

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO.63 OF 2016

SHERIA SACCO SOCIETY LIMITED.....APPELLANT

=VERSUS=

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant is a deposit taking Sacco regulated by the Sacco Societies Regulatory Authority (SASRA) and draws it's members from various institutions including but not limited to the Judiciary, the State Law Office, the Office of the Director of Public Prosecutions, Immigration, National Council for Law Reporting, Kenya School of Law, Government Ministries and the 47 County Governments.
2. The Respondent is established under the Kenya Revenue Authority Act, CAP 469 of the Laws of Kenya and is charged with the mandate to collect revenue and administer the tax regime on behalf of the Government of Kenya.
3. The Appellant offers to it's members Back Office Services Activities (BOSA) and Front Office Services Activities (FOSA) , which services include ordinary loans, emergency loans, asset finance, business loans and salary advances that are guaranteed by members' contributions and/or otherwise.
4. The Respondent vide a letter dated the 16th day of September, 2014 addressed to the Appellant issued a notice under Section 56 of the Income Tax Act, CAP 470 of the Laws of Kenya and Section 48 of

the Value Added Tax Act, 2013 intimating an intention to undertake an in-depth audit in respect of the accounting years of income of 2011 and 2012.

5. The Appellant confirmed it's willingness to have the in-depth audit examination undertaken and accordingly invited the Respondent's officers to commence the audit process on the 16th day of October, 2014 vide its letter dated the 23rd day of September, 2014.
6. The Respondent upon conclusion of the audit process proceeded vide a letter dated 25th November, 2015 to communicate to the Appellant the Audit findings and demanded payment of assessed additional tax liabilities under Corporation Tax, PAYE, Withholding Tax and Excise Duty in the aggregate sum of **Kshs.16,955,173/=**, inclusive of penalties and interest.
7. The Appellant raised an Objection to the Audit findings and the demand for the additional tax payment vide it's letter dated the 22nd December, 2015. The Appellant however made some concessions on some assessed tax liabilities that it subsequently settled the principal sum thereof and applied for waiver in respect of accrued penalties and interest thereon.
8. The Respondent vide a letter dated 21st April, 2016 confirmed it's decision on the tax assessment as relates to Corporation Tax on the Appellant's FOSA services in the sum of **Kshs. 8,158,718/=**, inclusive of penalties and interest and PAYE in the all-inclusive sum of **Kshs.4,218,555/=** thereby occasioning in an assessed aggregate sum of **Kshs.12,377,273/=** in tax liability payable by the Appellant.
9. The Appellant following the confirmation decision of the Respondent was prompted to initiate the Appeal process as against the confirmation decision and accordingly issued and served upon the Respondent a Notice of Intention to Appeal vide a letter dated

19th May, 2016. The copy of the Notice of Appeal was lodged before the Tribunal on the same date.

10. The Appellant filed it's Memorandum of Appeal and Statement of Facts dated the 3rd June, 2017 before the Tribunal on the same date.

THE APPEAL:-

11. The Appeal as against the Respondent's Notice of Confirmation of tax liability assessed at an aggregate sum of **Kshs.12,377,273/=**, inclusive of penalties and interest, arising from Corporation Tax and PAYE was premised on the grounds as set forth in the Memorandum of Appeal as under:-

- i) The Respondent confirmed the Notice without due regard to the provisions of the Income Tax Act, the facts and circumstances of the case; the Respondent is of the view that the Sacco did not comply with the provisions under Section 19A (4) of the Income Tax Act.
- ii) That the Respondent misapprehended the law in holding that interest income from Front Office Services Activity (FOSA) services was not mutual income exempt from taxation as per Section 19A (4) (a) of the Income Tax Act.
- iii) That the Respondent in it's understanding gave the term "interest from members" a very restricted meaning and not the meaning as contemplated under Section 19A (4) (a) of the Income Tax Act. It is our considered view that this Section should be read in tandem with Section 2 of the Income Tax Act. The Section gives a precise definition of what constitutes interest as:

“interest (other than interest charged to 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 a commitment or service fee paid in respect of any loan or credit.”

- iv) That the Sacco consists of a total of 9,963 members. As required under Section 31 of the Sacco Societies Act, the Sacco only engages in business as authorized by the Sacco Societies Regulatory Authority (SASRA). In particular, that the Sacco does not engage in any sort of business with non-members as the same is prohibited by SASRA.
- v) That the tax demand of Kshs.8,158,718/= inclusive of penalties and interest on interest income from FOSA is erroneous. The appellant contends that this income constitute interest from members and thus exempt from tax as provided under Section 19A (4) (a) of the Income Tax Act.
- vi) Without prejudice to the foregoing, the Sacco has not been proscribed from applying the provisions under Section 19A (1) (a) and (b) by neither the Commissioner of Co-operatives nor the Commissioner of Domestic Taxes.
- vii) That Pay As You Earn (PAYE) tax demand of Kshs.4,218,555/= inclusive of penalties and interest is excessive and erroneous.
- viii) The Respondent did not take into account all information and explanations provided by the appellant in order to appreciate all the issues placed before him before arriving at the PAYE assessments.

- ix) The Respondent did not check the reconciliations of the staff costs between the Trial Balance (TB) and the financial statements as provided by the Sacco. The Sacco prepared reconciliations on the variances and presented this to the Respondent clearly demonstrating that all the emoluments were taxed in accordance with the provisions under the Income Tax Act.
 - x) The Respondent in their conformation letter included a component of medical allowance as a taxable benefit. This is not a taxable benefit as provided for under Section 5 (4) (b) of the Income Tax Act.
 - xi) That the Appellant's employees have paid all the taxes on their employment income and benefits as these are duly included in the payroll and taxed in accordance with Section 37 of the Income Tax Act.
 - xii) The Appellant has accounted for and duly remitted all the tax due on all payments made to its employees in accordance with Section 37 of the Income Tax Act ("ITA").
 - xii) The Appellant in the Appeals seeks for Orders:-
 - a) **THAT** the tax assessment be annulled and set aside.
 - b) **THAT** the Appellant be awarded the costs of the Appeal.
12. The Appellant contends that the interest income from the FOSA line of businesses is earned from its members who are both in BOSA as well as FOSA and that the Appellant does not trade with any other people other than those who are its members.
13. The Appellant contends that in the circumstances the interest income earned from its FOSA services is not taxable under Section 19A (4) (a) of the Income Tax Act, CAP 470 of the Laws of Kenya.

14. The Appellant maintained in the Statement of Facts that it had provided the Respondent with a reconciliation of PAYE between the Pay roll, Trial Balance and the Financial Statements and that there was no variance that could be subjected to tax.

THE RESPONSE BY THE RESPONDENT:-

15. The Respondent upon being served with the Memorandum of Appeal and the Statement of Facts filed before the Tribunal by the Appellant proceeded to file it's Statement of Facts dated the 28th day of June, 2016 through Chinga Angeline Advocate before the Tribunal on the same date.
16. The Respondent contends that interest income from FOSA is deemed to be other income that needs to be charged to tax on non-mutuality basis as FOSA activities and business is ordinarily open to both members of the Sacco as provided by the Appellant and non-members.
17. That FOSA business includes provision of financial services that are ordinarily provided by commercial banks and which services like loan advances require collateral that markedly differ from the normal guaranteeing of loans in mutual business backed by members share contributions as collateral.
18. That the fact that the Appellant has not only registered with the Commissioner of Co-operatives but has equally registered with the Central Bank of Kenya to provide FOSA services confirms that FOSA services constitute a separate business as spelt out in Section 19A (4) (d) of Income Tax Act, CAP 470 of the Laws of Kenya.
19. The Respondent contends in respect to the assessment under PAYE that a portion of remittances as emoluments to employees had not been taxed and the taxes were in the circumstances not remitted as required.

20. That the reconciliations provided by the Appellant fell short of what was expected to be reconciliation between payrolls and accounts on one hand and another between payrolls and trial balances which are primary records of the Appellant that ought to tally.
21. That the Respondent's prayer before the Tribunal is for the Commissioner's decision to be upheld and the Appellant to accordingly pay the assessed additional taxes in the sum of **Kshs.12,377,273/=** plus penalties and interest.

THE HEARING:-

22. When the matter came up for hearing on the 7th March, 2017 the parties indicated that a compromise had been reached upon in respect of the assessment relating to tax liability as to PAYE and the Tribunal was in the circumstances to strictly deal and determine the assessed tax liability in respect of a sum of **Kshs.8,158,718/=**, inclusive of penalties and interests, arising from Corporation Tax.
23. The Parties by the very nature of the dispute informing the Appellant's tax liability as to Corporation Tax opted not to call for any oral testimony but rather opted to make oral submissions on the basis of the pleadings and documents filed before the Tribunal.
24. The Parties were subsequent to the hearing permitted by their own consent to file and serve upon each other with Written Submissions and the Tribunal directed the parties to file a partial Consent in respect of the compromise arrived at relating to the Appellant's PAYE tax liability. Both parties duly filed elaborate and erudite submissions before the Tribunal and the Tribunal appreciates their efforts in addressing the matter timeously and in a serious manner.
25. On 10th March, 2017 the Parties filed before the Tribunal the duly executed Partial Consent relating to the compromise arrived at by

the parties in respect of the Appellant's PAYE tax liability. The PAYE assessment in the sum of **Kshs.4,218,555/=** was adjusted to a sum of **Kshs.236,910/=** inclusive of penalties and interest, and the amount was indicated as having been paid.

26. When the matter came up for Mention on the 22nd March, 2017 the Tribunal with the concurrence of the Parties admitted the documents filed by the parties with their respective Written Submissions and following their indication as to absence of any need to highlight on their respective Written Submissions the Tribunal directed that the decision in the matter was to be rendered on notice to be served upon the parties.

ANALYSIS AND DETERMINATION:-

27. The issue for determination by the Tribunal on the basis of the pleadings and both the oral and written submissions on record before the Tribunal is:-

Whether interest income from FOSA loans is taxable under Section 19A (4) (d) of the Income Tax Act, CAP 470 of the Laws of Kenya?

28. The Appellant in its submissions asserts that it has complied with the provisions under Section 19A of the Income Tax Act in regard to the discharge of its tax liabilities and that interest income from both its BOSA and FOSA loans is not chargeable to tax in pursuant to the provisions of Section 19A (4) (a) of the Income Tax Act.
29. That the Appellant does not deal with non-members and that interest income from its FOSA line of business is earned from its members who are both in BOSA as well as FOSA.
30. That the Appellant offers various types of loans to its members and all of which loans are guaranteed by members' deposits with none issued under any form of collateral security.

31. That the Respondent gave the term “interest from members’ a very restricted meaning and not the meaning as contemplated under Section 19A (4) (a) of the Income Tax Act. That the Section 19A (4) (a) of the Income Tax Act ought to be read in tandem with Section 2 of the Income Tax Act to appreciate the precise definition of what constitutes interest.
32. The Appellant in it’s submissions faults the Respondent’s reliance on the Ruling in *Muramati District Tea Growers Sacco Society Ltd (Unaitas Sacco) =Vs= Kenya Revenue Authority (2015) eKLR* in the confirmation decision vide the letter dated 21st day of April, 2016 on the basis that the Court was of the view that interest from a member would be excluded under Section 19A (4) (a) of the Income Tax Act and would be deemed to be for mutual benefit of the members.
33. The Appellant contends that revenue from FOSA services other than interest income from FOSA loans are subject to tax under Section 19A (4) (d) of the Income Tax Act and that the matter before the Tribunal is not on service fees.
34. The Appellant asserts that the Ruling in the **Muramati case** was very clear that interest income from loans advanced to members is not subject to tax and to that extent the tax demand by the Respondent for a sum of **Kshs.8,158,718/=**, inclusive of penalties and interest, on the interest income from FOSA loans is erroneous and unsustainable under the provisions of Section 19A (4) (a) of the Income Tax Act.
35. The Respondent in it’s submissions contends that FOSA services as defined by the Appellant are not contemplated as Sacco business under the Sacco Societies Act and that FOSA would in the circumstances appear to be service charge or fee charged in conduct

of Sacco business. That FOSA is to that extent taken out of the realm of Sacco business to that of gains or profits from business or services rendered as defined under Section 3 (2) (a) (i) and (ii) of the Income Tax Act.

36. That for the principle of mutuality to accrue to a Co-operative Society such as the Appellant herein it is necessary that the contributors should be the same people as those entitled to share in the surplus otherwise in the event the society trades with non-members it is liable to tax on the profits of such trading.
37. That while Sacco business as properly defined under Sacco Societies Act may amount to mutuality of income, a service fee charged to a member on conduct of Sacco business does not amount to mutuality of income but is rather seen as a Sacco Society trading with its members out of the realm of Sacco business.
38. That FOSA services are not services of a Sacco Society as contemplated under the Sacco Societies Act, CAP 490A of the Laws of Kenya and that to that extent interest accruing from FOSA services can only be defined as **"Any other income"** taxable under Section 19A (4) (d) as read together with Section 3(2) of the Income Tax Act which provides for taxation of any business carried on for whatever period of time.
39. The Respondent while relying on the holdings in the judicial decisions in *Republic =VS= Kenya Revenue Authority & Another Ex-parte Kenya Nut Company Limited (2014) eKLR* and that of *Inland Revenue Commissioners =VS= Wolfson (1949) 1 All ER 865* on the interpretation of specific legislative instruments asserts that were it the intention of legislation to exempt from taxation such of the Appellant's services as the interest income from FOSA services, then legislation ought to have provided for such an exemption as

opposed to restricting exemption to interest from members under Section 19A (4) (a) of the Income Tax Act.

40. That the FOSA services offered by the Appellant beat the principle of mutuality as envisioned by the Sacco Societies Act and that for instance the charging of loan processing on FOSA loans is quite markedly the opposite of BOSA loans processing and that the Respondent is to that extent in order to place any income including interest income arising from FOSA activities under Section 19A (4) (d) of the Income Tax Act.
41. That the Appellant on the basis on the information on its website www.sheriasacco.coop deals with non-members and that to qualify for a group loan only one member of the group ought to be a member of the Appellant.
42. That the membership and loan application forms provided by the Appellant cannot be sufficiently relied upon as to benefit from FOSA services one need not necessarily provide a membership number but may provide any other unrelated numbers such as employment number or other numbers not at all explained by the Appellant.
43. The Respondent asserts that the non-mutuality and the commerciality of the FOSA business by Saccos was clearly and explicitly determined by the findings in the *Muramati District Tea Growers Sacco Society Ltd (Unaitas Sacco) =Vs= Kenya Revenue Authority (2015) eKLR* and in the *High Court Income Tax Appeal No.6 of 2013 at Nairobi Nyeri Teachers Sacco =VS= The Commissioners of Domestic Taxes* and that the tax demanded of Kshs.8,158,718/= is proper and ought to be upheld.

44. The Appellant being a designated Co-operative Society is liable for taxation under Section 19A (4) of the Income Tax Act, that provides as thus:-

“19A (4) In the case of every designated Cooperative Society which is registered and carries on business as a Credit and Savings Cooperative 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 the provisions of this Act;
- c) Gains chargeable to tax under Section 3(2) (f);
- d) Any other income excluding royalties chargeable to tax under this Act not falling within Paragraph (a), (b) or (c) ascertained in accordance with the provisions of this Act.”

45. The core function of a Sacco being Sacco business is defined by Section 2 of the Sacco Societies Act, No. 14 of 2008 of the Laws of Kenya as follows:-

“Financial Intermediation and any other activity by a Sacco based on cooperative principles in accordance with this Act by way of;

- a) Receipt of withdrawable deposits, domestic money transfer service, loan advances and credit facilities; or
- b) Receipt of non-withdrawable deposits from members and which deposits are not available for withdrawal for the duration of the membership of a member in a Sacco Society

and may be used as collateral against borrowings and domestic money transfer services.”

46. The Appellant as a Co-operative Society has as its sole objective the promotion of the welfare and economic interests of its members on the basis of the principles enunciated under Section 4(b) of the Co-operatives Societies Act, CAP 490 of the Laws of Kenya as under: -

“has incorporated in its by-laws the following co-operative principles;-

- i) voluntary and open membership;
- ii) democratic member control;
- iii) economic participation by members;
- iv) autonomy and independence;
- v) education, training and information;
- vi) co-operative among co-operatives; and
- vii) concern for community in general.”

47. The Appellant is expected to transact its core business being receiving deposits and onward lending under the principle of mutuality with the profits shared out amongst its members. This is what essentially constitutes the Appellant’s BOSA activities and it is what was obviously calculated to benefit from the special tax regime accorded to mutual societies.

48. The FOSA activities are the additional services offered to the Appellant’s members and are in their very nature similar to the commercial services rendered by the banking institutions. Justice Farah S.A. Amin had these to say in respect of FOSA services in *HC Income Tax Appeal No. 6 of 2013 Nyeri Teachers Sacco =VS= The Commissioner of Domestic Taxes:-*

“in the circumstances those activities are not within the aims and objectives of SACCOS as set out in the two Acts and regulations.

They are not by their nature for the benefit of the members as collective. They cannot be said to be not for profit and the profits are not shared between the members and therefore cannot benefit from the mutual label and privileges that it brings. The Appellant has also not provided evidence of the necessary permissions to conduct such activities. It cannot be right that whatever a mutual society does becomes subject to mutuality. In fact it is the other way around the activities of a society defines it as mutual or commercial. In this case the FOSA activities are undoubtedly commercial in nature and therefore the Appeal must fail.”

49. The Appellant maintained and a fact that was not manifestly controverted by the Respondent that other than the BOSA and FOSA loans advanced by the Appellant all the other FOSA services rendered were brought to tax and the appropriate tax thereon duly paid on the part of the Appellant.
50. Though the Appellant insisted on the fact that all its BOSA and FOSA loans were strictly and exclusively advanced to its members there was no attempt on its part to identify and provide a clear distinction as between the BOSA and FOSA loans ordinarily advanced by the Appellant and the parameters or factors informing the difference in the nature of the two separate loan categories advanced to the Appellant's members or otherwise.
51. The Appellant argues and which argument is to a larger extent logical and reasonable that Section 19A (4) (a) of the Income Tax Act does not make specific distinction as to which of the loans between BOSA and FOSA loans are exempt from taxation but the hallmark and purport of the said statutory provision is that interest from members of a designated cooperative society is exempt from taxation. This found favour with the decision of **J. Kamau** in

Muramati District Tea Growers Sacco Society Ltd (Unaitas Sacco) =Vs= Kenya Revenue Authority (2015) eKLR when she stated thus:-

“bearing in mind the definition of Sacco business against the backdrop of the provisions of Section 19 A (4) of the Income Tax Act, the court found itself in agreement with the Respondent that it was not all income that was generated by a Co-operative Society could be deemed to be for mutual benefit of its members. However, interest from a member would be excluded as seen in Section 19A (4) (a) of the Income Tax Act and would be deemed to be for mutual benefit of the members.”

52. The Tribunal guided by the foregoing decision that is binding on it is of the considered view that FOSA loans strictly and exclusively advanced to the members of the Appellant can be properly deemed to be for the mutual benefit of the Appellant's membership and interest income from such loan advances enjoys the full benefit of the provisions of Section 19A (4) of the Income Tax Act.
53. The critical issue for due determination by this Tribunal in the circumstances is whether the FOSA loans advanced by the Appellant during the accounting years in issue were strictly and exclusively advanced to the Appellant's members and to that extent whether interest income arising from such FOSA loan advances was exempt from taxation under the provisions of Section 19A (4) of the Income Tax Act.
54. The Respondent has consistently maintained and a fact that has not been appropriately addressed and/or controverted on the part of the Appellant that from the information available from the Appellant's website and upon consideration of the loan application forms and the conditions for the grant of FOSA loans it is highly

possible that FOSA loans have and/or are capable of being advanced to parties who are not at all members of the Appellant. The Respondent for instance made specific reference to the group loans that could be advanced to any group provided one member of such a group is a member of the Appellant.

55. The Appellant was under an obligation to demonstrate to this Tribunal that all the FOSA loans advanced on its part during the accounting years of 2011 and 2012 and in respect of which the Appellant generated the interest income in issue were strictly and exclusively advanced to its specific members. It was not enough for the Appellant to allege without specific data and evidence as to whom the specific loans were advanced to so as to dissuade the Tribunal from in any manner holding that there was a possibility of the FOSA loans having been advanced to parties who were not members of the Appellant.
56. The Tribunal agrees with the Appellant to the extent that the decisions in the **Muramati District Growers Sacco Society Limited case** and the **Nyeri Teachers Sacco** dealt substantively with the commercial services under FOSA activities of Co-operative Societies in general and did not specifically concern itself with interest income from FOSA loans strictly and exclusively advanced to members of the Saccos.
57. The Tribunal has upon due consideration of the entire set of the pleadings and documents filed before it and the submissions of the parties on record found that the Appellant has failed to discharge its burden of proof under Section 30(b) of the Tax Appeals Tribunal Act No. 40 of 2013 in proving that the tax decision on the Corporation Tax arising from interest income on FOSA loans in respect of the years 2011 and 2012 ought not to have been made

by failing to demonstrate that the interest income in issue arose from FOSA loans strictly and exclusively advanced to the members of the Appellant and not otherwise howsoever as strongly suggested by the Respondent.

FINDINGS ON FINAL DETERMINATION:-

58. In the circumstances the Tribunal finds that the Appeal as relates to the assessment and confirmation of the additional Corporation Tax in the sum of **Kshs.8,158,718/=**, inclusive of penalties and interest, lacks merit and accordingly orders as follows:-

- a) The Appeal is hereby dismissed;
- b) The assessment of the additional Corporation Tax forming the basis of the Appeal is hereby upheld;
- c) The Appellant to pay the additional Corporation Tax in issue and any further accrued penalties and interest; and
- d) Each party to bear its own costs.

DATED and DELIVERED at NAIROBI this 2nd DAY OF August, 2017.

In the presence of:-.....Mr. Ilia.....for the Appellant

.....Nyaga h/b for Chinga.....for the Respondent

.....[Signature].....
ERIC NYONGESA WAFULA
CHAIRMAN

.....[Signature].....
PHILOMENA KIROKEN
MEMBER

.....[Signature].....
PONANGIPALLI V.R. RAO
MEMBER

.....[Signature].....
JOSEPH M. WACHIURI
MEMBER

.....[Signature].....
GABRIEL KITENGA
MEMBER