

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 194 OF 2018

CLEANSHELF SUPERMARKETS LIMITED.....APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES..... RESPONDENT

JUDGMENT

BACKGROUND

1. The Appellant is a limited liability company incorporated in Kenya under the Companies Act, No. 17 of 2015.
2. The Respondent is a principal officer of the Kenya Revenue Authority, a body established under the Kenya Revenue Authority Act, Cap 469 of the Laws of Kenya and is charged with the responsibility of collection and administration of domestic revenue on behalf of the Government of Kenya
3. The Respondent conducted investigations into the affairs of various companies and unearthed a fraudulent tax evasion scheme labelled as “*missing traders scheme*” whereby individuals would register businesses for manufacturing and selling invoices without actual delivery of goods.
4. According to the Respondent, the Appellant’s suppliers were among the traders profiled by its Investigation and Enforcement Department as printing and selling Electronic Tax Register (ETR) receipts without actual supplies, thus reducing its tax liability.
5. As a result, the Respondent issued a tax demand dated 13th April 2018 of Kshs. 5,907,264.68 for Value Added Tax (VAT) and Kshs. 11,076,121.27 for Corporation Tax from the Appellant for the period 2014 to 2015.
6. The Appellant objected to the tax assessment in its letter dated 19th April 2018 and the Respondent issued its Objection Decision on 11th July 2018 confirming the additional assessment for VAT.

7. The Appellant, being dissatisfied with the Respondent's Objection Decision filed the instant Appeal vide its Notice of Appeal dated 10th August 2018 followed by its Memorandum of Appeal and Statement of Facts both dated 24th August 2018.
8. The Respondent opposed to the Appeal through its Statement of Facts dated 21st September 2018 and filed on even date.

THE APPEAL

9. The Appellant premised the Appeal on the following grounds that: -
 - i. *The Respondent erred in law and fact by claiming that there were no purchases made by the Appellant from Zulma Trading Company Limited for the period 2014 to 2015 totalling to Kshs. 36,920,404.23 and therefore stating that there was no supply of taxable goods made by Zulma Trading Company Limited to the Appellant;*
 - ii. *The Respondent erred in law and fact by disallowing the Appellant's input VAT amounting to Kshs. 5,907,264.68 for the period 2014 to 2015 arising from the purchases made by the Appellant from its supplier, Zulma Trading Company Limited;*
 - iii. *The Respondent erred in law and fact by claiming that no purchases and deliveries were made to the Appellant from Zulma Trading Company Limited for the period 2014 to 2015 and subsequently disallowing the amount totalling to Kshs. 36,920,404.23 thus bringing to charge corporation tax totalling to Kshs. 11,076,121.27; and*
 - iv. *The Respondent erred in law and fact by upholding its decision to disallow the Appellant's purchases and input VAT arising from supply of taxable goods from its supplier Zulma Trading Company Limited notwithstanding the fact that records of the Appellant show that the purchases were made and VAT accounted for as provided under the law.*

10. In its prayers, the Appellant urged the Tribunal to find *inter alia* that the Respondent's demand for VAT and corporation tax was unjustified and that the Appellant is entitled to claim input VAT as well as expenses arising from its purchases from Zulma Trading Company Limited.

APPELLANT'S SUBMISSIONS

11. The Appellant submitted on two issues, thus: -
 - i. **Whether the Respondent erred in its finding that there was no supply of taxable goods made by Zulma Trading Company Limited to the Appellant;**
12. It was the Appellant's argument that it had supplied the Respondent with adequate documentation to prove that it had indeed purchased goods from the aforementioned supplier and that the said goods were actually delivered. Some of the documents availed were tax invoices, corresponding delivery notes and goods received notes, as well as the remittance advice notes and bank statement entries in support of the payments.
13. By providing these documents, the Appellant maintained that it had discharged its burden of proof as required under Section 56(1) of the Tax Procedures Act (TPA). Thus, the Respondent's allegation that the invoices in question were fraudulently generated to reduce the Appellant's tax liability was completely unfounded. The Appellant maintained that the invoices in question were valid as they had met all the requirements set out under Section 41(1) of the Value Added Tax (VAT) Act.
14. The Appellant submitted that the Respondent was the sole organization that approves and registers suppliers of ETR machines and regulates ETR receipts and supplier's business. Thus, the Respondent was in a position to investigate and authenticate ETR receipts issued instead of making unjustifiable claims of fraud.

15. Further, the Appellant contended that the Respondent was possessed of statutory power to verify and audit the transactions of the supplier in question and impose taxes, if any, without reference to the Appellant. It blamed the Respondent for abdicating its statutory powers and duties and instead, opting to make unfounded claims against the Appellant.
16. The Appellant argued that the standard of proof in fraud claims is higher than the normal balance of probabilities. It cited the case of Peter Bonde Nielsen vs The Commissioner of Domestic Taxes (Tax Appeal No. 177 of 2016) and Vijay Marjaria vs Nassingh Darbar & Another (2000) eKLR to support the contention. It concluded that the Respondent had failed to attain this standard in demonstrating that there was no supply of taxable goods made to the Appellant.

ii. Whether the Respondent erred in disallowing the Appellant's input VAT and purchases arising from the supply of taxable goods from Zulma Trading Company Limited.

17. The Appellant submitted that it was compliant with the VAT Act and Regulations and the Income Tax Act (ITA) and was therefore entitled to deduct input VAT from its output VAT and also to deduct from its income the cost of the supplies being expenditure wholly and exclusively incurred by the Appellant in the production of income.
18. The Appellant relied on Section 17 of the VAT Act, 2013 to argue that one of the key documents necessary for deduction of input tax was an original or a certified copy of a tax invoice issued for the supply of goods or services. It maintained that for the transactions in question it had been issued with valid tax invoices which it had availed to the Tribunal for perusal.
19. It was the Appellant's further submission that under Section 15 of the ITA, supplies sold to its customers were an allowable deduction. The Section provides:-

“(1) For the purpose of ascertaining the total income of any person for a year of income there shall, subject to Section 16 of this Act, be deducted all expenditure incurred in such year of income which is expenditure

wholly and exclusively incurred by him in the production of that income...”

20. The Appellant relied on the case of **Shreeji Enterprises (K) Limited vs Commissioner of Investigations and Enforcement (Tax Appeal No. 58 and 186 of 2019)** where the Tribunal observed that it is a common principle that a taxable person who makes transactions in respect of which VAT is deductible may deduct the VAT in respect of the 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.
21. In its conclusion, the Appellant maintained that the Respondent’s fraud allegations were baseless and in complete disregard of the information shared by the Appellant. It urged this Tribunal to find in its favour and allow the Appeal.

RESPONDENT’S CASE

22. Through its written submissions dated 21st September 2018, the Respondent argued that it conducted tax investigations into affairs of various companies which revealed that the Appellant’s suppliers were among traders who had devised a fraud scheme of printing and selling ETR invoices without actual supplies with the aim of reducing their tax liability. The Respondent pinpointed Zulma Trading Company Limited, a supplier to the Appellant, as one of the companies profiled as missing traders.
23. It averred that the Appellant used invoices from the aforementioned supplier to account for its input VAT even though no goods were supplied, thus reducing its tax liability. When the Appellant was invited to demonstrate that it had indeed purchased goods from a legitimate supplier, it failed to reasonably satisfy the Commissioner that that was the case.
24. The Respondent urged the Tribunal to adopt the test set out in **Edgeskill Limited vs. The Commissioner for Her Majesty’s Revenue and Customs** in considering whether the Commissioner was justified in refusing a claim of input tax. The test was set out as follows:

- a. Was there a VAT loss?*
- b. If so, was it occasioned by fraud?*
- c. If so, were the Appellant's transactions connected with such a fraudulent loss of VAT?*
- d. If so, did the Appellant know, or should it have known, of such a connection?*

25. It was the Respondent's further contention that under Section 17(3) of the VAT Act, it is not enough for the original tax invoice to be availed. The invoices must relate to an actual supply or importation of goods. Under Section 17(2) of the said Act, input tax is only deductible when a registered person is in possession of a valid document.
26. The Respondent further relied on Section 42(2)(b) of the VAT Act submitting that by virtue of the said provision, invoices should be issued in respect of supplies only by persons who are registered. It indicated that most of the traders that the Appellant claimed inputs from were not registered persons and could not fit in the definition of a supplier as per the VAT regulations.
27. The Respondent explained in detail how the missing trader tax evasion scheme works and how the Appellant was positioned to defraud the Commissioner. It mentioned that the Commissioner risked suffering a loss when a business entity such as the Appellant fraudulently claims a refund for non-existent input VAT. It insisted that the Appellant and its suppliers had not made any VAT payments yet they were seeking VAT refund from monies not received by the Respondent.
28. The Respondent cited Section 59 of TPA contending that the said provision grants it the powers to request for production of records and additional information where the Commissioner is of the view that the information available is insufficient. It mentioned that in line with Section 107 of the Evidence Act, it was the Appellant's burden to prove that the assertions made by the Respondent in its assessment and objection decision were incorrect. It was the Respondent's further contention that the Appellant was obligated under the "Know Your Customer" policy to carry out checks to establish the credibility and legitimacy of its suppliers.

29. In its conclusion, the Respondent summarized that there were no supplies and that the Appellant was a co-conspirator in a scheme tailored to defraud the Government of its revenue. It urged the Tribunal not to allow the Appellant to benefit from an illegality while maintaining that it was justified in demanding an additional VAT of Kshs. 5,907,264.68. It clarified that it had not raised any corporation tax assessments and therefore there was no an appealable case on that issue.

ISSUE FOR DETERMINATION AND ANALYSIS

30. Having carefully studied the parties' pleadings, submissions and all documentation provided, the Tribunal frames only one issue for determination thus:-

Whether the Appellant's claim of input tax and deductible expenses on invoices issued by Zulma Trading Company Limited is allowable.

31. The right to claim input VAT is premised on the assumption that the taxpayer had paid VAT during the purchase of its supplies. In this regard, the taxpayer is required to prove that it purchased taxable supplies. The proof is in transaction documents and it is the duty of the taxpayer to discharge this burden.
32. In the instant case, the Respondent alleged that the input tax claimed could not be allowed because the Appellant's supplier, Zulma Trading Company Limited, did not supply goods nor deliver them. It claimed that the Appellant was a beneficiary of a tax fraud scheme labelled as '*missing trader scheme*' which entailed printing and selling invoices without actual supply of goods. The Respondent further faulted the Appellant for failing to furnish sufficient documentation to prove that it indeed received supplies and that there were payments incurred towards the same.
33. The Appellant denied all these claims by the Respondent and maintained that it had availed all necessary documentation to confirm purchase and payment thereof.

34. The Tribunal observes that it is a common principle 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. In the Kenyan VAT system, this principle is espoused in Section 17(1) of the VAT Act which 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.”

35. Pursuant to Section 17 of the VAT Act, if a trader has incurred properly allowable input tax, he is entitled to set it off against its output tax liability or to receive a refund if the input tax credit due to him exceeds that liability. However, evidence is required in support of the claim for repayment. Section 17(3) lists various documents that must be availed by a registered person for a claim of input tax to be allowed. 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. (see ***TAT Appeal No. 159 of 2018 Osho Drapers Ltd vs. Commissioner of Domestic Taxes***)
36. 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.
37. In the instant Appeal, the Appellant argued that it supplied all the documents required under Section 17 of the VAT Act to the Respondent as proof that it indeed purchased goods from the listed suppliers which it sold to various customers. The Appellant further argued that it also made payments for all the purchases as can be confirmed from the documents attached to the Appellant's

bundle of documents. The said documents included invoices, delivery notes, good received notes and payment records.

38. The Respondent averred that the Appellant merely purchased invoices without the attendant goods. However, the Respondent failed to adduce evidence to support its averments. Indeed, it is crucial to note that even though the Respondent had filed a witness statement with the Tribunal, it did not call her to testify even after being granted opportunity by the Tribunal to do so. Instead, it opted to withdraw the filed witness statement on the date when the witness was to testify.
39. In the circumstances, the Tribunal finds that the Respondent failed to buttress its case with sufficient evidence and thus fell short of establishing a case that the Appellant was a beneficiary of an alleged tax evasion scheme.
40. The Appellant on its part produced documents indicating that there was indeed a purchase. The Respondent failed to counter the evidence adduced. The Tribunal, having perused the Appellant's bundle of documents, is satisfied that there was indeed purchase, delivery and payment for the goods in issue in this case. The Appellant availed copies of tax invoices, corresponding delivery notes and goods received notes in respect of purchases made from Zulma Trading Company Limited. The Appellant further adduced remittance advices and bank statements as evidence that payment of the invoiced amounts was actually made to the supplier. This evidence established *prima facie* that it indeed purchased the said goods. On its part the Respondent did not demolish this evidence.
41. Given the foregoing, the Tribunal finds that the Respondent erred in disallowing input VAT claimed by the Appellant for purchases made from Zulma Trading Company Limited.

FINAL ORDERS

42. The upshot of the foregoing analysis is that the Appeal is merited, and the Tribunal makes the following Orders: -

- i. The Appeal be and is hereby allowed.
- ii. That the Objection Decision dated 11th July 2018 confirming the assessment of Kshs. 5,907,264.68 for Value Added Tax (VAT) together with the resultant interest and penalties be and is hereby vacated.
- iii. Each Party to bear its costs.

43. It is so ordered.

DATED and DELIVERED at NAIROBI this 18th day of June, 2021.


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PATRICK LUTTA
CHAIRPERSON


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HELEN BILA
MEMBER


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MWAI MBUTHIA
MEMBER


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ELISHAH NJERU
MEMBER


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HABON FARAH
MEMBER