REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

JR MISC. APPLICATION NO. 366 OF 2009

REPUBLIC

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES (Large Tax Payers Office……..……..THE RESPONDENT

EX-PARTE

BRITISH AMERICAN TOBACCO

KENYA LIMITED…….……..THE APPLICANT

JUDGEMENT

Introduction

1. By a Notice of Motion dated 1st July, 2009, the *ex parte* applicant herein, **British American Tobacco Kenya Limited,** seeks the following orders:

1. **An Order of Certiorari to remove into the High Court for purposes of it being quashed the decision and order of the Commissioner of Domestic Taxes dated 8th June 2009 and consequently the assessment dated 24th October 2008 and the agency notices dated 7th November 2008.**
2. **An Order of Prohibition to prohibit the Commissioner of Domestic Taxes from demanding payment of excise duty on the basis of the assessment dated 24th October 2008.**
3. **An Order that the Respondent do pay the cost of the proceedings.**

Ex Parte Applicant's Case

1. The application was based on the following grounds:

a. **The Applicant is a manufacturer of cigarettes and tobacco products and pays excise duty in respect of the same.**
b. **The Applicant paid excise duty as set out in Part II of the Fifth Schedule ("the Schedule") of the Customs & Excise Act (Cap 470) ("the Act"). Prior to 13th June 2008, the Schedule categorised cigarettes into four categories which were differentiated by the Retail Selling Price ("RSP") and an excise duty rate was specified for each category.**
c. **The Finance Bill 2008 amended the Schedule and introduced a hybrid system of charging excise duty so that each of the four categories were categorised by a product description and**

RSP. A rate of excise duty was specified for each category.

d. **The amendment was ambiguous as it was not clear whether the product characteristics or the RSP should take precedence in determining the category within which the cigarettes were to be categorised.**
e. **The Minister for Finance agreed that the Schedule was ambiguous and informed the Respondent that the same was under review however pending clarification, the Minister directed the Respondent that the primary factor in determining the rate of excise duty payable was the product characteristic.**
f. **Despite the Minister's direction, the Respondent assessed the Applicant for payment of excise duty on the basis of RSP ascribed to each category and issued agency notices.**
g. **The Respondent suspended the agency notices pending the enactment of the Finance Act which was expected to provide clarification and remove the ambiguities.**
h. **When the Finance Act was enacted, the Schedule was amended so as to make it clear that product characteristic took precedence over the RSP.**
i. **Despite the clarification given to the Schedule when the bill was enacted into an Act, the Respondent has re-instated its agency notices.**
j. **The Provisional Collection of Taxes and Duties Act (Cap 415) clearly states that the order pursuant to which taxes are provisionally collected pending the enactment of a bill into law ceases to have effect when the bill is passed into law. In the event that the bill is amended when passed into law and the taxes collected pursuant to the order are in excess of the enacted law then the tax payer is entitled to a refund. Therefore the Respondent would, in any event, have been mandated by law to refund the excise duty demanded if the Applicant had paid it. Hence the Respondent has no jurisdiction to demand payment of the excise duty and issue agency notices in respect thereto.**
k. **Alternatively and without prejudice to (j) above, even if the Respondent has jurisdiction to demand payment of the excise duty, then he is acting in excess of that jurisdiction by demanding payment of the duty when the same is not payable**
l. **The Respondent has already reinstated its agency notices to enforce payment of the tax claimed. The enforcement of the agency notices issued to Banks will cripple the Applicant's business operations and cause the Applicant irreparable loss and damage.**

2. The application was supported by an affidavit sworn by **Lawrence Kimathi Kiambi**, the applicant's Finance Director.
3. According to him, the Applicant seeks to quash the decision of the Commissioner of Domestic Taxes dated 8th June 2009 wherein the Respondent has reinstated its agency notices issued on 7th November 2008 and consequently the assessment dated 24th October 2008 and the agency notices dated 7th November 2008.
4. It was deposed that the Applicant is a manufacturer of cigarettes and tobacco products (hereinafter referred to as the "cigarettes") and pays excise duty on its cigarettes pursuant the ***Customs & Excise Act*** (hereinafter referred to as the "Act") and at the rate prescribed in the Act. Prior to 13th June 2008, Part II of the Fifth Schedule set out four categories in which cigarettes were categorised in accordance with their Retail Selling Price (hereinafter referred to as "RSP") per mille and a mille is a bundle of 1000 cigarettes.
5. According to the deponent, the ***Finance Bill 2008*** (hereinafter referred to as the Bill) was published in the Kenya Gazette on 12th June 2008 and in accordance with an order made by the Minister for Finance in legal notice no.72 of 2008 under the ***Provisional Collection of Taxes and Duties Act*** (Cap 415), all the provisions of the Bill relating to taxes or duties were deemed to have effect as though the same had passed into law. The said Bill categorised cigarettes in Part II of the Fifth Schedule by way of a system that was referred to as a "hybrid" system in the Minister for Finance's (hereinafter referred to as "the Minister") budget speech which hybrid system categorised cigarettes in accordance with the given product characteristics and RSP and a rate of duty was prescribed for each category.
6. To the deponent, it was not clear whether the product characteristics or the RSP would be the primary factor in determining the category within which a particular brand of cigarettes would be categorised. However, on the basis of the comments made by the Minister in his budget speech specifically that the RSP based regime restricted free adjustment of prices, the Applicant took the

view that the product characteristics should be the primary factor and sought clarification from the Permanent Secretary Ministry of Finance on 13th June 2008 in which letter, the Applicant pointed out that the proposed legislation was ambiguous. As no response was received, the Applicant then wrote to the Chairman of the House Departmental Committee on Finance, Planning and Trade seeking clarification in respect of the ambiguity created by ***Finance Bill 2008*** but no response was forthcoming.

7. It was deposed that in view of the ambiguity that existed and having not received any clarification regarding the same, the Applicant applied the explanation given by the Minister in his budget speech and interpreted Part II of Fifth Schedule to mean that the product characteristic was the primary factor in determining the rate of duty payable and paid the duty accordingly. However, on 15th October 2008 the Applicant received a letter from the Respondent for payment of excise duty for the sum of Kshs 346,598,000 on the basis that according to the Applicant's published RSP, some of the Applicant's cigarettes should have been classified in a different category than that applied by the Applicant. To that letter, the Applicant responded vide its letter dated 22nd October 2008, pointing out that Part II of the Fifth Schedule of the said Bill was ambiguous and as stated in the Minister's Budget Speech, the intention of the system was to remove any artificial price controls that were created by the previous system whereby excise duty was based purely on RSP. The Applicant informed the Respondent that its understanding of Part II the Fifth Schedule was that product characteristic would be the key factor in determining the category within which a specific brand of cigarettes fell and that the RSP would only become relevant in the event that a product did not fall within any of the categories. The Applicant pointed out that it had already sought clarification on the issue and suggested that the parties wait for the enactment of the ***Finance Act*** so as to establish whether such clarification would be provided.
8. It was further deposed that the Applicant's representatives then met with the Respondent's representatives on 23rd October 2008 with a view of impressing upon the Respondent that as Part II of the Fifth Schedule of the said Bill was ambiguous, the Applicant should not be penalised for such ambiguity by having to pay the excise duty demanded until such ambiguity is clarified by the enactment of the ***Finance Act***. Despite the meeting, the Respondent on 24th October 2008 wrote to the Applicant and restated its position that the Applicant had misclassified various brands of cigarettes and under declared excise duty on the same and demanded payment of a sum of Kshs 594,076,450 which included penalties and interest. The Applicant then urgently appealed to the Permanent Secretary in the Ministry of Finance on 27th October 2008 restating its interpretation that cigarettes would be categorised primarily on the basis of product characteristics and that the Respondent's interpretation was different in claiming that the Applicant had under-stated the excise duty. On 4th November 2008 the Ministry for Finance wrote to the Respondent and clarified that under the Excise Duty regime introduced by the said Bill, the intention was to make the product characteristic dominant and that the proposed excise duty regime was under review in order to bring clarity to its application. The Permanent Secretary therefore agreed with the Applicant's interpretation and further agreed that there was ambiguity in the proposed regime hence the need for clarity.
9. It was averred that the Respondent however ignored the letter and on 7th November 2008 proceeded to issue agency notices on all the banks in which the Applicant held an account. As the agency notices were threatening to cripple the Applicant's business operations, the Applicant again held urgent meetings with the Respondent's representatives emphasising that the Permanent Secretary had agreed with the Applicant's interpretation and categorically stated that the proposed regime was ambiguous and was in the process of being reviewed so as to bring clarity and enable the Applicant to plan its business affairs accordingly and implored the Respondent to await the outcome of the enactment of the ***Finance Act 2008*** to see if such clarity would be provided but on 18th November, 2008, the Respondent wrote a letter restating its previous position. However, on 20th November 2008, the Respondent notified the Banks that the Agency notices had been suspended.
10. It was averred that on 15th December 2008, the ***Finance Act*** was enacted and Part II of the Fifth Schedule of the ***Customs & Excise Act*** was worded differently from the said Bill so as to clarify the excise duty regime and it was clear that the product characteristic was the key factor in determining the category within which a particular brand of cigarettes fell and the RSP was only a

secondary factor. It was contended that according to the final provisions of the Part II of the Fifth Schedule of the ***Customs & Excise Act*** as amended by the ***Finance Act, 2008***, the Applicant had correctly and fully discharged its excise liability during the relevant period prior to the enactment of the ***Finance Act, 2008*** which enactment came into force on 1st December 2008. Pursuant thereto, the Applicant wrote to the Respondent on 3rd December 2008, pointing out that Part II of the Fifth Schedule had been amended and as the enactment of the ***Finance Act*** brought clarity to the excise regime proposed by the said Bill and the said clarity was on all fours with the interpretation that the Applicant has applied when calculating excise duty during the period prior to the enactment on 1st December 2008, the Applicant was of the view that the Respondent would no longer pursue its claim that the Applicant had underpaid excise duty and would vacate its demand but no response was received from the Respondent despite a reminder on 29th January 2009.

11. On 30th March, 2009, without addressing the issues raised by the Applicant, the Respondent merely re-stated its position and reinstated its agency notices and demanded payment of excise duty for the period prior to 1st December, 2008 on the basis of its interpretation of the said Bill provisions which were rescinded by the enactment of the ***Finance Act, 2008***. It was averred that the Respondent sent the said decision directly to the Applicant's banks without any prior notice to the Applicant.
12. It was the deponent's contention that the Minister's order (Legal notice no.72 of 2008) ceased to have effect on 1st December 2008 because the said Bill as pertaining to Part II of the Fifth Schedule was amended to bring more clarity and enacted on that date. By virtue of the Act, the Applicant would have been entitled to a refund if it had paid the excise duty demanded by the Respondent. Therefore the Respondent has no jurisdiction to collect excise duty which it would have been mandated by law to refund to the Applicant as the Order pursuant to which it would have collected the excise duty ceased to have effect.
13. The deponent asserted that because of the reinstatement of the agency notices, the Applicant was in grave danger of being unable to operate its bank accounts which would have paralysed the Applicant's business operations and rendered its 640 employees jobless. Other than its employees, the Applicant also generates revenue for over 5,000 Kenyan tobacco farmers whose source of income and livelihood would have been b adversely affected, should the Applicant's business operations ceased.
14. The applicant's position was that it had always diligently paid its taxes and was recognised by the Kenya Revenue Authority in 2008 as one of the top tax payers.
15. By a further affidavit sworn on 3rd September, 2009, the same deponent reiterated the foregoing and added that ambiguity posed a practical difficulty to the Applicant in determining the category in which some cigarettes were to be categorised. The cigarettes were divided into four categories which were Plain, Soft-cup I, Soft-cup II and Hinge Lid cigarettes. Plain cigarettes are those that do not have a filter and according to the said Bill were classified under Category A. Soft-cup cigarettes are those packed in a "soft cup pack" which is a pack typically made up of three distinct layers of soft-sheet material comprising: an inner-wrap in the form of metallised paper folded in at its ends to contain the cigarettes, a paper outer wrap wrapped around the inner-wrap and displaying brand specific information to the consumer, and a transparent overwrap of, for example, cellophane material heat sealed over the outer wrap to seal the pack against the ingress of contaminants and thus preserve the freshness and moisture content of the cigarettes prior to opening. According to the said Bill, soft cup cigarettes were classified under category B and C as soft cup I and II respectively. No definition was provided in the Bill for "soft-cup I" and "soft-cup II". Hinge Lid cigarettes are packed in a rigid hinged-lid pack which is made from cardboard and has a lid that is hinged to the container by a hinge between the rear wall of the pack and the rear wall of the lid.
16. It was emphasised that the Hybrid System introduced by the said Bill was ambiguous in that in applying the system, it was not clear whether a plain cigarette with a retail selling price of more than Kshs 30 per pack of Kshs 1,500 per mille would be taxed under Category A or B. Similarly, it was not clear whether soft-cup cigarettes retailing at over Kshs 70 per pack or Kshs 3,500 per mille would be taxed under Category C or D, bearing in mind that category C was designed for soft-cup cigarettes retailing at between Kshs 50 and Kshs 70 and that Category D was designed for

Hinge lid cigarettes with a retail selling price of more than Kshs 3,500 per mille. Further, "Soft-cup I" and "Soft-cup II" were not defined.

17. It was averred that the Applicant did not at any time refuse to pay excise duty and the Applicant has never implied that the letter dated 4th November 2008 was a directive from the Minister not to collect duty. The Applicant in fact paid excise duty in accordance with its interpretation of the said Bill, which interpretation was confirmed by the Minister in his letter dated 4th November 2008. Because the Bill was tabled by the Minister and he explained the intention of the Bill during the Budget Speech, he was entitled to give guidance as to how the provisions of the Bill ought to be implemented and it is therefore incorrect for the Respondent to state that the Minister's letter dated 4th November 2008 did not have any legal effect
18. It was deposed that the Applicant did not at any time intimate to the Respondent that it would be willing to work out a payment schedule. It was always the Applicant's position that no excise duty was payable and therefore the Applicant would never have proposed a payment schedule. It was always the Applicant's understanding that the agency notices had been suspended pending the enactment of the Finance Act which was expected to give clarity and predictability to the Hybrid system as indicated by the Minister in his letter dated 4th November 2008.
19. To the deponent, the date of the enactment of the ***Finance Act*** is immaterial because the Act is very clear that every order made under the Act ceases to have effect when the Bill becomes law with or without modifications. The Act further provides that if any excess tax is paid in compliance of an order, such tax shall be refunded if the bill is not enacted into law or it is enacted with modifications which make the tax no longer payable. Therefore even if the Applicant had paid the excise duty demanded by the Respondent, the amount would have to be refunded to the Applicant after the ***Finance Act*** came into effect as the hybrid system proposed under the said Bill was modified so as to make it clear that product characteristic was the dominant factor. In any event the excise duty claimed by the Respondent was not due because in computing the same, the Respondent had used RSP as the dominant factor whereas it is clear from the Minister's letter dated 4th November 2008 that it was the intention of the hybrid system that product characteristic should be the dominant factor.
20. It was submitted that it was clear from the provisions of section 3(d) of the Act that the Minister's Order published in the Gazette ceased to have effect once the Bill was enacted into ***Finance Act***.
21. It was submitted that it was clear that the said Bill was modified before it was passed as the ***Finance Act*** and that the amendment to part II of the Fifth Schedule to the ***Customs & Excise Act*** was worded differently from the Bill so as to make it abundantly clear that product characteristic was the dominant factor.
22. It was therefore submitted that the applicant had correctly discharged its excise liability and had not underestimated the amount since the amount claimed by the Respondent was not payable. That being the position, it was submitted that under section 4 of the Act any payment made in excess of the tax or duty payable immediately after the Order has ceased to have effect, would be refunded. As the Finance Act clarified that the amount claimed by the Respondent in accordance with its interpretation was nolonger payable, when the Finance Act came into effect no tax was payable in accordance with the Respondent's interpretation and the Respondent would have been entitled to a refund of the tax by virtue of the provisions of section 4 of the Act.
23. It was therefore submitted that had the applicant paid the amount claimed the Respondent would have been entitled to refund the same to the applicant as required under section 4 of the Act. It was therefore submitted that the respondent had no jurisdiction to demand payment of the Excise Duty. The applicant cited similar provisions in the English legal system in support of its position. Based on **Keroche Industries Limited vs. The Kenya Revenue Authority Misc. Appl. No. 743 of 2006**, it was submitted that in ignoring clear provisions of the Act, which would have entitled the Applicant to a refund if it had paid the tax claimed, the Respondent has not properly addressed itself to the provisions of the Act hence its claim is a nullity.
24. The applicant however contended that the said Bill was admittedly ambiguous whi9ch ambiguity was appreciated by the Minister for Finance. In that event, it was submitted based on **Kanjee Naranjee vs. Income Tax Commissioner [1964] EA 257 at 259**, **Unilever Kenya Limited vs. The Commissioner of Income Tax Income Tax Appeal No. 753 of 2003** and **Commissioner of Income Tax vs. Westmont Power (K) Ltd Income Tax Appeal No. 626 of 2002** that the said ambiguity ought to have been resolved in favour of the applicant. According to the applicant the

clarification provided in the Minister's letter together with the fact that the enactment of the ***Finance Act*** confirmed the applicant's interpretation of the hybrid regime proposed by the Minister hence any ambiguity must be resolved in favour of the applicant.

25. According to the applicant since the hybrid regime proposed in the said Bill did not have an alternative rate of duty, section 2(3) of the ***Customs & Excise Act*** did not apply otherwise the Minister would have invoked the said section when the applicant sought clarification.
26. It was therefore submitted that the Respondent's continued demand for payment of excise duty over and above the amount already paid by the applicant is illegal by virtue of sections 3and 4 of the Act and that the Respondent exceeded its jurisdiction by reinstating the agency notices and its decision ought to be quashed and the Respondent prohibited from making further demands.
27. The applicant also distinguished the authorities relied upon by the Respondent and formed the view that the same were not relevant to the instant case.

Respondent's Case

28. In response to the application the respondent filed a replying affidavit sworn by **Anne Irungu**, the Respondent, Assistant Commissioner on 28th July, 2009.
29. According to the deponent, prior to July 2013, excise tax on cigarettes was applied "ad valorem", i.e. based on the ex-factory cost of production which meant that producers with higher manufacturing cost paid higher tax compared to those with lower cost which system, apart from being inequitable, also became unsuitable due to the potential for manipulation of manufacturing. To remedy the situation, a new tax regime was brought into force through the ***Finance Bill 2003***, which based taxation on retail selling price (RSP) in which Cigarettes were grouped into four categories on the basis of RSP with each category having specific rate of excise.
30. It was deposed that as indicated in the Minister for Finance's Budget Speech for the Fiscal Year 2008/2009 the hybrid regime was supposed to address the challenges associated with imported cigarettes by bringing into the tax net all imported cigarettes, and also to removing restrictions of free price adjustments. The minister further stated that the hybrid method was to be applied in order to help the industry players to make the necessary adjustments to eventually move to the characteristic based regime."
31. Accordingly, it was deposed, in 2008, the Minister introduced the ***Finance Bill*** 2008's amendment to the Fifth Schedule Part II of the ***Customs and Excise Act*** Cap 472, a new excise regime based on a hybrid method, where both the physical product characteristic and RSP were both used to assess excise duty on cigarettes. By the Legal Notice No. 72 dated 12th June 2008, the Minister, specified that the provisions of the said Bill 2008, whether imposing, creating, altering, or removing any duty would be effected as law during that period.
32. As opposed to the applicant's contention that this system was ambiguous, the deponent contended that, because this system is common in the Excise Acts where duty rate taxation is applied to other products, e.g. Alcohols. In her view, the Minister for Finance's letter dated 4th November 2008 and signed by the Director, Economic Affairs, confirmed categorically that the new system was hybrid, meaning that, in determining the excise duty, the characteristic must be weighed against the RSP range which letter was not a directive from the Minister of Finance to KRA, not to collect tax under the ***Customs and Excise Act*** Cap 472. As the Director of Economic Affairs did not declare the hybrid regime under the Fifth Schedule to the ***Customs and Excise Act*** to be ambiguous, it was deposed that the same cannot alter the application of specific provisions in the law, and in fact bears no legal effect.
33. It was therefore denied that the Minister directed that pending the enactment of the ***Finance Act*** 2008, the primary factor in determining the rate of excise duty payable was the product characteristic. To the deponent, the hybrid system prescribes the application of both methods at the same time. The characteristic can only be dominant with reference to the RSP and as the RSP is a mandatory part of the ratio, the Minister termed it Hybrid because the excise duties were not be determined based on characteristic alone. To the deponent, since section 2(3) of the ***Customs and Excise Act***, mandates that "where an alternative rate of duty is shown, (as in the Present case) the rate chargeable is that which results in the higher duty charged", this is the section that guides calculation of duty in a hybrid system such as in the present case hence the reason why the Applicant's assessment resulted in a higher duty. It was therefore deposed that the fact the

product description was rated according to a capped price range i.e. "Soft-cup II or Shs. 2501 - Shs. 3500" must mean that when applying the rate of duty, one must consider that there is a limit to each product range, and move to the high rate of duty when the product exceeds the capped price range.

34. The deponent averred that upon KRA conducting an audit, it was discovered that the Applicant had misclassified its brands of cigarettes, based on characteristic alone as opposed to the deponent's department's classification of the Applicant's cigarettes which was based on the hybrid classification prescribed both by the Ministry of Finance, and by the said Bill. To her, the difference in the duty rates between BAT's classification and her department's classification were brought about because her department applied the prescribed law at that time, i.e. said Bill as read together with the Actand Section 2 (3) of the ***Customs and Excise Act*** which resulted in higher excise duties amounting to Kshs 594,076,450.00 for the accounting period between June 2008 to November 2008 and a demand letter was issued by her department dated 24th October 2008. As by 7th November 2008, there had been no response from the Applicant, enforcement measures were applied by way of placing Agency Notices to the Applicant's bankers under Section 166A of the ***Customs and Excise Act*** Cap 472.
35. However as a result of concerns raised by the applicant and as KRA was willing to hear the Applicant and work out a payment schedule, the Agency Notices were suspended on 20th November 2008, pending those meetings, and not because of the Ministry's letter dated 4th November 2008 and were reinstated after no agreement could be reached on the mode of payment.
36. The applicant was emphatic that KRA never suspended the Agency Notices in order to await the enactment of the ***Finance Act*** since to fail to apply the provisions of the said Bill would be to create a vacuum in the law, a scenario that could not be allowed by Parliament hence the enactment of the Act, in order to give life to Finance Bills. In the deponent's view by the enactment of ***Finance Act*** 2008 with 1st December 2008 as the effective date, the taxes that had been found to be due based on the said Bill were not affected because KRA's tax audit was in relation to a prior period, i.e. June 2008 – November 2008 since this law did not have a retrospective effect.
37. It was the deponent's view that the effect of the Minister for Finance not backdating the effective date of the ***Finance Act*** 2008 to 13th June 2008, meant that any taxes collected under the Act are legally collected and are due. To not give effect to that law would be, contrary to the Legal Notice No. 72 dated 12th June 2008 and would render the law nugatory.
38. It was the position of the deponent that KRA has at all material times acted within the law and the taxes demanded are due and payable. To her section 2 of the Act states that the Minister may make an order that all or any specified provisions of a Bill where any tax or duty, or any rate, allowance or administrative or general provisions in respect thereof, would be imposed, created, altered or removed, and that Bill shall have effect as if the Bill were passed into law.
39. It was averred that the deponent's department wrote to the Applicant a letter dated 30th March 2009, informing them that the tax was still due and continued to remain payable and upon receiving no feedback from the Applicant and having failed to reach an agreement on a payment schedule, all the suspended Agency notices were re-instated, with apologies to the banks for any inconvenience caused to the bank, and not to the defaulting taxpayers.
40. To the deponent whereas the Applicants are insisting that the Domestic Taxes Department was restricted to applying solely the characteristic method only for calculating duty, such a method, at the material time, was not law as the law in force at that time was the Hybrid Bill whose commencement date was 13th June 2008, which was having the force of law by virtue of the Act. Whereas the ***Finance Act*** 2008 whose effective date was 1st December 2008 introduced product characteristic as the dominant basis for excise computation and assessment, the regime in the ***Finance Act*** is still a hybrid regime.
41. To the deponent whereas all other parliamentary bills do not have the force of effect of law, until they are enacted, for purposes of taxation, the ***Finance Bills*** are applied as law in order to avoid a vacuum in the law and to enable continuous collection of taxes and that taxes collected by virtue of that law are not rendered nugatory when the Act comes into effect, especially when the effective date is not backdated and that taxes are refunded only if they have been paid, and paid in error. To her the law as worded in the said Bill was clear and appropriate as it prescribed the

cigarette characteristic as the minimum benchmark for taxation purposes and also provided for a higher duty where the product is sold on premium price. In her viewthe intention of the law is to not only somewhat level the playing field (by prescribing characteristic as the minimum benchmark) but to also take advantage of the premium pricings for tax purposes.

42. On behalf of the Respondent, it was submitted that revenue statutes can be varied annually through Finance Acts in order to suit the government's Annual Budgetary needs, hence the reason why annual amendments are purposely made through the Finance Acts in order to accommodate National Debt and Public Revenue. While outlining the statutory mandate of the KRA, it was submitted that the Legislature knew full well what it intended the law to be and expressed it through legislation.
43. It was submitted that the mere fact that the law was under review did not make it invalid taking into account the Minister's order that the Bill would be affected as law during the period. As the ***Finance Act***, 2008 had an effective date of 1st December, 2008 it did not apply retrospectively hence before the effective date of the Act the Bill was the applicable law Citing the principles of statutory interpretation, it was submitted that the Court should lean against the construction which reduces a statute to futility but lean in favour of an interpretation which makes it effective and operative.
44. To the Respondent there was no ambiguity in the legislative provisions in issue and that the applicant was the one who misunderstood the provisions. It was submitted that the Minister never said that the law was ambiguous as alleged by the applicants. To the Respondent KRA has treated all the other cigarette manufacturers in the industry equally, and to do otherwise would be unfair treatment and reference was made to **Mastermind Tobacco Ltd vs. KRA & 2 Others JR No. of 2008**. It was therefore submitted that legitimate expectation cannot apply in the clear face of the law. It was therefore submitted based on **Kenya National Examinations Council vs. Republic CA No. 266 of 1996** and **Republic vs. Commissioner of Income Tax exp Pili Management HCMA No. 525 of 2006** that the orders sought herein are not merited.
45. According to the Respondent the taxes paid pursuant to the Bill cannot be termed as excess tax or duty. To the contrary excess duty is one arising from payment in excess of what the order provides.

Determinations

46. This being a dispute revolving around tax legislation, it is important to revisit the principles guiding such legislation. The said principles were restated in **Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD [2012] eKLR** where the learned judge held:

> **"The approach to this case is that stated in the oft cited case of *Cape Brandy Syndicate v Inland Revenue Commissioners* [1920] 1 KB 64 as applied in *T.M. Bell v Commissioner of Income Tax* [1960] EALR 224 where Roland J. stated, *" …in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing it to be implied. One can only look fairly at the language used… If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."* As this case concerns the interpretation of the *Income Tax Act,* I am also guided by the dictum of Lord Simonds in *Russell v Scott* [1948] 2 ALL ER 5 where he stated, *"My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed 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 upon him"* adopted in *Stanbic Bank Kenya Limited v Kenya Revenue Authority* CA Civil Appeal No. 77 of 2008 (Unreported) [2009] eKLR per Nyamu JA (See also *Jafferali Alibhai v Commissioner of Income Tax* [1961] EA 610, *Kanjee Naranjee v Income Tax Commissioner* [1964] EA 257). Any tax imposed on a subject is dictated by the terms of legislation and taxing authority must satisfy itself that the transaction fits within the definition of the statute. In *Adamson v Attorney General* (1933) AC 257 at p 275 it was held that, *"The section***

is one that imposes a tax upon the subject, and it is well settled that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used, and if there is any doubt or ambiguity this defect-if it be in view of the Crown a defect can only be remedied by legislation."

47. In **Tanganyika Mine Workers Union vs. The Registrar of Trade Unions [1961] EA 629**, it was held that where the provisions of an enactment are penal provisions, they must be construed strictly and that in such circumstances you ought not to do violence to its language in order to bring people within it, but ought rather to take care that no-one is brought within it who is not brought within it in express language. See **London County Council vs. Aylesbury Dairy Company Ltd [1899] 1 QB 106 at 109; Muini vs. R through Medical Officer of Health, Kiambu [2006] 1 KLR (E&L) 15; Hardial Singh and Others [1979] KLR 18; [1976-80] 1 KLR 1090.**
48. As was held in **Vestey vs. Inland Revenue Commissioners [1979] 3 All ER at 984**:

"Taxes are imposed on subjects by parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined."

49. In the same vein, it was held in **Russell (Inspector of Taxes) vs. Scott [1943] AC 422 at 433**:

"I must add that the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind I feel that the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected...my Lords, there is a maxim of income tax law, which though it may sometimes be overstressed 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 tax upon him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion."

50. In these kinds of cases the Court is not entitled to attempt a discovery at the intention of the Legislature but is restricted to the clear words of the statute. In a taxing Act one has to merely look at what is clearly said since there is no room for any intendment. There is no equity about tax and there is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only fairly look at the language used. See **H vs. The Commissioner of Income Tax [1958] EA 303.**
51. Similarly, in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others [2007] 2 KLR 240** it was held:

"taxation can only be done on clear words and cannot be on intendment. Linked to this is that a penalty must be imposed in clear words. Finally even where the inclination of the legislature is not clear or where there are two or more possible meanings, the inclination of the court should be against a construction or interpretation which imposes a burden, tax or duty on the subject...Nothing summarises the above position better than *Brooms Legal Maxims*: 'a remedial statute therefore shall be construed so as to include cases which are within the mischief which the statute was intended to remedy; whilst, on the other hand, where the intention of the Legislature is doubtful, the inclination of the court will always be against that construction which imposes a burden, tax or duty or the subject. It has been designated as "a great rule" in the construction of fiscal law, "that they are not to be extended by any laboured construction, but that you must adhere to the strict rule of interpretation; and if a person who is subjected to a duty in a particular character or answers that description, the duty no longer attaches upon him and cannot be levied. A penalty moreover must be imposed by clear words. The words of a statute shall be restrained for the benefit of him against whom the penalty is inflicted, and the language of the statute must be strictly looked at in order to see whether the person against whom the penalty is sought to be enforced has committed an offence to do with it.'…The principle

remarked Lord Abinger "adopted by Lord Tenterden, that a penal law ought to be construed strictly is not only a sound one, but the only one consistent with our free institutions. The interpretation of statutes has always in modern times been highly favourable to the personal liberty of the subject and I hope will always remain so. This Court of course does appreciate the point made by the respondents' Counsel that if the meaning of the provisions of the relevant empowering taxation laws is clear the court has no business intervening. This principle is based on the high authority of *Bennun on Statutory Interpretation* at page 726, 727 as follows:- .....If the meaning of the provision is reasonably clear, the courts have no jurisdiction to mitigate such harshness. It is of course regarded as penal for a person to be taxed twice over in respect of the same matter." The significance of this quotation is that although the applicant did file monthly returns and keep daily production records, and the stockbook as required the tax imposed by the subsequent formula based on input and output purports to tax the company twice. This is also reflected in the inconsistent figures reflected by the three major audits. The taxman had come up with inconsistent figures for the same period due to its lapse in adhering to the law especially s 137 of the Act. I find that they cannot tax the applicant twice over *Bennion* adds:- 'Nevertheless taxation is clearly "penal" within this section of the Code, and must not be enforced by the courts unless clearly imposed. As Evans LJ said in the context of tax legislation it is necessary to consider the legal analysis with the utmost precision so that the taxpayer shall not become liable to tax unless this is clearly and unequivocally the object of the statutory provisions ... The Courts are reluctant to adopt a construction permitting a person's tax liability to be fixed by administrative discretion.'…This is how this court has regarded the assessment of tax on an arbitrary input-output formulae because it is not supported by any law nor is its retroactivity permitted by law…The same principles as above, were accepted and applied in the case of *Cape Brandy Syndicate vs. Inland Revenue Commissioners [1921] KB 64* where Ronlat J, restated the principle in these words: 'in a taxing Act clear words are necessary in order to tax the subject. Too wide and fanciful a construction is often to be given to that maxim, which does not mean that words are to be unduly restricted against the Crown or that there is to be any discrimination against the crown in those Acts. It simply means that in a taxing Act one has to look merely at what is clearly said. There is no reason for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly on the language used.'… Again, in the case of *Ramsay Ltd vs. Inland Revenue Commissioner [1992] AC 300* the same principles were expressed as follows:- 'A subject is only to be taxed on clear words not upon intendment, or upon the "equity" of an Act'. Any taxing Act of Parliament as to be construed in accordance with this principle. What are "clear words" is to be ascertained upon normal principles; these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole and its purpose may, indeed should be regarded ..." ..... A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect."

52. Whereas the Court appreciates the need to collect taxes, in carrying out their statutory obligations the Respondents must adhere to the law. As was held in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others** (supra):

"It is no good answer for the taxman to proclaim that Kshs 1 billion (appx) is intended to swell the public treasury because due to the application of the above principles that money is not lawfully due… Applying the same reasoning, to the matter before this court, it does not matter that the respondents say and think they are owed over a billion Kenya shillings - what matters is whether the amount is lawfully due and whether the law allows its recovery? It is not a question of impression or perception of what is owed, instead it is what if anything, is owed under the relevant law and whether its assessment and recovery is permitted by the applicable law. If rightly due, the huge amount notwithstanding the court must uphold the right of recovery regardless of its consequence to the applicant and if not

due under the law it must not hesitate to disallow it and must disallow it to among other things to uphold both the law the integrity of the rule of law."

53. Whereas the obligation to pay taxes is a statutory obligation and the failure to collect the tax by way of withholding and remitting taxes in my view ought not to be lightly excused, the court must, not without a little anguish, find that where the decision by the Respondent is unjustified under the law such a decision ought not to be allowed to stand and the same must be quashed. As was held in **Inland Revenue Commissioners vs. Wolfson [1949] 1 All ER 864 at 868**:

"It was argued that the construction that I favour leaves an easy loophole through which the evasive tax payer may find escape. That may be so, but I will repeat what has been said before. It is not the function of a court of law to give words a strained and unnatural meaning because only thus will a taxing section apply to a transaction which had the legislature thought of it, would have been covered by appropriate words. It is the duty of the Court to give to the words of this subsection their reasonable meaning, and I must decline on any ground of policy to give them a meaning which with all respect to the dissentient Lord Justice I regard as little short of extravagance."

54. From a consideration of the relevant authorities it is clear that whereas under the principles of interpretation of statutes, the general rule is that the Court should lean against the construction which reduces a statute to futility but lean in favour of an interpretation which makes it effective and operative, in tax legislation the Court ought not to strain the language with the intention of bringing taxpayers within an otherwise vague and ambiguous legislation. Where the legislation is vague or ambiguous the Courts ought to adopt an interpretation which best favours the taxpayer.
55. The other exception to the general rule is with respect to the ***Provisional Collection of Taxes and Duties Act (Cap 415).*** The general rule is that no person ought to be taxed without a particular legal regime permitting the same. However, the preamble to the said Act provides that it is an "Act of Parliament to give statutory effect for limited periods, the orders of the Minister imposing any new tax or duty or rate of tax or duty, or creating any new allowance, or altering or removing any existing tax or duty, or such rate or allowance." I therefore agree with the Respondent's position that the objective of the Act is to give statutory force to tax measures pronounced in the Finance Bill pending enactment of the Act. The Act therefore allows the Government a limited leeway of ensuring there exist necessary safeguards on provisional basis awaiting the passing of the ***Finance Act***. It is therefore an exception to the rule against taxation without substantive legislation. The Act therefore ensures that the Finance Bill acquires the force of law on provisional basis. That being the position, the Bill is deemed to be the law for the limited period and all persons who are obliged to pay taxes or duty thereunder must comply therewith. It is therefore no excuse that the Act is yet to be enacted. Any person who fails to comply with a clearly worded Finance Bill is liable to penal consequences arising therefrom.
56. This being a provisional "legislation" section 3 of the aforesaid ***Provisional Collection of Taxes and Duties Act*** provides that it ceases to have effect inter alia when such a Bill, with or without modification becomes law. In other words once the ***Finance Act*** is enacted and becomes effective the ***Finance Bill*** ceases to have the force of law.
57. What then happens to the funds collected under the Bill? Here the parties herein are unable to agree. According to the applicant where the contents of the Bill are varied with the effect that the amount stipulated in the Act is less than the amount expressed in the Bill, the taxpayer is entitled to refund of the sum over and above the amount in the enacted Act. The Respondent on the other hand is of the view that since the ***Finance Act***, does not operate retrospectively, whatever sum was paid during the currency of the Bill remains valid and is not refundable unless the same was improperly paid under the said Bill.
58. Section 4 of the ***Provisional Collection of Taxes and Duties Act*** provides as follows:

Without prejudice to any provision of any law for the time being in force relating to the collection of any tax or duty, being a provision enabling a refund to be made of any tax or duty paid in compliance with such law and any order made under this Act in excess of the tax or duty payable immediately after such order has ceased to have effect, any such excess may, if it

has not been so refunded, or to the extent to which it had not been so refunded, be refunded by either of the following methods—

a. ***in the manner set out in the first proviso to section 15(1) of the Exchequer and Audit Act (Cap. 412); or***
b. ***by being charged on and paid out of the consolidated fund***

59. My understanding of the said provision is that any order made under the Act and in my view such an order would include the Minister's order bringing the Finance Bill into effect, that exceeds the tax or duty payable immediately after such order ceases to be effective is refundable. Accordingly as soon as the ***Finance Act*** becomes effective, any amount paid in taxes or duties under the ***Finance Bill*** which is in excess of the amount subsequently enacted in the ***Finance Act*** is liable to be refunded. In my view, the ***Finance Bill*** is an enabling "legislation" and since it has a deeming effect, it has the effect of creating an artificial state of affairs. As was held in **Prof. Peter Anyan'g Nyong'o and 10 Others vs. Attorney General of Kenya & Others EACJ Reference No. 1 of 2006 [2007] 1 EA 5; [2007] 2 EA 5; [2008] 3 KLR (EP) 397**:

"The word "deemed" is commonly used both in principal and subsidiary legislation to create what is referred to as *legal or statutory fiction* and the legislature uses the word for the purpose of assuming the existence of a fact that in reality does not exist...The word "deemed" is used a great deal in modern legislation. Sometimes it is used to impose for the purpose of a statute an artificial construction of a word or phrase that would not otherwise prevail. Sometimes it is used to put beyond doubt a particular construction that might otherwise be uncertain. Sometimes it is used to give a comprehensive description that includes what is obvious, what is uncertain and what is, in the ordinary sense, impossible."

60. It follows that the deeming of the Bill as being operative pending the enactment of the ***Finance Act*** is meant to assume a set of circumstances which in reality do not exist till such a time as the Act is enacted. Once enacted, that set of circumstances is modified in accordance with the ***Finance Act***.
61. However until the ***Finance Bill*** ceases to be affective, it is valid law and penal consequences may attach to the failure to comply therewith. It is my view therefore that whereas on the effective date of the ***Finance Act***, any sums paid pursuant to the ***Finance Bill*** which exceeds the sum in the Act are refundable, any penalties accruing from the failure to comply with the provisions of the Bill are not refundable.
62. It however contended that since the ***Finance Bill*** was vague and ambiguous, the applicant was justified in making payment in accordance with the interpretation that was most favourable to it. It is contended that this position was acknowledged by the Ministry of Finance itself. In the letter dated 4th November, 2008 from the Permanent Secretary, Treasury, it was stated that "*the new hybrid excise duty under the Fifth Schedule to the Customs and Excise Act introduced product characteristics as a basis of determining the level of taxation of cigarettes in the said Act. The intention of the law, therefore, is to make product characteristics dominant where RSP is not applicable…It may also be noted that the proposed excise duty regime is currently being reviewed to ensure its clarity in application in order to bring stability and predictability to industry players and importers*."
63. What comes out from the foregoing is that even from the standpoint of the Minister the hybrid system of taxation introduced in the Bill was unclear and could not attain predictability. That being the position I agree with the applicant that it was entitled to pay the taxes in accordance with the system whose interpretation was more advantageous to it. Whereas under section 2(3) of the ***Customs and Excise Act*** provided that, "where an alternative rate of duty is shown, the rate chargeable is that which results in the higher duty charged", as was held in **Russell (Inspector of Taxes) vs. Scott** (supra), where *"the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind…the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected***".** It is therefore my view that section 2(3) above is only

applicable where the provision in question is clear and not where it is unclear as was acknowledged by the Permanent Secretary in the instant case**.**

64. I have considered the decision in **Mastermind Tobacco Ltd vs. KRA & 2 Others** (supra) and in particular the decision of **Maharatshra State Board of Secondary and Higher Secondary Education and Another vs. Kurmarsheth [1985] LRC** and whereas I agree that it is within the exclusive province of the Legislature to determine how the provision of the statute can be best implemented, in this case, unlike in ***Mastermind Case*** the applicant is not challenging the provisions of the ***Finance Act***, 2008, but is simply challenging the ***Finance Bill*** which was an order of the Minister which Order itself was acknowledged by the Minister's Permanent Secretary that it was unclear and was not capable of achieving the purpose for which the order was made. I therefore find that the said decisions though stating the correct legal position to be distinguishable from the instant case.
65. Having considered the matters raised in this application it is my view and I so hold that the Respondent's decision to reinstate the subject agency notices was unwarranted.

Order

66. In light of my findings hereinabove, the inescapable conclusion I come to is that the Notice of Motion dated 1st July, 2009 is merited. Accordingly, the orders which commend themselves to me and which I hereby grant are as follows:

a. **An order of Certiorari is hereby issued removing into this Court the decision and order of the Commissioner of Domestic Taxes dated 8th June 2009 and consequently the assessment dated 24th October 2008 and the agency notices dated 7th November 2008 for purposes of being quashed which decisions are hereby quashed.**
b. **An order of prohibition is hereby issued to prohibiting the Commissioner of Domestic Taxes from demanding payment of excise duty on the basis of the assessment dated 24th October 2008.**
c. **As the confusion that led to these proceedings was triggered by the Minister, each party will bear own costs.**

Dated at Nairobi this 15th day of January, 2015

G V ODUNGA

JUDGE

Delivered in the presence of:

Miss Malik for the ex parte applicant.

Mr Kirugi for Miss Lavuna for the Respondent

Cc Patricia