Tax Alert

The Tax Appeals Tribunal rules once more on VAT on exported services

May 2018

Introduction

Value Added Tax (VAT) treatment on export of services from Kenya has for a long time remained an issue of contention resulting in numerous disputes between the Kenya Revenue Authority ("the KRA") and taxpayers, engaged in cross border supply of services.

The disputes emanate from the lack of clarity in the VAT legislation on what constitutes 'use' or 'consumption' of services outside Kenya, which are critical terms in determination of whether services are exported or not.

In a recent ruling delivered on 9 March 2018, the Tax Appeals Tribunal ("the TAT", "the Tribunal") ruled that where services are performed in Kenya in relation to goods exported from Kenya, such services are local supplies and do not comprise exported services even where the party contracting for such services is a non-resident person.

According to the TAT, the export process commences from the date of issuance of the Bill of Lading ("BoL") and all services rendered prior to the BoL date are considered as consumed locally in Kenya and chargeable

to VAT at the standard rate of sixteen percent (16%). The Tribunal has further held that consumption is not determined by reference to the payer, location of the payer of the service or location of the person who is requisitioning the service; rather, what is key in determining export is the place of the consumption of the service.

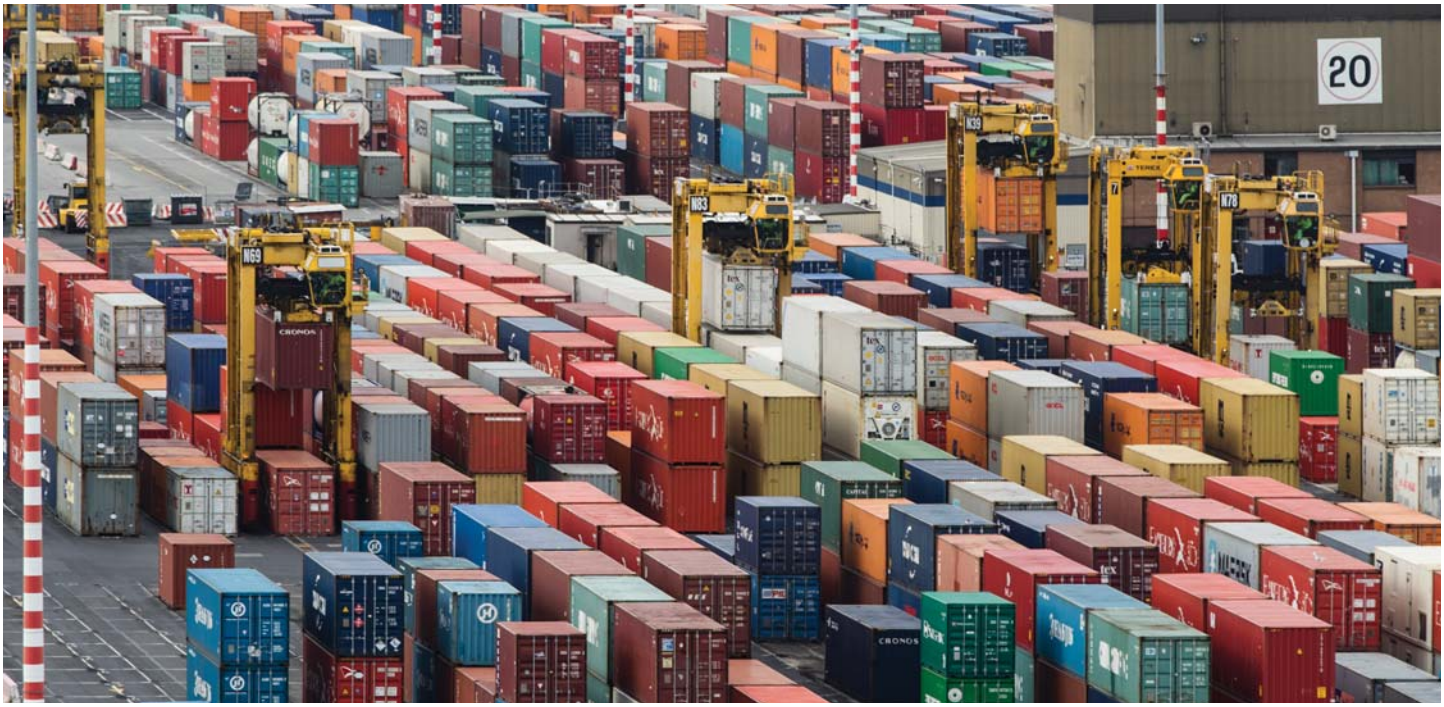
Brief facts of the case

The case related to an application by a local company ("the Appellant", "the Company") for VAT refunds from the Commissioner for Domestic Taxes ("the Commissioner", "the Respondent") on account of supplying exported services, which are zero rated for VAT purposes.

The Appellant in this case was contracted to provide logistical support services comprising handling services including documentation, cold room handling, vacuum cleaning and security (X-Ray screening) to its overseas parent company, a transport, freight and logistics company. The services provided by the Appellant were part of the parent company's logistical process.

The Commissioner rejected the Appellant's VAT refund claim on the basis that the services provided by the Appellant were not exported services. Accordingly, the Commissioner was of the view that the Appellant was not eligible for VAT refunds since its services were not zero-rated but rather subject to VAT at the standard rate of 16%.

The Appellant being dissatisfied with the Commissioner's decision unsuccessfully objected to his decision after which the Appellant lodged an appeal against the tax decision at the Tribunal. The Tribunal dismissed the appeal and ruled that services provided by the Appellant to its parent company were local services subject to VAT



at the standard rate of 16% and hence the company was not eligible for VAT refund.

Analysis of the case

The Appellant submitted that the services provided to its parent company were exported services as they were consumed outside Kenya. The Appellant was of the view that even if the actual place of supply or performance of the services was in Kenya, these services were provided in relation to exported goods and thus such services ought to be considered as export of services.

The Appellant inter alia relied on the Organization for Economic Co-operation and Development ("OECD") destination principle guidelines in support of its arguments.

The Appellant also citied similarities between its appeal case and the VAT Tribunal (predecessor of TAT) ruling in the case of FH Services Kenya Limited versus the Commissioner of Domestic Taxes ("the FH case") and further distinguished its case from the Tribunal case of Coca Cola Central East and West Africa Limited versus Commissioner of Domestic Taxes ("the Coca Cola case").

In rebuttal, the Commissioner contended that the services provided by the Appellant having its place of business in Kenya and being a company incorporated in Kenya cannot be considered as export of services and should be charged VAT at the standard rate of 16%. According to the Commissioner, it was the goods that were exported and not the services offered by the Appellant.

The Commissioner noted that the services provided by the Appellant were for the benefit of the exporter, as opposed to the Appellant's non-resident parent company, to ensure he/she met the required export standards and obtained requisite documentation for export.

In addition, the Commissioner cited the Tribunal's ruling in the Coca Cola case and submitted that what is pertinent in determining export of service is the location of the consumer. Further, the Commissioner submitted that there was no need to refer to the OECD guidelines since the legal provisions in respect to export of services under the Kenyan VAT Act are very clear.

The issues for determination before the Tribunal were:

a) Whether the requisition and payment for services necessarily amounted to consumption; and

b) Whether the services rendered by the Appellant were consumed in Kenya.

The Tribunal dismissed the appeal and upheld the Commissioner's decision to reject Appellant's VAT refund claims.

In arriving at its ruling, the Tribunal observed that consumption is not determined by reference to the payer of services or location of the person requisitioning for the services but what is key is the place of consumption.

Secondly, the Tribunal noted that the pre-shipment services offered by the Appellant were to confirm the export worthiness of the horticultural produce. The Kenyan exporter of the produce was therefore the final consumer of these services.

Thirdly, the Tribunal was of the view that actual export process commences from the date of issuance of BoL. Further, the TAT took the view that the services rendered by the Appellant being a company incorporated and having a place of business in Kenya were services provided in Kenya and therefore not exported services.

In addition, the Tribunal observed that the provisions of OECD guidelines were not applicable on the basis that the Kenyan legislation on export of services are very clear.

What does this TAT decision mean for affected taxpayer?

A decision by the Tribunal has effect and is enforceable as if it were a decision of a Court. However, it is our understanding that the Appellant intends to appeal the decision of the Tribunal to the High Court.

If the Appellant successfully appeals the Tribunal's decision to the High Court, then such decision by the Court will form a binding precedent. However, in the absence of a successful appeal, the present Tribunal's ruling will serve as the binding precedent on both the Commissioner and the taxpayer.

The above said, the decision by the Tribunal elicits several questions and in our view fell short in providing guidance to a contentious aspect of our VAT legislation. Some of the questions that remain unanswered include:

1. What is the relevance of the provisions of Regulations 13 (1) of the VAT Regulations, 2017 which encapsulates services in relation to transportation of goods in the definition of exported services? The Regulation provides that '… exportation of services shall not include—(a) taxable services consumed on exportation of goods unless the services are in relation to transportation of goods which terminates outside Kenya…'
2. Was the Tribunal correct in holding export of service provisions in the Kenyan legislation are very clear and that the OECD guidelines were not applicable in the current case? As highlighted above there are numerous disputes between the KRA and taxpayers on the interpretation of the terms 'use' and 'consumption' outside Kenya, which are not defined under any Kenyan VAT tax statutes; and
3. What was the Tribunal's basis for holding that the consumer of the services were the local exporters of the produce whilst such parties did not contract with the Appellant for the services rendered? The ruling goes against the concept of Privity of Contract, which is fundamental to Kenyan Contract Law.

Conclusion

Even as Kenya positions' itself as a regional hub and gateway for multinational companies, we believe that policy makers should ensure certainty with regards to the taxation of cross border transaction.

It is important that our tax policies are in line with international best practice, simple, clear, succinct and stable to facilitate decision making by investors, which currently is not the case with our VAT laws on export of services.

We will continue monitoring developments on this matter and keep you updated.

However, in the meantime please feel free to contact your usual PwC contact or any of our VAT experts below should you wish to discuss this further.

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