Sagamore Hill.

TAX NEWSLETTER.

Issue 046 September 2025.

Understanding the concept of legitimate expectation.

In this issue, we delve into the concept of legitimate expectation, with respect to tax, highlighting some of the landmark cases that the courts and the tax appeal tribunal have determined.

In the case of **UNILEVER KENYA LIMITED**, Vs **the commissioner of customs and border control**, the appellant had made an application for the determination of the classification of tariffs, for customs valuation of several products. The commissioner sort to revoke the advance ruling made, as provided for in Section 248A, of the East Africa Community Customs Management Act. The section provides that,

1. A person intending to import goods, may make a written application to the Commissioner for advance binding rulings on any of the following –
    a. tariff classification;
    b. rules of origin; or
    c. customs valuation.
2. Subject to subsection (1) and upon direction from the Commissioner, the applicant shall furnish to the Commissioner sufficient information that may be used to make the decision.
3. The Commissioner shall within thirty days of receipt of the sufficient information issue an advance ruling or give reasons for the inability to issue an advance ruling on the application.
4. The decision issued under subsection (3) shall be binding on the Commissioner and the applicant for a period not exceeding twelve months.

Upon verification by the court, and several lab tests done to substantiate the components constituting the product, and how the product would be used in the production process, the court found that the **correct classification had been done**, and the advance ruling had been issued appropriately.

Further, the court emphasised that the taxpayer legitimately relied on the earlier ruling done by the authority, and they had a reason to do so.

In another case of **Ruaraka Diversified Investments Limited vs Commissioner of Domestic Taxes,** the applicant had made an application for a **private ruling** for tax implication of subdivision of land that the company intended to develop into commercial properties and residential properties. In the application, High Court noted that the "***The letter is clear, from the very word go, that the appellant was specifically seeking advice on compliance 'from a Capital Gains Tax (CGT) perspective' of the development of Garden City. I find that the tone of the appellant's letter was intended to pre-empt a specific response****. The scenario would have been different had the appellant laid all its cards on the table by clearly stating the full particulars of its dealings with the third party including its core business, financial statements, the purchase price it paid for the land in question and the amount that it expected to receive from the third party. It is however curious to note that nowhere in the said letter did the appellant disclose the amount of money involved in its transactions with the third party thus lending credence to the respondent's position that the letter dated 22nd April did not represent a private ruling as it was merely a response to a specific enquiry."*

Section 65 of the tax procedure Act allows a taxpayer to make an application to the commissioner. Such an application should meet certain criteria, including, 65(2).

(a) shall include all relevant details of the transaction to which the application relates together with all relevant documents;

(b) shall specify precisely the question on which the Commissioner's interpretation is required; and

(c) shall give a full statement setting out the interpretation by the applicant of the tax law in relation to the transaction.

Further, subsection 4 provides that “*If the taxpayer has made a complete and accurate disclosure of the transaction in relation to an application for a private ruling and the transaction has proceeded in all material respects as described in the application, the private ruling shall be binding on the Commissioner.”*

This clearly demonstrates that a private ruling has to meet a certain threshold, for commissioner to be bound by it.

In the present case, even thought the commissioner did issue a private ruling providing in the ruling that the transaction was subjected to capital gain tax, the court found that there cannot be a legitimate expectation on the commissioner, where the application for the private ruling did not meet the provided criteria. The court found that the commissioner was not bound by the private ruling.

The judges further stated that, *“As I have already stated in this judgment**, the respondent’s letter of 22nd April 2015 was a response to the appellant’s enquiry on Capital Gains Tax only and was therefore limited to the said specific enquiry**. I have already noted that the appellant did not furnish the respondent with all the relevant information that could have assisted it in making an informed decision and for this reason, I find that the doctrine of legitimate expectation does not arise in this case. I further find that the appellant could only give a final advisory on the taxes due from the subject transactions upon assessing the appellant’s audited accounts of the appellant.”*

A critical aspect comes up in this application for the private ruling, that;

1. The application must be objective, and seek an approval for a predetermined stance.
2. The applicant must avail all the required documents.
3. Provide all the facts to the case. Cherry pecking the details to provide to KRA can prove to be problematic and this may be taken to mean the taxpayer was adhering to the requirements.

Additional notes and commentaries.

The important aspect of these cases is the acknowledgement that legitimate expectation can only come up upon fulfilment of certain criteria.

1. It must not override the existing clear statutory provision. This ensures that the legislative function is left to the government arm that passes legislations, therefore, preserving the intentions of the legislators. A legitimate expectation that contradicts clear statutory provision is ultra vires. As to whether making of an ultra vires representation should be

recognised as maladministration entitling the representee to a petition, this has largely been exercised in within the scope of human right, and not within the scope of taxation.

2. For an expectation to be legitimate it must be founded upon a promise or practice by the public authority that is said to be bound to fulfil the expectation. This can be well guided by the statute establishing the said public authority, or it can an as well be drawn from historical practise, where the later must not contradict the former.
3. A change in a policy, or a statute, removes a legitimate expectation founded upon earlier policy.
4. An individual seeking protection of the expectation must themselves deal fairly with the public authority. Therefore, taxpayers who seek clearance from a revenue authority for their proposal, must make full disclosure before the revenue authority assurances will be binding. The assurance must itself be clear, unequivocal and unambiguous.
5. Consideration of the expectation may be beyond the jurisdiction of the court. For instance, when it would involve questioning proceedings in parliament contrary to the law of parliamentary privilege. These are **special legal rights, powers, and immunities** that are granted to Parliament (and its members) to enable it to perform its constitutional functions **effectively, independently, and without interference** from the executive, judiciary, or the public.

The courts have in the recent past, ruled against the revenue authority where the authority assumed a different position from what it had provided in the issued private rulings. Some of these cases include, the **Kenya Nut Company Ltd case,** where the revenue authority had issued a private ruling on product classification for VAT purposes. The tribunal set aside the 2024 reclassification and upheld the earlier classification provided for in the private ruling.

In the Unilever case, earlier mention in this issue, the authority had issued an Advance Ruling, which is an equivalent of private ruling, for purposes of customs. The revenue authority had sort to vacate from it's earlier ruling by reclassifying the product, but upon review, it was found that the product still fell in the same classification as earlier advised, with lab analysis to detail the components of the imported product, buttressing this position. This provides clear example that in addition to an earlier provided private ruling, in this case being the advance ruling for custom purpose, the authority can still go ahead and verify whether, not only that the information provided is accurate, but also that the private ruling is not founded on what would be a clear contradiction to a clear provision of a statute.

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