LG Electronics Africa Logistics FZE Kenya Branch v Commissioner of Domestic Taxes (Tax Appeal E064 & E062 of 2020 (Consolidated)) [2023] KEHC 22606 (KLR) (Commercial and Tax) (26 September 2023) (Judgment)

Neutral citation: [2023] KEHC 22606 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E064 & E062 OF 2020 (CONSOLIDATED)

DAS MAJANJA, J

SEPTEMBER 26, 2023

BETWEEN

LG ELECTRONICS AFRICA LOGISTICS FZE KENYA BRANCH .. APPELLANT

AND

COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT

(Being an appeal against the Judgment of the Tax Appeals Tribunal at Nairobi dated 31st March 2020 in Tax Appeal No.359 of 2018)

JUDGMENT

Introduction and Background

1. The appellant ("LG Kenya") is the Kenyan Branch of a company, LG Electronics Africa Logistics FZE incorporated and registered in Dubai ("LG Dubai"). LG Kenya offers an extensive range of marketing services on behalf of LG Dubai including but not limited to creation of market awareness of LG Dubai's branded products, carrying out marketing intelligence and other related activities.

2. The appellant and respondent ("the Commissioner") have lodged their respective appeals from the judgment of the Tax Appeals Tribunal ("the Tribunal") dated March 31, 2020 following LG Kenya's appeal from the commissioner's objection decision dated October 2, 2018 ("the Objection Decision"). LG Kenya is aggrieved by the tribunal's finding on Withholding Tax ("WHT") while the commissioner is aggrieved by its finding on Value Added Tax ("VAT"). Although the corporation tax was in issue prior to the hearing of the appeal, it was settled.

3. The appeals were disposed by way of written submissions supplemented by oral submissions by their counsel. Further, the parties' arguments and positions in relation to the contested matters are apparent from the brief background I will highlight in brief.

4. The commissioner, in the exercise of its statutory mandate, conducted an audit of LG Kenya's tax affairs for the income period January 2010 – December 2016. After the audit, the commissioner communicated its findings through the letter dated January 18, 2018.

5. On the issue of VAT, the Commissioner observed that LG Kenya is responsible for all marketing activities and advertising of LG products including brand building and enhancement within the region comprising 16 countries. It established that LG Kenya's functions include working with marketing and advertising firms to ensure brand visibility in the market through placing bill-boards and advertisements in newspaper, radio and TV, monitoring market share, overseeing product placement and distributor activities, local trainings on LG products to partners, activation and execution of promotions and offers in the market and supervision of merchandising staff.

6. The commissioner contended that the recipients, consumers of the messages conveyed through the marketing activities are the Kenyan public and the independent distribution companies and that part of the marketing activities are consumed locally since the target audience is in Kenya and such services are meant to influence consumers in the local market. Further, that these activities carried out by LG Kenya are invoiced to LG Dubai without charging of VAT and yet LG Kenya ought to have charged VAT on the marketing and advertising services performed in Kenya. The commissioner therefore charged a proportion of 54.8% of the total costs for provision of the service owing to the fact that from the information obtained, the Kenyan sales averaged about 55% of total sales in the region in that 54.8% was the actual Kenyan imports from LG Electronics by Kenyan distributors against total sales in the region. It accordingly held that the total VAT chargeable was Kshs. 325,649,691.00.

7. As regards WHT, the commissioner noted that for the services contracted to the marketing and advertising agents, WHT was not charged on their payments. That although LG Kenya explained that WHT was not operated since payment was done from Dubai and that it was LG Dubai that signed the contracts with the agents, the commissioner noted that all invoices for the services by the agents were addressed to LG Kenya who then forwarded them to LG Dubai for payment. That VAT was charged on the invoices and that for some of the service providers, the contracts had even been signed between them and LG Kenya. Thus, the Commissioner charged WHT on the amounts paid to the suppliers amounting to Kes 16,814,187.00. The Commissioner noted that from the financial statements and ledgers provided, legal, professional and accounting fees paid by LG Kenya attracted WHT but this was not charged as per the WHT ledger of LG Kenya. The Commissioner subjected these amounts to WHT of Kes 1,330,411.00.

8. LG Kenya responded to the commissioner's preliminary findings by its letter dated February 20, 2018. LG Kenya stated that the claim for VAT for the period 2010-2012 was time barred, that there was an absence of supply between LG Kenya and LG Dubai and that the commissioner used an erroneous and excessive base to charge VAT. Further and without prejudice, it urged the activities of a branch and its parent do not comprise supplies for Kenya VAT purposes. That should the commissioner determine that such supply exists, then the supply between LG Kenya and LG Dubai would constitute an export of services from Kenya and that services exported out of Kenya are taxable at the rate of zero in accordance with the provisions of paragraph 1 of the second schedule to the *VAT Act*, 2013. LG Kenya faulted the commissioner for relying on the VAT Tribunal case of *Coca Cola Central East and West Africa Ltd v Commissioner of Domestic Taxes* VAT Appeal No 11 of 2012 (UR) in arriving at the

decision to subject services performed by LG Kenya to tax at 16% as there is a clear distinction between the facts of that case and the current one.

9. On WHT, LG Kenya stated that the claim for the period 2010-2012 was statute barred by dint of section 29(1) of the *TPA*. As regards WHT on payments from oversees, LG Kenya stated that it did not operate WHT as the payments were made directly from Dubai to the marketing agents and that the contracts for the provision of the marketing and advertising services were entered into directly between the local agents and LG Dubai. That the invoices for marketing and advertising services were addressed to LG Dubai and in instances where they were addressed to LG Kenya, they were merely for the care of LG Kenya to be forwarded to LG Dubai. LG Kenya contended that addressing the invoice to LG Kenya's physical address did not mean that LG Kenya has made the payment in accordance with the definition of 'paid' as contained in the ITA.

10. LG Kenya contended that in accordance with sections 35(3) and (2) of the *ITA* only the agency fees charged in the invoices are subject to WHT. Further, subjecting the disbursements to WHT was factually incorrect since there was no margin on the disbursements and these were merely pass-through costs. Further, disbursements are neither management nor professional services. It faulted the commissioner for subjecting all the amounts posted to the legal and professional fees ledger to WHT because most of the payments therein related to government fees and levies. LG Kenya also stated that the commissioner erred in its computation of LG Kenya's unpaid WHT liability on legal, professional and accounting fees amounting to Kshs. 1,330,411.00 as it had not been factored in the WHT paid as presented in the letter therein.

11. After consultative meetings following LG Kenya's response, the commissioner reiterated its position that services offered by LG Kenya are subject to VAT and that the consumption of the services was also in Kenya. On WHT, the commissioner conceded that amounts charged relating to the period prior to 2013 were time barred and thus, the workings were amended to exclude WHT of Kshs. 192,869.00 relating to this period. The commissioner brought the amounts relating to the subsequent period to charge and assessed Kshs. 1,099,666.00 as the total tax due. Further, the commissioner stated that the workings on the agency fee charged on this issue amounted to Kshs. 3,685,144.00. The commissioner issued LG Kenya with an assessment of Kshs. 2,663,660,109.00 for the subject period 2010 – 2016 in respect of corporation tax, VAT and WHT.

12. LG Kenya formally objected to the assessments through its letter dated August 3, 2018. On VAT, it maintained that transactions between LG Kenya and LG Dubai do not constitute a supply of services far VAT purposes. That even if such transactions constituted a supply of services, such services are used and consumed outside Kenya hence taxable at 0%. That even if it was deemed that LG Kenya provided services to the local independent distribution companies, the output VAT would be zero since the consideration for the supply would be zero on the basis that LG Kenya and the independent distributors are not related. Further, that the facts in the case of *Coca Cola Central East and West Africa v Commissioner of Domestic Taxes* (supra) relied on by the commissioner were not applicable and binding. That the statutory limitation of time for the commissioner to issue a default assessment is five years and hence the purported assessment for the period 2010 to 2012 lacked any basis.

13. On WHT, LG Kenya still faulted the commissioner's position that marketing agents provided services to LG Kenya thus it was unclear what basis the commissioner used to arrive at the WHT. It restated that WHT is deducted upon payment to another person and that the issue of what constitutes 'paid' in accordance with section 2 of the *ITA* was determined by the Court of Appeal in *Republic v Kenya Revenue Authority ex-parte Fintel Limited* NRB CA Civil Appeal No 311 of 2013 [2019] eKLR where payment was defined as the delivery of money or other valuable thing and further noted that payment is a prerequisite for WHT to apply, and that in other words, for WHT to be applied, a payment must

have been made. LG Kenya therefore maintained that there has been no payment made by the LG Kenya on which WHT should be deducted. LG Kenya still faulted the Commissioner for imposing a 10% penalty for failure to deduct WHT from the payment for the marketing agent fees.

14. The commissioner issued its objection decision dated October 2, 2018 ("the objection decision"). In respect of the VAT objection, the commissioner held that LG Dubai through its permanent establishment, LG Kenya did not register for VAT as required by the provisions of section 34 of the *VAT Act*, 2013. It notified the taxpayer of the assessment through the letter of January 18, 2018 and the demand letter of July 5, 2018 and that under section 31(4) of the *TPA*, the 5-year time limitation period is exempt in instances of gross or willful neglect, evasion or fraud where a tax payer has been notified of an assessment as in the present case.

15. The commissioner insisted that the services offered, that is, marketing services are taxable supplies and thus subject to VAT and the consumption of the services offered is in Kenya by the independent distributors and the Kenyan public, who consume by purchasing the products offered. On the base for charging VAT, the commissioner maintained that its request to LG Kenya for provision of sales data for the distributors in the region was still not honoured and that this would have enabled the commissioner apportion the chargeable cost for the services in Kenya. The commissioner contended that the tax base is the actual value of the services by LG Kenya which is the profit attributed to it for the activities it performs in the Kenyan market and the commissioner thus used the proportion of income attributable to the Kenyan market as the actual value of services to the same market and that this was obtained from the actual sales of Kenya as compared to the actual sales to the region. Therefore, the Commissioner held that this proportion gave it the accurate value of service performed in Kenya for the Kenyan market and that the computation was based on Commissioner's best Judgement. Thus, it charged VAT on the taxable supplies of LG Kenya to the Kenyan market as Kshs. 80,774,657.00

16. On WHT, the Commissioner maintained that the fact that payment was done by LG Dubai does not extinguish the requirement for operation of WHT on the payments made. That it should be noted that any contracts signed between LG Dubai and the service providers also bind LG Kenya and hence the reason why the service providers invoice LG Kenya which cannot contract on its own since it is not a legal entity and thus all contracts have to be legally signed between LG Dubai and the suppliers. The commissioner held that the suppliers do not recognize two parties between LG Dubai and LG Kenya and that the marketing agents work with the staff of LG Kenya to execute the marketing activities. For these reasons, the Commissioner maintained that for the services performed, invoiced and paid, WHT should be charged for the period between 2013-2016 amounting to Kshs. 3,685,144.00.

17. Turning to the appeal before the tribunal, it framed the following issues for resolution. First, whether the VAT assessment of the period of January 2010 and May 2013 are statutorily time-barred and whether marketing services provided by LG Kenya to LG Dubai are exported services. Second, whether LG Kenya should have accounted for WHT for the services rendered by the marketing agents.

18. On the first issue of the VAT assessment being time barred, the tribunal held that LG Kenya is contracted by LG Dubai to provide marketing services which increase sales for the Kenyan distributors. It referred to the OECD Guidelines that provide that identity of the ultimate consumer is determined by the service agreement and the customer of the services that has the taxing rights over the said services. From the facts and evidence adduced, the tribunal held that there was no contractual nexus between LG Kenya and the Kenyan distributors and that from a reading of sections 3, 29 and 31(4) of the *TPA* and perusal of the documents on record, it was evident that the commissioner notified LG Kenya of its findings through the letter dated January 18, 2018 and later issued the assessment letter dated July 5, 2018 for the tax period of year 2010-2016, which facts are not disputed. The Tribunal accepted that the commissioner has power under section 31(4) to amend the assessment but it was nevertheless apparent

that the demand letter the commissioner relied on was issued outside the statutory period of five years and could not act as a timeline-cure for the assessment issued on July 5, 2018.

19. On whether the marketing services provided by LG Kenya to LG Dubai are exported services, the tribunal noted that the question before it was who is the consumer of these services. The Tribunal relied on *Commissioner of Domestic Taxes v Total Touch Cargo Holland ML* HC ITA No 17 of 2013 [2018] eKLR to hold that the marketing services provided by LG Kenya are to its head office, LG Dubai and not to the Kenyan distributors and the same can therefore not be given the meaning of section 8 of the *VAT Act*, 2013.

20. As to whether LG Kenya should have accounted for WHT for the services by the marketing agents, the tribunal noted that both parties agreed that the services rendered were marketing and advertising services with respect to LG products in Kenya and that the subject payments therefore relate to professional fees and fall under the income described in section 10 of the *ITA* and that the *ITA* does not subject payments made by non-resident persons not having permanent establishment in Kenya to withholding tax.

21. The tribunal noted that since LG Kenya conceded to payment of Kshs. 202,230,104.00 in corporation tax, it was clear that income accrued and expense was incurred, from its books of accounts and that the commissioner ought to impose the relevant expenses incurred by LG Kenya to WHT in accordance with the *ITA*. The tribunal further held that the penalty imposed by the commissioner on WHT by virtue of *TPA* failed.

22. The tribunal allowed LG Kenya's appeal in part by setting aside the objection decision on VAT. It directed the commissioner to impose WHT on the appellant's expenses as applicable thus precipitating this appeal.

Analysis and Determination

23. As I determine this appeal, I am cognizant of the fact that this court's jurisdiction is circumscribed under section 56(2) of the *TPA* which provides that "An appeal to the High Court or to the Court of Appeal shall be on a question of law only". This means that this court is not permitted to substitute the tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts but must give due deference to the tribunal on such factual issues and intervene only where the factual conclusion cannot be supported by the evidence or application of the law is clearly erroneous (see *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR).

24. Against the above background, I now proceed to deal with the two issues raised in the parties' appeals. I will start with the commissioner's appeal anchored in its memorandum of appeal dated May 29, 2020 then proceed with LG Kenya's which is also grounded in a memorandum of appeal of the same date.

Whether the Tribunal erred in setting aside the Commissioner's VAT assessment of LG Kenya

25. The commissioner's decision to charge VAT on LG Kenya's marketing services was on the ground that it never registered for VAT as required by section 34 of the *VAT Act*, 2013 and that LG Kenya was notified of the assessment through the letter dated January 18, 2018 thus the statutory time limit of 5 years was not applicable. The commissioner further stated that the recipients of the marketing services performed in Kenya were the Kenyan public and the independent distribution companies selling LG Products.

26. The Tribunal held that from the facts and evidence adduced, there is no nexus between LG Kenya and the Kenyan distributors at least contractually and that from a reading of sections 3, 29 and 31(4)

of the *TPA* and perusal of the documents on record, it was quite evident that the commissioner indeed notified LG Kenya of its findings through the letter dated January 18, 2018 and later issued the assessment letter dated July 5, 2018 for the tax period of year 2010-2016, which facts are not disputed. From the undisputed facts, I accept that the tribunal did not err in holding that under section 31(4), the commissioner has powers to amend the assessment but such amendment cannot cure a demand that it outside the statutory limitation period of five years.

27. On whether the marketing services provided by LG Kenya to LG Dubai are exported services, it was not in dispute that the marketing services performed in Kenya by LG Kenya was done for and on behalf of its head office, LG Dubai and that it was LG Dubai that paid for these services even when LG Kenya hired marketing agents. This court has held in several decisions including *Commissioner of Domestic Taxes v Total Touch Cargo Holland* (*supra*) 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. Therefore, the relevant factor is the location of the consumer of the service and not the place where the service is performed. In *Commissioner of Domestic Taxes v W.E.C. Lines (K) Limited* [2022] KEHC 57 (KLR) the court held that the relationship in a case where an agent is acting on behalf of the principal essentially means that the greatest beneficiary and consumer for the services performed by the agent is the principal.

28. From the evidence which the tribunal considered, it was in the interest of LG Dubai that its LG branded products are marketed and made visible to the Kenyan public for sale. Further, LG Dubai, rather than the Kenyan public or independent distributors was the greatest consumer of the marketing services performed by LG Kenya. In this respect therefore the Tribunal was indeed bound by the court's decision in *Commissioner of Domestic Taxes v Total Touch Cargo Holland* (supra) and not the decision by the defunct VAT Tribunal in *Coca Cola Central East and West Africa v Commissioner of Domestic Taxes* (supra) relied on by the commissioner. The tribunal decision was in any case set aside by this court in *Coca-Cola Central East and West Africa Limited v Commissioner of Domestic Taxes* [2020] eKLR where it was emphasized that the place of performance of the service is irrelevant and that for a service to be deemed as exported it has to be a service provided for use or consumption outside Kenya. I would also point out that while the tribunal is not bound by its own decisions and is entitled to depart from them when the need to do so arises, it is bound by the decisions of the superior courts and could not ignore the superior court decisions on the issue of exported services under the *VAT Act*, 2013 (see *SGS Kenya Limited v Energy Regulatory Commission & 2 others* SCK Pet. No. 2 of 2019 [2020] eKLR).

29. For the above reasons, I do not find any error in the tribunal's findings that the marketing services provided by LG Kenya are consumed by LG Dubai and not the Kenyan distributors and that the such service is deemed a service exported out of Kenya under section 2 of the *VAT Act*, 2013 which as per the same Act is zero-rated for purposes of VAT. It follows that the issue of whether the VAT assessment issued by the Commissioner was time barred was moot. In any event, I agree with LG Kenya that the output VAT was zero thus there was no obligation to register for VAT as contended by the Commissioner and thus, no willful or gross neglect by LG Kenya to enable the commissioner issue an assessment past the 5-year statutory period. The commissioner's appeal on VAT accordingly fails and is dismissed.

Whether the Tribunal erred in imposing WHT on LG Kenya's expenses as applicable

30. LG Kenya submits that given that the payment for the marketing and advertising services is made by LG Dubai and not LG Kenya, the payments cannot be deemed to be income which accrued in or was derived from Kenya and therefore, the payments are not subject to WHT in Kenya.

31. The commissioner takes the position that WHT was charged in accordance with section 35(1)(b) of the *ITA* as read with section 2 of the *ITA* as monies were paid for services conducted by marketing agents in Kenya and thus, LG Kenya ought to have operationalized and accounted for WHT as required by law.

32. In *Kenya Revenue Authority v Republic exparte Fintel Ltd* (*supra*), the Court of Appeal held that WHT is where the tax payer of certain income is responsible for deducting tax at source from payments made and remitting the deducted tax to the revenue body, that is the commissioner in this case. Sections 2, 3, 10 and 35 of the *ITA* are the relevant provisions when determining matters of WHT as they provide for important definitions together with the payments that are subject to WHT.

33. Section 2 defines some of the terms subject to WHT, section 3(1) is the charging provision and states that "…. income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya." Section 10 provides that where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of professional fees such as that of the marketing services offered by LG Kenya to LG Dubai, then that amount shall be deemed to be income which accrued in or was derived in Kenya provided that the said provision shall not apply unless the payment is incurred in the production of income accrued in or derived from Kenya or in connection with a business carried on or to be carried on, in whole or in part, in Kenya. The provision further states that 'for the avoidance of doubt, the expression "non-resident person" shall include both head office and other offices of the non-resident person.'

34. Based on the aforesaid provisions, the tribunal was correct to conclude that there is no provision for taxation of income paid by a non-resident not having a permanent establishment in Kenya. In this case, the payments were made by LG Dubai, a non-resident, to local agent. While the question whether LG Kenya was LG Dubai's permanent establishment in Kenya was contentious at the pre-appeal stage it was not considered by the tribunal. It appears that this was because the issue of corporation tax was settled.

35. The corpus of the tribunal findings was that having found that WHT was not applicable, it went on to hold that:

> Without prejudice to the above the tribunal would not be serving justice if it failed to acknowledge that the appellant conceded payment of Kshs. 202,230,104/= in corporation income tax. Following, it is clear that the income accrued and expense was incurred. From its books of accounts, the respondent ought to impose the relevant expenses incurred by the appellant to withholding tax in accordance with the *Income Tax Act*.

36. I do not find any rationale for the Tribunal ordering the commissioner to impose the relevant expenses incurred against the income accrued to WHT. As stated, WHT is only applicable to payments and not expenses and that in any case, it is always charged on the 'gross' amount. Having settled the issue of corporation tax, where the deduction of expenses would be an issue, I reject the tribunal's direction on WHT as it is not founded on any principle. In addition, the tribunal's direction is contradictory to its earlier finding that WHT was not applicable to such payments. The appeal therefore succeeds in this respect.

37. Before I dispose of the matter I wish to apologise to the parties for the delay in rendering this judgment. The matter fell through the cracks and was overlooked as a pending judgment. I only realised that it was due when conducting an audit of pending decisions following my impending transfer to the Civil Division.

Disposition

38. Following the decision I have reached on the two issues framed for determination, I now make the following dispositive orders:

    a. The appeal by the commissioner regarding VAT on exported services being ITA No E064 of 2020 is dismissed.

    b. The appeal by LG Kenya regarding WHT being ITA No E062 of 2020 is allowed and the judgment of the tax appeal tribunal to that extent is set aside.

    c. Each party shall bear its own costs.

DATED AND DELIVERED AT NAIROBI THIS DAY 26TH OF SEPTEMBER 2023.

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Ms Ouma instructed by Anjarwalla and Khanna LLP Advocates for the Appellant

Ms Chelangat instructed by Kenya Revenue Authority for the Respondent.