Commissioner of Domestic Taxes v Sybrin Kenya Limited (Income Tax Appeal E004 of 2022) [2024] KEHC 90 (KLR) (Commercial and Tax) (17 January 2024) (Judgment)

Neutral citation: [2024] KEHC 90 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E004 OF 2022

A MABEYA, J

JANUARY 17, 2024

BETWEEN

THE COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

SYBRIN KENYA LIMITED ..... RESPONDENT

(Being an appeal from the whole of the judgment of the Tax Appeal Tribunal in Nairobi delivered on 5/11/2021)

JUDGMENT

1. By a letter dated 8/11/2019, the appellant expressed its wish to carry out a verification process on the respondent's VAT records for the period January, 2016 to December, 2019. Pursuant thereto, on 20/2/2020, he issued an assessment of Kshs. 40,689,306/- as outstanding VAT.

2. The respondent gave a notice of objection on 25/2/2020 to which the appellant gave an objection decision on 30/10/2020 confirming the assessment. Aggrieved by that decision, the respondent lodged an appeal to the Tax Appeals Tribunal ("the Tribunal") which it upheld by its judgment dated 5/11/2021.

3. Dissatisfied by the said decision, the appellant lodged the present appeal by a Memorandum of Appeal dated 7/1/2022 citing three grounds of appeal which can be summarized as follows: -

    a. That the Tribunal erred in failing to recognize the user and the consumer of the services offered by the respondent.

    b. That the Tribunal failed to address itself on the issue of demand notices and reverse VAT.

4. The respondent opposed the appeal vide an undated statement of facts wherein it contended that it was sub contracted by Sybrin Systems (Proprietary Limited (SSPL) based in South Africa and Sybrin Limited (SL) based in Guernsey to provide contributory hardware and software services under a master service contract to various Kenyan Banks. That the services were to be exported for the use and consumption by SSPL and SL which services were fractional and would impart the Kenyan banks by rendering them ineffective.

5. It further contended that the Court was confined to issues of law despite the issues of facts being largely undisputed. Tat each of the grounds of appeal in the memorandum of appeal had been fully and conclusively determined.

6. The appeal was canvassed by way of written submissions which I have considered.

7. The appellant submitted that the consumer of the services provided by the respondent were Kenyan banks who are situated and located in Kenya. Counsel submitted that the appellant charged VAT at the final point of consumption of the services thus making the additional assessment issued on 10/2/2023 valid and proper. It was therefore submitted that no evidence had been granted to show that reverse tax was actually paid by the respondent as alleged.

8. The respondent submitted that the services were not consumed in Kenya but by SSPL and SL resident in South Africa and Guernsey. Counsel submitted that the services could not be said to have been consumed by Kenyan banks as they were merely a component of an overall package. That SSPL and SL stood to primarily benefit from the services provided and thus they constitute an export of services for purposes of the *VAT Act*. On whether the respondent was entitled to pay reverse tax, counsel submitted that since the services were exported services the issue of reverse tax did not apply. That the respondent did not have any relationship with the Kenyan banks.

9. I have considered the record and the submissions. The main issue for determination is whether the services offered by the respondent herein qualify to be exported services within the meaning of section 2 of the *VAT Act*.

10. The appellant's complained that the Tribunal failed to identify the user and consumer of the services offered by the respondent. It was the appellant's position that the respondent was contracted by SSPL resident in South Africa and SL in Guernsey for the production of a cheques clearing software that was beneficial to local banks here in Kenya.

11. According to the appellant, based on the contracts between the aforementioned parties, the territory for consumption was Kenya. That in view thereof, the services provided by the respondent were essential for the affiliate companies outside Kenya to sell the software in Kenya for the financial institutions.

12. On its part, the respondent submitted that the companies SSPL and SL stood to primarily benefit from the services provided by the respondent as it enabled SSPL and SL to integrate them into their product and provide Kenyan banks with a complete hardware solution. That SSPL and SL were the ultimate users of the services.

13. Under section 2 of the *VAT Act*, an export is described 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. A service exported on the other hand means, a service provided for the use or consumption out of Kenya.

14. In *Commissioner of Domestic Taxes v Total Touch Cargo Holland* HC ML ITA No. 17 of 2013 [2018] eKLR, it was held that: -

> " There is only one main issue for determination in the present appeal that is, whether the services rendered by KAHL to the Respondent can be considered to be exported services within the meaning of Section 2 of the VAT Act (now repealed) ...
>
> This dispute therefore revolves around the interpretation of the term "service exported out of Kenya" as provided for in Section 2 of the repealed VAT Act. Section 2 of the VAT Act (now repealed) defined "exported service" in the following terms "Service exported out of Kenya means a service provided for use or consumption outside Kenya whether the service is performed in Kenya or both inside and outside Kenya." 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."

15. In *Panalpina Airflo Limited v Commissioner of Domestic Taxes* ML HC ITA No. 5 of 2018 [2019] eKLR, 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.

16. In view of the above dictums, exported services are based on the place of final consumption. What seems to be the dispute is identifying the final jurisdiction for consumption. In this case, the Court is called upon to determine whether the companies SSPL resident in South Africa and SL in Guernsey were the final consumers as alleged by the respondent or the financial institutions in Kenya as alleged by the appellant.

17. Guideline 3.3 of the OECD Guidelines reads;

> "For the application of Guideline 3.2, the identity of the customer is normally determined by reference to the business greement.
>
> 3.12. Under Guideline 3.3, the identity of the customer is "normally determined by reference to the business agreement" as it is expected that business agreements reflect the underlying supply. The business agreement will assist the supplier, the customer and tax administrations in identifying the nature of the supply and the identity of the parties to the supply. When supplies are made between separate legal entities with only a single location, the location of the customer also will be known once the identity of the customer is determined. It is appropriate to first describe "business agreement" for the purposes of these Guidelines and explain how tax administrations and businesses may approach the determination of the business agreement."

18. In identifying the ultimate consumer of the products, the agreements between the companies becomes relevant. In the service and delivery agreement between the respondent and SSPL, the customers under clause 1.2.3 were defined to be the customers of Sybrin Systems who were located in Kenya. Further, under clause 3.2 of the said agreement, the respondent was tasked with providing hardware spares for maintenance as well as software maintenance. The agreement further gave the respondent the discretion to contact the customers directly for any additional works.

19. With respect to the 2nd contract between the respondent and the Sybrin Limited, clause 3.1 provided that: -

> " 3. 1 Software products required by the customer in the territory shall be sourced by Sybrin Limited from Sybrin Kenya at a commission payable of 35% of the selling price of the software as sold by Sybrin Limited to the customer."

20. The said agreement also defined territory to mean every area forming part of Kenya. From the foregoing, it is evident that the software or services given by the respondent were for the benefit of the financial institutions situate in Kenya.

21. The respondent also admitted that it was contracted to provide contributory hardware and software under the master service agreement to various Kenyan banks. The ultimate consumers therefore were the financial institutions in Kenya and not the entities situate outside Kenya as contended. The Court notes that in ascertaining the consumer of the service, it is important to establish the location of the person consuming the services. The two companies SSPL and SL cannot be the final consumers as the said services were for the consumption of the Kenyan Financial institutions.

22. The Court also notes that, having held that the determining factor is the location where the service is to be finally used or consumed, the services of the respondent do not qualify to be exported services. The ultimate consumer was the financial institutions in Kenya and based on the above I am unable to agree with the conclusion by the Tribunal that the services provided by the respondent were consumed outside the jurisdiction.

23. Accordingly, I find merit in the appeal and I allow the same with costs. The judgment of the Tribunal delivered on 5/11/2021 is hereby set aside.

It is so decreed.

DATED AND DELIVERED AT NAIROBI THIS 17TH DAY OF JANUARY, 2024.

A. MABEYA, FCI Arb

JUDGE