

**REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO.31 OF 2016**

REAL PEOPLE SERVICES LIMITED.....APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant, is a limited liability company incorporated in the Republic of Kenya as a subsidiary company of REAL PEOPLE KENYA (RPK) formerly known as AFRICAN PROVIDENT LIMITED (APL)
2. RPK is a micro finance company operating in Kenya from the year 2007 for micro lending purposes. The shareholding of both RPK and RPS is by Real People International Finance Limited (RPIF) a Mauritian company which holds 100% of the shares and in turn RPIF is wholly owned by the REAL PEOPLE INVESTMENT HOLDING PLC (RPIH) based in South Africa.
3. During the years relevant to this Appeal RPK and RPS were both involved in the business of providing loans to their customers. RPK had operations in Kenya prior to the commencement of the operations by the Appellant herein. The Appellant was incorporated specifically to obtain and reinforce specific funding provided by the larger group in South Africa.
4. The Appellant did not have the infrastructure to disburse the funds provided by the related entity in South Africa and in a bid to avoid payment of any extra cost in setting up any other infrastructure RPK agreed to place its infrastructure at the disposal of the Appellant.

5. The infrastructure being referred herein includes staff, computer systems, vehicle running expenses, bank charges and commissions, printing and stationery, postage and telephone, premises, communication systems and any other services required in assessing customers bank ability in obtaining loans, tracking and collecting the said loans. The Appellant therefore had no infrastructure to carry its own business and relied totally on the infrastructure provided by RPK.
6. The Respondent in fulfillment of its statutory duty as the body charged by Law to collect Revenue conducted a Tax Audit on the Appellant's operations covering the period between 2011 to 2013 culminating in an assessment communicated to the Appellant via its letter dated 19th November 2015. The assessment was for Kshs.8,865,882/= comprising of Kshs.5,000,708/= being principal Tax and Kshs.3,865,464/= as penalties and interest.
7. The Appellant objected to the said assessment by its letter dated 15th December, 2015 upon receipt of which the Respondent confirmed the assessment by its letter dated 21st March 2016.
8. On 4th of April 2016 the Appellant filed its Notice of its intention to Appeal and served it upon the Respondent on the same day. On the 15th of April 2016 the Appellant filed its Memorandum of Appeal which comprised of one ground namely that **"the Respondent erred in law by considering administrative costs comprising telephone , electricity, vehicle running expenses, bank charges, sales and commissions, among other costs, as management or professional fees as defined by section 2 of the Income Tax Act (ITA) and assessed withholding tax"** and urged this Honorable Tribunal to allow its Appeal, set aside the Respondent's confirmed assessment and award the costs of Appeal to it. With its said Memorandum of Appeal, the Appellant filed its Statement of Facts, Respondent's assessment,

Appellant's objection letter, Respondent's Objection Decision and Appellant's Notice of Intention to Appeal.

9. On the 16th of May 2016 upon receipt of the said documents from the Appellant the Respondent filed its Statement of Facts and other relevant annexures thereto.

HEARING

10. The Hearing of the Appeal commenced on the 11th August 2016 with the Appellant being represented by Mr. James Mulili, Mr. Benson Kyalo, Mr. Samuel Kioko all from PKF and Mr. Erick Naude from the Appellant's company. The Respondent was represented by Mr. Kirugi, Mr. James Nyareki and Mr. Nickson Omondi. During the hearing it was agreed by and between the representatives of both the Appellant and the Respondent that the Appeal would proceed by way of Oral Submissions, documents filed by both parties and written submissions to be lodged by the parties thereafter.
11. The hearing was concluded on the same day with an order that Submissions by the Appellant be filed within seven (7) days from that date and the Respondent's written Submissions be filed seven (7) days upon receipt of the Appellant's Submissions. In obedience to the said Order the Appellant filed its Submissions on 18th August, 2016 with the Respondent filing its Submissions on 14th September, 2016.

APPELLANT'S ARGUMENTS

12. Bearing the above facts in mind it is the Appellants case that having being accorded the infrastructural resources by RPK the volume of transactions exponentially increased thereby casting the Appellant in a dilemma as to how to allocate individual expenses rendered by RPK to the Appellant.

13. The Appellant stated that the original intention was to charge individual expenses incurred in respect of the services provided to it by RPK but claims that these became impractical due to the enormous volumes of transactions and costs associated with extracting this information. It claims therefore that it decided to adopt what in its view was a more realistic approach to recharge to cost based on 50% of income less bad debts.
14. The Appellant prepared Financial Statements which form the basis of the audit by the Respondent and it is clear from these statements that it did not have any operating expenses that would enable it to discharge its mandate. The Financial Statements for both the Appellant and RPK for the relevant years describe the expenses incurred by RPK for the Appellant in providing the administrative and management infrastructure to the Appellant as "Administration and Management Fees".
15. The Appellant concedes that any business must incur some basic cost elements, which are necessary for the business to operate and further admit that they include office rent, electricity, telephone expenses, motor vehicle expenses and other relevant expenses thereto. The Appellant also concedes that in its financial statements annexed to its documents no expenses have been captured associated with the running of the business as it does not have any expenses of its own.
16. The Appellant further concedes that its core-business of lending money is not a passive business as it entails identifying potential clients, vetting them, monitoring the outstanding loans, following up where the installments of the loans are not paid and initiating legal action where the borrowers remain in default.

17. It obviously concedes that the tasks and processes for carrying out its core business are not possible without the necessary staff, processes, procedures and equipment, in short the infrastructure. The Appellant exhibited the said operating expenses in “annexure six” in its bundle of documents which is further proof that the Appellant did not have the resources to carry out its business.
18. The Appellant argues that it and RPK share the basic facilities and infrastructure and that for ease of accounting RPK fully pays for these expenses and seeks reimbursement from the Appellant on the basis of 50% of income less bad debts.
The Appellant then introduces a novel accounting principle where it claims that by seeking a 50% reimbursement it adopted what it claims was the formula used within the same industry by similar enterprises faced with the same situation. It claims that this average had been achieved by its industry peers. It then insisted that it used this ratio in computing the portion of expenses it incurred for the relevant period of the assessment.
19. It is important to note at this juncture that the Appellant did not provide any independent evidence to confirm the notoriety of this formula in the industry and or persuasive material derived from recognized academic sources in respect to its alleged accounting principle to confirm the existence or notoriety of the said principle.
20. The Appellant argues that it was being penalized by the Respondent for having used estimate ratios in approximating the cost incurred and apportioning them accordingly. It contends that the Respondent was seeking payment of withholding Tax without identifying which specific section of the Income Tax Act it was relying upon. It further asserts that the Withholding Tax demanded by the Respondent does not fall within the provision of Section 35 (3) of ITA which states as follows:

(3) A person shall, upon payment of an amount to a person resident or having a permanent establishment in Kenya in respect of-

(f) Management or professional fee or training fees the aggregated value of which is twenty-four thousand shillings or more in a month".

Provided that for the purposes of this paragraph, contractual fee within the meaning of "management or professional fee "shall mean payment for work done in respect of building, civil or engineering works.

21. It contends that this section only applies to management or professional fees or training fees which is therefore inapplicable. To buttress its argument, it asserts that the definition of management or professional fee in section 2 of the ITA defines management or professional fee in such manner that it is inconsistent with the services rendered to the Appellant by RPK. Section 2 of the ITA defines management or professional fee“ as a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical or consultancy services however calculated”.
22. The Appellant further argues that from a reading of the said section of the ITA and the definition of the term “managerial” which according to the Collins Dictionary is “to direct or control the affairs of a business organization government etc”. There can be no element of management between the Appellant and RPK.
23. The Appellant claims that the Respondent was not justified in hijacking the Appellant’s misdescription of a cost title, which appears in its Financial Statements titled “**Management Fees**” which according to it did not amount to management fee but a reimbursement of cost, which did not constitute management fees, agency fee or training fees.

24. The Appellant urged this Tribunal relying on the cases of **Cape Brandy Syndicate v Inland Revenue Commissioners [1920] 1 KB 64** as applied in **Republic v Kenya Revenue Authority & Another Ex-parte Fontana Limited [2014]e KLR** and **Russel v Scott [1948] 2 ALL ER 5** to dismiss the Respondent's assessment as there was no express provision of the law which imposed any tax on the Appellant in the circumstances of this Appeal.

RESPONDENT'S ARGUMENTS

25. In Response to the Appellant's argument, the Respondent contends that from the Financial Statements of both the Appellant and RPK infrastructural expenses catered as administration and management fees were earned by RPK from the Appellant for the use of its infrastructural facilities. It further argues that the allegation of shared costs as advanced by the Appellant has no basis as no contract exists between the appellant and RPK that define this cost. It further contends that the services RPK offered to the Appellant are management services, which attract withholding tax. It finally argued that since the Appellant's operations were fully anchored in the RPK operating infrastructural systems the actions and responsibilities were nothing less than those of managing its activities for the Appellant at a fee.
26. The Respondent proceeded to define the term **"management"** as **"to be in charge of or to administer"** and that the relevant definition of **"administer"** in the Collins Dictionary is **"to direct and control the affairs of a business government etc."** further the Oxford English Dictionary defines management as **"the process of dealing with or controlling things or people"** and that therefore RPK was dealing or controlling the operations of RPS and the right to receive a management fee for the services rendered. The Respondent contended

that this was confirmed by the fact that the Appellant has claimed this management fee as an expense in its financial statements clearly defining it as “**Management Fee**” and RPK has recognized the same as an income derived from the services of managing the operations of the Appellant.

27. The Respondent further urged the Tribunal to adopt the decision of the Court of Appeal in **NRB. C.A.C.A No. 77 OF 2008 Stanbic Bank – vs- Kenya Revenue Authority** and to infer from the examination of the affairs and the business of the Appellant a payment of management and professional fees by the Appellant to RPK.

28. The Respondent further argued that Section 10 of the ITA is in all fours with the Appeal at hand which states;

10. “..... *Where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of-*

(a) a management or professional fee or training fee;

(b)
.....

The amount thereof shall be deemed to be income which accrued in or was derived from Kenya:

Provided that –

(i) this subsection shall not apply unless the payment is incurred in the production of income accrued in or derived from Kenya or in connection with a business carried on or to be carried on, in whole or part, in Kenya”

In its interpretation of that Section the Respondent argued that since the Appellant is a resident company incorporated and domiciled in Kenya in its business and activities the expenses incurred with regard to management fees are towards generation or production of its

income which it has recognized and declared in Kenya. Accordingly, the Respondent argued that the Withholding Tax as levied by it was proper and that the Appeal should be dismissed with costs.

ISSUES FOR DETERMINATION

29. From the foregoing the following issues lend themselves for determination. They are framed in the following interrogatories :-
- a) Did the Appellant and RPK “share” the same infrastructure.
 - b) Was the Appellant’s “formula” for sharing the infrastructural expenses valid.
 - c) Did the infrastructural services shared” between the Appellant and RPK attract Withholding Tax under relevant provisions of ITA.

ANALYSIS AND FINDINGS

30. Having carefully considered the Memorandum of Appeal and its accompanying Statement of Facts and all the annexures thereto together with the oral and written submissions by both the parties and the Respondent’s documents and the relevant authorities cited by the parties and relevant provisions of the Law, following are the respective findings of the Tribunal:
31. From the foregoing the following clear findings emerge :
- (a) The Tribunal is not convinced with the Appellant’s allegation that the amount declared in the records as Management Fee represents apportionment of the costs at 50% of the income less bad debts. It was incumbent upon the Appellant to discharge the burden placed upon it by the provisions of Section 30 of the Tax Appeals Tribunal Act, which states that;
(30) In a proceeding before the tribunal, the appellant has the burden of proving
a)-----

(b).....in any other case, that the tax decision should not have been made or should have been made differently.

This section is replicated in the provisions of Section 56(1) of the Tax Procedures Act No.29 of 2015 which states that;

(1) In any proceeding under this part, the burden shall be on the tax payer to prove that a tax decision is incorrect.

- (b) The Appellant does not dispute that it had an obligation to pay to RPK for the infrastructural services rendered to it and infact it states that the original intention was to charge individual expenses incurred by it for the said services provided by RPK, which however was not reflected in the accounts of the Appellant.
- (c) It is quite clear that the formula adopted by the Appellant of recharging to cost based on 50% of income less bad debts is arbitrarily subjective and self-serving. No evidence or persuasive objective material has been tendered before the Tribunal to demonstrate the notoriety of this formula in Law, principle or applicability and general acceptance in the industry. The Appellant does not identify the relevant source of Tax Law upon which this formula is based.
- (d) There is no dispute that the Appellant had no infrastructure of its own and that RPK provided all the infrastructural services. The Appellant's argument that the infrastructural services were shared between it and RPK is untenable, as the Appellant did not own part of the infrastructure of RPK. The notion of sharing connotes ownership.

The oxford English dictionary defines the term "share", inter alia as;

"Each of the notional parts into which property held by joint owners is divided"

Since the Appellant did not own any part of the infrastructure with RPK it could not claim to “share” the said infrastructure with RPK as the uncontroverted evidence has established that RPK owned 100% of the said infrastructure.

32. It is quite clear that the formula urged by the Appellant as the proper formula to be applied in respect to the issue of which entity, that is to say RPK or the Appellant was to meet the cost of the infrastructural expenses is beyond any doubt an **“income sharing formula”** and is not by any stretch of imagination, an expense sharing formula. On the basis of this finding the Appellant’s Appeal is incompetent and is for dismissing.
33. The Financial Statements of the Appellant for the relevant years describe the expenses incurred by RPK for the Appellant in providing the said administrative and management infrastructure as **“administration and management fees”**. The Respondent relied on these statements in arriving at its assessment.
34. The Appellant’s claim that it is being wrongfully assessed by having misdescribed the said infrastructural expenses is far-fetched and spurious as there was no other basis for the Respondent to carry out its assessment.

It is also significant that in its Financial Statements the Appellant did not capture the accounting formula of recharging the cost based on 50% of income less bad debts. The said formula is therefore an afterthought, is far fetched and cannot be sustained.

35. The Tribunal has carefully interrogated the authorities cited by the Appellant in support of its Appeal and made a finding that the said authorities are inapplicable to the facts before the Tribunal.

ORDER


36. The upshot therefore is that the Appeal is hereby dismissed with costs and the Respondent's assessment contained in the letter dated 19th November 2015 is sustained and upheld. The Respondent is entitled to costs in this Appeal which the Tribunal assesses at Kshs.10,000/= Orders accordingly.

DATED and DELIVERED at NAIROBI this ^{31st}.....DAY OF ^{July}.....2017

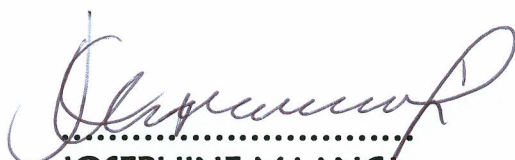
In the presence of:- ^{RUTH MWITI AND JEFF NTAMBAHO}.....for the Appellant

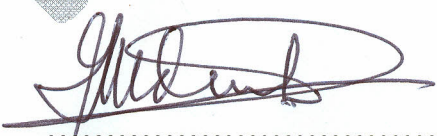
^{KAMUATH KIRUAI}.....for the Respondent


A.G.N KAMAU
CHAIRMAN


OMAR J. MOHAMMED
MEMBER


PONANGIPALLI V. R. RAO
MEMBER


JOSEPHINE MAANGI
MEMBER


WILFRED N. GICHUKI
MEMBER