

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
TAX APPEAL NUMBER 15 OF 2015

KENINDIA ASSURANCE COMPANY LIMITED.....APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

BACKGROUND:-

1. The Respondent during its desk audit of the Appellant in 2012 made an observation that on the 28th day of May, 2010 that the Appellant increased its issued share capital through capitalization of Kshs. 111, 338,000/=, from the statutory reserves held by the Appellant, for the benefit of its shareholders.
2. The findings of the audit and the assessment of the additional taxes payable as a consequence of the foregoing capitalization was formally communicated to the Appellant vide the Respondent's letter dated the 7th day of June, 2013 (*Marked as KA3 in the Respondent's Statement of Facts*).
3. The Appellant objected to the aforesaid additional assessment of taxes under Assessment Number 03052 010300428 for Kshs. 32,377,800/= vide a letter dated the 5th day of July, 2013 addressed to the Respondent by M/s Ernst & Young Certified Public Accountants (*See KA4 in the Respondent's Statement of Facts*). The objection by the Appellant was premised on the ground that the additional assessment amounted to double taxation in respect of income already taxed and was accordingly unfair and inconsistent to good tax practices to subject the same income to tax twice.
4. The Respondent vide a letter dated the 12th day of February, 2014 confirmed the additional tax assessment thereby prompting the Appellant to file the present Appeal on the 11th day of March, 2014 before the now defunct Income Tax Local Committee for Nairobi.

THE APPEAL:-

5. The Appeal by the Appellant against the Respondent's notice of confirmation of the additional tax assessment was premised on the grounds set forth in the Memorandum of Appeal dated the 10th day of March, 2014 as under:-
 1. The Commissioner confirmed the notice without due regard to the provisions of the Income Tax Act, the facts and circumstances of the case.
 2. The Assessment was made on wrongful inference that capitalization of reserves was appropriated from the life fund as opposed to the statutory reserve which was a reserve accessible by both policy holders and the shareholders.
 3. Tax had already been paid to the capitalized reserves and payment of the additional tax would result to double taxation, an approach which is unfair and inconsistent to good tax practices.
 4. The Commissioner did not consider the information and explanations provided thereby failing to appreciate all the issues before him before arriving at the additional assessment in the Appellant's case.
 5. The failure by the Commissioner to consider all the facts and the information provided in the Appellant's case is tantamount to breaching the rules of fairness and natural justice.
 6. The additional assessment of Kshs. 32,377,800/= is unwarranted since it is not backed by the provisions of the Income Tax Act.
6. The Appellant in the Memorandum of Appeal prays for the Orders being:-
 - i. **THAT** the tax assessment be stood over as it continues to attract interest pending determination of the matter.
 - ii. **THAT** the Commissioner withdraws the additional assessment which has been issued in contravention to the provisions of the Income Tax Act, due regard to the facts, circumstances of the case and the rules of fairness on natural justice.

THE RESPONSE BY THE RESPONDENT:-

7. The Respondent subsequent to being served with the Memorandum of Appeal filed before the Income Tax Local Committee for Nairobi the Respondent's Statement of Facts on the 9th day of April, 2014.
8. The Respondent's Statement of Facts dated the 8th day of April, 2014 signed by Moses Maina, Manager Domestic Taxes Department on behalf of the Respondent sets out under sub-headlines of the Point at issue, Relevant Statutes, Facts of the case, Respondent's contention and with recommendation being that the Local Committee to find that the capitalization of the reserves was rightfully treated as a transfer for the benefits of shareholders which is taxable under Section 19 (5)(b) of the Income Tax Act, CAP 470 of the Laws of Kenya.

THE HEARING:-

9. When the matter came up for hearing on the 19th day of January, 2016 the parties by the very nature of the dispute informing the Appeal opted not to call any witnesses but rather opted to make oral submissions.
10. The parties were subsequent to the hearing by oral submissions permitted by consent to file and serve upon each other written submissions. Both parties duly filed the written submissions before the Tribunal.
11. On the 16th day of February, 2016 the parties duly highlighted on the written submissions filed before the Tribunal on either side. The Tribunal directed that the decision was to be subsequently rendered with a prior notice to the parties.

ANALYSIS:-

12. The Appellant is a private limited liability company that provides both life insurance as well as general insurance business. The two lines of the business have been noted to be carried out independently and the accounting in respect of financial performance done separately.
13. The Appellant maintains two funds in its long term business being a statutory life fund and a statutory reserve. The statutory life fund is established and maintained in pursuant to the provisions of the Insurance Act and it is for the purposes of safeguarding the interests of the policy holders. The statutory reserve is maintained by the Appellant for the benefit of shareholders.
14. The Appellant created a statutory reserve in 2004 by transferring Kshs. 159,875,000/= from retained earnings and the amount in the fund was to be accessible to both the policy holders and the shareholders. The amount was admittedly on the part of both parties taxed.

15. The Respondent contends that since the statutory reserve as created by the Appellant was sitting in the general business it was a shareholders' appropriation reserve as opposed to a reserve created for the benefit of the policy holders. That the statutory reserve as presented in the Appellant's financial statements contravenes the provisions of Sections 45 and 46 of the Insurance Act, CAP 487 of the Laws of Kenya. That this was not a statutory reserve in terms of the foregoing provisions of the Act but rather an appropriation reserve attributable to the shareholders.
16. With the insurance industry now being fully regulated and supervised by the Insurance Regulatory Authority in regard to the compliance with the material provisions of the Insurance Act, CAP 487 of the Laws of Kenya the Tribunal is obviously not entirely competent and does not provide an appropriate forum to determine the Appellant's compliance with and/or contravention of Sections 45 and 46 of the Insurance Act, CAP 487 of the Laws of Kenya in the manner of the creation and maintenance of the statutory reserve fund.
17. The Appellant on the 28th day of May, 2010 increased its issued share capital through capitalization of a sum of Kshs. 111,338,000/= from the statutory reserve. The capitalization of the foregoing amount was obviously for the benefit of the shareholders and not the policy holders who were deprived of the benefit from the now reduced amounts in the statutory reserve.
18. The Respondent in giving effect to the provisions of Section 19(5) (b) of the Income Tax Act, CAP 470 of the Laws of Kenya as amended to take effect on the 1st day of January, 2009 by the Finance Act No. 8 of 2008 proceeded during the audit carried out in 2012 to tax the aforesaid amount of Kshs. 111,338,000/= capitalized from the statutory reserve.
19. The law on taxation at the point of creation of the statutory reserve in 2004 was admittedly different and distinct from the tax regime applicable at the instance of the capitalizations of the aforesaid amount transferred from the statutory reserve in 2010.
20. The issue for determination on the basis of both the oral and written submissions on record before the Tribunal is whether the taxation of the capitalized funds amounted to double taxation and offended the provisions of Article 47 of the Constitution of Kenya, 2010 as regards the Appellant's entitlement to a fair, legal and reasonable administrative action on the part of the Respondent.
21. The provisions of Section 19(5)(b) of the Income Tax Act, CAP 470 the Laws of Kenya provides that the gains or profits for a year of income from long term insurance business of a resident insurance company whether mutual or proprietary shall, inter alia, be any amount transferred from the life fund to the benefit of

shareholders. The purport of this Section is that any funds upon transfer for the benefit of the shareholders is taxable irrespective of how the fund was created.

22. The Appellant contends that the strict application of Section 19(5)(b) of the Income Tax Act, CAP 470 of the Laws of Kenya on the part of the Respondent to the funds already taxed from the retained earnings in 2004 is contrary to legitimate expectations that income suffers tax only once. That an assessment which provides for double taxation is inequitable and is illegal, unfair and unreasonable and violate the spirit and object of Article 47 of the Constitution of Kenya, 2010.
23. When the Appellant created the statutory reserve in 2004 from retained earnings that were taxed the operational tax regime in respect of taxable income of a life insurance company was determined as the higher of Income less Expenditure (I-E). The I-E system was based on the incomes from investment and insurance premiums less expenditure.
24. The taxed funds retained in the statutory reserve were in pursuant to the word and spirit of the Section 45 of the Insurance Act, CAP 487 of the Laws of Kenya strictly calculated for the benefit of the policy holders and such funds were ordinarily not to be easily accessible for the benefit of the shareholders. The subsequent application of Section 19(5)(b) of the Income Tax Act, CAP 470 of the Laws of Kenya to assess taxes on the capitalized funds from the statutory reserve calculated for the benefit of the shareholders is not double taxation and not at all inconsistent with the best tax practice.
25. The statutory and judicial authorities cited by the Appellant to suggest abhorrence to double taxation are not applicable in the situation obtaining in this Appeal and are clearly distinguishable. The judicial decisions and the Sections of the Income Tax Act, CAP 470 of the Laws of Kenya cited by the Appellant can obviously not be interpreted in isolation but rather within the entire context of the judicial decisions and the complete text of the statute.
26. With regard to the alleged Constitutional infringement of the rights and fundamental principles and values under the Constitution of Kenya, 2010 the Tribunal is not the best placed forum to agitate from and to determine such matters in the interpretation of the application of any specific tax legislation or regime.
27. The application of Section 19(5)(b) of the Income Tax Act, CAP 470 of the Law of Kenya from its clear reading imposes a strict obligation on the Respondent to demand and enforce payment of taxes on any transfer of funds from the statutory reserve for the benefit of shareholders. The fact that the retained earnings from which the statutory reserves fund was created were previously taxed seems to be immaterial. The Tribunal agrees with the Respondent's position that in interpreting statutes the principle of strict or literal construction applies and cites with approval

to the holding in *Cape Brandy Syndicate =VS= Inland Revenue Commissioners; CA 1921 (1 KB 64, 71)* that:-

"In a taxing statute one has to look merely 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 look fairly at the language used."

FINDING ON FINAL DETERMINATION:-

28. The Tribunal finds in the circumstances that the amount of Kshs. 111,338,000/= capitalized in the year 2010 from the statutory reserve by the Appellant was a taxable transfer for the benefit of the shareholders and the assessment of tax in respect thereof by the Respondent was appropriate. The Section 19(5)(b) of the Income Tax Act, CAP 470 of the Laws of Kenya is clear and applicable to the circumstances precipitating in the filing of this Appeal.

29. The Tribunal upholds the assessment of tax on the foregoing capitalized funds on the part of the Respondent and accordingly finds that the Appeal has no merit and proceeds to dismiss the same with costs to the Respondent.

Dated, signed and delivered at Nairobi this 15th day of April, 2016.

In the presence of :-

..... Ms. Ann Mainafor the Appellant

..... Mr. Eric Mwangifor the Respondent

1. ERIC N. WAFULA
Chairman

2. WILFRED GICHUKI
Member

3. PHILEMONA KIROKEN
Member

4. OMAR J. MOHAMMED
Member

5. ABDULBASID AHMED
Member

..... [Signature]

..... [Signature]

..... [Signature]

.....

..... [Signature]

..... Abdulbasid