



**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA AT NAIROBI**

**MILIMANI COMMERCIAL & TAX DIVISION**

**TAX APPEAL NO. 7 OF 2017**

**RABAI OPERATION & MAINTENANCE LIMITED.....APPELLANT**

**VERSUS**

**THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT**

**J U D G M E N T**

1. **Rabai Operation and Maintenance Limited (ROML)** by its Memorandum of Appeal dated 3<sup>rd</sup> February 2017 has filed this appeal against Judgment of the **Tax Appeals Tribunal (the Tribunal)** dated 9<sup>th</sup> December 2016. The Respondent in this appeal is the Commissioner of Domestic Taxes (Commissioner).

2. ROML is a Limited Liability Company incorporated in Kenya whose principal activity is to operate and maintain the 90MW Rabai Power Plant owned by Rabai Power Limited.

3. ROML gets revenue from the operation and maintenance services that it provides to Rabai Power Limited. ROML also incurs costs which include payment of salaries, Legal fees, consultancy fees and other administrative costs.

4. The Commissioner is an agency of the Government of Kenya established under Section 5 of the Kenya Revenue Authority Act Cap 469 and is charged with the duty of assessing and collecting taxes on behalf of the Government.

5. ROML was issued by the Commissioner with a Value Added Tax (VAT) assessment dated 7<sup>th</sup> June 2012 of Kshs. 20,211,475. This was after the Commissioner carried out a compliance tax audit on ROML for the period 2008-2010. The Commissioner, in response to objection by ROML revised the assessment to Kshs. 17,965,918 by VAT assessment No. 0220120000402 dated 10<sup>th</sup> October 2012. ROML filed an appeal, at the Tax Tribunal on 20<sup>th</sup> December 2012 against that assessment.

6. The Tribunal by its judgment of 9<sup>th</sup> December 2016 dismissed ROML's appeal with no orders as to costs.

7. ROML has filed this appeal against that dismissal. The grounds of appeal are 21 in number.

8. Section 56(2) of the Tax Procedure Act provides:

***“An appeal to the High Court or to Court of Appeal shall be on a question of Law only.”***

9. A case in point on the provision of Section 56(2) is **HEWLETT PACKARD EAST AFRICA LTD V COMMISSIONER OF DOMESTIC TAXES (2019) eKLR** thus:

***“The fact that an appeal before Court, from the Tax Appeals Tribunal, lies on a question of law was considered in the case OCEANFREIGHT (E.A) LIMITED –VS- COMMISSIONER OF DOMESTIC TAXES [2018] eKLR where Justice F. Tuiyott stated:***

***“Whilst the jurisdiction of this Court in this Appeal is to hear and determine questions of law only, issues of facts may turn out to give rise to a question of law. In Mercy Kirito Mutegei –vs- Beatrice Nkatha Nyaga & 2 Others [2013] eKLR, the Court of Appeal said as follows:-***

***“What are the points of law raised in this appeal? an appellant Court will not ordinarily differ with the findings on a question of fact, by the trial Judge who had the advantage of hearing and seeing the witnesses. Our role is to review the evidence and determine whether the conclusions reached are in accordance with the evidence and the law. A conclusion although based on primary factual evidence that is erroneous becomes a point of law.”***

***This is a demonstration that there will be occasion when facts or evidence matter in determining a question of law.”***

10. Further Section 56(3) of the Tax Procedure Act restricts a tax payer who appeals to the Tribunal, High Court or Court of Appeal to only rely on the grounds stated in the objection to which the decision relates unless the Tribunal or court allows that person to add new grounds.

11. I can confirm that ROML more or less has relied on the same grounds, as before the Tribunal, in this appeal.

12. The crux of this appeal from which all the other issues flow is whether ROML had a statutory right to claim input VAT from output VAT as per Section 11(1) of the VAT Act.

13. It is not denied that at the time ROML began to trade and due to the Legal Notice No. 95 of 2009 taxpayers were not required to separately be issued with a VAT registration. During that time tax payers paid taxes using only one Personal Identity Number (PIN).

14. VAT is chargeable on supply of taxable goods or services made or provided in Kenya and on importation of taxable goods or services into Kenya. VAT 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 for business purpose. The tax payable is the difference between the output tax and input tax. Input tax is defined in Section 10 of the VAT Act to mean:

***“(a) tax paid to the supply to a registered person of any goods or services to be used by him for the purpose of his business: and***

***(b) tax paid by a registered person on the importation of goods or services to be used by him for the purpose of his business.”***

15. In that same Section output tax is defined as to

***“mean tax which is due on taxable supplies.”***

#### **ROML SUBMISSIONS**

16. It began by stating that it began trading in 2009. It was issued with PIN and it was required to pay taxes only using that one PIN. On the basis of that number it regularly deducted input VAT from output VAT as required by Section 11 VAT Act. ROML maintained all records including invoices supporting the output and input VAT tax.

17. At this point it will be useful to refer to the provisions of Section 11 of the VAT Act as follows:

***“11.(1) Subject to the regulations and to the other provisions of this Section, input tax or tax withheld by a tax withholding agent may, at the end of either the tax period in 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 tax period:***

***Provided that no input tax 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 is withheld, as the case may be; or***

***(b) In the case of a motor vehicle or other assets purchased under a hire purchase or a lease financing agreement, more than twelve months after the issuance of a letter of undertaking or a clearance certificate for purposes of proviso to subsection (1A)”***,

***(1A). No input tax or tax withheld shall be deducted under subsection (1) unless a registered person is in possession of –***

***(a) A tax invoice issued under Paragraph (1) of the Seventh Schedule; or”***

18. In order for a tax payer to file returns on VAT the Commissioner required that they have their profile on the Commissioners Integrated Tax Management System (ITMS).

19. ROML submitted that it was not able to file its returns because it had not been set up on ITMS System. It was not set up because the system had technical problem.

20. ROML however submitted, and the Tribunal acknowledged that it paid VAT using its PIN which was the resultant of its deduction of input VAT from output VAT every month, to the Commissioner. Those deductions were made within the 12 months’ period set out in Section 11 of the VAT Act. ROML also submitted that it had all the invoices as required under Section 11 of the VAT Act which the Commission was shown during the audit.

21. ROML faulted the Tribunal in the Tribunal's formulation of the issue for determination which implied that ROML was not registered for VAT. ROML argued that that was not an issue before the Tribunal because the Commissioner had admitted ROML was registered for VAT. ROML submitted that the Tribunal, in formulating that issue it departed from the parties' pleadings contrary to the principle of Law as discussed in the case **INDEPENDENT ELECTORAL BOUNDARIES COMMISSION & ANOTHER V STEPHEN MUTINDA MULE & 3 OTHERS [2014] eKLR** thus:

***“In fact, that parties are not allowed to depart from their pleadings is on the authorities basic as this enables parties to prepare their evidence on the issues as joined and avoid any surprises by which no opportunity is given to the other party to meet the new situation.”.....***

***As the authorities do accord with our own way of thinking, we hold them to be representative of the proper legal position that parties are bound by their pleadings which in turn limits the issues upon which a trial court may pronounce. The learned Judge, no matter how well-intentioned, went well beyond the grounds raised by the petitioners and answered by the Respondents before her and thereby determined the petition on the basis of matters not properly before her. To that extent, she committed a reversible error, and the appeal succeeds on that score.”***

22. It is on the basis of the principle expounded in that case that ROML submitted that whether or not it was registered for VAT was not before the Tribunal because it was not denied by the Commissioner.

23. ROML referring to Section 11 of the VAT Act submitted that the wording of that Section was to the effect that input tax may be deducted from output tax as long as it was not deducted after the time period set out in Section 11(1)(a) that is within 12 months; and under Section 11(1)(a) that is the tax payer was in possession of the invoices. That it is only under the provisions of Section 11(1)(a) and (1A) (a) that a tax payer would be barred from deduction VAT.

24. Contrary to submissions of the Commissioner ROML argued that there was no reference, at all, in Section 11 to the filing of returns, which ROML could not in any case file because its profile was not on ITMS.

25. ROML referring to the case **T. M. BELL V COMMISSIONER OF INCOME TAX [1960] EALR 224** submitted that tax statute should be interpreted by applying the plain and clear meaning of the working of the statute. In that case it was held:

***“...in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used...” If a person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.”***

26. The above holding was applied in the case **R. V. COMMISSIONER OF DOMESTIC TAXES EX PARTE BARCLAYS BANK OF KENYA LIMITED MISC CIVIL APPLICATION NO. 1223 OF 2007** as follows;

***“Any tax imposed on a subject is dictated by the terms of legislation and the taxing authority must satisfy itself that the transaction fits within the definition of the statute.”***

27. ROML therefore stated that Section 11 did not require it to file VAT returns in order to benefit from its provisions.

28. ROML submitted, that in any case, its late filing of VAT return was due to the Commissioner's failure to upload ROML's profile on ITMS system and that it was unlawful and in violation of ROMALS constitutional right, under Article 47 of the Constitution, to deny it the right to deduct input VAT under Section 11.

### **COMMISSIONER'S SUBMISSIONS**

29. In the Commissioner's view the fact that ROML was registered for tax purposes in August 2009 and was assigned a PIN identifier and was assigned a VAT obligation compelling it to charge VAT; that in the Commissioner's view should be distinguished from registration of VAT where ROML could claim input VAT. The Commissioner submitted that the Tribunal should not be faulted in its formulation of the issue, in the matter, because the Tribunal appreciated that the online VAT registration, under ITMS, was mandatory and could not be dispensed with in respect to the claim for input VAT. That ROML could not file VAT returns until May 2009, when it was registered in the ITMS system, and until then it was barred from claiming input VAT.

30. Although the Commissioner conceded that ROML remitted VAT to it, it however argued that a tax payer should be assigned PIN identifier together with being registered under ITMS system for it to be obligated to charge and account for VAT. The Commissioner therefore submitted that the fact ROML was able to remit VAT should not be contrived as ROML having fully complied with the registration for claiming input VAT. That it was only after registration ITMS that a tax payer could claim input VAT.

31. The Commissioner made reference to Paragraph 9(1) of the VAT Regulation which requires VAT returns be filed.

32. In the Commissioner's view Section 11 should be read together with Paragraph 7 of the seventh schedule of the VAT Act, which Paragraph required every registered person to submit to the Commissioner a return on the twentieth day of each month. It is because of this period of submission of return to the Commissioner that the Commissioner argued ROML was out of the prescribed time under Section 11(1) (a). In the Commissioner's view the deduction of input VAT was subject to filing of returns.

33. The Commissioner argued that there was not sufficient evidence, before the Tribunal, to show that ITMS system had a problem which prevented ROML to register. That accordingly there was no infringement of ROML's constitutional right under Article 47.

#### **ANALYSIS AND DETERMINATION**

34. The dispute in this matter will be resolved by the determination of whether Section 11 needs to be read together with Paragraph 7 of the Seventh Schedule and further whether a tax payer is only entitled to deduct input VAT when it is registered or its profile is under ITMS.

35. The case of **T. M. BELL V COMMISSIONER OF INCOME TAX (Supra)** clearly sets out how tax statutes should be interpreted. "*One has to look at what is clearly said*" in the statute. The reason for that is obvious. Tax statutes should not have hidden meaning. One should be able to look at the language and know what the statute provides for.

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.

41. The Commissioner, in my humble view, made very swiping remarks on the issue and the need for VAT returns for purposed of qualifying to deduct input VAT. It conceded that ROML remitted VAT tax through Real-time gross settlement (RTG) yet argued that ROML was not registered for VAT but was registered for other tax purpose. That argument goes contrary to the Commissioner's submission that when ROML began trading tax payers were being issue with one PIN for purpose of paying taxes.

42. The Commissioner's insistence that a tax payer had to be registered under ITMS for it to benefit from deduction of input VAT is not supported by Section 11 at all.

43. The Tribunal also, in that regard, fell in error in holding that ROML was not registered for VAT, yet as stated before tax payer was issued with a PIN identifier for purpose of submitting tax, which ROML had been issued with.

44. The Commissioner also erred to submit that ROML failed to submit evidence of its difficulty to registering under ITMS. The evidence in my view was there and clear. First it was in ROML tax consultant (PWC's) letter of 17<sup>th</sup> February 2012, addressed to the Commissioner and it was also in the error reports which evidence ROML's attempts to register under ITMS in the internet. Those error reports show that ROML attempted to register under the Kenya Revenue Authority integrated tax management.

45. That evidence by ROML sufficiently met the evidential threshold and the burden shifted to the Commissioner. Further the fact that ROML often requested assistance of the Commissioner's officers in Mombasa the Commissioner could have obtained information from its employees in Mombasa to either confirm what ROML stated or disprove it. The Commissioner failed to rebut that evidential burden of proof.

46. It is for the above reason that I do not uphold the Tribunal's finding that ROML did not prove it had difficulty accessing ITMS system.

**47. It is also for above reason that I find there is merit in this appeal. The appeal is allowed and the Tribunal's judgment of 9<sup>th</sup> December 2016 is hereby set aside. It is substituted with a decision that the Commissioner's decision dated 8<sup>th</sup> November 2012 is hereby annulled. ROML is awarded costs of this appeal.**

Orders accordingly.

**DATED, SIGNED and DELIVERED at NAIROBI this 4<sup>TH</sup> day of OCTOBER, 2019.**

**MARY KASANGO**

**JUDGE**

*Judgment Read and Delivered in Open Court in the presence of:*

Sophie..... **COURT ASSISTANT**

..... **FOR THE APPELLANT**

..... **FOR THE RESPONDENT**