**Income Tax v T**

**Division:** Court of Appeal at Nairobi

**Date of judgment:** 10 January 1975

**Case Number:** 42/1974 (25/75)

**Before:** Spry Ag P, Law Ag V-P and Musoke JA

**Sourced by:** LawAfrica

**Appeal from:** High Court of Kenya – Harris, J

*[1] Judicial Precedent – Decision given per incuriam – Only when inconsistent statutory provision or*

*authority is ignored.*

*[2] Judicial Precedent – Full Bench – Application should be made for full Bench when Court asked to*

*overrule previous decision.*

*[3] Income Tax – Direction by Commissioner – Direction cannot stand if Commissioner influenced by*

*something which ought not to have been taken into account.*

*[4] Income Tax – Direction by Commissioner – No power exists to remit an assessment for*

*reconsideration – Income Tax Management Act* (*Cap.* 24), *ss.* 22, 103*.*

**JUDGMENT**

The following considered judgments were read.

**Spry Ag V-P:** This is an appeal by the Commissioner-General of Income Tax against a judgment and order of the High Court of Kenya, allowing four consolidated appeals from decisions of the East African Income Tax Tribunal. These proceedings spring from a direction issued by the Commissioner-General under s. 22 (then s. 23) of the East African Income Tax Management Act (Cap. 24). In this, after stating that he was of the opinion that the main purpose or one of the main purposes of four specified transactions was the avoidance or reduction of liability to tax or that the main benefit which might have been expected to accrue from those transactions in the three years immediately following the completion thereof was the avoidance or reduction of liability to tax, the Commissioner-General directed that the income arising from any dividend declared by a company known as Travis (E.A.) Ltd. should be treated as income of the respondent. The four transactions specified in the direction were as follows: (*a*) an agreement for Sale made between Travis Investments Ltd. and Travis (E.A.) Ltd., whereby the former was to sell to the latter certain properties for the sum of Shs. 2,598,940/-; (*b*) an agreement for sale made between Travcom Ltd. and Travis (E.A.) Ltd., whereby the former was to sell to the latter certain shares for the sum of Shs. 20,057/-; (*c*) the allotment of shares of Travis (E.A.) Ltd. to Athene Investments Ltd.; and (*d*) two Settlements made between the respondent and The Royal Trust Company of Canada (C.I.) Ltd. The connection between these transactions is not immediately apparent and requires some explanation. It appears that the respondent was, directly or indirectly, the major shareholder in Travis Investments Ltd. and Travcom Ltd., which were wound up in or about 1964. Those assets of the two companies which were situate outside East Africa were transferred to a company known as Jontine Ltd. but we are not concerned with that transaction. The assets in East Africa were transferred to Travis (E.A.) Ltd., a company formed in Kenya for the purpose, pursuant to the agreements shown as (*a*) and (*b*) above. All the shares of Travis (E.A.) Ltd. were allotted to Athene Investments Ltd., a company formed in the Channel Islands, all the shares of which were acquired by The Royal Trust Company of Canada (C.I.) Ltd., a company incorporated in Jersey. The cash payable by Travis (E.A.) Ltd. to Travis Investments Ltd. and Travcom Ltd. and receivable by the respondent on the liquidation of those companies formed the basis of the two settlements mentioned under (*d*) above, one of which was of £52,000 and the other of £78,000. These were irrevocable discretionary settlements mainly for the benefit of the respondent’s family. Neither the respondent nor his wife had or could derive any benefit under the first settlement but they had a potential interest in the second, although in fact they never received any benefit from it. The practical outcome of these transactions was that the East African assets of Travis Investments Ltd. and Travcom Ltd. became indirectly the property of the Royal Trust Company of Canada (C.I.) Ltd., upon the trusts of the two settlements. The case for the respondent was that these transactions were intended to serve two purposes. In the first place, he anticipated the introduction of East African exchange control. He accordingly wished to take certain British assets out of the ownership of the East African companies, Travis Investments Ltd. and Travcom Ltd., and vest them in an overseas company, Jontine Ltd. At that time, there was no restriction on the movement of assets within the old sterling area and there was nothing illegal or improper in so doing. Later, he wished to vest the shares of Travis (E.A.) Ltd. in an overseas company, Athene Investments Ltd., not to take the capital assets but only the dividends, out of the reach of the anticipated East African exchange control. Secondly, the respondent wished to remove his assets, or part of them, outside the scope of either Kenya or English Estate Duty. This purpose was intended to be achieved by the two settlements. The respondent conceded that this would have income tax benefits but he claimed that this was only incidental: he was over sixty years of age and in poor health and his concern was to protect his capital assets for the benefit of his family. The case for the Commissioner-General was, quite simply, that over the four tax years 1965-8, no tax was paid on the shares of Travis (E.A.) Ltd., whereas, but for the specified transactions, tax of Shs. 353,911/- would have been payable. He claimed that this was the main benefit that might have been expected to accrue from the transactions. In the High Court, the respondent gave evidence as to the reasons for the transactions, and he called his advocate and his accountant. The evidence of these witnesses was substantially consistent, although there were differences between them on the relative importance of the exchange control and estate duty aspects and as to which were the objects of particular transactions. The judge accepted these witnesses as truthful and regarded the inconsistencies between them as immaterial. The Commissioner-General called no evidence. The judge found as fact that the transactions shown under (*a*) and (*b*) above had for their sole purpose the safeguarding of the respondent’s overseas assets against the possible effects of exchange control. I confess that I find this difficult to understand, since these agreements appear to have related to East African assets. The agreements or transfers relating to the overseas assets and their ultimate vesting in Jontine Ltd. were not referred to in the direction and do not form part of the record of appeal. Secondly, the judge held that the transactions referred to under (*c*) and (*d*) above were designed primarily to protect the respondent’s assets against the effect of estate duty both in Kenya and to a lesser extent in the United Kingdom. Thirdly, he held that there was no connection either as to purpose or effect between the first two transactions on the one hand and the remaining ones on the other and that either could have proceeded to fulfilment without any need for the other. Fourthly, he held that no avoidance or reduction of liability to income tax resulted from the agreements (*a*) and (*b*) and that the main benefit of the agreements had no tax implications. This was, I think, undoubtedly correct and although one ground of appeal was directed against it, it was not pursued by Mr. Shields, who appeared for the Commissioner-General. Fifthly, the judge held that the first of the settlements amounted to an absolute gift and that this transaction did not fall within s. 22. This finding was not seriously challenged on the appeal. Sixthly, he held that although a measure of saving of tax did result, the avoidance or reduction of liability to tax was not one of the main purposes of any of the transactions referred to in the direction, nor was it the main benefit that might have been expected to accrue from them. Finally, he held that the direction was neither just nor reasonable. Although the judge thought it proper, and rightly so, to make findings on all the issues framed, he gave as his reason for allowing the appeal the fact that the direction was based partly on transactions that did not fall within the mischief contemplated by s. 22 and he relied on the decision of this Court in *Income Tax v. Armstrong*, [1963] E.A. 505 for the proposition that a direction must stand or fall as a whole and that “each transaction referred to in a direction must either be effected with avoidance purposes or must be a necessary corollary to another transaction effected with avoidance purposes” (per Newbold, J.A.). Mr. Shields asked us not to follow the decision in *Armstrong*’*s* case. He submitted in the first place that the decision was wrong, having been given per incuriam, and, secondly, that even if it had been good law, it was no longer binding in view of subsequent statutory changes. I would begin by saying that I think, with respect, that the suggestion that the decision was given per incuriam was inappropriate. A decision is given per incuriam where it is given “in ignorance or forgetfulness of some inconsistent statutory provision or of some authority binding on the court concerned . . .” (per Lord Evershed in *Morelle Ltd. v. Wakeling*, [1955] 1 All E.R. 708, cited in *Kiriri Cotton Co. Ltd. v. Dewani*, [1958] E.A. 239). The decision in *Armstrong*’*s* case may have been wrong, but it was a reasoned and carefully thought out decision and was certainly not given per incuriam. I would also remark that where it is intended to ask this court to reverse one of its own decisions, the President should be asked to consider convening a bench of five judges, although a bench-of-three has the same powers (see *Lands Commissioner v. Bashir*, [1958] E.A. 45). It is now well established that this Court has power to reverse its own earlier decisions and will do so in appropriate circumstances. It will not, of course, do so unless it is convinced that the earlier decision was wrong. I am not so convinced in the present case, although I think, with respect, that the dictum quoted above may have been expressed in rather too general terms. I would prefer to put the matter in this way: the Commissioner-General has a discretionary power to issue a direction; if it appears that in exercising that discretion he has misdirected himself in some material respect or has allowed himself to be influenced by something which ought not to have been taken into account, then clearly the direction cannot be allowed to stand, but I do not think that the inadvertent mention of an “innocent” transaction will necessarily invalidate a direction where there is no reason to think that it influenced the decision or that any other decision could reasonably have been reached on the facts. As I have said, the other leg of Mr. Shield’s argument was that even if *Armstrong*’*s* case was rightly decided, subsequent changes in the legislation have rendered it obsolete. The original s. 23 provided that where the Commissioner had reasonable grounds for believing that the main purpose or one of the main purposes for which any transaction was or transactions were effected was the avoidance or reduction of liability to tax, he might, if he deemed it just and reasonable, direct that any appropriate adjustments be made. The present s. 22 provides that where the Commissioner-General is of the opinion that the main purpose or one of the main purposes for which any transaction or transactions was or were effected was the avoidance or reduction of liability to tax 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 such avoidance or reduction, he may, if he considers it to be just and reasonable, direct that any appropriate adjustments be made. The original right of appeal to a judge conferred by s. 115 (1) (*b*) allowed for an appeal from a direction 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 were inappropriate. The present right of appeal conferred by s. 101 is against the assessment, and may apparently be brought on any ground. At first sight, the difference appears substantial. Under the old procedure the appeal was against the direction (except for appeals against adjustments) and if the appeal succeeded, the direction had to be quashed. This is illustrated by *Armstrong*’*s* case, where the judgment of Newbold, J.A., begins: “This appeal and cross-appeal relate to the validity of a direction . . .”. Now, the appeal is against the assessment and the question for the judge to decide is whether the taxpayer has been assessed for the correct amount. I have come to the conclusion, however, that the difference is more apparent than real. It would be important if the issue concerned a liability created by statute. Here, however, the liability to tax does not arise directly under the statute but under the exercise by the Commissioner-General of his discretion. I think the function of this Court, sitting in appeal, is limited to deciding whether that discretion has been properly exercised. If it has not, I do not think it is open to this court to exercise a discretion of its own. In this connection, it will be remembered that the Commissioner-General has not only to decide what were the main purposes of and the likely benefit to be derived from the transactions he is considering but also whether it would be just and reasonable to levy tax in respect of them. If I am right in thinking that the basic reasoning in *Armstrong*’*s* case is as appropriate now as it was when that case was decided, there is, in my opinion, a further reason why we should not depart from it, except to the very limited extent indicated above. Almost every year since that decision has seen some amendment of the East African Income Tax Management Act. The most important, for the present purpose, was Act No. 16 of 1965, when what is substantially the present section was substituted for the old s. 23 and the old s. 115 (1) (*b*) repealed. In the following year, Act No. 9 of 1966 made a further slight amendment to s. 23. The effect of these changes was to enlarge the discretionary power of the Commissioner. If this court, in deciding *Armstrong*’*s* case, had interpreted the Act in a way substantially contrary to the intention of the Legislature, I do not think it can be doubted that the revised sections would have included express provision enabling the Court, when holding a direction defective or bad in part, to remit it to the Commissioner for reconsideration. The fact that no such provision was included seems to me to amount to an implied approval of the decision. In the present case, ignoring the transactions referred to under (*a*), (*b*) and (*c*) above, the first two of which, at least, appear to have been irrelevant, we are left with two settlements, one of which, that under which neither the respondent nor his wife could derive any benefit, was clearly, in my opinion, outside the scope of s. 22. I think it was clearly wrong to include this in the direction and it materially affected the direction both in substantially increasing the amount of tax assessed and in its probable effect on the approach of the Commissioner-General to the other settlement. Mr. Shields, for the Commissioner-General, indicated that he would be content if this Court were to hold that the direction was just and reasonable as regards the other settlement only and were to remit the matter to the Commissioner-General for re-assessment. In this connection, he referred to the wide powers conferred by s. 103. With respect, I do not think this course is open to us. It would, in my opinion, be impossible to say that had he not misdirected himself, the Commissioner-General must inevitably have issued a direction regarding the second settlement. It is admitted that neither the respondent nor his wife in fact derived any benefit under the second settlement and they have since debarred themselves from doing so. This, as Mr. Slade, for the respondent, submitted, might well have been thought a reason why it would not be just and reasonable to exercise the discretion conferred by s. 22. The difference of approach adopted by the legislature in s. 22, compared with s. 24, coupled with the use of the words “just and reasonable” in the former, must be given proper recognition. Finally, as I have said, we cannot tell how far the Commissioner-General’s attitude towards the second settlement was influenced by his mistaken view that all the transactions were to be viewed as one. In my opinion, the direction was incurably bad and therefore the assessment cannot stand. I think the judge was correct in his decision and I would dismiss the appeal with costs. As the other members of the court agree, it is so ordered.

**Law Ag V-P:** The facts and background to this appeal are fully set out in the judgment of the Acting President. Once it is accepted, as I think it must be, that the transactions effected between Travis Investments Ltd. and Travcom Ltd. respectively with Travis (E.A.) Ltd., in March 1964, had no income tax implications whatsoever, it follows that the main purpose, or one of the main purposes, of these transactions was not the avoidance of, or reduction of liability to, income tax. These transactions could not therefore be the subject of a direction under s. 22 of the East African Income Tax Management Act, and should not have been specified in the Commissioner-General’s direction of 26 October 1970, with which we are concerned in this appeal, although in other respects the direction may have been validly made. Such a direction, partly good and partly bad, was held in *Income Tax v. Armstrong*, [1963] E.A. 505 to be wholly bad in law, and Harris, J. when dealing with the matter in the High Court quite rightly held that he was bound by the decision in Armstrong’s case. This court is not so bound. I do not think, however, that we should depart from that decision. With respect to Mr. Shields, it was not a decision arrived at per incuriam, and it is significant that although the Act had been amended on a number of occasions since 1963, the legislature seems to have accepted the law regarding the validity of directions as laid down in *Armstrong*’*s* case as being correct, no amendment having been introduced in all that time to alter the law in this respect. For these reasons, I agree that this appeal should be dismissed.

**Musoke JA:** I agree with the judgment of the Acting President and have nothing useful to add.

*Appeal dismissed.*

For the appellant:

*JF Shields* (Principal State Counsel) and *MM Olekeiwua* (State Counsel)

For the respondent:

*H Slade* and *T Noad* (instructed by *Daly & Figgis*, Nairobi)