Commissioner of Domestic Taxes v Microsoft East Africa Limited (Income Tax Appeal E212 of 2021) [2023] KEHC 17609 (KLR) (Commercial and Tax) (12 May 2023) (Judgment)

Neutral citation: [2023] KEHC 17609 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E212 OF 2021

JWW MONG'ARE, J

MAY 12, 2023

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

MICROSOFT EAST AFRICA LIMITED ..... RESPONDENT

(Being an appeal against the judgement of the Tax Appeals Tribunal at Nairobi delivered on 29/10/2021)

JUDGMENT

1. The Appellant has moved this court by a Memorandum of Appeal challenging the decision of the Tax Appeal Tribunal (Tribunal) in Appeal issued on November 29, 2021 in Tax Appeal Case No 465 of 2019.

2. The Respondent, Microsoft East Africa Limited, is a company incorporated and tax resident in Kenya, while Microsoft Ireland Operations Limited is a company incorporated and resident in Ireland. Both companies are wholly owned subsidiaries of Microsoft Corporation, a company incorporated and resident in the USA.

3. MIOL entered into an intercompany agreement with Microsoft East Africa Limited for the provision of various support services such as marketing its products in Kenya, Tanzania, Uganda, Rwanda, Ethiopia and Somalia.

4. The Respondent applied for a refund of excess input VAT of Ksh 56,177,733/- for the period 1/12/2013 to 31/8/2015, Ksh 3,543,006 for September 2015 and Ksh 2,965,872/- for April 2017. Thereafter the Appellant issued an objection decision disallowing the Respondent's refund claim of Ksh 59,261,006/-. The Respondent then appealed to the Tax Appeals Tribunal (tribunal) which

determined vide a judgement delivered on October 29, 2021 that the Appellant erred in disallowing the refund claim of Ksh 59,261,006/-.

5. The Appellant being dissatisfied with the said judgement of the tribunal appealed to this court via its memorandum of appeal dated December 24, 2021 against the whole decision on the grounds that:

> " 1. The Honourable Tribunal erred in holding that an agency relationship could not be implied from the conduct of the parties based on the Intercompany commission agreement.
>
> 2. That the honourable tribunal erred in finding that reimbursement of costs with a 13% mark-up by Microsoft Ireland Operations Limited to Microsoft East Africa did not create an implied agency relationship based on control.
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> 3. That the honourable tribunal erred in law and fact in its finding that the Respondent failed to demonstrate the specific conduct, outside the express terms of the intercompany commission agreement from which an agency could be implied.
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> 4. That the honourable tribunal erred in finding that the marketing services provided by Microsoft East Africa were consumed by Microsoft Ireland Operations Limited and therefore exported services.
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> 5. That the honourable tribunal erred in law and fact in failing to find that the services rendered by the Appellant are consumed in Kenya hence the charge of VAT at 16%.
>
> 6. That the honourable tribunal erred in law and fact by finding that section 2 of the *VAT Act* as read with regulation 13 (1), fell short of defining what amounts to "for use, consumption and enjoyment outside Kenya", and therefore Organization for Economic Cooperation and Development Guidelines (OECD guidelines) were applicable.
>
> 7. That the honourable tribunal erred in finding that respondent erred in disallowing the Appellant's refund claim.
>
> 8. That the honourable tribunal erred in ordering the appellant to process the Respondent's refund claim and refund the same in six (6) months which is an usurpation of the Appellant's statutory mandate."

6. Based on the above grounds of appeal, the Appellant prayed for the following orders;

> " 1. That the judgment of the Tax Appeals Tribunal dated October 29, 2021 be set aside and the Appeal in TAT No 465 of 2019 be dismissed.
>
> 2. That the appellant's objection decision dated September 13, 2019, be allowed and the taxes of Kshs 59,261,006.00/- be deemed due and payable.
>
> 3. That this honourable court do find and issue a declaration that Principal-Agent relationship could be implied based on the Intercompany commission agreement between Microsoft East Africa and Microsoft Ireland Operations Limited.

4. That this honourable court do find and issue a declaration that users or consumers of the advertising services were the Kenyan Viewers and listeners and the marketing services were therefore consumed locally.

5. That the costs of this appeal and those of the Appeal at the Tax Appeals Tribunal be awarded to the Appellant by this Honourable Court."

7. The Respondent opposed the appeal and filed a statement of facts dated 6/6/2022. In its opposition, the Respondent contended that the agreement between itself and Microsoft Ireland Operations Limited did not imply an agency agreement but rather that it provided marketing services to the Microsoft Ireland Operations Limited; that the fact that Microsoft Ireland Operations Limited pays Microsoft East Africa, a commission that equals a cost-plus 13% cannot be the basis of upon which the Appellant avers that there exists an agency relationship between Microsoft East Africa and Microsoft Ireland Operations Limited.

8. That the marketing services rendered by Microsoft East Africa to Microsoft Ireland Operations Limited were for the benefit of Microsoft Ireland Operations Limited, an entity incorporated in Ireland, thus the services were exported services taxable in the jurisdiction of final consumption and that the tribunal was correct in applying the OECD principles in its judgement.

9. The Respondent reiterated that input VAT was incurred in furtherance of its business hence it is claimable under the *VAT Act 2013*. Further that the resultant excess input tax was indeed eligible for refund since the same related to the provision of exported services to Microsoft Ireland Operations Limited.

10. Based on the above reasoning, the Respondent prayed to have the present appeal dismissed with cost.

11. I have looked at the entire record of appeal, the Tribunal's judgement, the Respondent's opposition to it and the submissions filed by both parties. The grounds of appeal can be condensed to the following issues:

    i) Whether there exists a principal-agent relationship between the Appellant and Microsoft Ireland Operations Limited.

    ii) Whether the services provided by the Appellant are exported services.

    iii) Whether the Respondent erred in disallowing the Appellant's input VAT refund claim.

Issue one: Whether there exists a principal-agent relationship between the Appellant and Microsoft Ireland Operations Limited.

12. Vide an objection letter dated 13/9/2019 (annexed on pages 36-37 of the record of appeal), the Appellant disallowed the Respondent's input tax refund claim and confirmed the value assessment of Ksh 59,261,006/- on the basis that the costs incurred by the Respondent are fully reimbursed by Microsoft Ireland Operations Limited plus a 13% mark-up therefore such costs do not form part of the expenses to be recognized as the Appellant's income.

13. The Appellant further noted that under section 13(5) of the *VAT Act* any disbursements to third parties made by an agent on behalf of the principal from the value of taxable supply is excluded thus only the 13% commission earned by the Appellant constituted a taxable supply.

14. The basis of the objection letter was that a principal-agent relationship existed between the Respondent and Microsoft Ireland Operations Limited, that Microsoft Ireland Operations Limited fully refunded

the costs of the Respondent plus a 13% mark-up therefore there was no taxable supply from the Respondent that was subject to deduction of input VAT under the *VAT Act*.

Issue 1; Whether a principal-agent relationship exist between the Respondent and Microsoft Ireland Operations Limited?

15. The Inter-company Commission Agreement which explains the relationship between the Respondent and Microsoft Ireland Operations Limited is found on pages 46-51 of the record of appeal. Paragraph 2.1 thereto states:

> " Subsidiary (the Appellant) shall have a non-exclusive right to market Microsoft products and services and provide support services in the territory." Paragraph 2.2.2 states: "Subsidiary shall only be authorised to inform customers of price, payment, delivery and other terms offered by Microsoft Ireland Operations Limited in accordance with information received from Microsoft Ireland Operations Limited and its affiliates, as appropriate. Unless otherwise authorised herein, Subsidiary shall not enter into any agreements with customers regarding Microsoft Products and services."

Paragraph 4.1 states:

> " In connection with its duties as defined in Article 2, MIOL shall pay the Subsidiary one hundred and thirteen percent (113%) of the Subsidiary's actual expenses, less revenues, incurred in connection with its duties as defined in Article 2..."

Paragraph 5.4 states:

> "Unless otherwise authorised herein, Subsidiary shall not have, nor represent itself as having any authority make agreements or licences in the name of, or binding on Microsoft Ireland Operations Limited, or pledge Microsoft Ireland Operations Limited's credit or extend credit on Microsoft Ireland Operations Limited's behalf."

16. A plain reading of the paragraphs above indicates to this court that a principal-agent relationship was not established in the agreement. Paragraph 5.4 explicitly states that the Respondent did not have the authority to enter into any contracts on behalf of Microsoft Ireland Operations Limited unless otherwise authorised. According to the agreement, the Respondent was contracted by MIOL to primarily market Microsoft products and services and to provide support services in the East African region.

17. In its objection decision the Appellant assumed that a principal-agent relationship exists between the Respondent and Microsoft Ireland Operations Limited due to the fact that Microsoft Ireland Operations Limited paid a commission plus a markup of 13% for the services offered. I agree with the Tribunal in finding that the Appellant did not prove why such reimbursement implied a principal-agent relationship. In the absence of proof of an implied principal-agent relationship, the express terms of the agreement stand.

Issue 2: Whether the services provided by the Appellant are exported services.

18. The Appellant submitted that the place of consumption of the services provided by the Respondent is within the jurisdiction of Kenya and are therefore vatable at 16% and that the tribunal failed to consider this thereby arriving at a wrong decision.

19. The Respondent submitted that the determining factor is where that service is to be finally used or consumed; that while the products were consumed locally, the marketing support services were consumed by the non-resident parties outside Kenya hence exported services.

20. The Tribunal in its judgement found that the consumption of the actual benefits of the marketing services accrue to Microsoft Ireland Operations Limited, an entity incorporated in Ireland and not the Kenyan people.

21. Paragraph 2 of the Intercompany Commission Agreement provides the services rendered by the Appellant. They include marketing of Microsoft products in the East African Region, liaising and meeting with customers, acting as a consultant for the dissemination of information and considering the feasibility of new markets for Microsoft products in the region.

22. Section 2 of the *VAT Act* states that a "service exported out of Kenya" means a service provided for use or consumption outside Kenya. Similarly, in the case of *Commissioner of Domestic Taxes v Total Touch Cargo Holland* (2018) eKLR the court held that 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. The court relied on the Indian case of *Paul Merchants Ltd –vs- Cce Chandigarh* [2012 (12) Tmi 424 – Cestat, Delhi Lb] where the tribunal was of the view that even though the services in question were rendered in india the word "used" 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.

23. I concur with the finding in the above authority. In this case the benefit of the services offered by the Appellant to the Respondent as highlighted under Paragraph 2 of the agreement accrued outside of Kenya ie in Ireland. The benefit of the marketing services carried out by the Appellant in Kenya were enjoyed by Microsoft Ireland Operations Limited. This is despite the fact that the Appellant carried out those services in Kenya. The Microsoft products, that were the subject of the marketing, were consumed in Kenya by Kenyans but the marketing services were consumed in Ireland by Microsoft Ireland Operations Limited.

24. I find therefore that the services provided by the Respondent fell within the scope of exported services and are VAT exempt.

Issue 3: Whether the Respondent erred in disallowing the Appellant's input VAT refund claim.

25. Section 7(1) of the *VAT Act* states:

> " 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."

Section 17(1) of the *VAT Act* states:

> " Subject to the provisions of this Act and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, at the end of the tax period in which the supply or importation occurred, be deducted by the registered person in a return for the period, subject to the exceptions provided under this section, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies."

Section 17(5) of the *VAT Act* states:

> "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) such excess arises from making zero rated supplies; or"

26. Guided by the provisions above and the fact that the court has established that the services provided by the Respondent are exported services and are taxable supplies, I find that the Respondent is entitled to a refund of its input tax incurred in generating sales to Microsoft Ireland Operations Limited.

27. The upshot of the above deliberations is that the court does not find merit in the present appeal and the same is dismissed with costs awarded to the Respondent. The tribunal's judgement of October 29, 2021 is upheld.

DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 12TH DAY OF MAY 2023.

J. W. W. MONG'ARE

JUDGE

In the Presence of:-

Ms. Nzia holding brief Ms. Wambui for the Applicant.

Mr. Ndungu holding brief for Mr. Omondi for the 1st Respondent.

Sylvia- Court Assistant.