REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAKURU

JUDICIAL REVIEW NO. 59 OF 2012

IN THE MATTER OF AN APPLICATION FOR JUDICIAL REVIEW IN THE NATURE OF CERTIORARI AND PROHIBITION

AND

IN THE MATTER OF SECTION 8 AND 9 OF THE LAW REFORM ACT CAP 26

AND

IN THE MATTER OF THE INCOME TAX ACT CAP 470

AND

IN THE MATTER OF THE KENYA REVENUE AUTHORITY ACT CAP 496

AND

IN THE MATER OF AN APPLICATION BY:

REPUBLIC ……..…....……...……. APPLICANT

VERSUS

KENYA REVENUE AUTHORITY ……..….. RESPONDENT

EXPARTE: STEP UP HOLDING (K) LTD

JUDGMENT

Before court is the Notice of Motion dated 9/10/2012 brought under Order 53 r3 of the Civil Procedure Rules. Leave to file the same was granted by this court on 4/10/2012. In said application the Ex Parte Applicant sought the following orders

> ***a. That this honorable court be pleased to issue an order of Certiorari to remove into the High Court and quash the decision of the Kenya Revenue Authority dated 10th August, 2012 demanding that the subject pays Kshs. 25,690,397/= being alleged tax arrears, interest and penalties.***
>
> ***b. That his honorable court be pleased to issue an order of prohibition to stop the Respondent from demanding from the subject Ksh 25,690,397/= alleged to be tax arrears, interest and penalties; and***
>
> ***c. That the costs of this application be provided for.***

The Application was supported by the Verifying Affidavit of **BERNARD GIKUDI**

the chairman of the Board of Directors of Step-up Holding (K) Ltd (the Ex Parte Applicant herein).

At the outset I wish to apologize to both parties for the delay in preparation of this judgment. This was caused by a bout of ill-health on my part which resulted in a brief stay in hospital. I sincerely regret the inconvenience caused to the parties as a result of this delay.

BACKGROUND

By a Memorandum of Understanding dated 1st September, 2008 Mount Kenya University (MKU) franchised its name to the ex-parte applicant who set up the Mount Kenya University Nakuru Campus. The ex-parte applicant solely ran and managed this campus including the recruitment and payment of the members of staff without any participation of Mount Kenya University. It filed its annual and audited accounts with the Respondent. When Mount Kenya University took over the management of the Campus on 26th September, 2011, the ex-parte applicant notified the Respondent that its last payments and returns for the Campus would be up to 31st August, 2011.

On 21st October, the Respondent conducted a compliance check of the ex-parte applicant in order to verify the ex-parte applicant's VAT, PAYE and Income Tax Declarations for the period between January, 2010 and August 2011. The Respondent informed the ex-parte in advance of this intended compliance check through their letter dated 8th October, 2011. The ex-parte contended that it had supplied the relevant documents as requested to the Respondent's officer, **'Mr. Ndung'u'** who was conducting the compliance check.

On 10th February, 2012 the Respondent issued the ex-parte applicant with Estimated Assessment Notices under Section 75 A of the Income Tax Act demanding tax arrears of Kshs. 29,850,000/= for the years 2008, 2009 and 2010. On the same day, the Respondent also issued agency notices on the ex-parte applicant's bankers: Bank of Africa, K-rep Bank, Family Bank and Equity Bank demanding that they remit the sum of Kshs. 29,850,000/= to the Respondent.

The ex-parte raised the objections dated 20th February, 2012, 27th February, 2012 and 12th March 2012 against the assessment notices but the Respondent did not reply to them. Instead, acting on its own motion, the Respondent sent its officer **'Mr. Kiptoon'** to carry out an audit of the ex-parte applicant on 18th April, 2012. On 23rd August, 2012 the Respondent served the ex-parte applicant with a demand for tax of Kshs 25,690, 397/= being the tax arrears, interest and penalties that were due. This sum was comprised of Kshs 9,299,644 being the corporate tax, Kshs 39,499 withholding tax, PAYE of Kshs 15,374,356/= being Ksh 1,746,459/= for the directors and Kshs 13,627,897/= for the part time lecturers, and stamp duty of Kshs 976,900/= for L.R No. 10386/28 and 10386/29. The ex-parte applicant was aggrieved by the action of the Respondent **KENYA REVENUE AUTHORITY** in applying a flat rate of 30% against salaries paid to the part-time lecturers. The ex parte applicant maintains that there existed no valid grounds upon which the respondent could issue the estimated assessment notices. The ex parte applicant argued that it has always filed returns with the Respondent which returns had been accepted and as such the Respondent is estopped from now declaring those returns incorrect and/or inadequate.

The ex parte applicant acknowledged the meeting held with **'Mr. G. Ndungu'** but argued that they were not served with a copy of the written notice as required by Section 56 of the Income Tax Act. Further the letter of compliance was for January 2010 to August 2011 yet the Respondent's demand letter covered the period 2008 and 2009 which was not included in the notice. The ex-parte applicant submitted that it had a constitutional right to access the information in the possession of the Respondent which was claimed to be the source of the alleged tip. It was argued that Act does not authorize the Respondent to investigate all tips from anonymous sources. The Respondent ought to be compelled to supply the ex-parte applicant with a copy of said complainant so that it may properly comprehend the nature of the allegations which it faces.

The ex-parte applicant further argued that there were no outstanding taxes due at the time the assessment notices were issued. The Respondent did not show any instruction by its head office to issue the estimated assessment notices. These are two separate processes. The compliance check conducted by **Mr. Ndung'u** was concluded in November, 2011 whilst the audit by **Mr. Kiptoon** was commenced on 18th April, 2012.

It was further contended by the ex parte applicant that the Respondent could not have based its decision on the report from the Banking Fraud Investigation Unit because this report was dated 10th February 2012 whereas the assessment notices were issued on 7th February 2012 (three days earlier). The alleged report from the Banking Fraud Investigation Unit was unsigned, had no addressee and was not on its letterhead and the Respondent failed to disclose how the same came into its possession.

The ex parte applicant argued that the document was probably manufactured by the Respondent and in the alternative the Respondent was acting upon the instructions of Mount Kenya University rather than on a genuine desire to collect tax. The audit report by Mount Kenya University was also said not to be authentic because it did not bear the Mount Kenya University letterhead, was not signed and the Respondent failed to disclose how it came into possession of the same.

The Respondent could not under Section 96 of the Income Tax Act issue agency notices, where a tax payer has already filed its returns in accordance with Sections 52 and 52B. The Respondent could not proceed with the audit against the objections or the ex-parte applicant, and it could not proceed without informing the ex parte applicant and allowing it sufficient time to prepare.

The ex –parte applicant contended that the 3rd Schedule Head B of Income Tax Act provided for different rates to be applied when calculating PAYE. It was argued that the Respondent ought not to have applied a flat rate of 30% PAYE for part-time lecturers. Instead the Respondent ought to have applied the graduated rate of 10%, 15%, 20%, 25% up to a maximum of 30%. The Respondent failed to give any basis for applying the maximum rate. Finally the ex-parte applicant argued that the Respondents actions were unprocedural, unreasonable and unlawful.

On their part the Respondent contended that its actions were lawful having been carried out in accordance with and pursuant to Section 56, 75A and 96 of the Income Tax Act which has now been repealed by Act No. 29 of 2015. Section 56(1) of the Act empowered the Respondent to carry out a compliance check of the ex parte applicant in order to ascertain that it was tax compliant. This check was conducted on 21st October, 2011 but the Respondent could not clear the ex parte applicant as not all relevant documentation had been availed. It was therefore agreed that a further audit would be conducted after two weeks when all documents would be submitted. However in the interim the Respondent received a tip from some unknown source that the applicant was likely to wind up after the termination of its MOU with the University Campus. The Respondent thus issued the ex-parte applicant with estimated assessment and agency notices in order to secure the outstanding taxes from 2008, 2009 and 2010 in accordance with Section 75A of the Income Tax Act. These estimates were based on the findings of the Banking Fraud Investigation Unit and the audit by the Mount Kenya University.

Following the issuance of the notice the ex parte applicant approached the Respondent to conduct a full audit of the company in order to establish the true position. This proposal was agreed to and the Respondent carried out the audit on 18th April, 2012. As a result of this audit the ex parte applicant was found to be in arrears of tax to the tune of Kshs 25,000,000/=.

The Respondent stated that it had not been able to effectively assess, collect and account for tax revenue because the tax regime is mainly entered on self-assessment. This required full disclosure and good faith by the tax payer. This system had been abused by persons who seek to evade tax. Therefore in 2004/2005 the Respondent introduced an information reward scheme where informants would provide the Respondent with tips of persons evading tax, manipulating records and other such malfeances. Any information so received would be accorded strict anonymity and would be treated as confidential. The Respondent would follow up on these tips and take relevant steps to ensure that the law was complied with. The Respondent insisted that it was not obliged to reveal its source.

The Respondent contended that the ex-parte applicant filed an objection dated 4th September, 2012 to the assessment of tax as contained in the demand letter dated 10th August, 2012. The objection was acknowledged and the demand for tax was stayed pending the determination of the objection. This objection is now pending awaiting the conclusion of this matter.

The ex-parte applicant did not disclose that it had business ventures other than managing Mount Kenya University. The Respondent discussed its audit report and it communicated its findings at every stage of the audit process to the applicant. It argued that the audit process was in compliance with the relevant tax law, its taxpayer's charter and the audit procedures. The Respondent contended that the part time employees were not below the tax of 30% and the onus was on them to prove otherwise. The ex-parte applicant refused to submit the details of the employees.

The Respondent urged this court to dismiss this present application as it was unmerited.

The application was disposed of by way of written submissions

The ex-parte applicant relied on its submissions dated 16th January, 2013. It submitted that the procedure through which the Respondent issues assessment notices is provided for by Section 73(1) of the Income Tax Act. Under this Section, an assessment can only be carried out when a person has failed to file his returns of income. When a person files his returns and they are accepted then Section 73(2) (a) provides that the Respondent must not issue any further notification. However in the event the Respondent has reasonable cause to believe that those returns are untrue or incorrect, then the Respondent is authorized by Section 73 (2) (b) to issue an assessment notice. The Respondent having accepted the returns filed by the ex-parte applicant is now barred from alleging that they are inadequate or incorrect particularly because it has not imputed fraud, willful neglect or default on the part of the ex-parte applicant. It is estopped from questioning the returns from the ex-parte applicant and claiming that the compliance check conducted was in bad faith, unreasonable and unlawful on this account. It also submitted that the Respondent did not issue it with any notice before issuing the assessment notice. It was not given a chance to pay the taxes before the agency notices were issued which led to the freezing of its accounts. It argued that this omission was a procedural impropriety from which is suffered prejudice.

The ex-parte applicant also faulted the Respondent for proceeding to carry out an audit against it and proceeding to demand payment from it without considering its objections dated 20th and 27th February, 2012. The ex-parte relied on the decision in **REPUBLIC Vs KENYA REVENUE AUTHORITY EX-PARTE MARY W. KAMAU & ANOTHER [2012] eKLR** and **NZIBA INTERNATIONAL TRADING COMPANY LIMITED Vs KENYA REVENUE AUTHORITY [2000] eKLR** which reinforce the statutory obligation of the Respondent to determine an objection raised against an assessment before demanding payment. It also argued that the audit was carried out without adequate notice as required by Section 56(1) of the Income Tax Act. It contended that the letter dated 3rd October, 2011 was not an adequate notice under the Act. The Respondent should have given the ex-parte applicant due warning of an impending decision or action, notice of the matters to be taken into account and then given the ex-parte applicant a chance to defend himself.

The ex-parte applicant further argued that the Respondents should not have applied a flat rate of 30% PAYE tax against its part time employees. This assessment was based on wrong principles and without any lawful basis. The ex-parte applicant referred to the decision in **REPUBLIC Vs KENYA REVENUE AUTHORITY [2009] eKLR** that computation of PAYE must be done in accordance with the third schedule of Income Tax Act. That, in applying the 30% tax rate, the Respondent in that case contravened the third schedule and accordingly its decision was illegal and must be quashed. The ex-parte applicant contended that the Respondent had no legal basis to settle the taxes of its directors which were included in the assessment as it is a separate legal entity. The ex-parte applicant further submitted that the Respondent took into account extraneous matters when assessing the tax. It failed to take into account that the management of Mount Kenya University was not the ex-parte's applicant sole business and failed to consider that it carries out other businesses. Its audit was also extended to the other businesses.

The Respondent submitted that it issued the assessment notices and agency notices pursuant to its powers under Section 75A and 96 of the Income Tax Act on the information that the ex-parte applicant was about to wind up or cease business without paying the outstanding taxes. It was the submission of the Respondent that the objections dated 20th and 27th February, 2012 were not valid because they raised irrelevant matters and did not prove the tax demanded. The Respondent disputed the contention that it conducted the compliance check without prior notice to the ex-parte applicant. It commenced the findings from the audit rather than the contents of the assessment notices. In its main motion the ex-parte applicant has asked the court to quash the demand letter dated 10th August, 2012 of Kshs 25,690,397 which was found owing from the audit and to prohibit the Respondent from demanding payment of this money.

ANALYSIS AND DETERMINATION

A major part of the ex-parte applicant's claim relates to the legality of the assessment notices and the agency notices issued to the ex-parte applicant's bankers by Respondent for the sum of Kshs 29,850,000/=. However the Respondent did not take any steps to enforce these assessment or agency notices. Instead the Respondent conducted an audit from which it was able to ascertain the amount of tax due from the ex-parte applicant. By consenting to conduct this audit to determine the correct amount of tax due, the Respondent effectively rescinded the

assessment and agency notices it had earlier issued. Therefore their legality or otherwise is no longer in question as they are no longer in force and were never acted upon either by the Respondent or by the ex-parte applicants bankers. In fact the prayers in the main motion relate to the findings from the audit rather than to the assessment notices. Indeed in that main motion the ex-parte applicant seeks to quash the demand letter dated 10th August, 2012 for Ksh 25,690,397/= which was found due and owing from the **audit** and sought to prohibit the Respondent from demanding payment of that sum. Thus the above issue becomes moot and this court will not make any determination on the same.

The only issue remaining for determination is whether the Respondents demand letter dated 10th August, 2012 should be quashed by way of certiorari. The judicial review order of certiorari is issued to quash a decision that has been made without or in excess of jurisdiction or where the rules of natural justice have not been complied with (**REPUBLIC Vs KENYA NATIONAL EXAMINATION COUNCIL).** It will issue where the decision complained of its unreasonable, illegal is tainted with malice or bad faith or it is unreasonable **(REPUBLIC Vs COMMISSIONER OF INCOME TAX EXPARTE COAST BOTTLERS).**

The ex-parte applicant argued that the respondent did not have any jurisdiction or reasonable cause to suspect that the ex-parte applicant was not tax compliant and therefore did not have a basis to carry out the audit of the ex-parte applicant. Its argument was that the Respondent did not properly exercise its powers in this instance because the ex-parte applicant has always paid its taxes and duly filed its returns as required by Section 52 and 52B of the Income Tax Act. The Respondent having accepted these returns is now estopped from alleging that they are incorrect. Under Section 73 of the Income Tax Act the Respondent can only assess tax where the person in question has failed to file their returns. Section 73 of the Income Tax provides that:-

> ***"73 (1) Save as is otherwise provided, the commissioner shall assess every person who had income chargeable to tax as expeditiously as possible after the expiry of the time allowed to that person under this Act for the delivery of a return of income.***
>
> ***(2) Where a person had delivered a return of income, the Commissioner may***
>
> > ***(a) (i) accept the return and deem the amount that person had declared as his self-assessment in which case no further notification shall be given; or***
> >
> > ***(ii) where the return is in respect of a year of income prior to 1992, accept that return and assess him on the basis thereof;***
> >
> > ***(b) if he had reasonable cause to believe that the return is not true and correct, determine according to the best of his judgment, the amount of income of that person and assess him accordingly".***

The above section in my view applies to the person who receives income that is chargeable to tax under the Act. Section 52 which creates the mandate to file returns states as follows

> ***"52. (i) The Commissioner may, by notice in writing, require a person to furnish him within a reasonable time, not being less than thirty days from the date of service of notice, with a return of income for any year of income containing a full and true statement of the income of that person, including income deemed to be in his under this Act, liable to tax and of those particulars that may be required for the purposes of this Act"***

The powers to assess income conferred by Section 73 is exercisable against a person who receives income. The ex-parte applicant was assessed under Section 37(1) which vests upon an **'employer paying emoluments to an employee the duty to deduct therefrom, and account for tax thereon, to such extent and in such manner as may be prescribed'**. Therefore it is my opinion that the filing of returns did not bar the Respondent from auditing the ex-parte applicant. The above section holds the employer accountable to the tax payable by its employees and therefore the employer is amenable to a compliance check under Section 56 for purposes of establishing that the employer has deducted and remitted the tax as required. The said section provides-

> ***"56(1) For the purpose of obtaining full information in respect of the income of a person or class of persons, the Commissioner may, by notice in writing, require, in the case of the income of a person, that person or any other person, and in the case of a class of person, any person-***
>
> > ***(a) To produce for examination by the Commissioner at the time and place specified in the notice, any accounts, books of account and other documents which the Commissioner may consider necessary; and the commissioner may inspect any such accounts, books of accounts or other documents and may, take copies of any entries therein;***
> >
> > ***(b) To produce forthwith for retention by the Commissioner for such period as may be reasonable for their examination any accounts, books of account and other documents which the Commissioner may specify in the notice;***
> >
> > ***(c) Not to destroy, damage, deface on or after service of the notice any of the accounts, books of account and other documents so specified without the permission of the Commissioner in writing"***

The fact that the ex-parte applicant has paid its taxes and filed its returns does not exempt it from being audited by the Respondent. The ex-parte contended that the Respondent's actions were prompted by ulterior motives and in particular to assist Mount Kenya University with whom the ex-parte applicant was engaged in a legal battle over the management of the Mount Kenya University Nakuru Campus. Its case was that ultimately the audit was unwarranted and the actions of the Respondent were unreasonable. Therefore notwithstanding that the Respondent had the powers to conduct the audit, this audit is unlawful and should be quashed as it was preceded by assessment notice that

did not have a proper basis. Section 56 vests in the Respondent the powers to carry out an audit either on its own motion or on the information of a third party **'for the purposes of obtaining full information in respect of the income of a person or class of persons'** . If it is latter, the Respondent does not have a mandate to disclose the third party. The only requirement under the section is prior written notice to the person from whom the information is sought. (Also see **REPUBLIC Vs COMMISSIONER GENERAL, KENYA REVENUE AUTHORITY & 2 OTHERS [2012]eKLR)**. In the circumstances that the decision of the Respondent to carry out the audit is not irrational or unreasonable as it is not a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it (see **ASSOCIATED PROVINCIAL PICTURE HOUSES LTD Vs WEDNESBURY CORPORATION [1948] 1 K.B 223).** In any event, the decision of the Respondent in this instance was based upon the ex-parte applicant's notification that it would cease managing Mount Kenya University campus.

The ex-parte applicant also accused the Respondent of contravening Section 56 by failing to issue it with a written notice before carrying out the audit on 18th April, 2012 from which it was established that the ex-parte applicant owed Ksh 25,690,397.00/=. The initial audit by the Respondent was conducted on 24th October, 2011 after due notice had been issued by the Respondent vide the letter dated 3rd October, 2011. The ex-parte applicant rightly did not challenge the legality of this audit as it was in compliance with Section 56 of the Income Tax. It was not in dispute that this audit was not successful as the ex-parte did not provide all the required material. By consensus, the audit was pushed to two weeks when the ex-parte undertook to avail the required documents. However, the Respondent issued the assessment notices containing an estimate of tax due before the two weeks lapsed. From the record the ex-parte objected to the assessment by the Respondent. It was established from the notes of the interview of the ex-parte applicant by the Respondent on 17th April, 2012 that this audit of 18th April, 2012 was carried out at the instance of the ex-parte applicant. The ex-parte applicant's representative indicated to the Respondent that the audit would establish the real position of the ex-parte applicant and if it would clear the company then he was ready to start the same day. He was duly informed and accepted to the audit being done the following day. By its letter dated 3rd May, 2012 the ex-parte applicant acknowledged the ongoing audit and it asked for more time to present some documents. Therefore the allegations that this audit was done without prior notice has no basis at all.

Furthermore the allegation by the ex-parte applicant that it was condemned unheard has no merit. The ex-parte applicant insisted that for this right to be realized it was mandatory for the Respondent to disclose the source of its confidential informants. I do not agree with this submission as the Respondent was not bound by the information given to it and there was no evidence that it acted on this information for purposes of carrying out the audit. As stated earlier the decision of the Respondent to carry out the initial audit was prompted by the letter from ex-parte applicant that it was closing its business. The information from the informant, the report of the Banking Fraud Investigation Unit and the audit report by Mount Kenya University only pertained to the assessment and agency notices which were rescinded. The audit was akin to an investigation of the tax position of the ex-parte applicant and I am satisfied that it conducted this audit after giving adequate notice to the ex-parte applicant and with its full participation.

The fourth issue raised in this matter concerned the assessment by the Respondent. The ex-parte applicant argued that the assessment of the corporate tax, withholding tax, stamp and PAYE were improperly assessed by the Respondent which resulted to the inflation of the tax that was allegedly due. The Income Tax provides at Part X for the mechanism through which a party that is aggrieve by an as assessment of tax under the Act may challenge the same. The person aggrieved may file an objection to the Commission and therefore file an appeal to the local committee. A further appeal from the decision of the local committee may be made to the Tribunal which was established in 2013. An appeal to this court from the decision of the tribunal shall lie on matters of law or fact.

Section 9 (2) precludes the court from reviewing an administrative action unless all mechanisms provided for, including mechanisms for interview review and appeal and other remedies provided for by written law have first been exhausted by the parties. Although the existence of those avenues do not bar a party from seeking judicial review remedies sub section (4) mandates the court to satisfy itself that there are exceptional circumstances and that it is in the interest of justice to issue the orders sought. I guided by the holding in **REPUBLIC Vs KENYA REVENUE AUTHORITY EX-PARTE INTERACTIVE GAMING AND LOTTERIES LIMITED[2016] eKLR** where the court held that the question of the assessment of taxes and how much is properly due is one that should be determined by the tribunals set out by law.

In the instant case, the ex-parte applicant exercised its right of appeal and filed an objection with the Commissioner dated 4th September, 2012 which has been stayed pending the determination of these proceedings. The court must await the determination of that appeal before delving into the issues of fact raised with regard to the assessment.

Based on the foregoing I find no merit in this present application. Accordingly I dismiss the same with cost to the Respondent.

Dated and Delivered in Nakuru this 31st day of January, 2018

Maureen A. Odero

Judge