IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: MUSINGA, GATEMBU & MURGOR, JJ.A)

CIVIL APPEAL NO. 111 OF 2013

BETWEEN

ABN AMRO BANK NV…… APPELLANT

AND

KENYA REVENUE AUTHORITY……..……..…RESPONDENT

(Being an appeal from the Order of the High Court at Nairobi (Gacheche, J.) dated 8th July 2011

in

Misc Civil Application Number 1135 of 2002

****

JUDGMENT OF THE COURT

This appeal which originates from a Judicial Review application filed by the appellant by way of a Notice of Motion dated 7th October 2002 in the High Court where the appellant sought the following orders:

> *a) An order of certiorari to be issued to remove to the Honourable Court the Respondent's letter dated 26th June 2002 for the purpose of the same being quashed.*
>
> *b) An order of prohibition be issued to prohibit the Respondent from issuing an agency notice to the Applicant's bankers for payment of the sum of Kshs. 117,232,198/= or any other sum on the basis that the Applicant's former employees were employed for a fixed term upto the age of 55 years.*
>
> *c) Costs of and incidental to thissuit.*

The brief background to the dispute is that, sometime in November 2001, the appellant, a bank that was operating in Kenya, made a decision to cease its operations in the country due to what it termed, world wide restructuring of its banking business. As part of the withdrawal process, it negotiated and paid a severance pay to its employees, and in conjunction with this paid an amount of Kshs. 215 million in taxes to the respondent who acknowledged receipt.

In a letter dated 28th January 2002, the respondent informed the appellant that the income tax amount paid

was incorrect, as the appellant had applied ***section 5 (1) (c) (iii)*** of the ***Income Tax Act*** that was concerned with unspecified term contracts when, it should have applied ***section 5 (1) (c) (i)*** of the ***Income Tax Act*** that was concerned with specified term contracts, on account of the inclusion of the employees retirement age. As a result it demanded additional tax of a sum of Kshs. 117,232,198.00.

The appellant was aggrieved and filed notice of motion dated 7th October, 2002 based on the grounds that the respondent wrongly converted an ordinary employment contract terminable by either party, into a fixed term contract, on the basis that a clause on the employees' retirement age was included in the contract; that the inclusion of the retirement age in the letter of appointment did not create a fixed employment, but that the insertion was in keeping with mandatory labour regulations pertaining to retirement age; that the decision made by the respondent was punitive, in excess of power and devoid of any justification in that it purported to confer rights upon the former employees and which rights never existed in fact; that the demand made by the respondent after such an inordinately lengthy period; that the demand made by the respondent is discriminatory of the appellant as other employees in similar circumstances have in the past paid tax to the respondent on the basis of ***section 5(2)(c)(iii)*** of the ***Income Tax Act*** and not on the basis of ***section 5(2) (c) (i)*** of the ***Income Tax Act*** and that the respondent has further applied an interest rate which is in excess of the rate specified by the Act.

The application was supported by the sworn affidavit of the appellant's Country representative, Adriaan Ruth van der Pol.

The appellant argued that it was erroneous for the respondent to base the contract term on the employees' retirement age, and furthermore, since the contracts also specified that the employment contract could be terminated by either party giving the other 3 months notice, or 3 months salary in lieu of notice, or on grounds of misconduct or inability to perform duties or pecuniary embarrassment; it could not be considered to be a fixed term or specified contract.

Upon receipt of the letter of 28th January 2002, the appellant consulted their tax consultant, Ernest & Young, who wrote to the respondent objecting to the respondent's demand.

In a letter of 26th June 2002, the respondent informed the appellant of its decision to compute the tax on severance pay on the basis of ***section 5 (1) (c) (i)*** of the ***Income Tax Act***, and in so doing demanded payment of the additional tax, penalties and interest of Kshs. 117,232,198.00.

By way of an affidavit sworn on behalf of the respondent by David Warungu Gicheru, a Principal Revenue Officer in the Large Taxpayer's Office, it was deponed that an audit was conducted of the appellant's records after it had closed down its operations, and rendered its employees redundant; that upon payment of the terminal benefits to the employees, the appellant was statute bound to deduct PAYE as stipulated under the Income Tax Act Cap. 470 before releasing funds to the employees; that the letters of appointment were specified term contracts as they included a provision specifying the employees retirement age of 55 years.

It was further deponed that, a Special Redundancy package was agreed upon, between the appellant and its employees, where all statutory deductions including taxes were to be effected, and that the appellant had deducted PAYE of the redundant employees under ***section 5(2) (c) (iii)*** of the Income Tax Act which provision relates to a contract for an unspecified term, instead of applying ***section 5(2)(c)(i)*** of the Income Tax Act which had resulted in the payment of less taxes; that tax on severance pay was not deducted in some of the months. On this account it was averred that the additional tax due was Kshs. 117,232,198 comprising of principal tax, interest and penalty under ***sections 37(i), 72(D)*** and ***94(I)*** of the Income Tax Act for all cadres of employees.

In its determination, the High Court concluded that, contrary to the complaint that it had not been accorded an audience, the appellant was accorded a hearing, which culminated in the letter dated 26th June 2002 which had communicated the respondent's decision to apply ***section 5 (2) (c) (i)*** and not ***section 5 (2) (c) (iii)*** of the ***Income Tax Act***. The court further concluded that the appellant ought to have appealed that decision under ***section 84*** of the ***Income Tax Act.***

The appellant was aggrieved by the decision of the High Court and appealed to this Court on the grounds that the learned judge fell into error in concluding that the appellant was heard by the respondent on the tax assessment complained of; in failing to find that the tax assessment complained of was manifestly unreasonable so as to make it amenable to judicial review; in failing to hold that the existence of an alternative remedy does not preclude a court from issuing prerogative orders in judicial review proceedings.

Mr P. Ogunde, learned counsel for the appellant, submitted that he would abandon the ground concerning the failure by the respondent to hear the appellant on the tax assessment complained of; but stated that the appeal turned on the question of whether a contract of employment with a provision for the retirement age becomes a fixed term contract. At the centre of the dispute was whether tax computation on severance pay should have been calculated in accordance with ***section 5 (2) (c) (i)*** *or* ***section 5 (2) (c) (iii)*** of the ***Income Tax Act***; that notwithstanding the inclusion of the retirement age provision, the employees' contracts were an unspecified term contract subject to ***section 5 (2) (c) (iii),*** and not ***section 5 (2) (c) (i)*** of the Income Tax Act, and that based on the unreasonableness of the decision the appellant was entitled to pursue judicial review proceedings.

In his reply, ***Mr. Ontweka***, learned counsel for the respondent, argued that by abandoning the complaint that the appellant was not heard prior to the decision being made, there was no basis for the judicial review proceedings. Counsel further submitted that the lower court rightly found that it was within the respondent's powers to make an assessment of the tax, and that the complaint against tax assessment sought to determine the merits of the assessment and not the process. Furthermore, the court below was right in concluding that the appellant ought to have appealed the respondent's decision to the Local Committee. See ***Pili Management Consultants Ltd vs. Commissioner of Income Tax, Kenya Revenue Authority Civil Appeal No. 154 of 2007; Kenya National Examination Council vs Republic Ex parte Geoffrey Gathenji Njoroge & 9 others Civil Appeal No. 266 of 1996, and Commissioner of Lands vs Kunste Hotel Limited Civil Appeal No 234 of 1995***.

In reply, ***Mr. Ogunde*** submitted that procedural fairness cannot be separated from irrational decisions, and if the decision was unreasonable, it was amenable to judicial review. Counsel faulted the trial court for failing to interrogate the reasonableness of the impugned decision.

We have considered the pleadings and the rival submissions of the parties and are of the view that the issues for our consideration are, whether the learned judge rightly determined that this was not a matter for judicial review; and if not, whether, the respondent's decision was irrational and unreasonable so as to warrant the interference by this Court with that decision.

Before we proceed further, we remind ourselves of the principles of Judicial review as stated by this Court in the case of ***Biren Amritlal Shah & Another vs Republic & 30 others [2013] eKLR*** thus;

> ***"Judicial review is not concerned with reviewing the merits or otherwise, of a decision by a public entity, in respect of which the application for judicial review is made, but the decision making process itself. It is important to note in every case, that the purpose of judicial review is to determine whether the applicant was accorded fair treatment by the concerned public body, and that it is not within the remit of the court to substitute its own opinion with that of the public entity charged by law to decide the matter in question."***

We would however observe at this early stage that, following the promulgation of the Constitution, the provisions of ***Article 47*** of the ***Constitution*** and the ***Fair Administrative Action Act of 2015,*** enacted subsequently thereto, have expanded the scope of Judicial review to encompass, to some extent, issues of merit as well. See ***Suchan Investment Limited vs Ministry of National Heritage and Culture & 3 others [2016]eKLR.***

The above notwithstanding, and guided by the preconditions prevailing at the time, the question we will begin with is whether this was a matter for judicial review, or whether the appellant ought to have appealed against the respondent's decision by utilizing the statutory appeals process specified under the

Income Tax Act.

In concluding that this was not a matter for judicial review the learned judge stated thus;

> ***"…the fact that the parties did not agree on the mode of taxation, cannot be taken to mean that the respondent had acted unreasonably, or that it acted beyond its powers or for that matter, in excess of its jurisdiction, and neither had it breached the rules of natural justice."***

The court below further stated that if the appellant was aggrieved by the respondent's decision it ought to have appealed against that decision under ***section 84*** of the ***Income Tax Act***. And with that, it dismissed the application.

In ***Republic vs. National Environment Management Authority Civil Appeal No. 84 of 2010*** this Court expressed itself as follows:

> ***"...where there was an alternative remedy and especially where Parliament had provided a statutory appeal process it is only in exceptional circumstances that an order for judicial review would be granted, and that in determining whether an exception should be made and judicial review granted, it was necessary for the court to look carefully at the suitability of the statutory appeal in the context of the particular case and ask itself what, in the context of the real issue is to be determined and whether the statutory appeal procedure was suitable to determine it..."***

And in ***R vs. Inland Revenue Commissioners exp National Federation of Self Employed and Small Business Ltd [1981] UKHL 2*** it was held that:

> ***"A taxpayer would not be excluded from seeking judicial review if he could show that the Revenue had either failed in its statutory duty towards him or had been guilty of some action which was an abuse of their powers or outside their powers altogether...I am persuaded that the modern case law recognises a legal duty owed by the Revenue to the general body of the taxpayers to treat taxpayers fairly...to ensure that there are no favourites and no sacrificial victims."***

In this case, upon reaching the decision to apply ***section 5 (2) (c) (i)*** of the ***Income Tax Act*** to compute additional taxes on the employees' severance pay, on the premise that, a fixed term contract was created by the inclusion of a retirement age clause within the employment contract, an underlying controversy arose as to whether that decision was reasonable, given the circumstances of the case.

When the issue of reasonableness is placed alongside the question of which of the two provisions, that is between ***section 5 (2) (c) (i)*** or ***section 5 (2) (c) (iii)*** of the ***Income Tax Act*** ought to be applied, it is apparent that the answer cannot be categorized as a straight forward tax assessment query, to be left solely to the discretion of the tax specialist authority upon appeal, but is a matter requiring the interpretation and application of the provisions of the Income Tax Act in conjunction with other relevant provisions of the law, as will be seen later.

In the case of ***CCSU vs Minister for Civil Service [1984] 3 All ER 935*** Lord Diplock addressed the sphere of judicial review thus;

> ***"Judicial review I think has developed to a stage today when, without reiterating any analysis of the steps by which the development has come about, one can conveniently classify under three heads the grounds on which administrative action is subject to control by judicial review. The first ground I would call 'illegality', the second irrationality, and the third 'procedural impropriety'….By irrationality' I mean what can by now be referred to a 'Wednesbury unreasonableness' … It applies to a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it."***

From the above, it can therefore be concluded that unreasonableness of a decision is a matter for judicial review, and we find that this being a matter questioning the reasonableness of the respondent's decision, it was a matter eligible for judicial review, placing the application squarely within the ambits of the court for determination. The learned judge misdirected herself when she concluded that the appellant should have filed an appeal under ***section 84*** of the ***Income Tax Act***, and not seek the Court's intervention by way of as a judicial review.

Having so found, it now behooves us to consider if the respondent's decision was irrational, given the circumstances of the case.

The test for unreasonableness was succinctly set out in the English case of ***Associated Provincial Picture House Ltd v Wednesbury Corporation (1947)*** **2 All ER 680** where Greene MR observed that;

> ***"In the present case we have heard a great deal about the meaning of the word 'unreasonable'. Lawyers familiar with the phraseology commonly used in relation to the exercise of statutory discretions often use the word 'unreasonable' in a rather comprehensive sense. It is frequently used as a general description of the things that must not be done. For instance, a person entrusted with a discretion must direct himself properly in law ... you may have something so absurd that no sensible person could ever dream that it lay within the powers of the authority … That is unreasonable in one sense. Theoretically it is true to say - and in practice it may operate in some cases - that if a decision on a competent matter is so unreasonable that no authority could ever have come to it, then the courts can interfere. That I think is right, but that would require overwhelming proof, and in this case the facts do not come anywhere near such a thing."***

In the same case, the court further expounded on the tenets of unreasonableness when it stated**;**

> ***"It has frequently been used and is frequently used as a general description of the things that must be done. For instance a person entrusted with a discretion must, so to speak, direct himself properly in law. He must call his own attention to the matters that he must consider. He must exclude from his consideration matters that are irrelevant to what he has to consider. If he does not obey these rules, he may truly be said, and often is said to be acting "unreasonably." Similarly, there must be something so absurd that no sensible person could ever dream that it lay within the powers of the authority." (emphasis ours)***

Bearing the above in mind, we turn to the, the impugned letter dated 26/6/2002 which stated in relevant part;

> "ERNST & YOUNG
>
> P.O. BOX 44286
>
> NAIROBI
>
> RE. ABN AMRO BANK
>
> TAXATION OF SEVERENCE PAY
>
> *I refer to your letter dated 13th February 2002 and the subsequent correspondence on the same. I had to seek the Head Office guidance before reverting to you and hence the delay.*
>
> *The letters of contract for the former employees of ABN AMRO Bank clearly and distinctly indicate the following:*
>
> *i) Effective date of appointment.*

ii) Amount of salaries and allowances payable.

iii) Passing of medical test as a prerequisite to employment.

iv) Specific probationary and confirmation of service periods.

v) Gratuity payment after 10 continuous years of service.

vi) Existence of retirement benefits scheme.

vii) Specified action in the event of breach of contract.

viii) Specified retirement age.

In view of the above, please note that the former employees were serving under a contract of a specific term and therefore severance pay qualifies for taxation under Sec. 5 (2) (c) (i) and not 5 (2) (c) (iii).

Please advise your client to pay the tax of Ksh. 117,232,198 arising from the audit

Due to the hefty tax involved, I am prepared to accept reasonable installments.

Yours faithfully

J.G. NDUATI

DEPUTY COMMISSIONER

LARGE TAXPAYER OFFICE

CC;

Mr. AR VAN DER POI

Contry (sic) Representative

ABN AMRO Bank

P.O. Box 30262

NAIROBI"

In challenging the decision, the appellant has argued that the applicable provision was ***section 5 (2) (c) (iii)*** since the employment contract relied upon for computing tax was not affixed or specified term contact as it could be terminated by either party giving one month's notice to the other.

The respondent's position is that, the contract was a fixed term or specified contract as it specifically included a clause specifying the employee's retirement age. Therefore, ***section 5 (2) (c) (i)*** was applicable. ***Section 5 (2) (c) (i)*** stipulates;

> ***"Where a contract is for a specified term, the amount included in gains or profit under this sub paragraph should not exceed the amount which would have been received in respect of the unexpired period of the contract and would be deemed to have accrued evenly in the expired period."***

Section 5 (2) (c) (iii) stipulates;

"Where a contract is for an unspecified term and does not provide for compensation on the termination thereof, any compensation paid is deemed to have accrued in the period immediately following the termination at a rate equal to the rate per annum of the gains or profit from the contract received immediately prior to termination, by the amount so included in gains or profit should not exceed the amount of three years remuneration at those rates."

In deciding which of the two provision was applicable, it was incumbent upon the respondent to consider relevant matters pertaining to a an employment matter such as this. The dispute concerned the computation of taxes on the employees' severance pay arising out of a declaration of redundancy of its employees by the appellant. This being the case, the provisions of the retired ***Employment Act, Chapter 226, Laws of Kenya*** could not be disregarded.

Section 14 of the Retired ***Employment Act*** stipulated;

(1) Every contract of service-

(a)for a period, or a number of working days which amount in the aggregate to the equivalent of six months or more; or (b)which provides for the performance of any specified work which could not be reasonably be expected to be completed within a period, or a number of working days amounting in the aggregate to the equivalent of six months shall be in writing.

(2)…

(3)…

(4)…

(5) Every contract of service not being a contract to perform some specific work, without reference to time or to undertake a journey shall, if made to be performed in Kenya, be deemed to be-

(i) where the contract is to pay wages daily, a contract terminable by either party at the close of any day without notice;

(ii) where the contract is to pay wages periodically at intervals of less than one month, a contract terminable by either party at the end of the period next following the giving of notice in writing;

(iii) where the contract is to pay wages periodically at intervals of or exceeding one month a contract terminable by either party at the end of the period of twenty- eight days next following the giving of the notice in writing:…"

In ***British Broadcasting Corporation vs Ioannou*** ***[1975] 2 All ER 999*** Lord Denning MR, defined a fixed term as an agreement which cannot be unfixed by notice. It must bind parties for the term stated in the agreement; and it cannot be determined by notice on either side.

The employees' contracts all incorporated a provision for termination of the contract of employment with a notice from either party which would mean that a contract for a fixed term was negated. The respondent, relied upon the retirement clause included in some of the contracts that reads;

"Based on the Bank's policy of retirement on attaining the age of 55, your retirement date will be the year..."

Much as we would have our doubts whether this could be the basis of a fixed term contract, we in any event find this to be the wrong basis upon which to compute taxes on redundancy and severance pay.

We have taken this view because, the employees were declared redundant on account of the appellant

having ceased to carry on its operations within the country. And, it is also not in dispute that the respondent's decision appreciated that compensation to the employees was in respect of severance pay when it stated that;

> ***"In view of the above, please note that the former employees were serving under a contract of a specific term and therefore severance pay qualifies for taxation under Sec. 5 (2) (c) (i) and not 5 (2) (c) (iii)."***

Since the issue involved redundancy, and the payment of severance pay, ascertaining how such compensation for redundancy was to be arrived at was of necessity. ***Section 16A*** of the repealed Employment Act adequately set out the manner in which compensation is computed following redundancy. ***Section 16A*** stipulated thus;

> ***"(1) A contract of service shall not be terminated on account of redundancy unless the following conditions have been complied with***
>
> ***–***
>
> ***(a)…***
>
> ***(b)…***
>
> ***(c)…***
>
> ***(d) any leave due to any employee who is declared redundant shall be paid off in cash;***
>
> ***(e) an employee declared redundant shall be entitled to one month's notice or one month's wages in lieu of notice;***
>
> ***(f) an employee declared redundant shall be entitled to severance pay at the rate of not less than 15 days pay for each completed year of service as severance pay."***

From this provision, an employee who was declared redundant would be entitled to any leave dues, one month's notice or one month's wages in lieu of notice and severance pay at the rate of not less than 15 days pay *for each completed year of service* as severance pay. The provisions make it clear that payments or benefits were based on sums that had already accrued to the employees during the period of employment, and by the time of the redundancy, or when the employment contract was terminated.

Clearly, ***section 16A*** is concerned with compensation to the employee at the time the contract is terminated, while ***section 5 (2) (c) (iii) of the Income Tax Act*** refers to an unspecified term, where compensation is paid in the period following termination. Based on the fact that the two provisions required to be applied to the period following termination of the contract, we find that, for the purposes of computing taxes on severance pay, ***section 5 (2) (c) (iii)*** was the appropriate provision to be applied, and not ***section 5 (2) (c) (i)***

Greater significance however, is that the provisions specify that, severance pay was to be determined by the number of years worked. Therefore the accrual of future payments or benefits on an unexpired term of the contract was not contemplated, not least, sums based on a retirement age that could not be attained following redundancy. Without the ability to compute future severance pay, we find the respondent's decision to apply ***section 5 (2) (c) (i)*** to be irrational and unreasonable, as there was no basis upon which taxes could be calculated. It can only be concluded that it was absurd for the respondent to seek to demand taxes on sums that could not, and did not exist by virtue of ***section 16A***.

Moreover, the material shows that based on the Special Redundancy package, various amounts were paid to the employees as compensation (severance pay), leave pay and arrears for loss of office. In the verifying affidavit, the appellant's Country representative, Adriaan Ruth van der POL avers that, in

November 2001, it *"…paid a negotiated severance pay to its employees and as a result of the same paid a sum of Kshs.215 million in taxes to the Respondent, which full payment was duly acknowledged."*

The appellant having paid the taxes on severance pay, accrued leave and arrears, that had accrued to its employees, and there being no way in which taxes for the unexpired period could be computed, meant that no further PAYE or taxes were payable. As such, we find that the demands for additional taxes were unreasonable and unjustifiable.

Having so found, we must interfere with the decision of the learned judge, and allow the appeal. We set aside the order of the High Court of 8th July 2011, and substitute it with an order of certiorari to quash the decision of 26th June 2002, and issue an order of prohibition to prohibit further demand for the amount of Kshs 117,232,198/-. The appellant shall have the costs of both this appeal and the costs in the High Court against the respondent.

It is so ordered.

Dated and delivered at Nairobi this 9th day of June, 2017.

D. K. MUSINGA

……

JUDGE OF APPEAL

S. GATEMBU KAIRU, FCIArb

……..……..

JUDGE OF APPEAL

A. K. MURGOR

…….……..

JUDGE OF APPEAL

I certify that this is a

true copy of the original

DEPUTY REGISTRAR