

# Tax Alert

## High Court declares Minimum Tax as unconstitutional



### Background

This alert brings to your attention the High Court's decision in **Stanley Waweru and Six Others (Petitioners) v the National Assembly, Kenya Revenue Authority (KRA) and the Attorney General (Respondents) (Constitutional Petition No. E005 of 2021 Consolidated with Petition No. 1 of 2021)**.

On 30 June 2020, the President assented to the Finance Act 2020, which through Sections 7 and 9, amended the Income Tax Act CAP 470 Laws of Kenya by introducing a Section 12D that imposed minimum tax at the rate of 1% of a business' gross turnover with effect from 1 January 2021.

The Petitioners instituted proceedings challenging the constitutionality of Section 12D of the Income Tax Act. The Petitioners' main argument was that the Constitution provides an exhaustive list of taxes that the government can impose, and minimum tax is not part of the list. In addition, the Petitioners argued that income tax is to be imposed on income only, but minimum tax was to be charged on gross turnover, regardless of whether a business was making profits or losses.

The High Court, in its 268- page judgement, found in favour of the Petitioners by holding that minimum tax offended the principles of public finance itemised under Article 201 (a)(i) of the Constitution. Consequently, the Court prohibited KRA from further implementation or enforcement of Section 12D of the Income Tax Act by collecting or demanding payment of minimum tax.

More details on the case and our opinion follow below:

### The Petitioners' Case

The Petitioners' arguments can be summarised as follows:

- a) Minimum tax cannot be categorised as Value Added Tax (VAT), custom duties or excise duty, which are some of the taxes provided for under Article 209(1) of the Constitution.
- b) Since the National Assembly included minimum tax under the Income Tax Act, it can be presumed that the Assembly wanted to include minimum tax as a category of income tax since the Act only deals with the assessment and collection of income tax. However, income tax is only chargeable on gains and not on gross turnover as is the case with minimum tax.
- c) Power to levy taxes must be express and not implied. Parliament can only levy taxes within the boundaries set by the law. A comprehensive reading of the Income Tax Act indicates that the legislation deals with taxation of income as opposed to turnover.
- d) The imposition of minimum tax was against the rights to a fair and equitable economic environment and right to property as enshrined under Articles 46 and 40 of the Constitution respectively.

- e) The imposition of minimum tax brought about confusion regarding the applicability of other provisions of the Income Tax Act that allow deduction of production costs or claims of capital expenditure in capital intensive industries. The minimum tax was therefore incongruent with the position of the Court of Appeal in **Ecobank Kenya Limited v Commissioner for Domestic Taxes [2012] eKLR** where the court stated that "**business people have a right of certainty and predictability in the applicability of economic activities**".
- f) The implementation of minimum tax was contrary to the provisions of Article 201(1) of the Constitution that provides for the principle of fair and equitable sharing of the tax burden. Imposing a tax on turnover on all persons including those in loss making positions would be contrary to an elementary principle of taxation; the principle of economic capacity which provides that the percentage of the income of the taxpayers that can be legitimately affected by a tax must not be greater than the wealth objectively available.

The Petitioners asked the Court to declare Section 12D of the Income Tax Act unconstitutional.

### The Respondent's Case

Some of the Respondent's arguments were as follows:

- a) The petition was an encroachment on the legislative mandate of Parliament and a violation of the principle of separation of powers that is provided for in the Constitution under Article 1(3). By granting the orders sought by the Petitioners, the Court, and by extension the Judiciary, would be interfering with Parliament's legislative authority.
- b) Parliament has the right to enact or amend any law. The Finance Act 2020 was passed by Parliament following all procedural and substantive legal requirements thus it should be deemed constitutional from the onset.
- c) Minimum tax was meant to provide additional revenue to the government to finance the national deficit. In addition, the impugned tax was also meant to cushion business during the COVID-19 pandemic by spreading the tax burden through the introduction of minimum tax that is lower than instalment tax.
- d) Imposition of minimum tax was not discriminatory because of exemption of businesses that dealt in government regulated products from minimum tax. The exemption could not be regarded as discriminatory as the Constitution does not prohibit classification and differentiation. In addition, the government is at liberty to choose its preferred mode of taxation and to make relevant policy decisions.

- e) Section 12D of the Income Tax Act imposing minimum tax is a non-obstante clause since it starts with the phrase “**notwithstanding any other provision of this Act**”. The implication of the words is that nothing in the Act including the objectives or usual regulatory scope can stand in the way of implementation of the provision. Subsequently, the fact that the Income Tax provides for assessment and collection of tax on income cannot prevent the imposition of tax on turnover by section 12D.

## Issues for determination

The court’s analysis narrowed down to the following issues:

- a) Whether courts can rule on the validity or constitutionality of a legally enacted legislation;
- b) Whether imposition of minimum tax is discriminatory;
- c) Whether taxes imposed under the Income Tax Act should be imposed only on income; and
- d) Whether section 12D of the Income Tax Act is unconstitutional.

## The Court’s decision

After considering the arguments by the parties, the Court held that:

- a) Separation of powers between the three arms of government incorporates the principle of checks and balances that allows courts to prevent abuse of power by the legislature and executive.
- b) The presumption of Constitutionality of a statute is a rebuttable one. The effect is to shift the burden of proof to the person alleging its unconstitutionality.
- c) Vague provisions, arbitrariness, unreasonableness or irrationality do not warrant the striking out of an enactment. A constitutional infirmity must be proven.
- d) The exemption of the suppliers of government regulated products from minimum tax was not discriminatory since Parliament and the executive are allowed to make policy decisions as they wish so long as the decisions are not unconstitutional.
- e) Section 12D of the Income Tax Act is a non-obstante clause thus the provisions of the Act must be read subject to the section. However, it is only in instances of a conflict between the provision and other provisions of the Act that the section prevails. Otherwise, Section 12D should be taken as part of the Income Tax Act.
- f) The implementation of minimum tax violated the principle that the burden of taxation is to be shared fairly and therefore Section 12D of the Income Tax Act is unconstitutional.

## Our Opinion

While the case had weighty issues on the constitutionality of minimum tax, ultimately the Court relied on the principle of equitable sharing of the tax burden in finding that imposition of minimum tax is unconstitutional. The court understood the KRA’s objective of using minimum tax to prevent fraudulent declaration of losses but observed that the “catch all” mechanism it had adopted is not a solution because not every business declares false losses.

Coming at a time when there has been a huge outcry on the rising cost of fuel, the judgment is a welcome relief especially for low-margin and loss-making businesses that have been negatively impacted by the Covid-19 pandemic.

The KRA has already communicated its intention to appeal the decision at the Court of Appeal in an attempt to rescind what is likely to be a big blow to its revenue collection ambitions. Should the KRA appeal the decision, the uncertainty around minimum tax will remain until the issue is finally determined.

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