Avic International Real Estate (K) Ltd v Commissioner of Domestic Taxes (Income Tax Appeal E071 of 2023) [2024] KEHC 5469 (KLR) (Commercial and Tax) (13 May 2024) (Judgment)

Neutral citation: [2024] KEHC 5469 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E071 OF 2023

FG MUGAMBI, J

MAY 13, 2024

BETWEEN

AVIC INTERNATIONAL REAL ESTATE (K) LTD ..... APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT

JUDGMENT

1. The appellant is a developer of a mixed user project comprising of both commercial and residential properties, in Westlands, Nairobi. It is not in dispute that the appellant was entitled to claim input VAT credits arising from expenses it incurred in developing the project.

2. The dispute is as to what percentage of the development constitutes commercial and what percentage constitutes residential for purposes of apportioning taxable supplies and exempt supplies. At the heart of this dispute is also the interpretation and application of Sections 17(1), (6) and (7) of the *Value Added Tax Act* (the *VAT Act*).

3. The implication of this apportionment is that supplies related to residential premises constitute VAT exempt supplies. This is by dint of paragraph 8 Part II of the First Schedule to the *VAT Act*. Supplies for hotels and commercial premises under which the serviced apartments fall are on the other hand subject to VAT at the rate of 16%.

4. The main bone of contention by the appellant is that the *TAT* erred by upholding the respondent's decision to apportion the appellant's tax credits using the rate of 34.87% of the costs incurred for developing the entire 4 blocks of apartments (A,B,C and D) as opposed to apportioning the cost at 18.26% of the costs of developing the 2 residential towers (B and C), which qualified for VAT exemption amounting to Kshs. 52,893,111/=.

5. On 15th November 2019 the respondent issued to the appellant 5 separate Value Added Tax Auto Assessments totalling Kshs.152,610,530/= for the tax period January 2018 to May 2018. The appellant objected to these, culminating in an objection decision dated 20th October 2020.

6. In the said decision the respondent accepted invoices in support of VAT of Kshs.151,686,583/= on the basis that the invoices and by extension the claimed input VAT in the VAT return met the requirements of section 17 of the *VAT Act*. The respondent however disallowed input tax amounting to Kshs.52,893,111/= which was stated as 34.87% of the appellant's costs of Kshs. 151,686,583/= for the period on the basis that they related to exempt supplies. Input VAT claims of Kshs.457,426/= was disallowed on the basis that the input tax was not supported by valid documentation.

7. Being dissatisfied with the objection decision, the appellant filed an appeal at the Tax Appeals Tribunal (the Tribunal) on 13th January 2021. In a decision dated 14th April 2023 the Tribunal considered and dismissed the appeal and upheld the respondent's objection decision. This is what has culminated to the present appeal, lodged through the Memorandum of Appeal dated 18th May 2023. In opposition to the appeal, the respondent filed statement of facts dated 14th July 2023. The appeal was canvassed by way of written submissions.

8. According to the appellant, the apportionment of the project evolved and the changes were due to the market dynamics. While the appellant had originally intended to have the said blocks as commercial blocks, during the construction phase, the appellant noted the changing market dynamics on occupancy rates and fees for commercial buildings vis-à-vis for residential apartments.

9. Based on this, a commercial decision was then made to shift the intended use of the project to better reflect the prevailing market sentiments. The appellant maintains that the respondent was at all times aware that the final usage would be subject to change depending on the various negotiations with third parties who had expressed interest in the project based on the final usage of the units they procured from the appellant.

10. The appellant takes issue with the alleged unilateral VAT adjustments that were issued by the respondent in its iTax portal. This, the appellant claims, was in complete disregard of pending negotiations that finally crystallized the apportionment rates and proportions of utilization of the project.

11. The respondent on its part maintains that the allowed input VAT was apportioned between taxable and exempt supplies in accordance to the proportions provided by the appellant's Chief Finance Officer during the audit. The respondent supports the finding of the Tribunal that the respondent was justified to base its assessment on the information and records availed by the appellant.

12. The information given to the respondent during the audit and later confirmed vide email dated 9th September 2021was that there were four blocks of high-end apartment towers, named Towers A, B C, and D. Towers B and C were earmarked for sale as residential apartments, while Towers A and D were earmarked for retention as serviced apartments. The residential apartments in this case were classified as exempt supplies whereas the rest of the property were classified as taxable supplies.

13. The respondent further submits that the documents which the appellant sought to rely on to justify their preferred percentage for apportionment were documents executed after the assessment and objection decision had already been issued. The documents could not therefore have had an impact on the assessments retrospectively.

Analysis and determination

14. The Court has analysed and considered the record of appeal, the opposition filed against it and submissions filed by the parties. The preferred grounds of appeal may be condensed to one issue for determination which in my view is whether the respondent erred in partially disallowing the appellant's input VAT claim.

15. Section 17(1) of the *VAT Act* stipulates the circumstances under which input tax may be claimed by a taxpayer on a taxable supply or importation made. It states as follows:

> "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."

16. Section 17 (6) and (7) of the *VAT Act* in turn provide for the formula for determining the input tax deductible by the person for acquisitions made during the tax period. The interpretation of these provisions is what has brought this appeal before the Court.

17. I find it appropriate to begin by citing the decision of this Court (Majanja, J) in *Commissioner of Domestic Services v Galaxy Tools Limited*, [2021] eKLR. The Court observed that Kenya operates under a self-assessment tax regime, which mandates taxpayers to calculate and remit taxes based on their own declarations and assessments of what they owe. Within this framework, tax laws empower the Commissioner to retrospectively review and determine the accuracy of the taxes remitted by the taxpayer.

18. Against this background the record confirms that vide an email dated 9th September 2020, the appellant through its Chief Financial Officer confirmed to the respondent that the residential occupancy of the project would be 34.87%. This figure was also confirmed by the appellant during an audit. Based on this information, the respondent issued its objection decision and disallowed a claim of 34.87% of input VAT as this related to exempt supplies.

19. The appellant's submission that the correspondence was misconstrued and that 34.87% represented the total of serviced and residential apartments is untenable and indeed an afterthought. The subject email sent by the appellant was unambiguous. The email at page 266 of the Record of Appeal reads in part as follows:

> "I have attached an image showing the proportion of our entire project. Also note that our residential occupancy is 34.87% of the entire project."

20. Besides this email, the Court further notes that in an earlier letter dated 16th July 2020, the appellant's General Manager informed the respondent that the project apartments were not necessarily residential apartments and that there were plans to have serviced apartments. The appellant promised to notify the respondent if there were any such changes. There is no correspondence availed to show that the appellant informed the respondent of such a change before the objection decision was issued on 20th October 2020.

21. True to this position, the appellant produced subsequent documents before the tribunal to justify its preferred percentage of 18.26% as the residential occupancy as opposed to the one provided by

the appellant during the audit of 34.87%. The documents included a contract executed between the appellant and the Pan Pacific Services Suits dated 16th September 2021 and the Technical Services and Pre-Opening Services Agreement signed on 30th June 2021.

22. The Court reiterates the position that the aforementioned agreements were not operational at the time the respondent rendered its objection decision on 20th October 2020 and could therefore not apply retrospectively.

23. Section 17(2) of the *VAT Act* as previously mentioned, outlines the documents a taxpayer must provide to substantiate VAT input claims. Crucially, these documents must be in the taxpayer's possession at the time a claim for input tax deduction is made.

24. The appellant has cited the decision of this Court in *Commissioner Investigations and Enforcement v Sangyug Enterprises(K) Limited* (Income Tax Appeal E056 of 2020), [2022] KEHC 59 (KLR) (Commercial and Tax) (4 February 2022) (Judgment), where similar sentiments were expressed by the Court. The Court held that a tax payer is entitled to deduct input VAT on taxable purchases but that the same can only be allowed if the taxpayer holds such documentation which documentation includes an original tax invoice issued for the supply or a certified copy of the same.

25. Drawing from this interpretation and recognizing tax declaration and payment as an ongoing, period-based process, the agreements cited by the appellant could only be considered in future tax assessments relevant to the periods they pertain to and not retrospectively. This Court therefore aligns itself with the finding of the Tribunal in this regard.

26. The appellant's attempt to extricate itself from the statement by the Chief Finance Officer (CFO) on the ground that the CFO did not understand the tax implications of the distinction between residential versus serviced apartments is also untenable.

27. I would align myself with the submissions made by the respondent and the decision of the Tribunal that the respondent was justified in relying on information emanating from the appellant's CFO. As the title suggests, a CFO yields significant responsibility and authority within a company including typically overseeing the financial operations and strategies of a company, including tax planning, reporting, and compliance.

28. For the appellant to turn around and feign ignorance in tax matters, especially on issues with substantial implications, such as the case before the Court casts a negative light on the appellant. The appellant has not denied that the CFO is an authorized officer and that he had authority to speak on behalf of the appellant. For these reasons I deem it appropriate to attribute responsibility to the appellant based on the declarations made by their agent.

29. Finally, I began with an observation of the self-assessment framework governing Kenya's tax system. This approach is founded on the principle that a taxpayer is best positioned to have comprehensive knowledge of their own tax affairs, with the tax authority's role being to validate the accuracy of the taxes declared and paid by the taxpayer. This precisely mirrors the scenario at hand.

30. I see no error in the respondent's decision to therefore rely on the information and documentation furnished by the appellant. This acknowledges the essential nature of self-assessment in tax regulation, whereby the responsibility initially lies with the taxpayer to report accurately, while the tax authority acts to ensure compliance through review and verification processes.

31. The upshot of this is that I find that the Tribunal's judgment was sound and I agree with its finding that the respondent was justified to base its assessment on the information and records availed to it by the appellant.Top of Form

Disposition

32. The appeal is dismissed and the objection decision of the Tribunal dated 14th April 2023 is hereby upheld. There shall be no orders as to costs.

DATED, SIGNED AND DELIVERED IN NAIROBI

THIS 13TH DAY OF MAY 2024.

F. MUGAMBI

JUDGE