



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

MISCELLANEOUS APPLICATION NO. 610 OF 2008

**IN THE MATTER OF AN APPLICATION BY THE KENYA NUT COMPANY LIMITED TO
APPLY FOR ORDERS OF CERTIORARI AND PROHIBITION**

AND

IN THE MATTER OF THE INCOME TAX ACT CAP 470 OF THE LAWS OF KENYA

REPUBLIC APPLICANT

VERSUS

KENYA REVENUE AUTHORITY..... 1ST RESPONDENT

COMMISSIONER OF DOMESTIC TAXES..... 2ND RESPONDENT

EX-PARTE APPLICANT: KENYA NUT COMPANY LIMITED

JUDGEMENT

Introduction

1. By a Notice of Motion dated 7th October, 2008, the *ex parte* applicant herein, **Kenya Nut Company Limited**, seeks the following orders:
1. **An order of Certiorari do issue to remove and bring to this court the decision contained in the letter/assessment notice dated 19th August, 2008 and in the assessment notices attached thereto in so far as they relate to withholding tax amounting to Kshs 33,534,855/= in respect of the Applicant issued by the Respondents for purposes of being quashed.**
2. **An order of prohibition do issue to prohibit and/or restrain the Respondents from enforcing, whether by themselves or through any agent or howsoever, recovery of the amount of Kshs 33,534,855/= or taking any adverse action against the Applicant based on the decision contained in or referred to in the letters/assessment notices dated 19th August 2008 and 10th June 2008 in so far as the said letters/assessment notices relate to withholding tax.**
3. **That costs be provided for.**

Ex Parte Applicant's Case

2. The application was supported by an affidavit sworn by **Michael Mwaniki**, the Applicant's Finance Manager on 3rd October, 2008.
3. According to the deponent, between early 2006 and August 2008, the Respondents carried out an audit into the Applicant's tax affairs for the years between 2002 and 2005, inclusive. The audit also covered other companies associated to International Controls Limited. In the course of the audit, the Respondents identified several issues including a dispute as to whether withholding tax is payable in respect of funds retained by several entities domiciled in foreign jurisdictions which source customers for the Applicant's goods. The said audit was concluded on an interim basis on or about 5th June 2006 and the Respondent wrote a letter dated 5th June 2006 to the Applicant and other associated companies outlining the issues that arose from the audit. To the said letter the Applicant responded on 29th June 2006 providing an explanation for all the issues raised by the Respondents. However, by a letter dated 17th July 2006 the respondent maintained its position as outlined in their letter dated 5th June 2006.
4. Thereafter, the Applicant and the Respondents held a meeting to try and narrow the areas of disagreement. On 15th April 2007, the Applicant's tax advisors wrote to the Respondents and explained that the fees and commissions noted in the Applicant's books of account in respect of foreign trading partners were at all times deducted by the overseas traders and that the Applicant had no control over the payments and could not therefore withhold tax. In view of the demonstrated difficulty in recovering withholding tax from the foreign traders, who are subject to the authority of their respective Tax Authorities, the Applicant's tax agent requested the Respondents to refrain from demanding the disputed withholding tax which Respondents are authorised to do under Section 123 of the **Income Tax Act** (hereinafter referred to as the Act). However, on 1st October 2007, the Respondents wrote to the Applicant indicating that they intended to conclude the audit by charging withholding tax together with interest thereon and additional tax in the aggregate sum of Kshs 33,534,855/=. In response, the Applicants tax advisor wrote back to the Respondents on 8th November 2008 making further clarification regarding some of the payments deducted by one of the foreign traders. Despite this, on 10th June 2008, the Respondents wrote to the Applicant stating that they had confirmed the withholding tax Kshs 33,534,855/= which confirmation was objected to by M/S Ernest & Young vide a letter dated 7th July 2008, in which M/S Ernest & Young wrote to the Respondents objecting to the assessment on the grounds submitted to the Respondents earlier but this objection was similarly rejected by the Respondent vide its letters dated 23rd July 2008 and 19th August 2008 and declined to amend the assessment issued on 10th June 2008. Instead, the Respondents confirmed their assessment.
5. According to the Applicant, during the period that the tax audit relates to, that is between 2002 and 2005, some of the Ex-parte Applicant's overseas trading partners retained promotional expenses amounting to US\$ 524,738.22 made up as follows;

YEAR	SALES (US)	EXPENSES (US\$)
2002	1,010,031.60	41,628.50
2003	2,574,022.00	136,402.00
2004	4,617,225.86	230,861.29
2005	5,696,463.22	115,846.43
524,738.22		

6. The contracts for sale entered into by the *ex-parte* Applicant and the overseas partners clearly indicated that the amounts retained by the said partners would be divided between fees and expenses. The promotional expenses deducted by overseas trading partners were imposed on the *ex-parte* Applicant for a specific amount and period of time to enable the *ex-parte* applicant access

- markets in Europe and the USA. Once a contract with customers was made by the overseas partners no further expenses would be paid for that customer in subsequent contracts. The promotional expenses were to be recovered from the proceeds of the initial contracts which expenses the trading partners labelled as commissions and expenses. Not all contracts with overseas partners had a requirement or covenant for payment of promotional expenses. No promotional; expenses were payable where the *ex-parte* Applicant had sourced a customer for itself without the assistance or involvement of the overseas partners.
7. The Respondents however reached the assessed withholding tax demand incorrectly assuming that all the goods exported by the *ex-parte* Applicant were subject to the promotional expenses retained by overseas trading partners.
 8. To the Applicant, the Respondent's authority to enforce the collection of taxes under the Act is limited to the existence of income belonging to a person, whether resident or non-resident. Hence, the Respondents must be in a position to demonstrate that the *ex-parte* Applicant's trading partners in fact received income that would justify the assessed tax. In this case, however, the *ex parte* Applicant's overseas trading partners only deducted a sum of US\$ 524,738.22 from the *ex-parte* Applicant's revenue after sale of products and even this amount was apportioned between fees and expenses, the latter which does not attract withholding tax. It was further contended that the Respondents have also demanded penalty and interest amounting to Kshs 16,179,482/= contrary to law.
 9. To the deponent, the *ex-parte* Applicant is prepared to meet with the Respondents to go through the invoices and contract documents related to overseas trading partners to establish the lawful amount that is subject to withholding tax and reach a settlement.
 10. The deponent averred that the position taken by the Respondent was that withholding tax was still payable by the Applicant since the Applicant was "in talking terms" with the foreign trading partners yet to be in "talking terms" with a trading partner or payee is not a legitimate or authorised basis for assessing taxes; and that whether commissions are withheld at the point of payment or actually remitted to the service provider does not affect the Applicants obligation to collect taxes on behalf of the Respondents.
 11. It was therefore the Applicant's view that the decision made by the Respondents is irrational and unreasonable since the Applicant cannot, in law and for tax purposes, be required to recover taxes as an agent of the Respondents even though it has no control of the taxable income. Therefore the Respondent's insistence on charging withholding tax, including penalty and interest thereon, in spite of the impossibility and overwhelming difficulty of recovering withholding tax from foreign traders on whom the Applicant relies on for its business survival, is a violation of the Applicant's legitimate expectation that the Respondents will be fair and reasonable, as contemplated by Section 123 of the Act, in enforcing the provisions of Section 35 and 96 of the Act. To the Applicant, the Act contemplates that withholding tax shall only be recovered when a tax payer constituted as an agent of the Respondents under Section 96, actually makes a deduction from funds within his control and not otherwise but does not create any obligation on an agent to recover funds that the taxpayer has not paid out or cannot withhold. Therefore the Respondent's demand for payment of withholding tax in the face of such manifest impossibility amounts to misinterpretation, frustration and/or unlawful extension of legislative purpose.
 12. It was further contended that the Respondents have acted unlawfully and unfairly by stretching the responsibility cast upon an agent such as the Applicant under Sections 35 and 96 of the Act to include a burden that the Applicant has no power or ability to discharge and a burden that is not only irrational or absurd but one that was not envisaged by parliament or the statute. By imposing a tax obligation and burden on the Applicant on the basis that the Applicant and its foreign trading partners are "in talking terms" as opposed to the standard set by statute namely that the Applicant is to withhold tax in respect of funds it holds on account of a payee, the Respondents have acted unfairly and unlawfully by.
 13. According to the deponent, interpretation of Sections 35 and 96 of the Act by the Respondents lacks statutory underpinning or authority and does not conform to accepted rules of interpreting revenue statutes namely that where a word or phrase is capable of two or more meaning or interpretations, it is right to adopt that interpretation which will prevent confusion; that the obscurity of an enactment or the uncontrollable width of the language of a statute ought to lead to the conclusion that no reasonable conclusion is available and that the tax payer is therefore not to

be charged; that the 2nd Respondent has authority under Section 123 of the Act to consult the Minister for finance and to desist from demanding tax that is impossible to recover or the recovery of which would entail effort or consequences disproportionate to the benefit of collecting such tax; that in cases where a statutory provision is capable of more than one meaning, the interpretation more favoured to the tax payer is to be preferred; that the words in a revenue or tax statute are to be given their ordinary common sense meaning; that there is no room for intendment in the interpretation of tax statutes nor is there presumption as to a tax; that as the object of the construction of a statute is to ascertain the will of the legislature, it is to be presumed that neither injustice nor absurdity is intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would void it, then such an interpretation may be adopted; and that particular words are to be construed in their context; it cannot be assumed that a word is used in the same sense throughout the Act.

14. The Applicant's position was therefore that the issuance of the aforesaid demand notices is unlawful

1st Respondent's Case

15. On behalf of the 1st Respondent a replying affidavit was on 3rd December, 2008 filed sworn by **Joseph Kinyua Kamungu**, a Senior Assistant Commissioner with the Domestic Taxes Department of the 1st Respondent.

16. According to him, Applicant is a limited liability company incorporated under the provisions of the **Companies Act** and it engages mainly in the growing, purchasing and processing of Macadamia and cashew nut for both domestic and overseas markets. Further, the Applicant sells the processed macadamia and cashew nut (hereinafter referred to as the goods) in the overseas market through selling and marketing agents.

17. It was deposed that the dispute in this matter is on withholding tax under the Act that arose from a tax audit that was carried out on the Applicant and its associate Company, International Controls Ltd between the years 2002 to 2005. Other companies in the group who were audited between mid 2006 and August 2008 were Kirima Kimwe Ltd, Thika Coffee Mills and Nando Ltd. Following the audit, the Applicant was informed of the various issues that arose from the audit exercise vide a letter dated 5th June 2006 and was advised to forward its comments on the same in order to have the audit finalized.

18. Vide a letter dated 29th June 2006 the Applicant provided an explanation for the issues raised by the Respondents after which a meeting between the representatives of the Applicant and Respondents was held on 12th July 2006 whereupon the issues that arose from the meeting were summarised vide the letter dated 17th July 2008. Among issues was that the Applicant was required to provide details as to why withholding tax should not be charged. The audit was subsequently concluded and the Applicant informed of the same vide a letter dated on 1st October 2007, wherein the withholding tax due was computed as being Kshs. 33,534,855 being the tax that ought to have been charged on the commissions paid to the Applicant's overseas selling and marketing agents. The Tax Assessments for the taxes owed which included withholding tax was confirmed vide letter dated 10th June 2008 and the Applicant was advised to make payment to avoid further accrual of penalties and interest. However, the Applicant objected to the Assessment vide a letter dated 7th July 2008 disputing that withholding tax was owed but was thereafter addressed vide a letter dated 23rd July 2008 that the tax was due and the assessed amount was reconfirmed and this position was reiterated vide a letter dated 19th August 2008 and the Applicant was asked to make arrangements to pay the tax demanded to avoid further accumulation of penalties and interest.

19. According to the deponent, for the period under review that is between 2002 and 2005, the Applicant entered into contracts with the following marketing agents and agreed to pay commission at the rates set out herein below:

- (a) Richard Fran 2%

- (b) Kenford 5%
- (c) Laterre 5%
- (d) Mac Farm 5%
- (e) Golden Boy 5%
- (f) Melji Traders 5%

20. The said agents received the goods from the Applicant and then remitted the sales proceeds while at the same time deducting their selling and marketing commission which they were entitled which means that the Applicant received the sales proceeds net of the selling and marketing commission due to the agents and the Applicant reflected sales in the Audited Financial Statements net of sales and marketing commission. However, the commissions were not reflected in the Applicant's accounts as expenses. It was therefore contended that the fact that the selling and marketing commission was withheld by the agents support the Respondent's view that this was a commission due to the marketing agents and which was paid by Applicant upon retention of the same by the agents. In the premises withholding tax is applicable on commission paid to the agent under Section 10 of the Act and the Applicant ought to have deducted and remitted the withholding tax on the selling and marketing commission and to remit the same to the Respondents in accordance with Section 35 of the Act.
21. The contract and invoices indicate that Richard Franco Agency Inc retained US\$ 115,846.43 and while Kenn Ford US\$408,891.79 both totalling to US\$ 524,738.22 as commission and marketing fees and not promotional expenses as stated by the Applicant and the invoices from Richard Franco and Kenn Ford clearly states that 2% and 5% will be retained as commission and marketing fees respectively. The term promotional Expenses is not used in the purchase contract, contract of sale and in the invoices and as such the Applicant's exhibits are an afterthought intended to confuse the court on the real issues in this matter. To him, the Applicant's contract documents and invoices do not break the 2% and 5% agreed to by the parties as commission and promotional expenses to be reimbursement by the Applicant but that the said percentages are retained by the Applicant partners as commission while ninety eight percent and ninety percent be remitted directly to the Applicant. The Applicant's contract of sale agreement for Richard Franco Agency Inc referred to by the Applicant in the Supporting Affidavit clearly indicates that "the buyer to open banker's confirmed letter of credit by cable at sight for 78% of invoice value against documents. Confirmation charges for the account of the beneficiary".
22. In his view, the negotiations to try and settle this matter failed after the Applicant failed to produce documents such as ledgers for the trading partners overseas that could be used to compare the invoices in order to establish the justification of the treatment in the promotional expenses in the books of accounts and as such the withholding tax of Kshs. 33,534,855/= demands is still due from the Applicant.
23. To him, the Applicant has not justified the promotional expenses and as such the amount for withholding tax which was based on the commission earned by their overseas partners is due and owing. Therefore the penalties and interest on the withholding tax has been properly charged in accordance with Sections 72D and 94 of the Act respectively and that the Respondent's computation on the outstanding withholding tax is based on the commissions earned by the Applicants overseas agents and not assumptions as alleged by the Applicant.
24. To the deponent, though the Respondents are not privy to terms of the contracts between the Applicant and his agents, such contracts should have clauses on whether the amount withheld as commission is gross or net of withholding tax. Therefore failure by the Applicant to factor in withholding tax during negotiations with selling and marketing agents should not jeopardise the subjecting of the selling and marketing commission to withholding tax. According to him, the payment of proceeds of sales net of commissions to the Applicant by his agent is as a result of a pre-negotiated business relationship, where the Applicant wilfully ceded control in blatant disregard of the provisions Sections 35 and 96 of the Act hence the Applicant cannot plead business impossibility for not effecting the deduction of tax as the requirement to withhold tax

- ought to have been factored in when the Applicant entered into contract with its selling and marketing agents.
25. According to the deponent, the Applicant has at paragraphs 9, 14 and 23 of the affidavit sworn by **Michael Mwaniki** 3rd October 2008 admitted that the tax is due but is seeking to rely on Section 123 of the Act. To him it is only tax that is due that can be forgone. However, the 2nd Respondent has not forgone neither does he intend to forego the tax it dispute since the law places the obligation on the Applicant herein to withhold the same and the failure to withhold the tax was therefore in breach of the law for which the Applicant is liable.
26. To the Respondents, they have not acted unreasonably in demanding withholding tax from the taxpayer because the taxpayer is the Principal, while the seller is the Agent, wherein the goods that gave rise to the commissions emanated from the Applicant and therefore he is in full control of the entire transaction. To the contrary, the Respondents have acted fairly and reasonably in demanding the withholding tax and is therefore not in breach of legitimate expectation. On the other hand the Applicant disregarded the clear provisions of Sections 35 and 96 of the Act to their own detriment. Further the Respondents have not frustrated or unlawfully extended or implemented legislative purpose, since payment of withholding tax does not only envisage a situation where the taxpayer undertakes physical payment in person but that the payment of the tax may also happen in reverse, where the service provider withholds part of the gross amount payable with direct or implied Authority from the payee. It is therefore incorrect to suggest that withholding of commission did not constitute a payment within the context of Section 96 of the Act. To the contrary, the Respondents acted fairly in casting upon the Applicant to operate withholding tax in accordance with Section 35 and 96 of the Act.
27. According to the Respondent, it is incorrect for the Applicant to suggest that such obligation was not envisaged by parliament or the statutes because rules of interpreting tax statutes bars the Tax Authority or the taxpayer from seeking to establish the intention of parliament. Statutes, it was averred should be interpreted strictly as there is no room for intendment nor is there presumption as to tax.
28. According to them, orders of Certiorari cannot issue because the Respondents have not acted without or in excess of their jurisdiction. Similarly, orders of Prohibition cannot issue because the Respondents have not acted without or in excess of their jurisdiction. On the contrary, there will be substantial loss to the government in terms of revenue, if the orders prayed for by the Applicant are granted hence it is only fair and just in the circumstances to allow the Respondents undertake its statutory duties unhindered and to safeguard much needed government revenue.
29. The Respondents urged the Court to dismiss the Application with costs.

Applicant's Submissions

30. On behalf of the applicant it was submitted by **Mr Macharia**, its learned counsel, that the applicant relies on overseas agents to market its products some of whom withheld some amounts as commissions and expenses. What triggered this dispute was the assessment of tax payable by the applicant based on the said withheld commissions which the Respondent assessed in the sum of Kshs 35,534,854.00 which consisted of the principal withholding tax, interests and penalties. According to learned counsel the dispute revolves around 4 broad issues and these are:
1. Whether the Respondent can charge tax other than in accordance with the statutes of Parliament.
 2. What is the nature of statutory duty cast on the respondent when assessing tax and whether the Respondents were under a duty to satisfy themselves on each and every contract entered into by the applicant that a commission was charged with respect to each contract.
 3. The rate of penalty the Respondent is entitled to levy if there was a default.
 4. The cannons of interpretation applicable.
31. It was submitted that withholding tax is the function of section 35 of the Income Tax which is now codified in Article 210(1) of the Constitution under which it is provided that no tax may be imposed except as provided by the law. Relying on the decision of **Majanja, J in Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD [2012] eKLR**, it was submitted that there ought to be clarity in tax matters.

- According to the applicant, the Respondent ought to look at the contract in question in arriving at a determination of the taxes payable. These contracts though availed to the Respondent, the Respondent ignored them. The said contracts, it was submitted split the percentage in question into commissions and expenses the latter which is not taxable. According to the applicant, the Respondent's position that the applicant did not offer any explanation was incorrect.
32. It was submitted that the Commission was not a permanent feature of the contractual arrangement between the applicant and the respondent since once the applicant accessed the markets, there would no longer be need for the said commissions. This however was not considered by the Respondent in assessing the taxes. Instead the Respondent applied a methodology which failed the statutory duty cast upon it. The applicant relied on the said decision of **Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD** (supra) in support of this submission.
33. Withholding Tax, it was submitted is a curious tax in the sense that section 35 of the Act constitutes the tax payer an agent of the authority entrusted with collecting the tax. However, in this case the applicant was receiving the money less the Commission hence the applicant had no power to withhold the payment. In these circumstances, there cannot be withholding tax. To contend that the applicant ceded control to the agents since where the goods emanated from the applicants, the applicant was in control was, according to learned counsel, incorrect, unreasonable and an unlawful assumption. Section 13 of the Act defines "payee" as one who receives payment after deduction of withholding tax and the "payer" as the one withholding tax. According to the applicant the rule did not contemplate a situation where the payee deducts for himself hence there is an ambiguity.
34. According to the applicant, it is clear from the amendment to section 35(6) dealing with default penalty which took effect on 1st July, 2004 that the Commissioner may impose penalty of 10% of the amount involved subject to a limit of Kshs 1 million. In this case, the Respondents imposed 20% instead and demanded Kshs 1 million. According to the applicant where there is an ambiguity, it has to be interpreted in favour of the applicant.

Respondents' Submissions

35. On behalf of the Respondent it was submitted that since the applicant's agents retained the sum due to them as commission, withholding tax is applicable under section 10 of the ***Income Tax Act*** and the applicant ought to have had withholding tax deducted from the commissions of the selling and marketing commission and remitted the same to the Respondents in accordance with section 35 of the Act. It was submitted that the Respondent are not privy to the terms of contract between the applicant and his agents which contracts should have clauses on whether the amount withheld as commission is gross or net of withholding. Therefore the failure by the applicant to factor in withholding tax during negotiations with selling and marketing agents should not jeopardise subjecting the selling and marketing commission to withholding tax. To the Respondents, the applicant ceded control in blatant disregard of sections 35 and 96 of the Act. The Respondents, in support of this submission relied on **Kenya Commercial Bank vs. Kenya Revenue Authority High Court (Milimani Commercial Courts) Income Tax Appeal No. 14 of 2007**.
36. It was submitted that by relying on section 123 of the Act, the applicant was admitting that the tax was due since under the said provision only tax which is due that can be foregone. In this case the Respondents have not forgone neither do they intend to forego the same. Since the applicant was the principal in the contract between it and its agents, it was submitted that based on **Republic vs. Commissioner of Income Tax ex parte SDV Transami (K) Ltd [2005] 1 EA 53**, the applicant was in full control of the entire transaction this the commissions paid to the said agents is subject to withholding tax.
37. On the issue of legitimate expectation, it was submitted the same does not arise since there was no representations made by the Respondent to the Applicant that the Commissions paid to the agents were not taxable. As an authority for this submission the Respondents relied on **Celtel vs. The Minister for Finance and 2 Others Nbi HCMA No. 165 of 2006** where it was held:

"We find that under the circumstances, there is no legitimate expectation that the Applicant would get remission on duty that could have arisen nor was it thwarted. It would have been

against public policy for the Minister to continue acting in breach of the law in order to honour the promise to the Applicant's to give them remission. The KEROCHE CASE (supra) cannot apply here because in that case there were specific representation made by the Respondents upon which the Applicants acted over along time and the abrupt change in that practice breached the Applicants expectations”

38. The Respondents further relied on Republic vs. Kenya Revenue Authority ex parte Aberdare Services Limited Nbi HCMA No. 946 of 2004 in which Council of Civil Service Unions vs. Minister for Civil Service [1995] AC 374 where it was held that the principle:

“must affect the other person by depriving him of some benefit or advantage which either (i) he had in the past been permitted by the decision maker to enjoy and which can legitimately expect to be permitted to continue to do until there has been communicated to him some rational grounds for withdrawing it on which he has been given an opportunity to comment or (ii) he has received assurance from the decision maker it will not be withdrawn without giving him first an opportunity to advance reasons for contending that they should not be withdrawn.”

39. In this case it was submitted the principle does not arise hence the Applicant disregarded sections 35 and 96 of the Act to its own detriment.

40. It was contended that it was incorrect for the Applicant to suggest that the obligation cast on the applicant was not envisaged by parliament or the statutes because the rules of interpreting tax statutes bars the Tax Authority or the tax payer from seeking to establish the intention of Parliament as such statutes should be interpreted strictly. In support of this submission the Respondents relied on Cape Brandy Syndicate vs. Inland Revenue Commissioner [1921] 1 KB 64. In that case it was held:

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

41. Further reliance was placed on Inland Revenue Commissioners vs. Wolfson [1949] 1 All ER 865 in which it was held:

“It is not the function of the court of law to give words a strained and unnatural meaning because only thus will a taxing section apply to a transaction which, had the legislative thought of it, would have been covered by appropriate words. It is the duty of the court to give words of this subsection their reasonable meaning.”

42. It was therefore submitted that it is the duty of the Court to give words in section 35 and 96 of the Act a reasonable meaning. It was submitted that under section 10 of the Act the commissions earned by the Applicant's agents are deemed to be income in accordance with section 10(a) of the Act as the same fall under the category of management or professional fee as defined in section 2 of the Act which is subject to withholding tax. Section 35 of the Act on the other hand it was submitted provides for the deduction of withholding tax on commissions earned by the agents of the applicant.

43. It was submitted that the Respondents have discretion under section 96 of the Act to demand and/or recover the taxes owed by the Applicants while paragraph 14A of the **Income Tax (Withholding Tax) Rules 2001** (hereinafter referred to as the Rules) allows the Respondent to charge penalties on withholding tax hence the Respondents' actions are neither ultra vires nor without jurisdiction in order to warrant orders of prohibition or certiorari.

44. On competency of the application it was contended that the same is incompetent since the same is brought in the name of the ex parte applicant rather than the Republic. In support of this submission the Respondents relied on Nasra Ahmed Abdul Wahab vs. Kenya Revenue Authority and Commissioner of Domestic Taxes HCMA No. 131 of 2007 and Stephen Ndirangu Waweru vs. The Commissioner General HCMA No. 570 of 2006.

45. These submissions were highlighted by **Miss Odundo**, learned counsel for the Respondents.

Determinations

46. Before going into the matter, it is important to note that the issue of exemption of fruits and vegetables from the taxation was abandoned by **Mr Macharia** in his reply. Accordingly that issue does not fall for determination in this judgement.

47. The principles guiding tax legislation were restated in **Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD** (supra) where the learned judge held:

*“The approach to this case is that stated in the oft cited case of **Cape Brandy Syndicate v Inland Revenue Commissioners** [1920] 1 KB 64 as applied in **T.M. Bell v Commissioner of Income Tax** [1960] EALR 224 where Roland J. stated, “...in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used... If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.” As this case concerns the interpretation of the **Income Tax Act**, I am also guided by the dictum of Lord Simonds in **Russell v Scott** [1948] 2 ALL ER 5 where he stated, “My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him” adopted in **Stanbic Bank Kenya Limited v Kenya Revenue Authority** CA Civil Appeal No. 77 of 2008 (Unreported) [2009] eKLR per Nyamu JA (See also **Jafferli Alibhai v Commissioner of Income Tax** [1961] EA 610, **Kanje Naranjee v Income Tax Commissioner** [1964] EA 257). Any tax imposed on a subject is dictated by the terms of legislation and taxing authority must satisfy itself that the transaction fits within the definition of the statute. In **Adamson v Attorney General** (1933) AC 257 at p 275 it was held that, “The section is one that imposes a tax upon the subject, and it is well settled that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used, and if there is any doubt or ambiguity this defect-if it be in view of the Crown a defect can*

only be remedied by legislation.”

48. The applicant's case was that since the Commissions were deducted by its agents outside the country, it was unreasonable to compel it to withhold taxes due therefrom as it could only withhold taxes which were in its hands. Section 35 of the **Income Tax Act** provides:

1. ***A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of...which is chargeable to tax, deduct therefrom tax at the appropriate non-resident rate.***

49. The issue for determination is at what stage is the taxpayer liable to deduct tax from a non-resident. The key words in the said section are “*upon payment of an amount*”. The difficulty here is that the commission in question though was paid by the applicant, the applicant was unable to deduct the sum at the time its agents were receiving payments due to the fact that the commissions were deducted at the source. Had the proceeds of the sale transaction been remitted to the applicant before the payment of the said Commission, there would have been no question of the applicant's liability to deduct the same in form of withholding tax.

50. However, in **Kenya Commercial Bank vs. Kenya Revenue Authority High Court (Milimani Commercial Courts) Income Tax Appeal No. 14 of 2007**, the court seems to have been of the view that it was upon the appellant alone who had the responsibility to devise workable procedures to ensure compliance with the Tax Law. In this case one may argue that the applicant ought to have devised a system by which its contractual terms with its agents would ensure that

withholding taxes were accounted for. In my view this may be a prudent course since the converse may very well open an avenue for tax evasion by unscrupulous agents thus render the whole idea of deducting taxes on commissions payable to non-residents a mirage. As attractive as this argument seems, it flies in the face of the decisions guiding the interpretation of tax legislation cited above. In **Tanganyika Mine Workers Union vs. The Registrar of Trade Unions [1961] EA 629**, it was held that where the provisions of an enactment are penal provisions, they must be construed strictly and that in such circumstances you ought not to do violence to its language in order to bring people within it, but ought rather to take care that no-one is brought within it who is not brought within it in express language. See **London County Council vs. Aylesbury Dairy Company Ltd [1899] 1 QB 106 at 109**; **Muni vs. R through Medical Officer of Health, Kiambu [2006] 1 KLR (E&L) 15**; **Hardial Singh and Others [1979] KLR 18; [1976-80] 1 KLR 1090**.

51. In my view to expand the phrase “upon payment of an amount” to include situations where commission is deducted by foreign agents from the source would be to overstretch the said phrase in order to bring those not expressly within the provision inside it. As was held in **Vestey vs. Inland Revenue Commissioners [1979] 3 All ER at 984**:

“Taxes are imposed on subjects by parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined.”

52. In the same vein, it was held in **Russell (Inspector of Taxes) vs. Scott [1943] AC 422 at 433**:

“I must add that the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind I feel that the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected...my Lords, there is a maxim of income tax law, which though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose tax upon him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion.”

53. In these kinds of cases the Court is not entitled to attempt a discovery at the intention of the Legislature but is restricted to the clear words of the statute. In a taxing Act one has to merely look at what is clearly said since there is no room for any intendment. There is no equity about tax and there is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only fairly look at the language used. See **H vs. The Commissioner of Income Tax [1958] EA 303**.

54. Similarly, in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others [2007] 2 KLR 240** it was held:

“taxation can only be done on clear words and cannot be on intendment. Linked to this is that a penalty must be imposed in clear words. Finally even where the inclination of the legislature is not clear or where there are two or more possible meanings, the inclination of the court should be against a construction or interpretation which imposes a burden, tax or duty on the subject...Nothing summarises the above position better than *Brooms Legal Maxims*: ‘a remedial statute therefore shall be construed so as to include cases which are within the mischief which the statute was intended to remedy; whilst, on the other hand, where the intention of the Legislature is doubtful, the inclination of the court will always be against that construction which imposes a burden, tax or duty on the subject. It has been designated as “a great rule” in the construction of fiscal law, “that they are not to be extended by any laboured construction, but that you must adhere to the strict rule of interpretation; and if a person who is subjected to a duty in a particular character or answers that description, the duty no longer attaches upon him and cannot be levied. A penalty moreover must be imposed by clear words. The words of a statute shall be restrained for the benefit of him against whom the penalty is inflicted, and the language of

the statute must be strictly looked at in order to see whether the person against whom the penalty is sought to be enforced has committed an offence to do with it.’...The principle remarked Lord Abinger “adopted by Lord Tenterden, that a penal law ought to be construed strictly is not only a sound one, but the only one consistent with our free institutions. The interpretation of statutes has always in modern times been highly favourable to the personal liberty of the subject and I hope will always remain so. This Court of course does appreciate the point made by the respondents’ Counsel that if the meaning of the provisions of the relevant empowering taxation laws is clear the court has no business intervening. This principle is based on the high authority of *Bennun on Statutory Interpretation* at page 726, 727 as follows:-If the meaning of the provision is reasonably clear, the courts have no jurisdiction to mitigate such harshness. It is of course regarded as penal for a person to be taxed twice over in respect of the same matter.” The significance of this quotation is that although the applicant did file monthly returns and keep daily production records, and the stockbook as required the tax imposed by the subsequent formula based on input and output purports to tax the company twice. This is also reflected in the inconsistent figures reflected by the three major audits. The taxman had come up with inconsistent figures for the same period due to its lapse in adhering to the law especially s 137 of the Act. I find that they cannot tax the applicant twice over *Bennion* adds:- ‘Nevertheless taxation is clearly “penal” within this section of the Code, and must not be enforced by the courts unless clearly imposed. As Evans LJ said in the context of tax legislation it is necessary to consider the legal analysis with the utmost precision so that the taxpayer shall not become liable to tax unless this is clearly and unequivocally the object of the statutory provisions ... The Courts are reluctant to adopt a construction permitting a person’s tax liability to be fixed by administrative discretion.’...This is how this court has regarded the assessment of tax on an arbitrary input-output formulae because it is not supported by any law nor is its retroactivity permitted by law...The same principles as above, were accepted and applied in the case of *Cape Brandy Syndicate vs. Inland Revenue Commissioners [1921] KB 64* where Ronlat J, restated the principle in these words: ‘in a taxing Act clear words are necessary in order to tax the subject. Too wide and fanciful a construction is often to be given to that maxim, which does not mean that words are to be unduly restricted against the Crown or that there is to be any discrimination against the crown in those Acts. It simply means that in a taxing Act one has to look merely at what is clearly said. There is no reason 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 to be implied. One can only look fairly on the language used.’... Again, in the case of *Ramsay Ltd vs. Inland Revenue Commissioner [1992] AC 300* the same principles were expressed as follows:- ‘A subject is only to be taxed on clear words not upon intendment, or upon the “equity” of an Act’. Any taxing Act of Parliament as to be construed in accordance with this principle. What are “clear words” is to be ascertained upon normal principles; these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole and its purpose may, indeed should be regarded ...” A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect.”

55. Whereas the Court appreciates the need to collect taxes, in carrying out their statutory obligations the Respondents must adhere to the law. As was held in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others** (supra):

“It is no good answer for the taxman to proclaim that Kshs 1 billion (appx) is intended to swell the public treasury because due to the application of the above principles that money is not lawfully due... Applying the same reasoning, to the matter before this court, it does not matter that the respondents say and think they are owed over a billion Kenya shillings - what matters is whether the amount is lawfully due and whether the law allows its recovery? It is not a question of impression or perception of what is owed, instead it is what if anything, is owed under the relevant law and whether its assessment and recovery is permitted by the applicable law. If

rightly due, the huge amount notwithstanding the court must uphold the right of recovery regardless of its consequence to the applicant and if not due under the law it must not hesitate to disallow it and must disallow it to among other things to uphold both the law the integrity of the rule of law.”

56. Whereas the obligation to pay taxes is a statutory obligation and the failure to collect the tax by way of withholding and remitting taxes by the principals in respect of commissions in my view ought not to be lightly excused, taking into account the language of section 35 of the Act, the court must, not without a little anguish, find that the decision by the Respondent was in the circumstances unjustified under the law. As was held in **Inland Revenue Commissioners vs. Wolfson [1949] 1 All ER 864 at 868:**

“It was argued that the construction that I favour leaves an easy loophole through which the evasive tax payer may find escape. That may be so, but I will repeat what has been said before. It is not the function of a court of law to give words a strained and unnatural meaning because only thus will a taxing section apply to a transaction which had the legislature thought of it, would have been covered by appropriate words. It is the duty of the Court to give to the words of this subsection their reasonable meaning, and I must decline on any ground of policy to give them a meaning which with all respect to the dissentient Lord Justice I regard as little short of extravagance.”

57. The word “upon” is defined in ***Ballentine’s Law Dictionary*** by **Jack G. Handler** as “on... Upon sight, same as at sight; upon trial, at trial, at the time of trial, when the court is tried, when the case was tried.” It follows that “upon payment” would similarly refer to ‘upon payment, when payment was made, at the time of payment.’ In this case, payment was by way of deduction of the Commission at source. Therefore the applicant was not in a position to effect deduction at the time when the agents paid themselves the said commission. I am not prepared to interpret the said phrase to mean anything else apart from what the phrase connotes in ordinary English language.

58. The applicant further contended that the amount retained by the agents encompassed commissions and expenses hence the Respondent ought not to have based its decision on the whole sum retained without making a distinction between the two since expenses unlike commissions are not subject to tax. The issue whether or not part of the sums retained by the agents were expenses was clearly a relevant factor to be taken into account and if the same was not taken into account that would render the decision of the Respondents irrational. As was held by the Court of Appeal in **Municipal Council of Mombasa vs. Republic & Umoja Consultants Ltd Civil Appeal No. 185 of 2001:**

“Judicial review is concerned with the decision making process, not with the merits of the decision itself: the Court would concern itself with such issues as to whether the decision makers had the jurisdiction, whether the persons affected by the decision were heard before it was made and *whether in making the decision the decision maker took into account relevant matters or did take into account irrelevant matters...* The court should not act as a Court of Appeal over the decider which would involve going into the merits of the decision itself-such as whether there was or there was not sufficient evidence to support the decision...It is the duty of the decision maker to comply with the law in coming to its decision, and common sense and fairness demands that once the decision is made, it is his duty to bring it to the attention of those affected by it more so where the decision maker is not a limited liability company created for commercial purposes but it a statutory body which can only do what is authorised by the statute creating it and in the manner authorised by statute.” [Emphasis mine]

59. In **Republic vs. Kenya Revenue Authority Ex parte Yaya Towers Limited [2008] eKLR** it was held that the remedy of judicial review is concerned with reviewing not the merits of the decision of which the application for judicial review is made, but the decision making process itself. It is important to remember in every case that the purpose of the remedy of Judicial Review is to ensure that the individual is given fair treatment by the authority to which he has been subjected

and that it is no part of that purpose to substitute the opinion of the judiciary or of the individual judges for that of the authority constituted by law to decide the matter in question. Unless that restriction on the power of the court is observed, the court will, under the guise of preventing abuse of power, be itself, guilty of usurpation of power. See *Halsbury's Laws of England 4th Edition Vol (1)(1) Para 60*.

60. However once the issue is considered and a finding made thereon, any challenge thereon cannot be entertained by way of judicial review proceedings since that would amount to trespassing onto the realms of merits unless it is shown that there was no evidence upon which such a finding could be made so as to render the finding *Wednesbury unreasonable*.

61. It was further contended that from the amendment to section 35(6) dealing with default penalty which took effect on 1st July, 2004 that the Commissioner may impose penalty of 10% of the amount involved subject to a limit of Kshs 1 million. In this case, the Respondents imposed 20% instead and demanded Kshs 1 million. It is clear from the letter dated 5th June 2006 that penalty was calculated at the rate of 20%. Rule 14A of the Rules provides:

For the purposes of section 35(6) of the Act, where a person, when under obligation to do so fails

(a) to make a deduction described in section 35(6) of the Act, in accordance with rule 4; or

(b) to remit an amount of tax deducted, as described in section 35(6)(b) of the Act, in accordance with rule 8,

the Commissioner may impose a penalty equal to ten percent of the amount of the tax involved, subject to a maximum penalty of one million shillings.

62. It is therefore clear that if the imposition of 20% penalty was on the failure to deduct and remit the tax under section 35(6) of the Act, the same would have been unlawful since it expressly violated the aforesaid provisions. **Miss Odundo**, nevertheless, submitted that the imposition of the said tax was a penalty under the Act and not a penalty under Rule 14A. However, a perusal of the letters from the Respondents did not seem to clarify under which provision the penalty was being imposed. Though it was contended at the hearing of this application that the penalty was imposed under the Act, no specific provision of the Act was cited to justify the same and the Court is unaware of the provision under which the same could be justified in respect to the claim the subject of this application. In **Republic vs. Commissioner of Income Tax ex parte SDV Transami (K)** (supra) **Ojwang', J** (as he then was) expressed himself as follows:

“The recorded communications between the Commissioner and the Applicant clearly show that the Respondent lacks a clear mind on whether or not ‘agency fees’ are payable by the Applicant... It is confounding that the Commissioner should communicate with the taxpayer using such terms as ‘agency fees’ and “contractual fees” interchangeably; it creates confusion and may indeed, be typified as a misunderstanding of the law and a possible ground for seeking quashing orders against the decisions taken by the Commissioner.”

63. Without a clear indication from the Respondents that the 20% penalty was justified under any other provision apart from Rule 14A aforesaid, that penalty cannot be justified.

64. Before I conclude this Judgement I must express my gratitude to the learned counsel who appeared in this application for their in depth research into the matter. If I have not referred to each and every authority cited, it is not out of lack of appreciation for their efforts.

Order

65. In light of my findings hereinabove, the inescapable conclusion I come to is that the Notice of Motion dated 7th October, 2008 is merited. Accordingly, the orders which commend themselves to me and which I hereby grant are as follows:

- a. An order of Certiorari is hereby issued removing into this Court the decision contained in the letter/assessment notice dated 19th August, 2008 and in the assessment notices attached thereto in so far as they relate to withholding tax amounting to Kshs 33,534,855/= in respect of the Applicant issued by the Respondents for purposes of being quashed which decision is hereby quashed.
- b. An order of prohibition is hereby issued to prohibiting and/or restraining the Respondents from enforcing, whether by themselves or through any agent or howsoever, recovery of the amount of Kshs 33,534,855/= or taking any adverse action against the Applicant based on the decision contained in or referred to in the letters/assessment notices dated 19th August 2008 and 10th June 2008 in so far as the said letters/assessment notices relate to withholding tax.
- c. The costs of this application are awarded to the Applicant.

Dated at Nairobi this 14th day of July 2014

G V ODUNGA

JUDGE

Delivered in the presence of:

Miss Maina for Mr Macharia for the Applicant

Cc Kevin