

Sagamore Hill. TAX NEWSLETTER.



Taxation of member welfares and trade associations.

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Every month for the last four years, we make publication of tax caselaws with the aim of keeping you up to date with the recent landmark tax rulings, from the tax appeal tribunal and the courts.

In this issue, we delve into taxation of member welfare associations, both for VAT and income tax. In this case, an assessment was done on Law Society of Kenya for both VAT and Income tax, where LSK objected the commissioner's assessment and later went to the tribunal.

The appeal was premised on the following issues,

1. That the Respondent erred in law and in fact by subjecting Membership fees to VAT contrary to Paragraph 11, Part II of the First Schedule to the Value Added Tax Act, 2013 (VAT Act).
2. That the Respondent erred in law and in fact by subjecting Practising Certificate fees to VAT contrary to Paragraph 11, Part II of the First Schedule to the VAT Act.
3. That the Respondent erred in law and fact by subjecting Continuous Professional Development (CPD) fees to VAT contrary to Paragraph 3, Part II of the First Schedule to the VAT Act.
4. That the Respondent erred in law and fact by subjecting fees charged for the Law Society Annual Conference to VAT contrary to Paragraph 3, Part II of the First Schedule to the VAT Act.
5. That the Respondent erred in law and fact by subjecting funds meant for charitable projects (Project Funds) to VAT.
6. That the Respondent erred in law and fact by subjecting fees charged by the Appellant for the Justice Cup games to VAT.
7. That the Respondent erred in law and fact by subjecting other ancillary income earned by the Appellant for services rendered to members such as library fund contributions and CSR donations to VAT.
8. That the Respondent erred in law and fact by subjecting the Appellant's Building Levy fee to VAT.

The appellant was.

1. The Respondent erred in law and in fact by subjecting membership fees to VAT contrary to Paragraph 11, Part II of the First Schedule to the VAT Act

On this issue, the appellant reinstated that its functions, as outlined in the LSK Act as read together with the Advocates Act clearly demonstrate that it does not carry out any business activities for profit. That rather, it serves a public interest role of regulating the legal profession by issuing practising certificates, setting ethical and professional standards, and mandating continuing professional education for advocates. That its initiatives are geared towards the advancement of legal education and the administration of justice, which are integral to its statutory mandate, as such, it operates as a professional body dedicated to the promotion of legal standards and not as a business enterprise.



The appellant further relied on the case of **Sigona Golf club** where the tribunal had determined that entrance and subscription fees are exempt from VAT pursuant to the VAT Act Par 11, Part ii.

2. The Respondent erred in law and in fact by subjecting practising certificate fees to VAT contrary to Paragraph 11, Part II of the First Schedule to the VAT Act

The appellant asserted that the issuance of practising certificate is exempt from VAT on two ground,

1. That the fee for acquiring a PC is equivalent to a —membership fee|| which would be an exempt supply pursuant to Paragraph 11 of Part II of the First Schedule to the VAT Act
2. That the issuance of PCs is not provided by way of business but rather as a means of ensuring that its membership has attained the legal threshold for practising as an Advocate.

Reliance was placed on of **Law Society of Zimbabwe v. Zimbabwe Revenue Authority, HC 6324/16** where the court ruled that membership fees were intended to support the society's regulatory and public interest functions rather than generate profit.

3. The Respondent erred in law and fact by subjecting fees charged for Continuous Professional Development (CPD) events to VAT contrary to paragraph 3, Part II of the First Schedule to the VAT Act

The appellant averred that the respondent erred on two grounds.

1. The CPD Programs qualify as education and vocational training which the Appellant offers exclusively to its membership;

The Appellant maintained that it administers the CPD program not as a commercial venture, but rather as a compulsory professional requirement in accordance with its statutory obligations as outlined in Section 4(e) of the LSK Act which mandates it to actively promote the acquisition of legal knowledge among its members and associated service providers, such as paralegals, by upholding rigorous standards of legal education and training.

2. The exemption for vocational training under the VAT Act does not impose any specific limitations on who can offer such training.

The Appellant further contended that the VAT Act does not restrict or exclude any parties from benefiting from tax exemptions when offering vocational training. That the only criteria to be met by a taxpayer in order to qualify for the exemption is proof that the body or entity offers vocational training or technical education.

4. The Respondent erred in law and in fact by subjecting fees charged for the Law Society Annual Conference to VAT contrary to Paragraph 3, Part II of the First Schedule to the VAT Act.

The appellant argued that the Conference functions as a pivotal platform for legal practitioners, scholars, policymakers, and stakeholders to converge, exchange ideas, and engage in robust discourse on pertinent legal issues facing Kenya and the broader global community. Further, the appellant argued that at its core, the Annual Conference serves an educational purpose, offering attendees access to cutting-edge insights, trends, and developments across various legal domains through keynote addresses, panel discussions, workshops, and seminars. That this educational aspect not only facilitates Continuous Professional Development among lawyers but also fosters a culture of lifelong learning within the legal fraternity.

5. The Respondent erred in law and in fact by subjecting funds meant for charitable projects (Project Funds) to VAT.

The appellant averred that the project funds do not constitute taxable supplies but rather are donations specifically designated for various training and legal initiatives conducted in partnership with other organisation.

The Appellant asserted that donations are not

payments for goods or services rendered but are intended solely to advance the public good through collaborative efforts with partners, thereby falling outside the scope of taxable supplies.

6. The Respondent erred in law and fact by subjecting fees charged for Appellant's the Justice Cup games to VAT

The appellant submitted that the amounts received during this competition is applied to sponsorship of costs that participants incur, such as providing foods, tent hire, marketing, and venue hire and purchase of awards for presentation to winning participants.

7. The Respondent erred in law and in fact by subjecting other ancillary income for services rendered to members such as library fund contributions and Corporate Social Responsibility (CSR) donations to VAT.

The Appellant explained these incomes as follows:

1. Library fund contribution: This income originates from fees or contributions paid by members of the library to support its maintenance, acquisition of new materials, and expansion of services.
2. LSK journal levy: The levy is collected from members to fund the publication and distribution of the LSK journal, which is a periodical associated with the Appellant's activities.
3. Identification cards fees: These fees are charged for issuing identification cards exclusively to members of the Appellant.
4. Donations for CSR activities: That it attached copies of reports from the CSR activities carried out within the period to its Appeal bundle.

5. Legal awareness week income: Income generated during Legal Awareness Week are from participation fees, sponsorships, or donations aimed at supporting public legal education and awareness initiatives hosted by the Appellant.



8. The Respondent erred in law and in fact by subjecting the Appellant's Building Levy fee to VAT.

The appellant averred that the fee serves as a financial mechanism to facilitate the construction, renovation, and upkeep of premises owned by the Appellant including office buildings, conference facilities, and administrative centres, which are instrumental in providing essential services to its members and the broader legal community.

9. The Respondent erred in law and in fact by concluding that the Appellant offers consultancy services since its training services extended beyond the members to the public.

The Appellant stated that informed by its objectives under the LSK Act, it undertakes various CSR programs that help in promotion of access to justice. That these programs include public interest litigation, legal awareness week and training of members of the general public. That training services are offered, and members

participate by giving their expertise during these programs. That these programs are not offered by way of business or for profit but as charitable activities

The courts' ruling.

On membership and practising fees.

The court relied on the provision of the Advocate Act which provides that ***those fees together with the fees for practising certificates and the Society's annual subscriptions, both of which shall be collected by the Society, shall be applied by the Society to all or any of the objects of the Society.*** Further, the objective of the appellant as defined the LSK Act, which include, assisting the governments in matters legislation, advance the rule of law, protect and assist the members of public on matters of law, enhance the matters of law formulate policies that promote the restructuring of the legal profession in Kenya which all do not point to a business motive or reason.

On CPD income.

The court noted that VAT Act exempts the supply of education services by an institution established for the promotion of adult education, vocational training or, technical education, noting that there is an existing proviso where such services must not be rendered by way of business. However, the act does not define what vocational is, with respect to vocational training therefore placing reliance on the definition in the Oxford Dictionary defining this as ***vocational means connected with the skills, knowledge, etc. that you need to have in order to do a particular job.***

The court relied on section 4 of the LSK Act that provided all the training mandates that the institution has, therefore making the court conclude that the appellant provided vocational training.

Project funding.

The tribunal noted that the appellant received the funds designated to various projects that are conducted together with other partners. Therefore, the tribunal found, the there is no evidence that the Appellant received the donated

funds in exchange for a supply of any good or service.

Justice cup income.

The court agreed with the appellant that these incomes were not generated with a business motive, and that the amounts collected were used exclusively in the facilitation of the competition activities.

Other Incomes

The tribunal agreed with the appellant, noting that, these incomes were not received in exchange of taxable service.

On Building levy

The respondent had argued that appellant is not an education institution and that these fees were charged for supply of taxable service. The tribunal noted that that the purpose of building levy income, explained by the Appellant is to facilitate the acquisition, construction, renovation, maintenance of premises, and development of office buildings, conference facilities, and administrative centres which are instrumental in providing essential services to its members and the broader legal community.

On whether the Appellant rendered these services to its members by way of business, the Tribunal noted that the nature of the Appellant's objects, on which it applies the building levy, does not in any way or form indicate a commercial or profit-making motive. The building levy is statutorily imposed and collected by the Appellant and applied to its objects. The Tribunal held that the services provided to its members as facilitated by the building levy were not rendered by way of business.

Our commentaries.

The taxation of member's welfare, and trade associations had experience a lot of changes recently. The Finance Act of 2023 introduced the most recent changes in **section 21 of income tax act** where these institutions are now considered to be engaging in business for all monies received, except joining fees, welfare contributions and

subscriptions. Earlier, these institutions were required to elect in writing to the commissioner, to be doing business, for them to be treated as such. The implication this amendment is that, any income received by such institution, and does not fall within the ambit of those exemptions, will be treated as income chargeable to tax. We provided much more clarity on this issue in our prior issue accessible [here](#).

This decision further gives clarity on the interpretation and application of the exemption schedule.

The member's welfare associations and clubs are largely registered in the Society's Act, and other in the Company's Act as companies limited by guarantee.

First schedule of VAT provides the transactions that are exempted from VAT, and this is where Paragraph 3 of the schedule exempts certain stipulated activities that are of educational in nature. The paragraph provides as follows.

The supply of education services For the purposes of this paragraph, education services means education provided by—

- a. A pre-primary, primary, or secondary school;
- b. A technical college or university;
- c. An institution established for the promotion of adult education, vocational training or, technical education but shall not apply in respect of business or user training and other consultancy services designed to improve work practices and efficiency of an organization.

Paragraph 11 further exempts some certain institutions provided as follows.

11. The supply of -

- (a) services rendered by educational, political, religious, welfare and other philanthropic associations to their members, or*
- (b) social welfare services provided by charitable organizations registered as such, or which are*

exempted from registration, by the Registrar of Societies under section 10 of the Societies Act (Cap. 108), or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organization Co-ordination Act (Cap. 134) and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act (Cap. 470), and approved by the Commissioner of Social Services:

Provided that this paragraph shall not apply where any such services are rendered by way of business.

Of importance to note, these institutions should make sure that they abide with the proviso, whereby, they should look into their activities to ascertain that they are not conducting these activities by way of business, where these activities would then become chargeable to VAT.

The important thing to note for trade associations, is the need for them to align their activities with the provisions of the articles of associations, or where such associations are formed by an act of parliament, like the appellant in this case, then the Act that establishes them has to provide in clear terms the objectives of the said welfare and trade associations as further buttressed by the case of ***Kenya Association of Music Producer Vs Commissioner of domestic taxes 13/2020***.

There has been, however, notable changes in the taxation of trade and welfare associations, where, the earlier provision was to require such organisation to elect to the commissioner to be carrying out businesses, but this has since been amended to regard all income received by such organisation to be taxable incomes, excluding any amount received as joining fees, welfare contributions and subscriptions only.

While clarity is still required on what subscription fees is, substance, and not mere labelling of funds as subscription fees, has to be taken into consideration.

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