IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: OKWENGU, MWILU & ODEK, JJ.A.)

CIVIL APPEAL NO. 251 OF 2008

BETWEEN

HIGHWAY FURNITURE MART LIMITED…….....…...…….APPELLANT

AND

COMMISSIONER OF VALUED ADDED TAX……...…...1ST RESPONDENT

REPUBLIC……..…2ND RESPONDENT

(Being an appeal from the Ruling and Order of the High Court of Kenya at Nairobi (Wendoh, J.) dated 19th October, 2006

in

H.C. Misc. Civil Case No. 1482 of 2001)

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JUDGMENT OF THE COURT

[1] Highway Furniture Mart, the appellant herein is aggrieved by the judgment of the High Court (Wendoh, J), delivered on 19th of October, 2006 dismissing its application for orders of certiorari and prohibition under ***Order 53*** of the former edition of the **Civil Procedure Rules** (now repealed). In effect, the application sought to quash a demand and/or assessment made by the Commissioner of Value Added Tax (herein the respondent), for Ksh. 19,372,167/= from the appellant, and prohibiting the respondent from attaching the appellant's assets or in any way enforcing the assessment.

[2] The appellant's motion was supported by a statutory statement and a verifying affidavit. The facts upon which the motion is anchored is that the appellant used to carry on retail hardware trade and was also a contractor but ceased these businesses in the year 1984. From this time the appellant carried out income generating activities which were not VAT designated. These were sale of coffee berries from appellant's agricultural farms to farmers; rental income from residential premises; cattle sales; and sale of old vehicles. Consequently, the appellant was not registered under the VAT Act. In September, 2001, the respondent's officers having visited the appellant's premises and left an application form for registration, the appellant wrote to the respondent informing it that it was not eligible for registration under the VAT Act.

[3] Despite the above, the respondent registered the appellant under the VAT Act, backdated the registration to 1st September 1993, and utilizing the annual returns submitted by the appellant under the Income Tax Act, and by a letter dated 5th November, 2001, demanded a sum of Kshs. 19,372,167/= as VAT due for the years 1993-1999. The appellant objected to that assessment contending that it was not eligible for registration; that the assessment was improperly calculated on the basis of its annual income and wrongly backdated to the year 1993; and that the assessment was an abuse of the respondent's power as it was borne out of malice and intended to harass, coerce and compel the appellant to pay the unjustified sum at the peril of execution and/or enforcement process. That the appellant, thus, sought the intervention of the court through an order of certiorari to quash the assessment made against the appellant, and an order of prohibition to restrain the enforcement of the assessment through attachment.

[4] The application was opposed by the respondent through a replying affidavit sworn by Dick Gari (Gari), who is an officer appointed by the respondent under ***section 3*** of the ***Value Added Tax Act Cap 476 of the Laws of Kenya*** (the VAT Act). This Act has been repealed by the Value Added Act No. 35 of 2013 although section 68 (2) of the new Act provides for saving provisions that make the previous Act remain alive for purposes of assessment and collection of tax due under the repealed Act. In this judgment, VAT Act refers to the repealed Act.

[5] Gari swore that in exercise of his powers under the VAT Act, he visited the appellant's premises to confirm whether it was registered under the VAT Act, and whether value added tax due in regard to a contract entered into between the appellant and the government had been paid. Gari deponed that he confirmed that the appellant was a contractor providing taxable services but was not registered under the VAT Act; that attempts to register the appellant were futile as it was alleged to have ceased operating businesses in 1984, which could have been taxable under the VAT Act; that contrary to that assertion the appellant had not ceased operations as it had submitted income tax returns for the years 1993, 1995, 1996, 1997 and 1998; that the appellant having failed to provide information relating to its taxable business, the respondent invoked the provisions of the Sixth Schedule paragraph 9 & 22 (a) to the VAT Act in determining the tax payable by the appellant, the penalty and the effective date; and that the assessment of the tax and penalties was not actuated by any malice but was necessitated by the appellant's failure to provide any information relating to the businesses.

[6] In her judgment, the learned Judge noted that what was in issue was whether the respondent had acted in excess of its jurisdiction, or maliciously, or unfairly, in breach of the rules of natural justice. In determining this issue, the learned Judge also posed the question whether at the material time the appellant carried on construction work/services that were VAT designated, and noted that there was evidence that the appellant was contracted by the government to provide construction services in 1986, and completed the construction in the year 1990, but final payments were made in 2001. The learned Judge concluded that the appellant's contention that it had ceased operations in 1984 could not have been true. The learned Judge added that although the appellant filed income tax returns the same did not indicate the activities it was engaged in.

[7] In its memorandum of appeal, the appellant has faulted the learned Judge contending that she erred in law: by finding that the respondent properly exercised his discretion in assessing the appellant's value added tax; in making a finding which was unsupported by evidence that the appellant was engaged in construction work for the period assessed for VAT; in finding that the respondent was justified in backdating the appellant's VAT registration to 1993; in failing to find that the respondent acted arbitrarily, capriciously and maliciously in assessing the appellant's tax; and that the learned Judge failed to exercise her discretion judiciously in all the circumstances of the case.

[8] In arguing the appeal, learned counsel Ms Mutua who appeared for the appellant submitted that the respondent wrongly exercised its discretion in backdating the appellant's VAT registration to 1993; that before the year 1993, construction work was not VAT designated; that the respondent failed to consider the explanation given by the appellant that it was not carrying out businesses that were VAT designated; and that there was no justification for backdating the VAT to 1993 as there was no evidence to show that work under the contract entered into between the appellant and the government was undertaken within that period.

[9] Counsel maintained that the respondent acted arbitrarily as it did not take into account the factors which it ought to have considered. The following authorities were relied upon in identifying factors that were relevant for consideration: ***Associated Provincial Picture Houses Vs. Wednesbury Corporation [1947] 2 ALL ER 680; R v Inland Revenue Commissioners, exparte National Federation of Self Employed and Small Businesses Ltd [1982] AC 617;*** and ***Republic Vs. Commissioner of Income Tax Ex-parte SDV Transami (Kenya) Limited [2005] eKLR.*** The court was urged to allow the appeal, set aside the order of dismissal made by the High Court, and issue the orders of certiorari and prohibition that were sought by the appellant in his motion.

[10] Miss Odundo, learned counsel who appeared for the respondent urged the court to dismiss the appeal. She submitted that the appellant was engaged in construction work that became vatable in 1993; that this was confirmed by the contract that was entered into between the appellant and the government, copy of which was availed to the court; that notwithstanding the appellant providing vatable services, it was not registered under the VAT Act, and the assessment by the respondent was based on the appellant's annual returns; that Schedule 7 paragraph 9 of the VAT Act gave the respondent the discretion to use evidence at its disposal in assessing VAT payable where no information has been provided to it; that the respondent also had discretion to backdate the VAT payable; and that the assessment was not unreasonable as it was arrived at using the appellant's available tax returns and explanations given for the calculations. Counsel dismissed the case of ***Atul Shah & Others vs Commissioner of Value Added Tax, H.C. Misc. Appl. No. 88 of 1988*** that was also relied upon by the appellant maintaining that it was not applicable to the circumstances of this case.

[11] The VAT Act is an Act of Parliament which imposes a tax known as Value Added Tax on identified goods and services supplied in Kenya. The Act commenced on 1st January, 1990. In the proceedings in the High Court, the appellant challenged the exercise of the respondent's discretion under paragraph 9 and 22 of the 6th schedule to the VAT Act; and paragraph 9 of the 7th schedule to the VAT Act.

In ***Associated Provincial Picture Houses Vs. Wednesbury Corporation (supra)*** Lord M. R. Greene, in his leading judgment stated:

> ***"When an executive discretion is entrusted by Parliament to a local authority, what purports to be an exercise of that discretion can only be challenged in the courts in a very limited class of case. It must always be remembered that the court is not a court of appeal. The law recognizes certain principles on which the discretion must be exercised, but within the four corners of those principles the discretion is an absolute one and cannot be questioned in any court of law.***
>
> ***What then are those principles? They are perfectly well understood. The exercise of such a discretion must be a real exercise of the discretion. If in the statute conferring the discretion, there is to be found, expressly or by implication, matters to which the authority exercising the discretion ought to have regard, then, in exercising the discretion they must have regard to those matters".*** *(Emphasis added).*

[12] The following quotation from the ***Chief Constable of North Wales Police vs Evan, [1982] 3 ALL ER***, which was referred to by the learned Judge is also instructive:

> ***"That a court will not act as court of appeal from the body concerned nor will the court interfere in any way with the exercise of any power or discretion which has been conferred on that body, unless it has been exercised in a way which is not within that body's jurisdiction or the decision is unreasonable. The functions of the court is to see that lawful authority is not abused by unfair treatment. If the court is to attempt itself the task entrusted to that authority by the law, the court, would under the guise of preventing the abuse of power be guilty itself of usurping power".*** *(Emphasis added).*

[13] It is evident from the above that the exercise of discretion conferred on an executive authority, can only be interfered with by the court in limited situations, where the court is satisfied that the discretion

has not been properly exercised either because relevant factors have not been taken into account, or irrelevant factors have been taken into account, or the discretion is exercised in an unreasonable manner resulting in abuse of power or unfair treatment. This means that where the exercise of discretion is challenged, the court does not sit as an appellate court considering the merit of the decision arrived at through the exercise of the discretion, but it considers the discretionary power as provided in the statute, the process of applying the discretion, and matters taken into account in the exercise of that discretion, in order to determine whether the discretion has been properly exercised. That is not tantamount to interfering with the exercise of the discretion but is simply ensuring that the discretion is neither abused nor discretionary power exceeded but exercised fairly.

[14] In this case, the relevant paragraphs providing the discretionary power to the respondent were as follows:

> **6th Schedule to the Act:**
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> **"(9) the Commissioner can vary the effective date of registration where he is satisfied that there are reasonable grounds justifying such variation**
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> **……..**
>
> **(22) Where in the opinion of the Commissioner**
>
> a. **Any person is a taxable person under para 1 and para 2 and that person has failed to apply for registration in the prescribed manner, the Commissioner may register that person forthwith: or**
>
> b. **any taxable person has failed to notify cessation of trading under para 15, the Commissioner may deregister that person forthwith and require that person to pay the tax due and payable on supplies made and stocks of materials and other goods on which tax has not been paid or on which tax has been credited as deductible input tax".**
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> **7th Schedule to the Act:**
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> **"9(1) where in the opinion of the Commissioner, any person has failed to pay any of the tax which has become payable by him under this Act by reason of:**
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> a. **his failure to keep proper Books of Account; records or documents, required under this Act, or the incorrectness or inadequacy of these books of account, record, or documents; or**
>
> b. **his failure to make any return required under this Act, or delay in view of such return or the incorrectness or inadequacy of any such return; or**
>
> c. **his failure to apply for registration as a taxable person under this Act, the Commissioner may, on such evidence as may be available to him assess the amount of the tax due and that amount of tax shall be due and payable forthwith by the person liable to pay the tax provided that the Commissioner may, in special cases referred to him by an authorized officer, adjust or review the amount of tax assessed under this paragraph in such manner as may be just and reasonable in the circumstances".**

[15] As conceded by the parties, construction work became a taxable service in the year 1993. Therefore, the issue for determination before the learned Judge was whether the appellant was carrying out a taxable service in the years 1993-1999 and if so, whether in registering the appellant, assessing and backdating the tax payable, the respondent properly exercised its discretion as provided under the VAT Act or abused its discretion and acted in an unfair manner.

[16] It is evident from the affidavit sworn by Gari that the events leading to the assessment of the VAT

tax by the respondent were precipitated by a letter dated 2nd August, 2001 addressed to the respondent by the Hon. Attorney General. The letter which was annexed to the affidavit of Gari, stated in substance as follows:

> ***"RE: CONFIRMATION OF REGISTRATION***
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> ***We have disbursed to the persons hereunder mentioned a sum of Kshs.22,500,000/= between July, 2000, and March 2001. There is a further claim for payment of amounts due in the same suit. Before we receive any sums for disbursement, please confirm registration and of any sums due to you. In which event, also do serve the Office of the President with the agency notices with a copy to us".***

[17] A visit was made to the appellant's premises by the respondent's officers and this was followed by a letter written by the appellant dated 18th September, 2001, in which the appellant indicated that it had ceased operations in providing contract services in the year 1984 and was therefore, not subject to VAT registration. The tax assessment done by the respondent through the letter dated 5th November, 2001, which the appellant sought to quash was anchored on two main factors. First, the contract entered into between the appellant and the Government of Kenya, for the appellant to provide contractual services in the erection and completion of Kirinyaga District Headquarters at Kerugoya. Secondly, the appellant's director's report accompanying their accounts and audit report for the year ended 1993 in which the principle activities of the company are indicated as "construction work, retail shop and workshop". The question is whether this provided sufficient evidence that the appellant was engaged in taxable goods or providing taxable services during the period in respect to which the valued added tax was assessed by the respondent.

[18] Regarding the contract entered into between the appellant and the government, the contract document and the certificate of practical completion which were annexed to Gari's affidavit, revealed that the contractual services were undertaken between the years 1986 and 1990 long before contract services became taxable in the year 1993. The letter dated 2nd August, 2001 indicates that some payments were made between July 2000 and March 2001. The facts revealed in ***Highway Furniture Mart Limited v Permanent Secretary Office of the President & Another [2006] eKLR,*** an authority which was relied on by the appellant is pertinent.

[19] The matter was an appeal to this Court from the ruling of the High Court in an application seeking review of the judgment of the High Court. The following extract from the judgment of this Court is instructive:

> ***"By a building contract dated 15th May, 1986 between the appellant and the Government of Kenya, the appellant agreed to undertake the erection and completion of Kirinyaga District Headquarters at Kerugoya at contract sum of Kshs.20,660,503/10 the date of completion being 25th November, 1987. It seems that the works were not completed within the contract period because the Certificate of Practical Completion from the Ministry of Works is dated 12th October, 1990. Thereafter, there was a dispute on final accounts. By a meeting held on 6th August, 1996, the Government's position was that the final accounts for the project was Shs.38,599,191/= against the approved contract sum of the project of Kshs.36,639,200/00. The Government decided to seek authority of the Treasury for the additional Kshs.1,960,991/95. According to the appellant, however, the final accounts was Kshs.47,517,458/45. The dispute was not resolved and by a letter dated 14th January, 1998, the appellant demanded from the Attorney General the balance of Kshs.11,257,118/=, with interest at 36% from 12th October, 1990 till payment in full. On 17th February, 1998, the appellant filed Nyeri High Court Civil Case No. 42 of 1998 through M/s Bali-Sharma & Bali-Sharma Advocates".***

[20] It is obvious to us that the contract subject of the dispute in High Court Civil Case No. 42 of 1998, was the same contract which the respondent relied upon as evidence that the appellant was carrying out

taxable services. However, it is clear from the extract of the judgment quoted above, that that contract was completed in 1990, but that payments for the services rendered were subject of a dispute which ended up in court. These are the payments which appear to have been referred to in the Attorney General's letter dated 2nd August, 2001. What comes out is that the contractual services were provided by the appellant long before 1993 although payments were made long after 1993. Under these circumstances, can the payments made after 1993, in regard to the services provided by the appellant before the VAT Act became applicable in 1993, be subject to the VAT tax?

[21] In our view, the letter dated 2nd September, 2001, was misleading if not malicious as the payments made to the appellant were in regard to services which were not subject to VAT Act and this was well within the knowledge of the Attorney General. In acting on the letter from the Attorney General the respondent was actuated by extraneous circumstances. In its letter dated 18th September, 2001 the appellant contended that it had ceased doing contractual work from 1984 due to non-allocation of building contracts and had also ceased to operate a hardware shop due to lack of funds. In light of the contract entered into between the appellant and the government in the year 1986, the appellant's contention did not reflect the true position as it is apparent that between 1986 and 1990, it was engaged in providing building contract services. However, such misrepresentation could not justify the conclusion that the appellant was still providing contract services in the year 1993, a fact that the 1st respondent had to establish.

[22] We note that in the appellant director's report for the year ended 1993, the directors indicate the activities of the company as construction work, retail shop and workshop. This information must be looked at in light of the accounts and audit report which was being presented. The balance sheet indicated income received during the period under review. The income did not necessarily come from activities carried out in that particular year, but included income from activities that may have been carried out in previous years but in respect of which payment is made in that audit year. Indeed, it is apparent that payments in regard to the government contract were made to the appellant long after the year in which the activities were undertaken. Therefore, the activities indicated in the director's report are activities resulting in the income and loss, and not necessarily activities carried out in that particular year. We find that neither the contract with the government nor the director's 1993 report provided evidence that the respondent was providing taxable services or goods under the VAT Act in the year 1993.

[23] In this case, the appellant exercised its discretion by using the annual returns to assess the VAT payable. In the case of ***Atul Shah & Others v Commissioner of Value Added Tax***, ***(supra)*** Hon. Githinji, J (as he then was) held that a VAT assessment could be arbitrary if relevant considerations are not taken into account. This is consistent with the statements in ***Associated Provincial Picture***

Houses vs. Wednesbury Corporation ***(supra), and Chief Constable of North Wales Police vs Evan (supra)*** that were cited above.

[24] Further, the respondent relied on annual returns that were submitted by the appellant under the Income Tax Act to assess the value added tax payable. Under the VAT Act, assessment of the tax is done on specific sales or services the rate of which is provided depending on the nature of the goods or service. As reflected under the provisions of the schedule to the Act that were quoted, Paragraph 22 of the 6th Schedule allows the commissioner to register any person who is a taxable person under the Act, but who has failed to apply for registration, and paragraph 9 of the 6th Schedule allows the commissioner to backdate the effective date of the tax payable. Under Paragraph 9 of the 7th Schedule to the VAT Act, the respondent had discretion to use the evidence available to him in assessing the amount of tax due where a taxable person has failed to pay the tax that has become payable by him under the Act by either failing to keep proper books of account, records or documents required under the Act; or failing to make any return under the Act or failing to apply for registration.

[25] The key word is "taxable person". This means that relevant factors pertaining to the exercise of the respondent's discretion included facts such as the appellant being a taxable person under the Act who has failed to apply for registration and who has also failed to keep or provide proper books of account, record

or documents required under the VAT Act. In this case, the evidence relied upon by the respondent did not establish that the appellant was undertaking a business involving taxable goods or taxable services under the VAT Act. The respondent's conclusion that that the appellant was a taxable person to whom the VAT Act applied, and who had failed to apply for registration was whimsical as it is based on what can only be described as rumour. Thus, the respondent could not properly exercise its discretion under the 6th Schedule, to register the appellant or backdate the effective date of registration nor could the respondent use returns provided under the Income Tax Act to assess the taxes payable.

[26] Since the appellant established its position that it was not providing services or goods that were taxable under the VAT Act during the period in question; its failure to file an objection under the VAT Act cannot be faulted as its contention was that it was not subject to the VAT Act. In our view, the procedure adopted by the appellant in seeking the intervention of the court by way of Judicial Review Orders was proper, as filing an objection under the VAT Act would have been tantamount to the appellant submitting itself to a law that was not applicable to it.

[27] The upshot of the above is that the learned Judge erred in dismissing the appellant's motion as there was sufficient evidence that the respondent acted without jurisdiction in applying the VAT Act to the appellant who was at the material time not providing services or goods that were taxable and therefore, not a taxable person to whom the VAT Act applied. Further, the respondent failed to exercise its discretion properly by failing to take into account matters that were relevant under the Act and taking into account extraneous matters.

[28] For the above reasons, we allow the appeal, set aside the judgment of the High Court and the order dismissing the appellant's notice of motion dated 20th December, 2001 and substitute thereof an order allowing the appellant's motion and issuing orders of certiorari and prohibition as sought in the motion.

We award the appellant costs of the motion in the High Court and costs of this appeal.

Those shall be the orders of this Court.

Dated and Delivered at Nairobi this 3rd day of July, 2015.

H. M. OKWENGU

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JUDGE OF APPEAL

P. M. MWILU

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JUDGE OF APPEAL

J. OTIENO-ODEK

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JUDGE OF APPEAL

I certify that this is a true copy of the original.

DEPUTY REGISTRAR