Banking, Finance & Projects and Tax & Exchange Control

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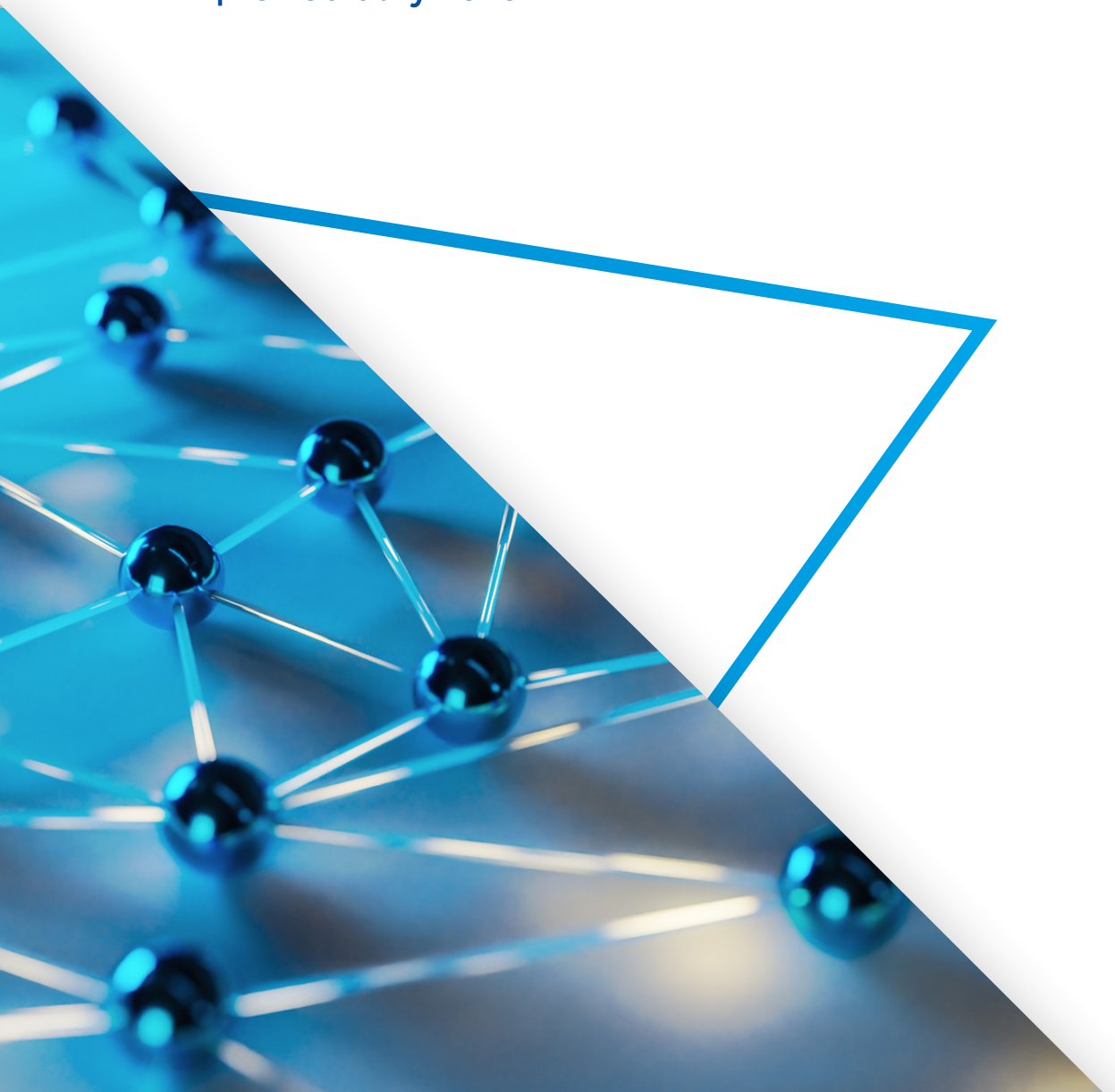

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BANKING, FINANCE & PROJECTS AND TAX & EXCHANGE CONTROL ALERT

Disposal of seized motor vehicles by banks, through auction, is subject to VAT

In a landmark ruling in *KCB Bank Kenya Limited v Commissioner Legal Services & Board Co-ordination* (Tax Appeal E023 of 2024) [2025], the Tax Appeals Tribunal (Tribunal) held that value-added tax (VAT) is chargeable on the disposal of seized assets, including the sale of motor vehicles through auctions by a bank to recover its debts.

Background

The Commissioner conducted an audit on KCB for the 2018–2021 period and issued an assessment of KES 1,190,578,054. KCB objected to the assessments, upon which the Commissioner revised the assessments upwards to KES 1,216,775,932. Dissatisfied with the objection decision, KCB appealed to the Tribunal. Most of the matters in the assessment were resolved through alternative dispute resolution, leaving only two matters for determination by the Tribunal, namely:

- VAT on the sale of vehicles through auctions; and
- withholding tax on interchange fees.

The focus of this alert is on the VAT on the sale of seized motor vehicles through auctions, where the Commissioner had assessed KCB for KES 67,539,788.03 for the 2018–2021 period.

Key arguments put forward by KCB

KCB argued that **Paragraph 1 (h) of Part 2 of the First Schedule to the VAT Act** exempts advancements on loans and credit facilities from VAT. It was the bank's position that the disposal of seized goods through auction is an integral aspect of providing credit facilities. Further to that, the seized goods are not sold for profit, instead, the reserve price is determined solely to recover the outstanding loan amounts that the bank has incurred or may incur due to defaults on the primary transaction, which is the issuance of credit. Thus, the bank argued that the sale of seized motor vehicles to recover bad debts should be exempt from VAT under Paragraph 1(h) of Part 2 of the First Schedule to the VAT Act, which exempts "*the making of any advances or the granting of any credit*".

The bank posited that it is an internationally accepted principle that, where a supply is incidental to another, the incidental supply will assume the VAT treatment of the principal supply. In this case, it contended that debt recovery through auction is an inseparable part of providing credit services. That it is merely a supplementary activity to the provision of credit and cannot stand as a separate supply. Essentially, the seizure and auction of motor vehicles due to loan defaults would not occur without the underlying principal supply, which is the granting of credit.

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On the issue of what constitutes a supply, the bank contended that the VAT Act defines a supply of goods under section 2 as *"a sale, exchange, or other transfer of the right to dispose of the goods as owner"*. It argued that its name on the logbooks of the motor vehicles was merely a declaration of the security interest (secured creditor) and not an indication of ownership. The bank also asserted that the title to the motor vehicle transfers from the defaulting customer to the highest bidder at auction, not directly from the bank. Thus, the bank does not transfer ownership of the goods as per section 2 of the VAT Act.

The Commissioner's arguments

The Commissioner argued that the sale of seized vehicles by the bank constituted a taxable supply under the VAT Act. The Commissioner emphasised that the bank was co-registered on the vehicles' logbooks alongside the borrowers and actively participated in the sale of the vehicles. Additionally, the Commissioner asserted that the primary nature of the transaction was the sale of a motor vehicle to an unrelated third party by a VAT-registered entity, and since the VAT Act does not expressly exempt such sales, the transaction is subject to VAT, and upheld the assessment as valid.

The Tribunal's analysis and determination

In making its determination, the Tribunal was of the view that Paragraph 1 (h) of Part 2 of the First Schedule to the VAT Act exempts only the granting of credit from VAT and not the recovery of the credit from the debtor.

It re-emphasised that tax laws must be interpreted strictly as stated, without assumptions, implications or inferred meanings. Strict interpretation of this provision simply means that the making of any advances or the granting of any credit is what is exempt from VAT. Therefore, the assertion by KCB that the auctioning of seized motor vehicles was incidental to the provision of credit facilities amounted to stretching the meaning of the law.

With regards to whether sale by auction is a taxable supply eligible for VAT, the tribunal was of the view that it is indeed a taxable supply since there is no explicit proviso under the VAT Act that exempts sales by auction in recovery of debt from VAT.

The Tribunal stated that an auction sale is considered a "*hostile sale,*" and in such cases, the creditor assumes the role of the debtor in executing the sale. As a result, the creditor is responsible for fulfilling all obligations that the debtor would have been required to meet, including the payment of taxes and levies related to the property being sold. The Tribunal further held that, since the appellant held a charge over the vehicles, it had the legal right to sell them to recover the loan, which effectively positioned the appellant as a seller under the definition provided in section 2(1) of the VAT Act.

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Comments

The Tribunal re-emphasises the principle that tax laws are to be construed in their strict sense. This decision means that financial institutions and any other entities engaged in debt recovery through auction sale of motor vehicles must ensure compliance with the VAT Act and remit VAT on such transactions.

The decision by the Tribunal has far-reaching consequences for banks if they have not factored VAT into the amount that ought to be recovered when selling movable assets such as vehicles and other charged assets to recover a loan amount. If banks were to factor recovery of VAT, then we would also expect the cost of borrowing, which is already high, to rise beyond the reach of many ordinary borrowers.

We anticipate that the Kenya Revenue Authority may target other banks for VAT on the forced sale of motor vehicles. We therefore recommend that other banks carry out their own self-assessment of the potential VAT exposure and come up with mitigation plans.

Parliament may consider amending the VAT Act to align the treatment of such transactions with the Income Tax Act. For example, for capital gains tax (CGT) purposes, when a bank sells property to enforce a security, it is deemed that the debtor is the one making the sale, even though the bank is physically conducting the transaction. In such a case, it is the debtor that is responsible for paying CGT on the transaction as the legal and beneficial owner of the property. Similarly, the Movable Property Security Rights Act, 2017 recognises that a bank only has a security right in the charged asset unless there is an outright transfer of a receivable which would not apply in the case of a joint registration of a log book between the bank and a borrower since the effect of such joint registration is to note the bank's interest as a secured creditor.

KCB has the right to appeal to the High Court.

Alex Kanyi, Stella Situma, Denis Maina and Ian Ounoi

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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