

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 331 OF 2019

GRANADA TRADING COMPANY LIMITED..... APPELLANT

-VERSUS-

**COMMISSIONER OF INVESTIGATIONS &
ENFORCEMENT..... RESPONDENT**

JUDGMENT

BACKGROUND

1. The Appellant is a limited liability company incorporated under the Companies Act, Cap 486 of the laws of Kenya. Its principal business activity is importation and sale of motor vehicles.
2. The Respondent is a principal officer of the Kenya Revenue Authority which is an agency of the Government for the collection and receipt of revenue.
3. The Respondent conducted a tax compliance audit of the Appellant's records in the year 2017, with a view of confirming its tax compliance. During the investigations, it asked for additional information on its sources of the deposits found in its bank account.
4. The Appellant held a meeting with the Respondent, on 22nd March 2018, where it stated that it was in the process of preparing records and explanations regarding the various sources of finances and requested for more time to furnish the same to the Respondent.

5. The Respondent issued investigations findings, on 28th March 2018, wherein it required the Appellant to provide explanations accompanied with supporting documents on the source of the credits in the bank statements provided, in order to ascertain the correct taxable income and capture the scope of the Appellant's business operations.
6. The Appellant, on 24th May 2018, presented copies of the financial statements and informed the Respondent that most of the deposits in the Prime Bank account were client's monies which were awaiting clearance to facilitate payment to various suppliers.
7. The Respondent issued a Notice of Tax Assessment dated 18th February 2019, demanding Kshs. 611,425,856.00 being Corporation Tax, VAT and WHT. The Appellant, in response objected to the assessment vide a letter dated 13th March 2019 and provided further documents and explanations.
8. Upon its objection, the Appellant and its Director continued to engage with the Respondent and notably, shared further information and documentation with the Respondent on 17th April 2019 and 29th April 2019.
9. The Respondent communicated its Objection Decision to the Appellant vide a letter dated 14th May 2019, confirming the assessment of Kshs. 406,270,332.00 together with the resultant penalty and interest.
10. Dissatisfied with the Respondent's Objection Decision, the Appellant filed a Notice of Appeal on 24th May 2019 and subsequently filed an Appeal before the Tribunal.
11. Upon filing the Appeal, The Appellant and the Respondent engaged in Alternative Dispute Resolution (ADR) negotiations culminating into a Partial Consent executed between the parties on the 18th February, 2021 and filed before the Tribunal on the same date, whereby the Appellant agreed to pay the Corporation tax of Kshs. 14,253,678.00 and Director's Income tax of

Kshs. 2,326,727.00. The Consent was adopted by the Tribunal as a Partial Judgment on the 1st day of March, 2021.

12. In pursuant to the Consent the Respondent's assessment was reviewed downwards from Kshs. 406,270,332.00 to Kshs. 16,580,405.00, inclusive of penalties and interest.
13. The Appellant and Respondent, mutually agreed that the issues of Withholding Tax (WHT) and Value Added Tax (VAT) be referred back to the Tribunal for determination.

THE APPEAL

14. The Appeal herein is premised on the following grounds as stated in the Memorandum of Appeal dated 11th July, 2019 filed on the 12th July, 2019;
 - i. That the Respondent erred in confirming the assessments and demanding Corporation Tax totaling Kshs. 97,866,458.00.
 - ii. That the Respondent erred in confirming the assessments and demanding Value Added Tax totaling Kshs. 72,940,072.00.
 - iii. That the Respondent erred by assuming that the bank deposits were income. The Appellant avers that the deposits relied upon were simply interest derived from fixed deposits invested in Prime Bank Limited.
 - iv. That the source of funds invested in the fixed deposits were loans borrowed by the company.
 - v. That the Respondent erred in law by charging VAT on interest earned when income on interest is not a vatable supply.

- vi. That the Respondent erred by ignoring or failing to analyze the supporting documents provided by the Appellant.
- vii. That the Respondent erred in confirming the assessments and demanding income tax totaling to Kshs. 124,953,643.00.
- viii. That the Respondent erred in confirming the assessments and demanding Value Added Tax totaling to Kshs. 103,618,713.00.
- ix. That the Respondent erred by confirming the assessments and demanding Withholding Tax totaling to Kshs. 6,891,446.00.
- x. That Respondent erred by disallowing the whole cost of sale on promotional materials claimed in the financial statements while the Respondent had provided all supporting documents.
- xi. That Respondent erred by disallowing the interest expense claimed in the audited accounts when all documents relating to the payment of loans had been provided to the Respondent.
- xii. That Respondent erred in law and in fact by disallowing costs claimed in the financial statements for the sale of motor vehicle instead the Respondent only apportioned costs according to CIF value.
- xiii. That Respondent has failed to take into account all explanations and documentation provided in order to appreciate all issues raised before arriving at the objection decision.

APPELLANT'S CASE

15. In its Statement of Facts dated the 11th July, 2019 filed on the 12th July, 2019, Written submissions dated and filed on the 8th March, 2021 and Further Written submissions dated 15th March, 2021 filed on the 16th March, 2021 the Appellant made the following arguments to support its Appeal.

16. The Appellant contends that the Respondent failed to take into account the provisions of the Companies Act which clearly provided that upon a company's registration, the company acquires a legal personality different from its directors. The Appellant submits that what the Respondent ought to have done but failed to do is, issue different tax assessments culminating into different objection decisions hence separate Appeals.
17. The Appellant submits that to the extent that the assessment was issued to and addressed to the director Mr. Rajendra Ratilal Sanghani, the same is a nullity *ab initio* to the extent that it relates to the tax affairs of the director.
18. The Appellant contends that it was agreeable with the Respondent's tax computation for Corporation Tax and Income Tax of the director. The Appellant has therefore conceded to a total principal corporation tax of Kshs. 11,263,627.00 and principal Director's Income Tax of Kshs. 1,309,122.00.
19. The Appellant is however not agreeable with the Respondent's computation of WHT and VAT amounting to Kshs.18,882,952.00 and Kshs.103,728,428.00, respectively. The parties therefore agreed that aspects of WHT of 15% arising from interest expenses claimed and VAT on the Director's income be referred to the Tribunal for determination.
20. The Appellant avers that the parties have reached an agreement on the issue of Corporation tax of the Appellant and the director's income tax amounting to Kshs. 14,253,678.00 and Kshs. 2,326,727.00 respectively totaling to a sum of Kshs. 16,580,405.00, inclusive of penalties and interest.
21. The Appellant contends that at the time of the assessment, the director Mr. Rajendra Ratilal Sanghani was not registered for VAT and as such the same should be "*void ab initio*". However, the Respondent submits that the director meets the threshold of registering for VAT, turnover of taxable

supplies of Kshs, 5,000,000 per annum, and even though he failed to do so ought to be charged VAT.

22. The Appellant submits that the Respondent acting pursuant to the VAT Act 2013, proceeded to charge VAT of Kshs. 64,470,933.00, a penalty of Kshs. 3,223,547.00 and interest thereon of Kshs. 36,033,951.00, totaling to Kshs. 103,728,429.00 on the director Rajendra Ratilal Sanghani.
23. The Appellant avers that the Respondents argument that the income from the director, apart from being subject to income tax, does not fall under the First and Second Schedule of the VAT Act and therefore attracts VAT of 16% which was not accounted for by the director as meeting the threshold as a genuine reason to levy taxes when it is clear he had not been registered, exposes the Respondent's deceitful tact in attempting to claim the taxpayer reached the threshold.
24. The Appellant submits that failure of the Respondent to give notice to the director was in breach of Section 8(9) of the Tax Procedures Act and due process as provided in the Constitution of Kenya, 2010 together with the retrospective application of the law. Consequently, any action by the Respondent based on its registration and demand of taxes cannot stand. It can only demand and collect taxes after the date of registration and after giving the director notice.
25. The Appellant further contends that the Respondent has not provided any proof to the extent that prior to assessment and demand of VAT, the said director Rajendra Ratilal was ever notified of the registration.
26. The Appellant avers that it proved to the Respondent the efforts made to recover the loan from said George Wainaina had been fruitless leading to the director claiming these supplies as bad debt.
27. The Appellant avers that the Respondent claimed the interest paid by the Appellant to Mr. Schon Noorani should have been subject to WHT at

source at 15%. However, the Appellant contends that the accrual of the interest expense in its books of account did not amount to payment of the same to Mr. Schon and that it was only a recognition of the crystallization of a liability due from it to the creditor and that the Appellant's decision to demand the payment of WHT, in the circumstances was *ultra vires*.

28. The Appellant submits that WHT is not a tax of the payer but a tax of the person whom is paid and the payer merely acts as an agent of the Respondent for purposes of collecting and accounting. Therefore, in the event that the payer does not withhold the tax due, being the agent, then the burden shifts to the payer and not the agent.
29. The Appellant avers that it could not make a deduction from funds that it was not holding. Furthermore, that before a demand for payment can be made, there must be an income and a deduction, and therefore WHT is leviable on the total income. The Appellant contends that the Directors had not finished paying Mr. Schon Noorani and that the Commissioner cannot claim WHT when the same has not been paid yet as per the agreement.
30. The Appellant submits that Mr. Rajendra Ratilal Sanghani paid the full loan less the interest income that is subject to WHT.

Appellant's Prayers

31. The Appellant in its submissions urged the Tribunal to find as follows:-
 - i. That the Honorable Tribunal set aside the VAT tax assessment of Kshs.64,470,933.00, a penalty of Kshs.3,223,547.00 and interest thereon of Kshs. 36,033,951.00, totaling to Kshs. 103,728,429.00 on the director Rajendra Ratilal Sanghani.
 - ii. That the Honorable Tribunal set aside the WHT tax assessment of Kshs.16,306,500.00 being the principal tax, penalty of Kshs.

863,000 and interest of Kshs.1,713,452.00 all totaling to Kshs.18,882,952.00 on the director Rajendra Ratilal Sanghani.

- iii. The issues for determination herein relate to the tax affairs of Rajendra Ratilal and not the Appellant herein and the Respondent erred in issuing an assessment on the tax affairs of the said Rajendra Ratilal to the Appellant.
- iv. In the alternative and without prejudice to (iii) above, the Respondent acted *ultra vires* the provisions of Section 29 of the Tax Procedures Act in issuing an assessment outside the five-year statutory period.
- v. Further in the alternative and without prejudice to (iii) above, the Respondent erred in failing to allow the director's bad debts that had become uncollectible.
- vi. Further in the alternative and without prejudice to (iii) above, the Respondent erred in demanding Withholding Tax from the director, where no payment had been made so as to attract such Withholding Tax.

RESPONDENT'S CASE

- 32. In its Statement of Facts dated and filed on the 2nd August, 2019 and written submissions dated and filed on 15th March, 2021, the Respondent made the hereunder arguments to support its opposition to the Appeal.
- 33. The Respondent contends that the tax assessment was reached at based on the information available and provided by the Appellant and the Commissioner is empowered by the Tax Procedures Act to make decisions.
- 34. The Respondent stated that it discovered that the Appellant had huge variances arising from declared income and bank deposits. It submits that it issued investigation findings dated 28th March 2018 requesting the Appellant to provide explanations and supporting documents on the source of the

deposits in the bank accounts failure to which the income will be treated as undeclared income and brought to charge accordingly. Among the documents requested were ownership details, importation documents of vehicles, proof of payment, copies of logbooks, and sale and transfer documents of vehicles sold.

35. The Respondent contends that its investigations revealed that the Appellant was non-compliant in filing Corporation Tax since its inception either by filing nil or no return yet was earning income, had not been declaring sales for VAT purposes, failed to file or pay PAYE and duty on vehicles and its directors were nil filers on iTax.
36. The Respondent states that further analysis and inquiry into the Appellant's bank statement, it was established that deposits in Granada Limited A/c no. 3000030836 and director's Rajendra Ratilal Sangani account A/c no. 2000011522 totaling Kshs. 329,772,210.00 and Kshs.734,133,545.00 respectively for the period 2013 – 2017. The Respondent based on his best judgment, issued a Notice of Assessment demanding taxes totaling Kshs. 611,425,856,00 for the period 2013 – 2017 on corporation tax, VAT and director's Income tax.
37. The Appellant lodged an objection dated 13th March 2019, and the Respondent vide a letter dated 12th April 2019, wrote to the Appellant requesting for documents to support the objection. The Respondent further submits that it also invited the Appellant for a meeting on 18th April 2019 to discuss issues arising from the objection in which the Appellant provided the following documents: Loan schedules, sales and purchases schedules for promotional items and schedule of FDR interest income.
38. The Respondent further requested the Appellant to provide the following additional documents; Loan Repayment Schedules, Cheques counterfoils, a schedule of loan principal and interest repayment among other documents.

Further, a reminder dated 24th April 2019 to provide outstanding documents was made to the Appellant.

39. The Respondent submits that the Appellant wrote to the Respondent vide a letter dated 29th April 2019, further clarifying the issues raised in the Objection Decision and provided documents in support of their position. The Respondent avers that the Appellant failed to provide further documents in support of the objection as requested by the Respondent who thereafter issued an Objection Decision dated 14th May 2019, confirming the assessment of Kshs. 406,270,332.00 together with the resultant penalty and interest.
40. The Respondent avers that the Appellant failed to provide the documents as requested and only sought more time to present the same upon which the Respondent reviewed the explanations provided for the bank deposits and an analysis of the bankings showed that the Appellant's explanations and supporting documents provided on the income were insufficient.
41. The Respondent submits that the tax assessment was not only correct but also conform to the Income Tax Act. The Tax Procedures Act places the onus of proof in tax objections on the taxpayer who in this case failed to avail evidence that would support a contrary assessment or that would have guided the Respondent at arriving at a different objection decision.
42. The Respondent asserts that the Appellant did not file all income tax returns for the audit period 2013 – 2017 years of income, contrary to the Tax Procedures Act, therefore the estimated tax assessments were correct.
43. The Respondent avers that the Appellant failed to meet the criteria set out in the VAT Act and the Commissioner's Guidelines. It further avers that bad debts can only be recognized in the year in which it is determined to be bad and not accounted for backwards to the year the sale occurred which was year 2013 and 2014.

44. The Respondent submits that there is no evidence that the Appellant has instituted any recovery measures for instant involving auctioneers and attaching properties apart from the court case that the Appellant have instituted in April 2019 and email correspondence hence the bad debt did not meet the threshold set by the bad debt guidelines and was therefore not allowed.
45. The Respondent submits that the Appellant under declared the income for the period under review contrary to provisions of the Income Tax Act, 2014. The Respondent avers that according to the Income Tax Act it is the responsibility of any person carrying on business to maintain records of all transactions.
46. The Respondent contends that the assessment was issued based on information provided and submits that an in-depth analysis of the deed of debt, loan schedules and principal and interest paid documents provided were banking test where the Appellant's Prime Bank documents were analyzed and adjustments made for output VAT, income declared and WHT deducted at source.
47. The Respondent asserts that an analysis of the documents provided by the Appellant was done and it established that the Appellant failed to demonstrate that the funds invested in the FDR accounts for generation of interest income were loans from friends. Hence, the Respondent therefore took the bankings as constituting inflows from known business activities and brought to charge the total bank deposits. The Respondent insists that the tax assessments were correct.
48. The Respondent contends that the expense interest claimed by the Appellant was excessive and in order to determine the correct allowable interest, apportionment of the expensed interest was done between the actual cost of sales incurred and the loan received. The interest incurring

from the unexplained difference of the loan after deducting the cost of sales was hence disallowed.

49. The Respondent avers that a taxpayer is obligated to maintain any document required under a tax law to enable the person's tax liability to be readily ascertained, as per Section 23 (1) (b) of the Tax Procedures Act. The Tax Procedures Act empowers the Respondent to carry out assessment based on the information available.

50. The Respondent submits that the documents provided by the Appellant did not demonstrate costs of Kshs. 86,227,228.00 incurred by the Appellant as claimed, consequently the Respondent disallowed the costs claimed. The Respondent further submits that the Appellant supplied insufficient documents and the Respondent has embraced the self-assessment regime through trust and facilitation and only verifies information when in doubt of the declarations made in the tax returns. The Respondent deals with each taxpayers' matter independently and based on available information.

Respondent's Prayers

51. The Respondent prays that this Tribunal considers the case and;
- i. Uphold the Objection decision of the Respondent and order the Appellant to pay the confirmed VAT and WHT tax assessment issued by the Respondent.
 - ii. Dismiss the Appellants Appeal for lack of merit.
 - iii. Award the Respondent the costs of the Appeal.

ISSUES FOR DETERMINATION

52. After considering the pleadings and submissions of both parties and the Partial Consent executed between them, we are of the view that the Appeal herein raises the following issues for our determination.

- i. Whether the Respondent was right in assessing the Appellant and demanding settlements of taxes attributable to the Director to wit Ranjendra Ratilal Sanghani.
- ii. Whether the Respondent was right in demanding payment of VAT from the Appellant's director, Ranjendra Ratilal Sanghani.
- iii. Whether the Appellant's director, Ranjendra Ratilal Sanghani had an obligation to withhold tax on payment of interest.

ANALYSIS

i. Whether the Respondent was right in assessing the Appellant and demanding settlements of taxes attributable to the Director to wit Ranjendra Ratilal Sanghani.

53. It was the Appellants contention that the issues for determination in this Appeal relate to the tax affairs of Rajendra Ratilal Sanghani and not the Appellant and that the Respondent erred in issuing an assessment on the tax affairs of the said Rajendra Ratilal Sanghani to the Appellant. Although this issue was raised several times by the Appellant in its submissions, the Respondent in its wisdom or nay otherwise, did not deny the Appellant's claim or give reasons why the assessment was charged on the Director of the Appellant.
54. The Tribunal had a perusal of the documents attached to the Appellant's Statement of Facts and noted that part of the substantive documents informing the assessment of the taxes in issue relate to the Director's bank statements at Prime Bank, Biashara Branch and friendly loans advanced to the Director.

55. It has been a long-established principle of law that a key characteristic of a properly incorporated company is that it possesses a distinct and separate legal personality from its directors and shareholders. Under this doctrine, birthed in the celebrated case of **Salomon v A Salomon & Co Ltd** [1897] AC 22, a corporate entity has its legal personality separate from that of its owners. According to Lord Halsbury. L.C.: in that case, “... *once the company is legally incorporated it must be treated like any other independent person with ... rights and liabilities appropriate to itself.*” Lord Mcnaghten observed that “.... *the company is not in law an agent of the subscribers or trustees*”
56. Thus in our view, the company is not responsible for personal tax affairs of its directors unless the tax liabilities were incurred on behalf of the company. That said, it is difficult to fathom the circumstances under which a company can be responsible for filing of personal tax returns of its directors. The Partial Consent executed between the parties unfortunately fell in the pitfall of having the tax assessment of, inter-alios, the Director charged on the Appellant.
57. A known exception albeit rare is when the tax authority has appointed the company to act as an agent under Section 42 of the Tax Procedures Act and collect taxes on behalf of the Authority and remit it to the Commissioner.
58. We have examined the bundles of documents submitted by both parties and did not find any evidence that the Respondent had appointed the Appellant as an agent to collect on its behalf, taxes from its Director to wit Mr. Rajendra Ratilal Sanghani and therefore Section 42 of the Tax Procedures Act does not apply in this dispute.
59. We in the circumstances find that the Respondent erred in visiting the tax assessment of the director’s activities on the Appellant the demand ought to have been made directly to the Director and not the Appellant.

60. In view of the foregoing, we find it difficult to pronounce ourselves on the remaining issues for determination because that relate to a person not before the Tribunal and with no opportunity to appropriately defend himself.
61. It is equally significant to appreciate and note that on the basis of the Partial Consent executed as between the parties the objection decision appears to have been spent. The objection decision dated 14th May, 2019 which was for the sum of Kshs. 406,270,332.00 was in pursuant to Clause 4 of the Consent reduced to a sum of Kshs. 16,580,405.00, inclusive of penalty and interest. The parties in pursuant to the Consent agreed on the Appellant's and Director's tax liability for Corporation tax and income tax, respectively, for the aggregate sum of Kshs. 16,580,405.00, which is the reviewed sum for the objection decision. The purport of the foregoing is that upon the endorsement of the Consent there was no tax dispute as it were referred back to the Tribunal for due determination.

FINAL DECISION

62. On the basis of the foregoing analysis the Tribunal makes the following Orders: -
- i. The Objection decision dated the 14th May, 2019 is hereby upheld to the extent of the Partial Consent adopted by the Tribunal on the 1st March, 2021.
 - ii. Each party to bear its costs.
63. It is so ordered.

DATED and DELIVERED at NAIROBI on this 25th day of June, 2021.



ERIC N. WAFULA
CHAIRMAN



CATHERINE N. MUTAVA
MEMBER



GABRIEL M. KITENGA
MEMBER



ABRAHAM K. KIPROTICH
MEMBER