

REPUBLIC OF KENYA
TAX APPEALS TRIBUNAL
APPEAL NO. 139 OF 2018

BHAI COMPANY LIMITEDAPPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

Background

1. The Appellant is a limited company incorporated under the relevant provisions of the Companies Act.
2. The Respondent is a principal officer appointed under the Kenya Revenue Authority Act, Cap 469 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 wrote to the Appellant on 17th April 2018 to demand unpaid tax amounting to Kshs. 2,740,217.00 and Kshs. 5,137,906.00 being VAT and Corporation Tax, respectively, for the years 2015 to 2017. The Respondent demanded that the tax should be paid within 7 days.
4. The demand was in respect to input VAT claimed from suppliers who had been profiled by the Respondent as ‘missing traders’. The suppliers in question

include: Kushal K Enterprise, Harshidi Enterprises Ltd, Kishna Enterprises, Royal King Kenya Limited and Sorez Enterprises.

5. The Appellant objected to the assessment via Notice of objection dated 20th May 2018. The Respondent issued its Objection Decision on 5th July 2018 confirming the assessed amount of Kshs. 2,740,217.00 for VAT only.
6. Being aggrieved by the Objection Decision, the Appellant filed an Appeal with the Tribunal on 3rd August 2018 for VAT (TAT 139 of 2018).
7. The Respondent further raised Corporation Tax assessments on 29th May 2019 amounting to Kshs. 4,529,244.00 and 10th September 2018 amounting to Kshs. 608,662.00.
8. The Appellant wrote back on 2nd November 2018 referring the Respondent to its Objection of 20th May 2018 where the Appellant stressed that it had objected to both assessments for VAT and Corporation Tax.
9. The Respondent issued its Objection Decision on 26th November 2018 confirming Corporation Tax of Kshs 608,662.00.
10. The Appellant being dissatisfied filed another Appeal on 21st December 2019 for Corporation Tax (TAT No. 419 of 2018).
11. The two Appeals were consolidated into TAT 139 of 2018 and heard before the Tribunal on 2nd February 2020.

Grounds for Appeal

12. 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

13. 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).”

14. 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.
15. The Appellant asserted that it had complied with the requirements set out in Section 17 of the VAT Act for its VAT input claims and it also complied with the provisions of Section 15(1) of the Income Tax Act. The Appellant therefore avers that it had a legitimate expectation that the Respondent would allow its input VAT claims.
16. The Appellant argued that the Respondent disallowed input VAT on 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.

17. 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 goods in question.
18. 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.
19. 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.
20. 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.
21. 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.

22. The Appellant argued that despite its Notice of Objection dated 20th May 2018, the Respondent raised additional income tax assessments of Kshs. 4,529,244.00 which was similar to the amount demanded earlier and proceeded to issue agency notices on the Appellant's bankers to recover the taxes that had been demanded.
23. The Appellant submitted that it wrote to the Respondent pointing to the oversight and drawing the Respondent's attention to its Notice of Objection of 20th May 2018.
24. The Appellant argued that the Respondent's Objection Decision of 23rd October 2018 was unlawful because it was issued beyond the mandatory 60 days given that the Appellant's Notice of Objection was dated 20th May 2018.
25. The Appellant contended that the Respondent had no jurisdiction to demand payment because it was deemed to have allowed the Appellant's objection to the assessment by virtue of Section 51(11) of the Tax Procedures Act since the Respondent had failed to communicate its decision within the statutory period.
26. The Appellant cited the following authorities to support its case:
 - A. **Republic vs Kenya Revenue Authority Ex Parte Aberdare Freight Services Ltd & 2 Others {2004} 2 KLR 530**
 - B. **Keroche Industries Limited vs Kenya Revenue Authority & 5 Others Nairobi HCMA No.743 Of 2006 {2007} KLR 240**

**C. Fleur Investments Limited v Commissioner of Domestic Taxes & Another
{2008} eKLR**

The Appellant's Prayers

27. The Appellant made the following prayers:

- I. That the Tribunal finds that the facts and circumstances giving rise to this Appeal point to abuse of office and power by the Respondent and the tribunal should not sanction such abuse of power.
- II. That the additional assessments issued by the Respondent for the period under review (2015-2017) for VAT and Income Tax together with penalties and interest were unlawful and improperly assessed and as such the same should be set aside.
- III. That the Objection Decision dated 5th July 2018 and 26th November 2018 and any other decision made by the Respondent in Tax Appeals No.139 and Tax Appeal No.419 of 2018 be declared null and void and quashed in their entirety.
- IV. That the Appeal be allowed with costs to the Appellant.

The Respondent's case

28. The Respondent submitted that it had been investigating various taxpayers among them the Appellant for involvement in a scheme in which fictitious invoices are generated to depict a business transaction but there is no actual

supply or movement of goods and services (ostensibly known as '*Missing Trader Scheme*').

29. The Respondent submitted that pursuant to its investigations, it established that certain traders devised a scheme in which they did not sell any goods nor deliver them but instead only print bogus invoices and ETR receipts, which they sell to other companies at a price.
30. The Respondent avers that from its investigations, it discovered that the Appellant was among the beneficiaries of the missing trader scheme. In particular, the Respondent established that the companies that were purported to have sold goods to the Appellant did not actually import any goods nor buy goods from local traders. For these reasons, the Respondent was of the view that the companies were not in a position to supply any goods to the Appellant.
31. The Respondent stated that its investigation revealed many beneficiaries of fictitious invoicing including the Appellant.
32. The Respondent further claims that the Appellant was asked to avail additional documents to prove whether there was a supply for purposes of claims relating to Corporation Tax but the same were not availed by the Appellant.
33. The Respondent avers that Section 17 of the VAT Act requires:

“(2) If, at the time when a deduction for input tax would otherwise be allowable under Section (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.’

34. The Respondent submitted that it disallowed the input VAT as it was not incurred as per Section 17 of the VAT Act as the Appellant did not procure any goods and services from the 5 suppliers despite having the documents. The Respondent claimed that no bank statements or stock movement register were produced by the Appellant as evidence that indeed the monies captured in the invoices were paid to the suppliers and that the stock purchased was indeed sold.

35. The Respondent contends that the invoices and delivery notes provided by the Appellant were not sufficient to prove that the actual delivery of goods purchased.
36. According to the Respondent, the bundle of documents produced by the Appellant do not have proof of payment like certified bank payment advise showing indeed the Appellant paid for the goods to the particular supplier, the delivery notes for some bulk items do not show the delivery vehicles used to deliver the goods.
37. The Respondent further maintained that the delivery notes have not been stamped or signed by the said Appellant to show that the goods were delivered and the Appellant cannot claim to have picked the goods from the suppliers' premises as the Appellant was unable to show the actual location of the supplier of the goods.
38. The Respondent avers that Section 56(1) of the Tax Procedures Act provides that the burden of proving the tax assessment is wrong lies with the taxpayer and the Appellant in this case has failed to prove to the satisfaction of the Commissioner that the goods alleged to have been sold to the Appellant were sold, delivered and the Appellant made payment in full for the same.
39. In response to the averment that the Objection Decision related to the Corporation Tax assessment was invalid, the Respondent submitted that the objection dated 20th May was replied to via the Objection Decision dated 5th

July 2018. The Respondent further submitted that the assessment dated 29th May 2018 was not objected to within 30 days whereas that of 10th September 2018 was objected to by a letter received on 2nd November 2018. Thus, the Respondent averred, the time for the Objection Decision started running on 2nd November 2018 as it could not deal with a letter it had not received. Thus, the Objection Decision dated 26th November was well within the statutory period.

40. The Respondent cited the following authorities to support its case;

- A. **Edgeskill Limited Vs The Commissioner for Her Majesty's Revenue and Customs (Supra).**
- B. **Mecash Trading Limited v Commissioner for the South African Revenue Service and Another.**
- C. **Invollate Wacike Siboe vs Kenya Railways Corporation & Another {2017} eKLR.**

The Respondent's prayers

41. The Respondent made the following prayers:

- i. That the assessments be upheld
- ii. That this Appeal be dismissed with costs to the Respondent as the same is without Merit.
- iii. That the Appellant be compelled to pay costs to the Respondent.

Issues for determination

42. 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:

- i) Whether the Objection Decision with respect to the Corporation Tax Assessment was valid?
- ii) Whether the Respondent erred in its decision to disallow Input VAT?
- iii) Whether the Respondent erred in assessing additional Corporation Tax after Disallowing Input VAT Claim?

Tribunal Analysis and Findings

i) Whether the Objection Decision with respect to the Corporation Tax assessment was valid?

43. In its submissions, the Appellant averred that it filed its Notice of Objection on 20th May 2020 and the Respondent issued its Objection Decision on 23rd October 2018. Consequently, the Appellant argued that the Objection Decision was time barred.

44. The Respondent on its part averred that it replied to the Appellant's objection dated 20th May through the Objection Decision dated 5th July 2018. It issued another assessment dated 29th May 2018 which it submitted the Appellant did not object to within 30 days. It issued yet another assessment on 10th

September 2018 which it averred was objected to by a letter received on 2nd November 2018. Thus, it argued, the Objection Decision dated 26th November was well within the statutory period.

45. The Tribunal reviewed the documents placed before it and only found one Objection Decision dated 4th July 2018 in the records. Thus, the Tribunal was forced to piece together the chronology of events from the submissions of both parties.
46. The Tribunal notes that there were various assessments raised by the Respondent. From the documents before the Tribunal we note that there was a demand raised on 17th April 2018 in respect of VAT and Corporation Tax to which the Appellant objected to via a Notice of Objection dated 20th May 2018. The records before the Tribunal indicate that the Respondent issued its Objection Decision in regard to this assessment via an Objection Decision dated 5th July 2018. Thus, this particular Objection Decision is valid as per Section 51(11) of the Tax Procedures Act.
47. It appears that another assessment was issued on 29th May 2018. The Respondent avers that the Appellant did not object to this assessment. The Appellant on its part states that it wrote to the Respondent informing it that it had objected to the assessment in its Notice of Objection dated 20th May 2018. The question of whether there was a valid objection in place in respect of this assessment did not arise and therefore the Tribunal did not interrogate it.

48. According to the Respondent's submissions, another assessment was issued by the Respondent on 10th September 2018. The Appellant objected to this assessment via a Notice of Objection dated 2nd November 2018. The Respondent issued its Objection Decision in respect of this assessment on 26th November 2018.

49. Section 51(11) of the Tax Procedures Act in dealing with Objection Decisions provides that:

“The Commissioner shall make the objection decision within sixty days from the date of receipt of—

(a) the notice of objection; or

(b) any further information the Commissioner may require from the taxpayer,

failure to which the objection shall be deemed to be allowed.”

50. It is unclear to the Tribunal which Objection Decision the Appellant is disputing as none dated 23rd October 2018 was placed before the Tribunal.

51. Based on the records before it, the Tribunal found that the Objection Decision dated 26th November 2018 is valid as it was issued within the 60-day statutory period required under law.

ii) Whether the Respondent erred in its decision to disallow input VAT?

52. In determining whether the Respondent's decision to disallow the input VAT by the Appellant was proper as per the provisions of the VAT Act and various authorities, the Tribunal set for itself the following tests:

- a. Whether the Appellant had furnished sufficient proof of purchase?
- b. Whether the Appellant's right to claim VAT was affected by the presence of fraud in the supply chain?
- c. Whether the Appellant knew or should have known that there was a fraud?

ii a) Whether the Appellant furnished sufficient proof of purchase?

53. The Respondent submitted that it disallowed the input VAT from the 5 suppliers who had been profiled through its investigation for printing and selling ETR invoices without actual supplies to the Appellant thus reducing its tax liability. The Appellant was therefore earmarked for investigations as a beneficiary of the missing traders scheme which revealed many beneficiaries of fictitious invoicing including the Appellant.

54. Based on the above, the Respondent argued that Section 17(2) of the VAT Act provides that input tax is only deductible when a registered person is in possession of a valid document. Since the Appellant did not actually purchase anything, the documents it held were not valid.

55. 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.

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.”

57. 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.

58. 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 in the

documentation listed in Section 17. The documentation must be supported by an underlying transaction and the taxpayer must furnish proof that there was an actual purchase.

59. 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."

60. Once the taxpayer adduces evidence that discharges his burden, the burden shifts to the Commissioner who must demolish such evidence. This view was held in Supreme Court of Canada's decision in **Hickman Motors Ltd. v. Canada**, [1997] 2 S.C.R. 336 the Court stated that:

"The taxpayer's initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least prima facie case... Where the Minister's assumptions have been "demolished by the appellant, "the onus.... shifts to the Minister to rebut the prima case" made out by the appellant and to prove the assumptions...The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minister's assumptions; ...Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed; and even if the evidence contained "gaps in logic, chronology, and substance", the taxpayer's Appeal will be allowed if the Minister fails to present any evidence as to the source of income."

61. The Tribunal notes that the Appellant furnished the Respondent with the documents detailing the transactions as provided by Section 17 of the VAT Act.

The Appellant further provided bank records, delivery notes and payment records. This evidence established prima facie that it indeed purchased the said goods. The Respondent on its part did not demolish this evidence.

62. The Respondent on its part averred it carried out an i-Tax analysis which revealed that the Appellant's suppliers only existed on paper for the purpose of milling bogus invoices to sell to various companies at a commission. Neither this analysis nor any other evidence in the hands of the Respondent was tabled before the Tribunal. Thus, all we have is the Respondent's averments. Madan J in his judgment in **CMC Aviation Ltd V Cruisair Ltd (1) [1978] KLR 103** observed that:

“Pleadings contain the averments of the parties concerned. Until they are proved or disproved, or there is an admission of them or any of them, by the parties, they are not evidence and no decision could be founded upon them. Proof is the foundation of evidence. Evidence denotes the means by which an alleged matter of fact, the truth of which is submitted for investigation. Until their truth has been established or otherwise, they remain un-proven. Averments in no way satisfy, for example, the definition of “evidence” as anything that makes clear or obvious; ground for knowledge, indication or testimony; that which makes truth evident, or renders evident to the mind that it is truth.”

63. The Tribunal found that these averments were not sufficient to prove the Respondent's case. The Respondent should have furnished information/evidence to prove that the invoices submitted by the Appellant to support its claim were fictitious. It was not enough to just allege that the documents presented were fictitious.

64. Accordingly, we are of the view that the Appellant furnished sufficient proof of purchase.

ii b) Whether the Appellant's right to claim VAT was affected by the presence of fraud in the supply chain

65. The right to claim input VAT undergirds the VAT scheme and in principle may only be limited in exceptional circumstances. It must be exercised immediately in respect of all the taxes charged on transactions relating to inputs.

66. The Respondent in this case averred that the Appellant's suppliers were engaged in fraud. It submitted that according to its i-Tax analysis (which was not placed before the Tribunal), the suppliers only existed on paper and did not buy anything locally nor import anything. If nothing else, this raises the question of whether there was fraud on the part of the suppliers. If the suppliers engaged in fraud, how does this impact the right of the Appellant to claim input tax?

67. The European Court of Justice held that the right to claim input tax remains even where there is a missing trader somewhere in the value chain. This right,

according to the court, can only be limited where the trader had knowledge of the fraudulent actions in the value chain. This was the holding in **Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise** [2006] EUECJ C-354/03 where it was held that:

“Under the common system of VAT...the entitlement of a trader to credit for payment in respect of VAT under a transaction should be judged by reference to the particular transaction to which the trader was a party. Transactions of which he has no knowledge and the fraudulent acts or intentions of other persons in the chain of supply of whose involvement he is unaware do not affect his entitlement.”

68. The Court in **Axel Kittel vs Belgium; Belgium vs Recolta Recycling SPRL** (joined cases C-439/04 and C-440/04) 2008 [BVC] 559, addressed itself to the same question and dealt with whether the intention of persons other than the taxpayer could be used to determine whether input tax was allowable. In doing so it stated that:

“...requiring the tax authorities to carry out inquiries to determine the intention of the taxable person would be contrary to the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional cases, to the objective character of the transaction concerned.

A fortiori, requiring the tax authorities, in order to determine whether a given transaction constitutes a supply by a taxable person acting as such and an economic activity, to take account of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge, would be contrary to those objectives...”

69. The court further held that the question whether the VAT payable on prior or subsequent sales of the goods concerned has or has not been paid to the Treasury is irrelevant to the right of the taxable person to deduct input VAT. In so doing, the court divorced the right to deduct input tax from the payment of the output tax by the supplier.
70. Consequently, the Tribunal finds that the Appellant’s right to claim VAT was not affected by the presence of fraud in the supply chain unless it had knowledge of fraudulent acts of its suppliers. The mere fact that its suppliers were suspected to have engaged in fraud does not extinguish the Appellant’s right to claim input VAT. This right can only be extinguished if the Appellant knew or ought to have known that the transaction was part of a fraudulent scheme.

71. Further, as stated by the court, the mere fact that the VAT charged by the Appellant's suppliers was not submitted to the Respondent is irrelevant to its exercise of claiming input tax that it incurred.

ii c) Whether the Appellant knew or should have known that there was a fraud?

72. The Respondent averred that the Appellant's claim to input tax was denied since it was dealing with what it termed to be missing traders. According to the Respondent, the Appellant's suppliers did not actually supply any goods and only sold invoices at a commission. The Appellant on its part argued that it actually purchased goods and therefor was entitled to claim the VAT therein.

73. Having established that the Appellant proved it indeed made purchases that were subject to VAT and that the Appellant's suppliers may have engaged in some fraud, the Tribunal then turned to the issue of whether the Respondent had established that the Appellant knew or ought to have known that its transactions were part of a VAT fraud.

74. The court in **Axel Kittel vs Belgium; Belgium vs Recolta Recycling** discussed the circumstances under which a taxpayer's right to claim input tax may be curtailed. It held that a taxable person who knew or should have known that through his purchase he was taking part in transactions connected with the fraudulent evasion of VAT must be regarded as a participant in the fraud, irrespective of whether or not he profited through the resale of the goods.

In such situations, the taxable person aids the perpetrators of the fraud and becomes their accomplice and must be denied the right to claim such input tax.

75. Thus, for the Appellant's right to deduct input of VAT to be curtailed, the Appellant must have known or ought to have known that it was part of a fraudulent transaction. In this case, the Respondent avers that the Appellant was part of the Missing Trader Fraud scheme and thus knew or ought to have known that it was part of a fraudulent transaction.

76. The Tribunal in **Calltel Telecom Ltd v HMRC [2007] UKVAT V202666** considered the question of burden of proof in cases where the question of knowledge of the taxpayer in Missing Trader Fraud scheme arose. The Tribunal stated thus:

“For those reasons we think it is incumbent on the Commissioners to raise a case, not necessarily amounting to proof but sufficient to demand an answer, that there were facts or circumstances which support, or at least are consistent with, the conclusion that the appellant knew, or should have known, of fraud in the chain. The mere fact that there was fraud will not be enough; there must be some reason which might lead the tribunal to conclude that the trader knew or could have known of it, or that he should have taken precautions. Although, as we have already pointed out, the Court of Justice, at paragraph 51 of its judgment in Kittel, referred to traders "who take

every precaution" as those who are not liable to forfeit their right to deduct, it should be borne in mind that most traders do not, and do not need to, carry out extensive enquiries into the honesty and creditworthiness of their suppliers and customers. But if the Commissioners are able to mount a case which demands some explanation, the burden shifts to the appellant to show that he took the precautions which could reasonably have been required of him and that, despite his having done so, he did not know, and could not have known, of the fraudulent purpose of others."

77. The position was also upheld in **HMRC v Brayfal Ltd (Unreported) CH/2008/App 082** where Lewison J stated that:

"In cases of this kind, the burden is on HMRC to establish a fraudulent tax loss and that the transactions giving rise to that loss are connected to the taxpayer's transactions. If that is established, then the taxpayer must show that it did not know and could not have known about the fraud."

78. Under Kenyan law, Section 107 of the Evidence Act, Cap 80 of the Laws of Kenya provides that:-

"(1) 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."

(2) When a person is bound to prove the existence of any fact it is said that the burden of proof lies on that person.”

79. Guided by the decisions of the court in **Brayfal** and **Calltell** and the provisions of the Evidence Act, the Tribunal finds that the burden of proof was upon the Respondent to establish that there was fraud and that the Appellant knew or ought to have known. As stated in **Calltell Telecom Ltd v HMRC [2007] UKVAT V202666**, the standard is not beyond reasonable doubt. Rather it is enough for the Respondent to establish a case that demands answers from the Appellant. Once it establishes its case, then the burden shifts to the Appellant.
80. Thus, in the case at hand, it was upon the Respondent to establish not only that there was fraud but also that the Appellant knew or ought to have known that the transaction of which it was a part was fraudulent.
81. The Tribunal analysed the evidence adduced before it as well as the submissions of both parties. The Respondent pleaded fraud and averred that the Appellant and its suppliers were part of a missing trader fraud scheme. We are of the view that that is not enough. The court in **Calltell Telecom Ltd v HMRC [2009] EWHC 1081 (Ch)** held that:

“The mere fact that a transaction forms part of a chain in which fraud occurred is not enough to justify the refusal of repayment of income tax. To justify such a refusal the tax authorities must prove that the

taxpayer was himself being fraudulent or knew or had the means of knowledge of fraud by others."

82. The Tribunal finds that the Respondent fell short of establishing a case that the Appellant knew or ought to have known about the fraud. It pleaded that some of the Appellant's suppliers had been noted as being part of the Missing Trader Fraud scheme. It averred that the Appellant merely purchased invoices without the attendant goods. However, it failed to adduce evidence to support its averments. The Appellant on its part produced documents indicating that there was indeed a purchase. The Respondent failed to counter the evidence adduced.

83. Thus, the Tribunal found that the Respondent did not discharge its burden of proof by establishing knowledge of the fraud on the part of the Appellant.

84. Given the foregoing, the Tribunal found that the Respondent erred in disallowing input VAT and cost of sales claimed by the Appellant.

iii) Whether the Respondent erred in assessing additional Corporation Tax after Disallowing Input VAT Claim?

85. Having found that the claim for input VAT was allowable, the Tribunal found that the Respondent erred in assessing Corporation Tax as a result of disallowing the input VAT.

Orders

86. The Tribunal makes the following Orders:

- I. The Appeal succeeds.
- II. The VAT assessment of Kshs. 2,740,217.00 is hereby set aside.
- III. The Corporation Tax assessment of Kshs. 608,662.00 is hereby set aside.
- IV. Each party to bear its costs.

DATED and DELIVERED at NAIROBI this 4th day of September, 2020.

**CATHERINE N. MUTAVA
CHAIRPERSON**

**WILFRED N. GICHUKI
MEMBER**

**GABRIEL M. KITENGA
MEMBER**

**ABRAHAM K. KIPROTICH
MEMBER**