**REPUBLIC OF KENYA**
**IN THE TAX APPEALS TRIBUNAL**
**APPEAL NO. 162 OF 2021**

**GITHIMA LIMITED.....................................................................APPELLANT**

**VERSUS**

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

# JUDGMENT

## BACKGROUND

1. The Appellant is a limited liability company incorporated in Kenya and engaged in property rental business and investment related activities.

2. The Respondent is a principal officer appointed under the Kenya Revenue Authority Act, Cap 469 of the laws of Kenya. Under Section 5 (1) the Kenya Revenue Authority 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 functions 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 purpose of assessing, collecting and accounting for all revenues in accordance with those laws.

3. Vide a letter dated 22nd May 2020, the Respondent issued the Appellant with a notice requesting the Appellant to provide various information and records.

4. The Appellant complied and engaged in discussion with the Respondent. Subsequently the Respondent through a letter dated 7th September 2020

issued the Appellant with a notice of assessment pursuant to Section 31 of the Tax Procedures Act 2015 (TPA 2015). In this notice, the Respondent;

a. Disallowed the following expense on the basis that it could not be related to the Appellant's property rental business;

   i. Interest expense of Kshs. 76,876,450 for the years 2016 to 2019;

   ii. Miscellaneous expenses of Kshs. 4,670,103 for the year 2019;

   iii. Bank charges of Kshs. 8,255,374 for the year 2019;

   iv. Other expense of Kshs. 1,163,375 for the year 2018; and

   v. Cost of sales of Kshs. 3,197,601 for the year 2017;
   An added the above expenses to the Appellant's income tax computation and computed corporation tax on the disallowed at the rate of 30%.

b. Deemed a dividend distribution of Kshs. 271,221,710 being 80% of the Appellant's retained earnings of Kshs. 339,027,137 and computed withholding tax of Kshs. 13,561,085; and

c. Alleged that the Appellant had current withholding vat credits of Kshs. 1,556,598 for February 2020 which translates to undeclared sales of Kshs. 67,094,741 and therefore computed VAT of Kshs. 10,735,159 (at the rate of 16% of Kshs. 67,094,741).

5. Aggrieved by the demand in the notice of assessment, the Appellant lodged a notice of objection vide a letter dated 7th October 2020.

6. Thereafter, the Respondent through an email sent on 5th November 2020 requested the Appellant for additional information, particularly the;

   a. Appellant's audited accounts for the period under review (2016-2019);

   b. The loan agreement between the Appellant and Equity Bank Limited for the loan of Kshs. 350,000,000;

   c. A schedule of all the properties owned by the Appellant setting out the year of acquisition, cost of acquisition and the physical location; and

   d. Information on the Appellant's investment in shares including information on the period of investment.

7. In line with the request, the Appellant provided the additional information through an email sent on 26th November 2020.

8. Vide an email sent on 8th December 2020, the Respondent confirmed to the Appellant that its objection was under review and invited the Appellant for a meeting to discuss the contested issues in the objection.

9. The Appellant in an email dated 10th December 2020 confirmed its willingness to meet with the Respondent and requested the Respondent to inform the Appellant of areas in need of clarification ahead of the meeting.

10. The Respondent in an email sent on 11th December 2020 forwarded to the Appellant a document setting out the Respondent's responses on the contested issues in the objection to guide the discussion during the meeting between the Appellant and the Respondent.

11. On 15th December 2020, the Appellant and the Respondent held their first consultative meeting. During the meeting the Respondent confided that the written responses sent by the Respondent via email on the 11th December 2020 was not an objection decision as provided for under Section 51 (9) of the TPA but rather was an overview of the Respondent's position on the contested issues in the Appellant's objection that was under review. Following this meeting it was agreed that the Appellant would further review the Respondent's position on the contested issues and get back to the Respondent.

12. Subsequently on 18th January 2021, the Appellant and the Respondent had a follow up meeting during which it was agreed that the Appellant would get back to the Respondent with additional information on the Withholding Vat issue.

13. On 19th January 2021, the Appellant through its Advocates on record, Anjarwalla & Khanna LLP sent the Respondent an email with additional information and explanation on the Withholding Vat issue including Equity Bank Limited's confirmation of the invoices issued by the Appellant for the rent relating to the period of 1st January 2017 to 31st December 2019.

14. Vide an email sent on 21st January 2021, the Respondent forwarded to the Appellant a summary of the Respondent's position following the Respondent's review of the objection and the additional information provided by the Appellant and confirmed that the Respondent would make the applicable tax adjustment in line with the findings set out in this summary.

15. On 27th January 2021, the Respondent issued the Appellant with another notice of assessment demanding taxes for the same period under review in the initial notice of assessment sent on 7th September 2020 (2016 to 2019).

16. Subsequently, the Respondent issued the Appellant with a tax demand on 10th February 2021 demanding payment of alleged outstanding principal taxes of Kshs. 52,753,812.00 within 14 days of the demand, failure to which the Respondent would take enforcement measures.

17. The Appellant responded to the demand on 18th February 2021 informing the Respondent that the Appellant was yet to be issued with an objection decision as required under Section 51 (8) and (9) of the TPA and therefore the Respondent should withdraw the notice of assessment and tax demand and issue the Appellant with an objection decision.

18. Vide an email correspondence the Respondent on 23rd February 2021 issued the Appellant with an objection decision dated 22nd February 2021 demanding payment of Kshs. 53,635,115.

19. The Appellant being dissatisfied with the Respondent's objection decision notified the Tribunal of its intention to appeal against the said decision vide a notice of appeal dated 24th March 2021.

## APPEAL

20. The Appellant filed its Memorandum of Appeal dated 7th April 2021 and challenges the Commissioner's decision of 10th March 2021 on the following grounds;

21. The Respondent's objection decision dated 22nd February 2021 is not a valid tax decision as provided for under Section 51 (10) of the Tax Procedures Act, 2015 (TPA).

    a. The Respondent's decision to disallow expenses wholly and exclusively incurred in the generation of taxable income is

contrary to the provisions of Section 15 of the Income Tax Act, Cap 470 of the Laws of Kenya (ITA).

b. The Respondent's decision to deem a dividend distribution is erroneous and contrary to the provisions of Section 24 of the ITA; and

c. The Respondent's decision to assess additional VAT in relation to the VAT withheld by an appointed withholding VAT agent is erroneous and contrary to the provisions of Section 42A of the TPA.

22. In line with the above grounds of appeal, the Appellant prayed as follows;

a. That a declaration that the Respondent's objection decision contained in the letter of 22nd March 2021 is invalid as it contravenes clear provisions of Section 51 (10) of the TPA and the tax demand of Kshs. 52,753,115 contained in the Respondent's objection decision dated 22nd March 2021 be vacated in its entirety.

b. In the alternative a declaration that;

i. The Respondent's decision to disallow deduction of expenses wholly and exclusively incurred in the generation of taxable income is erroneous and contravenes Section 15 (1) of the ITA;

ii. The Respondent's decision to deem a dividend distribution is erroneous and contravenes the provisions of Section 24 (1) of the ITA; and

iii. The Respondent's decision to assess additional Vat in relation to Vat withheld by an appointed withholding Vat agent is erroneous and contrary to the provisions of Section 42 A of the TPA.

c. The Appeal be allowed with costs to the Appellant; and

d. Any other orders that the Honorable Tribunal may deem fit.

23. In response to the above grounds of Appeal the Respondent filed his Statement of Facts on 17th June 2021 and contends as follows;

a. The Respondent avers that the provisions of Section 51 (10) of the TPA 2015 direct that an objection decision shall include a statement of findings on the material facts and the reasons for the decision. The Respondent asserts that the correspondence culminating into the issuances of the objection decision informed the Appellant of the information it needed to produce and further the reasons for the disallowance of the information that was provided, equally the notices and objection decisions were issued in conformity with Section 78 of the TPA 2015 that directs that tax demand notice shall not be deemed erroneous by reason that the provisions of the tax law under which it was made or issued have not been complied with. Further that it cannot be dismissed for lack of conformity on form and lastly shall not be effected by reason of any mistake, defect or omission therein.

b. The Respondent states that the provisions of Section 15 of the ITA gives directions on expenditure that is legally deductible in the computation of a taxpayer's income in the particular year of income. That for deduction to be allowed, the same ought to

have been incurred wholly and exclusively in the production of such an income. The Appellant's assertion were not supported with material facts and or information /documentation hence the disallowance. Equally the Appellant never complied with the provisions of Section 15 (7) (a), (c) & (e) of the ITA.

c. The provisions of Section 24 of the Income Tax Act directs that where a taxpayer/company has not distributed to its shareholders as dividends within a reasonable period, not exceeding twelve months after the end of its accounting period such part of its income for that period which could be so distributed without prejudice to the requirements of the company's business, he may direct that that part of the income of the company be treated for the purposes of this Act as having been distributed as a dividend to the shareholders in accordance with their respective interest and shall be deemed to have been paid on a date twelve months after the end of that accounting period. The Respondent thus avers that is actions were well placed within the confines of the law and that specific provision.

d. The tax payment and declaration is an individualized legal obligation. Equally the provisions of the said Section does not then relieve the Appellant from disclosing or accounting for tax in accordance with the VAT Act 2013 and the Regulations thereunder.

e. Vide Section 23 of the TPA 2015 the Appellant is legally obligated to keep a record and maintain any document required under a tax law so as to enable the person's tax liability to be readily ascertained. That the Appellant was not able to provide the said

documentation even after requested and specifically directed to which documentation was require to be able to discharge its tax burden.

f. That equally the directions of Section 30 of the VAT Act 2013, the Appellant is statutorily obligated to keep a record of its transaction and further that the Respondent is empowered to be supplied with this information on request at any point.

g. The Appellant's claims were not sufficiently proven as per Section 56 of the TPA 2015 as the burden of proof in discharge of a tax claim is always on the taxpayer.

24. On the premise of its averments, the Respondent prayed that this Honorable Tribunal to find and hold this appeal to be without merit and the same be dismissed with costs to the Respondent.

## PARTIES' SUBMISSIONS

### Appellant's Submissions

25. In its written submissions, the Appellant framed the following issues for our determination;

a. The Respondent's Objection Decision is not a valid tax decision as provided for under Section 51(10) of the Tax Procedures Act, 2015;

b. The Respondent's decision to disallow expenses wholly and exclusively incurred in the generation of taxable income is contrary to the provisions of Section 15 of the Income Tax Act, Cap 470 of the Laws of Kenya;

c. The Respondent's decision to deem a dividend distribution is erroneous and contrary to the provisions of Section 24 of the ITA; and

d. The Respondent's decision to assess additional VAT in relation to VAT withheld by an appointed withholding VAT agent is erroneous and contrary to the provisions of Section 42a of the TPA.

26. On the first issue, the Appellant submitted that the Respondent's Objection Decision is not a valid objection decision as envisaged under Section 51(10) of the TPA as it did not include a statement of findings on all material facts and neither did the Respondent give reasons for its decision. Section 51(10) of the TPA, which is couched in mandatory terms, provides that the Commissioner's objection decision shall include a **statement of findings on the material facts** and the **reasons for the decision.**

27. The Appellant avers that having lodged a valid Objection, the Respondent's Objection Decision failed to comply with the requirements of Section 51(10) of the TPA and Sections 4(2) and 6(1) and (2) of the FAAA on the following basis; it did not include a statement of findings on all the material facts, and it did not give reasons for the Respondent's decision but rather just stated the tax demand tax.

28. It was submitted for the Appellant that in the Respondent's responses shared on 11th December, 2020 and the summary sent on 21st January 2021 (the Respondent's Responses), the Respondent had attempted to explain its position on some but not all of contested tax issues. However, the Respondent confirmed that the Respondent's Responses were not an objection decision. This was also confirmed by the fact that the Respondent subsequently issued its formal Objection Decision on 22nd February 2021.

29. It was further submitted for the Appellant that the Respondent's Objection Decision only demanded the taxes due without giving reasons for demanding such taxes. This is despite the Appellant's Objection which elaborately discussed the issues in dispute and reasons for its position. The Appellant buttressed its arguments with the Tribunal's decision in ***Tax Appeals No. 50 of 2017, Local Productions Kenya Limited -vs- The Commissioner of Domestic taxes*** wherein the Tribunal upheld the need for giving reasons on the part of the Respondent. It was relied on the High Court decision in **Richard Bonham Safaris Limited Vs Commissioner of Income Tax [2006] eKLR** where the court stated as follows;

> *"In the absence of reasons...how is the aggrieved party supposed to know the grounds of the decision and assess his position before exercising his right of appeal? Without reasons...it is not harsh to say that the right of a party who wishes to challenge the assessment of the tax due from him is arbitrarily taken away."*

30. On the second issue, the Appellant averred that that the Respondent's decision to disallow expenses wholly and exclusively incurred in the generation of taxable income is contrary to the provisions of Section 15 of the Income Tax Act, Cap 470 of the Laws of Kenya (the **ITA**). That the said Section 15 of the ITA is couched in mandatory terms.

31. The Appellant submitted that interest expense disallowed for the years 2016 to 2019 relates to a bank loan of KES 350,000,000.00 taken by the Appellant from Equity Bank Limited (**Equity Bank**) in December 2015 and was directly used to refinance acquisition of Appellant's properties. The Appellant owns several properties, of particular interest being the Naivasha Properties (LR No 9247/5 and LR No 19964/5) purchased for KES

121,380,220.00 and the Mombasa Properties (MSA/Block XIX/266 and 267) purchased for KES 256,656,665.00.

32. The initial purchase of the properties was financed using a loan of KES 378,036,885.00 (being the total purchase price for the Properties) from the Appellant's directors. In December 2015, the Appellant resolved to refinance the directors' loan used in acquisition of the properties using a loan from Equity Bank, which had offered the Appellant a term loan of KES 350,000,000.00. The Appellant, acting through its board of directors passed a resolution on 1st December 2015; approving the terms of the loan from Equity Bank, and confirming that the loan should be used to refinance the acquisition costs of the Naivasha and Mombasa properties.

33. In compliance with the terms of the directors' resolution, the Appellant entered into a short term loan agreement with Equity Bank dated 10th December 2015. The loan facility was KES 350,000,000.00 for a term of five (5) months and the purpose of the loan was to finance purchase of the property. After the lapse of the term of the Short Term Loan Agreement (which was five (5) months), the Appellant entered into a refinancing loan agreement with Equity Bank Limited dated 26th May 2016 to refinance the Short Term Loan Agreement. The loan facility was KES 350,000,000.00 for a term of sixty (60) months (5 years) and the purpose of the loan was to refinance the existing Short Term Loan Agreement.

34. The **total interest cost** on the Loan from Equity Bank for the years 2016 to 2019 was **KES 112,326,335.** In line with the provisions of Section 15(1) and (3) the Appellant in computing its taxable income, **only** deducted **KES 77,023,773** being the **interest expense on the portion of the Loan from Equity Bank relating to the Mombasa Properties** which are the properties used in generating rental income subject to tax. The Appellant capitalised

the balance interest cost of KES 35,302,562.43 (i.e. 31.5%) for the portion of the Loan relating to the Naivasha Properties.

35. The Appellant further submitted that the Respondent in its Statement of Facts alleges that the interest expense is not deductible as the loan from Equity Bank was not wholly and exclusively used in the generation of the rental income but was instead used to finance acquisition of the investment shares held by the Appellant. That the Appellant does not dispute the Respondent's allegation that the Appellant made an investment in shares in 2015. However, contrary to the Respondent's allegation, the acquisition of these shares was financed using a separate loan from the Appellant's directors and not using the loan from Equity Bank.

36. The fact that acquisition of the investment shares was financed using a directors' loan advanced to the company is evidenced by the fact that, as at December 2014, the Appellant had an outstanding loan of KES 404,814,191.00. However, in the course of 2015 the Appellant's directors advanced the Appellant and additional directors' loan of KES 1,444,975,618.00 which totalled to KES 1,849,789,809.00 which was sufficient to finance the acquisition cost of the investment shares which was **KES 1,814,128,066.00.** The cost of acquisition of the shares of KES 1,814,128, 066.00 was well in excess of the Loan of KES 350,000,000.00 from Equity Bank.

37. With regards to the bank charges disallowed in 2019, the Appellant submitted that the Respondent in his objection decision alleged that the Appellant deducted bank charges expense of Kshs. 8,255,374.00 as an allowable expense in computing its taxable income for the year 2019. However, as evidenced in the Appellant's tax computation for the year 2019, the Appellant only deducted bank charges of Kshs, 55,374.00 as an

allowable expense which related to the upkeep and maintenance of the Appellant's investment properties and which expense was wholly and exclusively incurred in the production of the Appellant's taxable income a required under Section 15 (1) of the ITA. The balance of Kshs. 8,200,000.00 was disallowed in the Appellant's tax computation for 2019.

38. On the miscellaneous expenses for the year 2019, the Appellant referred to the explanation it gave in its objection notice, that a significant portion of the disallowed expenses in 2019 as contained in the Respondent's notice of assessment were already disallowed in the Appellant's tax computation for 2019 and were not deducted as allowable expenses in computing the Appellant's taxable income. The Appellant only deducted a total of Kshs. 855,996.00 as an allowable expense for both miscellaneous expenses and bank charges expenses. The Appellant only deducted KES 800,622.00 as an allowable miscellaneous expense in computing its taxable income, which amount was rightfully deducted as it relates to the upkeep and maintenance of the Appellant's properties and which expense was wholly and exclusively incurred in the production of the Appellant's taxable income as required under Section 15(1) of the ITA.

39. The Appellant also submitted in the cost of sales disallowed for the year 2017 and submitted that it explained that the disallowed cost of sales of KES 3,197,601.00 relates to the expenses incurred by the Appellant in the upkeep and maintenance of the Appellant's properties. In his objection decision, the Respondent allowed deduction of the expenses of **KES 562,309.00** relating to the Mombasa Property reducing the disallowed expense from **KES 3,197,601.00** to **KES 2,635,292.00**. The cost of sales of KES 2,635,292.00 which the Respondent has disallowed relate to land rent and utility expenses (security and garbage) incurred by the Appellant on its Naivasha Properties, Vipingo Property and Shanzu Property.

40. It was the Appellant's submission that the cost of sales of Kshs. 2,635,292.00 relates to the upkeep and maintenance of the Appellant's properties and were wholly and exclusively incurred in the production of the Appellant's taxable income pursuant to section 15(1) of the ITA and should therefore not be disallowed.

41. With respects to the issue of double taxation occasioned by the Respondent's treatment of the expenses the Appellant in its 2019 tax computation had already disallowed bank charges of KES 8,200,000.00 and similarly in the 2018 tax computation, the Appellant had already disallowed work permit expenses worth KES 400,450.00. The Respondent in its Objection Decision has added back these amounts and subjected them to corporation tax at the rate of 30%. This results in double taxation, as the bank charges and work permit expenses had already been disallowed in computing the Appellant's taxable income for 2018 and 2019, and the amounts had therefore been subjected to Corporation tax. For this position, the Appellant relied on the High Court case of ***Keroche Industries Limited v Kenya Revenue Authority and 5 others [2007] eKLR.***

42. On the third issue for determination, that is the Respondent's decision to deem a dividend distribution, the Appellant as of 31st December 2019, the Appellant had retained earnings of Kshs. 339,027,137.00. The Respondent has deemed a dividend distribution of Kshs. 271,221,710.00 being 80%of the Appellant's retained earnings and computed withholding tax of Kshs. 13,561,085.00 at the rate of 5% on the deemed dividend declaration.

43. In the above regard, it was the Appellant's submission that the Respondent has deemed a dividend distribution contrary to the provisions of Section 24(1) of the ITA. Based on Section 24(1) of the ITA, the Commissioner in exercising his power can only deem a dividend distribution where the

distribution of the retained earnings **will not prejudice** the requirements of the company's business. The Appellant buttressed its submission with the High Court holding in **Oceanfreight (E.A) Limited v the Commissioner of Domestic Taxes [2020] eKLR** (the **Oceanfreight Case**) where the High Court in interpreting Section 24 (1) of the ITA held that the purpose of this Section is to ensure that non-distribution of dividends that would in ordinary circumstances be distributable is not used for avoidance of tax liability. The High Court further held that the **Commissioner cannot deem dividends if it will prejudice or negatively affect the requirements of the taxpayer's business.**

44. It was the Appellant's submission that Appellant submits that it did not distribute its retained earnings as distribution of such earnings would prejudice the Appellant's business operations and affect business continuity. This is particularly based on the fact that as at 31st December 2019, the Appellant had significant **outstanding loans of KES 2,010,177,663.00** which was used to finance development of the Appellant's rental property and acquisition of the Appellant's income generating assets.

45. The Appellant further submitted that the power to recommend declaration of dividends lies with the directors as set out in Section 654 (3) of the Companies Act, 2015 (General requirements for contents of directors' report) which provides that: except in the case of a company that is subject to the small companies' regime, the directors shall specify in the report, amount (if any) that the directors recommend should be paid as a dividend. Section 654 (3) of the Companies Act is couched in mandatory terms and therefore, a company can only pay out dividends where the directors recommend declaration of a dividend. Where director do not make a recommendation for declaration of a dividend, then the company shall not distribute dividends.

46. Additionally, the Appellant asserts that the Respondent's decision to deem a dividend distribution of 80% of the Appellant's retained earnings is erroneous and contravenes the provisions of Section 24(1) of the ITA which provides that the Respondent can only deem a dividend distribution on the part of a taxpayer's income for that period which could be so distributed without prejudice to the requirements of the company's business. Given the Appellant's outstanding loan liability of KES 2,010,177,663.00 deeming a dividend distribution of 80% of the Appellant's retained earnings will negatively prejudice the Appellant's business.

47. The fourth issue for determination concerns the Respondent's decision to assess Value Added Tax (vat) withheld by an appointed withholding Vat agent under Section 42 A of the Tax Procedures Act 2015. On this issue, the Appellant submitted that withholding VAT rate was previously 6%, but following enactment of the Finance Act, 2019, which became effective on 7th November 2019, it was reduced to 2%. This is supplemented by the provision of Section 42A (4B) of the TPA which provides that the tax withheld under this Section shall be remitted to the Commissioner on or before the 20th day of the month following the month in which the deduction is made.

48. Flowing from the above submissions, the Appellant submitted that it is evident that where a withholding VAT agent withholds VAT but fails to remit the same to the KRA on the due date, the liability is on the withholding VAT agent and not on the taxpayer. It was further submitted that the Appellant is in the business of leasing out rental property and has leased commercial property (which is subject to VAT) to Equity Bank. Equity Bank has been appointed a withholding VAT agent by the KRA and is therefore required to withhold and remit VAT to the KRA on purchasing taxable supplies.

49. It was the Appellant's submission that pursuant to the terms of the lease agreement between Equity Bank and the Appellant, rent on the leased commercial properties was payable on a quarterly basis. Equity Bank as an appointed withholding VAT agent withholds VAT on the VAT charged on the quarterly lease payments billed by the Appellant in the rental invoices in respect of the commercial premises. That in February 2020, Equity Bank remitted to KRA withholding VAT of KES 1,556,598.00 in respect of the Appellant. The Respondent alleges that the KES 1,556,598 is current VAT interpreting it to mean that the Appellant has under declared sales of KES 76,829,880.00 and the VAT payable on the undeclared sales is KES 12,292,781.00. This was confirmed on 18th January 2021 by Equity Bank that the summary provided was a true reflection of all invoices issued by the Appellant from January 2017 to October 2019, and of the withholding VAT deducted.

50. In addition to the foregoing, it was the Appellant's further submission that Section 42 A (4) of the TPA provides that: f*or the avoidance of doubt, the withholding of tax under subsection (1) shall not relive the supplier of taxable supplies of the obligation to account for tax in accordance with this Act and the regulations.* The Appellant as required under Section 42A (4) of the TPA always accounted for the output VAT charged on the rental invoices to Equity Bank in the appropriate monthly VAT returns.

## Respondent's Submissions

The Respondent filed his submission on 21st December 2021 and framed three issues for determination, namely; whether the Respondent lawfully disallowed expenses not in compliances with Sections 15 and 16 of the Income Tax Act, whether the objection decision was within the mandates of Section 51 of the

Tax Procedures Act, and whether the Appellant has discharged its burden of proof.

51. On the first issue, the Respondent in relying on the provisions of Sections 15 and 16 of the Income Tax Act (hereinafter ITA) submitted that the Appellant, did not demonstrate that the expenses disallowed by the Commissioner were wholly used in the generation of that income and for that reason, the Commissioner disallowed the expenses. That it did not provide full details of where the shares were invested in order to ascertain among other things the relationship between the investment portfolio and the registered business activities with regard to the total incomes.

52. The Respondent averred that Section of the Income Tax Act, Cap 470 on the chargeability of tax in relation to business income. This is due to the fact that the taxpayer generated or earned income from the business operations liable to tax and so it was imperative to ensure that the amounts declared for tax purposes are proportional to the income generated.

53. With regard to the second issue, it was submitted for the Commission that the Respondent gave the Appellant a detailed explanation of the reasons and the manner in which the assessment was arrived at and the Respondent invites the Honourable Tribunal to read the assessment and the objection decision. In this regard, the Respondent relied on the provisions of Section 78 of the TPA which stipulates as follows;

> *"When a notice of assessments or any other document purporting to be made, issued, or executed under a tax law is, in substance and effect, in conformity with, is consistent with the intent and meaning of, the tax law under which it has been made and the person assessed, intended to be assessed, or affected by the document, is designated in it according to common intent and understanding-*

*a) The validity of the notice of assessment or other document is not affected by reason that any of the provisions of the tax law under which it has been made or issued have not been compiled with:*

*b) The notice of assessment or other document shall not be quashed or deemed to be void or voidable for want of form; and*

*c) The notice of assessment or other document shall not be affected by reason of any mistake, defect, or omission therein. (2) an assessment shall not be impeached or affected by reason of a mistake.*

*Whether the Respondent lawfully assessed the Appellant under Section 42 of the Income Tax Act."*

54. It was averred that the Respondent acted within the powers conferred by the provisions of Section 42 after the Commissioner established that there was no dividend distribution within a reasonable time, not exceeding twelve months after the end of the accounting period for the years under review. Section 42A (4) of the Income Tax Act which does not relieve the supplier, in this case the Appellant from the liability to account for tax within the operation withholding tax arrangement.

55. With regard to the third and final issue, it was submitted for the Commissioner that Section 56(1) of the Tax Procedures Act as read with Section 30 of the Tax Appeals Tribunal Act, 2013 place the burden on the taxpayer to prove that a tax decision is incorrect. In this particular case, the Appellant's objection was a mere statement and without evidence to back it up, and the Respondent had no other option than to confirm the

assessments. In this particular case, the Appellant has not proved that the tax decision should not have been made or should have been made differently. The Appellant has the burden of proofing that the decision of the Respondent is wrong. This can be done by providing documents that prove its case.

56. It was the Commissioner's averment that in this case, the Appellant has not provided any documentation to support the position that the expenses were used in the generation of income and how the loans to the directors were used. It follows consequently that it is upon the taxpayer to discharge this burden and where the burden is not discharged to the required standard, then the Taxpayer must pay the assessed tax. It was therefore incumbent upon the Appellant to prove that the tax amount imposed by the Respondent was incorrect.

57. For the above position, the Respondent buttressed his argument with the holding of Mary J Kasongo in **Sheria Sacco Society Limited V Commissioner of Domestic Taxes (2019) eKLR,** wherein she stated;

> ***" The SACCO however needs to appreciate that what the Tribunal was dealing with was an appeal against the commissioners confirming notice that the SACCO had taxes to pay. When one appreciates that then the submissions of the Commissioner, under this head, are correct that the burden of proof lay on the Sacco. This is what is provided under section 30(B) of Tax Appeal Tribunal Act cap 40. That section provides; in a proceeding before the tribunal, the Appellant has the burden of proving-***
>
> ***A. Where an appeal relates to an assessment, that the assessment is excessive; or***

***B. In any other case, that the tax decision should not have been made or should have been made differently.***

***The SACCO did not meet that burden of proof"***

58. The Respondent similarly relied on the oft cited Australian case of ***Mulheim v Commissioner of Taxation (2013) FCAFC 115*** where the full Federal Court of Australia (FFC) affirmed the critical need for supporting evidence in tax disputes, and emphasized that;

> "*Taxpayer must satisfy the burden of proof to successfully challenge income tax assessments. The FFC held that it is not enough for a taxpayer to simply demonstrate that the assessment issued by the Commissioner is incorrect. Rather, the onus is on the taxpayer in proving that an assessment issued by the Commissioner is excessive can only be discharged by the taxpayer by adducing positive evidence which demonstrates the taxable income on which tax ought to have been levied. That onus requires the taxpayer to positively prove his or her actual taxable income and in doing so, must show that the amount of money for which tax is levied by the assessment exceed the actual substantive liability of the taxpayer. From* ***Pierson v Belder (H.M. inspector of Taxes) (1956-1960) 38 TC 387*** *to be instructive; but the matter may be disposed of, I think even more shortly in this way: there is an assessment made by the additional Commissioner upon the Appellant; it is perfectly clearly settled by cases such as in the case of* **Norman v Golder 26 T.C. 293,** *that the onus is upon the appellant to show that the assessment made upon him is excessive or incorrect; and of course he has completely failed to do so. That*

*is sufficient to dispose of the Appeal, which is I accordingly dismiss with costs.*

## ISSUES FOR DETERMINATION

59. Having carefully reviewed the parties' pleadings, the evidence adduced, the submissions and authorities in support thereof, the Tribunal finds that the following issues fall for its determination;

    i. *Whether the Respondent's objection decision dated 22nd February, 2021 is valid in light of the provisions of Section 51 (10) of the Tax Procedures Act 2015*

    ii. *Whether the Respondent disallowed the expenses of the Appellant in accordance with Section 15 of the Income Tax Act*

    iii. *Whether the Respondent's decision to deem dividend distribution contravenes the provisions of Section 24 of the Income Tax Act, Cap 470 of the Laws of Kenya*

    iv. *Whether the Respondent erred in assessing Withholding Value Added tax on the Appellant in relation to VAT withheld by an appointed withholding Vat agent*

## ANALYSIS

### *i. Whether the Respondent's objection decision dated 22nd February 2021 is valid in light of the provisions of section 51 (10) of the Tax Procedures Act, 2015*

60. The Appellant has challenged the Commissioner's objection decision for failing to comply with the provisions of Article 47 of the Constitution, 2010, Section 51 (10) of the TPA and Sections 4(2) and 6(1) and (2) of the

Fair Administrative Action Act, 2015. Substantially, the Appellant's claim is that the objection decision did not have a statement of findings on the material facts neither did give reasons for the decision.

61. In refuting this assertion, the Commissioner submitted that the correspondences culminating into the issuance of the objection decision informed the Appellant of the information it needed to produce and further, the reasons for disallowance of the information that was provided. The Commissioner relied on Section 78 of the TPA 2015 to buttress his position and argued that this Section directs that the tax demand notice shall not be deemed erroneous by reason that the provisions of the tax law under which it has been made or issued have not been complied with.

62. In the above premise, it would be prudent to first reproduce the relevant Sections of the law as relied upon by the Appellant. Article 47(2) of the Constitution stipulates that;

> *"If a right or fundamental freedom of a person has been or is likely to be adversely affected by administrative action, the person has the right to be given written reasons for the action."*

63. The above provision is supplemented by the provisions of Sections 4(2) and 6(1) and (2) of the Fair Administrative Actions of Act which state as follows;

> *"4 (2) every person has the right to be given written reasons for any administrative action that is taken against him."*

> *"6 (1) Every person materially or adversely affected by any administrative action has a right to be supplied with such information as may be necessary to facilitate his or her application for an appeal or review in accordance with section 5."*

*"6 (2) The information referred to in subsection (1), may include—*

*a. the reasons for which the action was taken; and*

*b. Any relevant documents relating to the matter."*

64. Section 51 (10) of the TPA 2015 provides as follows;

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

65. From the edicts of the foregoing Sections of the law, we shall proceed to analysis whether the Commissioner's objection decision was issued in accordance with these laws. To begin with, Section 51 (10) of the TPA, being the primary procedural law on the subject matter at hand, stipulates that an objection decision issued by the Commissioner shall include a statement of findings on the material facts and the reasons for the decision. It is worth noting, in the first instance, that the Section is framed in mandatory terms, meaning that it grants the Commissioner no latitude whatsoever in the manner of rendering objection decision. Simply put, the Commissioner might choose any format at his disposal of writing an objection decision, but must at all times include a statement of findings on the material facts and reasons for the decision. [Our emphasis]

66. We have thoroughly perused the objection decision of the 22nd of February 2021 and note that the said decision minimally varies from the Commissioner's notice of assessment of 7th September 2020. Other regurgitating the contents of the assessment, there is not statement of findings, nor reasons underpinning the decision. To this end alone therefore, the Respondent cannot be said to have issued an objection decision in accordance with Section 51 (10) of the TPA, 2015. To effectively discharge the obligation under Section 51 (10) of the TPA, the

Commissioner's decision must demonstrate, for instance, what documents where examined under issue X, whether there are any variances between the documents presented on the issue and the Commissioner's initial assessment, and definitely, the conclusions that can be drawn from the variance.

67. Having found that, it is worth analyzing the two arguments fronted by the Commissioner in defense of his objection decision. Firstly, the Commissioner submitted at paragraph 11 of his Statement of Facts that 'the correspondences culminating into the issuance of the objection decision informed the Appellant of the information it needed to produce and further the reasons for the disallowance of the information that was provided.' Our disposition of this argument will be simply and three-pronged; first, there is not a single statement in the objection decision giving reasons for the disallowance of any information provided by the Appellant. Secondly, Section 51 (10) of the TPA does not give the Commissioner room to forego giving reasons in an objection decision account of explanations in a previous communication with the tax payer. Thirdly, and perhaps more imperative to this case, the Commissioner seems to be blowing both hot and cold air seeing as he was categorical that his previous responses did not amount to an object decision; case in point the Respondent's letter of 11th December 2020. This is our view point to a deliberate case of utmost bad faith on the part of the Respondent.

68. In his second argument in defense of the objection decision, the Respondent sought umbrage under the provisions of Section 78 (1) of the TPA 2015 which stipulates as follows;

> *"1) When a notice of assessment or any other document purporting to be made, issued, or executed under a tax law is, <u>in substance and</u>*

*effect, in conformity with, is consistent with the intent and meaning of, the tax law under which it has been made and the person assessed, intended to be assessed, or affected by the document, is designated in it according to common intent and understanding—*

*(a) the validity of the notice of assessment or other document is not affected by reason that any of the provisions of the tax law under which it has been made or issued have not been complied with;*

*(b) The notice of assessment or other document shall not be quashed or deemed to be void or voidable for want of form; and*

*(c) The notice of assessment or other document shall not be affected by reason of any mistake, defect, or omission therein."*

69. In our humble understanding of Section 78 (1) of the TPA, 2015, before questioning the or imputing defect on notice of assessment or other document, one must first verify whether the said assessment or document is in *in substance and effect, in conformity with, is consistent with the intent and meaning of, the tax law under which it has been made.* Put differently, the notice of assessment or other document will be defective if it is not in substance and effect in conformity with the tax law under which it has been made.

70. We are cautious to bringing an objection decision within the meaning of this Section on account of the ambiguity inherent in the phrase 'other document' in the Section. But assuming that objection decision fall within the ambit of 'other document', then the most important question will be, which is the tax law under which the objection decision was made, to which it must in substance and effect conform? In our view the tax law in question will Section 51 (10) of the TPA, and as we have noted elsewhere in

this Judgment, the Commissioner's objection decision does not conform to the substance and effect of Section 51 (10) of the TPA. Therefore, the presumption of validity stands effectively rebutted and the Commissioner cannot invoke the edicts of Section 78 (1) of the TPA in defense of his objection decision. To uphold the Commissioner's argument in this respect will be tantamount to sanctioning selective reading of the TPA.

71. The effect of our foraging analysis, that the Commissioner's objection decision was not issued in accordance with Section 51 (10) of the TPA, is that in not complying the law on issuance of objection decision, the Commissioner infringed on the Appellant's fair administrative rights under Article 47 (2) of the Constitution to be given reasons for the decision. In this respect we deem it apt to reproduce our decision in ***Tax Appeals No. 50 of 2017, Local Productions Kenya Limited -vs- The Commissioner of Domestic taxes*** wherein we upheld the need for giving reasons on the part of the Respondent. Similarly, the High Court in **Richard Bonham Safaris Limited Vs Commissioner of Income Tax [2006] eKLR** stated as follows;

> *"In the absence of reasons...how is the aggrieved party supposed to know the grounds of the decision and assess his position before exercising his right of appeal? Without reasons...it is not harsh to say that the right of a party who wishes to challenge the assessment of the tax due from him is arbitrarily taken away."*

***ii. Whether the Respondent disallowed the expenses of the Appellant in accordance with section 15 of the Income Tax Act.***

72. Our analysis of this issue will be guided by the categories of the expenses and the years in which the disallowed expenses were incurred. Notably, that the Commissioner has proffered a global response to all the expenses

he disallowed; that the Appellant failed to provide information and/or documentation in support of its expenses. This is evident in Paragraph 12 of the Respondent's Statement of Facts as well as paragraphs 21 and 22 of his submissions.

73. We begin our analysis with the interest expenses for the years 2016 to 2019. The Appellant in its objection decision as well as its Statement of Facts has underscored that the interest expense for this period under review relates to the Appellant's acquisition of property in the year 2012. The properties were initially purchased through director's loan. However, in December of 2015 the Appellant resolved to refinance the same through an external loan from Equity Bank Limited. From a cursory perusal of the record before us, the Appellant had supplied the Commissioner with a breakdown of how the loan from Equity Bank was apportioned. The Appellant also provided the Commissioner with loan account statements in respect of the facility issue by the Bank as well as the facility documents.

74. In light of the above, the Respondent cannot raise an issue of the Appellant failing to provide information or documents in respect of the loan from Equity bank. The Appellant in our humble view has sufficiently dispensed with the burden of proof placed upon it by Section 56 (1) of the TPA. It was upon the Respondent to request for more documents or information if it found that what was supplied by the Appellant was not enough.

75. Having found that, we turn to the actual crux of the issue at hand; whether the interest expense for this period is a deductible one. In this regard, the relevant parts of Section 15 of the ITA provide as follows;

> *"(1) For the purpose of ascertaining the total income of any person for a year of income there shall, subject to section 16 of this Act, be deducted all expenditure incurred in such year of income which is*

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

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

*(3) Without prejudice to subsection (1), in ascertaining the total income of a person for a year of income the following amounts shall be deducted:*

*(a) the amount of interest paid in respect of that year of income by the person upon money borrowed by him and where the Commissioner is satisfied that the money so borrowed has been wholly and exclusively employed by him in the production of investment income which is chargeable to tax under this Act:*

*Provided that—*

*(i) The amount of interest which may be deducted under this paragraph shall not exceed the investment income chargeable to tax for that year of income, and where the amount of that interest paid in that year exceeds the investment income of that year, the excess shall be carried forward to the next succeeding*

*year and deducted only from investment income and, in so far as the interest has not already been so deducted, from investment income of the subsequent years of income; and*

*(ii) For the purposes of this paragraph,* ***"investment income"*** *means dividends and interest but excludes qualifying dividends and qualifying interest;"*

76. We are clear in our minds that the interest expense incurred by the Appellant falls squarely within the parameters of Section 15 (3) of the ITA is deductible. This is because the loan facilities were incurred wholly and exclusively for the prosecution of the income in question for the period under assessment. We note that the Respondent through its letter of 11th December 2020 has argued that the interest expense resulting from the external refinancing of the directors' loans. This doesn't sound like an intelligible argument from where we sit. Generally, refinancing a loan allows a borrower to replace their current debt obligation with one that has more favorable terms. Through this process, a borrower takes out a new loan to pay off their existing debt, and the terms of the old loan are replaced by the updated agreement. This enables borrowers to redo their loan to get a lower monthly payment, different term length or a more convenient payment structure.

77. It could be that, for example, as is usually the case with rate and term refinancing, that the borrower negotiates for an interest rate of 6% as opposed to 8% with a previous creditor. Essentially, this borrower reduces the payments over the life of the loan thus freeing cash for more pressing financial needs of the business. Whatever the reason for refinancing, the point remains that the second favorable facility is still being taken out in respect of the same subject matter. In the context of this Appeal, the refinancing by Equity bank was still in respect of the acquisition of the various properties by the Appellant. If nothing else, the very term 'refinancing' should ideally point one to the conclusions we have drawn above; the second facility is in respect of the same subject matter-

acquisition of the property. As such, it is our findings that the Respondent erred and violated the edicts of Section 15 of the ITA in wrongfully disallowing this expense.

78. The next expense relates to bank charges disallowed in 2019. In this regard, the Respondent in his objection decision stated that the Appellant deducted bank charges expenses of Kshs. 8,255,374.00 as an allowable expense in computing its taxable income for the year 2019. The Appellant had responded by availing its computations for the year 2019, which indicates that for this year, the Appellant only deducted an expense of 55,374.00 as bank charges. To this end alone, the Respondent's argument of lack of documents or information from the Appellant to support its deduction fails.

79. The 2019 computation adduced by the Appellant categorically indicates that the Appellant disallowed from its taxable income for the year a figure of Kshs. 8,200,000.00. The Respondent has however, in his objection decision, disallowed a figured of Kshs. 8,200,000.00 and computed 30% corporate income tax. Substantially, the transaction relating to Kshs. 8,200,000.00 is being counted twice by the Respondent. This imposes significant financial loss for the Appellant, yet the Respondent offers so explanation for its actions in this double counting. As such, having found that the Appellant has adduced evidence in support of its deductible expenses in line with Section 15 of the ITA, we hereby set aside the taxes computed to additional figure of Kshs. 8,200,000.00.

80. With regards to the expense of the year 2018, the Respondent in his objection decision disallowed an expense of Kshs. 1,163,375.00. The Appellant had provided the Commissioner with evidence in relation to this figure. It has also availed before the Tribunal its tax computations for the Year 2018. Notably, just like the bank charges for the year 2019, the

Appellant has already disallowed Kshs. 400,450.00 relating to acquiring work permits. In the absence of any reasons or explanation as why this figure is being disallowed by Commissioner again, we see no basis of sanctioning the Respondent's wrongful double count of this figure.

81. With respect to the remaining Kshs.762,925.00, the Appellant had adduced evidence this figure relating to maintenance and upkeep of the property. The Respondent has not substantially interrogated that evidence nor has it controverted it. In the premises therefore we are inclined to accept the Appellant's argument and evidence that the same is deductible under Section 15 (1) of the ITA.

82. The final expense under this limb of determination relates to the cost of sales. The Respondent in his objection decision disallowed the costs of sales for the year 2017 amounting to Kshs. 2,635,292.00 The Appellant has, during the objection stage, and now before this Honorable Tribunal adduced evidence of its cost of sales for the year such as land rent payment receipts, security payment receipt to Eagle Tech Security, receipts of payment made to Opezi Garbage Collectors for the year 2017, receipts for the payment cleaning services, receipts for the payment of pest control and receipt or the payment of water bills and electricity among other. With all this evidence before him, we cannot possibly fathom what would lead the Commissioner to issue a discount of this costs of sales as an allowable expense. In our view, this costs were incurred wholly exclusively for generation of the income and as such a deductible under Section 15 of the ITA.

83. We buttress our position above with the holding in ***Hancock vs General Reversionary and Investment Company (1919) 1K.B.* 25** where Lush J said at page 37 that;

**"...the proper test to apply is this; was the expenditure incurred in order to meet a continuing business demand, in which case it should be treated as an ordinary business expense and an admissible deduction, or was it an expenditure incurred once and for all in which case it should be treated as capital outlay..."**

***iii. Whether the Respondent's decision to deem dividend distribution contravenes the provisions of Section 24 of the Income Tax Act, Cap 470 of the Laws of Kenya.***

84. Under this third issue for determination, the Appellant also challenges the Commissioner's decision to deem a dividend distribution of Kshs. 271,221,710.00 and compute 5% withholding tax on the same. The Appellant in relying on Section 24 (1) argued that the Commissioner's power in deeming dividends can only be exercised where the distribution will not prejudice the requirements of the company's business.

85. The Appellant argued that it did not distribute its retained earnings as distribution of such earning would prejudice its business operations and affect business continuity. This is particularly based on the fact that as 31st December 2019, the Appellant had significant outstanding loan of Kshs. 2,010,177,663.00 which was used to finance development of the Appellant's rental property and acquisition of the its income generating assets. As such the Respondent's decision to deem a dividend distribution of 80% of the Appellant's retained earnings is erroneous and contravenes the provisions of Section 24 (1) of the ITA.

86. The Commissioner on his part, in simply reproducing the provisions of Section 24 (1) of the ITA averred that his actions were well placed within the confines of the law and the specific provisions.

87. We have ample opportunity to review the opposing arguments and think it apt to first reproduce the provisions of the impugned Section 24 of the ITA as hereunder;

> *"(1) Where the Commissioner is of the opinion that a private company has not distributed to its shareholders as dividends within a reasonable period, not exceeding twelve months, after the end of its accounting period such part of its income for that period which could be so distributed without prejudice to the requirements of the company's business, he may direct that that part of the income of the company shall be treated for the purposes of this Act as having been distributed as a dividend to the shareholders in accordance with their respective interests and shall be deemed to have been paid on a date twelve months after the end of that accounting period.*
>
> *(2)...*
>
> *(3)...*
>
> *(4) A private company may at any time before making a distribution of a dividend to its shareholders inquire of the Commissioner whether the distribution would be regarded by him as sufficient for the purpose of subsection (1) of this section, and the Commissioner, after calling on the company for such information that he may reasonably require, shall advise the company whether or not he proposes to take action under this section."*

88. In our humble view, the overarching objective of Section 24 (1) of the ITA is to check that non-distribution of dividends that would in ordinary circumstances be distributable is not employed as a devise for avoidance of tax liability. Ideally, Section 24 of ITA empowers the Respondent to deem dividends where he is satisfied that the only reason for non-issuance of dividends is to evade taxation. Additionally, the Section establishes the standard of proof as whether deeming of dividends will prejudice the company's business.

89. On the other hand, the above Section 24 (4) of the ITA provides a mechanism for a company, before making a decision on distribution of dividend, to inquire with the Commissioner whether he deems the distribution sufficient for purposes of sub section 1. The Commissioner, after calling for any information from the company which he may reasonably require, advises the company on whether or not he proposes to take action under Section 24 of ITA.

90. Notably, subsection 4 is framed in permissive terms by virtue of its wording ***("A private company may")***, meaning the tax payer may or may not elect to activate this particular procedure. In this instance case, the Appellant herein chose not to follow the path laid in Section 24 (4). This therefore raises a question of burden of proof and who bears its. In this regard we are guided by the High Court decision in ***Ocean Freight (E.A) Limited v Commissioner of Domestic Taxes [2020] eKLR*** wherein it was held as follows;

> ***"Whether or not a tax payer opts to take the route of Subsection (4) should perhaps have an implication on who bears the onus of proving that the declaration of a dividend will or will not jeopardize the business of the company. If the Tax payer takes the voluntary option of Subsection (4) in which he furnishes the commissioner with any information that the Commissioner may reasonably require so as to form his opinion and the Commissioner persists on deeming dividends, then the onus must squarely lie on him to prove that his action will not prejudice the requirements of the business of the Company.***
>
> ***If however, like here, the company does not seek the advice of the Commissioner under Subsection (4), then the Tax payer should bear***

***the burden of proving that the Commissioner's action is detrimental to its business. This is because non-distribution of dividends has the potential of abuse and a tax payer should be happy and willing to prove that, in not distributing dividends, it is not engaging in tax avoidance.***"

91. In the spirit of the above holding, the onus is on the Appellant to proof that the deeming of dividends will prejudice the company's business. The Appellant herein has argued that the Respondent's decision to deem the dividends in relation to 80% of its retained earnings will prejudice its business. This especially in light of the fact it had an outstanding loan liability of Kshs. 2,010,177.663.00. We persuaded by the Appellant's argument in this regard considering that Appellant had discharged its burden of proof during the objection stage by availing to the Commissioner documents in support of its loan liabilities. Similarly, the Appellant has also provided us with the loan agreements in respect of its liabilities thus dispensing with its burden under Section 56 (1) of the TPA.

92. The Commissioner on the other hand has not afforded us any reason or computation justifying his insistence on deeming distribution dividends despite the evidence that was availed before him at the objection stage. Accordingly, we find that the Respondent erroneously and without basis deemed distribution of dividends on the Appellant's earnings.

***iv. Whether the Respondent erred in assessing Withholding Value Added tax on the Appellant in relation to VAT withheld by an appointed withholding Vat agent.***

93. The final issue for our determination concerns the Commissioner's decision to assess the Appellant to an additional withholding vat that had been withheld by the withholding vat agent. On this issue, the Appellant

submitted that Section 42A (1) gives the Respondent powers to appoint a vat withholding agent. Further Section 42A (4B) provides that the tax withheld shall be remitted to the Commissioner before the 20th day of the month following in which the deduction was made.

94. The Appellant argued that it leased its commercial property to Equity Bank and pursuant to the lease terms the rent on the premises was payable on a quarterly basis. The Bank was appointed a withholding vat agent and remitted in February 2020 to the Respondent withholding vat of Kshs. 1,556,598.00 in relation to the leased premises. That the Respondent was issued with a reconciliation of the quarterly invoices issued to the bank from 2017 to 2019 and the withholding vat remitted by the bank.

95. The Respondent in turn in his Statement of Facts has gone on a frolic citing the sections of the TPA on the obligations to file returns, keeping and maintenance of records among others, to argue that the Appellant's claims were not sufficiently proven in accordance with Section 56 of the TPA. In his submission at paragraph 28, the Commissioner in passing, touched on the issue of Section 42A (4) and averred that the Section does not relieve the supplier from the liability to account for tax within the operation of withholding tax arrangement.

96. From the foregoing computing arguments, we note that the bone of contention is withholding vat under Section 42A of the TPA. This Section provides as follows;

> *"1) The Commissioner may appoint a person to withhold two per cent of the taxable value on purchasing taxable supplies at the time of paying for the supplies and remit the same directly to the Commissioner:*

*Provided that the withholding tax shall not apply to the taxable value of zero rated supplies.*

*2)...*

*3)...*

*4) For the avoidance of doubt, the withholding of tax under subsection (1) shall not relieve the supplier of taxable supplies of* ***the obligation to account for tax in accordance with this Act and the regulations.*** *[Our emphasis]*

*4(A)...*

*4(B)...*

*4(C) A person who is required under this section to withhold tax commits an offence if the person —*

*(a) Fails to withhold the whole amount of the tax which should have been withheld; or*

*(b) Fails to remit the amount of the withheld tax to the Commissioner by the twentieth day of the month following that in which the deduction was made."*

97. In our view, Section 42A of the TPA, as the Appellant has rightly submitted, clothes the Commissioner with the power to appoint withholding VAT agent. It is in exercise of this power that the Equity Bank was appointed a withholding tax agent in rent for the leased premises. That being said, a resolution of this issue is pegged on understanding the provisions of Section 42A (4A) of the TPA. The subsection states that:-

*"for avoidance of doubt the withholding of tax under subsection (1) shall not relieve the supplier of taxable supplies of **the obligation to account for tax in accordance with this Act and the regulations.**"*

98. The most telling part of this subsection is the phrase '*'the obligation to account for tax in accordance with this Act and the regulations*'. Two things stand out, in our esteemed consideration, from this; first, there is an obligation to account for tax, and secondly, that obligation must be carried out in accordance with 'this Act and the regulations' (being the Tax Procedures Act, 2015). The question one must reasonably ask at this juncture is, what obligation is the supplier (the Appellant) not being relieved from? It mostly cannot be the obligation to withhold vat under 42A, after all can one be relieved from an obligation they don't bear. That cross, the obligation to account for withheld tax, is purely reserved for the withholding vat agent, in this case Equity Bank, under this the TPA.

99. In addition to the foregoing paragraph, our disinclination towards the Commissioner's argument is further buttressed by the provisions of section 42A (4C). This subsection creates an offense on the part of the withholding vat agent for failing to both withhold and remit the taxes so withheld. If at all the supplier (the Appellant) is not relived of the obligation to account for these taxes, then the subsection would have imputed these offenses to both the agent and the supplier. The fact it does not assign and punish the supplier for these offenses reaffirms the position that the obligation to withhold, remit and account for the taxes so withheld sits squarely with the withholding vat agent.

100. With respect and conviction therefore, we find that the Commissioner has fallen into utter misapprehension of the edicts of Section 42A (4A) of the TPA in arguing that the Appellant is not relieved of the obligation to

account for the taxes. Equity bank had in a letter dated 18th January 2021 confirmed the summary of invoices billed and tax withheld to be correct. As such, this leaves the agent as the only person the Commissioner can hold truly liable for the failure to remit those taxes.

101. Notably, the Commissioner has once again feebly raised an issue of failure to provide documents and dispense with the burden of proof by the Appellant. From the extensive record before us, we have every reason to believe that the Commissioner was supplied with sufficient proof to come to a conclusion different from that in his initial assessment. Accordingly, it is our finding that the Respondent erred in assessing the Appellant to withholding vat relating to the agent.

## FINAL DECISION

102. In light of the foregoing analysis, the Tribunal makes the following Orders;

    a. The Appeal herein be and is hereby allowed.

    b. The Respondent's assessment of 7th September 2020 and the objection decision of 22nd February 2021 be and are hereby set aside in their entirety.

    c. Each party to bear its own costs.

103. It is so ordered.



TAT

**DATED** and **DELIVERED** at **NAIROBI** on this **25th** day of **March, 2022.**

**MAHAT SOMANE**
**CHAIRPERSON**

**HELEN BILA**
**MEMBER**

**WILFRED GICHUKI**
**MEMBER**

**JOHN KINYUA**
**MEMBER**

**HABON FARAH**
**MEMBER**

TAT