VAT TREATMENT OF EXPORT SERVICES:

ANALYSIS OF THE COCA COLA CENTRAL EAST AND WEST AFRICA LIMITED VS COMMISSIONER OF DOMESTIC TAXES

TAT APPEAL NO. 5 OF 2018

On 31st March 2020, the Tax Appeal Tribunal (TAT) delivered the judgment in ***Coca Cola Central East and West Africa Limited Vs Commissioner of Domestic Taxes, TAT Appeal No. 5 of 2018*** (Hereinafter 'the Appeal'). The judgment in this case was issued in favor of the Taxpayer.

This was deemed as a win for the Taxpayer considering that there has been a lot of controversy and litigation on what actually amounts to ***'exported services.*** In that regard, we have analyzed the said case as follows: -

A. BACKGROUND OF THE CASE

To begin we need to set out a clear distinction that the case under review in this article relates to the same taxpayer, same issues but a different tax period and does not refer to ***APPEAL No. 11 of 2013 COCA COLA CENTRAL EAST AND WEST AFRICA LIMITED VS COMMISSIONER OF DOMESTIC TAXES*** which is currently being heard at the High Court level.

The Transaction Arrangement

The Appellant, Coca Cola Central, East and West Africa Limited is a company incorporated in Kenya whose principal business is to market and promote Coca Cola brands in Africa.

The Appellant is an affiliate of the Coca Cola Company incorporated and domiciled in the United States who owns the Coca Cola brands and its affiliates who manufacture and sell proprietary beverage concentrates which is the primary source of revenue.

The Coca Cola Export Corporation is an affiliate of the Coca Cola Company and has been granted the right to use these trademarks outside the US by the Coca Cola Company. The Coca Cola Export Corporation together with non-Kenyan affiliates manufacture and sell concentrates in various countries across the world.

The Appellant herein entered into a Service Agreement with the Coca Cola Export Company, wherein it was agreed that it will engage services providers to provide marketing services. These services and the genesis of this dispute arises as follows: -

VAT Refund and KRA Audit

In 2017, Appellant lodged a VAT refund claim. After which the Commissioner of Domestic Taxes (Herein the Respondent) conducted an in-depth audit for the respective periods related to the claim. In its preliminary findings, the Respondent disallowed the claim stating that the Appellant had not declared output tax on locally consumed services that they offered to Coca Cola Export herein referred to as "the Export Company" and its affiliates.

The Appellant objected to this assessment explaining that VAT should not be levied to the supplies to Coca Cola Export and its affiliates. However, the Respondent affirmed its position that the services offered to the Export Company and its affiliates attracted VAT at standard rate of 16% and therefore issued a final assessment which was objected by the Appellant. After which the Respondent issued a final objection decision which was subsequently objected and an Appeal filed at the Tax Tribunal Level.

We therefore review the case by focusing on the issues to be determined which were as follows;

a) What is the test in establishing whether the services were exported?
b) Who is the consumer of the marketing services provided by the Appellant?
c) Who has the taxing rights to the marketing services provided by the Appellant?

B. APPELLANT'S CASE

In its argument, the Appellant submitted that the service provided under the Service Agreement were exported services used and consumed outside Kenya within the meaning of Section 2 of the VAT Act and hence zero rated. Further, that the services were consumed by Coca Cola Export which was based in the United States of America and had no physical presence in Kenya. The Appellant further noted that under the OECD VAT/GST Guidelines 2017 and 2013, one of the core principles was the destination principle

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which was designed to ensure that the taxing rights on cross border transactions were granted to the jurisdiction of consumption and that an exported service was not taxed in the country of supplier of the service hence maintaining the neutrality within the VAT system.

In the instant case, the Appellant argued that since the Appellant and Coca Cola Export were considered businesses, the services subsequently provided by the Appellant were regarded as business to business services. Moreover, that since the companies were situated in different countries, the cross-border services transactions arose.

As for the destination principle, the Appellant relied on Guideline 3.1 of the OECD Guidelines which stipulate that: -

> ***For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of jurisdiction of consumption***

That business to business (B2B) supplies were taxed under VAT staged collective process. Indeed Guideline 3.2 of the OECD Guidelines noted that for B2B supplies, the jurisdiction in which the customer was located had the taxing rights over internationally traded services and intangibles.

With the above arguments in place, the Appellant noted that it was key to determine who then was the customer. In its argument, it relied on the provisions of Guideline 3.3 of the OECD Guidelines which stipulated that the identity of the consumer is normally determined by reference to the business agreement. It was its submission that based on the Service Agreement between the Appellant and Coca Cola Export, the consumer of the marketing and promotion services was the Coca Cola Export Company. The Service Agreement would assist in identifying the consumer for purposes of levying tax.

It was the Appellant' further argument that in observing the destination principle, the jurisdiction of the customer had the taxing rights which rights were not affected by circumstances that the supplier: -

a) Supplied a customer who supplied onward services to a third party
b) Directly provided services to a third party that was not a customer under the business agreement; and
c) Was paid by a third party that was not a customer under the business agreement

As per the OECD Guidelines, re-allocated services such as the ones above were not taxable in the country of supply. Further, that when a country of the customer had a consumption tax in place other that a common VAT system, the sane did not impact the classification of services performed as exported services, which were not subject to VAT in the country of the supplier.

To this end, the Appellant concluded that based on the OECD Guidelines, the marketing and promotion services rendered by it in Kenya to the Coca Cola Export in the United States of America should be treated as export services hence zero rated. It was its affirmation that the services were exported to a country without a presence in Kenya, the services were consumed outside Kenya, no Kenyan company or private consumer had contracted the Appellant to provide the said services and as such there was no direct consumption of the services in Kenya.

To firm up this argument, the Appellant relied on the case of ***Microsoft Corporation (India) Private Lts Vs Commissioner of Service Tax in the High Court of New Delhi No. 11460 of 2009*** where the term ' use of service outside India' was contrued to mean the benefit of the service accrued outside India. Subsequently, the Appellant urged the Tribunal to make reference to the Service Agreement and find that the benefit of the marketing and promotional services was the Coca Cola Export Company and hence an export service thus zero rated under the VAT Act, 2013.

C. RESPONDENT'S CASE

In opposition to the Appeal, the Respondent argued that the marketing services provided by the Appellant to Coca Cola Export were not exported services but local sales. That the

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consumer of the services was not the payer, that is, Coca Cola Export, but rather the local market as advertisments were done and prepared for the local market with a local context to make more consumers to buy the beverages. Consequently, the services could not qualify to be exported services within the meaning of Section 2 of the VAT Act and the OECD Guidelines. It was its argument that the supply of the services fell within Section 8 of the VAT Act which stipulates the place of supply of services for imposition of VAT.

The Respondent argued that the services were not used or consumed outside Kenya since the final consumer of the soft drink being advertised in Kenya was Kenyan. That the Value Added Tax was a tax where the final or household consumption occured. In this paticular instance, the Kenyan consumer was the final user of the services. As such, Coca Cola Export could not be termed as the final consumer of the service as the services were consumed in Kenya through the advertising which influenced Kenyan consumers to use the product.

The Respondent in responding to the Appellant's argument that should VAT be charged on the cost of the concentrate there will be a doube taxation, argued that the VAT was assessed based on the increase in the value of a product or service at each satge of production and at each stage of the value added. As such, the VAT charged on concentrate was diffrenet from that charged on services hence no double taxation.

To this end, the Respondent urged the Tribunal to find that the services under contestation were locally consumed in Kenya.

D. TRIBUNAL'S JUDGEMENT

In arriving at its judgment, the Tribunal formulated the issues for determination as follows:-

Issue 1-What was the test in establishing whether services are exported?

In order to respond to the said issue, the Tribunal considered whether the marketing and promotion services offered were indeed exported services. In that regard, the Tribunal relied on the provisions of Sections 2 of the VAT Act, 2013 which defined the following terms:-

> ***"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;

It was the Tribunal's finding that a literal reading of Section 2 of the VAT Act dictated that the determining factor for services exported out of Kenya was where those services were used or consumed which should not be in Kenya. As such, the question that needed to be answered in respect of this dispute was where the services were being offered by the Appellant.

Considering that the VAT Act did not define the terms 'use' or 'consume', the Tribunal resorted to rely on the OECD Guidelines. Indeed in the case of ***Unilever Kenya Limited vs Commissioner of Domestic Taxes (2005)Eklr*** ¸the High Court noted that it was no longer impossible to overlook or sideline what had come out of the wisdom of taxpayers and tax collectors of other countries

especially where Kenya did not provide for such as the instance with the Appellant's case herein.

With the above assertion, the Tribunal went on to note that the OECD Guidelines were built on two core principles, that is, the neutrality principle which stipulates that VAT is a tax on the final consumption that should be neutral for business and the destinition principle which notes that internationally traded services and intangibles should be subject to VAT in their jurisdiction.

It further relied on the findings of the High Court in ***Commissioner of Domestic Taxes Vs Total Touch Cargo Holland***, ***Income Tax Appeal No. 17 of 2013*** as relate to use and consumption of services where it was noted as follows:-

> ***To our mind it is immaterial where the place of performance of the service takes place, it can be China, in Latina America, Ireland, in Mesapotamia, in Asia, in Europe or even here in Kenya; what is material is where the use and consumption of the service takes place, not the place of services.***

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Issue 2- Who is the consumer of the marketing services provided by the Appellant?

In determining this issue, the Tribunal inferred to the flow of the services as between the Appellant and Coca Cola Export Company. It was the Tribunal's finding that the Appellant's services were engaged by Coca Cola Export, a foreign company, to market and promote the brands owned by or licenced to the Coca Cola Company, Sweppes Holdings Limited and Atlantic Industries as per the Service Agreement. There was no contractual relationship between the Appellant and the Kenyan bottlers. To this end, the Kenya consumer was a third party as far as the Service Agreement was concerned.

That although the marketing and promotion services were performed in Kenya, at that stage

there was no accurate and conclusive way of determining with finality that every Kenyan who saw the advert purchased the bevererage. The test was not where the service was performed or provided but where the consumer was located.

In the circumstnaces, the benefit of the Appellant's services was accrued by Coca Cola Export since it increased the sale of manufacture concentrate and at that stage fell within the scope of services used and consumed outside Kenya under the VAT Act. Moreover, under the Service Agreement, the Coca Cola Export was identified as a customer of the services as provided in the OECD Guidelines. To this end, the said servies were services exported out of Kenya hence zero rated.

Issue 3- Which Country has taxing rights?

As to which country had the taxing right between Kenya and the United States of America, the Tribunal noted that Kenyan consumers of the beverage were the target audience of the advertising service but the benefit of services was accrued to Coca Cola Export, which enhanced the business and sales of selling manufacture of concentrate. To that end, and based on the destinitaion principle, the United States had the taxing rights.

From the above analysis, the TAT proceeded to allow the Appeal noting that the services offered by the Appellant to Coca Cola Export Company were services exported out of Kenya and hence zero rated.

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