REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL AND TAX DIVISION

INCOME TAX APPEAL NO. 06 OF 2018

MARS LOGISTICS LIMITED..APPELLANT

Versus

THE COMMISSIONER OF DOMESTIC TAXES ....RESPONDENTS

(Appeal against the Judgment of the Tax Appeals Tribunal at Nairobi delivered on the 27th day of February 2018 in Tax Appeals Tribunal Tax Appeal No. TAT/212 of 2015).

JUDGMENT

Introduction

1. The appellant seeks to overturn the decision of the Tax Appeals Tribunal in Tax Appeal No. **212** of 2015 dated **27th** February 2018 dismissing its appeal against the Respondent's Tax assessment for the years 2013 to 2015 dated **8th** September 2015 demanding **Kshs. 105,693,847/=** (Income Tax- **Kshs. 22,711,603/=** and VAT- **Kshs. 82, 982,244/=).**

2. The appellant's core ground before the Tribunal revolved around the issues whether the Respondent erred by imposing VAT at **16%** on services offered by transporting goods in transit for the period between **2nd** September 2013 and **14th** September 2014 and whether the Respondent ignored the law that transportation services that end outside Kenya are exported services as defined in the VAT Act, 2013;

3. Other grounds advanced before the Tribunal were that the Respondent disregarded paragraph **1** Part **A** of the **2nd** Schedule of the Value Added Tax Act,[1]2013 (herein after referred to as the VAT Act, 2013); that the Respondent disallowed its claim for input tax for the period of **15th** September 2014 to **9th** March 2015 on the basis that the supplies made in respect of transportation of goods in transit were exempt; that the Respondent disregarded section **12 (1)** of the VAT Act 2013 which defines time of supply by holding that the payment of the motor bikes made in April 2013 and delivered on **11th** September 2013 were subject to VAT at **16%;** and that the Respondent erred in law by disallowing direct expenses it incurred in the production of taxable income contrary to section **15** of the Income Tax Act[2] (herein after referred to as the ITA).

The Impugned decision

4. A summary of the Tribunal's findings were:- that to be entitled for zero rated status, the same should have been specifically included in the **2nd** schedule to the VAT Act, 2013; that services offered in relation to goods in transit were previously zero rated under paragraph **11** of the **5th** Schedule of the Repealed VAT Act, but under the VAT Act, 2013 the said services were specified in the **2nd** Schedule and were accorded zero-rated status, hence they became taxable at **16%;** that on **14th** September, 2014, the Finance Act amended the **1st** Schedule to the VAT Act, 2013 by exempting services offered in relation to goods in transit from Value Added Tax; that income derived from transportation of transit goods is taxable at the applicable rate of **16%;** that input tax in relation to exempt supplies is not deductible and disallowable under section **17 (6)** of the VAT Act, 2013; that the appellant's sole business for the period **14th** September 2014 to **12th** June 2015 was transport services for transit goods which was exempt from VAT hence the appellant was not entitled to claim input tax for the said period.

5. Additionally, the Tribunal held that the appellant was not entitled to claim exempt status on the invoice dated **11th** September 2016 for the sale of motor bikes because it sold them on **11th** September 2013 and raised the invoice the same day; that no documentary evidence was provided to show that the payment was made in April 2013; and that the VAT Act 2013 came into force on **2nd** September 2013 thereby removing the motor bikes from the exempt status. Lastly, it held that it is a general accounting principle that an expenditure must be supported by evidence, and that, the appellant's petty cash vouchers were not supported by any other documentary evidence.

The appeal

6. The appellant challenges the said decision on the following grounds: -

> a. ***That*** *the Tribunal erred in failing to find that its trans-shipment cargo constituted a service exported out of Kenya within the meaning of section* ***2*** *of the VAT Act, 2013 and in categorizing the trans-shipment services provided between* ***2nd*** *September, 2013 and* ***14th*** *September, 2014 as taxable at the standard rate of* ***16%*** *and not at the applicable zero rate.*

> b. ***That*** *the Tribunal erred in law in disregarding paragraph* ***1*** *Part* ***A*** *of the* ***2nd*** *Schedule of the VAT Act 2013 which zero rates exported services and in failing to consider and properly apply the destination principle of VAT which provides that VAT is imposed at the point of consumption and consequently the exports should be zero rated.*

> c. ***That*** *the Tribunal erred in finding that the levy of VAT on the exported services did not amount to double taxation on the basis that the transportation costs could be considered an allowable expense by the importer of the goods at the final destination of the goods and that the importer would have been entitled to claim input tax in its books of accounts.*

> d. ***That*** *the Tribunal erred in law in finding that the appellant was not entitled to claim input VAT on services provided between* ***15th****September 2014 to March 2015 on the basis that the services were exempted from VAT pursuant to the amendments made by Section* ***28(b)*** *of the Finance Act, 2014; also the Tribunal erred in (a) failing to find that the services offered by the applicant were zero rated; (b) failing to make a finding on the ambiguity created by section* ***28(b)*** *of the Finance Act 2014 which classified "the supply of taxable services in respect of goods in transit" as exempt services as read with the section* ***5*** *of the VAT Act which provides that taxable services attract VAT; (c) failing to consider the said ambiguity and interpret the section in favor of the appellant to the effect that that services attracted VAT at the zero rate.*

> e. ***That*** *the Tribunal erred in fact and law in disregarding and /or failing to properly apply Section* ***12(1)*** *of the VAT Act 2013 on definition of time of supply by holding that the payments for the motorbikes made in April 2013 and delivered on* ***11th*** *September, 2013 were subject to VAT at 16%; and in upholding the Respondent's decision to disallow direct expenses incurred wholly and exclusively in the production of taxable income contrary to Section* ***15*** *of the ITA.*

> f. ***That*** *the Tribunal erred in law and fact in disregarding and/or failing to properly consider the test applicable in determining expenses incurred wholly and exclusively for income purposes as provided under section* ***15*** *of the ITA; and in disregarding its documents supporting the direct costs it incurred in the course of providing the transportation services; and in holding that it had not controverted the Respondent's Assessments dated* ***8th*** *September 2015 and in upholding it.*

7. The appellant prays that the said judgment be set aside; the appeal be allowed with costs to the appellant and any other relief this court may deem fit to grant in the interest of justice.

Respondent's Statement of Facts

8. The Respondent stated that the appellant provided the transport services in Kenya which fall within the definition of a supply of service under Section **2** of the VAT Act, 2013, hence paragraph **1** Part **A** of the **2nd**Schedule of the VAT Act 2013 is inapplicable. And, that the said services were not exempted or zero rated but were subject to VAT at **16%** as provided under section **5** of the VAT Act, 2013.

9. It also stated that previously, services offered to goods in transit were zero rated under paragraph **11** of the **5th** Schedule of the repealed VAT Act, but under the VAT Act 2013, the said services were not specified in the **2nd** Schedule, hence they became taxable at **16%,** hence, the transport services for goods in transit offered by the appellant for the period between **2nd** September **2013** and **14th** September **2014** were a taxable supply, hence they attracted VAT at **16%** under Section **5(1) (a)** of the VAT Act 2013.That levying tax on transport does not amount to double taxation because the transport cost is considered as an allowable expense by the importer at the destination if any, and, that the Tribunal rightly found that the services do not attract VAT in Kenya as the importer shall pay VAT in its country.

10. That the appellant was not entitled to claim input tax on the services provided between **15th** September 2014 to **12th** June 2015 because the said service was not exempted under the VAT Act, 2013 and section **28** of the Finance Act, 2014, and under section **17(6)** of the VAT Act 2013, input tax in relation to exempt supplies is non-deductible and disallowable, thus he appellant's claim of input tax of **Kshs. 428,868.00** was disallowed in accordance with Section **17(6)** of the VAT Act.

11. The Respondent also stated that the appellant's services were not zero rated during the period between **14th** September 2014 and **12th** June 2015, and that on **14th** September 2014, the Finance Act 2014 amended the **1st** Schedule of the VAT Act 2013 by exempting services offered in relation to goods in transit from VAT the effect of which was that no input tax can be claimed on supplies which are exempt, hence there is no ambiguity created by section **28(b)** of the Finance Act 2014 as alleged by the appellant.

12. That the Tribunal rightly applied Section **12(1)** of the VAT Act 2013 on definition of time of supply by holding that the payment for the motorbikes made in April 2013 and delivered on **11th** September 2013 were subject to VAT at 16%, and, that since the motorbikes were delivered and an invoice raised on **11th** September 2013, that was the tax point. Further, no documentary evidence was provided by the appellant to show that the payments for the motorbikes were made in April 2013, and in any event, the VAT Act came into effect on **2nd** September, 2013 thereby making the motorbikes taxable at **16%.**

13. That Tribunal rightly up held the Respondent's decision to disallow the appellant's direct expenses for lack of documentary evidence to

prove that they were wholly and exclusively incurred in the production of income. Further, that section **15** of the ITA only allows expenses that are wholly and exclusively incurred in the production of income to be deductible, while section **16** disallows any income that is not wholly and exclusively incurred in the production of income. The test applicable to determine expenses incurred wholly and exclusively for income purposes under Section **15** of the ITA is whether the expenditure is supported by actual documentation showing details of the expenses claimed.

14. Further, the Respondent states that the Respondent's in-depth scrutiny on the direct costs claimed by the appellant for the years under review revealed that the appellant had not fully complied with the tax regulations inconformity with the ITA because although the appellant raised petty cash vouchers for expenses incurred, they were insufficient documentation to prove that the expenses were actually incurred in the production of income.

Appellant's advocates Submissions

15. Citing section **68(3)** of the VAT Act, 2013 which provides that any subsidiary legislation made under the repealed Act in force at the commencement of the Act shall remain in force, so far as it is not inconsistent with the Act, until subsidiary legislation with respect to the same matter is made under the Act, the appellant's counsel argued that no subsidiary legislation was enacted until the VAT Regulations, 2017 were gazette, hence, the VAT Regulations under the repealed Value Added Tax Act[3] remained in force. He also cited section **24** of the *Interpretation and General Provisions Act**[4]*** which provides that " *where an Act or part of an Act is repealed, subsidiary legislation issued under or made in virtue thereof shall, unless a contrary intention appears, remain in force, so far as it is not inconsistent with the repealing Act until it has been revoked or repealed by subsidiary legislation issued or made under the provisions of the repealing Act and shall be deemed for all purpose to have been made thereunder* and Regulation **20(2)** which remained in force until the VAT Regulations, 2017 came into force provided that where transportation ends outside the country, the transport services shall be deemed to have been supplied outside the country. He submitted that the supply of transport services that end outside Kenya are exported services which is consistent with the 'destination principle' set out in the OECD International VAT/GST guidelines under which services are subject to tax in the jurisdiction in which they are consumed.

16. Counsel argued that Paragraph **1** of the **2nd** Schedule to the VAT Act, 2013 expressly provides that exported goods and services are zero rated. He also cited section **5(1)** of the VAT Act, 2013 which provides : - *'a tax, to be known as value added tax, shall be charged in accordance with the provisions of this Act on…a taxable supply made by a registered person in Kenya,* and section **2** of the VAT Act, 2013 which provides: -*"taxable supply" means a supply, other than an exempt supply made in Kenya by a person in the course or furtherance of a business carried on by the person, including a supply made in connection with the commencement or termination of a business."* Also, counsel cited section **2(1)** of the VAT Act, 2013 which defines a zero-rated supply as any supply listed in the **2nd** Schedule to the VAT Act 2013. He argued that the letter and spirit of the VAT Act, 2013 is clear and unambiguous that VAT will only apply to taxable supplies made in Kenya. He submitted that it is erroneous and contrary to the express statutory provisions for the Respondent to seek to collect VAT in Kenya on supplies which are made outside the country.

17. On the VAT status for services in respect of goods in transit between September 2014 and April 2015, the appellant's counsel submitted that section **28** of the Finance Act 2014 amended Part **II** of the **1st** Schedule to the VAT Act, 2013 by introducing Paragraph **19** which provides that:- *"The supply of the following services shall be exempt supplies…taxable services in respect of goods in transit."* He described this provision as an amendment relating to goods in transit as at **14th** September 2014 and cited section **2** of the VAT Act, 2013 which provides "exempt supplies "means supplies specified in the **1st** Schedule which are not subject to tax.'

18. Citing section **2** of the VAT Act, 2013, counsel argued that an exempt supply cannot be a taxable supply. He also cited section **5** of the VAT Act, 2013 and section **5(2)** of the VAT Act, 2013 and argued that the import of section **5** of the VAT Act, 2013 is that all taxable supplies, be they goods or services, are subject to tax at either **16%** or **0%.**

19. Additionally, the appellant's counsel argued that the status of being either 'taxable' or 'exempt' are disjunctive hence it is legally and logically incorrect and absurd to refer to a taxable service as being exempt. He relied on section **17(1)** of the VAT Act, 2013 and argued that a taxable service comes with the right to recover input VAT, but the VAT Act, 2013 does not permit any input VAT to be claimed in respect of exempt services. He drew a parallel from the UK VAT Guide Notice 700 and submitted that the services provided by the appellant were used and consumed outside Kenya, hence, they fall within the definition of 'services exported out of Kenya' under Section **2** of the VAT Act, 2013 which are zero-rated.

20. Counsel reiterated that the interpretation of tax statutes is restricted to the clear words of statute and relied on *Keroche Industries Limited v Kenya Revenue Authority & 5 Others **[5]*** which held: - *"taxation can only be done on clear words and cannot be on intendment. …even where the inclination of the legislature is not clear or where there are two or more possible meanings, the inclination of the court should be against a construction or interpretation which imposes a burden, tax or duty on the subject.'* He submitted that in case of an ambiguity or two or more possible meanings, the law should be interpreted in favour of the Taxpayer.

21. Regarding VAT on sale of the motorcycles, counsel submitted that under the **5th** Schedule of the repealed VAT Act, motor cycles were zero rated supplies, but they were left out of the Zero-rating in the **2nd** Schedule in the VAT Act, 2013 and effectively became taxable at the standard rate of **16%.** He cited section **12 (1)** of the VAT Act, 2013 which provides: -

> "*Subject to subsection (3), the time of supply, including a supply of imported services, shall be the earlier of—*
>
> *(a) the date on which the goods are delivered or services performed;*
>
> *(b) the date a certificate is issued by an architect, surveyor or any other person acting as a consultant in a supervisory capacity;*

(c) the date on which the invoice for the supply is issued; or

(d) the date on which payment for the supply is received, in whole or in part."

and faulted the Tribunal for holding that the invoices for motorcycles were raised on **11th** September 2013 which was the tax point. He argued that both the Tribunal and the Respondent incorrectly failed to consider that the supply was deemed to be made in April 2013 during the period when the repealed VAT Act applied.

22. Counsel submitted that the Respondent erroneously relied on Section **16(1)** of the ITA as the basis for disallowing expenses supported by petty cash vouchers. He cited *Hancock v General Reversionary and Investment Company****[6]*** for the holding 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..."*

23. Counsel submitted that expenses can only be disallowed where they are not incurred as an ordinary business expense and represent a capital outlay. He argued that the Respondent did not dispute the fact that the appellant expended amounts in the repair of its vehicles while they were involved in the transport of goods from Kenya to Uganda. He submitted that the *ad-hoc* repairs were conducted on a need's basis from the nearest possible vendor who often times did not issue tax invoices. He relied on *Cohan v Commissioner of Internal Revenue****[7]*** which held that deductions cannot be disallowed where receipts are unavailable provided that the computation basis is clear. Also, he cited *Vanicek v C.I.R.****[8]*** which held that deductions were allowable on the basis of the rule set out in the *Cohan case* where there was some basis on which estimates could be made. He submitted that the appellant provided Petty cash vouchers which set out the amounts expended by its drivers on *ad-hoc* roadside repairs and maintenance, and that the validity of these petty cash vouchers was not challenged.

24. Counsel cited section **54A (1)** of the ITA and argued that there is no legal basis for the refusal to accept the petty cash vouchers because the said section only requires the maintenance of records that are adequate for the purpose of computing tax but those records are not restricted to third party invoices. He argued that the only penalty for not complying with the said section under sub-section **(2)** is that- *"Any person who contravenes the provisions of subsection (1) shall be liable to such penalty, not exceeding twenty thousand shillings, as the Commissioner may deem fit to impose."* He submitted that the penalty under the said section cannot be the disallowance of the entire expense.

Respondent's advocates submissions

25. On whether the transhipment cargo constitutes a service exported out of Kenya within the meaning of Section **2** of the VAT Act, 2013, the Respondent's counsel submitted that section **8 (2)** of the repealed VAT Act provided that goods would be zero-rated if they were of a description contained in the **5th** Schedule or the **8th** Schedule of the repealed VAT Act. He referred to Paragraph **11** of the **5th** Schedule of the repealed VAT Act which provided for the zero rating of, "*The supply of taxable services in respect of goods in transit*."

26. Counsel argued that since transportation services are taxable services, the supply of transport services in respect of goods in transit was zero rated as per Paragraph **11** of the **5th** Schedule. He argued that to simplify VAT administration and reduce the compliance costs and to address the burden of VAT Refunds, the then VAT Act was repealed by the VAT Act, 2013 which provided for the reduction in exempt and zero-rated goods meaning most goods and services were taxable at the general rate of **16%.**

27. Counsel submitted that section **5 (1) (a)** of the VAT Act, 2013 provides that, "*A tax, to be known as value added tax, shall be charged in accordance with the provisions of this Act on a taxable supply made by a registered person in Kenya*." He argued that this appeal falls under Section **5 (2)** which provides, "*The rate of tax shall be – In the case of a zero-rated supply, zero percent; or* <u>*In any other case, sixteen percent of the taxable value of the taxable supply*</u>*, the value of imported taxable goods or the value of a supply of imported taxable services*." He argued that for a supply to qualify for zero-rating under Section **5 (2) (a),** the supply must fall within the provisions of Section **7 (2**) which provides that: - "*A supply or importation of goods or services shall be zero-rated under this section if the goods or services are of the description for the time being specified in the Second Schedule*."

28. Counsel argued that for the period 2**nd** September **2013** to **19th** September **2014**, Part **A** on Zero Rated Supplies of the **2nd** Schedule had expressly zero-rated only eight items which *did not include the supply of taxable services in respect of goods in transit,* hence, the supply of taxable services in respect of goods in transit was not provided for in the **2nd** Schedule to the VAT Act, 2013, meaning that the services were taxable at the general rate of **16%**.

29. He urged the court to evaluate the VAT Act, 2013 and find that between **2nd** September **2013** and **19th** September **2014**, the services rendered by the appellant were taxable at **16%,** and submitted that the Finance Act No. 16 of 2014 expressly exempted '*the supply of taxable services in respect of goods in transit*' in Part II of the **1st** Schedule and vide Finance Act. No. 14 of 2015 which came into force on **11th** September 2015 the supply of taxable services in respect of goods in transit' was zero-rated.

30. He argued that during the audit period, (2nd September 2013 to 14th September 2014), the supply of the service was taxable at the general rate of **16%.** He submitted that the impugned assessment complies with Article **210** of the Constitution. He cited *Cape Syndicate v Inland Revenue Commissioner*[9] which held that "*In a taxing Act one has to look merely at what is clearly stated…. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.*" Additionally, he cited *Republic v Kenya Revenue Authority Exparte Bata Shoe Company (Kenya) Limited*[10] and *Inland Revenue Commissioner v Duke of Westminister****[11]*** for the proposition that if one comes within the letter of the law he must be taxed.

31. On whether the appellant's trans-shipment cargo constituted a service exported out of Kenya counsel submitted that the service was executed within Kenya and it falls within the definition in Section **2** of the VAT Act, 2013 which defines the supply of services as: -

a) *"anything done that is not a supply of goods or money, including-*

b) *The performance of services for another person;*

c) *The grant, assignment or surrender of any right;*

d) *The making available of any facility or advantage; or*

e) *The toleration of any situation or the refraining from the doing of any act;*

32. Counsel submitted that the service was supplied and consumed in Kenya and falls within the definition of a supply of service under Section **2** of the VAT Act, 2013. He submitted that paragraph **1**-part **A** of the **2nd** Schedule of the VAT Act, 2013 does not apply because the services in question are not export services. He submitted that services exported out of Kenya are defined under Section **2** of the Act to mean: - *"a service provided for use or consumption outside Kenya,"* as opposed to the service offered by the applicant which was consumed within the borders of Kenya and therefore cannot be an export service. He referred to the definition of the word '*transit*' in the Oxford Dictionary that: - '*the carrying of people or things from one place to another*' or '*the action of passing through or across a place*' and argued that in the instant case the transit services are offered from the Port of Mombasa to the border point, hence the transit service is wholly used and consumed in Kenya.

33. Regarding the question whether the trans-shipment services provided by the appellant were zero rated or subject to standard **16%** rate during the period of review, counsel cited section **5(1)(a)** of the VAT Act, 2013 and argued that the section brings to charge supplies made by a registered person in Kenya which include the supply of transportation services for goods in transit. He referred to section **7** which specifies the goods and services that may be zero-rated as: - *"A supply or importation of goods or services shall be zero-rated under this section if the goods or services are of the description for the time being specified in the Second Schedule"* and submitted that unless a supply is listed in the **2nd** Schedule, it will be liable to the standard rate of tax as provided by Section **5**.

34. Additionally, counsel submitted that under the VAT Act 2013, services for goods in transit were not specified in the **2nd** Schedule as zero-rated supplies and therefore they were not accorded zero rated status, however, they became taxable at the standard rate of **16%.** He submitted that the Finance Act 2014 amended the VAT Act 2013 on **14th** September 2014 and exempted services offered in relation to goods in transit from VAT which meant that between **2nd** September 2013 and **14th** September 2014, services for goods in transit were liable to VAT at the standard rate of **16%,** hence, the appellant was charged VAT for the services offered during the period as required by section **5 (1)(a**) of the VAT Act 2013.

35. Counsel maintained that the '*supply of taxable services in respect of goods in transit*' was not listed in the **2nd** Schedule to the VAT Act, 2013, hence, the services cannot be deemed to be zero-rated. He submitted that under section **5 (2) (b)** of VAT Act, 2013, the rate applicable to the services rendered by the appellant is **16%** percent. He placed reliance on *Astall v HMRC****[12]*** and *Inland Revenue Commissioner v Hinchy*[13] which held that one has look at the purpose and intention of the relevant provision including the preamble to the Act.

36. Counsel argued that the Tribunal was right in noting that it was not true that the levying of tax on transport amounts to double taxation as the transport cost is considered as an allowable expense by the importer of goods at the destination and if any VAT is paid by the importer at the destination, the same was allowed to be claimed as input tax in the importer's books of accounts. He submitted that the appellant wrongly interpreted the destination principle because the Respondent imposed VAT on income earned for the transportation services within Kenya. He argued that the transport services within Kenya did not amount to exported services and could therefore not lead to a double taxation.

37. Counsel submitted that the OECD International VAT/GST Guidelines on Neutrality approved in June 2011 distinguish the destination principle on VAT of goods from that imposed on services. It states: *"Applying the destination principle to supplies of services and intangible products is more difficult. The nature of services and intangibles is such that there are no customs controls that can confirm their exportation and no customs controls to impose the VAT at importation. Thus, special guidelines have been developed for determining the jurisdiction of taxation for international supplies of services and intangibles that reflect the destination principle…"* He argued that the OECD Guidelines are to be applied where the law is not clear or the law has gaps that have to be filled by such guidelines. Counsel submitted that sections **5 (2) (b**) and **7 (2)** of the VAT Act, 2013 read together with the **2nd**Schedule to the Act leaves no doubt that the supply of transportation services in respect of goods in transit is chargeable to tax at **16%.** He invited this court to find that the VAT Act exhaustively covers the services in dispute herein and there is no need to refer to the OECD Guidelines.

38. On the issue whether the appellant could claim input tax for exempt services, counsel submitted that services offered in relation to goods in transit were made exempt pursuant to the amendment of the VAT Act 2013 by section **28** of the Finance Act, 2014. He argued that Input tax in relation to exempt supplies is non-deductible and disallowable under section **17(6)** of the VAT Act 2013. He submitted that the appellant was not entitled to claim input tax on services provided between **15th** September 2014 and June 2015 because during the said period, the appellant's sole business was transport services for transit goods, which service was made exempt by VAT Act 2013 and section **28** of the Finance Act, 2014. He argued that the appellant's services were not zero rated between **14th** September 2014 and **12th** June 2015, and that on **14th**September 2014, the Finance Act 2014 amended the **1st** Schedule of the VAT Act, 2013 by exempting services offered in relation to goods in transit from VAT. He argued that all services provided by the appellant between **15th**September 2014 and March 2015 were exempt from VAT, hence, no input tax can be claimed.

39. On the application of Section **12(1)** of VAT Act, 2013, counsel argued that the motorbikes were supplied on **11th** September 2013 on

which date the tax became due. He dismissed the appellant's claim that the motorbikes were delivered in April on grounds that no documentary evidence was provided such as a delivery note or an invoice raised at that point to substantiate his assertion adding that the appellant bears the onus of proof as per section **56 (1)** of the Tax Procedures Act[14] to provide contrary information to an assessment.

40. Regarding the question whether the appellant proved the expenses claimed, he argued that section **15** of the ITA allows expenses that are wholly and exclusively incurred in the production of income which must be supported by documentary evidence in order to be allowable. He submitted that the Tribunal correctly disallowed the direct expenses incurred by the appellant for being unsupported by documentary evidence to prove that they were wholly and exclusively incurred in the production of income. Counsel submitted that the test applicable in the determination of expenses incurred wholly and exclusively for income purposes is provided in section **15** of the ITA and argued that the documents provided by the appellant could not support the expenses as they were merely petty cash vouchers which were insufficient to prove that the expenses were actually incurred in the production of income. He submitted that the Commissioner of Domestic Taxes must be satisfied that the expenses claimed are supported and allowable and only if it is wholly and exclusively incurred in the normal course of business. He urged the court to be guided by *Republic v Commissioner for Domestic Taxes & Another Exparte: Stockman Rozen (K) Limited* ***[15]*** which held that: -*"…taxable income is that has accrued minus allowable deductions and that the said deductions from the accrued income must be those that are allowable under sections 15 (1) and (2) which includes debts at section 15 (2) (a).*

41. Additionally, the Respondent's counsel submitted that section **54(1)** of the ITA requires any person carrying out business to keep records of all receipts and expenses, goods acquired and vouchers among other records which in the opinion of the Commissioner are adequate for purposes of computing tax. He submitted that the impugned decision was not made in consideration of the relevant provisions of the VAT Act and the ITA. He urged the court to confirm the assessments dated **8th** September 2015.

Appellant's advocates further submissions

42. In his further submissions, the appellant's counsel essentially reiterated his earlier submissions and relied on *Republic v the Commissioner of Value Added Tax ex-parte Krystalline Salt Ltd****[16]*** *cited).* He argued that the OECD International VAT/ GST Guidelines on Neutrality are consistent with Kenyan legislation, and that the Respondent erroneously interpreted the destination principle as set out in the OECD VAT/ GST Guidelines on Neutrality Paragraph 1 of which provides-'*The application of VAT to international trade is based on the destination principle* which is sanctioned by the World Trade Organization rules. He argued that Paragraph **1** of Part **A** of the **2nd** Schedule to the VAT Act, 2013 provides for the zero rating of the exportation of goods or taxable services which is consistent with the destination principle.

43. Counsel argued that the destination principle requires that services exported out of Kenya should be zero-rated which is consistent with the VAT Act, 2013 and Regulation 20(2). He submitted that the Respondent has failed to address the issue whether supplies are either taxable or exempt. He cited *Commissioner of Income Tax v Westmont Power (K)****[17]*** which cited with approval *Inland Revenue v Scottish Central Electricity Company* which held that *"even though taxation is acceptable and even essential in democratic societies, taxation laws that have the effect of depriving citizens of their property by imposing pecuniary burdens resulting also in penal consequences must be interpreted with great caution. In this respect, it is paramount that their provisions must be express and clear so as to leave no room for ambiguity…any ambiguity in such a law must be resolved in favour of the taxpayer and not the Public Revenue Authorities which are responsible for their implementation.'*

44. Counsel submitted that the only requirement under section **15** of the ITA for the deducting expenses is that they must have been incurred wholly and exclusively in the production of income. He submitted that this section does not expressly or implicitly provide for the type of documentation or records required to support such expenditure. He cited section **37A (2)** of the Tax Procedures Act[18] which provides that: - *'Where a person has no documentation to support expenditure, such person shall be allowed a deduction of forty per cent of the expenditure.'* He argued that the appellant provided petty cash vouchers hence there was no statutory basis for the Respondent to reject the documentation.

Determination

45. Our Constitution requires a purposive approach to statutory interpretation.[19]The purpose of a statute plays an important role in establishing a context that clarifies the scope and intended effect of a law.[20] Schreiner JA, eloquently articulated the importance of context in statutory interpretation as follows: -

> "*Certainly, no less important than the oft repeated statement that the words and expressions used in a statute must be interpreted according to their ordinary meaning is the statement that they must be interpreted in the light of their context. But it may be useful to stress two points in relation to the application of this principle. The first is that 'the context', as here used, is not limited to the language of the rest of the statute regarded as throwing light of a dictionary kind on the part to be interpreted. Often of more importance is the matter of the statute, its apparent scope and purpose, and within limits, its background."*[21]

46. An interpretation which gives regard to the manifest purpose and contextual approach has been acknowledged as the proper and modern approach to statutory interpretation.***[22]***In resolving a problem, where the language of a statute leads to ambiguity the apparent purpose of the provision and the context in which it occurs will be important guides to the correct interpretation."[23] In the United Kingdom, the Chancery Division of the High Court, per Lord Greene MR in *In re Birdie v General Accident Fire and Life Assurance Corporation Ltd*, [24] stated the following on the contextual approach to statutory construction:-

> "*The real question to be decided is, what does the word mean in the context in which we here find it, both in the immediate context of the sub-section in which the word occurs and in the general context of the Act, having regard to the declared intention of the Act and the obvious evil that it is designed to remedy."*

47. A contextual or purposive reading of a statute must of course remain faithful to the actual wording of the statute and it must be sufficiently clear to accord with the rule of law.[25] Olivier JA provided useful guidelines for the factors to be considered when conducting a purposive interpretation of a statutory provision as follows: -[26]

> "*In giving effect to this approach, one should, at least, (i) look at the preamble of the Act or at the other express indications in the Act as to the object that has to be achieved; (ii) study the various sections wherein the purpose may be found; (iii) look at what led to the enactment (not to show the meaning, but also to show the mischief the enactment was intended to deal with); (iv) draw logical inferences from the context of the enactment."(Emphasis supplied)*

48. The above excerpt becomes clear if we read the preamble to the VAT At 2013, which reads "An Act of Parliament to review and update the law relating to value added tax; to provide for the imposition of value added tax on supplies made in, or imported into Kenya, and for connected purposes." A purposive interpretation requires the courts and regulatory bodies tasked with enforcement of the Act to interpret and apply the Act in a manner that gives effect to its objects as set out in the preamble.

49. The gravamen of the appellant's case is that its transportation services provided from the port of Mombasa to Kampala, Uganda are exported services within the meaning of section **2** of the VAT Act, 2013. A useful starting point is to examine the position under the Repealed VAT Act. The definition of *"service exported out of Kenya"* under the repealed Act read: - *"Service exported out of Kenya means a service provided for use or consumption outside Kenya whether the service is performed in Kenya or both inside and outside Kenya."* A reading of this definition shows that under the repealed Act, it did not matter whether the service was provided in Kenya or outside Kenya. The determining factor was whether the *service provided was for use or consumption outside Kenya*. On the other hand, The VAT 2013, defines *"service exported out of Kenya" to mean a service provided for use or consumption outside Kenya."* Under the VAT Act, 2013, the test is simple, namely, the service provided must be for use or consumption outside Kenya.

50. The definition under the repealed Act has been the subject of judicial interpreting. The High Court in *Commissioner of Domestic Taxes v Total Touch Cargo Holland* [27]a decision rendered on on **21st** day of December 2018 in a case in which which the facts were graphically identical to the instant case, stated: -

> *(13) There is only one main issue for determination in the present appeal that is whether the services rendered by KAHL to the Respondent can be considered to be exported services within the meaning of Section 2 of the VAT Act (now repealed)….*
>
> *(15) This dispute therefore revolves around the interpretation of the term "service exported out of Kenya" as provided for in Section 2 of the repealed VAT Act. Section 2 of the VAT Act (now repealed) defined "exported service" in the following terms "Service exported out of Kenya means a service provided for use or consumption outside Kenya whether the service is performed in Kenya or both inside and outside Kenya." A clear reading of this provision is that for a service to be deemed an "exported service," it matters not whether that service was performed in Kenya or outside Kenya. The determining factor is the location where that service is to be finally used or consumed. Therefore, an exported service will be one which is provided for use or consumption outside Kenya.*
>
> *(16) In F.H. SERVICES KENYA LIMITED –VS- COMMISSIONER OF DOMESTIC TAXES, Appeal No.6 of 2012, the Appeal tribunal found that what was pertinent, in Kenyan law as far as VAT legislation was concerned was where the services are finally used or consumed. In this a case F.H Services Ltd represented Flora Holland a company incorporated in the Netherlands, which was involved in trading of flowers. F.H Services provided services to Flora Holland for the export of flowers from Kenya to buyers overseas. The holding of the tribunal in that case was that since the benefit of the marketing services provided by F.H Services Ltd accrued outside Kenya, these were therefore exported services. In that case the Tax Tribunal held as follows:- To our mind then, it is immaterial where the place of the performance of the service takes place, it can be in China, in Latin America, in Ireland, in Mesopotamia, in Asia or Europe or even here in Kenya; what is material is where the use or consumption of the service takes place, not the place of services [emphasis supplied]. Similarly in the Indian case of PAUL MERCHANTS LTD –VS- CCE CHANDIGARH [2012 (12) TMI 424 – CESTAT, DELHI LB] the tribunal was of the view that even though the services in question were rendered in India the word "used" could not be equated with the word "performed" especially where the benefit of the service provided accrued outside India. Further in the case of Ms MICROSOFT CORPORATION (1)(P) –VS- COMMISSIONER OF SERVICE NEW DELHI. WP (c) NO.1460/2009 (Also an Indian Authority) the Tribunal concluded that the words "used outside India" referred to the place where the benefit of the service accrued.*
>
> *(22) The Appellant also submitted that Regulation 20 of the VAT Rules qualifies the definition of an exported service under Section 2 of the VAT Act (now repealed). Regulation 20 provides:- "Except as is otherwise provided in the Act, services shall be deemed to have been supplied in Kenya:-Where the supplier has established his business or has a fixed physical establishment in Kenya and the services are physically used or consumed in Kenya regardless of the location of the payer."*
>
> *(23) According to the Appellant where a supplier is physically established in Kenya then services provided by that supplier are taxable in Kenya. The Appellant further submitted that the fact that the new VAT Act 2013 incorporated Regulation 20 as a substantive provision being Section 8, made the intention of the legislature in this regard very clear. The Respondent however countered that under the 2012 VAT ACT (the applicable legislation in this matter), Regulation 20 amounted to subsidiary legislation in so far as it sought to provide that a service provided in Kenya cannot be deemed to be an exported service. It was the Respondents contention that a subsidiary legislation cannot override primary legislation being Section 2 of the VAT Act.*
>
> *(24) The Appeal Tribunal rejected the Appellants reliance on Regulation 20 to limit the ambit of Section 2 of the VAT Act. In the COCO COLA Case (Supra) the Tribunal held as follows:- "For a start, Regulation 20(i) (a) has no nexus with a service exported out of Kenya as defined under S.2 of the VAT Act. If a service has been exported out of Kenya i.e if a service has been provided for use or consumption outside Kenya and it is truly used and consumed outside Kenya, the issue of Regulation 20(1) can never arise. The Regulation is simply there to qualify what a local supply is. Similarly in the F.H Services case (Supra) the tribunal in holding that principal legislation is superior to subsidiary legislation stated that:- "The principal legislation is higher law than the subsidiary legislation, and unlike the subsidiary legislation which can be altered without going through Parliament, principal law*

can only be altered by Parliament. It is therefore critical for the Respondent to understand that in the event that he wants to rely on Regulation 20(i) (d) for his case, he must first go to the principal legislation, the main law that is contained in the main body of the VAT Act. Specifically, the meaning of "service exported out of Kenya" Based on the above it is clear that principal legislation overrides subsidiary legislation, thus the Appellant cannot rely on Regulation 20 to override the definition provided by Section 2 of the repealed Act of "services exported out of Kenya." To further buttress this point the Court of Appeal in WAVINYA NDETI –VS- INDEPENDENT ELECTORAL BOUNDARIES (IEBC) & 4 OTHERS [2014]eKLR held that:- It is an established principle of construction of statutes that no subsidiary legislation shall be inconsistent with the provisions of an Act (See Section 31(b) of the Interpretation and General Provisions Act – Cap 2 Laws of Kenya). A subsidiary legislation cannot repeal or contradict express provisions of an Act from which they derive their authority. Based on the above authorities I find that Regulation 20 being subsidiary legislation cannot negate or contradict the definition of an "exported service" in the principal legislation being Section 2 of the repealed Act.

(25) The Appellant also placed reliance of Section 6(3) and (4) of the repealed VAT Act which provides:- "(3) A person who makes or intends to make taxable supplies is a taxable person while he is, or is required under the sixth schedule and a taxable supply is a supply of taxable goods or services made or provided in Kenya. (4) Tax on any supply of goods or services shall be a liability of the person making the supply and (subject to the provisions of this Act relating to accounting and payment) shall become due at the time of supply." The Respondent contended that since the relevant services were provided in Kenya, taxes became due immediately upon supply. However it is trite law that the provisions of any statute should be read holistically in order to give meaning to what was intended bythe draftsman. In THE ENGINEERS BOARD OF KENYA –VS- JESSE WAWERU WAHOME & OTHERS CIVIL APEAL NO.240 OF 2013 the court stated that:- "One of the canons of statutory interpretation is a holistic approach…no provision of any legislation should be treated as "stand alone." An act of Parliament should be read as a whole, the essence being that a proposition in one part of the Act is by implication modified by another proposition elsewhere in the Act."

(26) Therefore Sections 6(3) and (4) of the repealed VAT Act reveal that what was intended by Section 2 of the same Act was that a service used or consumed outside Kenya would be an exported service whether or not the same was performed or supplied in Kenya. The Appellant misinterpreted the law by concluding that the services in question were consumed in Kenya merely by virtue of the fact that those services had been performed in Kenya.

51. As was correctly held in the above case, under the repealed Act, the determining factor was the location where that service is to be finally used or consumed. However, under the VAT 2013, the test is test is whether the exported service will be one which is provided for use or consumption outside Kenya. Essentially, consumption is not determined by reference to the payer, location of the payer of the services or location of the person who is requisitioning for the service. Under the VAT Act, 2013, what is important is the place of the consumption of the services. My understanding of the definition under the VAT 2013 Act is that the service must be consumed in Kenya. In the instant case, the transport services were consumed in Kenya.

52. A holistic reading of the Act requires that we bring into view the various provisions of the statute dealing with a particular subject and construe them together so as to bring out the purposes of the statute and the real intention of the legislature. The long title and the general scope of the Act constitute the background and the general scope of the context in which it must be examined. The whole or any part of the Act may be referred to and relied upon in seeking to construe any particular part of it, and the construction of any particular phrase requires that it is to be viewed in connection with the whole Act and not that it should be viewed detached from it. The words of the Act, and in particular the general words, cannot be read in isolation and their content is to be derived from their context. Therefore, words and phrases which at first sight might appear to be wide and general may be cut down in their construction when examined against the objects of the Act which are to be derived from a study of the Act as a whole including the long title. Until each part of the Act is examined in relation to the whole it would not be possible to say that any particular part of the Act was either clear or unambiguous.

53. It is now settled law that the title of a statute is an important part of the Act and may be referred to for the purpose of ascertaining its general scope and of throwing light on its construction, although it cannot override the clear meaning of the enactment.

54. Section **8** of the VAT Act, 2013 is relevant. It provides: -

(1) A supply of services is made in Kenya if the place of business of the supplier from which the services are supplied is in Kenya.

(2) If the place of business of the supplier is not in Kenya, the supply of services shall be deemed to be made in Kenya if the recipient of the supply is not a registered person and—

(a) the services are physically performed in Kenya by a person who is in Kenya at the time of supply;

(b) the services are directly related to immovable property in Kenya;

(c) the services are radio or television broadcasting services received at an address in Kenya;

(d) the services are electronic services delivered to a person in Kenya at the time of supply; or

(e) the supply is a transfer or assignment of, or grant of a right to use, a copyright, patent, trademark, or similar right in Kenya.

55. A reading of this section leaves no doubt the clear and manifest intention of the legislature. In the instant case, the services were performed in Kenya within the meaning of the above section and the definition in section 2.

56. There is no contest that the applicant's transit services were rendered between **2nd** September 2013 and **14th** September 2014. The VAT

Act, 2013 was assented on **14th** August, 2013. Its commencement date was **2nd** September, 2013; hence the Act applies to this case. Section 5 of the Act is relevant. It provides: -

5. Charge to tax

(1) A tax, to be known as value added tax, shall be charged in accordance with the provisions of this Act on—

(a) a taxable supply made by a registered person in Kenya;

(b) the importation of taxable goods; and

(c) a supply of imported taxable services.

(2) The rate of tax shall be—

(a) in the case of a zero-rated supply, zero per cent; or

(aa) in the case of goods listed in section B of Part I of the First Schedule, eight percent of the taxable value, effective from the date of assent;

(b) in any other case, fourteen per cent of the taxable value of the taxable supply, the value of imported taxable goods or the value of a supply of imported taxable services.

57. Even though it is common ground that the services were rendered in Kenya, it is useful to mention that Section **11** of the Act defines the place of supply as follows:-

11. Place of supply of goods

A supply of goods occurs in Kenya if—

(a) the goods are delivered or made available in Kenya by the supplier;

(b) the supply of the goods involves their installation or assembly at a place in Kenya; or

(c) where the goods are delivered outside Kenya, the goods were in Kenya when their transportation commenced.

58. The appellant argued that Regulation **20** of the Regulations made pursuant to the repealed act continued to apply until 2017 Regulations came into force. To fortify his argument, counsel cited section **24** of the *Interpretation of General Provisions Act**[28]*** and section **67** of the VAT Act 2013. The said argument is appealing. However, it collapses not on one but several fronts.

59. *First*, it is an elementary principle of law that subsidiary legislation cannot override the express provisions of a statute. (See *Republic v Kenya School of Law & Council of Legal Education ex parte Daniel Mwaura Marai;*[29] *Republic v Council of Legal Education & another Ex parte Sabiha Kassamia & another*[30] and *Republic v Council of Legal Education & another Ex-Parte Mount Kenya University*[31]*).* Also relevant is Section **31 (b)** of the *Interpretation and General Provisions Act*[32] which provides that no subsidiary legislation shall be inconsistent with the provisions of an Act of Parliament.

60. Under the VAT Act, 2013, transportation of goods in transit is not zero-rated nor was it exempted from VAT. As the Tribunal correctly held, to qualify for zero-rated status, the service should be specifically provided in the **2nd** Schedule to the Act. This renders the Regulation cited by counsel irrelevant to this case.

61. *Second*, Section **2** of the VAT Act, 2013 defines "zero-rated supply" to mean a supply listed in the **2nd**Schedule. Only the supplies listed in the **2nd** Schedule are zero-rated. As the Tribunal held, services offered in relation to goods in transit were previously zero rated under paragraph **11** of the **5th** Schedule of the repealed Act, but the VAT Act, 2013 did not list the said services in the **2nd** Schedule. Additionally, the Finance Act 2014 amended the 1st Schedule of the VAT Act 2014 by exempting services offered in relation to goods in transit from VAT. In addition, section **28** of the VAT Act, 2013 was deleted by the Tax Procedures Act[33]2nd Schedule which provides that the Value Added Tax Act, 2013, is amended in Part VII by deleting sections 20, 21, and 23 to 29. This amendment extinguishes the appellant's argument that the Tribunal erred in law in finding that the appellant was not entitled to claim input VAT on services provided between **15th**September 2014 to March 2015 on the basis that the services were exempted from VAT pursuant to the amendments made by Section **28(b**) of the Finance Act, 2014.

62. Regarding the appellant's claim on input tax, the Tribunal held that the services offered were exempt vide the above amendment to the VAT Act 2013 by section **28** of the Finance Act, 2014, an act of Parliament which amended the law relating to various taxes and duties and for matters incidental thereto. The said Act amended the **1st** Schedule to the VAT Act, 2013. My reading of the said amendment leaves me with no doubt that the Tribunal correctly found that the appellant was not entitled to claim input tax on the services in question.

63. The appellant faulted the Tribunal for failing to make a finding on the ambiguity created by section **28(b)** of the Finance Act 2014 which classified "the supply of taxable services in respect of goods in transit" as exempt services as read with the section **5** of the VAT Act which provides that taxable services attract VAT and failing to consider the said ambiguity and interpret the section in favor of the appellant to the effect that that services attracted VAT at the zero rate.

64. The appellant's argument premised on then alleged absurdity created by section **28 (b)** of the Finance Act is in my view legally frail. This is because there are important principles which apply to the construction of statues such as **(a)** presumption against "*absurdity*" – *meaning that a court should avoid a construction that produces an absurd result.* There was no attempt to demonstrate absurdity. **(b)** the presumption against unworkable or impracticable result - *meaning that a court should find against a construction which produces "unworkable or impracticable" result*. Again, nothing was said or alluded to about this test. **(c)** Presumption against anomalous or illogical result, - *meaning that a court should find against a construction that creates an "anomaly" or otherwise produces an "irrational" or "illogical" result.* No attempt was made to demonstrate that creating two categories creates an illogical or irrational result. **(d)** Presumption against artificial result – *meaning that a court should find against a construction that produces "artificial" result.* There was no argument at all that creating two categories result in an illogical result. **(e)** The principle that the law should serve public interest –meaning *that the court should strive to avoid adopting a construction which is in any way adverse to "public interest," " economic", "social" and "political" or "otherwise*." The appellant did not assault the decision from this perspective nor do I see any. On the contrary, the amendment created by the said section is clear and unambiguous.

65. Regarding the question whether payments for the motorbikes delivered in September 2013 were subject to VAT at 16%, the Tribunal found that no documentary evidence was availed to support the said position. The Tribunal correctly held that the VAT Act, 2013 came into force on 2nd September 2013 thereby removing the exempt status of the sale of motorbikes, hence the appellant was not entitled to claim exempt status on the invoice dated **11th** September 2016.

66. One of the fundamental conditions that must be satisfied for an item of expenditure to be deductible, is that it must incurred 'wholly and exclusively' for the purposes of the trade, profession or vocation. The 'wholly and exclusively' test can only be satisfied if the sole reason for incurring the expenditure is for the purposes of the trade in question. There are two matters for consideration in determining if this is the case, one of law and one of fact.

67. The question of law is whether expenditure is capable of being incurred wholly and exclusively for the purpose of the trade. After determining that the expense is capable of being incurred in this way, it is necessary to determine whether the expenditure was in fact incurred for the sole purpose of the trade in question.

68. These two questions determine firstly whether any deduction is allowed for tax purposes and, secondly, how much of a deduction is allowable. Other specific principles or tests developed over time which are applied in ascertaining whether expenditure is in fact used for the sole purpose of the trade are the principle of remoteness, the principle of duality and the principle of earning profit.

69. Expenses incurred in the production of gross income would be deductible so that it would only be nett income which would be subject to income tax. For the expenses, to be deductible, they must satisfy certain statutory requirements under the ITA. Generally, tax deductions are allowed for expenses incurred wholly and exclusively in the production of income. Expenses of a capital, private or domestic nature and expenses incurred prior to the commencement or after the cessation of a business are not tax deductible. All expenses attached to the performance of a business operation *bona fide* performed for the purpose of earning income are deductible, irrespective of whether such expenses are necessary for its performance or attached to it by chance or are *bona fide* incurred for the efficient conduct of such business operation, provided they are so closely linked to it that they can be regarded as part of the cost of performing it.[34] Schreiner J stated in *CIR v Drakensberg Garden Hotel (Pty) Ltd*:[35]–

> "*To be deductible the expenditure must have been actually incurred in the production of income, it must not be of a capital nature and it must have been wholly or exclusively laid out for the purpose of trade. It need not, however, have been causally related to the income which is the subject of the assessment in question.*"

70. The expenditure must, however, have some connection to the income-earning operations of the taxpayer to render it deductible. In *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd,**[36]*** Schreiner J stated that: -

> "*In deciding how the expenditure should properly be regarded the court has to assess the closeness of the connection between the expenditure and the income earning operations, having regard both to the purpose of the expenditure and to what it actually effects.*"

71. In order to determine whether a specific expenditure is incurred in the production of income, it has to pass the following dual test, namely, the expenditure must have been incurred for the purpose of producing income. This is the subjective leg of the test. It should be assessed by considering the stated intention of the taxpayer at the time when the expenditure was incurred. The effect of the expenditure must have been to produce income. This is the objective leg of the test. It requires a direct nexus between the expenditure and the income. The criterium for determining whether expenditure was incurred in the production of income is, in my view, whether the expenditure was connected to the taxpayer's income earning operations, rather than whether the expenditure actually produced income or was directly linked to income. The appellant relied on petty cash vouchers to support its claim. The law as I understand it is that the onus lies on the appellant to persuade the Commissioner that the expenses were incurred. In my view, the appellant failed to discharge the burden to the satisfaction of the commissioner by relying on petty cash vouchers instead of receipt. I find no reason to fault the Tribunal's decision on this ground.

72. I now turn to the destination principle. I find it necessary to reproduce an excerpt from the earlier cited case of *Commissioner of Domestic Taxes v Total Touch Cargo Holland* [37] which addressed this principle in detail as follows: -

> *(27) The Respondent referred to the VAT guidelines on International Trade and services in intangibles developed by the*

ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD). The said guidelines are applicable in interpreting Kenyan Tax Law as was held in the case of UNILEVER KENYA LIMITED –VS- THE COMMISSIONER OF INCOME TAX – Income Tax Appeal No.753 of 2003) where the court held… "The ways of doing modern business have changed very substantially in the last 20 years or so and it would be fool hardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own laws. To do otherwise would be highly short sighted." The Respondent submitted that under the "destination principle" in the OECD guidelines, goods, services and intangibles are zerorated when leaving one jurisdiction and are taxed upon importation in another jurisdiction. In OECD guidelines the "destination principle" is preferred to the "origin principle" as it helps to achieve VAT neutrality. The "origin principle" which is the opposite of the "destination principle" provides that tax accrues to the jurisdiction from which supply is made. In OECD guidelines export of a service is associated with the place of consumption of the service. The guidelines and the main rule by OECD on tax for internally traded services are as follows:- Guideline 1 - For consumption tax purposes internationally graded services and intangibles should be taxed according to the rules of the jurisdiction of consumption. Guideline 2 - For business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles. Guideline 3 – The identity of the customer is normally determined by reference to the business agreement. Main Rule – the jurisdiction where the customer is located has the taxing rights over a service or intangible supplied across international borders.

73. While the destination principle has been widely accepted as the basis for applying VAT to international trade, its implementation is nevertheless diverse across jurisdictions. Because VAT is generally applied on a transaction-by-transaction basis, VAT systems contain "place of taxation" rules that address all transactions indicating where the good or service supplied is expected to be used or consumed.

74. When a transaction involves goods being moved from one jurisdiction to another, the exported goods are generally free of VAT in the seller's jurisdiction (and are freed of any input VAT via successive businesses' deductions of input tax), whilst the imports are subject to the same VAT as equivalent domestic goods in the purchaser's jurisdiction. The VAT on imports is generally collected from the importer at the same time as customs duties, before the goods are released from customs control. Allowing deduction of the VAT incurred at importation in the same way as input tax deduction on a domestic supply ensures neutrality and limits distortions in relation to international trade. The application of the destination principle in VAT achieves neutrality in international trade. Accordingly, the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction of consumption and therefore all revenue accrues to the jurisdiction where the supply to the final consumer occurs. In this regard, I find no basis to fault the Tribunal's findings on this issue.

Conclusion

75. Flowing from my discussion and analysis above, I find no basis to fault the Tribunal's findings. Accordingly, I find that this appeal fails. The upshot is that I dismiss this appeal with no orders as to costs.

Orders accordingly

SIGNED AND DATED AT NAIROBI THIS 8TH DAY OF JANUARY 2021

JOHN M. MATIVO

JUDGE

DELIVERED ELECTRONICALLY VIA E-MAIL AND UPLOADED INTO THE E-FILING SYSTEM

JOHN M. MATIVO,

JUDGE

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[1] Act No. 35 of 2013.

[2] Cap 470, Laws of Kenya.

[3] Ca 476, Laws of Kenya.

[4] Cap 2, Laws of Kenya.

[5] {2007} 2 KLR 240.

[6] {1919} 1K.B. 25.

[7] 39 F.2d 540, 2 U.S. Tax Cas. (CCH) P 489, 8 A.F.T.R. (P-H) P 10552 (C.C.A. 2d Cir. 1930).

[8] 85 T.C. 731 (T.C. 1985).

[9] {1921} 1 KB 64.

[10] {2014} e KLR.

[11] {1936}

[12] {2010} STC 137 at 44.

[13] {1960}

[14] Act No. 29 of 2015.

[15] {2015} e KLR.

[16] JR. Misc. Civil. App. No. 315 of 2011.

[17] {2006} e KLR.

[18] Act No. 29 of 2015.

[19] For examples of a purposive approach to statutory interpretation, see *African Christian Democratic Party v Electoral Commission and Others* {2006} ZACC 1; 2006 (3) SA 305 (CC); 2006 (5) BCLR 579 (CC); at paras 21, 2

5, 28 and 31; *Daniels v Campbell NO and Others* {2004} ZACC 14; 2004 (5) SA 331 (CC); 2004 (7) BCLR 735 (CC) at paras 22-3; *Stopforth v Minister of Justice and Others*; *Veenendaal v Minister of Justice and Others* {1999} ZASCA 72; 2000 (1) SA 113 (SCA) at para 21.

[20] Thornton Legislative Drafting 4ed (1996) at 155 cited in JR de Ville *Constitutional and Statutory Interpretation* (Interdoc Consultants, Cape Town 2000) at 244-50.

[21] *Jaga v Dönges NO and Another; Bhana v Dönges NO and Another* 1950 (4) SA 653 (A) at 662-3.

[22] See the Supreme Court of Appeal of South Africa in *Natal Joint Municipal Pension Funds v Endumeni Municipality* 2012 4 SA 593 (SCA).

[23] Ibid, at (610B–C), Wallis JA.

[24]1949 Ch D 121 130.

[25] *Dawood and Another v Minister for Home Affairs and Others; Shalabi and Another v Minister for Home Affairs and Others; Thomas and Another v Minister for Home Affairs and Others* {2000} ZACC 8; 2000 (3) SA 936 (CC) ; 2000 (8) BCLR 837 (CC) at para 47.

[26] In *Stopforth v Minister of Justice and Others; Veenendaal v Minister of Justice and Others*, {1999} ZASCA 72; 2000 (1) SA 113 (SCA) at para 21.

[27] {2018} e KLR.

[28] Cap 2, Laws of Kenya.

[29] {2017} eKLR.

[30] {2018} eKLR.

[31] {2016} eKLR.

[32] Cap 2, Laws of Kenya.

[33] Act No. 29 of 2015.

[34] See *Port Elizabeth Tramway Co Ltd v CIR*, 1936 CPD 2417 at 246.

[35] 1960 (2) SA 475 (A) at 479H–480A.

[36] 1955 (3) SA 293 (A), at 229.

[37] {2018} e KLR.