REPUBLIC OF KENYA
TAX APPEALS TRIBUNAL
APPEAL NO. 159 OF 2018

OSHO DRAPPERS LTD .....APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

Background

1. The Appellant is a limited company incorporated under the Company Act and whose principal business is wholesale of general merchandise.
2. The Respondent is a principal officer appointed under the Kenya Revenue Authority Act, Cap 469 of the Laws of Kenya. Under Section 5(1) of the Act, the Kenya Revenue Authority is an agency of Government for collection and receipt of all revenue.
3. The Respondent issued a notice of assessment dated 17th April 2018 demanding VAT of Kshs 1,795,881.00 and Corporation Tax of Kshs 3,367,278.00 for the period July 2015 to May 2017.
4. The Appellant objected to the assessment via a Notice of objection dated 20th May 2018. The Respondent issued its Objection Decision on 11th July 2018 confirming the assessed amount of Kshs. 1,795,881.00 for VAT and

Kshs.3,367,278.00 for Corporation Tax together with the resultant penalty and interest.

5. Being aggrieved by the Objection Decision the Appellant filed an Appeal with the Tribunal on 10th August 2018.

Grounds for Appeal

6. The Appellant in its Memorandum of Appeal cited the following grounds for Appeal:

   i. That the Respondent erred in fact and in law by disallowing input VAT contrary to the provisions of the VAT Act 2013.

   ii. That the Respondent erred in fact and in law by disallowing input VAT based on investigation of non-compliance of tax by the company suppliers.

The Appellant's case

7. The Appellant submitted that the Respondent disallowed input VAT contrary to Section 17 of the VAT Act 2013 which provides that:

> *"(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) a customs entry duly certified by the proper officer and a receipt for the payment of tax;

(c) a customs receipt and a certificate signed by the proper officer stating the amount of tax paid, in the case of goods purchased from a customs auction;

(d) a credit note in the case of input tax deducted under section 16(2);

or

(e) a debit note in the case of input tax deducted under section 16(5)."

8. The Appellant argued that a claim for input VAT is based on the above listed documentation. The Appellant added that the VAT Act further provides the following requirements on deduction of input tax:

   i. The taxpayer is registered for VAT.

   ii. The purchase was for the purposes of making taxable supplies.

   iii. The input tax does not relate to the excluded purchases as set out in Section 17(4) of the VAT Act or exempt supplies.

   iv. The input tax is claimed within six months of receiving supply; and

   v. The claim for the input tax should be based on the documentation required under Section 17 of the VAT Act and the Regulations.

9. The Appellant submitted that it complied with the VAT Act as it is registered for VAT, it made taxable supplies charging VAT thereof, it claimed input VAT from its suppliers within the stipulated time and it is in possession of original tax invoices issued for the supply. The Appellant insisted that it is therefore entitled to claim the input VAT.

10. The Appellant asserted that the Respondent was under a duty to direct itself properly in law. In particular the Appellant submitted that the Respondent

ought to have paid attention to matters which it is bound to consider such as the provisions of Section 17 of the VAT Act and Section 15(1) of the Income Tax Act in arriving at the tax assessment.

11. The Appellant argued that the Respondent disallowed input VAT on the grounds that its investigation established a grand missing trader scheme, that the suppliers whom it purchased from do not sell or deliver goods at all. This, the Appellant avers, does not apply to it because it indeed purchased goods as indicated in the invoices, the goods were delivered as indicated on the delivery notes and payments were made as can be confirmed from the company bank accounts and payment records.

12. The Appellant maintained that the investigation findings are not only inaccurate and unreasonable but also unfair to the Appellant since the Appellant has to the best of its knowledge provided sufficient proof to show that it indeed purchased the goods in question.

13. The Appellant further averred that the basis for allowing the input VAT claim is set out under Section 17 of the VAT Act and the failure by the Respondent to allow the same is arbitrary, illegal and a violation of the Appellant's right to fair administrative action protected under Article 47(1) of the Constitution of Kenya 2010.

14. It was the Appellant's submission that the unsupported suggestions or presumptions that the goods were not bought and delivered is therefore inaccurate and untenable.

15. The Appellant averred that the Respondent was trying to attribute non-compliance of the listed suppliers to it which cannot be the basis of disallowing input VAT as provided for under the VAT Act or any other law of Kenya.

16. The Appellant further submitted that the documents provided prove that it indeed purchased goods from the listed suppliers which it sold to various customers. The Appellant also made payment for the purchases as can be confirmed from the documents attached to the Appeal.

17. The Appellant contended that having complied with the law, it had a legitimate expectation that the Respondent would allow its input VAT claims. The Appellant further averred that the facts and circumstances giving rise to this Appeal clearly points to abuse of office and power by the Respondent and that such abuse of power should not be sanctioned by the Tribunal.

18. To support its case, the Appellant cited **De Smith, Woolf & Jowell**, in *"Judicial Review of Administrative Action"* **6th Edn. Sweet & Maxwell page 609** where the authors state:

> *"A legitimate expectation arises where a person responsible for taking a decision has induced in someone a reasonable expectation that he will receive or retain a benefit or advantage. It is a basic principle of*

fairness that legitimate expectations ought not to be thwarted. The protection of legitimate expectations is at the root of the constitutional principle of the rule of law, which requires predictability and certainty in government's dealings with the public,"

19. The Appellant averred that a legitimate expectation may arise from express stipulations of the law as appreciated in **Keroche Industries Limited –Vs- Kenya Revenue Authority & 5 others Nairobi HCMA No. 743 of 2006 [2007] KLR 240** where the court held that:

"...legitimate expectation is based not only on ensuring that legitimate expectations by the parties are not thwarted, but on a higher public interest beneficial to all including the respondents, which is, the value or the need of holding authorities to promises and practices they have made and acted on and by so doing upholding responsible public administration. This in turn enables people affected to plan their lives with a sense of certainty, trust, reasonableness, and reasonable expectation. An abrupt change as was intended in this case, targeted at a particular company or industry is certainly abuse of power. Stated simply legitimate expectation arises for example where a member of the public as a result of a promise or other conduct expects that he will be treated in one way and the public body wishes to treat him or her in a different way...Public authorities must be held to their practices

and promises by the courts and the only exception is where a public authority has sufficient overriding interest to justify a departure from what has been previously promised...In order to ascertain whether or not the Respondents decision and the intended action is an abuse of power the court has taken a fairly broad view of the major factors such as the abruptness, oppressiveness and the quantum of the amount of tax imposed retrospectively and its potential to irretrievably ruin the applicant. All these are traits of abuse of power. Thus, I hold that the frustration of the applicants' legitimate expectation based on the application of tariff amounts to abuse of power."

20. The Appellant submits that the arbitrary decision by the Respondent with respect to the input VAT claims by the Appellant amounted to the thwarting of the Appellant's legitimate expectations that the said claims would be allowed.

21. The Respondent in arriving at the Objection Decision alleged that the input tax claimed could not be allowed because the suppliers of the Appellant did not supply goods nor deliver them. The Appellant alleges that the Respondent gave itself wide latitude in interpreting tax statute and ended up making irrelevant considerations in reaching the impugned decision.

22. To support its case, the Appellant cited **Fleur Investments Limited –vs- Commissioner of Domestic Taxes & another [2018] eKLR** where the court held that:

> *"This case falls squarely on all fours with the case of Municipal Council of Mombasa vs. Republic & Umoja Consultants Ltd (supra), because clearly, the respondents failed to consider the very relevant facts that their request for an audit meeting had already been met, all documents requested for had been availed and examined, and yet the assessment was premised on the erroneous premise that the appellant had failed to comply with the said requests. The need to take into account relevant considerations and ignore irrelevant facts in the decision making has close nexus with the need to act reasonably."*

23. The Appellant argued that the Respondent was bound to exclude from its consideration matters which are irrelevant, (such as requiring the Appellant, a legitimate trader, to give identities of its suppliers). As such, the Appellant submits that the Respondent acted unreasonably and the resultant assessments cannot stand.

The Appellant's Prayers

24. The Appellant made the following prayers:

I. That the Respondent failed to carry out proper and credible investigations and issue proper assessments as provided in law.

II. That the additional assessments established by the Respondent for the period under review 2015-2017 for Kshs 1,795,881 for VAT together with penalties and interest were unlawful and improperly assessed and as such the same should be set aside.

III. The Appeal herein be allowed with costs in favour of the Appellant.

IV. Any other remedy that this Honourable Tribunal deems just and reasonable.

The Respondent's case

25. The Respondent submitted that it had received intelligence information from the Investigation and Enforcement Department about traders that were making huge sales but declaring little or no taxable income. The allegation was that the said persons formed a network in such a way that they would supply almost equal amounts of goods to each other thus bringing the output to zero or end up in a credit position.

26. The Respondent claimed that it commenced tax investigations into the affairs of various companies and discovered that they had devised a fraud scheme where individuals would register businesses for invoicing purposes and the

businesses would sell the invoices and issue ETR receipts without making sales at all.

27. The Respondent avers that these traders have been labelled as "missing traders" since their business premises as declared on *iTax* by the proprietors cannot be located. Efforts to trace them through their declared mobile phones had not been successful as their phones are out of reach or the owners of the lines are different from the registered names or proprietors. The Respondent avers that the beneficiaries of this scheme would then claim input VAT from the fictitious purchases.

28. The Respondent stated that the Appellant was identified as among the beneficiaries of the suspect invoices, referred to as "missing trader" scheme where the suppliers on the invoices only printed and sold the invoices to the Appellant without actual delivery of goods, for a commission to the invoicing suppliers.

29. The Respondent further avers that the Appellant claimed input VAT in the month of July 2015 to May 2017 from invoices bought from the missing traders. The Respondent further claimed that the investigations revealed that the Appellant together with others not mentioned in this Appeal engaged in fraudulent activities by claiming purchases and the input tax thereto of goods not delivered by the invoicing suppliers.

30. The Respondent further explained that the "Missing Trader Scheme" is a global phenomenon taking on various variations and developments globally. It is, according to the Respondent, the theft of VAT from the government by organized crime gangs who exploit systems and the way VAT is treated.

31. To expound further the Respondent quoted the explanation by **Hon. Justice Hildyard** of the Upper Tribunal (Tax and Chancery Chamber) in the case **of Edgeskill Limited Vs The Commissioner Fer Her Majesty's Revenue And Customs [2014] UKUT 0038** Paragraph 4 of his decision;-

> *"MTIC (Missing Trader Intra Community) fraud is by no means uncommon, especially in the context of trade in bulk mobile phones and computer chips, and causes huge losses of revenue to the United Kingdom (estimated at some 12.6 billion Euros in 2006)."*

32. The Respondent explained further that in the fraud dubbed the Missing Trader VAT fraud scheme, businesses, which registered the VAT, obtain fictitious invoices. The invoices are introduced into their business purchase records with the sole purpose of illegally reducing the rightful VAT payments.

33. In the case at hand, the Respondent submitted that it conducted an *iTax* analysis of the suppliers that the Appellant had purportedly bought supplies from. According to the Respondent, the investigations revealed that they only

existed on paper with the sole purpose of milling bogus invoices to sell to various companies at a commission.

34. To support its case the Respondent submitted that the Courts in UK have developed strong jurisprudence to combat the Missing Trader VAT fraud menace, most famously in **Axel Kittel Vs Belgium; Belgium Vs Recolta Recycling Sprl (Joined cases C-439/04 and c-440/04) 2008 [BVC] 559,** which is regarded as a leading authority in this area and is often quoted, where the ECJ held in paragraph 61 of its judgement as thus;-

> *"...where it is ascertained, having regards to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.'*

35. The Respondent avers that the Appellant did not demonstrate to the Respondent how the purchased goods were ordered, recorded and sold. The Respondent further claimed that as part of the scam the payments are recorded in the books of the Appellant as cash whilst no actual cash pay-out was made to conceal the trail, notwithstanding the substantial amounts.

36. The Respondent submitted that it disallowed the said purchases on the basis that the purchases are purported to have been supplied by persons investigated

by the Respondent and found to be involved in a tax fraud scheme of printing and selling the respective invoices without actual supply of goods.

37. In reaching its determination, the Respondent avers that it applied the *reasonable man test* in trying to establish if the Appellant indeed was involved in a legitimate purchase of high value goods.

38. To support its argument the Respondent quoted the case of the Upper Tribunal in **S&I Electric Plc v HMRC [2015] UKUT 162 (TCC)** which had this to say in regard to the reasonable ma test:

> *"..the FTT's task was to apply the impersonal standard of the reasonable businessman to the facts which it found, on the basis of the evidence which it heard, as to the circumstances in which S&I carried out the transactions in issue. Would the reasonable businessman have concluded that S&I ought to have known that the only reasonable explanation for the transactions was that they were connected with fraud?"*

39. The Respondent contends that during the review of the Appellant's objection, the Respondent evaluated the records availed by the Appellant *vis a vis* the findings of the investigations carried out and found inconsistencies in the Appellant's records. These findings, the Respondent avers formed the basis of its Objection Decision.

According to the Respondent, the assessments were correctly issued and conform to Section 46(4) of the VAT 2013 which states:

"The amendment of an assessment under subsection (1) may be made:-

a) In the case of gross or willful neglect, evasion or fraud by or on behalf of the registered person submitted the return; or

b) In any case, within five years of

i. A self-assessment, the date that the registered person submitted the return; or

ii. Any other assessment, the date the commissioner served notice of the assessment,

And the Commissioner shall serve the registered person with a notice of an amended assessment within thirty days.

41. The Respondent holds that the Appellant did not receive the actual goods as purported and hence the Appellant did not make any taxable supplies as alleged and cannot therefore claim input VAT. The Respondent insisted that there were no supplies nor do any of the suppliers exist.

42. The Respondent submitted that the Appellant was a co-conspirator in an intricate scheme to defraud the Government of deserved revenue. The Respondent further avers that the Appellant knew that the transactions were connected with the fraudulent evasion of VAT, at the very least the factors

surrounding the case support a finding of knowledge on the part of the Appellant. In determining the Appellant's knowledge, the Respondent stated that it comprehensively analysed the transactions between the Appellant and the missing traders including, assessing whether the Appellant took reasonable steps to verify the integrity of its suppliers and supplies and established that the traders in the chain had entered into the transactions for no other purpose than to commit VAT fraud.

43. The Respondent avers that the Appellant filed their VAT returns under the self-assessment regime. According to the Respondent, the onus of the Respondent is to determine if the input claimed in the VAT returns meet the requirements as set out in the VAT Act 2013. This, it contends does not stop the Respondent from making further enquiries regarding the veracity of the invoices claimed. Moreover, the Appellant had not made purchases from other suppliers apart from the four specific suppliers whose input VAT had been disallowed.

44. The Respondent contends that the fact that the invoices from all suppliers in question had all the requirements of a tax invoice as required under the VAT Act 2013 and had ETR receipts attached thereon is not sufficient proof that the goods were actually delivered to the Appellant. Further the Respondent averred that contrary to the Appellant's assertions that the Respondent was trying to attribute non-compliance of the missing traders to the Appellant, which assertion are false and misguided, as the Respondent has not raised any

such requirement that failure of tax compliance by a supplier leads to tax liability on the part of the buyer, in this case the Appellant.

45. The Respondent asserted that it is only seeking to collect tax fraudulently claimed by the Appellant through purchase invoices for deliveries that were not made. The Respondent submitted that it relied on Section 46(4) of the VAT Act 2013 to demand the taxes in the assessments raised.

46. In response to the averment that the Appellant had provided documents to prove purchase, the Respondent submitted that the Appellant availed stamped receipts of payments made to each of the suppliers and all the payments were made by cash to the suppliers notwithstanding the invoices are stamped as paid by cheque and this it avers was how the tax evasion scheme was designed. The Respondent averred that it received copies of supplier invoices, delivery notes and payment receipts.

47. The Respondent submitted the Appellant had failed to furnish the Respondent with the bank accounts statements, stock control records and sales invoices of the respective purchased goods.

48. The Respondent stated that it was its position that Section 17(2) of the VAT Act provides that input tax is only deductible when registered person is in possession of valid documents. Further to this the Respondent pursuant to the provisions of Section 42(2)(b) of the VAT Act, avers that invoices should be

issued in respect of supplies only by persons who are registered. The Section states that:

> *"No invoice showing an amount which purports to be tax shall be issued on any supply—(a) which is not a taxable supply; or (b) by a person who is not registered."*

49. The Respondent alleged that investigations conducted by the Respondent revealed that most of the traders that the Appellant claimed inputs from were not registered persons.

The Respondent's prayers.

50. The Respondent made the following prayers:

    i. That the Honourable Tribunal to confirm the assessment dated 17th April 2018 and find that the taxes amounting to Kshs 5,163,159.00 together with the resultant penalty and interest are due and payable by the Appellant.

    ii. That this Appeal be dismissed with costs and the tax due collected

Issues for determination

51. Having carefully studied the parties' pleadings and all the documents attached to the Appeal and after hearing the submissions, the Tribunal was of the view that the issues for determination were:

    a. Whether the Respondent erred in its decision to disallow Input VAT?

b. Whether the Respondent erred in assessing additional Corporation Tax?

Tribunal Analysis and Findings

a. Whether the Respondent erred in its decision to disallow input VAT?

52. The Respondent submitted that it disallowed the input VAT from the 4 suppliers on the basis that the purchases are purported to have been supplied by persons investigated by the Respondent and found to be involved in tax fraud scheme of printing and selling the respective invoices without actual supply of goods. According to the Respondent the Appellant was unable to prove to the satisfaction of the Respondent that indeed it had received the said supplies.

53. The Respondent further stated that the Appellant availed stamped receipts of payments made to each of the suppliers and all the payment were made by cash to the suppliers notwithstanding the invoices are stamped as paid by cheque.

54. The Appellant on its part submitted that it indeed purchased goods as indicated in the invoices, the goods were delivered as indicated in the delivery notes and payment was made as can be confirmed from the company bank accounts and payment records. To support the transactions the Appellant supplied copies of ETR invoices from its suppliers, copies of delivery notes and payment acknowledgement receipts from the suppliers.

55. The Respondent however argued that there were other key documents that the Appellant did not provide including stock control records, sales invoices of the respective purchased goods and bank statements of the respective payment cheques.

56. Section 17(1) of the VAT Act in providing for input VAT claims provides as follows:

> *"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."*

This provision embodies the well-established principle of VAT law that a taxable person who makes transactions in respect of which VAT is deductible may deduct the VAT in respect of the goods or services acquired by him, provided that such goods or services have a direct and immediate link with the output transactions in respect of which VAT is deductible.

57. The Tribunal therefore agrees with the Respondent that for one to claim input VAT, there must be a purchase of a taxable supply. It is not enough to have the documentation listed in Section 17 of the VAT Act. The documentation

must be supported by an underlying transaction and the taxpayer must furnish proof that there was an actual purchase.

58. Section 30 of the Tax Appeals Tribunal Act places the burden of proof on the taxpayer to submit all the necessary documentation to support its case. The same position was held by the court **in Metcash Trading Limited –vs Commissioner for the South African Revenue Service and Another Case CCT 3/2000**, where it was held that:

> *"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."*

59. Section 107 of the Evidence Act provides that:

"Whoever desires any court to give judgment as to any legal right or liability dependent on the existence of facts which he asserts must prove that those facts exist."

60. Thus, it was upon the Appellant to prove that it indeed purchased the supplies. In a bid to discharge this onus, the Appellant furnished the Respondent with some documents detailing the transactions including, delivery notes, ETR invoices and payment acknowledgement receipts from its suppliers. Once it did so, the onus shifted to the Respondent. The Respondent raised questions as to the legitimacy of the documents pointing out that there was no proof of payment provided and that the documents submitted by the Appellant indicate that all the payments were made by cash to the suppliers notwithstanding the invoices are stamped as paid by cheque. This raised questions as to the credibility of the documents provided by the Appellant.

61. The Tribunal scrutinised the documents and agrees with the Respondent that while the payment receipts indicate that the payments were in cash, some of the corresponding invoices are indicated as having been paid by cheque. No other details of the said cheques were provided by the Appellant in any of its submissions.

62. In view of the above, it was the view of the Tribunal that the Appellant did not discharge its burden and thus did not prove that it indeed purchased the said supplies.

63. Accordingly, the Tribunal finds that the Appellant did not furnish sufficient proof of purchase. Given the above finding, the Tribunal found that the Respondent did not err in its decision to disallow input VAT.

b. Whether the Respondent erred in assessing additional Corporation Tax after Disallowing Input VAT Claim?

64. Having found that the claim for input VAT was not allowable, the Tribunal found that the Respondent did not err in assessing the resultant Corporation Tax.

Orders

65. The Tribunal makes the following Orders:

i) The Appeal is dismissed.

ii) The VAT assessment of Kshs. 1,795,881.00 is hereby upheld.

iii) The Corporation Tax assessment of Kshs. 3,367,278.00 is hereby upheld.

iv) Each party to bear its costs.

DATED and **DELIVERED** at **NAIROBI** this 9th day of **October, 2020.**

CATHERINE N. MUTAVA
CHAIRMAN

WILFRED N. GICHUKI
MEMBER

GABRIEL M. KITENGA
MEMBER

ABRAHAM K. KIPROTICH
MEMBER