Commissioner of Domestic Taxes v Karen Hospital Limited (Income Tax Appeal E023 of 2023) [2024] KEHC 6636 (KLR) (Commercial and Tax) (24 May 2024) (Judgment)

Neutral citation: [2024] KEHC 6636 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E023 OF 2023

MN MWANGI, J

MAY 24, 2024

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

THE KAREN HOSPITAL LIMITED ..... RESPONDENT

JUDGMENT

1. The respondent is a limited liability company whose principal activity is provision of medical services. The respondent employs different cadres of professionals referred to as locum on need basis. Each engagement of a locum is independent of any other, and supported by relevant documentation for work done, time taken and deliverables. It was stated by the respondent that locum income for convenience and administration purposes is all payable on a monthly basis after being subjected to withholding tax at 5%. That the respondent was subjected to a tax audit which resulted to it being issued with additional assessments on Income Tax Company, Withholding Tax, Value Added Tax (VAT), and Pay As You Earn (PAYE) for the periods 2013 to 2017 amounting to Kshs. 52,981,737.00.

2. On 26th March, 2021, the respondent lodged an objection against the additional assessment on PAYE amounting to Kshs.40,760,854.00 pertaining to locum payments that were charged PAYE for the periods 2013 to 2017. In an objection decision delivered on 15th November, 2021, the appellant found that locum are engaged under contract of service as employees of the respondent and not under contract for service as independent contractors, and confirmed the demand on PAYE. Aggrieved by the said decision, the respondent lodged an appeal at the Tax Appeals Tribunal (hereinafter referred to as "the Tribunal") against the appellant's objection decision vide a Memorandum of Appeal and statement of facts both dated 14th December, 2021. On consideration of the parties' pleadings, documents attached to the appeal and submissions, the Tribunal held the view that the only issue for determination was whether the appellant erred in confirming the assessment for PAYE.

3. In its judgment delivered on 13th January, 2023, the Tribunal held that the appellant did not follow the manner prescribed for charging PAYE, it had no excuse for using a blanket rate of 30% to compute PAYE. The Tribunal found in favour of the respondent, allowed the appeal, set aside the appellant's objection decision dated 15th November, 2021and directed the respondent to pay conceded taxes of Kshs.1,153.287.00 within 30 days of the date of delivery of the aid judgment.

4. Dissatisfied with the Tribunal's holding, the appellant has lodged the instant appeal against it vide a Memorandum of Appeal dated 6th March 2023 raising the following grounds of appeal –

    i. That the Honourable Tribunal erred in law and fact for failing to find the respondent's Appeal offended Section 52(2) of the *Tax Procedures Act*;

    ii. That the Honourable Tribunal erred in law and fact in failing to find that the locum staff hired by Respondent were under a contract of service and not a contract for service;

    iii. That the Tax Appeals Tribunal contradicted itself in holding that the respondent is liable to pay PAYE based on graduated rates but instead proceeded to erroneously direct the respondent to pay conceded Withholding Tax of Kshs.1,153,287.00 instead of PAYE calculated based on the graduated rates; and

    iv. That the Honourable Tribunal erred in law and fact in finding that the respondent is liable to pay an erroneous figure of Kshs.1,153,287.00 as PAYE on graduated scale, an amount the respondent unequivocally admitted to be Withholding Tax in its pleadings and not PAYE as erroneously held by the Tribunal.

5. The appellant's prayer is for this Court to set aside part of the Tribunal's judgment delivered on 13th January, 2023, find that the respondent's locum staff are on a contract of service and not on a contract for service, direct the respondent to pay PAYE on all the amounts paid to its locum staff based on PAYE graduated rates, and award the appellant costs of this appeal.

6. The appeal herein was canvassed by way of written submissions. The appellant's submissions were filed on 5th October, 2023 by Lemiso Leparan, Advocate, whereas the respondent's submissions were filed by the law firm of Njoroge O. Kimani & Company Advocates on 12th February, 2024.

7. Mr. Lemiso, learned Counsel for the appellant cited the provisions of Section 51 (1) & (3) of the *Tax Procedures Act* and submitted that the notice of assessment dated 5th November, 2018 was for an assessment of Corporation Tax, Withholding Tax, PAYE and VAT amounting to Kshs.52,981,737.00, but the respondent objected only to the additional assessment on PAYE, which means that the additional assessment on Corporation Tax, Withholding Tax, and VAT were uncontested. He referred to the provisions of Sections 52(2) of the *Tax Procedures Act* and further submitted that when lodging an Appeal to the Tax Appeals Tribunal, an appellant is required to first pay any taxes not in dispute, and then file a Notice of Appeal.

8. Mr. Lemiso stated that in this instance, the respondent filed its Notice of Appeal on 14th December, 2021 by which time it had not paid the undisputed tax. He contended that the said Notice of Appeal was invalid, fatally defective and incompetent, thus not properly before the Tribunal. He relied on the decisions in Hewlett Packard East Africa Limited v The Commissioner of Domestic Taxes [2019] eKLR and *Kaluworks Limited v The Commissioner of Domestic TaxesNairobi Income Tax Appeal No. E044 of 2021* and stated that it does not matter at what point a Taxpayer makes an admission, as once the admission is made the appeal is rendered null, unless and until the tax is paid or an agreement on how payment can be made is entered into. He further stated that the issue of unpaid admitted taxes is an issue of law, which could be raised at any point by either party or by the Tribunal suo moto.

9. Mr. Lemiso referred to the definition of a contract of service as provided for under Section 2 of the *Employment Act* and Section 2 of the Income Tax and argued that for there to be a contract of service, there has to be an agreement between the parties on services to be offered, the period the services will be offered, how the services will be rendered, payments for services rendered, who shall provide the tools of trade, who is answerable to who and for what. To buttress this argument, he relied on the case of Benjamin Joseph Omusamia v Upper hill Springs Restaurant [2021] eKLR. He submitted that the respondent provided for the position of the locum staff, locum rate of payments per hour/day worked, required period, name of the immediate supervisor, approvals by HOD and HR Managers. Further, that the respondent stated that the locum staff were required to fill a staff claim form in order to be paid for the services rendered.

10. It was stated by Counsel that the tests that Courts have employed over the years are the fourfold test; control, ownership of the tools, chance of profit, risk of loss, and the integration test. He cited the case of Stanley Mungai Muchai v National Oil Corporation of Kenya [2012] eKLR and further stated that the locum staff were under the control of the respondent in terms of working hours, supervision and approval by HODs and supervisors and the time and place of where the services were rendered. In addition, that the locum staff were required to adhere to the terms of the contract and were subject to the rules of the respondent in that they were required to sign the attendance register, fill a staff claim form and get approval of the HOD and supervisors before they receive payments just like any other of the respondent's employees.

11. Mr. Lemiso stated that the locum staff are not in the business of their own but instead they offer services to the respondent who takes the risk of loss or profit of the outcome of the services rendered since the locum staff do not have a business of their own. On the mutual obligation test, Counsel submitted that there was a mutual obligation between the respondent and the locum staff for different periods in that they entered into a contract for a pre-agreed period of time where the locum would provide services to the respondent and the respondent would pay for the same. Mr. Lemiso relied on the case of Montreal v Montreal Locomotive Works Limited [1947] I DLR and asserted that using the multiple test, the contract between the respondent and the locum staff was a contract of service since the services offered by the locum were offered as employees and not independent contractors.

12. He cited the provisions of Sections 3(2)(a)(ii), 5, 37 & Head B of the Third Schedule of the *Income Tax Act* and contended that the respondent had a responsibility of deducting tax on the payments made to the locum staff. He contended that since the respondent failed to deduct the said amount, they are liable to pay the tax not declared as per the statutory schedule. He submitted that Withholding Tax is a distinct and separate tax from PAYE, and it was an undisputed tax obligation which was due and payable as at the time of filing the appeal.

13. Mr. Sigoma, learned Counsel for the respondent submitted that the respondent employs different cadres of professionals on a locum basis on a need-by-need basis to meet its mission of providing medical services to patients. That the engagement of each of these professionals on locum is independent of the rest of the employees who are on the payroll on month-to-month salaries under contract of employment and is supported by relevant documentations of work completed, time taken on the work and the deliverables. He cited the provisions of Section 52(2) of the *Tax Procedures Act* and further submitted that by the time the respondent filed its appeal to the Tribunal, it had cleared all the taxes it ought to have filed including Corporate Taxes, PAYE, VAT and Withholding Taxes, thus the appellant's contention in respect to Section 52(2) of the *Tax Procedures Act* lacks basis.

14. Counsel for the respondent indicated that the appellant did not raise this issue at the Tribunal, as it submitted to the Tribunal's jurisdiction and participated in the proceedings therein to conclusion,

until the Tribunal rendered its judgement. Counsel asserted that in the event the Tribunal's judgment was in favour of the appellant, the appellant would not have raised this issue. It was stated by Counsel that the respondent's locum staff were under a contract for service and not a contract of service since they were recruited for a short period to perform certain specialized tasks and to ensure certain deliverables at the end of their engagements, at the end of which they would be paid. He further stated that in regard to services of a locum whether under a contract of service or contract for service, parties must agree on the position and capacity of engagement, the rate of payment for the performance of task in question and the duration of performance of the required service or task. He contended that the presence of these elements did not qualify the locum staff members as being under a contract of service.

15. Mr. Sigoma submitted that in order to streamline operations and ensure accountability within the Hospital, it is crucial that there be a way of ensuring that the work required to be done is done and that the personnel responsible for a task have performed it. He stated that in this case, the respondent's locum staff were availed Heads of Departments and HR personnel to be the link them and the respondent so as to determine whether or not a task to be performed by such staff members was performed to its expectation and whether or not the personnel were to be paid after rendering their services to the respondent.

16. He referred to the case of Stanley Mungai Muchai v National Oil Corporation of Kenya (supra) and argued that the appellant's Counsel has misapplied the tests in this case. On the control test, Mr. Sigoma argued that the locum staff were not under the control of the respondent or its Officers,and that the Heads of Departments and HR Personnel were merely a link between the locum staff and the respondent for the duration of their service.

17. He contended that the respondent did not meet the locum staff members' statutory obligation but only subjected their payments to 5% Withholding Tax, which gives credence to the fact that the locum staff were under a contract for service.

18. On the integration test, Mr. Sigoma submitted the locum professionals were never subjected to the respondent's policies, rules or procedures, and they were at liberty to perform their duties freely, but with the diligence, keenness and observance expected of professionals of their qualification.

19. On the economic or business reality, Mr. Sigoma asserted that locum staff practiced independently without the control of the respondent, as they were in their own independent businesses when they worked for the respondent. Further, that the time they worked for the respondent was negotiated for each locum professional who took the risks and losses of their engagement with the respondent, and that the respondent's profits and losses did not depend on the work done by the locum staff members. To the contrary, the payments it makes to them for the work done accounts for a portion of the total costs of operations incurred by the respondent.

20. Mr. Sigoma contended that on mutuality of obligations, parties make commitments to maintain the employment relationship over a period. He submitted that in a contract of service setting, services are provided in return for wages and mutual promises for future performance, but locum staff only work for the duration specified in the agreements signed with them without the promise of future engagement, and once the tasks for which they are engaged are performed and they are paid, they are normally free to work elsewhere and the respondent is at liberty to seek the services of any other available professional on a locum basis, if the current ones are not available in the future when their services may be needed. In the circumstance, Counsel asserted that the respondent's locum staff were engaged under a contract for service, thus their payments fall under professional fees and are chargeable to Withholding Taxes at 5% pursuant to Sections 10 and 35 of the *Income Tax Act* and the Income Tax (Withholding Tax Rules) 2001.

21. It was stated by Counsel that the Tribunal in its judgment directed the respondent to pay conceded taxes within 30 days, but it did not specify whether the nature of those taxes were Withholding or PAYE

ANALYSIS AND DETERMINATION.

22. Pursuant to the provisions of Section 56(2) of the *Tax Procedures Act*, an Appeal to the High Court from the decision of the Tax Appeals Tribunal or to the Court of Appeal shall be on a question of law only. The Court of Appeal in the case of John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others [2018] eKLR summarized what amounts to "matters of law" as hereunder-

> " The interpretation or construction of *the Constitution*, statute or regulations made thereunder or their application to the sets of facts established by the trial Court. As far as facts are concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court."

23. Based on the above decision, this Court is not permitted to substitute the Tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts, unless the Tribunal's decision cannot be supported by any evidence or the Tribunal misdirected itself.

24. On consideration of the Memorandum of Appeal, Record of Appeal and statement of facts filed by the appellant, the response to the Memorandum of Appeal by way of statement of facts filed by the respondent together with the written submissions filed by Counsel for the parties, the issues that arise for determination are -

    i. Whether the respondent's appeal to the Tribunal offends the provisions of Section 52(2) of the Tax Appeals Tribunal; and

    ii. Whether the respondent's locum staff were employed under a contract of service or contract for service and whether the respondent was required to subject their pay and/or wages to PAYE.

    Whether the respondent's appeal to the Tribunal offends the provisions of Section 52(2) of the Tax Appeals Tribunal.

25. Section 52(2) of the *Tax Procedures Act* provides that –

> " A notice of appeal to the Tribunal relating to an assessment shall be valid if the taxpayer has paid the tax not in dispute or entered into an arrangement with the Commissioner to pay the tax not in dispute under the assessment at the time of lodging the notice."

26. The appellant submitted that the respondent's appeal to the Tribunal was defective since the respondent had not paid the undisputed tax or entered into a payment plan with the appellant for the undisputed tax at the time of filing its Notice of Appeal. The respondent on the other hand submitted that by the time it filed its Notice of Appeal against the appellant's objection decision dated 15th November, 2021 to the Tribunal, it had cleared all the taxes it ought to have filed including Corporate Taxes, PAYE, VAT and Withholding Taxes. On perusal of the appellant's notice of amended assessments to the respondent dated 5th November 2018, it is evident that the appellant was demanding Kshs. 52,981,737.00 from the respondent, which sum comprised Corporation Tax, PAYE, VAT and Withholding Tax.

27. The respondent in its objection dated 17th August, 2020 objected against the assessment on PAYE Tax which had been assessed at Kshs.44,417,899.00. Vide an objection decision delivered on 15th November, 2021, the appellant stated that the payment to locum staff are chargeable to PAYE and not Withholding Tax, hence the respondent should make payments of Kshs.40,760,854.00. The respondent in its Notice of Appeal dated 14th December, 2021 filed at the Tribunal indicated that it intends to appeal against the appellant's whole decision dated 15th November, 2021. In light of the above, it is apparent that at the time the respondent filed its Notice of Appeal against the appellant's decision to the Tribunal, there were no undisputed taxes that would have obligated the respondent to comply with the provisions of Section 52(2) of the *Tax Procedures Act*.

28. This Court therefore finds that the respondent's appeal to the Tribunal did not offend the provisions of Section 52(2) of the *Tax Procedures Act*.

Whether the respondent's locum staff were employed under a contract of service or contract for service and whether the respondent was required to subject their pay and/or wages to PAYE.

29. A contract of service is defined under Section 2 of the *Employment Act* as hereunder –

> "...agreement, whether oral or in writing, and whether expressed or implied, to employ or to serve as an employee for a period of time, and includes a contract of apprenticeship and indentured learnership but does not include a foreign contract of service to which Part XI of this Act applies."

30. It is also defined under Section 2 of the *Income Tax Act* as follows –

> "...an agreement, whether oral or in writing, whether expressed or implied, to employ or to serve as an employee for any period of time, and includes a contract of apprenticeship or indentured learnership, under which the employer has the power of selection and dismissal of the employee, pays his wages or salary and exercises general or specific control over the work done by him; and for the purpose of this definition an officer in the public service shall be deemed to be employed under a contract of service."

31. The appellant's contention is that the respondent's locum staff were employed under a contract of service, thus their pay and/or wages should be subjected to PAYE, whereas the respondent asserts that its locum staff were employed under a contract for service and their wages were subjected to 5% Withholding Tax. This contentious issue has been the subject of litigation over the years. The Employment & Labour Relations Court in the case of *Omusamia v Upperhill Springs Restaurant (Cause 852 of 2017)* [2021] KEELRC 3 (KLR) in determining whether the relationship between the parties before it was one of a contract of service or a contract for service, relied on the *Employment Act* definition of a contract of service. The said Court defined a contract for service as hereunder -

> "a contract by which a person, contractor or service provider made a commitment to another person, the client, to carry out material or intellectual work or to provide a service for a price or fee. Its characteristic being that the contractor was free to choose the means of performing the contract and no relationship of subordination existed between the contractor or the provider of the service and the client in respect of such performance."

32. Further, in Stanley Mungai Muchai v National Oil Corporation of Kenya [2012] eKLR the Court held as follows-

> There is no doubt that a relationship that is a contract of service, unlike one that is a contract for service, will enjoy the statutory protections accorded by the employment legislation. This is more so in view of the definitions of "employee", "employer" and "contract of service" under the *Employment Act*, 2007 and the Industrial Court Act, 2011.
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> A contract of service invariably relates to "dependent" or "subordinate" employment and a contract for service relates to "independent" or "autonomous" employment. Thus, there is a constant line that is drawn between self-employed or independent contractors in a contract for service, and, employees in a contract of service. There is no universal formular for determining existence of a contract of service. Simon Deakin and Gillian S. Morris, Labour Law, 3rd Edition pages 146 to 168 have discussed some of the tests used by courts in determining "employment" or "service". They include the following:
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> a. The control test whereby a servant is a person who is subject to the command of the master as to the manner in which he or she shall do the work. However, the formal or personal subordination of a worker as a test for existence of a contract of service may not apply for highly specialized workers such as in the case of the doctors, lawyers, and other professionals.
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> b. The integration test in which the worker is subjected to the rules and procedures of the employer rather than personal command. The employee is part of the business and his or her work is primarily part of the business. However, staff of independent contractors may as well perform entries integral or primarily part of the business when in fact, they are not employees.
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> c. The test of economic or business reality which takes into account whether the worker is in business on his or her own account, as an entrepreneur, or works for another person, the employer, who takes the ultimate risk of loss or chance of profit.
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> d. Mutuality of obligation in which the parties make commitments to maintain the employment relationship over a period of time. That a contract of service entails service in return for wages, and, secondly, mutual promises for future performance. The arrangement creates a sense of stability between the parties. The challenge is that where there is absence of mutual promises for stable future performance, the worker thereby ceases to be classified as an employee as may be the case for casual workers.
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> e. Since none of the foregoing tests can resolve the issue decisively on their own, in many cases the issue will be resolved by examining the whole of the various elements which constitute the relationship between the parties; this has been called the multiple test."

33. The appellant herein confirmed to have been supplied with the position for each locum staff, locum rates of payment per hour/day worked, required period, name of supervisor and approvals by HODs and HR Managers. It submitted that the locum staff were also required to fill a staff claim form in order to be paid for the services rendered. For this reason, appellant was convinced that the respondent's locum staff were under a contract of service.

34. In regard to the "control test", on perusal of the locum recruitment request form, it is manifest that it provides for the duration of the locum and the rate of payment which is to be on a daily/hourly basis. It however does not provide the number of hours a day or days a week, the locum staff are expected to be at work. From the staff claim forms, it is evident that some of the locum staff's wages were based on a daily rate while others were based on an hourly rate. It is therefore my considered view that one cannot conclusively state that the respondent controlled the working hours of its locum staff, since a Doctor, Nurse, Radiologist or any of the other locum staff could decide on the number of hours to work at a particular day or the number of days to work in a week. The number of hours or days worked by a locum staff would then be filled in the staff claim form and would be verified by the HOD or HR Manager for purposes of payment. I am as such persuaded that the role of the Heads of Departments and HR personnel were to act as a link between the locum staff and the respondent, since those are the only people that would assist the respondent in processing payments to staff on locum for work done.

35. On the "integration test", I do not agree with the appellant that filling a staff register and a staff claim form passes this test. In my view, it was necessary for the locum staff to fill a staff claim form before they could be paid, so that they could be paid only for days and/or hours worked. This accuracy of the claim forms could only be verified by HODs and Supervisors whom I have already held were the link between the locum staff and the respondent. I am doubtful that employees who are under a contract of service are required to fill a staff claim form before they are paid. The normal practice has always been that an individual on a contract of service receives his/her salary, pay, dues and/or wages at the end of every month if the nature of their engagement provides for the same, without necessarily filling a staff claim form.

36. The test of "economic or business reality" brings about the element of risk, profit and loss. It is not disputed that the respondent's locum staff are engaged and/or paid on daily/hourly basis. This in my view means that the locum staff are free to engage in other business and/or other forms of gainful employment, but will only be paid for work done and/or services rendered to the respondent. I am therefore persuaded that professionals who were engaged on locum basis practiced independently and would choose when and for what period of time they would offer their services to the respondent. For that reason, they would bear the risks, losses, and/or profits of their engagement with the respondent.

37. On the "mutuality of obligations", the Court has to determine whether the nature of engagement between the parties herein contains a mutual promise for future performance, thus creating a sense of stability between the parties. It has been held that where there is absence of mutual promises for stable future performance, the worker ceases to be classified as an employee as may be the case for casual workers. In this case, this Court has already held that the locum staff determined the number of hours they would work per day and/or the number of days they would work over the period of their engagement, thus necessitating them to first fill a staff claim form before they were paid their dues by the respondent. In my considered view, that took away the mutual promise for future performance and sense of stability between the said parties.

38. The Court in Omusamia v Upperhill Springs Restaurant (supra) further held that –

> " The factors to consider in determining whether one was an employee and therefore under a contract of service was where:
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> a. the servant agreed to provide his own work and skill by providing services for that matter, in consideration of wages or other remuneration.
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> b. The servant agreed that in the performance of that service they would be subject to the master's control. Control included the power of deciding the

things to be done, the way in which they had to be done, the means to be employed and in doing them, the time and place where they were to be done.

c. The contract of service complied with the terms of an employment agreement. That entailed complying with the statutory requirements in the *Employment Act* including minimum wage, provision for leave and payment of income tax.....

In a situation where one was taking a stand as the respondent did, it would not be strange and or an over expectation, for the court to expect production of an agreement from which the relationship could be discerned, a document(s) in nature demonstrating that for the work, or skills that the claimant rendered, a payment or payments were made that in character were not wages or salary, for instance, payment invoices, local service orders, and a document inviting the claimant for the work. Some form of register too to demonstrate when and how the work was done was needed. Documents that could have been produced including local purchase orders and payment vouchers were documents used in contracts for services."

39. On perusal of the locum staff recruitment request form, I note that the locum staff do not enjoy the statutory protection accorded by the employment legislation such us entitlement to different types of leave days and notice before termination, in view of the nature of their engagement with the respondent. Further, from the locum staff recruitment request form it is manifest that the locum staff were not coming in as employees, but were stepping in for employees who were not at their work stations for the duration of the locum for one reason or the other. The appellant confirmed that the respondent's locum staff were expected to fill in a Staff Register which as explained before, would play a big role especially during payment. In the Omusamia case, the Court held that some of the documents that would have assisted the respondent therein to demonstrate that the nature of the claimant's engagement was a contract for service would be a local purchase order and/or payment voucher. In this case, the respondent supplied the appellant and the Tribunal with some payment vouchers that were used when effecting payment to the locum staff.

40. In light of the foregoing analysis, it is my finding that the nature of engagement between the respondent and its locum staff was one of contract for service. Therefore, the payment and/or wages made to locum staff ought to have been subjected to Withholding Tax and not PAYE as contended by the appellant.

41. In the circumstances, this Court finds that the appeal herein is bereft of merits. It is hereby dismissed with costs to the respondent.

It is so ordered.

DATED, SIGNED and DELIVERED at NAIROBI on this 24th day of May, 2024. Judgment delivered through Microsoft Teams Online Platform.

NJOKI MWANGI

JUDGE

In the presence of:

Ms Nyaringita h/b for Mr. Lemiso for the appellant

Mr. Sigoma for the respondent

Ms B. Wokabi – Court Assistant.