Guardian Bank Limited v Commissioner of Legal Services & Board Coordination (Income Tax Appeal E022 of 2023) [2024] KEHC 1399 (KLR) (Commercial and Tax) (26 January 2024) (Judgment)

Neutral citation: [2024] KEHC 1399 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI LAW COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E022 OF 2023

MN MWANGI, J

JANUARY 26, 2024

BETWEEN

GUARDIAN BANK LIMITED ..... APPELLANT

AND

THE COMMISSIONER OF LEGAL SERVICES & BOARD COORDINATION ..... RESPONDENT

JUDGMENT

1. The appellant is a bank incorporated in Kenya under the *Companies Act*, Cap 486 Laws of Kenya. It is licensed under the *Banking Act* to carry out banking and related services. The appellant's principal business activity is providing a range of banking and financial services including commercial finance and interbank transactions, investment services, deposits, cash management and electronic banking. The respondent carried out a review of the returns on vatable revenue streams, income declared as per VAT returns as compared to Income Tax returns and VAT ledgers on iTax, for the period 2015 to 2020. This review culminated in the issuance of an additional assessment of Kshs. 8,444,649.00 vide a notice dated September 14, 2021. Through a Notice of Objection dated October 13, 2021, the appellant objected to the additional assessment on grounds that it had not enrolled to register for VAT obligation, and the information on VAT registration was availed by the assessing team indicating that the Taxpayer had a VAT obligation from February 7, 2005.

2. In addition, the appellant stated that it did not meet the VAT obligation registration threshold which goes against Section 34(1) (a)(b) of the *VAT Act, 2013*.

   The appellant's case was that it does not offer security printing of cheque book supplies but outsources printing services from a third party, Punchline Limited, which is listed as an accredited printer by the Kenya Bankers Association. Punchline Limited prints cheque books for its customers at the agreed

price of Ksh.7.20 per leaf plus VAT which cost is charged to the appellant. Thereafter, the appellant being a Withholding Agent withholds 2% and remits it to KRA at the point of payment.

3. On December 10, 2021 the respondent issued the appellant with its Objection Decision confirming the additional assessment of Kshs.8,444,649.00 Subsequently, the appellant lodged an appeal with the Tax Appeals Tribunal (hereinafter referred to as "the Tribunal") against the respondent's Objection Decision vide a Memorandum of Appeal and statement of facts both dated January 21, 2022. In response thereto, the respondent filed a statement of facts dated February 20, 2022.

4. After consideration of the parties' pleadings, documents attached to the appeal and submissions, the Tribunal identified three issues for determination. These are; whether the respondent has a VAT tax obligation on cheque books' printing & recovery charges, and custodial services for which it is liable to charge and account for VAT; whether the appellant has met the threshold for registration under Section 34 of the *VAT Act, 2013*; and if the respondent was justified in assessing the appellant and raising the additional tax assessment in the Objection Decision dated September 14, 2021 in the sum of Kshs. 8,444,649.00.

5. In its judgment delivered on January 20, 2023, on the 1st issue, the Tribunal found that the exemption on financial services does not in any way refer to cheque books' printing and provision, but refers to cheque books already issued and are due for processing, clearing and settlement. The Tribunal held that the two services of cheque provision and custodial services are not exempt financial services within the ambit of the First Schedule to the *VAT Act, 2013* hence the respondent was justified in assessing VAT for custodial services.

6. On the 2nd issue, the Tribunal agreed with the respondent that the amounts charged by the appellant under the various sub-heads including charges for safe deposit rent and charges on cheque books meets the threshold of Kshs. 5,000,000/= and held that the appellant was subject to VAT registration under Section 34(1) of the *VAT Act*. Therefore, the respondent was justified in registering the appellant under Section 34(6) of the *VAT Act*. In view of the above holding, the Tribunal confirmed the respondent's additional assessment of Kshs. 8,444,649.00

7. Dissatisfied with the Tribunal's holding outlined in the above paragraph, the appellant lodged the instant appeal against the said decision, vide a Memorandum of Appeal dated March 8, 2023. The appellant raised the following grounds of appeal –

    i. That the Honourable Tribunal erred in law and fact by upholding an assessment for VAT despite the appellant not being registered for VAT;

    ii. That the Honourable Tribunal erred in law and fact by disregarding the appellant's evidence in support of the fact that it did not meet the threshold for registration as provided for under Section 34(1) of the *VAT Act* during the review period;

    iii. That the Honourable Tribunal erred in law and fact by finding that the respondent was justified to register the appellant for VAT without any notice;

    iv. That the Honourable Tribunal erred in law and fact by failing to consider the fact that the respondent did not issue the appellant with a Tax Registration Certificate as required under Section 34(5) of The *Value Added Tax Act*;

    v. That the Honourable Tribunal erred in law and fact by finding that the appellant ought to have applied for deregistration under Section 36 of the *VAT Act* despite the appellant having no notice of the alleged registration by the respondent;

vi. That the Honourable Tribunal erred in law and fact in failing to recognize that the cheque book printing services in question are undertaken by an unrelated third party and the cost incurred is recharged at cost;

vii. That the Honourable Tribunal erred in law and fact in failing to recognise that cheque book recovery charges constitute part of the financial services exempt under Paragraph l of Part 2 of the First Schedule to the *VAT Act*;

viii. That the Honourable Tribunal erred in law and fact in disregarding the appellant's detailed submissions and evidence to the effect that rent deposits for its custodial services were less than the Five Million Shillings in any of the twelve-month periods reviewed and therefore below the legal threshold for eligibility for registration for VAT;

ix. That the Honourable Tribunal erred in law and fact by upholding the respondent's erroneous lump up of the cumulative amounts charged for custodial services for the entire period under assessment to arrive at a flawed and erroneous understanding of the Kshs.5,000,000/= under Section 34 of the *VAT Act*; and

x. That the Honourable Tribunal erred in finding that the respondent was justified in assessing and raising the additional VAT tax assessment.

8. The appellant's prayer is for this Court to allow the appeal herein with costs, set aside the judgment and orders of the Tribunal made on the January 20, 2023 in Tax Appeal No. 51 of 2022, and for the respondent's objection decision dated December 10, 2021 to be dismissed in totality.

9. The instant appeal was canvassed by way of written submissions that were highlighted on October 11, 2023. The appellant's submissions were filed on May 10, 2023 by the law firm of Mutua Waweru & Company Advocates, whereas the respondent's submissions were filed by Otieno Winnie Advocate on September 12, 2023.

10. Mr. Mutua, learned Counsel for the appellant stated that the appellant has never applied for VAT registration and it was not made aware of any VAT obligation until June 30, 2021. He further stated that a search on the respondent's iTax PIN checker carried out on January 18, 2022 revealed that the appellant is not registered for VAT obligation thus the respondent's assertion that the appellant's VAT obligation was added on April 1, 2015 is untrue. Mr. Mutua pointed out that the appellant was not issued with a tax registration certificate by the Commissioner under Section 34(5) of the *VAT Act* as required for all persons registered under the said *Act*.

11. Counsel referred to the provisions of Section 34 of the *VAT Act* and asserted that for the period under review, the appellant did not make any taxable supplies which meet the Kshs. 5,000,000/= threshold as envisioned under the *VAT Act*, thus it did not have any legal or factual cause to register for VAT. On whether the appellant ought to have applied for de-registration under Section 36 of the *VAT Act*, Mr. Mutua submitted that the consequence of not being registered under the *VAT Act* does not qualify the appellant to apply for de-registration thus the analysis by the Tribunal was incorrect.

12. Mr. Mutua cited the provisions of Section 13(1) and (5) of the *VAT Act* and contended that the appellant does not offer security printing of cheque books' supplies, as the said services are offered by a third party. Counsel urged this Court to find that in view of the appellant's business model, the cheque book printing charges were not taxable supplies but mere reimbursements. He stated that the appellant's position is that of an agent meant to ensure that the cheque book is delivered to the customer. He referred to the provisions of Paragraph 1 of Part 2 of the First Schedule of the *VAT Act* and asserted that the Tribunal erred in holding that cheque book recovery charges are not VAT exempt

under the *VAT Act*, and that they constitute part of the financial services to the client who is an account holder with the appellant. He argued that for the said reason, they form part of the financial services exempted from VAT under the *VAT Act*.

13. Ms Otieno, learned Counsel for the respondent submitted that the appellant was registered for VAT obligation on April 1, 2015 which means that it had an obligation to charge or account for VAT from the said date. She stated that VAT obligation can either be done voluntarily by the Taxpayer or imposed by the Commissioner where the Taxpayer is dealing with vatable supplies and has failed to register for the obligation despite meeting the threshold for VAT registration. It was stated by Counsel that the appellant is a banking institution licensed as a bank, which carries out the supply of services in the form of among others, deposit taking, cash management and commercial finance. Additionally, that the appellant in its statement of accounts stated that it provides services such as provision of cheque books and provision of safe deposits which are services which do not fall under exempt supplies as per the definition of Section 2(1) of the *VAT Act, 2013*.

14. It was submitted by Counsel that in the year 2019, the appellant paid Kshs 2,019,420.00 to the vendor of the cheque books and in turn, it recovered Kshs 4,062,598.00, an amount which almost doubles the actual cost from the customers and claims to have recovered the same as cost. She further submitted that the balance of Kshs. 2,043,178.00 like the other related costs were neither explained nor accounted for in any other sub-head. Counsel for the respondent asserted that it is clear that these other costs are passed on to the appellant's customers hence the appellant ought to have charged and remitted VAT on the same.

15. Ms Otieno contended that the appellant met the threshold for VAT registration under Section 34 of the *VAT Act, 2013* since upon perusal of the amounts charged for provision of cheque books and provision of safe deposits, it is clear that the bank met the threshold of Kshs. 5,000,000/=. Ms. Otieno referred to the provisions of Section 34(6) of the *VAT Act, 2013* and stated that it empowers the Commissioner to register a person for VAT where the Taxpayer is eligible but has failed to do so, as is the case herein.Furthermore, should a Taxpayer dispute that it is liable for VAT obligation, the Act allows the Taxpayer under Section 36 to apply for de-registration, which the appellant has not done.

16. She stated that the appellant failed to account for the fact that the amount is recoverable from the end user that is the appellant's clients, who are the account holders. She cited Section 5 of the *VAT Act, 2013* and asserted that VAT is a consumption tax thus the appellant ought to have charged the same upon recovery of the printing charges.

17. Ms Otieno submitted that Section 2 of the *VAT Act, 2013* is clear on how to identify exempt services, and the same must be listed under the First Schedule. She stated that on perusal of the items listed under the First Schedule, it is crystal clear that rent on safe deposit boxes and cheque book charges are not listed under the said Schedule of the *VAT Act* thus it is not exempt as claimed by the appellant. In addition, that the custodial service for which the appellant rents safe deposit boxes to its customers is not exempt as claimed by the appellant, thus it is liable for VAT obligation. Ms. Otieno submitted that where there is no express provision for the exemption of custodial services, the same are regarded as vatable supply. She contended that the appellant had not discharged its burden of proof that indeed the aforementioned services were listed as exempt for the period under contention and it cannot hide behind exemption status to avoid charging and accounting for VAT.

18. It was stated by Counsel that the respondent charged VAT on recovery charges passed to the appellant's customers for facilitating the acquisition and issuance of cheque books by the appellant, and not on the amounts paid to the printing company for the printing of the cheque books. She expressed the view that since cheque book provision service is not listed amongst the exempt services and is taxable

under the general rate, the appellant as a registered person for VAT should have charged and remitted VAT on the cheque book printing services it offered to its customers. She referred to the definition of financial services in the *Banking Act*, Cap 488 and contended that the cheque book recovery charges do not constitute financial services exempt under the *Act* since it is a service that the appellant supplies, and recovers a cost from its customers.

19. It was submitted by Counsel that the word "cheque" used in Paragraph 1 of Part 2 of the First Schedule refers to cheques already issued and are due for processing, clearing or settlement. Ms. Otieno relied on the case of *Murugi Gateria Mugo v Judges and Magistrates Vetting Board & others* [2018] eKLR and asserted that the First Schedule Paragraph 1 Part 2 must be interpreted in its plain meaning.

Analysis and Determination.

20. I am alive to the provisions of Section 56(2) of the *Tax Procedures Act* that an Appeal to the High Court from the decision of the Tax Appeals Tribunal or to the Court of Appeal shall be on a question of law only. The Court of Appeal in the case of *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR summarized what amounts to "matters of law" as hereunder -

> "The interpretation or construction of the *Constitution*, statute or regulations made thereunder or their application to the sets of facts established by the trial Court. As far as facts are concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court."

21. Bearing in mind the provisions of Section 56(2) of the *Tax Procedures Act*, this Court is not permitted to substitute the Tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts, unless the Tribunal's decision cannot be supported by any evidence. Upon consideration of the Memorandum of Appeal, the Record of Appeal and statement of facts filed by the appellant, and the statement of facts filed by the respondent together with the written submissions filed by Counsel for the parties, the following issues arise for determination –

    i. Whether the appellant was registered for VAT obligation in the period under review; and

    ii. Whether services of cheques provision and custodial services are exempt financial services within the ambit of the First Schedule of the *VAT Act, 2013*.

    Whether the appellant was registered for VAT obligation in the period under review.

22. The appellant's case is that it is not registered for VAT obligation and has never been made aware of any VAT obligation until the respondent communicated to it a purported registration vide a letter dated June 30, 2021. The respondent on the other hand contended that the appellant was registered by the Commissioner for VAT obligation on February 7, 2005 and this information has been on the appellant's iTax portal as from April 2015. Section 34 of the *VAT Act, 2013* provides for registration for VAT obligation. It states as hereunder –

> "(1) A person who in the course of a business –

a. has made taxable supplies or expects to make taxable supplies, the value of which is five million shillings or more in any period of twelve months; or

b. is about to commence making taxable supplies the value of which is reasonably expected to exceed five million shillings in any period of twelve months,shall be liable for registration under this *Act* and shall, within thirty days of becoming so liable, apply to the Commissioner for registration in the prescribed form:

Provided that a person supplying imported digital services over the internet, an electronic network or through a digital marketplace shall register whether or not the taxable supplies meet the turnover threshold of five million shillings.

(2) In determining whether a person exceeds the registration threshold for a period, the value of the following taxable supplies shall be excluded

a. a taxable supply of a capital asset of the person; and

b. a taxable supply made solely as a consequence of the person selling the whole or a part of the person's business or permanently ceasing to carry on the person's business.

(3) Notwithstanding subsection (1), a person who makes or intends to make taxable supplies may apply, in the prescribed form, to the Commissioner for voluntary registration.

(4) The Commissioner shall register a person who has applied for voluntary registration under subsection (3) if satisfied that –

a. the person is making, or shall make taxable supplies;

b. the person has a fixed place from which the person's business is conducted;

c. if the person has commenced carrying on a business, the person –

i. has kept proper records of its business; and

ii. has complied with its obligations under other revenue laws; and

d. there are reasonable grounds to believe that the person shall keep proper records and file regular and reliable tax returns.

(5) The Commissioner shall issue a registered person with a tax registration certificate in the prescribed form.

(6) If the Commissioner is satisfied that a person eligible to apply for registration has not done so within the time limit specified in subsection (1), the Commissioner shall register the person.

(7) The registration of a person under subsection (1) or (6) shall take effect from the beginning of the first tax period after the person is required to apply

for registration, or such later period as may be specified in the person's tax registration certificate.

(8) The registration of a person under subsection (4) shall take effect from the date specified in the person's tax registration certificate.

(9) The Cabinet Secretary may, in regulations, provide for the registration of a group of companies as one registered person for the purposes of the *Act*."

23. From the foregoing, it is evident that sub-section 6 empowers the Commissioner to register an individual for VAT obligation if satisfied that a person eligible to apply for registration has not done so. Sub-section 5 on the other hand, which is couched in mandatory terms makes provision for issuance of a tax registration certificate to a Taxpayer upon registration. It is not disputed that the appellant was never issued with a tax registration certificate upon registration for VAT obligation, if at all it was ever registered.

24. In support of its assertion that the appellant was registered for VAT obligation, the respondent produced a copy of the appellant's non-individual taxpayer profile which shows that the appellant was registered for VAT obligation on February 17, 2005 and that the said information was rolled out on its iTax platform on April 1, 2015.

25. The appellant on the hand in proof of the fact that it is not registered for VAT obligation produced a copy of a PIN checker issued to it by KRA on January 18, 2022 which shows that its tax obligations are, Income tax-company, Income tax-PAYE, and Excise but it is not registered for VAT obligation. It is noteworthy that the respondent has not disputed the validity of the PIN checker produced by the appellant and the contents therein, neither has it claimed that the said document was not issued by them.

26. Notably, both the appellant's non-individual taxpayer profile and PIN checker relied on by the appellant are documents that were issued by the respondent. Therefore, since the said documents belong to the respondent, the said respondent bears the burden of clarifying whether or not the appellant is registered for VAT obligation.

27. In its submissions, the respondent submitted that the appellant cannot claim that it was not aware that it was registered for VAT obligation when all it needed to do was check its iTax portal which they have access to all the time, and confirm the same since this information has been there from April 2015.

28. In the judgment delivered by the Tribunal on January 20, 2023 it held at paragraph 71 that the appellant met the threshold for VAT registration under Section 34(1) of the *VAT Act*, therefore the Commissioner was justified in registering the appellant under Section 34(6), being eligible and having failed to register voluntarily. It further held at paragraph 70 of the said judgement, that the appellant was registered for VAT obligation and that meant that it had an obligation to charge VAT from the date of registration. The said finding is however not supported by any evidence and/or findings of how the Tribunal arrived at the conclusion that the appellant was registered for VAT obligation.

29. In view of the foregoing and the two documents issued by KRA giving different positions as to the status of the appellant's registration for VAT obligation, this Court is of the considered view that a tax registration certificate issued to the appellant upon registration for VAT obligation would help in ascertaining whether or not the appellant is registered for VAT obligation. Nothing would have been easier for the respondent than providing a copy of the said certificate in support of the assertion that the appellant is registered for VAT obligation. Other than the fact that the PIN checker issued on January 18, 2022, is the most recent document issued by the respondent showing the appellant's tax

obligations, the absence of the tax registration certificate gives credence to the fact that the appellant was not registered for VAT obligation.

30. This Court disagrees with the respondent and the Tribunal, and finds that the appellant was not registered for VAT obligation for the period under review going by the PIN checker issued on January 18, 2022 thus it was not required to file monthly VAT returns for the period in issue. As a result, the issue of de-registration provided for under Section 36 of the *VAT Act, 2013* does not arise.

Whether Services of Cheques Provision and Custodial Services are Exempt Financial Services within the Ambit of the First Schedule of the VAT Act, 2013.

31. It is not disputed that the appellant does not offer security printing of cheque books supplies as these services are provided for by a third party at their costs and recharged at cost. The respondent contended that in as much as the appellant insists on calling this service cheque book printing service, it made it very clear in the Objection Decision dated December 10, 2021 that what it brought to VAT was cheque recovery charges, which arose from printing charges paid to the third party. That the figures used by the assessing team for cheque recovery charges are the same, only that the appellant refers to them as cheque printing charges which is erroneous.

32. It was submitted by the respondent that cheque books are an integral part in the operation of a bank account for the benefit of the appellant's customers, and the costs for facilitating the same are costs passed to the account holder who is the user of the cheque, which is not listed as an exempt supply in the First Schedule of the *VAT Act, 2013*. The respondent further submitted that it charged VAT on the recovery charges passed to the appellant's customers for facilitating the acquisition and issuance of the cheque books by the appellant and not on the amounts paid to the printing company for the printing of the cheque books. In agreeing with the respondent, the Tribunal at paragraph 59 of its judgment held that the charges the appellant incurs on the cheque book printing services are ultimately recovered from the end user, the appellant's clients, who are account holders. Thus, VAT being a consumption tax ought to have been charged upon recovery of the printing charges.

33. The appellant's contention is that the aforementioned charges constitute exempt financial services under paragraph 1(g) of Part 2 of the First Schedule of the *VAT Act, 2013*. In response thereto, the respondent asserted that the word "cheque" used therein refers to cheques already issued and are due for processing, clearing or settlement. Paragraph 1 of Part 2 of the First Schedule of the *VAT Act, 2013* states that the supply of following services shall be exempt supplies -

    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;

    c. issuing of credit and debit cards;

    d. automated teller machine transactions, excluding the supply of automated teller machines and the software to run it;

    e. telegraphic money transfer services;

    f. foreign exchange transactions, including the supply of foreign drafts and international money orders;

g. cheque handling, processing, clearing and settlement, including special clearance or cancellation of cheques;

h. the making of any advances or the granting of any credit;

i. issuance of securities for money, including bills of exchange, promissory notes, money and postal orders;

j. the provision of guarantees, letters of credit and acceptance and other forms of documentary credit;

k. the issue, transfer, receipt or any other dealing with bonds, Sukuk, debentures, treasury bills, shares and stocks and other forms of security or secondary security;

l. the assignment of a debt for consideration;

m. The provision of the above financial services on behalf of another on a commission basis.

n. deleted by Act No. 10 of 2018, s. 19(b)(i).

o. any services set out in items (a) to (n) that are structured in conformity with Islamic finance"

34. It is trite that tax statutes should be interpreted strictly, with no room for implication or intendment. Further, that if there is any ambiguity in tax law, the same ought to be interpreted in the Taxpayer's favour.This position was upheld by the Court in the case of *Republic vs. Commissioner of Domestic Taxes Large Tax Payer's Office Ex-Parte Barclays Bank of Kenya Ltd* [2012] eKLR, where Majanja, held that:

> " The approach to this case is that stated in the oft cited case of *Cape Brandy Syndicate v Inland Revenue Commissioners* [1920] 1 KB as applied in *T.M. Bell v Commissioner of Income Tax* [1960] EALR 224 where Roland J. stated,
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> > " ...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 it 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"

35. In light of the foregoing, I am inclined to agree with the respondent that in as much as services for provision of cheque books is a financial service, it is not one of the financial services that are tax exempt under Paragraph 1 of Part 2 of the First Schedule of the *VAT Act, 2013*. As correctly submitted by the respondent, the word "cheque" as used in Paragraph 1(g) reproduced in Paragraph 33 of this ruling refers to cheques already issued and are due for processing, clearing or settlement and not production and/or printing of the cheque books. In addition, custodial services such as rent on safe deposits are also not provided for under the First Schedule of the *VAT Act, 2013* hence it is also not tax exempt.

36. In view of the finding that the appellant was not registered for VAT obligation, this Court finds that the appeal herein is merited. Consequently, it is allowed as prayed. However, even if the appeal has been allowed, it is noted that the respondent's arguments in regard to the 2nd issue were well grounded in law save for the fact that the appellant was not registered for VAT obligation at the time the VAT

tax demand was made by the respondent. For the said reason, each party shall bear its own costs of this appeal.

It is so ordered.

DATED, SIGNED AND DELIVERED AT NAIROBI ON THIS 26TH DAY OF JANUARY, 2024. RULING DELIVERED THROUGH MICROSOFT TEAMS ONLINE PLATFORM.

NJOKI MWANGI

JUDGE

In the presence of:

Mr. Mutua for the appellant

Ms Otieno for the respondent

Ms B. Wokabi – Court Assistant.