Commissioner of Domestic Taxes v Priyguru Company Limited (Income Tax Appeal E085 of 2020) [2021] KEHC 132 (KLR) (Commercial and Tax) (15 October 2021) (Judgment)

Neutral citation: [2021] KEHC 132 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E085 OF 2020

A MABEYA, J

OCTOBER 15, 2021

BETWEEN

COMMISSIONER OF DOMESTIC TAXES .... APPELLANT

AND

PRIYGURU COMPANY LIMITED .... RESPONDENT

(Being an appeal from the Judgment of the Tax Appeals Tribunal at Nairobi delivered on 21/8/2020)

JUDGMENT

1. The appellant carried out an investigation on the respondent's financial records, as a result of which the appellant assessed the respondent's VAT liability at KShs. 4,813,326/=. The respondent objected to the assessment and an objection decision was issued on 30/07/2018.

2. The respondent appealed against the objection decision to the Tax Appeals Tribunal (hereinafter "the Tribunal"). By a judgment made on 21/8/2020, the Tribunal allowed the appeal and overturned the objection decision.

3. Being dissatisfied with that judgment, the appellant appealed to this Court setting out 7 grounds of appeal which can be summarized as; that the Tribunal erred in failing to appreciate the provisions of section 59 of the *Tax Procedures Act* and section 43 of the *VAT Act* as to the production of additional information and documents and that the Tribunal erred in shifting the burden of proof to the appellant contrary to section 30 of the Tax Appeals Tribunal.

4. The respondent opposed the appeal vide its statement of facts dated 2/10/2020. It contended that it had provided sufficient documents to proof the purchases from its suppliers. That the appellant had

not proved that the respondent was a beneficiary of a fraudulent scheme. That it was not obliged to provide details of its suppliers as they were the appellant's agents for VAT purposes.

5. The respondent further contended that the appellant was the custodian of the iTax, VAT and ETR regulatory system hence it was not the respondent's responsibility to produce the missing traders. That the respondent was not under any legal obligation to inquire, query or verify the fact that the suppliers held a valid PIN yet the registration system was housed by the appellant. That the respondent's right to claim VAT refund was not in any way affected by fraud unless the respondent was aware of it.

6. The Court has carefully considered the record and the submissions of the parties on record as well as the impugned judgment.

7. The two grounds are related and will be determined together. These were to the effect that the Tribunal erred in failing to appreciate the provisions of sections 59 of the *Tax Procedures Act* and section 43 of the VAT Act as to the production of additional information and documents and the burden of proof.

8. The respondent's case was that; it had complied with the provisions of section 17 of the VAT Act. It had supplied the appellant with invoices, delivery notes and payment schedules for the supplies. The appellant on the other hand contended that, the investigations it had carried out had established that the 5 suppliers from whom the respondent had allegedly made purchases from were neither trading in the alleged goods nor trading at all. That due to questionable dealings by those entities, the appellant suspended their PIN but none came forward to either complain or seek reinstatement thereof. That it sought further information from the respondent to the alleged purchases but none were forthcoming.

9. That though the respondent presented business and tax invoice (ETR) receipts, it failed to avail other crucial documents including delivery notes and stock records. That there was no evidence to demonstrate how the goods were ordered, recorded, and sold. Further, the respondent recorded the payments as cash while no actual cash pay-out was made and no cash book was produced despite the substantial amounts alleged to have been paid.

10. The appellant thus declined the purchases on the basis of the foregoing, and on the fact that the suppliers were persons investigated by the appellant and found to be involved in the illegal VAT refund scheme of printing and selling the respective invoices without actual supply of goods.

11. The dispute between the parties relates to credits for VAT input which the respondent had claimed. Section 17 of the VAT Act ("the Act") provides for credit for input tax. Sub-section (3) thereof provides for the documentation that is required for purposes of the credit on input tax. It provides: -

> " (3) The documentation for the purposes of subsection (2) shall be-
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> a. an original tax invoice issued for the supply or a certified copy;
>
> b. ...
>
> c. ...
>
> d. a credit note in the case of input tax deducted under section 16(2); or
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> e. a credit note in the case of input tax deducted under section 16(5)".

12. At paragraph 30 of its judgment, the Tribunal found that the respondent had furnished documents showing purchases of taxable supplies from registered VAT traders with registration numbers and

registered ETR registers and valid PIN numbers. The Tribunal thus found that the appellant could not have claimed that the traders had no known business addresses or were missing.

13. The Tribunal then addressed the issue of fraud at paragraph 31- 33 of its judgment. In so doing, it found that the appellant had failed to criminally prosecute the 5 missing traders for alleged fraudulent activities. It thus found that the appellant had erred in its decision to disallow input VAT claimed by the Appellant.

14. With greatest respect, I think from the outset, the Tribunal got it wrong on the case before it. The appeal before the Tribunal was not about tracing the missing traders, nor was it for the purposes of determining the existence of fraud or not on the part of the suppliers. The appeal related to an assessment by the appellant and the obligation of the respondent as a tax payer to sufficiently proof that the tax assessment was wrong.

15. The respondent's case was that it had objected to the assessment on the grounds that it had provided all the necessary documentation to support its claim for VAT input. The appellant on the other contended that there was no supply of any goods, that the alleged suppliers were a fraud and that the respondent needed to provide him with additional information to prove that there had been purchase of the alleged goods.

16. Once the respondent provided the documents set out in section 17(3) of the Act as it did, it established a prima facie case against the appellant and the evidentiary burden of proof shifted to the appellant. Then it behooved the appellant to prove that his decision was right.

17. What the appellant did was to tell the Tribunal, that it had carried out investigations and concluded that the alleged suppliers were not trading, that they were only printing and selling ETR receipts. That it had informed the respondent of this fact and asked for additional information to prove that there had been commercial transactions between the respondent and the alleged suppliers but none was provided. A case in point were the stock records and cash book especially taking into consideration that the transactions were alleged to have been on cash basis.

18. In the view of this Court, once the appellant presented its case as aforesaid; that it believed the alleged suppliers did not exist or that there had been no commercial transactions for alleged VAT input and that he required information and documents to prove the alleged commercial transactions by way of documents, the evidentiary burden of proof shifted back to the respondent.

19. It was then upon the respondent to prove that there had been supply of taxable goods under section 17 of the Act. This the respondent failed to prove. That is where the burden lay and the moment the respondent failed to produce the documents and information sought by the appellant to prove the alleged commercial transactions, it cannot be held to have proved its case that the assessment was wrong.

20. It is clear that the appellant tasked the respondent with the provision of additional information to support the invoices which were presented as evidence for claiming a tax refund. The respondent failed to do so. At this point, the Tribunal ought to have considered the basis of the appellant making such a demand instead of pursuing the issue of fraud. The issue of fraud would have been gone into if and once the respondent had produced the additional information or documents requested to support the invoices in question.

21. Section 59 of the *Tax Procedures Act* and section 43 of the VAT Act, empowers the appellant to request for more and additional information to satisfy himself on the taxable income declared on matters tax. Such documents include invoices, copies of stock records, details of each supply of goods and services

among others. The respondent was unable to provide these documents despite that the burden of proof was always on it to sufficiently support its invoices from the alleged suppliers.

22. As was held in the case of *Commissioner of Domestic Services v Galaxy Tools Limited* [2021] eKLR, tax laws are unique as they are contrary to the general rule that he who alleges must prove. In that case, the Court explained that: -

> " This country operates under a self-assessment tax regime. Under this regime, the tax payer assesses self and declares what he considers to be taxable income on which he then pays tax to the authorities. For this reason, the tax laws are coached in a manner that gives the tax authorities wide powers and discretion in ascertaining ex-post facto, what taxable income is.
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> Further, the tax Laws reverse the well-known principle of evidence of "he who alleges must proof". In this regard, the tax authorities would assess what it considers to be the tax due from a taxpayer and the tax laws would burden the tax payer to disprove that the assessment or tax demanded is wrong or incorrect.
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> This is borne by the fact that the assessment and demand is ordinarily made way after the tax payer has assessed himself and made a declaration of what according to him is the tax payable and has already paid such tax. The burden is therefore shifted to the tax payer because, the tax authority has to rummage through the documents of the tax payer years after the tax payer assessed himself and paid what he considered to be his tax liability."

23. This position is set out in section 30 of the Tax Appeals Tribunal and section 56 of the *Tax Procedures Act*. Both provisions impose the burden of proof on the tax payer to prove that an assessment is excessive or a tax decision is incorrect. On the other hand, section 59 of the *Tax Procedures Act* and section 43 of the VAT Act, 2013 provide for the keeping and production of documents when required by the tax authorities. These documents must be kept for up to five (5) years. A prudent and keen trader who is genuinely guarding his business and undertaking honest business, will be expected to keep those documents at all times.

24. The above provisions, as was held in *Commissioner of Domestic Services v Galaxy Tools Limited* [2021] Eklr, ought not to be read in isolation. They must be read in conjunction with others.

25. In *Okiya Omtatah Okoiti v. Attorney General & Another* [2020] Eklr, the court held: -

> " Once again I observe that a section or sections of a law should not be read in isolation of the other provisions of that law. The impugned provisions are only meant to enforce the tax laws after a tax payer fails to self-assess for tax purposes or once it is evident that a tax payer is dishonest. The Act as a whole has safeguards that ensures that the taxpayers receive fair administrative action from the tax collector whenever the need arises to put a particular taxpayer through the administrative process".

26. From the foregoing, the appellant was well within the law to demand for the additional information. The respondent was under a legal obligation to provide the additional information and discharge its burden of proving that there had been commercial transactions that resulted in the alleged input VAT or the invoices produced. There was a genuine expectation that as a reasonable businessman, the respondent must have had the custody of all transaction details concerning the trade relations between it and its suppliers.

27. Having failed to provide those transaction details, its appeal before the Tribunal could not have been successful. Its case before this court cannot be successful as well.

28. The upshot is that I find merit in the appeal. The Tribunal failed to consider section 59 of the *Tax Appeals Tribunal Act* and section 43 of the VAT Act as to additional information and documents requested by the appellant to support commercial transactions for tax purposes. The Tribunal further failed to appreciate the burden of proof as set out in section 56 of the *Tax Procedures Act* and section 30 of the *Tax Appeals Tribunal Act*.

29. Accordingly, the appeal is merited and is allowed as prayed.

It is so decreed.

DATED AND DELIVERED AT NAIROBI THIS 15TH DAY OF OCTOBER, 2021.

A. MABEYA, FCI Arb

JUDGE