



**IN THE COURT OF APPEAL**

**AT NAIROBI**

**(CORAM: KARANJA, M'INOTI & SICHALE, J.J.A.)**

**CIVIL APPEAL NO. 195 OF 2017**

**BETWEEN**

**COMMISSIONER OF DOMESTIC TAXES (LARGE TAX PAYER OFFICE).....APPELLANT**

**AND**

**BARCLAYS BANK OF KENYA LTD.....RESPONDENT**

*(Appeal from the Judgment and Decree of the High Court of Kenya*

*at Nairobi (Odunga, J.) dated 20th May 2015*

**in**

**JR MISC. CA No. 46 of 2013)**

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**JUDGMENT OF THE COURT**

The crux of this appeal is whether withholding tax is payable by a bank for payments it has made to credit card companies and to other banks that issue credit cards. **The respondent, Barclays Bank of Kenya Ltd**, a limited liability company licensed to carry on the business of banking and financial services, is a member of networks established by three credit card companies, namely, **Visa International Services Association, MasterCard, Inc., and American Express Ltd**. The arrangement enables the respondent to issue its customers with credit, debit, and pre-paid cards, which the customers use to pay for services and goods purchased from contracted retail outlets. In turn the respondent has entered into agreements with the outlets to accept payments through the cards.

On 27th December 2012 and 21st January 2013, **the appellant, the Commissioner of Domestic Taxes** demanded from the respondent payment of withholding tax on payments that the respondent had made to the three card companies, as well as on payments made by the respondent to other banks (interchange fee). The demand was made under **section 35** of the **Income Tax Act (the Act)** on the basis that the payments to the card companies were royalty and those to the other banks (issuers) were for professional or management services.

The respondent took the position that it had not paid for royalty or any professional or management services rendered, and therefore the appellant had no basis for demanding withholding tax. It contended that the payments it made to the card companies did not constitute royalty as defined in **section 2** of the Act, so as to attract withholding tax under section 35 of the Act. In the alternative, the respondent contended that even if the appellant was entitled to collect withholding tax under the Act, none was due from or payable by it.

After the parties failed agree on whether or not the payments demanded by the appellant were justified, the respondent moved to the High Court on 7th February 2013 and after obtaining leave, applied for an order of *certiorari* to quash the appellant's demand for payment and an order of *prohibition* to stop the appellant from demanding the payments. The application was heard by **Odunga J.**, who by a judgment dated 20th May 2015, the subject of this appeal, granted the two orders and awarded the respondent costs of the application. The learned judge found that the tax demand by the appellant did not meet the level of clarity required in tax matters because the appellant did not clearly identify the category in which the demanded tax fell. In arriving at that decision, the learned judge followed and applied an earlier decision of the High Court (**Majanja, J.**), in **Republic v. The Commissioner of Domestic Taxes ex parte Barclays Bank of Kenya Ltd, Hc Misc App No. 1223 of 2007** where the court similarly held that the appellant had failed to bring clarity on the application of the law and facts.

In this appeal the appellant faults the learned judge for, among others, uncritically following the earlier decision of the High Court without appreciating that the present case was clear and precise; for failing to hold that the payments made by the respondent to the card companies

were royalties for which withholding tax was payable under section 35 of the Act; and for failing to find that the interchange fees paid by the respondent to other banks were management or professional services as defined in section 2 of the Act and equally subject to withholding tax.

The appellant, represented by **Ms. Lavuna**, learned counsel, started by laying the basis of the appeal and referred to various provisions of the Act which she contended made it clear that in the circumstances of this appeal, the respondent was obliged to pay withholding tax arising from its relationship and dealings with the credit card companies. Counsel submitted that the payments made by the respondent to the card companies were for royalty and therefore constituted income derived from Kenya, for which income tax was chargeable under the Act. She further contended that the contractual relationship in the card schemes involving the respondent gave rise to contractual rights and obligations which attracted tax. The first, she urged, was the relationship between the respondent and the card companies embodied in the membership and trademark licence agreement which granted the respondent the license to use the card companies' marks. The appellant further contended that the relationship included a guarantee of payment by the card companies and their members in the event of default. The second was the relationship between the issuing bank and the acquiring bank regarding payment for purchases, which was governed by the card companies' rules.

Counsel cited **section 3(1)** as read with **section 4(a)** of the Act and submitted that all income made in Kenya, whether by a resident or a non-resident, was taxable. She contended that the respondent was obliged, as a withholding agent, to withhold tax due from payments that it paid to the card companies based abroad. Counsel further invoked **section 10 (a)** and **(b)** of the Act and submitted that where a person resident in Kenya makes payment for royalty or pays management or professional fees to another person who is non-resident, such amount is deemed to be income accrued or derived from Kenya and the person making the payment is obliged to deduct tax at the appropriate non-resident rate.

On whether the payments made by the respondent to the card companies were royalty subject to withholding tax under section 35(1) (b) and 35(3)(g) of the Act, counsel submitted that the learned judge erred by uncritically following the earlier judgment by Majanja, J. She cited **F. A. R. Bennion on Statutory Interpretation, (Butterworths, 4th Ed. Page 434)** and submitted that notwithstanding the doctrine of precedent, courts do not act as automatons rigidly applying authorities without regard to circumstances and consequences. Counsel urged us, as the first appellate court, to re-evaluate the evidence on record and the law, which it contended showed that the demand for tax was within the law. She added that and that even if the appellant had not clearly demonstrated the basis of the tax demand in the first case, it did so in the case that gave rise to this appeal.

It was the appellant's further contention that the High Court erred in its appreciation of the meaning of the term "royalty" which it restricted to tangible things like "design", "model", "plan" and "formula" whereas the term has several components, including intangible things such as payments made as a consideration for the use of or the right to use a "patent", "trademark" or "process." In the appellant's view, the payments made by the respondent to the card companies comprised payments for use of logo, software license fees, trademark licensing and service fees which were payments for the right to use the global network services for purposes of linking the services to the users. It was contended that the payments were therefore for the right to use trademarks, patents and licenses, which are intellectual property rights and therefore fell within the definition of royalty. In the appellant's view, once the right of use was paid for by the respondent, it did not matter whether the use entailed transfer of information through software or transfer of digital information as was the case in the present appeal.

On whether the interchange fees paid by the respondent to other banks in the scheme were management or professional fees liable to withholding tax under section 35(1)(a) and 35(3) (f) of the Act, the appellant submitted that the payments were made in consideration of management or professional services undertaken by the issuer bank to the respondent as the acquirer bank and therefore were subject to withholding tax. Relying on the definition of management or professional fees in section 2 of the Act, the appellant submitted that the respondent paid interchange fee as consideration for managerial, technical, agency, contractual, professional or consultancy services rendered by the issuer banks. It was contended that section 2 of the Act focuses on outsourced services and that payment in e-commerce transactions for sale of services in a virtual environment constituted management or professional fees. In support of that argument the appellant relied on the **Report to Working Party No. 1 of the OECD Committee on Fiscal Affairs** entitled, "**Tax Treaty Characterisation Issue Arising from E-Commerce, February 2001.**"

On the contention that the appellant had failed to specify under which category the payments by the respondent fell (technical, agency, management, professional or consultancy services), the appellant urged that the services that the respondent paid for such as facilitating a medium of communication between the issuers, acquirers and merchants, sourcing of cardholders, maintenance of their accounts, confirmation of card-holders creditworthiness, management of the issuing bank's customers accounts, and advising and confirming to applicant banks that a cardholder was in good financial standing to settle bills via a credit card, all constituted agency, technical, management and professional services.

Lastly the appellant submitted that the learned judge erred by granting judicial review remedies whereas the appellant had not acted in excess of jurisdiction, irrationally, irregularly or unreasonably. We were accordingly urged to allow the appeal with costs.

The respondent, represented by **Ms. Malik**, learned counsel, opposed the appeal, and urged us not to interfere with the exercise of discretion by the learned judge in issuing the judicial review remedies, because his conclusion was not patently wrong. Counsel contended that the payments made by the respondent to the card companies and to other banks did not constitute royalty or management and professional fees and were therefore not subject to withholding tax. By demanding payment that were not due under the law, counsel urged, the appellant had acted illegally, unreasonably and in excess of jurisdiction and the High Court was justified in issuing orders of certiorari and prohibition. The respondent further submitted that the appellant had failed to precisely and categorically identify the service in section 2 of the Act that the issuers provided to the respondent to justify payment of withholding tax.

Starting with royalty, the respondent contended that the terms "*formula*" and "*process*" in section 35 of the Act did not apply to it. "*Formula*", it was contended, connotes a chemical or mathematical rule expressed in symbols and therefore implies something tangible and identifiable and it was not demonstrated what chemical formulas the credit card companies had provided to the appellant. Similarly, the respondent argued that "*process*" meant stages in manufacture or similar operation and that the appellant had failed to identify what product the respondent manufactured using the card companies' process. It was also the respondent's further contention that the card companies facilitated transactions on behalf of the respondent and that all those functions were performed by the card companies and therefore access

fees was not for any formula or process that the appellant was using.

As for the appellant's claim that the payments by the respondent were royalty by dint of being software licensing fees and payment for use of the card companies' trademark, the respondent submitted that the appellant did not adduce any evidence of software agreement or software license between the respondent and the card companies. It was the respondent's position that the clearing and settlement and payment functions were performed by the card companies and all that the respondent did was to pay a fee to access the network, without involving any software license to the respondent. For that reason it was contended that the VISA CEMEA fee guide relied upon by the appellant was not evidence of fees paid for VISA license. As regards the use of the logo, the respondent submitted that the trademark agreements between it and the card companies provided that no royalties were payable. On the authority of *Adamson v. Attorney General [1933] AC 257*, the respondent submitted the onus was on the appellant to prove that the tax demand was within the words used by the statute and that any doubt or ambiguity could be remedied only by legislation.

Moving on to interchange fee, the respondent submitted that the appellant had failed to show how such fees constituted management or professional fees. It was contended that "management or professional" services in section 2 of the Act connotes different kinds of services and that it was incumbent on the appellant to specify the category of service rendered to the respondent, because mere reference to management or professional services could not suffice. The respondent relied on the earlier judgment of the High Court as well as on *Republic v. Commissioner of Income Tax ex parte SDV Transami, CA No 212 of 2004*. In the respondent's view the appellant was giving the provision a broad interpretation whereas it should be interpreted narrowly and strictly.

Next the respondent urged us to reject the appellant's contention that the payment by the respondent were for managerial services because the tax demand itself did not state so. In any event, it was contended, the appellant did not produce any contract for management services between the respondent and the card companies. Using the Concise Oxford Dictionary and Black's Law Dictionary meaning of "manage", the respondent contended that the issuers did not have any control over its business or operations so as to be said to manage the same. According to the respondent, the interchange fee was not payment for any management or professional fees, but a balancing mechanism and an incentive to the issuers. On the same basis the respondent submitted that no agency relationship was proved.

The respondent concluded by urging us to find that the appellant had acted in excess of its jurisdiction when it demanded taxes without strictly following the law and that in the circumstances the High Court was justified in granting judiciary review remedies, which we should not interfere with. The respondent therefore urged us to dismiss the appeal with costs.

As we turn to consider the merits of the appeal, it appears to us that the appellant readily concedes that in its first application, it had not properly identified the basis upon which it was demanding withholding tax from the respondent. It however argues that in the application which led to this appeal, it corrected its earlier omissions and faults the learned judge for following the judgment in the first application without appreciating that it had rectified the defects noted in the first application.

There is no doubt in our minds that the decisions in *Adamson v. Attorney General (supra)*, *Cape Brandy Syndicate v. Inland Revenue Commissioners [1920] 1 KB 64*, *T. M. Bell v. Commissioner of Income Tax [1960] EA 224*, *Republic v. Commissioner of Income Tax ex parte SDV Transami (supra)* and the first judgment represent a correct statement of the law, namely strict construction of tax legislation, so that the tax demand must fall within the terms of the statute without ambiguity. If there's any ambiguity in the legislation, it is not to be rectified by considerations of intent, but by amending the legislation. However, determination of whether there is clarity or ambiguity in the legislation or whether a tax demand is precise and within the terms of the legislation, is not an abstract or pedantic exercise. It must be based on the evidence and the circumstances of each case. We agree with the majority of this Court in *Stanbic Bank Ltd v. Kenya Revenue Authority [2009] eKLR* that meaning of words should not be strained so as to find ambiguity.

It is common ground that the transactions that the appellant contends give rise to tax liability involve a tripartite arrangement. On the one hand is a bank called the issuer, which enters into arrangements with card companies to allow the issuer to provide credit or debit cards to its customers. The issuer thus provides credit facilities to its customers and assumes the bad-debt risk. The second party is also a bank called an acquirer. The acquirer enters into agreements with merchants to facilitate credit or debit card transactions. It is the acquirer who provides the merchants with the point of sale swipe machines and authorises the merchants to accept and honour a credit or debit card by confirming the creditworthiness of the customer. Lastly there is the merchant who sells his goods or services to the issuer's customer on the basis of the credit or debit cards, duly authorised by the acquirer. There is no agreement between the issuer and the merchant. In this appeal, the respondent is both an issuer and an acquirer.

We think it is apt to reproduce the steps in these transactions as explained by the respondent, which the appellant does not contest.

*Upon application, an issuer provides a credit or debit card to a customer. The customer uses the card to purchase goods or services from a merchant. The merchant swipes the card on a machine configured to accept that card. By swiping the card, the merchant seeks authorisation from the acquirer, who in turn seeks authorisation for the transaction through the credit or debit card's network. At that point the network gets to the issuer to confirm and verify the customer's credit status, before confirming the transaction to the merchant through the acquirer. Once the merchant receives the authorisation, a charge slip is generated and the customer receives his goods or services. The merchant next uploads the transaction for payment by the acquirer and the acquirer, after payment, sends details of the transaction to the card company's network. The network transmits that information to the issuer, who dispatches a statement to the cardholder. The cardholder then pays the issuer, who in turn pays the acquirer through the network.*

In the above transaction, the issuer pays the card company **transaction fees**, which the respondent contends are for access, authorisation, switching, PIN verification, clearing and settlement, among others, to enable it access and use the network. The appellant however claims that the payment constitutes royalty, for which withholding tax is payable. Similarly the acquirer pays to the issuer an **interchange fee** which the appellant contends is for services rendered and therefore constitutes payments for management and professional fees. On its part the respondent maintains that the payment of interchange fee to the issuer is merely for the use of the system card and to subsidise the cost of issuing the card and to incentivise the issuer. The payment is not made to the card company.

The first question for our determination is whether the appellant proved that the transaction fees paid by the respondent to the card companies truly constitute royalty within the meaning of the Act. The pertinent part of section 35(1) of the Act provides as follows:

“35. (1) A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of –

(a) a management or professional fee or training fee except –

(i) a commission paid to a non-resident agent in respect of flowers, fruits or vegetables exported from Kenya and auctioned in any market outside Kenya and audit fees for analysis of maximum residue limits paid to a nonresident laboratory or auditor; or

(ii) a commission paid by a resident air transport operator to a non-resident agent in order to secure tickets for international travel.

(b) a royalty or natural income;

.....

which is chargeable to tax, deduct therefrom tax at the appropriate non-resident rate.”

Section 2 of the Act defines “royalty” as follows:

“Royalty means a payment made as a consideration for the use of or the right to use—

(a) any copyright of a literary, artistic or scientific work; or

(b) any cinematograph film, including film or tape for radio or television broadcasting; or

(c) any patent, trademark, design or model, plan, formula or process; or

(d) any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific equipment or experience, and any gains derived from the sale or exchange of any right or property giving rise to that royalty.” (Emphasis added).

The definition of the term “royalty” encompasses four distinct payments and we agree with the respondent that it was incumbent upon the appellant to indicate with clarity the category that it claimed the payment by the respondent was for. The appellant contends that the relevant payment was for the right or license to use the card companies’ intellectual property such as trademarks and logos, covered in the (c) part of the definition of royalty. The appellant’s submission is that a payment made by the respondent in consideration for the right to use a patent, trade mark, design or model, plan, formula or process that belongs to the card companies that have registered it amounts to a payment for the license to use the intellectual property, and is therefore royalty.

The evidence on record shows that the respondent has entered into various agreements with the card companies regarding the card program. The agreement between the respondent and Visa International Service Association is headed

“Trademark License Agreement”. Visa International is described as the owner of the trademark and the respondent as the user. The recital states as follows:

“Whereas, owner is a membership corporation, is the owner of the trademarks VISA and the Blue, white and Gold Bands Design and contemplates becoming the owner of other trademarks which may hereafter be used in connection with an international bank card program of owner...”

Whereas user is desirous of using the marks in connection with the program as a member of owner:

By the agreement Visa International agrees to grant the respondent license to use the marks in connection with the program in agreed countries. The term of the agreement is unlimited so long as the respondent continues as a member in good standing.

Similarly, the agreement between MasterCard International and the respondent is headed “**Card Member License Agreement**” and describes MasterCard as the “licensor” and the respondent as the “licensee”. MasterCard is described as the owner of various service marks and trademarks intended to be used in whole or in part for the identification of services and goods, such as issuance of charge and debit service cards, establishment of agreements with merchants to provide goods and services to card holders, and the assignment, transfer or presentation by such merchants of the sales slips representing such transactions to financial institutions for payment, the operation of charge and debit services card transaction authorisation centres and networks, the settlement, honouring and interchange of the paper generated by the use of charge and debit services card, among others. The agreement further provides that the respondent “is desirous to obtain a license to use the marks in various aspects of the charge card and debit services business conducted or to be conducted by the licensee.” By the agreement MasterCard grants the respondent a license to use its marks in connection with such aspects of the charge card and debit service business as

may be performed or conducted by the licensee. Subject to the provisions of the agreement on termination, the terms of the agreement are perpetual. The agreement also provides that no royalties are payable by the respondent merely for the grant of license to use the marks. Instructively however, the agreement provides that it is the duty of the respondent to pay all taxes that might be charged by any country in which the charge card and debit card business is conducted.

As regards American Express Ltd (AMEX), there is also a Trademark License Agreement as a schedule to the Merchant Acquirer Agreement between AMEX and the respondent. By the agreement AMEX grants the respondent a non-exclusive, non-transferable, royalty-free license to use to use the AMEX licensed marks.

While the agreement with Visa International is silent on payment of royalty by the respondent for use of Visa's trademarks and logos, those with MasterCard and AMEX expressly provide that no royalty is payable or that the agreement is royalty free. For this reason, the respondent maintains that the transaction fees it pays to the card companies does to constitute royalty because the parties have expressly provided no royalty is payable for the use of the trademarks and logos.

The appellant, on the other hand contends that the transaction fees paid by the respondent to the card companies constitute royalty as defined in the Act, the provisions of the trademark agreements, notwithstanding. How are we to determine whether the payments made by the respondent to the card companies constitute royalty? Is it, as the respondent suggests, by reference only to the terms of the written agreements between the respondent or the card companies? In our view, it is by considering the terms of the statute, the written agreements, and the totality of the relationship between the respondent and the card companies, including the actual dealings between the parties.

In this case, it is patently clear that for the respondent to access and participate in any of the networks set up by the card companies, it must use the particular company's cards bearing that company's trade marks and logos, which are distinct and distinguish one card company from the other. The agreements between the respondent and the banks are clear that the trademarks are intended for use in the identification of services and goods. The debit and credit cards issued by the respondent to its customers bear the distinct logos and trade marks of the respective card companies, and in our view, from the trademark agreements we have referred to, this is a precondition for the appellant to access and use the card networks. Thus for example, in the Amex agreement, "Card" is defined as follows:

*"'Card' means (i) a card bearing an AMEX trademark or logo and issued by an Insurer or (ii) an account number issued by an issuer, which may be used to purchase goods or services as S/Es (service establishments) on the American Express Network and to obtain financial services."*

Without the use of credit and debit cards bearing those specific trademarks and logos from the authorising card company, the respondent cannot access or use the networks. In these circumstances we cannot see how the respondent can contend that the transaction payments, whatever else they cover, exclude payment of royalty to the credit card companies for use of their trademarks and logos.

We are satisfied that, in the circumstances of the case giving rise to this appeal, the appellant was able to identify with clarity the basis upon which it was claiming withholding tax from the respondent based on payment of royalty, however disguised. The appellant was able to demonstrate that the transaction fee constituted, in the circumstances we have explained above, payment for the right to use the card companies' trademarks and logos. The payment constituted royalty for trademark under section 2(c) of the Act. We agree with Lesiit, J's observation in **Kenya Commercial Bank v Kenya Revenue Authority, HC Income Tax Appeal No. 14 of 2007** that:

*"The definition given to 'royalty' is wide which I think is an indication of the extensive range of underlying transactions giving rise to royalty that the Income Tax Commissioner would target."*

It is in that context that the definition of royalty fee adopted in **Republic v. Commissioner of Income Tax ex parte SDV Transami (K) Ltd.** (supra) must be seen.

Accordingly we do not perceive any ambiguity in the statute that would require legislative intervention. Nor are we satisfied from the totality of the evidence on record that the respondent did not understand the basis of the appellant's demand for withholding tax as royalty for its use of the credit cards' trademarks and logos. As we have stated, whereas tax legislation must be construed strictly, the construction must also be reasonable based on the wording of the statute and the circumstances of each case.

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:

*"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."*

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.

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.

In *Stanbic Bank Ltd v. Kenya Revenue Authority (supra)*, the Court reiterated that where there is ambiguity in the legislation, the same must be construed in favour of the taxpayer. Conversely, where the meaning of legislation is clear, courts will give effect to the law. In this appeal we have come to the conclusion that there is no ambiguity in the law and that the appellant sufficiently demonstrated that the payments made by the appellant to the card companies are “royalty” under the Act and further that the interchange fees made by the respondent in its capacity as acquirer to issuer banks were for management and professional services within the meaning of the Act. The confusion or lack of clarity that was obvious on the part of the tax authority regarding what it claimed constituted royalty and management or professional fees in *Republic v. Commissioner of Income Tax ex parte SDV Transami (K) Ltd.* (supra) and in the first case between the parties in this appeal (before Majanja, J.), is not evident in the present appeal. We are persuaded that the evidence on record properly established that the payments paid by the respondent to the card companies were royalty as defined in the Act and further that the interchange fees it paid to issuer banks were for management and professional services as defined in the Act, and therefore both payments were subject to withholding tax under the Act.

Accordingly we find merit in this appeal and allow it with costs to the appellant. It is so ordered.

**Dated and delivered at Nairobi this 6th day of November, 2020**

**W. KARANJA**

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**JUDGE OF APPEAL**

**K. M’INOTI**

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**JUDGE OF APPEAL**

**F. SICHALE**

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**JUDGE OF APPEAL**

*I certify that this is a true*

*copy of the original.*

*Signed*

**DEPUTY REGISTRAR**