REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL & TAX DIVISION

INCOME TAX APPEAL NO. 22 OF 2017

BETWEEN

UAP LIFE ASSURANCE COMPANY LIMITED ....APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES ....RESPONDENT

(Being an Appeal from the Judgment of the Tax Appeals Tribunal delivered at Nairobi on the 22nd day of February 2017 in TAT No. 44 of 2016)

BETWEEN

UAP LIFE ASSURANCE COMPANY LIMITED ....APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES ....RESPONDENT

JUDGMENT

1. This judgment relates to an Appeal by the Appellant against the decision of the Tax Appeal Tribunal (herein “the Tribunal)” in Tax Appeal Tribunal No. 44 of 2016) dated 22nd February 2017. The Appellant is seeking for orders that;

> ***a) The appeal be allowed and the judgment of the Tribunal be set aside and be substituted therefore with an order allowing the appeal with costs to the Appellant;***
>
> ***b) The costs of the appeal be awarded to the Appellant;***
>
> ***c) Any other alternative relief the Honourable court may deem fit to grant.***

2. The background facts of the matter are that, by a letter dated 10th February 2015, the Respondent informed the Appellant, that it had assessed the Pay As You Earn (herein “PAYE”), tax payable by the Appellant, at Kshs. 20,226,055, inclusive of penalties and interest for a period covering January 2011 to December 2014.

3. The Appellant contested the assessment on the ground that the Respondent had based its decision on the fact that, the agents they engaged were employees and therefore liable to remit PAYE tax. The Appellant avers that, it offers all classes of long term covers such as; life assurance, retirements and savings plant, as such it engages several fixed insurance agents in the ordinary course of its business.

4. The Appellant appeal against the assessment but the appeal was not successful. The Appellant then lodged an appeal before the Tax Appeals Tribunal (herein “the Tribunal”) on 28th April 2016, on the grounds that,

> ***a) That the Respondent erred in law and fact by imposing PAYE on emoluments paid to insurance agents contracted by the Appellant;***
>
> ***b) That the Respondent erred in law and fact by assessing PAYE on the insurance agents of the Appellant as a result of failing to***

give due regard to the nature of the contractual and practical relationship between the said agents and the Appellant;

c) That the Respondent erred in law and fact by failing to consider the remuneration structure of the insurance agents when making its PAYE assessment;

d) That the Respondent erred in law and fact by treating employees and independent contractors in the same manner for tax purposes;

e) That the Respondent erred in law and fact by assessing the Appellant without given regard to the statutory requirements regarding the manner of engagement of insurance agents.

5. Upon the Respondent filing the statement of facts dated 25th May 2016 and the respective parties filing their submissions, the Tribunal rendered its judgment on 22nd February 2017 and upheld the decision by the Respondent. Being aggrieved by the decision of the Tribunal, the Appellant appeals against that decision on the following grounds:

a) The Tax Appeals Tribunal erred in law in failing to apply the provisions of the Insurance Act, being the relevant law governing the business of Insurance as carried out by the Appellant. Specifically, the Tribunal did not consider the provisions of Section 2 of the Insurance Act which provides that:

> ***"Agent means a person not being a salaried employee of an insurer who, in consideration of a commission, solicits or procures insurance business for an insurer or broker"***

b) The Tribunal erred in law in failing to take into account the provisions of; Section 2 of the Employment Act which defines an employee as'

> ***"A person employed for wages or a salary and includes an apprentice and an indentured learner"***

c) The Tribunal erred in finding that the description of an employee under the Employment Act and the definition of an agent under the Insurance Act were irrelevant and immaterial as to what constitutes a contract of service or a contract for service for purposes of the Income Tax Act. Tribunal did not consider all legislation governing and regulating the Appellant's business operations, all of which it must comply with;

d) The Tribunal erred in law in holding that the Appellant's Tied Insurance Agents were in fact its employees and therefore subject to PAYE. In so doing, the Tribunal failed to take into account that Tied Insurance Agents by their very nature are contracted to perform specific services and not to act as employees;

e) The Tribunal erred in law in only considering two of the four tests set out in the case of; Geoffrey Makan Asanyo vs Nakuru Water and Sanitation Services Company & 6 others (2014) eKLR for determining the existence of an employee/employer relationship. The Tribunal considered the control and the integration tests while specifically failing to consider and apply the economic/business reality and the mutuality of obligation tests, both of which are relevant to the Appellant's circumstances;

f) The Tribunal erred in law in only considering certain clauses of the contracts between the Appellant and its Tied Insurance Agents in isolation whilst failing to consider the entire contracting arrangement and the manner in which it was implemented;

g) The Tribunal erred in law in disregarding the Appellant's freedom of contract. The contracts between the Appellant and its Tied Insurance Agent are expressly stated as creating an Independent Contractor relationship. The Tribunal has disregarded the express contractual terms and the intention behind them by deeming the contracts as creating an employee/employer relationship.

6. However, the Respondent opposed the appeal and argued that, insurance agents known as tied agents employed by the Appellant for its insurance business, fall within the description of an employee under the Income Tax Act (herein "the Act") and the Respondent ought to have deducted the PAYE on their emoluments. The Respondent relied on the provisions of; Section (2), 3(2)(a)(ii) and 5(2)(a) of the Act.

7. Further the audit findings revealed that the contract between the Appellant and the tied agents was one where the Appellant exercised control over the agents, as envisaged under contract of service under Act, consequently Rules and Sections2,3,5 and 37 of the Act, which allows the Respondent to levy PAYE, on gains from contracts of service applies.

8. Finally, it was averred that both the Respondent and the Tribunal, reviewed documents provided by the Appellant including the sample copies of sale manager, unit manager, and financial advisors engagement, loans and mortgage contracts and concluded that, the tied agents were employees.

9. The parties disposed of the appeal by filing submissions and concurred that, the main issue for determination herein is whether or not the tied insurance agents were employees of the Appellant, and if so, whether they were liable to PAYE tax. In that regard, the Appellant submitted that, the relationship between it and the tied agents, is in the nature of a principal and agent. It is a contract for service. It is not an employer and employee relationship, which requires that parties must enter into a contract of service.

10. That the tied agents are independent contractors as they are remunerated in the form of commission and discretionary monthly subsidies. The Appellant relied on the cases of; ***Duncan Nderitu Ndegwa vs Kenya Pipeline Company Ltd & Anot. (2013) eKLR***, and ***John Kawa***

Ilume vs Gemina Insurance Co. Ltd (2014) eKLR.

11. Further, the principle of freedom of contract allows the parties to decide on the terms and obligations that will guide their relationship. The case of; ***Photo Producction Ltd vs Securicor Transport Ltd (1980) 1 ALL ER 556*** was relied on.

12. It was submitted that, the decision of the Tribunal goes contrary to the established in the insurance industry practice in particular, the life assurance business, where an agent in life insurance business is a non-employee sales agent, who sells the products of an insurer; receives a commission for each policy sold and a further commission on each subsequent renewal of the policy. The Insurers operate an exclusive agency system in which independent contractors are contractually bound to sell the products of a single insurer.

13. That the court in the case of; ***Geoffrey Makana Asenyo vs Nakuru Water & Sanitation Services Company (2014) eKLR*****,** set the tests to determine an employee and an independent contractor as follows;

> ***(a) The control test; where an employee is a person who is subject to the command of the master as to the manner in which he or she shall do the work;***
>
> ***(b) The integration test; in which the employee is subjected to the rules and procedures of the employer rather than personal command;***
>
> ***(c) The test of economic or business realty; which takes into account whether the employee is in the business of his or her own account or works for another person, the employer who takes the ultimate risk of loss or chance of profit;***
>
> ***(d) Mutuality of obligation; in which the parties make commitments to maintain the employment relationship over time. Under this test, a contract of service is for essentially services in return for wages, and secondly mutual promises for future performance.***

14. Yet, the Tribunal only considered the tests of control and integration only. Further reliance was placed on the case of; ***Tracision Maina Mwangi vs Evan Mweha & Another (2014) eKLR*****.** The agents herein were not subject to the control or direction of the Appellant as evidenced by clause 11 of the contract produced between the Appellant and Alice Wanjiku, a unit manager, and that there is no provision in the contract for working hours, as per practice that working hours are expressly stipulated by the employer/employee. The contract does not also indicate the location or premises of where work is to be performed by the agent.

15. Finally the Respondent submitted that, the tax assessment is tantamount to double taxation, in that, the Appellant deducted and accounted for withholding tax on payments to the agents and the agents then paid the Respondent all taxes on the payment received. There is no evidence these payments were not made.

16. However, the Respondent submitted that the tied agents serve under a contract of service as defined under the Income Tax Act and the definition of "Employee" and "Emoluments" under the Income Tax (PAYE) Rules (herein "the Rules"). The Respondent relied on the case of; ***Everret Aviation Limited versus Kenya Revenue Authority (2013)eKLR,*** where it was held that, the court cannot rely on description of work the parties put forward in determining an employee, it needs to distinguish a contract of service from a contract for service.

17. The Respondent submitted that, the legal and factual test that applies to determine whether the relationship is that of employment or of an independent contractor, include, the nature of service. That although the Appellants tied agents exercised interpersonal skill and judgment, they did not qualify as independent contractors, as they are tied to the Appellant and do not act for other insurance companies and are engaged under titles as; agency managers, unit managers, sales managers and financial advisors.

18. The control test; revealed that the tied agents could only work for the Appellant; are restricted to fixed places of work and are transferable to any of the Appellant's branches or locations. They supervise other managers or agents reporting to them. Further, their contracts contain general clauses consistent with an employment relationship which are not found in independent contractors' contracts. The Employer can vary, change or cancel the contracts and the agents are bound by the Appellant's code of conduct

19. The disbursement test reveal that the tied agents are bound to seek approval from the Appellant before incurring disbursements that exceeds Kshs. 5,000 and have to produce receipts in proof thereof, which is akin to imprest in the employment relationship. Finally the Remuneration test revealed that, their monthly payments are pegged on performance and other commissions. They are paid retainer on a monthly basis and commission at prescribed rates on introduction of a new client and on every renewal of policy. They enjoy benefits of car loans at reduced interest rates, mortgages, option for pension schemes and medical schemes, just as the employees of the Appellant.

20. The Respondent relied on the case of; ***Walls vs Sinnet (H.M. Inspector of Taxes) (1987) STC 236*** and ***McManu vs Griffiths (H.M. Inspector of Taxes (1997) STC 1089.*** Finally on the issue of double taxation, the Respondent submitted that, it is a new ground of appeal and should be struck out. Even then, there is no evidence, the tied agents' remitted tax to the Respondent.

21. I have considered the arguments and the submissions tendered and I find that, the main issue to consider is whether the Tribunal arrived at the proper decision in holding that the tied agents herein are employees of the Appellant and therefore subject to contract of service. The Tribunal in this determination raised one issue being; whether the tied agents are employees of the Appellant or independent contractors and hence whether the Appellant is liable to apy the additional PAYE assessment.

22. In addressing the issue the Tribunal observed that "for the purpose of determining the issue in question, the description of an employee under the Employment Act and the definition of an agent under the Insurance Act are completely irrelevant and immaterial as what constitutes a contract of service or a contract for service for purposes of the Income Tax Act. The Tribunal shall be strictly guided by the

provisions of the Income Tax Act in determining the issue indentified by both parties hereto as being in issue herein."

23. The Tribunal further held that the mandate of the Respondent is provided under section 122 of the Act and does not extent to ensuring that the tax payer has complied with its governing statutes. That the Respondent in discharging its mandate is strictly, guided by the relevant statues and its mandate shall not be vitiated or fettered by any contrary statutory interpretation and/or limitation.

24. It is this finding that the Appellant heavily faults. However the Respondent concurred with the Tribunal and submitted that it is in tandem with the interpretive maxim, "lex specialis derogate generalis" which provides that, the specific law governing a matter should be applied as opposed to a general law touching on the matter. Further, these statutes are legislated for different purposes.

25. The tribunal further held that a perusal of the general engagement letters and contracts of engagements between the Appellant and the tied "constitutes flexible labour principles where the employer enjoys substantive control over the person engaged in its service but the employer does not incur statutory and tax obligation that ordinarily attaches to such a relationship." Therefore the Appellant are bound to pay the PAYE as stipulated under Section 37 of the Act, as the contracts between the two parties amount to a contract of service.

26. In considering the decision of the Tribunal I find that it suffices to note that the key words herein to understand and appreciate its meaning are inter alia; an employee, an independent contractor, a tied agent, a contract of service and a contract for service.

27. It is also important at the outset to understand the income that attracts tax. In this regard the provisions of Section 3(2)(a)(ii) of the Act provides that:-

> ***"Subject to this Act, income upon which tax is chargeable under this Act is income in respect of employment or services rendered."***

28. Further, Section 5(2)(a) of the Act provides that;-

> ***"For the purposes of Section 3(2)(a)(ii), gains or profits, includes; wages, salary, leave pay, stick 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 after other than the year of income in which it is received shall be deemed to be income in respect of that year of income."***

29. The key words in the above provisions are "employer" and "employee". Section 2 of the Employment Act defines an employee to "means a person employed for wages or a salary and includes an apprentice and indentured learner" and employer to "means any person, public body, firm, corporation or company who or which has entered into a contract of service to employ any individual and includes the agent, foreman, manager or factor of such person, public body, firm, corporation or company." while the Income Tax defines an employer and states that "employer" includes any resident person responsible for the payment of, or on account of, emoluments to an employee, and an agent, manager or other representative so responsible in Kenya on behalf of a non-resident employer"

30. It is evident that the guiding definition of an employee and employer is under the Employment Act. The Employment Act is the substantive and primary legislation on employment matters, as clearly indicated in the preamble thereto that; it is an "Act of Parliament to repeal the Employment Act, declare and define the fundamental rights of employees, to provide basic conditions of employment of employees, to regulate employment of children, and to provide for matters connected with the foregoing" It is noteworthy that the Income Act does not define an employee, but the Income Tax (PAYE) Rules defines an employee as

> ***(a) " gains or profits from employment or service rendered which are payable in money;***
>
> ***(b) the value of house provided by the employer ascertained under sections 5(3) of the Act; and***
>
> ***(c) the value of the benefit or facility by the employee, where the total value exceeds three thousand shillings per month."***

31. Be that as it were the contract of employment is a contract of service not a contract for service. In this regard, both the Employment Act and Income Tax Act defines a contract of service, Section 2 of Income Tax Act defines a "contract of service as"

> ***"an agreement, whether oral or in writing and whether expressed or implied, to employ or to serve as an employee for a period of time, and includes a contract of apprenticeship or indenture learnership, under which the employer has the power of selection and dismissal of the employee, pays his wages or salary and exercises general or specific control over the work done by him, and for the purpose of this definition an officer in the public service shall be deemed to be employed under a contract of service."***

32. The Respondent relied on these provisions to submit that, tied-up agents herein were employees of the Appellant. That a tied agent is defined by the Cambridge Dictionary as; someone who is paid by a financial organization to sell and give advice only on its investment products, not on those of its competitors. In the context of insurers, a tied up agent sources insurance business for only one insurer and the insurer exhibits elements of control of control over the work of such an agent as in the case of the Appellant. Reliance was placed on the case of; ***Mjengo Limited vs Commissioner of Domestic Tax (2016) eKLR*.**

33. However the Appellant rlied on the case of; ***Duncan Nderitu Ndegwavs Kenya Pipeline Company Limited (2013)eKLR*** defined contract for service as an agreement to undertake a specific project or work, with the person undertaking the work being left free to do the assigned work and to choose the method of accomplishing it. This person undertaking the work is an independent contractor. Further in the case of; ***John Kawa Ilume vs Gemina Insurance Co. Limited 92014)e KLR*** where it was held that the fact that the claimant was paid a

salary retainer every month did not make it a salary or wage.

34. The Respondent argued that, the Tribunal should have taken into account the definition of an agent under the Insurance Act which states an “agent” means a person, not being a salaried employee of an insurer who, in consideration of a commission, solicits or procures insurance business for an insurer or broker”

35. In my considered opinion for all intent and purpose and with due respect to the Tribunal’s decision, the provisions of the Income Tax (PAYE) Rules cannot override the statutory provisions on the definition of an employee. The distinctive feature of an employee is payment of a salary or wage. The evidence herein reveals that the tied agents were being paid subsidy per month stated to be in the form of an allowance. The agents were not salaried employees. Therefore the provisions of Employment Act were relevant.

36. In this regard the arguments by the Respondent that the Income Tax Act, can assign an artificial definition to a term as opposed to the statutory meaning is not tenable. Neither is the argument that the term employee is defined in a peculiar way for the purpose of assessing tax of an employee as defined under the Act.

37. I find that although the Respondent argued that according to the letter dated 18th March 2016, written by Doreen Mbingi for Commission of Domestic Taxes Ltd, the decision to demand tax was based on the fact that the samples of unit managers contracts revealed that, these agents receive a retainer, otherwise known as a subsidy for the services offered; offer services at the employer’s premises; are required to give regular reports to the underwriter and this shows an element of control from the underwriter; select, recruit and develop agents who market the underwriter; and the services of these agents are only to be offered to the underwriter hence restricting them from working for more than one firm, thee did not qualify them to be employee of the Appellant.

38. Similarly the Appellant are in the business of insurance which is regulated by the Insurance Act. The understanding of an agent was material and the Tribunal should have considered the nature of the business and the trade practices thereof.

39. Be that as it were it is noteworthy that the Respondent is a public body charged with the responsibility of assessing and collecting revenue as provided for under Section 5 of the Kenya Revenue Authority Act (Cap 469) of the Laws of Kenya. All revenue must be subject to tax in accordance with the law. That brings me to the issue of double taxation raised by the Appellant. I concur with the Respondent that it was not one of the ground of appeal before the Tribunal and therefore should not have been raised herein however, the court takes judicial notice of the fact that every person must account for taxable revenue received and it is in the interest of justice to assist the Respondent collect revenue due for the economic development of the country.

40. The Appellant allege the tied agents remitted the tax on the amount paid. The Respondent is bound to establish and prove that the tax was remitted. To achieve this objective the Appellant must provide the Respondent with the records of proof of the payment within 21 days of this order to enable the Respondent take further action.

41. All in all I find that had the Tribunal considered the relevant provisions of the Employment Act and Insurance Act alongside the Income Tax Act, it would not have arrived at the decision that the tied agents herein are employees of the Appellant. I therefore find that the appeal has merit and I allow it as prayed save for the finding on the documents to be availed by the Appellant.

42. In view of the circumstances of this case and the finding of the court I order each party to bear its own costs.

Dated, delivered and signed on this 4th day of November, 2019

GRACE L.NZIOKA

JUDGE

<u>In the presence of;</u>

Mr Ruto for Mr Kiragu for the Appellant

Mr Manoti for Mr Nyagah for the Respondent

Dennis Court Assistance