



**REPUBLIC OF KENYA**  
**IN THE HIGH COURT OF KENYA**  
**AT NAIROBI**  
**CONSTITUTIONAL AND HUMAN RIGHTS DIVISION**  
**PETITION NO.589 OF 2013**

**BETWEEN**

**PHARMACEUTICAL MANUFACTURING (K) CO LTD.....1ST PETITIONER**

**KUMAR SHAH.....2ND PETITIONER**

**UTAMCHAND G. SHAH.....3RD PETITIONER**

**CHRISTINE D' SOUZA.....4TH PETITIONER**

**AND**

**THE COMMISSIONER GENERAL OF THE KENYA REVENUE AUTHORITY...1ST  
RESPONDENT**

**THE ATTORNEY GENERAL.....2ND RESPONDENT**

**THE COMMISSIONER OF CUSTOMS SERVICES.....3RD RESPONDENT**

**JUDGMENT**

**Introduction**

1. The 1<sup>st</sup> Petitioner is a Pharmaceutical manufacturing company incorporated under the **Companies Act (Chapter 486 Laws of Kenya)**. It owns a factory in Industrial Area Nairobi on LR No.209/6371 and manufactures medicine for sale within the Republics of Kenya, Tanzania and Uganda and allegedly supplies 28% of the medicine consumed in Kenya every year. It also has about 30 pharmaceutical plants in Kenya and about 6 to 8 plants in Uganda and Tanzania, respectively.

2. The 2<sup>nd</sup> Petitioner is a shareholder and the Managing Director of the 1<sup>st</sup> Petitioner while the 3<sup>rd</sup> Petitioner is a Director of the 1<sup>st</sup> Petitioner and the 4<sup>th</sup> Petitioner is the Administrative Manager of the 1<sup>st</sup> Petitioner.

3. The Petitioners have filed this Petition claiming *inter alia* that the 1<sup>st</sup> and 2<sup>nd</sup> Schedules referred to in **Sections 2 and 7(2) of the Value Added Tax (VAT) Act, 2013** were enacted in contravention of the guiding principles in **Article 201 of the Constitution** and further that **Section 7(2) of the VAT Act 2013**

is null and void to the extent that it imposes on the 1<sup>st</sup> Petitioner import VAT on raw and packaging materials imported for the purpose of manufacturing medicine in Kenya and that in any event, the 1<sup>st</sup> Petitioner ought to be exempted from payment of import VAT on imported medicine. They thus contend a violation of their right to equal protection and equal benefits of the law within the meaning of **Article 27(1)** of the **Constitution** and the right to non-discrimination within the meaning of **Article 27(4)** thereof, a violation of the 1<sup>st</sup> Petitioner's rights not to be deprived of property taking the form of import VAT exemptions under **Article 40** of the **Constitution** and the 2<sup>nd</sup> to 4<sup>th</sup> Petitioners' violation of their right to health to the highest attainable standard.

4. They therefore seek the following orders in their Amended Petition dated 7th January 2014;

**“Against the Attorney-General wrongly described as 1<sup>st</sup> Respondent**

*(a) A declaration that customs duty and import VAT exemptions granted to a pharmaceutical/medicine manufacturer in Kenya who acquired a factory or makes any other investment in that industry on the basis of the assurance by the State that the exemptions will always be forthcoming are property within the meaning of Article 40(1) of the Constitution.*

*(b) A declaration that a pharmaceutical/medicine manufacturer in Kenya who acquires a factory or makes any other investment in that industry on the basis of the assurance by the State that the exemptions will always be forthcoming has a right under Article 19 (3) of the Constitution not to have that property destroyed by ex post facto legislation like the Value added Tax Act, 2013.*

*(c) A declaration that the 1st and Second Schedules referred to in Sections 2 and 7(2) of the Value Added Tax Act, 2013 were enacted in contravention of the guiding principles in Article 201 of the Constitution mandating that the Country's public finance system promotes an equitable society, ensures that the burden of taxation is shared fairly and also that the financial management shall be responsible and consequently that the said second schedule referred to in Section 7(2) of the Value Added Tax Act, 2013 is null and void to the extent that it imposes on the 1st Petitioner import VAT on raw and packaging materials imported for the purposes of manufacturing medicine in the Republic of Kenya and exempts from payment of import VAT on imported medicine.*

*d. A declaration that the 1st Respondent has contravened the 1st Petitioner's right to equal protection and equal benefit of law within the meaning of Article 27(1) of the Constitution, and discriminated against it within the meaning of Article 27(4) of the Constitution purely for being a local pharmaceutical manufacturer, by permitting, vide the 1st and Second schedules in Sections 2 and 7(2) of the VAT Act, 2013, foreign manufacturers of medicine to sell their medicines in the Kenya market without paying import VAT whilst requiring the 1st petitioner, a local pharmaceutical manufacturer, to pay import VAT on imported raw and packaging materials used by the 1st Petitioner to manufacture the medicines which it sells in Kenya and neighbouring countries.*

*e. A declaration that the 1<sup>st</sup> Respondent has contravened the 1<sup>st</sup> Petitioner's right under Article 40 of the Constitution not to be deprived of property taking the form of import VAT exemption, not to be arbitrarily deprived of its property by imposition vide Section 7(2) of the VAT Act, 2013 of import VAT on the raw and packaging materials used in manufacturing medicine in Kenya thereby rendering the 1<sup>st</sup> Petitioner's investment worth Kshs.800 Million on L.R No.209/6371 idle to the extent of 60% production capacity as from 1<sup>st</sup> September, 2013.*

*f. A declaration that the 1<sup>st</sup> Respondent has, through the institution of the Parliament of Kenya which enacted the Second Schedule described in Section 7(2) of the VAT Act, 2013, contravened the 1<sup>st</sup> Petitioner right under Article 40(2) of the Constitution not to have made a law, like the said Second Schedule described in Section 7(2) of VAT Act, 2013, which restricts the enjoyment*

of the 1<sup>st</sup> Petitioner's property rights over LR. No.209/6371 by rendering the same idle as it is after 1<sup>st</sup> September 2013, financially ruinous to manufacture medicine in Kenya.

*g. A declaration that the purported denial of the 1<sup>st</sup> Petitioner, a pharmaceutical manufacturer of exemption from payment of import VAT on raw and packaging materials by Section 7(2) of the VAT Act, 2013 is the State deprivation of such pharmaceutical manufacturers of financial incentives necessary for the Country's security in medicine supply and abolition/reversal of the policy of import substitution in the Country's pharmaceutical industry.*

*h. A declaration that the purported deprivation, through the Second Schedule described in Section 7(2) of the VAT Act, 2013 of financial incentives to the 1<sup>st</sup> Petitioner and other manufacturers of medicine in Kenya is arbitrary, unfair defeats legitimate expectations created in the investors in that industry since 1960's, and is a contravention of the 1<sup>st</sup> Petitioner's right under Article 47 of the Constitution to an administrative action that is lawful, reasonable and procedurally fair and is null and void.*

*i. A declaration that the Second Schedule described in Section 7(2) of the VAT Act, 2013 is void to the extent that it denies the 1<sup>st</sup> Petitioner exemption from payment of import VAT on raw and packaging materials imported after 1<sup>st</sup> September, 2013.*

*j. A declaration that through the enactment of the Second Schedule described in Section 7(2) of the VAT Act, 2013 the 1<sup>st</sup> Respondent has contravened the rights of the 2<sup>nd</sup> to 4<sup>th</sup> Petitioners to the highest attainable standard of health care, services and affordable medicines in that the costs of medicines have been increased arbitrarily and unreasonable.*

*k. A declaration that the 1<sup>st</sup> Petitioner enjoys and is, under Second Schedule described in Section 7(2) of the VAT Act, 2013 entitled to exemption from payment of import VAT on raw and packaging materials imported for the manufacture in Kenya of medicines.*

- A declaration that between 1<sup>st</sup> January, 2008 and 31<sup>st</sup> August, 2013, the 1<sup>st</sup> Petitioner's importation of raw and packaging materials for manufacturer in Kenya of medicine was governed by Section 8(2) of the Repealed Vat Act Chapter 476 of the laws of Kenya and the 1<sup>st</sup> Petitioner enjoyed exemption from payment of the said import VAT.*

*m. An order that the Respondents do refund forthwith to the 1<sup>st</sup> Petitioner all the import VAT paid on raw and packaging materials imported as from 1<sup>st</sup> September, 2013 for manufacture of medicine in Kenya.*

*General Damages.*

**Against the 1<sup>st</sup> Respondent wrongly described as the 2<sup>nd</sup> Respondent and 3<sup>rd</sup> Respondents**

*o. A declaration that the 3<sup>rd</sup> Respondent's demand of 28<sup>th</sup> November, 2013 that the 1<sup>st</sup> payment pays it Kshs.121,660,538/- as import VAT or the period between 1<sup>st</sup> January, 2008 and 21<sup>st</sup> November, 2013 is a contravention of the 1<sup>st</sup> Petitioner's right under Article 47 of the Constitution to an administration action which lawful, reasonable and procedurally fair and is illegal null and void.*

*p. A declaration that between 1<sup>st</sup> January, 2008 and 21<sup>st</sup> November, 2013, the 1<sup>st</sup> Petitioner enjoyed under Section 8(2) of the Repealed VAT Act, Chapter 476 of the Laws of Kenya exemption from payment of import VAT on raw and packaging materials imported by it for manufacture of medicine.*

*q. As an alternative to (p) above a declaration that between 1<sup>st</sup> January 2008 and 21<sup>st</sup> November, 2013, the 1<sup>st</sup> Petitioner enjoyed under paragraph 26 of Part B of the Fifth Schedule made under Section 114(2) of the East African Community Customs Management Act, 2004 Kenya exemption from payment of import VAT on raw and packaging materials imported by it for manufacture of medicine.*

*r. An order of certiorari do issue to remove from the 3<sup>rd</sup> Respondent and bring to the High Court for quashing the demand dated 28<sup>th</sup> November, 2013 that 1<sup>st</sup> Petitioner pays to the 3<sup>rd</sup> Respondent Kshs.122,660,538/-within 30 days.*

*s. (i) An order of prohibition do issue restraining the 1<sup>st</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> Respondents from acting on the demand that the 1<sup>st</sup> Petitioner pays Kshs.121,660,538/-*

*(s)(ii)An order of prohibition do issue restraining the 1<sup>st</sup> and 3<sup>rd</sup> Respondents from claiming from the 1<sup>st</sup> Petitioner Kshs.212,660,538/- or any other sum by way of purported Import VAT for the period between January, 2008 and November, 2013.*

#### Against the 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> Respondents

*(t)(i)An order of mandamus do issue compelling the 1<sup>st</sup> and 3<sup>rd</sup> Respondent's to process in future the 1<sup>st</sup> Petitioner's import documents and release to the 1<sup>st</sup> Petitioner the imports to it under exemption code 'B0260'';*

*(t)(ii)An order that the Respondents do refund forthwith to the 1<sup>st</sup> Petitioner all the import VAT paid after 1<sup>st</sup> September, 2013 together with interests as compound rates;*

*(u)(t) General and Exemplary Damages.*

*(v)(u) Costs of the suit.”*

#### The Petitioners' Case

5. The Petitioners' case is contained in the Amended Petition dated 7<sup>th</sup> January 2014, the Affidavit in support thereof sworn by Christine D' Souza on 16<sup>th</sup> December 2013, the 4<sup>th</sup> Petitioner's Supplementary Affidavit sworn on 10<sup>th</sup> March 2014 and the written Submissions dated 24<sup>th</sup> March 2014.

6. The 1<sup>st</sup> Petitioner, it is claimed, has for many years been recognized as one of the Country's leading manufacturers of pharmaceutical medicine and as such it claimed that it is entitled to exemption from payment of import VAT. It alleged in that regard that between 1988 and August 2013, **Section 8(2) of the VAT Act, (Chapter 476 of the Laws of Kenya)** and the Schedules therein, exempted it from payment of import VAT on raw and packaging materials imported in connection with the manufacture of medicine in Kenya. However, in 2013, the 1<sup>st</sup> Respondent enacted **Section 7 of the VAT Act of 2013**, which Section repealed the provisions of the **VAT Act** on exemption of payments of import the raw materials for and packaging materials. It claimed therefore that it had enjoyed the said customs duty and import VAT exemptions since the same constituted a right to property within the meaning of **Article 40(1) of the Constitution** and accordingly the State cannot take any of the said exemptions without paying to the investor compensation for the loss suffered by deprivation of the same. They relied on the case of **Keroche Industries Ltd v Commissioner General Kenya Revenue Authority and Others in (2007) 2 KLR 240** in support of that proposition.

7. The Petitioners further contended that as a result of the purported removal of the import VAT on raw and packaging materials, the 1<sup>st</sup> Petitioner had since 1<sup>st</sup> September, 2013 paid to the 3<sup>rd</sup> Respondent between Kshs.700,000 and Kshs.1,000,000.00 as purported import VAT. Consequently, it has been

compelled to increase the prices of its medicines by 20% and its products are for that reason becoming less competitive in the Kenyan Market. It also claimed that its production capacity which used to be 100% has now been reduced to 40% and its monthly sales have also reduced. It is now apprehensive that unless the exemption from payment of import VAT is restored, its operations will be rendered useless by mid-2014.

8. It was the Petitioner's further position that the VAT Act of 2013 was passed in contravention of the guiding principles set out under **Article 201** of the **Constitution**, which mandates that the public finance system should promote an equitable society and ensure that the burden of taxation is shared fairly and also that the financial management system should be responsible. They also took issue with the fact that the VAT Act exempts foreign manufacturers of medicine from payment of import VAT whilst it requires local manufacturers to pay import duty on raw and packaging materials.

9. The Petitioners in that regard contended that **Article 27** of the **Constitution** guarantees every person enjoyment of the right to equal protection and equal benefit of the law and thus forbids discrimination on any ground, either directly or indirectly. They claimed further that **Section 7(2)** of the **VAT Act 2013** allows discrimination because it exempts from payment of import VAT, imported materials which do not include raw and packaging materials imported by the 1<sup>st</sup> Petitioner as a local manufacturer of medicine for sale in Kenya and in the neighbouring Countries but the 1<sup>st</sup> Schedule which is made under **Section 2** of the **VAT** grants import VAT exemptions for medicines manufactured outside Kenya. The Petitioners thus contended that the Second Schedule referred to in **Section 7(2)** of the **VAT Act 2013** is unconstitutional, null and void to the extent that it purports to deny the 1st Petitioner exemption from payment of import duty.

10. They further claimed that by excluding the raw and packaging materials used in manufacturing of medicine in Kenya from VAT by local pharmaceutical companies, the 1<sup>st</sup> Respondent is undermining the health security of Kenyans in that citizens will rely on medicines manufactured in foreign countries which may not necessarily be safe.

11. It was the Petitioners' further claim that the 1<sup>st</sup> Petitioner's rights under **Article 47** of the **Constitution** had been violated in that **Article 47** includes the right not to have the financial incentives granted to them removed and to justify their investing their money in the pharmaceutical industry. They relied on the case of ***Geothermal Development Co Ltd v Attorney General and 3 Others (2013) eKLR*** in that regard and they also claimed that the Government, in the promotion of its policies of import substitution in the medicine manufacturing sector, has created an expectation that investors in the sector will always be exempted from payment of customs duty and import VAT and to remove that exemption abruptly is unfair and unlawful.

12. The Petitioners further averred that in the 1960s, the Government introduced free medical care in Government hospitals and has over the years promoted that policy by exempting raw and packaging materials used in manufacturing of medicine in Kenya from customs duty and import VAT. That the said policy is also promoted by **Article 43** of the **Constitution** which guarantees every person the right to the highest standard of health which includes the right to the best health care service including affordable medicine and that the 2<sup>nd</sup> – 4<sup>th</sup> Petitioners as individuals also have a right to the same standards of health. They contended in that regard therefore that the removal of exemption of import VAT from the **Second Schedule** described in **Section 7(2)** of the **VAT Act, 2013** is a contravention of their collective right to good health under **Article 43** of the **Constitution**.

13. The Petitioners also claimed that the 3<sup>rd</sup> Respondent had demanded a sum of Kshs.122,660,538/- as purported Import VAT for the period 1<sup>st</sup> January 2008 to 21<sup>st</sup> November 2013 and it was their case that because of the prior provisions of the **VAT Act, Cap 476**, the alleged import VAT was not payable for that period or at all.

14. On the argument by the 1<sup>st</sup> and 3<sup>rd</sup> Respondents that payment of import VAT was payable under the **East African Community Customs Management Act**, the Petitioners claimed that **Section 114(2)** of

the **East African Community Custom Management Act** provides that duty was not payable on goods listed in Part B of the Fifth Schedule of that Act when imported in accordance with any condition attached thereto as set out in that Part. That in addition, the Council may by notice amend the Fifth Schedule and there was an exemption granted *vide* the Fifth Schedule at Paragraph 26 for exemption for import VAT which in 2004 was conditional on a recommendation for exemption being made by an authority responsible for medicaments made under subsidiary legislation. They therefore claimed that the 1<sup>st</sup> Petitioner continued and should continue enjoying exemption under the **VAT Act Cap 476** in spite of the provisions of the **EAC Customs Management Act**. They relied on the case of *Kenya Bankers Association v Minister of Finance (2002) KLR 61* where the retrospective application of a Statute was dealt with.

15. In any event, it was the Petitioners' further contention that until it was repealed by **Section 68(1)** of the **VAT Act 2013**, the **VAT Act Cap 476** was the law in force and administered by the 3<sup>rd</sup> Respondent at all material times and that under the **Repealed VAT Act**, the 3<sup>rd</sup> Respondent had between January 2008 and August 2013 considered and granted the 1<sup>st</sup> Petitioner exemption from payment of import VAT in respect of its imported raw and packaging materials made under **Section 8(2)** of the **VAT Act Cap 476**, and that during this period, the **East African Community Customs Management Act, 2004** also applied. The Petitioners therefore contended that the demand made dated 28<sup>th</sup> November 2013 is null and void.

16. The Petitioners also claimed that they should be able to plan their lives securely in the knowledge of legal consequences of their actions and this precept is violated by application of measures which were not in force at the time the actual events took place. That if the demand for taxes on raw and packaging materials was governed by the **East African Community Customs Management Act, 2004**, then the Respondents are estopped from denying the 1<sup>st</sup> Petitioner enjoyment of the exemption from payment of import VAT on all raw and packaging materials imported by the 1<sup>st</sup> Petitioner between January 2008 and August 2013. They therefore claimed that the demand of Kshs.122,660,538/- is neither lawful, reasonable nor procedurally fair and further that, the said demand offends the Petitioners' legitimate expectation created that it would carry on its business on the basis that it was exempted from payment of import VAT. For the above reasons, the Petitioner seek the orders elsewhere set out above.

### **The 1st and 3rd Respondents' Case**

17. The 1<sup>st</sup> Respondent, the Commissioner General, Kenya Revenue Authority, is the officer responsible for the administration of revenue laws in Kenya under **Section 3** of the **Kenya Revenue Authority Act**. The 3<sup>rd</sup> Respondent, the Commissioner of Customs Excise in the Kenya Revenue Authority is the collector of VAT and administrator of the **VAT Act, 2013** and was also the administrator of the **Repealed VAT Act, Cap 476 Laws of Kenya**.

18. The 1<sup>st</sup> and 3<sup>rd</sup> Respondents jointly opposed the Petition and they filed a Replying Affidavit sworn by Martin K'Otieno, a Senior Revenue Officer in the Customs Services Department of the 3<sup>rd</sup> Respondent on 30<sup>th</sup> December 2013, an Affidavit sworn on 21<sup>st</sup> February 2014 by Grace Okuku, a Revenue Officer in the 3<sup>rd</sup> Respondent and they also filed joint written Submissions dated 19<sup>th</sup> March 2014.

19. In their Affidavits, Martin K'Otieno and Grace Okuku explained that the dispute leading to this Petition was precipitated by a post clearance audit carried out on the import operations of the 1<sup>st</sup> Petitioner for the period between January 2008 and November 2013 under the **VAT Act, Cap 476** which was repealed on 2<sup>nd</sup> September 2013 and the audit was restricted to a five year period in compliance with the provisions of **Regulation 7(6)** of the **VAT Regulations, 1994** and **Section 135(3)** of the **VAT Act**.

20. It was the 1<sup>st</sup> and 3<sup>rd</sup> Respondents' case in that regard that VAT on imported goods was collected under **Section 9(1)(c)** of the **VAT Act, Cap 476** and VAT on imported supplies was collected under **Section 6(5)** of the **East African Community Customs Management Act**, and before then under the **Customs and Excise Act Cap 472, Laws of Kenya**. That VAT on imports is collected by the 3<sup>rd</sup>

Respondent at the port of importation together with duty of customs as if it were a duty of customs.

21. They claimed that under **Section 57** of the **VAT Act, Cap 476**, imported goods were liable to VAT, whether those goods were liable to any duty of customs or not and as if all such goods were liable to duties of customs and as if those duties included tax. That the determination of the value to which VAT was to be charged upon imported goods was ascertained as provided for under **Section 9(1) (c) and (d)** of the **VAT Act, Cap 476**. They therefore claimed that the demanded tax of Kshs.43,579,769/- from the 1st Petitioner was raised under the provisions of the **Repealed VAT Act, Cap 476** and the **East African Community Customs Management Act of 2004** for the period between January 2008 to November 2013. It was their further submission that the **Repealed VAT Act** was also saved by the provisions of **Section 68(1)** of the **VAT Act, 2013** which states that the provisions of the **VAT Act, Cap 476** shall remain in force for the purpose of the assessment and collection of any tax and the recovery of any penalty, payable under the Act outstanding at the date upon which the repeal became effective. They stated in that regard therefore that the tax being demanded became payable between 2008 and August 2013 when the Repealed Act was still in force and the claim was therefore saved and secured by the aforesaid provisions.

22. It was their further position that VAT on imported goods is generally collected under the Customs law as a percentage of the duty of customs, but the Customs officer is the accounting officer for the same since he is the one conversant with customs procedures and processes and who also does the post clearance audit.

23. The 1st and 3rd Respondents therefore in that regard and contrary to the Petitioners' claim that the demanded tax arrears of Kshs.43,579,769/- demanded by the 1st Petitioner, are not founded on the **VAT Act of 2013**. That during the post clearance audit, it was established that the 1st Petitioner in the period 2001 to 2013 when importing its raw materials and packaging materials for the manufacture of medicaments, had been declaring the same as exempt from VAT while the same should have attracted VAT at the rate of 16%. Consequently the VAT arrears aforesaid was demanded in compliance with **Regulation 7(6)** of the **VAT Regulations, 1994** and was therefore a lawful demand.

24. It was also their case that the Petitioners failed to apply for a review of the assessment of tax payable in accordance with **Section 229** of the **East African Customs Management Act of 2004** after the 3rd Respondent's demand for tax arrears was sent to them and added that the Petitioners cannot now claim a failure of observance of procedural fairness by the 1<sup>st</sup> Respondent given their own failure to interrogate the demand made.

25. As for the argument that the demand for taxes was not preceded by a notice of assessment, the 1st and 3rd Respondent contended that import VAT is declared at the port of entry and in which import duty of customs is self-declared by the importer or its clearing agent at the time of importation. That there is therefore no provision in law for an assessment of import VAT at entry and a letter of demand outlining how the import VAT arrears were arrived at, is sufficient notice.

26. It was also the 1st and 3rd Petitioners' submissions, that raw and packaging materials for manufacture of medicaments have never been exempt from import VAT, whether under the Repealed VAT Act or the VAT Act, 2013. That raw and packaging materials for manufacture of medicaments attracted import VAT at zero-rate (0%) between 1995 and 2000 but that incentive was removed vide the **Finance Act No. 6 of 31st December 2001** which amended the **Eighth Schedule** to the **Repealed VAT Act, Cap 476** by deleting Part B item 22 hence making "*raw materials for manufacture of medicaments*" subject to VAT before clearance through customs effective 15th June 2001. And from 15th June 2001 to the time the VAT Act, Cap 476 was repealed in September 2013, VAT on imported raw and packaging materials for the manufacture of medicaments was attracting VAT at the standard rate of 16% or any other standard rate which was applicable.

27. The 1st and 3rd Respondents contended that there was a difference between exemption from VAT and VAT at 0% and that during the period under review (2008 to 2013), the raw and packaging materials for manufacture of medicaments were not exempt from VAT neither were they zero rated. That such, the

Petitioners cannot benefit from the doctrine of estoppel and that even if the doctrine of estoppel were to apply, the Court of Appeal has already held in **Commissioner of Customs and Others v Amit Ashok Doshi and 2 Others Msa Civil Appeal No. 157 of 2007** that there cannot be estoppel as against the Government.

28. The 1st and 3rd Respondents however agreed with the Petitioners that the 1st Petitioner enjoyed exemption from import duty of customs on its imports of raw and packaging materials for the manufacture of medicaments under the **Customs and Excise Act, Cap 472** of the Laws of Kenya and now the **East Africa Customs Management Act** but they stated that the 1st Petitioner did not enjoy VAT on import duty. That import duty of customs is a levy on selected imported goods and it is levied under the **East African Community Customs Management Act, 2004** before the goods are allowed to enter the territory of Kenya while VAT is a domestic tax charged on selected goods and services at every point up to the final consumer. That the **East African Community Customs Management Act** and the **VAT Act** impose duty of customs and VAT, respectively which are separate tax regimes.

29. They therefore agreed that if any exemptions from VAT were to be granted for the relevant period, it would be so granted under the **VAT Act, Cap 476** and that if any VAT refunds to the members of the Federation of Kenya Pharmaceutical Manufacturers were made, they were so refunded in error and the same ought to be recovered by the Respondents. They thus claimed that due to the illegal zero rating for VAT of the 1st Petitioners' imports of raw and packaging materials for manufacture of medicaments, the 1st Petitioner for the period January 2012 to August 2013 claimed a total of Kshs.17,770,540/- in VAT refunds which could not be justified.

30. On the issue of legitimate expectation that the 1st Petitioner would continue enjoying VAT exemption on raw and packaging materials, the 1st and 3rd Respondents contended that there was no representation to the Petitioners that import VAT will not be charged on their imports and there is no law that provides for such an action. Further, that there was no promise made to the Petitioners by the Respondents that the **VAT Act, Cap 476** will never be repealed or amended and they thus claimed that both claims of legitimate expectations by the Petitioners have no legal basis.

31. They submitted that the **VAT Act, 2013** has reduced the listed goods and services that are zero-rated and exempted from VAT which was a noble tax policy aimed at increasing revenue for the Government, a policy the Petitioners and all citizens must embrace. They thus claimed that taxation having been enforced as provided for under statute then the same cannot be equated with deprivation of property contrary to **Article 40** of the **Constitution** as claimed.

32. The Respondents further contended that the Court has no powers to determine tax policy as that was the mandate of the legislature and that it was within the legislature's authority under the Constitution not to legislate for exemption of VAT or for zero-rating VAT for the Petitioners' imports of raw and packaging materials for the manufacture of medicaments. They relied on the case of **Kenya Union of Domestic Hotels, Education Institutions and Hospitals Workers Union v Kenya Revenue Authority Petition No. 544 of 2013**, where it was held that the legislative authority of the people of Kenya was vested on the Legislature on behalf of the said people of Kenya and that the Legislature has the mandate to lawfully enact the law.

33. The 1st and 3<sup>rd</sup> Respondents thus urged the Court to dismiss the Petition with costs and grant judgment as against the 2<sup>nd</sup> Respondent to failure to respond to the Petition.

### **The 2nd Respondent's submissions**

34. The 2nd Respondent, the Attorney General neither filed any response to the Petition nor made any arguments in respect thereof.

### **Determination**

35. Before I proceed to determine the substance or otherwise of this Petition, I recall that the Petitioners

claimed that they are entitled to judgment as against the 2<sup>nd</sup> Respondent for his failure to file any response or file any Affidavits in answer to the Petition. While I am aware of the rule that a party who alleges a fact has the onus of proving that fact, the opposing party is at the very least expected to file a response to those allegations of facts. Where such a party fails to appear in the proceedings and declines or neglects to file any pleadings in answer to those facts, then the Court can only but take it that the facts are actually uncontested as was stated in **Kariuki Gathitu v Attorney General Petition No. 1188 of 2003** and similarly, in the case of **Pradhan v Attorney General (2003) 1 KLR** the Court observed as follows;

***“Where facts had been proven that prima facie showed an infringement it was for the person alleged to have infringed that right to justify such infringement and in the absence of a counter affidavit, the averments contained in the supporting affidavit must be taken as true”.***

36. While generally that is the law as I understand it, I am not persuaded it is the case in the instant Petition and I decline to summarily find in favour of the Petitioners. I say so because the Petitioners urged me to find that the Attorney General the, 2<sup>nd</sup> Respondent, who has been sued on behalf of the Ministry of Finance, Ministry of Health and Ministry of Industrialization has by not answering the Petition thereby admitted the case against him and those he represents. It is of course not proper that the 2<sup>nd</sup> Respondent chose not to file any response to the Petition. However, even in such circumstances, I am unable to heed to the Petitioners demands and I say so because the 1<sup>st</sup> and 3<sup>rd</sup> Respondents have put a strong defence to the heavily contested issues which I must consider on their merits or otherwise in the context of the Petitioners’ claims and so to isolate the 2<sup>nd</sup> Respondent and enter judgment against him would be unjust and prejudicial to the 1<sup>st</sup> and 3<sup>rd</sup> Respondents. In the circumstances, I must determine the Petition based only on the totality of evidence before me and the applicable law and no more.

37. Having said so, and looking at the Petition again, I am of the view that although the Petitioners have sought numerous prayers that would mislead one to imagine that there are very many issues to determine, as can be seen from the summary of arguments above, the gravamen of the Petition is the question whether the imposition of import VAT on raw and packing materials for purposes of manufacturing medicine by the 1<sup>st</sup> Petitioner is lawful or not. All other issues rotate around that singular question including alleged violation of rights under **Articles 19, 27, 40 and 47** of the **Constitution**.

38. The first question to address therefore is whether prior to the enactment of the **VAT Act, 2013**, there was exemption granted to the 1<sup>st</sup> Petitioner from payment of import VAT for raw and packaging materials for medicaments.

### **Whether raw and packaging materials for medicaments have ever been VAT exempted.**

39. The Petitioners claimed that between 1988 and August 2013, the 1<sup>st</sup> Petitioner was exempted from the payment of import VAT under **Section 8(2)** of the **Repealed VAT Act** on raw and packaging materials imported in connection with the manufacturing of medicine in Kenya. They are therefore now aggrieved by the provisions of **Section 7** of the **VAT Act 2013** which allegedly removed the exemptions on import VAT. Their claim in that regard is that the said exemptions constitute property and the Respondents have therefore violated the 1<sup>st</sup> Petitioner’s right to own property under **Article 40**. On their part, the 1<sup>st</sup> and 3<sup>rd</sup> Respondents contended that VAT on imported goods was collectable under **Section 9(1) (c)** of the **Repealed VAT Act** and was never exempt from import VAT.

40. Before delving into which of the two positions is legally tenable, it must be clear that prior to the letter dated 28<sup>th</sup> November 2013 from the 1<sup>st</sup> Respondent to the 1<sup>st</sup> Petitioner, in which the former demanded Kshs.121,660,538/- plus penalties thereof from the latter, it is conceded that the 1<sup>st</sup> Petitioner was not paying any VAT on raw materials and packaging materials for manufacture of medicament. While the Petitioners are emphatic that the 1<sup>st</sup> and 3<sup>rd</sup> Respondents allegedly knew that the VAT was non-payable, the 1<sup>st</sup> and 3<sup>rd</sup> Respondents contend that the non-payment was a deliberate ploy by the Petitioners to evade tax which was lawfully payable and which was only unearthed during the Desk Audit for the period 1<sup>st</sup> January 2008 to 21<sup>st</sup> November 2013.

41. In that regard, I have read the letter dated 28<sup>th</sup> November 2013, and I have also read Item 26 of the **Third Schedule** to the **Customs and Excise Act, Cap.472**, Legal Notice No.343 issued on 31<sup>st</sup> October 1995, Item 26 part B of the Eighth Schedule to the **Repealed VAT Act**, and item 16 of Part B of the Fifth Schedule to the **East African Community Customs Management Act, 2004**. What I gather from a wholesome reading of the said laws is that;

i. Part A of the **Third Schedule to the Customs and Excise Act, Cap.472** was enacted in 1980 but amended severally over the years and was the provision for “*Exemptions from Duty*” and Part B was headed “*General Exemptions – Goods imported or purchased before clearance through the customs generally.*” One of the items in that category is Item 26 which reads as follows;

***“Raw materials for use in the manufacture of Medicaments – Raw materials which the Commissioner is satisfied are for the sole use in the manufacture of medicaments by a manufacturer approved and listed in the Gazette by the Commissioner in consultation with the Director of Medical Services or Director of Veterinary Services”***

Item 26 above was inserted by dint of an amendment vide the **Finance Act, No.13 of 1995** assented to on 20<sup>th</sup> December 1995. Legal Notice No.343 was made on 31<sup>st</sup> October 1995 by B.K Kipkulei, Permanent Secretary to the Treasury who gazetted an approved list of manufactures of medicaments for the purposes of that item i.e. Item 26 of Part B of the Eight Schedule to the VAT Act. Manufacturer No.15 in that list is the 1<sup>st</sup> Petitioner. Part B of the **Value Added Tax, Cap.476** is headed “*special Goods Subject to Zero-rating*” and Item 26 thereof is worded thus;

*“26. Jet fuel and Aviation Spirits jet fuel and aviation spirits purchased by an aircraft owner or operator for use in an aircraft engine”*

42. Pausing here for a moment, it seems that the exemption for purposes of VAT under item 26 in the Third Schedule to the **Customs and Excise Act** ought to have been done by the Commissioner of Customs in consultation with the Director of Medical Services or Director of Veterinary Services.

43. I have seen no Gazette Notice in that regard and my reading of Legal Notice No.343 of 31<sup>st</sup> October 1995 is that it is irrelevant to the present dispute not to mention that it was gazetted before Item 26 of Part B of the Third Schedule was inserted into the law and was gazetted by someone other than the authorized officer.

ii. The **Fifth Schedule** to the **East African Community Customs Management Act, 2004** at Part B provides for “*General Exemptions – Goods imported or purchased before clearance through customs*” and item 16 thereof is with regard to “*Packaging Materials for Medicaments*”. That item was inserted by Legal Notice No.2 of 15<sup>th</sup> September 2005 and further by Legal Notice No.36 of 8<sup>th</sup> December 2008 and exempted the payment of customs duty for “*packaging materials and raw materials for manufacture of medicaments upon recommendation of the authority responsible for manufacture of medicaments*”. I have seen no such recommendation as regards the 1<sup>st</sup> Petitioner.

### **VAT Exemption**

44. The Petitioner claimed that for many years it had been granted exemption from payment of import VAT, as provided for under **Section 8(2)** of the **VAT Act**. **Section 8(2)** provided that;

***“(8)(1) Where a taxable person supplies goods or services and the supply is zero rated then-***

***a. No tax shall be charged on the supply; or***

***b. It shall in all other respects be treated as a taxable supply and accordingly the rate at which tax is treated as charged on the supply shall be nil.***

**(2) A supply or importation of goods or services is zero rated by virtue of this Section if the goods or services are of the description for the time being specified in the Fifth Schedule or Part B and Part D of the Eight Schedule or are goods or services imported or purchased by persons specified in Part A or Part C of the Eight Schedule or the supply or importation is of a description so specified.”**

In addition to the above provisions, **Section 9(1)(c)** of the said **Act** also provided as follows;

**“(1) For the purpose of this Act, the taxable value of any supply of goods or services shall be-**

**(a) ...**

**(b) ...**

**(c) (i) the value of such taxable goods ascertained for the purpose of customs duty, in accordance with the Customs and Excise Act, whether or not any duty of customs is payable on those goods; and**

**(ii) the amount of the duty of customs, if any, payable on those goods whether or not a remission may have been issued.”**

The Second Schedule to the Act is headed **“Exempt Goods”** and nowhere in it have I seen that **“imports of raw and packaging materials for the manufacture of medicaments”** qualify as exempt goods.

The Fifth Schedule on the other hand is worded, **“zero rated supplies”** and some of the tariffs that are therein named are Tariffs Nos.3003.10.00-3004.90.00 which are all medicaments that are not raw but which contain penicillins, hormones, alkaloids, derivatives etc. These Items are not the same as raw imports. The Eighth Schedule of the Act applies to **“Public Bodies, privileged Persons and Institutions with zero-rated status on imports and purchases.”**

45. In his Affidavit sworn on 30<sup>th</sup> December 2013 and relating to the above matters, Martin K. Otieno, Senior Revenue Officer in the Customs Services Department at paragraph 21 thereof deposed as follows;

**“That for the period under review (January 2008 to November 2013), the 1<sup>st</sup> Petitioner was neither exempted from paying VAT under the 2<sup>nd</sup> and 3<sup>rd</sup> Schedules nor was it a privileged person under Part A of the Eight Schedule or were the goods imported listed as zero-rated under Part B of the Eight Schedule to the Repealed VAT Act, Cap.476”**

46. I am in agreement with the above deposition and from my summary of the law above, it is clear to me that whereas all the legal provisions relating to VAT exemptions existed and were in operation during the material time, there is no evidence that those provisions were applicable to the 1<sup>st</sup> Petitioner nor was it entitled to enjoy VAT exemption as claimed. It is also clear that VAT on imported supplies was charged on the imports, and that value was ascertained as provided for under **Section 9(1)(c)** as reproduced elsewhere above.

47. As a corollary to the above issue, the Petitioners made a lot out of the fact that **Section 7** of the **VAT, 2013**, repealed the provisions in the **Repealed VAT Act** which granted it exemption and that the said action was unlawful. I have seen the allegations made by Mr. Mark K. Otieno that during the post clearance audit, it had been established that the 1<sup>st</sup> Petitioner in the period under review had been declaring the imports of its raw and packaging materials for the manufacture of medicaments as VAT exempt had not been challenged. I agree with that position and the 1<sup>st</sup> Petitioner cannot therefore devise methods of avoiding tax and then claim that it had been exempted of the same. I digress and in any event,. my views above notwithstanding, I must state that I do not see any wrong doing on part of the 1<sup>st</sup> and 3<sup>rd</sup> Respondents since **Sections 68(1)** of the **VAT Act, 2013** mandates them to collect and recover any tax due and payable under the **Repealed VAT Act**.

48. I must at this stage hasten to add that the law today is different from the position obtaining above because there has been an enactment of the **Value Added Tax (Amendment) Act No.7 of 2014** which in **Section 2(v)** thereof amends the 1<sup>st</sup> Schedule to the **VAT Act of 2013** in regard to the subject of the Petition by adding to the list of materials which are exempt from the payment of VAT;

***“Inputs or raw materials (either produced locally or imported) supplied to pharmaceutical Manufactures in Kenya for manufacturing of medicaments, as approved from time to time by the Cabinet Secretary for National Treasury in consultation with the Cabinet Secretary responsible for health.”***

The obvious effect therefore is that there may well be exemption subject to the proper approvals being obtained and so some of the prayers in the Petition have been overtaken by events.

49. But that is not the end of the matter because the Petitioners raised constitutional issues namely;

- i. Whether the enactment of the **VAT Act 2013** was done in contravention of the guiding principles in **Article 201** of the **Constitution**.
- ii. Whether the right to property under **Article 40** of the **Constitution** was violated in the alleged removal of exemption from payment of import VAT by the 1<sup>st</sup> Petitioner.
- iii. Whether the right to non-discrimination in **Article 27** of the **Constitution** was breached by alleged denial of the right to equal protection and equal benefit of the law.
- iv. Whether the right to fair administrative action in **Article 47** of the **Constitution** was violated by alleged removal of financial incentives to justify the 1<sup>st</sup> Petitioner’s investment in the pharmaceutical industry.

50. With regard to the above matters, having held that there was no right to VAT exemption as contended by the Petitioners, no constitutional rights can accrue either and I do not see any reason to determine all the above issues. Had I however found otherwise, than there would have been value in doing so. I will however touch on all the above issues as I conclude the judgment to state my position in any event.

51. In spite of my holding as above, there was an issue that disturbed me throughout the consideration of this matter. Why did it take the 3<sup>rd</sup> Respondent such a long time to discover that import VAT was not being paid by the 1<sup>st</sup> Petitioner? It will be noted that he only sought a desk audit for 5 years because **Section 135(3)** of the **East African Community Customs Management Act, 2004** states as follows;

***“The proper officer shall not make any demand after five years from the date of the short levy or erroneous refund, as the case may be, unless the short levy or erroneous refund had been caused by fraud on the part of the person who would have paid the amount short levied or to whom the refund was erroneously made, as the case may be.”***

52. It is obvious from the documents placed before me that in fact the 1<sup>st</sup> Petitioner had not paid import VAT since Item 26 of Part B to the Third Schedule was introduced in 1995. There is no evidence that the 1<sup>st</sup> Petitioner fraudulently acted not to pay the tax and it may well have acted in error and a misapprehension of the law but why did the 3<sup>rd</sup> Respondent act as he did? The hardship caused to the 1<sup>st</sup> Petitioner is obviously heavy but the remedies sought cannot assuage its pain. In saying so, I am aware of a similar situation in **Commissioner of Customs & Others vs Amit Shok Doshi (supra)** where the Court of Appeal approved the following statement by Georges CJ in **Tarmal Industries Ltd vs Commissioner of Customs and Excise [1968] E.A. 471.**

***“The fact that he failed to do so, on the authorities above cited cannot estop him from carrying out his duty when he discovers the original error. Indeed, his earlier classification under Item 108(k) was in breach of Section 195 of the East African Customs Management Act. It was a***

*breach of statutory duty and in that case since it was not lawful estoppel cannot be raised against him to prevent him from correcting that act. Naturally one reaches such a conclusion with a certain measure of reluctance as it undoubtedly hard on the defendant company to be called upon long after the event to find such a substantial sum which would not have been payable but for the plaintiff's negligence in the first instance in not having the pellets which were set to him for examination properly tested. One can well understand, however, that on balance it is preferable that the law should be as it is. It is not in the interest of consistent application of the law that errors should be sanctified as principle ..."*

53. I agree with the above holding despite my misgivings about the conduct of the 3<sup>rd</sup> Respondent.

### **Conclusion**

54. While voluminous documents were submitted and long Submissions were made in this case, I deliberately narrowed down the dispute to the one real issue in contest and once I ruled on it, all other arguments collapsed around it. If the Petitioners have any grievance regarding the applicable law today i.e. **the VAT Act, 2013**, I can do no better than agree with Majanja, J. in **KUDHEHIA vs KRA & Others, Petition No.544 of 2013** where he stated as follows;

*"As I understand it, the Petitioner's grievance concerns the appropriate policy to be pursued by the 2013 Act in relation to its members. Whether the policies pursued by the Acts are proper or not is not a matter for the Court but one for the legislature. In Commission for the Implementation of the Constitution v Parliament of Kenya and 2 Others Nairobi Petition No.454 of 2012 [2013]eKLR, the issue for consideration was whether the Leadership and Integrity Act, No.19 of 2012 fell short of the threshold required by the Constitution for effective legislation by adopting one approach over another to the enforcement of Chapter Six of the Constitution. The Court observed thus;"[63]{The question}... Whether to have a "one stop-shop" or have a various public entities involved in the implementation of Chapter Six under the umbrella of EACCF is a matter for the legislative policy. Attractive and weighty arguments can be marshalled for wither position but it is not a matter in which the Court should delve into unless the Constitution is contravened." The Court further noted that, "[69] Declaring a statute as unconstitutional, needless to say is a serious issue with deep-seated ramifications and the Court should not be overly enthusiastic in pronouncing so unless clear grounds known in law have been clearly established. I agree and adopt these sentiments and I find and hold that in the absence of any specific violation of the Constitution and in particular of the Bill of Rights the Court cannot intervene in directing the legislature to adopt the Petitioner's approach."*

55. He then added as follows;

*"Article 94 vests legislative authority of the people of Kenya in Parliament and Article 118(1)(b) obliges the legislature to "facilitate public participation and involvement in the legislative and other business of Parliament and its committees." Since all statutes come with a presumption of constitutionality, it is incumbent upon the Petitioner to demonstrate that there has been no public participation to the extent that the law is invalid. In Law Society of Kenya vs Attorney General Nairobi Petition No.318 of 2012 (unreported), the Court observed as follows, "[51] In order to determine whether there has been public participation the Court is required to interrogate the entire process leading to the enactment of the legislation; from the formulation of the legislation to the process of enactment of the statute. I am entitled to take judicial notice of the Parliamentary Standing Orders that require that before enactment, any legislation must be published as a bill and to go through the various stages in the National Assembly. I am entitled to take into account that these Standing Orders provide for a modicum of public participation in the sense that a bill must be advertised and go through various Committees of the National Assembly which admit public hearings and submission of memoranda." I have considered the Petition and the deposition in support and they are starved of evidence to support the conclusion that there was lack of public participation in the enactment for the 2013, Act.*

*The 2013 Act is a revenue statute of general application and although it affects the Petitioner's members, it not a labour or labour standard setting statute to which the provision of the ILO Convention No.144 in 1976. Nevertheless, as I have outlined, the Petitioner has not discharged its burden of proving that there was no public participation.*

*As regards the interpretation of the 2013 Act, I do not think there is any ambiguity or lacuna in its provisions into the treatment of service charge. The intent of the legislation is clear when one looks at the provisions of the Repealed Act and the 2013 At vis-à-vis service charge. Section 9(4) of the Repealed Act which dealt with service charge was only replicated to the extent that only the levy imposed under the Tourism Act was excluded in the 2013 Act. Otherwise Section 13(3) (c) of the 2013 Act is clear what constitutes the taxable value of the supply."*

56. He concluded as follows;

*"I also find that the Petitioner has not established that the 2013 Act violates its members' fundamental rights and freedoms. First, I do not think that the 2013 Act violates the freedom of association or any labour rights. The Petitioner's right to renegotiate the CBA in light of change of circumstances of the law has not been abridged conversely, of the Petitioner's argument were allowed to prevail, the Petitioner and like organisations would have a veto on tax legislation simply on the grounds that a certain position affecting tax liability had been sealed by the CBA. The Petitioner had its members right to negotiate the terms of the CBA is still available subject to the applicable law.*

*Second, discrimination of the Petitioner's members has not been established. The law does not single out the Petitioner's members for special and prohibited treatment under Article 27 of the Constitution. The application of the tax is neutral and though it affects the Petitioner's members in a specific way, the reason for imposing the tax on service charge is that the purpose of the tax is to broaden the tax net.*

*Finally, the imposition of taxes is reposed in the legislature. The imposition of tax by statute cannot, of itself, amount to arbitrary deprivation of property contrary to Article 40 of the Constitution."*

57. All the above finding apply squarely to the present Petition and while the sum demanded of the 1<sup>st</sup> Petitioner is indeed high and no business entity, however successful, will find it easy to pay. If so, let parties negotiate a less stressful approach to the issue including seeking waivers and payments by instalments.

58. As for the Petition before me, I have said why it cannot succeed. It is hereby dismissed and as for costs, I see no reason to grant costs to any of the Respondents as the 1<sup>st</sup> and 2<sup>nd</sup> Respondents by their conduct aggravated the situation by delaying the desk audit and the role of the 2<sup>nd</sup> Respondent has always been peripheral. Let each party therefore bear is own costs.

59. Orders accordingly.

**DATED, SIGNED AND DELIVERED AT NAIROBI THIS 26<sup>TH</sup> DAY OF AUGUST, 2014**

**ISAAC LENAOLA**

**JUDGE**

**In the presence of:**

Kariuki – Court clerk

Dr. Kuria for Petitioner

Dr. Kirugi holding brief for Mr. Matuku for 1<sup>st</sup> and 3<sup>rd</sup> Respondent

**Order**

Judgment duly delivered.

Copies of the Judgment to be supplied and Proceedings to be supplied as well.

**ISAAC LENAOLA**

**JUDGE**

**By Consent**

Let the Conservatory Orders remain in force for 14 days pending the filing of a formal application.

Mention on 6<sup>th</sup> October 2014

**ISAAC LENAOLA**

**JUDGE**