

26 APRIL 2023

Tax & Exchange Control ALERT

IN THIS ISSUE

KENYA

High Court declares the power to issue income tax exemptions through a gazette notice unconstitutional

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The National Treasury signed 16 financing agreements with the Government of Japan between 20 December 2007 and 18 September 2020 that exempted Japanese companies, Japanese employees, and Japanese consultants involved in specific projects in Kenya from paying income tax. This exemption was made through Legal Notice No. 15 of 2021 dated 25 February 2021. Among the projects covered in the tax exemption were the infrastructure development at the Mombasa Special Economic Zone, power distribution system in Nakuru and Mombasa, Olkaria 1 Unit 1, 2 and 3 rehabilitation, among others.

The petitioner argued that the Cabinet Secretary's action threatened the supremacy of the Constitution by elevating Japanese claims while subordinating the Kenyan Constitution. He urged the court to quash the legal notice for violating the constitutional principles of equality, non-discrimination and public

participation. Additionally, he sought a declaration that the National Assembly acted unconstitutionally by waiving public participation when ratifying the legal notice.

The Cabinet Secretary argued that his actions were lawful as he had acted pursuant to the authority derived from section 13(2) of the Income Tax Act. The section grants the Cabinet Secretary power to issue exemptions on income that is accrued in or derived in Kenya to the extent specified through a notice in the gazette.

Power to originate or amend money bills lies exclusively with the National Assembly

Article 114(3) of the Constitution categorises provisions relating to taxes as money bills and hence these must originate from Parliament. The court held that the mandate lies with Parliament to impose or exempt tax through the legislative process as per Article 210 of the Constitution.



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KENYA

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The latter article provides that no tax or license may be imposed, waived, or varied except as provided by law. Consequently, the Cabinet Secretary had no power to grant the exemptions contrary to the set out constitutional procedures.

The court further held that in addition to authorisation by law, and subject to the Income Tax Act, every waiver must be reported to the Auditor General, accompanied by a reason for such waiver and a public record of the waiver maintained.

Interestingly, the gazette notice notifying the waiver by the Cabinet Secretary stated that the exemption was to the extent specified in the financing agreements, which were not available to the public. The court noted that the notice fell short of the Income Tax Act it sought to rely on, which requires that the notice must contain the specific amount waived.

Tax waiver was discriminatory

The court sought to clarify that the Income Tax Act granted the exemption to income or a class of income. It did not give the power to exempt a people or a class of people. Thus, the specific waiver exclusive to Japanese people was discriminatory and therefore contrary to the law. It did not specify a reason for the exemption other than race and ethnicity.

Drawing an inference from the exemption granted to persons living with disabilities, the court noted that a valid exemption under the law must contain some form of objective criteria for qualifying persons, and not merely birth.

Notably, the only justification put forward for the waiver was that it was lawful, and no reasons were advanced as to the effect it would have. The court opined that such blanket exemption together with Legal Notice No. 15 of 2021 could not be justifiable in an open and democratic society.

Lack of public participation

Finally, the court emphasised the importance of involving the public in governance, including the enactment of legislation. It highlighted public participation as one of Kenya's national values and as an attribute of good governance. Public participation, it observed, is the tendon that holds the Kenyan people together and gives decision-making power to the Government, and it cannot be waived.

The court accused the National Assembly of being used to rubber stamp Legal Notice No. 15 of 2021 without any public participation despite it being a statutory instrument.

As a result, section 13(2) of the Income Tax Act was declared unconstitutional for authorising tax waivers through a notice in the gazette and for specified persons without regard to fundamental constitutional dictates.

KENYA

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What does this decision mean?

The decision of the court has far-reaching implications. To the Japanese companies who are involved in the projects financed under the financing agreements in Legal Notice No. 15 of 2021, the tax exemptions ceased from 17 February 2023, i.e., when the decision was delivered. Additionally, income tax will be collectable from them going forward, but shall not be backdated.

To the Government or entities owned by the Government, it means that the taxes that were being foregone would be factored into the project cost which the Government must then pay. It is unlikely that foreign governments will finance a project and finance the taxes in the project.

For Japanese companies that intend to bid for projects funded by the Japanese Government, they may have to seek consultation on the tax implications of the project and how the taxes will be accounted for where there is no exemption.

The parties in this case, however, still have a right of appeal to the Court of Appeal.

[Alex Kanyi, Brandon Otieno and Ndinda Munyaka](#)



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The Legal 500 EMEA 2022 recommended **Emil Brincker** as a leading individual for tax.

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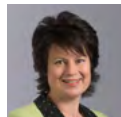
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