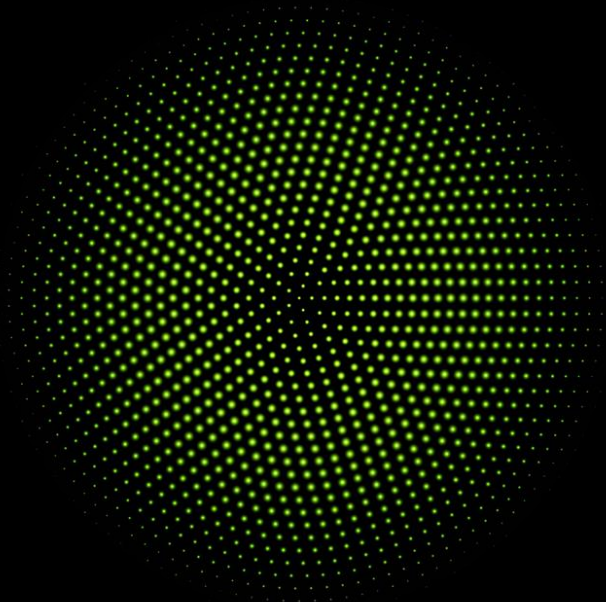


Tax & Legal Alert
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Minimum Tax

The High Court declares minimum tax provisions of the Income Tax Act unconstitutional and therefore null and void

The High Court of Kenya (“HC”), vide judgement issued on 20 September 2021 (“the Judgement”), determined Constitutional Petition No. E005 of 2021 challenging the legality and constitutionality of Section 12D of the Income Tax Act (ITA). Section 12D of the ITA imposed 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 by way of instalments, where the instalment tax payable by the taxpayer is lower than the MT payable.

In the Judgement, the HC declared, inter alia, that Section 12D of the ITA is unconstitutional and ultimately null and void to the extent that it violated the principles of public finance itemized under Article 201 (b) (i) of the Constitution of Kenya, 2010 (“the CoK”).

We discuss hereunder the salient arguments advanced by the Petitioners and the Respondents, 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. In addition, the Kenya Revenue Authority ("KRA") issued guidelines on the implementation of Section 12D.

Aggrieved by the imposition of the MT regime by Section 12D, several parties filed two constitutional petitions before the HC challenging the constitutionality and legality of the MT regime. Vide the petitions, consolidated into Constitutional Petition E005 of 2021, the Petitioners sought that Section 12D of the ITA be declared unconstitutional and therefore null and void, and further, the KRA be restrained from implementing, collecting and/or demanding the payment of MT.

In the interim, the HC, in April 2021, granted conservatory orders restraining the KRA from further implementing or enforcing Section 12D of the ITA, pending the hearing and determination of the petitions challenging its validity.

Petitioners' case

Below are some of the arguments that were advanced by the Petitioners in support of their case:

- **MT falls outside the income tax regime** - The Petitioners were of the view that MT can not fall within the income tax regime as income tax is only chargeable on gains and not gross turnover as is the case with MT. In addition, the Petitioners were of the view that MT falls beyond the taxes imposable by the National Government under Article 209 (1) of the Constitution.
- **Certainty in legislation** - Section 12D is inconsistent with Sections 3 and 15(1) of the ITA, which impose income tax on **gains and profits after the deduction of expenditure** wholly and exclusively incurred in production of income. This, according to the Petitioner, contravenes the requirement of certainty in legislation, which is a key component of the Rule of Law under Article 10 of the Constitution
- **Taxation of capital** - MT violates Article 201(b) of the Constitution, which provides that the burden of taxation should be shared fairly, by imposing a tax on taxpayers who are likely to be in loss-making positions.
- **Discriminatory exemptions** - Section 12D violates Article 27 of the CoK on equality and freedom from discrimination, by selectively exempting taxpayers in the energy, petroleum and insurance sectors from MT due to the regulation of their retail prices despite the fact that taxpayers in other sectors are not in full control of their retail prices.





- **Transition clause** - MT has the unintended impact of clawing back investment allowances previously provided for by the Second Schedule of the ITA, whose permitted deduction from gains or profits may result in a tax loss position. MT would still be payable in such a scenario, thus defeating the incentivizing intention of investment allowances.
- **Double taxation** - In instances where a taxpayer in a tax loss position becomes profitable within its financial year, therefore, required to pay corporation income tax via the instalment tax mechanism, the minimum tax paid during the loss-making period of the year will neither be a tax-deductible expense nor a tax credit.
- **Involvement of the Senate** - The introduction of MT should have involved the Senate in accordance with Article 110 of the CoK to the extent that its imposition on gross turnover would impact county government revenues.
- **Legality of MT guidelines** - The publication of the Guidelines on MT by the KRA did not adhere to the procedures set out in the Statutory Instruments Act 2013, including stakeholder consultation, public participation, and parliamentary approval.

Respondents' case

The Respondents, who were the National Assembly, the KRA and the Attorney General, advanced the following arguments in rebuttal:

- **Separation of powers** - The legislature is vested with law-making authority under Articles 94, 95, and 209 to define the scope, administration, and collection of a tax via Statute; it is not for the Court to interfere merely because a taxpayer is disgruntled.
- **The Constitution permits introduction of any form of tax, including MT** - While MT is not within Article 209(1), Article 209(2) allows Parliament to sanction the imposition of any other taxes by statute. MT falls within this category of "any other" permitted taxes since it was introduced via statute, the Finance Act, 2020.
- **Distribution of tax burden** - MT aims at ensuring that all persons, including taxpayers posting perennial losses, contribute towards government revenue, hence, it is not an unfair distribution of the burden of taxation.
- **"Non-obstante" provision** - Section 12D begins with the phrase "Notwithstanding any other provision of this Act...", which renders the argument that it is inconsistent with other sections of the ITA moot.



- **Public ruling** - The Guidelines on MT were not issued as regulations under a statute, but as a public ruling under the Tax Procedures Act. The Guidelines were thus not binding to the public, nor were they under the ambit of the Statutory Instruments Act 2013.

The High Court's determination

The HC, in its analysis, determined the issues in dispute as follows:

- Under Article 209 of the CoK, the definition, administration and collection of tax falls within the purview of Parliament to determine via statute and it is not for the court to interfere.
- Although Parliament has legislative authority under the CoK, the High Court has jurisdiction under Article 165(3) to determine whether any law, including one allowing for the imposition of a tax, is constitutional or not.
- A key rule of statutory interpretation is the “holistic approach”. A statute must be read as a whole, with no single provision being regarded by itself or against others in the same statute.
- The statutes introducing and amending Section 12D on MT, that is the Finance Act 2020 and the Tax Laws (Amendment) Act 2020, did not require the Senate’s input, since the effect of MT on county finances is not direct.
- MT unfairly distributes the burden of taxation contrary to Article 201 (b), by presenting the possibility of double taxation.
- To further buttress the point on equity and fairness as envisaged under Article 201 (b) (i) and (ii) of the Constitution, the HC made a finding that taxpayers who are genuinely making losses will be forced to diminish their capital to pay MT, while those making profits will pay income tax from their profits.
- The exemption of entities in the energy and petroleum sectors from MT is not discriminatory since the exemption applies to all those engaged in business whose retail price is controlled by the Government.
- The Court further held that the guidelines were a statutory instrument, and since no stakeholder consultation was conducted as required by Section 5 of the Statutory Instruments Act, the Guidelines are null and void. According to the HC, the argument that the Guidelines on MT were a public ruling cannot hold since the Guidelines did not state that it was a public ruling as required by Section 63 of the Tax Procedures Act.



Conclusion and our view

The HC's decision augurs well for taxpayers, including those who may have made losses in the last two years in the wake of the Covid-19 pandemic and low margin business, since they will not be required to remit 1% of their gross turnover as MT.

The judgement also sets a good precedent on the legality of guidelines issued by the KRA on a regular basis. Going forward, the KRA is required to follow the provisions of the Statutory Instruments Act. In the same vein, the judgement similarly underscores the importance of government agencies to be conscious of the dictates of the CoK, alongside the provisions of implementing legislation, such as the Statutory Instruments Act, when formulating laws, policies, guidelines, or regulations.

The above notwithstanding, the KRA has indicated that it intends to appeal against the decision of the HC before the Court of Appeal for a final determination on the matter. Should the HC's decision be upheld, taxpayers who had already complied with Section 12D will be eligible to apply for a refund of the MT they had remitted to the KRA, on the basis that the tax was paid in error.

However, should the HC's decision be overturned, MT will be deemed to have been effective from 1 January 2021. Thus, any affected taxpayers will be required to pay the amount due plus accrued penalties and interest. We therefore recommend that any provisions that may have been set aside to cater for this eventuality be retained pending the determination of a possible appeal by the KRA. Further, procedurally, within the KRA, processing of refund of the MT that had already been remitted may further be complicated by this appeal pending full hearing and determination of the case.

In the meantime, and in absence of a successful appeal, the MT provisions of the Income Tax Act are not enforceable.

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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