CASES DIGEST

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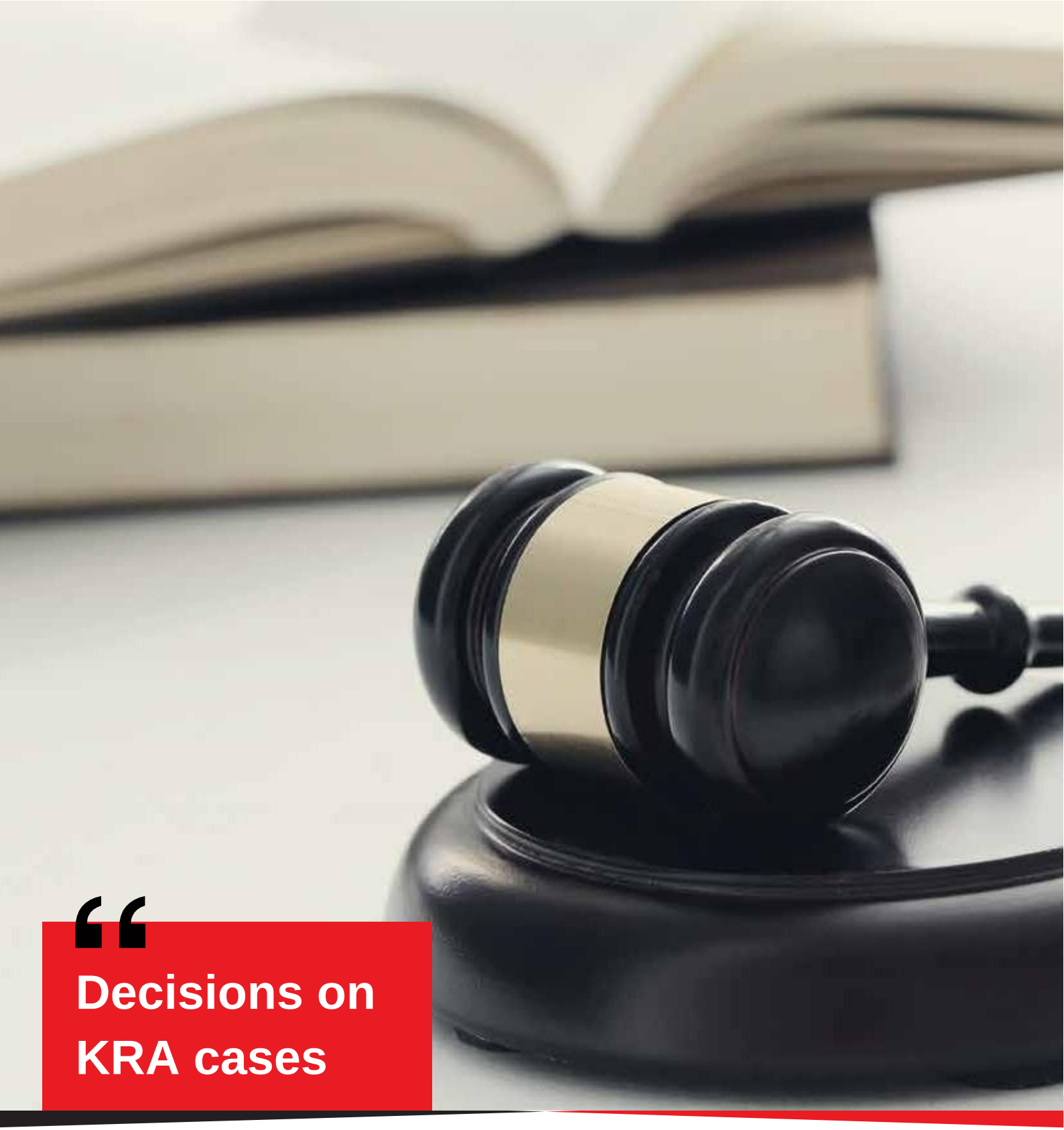

Decisions on KRA cases

KENYA REVENUE AUTHORITY

Tulipe Ushuru, Tujitegemee!

Tulipe Ushuru, Tujitegemee!

A publication of the

Kenya Revenue Authority

Vision

A Globally Trusted Revenue Agency Facilitating Tax and Customs Compliance

Mission

Building Trust through Facilitation so as to foster Compliance with Tax and Customs Legislation

Values

Trustworthy, Ethical, Competent, Helpful

Forward

Kenya Revenue Authority is the Government Agency established through the Kenya Revenue Authority Act, Chapter 469 of the Laws of Kenya with the role of collecting revenue and enforcing tax laws. We are pleased to publish the 6th edition of the Kenya Revenue Authority (KRA) Cases Digest.

A number of decisions on various issues have been delivered by courts and Tribunals since the establishment of the Kenya Revenue Authority in the year 1995. This digest documents judicial jurisprudence as determined by Courts in Customs and tax cases.

This case digest focuses on assessment of taxes and duties under the tax and customs laws respectively. It highlights the judgements issued by the Courts setting out guiding principles on the matters.

The digest is relevant to legal practitioners as reference point as precedent, scholars as a reference tool for training and reading, KRA staff and all persons interested in the Authority's operations as a guide on decisions relating to the tax matters.

I wish to thank the editorial and design teams for the concerted efforts made towards the publication of this 6th edition of the Kenya Revenue Authority cases digest.

C.S. Paul M. Matuku

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Executive Summary

This volume features cases on assessment of tax and customs duty under tax and customs laws. It highlights the interpretation of the law by the courts on the provisions relating to tax assessment. In *Civil Appeal No. 10 of 2018: Commissioner of Domestic Taxes Vs Ocean Freight (East Africa) Limited [2020] eKLR*, the Court held that under section 15 and 16 of the Income Tax Act, before any expenditure can be deducted from a person's taxable income it ought to have been exclusively incurred in the production of the said income.

In Civil Appeal No. 150 of 2018: Kenya Revenue Authority Vs Universal Corporation Limited (2020) eKLR the Court held that the Appellant is duty bound to exercise its statutory power with due diligence and as prescribed for by the law namely within the time frame permitted for by law to allow the Respondent claim a refund it is entitled to in law within the time frame stipulated for within the law. Tax law with penal consequences must be interpreted with great caution and that any ambiguity in such a law must be resolved in favour of a tax payer.

In *Nairobi Civil Appeal No 175 Of 2016: Interactive Gaming & Lotteries Limited Vs Kenya Revenue Authority [2018] eKLR* held that there are elaborate processes under tax laws giving the taxpayers an opportunity to object to assessment notices issued by the Commissioner. Taxpayers are required to object to the assessment notices issued by KRA. It is wrong for a taxpayer to file judicial review proceedings after receiving assessment notices when the appropriate remedy is to file objection proceedings before the Commissioner.

In *Nairobi Tax Appeal No. E002 of 2020- Leah Njeri Njiru Vs Commissioner of Investigations & Enforcement Kenya Revenue Authority and Chief Manager Debt Collection and Enforcement,* the Court held that Business entities are afforded an opportunity to deduct all their expenses on their total income, such that only their profit is subject to tax as their personal income. Pursuant to section 54A (1) business should keep records of all their expenditures so as to prove as such. The burden of proof lies on the taxpayer to demonstrate that a tax assessment is faulty. Further, the taxpayer is obligated to prove the extent of their expenses to include the cost of operating the business.

In Nairobi Income Tax Appeal No. 7 Of 2017: Rabai Operation & Maintenance Limited Vs Commissioner Of Domestic Taxes [2019] eKLR the Court held that the only conditions for a taxpayer to deduct input VAT are the ones outlined in in section 17 of the repealed VAT Act, Cap 476 and subject the VAT Regulations. The Court held that a taxpayer does not have to file monthly VAT returns for them to be able to deduct input VAT under Section 11 of the repealed VAT Act, Cap 476. The Commissioner's insistence that a tax payer had to be registered under ITMS for it to benefit from deduction of input VAT is not supported by Section 11 of the repealed VAT Act Cap 476.

In Tumaini Distributors Company (K) Limited v Commissioner of Domestic Taxes [2020] the Court held that the Company failed to object to the assessments it appealed against to the Tribunal as it objection were filed out of time and rejected. The application for amendment under section 31 of the *TPA* constitutes a separate process and could not implicate or affect the assessments already confirmed by the failure of the Company to lodge its objection in time. The decision by the Commissioner and the Tribunal in respect of the assessments appealed against were in accordance with the evidence and material available to the Commissioner. The Appellant did not discharge its burden of showing that the tax decision was wrong or incorrect. The issue of amendment of the self-assessment was not the subject of the tax decision that was being challenged in the appeal before the Tribunal.

December 2021

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Digest of Cases on Assessment of taxes and duties

A.Digest of Cases on Assessment of taxes and duties

1. Malindi Civil Appeal No. 10 of 2018: Commissioner of Domestic Taxes Versus Ocean Freight (E.A) Limited *(Being an Appeal from the Judgment of the High Court of Kenya at Mombasa delivered on the 12th May 2017 in the High Court Income Tax Appeal No. TAT 97 of 2010.*

Coram: Alnashir Vishram, Wanjiru Karanja, Martha Koome JJA.

Date of judgment: 27th September 2020

Keywords: assessment, Total income of a persons, wholly and exclusively incurred in the production of income, gains or profits chargeable to tax,

Sections of the law: Sections 15(1), (2)(a) and 16(1)(a) of the Income Tax Act

Section 15 Income Tax Act

In ascertaining the total income of a person before any expenditure can be deducted from a person's taxable income it ought to have been exclusively incurred in the production of the said income.

Implications

Section 15 and 16 of the Income Tax Act requires that before any expenditure can be deducted from a person's taxable income it ought to have been exclusively incurred in the production of the said income.

There is no single test for determining whether a person is an employee, the control test that used to be considered sufficient, can no longer be considered sufficient, especially in the case of the employment of highly skilled individuals.

The question whether the person is integrated into the enterprise or remained apart from and independent of it has been suggested as an appropriate test, but is likewise only one of the relevant factors, for the modern approach is to balance all of those factors in deciding on the overall classification of the individual.

The factors relevant in a particular case may include, in addition to control and integration: the method of payment; any obligation to work only for that employer, stipulations as to hours; overtime, holidays etc; arrangements for payment of income tax and national insurance contribution..

Background

The Appellant *(The Commissioner)* carried out an audit carried out on the Respondent (Ocean Freight (East Africa) Limited) account for the period running from 2002 to 2006 (audit period). Pursuant to an agency agreement between Respondent and Mediterranean Shipping Company S.A (MSC) which carries out shipping business, the Respondent acted as MSC's agent in Kenya. It is on the basis of the said audit that the Appellant demanded for payment of Kshs.51,319,757 as corporation tax arrears for the audit period. Additionally, Appellant also demanded from the Respondent as an agent of MSC, a sum of Kshs. 53,417,116 as tax arrears for non-resident income earned during the audit period by MSC.

Halsburys Laws of England, Vol 126, 4th Edition on determining an Employment Relationship

"There is no single test for determining whether a person is an employee, the test that used to be considered sufficient, that is to say the control test, can no longer be considered sufficient, especially in the case of the employment of highly skilled individuals, and is now only one of the particular factors which may assist a court or tribunal in deciding the point. The question whether the person was integrated into the enterprise or remained apart from and independent of it has been suggested as an appropriate test, but is likewise only one of the relevant factors, for the modern approach is to balance all of those factors in deciding on the overall classification of the individual. The factors relevant in a particular case may include, in addition to control and integration: the method of payment; any obligation to work only for that employer, stipulations as to hours; overtime, holidays etc; arrangements for payment of income tax and national insurance contribution".

The respondent objected to the corporation tax demand. The objection was on the grounds that the Appellant had failed to take into account the Respondent's deductible expenses under *Section 15* of the *Income Tax Act*. Specifically, the Appellant had not factored in that the salaries and emoluments of two of the respondent's employees who also acted as directors, namely, Captains Tommaso Castellano and Fiorenzo Castellano (the Castellanos) were deductible expenses as against the respondent's income. Similarly, the Appellant failed to take into account that outstanding and written off freight were bad debts within the meaning of *Section 15(2) (a)* and subject to deduction from the respondent's taxable income. The appellant did not agree with the objection raised and communicated as much to the Respondent.

Issues for determination

a) Whether the two directors i.e. Messrs Tommaso Castellano and Fiorenzo Castellano were employees of MSC and whether the expenses incurred on behalf of the two Directors were not allowable against the income of the Respondent

b) Whether the bad debts arising out of the unpaid freight charges were debts of Mediterranean Shipping Company (MSC) and therefore not allowable against the income of the Respondent.

Decision of the Court

It is discernible from the provisions of Section 15 and 16 of the Income Tax Act which we have set out herein above that before any expenditure can be deducted from a person's taxable income it ought to have been exclusively incurred in the production of the said income. The starting point would be to consider whether the Catellanos were employees of the Respondent for purposes of establishing whether their salaries were wholly and exclusively incurred for production of the Respondent's income.

The discussion on the test of determining an employer/employee relationship by learned authors of ***Halsbury's Laws of England Vol I26, 4th Edition at paragraph 3*** is instructive:

"There is no single test for determining whether a person is an employee, the test that used to be considered sufficient, that is to say the control test, can no longer be considered sufficient, especially in the case of the employment of highly skilled individuals, and is now only one of the particular factors which may assist a court or tribunal in deciding the point. The question whether the person was integrated into

the enterprise or remained apart from and independent of it has been suggested as an appropriate test, but is likewise only one of the relevant factors, for the modern approach is to balance all of those factors in deciding on the overall classification of the individual. The factors relevant in a particular case may include, in addition to control and integration: the method of payment; any obligation to work only for that employer, stipulations as to hours; overtime, holidays etc; arrangements for payment of income tax and national insurance contribution; …".

The Court held that it was not satisfied that there was cogent evidence to demonstrate that the Castellanos were employed by the Respondent. More evidence was required to establish the employment relationship. Taking into account that the application for renewal of the Castellanos working permits indicated that they were employees of MSC a fact which was admitted by the Respondent. There was also no documentary evidence e.g. payslips tendered to show that the Respondent paid their salaries or remitted P.A.Y.E on their behalf. Consequently, we find that the learned Judge erred in finding that the salaries in question were deductible under Section 15 of the Income Tax Act.

As regards unpaid freight charges as bad debts, the Court noted that the exercise of the Appellant's discretion under Section 15 (2) (a) of the Income Tax Act to determine what amounts to a bad debt was not in issue. The Court found that the unpaid freight charges were bad debts which ought to have been considered when assessing the tax payable. The issue is whether the Local Committee was right in its finding that the bad debts could not be taken into account because the Respondent was not authorised by MSC to give credit to her customers. The Court agreed with the finding by the High Court that the Local Committee had misapprehended the Agency agreement.

Read the full judgment here

2. NAIROBI CIVIL APPEAL NO. 150 OF 2018: KENYA REVENUE AUTHORITY V UNIVERSAL CORPORATION LTD [2020] eKLR

Coram: R. Nambuye, J. Mohamed, W. Karanja, JJA

Date of judgement: 7th August 2020

Court: Court of Appeal sitting in Nairobi

Key words and Phrases: tax audit, short levied tax assessment

Sections of the Law: Section 235 (1) of the EACCMA and Regulation 7 (6) of the Value Added Tax Regulations 1994, Section 114 and paragraph 16 of the Fifth Schedule of the EACCMA, 2004

Section 235(1) of EACCMA, 2004

The proper officer may, within five years of the date of importation, exportation or transfer or manufacture of any goods, require the owner of the goods or any person who is in possession of any documents relating to the goods–

(a) to produce all books, records and documents relating in any way to the goods; and

(b) to answer any question in relation to the goods; and

(c) to make declaration with respect to the weight, number, measure, strength, value, cost, selling price, origin, destination or place of transhipment of the goods, as the proper officer may deem fit.

Implications of the judgment

Respondent is obligated to meet its tax commitments to the Appellant either as self-assessed or upon assessment by the Appellant. The Appellant is duty bound to exercise its statutory power with due diligence and as prescribed for by the law namely within the time frame permitted for by law to allow the Respondent claim a refund it is entitled to in law within the time frame stipulated for within the law.

Tax law with penal consequences must be interpreted with great caution and that any ambiguity in such a law must be resolved in favour of a tax payer. The penal consequence in the law is that the appellant was mandated to demand short levied taxes as and when assessed while the ambiguity in the said law arose from the failure to provide a window for the affected taxpayer to apply for late refund for such short levied tax demanded for after the period for claiming a refund has long lapsed.

Background

The Respondent sought against the appellant Judicial Review (JR) orders namely an order of certiorari to quash the decision by the Appellant requiring the Respondent Company to pay the Appellant Kshs 427,918,033 as VAT for the period of January, 2008 to October, 2013, an order of prohibition against the Appellant prohibiting it from purporting to take any action against the Respondent's company in an attempt to recover the sumof Kshs 427,918,033 and an order of prohibition against the Appellant prohibiting it from purporting to take any action that may violate the rights of the respondent's company."

The Appellant explained that it was in the exercise of its lawful and legitimate mandate under the relevant law that the Appellant conducted a tax audit on several Companies (the affected companies) inclusive of the respondent that were importing the subject raw materials which established that the said Companies were declaring the subject raw materials as exempt from VAT, when the said subject raw materials attracted VAT at the rate of sixteen percent (16%). This precipitated the appellant to variously raise short levied tax assessment demands against the affected companies. The demand directed at the respondent was in respect of an amount of Kshs 427,918,033 for the period between 1st January,

2008 and 31st October, 2013 (five (5) years), in compliance with section 235 (1) of the EACCMA and Regulation 7 (6) of the VAT Tax Regulation 1994.

The Appellant conceded that in 2005, the EACCMA, came into force and replaced the Customs and Excise Act, Cap 472; and that section 114 and paragraph 16 of the Fifth Schedule exempted the subject raw materials from duty; that the subject raw materials remained Zero Rated for VAT purposes between the years 1995 and 2012 which years were not covered under the short levied taxes audit exercise in issue; that from 1st January, 2008 to 31st October, 2013, the respondent was neither exempted from paying VAT under the second and third Schedule nor were the goods imported listed in the zero rated VAT tax under the fifth schedule of the repealed VAT Act Cap 476.

Issue

Whether the Short levied taxes assessed by the Appellant were payable

Decision of the Court

The Court of Appeal in dismissing the appeal agreed with the reasoning of the trial judge that the Respondent was obligated to meet its tax commitments to the Appellant either as self-assessed or upon assessment by the Appellant. The Appellant was duty bound to exercise the power with due diligence and as prescribed for by the law namely within the time frame permitted for by law to allow the Respondent claim a refund they were entitled to in law within the time frame stipulated for within the law.

The Court of appeal gave out the following reasons for its judgment. The Appellant as the indisputable public authority charged with the mandate of carrying out tax audits for purpose of detecting and enforcing recovery of short levied taxes in the first instance and as the chief administrator of the tax law in the second instance, was aware of the Respondent's right to be requested to meet its obligation with regard to any short levied

taxes that may be found due and payable from it in a time frame that would allow the Respondent an opportunity to claim a refund to which the Appellant has not disputed that the Respondent was indisputably entitled to in law.

Since the Appellant failed to explain itself for inaction, its action of moving to recover the short levied taxes at a time when the Respondent was not in a position to recover the same was unfair, irrational and unreasonable. The Appellant's gain in recovering the short levied taxes from the Respondent at that point in time was not proportional to the total loss the Respondent stood to suffer on account of inability to recover refunds lawfully due to it and which it would have rightfully claimed had it not been for the appellant's inaction and default in failing to demand for the same timeously.

The Appellant's decision was irrational as its decision to demand for the said short levied taxes at that point in time was not only unfair but also unjust. It was unreasonable because no justification was given for the Appellant's action of moving at that point in time to penalize the Respondent for the Appellant's mistakes arising from it having in place a system of operations established and managed by itself which led to the late discovery that there were short levied taxes owed to it by the Respondent;

The issue of eight (8) other companies that never complained and those others that entered into an arrangement with the appellant to meet their payment were irrelevant considerations in the circumstances of this appeal as they were neither contested at the trial nor ruled upon by the trial Judge and were not to be considered on appeal, especially when the circumstances under which those other companies came to the above arrangements with the Appellant were not part of the rival pleadings and facts that fell for interrogation by the trial Judge.

Read full judgment here

3. NAIROBI CIVIL APPEAL NO 175 OF 2016: INTERACTIVE GAMING & LOTTERIES LIMITED V KENYA REVENUE AUTHORITY [2018] EKLR

C

Coram: G. B. M. Kariuki, Sichale, Kantai, JJ. A

Date of judgement: 28th September 2018

Court: Court of Appeal sitting in Nairobi

Key words and Phrases: Assessment Notice, Estimated assessment.

Sections of the Law: Article 47 of the constitution of Kenya, Order 34 Civil Procedure Act, Section 35-, 73 & 84 of Income Tax Act, Fair Administrative Actions Act, Sections 50, 51 & 52 of the Value Added Tax Act.

Implications of the judgment

There are elaborate processes under the Income Tax Act and the Value Added Tax Act giving the taxpayers an opportunity to object to assessment notices as received. Taxpayers are required to object against the assessment notices to make the Kenya Revenue Authority duty bound in law to consider the same and if the dispute is not settled, processes in the statutes give appropriate remedies to the Taxpayer.

It is wrong for a taxpayer to file judicial review proceedings after receiving assessment notices when the appropriate remedy is to file objection proceedings before the Commissioner.

Recourse upon receipt of assessment notices from the Commissioner

It is wrong for a taxpayer to file judicial review proceedings after receiving assessment notices when the appropriate remedy is to file objection proceedings before the Commissioner.

Background

The parties in the subordinate court were the Appellant herein as plaintiff who sued *Flint East Africa Limited* as 1st defendant (*hereafter "Flint"*), *Safaricom Limited* as 2nd defendant *(hereafter "Safaricom")* and the Respondent as 3rd defendant *(hereafter "KRA")*. It was stated in the plaint that the appellant herein was the promoter of a public lottery being carried out under a public lottery permit issued by the Betting Control & Licensing Board to run for a period from 1st October 2010 to 31st December 2010 and that the period was extended to 15th March 2011.

It was further stated that Flint was the holder of Short Code Platform 6969 assigned to it by Safaricom and other mobile service providers for its own purpose or on behalf of third parties that may appoint it as a Premium Rate Service Provider (PRSP). It was further stated that an invoice dated 14th January 2011 Flint had sought payment from Safaricom of Kshs. 93,975,040.88 exclusive of Value Added Tax for the period ending 31st December 2010 but that lottery had continued up to 17th January 2011 by which time Safaricom had collected a further amount of Kshs. 52,480,592.74 exclusive of Value

Added Tax. A net sum of Kshs. 146,455,633.28 was said to be owing to Flint on behalf of the appellant from Safaricom in unremitted lottery revenue.

The subject of this appeal however was that KRA had confirmed on oath in the subordinate Court that it was not claiming any taxes from the appellant and that a finding to that effect was made by the court in the judgment delivered on 30th April 2014. The appellant went on to state that it was incorporated on 17th September 2010 and could not have any tax liability by 31st December 2010 and that the lottery that gave rise to the funds held by Safaricom was ran in December 2010 and January, 2011 and KRA was aware that proceeds of the lottery had never been received by the appellant. It was alleged by the appellant that KRA had confirmed in the proceedings in that suit that Safaricom had deducted Value Added Tax and Withholding Tax and remitted it directly to KRA and that a claim for tax could not be made again.

Issues

a) Whether there was an alternative remedy available to the Appellant instead of the route of Judicial review proceedings.
b) The effects of the judgement and findings of the High Court.

Decision of the Court on the issues

The Court was guided by the decision in ***Pili Management Consultants Limited v Commissioner of Income Tax Kenya Revenue Authority [2010] eKLR***. Under Section 84 of the Income Tax Act Cap 470 Laws of Kenya a procedure is set out which obligates a person on whom an assessment has been made and who disputes the same to object the same to the Commissioner of Income Tax or Commissioner of VAT, as the case may be. The said and other provisions of taxation laws set out an elaborate procedure for a person who disputes the assessment to object or appeal against the same. The said section proceeds to set out the steps such a person must take for the objection to be valid.

In addition, it was also held in Municipal Council of Mombasa v Republic and Another [2002] eKLR that judicial review is concerned with the decision-making process not with the merits of the decision itself. The Respondent cannot be barred from claiming taxes if due since the issue of taxes was not an issue for consideration in the interpleader proceedings.

Read the full judgement here

4. NAIROBI TAX APPEAL NO. E002 OF 2020- LEAH NJERI NJIRU V COMMISSIONER OF INVESTIGATIONS & ENFORCEMENT KENYA REVENUE AUTHORITY AND CHIEF MANAGER DEBT COLLECTION & ENFORCEMENT

C

Coram: D.S. Majanja

Date of Judgement: 26th March 2021

Key Sections of the law: Section 3(1), 15(1), 16(1), 52B, 54A of the Income Tax Act, Section 29, 56(1) Tax Procedures Act

Key words and Phrases: Assessment, personal income, default assessment, amended assessment, notice of assessment.

Determination that Commissioner's assessment is incorrect

The taxpayer bears the burden of proof that the assessment and demand by the Commissioner is incorrect.

Section 56
Tax Procedures Act

Implications of the judgment

Business entities are afforded an opportunity to deduct all their expenses on their total income, such that only their profit is subject to tax as their personal income. Pursuant to section 54A (1) business should keep records of all their expenditures so as to prove as such. The burden of proof lies on the taxpayer to demonstrate that a tax assessment is faulty. Further, the taxpayer is obligated to prove the extent of their expenses to include the cost of operating the business.

Background

The Respondents carried out an investigative tax audit in 2015 on the Appellant, for the tax period of January 2008 to December 2015. From the investigation, the Commissioner discovered that despite making a substantial amount, the Appellant had not declared any income. Consequently, the 1st Respondent issued the Appellant t with an additional income tax assessment amounting to KES 127,462,486.00 as principal taxes on income earned from business.

Subsequently, the Appellant sought to resolve the issue trough a letter dead 30th January 2017. Later, the parties embarked on a series of meetings and exchange of

correspondence either view to resolving the dispute. In the course of these meetings, the Appellant provided additional information which the 1st Respondent used to calculate her tax liability at KES 306,176,144.00 inclusive of penalties and interest accrued. Following his, the Appellant made an objection to which the 1st Respondent issued an objection decision on 29th March 2017. Further aggrieved by the decision the parties resorted to alternative dispute resolution mechanism that resulted in reduction of the Appellant's tax liability from KES 306,176,144.00 to KES 18,006,461.00. The latter amount formed the basis of the matter that in Income Tax Appeal No. 79 of 2019. It is the decision of the tribunal that is in contention in the instant appeal.

The principal arguments made by the Appellant were that Commissioner had arrived at an irrational and unreasonable assessment by failing to factor in operating expenses of the business. She also argued failure by the Commissioner to issues a notice of Assessment.

Issues for Determination

a) Whether the Commissioner had issued the Appellant with a Notice of Assessment and if not whether this omission nullified the Commissioner's assessment of the Appellant's tax liability for the year 2008. 2009. 2011 and 2014?
b) Whether the Tribunal erred in upholding the Commissioner's revised tax assessment of the Appellant at KES 18,006,461.00?

Determination by the High Court

In its analysis the Court found that the Respondent had issued the required notices through the Appellant's agent. Further, alluding to the submissions made by the parties, the fact that the Appellant made objections to some of the assessments also spoke to the fact that the Respondent had issued requisite notices. Therefore, the Court held that this claim had no basis and was dismissed.

On the latter issues, the Court held that the burden to prove that a tax decision is incorrect lay fully on the taxpayer. He who alleges must prove. Further that appeals of tax decision made to the High Court or Court of Appeal ought to strictly be on matters of law. It also held that it was not sufficient for the Appellant to claim those expenses without producing documents to that effect. The learned judge reiterated the statutory provision that obligates business entities to maintain records of all their expenses such as all receipts and expenses, goods purchased and sold and accounts, books, deeds, contracts and vouchers which in the opinion of the Commissioner, are adequate for the purpose of computing tax.

Read the full judgment here

Burder of proof

"Under section 56(1) of the TPA, the taxpayer bears the burden of proving that the tax decision is incorrect. The Commissioner arrived at the revised assessment of KES. 18,006,461.00 after correspondence and meeting between it and the Appellant. The Appellant was able to present her case to the fullest extent. At the Tribunal, the Appellant did not demonstrate the tax decision was wrong." Justice D.S. Majanja.

5. NAIROBI INCOME TAX APPEAL NO. 7 OF 2017: RABAI OPERATION & MAINTENANCE LIMITED V COMMISSIONER OF DOMESTIC TAXES [2019] EKLR.

C

Coram: Mary Kasango

Date of delivery of Judgment: 4th October 2019

Key Articles/Sections of the law: Article 47 of the Constitution, Section 10, 17 Value Added Tax Act, Paragraph 7 of the Seventh Schedule of the VAT Act, Paragraph 9 of the VAT Regulations, Legal Notice No. 95 of 2009, Section 56(2) Tax Procedure Act.

Key Words and Phrases: VAT Assessment, Input and Output tax system, Integrated Tax Management System (ITMS), Interpretation of Tax Statutes.

Implications

The only conditions for a tax payer to deduct input VAT are the ones outlined in in section 17 and subject the VAT Regulations. That is; a taxpayer does not have to file monthly VAT returns for them to be able to deduct input VAT under Section 11 of the VAT Act. The Commissioner's insistence that a tax payer had to be registered under ITMS for it to benefit from deduction of input VAT is not supported by Section 11 of the VAT Act 2013 at all.

Implications of the Judgment

A taxpayer does not have to file monthly VAT returns for them to be able to deduct input VAT under Section 11 of the VAT Act. The Commissioner's insistence that a tax payer had to be registered under ITMS for it to benefit from deduction of input VAT was not supported by Section 11 of the repealed VAT Act, Cap 476

Background

The Appellant started trading in 2009 with a PIN which it used to pay all its taxes. On the basis of that PIN, the Appellant regularly deducted input VAT from output VAT as required by Section 11 of the VAT Act. The Appellant was however unable to file returns because it had not been set up on ITMS system due to a system technical problem. The Commissioner and the Tribunal acknowledged that the Appellant paid VAT monthly which was as a resultant of deduction of input VAT from output VAT.

The Commissioner however argued that a tax payer should be assigned PIN together with being registered under ITMS system for it to be obligated to charge and account for VAT. Further, that the fact that the Appellant was able to remit VAT should not be contrived as having complied with the registration for claiming input VAT. That it is only after registration on ITMS that a taxpayer can claim input VAT.

The Commissioner on that basis issued the Appellant with VAT assessments, which after objection were revised to Kshs.17,965,918 for the period 20008-2010. The Appellant appealed this assessment and argument in the Tax Appeal Tribunal which dismissed the Appellants appeal and held that the Appellant was not registered for VAT. The Appellant being aggrieved by the said Tribunal decision, appealed to the High court which is the subject of this judgment.

Rule of interpretation of Laws

A rule or schedule (Subsidiary legislation) cannot override or be construed to contradict the provisions of the Act. Section 11 of the repealed VAT Act, Cap 476 recognized that it is subject only to the regulations. It could not be construed to be contradicted by a paragraph of the Schedule.

Issues for determination

a. Whether Section 11 of the VAT Act needs to be read together with Paragraph 7 of the Seventh Schedule.

b. Whether a tax payer is only entitled tot deduct VAT when it is registered or its profile is under ITMS.

Determination by the court

A rule or schedule (Subsidiary legislation) cannot override or be construed to contradict the provisions of the Act. Section 11 of the repealed VAT Act, Cap 476 recognized that it is subject only to the regulations. It could not be construed to be contradicted by a paragraph of the Schedule.

Further, the requirement for VAT monthly returns was not a condition for deduction of input VAT under section 11 of the VAT repealed VAT Act, Cap 476. The Court held that the Commissioner's insistence that a taxpayer had to be registered under ITMS for it to benefit from deduction of input VAT was not supported by section 11 of the VAT Act, Cap 476.

Read the full judgment here

6. NAIROBI TAX APPEAL NO. 3 PF 2020: TUMAINI DISTRIBUTORS COMPANY (K) LIMITED V COMMISSIONER OF DOMESTIC TAXES [2020] eKLR

***Coram**: D.S Majanja*

***Date delivered:** 22nd June 2020*

***Key Words**: Assessment, Amended assessment, self-assessment*

***Sections of the Law:** Section 2, 31, 51, 56 Tax Procedures Act, Section 12, 30 of the Tax Appeals Tribunal Act, 2013*

Implications of the Judgment

The Taxpayer must discharge its burden that the assessment by the Commissioner is incorrect as per the provisions of Section 56(1) of the Tax Procedures Act, 2015.

Background

The appellant ("the Company") appealed against a decision of the Tax Appeals Tribunal ("the Tribunal") dismissing its appeal and upholding assessments by the Commissioner of Domestic Taxes in which it assessed tax at Kshs. 31,217,489.00. In September 2016, the Commissioner identified the Company for review and compliance. Following review of documents provided by the Company, the Commissioner disallowed certain expenses claimed in respect of the income tax.

The Commissioner concluded that the documents furnished by the Company were inadequate to address the issues it had raised and further audience with the Company did not yield any results. It therefore decided to issue additional assessments for Kshs. 31,217,489.00 for VAT and income tax.

Thereafter the Commissioner commenced enforcement proceedings by issuing agency notices prompting the Company to lodge objections to the assessments. It also made an application dated 22nd June 2017 to amend its self-assessment.

A meeting was held between the Company's Auditor and the Commissioner where the Company was requested to present certain documents which the Commissioner considered but which it found insufficient. Thereafter, the auditor on behalf of the Company made an, "application for amendment of self-assessment for the period 2014 and 2015 (VAT and Income Tax).

The Company thereafter filed an appeal before the Tribunal on the ground that its application for amendment was not resolved despite the fact that it had all the supporting documents including invoices, ledgers and expense records.

Issues for Determination

a) *What are the statutory requirements on the burden of proof that the tax decision by the Commissioner is wrong or incorrect?*

b) *Whether a taxpayer can apply to amend self-assessment outside the statutory timeline.*

Determination of the issues by the Court

The Company failed to object to the assessments it appealed against to the Tribunal as it objection were filed out of time and rejected. The application for amendment under section 31 of the *TPA* constitutes a separate process and could not implicate or affect the assessments already confirmed by the failure of the Company to lodge its objection in time.

The decision by the Commissioner and the Tribunal in respect of the assessments appealed against were in accordance with the evidence and material available to the Commissioner. The Appellant did not discharge its burden of showing that the tax decision was wrong or incorrect. The issue of amendment of the self-assessment was not the subject of the tax decision that was being challenged in the appeal before the Tribunal.

Read the full judgment here

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Tulipe Ushuru Tujitegemee!