REBUPLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL AT NAIROBI
APPEAL NO. 74 OF 2017

BEMMS LIMITED……APPELLANT

VERSUS

COMMISSIONER OF DOMESTIC TAXES……RESPONDENT

JUDGEMENT

A. INTRODUCTION

1. The Appellant is a limited liability company based in Mombasa that offers the services of transporting transit cargo from Mombasa-Kenya to neighboring countries such Uganda, Rwanda and Democratic Republic of Congo.

2. The Respondent is a principal officer appointed under Section 13 of the Kenya Revenue Authority Act, 1995. Under Section 5 (1) of the Act the Kenya Revenue Authority is an agency of the Government for the collection and receipt of all revenue. Further, under Section 5 (2) of the Act with respect to the performance of its functions under Sub-Section 1, the Authority is mandated to administer and enforce all provisions of the written laws set out in Part 1 & 2 of the First schedule to the Act for the purposes of assessing, collecting and accounting for all revenues in accordance with those laws.

B. BACKGROUND

3. The Respondent conducted an audit on the records of the Appellant relating to its tax affairs following an audit notice dated 19th May 2016 covering Value Added Tax, PAYE and Withholding Tax. The Respondent vide a letter dated 31st October 2016 communicated its audit findings to the Appellant. According

to the Respondent its investigations established that the Appellant did not charge VAT in the years 2013 and 2014 as per the VAT Act requirements but at the same time it claimed input tax in the year 2014/15.

4. The Appellant objected to the assessment vide a letter dated 29th November 201 and received on 5th December 2016. On 19th December 2016 the Respondent herein acknowledged receipt of the objection and informed the Appellant that its objection was not valid as it did not meet the requirements of Section 51 (3) of the Tax Procedures Act, 2015 which requires a tax payer to object within 30 days of the assessment. Further, that an objection is to be treated as invalid in the event that it did not state precisely the grounds of objection, the amendments required to be made to correct the decision and the reasons for the amendments.

5. On 31st January 2017, the Respondent issued the Appellant with a tax demand for the tax liability which was payable within 14 days.

6. The Appellant on 1st February 2017 issued the Respondent with a letter dated 31st January 2017 named objection to assessment. According to the Respondent the contents of the letter did not meet the requirement of a valid objection.

7. On 7th February 2017, the Appellant herein responded to the tax demand dated 31st January 2017 stating that the same was not collectable as it had engaged the Commissioner General on the issue and further the VAT Act had been amended to exempt supply of taxable service in respect of goods in transit. Additionally, on 10th February 2017, the Appellant requested for extension of time before the collection could be undertake.

8. The Respondent indulged the Appellant and on 30th March 2017 issued the Appellant with the final demand requesting it to immediately make payment as it had failed to honor the demand despite being granted over a month for the same.

9. Subsequently, the Appellant on 19th April 2017 served the Respondent with a notice of intention to Appeal and a Memorandum of Appeal on 5th May 2017.

C. APPEAL

10. The Appeal herein is premised on the following grounds as contained in the Appellant's Memorandum of Appeal dated 5th May 2017;

    a. That the Respondent erred in law and fact in holding that the Appellant ought to have levied 16% VAT and remitted to the Respondent for transport services offered to goods in transit through Kenya destined to Uganda during the period of September 2013 to August 2014.

    b. That the Respondent erred in law and fact by stating that the Appellant ought to have remitted output vat charged for local transport services totaling to Kshs. 45,958,.60 and Kshs. 45,6000.00 for the months of September 2014 and April 2015 respectively on the grounds that VAT was exempted yet the Appellant had cumulative VAT Credits of Kshs. 907,919.89 and Kshs. 1,126,712.49 brought forward in the months of September 2014 and April 2015 respectively.

    c. That though the Respondent had through their audit findings established that the Appellant did not charge 16% VAT for transport services offered to goods in transit through Kenya for the period of September 2013 to August 2014, it went ahead and introduced an

additional 16% VAT on invoiced sums to arrive at the alleged principal taxes purported defaulted.

d. That the Respondent disallowed the Appellant from making use of cumulative VAT credits brought forward from previous periods to offset the output VAT totaling to Kshs. 91,558.60 yet the Respondent had established that the Appellant indeed had unutilized VAT credits which have neither been claimed by the Appellant nor refunded by the Respondent.

e. That the Respondent in total disregard of the law went ahead and levied late payment interest charged amounting to Kshs. 1,864,851.00 on non-existent VAT and demanded a total of Kshs. 7,906,261.00 being principal VAT and late payment interest charges.

f. That the Respondent totally disregarded the principal behind the establishment of the VAT as consumption tax and incorrectly interpreted it as a production tax hence demanding the non-existent tax from the Appellant who is a producer of the export services which were consumed in Uganda.

11. Accordingly, the Appellant prays that the Tribunal to;

a. Quash and set aside the decision of the Respondent and rule that transport services to goods on transit through Kenya for consumption outside Kenya is an export service which is zero rated as per the Second Schedule of the VAT Act, 2013.

b. Quash the Respondent's audit finding on VAT dated 31st October 2016 and all consequential orders including the tax demands from the Appellant for Kshs. 7,906,261 dated 31st January 2017 and 30th March 2017.

c. Rule that if the Appellant is compelled to pay the demanded taxes for transport services rendered on transit goods, then it will amount to double taxation since the Appellant's taxable profits were based on invoiced valued and the Appellant has no avenue of demanding and receiving VAT from their Ugandan importers. Any demand of the 16% VAT from the Ugandan importers will be interpreted as the Appellant's attempt to defraud its export customers since the law is clear and the Kenya Government position on VAT on services rendered goods in transit was given by the Commissioner General of the Respondent's institution.

d. Rule that the output VAT totaling to Kshs. 91,558.60 charged in the months of September 2014 and April 2015 is not due to the Respondent since the Appellant was not in a VAT refund status and has never received any VAT refunds from the Respondent.

e. The Costs of the Appeal be awarded to the Appellant.

12. The Respondent on its part responds to the above grounds of Appeal as follows;

a. The Respondent avers that at all material times it only subjected to taxable supply made by the Appellant to Value Added Tax as provided under the VAT Act which is applicable at the material time when the supply is made and becomes payable.

b. In line with the provisions of Section 5 of the VAT that it follows that when a taxpayer makes a taxable supply he has an obligation to charge VAT and remit the same to the Commissioner.

c. The VAT Act, 2013 was enacted on 14th August 2013 and become operational on 2nd September 2013. The Act did not have a provision of supply of taxable services in respect of goods in transit and therefore the same was taxable supply until 19th September 2014 when an amendment was introduced by the Finance Act, 2014.

d. That the Appellant's position is misguided as exportation is with regard to goods which originate from that particular country. The goods in this instance originated from Kenya.

e. The Appellant never availed any documents to show that any expectation was ever made to them which required them not to pay taxes which were payable under the law.

f. That the Respondent is an implementation agency and does not have the mandate to amend Acts of Parliament as that is a reservoir of the Legislature under the Constitution of Kenya.

g. The Respondent avers that it did not disallow the taxpayer from utilizing its credits brought forward, as the credits were utilized and extinguished in September 2013 to September 2014 when VAT was chargeable at general rate of 16%.

h. The Respondent avers that it could not remit output VAT of Kshs. 45,958.60 and Kshs. 45,600 for the month of September 2014 and April 2015 as the taxpayer did not have an exemption certificate.

i. The Respondent assets that not all clients of the Appellant are in Uganda from the invoices provided in the statement of facts such as

Magellen Logistics (K) Ltd, Sinza Freight and Logistics Ltd, Mombasa, Three Ways Shipping Services Ltd-Nairobi Agility, Interspeed Logistics-Mombasa. The consumption at that point was in Kenya and not exported as claimed.

j. The Respondent maintained that the taxpayer is not sure whether his services are exported or provision of services to goods on transit. From the documents provided as customs entries that tax regime codes are T8s which refer to transit. Therefore, the interpretation of this services should be as such.

k. The Respondent avers that transport services offered by the applicant are supply within the meaning of the Valued Added Tax Act, Section 2 which states that services exported out of Kenya means a service provided for use or consumption outside Kenya or outside Kenya whether the service is performed in Kenya or outside Kenya or both inside or outside Kenya.

13. The Respondent makes the following prayers;

a. The assessment dated 31st October 2016 on the applicability of 16% VAT on transportation of transit cargo for the period of 1st September 2013 to 31st August 2014 is proper in law.

b. The tax demand dated 31st January 2017 is not an Objection decision for which an appeal can be preferred; and

c. That this appeal be dismissed with costs to the Respondent as the same is without merit.

D. ISSUED FOR DETERMINATION

14. Having carefully considered the grounds of Appeal, the Submissions of the parties and authorities cited in support thereof, it is clear to us that only one issues falls for determination by the Honorable Tribunal. We restate that single issue as being;

a. *Whether the transport services rendered by the Appellant in respect of goods on transit is a vatable services for the purposes of the VAT Act 2013*

E. ANALYSIS

15. The Appellant argues that following the enactment of the VAT Act 2013, there was an inadvertent omission in the Second Schedule of the Act whereby the supply of taxable services in respect of goods in transit was not explicitly exempted or zero rated hence providing fertile grounds for misinterpretation. However, despite this apparent omission, the same Act in the Second schedule on zero rated supplies provided for the "exportation of goods or taxable services" as one of the zero rated supplies.

16. That the Respondent was advised by its counterpart from Uganda via an email communication dated 23rd October 2013 that VAT is not chargeable for goods not meant to be consumed in Kenya or services in respect of such goods. Further, that transport services in respect of goods in transit do not attract VAT. It is following this communication that the Commissioner General took steps to cure the omission in the VAT Act 2013. An amendment in the Second Schedule re-introduced expressly providing that services in respect of goods in transit are zero rated.

17. Further, that the Appellant during the audit of its business affairs provided the Respondent with invoices, delivery orders and customs entries confirming that the goods actually crossed the Kenyan borders into Uganda, thus proving that the same was not locally consumed in order for VAT to be levied at 16%. The same issue was explicitly addressed in the Appellant's notice of objection, which the Respondent whimsically dismissed.

18. The Respondent on its part alleges that at all material times it only subjected the taxable supply made by the Appellant to Value Added Tax. That the Act did not at that time have position for exemption of supply of taxable services

in respect of goods in transit and therefore the same was a taxable supply until 19th September 2014 when an amendment was introduced by the Finance Act, 2014.

19. In light of the foregoing rival contentions by the parties herein, it is prudent to reproduce the relevant Sections of the law in so far as zero rating of goods and services is concerned. In this respect, Section 7 (1) of the VAT Act, 2013 provides thus;

"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."

20. Section 2 of the Act also defines, export service and services exported outside Kenya as follows:-

*"**Export**" means to take or cause to be taken from Kenya to a foreign country, a special economic zone enterprise or to an export processing zone;*

*"**Services**" means anything that is not goods or money;*

*"**Service exported out of Kenya**" means a service provided for use or consumption outside Kenya;"*

21. The Act does not define what goods in transit are but simple logic would dedicate that these goods originating or imported from a foreign place to another foreign designation through Kenya. Hence, we find that the Appellant's business activities fit this definition and thus qualify for zero rating as per the law as they are exported services.

22. In our view and from the foregoing definitions, the question of whether a service is an exported service for purposes of the VAT Act 2013, is dependent on whether the said service is used and consumed outside Kenya. What is

material, for the purposes of identifying a service as an exported service, is not just the place of supply but also the place of final use and consumption, being outside Kenya.

23. There is no shortage of authorities on applicable rates and treatment of exported services. For instance, this Honorable Tribunal in a differently constituted Panel in the case of ***F.H Services Kenya Limited vs Commissioner of Domestic Taxes, Appeal No. 6 of 2012***, found that what is pertinent, as far as VAT legislation was concerned was where the services are finally used and consumed.

24. Further, in ***Commissioner of Domestic Taxes vs Total Touch Cargo Holland, Income Tax Appeal No. 17 of 2013*** and ***Republic vs Kenya Revenue Authority & Another Ex-parte Fontana Limited [2014] eKLR***, the various courts held that for a service to be deemed as exported, it matters not whether the service is performed in Kenya or outside Kenya as the determining factor is the location where the service is to be finally consumed or used, which should be outside Kenya.

25. Now, having determined that the services rendered by the Appellant in respect of the goods in transit is an exported service, it then follows that the proper treatment of the same is to zero rate the services as per the provisions of the Second Schedule of the Act, 2013.

26. The test of course is that, per Section 7 (2) the "*goods or services should be of description for the being specified in the second schedule*". As at the time of the assessment of the Appellant herein, the Second Schedule of the VAT Act did not provide distinctly that the transportation of goods in transit was zero rated. However, paragraph 1 of the Part A of the Second schedule to the Act provided the exportation of goods or taxable services as one of the zero rated services.

27. In our assessment the services provided by the Appellant would clearly fit under the Paragraph of the Schedule even before the amendment by the Finance Act 2015. The amendment introduced by the Finance Act only served to bring clarity to the ambiguity and confusion produced by the Paragraph 1 of the Second Schedule of the Act. We therefore, must disfavor with alacrity the Respondent's assertion that the VAT Act did not have provisions for exemption of supply of taxable services in respect of goods in transit prior to the 19th September 2014.

28. This therefore leads us to the inevitable conclusion the Respondent was misguided in his construction of the law on transit goods and their proper treatment as per the VAT Act.

F. DETERMINATION

29. In light of the foregoing analysis we find that the Appellant has defended its position against levying of 16% charge on the transportation of goods in transit as the same are zero rated. Accordingly, the Tribunal makes the following Orders;

    a. The Appeal herein is merited.
    b. The Transportation of goods in transit is an export service and therefore zero rated.
    c. The Respondent's audit findings dated 31st October 2016 and the consequential tax demands dated 31st January 2017 and 30th March 2017 are hereby set aside.
    d. Each party to bear its own costs.

It is so ordered.

DATED and **DELIVERED** at **NAIROBI** on this **4th** day of **September 2020.**

MAHAT SOMANE
CHAIRPERSON

PATRICIA MAGIRI
MEMBER

TIMOTHY CHESIRE
MEMBER

WAMBUI NAMU
MEMBER