Commissioner of Domestic Taxes v Fortune Container Depot (Tax Appeal E063 of 2020) [2021] KEHC 249 (KLR) (Commercial and Tax) (19 November 2021) (Judgment)

Neutral citation: [2021] KEHC 249 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E063 OF 2020

DAS MAJANJA, J

NOVEMBER 19, 2021

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

FORTUNE CONTAINER DEPOT ..... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 31st March 2020 in Tax Appeal No. 205 of 2019)

JUDGMENT

Introduction and Background

1. The Respondent is a Kenyan limited liability company whose principal activity is the handling, storage, repairs and cleaning of empty containers at the port of Mombasa on behalf of shipping companies such as Mediterranean Shipping Company (MSC) and WEC Holland BV ("non-resident shipping lines") through the entities Oceanfreight (E.A) Limited and WEC Lines (Kenya) Limited ("General Agents") respectively.

2. The Appellant ("the Commissioner"), as part of its mandate, issued an audit notice on 17th May 2018 and carried out an in-depth audit of the Respondent's tax affairs for the period between July 2015 and June 2018. The Commissioner communicated its findings through its letter dated 27th February 2019 where it termed the sales accrued by the Respondent to the services it rendered to MSC as chargeable to VAT and not zero-rated supplies as classified by the Respondent. Based on this, it adjusted the Respondent's VAT liability to KES 82,056,714.00. The Commissioner also raised additional VAT assessments in the month of February 2019 amounting to KES 91,268,003.73.

3. Being dissatisfied with the Commissioner's findings, the Respondent raised objections to the assessments. The Commissioner, issued objection decisions on 11th April 2019 and 6th May 2019 ("the Objection Decisions") confirming its earlier assessments, disallowing the Respondent's objections. The Respondent lodged an appeal at the Tax Appeals Tribunal ("the Tribunal") which after hearing the parties' arguments, allowed the Respondent's appeal and set aside the Objection Decisions.

4. In this appeal, the Commissioner now challenges the Tribunal's decision grounded on its Memorandum of Appeal dated 29th May 2020 containing 17 grounds. However, in its written submissions, the Commissioner outlines and condenses the grounds of appeal into two; First, whether the services rendered by the Respondent were exported services and second, whether the Tribunal erred by holding in favour of the Respondent on all its alternative arguments. The Respondent relies on the Statement of Facts dated 2nd July 2020. The appeal was canvassed by written submissions.

Issue for Determination

5. From the record and submissions, the singular issue for determination in this appeal is whether the services provided by the Respondent are zero rated for VAT on the ground that they are exported services. The Tribunal held that the services rendered by the Respondent are exported services within the meaning of section 2(1) of the *VAT Act*, 2013 and are therefore zero rated under section 7 as read with the Second Schedule, Part A of the VAT Act, 2013 (''the VAT Act"). For ease of reference, the relevant part of section 2 of the VAT Act provides as follows:

> "export" means to take or cause to be takes from Kenya to a foreign country, a special economic zone enterprise or to an export processing zone
>
> "services exported out of Kenya" means a service provided for use or consumption outside Kenya.

Commissioner's Submissions

6. The Commissioner submits that it sought to charge VAT at the general rate of 16% on the services rendered by the Respondent to its clients; WEC Lines (K) Ltd and MSC c/o Ocean Freight (E.A.) Limited as the Commissioner's position was that the services rendered by the Respondent to its clients were used and consumed in Kenya based on section 2(1) of the VAT Act.

7. The thrust of the Commissioner's case is that the Respondent was contracted by and was offering services to the local companies and not to non-resident companies. It submits that it cannot be said that the services were exported outside Kenya. In its view, it is only the agents of the non-resident shipping lines and not third parties such as the Respondent who can allege that they are offering exported services.

8. The Commissioner therefore submits that the services provided by the Respondent were consumed and used in Kenya by the importers/consignees who used the containers to import goods into the country. It points out that the sample invoices adduced before the Tribunal show that the importer is being charged for cleaning, drop off and terminal handling charges by the Shipping Companies and that from the record, the specific duties of the General Agents with regard to the containers include "to collect demurrage and any other charges associated with the containers such as for cleaning and damage, and provide monthly reports on collected and uncollected charges".

9. To support its case, the Commissioner relies on international best practices to argue that it is the responsibility of the consignee or receiver to ensure that the containers are returned in good order. It cites an article, Jim Chubb, ICHCA International Limited's Safe Cleaning of Freight Containers

published on behalf of the International Cargo Handling Coordination Association whose objective is to improve efficiency in cargo handling by all modes of transport, at all stages of the transport chain and in all regions of the world. Paragraph 2.1 of the article states that, "Under the terms of a bill of lading for a full container load (FCL), it is normally the consignee's/receiver's responsibility to ensure that a container is returned to the carrier/Container operator in a clean condition". The Commissioner submits that, a shipper may, as in this instance, appoint a cleaning contractor to maintain standards and uniformity in cleaning of the containers but such an appointment does not take away the responsibility of cleaning the containers from the consignee and as such remains an administrative function. In sum the Commissioner maintains that the consignees are the consumers of the container cleaning services provided by the Respondent therefore those services cannot be termed as exported services.

10. The Commissioner also submits that the containers were in Kenya because the consignees/importers had imported goods which were packaged in containers for transportation. It maintains that it is the consignees who are consumers of the services performed by the Respondent on the containers and that had the importers not imported goods which were conveyed using containers, no containers would have been in Kenya and no services would have been performed on the containers.

11. The Commissioner urges the court to consider the terms of the VAT Act, the written agreements, the totality of the relationship between the Respondent, the non- resident shipping lines, the shipping lines' General Agents in Kenya and the importers and the actual dealing by the parties in determining whether the services rendered by the Respondent were consumed in Kenya or were exported services.

12. On the agency agreement between MSC Shipping Company SA and Ocean freight (EA) Ltd, the Commissioner submits that Ocean Freight EA acts as an agent of its Principal which means that any contract entered into by Ocean Freight (EA) Ltd with the Respondent is a local contract. It further submits that the Respondent cannot allege that it is rendering services to the non-resident shipping lines since it was not contracted by the shipping lines but by local companies. It points out that the Respondent was contracted by Ocean Freight (EA) Ltd who was the agent of MSC Shipping Company SA and by WEC Lines Kenya Limited who was the agent of WEC Lines BV.

13. The Respondent supports the Tribunal's decision and states that it provides Container Depot Services to the non-resident shipping lines pursuant to Depot Tariff Agreements entered into with the non-resident shipping lines contracting through their General Agents.

Respondent's Submissions

14. The Respondent submits that the Commissioner is taking positions contrary its Objection Decisions and pleadings. It states that in the Objection Decision dated 11th April 2019, the Commissioner stated that the Container Depot Services provided by the Respondent were not zero-rated for VAT purposes because the agreements were entered into with the General Agents of the non-resident shipping lines as follows:

> Similarly, you entered into a contract agreement with WEC Lines Kenya Limited as an agent of WEC Holland BV to provide the services of storage, repair and transport of containers to the port of Mombasa.
>
> Both Ocean freight East Africa Limited and WEC Lines Kenya are resident companies in Kenya.
>
> We therefore contend that these services are provided for use and consumption in Kenya hence not services exported out of Kenya.

15. The Respondent adds that the Commissioner maintained the same position in its Objection Decision dated 6th May 2019 and arguments before the Tribunal but in this appeal, the Commissioner takes a new position that the Container Depot Services provided by the Respondent were used and consumed by the importers of cargo. The Respondent submits that parties are bound by their pleadings and that this court, in exercising its appellate jurisdiction, its role is to determine if the Tribunal arrived at the correct decision based on the pleadings and the evidence placed before it.

16. The Respondent submits that the Tribunal made the factual determination that there is no contractual nexus between the Respondent and the General Agents of the non-resident shipping lines and that the Commissioner's position was contrary to the law of contract and agency in that an agent therefore does not contract on its own behalf but rather on behalf of its principal. Further, that there is no privity of contract between the agent and the third party. The Respondent relies on *Garnac Grain Co. Inc. v H.M.F. Faure & Fairclough Ltd. [1967] 2 All E.R. 353* and *Libert Forwarders (K) Ltd v Kenya Ports Authority MSA HCCC No. 607 of 2001 [2002] eKLR* to support this position.

17. The Respondent explains that in the present case, the General Agents sign the Depot Tariff Agreements in their capacity as agents, on behalf of the non-resident shipping lines which created privity of contract between the Respondent and the non-resident shipping lines only. Thus, the Depot Tariff Agreements were between the Respondent and the non-resident shipping lines. It submits and maintains that the services it provided to the non-resident shipping lines were services exported out of Kenya and therefore zero-rated for VAT purposes.

18. The Respondent submits that it provides Container Depot Services to the non-resident shipping lines pursuant to the Depot Tariff Agreements between the Respondent and the non-resident shipping lines and that this was a supply of services under section 2 of the VAT Act which provides that "supply of services" means "anything done that is not a supply of goods or money, including – (a) the performance of services for another person'. That in this instance, the Respondent performed Container Depot Services for the non-resident shipping lines under the Depot Tariff Agreements and that in order to 'perform' a service as provided for above, there must be a legal obligation to do so, which in this case, the Respondent had the legal obligation to perform the Container Depot Services under the Depot Tariff Agreements.

19. The Respondent submits that the direct contractual relationship between a supplier and its customer as a recipient of the supply, dictates the nature of the supply of services. It states that the Depot Tariff Agreements between the Respondent and the non-resident shipping lines determine the nature of the supply made by it and the VAT consequences.

20. The Respondent contends that it does not have any contractual relationship with the importers of the goods or the General Agents who do not act in their own capacity but act on behalf of the non-resident shipping lines. The Respondent submits that the non-resident shipping lines benefited from the Container Depot Services; they received containers that are clean and in a good state of repair and that these containers can then be used by other customers who contract them to provide international carriage of goods.

21. The Respondent reiterates that services exported out of Kenya are zero-rated for VAT purposes under Paragraph 1 of Part A of the Second Schedule to the VAT Act and that the Container Depot Services provided were used and consumed by the non-resident shipping lines outside Kenya and are therefore zero-rated for VAT purposes. This is because the Container Depot Services were provided pursuant to the Depot Tariff Agreements between the Respondent and the non-resident shipping lines and the clean and repaired containers were dispatched outside Kenya to the non-resident shipping lines for use by their other customers wherever they may be.

22. The Respondent rejects the Commissioner's contention that the Respondent provided services to the importers of goods and that the service provided by the Respondent were consumed and used in Kenya by the importers/ consignees who used the containers to import goods into the country. The Respondent also restates that the non-resident shipping lines are the consumers of the Container Depot Services as the Respondent dispatches to them clean and repaired containers that are ready for use by their future costumers.

Analysis and Determination

23. The main ground upon which the Commissioner's rejected the Respondents objection was on the basis of the nature of the contract signed between the Respondent and General Agents. From the material on record, which is not in dispute, the General Agents, WEC Line (Kenya) Limited and Oceanfreight East Africa Limited were agents of the non-resident shipping line companies, Mediterranean Shipping Company (MSC) and WEC Lines BV respectively. This is confirmed by the agency agreements between the non-resident shipping lines and the General Agents which point to the fact that the General Agents were indeed agents of the non-resident shipping lines. The General Agents were contracting with the Respondent on behalf of the non-resident shipping lines and thus it is the non-resident shipping lines who were the principals contracting the Respondent for their services.

24. I find that any other interpretation that suggests that the General Agents were contracting with the Respondent on their own behalf is flawed and unsupported by the evidence as all actions by agents are deemed to be those of the principal. This is the basic principle of the law of agency as stated in Libert Forwarders (K) Ltd v Kenya Ports Authority (Supra) where the court cited the following passage of G.H.L. Fridman, 'The Law of Agency' at page 169 that, ''[T]he normal, general, effect of the making of a contract by the agent on his principal's behalf is that the agent is not a party to the relationship created by such contract.''

25. Turning to the issue whether services were exported as defined by section 2 of the VAT Act. They key consideration is whether the service is provided for use or consumption outside Kenya. This is not a novel issue and has been considered by our courts in cases cited by both parties. In *Commissioner of Domestic Taxes v Total Touch Cargo Holland ML HC ITA No. 17 of 2015 [2018]eKLR* the court held as follows:

> (15) .... A clear reading of this provision is 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.

26. The aforesaid interpretation is consistent with the principle that the tax statutes must be interpreted strictly without any intendment (see *Cape Brandy Syndicate v I.R. Commissioners [1921] 1KB 64*, *Mount Kenya Bottlers Ltd & 3 others v Attorney General & 3 others NRB CA Civil Appeal No. 164 of 2013 [2019] eKLR* and *Stanbic Bank Kenya Limited v Kenya Revenue Authority CA Civil Appeal No. 77 of 2008 [2009] eKLR*). Thus the determining factor is the location where that service is to be finally used or consumed.

27. In Commissioner of Domestic Taxes v Total Touch Cargo Holland (Supra), the issue was whether the services offered by Kenya Airfreight Handling Limited including scanning, cooling and palletizing horticultural produce before it was shipped to Europe were exported services. The court upheld the Tribunal's decision that the services were for the benefit of the users and consumers who received it in a fresh state hence the services were exported services under section 2 of the VAT Act.

28. The same conclusion was reached by the court in *Panalpina Airflo Limited v Commissioner of Domestic Taxes ML HC ITA No. 5 of 2018 [2019] eKLR*. The appellant provided handling services for horticultural products including documentation, cold room handing, vacuum cooling and screening. The court agreed that services offered by the appellant's agents were to facilitate export of flowers for consumption and use by persons outside Kenya who expected delivery of fresh flowers.

29. From the totality of the evidence, it is clear that it is in the best interests of the non-resident shipping lines, as owners of the containers, to ensure that their containers were well serviced by the Respondent and since they were foreign entities, it follows that the services offered by the Respondent to them were exported services and were ultimately consumed by the non-resident shipping lines who needed their containers clean and in repair in order to offer their services.

30. The Commissioner contended that the consignees and or importers were the ultimate beneficiaries of the Respondent's services. I reject this contention. The importer/consignee interest is in the goods and not the container. The container is repaired and cleaned only after delivery of the goods. The consignee or importer only benefits from a container that is cleaned in the country of origin and not in the country where the goods are delivered.

31. The Commissioner also pointed out that the non-resident shipping line invoiced the importer/consignee for cleaning services which is an indication that the services offered by the Respondent were for their benefit. Accepting this position would be contrary to the express terms of section 2 of the VAT Act, which refers to the place of use or consumption and not the person who pays. The shipping lines is entitled to recover the costs of the services it renders from any person.

32. Ultimately, I accept the Tribunal's findings that the General Agents did not at any point contract the Respondent in their own capacity as companies but rather on behalf of their principals and that the economic benefit of the services provided by the Respondent flows directly to the non-resident shipping lines. It follows therefore that the Respondent, having offered an exported service, could not pay VAT as the said exported service was zero-rated.

33. The Commissioner complained that the Tribunal considered and upheld all the alternative arguments put forth by the Respondent which resulted in inconsistent holding contrary to the principle that tax laws must be interpreted strictly and there is no room for alternative arguments. It contends that the Tribunal ought to have pointed out with certainty what the services in contention between the parties were and by the Tribunal agreeing with the Respondent on all its proposed arguments, the Tribunal created ambiguity and uncertainty and as such, its holding cannot stand. From the facts, the services of handling, safekeeping, cleaning, repair and delivery of containers back to the shipper is a continuum of services necessary to ensure that the containers are in repair once the goods are delivered and the container is returned.

34. It is correct that the Tribunal determined the alternative arguments put forth by the Respondent but this cannot be blamed on the Tribunal because the alternative arguments were indeed dealt with by the Commissioner in the Objection Decisions. The Commissioner held that the services proved by the Respondent did not qualify as services to goods in transit under paragraph 10 of Part A of the Second Schedule of the VAT Act. It also held that a container is not considered to be an international sea carrier hence the services rendered by the Respondent do not qualify as taxable services provided to international sea carries on international voyage in accordance with paragraph 6 of Part A of Second Schedule of the VAT Act.

35. The Tribunal cannot be blamed for dealing with issues that the Commissioner raised in the Objection Decisions. On my part though, I do not think that that the alternative arguments are necessary for

resolution of the matter at hand in view of the nature of services rendered by the Respondent to the non-resident shipping lines which are clearly defined in the agreements and it these services that the non-resident shipping lines benefited from.

Conclusion and Disposition

36. For the reasons I have set out above, this appeal lacks merit and is hereby dismissed. The Appellant shall bear the costs of this appeal.

DATED AND DELIVERED AT NAIROBI THIS 19TH DAY OF NOVEMBER 2021.

D. S. MAJANJA

JUDGE

Mr Marigi, Advocate instructed by the Kenya Revenue Authority for the Appellant.

Mr Kimani, SC with him Mr Ruto instructed Hamilton, Harrison and Mathews Advocates for the Respondent.