

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NUMBER 7 OF 2016

KINGDOM KENYA 01 LIMITED.....APPELLANT

=VS=

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant is a private limited company incorporated in Kenya and registered under the Companies Act. It is owned 100% by Kingdom Hotels Investment Limited which is based in the Cayman Islands. Kingdom Kenya 01 owns the Norfolk Hotel and Mara Safari Club which are operated by Fairmont Hotels and Resorts
2. Fairmont Hotels & Resorts is a Canadian operator of luxury hotels and resorts. Currently, Fairmont operates properties in 22 countries: Canada, the United States, Azerbaijan, Barbados, Bermuda, and People's Republic of China, Egypt, Germany, India, Indonesia, Kenya, Mexico, Monaco, the Philippines, Saudi Arabia, Singapore, South Africa, Switzerland, Turkey, Ukraine, the United Arab Emirates, and United Kingdom and provides a number of services for the cluster of Hotels including Global reservation system, centralized IT system and marketing for which it charges management fees. It also administers a global guest recognition programme.
3. The Respondent was established under the Kenya Revenue Authority Act, Cap 469 as an agency of the government, for the purpose of collection and accounting of government revenue. It is required to administer and enforce all provisions of the laws set out in the KRA Act.
4. Following an audit for the years of income 2011- 2015 the Respondent determined that the

i.	Withholding tax inclusive of interest and penalties	<u>Kshs. 6,200,627/=</u>
ii.	Value Added Tax	<u>Kshs. 86,654,431/=</u>
	TOTAL TAX	<u>Kshs. 92,855,058/=</u>
iii.	Less tax paid on account	<u>Kshs. 9,975,061/=</u>
iv.	Confirmed assessment	<u>Kshs. 82,879,997/=</u>

5. The assessment was in respect of: VAT and Withholding tax on expenses related to guest recognition programs, Restriction of input VAT on exempt services provided by the appellant and VAT on transportation services. Being aggrieved by the assessment, the Appellant filed an appeal in the Tax Appeals Tribunal.

THE APPEAL

6. The Appellant's grounds of Appeal are as follows;

- i) That the Respondent has erroneously characterized guest recognition expenses incurred by the Appellant as being a payment for a service, rather than pure cost recharge, and demanded withholding tax and VAT on this amount.
- ii) The Respondent disregarded alternative provisions in the VAT Act with respect to the deduction of input VAT.
- iii) The Respondent has classified transportation of tourists as being subject to VAT.
- iv) The Respondent has disregarded the Appellant's appeal for understanding given the inequitable position on the VAT law with respect to reclaiming VAT on travel agent commission under reverse VAT regime.

7. The Respondent filed their response in opposition to the Appeal and stated as follows;

- i) That the Guest recognition expenses were payments for costs of providing the loyalty programme including reimbursement of costs such as salaries. Out of pocket expense and disbursements

and overhead costs are management fees and attract both withholding tax and reverse VAT.

- ii) The Appellant failed to use the second method as provided under paragraph 17 of VAT regulations CAP 476. The VAT legislation in force then required restriction of input tax such input tax claimed attributable to exempt sales exceed 5% of input tax.
- iii) The Transport services offered to guests is actually hiring out the vehicle to the clients. The Respondent contends that the hotel is not in the business of transportation but hires/charters out its vehicles to clients and in turn charges them for this service. Paragraph 7 of the first schedule to 2013 VAT Act excludes means of conveyance hired out or chartered and thus the service is subject to tax.

APPELANTS CASE

8. It was the Appellant's case that:

- a) Its guest recognition expenses were not expenses of managerial, technical, agency contractual or consultancy nature as defined in the Income Tax Act Cap 470. Rather, the expenses represent reimbursements of costs incurred in operating Fairmont's loyalty program known as the President' Club. It consistently complies with section 35 of the Income Tax Act and section 6 of the VAT Act and pays management fees, and reverse VAT on such services. In return for the management fees, it is allowed to use Fairmont's Brand name and established hotel management skills to attract customers. The services provided by the Fairmont's Presidential Club are provided to the Fairmont's guests and not to the Appellant itself.

- b) On the issue of restriction of input tax the repealed VAT Act (Cap 476) provided that:

Where a registered person supplies both taxable and non-taxable goods and service he can only deduct that part of his input tax which is attributable to taxable supplies, which attribution shall be approved by the Commissioner, but he may use either of the

under mentioned methods to determine the amount of the deductible input tax without the approval of the commissioner-

(a) Value of taxable supplies x deductible Input tax Value of total sales ; or

(b)(i) full deduction of all the input tax attributable to taxable goods purchased; and sold in the same state;

(ii) no deduction of any input tax attributable to exempt outputs and

(iii) Deduction of the input tax attributable to the remainder of the taxable supplies as under paragraph

(a)

- c) The Respondent is seeking to deny the Appellant the opportunity to choose which of the two methods it uses in determining the deductible input tax based on the fact that it did not apply the method at the point of filing the monthly returns. This position by the respondent is inequitable. Given the freedom of choice of the method to use by the law, the Respondent should not insist on the choice that results in a larger tax liability. The Appellant has already paid the tax determined under method 2, amounting to Kshs. 3,854,089/=.
- d) On the issue of VAT on transportation of passengers, Paragraph 7 of the First schedule to the VAT Act exempts from VAT *“transportation of passengers by means of conveyance excluding international air transport or where the means of conveyance is hired or chartered”*. Based on this, the appellant did not charge VAT on what it charges its guests in respect of the transportation provided from the airport to the hotels and back, as well as the use of the vehicles in and to the game reserves, to VAT.
- e) Respondent's view was that the Appellant was not in the business of Transportation but hires/charters out its vehicles for the service provided to the guests for a charge. The question that arises is what is a hire or charter. The term Hire or charter is not defined in the VAT Act therefore we are left to rely on either ordinary or dictionary meaning of the words. www.businessdictionary.com defines it as transportation of people who have contracted to have exclusive use of a vehicle at a fixed rate under one contract for a specified itinerary.

- f) That the guests transported by the Appellant were not a homogeneous group but a rather disparate group who would enter into separate contracts with the hotels for a specified itinerary. The appellant was using its own vehicles to transport its guests and relied on paragraph 7 of the first schedule to the VAT Act 2013 and treated the transportation as exempt as was the resale VAT Act (Cap476) which exempted transportation of tourists from VAT.
- g) On reverse VAT on travel agents commission, Whilst the Appellant concedes that reverse VAT should have been accounted for on travel agents' commission, it is of the opinion that the nature of the law is inequitable due to the sole fact that because of a timing issue, the appellant is unable to reclaim the reverse VAT on a subsequent VAT return whereas the respondent may request payment of the VAT within a much longer time limit. As a result rather than this being a tax neutral position due to the reverse VAT system, this item will have a negative impact on the appellants cash flow, which it can ill afford at this time due to challenges faced in tourism industry in which the appellant operates.

9. The Appellant prays that the honorable Tribunal finds that:

- a) Neither VAT nor withholding tax should apply to the transaction relating to guest recognition programme and sets aside the assessed taxes.
- b) No further tax is due in respect of restricted input VAT as the method used and upon which the tax had already been settled by the appellant was based on a legal provision relating to the matter under consideration.
- c) The transportation provided by the Appellant to its guests via the use of the appellants own vehicles is not a service subject to VAT but rather transportation of passengers which is an exempt supply.
- d) The law inequitable and compels the respondent either to allow claim of the reverse VAT once paid or sets aside the assessment on grounds of lapse of time and the fact that the omission was innocent and did not benefit the appellant.

RESPONDENT'S CASE

10. The Respondent's case was that:

- a) Guest recognition expenses are the company's share for administration cost for the group loyalty program known as the Fairmont's Presidents club. These payments are a recovery of expenses incurred to operate the Fairmont's Presidents club as shared among the various managed hotels.
- b) The Fairmont's Presidents club is a guest recognition or loyalty programme similar to the programs offered by similar industry players such as Starwood Hotels and Resorts and Marriot international. In essence under this program, managed hotels are charged with the cost of operating the loyalty program including the estimated cost of future redemption obligation.
- c) Typically the relevant management agreement requires that the managed hotel reimburses the operator the prorated costs of operating the loyalty program including marketing, promotions and communications and performing member services for the loyalty programme. Under the hotel management agreement, the operator is not only engaged to provide management services to the appellant but is also engaged to provide centralized services which included among other things the Fairmont's Presidents Club programme.
- d) Under the Hotel Management agreement the Appellant is required to reimburse the Hotel Operator for the hotels prorated share of the expenses for the operation/administration of the loyalty programme. This payment is for costs of providing the loyalty program and includes reimbursement of costs such as salaries, pocket expense disbursements and overhead costs. The respondents submit that these are part of management fees paid by the appellant to the administration of the Fairmont's, Presidents Club.
- e) The fact that this is a reimbursement as argued by the appellant does not change the fact that it should attract withholding tax and reverse VAT. The costs have been incurred on behalf of the Appellant and the Appellant claims the costs incurred in its books. The Appellant submits that these are management fees

and attract withholding tax and reverse VAT as provided for under section 35 of the income tax Act and Section 6(6) of the repealed VAT Act.

- f) Section 2 of the repealed VAT Act defined management fees as :

Management or professional fee means a payment made to a person, other than a payment made to an employee by his employer as consideration for managerial, technical, or agency or consultancy services however calculated.

Section 35(1) of the income tax Act Cap470 states that:

A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of..... (a) Management or professional fee..... which is chargeable to tax, deduct there from tax at the appropriate nonresident rate.

Section 6(6) of the repealed VAT Act provides that ; *Tax on services imported into Kenya shall be payable by the person receiving the taxable service.*

- g) On transportation of tourists, the Repealed VAT Act CAP 476 dealt with exempt services . paragraph 21 of the third schedule reads: *“Transportation of tourists by means of conveyance”* from the foregoing it is evident that the repealed the repealed act expressly exempted the transportation of tourists from VAT. However the VAT Act 2013 has not expressly exempted the transportation of tourists and it is therefore not listed as one of the exempt services under Part II of the first schedule. The repealed act in paragraph 9 of the third schedule also provided: *Transportation of passengers by any means of conveyance but excluding where the means of conveyance is hired or chartered.* The VAT Act 2013 under first schedule Part II in paragraph 7 provides: *Transportation of passengers by any means of conveyance but excluding where the means of conveyance is hired or chartered.*
- h) The Appellant seeks to rely on Paragraph 7 of the first Schedule part II of the VAT Act 2013 which they contend exempts the transportation of tourist from VAT. This is erroneous and misleading since, if the intention of the legislature was to exempt the transportation of tourists from VAT, nothing would have

been easier than to expressly state so as had previously been state for in paragraph 21 third schedule of the repealed Act. This position is stated in the case of *RusselloV United states*, 464 US16,23,78,L ED2d 17, 104ct 296(1983) and *Keene Corp. V United States* , 118 US 124L Ed 118,113 S ct (1993) where the court recognized that *“this fact only underscores our duty to refrain from reading a phrase into the statute when congress has left it out, where congress includes particular language in one section but omits it in another... it is generally presumed that congress acts intentionally and purposely in the disparate inclusion or exclusion.”* The position of the respondent is supported by the principle laid in *Cape brandy Syndicate V I.R.C* (1KB64,71) where it was stated that: *“in a taxing statute one has to look merely at what is clearly said. There is no intendment there is no equity about tax there is no presumption as to tax nothing is to be read in, nothing is to be implied. One can look fairly at the language”*

The appellant submits that the transportation of tourists is subject to VAT as it is not specifically excluded in the first Schedule of the VAT act 2013

i) Paragraph 17 of the VAT regulations 1994 provides that:

(1) Where a registered person supplies both taxable and non-taxable goods and service he can only deduct that part of his input tax which is attributable to taxable supplies, which attribution shall be approved by the Commissioner, but he may use either of the under mentioned methods to determine the amount of the deductible input tax without the approval of the commissioner-

- (a) Value of taxable supplies x deductible Input tax
Value of total sales; or*
- (b) (i) full deduction of all the input tax attributable to taxable goods purchased; and sold in the same state;
(ii) no deduction of any input tax attributable to exempt outputs and
(iii) Deduction of the input tax attributable to the remainder of the taxable supplies as under paragraph (a)*

(2) Notwithstanding Paragraph (1) where the amount of input tax attributable to exempt supplies is less than five percent of the total input tax, then all the input tax can be deducted

- j) The Respondent states that the Appellant deals in both taxable and exempt supplies i.e. accommodation, provision of meals and transportation of tourists (exempt under repealed VAT Act cap476) respectively. In such instances the law required that input VAT be restricted. It is not in dispute that the VAT act accords a taxpayer the liberty to choose either of the method outlines under paragraph 17(1) without the prior approval from the commissioner.
- k) The Respondent contents that the Appellant claimed input VAT that was attributable to exempt sales contrary to the law. The VAT Act clearly spells out that the appellant ought to have restricted input VAT relating to exempt sales as it exceeded 5% of the total sales claimed contrary to paragraph 17 of the VAT regulations 1994 of the repealed VAT Act Cap476. This method can only be used where taxable goods purchased are sold in the same state and no deduction of any input tax which is directly attributable to exempt outputs. In this case, the audit established that input tax was claimed for directly attributing exempt output for example on repairs, spare parts of vehicles and administration costs. The Respondent submits that to arrive at the correct amount of input tax that is deductible in the case of the first method paragraph 17 of the VAT regulations 1994 should be used.
- l) The Appellant received travel agents' commissions which they should have accounted reverse VAT on. The repealed VAT Act Cap 476 provides that: ***“ provided that no input tax or tax withheld may be deducted- (a) more than twelve months after that input becomes due and payable pursuant to section 13 or the tax is withheld, as the case may be.”*** The issue that the appellant raised was the in equitability of the law. This according to them arises as they are required to pay reverse VAT of travel commissions but are not in a position to claim it in

subsequent VAT returns as they are time barred as per section 11 of the repealed VAT Act Cap 476

- m) The Respondents submit that the appellant ought to have accounted for Reverse Vat when they paid the Travel agent Commissions which they did not at the time. Had they charged in time, they would have had the opportunity to claim it within the stipulated time provided by the law. Their obligation does not diminish simply because they have lost the opportunity to claim it in their VAT return

11. The Respondent prays that the Tribunal finds as follows:

- i) That withholding tax and reverse VAT is chargeable on Guest Recognition expenses
- ii) That VAT on transportation of tourist is subject to VAT under the VAT Act 2013
- iii) That reverse VAT is chargeable on travel Agents Commission
- iv) That the assessment be upheld based on the facts cited and the existing laws.

ISSUES FOR DETERMINATION

12. Having listened to the parties and read both submissions the tribunal found the following issues standing out for determination

- i) Whether withholding tax and reverse VAT ought to have been charged on Guest recognition expenses
- ii) Whether VAT should have been paid on transportation of guests
- iii) Whether input VAT should be restricted where exempt sales exceed 5% of the total sales
- iv) Whether Reverse VAT should be paid on account of a time barred input VAT

ANALYSIS AND FINDINGS

13. Guest recognition programs are incentive-based programs whereby a company offers rewards, in exchange/consideration of certain consumer. Under these programs, a member of a program earns points by being loyal to a particular brand. Members do this by patronizing particular hotel chains, earning points for staying and

spending money in specific hotels. These programs are marketing programs. Their purpose is to encourage members to choose hotels in a specific chain over other hotels. Clearly hotels do not give free hotel rooms out of the goodness of their hearts. Rather, the hotel chains set up a mechanism for the reimbursement of costs associated with the hotels' participation in these marketing programs. On the front end, when a member stays in a participating hotel and earns points, that hotel is required to pay some agreed amount of the hotel folio into a fund that is usually a separate entity established by the hotel chain to administer the program. The job of this fund is to collect these contributions from all hotels in the chain and then administer the program by paying marketing expenses, operating costs, and handling the reimbursement system when members ultimately redeem points for free rooms.

14. In the instant case, the Respondent has assessed VAT on the Hotel's contribution to the management of the fund which contribution the Appellant claims is a reimbursement to the Club for administration of the program. In view of the fact that there is no relationship between the administrator of the program and the appellant, reimbursement viewed third party consideration. The VAT Act 2013 does not address itself clearly on Third party consideration and tends to envisage a scenario where consideration goes directly to the supplier of the taxable supply or service to a purchaser of that service. Here, the Appellant pays the Fairmont Presidents club for services which will benefit the clubs members. It is not easy to see the reimbursement of cost as being a consideration of anything flowing from the club to the Appellant. For a tax to apply on funds flowing between the Fairmont Presidents Club and the participating hotels there has to be a transaction that has as its primary purpose the furnishing of something taxable.
15. The Tribunal finds that in developing what is now popularly called the *Redrow* Principle, the House of Lords looked at the issue of third party consideration in *Redrow* [1999] STC 161. *Redrow* built houses, and as a sales promotion scheme undertook to pay, on behalf of any person who bought a new *Redrow* home, estate agency fees incurred in the sale of their former home. The Commissioners analyzed this as

Redrow paying fees incurred by a third party, on behalf of that third party. The taxpayer analyzed this as **Redrow** paying fees for services supplied to it by the estate agent: not third party consideration at all but consideration for a service supplied to **Redrow**. It was held that *the key question to ask is whether, in the course of his business, something is done for the taxpayer for whom he has had to pay a consideration which attracted VAT*. Under the **Redrow** principle, once it is shown that the taxpayer derived any benefit from the transaction, then he could charge output tax and claim input tax. It was not important to quantify the benefit accruing to the taxpayer.

16. The Tribunal further finds that the Appellant admits that in return for paying for administration of the program, it benefits from return visits, increased occupancy in their hotels and a right to use Fairmont's brand name.
17. The Tribunal then turned its attention to the question as to whether VAT should have been paid on transportation of guests. It is not in doubt that the repealed VAT Act (Cap486) did specifically exempt transport of tourists from VAT. Both the Respondent and the Appellant acknowledge this and it is indeed true that this provision does not exist in the VAT Act 2013. The issue in dispute was the effect of omission of paragraph 21 from the new legislation. The paragraph expressly exempted *"Transportation of tourists by means of conveyance"* on the other hand The VAT Act 2013 under First schedule Part II in paragraph 7 exempts from VAT *"Transportation of passengers by any means of conveyance but excluding where the means of conveyance is hired or chartered"*.
18. In *Adamson v Attorney General (1933) AC 257* it was stated that *"the Section is one that imposed a tax upon the subject, and it is well settled law that in such cases it is incumbent on the Crown to establish that its claim comes within the very words used, and if there is any doubt of ambiguity, this defect, if it be in view of the Crown a defect, can only be remedied by legislation."* Weighed against paragraph 7, the Tribunal is not convinced that the very words used exclude tourists from the meaning of passengers. Moreover, if it is true that there was an intention of excluding tourists from enjoying the exemption,

nothing would have been easier than to state so in paragraph 7. Further, following the maxim *expressio unius est exclusio alterius*, a principle in statutory construction saying that when one or more things of a class are expressly mentioned others of the same class are excluded, one can say that transportation of passengers of all classes be they tourists, drivers, pilots, farmers, engineers or any other class are exempt to the extent that the means of conveyance has not been hired or chartered. The Tribunal relies on the case **Russell v Scott [1948] 2 ALL ER 5** where it is stated that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him.

19. The Tribunal was of the view that under the previous Act, transportation of tourists was exempt from VAT under two provisions: one that specifically isolated the transport of tourists and the one that exempted transportation of passengers. For if a tourist being transported to the airport or for a game drive is not a passenger, and then what is he? The Tribunal is of the view that exclusion of tourists from the current exempt schedule did not fully exclude them as they could still be referred to as passengers.
20. The question then is whether a group of hotel guests of whatever class sitting in a bus branded and owned by a hotel can be considered to have hired or chartered the service. The Tribunal does not think so otherwise every other use of hotel assets by guests would also be considered a charter or hire.
21. Both parties agree that a taxpayer is liable to use any of the two methods of calculating VAT payable. The question then is how to treat VAT attributable to exempt sales where they exceed 5% of the total sales. The relevant regulation provided that guidelines for calculating VAT where a supplier supplied both exempt and taxable supplies. It is a common occurrence for business to provide both. The regulation gives the formula for calculating VAT for such a supplier but gives an exclusion:

(2)Notwithstanding Paragraph (1) where the amount of input tax attributable to exempt supplies is less than five

percent of the total input tax, then all the input tax can be deducted.

This in the understanding of the Tribunal means that the formula given in paragraph 1 is only to be ignored if the input tax attributable to exempt supplies is material. Thus if the input tax attributable to exempt supplies, the standard formula for calculating VAT is to be used and the input tax was to be deducted as if there were no exempt supplies.

22. In view of the above, a taxpayer producing both exempt and taxable supplies can use any methods described in paragraph 1, only if the amount of exempt sales exceed 5% regardless of which method yielded a lower tax burden.
23. It is not in dispute that reverse VAT should have been paid in respect of imported services. Both parties agree with this fact with the Appellant saying that the only reason that he should not pay is because it is inequitable especially because there is a limit of time within which it can claim input tax. It submits that if it pays now, it will not be able to claim input VAT.
24. The Tribunal is of the view that it is not in its place to determine the existence of equity or lack of it in a tax statute. It is however persuaded that as was held in the *Cape brandy case* cited above where Rowlatt, J said that “*there is no Equity about tax*”. Similarly, the supreme court of India in *Murarilal Mahabir v V.R Vad AIR 1976 313: (1975) 2 SCC736* reiterated this position and explained that “*There is no equity about a tax in the sense that a provision by which a tax is imposed has to be construed strictly, regardless of the hardship that such a construction may cause either to the treasury or to the taxpayer. If the subject falls squarely within the letter of the law, he must be taxed however inequitable the consequences may appear to the judicial mind.*”
25. It may be inequitable that the claim of input tax may be restricted but the obligation to pay tax overrides the inconvenience to be endured by the taxpayer given that the delay in the discharge of his obligation

was in his control and not that of the tax collector. Justice KORIR observed in *Republic v Kenya Revenue Authority Ex parte Bata Shoe Company (Kenya) Limited [2014] eKLR* that Payment of tax is an obligation imposed by the law. It is not a voluntary activity. That being the case, a taxpayer is not obliged to pay a single coin more than is due to the taxman. The taxman on the other hand is entitled to collect up to the last coin that is due from a taxpayer. Similarly as observed by Justice Lenaola in *Mount Kenya Bottlers Limited & 3 Others V Attorney General & 3 Others [2012] eKLR* Whether the taxation imposed is unfair, harsh or inequitable cannot be the reason for holding that it should not be imposed.

26. The Tribunal having analyzed the pleadings makes the following findings:
- (a) Withholding tax and reverse VAT ought to have been charged on Guest Recognition expenses
 - (b) The transportation of guests shall not attract a charge of VAT as the VAT Act at Paragraph 7 of the First Schedule refers in general terms to passengers who are exempt.
 - (c) Input VAT should not be restricted where exempt sales exceed 5% of the total sales.
 - (d) By admission of both parties Reverse VAT is payable even when input VAT is time barred.

DECISION

27. The Appeal partially succeeds and varies the assessment in terms of the (a), (c) and (d) above directs the Respondent to issue fresh assessment in terms of the findings of the Tribunal
28. There shall be no Orders as to costs.

DATED and DELIVERED at NAIROBI this 2ND Day of MAY, 2016


In the presence of:-

IBRAHIM KHALIF, LEILA OMAR and CHARLES KARISA for the Appellant

RAPHAELA MURUKA for the Respondent



.....
LILIAN RENEE OMONDI
CHAIRPERSON



.....
ABDULBASID AHMED
MEMBER



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GABRIEL KITENGA
MEMBER



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DANIEL TANUI
MEMBER



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BONIFACE DIMMO
MEMBER