Stefanutti Stocks Kenya Limited v Commissioner of Domestic Taxes (Tax Appeal E117 of 2021) [2023] KEHC 2322 (KLR) (Commercial and Tax) (22 March 2023) (Judgment)

Neutral citation: [2023] KEHC 2322 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E117 OF 2021

DAS MAJANJA, J

MARCH 22, 2023

BETWEEN

STEFANUTTI STOCKS KENYA LIMITED ..... APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 11th June 2021 in Tax Appeal No. 142 of 2020)

JUDGMENT

Introduction and Background

1. The Appellant is a subsidiary of Stefanutti Stocks International Holdings Limited, a company resident in the Republic of South Africa that carries on the business of providing engineering solutions and construction services for marine, civil and general works. The Appellant commenced operations in Kenya in 2012 and was awarded the first contract in 2013 and the second one in 2017, both with Base Titanium.

2. In order to appreciate the appeal and the parties' arguments, it is necessary to set out the history of the matter as well as the parties' contentions.

3. The Commissioner carried out a review of the Appellant's financial records for the year of income ending February 2013 and issued the first additional assessment in respect of Corporation Tax on September 6, 2019. The Appellant objected to this assessment through its letter dated October 4, 2019 on the grounds that the Commissioner had not considered salaries paid out to its expatriate employees as an expense while computing its taxable income and that the cost of these employees was recharged from its head office to the Appellant through an intercompany invoice.

4. In its letter dated December 9, 2019, the Commissioner allowed the salaries and wages as expenses incurred in the production of business income but took the position that these amounts be subjected to Pay As You Earn (PAYE). The Commissioner stated that the Appellant's explanation confirmed that the expatriates' salaries for the period August 2012 to February 2013 had not been subjected to PAYE. The Commissioner also deemed expenses relating to rent, cable television subscription, installation and activation fees and other miscellaneous payments by the Appellant for the benefit of expatriate personnel as employee benefits and therefore subject to PAYE in the absence of an explanation.

5. The Commissioner held that all emoluments paid to expatriate employees and non-cash benefits provided to the Appellant's employees are chargeable to tax in Kenya in accordance with section 3 of the *Income Tax Act* (Chapter 470 of the Laws of Kenya) ("the ITA") which brings to charge all income of a person whether resident or non-resident that accrues or is derived from Kenya and for an individual, such tax is chargeable on gains or profits from employment or services rendered. The Commissioner further relied on section 5(1)(b) of the *ITA* which provides that an amount paid to a non-resident person in respect of any employment with or services rendered to an employer who is resident in Kenya or the permanent establishment in Kenya of an employer who is not so resident is income which accrued in or is derived from Kenya and is therefore taxable in Kenya. The Commissioner thus held that the non-cash benefits provided by the Appellant to its employees are chargeable to tax as provided for under section 5(2)(b) and (e) of the ITA. It further stated that section 37 of the *ITA* requires the Appellant, upon paying emoluments to an employee to deduct and account for tax thereon in the prescribed manner and that such tax is recoverable from the Appellant as if it were tax due and payable by the Appellant should the Appellant fail to deduct and remit the tax as required. From the foregoing, the Commissioner concluded that salaries paid to expatriate employees and benefits provided to them for the period August 2012 and February 2014 had been brought to charge.

6. The Commissioner maintained that the Appellant paid PAYE on salaries paid to its local staff but omitted to charge tax on salaries paid to expatriates and the non-cash benefits provided to them. That this was despite the fact that payroll services had been outsourced to a professional firm of accountants; BDO Kenya for the period 2013-2017. That although section 31(4)(b) of the *Tax Procedures Act*, 2015 ("the TPA") sets the time limit within which the Commissioner may amend a self-assessment return within five years from the date of filing the return, in this instance, the Commissioner noted that the Appellant had committed gross or wilful neglect while filing its PAYE returns thus the assessment could be issued beyond the statutory period of five years. In conclusion, the Commissioner issued PAYE assessments amounting to Kshs 142,285,361.00 inclusive of penalty and interest.

7. The Appellant objected to the assessment through its letter of January 8, 2020 and urged the court to set it aside. It averred that under section 34 of the *TPA*, the Commissioner is required to raise an assessment within 5 years of the date of the self-assessment return filed by the tax payer and that since the assessment covered the tax period August 2012 to February 2014 and was issued on December 9, 2019, it exceeded the time limit for raising a tax assessment stipulated by the TPA. The Appellant denied that it had committed any act or omission constituting gross or wilful neglect hence there was no statutory basis for the assessment issued beyond the stipulated five-year period. The Appellant contended that gross negligence required that the party involved possess an appreciation of the risk of harm and some degree of fault or blame and that such degree of blame should be more exceptional that required for ordinary negligence. That this intent remains one of the defining characteristics in attempting to distinguish between ordinary negligence and gross negligence. The Appellant averred that its in-house accounting team is competent and qualified and that the omission to properly and accurately account for tax is an inadvertent omission that arose due to unfamiliarity with the taxation regime in Kenya.

8. The Appellant further argued that majority of the expatriates were present in the country for less than 6 months for each year of income and are thus not required to be registered for tax in Kenya and that they were also not required to account for any tax in respect of their presence in Kenya because they fell below the threshold of residence. On the intercompany recharges, the Appellant stated that part of the payroll costs related to intercompany allocation of the staff costs of employees working on projects that were being implemented in Kenya by the Appellant but were not employees of the Appellant. That these payments constituted a compensation for use of the workforce of a related party and that since the employees were not present in Kenya and were not employees of the Appellant, the payments were not subject to PAYE.

9. On March 5, 2020, the Commissioner made its objection decision ("the Objection Decision"). On limitation of time, the Commissioner stated that the emoluments of the expatriates were first subjected to corporation tax which amendment was done in 2019 and that the assessment of the same under PAYE was done within a month of the amendment to the earlier assessment. That the earliest return filed with the Commissioner was the 2014/2015 return that was filed on October 23, 2017 and that the PAYE Additional Assessment referred to the period 2012 to 2014 and the said salaries and wages expenses were claimed in the financial periods;2012/2013 and 2013/2014 for which the Income Tax Return was not evident in the Commissioner's systems and neither did the manual return bear a received stamp imprint to indicate that it was indeed received by the Commissioner.

10. From the above observations, the Commissioner concluded that the 5-year rule had not been breached since the first return observed in the Commissioner's records was the Self-Assessment return for the year ending February 2015 that was filed as stated above on October 23, 2017. On the objection that the Appellant did not engage in any acts of commission or omission that amounted to gross or wilful neglect, the Commissioner observed from the Appellant's arguments that the Appellant was aware that the services for which it paid the expatriate staff were rendered in Kenya as well as the non-cash benefits for the same staff which would only accrue to these employees and be allowed as expenses by virtue of the services being rendered in Kenya and thus any such emoluments ought to be subjected to PAYE in accordance with sections 3 and 5 of the ITA. That it was further clear that the Appellant's failure to account for the PAYE relating to specifically expatriate employees' emoluments as well as non-cash benefits accruing to this specific cadre of employees was evidently wilful in that it was a deliberate decision to only account for PAYE on emoluments paid to local staff and as such, gross or wilful negligence threshold had been met and as such it could proceed to raise the assessments beyond the stipulated 5 years.

11. The Commissioner also restated that the Appellant had retained BDO-Kenya to manage its payroll function and hence it was clear that the person(s) charged with this responsibility were competent enough to understand Kenya tax law and the requirements and hence adequately address the tax matter and thus this proved the competence that the Appellant was challenging in its objection. On the residence status of expatriates, the Commissioner did not find any supporting documentation to support the claim that the expatriate employees on whose emoluments this PAYE additional assessment was based were not resident in Kenya in the years in question having been in Kenya for less than 6 months. Thus, the Commissioner held that it was not possible to determine the veracity of this claim.

12. On the intercompany charges, the Commissioner stated that an examination of the assessment and documents used to support the expense as a legitimate business cost revealed that the Appellant did not segregate expenses relating to its expatriates and expatriates for the other related parties and that it was also noted that the whole expense was debited to salaries and wages account which account is reserved for employees' emoluments. The Commissioner thus held that the Appellant had not provided any

document to prove the contrary. The Commissioner also stated that a further examination of the assessment and the subsequent objection realized that there was no dispute that services were indeed rendered to the Appellant by these expatriates. That it was also not in dispute that non cash benefits accrued to these employees were enjoyed in Kenya and was a result of services rendered by these expatiates. The Commissioner concluded that these benefits were earned by employees who offered their services in Kenya to a resident employer and as such these emoluments were taxable as per the provisions of sections 3 and 5 of the ITA.

13. The Commissioner ultimately rejected the Appellant's objection and confirmed its earlier assessment. Aggrieved, the Appellant lodged an appeal with the Tax Appeals Tribunal ("the Tribunal") mainly challenging the Commissioner's findings on the assessments made after 5 years and that of gross and wilful neglect against the Appellant.

14. After considering the parties' contentions, the Tribunal rendered a judgment on June 11, 2021. It framed two issues for determination;

    a) Whether there was gross or willful neglect by or on behalf of the Appellant in accounting for PAYE during the period August 2012 to February 2014.

    b) Whether the Commissioner erred in law or in fact by raising a PAYE additional assessment on the Appellant in respect of the period August 2012 to February 2014.

15. On the Commissioner's position that the first return in its records was for the year ended February 2015 that was filed by the Appellant on October 23, 2017, the Tribunal noted that this reference was in respect of income tax, a direct tax, while the issue at hand is on PAYE, an agency tax. On whether the Appellant, in dealing with the accounting for PAYE during the period August 2012 to February 2014, acted in blatant indifference to its legal duty, the Appellant relied on the Tribunal's decision in *Kenya Fluorspar Company Limited v Commissioner of Domestic Taxes* (Tax Appeal Number 1 of 2016 and 37 of 2016 - Consolidated). However, the Tribunal stated that that this decision was distinguishable from this case in that in Kenya Fluorspar Case, the responsibility of the filing of the returns was assigned to its payroll clerk which was a function delegated to the officer by the appellant and in addition, the omission was in respect of reverse VAT, an indirect tax. That in this case, the Appellant admitted that it had a qualified and competent in-house accounting team. To complement the team, the Appellant outsourced its payroll services to BDO-Kenya, a member firm of BDO International which has offices in Nairobi. In addition, its tax agents at the time were Mazars-Kenya, a member firm of Mazars International which described itself as "a leading international audit, tax and advisory firm".

16. The Tribunal held that the omission was in accounting for PAYE for the 19-month period between August 2012 to February 2014 and that PAYE is an agency tax as contrasted with VAT which is an indirect tax. The Tribunal also found the arguments by both parties in respect of the filing of the self-assessment returns with regard to Corporation tax as insignificant as the matter at hand concerned the Appellant's PAYE obligations. The Tribunal rejected the Appellant's contention that the omission to account for PAYE for 19 months was inadvertent as it had the competence to handle its PAYE affairs. The Tribunal held that the Appellant acted in blatant indifference to its legal duty in accounting for PAYE for the 19-month period and in view of the foregoing, it found that the Appellant's action amounted to gross or wilful neglect by or on behalf of the Appellant in accounting for PAYE for that period.

17. Having found that there was gross or wilful neglect by, or on behalf of the Appellant in accounting for PAYE, the Tribunal also held that the Commissioner's right to issue a PAYE additional assessment was not limited to five years. The Tribunal therefore turned to determine whether the expatriates' and recharge costs allowed for Corporation tax by the Commissioner were subject to PAYE. On the

Appellant's contention that the majority of the expatriates that worked in Kenya were present in the country for less than six months for each year of income and were thus not required to be registered for tax in Kenya, the Tribunal observed that PAYE is an obligation on the part of an employer not the employee and the period of stay in Kenya for an employee is not relevant for PAYE operations. That the expatriates' costs met by the Appellant are subject to tax under section 3(2)(a) (i) of the ITA and that the costs form part of income from employment as set out in section 5(1) of the ITA and the same are subject to PAYE under section 37(1) of the ITA.

18. On the Appellant's further contention that part of the payroll costs related to intercompany allocation of the staff cost of employees working on projects that are being implemented in Kenya by the Appellant but are not employees of the Appellant, the Tribunal noted that the payroll costs relating to employees of the non-resident employer were met by the Appellant. That the Appellant is therefore an employer of the said employees in accordance with section 2 of the ITA and it should have accounted for PAYE in respect of the said emoluments and benefits hence the Commissioner did not err in law or in fact by raising a PAYE additional assessment on the Appellant.

19. The Tribunal dismissed the Appellant's appeal with consequence that the Commissioner's Objection Decision and the respective principal tax assessment of Kshs 80,302,793.00 plus interest and penalties was upheld.

20. The Appellant is dissatisfied with the Tribunal's judgement and has appealed against the same to the court through the Memorandum of Appeal dated August 4, 2021. The Commissioner has responded to the appeal through its Statement of Facts dated August 25, 2021. Both parties have supplemented their arguments through written submissions which are on record. Since the appeal and the parties' submissions mirror their positions as already highlighted above, it is not necessary to summarize them again. I will only make relevant references in the findings.

Analysis and Determination

21. The court's jurisdiction in determining this appeal is circumscribed by section 56(2) of the TPA" which provides that "An appeal to the High Court or to the Court of Appeal shall be on a question of law only". A court limited to resolving matters of law is not permitted to substitute the Subordinate Court's decision with its own conclusions based on its own analysis and appreciation of the facts unless the findings are so perverse that no reasonable tribunal would have arrived at them (see *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR).

22. Although the Appellant has raised four grounds in its Memorandum of Appeal, it has condensed the same to three issues for determination in its submissions as follows;

    i. Whether the additional tax assessment issued by the Commissioner to the Appellant on December 9, 2019 is time barred;

    ii. Whether there was gross or wilful neglect by or on behalf of the Appellant in accounting for PAYE during the period of August 2012 to February 2014

    iii. Whether the Commissioner's assessment dated December 9, 2019 should be upheld.

Whether the assessment of December 9, 2019 was time barred

23. The Appellant avers that the Commissioner's additional tax assessment dated December 9, 2019 is unlawful, null and void as it was time barred under the express provisions of section 31(4)(b)(i) of the TPA which provides as follows:

The Commissioner may amend an assessment—

(a)in the case of gross or wilful neglect, evasion, or fraud by, or on behalf of, the taxpayer, at any time; or

(b) in any other case, within five years of—

(i) for a self-assessment, the date that the self-assessment taxpayer submitted the self-assessment return to which the self-assessment relates; or

(ii) for any other assessment, the date the Commissioner notified the taxpayer of the assessment: [Emphasis mine]

24. I agree with the Appellant that an interpretation of the aforementioned provision has to observe the strict principles of interpretation of tax statutes as enunciated by the Court of Appeal in *Mount Kenya Bottlers Ltd and 3 Others v Attorney General and 3 Others* NRB CA Civil Appeal No. 164 of 2015 [2019] eKLR that "....the statute must be looked at using slightly different lenses. With regard to tax legislation, the language imposing the tax must receive a strict construction." A simple and strict interpretation of the above provision is that the only time the Commissioner may amend an assessment beyond the five-year statutory period after the filing of a self-assessment return is in the case of gross or wilful neglect, evasion, or fraud by, or on behalf of, the taxpayer.

25. The obvious question that follows is whether the Appellant was guilty of gross or wilful neglect, evasion, or fraud for the Commissioner to amend its self-assessment beyond the five-year period as required by law. This is a question of fact that was within the province of the Tribunal and this court, dealing with only matters of law can only make a determination whether the Tribunal correctly apprehended the evidence and came to the right conclusion. The Tribunal was correct to state that the TPA does not define 'gross or wilful neglect' and in the circumstances, it could not be faulted for seeking and finding its ordinary meaning in the Black's Law Dictionary which defines gross negligence as "a severe degree of negligence taken as reckless disregard. Blatant indifference to one's legal duty, others safety, or their rights, are examples."

26. In arriving at the decision that the Appellant was guilty of blatant indifference to its legal duty in dealing with accounting for PAYE during the 19-month period between August 2012 to February 2014, the Tribunal considered that the Appellant had the competence to handle its PAYE affairs through not only its own employees but also its outsourced firm of payroll accountants and tax agents and accountants. I agree. Indeed, since it was not disputed that the Appellant's tax affairs were being managed by reputable tax consultants and agents, then it ought to have known that under section 3(1) of the ITA, PAYE is payable on the income of a person whether resident or non-resident that accrued in or was derived from Kenya and that under section 5(1) of the ITA, an amount paid to a non-resident person in respect of employment or services rendered to an employer who is resident in Kenya or the permanent establishment in Kenya of an employer who is not so resident shall be deemed to have accrued in or to have been derived from Kenya.

27. I also agree with the Tribunal that the period of stay in Kenya of an employee is not relevant in PAYE obligations and that the expatriates' costs met by the Appellant are subject to tax under Section 3(2)(a)(i) of ITA and the costs form part of income from employment as set out in section 5(1) of the ITA. The costs form part of the emoluments and are subject to PAYE under section 37(1) of the ITA which provides that, "An employer paying emoluments to an employee shall deduct therefrom and account for tax thereon, to such extent and in such a manner as may be prescribed".

28. I do not find any fault in the Tribunal's conclusion that the Appellant was guilty of gross of willful neglect in accounting for PAYE during the period August 2012 to February 2014. This being the case, it follows that the Commissioner could amend the Appellant's self-assessment beyond the statutory period allowed of 5 years and issue an additional assessment. This finding disposes of the other grounds raised by the Appellant as the additional tax assessment issued by the Commissioner to the Appellant on December 9, 2019 is not time barred.

Disposition

29. For the reasons I have outlined, I find that the Appellant's appeal lacks merit and it is dismissed. There shall be no order as to costs.

DATED AND DELIVERED AT NAIROBI THIS 22ND DAY OF MARCH 2023.

D. S. MAJANJA

JUDGE

Court Assistant: Mr Michael Onyango.

Mr Wasonga instructed by Wasonga B. O and Associates Advocates for the Appellant.

Mr Lemiso, Advocate instructed by Kenya Revenue Authority for the Respondent.