REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL AND TAX DIVISION

INCOME TAX APPEAL NO. 13 OF 2018

MUNGANGIA TEA FACTORY COMPANY LIMITED.....1ST APPELLANT

K.T.D.A MANAGEMENT SERVICES LIMITED.....2ND APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

(CONSOLIDATED APPEALS NOS. 13-30 OF 2018)

J U D G E M E N T

1. **MUNGANIA TEA FACTORY LTD and KTDA MANAGEMENT SERVICES LTD ,** the 1st and 2nd Appellants respectively were dissatisfied with the decision of the Tax Appeal Tribunal delivered on 27th March 2018 vide Appeal No.191 of 2015. In that appeal, the Appellants had sought an appeal against the Commissioner of Domestic Taxes, the Respondent, (Also Respondent herein) for its tax assessment of **Kshs.603,968,757/-** for the audit period of 2008-2014 years of income.

2. The main contention by Appellants at the Tribunal was that the Respondent had written a letter of waiver of requirement by companies to treat income accounts,dividend account and interest accounts separately for purposes of computation of tax payable. The main issue at Tax Tribunal therefore was whether the principle of separation of accounts in law for specified sources of income applies to the interest, dividend and rental incomes of the Appellants. The Tribunal in summary determined that interest account is a separate source of income as that income is earned separately from the gains and profits of the Appellants ***"Business Income"*** which arose from the manufacture and sale of green tea. It was the decision of the Tax Tribunal that interest income should be treated separately as expressly provided for by the provisions of **Section 15(7))a)** of the Income Tax Act as read with **Section 15(7) (e)** part 5 of I.T.A. It further determined that the purported letter dated 7th February 1979 of ***"waiver"*** did not amount to a waiver or estoppels to oust the specific provisions of Section15 of the I.T.A.

3. Aggrieved by the decision of the Tribunal, the Appellants preferred this appeal raising the following grounds in its amended memorandum Appeal namely:-

i. That the Tribunal erred by holding that the 1st Appellants were engaged in agricultural activities without stating any reasons for the finding yet the verifications were to remove the 1st Appellant from the class of beneficiaries who exempted from having separate sub-accounts.

ii. That the Tribunal erred in failing to differentiate between the activities of the 1st Appellant as

a separate legal entity being a company which manufactures (process) and sell tea for and on behalf of its individual shareholders, the tea farmers who grow tea and cause it to be delivered to them for manufacturing (processing)

iii. That the tribunal erred in failing to hold that the 1st Appellant as a company engaged in the principal business of large manufacturing of tea, was exempted from the requirement of preparation of separate Sub-accounts of its income for purpose of assessment of income tax pursuant to the Respondent's own authorized waiver Notice dated 7th February 1979 and thereby failing to be bound by decisions of superior judicial organs and principle of stare decisis and subjecting the 1st Appellant to a further taxation in breach of overriding principles of certainty and predictability.

iv. That the tribunal erred in failing to hold that subjecting the separation of accounts under Section 15(7) of the Income Tax Act would be an unlawful discriminatory act on the part of the Respondent as the same Respondent had expressly communicated in writing that similar Tea Factory companies engaged in the same business as the 1st Appellant and managed by the 2nd Appellant in a similar Management Agreement would not be subjected to Section 15(7) of I.TA on matters of separation of accounts for purposes of income tax.

v. That the Tribunal erred in funding that the doctrine of legitimate expectation and estoppel was not available to the 1st Appellant

vi. That the Tribunal erred in failing to hold that the Appellant's business model, the income earned from tea sales ("business income") and the income earned from the placement of the business income or portion thereof in advance deposit account ("interest income") are both payable the tea farmers as one income and fall under the perview of the provisions of Section 15(7)(e) (v) of I.T.A as specified source of income and ought not to attract separate sub-accounts for the purpose of assessment of income tax

vii. That the tribunal erred in failing to hold that even if the 1st Appellant's business and income accounts were to be categorized as taxable under separate sub-accounts, then under Section 15(2) of the I.T.A, the Respondent was obliged to take into consideration the expenditure incurred in the generation of the interest income which in its view led erroneous assessment of tax on gross interest income instead of net interest income.

viii. That the Tribunal erred in failing to hold that dividend income earned by the 1st Appellant as 1.85 % shareholder of the 2nd Respondent is a qualifying dividend and pursuant to Sections 2, 34 (1) (d) and paragraph 5(e) of the Third Schedule of the I.T.A, withholding tax is the final tax payable on the dividend.

ix. That the Tribunal erred in failing to hold that pursuant to Section 15(1) of I.T.A the Respondent was bound to take into account the expenditure in the generation of rental income and that it assessed gross rental income as taxable income as opposed to the net rental income if ascertained and if not 40% deduction of the gross rent as allowed by statute.

x. That the Tribunal erred by failing to hold that the Respondent's actions or omissions complained of in the appeal constituted introduction of a different tax regime against the 1st Appellant and application of unlawful amended tax regimes retrospectively in breach of the Appellant's rights and legitimate expectation of a tax regime that is consistent, fair, predictable, certain and reasonable within acceptable standards of a democratic society bound by constitution and the rule of law.

xi. That the Tribunal erred in stating that the issue of rental income and dividend were baseless when the same had come up by consent in pleadings.

4. In their written submissions through Ms Millimo, Muthomi & Co. Advocates, the Appellants reiterated the grounds of their appeal and stressed that a letter from the Respondent dated 7th February 1979 addressed to ICPAK exempted those engaged in large manufacturing activities from filing separate accounts and that by virtue of that the 1st Appellant was exempted from filing separate sub accounts for tax purposes.

5. The Appellants contend that when the Tribunal referred to the Agriculture Act in its decision of 27th March 2018, it failed to note that the said Act was repealed by Agriculture & Food Authority Act No.13 of 2013 (AFAA).

They submit that the Tribunal ignored the provisions under Schedule 12 of I.T.A . In their view the Tribunal should have demonstrated that the Appellants' activities were two thirds agriculture as per schedule 12 of I.T.A. They contend that the Respondent had conceded in its statement of facts that manufacturing was different from agricultural activities. They submit that tea farmers engage in growing of the crop and supply green leaves to the 1st Appellant who then engages in manufacturing of tea. The tea farmers are shareholders of the 1st Appellant which in their view they cannot be described as tea farmers.They point out that AFAA defines what manufacturing entails and the 1st Appellant in their view, fall within the said definitions.

6. They contend that the tribunal has misdirected itself by deciding that the effect of the letter dated 7th February 1979 did not oust legal provisions instead of determining whether the 1st Appellants were exempted from filing separate Sub-accounts. They contend that a waiver is a private decision of a commissioner on interpretation of the Law and that the waiver had not been revoked and even if it was to be revoked, there would have to be a fair administrative process. They insist that the contents of the said letter 7th February 1979 was binding on the Respondent.

7. The Respondent has relied on the decision in ***Ecobank Kenya Ltd -vs- The Commissioner of Domestic Taxes [2012] eKLR*** submitting that the decision was binding to the Tribunal and that they were not in a position to overturn or review the position taken by the court in that case. In the said case the court was called upon to determine whether the same letter dated 7th February 1979 exempted large companies to prepare sub-accounts. The court held as follows:-

> " ***It is not in dispute that the letter dated 7th February 1979 and in particular paragraph 9 expressly waived the requirement for large companies to prepare separate Sub-accounts. If read together with paragraph 9 of the said letter, which waived the requirement for larger companies to prepare separate accounts it could as well mean that large companies were not required to prepare the separate sub- accounts to be in compliance with Section 15(7) of the Act. If there was any ambiguity, then the same should be construed against the maker of the document in this case the Respondent."***

The Appellants submits that being a large company, they fall within the ambits of the said exemption as provided by the said letter as upheld by the above decision.

8. The Appellants contend that the decision in the Ecobank case stands as the court determined the issue of enforceability of the paragraph of the subject letter which was to the effect that large companies were exempted from filing separate sub-accounts.The Appellant claim that the Respondent has issued letters to other tea companies withdrawing their additional assessments on interest income citing the decision in the Ecobank case. They claim it was discriminatory for the 1st Appellant to be treated differently and told to pay for the same additional charges that others are exempted. Theyfurther content that principles of certainty and predictability are important in taxation.

9. They have cited the provisions of **Section 120** of the **Evidence Act** which states where a person has by a declaration, act or omission, intentionally cause or permits another person to believe a thing to be true and to act upon such a belief, that person shall not be allowed in any suit or proceedings between

himself and that person to deny the truth of that thing. They contend that the Tribunal misinterpreted that doctrine of estoppel as to whether it can oust legal provision when none of the parties had raised it in pleadings or at the oral hearing

10. They have given a narration of the transactions between the 1st Appellant and the 2nd Defendant explaining that Tea farmers supply green leaf to tea companies. The price of a kilogram of green leaf, they aver, is not established at the onset of the transaction. The price per Kg in their view is set after accounts have been audited. Tea Factories pay out first instalment price which is a portion of the total unit price of each Kg of tea. All other interests from the money kept in accounts and other sources including dividend income is paid to the farmer in a second instalment. They further explain that the price of a Kg of tea is usually determined at the close of a financial year. They further allege that all money received is on behalf of the farmers and is remitted to the farmers. They claim that the money received fall under one income to the farmers and is not separable which is a concept they submit, the tribunal failed to take note.

11. The Appellants have faulted the Respondent for failing to take into consideration expenses incurred in generating the interest income. They point out that the management fees were not deducted and therefore the tax assessed was not lawful.

12. They aver that the Tribunal went outside the framed issues by the parties and made other declarations which was contrary to the consent on the agreed issues for determination.

13. They cite the provisions of **Section 123 c (3)** which state where a person has no documentation to support expenditure, such person shall be allowed a deduction of 40% of the gross rent, premium or similar consideration for use or occupation of immovable property. The section also provide that landlords were exempted from taxes, penalties and interest for the year 2013 and prior and were also to receive amnesty on penalties and interest for 2014 and 2015. They claim that the Tribunal overlooked the said provision.

14. The Appellant submit that the 1st Appellants are managed by the 2nd Appellant and that in this agent relationship between tea factories and KTDA Management Services, the former charges management fees out of fees it gives to the tea factories from Active Deposit Account. They further claim that the interest earned are subject to deduction of management fees and that under **Section 15(1)** of I.T.A the amount in payment of the management fee is an allowable expenditure that the Respondent was required to take into account. They claim that the Respondent did not deduct Management fee in computation of taxes payable. The assessment by the Respondent in their view was contrary to law and have relied on the decision of ***R- vs- Kenya Revenue Authority & Another Ex-parte Kenya Nut Company Ltd [2014] eKLR*** where the court noted that what matters is not the figure but whether the amount is lawfully due and whether the law allows its recovery.

15. The Appellants have faulted the Tribunal for going beyond what the parties had agreed would be issues for determination. They claim that the tribunal crystallized the issues for determination into following:-

i. Whether the principle of separation of accounts for specified sources of income of the Appellant.

ii. Whether the principle of separation of accounts for specified sources of income applies to the dividend income earned by the Appellant

iii. Whether the principle of separation of accounts for specified sources of income applied to the rental income of the Appellant.

16. The Appellant aver that they made submissions on the above issues and that the assessment by the Respondent was related to interest income, dividend income and rental income. They aver that it was erroneous for the Tribunal to find that the Appellant had not raised an objection as regards the issue of

Dividend Rental income. In their view, the Respondent had indicated which companies had their Dividend and Rental Income assessed and had filed appeals against the assessment.

17. The Appellants further submit that the dividend income is a qualifying dividend and that they had clarified before the Tribunal that the factories are share holders of KTDA Holdings which earns income from investments through subdiaries. They claim that the profit made is distributed to the respective shareholders and the Appellant therefore earn income passively. In their view such an income can only be taxed through withholding tax because it is a qualifying dividend. They contend that the Respondent had charged unlawful tax on divided interests contrary to the provisions of **Section 34(1)** and paragraph **5(e)** of the Third Schedule of the Income Tax Act. They contend that withholding tax paid on that dividend is a final tax and the further taxation on the subject interests by the Respondent was unlawful.

18. They claim that the Tribunal failed to interpret the law wholistically and that both the Appellants and Respondents agreed that the dividend earned by the Appellants were qualifying dividend and that the rate of tax applicable was 5% and has referred this court to the provisions of **Section 2** of **Income Tax Act** on what constitutes qualifying dividend rate of tax and the Third Schedule of the Income Tax Act under paragraph 5(e). They contend that the Tribunal failed to consider the said provision and **Section 34(1) (d) (e).** They have further cited the provisions of **Section 76A** of **Income Tax Act** which states;

> "***The commissioner shall not assess any person for any year of income on that portion of income which has been subjected to withholding tax which is also final tax"***

19. They have relied on the decision of ***Silver Chain Ltd -vs- Commissioner Income Tax & 3 Others [2016] eKLR*** where the court stated;

> ***"The task of collecting taxes should not lead to discouraging taxpayers from carrying on with their businesses. If the tax payers close shop, there will be no taxes to be collected. On the other hand if no taxes are paid there will be no funds to run government operations. This calls for a balance between the tax collectors and tax payers whereby the process becomes inclusive as opposed to being unilateral. There must be fairness in the process of tax assessment. If the court is of view that the process used to assess the tax being demanded was not fair, orders of Judicial review will be granted."***

The Appellants contend that the amounts being demanded by the Respondent is colossal and will amount to the closure of the 1st Appellant's business. In their view the tax imposed was not fair and did not follow due process of law.

20. **The Respondent's case**

The Respondent has opposed this appeal through its statements of facts filed on 4th July 2019 and written submissions dated 6th September 2019 filed on 6th September 2019.

21. The Respondent states that on 23rd January 2015 one of its officers visited the Appellants' offices to brief them on the provisions of **Section 15(7) (a) (c)** of **Income Tax act.** The Respondent further states that it was agreed between them that the issue be communicated in writing which was done vide a letter dated 11th February 2015 adding that the Appellant had not been separating its income from other sources of income which had resulted in additional taxes of over Kshs.22 million. It claims that the Appellant wrote a response citing mainly that interest was not a specified source of income under **Section 15(7) (e)** of **Income Tax Act** and that the Commissioner had waived separation of income for large companies in a letter dated 7th February 1979 addressed to Institute of Certified Public Accounts of Kenya. It further adds the Appellants also cited that the issue had not arisen in previous audits and that a follow up meeting was held on 12th March 2015 where it was agreed that there were computational errors and that the issue of interest income as a separate income was not settled. It states that it raised additional tax assessment for the year 2009, 2011, 2012, 2013 and 10th April 2015. The Respondent states that Appellants filed an appeal to the Tribunal being case No.191 of 2015 and that several other tea

factories which had suffered the same manner of additional assessments also appealed to the Tribunal which dismissed the appeals leading to this present appeal.

22. The Respondent avers that the Appellants have unreasonably relied on a letter dated 7th February 1979. While it agrees with the Appellants that the 1st Appellant is engaged in Tea processing, it contends that the company's activities are those of an agricultural in nature defined in the Agriculture Act. It contends that the letter dated 7th February 1979 was neither a legal instrument or a waiver notice and cannot be relied on by the appellants to disregard the law. In its view the letter did not create any legitimate expectation or predictability. It submits that the contents of a letter cannot oust a statute.

23. The Respondent further contends that the decision in Ecobank relied on by the Appellants is distinct as it is the ratio applied to a financial institutions and that the Tribunal never ignored but merely distinguished it from the present case.

24. The Respondent avers that the tribunal was right in holding that business income and interest income are separate sources of income hence subject to separate accounts. It contends that the issue of rental and dividends income as a separate income stood to be dismissed by the tribunal as they were raised during appeal as an afterthought. It further contends that even if the Tribunal considered the issues on merit, it cannot be said to be contradictory. It supports the Tribunal for holding that dividends income is a separate Sub- account under **Section 15(7)** of the I.T.A. It is the Respondent's position that withholding tax cannot be said to be final tax on dividend as the Appellants have corporate entities which attracts a separate corporate tax as per paragraph 2 of the Third Schedule of ITA.

25. The Respondent faults the Appellants' arguments on rental income, stating that the Appellants failed to provide documents to support their arguments on expenses incurred in earning rental income so that the Respondent could establish whether the expenses were for structural adjustments, maintenance or expansion.

26. In its written submissions, the Respondent has faulted the Appellants' reliance of a letter dated 7th February 1979. It has cited a decision in Commissioner of Inland Revenue -vs- The ***Duke of Westminister (1986) AC*** to support its contention.

27. The Respondent submits that taxation is a matter of strict interpretation and must correspond with the statute. It cites **Article 210 (1)** of the Constitution which provide as follows:-

" No tax or license fee may be imposed, waived or varied except as provided by legislation,"

28. The Respondent disputes the Appellants' contention that the letter dated 7th February 1979 ousted express provision of the law. It points out that **Section 15(7)** of the ITA obligates persons registered for taxations in Kenya to maintain separate accounts for their different sources of income in order to avoid lumping of different incomes together wherein the losses of one source can cat the profits of the other source. The Respondent maintains that it conducted a tax compliance check on the Appellants in 2015 and found that they were not maintaining separate accounts for their separate sources of income. It is the Respondents case that the Appellants had lumped their business income with their interest income, rental and dividend income.

29. The Respondents points out that when the Appellant was asked to pay taxes on separate accounts they raised objections invoking the contents of the letter dated 7th February 1969 where the Commissioner of Domestic Taxes had given a waiver of the obligation to maintain separate sub accounts to insurance companies, banks, large manufacturing concerns and all companies quoted in the Nairobi Stock Exchange. The Respondent insists that the waiver did not apply to comprises whose activities include those of agriculture.

30. The Respondents submits that Appellants are manufacturers of tea but their activities include those of agriculture and that they tried to create an impression they are not involved in agricultural activities in

order to bring themselves within the armpit of waiver given under paragraph 9 of the letter dated 7th February 1979. The Respondent submits that the issue whether the Appellants business is purely that of agriculture or it engages in agriculture activities is an issue of fact that was determined on evidence at the Tribunal. It is the Respondent's case that the evidence presented before the tribunal including Appellant's audited accounts indicated that the Appellants engaged in agricultural activities.

31. The Respondent contends that the main issue of the Tribunal was whether the provisions of **Section 15(7)** with regard to the separation of sources of income applied to the Appellants interest, rental and dividend incomes and whether the Appellants were right to rely on the letter dated 7th February 1979 as a waiver. The Respondent contends that the same issues obtains in this appeal.

32. The Respondent has faulted the Appellants for faulting the Tribunal that it did not consider expenses incurred in production of interest income in separate accounts. According to the Respondent that was not a ground of appeal. The Respondent submits that the Appellants only sneaked in the issue at the stage of submissions.

33. The Respondent further submits that the Appellants did not provide any proof of such expenses in any event and that **Section 15(1)** obligates a tax payer to show that expenses were incurred in production of its income and provide proof of the same.

34. The Respondent further submits that the Eco Bank case cited by the Appellants does not apply because in its view the Ecobank case is distinguishable because Ecobank was a financial institution that the letter dated 7th February 1979 applied as opposed to the Appellants whose activities included agriculture. It submit that the rule of precedent did not bind the Tribunal in that regard and has cited the Supreme Court decision in ***National Bank of Kenya -vs- Anaj Ware housing Ltd.*** It contends that there is no way a legitimate expectation or estoppel can operate against the law.

35. This court has considered the submissions from both sides in this appeal which was consolidated with Appeals Nos. 14 to 30 of 2018 pursuant to court order given on 4th July 2018. This appeal in my considered view has raised two main issues for determination by this court. The issues are namely;-

i. Whether the appellants activities included agricultural activities and whether section 15(7) Income Tax Act applied.

ii. Whether the contents of letter dated 7th February, 1979 provided a waiver to the legal requirements.

36. The above issues with perhaps a 3rd issue were the same issues raised before the Tribunal by the parties herein. The main issue however is the question of requirements of separation of income by entities which brings about the separate analysis of interest income, dividend and rental income for purposes of computation of tax payable as provided under **Section 15(7)** of **Income Tax Act.**

Whether the appellants Activities included agriculture and whether the provisions of Section 15 (7) ITA applied?

37. It is necessary to have a look at the relevant law to get guidelines on what constitutes taxable income. **Section 3(2)** Income Tax Act provide as follows:

" Subject to this Act, income upon which tax is chargeable under this Act is income in respect of -

(a)gains or profits from;

(i) any business, for whatever period of time carried on;

(ii) any employment or services rendered;

(iii) any right granted to any other person for me or occupation of property.

(b) dividends or interests.....

(c) an amount deemed to be income of any person under this Act or by rules under this Act.....”

38. A further look at **Section 2** of **Income Tax Act** offers interpretations of terms used in the Act and defines ***"qualifying dividends”*** the aggregate dividend that is chargeable under **Section 3(2)(b)** and which has not been otherwise exempted under any other provision of income Tax Act but shall not include a dividend paid by a designated cooperative Society subject to tax under **Section 19A(2)** or **19A(3).** It defines **"dividend”** as any distribution (whether in cash or property, and whether made before or during a winding up by a company) to its shareholders with respect to their equity interests in the company.

39. The big question is whether the 1st Appellants were subject to declaration of separate sources of income as per **Section 15(7)** of **Income Tax Act** which brings about the issue of interest income as a separate income from business income. **Section 15(7)** of Income Tax Act provides as follows:-

"Notwithstanding anything contained in this Act.

a) The gains or profits denied from any one of the seven sources of income respectively specified in paragraph (e) of this subsection (and in this subjection called "specified sources") shall be computed separately from the gains or profits of that person derived from any other of the specified sources and separately from any other income of that persons."

b) Where the computation of gains or profits of a person in a year of income derived from a specified source results in a loss, that loss may be deducted from gains or profits or that person derived from the same specified source in the following year and, in so far as the loss has not already been so deducted, in subsequent years of income;

c) The subparagraphs of paragraph (e) of this section shall be construed so as to be mutually exclusive;

d) gains chargeable under Section 3(2) (f), this Act and losses referred to in Subsection 3(f) of this section shall not be deemed income or losses derived or resulting from specified sources for the purposes of this subsection;

e) the specified sources of income are-

(i) .....

(ii) .....

(iii) .....

(iv) agricultural, pastoral, horticultural, forestry or similar activities not facing within subparagraphs (i) and (ii) of this paragraph.

(ivA) .....

(ivB).....,,,,

(v) other sources of income chargeable to tax under Section 3 (2).

(g) not falling within subparagraph (i) (ii) (iii) or (iv) of this paragraph".

My reading of Sections **15(7)** (e) (v) read together with **Sections 3(2) (a)** shows that the income derived from interest from the money held on behalf of farmers by the 1st Appellant is definitely different from the income from sale of tea.

40. The question posed is whether the 1st Appellants are engaged in agricultural activities. It is not disputed that the 1st Appellant are manufacturers of tea. They are not engaged in ***"agricultural activities"*** and the contrary finding by Tribunal was erroneously in my view because the Agriculture and Food Authority Act No.13 of 2013 came into force (14th January 2013). The Agricultural and Food Authority Act defines agriculture ***as "cultivation of land and use of land for any purpose of husbandry and food production and includes-***

a) cultivation of crops and horticultural practices within the meaning of the crops Act....." and manufacture as "processing of agricultural products and includes packaging, labeling, distribution or importation of scheduled agricultural products for sale in Kenya. "

The statute (AFAA) distinguishes manufacture and agriculture because they are different aspects. The 1st Appellants did not cultivate what they process. In essence they are processors of farming products and cannot be said to be engaged in agricultural activities.

41. This court in the foregoing finds that the Tribunal's decision in that regard having based its decision on the repealed Act in determining that the Respondent engaged in agricultural activities was erroneous.

Whether the letter dated 7th February 1979 offered a waiver to the legal requirements.?

42**.** Again it is not disputed that under **Section 15(7)** of Income Tax Act, the Appellants were required to maintain separate accounts for tax purposes. However the question posed is what is the effect of the letter dated 7th February 1979 and did the Respondent through either acknowledgment acquiescence or omission make the Appellant have legitimate expectation that they had a genuine waiver to the legal requirement.

43. It is not disputed that the letter dated 7th February 1979 is at the core of this appeal. The letter from the then Commissioner of Domestic Tax at paragraph **3(c)** lists agricultural services as harvesting , threshing, selling etc at a fee or contract basis as well as pest destroying or rental of farm machinery. Unfortunately the commissioner in that letter what entailed and did not define ***"etc"*** it is really not in our place to place words where there are none.

44. This court concurs with the Appellants contentions that their activities could not be classified as agricultural activities because the Respondent tendered no evidence at the tribunal to prove that the 1st Appellant activities fell within the bracket of the definition of an agricultural activity company as defined under **Schedule 12** of the **Income Tax Act** and instead opted for a definition given under a repeated Act (Agricultural Act.).

45. Given the above findings that the 1st Appellants are not engaged in agricultural activities, the next issue then is whether the waiver applies to them to file sub-accounts. It is agreed that large manufacturers were privy to the waiver and therefore exempted from filing sub-accounts. Although the letter did not define what ***"large manufacturers"*** constituted, I concur the reasoning by ***Hon. Judge Ogolla in Ecobank Kenya Ltd -vs- Commissioner Domestic Taxes [2012] eKLR*** when he made the following observations.

" In the circumstances, it is only reasonable to deduce that the second letter did not revoke the first one. However in any event and more importantly it must be noted that the Respondent has

always been aware of the existence and effect of Section 15 (7) (a) (b) and (c) of Income Tax Act. It cannot be said that these provisions of the Act have suddenly emerged requiring the Respondent to demand immediate compliance from the Appellant in regard thereto....."

46. The Respondent in this instance demanded the disputed tax in arrears in 2015 and the question is why would it do that? Why had it not demanded for the payments earlier or even better still issue another letter expressly cancelling the contents of the letter dated 7th February 1979? The Appellants herein have made a good basis of legitimate expectation which was also an issue in the Ecobank Case (Supra). The court in that decision noted as follows;

"On the issue of legitimate expectations it is the Appellants' submission that they had relief on the express waiver of over 25 years during which period they never prepared sub-account in respect of its rental income. In addition, the Respondent never raised an issue for over 25 years, a clear representation that the Appellant was not required to prepare sub-accounts and consequently to compare for rental income separately. The Appellant in this regard submitted that they were entitled to legitimately expect that they would not be assessed separately for tax in respect of rental income. On the other hand the Respondent submits that there can be no legitimate expectation where there is a specific statutory provisions militating against the expectation. In the English decision of COUNCIL OF CIVIL SERVICES UNION -VS- MINISTER FOR CIVIL SERVICES (1985) AL 375 Lord Frazer stated as follows: "a legitimate expectation may arise either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue"

In this instant case, the waiver was given way back in 1979 which is a long time. For over 26 years the Respondent was fine with the manner the Appellant presented their accounts and paid taxes. It is quite clear that both parties acted in the belief that the waiver set out in the letter dated 7th February 1979 stood. Now the question posed is whether it is fair and justified for the Respondent to just wake up one day and demand payments as provided by the law disregarding the waiver it had earlier issued and without giving express and adequate notice that the waiver had been vacated? In my view the answer has to be in the negative because it is given that for businesses to thrive there must be a degree of certainty and predictability in a well regulated business environment. To that extent

I am inclined to concur with the sentiments expressed in the Ecobank case that ;

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

47. This court finds that while the Respondent's demand may have been backed by the legislation in place, the abrupt demand for additional taxes and particularly retrospectively demanding additional payments from 2009, to 2015 was not proper for the business environment. Besides this, the Respondent conceded that they relied on Ecobank case in withdrawing some of the tax demands to other tea companies. They however did not specify why some tea companies doing same business and represented by the 2nd Appellant were exempted when the 1st Appellants were subjected to additional tax assessment. That is discriminatory treatment and is not tenable.

48. The 1st Appellants have complained of the apparent discriminatory conduct by the Respondent and the absence of any explanation it appears that there is indeed some bias in the application of **Section 17(5)** of the Income Tax Act and the letter dated 7th February, 2019. In **Republic -vs- AG and Another Ex parte Waswa & 2 Others (2005) 1 KLR** the court held;

"The principle of a legitimate expectation to a hearing should not be confined only to past advantage or benefit but should be extended to a future promise or benefit yet to be enjoyed. It

is a principle, which should not be restricted because it has its roots in what is gradually becoming universal but fundamental principle of law namely the rule of law with its offshoot principle of legal certainty. If the reason for the principle is for the challenged bodies or decision makers to demonstrate regularity, predictability and certainty in their dealings, this is, in turn enables the affected parties to plan their affairs, lives and businesses with some measure of regularity, predictability, certainty and confidence. The principle has been very ably defined in public law in the last century but it is clear that it has its cousins in private law of honouring trusts and confidences. It is a principle, which has its origins in nearly every continent. Trusts and confidences must be honoured in public law and therefore the situations where the expectation shall be recognized and protected must necessity defy restrictions in the years ahead. The strengths and weaknesses of expectations must remain a central role for the public laws courts to weigh and determine."

49. Going by the above principle, this court finds that the Respondent acted unfairly by letting the Appellants believe in the existence of a waiver (which belief was buttressed by the Respondent's conduct for 26 years) only to abruptly, arbitrary and without any notice not only demanded additional taxes but backdated the demands to 2009. In ***Export Trading Co. -vs- K.R.A [2018] eKLR***, the court while holding a similar position cited Court of Appeal decision in ***Republic - vs- Commissioner of Cooperatives Kirinyaga Tea Growers & Savings & Credit Society Ltd [1999] 1 EA 245*** where the court held as follows:-

"It is automatic that statutory power can only be exercised validly if exercised reasonably and not arbitrarily or in bad faith."

Further to the above, in ***Republic-vs- K.R.A Ex Parte Universal Corporation Ltd [2016] eKLR Hon. Odunga J*** expressed the following sentiments on a similar situation where the tax man raised an issue long after the fact;

" Nevertheless, where the delay in exercising Statutory Power has led to injustice which would otherwise have been avoided and no explanation is forthcoming for such inaction the law must step in to ameliorate the injury. In the circumstances of this case, the Respondent's actions and inactions legitimately created an expectation on the Applicant that the taxes were not payable as was held by Nyamu J in Akaba Investiments Ltd -vs- Kenya Revenue Authority [2007] eKLR, that legitimate expectation may arise either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue."

50. The Appellants have also raised issues touching on expenditure and that the Respondent did not take into account expenditures in raising the income the subject of taxation but I find that the issue was not raised in the Tribunal and therefore cannot be a subject in this appeal. Having said that this court wishes to nevertheless state that the responsibility to pay taxes by all tax payers in Kenya is an obligation which must be respected because the same taxes run government operations among other core mandates of the Government. However the collection of these taxes must not appear to be punitive, arbitrary, abrupt, discriminatory or unfair because if the tax payer's closes shop because of perceived irregularity, arbitrariness or frustrations, there will be no tax to collect. In ***Silver Chain Ltd -vs- Commissioner Income Tax & 3 others [2016] eKLR***, the court made the following observations which I find useful;

"The task of collecting taxes should not lead to discouraging tax payers from carrying on with their businesses. If the task payers close shop, there will be no taxes to be collected. On the other hand, if no taxes are paid, there will be no funds to run government operations. This calls for a balance between the tax collectors and tax payers whereby the process becomes inclusive as opposed to being unilateral. There must be fairness in the process of tax assessment....."

51. There was nothing and indeed there is nothing that prevented the Respondent from writing a letter expressly cancelling the waiver issued on 7th February 1979 and giving the Appellants adequate notice

that going forward they were required to henceforth comply with the requirements of the law and file separate accounts for purposes of assessment of taxes. If such a notice was to apply across the board without any discrimination the Appellants and all others in that sector would have a legitimate expectation of the business environment they will be required to operate in future. In the end this court finds merit in this appeal. The decision of the Tribunal dated 23rd June 2015 is hereby set aside and the Respondent's demand of **Kshs.13,323,420.73** is hereby quashed. There shall be no order as to costs, so each party to bear own costs.

Dated and signed by;

HON. JUSTICE R. K. LIMO.

SIGN ..... DATE .....

Dated, signed and delivered in the open court on 30th day of January, 2020

By:

HON. JUSTICE .....