REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI CITY

COURT NAME: MILIMANI LAW COURTS

CASE NUMBER: HCCOMMITA/E086/2020

CITATION: KENYA REVENUE AUTHORITY VS PEARL INDUSTRIES LIMITED

JUDGMENT

Introduction and Background

1. The Respondent is in the business of manufacturing and selling of fabrics. The Appellant ("the Commissioner") in exercise of its power to, inter alia, assess and collect tax revenue issued a letter dated 30th November 2017 pursuant to section 59(1) of the Tax Procedure Act, 2015 ("the TPA") stating its intention to conduct an investigation into the Respondent's tax affairs with a view of establishing whether it was involved in a VAT fraud scheme, verify whether the input tax claimed by the Respondent was valid and collect any unpaid taxes. The Commissioner requested the Respondent for information and documents, including statements, invoices, delivery notes, payment vouchers and ETR receipts issued or received from a number of the Respondent's suppliers over the period starting January 2012 to the date of the letter.

2. After going through the documents supplied to it by the Respondent, the Commissioner, through its letter dated 23rd March 2018, disallowed some of the input tax claimed by the Respondent for lack of supporting documents and issued it with additional assessments of KES 306,051,182.00 and 166,512,947.00 in respect of Corporation Tax and Value Added Tax ("VAT") respectively.

3. The Respondent disputed the Commissioner's findings and filed an objection through its letter dated 26th April 2018. The Commissioner, through its letter dated 26th June 2018 rendered its decision on the objection ("the Objection Decision") by confirming its earlier assessments. Aggrieved, the Respondent appealed to the Tax Appeals Tribunal ("the Tribunal"), which after hearing the matter, allowed the Respondent's appeal and quashed the demand as contained in the Commissioner's Objection Decision.

4. The Tribunal dealt with and framed the following issue which is germane to this appeal; whether the Commissioner erred in its decision to disallow input VAT, the costs of sale in computation of Corporation Tax. The Commissioner disallowed input VAT and costs of sales in computation of Corporation Tax arguing that the impugned supplies to the Respondent were fictitious as the suppliers did not supply any goods and were only in the business of selling invoices to facilitate missing trader fraud. On its part, the Respondent argued that Commissioner was trying to attribute non-compliance of its suppliers.

5. In resolving the issue, the Tribunal considered whether the Respondent had furnished sufficient proof of purchase, whether it knew or ought to have known that there was fraud and whether the right to claim VAT was affected by presence of fraud in the supply chain. The Tribunal held that in the instant case, the Respondent had discharged its obligation of proving that that there was a purchase by providing invoices and proof of payment for the supplies. It further held that the Commissioner, who had the burden of proving that the Respondent knew or ought to have known the transaction was part of a fraudulent scheme, failed to establish fraud. Lastly, the Tribunal held that the Commissioner, having failed to prove that the Respondent was part of a fraudulent scheme involving suppliers, erred in disallowing input tax and cost of sales in the computation of Corporation Tax.

6. It is this decision by the Tribunal that forms the subject and substance of the instant appeal which is grounded in the Commissioner's Memorandum of Appeal dated 17th September 2020. The Respondent filed its Statement of Facts dated 21st October 2020. Pursuant to the court's directions, the appeal was disposed by way of written submissions.

7. It is apparent from the Tribunal's decision that the dispute revolved around the burden of proof hence the Commissioner has condensed the issues for determination as follows:
a) Whether the Tribunal erred in fact and in law in failing to appreciate that the dispute before it was based on section 59 of the TPA which expressly gives power to the Commissioner to request the production of records and additional information which can fully satisfy the Commissioner where it is of the view that the information given is insufficient.
b) Whether the Tribunal erred in fact by failing to appreciate that in this case there was an intended VAT loss because there was no exchange of goods or services in respect of which VAT input was claimed by the Respondent.

8. Having considered the submissions by the parties, it is common ground that in raising the additional assessments upon the Respondent, the Commissioner disallowed some of the Respondent's purchases and claims of input VAT by alleging that no purchases were actually done and that some of the Respondent's suppliers were non-existent and/or were issuing it with bogus invoices, ETR receipts and non-existent supplies in what the Commissioner described as an illegal VAT refund scheme where the Respondent was either a beneficiary or an accomplice.

9. In resolving this matter is it important to clarify how the Kenyan VAT system operates. VAT is a tax chargeable on supply of taxable goods or services made or provided in Kenya and on importation of taxable goods or services into Kenya. It works under the input and output tax system. Output tax refers to the VAT charged on the sales of taxable goods or services, while input tax refers to VAT charged on taxable purchases of goods and services for business purposes. The tax payable is the difference between the output tax and input tax. Thus, the Respondent is correct to submit that it had the right to deduct input tax from its VATable transactions as an integral part of the VAT scheme as a taxable person who makes a transaction in respect of which VAT is deductible, may deduct the VAT in respect of goods and services acquired by him provided that such goods and services have a direct and immediate link with the output transaction in respect of which VAT is deductible (see Highlands Mineral Water Limited v Commissioner of Domestic Taxes ML HC ITA Mo. E026 OF 2020 [2021] eKLR)

10. The aforementioned position is anchored under section 17 (1), (2), (3) and (5) of the VAT Act, 2013 which provide as follows:
17. Credit for input tax against output tax
(1) Subject to the provisions of this section and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or

importation occurred, be deducted by the registered person, subject to the exceptions provided under this section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies.
(2) If, at the time when a deduction for input tax would otherwise be allowable under subsection (1), the person does not hold the documentation referred to in subsection (3), the deduction for input tax shall not be allowed until the first tax period in which the person holds such documentation.
Provided that the input tax shall be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred.
(3) The documentation for the purposes of subsection (2) shall be—
(a) an original tax invoice issued for the supply or a certified copy;
(b) .....
(c) .....
(d) .....
(4).....
(5) Where the amount of input tax that may be deducted by a registered person under subsection (1) in respect of a tax period exceeds the amount of output tax due for the period, the amount of the excess shall be carried forward as input tax deductible in the next tax period:
Provided that any such excess shall be paid to the registered person by the Commissioner where —
(a) such excess arises from making zero rated supplies; or
(b) such excess arises from tax withheld by appointed tax withholding agents; and
(c) such excess arising out of tax withheld by appointed tax withholding agents may be applied against any tax payable under this Act or any other written law, or is due for refund pursuant to section 47(4) of the Tax Procedures Act, 2015; and
(d) the registered person lodges the claim for the refund of the excess tax within twenty-four months from the date the tax becomes due and payable.
Provided further that, notwithstanding section 17(5)(d), a registered person who, within a period of thirty-six months prior to the commencement of section 17(5)(b) and (c), has a credit arising from withholding tax, may make an application for a refund of the excess tax within twelve months from the commencement date.

11. Further, as the Commissioner submitted, section 43 of the VAT Act, 2013 provides for the requirement that a tax payer is required to maintain records as follows:
43. Keeping of records
(1) A person shall, for the purposes of this Act, keep in the course of his business, a full and true written record, whether in electronic form or otherwise, in English or Kiswahili of every transaction he makes and the record shall be kept in Kenya for a period of five years from the date of the last entry made therein.
(2) The records to be kept under subsection (1) shall include—
(a) copies of all tax invoices and simplified tax invoices issued in serial number order;
(b) copies of all credit and debit notes issued, in chronological order;
(c) purchase invoices, copies of customs entries, receipts for the payment of customs duty or tax, and credit and debit notes received, to be filed chronologically either by date of receipt or under each supplier's name;
(d) details of the amounts of tax charged on each supply made or received and in relation to all services to which section 10 applies, sufficient written evidence to identify the supplier and the recipient, and to show the nature and quantity of services supplied, the time of supply, the place of supply, the consideration for the supply, and the extent to which the supply has been used by the recipient for a particular purpose;
(e) tax account showing the totals of the output tax and the input tax in each period and a net total of the tax payable or the excess tax carried forward, as the case may be, at the end of each period;
(f) copies of stock records kept periodically as the Commissioner may determine

(g) details of each supply of goods and services from the business premises, unless such details are available at the time of supply on invoices issued at, or before, that time; and
(h) such other accounts or records as may be specified, in writing, by the Commissioner.
(3) Every person required under subsection (1) to keep records shall, at all reasonable times, avail the records to an authorised officer for inspection and shall give the officer every facility necessary to inspect the records.
(4) For the purposes of this section, the Commissioner may, in accordance with the regulations, require any person to use an electronic tax register, of such type and description as may be prescribed, for the purpose of accessing information regarding any matter or transaction which may affect the tax liability of the person.
(5) A person who contravenes any of the provisions of this section commits an offence

12. It is agreed that in interpreting tax statutes, the court adopts the principle that the same must be interpreted strictly, leaving no room for intendment or implication. This view was summarised by Nyamu JA., in Stanbic Bank Kenya Limited v Kenya Revenue Authority CA Civil Appeal No. 77 of 2008 [2009] eKLR as follows:
In my interpretation of the law, it is quite evident that I have not sought any assistance from outside a dictionary in ordinary use. Moreover, I have not strained the meaning of the words in order to achieve any particular result. I have simply adopted the ordinary meaning of the words used in the relevant tax statute. This is because as regards tax law the issue of intention or intendment does not arise. If there is any ambiguity, and I did not detect any in my analysis, the same must be construed in favour of the tax payer. In tax law, the converse is also true that if the meaning is clear, that tax is chargeable, the issue of what was intended is not the function of the court and where tax liability is expressed and located by law the courts must uphold the taxman's position.

13. A simple reading and interpretation of section 17 above relevant to this appeal is that a registered tax payer is entitled to deduct input VAT on taxable purchases but that the same can only be allowed if the taxpayer holds such documentation which documentation includes "an original tax invoice issued for the supply or a certified copy". Section 43 on the other hand provides that a taxpayer is to keep and maintain specific records for a period of five years from the date of the last entry and that those records shall at all times be available for inspection by the Commissioner. Section 59 (1) of the TPA also provides that a tax payer shall produce records when required to dos so by the Commissioner as follows:
59. Production of records
(1) For the purposes of obtaining full information in respect of the tax liability of any person or class of persons, or for any other purposes relating to a tax law, the Commissioner or an authorised officer may require any person, by notice in writing, to—
(a) produce for examination, at such time and place as may be specified in the notice, any documents (including in electronic format) that are in the person's custody or under the person's control relating to the tax liability of any person;
(b) furnish information relating to the tax liability of any person in the manner and by the time as specified in the notice; or
(c) attend, at the time and place specified in the notice, for the purpose of giving evidence in respect of any matter or transaction appearing to be relevant to the tax liability of any person.

14. It is also not in dispute that section 30 of the Tax Appeals Tribunal Act and section 56 of the TPA impose the burden of proof on the tax payer to prove that an assessment is excessive or a tax decision is incorrect. All these provisions must be read holistically hence I am in agreement with the dictum in Okiya Omtatah Okoiti v Attorney General & another NRB HC Petition No. 156 of 2017 [2020] eKLR that:
99. Once again I observe that a section or sections of a law should not be read in isolation of the

other provisions of that law. The impugned provisions are only meant to enforce the tax laws after a taxpayer fails to self-assess for tax purposes or once it is evident that a taxpayer is dishonest. The Act as a whole has safeguards that ensures that the taxpayers receive fair administrative action from the tax collector whenever the need arises to put a particular taxpayer through the administrative process.

15. As stated in the introductory part, the inquiry on the Respondent began on 30th November 2017, when pursuant to section 59(1) of the TPA, the Respondent was requested by the Commissioner to furnish documents including supplier statements, delivery notes, payment vouchers and ETR receipts in respect of some listed suppliers. From the Commissioner's letter dated 23rd March 2018, it appears that the Respondent only provided copies of invoices and supplier statements and not ETR receipts, signed delivery notes and payment documents which according to the Commissioner, was to enable it establish that actual purchases took place. The Commissioner further stated that its investigations had established that some of the suppliers the Respondent claimed input VAT from did not in fact supply any goods and therefore, the Commissioner disallowed the input VAT claim for lack of supporting documents.

16. After the Respondent objected to the Commissioner's findings, the Commissioner affirmed its position in the Objection Decision that the said suppliers did not sell or deliver any goods at all but have instead devised a scheme where they only print fictitious invoices and ETR receipts which they sell to other companies to inflate their inputs. The Commissioner further stated most of the businesses the Respondent was claiming input VAT from were not registered persons. The Commissioner further faulted the Respondent's proof of payments by stating that what was presented were only cheque withdrawals which did not show who was being paid thus the same never amounted to proof of payment.

17. Under section 56 of the TPA, it was incumbent upon the Respondent to prove that the Commissioner's findings above were wrong. How could it do so? By providing evidence and supporting documentation to dislodge the Commissioner's findings. For instance, it could have provided PIN certificates of its suppliers to prove that they were actually registered persons capable of making taxable supplies. Since the validity of the invoices, ETR receipts and delivery notes issued to it were doubted by the Commissioner, the Respondent could have produced witnesses including some from the suppliers to prove that they actually supplied goods to it.

18. I therefore disagree with the Tribunal that it was upon the Commissioner to prove that the invoices and deliveries were not genuine and that the withdrawals made by the Respondent went to other persons other than the Respondent's suppliers. I also do not think that the documents requested for by the Commissioner were unreasonable or outside of the law as had been insinuated by the Tribunal because the request was within the Commissioner's powers under section 59 of the TPA.

19. In this case, the pendulum of proof swung three times; the first was upon the Respondent, which it did by providing the documents requested by the Commissioner; the second shifted the Commissioner, who after reviewing the documents challenged their authenticity and validity. This meant that the burden of proof finally swung back to the Respondent to prove that the Commissioner was wrong in its position and overall findings.

20. This position of who bears the burden of proof was also considered by the court in Commissioner of Domestic Services v Galaxy Tools Limited ML HC ITA No. E088 OF 2020 [2021] eKLR where it cited with approval the decision in the case Metcash Trading Limited v Commissioner for South Africa Revenue Service and Another CCT/2000 where the South Africa Constitutional Court stated as

follows:
But the burden of proving the Commissioner wrong then rests on the vendor under section 37. Because VAT is inherently a system of self-assessment based on a vendor 's own records, it is obvious that the incidence of this onus can have a decisive effect on the outcome of an objection or appeal. Unlike income tax, where assessments can elicit genuine differences of opinion about accounting practice, legal interpretations or the like, in the case of a VAT assessment there must invariably have been an adverse credibility finding by the Commissioner and by like token such a finding would usually have entailed a rejection of the truth of the vendor's records, returns and averments relating thereto. Consequently, the discharge of the onus is a most formidable hurdle facing a VAT vendor who is aggrieved by an assessment unless the Commissioner's precipitating credibility finding can be shown to be wrong, the consequential assessment must stand.

21. The Court of Appeal, in Total Kenya Limited v Kenya Revenue Authority NRB CA Civil Appeal No. 148 of 2013 [2018] eKLR dealt with a similar issue where the appellant therein had claimed to have paid import duty and submitted copies of Import Entries of the consignments it claimed to have paid. Investigations by the respondent therein revealed a different story in that the import documents as well as the receipt were all forgeries since they related to a different consignment altogether, as opposed to the subject of the demand. This position was not countered by the appellant and the appellate court found that indeed fraud had been proved and that it was specifically pleaded by the respondent in its replying affidavit.

22. Likewise, in this case, the Commissioner's responses to the Respondent directly to it and before the Tribunal were in great detail and specificity on the issue of fraud and how it was being perpetrated. The Respondent failed to counter this with satisfactory evidence, thus the issue of fraud remained uncontested and thus proved. I therefore find and hold that the Respondent failed to discharge its burden of proof as a tax payer as it did not demonstrate how the Commissioner's findings were wrong. This means that the Commissioner's findings that the invoices, ETR receipts, delivery notes issued by the suppliers and the goods apparently supplied to the Respondent were bogus and that the said suppliers were not registered persons, were proven.

23. In conclusion, I find and hold that the Respondent could not claim input VAT for purchases that did not happen and from persons that were unregistered thus, the Respondent could not make any deductions from its sales (output) VAT therefore the Commissioner was entitled to charge VAT on the output tax as is. Since no purchases were made, no deductions could have been made from the Respondent's income thus the Commissioner was entitled to charge corporation tax on its income without any deductions of the unproven purchase expenses.

Disposition
24. In light of the conclusions I have reached, I find that the Tribunal erred in its application of sections 56 and 59 of the TPA and section 30 of the Tax Appeals Tribunal Act and arrived at the wrong conclusion in this matter.

25. I therefore allow that appeal, set aside the judgment of the Tribunal dated 21st August 2020 with the result that the assessments of the Commissioner issued in its Objection Decision dated 26th June 2018 are upheld.

DATED and DELIVERED at NAIROBI this 31ST day of JANUARY 2022.

D. S. MAJANJA
JUDGE

SIGNED BY: HON. MR. JUSTICE D. S. MAJANJA

THE JUDICIARY OF KENYA.
MILIMANI HIGH COURT
HIGH COURT COMMERCIAL AND TAX
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