Kenya Revenue Authority v Republic (Ex Parte: Fintel Ltd) (Civil Appeal 311 of 2013) [2019] KECA 1066 (KLR) (5 February 2019) (Judgment)

Neutral citation: [2019] KECA 1066 (KLR)

REPUBLIC OF KENYA

IN THE COURT OF APPEAL AT NAIROBI

CIVIL APPEAL 311 OF 2013

W OUKO, MSA MAKHANDIA & SG KAIRU, JJA

FEBRUARY 5, 2019

BETWEEN

KENYA REVENUE AUTHORITY ..... APPELLANT

AND

REPUBLIC (EX PARTE: FINTEL LTD) ..... RESPONDENT

(Being an appeal from the Judgment of the High Court of Kenya at Nairobi (Majanja J) dated 5th October, 2012 in J.R Misc. Application No.1768 of 2004)

JUDGMENT

1. R.M. Engelhardt, a New York based poet and writer in his famous collection of poems The Last Cigarette reminds us that;

> Words are powerful.
>
> Words make a difference.
>
> They can create and destroy.
>
> They can open doors and close doors. Words can create illusion or magic, love or destruction. ... All those things."

2. The words whose construction has given rise to this appeal are "paid" and "upon payment" as used in section 2 as read with section 35 of the *Income Tax Act*. As long ago as 1936 the House of Lords in Inland Revenue Commissioners V. Duke of Westminster [1936] A.C. 1; [1] 19 TC 490, which has been widely cited in Kenya, elucidated the rule of construing tax laws. Lord Atkinson said;

> It is well established that one is bound, in construing Revenue Acts, to give a fair and reasonable construction to their language without leaning to one side or the other, that no tax can be imposed on a subject by Act of Parliament without words in it clearly showing an

intention to lay the burden upon him, that the words of a statute must be adhered to, and that so-called equitable constructions of them are not permissible."

3. Lord Simonds in the House of Lords' decision of Russel V Scott. (1948) 2 ALL ER 5 repeated that;

> ...there is a maxim of income tax law which, though it may sometimes be over-stressed, 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 on him".

4. The uncontroverted facts in this appeal are that on or about 21st April, 2009, Fintel Ltd, the respondent, entered into an agreement with China Jiangsu International Economic Technical Co-operation, (the contractor) for the construction of a rental building. It was a term of the contract that the respondent would pay to the contractor interest on any contract fees outstanding after the due date. It is this term that is at the heart of the controversy; that if any contract fees remained unpaid after the due date it would attract interest which the respondent undertook to pay to the contractor.

5. In the course of the contract, the respondent experienced difficulties in settling the outstanding fees to the contractor on due dates. In accordance with accounting practices, the interest due to the contractor was recorded as a liability in the respondent's books of accounts. Similarly, in its audited accounts for the year ending 31st December, 2001, the respondent made provision for that interest. Following an audit of the respondent's books by the Kenya Revenue Authority, "the appellant" demanded the immediate payment of the "deducted withholding tax on interest which had already been claimed as an expense in the audited accounts" assessed at Kshs. 4,787,257.

6. The respondent filed an objection to the assessment, which the Commissioner of Income Tax considered and rejected. The respondent then sought the Court's intervention by applying for an order for certiorari, contending that the accrual of the interest expense in its books of account did not amount to payment of the same to the contractor; that it was only a recognition of the crystallization of a liability due from it to the contractor; that the appellant's decision to demand the payment of withholding tax, in the circumstances was ultra vires.

7. In its defence, the appellant insisted that the interest charged, though not paid to the contractor, remained a debt which was recognized in the books of accounts and claimed as an accrued expense in the profit and loss account; that this had the effect of reducing the amount of profit chargeable as corporation tax; that by recognizing accrued interest as a liability in its books of accounts, the respondent acknowledged that interest was credited to the account of the payee therefore fell within the definition of the term "paid" as defined in section 2 of the *Income Tax Act* and was therefore subject to the withholding tax under section 35(1)(e) of the *Income Tax Act*.

8. Majanja, J. who heard the application framed the following three issues; whether the decision contained in the letter dated 29th July, 2009 rejecting the respondent's objection to assessment of withholding tax was ultra vires the *Income Tax Act*; whether the failure to give reasons for dismissing the objection rendered the decision a nullity and; whether the respondent had an alternative remedy. On the first issue, the Judge said:

> 41. The issue in this case is really whether the applicant must deduct withholding tax on interest claimed as an expense in audited account under section 35 of the Act. As I have pointed, the meaning of "paid" and the language of sections 2 and 35 of the *Income Tax Act* as a whole do not support the respondent's position. Sections 35(1) and (3) clearly state that tax is withheld "upon payment" and payment is a necessary prerequisite for the withholding tax to apply.

42. I find and hold that the decision made to impose tax on the applicant in this case is without jurisdiction and without mandate of the *Income Tax Act* and therefore an order of certiorari is appropriate to quash the ultra vires act of the respondent in demanding tax outside its mandate."

9. On whether the appellant's decision was a nullity for failure to give reasons, the learned Judge, relying on the case of Breen V Amalgamated Engineeering Union (1971) QB 175,191 and Article 47(2) of *the Constitution* agreed with the appellant that, considering the contents of the demand letter together with those of the impugned letter of 29th July, 2009, there was no doubt that reasons for rejecting the objection were clear and obvious.

10. Lastly, on the existence of an alternative remedy, the learned Judge observed that although the appellant had issued a Notice of Appeal to the Local Committee to challenge the decision of the appellant, there was nothing untoward in pursuing a judicial review route; that the move was not actuated by mischief or bad faith; and that the paucity of the decision was the very ground for seeking the judicial review relief. Accordingly, the Judge issued an order of certiorari to quash the decision by the Commissioner contained in his letter dated 29th July, 2004.

11. That determination aggrieved the appellant who has challenged it before us, arguing that the learned Judge erred; by finding that the decision to impose tax was ultra vires the *Income Tax Act*; in his interpretation of the words 'paid', 'payment' and 'credited' in the *Income Tax Act*; by misapplying the basic principles of accounting and taxation; and in failing to find that the respondent was guilty for failure to disclose the existence of an alternative remedy. The appellant now seeks the setting aside of the High Court's orders with costs and a declaration that the respondent was taxable under the *Income Tax Act*.

12. In their submissions before us, Ms. Wambui and Mr. Nyaga holding brief for Ms. Odundo on behalf of the appellant argued that payments due to the contractor fell within the ambit of section 35(3)(f) of the *Income Tax Act*, being professional or management fees in respect of building, civil and engineering works therefore constituting withholding tax which the law permits the appellant to collect; that for the full import, section 35(1)(e) should be read with section 2; that any amount recognized as an expense in the books of accounts is a credited amount in the payees account and is therefore "paid" within the meaning of section 2 aforesaid. Borrowing from South African's *Income Tax Act* and though the word "paid" in relation to withholding is not defined in that legislation, the courts there have said, for instance in the cases of Singh V C, SARS(2003 (4) SA 520 (SCA), Commissioner for South African Revenue Service V Brummeria Renaissance (Pty) Ltd and Others, 69 SATC 205, CIR V People's Stores (Walvis Bay) (Pty) Ltd 52 SATC 9, and Cactus Investments (Pty) Ltd V CIR 61 SATC 43, that the debt must be one in respect of which the debtor is under an obligation to pay immediately.

13. Counsel further submitted that the word "payable" could be defined in two different ways: that which is due or must be paid; and that which may be paid or may have to be paid. The former being a present liability due and payable, the latter being a future or contingent liability. Based on this categorization counsel submitted that the debt arose from the moment it became due and it became payable once it was featured in the books of accounts and claimed as a loss by the respondent. On the basis of those submissions and the persuasive authorities cited, counsel urged us to find that the learned Judge's interpretation that "upon payment" implied "delivery of money or any other valuable thing..." was erroneous as it restricts the meaning of the word "paid" under section 2.

14. On the adoption of the "ejusdem generis" rule in interpreting the word "paid", counsel maintained, relying on Justice G.P Singh's treatise 'Principles of Statutory Interpretation', the case of Mjengo Ltd

V Commissioner of Domestic Tax, Civil Appeal No.85 of 2014 and Stroud's 'Judicial Dictionary of Words and Phrases' that the Judge was wrong as he did so in a restrictive manner.

15. Counsel submitted that the Judge misapplied the basic principles of accounting, by failing to appreciate the two primary accounting concepts being cash and accrual concepts, which presents options for the taxpayer; that in the dispute, the respondent elected the accrual option. In their statement of profit and loss, the interest charged though not paid to the contractors and remained a debt owing was recognized in the books of account as an accrued expense, the effect of which was to reduce the amount of profit chargeable to tax as corporation tax. Counsel referred the Court to the revenue recognition principle under Financial Accounting Standards Boards (FASB) and Simon's Income Tax Vol 1 Replacement 1964-65 at page 215.

16. On whether the appellant acted ultra vires, it was counsel's submission that section 120 of the Act mandates any officer authorized by the Commissioner to inquire into the affairs of a person for purposes of collection and assessment of income tax and; that it is upon this authority that the appellant proceeded to inquired into the affairs of the respondent. That from the language of section 3(1) of the Act it is clear that the income of a person, whether resident or non-resident, is chargeable to income tax, provided the income accrued was derived from Kenya; that as a general principle of taxation under the Act, tax on interest declared is payable whether actual payment is made or not, and withholding tax becomes due at the source where it arose, hence the appellant's action was within the law.

17. Lastly, we were urged to find fault in the learned Judge's failure to find that judicial review was not available to the respondent without exhausting all other statutory mechanisms elaborately set out under the *Tax Procedures Act* to ventilate its case. In support of this submission counsel cited this Court's decision in Mutanga Tea & Coffee Company Ltd V. Shikara Ltd & Another, Civil Appeal No.54 of 2014, and that of the High Court in R V IEBC & Others Ex Parte the National Super Alliance Judicial Review No. 378 of 2017.

18. In opposition, Mr. Kahonge learned counsel for the respondent submitted in agreement with the learned Judge that the term "paid" under section 2 of the *Income Tax Act* can only mean delivery of money and discharge of settlement. That since the respondent neither settled the outstanding contractual fee nor paid any interest charged by the contractor, even though the interest was recognized as a liability in the respondent's books of accounts, no withholding tax was due from that transaction; that in ascertaining the stage at which the withholding tax becomes payable one must ascertain whether it should be when the expenses accrued or when they are actually paid; that in terms of section 35(1) and (3) of the Act tax is withheld 'upon payment' of the expenses; that the fact of payment is therefore a necessary prerequisite for withholding tax to apply. He observed that, just as the Act does not define the term accrued, the Withholding Tax Rules are themselves not clear on the timing of the deduction of the tax, whether upon payment or accrual. According to counsel the settlement of an obligation may be through receipt of cash, cheque or other mode of settlement or discharge; that an accrual is not a discharge of debt. 'Upon payment' denotes the discharge of a debt or liability; that it was premature for the appellant to demand payment of the withholding tax before the actual payment of interest; that by doing so it exceeded its powers under section 2 as read with section 35(1) and (3) of the Act.

19. On the other grounds, counsel submitted that without giving of reasons for rejecting the objection, the appellant denied the respondent a chance to understand the basis of the decision. It is because of this omission that the respondent resorted to judicial review. Counsel cited Minister of National Revenue V Wrights Canadian Ropes Limited (1947) AC 109 to 123 and Padfield V Minister for Agriculture Fisheries and Food (1986) AC 977, where it was held that a minister who fails to explain a decision satisfactorily may be declared as arbitrary and liable to a censure by judicial review.

20. Considering these rival and equally persuasive arguments, we bear in mind, like the Court did in Selle & another V Associated Motor Boat Co. Ltd.& others (1968) EA 123 pursuant to Rule 29(1) (a) of the Rules of this Court, that an appeal to this Court from a trial by the High Court is by way of retrial, except that we have not had the opportunity of seeing and hearing the witnesses. Just like in a retrial, the appellate court is required to reconsider the evidence on record, evaluate it itself and draw its own independent conclusions.

21. As we have said, both sides presented powerful persuasive submissions regarding the interpretation of section 35 (3) as read with section 2 of the *Income Tax Act*. Needless to say, withholding tax is where the tax payer of certain incomes is responsible for deducting tax at source from payments made and remitting the deducted tax to the revenue body, in our case, the appellant.

22. See also definition in Black's Law Dictionary where withholding Tax is defined as:

> A portion of income tax that is subtracted from salary, wages, dividends, or other income before the earner receives 'payment.'

Section 35(3) stipulates that;

"(3) Subject to subsection (3A), a person shall, upon payment of an amount to a person resident or having a permanent establishment in Kenya in respect of—

.....

(f) management or professional fee or training fee, the aggregate value of which is twenty-four thousand shillings or more in a month.

Provided that for the purposes of this paragraph, contractual fee within the meaning of "management or professional fee" shall mean payment for work done in respect of building , civil or engineering works which is chargeable to tax, deduct therefrom tax at the appropriate resident withholding tax." (Our emphasis).

23. The key words are "upon payment". The Court has extensively discussed the meaning of that phrase in Cimbria (EA) Limited V Kenya Revenue Authority (2017) eKLR and observed that;

> These words may appear simple and straight forward, but not so in tax law. Indeed they have been subject of interpretation in many decisions both within and outside our jurisdiction. We start the interpretation with the simple English dictionary meaning attached to these words. In normal English parlance, the word "on" and "upon" are used interchangeably and are taken to have similar meaning..... It follows that "upon payment" would similarly refer to 'upon payment, when payment was made, at the time of payment.'.....
>
> it is clear that the words "upon payment" would mean 'on payment', and in this case, it would also mean "paid". We agree with the learned Judge's interpretation of the said phrase in the case of Republic v. Kenya Revenue Authority & Another Ex parte Kenya Nut Company Limited [2014] eKLR, where the court held that the word 'upon payment' literally means 'paid'....we come to the following conclusions; That the words "upon payment" mean "paid" and not "payable".

24. If "upon payment" means "paid" then what does "paid" under the *Income Tax Act* mean. Under section 2 the word "paid";

> .... includes distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person and "pay", "payment" and "payable" have corresponding meanings". (Our emphasis).

25. Withholding tax is to be deducted from taxable management or professional fee for building, civil or engineering works "upon payment" of the amount due. While it was common factor that the respondent never paid the outstanding contractual fee as well as interest charged on the outstanding fee, it was the view of the appellant that, applying the meaning of the words "upon payment" and "paid", as defined above, the respondent was bound to withhold the tax on account of the contractor even if it had not paid out the interest to the latter because an obligation to make payment had arisen; and that the interest payment was accordingly included in its books of account as a credit to the contractor.

26. The respondent for its part contended that the ordinary meaning of the phrase "paid" or the words "upon payment" is that withholding tax was only to apply upon proof, in the form of a cheque, cash or other form that the interest under the contract was actually paid to the contractor; that since no actual payment was made, there was nothing to deduct and remit to the appellant. The learned Judge agreed with the respondent. Quoting from the Concise Oxford English Dictionary the Judge said that the words "upon payment" and "paid" connote "delivery of money or some other valuable thing", "to give (a sum of money) thus owed", suggesting actual payment; that by section 35(5) requiring that the amount deducted be remitted to the appellant on or before the twentieth day after the deduction, can only mean that payment must be actual.

27. No issue will arise where actual payment has been made in respect of building, civil or engineering works. But here it is conceded that no such payment was made. In such a situation, should the appellant insist on the respondent remitting the withholding tax? The answer is in the construction of section 2 aforesaid, which bears repeating here. The word:-

> 'Paid' includes distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person and "pay", "payment" and "payable" have corresponding meanings."

28. It is not in dispute that the respondent, in its profit and loss account recognized and included the interest payable. It credited that amount in favour of the contractor. The strict application of the definition of the word "paid" will of necessity include any amount credited in the interest or on behalf of a person, in this case, the contractor.

29. We are reminded by a long line of authorities that where the provisions of an enactment are penal in nature, they must be construed strictly and in doing so care must be taken so that no-one is brought within it who is not brought within it in the express language of the statute. See Tanganyika Mine Workers Union V. The Registrar of Trade Unions [1961] EA 629, London County Council V. Aylesbury Dairy Company Ltd [1899] 1 QB 106 at 109; Muini vs. R through Medical Officer of Health, Kiambu [2006] 1 KLR (E&L) 15; RE Hardial Singh and Others [1976-80] 1 KLR 1090.

30. Similarly it has been emphasised that;

> 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."

31. See Vestey V. Inland Revenue Commissioners [1979] 3 All ER at 984. On the construction of a statute we restate the ratio expressed in Privy Council's decision in Mangin V Inland Revenue Commissioner [1971] AC 739 by Lord Donovan that in construing tax laws;

> ...the words are to be given their ordinary meaning, looking only at what is clearly said. There is no room for any intendment. There is no presumption so to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used..... In that process, the court is under a duty to adopt an approach that produces neither injustice nor absurdity; in other words, an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein."

32. While the words "upon payment" in their colloquial and ordinary parlance suggest "payment" or "paid", that is, to be given money for something in exchange, it is our considered view that the relevant statute, the *Income Tax Act* must be the source of the meaning to be attached to it. The interpretation must be contextual.

33. A statute ought to be looked at, in the context of its enactment and as a whole as opposed to picking and choosing words in isolation. "No part of a statute and no word of a statute can be construed in isolation. Statutes have to be construed so that every word has a place and everything is in its place." So said the learned Judges of the Supreme Court of India in Reserve Bank of India V. Peerless General Finance and Investment Co. Ltd., 1987 SCR (2) 1.

34. See also The Engineers Board of Kenya V. Jesse Waweru Wahome & others Civil Appeal No 240 of 2013.

35. The *Income Tax Act* has given the word "paid" a technical as opposed to an ordinary definition. Tax law is ever changing, complicated and highly technical.That is why we, with respect disagree with the learned Judge for insisting that "upon payment" must only convey the meaning that money or some valuable thing was delivered. He gave the phrase a very narrow construction. In the context of the *Income Tax Act*, payment is deemed to have been made even when no money has passed over. We therefore reject the contention that it was not practical to deduct and remit the tax without first actually paying the interest to the contractor. Although section 35(5) requires that where withholding tax is payable, the tax payer must "deduct" and remit the amount so deducted to the Commissioner, the sense in which the word "deduct" is used, as an accounting term refers to the act or process of subtraction of an item or expenditure from gross income to reduce the amount of income subject to income tax. This need not be done physically or practically but as a book entry.

36. We believe it is accurate to state that the income tax regime is based on accrual system. This is clear from Sections 3 and 10, among others. The former, under the heading, "Imposition of Income Tax" provides:

> 3. Charge of Tax
>
> (1) Subject to, and in accordance with this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.
>
> (2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of:
>
> (a) gains or profits from-
>
> (i) Any business, for whatever period of time carried on;

(ii) Any employment or services rendered;

(iii) Any right granted to any other person for use or occupation of property;

(iv) Dividends or interest

....." (Our emphasis)

37. On the other hand, Section 10 provides that:

10. . Income from management or professional fees, royalties, interest and rents

(1) For the purposes of this Act, where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of

(a) Management or professional fee or training fee;

(b) .....

(c) Interest and deemed interest

(d) .....

(e) .....

(f) .....

(g) .....

(h) .....

The amount thereof shall be deemed to be income which accrued in or was derived from Kenya." (Our emphasis)

38. By making the entry of the interest due to the contractor in its profits and loss account, the respondent reduced its taxable income, which passed to it as a benefit since the amount of profits chargeable as corporate tax was reduced.

39. We turn to grounds 4 and 5 in which the appellant complained that the learned Judge failed to appreciate the existence of the two principles or methods of accounting; cash or accrued. The appellant explained that in the former, expenses are paid in cash while the latter simply records an income items when they are earned; it also records deductions when expenses are incurred, regardless of the flow of cash. According to the appellant, the respondent elected the latter method, whose effect is that accrued revenue is an asset and includes unpaid proceeds from a delivery of goods or services with a promise to pay in future. This phenomenon was not argued before the court below and the learned Judge did not express an opinion one way or the other on it.

40. From the issues framed for our consideration, we believe with that determination this appeal succeeds. The learned Judge erred in his construction of sections 2 and 35 for the true meaning of the words "upon payment" and "paid" and reached an erroneous conclusion that the appellant's decision to demand for payment of the tax withheld from the payment of interest under the contract was in excess of its powers.

41. The Kenya Revenue Authority is established under an Act of Parliament bearing the same name. Its sole role is expressed to be revenue assessment and collection, administration and enforcement of the laws relating to revenue. This role is recognized in section 120 of the *Income Tax Act* which permits

the appellant to inquire into the accounts of a company, assess tax and demand payment. Certiorari, an order that quashes the decision made without jurisdiction or in excess of jurisdiction, or where the rules of natural justice have not been complied with, was inappropriate.

42. In the last ground, the appellant complained that the Judge ought to have debarred the respondent from seeking relief in judicial review proceedings after failing to disclose the existence of an alternative remedy.

43. The argument was that the respondent, having been aggrieved by the decision of the Commissioner, through its appointed tax agent issued a Notice of Appeal to the Local Committee under section 86 of the *Income Tax Act* expressing an intention to challenge the decision but instead of pursuing that to the end, filed judicial review proceedings.

44. The learned Judge found nothing untoward in this. While we ourselves think that there was no justification for the respondent to move the High Court after invoking the jurisdiction of the Local Committee, it was excusable as it was done in good faith and the appellant suffered no prejudice. See: Republic V Econet Wireless Company (RE Kenya National Cooperatives Limited) (2004) 2 EA 28.

45. For all the reasons we have given, the appeal succeeds. The judgment of the superior court below rendered on 5th October, 2012 is set aside with costs to the appellant. We also award costs in the High Court to the appellant.

DATED AND DELIVERED AT NAIROBI THIS 5TH DAY OF FEBRUARY, 2019.

W. OUKO, (P)

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JUDGE OF APPEAL

ASIKE – MAKHANDIA

.....

JUDGE OF APPEAL

S. GATEMBU KAIRU, FCIArb

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JUDGE OF APPEAL

I certify that this is a true

copy of the original.

DEPUTY REGISTRAR