

Tax Case Law – Recent Updates

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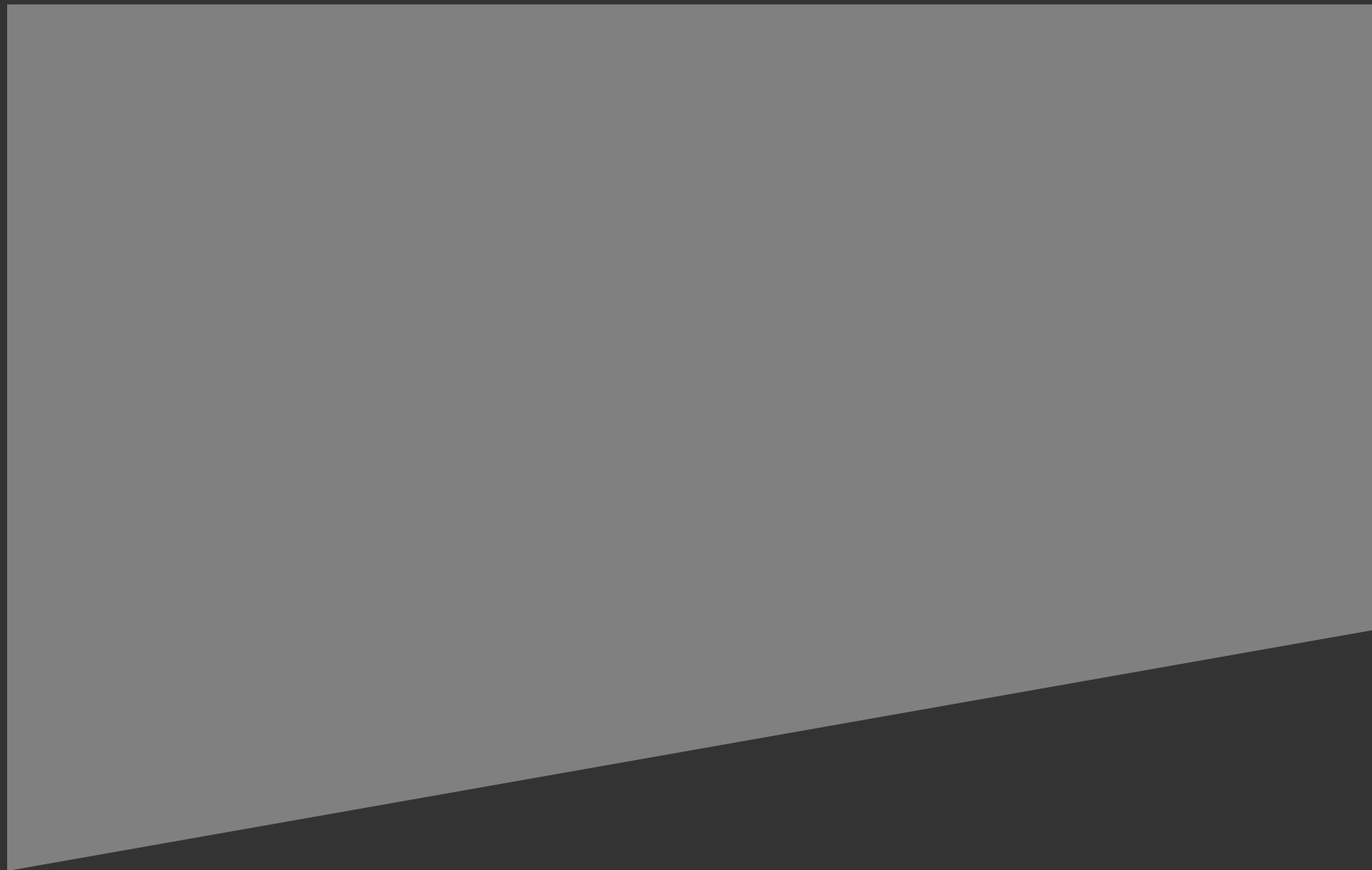


Course content



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- ❑ Significant tax cases from Kenyan Courts
 - ❑ Retrospective application of the law
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Instituting Court Proceedings



A right under the Constitution



▶ Article 47: Fair administrative Action:

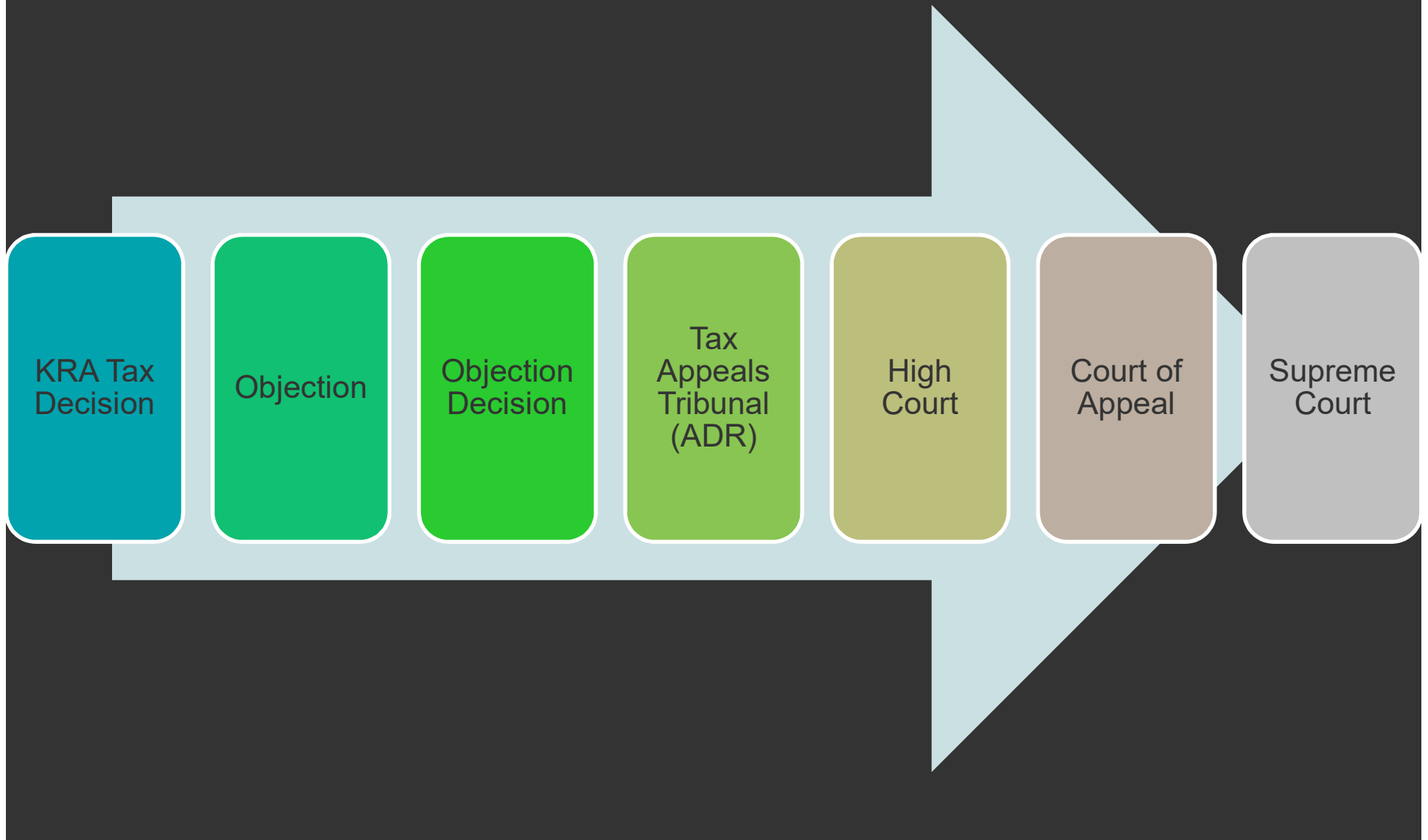
‘Every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.’

▶ Article 201: Principles of public finance:

‘there shall be openness and accountability, including public participation in financial matters’

‘the public finance system shall promote an equitable society, and in particular... the burden of taxation shall be shared fairly...’

Dispute Resolution Process



Dispute Resolution Process



Appeals to the High Court

- From technical decisions of the TAT
- Appeals only on questions of law
- Abuse of process or other administrative excesses by KRA
- Infringement of constitutional rights
- Both the Taxpayer and KRA may call oral or written evidence

Appeals to the Court of Appeal

- From decisions of the High Court
- Appeals only on questions of law
- Must be filed within 30 days of High Court decision

Appeals to the Supreme Court

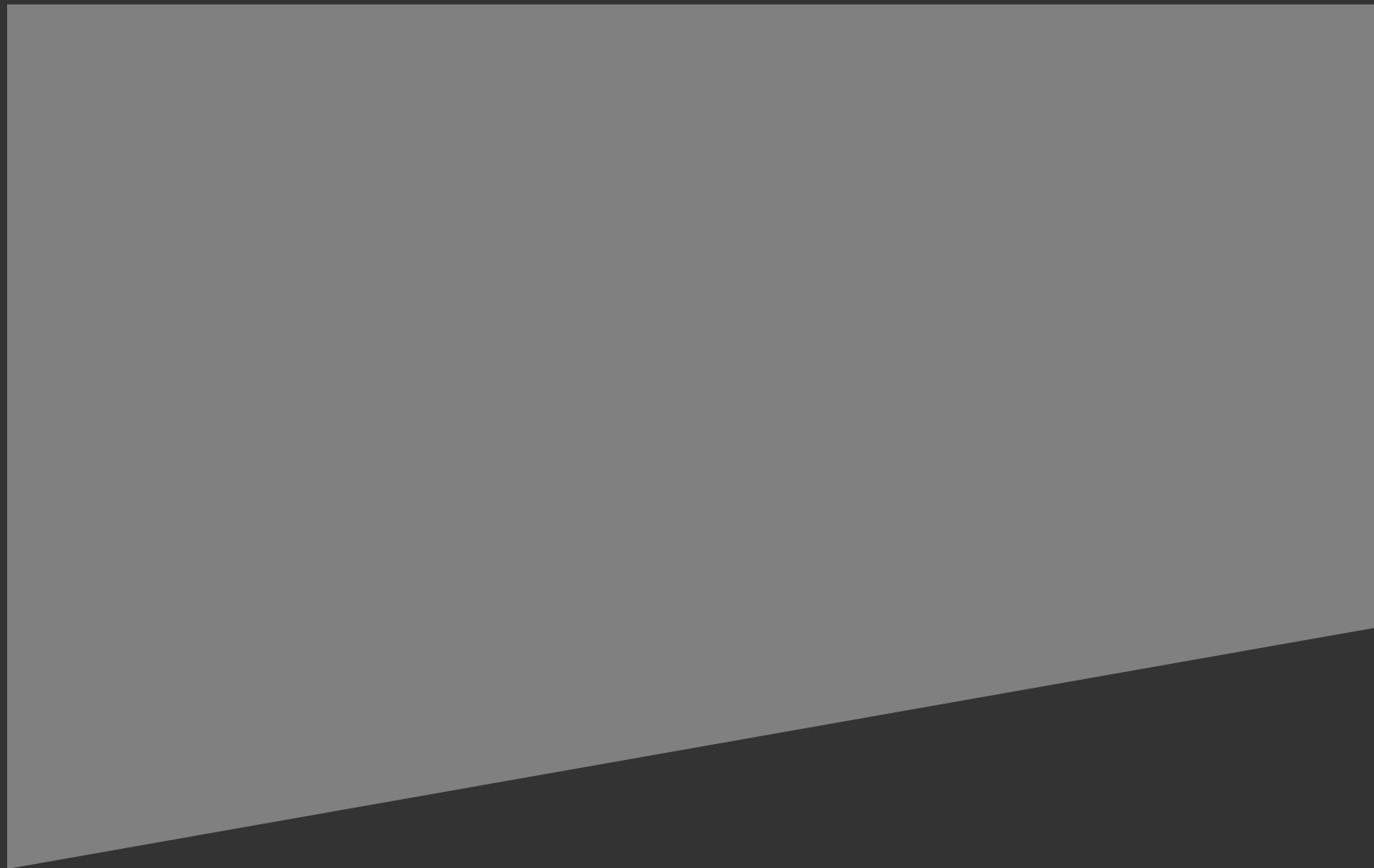
- From decisions of the Court of Appeal
- Automatically in cases involving interpretation of the Constitution.
- An intended appeal raising a matter of general public importance.
- There is risk of miscarriage of justice

Remedies in court processes



- ▶ Conservatory Orders to maintain status quo pending determination
- ▶ Injunctions to stop an action being done
- ▶ A declaration of rights
- ▶ Declaration of invalidity of any law that
 - ▶ denies, violates, infringes or threatens a right or fundamental freedom in the bill of rights and is not justified under Article 24
- ▶ An Order for compensation
- ▶ An order for judicial review
 - ▶ Considers the manner in which an administrative body, e.g. KRA makes a decision and the merit of the decision itself

Significant tax cases from Kenyan Courts



Retrospective application of the law



General Rule:

- ▶ *Nulla poena sine crimen*: no penalty without a crime.
- ▶ *Nulla crimen sine lega*: no crime without a law

For tax purposes

- ▶ **Section 2 of the *Provisional Collection of Taxes and Duties Act*** provides that a Finance Bill imposing a tax may come into operation before it is passed into law.
- ▶ **Section 28 of the Interpretation and General Provisions Act** provides that subsidiary legislation operate retrospectively, but not at a date earlier than the commencement of the written law under which the subsidiary legislation is made. Moreover, an individual shall not be liable to any penalty accruing from an act or omission before the day of the subsidiary legislation.

Retrospective application of the law cont'd



Okiya Omtatah Okiiti v CS National Treasury & 3 others Petition No. 253 of 2018

- ▶ Petitioner challenged the constitutionality of:
 - ▶ the Provisional Collection of Taxes & Duties Act (PCTDA), that makes provisions in a Finance Bill effective before it is passed into law (before legislation); and
 - ▶ the Provisional Collection of Taxes and Duties Order, 2018 (the Order), which gave effect to Finance Bill, 2018 prior to being passed into law by Parliament.
- ▶ The court held that the PCTDA and the Order are unconstitutional and therefore invalid, null and void. This impact the manner in which new taxes are introduced during the annual budget cycle.

Note:

- ▶ Legislative power vested in the parliament and thus taxes must be approved by Parliament.

Retrospective application of the law cont'd



Law Society of Kenya v Minister for Finance & 2 others [2017] eKLR

- ▶ Finance Act 2004 which amended the Value Added Tax Act, Cap 476 giving authority to the Commissioner to require persons to use electronic tax registers was enacted before the provisional order introducing the Value Added Tax (Electronic Tax Registers) Regulations could come into effect.
- ▶ The retrospective aspect of the regulations was challenged.
- ▶ It was held that the provisional order simply expired (before its effective date) and was replaced by the Finance Act on the effective date.
- ▶ The regulations were not in conflict with the Finance Act. As a subsidiary legislation, the regulations remained in force so far as they were not inconsistent with the Finance Act until they were revoked or repealed.
- ▶ Affirms the provision of Section 28 of the Interpretation and General Provisions Act. Subsidiary legislation is applicable retrospectively but not later than the effective date of the principal legislation.
- ▶ ***Would one be required to pay penalties and interest, if any?***

Retrospective application of the law cont'd



Kenya Bankers Association v Attorney General & KRA [2018] eKLR

- ▶ Petitioner challenged the introduction of the 'Robin Hood' Tax through Finance Bill 2018 i.e. excise duty on the transfer of money in excess of Kshs 500,000.
- ▶ The applicant's case was that the Tax Laws (Amendment) Act, 2018, assent 18th July 2018, gazetted on 25th July 2018, yet the effective date of some amendments 1st July 2018.
- ▶ The court gave initial ruling giving conservatory orders suspending the implementation of the excise duty until such a time as proper definition of 'money transferred by banks' is provided.

Note:

- ▶ Tax legislation must be clear and unambiguous
- ▶ Conservatory orders are remedies in respect of a particular state of affairs

Legislative process–Public Participation



Pevans East Africa Limited & another v Chairman Betting Control and Licensing Board & 7 others [2017] eKLR

- ▶ Petitioner challenged the constitutionality of the 50% Betting, Gaming & Lotteries Tax introduced in Finance Bill, 2017 on the ground, among others, of lack of adequate public participation.
- ▶ Although the petition was dismissed, the court held that public views ought to be considered in the decision making process and as far as possible the product of the legislative process ought to be true reflection of the public participation so that the end product bears the seal of approval by the public.

Note:

- ▶ Differential tax schemes with legitimate considerations and not arbitrary are not unconstitutional and are therefore not 'unfair'

Power of search, seizure and forfeiture of goods



Robert K. Ayisi v Kenya Revenue Authority & another [2018] eKLR

- ▶ KRA sought details of transactions between the petitioner & a third party, which had been confiscated by EACC. Petitioner was arrested and detained at Times Tower for 3 hours
- ▶ The Petitioner challenged the constitutionality of sections 44(1) & (2) and 60(1)(3) of the TPA, 2015 which empowered KRA to unilaterally and arbitrarily exercise the power of search, seizure and forfeiture of goods was thus challenged.
- ▶ Court held that Sections 44(1) and (2), 60(1) and (3) and 59(4) of the TPA, 2015 are not in compliance with Article 31 of the Constitution 2010 which provides for the right to privacy.

Tax disputes and appeal procedures



Republic v KRA Ex Parte M-Kopa Kenya Limited [2018] eKLR

- KRA issued a Private Ruling to M-Kopa under section 65(1) of the Tax Procedures Act, 2015 to the effect that television sets were exempt from VAT.
- Thereafter, KRA reversed its position and assessed taxes.
- Court stated that validly issued Private Ruling creates a legitimate expectation which can only be withdrawn where rational grounds of the intention to withdraw the same have been communicated to the beneficiary of the expectation in clear terms and he has been given an opportunity to comment thereon.

Tax disputes and appeal procedures



Republic v Commissioner of Domestic Taxes Ex-Parte I&M Bank Limited [2017] eKLR

- I&M Bank filed an appeal at the TAT to challenge the substantive issues arising from an assessment
- The bank also filed judicial review proceedings at the High Court to challenge procedural flaws with the assessment.

The court held that

- taxpayers cannot 'forum shop'
- where there is a clear procedure for redress of any particular grievance prescribed by the Constitution or an Act of Parliament, that procedure should be strictly followed, and
- judicial review is a remedy of last resort unless under the statute, to resort thereto would be less convenient or otherwise less appropriate.
- Taxpayers must carefully consider the correct forum to challenge a Tax Decision.

Capital Gains Tax



Law Society of Kenya v Kenya Revenue Authority & another [2017] eKLR

- ▶ LSK argued that Paragraph 11A of the Eighth Schedule of the Income Tax Act, which imposes a requirement that tax is to be paid 'before the property is transferred', contradicts various statutes and the Constitution. The LSK argued that CGT should only apply when transfer of the property is successful registered.
- ▶ The court held that requiring payment of CGT before registration of the transfer was contrary to Article 201 of the Constitution as citizens were required to pay tax before they were legally due.
- ▶ Current practice: Before purchaser can pay stamp duty on i-Tax, the vendor must pay CGT. On i-Tax portal, you cannot pay stamp duty without the acknowledgement number generated from payment of CGT.

Capital Gains Tax Cont'd



Kenya Bankers Association v KRA [2018]

- ▶ KBA argued that CGT is only payable upon registration of the transfer by the charger, because, when banks create a charge over land, the lender doesn't qualify as owner of the charged land. Therefore, transferring the land upon default should not attract CGT.
- ▶ The High Court of Kenya, on 13 March 2018, quashed an administrative action requiring commercial banks to pay stamp duty and CGT on all land sold to recover bad loans.
- ▶ Upon the sale of the land by the banks, the CGT would be payable at the time of registration of the transfer by the charger (owner of the property) unless the bank realizes a surplus over and above the loan borrowed. In such a case, the bank would be required to account for CGT on the surplus.

Excise duty



PZ Cusssons East Africa Limited v Kenya Revenue Authority [2013] eKLR

- KRA assessed CIT and Excise Duty on the basis that the petitioner had under-declared its sales (export sales).
- Variance was with the Simba System which indicated entries made on behalf of the Petitioner by a clearing agent unknown to them.

Decision

- Excise Duty & CIT assessments were quashed
- KRA issuing assessments in the circumstances in light of claims of fraudulent agents who were not the company's agent was unreasonable and unfair and in breach of the right to fair administrative action under Article 47.

Liability to import duties



Republic v Kenya Revenue Authority & another Ex-parte Unilever Tea Kenya Limited [2011]

- The applicants used a licensed clearing agent to clear imported goods into Kenya.
- KRA alleged that no payments had been made and that the licensed clearing agent had made fraudulent declarations. KRA further alleged that the receipts produced were forgeries as they had not been issued by genuine KRA officers.

Decision

- Clearing agents owe importers a fiduciary duty. Where an agent acts in excess of its authority the agent will be personally liable for such acts.
- KRA ought to pursue the clearing agent to make good on its promise to pay and not make unnecessary demands on the applicants.

Liability to import duties



Republic v Kenya Revenue Authority Ex-parte Bata Shoe Company (Kenya) limited [2014] Eklr

- KRA assessed KShs. 90 million on Bata as a result of considering distribution royalties as being part of customs value.
- KRA alleged that the royalties were paid as a 'condition of sale' within the meaning of EACCMA, 2004.

Decision

- *'Whether payment of royalty or licensing fees is to be added to the price payable or actually paid will depend on the relationship between the licensee and the licensor and third parties. Where the nexus between the sale and the royalty payment is remote, it cannot be said that the royalty payment is made as a condition of sale.'*

Note

- It is important to carefully consider the terms of a license agreement between the Licensor and Licensee to establish the connection between the sale and royalty payment.

Withholding Tax



Kenya Postel Directories Limited v Commissioner of Domestic Taxes Appeals No. 28 of 2018

- ▶ Tax point for WHT on dividends
- ▶ The Tax Appeals Tribunal decision in this case held that dividends become payable upon them being credited to the Dividend Payable Account of the shareholders upon the authorization of a resolution from the AGM.
- ▶ Therefore WHT is payable once dividends payable are sanctioned and authorised in an Annual General Meeting since they are assumed to accrue benefit to the shareholders regardless of the time when they were actually paid to the shareholders.
- ▶ This decision has since been appealed to the High Court.

Withholding tax cont'n



R v Ex Parte Fintel Limited & KRA Misc. Appl. No. 1768 of 2004

- ▶ Definition of “paid”.
- ▶ The taxpayer was unable to pay the fee due to the service provider resulting in interest accruing on a monthly basis. The taxpayer went on to make a provision for the interest penalty in its books. KRA issued an assessment for WHT on the interest by relying on Section 2 of the ITA which defines “paid” as including “distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person.”
- ▶ The Court resorted to the ordinary meaning of ‘paid’ in the Dictionary meaning that the mere entry of an expense in its books without any further benefit to the intended recipient did not constitute payment.
- ▶ In *Cimbria vs KRA case*, the court had resolved that the inclusion of interest in the financial statements, though not already paid, already conferred benefit to entire group company since the applicant was a subsidiary of the company.

Withholding tax cont'n



KRA vs Republic (Ex Parte: Fintel Ltd Civil Appeal No. 311 of 2013)

- ▶ Definition of “paid” and “upon payment” as used under Section 2 and read with Section 35 of ITA. In Cimbria vs KRA case, the Court had concluded that the term ‘upon payment’ meant ‘paid’.
- ▶ Fintel entered into an agreement with a contractor in which interest was payable on outstanding contract fees. Fintel recorded the interest as a liability and claimed as an expense. KRA demanded WHT on this arguing that by recognising a liability it fell within the definition of paid.
- ▶ The Court of Appeal on 5 February 2019 annulled an earlier judgement by the High Court of Kenya that ‘paid’ implied delivery of money or any other valuable thing in the context of the Income Tax Act (ITA).
- ▶ The judgement affirmed that ‘paid’ includes accrual for purposes of the ITA and hence WHT is payable on the earlier of accrual or the actual transfer of money or some other valuable thing.
- ▶ Interpreting words as used in the ITA need to be contextual.

Labour and Employment



Samuel Gachie Kamiti v Equity Bank Limited & 6 others [2018] eKLR

- ▶ Samuel Gachie Kamiti, as an employee of Equity Bank, purchased over time, 6,557,080 ESOP Units (with one unit equivalent to one share in Equity Bank). Upon his exit, he wrote to the bank requesting for redemption of his shares at market value (at a value of Ksh. 103,274,010.60).
- ▶ The bank refunded Ksh. 24,340,000 relying on the provisions of Rule 6.6 of the Settlement Deed which provided that an Employee who ceased to be an Employee of the Bank for whatever reason before the vesting date of his shares, was not permitted to or deemed to have given a Redemption Notice and the Employee would forfeit all such Rights to such Units without any Right to Compensation (Basis: to ensure retention of employees).
- ▶ The Court faulted the bank for changing the rules governing ESOP (through a Deed of Variation dated 11th November 2009) which effectively cut Mr Kamiti's entitlement without informing him in advance. Therefore, it ruled in favour of the Plaintiff for payment of Ksh. 78,934,010/= with Interest from the date of filing suit until payment in full.
- ▶ Companies need to be open and clear on policies around ESOPs as communicated to their employees

Labour and Employment cont'n



ABN Amro Bank NV v Kenya Revenue Authority [2017] eKLR

- ▶ The KRA issued an assessment to ABN AMRO relating to severance payments of its employees on closure of its operations in Kenya. KRA asserted that the severance pay was to be made under specified term employment contracts and not unspecified term employment contracts, based on the retirement age stipulated in the employment contracts.
- ▶ The Court of Appeal ruled in favour of ABN AMRO stating that the severance payment was made under unspecified term contracts and not fixed term contracts, hence no further taxes were payable. The demand for additional taxes was unreasonable and unjustifiable.
- ▶ The law has since been amended so that the approach taken is as follows:
 - Fixed term contract – compensation received is deemed to accrue evenly over the unexpired term of the contract.
 - Unspecified term contract – compensation is deemed to accrue evenly over the three years following the termination.
- ▶ In both cases annual tax rates apply, so there is not a significant practical difference between either approach. In addition to giving employers certainty on method for taxing termination payments the ruling also confirmed that decisions by the KRA may be subject to judicial review giving employers an additional avenue to challenge KRA decisions where appropriate.

Value Added Tax



Barclays Bank of Kenya vs Commissioner of Domestic Taxes Tax Appeals Tribunal Appeal No 114 of 2015

- ▶ This case involves the treatment of tax on the fees paid by banks to international credit card companies such as VISA, MasterCard, American Express as well as related local and international remittances paid by banks to issuers.
- ▶ Before the ruling, banks considered usage fees paid to international credit companies as service charges incurred in provision of financial services and therefore within the scope of exempt supplies. For the same reasons, they did not account for reverse charge VAT on interchange fees due to issuers.
- ▶ On 16 March 2018, the Tribunal held that interchange fees were not classified as exempt in the VAT Act and that payments to international credit companies constitute royalties. As such, local and international remittance paid by a merchant's bank (acquirer) to a card holder's bank (issuer) are taxable supplies attracting VAT at a standard rate of 16%.
- ▶ Based on this single decision, KRA has proceeded to raise assessments on 20 other banks on the same basis.

VAT Refunds



Kenya Data Networks Limited v Kenya Revenue Authority [2013] eKLR

- ▶ KRA had failed to pay VAT refunds to KDN amounting to over Ksh. 900 million hence KDN argued that this was an infringement of its right to property.
- ▶ The Court held that KRA's failure to process the petitioner's VAT refunds even for periods when there was no dispute was a violation of Article 47 of the Constitution on Fair Administrative Action.
- ▶ Effect: changes included in the Finance Act 2016, which amended section 47 of the Tax Procedures Act 2015, with effect from 1st January 2017, requiring the Commissioner to pay late refund interest at a rate of 1% per month/ part thereof after expiry of two years from the date the tax payer lodges an application for refund.
- ▶ This implies that refunds for 2016 and prior years were payable before 31 Dec 2018, otherwise the Commissioner should incur the prescribed interest for late refund.

VAT on services exported out of Kenya



Coca Cola Central East and West Africa Ltd vs Commissioner of Domestic Taxes Appeal No 11 of 2013

- ▶ Coca Cola was paid to carry out the promotion of various local Coca Cola brands in a number of African countries by a US resident company, Coca Cola Export Corporation. In Kenya this was done through Radio, TV, dailies and billboards. KRA assessed VAT on these amounts on the basis that the services provided were used and consumed in Kenya. Coca Cola appealed against the Commissioner's decision.
- ▶ VAT Appeals Tribunal decision: the consumption of a service was neither determined by the payer of the service nor by the person requisitioning the service but by the location of the final consumer of the service. The location of the person who earns revenue from the services undertaken is immaterial. As such even parties that were not privy to the transaction could be found to be the ultimate consumers of services.

VAT on services exported out of Kenya



Commissioner of Domestic Taxes vs Total Touch Cargo Holland Appeal No 17 of 2013

- ▶ The Commissioner argued that since services of scanning, cooling and palletizing relating to flowers exported to Europe were performed in Kenya, they are services offered within the Country, not exported and thus VAT is payable on the services. In this view, services performed in Kenya could not be considered as exported services.
- ▶ Total Touch argued that the benefit of the services accrued to an entity and consumers based outside of Kenya (Holland). Hence they are exported services within the meaning of Section 2 of the VAT Act.
- ▶ High Court decision: the Court upheld the ruling of The VAT Tribunal (now disbanded) that scanning, pelletizing and cooling services provided locally on exported flowers to Holland were for use and consumption in Netherlands where the flowers were destined, and therefore zero rated (exported services).
- ▶ The relevant factor is the location of the consumer of service and not the place where the service is performed.



Questions & Answers