



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI

JUDICIAL REVIEW DIVISION

JR CASE NO. 19 OF 2012

REPUBLICAPPLICANT

VERSUS

THE COMMISSIONER OF INCOME TAX.....RESPONDENT

Ex-parte

IRON ART LIMITED

JUDGEMENT

1. Through the notice of motion dated 31st January 2012 and amended on 21st November, 2012 the Applicant, Iron Art Limited pray for orders as follows:

“1. AN ORDER OF CERTIORARI to remove to the High Court for the purpose of being quashed the decision of the Commissioner of Income Tax made on the 11th October 2011 in exercise of his statutory power and discharge of his public duty under the Income Tax Act, Chapter 470 of the Laws of Kenya demanding payment from the Applicant of arrears in additional tax and penalties of income tax in the total sum of Kshs.7,243,818.00.

2. AN ORDER OF PROHIBITION to restrict or prohibit the Respondent whether by himself, servants, agents or whosoever from executing, pursuing or effecting the recovery of the outstanding income tax of Kshs.7,243,818.00.

3. AN ORDER OF PROHIBITION to restrict or prohibit the respondent whether by himself, servants, agents or whosoever from proceeding with any threatened enforcement action for the recovery of the sums sought as allegedly due and owing to them.

4. AN ORDER OF PROHIBITION to restrict or prohibit the Respondent whether by himself, servants, agents or whosoever from acting in abuse of power.

5. COSTS of this application be provided for.

6. Such further and other reliefs that the Honourable Court may deem just and expedient to grant.”

7. The application is supported by the statutory statement and the verifying affidavit of Murlidhar Shetty, the Managing Director of the Applicant filed together with the chamber summons application for leave on 20th January, 2012.

8. The Applicant's case as gleaned from the papers filed in Court is that it was registered in July 1997 to carry out the business of manufacturing wrought iron products for local and export markets. The Applicant commenced business in January, 1998 and filed its first income tax return on 31st December, 1998. Thereafter the Applicant consistently continued filing its tax returns on or before 31st December of every year.

9. It is the Applicant's case that on 12th April, 2010 the Respondent, the Commissioner of Income Tax wrote a letter stating that twelve months from the date of the Applicant's registration had elapsed in July, 1998 and the Applicant's initial tax returns should have been filed on 31st July, 1998 instead of 31st December, 1998. The Respondent informed the Applicant that all subsequent tax returns had been filed late and had accordingly accrued interest and penalties amounting to Kshs.5,141,047 for the period 1998-2008.

10. The Applicant's accountant through a letter dated 12th April, 2010 informed the Respondent that the Applicant's accounting date was 31st December and not 28th February. The parties kept on exchanging correspondences and on 11th October, 2011, the Respondent issued a demand notice to the Applicant for the sum of Kshs.7,243,818 being additional tax and penalties due.

11. It is the Applicant's case that the said demand was made without following the provisions of the Income Tax Act, Cap 470 (I.T.A.) and the demand and assessment is therefore void for being *ultra vires* the powers of the Respondent under the I.T.A. The Applicant contends that the Respondent's decision is an abuse of power as it demands additional tax and penalties yet the Respondent had collected taxes from the Applicant for the past eleven years. Further, that the tax demand is time barred as the Respondent can only assess taxes any time prior to the expiry of seven years after the year of income to which the assessment relates. It is the Applicant's case that the Respondent is in this case trying to assess taxes after expiry of seven years from the year of income to which the assessment relates to.

12. The Respondent opposed the application through the replying affidavit of Dorcas Matoke sworn on 16th July, 2013. The Respondent's case is that the Applicant has been a registered taxpayer since 1996. On 23rd December, 1996 it submitted its maiden income tax return declared by one Kalpesh R. Patel indicating that its accounting period of twelve months was ending on 28th February of every year. It is the Respondent's case that as per Section 27(A) of the I.T.A., the Applicant could only alter the date of which its accounts are made up with the written approval of the Respondent. The Respondent asserts that the Applicant has never sought or obtained approval to change its accounting period.

13. The Respondent states that sometimes in 2010, the Applicant made an application to be issued with a tax compliance certificate. The Respondent on 12th April, 2010 notified the Applicant that the document could not issue as there was an outstanding corporation tax of Kshs.5,141,047 and the same needed to be settled before the tax compliance certificate could issue. It is the Respondent's case that the outstanding corporation tax was lifted from the records submitted by the Applicant between 1998 and 2008. The Applicant wrote back on the same date disputing the corporation tax but acknowledging that the additional tax charged was a result of the different accounting dates applied by the parties.

14. It is the Respondent's case that an audit was carried out in the Applicant's establishment with a view to verifying the Applicant's records for tax compliance for the period between January, 2008 and December, 2009 and an audit report dated 7th June, 2011 was

prepared and it revealed that the Applicant's corporation tax debt was still outstanding.

15. On 11th October, 2011 a demand notice was sent to the Applicant requesting payment of the outstanding corporation tax of Kshs. 7,248,818. The Applicant asked for more time to respond to the demand but the request was rejected. The Respondent subsequently issued agency notices to the Applicant's bankers appointing them agents for the purpose of collecting the corporation tax of Kshs.7,441,252.

16. The Respondent asserts that due process was followed in demanding the tax from the Applicant. The Respondent's case is that the tax demand is not time barred as the same did not arise from assessment but had accrued over the years due to the Applicant's breach of the provisions of Section 27 (1A) of the I.T.A.

17. From the papers filed in Court it is apparent that this matter revolves around the accounting period of the Applicant. Section 2 of the I.T.A. states that **"an "accounting period" in relation to a person, means the period for which that person makes up the accounts of his business."**

18. Section 27 of the I.T.A further provides on "accounting period" as follows:

"27.(1) Where a person usually makes up the accounts of his business for a period of twelve months ending on a day other than 31st December, then, for the purpose of ascertaining his total income for a year of income, the income of an accounting period ending on that other date shall, subject to such adjustment as the Commissioner may consider appropriate, be taken to be income of the year of income in which the accounting period ends -

(a) in the case of a person other than an individual, as regards all

income charged under section 3; and

(b) in the case of an individual, as regards all income charged under that section other than gains or profits from employment or services rendered.

(1A) A person carrying on an incorporated business may subject to the prior written approval of the Commissioner alter the date to which the accounts of the business are made up.

(1B) A person seeking the approval of the Commissioner under subsection (1A) shall apply in writing to the Commissioner at least six months before the date to which the accounts are intended to be made up.

(1C) The Commissioner shall within six months from the date of receipt of the application communicate his decision in writing to the applicant.

(2) Where a person makes up the accounts of his business for a period greater or less than twelve months, the Commissioner may, subject to such adjustment as he may consider appropriate, including the assessment for a year of income which, but for any alteration in the date to which the accounts of the business are made up, would have been assessed for that year of income, treat the income of that accounting period as income of the year of income in which the accounting period ends, and tax shall be charged accordingly.

(3) The accounting period of a person carrying on any unincorporated Business shall be the period of twelve months ending on 31st December each year, and

(4) Any person to whom subsection (3) applies shall not later than 31st December, 1998

change the accounting date to comply with the provisions of that subsection.”

19. The Applicant insisted that from its inception its accounting period has always ended on 31st December. The Respondent, however, states that when the Applicant started trading in 1996, the first income tax return filed indicated that its accounting period ended on 28th February. It is the Respondent’s case that although the Applicant later changed the end of its accounting period to 31st December, it did so without obtaining its consent as required by Section 27 (1 A), (1B) and (1C) of the I.T.A.

20. This issue will therefore be resolved by looking at the evidence placed before the Court by the parties. In his verifying affidavit sworn on 20th January, 2012, Murlidhar Shetty the Managing Director of the Applicant averred that the Company was registered in 1997 (see paragraph 5) and commenced business in January, 1998 and its first year of income ended in December, 1998 when the first tax return was filed on 31st December, 1998 (see paragraphs 6 and 7).

21. From the replying affidavit sworn by Dorcas Matoke on 16th July, 2013 the Respondent’s case is that the Applicant was registered as a taxpayer under PIN Number P0511113098 in 1996. Its business was that of manufacturing wrought iron products (see paragraph 8). On 23rd December, 1996 the Applicant submitted the maiden tax return declared by one Kalpesh R. Patel indicating that its accounting year ended on 28th February. A copy of the tax return has been exhibited. (See paragraphs 9 and 10 of the replying affidavit). The Respondent’s case is that the Applicant has never sought to alter its accounting period. It is only when the Applicant sought a tax compliance certificate in April, 2010 that it was noticed that the Applicant had unilaterally changed its accounting period to end on 31st December.

22. The parties appear to agree that if the Applicant unilaterally changed the accounting period then additional tax would be due.

23. In a letter dated 21st April, 2010 which was a reaction to the Respondent’s letter dated 12th April, 2010 demanding Kshs.5,141,047, M.S. Shah & Co., the Applicant’s accountants stated in part:

“Please note the accounting date of the company is 31st December and not 28th February reflected on all statements of account. Because of the wrong accounting date, all the statements of account show erroneous additional tax charged under Section 72 (I) of the Income Tax Act for late submission of self assessment returns.”

24. In the supplementary affidavit sworn by Hiteshbhai B. Patel on 10th April, 2014 and the further supplementary affidavit of Jotham Okome Arwa sworn on 24th November, 2014, the Applicant insists that its accounting period ends on 31st December and not 28th February. The maiden tax return which was exhibited by the Respondent is disowned and the authenticity of the document is queried. It is the Applicant’s case that the copy of the maiden income tax return exhibited by the Respondent is a creation of the Respondent.

25. Dorcas Matoke in her replying affidavit of 16th July, 2013 exhibited as DM8 a copy of a letter dated 26th October, 2011 addressed to the Respondent by the Applicant’s tax consultants. The letter which has not been disputed by the Applicant states:

“TAX IN ARREARS – KSHS.7,243,818

We refer to your letter dated 11 October, 2011, our clients letter dated 21 October 2011 requesting for extension of time and your response letter dated 25 October 2011.

We have noted the contents of your letter of 25 October 2011 whereby you are stating that a lot of time has been spent on the case without any move which we decline to accept on behalf of our client.

We have on all occasions explained to you that the amount stated in your demand is with reference to penalties and interest due to an error in your system which is showing the year end of the above named company as February and not December.

The following matters have also been explained to you in detail regarding the above matter.

1. The previous auditors of the above named company were Kassim Lakha & Company (now known as PKF). We have managed to retrieve the letter from Fiscal and Taxation Services Ltd which was the taxation department of Kassim Lakha & Company. The letter requesting for change of name was sent to your department of 3 August 1996 and a copy of the acknowledged letter is attached herewith for the ease of your reference.
2. There was a compliance check carried out by East of Nairobi station (a report of which is enclosed herewith for the ease of your reference). It is stated in your report that the outstanding amount for the years 1998 -2008 is in view of an error in your system and there is proof for the same in terms of audited accounts and payment receipts and we are following up for the rectification.

Our client has clearly indicated in his letter of 21 October 2011 that your letter of 11 October 2011 was hand delivered on 19th October, 2011 and in view of the holidays was requesting for an extension of time so that he can liaise with the previous auditors to obtain the letter which was requesting for extension of time. We are surprised to note that this letter is not in your file records and for the same you are now giving us a deadline which is not in order.

We also wish to take this opportunity to portray our disappointment with the way this matter has been handled:

1. Our client has regularly paid all his taxes on time and never defaulted since the day the company was incorporated. He has regularly paid all his corporation tax, VAT and PAYE which can also be ascertained from your ledger.
2. The taxes you are demanding is in view of the error in the accounting period which we had also explained to East of Nairobi section when they carried out the compliance check whereby they also recommended to us that we have sufficient evidence which can be acceptable for the change of year end.

We are therefore requesting you to cancel your demand and accordingly request you to amend your system to show the correct year end and accordingly there shall be no tax due.

In case you seek any further clarification please do not hesitate to call the undersigned and request you to not to enforce any recovery procedures in view of the above reasons.”

[Underlining is mine].

26. The Respondent replied to that letter on 2nd November, 2011 as follows:

“RE: IRON ART LIMITED – TAX IN ARREARS KSHS 7,243,818

Reference is made to your letter dated 26th October, 2011 on the above subject.

I have noted with concern that despite evidence given to you in the past that your client never applied for change of accounting period as per the provisions of Section 27 of the Income Tax Act you have remained adamant not to have the outstanding tax paid by your client.

Please note that the purported evidence attached to your letter under reference does not amount to an application (as prescribed above) or approval for change of accounting period by the Commissioner. Besides there is no sufficient evidence adduced to prove that the copy of your letter (attachment) dated 3rd August, 1996 was actually received by our offices.

In the circumstances I am proceeding to recover the outstanding tax in full.”

27. The Applicant insisted that the information showing that its accounting period ends on 28th February was erroneously entered in the Respondent’s system. However, the Applicant’s letter reveals crucial information namely that the Applicant was in business in 1996 and that it had sought to change its accounting period and it had been advised that it had sufficient material for requesting such a change. In the verifying affidavit, the Applicant indicated that it started business in 1998. Why the dishonesty? What was the Applicant hiding about the years 1996 and 1997? Why would the Respondent’s officers create a tax return for the Applicant? The Applicant’s case is unbelievable.

28. From the evidence before the Court, it is apparent that the Applicant failed its duty of candour to the Court. The Applicant had a duty to place all its cards on the table. The moment the Applicant decided to approach this Court for judicial review orders, it had a duty to make full and frank disclosure. The importance of full disclosure was discussed in **Brink’s-Mat Ltd v Elcombe and others [1988] 3 All ER 188** where it was stated that:

“In considering whether there has been relevant non-disclosure and what consequence the court should attach to any failure to comply with the duty to make full and frank disclosure, the principles relevant to the issues in these appeals appear to me to include the following. (i) The duty of the applicant is to make 'a full and fair disclosure of all the material facts': see *R v Kensington Income Tax Comrs, ex p Princess Edmond de Polignac* [1917] 1 KB 486 at 514 per Scrutton LJ. (ii) The material facts are those which it is material for the judge to know in dealing with the application as made; materiality is to be decided by the court and not by the assessment of the applicant or his legal advisers: see the *Kensington Income Tax Comrs* case [1917] 1 KB 486 at 504 per Lord Cozens-Hardy MR, citing *Dalglish v Jarvie* (1850) 2 Mac & G 231 at 238, 42 ER 89 at 92, and *Thermax Ltd v Schott Industrial Glass Ltd* [1981] FSR 289 at 295 per Browne-Wilkinson J. (iii) The applicant must make proper inquiries before making the application: see *Bank Mellat v Nikpour* [1985] FSR 87. The duty of disclosure therefore applies not only to material facts known to the applicant but also to any additional facts which he would have known if he had made such inquiries. (iv) The extent of the inquiries which will be held to be proper, and therefore necessary, must depend on all the circumstances of the case including (a) the nature of the case which the applicant is making when he makes the application, (b) the order for which application is made and the probable effect of the order on the defendant: see, for example, the examination by Scott J of the possible effect of an Anton Piller order in *Columbia Picture Industries Inc v Robinson* [1986] 3 All ER 338, [1987] Ch 38, and (c) the degree of legitimate urgency and the time available for the making of inquiries: see *Bank Mellat v Nikpour* [1985] FSR 87 at 92-93 per Slade LJ. (v) If material non-disclosure is established the court will be 'astute to ensure that a plaintiff who obtains ... an ex parte injunction without full disclosure is deprived of any advantage he may have derived by that breach of duty ... ': see *Bank Mellat v Nikpour* (at 91) per Donaldson LJ, citing Warrington LJ in the *Kensington Income Tax Comrs* case. (vi) Whether the fact not disclosed is of sufficient materiality to justify or require immediate discharge of the order without examination of the merits depends on the importance of

the fact to the issues which were to be decided by the judge on the application. The answer to the question whether the non-disclosure was innocent, in the sense that the fact was not known to the applicant or that its relevance was not perceived, is an important consideration but not decisive by reason of the duty on the applicant to make all proper inquiries and to give careful consideration to the case being presented. (vii) Finally 'it is not for every omission that the injunction will be automatically discharged. A locus poenitentiae may sometimes be afforded': see *Bank Mellat v Nikpour* [1985] FSR 87 at 90 per Lord Denning MR."

29. In the case before this Court the Applicant failed to make crucial disclosures to the Court but opted to hinge its application on falsehoods. The Court cannot exercise its discretion in favour of such a litigant. It appears the Applicant simply changed its accounting period to end on 31st December instead of 28th February without taking care of the legal aspect of the matter. It is now blaming the Respondent for its woes. That cannot be allowed. The application before this Court is based on non-disclosure of material evidence. The year in which the Applicant commenced business is indicated as 1998 but the documents availed to the Court shows that it commenced business in 1996. The maiden income tax return form filled shows that its accounting year ends on 28th February. Although the Applicant in its subsequent returns indicated the accounting period as ending on 31st December, there is no evidence that it applied for change of the accounting period as required by Section 27(1A) of the I.T.A.

30. One of the definitions of fraud at page 731 of the 9th Edition of Black's Law Dictionary is:

"A misrepresentation made recklessly without belief in its truth to induce another person to act."

The Applicant's decision to change its accounting period without seeking the authority of the Respondent was therefore fraudulent. The Applicant cannot therefore rely on Section 79(1) of the I.T.A. to claim that the Respondent acted *ultra vires* by assessing taxes after seven years from the year of income to which the assessment relates. Its actions were fraudulent and the proviso in Section 79(1) (a) kicks in. No time limit for assessment of taxes has been placed on the Respondent where fraud has been committed. Fraud was committed in relation to the Applicant's returns and the Respondent is entitled to make assessments on returns made over seven years from the time the fresh assessment is being done.

31. From the evidence placed before this Court, I find that the Applicant's case has no merit. The Application is therefore dismissed with costs to the Respondent.

Dated, signed and delivered at Nairobi this 19th day of March, 2015

W. KORIR,

JUDGE OF THE HIGH COURT