Family Fashion Clothing Limited v Commissioner of Investigations and Enforcement (Income Tax Appeal E050 of 2021) [2023] KEHC 17608 (KLR) (Commercial and Tax) (19 May 2023) (Judgment)

Neutral citation: [2023] KEHC 17608 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E050 OF 2021

JWW MONG'ARE, J

MAY 19, 2023

BETWEEN

FAMILY FASHION CLOTHING LIMITED ..... APPELLANT

AND

COMMISSIONER OF INVESTIGATIONS AND ENFORCEMENT ..... RESPONDENT

(Being an appeal from the judgement of the Tax Appeals Tribunal dated 23/4/2021 in Tax Appeals Tribunal, Appeal NO. 226 of 2018)

JUDGMENT

1. The appellant, being dissatisfied by the decision of the Tax Appeals Tribunal(tribunal) issued on April 23, 2021 dismissing its appeal against the decision of the respondent dated July 26, 2018 appealed to the High Court against the whole decision on the following grounds:

> " 1. The honourable Tax Appeals Tribunal ("the honourable tribunal") erred in holding that there was Value Added Tax ('VAT") and Corporate Tax amounting to Kshs 359,542,702.00/- due from the appellant as assessed and demanded by the respondent.
>
> 2. 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 May 9, 2018 and the objection decision dated July 26, 2018 as raised by the appellant.

3. The honourable tribunal erred in failing to find and hold that, contrary to section 49 of the *Tax Procedures Act*, 2015 ('the TPA'), the respondent failed to provide reasons for its rejection of the appellant's VAT claims and the raising of an assessment for Kshs 359,542,702.00/-. The assessment was therefore invalid as contra statute.

4. The honourable tribunal erred in failing to find and hold that the respondent's failure to disclose the substantive legal provision(s) on the impugned assessment pursuant to which it was raised invalidated it.

5. 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 51(3), as the respondent failed to immediately notify the appellant that its notice of objection was invalid, the rejection of the appellant's objection was improperly rejected.

6. 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 ground given for the summary rejection of the appellant's objection— failure to provide supporting documents— is not one of the stipulated grounds in section 51(3) for summary rejection of objections.

7. 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."

8. 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.

9. The honourable tribunal erred in failing to appreciate and consider the following:

    a) Section 17 (1) of the *VAT Act* provides that;

    b) Section 17 (3) of the *VAT Act*

    c) Regulation 7 of the VAT Regulations of 2017

    d) 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 input VAT are invoices and corresponding ETRs, delivery notes, payment records and store records, which documents were provided and acknowledged as received by the respondent.

10. The honourable tribunal erred in finding and holding in paragraph 106 of the judgement that ' ...it is not enough for the taxpayer to hold the documentation listed in section 17(3) of the *VAT Act*. The documentation must be representative of an underlying transaction that took place. The taxpayer must have bought the goods, had them delivered and used them in making taxable supplies...'while so finding, the honourable tribunal failed and/ or declined to take cognisance of the fact that the respondent had been

numerously provided with copies of the said documents and produced the same as evidence before the honourable tribunal and had not at any particular time contested the authenticity of the said documents.

11. The honourable tribunal misconstrued the provisions of both section 30 of the *Tax Appeals Tribunal Act* and section 307 of the *Evidence Act* in concluding that the appellant 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 it requested for as proof of the 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.

12. The honourable tribunal erred in finding at paragraph 112 of its judgement that the appellant '...by failing to provide the required documentation to show that there was indeed a purchase...failed to discharge its burden of proof...' This is notwithstanding the fact that the appellant did procure the merchandise from its suppliers for which it was issued with invoices and made payments upon delivery as evidence by the invoices, RTGS and delivery notes furnished to the respondent.

13. 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*...

14. The honourable tribunal erred in failing to find that section 15(1) of the *Income Tax Act* 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.

15. The honourable tribunal erred in failing to find that the respondent erred in its decision to disallow the input VAT and purchase costs.

16. The honourable tribunal fundamentally erred in failing to take cognisance of the fact that the appellant duly issued the respondent with copies of invoices and corresponding ETR, proof of payments, delivery notes 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 remained uncontested.

17. The honourable tribunal erred in failing to follow its own decisions in *Shreeji Enterprises (K) Limited v The Commissioner for Tax and Investigations* Tax Appeals Nos 58 and 186 of 2019.

18. 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 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 also 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 input VAT was remitted by its suppliers."

2. The appellant is a garments company incorporated in Kenya involved in the business of purchasing fabric, accessories and related items and using them to manufacture garments which are then sold to various customers locally and overseas.

3. The respondent is a principal officer appointed under the *Kenya Revenue Authority Act* Cap 469 of the Laws of Kenya and is an agency of the government for the collection and receipt of revenue.

4. The respondent states that it carried out an investigation into the tax affairs of the appellant and thereafter issued a tax investigation finding dated April 18, 2018 in which it demanded Kshs 359,542,702.00/- being VAT of Kshs 125,058,331.00/- and corporation tax of Kshs 234,484,371.00/-. This was then formalised in an assessment dated May 9, 2018.

5. The appellant raised an objection against the assessment and the respondent confirmed the assessment through an objection decision dated July 26, 2018. Being aggrieved by the respondent's objection decision, the appellant filed an appeal before the tribunal.

6. The tribunal, in its judgement delivered on April 23, 2021, dismissed the appeal and found that the objection decision dated July 26, 2018 was valid and allowed the tax demand of Kshs 359,542,702/-.

7. Based on the above grounds the appellant moved to this court to, on appeal to have the judgement of the tribunal reversed and substituted with orders setting aside the objection decision dated 26/7/2018 and the notice of assessment of tax dated 9/5/2018.

8. In opposition, the Respondent filed a Statement of Facts dated 24/6/2021. In the said Statement of Facts the Respondent contended that the Tribunal rightly held that it provided reasons for the assessments it raised; that the Respondent disallowed input VAT for the reason that its investigations revealed that the suppliers of the Appellant only existed on paper and did not actually sell anything; that the Tribunal rightly held that the Respondent discovered that the Appellant had claimed imports whose entry numbers did not belong to it and that a further review of its ICT systems revealed that the Appellant had not disclosed most of its sales.

9. The Respondent further argued that the Tribunal rightly held that the Respondent had satisfied the requirements of Section 49 of the *Tax Procedures Act*(TPA) by providing reasons for its decision; that the Tribunal rightly held that the Respondent's objection decision satisfied Section 58(10) of the *TPA* as it contained a statement of findings of its investigations and laid out the reason for arriving at the decision as a failure of the Appellant to provide documentation to support its grounds of objection.

10. The Respondent contended that the Appellants failed to show that the invoices provided related to an actual supply or importation that was acquired by the trader to make a taxable supply hence was rejected by the Respondent on the basis that it fell under the 'missing trader fraudulent scheme" and that the Tribunal rightly interpreted the provisions of Section 30 of the TPA and Section 107 of the Evidence Act which placed the burden of proof on the taxpayer to adduce all the necessary documentation to support its case.

11. The Respondent pleaded that the Appellant was given every reasonable opportunity to produce evidence to support its position but was unable to provide sufficient documentation to satisfy the

Respondent that the input VAT was properly deductible and therefore the Respondent's assessment and objection were justified.

12. For the above reasons, the Respondent prayed to have the court dismiss this appeal and uphold the decision of the Tribunal.

13. The court has analysed the entire Record of Appeal, the grounds of appeal and the pleadings filed in opposition to the appeal and considered the submissions filed by the parties and note that the grounds of appeal can be condensed to the following issues for determination:

Issue 1: Whether the assessments and objection decisions were valid.

Issue 2: Whether the Respondent erred in its decision to disallow the input VAT.

Issue 1: Whether the assessments and objection decisions were valid.

14. From the pleadings and the available evidence, the court notes that the Appellant submitted that the Respondent not only failed to address the grounds of the Appellant's notice of objection but did not disclose the legal and factual basis for both its assessment and objection decision as required by Section 51(10) of the *Tax Procedure Act* which states:

> "An objection decision shall include a statement of findings on the material facts and the reasons for the decision."

15. Arising from the pleadings, I note that the Respondent carried out an investigation into the tax affairs of the Appellant and thereafter issued a tax investigation finding dated 18/4/2018 in which it demanded Ksh.359,542,702.00/- being VAT of Kshs.125,058,331.00/- and corporation tax of Ksh.234,484,371.00/-. This was then formalised in an assessment dated 9/5/2018.

16. Further, in the investigation's findings (found on page 27-32 of the Record of Appeal), the Respondent stated that it had analysed the Appellant's VAT returns for the period 2015-2018 and noted that it claimed local purchases from traders that only existed on paper as they did not buy or sell any goods neither did they have a physical office or location from where they operated. The Respondent further stated that the Appellant claimed imports whose entry numbers did not belong to the company.

17. Based on the said findings, the Respondent required the Appellant to provide justifiable grounds because its input VAT and costs claimed should be allowed as claimed.

18. The Appellant opposed the assessment through its notice of objection letter dated 7/6/2018 (found on pages 25-26 of the Record of Appeal). Its grounds of objection were that it received goods from the suppliers, that they had supporting documentation and payments were made to these respective suppliers.

19. The Respondent issued its objection decision dated 26/7/2018 after considering the Appellant's notice of objection. (Found on page 24 of the record of appeal). It held:

> "Notwithstanding your assertion that the company has maintained full records for the purchases disallowed, the commissioner has established that there was no supply of taxable goods made by the suppliers highlighted on our letter of 16th April 2018."

20. I have considered the objection notice and note that it complied with Section 51(10) of the Tax Procedures Act in that it included a statement of findings on the material facts and the reasons for the decision which was that, the Commissioner, had established that there was no supply of taxable goods

made by the suppliers. I am satisfied by the finding of the Tribunal that the assessment and objection decision were valid.

Issue 2: Whether the Respondent erred in its decision to disallow the input VAT.

21. In its submissions, the Appellant submitted that it furnished the Respondent with invoices, corresponding ETRs, delivery notes, proof of payments and store records to prove purchases from its suppliers; and therefore and though the burden of proof lies with the Appellant, the appellant argued that it was the duty of the Respondent to demonstrate that the evidence adduced by the Appellant was insufficient and to prove the alleged "missing trader" fraudulent scheme.

22. The Respondent on its part submitted that the Appellant sought to abuse the VAT tax regime by claiming input VAT from a list of companies that were identified by the Respondent as "missing traders"; that the said companies that the Appellant was purportedly trading with existed only on paper; that the Respondent disallowed the Appellant's claim for input VAT and advised the Appellant to produce documents that would justify the claim however the documents provided were not sufficient to prove that the Appellant received the supplies from the listed traders, hence additional assessments for VAT was raised and confirmed. Further that most of the traders that the Respondent claimed inputs from were not registered persons in the Respondents records as taxpayers.

23. Section 17(1) of the *VAT Act* states:

> " 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."

24. The Respondent in its investigation report which was later adopted as its assessment found that the Appellant had claimed local purchases from fictitious traders and that the Appellant claimed imports whose entry numbers did not belong to the company. The Respondent then gave the Appellant the opportunity to provide justifiable grounds why the input VAT and costs claimed from the traders should be allowed as claimed.

25. The Appellant was thus given an opportunity to rebut the findings of the Respondent. I note however in the Appellant's notice of objection, the Appellant only made statements to the effect that the Appellant had supporting documentation to prove that it paid and received goods from its suppliers.

26. It was the position taken by the Respondent that, after its investigations, it found out that the documents provided by the Appellant were not satisfactory or sufficient to allow the claim for input VAT claim and that it requested the Appellant for justifiable grounds as to why the claim ought to be allowed. Instead of providing additional proof, the Appellant claimed to have provided sufficient evidence of the sale and import transaction but the Respondent still did not find this to be sufficient. Section 56(1) of the Tax Procedure Act states:

> " In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect." Further, Section 30 of the *Tax Appeal Tribunal Act* provides: "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."

27. The provisions above indicate that the burden of proof was still on the Appellant to prove the tax assessment wrong despite the fact that it had earlier provided some documents. For instance, the Respondent could have provided additional documents such as PIN Certificates of its suppliers to prove that they are registered persons capable of making taxable supplies and witnesses including some from its suppliers to prove that they actually supplied goods to it.

28. Section 59 of the *Tax Procedures Act* and Section 43 of the *VAT Act* gives power to the Respondent to request for more and additional information to satisfy himself on the taxable income declared or matters tax. As held by the court in the case of *Commissioner of Domestic Services v Galaxy Tools Limited* [2021] eKLR, where Mabeya J held:-

> "With greatest respect, the Tribunal got it wrong. What the Respondent had done in 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 bare before the Tribunal.
>
> 22. On the foregoing, the evidentiary burden of proof shifted back to the Respondent to show that its documentation was legitimate. This would have been by production of other transactional documentation to support the legitimacy of the alleged transactions. It is at that juncture that Sections 59 of the *Tax Procedures Act* and Section 43 of the *VAT Act* kicks in.
>
> 23. The said provisions give power to the Appellant to request for more and additional information to satisfy himself on the taxable income declared or matters tax. Some of the documents to be kept by a taxpayer and which should be availed to the Appellant are, copies of invoices, copies of stock records, details of each supply of goods and services among others. According to the Appellant, save for invoices, none of these documents were supplied."

29. I concur with the finding above. Once the Respondent found that the documents adduced by the Appellant were insufficient the burden lay squarely on the Appellant to disprove this. Further, the law allowed the Respondent could ask for additional documents/evidence if it found that the documents provided were not sufficient, which it did, and the Appellant was under an obligation to satisfy the said demand, in order to sustain its claim and discharge its burden as set by the law above.

30. I note further that in this appeal and the one before the Tribunal, the Appellant did not adduce the documents that it claimed it had provided to the Respondent to prove purchases from its

suppliers. Therefore, this court, just like the Tribunal, cannot analyse the said documents in order to determine whether the Appellant acquired stock from the suppliers in question.

31. The upshot of the above findings is that the Appellant has not discharged its burden of proof despite having the opportunity to furnish sufficient proof. The appeal as filed is dismissed and the decision of the Tribunal upheld in its entirety. Costs of the appeal are awarded to the Respondent.

DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 19TH DAY OF MAY 2023.

.....

J. W. W. MONG'ARE

JUDGE

In the Presence of:-

1. Ms. Wangechi holding brief for Ms. Onyango for the Appellant.

2. Ms. Chelangat for the Respondent

3. Sylvia- Court Assistant