

Kenyan Tax Appeals Tribunal holds claim of input VAT must be supported by evidence of an underlying transaction

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Executive summary

The Kenyan Tax Appeals Tribunal (TAT) recently held that the claim of input Value Added Tax (VAT) must be supported by proof of purchases made by the taxpayer.

This was following an assessment by the Kenya Revenue Authority (KRA) accusing the taxpayer of fraud.

Additionally, the associated purchases were treated as not deductible for corporate income tax.

Detailed discussion

Background

The Appellant, a general merchandiser, filed an appeal at the TAT against the KRA following an assessment dated 17 April 2018 covering VAT and corporation tax that was preceded by an audit of its financial records for the period of July 2015 to May 2017. The following matters in dispute were:

1. Whether input VAT should be disallowed as per the provisions of the *VAT Act 2013*
2. Whether the Respondent erred in assessing additional corporation income tax

The Appellants' position

Disallowing input VAT

The Appellant argued that the Respondent disallowed input VAT contrary to Section 17 of the VAT Act 2013 which provides that:

- (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 customs auction;*
 - (d) *a credit note in the case of input tax deducted under section 16(2); or*
 - (e) *a debit note in the case of input tax deducted under section 16(5).*

The Appellant's claim for input VAT was based on possession of some of the above listed documentation including original tax invoices issued for the supply, delivery documents, Electronic Tax Register (ETR) receipts, payment checks, bank account statements and payment receipts. The Appellant had claimed input VAT related to four suppliers that comprised local purchases.

The Respondent contended that stock control records and bank account statements of respective payment checks were not provided.

The Appellant contended that the basis for allowing the input VAT claim is set out under Section 17 of the VAT Act and failure by the Respondent to allow the same is arbitrary, illegal and a violation of the Appellant's right to fair administrative action protected under Article 47(1) of the Constitution of Kenya 2010.

Additional Corporate Income Tax (CIT) assessment

The Appellant contended that the Respondent erred in fact and in law by disallowing purchases based on investigation of non-compliance by the company suppliers which consequently led to an additional assessment of CIT.

The Respondent's position

Disallowing input VAT

The Respondent submitted that it had received intelligence from the Investigation and Enforcement Department about traders that were making significant sales but declaring 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 to zero or ending up in a credit position.

These traders have been labelled as "missing traders" since their business premises as declared on iTax by the proprietors cannot be located.

The Respondent further asserted that the Appellant claimed input VAT during the period under review from invoices of goods purchased from the "missing traders" and that the investigations revealed that the Appellant engaged in fraudulent activities by claiming purchases and the input tax on goods not delivered by the invoicing suppliers.

The Respondent submitted that it had conducted an iTax analysis of the suppliers that the Appellant had purportedly bought the taxable supplies from. According to the Respondent, the investigations revealed that they only existed on paper with the sole purpose of producing fictitious invoices that were then sold to various companies at a commission to enable the purchasers to claim input VAT. The Respondent contended that the Appellant did not demonstrate to the Respondent how the purchased goods were ordered, recorded and sold.

Additional CIT assessment

The Respondent claimed that it did not err in its assessment of the additional CIT since it disallowed the said purchases on the basis that the purchases were purported to have been supplied by persons investigated by the Respondent and found to be involved in a tax fraud scheme of printing and selling the respective invoices without the actual supply of goods.

The Tribunal's Decision

Whether the Respondent erred in its decision to disallow input VAT

The Tribunal found that the Respondent did not err in its decision to disallow input VAT given that the Appellant did not furnish sufficient proof of purchase.

The Tribunal agreed with the Respondent that for a claim of input VAT, there must be a valid purchase of a taxable supply. It is not sufficient to have the documentation listed in Section 17 of the *VAT Act*. The documentation must be supported by an underlying transaction and the taxpayer must furnish proof that there was an actual purchase.

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, as was held in the case of *Metcash Trading Limited vs Commissioner for the South African Revenue Service* and Another Case CCT 3/2000.

Whether the Respondent erred in assessing additional CIT

Based on the determination that the claim for input VAT was not allowable, the Tribunal found that the Respondent did not err in assessing the resultant CIT.

Next Steps

This ruling implies that taxpayers must keep evidence of the underlying transaction in addition to the associated invoices. Tax invoices are not sufficient proof of execution of a transaction or the delivery of goods. In addition to tax invoices, taxpayers should carry out supplemental inspections to rule out negligent or intentional conduct attributable to the invoice or to the issuers of the invoice. Such additional steps are sufficient to rule out fraud or perceived collusion with the supplier.

A taxpayer who knows or ought to have known that through a purchase they were taking part in a transaction connected with the fraudulent evasion of VAT is likely to be considered a participant in the fraud whether he subsequently declared and paid output VAT on the supplies. Although the requirements of a valid tax invoice are stipulated, due diligence is recommended on the underlying transaction to include records such as supplier vetting, proof of delivery, proof of possession of goods and proof of payment. Such vetting is especially useful in transaction models where the underlying transaction is not apparent.

It is, however, notable that the Tax Appeals Tribunal on 25 March 2020, in a similar case, decided that the Respondent needed to prove that indeed fraud took place in accordance with Section 7 of the *Evidence Act*.

The *VAT Act* has since been amended to the effect that taxpayers must ensure that the supplier has declared the corresponding output VAT before claiming input tax.

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