Kenya Revenue Authority v Family Bank Ltd; Tea Machinery Engineering Ltd (Interested party) (Miscellaneous Application E010 of 2022) [2022] KEHC 32 (KLR) (Commercial and Tax) (31 January 2022) (Ruling)

Neutral citation number: [2022] KEHC 32 (KLR)

Republic of Kenya

In the High Court at Nairobi (Milimani Commercial Courts Commercial and Tax Division)

Miscellaneous Application E010 of 2022

A Mabeya, J

January 31, 2022

IN THE MATTER OF: THE TAX PROCEDURES ACT NO. 29 OF 2015 AND IN THE MATTER OF: AN APPLICATION BY KENYA REVENUE AUTHORITY FOR AN ORDER UNDER SECTION 43 (3) OF TAX PROCEDURES ACT, 2015

Between

Kenya Revenue Authority

Applicant

and

Family Bank Ltd

Respondent

and

Tea Machinery Engineering Ltd

Interested party

Ruling

1.Vide a letter dated 8/12/2021, the applicant communicated to the Interested Party that it had carried out investigations and discovered that the interested party had under-declared its income. The applicant therefore demanded Kshs. 95,834,896/- as taxes that were due failure to which the taxes would be assessed.

2.A Notice of Preservation of Funds was subsequently issued by the applicant on 29/12/2021 against the interested party's bank account held with the respondent.

3.By a Motion on Notice dated 14/1/2022, the applicant applied for the preservation of the funds in the account aforesaid. There was also an alternative prayer for security for the said taxes. The application was brought, inter-alia, under section 43 of the Tax Procedures Act, 2015 ("the Act).

4.The application was premised on the grounds that the applicant had reasons to believe that the interested party was engaged in tax evasion. This was because of failure to declare the correct amount of income and/or sales for purposes of both Corporation Tax and Value Added Tax for the tax periods between 2015 -2020.

5.It was further contended that preliminary findings indicated that the interested party had been under declaring its income and/or sales resulting in revenue loss of Kshs. 95,834,896/- comprising Kshs. 69,639,993/- Corporation Tax, and Kshs. 26,194,903/- VAT. That other than the funds held by the respondent, there were no other known assets belonging to the interested party capable of satisfying the taxes to be found due and payable.

6.The application was opposed vide the replying affidavit of Michael Kimeli Cherituch sworn on the 19/1/2022 and a Motion on Notice dated 18/1/2022 seeking to set aside the exparte orders made on 14/1/2022. It was averred that the interested party was tax compliant. It had fulfilled all its tax obligations in the past and had availed to the applicant all its financial statements for the period under investigation.

7.That the interested party gave the applicant an elaborate response to the investigations findings on 22/12/2021 and furnished additional documents as requested. Nevertheless, the applicant proceeded to

issue the preservation order without any basis. That the applicant ought to have gone through the ordinary audit process and then make an assessment once satisfied that there were any taxes due and owing.

8.It was further contended that the applicant had not met the preconditions laid out under section 43(1) of the Act. That the preservation order fell foul of the Fair Administrative Action Act (hereinafter 'FAAA'). That the ex parte order of 14/1/2022 was obtained through concealment of material facts.

9.The Court has carefully considered the parties' respective cases and submissions. It has also reviewed the authorities relied on.

10.It is the duty of every citizen to pay tax. In Pili Management Consultants Ltd vs Commissioner of Income Tax [2016], eKLR, it was held that every taxpayer has a duty to file tax returns and pay taxes Article 210 of the Constitution provides for the duty of every citizen to pay tax. It is for that reason that there are elaborate provisions on imposition and collection of taxes. While payment of taxes is a civil duty, if its imposition and collection is not undertaken in accordance with the law it might result in wrongful deprivation of property. It is for that reason that tax statutes are to be interpreted strictly.

11.In Mount Kenya Bottlers Ltd & 3 others v Attorney General & 3 Others NRB CA Civil Appeal No. 164 of 2013 [2019] Eklr, the Court of Appeal observed: -[…], when it comes to interpretation of tax legislation, the statute must be looked at using slightly different lenses. With regard to tax legislation, the language imposing the tax must receive a strict construction. Judge Rowlett in his decision in Cape Brandy Syndicate v I.R. Commissioners [1921] 1KB (cited by the appellants), expressed the common law position in this area when he stated '…in a taxing Act one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used'".

12.The dispute before Court touches on Section 43(1) of the Act. It provides: -"(1)This section applies if the Commissioner reasonably believes: -(a)That a tax payer-(i)Has made taxable supplies, has removed excisable goods, or has derived an income, in respect of which tax has not been charged; or(ii)Has collected a tax, including withholding tax, that has not been accounted for; and(iii)That the taxpayer is likely to frustrate the recovery of the tax".

13.In Kenya Revenue Authority v Jane Wangui Wanjiru & 2 others [2018] eKLR, it was held that;"The purpose of section 43 of the TPA is to allow KRA to preserve a taxpayer's money in the hands of a third party without notice to the taxpayer for a limited period before moving the court for formal orders of preservation. Since the exercise of the power to collect taxes, in the manner outlined by the statute, is a justifiable limitation on the right to privacy protected by Article 31 of the Constitution, it must be construed strictly. This approach is buttressed by and is consistent with the principle that tax statutes must be interpreted strictly".

14.This provision applies where no assessment of tax has been undertaken. It is based on the Commissioner's reasonable belief of the twin matters set out therein, viz that there is tax due which has not been unremitted and that the tax payer is likely to frustrate the collection of that tax. It is only when such reasonable belief exists that the draconian procedure set out therein is to be resorted to.

15.In Crawford Adjusters (Cayman) Ltd v Sagicor General Insurance Ltd [2014] AC 366, Lord Kerr observed: -"… in demonstrating an absence of reasonable or proper cause 'requires the proof of a negative proposition, normally among the most difficult of evidential requirements.' The test for establishing whether there is an absence of reasonable and proper cause requires both a subjective and

objective assessment. The subjective test requires an assessment as to whether the claimant honestly believed the defendant was liable in respect of the claims brought. If the Court is convinced as to the subjective state of mind, it should then consider whether, based on the information available to the claimant at the time it initiated proceedings, it was reasonable for the claimant to have reached the conclusion it did in respect of the defendant".

16.In Hicks v Faulkner {1878} 8Q.B.D. 167, 171, Hawkins J observed: -"I should define reasonable and probable cause to be an honest belief in the guilt of the accused based upon a full conviction, founded on reasonable grounds of the existence of a state of circumstances which, assuming to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the accused to the conclusion that the person charged was probably guilty of the same imputed".

17.Reasonable belief is the cornerstone of any action under section 43 of the Act. To this Court's mind, reasonable belief means a belief that would be held by an ordinary and prudent person in the same circumstances as the actor. The belief is to be based on reasonable grounds. It is not necessarily that the belief should be correct, but it must pass the test of reasonableness.

18.In this regard, therefore, the applicant was under a duty to satisfy the Court that the twin conditions set out in section 43(1) of the Act had been complied with. These are; that the Commissioner was under a reasonable belief that there was tax due and unremitted and that the interested party was likely to frustrate the recovery thereof.

19.In the present case, the applicant submitted that it had carried out investigations which had revealed that the interested party had derived income for which tax had not been charged and/or made supplies in respect of which VAT had not been charged. That this allowed it to invoke section 43 of the Act.

20.Further, it was the applicant's case that the interested party was likely to frustrate the recovery of the tax due. The applicant held this belief due to the gross under declaration of tax and the huge amount of taxes claimed.

21.On its part, the interested party submitted that a reasonable belief that a taxpayer has accrued a tax liability can only be demonstrated by the issuance of a tax assessment that expressly states the nature of the tax demanded, the legal provision underpinning the tax demand, the amount demanded, and the remedies available to an aggrieved party including the right to object or appeal the tax assessment.

22.It was contended that the applicant had only carried out investigations which were still ongoing but an assessment had not been done. That pending the finalization of the investigation, the taxpayer is entitled to be heard through a reconciliation meeting for the parties to peruse the investigation reports and address any errors or omissions. That it was not likely to frustrate the collection of taxes as it had shown cooperation with the applicant during its investigations.

23.As already stated, the applicant had to demonstrate and prove the twin conditions in section 43 of the Act. On first condition, the letter dated 8/12/2021 from the applicant to the Interested party indicated the results of its tax investigations for the years 2015/16 to 2019/2020. It concluded that taxes in excess of Kshs.95 million was due.

24.The Court notes that the said letter may not have been conclusive on the tax due. Indeed, it invited a response from the interested party. However, the fact that the conclusions therein were arrived at after a thorough investigation, that in my view can be said to be a basis for a reasonable belief that there was tax due that was unremitted.

25.In my view therefore, although there had been no tax assessment, there having been investigations, in which the interested party was informed of, which revealed some taxes to be due, the first condition under section 43 of the Act had been met.

26.In my view, under section 43 of the Act, it is not necessary that there be an assessment of tax before reasonable belief can be inferred that there is tax due. Where there is an investigation whose findings are revealed to the tax payer and which reveal that there is tax due, that will be sufficient for purposes of the first condition in section 43 of the Act.

27.The second condition to be met under sub-section 1 is that the Commissioner should have reasonable belief that the tax payer would frustrate the collection of such tax.

28.It was submitted that the Court has to look at the circumstances surrounding the claim by the applicant. That the gross-undervaluation constituted reasonable belief that the interested party will frustrate the recovery of the tax. It was submitted otherwise for the interested party.

29.I agree with Mr. Ado, Learned Counsel for the applicant that, in order to ascertain whether the tax payer will frustrate the recovery of tax, the Court has to examine the circumstances surrounding each case. Indeed, it is the conduct of the tax payer that would determine whether there is belief that he would frustrate the recovery of tax.

30.In the present case, it is not in dispute that the interested party has hitherto been paying tax. It is only being accused of under-declaration during the period in question. The applicant called the interested party into a meeting and informed it of the pending/ongoing investigations. The interested party not only attended the said meeting(s) but also gave to the applicant all information and documents requested.

31.Further, in its letter of findings to the interested party dated 8/12/2021, the applicant informed the interested party thus: -“If you wish to engage the Commissioner in resolving the above issues, kindly respond to the above findings and make payment of uncontested taxes or provide a settlement plan within 14 days from the date of receipt of this letter, failure of which the taxes shall be assessed”.

32.As requested by the applicant, the interested party responded to the findings vide its letter of 22/12/2021. In that letter, the interested party gave a detailed response to the findings. It also sought clarification on how some of the conclusions were arrived at by the applicant.

33.The applicant’s response was a swift invocation of the drastic powers donated to it by law under section 43 of the Act vide its Notice of Preservation of funds. With greatest respect, what conduct of the interested party informed the Commissioner to believe that the interested party would frustrate the collection of that tax" Why rush to freeze the accounts while the parties seemed to be negotiating" Why close the door of negotiation with a sledge hammer"

34.The Court can only conclude that the decision was not only irrational, and unreasonable but that it was made in extreme bad faith. Such action would be expected to be directed on a recalcitrant, uncooperative and imprudent tax payer. One who would hurriedly start moving or transfer funds from his/her accounts, dispose-off assets and generally prevaricate with a view to delay the settlement of the matter or the pending assessment. That was not the case here.

35.The letter of 8/12/2021 itself only indicated that if there was no payment of the uncontested taxes or provision of a settlement plan, the taxes will be assessed. Natural justice dictates that the applicant should have considered the interested party’s response of 22/12/2021 before any adverse action could

be taken. The applicant should have for example rejected the response with reasons and then advise the interested party that it would then proceed with the intended action.

36.This is a fit case where the applicant should have proceeded to assess the taxes due and follow the procedure set out in sections 49 to 54 of the Act than move for preservation of funds. This is so considering the cooperation which the interested party had shown.

37.Worse still, the interested party holds a Tax Compliance Certificate which has not been revoked. The applicant ought to have first revoked such Certificate after concluding investigations, advise the tax payer of the taxes it considers to be due, if the same is agreed upon, the matter would have rested there. If the tax payer still challenged the same, the applicant should have then taken the route of assessment.

38.As I have already stated, section 43 of the Act should be sparingly used. Only in clear cases where the tax payer is a serial defaulter of tax payment and is one I have described as recalcitrant, un-cooperative and imprudent. One whose response to tax investigation is movement of funds from his/her accounts or one who resorts to disposing off his assets.

39.Be that as it may, the court has to consider the likely peril that may be suffered if the applicant is ultimately found to be right. The tax alleged to be due is hefty. The interested party was not averse to giving security. The interested party is also a running corporation. Weighing all the interests of the respective parties, in the scales of justice, I grant the alternative prayer. Let security amounting to Kshs. 20 million be given to the applicant for the discharge of the interim orders in force.

40.Each party to bear own costs.

It is so ordered.**DATED AND DELIVERED AT NAIROBI THIS 31ST DAY OF JANUARY, 2022.A. MABEYA, FCI ArbJUDGE**