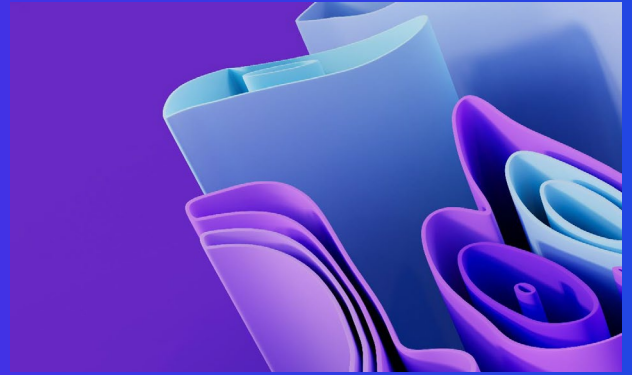




# Tax Alert

## VAT on exported services is standard rated at 16%



### Introduction

This alert brings to your attention the High Court's decision in *Mwaura Kabata & 4 Others v The National Assembly & Others*. (Consolidated Petition No. E338 of 2022). The petition, among other things, challenged the imposition of VAT on exported services by the Finance Act 2022. The High Court dismissed the appeal contending that Parliament acted within its constitutional mandate to introduce the amendments in the Finance Act. According to the Court, the Petitioners did not demonstrate the constitutional violations alleged in the petitions.

### Background

The Finance Act, 2022 introduced amendments to various tax laws including the Value Added Tax Act, 2013 (VAT Act).

The Petitioners filed five separate petitions challenging various provisions of the Finance Act. The court having identified similarities between the five cases, consolidated the petitions.

The Petitioners, in the 2nd Petition challenged the constitutionality of Section 30(b) of the Finance Act which amended the First Schedule to the Act by deleting the export of services from the list of zero-rated services. This deletion effectively made the export of service subject to VAT at the standard rate of 16% effective 1 July 2022.



### Petitioners' case

The Petitioners argued that by deleting Paragraph 32 of the First Schedule to the VAT Act which exempted exportation of taxable services from VAT, the export of services would be subjected to VAT both in and outside of Kenya which amounts to double taxation.

Further, while it was admitted that the Finance Bill, 2022 was subjected to public participation, the Petitioners argued that Section 30(b) of the Finance Act was not contained in the Finance Bill.

According to the Petitioners' the deletion of Paragraph 32 to make export of services vatable had a significant impact on taxpayers. The amendment therefore ought to have been subjected to public participation and the failure to do so by the Respondents was a violation of the Constitution of Kenya, 2010 (the Constitution).

### The Respondents' arguments

According to the Respondents', the process of preparing the Finance Bill, which is done on an annual basis, begins with preparation of the annual budget statement and budget estimates which are tabled before Parliament for approval. In submitting the same for approval, a policy statement expounding on the revenue raising measures to be adopted is presented before Parliament.

This process involves extensive public and stakeholder engagement during which the objects and purpose of the Finance Bill is made known to the public. According to the Respondents, Parliament is mandated by the Constitution to enact tax laws with the aim of raising revenue. It therefore is within its powers to introduce amendments as may be necessary provided that such amendments are in line with the objects of the law.

The Respondents further argued that the Finance Act, 2022 enjoyed the presumption of constitutionality. In determining the dispute, the court therefore ought to look at the purpose and effect of the impugned Finance Act and if the purpose and/ or the effect of the statute do not infringe on a right guaranteed by the Constitution, the Act is not unconstitutional.

## The Court's analysis and findings

The Court considered whether the additional amendments introduced in the Finance Act ought to have been re-submitted to the public for public participation.

According to the Court, Parliament is empowered to introduce amendments to a Bill at the Committee stage provided that the amendments are in line with the subject matter of the Bill that has already been agreed to.

In this case, the Finance Bill, which was subjected to public participation, was intended for the amendment of tax laws. The amendment of the VAT Act fell within the scope of the purpose of the Bill. The amendment cannot therefore be said to be contrary to the object and purpose of the Bill.

On the issue of whether the imposition of VAT on export of services would subject taxpayers to double taxation, the court associated itself with the Organization for Economic Co-operation and Development's (OECD) paper: Addressing the Tax Challenges of the Digital Economic (2014).

In this paper the OECD noted that "the exercise of tax sovereignty may entail conflicting claims from two or more jurisdictions over the same taxable amount, which may lead to juridical double taxation." Bilateral tax treaties address instances of double taxation by allocating taxing rights between the contracting states.

In dismissing the claim for double taxation, the Court opined that Kenya has various double taxation avoidance agreements in place to address the issue of double taxation in two jurisdictions.

## Our opinion

Whereas the main issue before the High Court was the constitutionality of the Finance Act, 2022, the decision rendered appears to sanction a departure from the destination principle that provides for allocation of taxing rights to the jurisdiction where final consumption occurs.

As to whether the VAT on export of services would expose taxpayers to double taxation, it is our view that such exposure cannot be addressed by Double Taxation Agreements (DTAs) primarily because DTAs assign taxation rights on direct taxes and not indirect or consumption taxes such as VAT.

Based on this decision, taxpayers who export taxable services shall be required to charge VAT at the rate of 16%. The imposition of VAT on export of service has put Kenya at a competitive disadvantage compared to its counterparts Tanzania, Uganda, Rwanda and even South Africa which zero rate of export of service. This will make exported services unattractive in the global market to the extent that clients will be reluctant to contract for services emanating from Kenya owing to the risk of double taxation.

The Petitioners have filed a notice of Appeal before the Court of Appeal. It is expected that the issue of double taxation shall be canvassed before the appellate court. In the meantime, where a taxpayer offers a taxable service which is not classifiable as a business process outsourcing, such taxpayers shall be expected to charge and account for VAT on the service.

KPMG is happy to assist on any issues arising from this alert. Contact our tax and regulatory team on cakora@kpmg.co.ke or taxandregulatory@kpmg.co.ke

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