REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL & ADMIRALTY DIVISION

WINDING UP CAUSE NO. 52 OF 1998

IN THE MATTER OF MIDCO HOLDINGS LIMITED

AND

IN THE MATTER OF THE COMPANIES ACT

JAYANTKUMAR V. SHAH .....1ST APPLICANT

MRS. SHIKSHS DEVIDAS.....2ND APPLICANT

VERSUS

MIDCO HOLDINGS LIMITED.....1ST RESPONDENT

SUMMIT TEXTILES (EA) LIMITED.....2ND RESPONDENT

RULING

1. This Court is asked to determine the Chamber Summons dated 4th May 2016 for the following orders:-

> **1. THAT this Honourable Court be pleased to enter judgment in favour of the Applicants against the Respondents in terms of the Award made on 8thFebruary 2012 and Supplementary Award made on 24th March 2015.**
>
> **2. THAT the said Award made on 8th February 2012 and Supplementary Award made on 24th March 2015 be enforced as a Judgement of this Honourable Court.**
>
> **3. THAT the Respondent be compelled by this Honourable Court to furnish the Applicants with tax receipts confirming settlement of corporation tax on assumed profits pursuant to the Award and Supplementary Award.**
>
> **4. THAT in the alternative an order do issue compelling the Respondents to pay to the Applicants the amount deducted as corporations tax by the Arbitrator from the value of the Applicants Shares in the Award and Supplementary Award together with interest at Court rates from 31st March 2001 which is the date of valuation until the date of payment in full.**
>
> **5. THAT this Honourable Court be pleased to issue any or such further orders as it may deem just and proper.**
>
> **6. THAT the costs of this Application be provided for.**

The Application is brought substantially under the Provisions of Section 36(1) of The Arbitration Act.

2. It must be noted that this Application is at the tail end of a long drawn dispute between some Shareholders of Midco Holdings Limited and Summit Textiles (EA) Limited (the Companies or Respondents). Jayantkumar Vrajalal Shah and Shiksha Devi Das (hereafter the Applicants) sought the Winding up of the Companies through a Petition presented on 13th November 1998. After a long journey, the dispute was reduced to the issue of the sale of the Applicant's Shares as an alternative remedy to Winding up of the Companies. For that reason it was required that a fair value of the Applicants Shares be reached so that they would be purchased by the majority Shareholders

3. Mr. James Birnie was appointed by the Parties as the Sole Arbitrator to the now narrowed dispute. In an Award said to be made on 8th February 2012 the Sole Arbitrator found as follows:-

> **i) The Shares of each of the two Applicants – Kshs. 15,825,890/= each.**
>
> **ii) Interest to each of the Applicants at Kshs.15,884,778/= less withholding Tax of Kshs.2,382,715 to give a Net Interest of Kshs.13,502,063/=.**

The value of the Shares was reached after a deduction of 30% Corporation Tax.

4. The Applicants were unhappy with that Award and on 3rd may 2012 filed an Application to set it aside. In a Ruling dated 27th February 2014, Gikonyo J. partially set aside the said Award and remitted the matter back to the Arbitrator for reconsideration of the Award as relating to the application of the discount on the value of Applicants' Shares. The Judge held:-

> **"I hereby set aside that part which applied the discount of 25%. Instead, I order that the figures to be re-worked on the basis of the finding herein. Needless to say, parties should be given an opportunity to submit on the average PE Ratio and the Arbitrator to make his best judgment as by Law required".**

5. There was reconsideration and in a revision, the Arbitrator made the following Award:-

> **"Accordingly I have valued the Shareholdings of both Jayantkumar V. Shah and Mrs. Shiksha D. Das at Kshs.21,238,344(Twenty one Million, two hundred and thirty eight thousands, three hundred and forty four shillings). Gross interest accruing on the Award up to 31st March 2015 amounts to Kshs.30,931,098. Withholding Tax at the rate of 15% (ies Kshs.4,638,657) should be deducted from the Gross Interest and paid over to Kenya Revenue Authority by the Respondents in accordance with current Kenyan Tax Legislation".**

6. It is common ground that the Respondents have paid to the Applicants all sums due to them under the terms of the Award. In addition the Respondents have forwarded to the Applicants copies of receipts in support of payment of withholding Tax of Kshs.9,278,314/= on the interest element of the Award.

7. What has triggered the current Application is the issue of the 30% Corporation Tax being Ksh.23,988,697.60/= that was deducted by the Arbitrator from the value of the Applicants Shares. The Applicants want this accounted for and complain that the Respondents have refused to forward to them Tax receipts confirming settlement of the said Corporation Tax. The Applicants are apprehensive that due to the Respondents past conduct of evading Taxes, the Respondents have taken the benefit of the said amount which was payable to the Kenya Revenue Authority to the detriment of the Applicants.

8. The position of the Respondents is that from the inception of the Arbitration proceedings, the Arbitrator's mandate was limited to valuation of the subject Shares and not to determining the Tax payable. In addition there was no order by this Court for the payment of Tax.

9. The Respondents assert that the onus to pay Corporation Tax or any other Tax rests with the Respondents and the discharge of that obligation rests with the Respondents. That at any rate, the Applicants are no longer Shareholders of the Respondents and are not entitled to demand information regarding the Respondents Tax Records.

10. This Court has read and understood the written submissions filed by the Parties and the Oral highlights of Counsel.

11. I begin with what must be plain sailing. Section 36 of The Arbitration Act (The Act) provides for Recognition and Enforcement of Awards. Section 37 of The Act sets out grounds for refusal of Recognition or Enforcement. While Section 35 provides instances upon which an Arbitral Award may be set aside.

12. The Award made on 8th February 2017 and the Supplementary Award made on 24th March 2015 have not been set aside. Secondly none of the Parties have raised any Grounds for the refusal of recognition or enforcement of those related Awards. For this, reason prayers (1) and (2) of the Chamber Summons of 4th May 2016 which seeks their recognition and enforcement are for granting.

13. That however does not address the main concern by the Applicants, being the issue regarding the Corporation Tax. It is common ground that in arriving at the value of the Applicants Shares, the Arbitrator made a deduction of 30% Corporation Tax. Looking at the Awards, the Arbitrator has made it clear that his valuation of Shares is based on an assumed after tax profits of The Companies. The Arbitrator does not pretend to give any directions as to how the Company should deal with the Corporation Tax.

14. That is unlike his Orders on the withholding Tax which was deductable from the Award on the Gross interest he had made. On this the Arbitrator stated,

> **"Withholding Tax at the rate of 15% (ie. 4,639,657) should be deducted from the Gross Interest and paid over to Kenya Revenue Authority by the Respondents in accordance with current Kenyan Tax Legislation".**

It is not in contention that, in obedience to this limb of the Award, the Respondents have furnished evidence to the Applicants that they have paid Kshs. 9,278,314/= as withholding Tax.

15. Evidently, as there is no specific order on the payment of Corporation Tax, the Award even if recognized and enforced would not address the Applicants' concern on that vexed question. It would be for this reason that the Applicant had sought prayers (3) and (4) as below:-

> **3. THAT the Respondent be compelled by this Honourable Court to furnish the Applicants with tax receipts confirming settlement of corporation tax on assumed profits pursuant to the Award and Supplementary Award.**
>
> **4. THAT in the alternative an order do issue compelling the Respondents to pay to the Applicants the amount deducted as corporations tax by the Arbitrator from the value of the Applicants Shares in the Award and Supplementary Award together with interest at Court rates from 31st March 2001 which is the date of valuation until the date of payment in full.**

16. The Applicants were fully aware that in the Award of 8th February 2012, the Arbitrator had not directed on the payment of the Corporation Tax by the Respondents. This is revealed in their Application of 3rd May 2012 seeking to set aside the said Arbitral Award. The Applicants had asserted as follows:-

> **a) Despite making a finding of Tax evasion by the Respondents, the Arbitral Tribunal failed to direct the payment of the Tax by the Respondents. As a result, the Respondents have retained the advantage of evading tax which flies in the face of the Public Policy of Kenya.**
>
> **b) <u>The Arbitrator failed to make a final determination on payment of deducted tax which issue flowed from his Decision. This again was contrary to Public policy and the Laws of Kenya.</u>***(my emphasis)*

17. That assertion was canvassed before Gikonyo J, who made the following determination:-

> **"I concur with Mr. Chacha, that the arbitrator was not obligated by the terms of reference to order parties to pay taxes. What he had to do was to provide for tax deductions in his valuation, which he did. The obligation to remit tax is governed by the relevant tax laws and the Companies Act; those taxes should be factored in the companies' accounts and remitted accordingly. Any retainer of government taxes is illegal and punishable under the tax legal regime. But I reckon that a judgment of Court or award of arbitral tribunal which has implications or provisions is a basis on which tax authorities could act or for a party to provide information to the tax authority. That is enough for this ground".**

18. The Applicants have submitted that pursuant to the said Ruling, the Arbitrator revised the value of Shares to Kshs.21,238,344.00 each and provided for a 30% Tax deduction of Corporation Tax and that this deduction was from the Applicants' Share of profits.

19. That may be so but in my view there was no shift in the manner in which the Arbitrator dealt with the item of Corporation Tax when he revalued the Applicants shares. So as to put this in a clear perspective, the task of the Arbitrator in the remitted proceedings must be understood.

20. When the Applicants approached the Court for the setting aside of the Award of 8th February 2012, one of the reasons for challenge was that, upon arriving at a value of the Applicants shares, the Arbitrator had applied a discount of 25% when there was no basis for it. A discount would ordinarily be allowed on the value of shares to be sold to cater for uncertainties of getting purchasers at all or at the full value. In this situation there was no uncertainty of buyers as the majority Shareholders were to purchase the shares. The Court was persuaded by the Applicants'contention that the application of the discount was erroneous and it set aside that aspect of the Award. In remitting back the award for reconsideration, Gikonyo J. ruled that the application of a discount to applied PE ratios was not appropriate.

21. When the matter went back before Arbitrator, he observed as follows,

> **"On 14th June I had suggested that as the only issue that would alter the award was the application of the discount, then the revision of the award was merely a matter of arithmetic and could well be agreed by the parties without my intervention. However on 2 December 2014 the advocates representing both parties requested that I re-calculate the value of the Claimants' shares and the interest up to the date of the supplementary award".**

The Arbitrator then reworked the interest and value after explaining:-

> **"This I have done and attach to this Report the revised value of the shareholdings and the interest accrued up to 31st March 2015. The attached schedule show how the revised and updated figures are arrived at. In particular I have applied a PE ration of 6.71 to the assumed after-tax profits of the Companies (instead of a PE ratio of 5), as arrived at in appendix 7 of the original award"**

The schedule to the Supplementary Award shows the new value arrived at after a deduction of Corporation Tax. The role of the Arbitrator in the remitted proceedings was that plain and simple. He did not, and was not required, to give any directions on the Corporation Tax.

22. My understanding is that, just as in the original Award, the Supplementary Award gives no direction of the payment of Tax by the Respondents. So that even if this Court was to enforce the Awards it cannot direct the Respondent on the payment of Corporation Tax. There was already a Decision by Gikonyo J. that "the Arbitrator was not obliged by the terms of reference to order parties to pay taxes", and indeed the Arbitral Tribunal did not do so in the Supplementary Award. If this court was to grant prayers (3) and (4) of the Chamber Summons then it would not be enforcing the Awards but making addition orders not contemplated by the Award, a power that is not available to this Court in its jurisdiction under the provisions of Section 36 of The Arbitration Act.

23. Let me add this, the value of the shares of the Applicants was based on assumed after tax profits of the Companies. Looking at the Award of 8th February 2017, the Arbitrator was keenly aware that the books of the Respondents had not fully disclosed certain sales. In arriving at the profits to be used for purposes of valuing the Applicants profits, the Arbitrator took into account concealed sales. This is what the Arbitrator said,

> **""I have set out the workings for my valuation as an appendix to the report, but basically I have taken the following factors into account.**
>
> **a) <u>I have accepted that there were undisclosed sales and have extrapolated the ratio of recorded and unrecorded sales in 1997 to the results for the year ended 31 March 2001.</u>**
>
> **b) I have based the valuation on profits after taxation.**
>
> ***c)* I have applied a PE ration of x5 which I consider appropriate for these companies. This is also the PE ration that was applied in the** formula and by Mr. **Gregory in his profits based valuation**"*(my emphasis)*

It has to be remembered that the assumed after tax profit remained the same in both the Award of 8th February 2012 and the Supplementary Award.

24. The Applicants were quiet happy to go by that Supplementary Award. They did seek to set it aside. The argument by the Respondents that the Arbitrator's rough estimates of the Companies taxes are not binding on the Companies is therefore not without merit. To argue that the Applicants could be entitled to more money, if the actual after tax profits turns out to be different from the estimates, would be to depart from a fundamental element of the Arbitral Award that the valuation was based on assumed after tax profits. That notwithstanding this Court reiterates the observation made by Gikonyo J. that a retainer of Government Tax that is due is illegal and punishable by law.

25. The upshot. For what it may be worth, prayers 1 and 2 of the Chamber Summons of 4th May 2016 are allowed. Prayers 3 and 4 thereof are declined. The Parties to bear their own costs.

Dated, Signed and Delivered in Court at Nairobi this 15th day of June, 2017.

F. TUIYOTT

<u>JUDGE</u>

***<u>PRESENT</u>*:**

Ouma h/b Ogula for Applicant

Kavase for Chacha Odera for Respondent

Alex - Court clerk