

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 337 OF 2020

KUEHNE+ NAGEL LIMITED.....APPELLANT

-VERSUS-

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

A. INTRODUCTION

1. The Appellant is a limited liability company incorporated in Kenya whose main business activity is to provide transport, logistics, clearing and forwarding services to and from Kenya to its imports and export customers.

2. The Respondent is a principal officer appointed under the Kenya Revenue Authority Act, Cap 469 Laws of Kenya as an agency of the Government for the collection and receipt of all revenue as well as administration and enforcement of all provisions of written laws set out in Part I & II of the first schedule of the KRA Act and other such functions as may be directed from time to time.

B. BACKGROUND

3. The genesis of the matter emanates from the Respondent conducting an audit on the Appellant's affairs for the years 2010-2012 and by a letter dated 9th July 2013 outlined its position on the audit issues.

4. The Appellant on or about 7th August 2013 objected to VAT demand in respect of local transportation service on grounds among others that;
 - a. Transport was a supply of services in respect of unprocessed agricultural and agro-forestry produce which is VAT zero-rated under Paragraph 17 of Part A of the Fifth Schedule of VAT Act CAP 476 (now repealed).
 - b. The transportation ended outside Kenya. Therefore, pursuant to Regulation 20(2) of the VAT Regulations, 1994, transport services were supplied outside Kenya and therefore VAT zero-rated.
5. The Respondent vide letter dated 17th March 2014 communicated its final position by which it confirmed the VAT demand of Kshs 20,033,422.00 in respect of cut flowers from the farms to the airport, which was deemed to be local transport subject to VAT at 16%.
6. The Appellant being dissatisfied with the Objection Decision by the Respondent filed the Appeal herein.

C. APPEAL

7. The Appellant appeals to the Tribunal against the decision issued by the Respondent vide a Memorandum of Appeal dated 29th April, 2014. The grounds of Appeal are as follows;
 - a. Paragraph 17 of Part A of the Fifth Schedule to the VAT Act, Chapter 476 of the Laws of Kenya (VAT Act, now repealed) provides that the supply of transportation services in respect of unprocessed agricultural and agro-forest produce shall be zero-rated.

- b. The flowers that the Appellant transports from its customers' flower farms to customers named destination in the European Union are unprocessed.
 - c. The Appellant's service of transporting unprocessed flowers is VAT zero rated in accordance with Paragraph 27 of Part A of the Fifth Schedule to the VAT.
 - d. Regulation 20(2) of the VAT Regulations, 1994, provides that where transportation ends outside the country, the transport services shall be deemed to have been supplied outside the country.
 - e. The Appellant transports the flowers from a place in Kenya to a place outside Kenya. The transportation service ends outside Kenya and therefore the applicable VAT rate on this transportation service is 0% and not 16%.
8. The Appellant prays for the following;
- a. That the VAT Tribunal sets aside and annuls the KRA's assessment of Kshs 20,033,422.00 being VAT on transport of unprocessed agricultural produce and or transportation that ended outside Kenya; and
 - b. For costs of this Appeal.

D. RESPONSE TO THE APPEAL

9. The Respondent responded to the grounds of Appeal in a Statement of Facts dated 23rd August 2019.

- a. The Appellant offered transport services on cut flowers from local farms to the airport and did not charge VAT whereas transportation services offered by a registered firm locally should be charged VAT.
- b. The cut flowers transported by the Appellant, are not unprocessed products that are VAT zero-rated under Paragraph 17 of Part A of the Fifth Schedule of VAT Act CAP 476 (now repealed).
- c. That the transportation of the cut flowers by the Appellant, from farms in Kenya, ended at the Jomo Kenyatta International Airport, within the country and it is the portion of local transportation that was charged by VAT.
- d. That VAT Act, CAP 476 (now repealed) in Paragraph 20 (1) & (2) regarding Services supplied in Kenya is explicit that :-

“ 1. Except as is otherwise provided in the Act, services shall be deemed to have been supplied in KENYA-

- a. Where the supplier has established his business or has a fixed physical establishment in Kenya and the services are physically used or consumed in Kenya regardless of the location of the payer;*
- b. In connection with immovable property, the property is situated in Kenya; or*
- c. In connection with receiving a signal or service for the supply of television, radio, telephone or any other communication service, the person receiving the signal or service is in Kenya.*

2. *Where transportation ends outside the country, the transport services shall be deemed to have been supplied outside the country.”*

10. The Respondent prays that the Honorable Tribunal finds that;-

- i. Uphold the Respondent’s decision dated 17th March 2014 confirming VAT demand of Kshs 20,033,422.00.
- ii. Dismiss the Appeal with costs to the Respondent.

E. ISSUES FOR DETERMINATION

11. In this Appeal a single issue crystallizes for determination by the Honorable Tribunal, namely;

- a. *Whether the Respondent erred in demanding Value Added Tax in respect of cut flowers from flowers to the airport.*

F. ANALYSIS

12. It is the Appellant’s contention that the Respondent erred in demanding Kshs. 20,033,422.00 in respect of transportation of uncut flowers from the farms to the airport. The Appellant submitted that the transport was a supply of transport services in respect of unprocessed agricultural and agro-forest produce which is zero rated for Value Added Tax (VAT) purposes under Paragraph 17 Part A of the Fifth schedule to the VAT Act. Further that the transportation ended outside Kenya. Therefore, pursuant to Regulation 20 (2) of the VAT Regulations 1994, the transport services were supplied outside Kenya and therefore VAT zero rated.

13. The Appellant further submitted that it disagrees the Respondent's averment that the goods are unprocessed agricultural and agro-forest produce as per Paragraph 17 of the 5th Schedule of the VAT Act. In this respect, the Appellant relied on a notice by the Respondent titled 'Clarification on the Value Added Tax Act, 2013.
14. According to the Appellant, the Respondent by this notice implied that milk remains as unprocessed as the essential character of the milk has not changed. Similarly, the essential character of the flowers does not change from the time they are harvested at the customer's farm and delivered to the named destination.
15. The Appellant argued that the flowers it transports are unprocessed as they are not subjected to any changes as a result of which they become a new and distinct article. The flowers are picked from the customer's farms as flowers and delivered to the customer's named destination outside Kenya as flowers.
16. In response to this, it was submitted on behalf of the Respondent that the Appellant offered transport services on cut flowers from local farms to the airport and did not charge vat whereas transportation services offered by a registered firm locally should be charged to vat.
17. Further, that the cut flowered transported by the Appellant are not unprocessed products that are vat zero rated under Paragraph 17 Part A of the Fifth Schedule to the VAT Act, Cap 476 (now repealed). The transportation of the uncut flowers by the Appellant from the farms in Kenya ended at the Jomo Kenyatta International Airport within the country and it is the portion of local transportation that was charged to VAT.

18. The parties foregoing submission boil down to two issue which we must pronounce ourselves on for proper resolution of this dispute. That is whether the uncut flowers are processed or unprocessed, and whether the transportation of the same is zero rated or standard rated.
19. Before we begin our analysis of these issues we think it apt to first reproduce the impugned Sections of the VAT Act, Cap 476 as relied on by both parties herein. Accordingly, Paragraph 17 of the Fifth Schedule to the VAT Act (now repealed) provided as follows;

“Where, subject to the satisfaction of the Respondent, the following supplies take place in the course of a registered person’s business, they shall be zero rated in accordance with the provisions of Section 8:

The supply of transportation services in respect of unprocessed agricultural and agro-forest produce.”

20. Regulation 20 (1) & (2) of the VAT Regulations 1994, as relied upon by the Respondent stipulated as follows;

“(1) Except as is otherwise provided in the Act, services shall be deemed to have been supplied in Kenya—

(a) Where the supplier has established his business or has a fixed physical establishment in Kenya and the services are physically used or consumed in Kenya regardless of the location of the payer;

(b) In connection with immovable property, the property is situated in Kenya; or

(c) In connection with receiving a signal or service for the supply of television, radio, telephone or any other communication services, the person receiving the signal or service is in Kenya.

(2) Where transportation ends outside the country, the transport services shall be deemed to have been supplied outside the country.”

21. In line with the above, one first task is to determine whether the cut flowers are processed produce or not. In this respect the Respondent argued that the process of processing involves subjecting an item to chemical or mechanical changes. The Appellant dipped the flowers in water and hydrating solution to preserve their life while awaiting transportation. The dipping on the flowers in hydrating solution as such subjected them a process hence they cannot be categories under Paragraph 17 of the Fifth Schedule to the VAT Act (now repealed). The Respondent’s witness at the hearing of the matter regaled us in rather comical testimony to the effect that even potatoes, so long they are harvested and washed, qualify to be processed produce.
22. However, the Appellant urged us to decline from this mechanical interpretation of the term “processed” and instead infer from the Respondent’s own notice in clarifying what amount to processed milk. The said notice, in the substantive bit states as follows;

“Unprocessed milk shall include milk that has undergone heat treatment to eradicate harmful bacteria but for which no significant value addition has taken place so as to change its essential character as milk meant for ordinary use, whether sold in packaged form or otherwise dispense.”

23. The Appellant urged to make an inference and bind the Respondent definition adopted above of the term unprocessed regardless of the product in question. This is most certainly a logical conclusion we appreciate and are persuaded to adopt. In our understanding, the very term “processed” indicates that an item has been subjected to a particular process which results in material alteration of the original form of the said item.
24. The clarification offered by the Respondent in the notice in respect unprocessed milk speaks as much to this conclusion insofar as there was no significant value addition that has taken place to change the essential character of milk meant for ordinary us.
25. The Respondent’s argument in classifying the cut flowers as processed hinges on the fact that the flowers were dipped in water and hydrating solution. This in our opinion is but half the test and one needs to take the extra step to ascertain whether the process used resulted in a material and significant alteration or value addition whatsoever. In the same manner the heating of the milk eradicated bacteria in unprocessed milk, we find the dipping of the flowers in water and hydrating solution maintained the structural integrity of the rose flowers thus preserving its lifespan for its intended ordinary use; aesthetics.
26. The dipping of the flowers did not create an altogether new or different product all together; the end product was still a flower to be used for decoration and not rose waster for use, say in the cosmetics industry. It is disingenuous for the Respondent to exclude cut flowers from the logical of classifying heated milk as unprocessed.

27. We therefore find the cut flowers in which the Appellant herein deals in are unprocessed and as such Paragraph 17 of the Fifth Schedule to the VAT Act (now repealed) has application in the circumstances of this Appeal.
28. Having so found, we now turn our collective attention treatment proffered by the Respondent against the transportation of the cut flowers from the farms to the airport. The Respondent has argued that the transportation of the flowers should be standard rated (at 16%) as the transportation ended at the airport. In this respect reliance was placed on Paragraph 20 (1) of the VAT Regulations 1994.
29. On its part the Appellant submitted that it bills its customers for the transportation from the farm to the airport and this portion of transport was billed at zero rated as per the provision of the repealed VAT Act on the transportation of unprocessed agricultural produce. That this is the transportation of unprocessed agricultural produce which has ended in outside the country.
30. We have reviewed the sample agreement transport services provided by the appellant to its customers as well as the applicable law in Paragraph 17 of the Fifth Schedule of the VAT Act and the Regulation 20 of the VAT Regulations 1994. The transportation services was in respect of unprocessed agricultural produce which ended outside as rendered to the Appellant's customers resident outside the jurisdiction of the Kenya. The repealed VAT Act expressly envisages the zero rated of such transport and the Respondent erred in charging the same to the standard rate of 16%.

G. CONCLUSION

31. The upshot of the foregoing analysis is that we find the Appeal herein is merited and accordingly, the Tribunal makes the following Orders;-

a. The Respondent's demand of Kshs. 20,033,422.00 in respect of transportation of cut flowers from the farms to the airport be and is hereby set aside.

b. Each party to bear its own costs.

32. It is so ordered.

DATED and DELIVERED at NAIROBI on this 21st day of May 2021.


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MAHAT SOMANE
CHAIRPERSON


.....
WILFRED GICHUKI
MEMBER


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ROSE WAMBUI NAMU
MEMBER


.....
JOHN KINYUA WANGARI
MEMBER


.....
TIMOTHY CHESIRE
MEMBER

