



**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA AT NAIROBI**

**MILIMANI LAW COURTS**

**COMMERCIAL & ADMIRALTY DIVISION**

**CIVIL SUIT NO. 541 OF 2015**

**DAVID MWANGI NDEGWA.....PLAINTIFF**

**-VERSUS-**

**KENYA REVENUE AUTHORITY.....DEFENDANT**

**JUDGMENT**

1. **David Mwangi Ndegwa**, the plaintiff, has brought this action against **Kenya Revenue Authority**, the defendant, seeking the following orders:

- a) *A declaration that, VAT is not payable on a transaction for the sale or purchase of land, regardless of whether or not the buildings standing thereon are residential or commercial buildings.*
- b) *A refund to the Plaintiff's by the Defendant of **Ksh.11,200,008.00**, together with interest at Court rates, from January 2014, till payment in full.*
- c) *Costs of and incidental to this suit, with interest at Court rates, from the date of filing of this suit till payment in full.*
- d) *Such other or further relief as this Honourable Court deem fit and just to grant.*

2. The defendant is a public body and a body corporate charged with statutory authority and responsibility to charge and collect taxes on behalf of the Government of Kenya.

**BACK GROUND**

3. On **11<sup>th</sup> December 2013** the plaintiff purchased a parcel of land registered as **Kiambu Town Block/11/74** together with buildings erected thereon from **Standard Chartered Bank Kenya Limited**.

4. By his pleadings the plaintiff stated that he was compelled to pay **Ksh11,200,008.00** on account of Value Added Tax (VAT) at the rate of 16% of the purchase price. Plaintiff further pleaded that he protested against the request to pay that VAT but however made the payment at the insistence of the vendor's advocates.

5. The plaintiff seeks the determination of this court that no VAT was chargeable for his purchase of the property under the provisions of section 8 of Part II of VAT Act 2013. The plaintiff therefore seeks an order for refund to him by the defendant of **Ksh.11,200,008.00** with interest at court rate from **January 2014** until payment in full.

6. The defendant has denied the plaintiff's claim. The defendant referred to **The First Schedule of VAT Act 2013** which provides for Exempt supplies. That more specifically under Part II services set cut in paragraph 8 are exempt. This paragraph provides the exempted supplies are:

***“Supply by way of sale, renting, leasing, hiring, letting of land or residential premises;”***

7. The defendant by its defense stated that the implication of that paragraph is that VAT exemption is in respect of sale of real property but only applies to sale of land and residential premises which have been specifically exempted. That accordingly the sale, renting, leasing, hiring or letting of commercial building is taxable supply and is subject to VAT at the rate of 16%.

8. On that basis the defendant pleaded that the plaintiff's purchase of the stated property was a transaction where VAT was payable. On that basis the defendant denied the plaintiff's case.

9. Because the issue before court is one of determination of a point of law the parties in this matter consented to proceed with the hearing of this matter by way of submissions.

10. The plaintiff's learned advocate, by his submissions, began by referring to paragraph 8 of Part II of the First Schedule of the VAT Act. This paragraph sets out the exempted supply as "**supply by way of sale, renting, leasing, hiring, letting of land or residential premises**" (the advocate's emphasis).

11. The learned advocate proceeded to submit that this court needs to answer the question – what type of property does: supply by way of sale, supply by way of renting, supply by way of leasing, supply by way of hiring, is referred to under paragraph 8. In his view the learned advocate stated that the supply is by way of sale, renting, leasing and hiring of land. He further stated that the said paragraph only exempted residential premises only in respect to the supply of letting. By that parity of argument the advocate stated that it would follow that what is not exempted is the letting of commercial premises.

12. Plaintiff's learned advocate took issue with defense reference to commercial premises and submitted that that term, commercial premises, was not a legal term. The advocate however stated that even a commercial premises stands on land.

13. The plaintiff is of the view that since the defendant, through the defense, had conceded that the sale of land was exempt, by the defendant stating that commercial premises are not exempt, the defendant was creating a legal distinction between land and buildings that stand on land. The plaintiff by his submission then posed a question:

***'Can one sell land without selling the building standing on the land.'***

14. The plaintiff submitted that the court needed to consider the definition of land. He looked at section 2 of The Land Act 2012 where it is provided that land has the meaning assigned to it under Article 260 of the Constitution of Kenya 2010. In the plaintiff's view the definition of land under Article 260 includes the surface of the earth and the airspace above the surface. In this regard the plaintiff submitted that that definition that development on the surface of the earth and above the surface of the earth constituted part of the land. That since the sale of land is exempt it followed that the sale of commercial building, whether on the surface of the earth or above the surface, was also exempt from VAT. This is because one cannot sell and transfer a parcel of land separately from the building that may stand on that land. Learned advocate submitted that in law the sale of land and the buildings standing on the land cannot be done except in one indivisible sale transaction.

#### **DEFENDANT'S SUBMISSIONS**

15. The defendant began by stating VAT tax is:

***"VAT is a consumption tax, which applies to the supply of goods and services. It is a tax levied on value created at each stage of the production and distribution value chain. The burden of the tax is eventually borne by the final consumer; tax is built in to the cost of items produced at each stage.***

***The VAT Act is the principle act which levies VAT on goods and supplies and administered by the Commissioner of Domestic Taxes of the Defendant. The Act avers two rates of tax 0% also known as zero rated and 16% also known in some quarters as standard rate of VAT. Outside these two rates, supplies become exempt from VAT and no tax is levied on the same."***

16. Defense defined commercial premises to mean "Land or building not occupied or not capable of being occupied as residential premises."

17. In the defendant's view paragraph 8 only exempts sale of residential premises but the sale of commercial premises was not exempt. In this regard defense drew the court's attention to the agreement of sale between the plaintiff and Standard Chartered Bank Kenya Ltd paragraph 1.3 which provided the purchase by the plaintiff, of the property, comprised of stores and toilets. That the agreement also described the subject property with building and improvement. This according the defendant showed the plaintiff purchased commercial premise which was not exempt from VAT. That there was no ambiguity in paragraph 8.

18. On the plaintiff's prayer for a refund the defendant submitted that the plaintiff did not pay the VAT to the defendant but rather paid it to the vendor and it is therefore the vendor who ought to have lodged the claim for refund.

19. Defendant also submitted that the plaintiff's claim is time barred by virtue of section 30 of the VAT Act 2013. That under that section a claim for refund should have been lodged within 6 months from the date the tax became due.

#### **ANALYSIS AND DETERMINATION**

20. The issue for determination in this matter identified by the plaintiff, in his submissions, is relevant and will assist me in the analysis and determination of this matter. That is: *'whether or not VAT is payable on a transaction for sale of land on which stands a commercial building!*

21. Let me start from the beginning by again considering what paragraph 8 provides as exempted supply it provides:

***“The supply of the following services shall be exempt supplies-***

***8. supply by way of sale, renting, leasing, hiring, letting of land or residential premises;”***

22. The question that falls for determination, here, is whether commercial premises are within the supply that is exempt.

23. It is clear from paragraph 8 that what is exempt is the sale, renting, leasing, hiring, letting of land; and the sale, renting, leasing, hiring letting of residential premises. One will note that there is the use of word “or” between land and residential premises. The word “or” is defined in Oxford Advance Learner’s Dictionary 7<sup>th</sup> edition as:

***“used to introduce another possibility”***

It follows that the exempt supply relates to land or residential premises. That mean exempt supply is in respect to land and residential premises.

24. The parties in this matter are in agreement that the definition of land is the one in Article 260 of the Constitution which defines land:

***“Land includes-***

- a) The surface of the earth and the subsurface rock;*
- b) Any body of water on or under the surface;*
- c) Marine waters in the territorial sea and exclusive economic zone;*
- d) Natural resource completely contained on or under the surface; and*
- e) the airspace above the surface.”*

25. I wholly agree with the plaintiff’s submissions that that definition applies to what is on the surface of the earth and in the air space above the surface of the earth.

26. The VAT Act is a product of Parliament Article 94 of the Constitution provides:

***“The legislative authority of the republic is derived from the people and, at the national level, is vested in and exercised by Parliament.”***

27. In enacting any law Parliament is bound; just as all state organs, state officers, public officers and all person; by the national values and principles of governance in Article 10 of the Constitution. Of importance to the matter at hand is that they are bound to have the value of transparency and accountability. These values should be upheld by Parliament remembering that under Article 94 of the constitution their legislative authority is derived from the people of Kenya.

28. That responsibility placed upon the legislature demands that any legislation passed by them must be clear and unambiguous. That cannot be said of paragraph 8 of the VAT Act. This is because the constitution itself defines what land is. That definition includes all land both with commercial and residential premises. Since my finding is that the supply which is exempt under paragraph 8 is both to land and residential premises, and because what the plaintiff purchased was land he then was not liable to pay VAT on the purchase price.

29. If there is doubt that what the plaintiff purchased was land one only needs to consider clause 2 A and B of the agreement of sale which provides:

***A. The Vendor is registered as lessee from the Government of Kenya for a term of ninety nine (99) years from the first day of August one thousand nine hundred and seventy three of ALL THAT parcel of land situated in Kiambu District containing by measurement nought decimal nought nine three nine (0.00939) of a hectare or thereabouts that is to say Title Number Kiambu Town Block 11/74 which is more particularly described in a Certificate of Lease registered in the Kiambu District Registry on 19<sup>th</sup> January 1990 (hereinafter with the buildings and improvements erected thereon called “the Property.”)***

***B. The Vendor has agreed to sell the Property to the Purchaser, and the Purchaser has agreed to purchase the Property from the Vendor on the terms and conditions set out in this Agreement.***

30. The ambiguity that the Legislature introduced in paragraph 8 of the VAT Act is to allow a presumption that the purchase of land where there is a commercial premises is not exempt.

31. The plaintiff is right to submit that such a definition would lead to absurdity. That absurdity is not any less if the agreement for sale, as the one of the plaintiff, describes the ‘demise premises’ as having stores and toilet. That alone does not satisfy the definition of commercial premises.

32. But I believe, as pointed out by the plaintiff, the greater evil of such a definition is what would be liable for VAT when a premises is partly commercial and partly residential. Where would it fall. Would it be classified as residential or commercial or would it be classified simply as land.

33. The submissions of the plaintiff ring very true, when one considers my discussion above, when the plaintiff stated:

***“It is trite law that, the Government of Kenya, through the defendant, cannot levy taxes on the citizenry except as may be expressly provided by a statute.”***

34. The statute, in this case paragraph 8, does give exemption to “supply by way of sale, renting, leasing, hiring, letting of land.” The plaintiff purchased land which means what was on the surface of the earth and the subsurface rock and the air space above the surface. His transaction was VAT exempt as per VAT Act 2013 Part II paragraph 8.

35. The defendant erred to plead that the plaintiff’s was time barred by virtue of section 30 of the VAT Act. That section refers to payment of VAT paid in error. For such payment a claim should be lodged within 12 months. In this case the payment was firstly not in error. The plaintiff tried to resist the payment but the advocate carrying out the transaction refused to conclude the sale in the absence of that payment. Secondly the plaintiff wrote to the defendant requesting for refund but the defendant declined by its letter dated **10<sup>th</sup> April 2015**.

36. The defendant also erred to submit that if any refund is due it was payable to **Standard Chartered Bank Kenya Ltd** the vendor. That argument is rejected because the VAT was transmitted to the defendant which the defendant has confirmed. Since the payment of that VAT was by the plaintiff it is the plaintiff who rightly should seek a refund.

37. The plaintiff’s case is merited and believe it should lead the defendant to seek to have clarity from the legislature on which supply is exempt of VAT. Although the plaintiff has succeeded I am of the view that in this case costs should not be awarded because the erroneous collection of VAT from the plaintiff was due to a legislation which is open to more interpretation than one.

38. In the end I grant the following orders:

*a) A declaration is hereby made that Value Added Tax is not payable on transaction for the sale or purchase of land whether or not the building thereon are residential or commercial buildings.*

*b) The defendant shall refund the plaintiff **Ksh.11,200,008.00** with interest at court rate from the date of this judgment until payment in full.*

*c) There shall be no order as to costs.*

**DATED, SIGNED and DELIVERED at NAIROBI this 29<sup>th</sup> day of November, 2018.**

**MARY KASANGO**

**JUDGE**

**Judgment read and delivered in open court in the presence of:**

Court Assistant.....Sophie

..... for the Plaintiff

..... for the Defendant

**MARY KASANGO**

**JUDGE**