



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

CONSTITUTIONAL AND JUDICIAL REVIEW DIVISION

JUDICIAL REVIEW MISCELLANEOUS APPLICATION NO. 91 OF 2009

**IN THE MATTER OF: APPLICATION BY NDYKAK INVESTMENTS LIMITED THE
ORDERS OF PROHIBITION, CERTIORARI AND MANDAMUS**

AGAINST

THE KENYA REVENUE AUTHORITY

AND

**IN THE MATTER OF: IN THE MATTER OF THE INCOME TAX ACT, CAP 470 OF THE
LAWS OF KENYA
AND**

**IN THE MATTER OF: ASSESSMENT NOTICES BY KENYA REVENUE AUTHORITY
DEMANDING K.SHS12,974,238/- FROM NDYKAK
INVESTMENTS LIMITED.**

-BETWEEN-

REPUBLICAPPLICANT

AND

THE COMMISSIONER GENERAL KENYA REVENUE AUTHORITYRESPONDENT

EX-PARTE:

NDYKAK INVESTMENTS LIMITED

JUDGMENT

NDYKAK INVESTMENTS LIMITED, which is the ex parte applicant herein, is aggrieved by the decision to declare an additional tax liability of K.Shs.12,974,238/-, and to demand payment.

It initially moved this court on 11/2/2007 and obtained orders for leave to commence these proceedings for the orders of certiorari, prohibition and mandamus against **THE COMMISSIONER GENERAL KENYA REVENUE AUTHORITY** ('the respondent').

It has now moved this court seeking for:

- *An order of Mandamus to compel the respondent to lift and/or cancel the Agency Notices dated 30/10/2008 seeking to recover and/or realize a sum of K.Shs 6,271,537 towards unpaid Corporation Tax arrears and a further sum of K.Shs 6,702,702/- for unpaid Pay As You Earn (PAYE) against it through its bank account number 006020001288 held with K-Rep Bank Limited.*
- *An order to prohibit the respondent from demanding, collecting and/or in any way whatsoever from recovering a sum of K.Shs 12,974,239/- from it either through its aforementioned bank account and/or any other person legal entity and/or other entities including but not limited to Tusker Mattresses Limited that may in any way whatsoever be deemed to be its creditors.*
- *An order of Certiorari against the respondent to quash the finding that it is liable to pay the sum of Kshs12,974,239 as additional taxes as demanded in the respondent's notices dated 29/10/2008, 20/1/2009 and 3/2/2009.*
- *An order of mandamus do issue to compel the respondent to accept its amended audited financial statements and/or accounts for the years ending 30th June 2004, 2005, 2006, and 2007 as being duly filed in accordance to the law and as its lawful records.*
- *An order of Certiorari against the respondent to quash lift and/or cancel the letter dated 5/11/2008 and the Agency Notice dated 25/11/2008 addressed to Tusker Mattresses Limited purportedly seeking to recover a sum of K.Shs 6m271,537/- for unpaid corporation tax arrears from this ex parte applicant.*
- *An order to prohibit the respondent from seeking to interfere, temper with and/or take over the accounts of Tusker Mattresses Limited in an effort to collect receive and/or realized a sum of K.Shs 12,974,239/- on behalf of this ex parte applicant.*

The ex parte applicant which also prays for costs, and which is of the view that the respondent acted in excess of its jurisdiction, maintains that the contentious decision is not only unlawful, but that it is illegal for failure to apply the relevant law correctly, and that it violated its legitimate expectations.

It relies on the grounds inter alia that, it was not served with the relevant notices; that the assessment not served and therefore it was not explained; that the Agency notices are null and void. It however concedes that it has not referred the matter to the local Tax Committee because it offered to settle the matter.

It avers that it was condemned unheard contrary to the rules of natural justice, and that the respondent's actions will amount to perpetrating a fraud, and therefore maintains that unless restrained, the respondent shall continue to violate the law to its irreparable damage, injury, loss; that its entire operations may be brought to a halt and it will not be able to honour its financial obligations.

The application is however opposed on the grounds that not only did the respondent comply with the correct procedure, when it ordered for the extensive audit of the ex parte applicant's accounts for the period covering 1/1/2005 to 30/6/2008, but that respondent's officers conducted interviews and held discussions with the ex parte applicant's directors and its appointed agents on diverse dates between June and September 2008; that they provided various documents amongst which were lease agreements, rent books, cash books, cheque counterfoils, creditors invoices, all ledgers and PAYE records and returns which the respondent had called for.

The fact that Ms. Mella Alling & Associates who described themselves as the duly appointed auditors, compiled, prepared and submitted the ex parte applicant's returns, reports and financial statements for the entire audit period under audit, is not in doubt. It is evident from the record that the directors of the ex parte applicant signed and approved the said returns as required under section 54 of the Income Tax Act ('the Act'). In my view and in line with the provisions of section 71 of the Act, which provides that "*a return, statement, or form, purporting to be furnished under this Act by or on behalf of a person shall for all purposes be deemed to have been furnished by that person or by his authority, as the case may be,*

unless the contrary as proved, and a person signing the return, statement, or form, shall be deemed to be cognizant of all matters contained therein". Having appointed and involved Ms. Mella Alling & Associates as their tax consultants, the ex parte applicant would now be hard pressed to deny that they were authorised to act for them at all, or even to allege that 'the audited financial statements and/or accounts that their appointed agents provided to the Respondents did not reflect the true facts and/or position of the Applicant's financial affairs and that they were full of fictitious and erroneous entries'. I would in the circumstances hold that the said professional firm was their duly appointed agent.

Be that as it may, the respondent has also been able to demonstrate that contrary to its allegations that it was never provided with the findings of the assessment report it had actually been discussed between them and was also availed in writing.

Indeed it gave the full explanation to the ex parte applicant's auditors vide its letter of 14/11/2008, which read as follows:

"File No. 18/33717

Pin: PO51179119Z

Littlewoods Consultancy

P.O. Box 1914-00100,

NAIROBI.

RE; NDYKAK INVESTMENTS LTD

We refer to your letter on the above and wish to respond as follows:

1) Service of Notice of Assessment

This was addressed to the authorised Tax Agent and a copy sent to the client.

2) Agents – Mella Aling and Kuria

Our records show that they have been the company's authorized agents contrary to you allegation. Previous company's returns and accounts were also prepared and filed by them.

3) Notice to enforce payment

Taxes being demanded arose from an audit exercise, which are normally paid immediately or even on account when the exercise is still going on.

4) Service of Agency Notice to the Bank

In response to our demand letter of 29th September, 2008, you client wrote on 21st October 2008 committing themselves to commence payment before the end of October 2008, which they did not honour. The Agency Notice was actually served on you client's bankers, (K-Rep, Buru-Buru Branch) on 3rd November, 2008 after they failed to pay on the promised date. The Cheque for K.Shs. 500,000 dated 4th November, 2008 was only issued after the attachment.

5) Dispute Resolution

Please note that the assessments are not in dispute. Audit finds were discussed with your client and their tax agent, Mr. Kuria Joseph.

All the issues raised were addressed and by the time of serving the letter, they were fully aware of the issues, which gave rise to additional taxes.

6) Tax Computation

You appear to be having difficulties in understanding how tax was computed. Please contact the undersigned for detailed briefing on the same. Facts about the tax computation are as follows:

I. PAYE

Please note that records including ledgers are never provided by officers from this department but by the taxpayer. From the ledgers your client provided (which you have also attached in your letter), the salaries earned are as charged in our computation. Note that PAYE is charged on calendar year basis. Kindly acquaint yourself with the relevant legislations.

II. Withholding Tax

Documents provided by your client show that the amounts were paid as interest to Tusker Mattresses Ltd. However, should you have evidence to the effect that the amounts included Bank charges, we would be most obliged to peruse them.

III. Rent

The source was clearly explained to your client in the presence of their tax agent. Most of the claimed expenses could not be supported and as a result, part of it was allowed and the balance brought to charge. Details of the adjustment were communicated to your client.

Please study and understand you clients' books and records more carefully to be able to make an informed opinion on them.

7) **Lifting of the Agency Notice**

Based on the above facts you will realize that the taxes for which the notices were issued must be paid without undue delay.

Please advise you client to co-operate and have them settled immediately since the unpaid tax continues to attract interest on monthly basis.

Signed by

B. O. Oriaro

For: Snr. Assistant Commissioner

East of Nairobi

CC.

The Directors,

Ndykak Investment

P.O. Box 54280-00200

Nairobi.

It also sent the following letter on 20/1/2009:

“The Managing Director

M/s. Ndykak Investments Ltd

P.O. Box 54280 – 00200

NAROBBI

Dear Sir,

RE: M/S NDYKAK INVESTMENTS LTD. – PO51179119Z

I refer to your tax consultant's letter of 5th January, 2007.

Please note, it does not address anything. It is not clear of what is expected of us. Submission of fresh Accounts which I do not know where they fit in the Audit we carried out and gave you the result of just leaves us where we were.

In our last meeting, it was clearly stated to you that new set of Accounts can be only submitted where relieve under **Section 90 Cap 470 of the Laws of Kenya** I applied for.

In the case at hand, we are not dealing with a Self Assessment but additional Assessment based on Audit findings. During the Audit, the Finance Administration Manager and General Manager of Ndykak Limited were totally involved up to the last minute and they are aware of how the result of the Audit was arrived at.

In their letter of 21st October, 2008, they agreed to pay the Principal Tax as per the result of the Audit.

I therefore find it strange that a Tax Consultant who was not involved in any way during the Audit is coming up with issues touching on the income arrived at during the Audit which was agreed upon, between the former Auditors, the General and the Finance Managers of the company and the officer of the Department of Kenya Revenue Authority.

The tax Consultant is quoting substantial and material facts and figures found inaccurate in the account submitted, this is the whole essence of an Audit and it does not necessarily mean – that the fresh accounts

submitted are any different if subjected to an Audit as documentation in support of expenses feature in the fresh Accounts submitted. The only major area of dispute identified during our last discussion revolved around 2006 overstated rent and directors allowances claimed for various years in the rent schedules. Information provided also indicated that part of the borrowing was used for purchase of farming land and machinery.

I would like to point out the following so that we avoid using a long route for a short journey in the light of the above issues:-

1. The need to understand the issues at stake i.e. that true Taxable income was based on facts availed during the audit and not on the self Assessments submitted.
2. That the legal fees of K.Shs. 2,422,939 paid for Karen Land transaction attracts withholding tax. Cheque for the withholding tax involved has not been remitted. It should, because the amount will not change even if new sets of Accounts are submitted. The company purchased land and paid legal fee and that is not in dispute. Professional fees attract withholding tax per provisions of Cap 470 of the Laws of Kenya.
3. While the new set of Accounts as pointed above cannot form part of the Audit in question, even if they (Accounts) were to be used as a basis of the Audit in question, it is obvious that rent income will be adjusted for, with all the expenses found not qualifying under sub-Section 15(i) and 15(7) (e) of Cap 470 of the Laws of Kenya being added back because of the following reasons:-
 - a) In the earlier Audit, most of the expenses were unsupported and it was explained to you that only 25% would be allowed in such circumstances.
 - b) Most of the expenses relate to farming and not rent and should be allocated on prorata basis between the two activities as per Section 15 (7) (e) of the Income Tax Act.
 - c) All supported expenses, except for interest debited in the rent schedules for 2004 and 2005 should be allocated at 75% for farming and 25% rent. This would mean that rent for the years 2004 to 2007 has to be adjusted as follows whether you had started earning farming income or not as you were involved in Karen and Rongai farms preparatory activities. Farming expenses cannot be allowed against rent.

2004	2005	2006	2007		
Gross rent		6,000,000	6,000,000	6,215,000	6,300,000
Less:-					
Administration Expenses 25%	153,750	153,750	432,146		50,000
Establishment Expenses 25%		522,760	1,029,804	707,500	645,023
Finance Expenses 25%	2,035,127	2,026,142	1,854,566	703,189	
Adjusted rental Income	3,488,363	2,790,304	3,230,788	4,901,788	
Principal Tax		1,046,508	837,091	969,236	1,470,536
Thereof					
Sec. 72D Penalty	209,301	1,674,118	193,847	294,102	
Sec. 94 interest	1,105,112	642,885	452,033	282,342	
TOTAL		2,360,921	1,647,394	1,615,116	2,046,980

In the light of the above computation, it is clear that the principal tax due is as follows after the adjustments above:-

Corporation Tax		KShs.4,323,371
PAYE		-
W/T – Per your analysis	2,618,114	
Add – W/T on professional		
Legal fees not		
Provided for	121,146	<u>2,739,260</u>
Total principal tax due		<u>7,062,631</u>
Total tax plus penalty and		
Interest would therefore be:-		
Corporate tax		7,670,411
Withholding tax		<u>5,370,876</u>
Total tax payable		13,071,281
Less paid		<u>3,007,655</u>
Tax payable		10,033,626

To enable me lift the Agency Notice, the outstanding balance as above indicated would have to be cleared even if the fresh Accounts were to be used as a basis of the Audit.
Arrange to send us the cheque to clear this Audit.

Yours faithfully

J.I.N.G. Kamwana
Senior Assistant Commissioner
EAST OF NAIROBI
c.c. Managing Partner
M/s. Littlewoods Consultancy
P.O. Box 281108 – 00200”

It is also evident that prior thereto, the ex parte applicant had undertaken to pay off vide its letter of 21/10/2008, which read as follows:

“DYKAK INVESTMENTS LIMITED

21ST October, 2008
Senior Assistant Commissioner – East of Nairobi
Kenya Revenue Authority
Times Towers,
NAIROBI

Payment of Tax

We refer to your letter date 15th October 2008 and our subsequent discussion on 17th October 2008.

As Mentioned in our discussion, we will commence payment of the principal amount before the end of the month of October 2008.

Kindly give us this chance to organize our finances.’

The letter was signed by F.N. Kamau and D.M.Ndirangu, the General Manager and the Finance and Administration Manager respectively.

Having conceded as such, and given the above circumstances, they cannot deny the fact that they were actually served with the tax assessment, or that they had been given a fair hearing.

Granted, there might be a relationship between this ex parte applicant and Tusker Mattresses Ltd., and the two might have common directors, but each company is a distinct legal entity and unless it can be

categorized as an agent under section 96 of the Act, then the Agency notice that was served upon it cannot lie. However in view of the fact that the ex parte applicant conceded that Tusker Mattresses Ltd., is its tenant, then the latter would be a recognized agent for purposes of the Act, by virtue of such a relationship, and the respondent acted properly when it served it with the agency notice.

I am however not convinced that the respondents the agents sufficient time to comply with the agency notices which were to be enforced in November 2008, which is the same month within which they were issued. Once appointed, an agent has a clear 30 days within which to comply

Though I find that the respondent acted lawfully and procedurally in the assessment and the application is bound to fail, I find that the respondent has however flouted the rules pertaining to the enforcement and in the circumstances, I order that the respondent refund the sums collected from the ex parte applicants accounts with K Rep Bank Ltd., with immediate effect. I also order the respondent to comply strictly with the provisions of section 96 (6) of the Act as pertains to the grace period given to agents.

Otherwise the application is for the above reasons hereby dismissed.

Each party shall bear its own costs.

Dated and delivered at Nairobi this 6th day of July 2010.

JEANNE GACHECHE

Judge

Delivered in the presence of:

For the ex parte applicant – Mr. Mituga holding brief for Mr. Singh

For the respondent - Miss Lavuna
