

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL AT NAIROBI
APPEAL NO. 148 OF 2018
(CONSOLIDATED WITH APPEAL NO. 344 OF 2018)

COMPUTECH LIMITED.....APPELLANT
VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

A. INTRODUCTION

1. The Appellant is a private limited liability company duly incorporated in Kenya under CAP 486 of the Laws of Kenya (now repealed) and carrying on the business of IT systems and integration within the Republic of Kenya.
2. The Respondent is appointed under Section 13 of the Kenya Revenue Authority Act, 1995 and in pursuant to Section 5 (1) of the Act the Kenya Revenue Authority is an agency of the Government for the collection and receipt of all revenue. Further, under Section 5 (2) with respect to the performance of its functions under Sub-Section (1) the Authority is mandated to administer and enforce all provisions of the written laws set out in Part 1 & 2 of the First schedule to the Act for the purposes of assessing, collecting and accounting for all revenues in accordance with those laws.

B. BACKGROUND

3. Vide a letter dated 16th April 2018 the Respondent issued a tax demand to the Appellant following a review of the Appellant's tax declarations in accordance with the provisions of Section 5 (2) (a) of the Kenya Revenue Authority Act, CAP 469 of the Laws of Kenya. The Commissioner indicated that the Appellant used, for the period of June 2016 to July 2016, invoices from suppliers (Zulma Trading Limited and Halinto Distributors) to account for input VAT. The same invoices were used to account for expenses in the financial statements thus reducing the Appellant's income Tax liability. A tax liability of Kshs. 37,079,337.00 was raised against the Appellant.
4. The Appellant via a letter dated 23rd April 2018 denied the tax assessment in the demand dated 16th April 2018 and offered the Commissioner the following reasons for so disagreeing with the demand issued;

That:-

- a. "We purchased goods from Zulma Trading and Halinto Distributors. The contact person Mr. Mohamed Hussein Ali of Telephone number 0799933369/0722511205 supplied us goods with invoices and ETR receipts. The goods procured were then supplied to various customers for which we have raised ETR invoices. Payments for the supplies were made in the normal fashion by cheques or RTGS which is normal process with all purchases. Your claim of "no deliveries were made" is invalid and a detailed explanation of each invoice follows."
- b. "VAT was charged to all the relevant customers and duly paid. The VAT from these two suppliers was also paid and recorded in our VAT returns.

In fact, during this time we were appointed VAT withholding agents and deducted statutory tax of 6% withholding tax on one of these payments. Hence your statement of VAT input is also invalid.”

C. APPEAL

5. The Appeal herein is premised on the following grounds as enumerated in the Appellant’s amended Memorandum of Appeal dated 6th September 2019;
 - a. That the Respondent erred in fact in its findings that there was no supply of taxable goods made by Zulma Trading Limited and Halinto Distributors to the Appellant.
 - b. That consequent to the above, the Respondent erred in law and in fact by disallowing the Appellant’s input value added tax amounting to Kshs. 80,607,679.00.
 - c. That the Respondent erred in law and in fact by upholding its decision to disallow the Appellant’s input VAT arising from the supply of taxable goods from its suppliers notwithstanding the fact that records of the Appellant show that the purchases were made and VAT accounted for as provided under the law.
 - d. That due to the misconception as stated in (a) above, the Respondent also erred in law and fact by disallowing the Appellant’s purchases amounting to Kshs. 80,607,679.00 and demanding additional tax of Kshs. 21,435,367.00.

- e. That the Respondent erred in fact by failing to take into consideration all the evidence of the purchases and sales by the Appellant including ETR receipts, delivery notes, proof of payments, sale invoices and even written confirmations from the Appellant's suppliers and client confirming that they indeed made or received the supplies.
6. By the same Memorandum of Appeal the Appellant made the following prayers:-
- a. The Respondent's demand for additional taxes dated 16th April 2018, the confirmation of assessment dated 12th July 2018, its income tax additional assessments dated 4th June 2018 and the confirmation of assessment dated 4th October 2018 be struck out in their entirety.
 - b. The Respondent's actions to demand additional taxes despite having been provided with all the relevant information and documentation be declared arbitrary, unreasonable, unfair and contrary to the administration of justice and legitimate expectations of the Appellant.
 - c. The Respondent, its employees, agents or other person purporting to act on its behalf be barred from demanding or taking any further steps towards enforcement or recovery of principal tax, penalties and interest on the Respondent's demand as stipulated above.
 - d. The costs of this appeal; and
 - e. Any other remedies that the Honorable Tribunal deems just and reasonable.

D. THE RESPONSE TO THE APPEAL

7. The Respondent by its Statement of Facts dated 29th November 2018 argued their case as follows;

- a. In response to ground 1 of the Appellant's Memorandum of Appeal and grounds 4, 5, 6 and 7 of its Statement of Facts, the assessments were correctly issued and conform to the Income Tax Act. Investigations done by the Respondent revealed that the Appellant together with others not mentioned in this appeal engaged in fraudulent activities by claiming purchases of goods not delivered. 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 to a different objection decision.
- b. In response to ground 2 of the Memorandum of Appeal and grounds 11, 12 and 13 of the Statement of Facts, the fact that the invoices from all suppliers in question had all the requirements of a tax invoice as required under the Tax Procedures Act and had ETR receipts attached thereon is not sufficient proof that the goods were actually delivered. An additional assessment was therefore raised based on the gross amount received as per the Appellant's summary stock data reviewed. The assessment was based on the information provided.
- c. Further in response to ground 2 of the Memorandum of Appeal and grounds 11, 12 and 13 of statements of facts, the stock movement register provided by the Appellant is an afterthought since investigations carried out by the Respondent revealed that no

goods were received by the Appellant. The Respondent sought to confirm sales made to the Appellant's client and indeed the Appellant's clients confirmed receipt of goods. However, the Respondent cannot confirm that there were actual goods supplied to the Appellant.

- d. In response to ground 3 of the Memorandum of Appeal and ground 17 and 18 of the Statement of Facts, the Appellant did not avail all the documents required to prove their allegation. The Appellant duly availed records of payments made to each of the suppliers and the payment in most cases were made by RTGS or cheques to the bank accounts of the suppliers and this is how the Tax evasion scheme was designed. The Respondent received the following records after the assessments were raised;
- i) Copied of the invoices from the supplier.
 - ii) Copies of payment documents including RTGS and bank statements.
 - iii) Copy of the stock movement schedule.
- e. The Respondent's investigations indicated that the Appellant devised the scam in such a way that it made payments to the suppliers through Diamond Trust Bank via RTGS or cheques and the money would find its way back to it.
- f. It was established that the Appellant did not receive the actual goods as purported same which is contrary to the provisions of Section 54 A and 55 (2) the Income Tax Act.

- g. In further response to ground 3 the Memorandum of Appeal the Appellant did not provide sufficient documents to support their objection and on inquiry by the Respondent, the Appellant confirmed that they maintain a nil stock policy. The Respondent states that it did not receive any letter from the Appellant's suppliers confirming the purchases as claimed by the Appellant. The Stock movement register provided by the Appellant is an afterthought since investigations carried out by the Respondent revealed that no goods were received by the Appellant.
- h. In response to ground 4 of the Memorandum of Appeal and ground 19 and 20 of the Statement of Facts, the Respondent indeed carried out thorough investigations over a period of time prior to raising the assessments. The Respondent evaluated the records availed by the Appellant in comparison to the findings of the investigations carried out and found inconsistencies in the Appellant's records. These findings formed the basis of the Respondent's objection decision. The Respondent is empowered by Section 24 of the Tax Procedures Act, 2015 issued an assessment based on information provided.
- i. Further in response to ground 4 of the Memorandum of Appeal and ground 19 of the statement of facts, the documents provided by the Appellant as were insufficient in evidence that would have altered the assessment. The Respondent sort to confirm sales made to the Appellant's clients and indeed the Appellant's clients confirmed receipt of goods. However, the Respondent cannot confirm that the goods supplied were from the "missing traders".

- j. In response to ground 5 of the Memorandum of Appeal and grounds 14, 15 and 19 of the Statement of Facts, 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 in available information. The Respondent has used Section 15 and 16 of the Income Tax Act.
- k. That in further response to ground 6, the Respondent carefully considered the documents submitted by the Appellant and issued an objection decision in line Section 51 of the Act.
- l. The Respondent has at all times ensured that no goods enter into the country without the payment of taxes at the point of entry.
- m. The Respondent acknowledges that the suppliers whose invoices have been disallowed under this assessment have taken the Respondent to Court under Petition 167 of 2018 and the matter is pending in Court. This does not sanctify the actions of the Appellant in using the mentioned suppliers' invoices to claim income tax.
- n. In response to the statement of facts, the Respondent reiterates that as a result of its under-declaration, the Appellant is in debt of Kshs. 21,435,367.50. the Respondent avers that the Appellant is underserving of the prayers sought due to the aforementioned reasons.

8. The Respondent prays as follows;

- a. The outstanding tax arrears of Kshs. 21,435,367.50 are due and payable by the Appellant.

- b. The confirmed assessments dated 4th June 2018 were proper in law.
- c. That the Appeal herein be dismissed with costs to the Respondent.

E. THE PARTIES' SUBMISSIONS

I. APPELLANT

- 9. Counsel for the Appellant Ms. Sharon Olbara submitted that the genesis of this Appeal is the Respondent assessment of the Appellant's tax liability and the disallowance of the Appellant's claim for input VAT and purchases amounting to Kenya Shillings Eighty Million (Kshs. 80,000,000.00) from invoices from Zulma Trading Limited and Halinto Distributors. Counsel averred that the main argument by the Respondent is that the invoices from these suppliers were used to account for input value added tax and expenses reducing the Appellant's value added tax and income tax liability.
- 10. It was submitted for the Appellant that one of the issues in contention is whether the suppliers (Zulma Trading Limited and Halinto Distributors) made a supply of taxable goods to the Appellant. The Tribunal was referred to Paragraph 19 of the Appellant's Statement of Facts dated 6th September 2018, that the Appellant indeed dispensed with its burden of proof as required under Section 56 (1) of the Tax Procedures Act, 2015. Counsel submitted that the goods were actually purchased, delivered and sold to the Appellant's customers as evidenced by the attached invoices, ETR receipts, purchase orders and delivery notes.
- 11. The Appellant further submitted that in addition to the invoices, ETR receipts, purchase orders and delivery notes, there was proof of payment to the two suppliers. The Tribunal was referred to the Appellant's attachments at pages 55 to 74 of its Memorandum of Appeal, indicating

that the Appellant did instruct its bank, Diamond Trust Bank to make payment to both its suppliers; Zulma Trading Limited and Halinto Distributors.

12. To further buttress the foregoing position, it was submitted for the Appellant that indeed the Appellant was withholding agent for the period of the assessment, at the accepted rate of 6%. In this regard, the Appellant attached the withholding certificate for Halinto Distributors at page 75 of the Appellant's Memorandum of Appeal. This is coupled with the confirmation letter from Halinto General Distributors basically confirming that they did deliver the goods to the Appellant.

II. RESPONDENT

13. Counsel for the Respondent, Ms. Marion Gitau, submitted that the Respondent issued the assessment to the Appellant following an investigation in which the Appellant was implicated in a scheme where the Appellant had used tax invoices from companies known as Zulma Trading Limited and Halinto General Distributors for the period of 2016. Counsel further averred that the scheme was crafted in such a manner that the Appellant would have ETR receipts, tax invoices and even evidence of payment but in real sense the goods were not delivered as the two suppliers were not in a position to deliver the said goods. The Respondent further alleged that the two companies in question were registered for the sole purpose of invoicing to help the Appellant claim input tax under Section 17 (1) of the VAT Act, 2013.
14. It was averred on behalf of the Respondent that the Appellant does not keep a stock policy. In particular response to ground number 3 of the

Appellant's Memorandum of Appeal, the Respondent alleges that the way the Respondent would have verified the Appellant's purchases was through the stock movement, which was not availed to the Respondent.

15. The Respondent further submitted on the bank statements that the scheme was crafted in such a manner that the Appellant would purport to pay these two companies but at the same money would be withdrawn by these two companies and paid back to the Appellant. The Appellant would withdraw the money, purport to pay and then the same money is returned.
16. It was further submitted that the Appellant gave contacts for these two companies which happened to be the same one to wit Mr. Hussein Mohammed Ali. But when the Respondent tried to contact these particular companies they could not be reached for verification. This led the Respondent to the conclusion that these companies were not in the business of trading but in the business of selling invoices to assist businessmen benefit from the tax regime.

F. ISSUES FOR DETERMINATION

17. After a careful reading and analysis of the contesting pleadings, submissions and documentary evidence on record the following issue crystalizes for determination by this Honorable Tribunal;
 - a. *Whether the Appellant is entitled to input value added tax as claimed?*

G. ANALYSIS

a. Whether the Appellant was supplied with taxable goods by its suppliers, namely Zulma Trading Limited and Halinto General Distributors?

18. This Honorable Tribunal has thoroughly examined the assemblage of evidence and arguments advance by both parties to this Appeal and it appears that the Appellant made an application for claiming input tax as is the practice in jurisdictions where Value added Tax is applied. To its surprise, the Appellant's application was rejected by the Respondent who in turn demanded the input on account of the Appellant not making a taxable supply.
19. The Appellant contends that contrary to the Respondent's assertion the goods in question were actually delivered and sold to the Appellant's customers as evidenced by the invoices, ETR receipts, purchase orders and delivery notes supplied to the Respondent during the audit and attached to the Appeal herein. Additionally, that the Appellant was a withholding tax agent for the period of assessment in review.
20. On the other hand, the Respondent avers that the Appellant together with others not mentioned in this Appeal engaged in fraudulent activities by claiming purchases of goods not delivered. That the Respondent evaluated the records availed by the Appellant in comparison to the findings of the investigations carried out and found inconsistencies in the Appellant's records. This therefore formed the basis of the Respondent rejecting the Appellant's refund application and thus the objection decision.

21. From the foregoing, it appears to us that this is yet another case of the so-called missing trader fraud on the system of value added tax. And the crux of the dispute herein is whether the Appellant is entitled to input tax refund. Notably, the Value Added Tax regime currently in force does not envisage or recognize an offence known as the missing trader fraud, let alone defining it or who a missing trader actually is. In the premise therefore, the Tribunal gains assistance from the wealth of judicial experiences advanced in other jurisdictions where this fraud is more prominent than in our jurisdiction.
22. We place reliance on Article 2 of the *European Union's COMMISSION REGULATION (EC) No 1925/2004 of 29 October 2004* which defines a missing trader as a trader registered as a taxable person for VAT purposes who, **potentially with a fraudulent intent**, [*Emphasis added*] acquires or purports to acquire goods or services without payment of VAT and supplies these goods or services with VAT, but does not remit the VAT due to the appropriate national authority.
23. With that in mind, courts in the United Kingdom, where this offence is sometimes referred to as the Missing Trader Intra-Community fraud or carousel fraud, have generated an abundance of authorities on this issue. In particular, the test for determining whether a trader participated in the missing trader fraud on the vat system was laid down in **Kittel v Belgium, Belgium v Recolta Recycling SPRL (C-439/04 and C-440/04) [2006] ECR I-6161 ("Kittel")**. The European Court of Justice provided the legal basis for the denial of the right to deduct on account of the missing trader fraud by formulating a two part test by asking itself the following questions;

“a. Whether the trader knew or should have known he was participating in a transaction involving fraudulent evasion of VAT

b. Whether 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.”

24. The court at paragraph 51 of its judgment expounded on this test in holding that traders who take every precaution **which could reasonably be required** of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing the right to deduct the input VAT. However, where the tax authorities find that the right to deduct has been exercised fraudulently; they are permitted to claim repayment of the deducted sums retroactively.
25. The Kittel test was further clarified by Moses LJ in *Mobilx Ltd and The Commissioners for Her Majesty’s Revenue and Customs, [2010] EWCA Civ 517 (“Mobilx”)*. The Judge noted that the test in Kittel embraces not only those who know of the connection but those who *“should have known”*. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion.
26. Additionally, Arden LJ in the Court of Appeal (**[2015] EWCA Civ 39**) observed that the trader has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some

transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge.

27. In light of the foregoing judicial experience, it occurs to us that the test in Kittel does no more than to remove from the scope of the right to deduct, a person who, by reason of his degree of knowledge, is properly regarded as one who has aided fraudulent evasion of VAT. However, to properly adopt this test within the context of our legal system, particularly in light of the Vat Act 2013, some adjustments become necessary. Therefore, we must act cautiously and carefully in formulating an appropriate test.
28. In our understanding, the first part of the Kittel test requires actual knowledge of connection with fraudulent evasion of vat on the part of the tax payer. Not only that, the taxpayer is required “to have known” of such fraudulent connection, thus introducing an “ought to” element. It has underlying implications for the taxpayer to conduct some form of due diligence.
29. Accordingly, we note that the laws currently in force do not place any such burden on a taxpayer, neither is this Tribunal in a position to place such a burden. There is no requirement of due diligence a trader must conduct before engaging another trader. Neither, is there any requirement to investigate whether a trading company is legally registered. For VAT purposes, the only investigatory and due diligence mandate a taxpayer has to dispense with is to confirm that it purchased its supplies from a VAT registered, who has an ETR register.

30. The evidence placed before us and before the Respondent during the audit fully supports the Appellant's purchases and sales. It also sufficiently supports this Appeal on the Appellant's entitlement to a credit refund as per Section 17 (1) of the VAT Act, 2013. As such, this Tribunal finds that the right to deduct input tax is an integral part of the VAT scheme and in principle may not be limited. It must be exercised immediately in respect of all the taxes charged on transactions relating to inputs.
31. The second part of the Kittel test concerns itself with whether to consider prior or subsequent transaction in determining a taxpayer's involvement in a fraudulent evasion of value added tax. Our take on this is very straightforward. The entitlement 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.
32. Now, having qualified this test, we must turn our attention to the Respondent's case. There is not a shred of evidence on record from the Respondent to support its allegation that the Appellant's transactions form part of a set of contrived relating to two of its suppliers. From the documents provided, the Respondent was under legal duty to put forth a cogent case disentitling the Appellant to the credit refund sought. No such thing has been done.
33. The Appellant put forth a prima facie case for its entitlement to deduct input tax. It provided both the Respondent and the Tribunal in this Appeal with the relevant documentary evidence in support of its assertion and claim. As at this point, the Appellant dispensed with its burden of proof as provided for under Section 56 (1) of the Tax Procedures Act, 2015.

However, this burden shifted to the Respondent at the point of raising allegations of fraudulent evasion of value added tax.

34. We note that the legal burden of proof normally rests upon the party desiring the court to take action; thus a claimant must satisfy the court or tribunal that the conditions which entitle him to a claim have been satisfied. This is in line with the provisions of **Section 107 of the Evidence Act, Cap 80** of the Laws of Kenya, which stipulates thus;

“a. 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?

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

35. Moreover, the standard of proof in fraud is distinctly higher than the normal civil standard of balance of probability and the Respondent has not attained or satisfied that standard. In this case, we find that the Respondent has not only failed to proof its case, but also accused the Appellant of fraud without showing any nexus to the offence allegedly committed by the missing trader.

36. The Respondent’s predicament is further compounded when one considers the nature of the allegation laid against the Appellant. The Respondent contends that the Appellant was involved in fraudulent evasion of valued added tax together with two of its suppliers. It is trite law that any allegations of fraud must be pleaded and strictly proved. The Respondent herein has not placed before us any evidence to merit denial of the

Appellant's claim for input tax. As it is an established principle of law to specifically plead fraud, we do not consider it necessary to set out an explanation in great detail. Accordingly, we are guided by Justice Tunoi's holding in *Vijay Morjaria vs Nansingh Madhusingh Darbar & Another* [2000] eKLR;

“It is well established that fraud must be specifically pleaded and that particulars of the fraud alleged must be stated on the face of the pleading. The acts alleged to be fraudulent must, of course, be set out, and then it should be stated that these acts were done fraudulently. It is also settled law that fraudulent conduct must be distinctly alleged and distinctly proved, and it is not allowable to leave fraud to be inferred from the facts.” [Emphasis added].

H. CONCLUSION

37. We conclude, on a balance of probabilities, that in respect of the period under Appeal, the Appellant has indeed put forth a solid case in support of its entitlement to credit refund as claimed. The Respondent's case is woefully inadequate and generally lacking in tact given the number of “missing trader” cases currently before this Honorable Tribunal. Accordingly, in light of the totality of evidence on record and the foregoing analysis, the Tribunal makes the following Orders;

- a. The Appeal herein is merited
- b. The Appellant was not involved in any fraudulent vat evasion scheme.

- c. The Respondent's demand for additional taxes dated 16th April 2018, its VAT assessments dated 25th April 2018, the confirmation of assessment dated 12th July 2018, its income tax additional assessments dated 4th June 2018 and the confirmation of assessment dated 4th October 2018 are hereby struck out.
- d. Each party to bear its own costs.

It is so ordered.

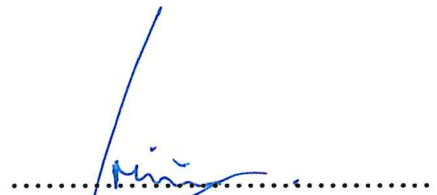
DATED and DELIVERED at NAIROBI this 30th day of July, 2020



MAHAT SOMANE
CHAIRPERSON



PATRICIA MAGIRI
MEMBER



TIMOTHY CHESIRE
MEMBER



WAMBUI NAMU
MEMBER

