IN THE COURT OF APPEAL

AT NAIROBI

[CORAM: OUKO (P), OKWENGU & SICHALE, JJA]

CIVIL APPEAL NO. 213 OF 2018

BETWEEN

KENYA REVENUE AUTHORITY.............APPELLANT

AND

KENYA BANKERS ASSOCIATIONS.....RESPONDENT

(Being an appeal from the Judgment of the high Court of Kenya at Nairobi (G.V. Odunga) dated **13th March, 2018 IN H. C. Misc. Civil Application No. 510 of 2017)**

****

JUDGMENT OF THE COURT

The central issue in this appeal is whether a chargee upon exercise of its statutory power of sale is obligated to pay Capital Gains Tax (CGT).

A brief background will provide the context. In a notice published in the Daily Newspaper of **4th October, 2016**, the appellant, Kenya Revenue Authority (hereinafter KRA), discontinued the manual payment of both Stamp Duty and CGT and required the simultaneous payment of both taxes online. The effect of this was that the I-Tax system would not permit the payment of Stamp Duty on a transfer unless and until the CGT was also paid.

The respondent, being an Association of forty-two (42) licensed commercial banks, one mortgage finance bank and two microfinance banks was aggrieved by the appellant's action to twin the payment of CGT and Stamp Duty as it contended that this would be an infringement on the right to property of both the bank as a chargee and the purchaser and would place the burden of paying the chargor's liability on either the bank or the purchaser. Consequently, the respondent filed a Judicial Review application challenging the action by the appellant. In a ruling rendered on **13th March, 2018**, **Odunga, J** made the following declarations and orders.

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

The appellant was dissatisfied with the said outcome, hence this appeal.

In a Memorandum of appeal dated **2nd July, 2018**, the appellant listed six (6) grounds of appeal faulting the learned judge in several respects which can be summarized as follows:

i. finding that a chargee does not acquire any proprietary right in the chargor's property when exercising its statutory power of sale,

ii. finding that a chargee has proprietary rights only on the charge and not the charged land,

iii. finding that a chargee is not in a position to calculate CGT when exercising its statutory power of sale and finally,

iv. for ignoring the express provisions of Income Tax Act and the Land Act that obligates a chargee to pay CGT.

On **17th June, 2019**, the appeal came before us for plenary hearing. **Mr. Manoti**, learned counsel for the appellant wholly relied on their written submissions filed on **21st January, 2019**. On behalf of the appellant, it was submitted that whereas the Income Tax Act provides for payment of CGT by a proprietor of land, the judge failed to give due consideration to the meaning of "proprietor" as defined in Section 2 of the Land Registration Act, 2012; that once a charge is created in favour of a bank, the latter becomes the proprietor of the charge and that Section 2 of the Land Act defines a charge as "**….** ***an*** **interest in land securing the payment of money or money's worth or the fulfilment of any condition, and includes a sub-charge and the instrument creating a charge …..**". Further, the judge was faulted for finding that "***the chargee is only the proprietor of the charge, not the land"***. According to the appellant, a chargee is for all intents and purposes the proprietor of a charged property. In support of the proposition that a chargee is not only a proprietor of a charge but also the charged property, counsel cited paragraph 5 (2) of the Eight Schedule of the Income Tax Act of 2015, which provides:

> **"where a person entitled to property by way of security or to the benefit of a charge or encumbrance on property, deals with the property for the purpose of enforcing or giving effect to the security, charge or encumbrance, his dealings with it shall be treated as if they were done through him as nominee by the person entitled to the property subject to the security, charge or encumbrance, and this subparagraph shall apply to the dealings of a person appointed to enforce or give effect to the security, charge or encumbrance as receiver and manager as it applies to the dealings of the person so entitled."**

It was submitted that in exercise of its statutory power of sale, income is derived by the chargee and the monies received by a chargee are applied to recover the unpaid loan.

In support of this proposition, the appellant placed reliance on Section 101 of the Land Act, 2012 which provides that:

> **"S.101 ... the purchase money received by a chargee who has exercised the power of sale shall be applied in the following order of priority –**
>
> **a. first, in payment of any rates, rents, taxes charges or other sums owing and required to be paid on the charged land; …"**

It was further contended that a chargor has no role to play in the exercise of a chargee's statutory power of sale and neither is the chargor a party to the sale/transfer on a forced sale. Hence, according to the appellant, the respondent is obligated to pay taxes in respect of the charged property, in this case CGT.

On the issue of whether a chargee is in a position to calculate CGT when exercising its statutory power of sale, it was submitted that valuations are carried out before the lending in order to establish the forced sale value of a property, hence a calculation of the CGT is not an impossibility on the part of a chargee

In opposing the appeal, **Mr. Fraser**, learned counsel for the respondent highlighted the respondent's written submissions filed on **3rd December, 2018** as well as its authorities filed on **8th December, 2018**. Reliance was placed on Section 56 of the Land Registration Act which provides that:

> **"56 (5) A charge shall have effect as a security only and shall not operate as a transfer",** and that Section 80 of the Land Act 2012 provides that:
>
> **"(1) upon commencement of this Act, a charge shall have effect as a security only and shall not operate as a transfer of any interests or rights in the land from the chargor to the chargee but the chargee shall have, subject to the provisions of this Part, all the powers and remedies in case of default by the chargor and be subject to all the obligations that would be conferred or implied in a transfer of an interest in land subject to redemption";** that,

whereas the law gives a chargee the right to exercise its statutory power of sale, the Land Registration Act and the Land Act recognize that a chargee is a proprietor of the charge and the chargor remains the proprietor of the land until such time that the chargor's interests are extinguished by the chargee exercising its statutory power of sale; that CGT is a tax imposed on the income of a person and not tax on land; that a chargee is a nominee of the owner pursuant to the charge; that the appellant's unilateral administrative action of demanding that a chargee pays CGT is contrary to Article 47 of the Constitution and Sections 4(1) of the Fair Administrative Action Act, 2015.

The appeal before us is a first appeal and our mandate is well spelt out in several decisions of this Court including **Selle & Another vs.**

Associated Motor Boat Company Limited & others [1968] E.A 123, wherein, it was held:

> **" an appeal from the High Court is by way of re-trial and the Court of Appeal is not bound to follow the trial judge's finding of fact if it appears either that he failed to take account of particular circumstances or probabilities or if the impression of the demeanor of a witness is inconsistent with the evidence generally.**
>
> **An appeal to this court from a trial by the High Court is by way of a re-trial and the principles upon which this court acts in such an appeal are well settled. Briefly put they are that this court must reconsider the evidence, evaluate it itself and draw its own conclusions though it should always bear in mind that it has neither seen nor heard the witnesses and should make due allowance in this respect.**
>
> **In particular, this court is not bound necessarily to follow the trial judge's findings of fact if it appears either that he has clearly failed on some point to take account of particular circumstances or probabilities materially to estimate the evidence or the impression based on the demeanor of a witness is inconsistent with the evidence in the case generally (Abdul Hameed Saif –vs-Ali Mohamed Sholan (1955)22 EACA 270".**

We have considered the record, the rival written and oral submissions, the authorities cited and the law in light of our mandate as stated above. For a start, it is worth pointing out that CGT is not a new phenomenon as it is provided for in the Income Tax Act. However, it was suspended in 1985 only to be re-introduced in the Finance Act, 2014, the effective date being **1st January, 2015**. Be that as it may, it was the respondent's position that by an administrative action published in the Daily Nation of **4th October, 2016**, the appellant demanded that both CGT and Stamp Duty be paid simultaneously before a transfer.

The appellant relied on Section 2 (b) of the Land Registration Act in asserting its position that a chargee is a proprietor of land once a charge has been created and that there is no distinction between land and the charge. It was the appellant's further position that the judge erred when he found that a chargee is only the proprietor of the charge and not the land.

On the other hand, the respondents contended that to demand the payment of CGT when the Banks are exercising a statutory power of sale is unreasonable and unfair as the Bank is not the owner of the property.

Section 2 of the Land Registration Act, 2012 defines a proprietor thus:

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

Then, there is section 98 (4) of the Land Act which provides as follows:

> **"(4) upon registration of the land or lease or other interest in land sold and transferred by the chargee the interest of the chargor as described therein shall pass to and vest in the purchaser free of all liability on account of the charge, or on account of any other charge or encumbrance to which the charge has priority, other than a lease easement of which the chargee had consented in writing".**

In our view, a charge is an instrument that facilitates the transfer upon a chargor's failure to repay the sum secured by the charge. This power is given to a chargee by virtue of its statutory power of sale. A chargee does not become the owner or the proprietor of the land but of the charge. In our view, to place a chargee and a chargor on equal footing will in effect blur the distinction between a chargee and a chargor.

The judge considered paragraph 5(2) of the Eight Schedule of the Income Tax Act which provides as follows:

> **"Where a person entitled to property by way of security or to the benefit of a charge or encumbrance on property, deals with property for the purpose of enforcing or giving effect to the security, charge or encumbrance, his dealings with it shall be treated as if they were done through him as nominee by the person entitled to the property subject to the security, charge or encumbrance.…"**

He came to the conclusion, rightly so in our view, that:

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

We agree with the above summation of the judge's distinction between a chargee as a proprietor of the charge and not of the land while a chargor is the proprietor of the land.

The respondent remains a chargee and not the owner of the property. The interest of a chargee is confined to the sum borrowed and a chargee's statutory power of sale is invoked upon the chargor's default to repay the loan. Indeed, in executing the transfer (after exercising its statutory power of sale), a chargee does so in its capacity as a nominee. It does not become a proprietor of the land.

Indeed, as summed up by the judge,

> "**. . . . S.98 (3) and (4) of the Land Act which provides as hereunder:**
>
> **"(3) A sale of the charged land by a chargee in exercise of the power of sale shall be made in the prescribed form and the Registrar shall accept it as sufficient evidence that the power has been duly exercised.**
>
> **4. Upon registration of the land or lease or other interest in land sold and transferred by the chargee, the interest of the chargor as described therein shall pass to and vest in the purchaser free of all liability on account of the charge, or on account of any other charge or encumbrance to which the charge has priority …"**
>
> **I therefore agree that the scheme of the land legislation is to create security over land which the chargee may sell after complying with the various statutory obligations and that at no time does the chargee step into the shoes of the owner of the land or become the owner of the land"."**

It is because of this power that it can transfer as if it was the owner.

The appellant further relied on section 101 (a) of the Land Act, 2012 in his assertion that CGT is a form of tax to be paid by the chargee. Section 101 (a) of the Land Act provides:

> **"The purchase money received by a chargee who has exercised the power shall be applied in the following order of priority – of sale**
>
> **a. first, in payment of any rates, rents, taxes, charges or other sums owing and required to be paid on the charged land;**
>
> **b. second, in discharge of any prior charge or other encumbrance subject to which the sale was made;**
>
> **c. third, in payment of all costs and reasonable expenses properly incurred and incidental to the sale or any attempted sale;**
>
> **d. fourth, in discharge of the sum advanced under the charge or so much of it as remains outstanding, interests, costs and all other money due under the charge, including any money advanced to a receiver in respect of the charged land under section 92; and**
>
> **e. fifth, in payment of any subsequent charges in order of their priority, and the residue, if any, of the money so received shall be paid to the person who, immediately before the sale, was entitled to discharge the charge".**

S. 101 of the Land Act providing on how the money is to be applied presupposes that it is after the event. '***It is money received***' (after the exercise of the statutory power of sale) that will be applied to pay rates, rents, taxes and charges. It is therefore improper for the appellant to demand money that has not been received by a chargee. Supposing the sale/purchase was to go awry?

With respect, we also concur with the judge's conclusion that CGT is a charge on the income of a person. The judge stated:

> **"The fact that Capital Gains Tax is a species of income tax comes clearly from a reading of section 3 (2) (f) of the Income Tax Act which provides that:**
>
> **"Subject to this Act, income upon which tax is chargeable under this Act is income in respect of- …(f) gains accruing in the circumstances prescribed in, and computed in accordance with the Eighth Schedule."**
>
> **However, section 3(1) of the Income Tax Act [Cap 470] provides as follows:**
>
> **" Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya. Therefore, it is clear that income tax is only charged upon the income of a person."**

The conclusion that it is the income of a person that is taxed is further supported in paragraph 2 of the Eight Schedule of the Income Tax Act which states:

> **"Subject to this Schedule, income in respect of which tax is chargeable under section 3(2)(f) is the whole of a gain which accrues to a company or an individual on or after 1st *January, 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1st January, 2015".***

And paragraph 4 (1) of the Eight Schedule states:

> **"The gain which accrues to a person on the transfer of any property is the amount by which the transfer value of the**

property exceeds the adjusted cost of the property".

Furthermore, in order for one to be liable to payment of CGT, it has to be established that there has been a gain.

Section 15 (3) (f) of the Income Tax Act provides:

> **"Without prejudice to subsection (1), in ascertaining the total income of a person for a year of income the following income shall be deducted:**
>
> **The amount of any loss realized in computing, in accordance with paragraph 5(2) (f); but the amount of any such loss incurred in a year of income shall be** ***deducted only from gains under section 3(2)(f) in that year of income and, in so far as it has not already been deducted, from gains in subsequent years of income".***

It is therefore our conclusion that Income Tax is a tax on the income of a person. To this extent, we are in agreement with the respondent's counsel that Section 19 of the Land Act is not applicable as it refers to "***taxes to be paid on the charged land***".

Further, Article 47 of the Constitution provides:

> **"(1) every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.**
>
> **2. if a right or fundamental freedom of a person has been or is likely to be adversely affected by administrative action, the person has the right to be given written reasons for the action".**

In addition, Section 4(1) and (2) of the Fair Administrative Action Act, 2015 provides that:

> 4. **(1) every person has the right to administrative action which is expeditious, efficient, lawful, reasonable and procedurally fair.**
>
> **2. every person has the right to be given written reasons for any administrative action that is taken against him.**

The respondents herein were not given an opportunity to present their points of view concerning this move by the appellant. The unilateral decision to demand that the respondents' members collect CGT from its various borrowers by twinning the payment of CGT and Stamp Duty was clearly unfair and irregular.

It is in view of the foregoing that we find no merit in this appeal. It is hereby dismissed with costs.

DATED AND DELIVERED AT NAIROBI THIS 24TH DAY OF JANUARY, 2020.

W. OUKO (P)

....

JUDGE OF APPEAL

HANNAH OKWENGU

....

JUDGE OF APPEAL

F. SICHALE

....

JUDGE OF APPEAL

I certify that this is a true copy of the original.

<u>DEPUTY REGISTRAR</u>