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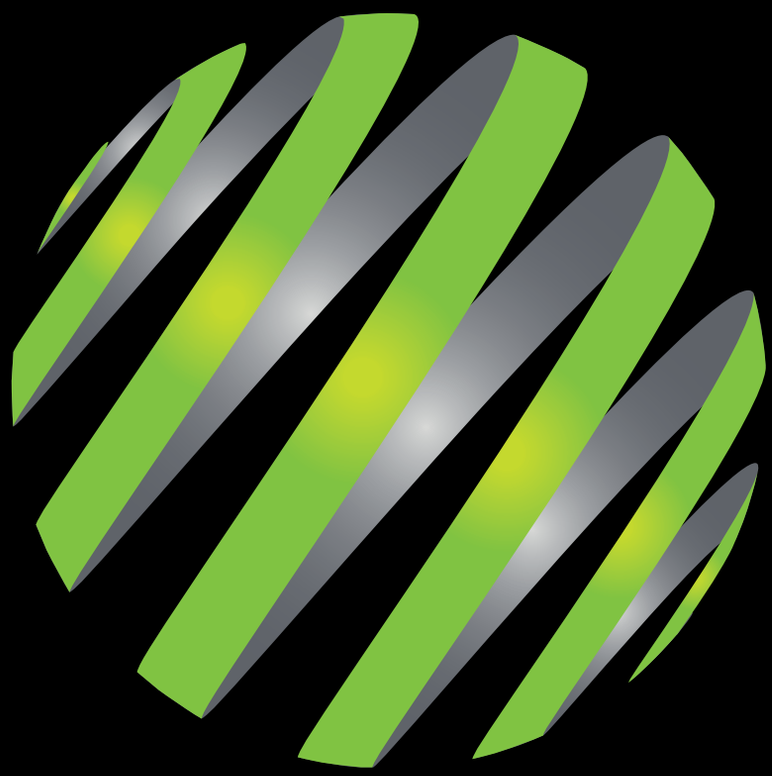
Tax Alert
March 2019



High Court Ruling on VAT on exported services

What it means to taxpayers

The High Court sitting in Nairobi on 21 December 2018 made a ruling that exported services should be zero rated in a case pitting the Commissioner of Domestic Taxes against Total Touch Cargo Holland.

The ruling, though not conclusive in the criteria to be used to determine whether a service is used or consumed out of the country, is a welcome move for taxpayers engaged in cross-border trade since the issue of export of services has always been marred by unending disputes between the Kenya Revenue Authority ("KRA") and taxpayers.

Background

The High Court sitting in Nairobi's Milimani Commercial and Tax Division made a ruling that exported services should be zero rated as provided in the VAT law, dismissing an appeal filed by the Commissioner of Domestic Taxes in the case of Total Touch Cargo – Holland ("TTC-H").

The Commissioner had filed an appeal at the High Court following the VAT Tribunal's ruling ("The Tribunal") issued on 17 September 2013 which had held that the services provided by Kenya Airfreight Handling Limited ("KAHL") to TTC-H were consumed outside the country hence zero rated.

We analyze below the facts of the case and our opinion on the judgement:

Background of the case

The case before the High Court was an appeal pitting the Commissioner of Domestic Taxes against Total Touch Cargo – Holland ("TTC-H"), a company located in the Netherlands.

TTC-H provides transport and handling services for its customers exporting flowers and other horticultural products from Kenya to Europe, and is part of a group of companies known as The Stamina Group, who registered a subsidiary in Kenya, known as Total Touch Kenya ("TTC-K").

TTC-K's role was to provide the service of blocking airspace in aircrafts and to provide cooling services to the parent company based on a joint venture between Stamina Group and Kenya Airways. TTC-K subsequently contracted the services to KAHL.

KAHL started invoicing TTC-K and charging VAT, a position that TTC-H disputed and instead requested KAHL to invoice the parent company directly without charging VAT, owing to an earlier private ruling by the Kenya Revenue Authority which stated that the services provided to TTC-H by TTC-K were exported hence zero rated. KAHL subsequently sought KRA's opinion on the VAT treatment of the services provided to TTC-H. The KRA responded stating that the services were local supplies and directed TTC-H to pay the attendant VAT. TTC-H, being aggrieved by the Commissioner's decision successfully appealed the Commissioner's decision at the Tribunal.

Subsequently, the Commissioner, being aggrieved by the Tribunal's decision, appealed against the decision at the High Court, citing various grounds, key among them being that the Tribunal erred in finding that the consumption of the services in question were not in Kenya hence the services were not taxable at the general rate.

Determination by the High Court

Having analysed both the Appellant's and Respondent's cases, the court narrowed down to one issue for determination – whether the services provided by KAHL to TTC-H were exported in context of the VAT law. Of importance was the interpretation of the term "service exported out of Kenya" as provided for in Section 2 of the repealed VAT Act, which defined the term as "a service provided for use or consumption outside Kenya whether the service is performed in Kenya or both inside and outside Kenya".

The Court made the following observations in relation to the interpretation of the term "service exported out of Kenya" in the context of the appeal:

a. For a service to be deemed as exported, it matters not whether the service is performed in Kenya or outside Kenya. Rather, the determining factor is the location where the service is to be finally consumed or used, which should be outside Kenya. In the case of TTC-H, the services provided by KAHL were aimed at ensuring that the horticultural produce and flowers reached Europe in a state fit for consumption by the foreign buyers, effectively rendering the services exported despite the fact that they were performed in Kenya.

b. The Court dismissed the Commissioner's argument that the consumers of the services provided by KAHL were the Kenyan farmers who required their produce to be prepared into a merchantable state prior to export to Europe. The Court noted that the Commissioner's submission in this regard was flawed as it failed to provide evidence of a contract between the farmers and KAHL. Rather, the only evidence which was adduced was the agreement between KAHL and TTC-H. In this respect, the Court agreed with the Tribunal's ruling that emphasis must be put on the purpose of entering into an agreement between the Stamina Group and Kenya Airways to establish KAHL to provide scanning, cooling and palletizing services.

c. The Court further provided clarification that reliance on Regulation 20 under the repealed VAT law to justify that a service cannot be exported where a supplier provides the service from his fixed place of business in Kenya regardless of the location of the payer was fundamentally wrong. This is owing to the basic reason that a principal law overrides subsidiary legislation, as has been held by the Courts on numerous occasions.

d. The Court also made reference to the OECD guidelines on internationally traded services, which provide that the jurisdiction where the customer is located has taxing rights over a service or intangible supplied across international borders. Consequently, the Court found that it is Netherlands that had the taxing rights on services provided by KAHL to TTC-H from a VAT standpoint.

Our view

The ruling provides reprieve to taxpayers who are engaged in cross border transactions of services. Whilst we understand that the KRA is in the process of appealing against the High Court decision at the Court of Appeal, we hold the view that in absence of a contrary ruling at the appellate court, the case provides a precedence upon which taxpayers can rely upon in making decisions relating to cross-border services.

We further note that the ruling in this case differs with the decision of the Tribunal in Coca Cola Central, East and West Africa Limited vs Commissioner of Domestic Taxes ("Coca Cola case"). The High Court, though in a subtle way, guided that the contract of service between the parties engaged in cross-border transactions should be the primary point of reference in determining the place of consumption of the services. This is contrary to the reasoning adopted by the Tribunal in the Coca Cola case that a place of consumption could be determined by merely looking at the location of the perceived consumer of a service rather than the salient features of the contract of service between the parties in the contract. In the Coca Cola case, the Tribunal had ruled that the consumers of the advertisement services were the people who bought the products as a result of the advertising activities.

Despite the ruling, our view is that gaps still exist in interpreting the law as pertains the VAT treatment of services traded across borders. We highlight below some of the areas that need to be addressed:

- The ruling seems to draw linkage between the place of use or consumption of services to that of final consumption of goods in respect of which the services are provided. Would this ruling set precedence where the goods in respect of which cross border services are provided are consumed locally? Should we separately determine the place of use or consumption of services without linking this to the place of final consumption of the goods?
- The VAT Regulations, 2017 exclude services provided in Kenya but paid for by non-residents from the purview of exported services. In our view, the Regulations are inconsistent with the provisions of the main law in this regard and to the extent of the inconsistency should be nullified.

The Court ruling is obviously founded on the petitions before the Court and would not stretch to all scenarios of services traded across borders. Where the facts and circumstances are different, the ruling may not hold as precedence. It is therefore important that the Government addresses the need for clarity on the taxation of services traded across borders through legislative intervention.

In absence of a detailed guidance in this regard, we are likely to see continued disputes between the KRA and affected taxpayers.

Conclusion

The High Court ruling remains in force until such a time when a successful appeal overturns it. In the meantime, taxpayers engaged in cross border services may need to review their VAT treatment of such services in light of the ruling to determine the impact it may have on their levels of compliance.

Should you have any question on this, kindly contact your relationship manager at Deloitte who will be more than glad to offer you guidance and assistance as necessary.

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