REPUBLIC OF KENYA
TAX APPEALS TRIBUNAL
APPEAL NO. 141 OF 2018

SHAILESH JAGJIVEN DATTANI.....APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant is a limited liability company whose principal business activity is the general trading of goods.
2. The Respondent is a principal officer of the Kenya Revenue Authority which Authority is established under Section 3 of the Kenya Revenue Authority Act Cap 469 of the Laws of Kenya and its core mandate is to assess, collect and account for Government revenue.
3. The Respondent carried out investigations into the affairs of the Appellant for the period of 1st September 2015 to 31st August 2017. Pursuant to the investigations, the Respondent communicated its findings to the Appellant on

16th April 2018 demanding for Kshs 16,644,701.24.00 composed of Kshs. 5,789,461.00 for VAT and Kshs. 10,855,240.00 for Corporation Tax.

4. The Appellant objected to the assessments in its letter dated 14th May 2018. The Respondent issued an objection decision to the Appellant through their letter dated 4th July 2018 to confirm the assessments.

5. The Appellant being aggrieved by the Respondent's objection decision filed its notice of Appeal to the Tax Appeals Tribunal in its letter dated 3rd August 2018.

GROUNDS FOR APPEAL

6. The Appellant cited the following as its grounds for Appeal.

   i. THAT the Respondent erred in fact and law by disallowing input VAT contrary to the provisions of the VAT Act 2013.

   ii. THAT the Respondent erred in fact and law by disallowing input VAT based on investigation of non-compliance of tax by the suppliers.

THE APPELLANT'S CASE

In its Statement of Facts and Written Submissions, the Appellant made the following submissions to support its Appeal.

7. The Appellant submitted that the Respondent in processing any input claims for VAT ought to be guided by the provisions of Section 17 of the VAT Act.

The Appellant argued that the Respondent disallowed input VAT contrary to Section 17 of the VAT Act. The Section provides that:

"17 (1) Subject to the provisions of this section and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person, subject to the exceptions provided under this section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies

(2) If, at the time when a deduction for input tax would otherwise be allowable under subsection (1), the person does not hold the documentation referred to in subsection (3), the deduction for input tax shall not be allowed until the first tax period in which the person holds such documentation.

Provided that the input tax shall be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred.

(3) The documentation for the purposes of subsection (2) shall be—

(a) an original tax invoice issued for the supply or a certified copy.

(b) a customs entry duly certified by the proper officer and a receipt for the payment of tax.

(c) a customs receipt and a certificate signed by the proper officer stating the amount of tax paid, in the case of goods purchased from a custom auction.

(d) a credit notes in the case of input tax deducted under section 16(2); or (e) a debit notes in the case of input tax deducted under section 16(5)."

8. The Appellant contended that a claim for input VAT should be based on the documents listed under Section 17(3) of the VAT Act as listed below:
   i. An original invoice issued for the supply or a certified copy
   ii. Customs entry duly certified and receipt for tax payment;
   iii. Customs receipt and certificate stating the amount of tax paid;
   iv. Credit note and debit note.
9. The Appellant argued that based on the provisions of Section 17 of the VAT Act, the considerations that the Respondent should have taken into account in processing the VAT claims are:
   a. The taxpayer is registered for VAT.
   b. The purchase was for the purposes of making taxable suppliers.
   c. The input tax does not relate to the excluded purchases as set out in Section 17(4) of the VAT Act or exempt supplies.
   d. The input tax is claimed within six months of receiving the supply; and
   e. The claim for the input tax should be based on the documentation required under Section 17 of the VAT Act and Regulations.

10. The Appellant contends that despite having met the threshold set out for VAT input claims, the Respondent disallowed its claim allegedly on the grounds that its investigation established that the suppliers from whom the Appellant purchased the goods were non-existent, do not sell nor deliver goods.

11. These findings, the Appellant argued, are not only inaccurate and unreasonable but also unfair to the Appellant since it has to the best of its knowledge provided sufficient proof to show that it indeed purchased the goods in question. This, the Appellant submitted, is evidenced by the documents it provided which include but are not limited to invoices, delivery notes and evidence of payments made to the suppliers as indicated in the Appellant's bank account statements and payment records.

12. The Appellant argued that having met the requirements as set out under Section 17 of the VAT Act, it had a legitimate expectation that the Respondent would allow its input VAT claims. To buttress its case, the Appellant cited the case of **Keroche Industries Limited v Kenya Revenue Authority & 5 Others Nairobi HCMA No 743 of 2006 [2007] KLR 240** where it was held that:

"...legitimate expectation is based not only on ensuring that legitimate expectations by the parties are not thwarted, but on a higher public interest beneficial to all including the respondents, which is, the value or the need of holding authorities to promises and practices they have made and acted on and by so doing upholding responsible public administration. This in turn

enables people affected to plan their lives with a sense of certainty, trust, reasonableness and reasonable expectation.

An abrupt change as was intended in this case, targeted at a particular company or industry is certainly abuse of power. Stated simply legitimate expectation arises for example where a member of the public as a result of a promise or other conduct expects that he will be treated in one way and the public body wishes to treat him or her in a different way. In this case the applicant did not expect an abrupt change of tariff where the process of manufacture or its products had not changed. Public authorities must be held to their practices and promises by the courts and the only exception is where a public authority has a sufficient overriding interest to justify a departure from what has been previously promised....

In order to ascertain whether or not the Respondents decision and the intended action is an abuse of power the court has taken a fairly broad view of the major factors such as the abruptness, arbitrariness, oppressiveness and the quantum of the amount of tax imposed retrospectively and its potential to irretrievably ruin the applicant. All these are traits of abuse of power. Thus I hold that the frustration of the applicants' legitimate expectation based on the application of tariff amounts to abuse of power."

13. The Appellant contends that by insisting that the Appellant's suppliers did not supply the goods and completely disregarding the documents provided by the

Appellant, the Respondent was introducing grounds that are not provided for in law to deny the Appellant legitimate input VAT claims.

14. The Appellant further averred that the Respondent unfairly attributed non-compliance of the listed suppliers referred to as the *'missing traders'* to the Appellant which cannot be a legal basis for disallowing input VAT and the same is not envisaged under the provisions of the VAT Act or any other law.

15. The Appellant argued that in arriving at its Objection Decision, the Respondent alleged that the input tax claimed could not be allowed because the Appellant's suppliers neither supplied goods nor delivered them. In doing so, the Respondent gave itself wide latitude in interpreting tax statute and ended up making irrelevant considerations in reaching the impugned decision.

16. The Appellant argued that the Respondent is under a duty to direct itself properly in law. As such, according to the Appellant, the Respondent ought to have paid attention to matters which it is bound to consider under the provisions of Section 17 of the VAT Act and Section 15(1) of the Income Tax Act. To support its case, the Appellant cited the case of **Fleur Investments Limited v Commissioner of Domestic Taxes & Another [2018] eKLR** where the court held that:

"This case falls squarely on all fours with the case of Municipal Council of Mombasa vs. Republic & Umoja Consultants Ltd (supra), because clearly, the respondents failed to consider the very relevant facts that their request for an

audit meeting had already been met, all documents requested for had been availed and examined, and yet the assessment was premised on the erroneous premise that the appellant had failed to comply with the said requests. The need to take into account relevant considerations and ignore irrelevant facts in the decision making has close nexus with the need to act reasonably."

17. The Appellant averred that it is registered for VAT and made taxable supplies charging VAT thereof, claimed input VAT from its suppliers within the stipulated time and is in possession of original tax invoices issued for the supply. According to the Appellant, it is therefore entitled to claim the input VAT.

18. The Appellant submitted that the Respondent disallowed input VAT on the grounds that its investigation established a grand missing trader scheme, that the suppliers whom it purchased from do not sell or deliver goods at all. The Appellant argued that this does not apply to it because it purchased goods as indicated in the invoices, the goods were delivered as indicated in the delivery notes and payments were made as can be confirmed from the Appellant's bank accounts and payment records.

19. The Appellant argued that the unsupported suggestions or presumptions that the goods were not bought and delivered is therefore inaccurate and untenable. According to the Appellant, the Respondent is trying to attribute non-compliance of the listed suppliers to the Appellant which cannot be a basis

for input VAT as provided for under the VAT Act No. 35 of 2013 or any other laws.

20. The Appellant submitted a bundle of documents which it argued was proof that it indeed purchased goods from the listed suppliers which were sold to various customers. The Appellant further submitted that it made payments for all the purchases as can be confirmed from the bundle of documents.

21. The Appellant averred that the facts and circumstances giving rise to this Appeal clearly point to abuse of office and power by the Respondent which should not be sanctioned by the Tribunal.

APPELLANT'S PRAYERS

22. The Appellant prays the Tribunal to find that:

    a. The Respondent failed to carry out proper and credible investigations and issue proper assessments as provided in law.

    b. The additional assessments established by the Respondent for the period under review 2015-2017 for Kshs. 15,789,461 for VAT together with penalties and interest were unlawful and improperly assessed and as such the same should be set aside.

    c. The Appeal herein be allowed with costs in favour of the Appellant.

    d. Any other remedy that this Honourable Tribunal deems just and reasonable.

THE RESPONDENT'S CASE

23. In opposing the Appeal, the Respondent advanced the following arguments.

24. In response to the Appellant's assertion that the Respondent had introduced grounds not provided in law to deny its input VAT claims, the Respondent averred that the Appellant was one of the beneficiaries of the missing trader scheme.

25. According to the Respondent, in the fraud dubbed Missing Trader VAT fraud scheme, businesses which are registered for VAT obtain fictitious invoices. The invoices are introduced into their business purchase records with the sole purpose of illegally reducing their rightful VAT payments. The fictitious invoices are invoices generated to depict a business transaction whereas there is no actual supply/movement of goods and services.

26. The Respondent averred that it carried out an iTax analysis of the suppliers that the Appellant had purportedly bought supplies from. The investigations, according to the Respondent, revealed that they only existed on paper with the sole purpose of milling bogus invoices to sell to various companies at a commission.

27. The Respondent submitted that Missing Trader VAT Fraud is a tax evasion scheme covered under Section 66 of the VAT Act and the said Section empowers the Respondent to determine the tax liability of the person who

obtained such fraudulent tax benefit. To support its case, the Respondent cited the case of **Axel Kittel vs Belgium; Belgium vs Recolta Recylcing SPRL (joined cases C-439/04 and C-440/04) 2008 [BVC] 559** where the court stated that:

> *"where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct."*

28. The Respondent averred that it invited the Appellant to demonstrate and prove that it indeed bought and received supplies from legitimate suppliers. The Respondent submitted that the Appellant was unable to demonstrate to the satisfaction of the Respondent that it had indeed received the said supplies. According to the Respondent it reached this determination by applying the reasonable man test. To support its case, the Respondent cited **Healthcare at Home Limited vs The Common Services Agency [2014] UKSC 49** where the court held that:

"The behaviour of the reasonable man is not established by the evidence of witnesses, but by the application of a legal standard by the court. The court may require to be informed by evidence of circumstances which bear on its application of the standard of the reasonable man in any particular case; but

it is then for the court to determine the outcome, in those circumstances, of applying that impersonal standard."

29. The Respondent submitted that some of the queries it raised were:

    a. Is it reasonable for the Appellant to enter into a high value deal for supply of goods (stationery) with no formal contractual arrangements?

    b. Was the supplier nearly established with minimal trading history offering to supply the goods (stationery) cheaper than a long-established supplier?

    c. Is there additional paperwork to support the invoices that the Appellant sought to rely on in obtaining the tax refund? For example were there delivery notes? Purchase orders? Inspection reports? Any logs that show the movement of the goods into their premises?

30. The Respondent urged the Tribunal to apply the test set out in **Edgeskill Limited vs The Commissioner for Her Majesty's Revenue and Customs** in determining whether the Respondent was justified in refusing a claim of input VAT as follows:-

"(1) Was there a VAT loss?

(2) If so, was it occasioned by fraud?

(3) If so, were the Appellant's transactions connected with such a fraudulent VAT loss?

(4) If so, did the Appellant know, or should it have known, of such a

connection?"

31. The Respondent argued that it was entitled to disallow the input VAT as Section 17(2) of the VAT Act provides that input tax is only deductible when a registered person is in possession of valid documentation.

32. Further, in pursuant to Section 42(2)(b) of the VAT Act, invoices should only be issued in respect of supplies by persons who are registered. According to the Respondent, most of the traders that the Appellant claimed input VAT from were not registered persons.

33. The Respondent averred that missing traders sold bogus invoices and ETR receipts to the Appellant. The Respondent argues that it risks suffering a loss when a business entity such as the Appellant fraudulently claims a refund from the Respondent for the non-existent input VAT collected.

34. In response to the Appellant's averment that the burden falls upon the Respondent to establish the whereabouts of the missing traders, the Respondent submitted that **'know your customer'** is an ongoing obligation that cannot be derogated. The Respondent further submitted that the Appellant has a duty to carry out checks to establish the credibility and legitimacy of its suppliers as well as the supplies made. According to the Respondent, the Appellant did not take any reasonable steps to verify the integrity of its supply chain.

35. Thus, in view of the foregoing, the Respondent averred that there were no supplies nor do any of the suppliers exist. Accordingly, the Appellant is a co-conspirator in an intricate scheme to defraud the Government of deserved revenue. Thus, allowing the input tax claimed by the Appellant would be unjustly enriching the Appellant.

36. In response to the claim for legitimate expectation the Respondent submitted that the right is not absolute. According to the Respondent, the Appellant's legitimate expectation cannot be actualized since 2 ingredients are lacking in the input claim i.e. an actual supply of goods from the suppliers and a valid invoice. To buttress its case, the Respondent cited the case of **Invollate Wacike Siboe v Kenya Railways Corporation & another [2017] eKLR** where the court stated that:

"The same position applies to legitimate expectation; no legitimate expectation can arise if effectuating the expectation would result in violation of a statute. The contours of the doctrine are well mapped. Legitimate expectation arises where representation by a decision maker has created a genuine expectation that it is within his power to honour and make good. The law however does not protect every expectation; it protects only legitimate expectations. Where the representation is one, which the decision maker is not competent to make, reliance on it cannot in law give rise to legitimate expectation. Hence legitimate expectation cannot arise when the

decision maker is acting ultra vires his or her powers. In addition, where the words of a statute are clear and express, they must override any expectation to the contrary that a party may claim to have. On the same note, where a public authority has made a representation that it does not have power to make, it is not estopped from asserting the correct position in law."

RESPONDENT'S PRAYERS

37. The Respondent prays that the Tribunal finds that:

    a. The assessments and all decisions thereto were proper.

    b. The assessment be upheld.

    c. The appeal be dismissed with costs to the Respondent.

ISSUE FOR DETERMINATION

38. Having carefully studied the parties' pleadings, submissions and all documentation, the Tribunal is of the respectful view that the issue for determination was whether the Respondent erred in its decision to disallow the input VAT and the cost of sales in the computation of Corporation Tax as claimed by the Appellant.

TRIBUNAL'S ANALYSIS AND FINDINGS

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

    a. Whether the Appellant had furnished sufficient proof of purchase?

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

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

a) Whether the Appellant had furnished proof of purchase

40. The Respondent in arriving at the Objection Decision alleged that the input tax claimed, and cost of sales could not be allowed because the suppliers of the Appellant neither supplied goods nor delivered them. It claimed that the Appellant was involved in a missing trader fraud scheme.

41. The Respondent submitted that the law governing the right to deduct is contained in Section 17 (5) of the VAT Act. The said section of the law provides that if a trader has incurred properly allowable input tax, he is entitled to set it off against its output tax liability or to receive a refund if the input tax credit due to him exceeds that liability. Evidence is required in support of the claim for repayment.

42. The Appellant argued that it supplied the Respondent with all the documents required under Section 17 of the VAT Act as proof that it indeed purchased goods from the listed suppliers which it subsequently sold to various customers. It further argued that it also made payments for all the purchases as can be confirmed from the documents attached to the Appellant's bundle of documents. The said documents were invoices, account statements and payments.

43. 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 VAT Act which provides as follows:

"Subject to the provisions of this section and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person, subject to the exceptions provided under this section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies."

44. The Tribunal agrees with the Respondent that the right to claim input tax is hinged upon the underlying requirements of the transaction as outlined in the VAT Act being met. According to Section 17(1) of the VAT Act, input tax is deductible where it is incurred on purchases that it made. This means that for a taxpayer to deduct input tax, it must have actually made a purchase. It is not merely enough to possess documentation. The documentation must be supported by an underlying transaction and the taxpayer must furnish proof that there was an actual purchase.

45. Section 30 of the Tax Appeals Tribunal Act places the burden of proof on the taxpayer to submit all the necessary documentation to support its case. The same position was held by the court in **Metcash Trading Limited –vs Commissioner for the South African Revenue Service and Another Case CCT 3/2000**, where it was held that:

"But the burden of proving the Commissioner wrong then rests on the vendor under section 37. Because VAT is inherently a system of self-assessment based on a vendor's own records, it is obvious that the incidence of this onus can have a decisive effect on the outcome of an objection or appeal. Unlike income tax, where assessments can elicit genuine differences of opinion about accounting practice, legal interpretations or the like, in the case of a VAT assessment there must invariably have been an adverse credibility finding by the Commissioner; and by like token such a finding would usually have

entailed a rejection of the truth of the vendor's records, returns and averments relating thereto. Consequently, the discharge of the onus is a most formidable hurdle facing a VAT vendor who is aggrieved by an assessment: unless the Commissioner's precipitating credibility finding can be shown to be wrong, the consequential assessment must stand."

46. Once the taxpayer adduces evidence that discharges his burden, the burden shifts to the Commissioner who must demolish such evidence. This view was held in Supreme Court of Canada's decision **in (Hickman Motors Ltd- vs- Canada, 1997 CanLII 357 (SCC), [1997] 2 S.C.R. 336 at paragraphs 92 to 94; House –vs- Canada, 2011 FCA 234 (CanLII), 2011 FCA 234, 422 N.R.144** where at paragraph 30 the Court stated that:

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

appeal will be allowed if the Minister fails to present any evidence as to the source of income."

47. Although the current tax laws provide that the burden of proof lies with the Appellant to prove that tax was paid or 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. In demanding the production of documents that are not prescribed by legislation, the tax authority should be guided by reasonableness, the nature, and circumstances of the trader otherwise it would, as it occasionally does, demand information ad nauseum.

48. The Tribunal notes that the Appellant furnished the Respondent with the documents detailing the transactions as provided by Section 17 of the VAT Act. The Appellant further provided bank records, delivery notes and payment records. This evidence established prima facie that it indeed purchased the said goods. The Respondent on its part did not demolish this evidence.

49. While this list is not exhaustive on the documents that must be furnished as proof of purchase, the Tribunal is of the view that the Respondent should have furnished information to prove that the invoices submitted by the Appellant to support its claim were fictitious. It was not enough to just allege that the documents presented were fictitious.

50. The Tribunal was therefore of the view that the Appellant furnished sufficient proof of purchase.

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

51. The right to claim input VAT 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. The European Court of Justice held that this system should apply even where there is a missing trader somewhere in the value chain. This right can only be limited where the trader had knowledge of the fraudulent actions in the value chain. This was the holding in **Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise** [2006] EUECJ C-354/03 where it was held that:

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

52. The ECJ in the **Axel Kittel v État belge and État belge v Recolta Recycling SPRL [2006] ECR I-06161, s**tated that the doctrine of Optigen and others is also applicable to fraudulent transactions where the recipient of the supplies did not know or could not have known that the transaction was fraudulent. So if a supplier is fraudulent, but the recipient did not know or could not have known of the fraudulent intent, the recipient's right to deduct input VAT, connected with that transaction, stays intact.

53. The court further held that the question whether the VAT payable on prior or subsequent sales of the goods concerned has or has not been paid to the Treasury is irrelevant to the right of the taxable person to deduct input VAT. In so doing, the court divorced the right to deduct input tax from the payment of the output tax by the supplier.

54. The Respondent in this case adduced evidence that there was fraud on the part of the Appellant's suppliers. It submitted that some of the Appellant's suppliers were not registered for VAT and did not submit the VAT they charged. This, at the very least implies that there was some fraud on the part of the suppliers.

55. However, as stated by the European Court of Justice, the Appellant's right to claim VAT was not affected by the presence of fraud in the supply chain unless it had knowledge of fraudulent acts of its suppliers. The mere fact that its suppliers were engaged in fraud does not extinguish the Appellant's right to claim input VAT. This right can only be extinguished if the Appellant knew or

ought to have known that the transaction was part of a fraudulent scheme. Further, as stated by the court, the mere fact that the VAT charged by the Appellant's suppliers was not submitted to the Respondent is irrelevant to its exercise of claiming input tax that it incurred.

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

56. The case of **Kittel-vs- Belgium, Belgium-vs- Recolta Recycling SPRL (C-439/04 and C-440/04) [2006]** hereinafter called "Kittel", provided the legal basis for denial of the right to deduct in certain circumstances. It was stated:

"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...In the same way a taxable person who knew or ought to have known that, by his purchases, he was taking part in a transaction connected with fraudulent evasion of VAT must... be regarded as a participant in that fraud. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice... Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the

basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'."

57. The Court went on to add that taxable persons who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud must be able to rely on the legality of those transactions without the risk of losing their right to deduct input VAT.

58. Moses LJ in his judgment in **Mobilx Ltd v HMRC [2010] EWCA Civ 517** analysed the Kittel Case stating that:

"Kittel...extended the category of participants who fall out with the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct..."

59. The court went on to explain that:

"The test in Kittel is simple and should not be over-refined. It 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. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in Kittel. The true principle to be derived from Kittel does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction related to fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

60. Thus, for the Appellant's right to deduct input of VAT to be curtailed, the Appellant must have known or ought to have known that it was part of a fraudulent transaction. In this case, the Respondent avers that the Appellant

was part of the Missing Trader Fraud scheme and thus knew or ought to have known that it was part of a fraudulent transaction.

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

"For those reasons we think it is incumbent on the Commissioners to raise a case, not necessarily amounting to proof but sufficient to demand an answer, that there were facts or circumstances which support, or at least are consistent with, the conclusion that the appellant knew, or should have known, of fraud in the chain. The mere fact that there was fraud will not be enough; there must be some reason which might lead the tribunal to conclude that the trader knew or could have known of it, or that he should have taken precautions. Although, as we have already pointed out, the Court of Justice, at paragraph 51 of its judgment in Kittel, referred to traders "who take every precaution" as those who are not liable to forfeit their right to deduct, it should be borne in mind that most traders do not, and do not need to, carry out extensive enquiries into the honesty and creditworthiness of their suppliers and customers. But if the Commissioners are able to mount a case which demands some explanation, the burden shifts to the appellant

to show that he took the precautions which could reasonably have been required of him and that, despite his having done so, he did not know, and could not have known, of the fraudulent purpose of others."

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

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

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

"(1) Whoever desires any court to give judgment as to any legal right or liability dependent on the existence of facts which he asserts must prove that those facts exist.

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

64. Guided by the decisions of the court in **Brayfal** and **Calltell** and the provisions of the Evidence Act, the Tribunal finds that the burden of proof was upon the

Respondent to establish that there was fraud and that the Appellant knew or ought to have known. As stated in **Calltell Telecom Ltd v HMRC [2007] UKVAT V202666**, the standard is not beyond reasonable doubt. Rather it is enough for the Respondent to establish a case that demands answers from the Appellant. Once it establishes its case, then the burden shifts to the Appellant.

65. Thus in the case at hand, it was upon the Respondent to establish not only that there was fraud but also that the Appellant knew or ought to have known that the transaction of which it was a part was fraudulent.

66. The Tribunal analysed the evidence adduced before it as well as the submissions of both parties. The Respondent pleaded fraud and adduced evidence indicating that there may indeed be a Missing Trader Fraud scheme. However, that is not enough. The court in **Calltell Telecom Ltd v HMRC [2009] EWHC 1081 (Ch)** held that:

"The mere fact that a transaction forms part of a chain in which fraud occurred is not enough to justify the refusal of repayment of income tax. To justify such a refusal the tax authorities must prove that the taxpayer was himself being fraudulent or knew or had the means of knowledge of fraud by others."

67. The Tribunal finds that the Respondent fell short of establishing a case that the Appellant knew or ought to have known about the fraud. It pleaded that some of the Appellant's suppliers had been noted as being part of the Missing Trader

Fraud scheme. It averred that the Appellant merely purchased invoices without the attendant goods. However, it failed to adduce evidence to support its averments. The Appellant on its part produced documents indicating that there was indeed a purchase. The Respondent failed to counter the evidence adduced.

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

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

Orders

49. The Tribunal makes the following Orders: -

I) The Appeal succeeds.

2) That the Objection Decision dated 18th July 2018 confirming the Assessment of Kshs.1,698,702.00 for Value Added Tax (VAT) and Kshs.3,210,651.00 for Corporation Tax together with the resultant interest and penalties is hereby vacated.

3) Each Party to bear its costs.

DATED and DELIVERED at NAIROBI this **28th** day of **August, 2020**.

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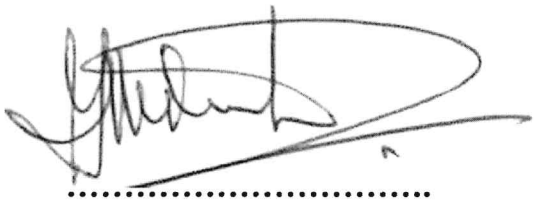
CATHERINE N. MUTAVA
CHAIRPERSON



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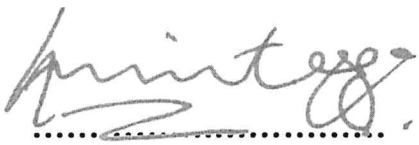
WILFRED N. GICHUKI
MEMBER



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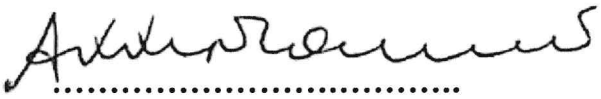
GABRIEL M. KITENGA
MEMBER



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ABRAHAM K. KIPROTICH
MEMBER