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Tax & Legal Alert
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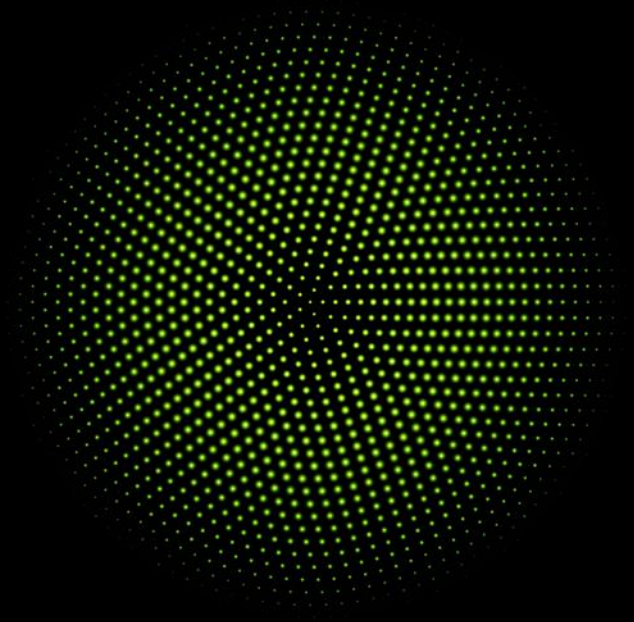


Tax Alert

High Court determines that the KRA cannot demand unpaid withholding tax arising between June 2016 and November 2019 from withholders

The High Court of Kenya ("HC"), vide its ruling delivered on 13 May 2022 ("the Ruling") in the matter of ***Commissioner of Domestic Taxes*** ("the Appellant", "the Commissioner") ***vs Pevans East Africa Limited*** ("the Respondent"), ***Shop & Deliver Limited and 5 others (Interested parties***), determined that the Commissioner has no legal basis for collecting un-deducted withholding tax ("WHT") arising in the period between June 2016 and November 2019 from taxpayers who did not withhold as required under the law.

In the Ruling, the HC determined that following the repeal of Section 35(6) of the Income Tax Act ("ITA") with effect from 9 June 2016, which provision was reintroduced in November 2019 vide Section 39A of the Tax Procedures Act, 2015 ("TPA"), there was no operative provision in tax legislation allowing the Commissioner to collect un-deducted WHT from withholders during this period.

In this alert, we discuss the salient arguments advanced by the parties to the dispute, and our view on the Ruling.

Background

The taxpayer ("Respondent") is a company incorporated in Kenya. On 24 June 2019, the Commissioner demanded from the Respondent the payment of WHT on winnings paid to punters between 2018 and 2019.

Aggrieved by the demand, the Respondent objected to the same on 25 June 2019. Notwithstanding their objection, the Commissioner proceeded to issue Agency Notices to the Respondent's bankers.

Further aggrieved by the agency notices and the demand, the Respondent filed an appeal before the Tax Appeals Tribunal ("TAT") on 28 June 2019, seeking orders that the Commissioner's demand for payment of WHT on winnings be set aside.

The Determination of the TAT

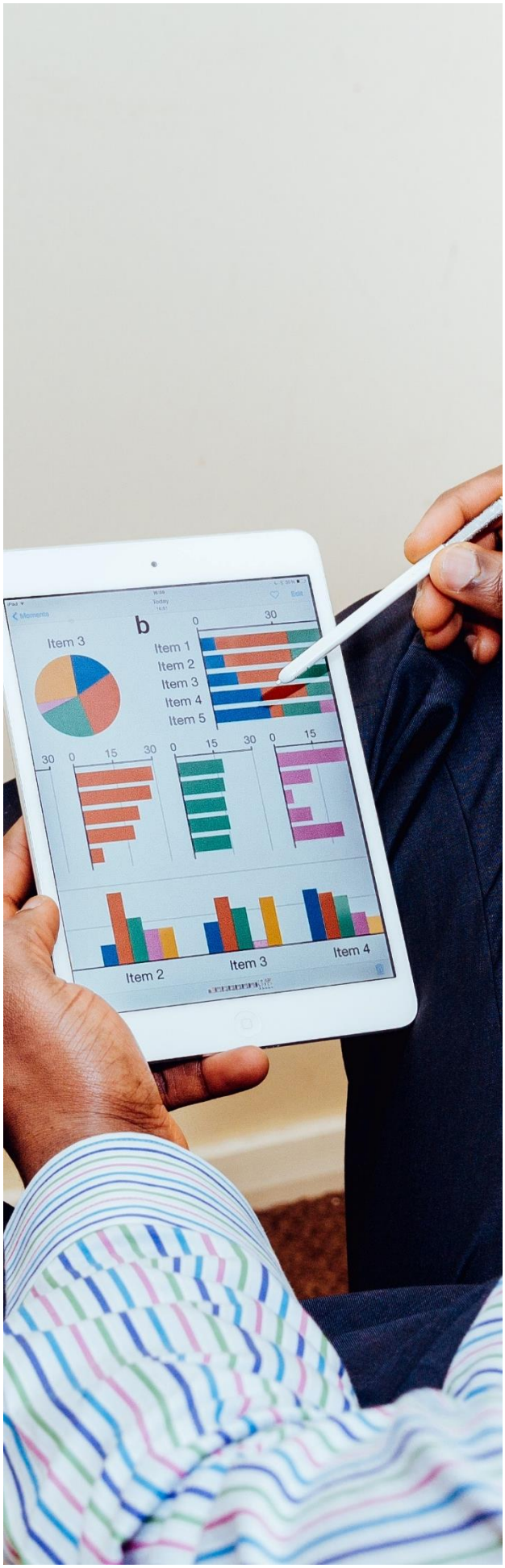
The TAT settled on several legal questions for determination in the dispute. However, the main issue was whether the Commissioner had erred in issuing demands for WHT from the Respondent, given the repeal of Section 35(6) of the ITA with effect from 9 June 2016.

In support of its case, the Respondent advanced the following arguments:

- Prior to 2016, Section 35(6) of the ITA authorized the Commissioner to collect unpaid WHT and attendant penalties from withholders as if they were due and payable by them, if they failed to deduct WHT from qualifying payments or to remit the same to the Commissioner.
- However, the above provision was deleted by the Finance Act, 2016, with effect from 9 June 2016. Accordingly, with respect to any un-deducted WHT, the Commissioner had no legal mandate to recover unpaid WHT from withholders. The only recourse for the Commissioner was to recover the unpaid WHT from the recipients of the payments ("the withholdees") by way of income tax.
- Further, that the reintroduction of the above provision by the Finance Act, 2019, albeit through Section 39A of the Tax Procedures Act, 2015 ("TPA"), was an implicit recognition of the fact that the Commissioner had no legal recourse to recover unpaid WHT from withholders following the deletion of Section 35(6) of the ITA in 2016.
- The Respondent further submitted that the only penalty for failure to deduct or remit WHT during this period (June 2016 to November 2019) was ten percent (10%) of the tax payable, subject to a maximum amount of KES 1 million, as provided for by the Income Tax (Withholding Tax) Rules, 2001. ("the WHT Rules")

In rebuttal, the Commissioner advanced the following arguments:

- The Respondent had the statutory obligation under Section 35(5) of the ITA to deduct and remit WHT within the stipulated timelines. Accordingly, the Respondent's failure to do so was in breach of its obligations as a taxpayer.
- Further, that the Respondent's failure to deduct and pay WHT as required by law necessitated the Commissioner's exercise of its enforcement powers under the TPA.



The TAT, in its judgement delivered on 6 November 2019, held that:

- Prior to the deletion of Section 35(6) of the ITA in 2016, the Commissioner was entitled to recover any un-deducted and unpaid WHT from withholders as if it was due and payable by them. However, following the deletion of the above provision by the Finance Act, 2016, the Commissioner could not demand unpaid WHT from the withholders.
- Further, that if it was Parliament's intention for un-deducted WHT to be recovered from withholders during this period, the tax legislation would have expressly provided so.
- The reintroduction of a similar provision vide the Finance Act, 2019, albeit in Section 39A of the TPA, was sufficient proof that a provision allowing the Commissioner to recover unpaid WHT from withholders was not in existence between June 2016 and November 2019.
- The TAT further held that, in line with established principles of interpretation of tax legislation, tax laws ought to show with clarity whether a taxpayer is liable to any tax, burden or obligation.
- Accordingly, in the absence of an operative provision in the ITA between 2016 and 2019, the Commissioner's demand of unpaid WHT relating to 2018 and 2019 from the Appellant had no legal basis in the ITA and was therefore *ultra vires* its mandate.

The Determination of the HC

Aggrieved by the TAT's decision, the Commissioner lodged an appeal before the HC on 6 November 2019.

In support of its appeal, the Commissioner advanced the following arguments:

- For purposes of recovery of unpaid WHT, Rule 10 of the Income Tax (Withholding Tax) Rules provides that a person required to deduct and remit WHT shall be deemed to be appointed as an agent of his payee under Section 96 of the ITA. The Commissioner was therefore entitled to demand WHT from the Respondents as agents of their payees (the punters).
- Further, under Section 42 of the TPA, the Commissioner is empowered to collect tax from an agent of a taxpayer. Based on the definition of "agent" to include a person who owes or holds money on account of another person, the Respondents could be deemed to be agents of the punters or withholdees. Accordingly, the Commissioner contended that its efforts to collect unpaid WHT from the Respondents rather than the punters were legally justifiable.

The HC, in its judgement delivered on 13 May 2022, concurred with the TAT, and held that the Commissioner could not recover the WHT from the Appellant during the period in question.

Specifically, the HC held that:

- It is trite law that tax statutes should be interpreted strictly, with no room for implication or intendment. Further, that if there is any ambiguity in tax law, the same ought to be interpreted in the taxpayer's favour.

- The HC therefore held that following the deletion of Section 35(6) of the ITA in 2016, and its subsequent reintroduction vide the TPA in 2019, the Commissioner could not demand un-deducted WHT arising during the period between 9 June 2016 and 7 November 2019 from withholders.
- Further, that the Commissioner could not rely on Rule 10 of the Income Tax (Withholding Tax) Rules as the same is anchored on Section 96 of the ITA, which provision was repealed in January 2016 by the TPA. In addition, the Commissioner could not rely on Section 42 of the TPA at the HC appeal stage as it had not relied on the same provision before the TAT.
- Consequently, the HC determined that the Commissioner's only option to recover unpaid WHT arising during this period was to demand it directly from the withholdees by way of income tax.
- The HC further made the crucial determination that the issuance of an agency notice is an "appealable decision" as defined by the TPA. To that effect, a taxpayer can appeal an agency notice directly to the TAT, without having to lodge a notice of objection first.
- In addition, the HC held that it was not necessary for the Commissioner to ascertain the tax liability or issue an assessment before issuing an agency notice, with the implication that an agency notice can be issued to taxpayers even before the conclusion of a tax dispute.

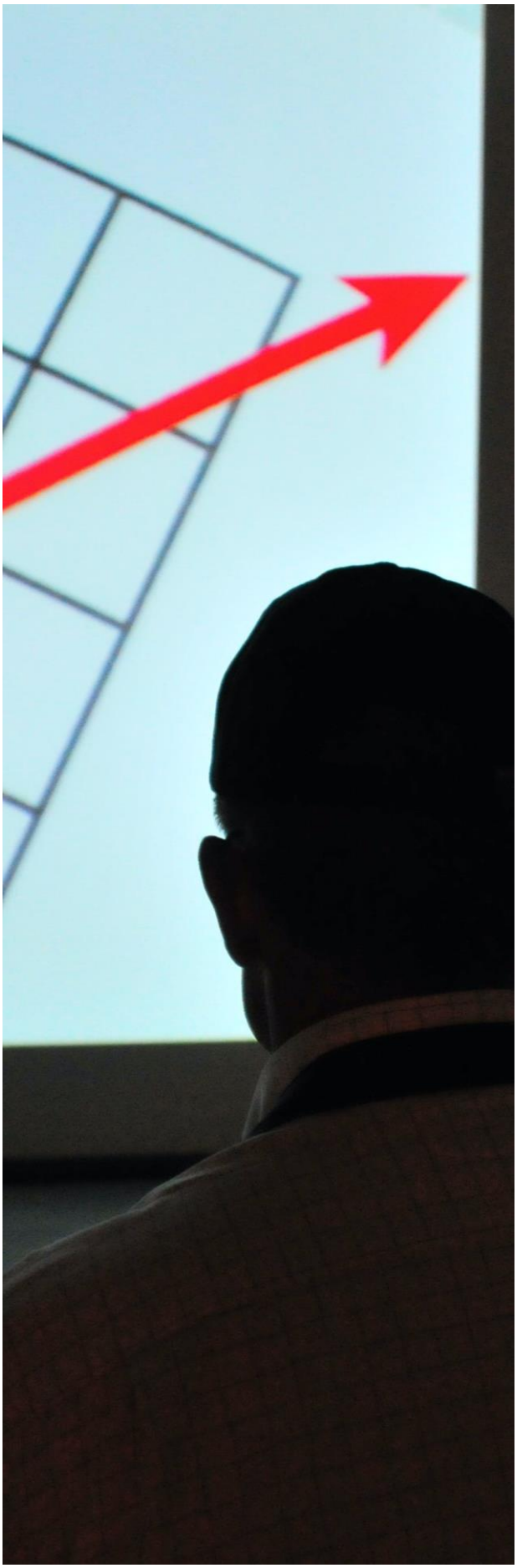
Our View and Conclusion

The HC ruling is a welcome respite to taxpayers, particularly those who erroneously failed to deduct WHT upon making payments that are liable to WHT, as demands for unpaid WHT relating to any period between June 2016 and November 2019 are now devoid of legal basis. In addition, the Ruling is an affirmation of the need, and legal requirement, of certainty in tax legislation; with the implication that any gaps in tax law should benefit the taxpayer.

The HC ruling further accentuates the need for any action or decision by the Commissioner to be backed by an operative provision in law, without which the same becomes a nullity. Any actions or decisions from the Commissioner not backed by a clear provision in law can be challenged by taxpayers on this basis.

The HC ruling also has implications for taxpayers wishing to disclose unfulfilled tax obligations under the Voluntary Tax Disclosure Programme ("VTDP"). With the HC determination that unpaid WHT arising between June 2016 and November 2019 can only be recovered from recipients or withholdees, the onus would be on the recipients to disclose their income and account for the tax due.

That said, the Commissioner has the right of appeal to the Court of Appeal ("CoA"). Should the CoA overturn the HC ruling, the Commissioner will be entitled to demand unpaid WHT arising between 2016 and 2019 from withholders, subject to the statutory limitation of five (5) years. However, if the CoA upholds the HC ruling, then the matter would be settled in favour of taxpayers based on this jurisprudence



With respect to the HC's finding that the Commissioner can issue an agency notice before the issuance of an assessment, we note that the Finance Act, 2022 amended Section 42 of the TPA to require that an agency notice shall not be issued unless the Commissioner has confirmed its assessment in an objection decision and the taxpayer has failed to appeal the decision to the TAT within 30 days. Consequently, taxpayers should note that any agency notice issued prior to an objection decision, or during the pendency of an ongoing dispute before the TAT, can be further challenged on its own before the TAT on this ground.

Should you wish to discuss this further, kindly reach out to 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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