Commissioner of Domestic Taxes v Masai Rollingmills Limited (Income Tax Appeal E082 of 2023) [2024] KEHC 8953 (KLR) (Commercial and Tax) (11 July 2024) (Judgment)

Neutral citation: [2024] KEHC 8953 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E082 OF 2023

WA OKWANY, J

JULY 11, 2024

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

MASAI ROLLINGMILLS LIMITED ..... RESPONDENT

(Being an Appeal against the judgment of the Tax Appeals Tribunal Appeal Number 75 of 2021delivered on 14th April, 2023 in TAT No. 670 of 2021)

JUDGMENT

The Parties

1. The Appellant herein is the Commissioner of Domestic Taxes, an officer of the Kenya Revenue Authority, a public body whose mandate is to assess and collect revenue alongside the administration and enforcement of tax legislation on behalf of the Government of Kenya.

2. The Respondent herein (MRML) is a limited liability company incorporated in Kenya under the *Companies Act*.

Background

3. The Appellant's Domestic Taxes Department, Medium Taxpayers Office, sent the Respondent a Pre-assessment notice for Income TAX and Vat for the years 2017-2020 claiming that there were variances between the sales by the Respondent's suppliers and purchases claimed by MRML's PIN by customers, inconsistencies between Income TAX and VAT returns; variances between employment cost subjected to PAYE and those passed in the Income tax returns by MRML. The notice required

MRML to amend its tax returns within 14 days failure to which the Commissioner would proceed to issue assessments without reference to the taxpayer.

4. The Commissioner followed up the Notice of 28th December, 2020 with another one dated 19th January, 2021 which was a Notice under Section 59 of the *Tax Procedures Act* where they asked to be supplied with the relevant documentation.

5. On 26th January, 2021 the Respondent wrote to the Appellant acknowledging that there were variances between the computation by the Appellant and the records kept by itself and requested for 21 days to be able to analyze the information and find out the source of the variance.

6. On 1st March, 2021 and after several correspondences, the Appellant sent a further a Tax Demand Notice to the Respondent claiming that MRML made unsupported claims for purposes of input VAT. The appellant then tallied the said unsupported purchases claimed by customers but not declared as sales, VAT summary for years 2017-2020 and corporation tax. The Appellant declared the notice as a formal assessment in the sum of Kshs. 762,112,3251 which the Respondent was required to settle in full.

7. On 4th March, 2021, the Appellant invoked its powers under Section 42 of the *Tax Procedures Act* and issued a Demand Notice to MRML's Bank, Kenya Commercial Bank (KCB), for the bank to pay monies held by themselves belonging to the Respondent to KRA to settle the tax arrears of Kshs. 762,112,325/=.

8. On 4th March, 2021, the Respondent lodged a Notice of Objection against the entire tax liability claimed by Appellant and four days later requested that the that the Agency Notice issued to its bank KCB, be lifted. The Respondent also protested the fact that they had not been given time to respond to the demands before the Appellant issued the notice on the bank.

9. The Appellant responded by issuing a further Notice under Section 59 of the *Tax Procedures Act* demanding to be supplied with the following documents: -

    i) Trial balance for financial years 2017 to 2019

    ii) Copies of Audited Accounts 2017 to 2019

    iii) Sales ledges Financial year 2017 to 2019

    iv) Purchases Ledgers Financial year 2017 to 2019

    v) Listed suppliers' ledgers as per their earlier tax notice

    vi) Bank statements January 2017 to December 2020.

10. On 20th May, 2021, the Respondent wrote to the Appellant confirming that it had sent the documents that they had requested in accordance with Section 59 of the *Tax Procedures Act* (TPA). The documents included the Payroll, overtime payments, contract agreement and supporting payment for Barford (one of its suppliers).

11. On 17th July, 2021, the Appellant sent an email to Respondent acknowledging the receipt of the documents but requested to be supplied by delivery notes as evidence that the Respondent traded with the suppliers that the Appellant had identified in the list of suppliers.

12. On the same day, 17th July, 2021, the Respondent sent an email to the Appellant explaining that no delivery notes were generated by the suppliers as the material supplied was scrap metal in an unsorted form for which the supplier was not in a position to generate a delivery note as it is not any

one particular type of scrap metal supplied. The Respondent further explained that the evidence of purchase in lieu of the delivery notes were weighbridge tickets generated by the Respondent itself.

13. On 28th September, 2021, the Appellant made an Objection Decision on the taxes due as follows:

    i. VAT purchases claimed by MRML Kshs. 151,349,336.

    ii. VAT (Variance- IT2C and VAT sales) - Kshs. 2,634,055

    iii. Withholding Tax @ 5% - Kshs. 466,039.25.

14. The Respondent did not dispute the VAT (Variance between the Corporation Tax declared and the VAT sales) claimed by the Appellant and the Withholding tax for management services amounting to Kshs. 3,100,094/= which it agreed to settle in full.

15. VAT purchases claimed by Respondent amounting to Kshs. 151, 349,360/= was however disputed alongside the Appellant's claim that the Respondent did not provide information on their suppliers and evidence of the purchases from the suppliers who had been pointed out by the Appellant.

16. The Respondent lodged an Appeal against the Appellant's decision before the Tax Appeals Tribunal (TAT). In a judgment delivered on 14th April 2023, the TAT rendered a judgment in the Respondent's favour thereby precipitating the filing of the instant appeal.

The Appeal

17. The Appellant listed the following Grounds of Appeal: -

    a. That the Honourable Tribunal erred in law and in fact in failing to appreciate that the dispute before it was based on section 59 of the *Tax Procedures Act* which expressly gives power to the Appellant to request the production of records and additional information which can fully satisfy the Appellant where it is of the view that the information given is insufficient.

    b. That the Honourable Tribunal erred in fact by failing to appreciate that in this case there was no VAT loss because there was no exchange of goods or services in respect of which VAT input was claimed by the Respondent.

    c. That the Honourable Tribunal failed to appreciate and/or give due regard to the provisions of section 43 of the VAT Act 2013 applicable to the dispute which requires the taxpayer to keep records for a period of five years which would authenticate the input claimed.

    d. That the Honourable Tribunal erred in law and in fact in failing to appreciate that the documents and information sought with regard to the Appellant's suppliers were very critical as to ascertaining the accuracy and authenticity of the declared transactions.

    e. That the Honourable Tribunal erred in law and in fact in ignoring the fact that the suppliers whose credibility was in question and could not be traced, had traded several times and in huge amounts as such it was not credible for them not to have their functioning contact and/or not know their physical locations.

    f. That the Honourable Tribunal erred in law and in fact in ignoring the fact that the information relating to contacts, physical address, and proof of delivery by the said Suppliers was critical in authenticating the input claimed.

    g. That the Honourable Tribunal erred in law and in fact in not appreciating that the Respondent and the Suppliers were trading in huge and heavy metals and therefore in the absence of delivery

notes then they should know their physical location, where the goods are stored, and collected from.

h. That the Honourable Tribunal erred in law and in fact in failing to appreciate that it was doubtful that in the whole supply chain from order to delivery and to sale, no document emanated from the suppliers confirming delivery to the Respondent save for the invoice for which the claim was made.

i. That the Honourable Tribunal erred in law and in fact in failing to appreciate that the Respondent's information that was not availed or could not be ascertained were competent and very relevant evidence in authenticating that the claimed transactions actually took place.

j. That the Honourable Tribunal erred in law and in fact in ignoring once the credibility of the supplies was questioned, the legal burden of proof shifted back to the Respondent to proof the authenticity of the said transactions which was not done.

k. That the Honourable Tribunal erred in law and in fact in ignoring the fact that the invoices provided had attached documents showing other persons as the suppliers and not the person to who the invoice was addressed. Further casting doubts as to the authenticity of the transactions.

l. That the Honourable Tribunal erred in law and in fact in relying on facts not presented before it in arriving at the finding that the Respondent had proved the transaction.

m. That the Honourable Tribunal erred in law and in fact in ignoring the facts that no evidence, even at the Appeal was provided to support the claim that the Respondent paid Withholding tax to the management services received.

n. That the Honourable Tribunal erred in law and in fact in ignoring the fact that the Respondent was a Withholding Tax agent but failed to provide any WHT certificate on the services it received.

18. The Appellant seeks the following orders in this appeal: -

a. That the Appeal filed herein be allowed.

b. That the Judgment of the Tax Appeals Tribunal delivered on 14th April, 2023 in Tax Appeal No. 670 of 2021 be set aside.

c. That the Appellant's assessment be upheld.

d. That the cost of this Appeal be awarded to the Respondent (sic).

19. The Respondent filed a Statement of Facts dated 14th July, 2023 in response to the appeal wherein it narrated the genesis of the dispute and the outcome of the appeal before the TAT.

20. The Appeal was canvassed by way of written submissions.

Appellant's Submissions

21. On whether the Appellant was justified in disallowing the claimed input VAT following the Respondent's failure to provide proof of authenticity, the Appellant submitted that the Respondent claimed VAT inputs for tax demand of Kshs. 154,449,430/= for which none of the six suppliers could not be traced as their contacts or physical location could not be ascertained.

22. The Appellant faulted the tribunal for making a decision based on facts which were not supported by evidence. Reference was made to the decision in Francis Otile v Uganda Motors Kampala HCCS No. 210 of 1989 where it was held that the court cannot be guided by pleadings since pleadings are not evidence and nor can they be a substitute thereof.

23. Reference was also made to Section 56(1) of the *Tax Procedures Act* (TPA) for the argument that the legal burden, to support the averments, rested on the Respondent. The Appellant relied on the decision in the case of Tumaini Distributors Company (K) Limited v Commissioner of Domestic Taxes [2020] eKLR where it was held that under section 56(1) of the TPA, the Company bears the burden of demonstrating that the commissioner's decision on reaching the assessments complained of was incorrect.

24. The Appellant cited section 17 (1) of the *Value Added Tax Act* for the argument that for any alleged input tax to be allowed, conclusive evidence supporting the claim that the same was paid must be availed and that any doubts as to the authenticity must be addressed before any person can be allowed to claim such inputs.

25. It was submitted that the Appellant correctly disallowed the suspicious input claims, after the Respondent failed to provide information to verify the existence of the six suppliers. The Appellant reiterated that the actual supplies were not authenticated through delivery notes from the suppliers in order to qualify as a taxable supply that warrant a claim of input VAT.

26. On whether the Respondent correctly charged the withholding tax on management service, it was submitted that the Respondent did not charge withholding tax on management services contracted contrary to section 39A of the TPA.

Respondent's Submissions

27. The Respondent submitted that withholding tax (WHT) for management services was not an issue for determination before the tribunal as the same was not in dispute since the Respondent conceded to it and settled the claimed amount in full before lodging the Appeal at the TAT.

28. The Respondent explained that it sent a letter dated 25th October, 2021 where it conceded that Kshs. 466,039/= WTH and Kshs. 2,634,055/= VAT (Variance IT2C and VAT Sales) as assessed in the Objection Decision was not in contention and that it was indeed due and payable. The Respondent added that it proposed a payment schedule in respect to the WHT and on 7th November, 2021 entered into a Debt Payment Installment Agreement with the Appellant where it was agreed that the debt would be offset in three installments.

29. It was submitted that the Objection Decision related to tax assessment for the tax period between 2017 and 2020, the disallowed VAT (Purchases Claimed by the Respondent) for the years 2019 and 2020 is Kshs. 63, 944,604/= and Kshs. 4, 055,547/= respectively. The Respondent argued that it was therefore misleading for the Appellant to claim that the tax period since the Respondent was appointed as a withholding tax agent was not included in the assessment, when the Appellant has never disputed that it received the 2% WHT for the suppliers it disallowed Input VAT for as claimed by the Respondent.

30. It was submitted that having withheld and remitted the 2% VAT due from its suppliers on behalf of the Appellant, the Appellant ought to have been able to collect the 14% from the said suppliers as the Respondent was not withholding phantom VAT and that it withheld the tax for PIN registered taxpayers. It added that it was the duty of the Appellant to employ all legal mechanisms to ensure tax compliance of its taxpayers as it cannot burden other taxpayers to produce non-compliant taxpayers to it before they can become entitled to their legitimate claims.

31. On whether the tribunal erred in finding that the Appellant had erred in disallowing input VAT of Kshs. 151,349,336/=, the Respondent submitted that at no time, prior to the delivery of its Objection Decision, did the Appellant raise the issue of the insufficiency of the documents produced by the Respondent and that the Appellant made a decision that was not supported by any evidence to show that the Respondent had not transacted with the suppliers other than the claim that the Respondent had failed to identify its suppliers' physical location.

32. The Respondent cited section 17 (3) of the *Tax Procedures Act* which provides for the documentation a taxpayer should produce to be entitled to claim a refund and submitted that being cognizant of that fact, it kept and produced the original tax invoices for transactions with its suppliers. The Appellant argued that the parties herein should not lose sight of the reason for the initial appeal to the Tax Appeals Tribunal, which was that the Appellant had disallowed the Respondent's claim to Input VAT.

33. It was submitted that the Respondent having provided uncontroverted proof of having obtained taxable supplies from the impugned suppliers, it was, for purposes of Section 17 of the VAT Act, completely compliant and that the Appellant therefore had no reason to disallow the claim.

34. It was submitted that some of the documents that the Appellant requested for, under Section 59, were outside of the documents required by the law and that the expectation by the taxpayer is that the Appellant would only request additional transactional documents and information related to the purchase of taxable supplies. The Respondent maintained that it supplied all the supporting documents to show that it purchased supplies from Bixol Enterprises, lftek Enterprises, Saj Metals, Jambali Chuma Ent, Royal Engineering, and Rarnaki Enterprises.

35. The Respondent asserted that it provided documentary proof that it traded with the impugned suppliers in its bundle of Statement of facts which contained samples of payment vouchers, invoices, weighbridge tickets and a breakdown summary of VAT Input for January and February 2020 for the supplier called Jambali Metals.

36. According to the Respondent, the documents it produced are all transactional documents that satisfy the description and content of the documents required by statute as none of them is in the nature of proforma invoices.

37. The Respondent submitted that its reading of all the tax statutes relevant to Value Added Tax did not disclose the existence of a document titled a "delivery note" which must be produced as evidence of purchase or sale of taxable supplies. It explained that it understood the purpose of a delivery note as evidence of purchase but was of the view that the document that is evidence of delivery or collection of the taxable supply may be called by any other name and serve the same purpose.

38. The Respondent referred to the decision in Republic v Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD (2012) eKLR where Majanja J. held:

> " The approach to this case is that stated in the oft cited case of Cape Brandy Syndicate v Inland Revenue Commissioners [1920] 1KB64 as applied in T.M.Bell v Commissioner of Income Tax [1960] EALR224 where Roland J. stated, "....in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing it to be implied. One can only look fairly at the language used... If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be." As

his case concerns the interpretation of the *Income Tax Act*, I am also guided by the dictum of Lord Simonds in Russell v Scott [1948] 2ALL ER5 where he stated, "My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed yet ought not to be forgotten; It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him" adopted in Stanbic Bank Kenya Limited v Kenya Revenue Authority CA. Civil Appeal No. 77 of 2008 (Unreported) [2009] eKLR- per Nyamu JA (See also Jafferali Alibhai v Commissioner of Income Tax [1961] EA 610, Kanjae Naranjee v lncome Tax Commissioner [1964] EA 257) . Any tax imposed on a subject is dictated by the terms of legislation and taxing authority must satisfy itself that the transaction fits within the definition of the statute. In Adamson v Attorney General (1933) AC 257 atp 275 it was held that: The section is one that imposes a tax upon the subject, and it is well settled that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used; and if there is any doubt or ambiguity this defect-if it be in view of the Crown a defect can only be remedied by legislation. -"

39. The Respondent submitted that there can be no room for intendment on the part of the Appellant, such that if a document must be kept and titled a certain way, it must be provided for in law in clear and unambiguous language. It was submitted that if the Appellant calls for additional information of a certain type and it is delivered but bearing a name different from what the Appellant refers to the document that the taxpayer referred to the document' by a different name can't be a basis to disallow the legitimate claims of the otherwise compliant taxpayer.

40. It was submitted that even though the Appellant claimed, in the Objection Decision, that it disallowed the input VAT claims by the Respondent because the Respondent had failed to point out the physical locations and contacts of its suppliers, the Respondent gave the Appellant the information it had on the suppliers and provided their PIN numbers, their last known telephone numbers, and Bank Account details.

Analysis & Determination

41. I have carefully considered the impugned TAT's decision, the Memorandum of Appeal, the statement of facts and the parties' rival submissions. I find that the main issue for determination is whether the TAT arrived at the correct finding when it held that the Respondent was entitled to the claim for input VAT.

42. The crux of the appeal was the Appellant's argument that it properly disallowed the Respondent's claim for input VAT demand of Kshs. 154,449,430/= because none of the six suppliers could not be traced since their contacts or physical location were not provided. The Appellant further argued that the Respondent did not furnish it with the relevant delivery notes for the said supplies so as to authenticate the existence of the transactions with the said suppliers.

43. The Respondent, on its part, maintained that it furnished the Appellant with all the relevant documents that it had requested for and provided the full details of the 6 suppliers that it had dealings with including their PIN numbers, last known telephone numbers, and Bank Account details.

44. The TAT found that the Respondent had established the existence of the suppliers and rendered itself as follows on the issue of input VAT: -

> " ...The Appellant has therefore fully demonstrated that the suppliers do exist and have made the supplies in issue and has also complied with all the legal requirements on its part. There

is therefore no reason for the Commissioner to disallow the Appellant's claim of input VAT. The upshot of the foregoing is that the Appeal is merited ..."

45. Section 23 of the *Tax Procedures Act* requires the taxpayers to keep documents for a period of at least 5 years to enable the Commissioner to ascertain their taxes due.

46. The Appellant claimed that the Respondent did not supply it with the documents that it had requested for to support the claim for input VAT contrary to the provisions of Section 59 of the *Tax Procedures Act*, which grants it the power to request the Respondent to produce documents for ascertaining its tax liability. As I have already noted in this judgment, the Tribunal on Appeal found that the Respondent had satisfied the VAT input requirements.

47. In Tax Appeals Tribunal No.286 of 2020 Morgan Air Sea Freight and Logistics Kenya Limited v the Commissioner of Domestic Taxes, the Tribunal held that:-

> "... the Respondent did not provide reasons for rejecting the claims of input VAT by the Appellant. The Respondent did not provide proof as to how it arrived to the conclusion that the Appellant is an agent of its non-customers."

48. In the instant case, I note that the Appellant sent a notice to the Respondent requesting to be supplied with documents to support the claim for input VAT and in its response dated 20th May, 2021, the Respondent confirmed that it had sent the documents as demanded by the Appellant under section 59 of the *Tax Procedures Act*. I also note that the Appellant confirmed receipt of the relevant documentation but still requested to be supplied with delivery notes to ascertain that the supplies actually took place.

49. My finding is that the Appellant should have acted on the information that the Respondent supplied to it by verifying the sales and purchases, which it did not. The Appellant was also expected to confirm the existence of the Respondent's suppliers who the Respondent identified by name, PIN numbers, telephone numbers and account numbers.

50. In Commissioner of Taxes vs. Galaxy Tools Ltd [2021] eKLR, the Court held: -

> "With greatest respect, the Tribunal got it wrong. What the respondent had done by producing the invoices, the delivery notes and payment schedules was only prima facie evidence of purchase. On producing the said documents, the evidentiary burden of proof shifted to the appellant. The appellant in answer not only queried the said documents but informed the Tribunal that; he had carried investigations on the alleged suppliers and concluded that they never existed, that there was no supply of any goods at all. That the documents produced did not contain critical details to support any reasonable commercial transaction. All this was laid before the Tribunal."

51. Taking a cue from the above cited case, I find that the Respondent presented sufficient information and detail to the Appellant that could have assisted it to establish the identity of the suppliers and the particulars or proof of their transactions. A perusal of the Respondent's Statement of Facts reveals that it attached bundle of documents such as payment vouchers, invoices, weighbridge tickets and a breakdown summary of VAT Input for January and February 2020 for a supplier known as Jambali Metals. The bundle also captured the summary of the supplier's PIN No., the invoice numbers, the description of supplies (scrap metal), the VAT paid, the date of payment of the invoice amount and the bank clearing date.

52. On the issue of withholding tax, I agree with the Respondent's argument that this was not an issue for determination before the tribunal as the same was not disputed since the Respondent conceded and settled the same by remitting the entire amount to the Appellant.

53. For the reasons that I have stated in this judgment, I find that the instant appeal is not merited and I therefore dismiss it with costs to the Respondent.

54. It is so ordered.

JUDGMENT DATED, SIGNED AND DELIVERED AT NYAMIRA VIRTUALLY VIA MICROSOFT TEAMS THIS 11TH DAY OF JULY 2024.

W. A. OKWANY

JUDGE