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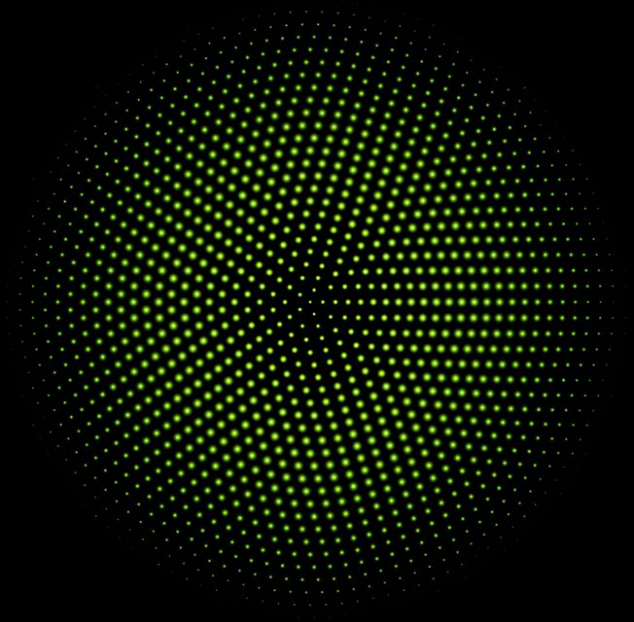

Minimum Tax

The Court of Appeal upholds the High Court decision declaring minimum tax unconstitutional and therefore null and void.

The Court of Appeal of Kenya ("CoA"), vide its judgement issued on 2 December 2022 ("the Judgement"), determined Civil Appeal No. E591 of 2021 upholding the decision by the High Court of Kenya ("HC") which had declared Section 12D of the Income Tax Act ("ITA") unconstitutional. Section 12D sought to impose a Minimum Tax ("MT") regime in Kenya through which taxpayers would be required to pay MT at the rate of 1% of their gross turnover where the instalment tax payable by the taxpayer is lower than the MT payable.

In the Judgement, the CoA declared, inter alia, that Section 12D of the ITA is unconstitutional and ultimately null and void to the extent that the levying of MT would be contrary to taxpayer's constitutional right to fair treatment and finding as envisioned under the spirit of Articles 28 and 201 of the Constitution of Kenya, 2010 ("CoK").

We discuss hereunder the salient arguments advanced by the Petitioners and the Respondents, the basis of the judgement, and our view on the same.

Background

The Finance Act, 2020 introduced Section 12D to the ITA which provides for the imposition of MT at the rate of 1% of taxpayers' gross turnover, with effect from 1 January 2021. The provision was subsequently amended vide the Tax Laws (Amendment) Act, No. 2, 2020. The Kenya Revenue Authority ("KRA") thereafter issued guidelines on the implementation of Section 12D.

Aggrieved by the imposition of the MT regime by Section 12D, two petitions were instituted in the HC challenging the constitutionality and legality of the MT regime. This culminated in a judgement issued by the HC on 20 September 2021 declaring MT unconstitutional and therefore null and void thereby setting the stage for the CoA pronouncing itself on this matter upon appeal.

We discuss hereunder the pertinent issued raised on appeal before the CoA.

Issues for Determination

Being aggrieved by HC's decision, the Appellant ("the KRA"), proffered an appeal against the judgement based on 25 grounds. The CoA reframed the grounds into seven thematic areas as summarised below:

- The HC failed to appreciate the concept of double taxation as applied to the MT regime and therefore misconstrued the correlation between the MT regime and Section 3 (2) of the ITA;
- Despite its conclusion on the non obstante nature of the MT provisions of the ITA, the HC failed to appreciate that Section 12D was not subject to Sections 15 and 16 of the ITA;
- The HC failed to differentiate between gross turnover and capital resulting in an erroneous finding on unfairness with reference to Article 201 (b) (i) of the CoK;
- The HC's finding on unfairness failed to consider that MT was levied on every loss-making entity of similar nature;
- The HC challenged the constitutionality of the Minimum Tax Guidelines ("the Guidelines") despite the same not forming part of the prayers sought;
- The HC faulted the definition of 'gross turnover' included in the Guidelines despite the same carrying the ordinary dictionary meaning and therefore determinable without reference to the Guidelines; and
- The HC misguided itself by concluding that levying minimum tax on everyone assumed that they are tax evaders hence violating the right to dignity guaranteed under Article 28 of the CoK.

You may refer to our detailed analysis of the various arguments raised before the HC, and subsequently the CoA, here.

The Court of Appeal's Determination

The CoA dismissed the KRA's appeal and concurred with the HC's view that the MT provisions of the ITA were contrary to the spirit and threshold imposed by Articles 28 and 201 of the CoK. Specifically, the CoA advanced the view that:

- The imposition of MT on gross turnover as opposed to gains and profits would translate to loss-making taxpayers shouldering a heavier tax burden than other taxpayers contrary to Article 201 of the CoK; and
- On the understanding that MT primarily targets tax evaders, the inclusion of innocent loss-making taxpayers within this ambit contravenes their constitutional right to fair treatment and dignity as espoused under Article 28 of the CoK.

The above notwithstanding, the CoA dissented with the HC's findings on:

- The double taxation impact of the MT provisions of the ITA on the basis that any person who has remitted MT is excluded from corporation tax under Section 3(2). Likewise, should the same taxpayer become profitable in the course of the year, they would be liable to corporation tax under the instalment tax mechanism. Accordingly, the CoA concluded that the MT regime does not trigger double taxation.
- The issue of Section 12D being a non-obstante clause. Specifically, the CoA agreed with the KRA that Section 12D was not subject to any contradicting clause in the ITA. Therefore, the provisions of Sections 15 and 16 are not applicable in determining liability to MT.

Conclusion and our View

The CoA's decision is auspicious for taxpayers, especially those who may have made losses in the last few years due to the turbulent business environment in the country and beyond. The ruling sends a strong message to the policy makers that tax laws should not be introduced with the sole aim of netting a certain category of taxpayers, in this case tax evaders, without necessarily considering the impact the same would have on other categories of taxpayers, in this case taxpayers who would end up making genuine losses.

In addition, the holding that any taxes imposed under the ITA in a manner that contradicts the basis for charge as specified in the charging section would be contrary to the purpose and objects of the ITA is also a welcome reaffirmation of the judicial precedent that ambiguity in taxing provision must be interpreted in favour of the taxpayer . This calls for tax legislation to be drafted in clear and unambiguous manner to make it possible for taxpayers to comply without undue difficulty.

On the flip side, by determining that the non-obstante nature of the MT provision meant that it superseded any other contradicting provision in the ITA, the CoA overturned the HC's decision that non-obstante clauses, especially those which are couched in general terms like Section 12D, cannot be interpreted as though they override the entire statute and stand all alone by themselves. This might result in the drafting of future amendments as non-obstante clauses and in general terms, without due regard to the amendments' coherence with the rest of the statute.

In the meantime, the MT provisions of the ITA are not enforceable unless an appeal is admitted at the Supreme Court and such appeal succeeds. Furthermore, taxpayers who had already complied with the provision and remitted MT to the KRA have the leeway to lodge a refund on the basis that the tax was paid in error. We understand that the KRA has already provided a leeway, administratively, for taxpayer who would like to utilize the MT paid in offsetting against corporate income tax payable to do so.

Given the continued push to widen the tax base, there is a chance that the Government may seek to re-introduce a different version of MT taking into account the lessons learnt from the Courts.

Should you wish to discuss this further, kindly feel free to contact any of the contacts below or your usual Deloitte contact who will be more than glad to offer you guidance and assistance.

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