



It sought and obtained tax remission on the imported capital goods, from **KENYA REVENUE AUTHORITY** ('KRA'/'the respondent').

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On or about 23/10/2006, KRA demanded from Flashcom the payment of the sum of K.Shs.17,882,462/-, being what it claimed was tax owing from payments made by Flashcom pursuant to the said contracts, which sum comprised of withholding tax and more in particular sums arising from royalties as a result of the software embedded in the equipment.

Flashcom paid the sum of K.Shs.314,927/-to KRA, which sum was not in dispute, and on 5/2/2007, it objected to the payment of the sum demanded for software and technical services in relation to the equipment.

The two engaged in discussions on the demanded sum with a view to reaching an amicable settlement, and on 29/10/2008, KRA issued Agency Notices and served them upon Flashcom's bankers the day after, demanding the payment of the sum of K.Shs.23,423,874/- being tax allegedly due from Flashcom.

Flashcom, which maintained that KRA did not serve it with the said Agency Notices or any notice of assessment prior to the issuance of the Agency Notices, moved this court on 2/12/2008, by way of a Notice of Motion in which it seeks the following orders against KRA:-

- An order of certiorari to bring into this court and quash the Agency Notices issued by the respondent dated 29/10/2008.
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- An order of prohibition restraining the respondent from issuing any or further Agency Notices to its clients and/or bankers before service of a Notice of Assessment of Tax.

The Notice of Motion is based on the several grounds but mainly that:-

- a) That the Agency Notices issued by the respondent on 29/10/2008, were issued prematurely and before a formal notice of assessment of tax had been served upon the Applicant under section 78 of the Income Tax Act.
- b) Failure to serve a notice of assessment has deprived the ex parte applicant the opportunity to know how the demanded tax has been computed and arrived at.
- c) Failure to serve a notice of assessment has further denied the ex parte applicant the statutory right of objection to the Commissioner and the right of appeal

to the local committee as provided under sections 84, 85 and 86 of the Income Tax Act.

- d) The respondent has demanded payment of tax without an assessment notice and proceeded to enforce the collection thereby depriving the ex parte applicant the right to pursue its statutory guarantees within the procedure set out by the Income Tax Act.
- e) The Agency Notices issued on 29/10/ 2008 were issued in bad faith and for ulterior and/or improper motive.
- f) The premature issuance of the Agency Notices amounts to an abuse of the respondent's authority.
- g) The Agency Notices are ultra vires the respondent's authority and are extremely unreasonable.
- h) The Agency Notices are inconsistent with the law.
- i) The Agency Notices deny the ex parte applicant its right to object to assessment and this is bound to occasion the ex parte applicant irreparable loss and damage.

j) The Agency Notices contravene the ex parte applicant's legitimate expectation.

Flashcom also relies on the affidavit sworn by **ARTHUR KARANJA MBURU** on 31/10/2008 and filed in court on 3/11/2008.

The application is however opposed and the respondent has had filed a replying affidavit sworn by **JOHN RUKORIO KIMANI**, its Assistant Commissioner, Domestic Taxes Unit, Investigations and Enforcement Department.

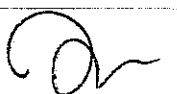
Flashcom contends that the respondent's decision to issue Agency Notices against it was done in contravention of the Statutory Procedure; was done prematurely and in breach of the rules of natural justice and ultra vires the provisions of sections 78, 84, 85 and 86 of the Income Tax Act (the Act').

The said section 78 provides that:-

*"The Commissioner shall cause a notice of assessment or provisional assessment, or instalment assessment to be served on the person assessed, and the notice shall state the amount of income assessed and the amount of tax payable and shall inform the person assessed of his rights under section 84...."*

Flashcom further contends that the respondent demanded payment of tax and issued Agency Notices against it without an assessment notice which amounts to violation of the provisions of the Income Tax Act. It thus maintains that when a statute stipulates a procedure to be followed by a public authority while performing its functions, the execution of the same would be null and void if the prescribed procedure is not adhered to. The procedure which Flashcom makes reference to is set out in sections 84, 85 and 86 of the Income Tax Act, which also details the rights of a person served with a notice of assessment of tax. Section 84(1) of the said Act provides that "*a person who disputes an assessment made upon him under this Act may, by notice in writing to the commissioner, object to the assessment.*"

Flashcom claims that by proceeding to enforce collection in disregard of the explicit provisions of sections 84, 85 and 86 of the Act, the respondent deprived it of the window of thirty (30) days period within which to object to the assessment made against it, thereby denying it the right to pursue statutory guarantees within the procedure set out by Act. It relies on the decision in the case of **REPUBLIC v COMMISSIONER OF INCOME TAX EX PARTE SDV TRANSAMI (KENYA) LTD MISC. H.C C. App No. 212 of 2004** where the court at page 24 stated as follows:-



*"I have found in these proceedings that the commissioner of Income Tax is exercising far reaching tax-levying powers in a rather haphazard manner which is not in accordance with the law. While the law entrusts tax collection powers to the commissioner, and it is indeed in the public interest that he should discharge that mandate, he must not apply methods that are random and wanting irregularity, with the result that unequal and oppressive conduct results."*

It further argues that the respondent has acted ultra vires and in abuse of its power, and in support of this contention, it relies **WESTMINISTER CORPORATION v LONDON AND NORTHWESTERN RAIL CO. [1905] AC 426** at page 430 where Lord Macnaughten stated as follows:-

*"It is well settled that a public body invested with statutory powers such as those conferred upon the corporation must take care not to exceed or abuse its powers. It must keep within the limits of authority committed to it. It must act in good faith and must act reasonably..."*

It also relies on the decision in the case of **AGRICULTURAL TRAINING BOARD v AYLESBURY MUSHROOMS LTD (1972) 1 ALL ER 280** where the court held that *'where parliament has laid a procedure which should be followed before a body can exercise its powers, the body will be acting ultra vires if it does not follow the procedure'*.

Flashcom raises the issue of legitimate expectation, and it argues that it is trite law that where a public authority has made a promise or adopted a practice that represents how it proposes to act in a given area, fairness requires that the promise or practice be honoured unless there is overriding reason not to do so. It relies on **COUNCIL OF CIVIL SERVICE UNION v MINISTER FOR THE CIVIL SERVICE (1984) 3 ALL ER 935** where the court held that *'legitimate expectations may arise from representations or from consistent past practice which the claimant can reasonably expect to continue'*.

All in all it submits, that in commencing consultations with the respondent with a view to amicably resolving the dispute, it was its legitimate expectation as per the correspondence exchanged between them, that the respondent would review the position held by Flashcom and reconsider the decision before the ex parte applicant had sought and was granted exceptions from all applicable taxes on the equipment and was advised by the respondent that the same would not be subjected to any other taxes including withholding taxes. It further states that it had reasonable expectations both arising from practice and as a matter of law that

the provisions of the Act would be complied with, prior to the issuance of the Agency Notices and that it's expectation was therefore breached when the respondent failed to comply with the procedure as set out in sections 78, 84 and 86 of the said Act.

In the case of **KEROCHE INDUSTRIES LTD v KENYA REVENUE AUTHORITY & 5 OTHERS MISC. CIVIL APPLICATION NO 743 OF 2006**, the court held that:-

*"Certainty of law is a major requirement to business and investors. Imposition of a different tariff, to that an investor contemplated when setting up an industry is reckless, irrational and unreasonable and it violates the principal of certainty and rule of law. Such a style of decision making cannot offer a conducive business or investment climate. The courts have a role in keeping public authorities within certainty of law ..... For now let it suffice to state and hold that the actions and decisions of public authorities must be questioned, directed and shaped by the law and if not the court must intervene."*

Flashcom further submits that the respondent's decision to issue the Agency Notices against it was illegal as it had no legal basis to

demand the withholding tax on the payments made by it in relation to the specified equipment, and that the said payments would not constitute 'royalties' as more specifically defined by section 2 as read with section 35 of the Act.

Section 35(1) of the said Act provides that "A person shall upon payment of an amount to none resident person not having a permanent establishment in Kenya in respect of a ..... A royalty.....which is chargeable to tax, deduct there from tax at the appropriate non-resident rate."

'Royalty' is defined in section 2(1) of the said Act as "a payment made in consideration of a right to use the copyright of a literary artistic or scientific work or.... a patent, trade mark, design or model, plan formula or process.....".

Flashcom maintains that the supply contracts were purchase contracts relating to transfer of software elements of the equipment, and that payment for the same, should not therefore have been treated as 'royalty' for software, in any event, being part of the telecommunication equipment, the operating software was embedded and inbuilt in the same and that it is as such firmware and should not be treated as severable for purposes of taxation or be subjected to withholding tax.

KRA which opposes this application has attempted to state the main issues for determination as follows:-

- *Did the respondent fail to issue a Notice of Assessment thus depriving the ex parte applicant an opportunity to know how the demanded tax was formulated?*
- *Were the Agency Notices that were issued by the respondent on 29<sup>th</sup> October, premature and inconsistent with the law?*

It contends that it issued a tax demand in form of demand letters to the ex parte applicant on various occasions as shown in the annexures to its replying affidavit which was sworn on 26/2/2009, and which show the various amounts owed and how they were computed.

It also contends that the ex parte applicant never raised the issue of non-issuance of the notice of assessment when the demands were issued but that the ex parte applicant acted on the tax demands and raised objections to the amounts so demanded; that the ex parte applicant did not request for a notice of assessment as the demand letters were sufficient as demand notices.

The respondent also relies on section 127(1) of the Act which stipulates that *"the commissioner may specify the form of a notice, return of income, or other form or return required for the purposes of*

this Act, and where any form has been so specified, then that notice, return of income, or other form or return shall be in the form so specified", and it thus maintains that in the instant case, the demand notice was in the form of a demand letter which is a recognized method of notification as provided for in the aforesaid section of the Act, and it also relies on the provisions of section 81 of the Act which provides that:-

"1. No assessment, warrant or other document purporting to be made, issued or executed under this Act shall be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if it is in substance and effect in conformity, with or according to the intent and meaning of this Act and if the person assessed or intended to be assessed or affected thereby is designated therein according to common intent and understanding."

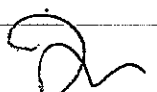
2. An assessment shall not be impeached or affected by reason of (a) Mistake therein as to  
(i) the name of the person assessed; or  
(ii) the description of any income."

It submits that from the above provisions, it is clear that the demand letters which it issued under the Act cannot be quashed or deemed to be void for want of form or by virtue of a reason of a mistake or defect, if it conforms to the intent and meaning of the Act, and it is thus of the view that Flashcom ought to have appealed to the local committee as provided for under section 35 of the Act instead of bidding its time since October 2006. It also contends that it issued various demands to Flashcom requiring payment of taxes that were assessed as due and owing; that the latter failed to settle the tax liabilities and did not appeal to the local committee as is expected of a tax payer who feels that he has a genuine grievance and that since Flashcom did not comply with the above, it had no choice but to issue the Agency Notices in October 2008.

It argues that the Act authorizes it to issue Agency Notices in order to enforce the collection of taxes due to the Government and as such the act of issuing the said Agency Notices was well within its statutory power and it cannot be said that it acted ultra vires as alleged by the ex parte applicant.

I have perused the pleadings herein and have taken the submissions of counsel on record, and as I discern it, the issues for determination are as follows:-

- 1. Were the Agency Notices issued in an unlawful manner, in excess of jurisdiction and hence was the decision to issue them ultra vires?**



2. Was KRA's decision to issue the Agency Notices one that went against the legitimate expectation of the ex parte applicant?
3. Was the said decision to issue the Agency Notices unreasonable?
4. Who should pay the costs of this case?

Before I deal with the above issues, I feel that it is imperative that I point out that the province of judicial review is only limited to the scrutiny of the decision making process as opposed to the merit of the decision. The scope of judicial review is limited to ensuring that the respondent adhered to fairness in decision making process and it is not for this court to look into the correctness of the challenged decision. In case of **REPUBLIC v JUDICIAL SERVICE COMMISSION EX PARTE PARENO NAIROBI HCC. Misc App. No. 1025 OF 2003 [2004] eKLR 203**, the court held inter alia:-

*"The remedy of judicial review is concerned with the reviewing not of the merit of the decision in respect of which the application is made, but the decision making process itself..... It is important in every case that the purpose of the remedy of judicial review is*

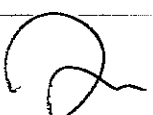
*to ensure that the individual is given a fair treatment by the authority which he has been subjected and that it is no part of that purpose to substitute the opinion of the judiciary or individual judges for that of the authority constituted by law to decide the matter in question."*

In the matter at hand, the focus should be on the credibility or the lack of it, of the decision making process, which led to the issuance of the said Agency Notices, which action has prompted this application.

First and foremost, the issuance of Agency Notices per se cannot be unlawful, for the said action is a mode that is recognized by the Act as a means of enforcing collection of tax that is due and owing. Indeed section 96 (2) thereof provides that:-

*"(2) The commissioner may by written notice addressed to any person-*

*(a) Appoint him to be the agent of another person for purposes of the collection and recovery of tax due from that other person, and*



(b) Specify the amount of tax to be collected and recovered.

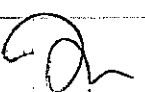
(c) An agent shall pay the tax specified in his appointment notice out of any moneys which may, at any time during the twelve months following the date of the notice, be held by him for or due from him to, his principal."

In my view, since KRA was executing its statutory obligations as clearly provided for under the said Act, it is inconceivable that the issuance of the Agency Notices per se, would be unlawful or even ultra vires.

I have taken note of the fact that there was protracted exchange of correspondence between these two on the issue of the tax due and owing.

KRA wrote to Flashcom on 10/1/2007 demanding withholding tax of K.Shs.17,882,462/- as follows inter alia:-

*"Please refer to our demand notice dated 23<sup>rd</sup> November, 2005. Kindly note that you have not paid the tax due.*



In view of the above and pursuant to provisions of section 124 of Income Tax Act. I give you this notice to make a full payment of the demanded taxes immediately to avoid enforced collection measures which will be instituted in accordance with the provision of section 96 of the Income Tax Act Cap 470."

M/s Ernst & Young, who were Flashcom tax consultants objected to the demand and replied to the aforementioned letter, vide their letter of 5/2/2007. That objection was however rejected on 31/3/2008 and the tax consultants were informed accordingly in the following manner:-

"Having looked at your explanation and the contract for the supply of equipment and software we are of the conclusion that our demand is justified as the amounts allocated to each item are not arbitrary and the appendix specifying the bills of quantities is per the agreement part of the contract and cannot thus be disregarded. You should thus ask your client to pay the amount demanded without



*further delay as it continues to attracting interest and penalties."*

The letter was copied to Flashcom.

On 23/6/2008 KRA wrote yet another letter referenced "TAX MATTERS", in which it stated as follows:-

*"Refer to our letter dated 31<sup>st</sup> March, 2008. No response has been received to date. Please note that if payment is not received within 7 days from the date of this letter we shall proceed and institute enforcement measures to recover the tax due."*

KRA issued yet another letter of 12/9/2008 in which the concluding paragraph reads as follows:-

*"Taking into consideration the time this case has taken, we wish to inform you that the amount of Ksh.24,423,874/- (as per attached schedule) is due and payable. You are therefore required to make the payments immediately, failure to which collection measures shall be instituted without further*



*reference to yourselves. Be advised that you may make an appeal to the local committee if you are not in agreement with our position."*

I have perused the pleadings herein and I find no evidence that Flashcom, or its tax consultants replied to those letters. Of more interest is the fact that Flashcom has not denied having received the said letters.

I have considered the numerous correspondence and I find no proof of any procedural impropriety, illegality on the part of KRA, and on the same token I am not convinced that it's action was ultra vires. It is evident that there was an assessment which Flashcom objected to, and which objection dismissed. Flashcom was even made aware of its right of appeal to the local committee vide KRA's letter of 12/9/2008, yet it did not deem it fit to take advantage of that avenue, for it did not appeal at any one stage. All that it did was to have its tax experts lodge an objection, which as stated earlier was dismissed, after which it went into a slumber.

Given the above, it would be safe for one to assume that Flashcom waived its right of appeal and would now be too late for it to insist that it has the right of appeal which was allegedly denied by the Respondent.

It is clear from the pleadings that the ex parte applicant had sufficient time between the years 2006 and 2008, but that it never took advantage of the opportunity. One may be tempted to sympathise with Flashcom due to the fact that the amount in question is a colossal, however, a judicial review court has no competence and jurisdiction to inquire into the correctness of the tax assessed.

The other issue for my determination is whether the Agency Notices were against the ex parte applicant's legitimate expectation. In order to deal with this particular issue, one will need to establish what the ex parte applicant's expectations would have been.

The principle of legitimate expectation is underscored in the case of **COUNCIL OF CIVIL SERVICE UNIONS AND OTHERS v MINISTER FOR THE CIVIL SERVICE [1984] 3 ALLER 935** where the court held inter alia:-

*"An aggrieved person was entitled to invoke judicial review if he showed that a decision of a public authority affected him by depriving him some benefit or advantage which in the past he had been permitted to enjoy and which he could legitimately expect to be permitted to continue to enjoy either*

until he was given reasons for its withdrawal and the opportunity to comment on those reasons or because he had received assurance, that it would not be withdrawn before he had been given an opportunity of making representations against the withdrawal. The appellants' legitimate expectation arising from the existence of a regular practice of consultation which could reasonably expect to continue gave rise to an implied limitation on the Minister's exercise of the power contained in art 4 of the 1982 order, namely an obligation to act fairly by consulting the G CHQ staff before withdrawing the benefit of trade union membership."

In the '**Applicant's Guide to Judicial Review**' by Lee Bridges and others and published by London Sweet and Maxwell 1995, legitimate expectation is defined as follows:-

"It seems established that in certain cases where an applicant has been promised that there will be for instance, consultation before a decision is made, then a legitimate expectation will arise that

*consultation will take place and if it does not, then there will be a breach of duty to act fairly."*

I have considered the issue and in my humble opinion, I find no reasonable justification for the ex parte applicant's claim that the principle of legitimate expectation is applicable in its favour mainly because, the respondent had not made any promise of whatever nature to the ex parte applicant; and the latter is estopped from alleging that there were ongoing discussions between it and the respondent since its objection had already been dismissed, which fact was communicated to it vide various correspondences, after which, though it ought to have appealed against such decision, it however chose not to and it cannot now be heard to allege that there were pending discussions.

Needless to say, legitimate expectation is based on the need not to have bargains thwarted. The respondent did not make any representations to the ex parte applicant, and there was thus nothing for the latter to expect after the objection by its tax consultants was dismissed. I am of the view that for a representation to give rise to legitimate expectation the promise must be express or some established policy must be demonstrated.

For the reasons I have stated herein above, I make a finding that the issuance of agency notices did not go against the ex parte

applicant's legitimate expectation. Indeed, the issuance of the Agency Notices was a natural consequence of a protracted battle over payment of tax due and owing, in a matter where it now appears that the ex parte applicant buried its head in the sand instead of taking the appropriate measures.

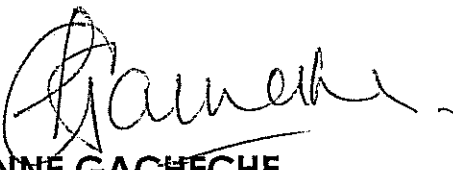
Was the issuance of the agency notices unreasonable? It is implied that a person or body exercising statutory power should act reasonably and in a justifiable manner. It is clear that the respondent acted within the law and in particular within the provisions of the Income Tax Act. In **ASSOCIATED PROVINCIAL PICTURES v WEDNESBURY CORPORATION [1948] 1KB 223**, Lord Green MR stated as follows:-

*"Decisions of persons or bodies which perform public duties or functions will be liable to be quashed or otherwise dealt with by an appropriate order of judicial review proceedings where the court concludes that the decision is such that no such a person or body properly directing itself on the relevant law and acting reasonably could have reached that decision."*

I find that the respondent acted in a fair and reasonable manner, in that as per the correspondence, the tax in issue has been discussed since 2005 and the Agency Notices were served on the ex parte applicant's bankers after several attempts to reconcile failed and even then after the latter failed to appeal against the dismissal of its objection. It is not possible to infer malice on the part of the respondent and as such it cannot be said that its action was Wednesbury unreasonable.

In view of the above reasons, I find that this application lacks in merit and I dismiss it with costs.

Dated and delivered at Nairobi this 4<sup>th</sup> day of November 2011.



**JEANNE GACHECHE**

**Judge**

Delivered in the presence of:-

For the ex parte applicant – Mr. Muchiri holding brief for Mr. Munyu.

For the respondent – No appearance.