IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: WAKI, MUSINGA & M'INOTI, JJ.A.)

CIVIL APPEAL NO. 44 OF 2013

MASTERMIND TOBACCO (K) LTD…….APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES…….1ST RESPONDENT

COMMISSIONER OF CUSTOMS & EXCISE…2ND RESPONDENT

THE KENYA REVENUE AUTHORITY……...3RD RESPONDENT

(Appeal from the judgment and decree of the High Court at Nairobi, (Majanja, J.) dated 21st September 2012

in

HC JR MISC. APP. NO. 710 OF 2008)

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JUDGMENT OF THE COURT

The central issue in this appeal is whether for the year 2007/2008, ***the 3rd respondent, the Commissioner of Domestic Taxes***, erroneously and unlawfully calculated the excise duty payable on the brand of cigarettes known as ***Supermatch,*** manufactured by ***the appellant***, ***Mastermind Tobacco (K) Ltd***. Before the High Court, the appellant contended that for the period in dispute, the 3rd respondent should have calculated the rate of excise duty on the said brand of cigarettes under ***Category B*** of the ***Fifth Schedule*** of the ***Customs and Excise Act***, ***Cap 472 (the Act)*** instead of ***Category C***. It maintained that the changes introduced to the Act by the ***Finance Act*** in 2008 created great ambiguity and uncertainty, the benefit of which should be given to it as a taxpayer. Accordingly the appellant applied for an order of *certiorari* to quash both the respondents' excise duty assessment based on Category C, and an agency notice by which the respondents appointed the appellant's bankers agents for purposes of collecting the disputed assessment. The appellant also prayed for an order of *prohibition* to stop the respondents from acting on the said assessment.

The respondents on the other hand maintained that the amendments to the Act by the Finance Act, 2008 did not have any relevance to the dispute and that the rate of custom and excise duty payable on the *Supermatch* brand of cigarettes was that specified in Category B rather than Category C. They denied that the amendments had created any ambiguity and submitted that since they had acted in accordance with the law, there was no basis upon which the court could issue the judicial review remedies sought by the

appellant. By the impugned judgment, the learned judge agreed with the respondents and dismissed the application with costs, thus provoking this appeal.

There are a number of issues that are not in dispute in this appeal. Firstly, the appellant is duly licensed as a manufacturer of exercisable goods under ***section 91*** of the Act, pursuant to which it manufactures the *Supermatch* brand of cigarettes. Secondly, ***section 117(1)*** of the Act provides for the right to charge excise duty and the obligation of licensed manufacturers of excisable goods and providers of excisable services, to pay duty. Thirdly, the 3rd respondent, the ***Kenya Revenue Authority***, is a Government agency established by an Act of Parliament, ***the Kenya Revenue Authority Act, Cap 469***, with the mandate of collecting revenue on behalf of the Government. The ***1st respondent, the Commissioner of Domestic Taxes*** and ***the 2nd respondent, the Commissioner of Customs and Excise,*** are officers of the 3rd respondents duly appointed under section 13 of the Kenya Revenue Authority Act. By express statutory provisions therefore, the respondents are under a legal obligation to collect excise duty when it is lawfully due under the Act, and the appellant is under a corresponding obligation to pay the same when it is lawfully due.

To fully appreciate the nature of the dispute in this appeal, it is necessary to delve briefly into the legislative history of the provisions that are in contention. Prior to 2003 excise duty on cigarettes was determined on the basis of production costs incurred by manufacturers. In that year, vide the **Finance Act No. 15 of 2003**, a new tax regime was introduced under which excise duty on cigarettes was to be calculated on the basis of retail selling price, so that the higher the retail price, the higher the excise duty. The *Supermatch* brand was then retailing between Kshs 1500 and Kshs 2500 and was in Category B. Although the Minister of Finance increased the rate of excise duty on cigarettes in 2005, 2006, and 2007, the *Supermatch* brand was not affected because its retail selling price did not increase and therefore continued in category B.

However, the respondents contended that with effect from 20th August 2007, the appellant increased the retail selling price of *Supermatch* from Kshs 1900 per mille (1000 sticks) to Kshs 2,560 per mille, thus moving the brand from category B to C. That notwithstanding, the appellant continued paying excise duty based on the retail selling price of Kshs 1,900 instead of Kshs 2,560. For its part, the appellant denied that assertion and maintained that the measure of excise duty on cigarettes was a *"mille"* rather than *"packets"*, *"cartons*" or *"bundles*" which the respondents had adopted and that it was not in control of the prices that its stockists and retailers sold the cigarettes. Accordingly it contended that the respondents erred by assessing excise duty on the basis of retail prices that included VAT and other excluded costs.

In 2008, the Finance Act amended Part II of the Fifth Schedule of the Act, which was introduced in 2003, so that product characteristics such as *"plain cigarettes"*, *"soft-cap cigarettes"* or *"hinge lid cigarettes"* would determine the rate of excise duty where retail selling price was not applicable. The amendment, which also set out the rate of duty for each type of cigarette, came into effect on 13th June 2008.

This is how the dispute leading to this appeal came into being. By a letter dated 24th June 2008, the 1st respondent demanded ***Kshs 442,205,324*** from the appellant, being principal under-declared excise tax and penalty for the year 2007. The appellant raised objections, contending, among others, that the calculation was erroneous and that the 2008 amendments had created uncertainty and ambiguity in the tax regime by introducing hitherto unknown and undefined product descriptions. After futile attempts at negotiations and amicable settlement, the respondents, on 23rd October 2008, issued two agency notices to the appellant's bankers, ***Consolidated Bank of Kenya Ltd.*** and ***Kenya Commercial Bank Ltd.,*** directing them to pay the claimed sum of Kshs 442,205,324.

The appellant responded by filing the judicial review application to which we have adverted, seeking orders of certiorari and prohibition, on the ground that the actions of the respondents were unreasonable and irrational within the meaning of the *Wednesbury* principles; that the respondent were acting illegally by charging duty under column 4 of the 5th Schedule of the Act, which did not exist; that the tax demand was in violation of the appellant's legitimate expectation; and that it was otherwise unfair, absurd, arbitrary, capricious, and calculated to frustrate legislative intent. As we have already stated, the High Court was not persuaded by the appellant's arguments, hence this appeal.

Although the appellant set out 5 grounds of appeal, its learned counsel, ***Mr. Macharia*** elected to argue all of them globally, faulting the High Court for holding that the tax demand by the respondents was lawful and payable. Counsel submitted that the learned judge erred by holding that assessment of excise duty on cigarettes is provided for under Part II of the Fifth Schedule to the Act and that neither section 127(2) or 137(1) nor any other section of the Act is applicable. It was contended that the High Court misdirected itself because under section 127 (2) of the Act, excise duty for cigarettes was based on *ex-factory* selling price and that by section 127(3) the *ex factory* selling price did not include value added tax, cost of returnable container or cost of excise stamps. The appellant therefore urged that the demanded tax was erroneously calculated because it included excluded costs. For that reason, the appellant contended, the tax demand must be quashed because it was unlawful, illegal and unreasonable.

The appellant further contended that the respondents had no legal basis to demand payment of the tax because column 4 of the 5th schedule, under which the rate of excise duty for cigarettes was supposed to be specified, did not exist. Relying on ***Whitley v. Burns*** ***[1908] 1 KB 705***, the appellant submitted that a tax statute must be construed strictly in favour of the taxpayer. The decision in ***Inland Revenue Commissioners v. Wolfson*** ***[1949] 1 All ER 864*** was invoked in support of the submission that a tax statute should not be interpreted in a strained or unnatural manner so as to bring a citizen under its provisions. Similarly, the decisions in ***Inland Revenue Commissioners v. Baldnoch Distillery Co. Ltd. (1948) 1 All ER 625*** and ***T. M. Bell v. The Commissioner of Income Tax*** ***[1960] EA 244***, were relied upon for the proposition that if a provision of a statute is capable of two meanings, the one most favourable to the subject (the taxpayer in this case) is to be preferred.

Lastly, the appellant submitted that the High Court erred by failing to hold that the decision by the respondents to demand tax from it, which precipitated the proceedings, was tainted by illegality, irrationality, and was in violation of its legitimate expectation. The decision of this Court in ***Henry Asava Mudamba v. Institute of Certified Public Accountants of Kenya, CA No. 210 of 2012*** was cited in support of the proposition a decision so tainted must be quashed.

The respondents opposed the appeal through their learned counsel, ***Ms. Onchwari***, who submitted that section 127 (2) of the Act concerns determination of the value of imported goods and was therefore extraneous to the dispute. In addition, it was contended that under the provision, the value of locally manufactured goods for purposes of levying *ad valorem* excise duty was the *ex factory* selling price. As regards section 137(1), the respondents submitted that the High Court did not err because the appellant was liable to pay duty at the retail price under Part II of the 5th Schedule to the Act, which was introduced vide an amendment to the Act by the Finance Act, 2003. In the respondents' view therefore, there was no ambiguity in the legislation.

Next, the respondents submitted that the tax demand was not tainted by illegality, irrationality or procedural irregularity because it was not arbitrary, unreasoned or lacking in logic and justification as contemplated in ***Council of Civil Service Unions & Others v Minister for the Civil Service*** ***[1983] 3 All ER 935*** and ***Pastoli v. Kabale District Local Government Council & Others*** ***[2008] 2 EA 300***. As for the agency notice, they contended that the same is expressly provided for by section 166A of the Act and that the respondents afforded the appellant the opportunity to be heard before the notices were issued.

We have carefully considered the record of appeal, the judgment of the High Court, memorandum of appeal, the submissions by learned counsel, the authorities that they relied upon and the law. Prior to 2008 sections 127(2) and (3), and 137(1) of the Act, on which the appellant relies, provided as follows:

> ***"127(2). The value of locally manufactured goods for purposes of levying ad valorem excise duty shall be the ex-factory selling price"***
>
> ***(3). For the purposes of subsection (2), the ex-factory selling price shall not include:***
>
> ***a) value added tax;***
>
> ***b) costs of returnable container, or***

c) cost of excise stamps"

"137(1). The duty on locally manufactured excisable goods other *than spirits shall become due and shall be charged at the rate in force when the goods liable to duty are delivered from the stock room of the licensee; and the duty shall, subject to any remission or rebate thereof which may be granted in accordance with the provisions of the Act, be paid by the licensee on its becoming due:*

PROVIDED that the commissioner may permit the payment to be referred to a date not later that the twentieth day of the month following that on which it became due."

According to the appellant, the excise duty payable on its *Supermatch* brand of cigarettes was to be determined under the above provisions. Another relevant provision that must be considered together with the above provisions is section 117(1) (d) of the Act, which at the material time provided as follows:

"***"117. Subject to the provisions of this Act, there shall be charged-***

...

(d) in respect of excisable goods specified in the second column of the Fifth Schedule, excise duties at the respective rates specified in the fourth column of that Schedule:

Provided that where excisable goods and services onwhich duty has been paid are converted into other excisable goods liable to a higher rate of duty, whether specified or ad valorem, then the converted excisable goods shall only be liable to duty at a rate equal to the difference between the higher rate of duty and the duty originally paid thereon;

...

and the duties shall be levied, collected, and paid in accordance with this Act." (Emphasis added).

In fact there was no fourth column to the Fifth Schedule. The appellant contends that due to lack of the fourth column, the respondents have no legal basis to charge the excise duty demanded from them.

It is common ground that the Act can be, and is regularly amended by the Finance Act, which is enacted every year. In 2003, the Finance Act (section 17) amended the Fifth Schedule of the Act and introduced PART II at the end thereof, which provided as follows:

"1). For purposes of this schedule, „retail selling price" means the average price at which excisable goods are sold to customers in an open market transaction where the seller and buyer are independent of each other;

2). Cigarettes shall be grouped into four categories for purposes of this schedule and the corresponding rate of duty will be as shown hereunder:

Category	*Retail Price per mille*	*Excise rate per mille*
A	*Up to Shs. 1500*	*Shs. 450*
B	*Shs. 1501 to Shs 2500*	*Shs. 650*
C	*Shs. 2501 to Shs. 3500*	*Shs. 900*

D *More than Shs. 3500* *Shs. 1400*

3). The Commissioner may from time to time through notice in the gazette adjust the retail price for each category of cigarettes for purposes of this schedule.

4). For purposes of adjusting the retail selling price, the commissioner may require manufacturers and importers to submit any information relating to manufacturing and pricing of excisable goods."

It is clear to us that the above amendment made a *specific* provision for determination of duty on cigarettes. The appellant cannot validly ignore the amendment and rely only on sections 127 and 173 of the Act. It cannot be gainsaid that a schedule is an integral part of the Act with the same status as the other provisions of the Act. In other words, a schedule does not have any less status than a provision of the Act. The learned authors of ***Halsbury?s Laws of England, 4th Ed. Re-issue, para. 1399 at page 853*** state thus:

"A schedule to an Act is to be construed by virtue of the functional construction rule, as an adjunct to the main body of the Act but nevertheless fully part of it. Any conflict between the inducing section (or any other section of the Act) and the schedule is to be resolved without regard to the fact that some of the relevant words are contained in the schedule rather than in the section."

In ***Centre for Rights Education & Awareness & 2 Others v. John Harun Mwau & 6 Others, CA Nos. 74 & 82 of 2012*** this Court reiterated that a schedule is an integral part of the statute and must be given effect like all other provisions of the statute. Accordingly, we are satisfied that the learned judge did not err in holding that assessment of tax on cigarettes is to be determined as specifically provided for in Part II of the Fifth Schedule.

The argument that the respondents cannot charge tax because of reference to "the fourth column" of the Fifth Schedule which did not in fact exist, is in our view disingenuous. The amendment we have referred to was clear enough on how duty on cigarettes was to be charged after the 2003 amendment. The continued reference to the "fourth column" of the Schedule, which did not exist, cannot obliterate the duty to pay taxes, which is otherwise clear enough in the Act. It was an aberration or irregularity that did not in any way create the ambiguity of the nature and magnitude that would benefit the appellant. That aberration was eventually removed vide an amendment effected by the Finance Act, 2008. In our view the learned judge did not err by refusing to interpret section 117 of the Act in the literal sense that the appellant invited him to do.

The other issue raised by the appellant in this repeal regards the alleged ambiguity introduced by the 2008 amendments to the Act by resort to product characteristics and use of new terminology. Again, with respect this is a red herring because the assessment in dispute related to the period *before*, rather than *after* the amendment. The statement of the law in the decisions relied upon by the appellant regarding ambiguities and strict construct of tax legislation is no doubt correct statement of the law, but it has no application in the facts of this case. We do not see any confusion or ambiguity as regards the period before the amendment, which is the period to which the dispute relates. For the period in dispute the rate of duty for the *Supermatch* brand was based on retail selling price which was supplied by the appellant itself and was therefore not in doubt or dispute.

Having concluded that the respondents had legal basis to demand payment of excise duty from the appellant; that the reference to the non-existent fourth column of the Fifth Schedule did not absolve the appellant from its duty to pay excise duty; and that the tax assessment in dispute related to a period before the 2008 amendment, there is in our view no justification for issuing judicial review remedies on the basis of illegality on the respondents' part. They did not act contrary to the law, *ultra vires* or without jurisdiction. In the same vein, we do not see how, in the circumstances of this appeal, the decision by the respondents to collect excise duty due from the appellant is unreasonable or irrational within the meaning of the *Wednesbury* principles. That decision cannot by any stretch of imagination be described as

irrational, outrageous, arbitrary or lacking in reason or logic such that no reasonable person could have arrived at it.

Lastly, as regards legitimate expectation, we are not persuaded that the appellant had any legitimate expectation as a manufacturer of cigarettes that it would not pay excise duty or that it would pay duty at a rate different from that stipulated in the relevant part of the Act. In ***Communication Commission of Kenya & 5 Others v. Royal Media Services & 5 Others, SC Petition Nos. 14, 14A, 14B & 14C of 2014,*** the Supreme Court observed that legitimate expectation arises when a body, by representation or by past practice, has aroused an expectation that is within its power to fulfill. For an expectation to be legitimate, therefore it must be founded upon a promise or practice by a public authority that is expected to fulfill the expectation. Besides having failed to establish these essential aspects for the application of legitimate expectation, the appellant cannot rely on legitimate expectation where it would amount to a violation of the law.

In ***Invollate Wacike Siboe v. Kenya Railways Corporation & Another, CA No. 157 of 2014***, this Court stated as follows on the application of legitimate expectation:

> ***"...[N]o legitimate expectation can arise if effectuating the expectation would result in violation of a statute. The contours of the doctrine are well mapped. Legitimate expectation arises where representation by a decision maker has created a genuine expectation that it is within his power to honour and make good. The law however does not protect every expectation; it protects only legitimate expectations. Where the representation is one, which the decision maker is not competent to make, reliance on it cannot in law give rise to legitimate expectation. Hence legitimate expectation cannot arise when the decision maker is acting ultra vires his or her powers. In addition, where the words of a statute are clear and express, they must override any expectation to the contrary that a party may claim to have. On the same note, where a public authority has made a representation that it does not have power to make, it is not estopped from asserting the correct position in law."***

We agree with the above postulation and find in the circumstances of this appeal that the appellant had no legitimate expectation that it would not pay excise duty as stated in the law and the respondents did not make any representation that the appellant would be exempt from paying duty, which representation the appellant relied upon to its detriment.

We have ultimately come to the conclusion that this appeal has no merit and the same is dismissed in its entirety with costs to the respondents. It is so ordered.

Dated and delivered at Nairobi this 6th day of October, 2017

P. N. WAKI

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JUDGE OF APPEAL

D. K. MUSINGA

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JUDGE OF APPEAL

K. M'INOTI

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JUDGE OF APPEAL

I certify that this is a true copy of the original

DEPUTY REGISTRAR