Commissioner of Domestic Taxes v Metoxide Limited (Income Tax Appeal E100 of 2020) [2021] KEHC 3 (KLR) (Commercial and Tax) (2 September 2021) (Judgment)

Neutral citation: [2021] KEHC 3 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E100 OF 2020

A MABEYA, J

SEPTEMBER 2, 2021

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

METOXIDE LIMITED ..... RESPONDENT

(An appeal against the Judgment of the Tax Appeals Tribunal delivered on 6/8/2020 in Tax Appeal No.162 of 2020)

Whether it was mandatory for a tax payer to prove a taxable supply or importation in order to be entitled to a refund on input Value Added Tax.

Reported by Eunice Chelimo

Statutes *– interpretation of statutes – Value Added Tax Act – interpretation of section 17(1) of the Value Added Tax on credit for input tax against output tax – what amounted to taxable supply or importation for which a taxpayer could base its claim for input tax refunds – whether it was mandatory for a taxpayer to prove a taxable supply or importation in order to be entitled to a refund on input VAT – Value Added Tax Act, section 17(1).*

Evidence Law *– burden of proof – burden of proof on proceedings relating to tax objections and appeals – who bore the burden of proving that a tax decision was incorrect – shift of burden of proof – where a claim that a taxpayer was supplied with taxable goods was contested – who bore the burden of proving that the taxable goods were supplied – when would that burden shift - Tax Procedures Act, section 56(1).*

Tax Law *– systems of taxation – self-assessment system – what amounted to self-assessment of tax – the requirement for the Commissioner of Domestic Taxes to assess the taxpayer in order to ascertain whether the tax remitted was proper or not – whether it was mandatory for the taxpayer to keep transaction documents in safe custody for a period of 5 years - documents required for a taxpayer to be entitled to claim a refund – whether the Commissioner of Domestic Taxes had the discretion to ask for additional information to satisfy himself as to the self-assessment made by a taxpayer - Tax Procedures Act, section 59; Value Added Tax Act, sections 17(3) and 43.*

Brief facts

In the tax period between July and December 2014, the respondent received supplies that were subjected to VAT payments and later claimed for an input tax deduction. The appellant rejected the respondent's application for an input tax deduction on the grounds that one of the respondent's suppliers, Harsidhi Enterprises Limited (impugned entity) was involved in the illegal printing of ETR invoices. Consequently, the appellant issued an objection decision on the basis that the respondent did not receive any taxable goods from the impugned entity. Aggrieved by the objection decision, the respondent appealed against it to the Tax Appeals Tribunal (tribunal). The tribunal allowed the appeal, ordering that the respondent was entitled to claim input tax.

Aggrieved by the decision of the tribunal, the appellant lodged the instant appeal arguing, among others, that the tribunal erred in holding that the respondent had discharged its burden of proof and in holding that the impugned entity that was accused of illegal profiting and selling of ETR invoices had to first be brought before it by the appellant before the appellant's accusation against it could hold against the respondent. The appellant contended that some of the proof of delivery by the respondent was by a vehicle that could not have practically ferried the alleged supplied goods.

Issues

i. Whether it was mandatory for a trader to prove a taxable supply or importation in order to be entitled to a refund on input Value Added Tax.
ii. Who bore the burden of proving that a tax decision was incorrect and when would that burden shift?
iii. What were the documents required for a tax payer to be entitled to claim a refund?
iv. Whether the Commissioner of Domestic Taxes had the discretion to ask for additional information to satisfy himself as to the self- assessment made by a tax payer.

Relevant provisions of the Law

Value Added Tax Act, No. 35 of 2013

Section 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.*

Held

1. Section 17(1) of the (VAT Act) provided that input tax on a taxable supply to or importation made by a registered person could be deducted by the registered person from the tax payable on supplies but only to the extent that the supply or importation was acquired to make taxable supplies. The central issue in the instant case was whether there was proof of a taxable supply for which the respondent could base its claim for input tax refunds. According to section 56(1) of the Tax Procedures Act, the taxpayer had the burden of proving that a tax decision was incorrect.
2. The Kenyan system of taxation was based on self-assessment. The taxpayer did self-assessment and remitted what they considered to be the tax due to the tax authorities. In that regard, the tax laws mandated the appellant to, later on, assess the taxpayer in order to ascertain whether the tax remitted was proper or not. Ordinarily, the assessment was made years after the tax had fallen due and been paid or the economic activity or commercial transaction for which the tax arose had been undertaken. It was for that reason that the tax laws shouldered the taxpayer with the burden of disproving the correctness of the appellant's tax decision. In so doing, the law required the taxpayer to keep transaction documents in safe custody for a period of 5 years so that on assessment, the tax authorities were able to access them accordingly.

3. There was nothing untoward by those provisions as the economic activity or commercial transaction by which the tax arose was undertaken by the taxpayer, the self-assessment was by the taxpayer and the transactional documents were always in the possession and custody of the taxpayer.
4. Since the instant case dealt with an input tax deduction, it was upon the respondent to prove that it was entitled to the same contrary to the findings of the appellant.
5. Considering the wording in section 17 of the VAT Act, the important words were taxable supply to, or importation made by. In order for a trader to be entitled to a refund on input VAT, he had to prove a taxable supply or importation. The basis of the refund was not just evidence of payment of the claimed VAT, but proof that there was a taxable supply or importation for which the tax was paid and therefore input tax was claimable.
6. The court was aware of the documents required under section 17(3) of the VAT Act for one to be entitled to claim a refund. However, where the appellant was doubtful, he was entitled to ask for additional information to satisfy himself as to the self-assessment made by a taxpayer. That was under section 59 of the Tax Procedures Act and section 43 of the VAT Act. The respondent produced invoices and evidence of payment to show that it had paid the impugned entity for the materials delivered. The tribunal relied on those documents in holding that the respondent had discharged its burden under section 56 of the Tax Procedures Act.
7. Even though the respondent contended that it had production documents to show that it had consumed the raw materials supplied by the impugned entity, it did not produce any requisition orders or delivery orders corresponding with the production documents relied on. That was so because the respondent admitted that it had many suppliers of the subject raw materials and that the impugned entity was just one of the many suppliers.
8. The existence of the production records could not be proof that the materials used was the ones supplied by the impugned entity. The respondent ought to have produced evidence of the supply of the taxable goods specifically by the impugned entity. The production records could as well have been in respect of the goods from the other suppliers. It was for the respondent to prove that the impugned entity supplied it with taxable goods. That was possible for a prudent trader who kept its documentation. That was what was expected of all traders.
9. The respondent having produced the documents it did, the evidentiary burden shifted to the appellant. The appellant retorted that the impugned entity had been profiled to be selling ETR invoices and receipts and was supplying nil goods. The appellant proceeded to produce a delivery note from the respondent which glaringly cast doubt as to the alleged delivery of the raw materials in question. With that, the evidentiary burden of proof shifted to the respondent to prove that it had been supplied with taxable goods by the impugned entity. It was expected that the respondent could have provided and produced to the tribunal copies of requisition orders, delivery orders or notes, copies of stock records, details of each supply of goods in the name of the impugned entity. All those records were in the custody and possession of and special knowledge of the respondent. It chose not to produce them.
10. The appellant produced one purported delivery by the impugned entity and demonstrated to the tribunal that a vehicle purported to have made the delivery was a nissan sunny. It was common knowledge and the court took judicial notice that such a vehicle could not have made delivery of a whopping 5200kg of the subject raw material.
11. The tribunal erred in holding that the respondent had discharged its burden under section 56 of the Tax Procedures Act. The documents produced by the respondent did not prove that the impugned entity had supplied the respondent with taxable goods. That ground succeeded.
12. The profiling of entities was done by the appellant. The appellant having stated so in its statement of facts and the same not having been denied, the said fact remained uncontroverted and therefore the truth. That which was not denied or challenged was admitted. In the circumstances of the instant case, the appellant was not required to produce any further evidence of the profiling.

13. The insistence that there ought to have been proof of charging with a criminal offense or the bringing of the impugned entity before the tribunal was out of order. The issue at the tribunal was whether the respondent had been supplied with any taxable goods by the impugned entity or not. It was the respondent to prove the supply and not to shift the burden of proof to the appellant. That ground also succeeded.
14. The accusation that the tribunal failed to consider the appellant's statement of facts and submissions could not be said to be groundless. The tribunal did not analyze and juxtapose the appellant's case as contained in the statement of facts or as submitted against that of the respondent. The tribunal could have ignored the appellant's assertions probably because it considered the appellant's statement of facts to have been filed out of time and therefore not worthy to look at. That ground succeeded.

Appeal allowed.

Orders

Appeal allowed, appellant costs of the appeal and before the tribunal.

Citations

Cases

1. *Commissioner of Taxes v Galaxy Tools Ltd* Tax Appeal E086 of 2021; [2021] eKLR — Explained

Statutes

1. Kenya Revenue Authority Act (cap 469) — In general Cited
2. Tax Appeals Tribunal Act,2013 (Act No 40 of 2013) — section 15(3) 4 — Interpreted
3. Tax Procedures Act,2015 (Act No 29 of 2015)— sections 56(1) ; 59 — Interpreted
4. Value Added Tax Act,2013 (Act No 35 of 2013) — sections 5 (1) ;17(1) ;17(3);43 — Interpreted

Advocates

None mentioned

JUDGMENT

1. The appellant is appointed under the Kenya Revenue Authority Act and has the responsibility of assessment, collection, accounting and the general administration of tax revenue on behalf of the government of Kenya.

2. The respondent is a limited liability company operating in Kenya and is in the business of manufacturing zinc oxide. In its operations, the respondent works with suppliers of raw materials used in the manufacture of zinc oxide.

3. In the tax period between July and December 2014, the respondent received supplies which were subjected to VAT payments and later claimed for input tax deduction in respect of the tax period.

4. The appellant rejected the respondent's application for input tax deduction on the grounds that one of the respondent's suppliers, Harsidhi Enterprises Limited was involved in illegal printing of ETR invoices.

5. Consequently, the appellant issued an objection decision on 4/7/2018 on the basis that the respondent did not receive any taxable goods from the said Harsidhi Enterprises Limited and thereby confirmed the assessment and found that the principal VAT amount of Kshs 1,990,784/- together with the penalty and interest was payable.

6. Aggrieved by the said objection decision, the respondent appealed against it to the Tax Appeals Tribunal ("the Tribunal"). By its Judgment made on 6/8/2020, the Tribunal made a finding that the

appeal was merited, that the respondent was entitled to claim input tax allowed the appeal and ordered each party to bear own costs.

7. The appellant has now appealed to this court against the said decision. The grounds of appeal are set out in its memorandum of appeal and can be collapsed into three, thus, whether the Tribunal erred in holding that the respondent had discharged its burden of proof under section 56(1) of the *Tax Procedures Act* , whether the Tribunal erred in holding that the suspect entity that was accused of illegal profiting and selling of ETR Invoices must first be brought before it by the appellant before the appellant's accusation against it can hold against the respondent, and whether the Tribunal disregarded the appellants statement of facts and submissions.

8. On the foregoing grounds, the appellant sought that the impugned judgment be set aside and the objection decision dated 4/7/2018 be upheld.

9. The respondent filed a statement of facts dated 17/12/2020 in opposition to the appeal. The respondent contended that section 5(1) of the 2013 *VAT Act* provides that value added tax is to be charged in accordance with the provisions of the VAT Act on a taxable supply made by a registered person in Kenya; that Harsidhi Enterprises Limited was a registered person for purposes of the VAT Act and had made taxable supplies to the respondent and issued the respondent with valid tax invoices.

10. The respondent contended that section 17 of the *VAT Act* allows a registered person, such as the respondent, to deduct input VAT incurred on taxable supplies to it, from the tax payable by the registered person to the extent that the supplies were acquired by it to make taxable supplies.

11. That it utilized the raw materials supplied by Harsidhi Enterprises Limited to manufacture zinc oxide and that it subsequently charged VAT on the zinc oxide and paid for the same to the appellant. In the premises, the input VAT charged on the supplies procured from Harsidhi Enterprises Limited were fully claimable under section 17 of the *VAT Act*.

12. The respondent further contended that the input VAT charged on the supplies procured from Harsidhi Enterprises Limited were fully claimable under section 17 of the VAT Act. In the premises, the objection decision was in contravention of the said provisions of the VAT Act.

13. Each party filed respective submissions which the court has carefully considered. The first ground is whether the respondent discharged its burden of proof under section 56(1) of the Tax Procedures Act.

14. The matter before court concerns section 17(1) of the *Value Added Tax Act* which provides that: -

> " 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." (Emphasis provided.)

15. The central issue is whether there was proof of a taxable supply for which the respondent could base its claim for input tax refunds. section 56(1) of the *Tax Procedures Act* provides that, the taxpayer has the burden of proving that a tax decision is incorrect.

16. It is common knowledge that, the Kenyan system of taxation is based on self-assessment. The tax payer assesses self and remits what he/it considers to be the tax due to the tax authorities.

17. In this regard, the tax laws mandate the appellant to later on assess the tax payer in order to ascertain whether the tax remitted was proper or not. Ordinarily, the assessment is made years after the tax has fallen due and been paid or the economic activity or commercial transaction for which the tax arises has been undertaken. It is for this reason that the tax laws in this country shoulder the tax payer with the burden of disproving the correctness of the appellant's tax decision.

18. In so doing, the law requires the tax payer to keep transaction documents in safe custody for a period of 5 years so that on assessment, the tax authorities are able to access them accordingly. See sections 59 of the *Tax Procedures Act* and section 43 of the VAT Act.

19. There is nothing untoward by these provisions as; the economic activity or commercial transaction by which the tax arises is undertaken by the tax payer, the self-assessment is by the tax payer and the transactional documents are always in the possession and custody of the tax payer.

20. The present case deals with input tax deduction. In this regard, it was upon the respondent to prove that it was entitled to the same contrary to the findings of the appellant.

21. The respondent submitted that it was entitled to input tax deductions under section 17 of the VAT Act as it had utilized the raw materials supplied by Harsidhi Enterprises Limited in the production of zinc oxide. That it had subsequently charged VAT on the zinc oxide and paid/accounted for the same to the appellant. That it was therefore entitled to claim under section 17 of the *VAT Act.*

22. In support of this contention, the respondent supplied various documents as evidence including production records to authenticate that the supplies purchased from Harsidhi Enterprises Limited were used for production of zinc oxide; an "account payee only" cheque for each supply; bank account statements showing that Harsidhi Enterprises Limited credited the cheques. These documents were produced at pages 14-47 of the respondent's statement of facts.

23. On the other hand, the appellant contended and submitted that, the respondent did not discharge the burden of proof under section 56(1) of the *Tax Procedure Act*. That Harsidhi Enterprises Limited is an entity which had been profiled for printing and selling ETR invoices to traders, like the respondent, without any actual supplies and that some of the proof of delivery by the respondent was by a vehicle which could not have practically ferried the alleged supplied goods.

24. The Tribunal found in favor of the respondent in that it had discharged its burden of proof under section 56(1) of the Tax Procedures Act. At paragraph 14 of its judgment, it stated: -

    'The appellant herein has claimed input tax for the period in question and in doing so has supplied the respondent with the relevant documentation. To this end the appellant has dispensed with its burden of proof as section 56(1) of the *Tax Procedures Act* demands of it."

25. With greatest respect to the Tribunal, the beginning point is the wording in section 17 of the VAT Act. The important words are "taxable supply to, or importation made by". In order for a trader to be entitled to a refund on input VAT, he must prove 'a taxable supply or importation'. The basis of the refund is not just evidence of payment of the claimed VAT, but prove that there was 'a taxable supply or importation' for which the tax was paid and therefore input tax is claimable.

26. The court is aware of the documents required under section 17(3) of the VAT Act for one to be entitled to claim a refund. However, where the appellant is doubtful, he is entitled to ask for additional information to satisfy himself as to the self- assessment made by a tax payer. This is under sections 59 of the Tax Procedures Act and section 43 of the VAT Act.

27. In the present case, the respondent produced invoices and evidence of payment to show that it had paid Harsidhi Enterprises Limited for the materials delivered. The documents relied on were set out at pages 14 to 47 of the Statement of Facts. These are the documents the basis of which that the Tribunal held that the respondent had discharged its burden under section 56 of the *Tax Procedures Act.*

28. The respondent contended that it had production documents to show that it had consumed the raw materials that had been supplied by Harsidhi Enterprises Limited. However, the respondent did not produce any requisition orders or delivery orders corresponding with the production documents relied on. This is so because, in paragraph 5 of the Statement of Facts, the respondent admitted that it had many suppliers of the subject raw materials. That the entity known as Harsidhi Enterprises Limited was just one of the many suppliers.

29. In this regard, the existence of the production records would not be proof that the materials used was the one supplied by Harsidhi Enterprises Limited. The respondent should have produced evidence of the supply of the taxable goods specifically by the impugned entity. The production records could as well have been in respect of the goods from the other suppliers.

30. It should be recalled that the case by the appellant all through had been that, "there had been no supply of any taxable goods" by Harsidhi Enterprises Limited. That the said entity had been profiled as only selling ETR invoices for traders whereby those involved reduced their tax liability to the appellant.

31. Since the objection decision was based on this fact, it was for the respondent to prove that Harsidhi Enterprises Limited indeed supplied it with taxable goods. This is possible for a prudent trader who keeps its documentation. This is what is expected of all traders. Period!

32. In *Commissioner of Taxes v Galaxy Tools Ltd* [2021] eKLR, the Court held: -

> "With greatest respect, the Tribunal got it wrong. What the respondent had done by 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 before the Tribunal.
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> 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 this juncture that sections 59 of the Tax Procedures Act and section 43 of the VAT Act kicks in.
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> .... 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. ..."

33. I fully reiterate the foregoing here. In this case, after the respondent had produced the documents it did, the evidentiary burden shifted to the appellant. The appellant retorted that; the subject entity Harsidhi Enterprises Limited had been profiled to be selling ETR invoices and receipts and was supplying nil goods. The appellant proceeded to produce a delivery note from the respondent which glaringly cast doubt as to the alleged delivery of 5200kg of the raw material in question.

34. With that, the evidentiary burden of proof shifted to the respondent to prove that it had been supplied with taxable goods by the impugned entity. It was expected that the respondent should have provided and produced to the Tribunal copies of requisition orders, delivery orders or notes, copies of stock records, details of each supply of goods in the name of the aforesaid Harsidhi Enterprises Limited. All these records were in the custody and possession of and special knowledge of the respondent. It chose not to produce them.

35. Indeed, the appellant produced one purported delivery by the said entity and demonstrated to the Tribunal that a vehicle purported to have made the delivery was motor vehicle registration number KAT 011T which turned out to be a Nissan Sunny. It is common knowledge and the court takes judicial notice that, such a vehicle could not have made delivery of a whooping 5200kg of the subject raw material.

36. In view of the foregoing, the Tribunal erred in holding that the respondent had discharged its burden under section 56 of the Tax Procedures Act. With due respect, those documents did not prove that the impugned entity had supplied the respondent with 'taxable goods'. That ground succeeds.

37. The second ground was whether the Tribunal erred in holding that the suspect entity that was accused of illegal profiting and selling of ETR Invoices must first be brought before it by the appellant, before the appellant's accusation against it can hold against the respondent.

38. The Tribunal held that the appellant had not produced evidence that the impugned entity had been profiled as one of the entities printing and selling ETR invoices. It should be noted that the profiling is done by the appellant. The appellant having stated so in its Statement of Facts and the same not having been denied, the said fact remained uncontroverted and therefore the truth. The general rule is that, that which is not denied or challenged is admitted. In the circumstances of this case, the appellant was not required to produce any further evidence of the profiling.

39. The insistence that there should have been proof of charging with a criminal offence or the bringing of the subject entity before the Tribunal was out of order. What was before the Tribunal was, had the respondent been supplied with any taxable goods by the impugned entity or not. It was the respondent to prove the supply and not to shift the burden of proof to the appellant.

40. That ground also succeeds.

41. The last ground was that the Tribunal failed to consider the appellant's Statement of Facts and submissions. This accusation cannot be said to be groundless. In paragraph 15 of its judgment, the Tribunal stated that the allegations by the appellant were only contained in 'a four page Statement of Facts that has been filed out of the statutory timelines as per section 15(3) & 4 of the *Tax Appeals Tribunal Act*".

42. Apart from that, the Tribunal did not analyze and juxtapose the appellant's case as contained in the Statement of Facts or as submitted against that of the respondent. The Tribunal may have ignored the appellant's assertions probably because it considered the appellant's Statement of Facts to have been filed out of time and therefore not worthy to look at. That ground also succeeds.

43. Accordingly, I find the appeal to be meritorious. I allow the same as prayed. The appellant will have the costs of the appeal and before the Tribunal.

It is so decreed.

DATED AND DELIVERED AT NAIROBI THIS 2ND DAY OF SEPTEMBER, 2021.

A. MABEYA, FCI Arb

JUDGE