REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
TAX APPEAL NO. 205 OF 2019

FORTUNE CONTAINER DEPOT LIMITED.....APPELLANT

-VERSUS-

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND:-

1. The Appellant is a limited liability company, duly incorporated in Kenya under the Companies Act, Cap 486, Laws of Kenya, whose principal activity is handling, storage, repairs, cleaning and transporting empty containers to and from the port of Mombasa.

2. The Respondent is established under the Kenya Revenue Authority Act, (Cap 469) of the Laws of Kenya, charged with the mandate to administer and collect tax revenue on behalf of the Government of Kenya.

3. The Appellant provides services container handling, storage, repair, cleaning and transporting services to Mediterranean Shipping Company (hereinafter referred to "MSC"), a non-resident entity based on an agency agreement dated 1st June 2000, in which MSC is the Principal and the Appellant is contracted as its Agent.

4. The Respondent carried out a VAT refund audit of the Appellant's refund status for the period of June 2015 to July 2018 and thereafter issued VAT assessment orders on February vide the Appellant's iTAX platform on various dates being 4th February 2019, 21st February 2019, 22nd February 2019, 25th February 2019 and 26th February 2019 highlighting a VAT liability of Kshs.91,268,003.73.

5. The Respondent later raised additional VAT assessments vide its letter dated 27th February 2019 of Kshs.82,056,714 being VAT credit reduction of Kshs.5,141,756 and VAT liability of Kshs.76,914,958 inclusive of penalties and interest.

6. Being dissatisfied with the Respondent's, the Appellant objected to the assessment vide its Notice of Objection dated 28th March 2019 wherein the Appellant presented various grounds of objection.

7. Consequently, the Respondent in response to the Appellant's objection letter, issued two Objection Decisions dated 11th April 2019 and 6th May 2019. The Objection Decision dated 11th April 2019 confirmed the Respondent's VAT assessment for the period of June 2015 to December 2015 at Kshs.7,907,812 and disallowing the Appellant's Objection. The Objection Decision dated 6th May 2019 confirmed the Respondent's VAT assessment for the period of January 2016 to June 2018 at Kshs.51,488,370 and VAT credit reduction at Kshs.5,141,756 and disallowing the Appellant's Objection.

8. Being aggrieved by the two objection decisions, the Appellant has lodged this Appeal vide its Notice of Appeal dated 10th May 2019 and Memorandum of Appeal dated 23rd May 2019.

THE APPEAL

9. The Appellant lodged this Appeal against the Respondent's Objection Decision dated 17th January 2018 vide a Notice of Appeal dated 10th May 2019 and Memorandum of Appeal dated 23rd May 2019. The Appeal is brought on the following grounds:-

    i. THAT the Respondent erred in law and in fact by confirming, in its Objection Decisions, that services provided and offered by the Appellant do not, wholly or in part, constitute exported services and consequently do not qualify for zero-rating as provided for in

paragraph 1, part A of the Second Schedule to the VAT Act, 2013 despite the same being used and consumed outside Kenya.

ii. The Respondent erred in law and in fact by failing to appreciate the contractual terms between the Appellant and its non-resident principal, Mediterranean Shipping Company as stipulated in the contractual arrangement concluded between the two parties on 1st June 2000.

iii. THAT the Respondent erred in law and in fact by failing to consider international best practice to inform the interpretation of "use or consumption" as used in the definition of exported services provided in Section 2 of the VAT Act, 2013.

iv. THAT the Respondent further erred in law and in fact by adducing that services provided by the Appellant are provided for the benefit of Oceanfreight East Africa Limited ("OEAL"), the principal agent of Mediterranean Shipping Company ("MSC"). It is trite law that services provided to an agent, on behalf of its principal, are ultimately for the benefit of the principal.

v. THAT the Respondent erred in law and in fact by averring that empty containers handled by the Appellant, subject to the agency agreement between the Appellant and MSC, cannot be classified as goods in transit or goods imported into Kenya and therefore do not qualify for zero-rating as provided for in Paragraph 10, Part A of the Second Schedule of the VAT Act, 2013.

vi. THAT the Respondent erred in law and in fact by averring that containers serviced by the Appellant are not shipping units or international sea carriers, despite the definition accorded them under Article 59 of the United Nations Convention for the International Carriage of Goods Wholly or Partly by Sea, and hence do not qualify

for zero-rating under paragraph 6, Part A of the Second Schedule, to the VAT Act, 2013 relating to the supply of taxable supplies to international sea or air carriers on international voyage or flight.

vii. THAT the Respondent erred in law and in fact by failing to appreciate the numerous precedents set by courts of law from within the country and elsewhere on the issue of "exported services".

viii. THAT the Respondent erred in fact and in law by purporting to reject the Appellant's VAT refund claims with respect to the period April 2018 to September 2018 despite the same being the subject of an ongoing tax dispute that is currently undergoing the dispute resolution process established under the attendant legislative framework, that is the TPA 2015 and TATA 2013.

10. The Appellant prays that the Objection Decisions be annulled by the Tribunal.

11. The Respondent in response to the Appeal filed its Statement of Facts dated 21st June 2019 outlining its case and prays that the Appellant's Appeal be dismissed with costs to the Respondent and the Respondent's Objection Decisions be upheld as a true reflection of the Appellant's tax obligation.

APPELLANT'S CASE

12. The Appellants set out its case in support of the Memorandum of Appeal vide its statement of facts dated 23rd May 2019 and written submissions dated 2nd August 2019 and have narrowed down the Appeal to the following two issues:-

i. Whether the services provided by the Appellant to its non-resident principal, MSC, are zero-rated for VAT purposes; and

ii. Whether VAT refund claims amounting to Kshs.40,026,309.33 for the period from June 2015 to May 2018 ought to have been rejected by the Respondent, pending the determination of the present Appeal.

13. The Appellant describes itself as a company that provides inter alia, container handling services to MSC, a non-resident international shipper, based on an agency agreement dated 1st June 2000. The Appellant describes the services provided to its non-resident Principal as captured in paragraphs 14 and 15 below.

14. MSC, transports cargo contained in containers to its customers within the East African region through the port of Mombasa. Upon arrival at the port, the cargo is transported on land to MSC's various customers within the East African Region, following which empty containers are returned to the Port of Mombasa for onward transportation to MSC's destination of choice.

15. Prior to the empty containers being transported from the port to MSC's destination of choice, the Appellant services the empty containers by performing a number of tasks, as required by the Contract entered into by the two parties. Container handling services provided by the Appellant include:-

a) Container handling services-this involves lifting the empty containers from trailers and parking them accordingly in the Appellant's yard. Once the empty containers have been cleaned and/or repaired, they are lifted and placed on trailers for onward transportation to the Mombasa Port;

b) Repair, maintenance and cleaning services-this involves cold washing or steam cleaning of the empty containers as well as conducting general repairs of the same; and

c) Storage services.

16. The Appellant avers that the above services provided to MSC are necessary to enable the onward transportation of the empty containers to MSC's destination of choice for the furtherance of MSC's shipping business. The services are not provided to MSC's customers but rather for the sole consumption of MSC as the owner of the empty serviced containers.

17. On the first issue on whether the services provided by the Appellant to its non-resident principal, MSC, are zero-rated for VAT purposes, the Appellant opposed the Respondent's position expressed in its Objection Decision that the services supplied by the Appellant were provided for use and consumption in Kenya and thus chargeable to VAT at the standard rate of 16%. The Appellant conversely submits that the services provided by itself to MSC are exported services and are therefore zero-rated for VAT purposes.

18. The Appellant, while reiterating the contents of its notice of objection dated 28th March 2019 highlighted the definition of an exported service as provided in Section 2 of the VAT Act, 2013 as a service provided for use or consumption outside Kenya. The Appellant further averred that Paragraph 1, Part A of the Second Schedule to the VAT Act, clearly classifies exported services as zero-rated for purposes of VAT.

19. While relying on the case of **Nelson Andayi Havi vs Law Society of Kenya & 3 others (2018) eKLR,** the Appellant invited the Tribunal to apply the rule of literal interpretation and adopt the ordinary, literal, grammatical meaning of the terms "use or consumption" in the absence of a clear legal

definition in statute. The Appellant set out the definitions of consumption/use as defined in the Oxford Dictionary, Business Dictionary and the Black's Law Dictionary respectively as below:-

*Oxford Dictionary- **"Consumption"**- economic utilization of economic goods and services to satisfy needs or the action of using up a resource.*

*Business Dictionary-**"Consumption"**– the process in which the substance of a thing is completely destroyed, used up, or incorporated or transferred into something else in particular time period.*

*Black's Law Dictionary-**"Consumption"**- the act of destroying a thing by using it or the use of a thing in a way that exhausts it.*

***"Use"**– a long continued possession and employment of a thing for the purpose for which it is adapted.*

20. The Appellant asserted that it was pointless to read into the definition of an express statutory provision which may otherwise distort its meaning and scope. To buttress this position the Appellant relied on the decisions in **Cape Brandy Syndicate vs Inland Revenue Commissioner (1921) 1 KB 64** and **Russel(Inspector of Taxes) vs Scott 1943 AC 422** where the court held that in the interpretation of tax laws, the courts must only look at what the Act states.

21. The Appellant avers that the facts clearly highlight that the services supplied by the Appellant are used and consumed directly by its Principal, MSC, a non-resident international shipping entity based in Geneva, Switzerland. The Appellant submits that the determination of whether the services provided by the Appellant to its Principal, MSC, qualify as exported services should be restricted to the definition of exported services under section 2(1) of the VAT Act as to the final destination of consumption or use as stated in the case of **F.H Services Kenya Limited – vs- Commissioner of Domestic Taxes, Appeal No. 6 of 2012** where it was

stated that what was pertinent in Kenyan Law as far as VAT legislation was concerned, was where the services are finally used or consumed and therefore since the benefit of the services of the provided by F.H Services Ltd accrued outside Kenya, they were considered exported services. The Appellant submitted that similar positions were held in **Republic vs Kenya Revenue Authority and another ex-parte Fontana Limited (2014)eKLR** and **Paul Merchants Limited vs CCE Chandigarh 2012(12) TMI 424-CESTAT DELHI LB.**

22. The Appellant also relied on the decisions of **Panalpina Airflo Limited versus Commissioner of Domestic Taxes (2019) eKLR** where Court stated that the ultimate user or consumer of services provided determines the classification of the service under Kenya VAT legislation. The learned Judge in this case also made reference to **Paul Merchants Limited vs CCE Chandigarh 2012(12) TMI 424-CESTAT DELHI LB** where court noted that in determining whether a service was exported, the critical issue for consideration is where the services were in fact used, rather than the place of performance of the service.

23. The case of **Commissioner of Domestic Taxes v Total Touch Cargo Holland (2018) eKLR** was also quoted to reiterate this position where the court confirmed that of importance in determining whether a service is considered exported is not where the services were performed but rather the location where that service was finally used and consumed.

24. It is the Appellant's case that its handling services are provided with a view to directly further and sustain its Principal's primary business of shipping and transporting goods hence it was their sole responsibility as the supplier of shipments services to ensure that the containers were fit for their purpose and seaworthy. The ultimate consumer, MSC, is entitled to clean, serviced containers for purposes of its business needs and in accordance with the contract entered into by the parties. To this effect, MSC is entitled to examine the containers serviced by the Appellant to

ascertain that there are no defects and are capable of ferrying goods safely and under the right conditions.

25. The Appellant avers that upon provision of these services, MSC compensates the Appellant at a cost plus mark up. The flow of output in the nature of serviced containers is an indication of a flow of a benefit from Kenya to a destination outside Kenya where the actual consumption takes place.

26. The Appellant asserted that one cannot put the matter to rest without relying on the application of the destination principle as adopted in the OECD Vat/GST Guidelines with respect to taxation of cross-border services in order to avoid double taxation. The Appellant was guided by the court's decision in **Unilever Kenya Limited vs Commissioner of Income Tax** where court stated that in the event that the Kenyan legislation is inadequate, reliance may be placed on other jurisdictions and best practice. It averred that the destination principle requires that taxing rights belong to the country of destination in international traded services ie. the country in which the consumer is located by reference to the underlying contract. The Appellant submitted that the above position is reinforced by the decision of the court in **Panalpina Airflo Limited versus Commissioner of Domestic Taxes (2019) eKLR** which found that, with reference to the destination principle, internationally traded services should be taxed accordingly to the rules of the jurisdiction of consumption.

27. Without prejudice to the above assertions, the Appellant also argued any containers are goods in transit as defined in Section 2 (1) of the East Africa Community Customs Management Act, 2004 (EACCMA) and are therefore zero-rated for VAT purposes. The Appellant contends that the containers are stored at the port temporarily for maintenance and cleaning purposes before being loaded and shipped back to their country of origin.

28. Section 2(1) of the East Africa Community Customs Management Act, 2004 (EACCMA) defines transit as *'the movement of goods imported from a foreign country though the territory of one or more of the partner states to a foreign destination.'* The Appellant contends that the whilst it may not be in the business of transporting goods in transit within the East Africa region, the empty containers that it services amount to goods in transit, as they are transported into the country from a foreign destination through Kenyan territorial borders and subsequently sent back to a foreign final destination.

29. Prior to their transportation to a foreign destination, as determined by MSC, the containers are stored temporarily at the warehouse for cleaning, repair and maintenance services after which they are shipped back to a foreign destination.

30. In light of the above, the Appellants have put it to the Tribunal that the empty serviced containers amount to goods in transit and therefore services in respect of them are zero-rated for VAT purposes as per paragraph 10, Part A, Second Schedule of the VAT Act, 2013.

31. The Appellant has also advanced the argument that the supplied services are classified as services provided to international sea carriers on international voyage and for this reason are zero-rated for purposes of VAT as per paragraph 6, Part A, Second Schedule of the VAT Act, 2013. The Appellant states that a container is for all intents and purposes a part of an international sea carrier on international voyage and therefore services provided to it should be treated as services provided to the ship itself.

32. In support of the assertion above, the Appellant referred the Tribunal to Article 59 of the United Nations Convention on Contacts for the International Carriage of Goods wholly or partly by sea ("the Rotterdam rules") which states as follows:-

"Where a container, pallet or similar article is used to consolidate goods, the package or other shipping units enumerated in the bill of landing, if issued, or otherwise in any other document evidencing the contact of carriage by sea, as packed in such article of transport are deemed packages or shipping units"

33. The Appellant also relied on Her Majesty's Revenue and Customs on Freight Transport and Associated Services (VAT Notice 744B) ("HMRC") which states that services provided to an international sea carrier, include handling and storage services such as loading stores and discharging empties, stevedoring and porterage, loading, unloading, reloading, stowing, securing and shifting cargo and movement of goods to/from a ship.

34. Basing their argument on the above, the Appellant concluded that the services it provides are zero-rated as provided under Paragraph 6, Part A, Second Schedule, VAT Act, 2013.

35. In conclusion, the Appellant argued that the Respondent's rejection of its VAT refund claims for the periods of July 2015 to May 2018 at the center of an on-going tax dispute is prejudicial and unfair to the Appellant and amounts to a breach of its legitimate expectation and can be concisely termed as not acting in good faith.

36. The Appellant asks this Tribunal to set aside the confirmed assessments and allow the Appeal with costs.

RESPONDENT'S CASE

37. The Respondent's case is set out in its Statement of Facts filed on 21st June 2019 and its written submissions filed on 3rd September 2019 as follows:-

38. Following an audit notice issued on 17th May 2018, the Respondent conducted an in-depth audit on the Appellant's tax affairs for the period July 2015 to June 2018 and noted an anomaly that resulted in a tax liability of Kshs.76,914,958.

39. The Respondent vide its letter dated 27th February 2019, raised additional assessments against the Appellant inclusive of penalty and interest and a VAT credit reduction of Kshs. 5,141,756 raising the total tax liability to **Kshs.82,056,714**. The Respondent also informed the Appellant that during verification of VAT returns and records, it had been established that the Appellant had classified sales accrued from services to MSC c/o Ocean freight E.A Limited and WEC Lines Kenya Ltd as zero-rated supplies. According to the Respondent, these supplies are chargeable to VAT as per the VAT Act,2013 and had therefore been reclassified and subjected to VAT payable.

40. On 28th March 2019, the Appellant through its agent, Deloitte & Touche lodged an objection to the VAT assessments.

41. The Respondent issued two objective decisions, one dated 11th April 2019 covering the months of July 2015 to December 2015 and the second one dated 6th May 2019 covering the months of January 2016 to June 2018. The Respondent had reviewed the agency agreements between Oceanfreight East Africa Ltd as the principal agent and Mediterranean Shipping Company, a non-resident company; and the contract agreement between Fortune Container Limited and Mediterranean Shipping Company c/o Oceanfreight East Africa Ltd. Per the agreements, Oceanfreight E.A Ltd are to handle, manage and perform or arrange repair, maintenance and cleaning of empty containers in Kenya, the services for which they sought from Fortune Containers Depot.

42. The Respondent also noted that the Appellant had been contracted by WEC Lines Kenya Ltd as an agent of WEC Holland BV to provide the

services of storage, repair and transport of containers to the port of Mombasa. Both Oceanfreight E.A Ltd and WEC Lines Kenya are resident companies. Therefore these services that the Appellant was referring to as "exported" were actually provided in Kenya for use and consumption in Kenya.

43. In its submissions, the Respondent states that section 2(1) of the VAT Act, 2013 defines exported services out of Kenya to mean "a service provided for use and consumption outside Kenya. The Respondent also notes that the Act also goes an extra step and gives the definition of "export" as *"to take or cause to be taken from Kenya to a foreign country, a special economic zone or to an export processing zone"* and defines "service" as *"anything that is not goods or money".*

44. According to the Respondent, the framers of the law were not satisfied that the definitions of 'service' and 'export' were enough to comprehensively define an exported service. Therefore, they introduced two terms 'use' and 'consumption. These two words are meant to transport a service from Kenya to a foreign destination. The Respondent submits that since these two words were not defined in the VAT Act, naturally they have to take the ordinary meaning assigned to them in common usage.

45. The Respondent also notes that the VAT Act clarifies the place of supply of a service under Section 8(1) of the VAT Act, 2013 which states that "*a supply of services is made in Kenya if the place of business of the supplier from which the services are supplied is in Kenya.*" With that, the definition of what amounts to an exported service is captured clearly in unambiguous terms as simply a service provided for use or consumption outside Kenya.

46. To the Respondent, this definition does not make any qualifications as to the status of the person receiving these services, as long as the person

is outside Kenya, the condition is met. Conversely, regardless of the status or nationality of the person, if consumption happens inside Kenya, then the condition is not met. For this reason, a tourist walking down Nairobi and decided to have a local vendor shine his shoes, the local vendor cannot claim that he has performed an exported service.

47. The Respondent submits that in the present Appeal, the Appellant is in the business of providing services in the nature of storage, repairs and cleaning of empty containers. To the Respondent, these services were consumed in Kenya and so the location or status of the payer is irrelevant. The Appellant's argument of location of beneficiary also fails because the Appellant was contracted by resident companies who had been appointed as agents of non-resident entities and therefore the beneficiary was the agent. The agency agreements did not appoint both the Appellant and Oceanfreight E.A Ltd as agents for MSC.

48. The Respondent relied on the decision in **Cape Brandy Syndicate vs Inland Revenue Commissioner (1921) 1 KB 64** where the court held as follows:-

"In a taxing statute one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There in no presumption as to a tax."

Applying this rule of interpretation to section 2 and section 8 of the VAT Act, there is no confusion as to the status of the services being provided by the Appellant

49. The Respondent proceeded to a comparative study of the UK on the issue of 'the place of supply of services' which has been clarified via VAT Notice 741A. The UK gives directions for B2B supplies and B2C supplies and confirms that services are not treated with a broad brush; certain

services will be considered to be supplied where the recipient is located while others will be deemed to have been supplied where they were performed.

50. The Respondent also looked at India's IGST Act of 2017 to provide guidance on the issue of supply of services. The Respondent reproduced the provisions of Section 13 of the IGST Act as follows:-

"13 (1) The provisions of this section shall apply to determine the place of supply of services where the location of the supplier of services or location of the recipient of services is outside India;

(2) The place of supply of services except the services specified in sub-sections 3 to 13 shall be the location of the recipient of services; PROVIDED THAT where the location of the recipient of services is not available in the ordinary course of business, the place of supply shall be the location of the supplier of services.

(3) The place of supply of the following services shall be the location where the services are actually performed, namely..."

51. The Respondent avers that UK law and India do not have words like 'use' and 'consume'. However, the UK law defines the place of supply of a service as the place where that service is **treated** as being supplied. Our VAT Act does not afford a change of location depending on the nature of the service and so to enable us determine whether a service has been exported or not, one has to look at the definitions closely.

52. The Respondent submitted that the Tribunal and the High Court has previously ruled in **Commissioner of Domestic Taxes v Total Touch Cargo Holland (2018) eKLR** that *"the location where the service is provided does not determine the question of whether the service is exported or not. The test is the location (or place) of use or*

consumption of that service." That in this case, the service was found to be exported for the simple reason that it was inseparable from the goods that were being taken out of Kenya. The service ensured merchantability so that without the services, there would be no goods for export in the first place.

53. The Respondent also disagrees with the Appellant's contention that the VAT Act is inadequate on the issue. However, even if the Respondent was to concede that the legislation is indeed inadequate and therefore borrow from other jurisdictions, it would lead to the inevitable conclusion that in these jurisdictions as well, as demonstrated by UK and India, certain services will be deemed to have been consumed where they were performed. Therefore, in the upshot, the services were not used up outside Kenya. The containers were cleaned and repaired in Kenya. A strict interpretation of Section 2(1) and (8) places the consumption in the Appellant's premises.

54. The Respondent also submitted that on looking at the Appellant's contracts, it noted that the Appellant had been contracted by agents of MSC and WEC Holland BV. That the agency agreement dated 1st January 2015, between MSC and Oceanfreight E.A Ltd at clause 3.2.5, clearly vests inter alia the function of "performing or arrange the repair, maintenance and cleaning of empty containers" on Oceanfreight E.A Ltd. Secondly, the agreement for storage, transportation and repairs for WEC Holland BV dated 2nd August 2006, is between WEC Lines (Kenya) Ltd and Fortune Container Depot Ltd. In the said agreement, WEC Lines (Kenya) Ltd is identified as the agent for WEC Holland BV.

55. The Respondent therefore claims that the Appellant's submission that it acts an agent of MSC is inaccurate. According to the Respondent, the agreement referred to by the Appellant is not an agency agreement but rather an agreement for services where Oceanfreight E.A Ltd is acting on behalf of MSC.

56. It is the Respondent's case that in light of this, the services cannot be said to be for the benefit of MSC or WEC Holland BV. The Appellant has been sub-contracted by resident companies, and therefore the benefit is for these intermediaries. To the Respondent, only WEC Lines (Kenya) Ltd and Oceanfreight E.A Ltd can be heard to make the argument that their services are exported services. If indeed the agreement for cleaning containers is between the Appellant and MSC or WEC Holland BV, one is left to wonder why Oceanfreight E.A Ltd and WEC Lines (Kenya) Ltd are the ones signing contracts in capacity of agents? The danger posed by this arrangement, is that Oceanfreight E.A Ltd would pass off its own containers to the Depot as belonging to MSC; a clear conduit for tax evasion.

57. The Respondent submitted that it is important to distinguish between subcontracted third parties and the principal's agent; third parties do not become agents simply because the person who contracted them is an agent as well.

58. The Respondent relies on paragraph 143 of the judgment of the Honourable Tribunal in **Coca-Cola Central East and West Africa Ltd vs Commissioner of Domestic Taxes (VAT Appeals Tribunal Case No. 11 of 2013)** (hereinafter ***"the Cocacola case"***) where it was observed as follows:-

> *"It is also not important to put into account the location of the payer for the service or the person who requisitions the services. As earlier stated, what is material is the place of use or consumption of the service; for it is physically used or consumed in Kenya, it is subject to Kenyan VAT. On the other hand, if the service is provided for use or consumption outside Kenya, it is an exported service free of Kenyan VAT."*

59. The Respondent also argues that the invoices issued by Oceanfreight E.A Ltd murky up the Appellant's claim. The Respondent took the example of an invoice issued to Bajaber Industries Ltd and stated that a look at the invoice clearly indicates that Bajaber Industries Ltd are the real **consumers** of the **cleaning component** of the handling services.

60. On the question of whether the services provided by the Appellant amount to services provided to goods in transit, the Respondent begins by stating that the Appellant makes a fundamental error in referencing the East Africa Community Customs Management Act, 2004 (EACCMA) because it is not the taxing statute for VAT purposes.

61. Secondly, the Appellant is not in the business of handling goods in transit but handling empty containers including storage, repairs, cleaning and transport to the port. At no time are returnable containers considered as goods in transit or imported goods. To argue that freight containers whose purpose is to carry goods whether in transit or not, that they too form goods in transit would be stretching the argument to the absurd. Freight containers have never been treated as goods in transit and that is why duty is never paid on them , unless the container itself had been procured primarily as a good and declared as such in the import manifest.

62. According to the Respondent, a freight container, while being handled in its utilitarian function of holding cargo cannot be "goods" within the meaning of the VAT Act. The VAT Act only defines a word in reference to VAT and for something to qualify as a good within the meaning of the VAT Act, it must have a direct relationship with VAT, which is that the item is either taxable or exempt. A freight container has no relationship with VAT and therefore it cannot be considered to be 'goods in transit' under Paragraph 10, Part A, Second Schedule of the VAT Act.

63. On the question of whether the services provided by the Appellant amount to services provided to international sea carriers on international

voyage, the Respondent submits that freight containers do not fall within the meaning of international sea carriers on international voyage.

64. While addressing the Application of the United Nations Convention on Contracts for International Carriage of Goods Wholly or Partly by Sea (the Rotterdam Rules) the Respondent avers that the UN Convention is not a taxing statue neither does it provide any guidance on taxation of supply of services. The convention was established to ***"provide mandatory standards of liability for loss or damage arising from the international carriage of goods by sea".***

65. The Respondent concludes that the wording of Paragraph 6, Part A, Second Schedule of the VAT Act is clear; ***"The supply of taxable services to international sea or air carriers on international voyage or flight."*** A container is not an international sea carrier. The section does not read that the service in question is to "that which forms part of a sea carrier" if indeed one were to argue that a container forms part of a sea carrier. The zero-rated service is to the ship itself.

66. On the issue of the rejected VAT Refund claims raised by the Appellant, the Respondent argues that the Appellant ceased to be in a refund position owing to the fact that the Respondent had issued additional assessments that put the Appellant in a state of tax debt.

67. The Respondent also submits that the Appellant did not lodge a valid objection to the Respondent's decision to reject the VAT refund and therefore there does not exist an "appealable decision" on the issue of refund. The Appellant cannot bring a "tax decision" straight to the Tax Appeals Tribunal before it graduates to an "appealable decision" as required by Section 52 of the Tax Procedures Act.

68. It is also the Respondent's claim that the Appellant is using these proceedings to sneak in refund claims not captured in its Notice of Objection contrary to Section 56 (3) of the Tax Procedures Act which states that:-

> *"In an appeal by a taxpayer to the Tribunal, High Court or Court of Appeal in relation to an appealable decision, the taxpayer shall rely only on the grounds stated in the objection to which the decision relates unless the Tribunal or Court allows the person to add new grounds."*

69. In concluding its case, the Respondent submits that the resolution of the Appellant to proffer its grounds of objection on a "without prejudice basis" is suggestive of its attitude to clutch on any argument in order to shield it from paying taxes, which is an attitude that should be frowned upon by this Tribunal. That the format of lodging a notice of objection offends the basic tenets of taxation with regards to certainty and Section 51 (3)(a) of the Tax Procedures Act. Section 51 (3)(a) provides as follows:-

> *"A notice of objection shall be treated as validly lodged by a taxpayer under subsection (2) if the notice of objection states precisely the grounds of objection, the amendments required to be made to correct the decision, and the reasons for the amendments;..."*

The Respondent submits that lodging an objection on "without prejudice" is not precise and will not be able to objectively propose amendments to the tax decision.

70. The Respondent relied on the decision of **R v Kenya Revenue Authority ex-parte Funan Construction Limited (2016) eKLR** where the High Court held as follows:-

> *"The Respondent receiving the objection must be in a position to know what exactly the taxpayer is objecting to and what is not objected to.*

If it is the figures the taxpayer must indicate what in its view ought to be the correct figure unless the whole figure is objected to. In other words, the objection cannot be "in the alternative and without prejudice to the foregoing".

71. In light of the above, the Respondent submits that the Appellant has failed to demonstrate why the Objection Decisions should be vacated. They therefore urge the Tribunal to dismiss the Appeal with costs.

ISSUES FOR DETERMINATION

72. Upon analyzing all the material on record, including the Statements of Fact and Written Submissions filed by the respective parties, the Tribunal notes that the parties have narrowed down their issues to two main questions for determination as below;-

    a. ***Whether the services provided by the Appellant are zero-rated for VAT purposes?***

    b. ***Whether the Appellant's VAT refund claims ought to have been rejected by the Respondent?***

    c. ***Whether the Appellant's notice of objection was valid?***

ANALYSIS AND FINDINGS

Whether the services provided by the Appellant are zero-rated for VAT purposes?

73. The Appellant has proffered three arguments in support of its claim that the services it provides qualify as zero-rated under the VAT Act, 2013. The first of those being, that the services it provides to MSC and WEC amount to exported services under the meaning of section 2 (1) of the VAT Act and are therefore zero-rated as provided under paragraph 1, Part A of the Second Schedule of the VAT Act.

74. Having comprehensively set out the parties' assertions above, the Tribunal notes that both parties' generally agree that to determine whether or not the services provided by the Appellant are indeed exported, the Tribunal must answer the question of who is the final user or consumer of these services?

75. Both Parties also agree that the words "use or consume" must take their ordinary natural meaning in the absence of clear definition in the VAT Act. However according to the Respondent, the two words were simply used to expound and eliminate any ambiguity to the already clear meaning of "exported services". To the Respondent, the definition of exported services does not make any qualifications as to the status of the person receiving these services; as long as the person is **outside Kenya** the condition is met. Conversely, regardless of the status or nationality of the person, if consumption happens **inside Kenya** then the condition is not met.

76. Section 2 of the VAT Act, 2013 defines the following;-

"export" *means to take or cause to be taken from Kenya to a foreign country, a special economic zone enterprise or to an export processing zone*

"service exported out of Kenya" *means a service provided for use or consumption outside Kenya.*

77. Zero-rated supplies on the other hand are provided for under Section 7 and are specifically listed under the Second Schedule, Part A of the VAT Act, 2013 as follows:-

7(1) Where a registered person supplies goods or services and the supply is zero rated, no tax shall be charged on the supply, but it shall, in all other respects, be treated as a taxable supply.
(2) A supply or importation of goods or services shall be zero-rated under this section if the goods or services are of the description for the time being specified in the Second Schedule.

78. The Appellant has submitted that the services supplied by the Appellant are used and consumed directly by its Principal, MSC, a non-resident international shipping entity based in Geneva, Switzerland. Its handling services are provided with a view to directly further and sustain its Principal's primary business of shipping and transporting goods hence it was their sole responsibility as the supplier of shipments services to ensure that the containers were fit for their purpose and seaworthy.

79. The Respondent on the other hand has asked the Tribunal to consider the contracts on record between the Appellant and Oceanfreight E.A Ltd and WEC Lines (Kenya) Ltd in order to determine whether the services provided are indeed exported. According to the Respondent, the Appellant's argument due to two reasons; these services were consumed in Kenya, and so the question of the location or status of the payer is irrelevant and the Appellant was contracted by resident companies (Oceanfreight E.A Limited and W.E.C Lines Kenya Limited) who had been appointed as agents of the non-resident entities (MSC and WEC Holland BV), and therefore the beneficiary was the agent.

80. The Appellant also urged the Tribunal to be guided by international best practices due to the inadequacy created by the definition of exported services under Section 2. The Respondent however disputes this inadequacy and asserts that the law is very clear with regards to the dispute before this Tribunal.

81. The Respondent does however argue that even if the Tribunal were to look for guidance in international best practice, placing reliance on the comparative study on UK and India, the Tribunal would find that some certain services will be deemed to have been consumed where they were performed. Further, even the OECD VAT/GST Guidelines clearly state in their preface that ***"The Guidelines do not aim at detailed prescriptions for national legislation. Jurisdictions are sovereign with respect to the***

design and application of their laws. Rather, the Guidelines seek to identify objectives and suggest means of achieving them..."

82. Having stated the above, the Tribunal looks to various decisions for guidance on this issue some of which have been relied on by the parties. The High Court in the recent decision of **Commissioner of Domestic Taxes versus Total Touch Cargo Holland (2018) eKLR** had the following to say at paragraphs 15-17:-

"A clear reading of this provision is that for a service to be deemed an "exported service", it matters not whether that service was performed in Kenya or outside Kenya. The determining factor is the location where that service is to be finally used or consumed. Therefore an exported service will be one which is provided for use or consumption outside Kenya.

In ***F.H. SERVICES KENYA LIMITED –VS- COMMISSIONER OF DOMESTIC TAXES, Appeal No.6 of 2012****, the Appeal tribunal found that what was pertinent, in Kenyan law as far as VAT legislation was concerned was where the services are finally used or consumed. In this a case F.H Services Ltd represented Flora Holland a company incorporated in the Netherlands, which was involved in trading of flowers. F.H Services provided services to Flora Holland for the export of flowers from Kenya to buyers overseas. The holding of the tribunal in that case was that since the benefit of the marketing services provided by F.H Services Ltd accrued outside Kenya, these were therefore exported services. In that case the Tax Tribunal held as follows:-*

> ***To our mind then, it is immaterial where the place of the performance of the service takes place, it can be in China, in Latin America, in Ireland, in Mesopotamia, in Asia or Europe or even here in Kenya; what is material is where the use or consumption of the service takes place, not the place of services [emphasis supplied].***

Similarly in the Indian case of PAUL MERCHANTS LTD –VS- CCE CHANDIGARH [2012 (12) TMI 424 – CESTAT, DELHI LB] the tribunal was of the view that even though the services in question were rendered in India the word "used" could not be equated with the word "performed" especially where the benefit of the service provided accrued outside India. Further in the case of Ms MICROSOFT CORPORATION (1)(P) –VS- COMMISSIONER OF SERVICE NEW DELHI. WP (c) NO.1460/2009 (Also an Indian Authority) the Tribunal concluded that the words "used outside India" referred to the place where the benefit of the service accrued.

In the present case the scanning, cooling and palletizing services provided by KAHL, were performed in Kenya. However the user and consumer of these services being TTC-H and their European customers were based outside Kenya. The services were aimed at ensuring that the horticultural produce and flowers reached Europe in a fresh state fit for consumption by these foreign buyers. Accordingly despite the service being performed within Kenya it was in actual fact an exported service."

83. It is evident that the owners of the containers are MSC and WEC to whom the Appellant supplies its services of cleaning, storage, handling, repairs and transport based on contract. The Respondent argues that these contracts are signed by Oceanfreight E.A Ltd and WEC Lines (Kenya) Ltd and to that extent, the services provided by the Appellant are provided to Oceanfreight E.A Ltd and WEC Lines (Kenya) Ltd.

84. The Tribunal has looked at the contracts/agency agreements annexed to the Respondent's statement of facts as KRA 5 and KRA 6 and also considered the principles of agency. Oceanfreight E.A Ltd and WEC Lines (Kenya) Ltd expressly state in these contracts that they are procuring the services of the Appellant **"as agents for"** their non-resident principals. Clause 3.2.1 (f) of the agreement dated 1st January 2015 between Oceanfreight E.A Ltd and MSC authorizes the agent to ***"negotiate service***

contracts, always subject to the Principal's express approval of the terms and conditions and the Principal's express written authorization to sign the service contract on the Principal's name and behalf in each case"

85. Oceanfreight E.A Ltd and WEC Lines (Kenya) Ltd do not at any point contract in their own capacity as companies but rather on behalf of their principals. The Respondent's argument that these services are provided for the use or consumption of the agents therefore fails. In this regard, the Tribunal finds that the economic benefit of the services provided by the Appellant flows directly to the non-resident principal companies.

86. The application of section 8 (1) of the VAT Act, as proposed by the Respondent in this case does not arise. The Tribunal finds that the services provided by the Appellant are exported services within the meaning of section 2(1) and are therefore zero-rated for purposes of VAT.

87. Secondly, the Appellant advanced the argument that the services provided amount to services provided to goods in transit and are therefore zero-rated as provided by Paragraph 10, Part A, Second Schedule of the VAT Act, 2013. The Appellant refers the Tribunal to Section 2(1) of the East African Community Customs Management Act, 2004 (EACCMA), which defines transit as *the movement of* ***goods imported*** *from a foreign place through the territory of one or more of the Partner States, to a foreign destination.*

88. According to the Appellant, the empty containers that it services amount to goods in transit as they are transported into the country from a foreign destination through Kenyan territorial borders and subsequently sent back to a foreign final destination. Prior to their transportation to a foreign destination, as determined by MSC, the containers are stored temporarily at the warehouse for cleaning, repair and maintenance services after which they are shipped back to a foreign destination.

89. On the other hand, the Respondent submits that to argue that freight containers whose purpose is to carry goods whether in transit or not, that they too form goods in transit would be stretching the argument to the absurd. It is the Respondent's argument that freight containers are not treated as goods in transit and that is why duty is never paid on them. The Respondent further submitted that the containers cannot be considered to be 'goods' within the meaning of the word ***'goods'*** appearing in Section 2 of the VAT Act.

90. However, the Tribunal understands the Appellant's argument to be that in as much as they are not in the business of transporting goods, the containers do fall within the meaning of the word "goods" whether or not they are the subject of the import transaction. Further, the containers themselves are treated as goods in transit as they enter into the country from a foreign destination through Kenyan borders, they are temporarily held in the country for cleaning, maintenance and repair, on their way out to a foreign destination through Kenyan borders. That in our understanding amounts to goods in transit.

91. The Tribunal thus concurs with the Appellant that the services provided to the containers amount to services provided to goods in transit and in turn finds that the services are zero-rated as provided in Paragraph 10, Part A, Second Schedule of the VAT Act, 2013.

92. Thirdly, the Appellant also advanced the argument that services provided by it amount to services provided to international sea carriers on international voyage and therefore zero-rated under Paragraph 6, Part A, Second Schedule of the VAT Act, 2013. The Appellant argues that the container for all intents and purposes is a constituent part of the ship. The Appellant relied on Article 59 of the United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea which states as follows:-

1. Subject to articles 60 and 61, paragraph 1, the carrier's liability for breaches of its obligations under this Convention is limited to ***875 units of account per package or other shipping unit****, or 3 units of account per kilogram of the gross weight of the goods that are the subject of the claim or dispute, whichever amount is the higher, except when the value of the goods has been declared by the shipper and included in the contract particulars, or when a higher amount than the amount of limitation of liability set out in this article has been agreed upon between the carrier and the shipper.*

2. When goods are carried in or on a container, pallet or similar article of transport used to consolidate goods, or in or on a vehicle, the packages or shipping units enumerated in the contract particulars as packed in or on such article of transport or vehicle are deemed packages or shipping units. If not so enumerated, the goods in or on such article of transport or vehicle are deemed one shipping unit.

93. The Tribunal concurs with the Respondent's submissions that Article 59 provides for limits of liability of a carrier in the event of a breach of contract and thus cannot apply to support the Appellant's assertion above. To ascertain the intention of the said Article, it cannot be read and applied in isolation but has to read as whole. It is clear that the intention of Article 59 was to limit the liability of a carrier in the event of a breach of its obligations under the convention.

94. The Tribunal also concurs with the Respondent that the term 'shipping unit', as captured in Article 59 above does not refer to the ship itself but rather to the unit of the goods (packages) carried in the container subject of the shipping contract. The Rotterdam rules therefore have no application to this Appeal.

95. That said, the Tribunal however observes that the purpose of a container is to consolidate the cargo for ease of transportation from one destination to another. The cargo cannot be placed on a ship/sea carrier for transportation over a long distance without the container as this will interfere with the integrity of the cargo being transported across vast waters. It would be difficult to separate the purpose of the ship and container in an import transaction, as the ship/sea carrier cannot transport the cargo without the container and the container cannot in turn deliver the goods to the consignee/importer without the sea carrier/ship.

96. For this reason, the Tribunal does concur with the Appellant that the container is essentially part of the ship and the services provided to the container amounts to services provided to the ship/international sea carriers and are thus zero-rated for purposes of VAT under Paragraph 6, Part A, Second Schedule of the VAT Act, 2013.

b. Whether the Appellant's VAT refund claims ought to have been rejected by the Respondent?

97. On this issue, the Appellant's case is that the Respondent's rejection of its VAT refund claims that are at the center of an ongoing tax dispute resolution process amounts to a breach of legitimate expectation, natural justice and is not in good faith. According to the Appellant, the Respondent decided on this matter in isolation of the matters pending for determination before the Tribunal. It therefore Appeals to the Tribunal to set aside the Commissioner's decision on the VAT refund claim.

98. In response to this, the Respondent submitted that the Appellant's notice of objection was not a valid objection as it did not comply with the requirements of Section 51(3)(a) of the Tax Procedures Act. To the Respondent, the Appellant simply made a cursory remark.

99. The Appellant's objection on this issue was worded as follows:-

"...we note that you proceeded to reject VAT refund claims lodged by our client with respect to the periods April 2018 to September 2018...

We note that your efforts to reject our client's VAT refund claims periods April 2018 to September 2018 are prejudicial to our client given that the same relate to a matter that is currently undergoing the stipulated dispute resolution process and is yet to be determined.

Consequently, we would be grateful if you consider approving our client's VAT refund claims with respect to the periods not covered under your assessment dated 27 February 2019, and objected to vide this letter."

100. Section 51 (3) (a) of the Tax Procedures Act provides that a notice of objection must state precisely the grounds of objection, the amendments required to be made to correct the decision, and the reasons for the amendments. From our reading, the Appellant's ground of objection is that the issue of VAT refunds is the subject of a Tax Appeal before this Tribunal and therefore the Respondent was not justified in rejecting the refund claims until the dispute is determined.

101. Further, the Respondent in its Objection Decisions dated 11th April 2019 and 6th May 2019, replies to the Appellant's objection on the subject and renders its decision to reject the VAT refund and gives it reasons for doing so. This therefore changes the Respondent's decision from a "tax decision" to an "appealable decision" properly challenged before this Tribunal.

102. The Tribunal finds that the Appellant's objection was a valid objection within the meaning of Section 51 (3)(a) and takes notice that the VAT

refund status of the Appellant is the subject matter of another dispute before this Tribunal where the Tribunal shall render its comprehensive decision on the subject.

103. Perhaps unwittingly, the Appellant raised a very important point for determination before this Tribunal. **Tax Appeal No. 24 of 2018, Fortune Containers Depot Limited vs Commissioner of Domestic Taxes**, which arose from an audit of the VAT refund status of the Appellant is pending before this very Tribunal. The claim arose after the Appellant lodged VAT refund claims for the period **August 2014 to June 2015** following which the Respondent assessed the Appellant's VAT liability at Kshs.21,213,802.21 for the said period.

104. We also note that the present Appeal arises out of VAT assessments for the periods **immediately** following the periods the subject of Tax Appeal No. 24 of 2018. This raises the question of whether the Respondent may raise a further tax assessment/liability in respect of the same party with regard to the same tax assessment the subject of a dispute pending determination before the Tribunal?

105. The Respondent raised a further independent tax assessment on the Appellant's VAT liability leading the Appellant to commence two tax appeals in respect of the same set of facts and issues and in turn compelling this Tribunal to deliver different rulings on the same subject matter involving the same parties and based on a similar set of facts. Perhaps this was done to couch the Respondent against being locked out by the five year period imposed by Sections 23 and 31(4), in the event that this Tribunal finds in its favour in Tax Appeal No. 24 of 2018.

106. The Tribunal frowns upon the Respondent's conduct and finds it to be contrary to the national values and principles of governance contemplated under Article 10 and Fair administrative action under Article 47 of the Constitution of Kenya. The Tribunal however notes that

the issue was not specifically pleaded by the parties and has for this reason, proceeded to determine this Appeal on its merit as below.

FINDINGS

107. With respect to issues for determination, the Tribunal determines as follows:

   a. ***The services provided by the Appellant are zero-rated for VAT purposes.***

   b. ***The VAT refund is the subject matter of another dispute before this Tribunal.***

   c. ***The Appellant's notice of objection was valid?***

108. The Tribunal orders as follows:-

   I. The Appellant's Appeal is allowed.

   II. The Respondent's Objection Decisions dated 11th April 2019 and 6th May 2019 are hereby set aside.

   III. Each party to bear its own costs.

DATED and **DELIVERED** at **NAIROBI** this **31st** day of **March, 2020**

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PATRICK LUTTA
CHAIRPERSON

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HELEN BILA
MEMBER

.....

MWAI MBUTHIA
MEMBER

.....

ELI NJERU
MEMBER