REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

MILIMANI LAW COURTS

ITA CASE NO. 4 OF 2008

ROBERT MUHIA KARANJA…………..……………PLAINTIFF

VERSUS

COMMISSIONER OF DOMESTIC TAXES…..……....…DEFENDANT

JUDGMENT

The Appellant is a businessman who owns several businesses around Nairobi including service stations at Ruiru and Tigoni, rental houses in Pangani, Kariokor, Zimmerman, Kahawa West and Ruiru.

By a letter dated 16th August, 2005, the Respondent notified the Appellant of its intention to audit him for the years of income 2002 and 2003. The audit was to cover accounts, VAT, PAYE and Rent. The notice required the Appellant to avail for examination the records, books of accounts and other documents on or before 29th August, 2005. The documents required were detailed in the said notice and the audit was to be conducted at the Appellants premises. It would appear that the Appellant was only able to avail for examination the books for the period 1st January, 2002 and 31st December, 2002.

After the Audit the Respondent computed an additional tax of Kshs.1,402,204/- which it demanded from the Appellant. the appellant objected to the same on the grounds that it was estimated and excessive, that it was not in accordance with his 2002 self assessment return, accounts and rent Schedules and that penalties and interest imposed was excessive. The Respondent would not hear of that and it proceeded to confirm the assessment. The Appellant appealed to the Thika Income Tax Local Committee which appeal was however dismissed on 27th September, 2007. It is against that dismissal of his appeal that the Appellant has appealed to this court.

The Appellant relies on three grounds:-

1. **That the Thika Income Tax Local Committee confirmed the assessment on income which was based on mere estimates.**
2. **That the assessment confirmed by the local committee was excessive.**
3. **That the committee in the process of making the said decision contravened the provisions of Rule 10(j) of the Income Tax (Local Committee Rules)**

Parties filed written submissions which were highlighted by their respective Counsels on 13th October, 2011. It was submitted on behalf of the Appellant that the assessment confirmed by the Local Committee was based on mere estimates, that the tools and parameters used by the Respondent to re-assess the taxable income were not accurate, that it was open to error, that the assessment on the rental income was

also estimated in that it did not take into consideration the fact that some tenants had moved out of the Appellants premises whereby some rent was not paid or cleared, that some members of the local committee had questioned whether the investigations conducted at the Appellants Petrol Station had taken into consideration the issue of evaporation of the volatile fuel and pilferage by the Appellants employees, that the Local Committee failed to evaluate the re-assessment, that it ignored the issue of closure of Ocean Link Petrol Station in February, 2002, that since the tribunal and the Respondent relied on the same documents the Appellant had relied on when making his 2002 returns, the issue of arriving at different figures did not arise, that the Respondent relied only on lesser documents that it had demanded, that the assumption by the tribunal that the location of the houses of the Appellant meant that it was unlikely for those houses to miss tenants was erroneous.

On Ground 3, Mr. Karuga Learned Counsel for the Appellant faulted the procedure that the local committee used to arrive at its decision, that is negated the provisions of Rule 10(j) of the Income Tax (Local Committee) Rules, that there was no voting contrary to the requirement of that rule, that since some members had questioned the figures given by the Respondent, the committee should have voted to arrive at its decision, that under Section 73(2)(b) the committee should have shown reasonable cause why it did not agree with the Appellants self assessment, Counsel cited **Income Tax Appeal No. 753 of 2003 Unilever (k) Ltd. –vs- Commissioner of Income Tax** in support of the submission that so long as the tax payer is able to demonstrate that there was no tax fraud or tax cheating the method used by a tax payer for his self assessment should not be disturbed, that there was no tax fraud on the part of the Appellant, that failure by the Appellant to disclose the income from sale of a motor vehicle was proper as that was not income as the Appellant does not deal in the business of sale of motor vehicles, Mr.Karuga therefore urged the court to allow the appeal and uphold the Appellants self assessment.

The respondent filed its statement of facts as well as written submissions. According to the Respondent, in 2005 it carried out an audit of the Appellant, for the year 2002, that the audit revealed what it considered to be serious discrepancies relating to the sales figures at the Appellants Ocean Link 2000 Service Station at Ruiru and rental income from his rental properties, that the Appellant failed to produce his bank statements and receipt books which forced the Respondent to rely on actual daily meter books which record the opening stock shown on the petrol pumps meter readings at the beginning of the business day and the closing stock at the end of the business day which also show daily sales from each pump, that this enabled the Respondent to ascertain the total litres of petrol pumped out of the holding tanks from each petrol pump every day for the entire year 2002, that from its calculations the Respondent concluded that the total fuel sales for the year 2002 was Kshs.89,258,962/- whilst the Appellants Audited Accounts for year 2002 produced as “CDT 2” showed a sum of Kshs.86,645,480/-, that there was therefore a variance of Kshs.2,613,482/- on the fuel sales. The Respondent further asserted that the Appellant later produced copies of daily sales for the period under consideration (1st January, 2002 – 31st December, 2002) showing the actual sales for the year as being Kshs.73,701,303/-, that the Appellant was unable to explain the discrepancy between this figure of Kshs.73,701,303/- that had been computed from actual copies of daily sales produced by the Appellant and the amount of Kshs.86,645,480/- he had declared in his accounts for 2002.

As regards rent the Respondent asserted that it relied on the Appellants rent books, it sent representatives to the Appellants various premises situated in the areas earlier on described, that on computation, the Respondent found that the annual total rent from the various premises of the Appellant was Kshs.7,8080,700/-. Applying the appellants declared expense of Kshs.1,449,791/- the Respondent concluded that the Appellants total net rent was Kshs.6,358,909/- as opposed to the declared net rent of Kshs.4,649,309/-, that there was therefore a variance of Kshs.1,709,600/-, that after concluding the audit, the Respondent computed the Appellant’s additional taxable income as Kshs.4,674,012/- which included a sum of Kshs.350,930/- for an alleged motor vehicle sales that had been factored in the 2002 Accounts but whose evidence was not forthcoming. That it is on the basis of the foregoing additional taxable income that the Respondent issued an additional assessment notice demanding additional tax of Kshs.1,402,204 from the Appellant.

Miss Mwaniki, learned counsel for the Respondent submitted that what the Appellant was challenging was not the audit but the findings of the audit, that the local committee properly upheld the decision of the

Respondent because it was unable to believe the unsupported position put before it by the Appellant's agent, that the assessment was arrived at using the actual records supplied to the Respondent by the Appellant, that the assessment was not based on mere estimates but based on examination of actual records which were before the tribunal and court marked **CDT 2, CDT4, CDT5,** and **CDT6,** that the Respondents findings upon examination of the foregoing documents was **CDT3, CDT7** and **CDT8** which formed the basis of the assessment, that **Section 73(2) (b)** of the income tax allowed the Respondent to re-assess a tax payer, that further **Section 77** allows the Respondent to use his best judgment to carry out the assessment, that the local committee is not charged with any obligation of seeking further evidence than what is tendered before it.

Miss Mwaniki further submitted that under Section 87 (2) (b) of the Income Tax Act the onus is upon the tax payer to show that the assessment is excessive which the Appellant had failed to discharge, that there was no evidence tendered before the local committee to show that there was pilferage, evaporation or errors. Counsel relied on the cases of **Tudor –vs- Ducker 1918 -1924 24 tax cases 591** and P**erson –vs- Belcher 1959 Report on Taxes at Pg 387.** Miss Mwaniki was of the view that **Rule 10(j)** was never breached by the local committee as the same is meant to allow the committee deliberate the matter, that withdrawal by the tribunal need not necessarily be physical, that all the members of the committee were present, that the Appellant had not demonstrated what prejudice he had suffered by the local committee not having voted on the decision. She urged the court not to set aside the decision relying on the technical ground raised, she referred the court to the decision **in General Principles of Constitutional and Administrative Law (4th edition) John Alder at Pg. 387.** She urged the court to dismiss the Appeal.

I have considered the statements by the respective parties, their written submissions as well as the oral highlights.

From the statement and evidence of the Respondent it is evident that the Respondent demanded various documents from the Appellant to enable the Respondent carry out an audit of the Appellant's businesses. The Respondent relied on the documents supplied by the Appellant to reach a conclusion that the Appellant's petrol sales for year 2002 was Kshs.89,258,962/- and not Kshs.86,645,480/- declared by the Appellant in his 2002 Accounts. From the record, it would seem that when the Appellant was unable to produce the daily meter books for the period 1st February – 23rd March, 2002, the Respondent resorted to the use of daily meter/shift sheets to arrive at a figure of Kshs.14,454,263/- as the amount of sales for that period. That the daily sales produced by the Auditor(agent) showed total sales of Kshs.73,701,303/- whilst the agent had declared in the Accounts a total of Kshs86,646,480/-. This discrepancy was not explained by either the Appellant or the agent both before the tribunal or before this court. I am satisfied that the Respondent was entitled to use the procedure he did, i.e. daily meter/shift sheets to ascertain the sales for the period 1st February – 23rd March 2002. I am also satisfied that with the Appellant failing to produce and avail to the Respondent his bank statements and receipt books, the Respondent was entitled to use his best judgment, which was to rely on the actual daily meter books to be able to ascertain the total volume of the Appellants annual sales of fuel. This I believe is in tandem with the provisions of Section 77 of the Income Tax which provides:

"**Where the Commissioner considers that a person has been assessed at a less amount, either in relation to the income assessed or to the amount of tax payable than that at which he ought to be assessed, the Commissioner may, by an additional assessment, assess that person at such additional amount as, according to the best of his judgment, that person ought to be assessed."**
The operative words are "according to the best of his judgment." In my view, in the circumstances of this case, i.e. failure to produce required and appropriate documents, failure to explain discrepancies in total sales i.e. Kshs.73,701,303/- from own documents and kshs.86,646,480/- from own audited accounts, the Respondent was entitled as he did, to use the best of his judgment in his assessment. That judgment in my view, was not properly or effectively challenged before the Thika Local Committee for Income Tax to convince it to arrive at a different conclusion than the one it did.

On rentals, the Respondent's case was that it relied on the Appellants own rental books supplied by the Appellant himself and from interviewing his tenants at the subject premises. The Respondent produced copies of those rental records as "CDT6" in support of its case that there was a variation of Kshs.1,709,600/- between the rent income declared by the Appellant and the actual rent.

Before the Local Committee, the Appellant's explanation through his appointed agent was that fuel is a very volatile product and therefore easily evaporates, that since the fuel pumps run for 24 hours a day, they are bound to malfunction and thereby give misleading readings.

Section 87 (2) of the Income Tax Act provides

"2) In an Appeal under Section 86

b) <u>the onus of proving that the assessment decision appealed against is excessive or erroneous shall be on the appellant."</u>

The question that this Court has to answer therefore is did the Appellant discharge the foregoing burden before the Local Committee? From the proceedings before the Local Committee, what the agent stated was that there was possibility of evaporation of fuel, that he had made an adjustment of Kshs.12,944,177/- to the accounts to cover the period the station was under repair between February 2002 and March 2002. There was no evidence tendered, in my view, to counter the evidence of the Respondent. Whilst the Respondent maintained that the meter reading showed sales of approximately Kshs.14 million during the alleged period of repair, the Appellant was silent on the issue. He did not tender documents to show that whilst there were records of daily sales between 1st January, 2002 and 24th March to 31st December, 2002, there were none between February, 2002 and March, 2002 to convince the Committee that there was no trading during the period 1st February, 2002 and 23rd March, 2002. I note that the committee observed that due to the fact that, lack of documents and evaporation were not measurable, there should have been cogent evidence to rebut the Respondent's case. The Committee also observed that it was not possible for the petrol pumps to run when the tanks had been pulled out and the adjustment of Kshs.12,944,177/- by the Appellants Auditor was without basis and that it was clear then that if the pumps were running during February – March, 2002 the station was operating. The Committee also observed that evaporation of fuel is a loss that is passed over to the customer not the station owner.

I also note that the committee's decision was based on the fact that it was not able to believe the agent because of the agent's unsupported explanation.

From the evidence tendered from the local committee it is difficult to fault the committee from its decision since it was not the Respondent to prove its case but the Appellant to show that the assessment was estimated, excessive and unreliable. As I have already observed above, the Appellant did not tender any evidence by way of additional documents or otherwise to rebut the case of the Respondent put before the Local Committee. The Local Committee cannot therefore be faulted on its decision of 27th September, 2007. In any event, when the Appellant attempted to make an explanation by producing copies of sales records the amounts arrived at i.e. Kshs.73, 701, 303/- was in great variance with the Appellants Audited Accounts of 2002, which he also failed to explain.

On the issue of rentals the evidence presented before the Local Committee was that the documents used by the Respondent was availed by the Appellant, the Appellant did not refer the Local Committee to any document that was relied on by the Respondent that had either been wrongly considered or that did not emanate from the Appellant. I am not able to agree with counsel for the Appellant that the local committee was enjoined to look for more evidence other than the documents the parties before it produced and relied on. Section 108 of the Evidence Act Cap 80 Laws of Kenya is categorical that he who alleges must prove. The Appellant had alleged in its appeal before the Local Committee that the Respondent's assessment was excessive and or based on mere estimates. He did not prove that allegation by either production of documents or by faulting the procedure and method used by the Respondent. For the foregoing reasons I reject grounds 1 and 2 of the Appeal.

On the third ground of appeal Counsel for the Appellant argued that the Local Committee acted contrary to **Rule 10(j)** of the Income Tax (Local Committee) Rules on the ground that there was no voting, that the

tribunal failed to show why it did not agree with the Appellant and that Section **73 (2) (b)** of the Income Tax required the tribunal to show reasonable cause why it did not agree with the Appellant.

I have read **Section 73 (2) (b)** of the Income Tax and it has nothing to do with the Local Committee but with the Respondent. It gives the Respondent the discretion to determine the amount of income of a tax payer where he has cause to believe that the return by a particular tax payer is not correct. The Section provides:-

"2) Where a person had delivered a return of income the Commissioner may –
(b) <u>if he has reasonable cause</u> to believe that the return is not true and correct, determine, according to the best of his judgment, the amount of the income of that person and assess him accordingly."

I have already set out why I agree with the Respondent with his judgment in the assessment under this section.
Mr. Kiragu relied on the case of **<u>ITA</u> <u>No. 753 of 2003 Unilever Kenya Ltd –vs- The commissioner of Income Tax</u>** in support of his argument that before the Commissioner can make a tax payer to shoulder a higher tax liability than he has in his returns, there should be evidence of tax fraud or tax cheating or fraud trading. In that case, Alnashir Visram J (as he then was) allowed an Appeal on the above grounds. Of course I agree with the holding in that case but it was dealing with the provisions of Section 18 of the Income Tax which deals with ascertainment of gains or profits of business in relation to certain non-resident persons. In this case, the Appellant is wholly resident and the said Section is inapplicable.

Rule 10 (j) of the Income Tax (Local Committee) rules provides;
"(j) The decision of the Local Committee shall be determined by a majority of members present and voting at the meeting and in the case of inequality of votes the chairman shall have a vote in addition to have a deliberative vote."

Mr. Kiragu complains that the committee did not indicate how the members voted in their appeal before it. I agree with him that the proceedings are silent on the issue of voting.

However, in my view that requirement of voting presupposes where there is a split in the decision arrived at. The Appellant has not showed that different members of the Local Committee took a different position other than the final conclusion arrived at by the tribunal. The Appellant's agent was present at the proceedings, he has not sworn a statement to state that any of the members of the committee were of a different view than what appears as the Ruling. In my view, while it is important for the committee to indicate how voting is done, there is no prejudice that was suffered in the instance case as the ruling is recorded in the majority. Throughout the proceedings, most of the members who interjected seemed not to be in favour of the explanations given by the Appellant's agent. In my view, failure by the Committee to show the trend of voting does not invalidate the decision arrived at. Counsel for the respondent referred the court to an extract from the text; **<u>GENERAL PRINCIPLES OF CONSTITUTIONAL AND ADMINISTRATIVE LAW 4TH EDITION</u>** wherein at **page 387** the learned writers observed that **"Using their discretionally power to withhold a remedy the courts will set aside a decision for procedural irregularity only <u>if the harm or injustice caused to the applicant by the procedural flaw outweighs</u> the inconvenience to the government or the innocent 3rd parties in setting the decision aside."**

Although the proceedings before me are not of Judicial Review, which the text addresses, I am of the view that that observation would apply in the circumstances of this case as no prejudice is shown to have been suffered by the Appellant for non observance of Rule 10(s)

On the foregoing reasons, the Appellants' appeal is without merit and is hereby dismissed with costs to the Respondent.

Dated and delivered at Nairobi this **4th day of November, 2011**

JUSTICE A. MABEYA