**REPUBLIC OF KENYA**
**IN THE TAX APPEALS TRIBUNAL**
**APPEAL NO. 222 OF 2018**

**JARINTA (K) LIMITED.....APPELLANT**

**-VERSUS-**

**COMMISSIONER OF INVESTIGATIONS & ENFORCEMENT.....RESPONDENT**

# JUDGMENT

## BACKGROUND

1. The Appellant is a general supplies company incorporated in Kenya and registered as a taxpayer.

2. The Respondent is a principal officer of the Kenya Revenue Authority, which was established under Section 11 of the Kenya Revenue Authority Act and is charged with the responsibility of collecting and accounting for taxes on behalf of the Government of Kenya.

3. The Respondent undertook an investigation of the Appellant's tax affairs in early 2018 and demanded for taxes amounting to **Kshs. 188,319,871.00** comprising VAT and Corporation Tax in an assessment dated 24th May 2018 which the Appellant objected to in a Notice of Objection dated 21st June 2018.

4. An Objection Decision dated 26th July 2018 confirming the assessment was issued by the Respondent and the Appellant, being aggrieved by this Decision, filed a Notice of Appeal on 24th August 2018.

## APPELLANT'S CASE

5. The Appellant's grounds for appeal are:

    a) THAT the Respondent erred in law by raising additional Corporation Tax and Value Added Tax ('VAT') contrary to the provisions of the Income Tax Act ('ITA') and the VAT Act.

    b) THAT the Respondent erred on fact and in law by disallowing expenses incurred wholly and exclusively in generation of business income of the Appellant contrary to Section 15(1) of the ITA and supporting Sections.

    c) THAT the Respondent has erred on fact and in law buy disallowing input VAT incurred to make taxable supplies contrary to Section 17 of the VAT Act.

6. The Appellant's prayers are:

    a) The entire tax assessment amounting to Kshs.188,319,871.00 is set aside; and
    b) That the costs of this Appeal be awarded to the Appellant.

## RESPONDENT'S CASE

7. That sometime around January 2017, the Respondent received information about six traders that were making huge sales, but declaring little or no taxable income. These six traders were:

    a) Kishna Enterprises (PIN No. P051504985Q);
    b) Shanlester Enterprises (PIN No. P051448424G);
    c) Swala Wholesalers (PIN No. P051303441V);
    d) Vidija Enterprises (PIN No. P051556085S);
    e) Seanet Trading Enterprises (PIN No. P051556083Q); and
    f) Nimeshkumar Ratilal Patel (PIN No. A005864762J).

8. THAT the Respondent's investigations established that the aforementioned traders were engaging in the "*missing trader scheme*", whereby taxpayers reduce their VAT liability by claiming input tax from non-existent traders using fictitious invoices.

9. THAT the Respondent further established that the traders had carried out the massive fraud by claiming input VAT against invoices without any evidence that the goods had been bought or using fictitious invoices to support the claims.

10. THAT the Respondent analyzed various traders' purchases and sales data in its possession and noted that whilst the traders duly filed their VAT returns they did not file their income tax returns.

11. THAT, in a letter dated 19th April 2018, the Respondent informed the Appellant that it had established that as a result of the fraudulent scheme,

taxes amounting to **KShs.188, 319,870.00** comprising VAT and Corporation Tax were due and payable by the Appellant.

12. THAT the Respondent proceeded to issue a Notice of Assessment dated 24th May 2018 for the period 2015-2017 pursuant to Section 31 of the Tax Procedures Act ('TPA').

## SUBMISSIONS BY THE PARTIES

13. The Appellant submits that it is being punished for trading with non-compliant persons who neither filed VAT and Income Tax returns nor paid their taxes. That the instant case rests on a factual issue: whether the goods for which the Appellant incurred input and cost, were actually delivered to the Appellant.

14. It is the Appellant's contention that it is being punished for the sins of third-parties and that there is no evidence linking the Appellant to the allegations of non-compliance of the alleged fraudulent acts. That the Respondent's actions are contrary to the provisions of the VAT Act, ITA and case law.

**On the requirements for claiming input VAT and deducting expenses**

15. The Appellant submits that Section 17 of the VAT Act, the VAT Regulations (2017) and Section 15 of the ITA sets out the requirements for claiming input VAT and deduction of expenses.

16. Section 17 of the VAT Act provides that:

*(1) "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."*

*(2) If, at the time when a deduction for input tax would otherwise be allowable under subSection (1), the person does not hold the documentation referred to in subSection (3), the deduction for input tax shall not be allowed until the first tax period in which the person holds such documentation.*

*Provided that the input tax shall be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred.*

*(3) The documentation for the purposes of subSection (2) shall be—*

*(a) an original tax invoice issued for the supply or a certified copy;*
*(b) a customs entry duly certified by the proper officer and a receipt for the payment of tax;*
*(c)a customs receipt and a certificate signed by the proper officer stating the amount of tax paid, in the case of goods purchased from a customs auction;*
*d)a credit note in the case of input tax deducted under Section 16(2); or*
*(e)a debit note in the case of input tax deducted under Section 16(5).*

*(4) A registered person shall not deduct input tax under this Act if the tax relates to the acquisition of—*
*(a)passenger cars or mini buses, and the repair and maintenance thereof including spare parts, unless the passenger cars or mini buses are acquired by the registered person exclusively for the purpose of*

*making a taxable supply of that automobile in the ordinary course of a continuous and regular business of selling or dealing in or hiring of passenger cars or mini buses; or*

*(b)entertainment, restaurant and accommodation services unless—*

*(i)the services are provided in the ordinary course of the business carried on by the person to provide the services and the services are not supplied to an associate or employee; or*

*(ii)the services are provided while the recipient is away from home for the purposes of the business of the recipient or the recipient's employer:*

*Provided that no tax shall be charged on the supply where no input tax deduction was allowed on that supply under this subSection."*

17. Regulation 7 of the VAT Regulations, 2017, further stipulates that input tax deduction is not allowable unless:

    a) the input has been incurred by a registered person;
    b) the input tax is incurred to make taxable supplies;
    c) the input VAT is not specifically disallowed;
    d) the claim is backed by a proper tax invoice; and
    e) the input VAT was actually paid.

18. The Appellant submits that it fulfilled the afore-mentioned conditions as set out in Section 17 and Regulation 7 and maintained the supporting documentation for the same.

19. The Appellant further submits that Section 15(1) of ITA provides that only costs incurred wholly and exclusively in production of income of a person is tax deductible and the purchases in question meet this requirement.

20. Section 15(1) provides that:-

> *"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."*

21. The Appellant submits that taxation must be based strictly on the law, and cannot be implied or assumed. That this position was stated in the case of **KEROCHE INDUSTRIES LTD-VS.-THE KENYA REVENUE AUTHORITY AND FIVE OTHERS (MISC. CIV. APPLI. 743 OF 2006)** where the Nyamu JJA (as he then was) stated that:

> *"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 which imposes a burden, tax or duty on the subject (taxpayer)."*

22. The Appellant submits that there is no requirement in law for the Appellant to carry the tax compliance obligations of its suppliers and that the Respondent has the legal, financial, technical and other resources to undertake its duties in ensuring each and every taxpayer is compliant.

23. On the other hand, the Respondent submits that Section 17(2) of the VAT Act only provides for deduction of input tax against valid documentation.

24. The Respondent further submits that it sought evidence of the actual supply of the items made by the 6 traders in question but that none was availed as proof of purchases and/or costs. Neither has the same been tendered before the Tribunal.

25. The Appellant submits that whilst Section 15 of ITA allows the deduction of expenditure incurred exclusively in the production of income, it is the onus of the Appellant to prove the same to the satisfaction of the Respondent. Again, no satisfactory proof was provided.

**On the transfer or enjoinment of a taxpayer to the tax obligations of another party**

26. The Appellant submits that the law only contemplates the following to be the circumstances where a taxpayer assumes or is enjoined in the tax obligations of third parties, namely: with regard to agency taxes, on related party transactions and with regard to anti-avoidance provisions.

27. That with regard to agency taxes, one entity may be charged with the obligation of filing returns and remitting withheld amounts to the KRA. For example, withholding VAT against any vatable invoice and remitting the same to the Respondent, deducting Pay As You Earn ("PAYE") and remitting to KRA, and deduction and payment of withholding tax. That these circumstances are however clearly spelt out in law and do not require involvement into the tax compliance affairs of the third-party.

28. That with regard to related party transactions, the law only requires proof that the transaction was at arm's length if one of the entities is in a preferential tax regime (e.g. Export Processing Zones). Vatable supplies between related entities should be shown to be at the "open market value".

29. That anti-avoidance measures are covered under 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, 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.*

*(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 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;*

*(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 taxor 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."*

Similarly, Section 23 of the Income Tax Act (transactions designed to avoid liability to tax) provides that:

*"(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 any 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) of this Section, 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) Any 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."*

30. The Appellant submits that the summary of the anti-avoidance provisions is that there must be linkage and a tax benefit. That in this particular case, the Appellant did not obtain any form of tax reduction, postponement in the payment of tax or a tax benefit.

31. It is the Appellant's contention that it has no obligation of ensuring that its suppliers or customers file tax returns or pay taxes. That the Respondent should settle the matter with that specific taxpayer.

32. The Appellant is of the view that the Respondent was motivated by an internal guideline specifying that anyone who trades with a non-compliant person is also cited for non-compliance and their transactions are also disallowed, a blanket approach cannot be reasonably applied in tax matters. Every person and every transaction should be treated separately and carry its own cross.

33. The Appellant relies on the TAT's judgement in the Tax Appeals Tribunal No. 58 of 2015, wherein it was held (at Paragraph 59) that:

*"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 transactions against the actual facts which occurred fulfills the statutory conditions. This does not, as I see it, entitle the Courts to treat any transactions 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"*

34. The Respondent submits that its investigations proved that no taxable supplies were made to the Appellant by the suppliers referred to as the "missing traders" with whom they obtained tax invoices and ETR receipts which they used to account for input tax and reduce their income tax liabilities. That as a result, tax shown on the tax invoices for the fictitious sales/purchases were due and payable to the Commissioner as against the Applicants.

35. The Respondent further submits that its investigations had established that there was a fraudulent tax scheme in place within the definition provided in Section 66(4) of the VAT Act. That the Appellant was found to be a beneficiary of the scheme which enabled it to pay little or no VAT at all or carry forward huge liabilities in the of form trade creditors owing to huge input VAT claims from the missing traders.

36. The Respondent also submits that the Appellant had been unable to provide any evidence to show that the goods it had purportedly purchased were actually delivered and later sold to customers.

37. It is the Respondent's assertion that it was well within its mandate to issue the findings of tax investigations against the Appellant and this position is supported by the following provisions of the TPA.

a) Sections 59 of the TPA requires the production of documents and information to enable the Commissioner ascertain tax liability of a person. That the Appellant was, in the course of the investigations, notified and accorded an opportunity to engage with the Respondent's officers but did not cooperate.
b) Section 56 of the TPA places the burden to prove that a tax decision is incorrect on the Appellant.
c) The Appellant's inability and/or failure to produce the requested documents is in violation of Section 93 of the Tax Procedures Act.

**On double taxation**

38. The Appellant submits that it settled the invoices from 6 suppliers including the VAT charged. That this resulted in the input tax used in making taxable supplies for which the Appellant declared output VAT and paid the same to the Respondent. That it also deducted the expenses incurred towards making the profits of the business.

39. The Appellant submits that the Respondent's actions therefore result in double taxation. That tax policy frowns upon double taxation and tax law has been careful to ensure this does not arise.

40. The Appellant also submits that the Respondent breached its right to a fair administrative action as outlined in Article 47(1) of the Constitution which

Article provides that every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.

41. That having confirmed the taxpayer details and PIN legitimacy in iTAx portal, the Appellant had a legitimate expectation that it was trading with genuine tax payers and prays that this expectation be upheld by the Tribunal.

42. It is however the Respondent's submission that:

a) The Appellant has not come with clean hands given that it was on numerous occasions given an opportunity to engage the Respondent and it is therefore not deserving of the orders sought.
b) Tax evasion is a criminal offence under the TPA and the Appellant ought to be prosecuted for entering and participating in a tax evasion scheme.
c) The payment of taxes is a constitutional obligation as provided under Articles 209 and 210 of the Constitution.
d) Section 55 of the TPA provides for Alternate Dispute Resolution ('ADR'), an opportunity that was available for the Appellant to explore outside the Tribunal.

## ISSUES FOR DETERMINATION

43. Having carefully studied the parties' pleadings and all the documents attached to the Appeal and after hearing the submissions, the Tribunal finds that the issues for determination are as follows:-

i. **Whether the Respondent erred in its decision to disallow recovery of Input VAT; and,**
ii. **Whether the Respondent erred in the assessment of additional Corporation Tax.**

## ANALYSIS AND FINDINGS

**i) Whether the Respondent erred in its decision to disallow recovery of Input VAT.**

44. The Respondent submitted that it disallowed the input VAT from the 6 suppliers ("missing traders") on the basis that the purchases are purported to have been supplied by persons investigated by the Respondent and found to be involved in tax fraud scheme of printing and selling the respective invoices without actual supply of goods. According to the Respondent, the Appellant was unable to prove to the satisfaction of the Respondent that indeed it had received the said supplies.

45. The Appellant, on its part, argued that the purchases were genuine and that it had all the supporting documentation to prove the same including invoices, delivery notes and evidence of RTGS payments for the purchases.

46. Section 17 (1) of the VAT Act on input VAT recovery 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.

47. The Tribunal therefore agrees with the Respondent that in order to claim input VAT, there must be a purchase of a taxable supply. It is not enough to have the documentation listed in Section 17 of the VAT Act. The documentation must be supported by an underlying transaction and the taxpayer must furnish proof that there was an actual purchase.

48. 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

49. In **METCASH TRADING LIMITED-VS-COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE AND ANOTHER CASE CCT 3/2000**, the court held that:

> *"..the burden of proving the Commissioner wrong then rests on the vendor under Section 37. Because VA T 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 VA T 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."*

50. Thus, it was upon the Appellant to prove that it indeed purchased the supplies in a bid to discharge this onus. Whereas the Appellant has stated at Paragraph 13 of its submissions that invoices, delivery notes, RTGS payment records and stock records were available to support the purchases, none of these documents were placed before the Tribunal. The Tribunal did not have an opportunity to scrutinize them with a view of establishing whether they supported the Appellant's assertions.

51. In the absence of providing evidentiary records to buttress its case, the Tribunal has no option other than conclude that the Appellant did not discharge its burden of proving that it indeed purchased the said supplies.

52. Accordingly, the Tribunal finds that the Appellant did not furnish sufficient proof of purchase. As such, the Tribunal finds that the Respondent did not err in its decision to disallow input VAT.

**ii) Whether the Respondent erred in the assessment of additional Corporation Tax.**

53. Having found that the claim for input VAT was not allowable, it is the Tribunal's view that the Respondent did not err in assessing the resultant Corporation Tax.

## FINAL DETERMINATION

54. The Tribunal makes the following final 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. 188,319,871.00 is hereby upheld.
    iii. Each party shall bear its own costs.

55. It is so ordered.

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

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**PATRICK LUTTA**
**CHAIRPERSON**

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**HELEN BILA**
**MEMBER**

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**MWAI MBUTHIA**
**MEMBER**

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**ELISHAH NJERU**
**MEMBER**

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**HABON FARAH**
**MEMBER**