Tax Alert

2017 VAT regulations invalidated

Background

This alert brings to your attention the High Court's judgment in the case of **Commissioner of Domestic Taxes (KRA) vs W.E.C Lines (K) Limited *(Taxpayer)*** [2022] KEHC 57 (KLR).

The Taxpayer applied to the Kenya Revenue Authority (KRA) for VAT refunds amounting to **KES 6,440,624.00** for the period February 2015 to January 2018. The refunds were in respect of services that the Taxpayer provided to WEC BV.

The KRA rejected the application for refund after reviewing the Agency Agreement between the Taxpayer and WEC BV. In rejecting the refund applications, the KRA relied on Regulation No. 13 of the VAT Regulations, 2017 and concluded that the Taxpayer's supplies did not qualify as exported services and were taxable at 16%.

The Taxpayer appealed to the Tax Appeals Tribunal (Tribunal), which allowed the appeal. The KRA subsequently appealed the Tribunal decision to the High Court.

The KRA's grounds of appeal at the High Court

The KRA challenged the Tribunal's decision on the following grounds:

i. The Tribunal erred in finding that the VAT Regulations, 2017 were in conflict with the VAT Act, 2013. KRA argued that they complement each other;

ii. The Tribunal failed to appreciate that the services rendered by the Taxpayer of marketing, customer care and post landing services were used and consumed in Kenya;

iii. The Tribunal failed to recognize the tri-partite transaction between the Taxpayer, WEC BV and the importers thereby failing to appreciate that the Taxpayer was offering management and agency services to WEC BV and local services to the importers; and

iv. KRA submitted that while the VAT Regulations, 2017 were not tabled before the National Assembly, they have not been found to be unprocedural and/or illegal and are therefore operational.

Taxpayer's arguments

In rebutting KRA's arguments, the Taxpayer contended that:

i. The VAT Regulations 2017 were void by operation of law pursuant to section 11(4) of the Statutory Instruments Act, 2013;

ii. All facets of the services it provided as agent were for the benefit of WEC BV, who is the person who used and consumed these services. These are services provided by a Kenyan entity to a non-resident person and therefore fall within the ambit of the definition of a service exported out of Kenya and were zero-rated *(then)* for VAT purposes.

The Taxpayer urged the High Court to uphold the decision of the Tribunal and find that it was entitled to the VAT refund.

Issue(s) for determination

From the parties' pleadings, and written submissions, the High Court determined that the issues for determination were:

a. whether the VAT Regulations, 2017 were applicable;

b. if applicable, whether they were in conflict with the VAT Act, 2013;

c. whether the services provided by the Taxpayer were exported services as defined under the VAT Act *(at that time).*

The Court's findings

The High Court determined the matter in favour of the Taxpayer. In its decision, the Court observed that:

i. The VAT Regulations, 2017 ceased to have any effect immediately on the 8th day after the said Regulations were not tabled before the National Assembly within the required seven days. The Commissioner could not apply them to the Taxpayer's case as they were null and void;

ii. The beneficiary and consumer of the Taxpayer's services of marketing, customer care and post landing services was its principal WEC BV; and

iii. The Taxpayer was offering these services on behalf of WEC BV, a company incorporated in Netherlands and never contracted any third parties, customer and/or importers on its own behalf.

The Court concluded that the Taxpayer was entitled to the VAT refund because the services offered were exported services, which were zero-rated for VAT purposes.

Our opinion

The decision affirms the mandatory requirement for submission of all statutory instruments before Parliament as provided for under Section 11 of the Statutory Instruments Act, 2013. A statutory instrument means ***"any rule, order, regulation, direction, form, tariff of costs or fees, letters patent, commission, warrant, proclamation, by-law, resolution, guideline or other statutory instrument issued, made or established in the execution of a power conferred by or under an Act of Parliament under which that statutory instrument or subsidiary legislation is expressly authorized to be issued***". While Section 67 of the VAT Act empowered the Cabinet Secretary, National Treasury to come up with the VAT Regulations, 2017, they could only be valid after tabling the same to Parliament and obtaining its approval.

The VAT Regulations,2017 revoked other VAT Regulations such as The VAT Tax Regulations 1994, The VAT (Appeal) Rules 1990, The VAT (Distraint) Regulations 1990, The VAT Order 2002,The VAT (Electronic Tax Registers) Regulations,2004 among others. It is unclear if the invalidation of the 2017 Regulations means that we go back to the old regulations and if so, the impact of this going forward.

The Court's decision also brings to focus other recent VAT Regulations such as the VAT (Electronic Tax Invoice) Regulations 2020 and the VAT (Digital Marketplace Supply) Regulations 2020. Both Regulations are already being implemented by the KRA and would be invalid, by extension, if they were not tabled before Parliament.

In regard to export of services, the Court and the Tribunal has in the recent past been consistent on VAT on exported services. The Finance Act, 2021 however amended the VAT Act, 2013 to move exported services from the zero-rated to exempt category. Taxpayers will no longer be eligible to claim input VAT incurred in the supply of exported services.

KPMG is happy to assist on any issues arising from this decision.

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