



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

CONSTITUTIONAL AND HUMAN RIGHTS DIVISION

PETITION NO. 148 OF 2013

EXPORT TRADING COMPANY.....PETITIONER

– VERSUS –

KENYA REVENUE AUTHORITY.....RESPONDENT

JUDGMENT

Introduction

1. The Petitioner moved this Court vide petition dated 5th March, 2018 which petition is supported by the Affidavit of its Finance Manager, **Subramanya Hebbar**. The petitioner seeks the following prayers:-

- a) A declaration that demand of taxes by KRA constitutes an infringement of the Petitioner's rights under Article 47 of the Constitution, 2010 and a threat to the infringement of the Petitioner's rights under Article 40 of the Constitution.*
- b) A declaration that Legal Notice No. EAC/10/2007 is unlawful.*
- c) An order for judicial review by way of Certiorari to bring to this court and quash the decision to demand and the demand contained in KRA's letter of 27th February, 2013.*
- d) An order for permanent injunction order do issue restraining the KRA whether by itself, its officers, employees and/o agents from commencing, instituting or proceeding with any enforcement or prosecution action against the Applicant or its directors and/or officers in relation to or on account of the disputed taxes in the sum of Kshs. 378,016,680/- and the interest and penalties claimed thereon.*
- e) Any other orders that his Honourable Court may deem necessary to grant.*
- f) An order for costs of this application.*

Petitioner's Case

2. The Petitioner describes itself as a limited liability company duly incorporated under the provisions of the Companies Act and having its registered office in Kenya. The Petitioner states that it owns and manages the most vertically integrated agriculture supply chain on the African subcontinent with operations spanning in procurement, processing, warehousing, distribution and merchandising. The Petitioner contends that between the years 2008 and 2009, the Respondent processed and cleared various consignments of rice imported by the Petitioner from Burma, Vietnam and Thailand and imposed import duty assessed at a rate of 35% which the Petitioner paid in full. The Petitioner's case is that the Respondent has now alleged that the applicable import duty ought to have been 75% (and not 35% as stipulated in their clearing system) and that KRA had made a "*human and system error*" in under collecting import duty at the rate of 35%.

3. The petitioner contends that through a letter dated 27th February, 2013, the Respondent informed the Petitioner that the additional taxes were due and unpaid on account of imported rice to the tune of Kshs. 378,016,680/- .

4. The Petitioner also contends that on or about July, 2005, the East African Community (EAC) promulgated the Common External Tariff (CET) in accordance with the provisions of the East African Community Customs Management Act (EACCMA), 2004 which CET set import duty rate for rice imported from outside the EAC at 75%. The Petitioner adds that the Respondent effected the import duty in their Simba system only for a short period of time and subsequently changed the import duty from 75% to 35% for all rice imported from outside

the EAC regardless of origin.

5. It is the Petitioner's case that subsequent to the promulgation of the CET in July 2005, the Council of Ministers of the EAC issued Legal Notice No. 1 of 2005 on 15th December, 2005 which stayed the application of the CET rate of 75% on Pakistani rice for two years, that is, from 1st July, 2005 to 30th June, 2007 and that the Respondent however, maintained the import duty rate of 35% in the Simba system for all rice regardless of the origin. It is the Petitioner's contention that after the expiry of the two years, the Council of Ministers of the EAC issued Legal Notice No. EAC/10/2007 on 18th June, 2007 stayed the application of the 75% rate on Pakistani rice for a further two years from 1st July 2007 to 30th June, 2008. The Respondent nevertheless maintained the import duty rate of 35% in the Simba system for all the rice imports regardless of their origin and that is what the importers paid until 26th June, 2009 when the rate of 75% was effected in the Simba system and it was on that day that the Respondent informed importers through the Simba system that only rice from Pakistan attracted duty at the rate of 35%.

6. The petitioner further states that through a letter dated 26th July, 2007, it sought clarification on the rate applicable noting the Simba system still maintained the rate of 35% for all the rice, regardless of the origin despite the passing of Legal Notice No. EAC/10/2007 which letter elicited no response from the Respondent after which the Petitioner applied for review of the Respondent's decision to pay the taxes as provided under the East African Community Customs Management Act, 2004 on 18th February, 2013 but that the Respondent has not yet communicated to the Petitioner their decision on the review application as required under the said Act yet the Respondent vide a letter dated 27th February 2013 threatened to institute enforcement measures against the Petitioner to collect the alleged underpaid duty on the rice imported and sold over (4) years ago thereby giving rise to this Petition.

Respondent's Case

7. The Respondent opposed the Petition through the Replying Affidavit of **Jomo Masaki Nyakoe** dated 17th April, 2013 and a Supplementary Affidavit of **Joseph Chege** dated 21st September, 2018.

8. The Respondent contends that Kenya National Audit Office had in the year 2010 carried out an audit on M/S Kipevu Container Freight Station and picked up the issue of the Petitioner miss-declaring the origin of the rice it had imported as an audit query and required the Respondent to resolve the issue since a substantial amount of revenue had been lost. The respondent states that the audits established that there was a short levy of taxes because the wrong import duty rate had been applied to the rice imported by the Petitioner between the years 2008 and 2009. They contend that the Common External Tariff (CET) set the import duty at the rate of 75% for rice imported outside the EAC except for rice imported from Pakistan which was to be imported at the rate of 35%.

9. The Respondent's case is that failure by their Tradex System to capture the tariff rate was an error caused by human and technical oversight as a result of human and system errors and the same was to be corrected by making supplementary payment of the under collected duty. The Respondent states that on noting the error, it wrote to the Petitioner demanding the shortfall on the levied taxes of Kshs. 378,016,680/- which comprise of import tax due of Kshs. 228,306,204/-, penalties of Kshs. 138,295,476/- and interest of Kshs. 11,415,310/-.

10. The Respondent further states that the Tradex System (SIMBA) is an administrative tool used to collect taxes as provided for under the Common External Tariff, which is creation of Article 12 of the Protocol of Establishment of East African Community Customs Union. Thus, if there were any inconsistencies with the rates reflected on the system, the applicable rate is what was provided under the law in this case the Common External Tariff through the Legal Notice No. EAC/10/2007 of 18th June, 2007. It was the Respondent's contention that the Petitioner or their duly appointed agents were aware of the said legal notice and that the technological problem in their Tradex System (SIMBA) did not absolve the Petitioner from their obligations to pay taxes.

11. The Respondent adds that the Petitioner, through their advocates, applied for review vide a letter dated 18th February, 2013 in accordance with section 229 of the EACCMA and that the Commissioners considered the application and rejected the same and communicated to the Petitioner vide a letter dated 26th February, 2013 hence the appeal was dealt with within 30 days.

Petitioner's Submissions

12. On the legality of Legal Notices No. 1 of 2005 and EAC/10/2007, Mr. Kashindi, learned counsel for the Petitioner, submitted that the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO) principles apply in Kenya as a matter of law by virtue of Article 2(6) of the Constitution Kenya being a founding member of World Trade Organization (WTO). He further submitted that the Most Favoured Nation (MFN) principle which is a bedrock of the WTO requires members to accord the most favourable tariff and regulatory treatment given to the product of any one member at the time of import or export to all other members. It was therefore the Petitioner's position that by purporting to charge a preferential tariff of 35% on the rice imports from Pakistan and a tax rate of 75% for rice from other origins, the two legal notices contravened the WTO/GAT MFN principle and were therefore illegal. Counsel relied on the case of **Republic – vs- Kenya Revenue Authority Ex-parte Tom Odhiambo Ojienda SC t/a Prof. Tom Ojienda & Associates Misc. Civil Application No. 471 of 2016 (2018) eKLR.**

13. On whether the Respondent's actions amounted to an infringement of the Petitioner's constitutional rights, Mr. Kashindi submitted that Article 47 of the Constitution guarantees the fundamental right of fair administrative action that is, administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair. It was submitted that the tax demand was unlawful and illegal for contravening the WTO/GATT MFN principle.

14. Counsel further submitted that by adopting and using the Simba system which the Respondent could not update regularly because of supposed challenges attributable to its own short comings, it was totally unreasonable, irrational and unconscionable to require the Petitioner to bear the huge burden of such challenges. It was the petitioner's submission that it had no control over the Simba system and should not be made to suffer the consequences of inaction on the part of the Respondent.

15. Counsel also submitted that the Petitioner's legitimate expectations were fundamentally breached both by promise and conduct as illustrated above. Reliance was placed on the case of *Maasai Mara (Sopa) Limited v Narok County Government Nairobi (2016) eKLR* wherein the late Justice Onguto considered the issue of legitimate expectation. He submitted that the Petitioner's legitimate expectation was and remains that the Respondent having deliberately refrained from collecting import duty at the applicable rate and particularly having communicated to and assured importers and their agents that they would continue to process importation of all rice at the rate of 35% until change was effected in the Simba system, the Respondent would not afterwards demand additional tax on consignments cleared on reliance of such assurance on the pretext of it being under collected duty. The Petitioner also relied on the case of *Republic –vs- Kenya Revenue Authority and Nephets Interlink Service Limited Ex-parte Unilever Tea Kenya Limited (2011) eKLR* and *Republic v Commissioner General, Kenya Authority BOC Kenya Limited (2014) eKLR*.

16. The Petitioner further submitted that considering the disputed taxes arose out of alleged human and system or technological error on its part, KRA has power under Section 133 of the East African Community Management Act, 2004 to seek remission of disputed taxes but has reasonably declined to exercise this power and that the threatened enforcement action in the circumstances of this case was in bad faith and with an improper motive.

17. In a nutshell, the Petitioner submitted that they had demonstrated that the Respondent had no legal basis to claim the taxes in question, the tax assessment and tax demand were based on illegality.

Respondent's Submissions

18. Miss Odundo, learned counsel for the Respondent, submitted that in execution of its mandate under Sections 235 and 236 of the EACCMA, the Respondent has a statutory duty to carry out post clearance audits on import declarations made by taxpayers by verifying the accuracy of entry of goods or documents and to determine whether a person has made the correct customs declaration and paid all the taxes due. She maintained that the Petitioner and other rice importers were therefore subjected to a Post Clearance Audit covering the years 2008 and 2009 and this was precipitated by a discovery that the rice importers applied the duty rate of 35% instead of a duty rate of 75% on rice imported from other countries other than Pakistan.

19. Counsel also submitted that the audit revealed that the Petitioner owed the Commissioner a sum of Kshs. 378,016,680 being the shortfall on levied taxes accrued from the application of a duty rate at 35% instead of 75% and pursuant to Section 135 (1) of the EACCMA, and that the Commissioner, by a letter dated 20th December, 2011 demanded the short levied taxes from the Petitioner which the Petitioner declined to remit. It was therefore the Respondent's submission that it was not in breach of Article 47 of the Constitution as it acted within the confines of the law and that all the actions it took were reasonable and justifiable.

20. On whether the duty applicable was 75% or 35%, the Respondent submitted that Kenya is a member state of the East African Community and thus bound by the laws passed by the East African Legislative Assembly. Counsel submitted that the Council of Ministers vide Legal Notice No. EAC/10/2007 in exercise of powers conferred upon them by Articles 12 (3) and 39 (i) (c) of the Protocol on the Establishment of the East African Community Customs Union, reviewed the EAC Common External Tariff and at Paragraph 9 approved a duty rate of 35% on the rice imported from Pakistan and a duty rate of 75% on rice from any other jurisdiction. It was therefore the Respondent's submission that the Legal Notice No. EAC/10/2007 was published on 18th June, 2007 in the East African Community Gazette and was to come into force on 1st July, 2007 and had a lifespan of two years which ran up to 30th June, 2009 and the Respondent published a copy of the said gazette notice on the same date for all persons to acquaint themselves with the reviews rates. According to counsel, it is trite law that once a law, order, by-law, notice, rule, proclamation or decree is gazetted it assumes the force of the law and the same is deemed to be known to all persons to whom it is addressed. It was therefore the Respondent's case that the applicable duty was 75% and not 35%.

21. On the alleged contravention of the WTO principle on discrimination, the Respondent submitted that Article 12(3) of the Protocol on the Establishment of East African Community provides that Council may review the Common External Tariff structure and approve measures designed to remedy any adverse effects which any of the partner states may experience by reason of the implementation of this part of the Protocol or, in exceptional circumstances, to safeguard community interests. It was therefore submitted that the Respondent acted within the GATT when it applied to the EAC Council of Ministers to reduce the import duty rate of Pakistan from 75% to 35% in order to protect the Kenyan economy.

22. Counsel further submitted on the principle that ignorance of the law is no defence and argued that 1st July, 2007, being the commencement date of Legal Notice No. EAC/10/2007, all rice importers including the Petitioner were deemed to be aware that the duty rate of rice from Pakistan was 35% whereas rice from any other part of the world attracted a duty of 75%. In sum, the Respondent submitted that the orders sought by the Petitioner will only issue where a public body has acted in excess or without jurisdiction, acted in bad faith, acted unfairly, acted in manifest unreasonableness or the rules of natural justice have been breached. The Respondent therefore urged the court to dismiss the Petition with costs to the Respondent.

Analysis and Determination

23. I have considered the pleadings filed herein, the parties' respective submissions and the authorities that they cited. I discern the main issue for determination to be whether the Respondent's demand was reasonable, rational and in accordance with **Articles 10** and **47** of the **Constitution**. Depending on the answer to the above issue, the court will then consider the remedies, if any, it should grant.

24. This court notes that the importance of taxation and the collection of taxes for any government cannot be gainsaid. It must however be noted that the processes and procedures leading to the collection of the said taxes must meet the relevant legal and constitutional thresholds in order to ensure the citizen's rights have not been violated and/or are threatened with violation. The importance of having proper laws in taxation matters was emphasized in the case of *Okiya Omtatah Okoiti v Commissioner General, Kenya Revenue Authority & 2 others [2018] eKLR* where the court observed that:

“The imposition of the excise duty is bound to have an impact on the rights under Article 43 (1). Tax inherently infringes the right to property, being an expropriation of one's hard-earned money. It follows that for the tax to be lawful, the law introducing it must not only be lawful, but it must meet the Article 24 analysis test in that it must be reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including the nature of the right or fundamental freedom; the importance of the purpose of the limitation; the nature and extent of the limitation; the need to ensure that the enjoyment of rights and fundamental freedoms by any individual does not prejudice the rights and fundamental freedoms of others; and the relation between the limitation and its purpose and whether there are less restrictive means to achieve the purpose.”

25. In the instant case, the Petitioner contends that import duty was assessed by the Respondent's Simba system which was foolproof and devoid of any external interference and that unless all the taxes calculated by the system as being due and owing are paid in full, the Respondent will not issue customs clearance and the cargo shall not be cleared for importation and/or released. The Respondent on the other hand relied on the provisions of EACCMA which gives it the mandate to collect short levied taxes and Legal Notice No. EAC/10/2007 which gave effect to the import duty at the rate of 75% for rice imported from outside the EAC region except Pakistan which had a preferential rate of 35%. The respondent however admits that the failure to capture the import duty at 75% for rice outside EAC in their Simba System was as a result of human and system error.

26. This court notes that EACCMA is a valid law that derives its force from the provisions of Section 8 of the Treaty for the Establishment of the East African Community, 2000 (Act No.2 of 2000). Section 8 of that Act provides as follows:

1) The provisions of any Act of the Community shall, from the date of publication of that Act in the Gazette of the Community, have the force of law in Kenya.

2) An Act of the Community shall come into operation on the date of its publication in the Gazette of the Community or, if it is provided in that Act that some or all of its provisions shall come into operation on some other date (whether before or after the date of publication), those provisions shall come into operation on that other date.”

27. The **EACCMA** was published in the East African Gazette Notice No. 1 of 1st January, 2005 thus; the Act came into force on 1st January, 2005. I further note that EACCMA was implemented in Kenya by virtue of the Finance Act (Act No. 6 of 2005) which introduced various amendments to the Customs and Excise Act, (Cap 472, Laws of Kenya) and the Value Added Tax (Cap 476, Laws of Kenya) by deleting references to the Customs and Excise Act, and substituting in lieu thereof the ‘EACCMA’. Likewise, by virtue of the Finance Act, 2007, the First Schedule to the Kenya Revenue Authority Act, the EACCMA and the Annexes to the Protocol on the Establishment of the East African Community Customs Union (EACCU) as part of the Acts which are administered by KRA. In addition, Section 253 of the EACCMA provides;

‘This Act shall take precedence over the Partner States laws with respect to any matter to which its provisions relate.’

28. The above position being the case, this court finds that the mere fact that the Respondent is empowered to carry out the post clearance audit and demand short levied duty did not preclude the Respondent from exercising such power in a reasonable, fair, efficient and effective manner. As a public authority, the Respondent's obligation to act in the aforementioned manner while rendering decisions is envisaged under **Article 47** of the Constitution which at Sub- Article (1) thereof reads:-

“Every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.”

29. The main question in this petition is whether in the circumstances of this case, the Respondent can be said to have acted fairly, reasonably and in an expeditious manner. I am afraid that the answer to the above question is to the negative. I say so because the respondent did not furnish this court with any satisfactory explanation as to why the post clearance audit and the subsequent demand for the alleged short levied duty was made almost 4 years after the initial assessment and payment of the duty so assessed. I further find that it was not in dispute that **Section 135(3)** of the **EACCMA** allows the Respondent to make such a demand within 5 years. However, that is not to say that the Respondent should wait until the tail end of the said period before making such a demand. My humble view is that there ought to be sufficient reason(s) as to why such audit and demand is made too late and at the tail end of the given period. To my mind, the Respondent cannot simply stand behind the time limit given to justify its conduct of demanding the short levied duty in question about 4 years later. I am guided by the decision of the Court of Appeal in ***Fleur Investments Limited vs. Commissioner of Domestic Taxes & Another –Civil Appeal No. 158 of 2017 (unreported)***, while considering the absence of a rational explanation for a conduct/decision in question, such as in this case, adopted with approval the High Court's decision in ***Republic vs. Institute of Certified Public Accountants of Kenya ex parte Vipichandra Bhatt T/A J V Bhatt & Company Nairobi HCMA No. 285 of 2006***. Analyzing the said decision, this Court went on to state:-

“It was held that in the absence of a rational explanation, one must conclude that the decision challenged can only be termed irrational within the meaning of the Wednesbury unreasonableness, was in bad faith and constitutes a serious abuse of statutory power since no statute can ever allow anyone on whom it confers a power to exercise such power arbitrarily and capriciously or in bad faith.”

30. Taking a cue from the above decision, I similarly hold that in the absence of a satisfactory explanation as to why the post clearance audit and resulting demand for short levied duty was made after such a long time, such a demand can only be perceived to be irrational and not in tandem with the kind of efficiency and expediency that is envisaged under Article 47(1) of the Constitution more so considering that the petitioner's letter dated 26th July 2007 seeking the respondent's clarification on the applicable duty rate did not elicit any response from the respondent.

31. It is also worthy to note that the identification of the applicable rate of duty and assessment of duty payable was done by the Simba

System which is owned and controlled by the respondent and that the Petitioner had no role in declaring or setting the rate to be applied. I find that it is therefore unreasonable for the Respondent to turn around and pass the blame to the Petitioner by contending that it was, at all material times, aware of the right rate based on Legal Notice No. EAC/10/2007 more so considering that the Respondent's own officers verified the entries made and even inspected the consignments.

32. I further find that the Respondent's officers cannot be said to have been acting as a conveyor belt performing a perfunctory exercise while totally oblivious of their solemn duty to the public to furnish them with accurate information regarding the applicable taxation rate. It would appear that the respondent that the respondent abdicated its duty to the taxpayers by remaining tight-lipped even upon being prompted by the petitioner, through the letter dated 26th July 2007, to declare the correct applicable tax rate, only to wake up from the slumber several years down the line and demand what it alleges is the under paid taxes. It is in the performance of their duty that the respondent was expected to verify the accuracy of the entries and the duty payable before clearance of the consignments in question. Having verified the entries in issue, rate applied and assessed duty as correct, I find that a legitimate expectation arose in favour of the Petitioner that the assessed duty was correct and the respondent cannot, in the circumstances of this case be seen to hide behind the provisions of EACCMA in making a belated demand for taxes.

33. The principle of legitimate expectation was elaborated upon in the case of **Keroche Industries Limited vs. Kenya Revenue Authority & 5 Others Nairobi [2007] eKLR** where the Court held that:

“...legitimate expectation is based not only on ensuring that legitimate expectations by the parties are not thwarted, but on a higher public interest beneficial to all including the respondents, which is, the value or the need of holding authorities to promises and practices they have made and acted on and by so doing upholding responsible public administration. This in turn enables people affected to plan their lives with a sense of certainty, trust, reasonableness and reasonable expectation. An abrupt change as was intended in this case, targeted at a particular company or industry is certainly abuse of power. Stated simply legitimate expectation arises for example where a member of the public as a result of a promise or other conduct expects that he will be treated in one way and the public body wishes to treat him or her in a different way... Public authorities must be held to their practices and promises by the courts and the only exception is where a public authority has a sufficient overriding interest to justify a departure from what has been previously promised.”

34. Similarly in the case of **Republic vs. Attorney General & Another Ex Parte Waswa & 2 Others [2005] 1 KLR 280** it was held that:

“The principle of a legitimate expectation to a hearing should not be confined only to past advantage or benefit but should be extended to a future promise or benefit yet to be enjoyed. It is a principle, which should not be restricted because it has its roots in what is gradually becoming a universal but fundamental principle of law namely the rule of law with its offshoot principle of legal certainty. If the reason for the principle is for the challenged bodies or decision makers to demonstrate regularity, predictability and certainty in their dealings, this is, in turn enables the affected parties to plan their affairs, lives and businesses with some measure of regularity, predictability, certainty and confidence. The principle has been very ably defined in public law in the last century but it is clear that it has its cousins in private law of honouring trusts and confidences. It is a principle, which has its origins in nearly every continent. Trusts and confidences must be honoured in public law and therefore the situations where the expectations shall be recognised and protected must of necessity defy restrictions in the years ahead. The strengths and weaknesses of the expectations must remain a central role for the public law courts to weigh and determine.”

35. Taking a cue from the dictum in the above cited cases, I find that Consequently, in light of the foregoing, I find that the by failing to inform the petitioner of the applicable taxation rate within reasonable timelines and by purporting to demand alleged short levied taxes six years after the rice consignment was assessed, cleared and sold, the respondent abused its statutory powers. As was held by the Court of Appeal in **Republic vs. Commissioner of Co- Operatives, Kirinyaga Tea Growers Co-operative & Savings & Credit Society Ltd. [1999] 1 EA 245:-**

“It is axiomatic that statutory power can only be exercised validly if exercised reasonably and not arbitrarily or in bad faith.”

36. In conclusion therefore, having considered the petition, the responses and submissions by counsel for the parties, the authorities relied on by parties and also having considered the applicable law, I am persuaded that Respondent's demand was unreasonable, irrational and not in accordance with **Articles 10 and 47** of the **Constitution**. In the premise therefore, this petition partially succeeds and I make the following orders which I find appropriate;

a) A declaration that the demand of taxes by the Respondent constitutes an infringement of the Petitioner's rights under Article 40 and 47 of the Constitution.

b) An order of certiorari to bring to this court and quash the decision to demand and the demand contained in the Respondent's letter dated 27th February, 2013.

c) A permanent injunction restraining the Respondent whether by itself, its officers, employees and/or agents from commencing, instituting or proceeding with any enforcement or prosecution against the Petitioner or its directors and/or officers in relation to or on account of the disputed taxes in the sum of Kshs. 378,016,680/- and the interest and penalties claimed therein.

Dated, Signed and Delivered in open court at Nairobi this 9th day of January 2019.

W. A. OKWANY

JUDGE

In the presence of:

Miss Kashindi for the petitioner

Miss Nganga for Miss Odundo for the respondent

Court Assistant – Kombo