Tax Alert

Kenyan Tribunal clarifies that consumption does not extend to third parties who are not privy to a business contract in determining whether services have been exported for VAT purposes

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Introduction

The Tax Appeals Tribunal of Kenya ("Kenyan TAT") delivered its judgement in the case of LG electronics Africa Logistics FZE Kenya branch ("LG Kenya", "branch") versus The Commissioner of Domestic Taxes Kenya Revenue Authority ("KRA") on 31 March 2020, in determination of whether the marketing and advertising services provided by the branch to the head office qualified as an export of a service in accordance with the provisions of the Kenyan VAT Act.

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The Kenyan TAT held that for purposes of determining whether the marketing and advertising services had been exported, the consumer would be determined by reference to contractual relations contained in the business agreement between the branch and the head office. The Kenyan TAT among other things, held that there was no contractual link between LG Kenya and the Kenyan distributors who were alleged by KRA to be the local consumers of LG Kenya's marketing services in this case.

This ruling is useful in defining use and consumption when determining what qualifies as an export of services as required under Regulation 12 of the Uganda VAT Act. It will therefore set a good precedent for consideration by the Ugandan courts in interpretation of similar cases.

Background facts

KRA conducted a tax audit on LG Kenya and raised an assessment demanding taxes under several tax heads which included Value Added Tax("VAT") for the period commencing January 2010 to December 2016. KRA's view was that the marketing and advertising services rendered by the branch in Kenya was for the benefit of third-party distributors who imported LG electronic products from the non-resident head office for sale in Kenya. According to the KRA, since the third-party distributors (deemed as beneficiaries of the marketing and advertising services) were based in Kenya, this qualified the services as local supplies subject to VAT in Kenya at the standard rate of 16%.

LG Kenya objected to KRA's assessment and further appealed to the Kenyan TAT on the basis that supplies between a branch and

its head office qualified as exported services which attract VAT at a rate of zero percent (0%).

Analysis of the case

LG Kenya submitted to the Kenyan TAT that the Kenyan VAT legislation does not provide guidance on the determination of place of *'use'* and/or *'consumption'* of services. The branch is in the business of providing marketing and advertising services to its non-resident head office, LG Dubai. Accordingly, reliance had to be placed on decided cases as well as international best practice. The branch specifically sought to rely on the Organisation for Economic Co-operation and Development ("OECD") VAT/GST Guidelines. The branch argued that for purposes of exported services, a consumer is the person who requests for the services pursuant to a business agreement. In its view, the Kenyan distributors alleged by KRA to be the consumers of the services rendered were third parties who were not privy to the contract between the branch and its non-resident head office and could not legally be viewed as the consumers of its services.

On the other hand, KRA argued that the marketing and advertising services rendered by the branch were targeted at the Kenyan audience and therefore these services were meant to influence consumers in the Kenyan market. Accordingly, KRA submitted that the marketing services provided to the branch's head office were not exported services, but they were provided for use and consumption locally in Kenya.

KRA argued that regardless of the payer of the services being outside Kenya, the marketing services were never exported because they were used and consumed locally by the third-party distributors in Kenya.

The Kenyan TAT found that the key question for determination was *'who the consumer of the marketing services provided by the branch was',* which answer would then inform whether the services were indeed exported out of Kenya. In acknowledging that the Kenyan law does not provide for an interpretation of what constitutes *'use'* and *'consumption'* of services, the Kenyan TAT relied on decided cases and the position espoused in the OECD Guidelines.

The Kenyan TAT held that KRA's assertion that the services were consumed by the third parties not privy to the contract between the supplier and the non-resident counterparty was misplaced and lacking in legal merit. Accordingly, it was held that the marketing services provided by LG Electronics were to its head office and not to Kenyan distributors.

What does this mean for the Ugandan taxpayer?

Similar to Kenya, Uganda's VAT Act relies on use or consumption as the sole test for confirming that a service has been exported from Uganda as evidenced by documentary proof acceptable to the Commissioner General. However, the Act does not define use or consumption, leaving both the Uganda Revenue Authority ("URA") and taxpayers with the option of relying on decided cases and the literal dictionary interpretation of the words use or consumption.

On several occasions, we have seen the URA rely on other decided cases such as the Coca-Cola Central East and West Africa Ltd VS the Commissioner Domestic Taxes -KRA case to define consumption to include third party users of a service even where the contract to provide the services is with the non-resident parent company. In this case, Coca-Cola Central East and West Africa Ltd was incorporated in Kenya with the main objective of providing promotion services (advertising and support services) to the Coca-Cola brand on behalf of Coca-Cola Export Corporation domiciled in the United States of America. Coca-Cola Central East and West Africa Ltd engaged various agents in Kenya to advertise the Coca cola brand through television radio stations and Kenyan Local dailies.

The Tribunal ruled that the adverts and promotional services carried out by Coca-Cola Central East and West Africa Ltd were used and consumed by the people living in Kenya and hence could not qualify as exported services as argued by Coca-Cola Central East and West Africa Ltd. The Tribunal therefore concluded that adverts and promotional services were local supplies subject to output VAT.

However, this new decision by the Kenyan TAT now offers a welcome reprieve for taxpayers involved in export of services to their non-resident head offices. This decision rules out the possibility of consumption extending to third parties who are not party to a contract for provision of services such as marketing and advertising services to the head office. Taxpayers who pay significant amounts of VAT owing to the treatment of such services as local supplies subject to VAT at 18% as opposed to exports taxable at rate of 0% will be pleased to rely on this ruling.

Although the URA and taxpayers are now faced with two contradicting rulings on a similar matter, legally court still retains the liberty to rely on whichever case they deem to be more relevant to the facts at hand - since decided cases are used for persuasive purposes only.

We hope the URA will consider this recent TAT decision when addressing the issue of exported services especially concerning the provision of services by branches to their head offices.

In the meantime, we will be pleased to discuss with you the impact of the Kenyan TAT's decision on your business. Please feel free to contact your usual PwC contact or any of our VAT experts below, should you wish to discuss this further.