Baitul Investments Limited v Commissioner of Investigations and Enforcement (Income Tax Appeal E084 of 2021) [2023] KEHC 17363 (KLR) (Commercial and Tax) (12 May 2023) (Judgment)

Neutral citation: [2023] KEHC 17363 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E084 OF 2021

FG MUGAMBI, J

MAY 12, 2023

BETWEEN

BAITUL INVESTMENTS LIMITED .... APPELLANT

AND

COMMISSIONER OF INVESTIGATIONS AND ENFORCEMENT .... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi delivered on 28th May 2021 in Tax Appeal No. 224 of 2018)

JUDGMENT

Introduction and Background

1. The appellant is an electronics company registered and carrying on business in Kenya, its principal business being sourcing and resale of electronics in the local market. The respondent is an office within the Kenya Revenue Authority, a body corporate charged with collecting revenue on behalf of the government of Kenya.

2. The genesis of the dispute herein is an investigation conducted by the respondent into allegations of what has now commonly come to be known as the 'missing trader tax fraud'. This is a tax fraud scheme where taxpayers deliberately and fraudulently claim tax rebates from bogus purchases using fictitious documents such as tax invoices and ETR receipts as a result of which a taxpayer either pays less or no taxes at all, as part of the scheme. The tax payer may also carry huge liabilities as trade creditors from one year to another and make payments into fictitious bank accounts yet the alleged creditors and suppliers are actually non-existent.

3. The findings of the investigations in question were communicated to the appellant vide a letter dated 18th April 2018. The respondent then issued the appellant with a Notice of Assessment dated 16th May 2018, for Kshs. 438,137,615/= comprising of principal VAT and corporation tax. The appellant filed a Notice of Objection dated 13th June 2018 contesting the assessment.

4. Upon reviewing and considering the objection, the respondent issued its Objection Decision on 17th July 2018 confirming the assessment in its entirety. The appellant was aggrieved by the decision of the respondent and filed an appeal at the Tax Appeals Tribunal (hereinafter the Tribunal). The Tribunal on 28th May 2021 rendered its decision dismissing the appeal and upholding the assessment of Kshs. 438,137, 615/=. It is this chronology of events that has led to the appeal now before this Court, having been filed vide a Memorandum of Appeal dated 15th June 2021, listing 15 grounds of appeal which are that:-

    i. The Honourable Tax Appeals Tribunal (hereinafter the Honourable Tribunal) erred in holding that there was corporation tax and VAT amounting to Kshs. 438,137, 615/= due from the appellant as assessed and demanded by the respondent.

    ii. The Honourable Tribunal fundamentally 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 the respondent's assessment dated 13th June 2018 and the Objection Decision dated 17th July 2018 as raised by the appellant.

    iii. 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 raising an assessment for Kshs. 438,137, 615/= was contrary to section 59 of the *Tax Procedures Act* (2015), (hereinafter the TPA). The impugned assessment was therefore invalid as it was contra statute.

    iv. The Honourable Tribunal erred in failing to find and hold that the Objection Decision was not valid even if it was expressly made on the basis of section 53(1), as the respondent failed to immediately notify the appellant that its Notice of Objection was invalid and the rejection of the appellant's objection was improperly rejected.

    v. The Honourable Tribunal erred in failing to find and hold that the respondent's reliance on section 51(3) of the*TPA* was misplaced as the grounds given for the summary rejection of the appellants Objection was failure to provide supporting documents, is not one of the stipulated grounds under section 51(3) for summary rejection of objections.

    vi. The Honourable Tribunal erred in failing to find and hold that in any event the Objection Decision was invalid as it did not include a statement of findings on the material facts and the reasons for the decision.

    vii. 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 Appellants Notice of Objection.

    viii. 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 Decision and therefore the VAT demanded was due.

ix. The Honourable Tribunal erred in failing to appreciate and consider the following: -Section 17(1) of the *VAT Act* which provides that:

> 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, 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.

Section 17(3) of the *VAT Act* which further provides that; -

> (3) The documentation for the purposes of subsection (2) shall be—
>
> (a) an original tax invoice issued for the supply or a certified copy;
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> (b) a customs entry duly certified by the proper officer and a receipt for the payment of tax;
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> (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;
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> (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).

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

> a. 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.
>
> b. A deduction of input tax shall not be allowed unless
>
> c. The input tax to which the deduction relates is deductible under section 17 of the Act
>
> d. The registered person has provided the Commissioner with satisfactory evidence
>
> e. That input tax was paid on acquisition of the goods
>
> f. Of the quantities, descriptions and values of the goods on hand at the time of registration

xii. The Honourable Tribunal erred in law and fact in finding that 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 VAT are invoices and corresponding ETRs, delivery notes, payment records and store records which documents were provided and acknowledged as received by the respondents.

xiii. 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 had 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 that it requested for as proof of purchases by the appellant and did not at any particular time contest the authenticity of the same. 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.

xiv. 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* (hereinafter the ITA). The said section 15(1) of the *Act* provides that:

> For the purpose of ascertaining the total income of a person for a year of income there shall, subject to section 16, be deducted all expenditure incurred in that year of income which is expenditure wholly and exclusively incurred by him in the production of that income, and where under section 27 any income of an accounting period ending on some day other than the last day of that year of income is, for the purpose of ascertaining total income for a year of income, taken to be income for a year of income, then the expenditure incurred during that period shall be treated as having been incurred during that year of income.

xv. The Honourable Tribunal fundamentally erred in failing to take cognizance of the fact that the appellant duly issued the respondent with copies of invoices and corresponding ETR, RTGSs and store records for all its purchases as is normal business practice, a fact that was confirmed by the respondent's witness and their authenticity remains uncontested.

xvi. The Honourable Tribunal erred in failing to find that section 15(1) of the *ITA* 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.

xvii. The Honourable Tribunal erred in failing to find that the respondent erred in its decision to disallow the input VAT and purchase costs.

xviii. The Honourable Tribunal erred in failing to follow its own decisions in *Shreeji Enterprises (K) Ltd v The Commissioner for Tax and Investigations*, Tax Appeals No 58 and 186 of 2018.

xix. 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 it (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 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 that VAT was remitted by its suppliers.

5. Based on these grounds of appeal, the appellant prayed that the judgment of the Tax Tribunal be set aside and that its appeal be upheld. The Memorandum of Appeal was substantiated by the submissions filed by the appellant dated 31st October 2022. The submissions reiterated the lack of validity of the Assessment and the Objection Decision of the respondent. The appellant submits that at no time did the respondent inform him that his (the appellants) Notice of Objection was invalid as required under section 51(4). Instead, the appellant states that the respondent summarily rejected the Objection on the grounds that the documentation supplied was insufficient, a point that is denied by the appellant. This, according to the appellant, is an issue that the Honourable Tribunal also failed to consider.

6. The appellant further submitted that not only did the Objection Decision fail to disclose grounds for the Objection Decision, it also went on to raise different grounds of objection, and eventually confirmed the assessment that had been objected to. The appellant takes issue with this blatant disregard of its objection grounds, and states that the same was contrary to section 51(8) of the TPA and an upfront to article 47 of the *Constitution*. The appellant also submitted that the powers that the respondent yields under section 56 of the *ITA* ought to be exercised reasonably and within the confines of the law.

7. To further substantiate the Memorandum of Appeal, it was submitted by the appellant that the powers that the respondent had to demand information from a tax payer were not without limits and ought to be limited to the relevant documents that would be required by the respondent. The appellant in this regard invited this Court to look at previous decisions of the Honourable Tribunal in *Ukwala Supermarket v Commissioner of Domestic Taxes* as well as in *Shreeji Enterprises (K) Ltd v The Commissioner for Tax and Investigations*, Tax Appeals No 58 and 186 of 2018.

8. The appellant avers that its burden of proof had been discharged when it produced all the documents that the respondent required of it. Having done this, the onus had then shifted to the respondent to rebut the appellants prima facie case and to prove the fraud as alleged, against the appellant. The appellant submits that despite the respondent's allegation that it had reached its finding after investigating into the affairs of the appellant, no evidence was provided of such investigation or of the fraudulent dealings that the appellant was allegedly involved in.

9. In response to the Memorandum of Appeal, the respondent filed a Statement of Facts and written submissions dated 1st November 2022. Collectively the respondent's case was that both the Assessment and the Objection Decision were valid and in accordance to section 59 of the *TPA*. Responding to the submission by the appellant that no reasons were given for disallowing the input VAT Claims, the appellant states that there were reasons given by the respondent and points to paragraphs 101 and 102 of the Tribunal's judgment which made reference to these reasons. The respondent also avers that the details of the fraud were disclosed to the appellant. The respondent further avers that before the Objection Decision was issued, the appellant was granted an opportunity to produce documentation vide a letter dated 26th June 2018 but failed to do so and the Objection Decision was then issued confirming the Assessment.

10. The respondent's submission to the appellant's averment that no legal reasons were given for the Objection Decision is that the decision was in compliance with section 51(10) of the *TPA*. The respondent refers to the finding of the Honourable Tribunal that the Objection Decision did in fact meet the requirements. The respondent further maintains that the documentation that was provided by the appellant disclosed some irregularities and in the absence of the further documentation being provided, a tax assessment was raised. The onus was on the appellant to prove that the assessment was incorrect as per section 51(6) of the Act.

11. With respect to the requirement for the respondent to inform the appellant about the invalidity of its Objection, the respondent stated that the Objection was received on 14th June 2018 and the respondent requested for documents on 20th June 2018 which were not forthcoming and so the decision was then rendered.

12. With regard to the disallowed input VAT, the respondent contends that the appellants input VAT claims were disallowed because the appellant had not provided the documents required under section 17(3) of the *VAT Act*.

13. All in all, the respondent states that the appellant was also not able to provide records as required under section 59 of the *TPA*. In particular, the respondent had asked for evidence of actual supply of the items. The respondent avers that the appellant did not provide the respondent with proof of purchases or costs and for this reason there was no basis for the respondent to allow inputs as claimed by the appellant where it was stated that the appellant had been found to be a beneficiary of missing trader schemes. The respondent stated that one of the alleged traders had in fact confirmed in writing that it had never done any business with the appellant, a position that the appellant did not rebut.

14. In response to the deduction of expenses, the respondent also submitted that sections 15(1) and 16(1) of the *ITA* must be read together. It was the respondent's case that the expenditure incurred in the production of income must be proved to the satisfaction of the respondent. The respondent regrets that despite the demand letters issued to the appellant, the appellant did not produce the required documentation, noting that the onus required under section 56 of the *TPA* was on the appellant to discharge.

Analysis

15. Having read the pleadings and rival submissions presented by the parties, I find that the main issues for determination are whether the respondent's Assessment and Objection Decision were valid, whether the appellant was entitled to the input VAT as claimed, whether the Commissioner erred in assessing additional Corporation Tax after disallowing input VAT and lastly, whether the Tribunal rightly appreciated the provisions of sections 56 and 59 of the *TPA*, section 30 of the *TATA* and sections 17 and 43 of the VAT Act, 2013. In determining this appeal, I am also cognizant that this court's appellate jurisdiction is restricted under section 56(2) of the *Tax Procedures Act*,2015 to questions of law only. The Court of Appeal in *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR summarized what amounts to "matters of law" as follows:

> "The interpretation or construction of the *Constitution*, statute or regulations made thereunder or their application to the sets of facts established by the trial Court. As far as facts are concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court".

16. Applying the parameters to the present case means that an appeal limited to matters of law does not provide leeway to this court to substitute the Tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts unless the decision of the Tribunal cannot be supported by any evidence.

17. The appellant has stated in his pleadings and submissions that the Assessment and the Objection Decision were invalid. I have no reason to disagree with the Tribunal considering the documents before me that the appellant was aware of the findings of the investigations through the Assessment. In fact, it was on this basis that the appellant had been asked to provide evidence to show cause why the input VAT, costs and corporate tax ought to have been allowed by the respondent. It was contended by the appellant that the Objection Decision was also invalid for not considering the Objection filed by the appellant and not responding to the same.

18. The Tribunal disagreed with the appellant on the two allegations. It was the finding of the Tribunal that the Objection Decision had met the requirements of section 58(10) of the *TPA* and further that there is no obligation placed on the respondent to respond to 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. Despite noting that the law did not require the respondent to respond to the appellant, it nonetheless observed that in fact the Objection Decision did respond to the grounds stated by the appellants by stating that the documentation provided did not support the objection raised by the appellant. These are findings that this court finds no reason to disturb.

19. Section 17 of the *VAT Act* provides the requirements upon which input VAT is allowed and in particular section 17(3) which requires a tax payer to avail the following documents:

    (3) The documentation for the purposes 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);

    (e) a debit note in the case of input tax deducted under section 16(5); or

20. As noted by the Tribunal, it was not enough for the original tax invoice to be availed, the invoices must themselves relate to an actual supply or importation that was acquired by the trader to make the supply. This finding is supported by section 17 (1) and (2) of the *VAT Act* which provides that:

    (1) 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.

    (2) If, at the time when a deduction for input tax would otherwise be allowable under subsection (1)—

    (a) the person does not hold the documentation referred to in subsection (3), or

    (b) the registered supplier has not declared the sales invoice in a return, the deduction for input tax shall not be allowed until the first tax period in which the person holds such documentation:

Provided that the input tax shall be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred.

21. The appellant states that it provided the documents that were required of it to the respondent in support of its tax returns and tax claims and therefore discharged its burden of proof. The appellant submits that it was therefore up to the respondent to prove its allegations against the appellant. From the record before this Court, the documents presented by the appellant showed anomalies and the respondent was not satisfied that the appellant was not a beneficiary of the missing trader scheme. The respondent proceeded to ask for further documentation from the appellant to prove otherwise. No more documents were forthcoming from the appellant and the Tribunal also concluded that 'the actions of the respondent in disregarding the ETRs and supporting documents to be reasonable'.

22. This Court has on several occasions dealt with the question of the evidentiary burden of proof in tax matters. In *Commissioner of Domestic Taxes v Priyguru Company Limited* (Income Tax Appeal E085 of 2020) [2021] KEHC 132 (KLR) the Court held that:-

> " Once the appellant presented its case as aforesaid; that it believed the alleged suppliers did not exist or that there had been no commercial transactions for alleged VAT input and that he required information and documents to prove the alleged commercial transactions by way of documents, the evidentiary burden of proof shifted back to the respondent. It was then upon the respondent to prove that there had been supply of taxable goods under section 17 of the Act. This the respondent failed to prove. That is where the burden lay and the moment the respondent failed to produce the documents and information sought by the appellant to prove the alleged commercial transactions, it cannot be held to have proved its case that the assessment was wrong".

23. The reason behind this unique position of law is as was explained in *Commissioner of Domestic Services v Galaxy Tools Limited* [2021] eKLR to the extent that:-

> " Tax laws are unique as they are contrary to the general rule that he who alleges must prove".

24. To further explain the justification for this position, in the *Priyguru Company Limited case*, the court referred to the Galaxy Tools decision observing that in the latter decision, the Court explained that:

> " This country operates under a self-assessment tax regime. Under this regime, the tax payer assesses self and declares what he considers to be taxable income on which he then pays tax to the authorities. For this reason, the tax laws are coached in a manner that gives the tax authorities wide powers and discretion in ascertaining ex-post facto, what taxable income is. Further, the tax laws reverse the well-known principle of evidence of "he who alleges must proof". In this regard, the tax authorities would assess what it considers to be the tax due from a taxpayer and the tax laws would burden the tax payer to disprove that the assessment or tax demanded is wrong or incorrect.
>
> This is borne by the fact that the assessment and demand is ordinarily made way after the tax payer has assessed himself and made a declaration of what according to him is the tax payable and has already paid such tax. The burden is therefore shifted to the tax payer because, the tax authority has to rummage through the documents of the tax payer years after the tax payer assessed himself and paid what he considered to be his tax liability."

25. Further, in *Commissioner of Domestic Taxes v Trical and Hard Limited* (Tax Appeal E146 of 2020) [2022] KEHC 9927 (KLR) the court reiterated that the burden of proof in tax matters is not stationary

but is like a pendulum swinging between the taxpayer and taxman at different points but more times than not swings towards the taxpayer. This position has been upheld and further justification given in *Republic v Kenya Revenue Authority; Proto Energy Limited (Exparte)* (Judicial Review Application E023 of 2021) [2022] KEHC 5 (KLR) in which the Court again stated that

> "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".

26. I couldn't agree more with these decisions whose import are actually reflected in Kenya's tax legislation. Section 30 of the *TATA* and section 56 of the *TPA* both impose the burden of proof on the tax payer to prove that an assessment is excessive or a tax decision is incorrect. Moreover, and in adherence to section 59 of the *TPA* and section 43 of the *VAT Act*, a taxpayer is also required to keep and produce documents when required by the tax authorities. It is anticipated that every vigilant businessman would have his records intact especially for tax purposes. A presumption of correctness arises from the Commissioner's Assessment. This presumption remains until the taxpayer produces competent and relevant evidence to support their position. When the taxpayer comes forward with such evidence, the presumption vanishes and the case must be decided upon the evidence presented.

27. Going back to the case at hand, the respondent accused the appellant of being part of the missing trader scheme and being involved in transactions where no supplies were actually made. It was the respondent's conclusion that the tax invoices and ETR receipts were not genuine proof that supplies were made and that there were any sales and that these were meant to reduce the Respondent's tax liability.

28. Based on these averments the evidentiary burden swung to the appellant to prove that the Commissioner wrong. In this attempt, the respondent availed documents including copies of invoices issued for each impugned purchase, copies of delivery notes for each impugned purchase and copies of payment records and client statements. It is not true that the documents were disregarded by the respondent. On the contrary, once these documents were availed, the burden shifted to the Commissioner who then challenged the veracity of the evidence produced by the appellant.

29. I must agree with the decisions earlier cited that once this was done, the burden shifted back to the appellant to disprove the respondent. This is for the simple reason that the tax payer is required to produce cogent and concrete evidence to disprove the evidence produced by the Commissioner and only then can the burden shift to the Commissioner. In any case, as earlier stated, there was a genuine expectation that as a reasonable businessman, the appellant ought to have had the custody of all transaction details concerning the trade relations between it and its suppliers. The respondent was justified in seeking this additional evidence. While the general rule in evidence is that he who alleges must prove, it must also be the reason that section 112 of the *Evidence Act* makes provision that, "In civil proceedings, when any fact is especially within the knowledge of any party to those proceedings, the burden of proving or disproving that fact is upon him."

Determination and orders

30. For the reasons stated, the appeal is hereby dismissed. There shall be no order as to costs.

DATED, SIGNED AND DELIVERED IN NAIROBI THIS 12TH DAY OF MAY 2023

F. MUGAMBI

JUDGE

Court Assistant: Ms. Lucy Wandiri.