Golden Acre Limited v Commissioner of Domestic Taxes (Tax Appeal E022 of 2022) [2024] KEHC 11046 (KLR) (Commercial and Tax) (19 September 2024) (Judgment)

Neutral citation: [2024] KEHC 11046 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E022 OF 2022

JWW MONG'ARE, J

SEPTEMBER 19, 2024

BETWEEN

GOLDEN ACRE LIMITED ..... APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT

(Being an Appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 24th July 2020 in Tax Appeal No.112 of 2017)

JUDGMENT

Introduction and Background

1. The Respondent ("the Commissioner"), is an officer appointed under section 13(1) of the *Kenya Revenue Authority Act*, 1995 as an agent of the Government for purposes of collection, receipt and administration of all revenue and enforcement of all revenue laws. By a letter dated 30th November 2012, the Commissioner notified the Appellant that it was to conduct a compliance check on its business activities for inter alia corporation tax for the income period between 2006 and 2011.

2. The Commissioner stated that it would examine the Appellant's bank statements, schedule of expenses and source of funds, among other documents. In a letter dated 27th February 2014, the Commissioner informed the Appellant of its compliance findings including that the Appellant's rental income for its Kariobangi, Ngumba Estate and Kahawa properties were brought to charge and corporation tax of Kshs. 7,875,461.00/=, inclusive of penalties and interest, assessed.

3. The Appellant objected to the assessment through its letter of 27th March 2014(erroneously referred to as 27th March 2013). In the said objection letter, the Appellant lamented that the rental income adopted by the Commissioner was too high as it adopted deposits from the Appellant's I&M Bank

which account had never received any rental income and was instead, a loan account. The Applicant further argues that its income was deposited in its Co-operative Bank account and that it was wrong for the Commissioner to assume that all deposits in the bank were in respect of rental income as there were transfers into the account from other sources usually done to boost the account in order to make the account appear active for borrowing purposes. Among the arguments advanced by the Appellant were that such deposits would be from friends and directors and were usually refunded back in due course.

4. The Appellant further faulted the amount of Kshs. 174,000.00/= worked out by the Commissioner as rent per year as the Appellant stated that its Kahawa property had never been rented out and therefore should not have been factored in when calculating the rental income. The Appellant felt that rent income as per the accounts is the figure that ought to have been used to arrive at the gross rental income as this could be supported by bank deposits in the Co-operative Bank account. That in any case, the rent income could not be more than the rent schedules presented to the Commissioner. On interest on loans, the Appellant stated that the earlier year 2006 to 2008 had not been taken into account and that it was requesting its lenders to provide it certificates for interest paid which were to be availed to the Commissioner and support the interest paid. The Appellant further stated that it had enclosed supporting documents for repair and maintenance costs for the Commissioner's consideration.

5. In response, the Commissioner, in its letter of 28th April 2014 informed the Appellant that the onus was on the Appellant to support its source of income of the I&M bank account, that its tour of the Kahawa property and interview conducted with the Appellant's director indicated that the said property had a total income of Kshs. 174,000.00/= for the already occupied houses and that the Appellant had not provided supporting documents that it claimed in its audited accounts. The Commissioner pointed out that the excel sheet attached did not constitute supporting evidence. It further stated that loan interest had been allowed for the years the Appellant provided statements but that the interest for the said period 2006-2008 had not been allowed for want of records. The Commissioner thus maintained that the previously assessed tax still stood as assessed and demanded the same from the Appellant through demand notices dated 22nd August 2014 and 22nd September 2014.

6. In reply to these demands, the Appellant, in a letter dated 24th September 2014 maintained that it had supplied the Commissioner with all necessary information to support the accounts and tax returns filed including; rent schedules and explanations agreed to the rental income declared in the accounts and bank deposits, interest on loans statements from 2006 to 2011 and receipts and invoices in respect of repair and maintenance of buildings for the period under review. As such, the Appellant urged that there was no tax liability and requested the Commissioner to inform it on information it felt had not been supplied so that the same could be availed.

7. The Commissioner responded to the aforementioned letter through its letter of 13th October 2014. It reiterated the contents of its previous letter of 28th April 2014 noting that documentation for the interest on loans for the years 2006-2008 had not been supplied, schedule provided for the repair and maintenance was not supported by expense vouchers and that it had not explained the source of funds in its bank deposits. As such, the Commissioner stated that there was no new evidence or development since the said 28th April 2014 and it maintained the demand for the assessed taxes through the demand notice of 5th November 2014. In further response to this letter, the Appellant, in its letter of 12th November 2014, the Appellant reiterated the contents of its previous letter of 24th September 2014 insisting that it had supplied all requested information. It further reiterated the contents of its letter of 27th March 2014 that the rental income assessed was high compared to the figures declared in the accounts and supported by bank deposits and rent schedules.

8. In a letter dated 5th December 2014, the Appellant further stated that it had forwarded repair and maintenance schedules together with the supporting documents for the years 2007-2012 and soft copy documents for interest claimed from 2006 to 2008. The Appellants also stated that it would forward supporting documents for the deposits at I&M bank not related to the rental income and a loan agreement from the said bank to clarify that it has no connection with the Appellant.

9. The back and forth between the parties continued in 2015 and 2016. In a letter by the Appellant dated 2nd February 2015, it stated that the receipts and invoices previously forwarded were in respect of the Ngumba and Kariobangi houses which were already in existence and ought to have been allowed for tax computation purposes and that it was the Kahawa houses that were under construction at the time. The Appellant admitted that some loan statements were in the names of the director but then stated that the construction of the houses were financed by the directors from their own resources including personal loans.

10. The Appellant stated that it would be forwarding to the Commissioner bills of quantities for the buildings which would show the total costs incurred in the construction of the buildings for the Commissioner to compare with the total cost shown in the accounts. In the Commissioner's letter of 10th December 2015, it stated that the Appellant was yet to avail: expenses schedules and supporting documents in relation to electricity, water, garbage, security, audit fees and repairs and maintenance; director's accounts and bank statements to ascertain the amounts injected into the Appellant by the director and loan agreements and supporting documents on the borrowings from friends.

11. In letters dated 28th December 2015 and 2nd August 2016, the Appellant stated that it would avail the requested documents in due course. The Appellant then furnished the Commissioner with bank statements from Co-operative Bank and together with documents availed, the Commissioner issued the Appellant with what it termed as "Notice of Amended Assessment" dated 28th March 2017.

12. Subsequently, the Commissioner adjusted the adopted rental income from Kshs. 19,421,081.00 to Kshs. 3,649,479.00/=. It stated that the interest expense for the years 2006 to 2008 was not taken into account for tax purposes since the loan statements provided were in the name of the director and different companies, that the Appellant failed to provide a breakdown of the directors' accounts to show when the amounts were injected to into the Appellant and that no agreement was provided between the Appellant and the directors on the injection of the loan taken up by the directors on behalf of the Appellant.

13. The Appellant was further faulted for not withholding on the interest paid to the directors on the loans taken and that the bank deposits for the period 2006-2008 did not show any injection by the directors. The Commissioner thus allowed interest in relation to the Ngumba property that was financed by Housing Finance. It also allowed some administration expenses but disallowed others for various reasons including that the same were not supported, invoices were in the name of different companies. In light of the aforementioned, the Commissioner confirmed assessments in respect of corporation tax in the sum of Kshs.3,591,764.00/= which amount was inclusive of interest and penalties.

14. Aggrieved, the Appellant lodged an Appeal with the Tax Appeals Tribunal ("the Tribunal"). Upon careful consideration of the pleadings and documentation availed to it by the parties, the Tribunal rendered a decision on 24th July 2020 (https://www.kenyalaw.org/tribunals/TaxA*ppeal Tribunal/2020*/Golden_Acre_Limited_v_Commissioner_of_Domestic_Taxes[2020]eKLR.pdf). In the judgment, the Tribunal noted that the Commissioner's letter of 28th April 2014 (erroneously referred to as 27th April 2014) was the tax decision being objected to and not that of 28th March 2017. As such, the

Tribunal stated that it would proceed to determine this matter based on the 2014 assessment and not the 2017 one and having considered all the circumstances, it would not delve onto the technicalities but rather the substance of the tax dispute.

15. Consequently, the Tribunal determined the twin issues (1)"whether loan interest on Housing Finance loans were to be allowed for tax purposes, whether loan interest on loans taken by the Appellant's directors on behalf of the Appellant were to be allowed for tax purposes" and (2) "whether the sum of Kshs.546,000.00/= deposited in the Appellant's bank should be treated as income chargeable to tax."

16. On the first issue, the Tribunal noted that during the hearing, the Appellant contended that the Commissioner declined to allow part of the interest on the Housing Finance loan to be deducted while determining the tax due. That the Commissioner stated that the Appellant together with its co-director each took a loan of Kshs 9 million to develop the subject property. As to why the Appellant did not capture one of the loans in its financial statements for the period 2009- 2011, the Appellant stated that it was due to a regrettable omission on its part. The Tribunal stated that having analyzed the Appellant's submissions it noted that the Appellant had failed to demonstrate to its satisfaction as to why it failed to claim interest on one of the loans in its various financial statements for the period 2009- 2011. That the Appellant only claimed interest in relation to the loan Account No. 600-490 but did not claim interest in respect of loan Account No. 600-**492. The Tribunal held that the Appellant had a window of opportunity as provided for under section 90 of the *Income Tax Act*, to apply for an amendment of its returns to reflect the alleged omission but it failed to do so.

17. That pursuant to the said section 90, the Appellant had a right to amend its returns where it had made an error or omission in which case it would have applied to the Commissioner to amend the affected Financial Statements to reflect the true position or the alleged errors that had been made. That in the circumstances, the Commissioner was left with no option other than only allow the supported interest expenses as claimed in the Appellant's financial statements. In view of the foregoing, the Tribunal held that the Commissioner had no option other than decline to allow the said loan interest for tax purposes.

18. On the second issue, the Tribunal stated that the Commissioner had failed to persuade it by way of any evidence on the ownership of the Kariobangi property to rebut the Appellant's evidence. That the Appellant and its witness had demonstrated to the Tribunal's satisfaction that the Kariobangi property is not owned by the Appellant. In the circumstances, the Tribunal held that the Respondent's action of attaching liability or an obligation on the Appellant based on a rent schedule was not correct. Consequently, the Tribunal found that the Commissioner ought to have excluded the rental income from the Kariobangi property in its tax assessment as the income in relation to the said property was wrongly assessed on a party who did not own it, that is the Appellant.

19. In view of the foregoing, the Tribunal found that the interest on loans borrowed by the directors to finance the Appellant in construction of the residential buildings ought to be allowed for purposes of corporation tax. However, for the interest of loans borrowed by the directors to finance the Kariobangi property, the same ought not to be allowed for tax purposes in respect of corporation tax.

20. On the last issue, the Tribunal held that the Appellant had failed to show to the satisfaction of the Tribunal what the money was meant for and where it came from to disprove the Commissioner's finding that this was rental income. Consequently, the Tribunal stated that it would, in the absence of any explanation as to the source of the funds treat the Appellant's allegation as such, a mere allegation. In view of the foregoing, the Tribunal held that the sum of Kshs. 546,000.00/= deposited in the Appellant's bank should be treated as income chargeable to tax and was therefore properly brought to charge. In the upshot, the Tribunal held that the Appellant's Appeal partially succeeded with the

consequence that the Commissioner's tax assessment dated 28th April 2014 for Kshs. 7,875,461.00/ = was upheld.

21. This decision by the Tribunal has precipitated the filing of the instant Appeal by the Appellant which is set out in the Memorandum of Appeal dated 7th August 2020. The Commissioner has responded to the Appeal through its Statement of Facts and Preliminary Objection dated 21st September 2023. The parties have also relied on their oral submissions by their counsel which disposed of the Appeal and which regurgitate their respective positions summarized above hence I will not rehash the same but make relevant references in my analysis and determination below.

Analysis and Determination

22. In determining this Appeal, I am cognizant of the fact that this court is exercising appellate jurisdiction that is circumscribed by section 56(2) of the *Tax Procedures Act* (Chapter 469B of the Laws of Kenya) which provides that "An Appeal to the High Court or to the Court of Appeal shall be on a question of law only". The Supreme Court in Gatirau Peter Munya v Dickson Mwenda Kithinji & 2 others SCOK Pet. No. 2B of 2014 [2014] eKLR characterized the three elements of the phrase "matters of law" as follows:

    a. the technical element: involving the interpretation of a constitutional or statutory provision;

    b. the practical element: involving the application of *the Constitution* and the law to a set of facts or evidence on record;

    c. the evidentiary element: involving the evaluation of the conclusions of a trial Court on the basis of the evidence on record.

23. The apex court further accepted the Court of Appeal's definition and explanation of the expression "question of law", as employed to prescribe the limits of appellate jurisdiction and as was stated in M'Iriungu v. R [1983] KLR 455 at page 466 as follows:

> 'In conclusion, we would agree with the views expressed in the English case of Martin v. Glyneed Distributors Ltd that where a right of Appeal is confined to questions of law only, an appellate Court has loyalty to accept the findings of fact of the lower courts and resist the temptation to treat findings of fact as holdings of law or mixed findings of fact and law... unless it is apparent that, on the evidence, no reasonable tribunal could have reached that conclusion, which would be the same as holding the decision is bad in law....'

24. Therefore, the duty of this court is to determine whether the conclusions of the Tribunal were reflective of the material on record and the law and whether another tribunal similarly constituted would have arrived at the same dispositive conclusions.

25. I propose to first deal with the Commissioner's Objection that the Appeal was filed out of time and without the leave of court, contrary to Rule 3 of the Tax Appeals Tribunal (Appeals to The High Court) Rules, which provides that 'The Appellant shall, within thirty days, after the date of service of a notice of Appeal under section 32(1), file a memorandum of Appeal with the Registrar and serve a copy on the Respondent.' Without belabouring on this point, the court's Case Tracking System indicates that the Appeal, that is the Notice of Appeal and the Memorandum of Appeal were filed on 7th August 2020 as evidenced by the court assessment receipt of record. This was within the 30 days as stipulated by the Rule above and I thus find no merit in the Commissioner's objection.

26. Turning to the substance of the Appellant's Appeal, I note that it raises 3 issues in its memorandum of Appeal, to wit; (1.) that the Tribunal erred in failing to consider all the evidence tabled by the Appellant,

(2.) that the Tribunal failed to consider interest already paid and continually paid on the loans taken by the directors of the Appellant and (3.) that the Tribunal erred by considering material not evidenced at the exclusion of the Appellant's crucial and relevant evidence and a result arrived at an erroneous conclusion.

27. I further note that the Appellant, in its submissions, made highlights of issues that were not part of its Memorandum of Appeal. I agree with the Commissioner's submission that this court is only limited to matters in the parties' pleadings, that is the Memorandum of Appeal and statement of facts and the issues that emerged before the Tribunal that are now part of this Appeal. I will thus limit my determination to the same.

28. On the Tribunal's appreciation of the entirety of the evidence, let me also state, like the Tribunal did, that the parties got lost in their back and forth that led to the matter dragging on for so long and the Commissioner issuing two Appealable tax decisions; that of 28th April 2014 and that of 28th March 2017.

29. The Tribunal's decision was based on the former, contents which I have already highlighted in the introductory part. In brief, by this date, the Commissioner stated that the onus was on the Appellant to support its source of income of the I&M bank account, that its tour of the Kahawa property and interview conducted with the Appellant's director indicated that the said property had a total income of Kshs. 174,000.00/= for the already occupied houses and that the Appellant had not provided supporting documents that it claimed in its audited accounts.

30. The Commissioner pointed out that the excel sheet attached did not constitute supporting evidence. It further stated that loan interest had been allowed for the years the Appellant provided statements but that the interest for the said period 2006-2008 had not been allowed for want of records. The Commissioner thus maintained that the previously assessed tax still stood and demanded the same from the Appellant.

31. In its preceding objection letter, the Appellant had admitted that on interest on loans, for the years 2006 to 2008, it was requesting its lenders to provide it certificates for interest paid which were to be availed to the Commissioner and support the interest paid. It therefore follows that by the time the Commissioner was issuing the assessment letter of 28th April 2014, the Appellant had not provided sufficient documentation and information on the interest sought to be allowed for the years 2006-2008. It had also not provided sufficient documentation on its repair and maintenance costs as the Commissioner rightly stated that excel sheet schedules do not amount to proof of expenses and that the same are proved by primary documents (See *Commissioner Investigations and Enforcement v Kidero (Income Tax Appeal E028 of 2020)* [2022] KEHC 52 (KLR) (Commercial and Tax) (4 February 2022) (Judgment). Without supporting evidence, the Commissioner could not be expected to presume the Appellants' expenses and lower their chargeable income (See Leah Njeri Njiru v Commissioner of Investigations and Enforcement Kenya Revenue Authority & another ML Tax Appeal No. E002 of 2020 [2021] eKLR).

32. The law places upon the taxpayer the burden of proving that a tax decision is incorrect or excessive as clearly stated at section 30 of the *Tax Appeals Tribunal Act* and section 56(1) of the TPA which provide as follows:

> 30. Burden of proof
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> In a proceeding before the Tribunal, the Appellant has the burden of proving—
>
> a. where an Appeal relates to an assessment, that the assessment is excessive; or

b. in any other case, that the tax decision should not have been made or should have been made differently.

56. General provisions relating to objections and Appeals

(1) In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.

33. This legal position was expounded by the court in the case of *Republic v Kenya Revenue Authority; Proto Energy Limited (Exparte) (Judicial Review Application E023 of 2021*) [2022] KEHC 5 (KLR) (24 January 2022) (Judgment), by stating as follows:

48. The most significant justification for placing the burden of proof on the tax payer is the practical consideration that the Commissioner cannot sustain the burden because he does not possess the needed evidence. Under the system of self-reporting tax liability, the taxpayer possesses the evidence relevant to the determination of tax liability. It is simply fair to place the burden of persuasion on the taxpayer, given that he knows the facts relating to his liability, because the commissioner must rely on circumstantial evidence, most of it coming from the taxpayer and the taxpayer's records. The taxpayer must present a minimum amount of information necessary to support his position. This safety valve seems to place the burden of production on the taxpayer without relieving the Commissioner of the overall burden of proof. The tax payers' evidence must meet this minimum threshold.

49. A presumption of correctness arises from the Commissioner's determination/assessment. The presumption remains until the taxpayer produces competent and relevant evidence to support his/her position. When the taxpayer comes forward with such evidence, the presumption vanishes and the case must be decided upon the evidence presented.

34. The onus of proof may shift based on the stage of the proceedings and the actions taken by the parties. In *Commissioner of Investigations and Enforcement v Pearl Industries Limited (Tax Appeal E086 of 2020*) [2022] KEHC 51 (KLR) (Commercial and Tax) (31 January 2022) (Judgment) and Commissioner of Domestic Taxes v Trical and Hard Limited (Tax Appeal E146 of 2020) [2022] KEHC 9927 (KLR) (Commercial and Tax) (8 July 2022) (Judgment) the court described it like a pendulum swinging between the taxpayer and taxman at different points but more times than not swinging towards the taxpayer. This "pendulum of proof" swings at least twice and at most thrice; the first is when the Commissioner asserts its position and the tax payer is expected to disprove this position. Once the taxpayer states its position, the pendulum swings to the Commissioner who then reviews the position taken by the taxpayer. If it is determined that the position taken by the taxpayer is devoid of evidence or that the evidence is insufficient, incompetent and irrelevant, then the pendulum swings back to the taxpayer to prove that the Commissioner was wrong in its position and overall findings.

35. In discharging this burden, the Appellant was required to provide such evidence as is required by law to prove that the assessments as issued by the Commissioner were incorrect or excessive. This is because the law, inter alia section 59(1) of the *Tax Procedures Act* also provides that a tax payer shall produce records when required to do so by the Commissioner. This position is fortified and further reverberated under the *Income Tax Act* where section 54A requires a person carrying on a business to keep records adequate for the purpose of computing tax.

36. Going through the record, I find that by the time the Appellant was issuing its tax decision of 28th April 2014, the Appellant had not provided all documents sought by the Commissioner and that those documents presented were insufficient to discharge the Appellant's burden. The Appellant,

having been requested for records and documents by the Commissioner and having failed to produce the same meant that it did not discharge the burden of proof placed on it and thus it failed to prove that the Commissioner was wrong in its decision or that its assessments were excessive. The Commissioner could not thus be faulted for coming to the conclusion that the demanded tax amounting to Kshs.7,875,461.00/= was still due.

37. I therefore do not find any misapprehension of the law and evidence by the Tribunal in arriving at its decision. It is also not lost that in Commissioner of Domestic Taxes v Golden Acre Limited [2021] eKLR the court set aside the Tribunal's finding that the Kariobangi property belonged to the alleged directors and not the Appellant. That it is the Appellant who had included that property in the Schedule of those rental premises from which the tax was assessed and that at the hearing, no title was produced to prove that the property did not belong to the Appellant. Therefore, in light of my findings above and the court's finding in Commissioner of Domestic Taxes v Golden Acre Limited(supra) the Commissioner's assessment letter of 28th April 2014 stands as is without any condition or disclaimer, meaning that the Commissioner is entitled to demand the entire Kshs. 7,875,461.00/= demanded therein.

Conclusion and Disposition

38. The upshot of the above finding is that the Appellant's Appeal has no merit and the same is hereby dismissed in its entirety but with no order as to costs.

DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 19TH DAY OF SEPTEMBER, 2024.

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J.W.W. MONG'ARE

JUDGE

In the Presence of:-

1. Mr. Kirika for the Appellant.

2. Ms. Chelangat holding brief for Ms. Sega for the Respondent.

3. Amos - Court Assistant