



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
MILIMANI COMMERCIAL & TAX DIVISION

MISC. CIV. APPLN. NO. E222 OF 2021

CONSOLIDATED WITH

MISC. CIV. APPLN. NO. E231 OF 2021

GEO CHEM MIDDLE EAST LTD.....APPLICANT

VERSUS

KENYA REVENUE AUTHORITY.....1ST RESPONDENT

KENYA BUREAU OF STANDARDS.....2ND RESPONDENT

GEOCHEM ME (KENYA BRANCH).....3RD RESPONDENT

NATIONAL BANK OF KENYA LTD1ST INTERESTED/PARTY

KENYA COMMERCIAL BANK.....2ND INTERESTED/PARTY

SAFARICOM LIMITED.....3RD INTERESTED/PARTY

R U L I N G

1. *Section 43 of the Tax Procedures Act, 2015* provides for preservation of funds as follows: -

“1) This section applies if the Commissioner reasonably believes –

(a) that a taxpayer –

i) has made taxable supplies, has removed excisable goods, or has derived an income, in respect of which tax has not been charged; or

ii) has collected a tax, including withholding tax, that has not been accounted for; and

(b) that the taxpayer is likely to frustrate the recovery of the tax.

1) The Commissioner may by notice in writing, in respect of a taxpayer to whom this section applies, require a person –

(a) who owes or may subsequently owe money to the taxpayer;

(b) who owes or may subsequently hold money for or on account of the taxpayer;

(c) who owes or may subsequently hold money for on account of another person for payment to the taxpayer; or

(d) who has the authority from some other person to pay money to the taxpayer, to preserve such money, and that person

shall not transfer, withdraw, dispose of or otherwise deal with that money except as provided for in the notice for a period of 10 working days or until the application y the Commissioner made in accordance with subsection 3 is heard and determined by the High Court.

...

8) An order issued under this section shall expire on the service of a notice of assessment under subsection 7 unless the Court extends the order.”

2. By a Notice under the above provision dated 26/3/2021 (hereinafter “the Notice”), the 1st respondent demanded from the 2nd respondent to preserve any funds due to the 3rd respondent up to Kshs. 1,084,776,666/- until otherwise advised. By a Motion on Notice dated 30/3/2021, the 1st respondent applied to this Court in **HC Misc. Civ. Appln No. E231 of 2021** for an order extending the preservation orders contained in the aforesaid Notice for 60 days.

3. When the matter came up ex-parte before **Mativo J** on 6/4/2021, the Judge declined to grant the orders ought ex-parte but directed that the application be served for hearing inter-partes on 29/4/2021.

4. In the meantime, the applicant got wind of the Notice and rushed to Court on 31/3/2021 in **HC. Misc. Civ. Appln. No. E222 of 2021** seeking orders to restrain the 1st respondent from interfering with credit funds in the interested parties’ accounts based on the said Notice. It also sought the nullification of the said Notice. Further, the applicant took out a Motion on Notice dated 7/4/2021 in **HC Misc. Civ. Appln No. E231 of 2021** seeking to be enjoined therein and to have the same consolidated with this matter.

5. By the consent of all the parties, the two matters were consolidated on 19/4/2021 with this file being the lead file. Thereafter, the parties filed their respective responses to the applications dated 30/3/2021 and 31/3/2021, respectively. The same were orally argued on 19/4/2021 and this now is the ruling on the two applications. I will treat the application by the applicant as the main application while that of the 1st respondent will act as a response thereto.

6. **Senior Counsel Mr. Ngatia** teaming up with **Mr. Omwanza, Advocate** argued the application on behalf of the applicant while Learned Counsel **Mr. Osoro** and **Mr. Arwa** appeared for the 2nd and 3rd respondent, respectively.

7. It was submitted for the applicant that; the tax assessment by 1st respondent in respect of which the Notice was based on a fraud as it related to a company known as **Geochem ME (Kenya Branch)**, that the standard set in **section 43 of the Tax Procedures Act (“the Act”)** had not been met. That the preservation order under the said section connotes an equitable element of the 1st respondent acting in a manner that does not amount to an abuse of the court process. That in any event, the tax being sought by the 1st respondent is not yet due as the judgment of the Supreme Court was yet to be settled.

8. That while the applicant had performed its obligations under a contract with the 2nd respondent for 7 months, the earnings therefrom was appropriated by the 1st respondent. That **Ngatia SC** had since given his professional undertaking to the 1st respondent to pay over any taxes that might be found to be due from the applicant within 30 days of the same being computed.

9. For the 1st respondent, it was submitted that the preservation order dated 26/3/2021 was directed on the correct entity, the 2nd respondent. That under **section 43(6) of the Act**, the reference to **Geo chem ME** is curable. That the only mistake is that the order referred to a different taxpayer instead of the applicant. That the applicant had failed to comply with its obligations under **section 52 of the Income Tax Act**. That **sections 51 and 52 of the Income Tax Act** provides how the issue of **Mr. Ngatia SC’s** professional undertaking is to be handled.

10. **Mr. Arwa**, Learned Counsel for the 2nd respondent left the matter to Court. However, he confirmed that a sum of Kshs. 344,473,856/36 collected by the 1st respondent way back in 2012 has never been released or accounted to the 2nd respondent.

11. The Court has carefully considered the depositions on record, the able submissions of Learned Counsel together with the authorities relied on.

12. The undisputed facts are that by a contract between the applicant and the 2nd respondent entered into in 2009, the applicant carried out certain works for which a sum of Kshs. 344,473,856/36 was earned as fees. Out of this sum, the applicant was entitled to Kshs. 296,960,219/21 while the 2nd respondent was entitled to Kshs. 87,988,213/15.

13. That contract was wrongfully terminated leading to protracted litigation that ended in the Supreme Court of Kenya. Out of that litigation, the 2nd respondent was required to pay to the applicant a total sum of Kshs. 1,560,624,473/- less Kshs. 87,988,213/15. Armed with the judgment of the Supreme Court, the applicant garnisheed the 2nd respondent’s accounts with the three Garnishees. It is then that the 1st respondent sprung up, as it is statutorily entitled to, with its preservation order dated 26/3/2021 the subject of these applications.

14. The first attack on that order and the attempt to extend the same is that, the order was directed at the wrong party. That to the extent that the tax liabilities for which the order was issued was that of the 3rd respondent and not the applicant, the order cannot stand. That the order made reference to the 3rd respondent and not the applicant. The response to that attack was that the preservation order was served upon the correct entity and the mistake as to the taxpayer is curable under **section 43(6) of the Act**.

15. The preservation order dated 26/3/2021 served upon the 2nd respondent read, *inter – alia*, as follows: -

“Kenya Revenue Authority conducted an audit against Geochem ME and issued a tax assessment on the same.

In reference to the Supreme Court ruling application number 33 of 2020, we note that you are required to pay the abovementioned company USD 15,401,505.

...

By this notice, you are required to preserve any funds due to Geo chem ME up to Kshs. 1,084,776,666 until otherwise advised.

...”.

16. At the hearing of the application, it was common ground that the applicant and the 3rd respondent are two different entities. They hold separate and distinct Certificates of Registration as well as Tax Pin numbers. The Tax Pin Numbers are **P0xxxxxxxS** for the applicant while that of the 3rd respondent is **P 0xxxxxxxZ**.

17. In the supporting affidavit to the 1st respondent’s motion of 30/3/2021, **Phillip Munyao** swore that the 1st respondent had carried out an audit on the 3rd respondent which revealed suspected tax evasion leading to tax assessment for Kshs. 1,084,776,666/-. He produced a letter dated 25/3/2021 addressed to the 3rd respondent in respect of the said assessment. That letter clearly showed that the entity being dealt with was the 3rd respondent. That it came into existence in or about 2015.

18. It is after that, that **Mr. Munyao** in his said affidavit alluded to a contract entered into between the applicant and the 2nd respondent in 2009 and the Arbitral Award that culminated in the Supreme Court decision of March, 2021. The question that arises is, if the entity that the 1st respondent had audited and found to have tax liability was the 3rd respondent, can that liability be visited upon the applicant’s funds? Can the preservation order attach the funds meant for the applicant if the order was intended for another entity all together?

19. It was not clear why the 1st respondent, having dealt and audited the 3rd respondent which it knew existed, would then allude to matters touching on the applicant and 2nd respondent. It was never submitted and or contended that there was a mistake as to the name of the entity being dealt with. That version could not hold because the communication relied on by the 1st respondent showed clearly which entity it was dealing with. The Pin Number identified in the letter of 25/3/2021 clearly showed the entity the 1st respondent was dealing with to be the 3rd respondent.

20. The Court holds that this may not have been a genuine mistake. This is so because, in paragraph 7(b) of the supporting affidavit, **Mr. Munyao** was very clear as to when the 3rd respondent was registered in Kenya. That it registered its tax obligations in March, 2015. Yet then, he goes back to incidents of 2009 and 2012 between the 2nd respondent and the applicant, when the 3rd respondent could not have existed.

21. The foregoing leaves no doubt in the mind of the Court that the 1st respondent was not acting in good faith. It either intended to hide its actions from the applicant and therefore steal a match against it by sequestering the latter’s funds and spirit the same away without the knowledge of the applicant or to mislead the Court.

22. In the view of this court, that is not conduct to be encouraged of a litigant seeking the protection of the court. Even after being notified that the entities, the subject of the order and the funds were not the same, **Mr. Munyao** never corrected his aforesaid affidavit although he had the opportunity to do so. The applications were therefore argued and determined on the basis of the misleading material on the record.

23. In his replying affidavit sworn on 13/4/2021 in response to the applicant’s application, **Mr. Munyao** reiterated in paragraph 8 thereof that the preservation order of 26/3/2021 against the 2nd respondent was ***“on account of monies it holds on behalf of the Geochem ME of PIN No. P0xxxxxxxZ and/or the Geo Chem Middle East of PIN No. P0xxxxxxxS, Applicant herein”***.

24. That was misleading to say the least. The 1st respondent should have owned up to either its mistake or mischievous acts of having to preserve funds belonging to the applicant on tax liabilities of the 3rd respondent. Nothing prevented the 1st respondent from issuing a fresh preservation order based on the correct details. In any event, the 1st respondent had by 7/4/2021 issued a tax assessment to the applicant pursuant to which it should have issued a compliant preservation order but it chose not to.

25. A party who presents before Court misleading material or deliberately misleads the court or presents information that it has reason to believe to be incorrect should be denied any favours by the court of law or equity. Such conduct amounts to abuse of the process of the court and must be discouraged. Litigation should at all times be based on bona fides of the parties before court.

26. In **James Mulinge V Freight Wings Ltd & 3 Others [2016] eKLR** the court stated:-

“I find the subject affidavit deposed by Ms. Okallo and dated 28th July 2016 and the matters submitted by the Claimant with regard to averments set out in Ms. Okallo’s affidavit sworn and dated 14th April 2016 bear conflicting information with regard to her position held with the Respondent and her position held with the objectors. Where there is no clarification as to nature of changes leading to the factual differences in terms of positions held in either entity, and when challenged with regard to the same reliance was gone into the technicality of jurisdiction, either affidavit must be false. This does not aid the course of justice to make affidavits and statements under oath knowing the same to be false and or intended to derail the course of justice.

.....

The impact of the same for the application now before Court is that, the Respondent and the Objectors are in collusion to defeat the work of the Court in arriving at a fair decision. Such is with the intention by both parties to defeat the course of justice. An application thus made with the outright aim of derailing the course of justice should be dismissed instantly.

27. It was submitted for the 1st respondent that the mistake was curable under section 43 (6) of the Act. That subsection provides:-

“The commissioner shall serve the order under this section on the tax payer as soon as its practicable, and upon service, the tax payer may, within 15 days, apply to the court to discharge or vary the order”.

28. With due respect, that subsection does not cure the mistake of the 1st respondent. It does not provide that once a mistake has been committed by 1st respondent, as in this case, the same is curable either by amendment, withdrawal or in any way whatsoever. The subsection provides as to service of the preservation order upon the tax payer for the latter to seek the remedy of discharge.

29. In any event, it was not shown that the 1st respondent served the aforesaid preservation order on the applicant for the applicant to be deemed to have been the entity whom the 1st respondent intended to deal with on a bona fide basis.

30. On the foregoing alone, the 1st respondent is not entitled to the extension of the preservation order of 26/3/2021 either as sought in the motion dated 30/3/2021 or at all.

31. The foregoing is enough to dispose off the two applications but as already stated, the 1st respondent issued a tax assessment dated 7/4/2021 addressed to **GEO- CHEM Middle East** (Kenya Branch) for Kshs 1,084,776,666/=. It is clear that the said amount is the same as that sought in the preservation order of 26/3/2021. The 1st respondent alleged therein that the amount assessed was due as tax from the applicant.

32. The question that arises is whether that letter can be a basis of extension of the preservation order of 26/3/2021 or at all.

33. A preservation order under **section 43 (2) of the Act**, is only grantable if the conditions set out in sub section 1 of that section are fulfilled. The test is an objective one. These are that a taxpayer has collected a tax which has not been charged or that the tax payer is likely to frustrate the recovery of the tax. Failing of any of the two conditions, there will be no basis for a preservation order under that section.

34. In the case of **Commissioner for the South African Revenue Service Vs Tradex (PTY) Ltd & 2 Others**, the court held:-

“In every case where a taxpayer is liable or likely to become liable for tax, there is a theoretical possibility that the value of its assets may for some or other reason be diminished by the time SARS is able to execute. I do not think the lawmaker intended that a preservation order would routinely be available to SARS in every case of an actual or anticipated tax liability. There must be something by way of ‘requirement’ which places the particular case outside the ordinary run of cases. The existence of material risk that assets will be diminished is, as I have said, the obvious example...

The question whether a preservation order is ‘required’ and whether the court should exercise its discretion to grant one calls for a consideration the specific terms of the order sought by SARS.

.....

The question whether a preservation order is required cannot be answered in the abstract. The practical utility of the actual terms must be assessed.”

35. In the present case, it was for the 1st respondent to show that the pre-conditions set out in **section 43(1) of the Act** exists. On the first condition that there was tax that had not been accounted for, the 1st respondent relied on the Supreme Court decision which had affirmed the Arbitral Award in favour of the applicant in excess of 15Million USD. In its assessment dated 7/4/2021, the 1st respondent contended that those taxes, corporation tax and VAT, were for the period 2016. That is the year that the arbitral award was made. The question that arises is whether tax would have been chargeable or had arisen by the mere publishing of the award in question.

36. In **Income Tax on Gains and Losses in Litigation, 25 Cornell L. Rev.221 (1940)** at page 242 it is observed:-

“If a payment on account of a claim or a judgment is for any reason tied up in escrow or otherwise made unavailable to a taxpayer on the cash basis, it is not income to him until released.

.....

When a person reporting on the cash basis receives payments upon a judgment in instalments, the payments are applied first to the interest due (which is taxable) and then any balance is applied upon the Principal (which may or may not be taxable)..but if the Principal of the Judgment is of very doubtful collectability, none of the payments will be regarded as interest until the Principal has been recovered

.....

But if liability is not admitted, income does not arise from the mere accrual of a cause of action. The income may not be accrued until a settlement is made or, if the claim is litigated, until all possible appeals have been taken or the liability has become final by the expiration of time to appeal from a judgment for the taxpayer". (Emphasis added).

37. The income for which the corporation tax and VAT was assessed by the 1st respondent is the Arbitral Award made in 2016. That Award was not a judgment under the law. It had to be converted into a judgment by additional proceedings in the High Court. These proceedings were appealed against up to the Supreme Court of Kenya. The litigation only concluded in March, 2021 vide the Supreme Court case, **Kenya Bureau of Standards Vs Geo chem Middle East (Civil Application No. 33 of 2020) [2021] EKLR.**

38. In this regard, that income would only be due from the time the Supreme Court confirmed the Judgment of the High court on 20/12/2020. That being the case the issues of penalties and interest alluded to in the assessment of 7/4/2021 are doubtful. In this court's opinion therefore, the first pre-condition in **section 43 (1) of the Act** was not fulfilled by the 1st respondent to warrant the issuance of the preservation order or the extension thereof.

39. The second pre-condition is that the *tax payer is likely to frustrate the recovery of the tax*. In the present case the only submission and contention before court was that the applicant is a foreign company and no longer has business in Kenya. The only business it carried out went haywire in 2012 when the 2nd respondent terminated its contract and that in the event the funds are not preserved they may be spirited out of the country.

40. Those may be powerful contentions. However, the court notes from the record that the fresh decree being extracted by the applicant, after the decision of the Supreme Court in March 2021, indicate funds being set aside for the 1st respondent as tax. Secondly, it is incontestable that the 1st respondent already holds funds totalling to Kshs 256,485,643/20 due to the applicant as fees in respect of the work done to the 2nd respondent in 2009. Thirdly, none other than **Senior Counsel Mr. Ngatia**, a senior advocate of re-known repute and standing in the Kenyan Bar, has given his professional undertaking to pay to the 1st respondent any taxes that may be found to be due to the 1st respondent from the applicant.

41. The court does not agree with the contention of the 1st respondent that the professional undertaking of Senior Counsel **Mr Ngatia** is not adequate and should be treated under **section 51 & 52 of the Income Tax Act**. To this court's mind, the three reasons set out above militates against the contention that the applicant is likely to frustrate the recovery of the tax. The 1st respondent has in its possession Kshs. 256,485,643/20 belonging to the applicant. There is no evidence that it has given any credit for the same. There is also a credible professional undertaking on the table in its favour. The second pre-condition was also not met.

42. In view of the foregoing, the court is of the considered view that the pre-conditions set out in **section 43(1) of the Act** on the issuance and/or extension of preservation order have not been met.

43. Accordingly, the application by 1st respondent dated 30/3/2021 is without merit and is dismissed with costs. On the other hand the applicant's application dated 31/3/2021 is allowed in terms of prayer numbers 4 & 5 with costs.

DATED and DELIVERED at Nairobi this 22nd day of April, 2021.

A. MABEYA, FCI Arb

JUDGE