Foresight Infrastructure Inc v Commissioner of Domestic Taxes (Tax Appeal E124 of 2020) [2023] KEHC 18940 (KLR) (Commercial and Tax) (16 June 2023) (Judgment)

Neutral citation: [2023] KEHC 18940 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E124 OF 2020

DAS MAJANJA, J

JUNE 16, 2023

BETWEEN

FORESIGHT INFRASTRUCTURE INC .... APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES .... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 18th September 2020 in Tax Appeal No. 257 of 2018)

JUDGMENT

Introduction and Background

1. Before the court is an appeal by the Appellant challenging part of the decision of the Tax Appeals Tribunal ("the Tribunal") dated September 18, 2020 based on the following grounds contained in its Memorandum of Appeal dated November 11, 2020 where it states that the Tribunal:

    1. Erred in law and in fact by misapprehending, misapplying and/or incorrectly applying the provisions for claiming a credit for input VAT under Section 11 of the *Value Added Tax Act* (Repealed) Cap 476 Laws of Kenya and Sections 2, 17 and 19 of the *Value Added Tax Act*, 2013;

    2. Erred in law and in fact by misapprehending, misapplying and/or incorrectly applying the burden of proof as set out under Section 30 of the *Tax Appeals Tribunal Act* and Section 56(1) of the *Tax Procedures Act* to the facts before the Tribunal;

    3. Erred in law and in fact by misapprehending, misapplying and/or incorrectly applying the provisions of Regulations 7 and 19 of the Value Added Tax Regulations (Repealed), 1994;

4. Erred in law in disregarding the Stare Decisis principle, by manifestly misapprehending and misapplying the principles set out by this Honourable Court in the established and binding precedent in Income Tax Appeal No 7 of 2017, Rabai Operation & Maintenance Limited v Commissioner of Domestic Taxes [2019] eKLR; and

5. Erred in law and in fact by admitting and determining new issues never pleaded the parties.

2. The Appellant thus urges the court to allow the appeal and that the judgment of the Tribunal, to the extent that it upholds the Respondent's ("the Commissioner") objection decision dated 6th August 2018 ("the Objection Decision") and directs the Appellant to pay the Commissioner Kshs. 21,176,283.00 be set aside. The Commissioner has filed a Statement of Facts dated 11th December 2020. Both parties have filed written submissions.

3. The facts giving rise to this appeal are largely common ground and can be gleaned from the record. The Appellant is the Kenyan branch of Foresight Infrastructure Inc., incorporated in the Republic of Mauritius. It is a property management company earning rental income from its investment in commercial property. The Commissioner conducted a compliance check exercise of the Appellant's books and records for the income period January 2013 to August 2017. It communicated its findings through its letter of 11th April 2018. The Commissioner found, inter alia, that the Appellant neither filed nor paid Value Added Tax (VAT) for the years of income 2013 and 2014. The Commissioner charged VAT on the income declared in the income tax returns and raised an additional assessment of Kshs. 35,883,547.00, inclusive of penalties and interest.

4. The Appellant objected to the VAT assessment through its letter dated 8th June 2018. It challenged the legal basis for the imposition of the 20% penalty and late declaration Kshs. 218,950.00 interest levied for the 2013 year of income as it was the Appellant's view that the penalty applicable for non-submission of VAT returns was Kshs. 10,000.00 per return or 5% of the VAT payable and not the 20% indicated in the demand. The Appellant also challenged the imposition of interest of 52% and 40% and urged the Commissioner to clarify the computation calculations on the number of months that the Appellant had been adjudged to have been in default.

5. On the VAT charged, the Appellant stated that the Commissioner had not taken into account input VAT incurred by the Appellant on the purchases acquired by it to make taxable supplies. The Appellant asserted that it incurred input VAT which it deducted within the stipulated period of 12 months under the repealed VAT Act (Chapter 476 of the Laws of Kenya) ("VAT Act (Repealed)") and 6 months under the VAT Act, 2013 as evidenced by its VAT control account and other documentary evidence as provided for by the VAT Regulations. Further, that there were some months in 2013 and 2014 years of income where the Appellant was in a VAT credit position and that the only penalty applicable for these months ought to have been Kshs. 10,000.00 per return for non-submission of VAT returns as opposed to the penalty amounts currently demanded by the Commissioner. It thus asserted that the interest at the rate of 1% per month on the VAT payable should only be computed for the months that the Appellant was in a VAT position.

6. The Appellant contended that VAT Act (Repealed) and the VAT Act, 2013 do not peg the deduction of input VAT to the filing of VAT returns and that the law requires that the deduction of input VAT from output VAT should be done in the tax period in which the supply occurred provided that the registered person is in possession of the necessary documentation and the input VAT was incurred to make taxable supplies. Thus, the Appellant stated that it was in compliance with the provisions of the relevant VAT laws and Regulations when deducting the input VAT for the 2013 and 2014 years of income. That it has maintained all the records relating to input and output VAT since it began

operations and that these documents were available for verification by the Commissioner on request. Moreover, the Appellant stated that it has always maintained a VAT account showing the output VAT, input VAT and the VAT payable/recoverable for each month as required by the VAT Regulations.

7. The Appellant complained that the Commissioner's actions were unfair and violated Article 47(1) of *the Constitution*. It was of the view that the correct amount of VAT payable inclusive of penalties and interest is Kshs. 23,646,640.00 and the Appellant requested the Commissioner to amend the assessment accordingly. The Appellant then stated that it had settled the principal tax of Kshs. 15,996,201.00 and that would be applying for waiver of penalties and interest.

8. The Commissioner issued the Objection Decision. On the penalty of 20%, the Commissioner stated that this was a tax shortfall penalty and that it had applied section 84(2)(b) of the *Tax Procedures Act*, 2015 ("the TPA"). On the late payment penalty interest, the Commissioner stated that according to section 38 of the TPA, interest had been computed at a simple interest rate of 1% therefore there were 52 months between January 2014 and April 2018 and 40 months between January 2015 and April 2018 for the years 2013 and 2014 respectively. That late declaration interest of Kshs. 218,949.00 had been charged on the late declaration of the sales amounting to Kshs. 6,842,169.00 declared in 2015 instead of 2013.

9. On the input VAT deductibility, the Commissioner held the view that guided by section 17(2) of the VAT Act, 2013, input VAT for the period under review was time barred as at the time of issuing the demand and was therefore not allowable and that input VAT was claimable through filing of VAT3 return with the Commissioner. The Commissioner also denied that the Appellant was in a credit position for the period under review. For these reasons, the Commissioner maintained its earlier position as to the VAT demand and after taking into account the sum already paid by the Appellant, it now demanded the sum of Kshs. 19,887,346.00 in respect of VAT.

10. The Appellant appealed to the Tribunal against the Objection Decision. The Tribunal, after hearing the parties, partially dismissed the appeal and upheld the Objection Decision subject to the Commissioner charging the Appellant the penalty conceded of Kshs. 10,000.00. In arriving at this decision, the Tribunal framed three issues for determination; Whether input VAT deducted by the Appellant for years of income 2013 and 2014 was time barred, whether the filing of VAT returns is a prerequisite for deducting input VAT and whether the late payment interest and tax penalties charged by the Commissioner is legal.

11. On the issue of the input VAT deductions being time barred, the Tribunal referred to section 17(2) of the VAT Act, 2013 and stated that the provision is clear and unambiguous in so far as it sets out the criteria to be followed by a taxpayer in seeking a refund of input VAT and that it is couched in mandatory terms as to the documentation required and time prescribed, that it should be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred. That section 19(1) of the VAT Act, 2013 provides that tax shall be due and payable at the time of supply whereas section 19(2) of the VAT Act, 2013 allows a registered person to defer payment of tax due to a date not later than the twentieth day of the month succeeding that in which the tax became due.

12. Having studied the Appellant's documentation, the Tribunal noted that it commenced filing VAT in January 2015 and did not file 2013 and 2014 returns until April 2018 upon conclusion of the Commissioner's audit and that the Appellant did not demonstrate to the satisfaction of the Tribunal by way of any documentary evidence or even at least given dates and documents used to claim the input VAT so as to sustain its contention that it need not file VAT returns to claim the input VAT. The Tribunal was adamant that the law at hand, section 17(2) of the VAT Act, 2013 does not admit

any other interpretation except that a claim for input VAT cannot be beyond the time prescribed. The Tribunal further relied on section 30(a) and (b) of the *Tax Appeals Tribunal Act* and section 56(1) of the TPA which provides that the burden of proving that a tax assessment is excessive or should have been made differently is placed squarely on the Appellant. In view of the foregoing, the Tribunal made a finding that the input VAT for the years 2013-2014 was statutory time barred both under the VAT Act (Repealed) and VAT Act, 2013.

13. On filing of VAT returns as a prerequisite for deducting input VAT, the Tribunal held that the case of Rabai Operations and Maintenance Ltd v Commissioner of Domestic Taxes HC COMM TA No. 7 of 2017 [2019]eKLR relied upon by the Appellant was distinguishable from this case as in that case the Appellant conceded that VAT has been deducted within the 12 months and remitted by RTGS while in this case the Appellant had not demonstrated to the Tribunal why it failed to file the VAT3 returns for the relevant tax period when it was dealing in vatable supplies. The Tribunal agreed with the Appellant that it is a cardinal principle of law that a rule or subsidiary legislation cannot override or be construed to contradict the provisions of the Act. However, the Tribunal held that the two are not contradictory but the same must be read together so as to give full effect and tenor in any interpretation of tax laws. In view of the foregoing, the Tribunal held that the Appellant had failed to demonstrate to its satisfaction by way of any documentation or indication of the dates to show when the claim for input tax was lodged to support its contention. Consequently, the Tribunal held that the Appellant had failed to prove that it lodged the input claim on time as it did not file VAT returns for the relevant tax period.

14. As to whether the late payment interest and tax penalties charged by the Commissioner was legal, the Tribunal relied on the Appellant's admissions in its submissions to hold that the penalty that is payable by the Appellant is the late filing penalty of the higher of 5% of the tax payable under the return or Kshs. 10,000.00.

Analysis and Determination

15. The parties relied on their written submissions which highlighted the arguments I have set out above. The issue in this appeal mirrors what was determined by the Tribunal and concerns the interpretation and application of the law on VAT. In resolving the appeal, the court is guided by the limits of its jurisdiction under section 56(2) of the TPA which provides that "An appeal to the High Court or to the Court of Appeal shall be on a question of law only". The court must therefore accept the Tribunal's findings of fact unless such facts do not accord with the facts and evidence on record.

16. Before analyzing the Tribunal's conclusions and delving in to the issues, an appreciation of how our VAT system operates is important. VAT is a tax chargeable on supply of taxable goods or services made or provided in Kenya and on importation of taxable goods or services into Kenya. It works under the input and output tax system. Output tax refers to the VAT charged on the sales of taxable goods or services, while input tax refers to VAT charged on taxable purchases of goods and services for business purposes. The tax payable is the difference between the output tax and input tax.

17. The Appellant is therefore correct to submit that it had the right to deduct input tax from its VATable transactions as an integral part of the VAT scheme as a taxable person who makes a transaction in respect of which VAT is deductible, may deduct the VAT in respect of goods and services acquired by him provided that such goods and services have a direct and immediate link with the output transaction in respect of which VAT is deductible (see Highlands Mineral Water Limited v Commissioner of Domestic Taxes ML HC ITA Mo. E026 OF 2020 [2021] eKLR and Rabai Operation and Maintenance Limited v Commissioner of Domestic Taxes (Supra)).

18. The aforementioned position on the VAT system above is anchored under section 17 (1) and (2) the VAT Act, 2013 which provide 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.

19. The parties accept that at the time, the same was provided for by section 11(1) of the repealed VAT Act (Repealed) as follows:

    Subject to the regulation and to the other provision of this section, input tax or tax withheld by a tax withholding agent may, at the end of either the tax period which the supply, importation or withholding of tax occurred or the next following tax period, be deducted and to the extent and subject to the exemptions provided under this section, from the tax payable by him on supplies by him (referred to as output tax) in that period;

    Provided that no input or tax withheld may be deducted —

    (a) more than twelve months after that input tax becomes due and payable pursuant to Section 13 or the tax withheld, as the case may be....

20. While interpreting section 11 of the VAT Act (Repealed), the court in Rabai Operation and Maintenance Limited v Commissioner of Domestic Taxes (Supra) held as follows:

    36. In this case we are concerned with Section 11 of the VAT Act. It is reproduced above. That Section provides that its application is subject to regulations and to the provisions of the Section. The Section provides for deduction of input VAT on condition that no input tax may be deducted more than 12 months after the input tax becomes due and payable. The other condition for deduction is that the tax payer, wishing to deduct input tax, must be in possession of a tax invoice.

    37. Those provisions in that Section, are in my view as clear as day. There is no provision in that Section which makes it conditional to fulfilment of Paragraph 7 of the Seventh Schedule as argued by the Commissioner. The intention of the legislature, in that Section, did not include the fulfilment of that Paragraph 7 of the Seventh Schedule. The Commissioner was in error to argue that Section 11 was subservient to Paragraph 7 of the Seventh Schedule or that they were to be read together.

    38. The Tribunal erred to hold that Section 11 can be construed in reference to a Paragraph of a Schedule to the Act. It is principle of law that a Rule or (schedule subsidiary legislation) cannot

override or be construed to contradict the provisions of the Act. The provisions of the Section 11 of the Act cannot be construed to be contradicted by a Paragraph of Schedule. Section 11 recognizes that it is subject only to the regulations. There is no regulation that contradicts the provision of Section 11.

39. It follows therefore that ROML, since it was conceded that it deducted input VAT within the twelve months in Section 11 and had the invoices it qualified by that statutory provision to deduct input VAT.

40. The requirement for VAT monthly returns was not a condition for such deduction under Section 11.

21. In Highlands Mineral Water Limited v Commissioner of Domestic Taxes (Supra), the court, while interpreting section 17(2) of the VAT Act, 2013 held as follows:

> The straightforward interpretation of section 17(2) is that the 6-month period of claiming input VAT begins to run when the supply or importation occurred and not necessarily when the return is filed. Meaning, if a taxpayer files a VAT return say, 7 months after when the supply or importation occurred, then the input tax claimed on that return cannot be allowed.

22. It therefore follows that the only conditions provided for a taxpayer to qualify for input VAT are as follows:

   a. That the input tax was incurred on a taxable supply made to or on importation made by a taxpayer at the end of the tax period

   b. That the input tax is deducted by a registered person on taxable supplies made by him; and

   c. That the input tax is to be allowable for deduction within six months or twelve months after the end of the tax period in which the supply or importation occurred or after the input tax becomes due and payable depending on the applicable period.

23. The court in Highlands Mineral Water Limited v Commissioner of Domestic Taxes (Supra) did not find any fault in the Commissioner disallowing input VAT claims relating to purchases made outside the statutory window period from the date of supply or after the input tax becomes due and payable notwithstanding that a return was filed late. Plainly, the court stated that a VAT return is not a prerequisite or condition for qualifying for an input VAT deduction. What is material is whether the deduction was made within the statutory period.

24. The Tribunal found that there was no evidence before it to indicate that the Appellant had sought a deduction of the input VAT within the prescribed period. The Appellant also conceded in its objection that the documents in respect of the input VAT were in its premises and that same was available for inspection by the Commissioner on request. I think the Appellant failed to recognize the position it was in at the time. Whereas it now states that this issue of documentation was never pleaded by the Commissioner and only raised by it at the submissions stage before the Tribunal, I find that the Tribunal was not precluded from seeking primary documents from the Appellant to verify the said purchases and determine whether they qualified for the input deduction. ,

25. I agree with the Tribunal that it was upon the Appellant to demonstrate that the Commissioner was wrong in not allowing its input VAT deductions. To do this, it ought to have presented evidence before the Commissioner and the Tribunal that the deductions sought related to input tax that was incurred on taxable supplies made to or on importation made by it at the end of the respective tax

periods, that it is a registered person and thus is able to make the said deductions on taxable supplies made by it and that the deductions related to a period within six months or twelve months after the end of the tax period in which the supply or importation occurred or after the input tax became due and payable depending on the applicable period. This could not be done by availing a VAT schedule account as the Appellant did. A schedule of payments is not sufficient proof of expenses or purchases. In Commissioner Investigations and Enforcement v Kidero (Income Tax Appeal E028 of 2020) [2022] KEHC 52 (KLR) (Commercial and Tax) (4 February 2022) (Judgment), the court held that expenses ought to be ascertained, verified and/or confirmed by the Commissioner through the presentation of primary documents. A schedule or tabulation of the VAT input claimable is insufficient evidence.

26. Without the primary evidence, which the Appellant is required to keep, neither the Commission nor the Tribunal would have been able to compute the time and see whether the timelines within which the claim ought to be lodged were complied with. The Tribunal was therefore right to conclude that the Appellant had failed to prove that it lodged its input claim on time and that the input VAT for the years 2013-2014 was statutory time barred both the VAT Act (Repealed) and the VAT Act 2013.

27. As to whether the filing of VAT returns is a prerequisite for deducting input VAT, I have already found as the court has before in Highlands Mineral Water Limited (Supra) and Rabai Operation and Maintenance Limited (Supra) that input VAT is still allowable irrespective of whether a return has been filed or has been filed late. What is important is that the supply or importation was within the prescribed period, it related to a taxable supply and that it was a supply or importation made by a registered person. The fact that one has not filed a return does not necessarily mean that its input deduction cannot be disallowed as long as it has fulfilled the aforementioned requirements. In any case, I can only state that the proper way of claiming input tax is by filing the appropriate return and that a tax payer who does not file this return runs the risk of the resultant penalty for non-filing and after the expiry of the allowable statutory period cannot claim input VAT therein.

28. On the penalties and interest imposed by the Commissioner, the Appellant conceded that it had not filed returns. Therefore, the applicable penalty was that provided for by section 83(1)(c) of the TPA which provides for a late submission penalty of "five per cent of the amount of tax payable under the return or ten thousand shillings, whichever is the higher, if it is in relation to value added tax or excise duty". The Tribunal did not err by holding that the penalty payable by the Appellant was the higher of 5% of the tax payable or Kshs. 10,000.00. However, from the judgment the Commissioner accepted that the Appellant pay the Kshs. 10,000.00.

Disposition

29. It is clear that the Appeal lacks merit. It is dismissed.

DATED AND DELIVERED AT NAIROBI THIS 16TH DAY OF JUNE 2023.

D. S. MAJANJA

JUDGE

Court Assistant: Mr Michael Onyango.

Ms Macharia, Mr Muhindi and Mr Obegi instructed by Anjarwalla and Khanna LLP Advocates for the Appellant

Ms Kithinji instructed by Kenya Revenue Authority for the Respondent.