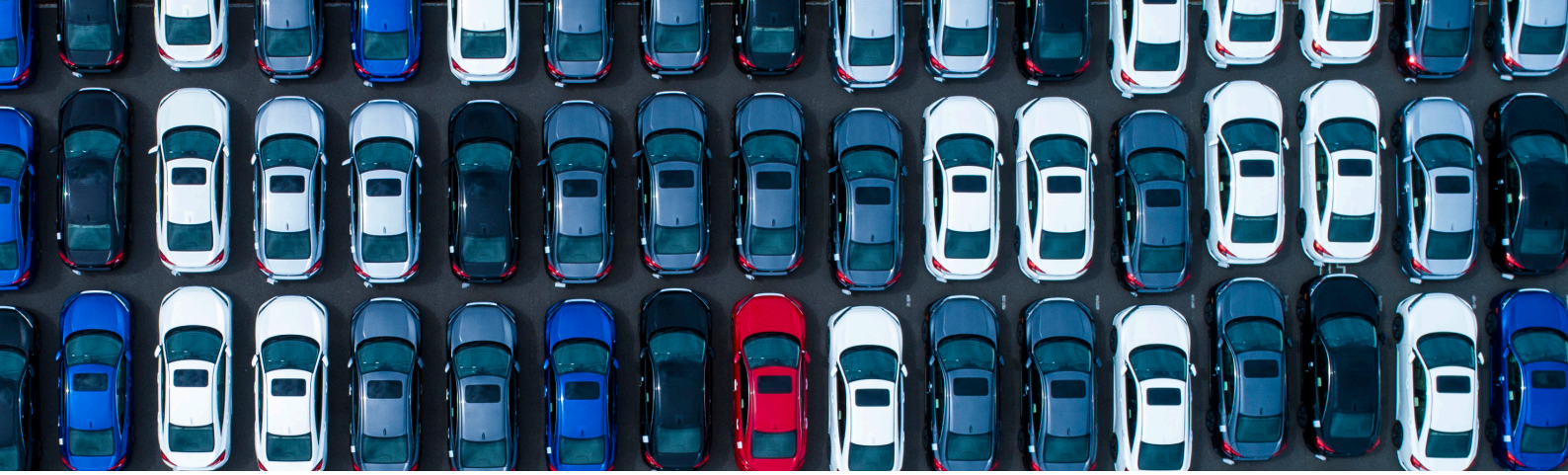

Tax Alert

VAT is chargeable on repossessed vehicles disposed of by financial institutions

February 2025

Recently, the Tax Appeals Tribunal ("Tribunal", "TAT") ruled that Value Added Tax ("VAT") is chargeable on repossessed motor vehicles auctioned by financial institutions.

The Tribunal, on 17 January 2025, delivered its judgement with respect to an appeal filed by KCB Bank Kenya Limited ("KCB", "the Appellant", "the Bank") against the Commissioner Legal Services & Board Co-ordination ("the KRA", "the Respondent") (Appeal E023 of 2024).

In the judgement, the TAT ruled in favor of the KRA imposing VAT on the seized / repossessed motor vehicles that the Bank had sold by way of auction.

The TAT disagreed with the Bank's assertion that VAT is not chargeable on the disposal of seized assets, as the seizure and auction of vehicles is intrinsically linked to the making of advances and the granting of credit, a VAT exempt financial service.

The Appellant averred that the disposal of seized goods through auction is part and parcel of the provision of credit facilities because the disposed goods are not intended to reap profits. Rather the reserve price is specifically set to recover unpaid loan facilities that the Bank has incurred/may incur owing to the default in the primary supply, which is the issuance of credit.

Background

The KRA conducted an audit on the Appellant's tax affairs for the period 2018 to 2022 and issued a notice of assessment dated 31 August 2023. The KRA demanded taxes amounting to KES 1,190,578,054 with respect to Corporation Income Tax (CIT), Value Added Tax (VAT), Pay As You Earn (PAYE), and Withholding Tax (WHT). Aggrieved by the decision, KCB objected to the assessments on 29 September 2023.

Subsequently, on 27 November 2023, the KRA issued KCB its objection decision, confirming the assessment and revising the interest upwards, resulting in a revised assessment of KES 1,216,775,932.

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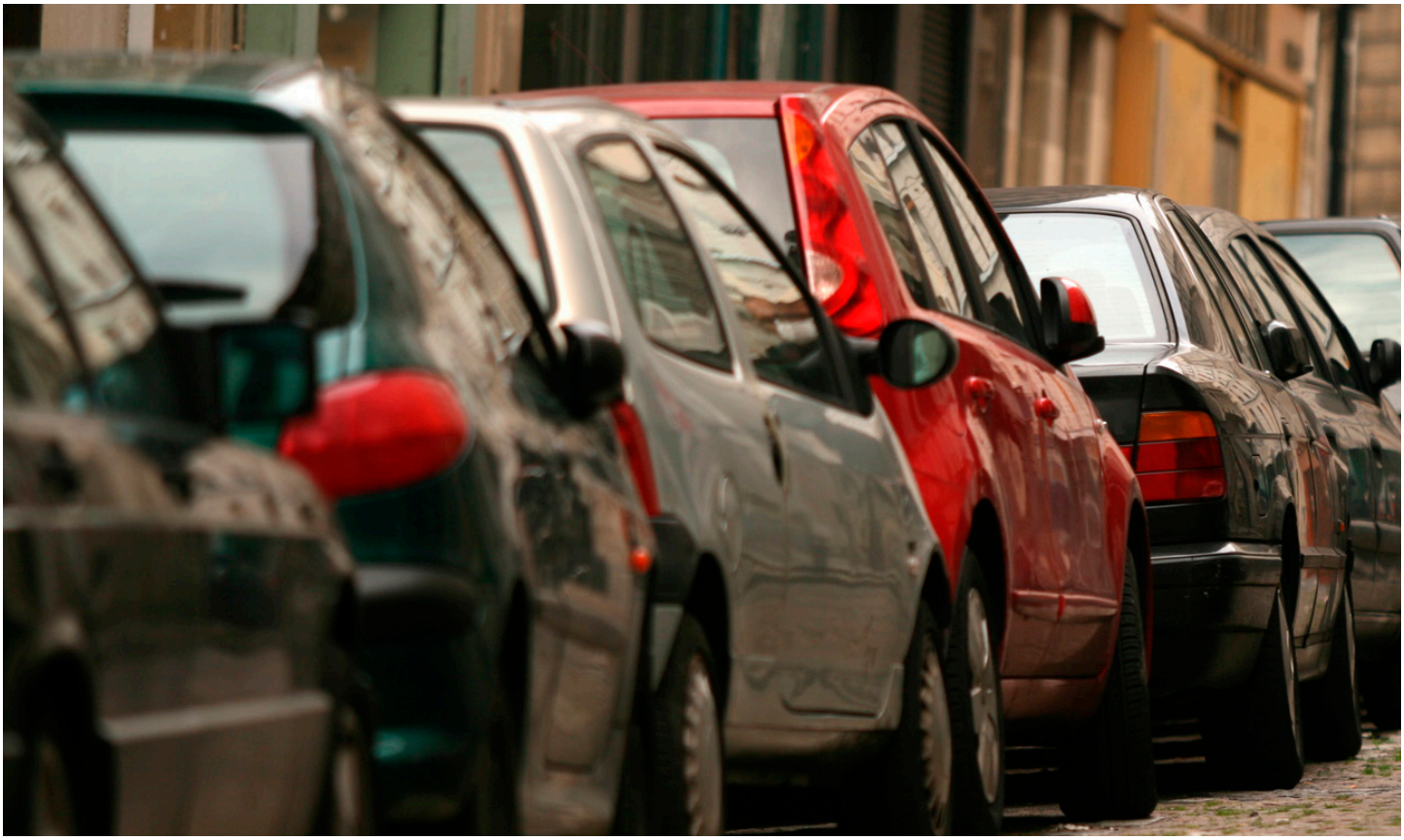

The Appellant, being dissatisfied with the objection decision, filed an appeal with the TAT on 27 December 2023.

In an effort to settle the matter, the parties engaged in Alternative Dispute Resolution ("ADR"), where they reached an agreement on CIT and PAYE issues and referred the WHT and VAT matters back to the TAT.

Stay tuned as we dive deep into the intricacies of the VAT dispute.

Issue for determination

With respect to VAT, the contention was as to whether the Respondent erred in subjecting VAT on the sale of seized motor vehicles through auction by the Appellant and subsequently demanding VAT amounting to KES 67,539,788 inclusive of penalties and interest for the periods 2018 to 2021.

Appellant's argument

The Appellant argued that Banks offer credit and seek to mitigate the risk of default by requiring the placement of security against the credit. This principle also applies where the Bank secures car loans through the holding of special rights to repossess and auction vehicles to the extent that a customer defaults.

The Appellant argued that in the Bank's operations, the disposal of seized goods through auction is part and parcel of the provision of credit facilities and that the disposed goods are not intended to reap a profit. Rather, the reserve price is specifically set in order to recover unpaid loan facilities that the Bank has incurred/may incur owing to the default in the primary supply, which is the issuance of credit.

The Appellant argued that the issuance of credit is explicitly exempted from VAT in accordance with Paragraph 1 (h) Part II of the First Schedule to the VAT Act.

KCB further argued that motor vehicles repossessed by the Bank from loan defaulters do not constitute a supply within the meaning of the word supply under Section 2 of the VAT Act.

KCB affirmed that the VAT Act defines a supply of goods under section 2 as "a sale, exchange, or other transfer of the right to dispose of the goods as owner...".

While in the case of loans for motor vehicles, the logbook is maintained in the names of both the customer and the Bank pending settlement of the loan obligation; and the Bank's name on the logbooks is in no way an indication of ownership. Rather, it is a declaration that the property in question carries a charge, to which the Bank has first rights on any default in its capacity as a secured creditor.

Finally, KCB argued that auctioning the motor vehicles does not amount to a supply of goods as envisioned under the VAT Act, since the title of the motor vehicles transfers directly from the defaulting customer to the highest bidder at auction, not as a direct transfer of the title from the Bank.

Respondent's argument

In rebuttal, the KRA highlighted that the Bank is co-registered in the vehicle titles, and the KRA assessed VAT on the sale of commercial vehicles.

The Respondent argued that the primary supply in the transaction is the sale of a motor vehicle to a third party, by the Bank, which is a VAT registered person. To this end, the KRA submitted that the VAT Act does not expressly provide an exemption for this type of supply and as such the supply is taxable as provided for under the VAT Act.

Determination

The Tribunal noted that Paragraph 1 (h) Part II of the First Schedule to the VAT Act exempts the making of advances or granting of credit from VAT, but not the recovery of credit from a debtor. The TAT emphasized that tax laws must be interpreted strictly, as such the assertion that disposal of seized goods through auction is part and parcel of the provision of credit facilities amounts to stretching the provisions of Paragraph 1 (h) to areas that the legislature did not provide for.

Further, the Tribunal stated that a sale by auction is referred to as a "hostile sale," where the creditor (the Bank) steps into the debtor's shoes to effect the sale. The Tribunal also noted that the Bank owes the debtor a duty of care to ensure the sale complies with the Auctioneers Act and related rules.

Specifically, Rule 5 of the Auctioneers Rules requires the Appellant to ensure all statutory conditions precedent to the seizure/repossession are met. Thus, the Bank must fulfill all obligations, including paying taxes and levies.

The Tribunal observed that by the vehicles being charged to the Bank as the creditor, it means the Bank had acquired the right to sell the vehicles. Consequently, the Bank qualifies as the seller under Section 2(1) of the VAT Act.

The TAT concluded that the KRA was justified in demanding for VAT on the disposal of the repossessed vehicles.

Conclusion

In light of the TAT's ruling, financial institutions, especially Banks, should consider the VAT implications on the disposal of repossessed vehicles to ascertain that they have been accorded the correct VAT treatment.

It is also recommended that financial institutions evaluate the VAT treatment on disposal of other collateral and identify any gaps for correction.

Taxpayers have the opportunity to make voluntary disclosures under the Tax Amnesty program that runs up to 30 June 2025.

Please feel free to reach out to your usual PwC contact or any of our indirect tax experts listed herein should you wish to discuss this.

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