REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
TAX APPEAL NO. 143 OF 2017

ADIX PLASTICS LIMITED.. APPELLANT

VERSUS

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

JUDGEMENT

INTRODUCTION

1. The Appellant is a company incorporated in Kenya under the Companies Act, and is principally involved in manufacturing of plastics and its located at the Industrial Area of Nairobi. The Appellant is a registered taxpayer bearing various tax obligations which include Value Added Tax, Income Tax, pay as you Earn and Withholding Tax.

2. The Respondent, Commissioner of Domestic Taxes, is an Officer of the Kenya Revenue Authority, appointed under Section 13 of the Kenya Revenue Authority Act, Cap 469 of the Laws of Kenya, whose mandate is to collect taxes on behalf of the Government of Kenya.

BACKGROUND

3. The Appellant was issued with a notice of intention to audit vide a letter dated 17th February 2017 with regards to investment deduction for the years 2011 to 2014. Accordingly, the Appellant was required to avail its books of accounts and records on or before the 1st of March 2017.

4. The Respondent tabled its finding on the investment deduction audit vide a letter dated 2nd June 2017 and disallowed the investment deduction demand of the Appellant. In it the Respondent raised a figure of Kes.75,460,740 as the total tax due from the Appellant for the years 2011, 2012, 2013 and 2014.

5. On the 23rd of June 2017, the Appellant raised an objection to the above assessment. The grounds of objection were as follows: -

    a) Machinery purchased whether old or new which is installed and used for manufacture in a new or old building are eligible for investment deduction as per paragraph 24(1)(d) of the Second Schedule to the Income Tax Act, Cap 470 of the Laws of Kenya.

b) All the main injection moulding machines have serial numbers as per the schedule that the Appellant provided during the KRA investment deduction inspection/audit. In any case serial numbers cannot be a basis to disallow cost of machinery but may facilitate identification of the machinery installed.

c) The machines and moulds have not depreciated and it does not matter whether investment deduction had already been claimed by the previous owners.

d) Installation is evidenced by the fact that the machinery was set up and subsequent production took place. The Income Tax Act defines installation as affixing to the fabric of a building in a manner necessary for and appropriate to the proper operation of the machinery concerned or otherwise setting up the machinery for use as may be appropriate for the type of machine.

e) The balance of new machinery bought and installed should not be moved to wear and tear on the basis that they were installed in an old building. Paragraphs 24(1)(c) and 24(1)(d) of the Second Schedule to the Income Tax Act allow both new and old machinery installed in a new or old building to be eligible for investment deduction.

6. The Respondent reviewed the above grounds of objection and confirmed the Assessment on the 21st of August 2017 for an amount of Kes.75,460,740. Aggrieved by this decision, the Appellant filed a Notice of Appeal on the 14th of September 2017.

APPEAL

7. The Appeal was premised on the following grounds: -

a. The Income Tax Act, CAP 470 provides in paragraph 24(1)(d) of the Second Schedule that "subject to this Schedule, where capital expenditure is incurred... on or after 1st January 1992 on the purchase and installation of machinery to be used for the purpose of manufacture, there shall be deducted, in computing gains or profits of the person incurring that expenditure for the year of income in which they were first used (hereinafter referred to as the year of first use`. Paragraph 24(1) lays emphasis on capital expenditure incurred. Therefore, the first test on whether machinery purchased qualify for investment deduction is whether the capital expenditure has been incurred. The second test is installation of machinery since for manufacturing to take place, installation of machinery MUST happen. The third test is whether the machinery is being used or has been used for manufacture.

b. Paragraph 24(1)(d) of the Second Schedule to the Income Tax Act legislated that costs incurred for the purchase of old or new machinery are eligible for investment deduction claim. However, it remains silent as to whether installation of machinery must be done by the first hand purchaser of machinery or the second purchaser for the same to qualify for deduction. The law simply states that machinery must be purchased and installed without stating whether it is only the first hand owner who can claim if machinery is subsequently sold as a going concern.

c. The Appellant's production and sales record depict that manufacture and sales took place immediately after takeover of the factory and therefore the investment deduction claim should be allowed in full.

d. The year of first use in reference to the Appellant is the year in which the second hand machinery was first used by the Appellant upon incurring capital cost on the same. For the Appellant, the year of first use cannot therefore be construed to mean the year which the first hand owner of the machinery used them.

e. The Appellant bought second hand machinery and the law allows for investment allowance. The Appellant has therefore not contravened paragraph 30 of the Second Schedule to the Income Tax Act as no other allowance has been claimed on the machinery except investment allowance. The paragraph simply means that the Appellant cannot enjoy wear and tear allowance on the same machinery once investment deduction has been granted. It does not mean that no further investment allowance can be claimed once the first hand owner has claimed investment deduction.

f. Notwithstanding the above, the Respondent disallowed the entire cost of machinery with total disregard of even wear and tear allowance for which machinery are ordinarily eligible in the absence of investment deduction claim.

g. Moulds are part and parcel of the machinery used for manufacture and the expenditure incurred on their purchase qualifies for investment deduction. Paragraphs 24(1)(c) and 24(1) (d) of the Second Schedule to the Income Tax Act clearly allow new or old machinery installed in a new or old building to be eligible for investment deduction. As already stated, the law is never implied but must be interpreted in its literal meaning. Paragraph 24(1)(c) and (d) have not distinguished new or old machinery and therefore it includes both new and old machinery installed in a new or old building as far as eligibility to investment deduction allowance is concerned. The matter was ruled in the Local Committee in ***Commissioner of Domestic Taxes vs Haco Industries Limited*** that moulds are part and parcel of machinery used for manufacture and expenditure incurred on their purchase qualify for investment deduction.

h. If moulds are replacement of machinery as contended by the Respondent, it follows that therefore moulds did not create an enduring benefit to the business and were therefore repairs which should be written off in the profit and loss account as revenue expenditure and not capital expenditure. Either way it will amount to 100% claim.

8. The Appellant prays that this Tribunal estops the Respondent from charging Corporation Tax, interest and penalties amounting Kes.74,460,740.

9. In response, the Respondent contends as follows: -

a. The 2nd schedule, paragraph 24(1) states that *subject to this schedule, where capital expenditure is incurred: (d) on or after the 1st January 1992 on the purchase and installation of machinery to be used for the purpose of manufacture; there shall be deducted, in computing gains or profit of the person incurring that expenditure for the year of income in which they were first used (hereinafter referred to as the year of first use), either both the building and machinery referred to in subparagraph (a) or both the machinery and, for the purpose manufacture, the part of the building in which that machinery* *has been installed referred to in subparagraph (b), or the building referred to in subparagraph (c), provided that, prior to its first being used for manufacture after its completion, it has been used for no other purpose, or the machinery referred to in subparagraph (d), or (dd) or the building referred to in subparagraph (e) or the building or machinery referred to in subparagraph (f) or machinery referred to in subparagraph (g), as the case may be, a deduction referred to as an investment deduction.* This indicates that the machinery qualified for investment deduction when it was first used. This means that the first owner ought to have claimed investment deduction on the machinery when they first used and no subsequent investment deduction claim can be allowed since it was claimed in the first year of its use and since it was previously being used for manufacture by Jaydees Knitting Factory.

b. The provisions of the Second Schedule paragraph 24(1)(d) indicate that one can purchase and install old machines and claim investment deduction only on the machine's first year of use. It does not give provisions for claiming investment deduction more than once even if the owners of the machines are different. Further, the accounting definition of Depreciation is "the gradual conversion of the cost of a tangible capital asset or fixed asset into an operational expense (called depreciation expense) over the asset's estimated useful life. Capital allowances are normally the difference in rates awarded or depreciation of tangible assets for tax purchases. By virtue of the first claimant receiving 100% allowance for the assets, the book value of the assets cannot be granted since, for tax purposes, the value of the assets purchased is nil.

c. The used machines and moulds were mostly non-functional at the time of purchase and during the inspection. The original importation documents were not provided and no production records specific to each machine was provided.

d. There were no valuation documents for the used machines and moulds purchased. The purchase contract did not provide any basis for the valuation and was neither dated nor signed.

e. The serial numbers of the machines are crucial in identifying the specific machines purchased, whether those specific machines were installed and actually used for manufacture. The fact that some of the machines had been dumped and not in use and the serial numbers could not be traced/identified coupled with the lack of production records linked to the specific machines, meant that it is possible that not all machines were installed and used for manufacture.

f. The taxpayer did not demonstrate the installation of the machinery. The business of Jaydees Knitting Factory Limited was taken over by Adix Plastics as a going concern and as such the machines continued to be used by the taxpayer in the same manner they were being used by the previous owners. There were no costs related to installation claimed. The 2nd Schedule, paragraph 24(1)(d) indicates that investment deduction is claimed on the purchase and installation of machinery to be used for the purpose of manufacture. The bit on installation was not demonstrated by the taxpayer.

g. Paragraph 30 of the Second Schedule provides that if a deduction is made under any part in respect of property, or in respect of capital expenditure on property, in computing the gains or profit of a person for a year of income, then, to the extent to which that deduction has been made, no further deduction shall be made under that Part or any other Part or under any other provision of this Act in respect of, or in respect of capital expenditure on, that property in ascertaining the total income of that person for the same or a previous or subsequent year of income. The Appellant has not demonstrated to date that Jaydees Knitting Factory Limited being the first users of the Machines had not claimed capital allowance on the machinery and moulds in their first year of use as per the provisions of the 2nd schedule, paragraph 24. Even if not claimed, then a claim cannot be made after first year of use.

h. In light of the above reasons, the Respondent disallowed the investment deductions claimed relating to the purchase from Jaydees Knitting Factory Limited of Kes.84,190,000 in 2011.

i. Paragraph 24 (1)(b) of the 2nd Schedule, states that where capital expenditure is incurred on the purchase and installation of new machinery in a part of a building other than a building or part thereof previously used for the purpose of manufacture, and the owner of the new machinery subsequently uses that machinery in that building for the purposes of manufacture; and the machinery has not been installed substantially in replacement of a machinery previously in use in an existing business carried on by the owner of that new machinery; there shall be deducted, a deduction referred to as an investment deduction.

j. Since the moulds are replaced every so often without necessarily changing the machine, then it follows that the mould was replaceable part of the machine and not a machine in itself since the Appellant is claiming it as a machine. Further, paragraph 24 (1)(b)(ii) gives has a proviso on claiming investment deduction if the machinery is not installed substantially in replacement of previously used machinery which are the old moulds being replaced by the new mould purchased every year.

k. The above provision is specific to new machinery and so all new machinery claimed should be on the basis of the 2nd Schedule, paragraph 24(1)(b). The paragraph goes ahead to give the definition of "new" as "not having been previously used by any person, or acquired or held (other than by a supplier in the normal course of trade) by any person for use by the person incurring expenditure under this paragraph.

l. Paragraph 24(1)(d) of the Second Schedule was introduced and stated that "where capital expenditure is incurred, on or after the 1st of January 1992 on the purchase and installation of machinery to be used for the purpose of manufacture, there shall be deducted, a deduction referred to as an investment deduction". This section was introduced to cater for second hand/use imported machines purchased by a company. Paragraph 24(1)(b) specifically deals with new machinery whereas paragraph 24(1)(d) deals with any other machinery that is not new.

m. Since the new machinery was purchased and installed in a building that was previously used for manufacture it was eligible for wear and tear allowance as opposed to investment deduction claim.

10. The Respondent makes the following prayers;

a. The Corporation Tax assessment on disallowed investment deduction claims be upheld.

b. The Respondent be entitled to the costs of the Appeal.

SUBMISSIONS

1. APPELLANT

11. The Appellant submitted that the Appeal is hinged on the claim for investment deduction under paragraph 24 of the Second Schedule to the Income Tax Act, Cap 470. There are two distinct aspects in the matter, the Appellant bought second hand plant and machinery in the period ending 31st December 2011 and also in the same period bought new plant and machinery. The Appellant is in the business of making plastic products. The Appellant's claim is in respect of investment deduction as per paragraph 24(1)(d) of the Second Schedule to the Income Tax Act which became operational on 1st January 1992.

12. The second hand machinery was purchased and duly installed and the Appellant immediately started production. Evidence of production was given by way of sales turnover. The Respondent contended that the first buyer of the second hand machinery is the one who should have been eligible for the 100% deduction. It is the Appellant's contention that the law does not state whether it is first or second hand machinery which should be eligible for 100% deduction. So long as it was used for manufacturing, it is eligible for 100% deduction. Additionally, the Appellant reported substantive turnover over the four years relating to manufacturing activities.

13. It was the Appellant's further assertion that the Respondent contended that the first year of use is the first year when the machinery was originally purchased. In response the Appellant holds that the same is not relevant because the operative date is 1st January 1992. Therefore, whether the machinery is new or used is irrelevant and the Appellant is entitled to the deduction claimed.

14. Paragraph 11 of the Second Schedule provides that when a seller of machinery sells that machinery to a purchaser, there is a provision in the tax law which brings those profits to charge. The original purchaser of the machinery should have accounted for the sales proceeds in his books of accounts and consequently the tax computation. The Appellant did not go to prove whether the original owner had claimed investment deduction or not, or whether he was charged tax on the sales profit. It should be appreciated that the Appellant has no such privileges.

15. The Appellant further submitted on the Respondent's reliance on paragraph 30 of the Second Schedule on double claim for allowances. In this regard, the Appellant contended that as of 1st January 1992 the law allows for investment deduction on second hand machinery without necessarily resulting to double claim of allowance. Finally, the Appellant submitted that moulds are an integral part of the manufacturing process. Reliance was placed on the case of *Haco Industries.*

RESPONDENT

16. The Respondent submitted that in order to enjoy investment deduction, there are certain requirements that need to be met. Among them are capital expenditure, purchase, installation, use for manufacture and the first year of use. The Appellant did not incur capital expenditure in buying the moulds in that moulds are revenue expenditure. The Respondent relied on the case of ***Commissioner of Income Tax vs M/S. TVS Motors Limited (2014) eKLR.*** The Respondent submitted that the case relied upon by the Appellant is not attached and its unreported. Hence, the Respondent requested that the same ought not to be relied upon by the Tribunal.

17. Counsel for the Respondent, Ms. Raphaela Muruka, averred that the Respondent does not disagree that there was purchase. The Appellant had actually bought the building and the machinery at the same time. What is in contention is the question of installation. At the time of buying the goods, the machinery was already installed in the building. Therefore, there was no installation that took place. In the Memorandum of Appeal, the Appellant actually agrees that indeed for investment deduction to accrue, installation must take place.

18. On the requirement of use for manufacture, the Respondent while on Section 56(1) of the Tax Procedures Act, submitted that the burden of proof is on the Appellant. That during the audit it was established that the machines that were bought were not working and the moulds were dumped behind the building. Therefore, it cannot be proved that there was any manufacturing going on. Further, the production records from the Appellant were not specific to the machines. The Appellant's claim that there was manufacturing going on and that it matters not if it is the machines that are actually working or other machines cannot be sustained.

19. Mr. Nyaga on record for the Respondent submitted that investment deduction as per the provisions of paragraph 30 of the Second Schedule is a benefit given to the property and not the person. Therefore, once the machine has enjoyed investment deduction previously, the same cannot be claimed again as it would amount to double claim for allowance.

20. Counsel further submitted that going by the Appellant's Memorandum and the tests laid down for investment deduction to accrue, the Appellant failed to demonstrated any installation of the said machinery taking place. Given that the test laid down is a cumulative test, the Appellant must prove installation taking place.

ISSUES FOR DETERMINATION

21. Having carefully considered the Grounds of Appeal, the submissions of the parties, the authorities cited in support thereof, it is clear to the Tribunal that only one issue falls for determination. We hereby restate this single issue as being:

a. *Whether the Appellant is entitled to investment deduction for the machinery and moulds?*

ANALYSIS

22. The crux of this Appeal turns on the interpretation assigned to paragraph 24(1)(d) of the Second Schedule to the Income tax Act, Cap 470 of the Laws of Kenya. According to the Appellant, for a party to claim investment deduction for machinery, it must meet the threshold stipulated in paragraph 24(1)(d) of the Second Schedule to the Income Tax Act. The paragraph stipulates that for investment deduction in respect of machinery to accrue, one must demonstrate that the machine in question had been purchased, installed and used for the purpose of manufacture.

23. The Respondent on other hand, while agreeing with the Appellant on the test for investment deduction argued that pursuant to paragraph 24(a) & (b) of the Second Schedule to the Income Tax Act, in order for investment deduction to accrue, the machinery in question must be new. The Appellant was the second owner of the machine having purchased it from Jaydees Knitting Factory Limited as a going concern. Therefore, the Appellant's claim fails not only on the 'new' machinery front but also on account of the machine being already installed by the first hand purchaser.

24. If We may, let us now turn to what we consider the key issue under contestation. It is simply this: whether the Appellant is entitled to investment deduction for machinery and moulds. Paragraph 24(1) states;

(1) *Subject to this Schedule, where capital expenditure is incurred—*

24(1)(d). on or after the 1st January, 1992 on the purchase and installation or otherwise setting up the machinery for use as may be appropriate for the type of machine, of machinery to be used for the purpose of manufacture; or

there shall be deducted, in computing the gains or profits of the person incurring that expenditure for the year of income in which they were first used (thereinafter referred to as "the year of first use"), either both the building and machinery referred to in subparagraph (a) or both the machinery and, for the purpose of manufacture, the part of the building in which that machinery has been installed referred to in subparagraph (b) or the building referred to in subparagraph (c), provided that, prior to its first being used for manufacture after its completion, it has been used for no other purpose, or the machinery referred to in subparagraph (d) or (dd), or the building referred to in subparagraph (e) or the building or machinery referred to in subparagraph (f), or machinery referred to in paragraph (g), as the case may be, a deduction referred to as an investment deduction;

25. We have considered all the positions presented by the contending parties and are persuaded to agree with the submissions proffered by the Appellant's Counsel. Paragraph 24(1)(d) of the Second Schedule is very clear on the threshold required for investment deduction to accrue in a claim for investment allowance. The standard established therein is that a claimant must demonstrate purchase and installation or otherwise setting up of the machinery for use as may be appropriate for the type of machine, of machinery to be used for the purpose of manufacture.

26. From the evidence before us, we are satisfied that the Appellant herein has met the above threshold. The Appellant indeed purchased the machinery in question from Jaydees Knitting Factory Limited. Additionally, the machinery was used for the purpose of manufacture as evidenced by the Appellant's production and sales records. Thus, the Appellant has equally satisfied the burden placed on it by virtue of Section 56(1) of the Tax Procedures Act, 2015 in order for investment deduction claim to accrue. To require the Appellant, as the Respondent did in its Statement of Facts at paragraph 5 on page 5, to provide the serial number of the machinery is to place undue and strenuous burden on the Appellant.

27. The Respondent, to negate the Appellant's claim placed the weight of it's oral submissions and it's Objection Decision dated 21st August 2017 on paragraph 24(1)(b) of the Second Schedule to the Income Tax Act. That

the Appellant is not entitled to investment deduction on account of the machinery herein not being "new" and the Appellant being the second hand owner or purchaser. Further, that if anyone was entitled to the allowance, it was the first hand owner in the first year of use and that they had not demonstrated that indeed the first hand owner did not claim the investment deduction.

28. In our view, we will be remiss if we did not point out that the Commissioner, firstly, relied on the wrong section of the law and has consistently placed undue burden on this taxpayer. Principally, the kernel of this appeal is pegged on paragraph 24(1)(d) of the Second Schedule. We note nowhere does this provision make a distinction between a first hand and second hand owner for purposes of claiming investment deduction. Even if we were to momentarily disregard the passionately guarded principle against implications in matters tax, we simply do not see the essence or feasibility of making such a distinction. Simply put, we find the argument in opposition of the Appellant's claim as spurious and a red herring. It is not helpful to the resolution of the real dispute herein.

29. Moreover, the Respondent has required the Appellant to demonstrate that the first hand owner of the machinery did not in fact claim the investment allowance. How the Respondent expected the Appellant to demonstrate this requirement or even have access to or be privy to such information is beyond us. This, we must say has no basis in law and places unnecessary burden on the taxpayer.

30. That aside, the Appellant further claimed that the moulds form part and parcel of the machinery. Thus, they equally qualify for investment allowance. In support of this claim, the Appellant placed reliance on the case of ***Commissioner of Domestic Taxes vs Haco Industries Limited*** as determined by the then Local Committee.

DETERMINATION

31. From the foregoing analysis and in the circumstances herein, the Tribunal makes the following orders;

    a. The Appeal herein is merited.

    b. The Respondent's demand for Corporation Tax, interest and penalties totaling Kes.74,460,740 is hereby dismissed.

    c. Each party shall bear its Costs.

DATED and **DELIVERED** at **NAIROBI** this **27th** day of **March 2020.**

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MOSES B. OBONYO
CHAIRMAN

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TIMOTHY K. CHESIRE
MEMBER

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PATRICIA MAGIRI-ANAMPIU
MEMBER