

REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT MILIMANI
COMMERCIAL & TAX DIVISION
INCOME TAX APPEAL NO. E213 OF 2024

AVERY LOUNGE LIMITED **APPELLANT**
VERSUS
COMMISSIONER OF DOMESTIC TAXES **RESPONDENT**

(Being an appeal from the Judgement of the Tax Appeals Tribunal delivered at Nairobi on 28 June 2024 in Tax Appeal Tribunal Appeal No. TAT E513 of 2022)

JUDGEMENT

1. The Appellant is a limited liability company duly incorporated in Kenya and a registered taxpayer. It operates a lounge along the Eastern Bypass Road.
2. The Respondent is a principal officer appointed under section 13 of the Kenya Revenue Authority Act, Cap 469 and the Kenya Revenue Authority, mandated to collect and receive all Government revenue in accordance with the various tax statutes.
3. The Appellant invokes the appellate jurisdiction of this Court under Section 56 of the Tax Procedures Act. While the statute generally confines appeals to matters of law, it is well-settled in our jurisprudence—and indeed argued by the Appellant—that a conclusion reached by a Tribunal that is unsupported by evidence, or is perverse to the evidence, constitutes a point of law. Thus, this Court is invited to scrutinize not only the legal principles applied by the

Tribunal but also whether its factual findings regarding the sufficiency of evidence were reasonable and grounded in the record.

4. The dispute involves substantial tax liability, encompassing Corporation Tax, Value Added Tax (VAT), and Pay As You Earn (PAYE). However, the monetary value is secondary to the precedential weight of the legal principles at play. This matter deals with the phenomenon of the "nil-filer"—a registered, operational business entity that declares zero income to the revenue authority while simultaneously transacting millions through the banking system.

Brief Background

5. The Appellant, Avery Lounge Limited, was incorporated in Kenya on 4 June 2019. Its principal activity involves the operation of a lounge and restaurant business, a sector known for high volumes of cash and electronic transactions.
6. Upon incorporation, the Appellant duly registered for tax obligations, specifically Income Tax, VAT, and PAYE. Under the Kenyan self-assessment regime, the Appellant was obligated to file returns declaring its income and remitting the attendant taxes. However, the Respondent's compliance monitoring systems flagged the Appellant as a non-compliant entity. Specifically, the Appellant was profiled as a 'nil-filer' or 'non-filer', meaning it either filed returns declaring zero income or failed to file returns altogether, despite visible signs of commercial activity.
7. Triggered by this discrepancy, the Respondent exercised its investigative powers. On 26 November 2021, officers from the Kenya Revenue Authority (KRA) conducted a field visit to the Appellant's premises. This visit confirmed that the business was fully operational, serving customers, and presumably generating revenue. This finding stood in stark contrast to the nil returns lodged with the Commissioner.

8. Faced with an operational taxpayer who claimed to have no income, the Respondent invoked Section 59 of the Tax Procedures Act to obtain third-party information. The Respondent issued notices to the Appellant's bankers and suppliers to compel the production of records. The banking data obtained revealed a significant flow of funds—deposits and credits—that had not been declared for tax purposes.
9. Armed with this third-party data, and in the absence of reliable books of account from the Appellant, the Respondent proceeded to raise default assessments on 5 May 2023. These assessments covered the years 2018 through 2021. The methodology employed was the Banking Analysis or Bank Deposit Analysis method, where the gross deposits in the Appellant's accounts were treated as gross turnover, subject to taxation.
10. The Appellant, aggrieved by these assessments, lodged a Notice of Objection on 2 June 2023. In its objection, the Appellant contended that the deposits did not entirely represent taxable sales but included non-income items such as loans and Director advances. Furthermore, the Appellant argued that the Commissioner had failed to allow for deductible expenses incurred in the generation of income.
11. Crucially, during the objection processing stage, the Respondent, via an email dated 12 June 2023, requested specific documentation to substantiate the objection. The requested documents included business and personal bank statements, M-Pesa statements, general ledgers and banking analysis, audited financial statements, loan agreements and repayment schedules and invoices and evidence of payment to support expenses.
12. It is a matter of record, and a finding of fact by the Tribunal below, that the Appellant failed to provide the bulk of these documents. Specifically, the Appellant did not provide ledgers, invoices, or audited accounts. Instead, the

Appellant provided bank statements for the year 2021 and a summary of the banking analysis.

13. Consequently, on 26 July 2023, the Respondent issued an Objection Decision confirming the assessments in their entirety. The Respondent's position was that in the absence of the requested documents, the Appellant had failed to support its objection.
14. The Appellant appealed to the Tax Appeals Tribunal (Appeal No. E513 of 2022). The Tribunal, after hearing the parties, dismissed the appeal on 28 June 2024. The Tribunal's *ratio decidendi* was anchored on the burden of proof; it held that the Appellant had failed to provide sufficient documentary evidence—specifically detailed schedules and transaction references—to rebut the Commissioner's assessment.
15. Aggrieved by the decision of the Tribunal, the Appellant lodged this appeal on the following grounds:
 - (i) That the Tribunal erred and misdirected itself by holding that the Appellant had not discharged its statutory burden of proof by failing to provide explanations and documentary evidence to demonstrate that the assessment was excessive and incorrect;
 - (ii) That the Tribunal erred and misdirected itself by disregarding the overwhelming evidence adduced by the Appellant that demonstrated that the Respondent had erred in relying on third party records such as bank statements to make an assessment and assuming that all the monies had passed through the Appellant's bank account were income and sales contrary to the Tax Act and Value Added Tax Act provisions;
 - (iii) That the Tribunal erred in law and violated the Appellant's right to fair administrative action and fair hearing under Articles 48 and 50 of The Constitution by failing to consider the evidence on record and holding

that the appeal was unmerited for it to determining other issues for determination, thereby occasioning a miscarriage of justice;

- (iv) That the decision appealed against is to the extent set out herein wrong in law and unjust in effect and, therefore, ought to be set aside.

16. The appeal was canvassed by way of written submissions.

The Appellant's Submissions

17. The Appellant submits that the burden of proof in tax disputes is not a static, crushing weight that rests permanently on the taxpayer. Instead, they invoke the metaphor of a pendulum. Relying on the decision in ***Kenya Revenue Authority v Maluki Kitili Mwendwa [2021] KEHC 4148 (KLR)***, the Appellant argues that the initial burden is merely to establish a *prima facie* case. Once the taxpayer provides a plausible explanation and available records, in this case, bank statements and a summary, the pendulum swings to the Commissioner to rebut that evidence.
18. The Appellant contends that it provided sufficient material to shift this burden. They argue that the Respondent's insistence on granular documentation was unreasonable given the nature of the assessment. By providing the bank statements and pointing out that not all deposits were income, the Appellant claims it demolished the basic facts of the assessment, a standard derived from the Canadian Supreme Court case of ***Johnston v. Minister of National Revenue***.
19. On the issue of methodology, the Appellant mounts a fierce attack on the 'Best of Judgment' assessment. Citing ***Van Boeckel v. Customs & Excise Commissioners STC 290*** and ***Raghubar Mandal Harihar Mandal v. The State of Bihar AIR 1952 Pat 235***, the Appellant submits that 'best of judgment' does not mean arbitrary guesswork. It must be honest guesswork. The Appellant argues that taxing gross deposits without allowing for expenses is capricious and vindictive, and fails the test of arithmetic soundness

established in **CA McCourtie**. The Appellant posits that the Respondent ignored the totality of transactions, specifically debit entries which represent business costs.

The Respondent's Submissions

20. The Respondent anchors its defence on the statutory supremacy of Section 56(1) of the Tax Procedures Act. The Respondent submits that the presumption of correctness attaches to the Commissioner's assessment, and this presumption is only displaced by competent and relevant evidence. The Respondent argues that averments are not evidence and that providing a summary without the underlying ledgers and invoices is insufficient to discharge the burden of proof.
21. The Respondent defends the 'Bank Deposit Analysis' as a standard, internationally recognized audit tool for non-compliant taxpayers. Citing **Digital Box Limited v. Commissioner of Domestic Taxes** (TAT Appeal No. 115 of 2017) and **Bachmann v. The Queen** (2015 TCC 51), the Respondent argues that where a taxpayer is a nil-filer and fails to keep records, the bank statement is the most objective evidence of income available. The Respondent contends that the method was unbiased because it considered all credit entries, and it was the Appellant's duty to segregate non-income deposits using credible evidence.
22. On the issue of expenses, the Respondent relies on Section 15 of the Income Tax Act, which requires expenses to be wholly and exclusively incurred in the production of income. Without invoices or receipts, the Respondent argues, there is no proof that the expenses were incurred or that they related to the business. The Respondent cites **Zulma Traders Limited v. Commissioner of Investigations & Enforcement** to assert that the failure to produce documents leads to the adverse inference that they do not exist.

Analysis & Determination

23. Having considered the pleadings, the record of appeal, and the extensive submissions by both learned counsel, I identify the following three issues as central to the determination of this appeal:
- (i) Whether the Appellant discharged the burden of proof under Section 56 of the TPA;
 - (ii) Whether the Respondent's use of the "Bank Deposit Analysis" method lawful and reasonable under Section 29 of the TPA;
 - (iii) Whether the Respondent erred in disallowing expenses and input VAT in the absence of primary documents.

The Burden of Proof

24. The allocation of the burden of proof is the fulcrum upon which tax disputes turn. Section 56(1) of the Tax Procedures Act is explicit:

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

25. This statutory provision codifies the common law position that the taxpayer, being the custodian of their own business affairs, possesses the specific knowledge and documentation necessary to determine their tax liability. As held by Mativo J. (as he then was) in ***Kenya Revenue Authority v. Maluki Kitili Mwendwa eKLR***, the Revenue Authority is often an outsider looking in, reliant on third-party data or the taxpayer's own declarations. Therefore, fairness dictates that the party with the information bears the burden of persuasion.
26. The Appellant has heavily relied on the Pendulum Theory—the idea that the burden shifts back and forth. This Court accepts that the burden of proof is not a static monolith. If a taxpayer produces credible evidence, the presumption of correctness attaching to the Commissioner's assessment evaporates. At that

point, the burden shifts to the Commissioner to show why that evidence should be disregarded.

27. However, the critical inquiry in this appeal is whether the Appellant ever triggered this shift. Did the Appellant establish a *prima facie* case?
28. To answer this, this Court must examine what constitutes evidence in a tax dispute involving a default assessment. The Appellant submitted bank statements and a summary of banking analysis. A summary is merely a derivative document; it is a claim, an assertion formatted in a table. It is not primary evidence. Primary evidence in accounting consists of the source documents: the sales receipts, the invoices, the loan agreements, the ledger entries that classify each transaction at the time it occurred.
29. The Tribunal found as a matter of fact that the Appellant did not include detailed schedules or transaction references and failed to provide ledgers and invoices. The Appellant does not deny this failure but argues that the bank statements themselves should suffice.
30. This Court disagrees. A bank statement is a record of the movement of funds, not a record of the nature of funds. A credit of Ksh 500,000/= in a bank account is neutral; it could be income, it could be a loan, it could be a refund. It is the taxpayer's statutory duty under Section 23 of the Tax Procedures Act to maintain records that explain these transactions.
31. By failing to provide the primary records that would allow the Commissioner and the Tribunal to interrogate the specific nature of the deposits, the Appellant failed to rise above the level of mere assertion. As established in ***Gashi v. Commissioner of Taxation FCA 638***, a taxpayer cannot simply poke holes in the Commissioner's assessment; they must positively establish what their actual taxable income is.

32. In **Zulma Traders Limited v. Commissioner of Investigations & Enforcement** (TAT Appeal No. 234 of 2018), the Tribunal held that a failure to respond to a request for documents leads to the inference that the documents do not exist or would be adverse to the taxpayer. I find this reasoning applicable here. The Respondent requested specific documents on 12 June 2023. They were not provided.
33. Consequently, the Appellant did not establish a *prima facie* case. The pendulum remained firmly on the Appellant's side. The Tribunal was correct in law to hold that the Appellant failed to discharge the burden of proof.

The 'Best of Judgment'

34. The Appellant contends that the Respondent's assessment was arbitrary, vindictive, and failed the test of 'Best of Judgment' under Section 29 of the Tax Procedures Act (TPA). They argue that taxing gross deposits without considering the totality of transactions (including debits) is unreasonable.
35. Section 29(1) of the TPA empowers the Commissioner to make an assessment to the best of his or her judgment where a taxpayer has failed to submit a return. Section 24(2) further clarifies that the Commissioner is not bound by the taxpayer's return and may use any information available.
36. The phrase 'best of judgment' is not a license for the Commissioner to act as a tyrant. It is a power constrained by administrative law principles of rationality and fairness. The foundational test comes from **Van Boeckel v. Customs & Excise Commissioners STC 290**, where Woolf J. held:

"The commissioners will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable... As long as there is some material on which the commissioners act then they are not required to carry

out investigations which may or may not result in further material being placed before them."

37. Similarly, in the Indian Supreme Court case of **Commissioner of Sales Tax, Madhya Pradesh v. H.M. Esufali, H.M. Abdulali 90 ITR 271**, it was held that while a 'best judgment' assessment involves some degree of guesswork, it must be honest guesswork. It must have a nexus to the material available.
38. Is the "Bank Deposit Analysis" method a valid basis for a best of judgment assessment? The Tax Appeals Tribunal in **Digital Box Limited v. Commissioner of Domestic Taxes eKLR** comprehensively addressed this. The Tribunal held that banking analysis is a legitimate method for reconstructing income, particularly where books of account are missing or unreliable.
39. This position finds support in international jurisprudence. In **Bachmann v. The Queen TCC 51**, the Tax Court of Canada affirmed that bank deposit analysis is an acceptable method to compute income where the taxpayer's records are inadequate.
40. In the present appeal, the Appellant was a nil-filer yet was fully operational. This is a profound contradiction that justifies the Commissioner's scepticism of the Appellant's declarations. When a taxpayer operates outside the tax net while utilizing the banking system, the bank statement becomes the most reliable objective evidence of their financial reality.
41. The Appellant argues that the assessment was not arithmetically sound because it included non-income items like loans. This argument misunderstands the methodology. The Bank Deposit Analysis operates on a rebuttable presumption: unexplained deposits in a business account constitute business income.

42. It is not the Commissioner's duty to guess which deposit is a loan and which is a sale. That knowledge lies exclusively with the taxpayer. If the Appellant had loans, it was incumbent upon them to isolate those specific entries and produce the loan agreements and repayment schedules. The Appellant failed to do so.
43. The Appellant also relies on **CA McCourtie LON/92/191** to argue that the sampling technique was biased. However, the Respondent did not use sampling; they analysed all credit entries for the period. This is the opposite of bias; it is a comprehensive review.
44. I find that the Respondent's use of the Banking Analysis method was reasonable under the circumstances. The Respondent did not act capriciously; they acted on the only material available (Section 29 TPA) because the Appellant failed to provide better material. To hold that the Commissioner cannot tax gross deposits in such a scenario would be to incentivize the destruction of records and the filing of nil returns.

Deductibility of Expenses and Specific Tax Heads

45. The Appellant argues that by taxing gross deposits, the Respondent effectively disallowed all business expenses, which violates Section 15(1) of the Income Tax Act. Section 15(1) allows for the deduction of expenditure wholly and exclusively incurred in the production of that income.
46. The operative word is incurred. The deductibility of an expense is a question of fact, not a matter of automatic right. The burden of proving that an expense was incurred lies with the taxpayer. Section 16 of the Income Tax Act explicitly disallows expenses that are not supported by proper documentation.
47. While it is judicially noticeable that a lounge business must have operating costs, the tax law requires proof of those costs. The Appellant cannot demand that the Commissioner estimate their expenses to reduce their liability while

simultaneously refusing to produce the invoices that would quantify those expenses. The burden is on the Appellant to show that the assessment is excessive. Without invoices, the quantum of expenses is pure speculation.

48. The Appellant contends that withdrawals by directors were business expenses. The Respondent treated them as income to the directors (subject to PAYE). In tax law, the separation between a company and its directors is paramount (***Salomon v. Salomon***). Money leaving the company to a director is presumed to be remuneration or a distribution of profit (dividend) unless proved to be a genuine business expense e.g., reimbursement. The Appellant failed to provide evidence showing that these funds were used for business purposes. Consequently, the Respondent was right to treat them as emoluments subject to PAYE.
49. The Appellant claimed input VAT. Section 17 of the VAT Act, 2013, is strict: input tax can only be deducted if the taxpayer holds a valid tax invoice. The Respondent submitted that no such invoices were provided. In the VAT system, documentation is king. Without valid tax invoices, the claim for input VAT must fail.

Constitutional Rights and Fair Administrative Action

50. Finally, the Appellant invokes Article 47 of The Constitution, claiming a violation of the right to fair administrative action. This Court takes the protection of constitutional rights seriously. However, Article 47 is not a shield against statutory compliance.
51. Fair administrative action requires that a decision be lawful, reasonable, and procedurally fair. The assessment was based on Sections 24, 29, and 59 of the TPA. The Appellant was given a notice of assessment, an opportunity to object, and an opportunity to be heard before the Tribunal. The Respondent requested documents and waited for them. The Appellant was not condemned unheard; they were heard and found wanting in evidence.

52. As discussed above, assessing a nil-filer based on bank deposits is a reasonable exercise of administrative power.
53. The Tribunal's decision was detailed and addressed the issues raised. A litigant's dissatisfaction with a decision does not equate to a violation of fair administrative action. I find no breach of Article 47 or Article 50.
54. The integrity of the tax system relies on a compact: the state allows taxpayers to self-assess, and in return, taxpayers must be honest and transparent. When a taxpayer files nil returns while conducting substantial business, they breach that compact.
55. The Respondent, faced with a non-compliant taxpayer, utilized the tools provided by Parliament—third-party information and best of judgment assessment—to protect the revenue. The Appellant had ample opportunity to displace this assessment by simply producing the standard books of account: ledgers, invoices, and receipts. They failed to do so.
56. A Court cannot aid a taxpayer who, having failed to keep statutory records, seeks to rely on generalities and summaries to defeat a specific, evidence-based assessment. The Bank Deposit Analysis remains a robust and lawful tool for the Commissioner in such instances.
57. The appeal is devoid of merit. For the reasons elaborated above, the appeal is hereby dismissed, with costs to the Respondent assessed at Kshs 50,000/=

Dated and Delivered at Nairobi this 30 day of JANUARY 2026

**HELENE R. NAMISI
JUDGE OF THE HIGH COURT**

Delivered on virtual platform in the presence of:

For the Appellant: mr Mandela

For the Respondent: Ms Njoroge

Court Assistant: Lucy Mwangi

Judgement