**Enterprises v Commissioner of Investigations and Enforcement (Income Tax Appeal E082 of 2021) [2024] KEHC 4605 (KLR) (Commercial and Tax) (15 April 2024) (Judgment)**

Neutral citation: [2024] KEHC 4605 (KLR)

**REPUBLIC OF KENYA**

**IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)**

**COMMERCIAL AND TAX**

**INCOME TAX APPEAL E082 OF 2021**

**JWW MONG'ARE, J**

**APRIL 15, 2024**

**BETWEEN**

**HEET ENTERPRISES ..... APPELLANT**

**AND**

**COMMISSIONER OF INVESTIGATIONS AND ENFORCEMENT ..... RESPONDENT**

**JUDGMENT**

1. The Respondent reviewed the Appellant's tax affairs for the period between October 2015 and June 2017 and discovered that the Appellant sourced construction material from two suppliers who had been profiled by the Respondent as being responsible for printing and selling ETR invoices without making actual supplies under the missing trader fraud scheme.

2. The Respondent issued VAT assessment orders to the Appellant dated 7th and 8th May 2010 totalling Kshs.61,750,835/= and the Appellant filed its objection against the assessment vide a letter dated 13th June 2018.

3. Vide its objection decision dated 26th July 2018, the Respondent rejected the Appellant's objection and confirmed the assessed sum of Kshs.21,478,551.00/=.

4. Aggrieved by the objection decision, the Appellant lodged an appeal before the Tax Appeals Tribunal (the tribunal). Upon considering the appeal, the tribunal dismissed it and upheld the objection decision dated 26th July 2018 confirming the assessment of the sum of Kshs.21,478,551.00/=.

5. The Appellant being dissatisfied by the decision of the tribunal appealed to this court against the whole of the said decision on the following grounds as set out in its memorandum of appeal dated 15th June 2021:-

"1. The Honourable Tax Appeals Tribunal ("the Honourable Tribunal") erred in finding that the Appellant was liable to pay Value Added Tax ('VAT') in the aggregate sum of Kshs.61,750,835.00/= as assessed and demanded by the Respondent yet the Respondent in its Objection Decision only confirmed an amount of Kshs..21,478,551/= being VAT.

2. The Honourable Tribunal erred by failing to consider the issues, facts and evidence placed before it. In particular, the Tribunal failed and/ or declined to address the issue of legality and validity of both separate Respondent's Assessments dated 7th and 8th May 2018 and the Objection Decision dated 26th July, 2018 as raised by the Respondent.

**a) Validity of the Respondent's Assessment and Objection Decision.**

3. The Honourable Tribunal erred in failing to find and hold that the Respondent's failure to provide reasons for rejecting the Appellant's VAT claim and the raising of a VAT assessment for Kshs.21,478,551/= ('the Impugned Assessment') was invalid as it was contrary to Section 49 of the *Tax Procedures Act*, 2015 ('the *TPA*').

4. The Honourable Tribunal fundamentally misconstrued the provisions of Section 51(10) of the *Tax Procedures Act* in finding at Paragraph 92 of its judgment that '...A reading of the above provision indicates that there is no obligation placed on the Respondent to respond to each of the grounds raised by the Appellant. The section merely requires the Respondent to provide a statement of the facts and the reason for the decision. A review of the Objection Decision indicates that it met these conditions...'

   By so doing the Honourable Tribunal erred in failing to find and hold that the Respondent's failure to disclose the substantive legal provision(s) upon which the Impugned Assessment was raised, invalidated it.

5. The Honourable Tribunal erred in failing to find and hold that in any event, the Objection Decisions were invalid as the "Commissioner has established that there was no supply of taxable goods made by the suppliers highlighted..."

6. The Honourable Tribunal fundamentally misconstrued the provisions of Section 51(10) of the *Tax Procedures Act* in finding that the Respondent did not have an obligation to respond to the grounds of the Appellant's Notice of Objection.

**b) Sufficient Proof of Purchase**

7. The Honourable Tribunal erred in law and fact in finding that the Appellant failed to provide sufficient proof to rebut the Respondent's Assessment and Objection Decisions and therefore the VAT and Corporation Tax demanded was due.

8. The Honourable Tribunal erred in failing to appreciate and consider the following:-

a) Section 17 (l) of the *VAT Act provides that:-*

> ' ...Subject to the provisions of this section and regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person, subject to the exceptions provided under this section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies.

b) Section 17(3) of the *VAT Act* further provides that:-

> ' ...(3) The documentation for the purpose of subsection (2) shall be-
>
> (a) an original tax invoice issued for the supply or a certified copy;
>
> (b) a customs entry duly certified by the proper officer and a receipt for the payment of tax;
>
> (c) a customs receipt and a certificate signed by the proper officer stating the amount of tax paid, in the case of goods purchased from a customs auction; and
>
> (d) a credit note in the case of input tax deducted under section 16(2); or
>
> (e) a debit note in the case of input tax deducted under section 16(5)...'

c) Regulation 7 of the *VAT Regulations* of 2017 is to the effect that;

> (1) A person shall be entitled to a deduction of input tax incurred for trading stock on hand at the date that the person becomes registered.
>
> (2) A deduction of Input Tax shall not be allowed unless -
>
> (a) the input tax to which the deduction relates is deductible under Section 17 of the *Act*;

(b) the registered person has provided the Commissioner with satisfactory evidence-

(i) that input tax was paid on acquisition of the goods;

(ii) of the quantities, descriptions, and values of the goods on hand at the time of registration...'

d) It is both legal and standard business practice that the documents required under both Section 17 of the *VAT Act* and *VAT Regulations*, 2017 to Support a claim for input VAT are invoices and corresponding ETRs, delivery notes, payment records and store records, which documents were provided and acknowledged as received by the Respondent.

9. The Honourable Tribunal erred in law by failing to consider the uncontested evidence, indeed produced by the Respondent, that the Appellant had provided copies of all the documents required to confirm the authenticity of the alleged fictitious purchases and therefore the Objection Decisions upholding the Assessments, were not well-founded,

(a) In paragraph 20(viii) of its statement of facts dated 14th October 2018, the Respondent admitted that the Appellant had provided records of payments to the suppliers for all impugned purchases.

(b) Both in his witness statement as well as oral testimony, the Respondent's Witness confirmed that the Appellant had provided all documents required of it including proof of payment of all the contested purchases.

(c) The Respondent never, then or before the Honourable Tribunal, questioned the authenticity of the documents provided by the Appellant.

(d) In light of these the Respondent's conclusion that this part of the evasion scheme in which the suppliers somehow paid the money back to the Appellant (MLOketch admitted they had no evidence) was without factual foundation or otherwise wholly arbitrary.

(e) No or no grounds were given by the Respondent for rejection of evidence provided by the Appellant.

(f) In absence of any good grounds, the Appellant's evidence neither the impugned assessments nor the Objection Decisions could stand.

10. The Honourable Tribunal misconstrued the provisions of both Section 30 of the *Tax Appeals Tribunal Act* and Section 107 of the *Evidence Act* in concluding that the Appellant failed to discharge its burden of proof. The Honourable Tribunal failed and/ or declined to take cognisance of the fact that the Respondent had been provided with all the documents it requested for as proof of the purchases by the Appellant. Having discharged its burden of proof, it was upon the Respondent to demonstrate that the evidence adduced was insufficient to prove the contrary and not the Appellant.

11. The Honourable Tribunal erred in finding at paragraph 108 of its Judgment that '...this burden placed upon the taxpayer in respect of input VAT claim is to the extent that the necessary documentation in support of the purchase is tabled, upon which a legitimate expectation for the claim to be allowed arises unless the credibility of the documents provided is impeached.'

    The Appellant indeed furnished the Respondent with the necessary documents.

12. The Honourable Tribunal erred in failing to find that the Appellant had a right to deduct the cost of purchases under Section 15(1) of the *Income Tax Act*. The said Section 15(1) of the *Income Tax Act* provides that:

    > ' 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."

13. The Honourable Tribunal erred in failing to find that Section 15(1) of the *Income Tax Act* is applicable to the Appellant's expenditure incurred for purposes of production of its income despite the Respondent being provided with evidence in support of the purchases and has without any reasonable factual or legal justification opted to ignore the same.

14. The Honourable Tribunal erred in failing to find that the Respondent erred in its decision to charge Corporation Tax on the disallowed expenses on purchases.

15. The Honourable Tribunal fundamentally erred in failing to take cognisance of the fact that the Appellant duly issued the Respondent with copies of invoices

and corresponding ETR, proof of payments, delivery notes and store records for all its purchases as is normal business practice, from its suppliers.

16. The Honourable Tribunal erred in failing to follow its own decisions in and its prior decision in Shreeji Enterprises (K) Limited v The Commissioner of Domestic Taxes Tax Appeals No.58 and 186 of 2019 and its prior decision in Karshan Limited vs Commissioner of Domestic Taxes Tax Appeals No.123 of 2018.

17. In particular, on the material before it, the Honourable Tribunal should have found and held that:-

    (a) in cases of assessments made in missing trader cases, as the Respondent asserted fraud, the burden of proof was not only upon it but it was a very high standard, a burden the Respondent had failed to discharge.

    (b) To be denied the input VAT it claimed, it had to be proved that the Appellant was not only in such fraudulent missing trader scheme(s), but also that it was personally implicated-proof that was absent in this case.

    (c) It was not the responsibility of a purchaser such as the Appellant to ensure input VAT was remitted by its suppliers."

6. Based on the forgoing lengthy Memorandum of Appeal, the Appellant prayed to have the appeal allowed with costs and the judgment of the tribunal reversed and substituted with an order setting aside the objection decision dated 26th July 2018 and the notices of assessment of tax dated 7th May 2018 and 8th May 2018.

7. The Respondent contended that an appeal to the Court of Appeal and High Court shall be on questions of law only; however, the Appellant disregarded this by alleging facts that they failed to prove when the matter was before the tribunal.

8. The Respondent asserted that its assessment and objection decision were valid as they met the conditions in the *Tax Procedures Act* and that the decision of the tribunal was well founded and in accordance with the tenets of the *VAT Act* 2013 as the Appellant failed to demonstrate that it indeed purchased the goods from the suppliers in question as no evidence was tabled to demonstrate delivery of goods.

9. The Respondent prayed to have the present appeal dismissed with costs.

**Analysis and Determination.**

10. The Appellant filed written submissions dated 15th February 2023 while the Respondents are dated 21st March 2013.

11. The court has carefully analysed and considered the Record of Appeal, the response filed against it and the submissions filed by the parties.

12. The court notes that the grounds of appeal as set out though lengthy in the Memorandum of Appeal dated 15th June 2021 can be condensed to the following two issues of determination:-

    i) Whether the tribunal erred in finding that the Objection decision was valid.

ii) Whether the tribunal erred in finding that the Respondent did not err in its decision to disallow the input VAT and purchase cost by the Appellant and to demand payment of the VAT claimed in the period under investigation.

**Issue 1: Whether the tribunal erred in finding that the Objection decision was valid.**

13. The Respondent issued an objection decision dated 26th July 2018 whereby it confirmed the assessment it had made earlier which was the demand of Kshs.21,478,551.00/- from the Appellant.

14. The Appellant submitted that the failure by the Respondent to provide reasons for rejecting the Appellant's VAT claim and the raising of VAT assessment for Kshs.21,478,551/- was invalid as it was contrary to Section 49 of the *Tax Procedures Act*.

15. On its part, the Respondent submitted that the tribunal rightly held that the Respondent provided reasons for disallowing the input VAT and costs claim.

16. The question the court must answer is whether the objection decision was valid.

17. Section 49 of the *Tax Procedures Act* states:-

> "Where the Commissioner has refused an application under a tax law, the notice of refusal shall include a statement of reasons for the refusal."

18. Section 51(10) of the *Tax Procedures Act* states that:-

> "An objection decision shall include a statement of findings on the material facts and the reasons for the decision."

19. The provisions above provide the requirements for an objection to be valid. In this case the objection decision (annexed on page 65 of the record of appeal) states in part:-

> "...Notwithstanding your assertions that the company has maintained full records for the purchases disallowed, the Commissioner has established that there was no supply of taxable goods made by the suppliers highlighted in our letter. The Commissioner hereby confirms the assessment as issued."

20. From the paragraph above, it is clear that the Respondent provided a reason for disallowing the purchases, which is that it had established that there was no supply of taxable goods. Further reading of the objection decision, I note that the Respondent informed the Appellant of its right to appeal against the objection decision at the tribunal.

21. I find therefore that the tribunal did not err in holding that the objection decision was valid.

**Issue 2: Whether the tribunal erred in finding that the Respondent did not err in its decision to disallow the input VAT and purchase cost by the Appellant and to demand payment of the VAT claimed in the period under investigation.**

22. The genesis of the dispute before this court is an assessment carried out by the Respondent whereby it found that the Appellant used invoices from suppliers from which no deliveries were made to account for input VAT. The said suppliers, known as Darwine Wholesalers Limited and Fahari Hardware & Build Wholesalers were found to be part of the missing trader fraudulent scheme.

23. The Appellant submitted that it had provided sufficient documents required to confirm the authenticity of the alleged fictitious purchases therefore the objection decision upholding the assessment were not well founded.

24. On the other hand, the Respondent submitted that it had carried out an iTax analysis and investigations of the suppliers that the Appellant had purportedly bought supplies from. The investigations revealed that the suppliers only existed on paper and their sole purpose was the production of fictitious invoices.

25. Deduction of input tax is provided for under section 17 (1) of the *VAT Act* which states:-

> "Subject to the provisions of this Act and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person in a return for the period, subject to the exceptions provided under this section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies."

Subsection (3) thereto provides the documentation necessary for a deduction of input tax to be allowable:-

> "(a) an original tax invoice issued for the supply or a certified copy
>
> (b) customs entry duly certified by the proper officer and a receipt for the payment of tax;
>
> (c) a customs receipt and a certificate signed by the proper officer stating the amount of tax paid, in the case of goods purchased from a customs auction; and
>
> (d) a credit note in the case of input tax deducted under section 16(2);
>
> (e) a debit note in the case of input tax deducted under section 16(5);"

26. Section 56 of the *Tax Procedures Act* and Section 30 of the *Tax Appeals Tribunal Act* place the burden of proof on the Appellant to prove that it made a purchase to which it is entitled to deduct input VAT.

27. In this case the Appellant objected to the assessment vide its letter dated 13th June 2018. In the letter, the Appellant stated that its documentary support for the purchases from the suppliers are purchase invoices, delivery notes, bank statements and monthly stock cards. Despite this the Commissioner found that the Appellant had failed to establish that there was a taxable supply.

28. The record shows that the investigations of the Respondent revealed that the address of one of the Appellant's suppliers, Darwine Wholesalers Ltd is non-existent and that the supplier did not have a go down in the said address where it would store voluminous and heavy steel materials that it allegedly supplied to the Appellant. Further that the Respondent through the iTax platform established that the Appellant's physical address was the same as that of Darwine Wholesalers Ltd which meant that the Appellant and its supplier were related companies.

29. The proceedings in the tribunal show that on cross examination the Appellant's director did not know where the location of Darwine Wholesalers Ltd was despite the fact that it received millions of shillings' worth of supplies from them.

30. The facts above raised suspicion on the apparent purchases that the Appellant made from its suppliers. The evidentiary burden was upon the Appellant to prove the said purchases to the satisfaction of the Commissioner.

31. In the case of *Commissioner of Domestic Services v Galaxy Tools Limited* [2021] eKLR, the court held:-

> "On the foregoing, the evidentiary burden of proof shifted back to the Respondent to show that its documentation was legitimate. This would have been by production of other transactional documentation to support the legitimacy of the alleged transactions. It is at that juncture that Sections 59 of the *Tax Procedures Act* and section 43 of the *VAT Act* kicks in.
>
> The said provisions give power to the Appellant to request for more and additional information to satisfy himself on the taxable income declared or matters tax. Some of the documents to be kept by a taxpayer and which should be availed to the Appellant are, copies of invoices, copies of stock records, details of each supply of goods and services among others. According to the Appellant, save for invoices, none of these documents were supplied."

32. Although the Appellant provided some documentation, the same was not satisfactory to the Respondent and the Appellant had the obligation to provide further documents to prove the purchases. The Appellant claimed that supplies worth millions of shillings were delivered to it therefore it would be prudent for it to provide more documents such as stock control record, sales invoices of the respective purchased goods, bank statements and produce logs to show the movement of the goods into their premises.

33. Based on the foregoing, I find that the tribunal did not err when it concluded that the Appellant failed to discharge its burden of proving that there was actual purchase and supply of taxable supplies.

34. I find that the Respondent was justified in issuing its objection decision and find no reason to interfere with the tribunal's judgement of 28th May 2021.

35. Subsequently I find and hold that the appeal before this court lacks merit and the same is dismissed with costs to the Respondent.

**DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 15TH DAY OF APRIL, 2024.**

**.....**

**J.W.W. MONG'ARE**

**JUDGE**

**In the Presence of:-**

1. Mr. Mathini and Mr. Opiyo for the Appellant.

2. Ms. Nganga for the Respondent.

3. Amos - Court Assistant

**MONG'ARE,J.**