

# Tax Alert - VAT on Exported Services - 3M Kenya Limited v Kenya Revenue Authority

## Summary

This alert brings to your attention the Tax Appeals Tribunal (the Tribunal) judgment in the case of 3M Kenya Limited (Appellant) vs. Kenya Revenue Authority (Respondent) on the imposition of Value Added Tax (VAT) on marketing support services provided to related non-resident entities.

## Facts

The Respondent conducted an audit of the Appellant's tax affairs for the period 2010 to 2015. Following the audit, the Respondent assessed the Appellant, VAT and Withholding Tax. The Appellant objected to the assessment and following deliberations with the KRA most of the issues were resolved except for the imposition of VAT on marketing support services.

The Appellant appealed to the Tribunal against the imposition of VAT on marketing support services. The Tribunal's decision is the basis for this alert.

## Appellant's case

The Appellant, a company incorporated in Kenya signed a service agreement to provide marketing and liaison services to related non-resident entities located in the UAE and South Africa. Under the agreements, the Appellant was to be compensated on a cost-plus mark-up basis.

The related non-resident entities executed separate agreements with distributors of their products who they invoiced directly for products imported directly from 3M Gulf in UAE and 3M South Africa.

The Appellant argued that the marketing support services enhance brand awareness of the products sold by the non-resident entities in Kenya. On this basis, the services were exported since it is the non-resident entities as opposed to the resident distributors who consumed the services.

The Appellant relied on Section 2 of the Value Added Tax Act that defines a service exported out of Kenya as a service provided for use or consumption outside Kenya. To support their case, the Appellant cited F.H. Services Limited vs Commissioner of Domestic Taxes, Appeal No.6 of 2012 where the Tribunal held that marketing and logistic services offered by F.H. Services to a related non-resident entity economically benefited the non-

resident and were therefore exported services. Equally, the Appellant referred to Total Touch Cargo Holland vs Commissioner of Domestic Taxes, Appeal No. 5 of 2013 where the Tribunal ruled that cooling and palletizing services provided by Total Touch Cargo Holland in Kenya for the benefit of its parent company in Netherlands constituted an export of service.

The Appellant further relied on the destination principle in the OECD International VAT and Sales Tax Guidelines which provides that for consumption tax purposes, internationally traded service should be taxed according to the rules of the jurisdiction of consumption. The general rule under the guidelines is that the jurisdiction where the customer is located has the taxing rights over the services.

## Respondent's case

The Respondent submitted that the Appellant wrongly classified market support services it provided to non-residents as zero rated even though the services did not qualify as exported services. Further, it was the Respondent's position that the effect of the services was to create product awareness among the Kenyan population with the objective of enhancing sales. The Respondent argued that the local companies that import and distribute products on behalf of the non-resident entities are the ultimate beneficiaries of the marketing services. It was the Respondent's view that such services are consumed locally and are therefore subject to VAT at the rate of 16%.

The Respondent further sought to differentiate between the case in question and the F.H. Services Limited case by asserting that in the F.H. case the product was destined for the export market and on this basis the attendant services were consumed outside Kenya.

It was the Respondent's submission that the consumer of the services is not necessarily the person who pays for them, but anybody, including the local distributors who rely on the Appellant's marketing support services to influence their consumer choices. In the Respondent's view, what is material is the place of consumption of the service and not the location of the person who earns the revenue.

## Issue for determination

The Tribunal established the key issue for determination was whether the marketing support services the Appellant provided to its related non-resident entities were exported services and therefore zero rated for VAT purposes.

## Findings

The Tribunal held that the marketing support services the Appellant provided were consumed outside Kenya by the two related non-resident entities, hence constituting exported services which are zero-rated for VAT purposes. The Tribunal relied on the destination principle under the OECD guidelines which provides that the jurisdiction where a customer is located has the taxing rights over internationally traded services.

The Tribunal distinguished between "marketing support services" and "3M Products" ruling that the support services were provided to 3M Kenya's non-resident related entities while the 3M products were provided by local distributors to local customers. As such, while 3M



products were consumed locally, the “marketing support service” was consumed outside Kenya.

The Tribunal agreed that while it was possible for a benefit to accrue to local distributors and customers from the marketing services, they were not contractual parties and any such benefits were secondary.

## Our Comments

The ruling reinforces the Tribunal decisions in F.H. Services Limited vs Commissioner of Domestic Taxes, Appeal No.6 of 2012 and Total Touch Cargo Holland vs Commissioner of Domestic Taxes, Appeal No. 5 of 2013 where it held that services provided to related non-resident entities amounted to exported services and were therefore zero rated.

There is now consistency in recent rulings on the issue of exported services and the current ruling will go a long way to enhance certainty on this important issue. An interesting departure from this trend is the ruling in Google Kenya Limited vs Commissioner of Domestic Taxes Appeal No. 120 of 2017 where the Tribunal focused on the place of performance as provided for under the local legislation to rule that the marketing services that Google Kenya provided to Google Ireland were taxable in Kenya at the prevailing VAT rate.

It is worth noting that the decision in the 3M case was delivered a month after that of the Google case. The 3M ruling provides useful guidance on VAT on exported services going forward.

The Google case is the subject of an appeal at the High Court of Kenya. It will be interesting to see how the High

Court will distinguish between the place of performance of the services, the place of consumption of the said services and the location of the business receiving the services, which are all key in determining whether a service is exported.

KPMG is happy to assist with any matters arising from this alert.

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