

**REPUBLIC OF KENYA  
IN THE TAX APPEALS TRIBUNAL  
APPEAL NO.164 OF 2015**

**TAYLOR WINCH (COFFEE) LTD.....APPELLANT**

**VS**

**THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT**

**JUDGEMENT**

**BACKGROUND**

1. The Appellant is a limited company which is incorporated in Kenya under the Companies Act and deals with procurement, purchase and supply of coffee to its sister company Volcafe Holding Limited (VHL) in Switzerland. The Appellant filed its Memorandum of Appeal on 30<sup>th</sup> April 2015 together with Statement of Facts. The Appellant's prayers are set out in the Memorandum of Appeal.
2. The Respondent alleges that the Appellant used to receive substantial prepayments from its sister company-Volcafe Limited which was meant for procurement, purchase and supply of coffee but the money advanced was not applied for that purpose only but was utilized for its operations which amount was interest free and had no fixed repayment period.
3. The Respondent further alleges that the Appellant purchased coffee from the Nairobi Coffee Auction within Kenya and sold or exported

the same to the sister company-the sole customer of the Appellant. The Respondent further contended that the Appellant maintained a trading Account reflecting its sales and purchases and the value of the coffee in Kenya Shillings currency.

4. The Respondent subjected the Appellant to an Audit on 22<sup>nd</sup> October 2013 for Withholding Tax among other tax heads and issued assessments for Kshs.33,175,467/= being withholding tax on deemed interest computed on the interest free advances in respect of years of income 2010-2013.
5. The Appellant being dissatisfied with the assessment issued lodged an objection on 15<sup>th</sup> April 2015 but the Respondent proceeded to confirm the assessment on 31<sup>st</sup> March 2015 in accordance with Section 85(1)(c) and (3)(b) of the Income Tax Act. This prompted the Appellant to lodge the present Appeal against the Commissioner's Decision to the Tax Appeals Tribunal on 30<sup>th</sup> April 2015.

#### **ISSUES FOR DETERMINATION**

- i. Whether Withholding tax is chargeable on deemed interest under Section 35(1)(e) from interest free amounts received by Taylor Winch (Coffee) Ltd (TWCL) from Volcafe Ltd (VL).
- ii. Whether the deemed interest rate should be calculated using the CBK 91 days KSHS. Treasury bill (TB) rate under section 16(5) of the Income Tax Act or the prevailing rate of an issuing sovereign bank that corresponds with the currency of the Loan in question.



## THE APPEAL

6. The Appeal came up for hearing on 9<sup>th</sup> March 2016 where both parties relied on the documents on record. It is the Appellant's case that the Commissioner of Income Tax misapplied the law by treating the prepayment money by its sister company as a loan as defined under Section 35(1) (e) of the Income Tax Act Cap 470(ITA).
7. It is the Appellant's position that the prepayment money sent by its sister company was wholly and exclusively used to purchase goods (coffee) at the behest of its sister company. The Appellant further contended that the payment by VL was based on a corresponding proforma invoice received from the Appellant for goods (coffee) purchased from the weekly auction conducted at the Nairobi Coffee Exchange (NCE). The Appellant further contended that they were the sole/dominant purchaser under *(a captive procurement agreement)* a procurement Agreement with VL signed on 1<sup>st</sup> October 2010, allowing the Appellant to receive money from VL meant for the sole purpose of procurement, purchase and supply of coffee on behalf of VL.

## ANALYSIS

8. From the onset, it is not in disputed by both parties before the Tribunal that the Appellant was a separate legal entity trading in its own right in a one supplier-one customer relationship. Further it is not disputed that the Appellant had been declaring its Corporate Income Tax on its income accrued from its sales.



9. The key issues in dispute is whether the money received by the Appellant from the VL towards ongoing auction purchases of coffee against a proforma invoice of the Nairobi Coffee Exchange amounted to a loan under Section 35(1)(e) of ITA.
10. It is the Appellant's contention that all what they were doing was conducting transactions related to the payment of goods and services under normal business trading practice and were not being advanced loans to help them run their business as the ownership of both businesses was one. The Appellant further contended that the initial request for funds from VL was linked to the proforma invoices issued for the purchase of Coffee from Nairobi Coffee Exchange (NCE) which was below the subsequent cost price due to value addition to the stock after purchase. The Appellant also contended that it is trite law that normal trading receipts do not constitute a loan as it is common business practice in both local and international trade that a proforma invoice was and is widely used to solicit funds from intended buyers where the terms are clearly 'payment first'.
11. The Tribunal was informed by the Appellant that in foreign trade, a proforma invoice is a document that states a commitment from the seller to provide the specified goods to the buyer at terms agreed between them. That it is a binding agreement between exporter and importer and accepted by the customs department for certain purposes as well as by banks for financing transactions in the nature of trade.



12. Further it is the Appellant's submission that the Respondent did not specifically identify any loan amount figure that was advanced to it by VL apart from extracting in a very general manner net balance from the ledger account of VL in the books of the Appellant. The Appellant's argument being that the coffee stocks in their balance sheet for the four years in question were greater than the moneys credited to VL.
13. To get to understand the meaning of "a loan" the Tribunal was called upon to analyze; first how the excess money in the Appellant's books of accounts which were being referred to as "loan" by the Respondent came about and thereby qualified as "indebtedness" by the Respondent.
14. A simple analogy presented by the Appellant to justify the excess in their books of account which the Respondent did not object to was that the excess money in the books of accounts was caused by the fluid fluctuation in the market price of the goods in this case which was unpredictable and also based on the quality of coffee on offer at the NCE. This scenario, according to the Appellant, was also affected by the fact that the Appellant would do the purchase of the coffee and hold on to it until the right time before they could export it to their sister company. This scenario which brought about the excess money is now the subject of the Appeal as to whether; it should be treated as "loan" because of its "indebtedness" or it should be treated as "capital asset".



15. In the Appellant's written submission, they have outlined basic features that must be present for money given to qualify as a loan. The Tribunal has taken the liberty to set them out in extensor:

*i. There must be an agreement and/or, as in the instant case, it must be seen to be a loan.*

*ii. It should be repayable and/or have clear repayment terms.*

16. The Tribunal proceeded to establish the meaning of the expression "Loan" as follows; *In finance, a loan is the lending of money from one individual, organization or entity to another individual, organization or entity. A loan is a debt provided by an entity (organization or individual) to another entity at an interest rate, and evidenced by a promissory note which specifies, among other things, the principal amount of money borrowed, the interest rate the lender is charging, and date of repayment. A loan entails the reallocation of the subject asset(s) for a period of time, between the lender and the borrower.*

*In a loan, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back or repay an equal amount of money to the lender at a later time.*

*The loan is generally provided at a cost, referred to as interest on the debt, which provides an incentive for the lender to engage in the loan.*

*In a legal loan, each of these obligations and restrictions is enforced by contract, specifying the terms and conditions of the **repayment of such***



*a sum and which can also place the borrower under additional restrictions known as loan covenants.*

Section 16(3) of ITA reflects the foregoing meaning and provides that;

***For the purpose of Subsection (2), the expression-***

*“all loans” means loans, overdraft, ordinary trade debts, overdrawn current accounts or any other form of indebtedness for which the company is paying a financial charge, interest, discount or premium.*

*“deemed interest” means an amount of interest equal to the average ninety-one-day Treasury Bill rate, deemed to be payable by 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.*

17. The Tribunal upon perusal of the copy of Procurement Agreement signed between the Appellant and VL noted that the process of prepayment was provided for and defined under Clause 2.4 as;

*“Distributor agrees to pay Procurer a sum equal to the price to be paid by Procurer to the original producers or at auctions. This sum is considered a prepayment of stock. The parties may enter other payment arrangements only by mutual agreement”.*

Further reading of Clause 4.1 of the same Procurement Agreement, it is provided;

*“Subject to extraordinary circumstances as below descriptions the Procurer shall be remunerated with a Return on Total Cost (ROTC) target of a minimum of 1%...”*

18. It was incumbent upon the Tribunal to ascertain whether the money paid to the Appellant by VL for the specific purpose of procuring and exporting coffee met the threshold outlined above in order for it to qualify as a loan as submitted by the Respondent in this Appeal.
19. The Tribunal noted the submissions by the Appellant at paragraph 2.6 of their written submissions to the effect that the Respondent consistently referred to the monies received by the Appellant from VL as Advance, loan or repayments in their written submission. The Appellant Tribunal produces the same verbatim;  
*“Remember that soon after the tax audit, (when things were still fresh in their mind) KRA called this “Advance”. They then switched to describe it as a loan, after we exposed the flaw in their argument. Again, during the hearing itself they repeatedly referred to these receipts by TWCL as advances and/or prepayments.”*

## FINDINGS

20. The Tribunal finds that the money remitted to the Appellant by VL did not meet the eminent features of a loan as the Respondent failed to demonstrate to it the prominent features required for such money to qualify to be categorized as a loan as provided for in Statute and the general interpretation and understanding of the term “ loan”. These features are inter alia, the principal amount of money borrowed, loan repayment time, interest on the debt, contract, specifying the terms and conditions amongst others.



21. The Tribunal took judicial notice, that it is a tenet of statutory construction that the legislature is supreme when creating law and if it deemed it fit, it would have assigned the term "loan" the wider meaning the Respondent intended to introduce in this Appeal. This is well captured in the case of **Consumer Product Safety Commission et al. vs. GTE Sylvania, Inc. et al.**, 447 U.S. Supreme Court where it noted that *"...we begin with the familiar canon of statutory construction that the starting point for interpreting a statute is the language of statute itself.... In interpreting a statute a court should always turn to one cardinal canon before all others. Court must presume that a legislature says in a statute what it means in a statute what it says there."*
22. In view of the above explanation and in the absence of clear demonstration by the Respondent to specifically pinpoint the statutory legislation which allows the prominent features of a loan as they have attempted to apply, the Tribunal faults the Respondent and dismisses their argument. This therefore leaves the Tribunal with one conclusion, that is, the money remitted to the Appellant did not qualify to be categorized as loan but was for the specific purpose of procuring coffee on behalf of VL at NCE.
23. On the issue as to whether the Respondent had the discretionary power to prescribe a uniform rate of interest for both Shillings and US Dollar as provided for under Section 16(5) of Cap 470. It is the Appellant's position that the Respondent applied the power granted



under statute irrationally to the detriment of the Appellant and or business people. The Appellant hinged its argument on the fact that the Act itself does not prescribe the rates as the law envisaged that it is difficult to pre-fix the same. This is because the rates depend mostly on prevailing market conditions and circumstances of each case.

24. It is the Appellant's argument that the Respondent should use its discretion responsibly. The Appellant submitted and adduced evidence to the effect that the functional currency for the auction purchases and sales was of US Dollar. They submitted that the Respondent did not seek professional opinion of the Governor of the CBK before levying the rates to US Dollar on the alleged "Advance loan".
25. The Tribunal having entered a finding that the money remitted to the Appellant by VL as not being a loan in the first limb of this Appeal, it is left with no option for the second limb other than to enter a finding which is concurrent with the finding of the first limb, that is in the absence of the monies remitted not being categorized as loan, then no interest can be levied.
26. From the foregoing findings by the Tribunal it is our considered view that the Respondent acted contrary to the statutory powers conferred to it to levy and collect taxes.
27. The Tribunal sets aside the confirmed decision of the Commissioner dated 31<sup>st</sup> March 2015 for the assessed sum of Kshs.33,175,467/= and the said confirmed assessment be and is hereby expunged.



28. The Appeal is allowed.  
29. Each party shall bear its costs.

DATED and DELIVERED at NAIROBI this <sup>6<sup>th</sup></sup>.....day of December 2016

In the presence of:-

ORLANDO COSTA LUIS.....for the Appellant

FIONA KERUBO KUYOKA.....for the Respondent

  
.....  
GEOFFREY KATSOLEH  
CHAIRPERSON

  
.....  
LILIAN RENEE OMONDI  
MEMBER

  
.....  
GABRIEL KITENGA  
MEMBER

  
.....  
FRANCIS K. KIVULLI  
MEMBER

  
.....  
PONANGIPALLI V.R. RAO  
MEMBER