

**REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 224 OF 2018**

BAITUL INVESTMENTS LIMITED.....APPELLANT

VERSUS

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

JUDGEMENT

A. BACKGROUND

1. The Appellant is a company incorporated in Kenya. The Appellant's principal business is selling of various electronics, mainly televisions, mobile phones and other assorted items.
2. The Respondent is a principal officer appointed under the Kenya Revenue Authority Act, Cap 469, and is an agency of the Government for the collection and receipt of all 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 in 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 vide letter dated 18th April 2018 issued its tax investigation findings. The Respondent then issued a Notice of Assessment dated 16th May 2018 for Kshs. 438,137,615.00 being principal VAT and Corporation Tax.

4. The Appellant filed a Notice of Objection dated 13th June 2018 contesting the Respondent's Notice of Assessment. The Respondent subsequently issued its Objection Decision on 17th July 2018 confirming the entire assessment.
5. Aggrieved by the Respondent's decision, the Appellant filed a Notice of Appeal on 24th August 2018 and subsequently filed a Memorandum of Appeal on 7th September, 2018.

B. THE APPEAL

6. The Appeal is premised on the following grounds as listed in the Memorandum of Appeal:
 - i. THAT the Respondent erred 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.
 - ii. 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 ITA and supporting sections.
 - iii. 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:
 - i. Validity of the Assessment and Objection Decision.
 - ii. Corporation tax.

iii. Value Added Tax.

iv. Supplier Records.

j) 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 (“TPA”), 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. Article 47 of the Constitution of Kenya, 2010 expressly enshrined in Section 4(3)(d) of the Fair Administrative Action Act, 2015 (“the FAA”), the Appellant argued, makes it 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 stated 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 is also 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 right to be given reasons, the Appellant argued, is part of the rights under the rules of Natural Justice particularly that of fundamental fairness. Further, 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. 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 decision 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.”

15. It was 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 Appellant stated that the Respondent in its Objection Decision against the Appellant failed to state the legal provisions upon which it was issued. Moreover, the Respondent did not address the grounds set out by the Appellant in its Notice of Objection.
16. 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...”*
17. According to the Appellant, that it was evident that the Respondent failed to disclose the substantive legal provision in which it raised both its assessment and the Objection Decision and further, declined to demonstrate how it arrived at the amount indicated in its Objection Decision.
18. The foregoing, the Appellant argues, is a fatal error which the Respondent’s witness, Mr. Wanende, attempted to salvage through his witness statement. The Appellant contends that if at all those are the same reasons for the Objection Decision, then the same should have been set out in the Objection Decision.

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

ii) Corporation tax

20. The Appellant referred to the provisions of Section 15(1) of the Income Tax Act which states that:

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

21. The Appellant explained that it sources its merchandise from its suppliers and sells the same to its customers locally. It incurs the cost of purchasing the merchandise exclusively in the production of its income. The Appellant made reference to the case of **Commissioner of Income Tax v Kencell Communications Limited (Now Airtel Kenya Limited) [2016] eKLR** where Justice Tuiyott stated:

“...21. And it must be said that this is the nature of inquiry that the Indian Tax Appellate Tribunal made in the case of Vodaphone Essar (Gujarat) vs. The Department of Income Tax cited to this Court by Kencell when it held,

“In *Bombay Steam Navigation’s Co, 1953 Ltd’s* case, it was held that the question whether a particular expenditure is revenue expenditure incurred for the purpose of business must be viewed in the larger context of business necessity or expediency. It was held that if the outgoing or expenditure is so related to the carrying on or the conduct of the business, that it may be regarded as an integral part of the profit earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition to the carrying on of the business, the expenditure may be regarded as revenue expenditure. The payment made by the assessee in the present case satisfies this test. The payment is related to the carrying on or of the conduct of the business.”

22. The Appellant submitted that it procured the merchandise from its suppliers and was issued with invoices. It made payment for the merchandise on delivery as evidenced by the invoices, RTGS and delivery notes furnished to the Respondent. Therefore, it had the right to deduct the same as cost of purchases under the above stated Section 15(1) of the Income Tax Act. If anything, the Respondent had not adduced any evidence to the contrary.

Deductibility of Purchases

23. It was the Appellant's assertion that it is standard business practice and in conformity with the law for one to be issued with an invoice and corresponding ETR when making a purchase. The Appellant avers that the invoices and corresponding ETRs were supplied and provided to the Respondent. On cross examination Mr. Wanende, the Respondent's witness, did not challenge the authenticity of those ETR receipts which means the Respondent must have received the output VAT as indicated (and has not volunteered to refund) those sales. Further, that upon delivery of goods, they would, though not invariably be delivered against an acknowledgment and entered into the store card. The Respondent, despite being provided with all those documents, essentially ignored them- convinced that there was a carousel scheme in play.
24. The Appellant insists 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 under Part IX of the Tax Procedures Act - see for example Section 59 of the Tax Procedures Act, it could have (and might have) easily confirmed if those RTGSs were fake. No such evidence was forthcoming and on cross-examination.
25. The Respondent did not at any particular time, the Appellant averred, contest the authenticity of any of the documents. Its witness, Mr. Wanende also accepted that they are authentic. In addition, the Respondent in its Objection Decision, Statement of Facts and Mr. Wanende's statement, did not identify any additional documents it had requested for but was not furnished with by the Appellant.

forcing it to arrive at its rather unjustified and erroneous assessments and Objection Decision.

26. The Appellant submitted that Section 15(1) of the Income Tax Act is applicable to expenditure that has been incurred in the production of the Appellant's income. The Appellant avers 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.
27. The Appellant maintains that it was wrong for the Respondent to claim there were no goods purchased, so as to exclude them from the Appellant's returns while retaining those sales for the alleged non-existent goods as part of the Appellant's revenue when computing the additional Corporation tax. Indeed, if there were no goods purchased in the first place, both the reported proceeds of their sale as well as costs of their purchase must be excluded from the Appellant's declared returns as there were no goods sold. If that is done, then it will be clear that far from fleeing the Exchequer, if the Respondent is to be believed, the Appellant has overpaid Corporation Tax on sales it never made and is entitled to a substantial refund.

iii) Value Added Tax

28. It was the Appellant's assertion 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 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;

“...(1) 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...”

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

- a) The input is incurred by a registered person;
- b) It 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) Input VAT was actually paid (New condition from 30th March 2017)

30. The Appellant insisted that it fulfilled each and all of the conditions of claim and maintained the supporting documentation for the same. The Appellant also avers 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. It subsequently pays VAT on the difference to the Respondent.
31. 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.

iv) Supplier Records

32. It was the Appellant's assertion that it purchased the goods from its suppliers, a fact that the Respondent has acknowledged. Despite confirming that the Appellant did purchase assorted goods from its suppliers the Respondent opted to ignore the same and concluded that the suppliers were non-existent. The Appellant 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.

33. The Appellant also averred that the Respondent failed in its attempt to paint it in bad light. It argues that it was co-operative throughout the investigation exercise and provided the Respondent with all the documents and/or information requested for.
34. According to the Appellant, the basis upon which the Respondent sought to justify its position, even though there is categorical evidence for the purchase of the goods which it has never and does not challenge, 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.
35. 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 assessment, Objection Decision or its own statement of facts as required by the rules Tribunal.
36. If such analysis was the basis of the assessments and Objection Decision, the Appellant argued, they should have been referred to before and shared with it 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 invited the Tribunal to view them askance.
37. 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**

38. According to the Respondent, 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 had failed to do so. 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..."

39. The Appellant also cited **Karshan Limited -vs- Commissioner of Domestic Taxes, TAT No.123 of 2018**, in which it was 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...”

40. The Appellant concluded its submissions by making reference to the Tribunal’s decision in TAT 187 of 2018, **Ukwala Supermarkets -vs- Commissioner of Domestic Taxes** in which it 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 taxpayer 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...”

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

Deduction of Expenses

42. The Appellant cited Section 15(1) of the Income Tax Act which it submitted sets the guiding principle on allowability of expenditure. The Appellant contended that the main point is that only costs incurred wholly and exclusively in production of income of a person is tax deductible. The specific purchases made by the Appellant meet this requirement as they relate to the income of the Appellant. It is on this basis that declared taxable income is produced.
43. It is a set rule of tax law, the Appellant argued, that taxation has to be based on the strict letters of the law and not implied or assumed. To support this the Appellant relied on 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)”*
44. 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.

45. The Appellant further considered under what circumstances can the Respondent transfer or enjoin a taxpayer to the tax obligations of another as hereunder:-

a) Non-transferability and agency taxes

46. 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.

47. 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 vatiable 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.

b) Related Party transactions and Arm's Length Rule

48. The other circumstances relate to anti-avoidance provisions. The Appellant 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.

c) Anti-Avoidance provisions and tax benefits

49. The Appellant was of the view that the more relevant area involves transactions designed to avoid tax. It avers 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.

50. To support its arguments, 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.”

51. The corresponding provision under the Income Tax Act is found under Section 23 which 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.”

52. According to the Appellant, 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.

53. 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 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, 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.

54. The Appellant urged the Tribunal to maintain the same observation as it did in *Tax Appeal No 58 of 2015 Longnot 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."

55. The Appellant argued 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.
56. The Appellant averred that the other points that ought to be considered are as follows:-

Other points to consider:

i) Double Taxation

57. According to the Appellant, 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 output VAT and paid tax to the Respondent.
58. Similarly, the Appellant argued 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 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.

ii) Information relied upon

59. It is the Appellant's assertion that the Respondent did not reveal the basis or detail of the information relied upon contrary to proper tax administration as addresses by the

High Court in the case of *PZ Cussons East Africa Ltd V Kenya Revenue Authority (Petition No 309 of 2012)*. 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.

iii) Taxpayer Rights

60. According to the Appellant, in undertaking the investigations that formed the basis of the assessment, the Respondent, breached the Appellant's right to a fair administrative action as outlined in Article 47(1) of the Constitution of Kenya, 2010. 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 inhuman interrogations and false information passed about the conduct of its business to third parties.
61. The Appellant stated that the Respondent is equipped with wide powers under statute and is also equipped with well trained staff and access to other government resources funded by the taxpayer. If it fails to ensure compliance by a non-filer, then the same cannot be expected from private persons.
62. 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. 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.

Appellant's Prayers.

63. The Appellant therefore 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 VAT Act and that the entire assessment amounting to Kshs. 438,137,615 be set aside;
 - b) The cost of this cause be awarded to the Appellant.

C. RESPONDENT'S CASE

64. In its Statement of Facts and written submissions, the Respondent made the following arguments to support its case:
65. It was 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 is no actual supply or movement of goods and services. The invoices are generated and sold at a fee by the 'missing traders' to existing companies in a racket that also inflates the cost of sales, thereby reducing the tax payable.

66. The Respondent avers that is carried out investigations with a view of establishing whether the Appellant was involved in the VAT fraud scheme and to verify whether input tax claimed by the Appellant were valid and supported.
67. The analysis, according to the Respondent, revealed that the Appellant had purchased goods from the following suppliers: Swala General Stores, Lava Trading, Pemusi Trading, Medina Electronics, Valcom Traders, Zamim Enterprise, Malachi Investments, Aucma Digital Technology Africa Ltd. The Respondent stated however that on checking the returns of the alleged suppliers in the KRA system, there were no corresponding sales to the Appellant by the above-mentioned alleged suppliers. A further analysis on the imports (Customs Simba System) claimed by the Appellant established that entries claimed were imports made by different traders.
68. The Respondent further averred that it wrote to the above-mentioned companies to confirm if they indeed traded with the Appellant. Only one company by the name Malachi Investments responded. However, the company denied having traded with the Appellant.
69. The Respondent then wrote to the Appellant requesting it to provide copies of the invoices from the listed companies. Invoices allegedly from Valcom Traders, Swala General Supplies, Zamin Enterprises Co. Ltd, lava Trading, Pemusi Trading, Medina Electronics and Aucma Digital Technology Africa Ltd. On analysis of the invoices, it was noted that the ETR Z reports attached to the invoices had similar serial number KRA/ETR/10032006, something that was not usual.

70. Following investigations, the Respondent issued an assessment dated 16th May 2018, which the Appellant objected to via letter dated 13th June 2018. In response to the Objection, the Respondent vide its letter dated 20th June 2018 requested purchase ledgers, stock sheets and payment documents in order to process the Objection. The Appellant failed to provide these documents.

71. The Respondent issued its Objection Decision on 17th July 2018 informing the Appellant that its objection was not supported by any relevant documents to show that it indeed purchased and paid for the supplies which it had claimed input on.

72. 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 justified in disallowing the Appellant's input for Value Added Tax (VAT).

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

73. According to the Respondent, the Appellant failed to demonstrate to its satisfaction that it had indeed purchased, paid for and received any supplies. The Respondent sought to rely on Section 51(3) of the Tax Procedures Act, 2015 which states that:

“(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.”

74. According to the Respondent, the Appellant in its objection claimed to have purchased and paid for the supplies. The Appellant claimed that the supplies were delivered and recorded in the purchase daybook. The Appellant further claimed to have been issued with receipts by the suppliers to which payments were effected by way of cash and cheques. The Respondent contends that all these claims were never supported by the Appellant.
75. The Respondent maintains that the Appellant never availed any invoices during its objection. The Appellant however later availed sample invoices, ETR receipts, Form C. 17 B (customs import entry declaration forms). These documents are attached in the witness statement of Eugene Wanende dated 24th November 2020. It is the Respondent's submission that all the documents attached in the witness statement of Eugene Wanende are documents that the Respondent referred to in its Statement of Facts dated 5th October 2018.

76. The Respondent submitted that upon analysis of these documents established the following:

- a) The customs entry declaration forms claimed by the Appellant were actually imports made by different traders as evidenced by the samples attached in the Respondent's witness statement.
- b) An analysis of the copies of invoices and ETR alleged to be from various suppliers showed irregularities in the ETR Z reports attached to the invoices. The ETR Z reports for Pemusi Trading Ltd, Zamin enterprises, Vaicom Traders and Lava Trading Ltd had similar serial no. KRA/ETR/10032006 which is irregular and impossible for more than one company to share the serial number of its ETR machine with another company.
- c) Once the Appellant realized the discrepancies in the ETR Z reports, the remaining invoices and ETR Z reports of suppliers like Medina electronics and Swala general supplies were availed with the ETR reports incomplete.
- d) The Respondent wrote letters to the alleged suppliers of the Appellant requesting for information on whether they traded with the Appellant, but the letters went unresponded to, except Malachi Investments limited who responded on 26th April 2018 denying trading or transacting with the Appellant.

77. Once a tax assessment is issued, the Respondent argued, the burden to prove the assessment as incorrect is on the Appellant as per Section 56(1) of the Tax Procedures Act, 2015 which provides as follows:-

"56. General provisions relating to objections and appeals

(1) In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.”

78. The Respondent insists that the Appellant had failed to discharge this burden.

b) **Whether the Respondent was justified in disallowing the Appellant’s input for Value Added Tax (VAT).**

79. Section 17 of the VAT Act, 2013 requires the Appellant to provide requisite documents whenever an input claim is made. The Section provides:

“Credit for input tax against output tax

(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).”

80. The Respondent avers that the Appellant had failed to avail the documents as stipulated under Section 17(3) of the VAT Act, 2013. It is the Respondent’s position that Section 17(2) of the VAT Act provides that input tax is only deductible when a registered person is in possession of a valid document. The documents availed by the Appellant were invalid and thus could not be used to claim input VAT. The Appellant is also required under Section 59 of the Tax Procedures Act, 2015 to produce records for purposes of ascertaining its tax liability when called upon to do so. Section 59 of the Tax Procedures Act, 2015 provides that:

“(1) For the purposes of obtaining full information in respect of the tax liability of any person or class of persons, or for any other purposes relating to a tax law, the Commissioner or an authorized officer may require any person, by notice in writing, to—

(a) produce for examination, at such time and place as may be specified in the notice, any documents (including in electronic format) that are in the person's custody or under the person's control relating to the tax liability of any person;

(b) furnish information relating to the tax liability of any person in the manner and by the time as specified in the notice; or

(c) attend, at the time and place specified in the notice, for the purpose of giving evidence in respect of any matter or transaction appearing to be relevant to the tax liability of any person.”

81. The Respondent submitted that Section 59 of the Tax Procedures Act gives it powers to request production of records and additional information which can fully satisfy the Commissioner if he is of the view that the information, they have been given is insufficient. The South African Case **Metcash Trading Limited v Commissioner for the South African Revenue Service and Another** reaffirms this position and asserts that the onus and burden of proof is on the taxpayer by submitting all the necessary documentation to support their VAT refund claim. Judge Kriegler states the following in paragraph 22 in his landmark ruling:

“...The prospect of having the Commissioner independently assess both the underlying amount and the VAT that is to be paid thereon must in itself be a powerful disincentive for recalcitrant, dishonest or otherwise remiss vendors. But the compulsive force of this mechanism of the Act goes a good deal further. The dissatisfied vendor can, by lodging an objection under

section 32 of the Act and, that failing, by noting an appeal under section 33 or 33A, both compel the Commissioner to reconsider the assessment and have its correctness reconsidered afresh by an independent tribunal. 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."

82. The Respondent also relied on ***Tax Appeals No. 159 of 2018, Osho Drapers Ltd –vs- Commissioner of Domestic Taxes***, where the Tribunal held in Paragraph 57 that:

"the Tribunal therefore agrees with the Respondent that for one 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”.

83. In Paragraph 59 of the foregoing Judgement, this Tribunal relied on Section 107 of the Evidence Act which states *that “whoever desires any court to give judgement as to any legal right or liability dependent on the existence of facts which he asserts must prove that those facts exist.”*

84. The Respondent therefore asked the Tribunal to take note that the Appellant’s Notice of Objection, as well as Memorandum of Appeal and Statement of Facts failed to disclose the documents relied on by the Appellant in its claim for input VAT.

Input VAT and deduction of costs

85. 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 is 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 has 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. No proof of purchase or costs had been tendered before the Tribunal either.
- x. For this reason, the Respondent did not have any legal basis to allow inputs claimed by the Appellant.

Deduction of Expenses

86. On deduction of expenses, the Respondent submitted that the starting point 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-

(a)...Expenditure or loss which is not wholly and exclusively incurred by him in the production of the income;

- i) 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 had to prove the same to the satisfaction of the Respondent.
- ii) According to the Respondent, 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.

- iii) The tax investigation findings and demand letters to the Appellant were 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.
- iv) This in itself was an opportunity for the Appellant herein to respond to the letters and provide justification before the assessments were issued.
- v) 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."

Alleged transfer of taxpayer obligations

87. Regarding the Appellant's claim of alleged transfer of taxpayer obligations, the Respondent stated as follows:

- 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, 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) The 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 Objection Decision.

88. 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. 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.

89. It was the Respondent's assertion that its investigations proved that no taxable supplies were made to the Appellant by the suppliers referred to as the "missing traders" from whom it obtained tax invoices and ETR receipts which it used to account for its input tax and reduce their income tax liabilities. As a result, tax shown on the tax invoices for the fictitious sales/purchases was due and payable to the Commissioner. The tax was pegged on the principal sum equal to the money paid to the fictitious suppliers for the fictitious purchases. This is based on the fact that no actual purchases were made to act as expenses incurred by the business in furtherance of its activities.

90. 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 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 (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....”

91. According to the Respondent, its investigations revealed that there was a scheme in playing being used for tax evasion purposes by fictitious registered suppliers referred to as ‘missing traders.’ The scheme falls within the definition provided in Section 66(4) of the VAT Act, 2013. The Respondent submitted that from the 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.

92. Further, the Respondent alleged that the Appellant tried to cover up the fictitious transactions by being issued with tax invoices, ETR receipts and further making payments into the bank accounts of the missing traders. The Appellant, however, did not provide any evidence to show that the goods it claims were purchased, were actually delivered and later sold to customers.
93. The Respondent asserts 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 legal procedures.
94. 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.
95. 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.
96. The Respondent avers that to fortify its actions as outlined above, 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.”

97. The Respondent reiterated that it availed the Appellant a chance to satisfy the legal obligation created by **Section 56 of the Tax Procedures Act**. But the Appellant failed in this obligation.

The Respondent's Prayers

98. The Respondent prayed that:
- a) The assessments as issued, being principal VAT and Corporation Tax together with the resultant penalties and interest, is upheld and deemed collectable by the Respondent, from the Appellant.
 - b) The Appeal is dismissed with costs to the Respondent.

D. ISSUES FOR DETERMINATION

99. Having carefully studied the parties' pleadings, witness statements, submissions and all the documents provided and after hearing the submissions by parties, the Tribunal is of the view that the following were the issues for determination:

- a) Whether the Objection Decision was valid.
- b) Whether the Respondent erred in its decision to disallow the input VAT.
- c) Whether the Respondent erred in its decision to disallow purchase costs claimed by the Appellant.

E. ANALYSIS AND FINDINGS

a. Whether the Objection Decision was valid.

100. The Appellant avers that the assessment issued by the Respondent was 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.”

101. A review of the tax investigations findings indicates that the Respondent provided reasons for disallowing the input VAT and costs claimed. It gave the reasons, in its letter of 18th April 2018, 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. The investigations had also revealed that these businesses only print and sell invoices with ETR receipts to various companies as a commission to reduce their tax liabilities. With regard to the imports, the Respondent indicated that the Appellant had claimed imports whose entry numbers did not belong to the company.

102. Reference to these reasons was 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.
103. 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.
104. The grounds of objection set out by the Appellant in the Notice of Objection were:
- a. That it indeed received the goods from the listed traders which were delivered, and receipt recorded in purchase daybook and that invoices from the suppliers are raised and settled after delivery. The goods purchased go into stock and are sold to customers.
 - 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.
 - c. That the documentary evidence for this is outlined in samples of purchase invoices for the period from the suppliers in dispute.
 - d. That it is incorrect that the Appellant is making fictitious input VAT claims. It then asked that the Respondent review the documents submitted in evidence.
105. 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.”

106. 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.
107. 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.
108. The Objection Decision therefore meets the conditions set out under the Tax Procedures Act and is therefore valid.

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

109. 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:-
- i. Whether the Appellant had furnished sufficient proof of purchase and import

- ii. Whether the Appellant's right to claim VAT was affected by the presence of fraud in the supply chain
- iii. Whether the Appellant knew or should have known that there was fraud.

b i) Whether the Appellant had furnished sufficient proof of purchase

- 110. The Respondent stated 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.
- 111. The Respondent also queried imports that were claimed by the Appellant which, according to the Respondent's records were based on entry numbers that did not belong to the Appellant.
- 112. The Respondent avers that it requested the Appellant for information to support the claim for the input VAT and purchase costs as well as documents to support its import entries.
- 113. 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.
- 114. 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.”

115. 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 VAT Act 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.
116. A close 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.
117. The Respondent submitted the documents provided by the Appellant as exhibits supporting its sole witness. In producing these documents, the Respondent

observed that on analysis of the invoices provided, the Respondent noted that the ETR Z reports attached to the invoices had similar serial numbers KRA/ETR/10032006. The Tribunal finds that this is indeed unusual as it is expected that each receipt would have its own serial number. No explanation or justification was given by the Appellant to explain this anomaly in its correspondence with the Respondent and in any of the documents that have been filed before this Tribunal.

118. The Respondent went further to produce a letter from one of the traders (Malachi Investments Limited) who confirmed that they never traded nor transacted any business with the Appellant. Again, the Appellant did not rebut this evidence or provide any clarification.
119. Based on the above, the Tribunal finds that the actions of the Respondent in disregarding the ETRs and supporting document to be reasonable.
120. The Respondent also provided the import entries which the Appellant had claimed import VAT, and which showed clearly that the Appellant was not the person on record. Again, in this instance, the Appellant provided no re-joinder or justification to explain why the imports were in the names of other persons or to even provide evidence that it indeed imported the goods that it claimed import VAT albeit under different entry numbers.
121. 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. Only upon establishing a prima facie case does the burden then shift to the Respondent. Thus, it was upon the Appellant to furnish the Respondent with evidence to prove its

case. This was the finding in **McMillan v. Canada 2012 FCA 126** where the Court of Appeal held that:

“In our respectful view, it is settled law that the initial onus on an appellant taxpayer is to “demolish” the Minister’s assumptions in the assessment. This initial onus of “demolishing” the Minister’s assumptions is met where the taxpayer makes out at least a prima facie case. Once the taxpayer shows a prima facie case, the burden is on the Minister to prove, on a balance of probabilities, that the assumptions were correct.”

122. The same position was held by the court in ***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.”

123. By adducing the documentation, the Appellant established a prima facie case. However, the Respondent on its part was able to counter the evidence adduced. It showed that the serial numbers in the ETRs provided were unusual since they had the same number despite being from different vendors. Similarly, it adduced evidence showing that the Appellant was not the person on record on the import documents. Finally, it adduced a letter from one of the suppliers who indicated that it had never traded with the Appellant. From the foregoing, it is the Tribunal's view that the Respondent provided documentary evidence to counter the Appellant's averments regarding documentation. At this point the burden of proof shifted back to the Appellant to prove that it indeed made any purchases from the suppliers and also imported the goods.
124. At this point the Tribunal found it appropriate to cite the provisions of Section 107 of the Evidence Act which provides that: *Whoever desires any court to give judgment as to any legal right or liability dependent on the existence of facts which he asserts must prove that those facts exist.* It was therefore the Appellant who bore the burden of providing evidence that proves that the assertions made by the Respondent in its assessment and Objection Decision were incorrect.
125. 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.
126. It is also the Tribunal's view that the Respondent's request for documentation was not unreasonable or unjustified in the circumstances.

127. 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.

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

128. 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 his transactions were part of a fraudulent scheme is rendered moot.

129. 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.

c) Whether the Respondent erred in its decision to disallow purchase costs claimed by the Appellant.

130. Similarly, with regard to purchase costs under the Income Tax Act, Section 15(1) as read with Section 16(1) of the Income Tax Act only permit expenses and losses that are wholly and exclusively incurred in the production of income, to be deducted as allowable expenses. The costs must be incurred in order to be

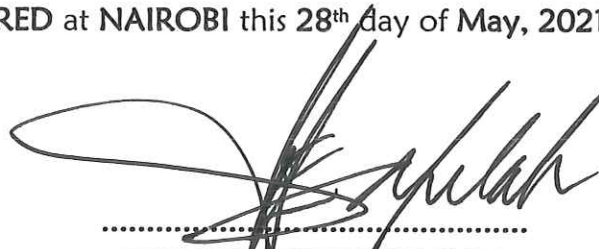
deducted in determining the taxable profits and indeed, the burden of proving that the expenditure was actually incurred lies with the taxpayer.

131. The Appellant did not provide the required proof. It did not provide any documentation to show that it actually purchased and imported the goods in question. It merely made averments that its purchases were real. Unfortunately, averments are not enough to discharge its burden.
132. Thus, we find that the Appellant failed to discharge its burden of proving that it incurred the costs it claimed.
133. Accordingly, the Tribunal therefore finds that the Respondent did not err in its decision to disallow purchase costs claimed by the Appellant.

F. FINAL DECISION

134. Based on the forgoing analysis, the Appeal is dismissed, and the Tribunal makes the following Orders:-
 - i. The Objection Decision dated 17th July 2018 confirming the assessment of the sum of Kshs. 438,137,615.00 is hereby upheld.
 - ii. Each party to bear its costs.
135. It is so ordered.

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



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ERIC NYONGESA WAFULA
CHAIRPERSON



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GABRIEL M. KITENGA
MEMBER



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CATHERINE N. MUTAVA
MEMBER



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ABRAHAM K. KIPROTICH
MEMBER

TAT