

AUTOMOBILE ASSOCIATION OF KENYA VS. COMMISSIONER DOMESTIC TAXES – GOOD TAX PLANNING

Prior to its amendment by the Finance Act, 2023, Section 21 of the Income Tax Act (ITA) exempted from taxation the income of bodies of persons that primarily serve their members, provided that not less than three-quarters of such income was derived from those members.

In a recent case, the Tax Appeals Tribunal ("the Tribunal") ruled that driving school learners affiliated with AA Kenya and classified as ordinary members under the Constitution of AA Kenya qualified as bona fide members. As a result, the income derived from these learners, was exempt from taxation.

BACKGROUND

Automobile Association of Kenya ("AA Kenya") was founded in 1919 and was registered in Kenya as an association in 1993, to promote and safeguard the interests of its members who are mostly motorists. AA Kenya also provides valuation services, maintenance and repair of vehicles, road mapping, technical training to its members, towing services, rescue services, driving classes among other services to its members.

The Kenya Revenue Authority (KRA) conducted a verification exercise on AA Kenya's operations covering the financial years 2016 to 2020. The exercise resulted in the KRA issuing a Corporate Income Tax (CIT) assessment amounting to over 27 million Shillings. The additional assessment was issued on the basis that AA Kenya did not qualify to be a members' club under Section 21 (1) of the Income Tax Act because more than 50% of its gross income was derived from driving school learners who did not qualify to be members.

AA KENYA'S SUBMISSIONS

AA Kenya submitted that its Constitution classifies members into 3 different categories, Honorary members, Life members and Ordinary members. AA Kenya submitted that despite the different levels, AA Kenya subjects its learners to the same recognition, and they have membership right to attend the Annual General Meeting and participate in the voting process.

AA Kenya maintained that learners are ordinary members because they were registered as ordinary members of the association upon payment of membership access fee. To substantiate this position, AA Kenya

produced a sample membership access card, sample membership application form and sample invoices. The invoice indicated that Suleiman Sudi, a learner, paid Kshs. 18,700 broken down as follows: Kshs. 15,500 for driving lessons, Kshs. 700 for the AA Manual, Kshs.580 for service charge and Kshs. 2,000 for Access Membership.

The ITA defines a member to mean:

> *"in relation to a members' club, a person who, while he is a member, **is entitled to** an interest in all the assets of such club in the event of its **liquidation**"*

AA Kenya submitted that the definition of "member" as per the ITA imposes an event or possibility of liquidation as a condition to determine "entitlement". AA Kenya opined that it is only at the point of liquidation that a member's right to the interest will crystalize.

AA Kenya submitted that the fact that the entire membership under Section 21 is tied to the hip to liquidation indicates that "entitlement" and by extension membership of AA Kenya is a prerogative a function of AA Kenya's contributories and creditors on instruction of a competent court as per the insolvency Act, 2015.

AA Kenya submitted that upon liquidation the provisions of the Insolvency Act, 2015 override any written law in respect with member entitlements. From the foregoing AA Kenya submitted that there was no provision under the ITA that allowed the KRA to inspect its accounts and determine whether its members are entitled to the assets in the event of liquidation.

AA Kenya opined that any right, material or immaterial, significant or insignificant were granted to its members is reasonable and falls under the purview of entitlement under Section 21 of the ITA.

Furthermore, AA Kenya, relying on the precedent set forth in ***Keroche Industries Limited vs. Kenya Revenue Authority & 5 others***, submitted that where the interpretation of "member" under the ITA resulted in two or more possible meanings the inclination of the court should be against a construction or interpretation which imposes a burden on the taxpayer.

AA Kenya opined that, like other members, the learners are eligible to shift their membership grade and renew their subscription annually. Members are encouraged to renew their subscriptions but no one is compelled to do so, this treatment is consistent for all the members.

KRA'S SUBMISSIONS

The KRA submitted that the driving school learners did not qualify as members of the club because:

i. The learners are given "temporary access" to the driving school facilities for a limited period of time only. It does not entitle them to other services offered by AA Kenya.
ii. The membership cards issued is only proof of entitlement to specific services such as emergency rescue or driving lessons but does not mention entitlement to assets.
iii. The learners real motive when engaging AA Kenya is to obtain training services and not membership to a member's club. That is why there is no continued subscription after completing the driving lessons.
iv. The membership fee charged is akin to registration fees charged by other colleges, which does not entitle the students to the assets of the college.
v. In ordinary member's club, members are subjected to vetting and recommendation before admission as members but in AA Kenya's case, the alleged members are walk in clients, meaning that there is no long-term commitment between the learners and the Association.
vi. The KRA argued that AA Kenya is not expressly registered as a members' club hence there is no evidence it is a member's club.

ISSUE FOR DETERMINATION

> *Whether AA Kenya's driving school learners meet the threshold of a "member" as defined under Section 21(3) of the ITA*

TRIBUNAL'S ANALYSIS AND FINDINGS

The Tribunal held that the learners were indeed members of the Association as per the Constitution of the Association.

The Tribunal noted that the ITA only recognizes members if those members are entitled to a share of the assets of the Association upon liquidation. The Constitution of AA outlines the rules on dissolution of the Association but does not mention the interest of members in the assets of the Association in the event of liquidation. Wherefore, the Tribunal held that such entitlement would only be determined by a court of

competent jurisdiction as stipulated under the Insolvency Act.

In the absence of a determination under the Insolvency Act, alienating the ordinary members from entitlements to the assets of the Association upon liquidation, the Tribunal ruled that the ordinary members were to be treated as members as per Section 21(3) of the ITA.

APPEAL TO THE HIGH COURT

Dissatisfied and aggrieved by the entire decision of the Tribunal, the KRA lodged an appeal before the High Court, submitting that the Tribunal had erred in law by holding that AA Kenya's driving school learners met the threshold of a "member" as defined under Section 21(3) of the Income Tax Act. The KRA urged the Court to set aside the decision of the Tax Appeals Tribunal in its entirety.

The Court held that determining whether the learners became members upon paying membership fees was a factual issue that the Tribunal was best placed to decide. The Court found no legal or factual error in the Tribunal's reasoning or conclusion and stated that it had no jurisdiction to re-evaluate evidence on a second appeal.

Given the Tribunal's sound determination that the learners were indeed members, the Court found no error in the Tribunal's interpretation or application of the law that would justify setting aside its decision.

CONCLUSION

This case underscores the importance of obtaining tax advice and considering tax implications from the onset when registering any business. The Tax Procedures Act (TPA) and the Income Tax Act (ITA) do not prohibit taxpayers from engaging in tax planning, which involves organising affairs in a way that incidentally results in tax savings. Proper tax planning can help ensure compliance and optimise tax benefits, highlighting the need for thorough and informed tax strategies in business operations. For tax advice, please contact Tabitha at ***tmuchiri@cmadvocates.com***

HOW WE CAN ASSIST

Our team of experienced tax consultants and legal experts can help you with tax advisory to ensure compliance, we review and advise on tax filings and audits to ensure compliance with tax laws. and we also assist with dispute resolution and representation if you find yourself facing issues with the KRA or other tax authorities. Don't risk facing penalties or tax assessments. Let us help you stay on top of your tax obligations and keep your business running smoothly. For any queries contact the contributors through taxteam@cmadvocates.com.

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