Publication: Business Day (Late Final), Business Law & Tax
Date: Monday, April 01, 2019
Page: 4

VIEWPOINT AFRICA

Kenyan court rules in landmark exports tax case

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On December 21 2018 the Kenyan High Court delivered judgment in the case of Commissioner of Domestic Taxes (KRA) v Total Touch Cargo Holland (TTC-H) (Nairobi Income Tax Appeal No. 17 of 2013) on when services are deemed to be exported and thus zero-rated for value-added tax (VAT) purposes.

In the case, TTC-H, a limited liability company incorporated in the Netherlands and part of the Stamina Group, provided transport and handling services for customers importing flowers and other horticultural products from Kenya to Europe.

The group also has a subsidiary in Kenya called Total Touch Cargo Kenya Limited (TTC-K), responsible for blocking airspace in aircraft and providing cooling services to its Dutch parent company.

TTC-K later contracted these services to Kenya Airfreight Handling Limited (KAHL). TTC-H claimed that KAHL began to erroneously raise VAT invoices to TTC-K instead of itself and directed KAHL to direct all invoices to itself, as TTC-K was merely an agent of TTC-H and had no connection or agreements with buyers in Europe.

KAHL approached the KRA for an interpretation of the law on whether VAT at the standard rate was chargeable on the services rendered by KAHL to TTC-H.

After initially agreeing that the services were subject to VAT zero-rating, the KRA later required VAT at the standard rate to be charged as the services rendered by KAHL were deemed to be local supplies. TTC-H filed an appeal before the VAT tribunal challenging the KRA's decision directing them to pay VAT. The tribunal ruled in September 2013 that no VAT was chargeable on account of the cooling, scanning and palletising services rendered by KAHL to TTC-H as these were services exported out of Kenya.

The KRA appealed to the high court and argued inter alia that the VAT tribunal erred in finding that the services in question were not in Kenya and therefore not VATable. It contended that the services were rendered by KAHL in Kenya to TTC-K, a local company, and that the consumer of the services was the flower farmer in Kenya, whose cut flowers would benefit from the services offered by TTC-H in order to have its flowers certified as fit for exportation.

Accordingly, the services did not qualify as exported services and were liable to 16% VAT. It also argued that TTC-H had amended the party to be invoiced by KAHL from TTC-K to TTC-H as a scheme to evade tax.

TTC-H, on the other hand, argued that the services could only be considered as exported services in terms of section 2 of the VAT Act (now repealed), on the basis that such services are provided for use or consumption outside Kenya, irrespective of whether the services are performed in Kenya.

It also indicated that the KRA had previously confirmed that the services rendered by TTC-K to TTC-H were offered to ensure that the produce reached the market in Europe in a state fit for consumption.

As TTC-H was a company incorporated in Holland with its buyers based in Europe, the services could only be considered as exported services, ultimately enjoyed or used by the buyers (consumers) of the horticultural produce and flowers outside of Kenya.

TTC-H referred to the VAT Guidelines developed by the Organisation for Economic Organisation Co-operation and Development (OECD) in respect of the international supply of services and intangibles. These guidelines distinguish the "destination principle" from the "origin principle" to allocate taxing rights in respect of cross-border services. In terms of the "destination principle", goods, services and intangibles are zero-rated when leaving one jurisdiction and are taxed upon importation in another jurisdiction, whereas the "origin principle" provides that tax accrues to the jurisdiction from which supply is made. In terms of the OECD guidelines, the "destination principle" is preferred and, accordingly, the jurisdiction where the customer is located has the taxing rights over a service or intangible supplied across international borders.

The court rejected the KRA's argument that the consumers of KAHL's services were actually the Kenyan farmers as there was no evidence or even suggestion that any of the farmers had a contract or agreement with KAHL or TTC-H.

The service contract existed between KAHL and TTC-H to facilitate the export of horticultural produce and flowers for consumption and use by persons outside Kenya.

The court also held that section 2 of the repealed VAT Act which stipulates that an "exported service" is that which is provided for use or consumption outside Kenya, is in keeping with the destination principle under the OECD Guidelines.

In the case at hand, the final consumer of the horticultural produce and flowers being prepared for export is TTC-H and its customers in Europe, and the services rendered by KAHL to TTC-H ensure that such consumers receive fresh and consumable produce.

THESE GUIDELINES DISTINGUISH THE 'DESTINATION PRINCIPLE' FROM THE 'ORIGIN PRINCIPLE'

The court dismissed the appeal, agreeing with the findings of the tribunal 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 of the use or consumption of such service. In this case, the service provided by KAHL was for use and consumption in Europe and is, therefore, subject to VAT at the zero rate in Kenya.

Interestingly, the court did not rule on the KRA's contention that the invoicing arrangement was amended in order to evade tax.

The new VAT Act No 35 of 2013 follows the destination principle by defining a service exported out of Kenya, which is zero-rated for VAT purposes, as "a service provided for use or consumption outside Kenya".

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