WHAT NEXT AFTER KENYA'S HIGH COURT NULLIFIES MAURITIUS-KENYA DOUBLE TAX AGREEMENT?

Background

The High Court of Kenya on 15 March 2019 rendered a judgement on the validity of the Mauritius-Kenya Double Taxation Agreement (the "**DTA**") further to a case by the Tax Justice Network Africa ("the **Petitioner"**), a Non-Governmental Organisation, against the Cabinet Secretary for National Treasury and Planning, the Kenya Revenue Authority and the Attorney general (the **Respondents**).

Kenya and Mauritius signed the DTA on 7 May 2012, which Kenya thereafter ratified on 23 May 2014 through a publication in the Kenya Gazette under Legal Notice Number 59 of 2014 (the **Legal Notice**). It was expected that the treaty would come into force on 1 January 2015 with the exchange of ratification instruments. The DTA, however, is yet to come into force since Kenya has to date not notified the Mauritian Government on completion of the ratification process.

Brief overview of the arguments at the High Court

The Petitioner challenged the constitutionality of the DTA before the High Court on multiple grounds, including alleged lack of openness in the DTA making process, the need for public participation in the exercise, lack of parliamentary scrutiny as required by law and that the DTA was not for the benefit of Kenya.

The key question for determination by the High Court was whether the DTA was in violation of the Constitution of Kenya having been enacted without public participation and parliamentary scrutiny. The Statutory Instruments Act, 2013, which came into force on 25 January 2013, provides that a copy of a statutory instrument must be laid before the National Assembly within seven days of being published by the Cabinet Secretary responsible for the relevant regulation making authority. The Act further provides that a statutory instrument shall cease to have effect immediately after the last day set for it to be tabled in Parliament. If a statutory instrument is not laid before the National Assembly as required, it becomes void. In relation to the Legal Notice therefore, the Cabinet Secretary for the National Treasury had until 30 May 2012 to table the Legal Notice in Parliament, which appears not to have been done.

In its judgement, the High Court of Kenya found the constitutional claims to "lack merit". It also held that the petition "lacked specifics" in respect of the argument on accountability and that the economic arguments that had been raised by the Petitioner had not been substantiated. In its view, the Respondents had demonstrated, to its satisfaction, that there was input from the Kenya Revenue Authority, an entity mandated to deal with matters concerning revenue; the Attorney General Office, an office mandated to give the Government legal advice; and the Cabinet, which is part of the executive arm of the Government. The inclusion of all these entities demonstrated accountability and openness.

According to the Judge, however, the Legal Notice that was intended to domesticate the DTA was void because it was not tabled before Parliament within the time period required by the Statutory Instruments Act, 2013. Therefore, contrary to what has been expressed in some publications, the invalidity of the DTA is only due to a procedural defect. We point out that this is a curable defect and that the Kenyan Government can proceed to publish a fresh Legal Notice in the Kenya Gazette, which can then be tabled before the National Assembly within the stipulated timelines.

Why are DTAs important?

DTAs play a key role in cross border transactions. They are international tax agreements that are aimed at reducing or eliminating the unfair burden of double tax on the same income and for identical or overlapping periods or due to connecting factors. The legal certainty that they provide on how international income will be taxed encourages foreign investment in developing countries. DTAs further increase the competitiveness of a country in attracting foreign direct investment without eroding its local tax base. International investors would be deterred from investing if the returns are made unattractive due to high tax rates in repatriating returns and if fiscal risks are uncertain. Last but not least, DTAs also prevent fiscal evasion as they provide for tax information exchange between the parties to the agreement.

Kenya and Mauritius have a history of cordial relations and much has been done over the years to further consolidate economic and bilateral relations between the two countries. As an internationally recognised and acclaimed financial hub, Mauritius looks forward to continuing to facilitate investment and trade with Kenya for the benefit of both countries. Mauritius prides itself in having adopted and embraced international norms and standards that are recognised by international organisations such as the Organisation for Economic Co-operation and Development and the EU amongst others.

Impact of the decision and practical implications on Mauritian structures

Given that the DTA was yet to come into force, the preferential withholding tax rates set out in the DTA were not applicable and payments made to a Mauritian company were treated in a similar manner as payments to non-resident persons based in jurisdictions that do not have a DTA with Kenya. In this regard therefore, the decision does not result in any adverse implications for Kenyan companies with structures in Mauritius and the withholding tax rates set out in the Income Tax Act would continue to apply to payments being made by Kenyan subsidiaries to their Mauritian holding companies.

While it is acknowledged that emerging economies such as Kenya require bilateral agreements to attract and promote foreign direct investments, the court's decision stresses on the importance of adhering to due procedure and the rule of law. In particular, a number of statutory instruments have been published over the last few years, including the VAT Regulations 2017, DTAs with the United Arab Emirates and South Africa and other recent regulations such as the Housing Fund Regulations. The decision could open a Pandora's box in relation to the compliance status of these instruments with the Statutory Instruments Act.

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Conclusion

It is not yet clear whether the Kenyan Government will lodge an appeal against the decision by the High Court or if it will publish a fresh Legal Notice that will be tabled in Parliament within the statutory timelines. While we continue to monitor the situation and update our clients on any further developments, we would emphasise that the High Court's decision does not have any impact on existing Mauritian structures and we would expect that Mauritius will continue to be a preferred holding company jurisdiction for investments to Kenya.

Should you require more information, please do not hesitate to contact Jason Harel, Assad Abdullatiff or Daniel Ngumy.

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