



Tax Alert

Uncertainty in the application of Withholding Tax on trade payables (ordinary trade debt)

August 2024

Do you have trade payables, or any amounts owed to a non-resident on your balance sheet?

The KRA has in previous instances been deeming trade payables as “loans” and collecting withholding tax on the deemed interest.

In 2020, a taxpayer (Socabelec East Africa Limited) approached the Tax Appeals Tribunal (“TAT”) for a determination on whether the Kenya Revenue Authority (“KRA”) could impose withholding tax on deemed interest for supplier balances that are payable for invoices.

TAT Decision

The TAT in a judgement issued in 2020 decided that because the Income Tax Act (“ITA”) does not define the term “loan”, it would use the definition of “all loans” provided in section 16(3) of the ITA.

According to Section 16(3), “all loans” include a “loan”, “trade debt” or “other forms of indebtedness” for “which the company is paying a fixed charge, interest, discount or premium”.

Therefore, the TAT concluded that for any form of indebtedness to qualify as a loan, there must be a fixed charge, interest, discount or premium.

High Court decision

The KRA appealed the TAT’s decision to the High Court. The KRA argued that since the ITA doesn’t define the term “loan”, the ordinary meaning of loan should apply.

However, the High Court did not use the ordinary meaning but followed its earlier ruling in the case of Commissioner of Domestic Taxes v Dominion Petroleum Kenya Limited. In that case, the High Court had previously decided that deemed interest applies to interest-free loans from foreign entities in Kenya.



The Court ruled that withholding tax applies to loans owed to non-resident entities regardless of whether there is interest charged. The only difference is that where there was no interest, deemed interest would apply at the 91-day Treasury bill rate.

The High Court also ruled that the TAT was wrong in saying that a loan must include a fixed charge, interest, discount, or premium to qualify. The correct interpretation is that deemed interest applies to interest-free loans.

This publication has been prepared as general information on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice.

NAHASHON.W.MWANGI
Audit & Tax Associate
nahashon@ema-advisory.com
+254 727 647 428

JAMES.N.NDIRANGU
Audit & Tax Associate
James@ema-advisory.com
+254 701 504 337

In 2020, a taxpayer (Socabelec East Africa Limited) approached the Tax Appeals Tribunal for a determination on whether the Kenya Revenue Authority could impose withholding tax on deemed interest for supplier balances that are payable for invoices



Observations

The KRA had asked the High Court to overturn the Tribunal’s decision, arguing that the Tribunal wrongly used the definition of ‘all loans’ from Section 16(3) instead of relying on the ordinary meaning of the term “loan” and as a result it reached the erroneous conclusion that for any form of indebtedness to qualify as a loan, there must be a fixed charge, interest, discount or premium.

In the appeal, the KRA also argued that for a debt to be considered a loan in the ordinary sense of the word, it doesn’t need to have a fixed charge, interest, discount, or premium.

In its decision, the High Court seems to have resolved the question whether Section 16(3) of the ITA applies to charging withholding tax on deemed interest. The court’s position is clear from its support of the Dominion Petroleum Kenya Limited case.

The case clarified that if a loan from a non- resident includes interest, withholding tax would apply at the rate listed in the Third Schedule of the ITA.

If there is no interest, withholding tax would still apply to the ‘Deemed Interest’ at the 91-day Treasury Bill rate.

What the High Court did not provide clarification on is the definition of a loan. In its Judgement, the High Court states that *“it is clear that if **there is an indebtedness** to a non-resident entity, withholding tax would apply whether there was interest payable or not”*.

The ITA in its definition of deemed interest does not use the term “indebtedness”.

It instead uses the term “loan.”

It may be considered that the opportunity to distinguish between “a loan” and “indebtedness” was missed. For instance, the ITA in section 2 lists ‘loan’ and ‘debt’ separately in its definition of interest.

Cases in the Commonwealth have in the past also noted that “though a loan contracted creates a debt, there may be a debt created without contracting a loan; in other words, the concept of debt is more comprehensive than that of loan.”

The High Court decision may need to be interpreted and applied within the specific context of the case. This is because the form of debt under consideration in Socabelec’s case were trade payables that were classified as “borrowings” in the financial Statements (balance sheet). In the Dominion Petroleum Kenya Limited case relied on in the High Court decision, the debt was contained in contractual financing agreements. However, the TAT issued a decision on June 28, 2024, in **Heineken East Africa Import Company Ltd v. Commissioner of Investigation & Enforcement (Tax Appeal No. E021 Of 2023)**, which found that the KRA could assess a taxpayer for withholding tax on trade payables.