Executive Summary

We received a dossier of 26 custom documentation and correspondences of Bidco Africa Limited, formerly Bidco Oil Refineries Limited (hereinafter referred to as “Bidco” or “the company”) on which duty and VAT were not paid. The company imported High-density polyethylene (“HDPE”), multilayer film for packaging as well as Refined, Bleached & Deodorised (“RBD”) palm olein and palm stearin on which no duty (including VAT) were paid.
The objective of this report is to review the customs documentations in order to assess the company’s level of compliance with Kenyan tax laws with regards to the documentations contained in the dossier.
Once we obtained the custom documentation and the correspondences, we undertook the following tasks: Internal Verification

1. **Internal Verification** – this entailed the following:
    a. Reviewing the 26 C15 custom entries as well as the supporting documentation;
    b. Reviewing the legal process for importing raw materials and finished goods;
    c. Reviewing the applicable tax legislation;
    d. Analysing the Export Promotion Programmes Office (“EPPO”);
    e. Reviewing the letter from the Ministry of Finance dated 12th September 1995 (contained in Appendix D);
    f. Determining whether there were sufficient grounds for the company to qualify for duty remission as per the EPPO and the relevant tax legislation.

    Our internal verification process established that the goods imported (HDPE, multilayer film for packaging as well as RBD palm olein and palm stearin) did not qualify for duty remission as per the prevailing legislation. This position was strongly backed by the letter from the Ministry of Finance dated 12th September 1995 which declined to grant duty remission to Bidco.

2. **External Verification** – This task aimed at verifying the authenticity of the documents i.e. the 26 custom entries as well as the letter from the Ministry of Finance. All the documentation provided were compared with the records at KRA’s Customs Department and the records at National Treasury (formerly Ministry of Finance). These documents are contained in Appendices A, B, C and D. All the documentation were verified to be authentic.

3. **Palm Oil Manufacturing and Refining Process** – due to the technical nature of the goods manufactured, it was critical to demonstrate how palm oil is processed so as to verify that RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin), and whether it would qualify for duty remission based on the finished goods it was being used to manufacture for export. We established that RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin). This is a finished good as per Legal Notice 146 of 1993. Therefore, as a finished good, it does not qualify for duty remission.

4. **Quantification of Tax Exposure** – Once we established that the goods imported did not qualify for duty remission as per the prevailing legislation and applied the technical aspects of palm oil processing and refining, we computed the potential tax exposure on unpaid duty (including VAT). The total tax exposure on the unpaid duty (including VAT) as at 31 December 2015 was **KES 4,394,779,047**.

We have highlighted the significant exposure with regards to unpaid tax as set out above. We have established that no formal statute of limitations would prevent the relevant authorities from investigating this tax avoidance scheme. In addition, our findings may not include all penalties – civil and criminal, including mandatory prison sentences - that the revenue authorities and judicial system have in their powers.

The penalties associated with tax evasion are quite punitive. Section 193 of the East African Community Customs Management Act ("EACCMA") states that "a person who conspires with another person or persons to contravene any of the provisions of this Act commits an offence and shall be liable on conviction to imprisonment for a term not exceeding five years". Furthermore, Section 200(d)(iii) of EACCMA states a person who acquires, has in his or her possession, keeps or conceals, or procures to be kept or concealed, any goods which he or she knows, or ought reasonably to have known, to be uncustomed goods commits an offence and shall be liable on conviction to imprisonment for a term not exceeding five years or to a fine equal to fifty percent of the dutiable value of the goods involved, or both. Uncustomed goods are goods on which no duty has been paid. Apart from the EACCMA, Section 104(3) of the newly enacted Tax Procedures Act 2015 ("TPA") states that "a person convicted of an offence under section 97 shall be liable to a fine not exceeding ten million shillings or double the tax evaded, whichever is higher or to imprisonment for a term not exceeding ten years, or to both". Section 97 of the TPA states that "a person who knowingly:

a) omits from his or her return any amount which should have been included; or
b) claims any relief or refund to which he or she is not entitled; or
c) makes any incorrect statement which affects his or her liability to tax; or
d) prepares false books of account or other records relating to that other person or falsifies any such books of account or other records; or
e) deliberately defaults on any obligation imposed under a tax law,

commits an offence". All the above subsections apply in Bidco's case.

Finally, it is important to recognize that the exposure on non-compliant areas is based on the 26 C15 custom entries that we examined, and may not therefore represent Bidco's full tax exposure before, during or after the period examined.

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Appendices

Definitions and Abbreviations

Unless the context otherwise requires, the definitions and abbreviations set forth in this section shall apply whenever any of the following words and expressions are used in this advice.

Abbreviation	Definition
CPO	Crude Palm Oil
CSD	Customs Services Department
EACCMA	East African Customs Management Act 2004
EFB	Empty Fruit Bunches
ETP	Effluent Treatment Plant
EPPO	Export Promotion Programmes Office
FFA	Free Fatty Acids
FFB	Fresh Fruit Bunches
HDPE	High-density Polyethylene
IDF	Import Declaration Fee
KRA	Kenya Revenue Authority
NBDPO	Neutralized, Bleached And Deodorized Palm Oil
PK	Palm Kernel
POME	Palm Oil Mill Effluent
RBD	Refined, Bleached & Deodorised
TREO	Tax Remission for Export Office
VAT	Value Added Tax

1. Introduction

Our understanding

We received a dossier of 26 customs entries and documentation of Bidco. We then proceeded with verification of the following documentation:

- Customs entries as well as supporting documents;
- Letters from the National Treasury;
- Legislation relating to the operation of the Export Promotion Programmes Office ("EPPO")

Objective of the assignment

The objective of this report is to review the customs documentations in order to assess the company's level of compliance with Kenyan tax laws regarding Value Added Tax ("VAT") and Customs & Excise Tax with regards to the documentations contained in the dossier.

Period of the review

The tax review covered the period of the 26 customs entry from June 1992 to April 1998.

Our approach

A complete review of all the documentation provided was carried out. Based on previous experience, the 26 custom entries did not warrant any sampling due to the adequate size of the population. The sampling basis is discussed under each respective tax head.

Legal Basis

The provisions of the VAT Act, VAT Act 2013 and the Customs and Excise Act (Cap 472), the East African Customs Management Act 2004 ("EACCMA") form the basis of our findings and report.

On 2 September 2013, the Value Added Tax Act (CAP 476) was repealed and replaced with a new VAT Act 2013. For the purposes of this report, all references to VAT Act are in relation to Value Added Tax Act (CAP 476) and VAT Act, 2013 which were the prevailing legislation for the period under review.

We have summarised our findings in the table below.

Item No.	Tax Issue	Comments based on the documentation provided
1	Review of the C15 custom entries	Our review indicated that the C15 were correctly filled out with regards to the tariff classification, prevailing duty and VAT rate applied as well as numerical accuracy.
2	Imported materials	During the period under review, the company imported raw materials (HDPE) and finished goods (multilayer film for packaging, RBD olein and RBD stearin which did not qualify for duty remission as per the Customs and Excise Act CAP 472. This has been confirmed by letter from the Ministry of Finance confirming that the company does not qualify for duty remission in the importation of HDPE. This has resulted in the company being exposed to significant tax exposure arising from unpaid tax as well as resultant penalty and interest.
3	External verification	The 26 custom entries together with their supporting documentation and the Ministry of Finance letter were verified by the relevant statutory bodies' records for their authenticity. All the documents were verified to be genuine.
4	Palm oil manufacturing	RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin). This is a finished good as per Legal Notice 146 of 1993. Therefore as a finished good, it does not qualify for duty remission. This was only allowed in 2002 as per Regulation 5(f) of Legal Notice 91 of 2002.
5.	Quantification of tax exposure	From an analysis of the applicable tax legislation, the company has a tax exposure of **KES 4,394,779,047** arising from non-payment of duty (and VAT).

2. Internal Verification

We carried out a review on the company's customs documentation with the aim of determining the level of compliance with customs laws and regulations and addressing any risk areas identified.

From our review, we noted that the company imported raw materials and finished goods mainly from offshore companies.

We undertook the following:

- Review of the 26 C15 custom entries as well as the supporting documentation:
- Gain an understanding of the imported raw materials and finished goods;
- Review of the applicable tax legislation;
- Gain an understanding of the Export Promotion Programmes Office ("EPPO");
- Review of the letter from the Ministry of Finance dated 12th September 1995 (contained in Appendix D);
- Determine whether there were sufficient grounds for the company to qualify for duty remission as per the EPPO and the relevant tax legislation.

We noted that the following are the main imported raw materials:

- High-density polyethylene ("HDPE") - is a polyethylene thermoplastic made from petroleum. It is sometimes called "alkathene" or "polythene" when used for pipes. With a high strength-to-density ratio, HDPE is used in the production of plastic bottles, corrosion-resistant piping, geomembranes, and plastic lumber[1]. This is contained in Appendix A
- Multilayer film for packaging. This is shown in Appendix B

Imported finished goods include:

- Refined, Bleached & Deodorised ("RBD") palm olein[2] – is obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin);
- RBD palm stearin - this is obtained from fractionating refined palm oil to separate olein from stearin.
    - Both the above are contained in Appendix C.

[1] http://www.bpf.co.uk/plastipedia/polymers/HDPE.aspx
[2] http://www.palmoilworld.org/applications.html

Overview of applicable tax legislation

The provisions of the VAT Act, VAT Act 2013 and he Customs and Excise Act (Cap 472) form the basis of our findings and report. In particular, reliance was placed on the following Customs and Excise Regulations contained in:

- Legal Notice 435 of October 1990;
- Legal Notice 146 of June 1993;
- Legal Notice 91 of 2002;
- Legal Notice 129 of 2002 – The Customs and Excise (Duty Remission) Regulations; and
- Legal Notice 66 of 2003.

On 2 September 2013, the Value Added Tax Act (CAP 476) was repealed and replaced with a new VAT Act 2013. For the purposes of this report, all references to VAT Act are in relation to Value Added Tax Act (CAP 476) and VAT Act, 2013 which were the prevailing legislation for the period under review.

Prior to 1994, manufacturers applied for duty exemption on raw materials to be used in manufacturing goods for export under Legal Notice 435 of 1990.

The EPPO was introduced in 1994 after the Export Compensation Scheme ended. Under this programme, the importer applied for duty remission on specific quantities before importing the same. Upon approval of the application, the raw material was imported into the country duty free against a security bond whose value was equivalent to the duty amount remitted. This bond was used to secure the taxes due, in the event that the raw material was not used in the manufacture of goods for export. Once the goods were exported, the manufacturer/importer applied for security bond cancellation.

In 2002, the Tax Remission for Export Office (“TREO”) replaced EPPO. TREO is an office located in the Ministry of Finance which is responsible for matters relating to the administration of the regulations that govern the Duty Remission Scheme. The Ministry of Finance manages the scheme in conjunction with the TREO Audit unit within KRA’s Customs Services Department (“CSD”). The objective of the scheme is to enhance the competitiveness of Kenya’s manufactured products in both the local and international markets.

The EPPO scheme was replaced by TREO which is provided for under the Customs and Excise Act, cap 472 of the Laws of Kenya in 2002. The TREO regulations were gazetted in Legal Notice No. 129 of 19 July 2002. Section 141 (2) of the Customs and Excise Act provides for the remission of 100 per cent duty for raw material imported under TREO, for the manufacture of goods for export and/or essential goods for home use, with an exception of industrial sugar. Unlike other raw materials which attract a 100 per cent remission, industrial sugar when imported under this scheme attracts 25 per cent duty. Similar to EPPO, Under TREO, a manufacturer can only import approved and gazetted quantities. All goods imported under TREO are subject to a security bond whose value is equivalent to that of the duty that is remitted. This is a requirement that helps safeguard the remitted taxes in the event that the imported raw material is diverted to other uses other than that for which it was imported.

Once the goods that are manufactured using raw materials imported under this scheme have been exported, the importer applies for bond cancellation. The cancellation is only effected after an audit has been conducted by the CSD audit team. The objective of both EPPO and TREO was:

- To reduce the cost of production on goods manufactured in Kenya;
- To give local goods a competitive edge both in the international and regional market;
- To support manufacturers who export locally manufactured goods;
- To assist manufacturers maximise the installed capacity of their plants by manufacturing for both domestic and international markets.

Under EPPO and TREO, duty is defined as including VAT.

2.1 Review of the C15 Custom Entries

Observation

We reviewed the completeness of the C15 customs entries including the prevailing duty and VAT rate, accuracy of calculation. We reviewed the tariff codes declared in the entries for the period under review to assess the accuracy of the tariff codes as per the Customs and Excise Act. All the above were accurately reflected in all the C15 custom entries as well as the supporting documentation (EPPO approvals, security bond).

The tariff codes used are as follows.

Description of Goods	Tariff Code	Comments
Plastic raw material (HDPE)	3901.20.00	Correct tariff code
Multilayer film	3920.10.00	Correct tariff code
RBD olein	1511.90.90	Correct tariff code
RBD stearin	1511.90.90	Correct tariff code

2.2 Materials Imported by the Company

Observation

As mentioned earlier, the company imported the following goods:

- HDPE;
- Multilayer film for packaging;
- RBD palm olein; and
- RBD palm stearin - this is obtained from fractionating refined palm oil to separate olein from stearin.

Tax legislation

Regulation 2 of Legal Notice 146 states *"…remission of duty may be granted by the minister in respect of-*

(a) *Goods imported for use in, or to be attached to, goods manufactured or produced in Kenya for subsequent exportation; and*

(b) *Imported goods, other than fuel, lubricants, plant, machinery or equipment, for direct consumption or be expended in the manufacture of or production in Kenya of goods for subsequent exportation."*

Manufacture for the purposes of Legal Notice 146 is defined as "…*any process by which a commodity is finally produced including assembling, packing, bottling, repacking, mixing, blending, grinding, cutting, bending, twisting, joining or other similar activity."* Goods shall be deemed to have undergone a substantial transformation in Kenya if they have undergone a process of manufacturing in Kenya which has transformed the constituent material in form, value, description, use, name or appearance; or which has led to a change in the tariff heading.

We now look at each of the materials imported with specific aim of establishing whether they qualify for duty remission as per the Customs and Excise Act.

HDPE

HDPE is a raw material used in the manufacture of plastic materials such as bottles. As per the company's declaration in form C56, Bidco is to export refined edible vegetable oils/ fats and NOT plastic materials. The company does not possess a plastic manufacturing machinery and does not export plastic materials. Therefore HDPE does not qualify for VAT remission as per the Customs and Excise Act and its various Regulations.

In a letter dated 12th September 1995, the Ministry of Finance advised Bidco that HDPE does not qualify for duty/VAT remission as the processing of the HDPE is done by a third party and not by Bidco.

Multilayer Film

This is a manufactured packaging material in sachets and consist of multilayer films.

Goods shall be deemed to have undergone a substantial transformation in Kenya if they have undergone a process of manufacturing in Kenya which has transformed the constituent material in form, value, description, use, name or appearance; or which has led to a change in the tariff heading. This multilayer film does not meet the threshold of being labelled as a raw material as this is a finished good. Therefore as a finished good, it does not qualify for duty remission as per Legal Notice 435 of 1990.

RBD Palm Olein and Stearin

RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin). This is a finished good as per Legal Notice 146 of 1993. Therefore as a finished good, it does not qualify for duty remission. This was only allowed in 2002 as per Regulation 5(f) of Legal Notice 91 of 2002 which states that *"the manufacturer or producer who uses crude palm olein or stearin in producing edible oils and raw materials for the manufacture of laundry toilet soaps and detergents for sale in the domestic market."*

Tax implication

The above material do not qualify for duty remission as per the Customs and Excise Act. Therefore the company is liable to pay the unpaid duty and VAT as well as the resulting penalties and interest on the same.

In view of the above, there is a significant exposure in respect of import duty and VAT on unpaid tax.

2.3 Statute of Limitation

The review period is the years 1992-1998. We therefore reviewed the applicable statute of limitation as there is a significant lapse of time.

Tax legislation

Regulations 19 and 20 of the Customs and Excise (Amendment) Regulation contained in Legal Notice 146 of June 1993 state that:

"18 Maintenance of books and records

Every person who has been granted a remission from duty shall keep and maintain at his place of business detailed books and records relating to the purchase, importation, stocks of goods, packing, sales, shipping and exportation of all goods.

19 Examination of books and records

The books and records referred to in regulation 18 shall be kept for five years from the time of application for remission and shall be made available, upon request, to the proper officer, including an officer of the Tax Remission for Exports Office, for examination and verification at all reasonable times."

Regulations 19 and 20 of the Customs and Excise (Duty Remission) Regulation 2002 also contain similar Regulations as above.

Tax implication

KRA can commence an audit within 5 years from the time the application for remission was done. However in practise, this period is extended in cases of significant tax leakages and cases where material facts are established after the expiry of the five years. In light of the above evidence consisting of C15 custom entries, materials imported as well as the Ministry of Finance letter dated 12th September 1995, there is a strong possibility of KRA initiating a full blown custom audit on Bidco to recover unpaid tax. In addition, no section of the Customs and Excise Act and the VAT Act prevents KRA from undertaking an audit that goes back more than five years.

3. External Verification

The external verification exercise was primarily aimed at verifying the authenticity of the documents i.e. the 26 custom entries as well as the letter from the Ministry of Finance. All the documentation provided were compared with the records at KRA's Customs Department and the records at National Treasury (formerly Ministry of Finance). These documents are contained in Appendices A, B, C and D.

The external verification included the following:

- Review of the authenticity of the 26 C15 custom entries as well as the supporting documentation. This included verifying the following:
    - Customs entry number;
    - Importer's name;
    - Import declaration fee ("IDF") number;
    - Bill of lading number;
    - Particular bond number;
    - Tariff codes and description of the goods;
    - Import duty rate;
    - VAT rate;
    - Remission order number;
    - Signoff by the Customs officials and the owners of the goods (or agents duly authorised by the owners)
- Review the authenticity of the supporting documentation which included verification of :
    - For imports prior to the gazettement of Legal Notice 146 of 1993, the appropriate legislation was Legal Notice 435 of 1990. The supporting documentation was application for duty exemption for exemption- Form C56;
    - The EPPO approval number for the imports after the enactment of Legal Notice 146 of 1993-Form C56.
- Verify the letter from the Ministry of Finance dated 12 September 1995.

Each of the above documents were verified (for all the 26 custom entries). The results of the validation exercise were as follows.

CUSTOM ENTRIES (C15s)-26 ENTRIES	
Item to be Verified	**Status**
Customs entry number	Verified
Importer’s name	Verified
IDF number	Verified
Bill of lading number	Verified
Particular bond number	Verified
Tariff codes and description of the goods	Verified
Import duty rate	Verified
VAT rate	Verified
Remission order number	Verified
Signoff by the Customs officials and the owners of the goods (or agents duly authorised by the owners)	Verified
SUPPORTING DOCUMENTATION	
Item to be Verified	**Status**
EPPO Approval number (Form C56)	Verified
LETTER FROM THE MINISTRY OF FINANCE	
Item to be Verified	**Status**
Letter from Ministry of Finance dated 12 September 1995	Verified

All the 26 custom entries together with the supporting documents and the letter from the Ministry of Finance were verified to be authentic.

4. Palm Oil Manufacturing and Refining Process

This section is mainly concerned with gaining an understanding of how palm oil is processed so as to verify that RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin).

The manufacturing process was obtained by interviews with investors who have had several years of experience in the palm oil industry as well as industry reports and online research.

4.1 Palm Oil Manufacturing Process

Background

Palm oil is produced from a species of palm tree originally from West Africa. The species of tree has emerged over last few decades as one of the world's widely used crops. Palm oil goes into a range of products available in virtually every supermarket, pharmacy, and department store.

It is used in:

- Manufacture of cooking oil and cooking fat;
- Processed foods ranging from crackers, peanut butter and ice cream;
- Beauty products like shampoo, cosmetics, shaving cream, and soap (which account for nearly 10 percent of global consumption of palm oil);
- Industrial lubricants; and
- Biofuel.

Its versatility, combined with a yield far in excess of any other oilseed, has fueled its rapid expansion across Southeast Asia: today, Indonesia and Malaysia—which account for 85 percent of global palm oil production—have more than 50,000 square miles of palm plantations, up from fewer than 580 square miles in 1984. However, the crop's success has come at a great environmental cost: more than half of the expansion since 1980 has come at the expense of natural forests.

As such, palm oil has been targeted by environmentalists and scientists concerned about biodiversity loss, greenhouse gas emissions, and pollution. Palm oil industry has been challenged by land rights issues and social abuses, since expansion is occurring in areas where communities may traditionally use forests but lack title to land.

The palm tree has both perennial and evergreen nature (giving a continuous year-round canopy cover intercepting a high proportion of incoming radiation), the year-round production of fruit bunches and the high partition of total assimilates into harvested product.

The fruit of new tree varieties has a higher proportion of flesh (from which the palm oil is obtained) relative to kernel (from which palm kernel oil is extracted). Generally, palm oil is used as cooking oil while palm kernel oil is used in making processed foods.

Production of Crude Palm Oil and Palm Kernel

In its conversion to cooking oil, FFB goes the following milling processes:

- Palm Oil Milling Process of FFB;
- Palm Oil Refining Process.

Palm Oil Milling Process

About 80% of the national production of crude palm oil is used for food purposes, mainly as cooking oils. The crude palm oil ("CPO") produced by the mills have to be refined to meet the industry's and international standards (FAO's Codex Alimentarius) for edible oils.

Fresh fruit bunches ("FFB") are processed as soon as possible after cutting down from the trees to prevent a rapid rise in free fatty acids ("FFA") which affect the quality of the CPO. Palm oil mills are generally located in the plantations to facilitate timely transportation and effective processing of FFB. The palm oil milling process involves the physical extraction of palm products namely, crude palm oil and palm kernel from the FFB.

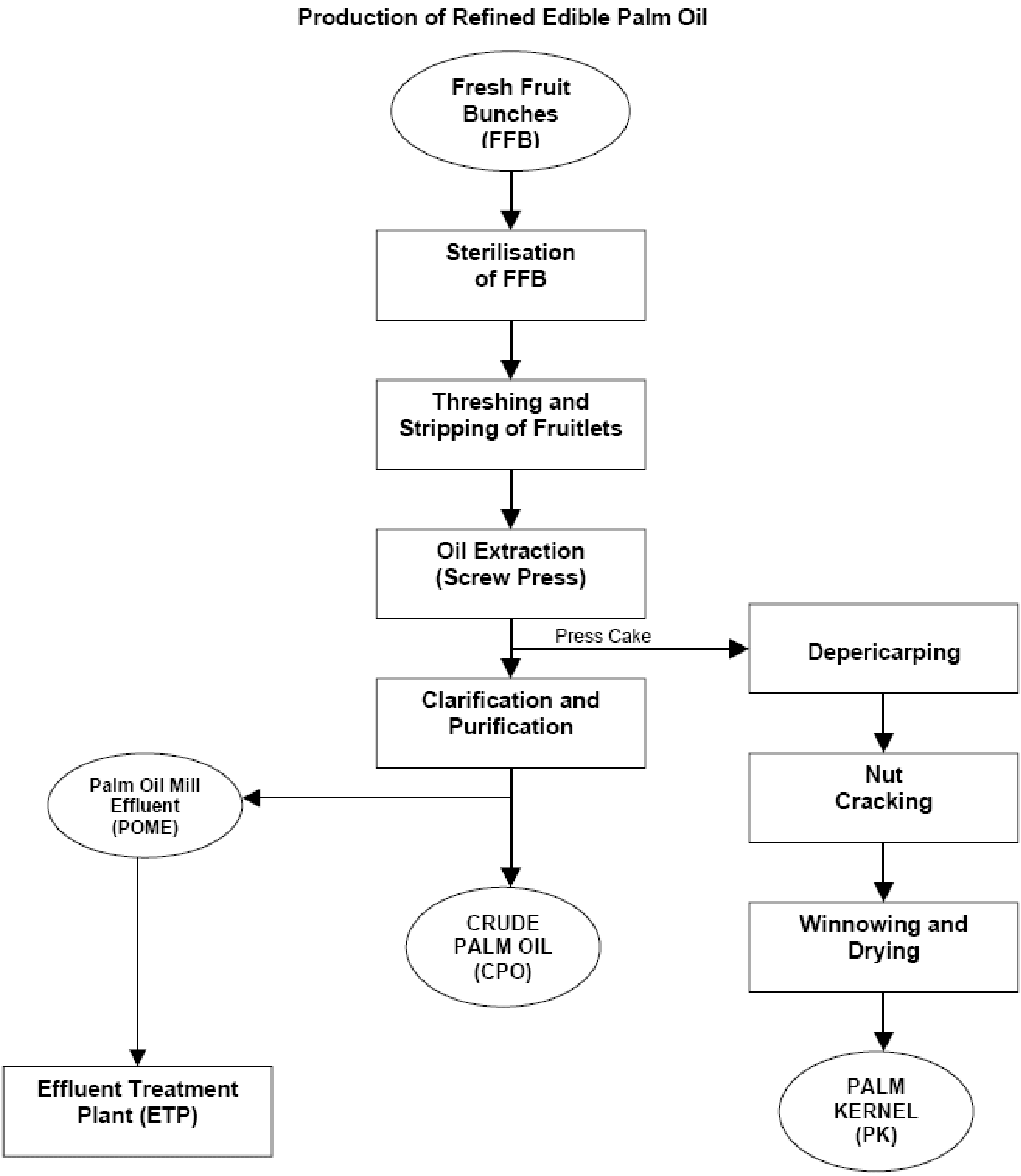
The process begins with sterilization of the FFB. The fruit bunches are steamed in pressurized vessels up to 3 bars to arrest the formation of free fatty acids and prepare the fruits for subsequent sub-processes. The sterilized bunches are then stripped of the fruit lets in a rotating drum thresher. The stripped bunches or empty fruit bunches ("EFB") are transported to the plantation for mulching while the fruit lets are conveyed to the press digesters.

In the digesters, the fruits are heated using live steam and continuously stirred to loosen the oil-bearing mesocarp from the nuts as well as to break open the oil cells present in the mesocarp. The digested mash is then pressed, extracting the oil by means of screw presses. The press cake is then conveyed to the kernel plant where the kernels are recovered.

The oil from the press is diluted and pumped to vertical clarifier tanks. The clarified oil is then fed to purifiers to remove dirt and moisture before being dried further in the vacuum drier. The clean and dry oil is ready for storage and dispatch.

The sludge from the clarifier sediment is fed into bowl centrifuges for further oil recovery. The recovered oil is recycled to the clarifiers while the water/sludge mixture which is referred to as Palm Oil Mill Effluent ("POME") is treated in the effluent treatment plant ("ETP").

The press cake is conveyed to the depericarper where the fiber and nuts are separated. Fiber is burned as fuel in the boiler to generate steam. The nuts are cracked and the shell and kernel are separated by means of a winnower and hydro-cyclone. The clean kernels are dried prior to storage.



Palm Oil Refining Process

The refining process removes free fatty acids, phosphatides, odoriferous matter, water as well as impurities such as dirt and traces of metals from the CPO; the objective being to produce an edible oil of consistent quality that meets industry's standards and satisfies customer requirements particularly in respect of FFA, moisture and impurities, Iodine Value, Peroxide Value, melting point, color and flavor. The refined oil is tasteless and has a bland flavor.

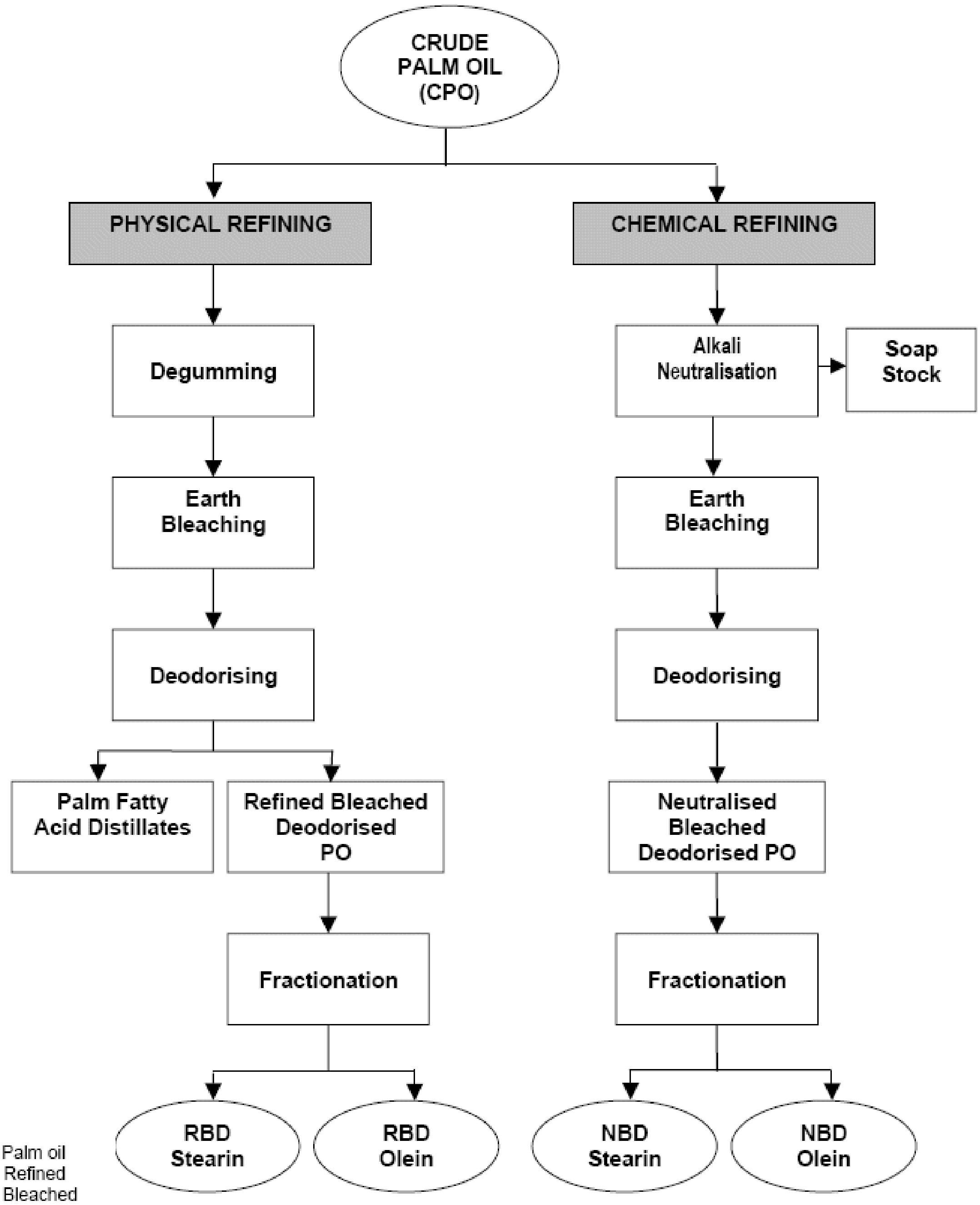
CPO is processed by either physical or chemical refining to produce either refined, bleached and deodorized palm oil (“RBDPO”) or neutralized, bleached and deodorized palm oil (“NBDPO”). These are subjected to fractionation to obtain the respective liquid olein fraction and the solid stearin fraction. Of the two processes, physical refining is the predominant approach adopted by the refineries as it is simpler, less capital intensive, more efficient and produces a lower effluent load.

Physical or steam refining begins with degumming when the CPO is treated with food grade phosphoric acid or citric acid to remove natural gums in the form of phosphatides, followed by bleaching with activated earth (Fuller’s Earth) under vacuum to remove coloring matters as well as to adsorb any metal ions. The treated oil is then heated to 240 C - 260 C under 2- 6 mm Hg for simultaneous deacidification and deodorization. The FFA is stripped off by live steam and is recovered together with the entrained oil is as palm fatty acid distillate. The steam distillation process also removes odors and off-flavors from the CPO (‘Deodorization’). The oil is then cooled to 55°C before polishing.

In the chemical refining process, the FFA present in CPO is removed by neutralization with caustic soda (sodium hydroxide), the concentration of the latter being dependent on the quality of the CPO feedstock. This chemical reaction produces neutralized CPO and a soap stock; the latter is separated from the oil by a high-speed separator. The neutralized oil is subjected to earth bleaching to remove color pigments and metal ions followed by deodorization - steam distillation under vacuum to remove odoriferous matters such as aldehydes and ketones.

The refined oil contains triglycerides of various compositions and melting points, the main fractions being palm olein and palm stearin. These fractions can be separated by dry fractionation, detergent fractionation and solvent fractionation. Dry fractionation is commonly used whereby the refined oil is allowed to crystallize under controlled temperature and the resultant slurry is pumped through a membrane filter press to obtain the liquid olein fraction and the solid stearin portion. The olein could also be fractionated for a second time (‘double fractionation’) to produce a ‘super olein’ and a solid palm mid-fraction (“PMF”) which is the feedstock for production of specialty fats and other products.

Appendix E contains technical information on Bidco’s refining process and how it refines its various products.



PO = Palm oil
R = Refined
B = Bleached
D = Deodourised
N = Nentralised

The following by-products are obtained from the refining of palm oil.

Fatty acids

- Medium chain triglycerides for use in the flavor and fragrance industries;
- Processing aids for rubber products, for softening and plasticizing effect;
- Production of candles;
- Manufacture of cosmetic products from myristic, palmitic and stearic acids;
- Production of soaps via a neutralization process; and
- Production of non-metallic or non-sodium soaps.

Fatty esters

- Production of pure soap – better quality than soaps from fatty acids;
- Alfa-sulphonated methyl esters as active ingredients for washing and cleaning products (anionic surfactants); and
- Palm-based methyl esters as a substitute for diesel fuel for vehicles and engines.

Fatty alcohols

- Production of washing and cleaning products;
- Fatty alcohol sulphates (anionic surfactants);
- Fatty alcohol ethoxylates (nonionic surfactants) ; and
- Fatty alcohol ether sulphates (anionic surfactants).

Fatty nitrogen compounds

- Imidazolines with good surface active properties (rust prevention); and
- Esterquats as softeners.

Glycerol (Monoglycerides and Diglycerides)

- Wide range of applications such as a solvent for pharmaceutical products, humectants in cosmetics and tobacco, stabilizers, lubricants, antifreeze, etc.

4.2 Conclusion

As seen above, RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin). This is a finished good as per Legal Notice 146 of 1993. Therefore as a finished good, it does not qualify for duty remission. This was only allowed in 2002 as per Regulation 5(f) of Legal Notice 91 of 2002 which states that *“the manufacturer or producer who uses crude palm olein or stearin in producing edible oils and raw materials for the manufacture of laundry toilet soaps and detergents for sale in the domestic market.”*

5. Quantification of Tax Exposure

We carried out a review on the company's customs documentation contained in the dossier with the aim of determining the level of compliance with customs laws and regulations and addressing any risk areas identified.

From our review, we noted that the company imported raw materials and finished goods mainly from offshore companies.

5.1 Review of the C15 Custom Entries

Observation

We reviewed the completeness of the C15 customs entries including the prevailing duty and VAT rate, accuracy of calculation. We reviewed the tariff codes declared in the entries for the period under review to assess the accuracy of the tariff codes as per the Customs and Excise Act. All the above were accurately reflected in all the C15 custom entries as well as the supporting documentation (EPPO approvals, security bond).

The tariff codes used are as follows.

Description of Goods	Tariff Code	Comments
Plastic raw material (HDPE)	3901.20.00	Correct tariff code
Multilayer film	3920.10.00	Correct tariff code
RBD olein	1511.90.90	Correct tariff code
RBD stearin	1511.90.90	Correct tariff code

5.2 Materials Imported by the Company

Observation

As mentioned earlier, the company imported the following goods:

- HDPE;
- Multilayer film for packaging;
- RBD palm olein; and
- RBD palm stearin - this is obtained from fractionating refined palm oil to separate olein from stearin.

Tax legislation

Regulation 2 of Legal Notice 146 states *"…remission of duty may be granted by the minister in respect of-*

(c) *Goods imported for use in, or to be attached to, goods manufactured or produced in Kenya for subsequent exportation; and*

(d) *Imported goods, other than fuel, lubricants, plant, machinery or equipment, for direct consumption or be expended in the manufacture of or production in Kenya of goods for subsequent exportation."*

Manufacture for the purposes of Legal Notice 146 is defined as "…*any process by which a commodity is finally produced including assembling, packing, bottling, repacking, mixing, blending, grinding, cutting, bending, twisting, joining or other similar activity."* Goods shall be deemed to have undergone a substantial transformation in Kenya if they have undergone a process of manufacturing in Kenya which has transformed the constituent material in form, value, description, use, name or appearance; or which has led to a change in the tariff heading.

We now look at each of the materials imported with specific aim of establishing whether they qualify for duty remission as per the Customs and Excise Act.

HDPE

HDPE is a raw material used in the manufacture of plastic materials such as bottles. As per the company's declaration in form C56, Bidco is to export refined edible vegetable oils/ fats and NOT plastic materials. The company does not possess a plastic manufacturing machinery and does not export plastic materials. Therefore HDPE does not qualify for VAT remission as per the Customs and Excise Act and its various Regulations.

In a letter dated 12th September 1995, the Ministry of Finance advised Bidco that HDPE does not qualify for duty/VAT remission as the processing of the HDPE is done by a third party and not by Bidco.

Multilayer Film

This is a manufactured packaging material in sachets and consist of multilayer films.

Goods shall be deemed to have undergone a substantial transformation in Kenya if they have undergone a process of manufacturing in Kenya which has transformed the constituent material in form, value, description, use, name or appearance; or which has led to a change in the tariff heading. This multilayer film does not meet the threshold of being labelled as a raw material as this is a finished good. Therefore as a finished good, it does not qualify for duty remission as per Legal Notice 435 of 1990.

RBD Palm Olein and Stearin

RBD palm olein and stearin are obtained from fractionating refined palm oil to separate liquid parts (olein) from solid parts (stearin). This is a finished good as per Legal Notice 146 of 1993. Therefore as a finished good, it does not qualify for duty remission. This was only allowed in 2002 as per Regulation 5(f) of Legal Notice 91 of 2002 which states that *"the manufacturer or producer who uses* *crude palm olein or stearin in producing edible oils and raw materials for the manufacture of laundry toilet soaps and detergents for sale in the domestic market."*

Tax implication

The above material do not qualify for duty remission as per the Customs and Excise Act. Therefore the company is liable to pay the unpaid duty and VAT as well as the resulting penalties and interest on the same.

In view of the above, there is a significant exposure in respect of import duty and VAT on unpaid tax.

5.3 Quantification of Tax Exposure

Tax legislation

Section 249 (1) of the EACCMA states that *"Where an amount of duty or other sum of money which is due under this Act remains unpaid after the date upon which it is payable, an interest of two per cent per month or part of the month, of the unpaid amount shall be charged."*

Section 225 A (1) of the Customs and Excise Act state that *"Subject to sections 20(2) and 158 where an amount of duty or other sum of money which is due under this Act remains unpaid after the date upon which it is payable, a penalty of two per cent per month or part thereof, of the unpaid amount shall forthwith be due and payable"*

Regulation 2 of Legal Notice 146 states *"…remission of duty may be granted by the minister in respect of-*

(e) Goods imported for use in, or to be attached to, goods manufactured or produced in Kenya for subsequent exportation; and

(f) *Imported goods, other than fuel, lubricants, plant, machinery or equipment, for direct consumption or be expended in the manufacture of or production in Kenya of goods for subsequent exportation."*

In addition, the Commissioner may apply Section 200 d (iii) of the EACCMA and levy to a fine equal to fifty percent of the dutiable value.

Section 21 (1) and (2) of the VAT Act 2013 provides for compounded interest of 2% per month on any outstanding interest.

It is important to note that under EPPO and TREO, duty is defined as including VAT.

Once KRA makes a demand pursuant to Section 185 (1),The Commissioner may seek to apply Section 185 (2) of the EACCMA which states that *"a further duty of a sum equal to five percent of the amount demanded shall be due and payable by that person by way of a penalty and a subsequent penalty of two percent for each month in which he or she defaults*."

Tax implication

The total tax exposure on the unpaid duty (including VAT) as at 31 December 2015 is **KES 4,394,779,047**. Detailed workings of the tax exposure is provided in **Appendix F.**

Conclusion

We have highlighted the significant tax exposure with regards to unpaid tax as set out above. However, it is important to recognize that the exposure on non-compliant areas is based on the 26 C15 custom entries that we examined and may not therefore represent the full exposure.