Commissioner of Domestic Taxes v Biojoule Kenya Limited (Income Tax Appeal E168 of 2021) [2023] KEHC 17362 (KLR) (Commercial and Tax) (12 May 2023) (Judgment)

Neutral citation: [2023] KEHC 17362 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E168 OF 2021

FG MUGAMBI, J

MAY 12, 2023

BETWEEN

THE COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

BIOJOULE KENYA LIMITED ..... RESPONDENT

JUDGMENT

Background Information

1. The facts giving raise to this appeal are uncontroverted. On 15th November 2019, the respondent received auto assessments on itax relating to its VAT returns for the period January to May 2018. The respondent objected to the assessment by a Notice of Objection dated 9th December 2019 and supplied relevant documents to the Commissioner. Upon consideration of the respondent's objection and review of the documents presented, the Commissioner made a finding and issued an Objection Decision to the respondent on 20th July 2020.

2. The gist of the decision was that the appellant allowed all the other input taxes save for the tax represented by invoice No. 201806DC0010670507. The reason given for disallowing the invoice is that it had been 'pre claimed as it was dated 01/06/2018 yet claimed on 31/05/2018'. Being dissatisfied by the decision of the Commissioner, the respondent herein appealed against this finding, to the Tax Appeals Tribunal, on 9th December 2019.

3. The Tribunal framed one issue for determination and that is whether the respondent erred in disallowing the appellants input tax deduction for the period of 2nd May 2018 to 1st June 2018. In allowing the appeal, the Tribunal noted that the appellant had complied with the requirements of section 17 of the Act in so far as the production of the documents was concerned. The Tribunal further noted that the input VAT claim had been lodged within six months after the end of the tax period in

which the supply occurred. In conclusion it was the finding of the Tribunal that the respondent had erred in disallowing the appellants input tax claim for the period of 2nd May 2018 to 1st June 2018.

4. The Tribunal allowed the appeal and set aside the appellant's assessments disallowing the respondents input VAT claim of Kshs. 334,759.56, thereby triggering the present appeal.

5. By way of a Memorandum of Appeal dated 14th September 2018 to this court, the appellant set out two grounds of appeal, that;

    i. The Tribunal erred in law in misinterpreting section 17(2) of the *VAT Act*

    ii. The Tribunal erred in fact and in law in failing to appreciate what a tax period is for VAT purposes.

6. To buttress its case, the appellant also filed submissions dated 7th September 2022. The first point that the appellant makes is that VAT payable by a registered company is calculated based on output VAT (which is VAT charged by a business to its customers) less input VAT (which is VAT that the business is charged by its suppliers).

7. It was further submitted that in line with section 17 of the *Act*, input VAT could only be allowed upon production of relevant documentation to the appellant. The documentation required under section 17(2)(a) was an original tax invoice or a copy at the time of claiming input VAT. It was the appellant's case that where a person was not in possession of the original or copy of the tax invoice, they were required to wait until they had such document in their possession, so long as the tax was claimed within six months from the tax period when the supply occurred.

8. It was therefore the appellant's case that since the supply occurred in May 2018, and the invoice was dated 1st June 2018 the respondents ought to have claimed the input in June 2018, which would be well within the 6 months and the next tax period when the taxpayer came into possession of the original invoice. The appellant argues that the Tribunal misdirected itself or did not consider the meaning of a tax period as provided for in section 2(1) of the *VAT Act* in reaching a contrary decision.

9. Finally, the appellant averred that claiming an invoice before its existence would put the respondents in a credit position as opposed to a payment position and was an abuse of the tax system. The appellant pointed out that the decision rendered by the Tribunal was likely to have catastrophic effects to the functioning of the appellant in terms of future interpretation and application of the provision.

10. In opposing the appeal, the respondent filed a Statement of Facts dated 17th March 2022 and submissions dated 14th November 2022, indicating that it was relying on the Memorandum of Appeal and written submissions filed at the Tribunal. It was conceded by the respondent that the only bone of contention between the parties was whether the respondent was entitled to deduct the VAT represented in the 1st June invoice from the tax due from it for the period ending May 2018. The respondent submitted that the Tribunal had acted within the law in allowing the appeal.

11. The gist of the respondent's case was that it had incurred input VAT for consumption during the period 2nd May to 31st May 2018. It was therefore entitled to deduct input tax any time after 31st May 2018 up to six months thereafter as provided under section 17(2) of the *VAT Act*. It was further averred that since the invoice was issued on 1st June 2018, this was also within the date of filing returns which was 20th June 2018 as per section 44 of the *Act*. The respondent urged that to disallow the claim would subject it to hardship.

12. Finally, the respondents urged the Court to find that the interpretation of the Tribunal was sound in that it found that the respondent had complied with the requirements of section of the *VAT Act*. It is the respondent's prayer that this Court upholds the Tribunals determination.

Analysis And Determination

13. I have considered the pleadings, authorities cited and the rival submissions by counsel. This appeal is centered around te interpretation of section 17 of the *VAT Act*. It is not in dispute that the respondent is a registered person for purposes of VAT. It is also not disputed that the respondent incurred the VAT set out in invoice number 201806DC0010670507 from Kenya Power and Lighting Company (KPLC) for consumption for the period of 2nd May to 31st May 2018. The bone of contention is whether the VAT represented in the invoice dated 1st June 2018 should have been deducted during the tax period ending 31st May 2018 or the next tax period, being June 2018. The respondent's tax return was dated 19th June 2018 and had included the invoice as deductible tax.

14. In simple terms, VAT enables a registered business to claim its input tax as an expense used to generate goods and services that it supplies on which it collects tax and remits to KRA. The VAT component that is paid by a registered person to a supplier when buying something from them for resale is called input VAT. The VAT that the registered person in turn charges customers while making a sale is called output VAT. Section 2 of the *VAT Act* defines the two terms. The law allows for a registered trader to therefore subtract the input VAT that he has paid from that which has been paid to him output VAT and to thereafter remit the difference to the appellant.

15. Against this momentary background, counsel for both parties have laid before this Court numerous helpful decisions touching on the interpretation of tax statutes. These authorities point towards what this Court must consider in rendering its decision in this matter. This includes the requirement that words in a tax statute should be given their ordinary meaning, with no room for intendment or presumption; that the approach taken should not produce an injustice to either party or an absurd result; that the statute should be read holistically and in full knowledge of the intent, paying attention to the context of its enactment by the legislature.

16. The appellant relies on the case of *Adrian Kamotho Njenga v Kenya School of Law* [2017] eKLR, *Republic v Kenya Revenue Authority ex parte Bata Shoe Company (k) Ltd* [2014]eKLR, *Republic v Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya Ltd* [2012] eKLR and *Primarosa Flowers Ltd v Commissioner of Domestic Taxes* [2017]eKLR. In addition, the respondent has cited the Court of Appeal decision in *Kenya Revenue Authority v Republic ex parte Fintel Ltd* [2001] eKLR as well as the decision in *Rabai Operation & Maintenance Ltd v Commissioner of Domestic Taxes* [2019] eKLR.

17. I could perhaps cite, in addition, the case of *Republic v Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya Ltd* [2012] eKLR while citing *Cape Brandy Syndicate v Inland Revenue Commissioners* [1920] 1 KB 64 as was also applied in *T.M. Bell v Commissioner of Income Tax* [1960] EALR 224 where it was held as follows:

> " ...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."

18. Similarly, in emphasis, the Court of Appeal in *Kenya Revenue Authority v Republic (ex-parte Fintel Ltd)* NRB CA Civil Appeal No. 311 of 2013 [2019] eKLR, cited with approval the *dictum* of Lord Atkinson in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1 where it was observed as follows;

> "It is well established that one is bound, in construing Revenue Acts, to give a fair and reasonable construction to their language without leaning to one side or the other, that no tax can be imposed on a subject by Act of Parliament without words in it clearly showing an intention to lay the burden upon him, that the words of a statute must be adhered to, and that so-called equitable constructions of them are not permissible".

19. The court also cited the observation by Lord Simonds in *Russell v Scott* [1948] 2 ALL ER that;

> " [T]here is a maxim of income tax law which, though it may sometimes be over-stressed, 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 on him".

20. And so, against this background and in the complete appreciation of these interdicts, I now proceed to determine the import of section 17 of the *Act*. The relevant parts of the heavily contested provision states as follows:

> 17. Credit for input tax against output tax
>
> (1) Subject to the provisions of this section 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.
>
> (2) If, at the time when a deduction for input tax would otherwise be allowable under subsection (1), the person does not hold the documentation referred to in subsection (3), 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.
>
> (3) The documentation for the purposes of subsection (2) shall be—
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> (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; 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

21. In my view, section 17(1), 17(2) and 17(3) should be read and understood to build on to each other. A plain interpretation of section 17(1) is that where a person is registered for purposes of VAT, and he has acquired or imported supplies which he used to make taxable supplies, he is allowed to deduct input tax. Such input tax may be deducted at the end of the tax period in which the supply or importation occurred. A tax period as defined in section 2 of the *Act* means one calendar month or such other period as may be prescribed in the regulations. (emphasis mine).

22. Section 17(2) goes on to provide for the period within which the relevant documentation must be provided. The ideal position being that during the time of deducting the input tax, that is, at the end of the tax period, a taxpayer should be able to file his returns together with a tax invoice, a receipt for the payment of tax and other documentation provided under section 17(3).

23. In the event that these are not available to the taxpayer within the period of deduction of input tax, which is at the end of the tax period, section 17(2) sets in with the alternative for the deduction to be made in the next tax period when the taxpayer receives the required documentation so long as this return is filed within six (6) months from the date of the supply. (See Majanja J in the case of *Highlands Mineral Water Limited v Commissioner of Domestic Taxes* [2021] eKLR).

24. The import of section 44 of the *Act* has also been referred to. It is my view that this section must be read alongside section 17. Section 44 provides that;

> Every registered person shall submit a return, in the prescribed form and manner, in respect of each tax period not later than the twentieth day after the end of that period.

25. The purpose of this section is not to create a different timeline than that provided under section 17 within which deductions will be allowed, as intimated by the respondent. I understand the purport to section 44 to be that a taxpayer has 20 days after the end of the relevant tax period to put in the documents that are stated in section 17, but relating to the tax period.

26. What this means in the present case is that supplies were incurred by the respondent with respect to the tax period 1st May to 31st May 2018. Being a registered person under the Act, the respondent was entitled to deduct the input tax for that period and submit the relevant documentation relating to that period to the appellant by 20th June 2018. The invoice dated 1st June 2018 would not be allowable within this period. The invoice dated 1st June is not proof of purchase. An invoice merely indicates a business is requesting payment for goods or services provided.

27. A receipt will be issued as proof of purchase once the transaction is partially or fully complete. There must therefore be a corresponding receipt to prove the payment of the invoiced account. A receipt for payment of tax is a requirement under section 17(3)(b). In this regard I do agree with the appellant that to accept the invoice of 1st June 2018 would be tantamount to giving a false credit, without a concurrent receipt to prove that tax had been paid, to discharge the burden under section 62 of the Act. This result would also create an absurdity.

28. Finally, I do find that this interpretation does not cause injustice to any party as it allows the respondent to claim the deduction in the next tax period or any time before the end of six months from May 2018, and allows for the proper administration of taxes by the appellant. While the respondent claims that he will incur hardship if the deduction is disallowed, this averment has not been substantiated. I do not see the hardship that the respondent stands to suffer out of this and future similar transactions. This

is because the law allows a taxpayer to deduct input tax, either within the tax period that the supply occurred, subject to having all required documentation, and if not, up to 6 months from the date that the supply is made, in subsequent tax periods.

Disposition And Order

29. For these reasons I am satisfied that the Tax Appeals Tribunal erred in holding that the invoice dated 1st June 2018 was allowable, when the invoice was dated outside the taxable period and when it should have been filed in the next taxable period, so long as the payment was made and a receipt filed either in the next tax period or any time within 6 months.

30. The upshot is that this appeal is allowed. The decision of the Tax Appeals Tribunal dated July 16, 2021 is set aside and the assessments dated November 15, 2019 and confirmation dated July 20, 2020 are upheld.

31. 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.