Commissioner of Domestic Taxes v Coca Cola Central East and West Africa Ltd (Income Tax Appeal E038 of 2020) [2023] KEHC 1407 (KLR) (Commercial and Tax) (3 March 2023) (Judgment)

Neutral citation: [2023] KEHC 1407 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E038 OF 2020

EC MWITA, J

MARCH 3, 2023

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

COCA COLA CENTRAL EAST AND WEST AFRICA LTD ..... RESPONDENT

(Appeal against the judgment of the Tax Appeals Tribunal dated 31st March 2020 in TAT No. 5 of 2018, Coca Cola Central East and West Africa LTD v Commissioner of Domestic Taxes)

JUDGMENT

Introduction

1. This is an appeal by the Commissioner of Domestic Taxes, (the Commissioner), against the judgment of the Tax Appeals Tribunal (TAT) delivered on 31st March 2020 in TAT No. 5 of 2018, allowing an appeal by Coca cola Central East and West Africa Limited, [Coca Cola Africa], against an objection decision by the Commissioner declining VAT input refund on export services. The Commissioner filed a Memorandum of Appeal dated 13th May 2020 to have the decision of the TAT set aside and objection decision by the Commissioner be upheld.

Background

2. The respondent, Coca cola Central East and West Africa Limited, [Coca Cola Africa], is a limited liability company incorporated in Kenya with the main objective of marketing and promoting Coca-Cola brands. Coca Cola Africa entered into a service agreement with Coca Cola Export Corporation [Coca Cola Export], a company incorporated and domiciled in the United States of America which deals in the manufacture of beverages and concentrates with authority of the Coca Cola Company in

various parts of the world. Under the service agreement, Coca Cola Africa provided marketing and promotion services to Coca-Cola Export at a fee, intended to enhance sale of the concentrates and brands.

3. In 2017, Coca Cola Africa applied for a refund of input VAT under section 17(5) of the VAT Act, 2013, of Kshs. 903,182,037. The Commissioner carried out an audit of Coca Cola Africa's VAT returns for April 2014 to June 2016, a period during which Coca Cola Africa had undertaken customized advertising in Kenyan local dialects through the media, road shows and brand activation.

4. On 25th January 2017, the Commissioner issued preliminary findings disallowing Kshs. 725,082,158 from the claim for input VAT due to undeclared output tax on locally consumed services and local sales.

5. On 20th March 2017, Coca Cola Africa responded explaining that the services supplied to Coca Cola Export were exported services thus exempted from VAT. However, the Commissioner confirmed its findings in an assessment dated 15th June 2017. On 14th July 2017, Coca Cola Africa objected to the assessment arguing that the assessment did not set out the manner that Coca Cola Africa could object in terms of section 31(8) of the *Tax Procedures Act*. On 30th August 2017, parties deliberated on the issues in a technical forum but failed to resolve the issue.

6. On 5th September 2017, the Commissioner issued a notice of amended assessment confirming the tax assessment on undeclared output VAT on locally consumed services and time barred input VAT. In response, Coca Cola Africa issued a notice of objection dated 4th October 2017. On 30th November 2017, the Commissioner issued an objection decision dated 27th September 2017 confirming the VAT assessment on the services but conceding on the time barred input VAT.

7. Dissatisfied, Coca Cola Africa filed an appeal before the TAT on 11th January 2018. The TAT heard the appeal and issued a decision allowing the appeal on the premise that Coca Cola Africa had rendered export services to Coca-Cola Export which were zero-rated.

Appeal

8. The Commissioner was dissatisfied and filed this appeal, raising the following grounds:

    1. The Tribunal erred in law and fact in ignoring that the matter raised was already *Res judicata* and the same had already been determined in VAT Appeal No. 11 of 2013 - Coca-Cola Central East & West Africa Limited v Commissioner of Domestic Taxes;

    2. The Tribunal erred in law and fact in departing from the earlier decision in TAT Appeal No. 11 of 2013 - Coca-Cola Central East & West Africa Limited v Commissioner of Domestic Taxes contrary to the well-established doctrine of stare decisis;

    3. The Tribunal erred in law in finding that the marketing and advertising services issued by the Respondent in Kenya as per the Service agreement were exported services and are therefore not taxable under the *Value Added Tax Act*, 2013;

    4. The Tribunal erred in law and fact in misapplying the service agreement which only shows the payer of the services and not the user and consumer of the advertising services;

    5. The Tribunal erred in law and fact in misdirecting itself as to the correct application of the destination principle to find that the final consumer of the advertising service was the Coca Cola export and not the Kenyan Consumer for whom the advertisement targets and local manufacturers whose product is being advertised;

6. The Tribunal erred in law and fact in finding that the marketing and advertising services issued by the Respondent in Kenya are consumed by the Coca Cola Export which is based in the United States of America and not the Kenyan Consumer who are target audience;

7. The Tribunal erred in law and fact in finding that advertisement which is customized for the local Kenyan Consumers is consumed by the Coca Cola export which is in the United States of America.

8. The Tribunal erred in law and fact in finding that the Kenyan consumers were the target audience of the advertising services but the benefit was accrued by Coca Cola Export hence United States of America had the taxing right and not Kenya.

9. The Tribunal erred in law and fact in finding that the benefit was accrued by Coca Cola Export when the advertising was not for the concentrate but for the final locally manufactured product which has other ingredients.

10. The Tribunal erred in the law and fact by failing to appreciate that what was being advertised was the final local product which is the soft drink and not the concentrate which is just but one of the raw materials that make up the soft drink hence misdirecting itself as to the correct tax treatment.

11. The Tribunal erred in law and fact in misdirecting itself into considering that the benefit from advertising accrued to Coca Cola Export and based taxation on it while the same is not a consideration under either the OECD guidelines nor Value Added Tax Act;

12. The Tribunal erred in basing taxability of the services on what they considered the beneficiary of the service and ignored that the Kenyan consumer also benefited from the advertisement and the same is not a consideration in determining taxation under *Value Added Tax Act,* 2013.

13. The Tribunal erred in law and fact in not finding that Value added Tax is based on consumption of the service which were consumed by the Kenyan consumer for whom it is targeted at and not the payer hence taxable in Kenya.

14. The Tribunal erred in law by blatantly ignoring the express provisions of Section 8 of the *VAT Act* 2013, and thereby arriving at an absurd finding not in tandem with the clear intention of the legislature.

Submissions

9. This appeal was disposed of through written submissions with oral highlights. The Commissioner filed written submissions dated 24th September 2020, and bundle of authorities both dated 24th February 2021, response to further submissions dated 2nd June 2021 and further bundle of authorities dated 3rd November 2021. Coca Cola Africa also filed written submissions and bundle of authorities dated 20th January 2021 and further submissions dated 31st May 2021.

Submissions by the Commissioner

10. The Commissioner argued that the marketing and advertising services were locally consumed by the Kenyan buyers who are influenced by the advertisement to make decisions to buy. This is because the advertisements are tailored to the Kenyan market to increase consumption of soda and not the concentrate which Coca Cola Export deals with. In that regard, the Commissioner asserted, one cannot advertise their own products to themselves and the service agreement does not mention the concentrate.

11. The Commissioner relied on the TAT decision in Coca Cola Central East and West Africa Limited v Commissioner of Domestic Taxes (Appeal No. 11 of 2013), a decision of the TAT, on the definition of consumption.

12. The Commissioner again relied on paragraph. 3.1 of the International VAT and Gross Sales Tax Guidelines (OECD Guidelines) on the destination principle. The Commissioner posited that although Coca Cola Export was the paid for the services, it is a business and is, therefore, incapable of final consumption of advertising and marketing services of soda produced by local bottlers.

13. The Commissioner again relied on paragraph. 2.35 of the OECD Guidelines to argue that the ultimate burden of tax would be transferred to the local consumers of the soda by the local bottlers. Reliance was placed on Commissioner of Domestic Taxes v Total Touch Cargo Limited (ITA No.17 of 2013) for the proposition that the determining factor is the location where that service is to be finally used or consumed. The Commissioner maintained that that what is important is the place of consumption of the service and not the fact that an overseas company requisitioned for that service.

14. On the argument of double taxation, the Commissioner contended that VAT is a layered tax hence there cannot be double taxation as input tax is offset against output tax at every stage; that there was no evidence that Coca Cola Export paid VAT in the USA for the same supply and that apart from double taxation, OECD Guidelines were also meant to address unintended non-taxation

15. The Commissioner faulted the TAT for holding that the beneficiary of the services was Coca Cola Export yet the Kenyan consumer was the target of the advertisement. This is because VAT is charged based on consumption and not beneficiary. The Commissioner, however, conceded that though the direct beneficiaries were Kenyan consumers, bottlers, wholesalers and retailers of soda, this was not a consideration for determining whether the marketing and advertising services were locally consumed or exported.

Submissions by Coca Cola Africa

16. Coca Cola Africa argued that Kenyan consumers were the target of the advertisement but not the consumers of the marketing and advertisement services. It was contended that since "use" or "consumption" is not defined in the VAT Act, OECD Guidelines apply; that the supply of services was to Coca Cola Export, the customer identified in the relevant business agreement in terms of paragraph.3.4 of the OECD guidelines; that the Commissioner's witness Mr. Kemboi admitted that Coca Cola Export was the customer in that agreement; that there was no privity of contract between the Kenyan consumers and Coca Cola Africa and that the benefit of the services offered accrued outside Kenya as confirmed by its witness Ms. Edwards whose evidence was uncontroverted.

17. Coca Cola Africa relied on *Coca Cola Central East and West Africa Limited v the Commissioner of Domestic Taxes, ITA No. 19 of 2013 [2020]* eKLR, for the holding that even though the Kenyan audience was the target, they were not necessarily the consumers of marketing and advertising services. This is because promotion and marketing activities may not lead to a sale or consumption of the marketed product.

18. Coca Cola Africa asserted that supply of marketing and promotion service provided to Coca Cola Export was a business to business supply and taxing rights were in the jurisdiction of the customer as required in the destination principle under OECD Guideline 3.2. It was Coca Cola Africa's case that the TAT decisions the Commissioner relied on had since been overturned by the High Court.

19. Regarding the Commissioner's argument that the beneficiary is not known to the VAT regime, Coca Cola Africa contended that the TAT was entitled to apply the Indian case law to arrive at the finding

that a service used outside Kenya is where the benefit accrued outside Kenya. This is because it would be illogical for Coca Cola Africa to pay for a service it did not benefit from.

20. Furthermore, Coca Cola Africa argued, since the Commissioner did not raise the distinction between sale of soda and sale of the concentrates before the TAT, it could rely on this ground without permission of the court in terms of section 56(3) of the *Tax Procedures Act*.

21. Coca Cola Africa pointed out that according to its witness, Mr Van Der Part, the cost of the concentrates includes the cost of marketing. When the concentrates are imported, VAT is paid by the importer. Therefore, charging VAT on the business to business marketing services would result into double taxation. This would also violate the destination principle as export would bear the VAT burden yet it is a domestic consumption tax. Coca Cola Africa again cited the decision in Coca Cola Central East and West Africa Limited v the Commissioner of Domestic Taxes, (supra) where the court accepted this reasoning and stated that it was not persuaded that the arrangement avoids or minimizes taxation. Coca Cola Africa urged the court to dismiss the appeal with costs.

Determination

22. I have considered this appeal, submissions by parties and the decisions relied on. I have also read the record of the TAT and the impugned decision. Although the Commissioner raised 14 grounds of appeal in the memorandum of appeal, the core issue in this appeal is whether the service Coca Cola Africa provided to Coca Cola Export, was an export service, who the consumer of the service was and whether the service was exempt from VAT.

23. The Commissioner argued that although the service was provided to Coca Cola Export, a foreign company, the service was consumed in Kenya and was, therefore, subject to VAT. The Commissioner took the view, that members of the public in Kenya consumed the marketing and promotion services and not Coca Cola Export. Coca Cola Africa on its part maintained that the marketing and promotion services were export services within the ambit of section 2 of the VAT Act 2013 since the marketing and promotion services were used and consumed outside Kenya by the contracting company and its affiliates, thus were export service not subject to VAT.

24. In the appeal before the TAT, the TAT considered a long line of decisions and the definition of the word "exported service" in the Act [*VAT Act* 2013] and held, as a fact, that the service Coca Cola Africa provided was in relation to marketing and promotion of the brands owned or licensed by Coca Cola Company, a foreign company and that there was no contractual nexus between Coca Cola Africa and Bottling companies in Kenya.

25. The TAT went further and held that although marketing and promotion took place in Kenya, there was no proof that every Kenyan who saw the adverts purchased a beverage. According to the TAT, the test was where the consumer was located, and agreed with Coca Cola Africa, that the public in Kenya was the target audience of the advertising and promotion services, but the benefit accrued to Coca Cola Export for purposes of enhancing business of sales. The TAT concluded, therefore, that applying the destination principle, United States of America had the taxing rights.

26. The Commissioner's argument here, just like was before the TAT, was that the consumers of the marketing and promotion services were members of the public in Kenya. Both parties were in agreement that Coca Cola Africa is a company resident in Kenya while Coca Cola Export is domiciled in the United States. The two companies entered into a service agreement commencing 1st January 2006. According to that agreement, Coca Cola Africa was to advise and guide Coca Cola Export in areas of marketing, advertising and sales promotion for its brands, including funds necessary for promotion and advertising of the beverages; recommendations with respect to Coca Cola Export's

participation in the marketing or promotion expenditures; researching and determining economic, regulatory, technical and marketing conditions that impact upon production and marketing of the beverages, advice and guidance in connection with management information services and advice on implementing the rights and obligations of Coca Cola Export and its affiliates.

27. The marketing and promotion activities Coca Cola Africa was to undertake, were for purposes of implementing marketing strategy for the brands owned by Coca Cola Company with a view to promoting those brands. The marketing and promotion was to be done by Coca Cola Africa in Kenya and it was for that reason, that the Commissioner argued that consumption of the services was in Kenya because the target audience was the Kenyan public.

28. It is important to point out here, that this is not the first time this issue is arising between the same parties. The issue first arose in this court over the same service contract in Coca Cola Central East and West Africa Limited v Commissioner of Domestic Taxes [2020] eKLR. The facts in that appeal were similar to those in this appeal, save that the tax period covered was different from the period in this appeal. This fact was confirmed by counsel for the parties during the hearing of this appeal. The court in the former appeal Tuiyot, J. (as he then was), held that the service that had been rendered was export service. That notwithstanding, the same issue on the same facts, save the tax period, is before this court again.

29. Section 2 of the repealed *VAT Act* 2013 defined "export" to mean "take or cause to be taken from Kenya to a foreign country." "service exported out of Kenya" was defined to mean "a service provided for use or consumption outside Kenya." The operative words in that section were "use" or "consumption." To amount to exported service, the service was to have been provided for use or consumption outside Kenya.

30. Section 2 did not define the word "consumer" or "user." However, one must appreciate the meaning of the word "use" or "consume" as used in the section and not confuse it with the literal meaning of consumption. In determining who the consumer or user of the service was, in the relationship between Coca Cola Africa and Coca Cola Export, one must determine for whose benefit the advertising and promotion services were commissioned.

31. In service agreements involving local and foreign entities, the destination principle is key and applies so that even though the service was offered/rendered in Kenya the service would not necessarily be consumed in Kenya, but by the entity that commissioned the contract, depending on the location of the entity commissioning the marketing and promotion services and not the entity that marketed the services or where marketing and promotion took place.

32. On the facts of this appeal, Coca Cola Export which was based in the USA, commissioned the agreement with Coca Cola Africa based in Kenya. The objective was to promote through advertising, Coca Cola brands to local potential customers. Thereafter, Coca Cola Export would decide what to do with the information it would have obtained from this marketing and promotion exercise. That, really, would be the meaning of use or consumption in the context of the advertising and marketing of those brands.

33. It must be made clear, that consumers in Kenya were not receiving any service from Coca Cola Africa in the course of marketing and promoting the brands. Consumption, if any, would come in only after Coca Cola Export decided what to do with the brands that had been marketed and promoted, or if the brands were offered for sale usually on a future date. It is also worth noting, that according to the agreement, Coca Cola Africa provided marketing and promotion as the main service directly to Coca Cola Export, an overseas company, but did not receive remuneration from Kenyan public. Remuneration for marketing and promotion was to be paid by Coca Cola Export.

34. I, therefore, agree with the TAT that in accordance with the destination principle, this was an export service and the USA had the taxing rights. This view is consistent with the position taken in the earlier decision between the parties namely; *Coca Cola Central East and West Africa Limited v Commissioner of Domestic Taxes [2020]* eKLR, where the court dealt with the same issue and held as follows:

> [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.

The court concluded that what had been provided was an export service which was exempt from VAT.

35. This court also dealt with a similar issue in *Google Kenya Limited v Commissioner of Demestic Taxes (ITA No E 004 of 2021 (Consolidated with) Commissioner of Domestic Services v Google Kenya Limited (ITA No. E006 of 2021); [2022]* eKLR, considered the OECD Guidelines and the definitions in section 2 of the VAT Act then in force, and stated:

> (39) The Marketing services were commissioned by Google Ireland with the ultimate goal of increasing sales. This fact was appreciated by the TAT in its decision, that the Marketing and services would ultimately increasing sales in Kenya and, therefore, both Google Kenya and Google Inc. were the beneficiaries. In this respect, the TAT correctly found that the consumer of the service is the person contracted to receive the benefit from the service and Google Inc. and Google Ireland were to benefit from the R&D and marketing services respectively.

The court then stated:

> (42) There was no sale of Google Ireland's services to people in Kenya at the time of marketing of the services. Use or consumption of any of the marketed services would come at a later date, if and when, those products were offered for sale and the people persuaded or attracted, agree to take up Google Ireland's marketed services.
>
> (43) This view is informed by the fact that even after marketing of the services, there was no guarantee that people in Kenya would take up the products once offered for sale. Marketing of services cannot be taken to be sales because, quite often, products being marketed are given free of charge to persuade potential customers to take up the products or services at a future date. Those members of the public do not become consumers of those marketed services.

See also Commissioner of Domestic Taxes v 3M Kenya limited, ITA E096 of 2021 [2022] eKLR, Commissioner of Domestic Services v Total Touch Cargo Holland [2018] eKLR and Panalpina Air Flow Limited v Commissioner of Domestic Taxes [2019] eKLR).

36. All the decisions referred to above are consistent in one theme, that the consumer of the service is not necessarily where the marketing is done but the party who benefits from the marketing and promotion services. That is, the consumer or user of the service is the party who commissioned the contract and who directly benefited from the service provided.

37. In this appeal, the Commissioner did not argue that circumstances had changed from what they were when the court decided the earlier case in 2020 for this court to deviate from that holding. The Commissioner cannot deviate from the view consistently taken by courts on this issue when there was no change in the law. The principles of consistency apply in the taxpayer's favour and the Commissioner cannot adopt a divergent view for different periods when there were no changes on the facts and legislation.

Conclusion

38. Having considered this appeal, submissions and the decisions relied on, and after a careful reevaluation of the evidence on record, I am unable to find fault in findings and conclusions arrived at by the TAT that Coca Cola Export was the consumer of the marketing services, that the marketing services were export services and that the United States of America had the taxing rights. Consequently, this appeal fails and it is dismissed. Each party will bear own costs.

DATED SIGNED AND DELIVERED AT NAIROBI THIS 3RD DAY OF MARCH 2023

E C MWITA

JUDGE