REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT MOMBASA

MISCELLANEOUS CIVIL APPLICATION 1044 OF 2006

REPUBLIC ……...APPLICANT

VERSUS

THE KENYA REVENUE AUTHORITY…….……RESPONDENT

CIVICON LIMITED……..…….. EXPARTE APPLICANT

R U L I N G

Civicon Ltd, the exparte applicant herein, took out the notice of motion dated 27th November 2006 in which it sought for the following orders:

1. OF CERTIORARI; to bring into this court and to quash the decision of the Respondent set out in the Notices dated 28.4.2006 and 14.11.2006 purporting to DEMAND the payment of a purported tax liability assessed of Kshs.16,988,766/- on the Applicant, for being unreasonable, absurd, illegal, irregular, oppressive and for being based on irrelevant considerations.

2. OF PROHIBITION; to prohibit the Respondent from demanding, purporting to demand, and/or from taking any coercive action under the Income Tax Act, Cap 470 and/or any other enabling Provisions of the Revenue Laws of Kenya, to enforce the payment to the Respondent by the Applicant, of Kshs.16,988,677 (inclusive of interest and penalties and together with such further interest and penalties as may be charged thereon) or any part thereof on account of the purported tax liability illegally and unreasonably assessed on the Applicant on or about 28.4.2006 and demanded on 14.11.2006.

3. That the costs of these proceedings be borne by the Respondent.

The motion is verified by the affidavit of David Horsey sworn on 22nd November 2006. It is also accompanied by a statement of facts. Kenya Revenue Authority, the Respondent herein filed the replying affidavit of Humphrey E. Ekirapa sworn on 15th March 2007 to oppose the motion. Learned advocates appearing in this dispute agreed to dispose of the motion by filing written submissions without the need of making oral submissions.

I have considered the material placed before this court and the written submissions filed by the firm of Ndegwa Muthama & Katisya Associates for the Exparte Applicant and those of P.M. Matuku learned advocate for the Respondent. It is the submission of Mr. Muthama that Kenya Revenue Authority in administering and enforcing the Income Tax Act, is bound to have regard to the notorious well known principles of taxation that is to be equitable, clear and unambiguous, reasonable and just. It also enjoined to take into account internationally best practices, standards and guidelines in its interpretation of the provisions of the Income Tax Act so as not to visit absurd and unreasonable results and consequences either on the tax payer and or the Government of Kenya. It is said that the exparte applicant secured a contract with W.F.P. to undertake emergency roads repair in Southern Sudan in 2004 and was obliged to engage Sudanese citizens and was also obliged to charge and deduct at source such taxes as payable to the Government of Sudan on the incomes of Sudanese Nationals and to remit the same to the Secretariat of Finance & Economic Planning of New Sudan on a monthly basis. The exparte applicant states that it is duly charged and deducted at the source and remitted all the taxes on the income of Sudanese Nationals to the aforesaid Secretariat in accordance with the Laws of Sudan. It is the contention that the same cannot be subject to further taxation on income in Kenya under the provisions of Sections 3 and 5 of the Income Tax Act [Cap 470 Laws of Kenya). The applicant avers that the Respondent purported to subject the income of the Sudanese Workers, to the Kenyan Pay As You Earn Tax component amounting to Kshs.16,988,677/- and he purported to demand immediate payment. It is the submission of the exparte applicant that it does not owe any such taxes as the same is not chargeable under S.3,5,16 & 37 of the Income Tax Act.

The Respondent opposed the motion on the ground that the moment the applicant paid for the works done in Southern Sudan such funds as were paid to the applicant were technically brought to Kenya though there may have not been any physical movement of the money. This is because the applicant is and was a resident of Kenya for purposes of the Income Tax Act. It is argued that Kenya being the country in which the Sudanese income is sourced from has the primary right to tax that income under S.5 (1) (b) of the Income Tax Act. In any case it is argued that Kenya and Sudan do not have an avoidance of double taxation Agreement. It is submitted that S.5(1) of the Income Tax Act is to ensure that tax is not avoided by the transfer of assets abroad, migration of funds abroad, migration of funds abroad or by a resident company losing control of foreign subsidiary principally or by arrangement to avoid tax in the country of residence. Consequently, it is argued that the applicant was expected to deduct and account for tax thereon to such an extent and manner as may be prescribed under S.37(1) of the Income Tax Act. It is also submitted that the Organisation for Economic Co-operation and Development (OECD) Convention cannot override the Kenya Income Tax Law when Kenya has not rectified the same.

I have considered the written submissions filed by both learned counsels. I have further critically examined the material place before me. It is not in dispute that the Respondent has demanded to be paid Kshs.16,988,766 from the exparte applicants being tax liability inclusive of penalties and interest for the period between June 2004 and December 2005. I have considered the grounds argued for and against the sad demand. It is the submission of the applicant that the demand is unreasonable, absurd, illegal, irregular oppressive and based on irrelevant considerations. Of course the Respondent has claimed that it was justified to make the demand under sections 3 (2) (a) (ii), 5(1), 37, 41, 73 (2) (b) and 84 of the Income Tax Act (Cap. 470 Laws of Kenya).

Let me begin by examining the above issues raised by both sides. It has been argued that the assessed tax is illegal because it violates section 34 of the Income Tax Act. I agree with the submissions of the applicant that where tax is assessed without strict compliance with the provisions of the Act, the same becomes illegal hence will be reviewed and quashed. There is no doubt that the tax in question is a pay as you earn tax [PAYE]. That is a tax charged on the income of an employee arising from gains from employment or services rendered. It is imposed under Section 3(2) (a) (ii) of the Income Tax Act hereinafter referred to as the 'Act". Under S.37 of the Act the employer is appointed as the collection agent, The P.A.Y.E. tax is computed pursuant to the THIRD SCHEDULE of the Act. The relevant guide of the tax demand is the Pay As You Earn in Kenya (Revised Edition 2006). In brief the applicable rate is graduated from 10%, 15%, 20%, 25% upto a maximum rate of 30% for different income brackets. It is clear that the Respondent is not entitled to charge a flat rate say of 30%. In this matter it is not in dispute that the Respondent replied a flat rate of 30% on the total emoluments paid to the alleged employees for

the period between June 2004 and December 2005. It is apparent from the tax table for monthly incomes for that period that the Respondent in some instances charged and demanded almost double the PAYE tax. In my view that is oppressive to the exparte applicant. The Respondent was obliged to apply the graduating rate. Under the Third Schedule, the individual rates of tax shall be rates of Personal Relief and Tax. Section 34 (1) (a) of the Act provides as follows:

"**Tax upon the total income of an individual other than that part of comprising of wife's emolument income, fringe benefits and the qualifying interest, shall be charged for the year of income at the individual rates for that year of income."**

I am convinced the Respondent in applying a flat rate of 30% acted in contravention of Section 34 of the Act. The amount demanded therefore became illegal. The same is not even subjected to Personal Relief as required under S.29 of the Act. The form (i.e. form II.H.O.B.D.) availed to this court shows that the calculations by the Respondent failed to reduce the tax alleged to be due by the cumulative total personal relief of each employee. It would appear that the Respondent violated S.16 (2) (c) of the Act. It is clear that the Respondent failed to allow as deductions taxes paid by the Sudanese Nationals in Southern Sudan though the Secretariat of Finance and Economic Planning of the New Sudan. I am also persuaded to agree with the applicant that even if the tax was payable what the Respondent assessed and demanded cannot be possibly the amount due to the Respondent. There is also evidence annexed to the replying affidavit of Humphrey Ekirapa (C.T.1) that the 41st and 45th employees earned each a monthly sum of Kshs.7,00/-. That amount was subjected to taxation at the rate of 30%. The law is very clear that an employee earning Kshs.11,135 and below in 2005 was not subject to P.A.Y.E.. any employee who earned Kshs.10,267 and below in 2004 was not subject to P.A.Y.E. I think the Respondent should be prohibited from demanding taxes outside what the law provided.

It has been argued that the demand by the Respondent was unreasonable. It is not in dispute that the exparte entered into a joint venture project with the World Food Project to repair Faraksika – Rumbek Road. Part of the terms of the agreement is that the exparte applicant was to engage the services of Sudanese Nationals within that country. It would appear from the documents availed from court that the funds for paying the employee's wages would come from World Food Project and would be channeled through the exparte applicant in payroll in Kenya Shillings. There is evidence that the individual incomes were subjected to the taxation law of the Government of Southern Sudan. The employees identity cards were issued by the Civicon – W.F.P. Roads Project Southern Sudan. I am convinces that the Respondent acted unreasonably when it purported to demand P.A.Y.E. tax from the exparte applicant on account of emoluments paid to them by the applicant on behalf of W.F.P. That obligation is placed on the employer under S.37 of the Income Tax Act. The applicant in my view was just an executing agent not the Principal employer. Even assuming for a moment that the Sudanese nationals were employees of the exparte Applicant I am of the view that the Respondent's demand is still unreasonable – because there is evidence that the employees are foreign nationals who rendered services in a foreign nation using money sourced from another foreign country and paid in a foreign country.

A critical examination of S.3 (2) of the Act will reveal that the law is silent and ambiguous on the question of where the services are rendered by the employee and where the payment is made and received. It is also true that Kenya does not have an agreement with the Government with the Government of Southern Sudan on Avoidance of Double Taxation. In such cases I am persuaded by the position taken by Nyamu J (as he then was) that in such circumstances International instructions come in handy where the Act is silent on an essential matter. I am of the view that since the law is silent. The Respondent is obliged to apply the best international practice on avoidance of double taxation.

In the end I find the motion dated 27th November 2006 to be well founded. It is allowed as prayed with costs to the exparte applicant.

Dated and delivered at Mombasa this 28th day of May 2009.

J. K. SERGON

J U D G E

In open court in the presence of Mr. Sitonik h/b Muthama and Mrs. Umara h/b Matuku for the Respondent