REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 230 OF 2018

HEET ENTERPRISES ..... APPELLANT

-VS-

COMMISSIONER OF INVESTIGATIONS & ENFORCEMENT ..... RESPONDENT

JUDGMENT

BACKGROUND

1. The Appellant is a limited liability company duly registered under the Laws of Kenya. Its principal activity is the sale of different construction materials within the construction industry.

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 enforce all provisions of the written laws for purposes of assessing, collecting, accounting and general administration of tax revenue on behalf of the Government of Kenya.

3. The Respondent reviewed the Appellant's tax affairs for the period between October 2015 and June 2017 and discovered that the Appellant sourced construction material from two suppliers namely Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers. These two suppliers had been profiled by the Respondent as being responsible for

printing and selling ETR invoices without making actual supplies for purposes of reducing the purchaser's tax liability under the missing trader fraud scheme.

4. The Respondent issued a tax demand vide a letter dated 16th April, 2018 computing the Appellant's tax liability on account of VAT at Kshs. 61,750,835/- (inclusive of interest and penalties). The Respondent further called upon the Appellant to pay the taxes within seven days.

5. The Respondent formalized the demand into an assessment by issuing VAT Assessment Orders dated 7th and 8th May, 2018 totalling Kshs. 61,750,835/- (inclusive of interest and penalties).

6. Following a series of correspondence and engagements, the Appellant lodged its formal Objection vide a letter dated 13th June, 2018 contesting the assessments in their entirety.

7. The Respondent issued its Objection Decision vide a letter dated 26th July, 2018 rejecting the objection and subsequently confirming the assessed sum of Kshs. 61,750,835/-.

8. Aggrieved by the Respondent's Objection Decision, the Appellant lodged this appeal vide a Notice of Appeal dated 24th August, 2018 and filed on even date.

THE APPEAL

9. The Appellant instituted the Appeal vide a Memorandum of Appeal dated 7th September 2018 and filed on even date. The Appeal is premised on the following grounds as set out in the Memorandum of Appeal; -

    i. That the Respondent erred in law by raising additional value added tax assessment on an approach that contravenes the applicable sections of the Value Added Tax Act and applicable Kenyan jurisprudence.

    ii. That the Respondent erred in law and fact by disallowing expenses incurred wholly and exclusively in generation of business income of the Appellant, contrary to Section 15(1) of the Income Tax Act and supporting sections.

    iii. That the Respondent erred in fact and law by disallowing input VAT incurred in the making of taxable supplies, contrary to the stipulations of Section 17 of the Value Added Tax Act.

10. Based on the foregoing, the Appellant urged the Honourable Tribunal to find that;-

    i. The confirmed assessments are in violation of the provisions of the Income Tax Act and the Value Added Tax Act and that the entire assessment amounting to Kshs. 61,750,835/- be set aside;

    ii. That the costs of this cause be awarded to the Appellant.

11. The Respondent filed its Statement of Facts dated 4th October, 2018 on even date.

12. The Respondent stated that the Appellant's assessed tax was as a result of invoices from suppliers who had been profiled by the Respondent as being responsible for printing and selling ETR invoices without making actual supplies. These suppliers, namely, Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers were the Appellant's main suppliers among other steel companies.

13. The Respondent further stated that Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers' VAT inputs were mainly imports on which they claim input tax as per their VAT returns. Further analysis revealed that the imports claimed were neither addressed to them nor did the goods relate to construction materials. The Respondent pointed out that Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers could not sell to the Appellant goods which they did not have.

14. The Respondent thus computed the claimed inputs from the above suppliers for the period October 2015 to June 2017 and charged VAT amounting to Kshs. 61,750,835/-.

15. The Respondent prayed that this Tribunal considers the case and finds that;-

    i. The confirmed assessments were proper in law.

ii. The Appeal be dismissed with costs.

THE APPELLANT'S CASE

16. The Appellant averred that it provided evidence on how the contested transactions from Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers on which it claimed input VAT, and which were the basis of cost of purchases for the sales, on which it paid Corporation Tax, were proper. The Appellant submitted that despite providing 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.

17. The Appellant further averred that the assessments did not give a statement of reasons for disallowing the input VAT and thus is in violation of Section 49 of the Tax Procedures Act 2015, which provides that:

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

18. The Appellant submitted that Article 47 of the Constitution of Kenya, 2010 and as expressly enshrined in sub-Section 4(d) of the *Fair Administrative Action Act, 2015 (FAAA)* imposes a duty upon public officers to give reasons for their actions as part of the due process of administrative rights guaranteed by law.

19. The Appellant further submitted that the importance of being given reasons, (which by sub-Sections 4(3)(g) and 6 (2)(b) of the *Fair Administrative Action Act, 2015* includes material to be, or, relied on) as stipulated cannot be refuted especially where there is a right to object against adverse decisions. The Appellant argued that without such reasons, it was impossible to challenge the assessments.

20. The Appellant added that the right to be given reasons is part of the rights under the rules of natural justice. Further, the Appellant averred 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.

21. The Appellant averred that since the Objection Decision upholds assessments which the Appellant has demonstrated to be null and void, the same should be declared to be null and void and of no legal effect. The Appellant made reference to the case of **Republic v Institute of Certified Public Accountants of Kenya EX Parte Joy Vipinchandra Bhatt T/A JV Bhat & Company [2008] eKLR** where Emukule J quoted the words of Lord Irvine that;-

"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 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."

22. It was the Appellant's case that even if the assessments were valid, the Respondent, failed to state the legal provisions upon which the objection decision was issued. Moreover, the Respondent did not address the grounds set out by the Appellant in its Notice of Objection.

23. The Appellant averred that the Respondent in its Objection Decision acknowledged that the Appellant had provided the necessary documents required as follows;

"...Your grounds for the objection have been carefully considered and the Commissioner's decision as guided by Section 51 of the Tax Procedures Act on the same is as communicated here below... Notwithstanding your assertion that the company has maintained full records for the purchases disallowed, the Commissioner has established that there was no supply... 'it is noteworthy that your letter is general, lacks specificity and does not meet requirements of a validly lodged objection as stipulated under Section 51(3) of the TPA..."

24. The Appellant submitted that having established that the Respondent acknowledged that the Appellant provided the required documents, there was no reason advanced as to why the objection was rejected.

25. The Appellant placed reliance on Section 51 (9) of the Tax Procedures Act which provides that;-

> *"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..."*

The Appellant contended that the above is further buttressed by Sub-section (10) which provides that

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

26. The Appellant averred that it was evident that the Respondent failed to disclose the substantive legal provision on which it relied to raise both the assessments and the Objection Decisions; and further declining to demonstrate how it arrived at the amount assessed. According to the Appellant, the Objection Decision does not contain any statement of findings on the material facts nor are there any or adequate reasons for confirming the contested assessment.

27. Further, it was the Appellant's submission that it procured the merchandise from its suppliers and was issued with invoices. The Appellant made payment for the merchandise on delivery as evidenced by the invoices, RTGS and delivery notes furnished to the Respondent. The cost of purchasing the merchandise is exclusively incurred by the Appellant in the production of its income. Therefore, it was entitled to deduct the same as cost of purchases.

28. The Appellant further averred that it provided the Respondent with copies of RTGS for the said invoices, which is proof of payment to its suppliers by the bank. With its vast investigatory and enforcement powers, it could have (and might have) easily confirmed if the documents were authentic.

29. It was the Appellant's submission that the Respondent did not, at any particular time contest the authenticity of any document provided by the Appellant. The Appellant added that the Respondent in its Objection Decision and Statement of Facts did not identify any additional documents it had requested but was not furnished with by the Appellant, forcing it to arrive at its rather unjustified and erroneous assessments and Objection Decision.

30. The Appellant averred that it has demonstrated that the Respondent was provided with evidence in support of the purchases and has, without any reasonable factual or legal justification, opted to ignore the same.

31. The Appellant submitted 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 made reference to *Section 17 (1) of the VAT Act* and *Regulation 7 of the VAT Regulations of 2017* which provide as follows;

Section 17 (1) of the VAT Act provides that:

> *"... 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 is to the effect that;

> *"...(l) A person shall be entitled to a deduction of input tax 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...;"

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

    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 (condition imposed on 30th March 2017).*

33. The Appellant averred that it fulfilled each and all the conditions of claim and maintained the supporting documentation for the same.

34. The Appellant also averred that it is registered for VAT and filed 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.

35. The Appellant further averred 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.

36. Moreover, the Appellant submitted that the Respondent had failed in its attempt to paint it in a bad light. In light of this, the Appellant averred that the Respondent's assertion that *'... part of the fraud, the payments were being made to the suppliers through Diamond Trust Bank and the money would find its way back to the purchaser in this case the Appellant...'* was unsubstantiated. The Appellant maintained that it had been co-operative throughout the investigation and that it had provided the Respondent with all the documents and information requested.

37. 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 less than 72 hours before the hearing. The Appellant made reference to the Respondent's assertion that the impugned traders could not be traced and that there was neither known

storage of the bulky goods supplied nor the details of delivery/movement logs of the goods. The Appellant posed;

"...the adequacy or not of the supplier's storage space or lack of details of numerous lorry deliveries is proof of 'ghost' supplies? This is improper. The Respondent cannot rely on alleged factual evidence produced for the first time three 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 this Honourable Tribunal."

38. The Appellant argued that if such analysis was the basis of the assessments and Objection Decision, they 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 to view them askance.

39. 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; for instance, to demand to view the suppliers' storage space and number of lorries? 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.**

40. The Appellant averred that having discharged its burden of proving the purchase, the Appellant should not be penalized for indolence and malice on the part of the Respondent. It is the Respondent's duty to demonstrate that the evidence adduced was insufficient to prove the contrary. It has failed.

41. The Appellant placed reliance on the case of **Shreeji Enterprises Limited -vs- Commissioner of Investigations and Enforcement, (supra)** where the Honourable Tribunal determined that:

> *".... 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..."*

42. Further, the Appellant averred that in the case of **Karshan Limited -vs- Commissioner of Domestic Taxes, TAT No.123 of 2018,** this Honourable Tribunal found 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..."

43. 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.

44. 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. To expound on the assertion, the Appellant relied on Justice Nyamu's analysis in **Keroche Industries vs. the Kenya Revenue Authority and 5 Others, Miscellenous Civil Application No. 743 of 2006** 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 or more possible meanings, the inclination (or the court) should be against a construction or interpretation of a burden, tax, or duty on the subject (taxpayer)".

45. However, the Appellant averred that where it is shown that one of the main or the main purpose of a transaction is to evade tax, the Respondent is allowed to adjust that transaction back to the proper

position which would have existed if that purpose was not achieved. To support its arguments, the Appellant relied on Se*ction 66 (1) of the Value Added Tax 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...."

46. The Appellant submitted 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."

47. The Appellant submitted that its view of the anti-avoidance provisions is that the Respondent can only link one taxpayer to another on 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.

48. 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 argued that the Respondent was motivated by an internal guideline that anyone who trades with non-filers or persons cited for non-compliance is a mischievous taxpayer and all transactions with the alleged non-filers are to be disallowed for tax purposes; and 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.

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

> *"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 HA/IRC (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."*

50. The Appellant averred that the Respondent had 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.

51. Further, it was the Appellant's averment 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 of Kenya, 2010. It argued that assessing it on the basis of open factual errors and other persons' tax obligations was neither fair nor reasonable. It further averred that it was taken through inhumane interrogations and false information passed about the conduct of its business to third parties.

52. The Appellant argued that the Respondent is equipped with wide powers under the 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.

53. The Appellant stated that in the open market, business people traded with all manner of suppliers of goods and services. It is not possible to verify the compliance status of any business person 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. 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 input taxes 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.

54. In light of the foregoing, the Appellant prayed that the Honourable Tribunal allows the Appeal with costs as the tax imposed is not only illegal, but also unfair and unreasonable.

THE RESPONDENT'S CASE

55. The Respondent set out its case in its Statement of Facts dated 4th October, 2018, the witness statement of Sylvester Oketch sworn on 10th March, 2021 and its Written Submissions dated 21st March, 2021.

56. The Respondent averred that it received intelligence information from the Investigation and Enforcement Department about Traders that were making huge sales but declaring very little or no taxable income. The allegation was that the said traders formed a network in such a way that they would supply almost equal amounts of goods to each other thus bringing the output to zero or end up in a credit position.

57. The Respondent maintained that it discovered that individuals would register businesses for invoicing purposes upon which they would sell the invoices and issue ETR receipts without making any sales at all.

58. The Respondent states that the traders are labelled as 'missing traders' since their business premises as declared in iTax by the proprietors cannot be located. Efforts to trace them through their declared mobile

phone numbers has not been successful as their phones are out of reach or the users of the lines are different from the registered names of the proprietors. The Respondent further stated that the beneficiaries of the scheme would then claim input VAT from the fictitious purchases.

59. The Respondent submitted that the Appellant claimed input VAT from the month of October 2015 to June 2017 from invoices acquired from the missing traders namely, Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers, where there were no actual supplies made, thus reducing tax liability.

60. The Respondent argued that the two companies (Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers) were investigated by the Respondent and found to be involved in a tax fraud scheme of printing and selling the respective invoices to the Appellant, without actual supply of goods.

61. The Respondent added that from a scrutiny of the invoices provided by the Appellant, the address of Darwine Wholesalers Ltd, being MPPS Complex, Godown No. 10 Mombasa Road is non-existent. The investigations established that there were no such premises or go-down with the said name and address in the said location belonging to Darwine Wholesalers Limited, who were suppliers of hardware, steel and construction materials to the Appellant as alleged.

62. The Respondent contends that it was a clear case of fraud since Darwine Wholesalers Limited allegedly supplied voluminous and heavy steel

materials such as Angle Line and Mabati Gauge in huge quantities as seen from the invoices and such material would definitely require ample storage space yet the said MPPS Complex does not house any go downs.

63. Further, the Respondent averred that it established through the iTax platform that the Appellant's physical address as captured on iTax was the same address as that of Darwine Wholesalers Limited. To the Respondent, this meant that the Appellant and its supplier Darwine Wholesalers Limited are related companies, which raised greater suspicions on their dealings.

64. During the cross examination of the Appellant's witness on 12th March 2021, Mr. Mayur Malde, the Director of the Appellant Company testified that he did not know the address nor physical location of Darwine Wholesalers Limited. That Darwine Wholesalers simply delivered the goods purchased to the Appellant's Company, therefore the Appellant Company did not know where these goods were being delivered from, and there was no need to know the same.

65. It was the Respondent's submission that this is not only suspicious but beats business logic to conduct business worth millions of shillings with an entity whose location/premises is unknown. The Respondent further added that the invoices from Darwine Wholesalers Limited, and which this Honourable Tribunal had an opportunity to scrutinize, show that the Appellant on almost consecutive days would allegedly purchase voluminous materials worth millions of shillings from Darwine

Wholesalers and yet the Appellant's Director did not know where the location of Darwine Wholesalers Limited was.

66. The Respondent further averred that the Appellant failed to produce purchase orders to support the alleged voluminous purchase of hardware materials it was making from Darwine Wholesalers Limited. The Respondent thus submits that this is proof that the Appellant did not make any such purchases from Darwine Wholesalers Ltd and the said invoices were thus fictitious.

67. Moreover, according to the Respondent it was the Appellant's witness testimony that he did not know the name of the Director(s) of Darwine Wholesalers Limited. He alleged that he only knew the Director as a Mr. Mohamed, which is so generic and very questionable seeing as the alleged transactions with the said company on an almost daily basis runs into millions of shillings.

68. The Respondent stated that the fact that the Appellant knew nothing about the impugned suppliers begged the question of how it dealt with any cases of faulty or substandard materials delivered to it, and which were in very large quantities and worth of millions of shillings. The Respondent questioned to which address such materials would have been forwarded to whenever found to be substandard or faulty without knowing the address or physical location of the Appellant.

69. The Respondent averred that the fact that the invoices from all suppliers in question had all the requirements of a tax invoice as required under the VAT Act 2013 and had ETR receipts attached thereon is not sufficient proof that the goods were actually delivered to the Appellant.

70. The Respondent added that contrary to the Appellant's assertions that the Respondent is trying to attribute non-compliance of the missing traders to the Appellant, which assertions are false and misguided, the Respondent has not raised any such requirement that failure of tax compliance by a supplier (missing traders in this case) leads to a tax liability on the part of the buyer, in this case the Appellant.

71. The Respondent also averred that it has at no time required the Appellant to follow through the supply chain and demand from the suppliers the origin of their goods.

72. The Respondent averred that the issue of the suppliers/missing traders being compliant or non-compliant for VAT is therefore secondary to the issue at hand. The Respondent only seeks to collect tax fraudulently claimed by the Appellant through purchase invoices for deliveries that were not made. The Respondent has relied on Sec 46(4) of the VAT Act 2013 to demand the taxes in the assessments raised.

73. The Respondent urged the tribunal to adopt the Test used in the Missing trader Case of **EDGESKILL LIMITED vs THE COMMISSIONER FOR HER MAJESTY'S REVENUE AND CUSTOMS (2014) UKUT 0038** where the Hon. Mr. Justice Hildyard reiterated the test applied by the FTT' (which

is a specialist tax tribunal) when considering whether the Commissioners were justified in refusing a claim of input tax. The test, as set out in paragraph 37 of the Decision, is:-

"

i. *Was there a VAT loss?*

ii. *If so, was it occasioned by fraud?*

iii. *If so, were the Appellant's transactions connected with such a fraudulent loss of VAT loss?*

iv. *Is so, did the Appellant know, or should it have known, of such a connection?"*

74. The Respondent urged the Tribunal to apply the above test, which will no doubt find that the Appellant was a beneficiary of a "Missing Trader" tax evasion scheme.

75. The Respondent maintained that the Appellant was unable to demonstrate to the satisfaction of the Commissioner that indeed they had received the said supplies. In reaching its determination, the Respondent applied the "reasonable man test". This is an objective test that the Respondent used in trying to establish if the Appellant indeed was involved in a legitimate purchase of high value goods.

76. The Respondent relied on the decision of the Upper Tribunal in **S&I ELECTRIC PLC v HMRC [2015] UKUT 162 (TCC),** which had this to say in regard to the reasonable man test proposed above:

> *"...the FTT' (a specialist tax tribunal) task was to apply the impersonal standard of the reasonable businessman to the facts which it found, on the basis of the evidence which it heard, as to the circumstances in which S&I carried out the transactions in issue. Would the reasonable businessman have concluded that S&I ought to have known that the only reasonable explanation for the transactions was that they were connected with fraud?"*

77. The Respondent averred that a thorough analysis of the 'Reasonable Man Test' (and therefore by inference or by extension a 'Reasonable Businessman') was offered in **HEALTHCARE AT HOME LIMITED VS. THE COMMON SERVICES AGENCY [2014] UKSC 49** where the Supreme Court of the United Kingdom observed as follows:

> *"...the behaviour of the reasonable man is not established by the evidence of witnesses, but by the application of a legal standard by the court. The court may require to be informed by evidence or circumstances which bear on its application of the standard of the reasonable man in any particular case; but it is then for the court to determine the outcome, in those circumstances, of applying that impersonal standard."*

78. The Respondent prompted the following queries to demonstrate that the Appellant fails under the reasonable man's test;-

"

i. Is it reasonable for the Appellant to enter into a high value deal for supply of goods with no formal contractual arrangements?

ii. Is it reasonable for the Appellant to purchase high value goods from a supplier without knowing the supplier's business premises/ physical address?

iii. Is there additional paperwork to support the invoices that the Appellant sought to rely on in obtaining the VAT tax refund? For example, were there delivery notes? Purchase orders? Inspection reports? Any logs that shows the movement of the goods into their premises?"

79. The Respondent concluded that the Appellant as a prudent business entity was highly unlikely to allow such lapses and oversights in its supply chain. The Respondent added that it requested additional documentation in support of the invoices yet the Appellant has been unable to provide the same.

80. In view of the foregoing, the Respondent prayed that the Appeal be dismissed with costs.

ISSUES FOR DETERMINATION

81. Having carefully considered the pleadings, documentation, and submissions, the following issues fall for determination: -

    i. **Whether the Appellant's Right to fair Administrative action was infringed by the Respondent.**
    ii. **Whether the Objection decision was valid.**
    iii. **Whether the Respondent's decision to disallow the input VAT claim was justified and proper in law.**

82. Before delving into the specific issues identified, the Tribunal wishes to point out that the Respondent neither raised any assessment on account of Corporation Tax nor was Corporation Tax deliberated on in the Objection Decision. This is contrary to the Appellant's assertions in its Memorandum of Appeal, Statement of Facts, and Written Submissions insinuating that an assessment on account of Corporation Tax had been issued.

ANALYSIS AND FINDINGS

i. Whether the Appellant's Right to fair Administrative action was infringed by the Respondent.

83. The Appellant averred that the investigations and assessments were in breach of the Appellant's right to fair administrative action contrary to Article 47(1) of the Constitution of Kenya, 2010.

84. The Tribunal acknowledges that a fair hearing is a basic principle of justice that cannot be overlooked, both procedurally and substantively. The Appellant averred that the Respondent did not reveal the basis of the information relied upon in the issuance of the assessments and on whose basis the same has been confirmed contrary to proper tax administration practices. This appears to be the only argument fronted by the Appellant on this limb. The Tribunal takes this to mean that the Appellant claims to have been prejudiced in responding to the queries from the Respondent or marshalling its Defense.

85. Having perused the correspondence between the Appellant and the Respondent, the Tribunal finds no indication whatsoever that the Appellant's right to a fair hearing was infringed.

ii. Whether the Objection decision was valid.

86. 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."*

87. A review of the Objection Decision shows that the Respondent provided reasons for disallowing the input VAT and costs claimed. It stated that

> *"...Notwithstanding your assertions that the company has maintained full records for the purchases disallowed, the Commissioner has established that there was no supply of taxable goods made by the suppliers highlighted on our letter..."*

The reason given as the basis for the confirmation of the assessment was that there were no goods supplied.

88. The Appellant majored on defending the view that no reasons were given instead of impeaching the assertion that no goods were supplied by demonstrating otherwise. Thus, it is clear that the Respondent provided reasons for its decision as required under Section 49 of the Tax Procedures Act.

89. 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.

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

    i. That it indeed purchased and received the goods and that invoices from the supplier are settled after delivery.

ii. 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.

91. 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."

92. A reading of the above provision indicates that there is no obligation placed on the Respondent to respond to each of the grounds raised by the Appellant. The section merely requires the Respondent to provide a statement of the facts and the reason for the decision. A review of the Objection Decision indicates that it met these conditions.

93. Needless to state, the Respondent in its objection decision also informed the Appellant of its right to Appeal within 30 days as per the provisions of the Tax Appeals Tribunal Act.

94. Without prejudice to the foregoing, the law only contemplates that an Appellant should not be prejudiced in pursuing their rights pursuant to a tax demand as outlined in the case of **Geothermal Development Company Limited v Attorney General & 3 others [2013] eKLR (Petition No. 352 of 2012)**, where the court observed as follows;

"A notice of the nature issued to enforce collection of taxes must clearly state to be such a notice, state the amount claimed, state the legal provision under which it is made and draw the taxpayers attention to the consequences of failure to comply with the law and the opportunity provided by the law to contest the finding. ***Such a notice would give the opportunity to any Kenyan to know the case against it and utilise the legal provisions to contest the decision."*** (Emphasis ours).

95. Based on the above decision, the purpose of a notice issued to enforce collection of taxes (this includes an assessment and an objection decision) must accord the taxpayer an opportunity to know the case against it and utilise the legal provisions to contest the decision.

96. The Tribunal finds that the assessment and the Objection Decision were valid as they met the conditions and did not prejudice the Appellant in any way as held in **Geothermal Development Company Limited v Attorney General & 3 others (supra).**

iii. Whether the Respondent's decision to disallow the input VAT claim was justified and proper in law.

97. 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 wishes to rely on the tests relied upon in **Tax Appeals Tribunal No. 225 of 2018 Rahisi Cash & Carry Traders Ltd —vs- Commissioner of Investigations & Enforcement** as follows; -

"

a. Whether the Appellant furnished proof of purchase.

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."

a. Whether the Appellant furnished proof of purchase

98. 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 that established that the Appellant claimed to have purchased supplies from Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers, who were missing traders and claimed input VAT accordingly.

99. The Respondent avers that it requested the Appellant for information to support the claim for the input VAT and purchase costs, but despite providing some documentation, it confirmed that the said goods were not supplied.

100. 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 requested to prove purchase and payment for the said supplies.

101. 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."*

This provision embodies the well-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.

102. The Tribunal relies on the decision of **Rahisi Cash & Carry Traders Ltd —vs- Commissioner of Investigations & Enforcement (supra),** at paragraph 122 as follows;

"In a functional VAT system claiming input VAT paid on purchases related to a sale is an unassailable right of taxpayers. However, such a system cannot be functional if the tax collector is to refund what it never received in the first place. The taxpayer should prove that it actually paid by providing proof of purchase. Once the proof of purchase has been provided, the tax authority should either give the refund or challenge the proof of purchase."

103. The right to claim input VAT is premised on the assumption that the taxpayer paid VAT during the purchase of their supplies. Section 17(3)(a) of the Value Added Tax Act, 2013 further provides that in order to claim input VAT, the relevant documents to be provided are the original tax invoice or a certified copy of the same.

104. A reading of this Section shows that it is not just enough for the original tax invoice to be availed, the invoices must themselves relate to an actual supply or importation that was acquired by the trader to make the taxable supply. Indeed, the 'missing trader fraudulent scheme' that the Respondent has described would flourish on the basis that only an original tax invoice or ETR receipt is availed and therefore it is important to rely, not just on the invoice but a proper demonstration of the invoices actually relating to purchases of the goods and services that are applied in the production of the taxable supplies.

105. In view of the foregoing, it can be plainly put that the possession of an invoice and a corresponding ETR receipt does not entitle one to claim

input VAT if there was no underlying transaction, as the same would be synonymous with unjust enrichment where the tax collector is called upon to refund what it never received in the first place.

106. Section 30 of the Tax Appeals Tribunal Act places the burden of proof on the taxpayer to submit all the necessary documentation to support its case. The same position was vividly captured by the court in the South African case of **Metcash Trading Limited —vs Commissioner for the South African Revenue Service and Another Case CCT 3/2000,** where it was 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, it is obvious that the incidence of this onus can have a decisive effect on the outcome of an objection or Appeal. Unlike income tax, where assessments can elicit genuine differences of opinion about accounting practice, legal interpretations or the like, in the case of a VAT assessment there must invariably have been an adverse credibility finding by the Commissioner; and by like token such a finding would usually have entailed a rejection of the truth of the vendor's records, returns and averments relating thereto. Consequently, the discharge of the onus is a most formidable hurdle facing a VAT vendor who is aggrieved by an assessment: unless the Commissioner's precipitating credibility finding can be shown to be wrong, the consequential assessment must stand"

107. Further, once a tax assessment is issued, the burden to prove the assessment as incorrect is on the Appellant in line with Section 56(1) of the *Tax Procedures Act, 2015* which provides;

> *"In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect."*

108. However, this burden placed upon the taxpayer in respect of input VAT claim is to the extent that the necessary documentation in support of the purchase is tabled, upon which a legitimate expectation for the claim to be allowed arises unless the credibility of the documents provided is impeached.

109. Therefore, once the taxpayer adduces evidence that discharges his burden by providing the documents required, the onus shifts to the Respondent to impeach the credibility of the documents for the assessment to stand. Such a position is clearly captured in the Supreme Court of Canada's decision in **Hickman Motors Ltd. v. Canada, [1997] 2 S.C.R. 336,** where the Court expressed itself thus:

> *"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."*

110. The Respondent averred that the impugned suppliers, Darwine Wholesalers Ltd and Fahari Hardware & Building Wholesalers, were in the business of printing and selling invoices and ETR receipts without supplying any goods to help taxpayers such as the Appellant reduce their tax liability and hence the reason as to why it raised the assessments.

111. It follows that it was incumbent upon the Appellant to indeed demonstrate that indeed goods were supplied. From a reasonable man's standpoint, the Tribunal agrees with the Respondent that the Appellant should have indeed provided at least the delivery notes and purchase orders to prove the delivery of the goods. Since the Appellant was dealing in high value purchases from the said suppliers, it would also have sufficed to produce logs that show the movement of the goods into their premises.

112. The Tribunal finds it more puzzling that the Appellant's physical address as captured on iTax was the same address as that of Darwine Wholesalers Limited, an implication that they are related companies. Whereas the Appellant zealously held that it did not know the supplier's directors or its physical location despite them being related, spirited attempts by the Respondent to establish the whereabouts of the said suppliers were not fruitful, further cementing the doubt that they were 'missing traders'. This raises huge suspicions on the dealings between the Appellant and the said suppliers.

113. The Tribunal finds that the Appellant failed to discharge its burden of proving that there was actual purchase and supply of taxable supplies.

114. The Tribunal agrees with the Respondent that it did not attribute non-compliance of the missing traders to the Appellant and that it has at no time required the Appellant to follow through the supply chain and demand from the suppliers the origin of their goods. The Respondent only seeks to collect tax fraudulently claimed by the Appellant through purchase invoices for deliveries that were not made.

115. The Tribunal finds that the Appellant failed to demonstrate that it indeed purchased the goods from the suppliers in question as no evidence was tabled to demonstrate delivery of the goods. Consequently, the Respondent is justified in its demand.

116. 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.

FINAL ORDERS

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

    i. The Appeal be and is hereby dismissed.

ii. The objection decision dated 26th July, 2018 confirming the assessment for the sum of Kshs. 61,750,835.00 is hereby upheld.

iii. Each party to bear its costs.

118. It is so ordered.

DATED and **DELIVERED** at **NAIROBI** on this **28th** day of **May, 2021.**

.....
PATRICK LUTTA
CHAIRPERSON

.....
HELEN BILA
MEMBER

.....
MWAI MBUTHIA
MEMBER

.....
ELISHAH NJERU
MEMBER

.....
HABON FARAH
MEMBER