Commissioner Investigations And Enforcement v Sangyug Enterprises(K) Limited (Income Tax Appeal E056 of 2020) [2022] KEHC 59 (KLR) (Commercial and Tax) (4 February 2022) (Judgment)

Neutral citation: [2022] KEHC 59 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E056 OF 2020

DAS MAJANJA, J

FEBRUARY 4, 2022

BETWEEN

COMMISSIONER INVESTIGATIONS AND ENFORCEMENT ..... APPELLANT

AND

SANGYUG ENTERPRISES(K) LIMITED ..... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 31st March 2020 in Tax Appeal No. 351 of 2018)

JUDGMENT

1. Introduction and Background

The facts giving rise to this appeal are largely common ground and can be gleaned from the record. The Respondent, a limited liability company, carries on the business of selling and supplying of various types of consumer products. The Commissioner, acting on its mandate of collecting and receiving revenue for and on behalf of the Government of Kenya carried out investigations on the Respondent's VAT returns for the period 2014-2017. It communicated its findings through its letter dated 17th April 2018 where it stated that a number of the listed suppliers where the Respondent claimed local purchases from only existed on paper as they do not buy or sell any goods neither do they have offices. Further, that the said businesses only print and sell invoices with ETR receipts to various companies at a commission to reduce their tax liabilities. The Commissioner thus disallowed the Input VAT claimed by the Respondent and required it to provide the Commissioner with justifiable grounds why the input VAT and costs claimed should be allowed, failure to which, the Commissioner would issue assessments and taxes demanded forthwith.

2. In response, the Respondent, through its letter dated 23rd April 2018 requested for more time to gather the required documents and records and further sought a meeting with the Commissioner. The Commissioner responded to this letter through its letter dated 4th May 2018 where it reiterated the contents of its previous letter and declined to grant the Respondent more time to provide the supporting documents stating that the issues had been raised with the Respondent since 30th November 2017 and thus the Respondent had more than five months to address the same. However, the Commissioner agreed to a meeting at its offices and informed the Respondent that failure to avail itself for the meeting will result in the Commissioner issuing assessments and commence prosecution for tax fraud.

3. Whether this meeting took place or not is unclear but what is clear is that between 6th July 2018 and 9th July 2018 the Commissioner issued the Respondent with various assessments claiming outstanding VAT. The Respondent objected to these assessments through its letter dated 2nd August 2018. The Commissioner, in its reply dated 24th August 2018 stated that the said objection was not validly lodged as provided by section 51(3) of the *Tax Procedures Act*, 2015 ("the TPA"). The Respondent then wrote to the Commissioner on 28th August 2018 reiterating the contents of its previous letter and expressed willingness to provide further supporting documents. The Commissioner responded through its letter dated 6th September 2018 and rescinded its earlier decision rejecting the Respondent's objection dated 2nd August 2018 and further asked the Respondent to provide it with documents including; stock records, bank statements, general ledger, delivery notes and any other relevant records for the years 2014 to 2017.

4. In response, the Respondent, through its letter dated 13th September 2018 sought more time to collate the documents requested. On 19th September 2018, the Respondent communicated that it had forwarded the invoices, bank statements and general ledger and that they were still endeavoring to put together stock records for the relevant period.

5. The Commissioner, in its letter dated 28th September 2018 made its objection decision ("the Objection Decision") in respect of the Respondent's objection dated 2nd August 2018 by confirming its earlier assessments and demanding tax of KES 39,984,253.00 and KES 74,970,475.00 in respect of VAT and Corporation Tax respectively. In summary, the Commissioner found that purchases from 12 companies totalling KES. 249,901,583.00 were not fully supported. This is what precipitated the Respondent filing an appeal at the Tribunal which after hearing the parties' arguments allowed the appeal and set aside the Objection Decision. It is this decision by the Tribunal that forms the subject of the instant appeal.

6. In its decision, the Tribunal framed a single issue for resolution; Whether the Respondent is entitled to deduction of input VAT as claimed under section 17(1) of the *VAT Act*, 2013. The Tribunal took the view that the right to deduct input tax is an integral part of the Value-added tax system which may not be limited hence the Commissioner's actions were void in so far as they sought to limit the taxpayer's rightful deduction more so on the basis that there were previous fraudulent activities by another trader. It added that the Commissioner could not impose the burden on of finding fraudulent traders on to a taxpayer. The Tribunal also held that the Taxpayer did not have a duty to conduct due diligence on every person they trade with as this would have the effect of paralysing commerce. In its view, the Taxpayer discharged its burden once it provided proper documentation to support a sale and supply including original tax invoices, customs receipts, local purchase orders, delivery notes and credit notes. Ultimately, the Tribunal concluded that the burden of proof, which essentially rests on the taxpayer, shifted to the Commissioner at the point VAT fraud was raised.

7. The Commissioner now appeals against the Tribunal decision based on the grounds set out in its Memorandum of Appeal dated 21st May 2020. It has also filed written submissions. The Respondent opposes the appeal and has filed its Statement of Facts dated 23rd June 2020 together with its written submissions. The Commissioner framed two issues for determination: First, whether the Tribunal erred in shifting the burden of proof to the Appellant and second, whether the Tribunal ignored relevant tax provisions in arriving at its finding on documentation.

Analysis and Determination

8. As this is a tax appeal, the it is important to recall that the jurisdiction of this court in determining this appeal is circumscribed by 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 of Appeal in *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others [2018] eKLR* summarised what amounts to "matters of law" as follows:

> (38) [T]he 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.

9. From the issues framed by the Commissioner, it is clear that the dispute between the parties revolves around the authenticity and veracity of the purchases made by the Respondent from a number of listed suppliers to enable it claim input VAT. According to the Commissioner, its investigations revealed that these suppliers only existed on paper as they do not buy or sell any goods neither do they have offices. Further, these businesses only print and sell invoices with ETR receipts to various companies at a commission to reduce their tax liabilities.

10. The Respondent concurs with the Tribunal's findings and submits that it complied with all requirements of the VAT Act and provided the Commissioner with all required information in support of its claim and the Commissioner did not specifically plead fraud in its pleadings and did not dispense off the legal burden of proof that the Respondent was involved in a fraudulent evasion scheme.

11. The relevant tax provisions applicable to this dispute are common ground, so is the principle of interpretation of tax statutes that the same must be interpreted strictly, leaving no room for intendment or implication (see *Mount Kenya Bottlers and 3 Others v Attorney General and 3 Others NRB CA Civil Appeal No. 164 of 2013 [2019] eKLR*). I will reproduce a few of those relevant tax provisions below for ease of reference. These provisions are sections 17 (1), (2), (3) and (5) of the VAT Act, 2013 and they 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.

(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. .....

c. .....

d. .....

(4) .....

(5) Where the amount of input tax that may be deducted by a registered person under subsection (1) in respect of a tax period exceeds the amount of output tax due for the period, the amount of the excess shall be carried forward as input tax deductible in the next tax period:

Provided that any such excess shall be paid to the registered person by the Commissioner where —

a. such excess arises from making zero rated supplies; or

b. such excess arises from tax withheld by appointed tax withholding agents; and

c. such excess arising out of tax withheld by appointed tax withholding agents may be applied against any tax payable under this Act or any other written law, or is due for refund pursuant to section 47(4) of the *Tax Procedures Act*, 2015; and

d. the registered person lodges the claim for the refund of the excess tax within twenty-four months from the date the tax becomes due and payable.

Provided further that, notwithstanding section 17(5)(d), a registered person who, within a period of thirty-six months prior to the commencement of section 17(5)(b) and (c), has a credit arising from withholding tax, may make an application for a refund of the excess tax within twelve months from the commencement date. [Emphasis mine]

12. Section 43 of the VAT Act 2013 provides for the requirement that a tax payer is to maintain records as follows:

43. Keeping of records

(1) A person shall, for the purposes of this Act, keep in the course of his business, a full and true written record, whether in electronic form or otherwise, in English or Kiswahili of every transaction he makes and the record shall be kept in Kenya for a period of five years from the date of the last entry made therein.

(2) The records to be kept under subsection (1) shall include—

(a) copies of all tax invoices and simplified tax invoices issued in serial number order;

(b) copies of all credit and debit notes issued, in chronological order;

(c) purchase invoices, copies of customs entries, receipts for the payment of customs duty or tax, and credit and debit notes received, to be filed chronologically either by date of receipt or under each supplier's name;

(d) details of the amounts of tax charged on each supply made or received and in relation to all services to which section 10 applies, sufficient written evidence to identify the supplier and the recipient, and to show the nature and quantity of services supplied, the time of supply, the place of supply, the consideration for the supply, and the extent to which the supply has been used by the recipient for a particular purpose;

(e) tax account showing the totals of the output tax and the input tax in each period and a net total of the tax payable or the excess tax carried forward, as the case may be, at the end of each period;

(f) copies of stock records kept periodically as the Commissioner may determine;

(g) details of each supply of goods and services from the business premises, unless such details are available at the time of supply on invoices issued at, or before, that time; and

(h) such other accounts or records as may be specified, in writing, by the Commissioner.

(3) Every person required under subsection (1) to keep records shall, at all reasonable times, avail the records to an authorised officer for inspection and shall give the officer every facility necessary to inspect the records.

(4) For the purposes of this section, the Commissioner may, in accordance with the regulations, require any person to use an electronic tax register, of such type and description as may be prescribed, for the purpose of accessing information regarding any matter or transaction which may affect the tax liability of the person.

(5) A person who contravenes any of the provisions of this section commits an offence.

13. Section 17 provides the statutory basis to deduct and claim input VAT. A registered tax payer is entitled to deduct input VAT on taxable purchases but that the same can only be allowed if the taxpayer holds

such documentation which documentation includes "an original tax invoice issued for the supply or a certified copy". Apart from the documentation required, section 43 provides that a taxpayer is to keep and maintain specific records for a period of five years from the date of the last entry and that those records shall at all times be available for inspection by the Commissioner.

14. Section 59 (1) of the TPA also provides that a tax payer shall produce records when required to do so by the Commissioner as follows:

> 59. Production of records
>
> (1) For the purposes of obtaining full information in respect of the tax liability of any person or class of persons, or for any other purposes relating to a tax law, the Commissioner or an authorised officer may require any person, by notice in writing, to—
>
> (a) produce for examination, at such time and place as may be specified in the notice, any documents (including in electronic format) that are in the person's custody or under the person's control relating to the tax liability of any person;
>
> (b) furnish information relating to the tax liability of any person in the manner and by the time as specified in the notice; or
>
> (c) attend, at the time and place specified in the notice, for the purpose of giving evidence in respect of any matter or transaction appearing to be relevant to the tax liability of any person. [Emphasis mine]

15. In addition, section 30 of the *Tax Appeals Tribunal Act* provides that in a proceeding before the Tribunal, the appellant has the burden of proving that where an appeal relates to an assessment, that the assessment is excessive or in any other case, the tax decision should not have been made or should have been made differently while section 56 of the TPA states that in any tax appeals, the tax payer bears the burden of proving that the tax decision is incorrect. All these tax law provisions I have cited should not be read in isolation but together (see *Okiya Omtatah Okoiti v Attorney General & another NRB HC Petition No. 156 of 2017 [2020] eKLR*).

16. Under section 56 of the TPA, it was incumbent upon the Respondent to prove that the Commissioner's investigative findings were wrong. That is to say, it was upon the Respondent to prove that the said suppliers not only exist on paper but that they also buy or sell goods and have offices and that they don't print and sell invoices with ETR receipts to various companies at a commission to reduce the said companies' tax liabilities, including that of the Respondent. The question is, did the Respondent prove the Commissioner wrong? According to the Tribunal, the Respondent discharged this burden as evidenced by the sales and purchases documentation supplied to the Commissioner during the audit process and that based on them, the Respondent had dispensed with its duty in law for deduction in respect of input tax.

17. Before considering whether the Tribunal reached the correct conclusion, it is important to reiterate the salient facts on record. In the letter dated 6th September 2018, the Commissioner specifically requested for the stock records, bank statements, general ledger, delivery notes and any other relevant documents. In the last correspondence which is the letter dated 13th September 2018, the Respondent requested for a 7-day extension on the ground that it was collating those documents. On 19th September 2018,

it provided the bank statements and general ledger and hard copies of invoices. It stated that it was seeking time to put together the stock records.

18. In light of the above facts, I am constrained to the disagree with the Tribunal for several reasons. First, the fact that the Respondent provided the Commissioner with sales and purchase documents, though prima facie proof, is not conclusive once the authenticity and validity of those documents are impugned or challenged by the Commissioner as in this case. If presentation of sales and purchase receipts was all that was necessary to prove a purchase or sale without any verification from the Commissioner, one can only imagine the flooding of fake and bogus documents in the markets in a bid to evade tax and cheat the tax system. The burden shifts back to Respondent as the taxpayer to disprove the Commissioner and prove that the said documents are genuine and that actual goods were purchased from entities who actually existed and operated actual offices. While the general rule or requirement under the sections 107 and 108 of the *Evidence Act* (Chapter 80 of the Laws of Kenya) is he who asserts must prove, it must also be remembered that a person has the burden of proving facts that are peculiarly within its knowledge as provided by section 112 of the *Evidence Act* which states 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."

19. Second, the burden always and ultimately rests on the taxpayer to prove that the Commissioner's decision is wrong even in cases where the Commissioner pleads and alleges fraud on the taxpayer's part. As I understand, all the Commissioner was saying in its decisions is that the Respondent has not made any purchases from the 9 companies set out in the Objection Decision by showing that it made direct purchases. In the absence of the documents showing proof of purchase, the Commissioner was entitled to reject the claim for input VAT.

20. Third, from the correspondences between the parties, more so the last letter by the Respondent dated 19th September 2018, it was yet to provide all the documents sought by the Commissioner in its earlier correspondence. The Respondent did not contest complain that the request contained in the letter dated 6th September 2018 was unreasonable. Although it provided bank statements and ledgers and invoices, the Respondent did not provide stock records and delivery notes as requested. The conclusion that the Respondent provided all the documents to the satisfaction of the Commissioner is therefore not supported by the evidence on record. The Respondent never intimated that it was not in position to provide those documents requested or that the said documents so requested were unreasonable in the circumstances.

21. In this case, the Objection Decision contained in the letter dated 28th September 2018 could not have been clearer. The Commissioner stated, "After reviewing the records provided by the taxpayer, we have observed that the taxpayer failed to provide evidence confirming direct purchases between the company and the traders whose invoices were disallowed" and that, "The purchases totaling Kshs. 249,901,583 are still disallowed considering that you are not able to support them fully as required by section 17 and 42 of the VAT Act, 2013." The Respondent was unable to surmount the conclusion reached by the Commissioner by furnishing the documentation.

22. Before I conclude this judgment let me touch on the case of *Optigen Limited and Others v Commissioners of Customs and Excise [2006] EUECJ*, a decision of the European Court of Justice which the Tribunal discussed in the context of the ''missing trader''. The missing trader is a VAT taxable person who, with fraudulent intent acquired goods or services without payment of VAT and supplies goods and services with VAT but does not remit the VAT. In summary, European Court of Justice determined the extent to which an innocent trader can be deprived of VAT refund on the basis that transactions in question were not genuine. In light of the Optigen Case (Supra), the Tribunal explained that the Commissioner was faced with a scenario where the named companies failed to file periodic

returns and remit VAT earned from the Respondent hence it took the position that Commissioner wants to visit the effects of the named companies illegal gain and disappearance on the Respondent who was exercising its right to seek input tax.

23. The issue in this case was whether the taxpayer made direct purchases from the named companies. Under our law, and it has not been disputed, the Commissioner is empowered to make inquiries and investigation by requesting for information and documents. As I have found, the Respondent failed to provide all the documents which the Commissioner requested to prove that it purchased or received goods from the named companies it purported to make the purchases from. In the absence of this evidence, the Commissioner was entitled to conclude that the claim for input VAT was fictitious or fraudulent. Put another it another way, without the documents, the Commissioner could not conclude that the Respondent was an innocent trader. If the Respondent provided the necessary information and documents, it was open to the Commissioner to conclude that Respondent was innocent and was entitled to claim input VAT.

Conclusion and Disposition

24. In conclusion, I find and hold that the Respondent failed to discharge its burden of proof as a tax payer as it did not demonstrate how the Commissioner's findings were wrong. Further, the Tribunal erred in its interpretation and application of sections 56 and 59 of the *Tax Procedures Act* and section 30 of the *Tax Appeals Tribunal Act* and arrived at the wrong conclusion in this matter.

25. Consequently, I allow the appeal and set aside the judgment of the Tribunal dated 31st March 2020 and uphold the Commissioner's Objection Decision dated 28th September 2018.

DATED AND DELIVERED AT NAIROBI THIS 4TH DAY OF FEBRUARY 2022.

D. S. MAJANJA

JUDGE

Ms Mwongera, Advocate instructed by Kenya Revenue Authority for the Appellant.

Mr Thiongo instructed by Thiongo and Partners Advocates for the Respondent.