Mechai International v Commissioner of Domestic Taxes (Income Tax Appeal E040 of 2022) [2024] KEHC 4834 (KLR) (Commercial and Tax) (25 April 2024) (Judgment)

Neutral citation: [2024] KEHC 4834 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E040 OF 2022

PM MULWA, J

APRIL 25, 2024

BETWEEN

MECHAI INTERNATIONAL .... APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES .... RESPONDENT

(An appeal from the Judgment and Decree of the Tax Appeals Tribunal delivered on 8th April 2022)

JUDGMENT

1. The appellant, Mechai International, is a private company limited by guarantee and registered under the *Companies Act*, Cap 486 (Repealed). Its main objective is assisting communities to construct churches for furtherance of their spiritual faith.

2. On 7th October 2019, the Commissioner of Domestic Taxes (Respondent) raised VAT assessments for 2015, 2016, 2017 and 2018 based on income declared by the appellant in its tax returns but not declared in VAT returns. On 19th November 2019, the appellant filed a notice of objection on grounds that all purchases and input VAT for the period (general rate) was backed by ETR receipts; the ETR receipts were generated by suppliers who are registered for VAT; the input VAT was claimed within the specified time allowed and that the figures used to compile the auto assessment orders were not correct as they do not conform with the VAT returns submitted to KRA.

3. However, on 21st February 2020, the Commissioner confirmed the assessment because, despite reminders issued on 10th and 17th February 2020, the appellant did not provide documents in support of its objection.

4. Aggrieved, the appellant lodged an appeal before the Tax Appeal Tribunal (TAT) through a notice of appeal dated 21st January 2021. Through the judgment dated 8th April 2022, the Tribunal confirmed the Commissioner's assessment.

5. Still disatisfied, the appellant filed the present appeal through its memorandum of appeal dated 22nd April 2022, on the following grounds:-

    1) That the Honourable Tribunal erred in law and fact in dismissing the Appellant's Appeal against the weight of evidence.

    2) That the Honourable Tribunal erred in law and in fact by failing to consider the issues of evidence raised by the Appellant to wit;

        a) That the Applicant though registered as a Company, it is limited by Guarantee and does not engage in business and thus its only source of income are donations and therefore it ought not to be charged income tax.

        b) That being a charitable organization, the Appellant is exempt from Value Added Tax under the *VAT Act*.

    3) That the Honourable Tribunal erred in law and in fact in employing the wrong analysis of law and facts hence arriving at a wrong determination.

    4) That the Honourable Tribunal erred in law and in fact in considering irrelevant and unsubstantiated factors hence influencing the outcome of his decision.

    5) That the Honourable Tribunal erred in law and in fact in misapplying and exercising his discretion against the Appellant against the weight of evidence.

6. In opposing the appeal, the respondent filed a statement of facts dated 6th February 2024.

7. The appeal was canvassed through written submissions. The appellant filed written submissions dated 20th February 2024. On the other hand, the respondent filed written submissions both dated 6th February 2024.

8. The appellant contended that since it is a charitable organization engaged in religious work, it is exempt from tax obligations both under the VAT and Income Tax Acts and that even though its tax exemption certificate was not extended by the Commissioner, it remained exempted and had legitimate expectation that the same would be extended because its activities did not change.

9. The appellant relied on Section 7 of the *Companies Act*, 2015 on the definition of a company limited by guarantee, to argue that it is a specific corporation used for non-profit organizations entitled to exemption from payment of income tax under Para. 10 of the First Schedule of the *Income Tax Act*; Schedule 3 Para. 11 of the *VAT Act*, 2013 to argue that regardless of the nature of its incorporation, it is a non-profit charitable organization and is qualified for exemption. It also relied on the case of Commissioner of Domestic Taxes v Lewa Wildlife Conservancy Limited [2019] eKLR to the effect that in interpreting statute and in the absence of express legislative intention the language must be taken as conclusive.

10. The respondent contended that although the appellant is registered as a company limited by guarantee, it is not registered as a charitable organization under the First Schedule PART II, para.11 of the VAT

Act, 2013. The respondent further contended that during the period in question, the appellant did not have a valid tax exemption certificate as per Para. 10 of the First Schedule of the *Income Tax Act* as their application for the same was rejected vide the letter dated 13th March 2018 due to the appellant's failure to provide sufficient documentation. The respondent therefore argued that tax is chargeable for the periods when the appellant was not issued with a valid tax exemption certificate.

11. The respondent relied on Section 5(1) of the *VAT Act* which provides that VAT shall be charged on a taxable supply made by a registered person; on Section 24(2) of the *Tax Procedures Act* which provides that the Commissioner shall not be bound by a tax return or information provided by, or on behalf of, a taxpayer and the Commissioner may assess a taxpayer's tax liability using any information available to the Commissioner. He quoted the cases of *Keroche Industries Limited v Kenya Revenue Authority & others* Misc. Civil Application No 743 of 2006 to the effect that tax statutes ought to be interpreted strictly and *Tumaini Distributors Company (K) Limited v Commissioner of Domestic Taxes* [2020] eKLR and *Boleyn International Limited v Commissioner of Investigations and Enforcement*, TAT Appeal No 55 of 2018, that a taxpayer has the burden to prove that the tax decision is wrong.

Analysis and determination

12. I have considered the grounds of appeal, the record of appeal, the respondent's statement of facts and the parties' respective submissions and authorities relied on. The only issue for determination is whether the assessments for December 2015, 2016, 2017 and 2018 were invalid because the appellant is a company limited by guarantee and carried on charitable work.

13. It is not disputed that the appellant is a company limited by guarantee. As a consequent, the appellant contended that due to the fact that it is a company limited by guarantee and carried on charitable work, it ought to be exempted from both income tax and VAT. On the contrary, the respondent argued that tax is chargeable for the periods when the appellant was not issued with a valid tax exemption certificate.

14. On this issue, the Tribunal at para. 24 of the impugned judgment, observed as follows:-

> " 24. Another argument fielded by the Appellant in this Appeal is that it received donations from sponsors and locations churches to construct a church. While we comment (sic) the Appellant for its efforts in taking it upon itself to provide such centers of worship, we most certainly find it difficult to believe that the Appellant could not produce a single document as proof of its claim. Even before this Tribunal, in this Appeal, the tax payer has not furnished us with a shred of evidence in this regard. As such we find that the Appellant has equally failed to dispense with the burden of proof before the Tribunal."

15. Both the appellant and respondent relied on various statutory provisions to support their distinct positions. Hence, I find it prudent to consider the core principle in interpretation of tax statutes as restated by the Court in *Republic v Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya LTD* [2012] eKLR, as follows:-

> " The approach to this case is that stated in the oft cited case of *Cape Brandy Syndicate v Inland Revenue Commissioners* [1920] 1 KB 64 as applied in *T.M. Bell v Commissioner of Income Tax* [1960] EALR 224 where Roland J. stated, '...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 it 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'."

16. Para. 10 of the First Schedule of the *Income Tax Act* headed 'Income Accrued In, Derived From Or Received In Kenya Which Is Exempt From Tax', provides that:

> " Subject to section 26, the income of an institution, body of persons or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education—
>
> (a) established in Kenya; or
>
> (b) whose regional headquarters is situated in Kenya, in so far as the Commissioner is satisfied that the income is to be expended either in Kenya or in circumstances in which the expenditure of that income is for the purposes which result in the benefit of the residents of Kenya:
>
> Provided that any such income which consists of gains or profits from a business shall not be exempt from tax unless such gains or profits are applied solely to such purposes and either—
>
> (i) such business is carried on in the course of the actual execution of such purposes;
>
> (ii) the work in connexion with such business is mainly carried on by beneficiaries under such purposes; or
>
> (iii) such gains or profits consist of rents (including premiums or any similar consideration in the nature of rent) received from the leasing or letting of land and any chattels leased or let therewith; and provided further that an exemption under this paragraph—
>
> (A) shall be valid for a period of five years but may be revoked by the Commissioner for any just cause; and
>
> (B) shall, where an applicant has complied with all the requirements of this paragraph, be issued within sixty days of the lodging of the application.

17. The above proviso is clear that the income of a charitable organisation shall only be exempted from income tax where the organization has obtained a tax exemption certificate upon compliance with all the requirements of para. 10 of the First Schedule. Therefore, I agree with the respondent's proposition that tax is chargeable for the periods when the appellant was not issued with a valid tax exemption certificate. Accordingly, the appellant's contention that even though its tax exemption certificate was not extended by the Commissioner it remained exempted and had legitimate expectation that the same would be extended because its activities did not change, fails.

18. As regards exemption from VAT, Third Schedule Para. 7 of the *VAT Act*, 2013 provides that: -

> The following services shall be exempt services for purposes of the Act-
>
> "Social welfare services provided by charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the *Societies Act* (Cap. 108), or by the Non-governmental Organizations Co-ordination Board under section 10 of the Non-governmental Organizations Coordination Act, 1990 (No 19 of 1990) and

whose income is exempt from tax under paragraph 10 of the First Schedule to the *Income Tax Act* (Cap. 470) and approved by the Commissioner of Social Services."

19. From my reading, the above provision stipulates that social welfare services rendered by charitable organizations are only exempt from VAT where the income is exempt from tax under paragraph 10 of the First Schedule to the *Income Tax Act* (Cap. 470).

20. In the instant matter, it is evident that the appellant failed to obtain a tax exemption certificate for the years 2015, 2016, 2017 and 2018. The assessments by the respondent were based on the income declared for that period. Although the appellant claimed that the income came from grants, despite being granted an opportunity to furnish the documents to support their claims, they failed to provide the requisite documents. As earlier noted, the Tribunal also concluded that the appellant failed to discharge its burden of proof by failing to furnish it with documents to prove its claims.

21. Under Section 56 of the Tax Proceedings Act and Section 30 of the *Tax Appeals Tribunal Act*, it is the taxpayer's burden to prove that a tax decision is wrong or excessive. The rationale behind these provisions is that the Kenyan tax system is premised on self-assessment and the evidence required to support transactions is in the hands of the tax payer. This was clearly explained in the case of *Republic v Kenya Revenue Authority; ex-parte Proto Energy Limited* (JR Appn E023 of 2021) [2022] KEHC 5 (KLR), where the Court held:

> "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."

22. Accordingly, I find that the appeal is not merited and it is hereby dismissed. The judgment of the Tribunal dated 8th April 2022 upholding the respondent's assessment of 21st February 2021 is upheld. There shall be no orders as to costs.

JUDGMENT DELIVERED, DATED AND SIGNED AT NAIROBI THIS 25TH DAY of APRIL 2024.

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P. MULWA

JUDGE

In the presence of:

Mr. Mandela for Appellant

Mr. Wairire for Respondent

Court Assistant: Carlos