

Why High Court decision on export VAT is important for businesses Wednesday, January 30, 2019
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VAT is a levy that is charged on consumers of goods and services along the transaction value chain. FILE PHOTO | NMG

The Value Added Tax (VAT) has gained prominence globally as a revenue earner for governments, as they struggle to fully finance national budgets.

VAT is a levy that is charged on consumers of goods and services along the transaction value chain.

For governments, two attractive features of VAT are that it is easy to administer and its reach is broad – for as long as you consume a VATable good or service, government will collect the tax, ideally.

In Kenya, most businesses with cross-border supplies, especially of services, often refer to VAT as the “Very Annoying Tax”, for the reason that VAT on exported services is a thorny issue. The main concern that most taxpayers have is, what exactly is an exported service? The VAT Act, 2013 is clear that an exported service is one which is “provided for use or consumption outside Kenya.”

However, the VAT Act does not define what “use or consumption” is. As a result of this gap, taxpayers and the Kenya Revenue Authority (KRA) have different views of where a service is consumed and therefore whether such service should be subject to 16 percent or 0 percent VAT.

The VAT Tribunal has opined that “to consume” is to “use up” while to “use” is “to put to a particular purpose.” Given this definition by the tribunal, one would think that for exported services, it is clear who consumes or uses the service.

The reality, however, is that there is still significant disagreement between the KRA and taxpayers on who consumes a service and therefore, where the service has been consumed for VAT purposes.

The December 2018 High Court decision in the case of Commissioner of Domestic Taxes vs Total Touch Cargo Holland clarifies the issue of who consumes a service and where the service is consumed.

In the case, Total Touch had contracted Kenya Airfreight Handling Limited (KAHL) to cool, palletise and scan horticultural products for export to Holland. The KRA argued that the cooling, palletising and scanning services provided by KAHL were performed and consumed in Kenya by the farmers whose horticultural products were exported. Total Touch, however, argued that although the services were performed in Kenya, the cooling, palletising and scanning services were consumed in Holland by the buyers of the service.

In concurring with Total Touch, the High Court held that the users and consumers of the cooling, palletising and scanning services were Total Touch Holland. This was because the cooling, palletising and scanning services were “aimed at ensuring that the horticultural produce and flowers reached Europe in a fresh state fit for consumption by these foreign buyers.”

In its decision, the High Court also affirmed the internationally accepted VAT destination principle on international trade and services. The import of this, is that taxpayers have to consider whether their transaction is a business to business (B2B) or business to consumer (B2C).

In a B2B transaction, the consumer of the service is the business and if located outside Kenya, the service is clearly consumed outside Kenya. Such services are therefore exported and subject to 0 percent VAT. However, in a B2C transaction, the customer is the final consumer of the service provided. If the customer is in Kenya, then the service is not exported but consumed or used in Kenya. Consequently, such services should be subject to 16 per cent VAT.

This affirmation of the destination principle is also important because taxpayers must look at the contract under which the services are supplied and the parties to the contract. Thus for example, in the Total Touch case, the farmers did not feature in the contract between KAHL and Total Touch. Therefore, this was a B2B transaction and the consumption was clearly by Total Touch in Holland.

Although KRA has appealed this decision, for taxpayers and practitioners, the Total Touch case is a welcome decision as it has not only clarified the simmering VAT dispute, but also goes a long way in reinstating Kenya’s position as the preferred location for regional business headquarters and business process outsourcing services.

This decision also reaffirms the international nature of taxation and the importance of the revenue authority adopting international best practice. This way, taxpayers' obligations are clear and businesses can plan with certainty — a key driver of investments in any country.

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