



IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL AND TAX DIVISION

CORAM: D.S. MAJANJA J.

TAX APPEAL NO. E003 OF 2020

BETWEEN

CHINA ROAD AND BRIDGE CORPORATION APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES RESPONDENT

(Being an appeal from the Judgment of the Tax Appeals Tribunal at Nairobi dated 17th December 2019 in Tax Appeal Tribunal Appeal No. 162 of 2017)

JUDGMENT

1. The Appellant (“CRBC”) has filed the Memorandum of Appeal dated 27th January 2020 contesting the judgment of the Tax Appeals Tribunal (“the Tribunal”) dated and delivered on 17th December 2019. Although the Memorandum of Appeal sets out 15 grounds of appeal, the substance of the appeal can be gleaned from the following main prayers:

[a] This Appeal be allowed and the orders of the Honourable Tribunal be quashed, vacated or set aside.

[b] The Appellant does not bear the responsibility in law to deduct and remit PAYE. for allowances paid to the Police Officers guarding the Standard Gauge Railway.

[c] A declaration be issued that the taxes demanded of Kshs. 64,716,060 were not payable by the Appellant.

[d] The Respondent bears the costs of the proceedings before the Tribunal and those before this Honourable Court.

2. Apart from its memorandum of appeal and record of appeal, the CRBC relies on its written submissions. The Respondent (“the Commissioner”) has opposed the appeal and filed the Statement of Facts on 25th February 2020. It also filed written submissions. The facts giving rise to this appeal are largely common ground.

Statutory Provisions

3. As is evident from the prayers in the Memorandum of Appeal I have set out above, this appeal concerns the “Pay As You Earn” (“PAYE”) which is a method of deducting income tax from employees emoluments. The resolution of this appeal implicates several provisions of the *Income Tax Act* (“the *ITA*”) including the relevant parts of **sections 2, 3(1) and (2), 5(2)(a) and 37** which I shall set out in order to provide context for this matter.

4. **Section 2** which is the definition section provides 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 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 public service shall be deemed to be employed under a contract of service.

“employer” includes any resident person responsible for the payment of, or on account of, any emoluments to any employee, and any agent, manager or other representative so responsible in Kenya on behalf of any non-resident employer;

Charge of tax

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) any business, for whatever period of time carried on;

(ii) any employment or services rendered;

(iii) any right granted to any other person for use or occupation of property;

(b) -----

(c) -----

(d) -----

(e) -----

(f) -----

Income from employment, etc.

5. (1) For the purposes of section 3(2)(a)(ii) of this Act, an amount paid to—

(a) a person who is, or was at the time of the employment or when the services were rendered, a resident person in respect of any employment or services rendered by him in Kenya or outside Kenya; or

(b)-----.

(2) For the purposes of section 3(2)(a)(ii) “gains or profits” includes—

(a) any wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, or subsistence, travelling, entertainment or other allowance received in respect of employment or services rendered, and any amount so received in respect of employment or services rendered in a year of income other than the year of income in which it is received shall be deemed to be income in respect of that other year of income:

Provided that—

(i) where any such amount is received in respect of a year of income which expired earlier than four years prior to the year of income in which it was received, or prior to the year of income in which the employment or services ceased, if earlier, it shall be deemed to be income of the year of income which expired five years prior to the year of income in which it was received, or prior to the year of income in which the employment or services ceased as the case may be; and

(ii) where the Commissioner is satisfied that subsistence, travelling, entertainment or other allowance represents solely the reimbursement to the recipient of an amount expended by him wholly and exclusively in the production of his income from the employment or services rendered then the calculation of the gains or profits of the recipient shall exclude that allowance or expenditure; and

(iii) notwithstanding the provisions of subparagraph (ii), where such amount is received by an employee as payment of subsistence, travelling, entertainment or other allowance, in respect of a period spent outside his usual place of work while on official duties, the first two thousand shillings per day expended by him for the duration of that period shall be deemed to be reimbursement of the amount so expended and shall be excluded in the calculation of his gains or profits;

Deductions of tax from emoluments

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.

5. Also relevant to the determination of this appeal are the **Income Tax (P.A.Y.E) Rules** (“the **PAYE Rules**”). The salient provisions **Rules 2** and **4** thereof state as follows:

Rule 2

“*emoluments*” means—

(a) gains or profits from employment or services rendered which are payable in money; and

(b) the value of housing provided by an employer ascertained under section 5 (3) of the Act; and

(c) the value of benefit or facility provided by the employer, where the total value exceeds three thousand shillings per month; and

(d) -----

but does not include gains or profits which, in the opinion of the Commissioner, are in respect of casual employment only;

“*employee*” includes an individual receiving emoluments in respect of any employment, office, appointment or past employment;

Rule 4

An employer who makes a payment of, or on account of, emoluments during a month to an employee of his who is liable to payment of tax shall deduct tax from those emoluments in accordance with these Rules.

Factual background

6. CRBC is a limited liability company incorporated in Kenya. It is principally involved in the business of construction of roads, bridges, railways, airport and other infrastructure facilities. It entered into a construction contract with Kenya Railways Corporation (“Kenya Railways”) for the construction of the Standard Gauge Railways (“SGR”) from Mombasa to Nairobi. The construction of the SGR commenced in 2014 and was completed in May 2017.

7. CRBC asserts that one of the conditions of the contract was that Kenya Railways was required upon request and at a cost to it to provide reasonable additional assistance in matters of security. It contends that its sole responsibility was to construct the SGR and that security services were not part of its contractual obligation. In that regard, a meeting between it, Kenya Railways and the National Police Service (“the NPS”) was held on 15th September 2014 at the Railways Police Headquarters. The meeting resolved *inter alia* that;

(a) The Kenya Railway Police Unit, a unit of the National Police Service and established under the Kenya Police Standing Orders (1962) with its main function being *inter alia* the provision of security along the railway line and to ensure prevention and detection of crimes along the railway line within the country as well as to safeguard Kenya Railway properties was to be deployed along the SGR line and stations to provide necessary security.

(b) The Commandant Railway Police Unit, as mandated by law would be in charge of the Kenya Railway Police Unit operations along the SGR.

(c) The members of the Kenya Railway Police Unit deployed to provide the SGR security services would still remain members of the National Police Service and their employment or terms of services shall remain with the National Police Service.

(d) The rates of allowances payable to the said officers posted to provide security and man the SGR line were agreed upon between the parties and were to be paid by the CRBC.

(e) The said allowances did not constitute salaries but were limited to the extra time the officers would expend in the carrying out of security services within SGR.

8. On the basis of the above understanding, Police Officers were deployed on a rotational basis to provide security during the construction of the SGR. The management and administration of the Police Officers providing security services to the SGR was fully carried out by the NPS through the Kenya Railways Police Unit. CRBC’s role was limited to the payment of the allowances of assigned officers as determined by the NPS while their salaries were paid by and received from the NPS and not itself as its only mandated to remit their allowances.

9. On 30th June 2017, the Commissioner issued CRBC with an investigation finding for the years 2014 to 2016 wherein it claimed that the allowances paid to the Police Officers amounted to salaries and that the CRBC ought to have remitted PAYE on the same. Based on this position, the Commissioner elected to increase the PAYE payable by CRBC with an additional Kshs. 44,326,069.00 being the purported PAYE due on the police officers’ allowances.

10. CRBC objected to the Commissioner’s decision by its letter dated 27th July 2017. It disputed the alleged PAYE of Kshs. 44,326,069.00 together with the accrued interest and penalties which made up a total amount of Kshs. 62, 943, 018.00 arising from the Police Officers allowances.

11. The Commissioner rejected the objection and on 19th September 2017 confirmed the demand for Kshs. 64,716, 060.00 on the allowances paid to the Police Officers attached to the SGR for the overtime services rendered by the said police officers.

12. Aggrieved by the Commissioner's decision, CRBC appealed to the Tribunal. The Tribunal heard the parties and framed two issues for its determination;

a. Whether there exists an employer-employee relationship between the Appellant and police officers. If such a relationship is a predictor who shall [pay] the taxes (sic)

b. Whether the Appellant bears the statutory duty of deducting and remitting PAYE due from the police officers.

13. On the first issue the Tribunal found as follows;

This Honourable Tribunal is persuaded by the foregoing submissions of the Appellant. We cannot, as the Respondent would have us believe, accept the premise that there exists an employer-employee relationship between the Appellant and the police officers as enumerated in paragraph 27 of the Respondent's Statement of Facts. This is constitutionally untenable. However, in the opinion of the Tribunal, this is NOT the only determinant on the issue of PAYE. The employment relationship has to be looked [at] together with the statutory relationship and duty of remitting such dues.

14. On the second issue, the Tribunal determined that in light of **sections 3(1) and (2)** as read with **section 5(2)(a)** of the *ITA*, the allowances paid to the police officers amounted to income for the police officers concerned for services rendered. The Tribunal then considered **section 37(1)** of the *ITA* and proceeded to hold as follows;

... If the Income Tax Act is to be read wholesomely, we hold that it equally applies to instances where a party has, like in the present case, rendered services from which income is accrued or derived and the Appellant had taken responsibility of the tax obligation when it undertook to pay. We find that it would be prejudicial to the taxing authority to limit the ambit of Section 37(1) of the Income Tax Act to scenarios where only an employer-employee relationship exists. As such, the incidence of tax and statutory obligation to remit the taxes in this cases is triggered not by an employer-employee relationship, but by the payments of emoluments to the officers and who has control over the amounts being paid, in this case this are the Appellants.

In this case the Appellants had the reasonable option of remitting the amounts due to the Police Officers to the National Police Service, in which case they would have discharged their statutory obligation as to the payments of the said taxes. Once they made a decision they would pay the officers directly, the obligation was on them to pay the said taxes.

15. The Tribunal upheld the Commissioner's decision dismissing the objection and found the demand for taxes proper and that the taxes were therefore due and payable. It is this decision that has now precipitated this appeal.

Appellant's submissions

16. CRBC asserts that the employer-employee relationship is the sole basis in law for PAYE deductions as provided under **section 37(1)** of the *ITA* as underscored by the **PAYE Rules**. CRBC also refers to the Kenya Revenue Authority (KRA) **Employers Guide to Pay as You Earn (P.A.Y.E.) in Kenya 2017** which, at paragraph 2, set out the employer's duty to deduct income tax as follows, "It is the employer's statutory duty to deduct income tax from the pay of his employees whether or not he has been specifically told to do so by the Department."

17. CRBC emphasizes that the only legal basis for PAYE is the existence of the employer-employee relationship as stated in the in **Tax Law Design and Drafting** published by the International Monetary Fund that, "With respect to the taxation of wage income, three parties are involved—the employee, the employer, and the tax administration. Their involvement varies from country to country, but the emphasis is on the employer and the tax administration."

18. Counsel for CRBC submits that a plain and simple reading of **section 37 (1)** of the *ITA* together with the **PAYE Rules**, demonstrates that PAYE is strictly applicable based on an employer-employee relationship. Counsel submits that the Tribunal erred by attempting to expand the scope of PAYE to this case where there the employer-employee relationship does not exist. Counsel points out that Tribunal decision was inconsistent. On the one hand, it held that there is no employer-employee relationship between CRBC and the Police Officers and on the other holding that the CRBC was liable to remit PAYE simply because CRBC was required to pay overtime allowances to the Police Officers. Counsel cited **Ian Edwards v Bytes Technology Group Kenya Ltd NRB CA Civil Appeal No. 314 of 2017 [2018] eKLR** where the Court of Appeal held that the *ITA* places such responsibility on the employer to comply and in this case CRBC was not the employer.

19. Counsel for CRBC submits that the facts of this case, show that the relationship between the CRBC and the Police Officers was not that of employer-employee for several reasons. First, that no person, whether an individual or private company can employ or have control over Police Officers other than the NPS.

20. Second, the Constitution as read together with the **National Police Service Act, 2011** ("the *NPSA*") does not permit an employer-employee relationship between the police and any other person for purposes of remitting PAYE. It submits that **Article 243** of the Constitution establishes the NPS which is operationalized by the *NPSA* which provides for the composition, organization and control of the members of the service. **Article 245(4)(c)** of the Constitution provides that no person may give direction to the Inspector-General with respect to employment, assignment, promotion, suspension or dismissal of any member of the NPS. Further that **Sections 45 and 71** of the *NPSA* on the nature and status of employment of police officers stipulate that police officers are always considered to be on duty and prohibits police officers from engaging in other forms of trade, business or employment.

21. CRBC contends that in arriving at its decision, the Tribunal failed to appreciate and/or take into consideration the express provisions of the Constitution and the law meant to ensure that no person can have control over the police service and this includes payment of taxes on behalf of the police officers. According to CRBC, assuming such a role is tantamount to having control and influence over the police service in breach of the Constitution and the *NPSA*.

22. CRBC adds that deployment of the Police Officers to man the SGR was for the protection of the public good and interest because the project was/is a national project by the National government for the benefit of all Kenyans. It asserts that it is plainly unfair and unlawful to punish it by holding that it bears the incidence of tax with respect to known police officers who are employed by the National Police Service Commission who dictated the rates of the allowances.

23. Third, CRBC supports its case by arguing that the *ITA* must be interpreted strictly and literally leaving no room for perceived intentions other than that which is expressly provided. Counsel cited several cases to support this principle including *Republic v Commissioner of Domestic Taxes Large Tax Payer's Office Ex-parte Barclays Bank of Kenya Limited* [2012] eKLR and *Keroche Industries Limited v Kenya Revenue Authority & 5 others* [2007] e-KLR where the court cited with approval *Cape Brandy Syndicate v IRC (1) (1930) 12 TC 358* where the court held that in a taxing statute there is no room for intendment and that there is no equity about tax and nothing is it to be read or implied in the clear language of the statute.

24. CRBC submits that the Tribunal erred in law by relying on **section 3(2)** of the *ITA* and accentuated the words '*for services rendered*' without taking all the relevant considerations required for the existence of an employer-employee relationship to underpin the statutory obligation to deduct and remit PAYE and in doing so attempted to erroneously expand the scope of application of **section 37** of the *ITA* without regard to the principle that where a statutory provision has two possible meaning, the court should not be inclined to adopt an interpretation that imposes a burden, tax or duty on the subject.

25. Fourth, CRBC submits that it cannot lawfully and regularly apply the graduated scale of PAYE because it does not have custody of the Police Payroll making it difficult for it to comply with the *Employers Guide to Pay as you Earn, 2017* which gives guidance that PAYE is to be calculated on the consolidated salary. It urges that since it is not in control of the Police Payroll and does not employ the Police Officers, it would be unfair and inequitable to impose on it the burden of paying PAYE.

26. CRBC also submits that PAYE is to be deducted by an employer at source and remitted to the Commissioner, any other contention and/or suggestion other than this plain construction of the provisions of the law is untenable and must be rejected. It maintains that in this case, there is no clear and/or unambiguous word in the *ITA* which clearly vests the incidence of deducting and remitting PAYE for the Police Officers on it.

Respondent's submissions

27. The Commissioner submits that it is the statutory duty of the person paying allowances to deduct income tax from the payee. In this case, it submits that CRBC has a responsibility of deducting PAYE from the Police officers who were deployed to provide security during the construction of the SGR. That payments were made by CRBC directly to the police officers attached to its various stations through cash vouchers hence the NPS could not have withheld the emoluments since the payments were not made to the NPS.

28. The Commissioner further submits that CRBC was required to remit the PAYE as the allowances paid to Police Officers constitute income under **section 3** as read with **section 5(2)(a)** of the *ITA*. That the allowances paid to Police Officers for services rendered to CRBC were chargeable with income tax and that under **section 37(1)** of the *ITA* the employer when paying emoluments was required to deduct the taxes thereon and remit the same to the Commissioner.

29. The Commissioner contends that under **section 2** of the *ITA* and **Rule 2** of the *PAYE Rules*, the term 'Employer' is not exhaustive and includes any person responsible for the payment of or on account of emoluments to an employee such as CRBC. This means any person who remits any sums to an employee on account of services rendered, including an employee on secondment, ought to deduct and account for the taxes.

30. The Commissioner rejects the argument by CRBC that there is no contract of service between itself and the Police Officers merely because CRBC did not determine their work and that they not answerable to it. The Commissioner relies on **section 2** of the *ITA* which defines a contract of service to argue that owing to the unique character of the services offered by Police Officers, a service that is pre-determined by the *NPSA*, it is not necessary for CRBC to determine the work done by Police Officers or for them to be answerable to it. It is sufficient that the Police Officers are stationed at the various stations at CRBC's request and CRBC received those services from them and in return pays allowances which should be subject to tax.

31. The Commissioner points out that in Minute 4/2014 of the '*Minutes of Standard Gauge Railway Security Held at Railways security Held at Railways Police Headquarters on 15/9/2014*', CRBC's Security Manager in addition to determining the bonuses to be paid also set out the criteria applicable for the remittance of the allowances. The Commissioner maintains that contrary CRBC's assertions that the allowances were reimbursement of expenses incurred by the Police Officers towards food and accommodation, the schedule of rates payable to different persons serving in different ranks clearly establishes that these were negotiated allowances for services rendered and were paid by CRBC.

32. The Commissioner concludes that these allowances remitted by CRBC to the Police Officers were subject to the provisions of **sections 3(1) and (2), 5(2)(a) and 37** of the *ITA* and urges the court to affirm the Tribunal's decision dismissing CRBC's objection and consequently dismiss the appeal.

Analysis and determination

33. In resolving this appeal, this court is guided by **section 56** of the *Tax Procedures Act* which provides as follows:

56.(1) In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.

(2) An appeal to the High Court or to the Court of Appeal shall be on a question of law only.

(3) In an appeal by a taxpayer to the Tribunal, High Court or Court of Appeal in relation to an appealable decision, the taxpayer shall rely on the grounds stated in the objection to which the decision relates unless the Tribunal or Court allows the person to add new grounds. [Emphasis mine]

34. Following the Supreme Court decision in **Gatirau Peter Munya v Dickson Mwenda Kithinji and 2 Others [2014] eKLR**, the Court of Appeal in **John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others [2018] eKLR** summarised what amounts to “matters of law” as follows:

[38] *[T]he interpretation or construction of the Constitution, statute or regulations made thereunder or their application to the sets of facts established by the trial Court. As far as facts are concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court.*” [Emphasis mine]

35. As I stated earlier, the issue in this appeal is whether the CRBC bore the burden of deducting and remitting PAYE due on allowances paid to Police Officers. The Tribunal accepted the position taken by CRBC that there was no employer-employee relationship between it and the Police Officers deployed to render security services as this would be inconsistent with the provisions of the Constitution and the **NPSA** establishing and guaranteeing the independence of the NPS. Since this finding has not been appealed against, it follows that what is left for the court to interrogate is whether, in the absence of an employer-employee relationship, CRBC had an obligation to deduct and remit PAYE due from the Police Officers.

36. It is also not in dispute that the allowances paid to the Police Officers amount to income under **section 3(1) and (2)** and **section 5(2)** of the **ITA** upon which income tax is chargeable. In summary under **section 3(2)(a)(ii)**, the allowances amount to a gain from, “an employment or services rendered” and under **section 5(2)(a)** it is an amount, “received in respect of employment or services rendered...” The Tribunal reasoned that the allowances paid to police officers was income within **section 3(2)(a)(ii)** of the **ITA** and in this particular case, the income was for “services rendered” and was therefore liable to tax and subject to PAYE under **section 37** of the **ITA**.

37. If the Police Officers are not employees, does CRBC have a duty to deduct and remit PAYE? This calls for interpretation of the provisions of the **ITA**. The principles guiding tax legislation were restated in **Republic v Commissioner of Domestic Taxes Large Tax Payer’s Office Ex-Parte Barclays Bank of Kenya Ltd [2012] eKLR** which the court summarised as follows:

[13] *The approach to this case is that stated in the oft cited case of Cape Brandy Syndicate v Inland Revenue Commissioners [1920] 1 KB 64 as applied in T.M. Bell v Commissioner of Income Tax [1960] EALR 224 where Roland J. stated, “...in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used... If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.”*

[14] *As this case concerns the interpretation of the Income Tax Act, I am also guided by the dictum of Lord Simonds in Russell v Scott [1948] 2 ALL ER 5 where he stated, “My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him” adopted in Stanbic Bank Kenya Limited v Kenya Revenue Authority CA Civil Appeal No. 77 of 2008 (Unreported) [2009] eKLR per Nyamu JA (See also Jafferli Alibhai v Commissioner of Income Tax [1961] EA 610, Kanjee Naranjee v Income Tax Commissioner [1964] EA 257).*

[15] *Any tax imposed on a subject is dictated by the terms of legislation and taxing authority must satisfy itself that the transaction fits within the definition of the statute. In Adamson v Attorney General (1933) AC 257 at p 275 it was held that, “The section is one that imposes a tax upon the subject, and it is well settled that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used, and if there is any doubt or ambiguity this defect-if it be in view of the Crown a defect-can only be remedied by legislation.”*

38. Turning to the matter at hand, the basis of PAYE is **section 37 (1)** of the **ITA**. The clear language of this provision refers to, “An employer paying emoluments to an employee” It would therefore be improper to imply or read into this provision any other relationship other than an employer or employee. To do so violates the clear words of the statute. It also violates the principles of interpretation of tax statutes.

39. The Tribunal therefore fell into error by holding that **section 37** of the **ITA** applies to a situation where, absent an employer-employee relationship, the person paying for services rendered is subject to PAYE. Further, it also erred by holding that, “it would be prejudicial to the taxing authority to limit the ambit of Section 37(1) of the Income Tax Act to scenarios where only an employer-employee relationship exists.” In so doing, the Tribunal expanded the scope of statutory provisions beyond the words of the statute.

40. I therefore find and hold that **section 37** of the **ITA** bespeaks an employer-employee relationship. Since CRBC was not an employer, it was not under a statutory obligation to deduct and remit any tax in accordance with **section 37(1)** of the **ITA**.

Disposition

41. For the reasons, I have set out above, I allow the appeal. The decision of the Tribunal is set aside together with the Respondent's objection decisions dated 19th September 2017. The Respondent shall bear the costs of the appeal.

DATED and DELIVERED at NAIROBI this 5th day of FEBRUARY 2021.

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Mr Agwara instructed by for the Appellant.

Ms Chelanga instructed by Kenya Revenue Authority for the Commissioner of Domestic Taxes.