Tax Alert

VAT exemption on transportation of sugarcane from farms to milling factories

September 2016

Introduction

The President, on 4 August 2016, assented to the Value Added Tax (Amendment) Act, 2016 ("VAT Amendment Act"), a law whose objective is to amend the Value Added Tax Act, 2013 ("VAT Act") to exempt the levying of Value Added Tax ("VAT") on transportation of sugarcane from farms to sugar milling factories. In this regard, the exemption has been introduced in Part II of the First Schedule to the VAT Act with effect from 24 August 2016.

The effect of the amendment

Transport costs account for a significant portion of the cost of sugar production. The government anticipates that with the change in legislation, sugarcane farmers are now exempted from paying VAT on the transportation of the crop to the mills thereby resulting in a reduction of the cost of sugar production.

The expected effect is a corresponding decrease in sugar prices and an upturn in the dwindling fortunes of the Kenyan sugarcane farmer. However, it may be misguided for the industry to celebrate the anticipated cost reduction.

While the Government's efforts to support Kenya's sugarcane industry are laudable, the amendment to the VAT law in our view may fail to achieve the desired effect. It is important to note that the VAT Act prohibits the claiming of input tax credits in relation to VAT incurred in the course of making exempt supplies.

Accordingly, under the amended VAT law, transporters of sugarcane will not be able to recover any VAT incurred by them in relation to their transportation services to the sugarcane farmers. For instance any VAT incurred on the acquisition and/or repair of their transportation vehicles, will be a sunk cost for the transporters.

Invariably, it is our view that the transporters will seek to recoup their non-recoverable VAT costs by way of increased transport charges to farmers. Accordingly, whilst VAT may not be applicable on the sugarcane transportation costs, the desired cost reduction objective is unlikely to be met.

The ideal amendment

Unlike the case of VAT exemption, if the transportation of sugarcane from farms to mills were to be zero rated, the suppliers of these services would (to the extent they are registered for VAT) be entitled to claim input tax credits in relation to VAT incurred in the course of their business. Consequently, transporters would have no reason to hike their transportation charges and the desired cost reduction to farmers would be achieved.

Furthermore, the repealed VAT Act, Cap 476, provided for zero rating of the supply of transportation services in respect of unprocessed agricultural and agro-forest produce. The current amendment mainly focuses on the sugarcane industry whereas the repealed Act covered the entire agricultural industry. It is not clear to us why the Government has sought to provide VAT reprieve to a specific sub-sector within the agricultural sector.

Equity is an important principle or canon of taxation and we would have expected the present amendment to the VAT legislation to cover transportation services in respect of all unprocessed agricultural and agro-forest produce as opposed to sugarcane alone.

Conclusion

It is an undisputed fact that Kenya's agricultural sector is a significant contributor to the economic growth and development of the nation and that any policies, laws and regulations that affect the sector adversely will by extension slow down economic growth and development.

Taking into account the goodwill already demonstrated by the Government with regard to this matter, it is our view that the National Treasury and the National Assembly should actualize the desired reprieve for the farmers by zero rating of transportation services in relation to unprocessed agricultural and agro-forest produce as opposed to exempting such services from VAT.

It is noteworthy that the national budget cycle for the fiscal year 2017/18 has been brought forward by three months to accommodate the 2017 election polls. Tentatively, the Budget Statement for 2017/18 fiscal year will be read on 17 March 2017. In this regard, industry players should consider engaging National Treasury on the proposed change in the VAT law as soon as possible if this changes are to be incorporated in the 2017/18 budgetary cycle.

Let's talk

For an in-depth discussion on how this may affect your business and for guidance on the engagement with National Treasury and other relevant stakeholders, please contact:

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