

REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
MILIMANI LAW COURTS
COMMERCIAL AND TAX DIVISION
INCOME TAX APPEAL NO. E306 OF 2024

COMMISSIONER OF DOMESTIC TAXES
APPELLANT

-VS-

HEMINGWAYS WATAMU LIMITED
RESPONDENT

**(Being an appeal against the whole judgment delivered
at the Tax Appeals Tribunal on the 4th October 2024)**

JUDGEMENT

1. The Appellant herein, Commissioner of Domestic Taxes issued the Respondent with a notice of assessment of VAT and income tax loss adjustment on **26th June 2023** for the period 2017 and 2021. The additional VAT assessments were based on disallowed input VAT which had been double claimed and disallowed input which did not meet requirements under **Section 17** of the **VAT Act 2013** for deduction of input tax and variances between sales per income tax returns and sales per VAT returns while the income loss adjustments was based on disallowed investment deduction claims for 2018 and 2019.

2. The Respondent filed its Notice of objection on **26th July 2023**. The appellant issued its objection decision on **5th October 2023**. Being aggrieved by the decision issued by the appellant, the Respondent lodged an appeal vide a Notice of appeal dated **30th October 2023** and filed on **3rd November 2023**.
3. The Tax Appeal's Tribunal delivered its judgment on **4th October 2024**. The Tribunal allowed the appeal and the appellant's objection decision dated **5th October 2023** was set aside.
4. Being dissatisfied by the judgment, the appellant preferred an appeal before this Court by way of a Memorandum of appeal dated **20th November 2024** and amended on **5th May 2025** setting out the following grounds;
 - i. **THAT the Honourable Tribunal erred in law and in fact in setting aside the Appellant's objection decision dated 6th October 2023.**
 - ii. **THAT the Honourable Tribunal erred in law in failing to make a finding on the disallowed input which had been double claimed by the Respondent.**
 - iii. **THAT the Honourable Tribunal erred in law and in fact in holding that the Respondent qualified for investment deduction at the rate of 150%.**
 - iv. **THAT the Honourable Tribunal erred in law and in fact in holding that the Appellant erred in**

disallowing costs incurred by the Respondent in construction of the Hotel in Watamu.

- v. THAT the Honourable Tribunal erred in law and in fact in holding that the Respondent discharged its burden of proof.**
- vi. THAT the Honourable Tribunal erred in law and in fact by failing to consider the evidence tendered by the Appellant herein thereby arriving at an erroneous decision.**
- vii. THAT the Honourable Tribunal misapplied the law and facts and therefore arrived at the wrong decision.**

5. The Appellant prays that this Honourable Court;

- a) Allows the appeal herein with costs to the appellant.**
- b) The judgment of the Tax Appeals Tribunal delivered on 4th October 2024 be set aside.**
- c) Any other orders or reliefs that this Honourable Court deems just and reasonable.**

6. In response to the Memorandum of appeal, the Respondent filed a statement of facts dated **28th April 2025**. In summary the Respondent states that in the year ending **31st December 2018**, the Respondent constructed a hotel in Watamu at the cost of Kshs. 647,334,878/=. The amount was arrived at after apportioning costs related to the construction of apartments which the appellant treated

separately and did not claim an investment deduction. On **24th June 2021**, the Respondent received a letter dated **21st June 2021** from the Respondent where it intended to carry out a return review check on its records based on various issues that had been identified from its I-tax profile, tax returns and records held at the Respondent's office.

7. The Respondent states that review was conducted and a pre-assessment notice was issued vide a letter dated **20th April 2022**. The Respondent's tax agent responded to the pre-assessment notice on returns review vide their letter dated **14th May 2022** explaining and answering the appellant's questions and providing documents. On **26th June 2023**, the appellant issued a Notice of findings and assessment under Section 31 of the Tax Procedures Act. The appellant took the position that for VAT, the tax liability arising is a total sum of Kshs. 3,566,878/= . Additionally, it disallowed investment deductions for the year 2018 at Kshs. 526,684,432/= and for the year 2019 at Kshs. 5,405,769/=.
8. This appeal proceeded by way of written submissions. The Appellant's submissions are dated **5th June 2025** whereas the Respondent's submissions are dated **16th June 2025**. This court will proceed to consider the parties' submissions in its final analysis and determination.

Appellant's submissions

9. The appellant raised three issues in its submissions. the first issue is in regard to whether the Tribunal exercised its discretion wrongly by issuing a judgment that contravenes an express provision of the law. The appellant submitted that the year ending **31st December, 2018**, the Respondent constructed a hotel and apartments in Watamu. The construction costs were apportioned to the hotel and apartments based on allocation of 40%:60% respectively and the allocation criteria was based on the percentage coverage area in square metres covered by the hotel and apartments. The total cost of the hotel was Kshs. 629,357,254. Therefore, the Respondent proceeded to claim Investment Deduction of Kshs. 944,035,881 being 150% on total construction cost of the hotel.
10. During a returns review, the Appellant noted that the applicable rate was 100% and not 150% as claimed by the Respondent and therefore proceeded to disallow the over claimed amount of Kshs. 314,678,627 for the period 2018. The Appellant also noted that costs amounting to Kshs. 212,005,805 and Kshs. 5,405,769 for the period 2018 and 2019 respectively which had been claimed for Investment Deduction were not allowable hence these costs were disallowed. The Appellant submits that the 150% claim is only applicable to persons who satisfy both conditions of having a building and installing machinery therein as provided under second schedule paragraph 24 (1) (f) of the

Income Tax Act. Paragraph 24 (1) (e) of the second schedule of the Income Tax Act states as follows;

**“Subject to this Schedule, where capital expenditure is incurred—
(e) on the construction of a hotel building which is certified as an industrial building under paragraph 5(1)(c)”**

11. The appellant urged that some items were operating expenses which should have been transferred to profit and loss account. Some items claimed did not form part of the hotel building while some were not supported and were disallowed.
12. On the second issue of whether the Tribunal erred in failing to make a finding on the disallowed input VAT which had been double claimed, the appellant submitted that the Respondent had double claimed VAT inputs in their VAT declarations hence the double claimed inputs were disallowed. Additionally, the Appellant had claimed VAT inputs which did not meet requirements of section 17 of the VAT Act for claiming input VAT. These inputs were automatically disallowed while raising the assessments in iTax. The Respondents submitted that **Section 17(1)(2)(3)(a)** of the VAT Act is instructive and guides on what is required to be done to obtain the desired outcomes in matters of claim of input VAT. The appellant submitted that when the Respondent was requested to provide supporting

documents, the Respondent provided schedules of the input VAT claimed without supporting documents. The Respondent maintains custody of its documents which it ought to have provided in order to discharge its burden of proof. Reliance was placed on the cases of **Heet Enterprises vs Commissioner of Investigations and Enforcement TAT No 230 of 2018(2021) eKLR** and **Mechai International vs Commissioner of Domestic Taxes, TAT No 38 of 2021.**

13. In regards to the additional assessments being illegal, the appellant submitted that the the assessments were based on **Section 31** of the **Tax Procedures Act** which allows the Commissioner to decide based on best judgment and information available to the Respondent. **Section 31** of the **Tax Procedures Act** empowers the appellant to make alterations or additions to original assessments from available information for reporting period based on the available information and the Commissioner's best judgment. The appellant cited the case of **DIGITAL BOX LTD VS COMMISSIONER OF INVESTIGATION & ENFORCEMENT (2019) eKLR** the Respondent is allowed to use any information that is available to it and use the best of his or her judgment in making the assessment.

14. Further reliance was placed on **Section 59** of the **Tax Procedures Act** which empowers the appellant to seek any information relating to ascertaining of the correct tax liability of the Respondent. In the case of **OSHO DRAPERS**

LIMITED VERSUS COMMISSIONER OF DOMESTIC TAXES [2022] eKLR, the Court held that Section 59 of the Tax Procedures Act empowers the Commissioner to request for more and additional information to satisfy himself on the taxable income declared.

15. The appellant urged the Honourable Tribunal to find that the additional assessments were anchored in law and that the same were factually and legally justified.
16. On whether the appellant discharged its burden of proof, it was submitted that the Respondent did not adduce evidence to support its case at the Tribunal and at the objection stage. The Respondent did not discharge its burden under Section 56 (1) of the Tax Procedures Act and Section 30 of the Tax Appeals Tribunal Act. The law places the onus on the tax payer to prove their case. The Respondent has not proved that the tax decision should not have been made or should have been made differently. It was therefore incumbent upon the Respondent to prove that the tax amount imposed by the Appellant was incorrect. Reliance was placed on **Sheria Sacco Society Limited V Commissioner of Domestic Taxes [2019] eKLR** and **Kenya Commercial Bank vs. Kenya Revenue Authority High Court (Milimani Commercial Courts) Income Judgement Appeal No. 193 of 2015**.

Respondent's submissions

17. The Respondent raised several issues in support of its case. The first issue as whether this Honourable Court has jurisdiction to hear and determine matters of fact in this Appeal, the Respondent submitted that this Court can only hear matters of law. **Section 56 (2) of the Tax Procedure Act, 2015**, provides that:

(2) An appeal to the High Court or to the Court of Appeal shall be on a question of law only.”

18. The Respondent cited the Supreme Court decision in **Gatirau Peter Munya v Dickson Mwenda Kithinji & 3 others [2014] eKLR**. From the judgment this Honourable court has to re-examine the probative value of evidence tendered before the Tribunal, then such grounds will be on matters of fact, which this Court does not have jurisdiction to determine. The appellant urged this Court to limit itself only to matters of law and not fact.

19. As to whether there was any error in the Tribunals well-reasoned finding that the Respondent was entitled to investment deduction at 150%, the Respondent submitted that the Tribunal made a well-reasoned finding that the Respondent was entitled to investment deduction at 150%. As admitted by the appellant, there is no contention that the apportionment of 40%-60% was improperly reached by the Respondent. The appellant equally admits that the total construction costs came to Kshs. 629,357,254/= out of

which the Respondent claimed 150% being Kshs. 944,035,881/=. The Tribunal's judgement referred to the second schedule paragraph 24 sub-paragraph (1) (f) of the **Income Tax Act (edition, 2017)** (now repealed) (ITA). The said schedule provided as follows:

“(f) on the construction of a building or purchase and installation of machinery outside the City of Nairobi or the Municipalities of Mombasa or Kisumu whereof the value of the investment is not less than two hundred million shillings;

“there shall be deducted, in computing the gains or profits of the person incurring that expenditure for the year of income in which they were first used (hereinafter referred to as “the year of first use”), ...or the building or machinery referred to in subparagraph (f)... as the case may be, a deduction referred to as an investment deduction;”

20. According to the Respondent, the Tribunals interpretation of the said sections rightly agreed with our interpretation which is that it requires the following grounds to be satisfied:

- (a) The construction of a building or purchase and installation of machinery.
- (b) Outside the City of Nairobi, Municipality of Mombasa or Kisumu.
- (c) The value of investment is not less than Kes. 200, 000, 000/-.

21. Based on that the Respondent submitted that it established all the requirements of the second schedule paragraph 24 (1) (f) of the ITA. The above Section does not require further interpretation. The Tribunal was right in its finding that the Respondent was entitled to claim investment deduction at 150% of its investment, being the sum of Kes. 944, 035, 881/=.

22. The Respondent cited the case of **Kenya School of Law v Akomo & 41 others (Civil Appeal E472 of 2021) [2022] KECA 1132 (KLR)**: where the Court held as follows:

“49. It is our considered view that the conjunction ‘or’ in sections 1(a) and 1 to the Second Schedule of the KSL Act, should be read disjunctively...”

23. The Respondent urged that the above case is in tune with our submission and thus, having demonstrated the correct interpretation of the ITA, the Tribunal's decision on this issue was correct and the Respondent is entitled to the deduction claimed. The Respondent has demonstrated that it is entitled to an investment deduction at 150%, and the Tribunal's finding on the same was well-reasoned and valid.

24. On VAT the Tribunal factually analyzed the costs involved in construction of the hotel and rendered a decision that all costs inclusive of Vat were allowable. The

Respondent urged that VAT was infact illegal, null and void because the appellant issued their notice of findings and assessment under Section 31 of the TPA through their letter dated 26th June 2023.

25. The Respondent received a payment registration number for the payment of the VAT sum of Kes. 519, 348.00/-. Consequently, apart from the remaining balance of Kes. 833, 237/- where no PRN number and/or assessment for the month of October and December 2018 had been issued, the Respondent believed that the VAT claim was settled.

26. According to Section 50 (a) of the TPA when the taxpayer then makes an objection, the commissioner can review the information provided and then proceed to make an objection decision. It is instructive that the commissioner does not have the right nor power to come up with a fresh assessment that increases the assessment sum, which is the position espoused by section 51 (8) of the TPA.

27. Further under, Section 51 (8), once a notice of objection has been lodged, the Commissioner can only allow the objection in whole or in part, or disallow it entirely, the decision of which is referred to an objection decision. Reliance was placed on the case of in the case of

Anne Wanjiku Kahwai & another v Kenya Revenue Authority & another [2019] eKLR.

28. The Respondent submitted that VAT issue and found it right to consolidate the issues into one of, whether the costs incurred were allowed for deduction and ultimately factually found that all the costs including VAT were part of the building. Therefore, the Tribunal found that all the costs inclusive of VAT were expended and part of the capital expenditure for the building.

29. On whether the Tribunal erred in its finding on burden of proof, the Respondent submitted that the Tribunal in its judgment rightly placed the burden on the Respondent under Section 56 of the Tax Procedures Act and Section 30 of the Tax Appeals Tribunal, 2013. The Respondent discharged its burden of proof by providing the documents constituting its rebuttal to the assessment and the appellant did not aver that the documents were not authentic. The Respondent urged that the burden swung back to the appellant who did not discharge this burden.

Analysis and determination

30. Upon considering the Record of appeal, the statement of facts, the rival submissions together with the authorities relied upon, I find the following issues condensing for determination in this appeal;

- i. **Whether the Tribunal erred in holding that the Respondent qualified for investment deduction at the rate of 150%.**
- ii. **Whether the Tribunal erred in setting aside the disallowance of input VAT by the Appellant?**
- iii. **Whether the Respondent discharged its burden of proof under Section 56 of the Tax Procedures Act?**
- iv. **Whether the Tribunal erred in law and fact by failing to consider the Appellant's evidence?**

31. On the first issue of investment deduction it was urged by the appellant that the Tribunal erred by allowing deduction at 150% in respect of the hotel. According to the appellant, hotels are not entitled to 150% investment deductions. Paragraph 24 (1) (f) of the Second Schedule to the income Tax Act was intended to act an incentive for industrial buildings in special economic zones and certain manufacturing facilities.

32. Paragraph 24(1) (f) provides that;

“Subject to this schedule, where capital expenditure is incurred on the construction of a building, or purchase and installation of machinery outside the city of Nairobi or the Municipalities of Mombasa or Kisumu whereof the value of investment is not less than two hundred million shillings: there shall be deducted, in computing the gains or profits of the person incurring that

expenditure for the year of income in which they were first used (hereinafter referred to as the year of first use of the building or machinery referred in subparagraph (f)), a deduction referred to as an investment deduction.”

33. The Respondent urged that its hotel project qualified under Paragraph 24(1)(g) of the Second Schedule as a hotel building outside Nairobi and Mombasa, thereby entitled to 150% investment deduction as per the prevailing law.

34. Upon examining the Second Schedule to the Income Tax Act and note that Parliament has, in certain years, extended enhanced investment deduction (up to 150%) to specific classes of buildings, including hotels, as a policy to spur tourism and regional development. The burden rested upon the Respondent to demonstrate that the Watamu hotel fell within the prescribed class. It was a finding of the Tribunal found that the Respondent provided audited accounts, architectural approvals, and expenditure records showing that the hotel was constructed and operationalized in 2018. The Appellant did not dispute the existence of the hotel but questioned whether the statutory threshold for 150% deduction was met.

35. In my considered view, while the law provides for investment deduction for hotel buildings, the enhanced

rate of 150% is restricted to certain categories. Unless specifically provided, the general rate of 100% under Paragraph 24 applies. In this instance, I am persuaded that the Respondent was entitled to investment deduction, but not at the enhanced rate of 150%. The Tribunal therefore erred in awarding the higher rate without demonstrating the legislative basis.

36. In regards to VAT input claims, the appellant disallowed certain VAT claims on grounds of double claiming and failure to meet the conditions under **Section 17** of the **VAT Act, 2013**. Section provides as follows;

(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.**

37. It is clear that **Section 17 (2)** of the VAT Act is explicit that input tax is deductible on if supported by a valid tax invoice, the goods or services are used in making taxable supplies and the claim is made within the statutory time limit.

38. In the instant case, the appellant submitted that when the Respondent was requested to provide supporting documents, it provided schedules of the input VAT claimed without supporting documents. The Respondent on the other hand argued that the Tribunal rightfully found the Respondent was entitled to claim all the costs as capital expenditure and that they were inclusive of VAT. Further submitted that the VAT assessment was illegal, null and void. The Respondent filed an objection to the assessment and argued that the VAT assessment was inclusive of input

claims of May, 2017 and November 2017 which could not be allowed as they exceeded the 5 year period mandated by law. The Respondent maintained that it had submitted purchase invoices, schedules, and reconciliations during the objection process, which demonstrated that the inputs were properly claimed.

39. I have perused the Tribunal's judgement and noted that the issue of VAT was never determined. The Respondent agrees that the Tribunal failed to decide on the issue of VAT.

40. In the case of **Commissioner of Domestic Services vs Galaxy Tools Limited (2021)eKLR**, the Court held that;

“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.

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.

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.

41. As clearly stated in the above cited authority that our tax regime is based on self-assessment. The Respondent having played its role and the appellant proceeded to issue an assessment on VAT, the Tribunal was bound to decide on the VAT assessment. In the absence of any determination by the Tribunal on the issue, this court has no option but to remit back the issue for determination by the Tribunal.

42. On burden of proof the law is provided under **Section 30** of the Tax Appeal Tribunal Act and **Section 56(1)** of the **Tax Procedures Act**. Section 56(1) states that;

“In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.”

43. The law therefore places the burden of proof on the taxpayer to prove that a tax decision is excessive or unlawful. In the present case, the Respondent produced detailed records and reconciliations, which were evaluated by the Tribunal. The Appellant contends that the burden was not discharged.

44. **Section 107** of the **Evidence Act** provides that the burden of proof lies on the party asserting the existence of a fact. **Section 108** defines the incidence of the burden, meaning that the party who would fail if no evidence were given on either side bears the burden of proof. It is trite law 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. Under the law of taxation, this duty is placed on the tax payer.

45. In the case of **Republic vs Kenya Revenue Authority; Proto Energy Limited (Exparte) [2022] KEHC 5 (KLR) Mativo J** as he the was held thus;
“The most significant justification for placing the burden of proof on the tax payer is the practical consideration that the Commissioner cannot sustain the burden because he does not possess the needed evidence. Under the system of self-reporting tax liability, the taxpayer possesses the

evidence relevant to the determination of tax liability. It is simply fair to place the burden of persuasion on the taxpayer, given that he knows the facts relating to his liability, because the commissioner must rely on circumstantial evidence, most of it coming from the taxpayer and the taxpayer's records. The taxpayer must present a minimum amount of information necessary to support his position. This safety valve seems to place the burden of production on the taxpayer without relieving the Commissioner of the overall burden of proof. The tax payers' evidence must meet this minimum threshold.

A presumption of correctness arises from the Commissioner's determination/assessment. The presumption remains until the taxpayer produces competent and relevant evidence to support his/her position. When the taxpayer comes forward with such evidence, the presumption vanishes and the case must be decided upon the evidence presented. The question here is that the applicant cannot refuse to furnish the information requested and fault the Respondent for refusing to allow its request for amendment. The Respondent cannot allow the amendment without any basis nor is the Respondent obligated to grant the amendment. On the contrary, the law permits the Respondent to decline the request.”

46. It is my finding that the Tribunal correctly applied the law. Once the Respondent produced documentation supporting its position, the evidential burden shifted to the Appellant to demonstrate falsity, duplication, or ineligibility.

47. On the fourth issue, the record demonstrates that the Tribunal considered the evidence tendered by both parties, including the Appellant's audit findings and the Respondent's reconciliations. The Appellant has not pointed to any specific evidence that was ignored. Having read through the Tribunal's judgment I am convinced that the Tribunal considered all evidence placed before it and therefore the appellant's argument fails.

48. For the aforesaid reasons, it is a finding of this court that the appellant's appeal partially succeeds. The tribunal erred in awarding investment deduction at the rate of 150%, absent clear statutory authority for the enhanced rate in respect of the Respondent's Watamu hotel. I proceed to make the following orders;

- i. The appeal is partially allowed.**
- ii. The judgment of the Tax Appeals Tribunal delivered on 4th October 2024 is hereby set aside to the extent that it allowed investment deduction at the rate of 150% and it is substituted with a finding that the Respondent is entitled to investment deduction at the statutory rate of 100%.**

- iii. The matter is remitted back to the Tribunal to make a determination on VAT assessment.**
- iv. Each party shall bear its own costs.**

30 days stay of execution

It is so ordered.

Judgement delivered, dated and signed Virtually this 7th day of October 2025.

.....
Hon. Julius K. Ng'arng'ar
Judge

Judgement delivered in the presence of:
Siele Court Assistant
Almadi for the Appellant
Kimosop for the Respondent