REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

JUDICIAL REVIEW DIVISION

JR CASE NO. 343 OF 2013

REPUBLIC ……..…….APPLICANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES ……RESPONDENT

EX-PARTE

AFFILIATED BUSINESS CONTACTS LTD

JUDGEMENT

1. In early 2012 a Pay As You Earn (PAYE) audit was carried out by the Respondent, the Commissioner of Domestic Taxes under the Income Act, Cap 470 on the records of the ex-parte Applicant, Affiliated Business Contacts Limited for the period 1997 to 2001. At the end of the audit exercise, the Applicant was informed of the findings through a letter dated 6th March, 2002. The Applicant was required to pay an additional tax of kshs.4,526,901/=.

2. A payment arrangement for the settlement of the additional tax was entered into between the Applicant and the Respondent. Five post-dated cheques were issued to the Respondent. Three cheques for Kshs.3 million were honoured by the bank while three cheques for Kshs.1,526,901/= were dishonoured.

3. Apart from other details which I will highlight in due course, things went quiet until 30th August, 2013 when the Respondent wrote a letter to the Applicant demanding the sum of Kshs.1,526,901/= plus penalties and interest all amounting to Kshs. 3,627,425/=. A few days later the Respondent issued an agency notice to the Applicant's bank for the said amount. The decision to demand the additional tax and the agency notice are what the Applicant seeks to quash through these proceedings.

4. Through the notice of motion application dated 16th October, 2013 the Applicant therefore prays for orders as follows:

> **"1. An Order of Certiorari to remove into the High Court for purposes of being quashed the decision and order of the Respondent–the Commissioner of Domestic Taxes dated 5th September 2013 and Agency Notice issued to Commercial Bank of Africa–the Applicant's bankers to pay to the Respondent the sum of Kshs.3,627, 435/- being the alleged principal tax due by the Applicant to the Respondent.**
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> **2. An Order of Prohibition to prohibit the Respondent–the Commissioner of**

Domestic Tax from demanding payment of Kshs.3,627,435/- being the alleged outstanding principal tax owed by the Applicant in 2002 together with penalties and interest charged thereon.

3. An order that the Respondent do pay the cost of these proceedings."

5. Although at the beginning of this judgment I outlined the uncontested facts, I am obligated to state the Applicant's case as it sees it. It is the Applicant's case that upon receiving the demand dated 6th March, 2002 for Kshs.4,526,901/= being tax assessed plus interest and penalties, it managed to pay Kshs.2,170,607/= in principal tax and Kshs.829,393/= in penalties and interest. Thereafter it wrote to the Respondent on 29th November, 2002 requesting for waiver of the outstanding penalties and interest. The Respondent did not respond to the application for waiver nor take any action until the demand of Kshs.3,627,425/= was made through the letter dated 30th August, 2013. The demand was in regard to the balance of Kshs.1,526,901/= being the tax outstanding from the 2002 claim, penalty of Kshs.573,623/= and interest capped at Kshs.1,526,901/=.

6. The Applicant asserted that after the agency notice was issued, attempts were made to settle the matter with the Respondent and Kshs.200,000/= was even paid but this did not in any way waive the Applicant legal rights.

7. According to the Applicant, the Respondent's tax claim is unlawful, unfair and unreasonable. The Applicant contends that by a letter dated 29th November, 2002 it informed the Respondent that it had paid the principal tax as well as Kshs.829,393/= as penalties and interest and was unable to pay the outstanding penalties and interest. It is the Applicant's position that the Respondent did not thereafter dispute the Applicant's contention that the principal had been paid in full.

8. The Applicant contends that it is wrong for the Respondent to demand tax eleven years later as Section 79 of the Income Tax Act provides that an assessment of tax can only be made before the expiry of seven years after the year of income to which the assessment relates. Further, that Section 123A of the Income Tax provides that the Respondent is to refrain from assessing tax or recovering penalties and interest in respect of any year of income ending on or before 31st December, 2003 where the tax had already been paid and the returns containing a full disclosure of the previously undisclosed income had been submitted.

9. The Applicant also asserts that the Respondent's exercise of its powers under Section 96 of the Income Tax Act to declare the Applicant's banker its agent and requiring the banker by the letter dated 5th September, 2013 to pay to the Respondent Kshs.3,627,425/= was contrary to the law.

10. The Respondent opposed the application through a replying affidavit sworn on 7th February, 2015 by an Assistant Commissioner, Joseph Nalyanga. It is the Respondent's case that the tax demand arose from a PAYE audit carried out simultaneously with an income tax audit on the Applicant's records for the years 1997 to 2001. The audit was conducted under the Income Tax Act 2002-2003. At the end of the audit exercise an assessment of Kshs.4,526,901/= was raised since it was established that the Applicant had understated the value of non-tax benefits. The assessment was communicated to the Applicant through a letter dated 6th March, 2003 clearly showing how the assessment of the outstanding taxes was arrived at. The Applicant did not object to the assessment and on 25th March, 2002 entered into a payment arrangement with the Respondent to settle the demanded tax in instalments.

11. It is the Respondent's case that the Applicant went ahead and issued eight post-dated cheques for Kshs.4,526,901/= five of the cheques amounting to Kshs.3million were cleared but three cheques amounting to Kshs.1,526,901/= were returned unpaid due to lack of funds. The Respondent asserts that this amount is payable under Section 94 of the Income Tax Act. It is the Respondent's assertion that Section 94(2) of the Income Tax Act 2002 -2003 provided **"that penalties under Section 72, 72B, 72C and 72D and late payment interest charged shall for the purpose of the provisions relating to the collection and recovery of tax, be deemed to be tax."**

12. The Respondent stated that upon the cheques being dishonoured the Applicant immediately thereafter proceeded to apply for waiver of interest and penalties through a letter dated 29th November, 2002. The Respondent averred that the application for waiver of penalties and interest was made in bad faith with a view to frustrating the recovery of the outstanding taxes as the Applicant had not initially disputed the assessment and could not be allowed to apply for waiver as it had agreed to settle the entire tax demanded.

13. The Respondent averred that on 30th August, 2013 a demand for Kshs.3,627,425/= made up of Kshs.1,526,901/= being the outstanding tax, Kshs.573, 623/= being penalty of 20% as per Section 72D of the Income Tax Act and Kshs.1,525,901/= being interest as per Section 94(1) of the same Act was demanded from the Applicant. It is the Respondent's case that the Applicant failed to make payment thus necessitating the issuance, under Section 96 of the Income Tax Act, of the agency notice dated 5th September, 2013 to the Applicant's banker.

14. After the agency notice was issued the Applicant on 17th September, 2015 wrote to the Respondent asking to be allowed to make payment through instalments of Kshs.200,000/= per month but the request was rejected.

15. According to the Respondent, Section 79 of the Income Tax Act 2002-2003 relates to time limits for making assessments but does not apply to unpaid debts like that of the Applicant. Further that, Section 79(2) provides that any question as to whether an assessment has been made after the time set in Section 79 shall be raised only on an objection made under Section 84 and on any appeal consequent thereto. It is also the Respondent's position that the demand for the taxes from the Applicant is not statutorily barred.

16. On the Applicant's reliance on Section 123A of the Income Tax Act, the Respondent contended that the Section does not apply to the Applicant as the Applicant falls under the proviso of the said Section.

17. In summary, the Respondent's case is that its actions were lawful and the orders of judicial review are consequently not available to the Applicant.

18. The question that needs to be answered in this judgment is whether the Respondent's demand dated 30th September, 2013 is lawful, reasonable and in compliance with the rules of natural justice.

19. The Applicant's case is that the demand is unlawful as it goes against Sections 79 and 123A of the Income Tax Act. Section 79 states:

> **"79.(1) An assessment may be made under this Act at any time prior to the expiry of seven years after the year income to which the assessment relates, but –**
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> **(a) where fraud or gross or wilful neglect has been committed by or on behalf of a person in connection with or in relation to tax for a year of income, an assessment in relation to that year of income may be made at any time;**
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> **(b) in the case of income consisting of gains or profits from thereon may be made at any time prior to the expiry of seven years after the year of income in which the gains or profits are received;**
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> **(c) in any case to which the proviso to paragraph (d) of section 4, or paragraph 21 of the Second Schedule applies, an assessment in relation thereto may be made at any time prior to the expiry of seven years after the year of income in which the circumstances which gave rise to the assessment occurred;**
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> **(d) in the case of an assessment made upon the executors or administrators of a deceased person in respect of the income of that person, the assessment shall be made prior to the expiry of three years after the year of income in which that deceased person died.**

(2) The question whether an assessment has been made after the time set in this section for the making thereof shall be raised only on an objection made under section 84 and on any appeal consequent thereon."

Section 123A provides that:

"123A. Notwithstanding any other provisions of this Act, the Commissioner shall refrain from assessing or recovering penalties and interest in respect of any year of income ending on or before the 31st December, 2003 where –

(a) the tax is paid; and

(b) the returns, or amended returns, containing a full disclosure of the previously undisclosed income, are submitted, on or before 31st December, 2004:

Provided that this section shall not apply in respect of any tax if the person who should have paid the tax –

(i) has been assessed in respect of the tax or any matter relating to the tax; or

(ii) is under audit or investigation in respect of the undisclosed income or any matter relating to the undisclosed income."

20. Section 79 limits the time for assessing taxes. The Respondent asserts that there was no fresh assessment and the demand made was for taxes that had already been assessed.

21. The Applicant holds the view that the Respondent's tax claim arose from a fresh assessment. According to the Applicant, the Respondent through its demand of 30th September, 2013 demanded for payment of a completely different amount which is further evidence that it was an assessment well past the statutory period.

22. The Applicant may have a valid argument. The demand for Kshs.4,526,901/= that had been made by the Respondent through the letter dated 6th March, 2002 included interest and penalty. The Respondent admits at Paragraph 19 of the replying affidavit that interest is capped. If the amount demanded in 2002 included interest then where did the fresh interest of Kshs.1,525,901/=demanded in 2013 come from? It seems the law only allowed collection of Kshs. 1,526,901/= which was the outstanding tax as per the 2002 assessment.

23. Another argument by the Respondent is that under Section 79(2) of the Income Tax Act the question whether an assessment has been made after the time set in Section 79 shall be raised only in an objection made under Section 84 and on any appeal consequent thereon. In my view, Section 79(2) cannot deny a party the right of approaching the Court for judicial review orders on the ground that an assessment had been made out of the statutory time. The said Section cannot be an ouster of the constitutional power given to this Court by Article 165(6) of the Constitution to exercise supervisory jurisdiction over the subordinate courts and over any person, body or authority exercising a judicial or quasi-judicial function. The actions of the Respondent must at all times pass the legality test. If they fail to do so, then judicial review orders will be available to an applicant aggrieved by the Respondent's actions.

24. The Applicant also asserted that Section 123A of the Income Tax Act gave it amnesty. The Respondent's answer to this is that the Applicant falls within the proviso to that Section which provides that amnesty cannot be claimed in respect of tax already assessed or where the undisclosed income is under audit. The Applicant's rebuts this argument by stating that this was a fresh assessment. Even if there was a fresh assessment, the Respondent is correct that the Applicant could not have benefited from Section 123A as the 2002 assessment arose from an audit as a result of undisclosed income.

25. The decision in this matter will not rest on the legality or otherwise of the Respondent's actions. In

my view, the decision will be determined on the reasonableness of the Respondent's actions.

26.The case of **Associated Provincial Picture Houses Ltd. v Wednesbury Corporation [1948] 1 KB 223** sets out the standard of unreasonableness (now commonly known as Wednesbury unreasonableness) of the decisions of public bodies that would make them liable to be quashed on judicial review. The test was stated by Lord Greene, M. R. at page 229 as follows:

> **"It is true the discretion must be exercised reasonably. Now what does that mean? Lawyers familiar with the phraseology commonly used in relation to exercise of statutory discretions often use the word "unreasonable" in a rather comprehensive sense. It has frequently been used and is frequently used as a general description of the things that must not be done. For instance, a person entrusted with a discretion must, so to speak, direct himself properly in law. He must call his own attention to the matters which he is bound to consider. He must exclude from his consideration matters which are irrelevant to what he has to consider. If he does not obey those rules, he may truly be said, and often is said, to be acting "unreasonably." Similarly, there may be something so absurd that no sensible person could ever dream that it lay within the powers of the authority. Warrington LJ in Short v Poole Corporation [1926] Ch. 66, 90, 91 gave the example of the red-haired teacher, dismissed because she had red hair. That is unreasonable in one sense. In another sense it is taking into consideration extraneous matters. It is so unreasonable that it might almost be described as being done in bad faith; and, in fact, all these things run into one another."**

27. For the court to intervene in the decision of a public body or officer, it must be satisfied that the decision maker took into account factors that ought not to have been taken into account, or failed to take into account factors that ought to have been taken into account, or the decision was so unreasonable that no reasonable authority would ever consider making such a decision.

28. In the case of **Council of Civil Service Unions v Minister for the Civil Service [1984] All ER 935,** Lord Diplock stated that a decision would be Wednesbury Unreasonable if it is "**[s]o outrageous in its defiance of logic or accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it."**

29. There is agreement between the parties that after the three cheques bounced, the Applicant wrote to the Respondent on 29th November, 2002 asking for waiver of interest and penalties. It is the Applicant's case that this was done under Section 123 of the Income Tax Act which states:

> **"123.(1) Notwithstanding the provisions of this Act, in any case where he is of the opinion that he should refrain from assessing to tax, or recovering tax from, a person by reason of -**
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> **(a) uncertainty as to any question of law or fact; or**
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> **(b) consideration of hardship or equity; or**
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> **(c) impossibility, or undue difficulty or expense, of recovery of tax, the Commissioner may, with prior approval of the Minister, refrain from assessing or recovering the tax in question and thereupon liability to the tax shall be deemed to be extinguished or the tax shall be deemed to be abandoned or remitted, as the case may be, and the provisions of this Act other than this section shall no longer apply thereto.**
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> **(2) In any case which has been referred to him, and where he considers it appropriate, the Minister may in writing direct the Commissioner –**
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> **(a) to take such action under this section as the Minister may deem fit; or**

(b) to obtain the direction of the Court upon the case.

(3) (Deleted by 4 of 2004 s.58)"

A reading of Section 123 reveals that the provision gives power to the Commissioner's to abandon or remit tax.

30. As pointed out by the Respondent, the correct provision which gives the Commissioner the discretion to remit interest or penalties is Section 94(4) of the Income Tax Act which provides that:

> **"The Commissioner may, upon application by a person from whom interest is due under this section, remit the whole or part of any penalty or late payment interest or both such penalty and interest charged under section 72D up to a maximum of one million five hundred thousand shillings each per person per annum:**
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> **Provided that -**
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> **(a) the Commissioner may remit any amount of penalty or late payment interest in excess of one million five hundred thousand shillings with the prior written approval of the Minister; and**
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> **(b) the Commissioner shall make a quarterly report to the Minister of all penalties and late payment interest remitted during that quarter."**

31. The Respondent states that the Applicant's letter dated 29th November, 2002 did not meet conditions for a remit of penalties and interest. Further, that the Commissioner could not remit any penalties and interest in excess of Kshs.500,000/= without the prior written approval of the Minister. For purposes of record it must be stated that the upper limit was Kshs. 500,000/= but the amount has since been enhanced to Kshs. 1.5million.

32. The Applicant's case is that it was never informed of the outcome of its application for waiver and it had a legitimate expectation that the waiver had been accepted.

33. The Respondent did not respond to the Applicant's application for waiver. The Respondent is correct that it can only waive any amount in excess of Kshs. 500,000/= (now Kshs.1.5million) with the prior written approval of the Minister. The amount is not the issue in this case. The question is the manner the Respondent treated the application for waiver of interest and penalty. The duty to seek approval of waiver of any amount in excess of Kshs. 1.5 million from the Minister belongs to the Respondent. The Respondent failed to communicate to the Applicant and has not shown any evidence that the application of the Applicant was forwarded to the Minister.

34. Thereafter everything went quiet and the Applicant continued filing returns and eleven years later, the Respondent issues the demand of 30th September, 2013. The action of the Respondent is irrational. The Respondent cannot be allowed to operate in the manner it did. The Applicant's application for waiver may have been made in bad faith and may not have been deserved. The Respondent was, however, expected to reply to the Applicant stating why its application for waiver could not be allowed.

35. It was not proper for the Respondent to keep quiet. That silence gave the Applicant the confidence that its application for waiver had been accepted. There is also another aspect of irrationality riding on the Respondent's decision. Section 79 of the Income Tax provides the time limit in which the Respondent can assess taxes. Parliament deemed it necessary that unless there is fraud or gross or wilful neglect on the part of a taxpayer, an assessment can only be made any time prior to the expiry of seven years after the year of income to which the assessment relates. It would therefore be unreasonable to demand tax eleven years after assessment when it is quite clear that the upper limit for assessment is seven years. Where tax has been assessed, the Respondent should endeavour to recover the same within a reasonable period of time.

36. In the circumstances of this case I agree with the Applicant that it would be unreasonable to allow the Respondent to demand taxes eleven years after assessment in a situation where the Respondent had not replied to the Applicant's application for waiver of interest and penalty. The Respondent has a responsibility to collect taxes but that duty must be exercised reasonably.

37. An order of certiorari is therefore issued removing into this Court the Respondent's agency notice dated 5th September, 2013 and quashing it. The Respondent is prohibited from claiming the sum of Kshs.3,627,435/= being tax, interest and penalties assessed on a tax claim arising in 2002. Each party will meet own costs of these proceedings.

Dated, signed & delivered at Nairobi this 20th day of August, 2015

W. KORIR,

JUDGE OF THE HIGH COURT