Deloitte.

MAKING AN IMPACT THAT MATTERS since 1845

Tax & Legal Alert
February 2022

High Court invalidates VAT Regulations, 2017

The High Court has invalidated the VAT Regulations, 2017 and also determined that maritime agency services provided to non-resident shippers qualify as exported.

On 31 January 2022, in the matter of **Commissioner of Domestic Taxes v W. E. C. Lines (K) Limited (Tax Appeal E084 of 2020) [2022] KEHC 57 (KLR)**, the High Court of Kenya determined in favor of the taxpayer in respect of the issues under appeal. In summary, the Court held as below:

1. That the VAT Regulations, 2017 which were made on 30 March 2017 did not have the force of law for failure by the Cabinet Secretary for the National Treasury to table the said regulations before the National Assembly for approval. The Court therefore annulled the Regulations for this procedural defect, and
2. That the agency services provided by W. E. C. Lines (K) Limited, an exclusive local shipping agent of WEC Lines BV, Netherland qualified as exported in character and that, consequently, the Company was entitled to refund of excess input tax occasioned by zero-rating.

In this alert, we summarize the judgement and our view on the same.

Background

W.E.C Lines (K) Limited (the Respondent) is the exclusive local shipping agent of WEC Lines DV, a Dutch entity dealing in international maritime transportation of containerized goods. The local agency represents WEC Lines BV locally pursuant to an agency agreement.

W.E.C Lines (K) Limited considered its agency services to WEC Lines BV as exported and therefore, at various dates, sought refund of excess input tax occasioned by zero-rating from the Kenya Revenue Authority ("KRA", "the Appellant").

However, the KRA rejected the refund claims on grounds that the services did not meet the export of service threshold. The Company objected and the KRA reaffirmed its view that the Company was not entitled to refunds. W.E.C Lines (K) Limited then proffered an appeal at the Tax Appeals Tribunal which appeal was determined in favour of the Company.

Aggrieved by the Tribunal's decision, the KRA challenged the Tribunal's decision at the High Court.

Appellant's Case

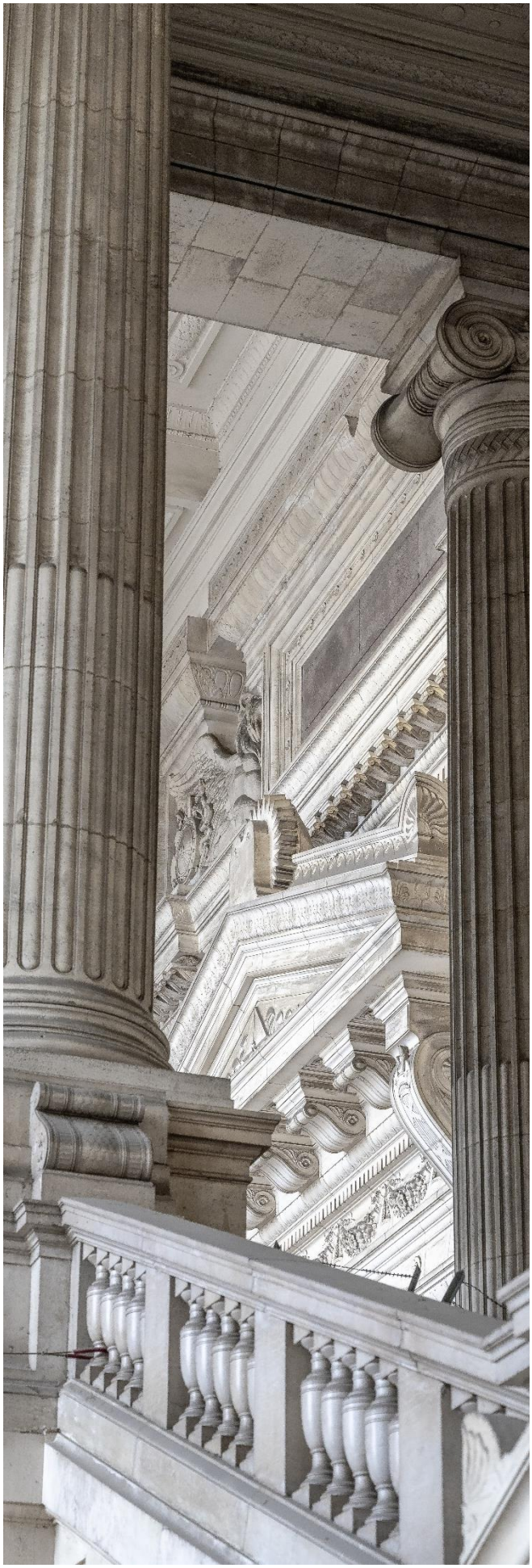
The Appellant advanced the following arguments in support of its case:

- The Appellant (KRA) submitted that the Respondent's services which included, among others, solicitation of business, customer service, booking, documentation, quotation of rates, collection, administration and forwarding of claims were offered to third parties, customers and/or importers based in Kenya and did not qualify as exported. They therefore argued that the Respondent was not entitled to refund of excess input tax.
- The Commissioner also argued that only services provided to the vessels, and not the owners, qualified for zero-rating.
- In respect of the applicability of the VAT Regulations, the Appellant, while admitting that the VAT Regulations, 2017 were never tabled before the National Assembly, contended that they were not found to be unprocedural or illegal and thus they were valid.

Respondent's Case

The Respondent, on the other hand, argued as follows:

- That pursuant to the agency agreement in place with WEC Lines BV, it provided agency services for its principal which qualified as exported and therefore zero-rated. That, as such, it was entitled to refund of excess input tax occasioned by the nature of its supplies; and
- That the VAT Regulations, 2017 which the Appellant relied on were null and void to the extent that they conflicted with the primary legislation, the VAT Act. The Respondent also challenged the validity of the VAT Regulations as they failed to meet the procedural legislative requirements as provided by the Statutory Instruments Act.



The High Court's Determination

The Court found in favor of the Respondent and dismissed the KRA's appeal. In summary, the Court found as follows:

- Relying on the fiduciary nature of the contract between the Respondent and WEC Lines BV, the Court found that there was no privity of contract between the Respondent and the importers of cargo who contract with its principal. The High Court concluded that the greatest/ultimate consumer of the Respondent's marketing, customer care and post landing services was its principal WEC BV, in Netherlands. As such, the Court was persuaded that the Respondent's services met the export of service threshold and that the Company was entitled to refund of excess input tax.
- The Court further found the VAT Regulations, 2017 to have been invalid for procedural defect. This was because the Cabinet Secretary for The National Treasury failed to table the Regulations before the National Assembly contrary to the requirement of Section 11(4) of the Statutory Instruments Act, 2013. It is instructive to note that the invalidity of the Regulations was within eight days after publication of the Regulations.

Conclusion

In our view, the High Court's decision provides clarity on two pertinent matters:

- The invalidity of the VAT Regulations, 2017 which is a matter that has previously been subject to debate. The judgement concludes that the Regulations, together with subsequent amendments should not be considered as forming part of the tax laws in Kenya. In effect, any decisions that the KRA may have made based on the regulations lack legal merit.

  Specific decisions come to the fore:

  - The application of Regulation 8 to restrict VAT refund claims. This perhaps presents room for taxpayers to seek refund of any amounts previously restricted from refund;
  - The application of Regulation 13 in determining the matter of export of service.
- The invalidation of the VAT Regulations may also pose questions as to whether the Regulations under the repealed VAT Act (CAP 476) continued to apply during the period prior to invalidation of the VAT Regulations, 2017 by the High Court. This is because the transitional provisions of the VAT Act, 2013 required that the Regulations under the previous VAT regime continue to apply until new regulations were enacted.
- Lastly, the judgement strengthens the case for shipping agents to obtain VAT refunds from the KRA. Barring a successful appeal on the decision, this judgement becomes precedent and binds the Commissioner.

The above notwithstanding, the KRA retains its right of appeal before the Court of Appeal ('CoA'). Should the KRA exercise this right, the CoA would conclusively weigh in on this matter.

Should you wish to discuss this further, kindly feel free to contact any of the contacts below or your usual Deloitte contact who will be more than glad to offer you guidance and assistance.

Contacts for this alert

Fred Omondi
Tax & Legal Leader
+254 719 039 318
fomondi@deloitte.co.ke

Lillian Kubebea
Partner
+254 719 039 113
lkubebea@deloitte.co.ke

Walter Mutwiri
Partner
+254 719 039 253
wmutwiri@deloitte.co.ke

Patrick Chege
Associate Director
+254 719 039 322
pchege@deloitte.co.ke

Charles Musyoka
Manager
+254 719 039 019
cmusyoka@deloitte.co.ke

Kennedy Okoyo
Manager
+254 719 039 428
kokoyo@deloitte.co.ke