REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

JUDICIAL REVIEW DIVISION

MISCELLANEOUS CIVIL CASE NO. 510 OF 2017

IN THE MATTER OF AN APPLICATION BY KENYA BANKERS ASSOCIATION FOR LEAVE TO APPLY FOR AN ORDER OF MANDAMUS AND FOR A DECLARATION OF RIGHTS

AND

IN THE MATTER OF PAYMENT OF STAMP DUTY ON SALE OF LAND BY CHARGEE PURSUANT TO CHARGEE'S POWER OF SALE

AND

IN THE MATTER OF THE STAMP DUTY ACT [CAP 480]

AND

IN THE MATTER OF THE INCOME TAX ACT [CAP 470]

AND

IN THE MATTER OF THE FAIR ADMINISTRATIVE ACTION ACT, 2015

KENYA BANKERS ASSOCIATION…….APPLICANT

VERSUS

KENYA REVENUE AUTHORITY……...……..RESPONDENT

JUDGEMENT

Introduction

1. By a Notice of Motion dated 19th Day of October, 2017, the *ex parte* applicant herein, **Kenya Bankers Association**, incorrectly named as the main applicant which should be the Republic, seeks the following orders:

> **1. A declaration that the administrative action by the respondent requiring simultaneous payment of Stamp Duty and Capital Gains Tax on sale of land by a chargee pursuant to a chargee's power of sale is unreasonable, unfair and influenced by an error of law.**
>
> **2. A declaration that the administrative action by the respondent requiring payment of Capital Gains Tax by the chargee or purchaser on the sale of land by a chargee pursuant to a chargee's power of sale is unreasonable, unfair and influenced by an error of law.**
>
> **3. A declaration that on the sale of land by a chargee pursuant to a chargee's statutory power of sale, Capital Gains Tax is payable upon registration of the transfer by the chargor of the land pursuant to paragraph 5(2) of the Eighth Schedule of the Income Tax Act and not by the chargee or purchaser.**
>
> **4. An order of mandamus compelling the respondent to allow payment of Stamp Duty on an instrument of transfer following**

the sale of land by a chargee pursuant to a chargee's power of sale, without requiring payment of Capital Gains Tax or an acknowledgment number for payment of Capital Gains Tax.

5. The costs of the proceedings be paid by the respondent.

***Ex Parte* Applicant's Case**

2. According to the applicant, it is a registered Trade Union and is a body corporate with the capacity to sue in its own name and its membership comprises of forty two licensed commercial banks, one mortgage finance bank and two microfinance banks. Its function, it was averred is to look after the interests of its members and where appropriate to make representations or submissions on matters which may have an effect or impact on the business operations of the members of the applicant. In bringing this application, it was averred that the applicant is acting in the interest of its members in bringing this Petition.

3. The respondent on the other hand was described as a body corporate established under section 3 of the ***Kenya Revenue Authority Act*** [Cap 469] and by section 5 and the Schedule to the ***Kenya Revenue Authority Act*** the respondent is charged with the assessment and collection of revenue under the ***Income Tax Act*** [Cap 470] and the ***Stamp Duty Act*** [Cap 480].

4. According to the applicant, its members [hereinafter referred to as "the Bank"] in the course of their business provide to their customers various credit and banking facilities including loans and overdrafts against the security of a charge over land, which charge, which charge may be from the customer or from a third party who offers his land as security for the repayment of the facility to the Bank. In the event of a default in payment by the customer, the Bank, after giving the necessary notices under section 56 of the ***Land Registration Act 2012*** and sections 90 and 96 of the ***Land Act 2012***, may proceed to sell the charged land pursuant to sections 97 and 98 of the ***Land Act 2012***, which sale will normally be by public auction, but may also be by private treaty, in which event the instrument of transfer of the charged land to the purchaser is executed by the Bank as chargee. Therefore in such cases the chargor, whether the customer or a third party, is not a party to the instrument of transfer.

5. It was averred that by an administrative action announced in a notice published in the *Daily Nation* newspaper of 4th October, 2016 the respondent discontinued the manual payment of both Stamp Duty and Capital Gains Tax and required the simultaneous on line payment of both Stamp Duty and Capital Gains Tax. To the applicant, the effect of this announcement is that Stamp Duty has to be paid through the respondent's I-tax system simultaneously with the Capital Gains Tax. However, the I-tax system will not permit the payment of Stamp Duty on a transfer unless an acknowledgment number for the payment of Capital Gains Tax on that sale is entered into the I-tax system.

6. It was explained that Stamp Duty is payable on the instrument of transfer before the instrument of transfer can be presented for registration by the purchaser under item 12A of the Schedule to the ***Stamp Duty Act*** [Cap 480] as amended by the Eleventh Schedule to the ***Finance Act, 1994***. On the other hand, Capital Gains Tax is payable upon registration of the instrument of transfer by the owner of the land i.e. the chargor.

7. In this respect the applicant cited sections 3(2)(f), 15(3)(f), of the ***Income Tax Act,*** paragraphs 2, 4(1) and 8 of the Eighth Schedule to the Act.

8. According to the applicant, paragraph 5(2) of the Eighth Schedule provides that where a chargee *"deals with property for the purpose of enforcing ...security... 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 security."*

9. It was however the applicant's case that since only the chargor has the information necessary for the calculation of any gain which may have been made, by requiring the simultaneous payment of both Stamp Duty and Capital Gains Tax before presentation of the instrument of transfer for registration, the respondent is infringing on the right to property of both the Bank as chargee and the purchaser and places the burden of paying the chargor's tax liability on either the Bank or the purchaser.

10. It was explained that prior to the announcement of 4th October, 2016 and the requirement that Stamp Duty be paid through the respondent's I-tax system, the respondent 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 Capital Gains Tax. However, by letter dated 1st July, 2016 the respondent 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 paragraph 5(2) the obligation to account for Capital Gains Tax primarily lay with the Bank.

11. Despite the foregoing, after the letter of 1st July, 2016 the respondent continued to accept payment of Stamp Duty on an instrument of transfer following a sale by the chargee without any conditions as to payment of Capital Gains Tax. Following the announcement of 4th October, 2016 the applicant wrote to the respondent on 22nd November, 2016 setting out the applicant's argument as to why the Bank does not assume the obligations of the chargor and why the Bank should not be expected to settle the tax obligations of the chargor but there has been no response thereto.

12. It was the applicant's case that the respondent's decision to charge capital gains tax under paragraph 5(2) of the Eighth Schedule to the ***Income Tax Act*** on a Bank that is exercising its power of sale under a charge is unreasonable, unfair and influenced by an error in law. Further, the respondent failed to take into account the fact that the bank is not the owner of the property and does not make a gain when exercising its power of sale under a charge.

13. In its submissions highlighted by its learned counsel, **Mr Fraser, SC**, it was contended on behalf of the applicant that the applicant is challenging the administrative action by the respondent to compel a chargee to pay Capital Gains Tax on the sale of land under the chargee's

statutory power of sale. Accordingly, the applicant is not challenging the imposition of Capital Gains Tax on the sale of land. Therefore the matters of policy set out in the Replying Affidavit have no relevance to the application.

14. It was submitted that the applicant's status and representation of the commercial banks is set out in the Statement filed in support of this application as verified by the verifying affidavit herein.

15. As to the circumstances in which the chargee's statutory power of sale arises and how it is enforced, reliance was placed on the contents of the Statement and section 56 of the ***Land Registration Act, 2012*** as well as the definition of "proprietor" in section 2 of the ***Land Registration Act*** as read with section 2 of the ***Land Act, 2012.*** It was submitted that these provisions of the ***Land Registration Act*** clearly establish that a charge is only security and does not operate as any transfer of the land and that the chargee is only the proprietor of the charge, not the land. Therefore the statement in paragraph 13(a) of the replying affidavit that "the chargee is the registered owner of the property when exercising the statutory right to sell" is wrong in law and contrary to the clear wording of the said Acts.

16. The applicant also relied on sections 90(1)(3)(e) and 96(1) of the ***Land Act, 2012*** and averred that section 97 of the ***Land Act*** sets out the duty of care which the chargee owes to the chargor in exercise of the chargee's statutory power of sale while section 98(3) and (4) thereof sets out the powers incidental to the power of sale. It was submitted that the scheme of the land legislation is to create security over land which the chargee may sell after complying with the various statutory obligations and that at no time does the chargee step into the shoes of the owner of the land or become the owner of the land.

17. It was however noted that Income Tax is a tax on "the income of a person" and the charge to tax is contained in section 3(1) of the ***Income Tax Act*** [Cap 470]. In this case it was submitted that Capital Gains Tax is one of the taxes on the income of a person and is created by section 3(2)(f) of the ***Income Tax Act*** as read with section 15(1) of the ***Income Tax Act***. According to the applicant, any tax charged under the ***Income Tax Act*** is a tax on the income of a person and is not a tax that can be imposed by administrative action on a third party. In its view, a deduction is allowable under section 15(3)(f) of the ***Income Tax Act*** where the person on whose income the tax is assessed suffers a loss on the sale of land. It was reiterated that a bank or chargee would not know whether the owner of the land being sold had incurred any loss which could be deducted.

18. The applicant further submitted that the calculation of the income on which Capital Gains Tax is payable is set out in the Eighth Schedule to the ***Income Tax Act*** and reference was made to paragraphs 2 and 4(1) thereof. In the applicant's submission, the company or individual is the person whose income is being taxed and that person can only be the owner of the land. In its view, it is a gain accruing to a person and that person can only be the person whose income is being taxed, namely the owner of the land.

19. As for "Adjusted cost" the applicant referred to the definition of the term in paragraph 8 of the Eighth Schedule and reiterated that only the chargor has the necessary information for the calculation of any gain since there is no way a bank would know how much the chargor spent to acquire the land or to construct buildings or to enhance the value of the property or whether the chargor has spent money to establish, preserve or defend the title or right to the property. It was therefore submitted that paragraph 5(2) of the **Eighth Schedule** makes clear that the owner remains liable to capital gains tax on the sale even where the sale is by a chargee under the statutory power of sale.

20. According to the applicant, for the purposes of Capital Gains Tax the sale is deemed to be by the owner and the chargee is merely acting as nominee for the owner pursuant to the security or charge. However, since nothing in the ***Income Tax Act*** imposes the tax on a chargee exercising the statutory power of sale, there is no statutory basis for the assertion to the contrary in the Replying Affidavit. In the applicant's view, this is consistent with paragraph 6 of the **Eighth Schedule.** In the applicant's contention paragraph 6(1)(a) constitutes the sale as a transfer for the purposes of paragraphs 2 and 4(1) while paragraph 6(2) recognises the difference between creation of a security and transfer of property and this is consistent with sections 2 and 56(5) of the ***Land Registration Act***. It was the applicant's case that none of these provisions impose any tax on the chargee as the chargee is not making any gain. In many cases the chargee will make a loss if the property sells for less than the amount secured.

21. It was submitted that as the respondent had not sought to make the chargee liable for Capital Gains Tax prior to the Notice of 4th October, 2016, this change in the manner in which the respondent administers Capital Gains Tax is not due to any change in the legislation governing Capital Gains Tax but is solely as a result of administrative action taken by the respondent in firstly requiring the payment of Stamp Duty through I-tax and secondly in setting up I-tax in such a way that Stamp Duty can not be paid without an acknowledgment number for payment of Capital Gains Tax. It was contended that while Stamp Duty is on the transfer of land is payable by the transferee under the Schedule to the ***Stamp Duty Act*** the action of the respondent prevents the purchaser from stamping the transfer and acquiring title.

22. It was the applicant's submission that it is this administrative action which is challenged by the applicant as unreasonable, unfair and influenced by an error of law and contrary to Article 47 of the Constitution and sections 4 (1) of the ***Fair Administrative Action Act, 2015.***

23. In the applicant's contention, the effect of the administrative action taken by the respondent is to impose capital gains tax on the chargee, yet it is well established that liability to tax can only be imposed by plain words and there is no room for intendment as to tax. Based on **Petition 39 of 2017 - The Law Society of Kenya vs. The Kenya Revenue Authority and the Attorney General [2017] eKLR** at pages 2 and 8 and **R vs. Kenya Revenue Authority ex parte Universal Corporation [2017] eKLR** at page 22 paragraph 103 and page 27 paragraphs 121 and 122, it was submitted that no such words have been used in the ***Income Tax Act*** so as to impose liability for payment of Capital Gains Tax on a chargee exercising his statutory power of sale.

24. According to the applicant, the High Court has already held in **Petition 39 of 2017 - The Law Society of Kenya vs. The Kenya Revenue Authority and the Attorney General [2017] eKLR** at pages 13 and 14 that paragraph 11A of the Eighth Schedule violates the provisions of Article 201 (b) (i)) of the Constitution in that it unfairly imposes a tax burden on the public to the extent that it purports to impose an obligation on a tax payer to pay Capital Gains Tax on or before presenting the transfer instrument for registration instead of upon registration of the transfer instrument in favour of the transferee.

25. It was the applicant's case that by the administrative conduct complained of in this application the respondent is going even further by

tying the payment of Capital Gains Tax to the payment of Stamp Duty, which must be paid before the transfer is presented for registration. It was disclosed that though the parties have corresponded this correspondence shows the entrenched position taken up by the respondent hence the allegation that the respondent has been engaging members of the applicant "and the cases have been handled successfully" is without any substantiation or foundation. The applicant maintained that these proceedings would not have been filed if the issue had been "handled successfully". Further it is unfair administrative action for the respondent to require each chargee to engage individually with the respondent on every forced sale.

26. For these reasons the applicant submitted that the respondent's administrative action is unreasonable, unfair and influenced by an error of law contrary to Article 47 of the Constitution and sections 4(1) of the ***Fair Administrative Action Act, 2015*** and that the applicant is entitled to the declarations and the order of mandamus sought in the Notice of Motion together with costs pursuant to sections 7(1), 7(2) (c), (d), (k) and (n) and 11 (1) (a), (b) and (d) of ***Fair Administrative Action Act, 2015.***

Respondent's Case

27. The application was opposed by the respondents.

28. According to the Respondent, it is established under the ***Kenya Revenue Authority Act***, Cap 469 Laws of Kenya and under section 5(1), it is an agency of the Government for the collection and receipt of all revenue. Further, under Section 5(2) with respect to the performance of its functions under subsection (1), the Authority is required to administer and enforce all provisions of the written laws set out in Part 1 and 2 of the First Schedule for the purposes of assessing, collecting and accounting for all revenues in accordance with those Laws.

29. It was averred that the Capital Gains Tax (CGT) was re-introduced via the ***Finance Act, 2014*** at the rate of 5% effective from 1st January 2015. It was however contended that the tax is not new since provisions for the tax exist in the ***Income Tax Act*** Cap 470, but its provisions were suspended by the Government in 1985 to enable the growth of the property market. According to the Respondent, the re-introduction of the CGT at this time was for the following reasons:

a. **Equity requirements**: the Constitution of Kenya, in Chapter 12 (Public Finance) provides the principles that guide all aspects of Public Finance in the Republic. A critical requirement is the principle of equity which requires, among others that the burden of taxation shall be shared fairly specifically under Article 201 of the Constitution. In this regard, the re introduction of the capital gains tax is consistent with ensuring *horizontal* and *vertical* equity in taxation:

i. ***Horizontal equity,*** where individuals with similar economic circumstances should bear a similar tax burden, irrespective of the source of the income. Absence of capital gains tax ensures that those whose earn income from capital gains do not bear a similar burden to those who earn labour or other incomes, undermining this principle.

ii. ***Vertical equity*** which requires taxpayers with greater ability to pay to bear a larger tax burden than those with lesser ability. Since capital gains tend to disproportionately accrue to the wealthier segments of society, failure to tax these gains undermines this principle.

b. **Economic Efficiency**: If capital gains are untaxed, there is a strong incentive to invest in assets that provide capital gains as opposed to income producing. Thus tax policy leads to mis-allocation of investment resources when gains are not taxed.

c. **Regional and international experience**: It is common practice to have a capital gains tax regime. In the East African Community region, both Uganda and Tanzania have capital gains tax regime. This is also the case in the wider African context and also in the West.

d. **Minimization of tax avoidance and evasion**: When capital gains are not taxed taxpayers have an incentive to shift assets from income bearing to assets that produce capital gains, eroding the tax base. Absence of capital gains is also likely to lead to the development of complex schemes to convert income to capital gains to avoid taxation.

30. According to the Respondent, in a letter dated 26th January 2016, Applicant (KBA) wrote to the Respondent (KRA) seeking clarification on who has the obligation to account for Capital Gains Tax (CGT) on forced sale and in response thereto vide a letter dated 1st July 2016, the Respondent clarified that the obligation to account for CGT primarily lies with the bank in accordance with Paragraph 5(2) of the Eighth Schedule to the ***Income Tax Act*****.** This letter was later followed by two engagement forums with the Applicant held on 7th October 2016 and 24th February 2017 in which the Applicant was invited and well represented. During the said engagements KBA raised the same issues. According to the Respondent, it has been engaging members of KBA individually on CGT cases arising out of forced sale transactions and the cases have been handled successfully.

31. In support of its case the Respondent relied on section 96(1) of the ***Lands Act, 2012*** as well as paragraph 5(2) of the Eighth Schedule of the ***Income Tax Act 2015*** and averred that from the foregoing, the action taken by the Respondent is not contrary to Article 47 of the Constitution of Kenya and section 4(1) of the ***Fair Administrative Action Act 2015.*** According to it, under the sad paragraph, the obligation to account for Capital Gains Tax primarily rests with the Bank in the case of a forced sale and this is supported by the fact that the bank will facilitate transfer on behalf of the client (defaulter). To the Respondent, the Chargee is the registered owner of the property when exercising the statutory right to sell the property to recover the monies owed by the Chargor hence the obligation to account for CGT primarily lies with the chargee since the chargor is not party to the instrument of transfer on a forced sale and the transfer is executed by the Chargee (Bank). During the whole Auction Exercise the defaulter is not involved in the whole process at all.

32. It was further averred that the applicant's demand that its members should not be held accountable for CGT on disposal of property by way of forced sale is contrary to paragraph 6(1)(a) of the Eighth Schedule of the ***Income Tax Act.***

33. According to the Respondent, since it is quite apparent that during the auction the financier will undertake the whole transfer process without involving the Chargor, it should take responsibility in accounting and paying the CGT as can be computed from the records held by the Banks or members of the Applicant.

34. The Respondent contended that it is important to note that the decision to impose capital gains tax is based on various economic reasons including the ones stated above and not just the material contribution of the tax.

35. As regards, the system use challenges, the Respondent stated that it is aware the Applicant's members have their own systems to support their business processes which is also the case for the Respondent which uses the *i-tax* system to facilitate tax collection. In its view, the failure by the Applicant to present before the court evidence or a factual basis on which this Honourable Court can make a determination whether or not there has been a violation of Article 47 of the Constitution is akin to asking the court to make a pronouncement in vain. It was therefore its position that the Notice of Motion application does not meet the threshold required to warrant the grant of orders sought.

36. According to the Respondent, section 23 of the ***Finance Act***, 2014 amended paragraph 2 of the Eighth Schedule to the ***Income Tax Act*** by subjecting the gain accrued by a person on or after 1st January, 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1st January, 2015. Capital gain tax is imposed on gain made upon the transfer of property and only if that transfer was done on or after 1st January, 2015. According to it, Article 209 of the Constitution gives the National Government power to impose income taxes and as such capital gains tax was imposed by law in compliance with Article 210 of the Constitution.

37. It was in any case contended that its primary mandate is the implementation of the tax laws. With the enactment of every new law and systems, various challenges are usually encountered at the initial stages of implementation and it has always endeavoured to assist taxpayers to comply, just as it is doing in this case with the Applicant's members in the engagements referred to above. Its view was therefore that it would therefore be unlawful if the law were to be suspended or the court was to direct the Respondent to allow payment of stamp duty without payment of CGT on sale of land by chargee as prayed by the Applicant as there will be substantial loss to the Government in terms of tax revenue, if the orders prayed for by the Applicant are granted.

38. The Respondent therefore prayed that the Notice of Motion does not disclose any reason or ground for the court to decide against the Respondent and the same should be dismissed with costs and the Respondent be allowed to perform its statutory duty.

39. On behalf of the Respondent, it was submitted through its learned counsel, **Mr Ontweka,** that the crux of this matter lies in determining two major issues namely:

> i. Whether the Applicant's members are proprietors of charged properties whenever their Statutory Power of Sale accrues and they desire to exercise it and as such liable to pay Capital Gains Tax on the property; and
>
> ii. Whether in dealing with property that is subject of a Statutory Power of Sale *"...as nominee by the person entitled to the property..."*, the Applicant's members can nonetheless pass the obligation of paying Capital Gains Tax on the forced sale transaction. Simply put, who is responsible for paying Capital Gains Tax in case of a forced sale by the Applicants members?

40. After reiterating what in its view was the background of the Capital Gains Tax (CGT) the respondent submitted that the tax is paid by the proprietor of the property upon sale and relied on the definition of "proprietor" in section 2 of the ***Land Registration Act, 2012*** as well as paragraph 5(2) of the Eighth Schedule to the ***Income Tax Act***, Cap 470 that spells out the obligations of a person entitled to property by way of security or to the benefit of a charge for purposes of giving effect to the security. According to the Schedule, such person's dealings shall be treated as if they were done through him as nominee by the person entitled to the property.

41. In support of its submissions the Respondent relied on section 2 of the ***Land Act, 2012*** which defines a charge and contended that it is clear that the creation of a charge secures both the value of the charged property from the time of charging it until the time the chargee's right of sale accrues or the chargor discharges it by fulfilling its rights under the charge. The money's worth includes the accruing loan interests, which are in themselves, the bank's profits, and would include the costs related to realizing the charge e.g. auctioneer's fees. Based on sections 2 and 56(3) of the ***Land Registration Act, 2012***, the Respondent averred that the allegation that Applicant's members are proprietors of the charge and not the land is farfetched and in total misapprehension of the law since there are is no way you can separate the charge from the land – a charge cannot exist in the absence of the land.

42. In the Respondent's view, at the time the Applicant's members exercise their right of sale, they must meet all the obligations as set out in sections 97(1) and (2) of the ***Land Act, 2012***, which obligations include the duty of care of ensuring that the property fetches the best market value. The Act further obligates Applicant's members to conduct a forced sale valuation before exercising the right of sale.

43. It was submitted that at sale, the chargor's rights over the charged property are extinguished while the chargee's right to realise his security crystallizes. Therefore although the Chargee is accountable to the '*chargor in default'*, he is for all intents and purposes the proprietor of the charged property, responsible for instructing the sale of the property, conducting a valuation on the property and ultimately, effecting the transfer to the purchaser of the property.

44. In the Respondent's view, the second definition of 'proprietor' as contained in section 2 of the ***Land Registration Act, 2012*** envisages a situation where the Chargee's right over the charged property has crystallized and has to take over the property. This is the exception to section 56(5) of the ***Land Registration Act*** because at this time the Chargee deals in the property in accordance with the terms of the charge instrument. It was therefore its position that the distinction between 'a charge' and 'land' that the Applicant has attempted to paint in its submissions is self-serving and a total misrepresentation of the truth since as already submitted above, a charge cannot exist without land. In support of this position the Respondent relied on sections 98 (3) and (4) of the ***Land Act*** that it is the Chargee who sells and oversees the transfer and registration of charged land. Nowhere does the provision distinguish between 'charge' and 'land' but rather uses 'charged land'.

45. As to who is responsible for paying capital gains tax in case of a forced sale by the applicants members, the respondent relied on paragraph 5(2) of the Eighth Schedule of the Income Tax Act 2015 and reiterated that the Chargee who exercises its Statutory power of sale is the proprietor of the said property since that the Chargor's rights are extinguished once the chargee's power of sale crystallizes.

46. It was similarly submitted that the Applicant has misapprehended the law by trying to differentiate between a sale of property by *'a person'* and a sale by *'a person entitled to property by way of security'* as contemplated in the ***Income Tax Act***.

47. In the Respondent's view, a Chargee's sale to realize the charged land is actually income on the part of the Chargee and not on the part of the Chargor as the monies are applied to recover the unpaid loan amounts which include interests on the loan.

48. It was submitted that the information referred to in the Applicant's written submissions is available with all the Applicant's members and forms part of the due diligence undertaken by the Applicant's members before accepting the chargor's collateral. It is for this reason that the chargee conducts a valuation on the property to be charged. Further, it is for this reason that section 97(2) of the ***Land Act*** imposes an obligation on the chargee to conduct a forced sale valuation before exercising their statutory power of sale. In this respect the Respondent relied on **David Ngugi Ngaari versus Kenya Commercial Bank Limited [2015] eKLR** in which **Gikonyo, J** while quoting **Maithya vs. Housing Finance Company of Kenya and Another [2003] 1 E.A 133** noted thus at page 8 of judgment:

> **"Charged properties are intended to acquire or are supposed to have a commercial value otherwise lenders would not accept them as securities...before lending, many lenders, banks and mortgage houses are increasingly insisting on valuations being done so as to establish forced sale values of the properties to constitute the securities for the borrowings or credit facilities..."**

49. It was the Respondent's position that as such valuations take into account all the aspects of adjusted cost contemplated in paragraph 8 of the Eighth Schedule to the ***Income Tax Act*** Cap. 470, it is therefore entirely misleading for the Applicant to state that its members have no capacity to ascertain the same. According to the Respondent, it should not be lost to this Honourable Court that it is the chargee bank that authorises the auction of the property and also sets the terms of the auction. Although the chargor is the registered owner of the auctioned property, he has no role to play in the transaction. In fact, the chargee does not involve him in the sale transaction. The obligation to account for Capital Gains Tax cannot therefore be left to the Chargor since the chargor is not party to the instrument of transfer on a forced sale and the transfer is executed by the Chargee (Bank). During the whole Auction Exercise the defaulter is not involved in the whole process at all. This is supported by the fact that the bank will facilitate transfer on behalf of the client (defaulter).

50. It was the Respondent's position that as the Chargor in default is, during the whole Auction exercise not involved in the whole process at all, clearly, the Chargee is the registered owner of the property when exercising the statutory right to sell the property to recover the monies owed by the Chargor. The obligation to account for Capital Gains Tax primarily lies with the chargee since the chargor is not party to the instrument of transfer on a forced sale and the transfer is executed by the Chargee (Bank).

51. In the Respondent's opinion, the Applicant's demand that its members should not be held accountable for Capital Gains Tax on disposal of property by way of forced sale is contrary to paragraph 6(1)(a) of the Eighth Schedule of the ***Income Tax Act***.

52. The Respondent insisted that although denied, it had actually successfully engaged members of Applicant individually on Capital Gains Tax cases arising out of forced sale transactions and the cases have been resolved according to the law.

53. It was noted that since, the Applicant had not demonstrated how the monies realised from a forced sale are applied so as to hold the Chargor liable for a transaction that he did not take part in, the Respondent remains apprehensive that the Applicant's Notice of Motion is misguided, misapprehended and ill intended. Moreover, section 101 of the ***Land Act*** provides in express terms, how the proceeds realised from a forced sale by Chargee are to be applied. However, and as you will note from the Applicant's submissions, this provision is conspicuously missing, yet this is one of the fundamental provisions that the Applicant's members apply whenever they exercise their statutory right/power of sale.

54. In the Respondent's view, Capital Gains Tax as a form of tax rests squarely within the taxes contemplated in section 101 (a) of the ***Land Act, 2012*** and are ranked first before any other obligations that the proceeds realised from the sale should meet. Therefore, it is only the Applicant's members who can remit the taxes to the property since they are the ones with the sale proceeds.

55. It was submitted that the Applicant has not demonstrated how its members end up into losses and as such its submissions along those lines are self-serving. As demonstrated from the foregoing, the Respondent's actions are supported by clear and express provisions of the law as regards the payment of Capital Gains Tax on sale of property by the chargee. Therefore the Respondent's actions do not offend the principles of ***Fair Administrative Action*** as contemplated in Article 47 of the Constitution and the relevant provisions of the ***Fair Administrative Action Act, 2015***, neither are they founded on an error of the law. Rather, the Respondent submits that its actions are in line with the laid down principles of Public Finance as enshrined in Article 201 of the Constitution of Kenya and are intended to ensure that all property transactions that are subject of Capital Gains Tax are treated equally before the law.

56. The Respondent's view was that the Applicant seeks to hide behind the veil of judicial review to safeguard its members from being held liable for taxes that are lawfully liable from them. According to it, the case cited by the Applicant does not apply in the circumstances of the present suit as the same challenged the twining of Capital Gains Tax and Stamp Duty. It did not at all question who between the Chargee and the Chargor should remit Capital Gains Tax in the case of a forced sale.

57. The Respondent took the view that should this Court be inclined to grant the Orders sought by the Applicant there is a likely hood that the Applicant's members will transfer all properties that that they forcibly sell without payment of CGT on sale of land by chargee as prayed by the Applicant. This, according to it, will result to not only substantial loss of revenue to the Government, but also result into unfair tax burden where some property owners will pay Capital Gains Tax while others (the chargee realizing their security) pocket all the proceeds realized from the sale of charged property, but still pass the burden to pay Capital Gains Tax to the chargor. This is a ploy by the Applicant to

evade the Capital Gains Tax altogether. To the Respondent, this will offend both the provisions of Article 201 of the Constitution as well as the provisions of Paragraph 6(1)(a) of the Eighth Schedule of the ***Income Tax Act***.

58. It was therefore prayed that the Notice of Motion does not disclose any reason or ground for the court to decide against the Respondent and the same should be dismissed with costs and the Respondent be allowed to perform its statutory duty.

Determinations

59. I have considered the issues raised in this application.

60. The issue before me as far as I can gather is whether the duty or obligation to pay capital gains tax rests on a chargee upon the exercise its statutory power of sale. It is not, as the Respondent has taken it, whether or not capital gains tax is lawful.

61. This being a dispute revolving around tax legislation, it is important to revisit the principles guiding such legislation. The said principles were restated in **Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD [2012] eKLR** where the learned judge held:

> **"The approach to this case is that stated in the oft cited case of *Cape Brandy Syndicate v Inland Revenue Commissioners* [1920] 1 KB 64 as applied in *T.M. Bell v Commissioner of Income Tax* [1960] EALR 224 where Roland J. stated, *" …in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing it to be implied. One can only look fairly at the language used… If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."* As this case concerns the interpretation of the *Income Tax Act,* I am also guided by the dictum of Lord Simonds in *Russell v Scott* [1948] 2 ALL ER 5 where he stated*, "My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him"* adopted in *Stanbic Bank Kenya Limited v Kenya Revenue Authority* CA Civil Appeal No. 77 of 2008 (Unreported) [2009] eKLR per Nyamu JA (See also *Jafferali Alibhai v Commissioner of Income Tax* [1961] EA 610*, Kanjee Naranjee v Income Tax Commissioner* [1964] EA 257). Any tax imposed on a subject is dictated by the terms of legislation and taxing authority must satisfy itself that the transaction fits within the definition of the statute. In *Adamson v Attorney General* (1933) AC 257 at p 275 it was held that*, "The section is one that imposes a tax upon the subject, and it is well settled that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used, and if there is any doubt or ambiguity this defect-if it be in view of the Crown a defect can only be remedied by legislation."***

62. As was held in **Vestey vs. Inland Revenue Commissioners [1979] 3 All ER at 984**:

> **"Taxes are imposed on subjects by parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined."**

63. In the same vein, it was held in **Russell (Inspector of Taxes) vs. Scott [1943] AC 422 at 433**:

> **"I must add that the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind I feel that the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected...my Lords, there is a maxim of income tax law, which though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose tax upon him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion."**

64. Similarly, in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others [2007] 2 KLR 240** it was held:

> **"taxation can only be done on clear words and cannot be on intendment. Linked to this is that a penalty must be imposed in clear words. Finally even where the inclination of the legislature is not clear or where there are two or more possible meanings, the inclination of the court should be against a construction or interpretation which imposes a burden, tax or duty on the subject...Nothing summarises the above position better than *Brooms Legal Maxims*: 'a remedial statute therefore shall be construed so as to include cases which are within the mischief which the statute was intended to remedy; whilst, on the other hand, where the intention of the Legislature is doubtful, the inclination of the court will always be against that construction which imposes a burden, tax or duty or the subject. It has been designated as "a great rule" in the construction of fiscal law, "that they are not to be extended by any laboured construction, but that you must adhere to the strict rule of interpretation; and if a person who is subjected to a duty in a particular character or answers that description, the duty no longer attaches upon him and cannot be levied. A penalty moreover must be imposed by clear words. The words of a statute shall be restrained for the benefit of him against whom the penalty is inflicted, and the language of the statute must be strictly looked at in order to see whether the person against whom the penalty is sought to be enforced has committed an offence to do with it.'…The principle remarked Lord Abinger "adopted by Lord Tenterden, that a penal law ought to be construed strictly is not only a sound one, but the only one consistent with our free institutions. The interpretation of statutes has always in modern times been highly favourable to the personal liberty of the subject and I hope will always remain so. This Court of course does appreciate the point made by the respondents' Counsel that if the meaning of the provisions of the relevant empowering taxation laws is clear the court has no business intervening. This principle is based on the high authority of *Bennun on Statutory Interpretation* at page 726, 727 as follows:- .....If the meaning of the provision is**

reasonably clear, the courts have no jurisdiction to mitigate such harshness. It is of course regarded as penal for a person to be taxed twice over in respect of the same matter." The significance of this quotation is that although the applicant did file monthly returns and keep daily production records, and the stockbook as required the tax imposed by the subsequent formula based on input and output purports to tax the company twice. This is also reflected in the inconsistent figures reflected by the three major audits. The taxman had come up with inconsistent figures for the same period due to its lapse in adhering to the law especially s 137 of the Act. I find that they cannot tax the applicant twice over *Bennion* adds:- 'Nevertheless taxation is clearly "penal" within this section of the Code, and must not be enforced by the courts unless clearly imposed. As Evans LJ said in the context of tax legislation it is necessary to consider the legal analysis with the utmost precision so that the taxpayer shall not become liable to tax unless this is clearly and unequivocally the object of the statutory provisions ... The Courts are reluctant to adopt a construction permitting a person's tax liability to be fixed by administrative discretion.'…

65. The Court added:

> **"This is how this court has regarded the assessment of tax on an arbitrary input-output formulae because it is not supported by any law nor is its retroactivity permitted by law…The same principles as above, were accepted and applied in the case of *Cape Brandy Syndicate vs. Inland Revenue Commissioners [1921] KB 64* where Ronlat J, restated the principle in these words: 'in a taxing Act clear words are necessary in order to tax the subject. Too wide and fanciful a construction is often to be given to that maxim, which does not mean that words are to be unduly restricted against the Crown or that there is to be any discrimination against the crown in those Acts. It simply means that in a taxing Act one has to look merely at what is clearly said. There is no reason for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly on the language used.'… Again, in the case of *Ramsay Ltd vs. Inland Revenue Commissioner [1992] AC 300* the same principles were expressed as follows:- 'A subject is only to be taxed on clear words not upon intendment, or upon the "equity" of an Act'. Any taxing Act of Parliament as to be construed in accordance with this principle. What are "clear words" is to be ascertained upon normal principles; these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole and its purpose may, indeed should be regarded ..." ..... A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect."**

66. From a consideration of the relevant authorities it is clear that whereas under the principles of interpretation of statutes, the general rule is that the Court should lean against the construction which reduces a statute to futility but lean in favour of an interpretation which makes it effective and operative, in tax legislation the Court ought not to strain the language with the intention of bringing taxpayers within an otherwise vague and ambiguous legislation. Where the legislation is vague or ambiguous the Courts ought to adopt an interpretation which best favours the taxpayer.

67. In this case the Respondent contends that the Capital Gains Tax (CGT) was re-introduced via the ***Finance Act, 2014*** at the rate of 5% effective from 1st January 2015. It was its case that the tax is not new since provisions for the tax exist in the ***Income Tax Act*** Cap 470, but its provisions were suspended by the Government in 1985 to enable the growth of the property market. This contention is not seriously disputed by the applicant. In other words what is being challenged by the applicant is not the statutory provision through which the Capital Gains Tax was introduced, but rather the administrative action announced in a notice published in the *Daily Nation* newspaper of 4th October, 2016 by which the respondent discontinued the manual payment of both Stamp Duty and Capital Gains Tax and required the simultaneous online payment of both Stamp Duty and Capital Gains Tax via the respondent's I-tax system which does not permit the payment of Stamp Duty on a transfer unless an acknowledgment number for the payment of Capital Gains Tax on that sale is entered into the I-tax system.

68. The basis upon which the Capital Gains Tax is being imposed on the chargees exercising their statutory power of sale seems to be paragraph 5(2) of the Eighth Schedule to the ***Income Tax Act*** which provides that:

> ***"Where a person entitled to property by way of security or to the benefit of a charge or encumbrance on property, deals with 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 security, charge or encumbrance ..... "*** [Emphasis provided].

69. It is this provision that seems to be the source of disagreement between the parties herein with the Respondent seemingly taking the position that a chargee, while exercising its statutory power of sale steps into the shoes of the chargor for the purposes of payment of Capital Gains Tax and must settle the same before a transfer is effected in favour of the purchaser. However the applicant takes the view that for the purposes of Capital Gains Tax the sale is deemed to be by the owner and the chargee is merely acting as nominee for the owner pursuant to the security or charge since nothing in the ***Income Tax Act*** imposes the tax on a chargee exercising the statutory power of sale.

70. The word "nominee" in so far as it is relevant to this case is defined by ***Black's Law Dictionary***, 9th Edition at page 1149 as:

> ***"A person designated to act in place of another, usu. In a very limited way; a person who holds bare title for the benefit of others or who receives and distributes funds for the benefit of others."***

71. It is therefore clear that a chargee in his capacity of a nominee pursuant to paragraph 5(2) of the Eighth Schedule to the ***Income Tax Act*** does not possess the absolute powers possessed the chargor, but as the paragraph expressly states "*subject to the security, charge or encumbrance"*. In other words the chargee's powers to step into the shoes of the chargor must be read within the context of the security, charge or encumbrance in question.

72. The fact that Capital Gains Tax is a species of income tax comes clearly from a reading of section 3(2)(f) of the ***Income Tax Act*** which provides that:

> ***"Subject to this Act, income upon which tax is chargeable under this Act is income in respect of - ..... (f) gains accruing in the circumstances prescribed in, and computed in accordance with the Eighth Schedule."***

73. However, section 3(1) of the ***Income Tax Act*** [Cap 470] provides as follows:

> ***"Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya."*** [Emphasis supplied].

74. Therefore it is clear that income tax is only charged upon the income of a person. However as held in **Vestey vs. Inland Revenue Commissioners** (supra), a before a person can be compelled to pay tax, his liability must be expressed in clear terms by a taxing Act and the amount of his liability must also be clearly defined.

75. It is however the applicant's case that since only the chargor has the information necessary for the calculation of any gain which may have been made, by requiring the simultaneous payment of both Stamp Duty and Capital Gains Tax before presentation of the instrument of transfer for registration, the respondent is infringing on the right to property of both the Bank as chargee and the purchaser and places the burden of paying the chargor's tax liability on either the Bank or the purchaser. Further, the respondent failed to take into account the fact that the bank is not the owner of the property and does not make a gain when exercising its power of sale under a charge. To determine this issue one needs to deal with the interest of chargor in a charged property. section 56 of the ***Land Registration Act, 2012***which at material parts state that:

> ***(1) A proprietor may by an instrument, in the prescribed form, charge any land or lease to secure the payment of an existing, future or contingent debt .....***
>
> ***(2) A date for repayment of the moneys secured by a charge may be specified in the charge instrument, and if no such date is specified or repayment is not demanded by the charge on the date specified, the money shall be deemed to be repayable three months after the service of a demand, a written, by the chargee. [there is clearly a printing error for "a demand in writing"]***
>
> ***(3) The charge shall be completed by its registration as an encumbrance and the registration of the person in whose favour it is created as its proprietor and by filing the instrument.***
>
> ***(4) A charge shall have effect as a security only and shall not operate as a transfer."***

76. Therefore a chargee's interest in a charged property is only to the extent of the sum due under a charge and not in the property. He does not acquire any proprietory right in the property as such. My view is fortified by the definition of "proprietor" in section 2 of the ***Land Registration Act*** and in section 2 of the ***Land Act, 2012*** as meaning:

> ***(a) in relation to land or a lease, the person named in the register as the proprietor; and***
>
> ***(b) in relation to a charge of land or a lease, the person named in the register of the land or lease as the person in whose favour the charge is made.***

77. In other words the proprietory rights of a chargee is limited to the interests conferred by the charged document. I therefore agree with the position of the applicant that the chargee is only the proprietor of the charge, not the land. This position in my view is supported by the provisions of section 98(3) and (4) of the ***Land Act*** which provides as hereunder:

> ***"(3) A transfer of the charged land by a chargee in exercise of the power of sale shall be made in the prescribed form and the Registrar shall accept it as sufficient evidence that the power has been duly exercised.***
>
> ***(4) 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 ...."***

78. I therefore agree that the scheme of the land legislation is to create security over land which the chargee may sell after complying with the various statutory obligations and that at no time does the chargee step into the shoes of the owner of the land or become the owner of the land.

79. However, for one to be obliged to pay Capital Gains Tax, it must be shown that the person has in fact made a gain in income arising from the disposal of the property. In other words the mere disposal of a property does not give rise to liability to pay the tax. That a loss arising from the disposal of property cannot give rise to liability to pay the tax is clear from the reading of section 15(3)(f) of the ***Income Tax Act*** which provides that:

> ***Without prejudice to subsection (1), in ascertaining the total income of a person for a year of income the following income shall be deducted:***

The amount of any loss realized in computing, in accordance with paragraph 5(2), of the Eighth Schedule, gains chargeable to tax under section 3(2)(f); but the amount of any such loss incurred in a year of income shall be deducted only from gains under section 3(2)(f) in that year of income and, in so far as it has not already been deducted, from gains in subsequent years of income.

80. In other words a loss made in the process of disposal of a property leads to a deduction of any income tax payable or due from a tax payer. It is therefore necessary before the tax is imposed that the taxing authority establishes that a gain has in fact been made. In other words the obligation to pay the tax only accrues after the conditions precedent necessary for it to arise have been satisfied. What then are these conditions? **Mativo, J** in **Law Society of Kenya vs. Kenya Revenue Authority & Another [2017] eKLR** expressed himself on the matter as follows:

"In my view, the interpretation offered by counsel for the petitioner on when transfer takes place is the correct legal interpretation. Counsel for the petitioner cited *Halsbury's Laws of England* which stipulates three prerequisites namely; *(a) The disposal of an asset;(b) The accrual from that disposal of a chargeable gain; and (c) The accrual of that gain to a person chargeable to Capital gains tax-*. These three are the requisite prerequisites for payment of Capital Gains Tax. These prerequisites in my view clearly answer the question when liability to pay Capital Gains Tax accrues… Also, as correctly pointed out by counsel for the petitioner, requiring payment of the tax before registration of the transfer essentially means the tax is payable before the prerequisites enunciated in Halsbury's laws of England cited earlier. The effect is that a citizen may be called to pay tax before it is legally due, thereby creating an unfair tax burden to the citizens. The term unfair burden must be defined taking specifically into account the degree and capacity of the citizens to shoulder the tax in question, bearing in mind what may be burdensome to one person may not be so to another."

81. It is therefore clear that before the tax can be imposed there must be a specific determination that the sum accruing from the exercise of the statutory power of sale is actually a chargeable gain. That is a determination that can only be made on a case to case basis and cannot be made to apply generally to all sales made in pursuance of the exercise of statutory power of sale. Therefore there cannot be an administrative fiat that Capital Gains Tax is payable at the same time as the payment of the stamp duty.

82. A "gain" is however dealt with in paragraph 4(1) of the Eighth Schedule which states that:

The gain which accrues to a person on the transfer of any property is the amount by which the transfer value of the property exceeds the adjusted cost of the property.

83. Therefore in order to determine whether or not there is a gain a determination will have to be made on the transfer value as well as the adjusted cost of the property which is defined in paragraph 8 of the Eighth Schedule as hereunder:

"The adjusted cost of property is:

(a) the amount of or value of the consideration for the acquisition or construction of the property;

(b) the amount of expenditure wholly and exclusively incurred on the property ..... for the purpose of enhancing or preserving the value of the property...;

(c) the amount of expenditure wholly and exclusively incurred .... by the transferor establishing, preserving or defending the title to or a right over, the property;

(d) the incidental costs to the transferor for acquiring the property.".

84. I agree with the applicant that these are not issues that may be within the knowledge of a chargee and that only the chargor has the necessary information for the calculation of any gain since there is no way a bank would know how much the chargor spent to acquire the land or to construct buildings or to enhance the value of the property or whether the chargor has spent money to establish, preserve or defend the title or right to the property.

85. *The Respondent however relied on* section 97(1) of the ***Land Act, 2012***, which states that:

A chargee who exercises a power to sell the charged land, including the exercise of the power to sell in pursuance of an order of a court, owes a duty of care to the chargor, any guarantor of the whole or any part of the sums advanced to the chargor, any chargee under a subsequent charge or under a lien to obtain the best price reasonably obtainable at the time of sale.

86. It is however clear that this provision does not necessarily constitute a chargee a trustee for a chargor in the exercise of the former's statutory power of sale. That was the position of the Court of Appeal in **Mbuthia vs. Jimba Credit Finance Corporation and Another [1986-1989] EA 340; [1988] KLR 1** where it was held that*:*

"a mortgagee is not a trustee of the mortgagor as regards the exercise of the power of sale. He has his own interest to consider as well as that of the mortgagor, and provided that he keeps within the terms of the power *bona fide* for the purpose of realizing the security and takes reasonable precautions to secure not the best price but a proper price, the Court will not interfere nor will it inquire whether he was actuated by any further motive… A mortgagee is entitled to sell at a price just sufficient to cover the amount due to him, provided the amount is fixed with regard to the value of the property. The only obligation incumbent on a mortgagee selling under a power of sale in his mortgage, is that he should act in good faith.

Whether selling under an express statutory power, he may generally conduct the sale in such manner as he may think most conducive to his own benefit, unless the deed contains any restrictions as to the mode of exercising the power, provided he acts *bona fide* and observes reasonable precautions to obtain, not the best price, but a proper price."

87. That was also the position in **James Ombere Ockotch vs. East African Building Society & 2 Others Civil Appeal No. 202 of 1996** *and* **Eccon Construction and Engineering Ltd vs. Giro Commercial Bank Ltd and Another [2003] 2 EA 426.**

88. The Respondent also relied on section 97(1) of the ***Land Act, 2012***, which states that:

A chargee shall, before exercising the right of sale, ensure that a forced sale valuation is undertaken by a valuer.

89. Whereas it is true that a chargee is required to undertake a valuation of a property before accepting the same as security and at the time of the sale thereof, it does not necessarily follow that if a property was valued at a particular sum, that is the sum that will eventually be realised upon sale. The valuation, in my view is meant to ensure that the chargee obtains the best price reasonably obtainable at the time of sale but does not necessarily mean that it is the real price of the property, in other circumstances.

90. Whereas I agree with the Respondent that to expect a chargor to pay Capital Gains Tax in respect of a transaction which he has no control is unreasonable, it is equally unreasonable to demand that a chargee pays Capital Gain Tax upfront notwithstanding whether the property is sold at a profit or a loss and without first making a determination, based on the relevant factors, whether there is in actual fact a capital gain or loss. In my view whereas the chargee is a nominee of the chargor for the purposes of payment of Capital Gains Tax where, after the sale of the property the same is found to be lawfully due and payable, such a decision must be determined on a case to case basis. Therefore it is irrational to direct that Capital Gains Tax must be paid in respect of all transactions entered into pursuant to the chargee's exercise of its statutory power of sale before such a sale can be completed. In other words the chargee is only a trustee for the chargor in respect of the surplus arising from the sale in which event the same may be defrayed towards the payment of any taxes due including the Capital Gains Tax.

91. This is my understanding of the holding in **Mbuthia vs. Jimba Credit Finance Corporation and Another [1986-1989] EA 340; [1988] KLR 1** *where it was held that:*

***"a* sale destroys the equity of redemption in the mortgaged property, and constitutes the mortgagee exercising the power of sale a trustee of the surplus proceeds of sale, if any, for the persons interested according to priorities."**

92. In other words the chargee only becomes a trustee of the chargor in respect of the surplus realised from the sale of the charged property, if any. In that event he is obliged to remit to the tax authority any sum determined as payable in respect of the Capital Gains Tax. The distinction between situations where a proprietor sells land to another person directly and where the land is sold pursuant to the exercise of statutory power of sale is clear from a reading of paragraph 6 of the **Eighth Schedule** which provides that:

(1) Subject to this Schedule there is a transfer of property for the purposes of this Schedule - (a) where property is sold, exchanged, conveyed or otherwise disposed of in any manner whatsoever (including by way of gift), whether or not for consideration; .....

(2) There is no transfer of property for the purpose of this Schedule - (a) in the case of the transfer of property for the purpose only of securing a debt or a loan, or on any transfer by a creditor for the purpose only of returning property used as security for a debt or loan ...."

93. The Respondent's position was that it would therefore be unlawful if the law were to be suspended or the court was to direct the Respondent to allow payment of stamp duty without payment of CGT on sale of land by chargee as prayed by the Applicant as there will be substantial loss to the Government in terms of tax revenue, if the orders prayed for by the Applicant are granted. In this case, the applicant is not seeking any change in the law imposing the payment of Capital Gains Tax. What the applicant is challenging is the administrative action taken by the respondent in firstly requiring the payment of Stamp Duty through I-tax and secondly in setting up I-tax in such a way that Stamp Duty cannot be paid without an acknowledgment number for payment of Capital Gains Tax.

94. Whereas it is true that Article 209 of the Constitution gives the National Government power to impose income taxes and that as long as such imposition is in accordance with Article 210 of the Constitution, it is proper, the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him and that the legal provision being invoked is one that imposes a tax upon the subject. It is therefore incumbent on the tax authority to establish that its claim comes within the very words used, and if there is any doubt or ambiguity this defect, if it is indeed one, can only be remedied by legislation. The Tax Authority cannot in those circumstances purport to remedy the defect by way of administrative or policy decision since imposition of tax must be by an express provision in a legislation.

95. It was contended that should this Court be inclined to grant the orders sought by the Applicant herein will result to substantial loss of revenue to the Government. To the Respondent, this will offend both the provisions of Article 201 of the Constitution as well as the provisions of paragraph 6(1)(a) of the Eighth Schedule of the ***Income Tax Act***. Whereas the Court appreciates the need to collect taxes, in carrying out their statutory obligations the Respondents must adhere to the law. As was held in **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others** (supra):

"It is no good answer for the taxman to proclaim that Kshs 1 billion (appx) is intended to swell the public treasury because due to the application of the above principles that money is not lawfully due… Applying the same reasoning, to the matter before this court, it does not matter that the respondents say and think they are owed over a billion Kenya shillings - what matters is whether the amount is lawfully due and whether the law allows its recovery? It is not a question of impression or perception of what is owed, instead it is what if anything, is owed under the relevant law and whether its assessment and

recovery is permitted by the applicable law. If rightly due, the huge amount notwithstanding the court must uphold the right of recovery regardless of its consequence to the applicant and if not due under the law it must not hesitate to disallow it and must disallow it to among other things to uphold both the law the integrity of the rule of law."

96. Whereas the obligation to pay taxes is a statutory obligation and the failure to collect the tax by way of withholding and remitting taxes in my view ought not to be lightly excused, the court must, not without a little anguish, find that where the decision by the Respondent is unjustified under the law such a decision ought not to be allowed to stand and the same must be quashed. As was held in **Inland Revenue Commissioners vs. Wolfson [1949] 1 All ER 864 at 868**:

"It was argued that the construction that I favour leaves an easy loophole through which the evasive tax payer may find escape. That may be so, but I will repeat what has been said before. It is not the function of a court of law to give words a strained and unnatural meaning because only thus will a taxing section apply to a transaction which had the legislature thought of it, would have been covered by appropriate words. It is the duty of the Court to give to the words of this subsection their reasonable meaning, and I must decline on any ground of policy to give them a meaning which with all respect to the dissentient Lord Justice I regard as little short of extravagance."

97. In **Republic vs. Kenya Revenue Authority Ex-parte Bata Shoe Company (Kenya) Limited [2014] eKLR**, the Court expressed itself as hereunder:

"**This brings me to the role and interpretation of tax laws. Payment of tax is an obligation imposed by the law. It is not a voluntary activity. That being the case, a taxpayer is not obliged to pay a single coin more than is due to the taxman. The taxman on the other hand is entitled to collect up to the last coin that is due from a taxpayer**."

98. This is the position adopted even in other jurisdictions as was held in **R vs. Inland Revenue Commissioners exp National Federation of Self Employed and Small Business Limited [1981] UKHL 2** at page 22 here the Court was:

"…persuaded that the modern case law recognises a legal duty owed by the Revenue to the general body of the taxpayers to treat taxpayers fairly; to use their discretionary powers so that, subject to the requirements of good management, discrimination between one group of taxpayers and another does not arise; to ensure that there are no favourites and no sacrificial victims. The duty has to be considered as one of several arising within complex comprised in the management of tax, every part of which it is their duty, if they can, to collect."

99. In **Samura Engineering Limited and & Others vs. Kenya Revenue Authority HC Petition No. 54 of 2011 [2012] eKLR** where **Majanja, J** in paragraph 58 emphasised that:

"…Kenya Revenue Authority as the State agency charged with the collection of taxes is bound by the provisions of the Bill of Rights to the fullest extent in the manner in which it administers the laws concerning the collection of taxes. The values contained in Article 10 must all times permeate its functions and activities which it is mandated to carry out of by statute."

100. According to Article 47 of the Constitution:

(1) Every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.

(2) If a right or fundamental freedom of a person has been or is likely to be adversely affected by administrative action, the person has the right to be given written reasons for the action.

101. The position is re-enacted in section 4(1) and (2) of the ***Fair Administrative Action Act, 2015***.

102. In **Judicial Service Comission vs. Mbalu Mutava [2015] eKLR at para 23 Githinji, JA** it was held that:

"Article 47(1) marks an important and transformative development of administrative justice for, it not only lays a constitutional foundation for control of the powers of state organs and other administrative bodies, but also entrenches the right to fair administrative action in the Bill of Rights. The right to fair administrative action is a reflection of some of the national values in article 10 such as the rule of law, human dignity, social justice, good governance, transparency and accountability. The administrative actions of public officers, state organs and other administrative bodies are now subjected by article 47(1) to the principle of constitutionality rather than to the doctrine of *ultra vires* from which administrative law under the common law was developed."

103. **Majanja, J** on his part in **Dry Associates Ltd vs. Capital Markets Authority and Another – Petition No. 328 of 2011,** held that:

"Article 47 is intended to subject administrative processes to constitutional discipline hence relief for administrative grievances is nolonger left to the realm of common law…but is to be measured against the standards established by the Constitution."

104. In this case, the implementation of the impugned administrative decision amounts to imposition of tax upon the applicant's members in situations where they may well not be obliged to pay the same. That is clearly unlawful. The said decision is further being taken without the applicants' members being afforded an opportunity of being heard as to whether in the exercise of their statutory power of sale they in fact

made capital gains. That is clearly procedurally unfair.

105. I therefore find that this application is merited.

Order

106. Consequently, I grant the following orders:

> **a) A declaration that the administrative action by the respondent requiring simultaneous payment of Stamp Duty and Capital Gains Tax on sale of land by a chargee pursuant to a chargee's power of sale is unreasonable, unfair and influenced by an error of law.**
>
> **b) A declaration that the administrative action by the respondent requiring payment of Capital Gains Tax by the chargee or purchaser on the sale of land by a chargee pursuant to a chargee's power of sale without first ascertaining whether there is in fact capital gain is unreasonable, unfair and influenced by an error of law.**
>
> **c) A declaration that on the sale of land by a chargee pursuant to a chargee's statutory power of sale, Capital Gains Tax is payable upon registration of the transfer by the chargor of the land pursuant to paragraph 5(2) of the Eighth Schedule of the Income Tax Act and not by the chargee or purchaser, unless there is a surplus from the proceeds of sale as to constitute the charge a trustee for the chargor.**
>
> **d) An order of mandamus compelling the respondent to allow payment of Stamp Duty on an instrument of transfer following the sale of land by a chargee pursuant to a chargee's power of sale, without requiring payment of Capital Gains Tax or an acknowledgment number for payment of Capital Gains Tax.**

107. As regards costs, the Motion was not properly intituled. In judicial review applications, the applicant is always the Republic rather than the person aggrieved by the decision sought to be impugned. See **Farmers Bus Service & Others vs. Transport Licensing Appeal Tribunal [1959] EA 779.**

108. The rationale for this was given in **Mohamed Ahmed vs. R [1957] EA 523** where it was held:

> **"This recital reveals a series of muddles and errors which is not unique in Uganda and is attributable to laxity in practitioners' offices and in some registries of the High Court. The appellant's advocate appears to have failed entirely to realise that prerogative orders, like the old prerogative writs, are issued in the name of the crown at the instance of the applicant and are directed to the person or persons who are to comply therewith. Applications for such orders must be intituled and served accordingly. The Crown cannot be both applicant and respondent in the same matter".**

109. In **Jotham Mulati Welamondi vs. The Electoral Commission of Kenya Bungoma H.C. Misc. Appl. No. 81 of 2002 [2002] 1 KLR 486 Ringera, J** (as he then was) expressed himself as follows:

> **"Prerogative orders are issued in the name of the crown and applications for such orders must be correctly intituled and accordingly, the orders of *Certiorari*, *Mandamus* or Prohibition are issued in the name of the Republic and applications therefore are made in the name of the Republic at the instance of the person affected by the action or omission in issue and the proper format of the substantive motion for *Mandamus* is: -**
>
> **"REPUBLIC……..…..……. APPLICANT**
>
> **V**
>
> **THE ELECTORAL COMMISSION OF KENYA….RESPONDENT**
>
> **EX PARTE**
>
> **JOTHAM MULATI WELAMONDI"**

110. In the premises there will be no order as to costs.

111. It is so ordered.

Dated at Nairobi this 13th day of March, 2018

G V ODUNGA

JUDGE

Delivered in the presence of:

Mr Fraser, SC for the ex parte applicant

Mr Manoti for Mr Ontweka for the Respondent

CA Ooko