

**REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 14 OF 2016**

OCEAN SPORTS (2006) LIMITEDAPPELLANT

VS

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant is a limited liability company incorporated in Kenya on 29th of May, 2006 and operates a tourist hotel in Watamu area, Malindi, Kilifi County. The company is 100% foreign owned with JMN Investments Limited domiciled in Mauritius, holding 99% shareholding. The other shareholders are Anthony Francis Garnham Wilkinson (1%) and ML Nominees Limited (1%).
2. In the year 2008, JMN Investments Limited and Kifaru Holdings Limited advanced a sum of Ksh.184,188,408/= to the Appellant which they stated were funds to acquire the property on which the resort is situated and for the refurbishment of the property.
3. The Respondent served a notice of audit upon the Appellant on various tax heads on 13/11/2013 and proceeded to conduct an in-depth audit on the Appellant for the period 2010-2014. It then issued tax assessments on 16/5/2014 for Ksh.15,092,307/= for Corporation Tax, PAYE, Withholding Tax and VAT. The audit findings were concluded and its findings communicated to the Appellant on 16/5/2014.
4. The Appellant objected to the assessment vide their letter of 10/6/2014. The Respondent acknowledged the objection and proceeded to issue an amended assessment on 30/4/2015. The revised assessment was in respect of withholding tax on deemed interest.

5. Having been aggrieved by the Respondent's assessments, the Appellant filed this Appeal on 28/5/2015 against the said decision of the Respondent.

APPELLANT'S ARGUMENTS

6. The Appellant argued that the assessments were based on the Respondent's wrong assumption that the amounts advanced by JMN Investments Limited were a loan, a fact that the Appellant disputes. The Appellant contended that the amounts were advanced to the Appellant on instructions of the shareholders of JMN Investments Limited on a personal capacity and the same were held on trust to JMN Investments Limited and are therefore not loans.
7. The Appellant further argued that the Respondent's assessments are not in accordance with the supporting documents that they submitted to the Respondent and further that their commitment to clear and streamline their tax matters are a sign that they are law abiding citizens and needed ample time to do so.
8. The Appellant submitted that the amounts in issue were investment funds injected by the company shareholders to acquire property and for re-furbishment purposes. This was based on the fact that the company was newly incorporated and did not have any other source of income at its inception. The Appellant produced extracts of financial statements for the years of income to show that the funds were wired in the years 2007-2008.
9. The Appellant argued that it is unfair for the Respondent to impose withholding tax on deemed interest in this case where the initial outlay was financed by the company's shareholders by virtue of being a non-resident parent company, particularly when Kenyan operations financed by such investments had not yet started generating income.
10. The Appellant submitted further that it operates a tourist hotel business, which has been adversely affected by negative travel advisories, leaving the hotel to operate at between 10% - 30% occupancy level. This has resulted in deterioration of the hotel buildings requiring funds for refurbishment and repairs as evidenced by the pictorials presented before the Tribunal during the proceedings.

11. The Appellant further contended that if it is ordered to pay the assessed taxes, it would be forced to auction the hotel together with its assets to raise the said assessed tax liability. It therefore submitted that it be given more time to revive its operations and thereafter streamline its tax matters.

RESPONDENT'S ARGUMENTS

12. The Respondent argued that the fact that the amounts advanced by JMN Investments Limited to the Appellant have to be repaid, qualifies the advances as a loan. It further argued that the Appellant declared the said amounts advanced in its end year 2011, financial statements as borrowings, which reinforces the fact that they were to be repaid, hence qualifying as a loan. The said amounts were shown as a liability to the Appellant in their said end year accounts.
13. The Respondent submitted that the allegation by the Appellant that the funds are held in trust by JMN Investments Limited has not been supported by any document and/or evidence, as no details of shareholder lenders or individual accounts lent have been produced.
14. The Respondent stated that pursuant to Section 10 of the Income Tax Act, Cap 470, the application of withholding tax on deemed interest is neither determined by the time of issue of the loan nor the usage of the loan. Its contention was that the facility advanced by JMN Investments Limited, a non-resident, is treated as a loan in the books of the Appellant.
15. The Respondent concluded its submissions by stating that it is aware of the decline in the tourism industry and the negative impact of the same on the hotel industry as a whole but its hands are tied as the law does not provide for exclusion of payment of taxes under such circumstances.

ANALYSIS

16. The Tribunal has studied both parties pleadings and submissions and note that the issues of its determination are as hereunder:-

- (i) Whether amounts advanced to the Appellant i.e. Ocean Sports (2006) Limited by JMN Investments Limited constitute a loan granted to it by a non-resident person.
 - (ii) If so, is tax chargeable on the deemed interest.
17. The Tribunal notes that the Appellant Company was incorporated in the year 2006 and the said amounts were advanced to it in the year 2008. The Appellant's financial statements for the year ended 30/4/2011 under non-current liabilities indicate borrowings in the sum of Ksh.188,425,653/= which were approved by the Board of directors on 22/9/2011. It is therefore a finding of the Tribunal that the fact that the amounts advanced were indicated by the Appellant as borrowings meant that the same were to be repaid and therefore qualifies the same as a loan. Furthermore, the Appellants end year accounts clearly confirm that the advance was a liability of the Appellant.
18. The Appellant argued that the said amounts were advanced as an investment and not a loan. The Appellant has annexed a letter dated 5/2/2011 as appendix V11, by JMN Investments Limited addressed to the Appellant to the effect that they did not advance a loan to it. The letter is evidence that the investor is clearly identified as JMN Investments Limited, who advanced funds to be used for the purchase and refurbishment of property and the recipient of the funds is the Appellant. The Tribunal notes that section 10 of the Income Tax Act, provides that withholding tax on deemed interest is not determined in the issue of the loan or the usage of the loan. Section 16(3) of the same Act defines deemed interest as interest deemed to be payable by a resident person in respect of an interest free loan from a non-resident person. It states;
- “deemed interest’ means an amount of interest equal to the average ninety - one day Treasury Bill rate, deemed to be payable to a resident person in respect of any outstanding loan provided or secured by the non-resident, where such loans have been provided free of interest’
19. The Tribunal notes that if indeed the said sum of Ksh.188,475,633/= was capital injection as alleged by the Appellant, it then would have increased the value of the company in that there could have been an

increase in the share capital. The Annual Returns tendered before the Tribunal shows that as at 2011, the nominal share capital of the Appellant was One Million (1,000,000) It is worth noting that the injection of the capital was in the year 2008.

20. Moreover, it is noted that even the Annual Returns for the year 2015, dated 16th March 2015, shows the nominal share capital of the Appellant as only Two Million (2,000,000) and therefore did not reflect the injection of the capital advanced as alleged in the correspondence by JMN Investments Limited. The tribunal makes a finding that the said letter is of no evidential value to the Appellant's appeal herein.
21. It is worth noting that the effective date for withholding tax on deemed interest is 9/6/2011. Therefore withholding tax on deemed interest was charged for the period June, 2011 to March 2014. Moreover, for deemed interest to apply the loan has to be advanced by a non-resident person and it is noted that the funds were advanced by two companies, namely:-

(i)	JMN Investments Limited	Ksh. 4,287,225
(ii)	Kifaru Holdings Company	Ksh. <u>184,188,404</u>
		Ksh. <u>188,475,633</u>

This is clearly indicated in the Appellant's journal entries for the year ended 30/4/2010 as exhibited in Appendix 6, read together with the financial statements for the year ended 30/4/2011, under note 10 thereof, under borrowings. The Tribunal notes that under the borrowings, note 10 provides as follows:

"This comprises of loan capital injected mainly by shareholder companies. The loan is unsecured interest free and has no fixed repayment date".

22. In view of the above, the Tribunal is satisfied that the Appellant declared the funds advanced in its end year 2011 financial statements that the same were to be repaid, which amounts were advanced by a non-resident person and it was on this basis that the Respondent correctly assessed and charged withholding tax on deemed interest.

23. The upshot of the above is that the Tribunal finds that the Appeal herein lacks merit and is accordingly dismissed. There will be no orders as to costs.

THESE ARE THE ORDERS OF THIS HONOURABLE TRIBUNAL.


DATED and DELIVERED at NAIROBI this 9th Day of December, 2016

In the presence of:-

**LUCY WATITU & ESTHER WANJIRU
(JOSIAH NJENGA ASSOCIATES TAX
AGENTS) for the Appellant**

NAFTALI OYUGI for the Respondent


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**JOSEPHINE K. MAANGI
CHAIRPERSON**


.....
**JOSEPH WACHIURI
MEMBER**


.....
**BONIFACE DIMMO
MEMBER**