



August 2026 Newsletter



A mother's pride, a son's achievement!
A journey marked by excellence

Some journeys are worth celebrating. Paul's is one of them!

Paul's journey with the Firm began long before he ever imagined becoming an advocate. For 22 years, his mother Monica Musyoka has been a valued member of the Firm, and from a young age, Paul would accompany her to Firm activities, including marathons and other events. He had the opportunity to interact with and admire the advocates he encountered, unknowingly being introduced to a profession that would one day become his own.

His mother played an important role in nurturing that ambition. Through her years at the Firm and her day-to-day interactions with advocates, she encouraged Paul to pursue law and gave him an early appreciation of the dedication the profession demands. Years later, his journey came full circle when Paul joined the Firm in his first year of university as an intern.

What began as a holiday internship soon became a journey that continued throughout Paul's university life. Every long school holiday, he returned to the Firm to learn, gain practical experience, take on new responsibilities and grow professionally, while remaining committed to his studies.

Mentorship was central to this journey. Our Managing partner recognised Paul's potential early on and encouraged him to work hard, study hard and strive for excellence. The Firm provided him with an opportunity not only to gain experience, but also to learn, grow and build a strong foundation for his career.

Today, we celebrate the remarkable result of that commitment: Paul has graduated with First Class Honours. His achievement is a testament to his discipline, determination and hard work.

From a young boy accompanying his mother to Firm activities, to a university intern and now a First Class graduate, Paul's journey reflects the lasting impact of exposure, opportunity and mentorship.

We are incredibly proud to have been part of his journey. Congratulations, Paul, on this well-deserved achievement! We look forward to seeing all that you will accomplish in the next chapter!

Substance Over Form: How IFRS 15 and Fiduciary Reality Saved NEXTGEN MALL/ why Service Charges are Non-Taxable Fiduciary Conduit Funds

Nextgen Mall Management Company Limited
Vs Commissioner of Legal and Board Services
(Tax Appeal No. E1498 of 2025)

By :
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Introduction and Fiduciary Service Charge Structures

In the commercial real estate sector, property management companies are commonly incorporated as administrative vehicles designed to ease the management of shared facilities on behalf of individual unit purchasers. Under standard sale agreements, unit owners commit to paying proportional service charge contributions to cover joint operational outgoings including security, utility bills, maintenance, repairs and administrative tasks. Any surplus collected in a financial year is contractually carried forward to the subsequent year to offset the owners' upcoming liabilities or in

some instances is retained by the management. This former model operates as a fiduciary common fund, rather than a commercial or profit-making enterprise aiming to trade with its members for gain while in the latter model questions may arise on whether the funds profits/gains or fiduciary in nature.

In *Nextgen Mall Management Company Limited v. Commissioner of Legal and Board Services*, the Tax Appeals Tribunal at Nairobi was called upon to resolve a dispute arising from a massive Kshs. 119,873,193.00 assessment levied by the Kenya Revenue Authority (KRA). The Authority's audit spanned 2016 to 2020 and resulted in assessments of Kshs. 38,550,556.00 in additional income tax on declared surpluses and Kshs.

81,322,637.00 in VAT under forced VAT registration.

The KRA Audit and the Formalistic Tax Trap.

The authority's massive tax assessment was built on a simple, formalistic premise: because the Appellant's accountants had filed self-assessment returns declaring unit owners' contributions as "income" and claiming operating deductions, the Appellant was bound by its own ledger entries. The authority argued that "one man's expense is another's income" and asserted that it acted as a mere "consumer of data". Since the company's Memorandum of Association stated its object was "To Manage" the mall, KRA contended that these transactions constituted a taxable venture and a "business" under Section 3(2)(a) (i) of the Income Tax Act.

Additionally, the Appellant had indicated in their returns that the service charge surplus was tax exempt. The authority therefore argued that because the Appellant did not hold a formal tax exemption certificate, the surplus was not entitled to exemption.

Once the High Court in **HCITA No. E173 of 2024** directed the Tax Appeals Tribunal to review the substantive contractual agreements and invoices, KRA maintained its stance in its December 2025 objection decision, arguing that the taxpayer could not walk away from its filed self-assessment returns.

Interrogating the Financials: Fiduciary Agency and IFRS 15

A key element of this dispute was the Tribunal's willingness to go beyond surface-level tax filings and interrogate the underlying financial reporting mechanics. The Tribunal took judicial notice that the Appellant's accountants had fundamentally erred in their financial presentation, stating that fiduciary funds held for third parties are not and can never represent the revenue of the holder.

Under IFRS 15 (Revenue from Contracts with Customers),

"revenue" is strictly defined as income arising in the course of an entity's ordinary activities and the transaction price must exclude amounts collected on behalf of third parties (agent) [55, 56, 58]. Applying the *principal-versus-agent* test detailed in IFRS 15 (paragraphs B34 to B38), the Tribunal analyzed whether Nextgen controlled the services before they were transferred to the customer (principal) or merely arranged for them to be provided by third parties (agent) (55,56,59).

It concluded that Nextgen was a pure agent because:

(a)No Primary Execution: The actual facilities management services (security, utilities, cleaning, repairs) were outsourced to professional third-party managers—namely Davita Management Limited, Broll Kenya Limited and RDL Property Managers Limited—who invoiced the Appellant and charged standard VAT.

(b)No Inventory Risk: Nextgen carried absolutely no inventory risk under paragraph B37.

(c)No Price Discretion: Nextgen possessed no discretion in establishing prices; service charge rates were set, varied and ratified directly by the unit owners during General Meetings.

Under the International Accounting Standards Board Conceptual Framework, "income" requires an increase in assets or a decrease in liabilities that results in an increase in equity. Because Nextgen received these contributions with a strict, contractual obligation to expend them solely for the benefit of the unit owners, these funds answered the definition of a liability, not income. The correct accounting treatment is to recognize billing as a fiduciary liability (under trade and other payables per IAS 1), reduce the liability as third-party providers are paid and carry any unexpended balances as a **financial liability** under IAS 32, completely bypassing the profit and loss ledger.

The Jacaranda Gardens Litmus Test

A cornerstone of the Appellant's case and a critical focal point of the Tribunal's judicial reasoning was the landmark precedent of *Jacaranda Gardens Management Company Limited v. Commissioner of Domestic Taxes*. This case established two key legal realities for property management conduits in Kenya:

1.Facilitative Role: A management company acts as a manager procuring third-party services, rather than an entity executing the services itself.

2.Shift of Burden of Proof:

Once a taxpayer demonstrates its role as an administrative conduit, the burden of proof shifts to the KRA. To tax collected contributions, the authority must affirmatively demonstrate that the funds were retained by the management company as proprietary fees for services it personally discharged.

In *Nextgen*, the authority argued that Nextgen fell outside this safe harbor because it collected contributions directly, declared them as income in filed returns and retained substantial accumulated surpluses. The Tribunal decisively rejected the authority's distinctions and held that in the instant case the surplus is not in the Appellant's hands beneficially; it is contractually carried forward in a revolving fund and legally "offset against the ensuing year's service charge" to reduce the owners' future liabilities. The Tribunal affirmed that the authority cannot rely on a taxpayer's bookkeeping errors to manufacture tax liability when the underlying contractual reality reveals a non-beneficial, administrative conduit.

The VAT Double-Taxation Conundrum

The second major pillar of the KRA's assessment was the forced VAT registration under Section 34(6) and a claim of over Kshs. 81 million in VAT on the gross member contributions. Under Section 5(1) of the VAT Act, VAT is chargeable on "taxable supplies" made by a registered person in the course or furtherance of a business.

The Tribunal conducted a reality check on the operational flow of the mall's management.

The actual services including security, utility billing, cleaning, repairs and garbage collection were performed by professional third-party managers (Davita, Broll, RDL). These professional managers billed standard VAT on their invoices, which was paid out of the pooled unit owners' contributions. The Appellant acted as a mere conduit, receiving reimbursements from the unit owners to defray these costs.

The Tribunal held that **reimbursement of costs disbursed for another is not consideration for a taxable supply by the conduit**. To charge VAT on the gross contributions collected by Nextgen would be to tax the exact same services a second time.

This would violently conflict with the structural architecture of VAT, which is designed solely as a tax on the *value added* at each individual stage of supply. Consequently, because the contributions were not consideration for any taxable supply by Nextgen, the forced registration and VAT assessments were declared entirely without foundation.

Critical Compliance Takeaways for the Real Estate Sector

While the *Nextgen Mall* decision is a landmark victory for taxpayers, it serves as a stark warning about the dangers of careless bookkeeping.

The litigation costs, years of tax appeals and administrative paralysis could have been completely avoided if proper financial presentation had been maintained from day one. Property developers, management companies and tax advisors should therefore immediately implement the following compliance protocols:

1.Discontinue P&L Revenue Recognition:

Management companies must immediately stop presenting service charge collections as "revenue" and maintenance outgoings as "operating expenses" on their Statement of Profit or Loss. All collections must be recognized directly on the Balance Sheet as a *fiduciary liability*. Disbursements to third-party providers must directly reduce this liability,

completely bypassing the profit and loss ledger.

2.Strictly Segregate Own-Account Revenues: If a management company earns independent revenue (e.g., from running a kiosk, parking fees, billboard advertising, or charging a specific administration fee), this should be strictly segregated. Only these "own-account" revenues should enter the Statement of Profit or Loss and be subjected to standard corporate tax and VAT thresholds.

3.Reinforce Tripartite Contractual

Documentation: Ensure that agreements for sale and leases explicitly define the service charge as a proportionate reimbursement of actual outgoings, with unutilized balances legally locked into a revolving fund to the credit of the owners. Furthermore, minutes of Annual General Meetings (AGMs) must reflect that the unit owners (not the management company) have the final authority to set, vary and ratify service charge rates.

Conclusion

The Tax Appeals Tribunal's ruling in *Nextgen Mall Management Company* is an intellectually rigorous triumph of commercial reality over formalistic bookkeeping. By aligning tax outcomes with the actual operational and contractual substance, the Tribunal has protected property owners from double-taxation and provided a clear, logical framework for the industry. The holding reinforces a timeless tax doctrine: the ledger must faithfully represent the law, because revenue authorities will always be waiting to exploit an erroneous entry.

Key Judicial Principle:

"Liability to tax is imposed by statute upon the true nature and legal character of a transaction and not upon the accounting entries by which a taxpayer records it." An erroneous financial presentation can neither create income where none exists nor extinguish income where it does exist.



‘EXECUTIVE PUBLIC SPEAKER’

Celebrating Lawrence Muriuki

We are proud to celebrate Lawrence Muriuki on successfully graduating from the Institute of Dress to Impress Group (DTI Group) after completing the Executive Public Speaking Course.

This achievement marks an important step in his journey of personal and professional development. Public speaking builds confidence, strengthens communication, and empowers individuals to express their ideas and influence others effectively.

Lawrence’s commitment to continuous learning and self-improvement is truly commendable, and we look forward to seeing him put these skills into action and make an even greater impact.

Congratulations, Muriuki! Here’s to many more achievements and opportunities ahead!

**TOP STATESPERSON
REAL ESTATE & FINANCE
KENYA
2026**

Certificate of Recognition AWARDED TO

PERIS WANGARI KARANJA

FOR BEING TOP STATESPERSON (HIGHEST RANKING)
IN REAL ESTATE & FINANCE IN KENYA 2026

Paul Musyimi

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We are immensely proud of our Managing Partner for being recognised as a Top Statesperson (Highest Ranking) in Real Estate & Finance in Kenya, 2026, by The Lawyer Africa.

This prestigious recognition is a testament to his exceptional leadership, industry expertise, vision, and commitment to excellence. It reflects the impact of her work in shaping Kenya's real estate and finance landscape and advancing the standards of professional leadership.

Congratulations on this well-deserved recognition! We are proud to have you lead the way!

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LEGAL MAXIM OF THE MONTH

“Salus Populi Suprema Lex”

“The welfare of the people is the supreme law.”

Few legal maxims capture the broader purpose of the law as powerfully as Salus Populi Suprema Lex. It reminds us that at the heart of the law lies a responsibility to protect the welfare, rights and interests of society.

At its core, the maxim reminds us that the law must serve more than the resolution of individual disputes. It must uphold justice, protect rights, preserve order and promote the greater good.

Disclaimer

This Newsletter is intended solely for general informational purposes and should not be construed as legal advice. The content reflects our recent understanding of the subject matters addressed herein, which may be open to differing interpretations. By interacting with this newsletter, no client-advocate relationship is established. We are not liable for any actions taken or omissions made based on reliance on the information contained herein. For personalized legal guidance, we recommend consulting us through communications@knjenga.co.ke.

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