REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT MOMBASA

INCOME TAX APPEAL NO. 58 OF 1999

JAMES KAMAU GITOTHU NJENDU.....APPEALLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

R U L I N G

1. In its meeting held on the 12/5/1999 at Lotus Hotel, Mombasa, the local committee determined several cases including Case No. 03/1999 regarding file No. 5/75131, Assessment No. 00519300015/4 of 1993.

2. The matter was an appeal by the current appellant by which he sought to challenge the decision of the commissioner by which his tax obligations was re-assessed and imposed in the sum of Kshs.385,546/=

3. After submissions the committee delivered its determination dismissing the appeal on the following words:-

> **"The Committee noted that it was difficult to draw a line when the money ceases to be a fund but felt that it stopped at the first line which in this case was KWS. Any withdrawals, disbursements etc. to other people contracted to KWS was income and taxable.**
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> **Mr. Njendu told the Committee that the fund was exempted from VAT on procurements. He felt that if the contractor was exempted then by extension, it should exempt the other people.**
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> **The Chairman told Njendu that if the contractor was exempted from VAT that exemption was transferred to KWS. He regretted that Mr. Njendu had been put in a difficult position and disadvantaged tax wise. However, going by the law, their hands were tied. They could not vary tax laws. The tax had to be paid. He observed that Mr. Njendu had a valied contract which was enforceable, noting that he had suffered damages as a result of being misled on the incidence of tax and could claim those damages from KWS.**
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> **The Committee noted that although they had sympathy for Mr. Njendu the law was clear. The income he earned was taxable and the tax so levied was payable. They unanimously confirmed the assessment**
>
> **COMMITTEE RULED**
>
> **Assessment confirmed**
>
> **Total income 56,093".**

4. That decision provoked the present appeal in which the appellant faults the decision of the committee for being capricious and unjudicial, highly unjust and prejudicial, that the committee misapprehended the law and case and thus arrived at a wrong decision and finally that the tax demanded was not only erroneous but excessive. The basis of the appeal was that the contract was for consultancy for works awarded by KWS which was accepted by a gazette notice nol. 352 of 19/11/1993 hence the income earned by the applicant was tax exempted.

5. In response to the statement of facts by the appellant, the Respondent filed own statement of facts dated 18/7/2009 and opposed the appeal on broad terms to the effect that; that in submitting own Tax Assessment, the Appellant omitted income earned from a consultancy contract with Kenya Wildlife Services for which reason the Respondent issued an additional assessment to reflect the amount omitted to be declared. To the respondent, the Appellant misunderstood or misapprehended the legal notice No. 352 of 19/11/1993 which did not grant to him any exemption but only did so to Kenya Wildlife Service. That the exemption was limited to apply and benefit KWS only and did not extend to disbursements made by KWS to its contractors and that any representation by KWS to its contractors did not absolve such contractor from its statutory tax obligations. The Respondent therefore supported the decision of the local committed as being lawful, judicious and bereft of

caprice.

6. At some stage the court file went missing and the same was then to be reconstructed. Upon reconstruction it was by consent directed that the Appeal be canvassed by way of written submissions. Pursuant to such directions, the Appellant filed written submissions dated 5/11/2018 while the Respondents filed two sets dated 16/8/2018 and 14/11/2018.

7. In his submissions as highlighted by counsel the Appellant relied heavily on the contracts between him and KWS as being grounded on another contract between government of Kenya on behalf of KWS and International Development Association and a legal notice No. 352 of 19/11/1993. In so far as the two agreements were affirmative that no tax would be payable, the Appellant took the very strong view and position that it was not open to the Respondent, being not privity to such contract, to seek to benefit from its terms. For that position, the appellant cited to court the decisions in **Agricultural Finance Corporation vs Lengetia Limited [1985] eKLR** as well as **National Rule of Kenya vs Pipedcast Sacco (K) Ltd [2002] 2 EA 502** for the principle of privity of contract that only parties to a contract can sue on its or be bound by its terms so as to derive benefits and be burdened with obligation under it.

8. It was added that the principle is so established and sacrosanct that even a court of law cannot seek to re-write a contract negotiated and concluded between two parties. It was therefore concluded and urged that the court enforces the intentions of the parties in the consultancy agreement to the effect that the consultancy fees be exempt from taxation.

9. For the Respondent position was taken that the tax exemption only applied to the agreement between the KWS and IDA as clearly disclosed at **Recital D iii** of the consultancy contract. It was then submitted that the consultancy fees is indeed an income from service rendered and thus legally taxable under **Section 3 (2)(a)ii of Income Tax Act Cap 470.**

10. The third ground of opposition advanced by the Respondent was that the discretion to collect tax and even exempt the same did not reside within the province of authority of the KWS but solely on the Respondent a fact the Appellant was all along aware about and nothing would have stopped the appellant from making inquiries beforehand and before executing the agreement with KWS. For that reason, the Respondent submitted that the contract between appellant and the KWS was clearly in breach of Section 3 of the Income Tax Act as it sought to limit collective of tax on income derived and accrued in Kenya. Reliance was then placed on the provision of Section 3(1) and 44 of the Income Tax Act to place an obligation on every earner of every income accrued in or derived from Kenya to pay tax.

11. On whether there had been a legitimate expectation upon the Appellant that no tax would be chargeable on the consultancy fees, the counsel for the Respondent cited to court the decisions in **Republic vs Commissioner of Domestic Taxes *exparte* Kenton college trust [2013]eKLR** as well as the Court of Appeal decision in **Kalpana Rawal J vs Judicial Service Commission an others [2016]eKLR** and several other decisions for the proposition of the law that a legitimate expectation arises where the decision maker has by representation or past practice aroused an expectation that is within its power to fulfil and that there is no legitimate expectation where the representation is ultra vires the decisions makers powers.

12. On the propriety or legality of the assessment, the Respondent made submissions that the assessment was duly and legally undertaken and the correspondence between the parties was cited to show the extent and depths of engagement the Respondent went into before the final assessment. It was stressed that the Appellant was accorded the chance to avail materials and documents both at the level of objection and appeal to the local committee and the resulting outcome was legal, procedural and lawful and that the onus to prove that the assessment was arbitrary or incorrect was that of the appellant on onus he failed to discharge.

13. A decision by the U.S.A Supreme Court in **Wickwire vs Reinecke, 275 US 101**, was then cited for the proposition of law that the burden of proof in Civil Tax cases rested with the tax payer and not the Revenue Authority. With those submissions the Respondent prayed that the appeal be dismissed. In the further submissions, the Respondent made a case to the effect that the Respondent is an employee of the Kenya Revenue Authority itself, an agency of the Government of Kenya mandated by statute, Section 5(2) of Cap 469 to administer and enforce all the tax status, Income Tax Act included, and that the Respondent did nothing more than discharge its mandate in re-assessing the tax due from the Appellant. The submissions then delved into the interpretation of the purport and tenure of the legal notice No. 352 and application of Section 13 of the Income Tax Act granting to the Minister powers to grant exemption to a tax payer over taxable income provided the same is approved by parliament with a wrap-up that clause 1.9 of the agreement between the Appellant and KWS was unlawful and contrary to Section 3(1) of the Act.

14. Those submissions were then briefly highlighted orally by counsel for both parties. With the Appellant laying emphasis on the authorities cited, the legal notice and the letter dated 17/11/1994 in the hands of Permanent Secretary Treasury which sought to interpret the legal notice No. 352 of 19/11/1993 and maintained that both the agreement and the legal notice did afford to the Appellant Tax exemption.

15. For the Respondent full reliance was placed on the statement of facts as well as the two sets of submissions with a stress that the gazette notice was only applicable to the contract between Government of Kenya and International Development Association and did not extend to the Appellant. Counsel than added that for there to have been a tax exemption in favour of the Appellant, Section 13 of the Act ought to have been complied with which was never done. It was then emphasized that the subject income was taxable under Section 3(1) of the Act. It was then added that KWS had no authority to promise tax waiver of exemption and therefore there was clearly no basis to allege legitimate expectation which in any event would be contrary to the law. Lastly it was submitted that the contract between the Appellant and KWS was intended to be endorsed by the Treasury as evidence of concurrence with tax exemption clause but was never so endorsed hence there was never concurrence by the Treasury.

16. In his rejoinder counsel for the Appellant faulted the interpretation of the legal notice as proposed by the Respondent and urged that the court adopts an interpretation that meets the purpose and intendment of the exemption.

Analysis and determination

17. I have had the benefit of reading and appreciating the statements of facts filed and the documents exhibited there with together with the

submissions offered by both sides. Having done so, I have formed the opinion that the following issues call for determination by the court:-

i. Whether or not the income earned by the Appellant out of the consultancy agreement was taxable under the Kenyan law.

ii. Whether the **Legal Notice no. 352 of 19/11/1993** afforded to the Appellant tax exemption.

iii. Whether the local committee in deciding the appeal as it did committed any error as to warrant interference by this court as an appellate court.

iv. What orders need be made as to costs.

18. While the issues may be the three substantive and others ancillary Ones, the fulcrum upon which the entire decision must rotate is the interpretation the court gives to the Legal Notice No. 352 -whether it afforded to the Appellant Tax excemption or not. In deciding the framed issues the question of interpretation as to the meaning, purport and tenure of the legal notice No. 352 will thus be central.

19. That legal notice was worded as follows:-

"*Legal Notice No. 352*

THE INCOME TAX ACT

(Cap. 470)

EXEMPTION

IN EXERCISE of the powers conferred by section 13(2) of the Income Tax Act, the Minister for Finance directs that the credit or any income arising out of the Development Credit Agreement dated 30th March 1993, in various currencies equivalent to forty-four million eight hundred thousand Special Drawing Rights (SDR44,800,000) between the Republic of Kenya and the International Development Association, for use under the Protected Areas and Wildlife Services (PAWS) Project, shall be exempt from the provisions of the Act.

Dated the 11th November, 1993.

MUSALIA MUDAVADI

Minister for Finance".

20. I have reproduced the words of the legal notice here to help understand its purpose as it relates to the issues I have isolated for determination. I propose to deal with all the issues together because I consider all to be closely related and intertwined

Was the appellants income taxable?

21. Pursuant to Section 3 of the Income Tax Act, all income of every person, whether resident or non-resident in Kenya provided the income accrued or was derived from Kenya, is taxable. That obligation can only be waived in accordance with that statute. For the purposes of this appeal, the provision of the law that has been invoked to have afforded exception to the Applicant is Section 13. That provision of the law provides:-

"**Certain income exempt from tax, etc.**

(1) Notwithstanding anything in Part II, the income specified in Part I of the First Schedule which accrued in or was derived from Kenya shall be exempt from tax to the extent so specified.

(2) The Minister may, by notice in the Gazette, provide—

(a) that any income or class of income which accrued in or was derived from Kenya shall be exempt from tax to the extent specified in such notice;

(b) that any exemption under subsection (1) of this section shall cease to have effect either generally or to the extent specified in the notice.

A notice under subsection (2) of this section shall be laid before the National Assembly without unreasonable delay, and if a resolution is passed by the Assembly within twenty days on which it next sits after the notice is so laid that the notice be annulled, it shall thenceforth be

void, but without prejudice to the validity of anything previously done thereunder, or to the issuing of a new notice.

22. From the plain words of that provision and its headnote, it is in no doubt that the income intended to be exempted from tax must be those specific ones defined, enumerated and explained under the provision as well as under part I of the first schedule. I do think that the limitation is for good cause and must have informed the need to have the provision of universal taxation at Article 210 (3) of the constitution, 2010. A reading of the statute and its subsidiary legislation in the schedule reveal that consultancy fees paid to the Appellant did not become exempt from tax merely because it was paid out of the loan granted to the Government of the Republic of Kenya by the International Development Association. Such income was not isolated to be subject to the exemption. There was also no evidence that that type of income had been sanctioned by parliament for exemption as mandated under the Act. I do find that not being identified as exempt income there was no legal or reasonable basis for the Appellant to take the position he took.

23. In any event by law only the minister was vested with authority to grant the tax exemption. The grant given by the legal notice was in favour of the receipts from the International Development Association and not more.

24. I do find that by dint of Section 3(2) (a)ii the consultancy fees earned by the Appellant was taxable income which was never exempted by the competent authority under the law. The Kenya Wildlife Services is not vested with power to grant tax exemption. But, even then, the agreement between the Appellant and Kenya Wildlife services which is said to have granted the tax exemption leaves no doubt as to who the exemption was to benefit. At recital D(iii) the document

> **(D) "The Client has applied for a credit from the International Development Association (hereinafter called "the Association") towards the cost of the project and the services and intends to apply a portion of the proceeds of this credit to eligible payments under this contract, it being understood:-**
>
> > **i. That, payments by the Association will be made only at the request of the Client and upon approval by the Association.**
> >
> > **ii. That such payments will be subject in all respects to the terms and conditions of the agreement providing for the credit and,**
> >
> > **iii. That no party other than the Client shall derive any rights from the agreement providing for the credit or have any claim to the credit proceeds."**

25. I interpret this clause to have made it clear to the consultant that his agreement with KWS was to vest upon the consultant no benefits at all. In so far as the tax exemption was a term of the credit agreement none of its benefits was ever agreed to flow to the consultant. In addition, the principle of privity of contract is only parties to a contract can derive benefits therefore or be burden with its obligations [1]. **In Agricultural finance corporation Vs Lengetia Limited [1985]KLR** cited by the appellant, the Court of Appeal reinstated the principle of privity of contract and its ramifications in the following words:-

> **"as a general rule, a contract affects only parties to it, and cannot be enforced by or against a person who is not a party, even if the contract is made for his benefit and purports to give him a right to sue or to make him liable upon it. The fact that a person who is a stranger to the consideration of a contract stands in such near relationship to the party from whom consideration proceeds that he may be considered a party to the consideration does not entitle him to sue upon the contract"**

26. The Appellant having not been a party to the credit agreement was a stranger to its terms and tenure and thus could not validly and legally seek to benefit from any of the terms of that agreement.

27. The foregoing reasoning and determinations leave only clause 1.9 of the Consultancy Agreement as the only pedestal upon which the tax exemption could be pegged. I have said before in this decision that the authority to grant tax exemption was by Income Tax Act vested upon the minister and nobody else. The KWS had no authority to purport to grant to the Appellant any tax exception under the agreement and in all events. To that extent any representation in the contract and elsewhere was made outside the law and without authority and the appellant could not invite such as a basis of what he calls legitimate expectations. A legitimate expectation can only be grounded upon a valid and legally made decision. It cannot be grounded upon a decision arrived at by usurpation of a power not granted to the decision maker by the law. To the extent that clause 1.9 of the consultancy agreement purported to grant tax exemption contrary to the law, that part of the agreement must be seen for what it is, an illegality this court cannot offer succor to. An agreement contrary to statute is not only against public policy but unenforceable for being void *ab initio.*

28. If that clause was contra statute then it follows that it cannot be the basis of a legal claim to be enforced by the court. Even though the committee did not base its decision on this ground, the same was robustly and elaborately urged before me by both parties as to invite my determination on it. I do find that being grounded on an illegal and void term of an agreement the appeal cannot succeed but must fail.

29. I therefore find no fault with the decision of the local committee in its determination of the appeal to warrant an interference by this court as an appellate court and consequently dismiss the appeal and award the costs thereto to the Respondent.

30. It is so ordered.

Dated and delivered at Mombasa this 8th day of March 2019.

P.J.O. OTIENO

JUDGE