

Kenya's High Court rules that retrospective application of a tax law is not unconstitutional but must be practical and reasonable

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Executive summary

The High Court of Kenya (HC) recently ruled that retrospective imposition of higher excise duty on fees for money transfer services charged by Financial Institutions (FI's) for the period 1 July 2018 to 28 September 2018 was unfair and unreasonable.

The Kenya Bankers Association (KBA) (the Petitioner) had filed a case against the Attorney General (1st Respondent) and the Kenya Revenue Authority (KRA) (2nd Respondent) challenging the constitutionality of a retrospective increase in the excise duty rate from 10% to 20%.

In delivering its judgment, the HC acknowledged that the enactment of retrospective laws including tax laws is not unconstitutional. The retrospective law is, however, deemed unfair and unconstitutional when its retrospective application is impractical and unreasonable.

This Alert summarizes the case and the HC's decision.

Detailed discussion

Background

The *Finance Act 2018* which was assented to, on 21 September 2018, and published on 28 September 2018 introduced certain retrospective changes. These retrospective changes were meant to take effect from 1 July 2018. One such change was to increase excise duty on fees for money transfer services provided by FIs from 10% to 20%.

Prior to the publication of the *Finance Act 2018*, the petitioners' members were charging excise duty on money transfer services at the then prevailing rate of 10%.

The KBA filed a case seeking to declare the retroactive imposition of excise duty on fees charged on money transfer services as unconstitutional and that the same was not subjected to public participation.

The following issues among others were considered in the judgment:

- i. Whether the increase in excise duty rate was subjected to public participation
- ii. Whether the retroactive operation of the law violated the Constitution
- iii. Whether the increase in excise duty rate creates unfair imposition of tax

The Petitioner's position

Whether the increase in excise duty rate was subjected to public participation

The Petitioner claimed that there was no public participation with respect to the increase of the excise duty rate from 10% to 20% which was a contravention of the Constitution of Kenya (Constitution).

This was premised on the fact that the Finance Bill 2018, that had been subjected to public participation, did not include a proposal to increase the excise duty rate on fees charged for money transfer services by FIs. The proposal to increase the excise duty rate on the fees for money transfer services by FIs was recommended by the President when the Finance Bill 2018 was presented to him for assent.

Whether retroactive operation of the law violated the Constitution

The Petitioner claimed that the amendment to the *Excise Duty Act* created retroactive criminal offenses out of the members conduct of business, which was legal and in accordance with the law at the material time. This was thus contrary to the Constitution.

The Petitioner argued that it was unconstitutional and confusing to retroactively impose excise duty when the excise duty was to be charged at the point of supply of the service or product and at the rate prevailing at the time of supply.

Whether the increase in excise duty rate creates unfair imposition of tax

The Petitioner, referring to Articles 201 and 210 of the Constitution, contended that it was unconstitutional to increase the excise duty rate from 1 July 2018 when the legislation that increased the rate was published on 28 September 2018.

The Respondent's and interested party position

Whether the increase in excise duty rate was subjected to public participation

The parties claimed that there was adequate and extensive public participation in the process leading to the enactment of the respective legislation.

Additionally, the National Assembly debated on the memorandum from the President and accepted the President's recommendation on the increase in excise duty on fees charged on money transfer services by FIs. The general citizenry thus participated in the process through their duly elected representatives.

It was also contended that the increase in the excise duty rate from 10% to 20% was in substance within the parameters of what had been subjected to public participation when the Finance Bill was committed to the Parliamentary Committee on Finance, Planning and Trade.

The National Assembly was within its right to make subsequent amendments to the Finance Bill without subjecting the same to further public participation.

Whether retroactive operation of the law violated the Constitution

The parties asserted that the Constitution permits an enacted law to apply retrospectively since it does not expressly outlaw retrospective application of the law.

They also submitted that it was not the intention of the National Assembly to create criminal offenses and that any resulting offense was purely incidental and could be addressed with the KRA on a case-by-case basis.

They also asserted that Constitution only forbids retroactive application of criminal and penal laws and not revenue laws.

Whether the increase in excise duty rate creates unfair imposition of tax

The parties claimed that no taxation had been imposed without the requisite legislation and what had been done was consistent with the Constitution since a Finance Bill is introduced every year in the National Assembly after the presentation of the budget statement to give effect to the financial proposals of the Government.

The parties also asserted that the Constitution empowers the National Assembly to impose taxes, and the HC should not interfere merely because the legislature would have adopted a better or different definition of the tax or provided an alternative method of administration.

They stated that the imposition of tax by legislation had been duly enacted, and the collection of such tax could not amount to infringement of the constitutional right to taxation that is fair, or any other constitutional right or freedom.

High Court Ruling

Whether the increase in excise duty rate was subjected to public participation

The HC noted that the Petitioner had failed to bring forward any evidence or raise concise arguments on the alleged lack of public participation. The onus was, however, on the Respondents and the interested party to produce evidence that indeed there was adequate public participation contrary to the Petitioner's claim.

Despite the HC acknowledging the Petitioner's claim that the Finance Bill 2018 presented for public participation did not feature the increment in the excise duty rate, the HC agreed with the Respondents and the interested party that the said provisions of the *Finance Act, 2018* cannot be challenged on the ground of lack of public participation.

The HC relied on decided case law where it had been observed that for a Bill that had already been subjected to public participation, it would be impossible for Parliament to fulfil its legislative obligation, if every amendment proposed thereafter necessitated public participation.

Whether the retroactive operation of the law violated the Constitution

The HC noted that the Constitution provided for an Act of Parliament to come into force 14 days after it was published in the Gazette or any other date indicated in the Act. The HC further asserted that laws passed by the National Assembly should be applied prospectively unless the law expressly states that it will apply retrospectively.

With respect to *Finance Act 2018*, the HC noted that the drafters had provided the respective dates that each change was supposed to take effect and the same had been subjected to the legislative process and passed accordingly.

The HC further declared that the *Interpretation and General Provisions Act* empowers the legislature to enact laws which affect the previous operation of a written law, or anything duly done or suffered under a written law, or affect a right, privilege, obligation or liability acquired, accrued or incurred under a written law, so long as this intention is clearly expressed in the new law.

In conclusion and support of the Respondents and interested party positions, the HC pronounced that the enactment of retrospective legislation, including tax legislation, is not unconstitutional since it is not prohibited in the Constitution. The Constitution prohibits retrospective application of criminal laws.

In response to the Petitioner's claim that the enactment of the law culminated in a criminal sanction which did not exist before its enactment, the HC affirmed the Respondents' and interested party's claims that *Finance Act 2018* was not a criminal law nor did it impose criminal sanctions and as such it could be implemented retrospectively.

Whether the increase in excise duty rate creates unfair imposition of tax

The HC stated that the Constitution empowers the Government to impose tax and charges and that no tax may be imposed, waived or varied except as provided by legislation. While referring to decided cases in South Africa and England, the judge noted that the general presumption is that the legislature is not intended to impose additional liability on a transaction that has already been completed as it would be unreasonable to do that.

Retrospective application of the law is not aimed at undoing consequences that had come into effect before the retrospective law was enacted. To interpret that the retrospective application of the law would impact already completed transactions could lead to adverse consequences for persons who have committed no wrong.

Hence, for a law that is to be applied retrospectively, the drafters of the law must question whether the retrospective application of the law would be injurious to persons who had not committed any wrong before the enactment of the law.

The judge of the HC observed that the challenge the Petitioner's members faced with complying with the change was due to the fact that the change required the collection of tax emanating from transactions that had already been finalized by the date of enactment of the law.

The Petitioner's members only act as collection agents and excise tax due on the fees charged on money transfer services is borne by the customers. Consequently, the enactment of the change placed the Petitioner's members in an uncertain position because it was unclear if the additional 10% was to be recovered from the customers or from their profit.

In its conclusion, the HC declared that the enactment of the change presented the Petitioner's members with an impossible task and as such the provision was unfair and unreasonable. The HC ruled that the change culminated in the unfair imposition of tax and was unconstitutional in so far as it was to apply retrospectively from 1 July 2018 to the date of its publication on 28 September 2018.

Next steps

The ruling addressed a key issue on the retrospective application of the law that could impact how tax laws are drafted in future.

Despite the legislature having the power to draft laws with retrospective application, in drafting such laws the legislature must question the reasonableness and fairness in the retrospective application of the laws.

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