Unilever Kenya Limited v Commissioner of Customs and Border Control (Tax Appeal E007 of 2024) [2024] KETAT 1653 (KLR) (21 November 2024) (Judgment)

Neutral citation: [2024] KETAT 1653 (KLR)

REPUBLIC OF KENYA

IN THE TAX APPEAL TRIBUNAL

TAX APPEAL E007 OF 2024

CA MUGA, CHAIR, BK TERER, EN NJERU, E NG'ANG'A & SS OLOLCHIKE, MEMBERS

NOVEMBER 21, 2024

BETWEEN

UNILEVER KENYA LIMITED ..... APPELLANT

AND

COMMISSIONER O CUSTOMS AND BORDER CONTROL ..... RESPONDENT

JUDGMENT

Background

1. The Appellant is a company incorporated in Kenya under the *Companies Act*, CAP 486 of the Laws of Kenya. The Appellant's principal business activity is the manufacture and sale of food, home, beauty, wellbeing and personal care products in the East Africa region.

2. The Respondent is a principal officer appointed under Section 13 of the *Kenya Revenue Authority Act*, CAP 469 of Kenya's Laws (hereinafter "the Act"). Under Section 5 (1) of the Act, the Kenya Revenue Authority is an agency of the Government for the collection and receipt of all tax revenue. Further, under Section 5(2) of the Act with respect to the performance of its functions under subsection (1), the Authority is mandated to administer and enforce all provisions of the written laws as set out in Part 1 and 2 of the First Schedule to the Act for the purposes of assessing, collecting and accounting for all revenues in accordance with those laws.

3. The Respondent undertook an audit of the Appellant's import and export operations for the period between 2018 and May 2023. Upon conclusion of the audit, the Respondent issued a demand notice for additional taxes amounting in the sum total to Ksh. 1,875,950,576.00 through a letter dated 29th September 2023.The Appellant responded to the demand notice through a letter dated 26th October 2023 objecting to the entire demand.

4. After reconciliation meetings and provision of further documentation, the Respondent issued a review decision dated 24th November, 2023 revising the demand amount attributed to export consignments

downwards from Kshs. 993,191,100.00 to Kshs 353,052,475.00;Upholding the demand amount attributed to tariff classification of the imported flavour powders; and Upholding the demand amount attributed to royalty payments.

5. The Respondent in its review decision confirmed that the tax due by the Appellant was Kshs. 1,235,811,951.00. The Appellant, aggrieved by the Respondent's review decision filed its Notice of Appeal on 21st December, 2023.

6. On 11th September, 2024 a partial judgement was entered by the Tribunal in terms of the partial consent by the parties dated and filed on 24th July, 2024. The result of the partial judgement is that the excise duty amounting to Ksh. 9,850,948.00 and VAT of Kshs. 343,201,527.00 both in respect of the period 2018 to 2022 in relation to exports without certificates of exports were vacated.

The Appeal

7. The Appeal as contained in the Memorandum of Appeal dated and filed on 4th January, 2024 was premised on the following grounds:

    a. That the royalty payments made by the Appellant are neither related to the goods under consideration nor a condition of sale of those goods and thus should not form part of the transaction value as an adjustment.

    b. That the four (4) flavour powders imported by the Appellant are raw materials of a kind used in the food industry and are classifiable under HS Code 3302.10.00 as per General Interpretation Rules (hereinafter "GIRs") 1, 3(b) and 6.

    c. That the Respondent had issued tariff rulings classifying lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour under tariff code 3302.10.00 thereby creating a legitimate expectation that HS Code 3302.10.00 was the correct tariff code in the declaration of the products.

    d. That all export consignments by the Appellant were duly processed by the Respondent and exited the country.

    e. That the assessment is arbitrary and unreasonable.

Appellant's Case

8. The Appellant set out its case in its Statement of Facts dated and filed on 4th January, 2024 wherein it stated as follows:

9. That the Respondent undertook an audit of its import and export operations for the period between 2018 and May 2023 whereupon the Respondent on conclusion of the audit, issued a demand notice for additional taxes of Kshs. 1,875,950,576.00 in a letter dated 29th September 2023.

10. That in the said demand, the Respondent detailed its following findings as the basis for the additional tax assessment:

    a. That the Appellant had made royalty payments to Unilever Global IP Limited (under General Licence Agreements) that were not included in the customs values.

    b. That the Appellant had misclassified the following products during importation:

        i. Lovage Blend flavour powder under HS Code 3302.10.00 instead of HS Code 2103.90.00;

ii. Flavour powder type beef spice under HS Code 3302.10.00 instead of HS Code 2103.90.00;

iii. Onion dry flavour under HS Code 3302.10.00 instead of HS Code 2106.90.99; and

iv. Chicken flavour powder under HS Code 3302.10.00 instead of HS Code 2103.90.00.

c. That some of the Appellant's declarations were not supported by corresponding Certificates of Export and as such were liable to VAT and Excise Duty, where relevant.

11. The Appellant responded to the demand notice in a letter dated 26th October 2023 objecting to the entire demand on the following grounds:

a. That based on GIRs 1, 3(b), and 6, it applied the correct HS code 3302.10.00 in classifying imported flavour powders: lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour.

b. The Respondent had already issued tariff rulings classifying lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour under tariff code 3302.10.00 thereby creating a legitimate expectation that HS Code 3302.10.00 was the correct tariff code in the declaration of the products.

c. That the royalty payments made by it are neither related to the goods under consideration nor a condition of sale of those goods and thus should not form part of the transaction value of the goods for taxation purposes.

d. That all export consignments by the Appellant were duly processed by the Respondent and exited the country.

e. That the assessment was arbitrary and unreasonable.

12. The Appellant stated that pursuant to reconciliation meetings and provision of further documentation, in a letter dated 24th November 2023 the Respondent issued its review decision wherein it revised the demanded amount attributed to export consignments downwards from Kshs. 993,191,100.00 to Kshs. 353,052,475.00. It upheld the demanded amount attributable to tariff classification of the imported flavour powders as well that attributable to royalty payments.

13. The Appellant, in its statement of facts, analysed its grounds of its Appeal under the following headings:

I. The royalty payments made by the Appellant are neither related to the goods under consideration nor a condition of sale of those goods and thus should not form part of the transaction value for taxation purposes.

14. With regard to this ground the Appellant stated that it holds two categories of license agreements namely, Trademark Agreements and Technology Agreements, under which it pays royalties.

15. The Appellant stated that in the period prior to January 2020, it had in place one Trademark Agreement and one Technology Agreement applicable to all its products. Royalties were paid at a standard rate of 1% of the turnover for the Trademark Agreement and 2% of turnover for the Technology Agreement.

16. The Appellant stated further that in the year 2020, it revised the Trademark and Technology Agreements, the terms of which stated that royalties would be charged at different rates depending on its product lines, i.e., beauty and personal care, homecare and food and refreshments brands.

17. The Appellant averred that in the period starting January 2021, it executed a new set of Trademark and Technology Agreements based on its product lines as follows:

    a. Trademark Agreements in respect of :

        i. Beauty and Personal Care brands;

        ii. Homecare brands; and

        iii. Food and Refreshments brands.

    b. Technology Agreements in respect of :

        i. Beauty and Personal Care brands;

        ii. Homecare brands; and

        iii. Food and Refreshments brands.

18. The Respondent contended that the Appellant ought to have included the royalty payments made pursuant to the agreements as part of the customs value and since the Appellant did not the Respondent demanded additional taxes of Kshs. 773,369,686.00.

19. The Appellant stated that royalties are an upward adjustment to value referred to in Article 8.1 (c) of the WTO Agreement on Customs Valuation (hereinafter " WTO Agreement") and in Paragraph 9 (1) (c) of the Fourth Schedule of the East Africa Community Customs Management Act, 2004 (hereinafter "EACCMA"). Their addition to the transaction value is dependent on the following conditions being met cumulatively:

    a. The royalties and license fees are not already included in the transaction value.

    b. The royalties and license fees should be related to the goods being valued.

    c. The royalties and license fees should be paid by the buyer, either directly or indirectly, as a condition of sale of the goods being valued.

    d. The adjustment should be done based on objective and quantifiable data.

20. The Appellant stated that the conditions as set out in the paragraph above must be cumulatively fulfilled for the royalty payment to be considered as an adjustment to customs value and that further the interpretative notes to Paragraph 9(1)(c) of the WTO Agreement also outline the following instances when royalty payments should not be added to the transaction value:

    a. Charges for the right to reproduce the imported goods in the Partner state.

    b. Payments made by the buyer for the right to distribute or resell the imported goods, if such payments are not a condition of sale for export to the Partner state of the imported goods.

21. The Appellant was aggrieved by the Respondent's decision as it is its position that the cumulative conditions for the inclusion of royalties in the transaction value were not met. The Appellant's response was categorized in two as follows:

    a. Scenario 1: Royalties attributable to locally manufactured goods; and

b. Scenario 2: Royalties attributable to imported finished products.

22. With regard to Scenario 1 the Appellant stated that it manufactures and sells products in 3 categories namely; Food and Refreshments, Beauty and Personal Care; and Home Care. To this end, it imports raw materials from various suppliers in the open market for use in the manufacture of these products. Once manufactured, the finished goods are then sold under its different brands e.g., Omo, Sunlight, Geisha, and Vaseline among others.

23. Royalty or license fees that are remitted for know-how utilized in post-importation (i.e., domestic) manufacturing are not generally considered additions to the price paid or payable of imported goods that may be used in the manufacturing process. During the assessment of the instant commercial arrangement, it was critical to highlight the following aspects of the transaction:

a. That the royalties are based on turnover from the sale of finished goods.

b. That consequently, the goods imported by the company are raw materials only.

c. That the license agreements control the use of intellectual property only and not the goods imported by the company. There is no clause in the agreement imposing any obligation or control in respect to the sourcing of raw materials upon the company as the licensee.

24. As such, the Appellant does not purchase the goods from the licensor, and neither does the licensor exercise any control over the Appellant's purchase of the raw materials. In fact, the Appellant independently sources the raw materials from third parties without any influence from the Licensor. It is on that basis that the Appellant stated that there is no nexus at all between the royalties attributable to locally manufactured goods and the value of the goods imported by the company as raw materials.

25. Furthermore, the payment of royalties did not in any way constitute a condition of the sale of the raw materials but arose from a contractual legal obligation. For royalties to be a condition of the sale of the goods for export, the transfer of ownership of the goods being imported must be dependent upon the payment of the amount of the royalty fee by the purchaser.

26. From this preliminary context therefore, the royalties paid on the turnover of finished products were not in any way related to the imported goods as a matter of fact, and as pursuant to the guidance of World Customs Organisation (hereinafter "WCO") Advisory Opinions 4.13, where the Technical Committee of Customs Valuation (hereinafter "TCCV") held as follows:

> " Although the importer is required to pay a royalty to obtain the right to use the trademark, this results from a separate agreement unrelated to the sale for export of the goods to the country of importation. The imported goods are purchased from various suppliers under different contracts and the payment of the royalty is not a condition of the sale of these goods. The buyer does not have to pay the royalty in order to purchase the goods. Therefore, it should not be added to the price actually paid or payable as an adjustment under Article 8.1(c)."

27. Also, in further reference to WCO Advisory Opinion 4.17, the inputs imported by the Appellant are not branded goods nor are they patented or manufactured under a patented process for which a royalty payment is made. The payment of royalties is not related to the imported goods but is related to the use of the brands of the Licensor in the sale of the finished products.

28. In support of its case, the Appellant relied on the decision of the Tribunal in TAT Appeal No. 115 of 2020 BASF East Africa Limited v Commissioner of Customs and Border Control where it was held

that a finding for the existence of a condition of sale could not be made where a licensee was purchasing raw materials from third parties. The Tribunal stated thus:

> " The Tribunal having perused both license agreements notes that they do not provide for termination in the purchase of raw materials and imported goods in the event of non-payment of license fees. In any case, the raw materials and imported goods are acquired from other parties and not purchased from [the licensor]."

29. With regard to scenario 2 the Appellant stated that it also imports a significantly small percentage of finished products from related entities for niche market segments and that where it does not locally manufacture some products, it imports them for resale from related party companies. Under such circumstances, the sales agreement is between the company and the vendor related party. The royalties are however paid to the licensor under the licence agreement, which are separate entities.

30. With regard to the payment of royalties, Article 4.2 of the license agreements states as follows on the payment of royalties:

> " ...All invoices from Licensor to Licensee are suspended until such time as Licensee "becomes profit making" ("Invoice Holiday")..."

31. From a reading of the above clause, it was evident that the Appellant is entitled to a reprieve from paying royalties where it is not in a profitable position, meaning that where it was to be at a loss position in perpetuity, it would not be required to pay royalties. In fact, the company did not pay any royalties in the years 2020 and 2021 as it was allowed an invoice holiday.

32. Notwithstanding the invoice holiday, the Appellant was still allowed to enjoy the rights under the license agreement and was able to purchase and resell the imported finished products. The Appellant's invoice holiday or failure to pay the royalty fee did not entitle the vendors to refuse to sell the licensed goods or to repudiate the contract for their sale.

33. In Canada (Deputy Minister of National Revenue) V Mattel Canada Inc. [2001] 2 Scr, the Canadian Supreme Court held that royalties paid were not dutiable where the payments were not made as a condition of the sale of the goods. To this effect, it stated as follows:

> " Unless the vendor is entitled to refuse to sell the goods to the purchaser or repudiate the contract of sale where the purchaser fails to pay royalties or licence fees, s. 48 (5) (a)(iv) (the Canadian equivalent of paragraph 2(1) as read with Paragraph 9(1)(c) of the Fourth Schedule of EACCMA) is inapplicable."

34. From the set of facts and law indicated by the Appellant in Scenarios 1 and 2 above, it was clear to the Appellant that the Respondent's decision on royalties did not satisfy the cumulative conditions for the inclusion of royalties in the transaction value for the following reasons:

    a. The royalties are not in any way related to the goods imported since the Appellant imports' goods from third party suppliers who are both related and unrelated parties. Most of the goods accounting approximately 95% of its imports are raw materials purchased from unrelated third parties for the manufacture of finished goods, while the remaining 5% accounts for finished products imported for resale from related third parties who are not the licensor.

    b. The royalties are purely for the marketing and sale of finished products under the Appellant's brands. The payment of royalties is not a condition of sale of the imported goods. No clause

in the Royalty Agreements stipulates that the Appellant cannot import the goods from the various suppliers if the royalties are not paid to the licensors.

c. Further, the license agreements under Clause 4.2 allow for an invoice holiday where the Appellant is in a loss-making position. For example, the Appellant did not pay royalties for the years 2020 and 2021 since the firm was loss making. The Appellant nonetheless continued importing goods.

d. The adjustments made by the Respondent were not based on objective and quantifiable data. It would seem all royalty payments were lumped together and flat rates of 25% import duty, 16% VAT, 3.5% IDF and 2% RDL applied. This was in spite of different import duty rates for the various goods the Appellant's imports, most of which would be raw materials attracting 0% import duty, the application of uniform IDF and RDL rates of 3.5% and 2% respectively despite these rates having come into effect in November 2019 (Finance Act 2019), and ignoring the fact that as an approved manufacturer, the Appellant enjoyed preferential IDF and RDL rates of 1.5% on raw materials and intermediate products. In addition, there were imported goods that enjoyed preferential tariff treatment. In TAT Appeal No. 70 of 2020, Woolworths (Kenya) Proprietary Limited vs Commissioner of Customs & Border Control, the Tribunal held that even where royalty payments meet the conditions for inclusion in the customs value, the addition should be based on readily quantifiable and objective data to avoid infringement on the principle of certainty in taxation.

35. Further, the Appellant stated that subparagraph 3 of the interpretative notes to Paragraph 9 (1) (c) of Fourth Schedule to EACCMA provides that where objective and quantifiable data do not exist with regard to the additions required to be made under the provisions of Paragraph *9*, the transaction value cannot be determined under the provisions of Paragraph *2*. As an illustration of this, a royalty is paid on the basis of the price in a sale in the importing country of a litre of a particular product that was imported by the kilogram and made up into a solution after importation.

36. The Appellant stated that if the royalty is based partially on the imported goods and partially on other factors which have nothing to do with the imported goods such as when the imported goods are mixed with domestic ingredients and are no longer separately identifiable, or when the royalty cannot be distinguished from special financial arrangements between the buyer and the seller, it would be inappropriate to attempt to make an addition for the royalty.

37. In the circumstances, the Appellant maintained that none of the royalty payments constituted a condition for sale, and that the Respondent erred in raising the assessment on royalties.

II. The four (4) flavour powders imported by Unilever are raw materials of a kind used in the food industry and are classifiable under HS Code 3302.10.00 as per General Interpretation Rules (GIRs) 1, 3(b) & 6.

38. During the Post Clearance Audit (hereinafter 'PCA"), the Respondent identified the following four flavour powders imported by the Appellant as having been misclassified and demanded additional taxes in the sum of Kshs. 109,389,791.00.

39. The Appellant disputed the Respondent's reclassification of the four flavour powders and averred that the products imported by it are raw materials used in the manufacture of food seasoning products such as Royco Mchuzi Mix, Royco Cubes and Knorr Cubes among others, and ought to be classified in HS Code 3302.10.00. This tariff attracts 10% import duty and 16% VAT.HS Code 3302.10.00 covers mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in the food or drink industries.

40. The Appellant provided the ingredient information which has not been re-produced and proceeded to state that based on the information provided the flavour powders comprised mainly Flavourings and Additives carriers and other ingredients. Flavourings refer to substances that change or modify the original flavour of the food. Flavouring substances or raw materials find use in the manufacture of condiments and seasonings. Flavourings form part of seasonings or condiments. The following three main flavourings are used in the food industry:Natural flavouring substances: These are obtained from plant or animal raw materials through physical, microbiological or enzymatic processes, e.g. alcohols, esters, aliphatic acides, aldehydes, lactones, and ketones.Nature-identical flavouring substances: These are obtained through chemical synthesis of natural substrates and include esters, aldehydes, ketone acids and lactones.Artificial or synthetic flavouring substances: These are obtained from synthetic aromatics by fractional distillation or through additional manipulation of naturally sourced chemicals, crude oil, or coal tar.

41. To expound further on flavouring substances, the Appellant relied on the United States Food and Drug Administration's (FDA) Code of Federal Regulations (CFR) Part 101 and the European Commission's *Regulation No. 1334/2008*, which lay down the definitions for different types of flavourings and the general requirements for their safe use. Of particular interest is the definition of the term natural flavours or natural flavouring substances which are the primary constituents of the four (4) products in this dispute.

42. The Appellant stated that according to the EC's *Regulation No. 1334/2008*, a natural flavouring substance means a flavouring substance obtained by appropriate physical, enzymatic or microbiological processes from material of vegetable, animal or microbiological origin either in the raw state of after processing for human consumption by one or more of stipulated food preparation processes. Natural flavouring substances correspond to substances that are naturally present and have been identified in nature. A natural flavouring preparation is a product other than a flavouring substance obtained from food or material of vegetable, animal or microbiological origin through the processes described above.

43. According to the FDA's CFR Title 21 Part 101 Subpart B, the term natural flavour or natural flavouring means the essential oil, oleoresin, essence or extractive, protein hydrolysate, distillate, or any product of roasting, heating or enzymolysis, which contains the flavouring constituents derived from a spice, fruit, or fruit juice, vegetable or vegetable juice, edible yeast, herb, bark, bud, root, leaf or similar plant material, meat, seafood, poultry, eggs, dairy products, or fermentation products thereof, whose significant function in food is flavouring.

44. Due to the volatility of essential oils and oleoresins that characterize the flavouring constituents, flavouring preparations often incorporate other ingredients such as additives, carriers, emulsifiers, stabilizers, and antI-caking agents among others. For example, salt, sugar, starch, maltodextrin, and vegetable oil act as carriers, silicon dioxide e551 as an emulsifier and colour, and gum arabica as an additive.

45. In essence, flavourings are derived from odoriferous substances such as essential oils and extracted oleoresins. The four products imported by the Appellant comprise of odoriferous flavouring put up with additives and carriers and are used as raw materials in the manufacture of food seasonings.

46. The Appellant stated that it is a key player in the food industry in Kenya and produces several seasoning products that include Royco Mchuzi Mix (beef or chicken flavours etc.), and Royco and Knorr cubes (chicken or beef flavours etc.). To produce these products, the Appellant imports flavouring compounds that are used as raw materials in the production process that involves other ingredients.

As presented, the flavours are neither intended for direct human consumption nor for retail sale. According to the data sheets the ingredients are raw materials for consumer products.

47. The Appellant stated that Royco Mchuzi Mix (Chicken flavour) has the following as the ingredients: corn starch, iodized salt, sugar, flavour enhancers (E621, E632, E627), nature-identical flavours (onion and chicken), coriander, chilli, ginger, food colours, cumin, turmeric, cloves, citric acid, cinnamon, methee, fennel, and garlic. As such, it is clear that the flavouring compounds imported by the Appellant are just one of the raw materials or components used in the manufacture of the end-product. They are not the end product in themselves and cannot be directly used in food preparation either at the cooking stage or serving stage.

48. The Appellant then proceeded to outline what constitutes a Royco Beef Cube. The ingredients of a Royco beef cube, the Appellant stated include iodised salt, corn starch, onion powder flavour, beef flavour, vegetable fat, sugar, monosodium glutamate among other ingredients. The Appellant also produced a table which has not been reproduced herein outlining the four raw materials and the intended product.

49. Classification of goods in the Nomenclature (the Harmonised Commodity Description and Coding System or HS Code) is governed by the 6 GIRs. The six principles are applied sequentially. In addition, the Appellant stated that it important to note that goods are classified as presented. Further, the Appellant relied on the WCO Harmonized System (HS) Explanatory Notes (ENs) which constitute the official interpretation of the Nomenclature at the international level. While not legally binding, the Appellant stated that they are an indispensable complement to the HS.

50. The Appellant averred that based on GIRs 1, 3(b), and 6, the flavouring powders in dispute are classifiable under subheading 3302.10.00 of the East African Community Common External Tariffs (hereinafter "EACCET"). They are not classifiable in subheading 2103.90.00 or 2106.90.99. GIR 1 holds that the premier guide to classification is the terms of headings and any relative Section or Chapter Notes, provided they do not otherwise require.

51. The Appellant stated that the terms of heading 3302 provide for the following:

> "Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacture of beverages."

52. The Appellant also stated that Note 2 to Chapter 33 describes the expression "odoriferous substances" as used in heading 3302 as referring only to the following:Odoriferous constituents isolated from substances of heading 3301, andSynthetic aromatics.

> "These are substances that characterize flavourings and fragrances that find use as raw materials in food, drink, cosmetic, personal care, and home care industries."

53. The Appellant stated that Heading 3301 covers the following:

> "Essential oils (terpeneless or not), including concretes and absolutes; resinoids; extracted oleoresins; concentrates of essential oils in fats, in fixed oils, in waxes or the like, obtained by enfleurage or maceration; terpenic by-products of the deterpenation of essential oils; aqueous distillates and aqueous solutions of essential oils."

54. The Appellant averred that EN (A) to heading 3301 describes essential oils as raw materials in perfumery, food and other industries and are of vegetable origin. They are generally of complex composition and contain alcohols, aldehydes, ketones, phenols, esters, ethers and terpenes in varying proportions. Extracted oleoresins (prepared oleoresins or spice oleoresins) are obtained from natural cellular raw plant materials (usually spices or aromatic plants) and contain volatile odoriferous principles such as essential oils and non-volatile flavouring principles such as resins, fatty oils and pungency constituents which define the characteristic odour or flavour of the spice or aromatic plant. These products are used principally as flavouring agents in the food industry.

55. The Appellant further averred that ENs also list the principal essential oils and extracted oleoresins in an Annex to Chapter 33 ENs and among these are cinnamon, clove, lemon, onion, thyme, cumin, lovage, and paprika among others.

> " The flavouring powders imported by the Appellant are natural flavouring substances with a basis of essential oils and extracted oleoresins. For example, lovage blend powder and onion dry flavour have a basis of lovage and onion respectively."

56. The Appellant stated that ENs to heading 3301 further describe those products that would then be excluded from the heading and that these include the following:An essential oil, resinoid or extracted oleoresin which has been fractionated or otherwise modified (other than by the removal of terpenic hydrocarbons), so that the composition of the resulting product is significantly different from that of the original product, is excluded (generally heading 33.02).Products put up with added diluents or carriers such as vegetable oil, dextrose or starch (generally heading 33.02).

> " The products imported by the Appellant are put up with added additives and carriers such as maltodextrin (dextrose), starch, palm oil, salt, sugar, silicon dioxide, citric acid etc. This then implies that they are excluded from heading 3301, and ought to be generally classified in heading 3302."

57. The Appellant stated that the ENs to heading 3302 provide that the heading covers several mixtures provided they are of a kind used as raw materials in the perfumery, food or drink industries (e.g., in confectionery, food or drink flavourings). It is important to note that the notes place an emphasis on 'provided they are of a kind used as raw materials...'

58. The Appellant stated that EN (6) describes one such mixture as mixtures of one or more odoriferous substances (essential oils, resinoids, extracted oleoresins or synthetic aromatics) combined with added diluents or carriers such as vegetable oil, dextrose or starch. The Appellant stated that this aptly captured the products it had imported on the following basis:

    a. They have a basis of odoriferous substances that are then put up with carriers and other additives (described earlier) to enable their formulation as powders.

    b. they are of a kind used as raw materials in the food flavouring industry, specifically in the manufacture of seasonings.

> " Lovage blend flavour powder comprises natural flavouring preparations put up with additives and carriers that include maltodextrin, salt, and silicon dioxide E551."
>
> "Flavour powder type beef spice is made up of natural flavouring preparations, natural flavouring substances, nature-identical flavouring substances and process

flavourings as the flavouring constituents put up with additives and carriers that include maltodextrin, sugar, silicon dioxide E551, and salt among others."

"Chicken flavour powder comprises natural flavouring preparations, flavouring substances, thermal process flavourings, and natural flavouring substances put up with additives and carriers that include maltodextrin, palm oil, salt, citric acid E330, and starch modified tapioca E1450 among others."

"Onion dry flavour powder is made up of natural flavouring substances put up with additives and carriers that include maltodextrin, starch, salt, silicon dioxide E551 and potassium iodate."

59. The Appellant stated that based on their composition and constituents, the powders are products with a basis of odoriferous/aromatic substances put up with additives and are of a kind used as raw materials in the food industry, in this context, the manufacture of seasonings. Further, the terms of headings 3302 do put an emphasis on the intended use of the products to be classified there, which is that they are used as raw materials in industry.

60. The Appellant buttressed its position by citing the case Suntory Beverage and Food Kenya Limited vs. Commissioner Customs & Border Control [2021], where the Tribunal held that the purpose or use of a product ought to be first considered in classification, especially where the terms of headings envisage the intended use.

61. In addition, the Appellant stated that Rule 3(b) is relied upon in relation to the essential character of the goods under consideration. The essential character of the flavour powders imported by the Appellant is the mixtures of odoriferous substances that are the flavouring substances and agents. Rule 6 then is used to classify the products at the subheading level in that these products are of a kind used in the food industry. As such, 3302.10.00 is the most appropriate tariff line for these products.

62. The Appellant stated that Lovage blend flavour, beef spice flavour, and chicken flavour powder are not classifiable in HS Code 2103.90.00, neither is onion dry flavour in HS Code 2106.90.99. The terms of heading 2103 provide for the following:

> " Sauces and preparations therefor; mixed condiments and mixed seasonings; mustard flour and meal and prepared mustard."
>
> Explanatory Note (EN) (A) to heading 2103 provides that the heading covers preparations of a highly spiced character used to flavour certain dishes (meat, fish, salads etc.), and made from various ingredients that include eggs, vegetables, meat, fruit, flours, starches, oil, spices, mustard, flavourings etc.).

63. The Appellant was of the view that a plain reading of this note implies that preparations of this heading are ready to use for enhancement of flavours in certain dishes such as meat, fish and salads among others. It further indicates that such preparations are made from various ingredients, one of the ingredients being flavourings. As presented, the flavours imported by the Appellant are not ready to use but undergo further processing with other ingredients to produce end products such as Royco Mchuzi Mix and Royco Beef Cubes. It is these products that are classifiable under heading 2103, and not the flavouring raw materials imported by the Appellant. Indeed, they are imported as powders packaged in 25kg bags.

64. The Appellant further stated that the ENs further indicate that products of this heading are normally added to a food as it cooks or as it is served. The flavour powders, as imported, can neither be added to food as it cooks nor as it is served, and therefore cannot be classifiable under heading 2103. They

are not directly used in food but are used as one of the raw materials in the manufacture of products of heading 2103.

65. The Appellant stated that the notes further explain that mixed condiments and mixed seasonings containing spices differ from the spices and mixed spices of headings 0904 to 0910 in that they also contain one or more flavouring or seasoning substances of chapters other than chapter 9.

66. According to the Appellant this impliied that in addition to mixed spices of headings 0904 to 0910, the mixed condiments and seasonings of this heading also contain flavouring or seasoning substances of chapters other than chapter 9. As such, it was quite clear that flavourings are a constituent of condiments or seasonings, but not a condiment or seasoning in themselves. As such, the ENs to heading 2103 implicitly exclude flavouring raw materials from the heading.

67. The Appellant outlined the terms of heading 2106 which provide as follows: "Food preparations not elsewhere specified or included."

68. The Appellant stated that onion dry flavour powder is not classifiable under heading 2106 since its constituents, composition, and use is aptly captured by heading 3302. Based on the above, the four flavouring powders imported by the Appellant are raw materials with a basis of odoriferous constituents; are not intended for direct human consumption; are of a kind used in the food industry for the manufacture of seasonings and; are classifiable in heading 3302, specifically tariff code 3302.10.00.

69. The Appellant averred that other than the legal and scientific justifications of the flavour powders being classifiable under HS code 3302.10.00, it would defeat logic that a raw material would be classified in the same HS Code 2103.90.00 as the intended end-product. It also beats the purpose of the Appellant establishing a manufacturing facility to produce food seasoning products among other products, create employment opportunities, establish a market ecosystem of suppliers, logistics providers, distributors, and retailers, and contribute to industrial output, all the while incurring the same import duties on raw materials as on finished products. The re-classification can be interpreted as a signaling to the Appellant to abandon manufacturing in favour of importing and distributing finished products.

III. The Commissioner had issued tariff rulings classifying lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour under tariff code 3302.10.00 thereby creating a legitimate expectation that HS Code 3302.10.00 was the correct tariff code in the declaration of the products.

70. The Appellant stated that several tariff rulings were issued by the Respondent to the Appellant in 2017 confirming the classification of the subject flavour powders in HS Code 3302.10.00. Referring to a laboratory analysis of the products, the Respondent observed that they were preparations that contained volatile essential oils and other additives for example , salt and starch, and were of a kind used as raw materials in the food and drinks industry. These rulings had a two-fold effect, first, the Appellant stated, they did affirm that the powders were flavouring preparations with a basis of mixtures of odoriferous substances (volatile essential oils) with added additives; and second, they created a legitimate expectation on the part of the Appellant that the tariff code prescribed by the Respondent was correct.

71. The Appellant's view was that the advance rulings issued by the Respondent created a legitimate expectation as to the classification of the products. The doctrine of legitimate expectation ought to be examined in both procedural and substantive contexts. The former relates to a public authority granting the client a hearing or other appropriate procedure before deciding (the drawing of samples and testing). The second envisioned that where a public authority has expressly made a representation

(the tariff decision) to the benefit of a person, such benefit will continue and will not be varied to the disadvantage of the recipient, up until when procedurally revised. In this case, the Respondent acted against the principle of fairness in the retroactive and retrogressive application of a different HS Code for the same products.

72. The Appellant stated that in addition to the above, tariff rulings are important in supporting economic operators by providing them with a degree of certainty in their import and export operations. A tariff ruling therefore contributes to certainty and predictability of foreign trade, while also helping the parties to assume respective commercial commitments.

73. The Appellant in buttressing its position regarding legitimate expectation cited the Supreme Court case of Communications Commission of Kenya & 5 others v. Royal Media Services Limited & 5 others, SC Petitions No 14, 14A, 14B and 14C of 2014; [2014] eKLR, where the Supreme Court set out the following as emergent principles of legitimate expectation:There must be an express, clear, and unambiguous promise given by a public authority;The expectation itself must be reasonable;The representation must be one which it was competent and lawful for the decision-maker to make and;There cannot be a legitimate expectation against clear provisions of the law or the *Constitution*.

74. The Appellant averred that all the above stipulated principles were met. The Respondent tested various products and communicated findings in clear and unambiguous terms that the correct tariff code was 3302.10.00. The Respondent was well within its power in issuing the said guidance, and the Appellant reasonably relied on it with conviction on the understanding that the guidance was correct, and there being no provision of law to the contrary.

75. The Appellant cited the case Kenya Revenue Authority & 2 others v Darasa Investments Limited [2018] eKLR, where the Court of Appeal cited with approval the works of Pollard, Parpworth and Hughes writing at page 583 in the 4th edition of Constitutional and Administrative Law: Text with Material and stated as follows:

> "legitimate expectation refers to the principle of good administration or administrative fairness that, if a public authority leads a person or body to expect that the public authority will, in the future, continue to act in a way either in which it has regularly (or even always) acted in the past or on the basis of a past promise or statement which represents how it proposes to act, then, prima facie, the public authority should not, without an overriding reason in the public interest, resale from that representation and unilaterally cancel the expectation of the person or body that the state of affairs will continue. This is of particular importance if an individual has acted on the representation to his or her detriment."

76. The Appellant stated that the products have all along remained the same and there has been no material change in their composition and the Respondent was therefore not justified in withdrawing the representations to the detriment of the Appellant. The Appellant further relied on Ecobank Kenya Limited V Commissioner of Domestic Taxes [2012] eKLR where Ogola J. upheld the creation of legitimate expectation where there was express representation and passive conduct by the Respondent, and stated as follows:

> "I would add that the expectation herein is not just a legitimate expectation. It is an expectation backed by a written express waiver and a passive conduct in relation thereto for a period of twenty-five years. All this time the Respondent was aware of section 15 (7) of the *Income Tax Act*. In my finding, that expectation became so legitimate, and so strongly grounded, that it established an economic right that only an express, concise, and specific waiver clearly communicated and delivered, could uproot. The Appellant and

other businesspeople have a right of certainty and predictability in the applicability of conduct, rules, policies, and procedures which underlie the proper regulation of economic activities. This right necessarily militates against policies, regulations and procedures which are haphazardly resorted to by public regulatory bodies without adequate notice to those whose conduct or behaviour is to be regulated."

IV. The reclassification of the products was arbitrary, unreasonable, and in bad faith

77. The Appellant took cognizance of the fact that the demand merely communicated that the declared code, HS Code 3302.10.00, was incorrect and that the correct codes are 2103.90.00 and 2106.90.99. The Respondent never explained why the Appellant's declared code were wrong, and why 2103.90.00 and 2106.90.99 were supposedly the correct tariff codes.

78. The tariff classification of goods is guided by the EACCET, GIRs and WCO EN. There was no evidence of the Respondent's reasoning in accordance with the guidelines in determining the tariff code for the flavour powders. It was therefore unreasonable to arbitrarily change the tariff code, without any explanation for the decision in accordance with the recognized guidelines.

79. The Appellant stated that moreover, identical products were subjected to a laboratory analysis by the Customs and Border Control Department in 2017, and the determination made that the proper tariff code is 3302.10.00. It was noteworthy that the chemical composition and the use of the products remains the same. In Keroche Industries Limited v Kenya Revenue Authority & 5 Others [2007] eKLR, the High Court held that the omission of reasons in a decision by a public body was illegal and contrary to the right to fair administrative action. The Court stated as follows:

> " The exercise of the power to change the tariff was not admittedly based on the respondents addressing the law on tariff... The fact that this was done before that ascertainment is evidence of irrationality in the exercise of power and due to failure to give reasons for the change before effecting the change, the decision to change does clearly violate the rules of natural justice."

V. Export consignments by the Appellant were duly processed by KRA and exited the country

80. The Appellant stated that in its objection decision the Respondent indicated that it relied on its data to reconcile and eliminate entries without certificates of exports (COEs) and/or exit notes and cargo manifests (C2s). in doing this, the Respondent revised the amount attributed to export transactions from the initial Kshs. 993,191,100.00 demanded to Kshs. 353,052,475.00.

81. The Appellant stated the Respondent's averment that the onus of proof of export strictly lay on the exporter or their appointed agent, and that the exporter ought to ensure that the procedure for processing exports, including obtaining the relevant documentation from Customs, is adhered to for the entire cycle of export processing.

82. The Appellant stated that it adhered to the procedure of processing of exports including preparation of the relevant customs documentation for the entire export processing cycle. A typical export cycle involves the following steps:Receipt of order for goods from the customer.Lodging of an export customs declaration by a licensed customs agent.Acceptance of the customs declaration by the Respondent.Supervision of stuffing and sealing of the means of conveyance (e.g., trucks) by the Respondent.Processing of the relevant transport documents in the Customs system e.g., road manifests or C2s by the Respondent.Customs personnel then allows the release of the vehicles conveying the goods for export to proceed to the border of exit under electronic seal (for cargo tracking purposes).Once at the border, Customs personnel process the vehicles by confirming the integrity

of the cargo before allowing exit from Kenya to the country of destination.Upon confirmation of exit, Customs personnel perform system processes and issue the proof of export e.g., the COE to the exporter or their appointed customs agent.

83. The Appellant stated that by solely relying on system-generated data, the Respondent ignored the dynamics of export processing which include among others: system downtimes that necessitate manual processing, cancelled or unprocessed entries, traffic congestion at the border that necessitates manual interventions, and the use of different customs systems by the respective countries of destination.

84. The Appellant stated that all export consignments by it were duly processed by the Respondent and exited the country and that there was documentary evidence to support those facts, and the Respondent ought to have reviewed the documentation instead of solely relying on system-generated data.

85. The Appellant further stated that the consignments were also processed by the revenue authorities of the respective destination countries and there was documentary evidence for the same. In the interest of fairness, the Respondent ought to have reviewed all the available documentary evidence related to export consignments by the Appellant since the sole reliance on system-generated data is not objective and is prone to errors attributed to the integrity of the data. The Appellant adduced as evidence sample documentary evidence (COEs, Exit Notes, Bill of Ladings).

86. In addition, it was unfair and unreasonable, even indolent , for the Respondent to, time and again, casually and without care, place the burden of proof on the Appellant and/or other taxpayers especially in instances where the Authority wields extensive control of Customs processes as highlighted in the typical export process described above. The issuance of CoEs and other internal processes done in the Respondent's Customs systems e.g., gate, release, removal, and exit processes are to be done by the Respondent's personnel and not the Appellant.

87. The Appellant made the following prayers to the Tribunal:

    a. That the Tribunal finds that the royalty payments made by the Appellant are neither related to the goods under consideration nor a condition of sale of those goods and thus should not form part of the transaction value as an adjustment.

    b. That the Tribunal finds that the four (4) flavour powders (lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour) imported by the Appellant are raw materials of a kind used in the food industry and are classifiable under HS Code 3302.10.00 as per GIRs 1, 3(b) & 6.

    c. That the Tribunal finds that the 2017 tariff rulings issued by the Respondent classifying lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour under tariff code 3302.10.00 created a legitimate expectation on the correct HS Code for the products.

    d. That the Tribunal finds that all export consignments by the Appellant were duly processed by the Respondent and exited the country.

    e. That the Tribunal sets aside the entire sum of demanded additional taxes amounting to Kshs. 1,235, 811,951.00.

    f. Awards costs to the Appellant.

Respondent's Case

88. The Respondent's case was as set out in its Statement of Facts dated and filed on 2nd February, 2024.

89. The Respondent stated it conducted an Audit on the Appellant's customs declarations during which it examined the systems, processes, procedures and documentation, records and books of account which the Appellant had put in place to support its import and export operations in respect of the period 2018 to May, 2023. The audit was carried out pursuant to sections 234,235 and 236 of EACCMA.

90. The Respondent stated that the scope of the audit included the Appellant's compliance with relevant customs laws and regulations as well as requirements under any other law applicable in respect of its imports and export operations. The Respondent averred that the audit revealed instances of non-compliance with some customs laws and procedures summarised as follows:

Duties on Royalties

91. The Respondent noted that there were exclusive General Licence Agreements between the Appellant and Unilever Global IP Limited incorporated in the United Kingdom on Trademark and Intellectual Property Rights and Technology intellectual and property rights leading to remittance of royalties of a percentage of the turnover of sales of various products to the brand owner which ought to have been added back to the customs values. The duties on royalties were calculated at KShs. 773,369,686.00.

Tariff mis-classification

92. The audit established that consignments of 'Lovage Blend flavour powder', 'chicken flavour powder' and 'flavour powder type beef spice' were mis-classified under tariff code 3302.10.00 instead of Tariff Code 2103.90.00. The Respondent established that consignments of 'Onion dry flavour 'were mis-classified under tariff code 3302.10.00 instead of Tariff Code 2106.90.99. The misclassification led to a tax liability of Kshs. 109,389,791.00.

Exports without COE

93. The Respondent stated that its analysis of the Simba system, ICMS and Asyccuda established that in some instances certificates of exports were not issued on some of the Appellant's consignments for export. In light of this excise duty and VAT attributed to the same was charged amounting to Kshs. 353,052,475.00.

94. The Respondent stated that an exit meeting was held on 27th September 2023 in which the Appellant was presented with the audit findings. The management letter and notice of demand were issued on 28th September 2023 and 29th September 2023 respectively. The Appellant objected to the notice of demand vide letter dated 26th October, 2023. The Respondent then issued its review decision vide a letter dated 24th November, 2023.

95. The Respondent, in its statement of facts, proceeded to outline the Appellant's grounds for the Appeal and had the following reply on each of the grounds:

    (a) The royalty payments made by the Appellant are neither related to the goods under consideration nor a condition of sale of those goods and thus should not form part of the transaction value as an adjustment

96. In response to this ground of Appeal the Respondent outlined the following provisions of paragraph 9(1) (c) of the Fourth Schedule to the EACCMA:

> " 9.
>
> (1) In determining the customs value under the provisions of Paragraph 2 s hall be added to the price actually paid or payable for the imported goods as follows:
>
> .....
>
> (c) royalties and license fees related to the goods being valued tha the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued to the extent that such royalties and fees are not included actually paid or payable"

97. The Respondent's case was that the cited provision of EACCMA mirrored the provisions of Article 8 (1) (c) of the WTO Customs Valuation Agreement and that indeed the WTO Valuation Agreement provides for the implementation of the General Agreement on Trade and Tariffs (GATT) 1994 which indicates that Article 1 is to be read together with Article 8 that provides for adjustment to the price actually paid or payable where certain specific elements which are considered to form part of the customs value are incurred by the buyer but are not included in the price actually paid or payable in the imported goods.

98. The Respondent stated that during audit it established that there exists exclusive General License Agreement between the Appellant and Unilever Global IP Limited incorporated in the United Kingdom on Trademark Intellectual Property Rights and Technology IPR leading to remittance of royalties on a percentage of the turnover sales of various products to the brand owner. That unlike what the Appellant had averred, the royalties paid did actually meet the conditions of sale for the following reasons:

(i) The royalties and license fees paid by the Appellant were not included as part of the custom value since payments were done way after the goods were imported and sold or used for manufacture;

(ii) The general licence trademark agreement between the Appellant and the Unilever Global IP Limited provides in clause 13-4 a termination clause which reads:

> " Upon termination of this Agreement or a part thereof for any reason, Licensee agrees to make no further use of the relevant Intellectual property rights or of any confusingly similar Trade Marks or of any other trademarks or trade names or of any packaging material which tends to suggest that Licensee continues to manufacture, market, sell or distribute the products."

This clause clearly indicates that the royalties and license fees paid are actually related to the imported goods being valued.

(iii) Further, the royalties and licence fees paid were paid indirectly as a condition of sale of the goods being valued as illustrated by Articles 12 and 13 of both the Trademark Agreement and the Technology Agreement which stipulated that in the event of a termination, then the Appellant would not be able to use the Intellectual Property Rights for manufacture,

sale or distribution of the imported products In the case Direktor na Teritorialna direktsiya Yugozapadna Agentsiya 'Mitnitsi', formerly Nachalnik na Mitnitsa Aerogara Sofia, vs. 'Curtis Balkan' EOOD, the Court analysed various provisions of the Customs code and made the following determination:

> " Royalties and licence fees related to the goods to be valued
>
> 11. In determining whether a royalty relates to the goods to be valued, the key issue is not how the royalty is calculated but why it is paid i.e. what inf act the licensee receives in return for the payment ... Thus, in the case of an imported component or ingredient of the licensed product, or in the case of imported production machinery or plant, a royalty payment based on the realisation on sale of the licensed product may relate wholly, partially or not at all to the imported goods."
>
> " Royalites and licence fees paid as a condition fo the sale of the goods to be valued...
>
> 12. The question to be answered in this context is whether the seller would be prepared to sell the goods without the payment of a royalty or licence fee. The condition may be explicit or implicit. In the majority of cases it will be specified in the licence agreement whether the sale fo the imported goods is conditional upon payment of a royalty or licence fee. It is not however essential that it should be so stipulated."
>
> 13. When goods are purchased from one person and a royalty or licence fee is paid to another person the payment may nevertheless be regarded as a condition of sale of the goods under certain conditions (see Article160 of [Regulation NO 2454/93]
>
> Even if the actual sales contract between the buyer and seller does not explicitly require the buyer to make the royalty payments, the payment could be an implicit condition of sale if the buyer was not able to buy the goods from the seller and the seller would not be prepared to sell the goods to the buyer without the buyer paying the royalty fee to the licence holder."
>
> "in the context of Article 160 [of regulation No. 2454/93] when royalties are paid to a party which exercised direct or indirect control over the manufacturer (resulting in a conclusion that they are related under Article 143[of that regulation]) then such payments are regarded as a condition of sale. According to Annex 23 [to that regulation] , "one person shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter".

99. The Respondent stated in its view that the 'key take home' from the above judgement was that even where there is no explicit clause in an agreement stating that payment of royalties is a condition for sale; the same can be implicit by the following facts:

    i. If the Appellant is denied the opportunity to use the relevant Intellectual Property Rights for manufacture, market, sale or distribution if the agreement is terminated. (Refer to the termination clause of the Agreements).

ii. If there is some form of control by the licensee by the licensor. In this case control is evident by the fact that the Appellant cannot continue to utilise the intellectual property rights upon termination of agreement. Additionally, a cursory look at both the trademark and technology agreements reveals that the Licensor exercises control over the Appellant by dictating the quality standards of the products that the Appellant can manufacture.

100. The Respondent stated that Justice Musinga in the case of Republic *vs Kenya Revenue Authority Exparte BeisdorfEast Africa Ltd, Nairobi High Court Misc Application No. 413 of 2009* in determining whether a person is in a position to import and sell the goods without paying the royalties stated as follows:

> "In my view therefore, payment of royalties by the applicant to Beiersdorf is a condition of sale of their imported patented goods. I agree with the respondent that if royalties were not a condition of sale anyone would be at liberty to import, manufacture or even distribute Beiersdorfs products without permission of the patent holder. That would be an unacceptable trade practice. The relevant law must be interpreted in a manner that makes economic sense. The only instance in which payments made by a buyer for the right to distribute or resale imported goods may not be added to the price actually paid or payable for purposes of determining custom value is where the payments (including royalties) are not a condition of sale."

101. Echoing the words of the Court in the above case, the Respondent stated that that was condition of sale and that if it were not then the Appellant would not be the only entity having the right of use of the Licensor's Intellectual Property rights in manufacturing and selling the products that it does.

102. The Respondent stated that the Appellant's averment that the adjustments to the customs value were not based on objective and quantifiable data were incorrect as the adjustments it made were based on calculations of royalties paid by the Appellant pursuant to the general licence agreement between the Appellant and Unilever Global IP Limited and that reliance was made on data that was quantifiable and that the assessment was objective.

103. The Respondent proceeded to analyse ground (b) and (c) of the grounds raised by the Appellant as follows:

(b) The four (4) flavour powders imported by Unilever are raw materials of a kind used in the food industry and are classifiable under HS Code 3302.10.00 as per General Interpretation Rules (GIRs) 1, 3(b) and 6.

(c) The Commissioner had issued tariff rulings classifying lovage blend flavour powder, flavour powder type beef spice, chicken flavour powder, and onion dry flavour under tariff code 3302.10.00 thereby creating a legitimate expectation that HS Code 3302.10.00 was the correct tariff code in the declaration of the products.

104. The Respondent stated that GIR 1 provides that classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes. In particular, it states as follows:

> "The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes."

105. The Respondent also referred to the provisions of GIR 6 which further states as follows:

> " For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related Subheading Notes and, mutatis mutandis, to the above Rules, on the understanding that only subheadings at the same level are comparable. For the purposes of this Rule the relative Section and Chapter Notes also apply, unless the context otherwise requires."

106. The Respondent stated that the Appellant herein was audited for the period 2018 to 2023 and it was established that it had misclassified 4 items. 4 tariff rulings were issued towards this end and the Appellant was charged additional taxes of KShs. 109, 389,791.00 owing to the misclassification.

107. The Respondent urged the Tribunal by stating that it had made the following findings on four items that were subjected to laboratory testing as follows:

(i) For the product known as chicken flavour powder, a sample of the product analysed at the laboratory confirmed it to be a spiced preparation containing a mixture of various substances and inorganics of calcium and chlorine;

(ii) For the product known as Flavour Powder Type Beef Spice, a sample of the product analysed at the laboratory confirmed it to be a chemical preparation containing a blend of organic substances with chemical characteristics of phenolic compounds, aromatics, terpenes and terpenoids typical to aroma ingredients in essential oils;

(iii) For the product known as Lovage blend flavour powder, a sample of the product confirmed it to be an organic chemical preparation containing substances with chemical characteristics of terperies and terpenoids, typle starch typical to natural flavouring essential oils, taken into carbohydrate (dextrin and chloride salts); and

(iv) For the product onion dry flavour, a lab analysis confirmed it to be food preparation containing soluble starch with typical olfactory characteristics of onion aroma.

108. The Respondent stated that Products (i)-(iii) above were classified under the tariff heading 21.03 which covers the classification of sauces and preparations thereof; mixed condiments and mixed seasonings; mustard flour and meal and prepared mustard. This heading covers preparations generally of highly spiced character, used to flavour certain dishes (meat, fish, salads etc) and made from various ingredients (eggs, meat, fruits, flours starches, oil, vinegar, sugar spices, mustard, flavourings etc) It also includes preparations for sauces, usually in the form of powders to which only milk, water etc needs to added to obtain sauce.

109. The Appellant has claimed that the correct classification of the above products is under tariff head 3302 which states as follows:

> " Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacture of beverages.
>
> Odoriferous substances and preparations of a kind used in the food or drink industries."

110. The Respondent urged the Tribunal to consider the fact that , chicken, onion or beef flavour are not odoriferous substances or preparations, but rather food additives that are used to enhance the

taste and aroma of various dishes. According to the Respondent, odoriferous substances usually refer to aromatic or fragrant materials that are valued for their pleasant smell or aroma. In the context of food, this might include spices, herbs, essential oils, or other aromatic compounds that contribute to the overall fragrance of a dish and that the distinction lies in the purpose and composition of these substances. Chicken, onion, or beef flavors are more focused on taste enhancement, including the replication of the specific taste and aroma associated with these ingredients, rather than being primarily valued for their standalone odoriferous properties.

111. The Respondent insisted that the correct tariff classification could not therefore be 3302 and that further and in addition to the foregoing, Section 229 of EACCMA provides for the procedure that an Appellant should follow where they do not agree with the decision of the Commissioner. The Section states as follows:

> " 229.
>
> (1) A person directly affected by the decision or omission of the Commissioner or any other officer on matters relating to Customs shall within thirty days of the date of the decision or omission lodge an application for review of that decision or omission."

112. The Respondent asserted that in the present case, tariff rulings were issued on the 22nd March 2022, the 29th August 2023, and the 1st of September 2023 to the Appellant. The Appellant did not seek a review of these decisions. The Appellant did not also seek for an extension of time envisioned by Section 229 (2) of the EACCMA. The Appellant could not therefore seek redress against the tariff rulings where it did not follow the due process.

113. The Appellant has stated that the Respondent created legitimate expectation due to the tariff ruling it had made in the year 2017, confirming the classification of the subject flavours under tariff heading 3302. The Respondent wishes to state in response to this that applications for Advance rulings was enshrined in an amendment to the EACCMA Act in 2019 (Section 248A) and thus was not applicable in 2017 and that Moreover, advance rulings are binding to the parties for a period of 12 months from date of issuance. Section 248A provides as follows:

> " 248A. A person intending to import goods, may make a written application to the
> (1) Commissioner for advance binding rulings on any of the following -
>
> a. tariff classification;
>
> b. rules of origin; or
>
> c. customs valuation
>
> (2) Subject to subsection (1) and upon direction from the Commissioner, the applicant shall. Furnish to the Commissioner sufficient information that may be used to make the decision. (3) The Commissioner shall within thirty days of receipt of the sufficient information issue an advance ruling or give reasons for the inability to issue an advance ruling on the application. (4) The decision issued under subsection
>
> (3) shall be binding on the Commissioner and the applicant for a period not exceeding twelve months."

114. The Respondent stated that the uling issued in 2017 could not be applicable in this instance as the same was only valid for a period of 12 months. The Appellant's reliance on the same was not right. Regarding the issue of legitimate expectation, it is trite law that there can be no legitimate expectation in the face of clear statutory provisions. In the case at hand, the ruling referred to by the Appellant was only valid for a period of 12 months. The ruling could not therefore be used against the Respondent after its validity had expired; further advanced rulings were recognized under the law in 2019 when an amendment was made to EACCMA via Section 248A; entrenching the same in law. The issue of legitimate expectation therefore does not arise in this case.

(d) All the export consignments by UKL were duly processed by the Respondent and exited the country

115. The Respondent stated that during the audit it was established that in some instances where there were declarations on the Simba System, ICMS and Asyccuda, the Appellant failed to provide certificates of exports on some of the importer's consignment for exports. Consequently, Excise Duty and VAT were attributed to the same.

116. The Respondent proceeded to outline how the export process works as follows:

i. Once the exporter lodges the export declaration the Clearing Agent shall be required to submit the Original and the Supporting documents Entry to the Customs Exports Office (HVO). The HVO allocates the Entry to the Stuffing officer stationed at the designated/approved areas of stuffing Export goods.

ii. These areas are categorised into three: Designated/ Approved Owners premises, Containers Freight Stations (CFS's) and Kenya Ports Authority Inland Container Depots (KPA lCD's).

iii. The goods are loaded at the warehouse/place of loading and a message input in the system to confirm the same. The container is sealed with an ECTS seal in the presence of a customs officer and the same is used to monitor the truck to the exit point.

117. The goods are received at the exit point/station by a customs officer (please note: In the case of the border stations a joint verification is conducted with both KRA Customs and a Customs officer from the importing Revenue Authority). The ECTS tracking seal number is confirmed, verification is conducted at the exit point to ascertain that the goods description, quantities, values, tariffs received are as dispatched from the place of loading and a message input in the system confirming the same and the allocated serialized rotation number captured.

118. The Respondent averred that finally, a certificate of export is issued by customs electronically upon the physical exit of the goods from the country of exportation. As such, goods are deemed to have been exported where a certificate of export has been dully issued. A taxpayer has the onus of proving whether goods were exported or not. A Certificate of Export is the ideal proof of export.

119. The Respondent stated that in the instant case, the Appellant was not able to prove that there was exportation of goods to Uganda and Tanzania and therefore tax was attributed to these goods. The Respondent, in buttressing its position cited the case of TAT No. 98 of 2018 - Mastermind Tobacco (K) Ltd -vs- Commissioner of Investigations & Enforcement where it was held that the onus of proving that goods were exported lies on the taxpayer. In paragraphs 34-36 of its judgement, the Tribunal held as follows:

> " We have carefully and respectfully reviewed the contesting submissions by the parties under this issue for determination. We note in the first instance the Appellant herein is either

deliberately being oblivious or genuinely does not understand that the export from one country to the other within the East African Community is governed by the East African Community Custom Management Act 2004. In any event, we note that Section 78 of the EACC.MA. empowers the Respondent to require the Appellant to produce a certificate of discharge. A taxpayer should not have any difficulty in producing the same if at all an export took. place. Seeing as we have established above that the consignment was not exported, itis understandable why the Appellant herein is willing to cast aspersions to the legality and the fairness of the Respondent's request."

35. The Tribunal is of the considered view that the Respondent is empowered under the EACCMA. regime to request for the production of all the documents used at every stage of the export process. It should not be difficult for the Appellant to avail these documents, if indeed export did take place, the documents must either be in the custody of the Appellant's agents, its customers or they are traceable in the system of the Respondent and the Partners states.

36. In addition to the foregoing, we find that request of production of documents by the Respondent speaks greatly on the burden on the tax payer to prove that the Respondent's assessment was wrong by demonstrating proof of exportation through documentary evidence. Section 78, among other Sections of the EACCMA that empower the Respondent to seek production of documents manifestly constitute a valuable weapon in the Respondent's hands; a weapon appropriately used in the context of this Appeal. It is our finding therefore that the Respondent's request for the production of these documents was neither unreasonable, unfair nor a violation of the Appellant's rights under Article 47 of the *Constitution* of Kenya, 2010."

120. The Respondent stated that it is trite law that the burden of proving that an assessment is wrong lies with the taxpayer as stipulated under Section 56 of the *Tax Procedures Act* CAP 469B of the Laws of Kenya (hereinafter "TPA"), which provides as follows:

> " In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect."
>
> The Appellant having failed to provide the documents to illustrate exportation, did not discharge its burden as required by the law.

(e) The assessment is arbitrary and unreasonable.

121. The Respondent stated that Sections 235 and 236 of EACCMA gives it powers to call for documents and conduct a PCA on the import and export operations of a taxpayer within a period of five years from the date of importation or exportation. Where the PCA reveals that taxes were short levied, or erroneously refunded, Section 135 empowers it to recover any such amount short levied or erroneously refunded.

122. The Respondent stated that it followed due process in arriving at its decision and therefore the same cannot be said to be arbitrary and unreasonable. In the case of Beiersdorf (supra) Justice Musinga in finding that the Respondent's decision was not irrational and contrary to legitimate expectation stated:

> " With regard to the applicant's submission that the respondent's decision was contrary to its legitimate expectation that the respondent would not assess taxes payable by the applicant

for the period 1st January 2004 to 30th September 200, the respondent's Post Clearance Audit Division was operating within the five years period stipulated under Section 235 (1) of the EACCMA. It is trite law that there can be no legitimate expectation in the face of clear statutory provisions. See R vs KENYA REVENUE AUTHORITY ex parteABERDARE FREIGHT SERVICES LIMITED [2004] 2 KLR 530.

From what I have stated hereinabove, it is clear that the respondent did not act irrationally as alleged by the applicant. According to "JUDICIAL REVIEW OF ADMINISTRATIVE ACTION"(5TH Edition) by De Smith, Woolf & Jowell (1955) paragraph 13 - 019 on page 559, a decision is irrational if it lacks ostensible logic or comprehensible justification."

123. In light of the foregoing, the Appellant's claims as laid out in it Memorandum of Appeal and Statement of Facts were therefore unfounded, not supported by evidence and without any colour of law.

124. The Respondent made the following prayers to the Tribunal:

a. The Respondent's confirmation of assessment be upheld;

b. The taxes due and unpaid together with interest thereon be paid to the Respondent;

c. The Respondent reserves the right to adduce any further oral and written evidenced during the hearing of the Appeal;

d. That this Appeal be dismissed; and

e. That the Appellant be compelled to pay costs to the Respondent.

Parties' Submissions

125. On 11th September, 2024 the written submissions of the Appellant dated 22nd July ,2024 and filed on 24th July, 2024 were adopted by the Tribunal as were those of the Respondent dated and filed on 12th August, 2024.

126. Upon perusal of the written submissions of both parties, the Tribunal notes that the Appellant identified the following 3 issues for determination:

a. Whether the Royalty payments made by the Appellant meet the cumulative conditions for inclusion as an adjustment to the customs value of the imported goods.

b. Whether the Four (4) flavour powders imported by the Appellant are raw materials classifiable under HS Code 3302.10.00 or finished and ready to consume seasonings classifiable under HS Code 2103.90.00.

c. Whether the tariff rulings issued by the Respondent in 2017 classifying the four (4) flavouring powders in HS Code 3302.10.00 created a legitimate expectation.

127. The Tribunal notes that in analysing each of the issues that the Appellant had identified for determination, the Appellant regurgitated its statement of facts and therefore its written submissions will not be re-hashed.

128. The Respondent, in its submissions identified the following 3 issues for determination:

a. Whether the Appellant was obligated to pay duties on the royalty payments made to Unilever Global IP.

b. Whether the Appellant correctly classified the four flavour powders that were imported.

c. Whether the Respondent had created a legitimate expectation through its tariff rulings issued in 2017.

129. The Tribunal notes that in analysing the issues that it had identified fo determination, the Respondent, similarly regurgitated its statement of facts and accordingly, its written submissions will also not be rehashed.

Issues for Determination

130. The Tribunal having carefully considered the parties' pleadings, documentation and written submissions has identified two issues for determination namely:

i. Whether the Royalty payments were a condition for the sale of the goods imported by the Appellant.

ii. Whether the re-classification of the consignment by the Respondent from tariff code 3302.10.00 to 2103.90.00 was justified.

Analysis and Findings

131. Having identified the two issues for determination the Tribunal will proceed to analyse both as follows:

i. Whether Royalty payments was a condition for the sale of the goods imported by the Appellant.

132. The dispute between the parties under this issue is with respect to the determination of whether an adjustment ought to be made to the import value of the goods imported by the Appellant to include royalty payments and licence fees pursuant to the following provisions of paragraph 9(1)(c) of the Fourth Schedule of EACCMA:

> " royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable..."

133. The Tribunal notes the Appellant's averment that it was importing raw materials which it would manufacture and package for sale into the market. The Respondent did not controvert the averment by the Appellant that it imported raw materials.Instead the Respondent averred that it was implied by the Technology and Trademark licence Agreements (hereinafter together referred to as "Licence Agreements") which the Appellant adduced as evidence, that the value of the raw materials imported by the Appellant to manufacture various food and refreshments; beauty and personal care; and home care products ought to have been adjusted by the royalty payments made by the Appellant under the Licence Agreements.

134. The Tribunal notes that pursuant to the provisions of the said paragraph 9(1)(c) of the Fourth Schedule of EACCMA, the following are the conditionalities to be met in adjusting the importation value for royalty payments:

a. The importer must pay the royalties.

b. The royalties must be related to the imported goods being valued.

c. The importer must pay the royalties directly or indirectly.

d. Payment of royalties must be a condition of the sale of the imported goods being valued.

e. That royalties are not included in the price paid or payable for the imported goods at the point of importation.

135. The Tribunal in a review of the outlined conditionalities places reliance on Article 8(c) of the WTO Agreement and para 7 of the WCO Commentary 25.1 in finding that the Appellant imported raw materials and though it did not provide the Agreement for purchase of the raw materials, the Respondent did not controvert the averment by the Appellant that the goods purchased were raw materials. It is on this basis that the Tribunal can infer that the goods imported were raw materials. Instead the Appellant adduced the Licence Agreements as evidence that it had met the conditionalities established by paragraph 9(1)(c) of the Fourth Schedule of EACCMA.

136. Upon perusing the Licence Agreements, the Tribunal has found that the royalties paid under the Agreements were not related to the goods valued. The goods valued, being the raw materials imported by the Appellant.

137. With regard to the issue of whether the Royalty payments were a condition of the sale of the goods being valued, the Tribunal was unable to determine whether there was a reference to the royalty payment in the sale agreements and as such the Agreement for the importation of the raw materials cannot be relied upon since the same was not adduced as evidence for consideration by the Tribunal.

138. The Tribunal finds, pursuant to paragraph 7 of WTO Commentary 25.1 that first, there is no reference to the sale (importation of raw materials) in the Licence Agreements to show that the execution of the Licence Agreements is a condition of the sale (condition of the importation). Second, the Tribunal having perused the Licence Agreements, finds that the Licence Agreements are not terminated by breach of any of their specific terms but by the loss of control of the Appellant by its parent company and for this reason, the Licence Agreements do not indicate that payment of the royalties is a condition for the sale or importation of the raw materials. Finally, the Licence Agreements do not provide for a prohibition on importation of raw materials if royalties were not paid. In this regard the Tribunal notes that in fact, in the Licence Agreements entered into between the Appellant and the Licensor after 2020, the Appellant was granted invoice holidays until such time as it was in a profit-making position and the Tribunal can therefore infer that importation of the raw materials could continue in spite of unpaid royalty fees.

139. Consequently, the Tribunal will not depart from its holding and findings in the case BASF East Africa Limited vs. *Commissioner of Customs and Border Control (TAT APPEAL NO. 115 OF 2020*) and finds that royalty payments were not a condition for the sale of the goods imported by the Appellant.

(ii) Whether the re-classification of the consignment by the Respondent from tariff code 3302.10.00 to 2103.90.00 was justified.

140. On this issue, the Respondent referred to four tariff rulings that it had issued on 28th March, 2022,29th August, 2023 and 1st September, 2023 with respect to the following consignments:

a. Onion Dry Flavour;

b. Chicken Flavour Powder;

c. Beef Spice Flavour; and

d. Lovage Blend Powder Flavour.

141. The Tribunal notes that the Respondent in citing the provisions of section 229 (1) of EACCMA stated that the Appellant had objected to the tariff rulings late outside of the statutory stipulated timelines. Section 229 (1) of EACCMA provides as follows:

> " 229.
>
> (1) A person directly affected by the decision or omission of the Commissioner or any other officer on matters relating to Customs shall within thirty days of the date of the decision or omission lodge an application for review of that decision or omission.
>
> (2) The application referred to under subsection (1) shall be lodged with the Commissioner in writing stating the grounds upon which it is lodged.
>
> (3) Where the Commissioner is satisfied that, owing to absence from the Partner State, sickness or other reasonable cause, the person affected by the decision or omission of the Commissioner was unable to lodge an application within the time specified in subsection (1), and there has been no unreasonable delay by the person in lodging the application, the Commissioner may accept the application lodged after the time specified in subsection (1). "

142. The Tribunal notes that by consent parties agreed to having the matter regarding tariff classification referred back to the Tribunal for hearing. The partial consent dated and filed on 24th July, 2024 was adopted by the Tribunal as partial judgement on 11th September, 2024. It is the view of the Tribunal that the Respondent, by its action has accepted, by signing the consent, the late objection by the Appellant to its ruling. Accordingly, the Tribunal will proceed to consider the matter of the tariff rulings.

143. The Tribunal notes that on 4th September, 2017 the Appellant was issued with a private ruling by the Respondent who classified all the following items under tariff code 3302.10.00 upon carrying out a laboratory analysis:

a. Chicken Flavour Powder;

b. Beef Flavour Powder;

c. Flavour Powder (Lovage); and

d. Onion Powder.

144. The Tribunal also notes that averment by the Appellant that pursuant to the case Communications Commission of Kenya & Others v Royal Media Services and Others [2014] eKLR the tests for successful invocation of 'legitimate expectation' as follows:

> " i. there must be an express, clear and unambiguous promise given by a public authority; [emphasis]
>
> ii. the expectation itself must be reasonable;

iii. the representation must be one which it was competent and lawful for the decision-maker to make; and

iv. there cannot be a legitimate expectation against clear provisions of the law or the *Constitution*. [emphasis]'

145. The Tribunal notes that the Respondent gave a clear unambiguous promise to the Appellant and the expectation of the Appellant is reasonable and the representation was competent and lawful and the Respondent is the decision maker with full Authority under the Act. The Appellant therefore had a legitimate expectation that the Respondent would abide by its Ruling. The Tribunal notes however the averment by the Respondent that upon the amendment of EACCMA in 2019 section 248A was introduced that required that private rulings last 12 months.

146. The Tribunal notes that Section 248A of EACCMA was introduced by the East African Community Customs Management (Amendment) Act, 2019. Pursuant to the East African Community Customs Management (Amendment) Act, 2019, this section Commenced on 15th November, 2019. The following are the provisions of section 248A of EACCMA:

"(1) A person intending to import goods, may make a written application to the Commissioner for advance binding rulings on any of the following –

(a) tariff classification;

(b) rules of origin; or

(c) customs valuation.

(2) Subject to subsection (1) and upon direction from the Commissioner, the applicant shall furnish to the Commissioner sufficient information that may be used to make the decision.

(3) The Commissioner shall within thirty days of receipt of the sufficient information issue an advance ruling or give reasons for the inability to issue an advance ruling on the application.

(4) The decision issued under subsection (3) shall be binding on the Commissioner and the applicant for a period not exceeding twelve months. Amended by EACCM(A) 2019..."

147. The Tribunal notes the following provisions of Section 19 of the *Interpretation and General Provisions Act*, CAP 2 of the Laws of Kenya regarding the time when written law comes into operation:

"19. Time when written law comes into operation

Where any written law, or part of a written law, came or comes into operation on a particular day, it shall be deemed to have come or shall come into operation immediately on the expiration of the day next preceding such day."

147. The Tribunal notes that in view of the fact that application of the said Section 248A commenced on 15th November, 2019, and the private rulings were issued in September, 2017, the law does not apply retrospectively and accordingly the introduction of section 248A by the East African Community Customs Management (Amendment) Act, 2019 did not apply to the Ruling issued by the Respondent to the Appellant in September, 2017. Furthermore, the Tribunal notes that the Respondent did not

adduce evidence that it had cancelled the said private ruling dated 4th September, 2017. The Tribunal finds that the private rulings dated 4th September, 2017 are therefore applicable and valid in respect of the following which are all classified under tariff code 3302.10.00:

a. Chicken Flavour Powder;

b. Beef Flavour Powder;

c. Flavour Powder (Lovage); and

d. Onion Powder.

148. The Tribunal notes that notwithstanding the private ruling which is prima facie evidence of the tariff code classification of the flavours, the same would in any case be classified under tariff code 3302.10.00 upon application of GIR 1 which provides as follows:

> " The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes and, provided such headings or Notes do not otherwise require....."

149. The sub-heading of section 33.02 provides as follows:

> " Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacture of beverages."

150. The Tribunal in the case Suntory Beverage and Food Kenya Limited VS. Commisisoner of Customs and Border Control [2021] held that the purposes or use of a product ought to be first considered in classification. The description in sub-heading 33.02 is very much aligned to the consignment imported by the Appellant. In any case, the Tribunal's further view is that it would have been prudent for the Respondent to have carried out a laboratory analysis to determine if the composition of the consignment had changed.

151. Consequently, the Tribunal finds that the re-classification of the consignment by the Respondent from tariff code 3302.10.00 to 2103.90.00 and 2106.90.99 was not justified in the circumstances.

Final Decision

152. The upshot of the foregoing is that the Appeal is meritorious and the Tribunal accordingly proceeds to make the following Orders:

a. The Appeal be and is hereby allowed.

b. The review decision dated 24th November, 2023 be and is hereby set aside.

c. Adjustments pursuant to Paragraph 9 (c) of the Fourth Schedule to the EACCMA be and are hereby set aside.

d. The consignment imported by the Appellant, namely Chicken Flavour Powder; Beef Flavour Powder; Flavour Powder (Lovage); and Onion Powder be and are hereby classified under tariff code 3302.10.00.

e. Each party to bear its own costs.

153. It is so Ordered.

DATED AND DELIVERED AT NAIROBI ON THIS 21ST DAY OF NOVEMBER, 2024.

.....

CHRISTINE A. MUGA - CHAIRPERSON

**.....

BONIFACE K. TERER - MEMBER

.....

ELISHAH N. NJERU - MEMBER

.....

EUNICE N. NG'ANG'A - MEMBER

.....

OLOLCHIKE S. SPENCER - MEMBER