

**REPUBLIC OF KENYA**  
**IN THE TAX APPEALS TRIBUNAL**  
**APPEAL NO. 329 OF 2018**

**DISTINCT CONCEPT ENTERPRISES LIMITED..... APPELLANT**

**VERSUS**

**COMMISSIONER OF DOMESTIC TAXES..... RESPONDENT**

**JUDGMENT**

**A. BACKGROUND**

1. The Appellant is a limited liability company registered under the Companies Act and a registered taxpayer.
2. The Respondent is a principal officer appointed under Section 13 of the Kenya Revenue Authority Act, Cap 469 of the Laws of Kenya and is charged with the mandate to administer and collect tax revenue on behalf of the Government of Kenya.

**B. FACTS OF THE CASE**

3. The Appellant was incorporated in the year 2006. Its principal activity was construction with trading with equities and general trading as auxiliary activities.
4. Vide a letter dated 30<sup>th</sup> May 2018, the Respondent issued the Appellant with a notice that a review of the Appellant's tax declarations in accordance with the provisions of Section 5(2)(a) of the Kenya Revenue Authority Act

(Cap 469) Laws of Kenya as read together with Section 4 of the Tax Procedures Act, 2015, had commenced.

5. The letter further requested the Directors of the Company to appear in person and to bring further documentation.
6. On 4<sup>th</sup> September 2018, the Respondent issued an additional Assessment of Kshs. 1,500,861.58 being VAT inclusive of interest and Penalty.
7. The Appellant raised an Objection on the 21<sup>st</sup> September, 2018 under Section 51 of the Tax Procedures Act, to the Assessment and demand notice contained in the letter dated 4<sup>th</sup> September demanding Kshs. 1,500,862.00 relating to Income Tax.
8. The Objection was based on the following grounds;
  - I. The company had been dormant and has minimal operations over the years 2015-2017 as evidenced by the audited accounts for the same year,
  - II. KRA based its assessment on estimates on information received from Nairobi County on pending bills, which confirms their position that no taxable income was generated by the company in the year of income 2015,
  - III. KRA failed to review accounts of the Company in totality over 2012-2017 which reflects no cost was claimed over the years to generate the income assessed as earned by the company in 2015, and
  - IV. The KRA ignored the schedules provided and based their workings on estimates.

9. The Respondent's investigations found that the Appellant had not been tax compliant as it had not registered for VAT obligations, not registered for PAYE and never filed any Income Tax Returns yet.
10. An Objection Decision was issued on 3<sup>rd</sup> October, 2018 by the Respondent confirming the assessment and directed the Appellant to pay the tax due, being the Principal Corporation Tax of Kshs. 1,007,290.00 and Value Added Tax of Kshs. 1,534,917.00 together with penalties and interest per the assessment.

### **C. THE APPEAL**

11. Aggrieved by the Respondent's Objection Decision issued on 3<sup>rd</sup> October 2017, the Appellant appealed vide the Memorandum of Appeal and the Statement of Facts dated 22<sup>nd</sup> October 2018. The Appellant's position is that the Respondent erred in law and fact in finding that;
  - i. The Appellant generated taxable income in the year of income for the year ended 31<sup>st</sup> December 2015.
  - ii. The Respondent's tax tabulation was based on information obtained from Nairobi County on pending bills which was not factual.
  - iii. The Respondent did not allow taxable losses incurred by the Appellant prior to the year ended 31<sup>st</sup> December 2015.
12. It is the Appellant's position that the construction work it was awarded was in the year 2013 being the construction of part perimeter wall at City Primary School in Ngara West worth Kshs. 4,998,474.80. The other construction work that it undertook was in the year 2012, being the

rehabilitation of Police Post Road in Kasarani Ward, a project worth Kshs. 4,594,760.00.

13. The Appellant further states that it has not been paid for the projects done because the same had not been certified by the then Nairobi City County's architect and the debts remain due to date.
14. The Appellant raised a payment claim dated 7<sup>th</sup> June 2018 to the Nairobi City County. It claims that this was not an invoice but a mere acknowledgement by the Committee on finalization of pending bills and audit of procurement processes of the County of Nairobi. The Appellant has allegedly not received any payment for the work done as the project work was not certified by their in-house architect who failed to issue certificates of completion to the Appellant.
15. The Appellant maintains that the Respondent failed to consider the costs incurred and disclosed in the audited accounts for the year ended 2013. The Appellant is of the view that it made accumulated losses in the years 2012 to 2014 amounting to Kshs. 2,090,821.00 It further states that the cumulative amount from the projects in these years was Kshs. 5,972,442.00 and therefore the losses were allowable deductions under Section 15(4)(1) of the Income Tax Act. The Appellant asserts that it did not generate construction income as stated by the Respondent.
16. The Appellant prayed that the Respondent's Assessment be annulled.

#### **D. RESPONDENT'S CASE**

17. The Respondent in response to the Appeal filed its Statement of Facts on 23<sup>rd</sup> November, 2018, accompanied by a Witness Statement of Shairin Hadia Athmani dated 12<sup>th</sup> November, 2020.

18. Having not been supplied with sufficient and satisfactory information regarding the operations of the Appellant, the Respondent carried out further investigations into the affairs of the Appellant with a view of confirming its tax compliance status.
19. The Respondent found that the Appellant had been awarded two tenders by the Nairobi City Council worth Kshs. 9,593,234.00 in the year 2012. It was further found that the Appellant has never declared its income from the year 2006 when it was incorporated and has been filing nil returns even when it was generating income.
20. The Respondent faults the Appellant for not declaring its income since incorporation, filing nil returns despite earning income, for not registering for VAT, Income Tax as well as PAYE.
21. The Respondent prays that the Objection Decision dated 3<sup>rd</sup> October, 2018 be upheld as it is proper in law, and that the Appeal lacks merit and be dismissed with costs.

## **E. ISSUES FOR DETERMINATION**

22. The following issues fall for determination:
  - i) Whether the Appellant generated taxable supplies in the year 2012 and 2013 and whether it was liable to register and pay for VAT.
  - ii) Whether the Appellant made taxable profit in the year ending December 2015.
  - iii) Whether the debt owed by the defunct Nairobi City Council amounted to a bad debt.

## F. ANALYSIS AND DETERMINATION

### i) Whether the Appellant generated taxable supplies in the year 2012 and 2013 and whether it was liable to register and pay for VAT

23. The Appellant states that the contracts issued in the years 2012 and 2013 were both valued at less than Kshs. 5 Million in each year and to that extent the Appellant had not reached the statutory threshold to register for VAT.

24. The evidence on record indicates that both contracts were awarded to the Appellant in the year 2012. The Nairobi City Council vide letters referenced **DOP/RM/Min.16 11/2012/saj/4698/2012** dated 18<sup>th</sup> October, 2012 for **Contract No. CCN/CE/LAS/RT/63/2011-12** and **DOP/RM/Min.16-11/2012/saj/4663/2012** dated 4<sup>th</sup> October, 2012 for **Contract No. CCN/CE/LAS/RT/248/2011-12** wrote to the Appellant requiring them to complete the contracts within a period of twelve weeks and to further deposit a Performance Bond within 14 days from the date of the letter. The values of the contracts were Kshs. 4,998,474.80 and Kshs. 4,594,760.00, respectively.

25. Section 34(1) (a) and (b) of the Value Added Tax Act, 2013, provides that;

***“(1) A person who in the course of a business—***

***a. has made taxable supplies or expects to make taxable supplies, the value of which is five million shillings or more in any period of twelve months; or***

***b. is about to commence making taxable supplies the value of which is reasonably expected to exceed five million shillings in any period of twelve months, shall be liable for registration under this Act and shall, within thirty days of becoming so liable, apply to the Commissioner for registration in the prescribed form.”***

26. The Appellant concedes to have written to the Nairobi City County attaching all relevant documents while following up on payment for work done.
27. The Respondent avers that the Appellant had been awarded two tenders by the Nairobi City Council worth Kshs. 9,593,234.00 in the year 2012. It was further found that the Appellant has never declared its income from the year 2006 when it was incorporated and has been filing nil returns even when it was generating income.
28. The Respondent faults the Appellant for not declaring its income since incorporation, filing nil returns despite earning income, for not registering for VAT, Income Tax as well as PAYE.
29. Section 12 of the Value Added Tax Act, 2013, on the time of supply of goods states that;

***“(1) The time of supply, including a supply of imported services, shall be the earlier of—***

***(a) the date on which the goods are delivered or services performed;***

***(b) the date a certificate is issued by an architect, surveyor or any other person acting as a consultant in a supervisory capacity;***

***(c) the date on which the invoice for the supply is issued; or***

***(d) the date on which payment for the supply is received, in whole or in part.”***

30. It is not in issue that invoices were raised or that certificates of completion were issued, rather, what is in issue is the purpose of the document. The Appellant states that the purpose of raising the invoice was for purposes of informing the Nairobi City County's Financial Committee about the status of pending bills. Further having established that both contracts were issued in the year 2012, the cumulative amount was Kshs. 9,593,234. 90 which is above the 5 million threshold for registration of VAT.

31. Having considered the arguments of the parties, the Tribunal agrees with the Respondent's decision and is persuaded that this falls well within the provisions of Section 12 of the Value Added Tax Act, 2013, and holds that the Respondent was expected to register for VAT under Section 34(1)(b) and is therefore liable to pay the requisite taxes in accordance with the law.

ii) **Whether the Appellant made taxable profit in the year ending December 2015.**

32. The Appellant's main contention was that its audited accounts for the years ending 2012/2013 and 2014/2015 show taxable loss positions which were not taken into consideration by the Respondent and thus arrived at a wrong estimation.

33. The Appellant further illustrates the expenditure that it incurred wholly and exclusively for the year 2012, 2013, 2014 and 2015 towards the project cost of construction of part perimeter fence at City Primary School and the proposed Construction and Rehabilitation of Police Post Road in Kasarani Ward as follows;

	2012	2013	2014	2015	2016
	KShs	KShs	KShs	KShs	KShs
Construction work in progress	1,870,615	4,101,827	-	-	5,972,442
Other Expenses	762,019	832,519	662,119	155,078	2,411,735
<b>Total</b>	2,632,634	4,934,346	662,119	155,078	8,384,177
<b>Accumulated Losses</b>	(753,878)	(604,762)	(732,181)	-	(2,090,821)

34. The Appellant states that it was incorporated in the year 2006, and commenced operations in 2012. The Appellant allegedly incurred costs in the years 2012, 2013 and 2014 wholly and exclusively towards the project, direct material costs, trade finance, bank charges, security charges, insurance, telephone and postage. The Appellant faults the Respondent for finding that the costs incurred were specifically for generation of interest income.
35. The Appellant argued that the Respondent's legacy tax system was configured not to account for returns with losses over the years 2012 to 2014. In addition, the legacy system had no module to amend the filed returns in case of descriptive errors. Accumulated business losses of Kshs 2,090,821.00 were not taken into account, and cumulative project costs of KShs 5,972,442.00 which are allowable deductions.
36. In its submission, the Appellant relies on Section 15(4)(1) of the Income Tax Act (Cap 472) Laws of Kenya which provides that;

***“Where the ascertainment of the total income of a person results in a deficit for a year of income, the amount of that deficit shall be an allowable deduction in ascertaining the total income of such person for that year and the next four succeeding years of income: Provided that—***

*(i) any deficit for the year of income 1973 shall be regarded for the purposes of this subsection as having arisen entirely in that year of income.”*

37. The Appellant further avers that it is incorrect to allow 65% of income as expenses and 35% as the taxable profits as done by the Respondent, as this does not state the true position in the books as filed.
38. The Respondent submits that it reviewed the Appellant’s objection and found that the Appellant failed to provide sufficient and relevant documents in support of its objection to enable the Respondent arrive at a different or varied position. In particular, the Appellant failed to submit Audited Statements of Accounts for the years 2012 to 2017 for review by the Respondent. Further, the Respondent submits that the Appellant had not filed any returns for the period and it was never in contention that the Appellant had earned revenue during the said period.
39. The Respondent’s case is that the Appellant failed to declare income earned from the two tenders awarded to it by the Nairobi City Council and having failed to declare and file the respective returns, despite the additional documents, the taxes are still due and owing.
40. The Respondent in its submissions introduced new information that the Appellant sold land valued at Kshs.7, 410,000 and a Motor Vehicle for Kshs. 995,000 in the year 2014, however, the Appellant failed to sufficiently support the same and as such the same was subjected to taxation as demonstrated in the table below being income and value added tax.

Income Tax – Corporation Tax and Value Added Tax

Year of income	Under-declared Income	Tax @ 30%	Penalty @ 75%	Interest @ 2%	Total
2014	9,593,234	2,877,970	2,158,478	2,475,054	7,511,502
2014	8,405,000	2,521,500	1,891,125	2,168,490	6,581,115
<b>Total</b>	<b>17,998,234</b>	<b>5,399,470</b>	<b>4,049,603</b>	<b>4,643,544</b>	<b>14,092,617</b>
Year of income	Under-declared Income	Tax @ 30%	Penalty @ 75%	Interest @ 2%	Total
2014	9,593,234	1,534,917.44	1,151,188.08	1,320,029	4,006,134.52

41. The Respondent relies on Section 62 of the Value Added Tax Act which provides that:

***“in any civil matter under the Act, the burden of proving that any Tax has been paid or that any goods or services are exempt from payment of taxes shall lie on the person liable to pay the tax or claiming that the tax has been paid or that the goods or services are exempt from payment of tax.”***

42. It avers that no taxes have been paid by the Appellant despite earning income from services provided and from sale of its assets. Further, the Respondent submits that the Appellant’s returns were invalid and that the Respondent was right in issuing the additional assessment for the under declared income.

43. In the analysis, Section 3(2)(a)(l) provides that;

**“Subject to this Act, income upon which tax is chargeable under this Act is income in respect of—**

**(a) gains or profits from—**

**(i) any business, for whatever period of time carried on;”**

44. Section 15(1) on deductions allowed provides that,

***“(1) For the purpose of ascertaining the total income of any person for a year of income there shall, subject to Section 16 of this Act, be deducted all expenditure incurred in such year of income which is expenditure wholly and exclusively incurred by him in the production of that income, and where under Section 27 of this Act any income of an accounting period ending on some day other than the last day of such year of income is, for the purpose of ascertaining total income for any year of income, taken to be income for any year of income, then such expenditure incurred during such period shall be treated as having been incurred during such year of income.”***

45. The law provides under the Income Tax Act Section 15(4)(1) that;

***“Where the ascertainment of the total income of a person results in a deficit for a year of income, the amount of that deficit shall be an allowable deduction in ascertaining the total income of such person for that year and the next four succeeding years of income.”***

46. The foregoing Sections 3(2)(a)(1), Section 15(1) and Sections 15(4)(1) of the Income Tax Act, make sufficient provisions on taxation of income and on allowable deductions in the instances where there are losses. Having considered the parties' submission, we note that the Respondent is of the view that the Appellant filed a Nil Return for Income Tax in the year 2015. The manual returns submitted on iTax and attached as evidence in the Appeal show that the Appellant filed losses of income in that particular year. Further, during the hearing, it was established that the Appellant had declared the return showing a loss position.

47. So, was the Respondent justified in disregarding the loss returns as filed and using estimates to assess the taxes due upon the Appellant where the Appellant has provided information?
48. Having found that the Appellant had declared and filed a loss position the Tribunal relies on the case of Africa Oil Kenya BV vs Commissioner of Domestic Taxes Tax Appeal Number 347 of 2018 [2020] Eklr, where the Tribunal found that, *“Although the Respondent had argued that the Appellant had not submitted evidence to justify the distribution among the related parties, the Appellant had actually explained that the cost was shared according to the size of the operations among the related parties. To this end, the Tribunal finds that the Appellant had discharged its obligation to explain the expenditures by providing the formula for allocating its costs. It was not for the Respondent to suggest the formula.* The Tribunal further relied in the case of Hero Cycles(P) Limited Vs Commissioner of Income Tax Central Ludhiana[2015] 63 taxman.com 308SC the Supreme Court of India Held that; *“ we are not of the opinion that such an approach is faulty in law and cannot be countenanced.....the Revenue cannot justifiably claim to put itself in the armchair of the Businessman or in the position of the Board of Directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. It further held that the no businessman can be compelled to maximize his profit and that the income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. ”*

49. To this end, the Tribunal is persuaded that the Respondent erred in allowing 65% on income as expenses and 35% as the Taxable profits in the circumstances that the Appellant has declared its position and thus this estimation has no basis in law as the Tribunal finds that the Appellant did not make a taxable supply in the year 2020. The Tribunal finds that the Respondent will suffer no prejudice if it retreats to review this assessment.
50. On whether the Tribunal can admit the facts introduced through submissions by the Respondent without leave, the Tribunal holds that submissions are not pleadings and declines to admit this evidence as the Appellant has not had a chance to respond, cross examine and submit on the same, and in the interest of according a fair hearing to all the parties to this Appeal, the same is hereby expunged from the records.

iii) **Whether the debt owed by the defunct Nairobi City County amounted to a bad debt.**

51. The Appellant states that it won tenders in Nairobi City County and carried out the work as required under the terms of the tender however, it avers that no payment has been made to date. The Appellant attached a circular from the Office of the Controller of Budget dated 25th of October, 2018 regarding the status of the pending bills by County Governments as at 30th June, 2018 and following up on the payment of the debt.
52. The Appellant states that it had no basis for raising an invoice to the defunct City Council of Nairobi. It only issued the invoices to the committee for purposes of finalization of pending bills and for audit of procurement processes. It had also requested its lawyer to seek legal redress for the injustices meted on it. Further the Appellant, in evidence, has attached the

aforesaid circular from the Office of the Controller of Budget. The Appellant submits that this should instead be treated as a bad debt.

53. The Respondent has not pleaded nor submitted on this issue. However, the Tribunal will proceed to analyze and make a determination on the same.
54. The statutes as well as the courts have set the standard for determining what amount to a bad debt. A party has to satisfy itself that it has used all the avenues available in law before a debt is declared uncollectable hence declared a bad debt.
55. The law is very clear on the instances where a debt should be declared a bad debt. Section 15(2)(a) of the Income Tax Act provides that;

***“Without prejudice to sub-Section (1) of this Section, in computing for a year of income the gains or profits chargeable to tax under Section 3(2)(a) of this Act, the following amounts shall be deducted:***

***a) bad debts incurred in the production of such gains or profits which the Commissioner considers to have become bad, and doubtful debts so incurred to the extent that they are estimated to the satisfaction of the Commissioner to have become bad, during such year of income and the Commissioner may prescribe such guidelines as may be appropriate for the purposes of determining bad debts under this sub-paragraph;”***

56. This Section places discretion on the Respondent to determine what amounts to a bad debt. Similarly, Legal Notice No. 37 (pursuant to Section 15 (2) (a) of the Income Tax Act, 2011) provides the guidelines for allowability of a bad debt by the Respondent as follows;

***“1. A debt shall be considered to have become bad if it is proved to the satisfaction of the Commissioner to have become uncollectable after all reasonable steps have been taken to collect it;:***

***3. A bad debt shall be a deductible expense only if it is wholly and exclusively incurred in the normal course of business.***

***4. For the purposes of these guidelines, a bad debt which is of a capital nature shall not be an allowable expense.”***

57. In addition to the provisions of Legal Notice No. 37 (pursuant to Section 15 (2) (a) of the Income Tax Act, 2011), the Tribunal further relies on the holding in the case of ***I&M Bank Kenya Limited Vs. Commissioner of Domestic Taxes Appeal No. 72 of 2017(eklr)*** which succinctly describes what bad debts entail in determining this issue.

58. What action has the Applicant taken to recover the debt? From the evidence tendered, we find that there was a demand letter done by the Appellant’s legal representative addressed to Nairobi County seeking that the Appellant be paid for the work done. In the basic procedures of practice of law, a demand letter precedes a law suit. There is no evidence presented before this Tribunal that the Appellant sued its debtor in an effort to recover this debt. **Legal Notice No. 37 (pursuant to Section 15 (2) (a) of the Income Tax Act, 2011)** sets out the guidelines for allowability of a bad debt by the Respondent as follows;

***1. A debt shall be considered to have become bad if it is proved to the satisfaction of the Commissioner to have become uncollectable after all reasonable steps have been taken to collect it;***

59. The Appellant attached a circular from the Office of the Controller of Budget dated 25<sup>th</sup> of October, 2018 regarding the status of the pending bills

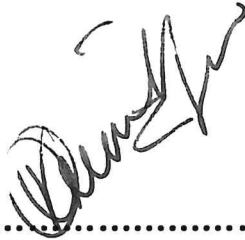
by County Governments as of 30<sup>th</sup> June, 2018 which proves that this is a debt that can still be paid in the future and thus it will be improper if the Tribunal finds that this is a bad debt.

60. The Respondent in its discretion found that the Appellant has not taken all the necessary and reasonable steps to collect the debt, the Tribunal will not interfere with this discretion. Justice Odunga in the case of **Republic v Commissioner for Income Tax & another Ex-Parte Stockman Rozen (K) Limited [2015] eKLR** held that *It is clear from the foregoing provision that the decision as to which of the gains or profits that have become bad and doubtful debts so as to be deducted in computing for a year of income the gains or profits chargeable to tax under Section 3(2)(a) is purely the discretion of the Commissioner.*
61. Therefore, the Tribunal finds that these debts did not amount to bad debts which ought to have been considered when computing the tax payable as the same can still be recovered.

## **G. FINAL DETERMINATION**

62. In view of the above findings, the Tribunal makes the following Orders:
- i) The Respondent's Objection Decision dated 3<sup>rd</sup> October 2018, specifically on Value Added Tax is hereby upheld.
  - ii) The Respondent's Decision on the additional Income Tax obligation KRA201813184145 is hereby set aside and the Respondent is directed to carry out a fresh assessment.
  - iii) Each party shall bear its own costs.
63. It is so ordered.

**DATED and DELIVERED at NAIROBI on this 23<sup>rd</sup> day of April, 2021.**



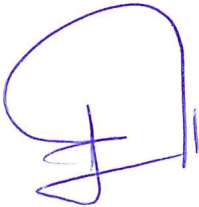
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**PATRICK LUTTA**  
**CHAIRPERSON**



.....  
**HELEN BILA**  
**MEMBER**



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**MWAI MBUTHIA**  
**MEMBER**



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**ELISHAH NJERU**  
**MEMBER**



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**HABON FARAH**  
**MEMBER**