



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL AND TAX DIVISION

CORAM: D.S. MAJANJA J.

TAX APPEAL NO. 2 OF 2016

BETWEEN

KENINDIA ASSURANCE COMPANY LIMITED.....APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal made on 15th April 2016 in Nairobi Tax Appeal No. 15 of 2015)

JUDGMENT

Introduction

1. The appellant, Kenindia Assurance Company Limited (“Kenindia”), is a company incorporated in Kenya. It carries on insurance business in accordance with the *Insurance Act (Chapter 487 of the Laws of Kenya)*. It appeals against a decision of the Tax Appeals Tribunal (“the Tribunal”) upholding the assessment of the Commissioner of Domestic Taxes (“the Commissioner”) dismissing its objection to that assessment. The Tribunal held that the increase in share capital through capitalization of Kshs. 111,338,000/= from statutory reserves held by the appellant was taxable income in terms of **section 19(5)(b)** of the *Income Tax Act* (“the *ITA*”).

Background Facts

2. The facts leading to this appeal are set out in the statement of facts and the judgment of the Tribunal and are not in dispute. In 2004, Kenindia created a statutory reserve as required by **sections 45** of the *Insurance Act*. This was effected by a transfer of an amount of Kshs. 159,875,000/= from Kenindia’s retained earnings of both its life and general business to the Statutory Reserve for the life business created in the year 2004. This transfer was reported in the restated audited financial statements for the same year.

3. Following the recommendation of its actuary, Kenindia transferred from its life fund, an actuarial surplus amounting to Kshs. 25,000,000.00 in 2010. This transfer was duly taxed in accordance to **section 19(5)** of the *Income Tax Act* (“the *ITA*”). In the same year, Kenindia, with the intention of strengthening its capital base, capitalized an amount of Kshs. 111,338,000/= which was part of the retained earnings amounting to Kshs. 159,875,000/= that was transferred to the statutory reserve created in 2004. This was reflected in its statement of changes in equity for the year of income 2010

4. The Commissioner conducted an in depth audit on Kenindia for the financial year 2010. By a letter dated 7th June 2013, the Commissioner issued an initial assessment number 030520100010/4 for Kshs. 32,377,800/=. Kenindia, through its tax agents, *Ernst and Young*, objected to the assessment under **section 84(1)** and **(2)** of the *ITA* by its letter dated 5th July 2013.

5. In the objection, *Ernst and Young* argued that the Commissioner erred in the interpretation of **section 19(5)** of the *ITA* relating to taxation of insurance companies on the basis that under the provision, a transfer would amount to taxable income only if appropriated from the life fund for the benefit of shareholders. It pointed out that there existed two reserves at the time the transfer took place, the Life Fund and the Statutory Reserve and that the amount capitalized was not appropriated from the Life Fund but from the Statutory Reserve. It showed that the Statutory Reserve decreased while the Life Fund was not affected as follows:

Reserve name	Bal. at 31.12.2009	Bal. at 31.12.2010	Variance
	KShs	KShs	KShs.
Life fund	7,634,280,621	9,135,130,621	1,500,850,000
Statutory reserve	437,273,000	318,516,000	(118,757,000)

6. It explained that the 2010 actuarial surplus of Kshs. 25,000,000.00 transferred from the life fund was appropriately taxed under **section 19(5)** of the *ITA*. It argued that the assessment disregarded statutory provisions, was unfair and inconsistent with good tax practice as it subjected the same income to double taxation.

7. The Commissioner confirmed the objection by the letter dated 12th February 2014 thus precipitating an appeal to the Tribunal. On 15th April 2016, the Tribunal delivered its judgment in favour of the respondent. It concluded as follows:

[28] The Tribunal finds in the circumstances that the amount of Kshs. 111,338,000 capitalized in the year 2010 from the statutory reserve by the Appellant was taxable transfer for the benefit of the shareholders and the assessment of tax respect thereof by the Respondent was appropriate. The Section 19(5)(b) of the Income Tax Act, CAP 470 of the Laws of Kenya is clear and applicable to circumstances precipitating in the filing of this Appeal.

The Appeal

8. The appellant is aggrieved by the judgment and has set out its grounds of appeal in the memorandum of appeal dated 13th May 2016. Through its counsel, Ms Onchwari, it had filed written submissions which counsel highlighted at the hearing. The respondent supported the assessment by the Commissioner and the decision of the Tribunal. Its counsel, Mr Marigi, filed written submissions opposing the appeal which he highlighted at the hearing.

Statutory provisions

9. Before I deal with the parties' submissions, it is important to set out the relevant statutory provisions applicable to this appeal. The first is **section 19(5)** of the *ITA* which defines a gain or profit of a life insurance company 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. [Emphasis mine]

10. The appellant also relies on the relevant provisions of **sections 45 and 46** of the *Insurance Act* which provide 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 separate 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-

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

(ii) transferred to another statutory fund.

(2) -----

(3) -----

(4) -----

(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.

(7) -----

Appellant's Submissions

11. The gravamen of the appellant's case is that the Commissioner and Tribunal misconstrued **section 19(5) (b)** of the *ITA* as read together with **sections 45** and **46** of the *Insurance Act* by holding that the capitalization from the Statutory Reserve of Kshs. 111,338,000 in the year 2010 was a taxable gain for purposes of **section 19(5)(b)** of the *ITA* which defines a gain or profit of a life insurance company.

12. In its submissions, the appellant raised and submitted on two issues;

(a) Whether the capitalisation of Kshs. 111,388,000.00 in the year 2010 is a taxable gain for purposes of **section 19(5)** of the *ITA*.

(b) Whether Kshs. 111,388,000.00 was been subjected to double taxation of income.

13. The appellant submitted that it maintained two reserves in its books; the Statutory Reserve for the benefit of both policy holders and shareholders and the Life Fund for the benefit of policy holders. In this case, the Statutory Reserve was created in 2004 by transferring Kshs. 159,875,000.00 from retained earnings. Counsel submitted that the Tribunal erred in its interpretation of **section 19(5)** of the *ITA* as the transfer would only amount to taxable income if appropriated from the Life Fund for the benefit of shareholders and that in this case, the reserves capitalised were not appropriated from the Life Fund but from the Statutory Reserve as demonstrated by the fact that for the period 2009 – 2010, the Life Fund increased while the Statutory fund decreased. The appellant contended that the capitalisation did not in any way deplete the retained earnings of Kshs. 159,875,000.00 transferred to the Statutory Reserve which demonstrates that the Life Fund was not affected negatively.

14. Counsel for the appellant relied on the principle in *Cape Brandy Syndicate v Inland Revenue Commissioners [1921] KB 64* that the tax statutes must be construed strictly to submit that the **section 19(5)** of the *ITA* provides that a transfer of an amount from the Life Fund for the benefit of the shareholders amounted to a gain or profit of a life insurance company. Counsel submitted that the provision relied on by the Commissioner and Tribunal was not applicable to the appellant's capitalisation of an amount that was transferred from the Statutory Reserve for the benefit of shareholders hence it does not fall within the meaning of a gain or profit within the law and therefore the assessment of Kshs. 32,377,800/- as tax should not be upheld by this court. The appellant maintained that the funds transfer from retained earnings to the

Statutory Reserve did not confer any benefit to shareholders since the funds still belonged to shareholders even without such transfer.

15. The appellant submitted that it complied with the **section 45** of the **Insurance Act** by maintaining separate accounts for life and general business and the Insurance Regulatory Authority had not raised any issue of non-compliance, a fact admitted by the Commissioner. It further submitted that having complied with these provisions, the capitalised amount of Kshs. 111,388,000.00 had already been subjected to taxation and did not exceed 30% of the reserve balance of Kshs. 437,273,000.00 as at December 2010 as required under **section 46** of the **Insurance Act**.

16. On the second issue whether Kshs. 111,388,000.00 had been subjected to double taxation, counsel for the appellant referred to ***Keroche Industries Limited v Kenya Revenue Authority and 5 Others HC Misc. Civil Appl No. 743 of 2006 [2007] eKLR*** where the court observed that, “*It is of course regarded as penal for a person to be taxed twice over in respect of the same matter.*”

17. Counsel for the appellant submitted that the Tribunal overlooked the fact that funds transferred from the retained earnings were already appropriated from taxed income. Counsel further submitted that it was not disputed that the funds appropriated from retained earnings to the Statutory Reserve had already been subjected to taxation. The appellant maintained that Tribunal erred by holding that the fact the funds in the Statutory Reserve were previously taxed is immaterial and the amount should undergo taxation once again is contrary to the principles of a good tax regime such as certainty and legitimate expectation.

18. In conclusion, counsel urged the court to consider the amount capitalised in 2010 amounting to Kshs. 111,388,000.00 sourced from already taxed income should not be subjected to taxation and the assessment for additional tax by the Commissioner should be dismissed by allowing the appeal and setting aside the decision of the Tribunal.

Respondent’s Submissions

19. From the respondent’s point of view, the issue for consideration was whether Kshs. 111,388,000.00 capitalized in the year 2010 from a “Statutory Reserve” held within the long term funds is a taxable transfer. Thus, the thrust of its case was that the Statutory Reserve was a fund within the Life Fund and that a transfer from it, such as the capitalisation in this case, for the benefit of shareholders fell within **section 19(5)(a)** of the **ITA**.

20. Counsel submitted for purposes of this determination, the Statutory Reserve Fund is explained in **section 45** of the **Insurance Act** as a ring fenced fund created by life insurers for the benefit of policyholders. He explained that these funds are set aside to protect policy holders who invest their money in long term insurance and the risk is mitigated by creating a fund to pay future claims. Counsel also referred to share capital which he submitted refers to funds that shareholders raise in exchange of issuing an ownership interest in the company in the form of shares which entitle the shareholders to payment of dividends when the company makes profit.

21. The respondent contended that **section 19(5) (b)** of the **ITA** deals with taxation of funds upon transfer irrespective of how the transfer was built or established as it clearly states that whenever an amount is transferred from the life fund of a life insurer, for the benefit of shareholders, the amount should be considered as a gain and profit from that insurer for that year of income and should be subjected to taxation. Counsel explained that **section 45** of the **Insurance Act** does not specify the source of funds for the statutory fund and it is likely that such funds are an admixture of shareholders and policyholders funds but for purposes of **section 19(5)(b)** of the **ITA**, the origin is irrelevant since the critical issue is the tax point which is the transfer from the fund for the benefit of shareholders. Counsel contended that this position accords with the strict or literal construction of tax statutes elucidated in the ***Cape Brandy Syndicate Case (Supra)***.

22. Counsel for the respondent referred to **section 19(5A)** of the **ITA** which spells out how to treat the Statutory fund upon injection of already taxed shareholder funds. These injections by shareholders are considered a ‘negative transfer’ and are treated as a loss. Counsel explained that prior to the change in the law in 2009, a hybrid method of taxation was in force where the taxable income of a life insurance company was determined as the higher of income less expenditure (I-E) or any transfers from the life fund for the benefit of the shareholders.

23. Counsel submitted that from 2004 to 2008 every transfer to the Statutory reserve was taxed under the I-E method until the law changed in 2009 when the appellant transferred Kshs. 64,000,000/= from the Life Fund which was accordingly taxed under **section 19(5)** of the **ITA**. In 2010, Kshs. 25,000,000/= from statutory reserve to the retained earnings was also taxed under the said provision however the transfer of the Kshs. 111,338,000/= from the same Statutory Reserve for the benefit of shareholders was not subjected to the same tax hence it is this amount that Commissioner brought to charge as per **section 19(5)** of the **ITA**.

24. Counsel for the respondent also submitted that the appellant’s case was based on an erroneous understanding of the law concerning the Life Fund and Statutory Reserve. Counsel submitted that under **section 45** of the **Insurance Act**, a statutory fund can only be established under one of the two broad business; life and general insurance and in without a life fund there can never be insurance business because a statutory fund is a life fund and an insurer may operate as many funds as the Commissioner may allow. In conclusion, counsel stated that **section 19(5)** of the **ITA** only targets the movement of money every time it is appropriated from the Life fund for the benefit of shareholders.

25. The respondent rejected the argument that the assessment amounted to double taxation. Counsel submitted that in arriving at the decision to charge tax on the transfer of funds from the Life fund, it was guided by the wording of the statute which creates a point of taxation which is certain and the question to be answered is whether the amount charged had been transferred from the Life fund for the benefit of shareholders and not whether, as the appellant contended, the funds establishing the fund had already been taxed because that is a different taxing point and it is immaterial to the clear provisions of **section 19(5)** of the **ITA**.

Determination

26. In considering this appeal, this court is guided by **section 56** of the **Tax Procedures Act** which provides as follows:

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]

27. Following 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 summarised 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.” [Emphasis mine]

28. The issue for determination in this appeal relates to the interpretation of the provisions of the *ITA* and the *Insurance Act* and the application of the law to the facts of the case which are undisputed. It is therefore a matter of law whether the Commissioner was entitled to impose tax on Kshs. 111,338,000.00 transferred from the Statutory Reserve and whether such amount was for purposes of **section 19(5)** of the *ITA* was, “any other amounts transferred from the life fund for the benefit of shareholders”. Thus the resolution of this appeal hinges on the meaning of the words “life fund” and “for the benefit of shareholder”.

29. Both parties cited the *Cape Brandy Syndicate Case (Supra)* for the proposition that a subject can only be taxed based on the clear words of the statute and that in tax matters there is no room for intendment or equity. In the issue of interpretation of tax statutes, the Court of Appeal in *Kenya Revenue Authority v Republic (ex-parte Fintel Ltd)* NRB CA Civil Appeal No. 311 of 2013 [2019] eKLR, cited with approval the dictum of Lord Atkinson in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1 where he stated that;

It is well established that one is bound, in construing Revenue Acts, to give a fair and reasonable construction to their language without leaning to one side or the other, that no tax can be imposed on a subject by Act of Parliament without words in it clearly showing an intention to lay the burden upon him, that the words of a statute must be adhered to, and that so-called equitable constructions of them are not permissible.

30. It also cited the observation by Lord Simonds in *Russell v Scott* [1948] 2 ALL ER that;

[T]here is a maxim of income tax law which, though it may sometimes be over-stressed, 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 on him.

31. The *ITA* does not define the meaning of “life fund” and since **section 19** of the *ITA* deals with ascertainment of income of insurance companies, it is necessary to turn to the *Insurance Act* which regulates them. The *Insurance Act* does not also define “life fund” but it provides at **section 46(1)** that for an insurer carrying on long term business in Kenya, must establish and maintain a statutory fund under an appropriate name in respect of that long term business. Under **section 2(1)** of the *Insurance Act*;

“long term insurance business” includes insurance business of all or any of the following classes, namely, ordinary life assurance business, industrial life assurance business and bond investment business and includes, in relation to any insurer, business carried on by the insurer as incidental to any such class of business; [Emphasis mine]

32. From that definition and from a reading of **section 45(1)** of the *Insurance Act*, an insurer must have a statutory fund to back up any long term business including ordinary life assurance business. That statutory fund may be referred to by whatever name but what is important is that it is established in reference to long term business carried on by the insurer. In addition, and with the permission of Commissioner of Insurance, an insurer may establish a separate statutory funds for each class of long term business. Thus, in the case of life assurance, an insurer may establish a statutory fund for that class of business or another statutory fund for bond investment business. I agree with the respondent’s submission that the purpose of such a statutory fund is to protect policy holders by ring fencing the policy holders’ funds from the vicissitudes of ordinary business. It is also clear from a reading of **sections 46** and **47** of the *Insurance Act* that the statutory fund contemplated therein is for purposes of protecting long term insurance business within the meaning of the *Insurance Act* and not for any other purpose. I say this because the Statutory Reserve in this case was for the purpose of the keeping retained earnings for the benefit of shareholders which is a matter outside the purview of **sections 46** and **47** the *Insurance Act*.

33. The respondent took the view that the term statutory fund is used in descriptive and prescriptive sense. Prescriptive in that it is necessary for establishment of long term insurance business and descriptive in the sense the law allows the Commissioner of Insurance to permit the creation of as many statutory funds in respect of the various classes of long term insurance business. In my view, the name of the statutory fund so established is secondary to the class of business for which it is established. In other words, what is important is the relationship the fund has to the long term business established under **section 45** of the *Insurance Act* rather than the label or name of such a fund. In this case it is clear that the statutory fund established by the appellant under **section 45** of the *Insurance Act* was in respect of its life assurance business hence the term used to refer to the fund is Life Fund.

34. In its submissions, the appellant referred to two funds; a Statutory Reserve for the benefit of policy holders and shareholders and a Life Fund for the benefit of policy holders. The Statutory Reserve, which the appellant submits is for the benefit of shareholders, is not one of the

funds contemplated under the provisions of **section 45** and **46** of the *Insurance Act* as it is not in relation to the long term business. In fact, **section 46(1)(b)** prohibits application of part of the assets of a statutory fund for payment, application or allocation as dividends or otherwise as profits to shareholders of the insurer except in accordance with **subsections 5** and **6** thereof.

35. I therefore find and hold that the statutory fund established under **section 45(1)** of the *Insurance Act* and which is a mandatory requirement to carry on long term insurance business including life assurance business is what is contemplated under **section 19(5)(b)** of the *ITA* as the “*life fund*”. That definition excludes any other type of statutory fund authorised by the Commissioner of Insurance and established to support other long term business example a bond investment fund. In this case, the appellant’s Life Fund is the statutory fund established by under **section 45** of the *Insurance Act* and it is the “*life fund*” referred to and contemplated by **section 19(5)(b)** of the *ITA*.

36. 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.

37. I therefore find and hold that it is only a transfer of money from the Life Fund for the benefit of shareholders that is caught by **section 19(5)(b)** of the *ITA*. Whether the transfer of Kshs. 113,338,000/= was from the Life Fund hence subject to taxation was answered in the Commissioner’s letter dated 7th June 2013 accompanying the assessment in which it stated as follows:

4. In 2010, Ksh. 17,631,000.00 was transferred from the long term business to the “statutory reserve.” In the same year, Kshs. 111,388,000.00 of the “statutory reserve” was capitalized and a further Kshs. 25,000,000.00 was transferred to shareholders.

The amount of Kshs. 25,000,000.00 transferred to shareholders was rightly taxed in 2010. The capitalized Kshs. 111,338,000.00 from the statutory reserve was not taxed. Additional shareholding for the benefit of shareholders, not policy holders; hence this capitalization is a transfer for the benefit of shareholders under section 19(5) and just taxable as the Kshs. 25,000,000.00. This position was upheld by the Nairobi Area Local Committee on 21st February 2013. [Emphasis mine]

38. What is apparent from the Commissioner’s position, and what he recognised, is that in fact there was a difference between the fund for long term business which is the Life Fund and the Statutory Reserve which was created in 2004 from the appellant’s retained earnings. In that letter, the Commissioner remarked that, “*Even at inception, it is very clear in your accounts that the statutory reserve is a shareholders fund. Where it sits therefore is not relevant.*” In reality and in fact, there were two separate funds, the Life Fund and the Statutory Reserve and for purposes of **section 19(5)(b)** of the *ITA*, only a transfer from the Life Fund for benefit of shareholders was chargeable.

39. I therefore find and hold that the Commissioner erred in finding that the capitalized Kshs. 111,338,000.00 from the Statutory Reserve was not taxed and that the transfer thereof for the benefit of shareholders ought to be taxed. The Tribunal also failed to consider the fact that the two funds were distinct and only the Life Fund fell within the provisions of **section 19(5)(b)** of the *ITA*. A transfer from the Statutory Reserve, as a distinct and separate fund, could not be taxed under the aforesaid provision.

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.

Conclusion

41. 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.*” [Emphasis mine]

42. The *Cape Brandy Syndicate Case (Supra)* and the decisions cited in *Kenya Revenue Authority v Republic (ex-parte Fintel Ltd) (Supra)* are clear that a tax statute must be construed strictly. The use of the word “*the life fund*” in **section 19(5)(b)** of the *ITA* was very deliberate and was intended to apply to statutory fund created under **section 45** of the *Insurance Act* specifically in relation to the life assurance business. It was not intended to cover any other funds outside the province of the **section 45** or in relation to other classes of long term insurance business.

43. I am satisfied that the appellant has proved that the tax decision made by the Commissioner and Tribunal was incorrect. The Commissioner and the Tribunal failed to consider and appreciate the distinct nature of the Life Fund. Since they erred in the application of **section 19(5)(b)** of the *ITA* to a transfer of funds from the appellant’s Statutory Reserve, this appeal must succeed.

Disposition

44. I allow the appeal and order as follows:

- (a) The Assessment of the Commissioner of Domestic Taxes dated 7th June 2013 and confirmed on 12th February 2014 be and is hereby set aside.
- (b) The judgment of the Tax Appeal Tribunal dated 15th April 2016 be and is hereby set aside.
- (c) The appellant shall have the costs of the appeal before the Tribunal and of this appeal.

DATED and DELIVERED at NAIROBI this 30th day of MARCH 2020.

D. S. MAJANJA

JUDGE

ORDER

In view of the declaration of measures restricting court operations due to the COVID-19 pandemic and in light of the directions issued by his Lordship, the Chief Justice on 15th March 2020, this ruling has been delivered to the parties online with their consent. They have waived compliance with **Order 21 rule 1** of the *Civil Procedure Rules* which requires that all judgments and rulings be pronounced in open court.

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Ms Onchwari instructed by Oraro and Company Advocates for the appellant.

Mr Marigi, Advocate instructed by Kenya Revenue Authority for the Commissioner of Domestic Taxes.