**Income Tax v Block**

**Division:** High Court of Kenya at Nairobi; Court of Appeal at Nairobi

**Date of judgment:** 1 October 1973; 31 July 1974

**Case Number:** 28/1972 (121/73); 11/1974 (81/74)

**Before:** Simpson J; Sir William Duffus P, Law Ag V-P and Mustafa JA

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*[1] Income Tax – Direction by Commissioner – Appeal – Taxpayer can challenge direction on appeal*

*against assessment based on it – Income Tax Management Act* (*Cap.* 24) *s.* 101*.*

*[2] Income Tax – Direction by Commissioner – Reasonableness – Where assets irrevocably transferred*

*not reasonable to direct income to be that of transferor.*

*[3] Income Tax – Settlement – Deemed settlement – Transfer of shares for no consideration – Whether a*

*settlement is deemed – Income Tax Management Act* (*Cap.* 24) *s.* 25*.*

*[4] Income Tax – Settlement – Settlor – Whether able to have access to trust fund – Whether positive*

*ability to obtain access necessary.*

**JUDGMENT**

**Simpson J:** In these three consolidated appeals the Commissioner-General of Income Tax appeals against decisions of the Tribunal sitting in Nairobi allowing appeals by the respondent against assessments for the years of income 1967, 1968 and 1969 which in effect invalidate a direction given by the Commissioner-General under s. 23 of the East African Income Tax (Management) Act 1958, now replaced by s. 22 of the East African Income Tax Management Act (Cap. 24). S. 23 so far as material reads as follows: “23 (1) Where the Commissioner is of the opinion that the main purpose or one of the main purposes for which any transaction or transactions was or were effected (whether before or after the passing of this Act) was the avoidance or reduction of liability to tax, for any year of income, or that the main benefit which might have been expected to accrue from the transaction or transactions in the three years immediately following the completion thereof was the avoidance or reduction of liability to tax, he may, if he determines it to be just and reasonable, direct that such adjustments shall be made as respects liability to tax as he considers appropriate to counteract the avoidance or reduction of liability to tax which would otherwise be effected by the transaction or transactions. (3) Any direction of the Commissioner under this section shall specify the transaction or transactions giving rise to the direction and the adjustments as respects liability to tax which the Commissioner considers appropriate.” Mr. Khaminwa for the Commissioner-General submitted that as a result of the repeal of s. 115 (1) (*b*) of the 1958 Act an appeal lay against an assessment but not against a direction made under s. 23. A taxpayer dissatisfied with an assessment made as a result of such a direction could appeal against the amount of the assessment but not against the making of the direction. It followed he said that the tribunal had no power to conclude as they did that the direction under s. 23 “must fail”. This point has already been considered by Harris, J. in *T. v. Income Tax*, [1973] E.A. 397. He was satisfied that the practice of permitting the direction itself to be challenged on appeal against the resulting assessment was correct and with respect I agree with him. S. 115 (1) (*b*) which was repealed by Amendment Act No. 16 of 1965 contained specific provisions for appeal by a person aggrieved by a direction given under s. 23. It was however replaced by a news. 111 which drew a distinction between appeals where an assessment is “based upon or consequent upon a direction issued under s. 23” and other appeals. As Harris, J. commented no purpose would be served by drawing this distinction if appeals were limited to challenging the assessment alone. It is true as Mr. Khaminwa pointed out that a person aggrieved by a direction cannot now as formerly appeal against the direction itself. He must appeal against the assessment based upon or consequent upon the direction but he is not precluded from grounding such appeal on his complaints against the direction. The Tribunal had power to make a finding with respect to the validity or otherwise of the direction. In allowing the appeals and refusing to confirm the assessments the tribunal apparently accepted the argument submitted on behalf of the respondent that since the transaction in question in this case is a settlement and ss. 24 and 25 of the Act specifically apply to settlements the Commissioner-General was not entitled to act under s. 23. These sections set out the circumstances under which incomes from settlements shall be deemed to be the income of the settlor. Supporting this decision of the Tribunal Mr. Slade for the respondent contended that these sections deal with all cases in which a settlement is suspect as a device for tax avoidance or reduction and that a presumption is raised that these were the only kinds of settlements the effect of which the Act was concerned to defeat. The settlement in this case was so drafted as to escape attack under these sections. S. 23 is a wide general provision empowering the Commissioner-General to give directions to counteract any avoidance or reduction of tax which would otherwise be effected by any transaction or transactions to which the section applies and I can see no reason for holding that he is not entitled to give a direction in the case of a settlement merely because ss. 24 and 25 of the Act contain specific provisions deeming certain income from settlements to be the income of the settlor. I am satisfied that the tribunal erred in allowing the appeals for the reasons given by them. I turn now to ground 5 of the Memorandum of Appeal: “(*a*) The Tribunal has erred in law in not holding that one of the main purposes of the said transaction in the form of the said Settlement was avoidance or reduction of liability to tax of the Respondent herein for the relevant year or years. (*b*) The Tribunal erred in law in not holding that the main benefit which might have been expected to accrue from the said transaction in three years immediately following the completion thereon was the avoidance or reduction of liability to tax of the Respondent herein for the relevant year or years.” Mr. Khaminwa, if I correctly understood his argument, contended that if the court or a tribunal had power to review a direction under s. 23 such power was severely limited by the substitution of the words “is of the opinion” for the words “has reasonable grounds to believe” made by Amendment Act No. 16 of 1965 coupled with the repeal of s. 115 (1) (*b*). This he said was a drastic change. The Commissioner-General had as a result only to form an opinion which need not be reasonable by objective standards and the onus was on the taxpayer to show that he did not form an opinion or that there was absolutely no rational basis for his opinion. It was conceded by Mr. Slade that since the provisions of s. 113 (*c*) laid on the taxpayer the onus of proving that the assessment was excessive, the burden lay on the taxpayer to prove that the Commissioner-General was wrong in his opinion. Mr. Slade submitted that he was not limited to proving that the direction was bad in law but also was entitled to show that it was bad in substance. Neither submission is I think entirely correct. S. 115 (1) (*b*) specifically provided a right of appeal: “Whether on the ground that the avoidance or reduction of liability to tax was not the main purpose or one of the main purposes of the transaction or transactions or on the ground that no direction ought to have been given or that the adjustments directed to be made are inappropriate.” Evidence could therefore be given in the appellate court to prove the main purposes of the transaction or transactions. As a result of the repeal of this provision and the amendment to s. 23 the court can I think interfere with the opinion of the Commissioner-General only if it appears to the court that such opinion could not reasonably have been formed by the Commissioner-General on a proper consideration of the facts before him. Thus the court is restricted to looking at the facts on which the Commissioner-General based his opinion. The court however is not so restricted in considering whether or not the determination of the Commissioner-General to make a direction was just and reasonable. The facts before the Commissioner-General were briefly as follows. The respondent and his wife have a large number of business interests and control several companies in East Africa. They are life directors and were in early 1966 the only shareholders in C.D. Ltd. a limited liability company, the bulk of whose income was derived as dividends from its holdings in E.F. Ltd. and G.H. Ltd. both private limited liability companies. In February 1966 Amendment Act No. 16 of 1965 was passed. This Act, *inter alia*, exempted from income tax dividends from resident companies in the hands of trustees and empowered the Commissioner-General to direct limited liability companies to declare dividends. A few months later a Deed of Settlement was drafted by Mr. Gill, a Chartered Accountant. It is dated 7 November 1966 and by it the respondent’s wife as settlor created a discretionary settlement. As trustees she appointed a brother of the respondent, Mr. Gill and Mr. Harley, an advocate. As trust fund she provided a sum of only Shs. 4,000/-. The beneficiaries consisted of the children of the respondent and his wife, several other persons including the respondent’s brother and some charities. The trust was not irrevocable. The trustees were empowered in their absolute discretion to appoint any day for the termination of what was termed the Special Trust Period. This was the period during which the trustees were directed to apply the income of the Trust Fund to the benefit of the available beneficiaries. The settlement conferred very wide powers upon the trustees for investment, accumulation of income and its treatment as capital. With the trust fund of Shs. 4,000/- the trustees purchased from the respondent and his wife 147 ordinary shares and 49 management shares in C.D. Ltd. at a nominal value of Shs. 20/- per share. The actual value of the shares at this time was approximately 100 times this figure. C.D. Ltd. then having received a substantial sum by way of dividends from E.F. Ltd. and G.H. Ltd. declared and paid a dividend for the year 1966 to the trustees amounting to Shs. 269,500/-. Dividends of Shs. 98,000/- and Shs. 63,700/- were paid to the trustees in the years 1967 and 1968. No payments had been made to any beneficiary up to the time the Commissioner-General made his direction. The Commissioner-General according to the appellant’s statement of facts was of the opinion not only that the main benefit which might have been expected to accrue from the creation of the settlement and the subsequent purchase of shares in C.D. Ltd. in the three years immediately following the completion thereof was avoidance or reduction of liability to tax of the respondent but that one of the main purposes of the transaction was avoidance or reduction of surtax liability of the respondent for these years. He further determined it to be just and reasonable to direct that dividends received by the trustees from C.D. Ltd. should be deemed to be the income of the respondent and his wife. The direction made by the Commissioner-General omitted to state that he determined it to be just and reasonable to make a direction under s. 23 but Mr. Slade conceded that this could be presumed. The respondent, his wife and Mr. Gill, their accountant, testified that the purposes of the settlement were to make provision for the children of the respondent and his wife and to effect a reduction of estate duty, the respondent having reached the age of 50. The avoidance or reduction of liability to tax was not one of the main purposes of the transaction nor was it the main benefit which might have been expected to accrue therefrom in the three years immediately following completion of the transactions. They agreed that one result was a considerable reduction of income tax payable by the respondent following the transfer of capital. Neither the respondent nor his wife indicated a clear intention never to resume control of the assets transferred to the trustee nor did Mr. Gill show that the deed was so drafted by him as to prevent any such resumption of control. The object of purchasing the shares in C.D. Ltd. at a nominal value Mr. Gill explained, was to minimise stamp duty. The stamp duty paid on the Deed of Settlement was £2. Had the trust fund been put at Shs. 400,000/-, the approximate value of the shares, the duty would have been £200. The shares were acquired by the trustees paying the Shs. 4,000/- in consideration of the respondent and his wife renouncing their right to an allotment of bonus shares. This renunciation attracted no stamp duty. This evidence was I think having regard to the views I have already expressed admissible only to show that the making of the direction was neither just nor reasonable or on the basis that it represented contentions previously expressed to the Commissioner-General. A number of factors apparently influenced the Commissioner-General in reaching his opinion.

1. The date of creation of the trust relative to the enactment of Amendment Act No. 16 of 1965 and the subsequent payment of large dividends by E.F. Ltd. and G.H. Ltd. to C.D. Ltd. followed by payment by C.D. Ltd. of dividends to the trust.

2. The failure to make any distribution to beneficiaries although the children of the respondent and his wife were still being supported by them and were of an age at which substantial financial assistance is usually required.

3. The wide range of beneficiaries in a trust set up entirely in the interests of the children of the settlor.

4. The possibility that the re-transfer of assets might be effected through the respondent’s brother who was both a trustee and a beneficiary or through other persons.

5. The powers of the trustees at their absolute discretion to appoint any day for the termination of the Special Trust Period. (Although it was provided that in the event of the failure or determination of the trusts the trustees would hold the trust fund for the benefit of these persons who would have become entitled to the estate of the settlor on her death intestate, specifically excluding the respondent, the wide powers given to the trustees leave open the possibility of re-transfer of the assets to the respondent or the settlor at the end of the Special Trust Period.)

6. The facts that a Deed of Settlement for the benefit of the children of the marriage was drafted by a chartered accountant instead of an advocate and that the settlor was the mother instead of the father as one would normally expect. Having regard to the foregoing I am satisfied that there was adequate justification for the opinion formed by the Commissioner-General. If the respondent and his wife had irrevocably transferred these assets to the trust it would not have been just and reasonable to make a direction. It is clear from the appellant’s Statement of Facts and Mr. Khaminwa’s submissions that the Commissioner-General’s determination was based on the belief that the transfer was not intended to be irrevocable and that the shares or their equivalent would eventually be re-transferred to the respondent and/or his wife. I am not persuaded that there was an intention on the part of the respondent and his wife to divest themselves irrevocably of the shares transferred to the trustees. In my opinion it has not been shown that the determination of the Commissioner-General to make the direction complained of was not just and reasonable. The direction was in the following terms: “That any dividend declared or any distribution directed to be made by C.D. Ltd. after 7/11/66 appertaining to the above-mentioned 147 Ordinary Shares and 49 Management Shares, and other income accruing or derived from the said shares or the proceeds of sale of any or all of the said shares shall be deemed to be the Income of the respondent and his wife.” It was not contended that these terms were inappropriate.

The appeal is allowed.

*Order accordingly.*

For the appellant:

*JM Khaminwa* (Deputy Counsel to the Community) and *LP Ouna* (Senior Assistant Counsel)

For the respondent:

*H Slade* and *KA Fraser* (instructed by *Hamilton Harrison & Mathews*, Nairob