Commissioner of Domestic Taxes v Equity Bank Kenya Limited (Tax Appeal E045 of 2022) [2023] KEHC 18721 (KLR) (Commercial and Tax) (31 May 2023) (Judgment)

Neutral citation: [2023] KEHC 18721 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E045 OF 2022

DAS MAJANJA, J

MAY 31, 2023

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

EQUITY BANK KENYA LIMITED ..... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 18th March 2022 in Tax Appeal No. 161 of 2017)

JUDGMENT

Introduction and Background

1. The Respondent is a bank licensed under the *Banking Act* (Chapter 488 of Laws of Kenya) and regulated by the Central Bank of Kenya under the *Central Bank of Kenya Act* (Chapter 491 Laws of Kenya).

2. Sometime in 2019, the Appellant ("the Commissioner") conducted a tax compliance audit of the Respondent's records for the income period 2013 to 2016 and communicated its findings through its letter dated June 21, 2017. The Commissioner stated, *inter alia*, that its analysis of the fees, other fees and commission income for the subject period showed that the Respondent failed to pay the right amount of tax and that its explanation as to why certain financial transactions were not charged Excise Duty proved to be insufficient.

3. The Commissioner held inter alia that the charges the Bank levied on the loan and credit facilities such as Temporary Overdrafts, Uncleared Effects, Letters of Credit, Bank Guarantees and invoice/bill discounting it granted its customers do not fall within the definition of 'interest' or 'return of a loan

amount' as provided for by the *Excise Duty Act*, 2015 and that these charges therefore attracted Excise Duty.

4. It was the Commissioner's further position that the Hunger Safety Network Program (HSNP) run by donor organizations such as the United Kingdom's Department for International Development ("DFID") in conjunction with the Government of Kenya was not a project operating within the ambit of the Financial Sector Deepening Trust (FSD) and that the MOU between the Government and DFID did not expressly exempt the program from taxation. Thus, the Commissioner charged Excise Duty on this item. The Commissioner also held that the charges levied by the Respondent at the initiation of the loan process are loan appraisal fees and evaluation fees and that they therefore attract Excise Duty.

5. After concluding that the Respondent ought to pay Excise Duty of Kshs 1,158,683,449.00 inclusive of penalties and interest, the Commissioner issued an assessment. The Respondent objected to this assessment through its letter dated July 21, 2017. It stated that the charges in respect of the aforementioned facilities were interest or a return on loan and thus, the same was not subject to Excise Duty. The Respondent relied on the definition of 'interest' as provided for by the *Income Tax Act* (Chapter 470 of the Laws of Kenya) ("the *ITA*") to conclude that any payment in any manner in respect of a loan constitutes interest. Thus, the Respondent stated that the Commissioner's claim that the charges on loans provided by the Respondent to its customers is not interest in nature is incorrect and unfair and goes against the generally accepted rules of interpretation.

6. On the HSNP program, the Respondent stated that the bilateral agreement between the United Kingdom's DFID and the Kenyan Government recognizes that the income is by way of grants/donor funding in accordance with the terms of FSD's trust deed, all of which are transfer incomes that have already been subject to the taxation framework in the country of origin. That the agreement further notes that such FSD income shall not be used to meet the cost of taxes or fiscal charges normally imposed by the Government whether directly and indirectly. The Respondent attached the contract between itself and the FSD which the states that FSD is engaged in the HSNP program as well as indicating the responsibilities of the Respondent in executing the agreement. In light of this, the Respondent averred that the HSNP program is an arm of FSD which has a bilateral agreement with the Government of Kenya exempting all its income from taxes or fiscal charges. The Respondent therefore contended that Excise Duty was not applicable in view of the exemption status of FSD and thus urged the Commissioner to vacate the demand on this matter.

7. The Commissioner issued an objection decision through its letter dated September 19, 2017 ("the Objection Decision") disallowing the Respondent's objection entirely. The Commissioner reiterated its earlier position that the charges/fees/commissions charged by the Respondent in relation to loan credit evaluations, temporary overdrafts, the HSNP program, uncleared effects and Trade Income Finance facilities are subject to Excise Duty as they fall within the definition of "other fees". That the only income charges explicitly exempted from excise by the *Excise Duty Act*, *2015* are interest and insurance premiums. The Commissioner rejected the Respondent's reliance on the *ITA* for the definition of 'interest' by stating that interest in the *ITA* is restricted only for the purposes of charge, assessment and collection of income tax, for the ascertainment of income to be charged, for administrative and general provisions relating thereto and for the matters incidental to and connected with the foregoing. The Commissioner thus stated that the provisions therein are not applicable to the administration of any other Act except where the same has been expressly provided.

8. Dissatisfied with the Objection Decision, the Respondent moved to appeal to the Tax Appeals Tribunal ("the Tribunal"). On March 18, 2022, the Tribunal rendered its judgment. It determined whether the income earned by the Respondent from the aforementioned facilities were subject to

Excise Duty and whether the fees charged by the Respondent to the HNSP program were subject to Excise Duty.

9. On the first issue, the Tribunal agreed with the Respondent that since the repealed *Customs and Excise Act* (Repealed) did not provide a definition of what interest entailed, then it was guided by section 2 of the *ITA* which defined interest as "....interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes any premium or discount by way of interest and any commitment or service fee paid in respect of any loan or credit". As such, the Tribunal concluded that income earned in the form of fees and charges from loan and credit valuation, temporary overdraft facilities, uncleared cheques constitute and fall within the definition of interest under the *ITA* and thus not subject to Excise Duty. The Tribunal further held that letters of credit, bank guarantees, incoice and bill discounting fell within the ambit of loans or credits and that income from such facilities was not subject to Excise Duty.

10. As to whether the fees charged to the HSNP program was exempted from Excise Duty, the Tribunal concluded that from the Financing Agreement between the Government of Kenya and the UK's DFID, any income associated to the delivery of the program shall be exempt from taxes or fiscal charges whether directly and indirectly. The Tribunal was of the view that the Commissioner, by collecting Excise Duty would be retracting from the intention of the parties to the agreement and that consequently the said fees charged by the Respondent to the said program were not subject to Excise Duty as the said programs were expressly exempted from taxes by virtue of the agreement between Kenya and the UK. For these reasons, the Tribunal set aside the Objection Decision in respect of the Excise Duty assessment.

11. This decision forms the basis of the present appeal by the Commissioner as set out in its Memorandum of Appeal dated May 4, 2022. The Respondent has responded to the appeal through its Statement of Facts dated July 27, 2022. The appeal was disposed by way of written submissions which are on record where the parties have restated their positions as outlined above, thus, I will not rehash the same but make relevant references in my analysis and determination below.

Analysis and Determination

12. From the facts I have outlined, the issues in this appeal concern the application and interpretation of the *Excise Duty Act*, *2015* and the ITA hence they fall within the mandate of this court under section 56(2) of the *Tax Procedures Act*, 2015 which states that, "An appeal to the High Court or to the Court of Appeal shall be on a question of law only". In resolving the appeal, the court is required to give due deference to the findings of fact by the Tribunal and only depart from them if they are perverse (see *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR and *Mercy Kirito Mutegi v Beatrice Nkatha Nyaga & 2 others* NYR CA Civil Appeal Mo. 48 of 2013 [2013] eKLR).

13. With the above principles in mind, I now turn to the appeal which from the Memorandum of Appeal raises similar grounds as those determined by the Tribunal. The Commissioner faults the Tribunal's application of the definition of 'interest' in the *ITA* to conclude that the said fees or charges by the Respondent to the various facilities it granted to its customers fell within the said definition of 'interest' and thus were not subject to Excise Duty. Whereas it also faults the Tribunal for holding that the fees charged to the HNSP program is exempt from Excise Duty, I note that it has not submitted on this issue thus I will assume that this issue has been abandoned. In any case, I will make a determination of the same for completeness.

Whether the income earned by the Respondent from the loan and credit evaluation reviews, temporary overdraft facilities and uncleared cheques was subject to Excise Duty.

14. The parties are in agreement that fees, charges or commissions charged by financial institutions such as the Respondent are subject to Excise Duty with the only exemption being interest. This is so because the Finance Act, 2013 introduced an amendment to the *Customs and Excise Act* (Repealed) where the term "Other Fees" was defined as "...any fees, charges or commissions charged by financial institutions, but does not include interest." The *Excise Duty Act*, *2015* expanded the definition to include "any fees, charges or commissions charged by financial institutions relating to their licensed activities, but does not include interest on loan or return on loan or any share of profit or an insurance premium or premium based or related commissions specified in the *Insurance Act* or regulations made thereunder". The aforementioned definitions are emphatic that Excise Duty is not applicable and chargeable on interest earned by the Respondent.

15. The Respondent's position is that the Excise Duty that was being demanded by the Commissioner was in respect of fees and charges that fell within the definition of 'interest' as per section 2 of the *ITA* which provided that "....interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes any premium or discount by way of interest and any commitment or service fee paid in respect of any loan or credit"and as such, not subject to Excise Duty. As stated, the Tribunal agreed with this position. The Commissioner assails the Tribunal's interpretation of the term "interest" and its reliance on the definition in the ITA. It contends that the said definition was in respect of a different tax head and that the said charges by the Respondent fell within the ambit of "other fees"

16. The reason why the Respondent and the Tribunal turned to the ITA to define ''interest'' is that the *Customs and Excise Act* (Repealed) and the *Excise Duty Act*, *2015* did not define the term. This issue is not novel and has been determined by the court in previous cases. In *National Bank of Kenya Ltd v Commissioner of Domestic Taxes* (Income Tax Appeal E155 & 533 of 2020 (Consolidated)) [2022] KEHC 10549 (KLR) (Commercial and Tax) (26 May 2022) (Judgment)] and Commissioner of Domestic Taxes v Co-operative Bank ML ITA No E095 of 2020 (UR) the courts held that while it is tempting to invite the court to borrow the definition of "interest" from the ITA, it should not be lost that in the construction of tax statutes, the plain and literal meaning of the words used in the statute should be applied first so as to discern the intention of Parliament. The court in *National Bank of Kenya Ltd v Commissioner of Domestic Taxes* (Supra) stated as follows:

> The definition of interest in the *Income Tax Act* should not have been resorted to in ascertaining the intention of Parliament in Section 7 of the Finance Act, 2013. In the *Income Tax Act*, the term interest is used for the purposes of charge, assessment and collection of income tax; for the ascertainment of the income to be charged; for the administrative and general provisions relating thereto and for matters incidental to and connected therewith and not otherwise.

17. I do not find any reason to depart from this position and I agree with the Commissioner that the ITA relates to a different tax head, that is in respect of income tax and the Tribunal should not have resorted to ITA in trying to find the definition of the term 'interest'. It ought to have been guided by the plain and literal interpretation of the term rather than by borrowing the definition from a different statute. Had the legislature intended to adopt this definition nothing would have been easier than to adopt it directly or by implication. This approach is consistent with the position the Court of Appeal took in *Stanbic Bank Kenya Limited v Kenya Revenue Authority* CA Civil Appeal No 77 of 2008 [2009]

eKLR where it stated that in interpreting a tax statute, it "...simply adopted the ordinary meaning of the words used in the relevant tax statute."

18. The ordinary meaning on interest can easily be seen from Black's Law Dictionary (10th Ed.) which defines the term as, "The compensation fixed by agreement or allowed by law for the use or detention of money, or for the loss of money by one who is entitled to its use; especially the amount owed to a lender in return for the use of borrowed money". Likewise, the Oxford Dictionary of Finance and Banking defines it as, "the charge made for borrowing a sum of money" while Halsbury's Laws of England states that it is, "the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another." These definitions mean that all fees incidental to obtaining a loan such as moratorium, loan appraisals and applications, loan negotiations, mortgage commitment cannot be termed as interest meaning that they are subject to Excise Duty. However, the consequential amount earned from this loan would be regarded as interest and thus exempt from Excise Duty.

19. I hold that the Tribunal fell in error by relying on the definition of interest in the *ITA* to conclude that the said fees charged by the Respondent in respect of those transactions were interest and this exempted them from Excise Duty. This decision cannot stand and as such, the Commissioner's appeal succeeds on this ground.

HSNP transactions

20. The Commissioner faulted the Tribunal for finding that the fees charged by the Respondent to the HSNP program was exempt from taxes by virtue of a financing agreement between the Government of Kenya and that of the UK thus not subject to Excise Duty. In the Objection Decision, the Commissioner stated that HSNP program was not a project operating within the ambit of the FSD and that the MOU between the Government and DFID did not expressly exempt the program from taxation. Thus, the Commissioner charged Excise Duty on this item.

21. On its part, the Respondent stated that further to the Finance Agreement between the Government of Kenya and that of the UK, FSD subsequently entered an agreement with the Respondent to facilitate the carrying out of the HSNP program to execute its mandate of providing financial support to the lower income groups in Kenya and the Respondent charged FSD various fees in connection with the provision of these services. The Respondent also stated that the Finance Agreement provided at Clause 30 that FSD income howsoever applied in delivery of programme so agreed with the Government shall not be used to meet the cost of taxes or fiscal charges normally imposed by the Government whether directly or indirectly.

22. The Commissioner did not deny the existence of these two agreements; that is the Finance Agreement between the Government of Kenya and the Government of the UK and the Service Agreement between FSD and the Respondent. The Tribunal relied on these agreements to conclude that the same provided for tax exemptions as the same had already been subject to the taxation framework in the country of origin. Going through the said Agreements, I cannot fault the Tribunal's conclusions. The Agreement between the Respondent and FSD is clear that FSD had engaged in the HSNP program which is contrary to the Commissioner's intention that it was not and that Clause 30 of the Finance Agreement had stated that FSD's income howsoever applied was not to be used to meet the cost of taxes or fiscal charges normally imposed by Government whether directly or indirectly. Thus, there was no way the Respondent could charge Excise Duty on the charges for the financial services it offered FSD on the HSNP program. I therefore agree with the Respondent's submission that the Tribunal was correct in finding that by charging Excise Duty, the Commissioner would be deviating from an agreement that its principal, the National Treasury acceded to and that the Tribunal's holding that the fees charged to

FSD were exempt from Excise Duty is well-grounded in law and the evidence that was before it. This ground therefore fails.

Disposition

23. As I have found that the Tribunal erred in holding that charges by the Respondent in respect of loan and credit evaluation reviews, temporary overdrafts, uncleared cheques, letters of credit, bank guarantees, invoice and bill discounting fell within the definition of 'interest' under the *ITA*, the finding is set aside. The Commissioner's Objection Decision is upheld and Excise Duty is also payable.

24. Each party shall bear its own costs.

DATED AND DELIVERED AT NAIROBI THIS 31ST DAY OF MAY 2023.

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Ms Chelang'at, Advocate instructed by the Kenya Revenue Authority for the Appellant

Mr Nyamburi instructed by Iseme, Kamau and Maema Advocates for the Respondent.