Commissioner of Domestic Taxes v Bank of Africa Kenya Limited (Tax Appeal E004 of 2023) [2023] KEHC 18719 (KLR) (Commercial and Tax) (12 June 2023) (Judgment)

Neutral citation: [2023] KEHC 18719 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E004 OF 2023

DAS MAJANJA, J

JUNE 12, 2023

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

BANK OF AFRICA KENYA LIMITED ..... RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 9th September 2022 in Tax Appeal No. 366 of 2021)

JUDGMENT

Introduction and Background

1. Before the court for determination is an appeal filed by the Appellant ("the Commissioner"). It is challenging the decision of the Tax Appeals Tribunal ("the Tribunal") delivered on September 9, 2022 where the Tribunal allowed the Respondent's appeal and set aside the Commissioner's objection decision dated May 21, 2021("the Objection Decision") where it had demanded Value Added Tax (VAT) of Kshs 2,183,051.00 in respect of interchange fees earned by the Respondent. The Respondent has responded to the appeal by filing its Statement of Facts dated April 6, 2023. The appeal was canvassed by way of written submissions which are on record.

2. In order to contextualize the appeal, I believe that a brief background of the facts is appropriate. The Respondent is a commercial bank duly licenced by the Central Bank of Kenya to provide financial services. The Commissioner carried out a review of the Respondent's tax declarations on transactions involving its card business for the 2018 year of income. The Commissioner communicated its findings through the letter dated December 18, 2020 where it stated that the Respondent had either omitted or underpaid VAT. The Commissioner held that as an issuer, the Respondent earns Toucan card business income (interchange fees) because of providing services to acquirers which includes facilitation fee

for facilitating a medium of communication between the issuers, acquirers and merchants and for confirmation of the creditworthiness of the cardholders. The Commissioner held that this interchange fee earned constitutes fees earned for management and professional services and are therefore subject to VAT. That the Respondent as issuer renders clear co-ordination, managerial, professional and contractual services to the acquirer for which the latter pays. The Commissioner thus stated that the interchange fees fall within section 5(1)(a) and 5(2)(b) of the *VAT Act, 2013*.

3. The Respondent objected to the assessment through its letter dated January 15, 2021. It explained that in a Point of Sale (POS) payment as an issuer, it will receive the payment authorization request, confirm if its customer, the cardholder, has sufficient funds in his/her account and depending on the status of the accountholder, it can either authorize or decline the authorization request. The Respondent stated that it is not an Acquiring Bank which banks are in charge of reviewing merchants and entering into contractual engagements. As such, it was the Respondent's position that the services it provides are financial services which are exempt from VAT under the First Schedule of the *VAT Act, 2013*.

4. The Respondent denied that it offers co-ordination, managerial, professional and contractual services to the acquirers for which the latter pays. It stated that does not co-ordinate any service and insisted that it merely provides financial services to its customers by way of operating the customers bank accounts as contemplated by the *VAT Act, 2013*. The Respondent stated that the *VAT Act, 2013* does not define "management, professional or contractual fees" and that given this lacuna, it was reasonable to be guided by other tax laws and it relied on the following definition in the *Income Tax Act* (Chapter 470 of the Laws of Kenya) which provides for

> "management and professional fees" as
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> > "a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated"
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> and
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> "contractual fees" as
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> > "payment for work done in respect of building, civil or engineering works".

That based on these definitions, the Respondent stated that it is neither licensed to nor does it provide building, civil or engineering works so as to come within the meaning of "contractual services". Further, that it does not provide professional services but financial services. For these reasons, the Respondent thus urged the Commissioner to vacate the said assessment.

5. After reviewing the objection, correspondences and documentation provided, the Commissioner responded by issuing the Objection Decision. The Commissioner maintained that the Respondent provides a composite service to Acquiring Banks in exchange for the interchange fees and that these services do not fall under Part II Para. 1 of the First Schedule of the *VAT Act, 2013* which exempt financial services. The Commissioner asserted that these services fall within section 5 of the *VAT Act, 2013* and thus attract VAT. The Commissioner dismissed the Respondent's reliance on the Tribunal's decision in *Barclays Bank of Kenya Limited v Commissioner of Domestic Taxes* TAT Appeal No 319 of 2018 (UR) and this court's decision in *Barclays Bank of Kenya Limited v The Commissioner of Domestic Taxes* TA No 8 of 2018 [2020] eKLR where it was held that interchange fees are exempt from VAT. The Commissioner averred that it had appealed against the said decisions to the High Court and Court of Appeal respectively and they cannot be relied on or executed against the Commissioner until the decisions of higher courts are rendered.

6. For these reasons, the Commissioner rejected the objection and confirmed its earlier assessment. Dissatisfied, the Respondent appealed to the Tribunal against the Objection Decision. The Tribunal rendered its judgment on September 9, 2022. The Tribunal considered the single issue for determination was whether the interchange fees earned by the Respondent is subject to VAT at 16%.

7. The Tribunal opined that the checks and activities from which the Respondent earns interchange fees must be undertaken to ensure a card transaction is completed and that these checks must also be done on any transaction and are incidental to the completion of any movement of cash from a card holder's account. Therefore, these checks are intrinsic components of any transactions involving the issue, transfer, receipt or any other dealing with money and cannot be separated from such transactions. The Tribunal relied on its decision in *Barclays Bank of Kenya Limited v Commissioner of Domestic Taxes* (TAT) (*supra*) that interchange fee is a fee paid by a merchant's bank (acquirer) to a card holder's bank (issuer) to compensate the issuer for value and benefit that merchants receive when they accept electronic payments. Further, that the interchange service provided by the bank is a service to its customers and not the acquiring bank. The Tribunal also considered its own decision in *NIC Group PLC and NIC Bank PLC v Commissioner of Domestic Taxes* TAT No 361 of 2018 (UR) where it held that interchange fees received by issuing banks are not subject to VAT. The Tribunal did not find any reasonable and sound cause to depart from its own decisions. The Tribunal fortified its reasoning by relying on *Barclays Bank of Kenya Limited v The Commissioner of Domestic Taxes* (HC) (*supra*) and its own decision in Bank of Africa Limited v Commissioner of Domestic Taxes TAT No 319 of 2018 (UR). As such, the Tribunal concluded that the interchange fees earned by the Respondent were not subject to VAT as they were exempt under *VAT Act, 2013*.

8. Based on the findings above, the Tribunal allowed the appeal and set aside the Objection Decision. It is this decision by the Tribunal has precipitated the present appeal whose analysis and determination I now turn to below.

Analysis and Determination

9. It is apparent from the dispute giving rise to this appeal that it falls within this court's jurisdiction under section 56(2) of the *Tax Procedures Act, 2015* which provides that

> "An appeal to the High Court or to the Court of Appeal shall be on a question of law only".

In dealing with matters of law, the court must also pay fealty to the findings of fact by the Tribunal but only intervene if such findings are perverse (see *Bashir Haji Abdullahi v Adan Mohammed Nooru & 3 others* NRB CA Civil Appeal No 300 of 2013 [2014] eKLR).

10. Even though the Commissioner raises nine grounds in its appeal, they dovetail into the same issue determined by the Tribunal, which is whether the interchange fees earned by the Respondent are subject to VAT and whether the Tribunal erred in finding otherwise.

11. The Respondent took the position that interchange fees are incidental/ancillary to transfer of money and therefore exempt from VAT as they are financial services. The Commissioner on its part held that this interchange fee earned constitutes fees earned for management and professional services and are therefore subject to VAT.

12. It is common ground that Para. 1 (b) of Part II of the First Schedule of the *VAT Act, 2013* which deals with exempt supplies provides that, "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" are financial services and are thus exempt from VAT. The Tribunal held that the services of the

Respondent are intrinsic components of any transactions involving the issue, transfer, receipt or any other dealing with money and cannot be separated from such transactions and that the role played by the Respondent in verifying the cardholder's information is a normal process related to the money transfer.

13. The Commissioner submits that although the Tribunal relied on its own decisions in *NIC Group* Case (TAT) (*supra*), Bank of Africa Limited Case(TAT) (*supra*), *Barclays Bank of Kenya Limited* Case (TAT) (supra) and this court's decision in the *Barclays Bank of Kenya Limited* Case (HC) (*supra*) to arrive at the decision that the said interchange fees are exempt from VAT, the Court of appeal has since clarified this issue in *Commissioner of Domestic Taxes (Large Tax Payer Office) v Barclays Bank of Kenya Ltd* NRB CA Civil Appeal No 195 of 2017 [2020] eKLR when it held that the services rendered by the Respondent in its capacity as the issuing bank are in the nature of professional, management and contractual services and therefore subject to VAT.

14. Resolution of this matter therefore turns on the meaning and interpretation of the decision by the Court of Appeal. First, I wish to point out that this decision is not appeal from the High Court decision in the *Barclays Bank of Kenya Limited* Case (HC) (*supra*) relied on by the Tribunal. Second, the case was an appeal in respect of Withholding Tax which the Commissioner was demanding from payments made by the bank therein to three credit card companies; Visa International Services Association, MasterCard, Inc., and American Express Ltd and on interchange fees the respondent therein, as an Acquiring Bank, paid to an issuer.

15. On interchange fees, the Court of Appeal held as follows:

> The second issue is whether the interchange fee paid by the respondent as an acquirer to an issuer constitutes management and professional services or whether it is merely a subsidy to create incentives. Section 2 of the *Act* defines "management and professional fee", for which tax is payable, as follows:
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> "management or professional fee" means any payment made to any person, other than a payment made to an employee by his employer, as consideration for any managerial, technical, agency, contractual, professional or consultancy services however calculated."
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> Like in the case of royalty, the Act defines management or professional fee to mean any of several things, either managerial, technical, agency, contractual or consultancy services. While the respondent contends that the appellant has failed to show the specific category of professional and management service for which it intends to levy withholding tax, the appellant responds that the services for which the respondent pays an interchange fee encompasses all aspects of management and professional fee as defines in section 2 of the Act.
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> We are persuaded that the management and professional fee does not have to fall within only one of the services defined in section 2; it can cover one or more. In our view, what is critical is whether looking at the totality of the evidence on record, there is clear explanation of what the appellant alleges to constitute management or professional fees, and whether that payment made by the respondent reasonably falls within the terms of the statute. That question cannot be answered by considering only how the parties have described or rationalised the payment. The appellant contends that the services for which the respondent as acquirer pays the issuer include facilitation fee for facilitating a medium of communication between the issuers, acquirers and merchants, and for confirmation of the creditworthiness of the cardholders. The respondent however argues that these are its own duties which it does not have to pay for.

> In our view part of the confusion arises from failure to clarify that while paying the interchange fee, the respondent, who is both an issuer and an acquirer, is actually acting in his latter capacity. In the transactions we have described above, there are clear co-ordination, managerial, professional, and contractual services rendered by the issuer to the acquirer, for which the latter pays. In our view, the appellant proved that those payments by the respondent in its capacity as acquirer to the issuer banks, satisfy the definition of management and professional fees as defined in section 2 of the Act.

16. While I agree with the Commissioner that from the above holding, the Court of Appeal stated that the services rendered by the issuer to an acquirer are co-ordination, managerial, professional and contractual services, the question before the Tribunal and now before this court is whether these services can also be deemed as financial services, hence exempt from VAT.

17. My understanding and interpretation of the Court of Appeal's holding above is that it never restricted the definition of co-ordination, managerial, professional and contractual services so as to exclude financial services. It is therefore possible that one can offer co-ordination, managerial, professional and contractual services that are also financial services. As stated above, Part II of First Schedule of the *VAT Act, 2013* exempts financial services which services include money transfer services and that the Tribunal held that these services are ancillary and incidental to the provision of money transfer services and cannot be detached from such transactions.

18. The court in *Barclays Bank of Kenya Limited* Case (*supra*) agreed with the Tribunal's holding on this position and stated as follows:

> (21) The issuing bank, as stated before and it was accepted by the parties before court, retains the interchange fee when remitting the payment through the card company's infrastructure to pay for the goods purchased from the merchant by its customer, the cardholder. I am persuaded by the submissions of BBK, in as far as interchange fee is concerned, that it relates to the relationship between the different players in a card transaction is to enable the cardholder transfer money form the cardholder's account to the merchant's account. I will add to that submission that the acquiring bank is in a sense a conduit in that transfer of information relating to the transmitted in the network. It follows that the authorization of use of the card by the issuing bank is part and parcel of the issuing bank's operation of its customers (the cardholder's) account. That being the finding of this court it follows that the said service of authorizing the use of the card is a service which is exempt from VAT as provided under the definition of services, set out above, and as provided under the Third Schedule paragraph 1 (a) and (b) of Cap 476.

19. Likewise, in *Commissioner of Domestic Taxes v Bank of Africa Limited* (Civil Appeal E127 of 2020) [2023] KEHC 1036 (KLR) (Commercial and Tax) (17 February 2023) (Judgment), the court while dealing with the appeal from *Bank of Africa Limited v Commissioner of Domestic Taxes* (TAT) (*supra*) also dealt with the same issue and held that the list of exempted financial services is inconclusive because the legislature used the word ''including" to define financial services. The court also agreed with the Tribunal that the respondent therein, who is also coincidentally the Respondent in this case, rendered a financial service to cardholders when verifying their identities and eligibility to use the cards when purchasing goods or services and eventually deducted money from their accounts which was a financial service exempted from VAT.

20. I cannot therefore fault the Tribunal for relying on the court's decision in arriving at the same conclusion as the Tribunal, being subordinate to the court was bound by the decision of the court which is superior to it. It is for this reason that I do not find any error of law by the Tribunal in adopting a similar position in the present case, as the same had been affirmed by the court.

21. I would be remiss not to comment on a statement made by the Commissioner in the Objection Decision that since it has appealed against certain decisions to this court to the Court of Appeal hence none of the said decisions can be executed or applied against it. This position is without precedent and suggests that the Commissioner is entitled to ignore binding decisions of the High Court merely on the grounds that it has expressed its intention to appeal or that the its appeal on similar issues has not been determined. I reject this contention. A decision of the High Court on a point of law is binding on the parties and remain valid, is to be complied with until it is set aside by the higher court.

Disposition

22. For the reasons I have set out above, the appeal is dismissed with no order as to costs.

DATED AND DELIVERED AT NAIROBI THIS 12TH DAY OF JUNE 2023.

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Mr Nyapara, Advocate instructed by the Kenya Revenue Authority for the Appellant.

Mr K. Kimani, SC with him Mr Ruto instructed by Hamilton, Harrison and Mathews Advocates for the Respondent