KPMG

Tax Alert

Import Duty and Levies on Petroleum Product Gains

Summary

This Alert brings to your attention the Tax Appeals Tribunal's ("the TAT" or Tribunal") judgement in the case of **Libya Oil Kenya Limited (Appellant) vs. Commissioner of Investigations and Enforcement (Respondent)** on import duty and levies on petroleum product gains.

Facts

The Respondent conducted a transfer pricing review on the Appellant's transactions for the years 2012 to 2014. Upon the issuance of preliminary audit findings for an estimated principal tax liability of ***KES 613,519,718,*** and following several consultative meetings and the Appellant's formal response to the preliminary findings, the Respondent issued a notice of assessment on 6 July 2018 demanding additional taxes amounting to ***KES 10,074,047,904*** for the years 2010 to 2016, broken down as follows:

Description	Amount in KES
Product gains	9,972,167,953.68
Variance between product purchases and duty paid volumes	13,674,657.08
Variance between turnover for VAT and Corporation Tax	11,477,626.36
Application for Section 90(1) (now repealed) of the Income Tax Act ('ITA')	76,743,255.00
	10,074,063,492.00

The Appellant lodged a Notice of Objection dated 2 August 2018 and the Respondent issued its Objection Decision dated 3 September 2018 confirming the Assessment in its entirety.

The Appellant, being dissatisfied with the Respondent's Objection Decision, filed a Notice of Appeal to the Tribunal on 1st October 2018.

At the request of the Respondent, the parties agreed to engage in Alternative Dispute Resolution discussions and a partial consent was recorded on 15 December 2020 with the Tribunal.

The parties submitted the unresolved principal tax assessment of ***KES 943,152,856*** on product gains arising from Kenya Pipeline Company (KPC) gains, temperature gains, hospitality gains and storage terminal gains to the Tribunal for determination.

The Appellant's key arguments before the Tribunal were that:

i. The Respondent had violated the Appellant's right to natural justice and fair administrative action as protected under the Constitution of Kenya, 2010, by failing to provide reasons for its Objection Decision contrary to the provisions of the East Africa Community Customs Management Act, 2004 (EACCMA) as read together with the Fair Administrative Actions Act, 2015.

ii. The Respondent's demand for tax for the years 2010 and 2011 was beyond the five (5) year statutory time limit prescribed under Section 31(4)(b) of the Tax Procedures Act.

iii. Product gains are part and parcel of the petroleum products for which duty is already paid directly to the Respondent by the Oil Marketing Companies (OMCs) and in specific cases, the importer pays all the duties and levies on behalf of the other OMCs and subsequently seeks reimbursement from the OMCs.

iv. Each of the petroleum facilities are manned by the Kenya Revenue Authority (KRA) Petroleum Monitoring Unit officers who ensure processing of relevant documentation upon payment of duties and levies before release of products to the OMCs. As such, no additional duties and levies are due and payable on the same petroleum products that were cleared and released by Customs.

v. The law only contemplates the payment of duties and levies at the point of importation and entry of goods into the country for home use, and at no other point. Therefore, subjecting petroleum products to taxation within the country would result in double taxation of the petroleum products which is not envisaged by the law.

vi. The assessment on the alleged 'product gains' was not based on any legal provision as there was no provision under the EACCMA and the Repealed Customs and Excise Act ('CEA') or any other law or regulation for the assessment of additional duties and levies on imported goods upon which duties and levies had already been paid, due to volume changes attributable to the nature of the product (such as product gains).

In response to the Appellant's arguments, the Respondent submitted as follows:

i. The parties had had numerous meetings and correspondence over the same issue where the reasons for the assessment, notice of objection and the decision were discussed. Further, the Respondent had issued a clarification letter to the Appellant within EACCMA timelines to give further explanation on the decision.

ii. The Respondent had powers to amend the self-assessment by the Appellant after the statutory limit of five years if it established that there was blatant failure to account for taxes. According to the Respondent, the Appellant`s conduct constituted a calculated scheme to evade taxes.

iii. The Appellant's arguments on product gains substantially related to dry cargo and not petroleum and that the payment of taxes on petroleum and petroleum products varied from ordinary dry goods which are taxable at the point of importation.

iv. The product gains used to compute taxes were obtained from the Appellant's books and the same was reflected in its financial statements. The Respondent treated them as such since the Appellant had recognised the gains in its books.

v. Duty paid products were drawn based on COSIS. Once the duty paid product was drawn, any remaining volume could only be drawn using zero manifests. Whatever was left was considered as "not duty paid" as the duty paid volumes had already been dispatched. Therefore, the gains made by the Appellant on the said period had not previously been taxed and the same ought to be brought to charge and taxed.

vi. From the analysis of the Appellant's inventory management, the Appellant had realised and recognised product gains on various products for the years 2010-2016, and the Appellant had in certain instances written to the Respondent to be allowed to draw product volumes (gains) on zero manifests. Therefore, the Appellant could not disown the fact that it did fill in zero manifests as there were gains by the Appellant and duty on the said gains had not been paid for.

vii. In response to the Appellant's contention that the product losses should have been netted off from the product gains, as a condition to claim this, the Appellant had to demonstrate how the loss occurred and must have supporting evidence to support the same before the loss could be allowed.

Issues for determination

The Tribunal framed the following issues for determination:

a) Whether the Respondent failed to provide reasons for its decision contrary to the provisions of the East Africa Community Customs Management Act, 2004 (EACCMA) as read together with the Fair Administrative Action Act, 2015;

b) Whether the Respondent erred in assessing duties and levies on the "product gains"; and

c) How should "petroleum product gains" and "petroleum product losses" be treated for tax purposes?

Findings

a) Whether the Respondent failed to provide reasons for its decision contrary to the provisions of the East Africa Community Customs Management Act, 2004 (EACCMA) as read together with the Fair Administrative Actions Act, 2015.
The Tribunal opted to address the substantive matters relating to the Appeal and not the procedural issues. The Tribunal observed that the parties had engaged extensively during the Alternative Dispute Resolution process which led to a part settlement of the issues.

b) Whether the Respondent erred in assessing duties and levies on the "product gains".
The Tribunal agreed with the Appellant's position that the tax point with regard to petroleum products for the payment of the various duties and levies is when the goods are imported and entered for home use measured at 20 degrees Celsius, a process that normally takes place prior to the release of the product to the OMCs by the Respondent and after payment of applicable duties and taxes at the point of entry.
The Tribunal noted that the Respondent had not disputed payment of taxes upon release of the products by Customs and it was persuaded that there was no basis on which the Respondent could levy additional taxes on product gains.

c) How should "petroleum product gains" and "petroleum product losses" be treated for tax purposes?

The Tribunal found that there was no justification for the levying of additional taxes on petroleum product gains entered for home use since they were already duty paid.

It followed therefore that, any products gains, or product losses should only be dealt with under the Income Taxation regime which levies taxes on profits or gains of a business and therefore, "product gains" or "product losses" are Profit and Loss items in a business' books.

Based on the above, the Tribunal:

i. Adopted the partial consent entered by the parties on 15 December 2020;

ii. Set aside the Respondent's Objection Decision relating to tax assessment of ***KES 943,152,856*** on product gains; and

iii. Ordered each of the parties to bear their costs.

Our opinion on the judgement

This judgement is a welcome relief to the oil and gas industry. The move by the KRA to collect import duty and levies on product gains is not anchored in law and this, if allowed, would set a wrong precedent. It is however critical to take note of the Tribunal's pronouncement to the effect that such gains or losses ought to be accounted for and taxed as business profits or income.

The judgement goes a long way in reinforcing the provisions of EACCMA and Miscellaneous Fees and Levies Act on the fact that payment of duties and levies are administered at the point of importation and entry of goods into the country for home use, and not once the goods are already within the country having been cleared and verified by the KRA's customs officers.

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

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