

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 13 OF 2019

HYPERTECK ELECTRICAL SERVICES LIMITED.....APPELLANT

-VERSUS-

**COMMISSIONER OF INVESTIGATIONS &
ENFORCEMENT RESPONDENT**

JUDGMENT

BACKGROUND

1. The Appellant is a limited liability company duly registered under the laws of Kenya, whose principal activity is importing and selling electrical goods/products.
2. The Respondent is a principal officer appointed pursuant to Section 13 of the Kenya Revenue Authority Act (Cap 469 of the Laws of Kenya) and is charged with the mandate of administering and enforcing various tax statutes.
3. The Respondent conducted a desk audit on the Appellant's tax affairs acting on intelligence information that some taxpayers were claiming VAT input tax based on fictitious invoices or purchases sourced from different missing traders or non-existent entities. The Respondent largely analysed the Appellant's purchase data based on what the Appellant's suppliers declared in their respective returns as well as the Appellant's bank statements.

4. The Respondent communicated its investigation findings vide a letter dated 13th June, 2018 and requested physical invoices with their respective ETR receipts and delivery notes in support of the online VAT filings in respect of purchases from Bedmak Holdings Limited amounting to Kshs. 167,560,341/- and a corresponding VAT liability of Kshs. 26,809,655/-.
5. The Respondent formalized the findings into a formal assessment vide a letter dated 13th September 2018, computing the Appellant's tax liability at Kshs. 52,043,270/- broken down into Kshs. 26,809,655/-, Kshs. 20,107,241/- and Kshs. 5,126,374 on account of principal tax, penalty and interest respectively. The Appellant advised that computation for corporation tax was ongoing and would be communicated to the Appellant in due course.
6. Dissatisfied with the assessment, the Appellant lodged its objection vide a letter dated 2nd October, 2018. The Respondent acknowledged the receipt of the objection vide a letter dated 11th October, 2018 and requested further documentation from the Appellant.
7. The Respondent issued its objection decision on 3rd December, 2018 whereupon it rejected the Appellant's objection and confirmed the assessment at Kshs. 52,278,592/- broken down as Kshs. 26,809,655/-, Kshs. 20,107,006/- and 5,361,931 on account of principal tax, penalty and interest, respectively.
8. Aggrieved by the objection decision, the Appellant lodged this appeal by filing its Notice of Appeal on 3rd December 2018 contesting the Respondent's objection decision.

THE APPEAL

9. The Appellant instituted the Appeal vide a Memorandum of Appeal dated 14th January, 2019 and filed on 16th January, 2019. The Appeal is premised on the following grounds as set out in the Memorandum of Appeal; -

- i) That the Respondent erred in law in demanding VAT, penalties and interest thereon amounting to Kshs. 52,278,592/- from the Appellant based on non-receipt of VAT charged by the Appellant's suppliers as opposed to sales made by the Appellant vis-à-vis VAT returns filed by the company during the investigations period.
- ii) That the Respondent erred in law and fact by not providing the basis for computing the VAT demanded and disallowing input tax claimed by the Appellant as this should be computed on the supplies made. The Respondent did not provide the individual transactions/supplies in which the Appellant did not account for VAT.
- iii) That the Respondent lacks or is exceeding his jurisdiction in raising the demand by reason of disallowing input tax that was rightfully incurred by the Appellant in the process of buying and selling goods it deals in within Kenya and demanding full payment of tax in full by the Appellant.
- iv) That the Respondent erred in law and fact by disallowing input tax that was claimed by the Appellant during the investigation period. The Appellant has been consistently filing its VAT returns and the Respondent disregarded the Appellant's input tax claimed during the investigation period.

- v) That the Respondent erred in fact and law by confirming an incorrect assessment well after the 60 days stipulated in law for the Respondent to respond to the Notice of Objection made by the Appellant.
 - vi) Further, the computation of penalties and interest in the demand issued by the Respondent is inaccurate and excessive.
 - vii) That the conduct of the Respondent in respect of this matter, with specific reference to failure by the Respondent to conduct the investigation by way of audit visits to the Appellant's premises where he would have been furnished with additional documents, failure to issue valid Income Tax and VAT assessments as required by the Tax Procedures Act instead of resorting to tax demand letters, threats to enforce tax collection before the expiry of the statutory timelines set out in the law, the repeated departure from courses of action agreed with the Appellant and the failure to adhere to representations made to the Appellant at various times has been capricious and unreasonable and the Appellant is entitled to have the assessment set aside.
 - viii) That the said decision is therefore wrong in law and in fact and should be annulled.
 - ix) That the Respondent has demanded an amount that is excessive, punitive and beyond the ability of the Appellant to pay contrary to the canons of taxation.
10. Based on the foregoing, the Appellant urged the Honourable Tribunal to annul or vary the decision in such a manner as may appear just and reasonable.

RESPONSE TO THE APPEAL

11. In response, the Respondent filed its Statement of Facts dated 14th February 2019 on even date.
12. The Respondent stated that its investigations revealed that the Appellant reduced its VAT liability by engaging in the “missing trader” fraud scheme by claiming input VAT from traders that did not supply and/sell goods.
13. The Respondent added that as a result of the missing trader scheme, the Appellant had a VAT liability of Kshs. 26,809,655/-, which was due and payable.
14. According to the Respondent, the Appellant failed to satisfy the legal requirements necessary to support its claim for VAT. Specifically, the Respondent submitted that the Appellant did not possess valid documents to back its claim.
15. The Respondent asserts that it acted within the scope of its jurisdiction in line with Section 31 and Section 51(9) of the Tax Procedures Act in issuing the assessment and objection decision respectively.
16. On the issue of the incorrect and erroneous computation of interest and penalties, the Respondent averred that the use of fictitious invoices to claim input VAT amounts to fraud that attracts a penalty of 75%.
17. The Respondent argued that the Appellant failed to provide the requested documentation even when it was called upon to do so, adding that the burden is on the Appellant to disprove the assessment and further, that the Appellant failed to provide details of the physical location of the alleged missing trader where the goods were allegedly collected from.

18. In light of the foregoing, the Respondent urges the Tribunal to dismiss the Appeal with costs and uphold the objection decision.

APPELLANT'S CASE

19. The Appellant in turn argued that the Respondent disallowed purchases from Bedmak Holding Limited (hereinafter Bedmak) on the grounds that it did not buy goods from Bedmak but rather procured invoices with ETR receipts from it for the purposes of claiming input tax without any goods being delivered.
20. The Appellant, while addressing the lack of a corresponding sales declaration by Bedmak averred that it procured the goods from the supplier for onward supply to the Kenya Power and Lighting Company Ltd. over a period of time during the year 2016. The Appellant added that it paid for the goods, which were delivered by Bedmak to the Appellant's warehouse along Thika Super Highway on various dates.
21. The Appellant submitted that it made payments to Bedmak in respect of the goods purchased in cash, which was the norm in their business dealings as there was no open credit line in the business dealings with Bedmak. The goods would be subsequently assembled by the Appellant for onward transmission to its clients. To demonstrate the cash payments, the Appellant provided the Respondent with Bank Statements for the period in question, depicting a cumulative cash withdrawal of Kshs. 69,229,280/- from its account, which was largely used in making the cash payments.
22. The Appellant averred that it took the Respondent to the corporate offices of Bedmak along Kirinyaga Road in Nairobi's Central Business District. The Appellant further stated that it provided the details and contacts of Mr. James Wanjohi, the manager of Bedmak, who coordinated the delivery of the supplies and collection of the payments.

23. The Appellant further submitted that it does not bear any legal obligation to keep checking on the location and relocation of a supplier prior to tax assessments. Without prejudice to the foregoing, the Appellant posited that it made attempts to locate the said supplier by taking the Appellant to the supplier's known location.
24. The Appellant stated that it had no capacity to know whether its suppliers were filing their tax returns and paying their fair share of taxes as this was beyond its control. The Appellant added that it insisted on being issued with ETR compliant invoices to enable them make payments.
25. The Appellant averred that it met the requirements for claim of input VAT as set out in *Section 17 of the Value Added Tax Act, 2013*, being in possession of the required documentation in support of the transactions in which VAT was deductible.
26. The Appellant submitted that it was entitled to claim input VAT as guided by the decisions of this Honourable Tribunal in **Tax Appeals no. 58 and 186 of 2019 Shreeji Enterprises (K) Limited v. Commissioner of Investigations and Enforcement** where the Tribunal agreed with the finding in **Optigen (Taxation) [2006] EUECJ C-354/03 (12 JANUARY 2006)** that it is a common principle that a taxable person who makes transactions in respect of the goods and services acquired, provided that such goods or services had a direct and immediate link with the output transactions in which VAT is deductible, the system of deduction would apply whether or not there is a missing trader somewhere in the value chain.
27. Relying on the above decision, the Appellant submitted that under the common system of VAT, the entitlements of a trader to credit for a payment in respect of VAT under a transaction should be judged by reference to the particular transaction to which the trader was a party. The Appellant posited

that transactions of which, the trader has no knowledge of the fraudulent acts, or intentions of other persons in the claim, or supply, or of whose involvement it is unaware, do not affect this entitlement.

28. Further, the Appellant submitted that under the prevailing legislation, the only obligations placed on the Appellant in respect of investigating the status of its counterparty was to confirm that it purchased its supplies from a VAT registered trader and that the trader had a registered ETR register.
29. The Appellant submitted that the amendment to Section 17 of the Value Added Tax Act in 2020 does not prejudice the Appellant's position as it cannot be applied retrospectively to the issues at hand, given that the issues arose in 2016 to 2018.
30. The Appellant argued that whereas the onus of proof lies with the Appellant to prove that the Respondent's assessment was wrong, it cannot have been the intention of the legislature to put the taxpayer in a position where he would be required to produce any document that the taxman may require as per the decision of the Honourable Tribunal in paragraph 47 of the Shreeji Enterprises case (supra). The Appellant called upon the Tribunal to apply, albeit sparingly, the Cohan rule established in the case of Cohan v. Commissioner of Internal Revenue, 39 F.2d 540 and accept reasonable explanations given by the taxpayer.
31. While acknowledging that the Respondent has the obligation to 'demolish' any evidence submitted by the Appellant, it submitted that fraudulent conduct must be distinctly alleged and distinctly proved as was outlined by Tunoi, JA (as he was then) in Vijay Morjaria v Nansingh Madhusingh Darbar & another [2000] eKLR.

32. The Appellant submitted that Harlsbury's Laws of England, 4th Edition, Volume 17, paras 13 and 14 dictates that the burden of proof, which essentially, in tax laws, rests on the taxpayer, shifts to the Respondent, at the point issues of VAT fraud are raised.
33. The Appellant averred that it had furnished documents showing the purchase of taxable supplies from registered VAT traders with registration numbers and registered ETR registers and valid PIN numbers issued by the Respondent. The Appellant added that the Respondent's claim that the traders do not have known addresses is to cast considerable doubt on its system of documentation and information management.
34. The Appellant invited the Tribunal to consider the following issues in respect of the Respondent's assertion that there were inconsistencies in the invoices, delivery notes and remittance advice which were considered to render their authenticity questionable;
- i. The Respondent does not deny receiving the invoices in support of the purchases and input VAT.
 - ii. There is no denial on record by Bedmak that it supplied the disallowed purchases.
 - iii. The inconsistencies are not sufficient to destroy the authenticity of the tax invoices, which have not been denied by the supplier, Bedmak.
 - iv. Mere doubt on the authenticity of a document by the Respondent is not sufficient to make it inadmissible, without denial of the same by the maker (in this case Bedmak).

- v. The only obligation placed on the Appellant in respect of investigating the status of its counterparty was to confirm that it purchased its supplies from a VAT registered trader and that the trader had a registered ETR Register.
35. The Appellant averred that the failure to declare corresponding sales by the supplier is not a legal basis for disallowing input VAT.
36. The Appellant further averred that the record of proof as to cash payments was at the material time and still, is not a legal requirement to disallow deduction of input VAT. It pointed out that *Section 17(3)* of the *Value Added Tax Act* does not prescribe the production of cash payment records as a condition for allowing input VAT. Therefore, the Appellant opined that the position taken by the Respondent that it was not convinced that the Bank withdrawals were used wholly to pay Bedmak was untenable and immaterial.
37. In view of the foregoing, the Appellant prayed that the Tribunal allows the Appeal and sets aside the objection decision and the confirmed assessment in its entirety with costs.

RESPONDENT'S CASE

38. The Respondent set out its case in the Statement of Facts dated 14th February, 2019 and filed on even date, the witness statement of Sammy Saruni dated 19th January, 2021 and the written submissions dated 20th April, 2021.
39. The Respondent stated that it received intelligence information from the Investigation and Enforcement Department about traders that were making huge sales but declaring very 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 VAT to zero or end up in a credit position.

40. The Respondent added that the Appellant claimed input VAT in the months of August 2016 to December 2016 from invoices acquired from Bedmak Holdings Limited. The Respondent averred that its investigations revealed that the Appellant claimed purchases and the input tax from unsupported transactions.
41. The Respondent claimed that it identified the Appellant as one of the beneficiaries of the “missing trader” scheme, a tax fraud scheme in which businesses registered for VAT obtain fictitious invoices that are subsequently introduced into their business purchase-records with the sole purpose of illegally reducing the right VAT payments. The Respondent added that the bogus invoices, are meant to illegally reduce the VAT payments registered taxpayers are supposed to comply with. The fictitious invoices are invoices generated to depict a business transaction whereas there is no actual supply /movement of goods and services, or simply that there is no commercial transaction or value.
42. The Respondent averred that it carried out an iTax analysis of Bedmak, a supplier that the Appellant had purportedly bought electronic products from. The Respondent added that 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.
43. The Respondent averred that vide a letter dated 13th June, 2018 it requested the Appellant to provide documents, including ETR receipts, delivery notes, bank statements and payment vouchers to prove purchase of goods. The Appellant failed to provide all invoices and delivery notes as requested by the Respondent.
44. The Respondent contended that upon reviewing some of the documents provided, it found inconsistencies, thus the Appellant failed to demonstrate

to the Respondent how the purchased goods were ordered, recorded, and sold.

45. The Respondent submitted that the Appellant failed to meet the threshold of Section 17 of the VAT Act 2013 as read together with Sections 42 and 43 of the VAT Act, 2015 as well as Paragraphs 7 and 9 of the Value Added Tax Regulations, 2017.
46. The Respondent added that it issued assessments dated 11th and 12th September, 2018 demanding VAT for the sum of Kshs. 26,809,655/- plus penalty and interest totaling Kshs. 52,043,270/-, which were objected to by the Appellant vide a letter dated 2nd October 2018.
47. The Respondent stated that it requested the Appellant, vide a letter dated 11th October 2018, to provide additional documents such as bank statements to enable it establish whether payments were made. The documents provided were remittance advices for Bedmak, Invoices and delivery notes.
48. The Respondent submitted that it found many inconsistencies in the documents availed by the Appellant upon reviewing them, a feature that raised doubt as to their authenticity. The inconsistencies outlined by the Respondent were;
 - a) Documents serialised as INV-B-8021/2016 and INV-B-7080/2016 had not been captured in what had been referred to as the remittance Advice.
 - b) Documents serialised as INV-B-5040/2016, B-4164/2016 and Ht4001 that were provided totalled Ksh. 167,560,034.13/- raising a VAT input of Kshs. 26,809,655/-.

- c) Some of the invoices and delivery notes had the same number but different dates for instance Invoice B-5040/2016 had been listed for 2nd August, 2016 as well as 2nd November, 2016.
 - d) Some of the delivery notes had due dates that were earlier than the delivery dates.
 - e) The invoices were neither signed nor acknowledged in any manner. Further, the delivery notes were similarly not signed leading to the inference that no person received the goods as none were supplied.
49. The Respondent also pointed out that the Appellant stated in the Objection that all payments were done in cash as there was no credit line, whereas the invoices gave a grace period of 3 months to pay. Further it was noted that in the remittance advice:-
- a) Supplies for 6th June 2016 were paid for on 19th July, 2016.
 - b) The supplies for 2nd August 2016 were paid for partly in September and partly on 5th December, 2016.
50. Consequently, the Respondent concluded that the objection was aimed at misleading the Respondent while the facts in practise were largely different.
51. According to the Respondent, the bank statements supplied by the Appellant from Equity Bank Limited indicated a total withdrawal of KShs. 62,229,280/- for the period January 2016 to 31st January 2017, contradicting the remittance advice which indicated that Bedmak alone as a supplier had been paid a total of KShs. 194,369,995.90/- in cash.

52. The Respondent averred that effectively there was no proof that Bedmak supplies received payments for the supplies it made to the Appellant. In the absence of such proof of payment, the Input VAT cannot validly be claimed.
53. The Respondent averred further that the Appellant did not provide any evidence to rebut the inconsistencies even after being invited to demonstrate and prove that it indeed bought and received supplies from legitimate suppliers. Therefore, the Respondent holds that there was no purchase of goods,
54. That the Appellant was unable to demonstrate to the satisfaction of the Commissioner, that indeed it had received the said electronic goods. In reaching this determination the Respondent was guided by the “reasonable man test”. This is an objective test that the Respondent used in trying to establish if the Appellant indeed was involved in a legitimate purchase of high value goods.
55. The Respondent averred that some of the queries it raised under the reasonable man’s test were:
- i. Is it reasonable for the Appellant to enter into a high value deal for supply of electronic goods with no formal contractual arrangements?
 - ii. Was the supplier newly established with minimal trading history offering to supply the raw materials cheaper than a long-established supplier?
 - iii. Is there additional paperwork to support the invoices that the Appellant sought to rely on in obtaining a tax refund? For example, were there delivery notes? Purchase orders? Inspection reports? Any logs that show the movement of the electrical products into their premises?

56. Consequently, the Respondent concluded that the Appellant being an established business entity is highly unlikely to allow such lapses and oversights in their supply chain. The Respondent added that it requested additional documentation to support the invoices but the Appellant has been unable to provide any.
57. The Respondent asserted that it considered the Appellant's objection and rendered its objection decision on 3rd December 2018 pursuant to Section 51 of the Tax Procedures Act giving the reasons therefor.
58. The Respondent urged the Tribunal to adopt the test used in the Missing Trader Case of **Edgeskill Limited Vs The Commissioner For Her Majesty's Revenue And Customs [2014] UKUT 0038** where the Hon. Mr. Justice Hildyard reiterates the test applied by the FTT (which is a specialist tax tribunal) when considering whether the Commissioners were justified in refusing a claim of input tax. The test, as set out in paragraph 37 of the Decision, is:

“ i. Was there a VAT loss?

ii. If so, was it occasioned by fraud?

iii. If so, were the Appellant's transactions connected with such a fraudulent loss of VAT loss?

iv. Is so, did the Appellant know, or should it have known, of such a connection?”

59. The Respondent submitted that the Appellant was not only a beneficiary of a “Missing Trader” tax evasion Scheme but also did claim purchases from a supply chain where VAT was fraudulently evaded, and that the Appellant knew or should have known that the transaction was connected to a fraud.

60. The Respondent pointed out 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.
61. The Respondent further submitted that the provisions of Section 42(2) (b) of the VAT Act provides that invoices should be issued in respect of supplies only by persons who are registered. It was the Respondent's contention that the investigations it carried out revealed that most of the traders from whom the Appellant claimed input taxes from, were not registered persons.
62. The Respondent posited that the Appellant was seeking to abuse the VAT tax regime in the hope of fraudulently claiming a tax refund. To demonstrate the abuse, the Respondent averred that under the VAT tax regime, businesses pay tax on the value they add to the goods and services they purchase from other businesses. VAT liability is typically calculated using what is known as the credit invoices method through which businesses apply the VAT rate to their sales but claim a credit for VAT paid on purchases of inputs from other businesses (shown on purchase invoices). The difference between the VAT collected on sales and the credit for VAT paid on input purchases is remitted to the government.
63. The Respondent further argued that at the heart of the VAT is the credit mechanism, with tax charged by a seller available to the buyer as a credit against their liability on their own sales and, if in excess of the output tax due, refunded to them. This creates opportunities for fraud and abuse of VAT tax regime, which can stem from either underpayment of taxes owed on sales, or overstating taxes paid on purchases, that is, refund fraud and "missing trader" fraud. VATs are vulnerable to refund fraud because businesses with taxable sales that are less than taxable purchases are entitled to refunds.

64. The Respondent said that it disallowed the Appellants claim for input VAT because the Appellant failed to provide documents to demonstrate that payment was made to its supplier Bedmak holdings.
65. While relying on the Tribunal's decision in the **Tax Appeal Tribunal Appeal No. 235 of 2018 Rahima Traders Limited.Vs. Commissioner of Investigations & Enforcement**, the Respondent urged the Tribunal to adopt the position reiterated in paragraph 82 of the said judgment as follows:-

" it was the Appellant who bore burden of providing evidence of proving the assertions made by the Respondent in its assessments and objection decision as incorrect. It's not sufficient for the Appellant to seek to hide behind the provisions of the law and claim that the Respondent acted unfairly when the facts point to the Appellant being given an opportunity to defend its case, holding discussion meetings with the Respondent and being given ample time to furnish the Respondent with the necessary documents. It's the Tribunals view that the Respondents request for documentation was not unreasonable in the circumstances."

66. The Respondent averred that some of the documents that were provided had numerous inconsistencies which raised question as to their authenticity and that the Appellant did not bring any new evidence to rebut the inconsistencies that were found in its invoices, delivery notes and remittance advice, on this basis the Respondent disallowed its claim for input VAT.
67. The Respondent submitted that it is empowered under Section 59 of the Tax Procedures Act (TPA) to request production of records and additional information which can fully satisfy the Commissioner, if he is of the view that the information given is insufficient. The Respondent further averred that the

South African Case of Metcash Trading Limited v Commissioner for the South African Revenue Service and Another (CCT3/00) [2000] reaffirms this position and asserts that the onus and burden of proof is on the taxpayer by submitting all the necessary documentation to support their VAT refund claim. Judge Krigler states the following in paragraph 22 in his landmark ruling:-

"...The prospect of having the Commissioner independently assess both the underlying amount and the VAT that is to be paid thereon must in itself be a powerful disincentive for recalcitrant, dishonest or otherwise remiss vendors. But the compulsive force of this mechanism of the Act goes a good deal further. The dissatisfied vendor can, by lodging an objection under section 32 of the Act and, that failing, by noting an appeal under section 33 or 33A, both compel the Commissioner to reconsider the assessment and have its correctness reconsidered afresh by an independent tribunal. 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."

68. The Respondent further submitted that *Section 43 of the Value Added Tax Act, 2013* required the Appellant to keep transactional records for a period of five years. It provides as follows:

“Every registered person shall, for the purposes of this Act, keep in the course of his business, a full and true written record, whether in electronic form or otherwise, in English or Kiswahili of every transaction he makes and the record shall be kept in Kenya for a period of five years from the date of the last entry made therein.

The records to be kept under subsection (i) shall include—

- a) copies of all tax invoices and simplified tax invoices issued in serial number order;*
- b) Copies of all credit and debit notes issued, in chronological order; No. 35 of 2013 Value Added Tax [Rev. 2018] 24*
- c) purchase invoices, copies of customs entries, receipts for the payment of customs duty or tax, and credit and debit notes received, to be filed chronologically either by date of receipt or under each supplier's name;*
- d) details of the amounts of tax charged on each supply made or received and in relation to all services to which section 10 applies, sufficient written evidence to identify the supplier and the recipient, and to show the nature and quantity of services supplied, the time of supply, the place of supply, the consideration for the supply, and the extent to which the supply has been used by the recipient for a particular purpose;*

- e) tax account showing the totals of the output tax and the input tax in each period and a net total of the tax payable or the excess tax carried forward, as the case may be, at the end of each period;*
- f) copies of stock records kept periodically as the Commissioner may determine;*
- g) details of each supply of goods and services from the business premises, unless such details are available at the time of supply on invoices issued at, or before, that time; and*
- h) such other accounts or records as may be specified, in writing, by the Commissioner".*

69. In responding to the Appellant's assertion that the burden shifts to the Respondent to establish the whereabouts of the missing traders, the Respondent averred that "Know Your Customer" policy is an ongoing obligation, which cannot be derogated. Furthermore, The Appellant has a duty to carry out checks to establish the credibility and legitimacy of its suppliers as well as the supplies made. It is obvious that the Appellant did not take any reasonable steps to verify the integrity of its supply chain.

70. The Respondent implored the Tribunal to consider and apply the doctrine of illegality, which is based on two principles; first, that a person should not benefit from his/her own wrong; and second, that the law should not condone illegality. This was set out in the case of Tinsley v Milligan 11994] 1 AC 340.

71. The Respondent submitted that by allowing, the input tax claimed by the Appellant, the Tribunal runs the risk of unjustly enriching the Appellant, as it has not proved on the balance of probabilities that it is entitled to the tax refund.
72. In view of the foregoing, the Respondent urged the Honorable Tribunal to confirm the assessments for the period August to December 2016 and find that the taxes of Kshs. 26,809,655/- are due and payable by the Appellant.

APPELLANT'S REPLY TO THE RESPONDENT'S SUBMISSIONS

73. The Appellant submitted that whereas the Respondent denies that some of the invoices were captured in the remittance advice that alone does not discredit the invoices assuming (but not admitting) that there was an omission to capture the invoices in the remittance advice, a possibility with an accounting procedure operated by humans.
74. The Appellant in response to the errors noted in the invoices stated that delivery notes are not a pre-deduction requirement under section 17(2) of the VAT Act (a post facto amendment) as read with subsection 3 thereof, any errors on the said delivery notes (though not admitted), are not grounds to deny a deduction, on the basis of innuendos attributable to precision or otherwise on documentation, and which in any event do not rebut that the delivery happened.
75. In respect of the reasonable man test, the Appellant responded that it is neither unreasonable to carry out transactions in cash, nor is it a pre-deduction of input VAT requirement. The Appellant added that the lack of formal contractual arrangements for high value deal: formality or otherwise is a matter of opinion, besides invoices, coupled with un-denied payments, are

sufficient to cover even non-prudent transactions contractually. It is not legally material, though, for VAT deductions.

76. The Appellant argued that whether the supplier was a newly established entity with minimal trading history but offering to supply the raw materials cheaper than a long-established supplier was irrelevant in the case at hand.
77. The Appellant submitted that it produced additional documents like bank statements, and delivery notes for the issue at hand, being VAT input deductions. The Appellant maintained that to require the Appellant to establish more from a supplier who has issued tax invoices with ETR receipts, relevant to the tax transaction at hand, is not only an abuse of the tax obligations of a tax payer, but is also to place an onerous duty on a tax payer who cannot be expected to have the relevant investigative capacity and resources.
78. In response to the Respondent's allegations to the effect that most of the traders that the Appellant claimed it paid VAT input to, were not registered, the Appellant submitted that the same amounted to a general unsubstantiated statement, not relevant to the particular transaction in dispute, and ought not to be relied on to the detriment of the Appellant.

ANALYSIS AND ISSUE FOR DETERMINATION

79. The Tribunal having considered the documentation, pleadings and submissions of the parties determines that that the Appeal distils into one issue for determination as follows;

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

80. In determining whether the Respondent's decision to disallow the input VAT claimed by the Appellant was proper as per the provisions of the VAT Act and various authorities, the Tribunal wishes to rely on the tests relied upon in *Tax Appeals Tribunal No. 225 of 2018 Rahisi Cash & Carry Traders Ltd —vs- Commissioner of Investigations & Enforcement* as follows; -

- i. Whether the Appellant furnished proof of purchase.
- ii. Whether the Appellant's right to claim VAT was affected by the presence of fraud in the supply chain.
- iii. Whether the Appellant knew or should have known that there was fraud.

I. Whether the Appellant furnished proof of purchase

81. The Respondent disallowed input VAT claimed by the Appellant on the basis that the Appellant was identified as one of the beneficiaries of the "Missing trader scheme". According to the Respondent, it conducted a thorough analysis that established that the Appellant claimed to have purchased supplies worth Kshs. 167,560,341/- from Bedmak Holdings Limited and claimed input VAT of Kshs. 26,809,655/-. It avers that it requested the Appellant for information to support the claim for the input VAT and purchase costs, but the documents provided were riddled with inconsistencies that impeached their authenticity.
82. The Appellant on its part insists that it purchased the goods and claimed the input VAT and purchase costs as allowed under law. It further avers that it provided the Respondent with the requisite information requested to prove purchase, delivery and payment for the said supplies.

83. It is an 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. In the Kenyan VAT system, this principle is found in Section 17(1) of the Value Added Tax Act, 2013 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.”

84. The foregoing 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.

85. The Tribunal relies on **Rahisi Cash & Carry Traders Ltd —vs- Commissioner of Investigations & Enforcement (supra)**, at paragraph 122 as follows:-

“In a functional VAT system, claiming input VAT paid on purchases related to a sale is an unassailable right of taxpayers. However, such a system cannot be functional if the tax collector is to refund what it never received in the first place. The taxpayer should prove that it

actually paid by providing proof of purchase. Once the proof of purchase has been provided, the tax authority should either give the refund or challenge the proof of purchase.”

86. The right to claim input VAT is premised on the assumption that the taxpayer paid VAT during the purchase of their supplies. Section 17(3)(a) of the VAT Act further provides that in order to claim input VAT, the relevant documents to be provided are the original tax invoice or a certified copy of the same.
87. A reading of this Section shows that it is not just enough for the original tax invoice to be availed, the invoices must themselves relate to an actual supply or importation that was acquired by the trader to make the taxable supply. Indeed, the “missing trader fraudulent scheme” that the Respondent has described would flourish on the basis that only an original tax invoice or ETR receipt if availed, is sufficient. Therefore, it is important to rely, not just on the invoice but a proper demonstration that the invoices actually relate to purchases of the goods and services that are applied in the production of the taxable supplies.
88. In this case, the Respondent submitted that it requested the Appellant to provide documents among them, supplier invoices, statements, delivery notes, payment vouchers and ETR receipts for the suppliers which it avers, the Appellant failed to provide.
89. 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 (supra)**, 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"

90. However, this burden placed upon the taxpayer in respect of input VAT claim is to the extent that the necessary documentation in support of the purchase is tabled, upon which a legitimate expectation for the claim to be allowed arises unless the credibility of the documents provided is impeached.
91. Therefore, once the taxpayer adduces evidence that discharges his burden by providing the documents required, the onus shifts to the Respondent to impeach the credibility of the documents for the assessment to stand. Such a position is clearly captured in the Supreme Court of Canada's decision in Hickman Motors Ltd. v. Canada, [1997] 2 S.C.R. 336, where the Court expressed itself thus:

"The taxpayer's initial onus of "demolishing" the Minister's exact assumptions are 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.”

92. The Tribunal finds that the Appellant discharged its burden by providing documents to demonstrate the actual purchase and supply of taxable supplies.
93. However, the Tribunal also finds that the Respondent impeached the credibility of the documents and evidence adduced by the Appellant by demonstrating that the evidence had glaring gaps in logic, chronology, and substance.
94. Based on the documents provided by the Appellant and tabled before the Tribunal by the Respondent the following inconsistencies are evident;-
 - i. Invoices serialised as INV-B-8021/2016 and INV-B-7080/2016 had not been captured in what had been referred to as the Remittance Advice.*
 - ii. Some of the invoices and delivery notes had the same number but different dates for instance Invoice B-5040/2016 had been listed for 2nd August, 2016 as well as 2nd November, 2016.*
 - iii. Some of the delivery notes had due dates earlier than the delivery dates.*
 - iv. The invoices were neither signed nor acknowledged in any manner.*
 - v. The Delivery Notes were not signed nor acknowledged that the goods were received in good condition as the signing spaces were left blank.*

95. Contrary to the Appellant's assertion that all payments to Bedmak were done in cash as there was no credit line, the Tribunal observed that;

i. The invoices gave a grace period of 3 Months to pay.

ii. Supplies for 6th June 2016 were paid for on 19th July, 2016 as depicted in the remittance advice

iii. The supplies for 2nd August 2016 were paid for partly in September and partly on 5th December, 2016.

96. The Respondent averred that the bank statements supplied by the Appellant from Equity Bank Limited indicated a total withdrawal of KShs. 62,229,280/- for the period January 2016 to 31st January 2017, contradicting the remittance advice which indicated that Bedmak alone as a supplier had been paid a total of KShs. 194,369,995.90/- in cash.

97. In respect of the withdrawals, the Tribunal agrees with the Respondent that it was not convinced that the Bank withdrawals were used wholly to pay Bedmak. Like in any other normal business setting, it is possible that some of the withdrawals were made for miscellaneous expenses. Without prejudice to the foregoing, it is clear that the Appellant failed to demonstrate how the payments for the goods worth KShs. 194,369,995.90/- were made, as the cash withdrawals only amounted to Kshs. 62,229,280/-. Besides, the Appellant did not give details of the person nor provide an acknowledgement of receipt of the payments, which is quite unusual, considering the huge amounts of money involved in the transactions.

98. The Appellant averred that the record of proof as to cash payments was at the material times and still is not a legal requirement to disallow deduction of input VAT, adding that Section 17(3) of the Value Added Tax Act does not prescribe the production of cash payment records as a condition for allowing input VAT. Therefore, the Appellant opined that the position that the Respondent was not convinced that the Bank withdrawals were used wholly to pay Bedmak was untenable and immaterial.

99. However, the Tribunal is alive to the provisions of Section 56(1) of the Tax Procedures Act 2015, which provides as follows;

“In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.

100. The Burden was on the taxpayer to debunk the Respondent’s assumption by proving that the impugned goods were indeed purchased, paid for, and delivered. Therefore, the demand for proof of cash payments by the Respondent was aimed at aiding the Appellant to discharge its burden. It is also the Tribunal's view that the Respondent's request for documentation was not unreasonable or unjustified in the circumstances.

101. The fact that the supplier in question (Bedmak) could not be traced, even with the help of the Appellant only buttresses the view that the said supplier was a missing trader.

102. At this point the Tribunal finds that it was the Appellant who bore the burden of providing evidence to prove that it indeed purchased the goods, paid for them and the same delivered.

103. It is not sufficient for the Appellant to seek to hide behind provisions of the law and claim that the Respondent was acting unfairly when the facts point to the Appellant being given an opportunity to defend its case but failed to do so.

104. It is worth noting that the Appellant has not given any reasons or explanations for the inconsistencies pointed out by the Respondent, which impeached the authenticity of the documents provided. Instead, the Appellant submitted that *“the inconsistencies were as a result of human errors, which are common for accounting procedures operated by humans”*.

105. Consequently, the Tribunal finds that the Appellant did not furnish sufficient proof to defend its position and to rebut the Assessment and the objection decision. The Respondent is therefore justified in its demand.

ii Whether the Appellant's right to claim input VAT and purchase cost was affected by the presence of fraud in the supply chain; and

iii Whether the Appellant knew or should have known that there was a fraud.

106. Having established that the Appellant failed to prove that it indeed made any purchases, the question of whether the Appellant knew or ought to have known that its transactions were part of a fraudulent scheme is rendered moot.

107. Accordingly, the Tribunal finds that the Respondent did not err in its decision to disallow the input VAT and purchase cost by the Appellant and to demand payment of the VAT claimed in the period under investigation.

FINAL ORDERS

108. Based on the foregoing analysis the Tribunal makes the following Orders:-

- i. The Appeal be and is hereby dismissed.
- ii. The objection decision dated 3rd December, 2018 confirming the assessment of Kshs. 52,278,592.00, inclusive of penalty and interest is hereby upheld.
- iii. Each party to bear its costs.

109. It is so ordered.

DATED and DELIVERED at NAIROBI on this 4th 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



.....
ELISHAH NJERU
MEMBER



.....
HABON FARAH
MEMBER

