



**Commissioner of Domestic Taxes v Muga Developers Limited (Tax Appeal E015 of 2020)
[2022] KEHC 11420 (KLR) (Commercial and Tax) (19 May 2022) (Judgment)**

Neutral citation: [2022] KEHC 11420 (KLR)

**REPUBLIC OF KENYA
IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)
COMMERCIAL AND TAX
TAX APPEAL E015 OF 2020
DAS MAJANJA, J
MAY 19, 2022**

BETWEEN

COMMISSIONER OF DOMESTIC TAXES APPELLANT

AND

MUGA DEVELOPERS LIMITED RESPONDENT

*(Being an appeal against the judgment of the Tax Appeals Tribunal
at Nairobi dated 4th March 2020 in Tax Appeal No.94 of 2019)*

JUDGMENT

Introduction and Background

1. The Respondent is a limited liability company incorporated as a Special Purpose Vehicle for the purpose of implementing the construction and development of a housing project called Fourways Junction, off Kiambu Road (“the Project”).
2. The Appellant (“the Commissioner”) conducted a review of its tax affairs to ascertain its compliance status for the income period 2015 to 2017. The Commissioner communicated its review findings in a letter dated 4th September 2018 where it stated that the Respondent had not filed tax returns for the subject period contrary to section 24(1) of the *Tax Procedures Act* (“TPA”). Further, that from the information available to the Commissioner, the Respondent developed the Project in partnership with Suraya Property Group Limited (“Suraya”) which was in three phases; Phase one and two comprising 756 units of which 695 units were sold as complete houses while phase three had ongoing off-plan sales. The Commissioner took the view that income arising from the sale of the units was not declared for tax purposes and that the Respondent had not filed income tax returns for the subject period thus had not declared the income and tax from the Project. The Commissioner assessed tax for the period at KES 2,915,192,263.00.



3. The Commissioner urged the Respondent to file all the corporation tax returns within 14 days of that letter, failure to which the Commissioner would issue the Respondent with a default assessment in accordance with the provisions of section 29(1) of the TPA. The Respondent filed original corporation tax returns on 20th and 21st September 2018 and the Commissioner reviewed those returns together with one filed on 28th October 2015.
4. The Commissioner in a letter dated 28th September communicated its findings on the returns in respect of the years of income 2014-2017. It maintained that the Respondent was a Special Purpose Vehicle incorporated by Suraya for the development of the Project and that Phases one and two of the Project which comprised of 756 units were sold as complete whereas Phase three comprised of 152 units which were sold off-plan. The Commissioner held that from the returns, the Respondent had under declared its gross turnovers and fell short of complete disclosure and as such brought to charge the gross revenue variances.
5. The Commissioner also noted that the Respondent had erroneously carried forward the taxable loss of KES 1,845,781,896.00 into the year of income 2017 instead of KES 1,439,780,437.00 expected from the year of income 2016. Thus, the tax computational variance of KES 406,001,459.00 in respect of the overstated taxable loss in 2017 was corrected and accordingly brought to charge.
6. The Commissioner revised the tax computations for the subject income years and determined the total additional principal tax payable by the Respondent as KES 3,553,263,459.00 and consequently issued additional assessments (“the additional assessments”). The Respondent wrote to the Commissioner on 26th October 2018 stating that its returns had been filed using draft accounts which had not been completed and signed off and that they had attached the final audited accounts for the Commissioner’s analysis and corrections as may be necessary. The Respondent further explained and sought to clarify that the turnover expected on the booked units of the Project was a cumulative figure that depicted the anticipated revenue from the Project while the revenue recognized for the year were the actual sales/income for the period and that the final accounts would be clearer on this. It further sought to file a late objection to the Commissioner’s additional assessments through its letter dated 14th November 2018. The Respondent explained that together with its principal shareholder, Suraya, they had been experiencing serious financial challenges based mainly on the fact of heavy indebtedness to Equity Bank Limited and that all monies received in the past four years (2014-2018) were mainly through Equity Bank’s lawyers or escrow accounts controlled by it. That the funds received had not been adequate to meet the repayment and loan servicing obligations to the Bank and to support operations and the building works in support of the Respondent’s principal activity virtually stalled over a period of two and a half years meaning it could not contribute to financing overheads and other operational aspects. The Respondent contended that the additional assessments were based on an incorrect interpretation of the financial statements and requested that the same be reversed.
7. In response, the Commissioner, through its letter dated 21st November 2018 granted the Respondent leave to file an objection out of time on condition that the Notice of Objection states precisely the grounds of objection, that is the amendments required to be made to correct the additional assessments and the reasons for the amendments and that any taxes including penalties and/or interest under the additional assessments are fully paid as provided for in section 51(7)(b) of the TPA. The Respondent was also required to furnish the Commissioner with records, documents and reconciliations/ computations which should include but not limited to all the tax computations for the years of income 2014-2017, all Trial Balances (in soft copies) in respect of the Management and Final accounts for all the years of income under review, all the Gross Revenue Accounts, Debtors Accounts and Creditors Accounts Ledgers (in soft copies) for the years under review, all the Cash Books (Cash & Bank in soft copies) for the years under review, all Revenue Recognition Accounts (in soft copies)



- for the years under review and any other records, documents, accounts and reconciliations deemed necessary.
8. The Respondent filed its Notice of Objection through a letter dated 28th November 2018 where it reiterated its earlier averments that the additional assessments were based on a misinterpretation of the information contained in the financial statements and returns. That the full project value for a project running over a period exceeding four years was repeatedly assumed to have been the annual turnover for each of the four years as shown in its response.
 9. The Respondent also maintained the position that the sale and construction of the units in the Project was yet to be completed as the Project stalled over two and a half years ago because of financial constraints. Thus, the Respondent stated that there was no tax payable and section 51(3)(b) of the TPA relating to tax not in dispute would therefore not apply, it further stated that other information had been forwarded in hard copy.
 10. The Commissioner responded to the objection through a letter dated 5th December 2018 where it held that the objection was admitted and the taxes in dispute stood over on the basis of this letter and that the system stand over was to follow in due course. The Commissioner reminded the Respondent that it was still expecting full supporting records/reconciliations with regard to the objection and as communicated earlier in the letter of 21st November 2018 and in accordance with section 56(1) of the TPA.
 11. By a letter dated 24th January 2019, the Commissioner made its Objection Decision (“the Objection Decision”) in respect of the Respondent’s objection. The Commissioner reaffirmed that section 56(1) of the TPA places the burden of proof that a tax decision is incorrect on the taxpayer. The Commissioner stated that the Respondent, despite being asked to furnish it with relevant records, had not sent the same and the Commissioner had not received a majority of the records requested which included those listed above in the letter of 21st November 2018 together with; the initial Joint Venture agreement between the principal investors (Mr & Mrs Gatabaki and Mr & Mrs Muraya) and all subsequent agreements, Contract agreement with China Wu Yi Company Limited the main Project contractor and any other sub-contracts, Copies of sale agreements in the years under review, Contract certificates (Copies) from China Wu Yi, Breakdown of project costs per year since inception, Shareholder loans agreement, All bank loan agreements and bank statements to confirm loan interest for the years 2014 to 2017, all records relating to sale of land to Classix @ Fourways Limited and any other records, documents, accounts and reconciliations deemed necessary in line with the review.
 12. The Commissioner confirmed that as of the date of the Objection Decision, it had only received the tax computations for years of income 2014 to 2017 but that a review of the profit/(loss) for the years of income 2015, 2016 and 2017 as per the tax computation on the iTax return compared with the signed audited accounts provided revealed a variance between the two. It also received the breakdown of sales per customers, sale contract numbers and sales amounts for the years 2015 to 2017 but that this was not sufficient in the absence of sales agreements and other records requested therewith. It further confirmed that it received the listing/schedule of China Wu-Yi certificates but that they were not sufficient without the actual certificates which were required arrive at the necessary conclusions. It further stated that it had received Equity Bank’s loan agreements dated 15th November 2011 and 19th September 2016 together loan accounts statements but that these records were insufficient for the Commissioner’s analysis without the other documents requested.
 13. The Commissioner thus concluded that in the absence of the documents requested to demonstrate that the additional assessments were incorrect, the Commissioner made the decision to disallow the objection and reconfirm the additional assessments totalling KES 3.5 Billion.



14. The Respondent was dissatisfied with the Objection Decision and proffered an appeal at the Tax Appeals Tribunal (“the Tribunal”) where it urged the Tribunal to find that the Respondent did not under-declare its turnover of the audit period 2014 to 2017 or any other period for that matter. That there was evidence of obvious error in the estimated assessment as presented by the Commissioner which resulted in gross overstatement of tax due and correcting the error would result in nil/zero tax payable by the Respondent. It further urged the Tribunal to find that its appeal had merit and should be allowed and granted with costs.
15. After studying the pleadings together with the submissions of the parties, the Tribunal held that the only issue that called for its determination was whether the additional assessments issued by the Commissioner were erroneous. The Tribunal noted that the Commissioner issued the additional assessments on the basis of the Respondent’s draft financial statements and that the values which the Commissioner had treated as sales revenue on the sold units were projected values at the end of the respective accounting periods and therefore, the additional assessments were issued on an incorrect basis and were excessive. On the issue of production of records requested, the Tribunal held that in a sworn deposition filed on 23rd October 2019, the Commissioner confirmed to have received sale agreements that had sale prices per unit which the Tribunal expected the Commissioner to calculate the estimated annual sales values in arriving at the additional assessments. Instead, the Tribunal considered the approach by the Commissioner to be inappropriate as the Commissioner extracted from the Respondent’s draft financial statements assumed turnover figures.
16. The Tribunal further held that alternatively, to the test of reasonableness of the additional assessments, the Commissioner should have used industry figures from a review of the tax compliance status of the said top fifteen real estate developers which according to the Tribunal, would have been considered more appropriate. On whether it was appropriate to receive bank statements from Suraya when the Commissioner requested for bank statements from the Respondent, the Tribunal found no fault in this and held that it was a practice and not uncommon in the real estate industry for using an agent for cash receipts as long as the cash is accounted for correctly and that the Respondent’s audited financial statements for 2014 to 2017 did not suggest an anomaly in this respect.
17. In view of the foregoing, the Tribunal found that the additional assessments were erroneous and held that the Respondent’s appeal was merited and succeeded. As a result, the Tribunal made dispositive orders inter alia setting aside the additional assessments.
18. It is this decision that the Commissioner is dissatisfied with and forms the basis of the instant appeal which has been canvassed by way of written submissions where the parties have regurgitated their positions summarized above.

Analysis and Determination

19. I have considered the Commissioner’s grounds of appeal raised in its memorandum of appeal dated March 20, 2020, the Respondent’s response contained in its amended Statement of Facts dated 26th March 2021 and the parties’ respective submissions.
20. It is not lost that this court is exercising appellate jurisdiction that is circumscribed by section 56(2) of the TPA which provides that “An appeal to the High Court or to the Court of Appeal shall be on a question of law only”. The Court of Appeal in *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR summarised what amounts to “matters of law” as follows:

(38) [T]he interpretation or construction of *the Constitution*, statute or regulations made thereunder or their application to the sets of facts established by the



trial Court. As far as facts are concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court.

21. The main issue for determination in this appeal is similar to what the Tribunal framed, which is whether the additional assessments were erroneous and the duty of this court is determining whether the Tribunal's positive conclusion on the same was correct.
22. As stated in the introductory part, in arriving at the additional assessments, the Commissioner reviewed the Respondent's returns and concluded that the Respondent had under declared its gross turnovers and fell short of complete disclosure and as such brought to charge the gross revenue variances. The Commissioner also noted that the Respondent had erroneously carried forward the taxable loss of KES 1,845,781,896.00 into the year of income 2017 instead of KES 1,439,780,437.00 expected from the year of income 2016. Thus, the tax computational variance of KES 406,001,459.00 in respect of the overstated taxable loss in 2017 was accordingly brought to charge of corporation tax by the Commissioner.
23. The Respondent responded by stating that its returns had been filed using draft accounts which had not been completed and signed off and that they had attached the final audited accounts for the Commissioner's analysis and correction as may be necessary. The Respondent further explained and sought to clarify that the turnover expected on the booked units of the Project was a cumulative figure that depicted the anticipated revenue from the Project while the revenue recognized for the year were the actual sales/income for the period and that the final accounts would be clearer on this.
24. In reviewing the Respondent's objection, the Commissioner required the Respondent to furnish it with records detailed in the letter dated 21st November 2018. This request is consistent with the taxpayer's obligation to maintain proper records. That the Commissioner is empowered to request those records is uncontested and a common legal position. Section 23(1) and (2) of TPA requires that records required under a tax law and those required to enable a person's tax liability to be ascertained to be kept in official languages (English and Kiswahili) and for a period of up to 5 years. This position is restated in the *Income Tax Act* (Chapter 470 of the Laws of Kenya) ("the ITA") particularly section 54A which requires a person carrying on a business to keep records adequate for the purpose of computing tax. Section 59(1) of the TPA empowers the Commissioner to require a taxpayer to produce for examination at such time and place as may be specified in a notice, any documents (including in electronic format) that are in the taxpayer's custody or under its control relating to the tax liability of that taxpayer and further require the taxpayer to furnish information relating to the tax liability of the taxpayer.
25. Further, under section 24(1) of the TPA, a tax payer is required to submit a tax return under a tax law in a manner approved by the Commissioner, in this case itax, however, section 24(2) of the TPA provides that the Commissioner shall not be bound by such a tax return or information provided by, or on behalf of, a taxpayer and the Commissioner may assess a taxpayer's tax liability using any information available to the Commissioner. This position of submission of a return is anchored under section 52(1) of the ITA where the Commissioner can require anyone to furnish a return for any year of income and section 52(B) requires every taxpayer to furnish a return of income not later than the last day of the sixth month following the end of their year of income.



26. It is also common ground and not in dispute that section 30 of the *Tax Appeals Tribunal Act* and section 56 of the TPA impose the burden of proof on the tax payer to prove that an assessment is excessive or a tax decision is incorrect. Once the Commissioner made the additional assessments based on the returns filed by the Respondent, then it was incumbent on the Respondent to disprove the Commissioner.
27. While the Respondent objected and explained that the Commissioner had misinterpreted the returns and sought to clarify the correct position, the Commissioner was not satisfied with the explanation as is and that is why it sought the records and documentation in its letter of November 21, 2018. From the parties' correspondence, more so the Objection Decision, it is clear the Respondent never furnished the Commissioner with all the documents requested and it is on this basis that the Commissioner reaffirmed its earlier position on the additional assessments.
28. I respectfully disagree with the Tribunal that the decision to affirm the additional assessments was because of a misreading of the filed returns as it is evident that the Respondent failed to provide the documentation required and even the documents provided were not to the satisfaction of the Commissioner and could not form the basis of disproving the Commissioner's tax decision on the additional assessments.
29. While it is true the Commissioner admitted that it received sale agreements for the units that had a sale price, the Respondent still did not provide all the documents requested by the Commissioner and the furnishing of these sale agreements did not in any way mean that the Respondent was now excluded from furnishing the other listed documents or that it had sufficiently discharged the burden of proof. What the Respondent cannot escape from is that it never provided all the documents sought. I do not hear the Respondent complaining that the documents and information was not available, could not be found or that the request was unreasonable. On the contrary, the documents and information sought by the Commissioner are within what is normally kept in businesses of the nature carried out by the Respondent.
30. I have holistically read the impugned affidavit of the Commissioner that was filed before the Tribunal. It was sworn by Jonathan Mwenda, a duly authorized officer of the Commissioner. He deponed that Phase one and two of the Project were complete and that the Phase one comprised of 256 units, which had all been sold at an average cost of KES 30,000,000.00 and that to arrive at the total number of units, the Commissioner relied on the Respondent's own information as relayed by the Respondent to the market through various means not limited to the information on its website. Mr. Mwenda maintained that the Respondent was at all material times requested to provide ALL the sale agreements to rebut the Commissioner's information and further to provide the bank statement where the sale proceeds were deposited. However, the Respondent only provided 330 sale agreements whereas the Commissioner was expecting 695 agreements for the sold units which would have assisted ascertain the correctness of the Respondent's assertion.
31. Mr. Mwenda stated that the Respondent's list of buyers and prices on its memorandum of appeal before the Tribunal was not conclusive and sufficient proof of prices of the units and number of units thereof as no corresponding sale agreement or bank statement to account for sale proceeds deposited had been provided. He maintained that the Respondent failed to provide records requested to support revenues and expenses in the audited accounts. As stated in the introductory part, the Tribunal's conclusion of this deposition was that the Commissioner confirmed to have received sale agreements that had sale prices per unit which the Tribunal expected the Commissioner to calculate the estimated annual sales values in arriving at the additional assessments. I find that the Tribunal read the deponent's averments in isolation to arrive at an erroneous conclusion as the Commissioner was consistent and



- maintained that the Respondent had not furnished it with all the requested records to assist in the review of revenues and expenses. I find this to be a misapprehension of the evidence on record which warrants the court's intervention.
32. The Tribunal also concluded that the Respondent was justified in furnishing the Commissioner with bank statements of Suraya rather its own bank statements. While I do not dispute that agents in the real estate sector may receive income on behalf of their principals, it was the Respondent and not Suraya, that was under a review and audit. I do not see any difficulty in the Respondent providing its bank statements as requested by the Commissioner and explaining that some or all of its income was being received by Suraya. In any case, the Commissioner's deponent stated that Suraya had been filing zero/ NIL returns in the subject period meaning that the said company never received any income from the Project. In furnishing Suraya's bank statements rather than the Respondent's, the Respondent only convoluted its own case making it difficult for the Commissioner to find in its favour.
33. From the totality of the record, I find and hold that the Respondent did not discharge the burden of proof required to satisfy that the Commissioner was wrong in issuing the additional assessments. The Respondent failed to provide documentation to support the variance between the income declared in its iTax return and signed audited accounts and in the absence of such documentation or presence of documentation that was insufficient, the Commissioner's position remained uncontroverted.
34. As to whether the Commissioner applied the 'best judgment' in determining the sale price value of the units in the Project, the Respondent can only have itself to blame. The Respondent, in failing to provide its bank statements to enable the Commissioner verify that the bank deposits tallied with the sale agreement values failed to discharge the burden of proof. It cannot now fault for the Commissioner for using the documents and information available to it, including the Respondent's own projected sales in its audited accounts and details of units sold to determine the gross income of the Respondent. The Respondent has cited the decision of *Republic v Kenya Revenue Authority Ex parte Jaffer Mujtab Mohammed* [2015] eKLR where Odunga J., held as follows:
- [A] taxing authority is not entitled to pluck a figure from the air and impose it upon a taxpayer without some rational basis for arriving at that figure and not another figure. Such action would be arbitrary, capricious and in bad faith. It would be an unreasonable exercise of power and discretion and that would justify the court intervening.
35. I find the above authority to be inapplicable and distinguishable in this case in that the Commissioner did not pluck a figure from the air and impose it on the Respondent. There was indeed a rational basis for arriving at that figure as outlined before as the Commissioner used the Respondent's own reported figures and I find nothing arbitrary, capricious or bad faith in the Commissioner's discretion that would justify the court's intervention.
36. It is for the above reasons that I once again respectfully disagree with the Tribunal's findings. The Tribunal misapprehended the facts and evidence on record and the applicable law to a point that they arrived at an erroneous decision that cannot stand and warrants the court's interference and intervention. What is clear is that the Respondent failed to discharge its legal burden of proof and failed to disprove the Commissioner.

Disposition

37. For the reasons I have set out above, I allow the appeal and set aside the judgment of the Tribunal dated March 4, 2020.



38. I however note that the Commissioner has in its submissions and in its Memorandum of Appeal agreed to give the Respondent a window to provide the documents requested in its earlier correspondences to ascertain the correctness of the additional assessments based on this concession I now make the following orders:

- a. The appeal is allowed and judgment of the Tribunal dated 4th March 2020 be and is set aside but on terms as hereunder.
- b. The Respondent be and is hereby granted sixty (60) days from the date of this judgment to furnish the Commissioner with all the documentation and information requested by the Commissioner in its letter dated November 21, 2018 failure to which the said additional assessments confirmed on January 24, 2019 shall be upheld.

DATED AND DELIVERED AT NAIROBI THIS 19TH DAY OF MAY 2022.

D. S. MAJANJA

JUDGE

Court Assistant: Mr Michael Onyango

Mr Osoro, Advocate for the Commissioner of Domestic Taxes instructed by Kenya Revenue Authority.

