

Kenya's Court of Appeal issues landmark ruling on income "paid" for withholding tax purposes

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Executive summary

Kenya's Court of Appeal, on 5 February 2019, annulled an earlier judgment by the High Court of Kenya which had ruled that the term "paid" implied an actual delivery of money or any other valuable consideration in the context of the *Income Tax Act* (ITA). Many taxpayers have been relying on this High Court ruling to determine the timing for taxpayers to impose withholding tax (WHT) on applicable services.

The ruling by the Court of Appeal is pursuant to an appeal that had been filed by the Kenya Revenue Authority (KRA) in relation to the timing for imposition of WHT on interest which had been accrued in the books of a Kenyan taxpayer. The judgment affirms that "paid" includes accruals for purposes of the ITA and hence WHT is payable on the earlier of an accrual (that is, when the expense is booked) or the actual transfer of money or some other valuable consideration.

Detailed discussion

The definition of the term "paid" has been subject to different interpretations. The ITA defines "paid" to include distributed, credited, dealt with or deemed to have been paid in the interest of or on behalf of a person.

In addition, the ITA imposes WHT on payments for certain services when rendered by a resident and/or nonresident person. The ITA uses the term "upon payment" in reference to the timing for deducting tax in advance in the form of WHT.

In an earlier case, *Cimbria (EA) Ltd vs KRA*, the term "upon payment" was extensively discussed and the Court concluded that it meant "paid." As a result, many taxpayers have accounted for withholding tax at the point of actual payment of the associated service. The Court of Appeal in this case has considered the meaning of the term "paid" for purposes of the ITA.

The Court observed that while the words "upon payment" in their colloquial and ordinary parlance suggest being given money for something in exchange, the ITA must be the source of the meaning to be attached to such words, by giving them context. The Court highlighted that the ITA has given the word "paid" a technical as opposed to ordinary definition.

The Court finally observed that the income tax regime is based on the accrual system of accounting as evidenced in various sections of the ITA.

Next steps

Persons who receive services subject to WHT should evaluate how this ruling affects their current as well as future tax obligations. In particular, they should:

- ▶ Consider if the accounting treatment accorded to certain expenses requires them to immediately account for WHT.
- ▶ Review the current contractual terms with service providers on the relevant services, where necessary.
- ▶ Consider the structure of their contracts with service providers going forward.

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