REPRIEVE FOR MANUFACTURERS AS THE TAX APPEALS TRIBUNAL PROVIDES CLARITY ON TREATMENT OF IMPORT VAT FOR GOODS IMPORTED UNDER THE INWARD PROCESSING PROCEDURE

SOUTHERN ENGINEERING COMPANY LIMITED VS COMMISSIONER OF CUSTOMS & BORDER CONTROL APPEAL NO. 4 OF 2020

A. BRIEF OF FACTS OF THE CASE

On 30th July 2021, the Tax Appeals Tribunal delivered its judgment in the case of Southern Engineering Company Limited vs Commissioner of Customs and Boarder Control, TAT Appeal No. 4 of 2020.

The brief facts of the case are that Southern Engineering Company Limited (Hereinafter "SECO") was awarded a tender by the Tanzania Ports Authority to design, build, supply and commission two cargo barges of Tanga Port.

Through various letters, SECO wrote to the Commissioner of Customs (Hereinafter the "Commissioner") requesting for its authority to import Duty free materials for construction of two barges for export to the Tanzania Ports Authority under Section 172 to 177 of the East African Customs Management Act of 2004 (EACCMA) as read together with Regulations 185 to 191 of the East African Community Customs Management Regulations, 2010 (EACCMR). In the abovementioned letters, SECO sought the approval of the Commissioner to import the materials to be used in the transaction under the Inward Processing Procedure (IPP). The Commissioner subsequently responded approving the SECO's application to import under IPP subject to certain conditions.

In view of the approval by the Commissioner, SECO lodged its application together with the requisite supporting documentation including the formal application for authorization of inward processing in the prescribed form C13 together with a security bond to cover the Import Duty and taxes payable on the goods in form of CB13

Based on the permission granted, SECO proceeded to import duty-free material necessary for the execution of the said transaction under the IPP with the full authorization, approval, and knowledge of the Commissioner. However, the Commissioner subsequently conducted a desk review of SECO's imports for the period beginning January 2018 and thereafter issued a demand for **Kshs. 21,361,954.24** being VAT on imports on grounds that the same had been erroneously exempted and/or zero rated at the time of clearance.

SECO filed its Objection noting that the alleged goods the subject of VAT were imported under the IPP where no taxes were due unless or until the goods had been entered for home use or not otherwise accounted for to the satisfaction of the Commissioner. However, by an Objection decision dated 3rd October 2019, the Commissioner affirmed its position that the demand of **Kshs. 21,361,945.24** being VAT on imports was payable by SECO.

Of note is that the said goods, after the manufacturing process, were subsequently exported to Tanzania. Upon reconciliation, the Commissioner affirmed that SECO had duly accounted for materials imported for manufacturing under the Duty Remission Scheme and hence the security bonds in respect of the said imported goods may be cancelled. Indeed, the said security bonds were subsequently cancelled vide various letters from the Commissioner.

B.ISSUE FOR DETERMINATION

Whether the Commissioner erred in demanding VAT on goods imported under the inward processing procedure

C.ANALYSIS OF ISSUE

1.SECO Submissions through Taxwise Africa Consulting LLP

During the hearing of the Appeal, SECO noted that the IPP was a Customs simplification procedure that allowed for temporary importation of goods into a Customs territory for purposes of repairs or manufacture of other goods.

Such goods were usually not intended to enter free circulation in that territory. That under normal Customs procedure, this would be treated like any other importation subject to Import Duties and taxes and other Customs formalities. The owners would subsequently seek a refund of Duties and taxes after the equipment had been re-exported. Such a regime exacted unnecessary delays, expense, and hardship without generating any taxes to the country.

That under Section 171 of the EACCMA, the same defined inward processing procedure to mean the Customs procedure under which certain goods can be brought in a Partner State **conditionally exempted from Duty on the basis that such goods are intended for manufacturing, processing or repair and subsequent exportation.**

SECO further argued that during the hearing of the Appeal, both the Commissioner and SECO agreed that the goods were indeed imported under the IPP. Therefore, as per the provisions of Section 172(2) of the EACCMA, goods entered under the IPP are relieved from Duty. Indeed, that Section 2 of EACCMA defined Duty to include import VAT. Further, SECO contended that based on the definition of the IPP under Section 171 as read with Section 172 (2) of the EACCMA, SECO having been duly granted permission by the Commissioner to import materials under the IPP was exempt from paying duty including the import VAT unless or until the goods were entered for home use or otherwise not accounted to the satisfaction of the Commissioner as per the provisions of Regulation 191 of the EACCMR, 2010.

In respect of the conditions stipulated by the Commissioner more specifically the condition which stipulated that VAT was payable (on Value Addition) as per the VAT Act, 2013, it was SECO's argument that at the point of importation of the goods, there was no value addition of the goods. That at the time of importation no value would have been added on the goods and therefore no tax was collectable by the Commissioner at that point as VAT is a tax on value added. SECO submitted that the value addition of the goods only occurred once the goods had been brought into the country, manufactured and processed at the customs territory.

It is at the point of manufacture and processing that the goods received value addition. However, upon exportation of the said goods, the same were treated as exports and hence zero rated for VAT as per the Second Schedule, Part A Paragraph 1 of the VAT Act. Based on the above submissions, it was SECO stand that there was no VAT payable.

2. Commissioner's Submissions

The Commissioner submitted that regarding the exemption of VAT by EACCMA, the exemption was specific to an Act and must be clearly provided for under the same Act. As such, the exemption of VAT on goods/services could only be provided for under the VAT Act and no other. That there cannot be an exemption of VAT by a separate Act apart from the VAT Act. As such, since the exemptions are provided for by the substance law, that is, the VAT Act, the EACCMA cannot provide for exemptions to the VAT Act.

Consequently, it was the submission of the Commissioner that SECO had failed to demonstrate which express provision of the VAT Act had allowed for the exemption of goods subject to the Inward Processing Procedure. That the VAT Act was clear and unequivocal that unless it expressly exempted VAT, it was to be taxed. Further, that when goods and services were not listed in the 1st Schedule of the VAT Act, they were subject to VAT at the rate of 16%. That at no time was SECO exempted from paying VAT on its imports and the only exemption that it enjoyed on importation of goods in dispute was on import duty under the EACCMA.

The Commissioner further noted that Customs Import Duty was a levy on select imported goods levied under the EACCMA before the goods were allowed to enter the territory of Kenya, while VAT was a domestic tax charged on select goods and services at every point of value addition, up to the final consumer. That these two regimes were separate tax regimes.

Further, that EACCMA is an Act for the management and administration of Customs and related matters while the VAT Act, is described as an Act of Parliament to review and update the laws relating to the Value Added Tax, to provide for the imposition of Value Added Tax on supplies made in or imported in Kenya. Based on the above arguments, it was the contention of the Commissioner that VAT was payable by SECO for goods imported under the IPP.

3. TAT Decision

In arriving at its decision, the TAT relied on the provisions of the Revised Kyoto Convention Specific Annex F which prescribes in Standard 2 as follows: -

"Goods admitted for inward processing shall be afforded total conditional relief from import duties and taxes. However, import duties and taxes may be collected on any products, including waste, deriving from the processing or manufacturing of goods admitted for inward processing that are not exported or treated in such a way as to render them commercially valueless."

Based on the above, the TAT noted that conditional relief from Customs Import Duties on goods imported under the inward processing procedure was not an exemption. Rather, the Duty became due if the goods were released from customs control for free circulation.

Further, the Tribunal noted that while there was nothing in the VAT Act that showed that VAT on goods imported for inward processing was exempt, there was power donated by Section 22(4) of the VAT Act to the Commissioner of Customs to treat the VAT payable on all imported goods as if reference to Import Duty included reference to VAT payable on imported goods.
To this end, the Tribunal noted the Commissioner's approval of goods to be entered into the IPP meant that both Import Duty and VAT were suspended during the pendency of the procedure. That it was instructive to note that a condition for approval of entry of goods for the procedure was that taxes were to be secured using a Customs Bond. This was meant to ensure that the taxes would be paid if the manufactured goods were not exported, or the goods were not used for the intended manufacture. As such, it was incorrect for the Commissioner to assert that suspension of tax under the IPP applied only to Customs only and not VAT.

Further, so long as the goods remained under bond, they were under Customs control and therefore not subject to payment of Import Duty or VAT. These taxes would only fall due when the goods were entered for free circulation and therefore the Commissioner could not ask for VAT unless the conditions given by the Commissioner were violated or the goods were consumed locally.

To this end, the Tribunal concluded that VAT was suspended on goods imported under the IPP although the Commissioner could demand security to guarantee that the VAT was paid if the goods were diverted to home use. Consequently, the Commissioner had erred in demanding VAT on goods imported by the Appellant under the Inward Processing Procedure.

D. CONCLUSION

Based on the above finding, the same has now provided more clarity on the treatment of Import VAT especially in the manufacturing industry who are engaged in importation of raw materials from the Partner States under the IPP only for the same to be exported to the Partner States as finished goods. With the clarity as to the treatment of Import VAT under the IPP, the IPP would now meet its intended purpose of freeing the manufacturer's cash flows for operational use without the Commissioner risking the non-payment of taxes should the imported material not be properly accounted for.

Its baffling that in the first instance, the Commissioner had taken such an adverse decision that would have crippled the IPP regime and hence, in the long term, leading to loss of much needed capital investments in the country.

The decision by the Tribunal is a welcomed move for entities that utilize the IPP. This will ensure that not only are cashflows utilized for investments and operational purposes instead of short-term tax payments, but will support the growth of manufacturing industry, leading to increased forex exchange earnings, more employment opportunities, less financing costs and overall, more tax collections by the Commissioner.

E. LET'S TALK

The objection and subsequent **Tax Appeals Tribunal (TAT) was undertaken by our tax litigation team**. Should you have any tax case or need any further information on this matter, contact your regular Taxwise Africa contact or reach us on the contacts below.

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