REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL No.106 OF 2016

SWEDISH SCHOOLS ASSOCIATION OF KENYA..................APPELANT

VERSUS

COMMISSIONER FOR DOMESTIC TAXES.......................RESPONDENT

JUDGMENT

BACKGROUND

1. The Appellant is a not-for-profit society operating the Swedish School in Kenya.

2. The Respondent a principal is an officer of the Kenya Revenue Authority, established under Section 11 of the Kenya Revenue Authority Act and is charged with the responsibility of collecting and accounting of taxes.

3. The Appellant’s operations are mainly funded by the Swedish Government—central and municipal- and donors.

4. The Respondent carried out an in-depth audit of the Appellant’s tax affairs which resulted to an assessment of KShs 131,624,862.00, inclusive of penalties and interest (Corporate Tax - KShs 4,894,553.00, VAT - KShs 7,224,930.00, PAYE - KShs 118,933,501.00 and Withholding Tax - KShs 571,877.00). The assessment was communicated in a letter from the Respondent dated 5th April 2016.
5. The Appellant objected to the assessment in a letter dated 3rd May 2016 and challenged the Corporate Tax and PAYE assessments.

6. The Respondent issued its Objection Decision on 30th June 2016 wherein it withdrew the Corporate Tax Assessment, but confirmed the PAYE assessment, which due to re-computation, amounted to **KShs 124,046,017.00** (penalties and interest included)

7. Aggrieved by the Respondent’s decision, the Appellant appealed the decision at the Tax Appeals Tribunal.

**APPELLANT’S CASE**

8. The Appellant’s grounds of Appeal are:
   a. **THAT** the Respondent in a letter dated 31st August 2012 had confirmed to the Appellant that the emoluments paid to expatriate staff were tax exempt by Paragraph 27 of the 1st Schedule to the Income Tax Act.
   b. **THAT** the Respondent’s letter was in response to the Appellant’s letter dated 1st August 2012 which had sought clarification on the correct tax treatment of the salaries and emoluments paid to its expatriate staff who enjoyed *Gratis Entry* permits.
   c. **THAT** the need for seeking clarification was brought about by the fact that the renewed bilateral agreement between the Governments of Sweden and Kenya was silent on the matter. The previous bilateral agreement granted exemption.
   d. **THAT** the *Gratis Entry* permits are normally issued to persons with diplomatic privileges and the expatriates’ emoluments were paid from Swedish Government funding.
e. THAT the Respondent had not written to the Appellant thereafter to withdraw its earlier letter confirming the exemption or advise otherwise.

f. THAT the Appellant is merely a collection agent for the Appellant and, since some of the expatriates had completed their tours of duty and left the country, it was not in a position to collect the PAYE from them and remit the same to the Appellant.

**RESPONDENT’S CASE**

9. THAT the bilateral agreement withdrew the Income Tax and PAYE exemptions on 7th December 2010.

10. THAT the Appellant correctly started declaring Income Tax in 2012, but failed to do so for PAYE on the expatriates’ salaries and emoluments.

11. THAT the expatriates were eligible for PAYE deductions with effect from 1st July 2011.

**SUBMISSIONS BY THE PARTIES**

12. The Appellant submits that the Respondent, in a letter dated 31st August 2012, had granted exemption from PAYE on the salaries and emoluments paid to the Appellant’s expatriate staff. In this letter, the Respondent stated that the expatriates’ emoluments paid from Swedish funds for their services in Kenya are therefore exempt from tax.

13. The Appellant further submits that the exemption was based on Paragraph 27 of the 1st Schedule to the Income Tax Act which provides that:

   "The emoluments payable out of foreign sources in respect of duties performed"
in Kenya in connexion with a technical assistance or other agreement for
developmental services or purpose to which the Government or the community is
a party to any non-resident person or to a person who is resident solely for the
purposes of performing those duties, in any case where the agreement provides
for the exemption of such emoluments.

14. The Appellant avers that prior to 2011 the expatriate staff were exempt from
PAYE through a bilateral agreement between the Government of Kenya and
Government of Sweden. However, when the agreement was renewed in 2011,
the new bilateral agreement expressly lifted exemption on Custom Duty, VAT,
Corporation Tax and Special Identity Cards for Swedish nationals in Kenya,
but was silent on taxation of expatriate staff. The exemption granted by the
Respondent was therefore after consideration of the old and the renewed bilateral agreements and relied on Paragraph 27 of the 1st Schedule to the

15. The Appellant submits that the second paragraph of Article 4 of the renewed
bilateral agreement provides that “Specific agreements which are entered into
by the parties before 1 July 2011 will still be governed by the agreement to
general terms and conditions entered into by the parties on the 11 November
2004 unless otherwise agreed.”

16. The Appellant submits that since the issue of taxation of expatriate salaries was
expressly dealt with in the bilateral agreement signed on 11th November 2004
whereas the 2011 agreement was silent on the matter, the fallback position would be the bilateral previous agreement of 2004.

17. The Appellant also argues that the Respondent granted it exemption vide its letter dated 31st August 2012 and the Respondent cannot now disown the letter. In any case, the Respondent has not withdrawn the letter notwithstanding the additional assessment.

18. The Appellant submits that it is merely an agent of the Respondent in deducting and remitting PAYE tax. That the expatriates in question have since finished their tours of duty and returned to Sweden. It is therefore unfair for the Respondent to turn around five years later and demand tax from Appellant yet the Respondent had authorized the Appellant to pay them gross salaries.

19. With regard to Respondent’s allegation that the Appellant, in its request for clarification from KRA, deliberately failed to attach the letter the Ministry of Finance had issued on 7th December 2010 and which the Respondent claims not to have been aware of, the Appellant submits that this letter merely advised that the exemption on VAT, Customs Duty and company profits had been lifted and will henceforth be taxable. The letter also advised that Swedish nationals would no longer be issued with special identity cards.

20. The Appellant submits that the letter was very specific on each tax head and silent on PAYE. That there was nothing to hide from the Respondent as alleged since the matter of PAYE on expatriate staff was not addressed in the letter. Therefore, the letter would not have in any way influenced the decision on the tax exemption by the Respondent’s Policy and Technical Unit. The issue of taxation of expatriates’ salaries was neither dealt with in the renewed bilateral
agreement, the aforementioned letter from the Ministry of Finance of 7th December 2010, nor in the Respondent’s letter dated 15th June 2012.

21. The Appellant submits that the Ministry of Finance is the parent Ministry of the Respondent, and it is reasonable to assume that the Respondent’s Technical and Policy Unit sought independent clarification on the bilateral agreements (both current and past) before granting the exemption to the Appellant. This was the Appellant’s reasonable expectation.

22. The Appellant also disputes the Respondent’s assertion that the Appellant’s prospective tax consultants, Viva Africa Consulting, had advised that expatriate salaries were subject to PAYE. The Appellant submits that the said letter was a ‘Proposal for Tax Consultancy Services’ and that the Respondent cannot rely on a mere proposal to provide tax consultancy services and where the prospective consultant is merely expressing its understanding of the background with regard to the proposed scope of work.

23. The Appellant further disputes the Respondent’s submission that in its letter dated 15th June 2012, the Respondent had advised the Appellant that the institution was not tax exempt. The Appellant submits that the heading of that letter was “Customs and VAT Exemption”. The letter therefore refers to exemption on Customs Duty and VAT. It does not mention PAYE on Expatriates’ salaries.

24. The Appellant reiterates that the exemption was on the basis of Paragraph 27 of the First Schedule to the Income Tax Act and that it has provided evidence that the school is funded by foreign government sources.
25. The Respondent meanwhile submits that Sections 37(1) and (4) of the Income Tax Act provides that:

37(1) - "An employer paying emoluments to an employee shall deduct therefrom, and account for tax thereon, to such extent and in such manner as may be prescribed"

26. That Section 37(4) of the Act further provides that:

37(4) - "Any tax deducted under this section from the emoluments of an employee shall be deemed to have been paid by that employee and shall be set-off for the purposes of collection against tax charged on that employee in respect of those emoluments in any assessment for the year of income in which such emoluments are received."

27. The Respondent admits that several communications took place between its officers and the Appellant over the issue of the exemption to payment of PAYE. The Respondent admits to:

   a. Receiving the Appellant’s letter dated 1st August 2012 seeking clarification on taxation of salaries and emoluments of expatriate staff with valid Gratis Entry permits;
   b. Writing the letter dated 8th August 2012;
   c. Receiving the Appellant’s Letter dated 24th August 2012; and
   d. Writing the letter dated 31st August 2016.

28. The Respondent however submits that the Appellant, in its letter of 1st August 2012 seeking clarification, conveniently failed to attach the letter from the Ministry of Finance dated 7th December 2010.
29. According to the Respondent, this letter clearly advised the Swedish Embassy that the new agreement to begin operating between 1st July 2011 and 31st December 2013 will include changes on VAT exemption, on custom duty, no exemption from taxes on company profits and no special identity cards for Swedish National in Kenya.

30. It is the Appellant’s contention that the Appellant was therefore aware of the change in law and its implications on the Appellant’s tax obligations. The Respondent therefore reads mischief in the Appellant’s failure to attach or bring this letter to the Respondent’s attention.

31. The Respondent further submits that Viva Africa Consulting, a tax consulting firm, wrote to the Appellant and advised them of the impact of the change in the law.

32. The Respondent also submits that the Appellant recognized the changes effected by the new bilateral agreement and started paying Corporate Tax and also conceded to paying VAT and Withholding Tax in its letter dated 20th May 2016. That the Appellant also started remitting PAYE on the expatriates’ salaries and emoluments two years later for a few months (i.e. from July 2013-January 2014) but stopped doing so upon instructions from its Board.

33. The Respondent submits that it had also advised the Appellant in its letter dated 15th June 2012 that the institution was not tax exempt in view of the amendments to the original bilateral agreement.
34. The Respondent contends that its mandate is to implement the law and policies of the government and cannot purport to re-write the same. It is therefore the Respondent’s view that its letter of 31st August 2012 contradicts the letter by Ministry of Finance dated 7th December 2010. Consequently, its letter dated 7th December 2010 was rendered void ab initio and it cannot implement it.

35. The Respondent reiterates that legal obligations are created by the law and policies. The fact that the Respondent has not officially written to the Appellant cancelling the “so-called exemption letter” cannot bind the Respondent to continue committing an illegality.

36. The Respondent’s final submission is that it is bound to implement revenue laws and collect taxes and whether or not the affected expatriates whose PAYE was unpaid have left the country is not its concern.

**ISSUE FOR DETERMINATION**

37. The Tribunal has framed the sole issue for determination to be:

   **Whether the Appellant was exempted from payment of PAYE on the salaries and emoluments paid to its expatriate staff?**

**ANALYSIS AND FINDINGS**

38. The Appellant has largely based its arguments for tax exemption from payment of PAYE on the salaries and emoluments paid to expatriates on the letter by the Respondent of 31st August 2012.
39. The aforementioned letter by the Respondent’s Policy and Technical Unit had advised that, “the conditions in which the expatriates render their service in Kenya are in conformity with the provisions of Paragraph 27 of the 1st Schedule to the Income Tax Act. The expatriates’ emoluments paid from Swedish funds for their services in Kenya are therefore tax exempt.”

40. Paragraph 27 of the 1st Schedule provides that:
“The emoluments payable out of foreign sources in respect of duties performed in Kenya in connexion with a technical assistance or other agreement for developmental services or purpose to which the Government or the community is a party to any non-resident person or to a person who is resident solely for the purposes of performing those duties, in any case where the agreement provides for the exemption of such emoluments. [emphasis ours]”

41. The Tribunal has considered the rival arguments by the parties and finds that the exclusion of PAYE aspect in the renewed 2011 bilateral agreement meant that the Appellant was liable to deduct the same from its expatriate staff salaries and emoluments and remit the same to the Respondent.

42. In the Tribunal’s view, an exemption under Paragraph 27 is only valid to the extent that the underlying agreement provides for the same. Since the revised bilateral agreement excluded the tax exemptions previously granted to the Appellant, the Tribunal finds that the salaries and emoluments paid by the Appellant to its expatriate staff could not qualify for exemption from PAYE.

43. It appears to the Tribunal that the Appellant was well aware of this position and deducted and remitted PAYE from the salaries and emoluments of its
expatriate staff from July 2013 to January 2014 notwithstanding the Respondent’s letter of 31st August 2012.

44. The Tribunal therefore agrees with the Respondent’s submission that its letter of 31st August 2012 was not supported by law and hence void ab initio.

45. The Appellant has raised a pertinent issue that the expatriates in respect of whom the tax demand was made by the Respondent completed their respective tours of duty and returned to Sweden with the Appellant having paid gross salaries on the strength of the Respondent’s disputed advisory of 31st August 2012.

46. Paragraph 37 (2) of the 3rd Schedule of the ITA empowers the Respondent to recover PAYE together with penalty as if it were tax due from the Appellant when the Appellant failed to deduct and remit the same from its staff’s salaries and emoluments. In the circumstances, the Appellant should use the available channels open to it in engaging the Respondent on that issue.

FINAL DETERMINATION

In the final analysis the Tribunal finds as follows:-

i. The Appeal be and is hereby dismissed.

ii. Each party shall bear its costs
DATED and DELIVERED at NAIROBI this 23rd day of October 2020

PATRICK LUTTA
CHAIRPERSON

HELEN BILA
MEMBER

MWAI MBUTHIA
MEMBER

ELISHAH NJERU
MEMBER

FARAH BILLOW
MEMBER