

# Commissioner of Domestic Taxes v ICEA Lion General Insurance Company Limited [2025] KEHC 14865 (KLR)

## BEYOND THE SALE: VAT ON SALVAGE DISPOSAL BY INSURANCE COMPANIES

### In this edition

The High Court upheld the Tribunal's decision and dismissed KRA's appeal. The Tribunal concluded that salvage disposal is incidental to insurance business and falls within the VAT exemption for insurance services under Paragraph 2 of Part II of the First Schedule of the VAT Act.

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# Key Highlights



1

2

3

4

5

Background and Legal  
Issue

Contentions presented  
by KRA and ICEA Lion  
regarding the VAT  
treatment of salvage  
disposal.

High Court's  
Determination

Implications for the  
Insurance Company

Conclusion

# Background

The dispute arose from a compliance review conducted by the Kenya Revenue Authority (KRA) on ICEA Lion General Insurance Company (ICEA Lion) for the years 2015 to 2018. Following the review, KRA issued an assessment demanding Kshs. 88.8 million in additional VAT, arguing that the disposal of salvaged motor vehicles constituted a taxable supply of goods under the VAT Act.

ICEA Lion objected, maintaining that the disposal of salvage was not a commercial transaction but an incidental process within its core insurance function. The matter escalated to the Tax Appeals Tribunal (TAT), which ruled in favor of ICEA Lion. Dissatisfied, KRA appealed to the High Court, setting the stage for a deeper legal examination of the VAT implications of salvage disposal.

## The Legal Issue

The High Court was tasked with determining whether:

- The disposal of salvaged motor vehicles by an insurer constitutes a taxable supply subject to VAT under the VAT Act; or
- The disposal forms part of the exempt insurance services under the First Schedule of the VAT Act.

This issue required the Court to interpret the scope of VAT exemptions in the context of insurance transactions and to decide whether salvage disposal was a separate taxable activity or an integral part of the insurance service.



# Contentions presented by KRA and ICEA Lion regarding the VAT treatment of salvage disposal.

## Arguments by the Kenya Revenue Authority (KRA)

- KRA adopted a strict and literal interpretation of the VAT Act. It argued that:
- The sale of salvaged vehicles is a distinct commercial transaction and therefore a taxable supply of goods under Section 2 of the VAT Act.
- Since the VAT Act does not expressly exempt salvage disposal, the exemption cannot be implied.
- The proceeds from such sales should be treated as income rather than compensation.
- The Insurance Act's definition of "insurance business" should not override the VAT Act's charging provisions.

KRA further relied on judicial precedents emphasizing that ancillary or incidental services can be separated from the principal supply and taxed independently. In essence, KRA's position was that the insurer's act of selling salvaged vehicles was a standalone commercial activity subject to VAT at the standard rate.

## Arguments by ICEA Lion General Insurance Company

- ICEA Lion countered with a purposive and harmonious interpretation of both the VAT Act and the Insurance Act. The insurer argued that:
- Salvage disposal is not a separate business activity but an incidental and integral part of the insurance service.
- Upon indemnifying the insured, the insurer steps into their shoes through the doctrine of subrogation and disposes of the salvage to mitigate loss.
- The insurer does not "purchase" the salvage; it acquires it by operation of law as part of the indemnity process.
- The disposal is a remedial step aimed at cost recovery, not a revenue-generating transaction.

ICEA Lion also drew from European VAT jurisprudence, invoking the doctrine of single composite supply, which holds that where a transaction comprises multiple elements, it should be treated as a single supply for VAT purposes if the elements are economically inseparable. The insurer maintained that the VAT exemption for insurance services should be interpreted broadly to include such incidental activities.

# High Court's Determination

The High Court upheld the Tribunal's decision and dismissed KRA's appeal. In its reasoning, the Court made several key findings:

- **Not a Distinct Taxable Supply:** The disposal of salvaged vehicles is not a separate taxable transaction but the final step in the indemnification process. The insurer's actions are rooted in the doctrines of indemnity and subrogation, not trade or commerce.
- **Harmonious Interpretation of Laws:** The Court emphasized that the VAT Act and the Insurance Act must be read together. While the VAT Act exempts "insurance services" without defining the term, the Insurance Act defines it broadly to include incidental activities.
- **Accounting Treatment Supports the View:** The Court noted that salvage proceeds are typically recorded as a reduction in claims expenses, not as revenue. Although accounting treatment is not determinative of tax liability, it reinforces the view that salvage disposal is a recovery mechanism, not a profit-making activity.

- **Composite Nature of Insurance Services:** The Court concluded that the disposal of salvage vehicles is part of a single, indivisible supply of exempt insurance services.

Ultimately, the Court held that ICEA Lion's disposal of salvage vehicles was not a commercial sale undertaken for profit but a necessary and incidental step in fulfilling its indemnity obligations.

## Implications for the Insurance Industry

This decision carries significant implications for insurers and other players in the financial services sector:

- **Clarification of VAT Liability:** The ruling provides much-needed clarity that salvage disposals arising from indemnity and subrogation are exempt from VAT, provided they are incidental to the insurance service.
- **Reduced VAT Risk:** Insurers can now operate with greater certainty regarding the VAT treatment of salvage disposals, reducing the risk of unexpected tax assessments.
- **Increased Scrutiny from KRA:** Despite this clarity, the decision signals that KRA may intensify audits and litigation over ancillary transactions in exempt sectors. Taxpayers must maintain robust documentation to demonstrate that such disposals are incidental to exempt services.
- **Contrast with Banking Sector:** The Court's reasoning contrasts sharply with the Tribunal's earlier decision in KCB Kenya Limited v Commissioner of Legal Services & Board Coordination [2025] KETAT 2 (KLR), where the disposal of repossessed vehicles by a bank was deemed taxable. This divergence underscores the importance of context—while both insurance and credit services are exempt, the legal nature of asset acquisition (subrogation vs. repossession) determines VAT treatment.

## Conclusion

The ICEA Lion decision is a milestone in Kenya's VAT jurisprudence, offering a nuanced understanding of how tax law interacts with the unique mechanics of insurance. By recognizing that salvage disposal is an incidental step in the indemnity process rather than a taxable sale, the Court has reinforced the principle that VAT should align with the economic and legal substance of transactions.

For insurers, the ruling provides welcome clarity and operational certainty. For the tax authority, it underscores the need for careful, context-sensitive enforcement. And for the broader financial sector, it serves as a reminder that the boundaries of VAT exemptions are not static; they evolve through interpretation, litigation, and the ever-changing landscape of commercial practice.

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