

Tax Alert

Court of Appeal Declares Minimum Tax Unconstitutional



Summary

This alert brings to your attention the Court of Appeal's decision in **Kenya Revenue Authority v Stanley Waweru and Six Others (Civil Appeal No. E591 of 2021)**. This was an appeal by the KRA against a ruling issued on 20 September 2021 by Justice Odunga, J. of the High Court of Kenya at Machakos (**Constitutional Petition No. E005 OF 2021**), where he declared Section 12D of the Income Tax Act unconstitutional.

Background

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 (Stanley Njuguna & 3 others) 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 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.

Dissatisfied with the High Court's decision, the KRA appealed against the ruling at the Court of Appeal.

KRA's grounds of appeal at the Court of Appeal

The KRA challenged the High Court's decision on 25 grounds summarized as follows:

- i. The High Court failed to appreciate the concept of double taxation and did not expound how minimum tax constituted double taxation.
- ii. The Court incorrectly observed that minimum tax was based on the provisions of the Income Tax Act in respect of gains and profits.
- iii. The Court having made a finding that Section 12D of the Income Tax Act was a non obstante clause (an overriding clause), failed to

appreciate that the Income to which minimum tax is levied under Section 12D was not subject to Section 15 and Section 16 of the Income Tax Act.

- iv. The Court did not appreciate the difference between the gross turnover of an entity and capital of the entity to reach a finding that the levying of the minimum tax amounted to unfairness.
- v. The Court delved into making a finding on the constitutionality of the Minimum Tax Guidelines, which was not part of the prayers sought in the Petitioners.
- vi. The Court failed to note that Section 12D of the Income Tax Act was a self-sustaining provision, capable of being implemented in the absence of the minimum tax Guidelines.
- vii. The Court incorrectly found that levying minimum tax on everyone assumed that everyone was a tax evader.

The Respondents' arguments

In rebutting KRA's arguments, the Respondents contended that minimum tax imposes an unfair burden which would require loss making entities to pay tax from capital and thus:

- i. The High Court correctly determined the issue before it, being the imposition of minimum tax.
- ii. The KRA was improperly subjecting loss-making entities to taxation thus undermining their dignity.
- iii. Non-obstante (overriding) clauses should not be interpreted as provisions which supersede provisions of the law, but as clauses which should not render the operation of the law impossible.
- iv. The said minimum tax was regressive and amounts to double taxation and does not share the tax burden fairly.

The Court's findings

Having identified the primary issue for determination to be whether Section 12D of the Income Tax Act was unconstitutional as determined by the High Court, the Court of Appeal determined the matter as follows:

- a) By virtue of Section 12D being an overriding clause, it in effect removed all obstructions which would arise in its implementation. Accordingly, the KRA's argument that Section 12D was not subject to any contradicting clause in the Income Tax Act, and that the income to which minimum tax is levied under Section 12D is not subject to Sections 15 and 16, which deal with deductions is upheld.

- b) On the issue as to whether the minimum tax is levied on gross turnover or capital, the court observed that Sections 15 and 16 of the Income Tax Act sheds light as to what is considered as taxable income. Thus, certain deductions in form of expenses must be allowed and, therefore, for the appellants to now claim that minimum tax is to be levied on gross turnover without allowing for deductions as provided for under the Act would be contrary to the purpose and objects of the Act.
- c) On whether the imposition of the minimum tax results in unfair taxation and contrary to Section 201(b), the court took the view that levying of minimum tax on gross turnover as opposed to gains or profit would lead to a situation where a loss-making taxpayer, would bear a heavier burden than other taxpayers contrary to Article 201 of the Constitution.
- d) As to whether the imposition of minimum tax infringes the right to dignity, the court found that there was no error in the High Court's finding that the imposition of a minimum tax will undoubtedly lump innocent business that are in a loss-making position with evaders, which violates the innocent taxpayers' right to dignity.
- e) As to whether imposition of minimum tax would amount to double taxation, the court observed that the High Court erred in its findings relating to double taxation as it did not expound on the same; the court also observed that the High Court failed to resolve the applicability of Section 12D as an overriding clause that is not subject to any provision to the contrary within the Income Tax Act.

In dismissing the KRA's appeal for lack of merit, the court affirmed that Section 12D of the Income Tax Act as introduced by the Finance Act, 2020 and as amended by the Tax Laws Amendment (No 2) Act, 2020 was null and void for the reason that the levying of minimum tax on gross turnover as opposed to gains or profit would lead to a situation where a loss making tax payer would bear a heavier burden than other taxpayers contrary to the spirit of Article 201 of the Constitution.

Our opinion

This decision not only affirms the High Court's position on minimum tax but also provides the much-needed clarity on the place of minimum tax for loss making taxpayers in Kenya.

Subject to any further appeal decision, taxpayers, the High Court, subordinate courts and other quasi-judicial forums remain guided by the interpretations and findings on minimum tax espoused by the Court of Appeal.

KPMG is happy to assist on any issues arising from this decision. Contact our regulatory lead on labala@kpmg.co.ke.

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