

**REPUBLIC OF KENYA**  
**IN THE TAX APPEALS TRIBUNAL**  
**APPEAL NO. 1221 OF 2022**

GLOBAL TEA & COMMODITIES (KENYA) LTD.....APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES..... RESPONDENT

**JUDGMENT**

**BACKGROUND**

1. The Appellant is a registered company and a wholly-owned subsidiary of Global Tea & Commodities Ltd UK. Its other related parties are Gold Crown Foods (EPZ) Ltd, Gold Crown Beverages (Kenya) Ltd and Global Tea and Commodities Malawi. Its principal activities are trade in tea in its account and purchase and export of tea on behalf of its parent company.
2. The Respondent is a principal officer appointed under Section 13 of the Kenya Revenue Authority Act, CAP 469 the laws of Kenya. Under Section 5 (1) of the Act, the Kenya Authority is an agency of the Government for the collection and receipt of all tax revenue. Further under Section 5 (2) of the Act with respect to performance of its functions under subsection (1), it is mandated to administer and enforce all provisions of the written laws as set out in Parts 1 & II of the First Schedule to the Act for the purposes of assessing, collections and accounting for all revenues in accordance with those laws.
3. The Appellant buys and ships tea, buys and blends the tea based on its customers' orders. It sells tea to its related parties and other non-related entities.

4. The Respondent conducted a tax audit on the operations of the Appellant in respect of issues arising from the commercial transactions between the Appellant and its non-resident related parties.
5. Vide a letter dated 8<sup>th</sup> June, 2022, the Respondent issued an assessment for the period 2015- 2018 years of income and demanded tax of Kshs 1,410,128,134.00 being Corporation tax inclusive of principal tax, penalty and interest.
6. The Appellant filed its notice of objection vide a letter dated 8<sup>th</sup> July, 2022 which the Respondent reviewed and issued its objection decision through its letter dated 6<sup>th</sup> September, 2022 confirming tax of Kshs 1,410,128,134.00.
7. Being aggrieved by the Respondent's decision, the Appellant filed its Notice of Appeal dated 5<sup>th</sup> October, 2022 on 19<sup>th</sup> October 2022.

## THE APPEAL

8. The Appeal is premised on the following grounds as enumerated in the Appellant's Memorandum of Appeal dated 18<sup>th</sup> October, 2022 and filed on 19<sup>th</sup> October, 2022:
  - (a) That the Respondent has wrongfully alleged that the Appellant's business was designed to avoid liability to pay tax in Kenya as evidenced by losses arising in the period under audit of 2015 – 2018.
  - (b) That the Respondent has erred in fact and law in concluding that the buyers auction licence held by the Appellant is a valuable intangible asset to the Appellant.
  - (c) That the Respondent has erred in fact and law in alleging that the Appellant and Tapal Tea PVT are related parties and therefore wrongfully rejecting the transaction as an independent comparable for the Appellant's related party transactions.

- (d) That the Respondent erred in law and fact in concluding that the Transactional Net Profit Margin Method (hereinafter 'TNMM') is the most appropriate method and not the Cost-Plus Method (hereinafter 'CPM') as selected by the Appellant.
- (e) That the Respondent's assessments are based on a fundamentally flawed TNMM functional analysis and benchmarking study undertaken in breach of the OECD Transfer Pricing Guidelines (hereinafter 'OECD TPG') and ITA.
- (f) That without prejudice to the above, the Respondent erred in fact and law in its benchmarking study.
- (g) That without prejudice to the foregoing, the Respondent's application of the TNMM is defective because it does not segment the financial results of the trading business from the agency business.

## **THE APPELLANT'S CASE**

9. The Appellant argued its case through its Statement of Facts dated 18<sup>th</sup> October, 2022 and filed on 19<sup>th</sup> October, 2022. It stated that it is a licenced tea buyer and a buyer member of the East Africa Tea Trade Association Auction (hereinafter 'EATTA') and that it participates in the Mombasa tea auction where it purchases tea on behalf of its Kenyan registered related parties as well as other foreign related parties and third parties. It stated further that it only buys tea after receiving an order from specific customers and based on the details specified as to quantity and quality of the tea required.
10. It contended that the remuneration earned by the Appellant, otherwise referred to as commission is in line with the industry standards. The industry practice is for buyers like the Appellant to quote for its services in terms of the margin/commission per kilogram, such margin/commission being charged over and above the actual cost of the tea.

11. The Appellant averred that contrary to the Respondent's claim that it had tested the commissions earned by the Appellant to determine whether the sale was at arm's length, it stated that at no time did the Respondent provide the Appellant with any proof that it tested the sufficiency of the commissions or margins earned by the Appellant. Further that the Respondent never provided the Appellant with reasons as why the commissions or margins charged to its related parties were not arm's length.
12. The Appellant refuted the Respondent's claim that it is in perpetual losses and incurring high interest charges by asserting that it is not a perennial loss maker as is borne out by the history of financial performance of the company since 2015. It asserted further that losses arising in the years under review in the Respondent's audit were commercially justifiable and arose due to materialisation of risks that the Appellant's business is lawfully exposed.
13. The Appellant asserted that it has demonstrated that its business earns considerable gross margins from the tea trade it undertakes both in form of direct sales and agency purchases and that the EBIT, loss reported between 2015- 2018 was justifiable based on business and commercial factors. It therefore contended that the Respondent failed to demonstrate that the Appellant has made deliberate effort to commit tax fraud and consequentially the Respondent erred and was wrongful in alleging that the Appellant's business was designed to avoid liability to pay tax in Kenya as evidenced by losses arising in the period under audit of 2015- 2018.
14. The Appellant contended that an EATTA licence cannot constitute an intangible asset, neither would it constitute property to the business. It argued therefore that the Respondent's decision to constitute the Mombasa auction buyer license as a valuable intangible asset not readily available to everyone is not borne out by the facts and circumstances and does not grant the Appellant any unique status or economic advantage. Further that the Agriculture and Food Authority (hereinafter

'AFA') Tea Directorate and EATTA have continued to licence and register new buyers who meet the well laid out criteria.

15. The Appellant averred that a tea auction licence cannot be transferred for value to a third party and that any person willing to become a member in order to participate in the auction as a buyer would have to be registered with the Board. It averred further that this license can be granted and withdrawn at any point by EATTA as is the case with other regulated industries.
16. The Appellant stated that when it was initially formed, it purchased all tea on behalf of the parent company GTCL for a fee/commission. However, over time it has developed sufficient means to source its own directly with customers and not rely on financing from its parent company, thus enjoying increased margins for the increased functions performed.
17. The Appellant faulted the Respondent for asserting that the Appellant and Tapal Tea PVT were related parties and therefore the use of the Appellant's transactions with Tapal Tea PVT cannot be construed as an independent comparable for its related party transactions. It asserted that the determination of related parties is stipulated in Section 18(6) of the Income Tax Act Chapter 470 of Kenya's laws (hereinafter 'ITA') and OECD TPG. It asserted that Tapal Tea PVT does not dictate availability of funds by the Appellant or GTC-UK and only aligns its orders for desired quantities with available financial capacity of both the Appellant and GTC-UK. Further proof is the samples of Tapal Tea PVT orders it provided dated November 2016 which orders do not in any way demonstrate that Tapal Tea PVT dictated how the purchasing will be split between the Appellant and GTC-UK.
18. In arguing that CPM is applicable to its case as opposed to the TNNM, the Appellant placed reliance on the High Court judgement in **Income Tax Appeal No.753 of 2003 Unilever Kenya Limited versus Commissioner of Tax (2005) eKLR** where it was held that in the absence of specific guidelines from the Respondent

under Section 18(3) of the ITA, determination of the arm's length principle ought to be made in accordance with international best practice as represented by the OECD TPG. In this regard, it prepared its Transfer Pricing Policy (hereinafter 'TPP') in line with the general guidance on comparability provided in the OECD TPG to determine the arm's length compensation.

19. The Appellant asserted that it followed the nine-step approach provided in the OECD TPG in preparing its TPP and arriving at the arm's length it earned from its transactions with related parties. It therefore argued that based on the functions, assets and risks analysis carried out in the TPP, the most appropriate method was the CPM.
20. The Appellant stated that the Respondent failed to understand the application of the CPM in that the margins per kg paid to tea buyers are highly competitive and are agreed to as a matter of negotiation between the buyer and their customers. Further that application of the CPM in the TPP illustrating the profit earned on a per kg basis from the margins is agreed to with various customers who may be related or unrelated. It asserted that the mapping of the profitability analysis was provided in the course of the audit therefore contended that CPM was the most appropriate method and that the Respondent therefore erred in law and fact in concluding that the TNMM was the most appropriate method and not the CPM as it selected.
21. The Appellant contended that the Respondent misclassified it as a wholesaler of tea whereas its functions properly disclose a different profit of contract buyer/procurement agent. It averred therefore that it is not a trading wholesaler of tea but rather an agent who purchases tea in bulk on behalf of its customers and that it does not bear any price risk on purchased tea and earns a fixed commission. It argued that the Respondent's benchmark study and economic analysis are therefore

incurably defective for want of compliance with a number of norms within the OECD TPG and ITA.

22. The Appellant asserted that the Respondent failed to correctly delineate the main transactions involved in the Appellant's operations and make the distinction between direct sales to third parties which are financed by the Appellant, and agency teas, which are financed by GTCL, thus lumping up the two transactions as one. This is because the Functions Assets and Risk (FAR) analysis for these separate transactions differ materially. The Appellant therefore averred that the Respondent's assessment was based on a fundamentally flawed TNMM functional analysis and benchmarking study undertaken in breach of the OECD TPG and ITA.
23. The Appellant averred that the Respondent erred in its application of the median of 4.85% return on EBIT based on the TNMM benchmarking study to adjust the Appellant's income as it was without any legal or rational basis. The Appellant referred to both the Tanzania Income Tax (Transfer Pricing) Regulations, 2018 and the Nigerian Income Tax (Transfer Pricing) Regulations, 2018 which have explicitly prescribed the Arm's Length Pricing (ALP) when statistical approaches are used, leaving no room for misinterpretation. The Appellant asserted that according to the globally accepted OECD TPG, the Respondent ought to prescribe the mode of adjustments to get the taxpayer's results into an arm's length price, which it failed to do.
24. The Appellant stated that the Respondent failed to demonstrate how selected comparables closely align to the operations of the Appellant based on OECD comparability factors and any adjustments undertaken for any functional differences thereof. It further stated that the Respondent had specifically excluded loss-making companies from its benchmarking study, thereby deliberately ignoring the economic realities and undue burdens faced by the Appellant. This approach artificially sought to portray conditions that did not reflect actual market

conditions. It contended that the Respondent erred in fact and law in its benchmarking study.

25. It was the Appellant's averment that the Respondent erred in law by adding GTC-UK's trading results to the Appellant's revenue without a basis in law. It argued that TNMM cannot be applied without recourse to the segmentation of the entire income statement in instances where the taxpayer has distinct transactions. It therefore asserted that the Respondent erred in law and fact by disregarding GTC-UK's agency trading transactions and treating these transactions as part of the Appellant's direct trading revenue.

### **Appellant's Prayers**

26. The Appellant therefore prayed that:
  - (a) The objection decision of the Respondent contained in the letter dated 6<sup>th</sup> September 2022 demanding payment for Corporation tax amounting to Kshs 1,410,128,134.00 be set aside.
  - (b) The Appeal be allowed with costs to the Appellant; and
  - (c) Any other orders that the Honourable Tribunal may deem fit.
  - (d)

### **THE RESPONDENT'S CASE**

27. The Respondent addressed the Appellant's grounds of Appeal through its statement of facts dated 9<sup>th</sup> December 2022 and filed on even date.
28. It argued that the fact that the company has been making perpetual losses means that the internal resources are not sufficient to support the operations of the company, and because of this it means that the company ought to be financed and in effect pay high cost of financing. It further argued that the choice of transfer

pricing method based on the FAR analysis carried out was not the most appropriate, which is an indicator of a scheme as it alluded to.

29. On the issue of whether the buyer's auction license held by the Appellant was a valuable intangible asset to the company, the Respondent asserted that this license is indeed a key and unique intangible asset, contrary to the Appellant's claim that the EATTA license is readily available to everyone. It stated that the OECD report on Action 8 titled Guideline on Transfer Pricing Aspects of Intangibles relied by the Appellant is not a mandatory requirement and does not determine the qualification of an intangible.

30. On whether the Appellant and Tapal Tea PVT were related parties and whether the Transfer Pricing Regulations apply to the relationship, the Respondent relied on Section 18(6) of the ITA as read together with Income Tax (Transfer Pricing) Rules 2006 (hereinafter 'the Rules') which provides as follows: -

*“For the purposes of subsection (3) a person is related to another if –*

- (a) Either person participates directly or indirectly in the management, control or capital of the business of the other, or*
- (b) A third person participates directly or indirectly in the management, control or capital of the business or both.*
- (c) An individual, who participates in the management, control or capital of the business of one, is associated by marriage, consanguinity or affinity to an individual who participates in the management, control or capital of the business of the other.”*

31. The Respondent contended that the Appellant incorrectly interpreted subsection 3(a) “either person” to mean an enterprise and not that of an individual (natural person). It contended further that Maria Tapal qualifies as a person as per the definition of this Section owing to common directorship of Typhoo Ltd with Directors of the Appellant and GTC-UK.

32. It was the Respondent's averment that Tapal Tea PVT is the largest of the Appellant's customers for over 20 years and the two parties have interacted closely, which relationship ought to be well document and have a binding contract for entities operating on an arm's length basis. It averred further that significant control had been demonstrated and therefore it was correct to conclude that the transactions were not at arm's length.
33. The Respondent agreed with the Appellant that the rebates paid to Tapal Tea PVT were reasonable as the percentages used by the Appellant in comparing with other supermarkets like Majid Al-Futtaim, Naivas Supermarkets and Quick Mart Ltd and may not be used as a criteria to infer that the two entitles are related parties.
34. On the issue of why the Respondent adopted the TNMM as opposed to the CPM, the Respondent argued that it noted that the margin analysis for the years 2015-2018 relied on Tapal Tea PVT as a comparable, and being a related party, it cannot be the reference of uncontrolled transactions.
35. The Respondent argued that the figures the Appellant used to calculate the profitability analysis/Margin to try and support the existence of a Margin (per kg) were not consistent with figures in the financial statements therefore making it difficult to authenticate, and that the incorrect use of Tapal Tea PVT as an independent comparable means that the Respondent was correct in rejecting the CPM and applying the TNMM.
36. On whether the assessments were based on a proper functional analysis and benchmarking study, the Respondent stated that the major variation between the Appellant's functional analysis as per its objection dated 8<sup>th</sup> July 2022 and the Respondent's functional analysis was on the Auction License. It contended that the Appellant was generally agreeable with the analysis of functions performed, Assets employed and Risks assumed. It therefore argued that for the Appellant to purport that the Respondent's functional analysis is fundamentally flawed was untrue and

that the selection of TNMM with an EBIT as the profit level indication was therefore justifiable and that it did not in any way act contrary to Section 18(3) of the ITA or the OECD Transfer Pricing Guidelines.

37. The Respondent averred that it conducted a benchmarking analysis using the Royalty Range Transfer Pricing commercial data base to search for the comparable transactions and that it selected the median weighted average of 4.85% from the statistical inference. Further, that the OECD Guidelines allow the use of any point within the range of the uncontrolled comparable margins hence it did not contravene the law in using the median result. It argued that the character of GTCK is not dissimilar from the character of the comparable companies and therefore the purported differences would not materially affect the methodology adopted by the Respondent.
38. The Respondent stated that it arrived at the total operating costs as declared in the financial statements which was subjected to 4.85% to arrive at the adjusted net profit. It stated further that segmenting of the two businesses was not a mandatory requirement in most cases especially when the functions were similar. It therefore reiterated that it did not err in its computation of the EBIT at 4.85% benchmarking nor did it err in changing the transfer pricing method from CPM to TNMM based on the level of functions performed, assets used and risks assumed.

### **Respondent's Prayers**

39. The Respondent prayed that the Tribunal -
  - (a) Dismisses the Appeal with costs for lack of merit; and
  - (b) Upholds the Respondent's assessment dated 24<sup>th</sup> February, 2022.

### **PARTIES' SUBMISSIONS**

40. The Tribunal will not consider the Respondent's Written Submissions as the same were filed late and will therefore proceed to consider the Appellant's submissions dated 29<sup>th</sup> May, 2023, where it submitted on seven issues in line with its grounds of appeal as hereunder.
- (i) **Whether the Respondent has wrongfully alleged that the Appellant's business was designed to avoid liability to pay tax in Kenya as evidenced by losses arising in the period of 2015- 2018.**
41. In refuting the Respondent's claim that it tested the commissions earned by the Appellant to determine whether the sale was at arm's length, the Appellant submitted that the Respondent neither provided the Appellant with any proof that it tested the sufficiency of the commissions or margins earned by the Appellant nor provided reasons why the commissions or margins charged to its related parties were not at arm's length. It submitted further that it's not a perennial loss maker as alleged by the Respondent as its business earns considerable gross margins from the tea trades it undertakes both in form of direct sales and agency purchases.
42. It submitted that whereas the margins agreed with customers were consistent over a given period due to the highly competitive nature of the business, operating costs vary from time to time and may have a significant negative impact on profitability of the business. It submitted that the reason for the financial performance during the audit period were commercial in nature and included increase in warehouse rent, salaries and wages, general insurance, legal and professional fees, security/guarding, increases in bank charges and overdrafts fees, and increases in foreign exchange losses realized on the payment of funds borrowed. All these factors resulted in increased operating costs.
43. In refuting the Respondent's allegation that the Appellant may have committed tax fraud or tax cheating, the Appellant sought reliance in the High Court decision in

**Unilever vs Commissioner of Tax Income Tax Appeal No. 753 of 2003** in which the court stated as follows: -

*“Section 18(3) of the Act has used words” and the course of that business is such.... “The subsection implies that the business so arranged must be such as show less income to enable the tax authorities to challenge it. The KRA has submitted that this arrangement has been made deliberately to show lesser earnings. But is that reality so? There is no evidence of tax fraud or tax cheating. The only evidence material, is in regard to methods used for computation of tax. Use of different methods, so long as proper or lawful or rather not unlawful is permissible and ought to be permissible so long as there’s no fraudulent trading with a view to “evading” tax. This makes the language of section 18(3) of the Act somehow obscure and a taxpayer is entitled to demand that his liability to a higher charge should be made out with reasonable clarity, before he is adversely affected. This is the dictum of Viscount Simon in Scott V Russell(1948) 2 ALL E.R 1 , which dictum was applied with approval in the case of Kanjee Nazanje vs Income Tax Commissioner(1924) E.A257 at 262 H.”*

44. It therefore submitted that the Respondent failed to demonstrate that the Appellant had made deliberate effort to commit tax fraud.

**(ii) Whether the Respondent has erred in fact and law in concluding that the buyers auction license held by the Appellant is a valuable intangible asset to the Appellant**

45. On this issue, the Appellant submitted that the EATTA licence cannot constitute an intangible asset, neither would it constitute property to the business. It submitted further that AFA Tea Directorate and EATTA have continued to license and register new buyers who meet the well laid out criteria and that with 122 licensed EATTA buyers in the market, it cannot be argued that buying licences are difficult to obtain. It argued that the license does not confer any special advantage on a licenced buyer

hence the Appellant's buyer license is not exclusive or limited in any way that affords it market advantages. The Respondent's mere assertion that auction licence constitutes a valuable intangible without any specificity on value created does not comply with the requirements of the OECD TPG (2017).

**(iii) Whether the Respondent has erred in fact and law in alleging that the Appellant and Tapal are related parties and therefore wrongfully rejecting the transaction as an independent comparable for the Appellants related party transactions.**

46. The Appellant submitted that the OECD TPG provide that two enterprises are associated if one of the enterprises participates directly or indirectly in the management, control, or capital of the other. It therefore contended that Tapal Tea PVT does not participate directly or indirectly in the management, control, or capital of the Appellant nor does the parent company of the Appellant GTC-UK or the Appellant exercise any management, control or capital of Tapal Tea PVT as neither have any controlling interest in the other. It therefore submitted that the Respondent's wrongful decision in rejecting the use of Tapal Tea PVT as an independent comparative was done in bad faith and contrary to law and should not be allowed to stand.

**(iv) Whether the Respondent erred in law and fact in concluding that the TNMM is the most appropriate method and not the CPM as selected by the Appellant.**

47. The Appellant submitted that it has a mandatory obligation to apply the most appropriate method as stipulated in Rule 8 of the Rules which are in line with precepts of the best method rules and that the rule provides that the arm's length result of a controlled transaction must be determined using the method that under the facts and circumstances provide the most reliable measure of an arm's length result. It stated that the Rules as the governing law purely vests the discretion to choose and apply the most appropriate method on the tax payer and that the

Respondent has no legal power to change the Appellant's chosen method especially without proffering cogent and legitimate reasons for upsetting the Appellant's choice.

**(v) Whether the Respondent's assessment is based on a judgementally flawed TNMM functional analysis and benchmarking study undertaken in breach of the OECD TPG and ITA**

48. The Appellant submitted that the main distinction in functions between the two transactions is the financing of teas. In the case of agency teas, the Appellant buys teas using funds from its related party and earns a lower fixed commission reflective of the lower risk and costs incurred, while in direct purchases, the Appellant sources its own funds to pay for the teas and earns a higher margin of agreed price with its customers to reflect the additional risks assumed.
49. The Appellant submitted that the Respondent's FAR analysis did not in any way demonstrate that the Appellant undertakes any extraordinary functions, risks and assets not assumed by other licensed buyers in the market. It contended that the Respondent was therefore obligated to restrict its selection of comparables in the Mombasa Tea Auction undertaking comparable functions, assuming similar risks and employing similar assets. Further that the Respondent's choice of comparables from which it had adjusted profits of the Appellant were obtained from foreign countries where there was limited availability of the information about the reliability of the comparable for correct use of the TNMM.
50. The Appellant asserted that in the economic analysis, the Respondent had wrongfully sought to adjust the Appellant's income based on TNMM with expected EBIT as the profit level indicator for the total tea purchasing operation, including agency teas on the basis of a faulty functional analysis. The Appellant further asserted that it has no capacity to purchase the teas using GTC-UK's funding because

it had no such funding facility. As such it is not entitled to a uniform return from GTC-UK agency sales. It stated that if indeed the Appellant was in possession of a valuable intangible as was argued by the Respondent, then under the OECD Rules, the Respondent ought to have applied a profit split method or alternatively selected the related parties of the Appellant as the tested party.

51. In making its case on the inclusion or exclusion of loss making comparables, the Appellant relied on the case of **Commissioner of Income Tax Appeals CIT(A) Mumbai vs Morgan Stanley Solutions Advantage Services Pvt Ltd August 2021**. The Appellant submitted that the Respondent specifically excluded loss making companies in its benchmarking study thereby deliberately seeking to ignore the economic realities and undue burden faced by the Appellant as it artificially seeks to portray conditions which are not market conditions. It submitted that this is highly prejudicial to it as it is not due from its operations. It therefore contended that the Respondent's assessments are based on fundamentally flawed TNMM functional analysis undertaken in breach of the OECD TPG and ITA.

**(vi) Without prejudice to the above, whether the Respondent erred in fact and law in its economic analysis.**

52. The Appellant asserted that the globally accepted OECD position is that if the relevant conditions of the controlled transactions (e.g. price or margin) are within arm's length range, no adjustment should be made. Further that where the Respondent has not prescribed the mode of adjustments, and a taxpayer's results are within, then no adjustment is required to get the taxpayer's results into an arm's length price. It asserted that there is no legal basis for an adjustment to the median and the actions of the Respondent in adjusting the Appellant's transactions with reference to the median are unfair, unnecessary, unprocedural and capricious.

53. The Appellant asserted that the issue of the Arm's Length Price (ALP) is very contentious around the world and that the Respondent has had the opportunity to provide direction on this matter since 2006. It asserted however that the Respondent has not only failed to provide guidance as to how to compute the ALP when using a range of data, but has also failed to define what a non-compliant ALP is and to prescribe how adjustments are to be made when a taxpayer's results fail to meet the ALP.
54. The Appellant submitted that a matter as important as how to determine the ALP cannot be left to conjecture or the Respondent's discretion at the point of an audit, especially, since the Respondent has had ample opportunity to prescribe the ALP, whereas the Appellant had complied with the law and developed the ALP Policy and determined the ALP within the accepted arm's length. It stated further that statistically an interquartile range of observations cannot be computed with less than four data points. Further that the Respondent carried out an economic analysis with comparables that are functionally dissimilar to the Appellant's and therefore not comparable to the Appellant.
55. The Appellant contended that the Respondent misclassified the Appellant as a wholesaler of tea, whereas its functions properly disclose a different profile of contract buyer/procurement agent. As such it does not bear any price risk on purchased teas and earns a fixed commission based on prices of teas purchased in the auction. The Appellant therefore submitted that the Respondent erred in fact and law in its economic analysis.

**(vii) Without prejudice to the foregoing, the Respondents application of the TNMM is defective because it does not segment the financial results so as to distinguish the results of the trading business from the agency business.**

56. The Appellant submitted that the Respondent erred in law by adding GTC-UK's trading results to the Appellant's revenue without a basis in law. It argued that TNMM cannot be applied without recourse to the segmentation of the entire income statement in instances where the taxpayer has distinct transactions. It therefore submitted that the Respondent had erred in law and fact by disregarding GTC-UK's agency trading transactions and treating these transactions as part of the Appellant's direct trading revenue.

## **ISSUES FOR DETERMINATION**

57. Having carefully considered the parties pleadings and documentation availed, the Tribunal is of the considered view that this Appeal distils into three issues for determination.

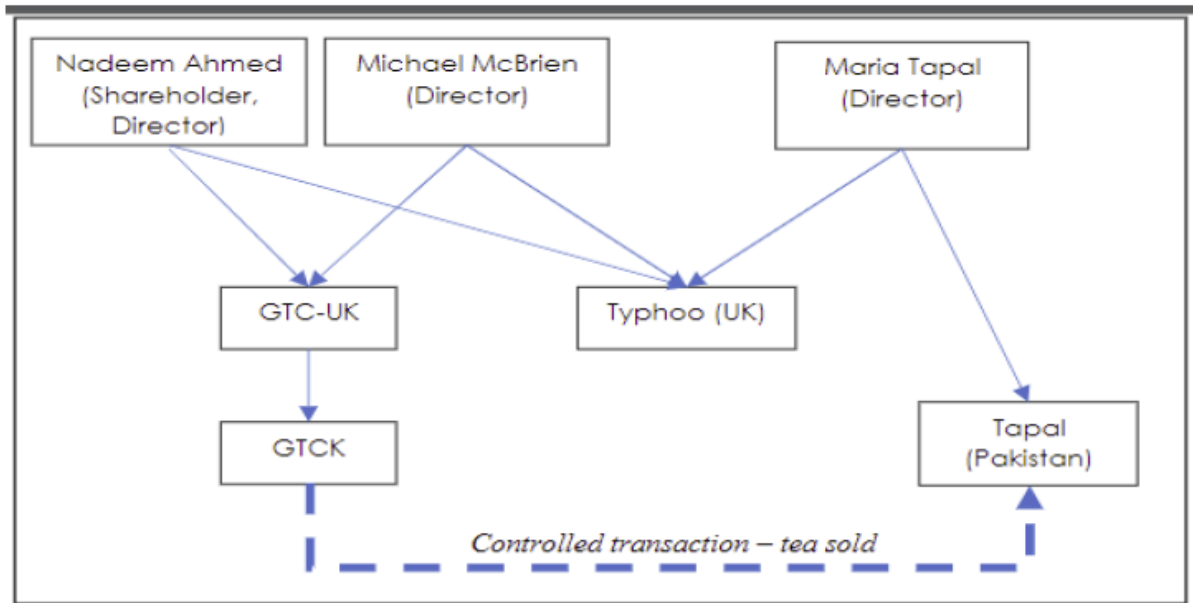
- a) **Whether the Appellant and Tapal Tea PVT Limited are related enterprises.**
- b) **Whether the transaction between the Appellant and Tapal Tea PVT Limited is a controlled transaction.**
- c) **Whether the Respondent was justified in using TNMM instead of CPM in determining the Arm's Length price of the Transactions between the Appellant and Tapal Tea PVT Limited.**

## **ANALYSIS AND FINDINGS**

58. Having identified the three issues that require its determination, the Tribunal will proceed to analyse them as herein under:

- (a) **Whether the Appellant and Tapal Tea PVT Limited are related enterprises.**

59. The Tribunal notes that this dispute arose when the Respondent carried out investigations on the Appellant culminating into an assessment letter dated 8<sup>th</sup> June, 2022. It is apparent from the Tribunal's review of the said letter, that the origin of this dispute was the Respondent's assertion that the level of operations and volume of trade of the Appellant mismatched its profit level. The Respondent outlined the losses made by the Appellant in respect of the 2015-2018 years of income, which were the subject of the assessments.
60. The Tribunal further notes that the Appellant indicated that it was related to Golden Crown Beverages (Kenya) Ltd, Gold Crown Foods (EPZ) Limited, Typhoo Tea limited and Global Tea and Commodities Limited (UK). However, the Appellant, claimed that it was not related to Tapal Tea PVT Limited which is a company that is based in Pakistan.
61. The Tribunal has reviewed the Appellant's organogram through which it outlined the global structure of the enterprises in the group. In the organogram the Appellant identified three persons, namely Mr. Nadeem Ahmed, Mr. Michael McBrien and Ms. Maria Tapal. Of the three persons, Mr. Nadeem Ahmed was identified as a shareholder and director of GTC (UK) whilst Mr. Michael McBrien was identified as a director in both GTC-UK and Typhoo Limited (also a UK Company) and Ms. Maria Tapal was identified as a Director in Tapal Tea PVT Limited and Typhoo limited.



62. The Tribunal further notes the fact that the level of shareholding of Mr. Nadeem Ahmed was not indicated in the diagram nor in the pleadings. However, the Tribunal takes particular note of the fact that Mr. Nadeem Ahmed is the only person identified in the organogram as both a shareholder and director within the Group structure. The other two individuals, namely Mr. Michael McBrien and Ms. Maria Tapal, are merely directors.

63. The provisions of Section 18 (6) of the ITA are as follows:

*“(6) For the purposes of subsection (3), a person is related to another if—  
either person participates directly or indirectly in the management,  
control or capital of the business of the other; [emphasis ours]  
a third person participates directly or indirectly in the management,  
control or capital of the business of both; or  
an individual, who participates in the management, control or capital*

*of the business of one, is associated by marriage, consanguinity or affinity to an individual who participates in the management, control or capital of the business of the other.....”*

64. The provisions of Paragraph 2 of the Rules are as follows:

*“related enterprises means one or more enterprises whereby-*

- (a) one of the enterprises participates directly or indirectly in the management, control or capital of the other; or*
- (b) a third person participates directly or indirectly in the management, control or capital of both.”*

65. Is whether there is direct or indirect participation in the management that would make the parties associated enterprises? It is not in dispute that there is no direct management. The question then is if there is any indirect participation in the management. A review of the structure of the parties involved indicates that there is some commonalities in the management of the companies with Maria ( a director of Tapal) sitting in the same management of Michael in Typhoo and Michael then sitting in the same management with Nadeem in the Appellant’s parent company. Does this amount to indirect management?

66. Paragraph 2 of the rules defines related parties to include a third party participating directly or indirectly in the management, control or capital of both. Indirect links including common interests can amount to indirect participation in the management of an entity. In this case the common interest between Maria and Michael in Typhoo creates an indirect management relationship in the management of the Appellant. One author stated:

*“When it comes to management questions arise concerning what sort of links that have to exist (for example family relationships, common interests or organisational relationships) as well as questions about what is meant by*

*management (the board or as well other levels of management). The relevance when dealing with participation related to management does not lie in how close the managers are linked. Instead, like with capital, the importance lies in the direct or indirect influence of the managing bodies of the enterprises concerned.”*

67. In view of the foregoing, the Tribunal notes that though Mr. Nadeem Ahmed was indicated as a shareholder, the Appellant did not clarify the percentage of shares he was holding in the various entities that were part of the entire group structure of the GTC group. However, the Tribunal is of the view that the mention of the fact that he is a shareholder is reflective of the control which he exercised directly or indirectly over the entities including in Tapal Tea PVT Limited.
68. The Tribunal is of the further view that combined with the issue of Mr. Nadeem Ahmed's shareholding there was an averment by the Respondent that Tapal Tea PVT Limited had been doing business with the Appellant for over twenty (20) years without having a defined contractual relationship. This averment was not disproved by the Appellant since it did not provide the requisite contract between it and Tapal Tea PVT Limited.
69. The Tribunal also notes the Respondent's averment concerning the level of sales between the Appellant and Tapal Tea PVT Limited which constituted over 70 % of its sales in the years under assessment. The averment regarding the level of sale was not sufficiently disproved by the Appellant. The Respondent's final averment that the indirect sales made by Tapal Tea PVT Limited through GTC (UK) from the Appellant were also not disproved and also constituted a high percentage which was not disclosed by either of the parties.
70. Accordingly, the Tribunal is of the view that Tapal Tea PVT Limited participates indirectly in the control and management of GTC(K) in a number of ways. First, Mr. Nadeem Ahmed is a sole shareholder and Director whilst Mr. Micheal McBrien

and Ms. Maria Tapal are directors in a common company, Typhoo limited, a company incorporated in the United Kingdom. Secondly, the volume of transactions between the Appellant and Tapal Tea PVT Limited is high, they have been in business for more than twenty (20) years and have no contractual relationship.

71. In view of the foregoing, the finding of the Tribunal is that the Appellant and Tapal Tea PVT Limited are related enterprises.

**(b) Whether the transaction between the Appellant and Tapal PVT Limited is a controlled transaction.**

72. The Tribunal has reviewed paragraph 2 of the Rules which provides as follows as to the meaning of controlled transactions:

*“controlled transaction” means a transaction which is monitored to ensure payment of an arm's length price for goods or services.”*

73. The Tribunal notes the provisions of Paragraph 6 of the Rules which outlines the transactions that would be subject to adjustment of prices as follows:

*“Transactions subject to Rules*

*The transactions subject to adjustment of prices under these Rules shall include-*

*(a) the sale or purchase of goods; [emphasis ours]*

*(b) the sale, purchase or lease of tangible assets;*

*(c) the transfer, purchase or use of intangible assets;*

*(d) the provision of services;*

*(e) the lending or borrowing of money; and*

*(f) any other transactions which may affect the profit or loss of the enterprise involved.”[emphasis ours]*

74. The relationship between the Appellant and Tapal PVT is a curious one with little to no paperwork being provided to show how it is governed. Further, rebates are paid to Tapal regardless of the losses made by the Appellant. Beyond the common directorship in the related parties, such a transaction would be difficult if not impossible to find in the open market.
75. In view of the Tribunal's finding that the Appellant and Tapal Tea PVT Limited are related, it is notable that the transaction between them that would be controlled is the sale of tea by the Appellant to Tapal Tea PVT Limited. The sale of tea by the Appellant to Tapal Tea PVT Limited is one that is subject to adjustment of prices and ought to be monitored to ensure that the same is sold at an arm's length price.
76. The Tribunal therefore finds that the transaction between the Appellant and Tapal Tea PVT Limited is a controlled transaction.
- (c) **Whether the Respondent was justified in using the Transactional Net Margin Method (TNMM) instead of Cost-Plus Method (CPM) in determining the Arm's Length Price of the transactions between the Appellant and Tapal Tea PVT.**
77. The Rules allow the Appellant to choose a method that it could apply in determining the arm's length price of the transaction between it and its related parties. Paragraph 8 of the Rules provides as follows:

***"Application of methods***

*(1) The methods set out in rule 7 shall be applied in determining the price payable for goods and services in transactions between related enterprises for the purposes of section 18(3) of the Act.*

*(2) A person shall apply [emphasis ours] the method most appropriate for his enterprise, having regard to the nature of the transaction, or class of transaction, or class of related persons or function performed by such persons in relation to the transaction."*

78. Paragraph 8 of the Rules require the Appellant in this case to justify the use of the method and why it is the most appropriate to its enterprise. This should be outlined in the TPP. The Appellant provided its TPP which documented its Function Assets and Risk (FAR) analysis.
79. The Tribunal has reviewed the TPP of the Appellant and found that the Appellant did not sufficiently justify the reason why it did not use the other methods to determine the arm's length price. The Appellant merely stated that CPM was a more direct method. This may have been so were it not for the fact that the direct sale of tea by it to Tapal Tea PVT Limited is a controlled transaction and further, the fact that Tapal Tea PVT Limited makes indirect purchases through GTC UK was also notably another controlled transaction. The lack of an uncontrolled comparable means that the use of CPM was not appropriate in this instance. The Tribunal also finds that it was not adequate for the Appellant to reject the TNMM and Profit Split methods by merely stating that CPM is a more direct method. In addition, the use of the transactions between it and Tapal Tea PVT Limited was incorrect as the Appellant treated transactions between it and Tapal Tea PVT Limited as independent transactions and used them as external comparables whilst it has been established that it is an enterprise related to it.
80. The Appellant averred that the Respondent did not explain why it opted to use the TNMM. The assessment letter that was laid before the Tribunal went into great detail on the choice of the method. In particular, it set out that the functions carried out by the Appellant were unique. The Respondent's averment that the most appropriate method in this case was TNMM was not disproved by the Appellant as required by Section 56 (1) of the Tax Procedures Act No. 29 of 2015 (hereinafter 'TPA') which provides as follows:

*“In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.”*

81. In selecting an appropriate Transfer Pricing method, Paragraph 2.1 of the OECD TPG provides that in the selection of a transfer pricing method the following should be considered:
- (a) *The respective strengths and weaknesses of the OECD recognised methods;*
  - (b) *The appropriateness of the method considered in view of the nature of the controlled transaction determined through a functional analysis.;*
  - (c) *The availability of reliable information (on uncontrolled comparables need to apply the selected method and/or other methods; and*
  - (d) *The degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them.*
82. The finding of the Tribunal in **Beta Health Care International Limited TAT Appeal No. 866 of 2022** was that Paragraph 3.20 of the OECD TPG outlines the information which is needed on the comparability factors in relation to a controlled transaction under review and in particular on the function's assets, risks of all parties to the controlled transactions including the foreign associated enterprises in determining the most appropriate transfer pricing methods to the circumstances of the case.
83. In paragraph 137 of the cited case, paragraph 1.36 of the OECD TPG was quoted with regards to the economically relevant characteristics or comparability factors that needed to be identified in the commercial and financial relations between associated enterprises in order to accurately delineate the actual transaction. These are categorised as follows:
- (i) **The contractual terms of the transaction [emphasis added];**
  - (ii) The functions performed by each of the parties to the transaction taking into account assets used and risks assumed, including how those functions relate to

the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction and industry practices;

- (iii) The characteristics of property transferred or services provided;
- (iv) The economic circumstances of the parties and of the market in which the parties operate; and
- (v) The business strategies of the parties.

84. In view of the foregoing, the Tribunal finds that the Appellant in failing to provide the contract between it and Tapal Tea PVT Limited further implied that it was related to Tapal Tea PVT Limited and as such there was no need for execution of a contract between the parties and the prices at which it sold Tea to Tapal Tea PVT Limited were therefore not at an arm's length. The assertions by the Appellant that it was not related to Tapal Tea PVT Limited were not proved.
85. In addition, the Tribunal is of the view that the level of profit of an enterprise depends on the functions a business performs, the risks assumed by the business and the assets utilised and required to be utilised in that business. As such the FAR analysis carried out by the Appellant and that of the Respondent were not much different, in establishing that the most functions, assets and risks assumed were undertaken by GTC (K). Accordingly, it would have been expected that the level of profit of GTC (K) would have been higher compared to the profit level of the other related enterprises within its group structure.
86. The Tribunal finds that the Appellant in applying the CPM method also used Tapal Tea PVT Limited as an external comparable yet as has been established, given that it is a related enterprise, the transactions between it and the Appellant were an inappropriate comparable. It is also notable that the Appellant had suggested the Berry Ratio (ratio of gross profit to operating expenses) as the most appropriate profit level indicator for the service of purchasing the tea on behalf of a number of its related enterprises. However, the Berry ratio was inappropriate since it would

apply where there are profits of limited risk distributors or service providers who do not own or use any intangible assets.

87. The Tribunal however finds that the Appellant had acquired the tea licence and the tea-tasting know-how which are both intangibles for tax purposes pursuant to Chapter 6.6 of the OECD TPG which provides as follows regarding the definition of an intangible:

*“in these guidelines therefore, the word ‘intangible’ is intended to address something which is not a physical asset or a financial asset which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Rather than focussing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction.”*

88. Paragraph 6.24 of the OECD TPG provides as follows regarding rights under contracts and Government licences:

*“Government licences and concessions may be important to a particular business and can cover a wide range of business relationships. They may include among others, a government grant of rights to exploit specific natural resources or public goods (e.g. a licence of bandwidth spectrum) or to carry on a specific business activity. Government licences and concessions are intangibles within the meaning of section A.1. However, Government licences and concessions should be distinguished from company registration obligations that are pre-conditions for doing business in a particular jurisdiction. Such obligations are not intangibles within the meaning of section A.1.”*

89. The importance of determining whether or not a Tea licence was considered an intangible is that it would affect the choice of the profit level indicator to be used in applying the TNMM method. Whereas the Appellant was of the view that it ought to use the Berry ratio as outlined in paragraph 82 above, the Respondent was of the view that the correct ratio for the profit level indicator was Earnings Before Interest and Tax (EBIT). EBIT was the correct profit level indicator based on the Respondent's FAR analysis, which was not that different from that of the Appellant, which showed that the party in the controlled transactions that made the most unique and valuable contributions was GTC (K).
90. Paragraph 2.4 of the OECD TPG provides as follows:
- “As another example, where there is no or limited publicly available gross information on third parties, traditional transaction methods might be difficult to apply in cases other than those where there are internal comparables and a transactional profit method might be the most appropriate method given the availability of information...”*
91. The Tribunal having reviewed the FAR analysis of both parties is of the view that the remuneration provided to GTC (K) for its functions performed, assets used and risk assumed was inadequate. The choice of the Respondent to apply the TNMM method using the net cost-plus profit level indicator was the most appropriate and it therefore correctly adjusted the taxable income and tax payable by the Appellant.
92. Accordingly, the Tribunal's finding is that the Respondent was justified in using the TNMM instead of CPM in determining the Arm's Length Price of the transactions between the Appellant and Tapal Tea PVT Limited.

## FINAL DECISION

93. The upshot of the foregoing analysis is that the Appeal lacks merit and the Tribunal accordingly proceeds to make the following final Orders:

- a) The Appeal be and is hereby dismissed.
- b) The Respondent's objection decision dated 6<sup>th</sup> September, 2022 be and is hereby upheld.
- c) Each party to bear its own costs.

94. It is so ordered.

**DATED and DELIVERED at NAIROBI this 28<sup>th</sup> day of June, 2024.**

**ERIC NYONGESA WAFULA  
CHAIRMAN**

**DELILAH K. NGALA  
MEMBER**

**CHRISTINE A. MUGA  
MEMBER**

**GEORGE KASHINDI  
MEMBER**

**SPENCER S. OLOLCHIKE  
MEMBER**

**MOHAMED A. DIRIYE  
MEMBER**