REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 608 OF 2020

AFRICA FAIRTRADE NETWORK LIMITED....................................APPELLANT

-VERSUS-

COMMISSIONER OF INVESTIGATIONS & ENFORCEMENT...RESPONDENT

JUDGMENT

BACKGROUND

1. The Appellant is a Kenyan branch of a nonprofit company limited by guarantee registered under the laws of Tanzania. Its principal activity is training farmers on production of quality products and other community-based projects that focus on women empowerment, workers' rights, child protection and climate change, among others.

2. The Respondent is a principal officer of the Kenya Revenue Authority (KRA). KRA is established under the Kenya Revenue Authority Act (Cap.469) and is charged with the mandate of administration, assessment and collection of revenue as an agent of the Government of Kenya.

3. The Respondent conducted a compliance check on the Appellant's corporation tax and consequently raised an additional assessment order dated 7th February 2020. It thereafter issued a demand for the additional taxes vide a demand letter dated 20th February 2020 seeking to recover Kshs 51,724,730.00.

4. The Appellant was aggrieved by the additional assessment order and the subsequent demand and lodged an objection dated 2nd March 2020 pursuant to Section 51(1) (2) of the Tax Procedures Act (TPA). From the pleadings, it is apparent that the parties herein engaged in various meetings and correspondences. The Respondent alleged that it requested the Appellant to provide documents to back up its contentions and that the latest request being on 4th September 2020. The Appellant provided its last batch of documents on 18th September 2020.

5. The Respondent considered the Appellant's documents and issued an Objection Decision on 13th November 2020 confirming the additional assessment.

6. The Appellant, aggrieved by the Objection Decision, filed a notice of appeal on 10th December 2020. The respective Memorandum of Appeal and Statement of Facts were filed on 23rd December 2020 and both documents served upon the Respondent.

7. Upon service, the Respondent filed its Statements of Facts on 15th January 2021.

8. When the matter came up for hearing both parties elected to proceed on the basis on their written submissions.

THE APPEAL

9. The grounds of the Appeal are outlined in the Memorandum of Appeal as summarized hereunder: -

   a) That the Respondent erred in law by failing to serve the Objection Decision within 60 days as required by Section 51 of the TPA;

b) That the Appellant carries out community development activities and it is exempt from taxes in accordance with the First Schedule to the Income Tax Act (ITA) therefore the Respondent erred in law by assessing taxes against it;

c) That the Respondent erred in law by treating surplus in the Appellant's accounts as profits therefore taxing the same yet what appears to be profits are in fact, grant funds balances that are rolled over to the subsequent year for project implementation. Further, that the Respondent arbitrarily assumed that the Appellant has shareholders and was involved in distribution of profits yet the Appellant is a branch of a company limited by guarantee and does not have shareholders as provided for under Clause 5 of the Appellant's Memorandum and Articles of Association;

d) That the Appellant acts as a secretariat for all the other member organizations, and thus the funds at its disposal are grants meant to be disbursed and not for profits purposes;

e) That the Respondent erred in law and fact by finding that Appellant's raised invoices means that it is conducting income-generating business. Inversely, the Appellant uses invoices because its model of operation uses an EPR system (Hansa) which only allows the Appellant to raise invoices against income received which is basically the accrual method of accounting and that the Appellant uses the system because it helps it to keep track of any grant income taking into account how the donors operate. Since some donors pay on advance basis while others on reimbursement and some on the rest based on project milestones, invoices act as a form of requisition to the donors; and

f) That the Respondent misconstrued the term, 'bad debt' since as per the provisions of Section 15(2) of ITA, a debt arises in the process of making profits/gains for business purposes yet the Appellant is a nonprofit entity. Bad debt in relation to the Appellant means grant incomes that have not been received and have been written off. Since grants are solicited for from voluntary donors, it would be unfair and unreasonable to follow the due process of debt collection as per the ITA therefore the Appellant relied on the Board Resolutions to support the objection.

10. In conclusion, the Appellant prays that:

a. The Tribunal be pleased to invoke Section 55 of the TPA to allow the Appellant to settle the matter through ADR;

b. The Tribunal be pleased to find that the Objection Decision was issued beyond 60 days in violation of Section 51 of the TPA;

c. The Tribunal do find that raising additional assessment in the system before any formal communication was violation of the law as per the requirements of the TPA;

d. The matter at hand is a case of misconstrued facts and the appeal should be allowed;

e. The Tribunal be pleased to find that the Appellant's nature of transactions are tax exempt;

f. The Tribunal be pleased to find that the Respondent should have allowed the bad debts since they are actually not debts but instances of unrealized grant income; and

g. Costs be in the cause.

THE RESPONSE

11. While relying on its Statement of Facts, the Respondent stated that the Appellant was notified on 17th March 2020 that the notice of objection was not validly lodged and requested the Appellant to validate the same and to provide supporting documents. Further, there were several meetings between the parties wherein the Appellant was requested to provide additional documents to substantiate its contentions as contained in the objection. The Respondent stated that the last request was done on 14th September 2020 while the Appellant provided the last batch of documents on 18th March 2020. The Respondent submitted that the Objection Decision was issued on 13th November 2020, 55 days from the last day of provision of the documents which was within the timelines under Section 55(11) of the TPA.

12. The Respondent vehemently denies that the Appellant is tax exempt and submitted that the Appellant sought for tax advisory opinion and was advised to seek and get an exemption from the Cabinet Secretary in charge of National Treasury. Therefore, the Appellant ought to have followed up with Treasury for the exemption in accordance with the law. The Respondent asserted that the Appellant was not granted the exemption; therefore, it is liable to pay taxes.

13. On issues concerning invoices, the Respondent submitted that since the Appellant was issuing invoices to its clients, it does not make sense that its income was made up of donations only. The Respondent stated that its investigations revealed that part of the Appellant's income comprised of monies paid by farmers as joining fees.

14. The Respondent also submitted that the Appellant has been paying taxes since the year 2013 to 2017 but it failed to pay taxes for the year 2018 yet there was no evidence indicating that it was income tax exempt.

15. According to the Respondent, the Appellant failed to prove that it had satisfied the conditions set out under Legal Notice 37 of 2012 on write off of bad debts therefore the decision to disallow bad debts was justified.

16. Due to the highlighted reasons, the Respondent prays that the Appeal be dismissed with costs.

ISSUES FOR DETERMINATION

17. The Tribunal has carefully considered the parties' pleadings and submissions and is of the respectful view that the issues that call for its determination are as hereunder: -

    a. **Whether the Respondent issued the Objection Decision within the required statutory timelines as per the Tax Procedures Act;**
    b. **Whether the Appellant is tax exempt; and**
    c. **Whether the Respondent erred in law and in fact in raising an additional income tax assessment on the Appellant in respect of the 2018 year of income.**

ANALYSIS AND FINDINGS

18. Before delving into the issues for determination, the Tribunal is cognizant of the fact that the Appellant's principal activity is training farmers on production of quality products and carries out other community-based projects that focus on women empowerment, workers' rights, child protection and climate change among other community based projects.

19. The Tribunal will move to review and address the above issues as hereunder:

a. Whether the Respondent issued the Objection Decision within the statutory timelines as per the Tax Procedures Act.

20. The Appellant submitted that the Respondent delayed to issue the Objection Decision yet the Appellant filed its Notice of Objection on 2nd March 2020 and the Respondent acknowledged receipt of the objection on the even date. The Appellant asserts that the delay is contrary to Section 51(11) of the TPA, which mandates the Respondent to issue an Objection Decision within 60 days from the date of the receipt of the Notice of Objection. On the other hand, the Respondent asserts that the Objection Decision is valid *in toto*.

21. The Tribunal will refer to the relevant legislation, being Section 51(11) of the TPA. It provides as follows:

> **'(11) The Commissioner shall make the objection decision within sixty days from the date of receipt of—**
>
> **(a) the notice of objection; or**
>
> **(b) Any further information the Commissioner may require from the taxpayer, failure to which the objection shall be deemed to be allowed.'**

22. It is worth noting that Section 51(11) of the TPA has two independent paragraphs: Paragraph (a) and Paragraph (b). Paragraph (a) applies when the Notice of Objection is validly lodged in compliance with Section 51(3) and the Respondent has not requested for further information. In such a situation, the Respondent has an obligation to issue an Objection Decision within 60 days from the date of the Notice of Objection.

23. The Tribunal notes that Section 51 (3) as read with Section 51(4) of the TPA give the Respondent powers and discretion to determine whether the Notice of Objection is validly lodged. The first step, upon receipt of the Notice of Objection, the Respondent must satisfy itself that that Notice of Objection is validly lodged, that is, by satisfying itself that the Notice of Objection meets the provisions of Section 51(2) and 51(3) of the TPA. Section 51(4) of the TPA mandates the Respondent to write to the Appellant immediately, informing the Appellant to validate the Notice of Objection if the Notice of Objection is not validly lodged.

24. The second independent part of Section 51(11) of the TPA is Paragraph (b) which requires the Respondent to issue its Objection Decision within 60 days from the date of receipt of any further information the Commissioner may require from the taxpayer, failure to which the objection shall be deemed to be allowed.

25. Having set the above analysis, the Tribunal will proceed to look at what is in dispute. In this Appeal, the Appellant relied on Section 51(11) (a) of the TPA and argued that the Objection Decision was issued out of time, while the Respondent relied upon Section 51(11) (b) of the same Act and argued that the Objection Decision was issued within the required timelines.

26. While relying on Section 51(11)(b) of the TPA, the Respondent was categorical that it wrote to the Appellant on 17th March 2020 advising that the Notice of Objection was invalid and requested the Appellant to provide more documentation to support the Notice of Objection. The Tribunal has perused the pleadings and has established that indeed on 17th March 2020, the Respondent wrote an email to the Appellant advising it to regularize the objection to comply with Section 51(3) of the TPA.

27. At this juncture, it is vital to note that Section 74 of the TPA allows the Respondent to issue notices through electronic means. Therefore, the Tribunal finds that the Respondent's email of 17th March 2020 notifying the Appellant about the invalidity of the Notice of Objection was in writing and in line with Sections 51(4) and 74 of the TPA. In fact, The TPA allows tax matters to be conducted electronically. Therefore, the Appellant's assertions that it was not given a written notice regarding the invalidity of its Notice of Objection is unfounded.

28. Whereas the Respondent issued a written notice to the Appellant regarding the invalidity of the Notice of Objection, it is necessary to find out whether the notice was issued in compliance with Section 51(4) of the TPA which requires the Respondent to issue a notice **'immediately,'** advising the Appellant on the invalidity of the Notice of Objection.

29. The Appellant filed its Notice of Objection on 2nd March 2020 while the Respondent issued a notice advising the Appellant that the Objection was invalid on 17th March 2020. The question then is, whether the Respondent notified the Appellant on the invalid Notice of Objection **'immediately'** within the meaning of Section 51(4) of the TPA.

30. The TPA does not define the word **'immediately'** which creates ambiguities. While trying to define the word 'immediately,' Cockburn, C. J., in ***Reg. v. Justices of Berkshire, 4 QB. Div. 471*** had the following to say about the word:

> **"It is Impossible to lay down any hard and fast rule as to what is the meaning of the word 'Immediately' in all cases. The words 'forthwith' and 'immediately' have the same meaning. They are stronger than the expression within a reasonable time and imply prompt, vigorous action, without any**

delay, and whether there has been such action is a question of fact having regard to the circumstances of the particular case."

31. Does the word, **'immediately'** mean that the Respondent has to notify the tax payer on the invalidity of the objection same minute, hour or day(s) when the Notice of Objection is received? Alternatively, does it mean the moment the Respondent discovers that the Notice of Objection is lacking in substance? The word **'immediately'** as used under Section 51(4) of the TPA is ambiguous. We are of the respectful view that the legislator ought to have specified the precise timeframe by specifying the number of days within which such notification should be issued.

32. The Tribunal is alive to the provision of **Article 159(2) (d)** of the Constitution of Kenya 2010. When exercising judicial authority, **Article 159(2) (d)** mandates Courts and Tribunals to be guided by the principle that justice shall be administered without undue regard to procedural technicalities.

33. In light of Article 159(2) (d), of the Constitution 2010, the Tribunal is of the view that the word **'immediately'** as used under Section 51(4) of the TPA requires a written notice to be issued **within a reasonable time** without prejudicing the taxpayer. The Tribunal is also of the view that it would be unreasonable for the Respondent to issue a notice on the invalidity of Notice of Objection after months after receiving the Notice of Objection. In the instant Appeal, the Respondent issued the notice after 14 days. The Tribunal, considering all the circumstances herein, is of the view that the delay was not unreasonable. Furthermore, the Tribunal is of the view that the Appellant is not prejudiced because it provided further documents to the Respondent as late as 9th September 2020.

34. Consequently, the Tribunal finds that the Respondent issued the Objection Decision within the statutory timelines as per the Tax Procedures Act.

b. Whether the Appellant is tax exempt.

35. The Appellant relied on Section 30 of the Non-Governmental Organizations Co-ordination Act, 1990, (the NGO Act), Public Benefit Organization Act, and Paragraph 10 of the First Schedule to the ITA to submit that it is tax exempt.

36. The Appellant relied upon Section 30 of the NGO Act to submit that the said Section allows tax exemptions. The Tribunal examined the said Act and finds that Section 30 of the NGO Act has nothing to do with taxes. The said Section deals with books of accounts and not taxes. In any event, the Appellant is not an NGO. It is a branch of a company limited by guarantee which is governed by the Companies Act 2015. The Appellant did not tender evidence that it is registered under the NGO Act. Further, the NGO Act was repealed by the Public Benefit Organization Act, which commenced on 9th September, 2016. Therefore, the Appellant cannot rely on the NGO Act.

37. The Appellant also relied heavily upon the Public Benefit Organization Act (PBO Act). However, what matters is whether the Appellant is registered under the said Act. The Appellant cannot rely upon the PBO Act unless it is registered thereunder. To this end, Section 6(1) of the said Act is self-explanatory. It provides as follows:

'A public benefit organization shall be registered under this Act for it to enjoy the benefits that accrue under this Act.'

38. Further, Section 6(2) of the PBO Act is also self-explanatory. It provides that:

'No organization that is registered under any other law in Kenya shall be registered under this Act while its registration under that other law subsists.'

(Emphasis ours)

39. The Tribunal notes that Section 6(3) of the PBO Act is relevant and self-explanatory too. It provides as follows:

'Without prejudice to subsection (1), registration of an organization under this Act supersedes any prior registration of that organization under any other law in Kenya.'

40. Furthermore, Section 6(4) of the PBO Act provides as follows:

'Where an organization is registered under this Act and under any other law, that organization shall be deemed registered under this Act and that other registration shall be deemed invalid.'

41. The Tribunal wishes to emphasize that registration under the PBO Act is a precondition for any organization to rely on the Act. There is no evidence that the Appellant is registered under the PBO Act.

42. The Appellant has stated that it is a branch of a company limited by guarantee and registered in Tanzania. The Appellant also stated it is registered in Kenya and has a certificate of compliance. This certificate was not adduced in evidence. The Tribunal takes notice that the Companies Act 2015 allows registration of branches of foreign companies in Kenya. Thereafter, issuance of a certificate of compliance. Therefore, if the Appellant is registered in Kenya, then it must have a valid compliance certificate.

43. In absence of evidence indicating that the Appellant is registered under the PBO Act, the Tribunal finds that the Appellant cannot validly invoke the provisions of the PBO Act.

44. The Appellant also relied on Paragraph 10 of the First Schedule to the ITA to assert that it is tax exempt. In part, Paragraph 10 of the First Schedule to the ITA provides as follows:

"Subject to section 26, the income of an institution, body of persons or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education—

(a) Established in Kenya; or

(b) Whose regional headquarters is situated in Kenya,

In so far as the Commissioner is satisfied that the income is to be expended either in Kenya or in circumstances in which the expenditure of that income is for the purposes which result in the benefit of the residents of Kenya..."

"...and provided further that an exemption under this paragraph—

(A) Shall be valid for a period of five years but may be revoked by the Commissioner for any just cause; and

(B) Shall, where an applicant has complied with all the requirements of this paragraph, be issued within sixty days of the lodging of the application." (Emphasis supplied).

45. The import of Paragraph 10 of the First Schedule to the ITA is that tax exemption is not automatic. There must be an application to the Commissioner for exemption, the Commissioner must be satisfied with the application, and if satisfied with the application, the exemption is granted and remains valid for five years only, but is revocable by the Commissioner.

46. For the Appellant to validly invoke Paragraph 10 of the First Schedule to the ITA as a defense; it must demonstrate that it made an application to the Commissioner for tax exemption, the Commissioner was satisfied by the application then allowed the exemption, the exemption has not expired and is still within the 5 years' rule, and the exemption has not been revoked by the Commissioner. The Appellant then, has to satisfy the Tribunal that despite existence of these facts, the Respondent is demanding to collect taxes with impunity.

47. There is no evidence that the Appellant is tax exempt. What the Appellant terms as 'tax exemption' is a letter dated 28th November 2013 from PKF Accountants and business advisers which merely states that, '**The application has been filed and we are presently following up with the KRA to issue the same."**

48. From the foregoing, income tax exemptions are not automatic. Similarly, legitimate expectation is not an automatic right. The Appellant stated that '**by nature of its activities it is entitled to tax emption and it had legitimate expectation that tax exemption will be issued in time....**' In the English case of ***Council of Civil Services Unions vs Minister for Civil services 1985 AC 374***, Lord Fraser stated as follows: **"A legitimate expectation may arise –either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue...."**

49. The Appellant cannot rely on legitimate expectation when the Respondent did not make a promise. Legitimate expectation cannot arise in this matter when the Appellant failed to follow up with the relevant authorities to obtain a certificate of income tax exemption. Legitimate expectation would have arisen if the Appellant had obtained a tax exemption certificate and if the Respondent had ignored it. Therefore, legitimate expectation does not arise in this matter.

50. The Appellant did not contest the Respondent's assertion that it paid taxes for the years 2013 to 2017. If so why did the Appellant fail to pay taxes for 2018? The Appellant is on record admitting that it had not received tax exemption. The Appellant has failed to persuade us that it is tax exempt.

51. Consequently, the Tribunal finds and holds that the Appellant is not tax exempt.

c) Whether the Respondent erred in law and in fact in raising an additional income tax assessment on the Appellant in respect of the 2018 year of income.

52. The Respondent submitted that investigations revealed that part of the Appellant's income included monies paid as joining fees by farmers. The Appellant did not contest this issue. Therefore, the Tribunal cannot fault the Respondent for enforcing Section 3(2)(a)(i) of the ITA, which allows charging tax upon gains or profits from any business, for whatever period of time carried on.

53. The Appellant submitted that the Respondent unfairly refused to allow bad debts. On the other hand, the Respondent asserted that the Appellant failed to prove that bad debts existed.

54. Whereas a debt is an asset and should be reflected as such in books of accounts, a bad debt is an expense and should be reflected as such in books of accounts. However, in tax matters, declaring a debt as 'bad debt' is not sufficient. As will be demonstrated below, the tax payer must comply with the provisions of Section 15(2) of the ITA for the bad debts to be treated not as assets, but as expenses.

55. The Appellant submitted that bad debt in relation to the Appellant's activities means grant incomes that have not been received and have been written off to help the organization keep track of the income. The Appellant also submitted that bad debts should be classified as unrealized grant income. Since grants are solicited for from voluntary donors, the Appellant argued that it would be unfair and unreasonable to follow the due process of debt collection as per the ITA. Therefore, the Appellant relied on the Board Resolution to support the objection.

56. The Appellant submitted that it decided to write off some grants due to failure by the donors to remit the said grant over a long period and as such, the same should not be treated as bad debts. However, in the Memorandum of Appeal, the Appellant states that, **'some donors pay on advance basis while others on reimbursement and some on the rest based on project milestones.'** What this means is that the Appellant can spend funds, then the donor reimburses. If the donor fails to reimburse, then the Appellant will have incurred an expense making the transaction a debt some of which the Appellant has admitted to writing off. Such write offs should be done transparently which enables the taxpayer to treat the debt not as an asset, but as an expense which is deductible from income leading to payment of lower tax.

57. The question then is, whether the Appellant's 'bad debts' though the Appellant calls them 'unremitted grants' should be treated as expenses under Section 15(2) (a) of the ITA. Section 15(2)(a) of the ITA provides as follows:

'Without prejudice to sub-section (1) of this section, in computing for a year of income the gains or profits chargeable to tax under section 3(2)(a) of this Act, the following amounts shall be deducted:

(a) **Bad debts incurred in the production of such gains or profits which the Commissioner considers to have become bad, and doubtful debts so incurred to the extent that they are estimated to the satisfaction of the Commissioner to have become bad, during such year of income and the Commissioner may prescribe such guidelines as may be appropriate for the purposes of determining bad debts under this subparagraph..."**

58. Pursuant to Section 15(2) (a) of the ITA, the Commissioner published guidelines on allowability of bad debts through legal notice No. 37 of 2011. guideline 1 provides that:-

"A debt shall be considered to have become bad if it is proved to the satisfaction of the Commissioner to have become uncollectable after all reasonable steps have been taken to collect it."

59. Contrary to the Appellant's submissions that it cannot force donors to pay the outstanding amounts, the Appellant adduced a contract between itself and some of its donors. Contracts have terms and conditions. For example, nothing would have been as easy as satisfying the Respondent that the debt is bad and uncollectible since some donor contracts have been terminated before remittances of funds. The Appellant did not allege that some debts could not be collected because contracts were terminated. Instead, it stated that it could not force donors to remit funds. As long as the contracts were in existence at the material time, then the debt cannot be termed as uncollectible. In the circumstances, the Tribunal is of the view that there were no sufficient grounds adduced to justify the writing off of debts.

60. The Tribunal further notes that some of the contracts the Appellant availed indicate that the Appellant is mandated to pay taxes and should the donor incur expenses such as taxes, then the Appellant is liable to indemnify the donor.

61. Under the circumstances, the Tribunal holds the view that the Appellant did demonstrate to its satisfaction that it was in compliance with Section 15(2) of ITA, as read with the guidelines on allowability of bad debts, that its writing off of debts was justified.

62. Consequently, the Respondent did not err in law and in fact in raising an additional income tax assessment on the Appellant in respect of the 2018 year of income.

FINAL DECISION

63. The upshot of the foregoing is that the Appeal is not merited and the Tribunal makes the following **ORDERS: -**

a) The Appeal is hereby dismissed.

b) The Respondent's tax assessment vide its Objection Decision dated 13th November, 2020 for the sum of Kshs.51,742,730.00 is hereby upheld.

c) Each party to bear its costs.

64. Orders accordingly.

DATED and **DELIVERED** at **NAIROBI** on this **5th** day of **November, 2021.**

JOSEPHINE K. MAANGI
CHAIRPERSON

....
PATRICIA M. ANAMPIU
MEMBER

....
TANVIR ALI
MEMBER

....
GEOFFREY KARUU
MEMBER

....
WAMBUI NAMU
MEMBER