

ANALYSIS OF KENYA REVENUE AUTHORITY VS KENYA BANKERS ASSOCIATION

CIVIL APPEAL NO. 213 OF 2018

A. BACKGROUND THE CASE

On 28th January 2020, the Kenya Bankers Association (KBA) issued a circular advising its members on the favourable decision issued by the Court of Appeal in ***Kenya Revenue Authority Vs Kenya Bankers Association, Civil Appeal No. 213 of 2018 (Previously Miscellaneous High Court No. 510 of 217)***.

Notice on payment of CGT and Stamp duty

On 4th October, 2016, Kenya Revenue Authority (KRA) issued an notice in the newspapers advising on the discontinuance of the manual payment of both Stamp Duty and Capital Gains Tax (CGT) and required the simultaneous on line payment of the said taxes via the Itax platform.

The effect of the said announcement however was that, a taxpayer had to pay CGT first after which they could then use the payment acknowledgment number to generate a payment slip for Stamp Duty. This was unlike the practice before where the payment of stamp duty was not hinged on the payment of CGT.

Statutory Power of Sale

A charge means an interest in land securing the payment of money or money's worth or the fulfillment of any condition, and includes a sub charge and the instrument creating a charge.¹

A borrower can secure a loan from a lender using a charge on an asset say land or property as collateral. In the event that a borrower(chargor) defaults on the loan, the lender (chargee) would then be able to execute a statutory power of sale.

This allows the lender to sell the property to recoup the amount borrowed.

Based on the notice issued by KRA, KRA therefore required the chargee to pay CGT when executing a statutory power of sale as opposed to waiting for the borrower (chargor) to account for the tax.

Facts of the case

According to KBA, since only the chargor had the information necessary for the calculation of any gain which may have been made, the requirement for the simultaneous payment of both Stamp Duty and CGT before presentation of the instrument of transfer for registration was an infringement of both the Bank as Chargee and the purchaser and placed the burden of paying the chargor's tax liability on either the Bank or the purchaser.

KBA explained that prior to the announcement by KRA, it had accepted payment of Stamp Duty on an instrument of transfer on a sale by the chargee pursuant to the chargee's power of sale without any conditions as to payment of CGT.

However, based on the notice issued by KRA, KRA had expressed the opinion that Paragraph 5(2) of the Eighth Schedule to the Income Tax Act required the Bank to facilitate the transfer on behalf of the Bank's customer and that in the context of the said Paragraph, the obligation to account for CGT lay with the Bank.

Case at the High Court Level

It is on the basis of the above arguments that KBA filed its judicial review application in the High

¹ Section 2 of the Land Act CAP 280.

Court seeking to have among others that the decision of KRA requiring the simultaneous payment of Stamp Duty and CGT on sale of land by a chargee pursuant to a chargee's power of sale be declared unreasonable, unfair and influenced by an error of law.

In its judgment delivered on 13th March 2018, the High Court found in favour of the KBA and allowed its Application. It is on this basis that KRA filed its Appeal at the Court of Appeal.(C.O.A).

Case filed at Court of Appeal Level

In the C.O.A the grounds of Appeal as pleaded by KRA were that the High Court erred in: -

- a) Finding that a charge does not acquire any propriety right in the chargor's property when exercising its statutory powers of sale;
- b) Finding that a charge has proprietary rights only on the charge and not the charged land;
- c) Finding that a charge is not in a position to calculate CGT when exercising its statutory powers of sale;
- d) For ignoring the express provisions of Income Tax Act and Land Act that obligates a charge to pay CGT

B. ARGUMENTS BY THE APPELLANT

The Appellants argued that whereas the Income Tax Act provided for the payment of CGT by the Proprietor of land, the judge failed to give due consideration to the meaning of "proprietor" as defined under Section 2 of the Land Registration Act (LRA), 2012. It held the argument that once a charge was created in favour of the bank, the bank became the proprietor of the charge.

It was the Appellant's further argument, that the judge erred in finding that the chargee was only the proprietor of the charge and not the land. In its submissions, a chargee was for all intents and purposes the proprietor of the charged property.

As such, since the chargee was a proprietor of land, once a charge had been created, there was no distinction between land and the charge.

To support this argument, the Appellant relied on the provisions of Paragraph 5(2) of the Eight Schedule of the Income Tax Act CAP 470 Laws of Kenya which provides as follows:-

"Where a person entitled to property by way of security or to the benefit of a charge or encumbrance on property, deals with the property for the purpose of enforcing or giving effect to the security, charge or encumbrance, his dealings with it shall be treated as if they were done through him as nominee by the person entitled to the property subject to the dealings of a person appointed to enforce or give effect to the security, charge or encumbrance as receiver and manager as it applies to the dealings of the person so entitled"

In this regard thus, the Appellant noted that the chargee in exercising its statutory power of sale derived income which were applied to recover the unpaid loan. That as per the provisions of Section 101(a) of the Land Act (LA), the same noted that the purchase money received by a charge who had exercised the power of sale shall be applied in the payment of among others, the tax charges required to be paid on the charged land.

Lastly, the Appellant noted that the chargor was never involved in the chargee's exercise of its power of sale and neither was it involved in the transfer upon sale. To this end, CGT was payable by the Chargee.

C. ARGUMENTS BY THE RESPONDENT

In its arguments, the Respondent highlighted the provisions of **Sections** 56(5) of the LRA which notes as follows:-

“A charge shall have effect as a security only and shall not operate as a transfer”

Moreover, that as per the provisions of Section 80(1) of the Land Act, the same explicitly provided that

Upon the commencement of this Act, a charge shall have effect as a security only and shall not operate as a transfer of any interests or rights in the land from the chargor to the chargee but the chargee shall have, subject to the provisions of this Part, all the powers and remedies in case of default by the chargor and be subject to all the obligations that would be conferred or implied in a transfer of an interest in land subject to redemption.

In this regard thus, the Respondent observed that both the LRA and the LA recognized that a chargee is a proprietor of the charge whereas the chargor remains the proprietor of the land until such time that the chargor's interests are extinguished by the chargee exercising its statutory power of sale. Moreover, that CGT was a tax imposed on the income of a person as opposed to tax on land.

D. COURT'S ANALYSIS AND FINDINGS

In arriving at its findings, the court relied on the arguments presented by both parties and observed as hereunder:-

That under Section 2 of the LRA, a proprietor in relation to a charge of land or lease is defined as the person named in the register of the land or lease as the person whose favour the charge is made. Moreover, that as per Section 98(4) of the Land Act the same notes that:-

Upon registration of the land or lease or other interest in land sold and transferred by the chargee the interest

of the chargor as described therein shall pass to and vest in the purchaser free of all liability on account of the charge, or on account of any other charge or encumbrance to which the charge has priority, other than a lease easement to which the chargee had consented in writing.

Based on the above provisions, it was the court's finding that a charge is an instrument that facilitates the transfer upon a chargor's failure to repay the sum secured by the charge. In essence, the chargee does not become the owner or proprietor of the land but of the charge since it is the charge that gives the chargee the statutory power to sale. It was the court's further finding that the interest of a chargee is confined to the sum borrowed and a chargee's statutory power of sale is invoked upon the chargor's default to repay the loan. That in executing the transfer, the chargee does so in its capacity as a nominee and not proprietor.

In relation to the argument presented by the Appellant on the requirement to make payments of tax charges on money received from the sale of a charged land, the court noted that it was improper for the Appellant to demand money that had not been received by the chargee. In fact it went on to question the practicability of making such payments where the sale was skewed.

As relates to the treatment of CGT, the court concurred with the High Court's finding that CGT was a charge on the income of a person. In that respect thus, Section 101 of the Land Act was not applicable as the same referred to "taxes to be paid on the charged land."

Lastly, the Court observed that the unilateral decision by the Appellants to demand the Respondents' members to collect CGT from its borrowers by twinning the payment of CGT and Stamp Duty was unfair and in violation of the Fair Administrative Actions Act.

To this end, the Court of Appeal proceeded to dismiss the Appeal filed by KRA.

E. IMPLICATION OF THE DECISION

The implication of the dismissal is that the High Court decision remains in force with the effect that in the sale of land by a chargee pursuant to its statutory power of sale, CGT is only payable upon registration of the transfer by the chargor of the land and not by the chargee or purchaser.

Moreover, the chargee can make the payment of Stamp Duty on an instrument of transfer following the sale of land pursuant to its power of sale without requiring payment of CGT or an acknowledgment number for the payment of CGT.

Let's talk

For further information on how the proposed tax provisions will affect your business or assistance on any other matter kindly contact your regular Taxwise Africa Analyst or the contacts below.



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