REPUBLIC OF KENYA

High Court at Nairobi (Nairobi Law Courts)

Commercial Civil Suit 3, 4, 5 & 6 of 2011

COMMISSIONER OF DOMESTIC TAXES.....APPELLANT

- VERSUS -

HOUSING FINANCE COMPANY LIMITED.....RESPONDENT

J U D G E M E N T

1. The Kenya Revenue Authority (K.R.A.) is a body corporate established under the Kenya Revenue Authority Act, Chapter 469 of the Laws of Kenya and is *inter-a-alia* charged with the responsibility of levying and collecting taxes under the **Income Tax Act Chapter 470 Laws of Kenya**, and in the instant case, carried out that duty through the Commissioner of Domestic Taxes who is the Appellant herein.

2. The Respondent is a public company carrying on *inter-a-alia* the business of mortgage financing for owner occupier, commercial properties, construction financing and general banking business.

3. The Appellant carried out a comprehensive tax audit on **February 2010** on the Respondents for the years **2006** to **2009**. The Appellant established that the Respondent had a Group Life Insurance contract for its employees with the Insurance Company of East African (**annexture CITI**). This was for the years of income 2006, 2007, 2008 and 2009. Payments for the premium were made and taxes raised as follows:-

YEAR	PREMIUM	TAXES
2007	Kshs. 3,054,343.00	Kshs.1,722,245.00
2007	Kshs. 1,344,924.00	Kshs. 889,264.00
2008	Kshs. 3,221,146.00	Kshs.1,793,534.00
2009	Kshs. 3,806,907.00	Kshs. 889,264.00
	Kshs.11,427,320.00	**Kshs.5,294,307.00**

4. By a memorandum of Appeal dated **28th April 2011**, the Appellant has appealed against the decision of the Local committee of **24th March 2011**. This decision allowed the Respondent's appeal against the demand by the Appellant on account of Pay As You Earn (PAYE) in respect of premiums paid for a Group Life Assurance Policy (hereinafter "**the Policy**") taken out by the Respondent for its employees for the years **2006**, **2007**, **2008** and **2009**.

The Memorandum of Appeal sets out 4 grounds of appeal, namely that the Local Committee erred in law and in fact in:-

(a) Holding that the Group Life Insurance Scheme was for the Respondent's benefit and hence not a taxable benefit in the hands of employees.

(b) Failing to take into account that group life premiums paid by an employer on behalf of his employees is a gain on profit chargeable to tax under Section 5 (2) (f) of the Income Tax Act.

(c) Failing to rely on the provisions and conditions of the policy endorsement which clearly outlines that the beneficiaries in the policy are the Respondent's employees.

(d) Freeing the Respondent insurance relief from its tax obligation yet it is not paid to a registered or unregistered pension scheme, pension fund, provident fund or individual retirement fund.

5. The background of this matter is largely set out in the Respondent's statement. In a nutshell, the Respondent has taken the policy, the subject of this appeal, on its employees to manage any obligations and/or liabilities that the Respondent may incur on any of its employees. This is a contract between the insurer and the policy holder, the Respondent herein.

On or about **February 2010**, a tax audit was undertaken on the Respondent for the years of income **2006** to **2009**. Following this tax audit, the Appellant issued a tax demand letter to the Respondent dated **5th May 2010** together with a schedule showing a breakdown of the taxes alleged as due to the Appellant. The Respondent was aggrieved by the Appellant's decision and/or tax demand and appealed to the Local Committee against the Appellant's assessment of taxes payable to it.

The basis of the Respondent's appeal to the Local Committee was that contrary to the appellant's position and tax demand, the policy was for the benefit of the Respondent and not a benefit to the Respondent's employees capable of taxation. For this reason, the Respondent's position was that the premium did not constitute a taxable benefit as alleged, or at all.

The issue for determination by the Local Committee whose decision is appealed against herein, was whether Group Life Insurance Scheme was for the benefit of the Respondent herein and therefore not a taxable benefit or whether the same was a taxable benefit to the Respondent's employees giving rise to PAYE taxable liability. The Local Committee after taking into account both parties' written and oral arguments and evidence, delivered its decision on **24th March 2011** and allowed appeal by the Respondent herein.

The Appellant's demand, the basis of the appeal to the Local Committee, was for a principal amount of **Kshs.3,428,196/=** for the years **2006**, **2007 2008** and **2009**. In addition to the alleged penalties and interest, the total amount demanded by the Appellant is **Kshs.6,743,448/=**.

Although the decision of the Local Committee was on the entire amount demanded for the year **2006**, **2007**, **2008** and **2009**, the Appellant herein specifically seeks for payment of PAYE for the year **2006**.

6. Both parties filed their respective statements, and written submissions. From the said statements and submissions, both parties appear to separately agree on the issues to be determined by this court, and that is:-

- Whether Group Life Insurance Premium paid by the Respondent is a benefit to the Respondent's employee which is taxable under the relevant provisions of the Income Tax Act.

7. The relevant provisions of the Income Tax are **Section 3 (2) (2) (a)** which states:-

"Subject to this Act income upon which tax is chargeable under this Act is income in respect of –

(a) Gains or profits from . . ."

Section 5 (2) (f) further defines gains and profits to include an amount paid by employer as a premium on

life insurance for his employers. It states:-

"For the purpose of Section 3 (2) (a) (ii), gain or profits include -

(f) An amount paid by an employer as a premium for an insurance on the life of its employee for the benefit of that employee or any of his dependants other than such an amount paid to a registered at unregistered pension scheme, pension fund, or individual retirement fund."

The Appellant submitted that the Respondent is not a registered or unregistered pension scheme, pension fund or individual retirement fund, and on the basis of the above law and the facts urged this court to allow the appeal and overturn the decision of the Local Committee for Nairobi dated **24th March 2011**.

8. On their part, the Respondent, submitting that the Group Life Insurance Scheme is for the Respondent's benefit and not for its employees, added that it has a statutory obligation to pay compensation to an employee involved in an accident resulting to the employee's death or disablement while at work. On this basis, the Respondent outsourced its obligation to cover this risk to an insurance company.

The Respondent is the insured party under the insurance policy and the cover is for the benefit of the Respondent. As such, the Respondents' employees have no insurable interest in the policy as it is the Respondent who is covered for the insured risks. The Respondent does not pay premiums on behalf of individual employees as alleged and the insurance cover does not, in any way, convey a taxable benefit to employees.

As held by the Local Committee, the employees cannot claim tax relief for payment of the premium as would have been the case had they insured themselves under individual personal accident and/or life assurance policies.

In the event the employees leave the Respondent's employment, no benefit is carried which would have been the case had they insured themselves under individual personal accident and/or life assurance policies.

If the insured event does not occur within the insurance period, the premiums paid to the insurer become a cost to the Respondent and do not constitute a benefit to the Respondent's employees in any way.

The court is urged to take into account that prior to the High court decision in **LAW SOCIETY OF KENYA – VS – ATTORNEY GENERAL AND CENTRAL ORGANIZATION OF TRADE UNIONS (K) PETITION NUMBER 185 OF 2008** delivered on **4th March 2009** (produced at pages 14 to 43 of the Respondent's statement), **Section 7 (1)** of the **Work Injury Benefits Act** made it mandatory for the Respondent to obtain and maintain an insurance policy with an insurer approved by the Minister in respect of any liability that the employer may incur to any of its employees.

Section 7 (1) of **The Work Injury Benefit Act** provided that: "*every employer shall obtain and maintain an insurance policy, with an insurer approved by the minister in respect of any liability that the employer may incur under this Act to any of his employees*." According to Section 7 (4), "*any employer who contravenes the provisions of subsection (1) commits an offence and shall on conviction be liable to a fine not exceeding Kshs.100,000 or to imprisonment for a term not exceeding three months, or both*".

As stated above and as held by the Local Committee, the true beneficiary is the Respondent herein since it has insured itself against a liability that is recognized it had to some designated group of employees. To support this contention, the Respondent invited the court to take into account that in the event of claims, the insurance company issued cheques in the Respondent's name. Further, the Respondent's employees could not claim tax relief for this payment as would have been the case had they insured themselves. In the event of the employees leaving the Respondent's employment, no benefit is carried which would have been the case in a self financed scheme.

The Respondent submitted that an employer has an insurable interest in the life of its employees which it can be indemnified for as opposed to personal life insurance which is not subject to indemnity. The Respondent cited on **Colinvaux's Law of Insurance** at page 614 para 18 – 20 which take cognizance of the fact that an employer has an insurable interest in the life of his employees.

The Respondent submits that the insurance cover did not convey a taxable benefit to the employees and hence not a taxable benefit under Section 5 (2) (f) of the Income Tax Act. As such there is no PAYE tax liability as Group Life Insurance cover is for the benefit of the Respondent as an employer. It is taken by the Respondent to indemnify itself against loss, damage and other diminution in value of its assets occasioned by happening of uncertain future events. The premiums paid for the cover is a cost to the Respondent and does not constitute a benefit to any of its employees as contemplated by **Section 5 (2) (f)** of the **Income Tax Act**.

Group Life Assurance Policies fall within the category of corporate insurance policies and products, just like any other classes of insurance taken by a company to indemnify itself against loss, damage and other diminution in value of assets occasioned by occurrence of uncertain future events. This must be distinguished from individual personal accident and/or life assurance policies which are categorized as personal insurance policies and products. As such, no taxable benefits accrue on individual employees on premiums paid by their employers

The fact that the insurance cover sets out the exact employees covered cannot be interpreted to mean that those employees will benefit. In short, premium was paid for the benefit of the Respondent and not the Respondent's employees.

9. I have carefully considered the issues raised by the parties. The Appellant raised four issues, namely:-

- What is Group Life Insurance?
- Is it a benefit?
- For whom is it a benefit?
- Is it a taxable benefit?

The Respondent raised two issues namely:-

- Is Group Life Insurance Scheme for the Respondents benefit or for the benefit of its employee?
- Whether premiums paid by the Respondent on behalf of its employees constitute taxable gains or profits on the individual employee under **Section 5 (2) (f)** of the **Income Tax Act**.

In regard to these issues, firstly, all parties agree that the policy in question is a Group Life Insurance Scheme and so I will not belabor the issue any further. Also, in my view the scheme confers a benefit upon the Respondent. This is clear from the Schedule to the said **Policy Number 4284**. The Assured is named as:

Housing Finance Company of Kenya Limited,
P.O. Box 30088,
NAIROBI.

Sum assured is said to be payable to the person assured or the Assigns of the person assured.

10. It is easy to understand why an employer would be taking out a policy over the life of its employees for its own benefit. An employer is recognized as having an insurable interest on the life of its employees. In addition it has become a requirement of the law since **2007** pursuant to **Section 7 (1)** of the **Work Injury Benefit Act** as correctly submitted by Mr. Kiragu for the Respondent.

11. The position taken by the Appellant that the premiums paid is for the benefit of the individual employees is in clear contravention established cannons of taxation. The first being the principle of certainty and unambiguity. In support of this position, is the decision in **REPUBLIC VS KENYA REVENUE AUTHORITY [2009] eKLR W**here the court held that Kenya Revenue Authority, in administering and enforcing the Income Tax Act, is bound to have regard to the notorious well known principles of taxation that is to be equitable, clear and unambiguous, reasonable and just. In addition, it is also enjoined to take into account international best practices, standards and guidelines in its interpretation of the provisions of the Income Tax Act so as not to visit absurd and unreasonable results and consequences either on the tax payer and or the Government of Kenya.

In interpreting *Section 5 (2) (f)* I am guided by the general principles of interpretation as discussed at length by Nyamu J. In the case of **KEROCHE INDUSTRIES LIMITED – VS – KENYA REVENUE AUTHORITY AND 5 OTHERS [2007] eKLR**. The Court upheld the doctrine that in taxation cases the subject is to be taxed, if in accordance with the court's view of what it considers the substance of the transaction, the court thinks that the case falls within the contemplation or spirit of the statute. The subject is not taxable by inference or by analogy but only by plain words of a statute applicable to the facts and circumstances of the case.

The view is further supported by decision in the case of **RAMSAY LTD. – VS – INLAND REVENUE COMMISSIONER [1992] AC 300** where it was held that "*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 liberal 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.

12. In conclusion, and pursuant to the foregoing I have found that the Group Life Insurance cover in question is for the benefit of the Respondent and at its own cost and that the Respondent and not its employees is the Insured under the policy. Accordingly, the premiums paid for the same is not a taxable gain and does not fall under the ambit of **Section 5 (2) (b)** of the **Income Tax Act, Chapter 470**.

13. The Respondent cited a case of similar facts being **INCOME TAX APPEAL NUMBER 10 OF 2011. COMMISSIONER OF DOMESTIC TAXES – VS – STANDARD CHARTERED (K) LIMITED** in which Mr. Justice Mabeya was faced with similar issues, and he founded for the Respondents and found as a matter of fact that the premiums paid under the policy did not constitute a taxable benefit under **Section 5 (2) (f)** of the **Income Tax Act**. I am not bound by that decision, but the interpretation contained in that Judgement is correct and I also adopt the same. In the upshot, I find that the Local Committee on **24th March 2011** arrived at a correct decision. Accordingly the appeal herein fails and is dismissed with costs to the Respondent.

This is the Judgement of the court.

DATED, READ AND DELIVERED AT NAIROBI

THIS 6TH DAY OF NOVEMBER 2012

E. K. O. OGOLA

JUDGE

PRESENT:

Twahir for the Appellant

Kimani for the Respondent

Teresia – Court Clerk