REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

INCOME TAX APPEAL NO.6 OF 2010

KENYA ELECTRICITY GENERATING COMPANY LIMITED.....APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

1. The Appellant, **KENYA ELECTRICITY GENERATING COMPANY LIMITED,** has moved to the High Court to challenge the decision made by the Local Committee for Nairobi on 24th March 2010.

2. Pursuant to the said decision, the Local Committee held that the appellant was liable to pay additional **WITHOLDING TAX** amounting to Kshs.289,957,877/=. That sum was said to be payable to the Respondent, the Commissioner of **DOMESTIC TAXES,** for the period between 2001 and 2004.

3. During the period in question, the appellant (who shall hereinafter be cited as **"KENGEN")** undertook the construction of the **OLKARIA II GEOTHERMAL POWER PROJECT** in Naivasha. The project was funded by foreign financiers, including the **INTERNATIONAL DEVELOPMENT AUTHORITY (IDA).**

4. The respondent conducted a Tax Audit covering the income of **KENGEN** for the period between 2001 and 2006.

5. It was the conclusion of the Commissioner of Domestic Taxes that **KENGEN** was liable to pay to the Commissioner Kshs.289,957,877/= in respect to Witholding Tax.

6. KENGEN objected to the demand made by the Commissioner, arguing that payments which had been made to the contractors and the consultants in the Olkaria Project were exempt from tax.

7. However, the Commissioner of Domestic Taxes held his ground, and insisted that the Witholding Tax was payable.

8. The resultant dispute was placed before the Local Committee for Nairobi. After giving due consideration to the matter, the Nairobi Local Committee, under the Chairmanship of Mr. John P.N. Simba, held that the Witholding Tax was payable by **KENGEN.**

9. Being disatisfied with that decision, **KENGEN** has now come to the High Court, through the present appeal. The three (3) Grounds of Appeal were as follows;

"1. The Local Committee erred in law and in fact inholding that payment to the consultant was incoome in the hands of the suppliers, contractors and consultants and therefore suscestible to witholding tax;

2. The Local Committee erred in law and in fact in finding that Witholding Tax was not being deducted from the project funds but rather from the income in the hands of the suppliers, contractors or consultant, which income was payment for services rendered to the project.

3. The Loal Committee erred in law and in fact in holding that no exemption from the payment of witholding taxes was applicable."

10. For those reasons, **KENGEN** requested this court to set aside the decision of Local Committee. In effect, the court was being invited to hold that witholding tax was not payable by **KENGEN.**

11. The court was also invited to order the Commissioner of Domestic Taxes to pay to **KENGEN** the costs of these proceedings as well as the costs of the appeal before the Local Committee.

12. In answer to the appeal, the Commissioner contended that the decision of the Local Committee was properly founded upon the relevant law, and the factual evidence that was provided by the parties.

13. When canvassing the appeal, the appellant did so under 7 grounds. The court will make its determination based on the said 7 grounds.

IRRATIONALITY

14. KENGEN submitted it was irrational and wrong for the Local Committee to conclude that **KENGEN** had an obligation to calculate and thereafter deduct witholding tax in respect to payments made to consultants or contractors, yet **KENGEN** was not the person who made payments to those persons.

15. As far as **KENGEN** was concerned, the payments to the contractors and consultants were made by **IDA**

16. It was the contention of **KENGEN** that its only role was limited to checking and confirming that the work or services for which invoices had been raised, were actually done or rendered.

17. According to **KENGEN** the process of receiving invoices could not be construed to include the payment for such invoices. **KENGEN** reiterated that it only reviewed the invoices, to verify that they reflected actual work or services rendered.

18. Thereafter, payment was made by **IDA.** In those circumstances, **KENGEN** insists that the proper entity which ought to have deducted witholding tax from the payments made to the consultants and contractors was **IDA** or the Government of Kenya, as the disclosed principal.

19. In answer, the respondent submitted that there was nothing irrational about their demand that witholding taxes be paid.

20. My take on that issue is that the appellant appears to be shooting itself in the foot. I say so because **KENGEN** seems to be suggesting that witholding tax was payable, but that **KENGEN** was not the right person to have deducted the said tax from the payments made to the contractors and the consultants.

21. This is what **KENGEN** said at paragraph 16 of its submissions;

*"In this case, **IDA** was the party responsible for paying the consultants and contractors. In the premises, the proper entity to deduct withodling tax for payments to the consultants and contractors was the **IDA** which made payment to the consortium or the Government of Kenya as the disclosed principal."*

22. If withholding tax was not payable at all, then there would have been nobody who could be deemed as the proper person to deduct witholding tax.

23. Secondly, and in any event, **KENGEN** appreciated the fact that Section 35 of the Income Tax Act imposed the liability to pay tax upon the person making payment.

24. Meanwhile, the word *"paid"* is defined at Section 2 of the Income Tax Act to include;

> *"distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person."*

25. As the Olkaria II Geothermal Project was undertaken by **KENGEN,** the contractors and consultants working on that project were doing so for **KENGEN.** Therefore, when those contractors and consultants were being paid for the work they had done, the payments were being made on behalf of **KENGEN.**

26. IDA did not give work to the contractors and consultants. It is **KENGEN** which gave work to them.

27. But because **KENGEN** did not have its own funds which it could use to pay the contractors and the consultants, **KENGEN** entered into an Agreement with **IDA** who provided the funding.

28. The appellant has confirmed that it checked and confirmed the work and services for which invoices had been raised, with a view to ascertaining that such work and services had actually been carried out. That further confirms that it was **KENGEN,** and not **IDA,** who knew the work and services to be renderd to the project. **IDA** only made payments on behalf of **KENGEN.** Therefore, **IDA** cannot have assumed an independent Legal obligation to deduct witholding tax.

29. If witholding tax was payable, then it was the responsibility of **KENGEN** to pay it. Therefore, I find nothing irrational about the demand from the respondent, that tax, if payable, be paid by **KENGEN.**

LEGITIMATE EXPECTATION

30. KENGEN submitted that the advice, direction and confirmation which was given by the Ministry of Finance was binding on the Commissioner.

31. The Ministry had, by a letter dated 2nd May 2006, infomred the Commissioner of Domestic Taxes thus;

> ***"RE: ENERGY SECTOR RECOVERY PROJECT:***
>
> ***CREDIT NO.3958 – EXEMPTION FROM TAXES AND DUTIES ON ALL CONSULTANCY SERVICES PROVIDED UNDER THIS PROJECT.***

This is to confirm that the above mentioned project is an official aid funded project. Accordingly, all services to the project qualify for zero rating.

By a copy of this letter, the Permanent Secretary, Ministry of Energy is requested to provide you with the relevant documents to facilitate zero rating of any request."

32. The letter was signed by the Permanent Secretary, Treasury, Mr. Wanyambura K. Mwambia.

33. Even assuming that the respondent was bound by the contents of that letter, it is obvious that the letter did not purport to constitute a waiver of witholding tax.

34. The letter made it clear the Project **CREDIT NO.3958** qualified for zero rating. However, the Permanent Secretary at the Treasury made it clear that his counterpart at the Ministry of Energy would be required to undertake some more work, with view to giving effect to the intention of achieving tax

exemption.

35. There is no evidence before this court that the Permanent Secretary, Ministry of Energy did undertake the requisite tasks which would have led to the achievement of the intended tax exemption.

36. Furthermore, the letter from the Permanent Secretary, Treasury, was in relation to a contract that was different from the one in issue in this case.

37. In my understanding, the Olkaria II Geothermal Power Project which is in issue was the Development Credit Agreement **(DCA) No.2966.** Therefore, when the Permanent Secretary made reference to the Agreement No.3958, that may be in relation to an Agreement which has no bearing on the matter before me.

38. At any rate, **KENGEN** has not demonstrated the connection, if any, between those two Agreements.

39. In the case of **KEROCHE INDUSTRIES LIMITED VS KENYA REVENUE AUTHORITY & 5 OTHERS NBI JR APPLT. NO.743 OF 2006,** Nyamu J. (as he then was) held as follows;

> *"Stated simply, legitimate expection arises for example where a member of the public, as a result of a promise or other conduct expects that he will be treated in one way and the public body wishes to treat him or her in a different way. In this case the applicant did not expect an abrupt change of tariff where the process of manufacture of its products had not changed. Public authorities must be held to their practices and promises by the courts, and the only exception is where a public authority has sufficient overriding interest to justify a departure from what has been previously promised."*

40. I am in full agreement with that holding.

41. However, there is no indication that the respondent herein made any promise to **KENGEN** and thereafter sought to depart from such promise.

ABUSE OF OFFICE AND DISCRETION

42. It is common ground that the Commissioner of Domestic Taxes assessed the witholding tax after **KENGEN** had made a claim for investment reduction. Therefore, **KENGEN** perceives the action of the Commissioner to have been a deliberate effort calculated to discourage the legitimate claim by **KENGEN.** For that reason, **KENGEN** submitted that the Commissioner was actuated by bad faith and ulterior purpose.

43. KENGEN expressed the view that the Commissioner was guilty of abuse of office or of misuse of his discretion, for the improper act of punishing **KENGEN** for having pursued a legitimate claim.

44. The respondent countered those submissions by insisting that it had never departed from the legal and reasonable use of its authority. As far as the Commissioner was concerned, the issuance of the tax assessment in issue was in line with the Commissioner's statutory obligation.

45. In my considered opinion, when **KENGEN** put forward a claim for investment reduction it should have expected the Commissioner to give due consideration to that application. As a part of the exercise of giving consideration to **KENGEN's** application, the Commissioner for Domestic Taxes was obliged to undertake an audit, which would help it in determining whether or not the claim was justified. Therefore, the Commissioner cannot be faulted for undertaking the audit.

46. Secondly, there is absolutely nothing to show any ulterior motive or bad faith on the part of the Commissioner.

BREACH OF ARTICLE 47 OF THE CONSTITUTION

47. KENGEN submitted that, pursuant to Article 47 of the Constitution of the Republic of Kenya, it was entitled to administrative action which was expeditious, efficient, lawful, reasonable and procedurally fair.

48. Therefore, the Commissioner should have taken an early opportunity to challenge the assertion of the Ministry of Finance, that the Olkaria II Geothermal Power Project was zero-rated. As the Commissioner did not act timeously, **KENGEN** believes that it should be told that the Commissioner could no longer be allowed to demand payment of taxes from money which had already been paid out two years before the Commissioner demanded tax from such funds.

49. As already indicated above, the letter dated 2nd May, 2006 did not give rise to any legal obligation on the part of the Commissioner for Domestic Taxes. The said letter provided information, that the project cited in that letter, qualified for tax exemption.

50. By a copy of that letter, the Permanent Secretary, Ministry of Energy was required to take some actions. It was not the responsibility of the Commissioner of Domestic Taxes to take steps which would have given effect to the intention to have the project exempted from tax.

PUBLIC INTEREST

51. There is no doubt at all that the Olkaria II Geothermal Power Project was meant to benefit the people in Kenya, who would have more electricity available to them.

52. There is also no doubt at all that if the cost of production of the additional electricity was made more affordable, the consumers would benefit from such reduction in costs if the benefit of the said reduction was cascaded down to the consumers.

53. For that reason, the desire and intention to have the project exempted from taxation was laudable.

54. KENGEN has asked this court to tell the Commissioner of Domestic Taxes that it should not levy the witholding tax, as the said taxes would constitute a burden which would trickle down to the consumers.

55. I am in agreement with **KENGEN,** that the concession in taxation was not intended to benefit **KENGEN** itself. The intended exemption was meant to enhance the greater public interest.

56. However, the court also appreciates that the collection of taxes is also meant to enhance greater public interest. It is neither an end in itself nor it is intended to benefit the Commissioner for Domestic Taxes.

57. There is no legal basis for contention that the demand for payment of witholding tax is against public interest.

EXEMPTION FROM TAXATION UNDER PARAGRAPH 1 OF THE FIRST SCHEDULE

58. Para 11 of the first Schedule to the Income Tax Act reads as follows;

> *"The income of a person from a management or professional fee, royalty or interest when the Minister certifies that it is required to be paid free of tax by the terms of an agreement to which the Government is a party either as principal or guarantor and that it is in the public interest that the income shall be exempt from tax."*

59. That provision empowers the Minister for Finance to certify that the income of a person from a managment or professional fee, royalty or interest be paid free of tax. The Minister may exercise that power in respect to agreements to which the Government is a party, either as principal or as a guarantor.

60. When he exercises that discretion, the Minister will certify the exemption from tax as being in public interest.

61. Pursuant to Section 13 of the Income Tax Act, the Minister is required to gazette the exemption: And **KENGEN** readily concedes that that is a legal requirement.

62. Of course, **KENGEN** was under no legal duty to move the Minister to gazette the exemption. However, the failure of the gazettment meant that the steps which would have turned into reality, the intention and desire to exempt the Olkaria II Geothermal Power Project from withholding tax, were never actualised.

DOUBLE TAXATION

63. The obligation to pay taxes is primarily that of the person who has earned the taxable income.

64. Therefore, **KENGEN** suggests that the Commissioner of Domestic Taxes can only be successful in its pursuit of witholding tax if it proved that the consultants and contractors did not pay their respective taxes.

65. This arguement was raised for the first time during this appeal. There is no factual information upon which the court can determine whether or not there was any double taxation, as alluded to by **KENGEN.**

66. Furthermore, because the matter was never determined by the Nairobi Local Committee, it cannot be deemed to arise by way of an appeal. This court cannot say that the Local Committee was or was not wrong on a matter which the Committee was never called upon to make a determination, and also on a matter upon which no determination was made.

67. In any event, **KENGEN** appears to be calling upon the court to make assumptions, without any factual material. The absence of factual material means that **KENGEN,** who had suggested the possibility that there could be double taxation, had failed to discharge the onus imposed on any party who puts forward an assertion: **KENGEN** failed to provide proof of the alleged double taxation.

68. The court refuses to be drawn into the realm of speculation, on the alleged possible double taxation.

69. It is noted that by a letter dated 24th March 2010, **KENGEN** made it clear to the Minister for Finance that **KENGEN** was still requesting the Government to exempt the Olkaria II Geothermal Power Project from witholding tax as envisaged by the Development Partners. **KENGEN** concludes that letter by saying that if the projects were not exempted from witholding tax;

> *".....then KenGen can factor the taxes in the projects, pay from its own funds and seek an appropriate bulk supply tariff."*

70. In my understanding of that letter, **KENGEN** was not convinced that it had yet been exempted from paying witholding tax.

71. I find no merit in the appeal, and I therefore dismiss it.

72. The appellant will pay to the respondent the costs of the appeal.

DATED, SIGNED and **DELIVERED** at **NAIROBI** this **30th day** of **January** 2015.

FRED A. OCHIENG

JUDGE

Judgment read in open court in the presence of

Nyaburi for the Appellant

Mrs. Nganga for Mbaye for the Respondent

Collins Odhiambo – Court clerk.