



IN THE HIGH COURT AT NAIROBI
MILIMANI LAW COURTS
CONSTITUTIONAL AND HUMAN RIGHTS DIVISION
PETITION NO. 544 OF 2013

BETWEEN

**KENYA UNION OF DOMESTIC, HOTELS,
EDUCATION INSTITUTIONS AND HOSPITAL WORKERS
(KUDHEIHA WORKERS UNION) PETITIONER**

AND

**KENYA REVENUE AUTHORITY 1ST RESPONDENT
COMMISSIONER OF DOMESTIC TAXES 2ND RESPONDENT
ATTORNEY GENERAL 3RD RESPONDENT**

AND

**KENYA ASSOCIATION OF HOTEL
KEEPERS AND CATERERS INTERESTED PARTY**

JUDGMENT

Introduction

1. The petitioner is a registered trade union representing domestic and hotel workers, workers in educational institutions and hospitals. The 1st respondent is a corporate body established under the *Kenya Revenue Act (Chapter 469 of the Laws of Kenya)* and is responsible for the collection of taxes while the 2nd respondent acts on its behalf.
2. The interested party is the principal umbrella association bringing together employers in the hotel, accommodation and allied services industry. Despite being served with process it did not participate in these proceedings.

3. The petitioner brings this case to impugn the provisions of Value Added Tax ("VAT") on service charge under the *Value Added Tax Act (Act No. 35 of 2013)*. The petitioner's case is that including service charge as part of taxable value of supply for purposes of calculating VAT violates the Constitution and its members' fundamental rights and freedoms.
4. As this case concerns how service charge is treated, it is important to set out the statutory provisions germane to the case. The *Value Added Tax Act (Chapter 476 of the Laws of Kenya)* ("the Repealed Act") was repealed and replaced by *Value Added Tax Act (Act No. 35 of 2013)* ("the 2013 Act").
5. Section 9(4) of the *Repealed Act* excluded service charge in lieu of tips as part of the price for purposes of calculating VAT. It provided as follows;
9.(4) In calculating the price of accommodation and restaurant services:-
 - (a) Any charge made in respect of the Catering Training and Tourism Development Levy; and*
 - (b) Any service charge made in lieu of Tips or gratuities:*
Shall be excluded:
Provided that the proceeds of the service charge referred to in paragraph (b) shall be distributed directly to the employees of the hotel or restaurant, in accordance with a written agreement between the employer and employees and the service charge shall not exceed ten percent of the price of the service excluding such service charge.
[Emphasis mine]
6. Section 13 of the *2013 Act* deals with value of the taxable supply which forms the basis for calculating the tax. It provides as follows;
13. (1) Subject to this Act, the taxable value of a supply, including a supply of imported services, shall be-
 - (a) the consideration for the supply; or*

- (b) if the supplier and recipient are related, the open market value of the supply.
- (2) The taxable value of a supply of mobile cellular services shall be the value of the services as determined for the purposes of the duty imposed under the law relating to excise.
- (3) Subject to subsections (4) to (6), the consideration for a supply, including a supply of imported services, shall be the total of –
- (a) the amount in money paid or payable, directly or indirectly, by any person, for the supply; or
 - (b) the open market value at the time of the supply of an amount in kind paid or payable, directly or indirectly, by any person, for the supply; and
 - (c) any taxes, duties, levies, fees, and charges (other than value added tax) paid or payable on, or by reason of the supply, reduced by any discounts or rebates allowed and accounted for at the time of the supply.
- (4) The consideration for a supply shall include the amount charged for –
- (a) any wrapper, package, box, bottle, or other container in which goods are supplied;
 - (b) any other goods contained in or attached to the wrapper, package, box, bottle or other container referred to in paragraph (a); or
 - (c) any liability that the purchaser has to pay to the vendor by reason of or in respect of the supply in addition to the amount charged as price.
- (5) In calculating the value of any services for the purposes of subsection (1), there shall be included any incidental costs incurred by the supplier of the services in the course of making the supply to the client: Provided that, if the Commissioner is satisfied that the supplier has merely made a disbursement to a third party as an agent of his client, then such disbursement shall be excluded from the taxable value.
- (6) The consideration for a supply shall not include –
- (a) in the case of a supply of goods under a hire purchase agreement, any financial charge payable in relation to a supply of credit under the agreement; or

(b) any interest incurred for the late payment of the consideration for the supply.

(7) The consideration for a supply of accommodation or restaurant services shall not include the Tourism Levy imposed on the supply under the Tourism Act (Cap. 383); or

(8) For the purposes of this Act, a person is related to another person if-

(a) either person participates, directly or indirectly, in the management, control or the capital of the business of the other;

(b) a third person participates, directly or indirectly, in the management, control or capital of the business of both; or

(c) an individual who participates in the management, control or capital of the business of one, is associated by marriage, consanguinity or affinity to an individual who participates in the management, control or capital of the business of the other. [Emphasis mine]

The Petitioner's Case

7. The petitioner's case is set out in the petition dated 12th November 2013 and is supported by the affidavit of Albert Njau, its Secretary General, sworn on 12th November 2013. The petitioner has also filed written submissions.

8. The petitioner's avers that since 1968, it has negotiated collective bargaining agreements ("CBA") with the interested party for the benefit of its members. The last CBA negotiated in June 2012, dealt with standardization of service charge. This was the result of complaints by workers that payments in kind or "tips" were only given to the waiters. It was therefore agreed to abolish "tips" and replace the same with a standardized service charge to be paid by all customers for the whole range of services provided by the establishments represented by the interested party.

9. The CBA provides that the money collected through service charge would be audited and distributed equally to all unionisable

employees after deducting an administrative charge. As a result the petitioner's members have been earning service charge monthly depending on the amount collected from customers.

10. The petitioner's case concerns how the service charge is treated under the *2013 Act*. The petitioner avers that the *Repealed Act* specifically excluded service charge in calculating the price of accommodation and restaurant services subjected to VAT. It submitted that the *2013 Act* has neither expressly imposed nor excluded the service charge from VAT imposition leaving a lacuna that is now being exploited by the respondent and some of the members of the interested party.
11. The petitioner's case is that failure or omission to expressly provide for the inclusion or exclusion of the service charge, the apparent VAT deductions by the 1st respondent from the petitioner's members service charge is in breach of their constitutional rights and fundamental freedoms and a violation of the Constitution.
12. The petitioner submits that its members have the right to engage in collective bargaining and in that respect negotiate matters such as standardized service charge as part of the CBA. Thus the failure to make provision or clarify the position of service charge in the *2013 Act* violates the rights of the petitioner's members as the terms of the CBA have made provision for how service charge is to be collected and paid to its members.
13. The petitioner submits that the law discriminates against its members and singles them out by imposing VAT on them while non-unionized workers in the same industry are not affected by application of the law. The petitioner avers that the imposition of the

tax is tantamount to interference with the petitioner's right to organise and the freedom of its members to associate under **Article 41** of the Constitution as it specifically targets employees who have made arrangements to standardize service charge. The petitioner avers that the result of the imposition of the tax is that it may lead employees to leave the Union in order to protect their extra income through tips and service charge.

14. The petitioner also complains that imposition of VAT in the circumstances also exposes them to double taxation in the sense that the service charge is subjected to VAT and when the balance is paid to the employee it is also subjected to income tax. The petitioners contend that this is also discriminatory, illegal and bad in law.
15. The petitioner asserts that as a result of the **2013 Act**, its members have lost income and motivation. They have suffered poor morale which has strained the relationship with their employers resulting in low productivity, low and poor service delivery to the customers.
16. As the enactment of the **2013 Act** affects the CBA, the petitioner avers that its members ought to have been consulted before its enactment as required by **International Labour Organisation Convention No. 144 of 1976**. In the circumstances, the petitioner contends that there was lack of public participation in the enactment of the **2013 Act**.

17. The petitioner seeks the following relief in the petition

- (a) *The respondents and interested party be stopped from further deductions and or imposition of 16% VAT upon the service charge collected by the employers and members of the*

interested party on behalf of the petitioner's members, employees.

- (b) *A declaration that failure or omission to expressly provide for the inclusion or exclusion of the Service Charges, the apparent 16% VAT deductions by the respondents and the Interested party from the petitioner's members service charge were and are in breach of their constitutional obligations under Articles 2, (1, 2, 3, 4 and 5), Articles 3(1), Article 10, 19, 20(1, 2, and 3) 21(1), 22, 23, 33, 36, 41 (1, 2, 3, 4 and 5) of the Constitutional and thus their decision was null and void to the extent of their inconsistency with the constitution.*
- (c) *A declaration that the monies belonging to the petitioner's members, already deducted by the respondents and the interested party as a result of the purported operation on the VAT Act 2013 and the misconceptions therein, be refunded to them forthwith.*
- (d) *A declaration that if there is a lacuna and or an ambiguity caused by failure to expressly include or exclude a provision (s) regarding the treatment of service charge by the respondents, it is unconstitutional discriminatory, ultravires, mala-fides to interpret the said Act as against the petitioner's members.*

Respondents' Case

18. The 1st and 2nd respondents oppose the petition on the basis of grounds of opposition dated 12th February 2014. They contend that they administer a tax imposed through an Act of Parliament in line with **Article 210(1)** of the Constitution. Thus they contend that the **2013 VAT** cannot be unconstitutional as it is anchored by law and the Constitution.

19. The 1st and 2nd respondents submit that the provisions of **2013 VAT** relating to the taxation of service charge do not admit any

ambiguity. According to the respondents **section 13(3)(c)** of the **2013 Act** expanded the meaning of taxable supply to encompass service charge and therefore the inclusion of service charge in accommodation and restaurants as part of the taxable value of the supply cannot be termed as violating the Constitution. The respondents argue that the purpose of the legislation is to ensure that the tax burden is shared fairly as required by **Article 201(b)(i)** of the Constitution.

20. The 3rd respondent's position is set out in the grounds of opposition dated 21st November 2013. The 3rd respondent argues that the petition does not disclose any constitutional violation and that the petitioner's interpretation of the Constitution and the **2013 Act** is clear in its provision relating to taxation of service charge.
21. The respondents submit that Parliament enacted the **2013 Act** after giving Kenyans an opportunity to express their views in line with **Article 118(1)(a)** and **(b)** of the Constitution. They deny that there was a lack of public participation in enactment of the legislation.
22. The respondents assert that the petition does not disclose a violation of the Constitution and the same ought to be dismissed.

Determination

23. The core issue for consideration is whether the provisions of the **2013 Act** are constitutional and a violation of the petitioner's members' fundamental rights and freedoms to the extent that they do not exempt service charge from imposition of VAT. The Act is also impugned on the basis of want of public participation.

24. Before I deal with the constitutionality of the impugned provisions, I think it is important to establish the legislative authority of the legislature to impose taxes. **Article 209** of the Constitution empowers the national government to impose taxes and charges. Such taxes include income tax, value-added tax, customs duties and other duties on import and export goods and excise tax. The manner in which the tax is defined, administered and collected is a matter for Parliament to define and it is not for the court to interfere merely because the legislature would have adopted a better or different definition of the tax or provided an alternative method of administration or collection. Under **Article 209** of the Constitution, the legislature retains wide authority to define the scope of the tax. (See *Bidco Oil Refineries v Attorney General and Others* Nairobi Petition No. 177 of 2012, paras. 53 – 56.) It is therefore within the legislative competence of Parliament to remove exemption of service charge from the *2013 Act*.
25. The principles upon which the court determines the constitutionality of statutes are now well settled. It is well established that every statute enjoys a presumption of constitutionality and the court is entitled to presume that the legislature acted in a constitutional and fair manner unless the contrary is proved by the petitioner. In considering whether an enactment is unconstitutional, the court must look at the character of the legislation as a whole, its purpose and objects and effect of its provisions (see *Ndyanabo v Attorney General of Tanzania* (2001) 2 EA 485, *Joseph Kimani and Others v Attorney General and Others* Mombasa Petition No. 669 of 2009 [2010] eKLR, *Murang'a Bar Operators and Another v Minister of State for Provincial Administration and Internal Security and Others* Nairobi Petition No. 3 of 2011 (Unreported)), *Samuel G.*

Momanyi v Attorney General and Another Nairobi Petition No. 341 of 2011 (Unreported).

26. The purpose of the **2013 Act** was to simplify the hitherto complex VAT regime, widen the tax net and reduce compliance costs with the intention of increasing revenue for the government. For example, the Act has reduced the goods and services that are zero-rated and exempt from VAT. By defining terms like business and importer and having an inclusive definition of taxable supply, the deliberate intention of the Act is to expand the tax base in order to make the tax more equitable. Thus, the removal for special provisions for taxation of service charge falls within the objective of the Act to remove exemptions and to widen the tax net. This is legitimate purpose and objective of any tax law. Thus, on the basis of the purpose of the Act, I am unable to find any breach of the Constitution.
27. As I understand the petitioner's grievance concerns the appropriate policy to be pursued by the **2013 Act** in relation to its members. Whether the policies pursued by the Acts are proper or not is not a matter for the court but one for the legislature. In ***Commission for the Implementation of the Constitution v Parliament of Kenya and 2 Others Nairobi Petition No 454 of 2012 [2013]eKLR***, the issue for consideration was whether the ***Leadership and Integrity Act, No. 19 of 2012*** fell short of the threshold required by the Constitution for effective legislation by adopting one approach over another to the enforcement of **Chapter Six** of the Constitution. The court observed thus; "[63][The question]..... Whether to have a "one stop-shop" or have a various public entities involved in the implementation of **Chapter Six** under the umbrella of EACC is a matter for the legislative policy. Attractive and weighty arguments

can be marshaled for either position but it is not a matter in which the Court should delve into unless the Constitution is contravened."

The Court further noted that, "[69] *Declaring a statute as unconstitutional, needless to say is a serious issue with deep-seated ramifications and the court should not be overly enthusiastic in pronouncing so unless clear grounds known in law have been clearly established.*" I agree and adopt these sentiments and I find and hold that in the absence of any specific violation of the Constitution and in particular of the Bill of Rights the court cannot intervene in directing the legislature to adopt the petitioner's approach.

28. The petitioner contends that its members ought to have been consulted as required by *Convention No. 144 of ILO*. The *ILO Convention No. 144 in 1976*, entitled the *Tripartite Consultation (International Labour Standards) Convention, 1976 (No. 144)*. It requires effective consultation between government, employers' and workers' representatives at each stage of the standards-related activities of the ILO, from setting the agenda of the International Labour Conference, through the supervision of the application of standards. Its purpose is to promote tripartism and social dialogue at the national level through ensuring the involvement of employers' and workers' organizations at each stage of ILO's standards-related activities.
29. **Article 94** vests legislative authority of the people of Kenya in Parliament and **Article 118(1)(b)** obliges the legislature to "*facilitate public participation and involvement in the legislative and other business of Parliament and its committees.*" Since all statutes come with a presumption of constitutionality, it is incumbent upon the petitioner to demonstrate that there has been no

public participation to the extent that the law is invalid. In *Law Society of Kenya v Attorney General Nairobi* Petition No. 318 of 2012 (Unreported), the court observed as follows, “[51] In order to determine whether there has been public participation, the court is required to interrogate the entire process leading to the enactment of the legislation; from the formulation of the legislation to the process of enactment of the statute. I am entitled to take judicial notice of the **Parliamentary Standing Orders** that require that before enactment, any legislation must be published as a bill and to go through the various stages in the National Assembly. I am entitled to take into account that these **Standing Orders** provide for a modicum of public participation, in the sense that a bill must be advertised and go through various Committees of the National Assembly which admit public hearings and submission of memoranda.” I have considered the petition and the deposition in support and they are starved of evidence to support the conclusion that there was lack of public participation in the enactment of the *2013 Act*.

30. The *2013 Act* is a revenue statute of general application and although it affects the petitioner’s members, it not a labour or labour standard setting statute to which the provision of the *ILO Convention No. 144 in 1976*. Nevertheless, as I have outlined, the petitioner has not discharged its burden of proving that there was no public participation.
31. As regards the interpretation of the *2013 Act*, I do not think there is any ambiguity or lacuna in its provisions in the treatment of service charge. The intent of the legislation is clear when one looks at the provisions of the *Repealed Act* and the *2013 Act* vis-à-vis service charge. **Section 9(4)** of the *Repealed Act* which dealt with service

charge was only replicated to the extent that only the levy imposed under the *Tourism Act* was excluded in the *2013 Act*. Otherwise **section 13(3)(c)** of the *2013 Act* is clear what constitutes the taxable value of the supply.

32. I also find that the petitioner has not established that the *2013 Act* violates its members' fundamental rights and freedoms. First, I do not think that the *2013 Act* violates the freedom of association or any labour rights. The petitioner's right to renegotiate the CBA in light of change of circumstances of the law has not been abridged. Conversely, if the petitioner's argument were allowed to prevail, the petitioner and like organisations would have a veto on tax legislation simply on the grounds that a certain position affecting tax liability had been sealed by the CBA. The petitioner and its members right to negotiate the terms of the CBA is still available subject to the applicable law.
33. Second, discrimination of the petitioner's members has not been established. The law does not single out the petitioner's members for special and prohibited treatment under **Article 27** of the Constitution. The application of the tax is neutral and though it affects the petitioner's members in a specific way, the reason for imposing the tax on service charge is that the purpose of the tax is to broaden the tax net.
34. Finally, the imposition of taxes is a constitutional imperative and the power to impose taxes is reposed in the legislature. The imposition of tax by statute cannot, of itself, amount to arbitrary deprivation of property contrary to **Article 40** of the Constitution.

Disposition

35. The petitioner's case in effect seeks an amendment of the *VAT Act, 2013* to exclude service charge as part of the basis for imposing the tax. While I sympathise with the petitioner's case, the arguments made against imposition of the tax on the petitioners members should be laid at the doors of the executive and legislature.

36. As no violation of the Constitution has been established, the petition must fail and it is hereby dismissed with no order as to costs.

DATED and DELIVERED at NAIROBI this 21st day of February 2014

D. S. MAJANJA
JUDGE

Mr Esuchi instructed by Otieno Okeyo and Company Advocates for the petitioner.

Mr Twahir, Advocate instructed by the Kenya Revenue Authority for the 1st and 2nd respondent.

Ms Muchiri, Litigation Counsel, instructed by the State Law Office for the 3rd respondent.