REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 226 OF 2018

FAMILY FASHION CLOTHING.....APPELLANT

-VERSUS-

COMMISSIONER OF INVESTIGATIONS & ENFORCEMENT..... RESPONDENT

JUDGMENT

A. BACKGROUND

1. The Appellant is a garments company incorporated in Kenya and a registered taxpayer. The Appellant's principal business involves purchasing fabric, accessories and related items and using them to manufacture garments which are then sold to various customers locally and overseas.

2. The Respondent is a principal officer appointed under the Kenya Revenue Authority Act, Cap 469 of the Laws of Kenya, and is an agency of the Government for the collection and receipt of revenue. Further, under Section 5(2), with respect to the performance of its function under subsection (1), the Authority is mandated to administer and enforce all provisions of the written laws as set out is Part 1 & 2 of the First Schedule to the Act for the purposes of assessing, collecting and accounting for all revenues in accordance with those laws.

3. The Respondent carried out an investigation into the tax affairs of the Appellant and thereafter issued a tax investigation finding dated 18th April 2018 in which it demanded Kshs. 359,542,702.00 being VAT of Kshs. 125,058,331.00 and Corporation Tax of Kshs. 234,484,371.00. This was then formalized in an assessment dated 9th May 2018.

4. The Appellant raised an Objection against the assessment dated 7th June 2018 and the Respondent confirmed the assessment through an Objection Decision dated 26th July 2018.

5. Being aggrieved by the Respondent's Objection Decision, the Appellant filed a Notice of Appeal dated 24th August 2018 and subsequently filed this Appeal on 7th September 2018.

B. THE APPEAL

6. The Appellant's Memorandum of Appeal listed the following grounds of Appeal:

   a. THAT the Respondent erred in law in law by raising the additional corporation tax and Value Added Tax assessment on an approach that contravenes the applicable Sections of the Income Tax Act, Value Added Tax (VAT) Act and applicable Kenyan jurisprudence.

   b. THAT the Respondent has erred in fact and in law by disallowing expenses wholly and exclusively in generation of business income of the Appellant, contrary to Section 15(1) of Income Tax Act and supporting Sections.

   c. THAT the Respondent has erred in fact and in law by disallowing input VAT incurred for the making of taxable supplies, contrary to the stipulations of Section 17 of the VAT Act.

7. In its submissions the Appellant's discussions centre around the following areas:

   a) Validity of the Assessment and Objection Decisions,

   b) Value Added Tax, and

   c) Supplier Records.

Validity of the Assessments and Objection Decisions

8. The Appellant averred that it provided evidence on how the contested transactions on which it claimed input VAT and were the basis of costs of the purchases of the sales on which it paid Corporation Tax, were proper. The Appellant submitted that despite being provided with documents and/or information, the Respondent did not provide it with the reasons for rejecting the evidence, whose validity was not and has never been questioned.

9. The Appellant referred to **Section 49** of the **Tax Procedures Act**, which provides that:

   "Where the Commissioner has refused an application under a tax law, the notice of refusal shall include a statement of reasons."

10. The Appellant submitted that the assessments do not give a statement of reasons for disallowing the input VAT.

11. The Appellant referred to Article 47 of the Constitution of Kenya, 2010 and expressly enshrined in Section 4(1)(d) of the Fair Administrative Action Act, 2015 ("the FAA"), and submitted that it is the duty of public officers to give reasons of their actions as part of the due process of administrative rights guaranteed by law.

12. The Appellant further submitted that the importance of being given reasons, (which by Sections 4(3)(g) and 6(2)(b) of the FAA includes material to be, or, relied on) as stipulated cannot be refuted especially where there is a right to object against adverse decisions.

13. It was also the Appellant's case that without such reasons it is impossible to establish where the Respondent might have gone wrong and formulate one's grounds for challenge. That the Respondent's witness accepted this fact during cross-examination and was unable to give reasons why the Respondent failed to explain the basis of its decisions and actions to the Appellant.

14. The Appellant submitted that the right to be given reasons is part of the rights under the rules of natural justice, particularly that of fundamental fairness. And further, that it is a well-accepted principle that any decision made in violation of the principles of natural justice is a nullity and should be quashed on the application of the person affected.

15. Since the Objection Decision upholds the assessments which as the Appellant has shown are null and void, it too is null and void and of no legal effect. The Appellant made reference to the decisions of the court in **Republic v Institute of Certified Public Accountants of Kenya ex parte Joy Vipinchandra Bhatt T/A JV Bhat & Company [2008] eKLR** where Emukule J stated as follows:

> *"Lord Irvine concluded, "An ultra vires Act or subordinate legislation is unlawful simpliciter and, if the presumption in favour of its legality is overcome by a litigant before a court of competent jurisdiction, is of no legal effect whatsoever." The latin used to say ex nihil est, nothing can come out of nothing, nor can legality be conferred upon a patently unlawful decision of the Disciplinary Committee either by the Committee, or the Council of the*

Respondent. In the premises, the Respondent's decision of 30th January 2006 adopting the Disciplinary Committee's findings against the applicant and recommendation to administer a reprimand against the Applicant for failing to meet "expected standards of professionalism" is illegal, null and void, and consequently of no legal effect."

16. It is the Appellant's case that even if the assessments were valid, there was yet another reason for holding that the Objection Decision was invalid. The reason being that the Respondent, in its Objection Decision, failed to state the legal provisions upon which the decision was issued. Moreover, the Respondent did not address the grounds set out by the Appellant in its Notice of Objection.

17. The Appellant relied on Section **51** of the **Tax Procedures Act** which provides that:

> *"(9) ...The Commissioner shall notify in writing the taxpayer of the objection decision and shall take all necessary steps to give effect to the decision, including, in the case of an objection to an assessment, making an amended assessment...*
>
> *(10) An objection decision shall include a statement of findings on the material facts and the reasons for the decision..."*

18. The Appellant submitted that it is evident that the Respondent failed to disclose the substantive legal provision in which he raised both its assessments and the Objection Decisions and further, that the Respondent declined to demonstrate how it arrived at the amount assessed.

19. It is the Appellant's assertion that the foregoing is a fatal error which the Respondent's witness, had attempted to salvage through his witness statement. The Appellant contends that if at all those are the reasons for the Objection Decision, then the same should have been set out in the Objection Decision.

20. It is therefore Appellant's submission that the Objection Decision is null and void, of no legal effect and should be set aside.

Value Added Tax

21. The Appellant averred that it not only incurred the input VAT for purposes of making taxable supplies, but it was also issued with tax invoices and ETRs which it furnished the Respondent. In support of this assertion, the Appellant referred to the following statutory provisions:

Section 17 (1) of the VAT Act:

"... Subject to the provisions of this Section and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person, subject to the exceptions provided under this Section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies."

Regulation 7 of the VAT Regulations of 2017:

"...(l) A person shall be entitled to a deduction of input tax or input incurred for trading stock on hand at the date that the person becomes registered.

(2) A deduction of Input Tax shall not be allowed unless-

(a) the input tax to which the deduction relates is deductible under Section 17 of the Act;

(b) the registered person has provided the Commissioner with satisfactory evidence-

(i) that input tax was paid on acquisition of the goods;

(ii) of the quantities, descriptions, and values of the goods on hand at the time of registration..."

22. The Appellant stated that in summary, the only conditions for a claim of input VAT are as follows:

    i. The input is incurred by a registered person;
    ii. It is incurred to make taxable supplies;
    iii. The input VAT is not specifically disallowed;
    iv. The claim is backed by a proper tax invoice; and
    v. Input VAT was actually paid (new condition from 30th March 2017)

23. The Appellant insisted that it fulfilled each and all the conditions of claim and maintained the supporting documentation for the same. The Appellant also averred that it is registered for VAT and files its returns monthly (over the assessed period) indicating the input VAT paid on purchase invoices and output VAT charged on sales and subsequently pays VAT on the difference to the Respondent.

24. The Appellant further stated that all the purchases are incurred in making vatable sales and the amounts in question are backed by tax invoices and bank statements. Any allegations that the transactions did not take place are therefore illogical.

Supplier Records

25. It was the Appellant's assertion that it purchased the goods from the listed suppliers, a fact that the Respondent has acknowledged. It thus questioned whether it was its duty to cross check and confirm the import records of its suppliers, especially considering the fact that it was not an importer but sourced its goods locally. The Appellant submitted that the Respondent's averments to this extent are unfounded and are purely meant to mislead the Honourable Tribunal as to the true facts of the case herein.

26. The Appellant submitted that the basis upon which the Respondent sought to justify its position, even though there is categorical evidence for the purchase of the goods which the Respondent never challenged, was sprung upon the Appellant days before the hearing. This basis being that the import records of the suppliers do not show that they imported the goods, so there were no goods to be purchased by the Appellant.

27. The Appellant submitted that the Respondent cannot rely on an alleged factual evidence produced for the first time two days before the hearing and not relied upon in the assessments, Objection Decision or its own Statement of Facts as required by the rules of the Tribunal.

28. Further, the Appellant argued that if such analysis was the basis of the assessments and Objection Decision, it should have been referred to before and shared with the Appellant or relied upon by the Respondent in its Statement of Facts in this Appeal. Even if it was permissible for the Respondent to rely on such belated reasons and material, the Appellant asked that the Tribunal should view them askance.

29. It was the Appellant's case that it simply does not follow that on analysis of the import data, (whose objectivity, thoroughness and accuracy it cannot verify, not just due to lack of time but also access to the relevant primary data) the suppliers did not have the goods to supply. The Appellant contended that there are several explanations which cannot been excluded as to why the goods might have failed to show up in that analysis. For instance, the analysis itself could have been flawed with wrong data such as the importer's correct details, either accidentally or otherwise, could have been entered. In addition, suppliers could have obtained the goods locally (as observed) or for their own reasons either for noble or nefarious reasons, imported them surreptitiously. The Appellant submitted that it is an unwarranted leap to conclude that because import data analysis failed to disclose the goods being brought in by the suppliers, they could not have been purchased. Evidence of such purchase is what the Respondent sought from the Appellant- proof of payment, ETRs, delivery notes, stock records etc- all of which were provided but improperly spurn or ignored.

30. The Appellant considered briefly what the Respondent's approach would imply for the business community. Before purchasing goods on which they would be entitled to claim or include as part of the cost of generating income, they must turn themselves into revenue amateur sleuths and demand records and proof of purchase from suppliers for each and everything purchased including say, the packets of milk one gets for staff and guests tea. Just how far would such inquiry go? Not just IDF records but also proof that the exporter had actually itself purchased the goods and further back- an endless regress not just down the supply chain but manufacturing process as well as raw material supply. The Appellant submitted that it was for this and like reasons that the Honourable Tribunal rejected a like position in **Shreeji Enterprises Limited -vs-**

Commissioner of Investigations and Enforcement, TAT Appeal No. 58 and 186 of 2019.

31. The Appellant also submitted that having discharged its burden of proving the purchase, it is the Respondent's duty to demonstrate that the evidence adduced was insufficient to prove the contrary and has failed to do so.

32. The Appellant referred to **Shreeji Enterprises Limited -vs- Commissioner of Investigations and Enforcement, TAT No. 58 and 186 of 2019** in which the Tribunal observed as hereunder:

> *"...Although the current tax law provides that the onus of proof lies with the Appellant to prove that tax was paid or that the Respondent's assessment was wrong...In demanding the production of documents which are not prescribed by legislation, the tax authority should be guided by reasonableness, the nature and circumstances of the trader otherwise it would, as it occasionally does, demand information which the trader cannot produce because he does not have..."*

33. Further the Appellant relied on the decision of the Tribunal in **Karshan Limited -vs- Commissioner of Domestic Taxes, TAT No.123 of 2018**, in which the Tribunal stated that:

> *"...While the list is not exhaustive on the documents that must be furnished as proof of purchase, the Tribunal was of the view that the Respondent should have furnished information to prove that the invoices submitted by the Appellant to support its claims were fictitious. It was not enough to just allege that the documents presented were not sufficient to prove purchase and delivery of the goods. The Tribunal was therefore of the view that the Appellant furnished sufficient proof of purchase..."*

34. The Appellant further made reference to the Tribunal's decision in **TAT 187 of 2018, Ukwala Supermarkets -vs- Commissioner of Domestic Taxes** in which it is stated that:

> *"...the Tribunal is of the considered view that the right to deduct input tax is an integral part of the VAT system and in principle may not be limited...The Tribunal holds that each transaction must be regarded on its own merits and the character of a particular transaction in the chain cannot be altered by earlier or subsequent events...on whether there is a duty on a tax payer to conduct due diligence on every person they trade with, the Tribunal thinks that the answer is fairly self- explanatory. ...All that a tax payer is required to do is provide proper documentation in support of supplies and sales as original tax invoices, customs receipts, local purchase orders, delivery notes and credit notes among others..."*

35. The Appellant also made the following arguments under its Statement of Facts which the Tribunal took time to consider.

Deduction of Expenses

36. The Appellant cited Section 15(1) of the Income Tax Act which it stated sets the guiding principle on allowability of expenditure. The Section states:

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

37. The Appellant contended that the main point of this provision is that only costs incurred wholly and exclusively in production of income of a person are tax deductible. The specific purchases made by the Appellant met this requirement as they relate to its income. It is on this basis that declared taxable income is produced.

38. The Appellant argued that it is a set rule of tax law that taxation has to be based on the strict letter of the law and not implied or assumed. To support this the Appellant cited the case of **Keroche industries Ltd Vs Kenya Revenue Authority and Five Others (Miscellaneous Civil Application No 743 of 2006)** where Justice Nyamu instructed in his analysis as follows;

> *"I accept the Applicant's counsel's powerful argument that taxation can only be done on clear words and that taxation cannot be on intendment.... Where the inclination of the legislature is not clear or where there are two possible meanings, the inclination (or the Court) should be against a construction or interpretation which imposes a burden, tax or duty on the subject (taxpayer)"*

39. The Appellant insisted that there is no requirement in law for the Appellant to carry the tax compliance obligations of any of its suppliers. The Respondent is equipped with legal, financial, technical and other resources to undertake its duties in ensuring each and every taxpayer is compliant. If one taxpayer has not fulfilled its obligations under the tax laws, such obligations cannot be shared out or transferred to other taxpayers who may be its suppliers or customers. The Respondent should thus treat one taxpayer as a distinct, separate and complete entity for tax compliance purpose unless avoidance provisions are cited.

Under what circumstances can the Respondent transfer or enjoin a taxpayer to the tax obligations of another?

Non-transferability and agency taxes

40. The Appellant averred that it is not envisioned in any of the tax statutes that tax compliance obligations may be shared with or routed to another taxpayer. When it comes to tax, everyone carries their own cross.

41. However, in regard to agency taxes, one entity may be charged with the obligation of filing returns and remitting withheld amounts to KRA. For example, withholding VAT agents withhold 6% of the gross amounts paid against any vatable invoice and remit the same to the Respondent. Employers also deduct PAYE and remit to KRA. The same principle applies to Withholding Tax. But these circumstances are clearly spelt out in law and do not necessarily invite one taxpayer to dive deep into the compliance position of the withholdee. They relate only to specific payments.

Related Party transactions and Arm's Length Rule

42. The Appellant stated that the other circumstances relate to anti-avoidance provisions. It gave the example of transactions between related parties which have to be shown to have been arm's length if one of the entities is in a preferential tax regime (e.g., EPZ). Vatable supplies between related entities should be shown to be at the "open market value". These are specific individual or group of transactions and they do not dive deep into the affairs of each for tax compliance purposes. It is not the business of one taxpayer whether the supplier or customer has filed returns or paid taxes. If only one entity has not complied, the Respondent should zero in and focus on that entity.

Anti-Avoidance provisions and tax benefits

43. The Appellant was of the view that the more relevant area involves transactions designed to avoid tax. It averred that where it is shown that one of the main or the main purpose of a transaction is to defeat tax, the Respondent is allowed to adjust that transaction back to the proper position which would have existed if that purpose was not achieved. The Appellant cited Section 66 of the VAT Act which states as follows:

> *"(1) Notwithstanding anything in this Act, if the Commissioner is satisfied that-*
>
> *(a) A scheme has been entered into or carried out;*
>
> *(b) A person has obtained a tax benefit in connection with the scheme; and*
>
> *(c) Having regard to the substance of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person referred to in paragraph (b) to obtain a tax benefit as if the scheme had not been entered into or carried out....*
>
> *(2) If a determination is made under subsection (1), the Commissioner shall issue an assessment giving effect to the determination*
>
> *.....*
>
> *(4) In this Section— .... "tax benefit" means—*
>
> *(a) a reduction in the liability of a person to pay tax;*
>
> *(b) an increase in the entitlement of a person to a deduction for input tax;*
>
> *(c) an entitlement to a refund;*
>
> *(d) a postponement of a liability for the payment of tax;*
>
> *(e) an acceleration of an entitlement to a deduction for input tax;*

(f) any other advantage arising because of a delay in payment of tax or an acceleration of the entitlement to a deduction for input tax;

(g) anything that causes a taxable supply or taxable import not to be a taxable supply or taxable import, as the case may be; or

(h) anything that gives rise to a deduction for input tax for an acquisition or import that is used or is intended to be used other than in making taxable supplies."

44. That on a corresponding basis, Section 23 of the Income Tax Act states as follows:

"(1)Where the Commissioner is of the opinion that the main purpose or one of the main purposes for which a transaction was effected (whether before or after the passing of this Act) was the avoidance or reduction of liability to tax for a year of income or that the main benefit which might have been expected to accrue from the transaction in the three years immediately following the completion thereof was the avoidance or reduction of liability to tax, he may, if he determines it to be just and reasonable, direct that such adjustments shall be made as respects liability to tax as he considers appropriate to counteract the avoidance or reduction of liability to tax which could otherwise be effected by the transaction.

(2)Without prejudice to the generality of the powers conferred by subsection (1), those powers shall extend –

(a) to the charging to tax of persons who, but for the adjustments, would not be charged to the same extent;

(b) to the charging of a greater amount of tax than would be charged but for the adjustments.

(3)A direction of the Commissioner under this Section shall specify the transaction or transactions giving rise to the direction and the adjustments as respects liability to tax which the Commissioner considers appropriate.

45. The Appellant's argued that the summary of the anti-avoidance provisions is that the Respondent can only link one taxpayer to another in an anti-avoidance scheme that results in a benefit. In this particular context, the Appellant did not obtain any form of tax reduction or postponement of payment of tax. The full invoice value with VAT was settled and the total cost incurred. If the supplier then failed to remit the tax or file, the returns on the same declared transactions that did not in any way offer a tax benefit to the Appellant.

46. It was the Appellant's assertion that it was not in good faith for the Respondent to make insinuations that it belongs to a scheme without showing any tax benefit accruing to it. The Appellant's view was that the Respondent was motivated by an internal guideline that anyone who trades with non-filers or persons cited for non-compliance are a mischievous taxpayer and all transactions with the alleged non-filers are to be disallowed for tax purposes. Further, that anyone who trades with the person who has done business with a non-filer is also cited for non-compliance and the transactions are also disallowed and so on. The Appellant believes that this blanket approach cannot be reasonably applied in tax matters. Every person and every transaction should be treated separately.

47. The Appellant urged the Tribunal to maintain the same observation as it did in ***Tax Appeal No 58 of 2015 Longonot Gate Development Limited Vs Commissioner of Domestic Taxes*** where it stated:

"59. The Tribunal also finds that the Respondent's use of its Internal Guidelines determined by its Policy Department is not binding unless it is specifically anchored in the Statute. In this regard, the Tribunal finds relevance in the ruling in Astall V HMRC (2010) STC, 137

...Applying purposive interpretation involves two distinct steps. Firstly, identifying the purpose of the relevant statute. In doing this, the Court must assume that the provision had some purpose and Parliament did not legislate without purpose; but the purpose must be discernible from statute. The courts cannot infer one without a proper foundation of doing so. The second stage is to consider whether the transaction against the actual facts which occurred fulfils the statutory conditions. This does not, as I see it, entitle the courts to treat any transaction as having some nature which in law it did not have but it does entitle the courts to assess in reference to reality and not simply to its form."

48. The Appellant averred that the Respondent has not presented any proof of a tax benefit accruing to the Appellant and without that specific provision and without stating the specific provision of statute that has been defaulted upon the assessment cannot stand.

49. The Appellant submitted that there were other points to be considered as hereunder: -

Double Taxation

50. It was the Appellant's assertion that when it settled the invoices from cited suppliers, it also paid the VAT charged on the invoices. The input was used in making taxable supplies for which the Appellant declared as output VAT and paid tax to the Respondent.

51. Similarly, the Appellant contended that disallowing the expense deduction while the same is incurred towards making of the profit of the business would also lead to a situation of double taxation. Since tax is paid on the difference between sales and expenses (profit), to disallow the cost would subject an additional portion to further taxation. The Respondent should not be allowed to exact such double taxation as this would be unfair and capricious.

Information relied upon

52. The Appellant averred that the Respondent did not reveal the basis or detail of the information relied upon contrary to proper tax administration as addressed by the High Court in the case of **PZ Cussons East Africa Ltd V Kenya Revenue Authority (2013) eKLR.** In this case Justice Majanja guided that KRA should not arbitrarily charge tax on the basis of information in its sole possession, especially if it has not provided the details of the items picked and without it verifying the validity. The Appellant prayed that the same principle be upheld by the Tribunal and the assessment set aside.

Taxpayer Rights

53. It was the Appellant's submission that the Respondent, in undertaking the investigations that formed the basis of the assessment, breached the Appellant's right to a fair administrative action as outlined in Article 47(1) of the Constitution. The Appellant argued that assessing it on the basis of open factual errors and other persons' tax obligations was neither fair nor reasonable. Further, the Appellant was taken through inhumane interrogations and false information passed about the conduct of its business to third parties.

54. The Appellant argued that the Respondent is equipped with wide powers under statute and is also equipped with well trained staff and access to other taxpayer funded Government resources. If it fails to ensure compliance by a non-filer, then the same cannot be expected from private persons. The

Appellant stated that in the open market, businesspeople traded with all manner of suppliers of goods and services. It is not possible to verify the compliance status on any businessperson especially if the Respondent confirms to the public, through the iTax portal the validity of the taxpayer registration PIN corresponding to the name of the trader.

55. That confirmation of taxpayer details to the public creates a legitimate expectation in persons trading with them that they are in proper standing with the Respondent. The expectation is also created by the Respondent's acceptance of returns month after month with inputs claimed against the specific invoices from cited suppliers. audits, compliance checks and issuance of tax compliance certificates also create the expectation on whose basis the assessment ought to be set aside.

The Appellant's prayers

56. The Appellant prays that the Tribunal finds that;

    a) The confirmed assessment to have been in violation of the provisions of the Income Tax Act and the Value Added Tax Act and that the entire assessment amounting to KES 359,542,702 be set aside;

    b) The Appeal be allowed; and

    c) That the cost of this cause be awarded to the Appellant.

C. THE RESPONDENT'S CASE

57. In its Statement of Facts and written submissions, the Respondent made the hereunder arguments to support its Appeal:

58. It is the Respondent's case that the Appellant was identified as one of the beneficiaries of the ***"missing trader scheme"*** where fictitious invoices are generated to depict a business transaction whereas there were no actual supply or movement of goods and services.

59. The Respondent averred that the Appellant had claimed input VAT from seven (7) identified suppliers, all of whom were found to only exist on paper as they do not buy or sell any goods. The Respondent also found that the Appellant had claimed VAT for imported goods for which they were unable to provide import entries to justify the same.

60. The Respondent further submitted that on or about 18th April 2018, it communicated its findings to the Appellant giving it 7 days to show cause why the input VAT and costs claimed from the listed suppliers should be allowed. The Appellant was advised on the person to contact in case it needed any clarification and the contacts provided in the said letter.

61. It is the Respondent's assertion that the Appellant ignored, neglected and/or failed to show cause or contact the Respondent through the provided contacts thereby compelling the Respondent to issue a Notice of Assessment dated 9th May 2018. The Appellant filed an objection against the assessment vide letter dated 7th June 2018. The Appellant in its objection set out grounds of objection but did not provide any document to support its claims, thereby necessitating the Objection Decision dated 26th July 2018.

62. The Respondent identified the following issues for determination:

    a. Whether the Appellant supported its objection of the assessment as provided by Section 51(3) of the Tax Procedures Act, 2015.
    b. Whether the Respondent was in the circumstances justified to confirm the assessment?

c. Whether the Appeal is merited?

Whether the Appellant supported its objection of the assessment as provided by Section 51(3) of the Tax Procedures Act, 2015.

63. It was the Respondent's submissions that the Appellant did not demonstrate by way of evidence that it complied with Section 51(3) of the Tax Procedures Act which provides as thus:

> "(3) *A notice of objection shall be treated as validly lodged by a taxpayer under subsection (2) if—*
>
> *(a) the notice of objection states precisely the grounds of objection, the amendments required to be made to correct the decision, and the reasons for the amendments;*
>
> *(b) in relation to an objection to an assessment, the taxpayer has paid the entire amount of tax due under the assessment that is not in dispute or has applied for an extension of time to pay the tax not in dispute under Section 33(1); and*
>
> *(c) all the relevant documents relating to the objection have been submitted."*

64. The Respondent averred that prior to issuing the letter of objection, the Appellant had been requested in the letter dated 18th April 2018 to show cause why the input VAT claimed for the listed suppliers should be allowed. The Appellant failed to show cause not only then but also during the objection process and the only conclusion would be that the Appellant had no proof of any actual supply. The Appellant should therefore be estopped from purporting to allege that it availed the Respondent with evidence in support of its objection.

Whether the Respondent was in the circumstances justified to confirm the assessment?

65. The Respondent submitted that it is not in dispute that upon its findings, it issued the Appellant with a notice to show cause why the input VAT claimed from the specific suppliers, should be allowed. The Respondent avers that, the Appellant ignored and/or neglected to show any cause leading to an assessment, which the Appellant vide letter dated 7th June 2018 objected to. In addition, the Respondent submitted that it is not in dispute that an Objection Decision was issued on 26th July 2018 confirming the assessment as the aforesaid Objection remained unsupported.

66. The Respondent referred to Section 51(3)(a) of the Tax Procedures Act which provides that:

> *"A notice of objection shall be treated as validly lodged by a taxpayer under* ***subsection (2)*** *if— the notice of objection states precisely the grounds of objection, the amendments required to be made to correct the decision, and the reasons for the amendments."*

67. The Respondent also relied on Section 56 of the Tax Procedures Act which provides in mandatory terms that *in any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.* This was also echoed in the **South African Case of Metcash Trading Limited v Commissioner for the South African Revenue Service and Another** wherein Kriegler.J. in paragraph 22 held that: -

> *"...But the burden of proving the Commissioner wrong then rests on the vendor under Section 37 Because VAT is inherently a system of self-assessment based on a vendor's own records,"*

68. The Respondent also relied on the provisions of Section 93 of the Tax Procedures Act, which makes it an offence for a person who fails to keep, retain or maintain a document that may be required to be kept, retained or maintained in accordance with a tax law without reasonable excuse during a reporting period.

69. The Respondent made reference to **Tax Appeal No. 108 of 2017 Roshina Timber Mart vs Commissioner of Domestic Taxes** where this Honourable Tribunal held that failure to keep, retain and maintain records is an offence under the Tax Procedures Act and the Tribunal would not aid criminal conduct.

70. The Respondent further submitted that the claims for input VAT is prone to abuse thus Section 66 of the VAT Act, provides that:

> *"Notwithstanding anything in this Act, if the Commissioner is satisfied that—*
>
> *(a) a scheme has been entered into or carried out;*
>
> *(b) a person has obtained a tax benefit in connection with the scheme; and*
>
> *(c) having regard to the substance of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person referred to in paragraph (b) to obtain a tax benefit, the Commissioner may determine the tax liability of the person who obtained the tax benefit as if the scheme had not been entered into or carried out.*

71. It was the Respondent's assertion that from the foregoing, there should be no doubt whatsoever that it was in the circumstances justified to confirm the assessment as it did.

72. In response to the specific grounds of Appeal, the Respondent stated as follows regarding the Appellant's averments on input VAT and deduction of costs:

i. Section 17(2) of the VAT Act provides that input tax is only deductible when a registered person is in possession of valid documentation.

ii. Taxes collected by and paid to the Respondent are not to its personal benefit but for the benefit of the citizens of Kenya and that there needs to be proper care in processing claims such as the present claims, to ensure that all proper taxes are certain and collected.

iii. Therefore, upon receipt of such claims the Respondent has to consider each application on its own merit to establish veracity and authenticity of a given claim.

iv. The Appellant's input VAT claims have not been fully audited and processed because the information surrounding the claims requested by the Respondent have not been supplied.

v. In particular, the evidence of the actual supply of the items was sought by the Respondent from the Appellant to no avail.

vi. The Respondent had in its possession, evidence that the *missing traders* issue fictitious invoices without actual sale having taken place in consideration for a commission and in some instances, the invoices are duplicated, and similar invoices issued and/or sold to other companies.

vii. The Appellant has a duty to furnish specific information requested by the Commissioner that is necessary to facilitate processing of the refund claims.

viii. It is not true that the Appellant provided proof of purchases and or costs. In fact, the Appellant was given a chance to provide documents in support of the inputs claimed but to date has failed to do so.

ix. For this reason, the Respondent did not have any legal basis to allow inputs claimed by the Appellant.

73. On deduction of expenses, the Respondent argued that the starting point to this matter is the provisions of Section 15(1) and 16(1) of the Income Tax Act which must be read together:

> *" 15. (1) For the purpose of ascertaining the total income of a person for a year of income there shall, subject to Section 16, be deducted all expenditure incurred in that year of income which is expenditure wholly and exclusively incurred by him in the production of that income, and where under Section 27 any income of an accounting period ending on some day other than the last day of that year of income is, for the purpose of ascertaining total income for a year of income, taken to be income for a year of income, then the expenditure incurred during that period shall be treated as having been incurred during that year of income.*
>
> *16. (1) Save for as otherwise expressly provided, for purposes of ascertaining the total income of a person for a year of income, no deduction shall be allowed in respect of-*
>
> *.... Expenditure or loss which is not wholly and exclusively incurred by him in the production of the income;"*

74. That While the Respondent agrees that Section 15 of the Income Tax Act allows the deduction of all the expenditure incurred exclusively in the production of income, it avers the Appellant has to prove the same to the satisfaction of the Respondent.

75. That in the present case there is no proof that the goods were purchased since most of the businesses that the Appellant claim to have purchased goods from do not exist, do not import, do not manufacture and neither do they buy goods from any local company to be able to supply the Appellant.

76. That the tax investigation findings and demand letters to the Appellant were very clear in the sense that they stated that failure to provide justifiable grounds why the input VAT and costs claimed by the Appellant should be allowed, then assessments would be issued.

77. That this is in itself was an opportunity for the Appellant herein to respond to the letters and provide justification before the assessments were issued.

78. It is the Respondent's view that pursuant to Section 56 of the Tax Procedures Act the onus is on the Appellant herein to prove the said expenditure.

79. Regarding the Appellant's claim of alleged transfer of taxpayer obligations, the Respondent stated that:

    i. The Respondent is alive to the fact that VAT is vulnerable to evasion and fraud and its credit and refund mechanism offers unique opportunities for abuse and this has been evidenced by numerous VAT input claims of fake/fraudulent purchase invoices.
    ii. In the present case involving the Appellant, the Respondent required the Appellant to provide justification for the input VAT claimed to ensure that the appropriate amount of VAT is collected from a chain of transactions, and to reduce collusion between businesses with the purpose of defrauding the system.
    iii. A taxpayer's claim for local purchases would be put to question if two parties have entered into a scheme to enable one or both of them to receive tax benefits which they are not entitled to and which they stand to benefit as a result of their engagement.
    iv. In view of the above, the Respondent maintains that the taxes due and payable by the Appellant were communicated to the Appellant in the respective Objection Decision to them.

80. The Respondent relied on Section 42 of the VAT Act which it avers provides that a tax invoice shall only be issued for taxable supply and where one issues such an invoice in contravention to the law, the person would be deemed to have committed an offence and the tax shown thereon shall become due and payable to the Commissioner within seven days of the date of the invoice.

81. According to the Respondent, its investigations proved that no taxable supplies were made to the Appellant by the suppliers referred to as "missing traders" from whom the Appellant obtained purchase invoices and ETR receipts which it used to account for its input VAT and reduce their income tax liabilities. The Respondent submitted that as a result, tax shown on the tax invoices for the fictitious sales/purchases was due and payable to the Commissioner.

82. The Respondent further cited Section 66 of the VAT Act which provides that;

"1)Notwithstanding anything in this Act, if the Commissioner is satisfied that-

(a) a scheme has been entered into or carried out;

(b) a person has obtained a tax benefit in connection with the scheme; and

(c) having regard to the substance of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person referred to in paragraph (b) to obtain a tax benefit as if the scheme had not been entered into or carried out.

2) If a determination is made under subsection (1), the Commissioner shall issue an assessment giving effect to the determination

3)A determination under subsection (1) shall be made within five (5) years from the last day of the tax period to which the determination relates.

4)In this Section- "scheme" includes a course of action, and an agreement, arrangement, promise, plan, proposal or undertaking, whether express or implied, and whether or not legally enforceable; and

"tax benefit" means-

a) A reduction in the liability of a person to pay tax

b) An increase in the entitlement of a person to a deduction for input tax...."

83. It was the Respondent's averment that the investigations revealed that there was a scheme in play being used for evasion purposes by fictitious registered suppliers referred to as "missing traders" which falls within the definition provided in Section 66(4) of the VAT Act. The Respondent submitted that from its investigations, the Appellant was found to be a beneficiary of the missing traders' scheme as it would pay very little or no VAT at all or carry huge liabilities as trade creditors from one year to another owing to huge input VAT claims, yet the purported creditors were in essence the missing traders.

84. Further, the Respondent alleged that the Appellant tried to cover up the fictitious transactions by stating that most of the purchases were on cash basis hence no receipts were issued. According to the Respondent, the Appellant did not provide evidence to show goods it claimed were purchased, were actually delivered and later sold to customers.

85. The Respondent asserted that it was well within its mandate to issue the findings of tax investigations against the Appellant as the same was done in accordance with the law and laid down procedures.

86. The Respondent submitted that it is empowered under Section 59 of the Tax Procedures Act to require the production of documents and information to enable it ascertain tax liability of a person. It further stated that it is in evidence, as seen from the findings on tax investigations, that the Appellant through itself and/or its agents, was at all times in the course of the investigations, notified and given every opportunity to engage with the officers of the Respondent but to no avail.

87. The Respondent also asserted that Section 56 of the Tax Procedures Act obligates, and squarely places the burden to prove that a tax decision is incorrect on the Appellant.

88. The Respondent avers that the Appellant's inability and/or failure to produce the requested documents is in violation of Section 93 of the Tax Procedures Act which states as follows;

> *"1)A person commits an offence if the person fails to keep, retain or maintain a document that may be required to be kept, retained or maintained in accordance with a tax law without reasonable excuse during a reporting period.*
>
> *2)A person commits an offence if the person deliberately prepares or maintains or authorises another person to prepare or maintain false documents in relation to a tax law.*
>
> *3)A person commits an offence if the person falsifies or authorises another person to falsify any in relation to a tax law."*

Whether the Appeal is merited?

89. It was the Respondent's submission that from the foregoing, it has established that, the Appellant, despite being required to show cause why the input VAT claimed from the listed suppliers should be allowed, failed to do so, and further failed to support its Objection by availing required documents in support of its objection.

90. The Respondent therefore submitted that the various authorities that the Appellant seeks to rely upon in its submissions are not available to his aid with the upshot that this Appeal is wholly unmerited.

The Respondent's Prayer

91. The Respondent prays that the Tribunal finds;

    a) That the assessment as issued, being principal VAT and Corporation Tax amounts of Kshs 359,542,702.00, together with the resultant penalties and interest, is upheld and deemed collectable by the Respondent from the Appellant.
    b) That the Appeal be dismissed with costs to the Respondent.

D. ISSUES FOR DETERMINATION

92. Having carefully studied the parties' pleadings, witness statements, submissions and all documentation provided, the Tribunal is of the view that there were two issues for determination:

    i. Whether the Objection Decision was valid.
    ii. Whether the Respondent erred in its decision to disallow the input VAT claimed by the Appellant.

93. We take note that the Appellant listed as part of its grounds of Appeal a dispute regarding a Corporation Tax demand. Substantial Sections of the Appellant's Statement of Facts also included a discussion regarding allowability of expenses under Section 15(1) of the Income Tax Act. However, the Objection Decision which is the subject matter of this Appeal does not contain a demand for Corporation Tax.

94. The Tribunal shall therefore focus its efforts on the VAT demand which constitutes the total tax demanded in the Objection Decision.

E. ANALYSIS AND FINDINGS

i) Whether the Assessments and Objection Decision were valid

95. The Appellant avers that the assessments issued by the Respondent were not valid. It argues that the Respondent did not provide it with the reasons for rejecting the evidence it provided, whose validity was not and has never been questioned. It placed reliance on Section 49 of the Tax Procedures Act which states:

> *"Where the Commissioner has refused an application under a tax law, the notice of refusal shall include a statement of reasons."*

96. A review of the tax investigations findings letter indicates that the Respondent provided reasons for disallowing the input VAT. It gave the reasons that its investigations had revealed that its suppliers only existed on paper and did not actually buy or sell anything neither do they have an office. It also stated that upon analysing the Appellant's VAT returns, it noted that the Appellant had claimed imports whose entry numbers do not belong to it. Reference to these reasons were made in the assessment as the Respondent had required the Appellant to provide justifiable grounds why the input VAT and costs claimed

by the Appellant should be allowed. Thus, it is clear that the Respondent provided reasons for its decision as required under Section 49 of the Tax Procedures Act.

97. The Appellant further insists that the Objection Decision failed to state the legal provisions upon which the decision was issued. Moreover, the Respondent did not address the grounds set out by the Appellant in its Notice of Objection.

98. The grounds of objection set out by the Appellant in the Notice of Objection were:

    a. That it indeed purchased and received the goods and that invoices from the supplier are settled after delivery.
    b. That the sales were declared in the VAT returns and input VAT claimed against output VAT based on the guidelines provided under the VAT Act.

99. That Section 58(10) of the Tax Procedures Act sets out what an Objection Decision must contain. The Section states:

    "An objection decision shall include a statement of findings on the material facts and the reasons for the decision."

100. A reading of the above provision indicates that there is no obligation placed on the Respondent to respond to the grounds raised by the Appellant. The Section merely requires the Respondent to provide a statement of the facts and the reason for decision. A review of the Objection Decision indicates that it met these conditions. It stated that the Notice of Objection was not properly lodged as the Appellant did not provide evidence to support the objection and the grounds of objection as set out in the letter remained unsupported. Notwithstanding the fact that the law does not require it to respond to the grounds set out in the objection, the Respondent responded to the grounds by

stating that it the Appellant did not provide the documentation to support its grounds. Accordingly, it confirmed the assessment.

101. The Objection Decision therefore meets the conditions set out under the Tax Procedures Act and is therefore valid.

ii) Whether the Respondent erred in its decision to disallow the input VAT.

102. In determining whether the Respondent's decision to disallow the input VAT by the Appellant was proper as per the provisions of the VAT Act and various authorities, the Tribunal set for itself the following tests:

a) Whether the Appellant furnished proof to defend its position.
b) Whether the Appellant's right to claim VAT was affected by the presence of fraud in the supply chain.
c) Whether the Appellant knew or should have known that there was fraud.

ii a) Whether the Appellant had furnished sufficient proof of purchase.

103. The Respondent disallowed input VAT claimed by the Appellant on the basis that the Appellant was identified as one of the beneficiaries of the ***"missing trader scheme".*** According to the Respondent, it conducted a thorough analysis to evaluate both suppliers and customers of the suspected companies and to establish the possibility of introducing a fictitious supply to meet the requirement of having a tax filing status as well as minimizing the VAT payable. It avers that it requested the Appellant for information to support the claim for the input VAT and purchase costs, but none was provided.

104. The Appellant on its part insists that it purchased the goods and claimed the input VAT and purchase costs as allowed under law. It further avers that it provided the Respondent with the requisite information.

105. It is an established principle of VAT law that a taxable person who makes transactions in respect of which VAT is deductible may deduct the VAT in respect of the goods or services acquired by him, provided that such goods or services have a direct and immediate link with the output transactions in respect of which VAT is deductible. In the Kenyan VAT system, this principle is found in Section 17(1) of the VAT Act which provides as follows:

> *"Subject to the provisions of this Section and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person, subject to the exceptions provided under this Section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies."*

106. Thus, based on the above provision, it is not enough for the taxpayer to hold the documentation listed in Section 17(3) of the VAT Act. The documentation must be representative of an underlying transaction that took place. The taxpayer must have bought the goods, had them delivered and used them in making taxable supplies. The taxpayer must prove that it purchased taxable.

107. In this case the Respondent submitted that it requested the Appellant to provide documents among them supplier invoices, statements, delivery notes, payment vouchers and ETR receipts for the suppliers which it avers the Appellant failed to provide. The Appellant was also required to provide proof confirming that the imports whose entry numbers did not belong to the company, were actually imported by the Appellant and VAT for the same paid.

108. Section 56 of the Tax Procedures Act places the burden of proof on the taxpayer to show that a tax decision is wrong. Proof is in the form of documents. Mere assertions are not enough. This was stated in **Janet Kaphiphe Ouma and another v. Marie Stopes International (Kenya), HCC No. 68 of 2007** where the court held that:

"In this matter, apart from filing its statement of defence the defendant did not adduces any evidence in support of assertions made therein. The evidence of the 1st plaintiff and that of the witness remains uncontroverted and the statement in the defence therefore remains mere allegations... ... Sections 107 and 108 of the Evidence Act are clear that he who asserts or pleads must support the same by way of evidence."

109. Only upon proving its case does the burden shift to the Respondent who then has to rebut any evidence adduced by the Appellant. This was the position of Supreme Court of Canada in its decision in **Hickman Motors Ltd- vs- Canada, 1997 CanLII 357** where the Court stated that:

"The taxpayer's initial onus of "demolishing" the Minister's exact assumptions are met where the appellant makes out at least prima facie case... Where the Minister's assumptions have been "demolished by the appellant, "the onus.... shifts to the Minister to rebut the prima case" made out by the appellant and to prove the assumptions...The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minister's assumptions; ...Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed; and even if the evidence contained "gaps in logic, chronology, and substance", the taxpayer's Appeal will be allowed if the Minister fails to present any evidence as to the source of income."

110. In this case, the Tribunal reviewed the Appellant's documents attached to this Appeal, including the Objection and the Appellant's Statement of Facts, and

found nothing to support the Appellant's averments including the documents that the Appellant had indicated in its submissions as having been presented to the Respondent. As such, there is no way to rebut the assertions made by the Respondent and indeed the Tribunal cannot determine that the Appellant did acquire stock from the suppliers in question.

111. We take great exception to the fact that the Appellant made an attempt, without leave of the Tribunal, to sneak in documents after the parties had made their final submissions and the window for filing any documentation had closed. This we find to be reprehensible and such documents are inadmissible. Such documents stand expunged from the record.

112. We are of the view that by failing to provide the required documentation to show that there was indeed a purchase, the Appellant failed to discharge its burden of proof. It is not sufficient for the Appellant to seek to hide behind provisions of the law and claim that the Respondent was acting unfairly when the facts point to the Appellant being given an opportunity to defend its case and being given ample time to furnish the Respondent with the necessary documents.

113. Consequently, the Tribunal finds that the Appellant did not furnish sufficient proof to defend its position and to rebut the Assessment and the Objection Decision and the Respondent is therefore justified in its demand.

ii b) Whether the Appellant's right to claim input VAT and purchase cost was affected by the presence of fraud in the supply chain and ii c) whether the Appellant knew or should have known that there was a fraud.

114. Having established that the Appellant failed to prove that it indeed made any purchases, the question of whether the Appellant knew or ought to have known that its transactions were part of a fraudulent scheme is rendered moot.

115. Accordingly, the Tribunal finds that the Respondent did not err in its decision to disallow the input VAT and purchase cost by the Appellant and to demand payment of the VAT claimed in the period under investigation.

F. ORDERS

116. Based on the foregoing analysis the Tribunal makes the following Orders: -

i. The Appeal is hereby dismissed.

ii. The Objection Decision dated 26th July, 2018 is valid and the tax demand for Kshs. 359,542,702.00 is hereby upheld.

iii. Each party to bear its costs.

117. It is so ordered.

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

.....
ERIC N. WAFULA
CHAIRMAN

.....
CATHERINE N. MUTAVA
MEMBER

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GABRIEL M. KITENGA
MEMBER

.....
ABRAHAM K. KIPROTICH
MEMBER