**N Ltd v Income Tax**

**Division:** High Court of Kenya at Nairobi

**Date of judgment:** 17 September 1973

**Case Number:** 56/1972 (46/74)

**Before:** Trevelyan J

**Sourced by:** LawAfrica

*[1] Income Tax – Capital or income receipt – Profit on sale of plot originally bought for trading from –*

*Capital receipt – Change of intention immaterial.*

**JUDGMENT**

**Trevelyan J:** The Kakamega Urban District Council advertised a plot of land for sale for use as a petrol service station. The appellant company applied for it on 11 April 1965, was successful, and, on 14 June 1966, got its grant of title to it. Buildings were erected on the plot and Caltex Oil (Kenya) Ltd. bought it with its developments for Shs. 165,000/-. The company made a profit of £4,437 on the transaction and this profit was assessed for income tax purposes in the sum of Shs. 35,496/-. The question for decision in the present appeal is whether that tax does, or does not, fall properly to be paid. At all material times, the appellant company’s main business was that of a distributor of petroleum and petroleum products, and it held exclusive rights for them in regard to Caltex within the Nyanza and Western Provinces. The company also owned a petrol station in Kisumu, but it did not itself run it. Mr. Shah, a director of the appellant company had, it seems, used his influence or good offices in the past to secure petrol station sites for Caltex, but the company had never before bought a plot and then sold it. I am told that the question of Caltex allocating the plot had not arisen by the year 1966, but I believe, from what is before me, that the appellant company wanted itself to run the petrol station on the plot at that time. I think I am right to say that it could have developed the plot at its own expense and then, having bought Caltex’s products, marketed them from it. But it preferred to sell or lease the plot to Caltex and then take it, on allocation, from them. Such allocation was denied it, but it is, as I think, what it was hoping for in 1966; or perhaps even before that, in 1965 According to Mr. Kimani, Caltex’s retail development co-ordinator, Caltex, indeed, hoped that the company would operate it; which is why it developed the plot. But that may have been later. I am not sure. Mr. Shah told us that the appellant company acquired the plot so that a petrol station might be built on it from which Caltex’s petroleum products could be sold. I believe it to be so. It seems to me that the prime object of the purchase of the plot was to enable the company to trade on it. This distinguishes the present transaction from Mr. Shah’s previous efforts on behalf of Caltex. Caltex was certainly asked to do something about the plot, but this was only to be expected. So too, would one have expected Caltex to have been in on the question of the application for the plot from the beginning; which it was. We have in evidence a minute dated 3 April 1967 which Caltex’s manager addressed to his managing director which says: “As you are aware Mr. Somchand Shah negotiated for a *gazetted* service station site in Kakamega township and secured the plot accordingly some 18 months ago. According to Mr. Shah, it was alleged that this action was taken by him at the verbal request of Mr. P. J. Wilson who was supposed to have stated some three years ago that he would have liked Mr. Shah to use whatever influence he could to achieve this.” The minute indicates reservation if not scepticism, but there is no reason to suppose that what Mr. Shah said was not true. Mr. Shah and Mr. Kimani may both have been less than accurate in regard to details and dates, but their evidence is nonetheless generally acceptable. We are, in any event, helped by the minute and, indeed, by another one dated 18 August 1966 addressed also to Caltex’s managing director, but this time by Caltex’s acting manager. I would like to have seen further correspondence, but none was available to me. Mr. Shah told us that he submitted plans for the erection of a petrol station on the plot in 1967 but that after they were approved, building operation were not commenced right away because, as he put it, “we had to explore the market to see if it was worthwhile”. That is not so. Mr. Shah approached Caltex long before. When Mr. Kimani was asked whether Mr. Shah had approached Caltex to buy the plot, or whether Caltex had approached Mr. Shah to sell it, he said that it was Mr. Shah’s (by which he meant the appellant company’s) intention to sell it to Caltex right from the beginning, but Caltex turned it down because, in his words, “we realised we could not get good gallonage to pay our money back”. When he was asked to explain what he meant by “right from the beginning” he said that when Mr. Shah acquired the plot he asked Caltex to buy it, but was refused, Caltex, however, having a later change of mind. Nonetheless I do not think that there was but a straight offer for sale or request to buy. At some time between the grant of title to the plot and 18 August 1966, i.e. within a period of two months or so, the appellant company wrote to Caltex. The letter is not before us, but, according to the minute of April 1967, the appellant company had twice before asked Caltex either to buy the plot, or take it on lease. The minute says: “On two previous occasions Mr. Somchand Shah has been advised that the Company has no intention of investing capital for a Company owned/leased outlet at Kakamega and we suggested that Nyanza Oil Distributors dispose of their site elsewhere. Mr. Somchand Shah, however, has strongly urged us to make some sort of offer and it is therefore our proposal that we lease on a rental per gallon basis, any outlet which N.O.D. wishes to construct on the plot with their own investment.” The minute seems to indicate that, whatever may have been the arrangement with Mr. Wilson, Mr. Shah may not have asked Caltex to develop the plot until after it was acquired. The minute indeed says: “After securing the site Mr. Shah approached us. However at that time, we said that we were not interested in any development in the Kakamega area. . . .” Having regard to the relationship between the parties (to say nothing of the arrangement) Mr. Shah may well have thought it safe enough to go ahead with the purchase of the plot in the reasonable expectation that Caltex would help him in some way or other in regard to it. There is no specific mention in the minute of Caltex allocating the developed plot to the company but, as I read it, that is to be inferred. In support of its case, the appellant company suggested that the sale of the plot resulted from Caltex’s policy of Africanisation; but I do not find it to be so. Mr. Shah told us: “I would not have operated that petrol station without having the rights for the whole of Nyanza – not a simple service station. . . . I initiated [selling the plot] when [Caltex] declined the agency of ours for marketing in Nyanza Province.” That, to say the least, is an over-simplification. It is true that the appellant company had its wide distribution (or wholesale) rights and that without those rights it probably had no interest in running just one, small, not very remunerative service station in the competitive arena of Kakamega, but I nonetheless do accept this evidence which Mr. Shah gave: “Caltex did not give me rights for this petrol station. They gave it to Mr. Elijah. Subsequently my rights for Nyanza Province were terminated. Caltex said they wanted to Africanise the marketing policy. Had I been given distribution rights for the petrol station, I would not have sold it. We developed the petrol station after being refused distribution rights for it.” According to Mr. Kimani: “Our policy resolved to follow Government’s policy of Africanisation since the Government declared it to be their policy. I am not sure but since 1968 we decided not to allocate service stations to non-citizens but to allocate only to African citizens . . . When we decided to allocate service stations to the Africans we informed them of our intention of stopping their distribution rights of our petroleum products. (*Q*) Except for implementation of Africanisation would you have given rights for Kakamega petrol station to them? (*A*) No . . . Before we decided to develop or agreed with Mr. Shah’s request, he guaranteed the station would sell about 7,000 gallons a month. Mr. Shah asked us because he wanted development. We could have given him the rights for the petrol station, but we could not go against the Government.” It is clear that the question of Africanisation only arose a good deal later in time than Mr. Shah’s first approach to Caltex about the plot; two, perhaps three, years before. The original intention of the appellant company does not call for the transaction to be considered other than as a capital one. The respondent, however, says that even if this be so, there was a change in intention which change requires the transaction to be considered as a revenue one, for which he relies on the fact of the plot having been developed before sale. One must bear everything in mind in coming to a decision in these cases, but, as I see it, the fact of the development does not enhance the value of the respondent’s case. The grant of the land contains conditions that buildings of approved design had to be erected on it within 24 months of 1 September 1965, that the land and buildings should only be used as a petrol station, and that no application for consent to alienate the land, or any part of it (except by way of security for a loan) would be considered until the buildings had been erected. Mr. Kimani told us: “. . . we lent Mr. Shah the money to develop the plot and he assured us he could get 7,000 gallons a month. (*Q*) When Mr. Shah was given the loan were you going to purchase it? (*A*) If Mr. Shah did not shift the gallonage he promised we had to buy that plot and ask Mr. Shah to pay 20 cents a gallon for the gallons he did not achieve. This was in the form of a letter.” But Mr. Kimani also told us that Caltex bought the plot because: “When we allocated the business to Mr. Elijah we could not control the dealer when the site was not directly at our control.” Caltex, as I see it, bought the plot because there had been an improvement as to its location and it might have a moral obligation to Mr. Shah to do so. Caltex paid Shs. 165,000/- for the developed site having lent the appellant company Shs. 60,000/- to develop it. This amount was thought to be, and seems to have been, the amount required and Caltex was content to give its erstwhile distributors a profit. I do not believe that anyone had in mind that the plot had to be developed so that a profit might be made. The plot had to be developed if the terms of the grant were to be observed, an undeveloped plot could have been of no use to Caltex, and, under the terms of the grant, the appellant company and no one but the appellant company could develop the plot. I am of the opinion that when the appellant bought the plot it did so to run a petrol station on it. Incidental to that were such matters as its ownership and the cost of its development. I do not suppose that any businessman ever buys, except in special situations, with a view to sale at a loss and I see no reason to think that Mr. Shah is an exception. But we do not know what he may have asked for the plot on his original requests to Caltex, nor do we know who suggested Shs. 165,000/-. Caltex was prepared to pay that amount for the developed plot and the company, I would think, was more than content to accept it. Perhaps the moral obligation played its part in the fixing of the price. Moreover the company had a plot which it was not going to be able to use as a petrol station or for anything else. What else could it prudently have done than to sell it? To whom else could it have sold it? I do not see how the transaction of sale can possibly amount to a revenue transaction. The profit which the appellant company made can attract income tax only if it can be said that it was from a business which it carried on: see s. 3 of the East African Income Tax Management Act (Cap. 24). As “business” is defined as including any trade, profession or vocation, and “trade” includes “every trade, manufacture, adventure or concern in the nature of trade”, what falls to be decided is whether the profit was made from an adventure in the nature of trade. I do not find that it was. I do not doubt that an isolated transaction such as we have here may be taxable but this can be so only if the venture – call it what you will – is in the nature of trade. Lord Clyde in *Commissioner of Inland Revenue v. Livingston*, 11 T.C. 538 at p. 542 said: “I think the profits of an isolated venture . . . may be taxable . . . provided the venture is ‘in the nature of trade’. I say ‘may be’ because in my view regard must be had to the character and circumstances of the particular venture. If the venture was one consisting simply in an isolated purchase of some article against an expected rise in price and a subsequent sale it might be impossible to say that the venture was ‘in the nature of trade’; because the only trade in the nature of which it could participate would be the trade of a dealer in such articles, and a single transaction falls far short of constituting a dealer’s trade . . . The trade of a dealer necessarily consists of a course of dealing . . . But this principle is difficult to apply to ventures of a more complex character . . . I think the test, which must be used to determine whether a venture . . . is, or is not, ‘in the nature of trade’, is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.” Rowlatt, J. in *Leeming v. Jones*, 15 T.C. 333 thought that this quotation “covers all the cases”. The characteristics of the transaction with which we are concerned are not those ordinarily to be found in the business of buying and selling of land, nor are they so to be found in the sale or marketing of petroleum and petroleum products. It is not a characteristic of ordinary trading in land to buy in the hope that one’s only supplier – that must be so vis-à-vis Caltex – will buy the land and then allocate it back so that it may be traded on. But the offer made was to sell or *lease* in any event. Even if we assume that the appellant company bought the land hoping to make a profit on its sale, it is of no importance in the circumstances before us. One can buy something with the declared intention of selling it at a profit and then sell it in pursuance of such intention without it perforce becoming a revenue transaction. Rowlatt, J. at p. 340 of the *Leeming v. Jones* case, had this to say: “Now what have [the Commissioners] found . . . : That the property was acquired with the sole object of turning it over again at a profit and without any intention of holding the property as an investment. That describes what a man does if he buys a picture that he sees going cheap at Christies because he knows that in a month he will sell it again at Christies. That is not carrying on a trade. Those words will not do as a finding of carrying on a trade or anything else. What the Commissioners must do is to say, one way or the other, was this, I will not say carrying on a trade, but was it a speculation or an adventure in the nature of trade.” In the instant case, apart from the question of trading on the plot, there was the offering to Caltex of the plot on sale *or lease*, so the matter of holding it as an investment was not abandoned, and must also be kept in mind. I am content to accept that a transaction can change into a revenue one, but there is no such change here. If Rowlatt, J.’s picture from Christies would likely to have sold at a higher price with a nice gilt swept frame around it, and the purchaser had so adorned, and then sold it, that would not, of itself, have required him to pay tax on the profit he made when he did so. Here the plot had to be developed by the appellant company if it was to sell it. Even if it had then formed the intention of making a profit on the deal that intention does not, in the circumstances, matter. Counsel for the respondent himself told me that intention alone is not conclusive.

In my view the purchase and subsequent development and sale of the plot was a capital transaction.

The appeal is allowed with costs.

*Order accordingly*.

For the appellant:

*Bhailal Patel*

For the respondent:

*DM Wekesa*