

Tax & Legal Alert  
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## Tax Appeals Tribunal ruling

### Taxpayers must apply for refund of overpaid tax

The Tax Appeals Tribunal (“TAT”) has ruled regarding offset of tax due against tax overpayment.

In a ruling delivered on 13 May 2021, the TAT held that taxpayers must lodge an application for tax overpaid with the Commissioner before utilizing it to offset tax due. According to the TAT, this is to afford the Kenya Revenue Authority (“KRA”) an opportunity to validate the tax overpayment as envisioned under Section 47 of the Tax Procedures Act 2015 (“TPA”), which deals with refund of overpaid tax.

From a return filing perspective, the TAT agreed with the KRA that the income tax return template (“the template”) need not to have any field to enable taxpayers to carry forward tax overpayments and that the tax credits claimed under the “credit under special arrangement” field of the template must relate to foreign tax credits strictly in line with the provisions of Section 42 of the Income Tax Act (“ITA”).

## Background

The tax dispute arose from an assessment issued by the Respondent with respect to alleged underpaid Corporation Income Tax (CIT) arising from utilization of tax overpayment in offsetting CIT liabilities in subsequent years.

Aggrieved by the decision of the Commissioner, the Appellant lodged an appeal before the TAT in September 2020.

The main point of contention was whether the Appellant was justified in utilizing CIT overpayment to offset CIT liabilities arising in subsequent years.

## Appellant's contentions

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

- Section 47 of the TPA, is titled "Refund of overpaid tax". This section should be read strictly in the context of a refund and should not apply where a taxpayer opts to utilize tax overpayments in offsetting future tax liability.
- The use of the word "may" under section 47 is merely permissive or directory and not obligatory. This empowers the Appellant to exercise his discretion on whether to lodge an application for refund.
- The Respondent's longstanding practice of allowing taxpayers to offset tax overpayments within the same tax head gave rise to a legitimate expectation.
- The longstanding practice can only be abrogated by an overriding change in law or other matters of inordinate public interest.
- The Respondent was not justified in disallowing tax overpayments on a mere fact that they were declared in the wrong field of the return while it had failed to provide an alternative field where such overpayments could be declared.
- The Appellant agreed with Respondent that "credit under special arrangement" field was reserved for foreign credits. The only reason why the CIT overpayment was declared under the field is because of lack of an appropriate field.

## Respondent's contentions

In rebuttal, the Commissioner advanced the following arguments:

- The provisions of Section 47 of the TPA are clear and should be looked at in their ordinary meaning.
- The Respondent is empowered under Section 47 to subject any overpayment to audit before it is processed.
- The overpaid tax for the year 2014 was in the process of being validated and the Appellant would be informed once the process is complete.
- The Respondent was justified in disallowing all the credits claimed "under special arrangements" on the basis that the claims were related to foreign tax.



## The TAT Decision

In its judgement, the TAT noted the following:

- It was not in dispute that the tax credits claimed under “credits under special arrangements” were not related to foreign tax.
- Lodging the credits under the above field was incorrect on the basis that the claim is not what was envisaged.
- Section 47 of the TPA authorises the Commissioner to ascertain the validity of a refund claim by subjecting the claim to a refund.
- The law does not envisage a scenario where a taxpayer would utilize its CIT overpayment to set off due taxes prior to verification by the Commissioner.
- To support its view, the TAT relied on its ruling in the case of ***Pevans East Africa Ltd vs the Commissioner of Domestic taxes***. This case was related to set off betting tax against withholding tax.

Based on the above, the TAT concluded that the Appellant is not automatically entitled to offsetting CIT due from a CIT overpayment and that “credits under special arrangements” field is only reserved for credits related to foreign tax only.

## Our view

The issue of utilization of tax overpayments has increasingly become a bone of contention between the KRA and taxpayers in recent months. This follows KRA’s stance on interpretation of Section 47 of the TPA. It is worth noting that the practice of offsetting CIT due against CIT overpayment has been longstanding and continues even after coming into force of the TPA on 19 January 2016.

The TAT decision, therefore, seeks to provide guidance on how Section 47 of the TPA should be interpreted. In our view, however, the decision raises fundamental questions and is a major setback for taxpayers.

Below are some of the key areas of consideration;

- **Scope of iTax in administration of taxes** – Prior to KRA’s stance, iTax was configured in such a way that it would allow automatic utilization of CIT overpayment. This avenue was blocked by the KRA last year without clear reasons or any change in the law.
- **Regional jurisprudence** - In the Ugandan case of ***Red Chilli Hideaway Limited v Uganda Revenue Authority (URA) TAT No 38 of 2018***, in relation to a tax law that is very similar to the Kenyan law, the Tribunal ruled that taxpayers ought to be able to utilize tax credits to meet tax liabilities and that it would defeat logic if a taxpayer would first seek a refund of money owed to them before utilization. It is unclear why the TAT never analyzed or gave their view on this case.
- **Recourse for taxpayers** – Although Section 47 of the TPA requires the Commissioner to decide and give notification on application of refund within 90 days from the date of receipt of the application, this provision does not prescribe any consequences should the Commissioner fail to abide. This leaves the taxpayer at the mercy of the Commissioner. In the instant case, as mentioned in the judgement, the Commissioner is yet to validate the 2014 overpaid tax 7 years down the line.
- **Right to property** - The KRA insists that taxpayers must settle current liabilities until a refund is approved. This allows the KRA to deny taxpayers the opportunity to utilize money owed to them until such time as the KRA deems fit. This raises issues regarding contravention of the right to property as provided for under the Constitution of Kenya 2010.
- **Proposed amendment vide Finance Bill 2021** – The Bill proposes that penalties and interest in relation to a liability that is settled using overpaid

tax shall only stop accruing on the date the Commissioner notifies the taxpayer that the application for refund has been ascertained. This will lead to payment of penalties and interest for reasons beyond taxpayer’s control. It is also unfair as the KRA does not pay any interest on overpaid taxes/ refunds.

- **Statute of limitation** – Section 47 of the TPA requires a taxpayer to lodge an application for overpaid taxes within 5 years of the date on which the tax was paid. Given that the position on utilization was unclear, the expectation is that taxpayers will not lose their legitimate tax credits that fall outside this period.
- **Payment of instalment taxes** – Arguably, most taxpayers use prior year basis in estimating instalment taxes on the understanding that even if the basis were to result to overpaid taxes, the same would be utilized in the following year. It may be prudent to be more cautious in estimating instalment taxes to prevent accumulation of tax refunds.

## Conclusion and way forward

Taxpayers are advised to review their tax position and make a prudent decision based on the circumstances.

In the meantime, we strongly recommend that a provision to allow the taxpayers the discretion to utilize tax overpayments or lodge for refund is introduced vide the Finance Bill 2021 to ensure that taxpayers are not unnecessarily punished. Where such credits are deemed to be invalid after Commissioner’s review, the Commissioner can assess and enforce collection in line with the provisions of the ITA.

*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.*

*Taxpayers are advised to review their tax position and make a prudent decision based on the circumstances.*

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