REPRIEVE FOR TAX PAYERS AS CHARGE OF MINIMUM TAX IS DECLARED UNCONSTITUTIONAL BY THE HIGH COURT OF KENYA

***B Y D I A N A C H E P K E M O I***

The Finance Act, 2020 amended the Income Tax Act (Cap 470) (Hereinafter the ITA) by inserting Section 12 D which introduced a new Tax known as Minimum Tax at the rate of 1% of the gross turnover effective 1st January 2021. To implement the said amendment, the Kenya Revenue Authority (KRA) in January, 2021, published the “Guidelines on Minimum Tax” whose centrality was the definition of Gross Turnover.



Vide the Constitutional Petitions No. E005 and 001 of 2021, the Petitioners filed a petition with the High Court in Machakos challenging the constitutionality of the amendments as introduced under Section 12D of the ITA.

In support of its Petition, the Petitioners relied on the following grounds in support of their case; -

# KEY GROUNDS OF THE PETITION

1. According to the Petitioners, by its very definition, the Minimum tax did not amount to Value-Added Tax, Custom duties nor Excise Tax, yet the KRA purported to include it in the category of income tax. However, by dint of Section 3 as read with Section 15(1) of the ITA, Income Tax is only chargeable on gains or profit and not as gross turnover as implied by Minimum Tax. As such, the Minimum Tax could not be deemed in any manner of form to amount to income tax.

The Petitioners also argued that on the one hand, ITA provides that income which is subject to tax under the Income Tax is income in respect of gains or profits having deducted all expenditure wholly and exclusively incurred in the production of that income while on the other hand minimum tax is chargeable on gross turn over including losses with no possibilities of deducting expenses or costs.

1. The Petitioners argued that Article 201(a)(i) of the Constitution in setting out the principles of public finance provides for the promotion of an equitable society through the fair and just sharing of the burden of taxation.

However, the imposition of Minimum tax as against gross turnover violates the cardinal principle of public finance. That, with the imposition of the Minimum Tax on gross turnover and not gains or profits, all persons, even those in a loss-making position are required to pay minimum tax. This means that a taxpayer who has no profit or is in a loss-making position will have to pay the minimum tax out of pocket or their capital.

1. Moreover, that contrary to Article 27 of the Constitution, the amendments in Section 12D of the ITA discriminates against the Petitioners and other traders in the consumer products sector by favoring those in the energy and petroleum sector and in the insurance sector.

Based on this argument, the Petitioners noted that the imposition of the said Minimum Tax essentially meant that it cared less about the ability of the taxpayer to pay, yet an elementary principle in taxation is the principle of economic capacity which states that the percentage of the income of the taxpayers that can be legitimately affected by a tax must not be excessive than the wealth objectively available.

1. Further, the Petitioners submitted that the Minimum Tax is very likely to occasion double taxation as against the Petitioner and other similar taxpayers. In support of this argument, the Petitioners noted that if a company in a tax loss position becomes profitable in the course of its financial year and is now required to pay corporation income tax, the minimum tax paid during the loss- making period of the company’s financial year will neither be a tax-deductible expense nor a tax credit in computing the taxable income and will therefore amount to double taxation of such companies.

To this end thus, the Petitioners noted that the actions of KRA in introducing the Minimum Tax was not only ultra vires but in contravention of the Constitution of Kenya 2010. Further that the said amendment was contrary to and inconsistent with the meaning and purpose of income tax as provided under the Income Tax Act.

in arriving at its judgment, the High Court made the following key determinations as follows as relates to the issues raised by the Petitioners as to the constitutionality of the Minimum Tax: -



# DETERMINATIONS

1. The Court was cognizant of the fact that though the implementation of the Statute may be difficult or inconvenient as opposed to being unconstitutional or unlawful, the same did not warrant it being declared unconstitutional since it is within the authority of the Legislature to enact legislation governing the manner in which a particular form of tax is administered including the manner in which it imposed, calculated and enforced. It was therefore within the sole mandate of the Legislature to decide when to legislate, what to legislate and how much to legislate and to decide the timing, content and extent of legislation.

The above notwithstanding and having analyzed the submissions as made by the Parties, the High Court held:

1. That it was unconstitutional and unlawful to subject taxpayers to double taxation. Based on Article 201(b)(i) one of the principles guiding Public Finance in the country is that the burden of taxation shall be shared fairly.

That a system of taxation that lends itself to possibility of double taxation cannot be said to be fair. Such a system fails the test prescribed in Article 201(b)(i) and it matters not that such a system is being applied in other jurisdictions. Apart from that, the introduction of the Minimum Tax means that those people who genuinely make losses will be forced to fall back on their capital in order to pay the Tax while those who make profits will be paying the income tax from their profits.

1. That taxation cannot be fair when a system of taxation is introduced that has the potential effect of diminishing the capital for those making losses while for others making profits, their capital base is unaffected. Taxation ought not to be applied so that those who have more are added while those who have little, have even that little taken away from them. Such a system cannot be said to be fair and in my view that system fails the test of fairness prescribed under Article 201(b)(i) of the Constitution.
2. The Court further noted that the Minimum Tax Guidelines were statutory instruments and as such the Respondent ought to have complied with the requirements of the Statutory Instruments Act for the same to be binding. Considering that this was not done, the Court held that the Minimum Tax Guidelines were null and void and as such Section 12D of the ITA could not be implemented.

From the foregoing, the Court noted that the Finance Act, 2020 which amended the ITA by introducing Section 12D providing for introduction of Minimum Tax at the rate of 1% of the gross turnover was not enacted in accordance with Article 201(b)(i) of the Constitution since its application violated the principle that the burden of taxation is to be shared fairly.

Further, that the imposition of the said tax had the potential of not only subjecting the people to double taxation but also unfairly targeting people whose businesses, for whatever reason, are in loss making positions, to pay taxes from their capital rather than from their profits, an advantage enjoyable by others merely because their businesses are thriving.

# JUDGMENT

To this end, the High Court made a declaration that the Section 12D of the Income Tax Act as introduced by the Finance Act,2020 and amended by the Tax Laws (Amendment) (No. 2) Act, 2020 violates Article 201(b)(i) of the Constitution and as such null and void. As such, the Minimum Tax was declared unconstitutional.

The KRA have stated that they will appeal the ruling at the Court of Appeal