PAYE Deductions Apply to Employment Settlement Awards Even Where the Consent Judgment is Silent on Tax

Mohamed v Barclays Bank of Kenya Limited (Civil Appeal E069 of 2023) [2026] KECA 75 (KLR)

Background

1.1 The Appellant (Kassim Abdulatiff Mohamed) was a former employee of Barclays Bank of Kenya Limited (the Respondent). A dispute subsequently arose between the parties in connection with the employment relationship, leading to proceedings before the Employment and Labour Relations Court at Mombasa.

1.2 On 25th November 2019, the parties filed a Consent Judgment for judgment in favour of the Appellant in the sum of Kshs. 6,000,000, payable within 14 days by way of RTGS into the Claimant's advocates' bank account. The parties further agreed that each would bear its own costs and the matter would thereafter be marked as settled.

1.3 In compliance with the Consent Judgment, the Respondent paid the agreed sum of Kshs. 6,000,000 but deducted Kshs. 1,623,398 as Pay As You Earn (PAYE) tax pursuant to Section 37 of the Income Tax Act (Cap 470), which amount was remitted to the Kenya Revenue Authority (KRA). The Respondent thereafter remitted the net balance of Kshs. 4,376,601 to the Appellant's advocates.

1.4 The Appellant contended that the parties had agreed, during negotiations leading to the Consent Judgment, that the sum of Kshs. 6,000,000 was an all-inclusive settlement amount and was not subject to any deductions whatsoever. Consequently, the Appellant threatened to commence execution proceedings for recovery of the deducted sum of Kshs. 1,623,398.

1.5 In response, the Respondent moved the Court under a Certificate of Urgency seeking, among other orders, a stay of execution and a declaration that it had fully complied with the Consent Judgment. The Respondent maintained that the deduction and remittance of PAYE to the Kenya Revenue Authority was undertaken pursuant to its mandatory statutory obligations under the law.

1.6 In determining the application, the trial court considered the legal framework governing the deduction of income tax from employment-related payments. The Court observed that Section 37(1) of the Income Tax Act requires employers paying emoluments to employees to deduct and remit PAYE to the Kenya Revenue Authority, while Section 49(2) of the Employment Act, 2007 provides that payments made to an employee as a remedy for wrongful dismissal or unfair termination are subject to statutory deductions.

1.7 The trial court therefore held that

1.7.1 an employer has a mandatory statutory obligation to deduct and remit income tax from such payments.

1.7.2 the Consent Judgment did not contain any clause indicating that the sum of Kshs. 6,000,000 was intended to be net of tax or all-inclusive;

1.7.3 unlike in some settlement agreements where the parties expressly provide that the employer will shoulder the tax obligations, the consent filed in this matter was silent on the question of tax. This silence meant that the statutory presumption applied, namely that the income was taxable and subject to PAYE deductions

1.7.4 Having already remitted PAYE to KRA, the Respondent could not be ordered to pay the Appellant money already paid to the Government. if the Appellant believed that any portion of the remitted tax was wrongfully deducted, his remedy lay in seeking a refund from the Commissioner of Domestic T axes and not in execution against the employer.

1.7.5 Aggrieved by the decision of the trial court, the Appellant appealed to the Court of Appeal on grounds that the learned Judge erred in wrongly presuming that the amount stated in the Consent Judgment was taxable.

2. Court of Appeal's Determination

The Court of Appeal dismissed the appeal and held as follows:

2.1 The Income Tax Act establishes a clear and comprehensive regime governing the taxation of all employment-related income. Specifically:

2.1.1 section 3(1) imposes income tax on "the income of a person which accrued in or was derived from Kenya." Under Section 3(2)(a)(ii), such income expressly includes "…gains or profits from employment or services rendered."

2.1.2 section 5(1), provides that: "For the purposes of section 3(2)(a)(ii), an amount paid to—a person who is, or was at the time of the employment or when the services were rendered, a resident person in respect of any employment or services rendered by him in Kenya or outside Kenya … shall be deemed to have accrued in or to have been derived from Kenya."

2.1.3 section 5(2) further expands the meaning of "gains or profits from employment" to include: …wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, or subsistence, travelling, ntertainment or other allowance received in respect of employment or services rendered…

These provisions make it clear that any amount paid to an employee or former employee in respect of employment or services rendered constitutes deductible tax incom

2.2 Section 37(1) of the Employment Act imposes a mandatory obligation on employers to deduct and remit PAYE from "any emoluments paid to an employee. When read together with Section 19(1)(f) of the Employment Act, employers are authorized to make lawful statutory deductions from payments due an employee. Hence, the legislative intent is unmistakable, namely that every payment arising from an employment relationship – whether salary, terminal dues, compensation, gratuity, or other lump-sum awards – is subject to withholding tax, unless expressly exempted.

2.3 In KRA 's Employers Guide on P.A.Y.E prescribes a *"Procedure on Lump Sum Payments Gratuities, Bonuses"* as follows:

A. *Notification Employers are no longer required to notify the Tax Department before making payments of terminal benefits to the employees upon leaving their employment. Every employer has an obligation under Section 37 of the Income Tax Act to recover appropriate tax from any lump sum amount before releasing the difference/balance to the employee.*

1. ….

2. *<u>Compensation for termination of employment:</u> Liability extends to any payment, whether voluntary or obligatory made to a person to compensate him for the termination of his contract of employment or services, whether the contract is written or verbal and whether or not there is provision in the contract for such payment. " Emphasis added.*

2.4 The combined effect of these provisions is clear. Any amount paid to an employee or former employee as a gain resulting from the rendering of professional services – including lump-sum settlement amounts, including interest awarded as compensation for delayed payment – constitutes taxable income. It therefore attracts PAYE, and the employer has a statutory duty to deduct and remit such tax before releasing the net balance to the employee.

2.5 The Employment and Labour Relations Court has consistently upheld the principle that any income accruing to an employee by virtue of the employment relationship, or from the rendering of services, is subject to income tax.

2.6 This position was reiterated in several decisions without number, including, *Kaniu vs Family Bank Limited [2023] KEELRC 3060 (KLR)* where the Court emphasized that statutory deductions apply to all employment-related payments; *Chagaba vs Artcaffe Coffee & Bakery Limited [2023] KEELRC 89 (KLR),* which affirmed that terminal dues constitute taxable income; and *Sakam Enterprises Limited vs W ando [2025] KEELRC 2917 (KLR)* in which it was held that employers are obligated to deduct PAYE before remitting any lump-sum exit payments. Similarly, in the recent case of *Ndungu vs Safaricom PLC; Martin Mwaniki t/a Anfield Auctioneers (Interested Party) [2025] KEELRC 2234 (KLR),* it was held that even settlement amounts arising from employment disputes are subject to statutory deductions. Collectively, these authorities underscore that employment-related income cannot escape the taxation regime regardless of the form or description of the payment.

2.7 Where a judgment or consent does not expressly provide for the payment or deduction of taxes, any amount paid to an employee on account of employment remains subject to taxation by operation of law. A court cannot, by consent or otherwise, exempt parties from mandatory statutory obligations unless the statute itself provides such an exemption.

2.8 The Consent Judgment signed by the parties was silent on the issue of income tax. In the absence of such wording, the Respondent was legally bound to deduct and remit PAYE in accordance with Section 37 of the Income Tax Act and section 19(1)(f) of the Employment Act. The deduction of statutory tax, therefore, did not vary, alter, or rewrite the consent; it merely reflected the Respondent's compliance with the law.

2.9 Accordingly, the Appellant' s contention that the trial Judge varied the consent was unsustainable. The Judge simply held that statutory tax obligations apply regardless of the parties' silence and cannot be circumvented through a Consent Judgment.

Key Contacts

Anne Muema
Advocate / Managing Partner

Email: amutheu@mutieadvocates.com

Maureen Kubai
Associate

Email: mkubai@mutieadvocates.com

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Website: www.mutie-advocate.com
Phone: +254 768 042 180
E-mail: info@mutieadvocates.com
Address: Assi Centre, School Lane, Westlands
P O Box 211-00621, Nairobi

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