



IN THE HIGH COURT OF KENYA

AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL AND TAX DIVISION

CORAM: D.S. MAJANJA J.

TAX APPEAL NO. E002 OF 2020

BETWEEN

LEAH NJERI NJIRUAPPELLANT

AND

COMMISSIONER OF INVESTIGATIONS AND ENFORCEMENT

KENYA REVENUE AUTHORITY1ST RESPONDENT

CHIEF MANAGER DEBT COLLECTION & ENFORCEMENT

KENYA REVENUE AUTHORITY.....2ND RESPONDENT

(Being an appeal against the Judgment of the Tax Appeals Tribunal at Nairobi dated 18th December 2019 in Income Tax Appeal No. 79 of 2017)

JUDGMENT

Introduction and Background

1. The Appellant is challenging the decision of the Tax Appeals Tribunal (“the Tribunal”) dated 18th December 2019 where the Tribunal upheld the decision of the 1st Respondent (“the Commissioner”) assessing her income tax liability at KES. 18,006,461.00.
2. Apart from her Memorandum of Appeal dated 17th February 2020 and the record of appeal, the Appellant also relies on her written and oral submissions. She prays that the appeal be allowed and the Commissioner’s revised tax liability against her of KES. 18,006,461.00 be set aside and her revised tax assessment for the periods 2008-2014 of KES. 1,925,725.00 be adopted. The Respondents have opposed the appeal and rely on their Statement of Facts dated 20th April 2020 together with their written and oral submissions.
3. For purposes of this appeal, it is not dispute that the Appellant’s income was banked an account at Barclays Bank and another at Equity Bank. The Commissioner established that net banking in the Barclays Account was income received on behalf of Paleah Stores Limited, a company in which the Appellant is a director, and was therefore not subject to assessment as personal income. Her personal income from Merica Café was banked at Equity Bank. The issue in this case concerns how the Commissioner treated the expenses, basically operating expenses and cost of goods sold, incurred in the course of business in accordance with **section 15(1)** of the *Income Tax Act* (“the *ITA*”) as read with **section 16(1) (a)** thereof which provide as follows:

15. Deductions allowed

15 (1) For the purpose of ascertaining the total income of any person for a year of income there shall, subject to section 16 of this Act, be deducted all expenditure incurred in such year of income which is expenditure wholly and exclusively incurred by him in the production of that income, and where under section 27 of this Act any income of an accounting period ending on some day other than the last day of such year of income is, for the purpose of ascertaining total income for any year of

income, taken to be income for any year of income, then such expenditure incurred during such period shall be treated as having been incurred during such year of income. [Emphasis mine]

16.(1) Save as otherwise expressly provided, for purposes of ascertaining the total income of a person for a year of income, no deduction shall be allowed in respect of –

(a) Expenditure or loss which is not wholly or exclusively incurred by him in the production of the income;
[Emphasis mine]

4. Returning to the facts of the case, in 2015, the Commissioner conducted an investigative tax audit on the Appellant's tax affairs for the tax period January 2008 to December 2014. At the conclusion of the exercise, the Commissioner determined that the Appellant, despite earning a substantial amount of income for the said period, never declared any income. The Commissioner proceeded to issue an additional income tax assessment for income from business in the sum of KES. 127,462,486.00 being principal taxes.

5. The Appellant objected to this assessment by a letter dated 30th January 2017. With a view to resolving the tax audit findings, the parties held meetings and exchanged correspondence. As a result, the Commissioner reviewed the Appellant's objection in light of additional information provided by her and arrived at an additional tax liability of KES. 306,176,144.00 inclusive of penalties and interest. The Appellant objected to the said assessments which after review by the Commissioner, issued an objection decision by the letter dated 29th March 2017 confirming the said assessments.

6. Aggrieved by the objection decision, the Appellant appealed to the Tribunal. Once again, the parties engaged the Alternative Dispute Resolution mechanism and as a result, the Appellant's tax liability was reviewed downwards from KES. 306,176,144.00 to KES. 18,006,461.00 being principal income tax, penalties and interests. It is this revised assessment of KES. 18,006,461.00 that was the subject of the Tribunal's decision rendered on 18th December 2019, which decision forms the subject of the instant appeal.

7. In its Judgment, the Tribunal framed two issues for determination. First, whether Commissioner erred in treating the unexplained bank deposits in the Appellant's bank accounts for the years 2008 to 2014 as income chargeable to tax on the Appellant. Second, whether the Appellant's bank deposits in the personal account should be considered as income of Paleah Stores Limited.

8. On the first issue, the Tribunal held that the Commissioner in revising the amended assessment from KES. 306,176,144.00 to KES. 18,006,461 gave the Appellant a fair hearing and opportunity to support her position and did not act arbitrarily as alleged by the Appellant as the onus of finding the Commissioner's assessment to be excessive and incorrect lay with the Appellant.

9. On the second issue, the Tribunal accepted that the Commissioner had isolated the corporate business income of Paleah Stores Limited from the Appellant's taxable income in respect of the accounts in her name and therefore came to the correct assessment. In conclusion therefore, the Tribunal confirmed the Commissioner's objection decision dated 29th March 2017 and reduced the tax liability to KES 18,006,461.00 this precipitating this appeal.

The Appellant's Case

10. The thrust of the Appellant's case is that the Commissioner failed to consider all the withdrawals made out of her bank account and only allowed expenses of KES. 8,402,579.00. She faults the Commissioner for only allowing salary expenses and expenses to one supplier yet one is expected to incur operating expenses. The Appellant submits that once the Commissioner accepted that the credit entries in her Equity Bank account was as a result of income realised from her business, it cannot claim or limit her expenses to those which "*they deem allowable*". The Appellant further submits that the Commissioner did not produce any evidence to contradict her assertions.

11. The Appellant complains that she produced all the necessary documentation to assist in the computation of her income and expenses but neither the Commissioner nor the Tribunal took anything into consideration. She cited ***Silver Chain Limited v Commissioner Income Tax and 3 Others NRB JR No. 2 of 2016 [2016] eKLR*** where the court held that the Commissioner must give a taxpayer the opportunity to explain its position before computing the tax due.

12. The Appellant urges the court to allow the appeal by allowing operating expenses in line with **section 15(1)** of the *ITA* and to be guided by the case of ***Hancock v General Reversionary and Investment Company [1919] KB 5, 37*** where Lush J., explained that;

[T]he proper test to apply in tax computation is; 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 out lay ...

13. The Appellant claims the Commissioner's assessment was irrational and unreasonable in the circumstances as it is absurd that a business earning KES 40,218,168.00 as income would incur a mere KES. 8,402,579.00 in expenses. The Appellant submits that the Commissioner's assessment is not only selective on the expenses it considered but also irrational by failing to appreciate all the expenses and the realities of operating a business where she incurred voluminous operating expenses regardless of the fact that they are unsupported. She therefore submits that the decision to disallow KES 32,637,199.00 claimed as business expenses was irrational, constitutes bad faith and exudes unreasonable exercise of power.

14. The Appellant submits that while the Commissioner has powers to assess and demand payment of taxes due, the statutory power bestowed on the Commissioner should be exercised reasonably, rationally and properly. The Appellant relies on the cases where the court have considered the irrational, unreasonable, capricious and arbitrary conduct by public bodies including ***Republic v Kenya Revenue Authority Ex- Parte Aberdare Freight Services Ltd & 2 others Misc. Civil Application No. 946 of 2004 [2004] eKLR, Keroche***

15. The Appellant also challenges the Tribunal's decision on the ground that the Commissioner failed to issue a Notice of Assessment for the years 2008, 2009, 2011 and 2014. The Appellant submits that she raised and argued the issue before the Tribunal but it was not determined. The Appellant therefore maintains that the tax liability of KES. 18,006,461.00 as assessed by the Commissioner is unlawful as no Notice of Assessment was issued for the year 2008, 2009, 2011 and 2014. She adds that the Tribunal failed to fully apply itself and determine all the issues raised by the Appellant and yet she was inclined to submit on all the years raised in spite of failure by the Commissioner to issue a Notice of Assessment to avoid being prejudiced by the decision of the Tribunal.

The Respondent's Case

16. The Commissioner position is the Appellant never filed any income tax returns despite proof of earnings income from several businesses contrary to **section 52B** of the *ITA* which provides that every person shall file a return of income every year. Since the Appellant failed to declare her income, the Commissioner issued a default assessment pursuant to **section 29** of the *Tax Procedure Act, 2015* ("the *TPA*") and in order to assess her income in accordance with **section 3(1)** of the *ITA*, it was constrained to treat the deposits in the Appellant's bank account for the tax period 2008 to 2014 as her income. Counsel for the Commissioner cited several decisions among them *Pili Management Consultants Ltd v Commissioner of Income Tax Kenya Revenue Authority Civil Appeal No. 154 of 2007 [2010] eKLR* where the Court of Appeal held that the Commissioner was entitled to view the monies in the appellant's account as income in the absence of proof to the contrary.

17. The Commissioner submits that the Appellant was given an opportunity to provide information and evidence to show that the amounts in the bank accounts had been derived from non-taxable sources but that the Appellant's evidence and contentions were not satisfactory. The Commissioner further contends that the Appellants failed to avail evidence of expenses it incurred in producing taxable income to enable the Commissioner allow deduction of such expenses. It urges the court to dismiss the appeal.

Analysis and Determination

18. Having considered the record of appeal and submissions, the following issue fall for determination;

- a. Whether the Commissioner issued the Appellant with a Notice of Assessment and if not, whether this omission nullified the Commissioner's assessment of the Appellant for the years 2008, 2009, 2011 and 2014
- b. Whether the Tribunal erred in upholding the Commissioner's revised assessment of the Appellant's tax liability at Kshs. 18,006,461/-

Whether the Commissioner issued a Notice of Assessment

19. The Appellant submitted that the Commissioner's assessments for the years 2008, 2009, 2011 and 2014 were invalid as the Commissioner did not issue any Notice of Assessment for those years. The Commissioner stated that the Notices were issued and served to the Appellant's former auditor. When put to task over the issue by the Tribunal, counsel for the Commissioner stated, "*I think that is incorrect. We served the former auditor with the assessment with the letter of assessment for these years*". The Tribunal then directed the parties to address the issue in their submissions.

20. The Commissioner's submissions before the Tribunal indicate how it arrived at the re-computed taxes payable by the Appellant for the years 2008 to 2014, after the Appellant provided bank statements and a schedule of her operating expenses. It is also common ground that the decision arriving at the sum KES. 18,006,461.00 was as a result of an ADR mechanism conducted with the participation of both parties. In her submissions before the Tribunal, the Appellant stated that the appeal therein was against the "*confirmed assessment dated 29th March 2017 for the years 2008-2014 conducted by the Respondent(Commissioner)*".

21. It is important to recall that these proceedings are a culmination of an investigative tax audit on the Respondent's affairs. The results of the audit covering the years 2008 -2014 were communicated to the Appellant's agent by the letter dated 13th December 2016. By the letter dated 30th December 2016, the Commissioner forwarded to the Appellant through her agent, Njuguna Wahome Consulting Ltd, additional assessments for the Years of Income 2008,2009, 2011 and 2014. In the letter, the Commissioner stated:

We note with concern that you have not honoured your promise to amicably resolve the audit issue already communicated to you. We have therefore issued additional assessments for Income Tax for the Company and its Directors **as attached**.

22. I therefore find that even though the Tribunal did not resolve this issue, there is evidence that the assessments were indeed forwarded to the Appellant through her agents at the material time. Further, following those assessments, the Appellant lodged an objection dated 30th January 2017 which was settled by the objection decision dated 29th March 2017. This ground of appeal lacks merit and is dismissed.

Whether the Tribunal erred in upholding the Assessment of KES. 18,006,461/-

23. In considering this appeal, this court is guided by **section 56** of the *Tax Procedures Act* which provides as follows:

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

(2) An appeal to the High Court or to the Court of Appeal shall be on a question of law only.

(3) In an appeal by a taxpayer to the Tribunal, High Court or Court of Appeal in relation to an appealable decision, the taxpayer shall rely on the grounds stated in the objection to which the decision relates unless the Tribunal or Court allows the person to add new grounds. [Emphasis mine]

24. Following the Supreme Court decision in *Gatirau Peter Munya v Dickson Mwenda Kithinji and 2 Others* [2014] eKLR, 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.” [Emphasis mine]

25. The gravamen of the Appellant’s case is that the Commissioner arrived at the sum of KES. 18,006,461.00 as the tax payable by the Appellant without considering and taking into account the expenses and costs incurred in the business in accordance with **section 15(1)** of the *ITA*.

26. In her submission, the Appellant explained that she took time to give a summary of income and expenditure set out in the schedules at Pages 473 to 484 of the Record of Appeal. The Schedules are extracted from the bank statement and show bank charges, purchases, cash purchases, salaries and wages and transfers. I have looked at the Schedules of Income and Expenditure and they remain exactly that, schedules. They do not indicate the nature of expenditure and the expenditure is not supported by any other documentation.

27. Just as the Appellant argues that it is absurd that a business earning an income of KES 40,218,168.00 would incur a mere expense of KES 8,402,579.00, it is equally absurd that a business earning such amount would not document its expenditure. For example, each entry would be supported by documents like supply contracts, utility bills, invoices and delivery notes from suppliers, petty cash vouchers, wage books etc.

28. As I understand the Appellant, the Commissioner ought to have presumed the expenses incurred by her in light of the nature of her business and income she was making notwithstanding that these expenses were unsupported. This is a misapprehension as the burden of proving one’s income and expenses lies with the taxpayer. The only way the Commissioner could have allowed deductions of expenses as per **section 15(1)** of the *ITA* is if they were supported to its satisfaction. This is in line with **section 54A(1)** of *ITA* which provides as follows:

54A Keeping records of receipts, expenses, etc

(1) A person carrying on a business shall keep records of all receipts and expenses, goods purchased and sold and accounts, books, deeds, contracts and vouchers which in the opinion of the Commissioner, are adequate for the purpose of computing tax. [Emphasis mine]

29. Under **section 56(1)** of the *TPA*, the taxpayer bears the burden of proving that the tax decision is incorrect. The Commissioner arrived at the revised assessment of KES. 18,006,461.00 after correspondence and meeting between it and the Appellant. The Appellant was able to present her case to the fullest extent. At the Tribunal, the Appellant did not demonstrate the tax decision was wrong. I therefore do not fault the Tribunal for accepting the conclusions reached by the Commissioner.

Disposition

30. For the reasons I have set out above, I dismiss the appeal with costs to the Respondent.

DATED AND DELIVERED AT NAIROBI THIS 26TH DAY MARCH 2021

D. S. MAJANJA

JUDGE

Ms Kiiru with instructed by Kiiru and Partners Advocates for the Appellant.

Mr Mutua, Advocate instructed by Kenya Revenue Authority for the Commissioner of Investigations and Enforcement.