Commissioner of Domestic Taxes v East Africa Reinsurance Co. Ltd (Tax Appeal E051 & E052 of 2023 (Consolidated)) [2024] KEHC 9883 (KLR) (Commercial and Tax) (29 July 2024) (Judgment)

Neutral citation: [2024] KEHC 9883 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI LAW COURTS)

COMMERCIAL AND TAX

TAX APPEAL E051 & E052 OF 2023 (CONSOLIDATED)

DKN MAGARE, J

JULY 29, 2024

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

EAST AFRICA REINSURANCE CO. LTD ..... RESPONDENT

(Appeal from the Judgment of the Tax Appeals Tribunal given in Tribunal Case No. 529 of 2021 in Nairobi on 10/3/2023.)

JUDGMENT

1. This is an appeal from the Judgment of the Tax Appeals Tribunal given in Tribunal Case No. 529 of 2021 in Nairobi on 10/3/2023. The Appellant set out 6 grounds of appeal.
2. The Memorandum of Appeal, however, is a classical study on how not to write a memorandum of appeal. The grounds are argumentative, unseemly and do not please the eye.
3. Order 42 Rule 1 requires that the memorandum of appeal be concise. The same provides as doth: -

> " 1. Form of appeal –
>
> 1. Every appeal to the High Court shall be in the form of a memorandum of appeal signed in the same manner as a pleading. (2) The memorandum of appeal shall set forth concisely and under distinct heads the grounds of objection to the decree or order appealed against, without any argument or narrative, and such grounds shall be numbered consecutively."

4. The Court of Appeal had this to say in regard to rule 86 (which is pari materia with order 42 Rule 1) in the case of Robinson Kiplagat Tuwei v Felix Kipchoge Limo Langat [2020] eKLR: -

> " We are yet again confronted with an appeal founded on a memorandum of appeal that is drawn in total disregard of rule 86 of the Court of Appeal Rules. That rule demands that a memorandum of appeal must set forth concisely, without argument or narrative, the grounds upon which a judgment is impugned. What we have before us are some 18 grounds of appeal that lack focus and are repetitively tedious. It is certainly not edifying for counsel to present two dozen grounds of appeal, and end up arguing only two or three issues, on the myth that he has condensed the grounds of appeal. This Court has repeatedly stated that counsel must take time to draw the memoranda of appeal in strict compliance with the rules of the Court. (See Abdi Ali Dere v. Firoz Hussein Tundal & 2 Others [2013] eKLR) and Nasri Ibrahim v. IEBC & 2 Others [2018] eKLR. In the latter case, this Court lamented:
>
> "We must reiterate that counsel must strive to make drafting of grounds of appeal an art, not an exercise in verbosity, repetition, or empty rhetoric...A surfeit of prolixious grounds of appeal do not in anyway enhance the chances of success of an appeal. If they achieve anything, it is only to obfuscate the real issues in dispute, vex and irritate the opposite parties, waste valuable judicial time, and increase costs." The 18 grounds of appeal presented by the appellant, Robinson Kiplagat Tuwei against the judgment of the Environment and Land Court at Eldoret (Odeny, J.) dated 19th September 2018 raise only two issues..."

5. Further in Kenya Ports Authority v Threeways Shipping Services (K) Limited [2019] eKLR , the court of appeal observed that : -

> " Our first observation is that the memorandum of appeal in this matter sets out repetitive grounds of appeal. The singular issue in this appeal is whether Section 62 of the *Kenya Ports Authority Act* ousts the jurisdiction of the High Court. We abhor repetitiveness of grounds of appeal which tend to cloud the key issue in dispute for determination by the Court. In *William Koross V. Hezekiah Kiptoo Kimue & 4 others, Civil Appeal No. 223 of 2013*, this Court stated:
>
> "The memorandum of appeal contains some thirty-two grounds of appeal, too many by any measure and serving only to repeat and obscure. We have said it before and will repeat that memoranda of appeal need to be more carefully and efficiently crafted by counsel. In this regard, precise, concise and brief is wiser and better."

6. The memorandum of appeal raises only two grounds, that is:

   a. The Tribunal erred in law and fact in finding that the Respondent's transfer from life fund was not subject to tax under Section 19(5) of the *Income Tax Act*.

   b. The Tribunal erred in law and fact in failing to find that the adjustments made by the Respondent to life fund were not permitted under Section 46(5) of the *Insurance Act*.

Pleadings

7. The Respondent filed the appeal to the tribunal following the rejection of its objection to taxation. It was averred that the Appellant conducted a corporation tax audit for the period 2014 to 2019 following which a tax demand of Ksh. 151,141,071/- was issued on 17/2/2021 in respect of alleged omissions and tax underpayments.

8. When the Appellant dismissed the Respondent's Objection, the Respondent preferred an appeal arguing in material that the Appellant erroneously considered deferred tax and corporation tax as actuarial surplus under the *Insurance Act* to be transferred from the life fund for the benefit of shareholders and as such was taxable under Section 19(5) of the *Income Tax Act*.

9. The Respondent's case on the other hand was that the corporation tax and deferred tax were necessary adjustments to the life fund surplus under Section 46(5) and (6) of the *Insurance Act* prior to the paying of dividends to the shareholders and were as such taxable.

10. The details are captured in the submissions by the parties which shall be detailed later in this judgment.

Evidence

11. The Respondent was the Appellant in the tribunal. It called one Purity Mumbe as witness. She relied on the Statement of Facts filed on 3/9/2021 and her witness statement dated 13/9/2021. The witness also relied on the documents filed in the tribunal which she produced as exhibits in support of the Respondent's case. She also relied on the submissions filed before the tribunal on 18/10/2022.

12. It was her stated case that based on the materials presented before the tribunal, it was clear that the Appellant operated a life fund and carried out actuarial valuations based on which the Respondent correctly accounted for and paid for the tax for the years 2015 to 2019 in accordance with Section 19 (5) of the *Insurance Act*.

13. The Appellant on the other hand was the Respondent in the tribunal. The Appellant called one Benard Kiagu who relied on his witness statement dated 19/09/2022. The witness also relied on the submissions of the Appellant filed on 18/10/2022. The witness grounded the Appellant's Defence on the statement of facts dated 30/9/2022 as well as the documents filed in the tribunal which he relied upon as exhibits in evidence.

14. It was the position of the witness that the profit or gain of the company originated directly from the surplus determined by actuary at the end of the year by deducting from the life fund the actuarial liability. Therefore, it was the case of the witness inter alia, that actuarial valuation is arrived at by factoring the assets and liabilities and the adjustments made including the tax in advance and tax provision.

Submissions

15. The Appellant submitted that taxes paid by the Respondent and deferred taxes are allowable taxes to the life fund under Section 45(5) & (6) of the *Insurance Act* and were as such subject to tax within the meaning of Section 19(5) of the *Income Tax Act* as follows:

> " The gains or profits for a year of income from the life insurance business of a resident insurance company, whether mutual or proprietary, shall be the sum of the following: -
>
> (a) the amount of actuarial surplus, as determined under the *Insurance Act* and recommended by the actuary to be transferred from the life fund for the benefit of shareholders and policy holders;
>
> (b) any other amounts transferred from the life fund for the benefit of the shareholders; and

(c) thirty per centum of management expenses and commissions that are in excess of the maximum amounts allowed by the *Insurance Act*."

16. It was thus submitted that the shareholders of the Respondent earned dividends on the life fund arising from the surplus from the actuarial report and such surplus was as such subject to taxation.

17. Further, the Appellant submitted that a surplus is deemed to be income or profit of the insurance company that may be paid out to the shareholders in terms of dividends. Therefore, life fund benefits the policyholders whereas the surplus benefits the shareholders. They relied on Kenindia Assurance Company Ltd v Commissioner of Domestic Taxes (2020)e KLR as follows:

> " Counsel for the respondent submitted that the term Life Fund is the insurance industry's acceptable term for the fund establishing the life insurance business. He cited the definition in the Longman Business Dictionary which defines the term as follows, "an amount of money from which life insurance payments are made and with which an insurance company makes investments ..." and the Cambridge Dictionary which states, "an amount of money that is paid to and invested by insurance companies for life insurance companies for life insurance, and from which money is paid when someone dies." I agree with this submission that from a general definition, a life fund is distinct from any other fund and that in fact, section 45 of the *Insurance Act* contemplates that such a fund which supports the long term business of life assurance must be separate and distinct from any other fund created in respect of any other class or classes of long term insurance business. The consequence of this finding is that the Statutory Reserve created by the appellant in 2004 for the benefit of shareholders and policy holders is different from the Life fund contemplated under section 19(5) of the ITA. I also reject the respondent's submission that Statutory Reserve was a fund within the Life Fund. A fund or reserve for retained earnings is entirely for the benefit of shareholders and has little relation to the insurers long term business."

18. It was also submitted for the Appellant that adjustments in the form of actual taxes paid on surplus for shareholders and deferred taxes were allowable deductions to the life fund under Section 46(5) & (6) of the *Insurance Act* since thus constituted actual income tax payable from the surplus recommended for transfer to shareholders deducted at source. That the same cannot be accounted for from life fund as submitted by the Respondent.

19. They relied on 46 of the *Insurance Act* as follows:

> " No part of the assets of a statutory fund shall, so long as the insurer carries on the class or classes of long term insurance business in respect of which the fund was established –
>
> (a) be available to meet any liabilities or expenses of the insurer other than-
>
> (i) liabilities or expenses referable to that class of long term insurance business; and
>
> (ii) liabilities charged on those assets or any of them immediately prior to the appointed date, or be otherwise directly or indirectly applied for any purpose other than the purpose of that class of long term insurance business;
>
> (b) be paid, applied or allocated as dividends or otherwise as profits to shareholders; or

(ii) transferred to another statutory fund.

...

(5) Notwithstanding subsection (1), an insurer may, for the purposes of declaring or paying a dividend to shareholders or a bonus to policy-holders, utilize the surplus disclosed in the valuation balance sheet of a statutory fund set out in the actuary's abstract relating to an investigation made in pursuance of Section 57 and accepted by the Commissioner, subject to the condition that the amount allocated or paid to the shareholders out of a statutory fund shall not exceed thirty per cent of the surplus disclosed therein after making the necessary adjustments to the surplus.

(6) The adjustments referred to in subsection (5) are-

(a) The actual amount of income tax deducted at source during the period following the date on which the last preceding investigation was made and preceding the date on which the investigation in question is made may be added to the surplus after deducting an estimated amount of income tax on the surplus, the addition and deduction being shown in the abstract prepared by the actuary;

(b) The surplus may be increased by contributions out of a reserve fund subject to the condition and only to the extent that the reserve fund has been made up solely of transfers from similar surpluses disclosed by investigations in respect of which the returns have been accepted by the Commissioner."

20. In rejoinder, the Respondent submitted that deferred tax and corporation tax were liabilities of the life fund deducted from the life fund to determine surplus value of the life fund under section 57 of the *Insurance Act*. That therefore, the Respondent correctly determined corporation tax to the total amount of actuarial surplus recommended to be transferred from the life fund for the benefit of shareholders.

21. Reliance was placed on Section 46 of the *Insurance Act* which provides as follows:

" 46 (1) Subject to this Act, no part of the assets of a statutory fund shall, so long as the insurer carries on the class or classes of long term insurance business in respect of which the fund was established-

(a) be available to meet any liabilities or expenses of the insurer other than-

(i) liabilities or expenses referable to that class of long term insurance business; and

(ii) liabilities charged on those assets or any of them immediately prior to the appointed date, or be otherwise directly or indirectly applied for any purpose other than the purpose of that class of long term insurance business;

(b) be-

(i) paid, applied or allocated as dividends or otherwise as profits to shareholders; or

(ii) transferred to another statutory fund.

46 (5) Notwithstanding subsection (1), an insurer may, for the purposes of declaring or paying a dividend to shareholders or a bonus to policy-holders, utilize the surplus disclosed in the valuation balance sheet of a statutory fund set out in the actuary's abstract relating to an investigation made in pursuance of section 57 and accepted by the Commissioner, subject to the condition that the amount allocated or paid to the shareholders out of a statutory fund shall not exceed thirty per cent of the surplus disclosed therein after making the necessary adjustments to the surplus.

46 (6) The adjustments referred to in subsection (5) are —(a) the actual amount of income tax deducted at source during the period following the date on which the last preceding investigation was made and preceding the date on which the investigation in question is made may be added to the surplus after deducting an estimated amount of income tax on the surplus, the addition and deduction being shown in the abstract prepared by the actuary;

(b) the surplus may be increased by contributions out of a reserve fund subject to the condition and only to the extent that the reserve fund has been made up solely of transfers from similar surpluses disclosed by investigations in respect of which the returns have been accepted by the Commissioner.

22. It was as such submitted that under Section 46(1), (5) & (6) of the *Insurance Act*:

(a) the assets of a statutory fund shall not meet the liabilities or expenses of a long term insurance business;

(b) the surplus disclosed in the statutory fund can be utilized to pay dividends and bonuses to long life policy holders provided that such payments do not exceed 30 percent of the surplus disclosed therein after making the necessary adjustments to the surplus.

(c) The adjustments to be worked out by Actuary is on the basis of the formula below:

Adjustments = Actual Income + Surplus – Estimated Income tax on surplus.

23. Therefore, they submitted that the obligation to account and pay tax was an obligation of the Respondent and not the shareholders and the tax could not be held to have been transferred from the life fund. This would amount to double taxation.

24. I was urged to dismiss the Appeal.

Analysis

25. This court is under the duty to re-evaluate and assess the evidence and make its own conclusions. It must, however, keep at the back of its mind that a trial court, unlike the appellate court, had the advantage of observing the demeanour of the witnesses and hearing their evidence first hand.

26. In the cases of Peters vs Sunday Post Limited [1958] EA 424 , the court therein rendered itself as follows:-

> " It is a strong thing for an appellate court to differ from the findings on a question of fact, of the judge who had the advantage of seeing and hearing the witnesses...But the jurisdiction to review the evidence should be exercised with caution: it is not enough that the appellate court might have come to a different conclusion..."

27. In Selle & Another vs. Associated Motor Boat Co. Ltd & Others [1968] EA 123, this principle was enunciated thus:

> " ...this court is not bound necessarily to accept the findings of fact by the court below. An appeal to this court ... is by way of retrial and the principles upon which this court acts in such an appeal are well settled. Briefly put they are that this court must reconsider the evidence, evaluate it itself and draw its own conclusions though it should always bear in mind that it has neither seen nor heard the witnesses and should make due allowance in this respect..."

28. In Mercy Kirito Mutegi v. Beatrice Nkatha Nyaga & 2 Others [2013] e KLR, the Court of Appeal held:

> " An appellate court will not ordinarily differ with the findings on a question of fact, by a trial Judge who had the advantage of hearing and seeing the witnesses. Our role is to review the evidence and determine whether the conclusions reached are in accordance with the evidence and the law. A conclusion although based on primary factual evidence that is erroneous becomes a point of law. This is a demonstration that there will be occasion when facts or evidence matter in determining a question of law".

29. The principles guiding taxation were restated in Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD [2012] eKLR where Majanja, J held:

> " The approach to this case is that stated in the oft cited case of Cape Brandy Syndicate v Inland Revenue Commissioners [1920] 1 KB 64 as applied in T.M. Bell v Commissioner of Income Tax [1960] EALR 224 where Roland J. stated, " ...in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing it to be implied. One can only look fairly at the language used... If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be." As this case concerns the interpretation of the *Income Tax Act*, I am also guided by the dictum of Lord Simonds in Russell v Scott [1948] 2 ALL ER 5 where he stated, "My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him" adopted in Stanbic Bank Kenya Limited v Kenya Revenue Authority CA Civil Appeal No. 77 of 2008 (Unreported) [2009] eKLR per Nyamu JA (See also Jafferali Alibhai v Commissioner of Income Tax [1961] EA 610, Kanjee Naranjee v Income Tax Commissioner [1964] EA 257). Any tax imposed on a subject is dictated by the terms of legislation and taxing authority must satisfy itself that the transaction fits within the definition of the statute. In Adamson v Attorney General (1933)

AC 257 at p 275 it was held that, "The section is one that imposes a tax upon the subject, and it is well settled that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used, and if there is any doubt or ambiguity this defect- if it be in view of the Crown a defect can only be remedied by legislation."

30. Tax legislation should be stated in clear and simple terms. In Tanganyika Mine Workers Union vs. The Registrar of Trade Unions [1961] EA 629, it was held that where the provisions of an enactment are penal provisions, they must be construed strictly and that in such circumstances you ought not to do violence to its language in order to bring people within it, but ought rather to take care that no-one is brought within it who is not brought within it in express language.

31. Similarly, it was held in Vestey vs. Inland Revenue Commissioners [1979] 3 All ER at 984 that:

> "Taxes are imposed on subjects by parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined."

32. In the same vein, it was held in Russell (Inspector of Taxes) vs. Scott [1943] AC 422 at 433:

> "I must add that the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind I feel that the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected...my Lords, there is a maxim of income tax law, which though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose tax upon him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion."

33. In *Commissioner of Income Tax vs. Westmont Power (K) Ltd Nairobi High Court Income Tax Appeal No. 626 of 2002*, the Court while citing Inland Revenue vs. Scottish Central Electricity Company [1931] 15 TC 761 expressed itself as follows:

> "Even though taxation is acceptable and even essential in democratic societies, taxation laws that have the effect of depriving citizens of their property by imposing pecuniary burdens resulting also in penal consequences must be interpreted with great caution. In this respect, it is paramount that their provisions must be express and clear so as to leave no room for ambiguity...any ambiguity in such a law must be resolved in favour of the taxpayer and not the Public Revenue Authorities which are responsible for their implementation."

34. Therefore, it is settled law that the legislation that imposes tax must be unambiguous. I add that the literal interpretation canon is most appropriate for the rules of taxation and such rules should be published and only then can the citizens be liable. Whereas the Court appreciates the need to collect taxes, in carrying out their statutory obligations, the tax authorities must adhere to the law. As was held in Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others (2007) eKLR:

> "It is no good answer for the taxman to proclaim that Kshs 1 billion (appx) is intended to swell the public treasury because due to the application of the above principles that money is not lawfully due...Applying the same reasoning, to the matter before this court, it does not matter that the respondents say and think they are owed over a billion Kenya shillings - what

matters is whether the amount is lawfully due and whether the law allows its recovery? It is not a question of impression or perception of what is owed, instead it is what if anything, is owed under the relevant law and whether its assessment and recovery is permitted by the applicable law. If rightly due, the huge amount notwithstanding the court must uphold the right of recovery regardless of its consequence to the applicant and if not due under the law it must not hesitate to disallow it and must disallow it to among other things to uphold both the law the integrity of the rule of law."

35. This dispute was ideally about the interpretation of the law. As was held in Inland Revenue Commissioners vs. Wolfson [1949] 1 All ER 864 at 868 where it was held that:

> " It was argued that the construction that I favour leaves an easy loophole through which the evasive tax payer may find escape. That may be so, but I will repeat what has been said before. It is not the function of a court of law to give words a strained and unnatural meaning because only thus will a taxing section apply to a transaction which had the legislature thought of it, would have been covered by appropriate words. It is the duty of the Court to give to the words of this subsection their reasonable meaning, and I must decline on any ground of policy to give them a meaning which with all respect to the dissentient Lord Justice I regard as little short of extravagance."

36. This court is alive to the trite law that statutory powers can only be lawful if exercised reasonably, rationally and properly in accordance with the statutory provisions in question. This does not exclude tax legislation. As was held in Republic vs. Commissioner of Co-operatives ex-parte Kirinyaga Tea Growers Co-operative Savings and Credit Society Ltd [1999] 1 EA 245 (CAK) at page 249, statutory powers can only be exercised validly if they are exercised reasonably, rationally and properly and no statute ever allows any public officer to statutory power arbitrary or capriciously. The same finding was made in Republic vs. Kenya Revenue Authority ex parte Aberdare Freight Services Limited [2004] eKLR that statutory powers and duty must be exercised and performed reasonably.

37. Therefore, I proceed to set out the relevant statutory provisions applicable to this appeal. Section 19(5) of the *Income Tax Act* which defines a gain or profit of a life insurance company states as follows:

19 (5) The gains or profits for a year of income from the life insurance business of a resident insurance company, whether mutual or proprietary, shall be the sum of the following: -

(a) the amount of actuarial surplus, as determined under the *Insurance Act* and recommended by the actuary to be transferred from the life fund for the benefit of shareholders and policy holders;

(b) any other amounts transferred from the life fund for the benefit of the shareholders; and

(c) thirty per centum of management expenses and commissions that are in excess of the maximum amounts allowed by the *Insurance Act*.

38. Further, Sections 45 and 46 of the *Insurance Act* provides as follows:

45(1) An insurer carrying on long term insurance business in Kenya on the appointed date shall, as at the date of commencement of his financial year next after the appointed date, and every insurer commencing long term insurance business in Kenya after the appointed date shall, as at the date of commencement of that business, establish and maintain a statutory fund under an appropriate name in respect of the long term insurance business carried on by him.

(2) An insurer may establish and maintain a separate statutory fund, under an appropriate name, in respect of any class or classes of his long term insurance business.

(3) Where an insurer carries on long term insurance business of more than one class, the Commissioner may in writing direct the insurer

(a) To establish, maintain and appropriately name one or more serrate statutory funds in respect of any class or classes of long term insurance business carried on by him;

(b) To maintain account in respect of each of the classes of long term insurance business and to carry and enter the receipts of each of those classes of business in the account maintained by him...

(4) All amounts received by an insurer in respect of any class of long term insurance business, after the establishment by the insurer of a statutory fund under this Section, shall be carried to that fund.

46(1) Subject to this Act, no part of the assets of a statutory fund shall, so long as the insurer carries on the class or classes of long term insurance business in respect of which the fund was established –

(a) be available to meet any liabilities or expenses of the insurer other than-

(i) liabilities or expenses referable to that class of long term insurance business; and

(ii) liabilities charged on those assets or any of them immediately prior to the appointed date, or be otherwise directly or indirectly applied for any purpose other than the purpose of that class of long term insurance business;

(b) be paid, applied or allocated as dividends or otherwise as profits to shareholders; or

(ii) transferred to another statutory fund.

...

(5) Notwithstanding subsection (1), an insurer may, for the purposes of declaring or paying a dividend to shareholders or a bonus to policy-holders, utilize the surplus disclosed in the valuation balance sheet of a statutory fund set out in the actuary's abstract relating to an investigation made in pursuance of Section 57 and accepted by the Commissioner, subject to the condition that the amount allocated or paid to the shareholders out of a statutory fund shall not exceed thirty per cent of the surplus disclosed therein after making the necessary adjustments to the surplus.

(6) The adjustments referred to in subsection (5) are-

(a) The actual amount of income tax deducted at source during the period following the date on which the last preceding investigation was made and preceding the date on which the investigation in question is made may be added to the surplus after deducting an estimated amount of income tax on the surplus, the addition and deduction being shown in the abstract prepared by the actuary;

(b) The surplus may be increased by contributions out of a reserve fund subject to the condition and only to the extent that the reserve fund has been made up solely of transfers from similar surpluses disclosed by investigations in respect of which the returns have been accepted by the Commissioner.

39. This court understands that under Section 56 of the *Tax Procedures Act* the tax payer, Respondent has the burden to prove that the tax decision was incorrect. The said section of the law provided as doth:

56.

(1) In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.

(2) An appeal to the High Court or to the Court of Appeal shall be on a question of law only.

(3) In an appeal by a taxpayer to the Tribunal, High Court or Court of Appeal in relation to an appealable decision, the taxpayer shall rely on the grounds stated in the objection to which the decision relates unless the Tribunal or Court allows the person to add new grounds. [Emphasis mine]

40. I note that the position of the tax payer (Respondent in this appeal) is that the deferred tax and corporation tax are liabilities of the life fund deducted from the life fund to determine surplus value of the life fund under Section 57 of the *Insurance Act*.

41. It is further averred that the tax payer thus correctly determined corporation tax to the total amount of actuarial surplus recommended to be transferred from the life fund for the benefit of shareholders. Therefore, that the obligation to account and pay tax was an obligation of the tax payer and not the shareholders and the tax could not be held to have been transferred from the life fund as this would amount to double taxation.

42. The position of the Appellant on the other hand is that taxes paid by the Respondent and deferred taxes are allowable taxes to the life fund under Section 46(5) & (6) of the *Insurance Act* and were as such subject to tax within the meaning of Section 19(5) of the *Income Tax Act*.

43. It is further argued for the Appellant that the shareholders of the Respondent earned dividends on the life fund arising from the surplus from the actuarial report and such surplus was as such subject to taxation.

44. The Appellant also maintained that a surplus is deemed to be income or profit of the insurance company that may be paid out to the shareholders in terms of dividends. Therefore, life fund benefits policyholders while the surplus benefits the shareholders so that adjustments in the form of actual taxes paid on surplus for shareholders and deferred taxes were allowable deductions to the life fund under Section 45(5) & (6) of the *Insurance Act* since it constituted actual income tax payable from the surplus recommended for transfer to shareholders deducted at source. That the same cannot be accounted for from life fund as submitted by the Respondent.

45. Bearing in mind the relevant provisions of the Income Tax and the *Insurance Act*, I am unable to agree with the position fronted by the Appellant that the corporation and deferred tax are necessary adjustments that must be deducted from the surplus prior to declaration of dividends to determine the net amount to be transferred to the shareholders.

46. Corporation tax must be taxed with respect to companies in a manner to avoid double taxation. The Court of Appeal in Kenya Revenue Authority v Waweru & 3 others; Institute of Certified Public Accountants & 2 others (Interested Parties) (Civil Appeal E591 of 2021) [2022] KECA 1306 (KLR) (2 December 2022) (Judgment) in reference to corporation tax under the *Income Tax Act* stated as doth:

Section 12D of the *Income Tax Act* eliminated the possibility of the same income being taxed twice, as it excluded a person who had already remitted minimum tax pursuant to section 12D, which effectively excluded such a person from corporation tax or taxation under section (2)(a)(i) of the *Income Tax Act*. On the other hand, if a loss-making entity subsequently moved to a profit-making position, then section 12(3) and (4) of the Act set in, thereby eliminating any possibility of double taxation.

47. In my view, the tax payer was entitled under Section 46 (5) and (6) of the *Insurance Act* to make payments out of the life fund for the purposes of paying dividends or bonuses that did not exceed 30% of the surplus disclosed after making the necessary adjustments. The said adjustments clearly do not include corporation and deferred taxes as urged by the Appellant. This is also because under Section 46(6) of the *Insurance Act*, the actual amount of tax deducted at source would be added to the surplus after deducting an estimated amount of tax on the surplus.

48. I note that the tribunal determined that Section 46(6) of the *Insurance Act* was an obstante clause that overrides Section 46(1) thereof thereby allowing for the deduction of the estimated tax on the surplus. Indeed the proviso to Section 46 of the *Insurance Act* was an overriding provision. To do otherwise would in my view defeat the letter of Section 19(5) of the *Income Tax Act*.

49. While dealing with similar issues in Kenindia Assurance Company Limited v Commissioner of Domestic Taxes [2020] eKLR Majanja J (may his Soul Rest in Eternal Peace) stated as follows:

> " Counsel for the respondent submitted that the term Life Fund is the insurance industry's acceptable term for the fund establishing the life insurance business. He cited the definition in the Longman Business Dictionary which defines the term as follows, "an amount of money from which life insurance payments are made and with which an insurance company makes investments ..." and the Cambridge Dictionary which states, "an amount of money that is paid to and invested by insurance companies for life insurance companies for life insurance, and from which money is paid when someone dies." I agree with this submission that from a general definition, a life fund is distinct from any other fund and that in fact, section 45 of the *Insurance Act* contemplates that such a fund which supports the long term business of life assurance must be separate and distinct from any other fund created in respect of any other class or classes of long term insurance business. The consequence of this finding is that the Statutory Reserve created by the appellant in 2004 for the benefit of shareholders and policy holders is different from the Life fund contemplated under section 19(5) of the ITA. I also reject the respondent's submission that Statutory Reserve was a fund within the Life Fund. A fund or reserve for retained earnings is entirely for the benefit of shareholders and has little relation to the insurers long term business.
>
> From my analysis above, I have found that the appellant created two funds; a Life Fund and a Statutory Reserve. The Life Fund is a mandatory requirement for an insurance company like the appellant to carry on long term insurance business and is specifically provided for under section 45(1) of the *Insurance Act* to support that business and to protect policy holders. It is separate and distinct from the Statutory Reserve which was created by the appellant in 2004 and which is for the benefit of shareholders. The transfer of Kshs.111,338,000.00 which the Commissioner subjected to taxation under section 19(5)(b) of the ITA was from the Statutory Reserve and not the Life Fund and was therefore not chargeable with tax under

the aforesaid provision which only applies to a, "transfer from the life fund for the benefit of shareholders.

50. The Learned Judge then concluded as follows at paragraph 40 of his Judgment:

40. Having reached the above conclusion, the issue of double taxation does not arise. The language of section 19(5)(b) of the ITA is clear that it is only a transfer from the life fund for the benefit of shareholders that is subject to tax. In this respect, I agree with the respondent's submission that it does not matter how the fund was established or whether the money entering the fund was already taxed as the point of taxation is the transfer from the life fund for the benefit of shareholders. I would surmise that the policy reason for the taxing a transfer from the life fund is to discourage the diminishing of the life fund in favour of shareholders.

51. I consequently do not find basis to interfere with the reasoning of the tribunal that correctly included tax provisions as part of adjustments so as to arrive at its taxable gains. To the contrary, the proposal by the Appellant was not the intention of Parliament in enacting Section 19(5) of the *Income Tax Act*. As was held by the Supreme Court decision in Gatirau Peter Munya v Dickson Mwenda Kithinji and 2 Others [2014] eKLR, the Court of Appeal in John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others [2018] eKLR summarized what amounts to "matters of law" as follows:

(38) [T]he interpretation or construction of *the Constitution*, statute or regulations made thereunder or their application to the sets of facts established by the trial Court. As far as facts are concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court."

52. I now proceed to determine the partial appeal by the East Africa Reinsurance Company Limited, Respondent in respect of part of the Judgment, and is based on the Memorandum of Appeal dated 4 May 2023 and filed in HCCOMMITA/E052/2023. It is limited to the finding by the Tribunal that the Respondent's decision to make provisions for bad debts amounting to Kshs. 69,364,748.00 did not meet the prescribed threshold outlined in Section 15(2) of the ITA as read with Legal Notice. No. 37 of 2011. I will consider this as a cross appeal to the Appeal herein now that the two appeals were consolidated.

53. On this, the Appellant prayed that the finding of the tribunal on bad debts be upheld. It was the position of the Appellant that indeed the bad debts projected by the Respondent were wishful and could not be concluded to be bad debts as there was no evidence that the liabilities could no longer be realizable.

54. On bad debts in the case of Equity Bank Kenya Limited vs Commissioner of Domestic Taxes [2021] eKLR, the Court stated as follows as regards Legal Notice No.37 of 2011 on the allowability of bad debts:

" Having considered the facts I have outlined, the arguments by the parties and the reasons proffered by the Tribunal, I cannot say that the conclusions reached by the Tribunal are unreasonable. As I stated earlier, the Guidelines do not require that Equity exhausts all the avenues for collecting the debt. It only needs to satisfy one or more of the Guidelines in order to satisfy the Commissioner."

55. In this regard, the Respondent submitted that the Tribunal failed to appreciate in totality the reasonable efforts taken by the Appellant to collect the bad debts which included sending multiple reminders and demands to collect the bad debts but the same did not yield any results.

56. The information filed before the tribunal did satisfy the conclusion that reasonable effort was engaged to recovery the alleged bad debts or that indeed they were truly bad debts.

57. As correctly observed by the tribunal, without evidence inter alia of bankruptcy or insolvency of debtors, lost rights over contractual debts or of unrealizable securities, the Respondent could not be held to have proved bad debts. As held elsewhere in this judgment, the burden was on the tax payer to prove such allegation as bad debts which I find that the Respondent failed.

58. Consequently, I find no merit in both Appeals and dismiss them. On the question of costs, this court has discretion. The discretion is circumscribed under Section 27 of the *Civil Procedure Act*, which, provides as follows: -

> "(1) Subject to such conditions and limitations as may be prescribed, and to the provisions of any law for the time being in force, the costs of and incidental to all suits shall be in the discretion of the court or judge, and the court or judge shall have full power to determine by whom and out of what property and to what extent such costs are to be paid, and to give all necessary directions for the purposes aforesaid; and the fact that the court or judge has no jurisdiction to try the suit shall be no bar to the exercise of those powers: Provided that the costs of any action, cause or other matter or issue shall follow the event unless the court or judge shall for good reason otherwise order.
>
> 2. The court or judge may give interest on costs at any rate not exceeding fourteen per cent per annum, and such interest shall be added to the costs and shall be recoverable as such."

59. The Supreme Court set forth guiding principles applicable in the exercise of that discretion in the case of Jasbir Singh *Rai & 3 others v. Tarlochan Singh Rai & 4 others, SC Petition No. 4 of 2012*; [2014] eKLR, as follows: -

> "(18) It emerges that the award of costs would normally be guided by the principle that "costs follow the event": the effect being that the party who calls forth the event by instituting suit, will bear the costs if the suit fails; but if this party shows legitimate occasion, by successful suit, then the defendant or respondent will bear the costs. However, the vital factor in setting the preference is the judiciously-exercised discretion of the Court, accommodating the special circumstances of the case, while being guided by ends of justice. The claims of the public interest will be a relevant factor, in the exercise of such discretion, as will also be the motivations and conduct of the parties, before, during, and subsequent to the actual process of litigation.... Although there is eminent good sense in the basic rule of costs– that costs follow the event – it is not an invariable rule and, indeed, the ultimate factor on award or non-award of costs is the judicial discretion. It follows, therefore, that costs do not, in law, constitute an unchanging consequence of legal proceedings – a position well illustrated by the considered opinions of this Court in other cases.

60. In the circumstances, the order that commends itself is that parties bear their costs.

Determination

61. In the upshot, I make the following orders:

    a. The Appeal HCCOMMITA/E051/2023 is dismissed in limine.

    b. The Appeal HCCOMMITA/E052/2023 is dismissed in limine.

    c. Each party to bear own costs in the appeal.

DELIVERED, DATED AND SIGNED AT NYERI ON THIS 29TH DAY OF JULY, 2024.

Judgment delivered through Microsoft Teams Online Platform.

KIZITO MAGARE

JUDGE

In the presence of:-

Ms. Almadi for Nyapara for KRA

No appearance for Respondent

Court Assistant – Jedidah