

**REPUBLIC OF KENYA**  
**IN THE TAX APPEALS TRIBUNAL**  
**TAX APPEAL NO. 45 OF 2017**

**CO-OPERATIVE BANK OF KENYA LIMITED.....APPELLANT**

**-VERSUS-**

**COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT**

**JUDGMENT**

**BACKGROUND**

1. The Appellant is a limited liability company duly incorporated in Kenya and is a bank duly licensed to carry on banking business in Kenya under the Banking Act, (Cap. 488) laws of Kenya and is also listed at the Nairobi Securities Exchange.
2. The Respondent is an office established under the Kenya Revenue Authority Act, (Cap 469) laws of Kenya and is charged with the mandate to administer and collect Domestic Tax Revenue on behalf of the Government of Kenya.
3. By a letter dated 15<sup>th</sup> October 2015, the Respondent issued the Appellant with a Notice of Intention to carry out a Compliance Check on the Appellant's business operations for the years of income 2013, 2014, and 2015.
4. The Respondent conducted the said Compliance Check following which it issued the Appellant with an Additional Tax Assessment dated 7<sup>th</sup> November 2016 amounting to Kshs. 1,025,205,410.00 inclusive of

interests and penalties. The Assessment raised additional taxes under various tax heads as illustrated below;

<b>Tax Head</b>	<b>Principal</b>	<b>Penalty</b>	<b>Interest</b>	<b>Total</b>
PAYE	86,040,677.00	17,208,135.00	19,603,452.00	122,852,264.00
WHT	14,752,505.00	2,950,517.00	3,812,630.00	21,515,652.00
VAT	245,033,327.00	-	35,010,331.00	280,043,658.00
Excise Duty	495,403,544.00	-	105,390,292.00	600,793,836.00
<b>Total</b>				<b>1,205,205,410.00</b>

5. The Appellant vide its letter dated 5<sup>th</sup> December 2016 conceded to certain items raised in the Additional Assessment and paid Kshs.5,456,181.00 towards the undisputed taxes being; Kshs.679,932.00 for PAYE, Kshs.3,593,515.00 for WHT and Kshs.1,182,733.00 for VAT all inclusive of interest. The conceded amount was paid prior to the Appellant issuing the Respondent with its Notice of Objection and the Respondent was informed of the Appellant's intention to apply for a waiver of the penalties.
6. Vide its letter dated 5<sup>th</sup> December 2015, the Appellant disputed and objected to the amount of Kshs.1,019,377,814.00 being the remainder of the tax Assessment.
7. The Respondent's Large Taxpayer Office (LTO) through the technical forum meeting held on 18<sup>th</sup> January 2017, agreed to forego all items in contention with the exception of WHT on Winnings and Excise Duty on financial transactions.
8. Following this resolution, the Respondent issued the Appellant with its Objection Decision dated 1<sup>st</sup> February 2017 and confirmed the

Assessment on WHT on Winnings of Kshs.57,200.00 inclusive of interest and penalty and Excised Duty on Other Fees of Kshs.621,537,611.00

9. The Appellant conceded to the assessment of Kshs.57,200.00 on WHT on Winnings and settled the same prior to filing of this Appeal.
10. The Appellant being dissatisfied with the Respondent's Objection Decision on the assessment of Kshs.621,537,611.00 for Excise Duty on Other Fees proceeded to lodge this Appeal pursuant to the provisions of Section 52 of the Tax Procedures Act, 2015 ("TPA") vide a Notice of Appeal dated 3<sup>rd</sup> March 2017.
11. On 15<sup>th</sup> May 2017, the Appellant made an application to resolve the dispute through the Alternative Dispute Resolution (ADR) Framework and the application was duly allowed. The matter was discussed at length and a partial consent dated 26<sup>th</sup> November 2018 was entered into by the parties. The Appellant conceded and paid an amount of Kshs.2,368,701 relating to bancassurance commissions for the year 2013. The other issues were referred back for determination by this Tribunal.

## **THE APPEAL**

12. On 17<sup>th</sup> March 2017, the Appellant filed its Memorandum of Appeal of even date setting out the Grounds of Appeal as outlined below:-
  - i. That the demand on the Appellant amounting to Kshs 621,537,611.00 in relation to Excise Duty is erroneous in fact and law. The Respondent raised the tax demand on the Appellant's interest income;
  - ii. That the Respondent's claim is based on material misunderstanding of Paragraph 4 of Part II of the First Schedule of the Excise Duty Act, 2015 and Paragraph 7 of Part III of the Fifth Schedule of the Customs and Excise Act (now repealed) which levies Excise Duty on "Other Fees" charged by financial institutions. The said section of the tax law specifically exempts interest charge from Excise Duty;

- iii. That the Respondent failed to take into account all information and explanations provided in order to appreciate all the issues placed before him before arriving at the objection decision;
  - iv. That the Respondent ignored the fact that no operative definition of the term '*interest*' has been provided in either of the Tax Laws mentioned in note 2 above.
  - v. The Respondent failed to rely on other primary sources of authority including the Income Tax Act, ordinary meaning, case law and International Accounting Standards in determining if the income items in question were interest or Other Fees for Excise Duty purposes;
  - vi. That the Respondent ignored efforts by the Umbrella body of the banking industry (that is, Kenya Bankers Association) to formulate a common guidance on how to administer Excise Duty in the banking industry.
13. For the above reasons, the Appellant prayed that this Tribunal allows the Appeal and:
- a) upholds the Objection filed by the Appellant;
  - b) sets aside and annuls the Objection Decision by the Respondent;
  - c) orders that the Respondent pays the costs of this Appeal; and
  - d) makes such other orders that it may deem appropriate.

## **RESPONSE TO THE APPEAL**

14. The Respondent filed its response to the Appeal vide a Statement of Facts dated 13<sup>th</sup> April, 2017 in which it prayed that this Honourable Tribunal finds that:-

- i. The Appellant failed to charge Excise Duty on commissions and fees as reported in their audited accounts for the years 2013, 2014 and 2015.
- ii. The commissions and fees are on loan appraisal, loan application, loan negotiation, moratorium, mortgage commitment among others.
- iii. The categorization of income in the audited accounts reflects the actual income streams of interest, commission and Other Fees. Commissions and Other Fees reported in the audited accounts are chargeable to Excise Duty as provided for by the Excise Duty Act, 2015
- iv. The Appeal be dismissed as the same is baseless and the Commissioner's Additional Assessment be upheld.

## **APPELLANT'S CASE**

15. The Appellant set out its case in support of the Memorandum of Appeal in its Statement of Facts dated 17<sup>th</sup> March 2017 and its Written Submissions filed on 17<sup>th</sup> July, 2019.

16. The Appellant averred that the Respondent's Confirmed Assessment on Excise Duty was unfair and in contravention of the provisions of the repealed Customs and Excise Duty Act and the Excise Duty Act, 2015. The Appellant submitted that the Respondent failed to amend the Assessment on the basis that:-

- a) **“Other Fees and Commissions”** income as reported in the Appellant’s Financial Statements and the relevant ledgers are not interest in nature since they are a slice of the whole amount and not based on any rate of interest.
- b) All income earned during the loan processing stage are commissions and not interest based on the Respondent’s opinion that interest can only accrue after the loan has been granted.

17. These **“Other Fees and Commissions”** amounting to Kshs.19,801,310,306.00 as reported in the Appellant’s Financial Statements were subjected to 10% Excise Duty and compared with the total amount of Excise Duty paid by the Appellant thus arriving at a shortfall amount which formed the basis of the additional demand. The Appellant broke down the “total fees and commissions” reported in the Appellant’s Financial Statements as set out below;-

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>Total</b>
Fees & Commissions	2,089,178,350.00	5,345,348,531.00	5,673,116,854.00	<b>13,107,643,736.00</b>
Loan Charges	739,216,336.00	1,935,329,514.00	1,867,041,142.00	<b>4,541,586,992.00</b>
Flexi & Moratorium	180,058,260.00	647,914,938.00	950,162,393.00	<b>1,778,162,592.00</b>
Interchange & Agency Incomes	62,275,901.00	154,225,564.00	175,415,066.00	<b>373,916,533.00</b>
<b>Total</b>	<b>3,070,755,848.00</b>	<b>8,082,818,549.00</b>	<b>8,647,737,472.00</b>	<b>19,801,311,870.00</b>

18. The Parties then referred the dispute to ADR and a partial Consent dated 26<sup>th</sup> November 2018 was entered into by the Parties. The Appellant conceded and paid Kshs.2,368,701.00 relating to bancassurance commissions for the year 2013 which it submitted was categorized under the item Fees and Commissions as illustrated above.

19. The Appellant submitted that the Other Fees are interest and thus not subject to Excise Duty. The Appellant relied on Paragraph 4 of Part II of the First Schedule to the Excise Duty Act, 2015 and Paragraph 7 of Part III of the Fifth Schedule to the Customs and Excise Duty Act (now repealed) as reproduced below:-

Paragraph 4 of Part II of the First Schedule of the Excise Duty Act, 2015; levies Excise Duty on “Other Fees” charged by financial institutions.

Part III of this Schedule defines the term “Other Fees” to include;

*“any fees, charges or commissions charged by financial institutions relating to their licensed financial institutions, **but does not include interest** on loan or return on loan or an insurance premium or premium based or related commissions;”*

Paragraph 7 of Part III of the Fifth Schedule to the Customs and Excise Duty Act (now repealed) defined Other Fees as follows:-

*“Other Fees” includes any fees, charges or commissions charged by financial institutions, but does not include.*

20. The Appellant contended that it was apparent from the above provisions that the intent of the tax law from the onset was to exclude interest from Excise Duty. However, none of the above provisions provided an operative definition of the term “**interest**”.

21. Therefore, in the absence of this clarity, the Appellant makes reference to the definition under Section 2 of the Income Tax Act as follows:-

*“**interest**” (other than interest charged on tax) means interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes any premium or discount by way of interest and a **commitment or service fee paid in respect of any loan or credit;***

22. The Appellant interpreted the above provision to mean that interest includes all charges incidental to advancing any loan or credit facilities by financial institutions to their customers. Therefore, all fees charged by the Appellant in respect of any loan or credit facility constitutes interest hence exempt from Excise Duty.

23. The Appellant relied on the case of **Kenya Commercial Bank vs Kenya Revenue Authority, Civil Appeal No. 184 of 2009**, where the **Court** held that bank charges on overdrawn Nostro accounts are interest and thus subject to WHT. The relevant excerpt of the Ruling was as quoted below;-

*“Whatever is charged by foreign banks on Nostro accounts falls within the meaning of interest as defined in Section 2 of the ITA. The charges also fall within the ambit of interest since they are levied in connection with credit advanced to the Appellants, financial obligation, claim, commitment or a service.”*

24. Turning to International Accounting Standards and International Best Practice, the Appellant relied on the case of **Unilever Kenya Ltd v Commissioner of Income Tax [2005] eKLR** where the High Court recognized that where legislation and KRA did not provide guidance on tax issues, recourse should be made to international best practice.

25. Guided by the above case, the Appellant noted that the International Accounting Standard (IAS) 18 on ‘Revenue’ provides that where an entity allows another person the use of its assets, the charges by the entity for the right to use its cash or cash equivalents (loan) results in interest income for the entity in question.

26. The Appellant submitted further that the OECD guidelines defined interest as inter alia *“income from debt claims or every kind, whether or not secured by mortgage or whether or not carrying a right to participate in the debtor’s profits....”*

27. To buttress its case, the Appellant drew the Tribunal's attention to the numerous discussions surrounding "Excise Duty on Other Fees" which was introduced by the Finance Act 2012. The Appellant stated that the amendment introduced significant uncertainty leading stakeholders to engage the Respondent in a number of forums in a bid to resolve these uncertainties which resulted in the Finance Act 2013. The Finance Act 2013 addressed some of the ambiguities. However, some fundamental issues remained unresolved. Some of these issues were further addressed by the Excise Duty Act 2015 but the Appellant insists that the Treasury is yet to provide clear guidelines on this.

28. The Appellant provided an explanation for each item on which Excise Duty was charged:-

For the Moratorium Interest received of Kshs. 812,619,689, the Appellant averred that this "fee" relates to interest charged on loans during the grace period granted before the borrower starts paying interest. The interest that the bank should earn during the grace period is calculated and in the event the borrower is unable to provide security for the interest during the grace period from an existing deposit account, it is loaned again to the borrower and the bank recognizes the interest in its books.

29. For the Flexi Interest payable of Kshs. 965,542,903.00, the Appellant explained that this largely relates to interest earned from short term loans; for example, in the case of advances against monthly salaries, the borrower provides their monthly salary as security under the check-off system and for risk mitigation purposes, the arrangement would be that the Bank disburses to the borrower the loan minus the interest. There is no other charge applicable for advancing this loan.

30. On interchange commissions amounting to Kshs. 23,362,361.00, the Appellant submitted that this amount constituted commissions received from other banks for use of the Appellant's ATMs by their customers in which case, Excise Duty on the commission had been fully accounted for by the issuer. For instance, at the point of withdrawing the money, the

other bank charges the Appellant's customer a fee for service rendered and Excise Duty which is submitted to the Respondent. The other bank subsequently shares this fee (net of Excise Duty) with the Appellant bank. According to the Appellant, subjecting this fee to additional Excise Duty would result in double taxation.

31. The Appellant also submitted that it received agency income from exported services which was essentially commissions received from inbound money transfer services amounting to Kshs.14,026,292.00. The Appellant explained that this income is earned when a customer based abroad sends money through MoneyGram/Western Union platform to the Appellant's customer based in Kenya. MoneyGram/Western Union charges a fee for facilitating the transaction, sends money to the customer and retains the fee charged. The Appellant issues the money to the customer without levying any bank charges. Based on agreement between the Appellant and MoneyGram/Western Union, the money transfer fee charged by MoneyGram/Western Union to the customer abroad is shared between MoneyGram/Western Union and the Appellant on a pre-agreed percentage and the money recorded as commission income. The Appellant submitted that Excise Duty is not charged on the commission received by the Appellant since the services are used by the overseas customer who pay for and use/consume the services outside Kenya. Since all money transfer from MoneyGram/Western Union are inbound, there is no basis to demand Excise Duty. The exemption from Excise Duty on exported services is supported by Section 7 (4) of the Excise Duty Act 2015, which provides inter alia, that:-

*“Excisable services shall be considered to be exported from Kenya if the services are supplied from a place of business in Kenya for use or consumption outside Kenya.”*

32. In its response to the Respondent's case, the Appellant stated as follows:-

- a) The claim by the Respondent that “Other Fees and Commissions” reported in the Appellant’s Financial Statements were not interest in nature is erroneous. The Appellant averred that there is proof that Moratorium and Flexi interest which form the higher of the amounts in contention were arrived at by applying an interest rate percentage on the principal loan amounts as opposed to the Respondent’s claim that the same is a slice of the whole amount. The Appellant refuted the Respondent’s claim that interest can only accrue after the loan has been granted and submitted that the same is not supported by the law.
- b) On the Respondent’s claim that the Appellant failed to charge Excise Duty on commissions and fees reported in the Appellant’s audited accounts which according to the Respondent, related to loan appraisal, loan application, loan negotiation, moratorium and mortgage commitment among others; which based on the categorization of these items as provided by the CBK Prudential Guidelines, were clearly commissions and other fees subject to Excise Duty; the Appellant submitted that the CBK Prudential Guidelines only provided guidelines and categorization/classification of the items for purposes of reporting in a Bank’s financial statement. The categorization is not intended to provide definitions on what constitutes interest. For instance, the Guidelines indicate that interest on non-performing loans should be excluded from the category of interest. Going by the Respondent’s reasoning, it would mean that the interest on non-performing loans should not be considered interest. In any event, the Guidelines do not indicate that the said classifications are for taxation purposes, neither do the Income Tax Act nor the Excise Duty Act refer to the Guidelines for reference or guidance for purposes of the definition of interest. The Appellant concluded that, had the drafters of the Tax Laws intended to refer to the Central Bank of Kenya Act and CBK Prudential Guidelines as regards taxation of income earned by Banks, they would have expressly provided for the same.

## RESPONDENT'S CASE

33. The Respondent's response to the Appeal is set out in its Statement of Facts dated 13<sup>th</sup> April 2017 and Written Submissions dated 29<sup>th</sup> August 2019 and filed on even date.
34. The Respondent averred that the compliance check confirmed its suspicion that the Appellant was deliberately not complying with tax requirements and in particular, the Appellant failed to charge Excise Duty on certain financial services falling in the ambit of fees & other income, among others.
35. The Respondent maintained that it rightly levied Excise Duty on the Appellant's financial transactions as provided under Section 5(1) (b) as read together with Paragraph 3 & 4 of Part II of the First Schedule to the Excise Duty Act, 2015. The Respondent further supported its position as follows:-
- a) The Appellant failed to charge Excise Duty on commissions and fees as reported in their audited accounts for the years 2013, 2014 and 2015.
  - b) The commissions and fees are on loan appraisal, loan application, loan negotiation, moratorium, mortgage commitment among others.
  - c) The categorization of income in the audited accounts reflects the actual income streams of interest, commission and Other Fees. Commissions and Other Fees reported in the audited accounts are chargeable to Excise Duty as provided in the Excise Duty Act, 2015.
36. According to the Respondent, the Act expressly excludes interest and income arising from trading and dealing in securities, derivatives and other financial instruments. The tax law sought to bring to charge all commissions, fees and other(sic) howsoever described and characterized by financial institutions.

37. The Respondent contended that Section 2 and 117 of the repealed Customs and Excise Duty Act as read with the Fifth Schedule had clearly set out the services on which Excise Duty is to be levied. Excise Duty on financial services was introduced in the Customs and Excise Duty Act by the Finance Act 2012 under paragraph 7 & 8 as follows;-

*“7. Excise Duty on fees charged for money transfer services by cellular phone service providers, banks, money transfer agencies and other financial institutions shall be ten per cent.*

*8. Excise Duty on Other Fees charged by financial institutions shall be ten per cent.”*

38. The Finance Act, 2013 made further amendments by defining Other Fees to include **“any fees, charges or commissions charged by financial institutions, but does not include interest”**. The Respondent submitted that it is not in dispute that the Finance Act 2013 expressly defined “financial institutions” and “Other Fees”. Be that as it may, by virtue of the fact that the Appellant is a Bank, it cannot purport to allege ambiguity and lack of understanding in the amendments to the Finance Act, 2012. In plain reading, the Finance Act 2012 clearly shows no fee on services provided by financial institutions is excluded and that the Finance Act, 2013 only served to clarify any fee is chargeable with the exception of interest.

39. The Respondent submitted that by using the term “include”, the legislature clearly intended to expand the meaning of Other Fees as per Justice G.P Singh in his book Principles of Statutory Interpretation wherein he writes;-

*“The Legislature has power to define a word even artificially. So the definition of a word in the definition section may either be restrictive of its ordinary meaning or it may be extensive. When a word is defined to ‘mean’ such and such, the definition is prima facie restrictive and*

*exhaustive whereas where the word is defined to “include” such and such, the definition is prima facie extensive.”*

40. The Respondent’s contention was that the definition of “Other Fees” was merely extensive and even without the same, it was clear as to what the same entailed in Finance Act, 2012.
41. The Respondent maintained that “Other Fees and commissions” reported in the Appellant’s Financial Statements are not interest in nature since they constitute payments not based on interest rates. All income earned during loan processing are commissions and fees as what constitutes interest is clear as it is earned from monies that have been drawn down.
42. The Respondent averred that the Appellant’s assertion that interest is not clearly defined is not true. The Respondent submitted that the definition of various categories of incomes by financial institutions have been provided in the Central Bank of Kenya Prudential Guidelines and have proceeded to reproduce the same at length. The relevant sections are captured below;-

#### “1. INTEREST INCOME

##### 1.1 Loans and advances

This covers interest income and discounts on loans and advances including bills and notes discounted/purchased and interest on commercial paper and corporate bonds. Interest income should not include interest on non-performing loans and this should exclude fees, commissions and penalties on loans and advances.

#### 4. OTHER OPERATING INCOME

##### 4.1 Fees and commission income on loans and advances

This includes all charges and commissions relating to lending e.g. appraisal fees, commitment fees, administration fees etc

##### 4.2 Other Fees and commission income

This includes all charges and commissions relating to account operations (e.g. ledger fees), fees received from managing other institutions/group companies, commissions earned (e.g. charges on standing.”

43. The Respondent submitted that from the above, it was clear that all charges and commissions relating to lending e.g. appraisal fees, commitment fees, administration fees, moratoriums and charges relating to account operations are fees, Other Fees and commission income and cannot be categorized as interest.
44. The Respondent further submitted that on 28<sup>th</sup> August 2007, the CBK conducted a survey on Bank Charges and Lending Rates and noted that a borrower may be charged other costs in addition to interest including; commitment fees, facility fees, processing fees, early repayment fees, negotiation fees, valuation fees, insurance, appraisal and legal fees. These costs cannot be intertwined with interest.
45. The Respondent additionally submitted that the Appellant is a member of the Kenya Bankers Association which released a Standard Banking Practices dubbed “A Consumer Guide to Banking in Kenya” wherein they detailed the various costs associated with loan facilities; application, negotiation fee or commission, processing, arrangement, commitment, option fees among others.
46. The Respondent relied on the case of **Cape Brandy Syndicate vs Inland Revenue Commissioner (1921) 1 KB 64** where it was held that:  
*“In a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a 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.”*
47. The Respondent also relied on the case of **High Court Petition No. 72 of 2011; Mount Kenya Bottlers Limited vs 3 others vs Hon. Attorney General & 3 others** where the court stated that *“any tax imposed on a subject has therefor to be dictated by the terms of legislation and it is*

upon the taxing authority to first satisfy itself that the transaction fits within the definition.” The Respondent thus argued that where the statute does not provide a definition then one must apply the ordinary meaning. Interest is defined as “a bank’s return on money it has lent to a borrower at a rate expressed as a percentage per unit of time.” The Respondent thus brings to charge all Other Fees that do not fit within this definition.

48. The Respondent also quoted the case of **Republic v Kenya Revenue Authority Ex-Parte: Cosmos Limited [2016] eKLR** where it was stated that;-

*“In my view this Court does not have the liberty to read into the tax legislation the effect of what was not expressed therein. Similarly, this Court is not permitted to draw on the past episodes to determine whether or not the tax is payable. In this case as long as the 2001 amendments to the Finance Act which removed the exemptions regime from the VAT Act and the Customs and Excise Act, the law is that prima facie the Applicant was liable to pay the said taxes. This position is reinforced by no less than the Constitution itself where in Article 210(1) it is expressly provided that:*

*(1) No tax or licensing fee may be imposed, waived or varied except as provided by legislation.*

*(2) If legislation permits the waiver of any tax or licensing fee—*

*(a) a public record of each waiver shall be maintained together with the reason for the waiver; and*

*(b) each waiver, and the reason for it, shall be reported to the Auditor-General”*

49. As to the issue of whether the Income Tax Act definition of interest under Section 2 can apply, the Respondent’s argument was that Excise Duty is a different tax head and it would be erroneous to apply the same.

Further, the Appellant's use of the word ALL charges incidental to advancing any loan is defective because the word ALL has not been used.

50. The Respondent further submitted that under principles of taxation, a definition of a word used in one statute can only be used to refer to allude to the definition of a word in another statute if such statutes deal with the same subject matter or form part of the same system. Thus, the definition of interest in the Income Tax Act should not be imported and termed as the definition of interest under the Excise Duty Act as the two deal with different classes of revenue. To buttress its case the Respondent relied on the case of **Mjengo Limited vs Commissioner of Domestic Taxes (2016) eKLR.**
51. To rebut the Appellant's submissions on moratorium interest, the Respondent submitted that a scrutiny of the loan statements showed that the moratorium had not been charged as interest as it would be expected. Charges such as insurance, negotiation and moratorium fees were a one-off payment which may either be added back to the loan or paid immediately by the borrower. Further from the loan application forms, it was clear that moratorium fees were not interests but fees as they are added separately to the total amount to be paid back by the Applicant.
52. On Flexi Interest, the lack of a proper interest rate averaged throughout the year and applied for the specific period in question negated the notion of interest. CBK guidelines rightfully categorized this charge as fee of commission.

## ISSUES FOR DETERMINATION

53. Upon analyzing all the material on record including the Statements of Fact and Written Submissions filed by the respective parties, the Tribunal finds that there is only one main issue for determination as below;-
  - a) *Whether the Respondent erred in charging Excise Duty on the total fees and commissions as appearing in the Appellant's Financial Statements?*

## ANALYSIS AND FINDINGS

### *a) Whether the Respondent erred in charging Excise Duty of total fees and commissions as appearing in the Appellant's Financial Statements?*

54. It has been submitted before the Tribunal that the Appellant failed to charge Excise Duty on "Other Fees and Commissions" amounting to Kshs.619,168,910.00 as provided under Section 117 (1) (d) of the Repealed Customs and Excise Duty Act, Cap 472 as read together with Paragraph 7, 8 and 9 and Section 5 (1) (b) of Excise Duty Act, 2015 as read together with the First Schedule, Part II, Paragraphs 3 & 4.
55. For ease of reference, the provisions of the Repealed Customs and Excise Duty Act, Cap 472 are set out below;-

*"Section 117(1) (d) Subject to provisions of this Act, there shall be charged in respect of excisable goods and services specified in the second column of the Fifth Schedule, excise duties at the respective rates specific in the Schedule;*

*Paragraph 7, Part II, Fifth Schedule; Excise Duty on fees charged for money transfer services by cellular phone service providers, banks, money transfer agencies and other financial institutions (previously financial service providers) shall be ten per cent.*

*Paragraph 8, Part II, Fifth Schedule; Excise Duty on Other Fees charged by financial institutions shall be ten per cent.*

*Paragraph 9, Part II, Fifth Schedule; For the purposes of items 7 and 8— "financial institutions" means—*

- (a) a person licensed under—*
  - (i) the Banking Act (Cap. 488);*
  - (ii) the Insurance Act (Cap. 487);*
  - (iii) the Central Bank of Kenya Act (Cap. 491); or*
  - (iv) the Microfinance Act, 2006 (Cap. 493D);*

*(b) a Sacco Society registered under the Sacco Societies Act, 2008 (No. 14 of 2008); or*

*(c) the Kenya Post Office Savings Bank established under the Kenya Post Office Savings Bank Act (Cap. 493B).*

*“Other Fees” includes any fees, charges or commissions charged by financial institutions, but does not include interest”*

56. Paragraphs 7 and 8 above were amended via the Finance Act, 2012 and the said provisions became operational on 1<sup>st</sup> January 2013. However, the provision on Paragraph 7 at the time read “financial service providers”. This provision was amended to read “financial institutions” by the Finance Act, 2013. The Finance Act, 2013 also included the definitions of “financial institutions” and “Other Fees” under Paragraph 9. The said provisions of the Finance Act, 2013 became operational on 18<sup>th</sup> June 2013.

57. The provisions under the Excise Duty Act, 2015 which came into operation on 1<sup>st</sup> December 2015 are as below:-

*“Section 5 (1) (b) Subject to this Act, a tax, to be known as Excise Duty, shall be charged in accordance with the provisions of this Act on—*

*(b) excisable services supplied in Kenya by a licensed person;*

First Schedule, Part II, Paragraph 3 & 4 read as follows;-

*3. Excise Duty on fees charged for money transfer services by cellular phone service providers, banks, money transfers agencies and other financial service providers shall be ten percent of their excisable value.*

*4. Excise Duty on Other Fees charged by financial institutions shall be ten percent of their excisable value.*

Under Part III “*Other Fees*” includes any fees, charges or commissions charged by financial institutions relating to their licensed financial institutions, but does not include interest on loan or return on loan or an insurance premium or premium based or related commissions;”

58. The purpose of setting out the various provisions is to avoid retrospective application of the statutes for purposes of this Appeal. For instance, the provisions of the 2015 Act can only apply to the Assessment of December 2015. The Assessments of January 2013 to November 2015 can in turn only be governed by the repealed Customs and Excise Duty Act as read together with the amendments introduced by the Finance Act, 2012 and 2013.
59. The Tribunal agrees with the Appellant’s submission that the Finance Act 2012 as introduced was riddled with a lot of ambiguity and was the subject of discussion in a multitude of forums on what constituted “Other Fees”. This ambiguity was partially cleared up by the Finance Act 2013 which included the definition of “Other Fees”. To that extent, would it be proper to impose Excise Duty on the “Other Fees” prior to introduction of these amendments?
60. It is the Tribunal’s considered opinion that it would be unjust to impose tax based on an ambiguity. Where a tax law is unclear, the law can only be interpreted in favour of the taxpayer. This principle is clearly brought out in the case of **Russell (Inspector of Taxes) vs. Scott [1943] AC 422 at 433** where the court held as follows;-

*“I must add that the language of the rule is so obscure and so difficult to expound with confidence that – without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind I feel that the tax payer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected...my Lords, there is a maxim of income tax law, which though it may sometimes be overstressed yet ought not to be forgotten. It is*

*that the subject is not to be taxed unless the words of the taxing statute unambiguously impose tax upon him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion.”(emphasis added).*

61. To that extent, any Excise Duty charged for the period preceding 18<sup>th</sup> June 2013 would not be payable by the Appellant. That said, the Tribunal shall now delve into the other items in dispute.
62. The Appellant’s contention was that the bulk of the Respondent’s assessment comprised what is termed as moratorium, flexi interest, interchange commission and agency income from inbound money transfer. The Appellant sought to clarify these categories of income as follows:-
  - a) For Moratorium Interest, the Appellant averred that this “fee” relates to interest charged on loans during the grace period granted before the borrower starts paying interest. The interest that the bank should earn during the grace period is calculated and in the event the borrower is unable to provide security for the interest during the grace period from an existing deposit account, it is loaned again to the borrower and the bank recognizes the interest in its books.
  - b) For Flexi Interest, the Appellant explained that this largely relates to interest earned from short term loans for example advances against monthly salaries. The borrower provides their monthly salary as security under the check-off system and for risk mitigation purposes, the arrangement would be that the Bank disburses to the borrower the loan minus the interest. There is no other charge applicable for advancing this loan.
  - c) On interchange commissions, the Appellant submitted that this amount constituted commissions received from other banks for use of the Appellant’s ATMs by their customers in which case, Excise Duty on the commission has been fully accounted for by the issuer. For instance, at

the point of withdrawing the money, the other bank charges the Appellant's customer a fee for service rendered and Excise Duty which is submitted to the Respondent. The other bank subsequently shares this fee (net of Excise Duty) with the Appellant bank. According to the Appellant, subjecting this fee to additional Excise Duty would result in double taxation.

- d) On agency income from exported services, it was explained that this was essentially commissions received from inbound money transfer services amounting to Kshs.14,026,292.00. The Appellant explained that this income is earned when a customer based abroad sends money through MoneyGram/Western Union platform to the Appellant's customer based in Kenya. MoneyGram/Western Union charges a fee for facilitating the transaction, sends money to the customer and retains the fee charged. The Appellant issues the money to the customer without levying any bank charges. Based on agreement between the Appellant and MoneyGram/Western Union, the money transfer fee charged by MoneyGram/Western Union to the customer abroad is shared between MoneyGram/Western Union and the Appellant based on a pre-agreed percentage and the money recorded as commission income.

63. On the other hand, the Respondent argued that:-

- a) Moratorium is part of the loan processing fees as it has not been charged as interest on the loan statement but rather constitutes the entire loan amount.
- b) Flexi fees lack a proper interest rate averaged throughout the year and applied for the specific period in question. This negates the notion that flexi charges are interest in nature and should fall under the category of Other Fees and Commissions.

64. The Respondent relied on the CBK Prudential Guidelines to clarify what amounted to interest income. The Appellant rebutted that the CBK

Prudential Guidelines do not provide definitions but instead provide guidelines for preparation of Financial Statements by financial institutions.

65. The Tribunal concurs with the Appellant in this case. The CBK Prudential Guidelines cited by the Respondent herein do not provide definitions but instead provide categories for purposes of preparation of financial accounts by financial institutions. Indeed the “definitions” provided by the Respondent are sourced from the Guidelines under the sub-title **“Publication of Financial Statements and Other Disclosures”**.
66. The Respondent further submitted that under principles of taxation, a definition of a word used in one statute can only be used to refer to or allude to the definition of a word in another statute if such statutes deal with the same subject matter or form part of the same system. Therefore, the definition of the word “interest” as set out in the Income Tax Act could not be imported and termed as the definition of interest under the Excise Duty Act as the two deal with different classes of revenue.
67. With respect, the Tribunal does not agree with this position. The taxman responsible for administration of a tax regime cannot purport to assert that taxes imposed on the same taxpayer conducting a particular business can then be administered as two completely different revenue streams and are not intertwined. In the absence of a definition of “interest” in the Excise Duty Act, this Tribunal finds that the operational definition is found in the Income Tax Act.
68. Under the Income Tax Act, interest is defined at Section 2 of the Income Tax Act as follows;-

*“interest” (other than interest charged on tax) means interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes any premium or*

*discount by way of interest and any commitment or service fee paid in respect of any loan or credit.*

69. Having set out the definition of interest as above along with the rival arguments on the various categories of income the subject of this Appeal. The Tribunal makes its findings under each sub-head as hereunder.
70. On moratorium interest, the Appellant submitted that this is the interest on the loan charged during the grace period and is accounted for as interest in its books. To that end, this item can only be recognized as an interest income and is not excisable under the Excise Duty Act.
71. Similarly, on the flexi interest, the interest on the short-term loan is deducted by the Appellant at the point of disbursement and the balance is remitted to the borrower free of any other charge. Therefore, this fee is interest by its very nature and can therefore not be chargeable to Excise Duty.
72. The same goes for the inter-change commissions for ATM transactions. The Appellant's customer withdraws money from a third party bank's ATM. The third-party bank ATM will charge the Appellant's customer a fee of say Kshs 200.00 for this withdrawal which is immediately deducted at the withdrawal point. The third party bank pays Excise Duty on the entire amount and remits the Appellant's share net of Excise Duty paid. Charging Excise Duty on the commission paid to the Appellant after the entire fee had been subjected to Excise Duty will essentially amount to double taxation.
73. Pertaining to the agency fees for inbound money transfer. It was illustrated that the Appellant issues the money to the customer without levying any bank charges. However, based on an agreement between the Appellant and MoneyGram/Western Union, the money transfer fee charged by MoneyGram/Western Union to the customer abroad is shared between MoneyGram/Western Union and the Appellant based

on a pre-agreed percentage and the money recorded as commission income.

74. To the Respondent, this income should be classified under “Other Fees”. However the Appellant submitted that Excise Duty is not charged on the commission received by the Appellant since the services are used by the overseas customer who pay for and use/consume the services outside Kenya. Since all money transfers from MoneyGram/Western Union are inbound, there is no basis to demand Excise Duty. The Appellant supported its position using Section 7 (4) of the Excise Duty Act which provides for exported services.
75. While the Tribunal refutes that this service is indeed an exported service under the Excise Duty Act which defines export to mean “*to take or cause to be taken from Kenya to a foreign country or to an export processing zone*”, the Tribunal is of the view that this agency fees does not fall within the ambit of “Other Fees” as the money transfer fees is not charged by the Appellant bank. The agency fees are accounted for as income in their books of accounts and taxed under the Income Tax Act. Therefore, the money transfer transaction cannot be considered an excisable service and is therefore not chargeable to Excise Duty.

## FINAL ORDERS

76. In light of the foregoing, the Tribunal makes the following Orders:-
- a) The Appeal is allowed and the Respondent’s Objection Decision on Excise Duty be and is hereby set aside.
  - b) Each party to bear its own costs.

DATED and DELIVERED at NAIROBI this 30<sup>th</sup> day of July, 2020



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**PATRICK LUTTA**  
**CHAIRPERSON**

<sup>1</sup>  


.....  
**HELEN BILA**  
**MEMBER**



.....  
**MWAI MBUTHIA**  
**MEMBER**



.....  
**ELISHAH NJERU**  
**MEMBER**