REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL AND TAX DIVISION

INCOME TAX APPEAL NO. E125 OF 2020

KENYA REVENUE AUTHORITY...APPELLANT

VERSUS

MAN DIESEL & TURBO SE, KENYA...RESPONDENT

*(Being an Appeal against the Judgement delivered on **18th** September 2020 at the Tax appeals Tribunal in Tax Appeals Tribunal Case No. 26 of 2017)*

JUDGMENT

Introduction

1. The factual matrix preceding this appeal as I discern it from the record of appeal is essentially uncontroverted. The Respondent, a Permanent Establishment (PE) in Kenya of MAN Diesel and Turbo SE Germany (MAN D-T) entered into a consortium with a firm called MPG Services to engineer, procure and construct an 87 MW generating capacity thermal power plant on behalf of Thika Power Ltd. The Respondent's role in the project as the record shows was mobilization, engineering and design, reservation of the diesel sets, and steam turbine and other start-up costs associated with its part of the works which included supervision of the assembly and installation of engines and commissioning the engines. MPG Services was responsible for the shipment of all the materials. MAN D-T was to provide for the materials up to the port of export. The appellant was to assist in the onshore part which included supervision of the assembly and installation work as well as commissioning the work but did not include supply of equipment.

2. In 2015, the appellant initiated an audit on the Respondent and issued a tax assessment on **6th** October 2016 demanding form the Respondent Corporation Tax of **Kshs 347,518,798.00** computed as follows: -

Kenya			
Penalty 20%	40,628,502		
Interest 1% pm	57,779,525	45,968,262	103,747,786
Interest 1% pm	57,779,525	45,968,262	103,747,786
Total		132,158,752	347,518,798

3. On **4th** November 2016, the Respondent objected to the assessment arguing that the assessment was wrong both in fact and in law and that it was not based on any material or true facts. On **4th** January 2017, the appellant confirmed the assessment claiming that the Respondent imported equipment into Kenya and sold it to Thika Power Ltd and attributed profit emanating from the sale to the Respondent. Aggrieved by the Objection decision, the Respondent filed appeal No. **26** of 2017 at the Tax Appeals Tribunal (the TAT) on **16th** February 2017 premised on the grounds that the Respondent erred in fact and in law in its demand for Corporation Tax of **Kshs 347,518,798/=** for the years of income 2012 and 2013 which is excessive and is not premised on any material facts provided by the appellant to the Respondent.

4. It also faulted the appellant for alleging that it imported the said goods and made a profit in Kenya. Also, it faulted the Respondent for erred in law and in fact by arbitrarily applying currency exchange rates in order to arrive at a higher sum and by attributing profit to the Respondent which profit did not arise from activities undertaken by the Respondent.

5. The Respondent prayed that: -

*i. <u>That</u> the Objection Decision dated **4th** January 2017 for the years 2012 and 2013 on corporation tax be struck out in its entirety.*

ii. The Respondent's actions to demand additional taxes be declared arbitrary, capricious, unreasonable, unfair and contrary to the administration of justice and legitimate expectations of a taxpayer.

iii. The Respondent, its employees, agents or other person acting on its behalf be barred and or estopped from demanding or taking any further steps towards enforcement or recovery of principal tax, penalties and interest on the Respondent's demand.

iv. The costs of this Appeal and any other remedies that the TAT deems just and reasonable

6. Upon considering the respective party's positions, the TAT distilled three issues, namely: -

a. Whether the Respondent erred in using customs values as the commercial invoice values of work done by the Appellant?

b. Whether income from offshore supply of equipment to Thika Power could be attributable to the appellant?

c. Whether income from offshore supply of equipment by MAN DT Germany can be taxed on MAN DT Kenya under Article 7 of the DTA by virtue of Force of Attraction Rule?

7. After addressing the above issues, the TAT allowed the appeal, quashed the Objection decision and ordered each party to bear its own costs.

The appeal

8. The appellant seeks to overturn the above judgment on the following grounds: -

*a. **<u>That</u>** the TAT erred in failing to find that the Respondent has a statutory duty to keep and produce all documents relating to its tax affairs as per the provisions of Section 23 of the Tax Procedures Act.*

*b. **<u>THAT</u>** the TAT failed to take into account the provisions of Section 18(3) of the Income Tax Act by holding that (sic).*

*c. **<u>That</u>** the TAT erred in finding that the Respondent was not involved in the acquisition and supply of equipment to Thika Power and therefore did not derive any income from this transaction.*

*d. **<u>That</u>** the TAT failed to appreciate and take into account the variance between the equipment and accessories exported by Man Diesel Germany worth Kshs. 6,155,648,066.00 FAC and the Customs Simba System showing importation of equipment worth Kshs. 5,613,934,706.00 CIF Mombasa.*

*e. **<u>That</u>** the TAT erred in faulting the appellant for using values declared in customs entries as the basis of determining income contrary to well established tax administration principles and the Tax Procedures Act which empowers the appellant to use all and any information available to it at the time of assessment to determine the tax affairs of a taxpayer.*

*f. **<u>That</u>** the TAT erred by failing to recognize that customs data is a tax point that can accurately be used to determine income attributable to a Permanent Establishment, in this case the Respondent.*

*g. **<u>That</u>** the TAT erred in failing to require the Respondent to account for all the income derived from the onshore works attributed to it which is then income derived from Kenya which the Respondent ought to be taxed.*

*h. **<u>That</u>** the TAT failed to appreciate that there existed an Engineering, Procuring and Constructing (EPC) Contract and any amounts paid over and above the customs value is for onshore works which should have been reported by the Respondent as income derived in Kenya in line with Section 18(5) of the Income Tax Act.*

*i. **<u>That</u>** the TAT failed to take into account the Income Tax Transfer Pricing Rules 2006 under Rule 5(b).*

*j. **<u>That</u>** the TAT failed to link the services offered by Man DT Germany to those offered by the Respondent which are similar or constitute similar activities which would then make them taxable under the Double Taxation Agreement.*

9. The appellant prays that the judgment of the TAT dated **18th** September 2020 be set aside and the appeal in TAT No. **26** of 2017 be dismissed. It also prays that the assessment dated **6th** October 2016 and confirmation of **4th** January 2017 demanding Corporation Tax of **Kshs. 347,518,798.00** be upheld and the taxes declared due and payable. Lastly, it prays that the costs of this appeal and those of the appeal at the TAT be awarded to the appellant.

The appellant's advocates submissions

10. The applicant's counsel submitted that the Respondent has a statutory duty to keep all documents relating to its tax affairs as required by section **23** of the Tax Procedures Act[1] (the TPA). She submitted that based on the audit, the appellant issued Preliminary findings of Pay as You Earn, Withholding Tax and reverse Value Added Tax which the Respondent duly paid. She argued that by making the payment, the Respondent admitted that it had undeclared income. She argued that investigations on import data led to a finding that there was undeclared income. Further, the Respondent was offered an opportunity to provide additional documents but it failed to provide. She cited section **23** of the TPA which provides: -

> *23. Record-keeping (1) A person shall—*
>
> > *(a) maintain any document required under a tax law, in either of the official languages;*
> >
> > *(b) maintain any document required under a tax law so as to enable the person's tax liability to be readily ascertained; and*
> >
> > *(c) subject to subsection (3), retain the document for a period of five years from the end of the reporting period to which it relates or such shorter period as may be specified in a tax law. (2) The unit of currency in books of account, records, paper registers, tax returns or tax invoices shall be in Kenya shillings.*
>
> *(3) When, at the end of the period specified in subsection (1)(c), a document—*
>
> > *(a) relates to an amended assessment, the person shall retain the document until the period specified in section 31(7) has expired; or*
> >
> > *(b) is necessary for a proceeding commenced before the end of the five-year period, the person shall retain the document until all proceedings have been completed.*
>
> *(4) When a document referred to subsection (1) is not in an official language, the Commissioner may, by notice in writing, require the person required to keep the document to provide, at the person's expense, a translation into an official language by a translator approved by the Commissioner by the date specified in the notice.*
>
> *(5) Despite anything in any tax law, the Regulations may provide for a simplified system of record-keeping for small businesses.*

11. Counsel submitted that based on failure to produce documentation, the appellant made an assessment based on the information available to him as mandated by Section **29** of the TPA and audited the Respondent. Also, the Respondent was required to provide several documents. Further, based on the documents provided, it was determined that there was income chargeable to tax that had not been declared by the Respondent. Counsel argued that it was noted that the Respondent carried on business in Kenya through an EPC Contract which involved both the supply of goods and services. She submitted that the appellant is empowered by Section **59** of the TPA to require production of documents for purposes of ascertaining the tax status of a Taxpayer. She argued that under Section **24** of the TPA, the Commissioner can use the information available to him at the time to make a tax decision.

12. Additionally, counsel argued that the TAT failed to take into account section **18 (3)** of the Income Tax Act[2] (ITA)which provides that:-

> "*Where a non-resident person carries on business with a related resident person or through its permanent establishment and the course of that business is such that it produces to the resident person or through its permanent establishment either no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of that resident person or through its permanent establishment or from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent person dealing at arm's length."*

13. She submitted that the Respondent violated the above provision by under-declaring the income earned by the PE and that the PE did not earn any income from Thika Power Limited but however charged an additional five per cent (5%) to the costs incurred and declared as its turnover. This turnover, she argued, was then paid to the PE by the Respondent thus under-declaring its income. She also agued that the TAT failed to appreciate that there existed an Engineering, Procuring and Constructing (EPC) Contract and any amounts paid over and above the customs value is for onshore works which should have been reported by the Respondent as income derived in Kenya in line with Section **18(5)** of the ITA.

14. Regarding the question whether the Respondent was involved in the acquisition of equipment to Thika Power and whether it derived an income therefrom, counsel submitted that the EPC contract involves both the supply of goods and services which were done offshore and onshore in Kenya and that the Offshore portion of work was the procurement element in the EPC. She argued that the procurement involved the supply of goods (the engines, gensets, auxiliary machinery and spare parts) which costs were fully declared to the Commissioner of Customs at the point of entry in the country for purposes of customs at CIF value which was used in determining the portion of the offshore component of the works done under the EPC contract. She also argued that there was documentation from the Ministry of Finance seeking remissions which was an indication that there was imminent importation of goods and equipment.

15. It was her contention that the goods were imported to Thika Power Limited at CIF (Cost, Insurance, Freight) which means the seller pays costs and freight and the risk is transferred to the buyer upon loading onto the ship, and the costs were declared by the Respondent as **Kshs. 3,680,373,632/=** and **Kshs. 1,933,561,073/=** in 2012 and 2013 respectively. Counsel argued that given the income earned by the company in Germany and the PE and the value of the declared value of the imported machinery, it was able to determine the actual value of work done by getting the difference and this was determined as **Kshs. 541,713, 360/=** for the years of income 2012 and 2013. She argued that the TAT failed to appreciate and take into account the variance between the equipment and accessories exported by Man Diesel Germany worth **Kshs.**

6,155,648,066/= FAC and the Customs Simba System showing importation of equipment worth **Kshs. 5,613,934,706/=** CIF Mombasa. Further, she argued that it is this difference that was deemed to be the income attributed to the PE and was brought to charge at the rate of **Kshs. 37.5%.**

16. Counsel faulted the TAT for using values declared in customs entries as the basis of determining income contrary to well established tax administration principles and the TPA which empowers the appellant to use all and any information available to it at the time of assessment to determine the tax affairs of a taxpayer. She argued that the TAT erred in failing to recognize customs data as a tax point despite it being a well-established principle in tax administration.

17. Counsel submitted that Customs data as a tax point can be used to accurately determine income attributable to a PE in a set up where the whole contract price is paid to a non-resident company which then reimburses costs to the PE in Kenya. Further, customs data was used to distinguish the different elements of works i.e the offshore works and the onshore works which then subjected to tax as income derived in Kenya. She argued that the appellant conducted an audit and determined a variation between the declared income and total income earned.

18. She cited Section **56(1)** of the TPA which places the burden on the taxpayer to prove that a tax decision is incorrect and relied on *Kilburn v Bedford (H.M. Inspector of Taxes)*[3] which held that *"… As regards the extra tax imposed upon those figures it was for the appellant to show that there was some reason why on the agreed figures tax should not be paid.."* She submitted that the appellant has not made any attempt to discharge this burden and therefore the assessment must stand. She faulted the TAT for failing to require the Respondent to account for all the income derived from the onshore works attributed to it which is income derived from Kenya which the Respondent ought to be taxed. Counsel cited *Income Tax Transfer Pricing Rules 2006 under Rule 5(b) and the DTA between Kenya and Germany* and argued that the TAT failed to link the services offered by Man DT Germany to those offered by the Respondent which are similar or constitute similar activities which would then make them taxable under the Double Taxation Agreement. She argued that the TAT violated the said rule and urged the court to allow the appeal.

The Respondent's advocates submissions

19. Regarding the argument that the Respondent failed to produce documents in accordance with Section **23** of the TPA and whether the Tribunal failed to take into consideration the provisions of section **18(3)** of the ITA, counsel argued that these two issues were not raised before the TAT. He cited *Tanganyika Farmers Association Ltd v Unyamwezi Development Corporation Ltd**[4]*** which held that "although an appellate court has discretion to allow an appellant to take a new point on appeal, it will not do so if the matter had not been properly pleaded or if all facts bearing on the new point have not been elicited in the court below."

20. Notwithstanding the above, counsel submitted that the claim of failure to keep and produce tax records is completely unfounded and while acknowledging the import of sections **23** and **59** of the TPA, he argued that the Respondent cannot be required to produce third party documents that it is not privy to. He argued that in assessing the Respondent, the appellant relied on third party documents, namely, customs entry forms declared by Thika Power when importing the equipment. Counsel submitted that it is absurd for the appellant to require the Respondent to produce documents that it does not keep or have access to. He argued that in the course of the hearing, the appellant's witness confirmed that the documents the Respondent was asked to produce, belong to Thika Power, that he did ask Thika Power for the import documents, but they were not forthcoming, thus the appellant took no more action. (See page 59 and 60 of Volume A of the Record of Appeal.)

21. Regarding section **18 (3)** of the ITA, counsel argued that even though the appellant did not raise this matter before the TAT, the TAT on its own motion considered and applied section **18 (3)** of the ITA as read together with the Income Tax (Transfer Pricing) Rules 2006 and the OECD guidelines in arriving at its decision. (Page **41**, para **118** and page **99** of the record).

22. He submitted that the appellant has failed to separate the Respondent's roles vis-å-vis its Parent company's roles. (See page **328** of the record. He submitted that the Respondent's role was to assist in the execution of the onshore part, which involved supervision of the assembly and installation work as well as commissioning work, but did not include the supply of equipment which was a role performed by its head office, and therefore the Respondent did not earn any income arising from the supply of equipment. Additionally, he submitted that the Respondent was not involved in engineering works contrary to the appellant's submission. He referred to pages **40-41** of the Record of Appeal and argued that the appellant having failed to show a connection between the supply of equipment and the Respondent, the TAT was correct in holding that the Respondent was not involved in the supply of equipment, hence, the income from the supply of equipment was not attributable to the Respondent.

23. Counsel submitted that the TAT was correct in holding that the appellant erred in using the values declared in the customs entry as a basis for determining the Respondent's income. Counsel submitted that section **29** of the TPA must be interpreted in context, and, that the section does not apply to the appellant's assessment as it is not a default assessment, but rather, Section **29** refers to a situation whereby a taxpayer has failed to submit a tax return for the reporting period. Counsel submitted that the Respondent had submitted all its tax returns. Further, counsel argued that even if section **29** could be invoked against the appellant, the assessment in question was not valid because the appellant had taken the wrong approach in ascertaining the amount of tax due before making the assessment because the appellant had misconstrued the whole transaction in the first instance.

24. He argued that under section **29,** the appellant is expected to use their 'best judgement' when deciding to raise an assessment. Counsel submitted that the appellant has failed to exercise its best judgement by relying on third-party customs documents in assessing the Respondent, while at the same time having at their disposal the transfer pricing policy that the Respondent based its income. He submitted that the appellant cannot impose taxes, by imposing figures on the Respondent without any reasonable justification. He cited *Republic Vs KRA (exparte J. Mohamed) civil application**[5]*** which held that the taxing authority must be exercised fairly and there ought to be a basis for the exercise of such powers nor is a taxing authority entitled to pluck a figure from the air and impose it on a taxpayer.

25. He also argued that the Commissioner, while demanding revenue, should demonstrate sufficiently that a certain payment forms the basis of tax and relied on *Republic v. Commissioner of Income Tax ex parte SDV Transami (Kenya) Limited* which held that taxes must be

consistent with the law. He also relied on *Republic v Commissioner of Domestic Taxes Larqe Tax Paver's Office Ex Parte Barclays Bank of Kenya Ltd*[6] for the proposition that the decision to tax must have a legal basis. He argued that section **56(1)** does not empower the appellant to make speculative assessments (citing *Johnson v Scott (Inspector of Taxes*) nor was it the intention of the legislature to put the taxpayer in a position where he would be required to produce any documents that the taxman requires. (Citing *Peter Bonde Nielson v Commissioner of Domestic Tax*[7]).

26. On the submission that the TAT failed to take into consideration Rule **5 (b)** of the *Income Tax Transfer Pricing Rules 2006*, counsel submitted that the said rule states that a permanent establishment shall be treated as a distinct and separate enterprise from its head office or other related branches, hence, the Respondent, being a permanent establishment is distinct from MAN DT and cannot be taxed on the income of its head office. Counsel submitted that the appellant was incorrect in attributing income to the Respondent in violation of the provisions of the ITA, *the Transfer Price Rules 2006*, the Double Taxation Treaty (DTT) between Kenya and Germany and the OECD Model Tax Convention to which Kenya is a signatory. The Respondent submitted that the TAT was clear that the appellant did not acquaint itself with the facts on the ground. Counsel cited Section **3** of the ITA which provides that 'Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya and argued that for income to be taxed in Kenya it must have been derived or accrued in Kenya.

27. Counsel cited Article **5** of the Kenya — Germany DTT, Protocol I(a) and Article **7(2)** of the DTT among other relevant provisions and argued that it is clear that in respect of a construction project, there is a clear distinction between installation services and the supply of equipment, so, since, the Respondent was not involved in the supply of equipment, the income arising from the supply cannot be attributable to the Respondent. He argued that the force attraction rule is inapplicable in this case and cited *Deputy Commissioner of Income-tax, Special Ranqe-26 v Roxon OY 9 ITLR 1045* for the proposition that that installation PE is not to be covered by the force of attraction principle even if the installation PE is selling the same or similar goods as sold directly by the enterprise abroad.

Determination

28. Before considering the issues raised in this appeal, it is important to point out that the jurisdiction of this court is circumscribed by statute. In this regard, section **56** of the TPA is relevant, and because the said provision stipulates a pertinent jurisdictional question, it is only proper that I reproduce the entire section below.

> ***56. General provisions relating to objections and appeals***
>
> > *(1) In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.*
> >
> > *(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 only on the grounds stated in the objection to which the decision relates unless the Tribunal or Court allows the person to add new grounds.*

29. An appeal limited to matters of law does not permit the appellate court to substitute the Tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts. The Court of Appeal in *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others*[8] summarized 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.*

30. Section **56** of the TPA in peremptory terms places the burden of proof in tax cases on the tax payer. The above section is reinforced by section **30** of the TAT Act which provides : -

> ***30. Burden of proof***
>
> *In a proceeding before the Tribunal, the appellant has the burden of proving—*
>
> > *(a) where an appeal relates to an assessment, that the assessment is excessive; or*
> >
> > *(b) in any other case, that the tax decision should not have been made or should have been made differently*

31. The import of the above provisions is that the party with the obligation of persuasion (what Wigmore termed the risk of non-persuasion) is said to bear the burden of proof.[9] The flip side of the foregoing is the effect of non-persuasion on a party with the burden of proof which is that the particular issue at stake in the litigation will be decided against him/her. Generally, the taxpayer has the burden of proof in any tax controversy. The tax payer must demonstrate that the commissioner's assessment is incorrect. The taxpayer has a significantly higher burden. The taxpayer must prove the assessment is incorrect.

32. The shifting of the burden of proof in tax disputes flows from the presumption of correctness which attaches to the Commissioner's assessments or determinations of deficiency.[10] The commissioner's determinations of tax deficiencies are presumptively correct. Although

the presumption created by the above provisions is not evidence in itself, the presumption remains until the taxpayer produces competent and relevant evidence to support his position.[11] If the taxpayer comes forward with such evidence, the presumption vanishes and the case must be decided upon the evidence presented, with the burden of proof on the taxpayer.

33. The other important issue to bear in mind is that under our system of self-reporting of tax liability, the taxpayer initially decides the extent and amount of his/her statutory obligation to pay tax. The taxpayer in such cases generally possesses the objective evidence. Certainly, with the exception of filed returns and information provided by the taxpayer, the Revenue authority is in a poor position to establish an affirmative case. The common-law allocation of the burden of proof to the party in possession of the evidence is clearly appropriate.[12] It has been argued that the allocation of the burden of proof to the party in possession of relevant knowledge surely meets this goal.[13] In the same parity of reasoning, where a tax payer pays tax in advance, and it turns out that it was an overpayment or the tax was not due, he/she can get a refund. It follows that payment of tax under such circumstances is not an admission of tax liability as the appellant's counsel suggested.

34. By placing the burden of proof on the party in possession of relevant information, the possibility of destruction of adverse information is minimized and time is saved by making that party responsible for culling through its own records to meet its burden. Placing the burden of proof on the government in tax cases would detract from these goals. Taxpayers might be tempted to destroy adverse relevant evidence and tax collection costs would increase because of the Revenue Authority's difficulty in finding relevant information.[14]

35. The uniqueness of tax laws is underscored by the fact that even where the constitutionality of such provisions has been challenged, courts have consistently held that placing the burden upon the tax payer is not unconstitutional nor is it contrary to Parliament's intent.[15]This is because there is a distinction between the legal burden of proof and the evidential burden of prove. These are two different concepts. The Evidence Act places the burden of proving the existence any fact in issue on the party who asserts. The evidential burden exists in the form of a tactical onus to contradict, weaken or explain away the evidence that has been led. It is the latter form of burden which may shift from one party to the other.

36. Placing the burden of proof in tax cases on the tax payer reflects the unique nature of the tax system. This is evident from the three-fold justifications for placing the burden on the tax payer. These are: - (a) the presumption of correctness; (b) the government's need for revenue' and, (c) the taxpayer's possession of evidence. The taxpayer's burden of proof comprises two parts: – establishing, with evidence, the underlying facts on which the law is to operate (and in this regard, the standard of proof to which each fact must be proved is relevant);[16] and – that the operation of the law when applied to those facts establishes that the assessment is excessive or erroneous.

37. As was held in *George v Federal Commissioner of Taxation,*[17] "the burden lies upon the taxpayer of establishing affirmatively that the amount of taxable income for which he has been assessed exceeds the actual taxable income which he has derived during the year of income" and that "…in order to carry that burden he must necessarily exclude by his proof all sources of income except those which he admits. His case must be that he did not derive from any source taxable income to the amount of the assessment." However, the manner in which a taxpayer can discharge the burden varies with circumstances.

38. As I observed in ITA No **078** of 2020, "Burden of Proof" is a legal term used to assign evidentiary responsibilities to parties in litigation. The party that carries the burden of proof must produce evidence to meet a threshold or "standard" in order to prove their claim. If a party fails to meet their burden of proof, their claim will fail. "Burden of Proof" at the Tax Court is somewhat unique. At the Tax Court, a taxpayer is required to disprove an assessment by the Commissioner. In other words, a Tax payer challenging a tax assessment will need to collect and present evidence in order to disprove the Commissioner's position. This is the basic principle. However, there are some situations where this responsibility or "onus" is reversed. **The onus may also shift based on the stage of the proceedings and the actions taken by the parties**.

39. The Supreme Court of Canada in *Johnston v Minister of National Revenue*[18] decided that the onus is on the taxpayer to "demolish the basic fact on which the taxation rested." Also, the Supreme Court of Canada provided guidance on this issue in *Hickman Motors Ltd. v Canada*[19] that the onus is met when a Taxpayer makes out at **least** a *prima facie* case. *Prima facie* is another legal term that literally means "*on its face.*" To prove a case *"on its face"* you must provide evidence that, unless rebutted, would prove your position. According to the said decision, a *prima facie* case is made when the taxpayer can produce unchallenged and uncontradicted evidence. Once the taxpayer has made out a *prima facie case* to prove the facts, the onus then shifts to the Revenue Authority to rebut the *prima facie* case. If the Revenue Authority cannot provide any evidence to prove their position, the taxpayer will succeed.

40. The question is whether the Respondent established by way of evidence before the TAT, that the tax assessment was erroneous or the tax was not due. As stated earlier, the TAT addressed three issues. Regarding the **1st** issue, the TAT concluded: -

> *110. The Respondent submitted that the determination of the income derived from the supply and installation of equipment to Thika Power Project was based on the difference between the values declared for customs purposes and the invoice raised by MAN Diesel Germany to Thika Power. It argued that the commercial invoices raised were for Kshs 4,030,552,569.00 and Kshs 2,125,095,497.00 in 2012 and 2013, respectively, for the sale of equipment. The Respondent submitted that from its customs data base contained in the Simba System, the total value of equipment imported was Kshs. 3,680,373,632/=and Kshs.1,933,561,073/=. for the years 2012 and 2013, respectively. The Respondent then computed variances between the sales purported to have been made to Thika Power and customs data in its Simba system and deemed the variance as under declaration of income by the Appellant and charged Corporation Tax on the Appellant at the rate of 37.5%, totaling to Kshs 215,360,046.00 and Kshs 132,158,752.00 in 2012 and 2013, respectively, inclusive of penalties and interest.*
>
> *111. The Tribunal examined the import documents presented by the parties namely the customs import entries supported by invoices and bills of lading and found that indeed the values declared were CIF values of the equipment and accessories that were imported. The invoices however indicated that the incoterm used for the Transaction was FCA Saint Nazaire, a port in France.*
>
> *112. Free Carrier (FCA) is a term of trade commonly used in international trade where the seller pays for the transport of goods*

to a said point of delivery and the risk passes when the goods are transferred to the first carrier. The cost of transport from the agreed point of delivery and other associated costs and risks up to the buyer's premises are borne by the buyer.

113. Although the customs values used for assessment of import duties were at CIF, (and they should as required by legal provisions governing valuation of goods for customs purposes), both the insurance and freight elements associated with the imported equipment were separately paid for by Thika Power Limited and were not part of the invoices raised by Man Diesel Germany.

114. During the hearing it transpired that MAN DT Germany had exported equipment and accessories worth Kshs 6,155,648,066.00 FAC (Port Nazaire France) and the Custom Simba system showed that Thika Power Project had imported Equipment worth Kshs 5,613,934,706.00 CIF Mombasa. The conclusion drawn from this disparity was that there were goods for which Thika Power could not produce import documents. Furthermore, subtracting CIF value from FCA value could not beget any meaningful figure. Furthermore, the cost of insurance and freight was paid to third parties by the importer.

115. The Respondent did not give any reason why it was unable to obtain information on the actual value of imported goods and equipment from Thika Power who were the importers nor did the Respondent show any direct link between the imported goods and the Appellant.

116. In view of the foregoing, the Tribunal determined that the Respondent erred in using the values declared on the customs entries as the basis for determining the income derived from sale of equipment to Thika Power

41. Regarding the **2nd** issue, the TAT held as follows: -

112. …, the Tribunal noted in the appellant's submission that the PE was established as a consequence of the contract for purposes of executing the onshore works of installation in Kenya. Therefore, the only part of the profits that were attributable to it was the work that was done in Kenya for which it had made returns and paid the requisite taxes. The profits made for the supply of the equipment was not attributable to the PE. It played no role in the supply. The contract was not executed at the initiative of the PE. Indeed, the contract was signed before the PE was formed.

113. The Tribunal finds that the income from offshore supply of equipment to Thika Power is not attributable to the Appellant.

42. Its finding on the **3rd** issue was the income from offshore supply of equipment by MAN DT Germany is not attributable to MAN DT Kenya under Article **7** of the DTA by virtue of the Force of Attraction Rule.

43. The TAT was persuaded by the Respondent's evidence. It was persuaded that the Respondent discharged the burden of proof. But more important, in auditing a taxpayer the Commissioner is required to properly consider the documentation provided and to understand the information. It is not sufficient for the Commissioner to merely request information and then disregard it and to issue an assessment as it sees fit. Where the Commissioner issues an assessment based on the taxpayer's accounts and records but has misconstrued those records then it will be sufficient for the taxpayer to explain the nature of the Commissioner's misconception, point out the flaws in the analysis and to explain how those records and accounts should be properly understood. In this regard, the Commissioner misconstrued the Respondent's exact role and in absence of any justifiable basis treated the Respondent as the importer of certain goods just because no documents were supplied. This misconception led to a second misconception, namely, demanding documents in the hands of a third party from the Respondent. As I will be stating shortly, a tax payer can only produce documents in his custody and relating to transactions undertaken by him/her.

44. Identifying the Commissioner's true case is important because of the nature of his statutory mandate which involves the exercise of an extraordinary administrative power enabling the Commissioner to apply the laws. The exercise of that power involves his 'determining' a tax liability. An appeal in this context is against the Commissioner's 'decision' namely his determination of a tax liability and its amount. The basic jurisdictional requirement for the exercise of the power is that the Commissioner is 'satisfied' of the various requirements. Once the Commissioner reaches the requisite level of satisfaction, an appeal must, of necessity go to whether he justified in being so satisfied. He must stand or fall by his reasons for exercising the power."

45. The reason offered by the Commissioner is that the Respondent failed to avail documents to support the income from the imports. This argument sounds attractive. But, the challenge is, the Respondent was not the importer and his role was clearly defined in the documents provided. That being the case, the Commissioner's decision that stands on shaky ground and the TAT correctly declined to uphold it.

46. Closely tied to the above ground is the appellant's argument that the Respondent did not produce some documents as required by section **23** of the TPA. Whereas the said section obliges a tax payer to avail records, the flip side of this position is that a party can only produce documents in his possession. It could not have been the intention of the law to compel tax payers to produce documents in the hands of a third party and more so, if the transactions were undertaken by third parties. The Respondent persuaded the TAT that it was not the importer and it could not produce documents in the hands of a third party. To expect the Respondent to produce import documents in the hands of a third-party amounts to overly overstretching the ambit of sections **23,** 56**(1)** and **30** of the TPA. On this ground, the appellant argument collapses.

47. The evidence on record on this particular issue leaves no doubt that the Respondent discharged the burden of proof. As Lord Denning held in *Miller v Minister of Pensions,*[20]

'The…{standard of proof}…is well settled. It must carry a reasonable degree of probability...if the evidence is such that the tribunal can say: 'We think it more probable than not' the burden is discharged, but, if the probabilities are equal, it is not.'

48. The burden placed upon the Respondent by the law was to establish by evidence that it was not the importer and to confirm its role under the contract. Simply put, it was required to demonstrate that the tax was not due. The test is whether the Respondent established a *prima facie* case and having done so, the evidential burden shifted to the appellant to persuade the TAT on the contrary. It never did so.

49. The other important point to bear in mind is that some of the appellant's grounds of appeal such as the first two attack the decision on findings of fact. It is trite that an appeal court is bound by the trial court's findings of credibility of evidence, unless they were found to be affected by a material misdirection or to be clearly wrong. The appeal court will only reverse these findings where it is convinced that the findings are clearly wrong. Earlier in this determination, I mentioned that an appeal to this court under section **56 (2)** of the TPA lies on points of law.

50. Appeal courts are reluctant to interfere with factual findings made by trial courts, more particularly if the factual findings depended upon the credibility of the witnesses who testified at the trial. Trial courts have advantages appeal courts do not have. The former is steeped in the matter; they observe witnesses, and are able and required to assess probabilities as they manifest within the circumstances prevailing, and as they apply to the particular witnesses testifying. Unless the factual findings of the trial court are clearly wrong, or unless the trial court will have misdirected itself, those findings are not to be upset on appeal. Wessels CJ said:-

'*The trial judge is not concerned with what is or is not probable when dealing with abstract business men or normal men, but is concerned with what is probable and what is not probable as regards the particular individuals situated in the particular circumstances in which they were.'*[21]

51. In ITA No. **078** of 2020 I observed that in our system, as in many similar systems of appeal, the cold record placed before the appeal court does not capture all that occurred at the trial. The disadvantage is that the appeal court is denied the opportunity of observing witnesses testify and drawing its own inferences from their demeanor and body language. On the contrary, this is the advantage enjoyed by every trial court. Hence an appeal court must defer to the trial court when it comes to factual findings. In Powell & Wife, Lord Wright formulated the principle thus:-

> "*Not to have seen the witnesses puts appellate judges in a permanent position of disadvantage as against the trial judges, and, unless it can be shown that he has failed to use or has palpably misused his advantage, the higher court ought not to take the responsibility of reversing conclusions so arrived at, merely on the result of their own comparisons and criticisms of the witnesses and of their own view of the probabilities of the case.*"

52. The TAT had the benefit of hearing the parties. It had the benefit of assessing the evidence and the documents before it, it weighed the credibility of the evidence. The evidence met the threshold of discharging the burden placed upon the Respondent by the law. I am unable to find any misdirection on the part of the TAT on its findings on facts. On this ground alone, the appellant's appeal is unsustainable.

53. The other important issue is the Respondent's argument that the appellant has introduced new grounds which were not raised at the trial. The appellants new grounds argument are premised on section **23** of the TPA (Record keeping) and section **18 (2).** A reading of the record shows that there was not argument premised on section **23** of the TPA. There is a long unbroken chain of judicial pronouncements abhorring the attempt by appellants to raise new matters which were not investigated before the trial court. A few examples will demonstrate courts reluctance to entertain new grounds on appeal.

54. In *Girdhari Lal Vidyarthi v Ram Rakha* ***[22]*** the East African Court of Appeal held that a plaintiff who had relied in his pleadings exclusively on a resulting trust in his favour could not on appeal be heard to allege an express trust, especially as the whole conduct of the proceedings below made it clear that only a resulting trust was in issue. In *Tanganyika Farmers Association Ltd v Unyamwezi Development Corporation Ltd*[23] it was held that although an appellate court has a discretion to allow an appellant to take a new point on appeal it will not do so if the matter had not been properly pleaded or if all the facts bearing on the new point have not been elicited in the court below. [24] Similarly, in *Alwi A Saggaf v Abed A Algeredi*,[25] it was held that a new point which had not been pleaded or canvassed should not be allowed to be taken on appeal, unless the facts, if fully investigated, would have supported it. Lastly, the Privy Council in *Warehousing and Forwarding Co v Jafferali* ***[26]*** in an appeal from the East African Court of Appeal which had allowed an appellant to raise a new point of law for the first time on appeal, Lord Guest delivering the opinion of the Board said that there would have been no objection if the facts had been fully investigated and would have supported the new case, but as the question was never investigated, the new point should not have been allowed to be argued.

55. Appeals courts do not usually consider new witnesses or new evidence. Appeals in either civil or criminal cases are usually based on arguments that there were errors in the trial's procedure or errors in the judge's interpretation of the law. The attempt to introduce new grounds and or challenge the TAT's decision on grounds not raised before the TAT is impermissible. The appellant cannot reconstruct its case at this late hour by introducing new matters.

Conclusion

56. In conclusion, I find no basis at all upon which I can interfere with the TAT's decision. The upshot is that the appellant's appeal fails. The appeal is hereby dismissed with costs to the Respondent.

Orders accordingly

Signed, dated and delivered via e-mail at **Nairobi** this **17th** day of **August** 2021

John M. Mativo

Judge

Delivered electronically via e-mail and uploaded into the e-filing system

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[1] Act No. 29 of 2015.

[2] Cap 470, Laws of Kenya.

[3] 1955 Chancery Division, 36, p.262.

[4] {1960} E.A 620.

[5] 312 of 2011.

[6] {2012}

[7] Tax Appeal No. 177 of 2016.

[8] {2018} e KLR.

[9] F. JAMES & G. HAZARD, CIVIL PROCEDURE § 7.6, at 314 (3d ed. 1985); C. MCCORMICK, EVIDENCE § 336, at 947-48 (1984); 9 J. WIGMORE, EVIDENCE § 2485, at 285 (J. Chadbourne rev. 1981).

[10] Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 Hastings L.J. 239 (1988).

[11] A & A Tool & Supply Co. v. Commissioner, 182 F.2d 300, 304 (10th Cir. 1950).

[12] Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 Hastings L.J. 239 (1988).

[13] Ibid.

[14] Ibid.

[15] 254 F.2d 416 (2d Cir. 1958).

[16] FCT v Thomas [2018] HCA 31 at [84] and [85] per Gageler J.

[17] {1952} HCA 21.

[18] {1948} S.C.R. 486.

[19] {1997} 2 SCR 33.6

[20] {1947} 2ALL ER 372.

[21] *Matshevha v S* (A342/2015) [2016] ZAGPJHC 89 (29 April 2016).

[22] {1957} EA 527.

[23] {1960} EA 620.

[24] The court cited with approval and followed three English authorities to the same effect, *Ex parte Firth* {1882} 19 Ch Div 419, North Staffordshire Railway Co v Edge [1920] AC 254, and The Tasmania [1890] 15 AC 223.

[25] {1961} EA 767.

[26] {1963} EA 385