

ARE A COUNTY'S OWN SOURCE REVENUE TAXABLE? TAX APPEALS TRIBUNAL CLARIFIES TAXATION LIMITS FOR COUNTY GOVERNMENTS



TAXES

In a significant legal battle between the ***County Government of Kiambu and Commissioner of Legal and Board Services (Tax Appeal E812 of 2025) [2026] KETAT 71 (KLR) (26 March 2026) (Judgment)***, the Tax Appeals Tribunal (TAT) has delivered a judgment that clarifies the boundaries of taxing a **County's Own Source Revenue [OSR]** and the treatment of employment benefits.

The Heart of the Dispute

The case originated from a compliance check by KRA, which led to a massive tax demand of Kshs 559,866,840.53 for the period between 2019/2020 and 2022/2023. This demand covered several tax heads, including Pay As You Earn (PAYE), Withholding Income Tax (WHIT), Withholding Value Added Tax (WHVAT) and Value Added Tax (VAT) on the county's **OSR**. After an initial objection by the County, the KRA revised the demand to Kshs 194,590,799.27, which the County subsequently appealed.

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VAT on Own Source Revenue: A "Business" or a Service?

A central issue was whether the KRA could lawfully charge VAT on revenue the County generated through licenses, permits and fees.

- **The County's Argument:** The County maintained it is a Constitutional creature established to provide services, not to make a profit. They argued that their revenue streams (OSR) are a form of statutory taxation and subjecting them to VAT would constitute unlawful double taxation.
- **The Tribunal's Findings:** The TAT agreed with the County, noting that county functions under the Fourth Schedule of the Constitution are intended to improve social welfare. Under Section 2(1) of the VAT Act, VAT is only charged on supplies made in the **"furtherance of a business"**. Furthermore, Paragraph 9 of the First Schedule of the VAT Act specifically **exempts community, social and welfare services** provided by County Governments. Consequently, the Tribunal set aside the VAT assessment.

The PAYE Battle: Airtime, Imprests and Pool Cars

The Tribunal also delved into what constitutes a "taxable benefit" for County employees:

- **Airtime Benefits:** The KRA attempted to tax airtime and internet bundles provided to staff at a 30% rate. The Tribunal ruled that since these were provided for official use and were not cash allowances, they did **not translate to a "gain from employment"** and were therefore not subject to PAYE.
- **Unaccounted Imprests:** The KRA sought to tax "unaccounted" imprests as employment income. The TAT firmly rejected this, stating that an **imprest is not income**; it is money provided to cover specific employer expenses and must be refunded or liquidated.
- **Motor Vehicle Benefits (The Loss for the County):** The County argued that their vehicles were "pool cars" used rotationally. However, because the County **failed to provide logbooks or movement schedules** to prove they were not for the personal use of senior officials, the Tribunal upheld the PAYE assessment on these vehicles.

Withholding Taxes and the Requirement for "Reasoned" Decisions

The Tribunal set aside assessments for Withholding Income Tax (WHIT) and Withholding VAT (WVAT). This was largely because the KRA failed to provide a specific breakdown or reasons for its decision after the County provided bank statements and EFT records. The Tribunal emphasized that under **Section 51(10) of the Tax Procedures Act**, an objection decision must include the specific reasons and basis for the decision to protect taxpayers from arbitrary assessments.

Conclusion: A Partial Victory.

The appeal was **partially allowed**. While Kiambu County remained liable for certain assessments where it failed to provide sufficient evidence (like motor vehicle logs and excess pension details), it successfully defended the principle that **constitutional service delivery is not a taxable business**.

This ruling serves as a vital precedent for other County Governments, reinforcing that the KRA cannot treat public service functions as commercial enterprises and must provide clear, substantiated reasons when confirming tax demands.