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When is a tax treaty not a treaty?

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Friday, April 12th, 2019

The High Court of Kenya gave judgement on 15 March 2019 on a challenge to the validity of the Kenyan-Mauritius double tax treaty in *Tax Justice Network- Africa v Kenya Revenue Authority and others*. The petitioners had sought a declaration that the treaty had not been subjected to the ratification of domestic law and the Kenyan constitution and the legal notice giving the treaty effect under Kenyan law was invalid. The case raises three distinct issues in treaty making:

- Constitutional issues
- Validity of the treaty under international law
- Effect of the treaty in domestic law

To some extent, the arguments on the three issues in this case were interwoven. In my view, it is essential to separate each out.

Constitutional issues

The constitutionality of the treaty was challenged on three grounds relating to the provisions of the treaty itself, firstly, those that limited Kenya's taxing rights contravened various policy considerations such as sustainable development, loss of tax revenue transparency and accountability. Secondly, the treaty has a minimum five-year duration before it can be terminated. Thirdly, the treaty waives a tax that is imposed by the national government and therefore contravenes article 114 of the Constitution that deals with Parliamentary procedure for money bills.

In relation to the first and second grounds, the court concluded that no case was made out as to how the substantive provisions of a treaty violated the constitution. A number of arguments that are frequently made as to why tax treaties including those patterned on the OECD and UN models are inappropriate for developing countries. In my view, in order to succeed on this ground, it would be necessary to show that the Constitution or other legislation precludes the executive from concluding tax treaties at all or on these terms. Sections 41 and 41A of the Kenyan Income Tax Act 1973 which give effect to tax treaties in domestic law, imply executive authority to conclude such treaties (this is similar to the UK position on treaty making power. See Schwarz on Tax Treaties, 5th ed. Chapter 2 para 10-100).

Validity of the treaty under international law

The Kenyan Revenue Authority correctly invoked article 27(1) of the Vienna Convention on the Law of Treaties that a state may not invoke provisions of its internal law to justify its failure to

perform the treaty and article 40 which provides that a state may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of its internal law unless that violation was manifest and concerned a rule of fundamental importance. Any attempt to impugn the validity of the treaty at the international plane would, of necessity, need to address these issues.

Effect of the treaty in domestic law

Much of the argument and analysis of the court focused on the process of ratification. The main principle underlying the lack of ratification was that the treaty was not subject to public scrutiny because it was not presented to Parliament for approval. This raised both constitutional issues and mechanical issues relating to the effect of the treaty in domestic law.

The constitutional issue was the requirement under article 10 of the Constitution to give effect to national values and principles of governance that involve public participation, integrity, transparency and accountability. The court declined this ground.

The court ruled that the treaty went through some form of ratification as parties signified consent to be bound by the Agreement by signing the same and Kenya published its consent as shown by Legal Notice no. 59 published on 23rd May 2014. This conclusion would also establish consent at the international plane.

Kenya, like many Commonwealth countries has legislation of a general nature to give effect to treaties under domestic law. In Kenya this is governed by the Treaty Making and Ratification Act 2012. This is certainly consistent with the definition of treaties in article 1 of the Vienna Convention on the Law of Treaties 1969 and the definition of treaty in section 2 of the Treaty Making and Ratification Act 2012 is identical to the definition in the Vienna Convention.The court treated the treaty as a treaty within this legislation.

Like many Commonwealth countries, separate provisions are contained in sections 41 and 41A of the Kenyan Income Tax Act to give effect to tax treaties. The legal notice that the petitioners sought to impugn giving effect to the treaty in Kenyan domestic law is expressed to be made pursuant to s 41 (Legal Notice 59 of 23 May 2014). Although the court did not consider s 41, it concluded that the legal notice is a statutory instrument and the legislation authorising the making of statutory instruments requires such instruments to be laid before Parliament within seven days after publication of the instrument. The outcome would be similar in either case, if s 41 were considered, since section 41(3) requires such notices to be laid before Parliament without delay.

The court found that there was no evidence that the legal notice had been laid before Parliament and therefore declared it to be void. Such a declaration goes to the effect of the treaty in domestic law rather than to its existence as a matter of international law. Thus, in terms, the treaty cannot be relied on by parties before the Kenyan courts.

Taxpayers' position

The position of taxpayers in such a situation is far from settled. A not dissimilar situation arose in relation to the 1977 treaty between Ghana and the United Kingdom. The UK made the statutory notice to give effect to the treaty, but in 1991, it was discovered that the treaty had not been properly ratified by Ghana. As a result, the previous 1947 treaty remained in effect.

The UK tax authorities took a pragmatic approach 1977 treaty and permitted taxpayers to choose

whichever treaty was more beneficial until the 1977 treaty was formally ratified. The legal basis for this appears to be a legitimate expectation that taxpayers would be entitled to the benefits of a treaty that had been held out as being in effect. This would have forestalled potential applications for judicial review, were treaty benefits to be denied (see *Schwarz on Tax Treaties* 5th ed. Chapter 2 para 10-450).

Future treaties

BEPS Action 6 Final Report OECD (2015), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, http://dx.doi.org/10.1787/9789264241695-en set out guidance on tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country which is now included in the OECD and UN Commentaries to their respective 2017 Model Conventions.

Union of India v Azadi Bachao Andolan [2004] 10 SCC 1 (SC). 5 a similar legal attack was made on the India-Mauritius double tax treaty. The Indian Supreme Court however considered that whether such treaties should exist and on what terms "is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations." This conclusion was not to exclude public debate on the subject but rather that a political rather than a judicial forum is more appropriate.

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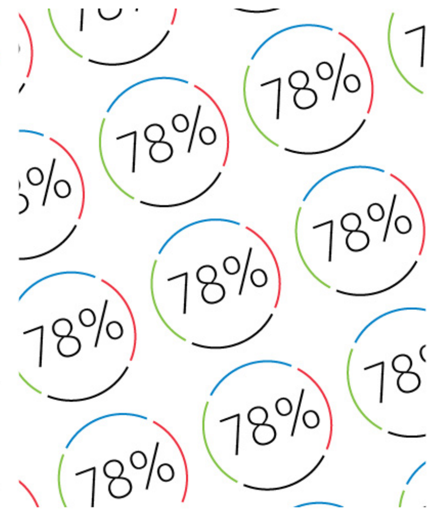

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