REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL & TAX DIVISION

MILIMANI LAW COURTS

INCOME TAX APPEAL 19 OF 2013

COCA-COLA CENTRAL EAST AND

WEST AFRICA LIMITED.....APPELLANT

-VERSUS-

THE COMMISSIONER OF DOMESTIC TAXES..... RESPONDENT

(An Appeal from the whole of the decision of the Value Added Tax Tribunal dated 26th November 2013)

IN

REPUBLIC OF KENYA

IN THE VALUE ADDED TAX APPEALS TRIBUNAL

APPEAL NO. 11 OF 2013

COCA-COLA CENTRAL EAST AND

WEST AFRICA LIMITED.....APPELLANT

-VERSUS-

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

(An Appeal from the decision the Commissioner of Domestic Taxes set out in its confirmation notice dated 10th September 2012)

JUDGMENT

1. In the end it came down to whether the business model adopted by Coca-Cola Export Corporation (Coca-Cola Export) resulted in the evasion or minimization of Value Added Tax (VAT) payable in Kenya.

2. The model. Coca-Cola Central East and West Africa (**the Appellant or Coca-Cola Africa**) is a limited liability company incorporated in Kenya. It's principal business is to provide marketing and promotion services for the world famous Coca-Cola brands. It is a subsidiary of the Coca-Cola Company which is incorporated in the United States of America and the owner of the Coca-Cola trade mark.

3. The Coca-Cola Company and its subsidiaries market, manufacture and sell proprietary concentrates used to prepare "Coca-Cola" beverage products. One such subsidiary is Coca-Cola Export, also incorporated in the United States of America. Coca-Cola Export and its subsidiaries manufacture concentrates in various locations around the world but not in Kenya. Concentrates are sold to authorized bottlers who purchase, import and use the concentrates in preparing and packaging beverage products that bear the Coca-Cola trademarks. There are seven such bottlers in Kenya; Nairobi Bottlers, Mt. Kenya Bottlers, Rift Valley Bottlers, Kisii Bottlers and Beverage Services (k) Ltd (together, the Bottlers). These Bottlers pay VAT on the import of concentrates into Kenya.

4. Coca-Cola Africa is located in Kenya and on my count, from the evidence, services 21 countries. It provides marketing and promotion services (**the services**) with respect to Coca-Cola brands in these countries and seeks to maintain, increase and grow the image, value and importance of the brands. It is common ground between the parties to this Appeal (see the statement of facts by both sides) that the marketing and promotion services enhance and encourage sales of the Coca-Cola beverages. In turn, it enhances and encourages sales of concentrates by Coca-Cola Export and its subsidiaries to the Bottlers.

5. Then there is divergence. Coca-Cola Africa asserts that the benefit of the marketing and promotion services accrues outside Kenya and should be treated as exported services. This, from the perspective of Coca-Cola Africa, is in consonance with the definition of the phrase "**a service exported out of Kenya"** found in section 2 of the repealed VAT Act (Cap 476) (now repealed) (**The Act**). For purposes of this dispute, the repealed Act is the relevant statute. Section 2 defines the phrase to mean;

> **"A service provided for use or consumption outside Kenya, whether the service is performed in or outside Kenya, or both inside and outside Kenya".**

6. The Commissioner of Domestic Taxes **(the Commissioner or the Respondent)** is of the view that the marketing and promotion services provided by Coca-Cola Africa are consumed locally as the target audience is Kenya and that such services should be treated as services consumed in Kenya.

7. These differences and views took a practical significance when the Commissioner conducted an in-depth tax audit into the operations of Coca-Cola Export for the period 2007-2010. An outcome of the audit is that, on 10th September 2012, the Commissioner issued a confirmation of assessment for Kshs.516,075,557/= being VAT on undeclared locally consumed services plus accrued interest compounded at the rate of 2% per month. The divergence of views turned into a tax dispute which escalated to the local committee and finally as an appeal before the VAT Tribunal (**the Tribunal**).

8. The Tribunal dismissed the Appeal in a decision dated 26th November 2013. Various aspects of that decision are later discussed in detail but at this stage the Court highlights some of the findings .The Tribunal held;-

> **"As we have said above, if the Respondent can demonstrate that a service supplied by a person with a fixed place of business in Kenya has been physically consumed in Kenya, the issue of an exported service should never arise. In our view, consumption of a service like advertising, marketing and sales promotion is an abstract concept which connotes the hearing of a thing, the enjoyment of a thing, the seeing of a thing, the feeling of a thing, the perception of a thing; and when that thing is physically heard, seen, enjoyed, felt, or perceived, that thing has been physically consumed."**

It then deduced that Coca-Cola Export, which is domiciled in United States, whilst requisitioning and paying for the services cannot be the consumer of the service rendered by Coca-Cola Africa **"for the simple reason that the service is heard, seen, enjoyed, perceived, et al by persons and households resident in Kenya.''**

9. The Tribunal, as well, took the view that while the Bottlers are independent of Coca-Cola Africa and Coca-Cola Export, they bottle Coca-Cola products under license from Coca-Cola Export which is the owner of the valued secret formula, the copyright and trade mark to the products. The Tribunal then remarked:-

> **"We would not be right to agree with counsel that the purpose for which Export requisitions for the marketing services of the brand name of a product associated with it, done through the methods described above is merely undertaken for the purposes of making people to be aware of the brand name; and no more. There is an ultimate aim behind the marketing service process, that people should be made aware about brand name of the product, and if they are aware of the brand name of the product, they will purchase the product associated with Export which is bottled by the bottling companies under license."**

10. To the mind of the Tribunal the following were immaterial:-

(a) Where the benefit accrued, or location or jurisdiction of the beneficiary.

(b) The location of the payer for the service or the person who requisitions the service.

(c) The person who earns revenue from the service that is provided.

The Tribunal repeatedly held that the crucial test to be applied is the physical place where the service was consumed or used and that advertising, marketing and sales promotion being an abstract concept can only be consumed when physically heard, seen, enjoyed, felt or perceived.

11. In a lengthy Memorandum of Appeal dated 9th December 2013, Coca-Cola Africa raises 6 grounds which themselves have sub grounds. Some are in fact argumentative and only serve to crowd and eventually obfuscate issues. A memorandum of appeal should, in crisp fashion, set out the grounds upon which an appeal is premised. Arguments, elaboration and the rest is left to hearing. So I abridge the grounds;

i. The Tribunal erred and fact by holding that the marketing and research services provided by Coca-Cola Africa are not services exported outside Kenya within the meaning of the Act.

ii. The Tribunal erred in law in failing to hold that the benefit of the services accrued to Coca-Cola Export.

iii. The Tribunal erred in law and fact in finding that the services rendered by Coca-Cola Africa were not consumed by Coca-Cola Export even though it was the person paying for them.

iv. The Tribunal erred in law in failing to uphold the "destination principle" as set out in the OECD International Guidelines that VAT should be charged in the jurisdiction of the customer in a business to business agreement.

v. The Tribunal erred in law in failing to appreciate that Regulation 20 (1) (a) of the VAT Regulations is *ultra vires* the Act in as far as it attempts to qualify S. 2 of the Act by imposing VAT on services that are physical consumed in Kenya regardless of the location of the payer.

vi. The Tribunal erred in law in allowing the Respondent to rely on evidence that was not annexed to the Respondent's statement of facts.

12. This Appeal is about VAT. It is a destination based consumption tax, one levied on commercial activities, not as a charge on the business but on the consumer. It is therefore a tax on activity. So as to identify who should bears VAT, it is necessary to identify the taxable event.

13. But as acknowledged world over and accepted by both sides, determining the place of consumption with regard to services and intangibles such as marketing and promotional services under discussion here is not a straightforward affair.

14. The starting point in finding an answer to this intractable issue is section 2 of the Act which is the interpretation provision to the statute. There an exported service is described as follows:-

> "A service provided for use or consumption outside Kenya whether the service is performed in Kenya or outside Kenya, or both inside and outside Kenya".

15. Yet the Tribunal took a firm position that the marketing and promotions services were not an exported service and that there was no need to resolve the matter from the standpoint of section 2. The Tribunal held:-

> "In our view, consumption of a service like advertising, marketing and Sales Promotion is an abstract concept which connotes the hearing of a thing, the enjoyment of a thing, the seeing of a thing, the feeling of a thing, the perception of a thing, and when that thing is physically heard, seen, enjoyed, felt or perceived, that thing has been physically consumed".

The finding of the Tribunal was that the services were physically consumed in Kenya and there was no place for section 2.

16. As to the breadth of consumers in Kenya, the Tribunal found as follows:-

> **"It may as well be that the bottlers as well as the wholesalers and retailers are the beneficiaries of the advertisements, sales promotion and marketing services with the result that they soar in profits, as a result of the activities of the Appellant, however, the issue in this Appeal concerns who the consumer of the service is; not the beneficiary of the service unless the beneficiary is also the consumer or unless the beneficiary is located in the jurisdiction of the final consumer; for Regulation 20(1) (a) which clarifies what a local supply is concerns itself with the physical use or consumption of a supply made by a supplier who has established his business or has a fixed physical establishment in Kenya which is the position of the Appellant; and not a beneficiary of a service**

17. Supporting this finding, Ms Lavuna for the Commissioner asserted that a business does not advertise for itself. Advertisement and marketing are undertaken so that someone else consumes the services. Counsel then argued that the consumers of the services were based in Kenya.

18. Of course the Appellant criticizes this approach. Ms Malik for the Appellant was of the view that neither the people buying the final product nor the bottlers had requisitioned for that service. Counsel then sought to make an analogy. KRA has run newspaper advertisements encouraging tax payers to pay on time and in the process could be winners of some prizes. Counsel's argument is that when a tax payer reads the advert he/she is reminded to pay tax on time and therefore avoids late payment penalties. To that extent a benefit accrues to the taxpayer. Counsel however asserts that the consumer of the marketing service is always KRA which benefits from increased tax collection and actually pays the Newspaper to put up the advertisement and is charged VAT for the service.

19. To this illustration, the Commissioner retorts that KRA is not a commercial entity but performing a statutory function. All its publishing activities are undertaken within its mandate of administering tax collection. That despite this, KRA is not exempt from paying VAT on invoices by various service providers. Counsel for the Commissioner then argues that the consumers of the publications are taxpayers because KRA pays for these publications with taxpayers' money. Again, emphasized is that KRA cannot give notices, advertisements or market for its own consumption.

20. I do not perceive the question as to who a consumer or user of marketing and promotional services to be as plain as characterized by the Tribunal. It is not contested that an underlying objective of the services is to maintain and grow the value and importance of Coca-Cola brands, and to increase consumption of Coca-Cola products. Ultimately this translates to increased sales by the Bottlers and therefore more uptake of concentrates from Coca-Cola Export. It is of course true that the target audience for those services is the Kenyan public who are either existing or potential buyers of the Coca-Cola drinks. But does that necessarily make the target audience consumers of the promotional and marketing services? And in posing this question, consumption of the soft drink must not be confused with consumption of the services. Indeed, a promotion or marketing activity may not lead to a sale or consumption of the promoted or marketed product.

21. The Act itself does not define the two key words **"use"** or **"consumption"** but in Black's Law Dictionary (Tenth Edition) use means;

> **"1. To employ for the accomplishment of a purpose; to avail oneself of <they use formbooks>. 2. To put into practice or employ habitually or as a usual way of doing something; to follow as a regular custom <to use diligence in research>. 3. To do something customarily or habitually; to be wont or accustomed <I used to avoid public speaking, but no longer>. 4. *Archaic.* To conduct onself toward; to treat <he uses me well>. 5. To make familiar by habit or practice; to habituate or inure < she is used to the pressure>. 6. To take (an amount of something) from a supply <the firm uses 50 reams of paper each day>. 7. To take advantage of (someone) for selfish purposes; to make (a person) an involuntary means to one's own ends <he uses his interns for personal errands>. 8. To take usu. Improper advantage of (a situation, position etc)<she uses her board membership to threaten staffers>. 9.To regularly take; to partake of (drugs, tobacco, etc) <he uses heroin>."**

Consume means;

> **"1. To destroy the substance of, esp. by fire; to use up or wear out gradually, as by burning or eating <the house was consumed by fire>. 2. To expend wastefully, to waste, to squander <he consumed all his resources within four months>. 3. To use up (time, resources, etc.), whether fruitfully or fruitlessly <45% of the paper we consume is recycled>. 4. To eat or drink; to devour <no alcohol may be consumed on these premises>. 5. To engage the attention or interest fully; to obsess <she was consumed with guilt after her father's death>."**

While, consumption means;

> **"The act of destroying a thing by using it; the use of a thing in a way that exhausts it."**

22. Construed and understood in dictionary sense, does the fact that a person heard, saw, enjoyed, felt or perceived the services mean that the person used or consumed the services? It must be remembered that the Commissioner accepts that a primary objective for providing the services is **"to increase brand awareness resulting in increased consumption of Coca-Cola soft drinks which interprets to increased sales and increased sales and increased profits for the Coca-Cola Company"** (paragraph 3.7 of the Commissioners' statement of facts). The services are not provided so that a member of the target audience can hear, see, enjoy, feel or perceive them for the sake of it but in the hope (of the provider of the services) that it triggers a purchase or a desire to purchase a Coca-Cola product. Contrast this with a person who purchases a ticket at a cinema hall to watch a 3D movie. That person hears, sees, perceives and perhaps feels the movie for the sake of enjoying, learning or for some like reason and for his own satisfaction or to fulfil a need. The same can be said about a person who buys a concert ticket to watch and hear his favourite artist. Unlike the two examples the person offering promotional and marketing services offers the services at no fee to the audience but in expectation that it will trigger a sale now or in the future. It may well be that the person becomes a user or consumer of the services only when, at the instigation or encouragement of the services, he consumes a product of Coca-Cola. What is to be said of the person who sees, enjoys, hears, perceives or even enjoys an advertisement but does not act on it. Can that person be said to have used or consumed the advertisement. Yet I must make it clear that at this point I make no call one way or other but only seek to demonstrate that the argument by Coca-Cola Africa that the Tribunal should not have excluded the provisions of section 2 in determining this matter is not a quibble.

23. Unraveling the question is not made any easier as the services offered by Coca-Cola Africa are in the context of a business to business relationship with Coca-Cola Export. This is was brought to the notice of the Tribunal and expressly conceded to by the Commissioner in further submissions filed on 30th January 2019 in this Appeal. In that relationship Coca-Cola Africa proclaims itself to be supplying the services to Coca-Cola Export at the pain of a fee by the latter. If the services are taken to be for purposes of business operations or as support services to business (in same category as logistical services which gets the product to the final customer or research and development to improve the product), can it be really said, without further ado, that for VAT purposes the final consumer of the Coca-Cola drink is the consumer of the services?

24. Given my appreciation of the difficulties above, the Court prefers not to be as quick as the Tribunal in deciding that the services offered by Coca-Cola Africa are physically used or consumed by the Kenyan audience. In the absence a statutory definition of the phrase **"used"** or **"consumed"**, the Court must look elsewhere to discover whether the use or consumption of the services is in or outside Kenya.

25. Citing Guidelines 1 through 3 of the OECD Guidelines Coca-Cola Africa contends that;-

a) Services provided by it are taxable in the jurisdiction of consumption.

b) The jurisdiction of consumption is the location of the customer of its services and;

c) The identity of the customer of its services should be determined by reference to the business agreement for the provision of such services.

26. The Coca-Cola Africa makes reference to a business agreement between it and Coca-Cola Export. Under the agreement, it receives a fee for the marketing and promotion services. The Appellant submits that the Coca-Cola Export is the customer for purposes of determining the correct jurisdiction to charge VAT. Coca-Cola Africa further argues that it does not receive any compensation for the performance of the services from independent Bottlers and neither are purchasers of the products from the independent bottlers the consumers of the services.

27. This Court was asked to give regard to the Main Rule for determining the jurisdiction of consumption of international services in the OECD guidelines. This Rule is discussed later in this decision. Coca-Cola Africa asserts that no reason exists to deviate from the general rule as long as VAT eventually applies upon final consumption as it does where the concentrate is imported into Kenya and sold to consumers in Kenya as ready to drink beverages.

28. The Appellant emphasized that imposition of VAT on the exported services would be contrary to the neutral application of VAT advocated by OECD guidelines. That this would result in the double imposition of VAT on such services, once upon export of the services by it and again upon import of the concentrate by the bottler.

29. In support of its arguments, the Appellant beseeched this Court to borrow a leaf from Courts and Tribunals in other jurisdictions who have considered the term **'used'**. Decisions cited to this Court such as **M/s Fanuc India Pvt v/s CCE & ST, Bangalore, Microsoft Corporation (I) (P) vs. Commissioner of Service New Delhi and Paul Merchants Ltd. vs. CCE, Chandigarh** shall be considered by this court.

30. The Appellant also sought to draw inspiration from two recent decisions of the Tribunal in **Coca- Cola Central, East and West Africa Vs Commissioner of Domestic Taxes (TAT Appeal No. 5 of 2018) and LG Electronics Africa Logistics Kenya Branch vs. The Commissioner of Domestic Taxes (TAT No. 359 of 2018).**

31. Relying on Section 2 of the Act and Regulation 20 of the Value Added Tax Regulations, the Commissioner argues that as long as a supply of service is provided physically in Kenya and are physically used in Kenya, then the supply is deemed to have been in Kenya. This would be regardless of the payer of the services being outside of Kenya. The Commissioner underscores that what is pertinent is the location of the consumer of the service.

32. Regarding the role of the bottling companies in marketing, the Commissioner was in agreement with Paragraph 127 of the Tribunal's finding that:-

> **"We agree that the bottling companies are independent of the Appellant and Export. But these companies bottle the Coca Cola products under license (as we were told) from Export (we presume) which is the one of a trade secret or secret formula as we understand it from our Intellectual Property law, as well as the owner of Copyright (design of its bottle, logo) and Trade Mark, (to prevent people from passing off its products)."**

33. The Commissioner references the service agreement to press the point that no distributor can carry out any advertising without the consent or delegated authority of the Appellant, which is the company contracted to provide these services.

34. The Commissioner accepts the applicability of the **'Destination principle'** enshrined in guideline 3.1 of the OECD guidelines which basically provides that on, internationally traded services, VAT is imposed at the point of consumption. The Commissioner, nevertheless, submits that one cannot advertise a product to himself. It is done with a view to provoking the consumer of the advertisement to buy the product.

35. On double taxation, the Commissioner takes the position that it is a hollow argument as long as it is not shown that similar tax was paid by Coca-Cola Export in the USA for the same supply.

36. The Organization for Economic Co-operation and Development (OECD) has developed VAT Guidelines in International Trade and Services in intangibles. The intention of the Guidelines is to address uncertainty and risks of double taxation and unintended non-taxation that result from the inconsistencies in the application of VAT to international trade and specifically trade in services and intangibles. It is common ground that OECD guidelines have a place in the interpretation of Kenyan tax law. On this place, Visram (J)(as he then was) in **Unilever Kenya Limited vs The Commissioner of Income Tax** (Income Tax Appeal No. 753 of 2003) **[2005] eKLR** said:-

> **"I have no doubt in my mind that the OECD principles on income and on capital and the relevant guidelines such as "Transfer Pricing" principles, the CUP method adopted for calculations of what ought to be the income, the Cost Plus Return method as well as Resale Minus Method adopted for looking into compliance with arm's length principles are not just there for relaxed reading. These have been evolved in other jurisdictions after considerable debates and taking into account appropriate factors to arrive at results that are equitable to all parties. 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 laws. To do otherwise would be highly short-sighted."**

37. A caveat is that the Guidelines are inapplicable where our tax statutes have an express provision which are not in consonance with the Guidelines. In that event the provisions of our statutes prevail.

38. Save for Regulation 20 of the VAT regulations (which this Court shall return to in due course), the statute itself does not flesh out the two important phrases that appear in the definition provision, **"use or consumption outside Kenya"** and **"performed in or outside Kenya"**. The Guidelines are, therefore, an invaluable tool in determining the place of use and consumption where, like here, it is not readily apparent that a service is used or consumed in Kenya.

39. Three main guidelines have been identified by Coca-Cola Africa as being useful in determining whether the marketing and advertising services offered by it are **"services provided for use or consumption outside Kenya."**

40. Before discussing these guidelines, I again state that there is consensus that the relationship between Coca-Cola and Coca-Cola Export is a business to business relationship. In this regard Guideline 3.1 of the OECD guidelines on Business to Business supplies would be the relevant provision.

41. Guideline 3.1 reads:-

"For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption."

It is explained that this is primarily to maintain neutrality within the VAT system as it applies to international trade. So where there is supply of an international service, it will be free of VAT within the suppliers own jurisdiction. It is expected that the jurisdiction where the consumption is deemed to occur will replicate, in so far as this is possible, by requiring that any VAT due is charged at importation.

42. On proxies to determine jurisdiction of consumption so as to apply Guideline 3. 1, Guideline 3. 2 provides:-

"For business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles."

The Guidelines note that by and large, a business buys a service from another jurisdiction for purposes of its business operation. The Court needs to emphasis that for this guideline to apply, this assumption must hold true. This may have some significance to this matter and the Court shall return to it.

43. Guideline 3.2 further elaborates that;

"The jurisdiction of the customer's location can stand as the appropriate proxy for the jurisdiction of consumption as it achieves the objective of neutrality. This is the jurisdiction where the customer has located its permanent business presence."

This proxy, christened the **"Main Rule"** in the Guidelines is to the effect that **"jurisdiction where the customer is located has the taxing rights over a service or intangible supplied across international borders".**

44. Guideline 3 counsels on determining customer location as follows:-

"The identity of the customer is normally determined by reference to the business agreement".

It is expected that the business agreement reflects the underlying supply. As to what is a business agreement, the Guideline provides:-

"Business agreements consist of the elements that identify the parties to a supply and the rights and obligations with respect to that supply. They are generally based on mutual understanding."

45. Shown to the Tribunal and also to this Court is the service agreement entered between Coco-Cola Export and the Appellant. The Appellant asked the Tribunal and this Court to find that it is the business agreement contemplated by Guideline 3.3. On the other hand, Counsel for Commissioner cautions that the term **"business agreement"** should not be construed in a technical manner and I agree because the Guidelines themselves state that the term has to be adopted as a general concept. This may be important because a business agreement can be dressed up to give a semblance of the business agreement contemplated in the Guidelines yet the relationship between the parties, looked at as a whole, reveals that important aspects have been deliberately or otherwise excluded from the written word of the agreement. I keep this caution in mind.

46. The recital of the Agreement provides:-

"WHEREAS, EXPORT having the right to market brands owned by or licensed to the Coca-Cola Company (hereinafter referred to as "Coca-Cola"), Beverage Partners Worldwide S.A (hereinafter referred to as "BPW"), Schweppes Holding Limited (hereinafter referred to as "SHL" and Atlantic Industries ("AI") shall assist Coca-Cola, BPW, SHL and AI by contracting with service providers for the performance of services in various countries including but not limited to Kenya, Eritrea, Ethiopia, Somalia, Tanzania, Uganda, Mauritius, Burundi, Reunion, Djibouti, Rwanda, Madagascar, Congo, Seychelles, Comoros, Mayotte, Democratic Republic of Congo, Angola, Malawi, Mozambique, St. Helena, Zambia, Zimbabwe, (hereinafter referred to as the "Territory(ies)") related to the beverages (hereinafter collectively referred to as the "Beverages") marked under trademarks owned by or licensed to Coca-Cola, BPW, SHL and AI."

47. Under the Agreement, Coca-Cola Africa was to provide services for purposes related to marketing and production of beverages, the enforcement of all quality control standards and specifications established by Coca-Cola, BPW, SHL and AI. The agreement, in clause 1, details the services to be provided by it to Coca-Cola Export. In terms of clauses 2 and 3, Coca- Cola Export pays Coca-Cola Africa for the services.

48. At first blush, Coca-Cola Export passes for the customer under Guideline 3.

49. In the statement of facts filed by Coca-Cola Africa, it states that:-

"3. The Coca-Cola Company and its subsidiaries market, manufacture and sell proprietary concentrates used to prepare trademarked beverage products. Operating revenues are generated by selling concentrate to authorized bottlers, who use the concentrate to prepare and package finished beverages products for sale to retailers. The Coca-Cola Company has transferred rights to use the Coca-Cola trademarks outside the United States to certain subsidiaries, including the Coca-Cola Export Corporation (Coca-Cola Export).

4. Coca-Cola Export is incorporated in the Unites States of America.

5. Coca-Cola Export and its subsidiaries manufacture concentrates in various locations around the world outside of Kenya. Unrelated bottlers purchase and import concentrate for use in the preparation and packaging of beverage products that bear Coca-Cola trademarks in specified territories within Kenya and elsewhere. Value Added Tax (VAT) is paid in Kenya on the import of concentrate into the country."

50. Emphasized as well is that the Appellant charges a fee for the marketing and promotion services whose purpose is to maintain and grow the image, value and importance of the Coca-Cola branches, which has the further benefit of enhancing and encourage sales of concentrates by Coca-Cola Export and its subsidiaries. The Appellant also states that Bottling Companies are independent entities that conduct distribution and sales activities.

51. The Respondent, on the other hand, states that through the marketing activities, the Appellants seeks to increase brand awareness resulting in increased consumption of Coca-Cola soft drinks which interprets to increased sales and increased profits for Coca-Cola Company. That the beneficiaries of the services are the Bottlers who sell more products as a result of the awareness created by the advertisements.

52. I would think that the nexus between the marketing and promotional activities and the activities of the bottling companies needs to be interrogated further. In the service agreement between the Appellant and Coca-Cola Export appears a reference in regard to the Bottlers.

"CCECA shall provide the following services to EXPORT in accordance with instructions it shall receive from EXPORT from time to time.

a) .....

b) Recommendations to EXPORT with respect to EXPORT's participation, if any, and the bottlers' marketing or promotion expenditures and/or in the conduct of EXPORT's own marketing or promotion expenditures."

53. The service agreement contemplates that Coca-Cola Export could participate in marketing and promotion expenditures of the Bottlers. There is then this fairly revealing information from the Coca-Cola Africa in its letter of 9th March 2011 to the Commissioner:-

"Through its marketing activities, CCECAL seeks to increase brand awareness, resulting in increased consumption of Coca-Cola soft drinks. While the increase in marketing activities benefits the bottling Companies, these companies are independent and the Coca-Cola Export Corporation does not participate in their profits.

In Kenya, the activities, of bottling soft drinks and marketing of the Coca-Cola brand are carried out separately with CCECAL engaged in the marketing activities while independent bottling companies engage in the bottling of the soft drinks. The increase in sales of Coca-Cola brands in the region is only a measure of the success of the marketing activities that CCECAL undertakes."

(My emphasis)

54. Although counsel for Coca-Cola Africa underscored that the Bottlers engaged in their own marketing and promotional activities, it is clear from the contents of the letter that the Bottlers benefit directly from the marketing activities of Coca-Cola Africa through increased sales. Indeed, the letter itself does seem to suggest that the Bottlers do not engage in marketing activities.

55. The Appellant nevertheless argues that it should not matter that the Bottlers also benefit because they neither procure nor pay for the services. In this regard, the Court was referred to the cases of **M/s Microsoft Corporation (I) (P) ltd Vs. Commissioner of Service, New Delhi 2014-TIOL-1964-CESTAT-DEL** and **Fanuc India Pvt Ltd Vs. Commissioner Of Central Excise & St Bangalore 2010 IST-571-Cestat-Bang**. Let me give attention to these two decisions.

56. In Fanuc, the Tribunal gives the following example:-

"Similarly, if an Indian event manager (a category II service [Rule service [Rule 3(1) (ii)]) arranges a seminar for an Indian company in U.K. the service has to be treated to have been used outside India because the plane of performance is U.K even though the benefit of such a seminar may flow back to the employees serving the company in India."

57. In Microsoft, Mathew John a member of the Tribunal observed:-

"I am of the view that the service that is sought to be taxed is the service provided to the person paying for the service and not the service which is provided to a person in India who is not paying for the service though such person may also be a beneficiary of such service."

58. Elsewhere in the decision another member, Archana Wadhwa stated:-

"Even otherwise also, I find that the disputed service being provided by the appellant to his principal located in Singapore. The marketing operations done by the appellant in India cannot be said to be at the behest of any Indian customer. The service being

provided may or may not result in any sales of the product in Indian Soil. The transactions and activities between the appellant and Singapore principal company are the disputed activities. As such, the services are being provided by the appellant to Singapore Recipient Company and to be used by them at Singapore, may be for the purpose of the sale of their product in India, have to be held as export of services."

59. In the Fanuc illustration, the benefits alluded to were to the employees of the company providing the service. No useful comparison can be drawn because in the matter at hand it is not the benefit that accrues to the local employees of Coca-Cola Export that is under scrutiny, it is a benefit to a related party. While the facts in Microsoft can be abridged to demonstrate some dissimilarity with this matter. In a market development agreement, Microsoft Operation PVT Ltd (MO) appointed Microsoft Corporation (I) P Ltd (MC) to provide technical support services including marketing of Microsoft products in places which included India. Both MO and MC were wholly owned subsidiaries of Microsoft Corporation of Washington. It was acknowledged by that the "consumer benefiting from the products sold in India and the after sales services done in India are located in India." Very much like the consumers of the finished beverage products in Kenya. However, there is a difference because in this matter and on evidence available from no less Coca-Cola Africa, it is the entity which is charged with marketing the Coca-Cola brand in Kenya while the bottling companies bottle the beverages. The Bottlers, whilst not paying for the services, are a major beneficiary of the marketing and promotional services as it can lead to the increase in sales of the Coca-Cola brands. A stated objective of the marketing activities is that it seeks brand awareness resulting in increased consumption of Coca-Cola soft drinks (page 7 of the letter of 9th March 2011). In this way the Bottlers are direct beneficiaries of the marketing and promotional services. They are not peripheral.

60. So as not to attract the suspicion that the arrangement is not merely a devise to avoid or to artificially minimize VAT, Coca-Cola Africa needed to prove that there was no leak in tax from Kenya and further that the arrangement does not lead to unintentional none taxation given no tax similar to VAT is imposed on the services in the State where Coca-Cola Export is domiciled. The onus of proof lay squarely on the Appellant (See **Metcash Trading Limited Vs. The Commissioner for the South African Revenue Service and another, Constitutional Court of South Africa Case CCT 3/2000**). If the business model adopted by it and Coca-Cola Export led to avoidance or minimization of VAT, then it would not benefit from the Main Rule principle. The OECD Guidelines themselves foresee that there will specified and exceptional circumstances where the place of taxation will vary from the Main Rule. In this regard Guideline 3.6 is relevant and reads:-

> **"The taxing rights over internationally traded services or intangibles supplied between businesses may be allocated by reference to a proxy other than customer location laid down as laid down in Guideline 3.2 when both the following conditions are met:**
>
> **a. the allocation of taxing rights does not lead to an appropriate result when considered under the following criteria**
>
> **-Neutrality**
>
> **-Efficiency of compliance and administration**
>
> **-Certainty and simplicity**
>
> **-Effectiveness**
>
> **-Fairness**
>
> **b. A proxy other than customer location would lead to a significantly better result when considered under the same criteria."**
>
> *(My emphasis)*

The criteria for fairness intends that the potential for tax evasion and avoidance should be minimized while keeping counteracting measures proportionate to the risks involved.

61. And at this juncture I have to commend Counsel for the Commissioner who argued against the Appeal at the Tribunal for bringing the provisions of this Guideline to the attention of the Tribunal.

62. Other than counsels statement from the Bar that the Bottlers also engage in marketing and promotional services, no evidence was put forward to debunk the Appellant's own admission that the mandate of marketing and promoting the Coca-Cola brand in Kenya is very substantially if not solely that of the Appellant. If the Appellant did not provide those services, then the Bottlers would have to undertake them. Payment for those services would attract VAT in Kenya and that would be passed to the final consumer. A red flag of tax avoidance could be raised because major beneficiaries of the services (the Bottlers) are in Kenya yet do not pay VAT for the services. But something sways me away from holding in favour of the Commissioner.

63. The evidence before the Tribunal and this Court, and this is borne out by the service agreement, is that Coca-Cola Export has the right to market brands owned by or licensed to the Coca-Cola Company, Beverage Partners Worldwide S.A, Schweppes Holdings and Atlantic Industries. Under the service Agreement Coca-Cola Export engaged the Appellant in services related to marketing and production of the beverages, and the enforcement of all quality control standards and specifications.

64. In the Appellant's statement of facts filed herein, and not disputed by the Respondent, the Appellant explains the relationship between Coca-Cola Company, Coca-Cola Export, the Appellant and Coca-Cola Bottlers. Coca-Cola Company and its subsidiaries market, manufacture and selling proprietary concentrates used to prepare trademarked beverage products. Operating revenues are generated by selling concentrates to authorized bottlers who use the concentrates to prepare and package finished beverage products for sale to retailers.

Coca-Cola Company has transferred rights to use the Coca-Cola trademarks outside United States in certain subsidiaries, including Coca-Cola Export. Coca-Cola Export and its subsidiaries manufacture concentrates in various locations around the world outside of Kenya. The bottlers in Kenya purchase and import concentrates for use in preparation and packaging of beverage products within Kenya. Value Added Tax (VAT) is paid in Kenya on the import of concentrate into the country.

65. It is common ground that under the terms of the service agreement, Coca-Cola Export pays fees to Coca-Cola Africa for services rendered, including promotional and marketing services. The Appellant strongly argues, I would have to agree, that inbuilt in the cost of the concentrate that is imported into Kenya are expenses incurred by Coca-Cola Export in the promotional and marketing activities in Kenya. Argued by Coca-Cola Africa is that all costs in the chain of activities prior and up to the point of importation of the concentrate into the Country is paid by the Bottlers when they purchase it. It therefore seems to me that the expenses on promotional and marketing services does not escape the VAT charge because the charge of VAT on the concentrate would partly be a charge on its costs, which includes these expenses. For that reason, the Court is not persuaded that the arrangement avoids or minimizes VAT and there is no reason for this Court to deviate from the Main Rule. In addition, the model of business does not lead to unintended none taxation. I need not belabor that the outcome may well have been different if the expenses incurred in the promotion and marketing did not find their way back into Kenya as part of a cost of an import.

66. In closing, the Court makes an observation on the proposition by Counsel for Coca-Cola Export that Regulation 20 of the VAT is *ultra vires* the Act. Regulation 20 reads:-

> **"20. Services supplied in Kenya**
>
> **(1) Except as is otherwise provided in the Act, services shall be deemed to have been supplied in Kenya—**
>
> **(a) where the supplier has established his business or has a fixed physical establishment in Kenya and the services are physically used or consumed in Kenya regardless of the location of the payer;**
>
> **(b) in connection with immovable property, the property is situated in Kenya; or**
>
> **(c) in connection with receiving a signal or service for the supply of television, radio, telephone or any other communication services, the person receiving the signal or service is in Kenya.**
>
> **(2) Where transportation ends outside the country, the transport services shall be deemed to have been supplied outside the country."**

67. On the other hand, the meaning of a service exported out of Kenya is **"a service provided for use or consumption outside Kenya whether the service is performed in Kenya or outside Kenya, or both inside and outside Kenya''(section 2).** Clearly the place of performance is irrelevant. My observation is that although Regulation 20 emphasizes on the place of the business of the supplier and physical use or consumption in Kenya, it does not derogate from the requirement of section 2 that for a service to be deemed as exported it has to be a service provided for use or consumption outside Kenya. In that sense it does not conflict with the provisions of the main Act and any attempt to read into it a restriction of the provisions of the Act will be a misreading of the Regulation. In that regard the Court agrees with the holding of the Tribunal that:-

> **"113. For a start, Regulation 20 (1)(a) has not nexus with a service exported out of Kenya as defined under s.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 its 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.**
>
> **114. The Regulation is not *ultra vires* the definition of an exported service at s.2 of the VAT Act. It simply clarifies that if a service supplied by a person with a fixed place of business in Kenya is physically used or consumed in Kenya, that supply is a local supply. On the other hand, if a service has truly been provided for use or consumption outside Kenya, making it an exported service, the issue of Regulation 20 cannot come in. Put another way, when a service is exported out of Kenya, it does not a local supply because it is provided for use or consumption outside Kenya, hence it is not physically consumed or used in Kenya and therefore Regulation 20 cannot apply. Conversely, if a service supplied by a person with a fixed place of business in Kenya has been physically consumed or used in Kenya, the issue of exported service does not arise because it is not provided for use or consumption outside Kenya and the issue of Regulation 20(1)(a) then is applicable. A service cannot be physically consumed in Kenya if it's an exported service."**

68. But for reasons given, I am unable to agree with conclusion reached by the Tribunal. I allow the Appeal. The decision of the VAT Tribunal of 26th November 2013 is hereby set aside. Costs of the Appeal to the Appellant.

Dated, Signed and Delivered in Court at Nairobi this 23rd Day of November 2020.

F. TUIYOTT

JUDGE

ORDER

In view of the declaration of measures restricting Court operations due to the COVID-19 pandemic and in light of the directions issued by his Lordship, the Chief Justice on 17th April 2020, this Judgment has been delivered to the parties through virtual platform.

F. TUIYOTT

JUDGE

PRESENT:

Ms Malik for Appellant.

Ochieng for Respondent.