REVISITING THE 2019 CASE OF TAX JUSTICE NETWORK- AFRICA versus CABINET SECRETARY FOR NATIONAL TREASURY & 2 OTHERS

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Overview

The main focus of this review is on the 2019 ruling of the High court of Kenya: the case regarding the Double Taxation Agreement (DTA) between Kenya and Mauritius. This review explores how the decision on the constitutionality of the Kenya- Mauritius DTA by the Kenyan High Court has broad impacts on the ability of Kenya to mobilize the requisite resources required for development. The review delineates the role that tax treaties play in financing for development investigating both the positive and negative effects on countries ability to mobilize resources that countries should potentially consider as they enter into these agreements. The review explores specific provisions of the Mauritius-Kenya DTA revealing that in fact Kenya stands to lose plenty of taxable revenue if such a treaty were to enter into force. Lastly, the review delves into a critique of the decision of the Kenyan High court in this particular case setting out other best-case scenarios that the court could have explored in order to render the agreement unconstitutional.

1. INTRODUCTION

Development agendas inform the direction a country should take in accelerating its socio-economic progress. These agendas are political commitments and Kenya has accordingly framed its own through Vision 2030 and its antecedent Big 4 Agenda that focus on; Affordable Housing, Universal Health Coverage, Enhanced Manufacturing and Food Security. Further, as part of the African continent, Kenya subscribes to the 2063 African Sustainable Goals and as part of the global community, the 2030 SDGs Agenda also inform Kenya's socio-economic policy. The implementation of the promises set out in these Agenda requires Financing for Development (FfD).

States seek to raise the requisite revenue for development in a variety of ways key among them being through the collection of taxes. Raising revenue through tax collection has traditionally been high in government agendas because of the critical role such revenue plays including as a source of budget revenue to undertake various development projects. Various studies have estimated that total tax revenues make up for more than 80% of total revenue garnered by governments in more than half the countries in the world (Ortiz-Ospina &Roser, 2020). The Addis Ababa Action Agenda(AAAA) - that acts as a framework for Financing for Development- highlights various means of FfD with great emphasis being placed on effective domestic resource mobilization (DRM) (UN, 2015).

Domestic Resource Mobilization is defined as the process through which a State raises and spends its own funds for development (Hearson, 2018). That the

collection of tax is key in a State's ability to mobilize resources can further be illustrated through the AAAA's focus on : the need for an increase in the efficiency of tax collection, the need to formalize the informal economic sector of developing countries (in order to widen the tax base) and the need for an increase in the efficiency of tax administrations (UN, 2015). Private investment, particularly Foreign Direct Investment (FDI) has been highlighted as a source of FfD both by the AAAA as well as the Monterrey Consensus, both putting forward that when private investment is aligned with national development goals, it can act as a significant catalyst for FfD. The AAAA strongly advocates for States to create a conducive environment for investment (UN, 2015) To this end, Kenya is increasingly branding itself as an attractive jurisdiction that foreign companies can use as a launch pad to make inroads into the African market as well as into the country itself because of its conducive investment climate (Ogono, Obange and Odhiambo, 2017).

One of the major steps that Kenya has taken, in this regard, is through expansion of its tax treaty network through the conclusion of Double Tax Agreements (DTAs). In 2012, the Kenyan government on the pretext of increasing foreign investment in Kenya and increasing its tax competitiveness in comparison to other African countries signed a double tax agreement with Mauritius (Legal Notice No 59 of 2014). Tax Justice Network Africa, a non-governmental organisation (NGO) in a petition to the High Court(Tax Justice NetworkAfrica v the Cabinet Secretary of the Treasury & 2 Others, 2019), challenged the constitutionality of this DTA between Kenya and Mauritius putting forward the argument that the agreement was unconstitutional based on two major grounds. First, that it violated the principle of public participation as enshrined in article 10 of the Constitution. Second, that it violated the principles of public finance pursuant to article 201 that consists of among other things the principle that the tax burden must be shared fairly. Moreover, they argued that the effect of entering into the DTA would be unconstitutional because its provisions had great potential for treaty abuse and tax avoidance that would adversely affect the socio-economic rights of Kenyan citizens directly and indirectly.

This review intends to critically analyse the role that tax treaties can play in FfD against the 2019 DTA Kenya – Mauritius case. It is divided into three sections. The first section addresses the role of tax treaties in financing for development, the second section deals with an analysis of the specific provisions of the DTA that allegedly violated constitutional provisions, the third section critiques the Court's *ratio decidendi*, drawing out principles, if any, that the court pointed out towards informing FfD.

2. THE ROLE OF TAX TREATIES IN FINANCING FOR DEVELOPMENT

Tax treaties are agreements entered into between two or more countries that serve to allocate taxing rights between the contracting states (OECD,2020). The general aim of tax treaties is to promote cross-border trade by preventing double taxation of income (Oguttu, 2016). This intention is reflected in various Double Taxation Agreement Model Conventions such as the Organisation for Economic Cooperation and Development (OECD) Model and the United Nations (UN) Model as well as the African Tax Administrative Forum (ATAF) model within their preambles that reiterate that the purpose of DTAs is to prevent such double taxation (OECD, 2017; UN, 2017; ATAF, 2015).

The role of tax treaties, however, goes beyond preventing double taxation. They help to create a stable and predictable environment through clearly delineating taxing rights between the investor country and the investee country. Investors are more likely to invest when they are certain of the fiscal risks. Tax treaties assure such certainty (Hearson, 2018). Tax treaties thus play a significant role in FfD by attracting Foreign Direct Investment (FDI). The AAAA holds FDI as important source of FfD and calls for governments to work towards creating *'transparent, stable and predictable'* environments in order to enhance private investment (UN, 2015). Inversely, tax treaties can also be detrimental to FfD. Tax treaties especially those with tax havens present huge risks. They open up avenues for potential abuse by Multinational enterprises through tax planning activities such as the use of conduit companies to shift profits to low tax jurisdictions, artificial avoidance of permanent establishment as well as the abuse of transfer pricing principles (Oguttu, 2016).

The risk that tax treaties pose to FfD is even more prevalent in Africa. This is because African countries have a tendency of ratifying treaties which are not favourable to their tax systems, such as treaties that have low withholding taxes on sources of passive income such as interests, dividends and royalties and tax treaties that favour residence-based taxation more than source based taxation (Oguttu, 2016).The problem is further compounded by the practice of providing tax incentives to foreign investors. African governments seem not to consider the costs and benefits of such incentives(Seatiniuganda.org, 2019).Such practices lead to the erosion of the tax base and the shifting of the tax burden unfairly to small and medium enterprises (SMEs) and domestic taxpayers as well as the overall loss of much needed revenue for development.

As much as tax treaties can be exploited for the purpose of tax avoidance, they can also be instrumental in enhancing Domestic Resource Mobilization (DRM). Tax treaties can help widen the tax base of a country through mechanisms such as lowering the threshold of permanent establishments as well as increasing taxing

rights to source countries (Oguttu, 2016). Further, major DTA Model Conventions such as the OECD Model, UN Model and the ATAF Model in addition to preventing double taxation, cite their purpose as preventing tax avoidance. These models contain anti-abuse measures such as beneficial ownership rules amongst others that seek to curb treaty abuse (OECD, 2017; UN, 2017; ATAF, 2015).The next section investigates how the 2019 DTA between Kenya and Mauritius affected former's ability to mobilize resources for FfD and the constitutional implications of this.

3. THE SPECIFIC DTA PROVISIONS AND HOW THEY VIOLATED THE CONSTITUTION OF KENYA, 2010

The petitioners argued that the DTA entered into between Kenya and Mauritius would affect the ability of the Kenyan government to domestically mobilize resources for development through taxation and demonstrated how they were in violation of article 10 (1) (a), (c) and 10 (2) (d), and article 201 of the Constitution of Kenya, 2010. The impugned articles provide:

Art 10 (1): The national values and principles of governance in this Article bind all State organs, state officers, public officers and all persons whenever any of them:
a) Applies or interprets this constitution
c) Makes or implements public policy decisions

Art 10 (2) The national values and principles of governance include:
(d) Sustainable development
Article 201: The following principles shall guide all aspects of public finance in the Republic
a)There shall be openness and accountability, including public participation in financial matters
b)The public finance system shall promote an equitable society, and in particular
i. the burden of taxation shall be shared fairly;
ii. revenue raised nationally shall be shared equitably among national and county governments;
iii expenditure shall promote the equitable development of the country, including by making special provision for marginalised groups and areas;
c) The burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations;
d)Public money shall be used in a prudent and responsible way; and
e)Financial management shall be responsible, and fiscal reporting shall be clear

The petitioners argued that the tax incentives given to Mauritius would not only erode Kenya's revenue base, by giving companies a legal leeway to shift profits

to Mauritius but also provided massive potential for treaty abuse. They argued that through its various articles, the DTA provided several avenues through which Kenya could potentially lose significant tax. It thus violated the principle of sustainable development, a key national value of article 10 in the Constitution and at the same time violated article 201(b) of the Constitution on sharing the tax burden fairly as the burden would fall back on Kenyans in order to raise enough revenue for the government. The flagged articles in the 2019 DTA between Kenya and Mauritius include:

a. Article 11: Interest

The petitioners put forward that article 11 that governs taxation of interests sets out limits of withholding tax at 10% contrary to the 15% rate as provided for under Kenya's domestic law. They argued that this adversely limits Kenya's tax base thereby undermining the principle of sustainable development.

b. Article 12: Royalties

This provision much like the previously discussed one is also in stark contrast from the country's domestic rate. Kenya through its Income Tax Act charges a 20% withholding tax on royalties sourced in the country while the DTA under its article 10 provides that there shall be a 10% withholding tax on royalties sourced from the country provided that the beneficial owner is a resident in the other contracting state. The consequence from the imposition of this provision is that the country would lose significant tax revenue if such beneficial owner of the royalty was resident in Mauritius. The petitioner argued that this would result in loss of revenue for sustainable growth and development.

c. Article 13: Capital Gains

The petitioner argued that for 32 years Kenya has not been taxing capital gains on disposal of shares, yet it is still struggling to attract investment. Financing for development denotes that countries should as much as possible seal all loopholes that multinational companies can exploit from its DTAs resulting in the loss of huge government revenue. In the DTA between Kenya and Mauritius, art 13(3) reserves to the country of residence the right to tax gains of immoveable property. Notably, Mauritius charges in its domestic law a capital gains tax rate of 0%. This is dangerous for Kenya as it, for instance, potentially allows a foreign company resident in Kenya to make acquisitions of companies' resident in Mauritius through Mauritian holding companies thus robbing the government of substantial revenue as it does not have the right to tax any profits from the sale of such companies (Odari, 2015). This results in loss of necessary revenue for sustainable development thus limiting the values of transparency and accountability.

d. Article 20: Other Income

This article reserves all taxation of *"other income"* not provided for under the

DTA to the resident state. This has resulted in the effective reduction of withholding tax to 0% on services, management fees, insurance commissions etc. Kenya's domestic rate on *"other revenue"* stands at 20% thus, through this provision Kenya stands to lose substantial tax revenue resulting in the breach of the principles of good governance, integrity, transparency and accountability set out under article 10 of the constitution.

4. CRITICISM OF THE COURT'S DETERMINATION

The High Court of Kenya rendered a judgement on the validity of the DTA between Kenya and Mauritius on 15th March 2019. The key arguments of the petitioners were that the content of the DTA was unconstitutional and that the process of its ratification was not adhered to due to a lack of public participation and transparency. Moreover, the judgement failed to adequately address the issues that were raised. This is because the judge concerned himself with addressing the process of the placement of the DTA before Parliament and not the whether the content of the DTA was constitutional or not.

Notably, it was peculiar that the judge ruled that a double tax agreement is not a treaty. The DTA was instead referred to as a statutory instrument under the Income Tax Act as read conjunctively with the Statutory Instruments Act rather than a treaty under the Treaty Making and Ratifications Act. Further, even in applying the provisions of the Treaty Making and Ratification Act, the Court concluded that taxation falls under government business as per section 3(4) of the Treaty Making and Ratification Act rather than a treaty that would affect the socio-economic rights of Kenyans in accordance with section 3(2)(b)(ii) of the Treaty Making and Ratifications Act. Simply put, the court wrongfully interpreted that the double tax agreement was entered into in pursuance of government business as a matter of course. It failed to critically investigate the effects that such an agreement would have on the socio-economic rights of its citizens.

The Court's position was contrary to the approach taken by other jurisdictions whenever the question of interpretation of Double Taxation Agreements arises. For instance, in the South African case of *AB LLC and BD Holdings LLC v The Commissioner of the South African Revenue Service* (South African Tax Court: Case Number 13276) the Court in paragraph 14 states how DTAs are to be interpreted stating that they are mainly modelled from Double Taxation Conventions such as the OECD Model, the UN Model and in some cases, the USA Model. These models are often accompanied by Commentaries in order to give meaning and further context to the provisions of a DTA. Justification for reliance on such Commentary is often based on Article 31 of the Vienna Convention on the Law of Treaties (VCLT) which provides that treaties should be interpreted within the ordinary meaning provided for their terms within their

context and in accordance with their object and purpose (Vienna Convention on the Law of Treaties, 1969).

Context as per the definition provided for pursuant to the VCLT, includes Commentaries, as seems to be the consensus by the International Association of Tax Judges (Levedag, 2012). It should be noted here that these interpretive rules are considered customary international law (Levedag, 2012) For this reason, in this case, the Court applied both the OECD Commentary and the Technical Application to the DTA to the interpretation of Article 5 on what constitutes a permanent establishment. (South African Tax Court: Case Number 13276) Kenya has signed and ratified the VCLT, and as earlier stated, the interpretive rules contained in Article 31 to 33 are considered to be customary international law and as such are binding in the interpretation of all international treaties. (http://treaties.mfa.go.ke/treaties) Further, the Court took note of the fact that ‘treaty’ and ‘agreement’ are used interchangeably when it comes to referring to DTAs, however at their core the Court treated this specific DTA between South Africa and the USA as a treaty in the fullest meaning of the word within the VCLT. (South African Tax Court: Case Number 13276) Terms used in the DTA are normally best defined by the Commentary and not the domestic income tax statutes as was evidenced by the practice of this Court.

While the question before the High Court in this case was not arising from a dispute between the parties of this DTA and therefore there was no need of interpretation of the provisions of the DTA, the Court should have still categorised the DTA correctly, particularly taking into account the procedural requirements that are key to each type of categorisation. The judge also failed to apply one of the key principles in interpreting the Constitution, which is that the Constitution must be read as an integrated whole and that one provision should not be struck out because of the reading of another provision in the constitution. (Major General David Tinyefuza v Attorney General [1997]). Failure of the petitioner to provide a legal basis for application ofarticle 20 of the Constitution of Kenya on the bill of rights should not have led to key legal arguments brought under Articles 10 (National Values) and 201 (Principles of public finance) being struck out.

The Court was also silent on the unconstitutionality of the DTA based on the effect that it would have on the public interests of Kenya, in this case, the public interest being financing for development. In so doing the Court overlooked another principle of interpretation as highlighted in the case of *R v Big M Drug Mart Ltd (1983),* rightly provided by the petitioners, where it was stated that a law whose purpose is not unconstitutional can still be deemed to be unconstitutional because its resultant impacts are unconstitutional.This was particularly concerning as the unintended consequences of such action would be the reduction of the country’s tax base that wouldsubsequently lead to a reduction in funds garnered towards the

country's development goals. The judge, further, did not declare the DTA invalid but solely faulted the absence of tabling the Legal Notice No 59 of 2014 before Parliament within the required timeline pursuant to Statutory Instruments Act of 2014 as the reason for striking out the Double Tax Agreement. The upside of this ruling was that the DTA is valid but lacks legal effect, as such, nothing can be done on tax revenue lost through rationalization of the 2019 DTA 5 years ago.

5. CONCLUSION

This review inquired into the 2019 decision on the constitutionality of the Kenya-Mauritius DTA by the Kenyan High Court. It focused on two salient features. One, the impact that the DTA would have on Kenya's ability to raise additional revenue and two, on the implications of the DTA in restricting mobilisation of revenue. Regrettably, the court did not apply its mind on determining these two issues. It instead focused on analysing the procedural aspect leading to the treaty's ratification. This review, therefore, sought to build upon some of the arguments made by the petitioner whose arguments also focused on specific provisions of the DTA that restrict Kenya's ability to mobilise revenue. These provisions have been discussed and the following conclusions are made:

a) The court did not inquire into the impact that the DTA had on FfD, failing to juxtapose the DTA to the development agenda Kenya has subscribed to. The Court failed to adequately investigate the provisions of the DTA as a result, Kenya could potentially enter into a tax agreement with questionable provisions that hold potential for abuse resulting in a huge loss of revenue required for development.

b) The court did not develop or indicate any principles that may inform future precedent on ensuring compliance of DTAs with constitutional provisions. This is clearly illustrated by the recent signing of a new and different tax treaty between Kenya and Mauritius signed in April 2019 which has yet to be made public as of time of writing (Ocs.world, 2019).

Further to the above, the review also makes two specific recommendations:

i. The need for a balance between attracting FDI and avoiding potential eroding of the tax base

Balance is required between policies that encourage FDI whilst avoiding the erosion of the tax base. A proper analysis of investment tax incentives is required that ascertains the effectiveness of these incentives in attracting investment and the capability of the tax authority in preventing these incentives from being abused. The government needs to harmonize its tax policies with its development agenda.

ii. The courts should do more to understand the link between human rights and taxation

The lack of appropriate consideration of the constitutional violations presented in this case highlighted an increasing need for more discourse on the link between taxation and human rights. Scholars such as Waris and Oguttu have postulated that relating human rights to taxation gives taxation legitimacy (Waris, 2013; Oguttu, 2016). Socio-economic rights are directly and indirectly affected by the revenue raised by a State and tax being one of the key sources of this revenue then directly affects socio-economic rights which are enshrined in the Constitution.

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