted under the provisions of Section 19A, 4(a) and further that the calculation of allowance deductions was not properly computed by the Respondent. The Appellant's contention was that the said exemption was supported by the fact that the said commission
was interest charged on outstanding loans held by members of the Sacco who would wish to redeem their loans before their end date so as to access fresh loans

(ii) Moreover, they argued that their intention was to be compensated for the loss of interest it would have earned had the loans gone to the full term.

(iii) They further stated that the name “commission” was informed by the fact that there existed another product in the market known as “interest” which would have led to confusion and further that the same distinction made their monitoring easy.

(iv) That the society assigned the name Fosa (Front Office Services Activities) which was licensed to operate in the year 2012 to help it monitor the growth and viability of its normal loan which is a Bosa (Back Office Services Activities) product.

10. The Appellant contended that on deductible expenses, (allowable deductions) the Respondent’s treatment of the Appellant’s accounts was wrong and without basis. They stated that the computation of expenses allowable (allowable deductions) was wrongly deducted from gross income in order to arrive at the taxable income.

11. The Appellant argued that pursuant to Section 15 of the ITA, allowable deductions are expenses which ought to be deducted from gross income in order to arrive at taxable income. They conceded that in the case of business entities which receive both taxable and exempt incomes, there is a formula used to calculate the same namely,
Taxable income x Total expenses

Total income

as opposed to what the Respondent used as their formula, namely,

Taxable income x Total expenses – Interest expenses

Total income.

12. The Appellant then contended that the Respondent’s computation as shown above amounted to double apportionment since the Respondent’s argument was that interest expense was to be taken to be wholly and exclusively incurred in the production of interest from members, which is exempted income.

THE RESPONDENT’S ARGUMENTS

13. The Respondent stated that it would rely on its Statement of Facts and Submissions filed on 3/8/2016 and 29/9/2016 respectively. They stated that the 10% interest charged on outstanding loans held by members of the Appellant who wish to redeem loans early to enable them access fresh ones, namely, top up is not true. They argued instead that the same is commission income which has been so classified in the Appellant’s audited accounts.

14. It was the Respondent’s assertion that if the commission is deemed to be interest income, it will be regarded as exempt pursuant to Section 19A (4) (a) of the ITA. Conversely, if it is a commission, it will be charged to tax pursuant to Section 19(4)(d) that charges tax to any other income to a Sacco other than rental income and capital gains. Therefore the Respondent stated that the same is a commission and not interest. The Respondent proceeded to rely on the extract from the Appellant’s website for the description of the commission and the
loan applications to support their contention that the description and character showed that the commissions are indeed not interest.

15. The Respondent further referred the Tribunal to NRB HCITA NO. 4 OF 2015, Muramati District Tea Growers Sacco Society Limited (UNAITAS SACCO) —vs- Kenya Revenue Authority to support their contention that the FOSA activities attracted tax and should be brought to charge under the relevant provision of the ITA.

16. On the issue of deductions allowable, the Respondent contended that since the Appellant was a business in receipt of both taxable and exempt income allowable deductions are calculated as per the following formula:-

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\text{Taxable income} \times \text{Total expenses (excluding interest expense)} = \text{Allowable Expenses.}
\]

17. The Respondent further buttressed their argument on the basis that in its financial statements, the Appellant had categorized its income as interest income and other income. Consequently, it argued that this is in line with the description of other income under Section 19A(4)(d) of the ITA and they therefore lawfully brought the same to charge.

ANALYSIS AND FINDINGS

18. The Tribunal has carefully analyzed the parties pleadings together with their submissions and is of the view that the following are the issues for its determination;

a) Whether the 10% commission on top up loans by the Appellant to its members qualify for exemption under the provisions of the Income Tax Act.
b) Whether interest income received by the Appellant is exempt under the provision of the Income Tax Act.

c) Whether the formula applied by the Respondent to determine the taxes due is lawful.

d) Whether the Respondent failed to communicate to the Appellant its decision to confirm an objection as stipulated in law.

19. The Tribunal notes that the Appellant’s argument is that the 10% commission on top up loans qualify for exemption under Section 19(A)(4)(a) of the ITA, whereas the Respondent contents that it is a commission and not interest and therefore falls under Section 19A(4)(d) of the said Act. The tax effect is that if the commission is deemed to be interest income, it will be treated as exempt under the provision of Section 19(A)(4)(a). However, if it is a commission, it will be taxed under Section 19(A)(4)(d) which charges to tax any other income to a Sacco, (other than rental income and capital gains). The Tribunal will refer to the said relevant section for its full intent and purposes. Section 19A (4) provides as follows:-

"In the case of a designated primary society which is registered and carries on business as a credit and savings co-operative society its total income for any year of income shall, notwithstanding any other provisions of this Act, be deemed to be the aggregate of-

(a) Fifty per centum of its gross income from interest (other than interest from its members);

(b) Its gross income from any right granted for the use or occupation of any property, not being a royalty, ascertained in accordance with provisions of this Act.

(c) Gains chargeable to tax under section 3(2)(f)."
Any other income (excluding royalties) chargeable to tax under this Act not falling within subparagraphs (a), (b) of (c ascertained in accordance with the provisions of this Act"

20. It is worth noting that the evidence on record clearly shows that in its website, the Appellant has described the commission to its members as hereunder:-

“A new product in the form of a top-up loan is currently available for those members with loan balances who wish to get normal loans. Members are allowed to request for this loan and a commission of 10% is charged on total outstanding loans. This loan is treated as a normal loan and therefore all applications should be received on or before 20th of every month. Authority for deduction of 10% commission should be done in writing. The 10% commission and the balance of the loan is reduced from the new loan”.

21. Moreover, the Tribunal notes that the evidence on record shows that the Appellant’s loan application form indicates that when the loan application is forwarded to the loan committee by a loans officer, it must indicate the commission imposed when applicable.

22. Furthermore, an excerpt of the Income Statement from the Appellant’s Audited Accounts for the years 2008 – 2012, shows that the Appellant in its declaration for the years 2008-2012 has specifically categorized the commission under “Other income” separate from “Interest as an income for members”, specifically under “Notes” thereof for the year ended 31st December, 2009.

23. The Tribunal notes that the Income Tax Act does not define the word “Commission”. It only defines the word interest in Section 2 as follows:-
“interest” (other than interest charged on tax) means interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes a premium or discount by way of interest and commitment or service fee paid in respect of any loan or credit.”

It is therefore the Tribunal’s respectful finding that the commission by the Appellant does not fit the above definition. Indeed the Appellant clearly stated during the proceedings before the Tribunal that the commission they referred to was compensation to the Appellant because the loan did not go the full term.

24. The Appellant contended that the use of the word commission in their records was for ease of doing its business and its use in their records as far as tax purposes was concerned was an error which ought not be used to punish them. The Tribunal makes a finding that the Appellant’s use of the word commission, considering all the evidence on record is correct as it gave its true character, which is that of a commission and not interest within the meaning of the Income Tax Act.

25. The Tribunal has carefully studied and taken into account the cases referred to herein and in particular Muramati District Tea Growers Sacco Society Limited (Unitas Sacco) –vs- Kenya Revenue Authority, In the High Court of Kenya at Nairobi, Income Tax Appeal No. 4 of 2013, where the court held as follows:-

i) “It was the considered view of the court that any interest accrued on FOSA services was not for the mutual benefit of members as it fell within the ambit of provisions of Section 3(2)(a)(i) and (ii) of the Act as taxable income. For all purposes and intent, the applicable provision relating to the income in question was therefore Section
19A(4)(d) of the Income Tax Act as had rightly been submitted by the Respondent”

ii) The court went on and noted that “the holding in the case of H - vs- The Commissioner of I.T (1958) E.A.303 that was cited by Majanja J. in the case Republic –v- Kenya Revenue Authority & Another Ex-parte-Kenya Nut Company Limited (2014) eKLR and relied upon by the Appellant to the effect that it was the duty of the court to give words of the sub-section their reasonable meaning. That is correct. Similarly, parties have a duty to assign the true meaning of words in any law but not to interpret the same to suit the unique circumstances of their case”.

26. Having carefully considered the foregoing, it is the respectful finding of the Tribunal that the Appellant failed to declare certain income for the stated years of income resulting into understatement of the income tax payable to the Respondent. It agrees with the Respondent that the commission was lawfully brought to charge under the provision of Section 19(A)(4)(d) of the ITA.

b) Whether interest income received by the Appellant is exempt under the provision of the Income Tax Act.

c) Whether the formula applied by the Respondent to determine the taxes due is lawful.

The Tribunal will consider these two issues b and c above simultaneously.

27. The Appellant argument was that in the case of businesses which are in receipt of both taxable and exempt income, the Respondent had no legal basis for the computations it made on the same. The Tribunal notes that the Appellant categorized its income in its financial
statements as interest income and other income. The description of other income is that of any other income under Section 19(A)(4)(d). The said Section has been reproduced above. The income in subparagraphs (b) and (d) has to be ascertained in accordance with the entire provisions of the Act, before it is included in the total taxable income of the Sacco. Furthermore, a careful reading of the said provision shows that in arriving at the total income of the Appellant, one must deduct exempt interest income i.e. interest income from its members.

28. It is worth noting that in order to ascertain income under Section 19(A)(4)(d), one must do so in conjunction with Section 15(1) of the ITA. Section 15(1) provides as follows:

“For the purpose of ascertaining the total income of a person for a year of income there shall, subject to section 16, be deducted all expenditure incurred in that year of income which is expenditure wholly and exclusively incurred by him in the production of that income, and where under section 27 any income of an accounting period ending on some day other than the last day of that year of income is, for the purpose of ascertaining total income for a year of income, taken to be income for a year of income, then the expenditure incurred during that period shall be treated as having been incurred during that year of income.”

29. The Tribunal is satisfied that the Appellant’s operational expenses ought to be apportioned between the taxable and exempt income because the expenses were incurred in generating both incomes and only the portion attributable to taxable income ought to be deducted from the taxable income. Therefore the Appellant’s reliance on the
case of Nairobi High Court Criminal Case No. 236 of 2003, Republic –vs- SAO is irrelevant as the Appellant’s position is not omnibus but specific. The Tribunal makes a finding that the formula used by the Respondent is in the circumstances lawful and is hereby upheld.

30. The Tribunal finds that there is therefore no infraction of the law as alleged by the Appellant. It is clear that Section 19(A)(b) and (d) of ITA specifies the categories of income that must be ascertained beforehand, while Section 15 provides for ascertaining with the resultant effect that any expenses that are wholly and exclusively incurred in the production of total taxable income to be deducted therefrom. The expenses that were apportioned were the ones that could not be attributable to a specific source of income.

31. It is also the finding of the Tribunal that the Appellant failed to provide supporting evidence to show the expenses that were attributable to exempt income leaving the Respondent with no option other than use their best judgment in computations so as to arrive at a reasonable assessment pursuant to Section 77 of the ITA which provides as follows:-

"Where the Commissioner considers that a person has been assessed at a less amount, either in relation to the income assessed or to the amount of tax payable than that at which he ought to be assessed, the Commissioner may, by an additional assessment, assess that person at such additional amount as, according to the best of his judgment, that person ought to be assessed”.

d) Whether the Respondent failed to communicate to the Appellant its decision to confirm an objection as stipulated in law.
32. The Tribunal has analyzed the sequence of events and communication thereto as set out in the background above and noted that the Appellant objected under Section 84 of the ITA. The Respondent received and reviewed the objection under Section 85 of the ITA and the matter had no specific time limit within which the Respondent would confirm the objection. At this point in time, the Tax Procedures Act was not in place.

33. Moreover, it is on record that both parties continued to engage each other in meetings before and after the Appellant’s objection in reviewing the issues in dispute. The Appellant is therefore estopped from alleging that there was unreasonable delay on the part of the Respondent. The Tribunal finds that the Respondent received and reviewed the objection under Section 85 of the ITA and the parties continued to engage each other before confirmation of the assessment. The Tribunal in the circumstances is satisfied that the Respondent has discharged its burden of laying the requisite basis hereof.

34. The upshot of the foregoing is that the Respondent’s additional assessment is upheld and the Appellant’s Appeal lacks merit and is hereby dismissed with no order as to costs.
DATED and DELIVERED at NAIROBI this 12th DAY OF JULY 2017.

In the presence of: .................................................. for the Appellant

................................................................. for the Respondent

JOSEPHINE K. MAANGI
CHAIRPERSON

JOSEPH WACHIURI
MEMBER

BONIFACE DIMMO
MEMBER

Judgement Appeal No.76 of 2016 (Hazina Sacco Society Limited)