REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

COMMERCIAL AND TAX DIVISION

INCOME TAX APPEAL NO. 5 OF 2018.

PANALPINA AIRFLO LIMITED.....APPELLANT

-VERSUS-

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

1. This appeal originates from the decision of the Tax Appeals Tribunal (hereinafter **"the Tribunal"**) delivered on 9th March 2018 in Tax Appeal No. 115 of 2016 consolidated with Tax Appeal No. 149 of 2016 arising from the respondent's objection decisions dated 18th July 2016, 4th October 2016 and 10th October 2016 .

2. The appellant filed the Memorandum of Appeal and statements of Facts on 16th April 2018. The respondent herein, the Commissioner of Domestic Taxes, opposed the Appeal and similarly filed a Statement of Facts on 21st September 2018.

3. On 6th December 2018, this court (differently constituted) issued directions that the appeal be canvassed by way of written submissions which the parties' counsel highlighted during the hearing that was conducted on 13th March 2019.

The appellant's case

4. The appellant describes itself as a limited liability company incorporated in Kenya wherein it carries out the business of provision of handling services including documentation, cold room handling vacuum cooling and security (x-ray screening) services to its client one Palpina Airflow BV, a limited liability company incorporated in the Netherlands and engaged in the business of offering logistical services to its customers in the Netherlands. It is the appellant's case that as part of the said logistical operations, Airflow BV entered into an agency contract with the appellant for purposes of offering logistical services in respect to export of flowers from Kenya. It is the appellant's contention that the said logistical services rendered are under the provisions of the Value Added Tax (VAT) treated as export of services and are therefore Value Added Tax zero rated as indicated in the appellants Value Added Tax returns for the period in dispute thereby precipitating the appellant's claim for Value Added Tax refund for kshs 1,367,706 and kshs 1,991,890 for the months of July and August 2015 respectively.

5. The appellant made subsequent claims for Value Added Tax refunds for the months of January 2016 and December 2015 for the sum of kshs 2,221,584 and 2,168,449 respectively and states that despite the fact that the respondent issued it with a "VAT claim Approval order," the respondent remarked that the supplies in question were not zero rated and that no Value Added Tax refunds would be made thereby triggering the filing of the notices of objection to the respondent who in turn confirmed its rejection of the Appellant VAT refund claims.

6. Aggrieved by the rejections, the appellant filed notices of appeal to the Tribunal being Tax Appeal numbers 115, 148 and 149 of 2016 in which it listed the following grounds:

> ***a) That the respondent erred in law and fact in alleging that the Appellant's services are subject to VAT contrary to the Appellant's assertions that the services were exported services which ought to be zero rated for VAT purposes.***
>
> ***b) That the respondent has and continues to err both in fact and in law by holding that the services offered by the Appellant are not exported services and purports that the services are used and consumed in Kenya.***
>
> ***c) That the respondent erred in law when it refused, declined and or ignored the provisions of the VAT Act under Section 7 and Section 17(5) which allow a tax payer to seek refund of excess input where he excess arises from making zero rated supplies.***

d) That the respondent erred in law by failing to provide comprehensive and satisfactory written reasons as to how they have arrived at their decision despite the Appellant clearly pointing out to the respondent that Section 7 as read together with Section 17 of the VAT Act (No 35 of 2013) allows a tax payer to seek refund of excess input tax, where the excess arises from making zero rated supplies.

7. In a judgment delivered on 9th March 2018 the Tribunal dismissed the said appeals and aggrieved by the said decision, the appellant filed the instant appeal in which it listed 12 grounds of appeal which can be summarized as follows:

1. That the Tribunal erred in finding that " the beneficiary of the services provided by the appellant was the exporter of the horticultural produce who is based in Kenya and hence the services are considered to be consumed in Kenya" and therefore consumed in Kenya attracting VAT at the Standard Rate of 16%.

2. The Honourable Tribunal erred in failing to find and hold that, in any event, assuming that it was the correct test, the ultimate beneficiaries of the Appellant's services were the clients of Airflow BV Limited, foreign based entities who had purchased the produce, FoB, from the local producers.

3. The Honourable Tribunal fundamentally erred in law in finding that pre- shipment services rendered should be considered to have been consumed locally before the issuance of the Bills of lading to Airflow BV because that is when the export commences, and were therefore subject to VAT at the standard rate of 16%.

4. The Honourable Tribunal misconstrued and consequently misapplied the provisions of Section 8(1) and (2) of the VAT Act, 2013 as overlooking the express terms of Section 2 of the VAT Act, 2013, which defines an exported service as one that is '… provided for use or consumption outside Kenya…' as is the case at hand. The fact the services were offered by the Appellant in Kenya is irrelevant in this case. For a service to be exported, for purposes of Section 2 of the VAT Act, 2013, the single requirement is that the place of consumption has to be outside Kenya.

5. The Honourable Tribunal erred in finding that OECD Guidelines are not applicable in this case on the basis that there is no ambiguity in the law yet the VAT Act, 2013, has not defined what amounts to a 'place of consumption' for purposes of determining whether there is an export of service or not.

8. At the hearing of the appeal Mr. Amoko learned counsel for the appellant posed the question of who the ultimate consumers of the products in question was and submitted that there was a misconception or error on the part of the Tribunal in holding that it is the exporters should pay VAT when the applicable law is clear that where a person offers services which are consumed outside Kenya (an export) the same shall be subjected to VAT at a zero rate.

9. It was submitted that under Section 2 of VAT Act, it is the place of consumption that determines whether VAT is payable or not. For this argument counsel relied on the decision in **F.H. Services Ltd vs Commissioner of Domestic Taxes Appeal No.6 of 2012** wherein it was held;

" The benefit of the services offered by the Appellant accrues outside Kenya for the simple reason that the beneficiary of this service is the final consumer of the flowers who is located far away from Kenya, in Holland, the destination jurisdiction ….It is for this reason that it is very clear in our minds that these services and all services that accompany and occasion exportation are provided of the sole purpose of benefitting the final consumer who is not in Kenya, the origin jurisdiction, but the final consumer who is located in the destination jurisdiction and therefore provided for the use or consumption outside Kenya…."

10. Counsel also relied on the decision in the case of **Commissioner of Domestic Taxes vs Total Touch Cargo Holland Income Tax Appeal No. 17 of 2013 in** which the decision of the Tribunal was overturned for similar reasons as the ones highlighted in this appeal.

The Respondent's case

11. As I have already noted in this judgment, the Respondent opposed the appeal through its statement of facts dated 20th September 2018. The respondent states that the services offered by the appellant are not export services and should therefore be charged VAT at the standard rate of 16%. The respondent's position is that the services offered by the appellant in Kenya are to ensure that that the flowers are in 'exportable' state thus making the services consumed and utilized in Kenya.

12. It is the respondent's contention that consumption is not determined by reference to the payer, the location of the person who is requesting for the service and asserts that Airflow BV was contracted by the appellant to offer services but it that it is not the services that were exported as the export was only in regard to the flowers. The respondent urged the court to uphold the judgment delivered by the tax Appeal Tribunal on 9th March 2018 and find that the instant appeal is without merit.

Analysis and Determination.

The law

Section 2 VAT Act defines services to mean**,** *anything that is not goods or money;*

Section 5 VAT Act on the other hand provides that *(5) Tax on the importation of taxable goods shall be charged as if it were duty of customs and shall become due and payable by the importer at the time of importation*.

Section 8 of the said Act stipulates as follows:-

Place of supply of services

(1) A supply of services is made in Kenya if the place of business of the supplier from which the services are supplied is in Kenya.

(2) If the place of business of the supplier is not in Kenya, the supply of services shall be deemed to be made in Kenya if the recipient of the supply is not a registered person and—

(a) the services are physically performed in Kenya by a person who is in

Kenya at the time of supply;

(b) the services are directly related to immovable property in Kenya;

(c) the services are radio or television broadcasting services received at an address in Kenya;

(d) the services are electronic services delivered to a person in Kenya at the time of supply; or

(e) the supply is a transfer or assignment of, or grant of a right to use, a copyright, patent, trademark, or similar right in Kenya.

Section 7 states:-

Zero rating (1) Where a registered person supplies goods or services and the supply is zero rated, no tax shall be charged on the supply, but it shall, in all other respects, be treated as a taxable supply. (2) A supply or importation of goods or services shall be zero-rated under this section if the goods or services are of the description for the time being specified in the Second Schedule.

Section 17(5) of the Act stipulates that:-

(5) Where the amount of input tax that may be deducted by a registered person under subsection (1) in respect of a tax period exceeds the amount of output tax due for the period, the amount of the excess shall be carried forward as input tax deductible in the next tax period: Provided that any such excess shall be paid to the registered person by the Commissioner where— (a) the Commissioner is satisfied that such excess arises from making zero rated supplies; and (b) the registered person lodges the claim for the refund of the excess tax within twelve months from the date the tax becomes due and payable.

Issues

13. I find that the main issue for determination is whether the services rendered by the appellant herein can be considered to be exported services within the meaning of section 2 of VAT Act. The Tribunal found in favour of the respondent by holding that the services rendered by the appellant are not export services within the meaning of section 2 of the V.A.T act and therefore ought to be taxed at 16%. In determining this issue I find it necessary to highlight the relevant part of the Tribunal's decision that gave rise to this appeal. The Tribunal held as follows:-

> ***"as related to the first issue the tribunal is of the view that the location of a person making a requisition or effecting payment for a service does not in itself amount to a place of consumption. Essentially, consumption is not determined by reference to the payer, location of the payer of the service or location of the payer of the service or location of the person who is requisitioning for the service. What is important is the place of the consumption of the service. The mere fact that an overseas company requisitioned for the services from the appellant does not necessarily mean that it was the consumer of the services rendered by the appellant."***

14. The appellant on the other hand contends that the services offered by Airflow BV are exported services and should therefore be VAT zero rated. According to the appellant, the place where the service is consumed is what determines whether the services rendered are exported or not. In this regard, the appellant argued that since Netherlands was the place where the flowers were to be consumed, the services in dispute were exportable services. As I have already noted in this judgment, the respondent was of the contrary view.

15. Section 2 of the VAT Act describes *an export to mean to take or to cause to be taken from Kenya to a foreign country, a special economic zone enterprise or to an export processing zone. While a service exported out of Kenya is defined as a service provided for use or consumption out of Kenya.*

16. It is important to note that the VAT Act does not describe the meaning of the words 'use' or 'consumption'. The appellant relied on the Blacks Laws dictionary definition of *consumption* as *"the act of destroying a thing by using it; the use of a thing in a way that thereby exhausts it.."* This case however revolves around the interpretation of services for export as provided for in section 2 of the VAT Act 2013.

17. While placing reliance on the decision in the case of **Cape Brandy Syndicate vs. Inland Revenue Commissioner [1921] 1 KB 64,** the respondent submitted that in the interpretation of tax laws the court must only look at what the Act states. In the cited case, the court held:

> ***"In a taxing Act one has to look merely at what is clearly stated. There is no room for any intendment. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used"***

18. The respondent also cited the case of **Russell (Inspector of Taxes) vs. Scott [1943] AC 422 at 433** wherein it was held:-

> ***"I must add that the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind I feel that the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected...my Lords, there is a maxim of income tax law, which though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose tax upon him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion."***

19. The appellant on the other hand, cited the decision in the case of **FH Services Kenya Limited V Commissioner of Domestic Taxes (supra), Commissioner of Domestic Taxes v Total Touch Cargo Holland (supra)** and **Republic v Kenya Revenue Authority & Another Ex-Parte Fontana Limited 2014 eKLR** wherein the various courts held that for a service to be deemed as exported, it matters not whether the service is performed in Kenya or outside Kenya as the determining factor is the location where the service is to be finally consumed or used, which should be outside Kenya.

20. In the Indian case of **Paul Merchants Ltd –Vs- Cce Chandigarh [2012 (12) TMI 424 – CESTAT, DELHI LB]** the tribunal was of the view that even though the services in question were rendered in India the word "u**sed"** could not be equated with the word "**performed**" especially where the benefit of the service provided accrued outside India. Further in the case of **Ms Microsoft Corporation (1) (P) –Vs- Commissioner Of Service New Delhi. WP (c) NO.1460/2009** (Also an Indian Authority) the Tribunal concluded that the words "**used outside India**" referred to the place where the benefit of the service accrued.

21. As can be seen from the judicial experience in the above cited authorities, this is not the first time that the court is grappling with the issue of whether services, such as those rendered by the appellant herein, should be considered as exported services within the meaning of section 2 VAT Act. In the present case, it was not disputed that the services offered by the appellant's agents was to facilitate the export of flowers for consumption and use by persons outside Kenya. These eventual buyers were the appellant's customers in Europe and specifically Netherlands. It was also not in dispute that the purpose of the services provided by **Airflow BV** was to ensure that the flowers are delivered to the appellant's customers in Europe a fresh state. The appellant, on whose behalf the services were being performed, was also based outside Kenya. It is therefore crystal clear that the services in question were ultimately used by the buyers/consumers of flowers who were also outside of Kenya and were performed on behalf of the appellant, a company based outside Kenya.

22. Having found that our courts have had occasion to pronounce themselves on the interpretation of Section 2 of the VAT Act, I find that I have no reason to reinvent the wheel by deviating from the position that has been adopted by the court in similar matters. In this regard I am in agreement with the findings of Odero J. in the case of **Commissioner of Domestic Taxes v Total Touch Cargo Holland (supra) wherein it was held:-**

> ***"From the above it is clear that Section 2 of the repealed VAT Act which stipulates that an "exported service" is that which is provided for use or consumption outside Kenya is in keeping with the destination principles under the OECD guidelines. As such the taxing rights in terms of VAT to be charged on the services offered by KAHL to the Respondent is in the Netherlands and not in Kenya, since the final consumer of the horticultural produce and flowers being prepared for export is the Respondent and its customers in Europe."***

23. In conclusion and having regard to the destination principle which provides that internationally traded services should be taxed according to the rules of jurisdiction of consumption and having found that the ultimate consumer of the impugned services is not within Kenya, I find that the instant appeal is merited and I allow it in the following terms:-

> ***i) The judgment delivered by the Tribunal on 9th March 2018 is hereby set aside.***
>
> ***ii) The appellant is entitled to the VAT tax refunds.***
>
> ***iii) Each party shall bear its own costs of the appeal.***

Dated, signed and delivered in open court at Nairobi this 31st day of May 2019.

W. A. OKWANY

JUDGE

In the presence of:

Mr. Darr for Mrs Onchwari for the appellant

Miss Sega for Miss Lavuna for the respondent