REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL AND ADMIRALTY DIVISION

INCOME TAX APPEAL NO. 2 OF 2009

EVERRET AVIATION LIMITED……..……..……..…….... APPLICANT

VERSUS

THE KENYA REVENUE AUTHORITY (THROUGH THE

COMMISSIONER OF DOMESTIC TAXES) …….....RESPONDENT

JUDGMENT

1. The appellant provides helicopter charter services in Kenya and abroad. Sometimes the charter services are ordinary day time flights. On other occasions it would provide highly specialized services like filming, evacuations, external load operations and night operations. The company employed two sets of pilots: freelance pilots resident in Kenya; and, non-resident freelance pilots.

2. On 24th March 2003, the Commissioner of Domestic Taxes of the Kenya Revenue Authority (KRA) made a claim for Pay As You Earn (PAYE) tax on a scheme of salaries paid to the appellant's pilots. The income tax demand was for Kshs 6,699,425 for the years 2000 to 2002. The appellant contested the claim through its auditors. The pith of the objection was that the pilots were not employees of the appellant but were sub-contracted to undertake special tasks, for example to land on a ship or to train the appellant's employed pilots. The bone of contention was that the commissioner had treated payments made to the pilots as salary and hence the claim raised for PAYE tax. The negotiations between the parties did not bear fruit. On 29th May 2008, KRA rendered a decision. Its key conclusion was that there was no distinction between full time employees and freelance pilots. The appellant was aggrieved and appealed to the Income Tax Local Committee.

3. On 2nd April 2009, the Local Committee issued the following brief decision:

> *"The Income Tax Local Committee made the following decision in your cases for 2000, 2001 and 2002:*
>
> *For Resident pilots, PAYE is payable. For Non-Resident pilots, withholding Tax is payable".*

The appellant was still dissatisfied with that decision and filed a memorandum of appeal to this court under section 86 (2) of the Income Tax Act. The decision of the Local committee is impugned on 3 principal grounds: That it erred in finding PAYE was payable in respect of freelance pilots resident in Kenya; that it erred in finding they were the appellant's employees; and, that having found that PAYE was not payable in respect of non-resident freelance pilots, the committee erred in imposing PAYE on the

freelance pilots resident in Kenya who provide similar services as the non-resident freelance pilots. In a synopsis, the appellant's case is that the decision of the Local Committee is wrong in law and fact and should be vacated. The memorandum is supported by a statement of facts and annextures detailing at length the grounds of the appeal.

4. The appeal is contested. The respondent has filed a statement of facts dated 17th June 2009. It is contended that the services offered by freelance pilots are subject to taxation in accordance with section 3 (2) (a) (ii) of the Income Tax Act and the PAYE Rules. Accordingly the respondent's letter dated 15th April 2009 was merely a clarification of taxation of pilots permanently so employed. In particular, the respondent's case is that both freelance pilots and pilots permanently employed render similar services and that freelance pilots are on a contract *of* service and not a contract *for* services. The mere fact of being subcontracted for short durations was not a bar to taxation under section 3 (2) of the Act. Accordingly, the appellant was under a legal duty by dint of section 37 of the Act to deduct PAYE and remit the tax to the respondent.

5. The appellant filed a reply to the respondent's statement of facts. The parties also filed written submissions. The matter was then mentioned before Leonard Njagi J on 18th March 2010. The parties informed the Learned Judge that they were relying wholly on the written submissions. Judgment was reserved for 13th May 2010. It was not to be. In the meantime, the Judge was removed from the bench by the Judges and Magistrates Vetting Board formed under the Constitution of Kenya 2010 and the Vetting of Judges and Magistrates Act. Before then, on 15th March 2013, both parties appeared before me. By consent, I ordered that the appeal be canvassed afresh. I allowed the parties to highlight their written submissions and arguments.

6. I have considered the pleadings and the rival submissions. I have come to the following decision. This appeal relates to only one aspect of the Local Committee's decision: the imposition of PAYE in respect of freelance pilots resident in Kenya for the years 2000, 2001 and 2002. The appellant has not preferred an appeal on the finding that non-resident pilots should remit withholding tax. That distinction is important for two reasons: Rule 14 of the Income Tax (Appeals to the High Court) Rules does not permit the appellant to argue a new ground; and, secondly the respondent did not prefer an appeal on the finding of the committee with respect to non-resident freelance pilots.

7. Under section 78 of the Civil Procedure Act the appellate court is conferred with duties akin to the courts of original jurisdiction in respect of suits instituted therein. The power of this court in reviewing the decision of the Local Committee is thus very wide. The crux of the appeal is two pronged: First, are freelance pilots resident in Kenya liable for PAYE to be deducted and remitted by the appellant? Secondly, is there a distinction in law and fact between the employment of freelance pilots resident in Kenya and freelance pilots not resident in Kenya? In short, was the committee entitled to create the distinction between the two sets of freelance pilots who were essentially performing similar tasks? Paraphrased, were the freelance resident pilots employees of the appellant and liable to PAYE tax?

8. To answer those questions, I will return briefly to the narrative of freelance pilots. The appellant's case is that they were not its employees. Many reasons are proffered: They were not integrated into the appellant's business. They would procure their pilot's licence independently. The appellant could not dismiss them or force them to fly. They did not carry out management duties. They were being hired for their special skills such as to carry a piece of machinery under their chopper and hover in the air until the machinery was bolted to the ground. They would be employed for a few hours or a few weeks. In short the appellant's gravamen of appeal is that it had no control over them and that they were not on a monthly wage: They were sub-contracted free pilots. The respondent retorts with a simple answer: the engagement of freelance pilots is a contract *of* serviceand not a contract *for* services.

9. The Income Tax Act does not define an *employee*. It defines an employer as follows:

> *" 'employer' includes any resident person responsible for the payment of, or on account of, emoluments to an employee, and an agent, manager or other representative so responsible in*

Kenya on behalf of a non-resident employer".

I have no difficulty in finding that the appellant was an employer. The next key question is whether it had employed the freelance pilots. The appellant does not contest that it was hiring the services of the freelance pilots and paying for those services however brief they were. It was not paying those emoluments to a third party employing those freelance pilots: It was paying the pilots directly. The freelance pilots thus had contracts *of* services*:* not a contract *for* services. The contracts were oral. But that does not alter the following facts: They were employed by the appellant to fly its helicopters for specific times and were paid for those services.

10. The Income Tax Act defines a contract *of* service as follows:

> *"Contract of service" means an agreement, whether oral or in writing, whether expressed or implied, to employ or to serve as an employee for any period of time and includes a contract of apprenticeship or indentured leadership under which the employer has the power of selection and dismissal of the employee, pays his wages or salary and exercises general or specific control over work done by him; and for the purpose of this definition an officer in the public service shall be deemed to be employed under a contract of service".*

11. I have sought further guidance from the Employment Act 2007. At section 2 the terms *contract of* service, *employee* and *employer* are defined as follows:

> *"employee" means a person employed for wages or a salary and includes an apprentice and indentured learner;*
>
> *"employer" means any person, public body, firm, corporation or company who or which has entered into a contract of service to employ any individual and includes the agent, foreman, manager or factor of such person, public body, firm, corporation or company;*
>
> *"contract of service" means an agreement, whether oral or in writing, and whether expressed or implied, to employ or to serve as an employee for a period of time, and includes a contract of apprenticeship and indentured learnership but does not include a foreign contract of service to which Part XI of this Act applies".*

12. There are also various tests to be employed when there is doubt whether a person is an employee. One of those tests is whether the person's duties are an integral part of the employer's business. See *Beloff vs Preddram Limited* [1973] ALL ER 241. The greater the direct control of the employee by the employer, the stronger the ground for holding it to be a contract of service. *See Simmons Vs Heath Laudry Company* [1910] 1 KB 543, *O' Kelly Vs Trusthouse Forte* [1983] 3 ALL ER 456. That test is however not conclusive. The passage cited by the appellant in *Halsbury's Laws of England* Vol I 26, 4th edition paragraph 3 is instructive:

"There is no single test for determining whether a person is an employee, the test that used to be considered sufficient, that is to say the control test, can no longer be considered sufficient, especially in the case of the employment of highly skilled individuals, and is now only one of the particular factors which may assist a court or tribunal in deciding the point. The question whether the person was integrated into the enterprise or remained apart from and independent of it has been suggested as an appropriate test, but is likewise only one of the relevant factors, for the modern approach is to balance all of those factors in deciding on the overall classification of the individual. The factors relevant in a particular case may include, in addition to control and integration: the method of payment; any obligation to work only for that employer, stipulations as to hours; overtime, holidays etc; arrangements for payment of income tax and national insurance contribution; how the contract may be terminated; whether the individual may delegate work; who provides tools and equipment; and who, ultimately, bears the risk of loss and the chance of profit. In some cases the nature of the work itself may be an important consideration".

13. That paragraph does not however end where the appellant quoted. It proceeds further to state the following, and which goes to the crux of the matter here:

> *"The way in which the parties themselves treat the contract and the way in which they describe and operate it is not decisive; and a court or tribunal must consider the categorization of the person in question objectively. Thus a person could have been described as self-employed during the currency of the engagement but upon its termination claim to have been in fact an employee for the purpose of claiming unfair dismissal, though such a course of action could have unfortunate taxation implications.*
>
> *In case of what is frequently referred to as 'atypical employment', such as temporary or casual work, sporadic work or homeworking, it may be appropriate, when deciding upon the employment status of an individual subject to such a regime, to consider whether there is sufficient mutuality of obligations to justify a finding that there was a contract of employment".*

See also *Market Investigations Limited Vs Minister of Social Security* [1968] 3 ALL ER 732, *Fall Vs Hitchen* [1973] 1 ALL ER 368.

14. The court has then to proceed carefully and objectively. It cannot rely on the descriptions of work that the parties put forward. There will be contracts *of* servicewhere the master cannot control the manner in which the work is done. But they remain contracts *of* service. It is thus important to distinguish between a contract *of* service and contract *for* service. There I am well guided by the holding of Denning L.J. in *Stevenson Jordan and Harrison Ltd Vs Macdonald and Evans* [1952] 1 TLR 101 at 110:

> *"I fully agree with all that my Lord has said on all the issues in this case. It raises the troublesome question of the distinction between a contract of service and a contract for services. The test usually applied is whether the employer has the right to control the manner of doing the work. Thus in Collins Vs. Herts County Council, Mr. Justice* Hilbery said:
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> *"The distinction between a contract for services and a contract of service can be summarized in this way: In the one case the master can order or require what is to be done, while in the other case he cannot only order or require what is to be done but how it shall be done.*
>
> *But in Cassidy Vs. Ministry of Health, Lord Justice Somervell pointed out that that test is not universally correct. There are many contracts of service where the master cannot control the manner in which the work is to be done, as in the case of a captain of a ship. Lord Justice Somervell went on to say: "One perhaps cannot get much beyond this 'Was the contract a contract of service within the meaning which an ordinary person would give under the words?"' I respectfully agree. As my Lord has said, it is almost impossible to give a precise definition of the distinction. It is often easy to recognize a contract of service when you see it, but difficult to say wherein the difference lies. A ship's master, a chauffeur, and a reporter on the staff of a newspaper are all employed under a contract of service; but a ship's pilot, a taxi-man, and a newspaper contributor are employed under a contract for services. One feature which seems to run through the instances is that, under a contract of service, a man is employed as part of the business, and his work is done as an integral part of the business; whereas, under a contract for services, his work, although done for the business, is not intergraded into it but is only accessory to it".*

Recent case law suggests that persons possessed of a high degree of professional skill and expertise such as surgeons and civil engineers may be employed on contracts *of* service notwithstanding that the employer has little control on use of their skills. Per Mocatta L.J. in *Whittaker Vs Minister* of *Pensions and National Insurance* [1966] 3 ALL ER at 537, [1967] 1 QB at 167. The resident and non-resident freelance pilots in our case fall well within this category.

15. The way I see it, the appellant, for the short duration it hired the services of freelance pilots was substantially in control: It bore the risk of loss and chance of profit. It identified the task, say for example to land the chopper on a ship or to tag a load and return; it determined the pay or emolument; it paid the

pilot and released him. True, it did not pay for his licence. It is contested whether the licence in fact was the tool of trade. In this case, the appellant had its fleet of helicopters. It used its own capital. It had special contracts. It was largely in control. I think it would be to expand the boundaries a little too wide to say that it could not dismiss the pilots or force them to fly. The fact is that it employed those pilots, they performed those special tasks, and it paid them. The duration of the contract is not material. Granted the thin line separating a contract *of* service and a contract *for* service, the Local Committee was well advised to lean on the side of reason and to adopt an interpretation that led to a fair computation and collection of tax . The freelance resident pilots may not have been on a wage bill but they fell well within section 3 (2) of the Income Tax Act. It is instructive that under that section, it matters not whether the person was resident or not. What is paramount is whether the income was derived from Kenya. It provides:

> *"3. (1) subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.*
>
> *(2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of-*
>
> *a) gains or profits from-*
>
> *i) a business, for whatever period of time carried on;*
>
> *ii) employment or services rendered;*

16. To that extent, and though not before me on this appeal, the Local Committee would have been entitled to find both non-resident freelance pilots and resident freelance pilots liable to PAYE. I say that *obiter* as the respondent did not appeal that part of their finding. The two classes of freelance pilots were to all intent and purposes doing similar tasks under contracts *of* service, their income was derived in Kenya and was paid by the appellant.

17. Having reached that conclusion, the appellant was then caught up and subject to section 37 of the Act which provides:

> *"37. (1) An employer paying emoluments to an employee shall deduct therefrom, and account for tax thereon, to such extent and in such manner as may be prescribed"*.

The *Inhouse Committee Bulletin* of the respondent that proposes different methods of assessment cannot override the Act. The PAYE Rules are made under section 130 of the Act. They apply to weekly wages, monthly wages, annual salaries, bonuses, commissions, director's fees and all cash emoluments. In particular *emoluments* mean gains or profits from employment or services rendered which are payable in money. I reach the inescapable conclusion that since the freelance pilots were employed on a contract *of* service, the appellant, as their employer, was obligated by statute to deduct tax by way of PAYE and to remit it to the respondent. The appellant has not appealed against the quantum or assessment of the tax demands of Kshs 6,699,425.

18. In the result, I find that the appellant has failed to impeach sufficiently or at all the decision of the Income Tax Local Committee made on 2nd April 2009. This appeal thus lacks merit. It is hereby dismissed with costs to the respondent.

It is so ordered.
DATED and **DELIVERED** at **NAIROBI** this 16th day of May 2013.

G.K. KIMONDO

JUDGE

Judgment read in open court in the presence of

Ms N. Malik for the Appellant.

Ms B. Odundo for the Respondent.

Mr. C. Odhiambo Court clerk.