Commissioner of Domestic Taxes v Barclays Bank of Kenya Limited (Income Tax Appeal E023 of 2021) [2023] KEHC 1272 (KLR) (Commercial and Tax) (24 February 2023) (Judgment)

Neutral citation: [2023] KEHC 1272 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E023 OF 2021

A MABEYA, J

FEBRUARY 24, 2023

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

BARCLAYS BANK OF KENYA LIMITED ..... RESPONDENT

(Being an appeal from the judgment of the Tax Appeals Tribunal at Nairobi delivered on 12/2/2021 in Tax Appeal No. 137 of 2016.)

JUDGMENT

1. The appellant undertook a review of the respondent's tax affairs with regard to VAT and Excise Duty for the period January, 2011 to December, 2015. By a letter dated June 6, 2016, he raised a Tax Assessment for the respondent's income between 2011 and 2015 for Kshs 2,304,240,863/-.

2. The respondent opposed the entire assessment through a notice of objection dated July 5, 2016. The appellant gave his objection decision by confirming an amount of Kshs 1,684,340,551/- as VAT and Excise duty.

3. The respondent lodged an appeal on October 4, 2016 before the Tax Appeal Tribunal (the Tribunal). Vide its judgment of February 12, 2021, the Tribunal made the following orders: -

    ' (a) The acquiring bank fees earned by the respondent is exempt from VAT and the tax demand in this respect is set aside.

    (b) The interchange fees earned by the appellant is exempt from VAT and the tax demand in this respect is set aside.

(c) Excise duty is not duty on the entire merchant service commission and the respondent's assessment in this regard is set aside.

(d) Exported services were not subject to excise duty under the Repealed Customs and Excise Act and the assessment in this respect is set aside.

(e) Lending fees were not subject to excise duty under the Repealed Customs and Excise Act and the assessment in this respect is set aside.

(f) The appellant was liable to excise duty for the period prior to August 1, 2013 and the respondent's assessment in this respect is upheld.

(g) The respondent erred in assessing the appellant's excise duty liability for the period December 1, 2015 to December 31, 2015 on the basis of the repealed Act and the assessment in this regard is set aside.

(h) The letter dated September 2, 2016 from the appellant to KBA acting on behalf of banks, did not create any legitimate expectation on the part of the appellant.

(i) Each party to bear its own costs.'

4. Both the appellant and respondent were dissatisfied with that decision and filed 2 different appeals before this Court being ITA E022/2021 AND ITA E023/2021. They were consolidated with ITA E023/2023 being the head file.

Appeal 1

5. In ITA E022/2021, the bank appealed against part of the aforementioned judgment vide a Memorandum of Appeal dated April 9, 2021. It raised the following grounds: -

' (a) The Tribunal erred in law by finding that the Appellant was liable to excise duty for the period prior to August 1, 2013.

(b) The Tribunal erred in law in upholding the Respondent's entire assessment with respect to excise duty for the period prior to August 1, 2013.

(c) The Tribunal erred in law and in fact in finding that the letter dated September 2, 2016 from the Respondent to Kenya Bankers Association did not create any legitimate expectation on the part of the Appellant.'

6. On the foregoing, the bank sought that that part of the judgment which found that the bank was liable to excise duty for the period prior to August 1, 2013 and the part that held that the letter dated September 2, 2016 from the appellant to the Kenya Bankers Association did not create any legitimate expectation be set aside.

7. In opposition, the appellant filed a statement of facts dated November 12, 2021. He contended that the letter dated September 2, 2016 did not create any legitimate expectation to the bank and that the intention of the letter was to remind the bank to comply with the provisions of the law; that the said letter was issued on September 2, 2016 long after the date of the assessments which was on June 6, 2016. Therefore, the said letter could not create any legitimate expectation retrospectively.

Appeal 2

8. This is the appeal by the Commissioner of Domestic Taxes who is the appellant in this appeal. The Memorandum of Appeal was dated April 9, 2021 and it raised 16 grounds which can be collapsed into five as follows: -

    a. That the Tribunal erred in law by misinterpreting the nature of services offered by the acquiring bank with respect to the merchant service contract.

    b. That the Tribunal erred in failing to appreciate that VAT is on a supply and further erred in holding that the VAT status of the ancillary services is dependent on the principal services thereby arriving at an erroneous decision that the services offered by the respondent are transfer of money.

    c. The Tribunal erred in failing to acknowledge that services offered by the issuing bank are issued to the acquiring bank and the fact that the Visa Rules provide for the relationship between the acquiring bank, the issuing bank and the customers.

    d. That the Tribunal erred in holding that the interface fees charged was not subject to VAT and it failed to put into consideration section 117(1)(d) of the Customs and Excise Act CAP 472 by holding that the Customs and Excise Act did not provide for excise duty on exported services.

    e. That the Tribunal erred in finding that lending fees and banking fees form part of interest and therefore the amortization by the respondent was proper.

9. The respondent filed a statement of facts dated May 13, 2021 in response to the appeal. It contended that the principal role of the acquiring bank was to facilitate payment and the respondent was tasked with receiving funds from the issuing bank and transferring it to the merchant bank account. That the respondent's assessment was based on ancillary services provided by the acquiring bank rather than considering the primary role of an acquiring bank. The respondent observed that the core function of the respondent being facilitation of transfer of money was therefore exempt from VAT

10. On the services offered by the issuing bank, the respondent contended that the core function of the issuing bank was also transfer of money service and the same was exempt from VAT. In that regard, it's position was that the interchange fee was exempt from VAT.

11. It contended that the Merchant Service Commission was an aggregate of the three separate independent fees and the respondent was only required to account for the excise duty on the acquiring bank fee or the interchange fee or both. The respondent termed the appellant's demand for tax on the whole merchant service commission from the respondent as misconceived and based on an erroneous assumption.

12. That the respondent only receives its portion of the commission and not the entire merchant service commission. That therefore, it would not be just to demand that the respondent accounts for the VAT and excise duty on funds it did not receive.

13. It was contended that the Customs and Excise Act Cap 472 (repealed) did not contain express provisions for charging Excise duty on exported services. That there lacked an express provision in the statute that provided that excise duty was to apply to exported services as excise duty could only be applied to services supplied in Kenya. It urged that the appeal be dismissed.

14. The appeal was canvassed by written submissions which I have carefully considered. In considering the appeals, the Court shall frame the grounds by way of issues for determination. These are as follows: -

    a. Whether the services rendered by the respondent as an acquiring bank or issuing bank are subject to VAT.

    b. Whether the appellant erred in demanding excise duty on the entire merchant service fees.

    c. Whether excise duty is chargeable against the respondent in relation to exported services at the material time.

    d. Whether the excise duty in relation to fees and commissions earned prior to August 1, 2013 should be charged Excise Duty, and

    e. Whether the letter dated September 2, 2016 from the appellant to KBA created any legitimate expectation on the part of the respondent.

15. In *Mount Kenya Bottlers Ltd & 3 Others vs Attorney General & 3 others [2019] eKLR*, the Court of Appeal held that:-

    ' As stated earlier, nothing is to be read in or implied in tax law and a strict constructionist interpretation must be adopted.'

16. The effect of the foregoing is that, unless a tax statute expressly identifies a tax, the tax payer and the mode of assessing or identifying such tax, no tax can be presumed. This arises from the principle that since tax is coercive and ultimate denial or taking of a citizen's property, the process must be expressly identified and permitted by law.

17. The dispute between the parties is based on Card transactions in Kenya. In such transactions, there are usually four (4) players. The platform owner (Visa, Mastercard etc), the acquirer bank, the issuing bank and the Merchant. For this service, there is a Merchant Service Commission which usually paid by the Merchant and it consists of three (3) charges. These are the processing fee which is paid to the platform owner, the acquirer fee payable to the acquiring bank and the interchange fees payable to the issuing bank.

18. The question therefore is whether the services offered by the acquirer or issuing bank are subject to VAT or not. All that an acquirer bank does is to guarantee the Merchant the payment of the amount incurred by the cardholder at the point of sale. It does so by confirming from the issuing bank through the platform the availability of funds or credit worthiness of the card holder. Upon such confirmation, the Merchant releases, the goods to the Cardholder, the issuing bank pays the acquirer the total amount incurred less its inter-change fees. The acquirer then pays the Merchant the balance less the platform owner's processing fee and the acquirer fee.

19. On the first ground, the respondent submitted that the services it provides as an acquiring bank in a card payment transaction is to facilitate a payment and to ensure that the money from the card holder's bank account is transferred into the merchant's bank account. That under the VAT Act 2013 and the repealed VAT Act CAP 476, transfer of funds services are exempt from VAT.

20. Conversely, the appellant submitted that the bank's services were not merely the transfer of money but included other services as stipulated in the Merchant Service Agreement which are not exempt from VAT.

21. At paragraphs 27 and 28, of the judgment the Tribunal found that the other services provided by the appellant including providing point of sale terminals, e-commerce and customer services were services to facilitate the transfer of funds from the customer's account to the merchant's. That these services were ancillary and the transfer of money was the primary transaction by the respondent that determines the VAT status of the infrastructure provided by the acquiring bank.

22. The role of an acquiring bank in a card payment transaction is to facilitate a payment electronically through the use of debit cards, credit cards or prepaid cards. The acquiring bank facilitates the transfer of money from a customer to a merchant and charges an acquiring bank fee.

23. Under the Merchant Service Agreement, found at pages 143, 673, 677 of the Record of Appeal, the other services offered by the respondent as the acquiring bank include:

> ' The deployment of card terminals at the point of sale, back-end customer service, risk management and marketing activities. The respondent also provided help desks that offer customer service and technical support to various merchants by having a dedicated contact point for all the merchants' queries. It also carries out the settlement process for merchants within the respective card systems.'

24. Having defined the role of the acquiring bank, the Court must now determine whether its services are subject to VAT.

25. Under paragraph 1 of part II of the first schedule to the VAT Act 2013 as well as paragraph 1 of the third schedule to the repealed VAT act CAP 476, the following services are exempt from VAT:

> ' (a) The operation of current, deposit or savings accounts, including the provision of account statements;
>
> (b) The issue, transfer, receipt, or any other dealing with money, including money transfer services, and accepting over the counter payments of household bills, but excluding the services of carriage of cash, restocking of cash machines, sorting or counting of money.'

26. The understanding of this Court is that, the acquiring bank's primary role is to facilitate the transfer of funds from the customer's account to the merchant's account. In order to carry out this transfer, certain facilities and services have to be provided by the acquiring bank such as provision of card terminals, technical support and customer service. These services need to be present in order for the transfer of funds to be effected smoothly. These, in the Court's view, are merely ancillary and not the main role of the acquiring bank.

27. Under the first schedule to the VAT Act and the third schedule to the repealed VAT Act, the issue, transfer, receipt, or any other dealing with money, including money transfer services, is exempt from VAT.

28. The Court finds that the goal of the acquiring bank is to transmit/transfer funds from the holder of a bank card to a merchant and it therefore falls squarely under the exempted transactions under the first schedule to the VAT Act.

29. As regards the services offered by the issuing bank, the respondent contended that these were not subject to VAT pursuant to Section a, b, c and h of the First Schedule VAT Act as well as paragraphs 1(a), (b) (c) and h of the Third Schedule of the repealed Act which provides that the financial services are exempt from VAT.

30. The respondent submitted that the core service provided by the issuing bank was primarily transfer of money a service which was exempted from VAT.

31. On his part, the appellant submitted that the issuing bank offered the acquiring bank's composite card payment processing service in the form of authorization, settlement and clearance to the acquiring bank. The appellant observed that the said actions were not exempt from VAT.

32. The appellant further submitted that the interface fee had been defined by various authorities, the UK Cards Association and Visa Inc to mean fees paid by acquirers to card users for each transaction. The appellant faulted the Tribunal for holding that interchange fee was a transfer of funds despite the appellant and the card companies clearly stating what it was. The appellants position was that the Tribunal ought to have looked at the totality of the transaction to reach the true character of the transaction.

33. The crux of the matter goes down to how the parties define and understand what interchange fee for the payment of service entails. On one hand the respondent is of the view that interchange fee is the fee charged for the transfer of money and therefore precluded from VAT while the appellant on the other hand was of the view that the fee received by the issuing bank was composite and was in the nature of fees paid by the acquiring bank to the issuing bank for the whole transaction.

34. Based on the foregoing, the question before the court is the nature of the transaction between the acquiring bank and the issuing bank. Is it a service offered to the customers who hold the electronic card thus amounting to transfer of money for the benefit of the customer or card holder or can it be viewed as a benefit acquired by the issuing bank for taking part in various transactions which are composite in nature?

35. My view is that in establishing whether the service given by the issuing bank is subject to VAT, the role played by the issuing bank in the transaction is crucial. In this case, the parties have not disputed that the issuing bank upon receiving instruction from the acquiring bank, establishes whether money is available in the Cardholders account and therefore payable to the transaction and approves or declines the same.

36. While it is clear that the VAT Act precludes financial services for transfer of money from payment of VAT, can this transaction solely be limited to transfer of money? My take is that one ought to look at the big picture and that is the business of the issuing bank. In this case, the issuing bank acts as a medium for exchange of money and its principal service is to transfer the money to the required destination ie the acquirer bank.

37. The upshot of this is that the benefit derived from the compensation of the issuing bank amounts to transfer of money and the same is not subject to VAT.

38. The appellant contended that the services offered by the acquirer and issuing bank were composite and not merely ancilliary. That the Commission charged is therefore subject to VAT. The Court has already found that tax laws are to be strictly construed. If it be the intention of the legislature that the Merchant Services Commission be subject to VAT nothing could have been easier than to expressly state so. This will enable the 3 players to be charged separately for their respective fee.

39. Accordingly, I uphold the finding by the Tribunal on this aspect. Ground one fails

40. On ground 2, the appellant submitted that it was within the law to charge excise duty on the Merchant Service Commission ('MSC') on the respondent according to the merchant service agreement as opposed to netting off the interchange fees and the dues and commissions to the card companies. He further submitted that the merchant service agreement laid out the contractual arrangements with the

respondent and the merchant and the consideration being the commission was subject to excise duty at gross level.

41. On the other hand the respondent submitted that the MSC was an aggregate of three separate fees paid to the parties in the card payment transactions. It was observed that the acquiring bank or the issuing bank could only account for excise duty for consideration of the amount received for the roles played by each of the parties. It was submitted that it would be unfair for the acquiring bank to account for excise duty on funds it did not receive or earn.

42. Section 117(1) of the repealed Customs and Excise Act CAP 472 provided that:-

> ' 117(1) subject to the provisions of this Act, there shall be charged-
>
> (d) In respect of excisable goods and services specified in the second column of the firth schedule, excise duties at the respective rates specific in the schedule;
>
> Paragraph 7 part III, 5th schedule Excise duty on fees charged for money transfer agencies and other financial institutions shall be ten percent.'

43. In its decision, the Tribunal found that the MSC was an aggregate of the three fees accruing to three distinct and separate parties and therefore each party should bear its tax burden.

44. From the foregoing, I appreciate the appellant's concerns that the merchant service commission should attract excise duty and taxes should be paid with respect to the same. The question however, is who bears the burden of paying this excise duty. In this case, there are three players involved and the payment of taxes is an obligation that is imposed on individual entities. In the same breadth, the canons of taxation dictate that there should be equality or equity in payment of tax. A tax regime ought to include neutrality and fairness. No one should shoulder taxes on behalf of another unless the law expressly so provides.

45. Accordingly, I therefore agree with the Tribunal that it would be unfair to impose, Excise Duty on the whole Merchant Service Commission solely on the respondent. The respondent's liability should be the specific fee received as commission.

46. That notwithstanding, the best recourse would be a requirement that the merchant service agreements contain clauses that provide for the manner in which payment of tax should be actualized.

47. On the third ground, the appellant submitted that the Tribunal erred in failing to appreciate that the law did not exempt Excise Duty for exported services. It was the appellants case that the merchant service commission was subject to excise duty whether consumed locally or exported.

48. For the respondent, it held the view that in the repealed statute the Customs and Excise Act Cap 472 did not contain provisions for charging Excise Duty on exported services. That there was no provision that expressly stated that Excise Duty was to apply to exported services.

49. In the case of *Cape Brandy Syndicate v Inland Revenue Commissioners [1920] 1 KB 64* as applied in *TM Bell v Commissioner of Income Tax [1960] EALR 224* and cited with approval in the case of

Republic V Commissioner Of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank Of Kenya Ltd[2012]eKLR it was stated:-

> ' In a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used. If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.'

50. Further in *Russell v Scott [1948] 2 ALL ER 5* it was held:-

> ' My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him'

51. In the present case, it is not disputed that the applicable statute at the time was the Customs and Excise Act CAP 472. Section 2 defined excise duty as:-

> ' Excise duty' means a duty of excise imposed on goods manufactured in Kenya or imported into Kenya and specified in the Fifth Schedule;

52. The respondent contended that from the definition of Excise Duty, it captured its territorial nature and could only be applicable on goods manufactured in Kenya.

53. Part 3 of the Fifth Schedule provides that:-

> ' (8) Excise duty on other fees charged by financial institutions shall be ten percent 'other fees' Includes any fees, charges or commissions charged by financial institutions but does not include interest.'

54. From the foregoing, it is clear that the bank as a financial institution was liable to pay excise duty for any other fee, charge or commission at the rate of ten percent. However, the same cannot be read independently because the Act's definition of excise duty limited it to goods manufactured in Kenya or imported into Kenya.

55. In this regard, I find that excise duty was not chargeable to the respondent with relation to exported services. Exported services did not fit into the definition provided by statute and the appellants decision to charge excise duty on exported services fell outside the language of section 2 of the Act.

56. On ground 4, the issue is whether excise duty in relation to fees and commissions earned prior to August 1, 2013 should be charged and whether the letter dated September 2, 2016 from the commissioner to KBA created any legitimate expectation on the part of the respondent.

57. The bank submitted that the Kenya Bankers Association (KBA) and the Commissioner entered into an out of court settlement whereby the Commissioner acknowledged that it was not possible for banks to charge excise duty and communicated that no excise duty would be demanded from any bank for the period prior to August 1, 2013.

58. That the parties also entered into a consent in which it was agreed, inter alia, that excise duty would not be charged for the period prior to August 1, 2013 as contained in the Commissioner's letter of September 2, 2016.

59. In opposition the Commissioner submitted that no evidence was produced to indicate that the Commissioner raised any expectation to the bank or any other third party for which reliance could be placed on. That the letter dated September 2, 2016 which the bank relied on was issued on September 2, 2016 long after the date of assessment which was on June 6, 2016 and the consent which the bank also relied on was dated April 12, 2017 more than 5 years after the taxes became due and payable.

60. That in the circumstances, the letter and the KBA consent did not create any legitimate expectation given that the tax assessments were raised long before the date of the letter and the consent.

61. At paragraph 86 of its judgment, the Tribunal found that there was no indication from the letter that the respondent had waived the taxes in respect of excise duty.

62. The subject letter dated September 2, 2016 is annexed at page 127 of the Record of Appeal. The last paragraph of the letter reads:-

> ' It is therefore important to note that the Finance Act 2013 gave an effective date of June 18, 2013 on the matter.The above guidance is therefore administrative and is informed by the fact that KBA members are mere collection agents and were faced with system configuration challenges during the periods under discussion.'

63. My understanding of the above paragraph is that the commissioner did not expressly waive excise duty. He was only urging KBA's members to comply.

64. In any event, under Article 210 of the *Constitution*, waiving of taxes can only be done as provided for by legislation. The relevant legislation in this case is section 37(2) of the *Tax Procedures Act* 2015 which states:

> ' Despite the provision of any tax law, the Commissioner may, with the prior written approval of the Cabinet Secretary, refrain from assessing or recovering an unpaid tax and the liability in relation to the tax shall be deemed to be extinguished or the tax shall be deemed to be abandoned or redeemed as the case may be.'

65. Further, the bank was assessed on June 6, 2016 while the subject letter dated September 2, 2016 was issued on September 2, 2016 and the consent between the commissioner and KBA was recorded on April 12, 2017 more than 5 years after the commissioner demanded the taxes. It is therefore illogical for the bank to rely on an apparent legitimate expectation established by a letter and a consent which were made way after the taxes became due.

66. In this regard, I uphold the Tribunal's finding that no legitimate expectation was created by the letter dated September 2, 2016 and that the excise duty in relation to fees and commissions earned prior to August 1, 2013 were properly levied.

67. As regards excise duty on lending fees and bank charges, the Courts have held that the same is chargeable. That the same is not interest and is therefore not exempt. See the cases of *Commissioner of Domestic Taxes vs National Bank of Kenya [2022] e KLR* and *Commissioner of Domestic Taxes vs Stima Cooperative Savings & Credit Society Ltd Tax Appeal No E090 of 2021 (UR)*

68. The upshot is that the two appeals: ITA E022/2021 and ITA E023/2021 lack merit and are dismissed with costs.

It is so decreed.

DATED AND DELIVERED AT NAIROBI THIS 24TH DAY OF FEBRUARY, 2023.

A. MABEYA, FCIArb

JUDGE