Republic v Cabinet Secretary for the National Treasury and Economic Planning & 3 others; Kenya Bankers Association (KBA) (Ex parte) (Miscellaneous Application E043 of 2023) [2024] KEHC 14673 (KLR) (Judicial Review) (11 October 2024) (Judgment)

Neutral citation: [2024] KEHC 14673 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI LAW COURTS)

JUDICIAL REVIEW

MISCELLANEOUS APPLICATION E043 OF 2023

JM CHIGITI, J

OCTOBER 11, 2024

BETWEEN

REPUBLIC ..... APPLICANT

AND

THE CABINET SECRETARY FOR THE NATIONAL TREASURY AND ECONOMIC PLANNING ..... 1ST RESPONDENT

THE KENYA REVENUE AUTHORITY ..... 2ND RESPONDENT

THE NATIONAL ASSEMBLY ..... 3RD RESPONDENT

THE ATTORNEY GENERAL ..... 4TH RESPONDENT

AND

KENYA BANKERS ASSOCIATION (KBA) ..... EX PARTE

The Income Tax (Financial Derivatives) Regulations, 2023 is illegal for applying a withholding tax on the losses of a resident person arising from a derivative transaction with a non-resident person

The application was against the Income Tax (Financial Derivatives) Regulations, 2023 (the impugned Regulations) the applicant claimed that it applied a withholding tax obligation on a resident person on the losses made by the resident person and yet they had no anchor on section 3 of the Income Tax Act. The court found that the impugned Regulations were incapable of being implemented by virtue of the fact that the tax on "gains from financial derivatives" was required to be withheld upon payment of an amount to the relevant non-resident person. The court noted that the Income Tax Act envisaged that any gains from financial derivatives shall be taxed by withholding a tax on a payment made to a non-resident person, comprising of gains made on the relevant financial derivative. The court finally found that the impugned Regulations were illegal.

Reported by Kakai Toili

Statutes *– interpretation of statutory provisions – interpretation of Income Tax (Financial Derivatives) Regulations, 2023, which sought to apply a withholding tax obligation on a resident person on the losses they made - whether the Income Tax (Financial Derivatives) Regulations, 2023 could be implemented where section 3 of the Income Tax Act provided for taxable income to include the gains from financial derivatives – whether the Income Tax (Financial Derivatives) Regulations, 2023 was illegal for applying a withholding tax on the losses of a resident person arising from a derivative transaction with a non-resident person - whether the gains from financial derivatives of a non-resident person could be deemed to be income accrued in or was derived from Kenya for tax purposes - Constitution of Kenya, article 10(2)(a); Income Tax Act (cap 470) sections 3 and 35(1); Income Tax (Financial Derivatives) Regulations, 2023, sections 3 and 4.*

Statutes *– statutory instruments - regulatory impact statements - whether a regulatory impact statement had to be prepared for the Income Tax (Financial Derivatives) Regulations, 2023 which sought to provide clarity as to when tax on gains from financial derivative contracts crystallised - Statutory Instruments Act (cap 2A), sections 6 and 9.*

Constitutional Law *– national values and principles – public participation - what was the nature of public participation in the legislative process – Constitution of Kenya, article 10.*

Brief facts

The Cabinet Secretary for the National Treasury and Economic Planning (the 1st respondent) through Legal Notice No. 4 of 2023 in Kenya Gazette Supplement No. 6 of 2023 published the Income Tax (Financial Derivatives) Regulations, 2023 (the impugned Regulations) on January 27, 2023. The applicant's case was that the impugned Regulations were fatally defective and mired with procedural impropriety as the 1st respondent did not prepare a regulatory impact statement prior to making the Regulations.

The *ex-parte* applicant stated that sections 3 and 4 of the impugned Regulations sought to apply a withholding tax obligation on a resident person on the losses made by the resident person and yet they had no anchor on section 3 of the Income Tax Act which provided for the income upon which tax was chargeable to include the gains from financial derivatives. Further, that there was no reference to "losses" under the Income Tax Act. According to the applicant, the impugned Regulations were incapable of being implemented, by virtue of the fact that the tax on "gains from financial derivatives" was required to be withheld upon payment of an amount to the relevant non-resident person.

It was further the applicant's case that sections 3 and 4 of the impugned Regulations proposed to charge the tax on losses made by the party in Kenya. It was the case that if a loss was made by a resident person, there could be no payment arising to the non-resident person on account of that loss on which the provisions of section 35 of the Income Tax Act could be applied, and on which payment an amount could be withheld.

The *ex-parte* applicant stated that the impugned Regulations were illegal in that they required a resident person to assume that their loss on a derivative transaction equated to the gain of the non-resident person, and against such presumed outcome, to withhold tax on a payment to the non-resident person at the rate of 15% of the payment made. Aggrieved, the applicant filed the instant application seeking among other orders; an order of *certiorari* quashing the impugned Regulations.

Issues

i. Whether the Income Tax (Financial Derivatives) Regulations, 2023 was illegal for applying a withholding tax on the losses of a resident person arising from a derivative transaction with a non-resident person.
ii. Whether the Income Tax (Financial Derivatives) Regulations, 2023 which sought to apply a withholding tax obligation on a resident person on the losses they made could be implemented where section 3 of the Income Tax Act provided for taxable income to include the gains from financial derivatives.
iii. Whether the gains from financial derivatives of a non-resident person could be deemed to be income accrued in or was derived from Kenya for tax purposes.

iv. Whether a regulatory impact statement had to be prepared for the Income Tax (Financial Derivatives) Regulations, 2023 which sought to provide clarity as to when tax on gains from financial derivative contracts crystallised.

v. What was the nature of public participation in the legislative process?

Held

1. Under article 10 of the Constitution of Kenya the respondents had a duty to uphold protect and promote public participation before coming up with any legislation. Public participation was a process through which the views of those affected or likely to get affected by a new legislation or changes in an existing legislation were considered. A legislative process that was driven and informed by the views of Kenyans was a process that was owned by the people. It was a legislative process that culminated in the affirmation and the promotion of the sovereign power of the people. Legislation that was enacted through a legislative process that was devoid of public participation offended the legitimate expectation of the people that they would get a law that was certain, constitutional and enforceable at the minimum.
2. Although Kenya did not have a specific legislation known as the Public Participation Act, public participation in Kenya had overtime been refined in different judicial pronouncements post 2010. Perhaps the time had come for the Legislature came up with a Public Participation Act.
3. The impugned regulations were gazetted on January 27,2023 in Legal Notice No.4 through Kenya Gazette Supplement No.6 of 2023 and submitted to the National Assembly via the National Treasury and Economic Planning letter Ref. TNT/ZZ/131/04 dated January 13, 2023. Public participation was undertaken in compliance with the provisions of section 5 of the Statutory Instruments Act and article 201(2) of the Constitution. The fact that a party participated in public participation must however never be construed to mean that the diverse views of the parties would be what the ultimate legislation would be. The applicant could not have its cake and eat it. There was public participation before the impugned Regulations were passed.
4. Section 6 of the Statutory Instruments Act provided for the preparation of the regulatory impact statement by the regulation making authority prior to making the statutory instruments in circumstances where a proposed statutory instrument was likely to impose significant costs on the community or a part of the community. However, section 9 of the Statutory Instruments Act provided for situations where regulatory impact statements may not be necessary.
5. Regulatory impact statement needed not be prepared for a proposed statutory instrument if it was a matter arising under legislation that was substantially uniform or complementary with the legislation of the National Government or if the proposed legislation only provided for an amendment of a fee, charge, or tax consistent with announced government policy. The regulations were in line with the provisions of the Income Tax Act (cap. 270), and a regulatory impact statement was not unnecessary. Paragraph 3 and 4 of the impugned Regulations provided the tax point for financial derivative transactions so as to provide clarity as to when tax on gains from financial derivative contracts crystallised.
6. Financial derivative contracts were entered into between two parties. Gains chargeable to tax in Kenya were those that accrued to non-residents from financial derivative contracts involving residents and non-residents. A gain from a financial derivative contract to a non-resident, on which withholding tax was applicable, would be a loss to the resident person with whom the contract was entered.
7. The impugned Regulations provided that a realised loss by a resident person from a financial derivative contract was allowed as a deduction against any gain accruing from similar activities to the extent that it had not been claimed. The resident person who entered into a contract with the non-resident person, was aware of the progress of the transactions affecting the contract during the period of the contract. The resident person was therefore able to accurately determine the amount of loss made from the

transactions. The impugned regulations flowed or sought to address matters arising under legislation that was uniform or complementary with the legislation of the National Government Regulations.

8. In judicial review, the court did not exercise its appellate powers. It mainly looked at the decision-making process to ensure that the citizen who had come into contact with an administrative body or tribunal had been treated fairly. The court could quash the decision if the same was so unreasonable to the extent that a reasonable tribunal addressing its mind to the facts of the case would not have arrived at such a decision. In doing so, the court would have descended into the arena of decision-making. For a court to justify such action it must be clearly obvious that the decision was truly and obviously unreasonable.

9. Under sections 3 and 4 of the impugned Regulations tax became due and payable by the 20th day of the month after which a loss from the transaction with a non-resident person was realised. Section 3 of the Income Tax Act was the charging provision pursuant to which all income tax liability in Kenya must be pegged. Sections 3 and 4 of the impugned Regulations effectively sought to apply a withholding tax obligation on a resident person on the losses made by the resident person and yet they had no anchor on section 3 of the Income Tax Act, which provided for the income upon which tax was chargeable to include the gains from financial derivatives. There was no reference to "losses" under the provisions of the Income Tax Act. The impugned Regulations were incapable of being implemented by virtue of the fact that the tax on "gains from financial derivatives" was required to be withheld upon payment of an amount to the relevant non-resident person.

10. Section 35(1) of the Income Tax Act provided that a person shall, upon payment of an amount to a non-resident person in respect of gains from financial derivatives deduct therefrom tax at the appropriate non-resident rate. The Income Tax Act envisaged that any gains from financial derivatives shall be taxed by withholding a tax on a payment made to a non-resident person, comprising of gains made on the relevant financial derivative. Sections 3 and 4 of the impugned Regulations proposed to charge the tax on losses made by the party in Kenya. If a loss was made by a resident person, there could be no payment arising to the non-resident person on account of that loss on which the provisions of section 35 could be applied, and on which payment an amount could be withheld.

11. The impugned Regulations were illegal, unreasonable, impracticable, unclear, created uncertainty and were oppressive in that they required a resident person to assume that their loss on a derivative transaction equated to the gain of the non-resident person, and against such presumed outcome, to withhold tax on a payment to the non-resident person at the rate of 15% of the payment made. The impugned Regulations did not provide at all on how gains would be computed for non-residents. That contravened article 10(2)(a) of the Constitution which provided that the national values and principles of governance included patriotism, national unity, sharing and devolution of power, the rule of law, democracy and participation of the people.

12. The architecture of the Income Tax Act was supposed to be predicated and driven by the rationale that a person was taxed on their own income, as ascertained by reference to their own circumstances. There was no provision in the Income Tax Act that supported the ascertainment of a person's income (whether the person was resident or non-resident) by reference to another person's expenses or losses. The impugned Regulations were *ultra vires*, null and void and incapable of being implemented.

13. In the absence of a deeming provision under section 10 of the Income Tax Act, the entire premise of the impugned Regulations failed as the gains from financial derivatives of a non-resident person could not be deemed to be income which accrued in or was derived from Kenya, for tax purposes.

14. No payment was made in the event of settlement for physically settled derivatives and exchange traded derivative transactions. The impugned Regulations were not clear on how the tax shall be computed. Certainty in laws that imposed taxes was essential for business planning and the applicant would be greatly prejudiced by the imposition and the implementation of uncertain Regulations. The impugned Regulations were illegal and they offended and breached the rule of law contrary to article 10 of

the Constitution as a result of which they were susceptible to scrutiny under judicial review. The 1st respondent did not exercise his powers in accordance with the Income Tax Act.

15. The order of prohibition was an order issuing out of the High Court directed to an inferior court or tribunal or public authority which forbade that court or tribunal or authority to act in excess of its jurisdiction or contrary to law. Prohibition was employed for the control of inferior courts, tribunals and public authorities. Prohibition was concerned with decisions of the future. Prohibition would issue to prohibit a determination in excess of jurisdiction, error of law on the face of the record or breach of the rules of natural justice.
16. When taking administrative action, all public authorities must at all times abide by and promote the principles of good governance as enshrined under articles 10 of the Constitution.
17. Article 47(1) of the Constitution provided that every person had the right to administrative action that was expeditious, efficient, lawful, reasonable and procedurally fair. The court had the power to review the impugned administrative decision of the 1st respondent since the action or decision in coming up with the impugned Regulations was materially influenced by an error of law under section 7 of the Fair Administrative Action Act. The 1st respondent did not exercise his powers in accordance with the Income Tax Act. The 1st respondent violated the applicant's right to fair administrative action as guaranteed under article 47 of the Constitution.

Application allowed.

Orders

i. *An order of prohibition was issued directed at the Kenya Revenue Authority either by itself, its agents or employees restraining it from taking any steps, actions, or measures to impose or collect any taxes from the members of the ex-parte applicant engaged in transactions involving financial derivatives and/or enforcement or implementation of the Income Tax (Financial Derivatives) Regulations, 2023.*
ii. *An order of certiorari quashing the Income Tax (Financial Derivatives) Regulations, 2023, as contained in Legal Notice No. 4 of 2023 in Kenya Gazette Special Issue Supplement No. 6 of 2023 published on January 27, 2023 was issued.*
iii. *A declaration was issued that the failure by the 1st respondent to exercise his powers in accordance with the Income Tax Act, the parent statute therein amounted to a violation of the ex-parte applicant's constitutional right to enjoy rule of law, fair administrative action and to a fair taxation burden guaranteed under articles 10(2)(a), 47 and 201(b)(i) of the Constitution of Kenya, respectively.*
iv. *Each party to shoulder its costs.*

Citations

Cases

Kenya

1. *British American Tobacco Kenya PLC v Cabinet Secretary for the Ministry of Health & 2 others; Kenya Tobacco Control Alliance & another (Interested Parties); Mastermind Tabacco Kenya Limited (Affected Party)* Petition 5 of 2017; [2019] KESC 15 (KLR) - (Explained)
2. *Cabinet Secretary for the National Treasury and Planning & another v Okoiti & 12 others* Civil Application E304 of 2023; [2023] KECA 1375 (KLR) - (Explained)
3. *Commissioner of Income Tax v Westmont Power (K) Ltd* Income Tax Appeal 626 of 2002; [2006] KEHC 3474 (KLR) - (Explained)
4. *Grain Bulk Handlers Limited v JB Maina & Co Ltd & 2 others* Civil Appeal 295 of 2003; [2006] KECA 126 (KLR) - (Explained)
5. *Kenya Revenue Authority v Waweru & 3 others; Institute of Certified Public Accountants & 2 others (Interested Parties)* Civil Appeal E591 of 2021; [2022] KECA 1306 (KLR) - (Explained)
6. *Mars Logistics Limited v Commissioner of Domestic Taxes* Income Tax Appeal 06 of 2018; [2021] KEHC 13348 (KLR) - (Explained)

7. *Mumo Matemu v Trusted Society of Human Rights Alliance & 5 others* Civil Appeal 290 of 2012; [2013] KECA 445 (KLR) - (Explained)
8. *Okoiti & 3 others v Anne Waiguru, the Cabinet Secretary, Devolution and Planning & 5 others* Petition 42 & 27 of 2014; [2021] KEELRC 2306 (KLR) (Consolidated) - (Explained)
9. *Republic v Commissioner of Domestic Taxes Large Tax Payer's Office ex-parte Barclays Bank of Kenya LTD* Miscellaneous Application 1223 of 2007; [2012] KEHC 1988 (KLR) - (Explained)
10. *Republic v Firearms Licensing Board & another; Ex parte Boniface Mwaura* Judicial Review Miscellaneous Application 47 of 2018; [2019] KEHC 10921 (KLR) - (Explained)
11. *SDV Transami Kenya Limited and 19 Others v Attorney General & 2 Others & another* Constitutional Petition 76 of 2012; [2016] KEHC 571 (KLR) - (Explained)
12. *Wambua, Paul Musili v Attorney General & 2 others* Petition 542 of 2013; [2015] KEHC 6936 (KLR) - (Explained)

Uganda

Francis Bahikirwe Muntu and others v Kyambogo University Miscellaneous Application Number 643 of 2005 - (Explained)

United Kingdom

1. *Civil Service Unions v Minister for the Civil Service* [1985] AC 374 - (Explained)
2. *Inland Revenue v Scottish Central Electricity Company* [1931] 15 TC 761 - (Mentioned)

India

Maharashtra State Board of Secondary & Higher Secondary Education v Kurmarsheth & Others 1984 AIR 1543; [1985] LRC - (Explained)

Regional Court

Pastoli v Kabale District Local Government Council & Others (2008) 2 EA 30 - (Explained)

Texts

1. Garner, BA., (Ed) (2009), *Black's Law Dictionary* St Paul Minnesota: West Group 9th Edn
2. Hogg, QM., (Lord Hailsham) et al (Eds) (1995), *Halsbury's Laws England* London: Butterworth 4th Edn Vol 1 page 2012 para 109
3. Kuloba, R., (Ed) (2011), *Judicial Hints on Civil Procedure* Nairobi:Law Africa 2nd Edn Vol 1 page 99

Statutes

Kenya

1. Capital Markets Act (cap 485A) In general - (Cited)
2. Civil Procedure Act (cap 21) section 27- (Interpreted)
3. Constitution of Kenya articles 10(2)(a); 47; 201(2) - (Interpreted)
4. Fair Administrative Action Act (cap 7L) sections 2, 3(1); 7; 11 - (Interpreted)
5. Finance Act, 2022 (Act No 22 of 2022) In general - (Cited)
6. Income Tax (Financial Derivatives) Regulations (cap 470 Sub Leg) rules 3, 4- (Interpreted)
7. Income Tax Act (cap 470) sections 2, 3, 9(3, 4); 10; 34(2); 35(1); 130; Schedule 3; part 4 - (Interpreted)
8. Interpretation and General Provisions Act (cap 2) In general - (Cited)
9. Statutory Instruments Act (cap 2A) sections 5, 6, 9, 11(1); 125; 23 - (Interpreted)

Advocates

None mentioned

JUDGMENT

1. By way of background, the Cabinet Secretary for the National Treasury and Economic Planning (the 1st respondent) through *Legal Notice No 4 of 2023* in Kenya Gazette Supplement No 6 of 2023 published the *Income Tax (Financial Derivatives) Regulations*, 2023 (the regulations) on January 27, 2023 in exercise of the powers conferred on him by section 9(4) of the *Income Tax Act*, chapter 470, Laws of Kenya (the ITA).

2. Dissatisfied with the above, the applicant filed the application dated December 18, 2023 seeking the following orders: -

    a. An order of prohibition directed at the Kenya Revenue Authority either by itself, its agents or employees restraining it from taking any steps, actions, or measures to impose or collect any taxes from the members of the exparte applicant engaged in transactions involving financial derivatives and/or enforce or implement the Income Tax (Financial Derivatives) Regulations, 2023.

    b. An order of certiorari quashing the *Income Tax (Financial Derivatives) Regulations, 2023* as contained in *Legal Notice No 4 of 2023* in Kenya Gazette Special Issue Supplement No 6 of 2023 published on January 27, 2023, for being adopted in a manner inconsistent with constitutional and statutory requirements.

    c. A declaration that the failure by the 1st respondent to exercise his powers in accordance with the *Income Tax Act*, chapter 470 of the Laws of Kenya, the parent statute herein amounts to a violation of the exparte applicant's constitutional right to enjoy rule of law, fair administrative action and to a fair taxation burden guaranteed under articles 10(2)(a), 47 and 201(b)(i) of the *Constitution of Kenya, 2010* respectively.

    d. The cost of this application be provided for.

3. The application is supported by the statutory statement dated April 20, 2023 and verifying affidavit sworn on April 24, 2023 by Dr Habil Olaka and the supplementary affidavit Dr Habil Olaka.

4. The ex parte applicant is the umbrella body of the institutions licensed and regulated by the Central Bank of Kenya, currently with a membership of forty-six (46) financial institutions and is therefore the financial sector's leading advocacy group.

5. The applicant's case is that the regulations are fatally defective and mired with procedural impropriety as the 1st respondent did not prepare a regulatory impact statement prior to making the regulations contrary to the provisions of section 6 of the *SI Act*.

6. On March 13, 2023, the Clerk of the National Assembly called for the members of the public and stakeholders to submit memoranda on the regulations.

7. On March 15, 2023 the exparte applicant wrote to the 2nd respondent for confirmation that the 1st respondent would not seek to implement the regulations pending the statutory process which had been commenced on 13 March 2023.

8. To the surprise of the exparte applicant, the 2nd respondent vide a letter dated March 28, 2023 informed the applicant that the regulations had come into force on January 27, 2023 notwithstanding the ongoing legislative process.

9. Sections 3 and 4 of the *Regulations* are *ultra vires* the *ITA* which is the parent statute. The 1st respondent acted in excess of jurisdiction and power conferred under the parent statute.

10. The regulations also contravene the Constitution of Kenya 2010 (the Constitution) the *Statutory Instruments Act*, 2013 (the SI Act) and the *Interpretation and General Provisions Act* (cap 2).

11. The tax payable under sections 3 and 4 of the regulations are due and payable by the 20th day of the month after which a loss from the transaction with a non-resident person is realized.

12. Section 3 of the *ITA* is the charging provision pursuant to which all income tax liability in Kenya must be pegged.

13. Sections 3 and 4 of the regulations effectively seek to apply a withholding tax obligation on a resident person on the losses made by the resident person and yet they have no anchor on section 3 of the *ITA*, which provides for the income upon which tax is chargeable to include the "...gains from financial derivatives...". There is no reference to "losses" under the provisions of the *ITA*.

14. According to the applicant,the regulations are incapable of being implemented, by virtue of the fact that the tax on "gains from financial derivatives" is required to be withheld upon payment of an amount to the relevant non-resident person.

15. Section 35(1) of the *ITA* provides that: "...A person shall, upon payment of an amount to a non-resident person...in respect of ...(p) gains from financial derivatives... deduct therefrom tax at the appropriate non-resident rate." It is therefore the case that the *ITA* envisages that any "gains from financial derivatives" be taxed by withholding a tax on a payment made to a non-resident person, comprising of gains made on the relevant financial derivative.

16. It is the applicant's case that sections 3 and 4 of the *Regulations* on the other hand propose to charge the tax on "losses" made by the party in Kenya. It is the case that if a "loss" is made by a resident person, there can be no "payment" arising to the non-resident person on account of that "loss" on which the provisions of section 35 can be applied, and on which payment an amount can be withheld. the regulations are incapable of being implemented.

17. The applicant believes the regulations are illegal, unreasonable, impracticable, unclear, create uncertainty and are oppressive in that they require a resident person to "assume" that their "loss" on a derivative transaction equates to the "gain" of the non-resident person, and against such presumed outcome, to "withhold" tax on a "payment" to the non-resident person at the rate of 15% of the payment made.

18. Sections 3(1) of the *Regulations* provide that any realised gain to a non-resident person, being a realised loss to the resident person who is a party to the financial derivative contract, shall be chargeable to tax under the *ITA*, that is, by the resident person withholding tax on such presumed gains at a rate of 15%.

19. These impose an unreasonable and oppressive burden on residents to assume that their losses on derivative transactions equate to gains of non-residents and withhold tax on such presumed gains at a rate of 15% of the payment made. This is unreasonable and impractical.

20. The regulations do not provide at all on how gains will be computed for non-residents person in this context, and it is practically impossible for a resident person to calculate the gains of a non-resident person.

21. According to the applicantt,this requirement is, unreasonable, impracticable, unclear, creates uncertainty and is oppressive as far as they require a resident person to "assume" that their "loss" on

a derivative transaction equates to the "gain" of the non-resident person, and against such presumed position, to "withhold" tax on a "payment" to the non-resident person at the rate of 15%.

22. This contravenes article 10(2)(a) of the *Constitution* which provides as follows: "The national values and principles of governance include patriotism, national unity, sharing and devolution of power, the rule of law, democracy and participation of the people."

23. One of the ingredients of the rule of law is certainty of the law. Certainty in laws that impose taxes is essential for business planning and KBA will be greatly prejudiced by the uncertainty the regulations have. The regulations therefore impose the burden on resident persons to calculate a non-resident person's gain with little, speculative or no information on the gain itself. The procedural pre-requisites in the enactment of the regulations were not followed.

24. The 1st respondent did not prepare a regulatory impact statement contrary to the provisions of section 6 of the *SI Act*.

25. The regulations do not fall within the ambit of section 9 of the *SI Act* which provides for statutory instruments which regulatory impact statements are unnecessary. The regulations will occasion great burden and injustice to the members of KBA. Since the 1strespondent usurped his powers as provided for under the *ITA* and did not comply with the procedural requirements, the regulations are illegal.

26. The ex parte applicant's position remains that the *Income Tax (Financial Derivatives) Regulations*, 2023 (the Regulations) are *ultra vires* the provisions of the *Income Tax Act* (chapter 470, Laws of Kenya) (the ITA), and are therefore null and void, and incapable of being implemented.

27. It is the applicant's case that the key principles of tax law in Kenya,

    a. First, the income of a person is taxable under the *ITA* where such income is accrued in or derived from Kenya. Unless an income can be brought under the provisions of section 3 of the *ITA*, such income is not taxable in Kenya. In this case, "gains from financial derivatives" is set out under section 3(2)(i) of the *ITA*;

    b. Next, payments to non-resident persons are not automatically assumed to constitute income "accrued in or derived from" Kenya. A payment to a non-resident person must be deemed to constitute income which has been accrued or derived from Kenya for it to be taxable under section 3 of the *ITA*. The provision that deems a payment to a non-resident person to constitute income which is taxable in Kenya is section 10 of the *ITA*.This section sets out the various payments which will be so deemed to be taxable in Kenya. In this regard, section 10(1) of the *ITA* provides that for the purposes of the *ITA*, where a resident person makes a payment to any other person (including a non-resident person) in respect of certain payments set out under section 10(1) of the *ITA*, then "...the amount thereof shall be deemed to be income which accrued in or was derived from Kenya".Where a payment to a non-resident person is not listed specifically under section 10 of the *ITA*, then such a payment has not been deemed to be income which was "accrued in or derived from" Kenya for purposes of section 3 of the *ITA*. It should be noted that either due to an oversight or an error, section 10 of the *ITA* does not include gains from financial derivatives" as income of a non-resident person which is deemed to be accrued in or derived from Kenya;

    c. Thirdly, section 34(2) of the *ITA* states that the income of a non-resident person (which will have been deemed to be taxable in Kenya pursuant to section 10 of the *ITA*) shall be taxed at the appropriate non-resident rate in force at the date of payment of that income. In this regard, section 34(2)(q) of the *ITA* includes "gains from financial derivatives". That notwithstanding, section 34(2)(q) is inoperable and is of no legal consequence because "gains from financial

derivatives" have not been deemed to constitute income that has been deemed to have accrued in or been derived from Kenya under section 10 of the *ITA*. Section 34 therefore only seeks to provide guidance on the rate that income set out under section 10 of the *ITA* is to be subjected;

d. Fourthly, section 35 of the *ITA* creates an obligation on a resident person, upon payment of an income deemed to have been accrued in or derived from Kenya, to withhold tax at the appropriate non-resident tax. Whilst section 35(1)(p) of the *ITA* creates this obligation on a resident person to withhold tax at the appropriate non-resident rate, it is predicated on two important factors; (i) that the "gains from financial derivatives" have been deemed to constitute income which is accrued or derived from Kenya pursuant to section 10 of the *ITA*; and (ii) that there is in fact a payment against which tax at the appropriate non-resident rate can be withheld;

e. Fifthly, the Third Schedule to the *ITA* under Head B paragraph *para_3 3*(r) provides that the applicable non-resident resident tax rate on gains from financial derivatives is 15% of such gains;

f. In this regard, and by way of illustration, if a Kenyan resident person has engaged a foreign supplier to provide certain services, and the Kenyan resident customer makes payment to the non-resident supplier, the payment on account of services rendered will be deemed to be Kenyan income (even though the non-resident person has never set foot in Kenya) by dint of Section 10 of the *ITA*.The payment on account of services rendered is deemed to have been "accrued in or derived from Kenya" by the non-resident supplier. Additionally, upon the payment on account of services rendered, the person in Kenya will be required to withhold tax at the appropriate non-resident rate.To illustrate this point further, if the resident customer was paying USD 10,000 to a non-resident supplier, then the resident customer would withhold USD 2,000 and remit this to the 2nd Respondent and would pay the non-resident supplier USD 8,000. It follows that if a payment is not made, withholding tax cannot be applied in respect of the payment of USD 10,000; and

g. Finally, the entire premise of the *ITA* is that a person is taxed on their own income, which income has been ascertained by reference to their own circumstances. There is no provision in the *ITA* that supports the ascertainment of a person's income (whether the person is resident or non-resident) by reference to another person's expenses or losses. In this regard, Part IV of the *ITA* is referenced "Part Iv- Ascertainment Of Total Income". Under Part IV of the *ITA* (section 15(1)), it is stated that "For purposes of ascertaining the total income of a person for a year of income there shall ... be deducted all expenditure incurred in that year of income .... by him".(Emphasis ours)

h. Against this background, it is my considered view that the regulations are ultra vires, null and void and incapable of being implemented. In the absence of a deeming provision under Section 10 of the *ITA*, the entire premise of the regulations fails as the "gains from financial derivatives" of a non-resident person cannot be deemed to be income which accrued in or was derived from Kenya, for tax purposes.

28. It is the applicants case that following from the above and by reference to section 15 of the *ITA* and other sections set out under Part IV of the *ITA*, the law does not permit the ascertainment of one person's income by reference to another person's expenses or losses. The underlying principle for this is that tax law, being a penal law, does not permit one to be taxed based on the circumstances of another.

29. Therefore, in the illustration of the foreign supplier above, withholding tax is charged with reference to the income made by the non-resident supplier (ie the USD 10,000 invoice raised by the foreign

supplier), and not by reference to the expense recorded in the books of the resident customer (ie the expense of USD 10,000 recorded in the resident's books).

30. In the 2nd respondents replying affidavit state that the tax base upon which the withholding tax rate is applied is anchored under regulation "3. Scope of gains from financial derivatives

    1. Any realized gain to a non-resident person, being a realized loss to the resident person who is a party to the financial derivative contract, shall be chargeable to tax in accordance with the Act."

31. Regulation 3 is bad in law, in that it seeks to ascertain the gains of one person, by reference to the losses of another person, contrary to the provisions of the *ITA*.The ascertainment of a person's income can only be by reference to that person's income and expenses, and not to expenses or losses of another.

32. The 2nd respondent confirms and admits at paragraphs 26 and 29 of the replying affidavit, that in complete disregard of the provisions of the *ITA*, the 2nd respondent intends to collect taxes charged on the non-resident person through losses or expenses of another person.

33. In this regard, paragraphs 26 and 29 of the replying affidavit state as follows:

    > " 26. That ideally, a gain from a financial derivative contract to a non-resident, on which withholding tax is applicable, would be a loss to the resident person with whom the contract was entered.
    >
    > 29. That the Commissioner appreciates that the resident person cannot establish the net gain of the non-resident person as they are not aware of the costs incurred by the non-resident. The resident person, however, knows the gross amount which is what they expense as a loss. The Commissioner seeks to tax this gross amount at the preferential rate of 15%. This rate compensates for the fact that the amount taxable on the non-resident is a gross gain." (Emphasis ours)

34. The ITA in its entirety does allow for taxation of losses of any person, whether directly or by deeming them to be the income of any other person.

35. T is the applicants case that ITax laws must be strictly construed, and in the absence of a specific provision in the *ITA* that provides a basis for which a taxpayer's actual loss would equate to a "deemed gain" of a different person, the Regulations must be found to be bad in law and ultra vires the provisions of the *ITA*.

    ii) Nature of Financial Derivative Transactions and the Challenge in Taxation

36. Financial derivative transactions of a category referred to as "forwards" are between two counterparties and are often entered into through International Swaps and Derivatives Association (ISDA) Master Agreement between the parties involved.

37. Under an ISDA Master Agreement, in almost every case the parties exchange security at the outset of the transaction, but there exists a myriad of outcomes of settlement which may not involve the exchange of cash. For instance, physically settled derivatives do not involve any payment of any amount by any party to the derivative transaction.

38. The 2nd respondent in the replying affidavit assumes that every derivative transaction involves a cash "payment", which is an inaccurate assumption. In this regard, it should be noted that withholding tax, as envisaged as being payable, requires an amount be withheld on a payment. In transactions where there is no payment on settlement, a withholding is not possible.

39. Regulation 3(2)(b) recognises that forward transactions can be settled otherwise than in cash but fail to provide how withholding tax would be paid in the case of physical settlement. Therefore, the intended outcome of section 35 of the *ITA* would fail, given the fact that no payment will be made where transactions are physically settled, and consequently no withholding is possible.

40. The regulations also fail to appreciate that there are significant differences between different types of derivative transactions. In regulation 2, it is stated that financial derivatives contract includes "... a futures contract including interest rate futures, stock index futures, volatility futures, weather futures or similar futures contract whether cash settled or not".

41. Unlike forward contracts, which are traded as between two counterparts, "futures" contracts are traded on a securities exchange where they can be bought and sold in a manner similar to shares.

42. In this regard, the *Capital Markets Act* (chapter 485A, Laws of Kenya) sets out various provisions relating to the creation of a futures exchange, and in July 2019, the Nairobi Securities Exchange created the first futures exchange in Kenya known as NEXT.

43. In order to demonstrate why the regulations cannot be applicable to a futures contract, the applicant uses the following illustration;

    a. A currency futures contract derives its value from the value of the underlying asset, in this case, currencies. For instance, take the USD/KES rate of KES 160. Therefore, a 1-month USD/KES futures contract would be trading at a slightly higher premium than the current USD/KES rate. For purposes of this illustration, we would assume that the premium is KES 5, and therefore a USD/KES currency future would be trading at KES 165. In this illustration therefore, the underlying asset is the USD/KES exchange rate and the 1-month futures contract being traded on the futures exchange is the currency derivative, at a price of KES 165 per future.

    b. A savvy trader on Kirinyaga Road, a Mr Kimani from Murang'a County, intends to import Toyota spare parts from Japan which will cost him USD100,000. If he was to make the payment today at the current exchange rate of USD/KES 160, he would be required to pay KES 16,000,000 for the spare parts. However, it is the case that between the date of placing the order and the time when he is required to make payment, a period of two months will pass.

    c. Mr Kimani is worried, as he is expecting the USD/KES rate to go up from 160 to 180 in the next couple of months. This means that Mr Kimani will end up paying KES 18,000,000 in two months' time, instead of KES 16,000,000 today, which is higher by KES 2,000,000. Such a loss would be unbearable for his business and would wipe out any profits he may generate from the sale of the spare parts.

    d. Being a savvy trader, Mr Kimani instead decides to hedge his risk by using a USD/KES currency futures contract. He buys on the exchange 100,000 lots of currency futures at the current trading price of KES 165 per future, which will cover his purchase cost of KES 16,000,000 in two months' time.

    e. He incurs a cost of KES 16,500,000 in buying the currency futures. If his guess is right that the USD/KES rate will go up to KES 180, then he makes a profit of KES 15 per future (ie KES 180 (actual currency rate on settlement date) less KES 165 (price he bought each future)). If his guess is wrong, and the USD/KES rate instead falls to KES 155, Mr Kimani makes a loss of KES 10 per future (ie KES 165 (price he bought each future) less KES 155 (actual currency rate on settlement date).

f. In this illustration, where Mr Kimani bought an exchange traded derivative, there exists no counterparty against whom he can withhold any tax, as at the time he entered into the futures currency transaction he did not know whether he would make a profit or a loss out of the transaction. Furthermore, Mr Kimani cannot tell whether the seller of the future on the exchange was a resident person or a non-resident. In any case, on the settlement date, he makes no payment to any party against which any amount can be withheld, even in the case where he makes a gain.

g. In the illustration above, the ludicrousness of the proposed provisions of the regulations can be demonstrated where Mr Kimani makes a loss. In that situation, he bought 100,000 futures for KES 165 each but the KES strengthens and he makes a loss of KES 10 per future. In total, he made a loss of KES 1,000,000 on the derivatives transaction. In this regard:

   i. it is incorrect to assume that Mr Kimani's loss of KES 1,000,000 equates to another party's gain, as a seller's gain can only be by reference to what they had bought the future for as against what they are selling it for, which information Mr Kimani would not know; and

   ii. it is an absurdity to ask Mr Kimani on top of the loss he made of KES 1,000,000 to withhold 15% tax, and remit this to KRA as this cost would be borne by him in this transaction and cannot be transferred to any other party. At the time he makes a loss, there is no payment to any counterparty. If this provision is in fact implemented, Mr Kimani will suffer a further KES 150,000 on account of a tax he has to withhold as against a loss he has made, instead of on account of a gain made by a non-resident party.

h. The regulations are therefore bad in law,unclear, ambiguous and do not provide a clear basis for the taxation of "gains from financial derivatives", noting that there is no basis or methodology to determine the realised gains of the non-resident person under the regulations as currently drafted.

44. It is the applicants argument that applying withholding tax on the losses of a resident person would result in an absurdity, and in any case is not supported by any provision under the *ITA*.

45. As an additional issue, the regulations provide that the tax payable under the regulations would be due and payable by the 20th day of the month after which a loss from the transaction with a non-resident person is realised.

46. This provision is impractical as there is in fact no payment made in the event of settlement for physically settled derivatives and exchange traded derivative transactions.

47. A forward derivatives transaction is one entered into between two parties. A basic form of a forward derivatives transaction would be where a party enters an agreement today, to acquire a commodity at a future date, but with the price agreed today.

48. The applicant invites the court to take the example of an airline operating out of Kenya. The airline enters into a forward contract with an international hedge fund (HedgeCo Bros) for the purchase of jet fuel. The airline has projected that it will require ten million (10,000,000) litres of jet fuel in July 2024 as it is expected that there will be increased global travel for the Easter holidays. In this example:

a. As at January 2024, the price of jet fuel based on international market prices is USD 0.53 per litre. The airline cannot, due to business and logistical reasons, purchase and stock the ten million litres of the jet fuel in January 2024. However, based on its predictions made of the jet

fuel market, it has been speculated that the price of jet fuel is likely to increase to USD 0.68 per litre as at July 2024;

b. The airline decides to hedge itself against the risk of increased jet fuel prices by entering into a forward contract with HedgeCo Bros pursuant to which the price of a litre of jet fuel will be capped at USD 0.60 per litre. In this regard, even if the price in July 2024 will be lower than USD 0.60 per litre, the airline will pay Hedge Co Bros this amount. On the other hand, if the price in July 2024 is higher than USD 0.60 per litre, the airline will not pay anything more than this amount (and the excess will be borne by HedgeCo Bros);

c. In July 2024, the actual market price of jet fuel is instead an amount of USD 0.58 per litre. The airline has therefore made a derivative loss of USD 0.02 per litre (being 0.60 per litre minus the actual market price of USD 0.58 per litre). But is this loss equal to HedgeCo Bro's profit as alleged by the 2nd respondent's Replying Affidavit? It is my considered view that this is incorrect. This is explained with the following three (3) non-exhaustive scenarios:

    i. Maybe HedgeCo Bros had bought the fuel back in 2022 when the jet fuel prices were USD 0.40 per litre. Therefore, HedgeCo Bros actually made a profit of USD 0.20 per litre(being the difference between USD 0.60 per litre which was the price it entered into with the airline in the futures contract and USD 0.20 per litre being the purchase price). On the other hand, the airline made a loss of USD 0.02 per litre. The reference to the airline's loss has no correlation to the foreign entity's profit;

    ii. In the second scenario, the price of jet fuel as at July 2024 has in fact risen to USD 0.62 per litre, meaning that the airline makes a derivative profit of USD 0.02 per litre(being the difference between the purchase price as entered into with the fund of USD 0.60 and the market price of USD 0.62 per litre.) On the other hand, HedgeCo Bros had bought the fuel back in 2022 when the jet fuel prices were USD 0.40 per litre. Therefore, HedgeCo Bros actually made a profit of USD 0.20 per litre (being the difference between USD 0.60 per litre which was the price it entered into with the airline and USD 0.40 per litre purchase price). In this case, both the airline and HedgeCo Bros make a derivative profit. It is therefore thecase that the local party's gain is not equal to the non-resident's loss, as has been assumed in the regulations; and

    iii. In the third scenario, maybe HedgeCo Bros expected the prices to remain lower than USD 0.60 per litre. However, due to Houthi rebels in the Red Sea, in March 2024 the international jet fuel prices begun to rise above USD 0.60 per litre. HedgeCo Bros concerned that they would lose money on the trade with the airline decide to enter intoa contract to buy the jet fuel in March 2024 at a price of USD 0.65 per litre, to hedge their risks. However, as fate would have it, in June 2024 there is peace in the Middle East and the prices of jet fuel come back down to USD 0.55 per litre. Therefore, airline has made a loss of USD 0.05 per litre (being the amount payable to Hedge Co of USD 0.60 per litre less the actual market price of USD 0.55 per litre). However, HedgeCo Bros has also made a loss of USD 0.05 per litre, as it bought the jet fuel at USD 0.65 per litre but is selling it to the airline at USD 0.60 per litre. It is therefore incorrect to assume that a loss by one party equates a gain on another.

In summary, the applicant set out the table below:

Scenario	Airline gain/loss for 10,000,000 litres	HedgeCo gain/loss for 10,000,000 litres	Is the local entity's loss/gain equal to the foreign entity's gain/ loss?
Scenario 1	USD 0.02 per litre loss USD 200,000 total loss	USD 0.20 per litre gain USD 2,000,000 total gain	NO
Scenario 2	USD 0.02 per litre gain USD 200,000 total gain	USD 0.20 per litre gain USD 2,000,000 total gain	NO
Scenario 3	USD 0.05 per litre loss USD 500,000 total loss	USD 0.05 per litre loss USD 200,000 total loss	NO

According to the applicant,the illustration above shows that the regulations are inaccurate as they assume that one party's gain is equal to another party's loss, which as has been illustrated above, is not accurate. In any event, and without prejudice to the above, in respect of derivative transactions such as forwards, it should be noted that pursuant to the ISDA Master Agreement, which is commonly used for forward derivative transactions, a party is required to "gross up" any payment made on account of any taxes charged in Kenya. A financial derivative may be physically settled i.e., no payments are made to the non-resident.

49. The 2nd respondent would be seeking to collect payments from a party which has not made any gain or has made a loss for tax purposes in Kenya. This is unfair and equally places an unfair tax burden on resident persons.

50. The exparte applicant argues that the regulations are ultra vires the Act. Withholding tax on non-resident persons is charged pursuant to section 10 as read together with section 35 of the *ITA*. However, section 10 of the *ITA* does not include "gains from financial derivatives" as income of a non-resident person which is deemed to be accrued in or derived from Kenya. According to section 35(1) of the Act, tax on gains from financial derivatives is withheld upon payment to a non-resident person.

51. However, not all derivative transactions involve payments to non-residents and therefore withholding is not possible. For example, regulation 3(2)(b) of the *Regulations* recognises that forward transactions can be settled otherwise than in cash but fail to provide how withholding tax would be paid in the case of physical settlement.

52. The regulations propose to charge tax on losses made by resident persons, which does not align with the provisions of the Act which imposes income tax on "gains or profits".

53. It is the case that if a "loss" is made by a resident person, there can be no "payment" arising to the non-resident person on account of that "loss" on which the provisions of section 35 can be applied,

and on which a tax amount can be withheld. This discrepancy renders the regulations impractical and unenforceable. Further, a person is charged based on their income and not another person's losses.

54. Section 15(1)), it is stated that "For purposes of ascertaining the total income of a person for a year of income there shall ... be deducted all expenditure incurred in that year of income .... by him". (Emphasis ours). This was emphasized by the Court of Appeal in the case of *Kenya Revenue Authority v Waweru & 3 others; Institute of Certified Public Accountants & 2 others (Interested Parties)* (Civil Appeal E591 of 2021) [2022] KECA 1306 (KLR) where it was held that "...tax becomes payable by an assessee by virtue of the charging provision in a taxing statute..."

55. Section 3 of the Act is the charging provision pursuant to which all income tax liability in Kenya must be pegged. Sections 3 and 4 of the regulations effectively seek to apply a withholding tax obligation on a resident person on the losses made by the resident person and yet they have no anchor on section 3 of the Act, which provides for the income upon which tax is chargeable to include the "...gains from financial derivatives...". There is no reference to "losses" under the provisions of the Act when ascertaining a person's taxable income.

56. It submits that an order of certiorari lies where a body acts without jurisdiction or in excess of jurisdiction.

57. It submits that in this case, the 1st respondent acted in excess of jurisdiction when enacting the regulations with an intended effect of overriding the provisions of the *ITA* yet the Regulations must be in strict compliance with the anchoring statute which is the *ITA*.

58. Reliance is placed As in the case of *Mars Logistics Limited v Commissioner of Domestic Taxes* [2021] eKLR, where it was held that "...it is an elementary principle of law that subsidiary legislation cannot override the express provisions of a statute..."

59. The ex parte applicant further relies on the case of *Okiya Omtatah Okoiti & 3 others v Anne Waiguru, the Cabinet Secretary, Devolution and Planning & 6 others* [2021] eKLR in its prayer for an order of certiorari where the court held as follows:

> "An act of ultra vires when the decision-making authority commits an error of law in the process of taking the decision or making the act, the subject of the complaint. Acting without jurisdiction or *ultra vires* or contrary to the provisions of law or its principles renders the decision made laced with illegality."

60. The Supreme Court of India enumerated on whether regulations are *ultra vires* in the case of *Maharashtra State Board of Secondary & Higher Secondary Education v Kurmarsheth & others* [1985] LRC (Const) is instructive. The court stated that:

> "The validity of regulation is to be determined by reference to specific provisions of the statute conferring the power of delegated legislation and to its objects and purposes. Provided the regulations have a rational nexus with the object and purpose of the statute, the client should not concern itself with the wisdom and effectiveness... The court should not concern itself with the merits or demerits of a policy pursued by means of delegated legislation, but only with the question whether the delegated legislation falls within the scope of power conferred by statute and is consistent with the Act and the Constitution." (Emphasis ours)

61. It is its case that the regulations do not provide how gains will be computed for non-residents person in this context, and it is practically impossible for a resident person to calculate the gains of a non-resident

person. This requirement is, therefore, unreasonable, impracticable, unclear, creates uncertainty and is oppressive as far as they require a resident person to "assume" that their "loss" on a derivative transaction equates to the "gain" of the non-resident person, and against such presumed position, to "withhold" tax on a "payment" to the non-resident person at the rate of 15%.

62. Where a "loss" has occurred, there is no "payment" to a non-resident person, and therefore it follows that no "withholding" can occur pursuant to section 35 of the Act. The lack of clarity and practicality in the regulations further supports the exparte applicant's case for quashing of the regulations.

63. The actions by the respondents contravene article 10(2)(a) of the *Constitution* which provides as follows: "The national values and principles of governance include patriotism, national unity, sharing and devolution of power, the rule of law, democracy and participation of the people."

64. One of the ingredients of the rule of law is certainty of the law. Certainty in laws that impose taxes is essential for business planning and the ex parte applicant will be greatly prejudiced by the uncertainty the regulations have.

65. The unfair and uncertain nature of the regulations would be evident in the following way: Financial derivative transactions are entered into using a standard International Swap Dealers Association (ISDA) Master agreement, pursuant to which there is a grossing up provision. This provision requires the party in Kenya to "gross up" the payment made to the non-resident person on account of any taxes charged in Kenya, and therefore the ultimate cost of any tax (whether imposed in accordance with the law or as is the present case, illegally so) would be borne by the Kenyan party, in this case, the members of the exparte applicant. In instances where no payment is made to a non-resident, the 2nd respondent would be seeking to collect a payment from a party which has already made a tax loss for Kenyan purposes. The regulations therefore impose the burden on resident persons to calculate a non-resident person's gain with little, speculative or no information on the gain itself which is discriminatory and imposes an unfair tax burden on resident persons.

66. They argue that the regulations impose a further unfair tax burden on the resident person by characterizing the gains from a financial derivative as a separate income.

67. This characterization imposes an onerous burden on the resident person particularly KBA's members whose core functions is trading in financial derivatives. In such a case it will be unduly difficult to separate the source of the gain from the financial derivative.

68. Reliance is placed in *Commissioner of Income Tax v Westmont Power (K) Ltd* Nairobi High Court Income Tax Appeal No. 626 of 2002, the court while citing *Inland Revenue v Scottish Central Electricity Company* [1931] 15 TC 761 expressed itself as follows:

> " Even though taxation is acceptable and even essential in democratic societies, taxation laws that have the effect of depriving citizens of their property by imposing pecuniary burdens resulting also in penal consequences must be interpreted with great caution. In this respect, it is paramount that their provisions must be express and clear so as to leave no room for ambiguity...any ambiguity in such a law must be resolved in favour of the taxpayer and not the Public Revenue Authorities which are responsible for their implementation."

69. The Financial Derivatives Regulations are ambiguous, and it are not anchored on the *ITA*.

70. In the case of *Republic v Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD* [2012] eKLR Majanja, J held as follows:

> "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)."

71. It is further its case that the regulations are also procedurally defective as the 1st respondent did not prepare a regulatory impact statement prior to making the regulations as required by section 6 of the *Statutory Instruments Act* (the SI Act).

72. This indicates a lack of proper assessment and consideration of the potential impact and consequences of the regulations, further supporting the need for quashing of the regulations.

73. The regulations do not fall within the ambit of section 9 of the *SI Act* which provides for statutory instruments which regulatory impact statements are unnecessary.

74. The regulations do not meet the threshold under section 9 of the *SI Act* for the following reasons:

    a. The regulations operate to the disadvantage of resident taxpayers in that it reduces their rights and imposes liabilities.

    b. The regulations are of legislative character and impose a tax obligation.

    c. The regulations did not consider prevailing Kenyan legislative drafting practice.

    d. The regulations are not substantially uniform or complimentary with the ITA, legislation of National Government or any other County.

75. The regulations are not uniform or complimentary with the *ITA*. The *ITA* provides for taxation on gains whilst the regulation provides for taxation on losses. The *Black's Law Dictionary* ninth edition definition of "uniform" is as follows: "Characterized by lack of variation, identical or consistent".

76. By the 2nd respondent's admission, the 1stRespondent did not prepare a Regulatory Impact Statement and we submit that it does not fall within the exceptions provided for under section 9 of the *SI Act* as it reduces the rights and imposes liabilities, it imposes a tax obligation and that it is not uniform or complimentary with the *ITA*.

The 1st Respondent's Case;

77. The 1st respondent opposes the application. It is its case that the Finance Act, 2022 introduced 15% withholding tax on gains from financial derivatives contracts earned by a non-resident person through an amendment to section 3(2), 9(3) and the Third Schedule to the *Income Tax*, cap 470. It advances the following arguments.

78. The introduction of withholding tax on financial derivatives requires the Cabinet Secretary National Treasury and Economic Planning to make regulations to facilitate the implementation of taxation gains from financial derivatives by non-residents.

79. The National Treasury in consultation with the 2nd respondent herein Kenya Revenue Authority prepared the *Income Tax (Financial Derivatives) Regulations*, 2023 pursuant to section 9 (4) as read together with section 130 of the *Income Tax Act*, cap 470.

80. The regulations were gazetted on January 27, 2023 in Legal Notice No.4 through Kenya Gazette supplement No.6 of 2023 and submitted to the National Assembly via the National Treasury and Economic Planning letter Ref. TNT/ZZ/131/04 dated 13th January 2023.

81. Public participation was undertaken in compliance with the provisions of section 5 of the *Statutory Instruments Act*, 2013 and article 201(2) of the *Constitution* of Kenya, 2010.

82. The National Treasury and Economic Planning through the Kenya Revenue Authority invited business organizations and members of the public to submit their views for consideration in the development of the Income Tax (Financial Derivatives) Regulations, 2022 on September 2, 2022 through a public notice on the KRA website and on September 6, 2022 in the newspapers.

83. Currently gains by non-residents from financial derivatives are not subject to tax as such creating unfairness to other taxpayers deriving income from Kenya. Hence, The Finance Act 2022 bridged this gap by creating a provision to impose tax on income derived from transactions involving financial derivatives.

84. The Kenya Revenue Authority upon considering comments from Citi Corporate and Investment Banking, Kenya Bankers Association, Kelvin Mbithi, Ernest Muriu among others development the draft Income Tax (Financial Derivatives) Regulations 2022 which were subjected to a second round of public participation from November 17, 2022 in compliance with the law.

85. It is its case that the primary objective of the regulations is the taxation of financial derivatives in order to bring equity and fairness in taxation of income derived/accrued from Kenya.

86. The proposed taxation of financial derivatives is expected to widen the tax base by taxing gains accrued from Kenya by non-resident persons while still maintaining the competitiveness of financial derivatives traded at the Nairobi Securities Exchange.

87. It argues that Kenya joins a host of other jurisdictions that have introduced taxation of gains from financial derivatives. Other jurisdiction that tax gains from financial derivatives include South Africa, United Kingdom, Brazil, India, US, Belgium among others.

88. It maintains that the decisions made by the 1st respondent were reasonable, rational, fair and lawful as prescribed under the law and well within their mandate and jurisdiction as an office and further in the interests of justice.

89. It believes that the application does not disclose any element of illegality, irrationality, procedural impropriety and/or unfairness in the manner in which the respondents proceeded with their constitutional duties that warrants a grant for leave to file a Judicial Review Application.

90. It is his strong persuasion that the 1st respondent continued to uphold National values and principles of governance as required by law and has promoted good governance, integrity, transparency and accountability of these procedures and processes, and have not flouted any law nor acted in excess of their powers.

The 2nd Respondents Case;

91. It is the 2nd respondent case that trading in financial derivatives is growing steadily as an integral part of the financial market. Significant growth and development in the derivatives market has been experienced in the world in the last three decades.

92. It is its case that currently, gains from financial derivative contracts by non-residents are not taxed. This brings about unfairness in the taxation system and further creates room for tax avoidance.

93. It argues that the taxation of the financial derivative contracts therefore is a positive development for Kenya as it provides a good platform of widening the tax base and ensures equity in taxation.

94. The *Finance Act*, 2022 introduced a 15% withholding tax on income earned by non-resident person from financial derivatives contracts through amendments to section 3(2), 9(3), 9(4) and the Third Schedule to the *Income Tax Act*, cap 470. The said amendments were to take effect on 1st January 2023.

95. The Act exempted from taxation gains arising from transactions in the Nairobi Securities Exchange Derivatives Market in order to spur its development.

96. Section 9(3) of the *Income Tax Act* was to be carried out in accordance with the regulations made by the Cabinet Secretary.

97. In light of the foregoing, the Income Tax (Financial Derivatives) Regulations, 2022 were made pursuant to section 9(4) as read with section 130 of the *Income Tax Act*, cap 470, for ease of administration and implementation of the financial derivatives contracts provisions.

98. It is its case that in furtherance of this objective, the Cabinet Secretary, National Treasury and Economic Planning invited business organizations and members of the public to submit their views for consideration.

99. Consequently, the 1st respondent through the 2ndrespondent conducted a second round of public participation wherein the following stakeholders participated:

    a. Citi Corporate and Investment Banking;

    b. Kenya Bankers Association;

    c. Kelvin Mbithi;

    d. Ernest Muriu;

    e. Citibank Kenya

    f. Ernst & Young LLP

    g. Ernst & Martin Associates

    h. EABX Public Limited Company

    i. Delloitte & Touché LLP

    j. Stanchart Bank

    k. Eco Bank

    l. Stanbic Bank

    m. PWC

n. Absa Africa & Equity Bank.

100. Regulations 3(1) provides that "Any realized gain to a non-resident person, being a realized loss to the resident person who is a party to the financial derivative contract, shall be chargeable to tax in accordance with the Act".

101. It is its case that the foregoing provides the tax base upon which the withholding tax rate is applied.

102. It argues that this is meant to bring clarity as to what constitutes the base of tax.

103. Section 2 of the *Income Tax Act*, defines a financial derivative as, a financial instrument the value of which is linked to the value of another instrument underlying the transaction which is to be settled at a future date.

104. The import of the above is that the result of a derivative transaction is a transfer or exchange of specified cash flows at defined future points in time. It is its case that in a typical derivative contract, two parties enter into a contract today, at a price set today also referred to as settlement price.

105. This price is set according to the industry standards and practices but in some cases, dictated by internationally quoted markets and agreements such as International Swaps and Derivatives Association.

106. Upon the expiry of the contract period, the person who sold the contract will deliver the necessary asset at the settlement (earlier agreed) price irrespective of the price of the asset in the market prevailing at the time of settlement to the party who purchased the contract or asset.

107. It is its case that in some instances, the parties agree to settle the contract in a net basis where whoever has lost, pays the counter party and the contract then is deemed settled also referred to as net settled contract.

108. It is its further its case that 3 instances are usually possible in a financial derivative contract: -

a. The person who sold/purchased the contract losses and the counter party gains. If the person is a resident of Kenyan and the counterparty is a non-resident, then it implies, the non-resident gained and the gain however settled will be subject to the withholding tax according to section 9(3) of the ITA and the Income tax (Financial Derivatives) Regulations.

b. The person who sold/purchased the contract gains and the counter party losses. If the person is a resident of Kenya and the counterparty is non-resident, then it implies that the non-resident has incurred losses on the financial derivative contract and no withholding tax will be applicable to the Kenyan resident according to the regulations.

c. The person who sold/purchased the contract and the counterparty neither gains nor losses. This is a contract where none of the parties have gained or lost and therefore no withholding tax will be applicable according to the regulations.

109. It argues that regulation 3 does not impose any additional burden on the residents since the records and documents required of these transactions are maintained in the ordinary course of business and are therefore very practical. Paragraph 4 of the regulations provide the tax point for financial derivative transactions so as to provide clarity as to when tax on gains from financial derivative contracts crystallises.

110. It is its case that paragraph *3* and *4* are therefore not ultra vires in any way as they are meant to provide clarity on the taxation of gains from financial derivative contracts.

111. Financial derivative contracts are entered into between two parties. Gains chargeable to tax in Kenya, are those that accrue to non-residents from financial derivative contracts involving residents and non-residents.

112. A gain from a financial derivative contract to a non-resident, on which withholding tax is applicable, would be a loss to the resident person with whom the contract was entered.

113. The regulations provide that a realised loss by a resident person from a financial derivative contract is allowed as a deduction against any gain accruing from similar activities to the extent that it has not been claimed.

114. The resident person is in contract with the non - resident person, is aware of the progress of the transactions affecting the contract during the period of the contract. The resident person is therefore able to accurately determine the amount of loss made from the transactions.

115. It is further its case that The commissioner appreciates that the resident person cannot establish the net gain of the non- resident person as they are not aware of the costs incurred by the non-resident. The resident person, however, knows the gross amount which is what they expense as a loss.

116. The commissioner seeks to tax this gross amount at the preferential rate of 15%. This rate compensates for the fact that the amount taxable on the non-resident is a gross gain.

117. Section 6 of the *Statutory Instruments Act* 2013 provides for the preparation of the Regulatory Impact Statement by the regulation making authority prior to making the statutory instruments in circumstances where a proposed statutory instrument is likely to impose significant costs on the community or a part of the community. However, section 9 of the *Statutory Instruments Act* 2013 provides for situations where Regulatory Impact Statements may not be necessary.

118. It is its case that regulatory impact statement need not be prepared for a proposed statutory instrument if it is a matter arising under legislation that s substantially uniform or complementary with the legislation of the National Government or if the proposed legislation only provides for an amendment of a fee, charge, or tax consistent with announced government policy.

119. It is its case that since these regulations are in line with the provisions of the *Income Tax Act* cap. 270, which is an announced government policy, a regulatory impact statement was considered unnecessary.

120. With the respondents having granted the public sufficient opportunity to participate, the regulations were made on January 19, 2023 and gazetted on January 27, 2023.

121. It argues that statutory instruments, such as regulations, become effective on the date of publication pursuant to section 23 of the *Statutory Instruments Act*.

122. The *Income Tax (Financial Derivatives) Regulations* 2022 were published on January 27, 2023 vide the Legal Notice No. 4.

123. Upon publication of the Legal Notice, the same was laid before the National Assembly in compliance with section 11 of the *Statutory Instruments Act*, 2013.

124. The applicant has made an assumption in its application that the requirement is unreasonable, impracticable, ambiguous, creates uncertainty and is oppressive.

125. The ex-parte applicant has not disclosed any procedural impropriety and has made unfounded and unsupported allegations.

126. It argues that the applicant's fears are based on an assumption made that the resident person will be required to assume that their loss on a derivative transaction equates to the gain of the non-resident person.

127. This assumption is however unfounded. The operation of the regulation has been explained in the foregoing paragraphs.

128. The regulations are to aid in the collection of taxes and the application is prejudicial and to the detriment of the government, having included the collections into its fiscal budget for the current and the next financial year.

129. It is its case that the amount of taxes to be collected runs into the hundreds of millions, which finance the government's projects.

130. It argues that the application discloses no reasonable cause of action under order 53 and is totally unfounded and ought to be dismissed with costs to the 2nd respondent.

The 3rd Respondent's Case;

131. The 3rd respondent opposes the application and argues that the 1st respondent is empowered to make regulations on imposition of taxes on financial derivatives under section 9(4) of the *Income Tax Act*.

132. The 1st respondent made the Income Tax (Financial Derivatives) Regulations, 2023 through LN No 4 of 2023 which was published on January 27, 2023 (the "regulations").

133. The regulations came into operation on January 27, 2023 upon publication in the under section 23 of the *Statutory Instruments Act*, 2013 (the "SIA").

134. It is its case that the regulations were thereafter submitted to his office on February 21, 2023 within the time prescribed under section 11(1) of the *SIA*. The regulations were submitted together with an explanatory memorandum under section 5A of the *SIA*.

135. It is its case that the regulations fell under the exemption category in section 9(1) of the SIA and therefore a regulatory impact statement was not required.

136. The regulations were tabled before the National Assembly on February 28, 2023 and thereafter committed to Committee on Delegated Legislation (the "Committee") under section 12 of the *SIA* and Standing Order 210.

137. The Committee considered the documents submitted by the 1st respondent evidencing the conduct of public participation and stakeholder engagement.

138. The Committee was satisfied that the Ministry and KRA had conducted adequate public participation and stakeholder engagement in the formulation of the regulations in line with the report on stakeholder comments and submissions.

139. The ex parte applicant was also invited by the Committee to make oral submissions on the impugned regulations on March 16, 2023 and thereafter forwarded written submissions on April 3, 2023 which were considered by the Committee.

140. Pursuant to the Standing Order No 210(4)(a), which provides that, if the Committee on Delegated Legislation resolves that a statutory instrument be acceded to, the Clerk shall convey that resolution to the relevant State Department or the authority that published the statutory instrument, the National Assembly sent an approval letter dated May 22, 2023 notifying the 1st respondent of the Committee

resolution to accede the impugned regulations. This was done through the approval letter dated May 22, 2023.

141. It is further its case that the ex parte applicant has failed to demonstrate how the 3rd respondent violated the Constitution or any of its fundamental rights or freedoms.

142. The *Income Tax Act* provides in section 9(3) that 'where a resident person enters into a financial derivatives contract with a non-resident person, any gain accruing to the non-resident person from that arrangement shall be subject to tax.'

143. The 1st respondent is empowered under section 9(4) to formulate the necessary regulations providing a framework for the taxation of financial derivative contracts.

144. The *Income Tax Act* further defines a financial derivative in section 2 as 'a financial instrument the value of which is linked to the value of another instrument underlying the transaction which is to be settled at a future date.'

145. Regulation 3(1) of the regulations thus requires that 'any realized gain to a non-resident person, being a realized loss to the resident person who is a party to the financial derivative contract, shall be chargeable to tax in accordance with the Act.'

146. It is its case that the regulations stipulate the types of Financial Derivative Contracts that are subject to the withholding tax to include:

    a. A futures contract including interest rate futures, stock index futures, volatility futures, weather futures or a similar futures contract whether cash is settled or not;

    b. A forward contract whether cash settled or not;

    c. A swap contract including a contract for interest rate swaps, currency swaps, credit default swaps and hybrid swaps;

    d. An option contract including put options, call options and option spreads; or

    e. Any other financial derivative instrument.

147. The Act, read together with the regulations, clearly defines the scope of their application to be on Financial Derivative Contracts as provided in the regulations.

148. Financial Derivative Contracts are used to trade in Financial Markets through 'financial bets' whereby the value of the derivative is determined either by the value placed on the contract (the derivative itself) or the price of the real or financial things that the derivatives are based on (the price of the actual item).

149. When two parties enter into a financial derivative contract, one party recognizes it as a debt or liability, and the other recognizes it as something they are entitled to like a claim or an asset. Eventually, one party gains from the transaction while the other loses.

150. The regulations clearly provide that in the case where the party gaining from the transaction is a non-resident person, the resident person is required to withhold a tax of 15% on the gain accruing to the non-resident person.

151. The objective and purpose of the regulations is to ensure that non-resident companies do not avoid payment of taxes from gains sourced from Kenya.

152. The regulations were thus formulated to ensure that the burden of taxation is shared fairly and to increase Kenya's tax base in accordance with the principles of taxation under article 201(b)(i) of the *Constitution*.

153. He argues that the resident person, having entered into a contract with the non-resident person is privy to the terms of the contract which stipulate the total amount to be paid to the benefiting party.

154. The contracting parties are therefore able to clearly distinguish the amount to be subjected to withholding tax. It believes that there is no ambiguity in the application of the law.

155. Reliance is placed on the Court of Appeal in Civil Application Numbers E304 of 2023, The *Cabinet Secretary for National Treasury and Planning & Attorney General v Okiya Omtatah Okoiti & 12 others*, and E310 of 2023, The *National Assembly and the Speaker of the National Assembly v Okiya Omtatah Okoiti & others*, held that "tax is a continuous and annual mechanism and members of the public can get a rebate for overpaid taxes and levies when paying levies and subsequent tax payments."

156. The 3rd respondents further relies on the following authorities:

The Court of Appeal in *Mumo Matemu v Trusted Society of Human Rights Alliance & 5 Others* [2013] eKLR stated as follows on the role of the court;

> "(77) For the avoidance of doubt, we also reiterate that a court reviewing the procedure of a legislature is not a super-legislature, sitting on appeal on the wisdom, correctness or desirability of the opinion of the impugned decision-making organ. It has neither the mandate nor the institutional equipment for that purpose in our constitutional design. Moreover, the process cannot be wrong simply because another institution, for example the courts, would have conducted it differently. It must be accepted that the institutional environment is controlling on the manner in which an organ disposes of its issues."

157. The National Assembly considered and approved the impugned regulations in accordance with the *Constitution*, the *SIA* and its Standing Orders.

158. In *Paul Musili Wambua v Attorney General & 2 others* [2015] eKLR, while agreeing with the decision of the Supreme Court of India in *Maharashtra State Board of Secondary and Higher Secondary Education and Another v Kumarstheth* [1985] LRC, the court held as follows while considering the constitutionality of statutory instruments:

> "so long as the body entrusted with the task of framing the rules or regulations acts within the scope of the authority conferred on it in the sense that the rules and regulations made by it have a rational nexus with the object and purpose of the statute, the court should not concern itself with the wisdom of the efficaciousness of such rules and regulations. It is exclusively within the province of the Legislature and its delegate to determine, as a matter of policy, how the provision of the statute can best be implemented and what measures substantive as well as procedural would have to be incorporated in the rules and regulations for the efficacious achievement of the object and purposes of the Act. It is not for the court to examine the merits and demerits of such a policy because its scrutiny has to be limited to the question as to whether the impugned regulation falls within the scope of the regulation-making power conferred on the delegate by the statute. The responsible

representative entrusted to make bylaws must ordinarily be presumed to know what is necessary, reasonable, just and fair."

159. The legislative mandate of a regulatory making authority is a delegated power which must be exercised in accordance with article 94(5) and (6) of the Constitution. In *SDV Transami Kenya Limited & 19 others v Attorney General & 20 Others & another* [2016] eKLR, Justice E. Muriithi held as follows:

> (174) clearly although the Judiciary is the final arbiter of constitutionality, Parliament would have done the initial sweep for mines that render the statutory instruments unconstitutional, ultra vires and, therefore, void, and for consideration apart from the question of constitutionality whether the legislation should more properly be dealt with as an Act of Parliament. ...There is always merit in the judicial policy that where the constitution or statute has made provision for dealing with a particular matter that mechanism should be followed strictly before the matter is presented to the court, see *Speaker of the National Assembly v Karume* [2008] KLR (EP) 425."

160. KBA's allegation that the impugned regulations came into force prior to their approval by the 3rd respondent is baseless. Section 23(1) of the SIA states that:

> " A statutory instrument shall come into operation on the date specified in that behalf in the statutory instrument or, if no date is so specified, then, subject to subsection (2), it shall come into operation on the date of its publication in the Gazette subject to annulment where applicable."

161. The jurisdiction of this court can only be invoked in the event of breach of the Constitution and the law. KBA has failed to demonstrate that the impugned regulations are contrary to the Constitution and the law. The application should therefore be dismissed with costs.

162. In exercising their mandate, courts should give state organs sufficient leeway to discharge their mandate and only accept an invitation to intervene when there is a contravention of the Constitution. This is the position taken by the Supreme Court of Kenya in *Justus Kariuki Mate & another v Martin Nyaga Wambora & another* [2017] eKLR.

> " (84) Where the express terms of the Constitution allocate specific mandates and functions to designated agencies of the State. Such restraint, in the context of express mandate allocation under the Constitution, is essential, as a scheme for circumventing conflict and crisis, in the discharge of governmental responsibility. No governmental agency should encumber another to stall the constitutional motions of the other. The best practices from the comparative lesson, signal that the judicial organ must practice the greatest care, in determining the merits of each case."

163. The impugned regulations are a result of a policy decisions emanating from an identified gap in law to ensure that the burden of taxation is shared equally.

164. In *Patrick Ouma Onyango & 12 others v Attorney General and 2 Others* [2005] eKLR, the court, on the issue of whether it should interfere with a formulation of policy, political or legislative process stated:

> " The answer the court gives to this question is that whatever the technicalities or the legal theory, sound constitutional law must be founded on the bedrock of common sense and

the courts must now and in the future appreciate the limitations on formulation of policy, legislative process and practical politics because the courts are ill equipped to handle such matters."

165. It closes by making a plea that should this honourable court be inclined to dismiss the application; it will be in the public interest for the ex parte applicants and its members to pay the taxes due and owing under the regulations from the date that those taxes were due and payable.

Analysis And Determination;

166. Upon analyzing the application, the various affidavits, the parties' submissions and authorities, the following turn out to be the issues for determination:

1. Whether or not there was public participation that culminated in the *Income Tax (Financial Derivatives) Regulations*, 2023 (the Regulations) on 27 January 2023.
2. Whether or not the regulations required an impact report.
3. Whether the regulations are ultra vires the Act.
4. Whether or not the applicant entitled to the orders sought.
5. Who shall bear the costs.

167. In *Republic v Firearms Licensing Board & another ex parte Boniface Mwaura* [2019] eKLR stated that:

> " The concept of Judicial Review under the Constitution of Kenya is similar to that under the Constitution of South Africa where the South African court held in *Pharmaceutical Manufacturers Association of South Africa in re ex parte President of the Republic of South Africa & others* that 'the common law principles that previously provided for the grounds for Judicial Review of public power have been subsumed under the Constitution and, insofar as they might continue to be relevant to public power have been subsumed under the Constitution and, insofar as they might continue to be relevant to Judicial Review, they gain their force from the Constitution. In the Judicial Review of public power, the two are intertwined and do not constitute separate concepts..."

Justice Mativo accordingly held that:

> " The entrenchment of the power of Judicial Review, as a constitutional principle should of necessity expand the scope of the remedy....section 7 of the Fair Administrative Action provides that any person who is aggrieved by an administrative action or decision may apply for review of the administrative action or decision to a court in accordance with section 8....
>
> Judicial Review is now a constitutional supervision of public authorities involving a challenge to the legal validity of the decision...Courts must develop judicial review jurisprudence alongside the mainstreamed 'theory of a holistic interpretation of the Constitution. Judicial review is no longer a common law prerogative, but is now a constitutional principle to safeguard the constitutional principles, values and purposes...."

The First Issue:

168. The applicants believe that the respondents did not conduct public participation before coming up with the impugned regulations while the respondents are of a contrary view.

169. Under article 10 of the *Constitution of Kenya* the respondents are a duty to uphold protect and promote public participation before coming up with any legislation.

170. Public participation is a process through which the views of those affected or likely to get affected by a new legislative or changes in an existing legislation are considered.

171. A legislative process that is driven and informed by the views of Kenyans is a process that is owned by the people. It is a legislative process that culminates in the affirmation and the promotion of the sovereign power of the people.

172. A legislation that is enacted through a legislative process that is devoid of public participation offends the legitimate expectation of the people that they will get a law that is certain, constitutional and enforceable at the minimum.

173. Although we do not have a specific legislation known as The Public Procurement Act, public participation in Kenya has overtime been refined in different judicial pronouncement post 2010.Perhaps the time has now come when the legislature came up with a Public Participation Act.

174. In the case of *British American Tobacco Kenya, PLC formerly British American Tobacco Kenya Limited v Cabinet Secretary for the Ministry of Health & 2 others; Kenya Tobacco Control Alliance & another (Interested Parties); Mastermind Tabacco Kenya Limited (Affected Party)* (Petition 5 of 2017) [2019] KESC 15 (KLR) (26 November 2019) (Judgment)

(i) Whether the process leading to the making of the Tobacco Regulations 2014 was unconstitutional for lack of public participation and consultation?

85. Public participation has been entrenched in our *Constitution* as a national value and a principle of governance under article 10 of the *Constitution* and is binding on all State organs, State officers, public officers and all persons whenever any of them: (a) applies or interprets the *Constitution*; (b) enacts, applies or interprets any law; or (c) makes or implements public policy decisions. As aptly stated by the appellate court, public participation is anchored on the principle of the Sovereignty of the People "that permeates the *Constitution* and in accordance with article 1(4) of the *Constitution* is exercised at both national and county levels".

86. Article 118 of the *Constitution* provides for public participation in the legislation making process, as follows:

"Public access and participation

(1) Parliament shall-

(a) conduct its business in an open manner, and its sittings and those of its committees shall be open to the public; and

(b) Facilitate public participation and involvement in the legislative and other business of Parliament and its committees".

Therefore, while the legislative mandate is delegated to Parliament, it must facilitate public participation as the onus of ensuring public participation rests with it.

87. Since the promulgation of the *Constitution* 2010, the question of the rationale, scope and application of public participation as a principle of governance has been subject of numerous decisions by the courts. The High Court in this matter appraised itself

of the various decisions on the same, which appraisal the Court of Appeal readily endorsed. In the Matter of the National Land Commission, the Supreme Court placed the principle of public participation at the core of the concept of checks and balances in governance in the execution of their functions by the various arms of government, when we stated:

> "[308] The conditioning medium within which these functions have to be conducted, is constituted by the national values and principles outlined in article 10 of the *Constitution*: in particular, the rule of law; participation of the people; equity; inclusiveness; human rights; non-discrimination; good governance; integrity; transparency and accountability. It is to be noted that, the very essence of checks-and-balances touches on the principles of public participation, inclusiveness, integrity, accountability and transparency; and the performance of the constitutional and statutory functions is to be in line with values of integrity, transparency, good governance and accountability..."

88. The Retired Chief Justice, Dr. Willy Mutunga, in his concurring opinion expounded on the principle and traced the place of the People in the *Constitution* making process thus:

> "[320] In the entire history of constitution-making in Kenya, the participation of the people was a fundamental pillar. That is why it has been argued that the making of Kenya's *Constitution* of 2010 is a story of ordinary citizens striving to overthrow, and succeeding in overthrowing the existing social order, and then defining a new social, economic, political, and cultural order for themselves. It is, indeed, a story of the rejection of 200 Parliamentary amendments by the Kenyan elite that sought to subvert the sovereign will of the Kenyan population. Public participation is, therefore, a major pillar, and bedrock of our democracy and good governance. It is the basis for changing the content of the State, envisioned by the *Constitution*, so that the citizens have a major voice and impact on the equitable distribution of political power and resources. With devolution being implemented under the *Constitution*, the participation of the people in governance will make the State, its organs and institutions accountable, thus making the country more progressive and stable. The role of the courts, whose judicial authority is derived from the people of Kenya, is the indestructible fidelity to the value and principle of public participation."

89. The Rtd Chief Justice drew from caselaw on the principles for public participation in various court decisions including *Speaker of the Senate & another v Attorney General & 4 others* Sup Ct Advisory Opinion No 2 of 2013; [2013] eKLR; *Thuku Kirori & 4 others v County Government of Murang'a Petition No 1 of 2014*; [2014] eKLR; *Nairobi Metropolitan PSV Saccos Union Limited & 25 others v County of Nairobi Government & 3 others* Petition No 418 of 2013; [2013] eKLR; and *Robert N Gakuru & others v Governor Kiambu County & 3 others*, Petition No 532 of 2013 consolidated with Petition Nos 12 of 2014, 35, 36 of 2014, 42 of 2014, & 72 of 2014 and Judicial Review Miscellaneous Application No 61 of 2014;[2014] eKLR [*Robert Gakuru case*](Most of these cases were also referred to by the High Court in this matter). He also referred to the jurisprudence from the South African Constitutional Court decision, *Doctors for Life International v Speaker of the National Assembly and others*[2006] ZACC 11;

2006 (12) BCLR 1399 (CC); 2006 (6) SA 416 (CC) which also considered the role of the public in the law-making process. It in part stated as follows:

> "The participation by the public on a continuous basis provides vitality to the functioning of representative democracy. It encourages citizens of the country to be actively involved in public affairs, identify themselves with the institutions of government and become familiar with the laws as they are made. It enhances the civic dignity of those who participate by enabling their voices to be heard and taken account of. It promotes a spirit of democratic and pluralistic accommodation calculated to produce laws that are likely to be widely accepted and effective in practice. It strengthens the legitimacy of legislation in the eyes of the people. Finally, because of its open and public character it acts as a counterweight to secret lobbying and influence peddling. Participatory democracy is of special importance to those who are relatively disempowered in a country like ours where great disparities of wealth and influence exist."

116. Therefore, our democracy includes as one of its basic and fundamental principles, the principle of participatory democracy. The democratic government that is contemplated is partly representative and partly participatory, is accountable, responsive and transparent and makes provision for public participation in the law-making processes. Parliament must therefore function in accordance with the principles of our participatory democracy"

90. Earlier on, the Supreme Court had reiterated the centrality of public participation as regards the issue of digital migration, in the case of *Communications Commission of Kenya & 5 others v Royal Media Services Limited & 5 others*,[2014] eKLR. We stated *inter alia*:

> "Public participation is the cornerstone of sustainable development and it is so provided in the Constitution...
>
> [381] Public participation calls for the appreciation by State, Government and all stakeholders implicated in this appeal that the Kenyan citizenry is adult enough to understand what its rights are under article 34. In the cases of establishment, licensing, promotion and protection of media freedom, public participation ensures that private "sweet heart" deals, secret contracting processes, skewed sharing of benefits-generally a contract and investment regime enveloped in non-disclosure, do not happen. Thus, threats to both political stability and sustainable development are nipped in the bud by public participation. Indeed, if they did the word and spirit of the Constitution would both be subverted."

91. The High Court in this matter, as observed by the Court of Appeal, appropriately referred to several decisions on public participation and consultation. All these cases are illuminating on the place of public participation in governance under the Constitution 2010.

92. In *Republic v Independent Electoral and Boundaries Commission (IEBC) Ex parte National Super Alliance (NASA) Kenya & 6 others Judicial Review No 378 of 2017*; [2017] eKLR among the issues for consideration before the High Court was whether the IEBC was constitutionally obliged to facilitate public participation as part of the tendering process. The High Court allowed the Petition and quashed the award of the tender for lack of public participation. It ordered that the procurement process begin de novo in accordance with the *Constitution*. IEBC appealed to the Court of Appeal. In upholding the appeal, setting aside the High Court decision, the Court of Appeal considered the big issue of justifiability and enforceability of article 10 of the *Constitution*, which encompasses the principle of public participation. The appellate court in *Independent Electoral and Boundaries Commission (IEBC) v National Super Alliance(NASA) Kenya & 6 others*,Civil Appeal No 224 of 2017; [2017] eKLR held that article 10(2) and the principles therein are for immediate realization, thus:

> "80. In our view, analysis of the jurisprudence from the Supreme Court leads us to the clear conclusion that article 10(2) of the Constitution is justiciable and enforceable immediately. For avoidance of doubt, we find and hold that the values espoused in article 10(2) are neither aspirational nor progressive; they are immediate, enforceable and justiciable. The values are not directive principles.
>
> We agree with this pronouncement and reiterate that the principle of public participation as anchored in article 10 of the *Constitution* is alive and the same is equally justiciable before our courts."

93. While the Court of Appeal in the above matter was dealing, particularly, with the question of the place of public participation in procurement, its pronouncement is illuminating on the principle of public participation in general. Having appraised several decisions on the issue, the appellate court stated thus:

> "164. Our analysis of the emerging jurisprudence from the Supreme Court and other superior courts as well as the reading of the express provisions of section 3 of the *Public Procurement and Asset Disposal Act*, 2015 as read with articles 10(2)(b) and 227 of the *Constitution* lead us to find that as a general principle (subject to limited exceptions) public participation is a requirement in all procurement by a public entity. The jurisprudence also reveals that allegation of lack of public participation must be considered in the peculiar circumstances of each case. The mode, degree, scope and extent of public participation is to be determined on a case by case basis.
>
> 165. What is critical is a reasonable notice and reasonable opportunity for public participation. In determining what is reasonable notice, a realistic time frame for public participation should be given. In addition, the purposes and level of public participation should be indicated. Reasonableness is also to be determined from the nature and importance of legislation or decision to be made, and the intensity of the impact of the legislation or decision on the public. The length of consultation during public participation should be given and the issues for consultation. Mechanisms to enable the widest reach to members of public should be put in place; and if the matter is urgent the urgency should be explained."

94. Finally, the Court of Appeal found that subject to a few stated exceptions, public participation was a mandatory requirement in all procurement done by a public entity. As regards lack of a framework on how to achieve public participation the court observed:

"……

[189]. We have considered this submission in light of the provisions of article 10(2) of the *Constitution* and other relevant articles where public participation is constitutionally required. In our considered view, the absence of a legal framework for public participation is not an excuse for a procuring entity or a State organ to fail to undertake public participation if required by the *Constitution* or law. A State organ or procuring entity is expected to give effect to constitutional principles relating to public participation in a manner that satisfies the values and principles of the *Constitution*.

95. Indeed the High Court, Odunga J, in *Robert N. Gakuru & others v Governor Kiambu County & 3 others*[2014] eKLR, in which case the Learned Judged extensively borrowed from the South African jurisprudence in *Doctors for Life International v Speaker of the National Assembly and others*, illuminated the law of public participation. He emphasized on the seriousness with which public participation should be undertaken:"

75. In my view public participation ought to be real and not illusory and ought not to be treated as a mere formality for the purposes of fulfilment of the constitutional dictates. It is my view that it behoves the County Assemblies in enacting legislation to ensure that the spirit of public participation is attained both quantitatively and qualitatively. It is not just enough in my view to simply "tweet" messages as it were and leave it to those who care to scavenge for it. The County Assemblies ought to do whatever is reasonable to ensure that as many of their constituents in particular and the Kenyans in general are aware of the intention to pass legislation and where the legislation in question involves such important aspect as payment of taxes and levies, the duty is even more onerous. I hold that it is the duty of the County Assembly in such circumstances to exhort its constituents to participate in the process of the enactment of such legislation by making use of as may fora as possible such as churches, mosques, temples, public barazas national and vernacular radio broadcasting stations and other avenues where the public are known to converge to disseminate information with respect to the intended action."

96. From the foregoing analysis, we would like to underscore that public participation and consultation is a living constitutional principle that goes to the constitutional tenet of the sovereignty of the people. It is through public participation that the people continue to find their sovereign place in the governance they have delegated to both the National and County Governments. Consequently, while courts have pronounced themselves on this issue, in line with this court's mandate under section 3 of the *Supreme Court Act*, we would like to delimit the following framework for public participation:

"Guiding Principles for public participation.

(i) As a constitutional principle under article 10(2) of the *Constitution*, public participation applies to all aspects of governance.

(ii) The public officer and or entity charged with the performance of a particular duty bears the onus of ensuring and facilitating public participation.

(iii) The lack of a prescribed legal framework for public participation is no excuse for not conducting public participation; the onus is on the public entity to give effect to this constitutional principle using reasonable means.

(iv) Public participation must be real and not illusory. It is not a cosmetic or a public relations act. It is not a mere formality to be undertaken as a matter of course just to 'fulfill' a constitutional requirement. There is need for both quantitative and qualitative components in public participation.

(v) Public participation is not an abstract notion; it must be purposive and meaningful.

(vi) Public participation must be accompanied by reasonable notice and reasonable opportunity. Reasonableness will be determined on a case to case basis.

(vii) Public participation is not necessarily a process consisting of oral hearings, written submissions can also be made. The fact that someone was not heard is not enough to annul the process.

(viii) Allegation of lack of public participation does not automatically vitiate the process. The allegations must be considered within the peculiar circumstances of each case: the mode, degree, scope and extent of public participation is to be determined on a case to case basis.

(ix) Components of meaningful public participation include the following:

a. clarity of the subject matter for the public to understand;

b. structures and processes (medium of engagement) of participation that are clear and simple;

c. opportunity for balanced influence from the public in general;

d. commitment to the process;

e. inclusive and effective representation;

f. integrity and transparency of the process;

g. capacity to engage on the part of the public, including that the public must be first sensitized on the subject matter.

97. With the above legal framework on public participation, we now proceed to consider whether the Tobacco Regulations 2014 are unconstitutional for limited or lack of public participation in the process leading to their enactment. In making this determination, we reiterate that we are limited to issues of constitutional interpretation and/or application only.

98. Upon evaluation of the Court of Appeal judgment, we find that the appellate court rightly appreciated the constitutional principle of public participation. The Court of

> appeal endorsed the High Court's analysis on several decisions on the issue, which we have also endorsed in this Judgment. We find that the Court of Appeal did not err in its findings on the meaning, scope and application of the principle of public participation. Having noted the law, the Court of Appeal considered the High Court's application of the affidavit evidence on record to the stated law and concluded that: " given the facts that were before the learned judge, we have no reason to fault the learned judge for finding that the stakeholder meetings, discussions and communications constituted adequate public participation and consultation." We find and hold that there is nothing of constitutional interpretation and/or application in this finding, and/or conclusion by the Court of Appeal on how the High Court evaluated the affidavit evidence before it. Consequently, that issue rests as before this court.

175. In the instant suit, the impugned regulations were gazetted on January 27, 2023 in Legal Notice No 4 through Kenya Gazette supplement No 6 of 2023 and submitted to the National Assembly via the National Treasury and Economic Planning letter Ref TNT/ZZ/131/04 dated January 13, 2023.

176. Public participation was undertaken in compliance with the provisions of section 5 of the *Statutory Instruments Act, 2013* and article 201(2) of the *Constitution of Kenya, 2010*.

177. I am satisfied that the National Treasury and Economic Planning through the Kenya Revenue Authority invited business organizations and members of the public to submit their views for consideration in the development of the regulations on September 2, 2022 through a public notice on the KRA website and on September 6, 2022 in the newspapers.

178. The Kenya Revenue Authority upon considering comments from Citi Corporate and Investment Banking, Kenya Bankers Association, Kelvin Mbithi, Ernest Muriu among others development the draft Income Tax (Financial Derivatives) Regulations 2022 which were subjected to a second round of public participation from November 17, 2022.

179. The regulations came into operation on January 27, 2023 upon publication under section 23 of the *Statutory Instruments Act, 2013*.

180. This court is satisfied that the 3rd respondent submitted on February 21, 2023 within the time prescribed under section 11(1) of the *SIA* together with an explanatory memorandum under section 5A of the *SIA*.

181. The regulations were tabled before the National Assembly on February 28, 2023and thereafter committed to Committee on Delegated Legislation (the "Committee") under section 12 of the *SIA* and Standing Order 210.

182. The Committee considered the documents submitted by the 1st respondent evidencing the conduct of public participation and stakeholder engagement.

183. The Committee was satisfied that the Ministry and KRA had conducted adequate public participation and stakeholder engagement in the formulation of the regulations in line with the report on stakeholder comments and submissions.

184. The ex parte applicant was also invited by the Committee to make oral submissions on the impugned regulations on March 16, 2023 who thereafter forwarded written submissions on April 3, 2023 which were considered by the Committee.

185. Pursuant to the Standing Order No 210(4)(a), which provides that, if the Committee on Delegated Legislation resolves that a statutory instrument be acceded to, the Clerk shall convey that resolution to the relevant State Department or the authority that published the statutory instrument, the National

Assembly sent an approval letter dated May 22, 2023 notifying the 1st respondent of the Committee resolution to accede the impugned regulation.

186. The fact that a party participated in public participation must however never be construed to mean that the diverse views of the parties will be what the ultimate legislation will be. The applicant cannot have its cake and eat it.

187. Upon subjecting and testing the *Income Tax (Financial Derivatives) Regulations, 2023* (the regulations) of January 27, 2023 to the prism and the principles as enunciated in the above cases, this court is satisfied that there was public participation before the impugned regulations were passed.

The 2nd Issue; Whether or not the regulations require the impact report:

188. Section 6 of the *Statutory Instruments Act 2013* provides for the preparation of the Regulatory Impact Statement by the regulation making authority prior to making the statutory instruments in circumstances where a proposed statutory instrument is likely to impose significant costs on the community or a part of the community. However, section 9 of the *Statutory Instruments Act 2013* provides for situations where Regulatory Impact Statements may not be necessary.

189. Regulatory impact statement need not be prepared for a proposed statutory instrument if it is a matter arising under legislation that is substantially uniform or complementary with the legislation of the National Government or if the proposed legislation only provides for an amendment of a fee, charge, or tax consistent with announced government policy.

190. The regulations are in line with the provisions of the *Income Tax Act* cap 270, and a regulatory impact statement was not unnecessary. Paragraph 3 and 4 of the regulations provide the tax point for financial derivative transactions so as to provide clarity as to when tax on gains from financial derivative contracts crystallises.

191. Financial derivative contracts are entered into between two parties. Gains chargeable to tax in Kenya, are those that accrue to non-residents from financial derivative contracts involving residents and non-residents.

192. A gain from a financial derivative contract to a non-resident, on which withholding tax is applicable, would be a loss to the resident person with whom the contract was entered.

193. The regulations provide that a realised loss by a resident person from a financial derivative contract is allowed as a deduction against any gain accruing from similar activities to the extent that it has not been claimed.

194. The resident person who enters into a contract with the non - resident person, is aware of the progress of the transactions affecting the contract during the period of the contract.

195. The resident person is therefore able to accurately determine the amount of loss made from the transactions.

196. The Commissioner appreciates that the resident person cannot establish the net gain of the non-resident person as they are not aware of the costs incurred by the non-resident.

197. The resident person, however, knows the gross amount which is what they expense as a loss.

198. The Commissioner seeks to tax this gross amount at the preferential rate of 15%. This rate compensates for the fact that the amount taxable on the non-resident is a gross gain.

199. It is this court's finding and I so hold that the regulations flow or seek to address matters arising under legislation that is uniform or complementary with the legislation of the National Government Regulations. However, the effect of this finding is subject to the determination of the next issue.

Whether or not the applicant is entitled to the orders sought;

200. In attending to this issue, this court is guided by the celebrated case of *Pastoli v Kabale District Local Government Council & others*, (2008) 2 EA 300, where it was held that:

> "In order to succeed in an application for Judicial Review, the applicant has to show that the decision or act complained of is tainted with illegality, irrationality and procedural impropriety: See *Council of Civil Service Union v Minister for the Civil Service* [1985] AC 2; and also, *Francis Bahikirwe Muntu and others v Kyambogo University*, High Court, Kampala, Miscellaneous Application Number 643 of 2005 (UR).
>
> Illegality is when the decision-making authority commits an error of law in the process of taking the decision or making the act, the subject of the complaint. Acting without Jurisdiction or *ultra vires*, or contrary to the provisions of a law or its principles are instances of illegality.... Irrationality is when there is such gross unreasonableness in the decision taken or act done, that no reasonable authority, addressing itself to the facts and the law before it, would have made such a decision. Such a decision is usually in defiance of logic and acceptable moral standards: *Re An Application by Bukoba Gymkhana Club* [1963] EA 478 at page 479 paragraph "E".
>
> Procedural impropriety is when there is failure to act fairly on the part of the decision-making authority in the process of taking a decision. The unfairness may be in non-observance of the Rules of Natural Justice or to act with procedural fairness towards one to be affected by the decision. It may also involve failure to adhere and observe procedural rules expressly laid down in a statute or legislative Instrument by which such authority exercises jurisdiction to make a decision. (*Al-Mehdawi v Secretary of State for the Home Department* [1990] AC 876)."

201. The Court of Appeal in *Grain Bulk Handlers Limited v JB Maina & Co Ltd & 2 others* [2006] eKLR summarized the purpose of judicial review by stating that: -

> "Judicial Review jurisdiction regulates the process by which a decision-making power given by the law is exercised by the person or body given the jurisdiction. The subject matter of Judicial Review is the legality of such decisions."

202. From the foregoing it is clear that in judicial review, the court does not exercise its appellate powers. It mainly looks at the decision-making process to ensure that the citizen who has come into contact with an administrative body or tribunal has been treated fairly. But as observed by Lord Diplock in the already cited *Civil Service Unions v Minister For The Civil Service* case, the court can quash the decision if the same is so unreasonable to the extent that a reasonable tribunal addressing its mind to the facts of the case would not have arrived at such a decision. In doing so, I submit, the court will have descended into the arena of decision-making. For a court to justify such action it must be clearly obvious that the decision is truly and obviously unreasonable.

203. Under sections 3 and 4 of the *Regulations* tax becomes due and payable by the 20th day of the month after which a loss from the transaction with a non-resident person is realised.

204. Section 3 of the *Income Tax Act* is the charging provision pursuant to which all income tax liability in Kenya must be pegged. Sections 3 and 4 of the regulations effectively seek to apply a withholding tax obligation on a resident person on the losses made by the resident person and yet they have no anchor on section 3 of the *ITA*, which provides for the income upon which tax is chargeable to include the "... gains from financial derivatives...". There is no reference to "losses" under the provisions of the *Income Tax Act*.

205. The regulations are incapable of being implemented by virtue of the fact that the tax on "gains from financial derivatives" is required to be withheld upon payment of an amount to the relevant non-resident person.

206. Section 35(1) of the *ITA* provides that: "...A person shall, upon payment of an amount to a non-resident person...in respect of ...(p) gains from financial derivatives... deduct therefrom tax at the appropriate non-resident rate."

207. The *ITA* envisages that any "gains from financial derivatives" shall be taxed by withholding a tax on a payment made to a non-resident person, comprising of gains made on the relevant financial derivative.

208. Sections 3 and 4 of the regulations on the other hand propose to charge the tax on "losses" made by the party in Kenya.If a "loss" is made by a resident person, there can be no "payment" arising to the non-resident person on account of that "loss" on which the provisions of section 35 can be applied, and on which payment an amount can be withheld.

209. The regulations are illegal, unreasonable, impracticable, unclear, create uncertainty and are oppressive in that they require a resident person to "assume" that their "loss" on a derivative transaction equates to the "gain" of the non-resident person, and against such presumed outcome, to "withhold" tax on a "payment" to the non-resident person at the rate of 15% of the payment made.

210. The regulations do not provide at all on how gains will be computed for non-residents. It is practically impossible for a resident person to calculate the gains of a non-resident person.

211. This requirement creates uncertainty as far as they require a resident person to "assume" that their "loss" on a derivative transaction equates to the "gain" of the non-resident person, and against such presumed position, to "withhold" tax on a "payment" to the non-resident person at the rate of 15%.

212. This contravenes article 10(2)(a) of the *Constitution* which provides as follows: "The national values and principles of governance include patriotism, national unity, sharing and devolution of power, the rule of law, democracy and participation of the people."

213. The architecture of the *Income Tax Act* is supposed to be predicated and driven by the rationale that a person is taxed on their own income, as ascertained by reference to their own circumstances.

214. There is no provision in the *ITA* that supports the ascertainment of a person's income (whether the person is resident or non-resident) by reference to another person's expenses or losses.

215. In this regard, Part IV of the *ITA* is referenced "Part IV- Ascertainment Of Total Income". Under Part IV of the *ITA* (section 15(1)), it is stated that "For purposes of ascertaining the total income of a person for a year of income there shall ... be deducted all expenditure incurred in that year of income .... by him".

216. Against this background, it is my considered view that the regulations are ultra vires, null and void and incapable of being implemented.

217. In the absence of a deeming provision under Section 10 of the *ITA*, the entire premise of the regulations fails as the "gains from financial derivatives" of a non-resident person cannot be deemed to be income which accrued in or was derived from Kenya, for tax purposes and I so hold.

218. No payment is made in the event of settlement for physically settled derivatives and exchange traded derivative transactions. The regulations are not clear on how the tax shall be computed.

219. Certainty in laws that impose taxes is essential for business planning and the applicant will be greatly prejudiced by the imposition and the implementation of uncertain regulations.

220. The impugned regulations are illegal and they offend and breach the rule of law contrary to article 10 of The *Constitution* as a result of which they are susceptible to scrutiny under judicial review.

221. In the case of *Francis Bahikirwe Muntu and others v Kyambogo University*, High Court, Kampala, Miscellaneous Application Number 643 of 2005 (UR), illegality is when the decision-making authority commits an error of law in the process of taking the decision or making the act, the subject of the complaint.

222. The 1st respondent did not exercise his powers in accordance with the *Income Tax Act*, chapter 470. The 1st respondent committed an error in the law and an order of *certiorari* must issue to quash the impugned regulations and I so hold.

Whether or not an order of prohibition should issue:

223. *Halsbury's Laws of England*, 4th Edition, Reissue Vol 1(1) page 2012 paragraph 109, The order of prohibition is an order issuing out of the High Court directed to an inferior court or tribunal or public authority which forbids that court or tribunal or authority to act in excess of its jurisdiction or contrary to law. Prohibition is employed for the control of inferior courts, tribunals and public authorities. Prohibition is concerned with decisions of the future. Prohibition will issue to prohibit a determination in excess of jurisdiction, error of law on the face of the record or breach of the rules of natural justice.

224. It is this court's holding that when taking administrative action, all public authorities must at all times abide by and promote the principles of good governance as enshrined under articles 10 of the Constitution.

225. Having found that the 1st respondent committed an error in the law, then the proper order for this court to issue in resolving this issue is to allow prayer.

226. Having been satisfied that the applicant has made out a case that warrants the grant of an order of prohibition as prayed it is this court's finding that an order of prohibition should be issued as prayed.

227. The applicant has also asked this court to issue a declaration that the failure by the 1st respondent to exercise his powers in accordance with the *Income Tax Act*, chapter 470 of the Laws of Kenya, the parent statute herein amounts to a violation of the exparte applicant's constitutional right to enjoy rule of law, fair administrative action and to a fair taxation burden guaranteed under articles 10(2)(a), 47 and 201(b)(i) of the *Constitution of Kenya, 2010*, respectively.

228. Article 47(1) of the *Constitution* provides that every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.

229. Section 2 of The *Fair Administrative Action Act* provides that in this Act, unless the context otherwise requires—

> " Administrative action" includes—
>
> i. the powers, functions and duties exercised by authorities or quasi- judicial tribunals; or
>
> ii. any act, omission or decision of any person, body or authority that affects the legal rights or interests of any person to whom such action relates.

230. The respondents are bound by section 3(1) of the *Fair Administrative Action Act* which provides that,

> " This Act applies to all state and non-state Application agencies, including any person-
>
> a. exercising administrative authority; or
>
> b. whose action, omission or decision affects the legal rights or interests of any person to whom such action, omission or decision relates.

231. This court has the power to review the impugned administrative decision of the 1st respondent since the action or decision in coming up with the impugned regulations was materially influenced by an error of law under section 7 of the *Fair Administrative Action Act*.

232. The court has already made a finding that the 1st respondent did not exercise his powers in accordance with the *Income Tax Act*, chapter 470.

233. Section 11 of *Fair Administrative Action Act* empowers this court to grant any order that is just and equitable, including an order-

a. declaring the rights of the parties in respect of any matter to which the administrative action relates;

b. prohibiting the administrator from acting in particular manner;

c. setting aside the administrative action and remitting the matter for reconsideration by the administrator, with or without directions.

234. This court hereby declares that the 1st respondent violated the applicant's right to fair administrative Action as guaranteed under article 47 of the *Constitution* and I so hold.

Costs: The applicant has also sought for an order for costs.

235. The general rule flowing from section 27 of the *Civil Procedure Act*, cap 21, Laws of Kenya is that costs should follow the event. That is to say, the successful party should be awarded its costs. This general rule is elaborated by Justice Kuloba in his book, *Judicial Hints on Civil Procedure,* Vol 1 at p 99 as follows:

> " The first question is what is meant by "the event" in the proviso to subsection (1) of this section? The words "the event" mean the result of all the proceedings incidental to the litigation. The event is the result of the entire litigation. .... Thus the expression "the costs shall follow the event" means that the party who on the whole succeeds in the action gets the general costs of the action." (Emphasis provided).

236. Section 11(2) of the *Fair Administrative Action Act* gives this court power to issue orders as to costs and other monetary compensation.

237. This is a public interest matter and in exercise of my discretion, I do hereby direct each party to shoulder its costs.

Disposition

238. The applicant has made out a case for the grant of the judicial review orders as sought.

Order ;

1. An order of prohibition is hereby issued directed at the Kenya Revenue Authority either by itself, its agents or employees restraining it from taking any steps, actions, or measures to impose or collect any taxes from the members of the exparte applicant engaged in transactions involving financial derivatives and/or enforcement or implementation of the *Income Tax (Financial Derivatives) Regulations, 2023*.

2. An order of certiorari quashing the Income Tax (Financial Derivatives) Regulations, 2023, as contained in *Legal Notice No 4 of 2023* in Kenya Gazette Special Issue Supplement No 6 of 2023 published on 27th January 2023 is hereby issued.

3. A declaration is hereby issued that the failure by the 1st respondent to exercise his powers in accordance with the *Income Tax Act*, chapter 470 of the Laws of Kenya, the parent statute herein amounts to a violation of the *ex parte* applicant's constitutional right to enjoy rule of law, fair administrative action and to a fair taxation burden guaranteed under articles 10(2)(a), 47 and 201(b)(i) of the *Constitution of Kenya, 2010*, respectively.

4. Being a public interest suit, each party to shoulder its costs.

DATED, SIGNED AND DELIVERED AT NAIROBI THIS 11 TH DAY OF OCTOBER, 2024.

J. M. CHIGITI (SC)

JUDGE