

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 322 OF 2018

COMMERCIAL BANK OF AFRICA LIMITED.....APPELLANT

-VERSUS-

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

BACKGROUND

1. The Appellant is a limited liability company incorporated in Kenya and licensed under the Banking Act, Cap 488 of the Laws of Kenya. The Appellant's principal activity is the provision of an extensive range of banking, financial and related services and its main sources of income are Interest, Fees & Commission, Foreign Exchange and Other Income.
2. The Respondent is a principal officer appointed under Section 11(4) of the Kenya Revenue Authority Act, Cap. 469 of the Laws of Kenya, and is responsible for control and management of the Domestic Taxes Department and accounting for tax due under the Income Tax Act, among others.

FACTS OF THE CASE

3. The Respondent carried out a desktop audit and issued iTax generated assessment notices dated 23rd April 2018 with a VAT liability of Kshs. 213,755,768.65, inclusive of penalties and interest, relating to alleged unpaid VAT for the period 1st January 2013 to 31st December 2017.
4. The Respondent vide a letter dated 12th June 2018 issued the Appellant with a VAT assessment for the period 1st January 2013 to 31st December 2017 and through the said letter, the Respondent demanded unpaid VAT liability amounting to Kshs. 304,430,041.60 made up of principal tax of Kshs. 209,344,480.00 a penalty of Kshs. 41,868,896.00 and interest of Kshs. 53,216,665.60.
5. The Appellant vide a letter dated 12th June 2018 responded to the Respondent's iTax generated assessments requesting for leave to file a notice of objection out of time. In the said letter, the Appellant also requested the Respondent to provide information and explanations of the basis for its VAT assessment.
6. The Appellant objected to the Respondent's notice of assessment vide a letter dated 23rd July 2018 disputing the VAT amount assessed in its entirety on the following grounds:-
 - i) Part of the assessment was issued past the five year statutory timeline;
 - ii) The Respondent's VAT assessment was based on erroneous workings;
 - iii) That iTax generated assessments were issued un-procedurally;
 - iv) Lack of clarity on the transactions forming basis of the VAT assessment;

- v) That the Appellant is not an Acquiring bank as alleged by the Respondent;
 - vi) Payments to card services companies are not in the form of royalties;
 - vii) Payments to card services companies and Acquiring banks fall under financial services and thus exempt from VAT;
 - viii) The Respondent should vacate the tax shortfall penalty as the Appellant did not provide any misleading information to the KRA but took an arguable position in respect to application of VAT on the financial services it provides; and
 - ix) The interest demanded and assessed is not applicable as it is based on an incorrect tax demand.
7. The Respondent vide a letter dated 30th July 2018 acknowledged receipt of the Appellant's notice of objection and requested for a meeting with the Appellant to engage on the matters raised in the Appellant's notice of objection.
8. The Appellant together with its tax representatives held a meeting with the Respondent on 5th September 2018.
9. The Respondent subsequently issued its objection decision vide a letter dated 6th September 2018 amending its original assessment by vacating its assessment in relation to the following:-
- i) ATM commissions;
 - ii) Credit card joining fees;
 - iii) Card late payment fee;
 - iv) Credit card cash advance fees;
 - v) Credit card limit excess fees; and
 - vi) Other credit income.

10. However, the Respondent confirmed its assessment in respect of interchange fees and issued the Appellant with an amended assessment of Kshs. 116,587,059.20 inclusive of penalties and interest as set out in the table below:-

B Description	2013	2014	2015	2016	2017	TOTAL
	Kshs.(00 0)	Kshs.(00 0)	Kshs.(00 0)	Kshs.(00 0)	Kshs.(00 0)	Kshs.(00 0)
VISA Card						
Interchange fees	74,986	87,350	101,485	119,129	119,129	502,079
Gross Card Income	74,986	87,350	101,485	119,129	119,129	502,079
VAT						
Thereon @ 16%	11,998	13,976	16,238	19,061	19,061	80,333
Penalty @ 20%	2,400	2,795	3,248	3,812	3,812	16,067
Interest @ 1%	6,239	5,590	4,547	3,050	762	20,187
Total	20,636	22,362	24,032	25,923	23,636	116,587

11. The Appellant being dissatisfied with the Respondent's decision lodged its notice of intention to Appeal against the whole decision on 5th October 2018.

THE APPEAL

12. The Appellant, having filed its Notice of Appeal filed its Memorandum of Appeal dated 19th October, 2018 on even date. The Appeal is premised on the following grounds:-
- a. **That** the Respondent erred in fact and in law by failing to take cognizance that interchange fees earned by the Appellant are consideration for financial services and are therefore exempt from VAT under the Third Schedule to the Value Added Tax (VAT) Act, Cap 476 (repealed) and Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act, 2013.
 - b. **That** the Respondent has erred in law and fact and acted *ultra vires* the provisions of Section 31 of the TPA by confirming the VAT assessment for the period January 2013 to May 2013 which period is time barred and should be vacated in its entirety.
 - c. **That** the i-tax assessment notices dated 23rd April, 2018 were issued un-procedurally and contrary to the provisions of Article 47 of the Constitution of Kenya, 2010(the Constitution).
 - d. **That** the Respondent erred in fact and in law in issuing a VAT assessment on interchange fees based on incorrect and erroneous workings (numbers).
 - e. **That** the Respondent erred in law and in fact in seeking to collect a tax shortfall penalty of 20% from the Appellant contrary to the provisions of the TPA.
 - f. **That** the Respondent erred in law and fact by seeking to collect interest from the Appellant based on an incorrect assessment contrary to the provisions of the TPA.

g. **That** the Respondent confirmed the notice of assessment without due regard to all records, explanations and information provided by the Appellant, thereby failing to appreciate all the issues presented by the Appellant before confirming the assessment.

13. Wherefore, the Appellant prays that the decision of the Respondent be annulled or varied in such a manner that may appear just and reasonable to the Honourable Tribunal.

14. In response to the Appeal, the Respondent filed its Statement of Facts dated 16th November, 2018 on even date. The Respondent responded in respect of the grounds of Appeal as set out in the Appellant's Memorandum of Appeal and Statement of Facts and prayed that this Honorable Tribunal considers the case and finds as follows:-

- (i) The Appellant's Appeal be dismissed for lack of merit.
- (ii) The Honorable Tribunal upholds the Respondent's Objection decision to charge tax amounting to **Kshs. 116,587,059.20** inclusive of interest under Section 38 of the Tax Procedures Act, 2015 and Tax shortfall penalty under Section 84.
- (iii) The Respondent be awarded the costs of the Appeal.

THE APPELLANT'S CASE

15. In support of its Appeal, the Appellant filed its Statement of Facts dated 19th October, 2018 on even date and requested this Honourable Tribunal to annul the decision of the Respondent dated 6th September, 2018 and order the Respondent to vacate his demand for taxes, interest and penalty based on the grounds of Appeal as provided below:-

16. The Appellant raised a preliminary ground of Appeal in respect of the period January 2013 to May 2013 which it contends should be declared null and void and set aside as the Respondent has acted *ultra vires* its powers in raising the demand. The Appellant relied on Section 31 of the TPA which provides that:-

“the Commissioner may amend an assessment by making alterations or additions to the original assessment to ensure that the taxpayer is liable for the correct amount of tax payable in respect of the reporting period to which the original assessment relates.”

17. Further, the TPA provides that ***the assessment shall not be made after five years immediately following the last date of the reporting period to which the assessment relates.*** Section 2 of the VAT Act, 2013 defines a ‘tax period’ as *one calendar month or such other period as may be prescribed in the regulations.* It is the Appellant’s understanding that the Commissioner has not prescribed a definition of the phrase ‘tax period’ in the VAT Regulations hence the phrase ‘tax period’ in the Appellant’s view, connotes one calendar month as defined in the VAT Act.
18. Accordingly, the Appellant submits that the Respondent’s objection decision in respect of the period January 2013 to May 2013 should be declared null and void and set aside, as the Respondent has erred in law and fact and has acted *ultra vires* and contrary to the provisions of Section 31 of the TPA by raising an additional assessment for the period January 2013 to May 2013, which tax periods are time barred.
19. The Appellant has set out its detailed grounds of Appeal against the tax decision as follows:-
20. The Appellant argues that interchange fees are integral to performance of financial services and thus exempt from VAT and points out that the Respondent’s confirmed VAT assessment of **Kshs. 116,587,059.20** relates to VAT on interchange fees.

21. The Appellant disputes the Respondent's averments that:-

(a) It is an Issuing bank and as an Issuing bank, it supplies composite services to the Acquiring bank and thus earns interchange fees; and

(b) The interchange fees are not payment for 'operation of account' but payments for composite services in the nature of authorization, capture, clearing and settlement which services fall within Section 5, 6(1) and 6(4) of the VAT Act Cap 476 or Section 5(1) and 5 (2) (b) of the VAT Act, 2013 dependent on the tax period assessed.

22. The Appellant submits that interchange fees are integral to performance of financial services and thus exempt from VAT under both the repealed VAT Act, Cap 476 and VAT Act, 2013.

23. The Appellant set out the parties involved in credit card transactions, the nature of transactions between the Appellant, an Acquirer bank, and card services companies to enable the Honourable Tribunal make a determination on this matter, as follows:-

a) ***Card services company*** e.g. VISA, Amex and MasterCard-

These are global card payment schemes that provide connectivity and financial services to various interested parties in the transaction chain globally. To access the card services companies' connectivity network and settlement network each party must be a licensed member of the scheme. Membership requires application and payment of requisite fees. Upon receiving the license each member commits to payment of the daily, monthly, quarterly and annual fees for services provided by the Card services company. The Card services company commits in the licensing agreement, to remit to the Issuing bank any income accrued to them as a result of their customers transacting using the branded cards.

24. The Appellant is a member of the VISA network and thus issues its customers with VISA branded cards.

b) ***Issuing bank-***

This is the financial institution that buys card services companies' membership and license rights to issue customers with international Card services company' branded cards for purposes of making payments.

The Appellant submits that for purposes of this Appeal, it is an Issuer bank.

c) ***Acquiring bank-*** This is a financial institution licensed by a Card services company to enter into contractual agreements with shopping outlet merchants and lay the card payment acceptance infrastructure in their premises. In turn the Acquiring bank receives a commission from the shopping outlets calculated as a percentage of the value of the transactions paid for using cards at the premises.

The Appellant submits that it is not an Acquirer bank and has no direct contractual relationship with any Acquiring bank.

d) ***Merchants-***

These are shopping outlets that have card Acquiring infrastructure to allow customers to pay using their cards in addition to other modes of payment. The merchant is not necessarily a Card services company member but may enter into a contractual agreement with Card services company members who are licensed as Acquiring banks in order to acquire the card acceptance infrastructure as a mode of payment. The merchants are charged a negotiated service fee (*merchant service commission/fee*) by the Acquiring bank, which is calculated as a percentage of value of card transaction processes.

e) *Cardholder*

This is the Issuing bank's customer who accepts to take the Issuer bank's card services companies' branded cards and uses it as a payment method. The cardholder is typically advised that card usage for shopping payment service does not attract any additional cost and they will typically be billed for the value of goods and services procured.

25. The Appellant submits that it has entered a membership agreement with VISA and issues VISA branded credit and debit cards to its bank customers.
26. The Appellant further submits that the transaction flows in a credit card transaction are as follows:-
 - a) Card services companies, such as VISA or MasterCard provide a settlement platform network connectivity and a payment infrastructure to its members, which are banks or financial institutions comprising Issuing and Acquiring banks;
 - b) An Issuing bank issues a credit card to its customer (the card holder), specifying the particular Card services company involved, the Issuing bank's identity, the tenure of the credit card, an embedded electronic chip to facilitate transactions through the card, and provides the cardholder an identification code (PIN No.) to be entered by the cardholder while procuring goods or services (so as to safeguard against unauthorized use);
 - c) A cardholder makes a purchase at a merchant outlet and completes the card payment process by inserting his card PIN to the Point of Sale (POS) machine and this serves as cardholder authorisation and authentication of the card transaction;

- d) The merchant submits a request to authorize the transaction to the Acquirer who in turn forwards to the Card services company for onward transmission to the respective card Issuer. The Issuer receives the electronic authorisation request instantly and undertakes validation checks on the transaction to confirm if the card is valid and has sufficient funds to cater for the transactions among other parameters. Once this is confirmed the Issuer sends a transaction authorisation code to the Card services company which in turn transmits the same to the Acquirer who is then tasked with forwarding the authorisation code to the merchant POS machine. The authentication and authorisation is enabled by the network platform provided by the global card service company;
- e) Once the transaction authorisation process is complete the merchants are able to provide the cardholder the required goods or services;
- f) At the end of day, the merchant electronically uploads the card transaction details from the POS machine to the Acquiring bank system via the settlement procedure protocol;
- g) The Card services company generates transaction settlement reports and provides these to both the card Acquiring and Issuing members to facilitate the net settlement positions;
- h) The cardholder is thereupon liable to make payment to the Issuing bank, of the full value of his/her transaction with the merchant establishment (within a period specified in the credit card agreement between the Issuing bank and the cardholder). The value deducted from the cardholder credit

card account is equivalent to the value of goods or services received from the merchant with no charges levied by the Issuing bank for this payment service;

- i) Upon receipt of the transaction settlement reports from Card services company, the card Issuer remits the net due funds to the Acquiring bank via Card services company appointed settlement agent;
- j) The Acquiring bank receives a settlement of the full value of merchant transaction done by the cardholder from the Issuer bank via the Card services company less any processing charges owed to the Card services company;
- k) The Acquiring bank then deducts the contractual merchant service commission from this payment (ranging from 3-5% of the value of the transaction) and credits the merchant account with the balance being the final settlement of the transaction by the cardholder;
- l) The Card services company mandates the Acquirer to cede part of the merchant service commission to the card Issuer as an incentive to continue their card issuance program and increase the number of cardholders through various activities. The card Issuer typically receives a 0.5-2% incentive fee called **interchange reimbursement fee** (IRF) depending on the type of card, type of transaction or location, as per the laid out guidelines of the Card services company; and
- m) The Issuing bank accounts for the transaction (for the purpose of recovery from the cardholder) and sends the cardholder a monthly (or periodical) statement.

27. The Appellant avers that the nature of the authorisation, clearing and settlement services by the Issuer and enabled by the card services companies networks are as follows;

- i) *Authorisation transactions*-the process of approving or declining a transaction before a purchase is finalised or cash is disbursed. The process is structured to prevent transactions from being approved for cardholders who have not satisfactorily maintained their card accounts or who are over their credit limits and to protect against the unauthorised use of cards that have been reported as stolen or fraudulent;
- ii) *Clearing*- the process of delivering final transaction data from the Acquirers to Issuers posting to the cardholder's account. Clearing also includes the calculation of certain fees and charges that apply to the Issuer and Acquirer involved in the transaction, as well as the conversion of transaction amounts to the appropriate settlement currencies; and
- iii) *Settlement* - the process of transmitting sales information to the Issuer for collection and reimbursement of funds to the merchant.

28. The Appellant reiterates that interchange fees are a portion of the merchant services commission deducted by the Acquirer bank when making payments to the merchant.

29. The merchant service commission is calculated as a percentage of the value of the card transaction and constitutes a cost to the merchant (i.e. it is paid by the merchant) which it absorbs and in return it expects higher transaction/sales values because of supporting varied payment methods, larger ticket purchases from cardholders and reduced operating costs and risks through cashless payment.

30. The Appellant submits that the interchange fee, is in fact, paid by the merchant and not the Acquiring bank; the Acquiring bank only passes the value through VISA network to the Appellant.
31. The Appellant therefore submits that the Respondent's contention that *"the Appellant earns interchange fee for supplying Issuing bank services to the Acquiring bank and that interchange fee is fee paid by Acquirers to card Issuers for each transaction..."* is erroneous and demonstrates the Respondent's lack of understanding of what an interchange fee is and accordingly, the Tribunal should set aside the Respondent's objection decision as it is based on a misunderstanding of the nature of interchange fees.
32. The Appellant notes that the Respondent avers that the Appellant as an Issuer bank supplies a composite service to the Acquiring bank in the nature of authorization, capture, clearing and settlement which are taxable services.
33. A composite service or multiple supply is a single supply with more than one component. The supply involves the supply of a number of goods or services and may or may not be liable to the same VAT rate.
34. The Appellant submits that even though the authorization, capture, clearing and settlement are composite services, the services are ancillary to transfer of money (principal service) between the Issuer, Acquirer and the merchant to the merchant through the Acquirer and cannot be artificially split.
35. The Appellant submits that this principle was discussed in detail in the case of **Card Protection Plan Ltd (CPP) v. Commissioners of Customs & Excise, Case C-349/96**, where the House of Lords at Paragraph 30 held that:-

"there is a single supply in particular cases where one or more elements are to be regarded as constituting the principal service,

whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but means of better enjoying the principal service supplied.....the national court's task is to have regard to the "essential features of the transaction" to see whether it is "several distinct principal services" or a single service and that what from an economic view is in reality a single supply should not be "artificially split". It seems that an overall view should be taken and over zealous dissecting and analysis of particular clauses should be avoided....the transaction performed by CPP for Dr. Howell is to be regarded for VAT purposes as comprising a principal exempt insurance supply and other supplies in the transaction are ancillary so that they are to be treated as exempt for VAT purposes..."

36. The Appellant notes that the Respondent has heavily relied on the case of **HRMC versus National Exhibition Centre Limited (ECJ, 26 May 2016) (NEC case)** in raising its objection decision whereby the ECJ held that booking fees charged to customers making advance bookings for concert and cinema on debit and credit cards are taxable and therefore do not qualify for VAT exemption. The Appellant distinguishes the facts in the NEC case with the present case in that;
- i. NEC owned an exhibition centre in Birmingham and hired its venue to third party promoters and sold tickets to customers on behalf of its promoters through its box office. The issue before the Tribunal related to booking fees in cases of credit and debit cards including where the credit card or debit card is used as the mode of payment. NEC argued that the booking fees when paid using credit or debit card were exempt for VAT purposes;

- ii. The ECJ in making its decision held that the supply could only be exempt if it was regarded as a transaction concerning transfers and payments. The ECJ was of the view that; “ *in order to be exempt, the services must, be viewed broadly, from a distinct whole, fulfilling in effect the specific, essential functions of a transfer and, therefore have, the effect of transferring funds and entailing changes in the legal and financial institution*”;
- iii. Further the ECJ was of the view that NEC only *created and transferred payment files and did not provide the underlying payment function; the payment function was undertaken elsewhere in the supply chain by the banks which actually moves the money*;
- iv. Accordingly, the Appellant submits that the NEC case is distinguishable in facts and law with the present case. This is buttressed by the fact that in the present case the Appellant provides the underlying banking services and payment function i.e. transfer of the amounts due to the Merchant to the Acquirer bank unlike the NEC case where the Appellant was only providing the booking services which booking services were paid for by swiping credit cards; and
- v. Further and as mentioned above, the authorisation, settlement and clearing services provided by the Appellant are integral to performance of transfer of money between the Issuer, Acquirer and the merchant i.e. they are composite services which are ancillary to transfer of money (principal service) to the merchant through the Acquirer and cannot be artificially split.

37. In addition, the Appellant disputes the Respondent's averments that the issue of taxation of the interchange fee was well settled in the **Barclays Bank of Kenya Limited Versus The Commissioner of Domestic Taxes, TAT No. 114 of 2015. ("the BBK case)** The Appellant submits that the BBK case did not in detail decide on whether local and international interchange commissions are management or professional fees for which VAT and reverse VAT are chargeable. The Tribunal at Paragraph 158 of the Judgement held that:-

“having determined that payments made for the use of the global service network are in the form of royalty, it was not necessary to establish whether those payments are management or professional fees.”

38. The Appellant submits that the Tribunal in the BBK case, erred in law and fact by insinuating that interchange fees are in the nature of management fees. The Issuer does not at any point provide any management or professional services to the Acquirer bank.
39. In this regard, the Appellant submits that interchange fees are not consideration for management services but integral to performance of financial services which are exempt from VAT as provided for under the repealed VAT Act, Cap 476 and VAT Act, 2013.
40. The Appellant points out that international best practice from other jurisdictions provides for exemption of financial services from VAT.
41. More specifically, the Appellant wishes to place reliance on the **Organisation for Economic Cooperation and Development report on Indirect Tax Treatment of Financial Services and Instalments** (hereinafter referred to as “the OECD report”). The OECD guidelines have in the past been accepted by courts of law in Kenya in reaching decisions where the Kenyan tax legislation is not clear. This precedence was set in the case of **Unilever Kenya Limited –v-The Commissioner of Income Tax (Income Tax Appeal No. 753 of 2003)** where it was held that the OECD guidelines are applicable in interpreting Kenyan tax law.

42. The OECD report provides that dealing in money, operation of bank accounts and credit card services are financial services and thus exempt from VAT across the various jurisdictions with a few exceptions as noted in the report.
43. The Appellant further submits that a review of VAT on interchange fees in most leading world economies revealed that interchange fees are exempt from VAT. The best practises reviewed included:-
- a) United Kingdom- The merchant service commissions which includes interchange fees are considered as VAT exempt;
 - b) Germany- Services provided by German Issuers qualify for VAT exemption as they concern granting of credit; and
 - c) India- The charge made to merchants (merchant commission which includes interchange fee) is VAT exempt.
44. The Appellant reiterates that Interchange fees are exempt from VAT as they are integral to performance of financial services.
45. A taxable service is defined under Section 2 of the repealed VAT Act, Cap 476 to mean a supply other than exempt supply. Similarly, exempt supplies are not taxable supplies as defined under Section 2 of the VAT Act, 2013. The Section defines a taxable supply as:-
- “a supply, **other than exempt supply**, made in Kenya by a person in the course or furtherance of a business carried on by the person, including a supply made in connection with the commencement or termination of business.”*
46. Paragraph 1 of Part II of the First Schedule to the VAT Act, 2013 which is similar to the Third Schedule under the repealed VAT Act, Cap 476 provides that:-

“The supply of the following financial services shall be exempt supplies-

The following financial services -

- 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) asset transfers and other transactions related to the transfer of assets into Real Estates Investment Trusts and Asset Backed Securities; and*
- o) any services set out in items (a) to (n) that are structured in conformity with Islamic finance.”*

47. In this regard, the Appellant reiterates that the interchange fees are a portion of the merchant services commission. The commission is deducted by the Acquirer as a consideration for enabling transfer of money and reimbursement to the merchant.
48. The issue, transfer or any other dealing in money is expressly exempt from VAT under both the Repealed VAT Act, Cap 476 and the VAT Act, 2013.
49. Further, the Appellant submits that interchange fee is a commission fee for facilitation of financial service and therefore exempt from VAT as provided under Paragraph 1(m) of the VAT Act, 2013 (which provision is similar to the Repealed VAT Act, Cap 476 which provides for exemption from VAT;

“The provision of the above financial services on behalf of another on a commission basis”

50. The Appellant takes cognizance of the fact that interchange fees are not expressly listed under the above mentioned exemption schedule. However, this does not negate the fact that the interchange fees are integral to performance of financial services. This issue was discussed in the case of **Barclays Bank of Kenya Limited –v-The Commissioner of Domestic Taxes, TAT No. 114 of 2015 (supra)** where the Honourable Judge observed that:-

“The Tribunal does not expect the legislature intended that details of all kinds of service being offered were to be numerically specified for all services rendered as the dictates of today’s economic order would militate against this by rendering this virtually impossible as the evolving economic development spins service not earlier contemplated and or visualised.”

51. Accordingly, it is the Appellant's humble submission that this Honourable Tribunal do find that interchange fees are consideration for the performance of financial services and thus exempt from VAT. In addition, the Appellant submits that the Tribunal should order and compel the Respondent to vacate its demand of VAT on interchange fee in its entirety.
52. Without prejudice to the above, the Appellant further submits that the Respondent's workings which it has used to issue the VAT assessment are erroneous and do not reflect the correct position of the Appellant's VISA interchange fees earned during the period under review.
53. More specifically, the Appellant submits that the Respondent has used the same figures (numbers) for 2016 and 2017 years of income to issue the VAT assessment. This approach by the Respondent assumes that there were no changes in the VISA interchange fees and incomes for 2016 and 2017 years of income. This assumption by the Respondent fails to take cognisance of the fact that the Appellant's VISA interchange fees fluctuate during the months/years with high and low seasons depending on the number of the bank's customer transactions, which are in turn, determined by the level of economic activity in any particular month. The Appellant has been cooperative and acted in good faith and provided its trial balance and other documents as requested by the Respondent. However, despite this, the Respondent has used incorrect figures.
54. The Appellant urges that the Respondent should be compelled to vacate its entire demand as it is based on inaccurate and erroneous figures and assumptions of the Appellant's VISA interchange fees.
55. The Appellant argues that the Tax shortfall penalty of Kshs. 16,066,528.00 should be vacated in its entirety on the following grounds:-

- a) That the Respondent has subjected the principal VAT on interchange fees demanded to a penalty of 20% according to the Respondent's computations. While the Respondent has not provided any basis for the penalty, the Appellant presumes that the penalty being imposed is based on the provisions of Section 84 of the TPA.
- b) Section 84(1) of the TPA provides that, a tax shortfall penalty is only applicable if a person knowingly makes a statement to an authorised officer that is false or misleading in a material particular or knowingly omits from a statement made to an authorised officer any matter or thing without which the statement is false or misleading in a material particular.
- c) Section 84(5) further provides that a tax shortfall penalty shall not be payable when-
 - i) the person who made the statement did not know and could not reasonably be expected to know that the statement was false or misleading in a material particular;
 - ii) the tax shortfall arose as a result of a tax payer taking a reasonably arguable position on the application of a tax law to the tax payer's circumstances in submitting a self-assessment return; or
 - iii) the failure was due to a clerical or similar error, other than a repeated clerical or similar error.

56. The Appellant submits that it neither knowingly provided any misleading information to the Respondent nor knowingly omitted any matter from a statement to the Respondent. In any case, the Appellant took a reasonably arguable view that excise duty was not due on its reinsurance commissions.

57. The Appellant further submits that the onus is on the Respondent to provide evidence that the Appellant 'knowingly' made false statements to the Respondent, which onus, the Appellant submits, cannot be dispensed with, by a mere assertion/ allegation by the Respondent.
58. The Appellant notes that the Respondent vide its confirmed assessment has subjected the Appellant to interest at the rate of 1% on the principal VAT due and submits that the Respondent's imposition of interest of **Kshs. 20,187,891.00** is based on incorrect VAT assessment. On this basis, the Respondent should be compelled to vacate its demand of the interest.
59. The Appellant requests that this Tribunal considers its grounds of Appeal and finds that:-
- a. VISA interchange fees are commissions earned by the Appellant in the course of providing financial services and are therefore exempt from VAT under the Third Schedule to the Repealed VAT Act, Cap 476 and Paragraph I of Part II of the First Schedule to the VAT Act, 2013;
 - b. The VAT assessment by the Respondent for the period January 2013 to May 2013 is time barred and should be vacated in its entirety; and
 - c. The iTax assessment notices dated 23rd April 2018 were issued un-procedurally and contrary to the provisions of Article 47 of the Constitution of Kenya, 2010.
60. In light of the above, the Appellant prays for orders that:
- i) The tax decision dated 6th September 2018 resulting in the

Respondent subjecting the VISA interchange fees earned by the Appellant to VAT of **Kshs. 116,587,059.20** made up of principal tax of **Kshs.80,332,640.00**, shortfall penalty of **Kshs. 16,066,528.00** and interest of **Kshs.20,187,891.20** is erroneous and should be vacated in its entirety;

ii) This Appeal be allowed with costs to the Appellant; and

iii) Any other orders that the Tribunal may deem fit.

THE RESPONDENT'S CASE

61. The Respondent's response to the Appeal is set out in its Statement of Facts dated 16th November, 2018 and filed on even date. The Respondent responded in respect of the grounds of Appeal as set out in the Appellant's Memorandum of Appeal and Statement of Facts as hereunder:-

62. The Appellant's assertion that the Respondent's demand for tax for the period January 2013 to May 2013 should be declared null and void is invalid. Section 31(6) of the Tax Procedures Act states:-

“(6). Where an assessment has been amended, the Commissioner may further amend the original assessment-

.(a) five years after –

(i). for a self-assessment, the date the taxpayer submitted the self-assessment return to which the self- assessment relates: or

(ii). for any other assessment, the date the Commissioner served notice of the original assessment on the taxpayer ...”

63. The Respondent avers that no further amendments were made to the Appellant's return, the initial amendment was only done at the point of issuing the Appellant with an assessment dated 23rd April 2018.
64. The Respondent further avers that Section 31 (4) of the Tax Procedures Act gives the Commissioner powers to issue assessments in cases of suspected tax evasion whereby a tax payer under- assesses themselves.
65. The Appellant as an issuing bank supplies a composite service to the acquiring bank who does not hold an account with them and is not their client and for that service, it is paid the interchange fee which is not a payment for operation of account.
66. The service that the Appellant supplies to the acquiring bank is a composite service in the nature of authorization and capture and settlement. The said service falls within Sections 5, 6(1) and 6(4) of the VAT Act Cap 476 and Section 5(1) (a) and 5(2) (b) of the VAT Act 2013 for the period September 2013 to October 2017.
67. The issue of taxation of the interchange fee is now well settled by the Honorable court as was held in Barclays Bank of Kenya Limited –v- The Commissioner of Domestic Taxes; TAT No. 114 of 2015 wherein the Tribunal held that:-

“It must be recognized that the issue raised by the Appellant on clarity as to what kind of services were rendered by it to warrant levying of taxes cannot stand the test of time even though, they were able to rely on two decided cases by the High Court. It can never be possible to narrate all kinds of services one is meant to offer as is mirrored by the legislature in its own wisdom when it decided to legislate in the fashion it did under Section 2 as to what is to qualify as services that attract taxes. The Section does not contemplate any requirement for a detailed particularity”

68. The Respondent's position is that the services provided by the card companies do not fall under the Third Schedule of the VAT Act, Cap. 476 and Part II Paragraph 1 of the First Schedule of the VAT Act, 2013 as well as Paragraph 1(b) of the Third Schedule to the VAT, Act, Cap.476 (Repealed) which outlines exempt financial services but excludes financial management and advisory services from financial services provided by banks and other financial institutions.
69. The card companies receive dues or assessment fees as a result of the services rendered which are allowing the Appellant to use their systems for facilitating transactions. In the case of **Barclays Bank of Kenya Limited –v- The Commissioner of Domestic Taxes; TAT No. 114 of 2015** the Tribunal held that:
- “In the absence of the use by the Appellant of the trademark license between it and the card companies, it would not be entitled to use the global payment services which link it to other users and therefore payment made to the Appellant in this regard is a royalty in law”.*
70. It is evident that the payment for clearing, settlement, risk monitoring and non-compliance fees are for the use of the card company's trademark. The payment made in lieu of these services is royalties in nature and attract VAT.
71. The Appellant argues that transaction fees retained by card companies are not in the nature of royalties. However it is clear that the Appellant enjoyed the rights and privileges of Trademark which is a royalty within the meaning of Section 2(1) of the Income Tax Act.
72. The use of Trademark license between the Appellant and card companies enables the Appellant to use the global network payment system. Hence payment made to the card companies is royalty.

73. On the allegations of Erroneous workings, the Respondent states that it relied on documents provided by the Appellant in the trial balances to compute the tax payable.
74. The Respondent adds that it has engaged with the Appellant at various stages during the review process and in various correspondence, which have been quoted, but at no point was the anomaly of the figures relating to the years 2016 and 2017 raised.
75. Further, the Appellants objection letter dated 23rd July 2018 has quoted the same figure but the Appellant did not bring out the issue of the anomaly.
76. The Respondent avers that the Appellant was charged a tax shortfall penalty as provided for under Section 84 of the Tax Procedures Act, 2015. This was on the basis that the Respondent was able to determine a difference between the tax liability computed as per the monthly statements (returns) filed and the actual liability computed per the monthly revenue streams in the ledgers and financial statements for the same period.
77. The Appellant had therefore given a false statement and knowingly omitted from its monthly returns some VATable revenue streams thereby leading to the tax shortfall.
78. The Respondent determined the tax shortfall penalty per Section 84(2) (b) of the Tax Procedures Act, 2015 on the basis that the omission may not have been deliberate.
79. The provisions of Section 84 (8) (a) of the Tax Procedures Act, 2015 defines a statement to include a return. The tax shortfall penalty is therefore applicable in this case.

80. The Respondent points out that the Appellant was charged late payment interest as provided for under Section 38 of the Tax Procedures Act, 2015. This was on the basis that the Respondent was able to determine that some amounts remained outstanding for the period commencing on the date the tax was due and ending on the date the tax is paid.
81. Further, the Tax Procedures Act, 2015 at Section 31(4)(a) gives the Commissioner power to amend an assessment, in the case of gross or wilful neglect, evasion, or fraud by, or on behalf of, the taxpayer, at any time.
82. Section 56(1) of the Tax Procedures Act provides that the burden of proving that the tax assessment is wrong lies with the taxpayer and the taxpayer herein has failed to prove to the satisfaction of the Commissioner that it incurred expenses as alleged. In the absence of such proof, the Commissioner was constrained to confirm the taxes as per the demand as due and payable from the Appellant.
83. The Respondent prays that this Honorable Tribunal considers the case and finds as follows:-
- (i) That the Appellant's Appeal is invalid and dismisses it for being filed contrary to Section 52 of the Tax Procedures Act, 2015, Section 13 of the Tax Appeals Tribunal Act and Rule 3 (1) (b) of the Tax Appeals Tribunal (Procedure) Rules, 2015.
 - (ii) The Honorable Tribunal upholds the Respondent's decision to charge tax amounting to **Kshs. 116,587,059.20** inclusive of interest under Section 38 of the Tax Procedures Act, 2015 and Tax shortfall penalty under Section 84.
 - (iii) The Honourable Tribunal dismisses the Appeal with costs.

THE APPELLANT'S SUBMISSIONS

84. The Appellant filed its submissions dated 6th April 2021 on 7th April, 2021. Some of the arguments highlighted in the submission are as set out in the following Paragraphs:-
85. The Appellant carries on the business of banking and financial services and is a member of networks established by card companies known as VISA International and Mastercard.
86. The networks enable banks who issue their customers with VISA or Mastercard credit, debit and pre-paid cards to make payments using their VISA or Mastercard credit, debit or pre-paid cards. The banks that issue the cards to their customers are referred to as 'Issuing Banks'. The Appellant herein is an Issuing Bank.
87. The network also establishes banks that provide Point of Sale (POS) machines to retail outlets (for example supermarkets, hotels, petrol stations etc.) to enable them to accept payments from shoppers who purchase goods using credit, debit or pre-paid cards. The retail outlets are referred to within the networks as 'Merchants' and the banks that provide the POS machines are known as 'Acquiring Banks'.
88. In Kenya, there are a number of Issuing Banks that issue credit or debit cards to their customers. As regards acquiring banks, there are six major acquiring banks in Kenya namely; ABSA Bank, KCB Bank, Co-operative Bank, Equity Bank, Stanbic Bank and Ecobank.
89. The Appeal filed before this Honourable Tribunal arises out of an Objection Decision issued by the Respondent on 6th September 2018 (The Respondent claimed that the Appellant received interchange fees as payment for authorization and capture, clearing and settlement services that it allegedly provides to the acquiring banks. The Respondent claimed

that the Appellant ought to have charged VAT for the provision of these alleged services.

90. The Appellant Appealed against the Decision to this Honourable Tribunal. The Appellant filed a witness statement dated 10th September 2020 sworn by its Head of Card and ATM Operations Christina Gichohi.
91. At the hearing of the Appeal scheduled on 18th March 2021, the Respondent's witness Stephen Kinyua was unable to attend as he was indisposed. The Respondent's advocate indicated that she wished to cross-examine the Appellant's witness. However since her own witness was not available for cross-examination, the Tribunal directed that the Respondent's advocate file a further Statement by close of business on 29th March 2021 pointing out her issues with the Appellant's witness statement and the Appellant file a response thereto by close of business on 30th March 2021. The witness statements of the respective witnesses were then adopted in evidence. No further statement has been served on the Appellant by the Respondent.
92. The Appellant submitted that the issues to be decided by this Honourable Tribunal are as follows:-
 - (a) Is interchange a payment for provision of services?
 - (b) If the answer to "a" above is "no", is VAT chargeable on interchange fees?
 - (c) Notwithstanding and without prejudice to the foregoing, if any services were provided, did they in any event constitute a transfer of funds which is exempt under Paragraph 1 of Part II of the First Schedule.
 - (d) Does the remittance of money by the Appellant from its customer's account to the network in any event constitute a supply of money, which does not fall within the definition of a service?

- (e) Was the assessment with regard to the time period between January to May 2013 time barred in any event?
 - (f) Notwithstanding and without prejudice to the foregoing, whether the VAT assessment issued based on incorrect and erroneous workings is merited in law?
 - (g) Whether the Respondent is in contravention of the law by imposing a tax shortfall penalty based on an incorrect tax assessment contrary to the provisions of the Tax Procedures Act, 2015?
 - (h) Whether the Respondent erred in law and fact by charging late payment interest based on incorrect VAT assessment contrary to the provisions of the Tax Procedures Act
93. The Appellant has adduced evidence through its Head of Card Operations, Christina Gichohi whose witness statement is dated 10th September 2020 . Christina, who has 10 years of experience in the card business, has confirmed by reference to the diagram at page 1 of her witness statement that the sequence of steps that are followed in a typical credit, debit or pre-paid card transaction is as follows:-
- (a) A customer applies to an Issuing Bank (the Appellant in this case) for a VISA/Mastercard enabled credit, debit or pre-paid card. The Appellant issues a VISA/Mastercard card to its customers.
 - (b) The cardholder goes to a Merchant (for example Naivas Supermarket) and uses the card to pay for the goods purchased. The Merchant inserts the cardholder's card on a POS machine configured to accept the card.
 - (c) The cardholder then enters a PIN number to seek authorization through the Acquiring Bank's POS, which then seeks authorization through the network such as Visanet if the card is a VISA card or Mastercard's network if the card is a Mastercard. The network then switches the transactions from the Acquiring Bank (for example

KCB) to the Issuing Bank (the Appellant). The Issuing Bank then checks the account of its customer, who is the cardholder, in order to confirm whether the account has sufficient funds to satisfy payment or to confirm that the purchase made is within the cardholder's credit limit if it is a credit card.

(d) The Issuing Bank (the Appellant) then sends an authorization message to the network, which then relays the authorization to the Acquiring Bank (KCB). Once received, the Acquiring Bank (KCB) sends the authorization to the Merchant (Naivas) who then generates two transaction slips, a Merchants copy and customer copy. The Appellant's customer thereafter takes possession of the goods and leaves with the customer's copy of the slip.

94. In her witness statement, Christina has likened the above verification process to that of a cardholder who walks into a banking hall to undertake an over the counter transaction ("OTC"). In a similar manner, in the OTC transaction the bank will verify the customer identity by examining their identity documents, verify the details of the account and verify that the bank customer has sufficient funds to complete the requested transaction whether it may be a transfer of funds or a withdrawal transaction;
95. Christina then explains in her witness statement that thereafter the settlement and clearing between the cardholder and the merchant is done within 48 hours and is carried out by the card companies' networks. Upon settlement and clearing, the merchant receives the amount spent by the cardholder less an amount known as Merchant Discount. This Merchant Discount has three components, these are - the interchange fee, the dues and settlements fee and the acquirer processing fee. The network allocates the interchange fee to the Appellant as the issuing bank, the network retains the fee referred to as the dues and assessment fee and passes the remaining amount to the acquiring bank.

96. Christina categorically states in her witness statement that she has considered the services listed in the Respondent's objection decision and they are not services provided by the Appellant to the Acquiring Bank. It is simply a response to the network's request for authorization so as to enable the Appellant's own customer to effect payment. Since credit or debit card transactions are initiated by the Appellant's own customer who wants to purchase goods or services, the Appellant as the issuing bank merely facilitates its bank customer, who is the cardholder, to be able to make the purchase. This involves the operation of customer's account by performing cardholder verification so as to enable the transfer of money from the customer's account. It is reiterated that this is similar to an ordinary over the counter (OTC) bank transaction. The verification of cardholder's information in a credit or debit card transaction is a normal process that must be undertaken before effecting a transfer of money from the cardholder's account to the network.
97. Christina also states categorically in her witness statement that there are no agreements between the Appellant, as the Issuing bank, and the Acquirer, or between the Appellant and the merchant for either party to provide services to another.
98. There are a number of independent authorities including write ups from the card companies, VISA and Mastercard that explain the purpose of interchange as being a balancing mechanism by reimbursing costs as well as an incentive for issuing banks to issue more cards.
99. In a write up by Mastercard - ***Understanding Interchange: MasterCard Inc.:*** states that:-

"Interchange actually serves to reduce costs for consumers by balancing incentives for merchants to accept cards, issuers to issue cards and cardholders to use their cards."

"By providing incentives for card issuers, interchange encourages banks to innovate and develop new payment options..."

“Interchange is set to accomplish one goal: maximise output meaning more cards in consumers’ hands, more merchants accepting cards and more sales. It provides a mechanism for balancing the higher costs of issuing card with the costs of card acceptance”.

It is worth noting at this stage that the Honourable Tribunal in **Standard Chartered Bank Kenya Limited –v- Commissioner of Domestic Taxes (Appeal no.302 of 2018)** recognized that interchange is a reimbursement of the costs incurred by the Appellant in issuing cards.

100. Similarly, in the excerpt from VISA on interchange there is a diagrammatic representation of how the balancing mechanism of interchange operates under the heading “the market forces of interchange”. The explanation provided after the diagram states:

“The Visa payment system is what economists call a “two sided” market because it consists of two distinct groups – cardholders and merchants- that provide each other with benefits. Cardholders want a payment card they can use at as many merchants as possible. Merchants want to accept a payment card that is carried by as many customers as possible.”

The next Paragraph then draws a comparison with the newspaper industry and the following Paragraph concludes:-

“Like other two-sided economic models, the Visa payment system must balance the needs and desires of all those involved. If the cost to merchants were too high, many businesses would stop accepting Visa cards thereby hurting the effectiveness of the system. Similarly, if the cost to consumers were too high, it would limit consumer’s use of Visa cards and as a result inhibit consumer spending.”

101. Other than explanations from card companies themselves, there are also independent authorities that explain the purpose of interchange. In a paper

titled “Interchange Fees in the Courts and Regulatory Authorities” by Howard H.Chang, states

“The interchange fee was thus designed to perform a balancing function.”

102. The Appellant avers that it is clear from the foregoing that no services are provided by the Appellant to the acquiring bank and interchange is therefore not a payment for provision of services.
103. The Appellant states that Section 5(1) of the VAT Act requires a VAT to be charged on a taxable supply. It submits that since there was no provision of services and therefore no taxable supply, VAT is not chargeable on interchange fees.
104. Notwithstanding and without prejudice to the foregoing, the Appellant poses the question; if any services were provided, did they in any event constitute a transfer of funds which is exempt under Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act 2013 ?
105. Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act 2013, stipulates:-

“ The supply of the 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. ”

106. Money is defined in Section 2 of the Value Added Tax Act, 2013 as follows:-

““Service” means anything that is not goods or money.

“Money” means-

- a. Any coin or paper currency that is legal tender in Kenya;*
- b. A bill of exchange, promissory note, bank draft, or postal or money order;*
- c. Any amount provided by way of payment using a debit or credit card or electronic payment system;”*

107. As the definition of money categorically includes a payment using a debit or credit card or electronic payment system, a transfer of funds from the issuing bank’s customer’s account (when the said customer makes payment using a credit or debit card) amounts to a transfer of funds which is expressly and unequivocally exempted from VAT under Paragraph 1 of Part II of the First Schedule.

108. This Honourable Tribunal in **NIC Group & NIC Bank Kenya PLC –v- Commissioner of Domestic Taxes (Tax Appeal no.361 of 2018)** set out the provisions of Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act 2013 and the definition of money in Section 2 of the VAT Act 2013 at Paragraphs 14 and 15 of the Judgment. The Tribunal then stated at Paragraphs 15 and 16 that:-

“the foregoing definitions invariably negate the Respondent’s contention that the card services between the Appellant as the issuing bank and the acquiring bank do not amount to transfer of money or operation of bank account, and that they are subject to value added tax under Section 5(1) & (2) of the VAT Act, 2013. We find that the service provided by the Appellant is to its customers and not to the acquiring bank, it involves a money transaction and it is not considered as a service subject to the valued added tax. In fact, the service of money transfer is exempt from value added tax

under the provisions of the Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act 2013, which stipulates;

The supply of the following services shall be exempt supplies-

- a. the operation of current, deposit or savings account 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; (emphasis ours)*

The Respondent also contends that the cardholder verification process is a distinct service from that of money transfer to the acquiring banks. This, in our minds, is an argument that cannot be sustained. In the first instance, a cardholder verification process is necessitated by a customer's intended purchase. We find that the role played by the Appellant bank in verifying the cardholder's information is a normal process appurtenant to money transfer. If not online, the cardholder will have to present themselves physically in an over the counter transaction, wherein verification still has to take place."

109. On the basis of the foregoing, the Tribunal in the **NIC Bank case** held that interchange fees was not subject to Value Added Tax as it was exempt under the VAT Act 2013.
110. Similarly the Honourable Tribunal in **Standard Chartered Bank Kenya Limited –v- Commissioner of Domestic Taxes (Appeal no.302 of 2018)** held as follows at Paragraphs 19 and 20 of the Decision:-

*“The provisions of Paragraph 1 (b) of Part II of the First Schedule of the VAT Act 2013 and Paragraph 1 (b) of the Third Schedule of the Repealed VAT Act (CAP 476) provide 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 exempt from VAT.*

It is abundantly clear to the Tribunal that the checks and activities from which the Appellant earns interchange fees must be undertaken to ensure a card payment transaction is completed. These checks must also be done in any kind of transaction and they are incidental to the completion of a cash withdrawal. These checks and activities are intrinsic components of any transactions involving the issue, transfer, receipt or any other dealing with money and cannot be separated from such transactions.”(emphasis ours).

111. The Tribunal then concluded that:-

“The interchange service provided by the Appellant is a service to its customers and not the acquiring bank. The card holder verification process performed by the Appellant is to confirm if the customer’s account has sufficient funds to make the purchase. The role played by the Appellant in verifying the cardholder’s information is a normal process related to the money transfer.

In absence of express provisions in our VAT laws in respect of VAT status of interchange fees, the Tribunal also notes that the Appellant has relied on international best practice and precedent to arrive at its treatment on this matter.

*We have considered **the TAT case Number 361 of 2018, NIC Group PLC and NIC Bank PLC versus the Commissioner of Domestic Taxes**, whose judgement was delivered on 31st March 2020. The holding was that interchange fees received by issuing banks are not subject to value-added tax. We do not intend to deviate from the same.*

*The Tribunal further makes reference to the **High Court Case Number 8 of 2018, Barclays Bank of Kenya Limited v The Commissioner of Domestic Taxes** which was delivered on the 5th August 2020 where the High Court stated as follows:-*

“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 from the cardholder's account to the merchant's account."

112. In a Judgment rendered as recently as 12th February 2021, the Tribunal in **Barclays Bank of Kenya v Commissioner of Domestic Taxes (Appeal no.137 of 2016)** again confirmed that interchange fees was exempt from VAT. The Tribunal framed one of the issues for determination as:

"Whether the services rendered by the Appellant as the issuing bank are subject to VAT as per the Respondent's assessment?"

113. The Tribunal then proceeded to hold at Paragraphs 37 to 40 that:-

"The issuing bank operates an account for its customer and as such its main function is confirming that the customer has sufficient funds or credit for the transaction, debiting the customer's account and finally transferring the funds to the acquiring bank for the onward transmission to the merchant.

The Appellant, as the issuing bank, undertakes these activities on behalf of its customers with whom it has a contractual relationship. The Respondent argues that these services are offered to the acquiring banks, a position we disinclined to accept for a number of reasons. In the first instance, there is no relationship between the Appellant as an issuing bank and the acquiring banks. The Respondent wishes to impose and imply a relationship between the issuing banks and the acquiring banks where there exists none. Secondly, and perhaps more imperative to note, a transaction for transfer of funds is initiated by the issuing bank's customer and not the acquiring banks. Therefore, we find that the Respondent was

incorrect in assuming a relationship between the issuing banks and the acquiring banks as the services undertaken by the Appellant as an issuing bank are done purely for the benefit of its customers.”

With regards to whether these service are vatable as Respondent argues, we have had occasion to underscore the services offered by the issuing bank are ancillary to its core mandate, which is the transfer of the funds from its customers' accounts. Transfer of funds is express exempt from VAT as per the provisions of Paragraph 1 (a) (b) (c) and (h) of the First Schedule to the VAT Act, 2013. In the circumstances we place reliance on our Judgement in Tax Appeal No. 361 of 2018, NIC Group & NIC Bank Ltd v Commissioner of Domestic Taxes as upheld by the High Court in Barclays Bank of Kenya Limited v Commissioner of Domestic Taxes [2020] eKLR for the position that interchange fees charged by the issuing bank is not subject to VAT at the standard rate but rather it is exempt.

The Respondent's assessment in this respect was erroneous and we therefore find that the services rendered by the Appellant, as the issuing bank, are not subject to VAT as per the Respondent's assessment.”

114. It is submitted by the Appellant that based on the foregoing numerous decisions by the Tribunal it is clear that even if interchange fees was payment for a service then that service was a transfer of money which is specifically exempt from VAT by virtue of the express provisions of *Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act 2013*. Further, in order to check whether its customer has sufficient funds in its account, the Appellant as the issuing bank would have to check its customers account which amounts to operation of its customers that is also exempt from VAT *Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act 2013.*

115. The Appellant submits that as the definition of service under Section 2 of the VAT Act excludes money, and the definition of money under the same Section includes any amount provided by way of payment using a debit or credit card or electronic payment system, then the remittance of money from the issuing bank's customers account is a supply of money which does not in any event fall within the definition of a service and VAT is not chargeable on a supply of money.
116. The Appellant states that the notices of assessment issued by the Respondent on 12th June 2018 included assessments for the period January to May 2013 which period was beyond the five-year statutory limit contrary to Section 31 of the TPA which provides that:-
- “the Commissioner may amend an assessment by making alterations or additions to the original assessment to ensure that the taxpayer is liable for the correct amount of tax payable in respect of the reporting period to which the original assessment relates.”*
117. The Appellant takes note of the Respondent's contention that the Appellant wilfully neglected to file accurate VAT returns and this is the reason why the Respondent amended the aforesaid assessments.
118. The Appellant disputes the Respondent's contention in totality and submits that for the time barred period of January to May 2013 under review, it filed accurate VAT returns.
119. Accordingly, the Appellant submits that the Respondent's objection decision in respect to the period January 2013 to May 2013 should be vacated as the Respondent has acted ultra vires its powers in raising the demand outside the prescribed statutory time limit.
120. Without prejudice to the above, the Appellant further submits that the Respondent's workings which it has used to issue the VAT assessment are erroneous and do not reflect the correct position of the Appellant's VISA interchange fees earned during the period under review.

121. The Appellant disputes the Respondent's contention that alludes that the Appellant did not flag this issue of incorrect numbers. The Respondent further alleges that the Appellant did not flag this issue in the objection which is erroneous as the Appellant highlighted the same in the notice of objection filed on 23rd July 2018.
122. In this regard, the Appellant submits that it has been cooperative and acted in good faith and provided its trial balance and other documents as requested by the Respondent. However, despite this, the Respondent has used incorrect figures.
123. The Appellant further avers that the Respondent's action to impose Excise Duty assessment based on incorrect figures and without giving due regard to information provided is *ultra vires*, arbitrary and in bad faith and goes against basic principles of a good taxation system. This position was upheld in the case of Republic vs Kenya Revenue Authority Ex-parte Althus Management & Consultancy Limited (2017) eKLR where the Honourable Judge observed that:-

“...Therefore whereas this Court is not entitled to question the merits of the decision of taxing authority, that authority must exercise its powers fairly and there ought to be a basis for the exercise of such powers. A taxing authority is not entitled to pluck a figure from the air and impose it upon a taxpayer without some rational basis for arriving at that figure and not another figure. Such action would be arbitrary, capricious and in bad faith. It would be an unreasonable exercise of power and discretion and that would justify the Court in intervening. In Republic vs. Institute of Certified Public Accountants of Kenya ex parte Vipichandra Bhatt T/A J V Bhatt & Company Nairobi HCMA No. 285 of 2006, it was held that in the absence of a rational explanation, one must conclude that the decision challenged can only be termed irrational within the meaning of the Wednesbury unreasonableness, was in bad faith and constitutes a serious abuse of statutory power since no statute can ever allow anyone on

whom it confers a power to exercise such power arbitrarily and capriciously or in bad faith."

124. To this end, the Appellant submits that it is incumbent upon a public body such as the Respondent, which has a monopoly over its discharge of its administrative action that affects the affairs of the taxpayers, to act in good faith and within its powers.
125. In issuing its assessments, the Respondent is expected to discuss its assessments with the taxpayers. This position was upheld in the case of **Silver Chain Limited versus Commissioner of Income Taxes & 3 others (2016) e-KLR (Judicial review no. 2 of 2016** where Justice S.J Chitembwe held that:

"My view is that any tax assessment by the respondents should involve the tax payer... The task of collecting taxes should not lead to discouraging tax payers from carrying on with their businesses..... This calls for a balance between the tax collectors and tax payers whereby the process becomes inclusive as opposed to being unilateral. There must be fairness in the process of tax assessment... The respondents are expected to discuss their assessment with a tax payer.... The totality of my above evaluation is that the applicant was not accorded the right to fair administrative action. The assessment of the tax was unilateral, arbitrary and oppressive. He was entitled to a clear explanation as to how the computation was made. The respondents' own documents indicate that during the period June 2013 to 31.7.2015, the applicant's total sales were Kshs.55,139,701/=. The amount of principal tax demanded is Kshs.27,825,525/=. This is almost 50% of the sales. The costs of the sales and operating expenses are not included. That is why I find the assessment to be oppressive..."

126. In this regard, the Appellant submits that the entire demand should be vacated as it is based on inaccurate and erroneous figures and assumptions of the Appellant's VISA interchange fees.

127. The Respondent has subjected the principal VAT on interchange fees demanded to a penalty of 20% according to the Respondent's computations. While the Respondent has not provided any basis for the penalty, the Appellant presumes that the penalty being imposed is based on the provisions of Section 84 of TPA
128. Section 84(1) of the TPA provides that, a tax shortfall penalty is only applicable if a person knowingly makes a statement to an authorised officer that is false or misleading in a material particular or knowingly omits from a statement made to an authorised officer any matter or thing without which the statement is false or misleading in a material particular.
129. Section 84(5) of the Tax Procedures Act further provides that; *a tax shortfall penalty shall not be payable when-*
- “a)the person who made the statement did not know and could not reasonably be expected to know that the statement was false or misleading in a material particular;*
- b)the tax shortfall arose as a result of a tax payer taking a reasonably arguable position on the application of a tax law to the tax payer's circumstances in submitting a self- assessment return; or*
- c)the failure was due to a clerical or similar error, other than a repeated clerical or similar error.”*
130. The Appellant submits that it neither knowingly provided any misleading information to the Respondent nor knowingly omitted any matter from a statement to the Respondent. In any case, the Appellant took a reasonably arguable view that excise duty was not due on its reinsurance commissions.
131. The Appellant further submits that the onus is on the Respondent to provide evidence that the Appellant 'knowingly' made false statements to the Respondent, which onus, we submit, cannot be dispensed with by a mere assertion/ allegation by the Respondent.

132. The Appellant notes that the Respondent vide its confirmed assessment has subjected the Appellant to interest at the rate of 1% on the principal VAT due.

133. Section 38 (1) of the TPA provides that:

“... a person who fails to pay a tax on or before the due date for the payment of the tax shall be liable for late payment interest at the rate equal to one percent per month or part of a month on the amount unpaid for the period commencing on the date the tax was due and ending on the date the tax is paid.”

134. The Appellant submits that Section 38 (1) of the TPA envisions payment of interest where one fails to pay a tax on the due date. A tax is only due if one has an obligation to pay the tax.

135. The Appellant avers that the income streams that the Respondent has imposed VAT on are not excisable and thus the Respondent has erred in law and fact by imposing late payment interest on a tax obligation that did not exist in the first place.

136. In this regard, the Appellant submits that the Respondent’s imposition of interest of **Kshs. 20,187,891.00** is based on incorrect VAT assessment and on this basis the Respondent should be compelled to vacate its demand of the interest.

137. The Appellant requests that this Tribunal considers its submissions and on the basis of the foregoing, vacates and sets aside the Objection Decision in its entirety with costs to the Appellant.

RESPONDENT’S SUBMISSIONS

138. In response to the Appellant’s Appeal, the Respondent filed a Statement of Facts and relies on the said Statement of Facts and all the annexures in support thereof together with the witness statement dated 28th August 2020 of by Stephen Kinyua.

139. According to the Respondent, the following are the Issues for determination:-

- a) Whether the Respondent issued the assessment past five years.
- b) Whether services provided by the Appellant are financial services exempt from VAT;
- c) Whether the Respondent's assessment is based on erroneous workings
- d) Whether the Respondent's decision to charge shortfall Penalty is lawful?

140. The Respondent submits that the assessments for the period January 2013 to May 2013 were issued within the required timelines and within the Respondent's powers under Section 31(6) of the Tax Procedures Act which states:-

“ Where an assessment has been amended, the Commissioner may further amend the original assessment.....(a) five years after –

(a) for a self-assessment, the date the taxpayer submitted the self-assessment return to which the self- assessment relates: or

(b) for any other assessment, the date the Commissioner served notice of original assessment on the taxpayer ...”

141. The Respondent avers that no further amendment was made to the Appellants return, the initial amendment was only done at the point of issuing the Appellant with an assessment dated 23rd April, 2018.

142. The Respondent further avers that Section 31 (4) of the Tax Procedures Act gives the Commissioner power to issue assessments in cases of suspected tax evasion whereby a tax payer under assesses themselves.

143. The Respondent submits that the Appellant has not demonstrated how the Commissioner violated its mandate under the law nor have they

demonstrated the specific law violated. On the other hand, the Respondent has been able to demonstrate the legal framework under which it handled and issued the amendments.

Whether services provided by the Appellant are financial services exempt from VAT.

144. The VAT Act, 2013 does not expressly state that Interchange fees are exempt financial services. Paragraph 1 (b) of Part II of the First Schedule of the VAT Act, 2013 states 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;”

shall be exempt from VAT.

145. This sub-Paragraph deals with the issue, transfer, receipt or any other dealing with money. The services rendered by the Issuer are not in the nature of issuing money, transfer or receipt of money. To the Respondent, the service involved distinct elements of services all of which must be completed to constitute a service. The phrase **“dealing with money”** should be interpreted *ejusdem generis* and therefore does not mean anything more than issue, transfer and receipt of money.

146. The Respondent submits that the term “*taxable supply*” under the VAT Act has been defined as

“supply of money, other than exempt service made in Kenya by a person in the course of furtherance of a business carried on by the person including a supply made in connection with the commencement or termination of a business”.

147. A reading of Paragraph 1 of the Third Schedule of the VAT Act, Cap 476 is clear that not all financial services are exempted and only those financial services listed under Paragraph 1 of Part II of the First Schedule to the VAT Act, 2013, which list has been reproduced below, are exempt:-

- (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 debits 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 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, 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.*

148. Service is defined in Section 2 of the VAT Act, 2013 to mean anything that is not goods or money. The Act also defines money as:-

- (a) any coin or paper currency that is legal tender in Kenya;
- (b) a bill of exchange, promissory note, bank draft, or postal or money order;
- (c) any amount provided by way of payment using a debit or credit card or electronic payment system;

149. Supply of services under Section 2 of the VAT Act, 2013 means anything done that is not a supply of goods or money, including –

- (a) the performance of services for another person;*
- (b) the grant, assignment, or surrender of any right;*
- (c) the making available of any facility or advantage; or*
- (d) the toleration of any situation or the refraining from the doing of any act.*

150. To determine whether the financial services offered by the Appellant in the card transaction were exempted under the repealed VAT Act, Cap 476 and the VAT Act 2013, it is necessary to examine the nature of the financial services that the Appellant offered.

151. The Respondent submits that these services are not listed under Paragraph 1 of the Third Schedule of the repealed VAT Act, Cap 476 or under VAT Act, 2013 in the First Schedule, Part II Paragraph 1 and therefore these services are not exempt financial services and are therefore taxable at the standard rate of 16%.

152. Section 5(1) of the VAT Act, 2013 provides that:-

- “ a tax to be known as value added tax, shall be charged in accordance with the provisions of this Act on –*
- (a) A taxable supply made by a registered person in Kenya;*
 - (b) the importation of taxable goods; and*
 - (c) a supply of imported taxable services.”*

153. The Respondent submits that in a taxing statute, one has to look merely at what is clearly said. There is no room for any intendment as to tax. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.
154. The Respondent further submits that given that the law is crystal clear on the exemptions, the Appellant is seeking to erroneously amend the law so as to include interchange fees as part of exemptions.
155. The Respondent submits that the services rendered by the Appellant as explained in its witness statement is not for free and the same is charged as demonstrated by the Respondent's witness statement.
156. The Respondent asserts that although this Honourable Tribunal has in previous cases before it, decided that interchange fees are exempt from VAT, this finding can no longer be viable as there is a Court of Appeal decision delivered on 6th November, 2020 in the case of **Commissioner of Domestic Taxes (Large Taxpayers Office) versus Barclays Bank of Kenya Ltd [2020]** where the Court of Appeal held as follows:-

“We are persuaded that the evidence on record properly established that the payments paid by the Respondent (Barclays Bank) to the card companies were royalty as defined in the Act and further that the interchange fees 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.”

157. The Court of Appeal has established that interchange fees paid to the issuer banks were management/professional fees with regard to VAT, the question for determination is whether this service is vatiable or exempt. The Respondent submits that the service is vatiable and it is in no way related to dealing with money as held by the Appellant herein.

158. The Court of Appeal in the above case in explaining how the card business works held that:

“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 trademark and logos, which are distinct and distinguish one card company from another. The agreement between the Respondents and the banks are clear and 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 trademarks of the respective card companies and in our view from the trademark agreements we have referred to, this is a precondition for the Respondent to access and use card network”

159. In the South African case of **Metcash Trading Limited v The Commissioner for the South African Revenue Service and another, Constitutional Court of South Africa Case CCT 3/2000** Kriegler, J. observed that the burden of proving that an assessment of VAT by the tax collector was wrong belonged to the merchant. This is how the court put it in Paragraph 11 to 15 of its judgment:-

“(11) in order to appreciate the effect of the challenged provision to evaluate the cogency of the challenge, one must have some understanding of the VAT system.....

(14) being a tax on added value, VAT is not levied on the full price of the commodity at each transactional delivery step it takes along the distribution chain. It is not cumulative but merely a tax on the added the commodity gains during each interval since the previous step.....”

160. The Respondent seeks reliance on the above explanation by the Court of Appeal in Kenya and invites this honourable Tribunal to look at how the card business works and how distinct it is from cash withdrawal.
161. The Court of Appeal case in as much as it dealt with the withholding tax whether it is payable for payments it has made to credit card companies and to other banks that issue credit cards went ahead to explain how the whole arrangement works and the bearing it has on interchange fees which is in dispute in this case.
162. The Respondent submits that the Court of Appeal has now fully settled the issue surrounding the issues of services that result in payment of interchange fees from card companies to payments made to banks like this particular case.
163. The Respondent submits that the allegations by the Appellant that the Respondent's assessment is based on erroneous workings are baseless and the Appellant has not availed any different figures neither have they availed any evidence of any letter they wrote to the Respondent bringing out the issues of the erroneous workings.
164. According to the Respondent, it is undisputed that it relied on documents provided by the Appellant in the trial balances to compute the tax payable.
165. The Respondent has engaged with the Appellant at various stages during the review process and in various correspondence which have been quoted but at no point was the anomaly of the figures relating to the years 2016 and 2017 raised by the Appellant.
166. The Appellant's objection letter dated 23rd July 2018 has quoted the same figure, but the Appellant did not bring out the issue of the anomaly. Therefore, the Respondent submits that this allegation at the Appeal stage cannot be entertained since it was never raised at the objection stage.

167. Published statements are kept by the taxpayers as a statutory requirement and are required to be accurate and represent the correct position of a company at any given point. These statements are then relied on by various parties, including the Respondent, to make decisions. For the Respondent, the decision relates to, *inter alia*, confirmation of the correct tax position.
168. The position in Kenya being the one of self-assessment regime, the taxpayers are required to relay the correct position in their returns, the Respondent verifies this information using the taxpayers' own documents.
169. The Appellant was charged a tax shortfall penalty as provided for under Section 84 of the Tax Procedures Act, 2015. This was on the basis that the Respondent was able to determine a difference between the tax liability computed as per the monthly statements (returns) filed and the actual liability computed as per the monthly revenue streams as per the ledgers and financial statements for the same period.
170. The Appellant had therefore given a false statement and knowingly omitted from its monthly returns some VATable revenue streams thereby leading to the tax shortfall.
171. The Respondent determined the tax shortfall penalty as per Section 84(2) (b) of the Tax Procedures Act, 2015, on the basis that the omission may not have been deliberate.
172. The provisions of Section 84 (8) (a) of the Tax Procedures Act, 2015 defines a statement to include a return. The tax shortfall penalty is therefore applicable in this case.

173. The Respondent submits that it has established the legal provisions and compliance herein whereas the Appellant has not controverted the facts herein.
174. The Appellant was charged with late payment interest as provided for under Section 38 of the Tax Procedures Act, 2015. This was on the basis that the Respondent was able to determine that some amounts remained outstanding for the period commencing on the date the tax was due and ending on the date the tax is paid.
175. It's the Respondent's submission that the Appellant failed to discharge the burden of proof required by Taxing Laws in Kenya.. Kasango J in **Sheria Sacco Limited vs Commissioner Domestic Taxes (2019) Eklr** held that:-

“The SACCO however needs to appreciate that what the Tribunal was dealing with was an Appeal against the Commissioners’ confirming notice that SACCO had taxes to pay. When one appreciates that then the burden of proof lay on the SACCO. This is what is provided under Section 30(b) of the Tax Appeals Tribunal Act. The Section provides that:

In a proceeding before the Tribunal, the Appellant has the burden of proving:

- a. Where an Appeal relates to an assessment that the assessment is excessive : or*
 - b. In any other case that the tax decision should not have been made or should have been made differently.*
176. The Respondent concludes that all the procedures under the Tax Procedures Act, 2015 and the VAT Act 2013 were fairly, legally and diligently followed by the Appellant; and the substantive tax assessment issues generated by the Respondent were within the law.

177. The Respondent submits that the Judgement from the Court of Appeal: **Civil Appeal No. 195 of 2017: Commissioner of Domestic Taxes vs Barclays Bank of Kenya Ltd** has now put the whole issue into perspective. The Court of Appeal specifically concluded that:

“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 fees as defined in the Act and therefore both payments were subject to withholding tax under the Act”

178. The Respondent submits that the Court of Appeal has now put the whole issue into perspective given that VAT was being charged by the Respondent (Barclays Bank) on the basis of the involvement of the card companies and the use of the Visa platform to initiate and finalize the transactions.

179. The Respondent submits that since the Court of Appeal found that the debit and the credit cards issued by the banks to its customers bear the distinct logos and the trademarks of the respective card companies and in the Courts view, from the trademarks agreements referred to which is a pre-condition for people to access and use the card networks.

180. Reasons wherefore the Respondent prays that the Honorable Tribunal:-

- (i). Upholds the Respondent’s objection decision dated 6th September 2018.
- (ii). Upholds the Respondent’s decision to charge interest under Section 38 and Tax shortfall penalty under Section 84 of the Tax Procedures Act, 2015.
- (iii). Dismisses the Appeal with costs.

APPELLANT'S REPLY TO THE RESPONDENT'S SUBMISSIONS

181. The Appellant replied to the Respondent's submissions vide its submissions dated 29th April, 2021.

182. To the Respondent's submission that the services do not fall within the exempt services under Paragraph 1(b) of Part II of the First Schedule to the VAT Act, 2013 and the Respondent's reliance on a Court of Appeal decision on withholding tax, the Appellant argued as follows:-

- i. The Respondent states that dealing with money as set out in Paragraph 1(b) of Part II of the First Schedule to the VAT Act, 2013 means nothing more than the "issue, transfer and receipt of money".
- ii. The Respondent therefore admits that the transfer of money is exempt under Paragraph 1(b) of Part II of the First Schedule to the VAT Act, 2013. Having made that admission in its submissions, the Respondent cannot escape the fact that its own witness Stephen Kinyua stated at Paragraph 20 (vi) of his witness statement filed on 2nd September 2020, which was adopted in evidence at the hearing, that the Appellant as the issuing bank allegedly provides services to the acquiring bank in reimbursing the acquiring bank **by sending funds** to the acquiring bank where the issuing and acquiring banks are different.
- iii. It is submitted that funds can only be sent by the transfer of money from the account of the issuing bank's customer to the card companies' network which then transfers the funds to the acquiring bank. The Respondent's own witness has admitted that there is a transfer of money so the Respondent cannot possibly state in its submissions that the service is not exempt under Paragraph 1(b) of Part II of the First Schedule to the VAT Act, 2013,

- iv. Further, the Respondent also acknowledges that the definition of money under Section 2 of the VAT Act, 2013 includes any amount provided by way of payment using a debit or credit card or electronic payment system.
- v. The sending of funds which the Respondent's witness Stephen Kinyua refers to in Paragraph 20(vi) of his witness statement is as a result of a cardholder using his credit or debit card to make a payment. This clearly falls within the definition of money and sending of funds as stated by the Respondent's own witness. It is therefore an admission that the services provided by the Appellant is a transfer of money which is specifically exempt. The Respondent cannot make a contradictory submission in the face of the admission made by its own witness.

183. On the Respondent's reliance on the case of **Commissioner of Domestic Taxes (Large Taxpayer Office) v Barclays Bank of Kenya Ltd Civil Appeal no.195 of 2017 (2020)eKLR**, the Appellant submitted that the Court of Appeal's decision in this case can be easily distinguished from the Appeal before the Tribunal.

184. The Decision was with respect to withholding tax as provided in the Income Tax Act and the Court of Appeal was considering the following two issues:-

- (i) Whether the payments by Barclays Bank to the Card Companies as the acquiring bank were royalties as defined in the **Income Tax Act** and if so, whether withholding tax was deductible; and
- (ii) Whether the interchange payments made by Barclays to the issuing banks were "management or professional fees" as defined in the **Income Tax Act** and if so, whether withholding tax was deductible.

185. The first issue as to whether the payment to the card company is a royalty is completely irrelevant to the Appeal before this Tribunal as the payment to card companies is not the subject matter of this Appeal.
186. With regard to the second issue on interchange fees, the first point of difference to note is that the dispute before the Court of Appeal was as a result of a withholding tax claim under the Income Tax Act. The Appeal before this Tribunal arises from a VAT claim under the VAT Act, which is a completely different Act. The Respondent itself acknowledges this in its submissions where it admits that the dispute before the Court of Appeal was as a result of withholding tax.
187. “Management of professional fees” is defined in the Income Tax Act as payment for managerial, technical, agency, contractual, professional or consultancy services. It is noteworthy that the term “management or professional fees” does not appear in the VAT Act 2013. More importantly however, the VAT Act 2013 has its own definition of “services” which at Section 2 of the Act is defined as follows:-

“services” means anything that is not goods or money.

188. A supply of services is defined in Section 2 of the VAT Act 2013, as follows:-

“supply of services” means anything that is not a supply of goods or money including-

- (a) the performance of services for another person;*
- (b) the grant, assignment, or surrender of any right;*
- (c) the making available of any facility or advantage; or*
- (d) the toleration of any situation or the refraining from the doing of any act;”*

189. It is submitted that if there was no definition for “services” or “supply of services” in the VAT Act then this Honourable Tribunal would, pursuant to the rules of statutory interpretation, be entitled to import the definition of

the same terms as defined in other taxing acts. In the Appeal before this Tribunal, there is no lacuna whatsoever as the terms services and supply of services are expressly defined. The Tribunal would therefore need to apply these definitions to determine the Appeal which arises under the VAT Act 2013.

190. By relying on the Court of Appeal decision in the **Barclays case**, the Respondent is urging this Honourable Tribunal to ignore the definitions which are expressly provided in the VAT Act 2013 and instead apply the definition of a completely different term in the Income Tax Act which is a completely different Act and which does not relate to this Appeal. This would amount to a gross violation of the canons of statutory interpretation.
191. The Appellant argues that just because the definition of services or supply of services under the VAT Act 2013 does not suit the Respondent, it cannot simply ignore the definition and seek to import a definition of a completely different term from an Act which was not invoked in the assessment. On this basis, the Court of Appeal's decision in the **Barclays case** is clearly and easily distinguishable from the Appeal before this Tribunal which arises under the VAT Act. Even from the Respondent's own submissions, it is clear that the Respondent struggled to locate a holding in the decision that could be applied to the definition of service or supply of services under the VAT Act 2013. It is for this reason that the quotes relied on by the Respondent in its submissions relate to the payments to the card companies which are completely separate payments and not in contention in the Appeal before this Honourable Tribunal.
192. Further, in the Income Tax Act, there is no provision for exemption of services that entail transfer of money or operation of an account, so a dispute determined under the said Act cannot be applied to the VAT Act where such an exemption is expressly provided for and the Tribunal is required to make a determination in respect of the same.

193. The Appellant opines that to infer a VAT obligation based on the provisions of a statute other than the VAT Act 2013, which clearly provides for the correct VAT treatment of interchange fees, the subject of the Appeal before this Honourable Tribunal, would be erroneous and contrary to well established legal principles. Lord Russel of Killowen in upholding this position in **Inland Revenue Commissioner vs. Duke of Westminster (1936) AC 1 24** held that:-

“...The subject is not taxable by inference or by analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case”

194. The Appellant also pointed out at this juncture that the Respondent did not at any point, in its assessment, Objection Decision or Statement of Facts filed before this Tribunal, allege that the Appellant provided managerial or professional services to the acquiring banks. The Respondent is thus barred from alleging that interchange is payment for managerial or professional services. It is submitted that even if the services were management or professional services, which is denied, as long as the services resulted in a transfer of funds or operation of a bank account, the services would be exempt under Paragraphs 1(a) and 1(b) of Part II of the First Schedule to the VAT Act, 2013.

195. In demonstrating this, the Appellant wishes to rely on the Respondent's own witness statement by Stephen Kinyua who at Paragraph 20 sets out the services as follows-

“As an issuing bank, the Appellant provides services which includes-

- i) Receiving the transaction information from the acquiring bank through the card system network;*
- ii) Checking to ensure that the transaction information is valid;*
- iii) Checking to ensure that the card holder has sufficient balance to make the purchase;*

- iv) *Checking to ensure that the account is in good standing;*
- v) *Responding by approving or declining the transaction;*
- vi) *Reimbursing the acquiring bank by sending funds to the acquiring banks when the issuer and acquirer are different.”*

196. From the Respondent’s own witness statement at Paragraph 20 (i),(ii),(iii),(iv) and (v), the checking of the account to ensure that the transaction is valid, has sufficient funds and is in good standing and the approval or declining of the transaction is a clear admission by the Respondent that the said services amount to an operation of current, deposit or savings account. These services are exempt under Paragraph 1(a) of Part II of the First Schedule to the VAT Act, 2013

197. Paragraph 1 of Part II of the First Schedule to the VAT Act, 2013 provides as follows:

“The supply of the following services shall be exempt supplies—

1. The following financial services—

(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;

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

198. The Appellant reiterates that the service stated at Paragraph 20(vi) of the witness statement that is, the sending of funds, is a transfer of money which is exempt under Paragraph 1(b) of Part II of the First Schedule to the VAT Act. So even if these were managerial or professional services, which is denied, they would still be exempt as long as they entail the operation of an account or transfer of money.

199. In **Commissioner of Domestic Taxes v Barclays Bank of Kenya Limited (Appeal no 8 of 2018)** the Court specifically held at page 184 that:-

“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 customer’s (the card holder’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. That Section exempts financial services from VAT as follows;

(a) the operation of current, deposit or savings accounts including the provision of account statement;

(b) the issue, transfer, receipt or any other dealing with money..”

200. The Appellant avers that the Court of Appeal’s understanding of the transaction flow in card business is not even supported by the Respondent’s own witness.

201. In reaching its decision that interchange fees is a payment for management and professional services under the Income Tax Act, the Court of Appeal at Paragraph 3 at page 11 of its decision holds as follows :-

“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.”

202. The Appellant submits that from the above excerpt, it is clear that the Appellate Court struggled to comprehend the transaction flow in card payments and even acknowledged that it was not clear whether interchange fees was being paid by Barclays Bank in its capacity as an issuer or acquirer.

203. The appellate court claims that the services were contractual yet the Respondent’s witness Mr. Kinyua categorically states at Paragraph 18 of his statement that:-

“the acquirer and the issuer have no direct contract among themselves”

204. Further, the Court of Appeal seems to suggest in its decision that co-ordination in a card transaction is done by the issuing bank yet the Respondent’s own witness states at Paragraph 8 (e) of his witness statement that it is the Card Company which provides the infrastructure for card transactions. Paragraph 10 of the Statement sets out a diagram which clearly shows that the transactions are routed through the card scheme. So even by the Respondent’s own account, the co-ordination was not done by the issuer.

205. From the foregoing, it is clear that the Court of Appeal decision relied on by the Appellant can be easily distinguished. The Appellant prays that the Honourable Tribunal applies its holding in the **NIC Group and NIC Bank, the Standard Chartered Bank** and **Barclays Bank (TAT no.137 of 2016)** decisions to find that Interchange fee is exempt from VAT under the

provisions of Paragraph 1 of Part II of the First Schedule to the VAT Act, 2013. The Appellant also reiterates its submissions filed on 6th April 2021 with regards to the assessment in respect of the time period between January to May 2013 being time barred and the workings being incorrect and erroneous. The Appellant also reiterates that the Respondent was not entitled to charge late payment interest.

ISSUE FOR DETERMINATION

206. The Parties raised a number of issues in their respective cases beginning with whether the Respondent's assessment with regard to the period January to May 2013 was time barred; whether the assessment was erroneous and the legality of the penalty levied thereon by the Respondent.

207. The Tribunal has considered the able and elaborate submissions made by the parties and found that determination of the main issue on VAT will dispose of the entire Appeal.

208. The Tribunal has therefore framed the single issue as follows:-

Whether the services provided by the Appellant are financial services exempt from VAT

ANALYSIS AND FINDINGS

Whether the services provided by the Appellant are Financial Services exempt from VAT;

209. The Tribunal has carefully considered the arguments of both parties as set out in detail hereinbefore and does not intend to restate them in the analysis. Suffice it to say that the dispute herein is not new and as outlined by the parties, a number of cases have been decided both at the Tribunal, the High Court and in the Court of Appeal. So to speak, it is a well beaten path.

210. These cases have touched on one aspect or other of taxation of Interchange fees for purposes of Income Tax, Excise Duty and VAT in the hands of mainly banks as either Issuer or Acquirer or both Issuer and Acquirer.
211. It is not disputed that the Appellant herein is an issuer and the subject matter is taxation of the fees earned for services it supplies as an issuer and the many facets of the service such as; is it a service for purposes of the VAT Act or is it excluded by virtue of the definition in the Act and/or the exemption provisions? If it is a service, is it a vatable service or is it exempt by virtue of being an exempt financial service?
212. The above questions have been answered one way or the other by previous decisions as already alluded to above. The Appellant's submissions in this respect have been persuasive in that the cases of the **NIC Group and NIC Bank, the Standard Chartered Bank and Barclays Bank (TAT no.137 of 2016)** have provided useful precedents.
213. In a Judgment rendered as recently as 12th February 2021, the Tribunal in **Barclays Bank of Kenya –v- Commissioner of Domestic Taxes (Appeal no.137 of 2016)** again confirmed that interchange fees was exempt from VAT. At Paragraph 13(b) the Tribunal framed one of the issues for determination as “**Whether the services rendered by the Appellant as the issuing bank are subject to VAT as per the Respondent's assessment?**”
214. The Tribunal then proceeded to hold as from Paragraphs 37 that:-
- “...The issuing bank operates an account for its customer and as such its main function is confirming that the customer has sufficient funds or credit for the transaction, debiting the customer's account and finally transferring the funds to the acquiring bank for the onward transmission to the merchant.*

38. The Appellant, as the issuing bank, undertakes these activities on behalf of its customers with whom it has a contractual relationship. The Respondent argues that these services are offered to the acquiring banks, a position we are disinclined to accept for a number of reasons. In the first instance, there is no relationship between the Appellant as an issuing bank and the acquiring banks. The Respondent wishes to impose and imply a relationship between the issuing banks and the acquiring banks where there exists none. Secondly, and perhaps more imperative to note, a transaction for transfer of funds is initiated by the issuing bank's customer and not the acquiring banks. Therefore, we find that the Respondent was incorrect in assuming a relationship between the issuing banks and the acquiring banks as the services undertaken by the Appellant as an issuing bank are done purely for the benefit of its customers.

39. With regards to whether these service are vatable as the Respondent argues, we have had occasion to underscore the services offered by the issuing bank are ancillary to its core mandate, which is the transfer of the funds from its customers' accounts. Transfer of funds is express exempt from VAT as per the provisions of Paragraph 1 (a) (b) (c) and (h) of the First Schedule to the VAT Act, 2013. In the circumstances we place reliance on our Judgement in Tax Appeal No. 361 of 2018, NIC Group & NIC Bank Ltd v Commissioner of Domestic Taxes as upheld by the High Court in Barclays Bank of Kenya Limited v Commissioner of Domestic Taxes [2020] eKLR for the position that interchange fees charged by the issuing bank is not subject to VAT at the standard rate but rather it is exempt.

40. The Respondent's assessment in this respect was erroneous and we therefore find that the services rendered by the Appellant, as the issuing bank, are not subject to VAT as per the Respondent's assessment."

215. The Tribunal finds absolutely no reason to deviate from the foregoing decision.

216. The Tribunal finds that the services rendered by the Appellant as the Issuing bank are not subject to VAT.

FINDINGS AND FINAL ORDERS

217. Pursuant to the above findings, the Tribunal makes the following Orders:-

- i. The Appeal be and is hereby allowed.
- ii. Authorisation, clearing and settlement services provided by the Appellant as an issuer bank are financial services exempt from VAT;
- iii. The Respondent's tax decision dated 6th September 2018 be and is hereby set aside.
- iv. The VAT charged on VISA interchange fees amounting to **Kshs. 116,587,059.20** made up of principal tax of **Kshs. 80,332,640.00**, shortfall penalty of **Kshs. 16,066,528.00** and interest of **Kshs. 20,187,891.20** be and is hereby vacated.
- v. Each party to bear its own costs.

218. It is so ordered.

DATED and **DELIVERED** at **NAIROBI** on this **11th** day of **June, 2021**.



.....
PATRICK LUTTA
CHAIRPERSON



.....
HELEN BILA
MEMBER



.....
MWAI MBUTHIA
MEMBER



.....
ELISHAH NJERU
MEMBER



.....
HABON FARAH
MEMBER