

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
MISC. APP. NO. 50 OF 2021

**HUBEI HONGYUAN POWER ENGINEERING
COMPANY KENYA BRANCH.....APPLICANT**

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

RULING

1. The Applicant vide a Notice of Motion dated the 4th day of June 2021 filed under certificate of urgency on the same date and supported by an Affidavit sworn by Jin Xi, the Deputy General Manager of the Applicant, on the even date sought for the following Orders:
 - i. Spent
 - ii. That pending the hearing and determination of this Application, this Honourable Tribunal be pleased to issue an interim order of stay of execution, implementation and enforcement of the agency notice dated 26th May 2021 issued to Equity Bank Ltd and/or any other bank requiring them to pay the Respondent the sum of Kshs.108,716,064.00.
 - iii. That pending the hearing and determination of the Appeal, this Honourable Tribunal be pleased to issue an order of stay of execution, implementation and enforcement of the agency notice dated 26th May 2021 issued to Equity Bank Limited and/or any other bank requiring them to pay the Respondent the sum of Kshs.108,716,064.00.

- iv. That this Honourable Tribunal be pleased to grant any such other or further orders as it may deem just and expedient.
- v. That the costs of this Application be borne by the Respondent.

2. The application is premised on, *inter alia*, the hereunder grounds:

- i. That on or about the 9th November 2017, the Applicant and Kenya Power and Lighting Company entered into an agreement pursuant to which the Applicant's parent company based in China and known as **HUBEI HONYUAN POWER ENGINEERING CO. LTD** would supply Kenya Power and Lighting Company Ltd with fittings for low voltage power transmission lines.
- ii. That the said contract was thereafter assigned to the Applicant pursuant to a Deed of Assignment between the Applicant and its parent company, **HUBEI HONYUAN POWER ENGINEERING CO. LTD** pursuant to which the Applicant would execute engineering services of the contract in Kenya while the parent company would supply the equipment directly to Kenya Power & Lightning Company Ltd.
- iii. That under the said contract, the obligation to pay taxes on the Plant and Equipment imported such as Value Added Tax fell squarely on Kenya Power & lighting Company Ltd.
- iv. That sometimes in May 2021, the Respondent advised the Applicant that it had carried out investigations and come up with findings.
- v. That on 5th May, 2021, the Respondent issued a letter dated 5th May 2021 demanding payment from the Applicant of Kshs.105,651,921.00, being the purported Withholding tax and Value Added Tax payable by the Applicant for fittings imported

by Kenya Power and Lighting Company Ltd from the Applicant's parent Company in China, **HUBEI HONYUAN POWER ENGINEERING CO. LTD.**

- vi. That in its response dated 31st May 2021, the Applicant disputed liability to pay the Value Added Tax and Withholding tax demanded as the obligation to pay the same under the contract fell squarely on Kenya Power & Lighting Company Ltd. The Applicant further challenged the procedure adopted by the Respondent in seeking the said payment since no assessment had been raised.
- vii. That instead of setting in place mechanisms to ascertain whether the amount demanded was in fact due and without any valid or proper basis, on the same 26th May 2021, the Respondent issued agency notices to the Applicant's bankers, Equity Bank Limited requiring them to pay the Respondent a sum of Kshs.108,716,064.00 allegedly owed by the Applicant.
- viii. That the agency notice was therefore issued on the erroneous and incorrect assumption that the Appellant owes the tax demanded and before the 30-day period for lodging an objection had lapsed.
- ix. That since the sum demanded has not been ascertained as being due, the Respondent had no power to issue the agency notices under Section 42 of the Tax Procedures Act and the impugned notices are, in the circumstances, *ultra vires*.
- x. That the Respondent acted *contra statute* in seeking to collect disputed taxes before the processes of ascertaining whether the tax demand is due has been finalized.

- xi. That the agency notices were issued prematurely and un-procedurally before according the Appellant an opportunity to challenge the tax demanded by filing an appeal before the Tax Appeals Tribunal. The agency notices are in the circumstances, illegal and unlawful.
- xii. That the Respondent's decision to demand contradictory sums of Kshs.105,651,921.00 vide its demand to the Applicant dated 5th May, 2021, Kshs.108,716,064.00 vide its agency notice dated 26th May, 2021 and Kshs.86,334,033.00 vide its letter dated 31st May, 2021 to Equity Bank Ltd is unreasonable, irritational and violates the principles of fair administrative action.
- xiii. That the Respondent's action amounts to abuse of power and authority.
- xiv. That by reason of the impugned agency notices, the Applicant now faces the imminent risk of ceasing to operate on the basis of illegal agency notices which will occasion it irreparable loss which cannot be remedied by an award of damages. If the said situation persists, the outcome of the Application and Appeal filed herewith would have been rendered nugatory.
- xv. That no prejudice will be occasioned to the Respondent if the orders sought herein are granted as it will still be at liberty to pursue payment of the sums demanded in compliance with the Tax Procedures Act should the Applicant not succeed in the Appeal.
- xvi. That this Tribunal has the power, and in the circumstances of this case, the obligation to stay the impugned agency notices so as to preserve the subject matter of the Appeal and ensure the

effectiveness of the proceedings so that the Appeal is not rendered nugatory.

xvii. That this Honourable Tribunal has jurisdiction under Section 18 of the Tax Appeals Tribunal Act to hear and determine this Application.

3. The Respondent opposed the application through a Replying Affidavit sworn by Stephen Sila, an officer of the Respondent, on the 24th day of June 2021 and filed on the same date. The grounds of opposition as highlighted in the Affidavit are, *inter alia*, as follows:

- i. That the Respondent carried out an audit on the Applicant's tax affairs and came out with findings.
- ii. That the Applicant's parent company entered into a Deed of Assignment of the contract where it assigned the contract to the Applicant.
- iii. That upon perusal of the Deed of Assignment, we noted that the said Deed has not explicitly mentioned that the engineering services of the contract are to be executed by the branch (the Applicant) while the parent company would supply the equipment directly to Kenya Power & Lighting Company.
- iv. That further upon perusal of the Deed Agreement, it is clear that both the parent company and the Applicant are collectively referred to as 'parties' or 'party'. Essentially, the Applicant is in another location of the parent company that operates entirely in Kenya.
- v. That pursuant to the Deed of Assignment, the parent company assigned rights and obligations of raising invoices under the contract

agreement to the Applicant. The Applicant was to adhere to the local tax laws and was in essence fully empowered to execute the contract, invoice and receive payments of the contract price.

- vi. That Kenya Power & Lighting Company in compliance with its contractual obligations in the above-mentioned contract paid the Applicant the contractual fees and withheld 3% withholding tax on account of the Applicant.
- vii. That from the Applicant's filed VAT returns for February 2019, it is clear that the Applicant was paid for contractual services.
- viii. That during the audit, the Respondent noted that despite receipt of the said contractual fee from the KPLC, the Applicant failed to deduct and remit all the requisite taxes under the Income Tax Act and VAT Act.
- ix. That pursuant to Section 5(3) of the Value Added Tax Act, tax on a taxable supply shall be the liability of the registered person making the supply and, subject to the provisions of this Act relating to accounting and payment and shall become due at the time of the supply.
- x. That under Section 5(4) of the Tax Procedures Act provides the amount of tax payable on a taxable supply, if any, shall be recoverable by the registered person from the receiver of the supply, in addition to the consideration.
- xi. That the Applicant was therefore obligated as the supplier of a taxable supply to remit all the requisite taxes under the law.
- xii. That the Respondent raised and issued a demand on 5th May 2021 demanding a total of Kshs.105,651,921.00 (VAT – 104305016.00 and Withholding Tax – 1,346,905.00). The VAT was on

contractual services made by the Applicant to KPLC and declared as exempt instead of vatable.

- xiii. That the Respondent's basis in raising the taxes are conferred in the Kenyan tax laws, for the Withholding tax governed by Section 35 of the Income Tax Act; while the VAT is charged based on VAT Act 2013.
- xiv. That even though the contract between the Applicant's parent company and KPLC states that the contract price is exclusive of taxes, this term in a contract cannot override the express tax obligations under statute.
- xv. That the Applicant's contract agreement is and was NOT exempted under the VAT Act 2013 and the whole sum is vatable.
- xvi. That the Contract Agreement under Clause 14 indicated that taxes were to be paid where applicable in line with Kenyan tax laws in the following words:

"14.1 Except as otherwise specifically provided in the Contract, the Contractor shall bear and pay all taxes, duties, levies and charges assessed on the Contractor, its Subcontractors or their employees by all municipal, state or national government authorities in connection with the facilities in and outside of the country where the site is located.

14.2 Notwithstanding GC sub-clause 14.1 above, the employer shall bear and promptly pay (a) all customs and import duties for the plant specified in Price Schedule No. 1; and (b) other domestic taxes such as, sales tax and value added tax (VAT) on the plant specified in Price Schedules No. 1 and No. 2 and that is to be incorporated into the facilities,

and on the finished goods, imposed by the law of the country where the site is located.”

- xvii. That the amount assessed and demanded was determined after due process was undertaken which included the notice of intention to verify tax returns; interview with the Applicant’s representative and their Auditors; examination of the Contract Agreement, invoices raised and bank details among a few other documents; holding discussions with the Auditors; agreeing on payment on account and in fact the Auditors requested for the assessment to be raised so that the Applicant could make payment plans.
- xviii. That the issuance of the agency notices on the 26th May, 2021 was in accordance with Section 42 of the Tax Procedures Act which gives power to the Respondent to collect taxes from persons owing money to a taxpayer.
- xix. That the Respondent’s decision to issue agency notices on the Applicant’s accounts was absolutely necessary to protect revenue.
- xx. That the Appellant had positively acknowledged the outstanding tax liability and averred that the tax was actually payable but only if the KPLC agreed to refund the tax amounts.
- xxi. That the Respondent’s various efforts to reach the Applicant’s contact person who had been authorized to act on behalf of the Applicant by power of attorney to obtain a payment plan for the outstanding acknowledged taxes were fruitless.
- xxii. That the Respondent noted that the contract between the Appellant and the KPLC, signed on 9th November 2017 would exist for a period of 2 years, which should have ended in 2019.

- xxiii. That the Respondent was prompted to issue agency notices to the Applicant because the Applicant is a branch of a foreign company and save for this contract, there is no further information availed to the Respondent on the Applicant's activities in the country.
- xxiv. That the Applicant is acting in bad faith as it very well knows that if the orders, it is seeking are granted the said Bank Account will be depleted and the Respondent's action to secure revenue will be in vain.
4. In compliance with the directions of the Tribunal to the effect that the Application was to be canvassed by way of written submissions, the Applicant filed its written submissions dated 28th September 2021 on the 30th September, 2021. The Tribunal has duly considered the written submissions in arriving at its determination in this Ruling.

Analysis and Findings

5. The Tribunal notes from the outset that the agency notice was issued in quick succession following the issuance of a tax assessment to the Applicant and prior to the lapse of the statutory period permissible for the Applicant to lodge a notice of objection to the tax assessment.
6. The Respondent in its letter dated 5th May 2021 communicated to the Applicant its findings and demand for VAT and Withholding Tax in the aggregate sum of Kshs.105,651,921.00 inclusive of penalty and interest. The letter stated in part as follows:

“If you wish to object to any of the assessments above, you may do so in writing within a period of thirty days from the date of service of the assessment stating precisely the grounds of objection as per Section 51 of Tax Procedure Act.”

7. The Respondent issued the agency notice on the 26th of May 2021 which was prior to the lapse of the thirty (30) days period it had indicated the Applicant had to lodge any notice of objection against the tax assessments. The Respondent intimates that the issuance of the agency notice prior to the conclusion of the period for the objection proceedings was informed by the fear that the Applicant was likely to cause the entire funds in its bank accounts withdrawn thereby frustrating the Respondent's enforcement of the collection of any taxes ultimately found to be due and payable by the Applicant.
8. The Respondent in exercise of its powers to enforce payment of taxes under Section 42 of the Tax Procedures Act was insistent on the fact that the Applicant being a company with disclosed foreign directors and having accrued taxable income from a contract whose term had lapsed was a flight risk. The Tribunal notes that there was no attempt on the part of the Applicant to controvert the extensive facts deponed in the Replying Affidavit as to the possibility of the collection of any taxes ultimately determined as payable being frustrated in the event the agency notice is lifted.
9. The Tribunal notes that the Respondent is enjoined under Section 42 of Tax Procedures Act to take pre-emptory actions calculated at safeguarding any taxes likely to fall due from a taxpayer who may ultimately be prevented by any cause from effecting payment of the taxes falling due. The Section provides as follows:-

“(1) This Section applies when a taxpayer is, or will become liable to pay a tax and –

(a) the tax is unpaid tax; or

(b) the Commissioner has reasonable grounds to believe that the taxpayer will not pay the tax by the due date for the payment of the tax.

(2) The Commissioner may in respect of the taxpayer and by notice in writing, require a person (referred to as the “payer”)-

- a) *who owes or may subsequently owe money to the taxpayer;*
- b) *who holds or may subsequently hold money for or on account of the taxpayer;*
- c) *...*
- d) *Who has authority from some other person to pay the money to the taxpayer, to pay the amount specified in the notice to the Commissioner, being an amount that shall not exceed the amount of the unpaid tax or the amount of tax that the Commissioner believes will not be paid by the taxpayer by the due date.”*

(Emphasis added)

10. The Tribunal is persuaded that the Respondent exercised its powers appropriately in the issuance of the agency notice under the manifestly disclosed facts and with the undisputedly calculated intention to safeguard the taxes believed to be ultimately recoverable from the Applicant by the Respondent.
11. It remains unclear whether there was an objection decision subsequently issued by the Respondent in respect of the Applicant’s notice of objection dated 31st May 2021 and what action may have been taken by the Applicant to vindicate its right of Appeal as against any adverse objection decision.

Disposition


12. In the light of the foregoing circumstances, the Orders that commend themselves to the Tribunal are as follows:

- a) That the Applicant to provide such security as may be acceptable to the Commissioner or as may be determined by the Tribunal with regard to the payment of any taxes that may be ultimately determined to be due and payable on the part of the Applicant, in the sum of Kshs. 86,334,031.00 being the principal taxes, pending further orders of the Tribunal.
- b) That the Agency notice to be lifted at the instance of the confirmation of the receipt of the security in (a) above on the part of the Respondent.
- c) That the matter to be mentioned after thirty (30) days of the date of delivery of this Ruling for the parties to provide a report on the status of the objection decision and/or of any pending appeal proceedings for the purposes of the further appropriate orders in respect of order (a) above.
- d) No orders as to costs.

DATED and DELIVERED at NAIROBI on this 25th day of March, 2022.




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ERIC N. WAFULA
CHAIRMAN



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CATHERINE N. MUTAVA
MEMBER



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GABRIEL M. KITENGA
MEMBER



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ABRAHAM K. KIPROTICH
MEMBER



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ELISHAH NJERU
MEMBER

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