KPMG

# Tax alert

## High Court Rules on Taxation of Product Gains on Petroleum Products

## Summary

This alert brings to your attention the High Court's decision in ***Commissioner of Investigations and Enforcement v Libya Oil Kenya Limited (Income Tax Appeal E104 Of 2021).*** This was an appeal by the Commissioner of Investigations and Enforcement (The Appellant) against the Tax Appeal Tribunal's decision issued in favour of Libya Oil Kenya Limited (The Respondent).

## Background

Parties to the Case

1. **Appellant:** Commissioner of Investigations and Enforcement (Kenya Revenue Authority - KRA).

2. **Respondent:** Libya Oil Kenya Limited.

The Appellant (KRA) had appealed against the decision of the Tax Appeals Tribunal (TAT) on the customs treatment on product gains. Specifically, the Appellant had sought to impose additional duties and levies of **KES 943,142,856** related to product gains after importation of petroleum products.

The Appellant had argued at the TAT that fluctuations in temperature or seasonal changes affect the observed volume of the product upon entry. Consequently, any gains in product volume following declaration ought to have been recorded under a separate manifest termed as a "zero manifest." This would entail a new entry distinct from the initial one, thereby making it liable for import duties.

However, the TAT disagreed with the Appellant's opinion and rendered judgment in favour of the Respondent.

### Appellant's Grounds of Appeal:

In its appeal, the Appellant raised the following grounds:

a) That TAT erred in law and fact by not appreciating the difference between customs entry and customs clearance and that the distinction is crucial in determining when and how goods are subjected to customs duties.

b) That TAT erred in law and fact in not appreciating the fact that product gains are entered under a new manifest called a zero manifest. The "zero manifest" requires that product gains be entered under a new customs entry different from the original.

c) The TAT erred in law and fact in not appreciating that the initial duty was paid based on the declared volumes of goods and the same released to the Respondent, and that the new entry was subject to duty.

d) The TAT erred in law and fact in not appreciating the entry under Section 34 of EACCMA is a self-entry which is verifiable only at the point of customs clearance and the volumes declared had been released to the Respondent, hence any extra volumes were undeclared and subject to duty.

e) The TAT erred in law and fact in not finding that duty is payable when the goods exit the customs area, and the volumes is what determines duty to be paid.

f) The TAT erred in law and fact in not finding that at all times the goods were under customs control, and it is only when they are released and verified that the correct volumes for customs purpose are ascertained.

### The Respondent's Arguments

In its response to the Appellant's grounds of Appeal, the Respondent raised the following grounds:

a) That the appropriate tax point for duties and levies on imported petroleum products is at the point of importation into the country. This is when the products are first assessed and duties are paid, and according to the Respondent, no additional duties should be applicable afterward.

b) That there is no provision in the statute that mandates product gains to be declared for customs a second time under a new manifest, called a zero manifest. The Respondent also argued that there is no legal requirement that such a new customs entry under the "zero manifest" must be subjected to additional import duties and levies.

c) That product gains are an inherent part of the petroleum products that have already been duty-paid. The Respondent also maintained that these gains, often due to operational factors like temperature changes or molecular expansion during storage and transit, should not be taxed again as they are already included in the volume for which duties were initially calculated and paid.

d) That the Appellant selectively levied additional duties on the product gains without granting the Respondent and other Oil Marketing Companies a credit for the corresponding product losses arising from the process. The Respondent argued that operational gains and losses should not be treated differently in terms of taxation. They emphasized that the same principle should apply to losses, suggesting that if gains were to be taxed, losses should similarly be credited, which is currently not the case.

### Issues for determination

In its judgment the High Court identified the following as issues for determination:

a) Whether the TAT erred in its judgment by failing to appreciate that product gains are not part and parcel of the petroleum products which are already duty paid and;

b) Whether the TAT erred in finding that there was no justification for levying additional taxes on petroleum products and that the same should be taxed under the Income Tax regime.

### High Court Decision

The High Court observed that both parties acknowledged that there are product gains and losses resulting from the petroleum products after the duties and taxes have been paid when the goods are imported for home use.

However, the High Court further held that applying import duty and levies on product gains is not anchored in law. The Court also found that the Appellant did not state under what provision of the law the taxation of product gains lies.

The High Court therefore held that the Appellant's assessment had no legal basis and went against the rules of statutory interpretation of taxing statutes.

In buttressing this point, the High Court emphasized the principle of strict interpretation of taxing statutes, referring to the decision in ***T. M. Bell v The Commissioner of Income Tax*, *1960 (EALR) 224***, which highlighted that tax laws should be clear and must not leave room for assumptions or implications to prevent any undue or unsupported tax liabilities.

Ultimately, the High Court dismissed the appeal, upholding the judgment of TAT and concluded that the Appellant had not adequately demonstrated a legal basis for the alleged tax on petroleum product gains.

### Our opinion

The High Court's decision provides the much-needed clarity to Oil Marketing Companies (OMCs) that petroleum product gains realized after import duty assessed by Customs authorities has been duly paid at the point of importation are not subject to any further tax.

Further, this decision creates certainty in OMCs business operations from a tax perspective. Thus, enabling them plan and execute their business strategies accordingly.

The judgment also emphatically reinforces the principle that tax laws must be interpreted strictly and precisely. It underscores that only clear and unambiguous terms in a statute can serve as a basis for taxation, which is crucial for maintaining fair and predictable tax enforcement.

KPMG is happy to assist on any issues arising from this decision.

## Contacts

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