Case Number:	Income Tax Appeal 17 of 2013
Date Delivered:	21 Dec 2018
Case Class:	Civil
Court:	High Court at Nairobi (Milimani Commercial Courts Commercial and Tax Division)
Case Action:	Judgment
Judge:	Maureen Akinyi Odero
Citation:	Commissioner Of Domestic Taxes v Total Touch Cargo Holland [2018] eKLR
Advocates:	-
Case Summary:	-
Court Division:	Commercial Tax & Admiralty
History Magistrates:	-
County:	Nairobi
Docket Number:	-
History Docket Number:	-
Case Outcome:	-
History County:	-
Representation By Advocates:	-
Advocates For:	-
Advocates Against:	-
Sum Awarded:	-

REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI COMMERCIAL & TAX DIVISION

INCOME TAX APPEAL NO.17 OF 2013

COMMISSIONER OF DOMESTIC TAXES.....APPELLANT

VERSUS

TOTAL TOUCH CARGO HOLLAND.....RESPONDENT

JUDGMENT

(1) Before this court is an Appeal filed by **THE COMMISSIONER OF DOMESTIC TAXES** against the decision of the **Value Added Tax Appeals Tribunal** in Value Added Tax Appeal Tribunal Case **No.5 of 2013** which Ruling was delivered on **17th September 2013**, The Appellant filed their Memorandum of Appeal dated **1st October 2013.** The Respondent **TOTAL TOUCH CARGO HOLLAND** opposed the Appeal.

(2) Following directions of the Court, the Appeal was disposed of by way of written submissions. The Appellant filed their written submissions on **24th July 2017**, while the Respondent filed their written submissions on **7th August 2017**.

BACKGROUND

(3) The Appellant is the **COMMISSIONER INCOME TAX** appointed under **Section 122** of the **Income Tax Act** and is responsible for the collection of and accounting for tax under the **Income Tax Act**. **TOTAL TOUCH CARGO HANDLING** (hereinafter referred to as **"The Respondent**") is a limited liability Company incorporated and based in the Netherlands. The Company provides transport and handling services for its customers who import flowers and other horticultural products from Kenya to Europe. The Respondent is part of a group of companies known as **The Stamina Group**, who have incorporated in Kenya a subsidiary called **TOTAL TOUCH CARGO KENYA LIMITED** (hereinafter referred to as **TTC-K**). The purpose of this subsidiary was to provide the service of blocking airspace in aircraft and to provide cooling services to the Parent Company in Holland, based upon a joint venture agreement between Stamina Group and Kenya Airways. **TTC-K Ltd** later contracted these services to **KENYA AIRFREIGHT HANDLING LIMITED** (hereinafter referred to as **KAHL**).

(4) The Respondent claims that **KAHL** began to erroneously raise VAT invoices to **TTC (K)** Ltd instead of to the Respondent Company. The Respondent directed **KAHL** to direct all the invoices to themselves and not the **TTC (K) Ltd** as the latter was merely an agent of the Respondents and had no connection or agreements with the buyers in Europe. **KAHL** then wrote to the Appellant seeking an interpretation of the law over the question of whether VAT was chargeable for the services rendered by **KAHL** to the Respondent.

(5) The Appellant responded vide their letter dated **5th March 2012** that VAT was chargeable to **TTC(K) Ltd** as the services which **KAHL** provided to the Respondent were deemed to be local supplies. The Respondent was surprised by this reply given that they had earlier received a letter dated **6th December 2011** in which in the Appellant had stated that the services rendered to them by **TTC(K)** were exported services for which VAT was **not** chargeable.

(6) The Respondent then filed an Appeal before the VAT Tribunal challenging the decision of the Commissioner of Tax directing them to pay VAT. The Tribunal rendered its decision on **17th September 2013** and found that no VAT was chargeable to the Respondent on account of the cooling, scanning and palletizing services rendered by **KAHL** to the Respondent as these were services exported out of Kenya. The Appellant being dissatisfied by that decision of the Tribunal filed this present appeal.

(7) The Memorandum of Appeal filed on 1st October contained 13 grounds of Appeal which can be summarized as follows:-

(i) THAT the VAT Tribunal erred in finding that matters argued by KRA to show that consumption in Kenya amounted to the introduction of issues not previously pleaded in the statement of facts and therefore contrary to the VAT Appeals rules and thus cannot be allowed.

(ii) THAT the VAT Tribunal erred in finding that the consumption of the services in question were not in Kenya and therefore not VAT able, whereas in fact those services had been consumed in Kenya and were therefore VAT able.

(iii) THAT the VAT tribunal erred by not recognizing that it is the Commissioners mandate to interpret the law and apply it accordingly, and that the decision dated 28th June 2012, was within his legal mandate to review an earlier decision or opinion made under a mis-interpretation of the law.

(8) The Appellant contended that the services which **KAHL** a local company provided to the Respondent were services provided within Kenya and thus did not qualify as export services. Accordingly said services were liable to 16% VAT. The Appellant alleged that the Respondent had changed the person to be invoiced by **KAHL**, as a scheme to remove tax liability and to evade tax. The Respondent referred to the letter dated **27th February 2012** written by Kenya Airways on behalf of **KAHL** to the Commissioner of Domestic Taxes which letter read in part as follows:-

"KAHL charges VAT on the invoice for the services rendered to TTC (K) among other customers and remits the same to Kenya Revenue Authority. However, the holding company has proposed a change of the business structure that would have KAHL invoice TTC (H) instead of TTC (K) for the services. As such, TTC (H) and the parent Company management are of the view that in this new realignment, no VAT should be charged on their invoices as the same is an export of a service which is zero rated according to the Kenyan legislation."

It is this realignment that is the bone of contention.

(9) The Appellant submits that this realignment was nothing more than a tax avoidance scheme by which the Respondent would incorrectly determine a service as being an exported service by having a non-resident company (**TTC-H**) invoiced. The Appellant argued that it was the horticultural produce that was exported not the service provided by **KAHL** before said produce left Kenya. The Appellant further submitted that in determining the **"user"** or **"consumer**" of a service, the party who pays for said service is irrelevant. That what matters is where that service is provided, who provides the service and the place of use of that service and the place of consumption.

Accordingly the Appellant was of the view that the consumer of the services provided by **KAHL** was the flower farmer in Kenya, whose produce (cut flowers) would benefit from the services offered by the Respondent in order to have said flowers certified as fit for exportation. The Appellant asserted that it was the Kenyan Flower farmers who contracted **KAHL** to provide the cooling palletizing and scanning services therefore those services could not be said to be "**exported services**." The Appellant cited Appeal **No.11 of 2013 COCO COLA CENTRAL EAST & WEST AFRICA LIMITED –VS- COMMISSIONER OF DOMESTIC TAXES** in which the VAT Tribunal stated that:

"to consume means to "use up" while use means "to put to a particular purpose," "to take up something."

In that same appeal the Tribunal rendered itself thus regarding consumption of a service.

"Consumption or use of a service is not determined by reference to the payer of the service or location of the payer of the service or location of the person who is requisitioning for the service. What is pertinent is the location of the consumer."

The Appellant insisted that it was **KAHL** who were rendering services to **TTC (K)** which was a local company and this was the tax point in dispute.

(10) The Appellant further insisted that since the services in issue were being provided in Kenya the tax would become due immediately upon provision of that service. The Appellant relied on **Section 6(3)** and **(4)** of the **VAT Act** (now repealed) and Regulation 20 of the Value Added Tax Regulations. The Appellants contention was that the Respondent was never the taxpayer, and that is why they did not assess them for tax so as to warrant these proceedings. The Appellant finally submitted that since **KAHL** provided the service in Kenya and the service was also performed in Kenya it followed therefore that the services in question were

local services for which VAT was payable.

(11) On their part the Respondent strenuously opposed the appeal. They submitted that vide letter dated **6th December 2011**, the Appellant had confirmed that the services offered by **TTC (K)** to the Respondent were offered in order to ensure that the produce reached the market in Europe in a state fit for consumption. As such these were exported services which were zero rated. The Respondent stated that they had all along relied upon this confirmation by the Appellant. The Respondent submitted further that since it was a company incorporated in Holland with its buyers based in Europe, then the services could only be considered as exported services within the meaning of Section 2 of the **VAT Act** (now repealed). The Respondent contended that the scanning, cooling and palletizing services offered to them by **KAHL** were services intended to ensure that the horticultural produce arrived in Europe in a fresh state suitable for consumption and use by its European buyers. Since the produce was consumed in Europe the Respondent contended that Regulation 20 of the VAT Rules were not applicable. They urged that Section 2 of the repealed **VAT Act** provided that a service for use or consumption outside Kenya is deemed to be a exported service. This remains the case whether said service is performed in Kenya or outside Kenya.

(12) Regarding the reliance placed by the Appellant on the **COCO COLA Case (Supra)**, the Respondent countered that the decision in that case was currently the subject of an appeal before the High Court.

ANALYSIS AND DETERMINATION

(13) There is only one main issue for determination in the present appeal that is whether the services rendered by **KAHL** to the Respondent can be considered to be exported services within the meaning of **Section 2** of the **VAT Act** (now repealed). The position held by the Appellant was that since the services of scanning, cooling and palletizing were performed in Kenya they are services offered within the Country. The Appellant insisted that that the said services are not exported and therefore VAT is payable. The fact that the person paying for those services being **TTC-H** was based in Holland is immaterial. The Appellant's view was that any services performed in Kenya could not be considered as exported services.

(14) The Respondent on the other hand insisted that the services provided by **KAHL** were in fact an exported services within the meaning of **Section 2** of the repealed **VAT Act**. The Respondent contended that the services in question were received and paid for by **TTC-H** and that the benefit of the service accrued to **TTC-H** and its consumers who were based outside of Kenya.

(15) This dispute therefore revolves around the interpretation of the term "**service exported out of Kenya**" as provided for in Section 2 of the repealed **VAT Act**.

Section 2 of the **VAT Act** (now repealed) defined **"exported service"** in the following terms

"Service exported out of Kenya means a service provided for use or consumption outside Kenya whether the service is performed in Kenya or both inside and outside Kenya." [emphasis supplied]

A clear reading of this provision is that for a service to be deemed an "**exported service**", 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. Therefore an exported service will be one which is provided for use or consumption outside Kenya.

(16) In **F.H. SERVICES KENYA LIMITED –VS- COMMISSIONER OF DOMESTIC TAXES, Appeal No.6 of 2012**, the Appeal tribunal found that what was pertinent, in Kenyan law as far as VAT legislation was concerned was where the services are finally used or consumed. In this a case **F.H Services Ltd** represented **Flora Holland** a company incorporated in the Netherlands, which was involved in trading of flowers. **F.H Services** provided services to **Flora Holland** for the export of flowers from Kenya to buyers overseas. The holding of the tribunal in that case was that since the benefit of the marketing services provided by **F.H Services Ltd** accrued outside Kenya, these were therefore exported services. In that case the Tax Tribunal held as follows:-

To our mind then, it is immaterial where the place of the performance of the service takes place, it can be in China, in Latin America, in Ireland, in Mesopotamia, in Asia or Europe or even here in Kenya; what is material is where the use or consumption of the service takes place, not the place of services [emphasis supplied].

Similarly in the Indian case of **PAUL MERCHANTS LTD –VS- CCE CHANDIGARH [2012 (12) TMI 424 – CESTAT,**

DELHI LB] 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.

(17) In the present case the scanning, cooling and palletizing services provided by **KAHL**, were performed in Kenya. However the user and consumer of these services being **TTC-H** and their European customers were based outside Kenya. The services were aimed at ensuring that the horticultural produce and flowers reached Europe in a fresh state fit for consumption by these foreign buyers. Accordingly despite the service being performed within Kenya it was in actual fact an exported service.

(18) The Appellants argument was that the consumers of the services provided by **KAHL** were actually the Kenyan farmers who required that their produce to be prepared and put in a merchantable state at the time of export to the eventual customer in Europe. The Appellant relied on **INCOTERMS** that were contained in their bundle of documents in the Appeal before the Tribunal in letter to the Commissioner dated **23rd February 2013** which stated in part:-

"We also that that our view is well explained by INCOTERMS which contain international rules for the interpretation of terms used in foreign trade contracts. When TTC-H is contracted by Kenyan farmers (sellers) the CIP contract applies. When TTC-H is contracted by non-Kenyan customers (buyers), the FCA contract applies.

The Appellant held the view that failure by **KAHL** to carry out the cooling, scanning and palletizing of the Kenyan farmers produce would result in that produce not being of merchantable quality when it eventually arrived at the European destination. The produce would then not be sellable to the foreign consumers. However there is no evidence or even suggestion that any of the Kenyan farmers had a contract or Agreement with **KAHL**, or with the Respondent to ensure that their produce was prepared to be merchantable in Europe. The service contract exsted between **KAHL** and the Respondent, to facilitate the export of horticultural produce and flowers for consumption and use by persons outside Kenya. These eventual buyers were the Respondents customers, in Europe.

(19) It is not in any dispute that the purpose of the services provided by **KAHL** was to ensure that the Respondent delivered the horticultural produce and flowers to their customers in Europe a fresh state. The Respondent on whose behalf the services were being performed was also based outside Kenya (in Holland). It is clear therefore that the services being provided by **KAHL** were consumed by the Respondent (a foreign based company) and said services were ultimately enjoyed or used by the buyers (consumers) of the horticultural produce and flowers who were also outside of Kenya.

(20) The basis of the Appellants appeal before the Tribunal was that since the services provided by **KAHL** were performed in Kenya, then it meant that said services were consumed in Kenya. Prior to the hearing before the Tribunal the Appellant had never raised the argument that the consumers of the services offered by **KAHL** were in actual fact the Kenyan farmers. This argument was nevertheless rejected by the VAT Tribunal. The Tribunal found instead that the Appellant had never named or identified the consumer of the services in question. The Tribunal stated that all facts which a party intended to rely upon were required by the **Rule 8(i) Value Added Tax Appeals (Rules) 1990** to be set out in the statement by facts before the Tribunal. Having failed to have identified the Kenyan farmers as the consumers of the service in their statement of facts the Appellant was effectively estopped from raising the same before the Tribunal.

(21) This court finds no reason to interfere with the ruling of the Tribunal in this regard. It is trite law that parties are bound by their pleadings. This ensures that a trial or an appeal is conducted fairly and avoids any type of ambush or surprise.

(22) The Appellant also submitted that **Regulation 20** of the VAT Rules qualifies the definition of an exported service under Section 2 of the **VAT Act** (now repealed). Regulation 20 provides:-

"Except as is otherwise provided in the Act, services shall be deemed to have been supplied in Kenya-

Where the supplier has established his business or has a fixed physical establishment in Kenya and the services are physically used or consumed in Kenya regardless of the location of the payer."

(23) According to the Appellant where a supplier is physically established in Kenya then services provided by that supplier are taxable in Kenya. The Appellant further submitted that the fact that the new **VAT Act 2013** incorporated Regulation 20 as a substantive provision being **Section 8**, made the intention of the legislature in this regard very clear. The Respondent however countered that under the **2012 VAT ACT** (the applicable legislation in this matter), Regulation 20 amounted to subsidiary legislation in so far as it sought to provide that a service provided in Kenya cannot be deemed to be an exported service. It was the Respondents contention that a subsidiary legislation cannot override primary legislation being **Section 2 of the VAT Act**.

(24) The Appeal Tribunal rejected the Appellants reliance on Regulation 20 to limit the ambit of **Section 2 of the VAT Act**. In the **COCO COLA Case** (Supra) the Tribunal held as follows:-

For a start, Regulation 20(i) (a) has no nexus with a service exported out of Kenya as defined under S.2 of the VAT Act. If a service has been exported out of Kenya i.e if a service has been provided for use or consumption outside Kenya and it is truly used and consumed outside Kenya, the issue of Regulation 20(1) can never arise. The Regulation is simply there to qualify what a local supply is.

Similarly in the **F.H Services case** (Supra) the tribunal in holding that principal legislation is superior to subsidiary legislation stated that:-

"The principal legislation is higher law than the subsidiary legislation, and unlike the subsidiary legislation which can be altered without going through Parliament, principal law can only be altered by Parliament. It is therefore critical for the Respondent to understand that in the event that he wants to rely on Regulation 20(i) (d) for his case, he must first go to the principal legislation, the main law that is contained in the main body of the VAT Act. Specifically, the meaning of "service exported out of Kenya"

Based on the above it is clear that principal legislation overrides subsidiary legislation, thus the Appellant cannot rely on Regulation 20 to override the definition provided by Section 2 of the repealed Act of "**services exported out of Kenya**." To further buttress this point the Court of Appeal in **WAVINYA NDETI –VS- INDEPENDENT ELECTORAL BOUNDARIES (IEBC) & 4 OTHERS [2014]eKLR** held that:-

It is an established principle of construction of statutes that no subsidiary legislation shall be inconsistent with the provisions of an Act (See Section 31(b) of the Interpretation and General Provisions Act – Cap 2 Laws of Kenya). A subsidiary legislation cannot repeal or contradict express provisions of an Act from which they derive their authority.

Based on the above authorities I find that Regulation 20 being subsidiary legislation cannot negate or contradict the definition of an "**exported service"** in the principal legislation being **Section 2** of the repealed Act.

(25) The Appellant also placed reliance of **Section 6(3) and (4)** of the repealed **VAT Act** which provides:-

"(3) A person who makes or intends to make taxable supplies is a taxable person while he is, or is required under the sixth schedule and a taxable supply is a supply of taxable goods or services made or provided in Kenya.

(4) Tax on any supply of goods or services shall be a liability of the person making the supply and (subject to the provisions of this Act relating to accounting and payment) shall become due at the time of supply."

The Respondent contended that since the relevant services were provided in Kenya, taxes became due immediately upon supply. However it is trite law that the provisions of any statute should be read holistically in order to give meaning to what was intended by the draftsman. In **THE ENGINEERS BOARD OF KENYA –VS- JESSE WAWERU WAHOME & OTHERS CIVIL APEAL NO.240 OF 2013** the court stated that:-

"One of the canons of statutory interpretation is a holistic approach…no provision of any legislation should be treated as "stand alone." An act of Parliament should be read as a whole, the essence being that a proposition in one part of the Act is by implication modified by another proposition elsewhere in the Act."

(26) Therefore Sections 6(3) and (4) of the repealed **VAT Act** reveal that what was intended by **Section 2** of the same Act was that a

service used or consumed outside Kenya would be an exported service whether or not the same was performed or supplied in Kenya. The Appellant misinterpreted the law by concluding that the services in question were consumed in Kenya merely by virtue of the fact that those services had been performed in Kenya.

(27) The Respondent referred to the VAT guidelines on International Trade and services in intangibles developed by the **ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD).** The said guidelines are applicable in interpreting Kenyan Tax Law as was held in the case of **UNILEVER KENYA LIMITED –VS- THE COMMISSIONER OF INCOME TAX – Income Tax Appeal No.753 of 2003**) where the court held…

"The ways of doing modern business have changed very substantially in the last 20 years or so and it would be fool hardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own laws. To do otherwise would be highly short sighted."

The Respondent submitted that under the **"destination principle"** in the **OECD** guidelines, goods, services and intangibles are zero-rated when leaving one jurisdiction and are taxed upon importation in another jurisdiction. In **OECD** guidelines the "**destination principle**" is preferred to the **"origin principle**" as it helps to achieve VAT neutrality. The **"origin principle**" which is the opposite of the **"destination principle**" provides that tax accrues to the jurisdiction from which supply is made. In **OECD** guidelines export of a service is associated with the place of consumption of the service. The guidelines and the main rule by **OECD** on tax for internally traded services are as follows:-

Guideline 1 - For consumption tax purposes internationally graded services and intangibles should be taxed according to the rules of the jurisdiction of consumption.

Guideline 2 - For business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles.

Guideline 3 – The identity of the customer is normally determined by reference to the business agreement.

Main Rule – the jurisdiction where the customer is located has the taxing rights over a service or intangible supplied across international borders

(28) The VAT Tribunal in Kenya has placed reliance on **OECD** principles in determining the charging of VAT based on the place of use and consumption of a good or service as in the **FH Services** Case as well as in the tribunals decision in the case resulting in this present appeal. At Page 31 of the **F.H Services** case the Tribunal guided by **OECD** guidelines held that:-

"The upshot of the guidelines is that the services are said to be used or consumed in the jurisdiction of the final consumer i.e where the supply to the final consumer occurs. This is the jurisdiction which has the right to tax the services according to the rules of the jurisdiction where the consumption occurs".

In the **Total Touch Cargo Holland** case (subject of this appeal) the VAT Tribunal in commenting on the **OECD** principles stated that:-

"The application of the destination principle in value added tax achieves neutrality in international trade…… Accordingly the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction of consumption and therefore all revenue accrues to the jurisdiction where the supply to the final consumer occurs" [emphasis supplied].

(29) From the above it is clear that **Section 2** of the repealed **VAT Act** which stipulates that an "**exported service"** is that which is provided for use or consumption outside Kenya is in keeping with the destination principles under the **OECD** guidelines. As such the taxing rights in terms of VAT to be charged on the services offered by **KAHL** to the Respondent is in the Netherlands and **not** in Kenya, since the final consumer of the horticultural produce and flowers being prepared for export is the Respondent and its customers in Europe.

(30) Finally and based on the foregoing my finding is that the services which are offered by **KAHL** to the Respondent are in fact exported services. The tax tribunal had the following to say in finding that the services in question were exported services.

"it seems to us that it is important that we must emphasize that the purpose of entering into agreement between the appellants group of companies and Kenya Airways was to establish KAHL whose activity is to scan, cool and palletize produce before it is shipped to Europe, which must arrive there as submitted by the Appellant in a fresh state to enable it to be used or consumed by the inhabitants of that continent…

We do not therefore agree with the Respondent's argument that the services provided by KAHL are consumed by the farmer…since failure to use these services would mean the goods would not reach Europe in a fresh state and consumable state. On the contrary we find that the service performed by KAHL ensures that the consumer of the produce who is in Europe receives fresh and consumable produce with the result that it is him, rather than the seller of the produce, who consumes the produce of the seller which arrives in Europe in a fresh and consumable state due to the service that is performed by KAHL and paid for by the appellant and not the seller.

…if it is an issue of physical consumption of the scanning cooling and palletizing service it occurs in Europe where the physical consumption of the produce occurs, since such an act takes place in respect to the produce exported from Kenya to Europe which could not be possible without the scanning, cooling and palletizing services.!"

I am in full agreement with the above finding by the tribunal. The location where the service is provided does not determine the question of whether the service is exported or not. The test is the location (or place) of use or consumption of that service. Therefore the relevant factor is the location of the consumer of the service and not the place where the service is performed. In this case the service provided by **KAHL** was for use and consumption in Europe.

Accordingly based on the foregoing, my finding is that the proper tax jurisdiction for the services provided by **KAHL** to the Appellant is the Netherlands and not Kenya.

The upshot is that this appeal fails and is hereby dismissed in its entirety.

Costs are awarded to the Respondent.

Dated in **Nairobi** this **21st** day of **December** 2018

Justice Maureen A. Odero