REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

INCOME TAX APPEAL NO.E 088 OF 2020

COMMISSIONER OF DOMESTIC SERVICES ……..…APPELLANT

-VERSUS-

GALAXY TOOLS LIMITED …….……...…….. RESPONDENT

(Being an appeal from the judgement of the Tax Appeals Tribunal dated 15/8/2020 in Tax Appeals Tribunal Appeal Number 183 of 2018)

J U D G M E N T

1. 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.

2. 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.

3. 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.

4. Some of these provisions are ***section 30 of the Tax Appeals Tribunal*** and ***section 56 of the Tax Procedures Act.*** These impose the burden of proof on the tax payer to prove that an assessment is excessive or a tax decision is incorrect. ***Section 59 of the Tax Procedures Act*** and ***section 43 of the VAT Act, 2013*** on keeping and production of documents when required by the tax authorities.

5. The foregoing provisions, amongst others, cannot be read in isolation. They have to be read in conjunction with others. In **Okiya Omtatah Okoiti v. Attorney General & Another [2020] Eklr,** the court held: -

> ***"Once again I observe that a section or sections of a law should not be read in isolation of the other provisions of that law. The impugned provisions are only meant to enforce the tax laws after a tax payer fails to self-assess for tax purposes or once it is evident that a tax payer is dishonest. The Act as a whole has safeguards that ensures that the taxpayers receive fair administrative action from the tax collector whenever the need arises to put a particular taxpayer through the administrative process".***

6. Vide his letter dated 18/7/2018, the appellant issued his objection decision against the respondent confirming the assessment of Kshs.1,698,702.00 for VAT and Kshs.3,210,651.00 for Corporation Tax. The respondent appealed against the objection to the Tax Appeals Tribunal.

7. In its judgment of 14/8/2020, the Tribunal allowed the appeal and overturned the said objection decision.

8. Being dissatisfied with that judgment, the appellant appealed to this Court setting out 7 grounds of appeal which can be summarized as follows: -

> **a) That the Tribunal erred in failing to appreciate the provisions of *section 59 of the Tax Procedures Act* and *section 43 of the VAT* act as to the production of additional information and documents.**

b) That the Tribunal erred in shifting the burden of proof to the appellant contrary to *section 30 of the Tax Appeals Tribunal*.

c) That the Tribunal erred in failing to appreciate that in this case, there was VAT lost and distinguish the present case where there was no supply of commodity, economic activity or commercial transaction with the case of Metcash Trading Ltd vs. Commissioner for the South African Revenue Service where there was actual trade in goods.

9. The respondent opposed the appeal vide its statement of facts dated 12/10/2020. It contended that it had provided sufficient proof of purchases from its suppliers by providing invoices and proof of payments to the supplies. That the appellant had not proved that the respondent was a bene?ciary of a fraudulent scheme. That its right to claim VAT refund was not in any way affected by fraud unless the respondent was aware of it

10. The respondent further contended that it was upon the appellant to establish that not only was there fraud, but that the respondent knew or ought to have known that the transaction of which it was part of, was fraudulent. That the appellant was seeking to penalize the respondent for non-compliance of its suppliers without a basis in law yet the PIN registration system is housed by the appellant.

11. The Court has carefully considered the record and the submissions of the parties on record as well as the impugned judgment.

12. The first and second ground are related and will be determined together. They were to the effect that the Tribunal erred in failing to appreciate the provisions of ***sections 59 of the Tax Procedures Act and section 43 of the VAT act*** as to the production of additional information and documents and the burden of proof.

13. The respondent's case was that; it had complied with the provisions of ***section 17 of the VAT Act.*** It had supplied the appellant with invoices, delivery notes and payment schedules for the supplies. The appellant on the other hand contended that, due to the investigations it had carried out, it had established that there were 10 suppliers from whom the respondent had allegedly made purchases from who, either they were not trading in the alleged goods or were not trading at all. That due to questionable dealings by those entities, the appellant suspended their PIN but none came forward to either complain or seek reinstatement thereof. These missing traders were but a fraud.

14. The appellant further contended that he had established that the said entities had no physical address from where they either traded or stored the huge materials allegedly purchased by the respondent. He further queried the delivery notes as they were incomplete and required further explanations. That it is for that reason that he had requested for further information and documents outside those set out in ***section 17 of the VAT Act*** to verify or satisfy himself on the tax the subject of the dispute.

15. The dispute herein relates to the credits for VAT input which the respondent had claimed. ***Section 17 of the VAT Act*** provides for credit for input tax. ***Sub-section (3)*** thereof provides for the documentation that is required for purposes of the credit on input tax. It provides: -

"(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) a credit note in the case of input tax deducted under section 16(2); or

e) a credit note in the case of input tax deducted under section 16(5)".

16. In paragraph 77 of the judgment, the Tribunal made a finding that the respondent had furnished documentation detailing the transactions as provided for under ***section 17 of the VAT Act***. That the respondent had provided bank records, delivery notes and payment records therefore establishing a prima facie case that it had purchased the said goods.

17. The appellant had contended before the Tribunal that it had carried out investigations on the suspect suppliers and found out that; they were curiously supplying to the respondent only (that the respondent was their only client), their PIN's were registered at the same time, they did not have a place of business nor were they registered to trade or import the goods they were allegedly supplying the respondent, they did not have any physical address and above all, all the payments were suspiciously made in cash.

18. Further, the appellant questioned the authenticity of the documents relied on by the respondent by querying what invoices related to what products, delivery notes did not specify the drivers who made the deliveries, the vehicles used for delivery and even the destination or place of delivery. It is for that reason that the appellant asked for additional information from the respondent to justify the alleged transactions but none was availed.

19. The appellant contended that having concluded that the alleged suppliers were none existent, it required the respondent to support the alleged transactions with additional information to show that there were actual commercial transactions that were undertaken.

20. The answer to the foregoing by the Tribunal is to be found in paragraph 78 of the judgment. The Tribunal, while appreciating that the list of documents set out in ***section 17 of the VAT Act*** was not exhaustive, noted thus: -

> ***"While this list is not exhaustive on the documents that must be furnished as proof of the purchase, the Tribunal was of the view that the Respondent should have furnished information to prove that the invoices submitted by the Appellant to support its claim was fictitious. The Tribunal was therefore of the view that the Appellant furnished sufficient proof of purchase".***

21. 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 tax payer 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.

24. The details that were disclosed to the Tribunal regarding what the appellant had unearthed was sufficient to ask the respondent to support its contention. However, it would seem that the Tribunal was already biased against the appellant as it had concluded in paragraph 76 of its judgment that the appellant cannot ask for documents that are not required under legislation. That in requesting for the additional information, the appellant was acting outside his powers. That was an error that led the Tribunal to arrive at a wrong decision.

25. The Court makes these findings aware that the alleged investigation report was not produced in evidence. The Court is alive to the fact that, such investigations and the resultant reports are ordinarily confidential, they may relate to other entities and that if they are produced, they may be highly prejudicial not only to the tax authorities' future investigations but also the entities named therein who may not be participating in the subject proceedings.

26. What is of importance was that, the gist of what concerned the respondent was communicated to it and was availed to the Tribunal by way of the Statement of Facts. In such circumstances, it is the opinion of this Court that what is required is for the appellant to give full and sufficient details of the investigation and the outcomes as concerns the particular tax payer sufficient for the tax payer to respond to the allegations. That was done in this case.

27. It would suffice if the appellant should put such information by way of affidavit by the concerned investigator to the extent that the same may be part of the evidence to be submitted to the Tribunal.

28. In this regard, the Court finds that, the Tribunal did not appreciate the purport, letter and spirit of ***section 59 of the Tax Appeals Tribunal and section 43 of the VAT Act*** as to additional information and documents required to support commercial transactions for tax purposes. The Tribunal further failed to appreciate the burden of proof set out in ***section 30 of the Tax Appeals Tribunal Act.*** In effect, the Tribunal shifted the burden of proof to the appellant which was contrary to law.

29. The other ground was that the Tribunal erred in not appreciating that in the present case, there was loss of VAT. The South African case of **Metcash Trading Limited -vs- Commissioner for the South African Revenue Service and Another Case CCT 3/2000** emphasized the basis of the burden of proof upon the tax payer. The court held: -

> ***"But the burden of proving the Commissioner wrong then rests on the vendor under section 37. Because VAT is inherently a system of self-assessment based on a vendor 's own records, it is obvious that the incidence of this onus can have a decisive effect on the outcome of an objection or appeal. Unlike income tax, where assessments can elicit genuine differences of opinion about accounting practice, legal interpretations or the like, in the case of a VAT assessment there must invariably have been an adverse credibility finding by the Commissioner and by like token such a finding would usually have entailed a rejection of the truth of the vendor's records, returns and averments relating thereto. Consequently, the discharge of the onus is a most formidable hurdle facing a VAT vendor who is aggrieved by an assessment unless the Commissioner's precipitating credibility finding can be shown to be wrong, the consequential assessment must stand."***

30. I reiterate the foregoing here in toto. The appellant had demonstrated that there was loss of VAT in the subject transactions. There having been no supply of any goods, the respondent cannot be said to have been innocent in the transactions. As a reasonable businessman, it was expected of it to keep all the transactional details of the subject transactions. It is only then it would have satisfied the appellant and the Court that it was innocent in the fraud perpetrated by the missing traders whom the appellant had concluded were in the business of selling air and invoices to colluding traders.

31. Accordingly, the Court finds that the appeal is meritorious and allows the same as prayed.

It is so decreed.

DATED and **DELIVERED at Nairobi this 5th day of July, 2021.**

A. MABEYA, FCI Arb

JUDGE