**T P Ltd v Income Tax**

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

**Date of judgment:** 14 June 1974

**Case Number:** 50/1973 (117/74)

**Before:** Harris J

**Sourced by:** LawAfrica *[1]*

*Income Tax – Capital or income payment – Land and construction of buildings to be surrendered to government – Whether a wasting capital asset – East African Income Tax Management Act* 1958, *s.* 14 (1) (*b*)*. [2] Income Tax – Refraint from assessment or collection of tax – No power to grant allowances or vary or reduce assessments – Whether Commissioner has discretion may be decided by court – East African Income Tax Management Act* 1958, *s.* 141*.*

**JUDGMENT**

**Harris J:** This is an appeal against an assessment to income tax for the year of income 1971, first on the ground that the assessment was wrong and secondly on the ground that the respondent mistakenly omitted to invoke his powers under s. 141 (1) of the East African Income Tax Management Act 1958 in relation to the assessment, believing (as is alleged) that no such powers existed in the circumstances before him. By an assignment dated 11 September 1968 the appellant company purchased for the sum of £20,000 certain premises in the city of Nairobi known as L.R. 209/71/74 for the balance then subsisting of the leasehold term of 99 years from 1 July 1902. The company, being minded to erect and operate a casino on the premises, entered into an agreement with the Government of Kenya whereby the latter undertook to grant to the company an exclusive casino licence for Nairobi and a similar licence for Mombasa at an inclusive annual fee of £500, both licences to be valid for a period of 15 years from 7 June 1968, and undertook also not to issue any other casino licences in Kenya during that period. The company for its part undertook to organise and manage the two casinos and for this purpose to secure suitable premises in Mombasa and to surrender to the Government at the expiration of the 15 years the land and buildings of both casinos free of encumbrances together with the casino licences, and the Government, expressly in consideration of this surrender, undertook to grant to the company the right to import free of duty the equipment and materials necessary for the construction of the buildings and also to grant a “quota of immigration” into Kenya of up to eighty expatriate personnel necessary for the efficient running of the casinos. The agreement further provided that if at the expiration of the period of 15 years the Government should wish to grant licences for the said two casinos so to be surrendered to it by the company the latter should have an option to acquire such licences on terms to be then arranged. No evidence was led as to the actual granting of the licences and the hearing proceeded on the footing that valid licences had in fact been issued and remained in force. The company’s accounts for the year to 31 March 1970 show that the capital outlay incurred to that date in the acquisition of fixed assets amounted to £221,448 made up of the cost of the land (including stamp duty, fees and expenses) £20,468 and the cost of buildings £200,979. These figures were not challenged and I accept them. The first ground of appeal as pleaded in the memorandum of appeal is that the sum of Shs. 982,744/- as assessed as tax is excessive and should have been Shs. 240,544/-, the error arising from the respondent having failed to take into account the company’s claims in respect of land and buildings as follows: (i) Year to 31.3.1970 (forming part of loss carried forward to 1971) .................. £14,737 (ii) Year to 31.3.1971 (forming part of loss carried forward to 1972) .................. £15,331 Total amount in dispute up to 31.3.1971 ........................................................ £30,068 The memorandum of appeal does not indicate why the company’s claims should have been taken into account or disclose the manner in which the assessment is alleged to have been erroneous and had the respondent applied to have this ground of appeal struck out as embarrassing such an application would have had to be seriously considered. In the course of the hearing, however, counsel for the company was able to clarify the position but it is desirable that attention be paid in these matters to r. 4 of the Income Tax (Appeal to the Kenya High Court) Rules which provides that the memorandum itself should set forth the grounds of appeal concisely and under distinct heads. It was conceded that the cost of the land and buildings did not fall within the Second Schedule to the Act and the company’s case on the first ground of the appeal is that it is entitled to an allowance or deduction in respect of this sum of £221,448 in view of the fact that:

(*a*) by virtue of the agreement of 7 June 1968 the company will be required to surrender to the Government without compensation its buildings, land and equipment at the expiration of the licence period of 15 years;

(*b*) by reason of the same agreement the company is precluded from disposing of or charging those assets; and

(*c*) the company has no prospect of enjoying the possibility of a capital appreciation of such assets at the expiration of that period. Mr. Lakha for the company contends that a payment made for the erection of a building or the purchase of land need not necessarily be looked upon as capital expenditure, and that the surrounding circumstances, including the purpose of the transaction, must be taken into account. In the present case the sole purpose, he says, was the earning of an income, and that the purchase of the land, the erection of the buildings and the acquisition of the casino licences were all one transaction. Relying on the judgment of Sir Kenneth O’Connor, P. in *Ralli Estates v. Income Tax*, [1958] E.A. 165 at p. 175 he submits that the court must look at both the form and the substance of the matter and that, although normally land and buildings constitute a capital asset and must be treated as such, in the present case the expenditure involved did not create such an asset for the agreement with the Government, under which the company was compelled to acquire the land and erect the buildings, was the price the company had to pay for the licences without which there would have been o income. Furthermore, he argues, had it not been for the agreement with Government requiring the company to acquire the land and erect the buildings suitable premises could have been rented and the rent claimed as an expense and little or no capital outlay at all would have been involved. In support of these contentions Mr. Lakha refers to a number of decisions which it is necessary to consider. In *Racecourse Betting Control Board v. Wild*, 22 T.C. 182, it was held that an annual sum fixed at a percentage of the cost of construction of certain buildings to be erected by a racecourse company and payable to that company by the board in consideration of the grant to the board of the exclusive right of user for a certain period of the buildings when erected and which, by a declaration not purporting to confer rights or obligations upon either party, was stated also to be in repayment of yearly instalments of the capital cost of construction of the buildings, constituted a revenue payment by the board and deductible for tax purposes. That case is clearly distinguishable from the present for there the expenditure on the buildings was being incurred not by the taxpayer board but by the company and the board itself was not acquiring a capital asset. There is no doubt that, as was said in *Mallaby-Deeley v. Commissioner of Inland Revenue*, 23 T.C. 153, at p. 166, upon which Mr. Lakha also relies, the distinction which is to be drawn for the purpose of the Income Tax Acts between payments of an income nature and payments of a capital nature is sometimes a very fine and rather artificial one and depends upon the precise character of the transaction. In the present case, however, I do not regard the distinction as being so very fine or in any way artificial. As Lord Denning said in delivering the advice of the Judicial Committee of the Privy Council in *Ralli Estates v. Income Tax*, [1961] E.A. 48, at p. 51, the court is entitled to look at the course of negotiations leading up to the agreement between the parties out of which the issue before it arises and in my opinion the answer to Mr. Lakha’s argument is to be found in the facts that, in the first place, the company was in no sense “compelled” to agree to surrender the premises to the Government at the end of the licence period for the entire transaction was purely voluntary and the undertaking to surrender the buildings was given expressly in consideration of the Government’s permission to allow the import of equipment free of duty and the entry into Kenya of expatriate staff; secondly, that the first recorded step in the matter, so far as is disclosed by the evidence, was the passing on 4 June 1968 of a resolution of the board of directors of the company authorising the acceptance from the Government of an offer to grant a casino licence on the terms set out in the agreement (including the provision for the surrender of the premises on the expiration of the licence) so that the entire project was initiated by the company rather than by the Government; and thirdly that it is hardly conceivable that the company, when it entered into this commercial bargain, was unaware of the implications of the fact upon which it now seeks to rely, namely, that the land so to be acquired and the buildings so to be erected would cease to constitute a capital asset of the company after the expiration of the licence. This view is, I think, consistent with the illustration given in *Ralli’s* case, at pp. 52 – 3 where Lord Denning said: “Their Lordships prefer therefore to turn back to the words of the Act and ask whether the payments were expenses wholly and exclusively incurred ‘in the production of the income’ of the payer: and this means that you must look at the purpose of the payments. Were they paid in order to acquire a capital asset? or for a capital purpose? If so, they are capital expenditure. But if for an income purpose, they are revenue expenditure. For instance, if a price is paid for freehold land, or a premium (properly so called) is paid for a long lease, it is not an expense incurred in the production of income, but in the production of capital. It is not deductible as revenue expenditure, no matter whether the price or premium is paid by a lump sum or by instalments. And this is true even when the lease is of a wasting asset, such as a coal mine, see *Mallett v. Staveley Coal and Iron Co.* (1928) 13 T.C. 772, at p. 778, by Rowlatt, J. Again, if a manufacturer expends money on machinery or plant which is used again in his manufacturing operations, it is capital expenditure, and is not deductible in assessing his income, no matter whether he pays for it cash down or any instalments. But if a trader pays money for trading stock which he means to sell to customers as soon as he can, it is an expense incurred in the production of income, no matter whether it is paid in a lump sum or by instalments: and it is deductible. Likewise with a rent, properly so called, which is paid for a lease out of which the lessee gets an income. It is a revenue expenditure and deductible.” Here the agreement for the surrender of the company’s asset was part of the cost of acquisition of the equipment and materials and the importation (as distinct from the wages) of staff. Admittedly, as Mr. Lakha said, it might not have been necessary in the present case for the company to have purchased the land for possibly it could have secured a suitable plot on a rental basis. In this event, however, although the rent would clearly constitute an allowable deduction, the claim now put forward for a deduction in respect of the purchase price would not have arisen. Reverting to the language of the Act, the loss of its capital investment by the company in 15 years will constitute, in my opinion, a “loss, diminution or exhaustion of capital” within the meaning of s. 14 (1) (*b*) and will not be saved by the provisions of either subsections (2), (3), or (5) of s. 13. Mr. Lakha relies upon s. 13 (1) of the Act and the general principles relative to the ascertainment of total income under the provisions of that section but these in turn are themselves subject to s. 14 (1) (*b*). For these reasons I must hold that the first ground of appeal fails. Turning now to the second ground of appeal it appears that in a letter dated 9 May 1972 addressed to the company and upon which this ground of appeal is based, the respondent wrote: “I refer to your visit to my office to explain your company’s problems in connection with the claim to depreciation allowances on its land and buildings. At the meeting you explained that in accordance with an agreement entered into between your Company and the Kenya Government the buildings and the land will be handed over to the Kenya Government after a fifteen year period and in view of the considerable financial outlay on these items you were requesting the Commissioner-General to invoke his powers under section 141 and grant special depreciation allowance so that when the time comes for your Company to relinquish the assets you will have recouped the above outlays. At that meeting I did explain that the powers given to the Commissioner-General under section 141 only cover two aspects namely not to assess and not to collect tax where equity would be gravely violated. His powers do not cover granting of any allowances. I have now duly consulted the Commissioner-General and he agrees with me that the problem is a special one and it is not covered by the powers given to him under section 141.” Sub-ss. (1) and (3) of s. 141 of the Act are as follows:

“(1) Notwithstanding the provisions of this Act, in any case where he is of the opinion that he should refrain from assessing to tax, or recovering tax from, any person by reason of ( *a*) u ncertainty as to any question of law or fact; or ( *b*) c onsiderations of hardship or equity; or ( *c*) Impossibility, or undue difficulty or expense, of recovery of tax, the Commissioner-General may, in his discretion, and subject to this section, elect to refrain from assessing or recovering the tax in question and thereupon liability to such tax shall be deemed to be extinguished or such tax shall be deemed to be abandoned or remitted, as the case may be, and the provisions of this Act other than this section shall no longer apply thereto. (3) No proceedings shall lie in any court to inquire into the refusal or failure of the Commissioner-General to elect to refrain from assessing or recovering tax under subsection (1).” Before dealing with the company’s submissions on this aspect of the case it is necessary to consider a preliminary objection taken by the respondent to this ground of appeal. This is shortly to the effect that the court has no jurisdiction to enquire into a refusal by the respondent to do otherwise than confirm the assessment, and reliance is placed on s. 141 (3). The company in reply claims that the refusal was based on the respondent’s mistakenly believing that he had no power to amend the assessment, that in so believing the respondent erred in law, and that the company is not precluded by s. 141 (3) from challenging the refusal. Being a taxing statute the Act must receive a reasonably strict construction and I read s. 141 (3) as meaning that no proceedings shall lie to inquire into the refusal or failure of the respondent *to elect* to refrain from assessing or recovering tax in the sense that the respondent, appreciating that he had a *choice* of courses open to him, namely, that of refraining from assessing or recovering tax or of not so refraining, and that in the knowledge of this position he exercised his choice. I am satisfied from the language of the respondent’s letter of 9 May 1972 that he was under the impression (rightly, in my view) that the purpose of the company’s approach to him was to seek the granting by him of a depreciation allowance. Such a request, as he correctly pointed out, was outside the purview of s. 141 and must be refused, but I am satisfied that, so far as the letter may be taken fairly to indicate what was in the respondent’s mind at the material time, he did not address himself to the making of an election such as is contemplated by sub-s.

(1) so that his action would therefore be protected from challenge by sub-s. (3). for these reasons I must hold that the preliminary objection fails. As to the issue raised by the second ground of appeal it follows from what I have said that s. 141 (1) confers upon the respondent, in any case where he is of the opinion that he should refrain from assessing to tax or recovering tax from any person by reason of considerations of hardship or equity, a discretionary power to elect to refrain from assessing or recovering the tax in question whereupon liability to such tax shall be deemed to be extinguished, or such tax shall be deemed to be abandoned or remitted, as the case may be. Looking again at the respondent’s letter of 9 May 1972 it is manifest, in the absence of any suggestion that the respondent misunderstood the request being made to him, that the company had requested him, in exercise of his powers under s. 141, to grant what he refers to as a “special depreciation allowance” so that at the end of the end of the licence period the company would have recouped its expenditure on the purchase of the land and the erection of the buildings. In answer to this request the respondent had no option but to reject it for the section gives him no power to grant allowances for depreciation or otherwise or in any way to vary or reduce (as distinct from refraining from making) an assessment. As he rightly stated in his letter the only powers given to him under s. 141 are either not to assess or not to collect tax. He has no power under the section to reduce or vary an assessment whatever hardship may be involved. For these reasons I am satisfied that the respondent was not mistaken in his view that he had no power to grant the company’s request mentioned in the letter of 9 May 1972 and that the second ground of appeal must fail. The appeal is accordingly dismissed with costs. *Appeal dismissed*

*.* For the appellant: *AA Lakha* For the respondent: *ASJ Tibamanya* (Principal Assistant Counsel) and *P Mulira* (Assistant Counsel)