



Commissioner of Domestic Taxes & another v Chase Bank Kenya Ltd (In Receivership) & another (Civil Appeal E080 & E073 of 2020 (Consolidated)) [2021] KEHC 28 (KLR) (Commercial and Tax) (3 September 2021) (Judgment)

Neutral citation: [2021] KEHC 28 (KLR)

**REPUBLIC OF KENYA
IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)
COMMERCIAL AND TAX
CIVIL APPEAL E080 & E073 OF 2020 (CONSOLIDATED)
JM MATIVO, J
SEPTEMBER 3, 2021**

BETWEEN

COMMISSIONER OF DOMESTIC TAXES APPELLANT

AND

CHASE BANK KENYA LTD (IN RECEIVERSHIP) RESPONDENT

**AS CONSOLIDATED WITH
CIVIL APPEAL E073 OF 2020**

BETWEEN

CHASE BANK KENYA LTD (IN RECEIVERSHIP) APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES APPELLANT

(Appeals against the judgement of the Tax Appeals Tribunal in TAT No. 49 of 2020, Chase Bank Limited v Commissioner of domestic Taxes dated 9th July 2020)

Income tax is a tax on income irrespective of other considerations such as legality

Reported by Kakai Toili

Tax Law – taxation – liability to pay taxes - factors to consider when establishing liability to pay tax – burden and standard of proof in establishing liability to pay taxes - who bore the burden of proof and what was the standard of proof required in proving non-liability or exemption in paying tax - whether illegally obtained income could be



taxed – who was an employer for purposes of pay as you earn tax - Tax Procedures Act, 2015, section 56(1); Income Tax Act, Cap 470, section 3(1).

Statutes – *interpretation of statutes – interpretation of tax statutes - what was the proper way of interpreting a tax statute where there was doubt regarding the imposition of tax.*

Brief facts

The 1st appellant, Commissioner of Domestic Taxes (Commissioner) investigated the affairs of the 2nd appellant and raised a tax demand note for Kshs 1,181,431,680. Aggrieved by the assessment, the 2nd appellant appealed to the Tax Appeals Tribunal (TAT) claiming among others that; the 2nd appellant misdirected itself in finding that the pay as you earn tax (PAYE) was payable by the 2nd appellant for the irregular and unauthorized payments towards purchase of property by the 2nd appellant's former chairman; and that the 2nd appellant erred in law and misdirected itself in finding that the payments towards the purchase of the property by the 2nd appellant's former chairman without the approval of the board of directors constituted gains and profits chargeable under the (ITA).

The 2nd appellant's case before the TAT was that its board of directors through a resolution approved a performance-based bonus payment to its former chairman which was payable over a five-year period in equal installments, but contrary to the approval, the entire bonus was paid in a period of one and a half months between June and July in 2015. However, following the fraudulent act, the bonus award was cancelled by a subsequent board resolution. Further, the 2nd appellant's position was that it was not liable to pay taxes for money illegally misappropriated or embezzled by its former chairman. It argued that the assessment of tax on the illegally earned income should have been made against the former chairman as the money did not constitute wages, salary, fees, commission, bonus gratuity, or other allowances received in respect of the employment services rendered.

The 1st appellant's case before the TAT was that it was entitled to assume that any transactions or obligations entered into by the 2nd appellant through its officers would be enforced by the 2nd appellant, and that, the 2nd appellant as the principal pursuant to a power of attorney was responsible for any actions or omissions of its agent, the former chairman. The TAT thus held that the payment of the bonus ought to be subjected to PAYE; the payments for the two properties should not be subjected to tax; and that the expenses and withdrawals amounting to Kshs.1,153,642,138 should not be subjected to tax. Aggrieved by TAT's decision, the appellants filed the instant consolidated appeals.

Issues

- i. Whether illegally obtained income could be taxed.
- ii. What were the factors to consider in establishing liability to pay tax?
- iii. What was the proper way of interpreting a tax statute where there was doubt regarding the imposition of tax?
- iv. Who bore the burden of proof and what was the standard of proof required in proving non-liability or exemption in paying tax?
- v. Who was an employer for purposes of pay as you earn tax?

Held

1. Statutory authority (legislation) was necessary before any tax could be imposed. It was the statute alone that had to be consulted to establish the liability for such tax. Legality of the income, accounting or related principles were not normally of concern in determining the tax liability of any taxpayer, except in instances where the ITA specifically so provided. Apart from legislation and the rules made thereunder which formed the main source of tax law, case law also constituted an authoritative source. A number of provisions of the Acts contained terms that were not defined in those Acts. Examples included all income which was used in the ITA. It was therefore necessary to refer to case law for guidance on the meaning of those terms.



2. In the case of doubt regarding a taxing statute, the *contra fiscum* rule had to be invoked. That meant that an ambiguous provision in a taxing statute had to be construed against the larger imposition or the benefit of the doubt had to be given to the person sought to be charged. Thus, where a section of the Act was reasonably capable of two constructions, the court would place the construction on it that imposed the smaller burden on the taxpayer (thus, against the *fiscus*). However, if the provision in question did not cause any doubt, the rule could not be applied.

3. In terms of section 56(1) of the (the TPA Act), the burden lay on the taxpayer to prove that a tax decision was incorrect. Thus, the burden of proof that an amount was exempt from or not liable to any tax; or was subject to any deduction, abatement or set-off; or that a valuation was correct; or that a particular tax rate applied to a transaction, event, item or class of taxpayer; or whether a decision that was subject to objection and appeal, was incorrect, rested on the taxpayer claiming such exemption, non-liability among others.

4. The burden of proof was squarely upon the shoulders of the taxpayer to show that the decision was incorrect. He did that by proving on a balance of probabilities (as opposed to beyond reasonable doubt) that his argument of the facts was more correct than the Commissioner's. The wording of a particular provision should be given its literal, grammatical meaning (unless there was ambiguity and a strict literal meaning would lead to absurdity). In such a case, the *contra fiscum* rule would apply.

5. The ITA used the nomenclature "all income". The Act did not specify whether the nature of income should be legal or illegal which left room for widely interpreting illegally obtained income and legally obtained both of which fit the description all income. Interpretation, in the context of fiscal legislation, was the cornerstone on which the revenue authorities could assess and collect taxes and correspondingly, the foundation on which a tax payer's rights were built.

6. The courts had remained of the view that imposition of tax was a burden on the assessee so it should be interpreted strictly and no such construction should be made on the basis of presumptions and assumptions as to the intention of the Legislature. No addition or subtraction should be allowed in a case of charging provisions in furtherance of fulfilling the purpose of the Act or to meet the intention of the Legislature. Tax laws should be interpreted in a manner so as to maintain a balance between interest of both revenue collector and the assessee.

7. The basic legal framework called for taxation according to the rule of law. The fundamentals of that framework were that;

- a. a tax could be levied only if a statute lawfully enacted so provided;
- b. a tax had to be applied impartially, and;
- c. revenue raised by a tax could be used only for lawful public purposes.

The rule of law contemplated that those principles would be enforced by independent courts.

8. Income tax was a tax on income irrespective of other considerations, notably, legality. Whether one had fixed property or lived by his wits he contributed to the tax if his income was above the prescribed limit. Under section 3(1) of the ITA, there were two requirements requisite for the income tax to be levied: there had to be income and the income had to have been accrued in or derived from Kenya. Additionally, the question as to what constituted income could further be viewed from two perspectives; the legality and illegality of the amount in question or the source of taxable income. Whereas the former was not an easy question to answer, regarding the latter, the ITA provided for taxation of all income from businesses, income from employment, income from the use of property, income from management or professional fees, royalties, interest, and rents.

9. It was the employer's statutory duty to deduct income tax from the pay of his/its employees whether or not he had been specifically told to do so by the revenue authority. The relevant legislation was contained in section 37 of the ITA and the rules made under section 130; and sections 38 and 83 of the Tax Procedures Act. If any employer failed to comply with section 37 and with the provisions of any rules made under section 130 which dealt with the payment of tax deducted and accounting for it to the Commissioner, the Commissioner could by order impose a penalty equal to twenty-five percent of the amount of tax involved or ten thousand shillings



whichever was greater, and the provisions of the Act relating to the collection and recovery of the tax should apply to the collection and recovery of any tax payable and such penalty as if it were tax due by the employer.

10. For pay as you earn (PAYE) purposes the term employer was to be taken, when necessary, to include;

1. any person having control of payment of remuneration;
2. any agent, manager or other representative in Kenya of any employer who was outside Kenya;
3. any paying officer of Government or other public authority;
4. any trust or insurance company or other body or person paying pensions.

11. The word employee was defined as inclusive of any holder of an appointment of office, whether public, private or calling, for which remuneration was payable. A paying point was the place at which remuneration was paid. Where an employee enjoyed a benefit, advantage or facility of whatsoever nature in connection with employment or services rendered; the value of such benefit should be included in the employee's earnings and charged to tax.

12. In determining whether an amount of money was income, it was immaterial whether that money was obtained from an activity which was illegal, immoral or *ultra vires*. Illegal business ventures and agreements were not robbed of all legal results just because they could be regarded as void. By parity of reasoning, the argument that the board of directors did not authorize the payments did not and could not absorb the 2nd appellant from complying with the tax laws.

13. Under the ITA, particularly to section 37 of the Act, it was the responsibility of the employer to deduct and remit taxes from the salaries, emoluments and allowances of its employees. The 2nd appellant had the statutory responsibility to deduct the taxes and remit the same to the tax authority.

Consolidated appeals dismissed.

Orders

Each appellant to bear its own costs.

Citations

Cases

East Africa

1. *Highway Furniture Mart Ltd v Commissioner of Value Added Tax & another* Civil Appeal 251 of 2008; [2008]eKLR — (Explained)
2. *Mount Kenya Bottlers Ltd & 3 others v Attorney General & 3 others* Civil Appeal 164 of 2013; [2019]eKLR — (Followed)
3. *Republic v Commissioner of Domestic Taxes Large Tax Papers Office, ex parte Barclays Bank of Kenya Ltd* Miscellaneous Application 1223 of 2007; [2012]eKLR—
4. *Republic v Kenya Revenue Authority ex-parte Yaya Towers Limited* Miscellaneous Civil Application 374 of 2006 — (Explained)
5. *W'njuguna, Samuel Mchiri & others v Kenya Tea Development Agency Limited & another* Civil Suit 1192 of 2003 & 26 of 2004 (Consolidated) ; [2015]eKLR— (Explained)
6. *Securex Agencies Kenya Ltd v Kenya Revenue Authority* Income Tax Appeal 3 of 2013; [2014]eKLR— (Explained)
7. *Stanbic Bank Kenya Limited v Kenya Revenue Authority* Civil Appeal 77 of 2008; [2009]eKLR — (Explained)

South Africa

1. *CIR v Delagoa Bay Cigarette Co* [1918] TPD —(Explained)
2. *MP Finance Group CC (in liquidation) v Commissioner for South African Revenue Service* [2007] ZASCA 71; [2007] SCA 71- (Followed)

United Kingdom

1. *Mann v Nash (HM Inspector of Taxes)* (1) (1929-1932) 16 Tc 523-(Explained)



2. *Cape Brandy Syndicate v Commissioners of Inland Revenue*(1) (1930) 12 TC 358 ;19211 KB 64- (Followed)
3. *Scott v Russel* [1948] 2 All ER 1-(Explained)
4. *Holman v Johnson* (1775) 1 Cowp 341-(Explained)
5. *Pickford v Quirke* [1927 - 28] 13 TC 251-(Explained)
6. *Coltness Iron Co v Black* [18881] 6 App Cas 315 (HL) 330 –(Followed)
7. *London County Council & others v Attorney General* (1901) – (Explained)
8. *Commissioner of Inland Revenue v Aken* [1990] BTC 352- (Followed)
9. *Southern (H.M. Inspector of Taxes) v AB* 1933 -LL -0101- (Followed)
10. *Partridge v Mallandaine (Surveyor of Taxes)* (1883-1890) TC 179 – (Followed)

United States of America

1. *Commissioner v Wilcox* (1946)- (Followed)
2. *James v United States* 366 US 213; [1961] 63 –(Explained)
3. *Rutkin v United States* [1952] 343 US 130-(Explained)
4. *Sullivan v United States* 395 US 169 (1969) – (Followed)

Statutes

1. Employment Act,2007 (Act No 11 of 2007 — sections 17(1); 19 (1) (f) — (Interpreted)
2. Income Tax Act (cap 470) — sections 2,3, 4, 5, 6, 10,37 — (Interpreted)
3. Kenya Deposit Insurance Act,2012 (Act No 10 of 2012) — sections 43(1), 43(2), 53(1) — (Interpreted)
4. Tax Procedures Act ,2015 (Act 29 of 2015)— sections 37, 130 – (Interpreted)

South Africa

Income Tax Act,1962 (Act No 58 of 1962) – In general (Cited)

Texts & Journals

- 1.Hogg, QM., Lord Hailsham (Ed) (1990) *Halsbury's Laws of England* London: Butterworth 4th Edn
2. Gupta R, (Ed) 2008 ‘*Taxation of illegal activities in New Zealand and Australia*’ 3 (2) Journal of the Australasian Tax Teachers Association 2, 106

Advocates

None mentioned

JUDGMENT

Introduction

1. This judgment determines two consolidated appeals, namely; ITA No 080 of 2020, *Commissioner of Domestic Taxes v Chase Bank Kenya Ltd* (In Receivership), (herein after referred to as the 1st appeal) and ITA No E073 of 2020, *Chase Bank Kenya Ltd (In Receivership) v Commissioner of Domestic Taxes*, (herein after referred to as the 2nd appeal). For the sake of brevity, the appellant in the 1st appeal shall hereinafter be referred to as the 1st appellant while the appellant in the 2nd appeal, shall herein after be referred to the 2nd appellant.
2. The common thread between the two appeals is that both appeals seek to disturb the same decision dated July 9, 2020 rendered by the Tax Appeals Tribunal (the TAT) in ITA No 49 of 2020 in which the 2nd appellant had sought to set aside the 1st appellant’s objection decision dated April 9, 2020 confirming tax assessment against it for the period 2013-2017. In the impugned decision, the TAT partly allowed the appeal and held that the demand for payment of tax with respect two properties



owned by the 2nd appellant's former chairman as well as expenses and withdrawals taken by him were not subject to tax. However, the TAT held that the bonus of Kshs 1,053,475,989 was subject to {PAYE payable by the 2nd appellant.

3. In order to fully appreciate the two appeals and the respective parties' arguments, it is necessary to highlight, albeit briefly, the factual background which triggered the appeal before the TAT including their opposing arguments before the TAT. The factual matrix which triggered this dispute is essentially common ground or uncontroverted.
4. On April 7, 2016, the Central Bank of Kenya in exercise of its mandate appointed Kenya Deposit Insurance Fund ("KDIC") as a receiver of the 2nd appellant in the interest of its depositors, creditors and members because it was experiencing liquidity difficulties and it was unable to meet its financial obligations. KDIC appointed a consulting firm to conduct an investigation over its management transactions and annual financial statements as at December 31, 2015 and specifically to investigate (a) The balance sheets; (b) Advances to the former director and significant shareholder; (c) Advances to the third parties owned by the 2nd appellant's former director; and (d) Withdrawals and payments made on behalf of its former director for the period January 2016 to December 2017.
5. It is said that the investigation revealed massive theft, fraud and misappropriation of the 2nd appellant's funds by its former Director/Chairman and companies affiliated to him. The Office of the Deputy Public Prosecutor following its enquiries into the alleged misappropriation of the funds by the taxpayer forwarded to the 1st appellant the report to determine whether any tax related offences had been committed. The 1st appellant investigated the affairs of the 2nd appellant based on the said findings and at the end of its investigations for the period January 2014 to December 2017 raised a tax demand note for Kshs 1,181,431,680 dated 9th April 2018 classified under the following tax heads: - (a) Principal amount Kshs. 863,835,005; Penalty Kshs 201,030,820; Interest Kshs 106,101,225; total Kshs 1,170,967,050. Withholding tax was tabulated as follows; (a) principal amount Kshs 7,267,164; penalty Kshs 1,453,421; Interest Kshs 744,105; total Kshs 10,464,690.
6. Aggrieved by the above assessment, the 2nd appellant appealed to the TAT citing the following grounds in its amended Memorandum of Appeal dated May 16, 2018: -
 - a. That the 2nd appellant erred in law and misdirected itself in finding that the PAYE was payable by the 2nd appellant for the irregular and unauthorized payments towards purchase of property by the 2nd appellant's former chairman;
 - b. That the 2nd appellant erred in law and misdirected itself in finding that the payments towards the purchase of the property by the 2nd appellant's former chairman without the approval of the board of directors constituted gains and profits chargeable under sections 2 and 3 of the *Income Tax Act*¹ (the ITA).
 - c. That the 1st appellant erred in law and misdirected itself in finding that the irregular and unauthorized expenses and /or withdrawal by the 2nd appellant's former chairman constituted gains chargeable under sections 2 and 3 of the *ITA*;
 - d. That the 1st appellant erred in law and misdirected itself in finding that PAYE was payable on bonus taken by the 2nd appellant's former chairman whilst the bonus was not authorized or sanctioned by the 2nd appellant's Board of Directors;

¹ Cap 470, Laws of Kenya.



- e. That the 1st appellant erred in law and misdirected itself in finding that withholding tax was payable on the consultancy fees drawn by the 2nd appellant's former Chairman as there was no consultancy agreement between the 2nd appellant and the former Chairman when the consultancy fees were drawn;
 - f. That the 1st appellant erred in law and misdirected itself in confirming the tax assessment in the sum of Kshs 1,181,431,680/=;
 - g. That the 1st appellant misdirected itself by failing to appreciate that there are pending recovery proceedings filed by the Receiver Manager against the 2nd appellant's former Chairman being HCC No 159 of 2017: *Chase Bank Limited (In receivership) v Zafrulla Khan & 19 others* seeking to recover the sums misappropriated;
 - h. That the 1st appellant misdirected itself in failing to consider and take into account the fact that there are pending criminal proceedings initiated by the Banking Fraud Investigation Unit against the 2nd appellant's former Chairman for defrauding and conspiracy to defraud the 2nd appellant.
7. The 2nd appellant's case before the TAT was that its board of Director's through a resolution approved a performance-based bonus payment to its former Director/Chairman which was payable over a five-year period in equal instalments, but contrary to the aforementioned approval, the entire bonus was paid in a period of one and a half months between June and July in 2015. However, following the fraudulent act, the bonus award was cancelled by a subsequent board resolution.
 8. Further, before the TAT, the 2nd appellant's position was that while it is cognizant of and respects the tax principle that illegally earned income is taxable, it is not liable to pay taxes for money illegally misappropriated or embezzled by its former Director/Chairman. It argued that the assessment of tax on the illegally earned income should be made against the former Director/Chairman, who unlawfully misappropriated and stole the money as the money does not constitute " wages, salary, fees, commission, bonus gratuity, or other allowances received in respect of the employment services rendered. It argued that the assessment was deeply flawed as the subject monies were not from benefits or sums earned but from employment or services rendered but as a result of fraud. It contended that the 2nd respondent had a statutory obligation to consider all the transactions and make a determination as to whether the transactions were authorized.
 9. The 2nd appellant argued that it did not sanction the subject payments nor were they part of the benefits or gains from employment for any services rendered by the former Director/Chairman. It faulted the 1st appellant for improperly exercising its statutory mandate in assessing tax of embezzled funds. It argued that it was a victim of a well-organized fraud by its former Chairman and some subordinates.
 10. Regarding the Withholding Tax, it argued that the assessment was erroneous as the former Chairman was not paid any retainer or consultancy fees after 7th April 2016 and that the PAYE returns made before the appointment of the KDIC confirms that the relevant tax was remitted. It sought to set aside the said tax together with the penalties and interests.
 11. On its part, the 1st appellant's case before the TAT was that it was entitled to assume that any transactions or obligations entered into by the 2nd appellant through its officers will be enforced by the 2nd appellant, and that, the 2nd appellant as the principal pursuant to a power of attorney is responsible for any actions or omissions of its agent, the former Chairman.



12. It contended that income tax is tax on income irrespective of other considerations, notably, legality, and that it employed the principle of tax neutrality and it is not concerned with the legality or illegality of the transaction. Further, that the properties purchased using the 2nd appellant's funds, the withdrawals made from its account and made to the former Chairman's companies should be treated as monies received in respect of employment and as such ought to be subjected to PAYE. Further, the consultancy services rendered by the former Chairman between January 2015 and December 2017 were not subjected to withholding tax as required under the ITA, hence the same should be treated as monies received in respect of employment and as such subject to PAYE.

The TAT's Decision

13. The TAT identified two issues, namely; (a) Whether the respondent was right in treating embezzled funds as emoluments provided by the 2nd appellant to its former Director/Chairman; (b) Whether the 1st appellant was right to charge tax to the 2nd appellant based on embezzled funds used in purchase of various properties by the former Director/Chairman. The TAT considered the provisions of sections 3, 4, 5 and 37 of the *ITA Republic v Kenya Revenue Authority ex-parte Yaya Towers*² which held that illegally earned income is taxable and that it is the responsibility of the employer to deduct taxes and held: - (i) the payment of the bonus amounting to Kshs 1,053,475,989 be subjected to PAYE; (ii) the payments for the two properties, Grand Opera 419,235,338 and Armani property 253,096,554 should not be subjected to tax; (iii) that expenses and withdrawals amounting to Kshs 1,153,642,138 should not be subjected to tax; and (iv) each party to bear its own costs.

The 1st Appellant's Appeal

14. The Commissioner of Domestic Taxes, the 1st appellant seeks to partly overturn the above decision on grounds that: - (a) That the Tribunal erred in holding that the payments for the two properties Grand Opera Kshs 419,235,338 and Armani Property Kshs 253,096,554 should not be subjected to tax; and, (b) That the Tribunal erred in finding that the expenses and withdrawals amounting to Kshs 1,153,642,138 should not be subjected to tax. It prays that the appeal be allowed, that the two properties the expenses and allowances be subject to tax.

The 2nd appellant's appeal

15. Chase Bank Kenya Limited (In receivership), the 2nd appellant's grounds of appeal are: -
- a. That the Tribunal erred in holding that PAYE was payable for the bonus irregularly taken by its former Chairman within two (2) months of its approval instead of five (5) years as approved by its Board of Directors on May 14, 2015.
 - b. That the TAT erred and misdirected itself in holding that the consideration was not whether the bonus was irregularly taken ahead of schedule as anticipated by the 2nd appellant but that tax was automatically due upon approval by its Board of Directors. PAYE is only due when the bonus is lawfully paid or the benefit was earned by the former chairman.
 - c. That the TAT erred in failing to hold that the sum of Kshs 1,053,475,989/= was illegally taken and was not a benefit or gain under section 19 of the *Employment Act* and therefore not subject to the ITA.

² {2008} e KLR.



- d. That the TAT disregarded the fact the its Board of Directors revoked the approval for the bonus on 5th December 2015 and therefore the bonus was not a benefit or gain subject to PAYE.
 - e. That the TAT erred in failing to hold that the illegal taking of the bonus prematurely was not ratified by the its Board of Directors and therefore its former Chairman is liable to pay tax on illegally earned income.
 - f. That the TAT improperly interpreted and analyzed the provisions of the ITA and the applicable laws and arrived at a wrong decision.
16. The 2nd appellant prays that the appeal be allowed and that the order directing payment of the bonus amounting to Kshs 1,053,475,989 be subjected to PAYE be set aside.

The 1st appellant's submissions

17. The 1st appellant submitted that the TAT did not pronounce itself on one of the issues placed before it, namely, on withholding tax charged by the 2nd appellant. It submitted that the 2nd appellant granted power of attorney to its chairman thereby creating a principal agent relationship between 2nd appellant and its chairman, and that it ceded its authority on land transactions to the Chairman, thus it was responsible for the decisions made by the Chairman.
18. Regarding the submission that the chairman's activities were illegal and not authorized by the Board of Directors, the 1st appellant argued that an illegal activity is defined as an act committed in violation of law, and that financial fraud committed by the Directors falls within the meaning of illegal activity. The 1st appellant submitted that the income was taxable even though the same was illegally earned through fraudulent means. It cited Lord McNaghten definition of income tax as a tax on income irrespective of other considerations, notably, legality, and whether one has fixed property or lives by his wits he contributes to the tax if his income is above the prescribed limit. It argued that section 3 of the ITA provides for the imposition of tax on income that has been derived from Kenya.
19. Additionally, the 1st appellant submitted that under the above section, there are two requirements requisite for the income tax to be levied: one, there has to be income; and two, the income must have been accrued in or derived from Kenya. It argued that the Act provides for taxation of: all income from businesses, income from employment, income from the use of property, income from management or professional fees, royalties, interest and rents. Also, it submitted that it is undisputed that the 2nd appellant's Chairman, while under its employment earned benefits while under contract terms. It cited *Pickford v Quirke* (infra) which provided a definition for ascertaining whether an amount in question is liable to income tax or not.
20. The 1st appellant also argued that the act uses the phrase "all income," and it does not qualify the nature of income to be either legal or illegal which leaves a wide margin for interpretation. It submitted that illegally obtained income and legally obtained income fit within the description 'all income' under section 3 of the ITA. It cited *Republic v Kenya Revenue Authority ex-parte Yaya Towers*³ which held that income from illegal activity was Subject to taxation provided it constituted a gain from an employment or business. It argued that the court in the said case despite finding that the employee's employment contract was illegal, proceeded to hold that income accrued from the said contract was liable to taxation.
21. It cited *Mann v Nash* (1932) in which the court rejected an argument similar to the one cited in this case stating that the Revenue laws happen to say that the profits made from trades have to be taxed. He also cited *MP Finance Group CC (in liquidation) U C: SARS (2007)* in which the perpetrators

³ {2008} e KLR.



- were operating an illegal investment enterprise. The Supreme Court held that an illegal contract is not without all legal consequences, and it can have fiscal consequences finding that the amount received by the perpetrators constituted receipts within the meaning of the ITA.
22. Additionally, it submitted that the ITA does not distinguish between legally or illegally derived incomes, and, that if an amount falls within the definition of assessable income, regardless of its legal or illegal roots, it makes perfect sense to subject it to tax. The 1st appellant also cited *CIR v Delagoa Bay Cigarette Co Ltd* {1918} TPD which held that that it is irrelevant whether the income derived came from illegal activities. It submitted that an unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it.
 23. The 1st appellant cited *James v United States*⁴ in which the court refused to distinguish between embezzlement and other unlawful means of increasing one's wealth which is taxable. It was submitted that under section 5(2) of the ITA, gains and profits resulting from employment and falling under section 3(2)(a)(ii) of the same Act are chargeable to tax. By parity of reasoning, the 1st appellant submitted that the two properties purchased using bank's funds were treated as monies received in respect of employment and as such subjected to PAYE. It argued that the withdrawals from the CBK settlement account could not have been done without the knowledge and authorization of the Board of Directors given that it is not a sole signatory account. Additionally, it argued that investigations revealed that in May 2015, the 2nd appellant's Board of Directors authorized the payment of bonus to Mr IGan to the tune of Kshs 1,052,000,000/= for his many years of service, which was approved, authorized and paid out to the Chairman but it was not subjected to PAYE.
 24. Lastly, the 1st appellant submitted that Mr Khan was engaged as a consultant between January 2015 and December 2017 and he earned consultancy fees of Kshs 137,267,520/= which was not subjected to withholding tax as required under Paragraph 5, head B of the Third Schedule to the ITA, and the tax was computed at Kshs 1,181,431,680.

The 2nd appellant's advocates submissions

25. The 2nd appellant submitted that on April 7, 2016, the Central Bank of Kenya appointed the Kenya Deposit Insurance Corporation as the Receiver for Chase Bank Limited (in receivership) pursuant to the provisions of section 43(1), 43(2) and (1) of the *Kenya Deposit Insurance Act*, 2012. Further, the 2nd appellant submitted that on April 12, 2017, it sued its former Chairman, his companies and other former employees who were instrumental in perpetuating the fraud against it which led to its placement under receivership. It submitted that the said case was premised on the investigations carried out into its affairs by Deloitte Consulting and especially the transactions that were done by or in favour of its director and Chairman Mr. Mohammed Zaffrullah Khan for the period January 2014 - December 2017 which formed the basis of the tax demand for Kshs 1,181,431,680.
26. It submitted that despite the TAT finding that the bonus was illegally taken, it erred in holding that it was immaterial it was paid in terms of the resolution passed by the board of directors. It submitted that the moment the former Chairman disregarded the resolution made and opted to unlawfully process the payment, it was no longer a bonus payment as authorized by the Board of Directors but theft of funds by the former chairman.
27. He submitted that the only tax due is from the former chairman for illegally acquired income on the part of Zafzrullah Khan and not PAYE, and that it is unreasonable to reward the former chairman for

⁴ 366 US 213, 216 (1961).



theft by ignoring the illegally acquired income and to penalize the 2nd appellant to pay PAYE in addition to the loss of Kshs 1,053,475,989.

28. It argued that the TAT erred in law in holding that the terms of payment of the bonus as per the resolution was immaterial. Reference was made to *Halsbury's Laws of England*⁵ in support of the proposition that 'a company, not being a physical person, can only act either by resolution of its members in general meeting, or by its agents.' It submitted that the unlawful and irregular processing of the bonus within one and a half months was not sanctioned by the respondent's Board of Directors and was never ratified or approved. It relied on *Samuel Mchiri W'Njuguna & others v KTDA*⁶ and faulted the TAT for finding that the bonus was 'paid' as defined in section 2 of the ITA whilst the same was not paid but illegally taken. It argued that the TAT failed to consider the evidence that the bonus was not paid through the normal bank ledger, and that the bonus could not be considered as an earning or a benefit on account of employment but as an amount stolen from the 2nd appellant.
29. Further, it argued that the TAT erred in finding that tax was due upon approval of the bonus by the 2nd appellant's board of directors and that it was insignificant that the bonus was to be paid in advance. It submitted that the TAT's position is contrary to section 19(2) of the *Employment Act* which provides that 'no employer shall make a deduction from the wages payable to an employee as an advance of wages in consideration of, or as a reward for, the provision of employment for that employee, or for retaining the employee in employment.
30. It also submitted that the TAT erred in holding that the payments for the two properties for Kshs 419, 235, 338 and Kshs 253,096, 554 was not a benefit subject to PAYE as well as the expenses and withdrawals by the former chairman amounting to Kshs 1,153,642,138. The 2nd appellant also argued that the TAT correctly found that the sale agreements were signed by the former director/chairman in his own capacity, that the 2nd appellant was not a party to the agreements, and, that under the doctrine of privity of contract, the appellant could not enforce any tax obligations arising therefrom on the 2nd appellant.
31. It submitted that the TAT properly analyzed the evidence which revealed that the properties were purchased by Mr Zafrullah Khan in his personal capacity and not for the bank,{{^}}and that there was no disclosure, discussion or approval in any of its board meetings. It submitted that the property was neither declared nor consolidated into the 2nd appellant's financial reports.
32. Additionally, the 2nd appellant submitted that the purchase of the properties in Dubai was not a benefit conferred on the Chairman, but it was outright fraud and misappropriation of funds. It argued that the 2nd appellant would not be liable in law for the taxes that are due from the Chairman for the illegally acquired assets. It cited sections 3(2)(a) and 5(2) of the ITA and argued it is not liable to pay taxes for money illegally misappropriated or embezzled by its former director and Chairman. It argued that money unlawfully embezzled by its former Chairman does not constitute 'wages, salary, fees, commission, bonus gratuity or other allowance received in respect of employment or services rendered.' It cited *Securex Agencies Kenya Limited v Kenya Revenue Authority*⁷ which held that "the PAYE rules are made under section 130 of the Act, which apply to weekly wages, monthly wages, annual salaries, bonuses, commissions, director 's fees and all cash emoluments. If I find the director has received a

⁵ 4th edition.

⁶ {2015} e KLR

⁷ {2014} eKLR



benefit from his office or employment, the appellant will be liable, by dint of section 37 of the Act, to deduct PAYE from the director or employee and remit the tax to the respondent."

33. The 2nd appellant faulted the TAT's findings arguing that the Chairman did not draw any benefit or earn the sums that form the basis of the assessment from his office, but he defrauded and misappropriated the 2nd appellant's money with the assistance of some of the employees who have been sued in the civil suit for recovery of the funds. He argued that the principle of law by Lord Simon's in *Scott v Russel*⁸ still applies in this country and in particular to the circumstances of this case which is "the subject is not taxed unless the words of the taxing statute unambiguously impose the tax upon him." It also relied on *Stanbic Bank Kenya Limited v Kenya Revenue Authority*⁹ for a similar proposition.
34. The 1st appellant argued that *Securex Agencies Kenya Ltd v Kenya Revenue Authority*¹⁰ does not support the 1st appellant's erroneous assessment. It argued that the 1st appellant was obliged to consider all the transactions and make a determination whether the impugned and fraudulent payments were authorized by the 2nd appellant so as to attract tax as was held in *Republic v Commissioner of Domestic Taxes Large Tax Papers Office, ex parte Barclays Bank of Kenya Ltd*.¹¹ It submitted that no benefit, advantage or facility was granted by the 1st appellant to its former Chairman in respect of his employment or services. It submitted that there were policies and procedures in place to safeguard against fraud and cited *Hiwa Furniture Mart Ltd v Commissioner of Value Added Tax*¹² which held that the key word is "taxable person." It argued that the evidence did not establish that the 2nd appellant was undertaking a business involving taxable goods or taxable services under the VAT Act. It argued that the 1st appellant could not properly exercise its discretion under the 6th Schedule, to register the 2nd appellant or backdate the effective date of registration nor could it use returns provided under the ITA to assess the taxes payable.
35. It submitted that the TAT improperly exercised its statutory mandate in assessing tax on the embezzled funds and relied on *Rutkin v United States*¹³ for the proposition that an unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it, and as a practical matter, he derives readily realizable economic value from it. (Also cited *Burnet v Wells*, 289 US 670, 289 US 678 and *Corliss v Bowers* 281 US 378). It also cited the US Supreme Court in *James v United States*¹⁴ which held that embezzled money is taxable income of the embezzler under the tax law which defines "gross income" as "all income from whatever source derived."
36. Regarding Withholding Tax, the 2nd appellant submitted that the TAT erred in not pronouncing itself on the withholding tax dispute. It faulted the 1st appellant for assessing PAYE on the consultancy payment that the former Chairman was entitled to until December 2017 because he was not paid any retainer or consultancy fees after April 7, 2016. It also faulted the TAT for holding that the facts were not controverted because this ground was raised by the 2nd appellant and was disregarded

⁸ {1948} 2 All ER 1.

⁹ {2009} eKLR.

¹⁰ {2014} eKLR.

¹¹ {2012} eKLR.

¹² Civil Appeal No 251 of 2008.

¹³ [1952] 343 U.S. 130

¹⁴ [1961] 63



completely by the 1st appellant as well as by the TAT. It argued that the assessment of withholding tax, penalty and interest in the sum of Kshs 10, 464, 629 was erroneous and should be set aside.

Determination

37. For starters, statutory authority (legislation) is necessary before a tax can be imposed. It is the statute alone that must be consulted to establish the liability for such tax. Legality of the income, accounting or related principles are not normally of concern in determining the tax liability of any taxpayer, except in instances where the ITA specifically so provides. Apart from legislation and the rules made thereunder which forms the main source of tax law, case law also constitutes an authoritative source. A number of provisions of the acts contain terms that are not defined in these acts. Examples include “all income” which is used in the ITA. It is therefore necessary to refer to case law for guidance on the meaning of this terms. For this reason, I will regularly refer to some important case law while resolving the issues raised in this case.
38. In the case of doubt regarding a taxing statute, the contra fiscum rule must be invoked. This means that an ambiguous provision in a taxing statute must be construed against the larger imposition or the benefit of the doubt must be given to the person sought to be charged. Thus, where a section of the act is reasonably capable of two constructions, the court will place the construction on it that imposes the smaller burden on the taxpayer (thus, against the fiscus). However, if the provision in question does not cause any doubt, the rule cannot be applied.
39. That the contra fiscum rule is universally accepted may be seen from the following classic statement of the rule attributed to Lord Blckburn in *Coltness Iron Co v Black*:¹⁵
40. In terms of section 56(1) of the *Tax Procedures Act*¹⁶ (the TPA Act), the burden lies on the taxpayer to prove that a tax decision is incorrect. Thus, the burden of proof that an amount is exempt from or not liable to any tax; or is subject to any deduction, abatement or set-off; or that a valuation is correct; or that a particular tax rate applies to a transaction, event, item or class of taxpayer; or whether a decision that is subject to objection and appeal, is incorrect, rests on the taxpayer claiming such exemption, non-liability, et cetera.
41. The burden of proof is squarely upon the shoulders of the taxpayer to show that the decision is incorrect. He does this by proving on a “balance of probabilities” (as opposed to “beyond reasonable doubt”) that his argument of the facts is more correct than the Commissioner’s. It is important to note the general rule that the wording of a particular provision should be given its literal, grammatical meaning (unless there is ambiguity and a strict literal meaning would lead to absurdity. In such a case, the contra fiscum rule will apply.
42. The ITA uses the nomenclature ‘all income.’ The Act does not specify whether the nature of income should be legal or illegal which leaves room for widely interpreting illegally obtained income and legally obtained both of which fit the description ‘all income.’ Interpretation, in the context of

¹⁵ {18881} 6 App Cas 315 (HL)at 330.

“ No tax can be imposed on the subject without words in an Act of Parliament clearly shewing an intention to lay a burden on him. But when the intention is sufficiently shewn, it is, I think vain to speculate on what would be the fairest and most equitable mode of levying that tax. The object of those framing a Taxing Act is to grant to Her Majesty a revenue; no doubt they would prefer, if it were possible, to raise that revenue equally from all, and, as that cannot be done, to raise it from those on whom the tax falls with as little trouble and cannot be done, to as equally as can be contrived; and when any enactment for the purpose can bear two interpretations, it is reasonable to put that construction on them which will produce these effects.”

¹⁶ Act No 29 of 2015.



fiscal legislation, is the cornerstone on which the revenue authorities can assess and collect taxes and correspondingly, the foundation on which a tax payer's rights are built. The established legal position of interpreting tax statutes was restated by the Court of Appeal in *Mount Kenya Bottlers Ltd & 3 others v Attorney General & 3 others*¹⁷ which held that a strict constructionist approach should be applied to the interpretation of tax statute.

43. The courts have remained of the view that imposition of tax is burden on the assessee so it should be interpreted strictly and no such construction should be made on the basis of presumptions and assumptions as to the intention of the legislature. No addition or subtraction should be allowed in case of charging provisions in furtherance of fulfilling the purpose of the Act or to meet intention of the legislature. Tax laws should be interpreted in manner so as to maintain a balance between interest of both revenue collector and the assessee. The principle of strict interpretation of taxing statutes was best enunciated by Rowlatt J in his classic statement in *Cape Brandy Syndicate v IRC*:-¹⁸

“In a taxing statute one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can look fairly at the language used.”

44. The basic legal framework calls for taxation according to the rule of law. The fundamentals of this framework are that (a) a tax can be levied only if a statute lawfully enacted so provides, (b) a tax must be applied impartially, and (c) revenue raised by a tax can be used only for lawful public purposes. The rule of law contemplates that these principles will be enforced by independent courts.
45. Lord McNaghten defined income tax as a tax on income irrespective of other considerations, notably, legality. Whether one has fixed property or lives by his wits he contributes to the tax if his income is above the prescribed limit.¹⁹ Under section 3(1) of the ITA, there are two requirements requisite for the income tax to be levied: First, there has to be income. Second, the said income must have been accrued in or derived from Kenya. Additionally, the question as to what constitutes income can further be viewed from two perspectives: (a) the legality and illegality of the amount in question or (b) the source of taxable income. Whereas the former is not an easy question to answer, regarding the latter, the ITA provides for taxation of: all income from businesses,²⁰ income from employment,²¹ income from the use of property,²² income from management or professional fees, royalties, interest and rents.²³
46. As to the applicable criteria, it is useful to refer to *Pickford v Quirke*²⁴ which held that the repeated nature of transactions is key in ascertaining whether the amount in question is liable to income tax or not. For example, income derived from a sporadic loot would not qualify as income under the Act,

¹⁷ {2019} e KLR

¹⁸ 1 KB 64, 71.

¹⁹ *London County Council & Others v The Attorney General* (1901), The United Kingdom Court of Appeal as adopted by the court in *Pili Management Consultants Ltd v Commissioner of Income Tax, Kenya Revenue Authority* (2010) e KLR.

²⁰ Section 4, *Income Tax Act*.

²¹ Section 5, *Income Tax Act*.

²² Section 6, *Income Tax Act*.

²³ Section 10, *Income Tax Act*.

²⁴ *Pickford v Quirke* (1927), The United Kingdom Court of Appeal.



but income derived from embezzlement by a career embezzler, save for the question of illegality would qualify as income from a business.²⁵

47. In *Republic v Kenya Revenue Authority ex parte Yaya Towers Limited*, the Kenya Revenue Authority sought to have an employee of the applicant remit his income tax, the court found the employee's employment contract to be illegal. The High Court further held that the Kenya Revenue Authority cannot use an illegal relationship to assess tax as that would be contrary to public policy.²⁶ In arriving at this conclusion, the court was guided by several judicial decisions, among them Lord Mansfield's proposition in *Holman v Johnson*²⁷ that no court will lend its aid to a man who founds his cause of action upon an immoral or illegal act.²⁸
48. On appeal, the Court of Appeal held that whether a business is illegal or services obtained were rendered by an illegal entity, it is still subject to tax for two reasons; firstly, holding otherwise would entitle a wrong doer to benefit from illegal profits earned from unlawful business and, on top of that, be exempted from taxation. It would be an absurdity to tax the gains of an honest man while the dishonest escape taxation. Secondly, if profits of an illegal business were not taxable, honest taxpayers would be incentivized to taint their businesses with an illegality for purposes of securing exemption from taxation.²⁹
49. In *Mann v Nash*,³⁰ an argument on the immorality of the taxation of tax profits was raised, but Rowlatt J rejected it asserting that: -

“The Revenue representing the State, is merely looking at an accomplished fact. It is not condoning it; it has not taken part in it; it merely finds profits made from what appears to be a trade, and the Revenue laws happen to say that the profits made from trades have to be taxed, and they say: ‘give us the tax’. It is not to the purpose in my judgment to say, ‘but the same State that you represent has said they are unlawful.’ That is immaterial altogether... It is said again: ‘Is the State coming forward to take a share of unlawful gains?’ It is mere rhetoric. The State is doing nothing of the kind; they are taxing the individual with reference to certain facts. They are not partners; they are not principals in the illegality, or sharers in the illegality; they are merely taxing a man in respect of those resources. I think it is only rhetoric to say that they are sharing in his profits, and a piece of rhetoric which is perfectly useless for the solution of the question which I have to decide.”

50. In *Commissioner of Inland Revenue v Aken*³¹ the issue was whether income from prostitution was taxable. Notwithstanding questions on morality of the trade, the court held that the profits from

²⁵ Section 2 & 4, *Income Tax Act* (Chapter 470); *Rutkin v United States* (1952), The Supreme Court of the United States; *James v United States* (1961), The Supreme Court of the United States.

²⁶ *Republic v Kenya Revenue Authority ex parte Yaya Towers limited* (2008) eKLR.

²⁷ *Holman v Johnson* (1775).

²⁸ *Holman v Johnson* (1775).

²⁹ *Kenya Revenue Authority v Yaya Towers Limited* (2016) eKLR.

³⁰ *Mann v Nash* (1932).

³¹ *Mann v Nash* (1932).



prostitution were taxable and that the word ‘trade’ in itself has no connotation of lawfulness.³² In *Southern (HM Inspector of Taxes) v AB27*, the court held that irrespective of the illegality of the businesses in question, they nevertheless fit the meaning of trade as posited by the Act and that the profits therefrom were properly assessable to income tax.³³

51. Gupta aptly argues that taxation, in theory, knows no morality³⁴ neither is it, in theory, an issue of fairness, but of statutory application and that is the same for the taxpayer earning income from criminal activities, which constitute business, as it is of the ordinary legitimate taxpayer.³⁵ The state does not tolerate lawbreaking, nor is it a silent partner to crime by taxing proceeds of illicit trade.³⁶ However, as explicated by Rowlatt J, the state is simply looking for an accomplished fact, which arises from application of express provisions of the law.³⁷ Taxing legal income while exempting illegal income is tantamount to incentivizing an illegality, which would in turn be contrary to public policy and not vice versa. Refraining from taxing ill-gotten gains would amount to exempting persons from one law simply because they have violated another.³⁸
52. In *Sullivan v United States*, the court ruled that there is no justice in taxing persons in legitimate enterprises while allowing those who thrive by violation of the law to escape.³⁹ In *Rutkin v United States*⁴⁰ in which the defendant was involved in extortion of funds, it was held that both lawful and unlawful gain constituted taxable income provided its recipient (the criminal) has control over the gain and derives realizable economic value from it.⁴¹ In *James v United States*,⁴² in which the petitioner embezzled large sums of money during the years 1951 through 1954 and, failed to report those amounts as gross income in his income tax returns for those years, the Supreme Court held that the embezzler was required to include his ill-gotten income.
53. In South Africa, a similar position was adopted in *CIR v Delagoa Bay Cigarette Co*⁴³ in which an issue of taxability of proceeds of an illegality was raised. The court held that the legality or illegality of the

³² *Commissioner of Inland Revenue v Aken* (1988).

³³ *Southern (HM Inspector of Taxes) v AB* (1933).

³⁴ In *Commissioner v Wilcox* (1946), The Supreme Court of the United States, the court posited as follows; ‘Moral turpitude is not a touchstone of taxability. The question, rather, is whether the taxpayer in fact received a statutory gain, profit or benefit. That the taxpayer’s motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of 22 (a)’.

³⁵ Gupta R, ‘Taxation of illegal activities in New Zealand and Australia’ 3 (2) *Journal of the Australasian Tax Teachers Association* 2, 2008 106.

³⁶ *Mann v Nash* (1932).

³⁷ *Ibid.*

³⁸ Lusty D, ‘Taxing the untouchables who profit from organized crime’ 10 *Journal of Financial Crime* 3, 2003, 2.

³⁹ *Sullivan v United States* (1927), The Supreme Court of the United States.

⁴⁰ *Rutkin v United States* (1952), The Supreme Court of the United States.

⁴¹ *Ibid.*

⁴² *James v United States* (1961), The Supreme Court of the United States.

⁴³ *CIR v Delagoa Bay Cigarette Co* (1918), The Supreme Court of South Africa.



source of income was immaterial. The court was guided by *Partridge v Mallandaine*⁴⁴ where profits of a betting business were held to be taxable as income tax. In *MP Finance Group CC (in liquidation) v C: SARS*,⁴⁵ the perpetrators were operating an illegal investment enterprise. It was held that an illegal contract is not without all legal consequences, and it can have fiscal consequences. It held that the amount received by the perpetrators constituted receipts within the meaning of the *Income Tax Act* of South Africa.

54. Section 19(1)(f) of the *Employment Act*⁴⁶ provides that the Notwithstanding section 17(1), an employer may deduct from the wages of his employee— any amount the deduction of which is authorized by any written law for the time being in force, collective agreement, wage determination, court order or arbitration award. Sub-section (4) provides that an employer who deducts an amount from an employee’s remuneration in accordance with subsection (1)(a),(f),(g) and (h) shall pay the amount so deducted in accordance with the time period and other requirements specified in the law, agreement court order or arbitration as the case may be. To underscore the seriousness of the above provision, Parliament at sub-section (5) provided that an employer who fails to comply with the provisions of subsection (4) commits an offence and shall on conviction be liable to a fine not exceeding one hundred thousand shillings or to imprisonment for a term not exceeding two years, or to both.
55. There is no contest that it is the employer’s statutory duty to deduct income tax from the pay of his/its employees whether or not he has been specifically told to do so by the Revenue authority. The relevant legislation is contained in section 37 of the ITA and the rules made under section 130; and sections 38 and 83 of the *Tax Procedures Act*. If any employer fails to comply with the provisions of section 37 and with the provisions of any rules made under section 130 which deal with the payment of tax deducted and accounting for it to the Commissioner, the Commissioner may by order impose a penalty equal to twenty five percent of the amount of tax involved or ten thousand shillings whichever is greater, and the provisions of the Act relating to the collection and recovery of the tax shall apply to the collection and recovery of any tax payable and such penalty as if it were tax due by the employer.
56. For “Pay As You Earn” purposes the term “employer” is to be taken, when necessary, to include: (i). Any person having control of payment of remuneration; (ii). Any agent, manager or other representative in Kenya of any employer who is outside Kenya; (iii). Any paying officer of Government or other public authority; (iv). Any trust or insurance company or other body or person paying pensions.
57. The word employee is defined as inclusive of any holder of an appointment of office, whether public, private or calling, for which remuneration is payable. A “paying point” is the place at which remuneration is paid. Where an employee enjoys a benefit, advantage or facility of whatsoever nature in connection with employment or services rendered; the value of such benefit should be included in employee’s earnings and charged to tax.
58. In determining whether an amount of money is income, it is immaterial whether that money was obtained from an activity which is illegal, immoral or ultra vires.⁴⁷ It is against this background that

⁴⁴ *Partridge v Mallandaine* (1886), The United Kingdom Queen’s Bench Division of the High court.

⁴⁵ *MP Finance Group CC (in liquidation) v C: SARS* (2007), The Supreme Court of Appeal of South Africa.

⁴⁶ ACT No 11 of 2007.

⁴⁷ RC Williams *Income tax in South Africa: Cases and Material* (1995) 181.



Williams opines that if the taxpayer's activities constitute 'trading'⁴⁸ any income from that trade is assessable for income tax, notwithstanding those the taxpayer's activities were illegal or not.⁴⁹ If the activity is a trade, it is irrelevant for taxation purposes that it is illegal. The word "trade" in itself has no connotation of unlawfulness.⁵⁰ There may be lawful trade; there may be unlawful trade. But it is still trade.⁵¹ It is correct to state that 'legality is not an essential characteristic of a trade.'⁵² Also, 'the gross income definition does not provide that a receipt must have been derived in the course of a legal pursuit in order to be included in a taxpayer's gross income. In ITC 1199,⁵³ it was held that the tax collector has cast his net wide enough to catch all income so that once a receipt is held to constitute income it is taxable in terms of the Act, irrespective of whether it is income derived from illegal activities or not. In other words, the revenue collector taxes 'incomes, from whatever source derived.'⁵⁴ It is my position that 'income received is subject to tax notwithstanding the fact that it is tainted with illegality or is received from illegal activities.'⁵⁵

59. The court in *CIR v Delagoa Bay Cigarette Co*⁵⁶ provided clarity on the taxability of income derived from illegal activities. Relying on the precedent of English case law, the court found that the legality or illegality of a business was irrelevant to the issue of whether income is subject to taxation. It is thus this court's position that the general contention is that illegal business ventures and agreements are not robbed from all legal result just because they may be regarded as void. By parity of reasoning, it is my finding that the argument that the Board of Directors did not authorize the payments does not and cannot absorb the 2nd appellant from complying with the tax laws.
60. Under the ITA, particularly to section 37 of the Act, it is the responsibility of the employer to deduct and remit taxes from the salaries, emoluments and allowances of its employees. The 2nd appellant had the statutory Responsibility to deduct the taxes and remit the same to the tax authority. In view of my analysis of the law and authorities discussed above, I find no merit in both appeals. Both appellants have not demonstrated that the TAT erred in its findings. I find no reason to interfere with the TAT's decision. Accordingly, I dismiss the consolidated appeals, namely, HCC ITA No E080 of 2020 and ITA No E073 of 2020. Each appellant will bear its own costs.

Orders accordingly

SIGNED, DATED AND DELIVERED VIA E-MAIL AT NAIROBI THIS 3RD DAY OF SEPTEMBER 2021

⁴⁸ See *CIR v Pick 'n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A)*, 54 SATC 271 at 280, where the court observed that whether or not a taxpayer was trading 'must be determined by applying ordinary common sense and business standards'

⁴⁹ RC Williams *Income tax in South Africa: Law and Practice* 4th ed (2006) 121. In the United Kingdom illegal proceeds will be taxed as long as they *arise or accrue from a trade, whether legal or illegal*.

⁵⁰ See *Commissioners of Inland Revenue v Aken* 63 TC 395, [1990] STC 497.

⁵¹ *Ibid*.

⁵² *Griffiths (Inspector of Taxes v J P Harrison (Watford) Ltd* [1963] AC 1 at 20.

⁵³ ITC 1199 (1973) 36 SATC 16 (T) at 19.

⁵⁴ H Hubbard 'From whatever source derived' (1920) 6(7) American Bar Association Journal 202.

⁵⁵ *CIR v Delagoa Bay Cigarette Co Ltd* 1918 TPD 391 at 394.

⁵⁶ *CIR v Delagoa Bay Cigarette Co Ltd* 1918 TPD 391 at 394.



JOHN M. MATIVO
JUDGE

