HAVE THE NEW VAT REGULATIONS REALLY SHED ANY LIGHT AS REGARDS WHAT CONSTITUTES AN EXPORT FROM A VAT PERSPECTIVE?

On 4 April 2017, the Cabinet Secretary for National Treasury gazetted the VAT Regulations, 2017, pursuant to section 67(1) of the VAT Act, 2013. These Regulations will only become effective when they are approved by the National Assembly, in accordance with section 67(2) of the VAT Act 2013 ("the VAT Act").

The Regulations are directed at making more detailed provisions for, amongst other matters, the exportation of services. Paragraph 13(1) of the Regulations provides as follows:

An exportation shall be a taxable supply –

(a) In the case of goods, when the taxable supply involves the goods being entered for export under the East African Community Customs Management Act and delivered to a recipient outside Kenya at an address outside Kenya; or

(b) In the case of services, when the taxable supply involves the services being provided to a recipient outside Kenya for use, consumption or enjoyment outside Kenya.

Provided that the exportation of services shall not include –

(a) Taxable services consumed on exportation of goods unless the services are in relation to transportation of goods which terminates outside Kenya;

(b) Taxable services provided in Kenya but paid for by a person who is not a resident in Kenya.

Whilst these Regulations are aimed at providing clarity on what does and does not constitute an export, they may actually have brought further confusion from the following aspects:

i. The opening paragraph “an exportation shall be a taxable supply” presumably, ought to have read “an exportation shall be a zero-rated taxable supply” in order to bring out the desired meaning.

In accordance with the VAT Act, taxable supplies constitute either zero rated or standard rated (rate of 16%) supplies. Exports of goods and taxable services forms part of the supplies expressly listed in the VAT Act, to be zero rated taxable supplies. It is for this reason that it would only make sense to revise the provision to read that “an exportation shall be a zero-rated taxable supply”, as leaving it as is implies that one may either apply the standard rate or the zero rate of VAT for the supplies that fall within paragraph 13(1) of the Regulations.

ii. With regards to goods, the Regulations refer to “goods being entered for export under the East African Community Customs Management Act (EACCMA) …”

From a customs perspective, it is appreciated that partner states of the East African Community (EAC) fall within one customs territory, and as such, one is considered to be exporting only when goods move from a partner state to a state outside the EAC, and not when they move from one partner state to another. On the other hand, the VAT Act does not recognize the EAC and thus the partner states constitute separate and distinct jurisdictions meaning that movement of goods from one partner state to another is considered to be an export despite the countries in question being member states of the EAC.

In the VAT Act, an export is defined to mean “to take or cause to be taken from Kenya to a foreign country, a special economic zone, or to an export processing zone.” Drawing from this definition therefore, goods taken from Kenya to any place outside Kenya, including within the other EAC partner states would qualify as an export.

Unless the substantive legislation (VAT Act) is amended to recognize the EAC as one customs territory for VAT purposes, the definition in the VAT Regulations would be void and therefore not have any legal standing. This is in line with the Interpretation and General Provisions Act of Kenya and the Statutory Instruments Act of Kenya which provide that where subsidiary legislation is inconsistent with the Act under which it is made shall be void to the extent of that inconsistency.

Further, and if (i) above is adopted, the provision ought to read “in the case of goods, when **the supply (not the taxable supply)** involves the goods being entered for export … “. This is because, exportation of all goods (rather than taxable goods), constitutes zero rated supplies. This can be contrasted to services, where only exports of taxable services constitute zero-rated supplies. Simply put, exports of all goods are zero rated, while for services, only taxable services are zero rated. Consequently, where an exempt good is exported, it would be zero rated but where an exempt service is exported, it would retain its exempt status.

iii. With regards to the proviso, the following is a critical analysis:

Provided that the exportation of services shall not include taxable services consumed on exportation of goods unless the services are in relation to transportation of goods which terminates outside Kenya.

As highlighted herein, “to export” means “to take something or to cause something to be taken outside Kenya to a foreign country or …”. Consequently, it is envisaged that for goods to be termed as “exported”, the same must be

transported to a place outside the customs borders of Kenya. As such, transportation of the same must terminate outside Kenya, as the goods must be taken outside of Kenya to qualify as an “export”.

The question that arises then is which category of services are consumed on exportation of goods but are not in relation to transportation of goods which terminates outside of Kenya. It must be that the intention of the legislators is to categorize the services provided in relation to exportation of goods into two being:

1. those that **are** “in relation to the transportation of goods which terminates outside Kenya”, and
2. those that **are not** “in relation to the transportation of goods which terminates outside Kenya”

It is not clear which kind of services would fall under either category and as such the provision is left open to varying interpretations, which was definitely not the intention of the legislators. This proviso should be drafted more clearly to enable an objective interpretation of the same.

Provided that the exportation of services shall not include taxable services provided in Kenya but paid for by a person who is not a resident in Kenya.

The effect of this proviso is that where a service is provided in Kenya, it cannot under any circumstance, qualify as an export. This would mean that only service providers that leave the customs borders of Kenya to perform their services, would be in a position to provide exports, otherwise all their services would be local supplies. This is definitely not in line with the spirit of the substantive legislation.

The VAT Act defines a “service exported outside of Kenya” to mean a service provided for use or consumption outside Kenya. It is clear that the place of performance is irrelevant, and that what is of essence is whether the service was consumed within or outside Kenya. It is worth pointing out that the repealed VAT

Act, Cap 476, defined a “service exported outside Kenya” to mean a service provided for use or consumption outside Kenya, whether the service is performed in or outside Kenya, or both inside and outside Kenya. The words “whether the service is performed in or outside Kenya, or both inside and outside Kenya” were deleted in the VAT Act, 2013, to avoid creating confusion, as they really did not add any value to definition on the basis that place of performance is irrelevant.

It is likely that the intention of the proviso was supposed to clarify that an export of service cannot be classified as such merely because an invoice was raised to a non-resident person. If this is correct, then the proviso should have read “Provided that the exportation of services shall not include taxable services consumed in Kenya but paid for by a person who is not a resident in Kenya”. This has the effect of rendering all services consumed in Kenya as local supplies, and subject to the standard rate of VAT, or exempt from VAT as the case may be.

Given the foregoing, it is clear that the Regulations need to be reconsidered, and more so paragraph 13(1) to ensure that the desired objectives are met. Where this particular paragraph remains as is, this will with no doubt, result into may disputes around the interpretation of the same, which is especially common where the literal (strict) interpretation of the law contradicts with the intention of the same.

For more information on this, please write to Mrs. Immaculate Wanderi-Ngure at IWanderi@vivaafricallp.com or write to us at info@vivaafricallp.com