VAT on Exported Services: A review of the recent decision in Commissioner of Domestic Taxes v Total Touch Cargo Holland

Background

Total Touch Cargo Holland (TTCH), a company incorporated in the Netherlands provides transport and handling services for its customers who import flowers and horticulture products from Kenya to Europe. In Kenya, a subsidiary of TTCH, Total Touche Cargo Kenya Limited (TTCK) was incorporated to provide to TTCH the service of blocking airspace in aircraft and to provide cooling services to TTCH. TTCK later contracted the cooling services to Kenya Airfreight Handling Limited ("KAHL").

The dispute arose from claims by TTCH that KAHL erroneously raised VAT invoices to TTCK instead of issuing the invoices to TTCH to whom the services were being provided. KAHL then wrote to the Kenya Revenue Authority seeking an interpretation over whether the services offered by KAHL to TTCH were Vatable.

KRA responded stating that the services rendered by KAHL to TTCK were vatable since they were deemed to be local supplies. According to TTCH, the aforementioned communication was contrary to a prior communication made to them by KRA in which KRA stated that the services rendered to TTCH by TTCK were exported services for which VAT was not chargeable.

TTCH challenged the decision of the Commissioner Domestic TaxesKRA at the VAT tribunal. The tribunal found that there was no VAT chargeable on the coling, scanning and palletizing services provided by KAHL to TTCH as these services were exported out of Kenya. The Commissioner appealed the decision of the tribunal to the Kenya court. The main contention at the High Court was whether the services rendered by KAHL to TTCH could be considered to be exported services within the meaning of Section 2 of the VAT Act

The Parties Arguments

The Appellant contended that the services which KAHL provided to the TTCH were services provided within Kenya and thus did not qualify as exported services thereby qualifying the services as Vatable at 16%.

The Appellant further alleged that the TTCH had realigned its business structure to avoid payment of tax. It argued that the exported service was horticulture produce not the service provided by KAHL before the produce left Kenya.

The Appellant further submitted that in determining the "user" or "consumer" of a service, the party who pays for said service is irrelevant. That what matters is where that service is provided, who provides the service and the place of use of that service and the place of consumption.

On the other, TTCH argued that Commissioner of Domestic Taxes had herself confirmed by letter that the services provided by TTCK to TTCH were offered in order to ensure that the produce reached the market in Europe in a state fit for consumption. As such these were exported services which were zero rated.

TTCH further relied on the VAT guidelines on international Trade and Service in intangibles as developed by the Organisation for Economic Co-operatin and Development (OECD). It argued that under the "destination principle", goods, services and intangibles are zero rated when leaving one jurisdiction and are taxed upon importation on another jurisdiction.

On that basis, TTCH contended that the scanning, cooling and palletizing services offered to them by KAHL were services intended to ensure that the horticultural produce arrived in Europe in a fresh state suitable for consumption and use by its European buyers. Accordingly, TTCH insisted that the services provided by KAHL were in fact an exported service within the meaning of Section 2 of the repealed VAT Act.

Findings of the Court

The Court noted that the dispute revolved around the interpretation of the term "service exported out of Kenya" as provided for in Section 2 of the repealed VAT Act.

Section 2 of the VAT Act (now repealed) defined "exported service" to mean a service provided for use or consumption outside Kenya whether the service is performed in Kenya or both inside and outside Kenya."

Based on the provision, the Court noted that for a service to be deemed an "exported service", it matters not whether that service was performed in Kenya or outside Kenya. The determining factor is the location where that service is to be finally used or consumed. Therefore, an exported service will be one which is provided for use or consumption outside Kenya.

In light of the above, the Court found that the scanning, cooling and palletizing services provided by KAHL, were performed in Kenya and the user being TTCH and their European customers were based outside Kenya. Accordingly,the Court found that despite the service being performed within Kenya it was in actual fact an exported service.

The Commissioner further sought to rely on Regulation 20 of the VAT Act to limit the ambit of Section 2 of the VAT Act (now repealed). Regulation 20 is to the effect that services shall be deemed to be supplied in Kenya where the supplier has established his or her business in a fixed physical establishment

in Kenya and services are physically used or consumed in Kenya regardless of the location of the payer.

The tribunal and appellate court dismissed this argument on the basis that it was subsidiary legislation which could not negate or contradict the definition of an "exported service" in the principle legislation being Section 2 of the repealed act (the applicable legislation in this matter). In arriving at this decision, the court relied on the case of **Coca Cola East and West Africa Limited vs Commissioner of Domestic Taxes, F.H. Services Kenya Limited vs Commissioner of Domestic Taxes and WanvinyaNdeti vs. Independent Electoral Boundaries (IEBC) & 4 others [2014].**

In the Coca Cola case, the court held that;

"For a Start, Regulation 20 (i) (a) has no nexus with a service exported out of Kenya as defined in Section 2 of the VAT Act. If a service has been exported out of Kenya i.e if a service has been provided for use or consumption outside Kenya and it is truly used and consumed outside Kenya, the issue of Regulation 20(1) can never arise. The Regulation is simply there to qualify what a local supply is.

In F.H. Services, the tribunal held that;

"The Principle legislation is higher law than the subsidiary legislation, and unlike the subsidiary legislation which can be altered without going through Parliament, principal law can only be altered by Parliament. It is therefore critical for the Respondent to understand that in the event that he wants to rely on Regulation 20 (i) (d) for his case, he must first go to the principal legislation, the main law that is contained in the main body of the VAT Act. Specifically, the meaning of "service exported out of Kenya"

In Wavinya Ndeti, the court of Appeal held that;

"It is an established principle of construction of statues that no subsidiary legislation shall be inconsistent with the provisions of an Act of the interpretation and General provisions Act...A subsidiary legislation cannot repeal or contradict express provisions of an Act from which they derive their authority.

Regarding the application of the OECD guidelines, the court found that the OECD guidelines were applicable in the case based on the finding in Unilever Kenya Limited v The Commissioner of Income Tax where it was held that:

"The ways of doing modern business have changed very substantially in the last 20 years or so and it would be fool hardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own law. To do otherwise would be highly short sighted. "

In applying the OECD guidelines to the issue in contention, the Court relied on the findings in F.H. Services and Total Touche Cargo Holland. In F. H. Services, the tribunal guided by the OECD guidelines held that:

"The Upshot of the guidelines is that the services are said to be used or consumed in the jurisdiction of the final consumer i.e. where the supply to the final consumer occurs. This is the jurisdiction which has the right to tax the services according to the rules of the jurisdiction where the consumption occurs.

In Total Touche Cargo Handling, the tribunal stated that:

"The Application of the destination principle in value added tax achieves neutrality in international trade... accordingly, the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction of consumption and therefore all revenue accrues to the jurisdiction where the supply to the final consumer occurs"

Based on the above, the court found that Section 2 of the repealed VAT Act is in tandem with the destination principle under the OECD guidelines. Consequently, the tax point for the services rendered by KAHL to TTCH was in Netherlands not Kenya since the final consumer of the service is in Europe.

Significance

The Court was in full agreement with the finding of the tax tribunal and held that the location where the service is provided does not determine the question of whether the service is exported or not. The test is the location (or place) of use or consumption of that service.

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