



**REPUBLIC OF KENYA**  
**IN THE HIGH COURT OF KENYA AT NAIROBI**  
**MILIMANI COMMERCIAL & ADMIRALTY DIVISION**  
**INCOME TAX APPEAL NO. 5 OF 2007**

**COMMISSIONER OF INCOME TAX :::::::::::::::::::: APPELLANT**

**VERSUS**

**PHOENIX OF EAST AFRICA**

**ASSURANCE COMPANY LIMITED :::::::::::::::::::: RESPONDENT**

**J U D G E M E N T**

1. This is the Judgement pursuant to an appeal filed herein by the Appellant on 10th May 2007. The appeal is from the decision of the Local Committee for Nairobi Area made on 27th March 2007 being Assessment No.00459400788/4. The Memorandum of Appeal is duly supported by the Notice of Decision dated 28th March 2007 marked “A”; a copy of the Notice of Appeal dated 11th April 2007 marked “B”; and a Statement of Facts marked “C”.
2. The Respondent in reply filed its statement of facts on 14th August 2007. The Appellant filed Skeleton submissions on 7th February 2012 and Supplementary submissions on 29th October 2014. The Respondent filed its submission on 6th May 2014 and Reply submissions on 5th November 2014.
3. There is no dispute as to the facts. The Statement of Facts is annexed to the Memorandum of appeal. The Appellant is the commissioner of Income Tax. The Respondent is an insurance company carrying on business in Kenya. The Appellant alleges that during the year of income 1994 the Respondent’s investments of the life fund earned dividend income of K£444,913. The Respondent did not charge this income to corporation tax under Section 3 (2) (a) (i) of the Income Tax (hereinafter referred to as the “Act”). The Respondent instead traded the dividend income as qualifying dividend and on which it withheld tax at a lower “qualifying dividend rate” as final tax. The Appellant raised additional assessment number 00459400788/4 to correct the anomaly and bring the omitted income to charge as normal trade income. The Respondent objected to the assessment on the ground that the treatment accorded to dividend income by the Appellant was incorrect. The Respondent then appealed to the Local Committee after the Appellant failed to amend the assessment in line with its objections. The Local Committee allowed the Respondent’s appeal and annulled the assessment raised by the Appellant. The Appellant submits that the Local Committee Appeal was decided on one single point, i.e. failure by the Appellant to appeal against a High court decision. The Local Committee delivered itself thus: “the department (read appellant herein) failed to appeal against the judgement of the HCCC No. 49 of 1997. Consequently, the 1993 and 1994 appeals are allowed and assessment annulled. The Appellant submits that the Local Committee disregarded the submissions made on behalf of the Appellant, and did not consider the issues and grounds enumerated in the Appellant’s précis to the Local Committee to support the treatment adopted by the Appellant. The Appellant submits that the Local Committee blatantly

- failed to consider the case on its merits.
4. In response to the Statement of Facts by the Applicant, the Respondent also filed its statement of Facts on 14th August 2007 and stated that in the year of income 1994 the Respondent received dividends of K£444,913 which were derived from investments made by it from time to time in shares of various Kenya companies. By an additional assessment No. 00459400788/4 the Respondent submitted that the Appellant wrongly assessed the Respondent to tax on the dividends under Section 3(2)(a)(i) of the Act. The Respondent submitted that the dividends were Qualifying Dividends as defined by Section 2(1) of the Act and were therefore chargeable to tax pursuant to Section 3(2)(b) of the Act and not under Section 3(2)(a)(i) of the Act.
  5. The Respondent appealed against the additional assessment to the Local Committee. The Appellant presented its own Appeal Précis to the Local Committee and in its Appeal Précis specifically asked the Local Committee to treat the Local Committee's previous decision dated 15<sup>th</sup> January 1997 in Case No **4/190/96 UAP Provincial Company Limited** as a precedent. However the Local Committee's decision dated 15<sup>th</sup> January 1997 (4/190/96 UAP Provincial Company Limited) was overruled by the High Court in **High Court Civil Appeal no. 49 of 1997, UAP Provincial Insurance Company Limited v. the Commissioner of Income Tax**. It is the Respondent's case that the decision of the High Court in Civil Appeal no. 49 of 1997 is legally binding on the Local Committee and it was correct in annulling the assessments on the basis of the said decision. The Respondent concurs with the annulment by the Local Committee of Assessment No. 00459400788/4, and submits that the appeal before this Court is therefore bad in law and an abuse of the process of this Court.
  6. Notwithstanding and without prejudice to the foregoing, the Respondent, in response to paragraph 3 of the Appellant's Statement of Facts, states that it does not have a life fund pursuant to which investments were allegedly made and the Appellant has incorrectly stated that the divided income was earned by its life insurance fund. The Respondent states that it was not required to charge the income from the dividends under Section 3(2)(a)(i) as the dividends were qualifying dividends and therefore chargeable to tax under Section 3(2)(b), Section 34(1)(d) and paragraph 5(a) of the Third Schedule to the Act. The Respondent states that the Local Committee was correct in annulling the assessment on the ground that the Judgment of the High Court in Civil Appeal no.49 of 1997 had not been appealed against. The Respondent reiterates that as long as the Judgment in **High Court Civil Appeal No. 49 of 1997, UAP Provincial Insurance Company Limited v. the Commissioner of Income Tax** (hereinafter called the **UAP case**) has not been overruled by the Court of Appeal, it continues to be binding on the Local Committee. The Respondent's case is that the facts in the said UAP case were also similar to the Appeal filed by the Respondent before the Local Committee. The Local Committee must have considered the merits of the appeal to arrive at the conclusion that the facts and issues of law raised in the appeal were the same as those raised in the UAP case. The Local committee was bound by this decision and it is therefore incorrect for the Appellant to state that the Local Committee did not consider the case before it on its merits. The Respondent reiterates that the Appellant in its Appeal Précis asked the Local Committee to treat its decision dated 15<sup>th</sup> January 1997 as a precedent. The Local Committee took cognizance of the fact that the decision in the UAP case overruled the Local Committee's previous decision and the Local Committee was bound by the said decision. The Respondent's case is that the decision of the Local Committee was right in law and should be upheld by this Court.

### **SUBMISSIONS**

7. Mr. Mutuku for the Appellant submitted that insurance companies are in the business of investing the policy holder's funds in various portfolio of investments which include: Real estate, Stocks and shares, Treasury Bills and Bonds, Corporate Bonds, Bank deposits etc. Income received from the investments forms part of their trading income which is taxable under Section 3(2)(a)(i) of the Income Tax Act as gains or profits from a business. Section 3(2)(b) applies to persons who are not involved on a day today basis in the business of re-investing their dividends whereby the income received is from a one-off or isolated dividend receipts transaction. This is not the case with respect to insurance companies. Mr. Mutuku appreciated the UAP case, but sought to distinguish it.
8. The Appellant's case is, that in the UAP case, the main point at issue whether insurance

companies carry out their investment activities as trading activities or not was not considered by the Court. The different treatment of dividend income in the hands of -

- i. a person whose nature of business is carrying out investment activities, and,
- ii. a person who invests surplus funds as one off or isolated transaction was not appreciated. Mr. Mutuku submitted that the learned Judge in the UAP case ruled that dividend income earned by an insurance company was taxable under both Section 3(2)(a)(i) and 3(2)(b) and wondered why U.A.P Provincial Insurance Company Limited should be subjected to the higher rate of tax under Section 3(2)(a)(i) (37.5%) when in fact Section 3(2)(b) provided for a lower rate of tax (15%).

In his Judgment the learned Judge made the following pertinent observations at page 13 of his Judgment:

***“If there is an overlap so that the dividends are found to be chargeable to tax under Sections 3(2)(a)(i) as well as Section 3(2)(b) of the Act,***

***the case of SUNNI Muslim Jamat V. The Commissioner of Income Tax applies.....***

***That issue is what we should do when we are faced with an item of taxation chargeable to tax both under Section 3(2)(a)(i) and Section 3(2)(b)..... at page 14.***

***In the instant appeal therefore the same dividends cannot be charged to tax under both Section 3(2)(a)(i) and Section 3(2)(b) at the same time. But under section 3(2)(a)(i) the income tax charged at 37.5% would be KShs.3,059,415.00 while under Section 3(2)(b) the tax charged would be KShs.1,223,766.00. Why should the Appellant be made to pay tax at the higher figure? I find no reason and therefore decide the conflict in favour of the Appellant paying the tax at the lower figure thereby coming to the same result was at when I was purely looking at the statute”.***

9. The Appellant’s case is that the point at issue, whether the dividend income earned by an insurance company is trading income or not, was therefore, not addressed. Mr. Mutuku submitted that **‘Investment Income’** prior to 1995 was defined in Section 19(7) of the Income Tax Act to mean **‘dividends and interest and does not include qualifying dividends’**. This definition was amended vide Finance Act 1994 to read **Investment income does not include dividends chargeable to tax under Section 3(2)(a)(i)**. After the amendment dividend income earned by insurance companies is exempt from Income Tax under Section 19(7) of the Income Tax Act. The Appellant urged the court to find that dividend income received by an insurance company in the year of income 1994 is chargeable to tax as ordinary business income under Section 3(2)(a)(i) and not as qualifying dividend income under Section 3(2)(b) of the Income Tax Act, and for these reasons the Appeal be allowed with costs.
10. The Appellant further submitted that the year of income at issue is 1995 and the relevant Income Tax Act is the 1989 Version the Revised Edition of 1996 which was applicable in 1995 before subsequent amendments. The Appellant further made reference to the Insurance Act Chapter 487 of the Law of Kenya. In 1995 Section 3(2)(a)(i) of the Income Tax (ITA) Chapter 470 of the Laws of Kenya charged to tax “gains or profits from a business for whatever period of time carried on”. While Section 3(2)(b) of the ITA charged to tax “dividends or interest”. “Qualifying dividend” and “qualifying dividend rate” were defined in Section 2 of the ITA. Qualifying dividend was a dividend chargeable to tax under Section 3(2)(b) (investment income) but excluding dividend paid by designated cooperative societies chargeable to income tax under Section 19A(2) for Cooperative Unions and Section 19A (3) for primary societies other than savings and credit cooperative societies). “Qualifying dividend” was chargeable to tax at a rate of 15% which was withheld by the company issuing the dividend in accordance with paragraph 5(a) of the 3<sup>rd</sup> Schedule to the ITA and Section 34(1)(d) of the ITA. This withholding tax was a final tax, meaning that it qualified as a final tax at withholding level and it was not subject to further taxation under the corporate rate of 30% or 37.5% or even the individual graduated rate between 10% to 30%. This was further amplified by Section 76A of the ITA which provided:

***“The Commissioner shall not assess any person for any year of income on that portion of income which has been subjected to withholding tax which is also a final tax”.***

11. Counsel submitted that the dividend receivable by an individual or a corporate body such as Insurance Companies and Banks whose holding and trading in shares was part of their operation deemed to be a trading transaction hence such dividend earned was a non-qualifying dividend (i.e. it did not qualify for the rate of withholding tax of 15% as the final tax) such dividend was brought to tax as a business trade income in accordance with Section 3(2)(a)(i) as opposed to Section 3(2)(b) of ITA. The Appellant submitted that in such instance the withholding tax withheld under paragraph 5(a) of the 3<sup>rd</sup> Schedule to the ITA and Section 34(1)(d) became a deposit towards the final tax assessment which was based at the graduated individual rate of 10% - 30% or the corporate rate of 30%. The withheld tax for such a corporate recipient of the dividend was non-qualifying as a final tax. At the end of the financial year, the recipient of the dividend was expected to pay the balance of 15% through a declaration of the annual income tax return. The Appellant noted that under Sections 41(2) and 50(2) of the Insurance Act Chapter 487 of the Laws of Kenya, an insurance company such as the Respondent, involved in general business is required to keep not less than the aggregate value of its admitted liabilities and KShs.10,000,000.00 million, or 15% of its net premium income during its last preceding financial year, whichever is the higher. The Appellant submitted that such an insurance company would earn dividends while the shares or stocks were held, such dividend together with the proceeds from the sale of the shares themselves would be trade income, “gains or profits”, under Section 3(2)(a)(i) hence not qualifying for a withholding tax rate of 15% as final tax under paragraph 5(a) of the 3<sup>rd</sup> Schedule to the 1995 ITA. In principle the Appellant submitted that:-

- a. In the insurance business model, the premium money collected from policy holders does not sit in the bank until someone makes a claim.
- b. In accordance with their business, insurance companies basically do three (3) things with the premium “shilling” pooled together by policy holders:
  - i. The pooled “shilling” pays claims;
  - ii. The pooled “shilling” pays for expenses involved in selling and providing insurance protection, and
  - iii. The pooled “shilling” (surplus) is invested in real property, shares, bonds etc.
- c. It is the earnings from these investments, specifically dividends from stocks, which the Appellant treated as gains or profits from business of the Respondent, under Section 3(2)(a)(i) of the ITA of 1995. It is argued that the tax rate was 30%, the corporate rate which included the 15% withheld under paragraph 5(a) of the 3<sup>rd</sup> Schedule to ITA 1995.
- d. If the same dividend was earned by an individual it will be treated the same way i.e. withholding tax rate of 15% under paragraph 5(a) of the 3<sup>rd</sup> Schedule to the ITA 1995 subsequently the balance to be subjected to the graduated individual tax rate of between 10% to 30%.

### **ANALYSIS AND DETERMINATION**

12. I have carefully considered the appeal and the submissions of the parties. In my view the issues to be decided by this court are:-

- i. ***Whether the Local Committee was correct in holding that the Appellant had not appealed the decision in High Court Civil Appeal no.49 of 1997, UAP Provincial Insurance Company Limited v. the Commissioner of Income Tax and it was therefore bound by the said decision?***
- ii. ***Whether, in any event, the assessment of the income tax in question should be under Section 3(2)(a)(i) or under Section 3(2)(b) of the Act ?***

13. To address the first issue, it is to be noted from the outset that the Local Committee being an inferior tribunal, is bound by the decisions of the High Court against which no appeal have been preferred. However, once there is an appeal to the High Court, as is the case in this matter, this

court is not bound by the decision of High Court which bind the Local Committee. The High Court decision becomes merely persuasive. This court is then mandated to scrutinize whether the decision of the High Court which bind the Local Committee raised exactly the same issues for determination, and establish whether the said High Court decision is one that can persuade this court. In this regard the court must look at the framed issues both before the High Court whose decisions binds the Local Committee, and the framed issues before the Local Committee and for the appeal before this court. This scrutiny is necessary because in matters like this there could be more than one issue for determination, but the *raison deit*re – the reason for the decision - must remain clear. Mr. Mutuku for the Appellant submitted that in the judgement of the High court the main point of issue i.e. whether insurance companies carry out their investment activities as trading activities or not was not considered by the court, and that the different treatment of dividend income on the hands of a person whose nature of business is carrying out investing activities, and a person who invests surplus funds as a one off or isolated transaction, was not appreciated. This submission could be correct. However, for the purposes of this appeal it is instructive to look at the issues framed and on record, both by the Tribunal, the High Court and in this appeal. The issue as framed is uncannily similar. In the UAP case the issue that was decided by the court was the same as that placed before the Local Committee. The learned judge framed the issue to be decided as follows:-

***“The main question in this appeal, I have been told, is whether the assessment of income tax in respect of the Appellant should be under Section 3 (2) (a) (i) or under Section 3 (2) (b) of the Income Tax Act.”***

(See page 1 of the decisions).

In the instant case, the Appellant has farmed the point in issue in its skeleton arguments filed on 7th February 2012 as follows:-

***“whether dividend income received by an insurance company is chargeable to tax as ordinary business income under Section 3 (2) (a) (i) or as qualifying dividend income under Section 3 (2) (b) of the Income Tax Act.”***

14. It is clear from the above that the issue to be decided is exactly the same as the UAP case. This kind of similarity would not allow any kind of adventure in interpretation, by the court exploring outside issues to find a reason for the decision away from the issue as framed. In interpretation of Tax Statues, an expansionist approach is by law frowned upon. A strict approach to interpretation is the lawful approach, and where there is any doubt in the interpretation of a Tax Statute or any framed issues related thereto, the benefit thereof, is always for the tax payer. It is the finding of this court that the issue to be decided on by the Local Committee was exactly the same as in the UAP case and the Local Committee was therefore correct in annulling the assessment on the basis that the Appellant had not appealed against the UAP decision, and the Local Committee was therefore bound by the same.

### **THE LAW**

15. The second issue is whether dividends received from investments made by an insurance company were taxable under section 3(2)(a)(i) or under section 3(2)(b) of the Act. This issue was considered in the UAP case wherein the Honourable Judge stated at page 6 that ***“I agree that the issue is whether the assessment of the income tax in question should be under Section 3(2)(a)(i) or under Section 3(2)(b) of the Act.”***

In the instant case, it is clear from the manner in which the Appellant has framed the issue to be decided, and its skeletal arguments, that both the Appellant and the Respondent are in agreement that the dividends were qualifying dividends. The issue is whether dividend income is chargeable

to tax under Section 3(2)(a)(i) or Section 3(2)(b) of the Act. The High Court has made a finding on this issue which finding I have established binds the Local Committee. The correctness or otherwise of that finding is now water under the bridge, provided there are justifiable grounds, as I have found, which caused the Local Committee to be bound by the said decision.

16. The doctrine of *stare decisis* by which precedents of a higher Court become binding on a Tribunal is well established in Kenya. Recently the Supreme Court in the case of ***Gatirau Peter Munya v Dickson Mwenda kithinji & Two others (2014) eKLR*** stated at page 42 of the decision that “Article 163 (7) of the Constitution is the embodiment of the time-hallowed common law doctrine *stare decisis*. It holds that the precedents set by this Court are binding on all other Courts in the land. The application, utility and purpose of this constitutional imperative are matters already considered in several decisions of this Court: ***Jasbir Singh Rai v Tarlochan Singh Rai & Others***, and quite recently, in ***George Mike Wanjohi v Steven Kariuki & others*** Petition No. 2A of 2014. In addition to the benchmark decisions to which this Court adverted in ***Wanjohi v Kariuki***, regarding the importance of the doctrine of *stare decisis*, the dictum in ***Housen v Nikoaisen (2002) 2 SCR*** is apt.

***“It is fundamental to the administration of justice that the authority of decisions be scrupulously respected by all courts upon which they are binding. Without this uniform and consistent adherence, the administration of justice becomes disordered, the law becomes uncertain, and the confidence of the public in it undermined. Nothing is more important than that the law as pronounced . . . should be accepted and applied as our tradition requires; and even at the risk of that fallibility to which all judges are liable, we must maintain the complete integrity of relationships between the courts.”***

17. The Appellant has made reference to sections 41(2) and 50(2) of the Insurance Act. However, the said sections were not referred to in the Appellant’s Memorandum of Appeal filed on 10<sup>th</sup> May 2007. The Appellant’s attempt to introduce a new ground of appeal by way of submissions is in complete contravention of Rule 14 of the Income Tax ( Appeals to the High Court) Rules. The said rule forbids the Appellant from relying on any other grounds other than those set out in its memorandum of appeal. By doing that the Appellant seeks to imply sections of the Insurance Act to given meaning to the wording of the provisions of the Income Tax Act. This goes against the rules of statutory interpretation when interpreting a taxing statute. In the case of ***T.M.Bell v The Commissioner of Income Tax 1960 (EALR) 224***, it was held at page 240 of the decision that ***“...in a taxing Act one has to look merely at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.”***

18. Again in paragraph 11 of its submissions, the Appellant seeks to introduce purported factual statements in its submissions which were not included in its Statement of Fact filed on 10<sup>th</sup> May 2007. The said statements cannot be introduced at this stage and in any event , the Appellant cannot ask this Court to make implications from these purported statements in light of the holding in both the ***T.M.Bell v the Commissioner of Income Tax Case*** as well as the ***UAP case***.

#### **19. CONCLUSION**

For the foregoing reasons, the Appellant’s appeal is dismissed with costs to the Respondent.

**READ, DELIVERED AND DATED AT NAIROBI**

**THIS 31ST DAY OF JULY 2015**

**E. K. O. OGOLA**

**JUDGE**

**PRESENT:**

Mr. Kirugi for the Appellant

M/s Malik for the Respondent

Teresia – Court Clerk