



IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: KOOME, SICHALE & ODEK, JJ.A)

CIVIL APPEAL NO. 55 OF 2009

BETWEEN

KENYA REVENUE AUTHORITY..... APPELLANT(ORIGINAL RESPONDENT)

AND

YAYA TOWERS LIMITED

THROUGH THE REPUBLIC RESPONDENT (ORIGINAL APPLICANT)

(Appeal from the Judgment and Decree of the High Court of Kenya at Nairobi (Nyamu, J) made on 21st November, 2008

in

NAIROBI H.C. MISC. CIVIL APPLN. NO. 374 OF 2006)

JUDGMENT OF THE COURT

The appellant **KENYA REVENUE AUTHORITY**, (the then respondent) filed an appeal against the judgment of Nyamu, J delivered on 21st November, 2008.

Briefly, the respondent herein (the then applicant) filed a Notice of Motion application dated 1st August, 2006 under Section 8 of the Law Reform Act and O.L III of the Civil Procedure Rule. In the main, it sought the following orders:

“(i) An order of certiorari to bring to this Honourable Court for the purpose of being quashed, the decision of the Respondent made on 31st March, 2006 in exercise of its statutory powers and discharge of its public duty under the Income Tax Act, Cap. 472, Laws of Kenya demanding payment from the Applicant of arrears of income tax in the total sum of Kshs. 17,775.190.10 cts.

(ii) An order of prohibition directed to the Respondent prohibiting the Respondent from enforcing the said decision or demanding the said payment from the Applicant.”

In a judgment dated and delivered on 21st November, 2008 the learned judge found in favour of the respondent. The appellant was aggrieved by the outcome of the motion hence this appeal.

In its memorandum of appeal dated 1st April, 2009 the appellant listed the following grounds of appeal:

1. ***The Learned Judge wholly misapprehended the nature of the Application before him thereby arriving at a wrong decision.***
2. ***The Learned Judge having found that Mr. David Peter Saunders was an employee of the Respondent erred in failing to find that the personal emoluments or salaries paid to Mr. David Peter Saunders should have been subjected to Pay As You Earn (PAYE) Tax.***
3. ***The Learned Judge erred in holding that the Appellant had no jurisdiction to assess and levy tax from transactions which have been done in breach of any written law or in furtherance of an illegality under common law.***
4. ***The Learned Judge erred in failing to find that in seeking to charge to tax the emoluments or salaries paid to Mr. David Peter Saunders by the Respondent, the Appellant was not seeking to enforce the “performance of an illegal contract” since the contract of employment between the Respondent and Mr. David Saunders had already been performed.***
5. ***The Learned Judge erred in failing to apply the relevant and applicable principles of Income Tax that made him arrive at a wrong decision.***
6. ***The Learned Judge erred in failing to find that the Respondent had failed to apply the provisions of section 37 of the Income Tax Act in so far as its engagement in employment of Mr. David Peter Saunders was concerned.***
7. ***The Learned Judge erred in considering extraneous and irrelevant issues which were not before it thereby arriving at a wrong decision leading to miscarriage of justice.***

The undisputed facts of the case are that the respondent entered into a consultancy contract between a firm known as Modave Technologies to offer the respondents services of one David Saunders who was a partner in the firm. Modave Technologies later changed its status to a Limited Liability Company and it continued to render services to the respondent, albeit under a new contract. It was the appellant’s case that the respondent was statutorily obligated to make Pay As You Earn Deductions in respect of David Saunders; a sum which was assessed at Kshs. 17,775,190.10 under the applicant’s letter of 31st March, 2006. The said sum was inclusive of penalties as that date.

It was the respondent’s case that the employment of Mr. Saunders was illegal and hence not subject to taxation.

On 2nd July, 2015 this court directed that the appeal be disposed of by way of written submissions. The appellant’s submissions dated 7th July, 2015 were filed on 13th July, 2015 whilst the respondent filed its submissions dated 21st July, 2015 on the same date. Thereafter, the matter was listed before us on 3rd February, 2016 for the highlighting of submissions.

Mr. Matuku learned counsel for the appellant urged the appellant’s case. It was his contention that the crux of this appeal i.e. ***“whether the appellant can lay a basis for assessing tax on an unlawful engagement.”*** He faulted the judge for finding that the appellant cannot lay basis for assessing tax on unlawful engagement ***“for doing so would go against public policy and would be benefiting from an illegality.”*** According to counsel, Section 3 (1) of the Income Tax Act provides for taxation of ***“all the income of person”*** by stating ***“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.”*** It was counsel’s contention that irrespective of whether the income was derived from an illegal trade, the same was taxable. He relied on several English authorities for his postulation. These are:

1. **Mann v. Nash (H.M Inspector of Taxes) Vol. 16-PART 8 Tax Cases at page 523 (also Reported on [1932] 1K.B752).**

2. **Southern (H.M Inspector of Taxes v. A.B; Tax cases Volume 18 page 59 (also reported in [1933] 1K.B 713).**

3. **F. A Lindsay, E.A Woodward and W. Hiscox v. The Commissioner of Inland Revenue; Tax Cases Volume 18 Page 43.**

4. **Commissioner of Inland Revenue v. Aken; Tax Cases Volume 63 Page 395 (also reported in [1988] QBD.**

In opposing the appeal, Mr. Oyatsi learned counsel for the respondent contended that the trial judge having found that the employment of Mr. Saunders was illegal, then there was no tax capable of being paid. He relied on this Court's authority of **Omega Enterprises (K) Ltd. v KTDC & Others (Civil Appeal No.**

59 of 1993) which held:

“If an act is void, then it is in law a nullity. It is not only bad, but incurably bad. There is no need for an order of the court to set it aside. It is automatically null and void without more ado, though it is sometimes convenient to have the court declare it to be so. And every proceeding which is founded on it is also bad and incurably bad. You cannot put something on nothing and expect it to stay there. It will collapse.

In his view, the contract of Mr. Saunder's employment was incurably bad and amounts to **“nothing”** in law and that the appellant wished to put **“something”** on **“nothing”** and expect it to stay in law. He dismissed the authorities cited by the appellant for being irrelevant. He concluded his submissions by stating that Section 37 of the Income Tax Act provides for an alternative remedy for the appellant.

Section 37 thereof provides:

“(1) An employer paying emoluments to an employee shall deduct therefrom, and account for tax thereon, to such extent and in such manner as may be prescribed.

2. If an employer paying emoluments to an employee fails –

a. to deduct tax thereon;

b. to account for tax deducted thereon; or

c. to supply the Commissioner with a certificate provided by rules prescribing the certificate, the Commissioner may impose a penalty equal to twenty five percent of the amount, and the provisions of this Act relating to the collection and recovery of that tax shall also apply to the collection and recovery of the penalty as if it were tax due from the employer:

“Provided that, instead of the Commissioner imposing a penalty under this subsection, prosecution may be instituted for an offence under Section 109 (1)

(f).”

He was of the view that the appellant was at liberty to pursue the options set out in Section 37 of Income Tax Act.

We have considered the record of appeal, the rival oral and written submissions by counsel and the judicial decisions cited as well as the ruling by the learned judge.

In our view, the appeal before us calls for our consideration on whether profits from an illegal services rendered to the respondent are taxable. It would also appear that we have no local decision emanating from this Court (or the Supreme Court) on this aspect.

However, having regard to the long chain of authorities from the commonwealth, it would appear that the issue is as clear as day and night.

In **Mann v Nash** supra, the appellant was in the business of providing automatic machines for public use, the use of which had been found to be illegal. The appellant contended that part of his profits was immune from taxation on the ground that it had been earned by unlawful means. The court found that the state could not keep its revenue eyes closed inspite of the illegality. Rowlatt, J in his judgment stated:

“The question really is whether as a matter of construction those words are to be cut down by an over-riding consideration that the trade is tainted with illegality. The great mainstay of Mr. Field’s argument, quite rightly from his point of view, was the case of Duggan (1), decided in the Irish Free State, and that decision of the Supreme Court seems to have gone upon this principle, that no construction could be admitted which recognized that the State should come forward and seem to take a profit from what the State prohibited because the State ought to have prevented it; and it was argued, if I may venture to say so, in a somewhat rhetorical style: Does the State keep its revenue eye open and its eye of justice closed? I must say, I do not feel the force of that observation at all. Would it have made any difference, I ventured to ask in the argument, if the State had kept both its eyes open and prosecuted the man for the lottery and taxed him for the profits at the same time? That would at any rate have protected the State from the reflections which were made upon it in the words I have quoted. But, in truth, it seems to me that all consideration is misconceived. The Revenue representing the State, is merely looking at an accomplished fact. It is not condoning it: it has not taken part in it. It merely finds profit made from what appears to be a trade, and the Revenue laws happen to say that the profits made from trades have to be taxed, and they say: “Give us the tax.” It is not to the purpose in my judgment to say:

“But the same State that you represent has said they “are unlawful:” that is immaterial altogether and I do not see that there is any contact between the two propositions.

It was said in the Irish case that allegans suam turpitudinem non est audiendus.

I cannot see that the State are alleging their own turpitude; it is the Appellant who is alleging his own turpitude. The State says: “It is a business;” the Appellant says: “It is an “unlawful one;” he is alleging his own turpitude.

It is said again: “Is the State coming forward to take a share “of unlawful gains?” It is mere rhetoric. The State is doing nothing of the kind; they are taxing the individual with reference to certain facts. They are not partners; they are not principals in illegality, or sharers in the illegality; they are merely taxing a man in respect of those resources. I think it is only rhetoric to say that they are sharing in his profits, and a piece of rhetoric which is perfectly useless for the solution of the question which I have to decide.”

Similarly, in **Southern (H. M Inspector of Taxes v AB** (supra) concerning profits of illegal vetting transactions the court held:

“That although the businesses carried on by the respondents were unlawful, they nevertheless constituted a trade within the meaning of the Income Tax Acts and that the profits therefrom were properly assessable to Income Tax.

In **F. A. Lindsay, E.A Woodward & W. Hiscox v Commissioner of Inland Revenue** (supra) the appellants contended that the transactions carried out by them were illegal and that the profit arising therefrom was not assessable. In his judgment Lord Morison stated:

“It is quite immaterial that the particular method of carrying on the trade involved the making of a false declaration to the Customs authorities or giving bribes to persons in America. In my opinion, these are entirely irrelevant considerations. When it is established that a trade has existed for a year, the question is whether it realised a profit as ascertained under the rules of the statute. It is quite in vain for the person who has realized the profit to prove that he made it by cheating or fraudulent trading, or to attempt to contend that the profit he has earned ought to escape chargeability because he might have been convicted of a breach of the law. During the discussion a question was raised as to whether the profits or gains of a burglar were subject to tax. Obviously not, because burglary is not a trade or business; but if a trader committed a housebreaking and stole his rival’s order book and, from its information, was able to increase the profits of his own business, I have no doubt that these profits are subject to tax. It is, in my opinion, absurd to suppose that honest gains are charged to tax and dishonest gains escape. To hold otherwise would involve a plain breach of the rules of the statute, which require the full amount of the profits to be taxed and merely put a premium on dishonest trading. The burglar and the swindler, who carry on a trade or business for profit, are as liable to tax as an honest business man, and, in addition, they get their deserts elsewhere.”

In another decision, namely, **Commissioner of Inland Revenue v Aken**

(Supra) the issue was whether income from prostitution was taxable. The court held that the profits of prostitution are taxable and that the word “trade” in itself does not have a connotation of lawfulness.

By parity of reasoning, and from the long chain of authorities, it would appear to us that even if the business is illegal, or as in this case the services obtained were rendered by an illegal entity, it is still subject of taxation. There is a lot of merit in this proposition; as otherwise holding would entitle a wrong doer to benefit from the illegal profits earned from unlawful business and on top of that be exempted from taxation. We wish to echo the words of Lord Morison that if we were to hold otherwise, then it would lead to absurdity that gains of an honest business are taxed whilst the dishonest escape taxation.

Secondly, if we were to hold that profits of such an illegal business are not taxable, tax payers would endeavor to have their business tainted with illegality for the purposes of securing exemption from taxation.

In contending that such an illegal business is not subject to taxation, Mr. Oyatsi for the respondent urged us to find that the remedy lies in prosecution for an offence under Section 109 (1) (f) of the Income Tax Act. Whereas, the Income Tax provides for that alternative remedy, we think the crux of the matter in this appeal is the determination of whether an illegal trade is subject to taxation. Having come to the conclusion, like we have done that it is indeed taxable, then the issue of alternative remedy may not be called into play, as this remedy would apply to non-compliance of payment of tax, whether from an illegal or honest trade.

We believe we have said enough to show that this appeal has merit and it is hereby allowed with costs. Accordingly, we set aside the ruling of the High Court dated 21st November, 2008 and all consequential orders.

Dated and delivered at Nairobi this 15th day of April, 2016.

M. K. KOOME

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JUDGE OF APPEAL

F. SICHALE

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JUDGE OF APPEAL

J. OTIENO-ODEK

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JUDGE OF APPEAL

I certify that this is a true copy of the original.

DEPUTY REGISTRAR