REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 366 OF 2021

BANK OF AFRICA KENYA LIMITED.....APPELLANT

-VERSUS-

COMMISSIONER FOR DOMESTIC TAXES..... RESPONDENT

JUDGMENT

BACKGROUND

1. The Appellant is a limited Company incorporated in Kenya under the Companies Act, Cap.486 of the laws of Kenya (now repealed by No. 17 of 2015).

2. During the audit period, the Appellant was licensed to carry on banking business under the provisions of the Banking Act, Cap. 488 of the laws of Kenya.

3. The Respondent is a principal officer of Kenya Revenue Authority, which Authority's mandate is the collection of revenue and the administration of tax laws within the Republic of Kenya.

4. The Respondent carried out a desk audit of the Appellant's self-assessment return (SAR) for the period January to December 2018 and assessed Value Added Tax (VAT) amounting to Kshs. 2,183,051.00 on the interchange fee earned from Toucan card business as tabulated below:

Particulars	Toucan card business	VAT @ 16%	Penalty @ 5%	Interest @ 1%	Total
Assessment amount Kshs.	10,659,427	1,705,508	85,275	392,267	2,183,051

5. In issuing its assessment dated 18th December 2020, the Respondent averred that the interchange fee earned by the Appellant constituted management and professional services and was therefore subject to VAT in line with Section 5(1) and 5(2)(b) of the Value Added Tax Act, 2013 (the VAT Act).

6. The Appellant objected to the assessment through its letter dated 15th January 2021 in which the Appellant provided an explanation of the interplay between issuing banks, acquiring banks and merchants in a typical transaction and how the Appellant earns the interchange fees.

7. The Respondent issued its objection decision through a letter dated 21st May 2021 in which it rejected the whole of the Appellant's objection and confirmed the assessment on the grounds that:

    a) The Tax Appeals Tribunal erred in law and fact in the case between **Bank of Africa Kenya Limited vs. Commissioner of Domestic Taxes (TAT No. 219 of 2018)** (the case) in stating that interchange fee is a compensation paid by the acquirer to the issuer for value and benefit that merchants receive when they accept electronic payment.

    b) The Tribunal erred in law and fact in finding that services provided by the Appellant are to the cardholder and not the acquirer bank.

c) The Tribunal erred in law and fact in misapplying the exemptions provided by Part II of the First Schedule to the VAT Act.

d) The Tribunal erred in law and fact in finding that interchange fees received by the Appellant as an issuing bank from an acquiring bank is in relation to money transfer undertaken for their customers.

e) TAT No. 219 of 2018 is the subject of an appeal at the High Court and therefore the ruling issued by the Tribunal could not be relied upon and executed against the Respondent pending the determination of the case by the High Court.

8. The Appellant being dissatisfied with the Respondent's objection decision dated 21st May 2021, filed a Notice of Appeal dated 18th June 2021.

THE APPEAL

9. The Appeal raises the hereunder grounds of appeal as stated in the Memorandum of Appeal dated and filed on 2nd July, 2022:-

a) The Respondent erred in law and fact in holding that the interchange fee is a compensation paid by the acquirer to the Appellant for value and benefit that merchants receive when they accept electronic payment.

b) The Respondent erred in law and fact in finding that the services provided by the Appellant are for the benefit of the acquirer bank and not the cardholder.

c) The Respondent erred in law and fact in concluding that the Appellant supplies an acquiring bank with composite services which acquiring banks do not hold an account with the Appellant and therefore the interchange fee paid is not for the operation of an account.

d) The Respondent erred in law and fact by failing to consider that the Appellant merely reviews its customer's bank balance and funds availability and either authorizes or declines the transaction depending on the outcome of the customer account search which squarely falls under the category of financial service.

e) The Respondent erred in law and in fact by failing to appreciate that the Appellant has an obligation to its customers, a principle anchored in law and precedence. The customers have acquired debit cards from the Appellant and have a reasonable expectation that they will be able to transfer or otherwise deal with their money on demand.

f) The Respondent erred in law and in fact by failing to appreciate that the services carried out by the Appellant are in fact for operation of a current or savings account by to the Appellant's customers and therefore fall under the exemption under Paragraph 1 of Part II of the First Schedule to the Value Added Tax Act, 2013 (VAT Act) as financial services which are VAT exempt.

g) Without prejudice to the above, even where the services are deemed to be a composite supply to the acquirer, the supply falls under the exemption under Paragraph 1 (m) of Part II of the First Schedule to the VAT Act as financial services provided to a third party (the acquirer) on commission basis.

h) The Respondent erred in law and fact by disregarding the principle of *stare decisis* by issuing a new assessment and confirming the same despite there being a pending decision on similar matters at the High Court and TAT. Therefore, pending the determination of these cases, the decisions issued by both the TAT and the High Court are binding on the Respondent.

APPELLANT'S CASE

10. The Appellant's case is premised on its Statement of Facts dated and filed on the 2nd July, 2021 together with the documents attached thereto and the Respondent's written submissions dated and filed on 10th June, 2022.

11. That the dispute concerns the Vat treatment of interchange fees earned by the Appellant. Interchange fees are the fees paid by a merchant's bank (acquiring bank) to a cardholder's bank (issuing bank) to compensate the cardholder's bank for verification of the cardholder's financial status prior to the merchant accepting electronic payments. The issuing bank's role in a card transaction includes reviewing whether the card details entered by the cardholder are correct and confirming if the cardholder has sufficient funds in their account to complete the transaction. The Appellant is an issuing bank. Therefore, the appeal concerns the Appellant's role as the issuing bank that earns interchange fees.

12. The underlying transaction is the electronic funds transfer at a point of sale (for example supermarket check out till) which allows payment to be made for goods and services by the electronic transfer of funds from the cardholder's account to the merchant's account. Simply put, this is the transaction that allows a cardholder to pay for goods and services using a debit card issued by the Appellant instead of using cash or cheque.

13. The interchange fees are only paid when a transaction is carried out. Payment by debit card unconditionally discharges the account holder's obligation to make payment for the goods or services and the cardholder is thereafter not required to pay cash or issue a cheque as the debit card transaction takes the place of these two means of payment.

14. The electronic funds transfer of funds is facilitated by the card network companies, which operate networks that process card payments and govern interchange fees. The issuing bank, in this case, the Appellant, reviews the cardholder's account status and informs the cardholder through the card network companies whether the cardholder has sufficient funds to conclude the purchase transaction.

15. There is no contractual or other legal relationship between the Appellant and the acquiring banks in respect of the above electronic transfer of funds transaction. The payment of the interchange fees is governed by the contract between the Appellant and the card network company, VISA, and the contract between the Appellant and its cardholding customers.

16. The Respondent's position is that the interchange fees are some form of management fees subject to VAT at the standard rate of 16%. The Appellant's position is that the interchange fees are fees in relation to the operation of a bank account and money transfer services and are therefore exempt financial services for purposes of VAT under Paragraph 1(a)(b) Part II of the First Schedule to the VAT Act, 2013.

17. The Appellant has in its written submissions summarised its grounds of appeal as set out in the Memorandum of Appeal as follows:

    a) The service provided by the Appellant, as the issuing bank, is merely a review of its customers' bank balance and funds availability and either authorizes or declines the transaction depending on the outcome of the customer account search which squarely falls under the category of financial services.

    b) The Appellant's debit cardholders are the consumers of the services provided by the Appellant and **not** the acquirer bank.

c) The services provided by the Appellant in the Toucan card business are in fulfilment of the Appellant's payment obligations to their account holders under a bank-customer relationship.

d) Without prejudice to the above, even where the services are deemed to be a composite supply to the acquirer bank, interchange fees are exempt from VAT under Paragraph 1 of the First Schedule to the VAT Act.

e) The Tribunal should apply the doctrine of stare decisis as it already issued a judgement on 18th September 2020, in the decision in TAT Appeal No. 319 of 2018, to the effect that no VAT is applicable on interchange fees earned from Toucan card business.

a) The service provided by the Appellant is merely a review of its customers' bank balance and funds availability and the appellant either authorizes or declines the transaction depending on the outcome of the customer account search which squarely falls under the category of financial services

18. That a transaction involving a debit card issued by the Appellant to one of its customers allows the debit cardholder to pay for goods and services as follows:

a) The debit card issued by the Appellant (issuing bank) is inserted into a merchant's card reader machine and the merchant enters the amount of the transaction - for example Kshs. 100,000.

b) The cardholder will then insert their personal identification number (PIN) into the card reader machine as a first level validation check, much like the cardholder would enter his/her PIN in an automated teller machine (ATM) withdrawal transaction.

c) The PIN acts as the debit cardholder's mandate to the Appellant for the for the Kshs. 100,000 to be removed from the account with the Appellant and the Kshs. 100,000 be paid to the merchant.

d) A message of the debit cardholder's mandate to the Appellant is transmitted through a network operated by the card association (VISA) to the Appellant and the merchant's bank (acquiring).

e) Once the message is received by the Appellant, subject to certain verifications such as availability of funds in the cardholder's account, the Appellant transfers the Kshs. 100,000 from the account holder's account to the merchant's bank (acquiring bank). This transaction is similar to an ATM dispensing cash to the cardholder upon a cash withdrawal request.

19. That payment by debit card unconditionally discharges the debit cardholder's obligation to pay the price being Kshs. 100,000. In other words, the debit cardholder will not have to pay cash or issue a cheque as it takes the place of these two means of payment. This is no different from a debit cardholder's withdrawing cash from their bank accounts to make payment or issuing cheques.

20. That put simply, the debit card transaction described above results in the transfer of money from the debit cardholder's account to the merchant's bank. This is a transfer of money.

21. That the activities that the Appellant carries out include, ensuring the validity of the transaction information, ensuring the debit cardholders have sufficient funds in their accounts and setting aside/ transferring to the merchant the amounts authorized.

22. That none of the activities set out above takes place outside of a bank account holder making payment to third parties for the purchase of goods and services. There is no single instance in which the Appellant carries out any of these activities without there being an underlying debit card transaction conducted by one of its account holders.

23. That the activities carried out by the Appellant in honoring debit card payments by account holders cannot be separated from the electronic funds transfer. The funds availability validation and transfer events have no existence in and of themselves. The transaction cannot also be done without one of the Appellant's account holders making payment for goods and services and using a debit card and the interchange fees are only paid when a debit card transaction is carried out. If the debit cardholder does not carry out any transaction and instead opts to pay by cheque or cash, no interchange fee will be paid. No bank has ever approached the Appellant and requested it to independently provide verification services, send authorization codes or agree to future remittances in exchange for an "interchange fee".

24. That the Respondent's assessment failed to consider that each of the activities set out above are also undertaken in any transfer of money (such as Electronic Funds Transfer) undertaken by the Appellant on behalf of an account holder and correspond generally to the Appellant's payment obligations under a bank-customer transaction.

25. That the Respondent's attempt to dissociate the interchange fees from underlying banking transactions carried out by the Appellant's account holder results in an artificial and contrived outcome. This is contrary to the principles laid out by the Court in the **Card Protection Plan Ltd vs. Commissioners of Customs and Excise (1998) EUECJ C-349/96** where the European Court of

Justice cautioned that a single supply should not be artificially split to avoid distorting the functioning of the VAT system.

26. That the House of Lords in **Card Protection Plan Ltd vs. Commissioners of Customs and Excise (2001) UKHL 4** also stated that:

> *"It seems that an overall view should be taken and* ***over-zealous dissecting and*** *analysis of particular clauses should be avoided."* (Emphasis added)

27. That even in over-the-counter withdrawals or payment by cheque, the Appellant will have to undertake some form of the activities set out above. For example, the Appellant, regardless of the means of payment will always have to confirm and verify the identity of the person seeking to access the funds, that he is, the account holder. The Appellant will also have to confirm the account balance of the account holder and that the transaction amount is within limits. The Appellant will also have to avail funds to the account holder (in the case of a cash withdrawal) or transfer of funds to a third party's bank account (in the case of a cheque).

b) The Appellant's debit cardholders, and not the acquirer bank, are the consumers of the services provided by the Appellant

28. That from the transaction descriptions in above, the services provided by the Appellant are not for the benefit of the acquiring but rather to the benefit of the Appellant's customers to whom it owes a contractual banking operation.

29. That in determining who consumes the Appellant's services, the Appellant invites the Honorable Tribunal to note that:

    a) All persons who are issued debit cards by the Appellant bank hold bank accounts with the Appellant. Thus, all debit cardholders are bank account holders.

b) The interchange fees are only paid to the Appellant when one of its cardholders carries out a money transfer transaction using a debit card.

c) Payment of the interchange fees allow the debit cardholders to pay for goods and services using their debit cards through electronic funds transfer from the appellant to the merchant's bank in the place of payment by cash or cheque, depending on availability of funds in the cardholder's account.

30. That the upshot of the above is that the Appellant earns interchange fees only when one of its cardholders, who is an account holder, carries out money transfer transaction(s) using their debit card. The whole transaction relating to the interchange fees is a supply, but to the extent that the cardholder is the recipient of this services as demonstrated in the foregoing paragraphs. Thus, the common denominator is the cardholders who consume the Appellant's services, and without whom the Appellant would not earn any interchange fees.

31. That the Respondent's proposition that the service rendered is for the benefit of the acquiring bank is but far-fetched as to artificially split the transaction of a cardholder from the whole concept of which the interchange fees are obtained.

32. That the position above is supported by Ellinger's Modern Banking Law 5th edition where the authors state that:-

> "There is a dearth of authority concerning the contract between the issuer and the dealer. It is clear that, in the master agreement, ***the issuer undertakes to pay the amount accrued by the use of the card less a given percentage.*** The Issuer is under a duty to perform this promise even if the cardholder absconds or fails. ***Indeed, the object of the transaction is to***

enable the cardholder to obtain goods and services on the issuer's credit." (Emphasis added)

33. That the Tribunal in **NIC Group and NIC Bank Kenya PLC vs. Commissioner of Domestic Taxes (TAT) Appeal No. 361 of 2018** held that:-

> *"The Respondent also contends that the cardholder verification process is a distinct service from that of money transfer to the acquiring banks. This in your minds is an argument that cannot be sustained. In the first instance, a cardholder verification process is necessitated by a customer's intended purchase. All that the appellant bank is doing is confirming that indeed the customer's account has sufficient funds in order that the customer may continue with the purchase..."*

34. That the Court, in **Barclays Bank of Kenya Limited vs. Commissioner of Domestic Taxes (2020) eKLR**, held that:-

> "***It follows from the above that I find and hold that the interchange fee by the issuing bank is not for any service rendered by the issuing bank to the acquiring bank, here BBK.*** Having answered the first issue in the negative there is therefore no need to proceed to determine whether the service is exempt from the charges of VAT because no service was offered by the issuing bank to BBK." (Emphasis added)

35. That the case of **Nicholas R. O. Ombija vs. Kenya Commercial Bank Ltd (2009) eKLR** is a binding authority for the proposition that the beneficiary of the services listed by the Respondent is the Appellant's customer whom it owes a duty of care. In case of any breach, the customer would have a cause of action as against the Appellant as the issuing bank.

36. That the debit cardholders are the ultimate beneficiaries of the Appellant t's services as they are able to pay for goods and services using their cards, and in the event of any adverse action they have recourse against the Appellant and not the acquiring bank.

c) The services provided by the Appellant in the Toucan card business are in fulfilment of the Appellant's payment obligations to their account holders under a bank-customer relationship

37. That the direct contractual relationship between a supplier and its customer as a recipient of the supply, dictates the nature of the supply of services. In **CSARS v Respublica (Pty) Ltd (1025/2017) (2018) ZASCA 109**, the South African Supreme Court in determining whether a supply has been made to an end user, held:-

> "the general principle (as recognized in other VAT jurisdictions) [is] that **the VAT consequences of a supply must be assessed by reference, first and foremost, to the contractual arrangements under which the supply is made...**" (Emphasis added)

38. That in applying the principles in the Respublica case, the consumers of the services provided by the Appellant are the bank account holders. A similar approach has been adopted in English law, where the majority of the Supreme Court in **Airtours holidays Transport Limited v Commissioner for Her Majesty's Revenue and Customs** observed that:-

> *"when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally,* ***characterise the relationship by reference to the contracts and then consider whether that characterization is vitiated by [any relevant] facts"*** (Emphasis added)

39. That the Appellant has a contractual relationship with the debit cardholders who are bank account holders. Under **clause 2(h) of the Terms and Conditions of the Debit Card Application form**, the Appellant is obligated to give effect to Transaction Instructions given by the cardholder. A Transaction instruction is defined as an instruction given by use of the card.

40. That the Appellant is obligated to undertake activities above to ensure that there is no wrongful dishonor of an account holder's instructions to transfer funds. **Paget's Law of Banking (14th Edition)** observes that:-

> *"The bank is under duty to obey the customer's mandate. Where the bank acts outside of the mandate, e.g. transmitting a payment message to the wrong bank, to the wrong payee, or the wrong account, it cannot debit its customer's account."*
>
> ....
>
> *"When executing the customer's instructions to make a funds transfer the bank acts as its customer's agent. Acting as agent the bank owes the customer duty to observe reasonable care and skill in and about executing the customer's orders..."*

41. That if the Appellant fails to exercise reasonable care and skill in executing an account holder's instructions to transfer funds, the Appellant can be held liable for breach of contract and defamation. The High Court in **Equity Bank Limited &Another v Robert Chesang (2016) eKLR** and **Hon. Nicholas R. O. Ombija v Kenya Commercial Bank Ltd (2009) eKLR** held the respective banks liable for defamation and breach of contract for wrongfully dishonouring payment instructions made through debit cards by account holders.

42. That the Appellant asserts that all the activities undertaken by themselves in a debit card transaction are to ensure that money is securely moved from one account to another based on the account holder's instructions.

43. That it is not in dispute that the fees earned by the Appellant when debit card holders withdraw cash from their bank accounts or issue cheques are exempt from VAT. If these fees are exempt from VAT, why wouldn't interchange fees arising from electronic funds transfer transactions also be exempt from VAT?

44. That the Respondent's act of subjecting interchange fees to VAT would lead to an absurd outcome as the VAT treatment of payment transactions would be determined by whether the card holder decided to use cash (VAT exempt), issue a cheque (VAT exempt) or make payment using a debit card (purportedly subject to VAT). The Appellant urges this Honorable Tribunal to find in favour of the Appellant and not countenance the absurdity occasioned by the Respondent's assessment.

d) The interchange fees earned by the Appellant are exempt from VAT

45. That without prejudice to the Appellant's arguments above, even where the services are deemed to be a composite supply to the acquirer bank, the supply falls under the exemption under Paragraph 1(m) of Part II of the First Schedule to the VAT Act as financial services provided to a third party (the acquirer bank) on a commission basis.

46. That Paragraph 1 of Part II of the First Schedule to the VAT Act provides that the VAT exemption of financial services as follows:

> *"(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;

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

47. That transfer of money for purposes of VAT involves movement of money from one bank account to another. This position was clarified by the European Court in **Sparekassernes Datacenter (SDC) v Skatteministreriet (1997) EUECJ C-2/95** as follows:-

"a transfer is a transaction consisting of the execution of an order for the transfer of a sum of money from one bank to another. ***It is characterised in particular by the fact that it involves a change in the legal and financial situation existing between the person giving the order and the recipient and between those parties and their respective banks and, in some cases, between the banks.*** *Moreover, the transaction which produces this change is solely the transfer of funds between accounts, irrespective of its cause."*

48. That the Appellant's position is that all steps involved in the money transfer as effected through a debit card transaction are exempt from VAT under Paragraph 1 of Part II of the First Schedule to the VAT Act, including:-

a) the operation of bank accounts (paragraph 1(a));

b) the issuance of debit cards (paragraph 1(c));

c) transfer of money from the account holders' accounts to the merchants' bank accounts (paragraph 1(b)).

49. That the provision outlined clearly exempts the entire process of operation of bank accounts, issuance of debit cards and transfer of money from account holders' accounts from VAT.

50. That the Court in **Field Fisher Waterhouse, C-392/11, EU:C:2012:597**, in determining that the supply of services such as water to a leased building exempted from VAT constituted a single supply and stated as follows:-

> "Where, however, a transaction comprises several elements, the question arises whether it is to be regarded as consisting of a single supply of several distinct and independent supplies which must be assessed separately from the point of view of VAT. According to the Court's case law, ***in certain circumstances several formally distinct services, which could be supplied separately and thus give rise, in turn, to taxation or exemption, must be considered to be a single transaction when they are not independent.***"
>
> "In that regard, the Court has held that ***a supply must be regarded as a single supply where two or more elements or acts supplied by the taxable person are son closely linked that they form, objectively, a single, indivisible economic supply which it would be artificial to split*** (see to that effect, **Case C-41/04 Levob Verzekeringen and OV Bank (2005) ECR I-9433**, paragraph 22, and Everuthing Everywhere, paragraph 24 and 25.) (Emphasis added)

51. That the Appellant submits that the interchange fees is an intrinsic part of the entire process of the operation of the bank accounts, issuance of a debit card and transfer of money from the account holders' account to the acquirer and therefore dependent on each of the listed distinct services to form a composite supply exempt from VAT.

52. That the Appellant fault the Respondent for attempting to artificially split the elements of a single supply of services and that the same would distort the entire principles on the functioning of the VAT system.

53. That the Appellant is only obligated to act on the cardholder instructions to remit funds to the merchant's account through the acquiring bank if there are sufficient funds in the cardholder's account.

54. That the Appellant submits that to determine whether interchange services supplied are independent services supplied to the cardholder. The Court in **BGZ Leasing, C-224/11 EU:C:2013:15** at paragraph 32 observed that:-

> *"In order to determine whether the services supplied constitute independent services or a single service, it is necessary to examine the characteristic elements of the transaction concerned. However, it must be recalled that there is no absolute rule for determining the extent of a service for VAT purposes, and in order to determine the extent of a supply of a service and, therefore, in order to determine the extent,* ***all the circumstances in which the transaction concerned takes place must be taken into account.*** "(Emphasis added)

55. That it is critical to note that the transaction culminating into interchange fees is but a composite of a series of transactions that relays information on the financial position of a cardholder and thus the operation of the account of a cardholder in order to remit such funds to the acquiring bank from the issuing bank as clearly stated by the respondent in its objection decision.

56. That the circumstances in which the transaction concerned takes place cannot be, as is being purported by the Respondent to be, artificially split to constitute a single transaction that is "VATable" for purposes of interchange fees.

57. That indeed the Respondent erred in law and in fact by failing to appreciate that the services carried out by the Appellant are in fact for operation of a current or savings account by the Appellant's customers and therefore fall under the exemption under Paragraph 1 of Part II of the First Schedule to the VAT Act as financial services which are VAT exempt.

58. That the Appellant urges this Honorable Tribunal to determine and find that the transactions in question are closely linked and intertwined that they constitute a single supply that is financial services and therefore VAT exempt under Paragraphs 1(a) and 1(b) of Part II of the First Schedule to the VAT Act.

e) The Doctrine of stare decisis

59. That the Appellant asserts that the Respondent has no basis whatsoever to depart from the position and findings of this Honorable Tribunal in similar cases including in **Bank of Africa Limited v Commissioner of Domestic Taxes TAT No. 319 Of 2018** where the Tribunal found that the interchange fee in an identical transaction is VAT exempt.

60. That in light of the above, the Respondent has failed to adhere to the doctrine of stare decisis which provides for certainty, stability, predictability and consistency in judicial decision making.

61. That "***stare decisis***" is defined in the Black's Law Dictionary, 9th Ed. As:

> *"The doctrine of precedent, under which a court must follow judicial decisions when the same point arises gain in litigation."*

62. That the term ***"precedence"*** is also defined thereunder as:

"... the making of law by a court in recognizing and applying new rules while administering justice.... A decided case that furnishes the basis for determining later cases involving similar facts."

63. That it is evident that the facts and issues in the case are similar to the facts and issues raised in **Bank of Africa**

64. **Kenya Limited v Commissioner of Domestic Taxes TAT No. 319 of 2018.** Indeed, the only difference is the two cases is the period assessed.

65. That, similarly, the High Court also determined that interchange fees are exempt from VAT in **Barclays Bank of Kenya (now Absa) v Commissioner of Domestic Taxes (2020) eKLR.**

66. That the Respondent's action of issuing subsequent year assessments against the Appellant over a matter that has been litigated and determined before this Honorable Tribunal, is in absolute disregard of the judicial pronouncements by this Honorable Tribunal and the High Court alike and not only offends the well-established doctrine of stare decisis but also amounts to gross violation of the Appellant's right to procedural fairness as espoused in Article 47(1) of the Constitution of Kenya, 2010.

Appellant's Prayers

67. The Appellant made the following prayers;

a) The assessment of Kshs. 2,183,051.00 be vacated together with all attendant penalties and interest.

b) The Appeal be allowed with costs to the Appellant.

THE RESPONDENT'S CASE

68. The Respondent's case is premised on the hereunder filed documents and proceedings before the Tribunal: -

    i. The Respondent's Statement of Facts dated and filed on 30th July 2021 together with the documents attached thereto.

    ii. The Respondent's written submissions dated and filed on 10th June 2022 together with the legal authorities filed therewith.

Services offered

69. That the Appellant issues credit cards to its customers. When the bank's customers use credit and debit card at a merchant, the Bank provides services in form of authorization, settlement and clearance to the acquiring bank.

70. That as an issuing bank, the services provided by the bank include receiving the transaction information from the acquiring bank through card system network, ensuring that transaction information is valid and checking to ensure that account is in good standing.

71. That 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.

72. That there are five (5) parties to a card transaction as follows:

    a) *Card holder* - this is the individual to whom a card has been issued. It is the person who possesses and uses the debit or credit card. The card holder maintains a banking account with the issuing bank and is

charged fees like: joining fees, annual fee, replacement card fee, cash advance fee, statement retrieval fee and surcharge/ service charges.

b) *Issuer (issuing bank)* - this is an organisation or a financial institution that issues cards to card holders. The cards specify the card association involved, issuing bank's identity, tenure of the card, an embedded electronic chip to facilitate transactions through the card and identification code. The issuing bank receives the transaction information from the acquiring bank through the association network. It also checks to ensure, among other things, that the transaction information is valid, the card holder has sufficient balance to make the purchase and the account is in good standing. Further, it approves or declines the transaction and reimburses the acquiring bank by sending funds to the acquiring banks. All issuing banks operate under the rules provided by the respective card associations.

c) *Acquirer (acquiring bank)* – this is an organisation (not necessarily a bank) which contracts merchants for provision of card processing services. It may be a bank, a card issuer or a third party called an Independent Service Organisation. They undertake the liability to settle payments for goods or services provided by the merchant and consumed by the card holder, irrespective of the acquirer's ability to recover such amount from the issuer. The acquirer provides payment processing services to the merchant, enabling it to accept payments from card holders. To facilitate the service to the merchant, the acquirer enters into a merchant agreement with the merchants. The acquirer levies merchant service charge (MSC) on every transaction at the merchant's point of sale (POS) terminal to generate its revenue.

d) *Merchant* – sells goods or services to the card holder. With respect to a card purchase transaction, the merchant has no contract with the issuer.

e) *Card association (card companies)* - card companies that provide infrastructure which enables credit and debit card transactions to take place, for example, Visa Inc., Mastercard, JCB, Union Payment International and American Express.

The Respondent further provided a transaction flow diagram to demonstrate a typical transaction as well as the role of the 5 parties to a card transaction.

73. That the service that the bank supplied to the acquiring bank is a composite service in the nature of authorisation, capture and settlement.

74. That the Appellant as an issuer provides services to the acquiring bank, including:

a) Receiving the transaction information from the acquiring bank through the card system network;

b) Checking to ensure that the transaction information is valid;

c) Checking to ensure that the card holder has sufficient balance to make the purchase,

d) Checking to ensure that the account is in good standing;

e) Responding by approving or declining the transaction; and

f) Reimbursing the acquiring bank by sending funds to the acquiring banks when the issuer and acquirer are different.

75. That as an issuer the Appellant therefore earns interchange fees (Toucan card business income) because of providing services to acquirers which includes facilitation fee for facilitating a medium of communication between issuers, acquirers and merchants, and for confirmation of the creditworthiness of cardholders.

76. That ***interchange fee*** is a term used in the payment and card industry to describe the fee paid between banks for the acceptance of card-based transactions. Usually for sales/ services transactions it is a fee that a merchant's bank (the acquiring bank) pays the customer's bank (the issuing bank).

77. That the interchange fee earned constitutes fees earned for management and professional services and are therefore subject to VAT. The bank as an issuer renders clear co-ordination, managerial, professional and contractual services to the acquirers for which the latter pays.

78. That these described above for which the bank earns interchange fees falls within Sections 5(1)(a) and 5(2)(b) of the VAT Act 2013.

79. The in view of the foregoing, contrary to the Appellant's contention, the said interchange fees are not VAT exempt under VAT Act. The merchant service charge does not fall under Part II Paragraph 1 of the First Schedule of the Vat Act which outlines exempt financial management and advisory services from financial services provided by banks and other financial institutions.

80. That interchange fees are VAT exempt under Paragraph 1(m) of Part II of the First Schedule to the VAT Act, the Respondent reiterates its averments above on the nature of interchange fees and avers that the same are not exempt as explained by the Appellant.

81. The Respondent reiterates its position that it has demonstrated that the services offered by the Appellant as an issuer is a composite service to which the Appellant earned interchange fee that is subject to VAT.

82. That the period under dispute in this case is different from the Appellant's earlier case. The Respondent further avers that the case is under Appeal and the Respondent is at liberty to issue assessments for different periods on the Appellant.

Whether the services offered by the Appellant constitutes services as defined under Section 2 of the VAT Act, 2013 and therefore taxable under Section 1 of the VAT Act, 2013

83. That VAT is payable for goods or services that are not zero rated and not exempt. This means that when the Respondent seeks to tax goods or services, the Respondent is required to demonstrate that the same is a taxable supply as defined under the Act and **that they are neither zero rated nor exempt**.

84. That this means that under the VAT regime, the Act provides specifically for goods and services that are either exempt nor zero rated. Anything outside this is subject to VAT.

85. That Section 2 of the Vat Act defines "***services***" to mean "*anything that is not goods or money*".

86. That the Section further defines "***supply***" to mean "*a supply of goods or services*".

87. That, further, Section 2 of the VAT Act defines "***supply of services***" to mean "*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...*"

88. That the Appellant being an issuer provided a supply of a service as defined under Section 2 of the VAT Act.

89. That having established that there was a supply of a service, the next question is whether the same is a taxable supply.

90. That Section 5 of the VAT Act is the charging Section and provides that:

"(1) 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

(2) The rate of tax shall be -

(a) in the case of a zero-rated supply, zero percent; or

(b) in any other case, sixteen percent of the taxable value of the taxable supply, the value of imported taxable goods or the value of a supply of imported taxable services."

91. That Part II of the First Schedule to the Vat Act then provides for exempt supplies.

92. That having established that there was a supply of services by the Appellant to acquiring banks, then the next issue to be determined is the nature of the said services and whether the same can be subjected to Vat under Section 5 of the VAT Act.

93. That the services offered by the Appellant are in the nature of management and professional services and are subject to VAT and that these services are not listed under Part II of the First Schedule to the Act. Specifically, they are outside the scope of the services listed under Paragraph 1 of the First Schedule to the VAT Act.

94. That the **Court of Appeal in Nairobi Civil Appeal No. 195 of 2017: Commissioner of Domestic Taxes vs. Barclays Bank of Kenya Limited** had a chance to consider the nature of interchange fees earned by an issuing bank from an acquiring bank and pronounced itself, in part, as follows:

> "*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."

95. That in **Stanbic Bank Ltd v. Kenya Revenue Authority (supra)**, the Court reiterated that

> *"...where there is ambiguity in the legislation, the same must be interpreted in favour of the taxpayer. Conversely, where the meaning of legislation is clear, Courts will give effect to the law. In this appeal, we have come to the conclusion that there is no ambiguity in the law and that the Appellant sufficiently demonstrated that the payments made by the Appellant to the*

card companies are "royalty" under the Act and further that the interchange fees made by the Respondent in its capacity as acquirer to issuer banks were for management and professional services within the meaning of the Act..... ***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 under the Act and further that the interchange fees it paid to issuer banks were for management and professional services as defined in the Act, and therefore both payments were subject to withholding tax under the Act."***

96. The Respondent submits that the issue of whether payment of interchange fee by an acquirer to the issuer is a fee for professional or management fees has been settled by the Court of Appeal.

97. That the Respondent relies on the following authorities to argue that the services offered by the Appellant as an issuer are not exempt but VATable at the standard rate of 16%. Further, the Respondent relies on these authorities to buttress its argument that the services provided by the issuing banks paly no specific and essential part in facilitating transfer of money.

    a) **Bookit Ltd v. Commissioner for Her Majesty's Revenue and Customs** where the Court stated that "*a card handling service, such as that at issue, in an exchange of information between trader and its merchant acquirer, with a view to receiving payment for a product or service offered for sale, cannot fall within the scope of the exemption provided in Article 135(1)(d) of the VAT Directive for transactions concerning payments and transfers.*"

    b) **Supreme Court of India Civil Appeal No(s). 8228 of 2019: Commissioner of GST & Central Excise vs. M/S Citi Bank N.A** where

the Supreme Court of India interrogated the card transaction similar to the one in dispute and laid out roles of each party in the transaction, the consideration gained by each party and whether the said consideration was subject to tax.

98. That the Appellant's submission and authorities to the effect that the Respondent has sought to artificially split transactions are submissions made to confuse the Honourable Tribunal on the transaction under review.

99. That the NIC Bank and the Bank of Africa cases ruled by this Honourable Tribunal are currently under appeal by the Respondent and in its view, the Honourable Tribunal is not bound by its own judgements and can depart from its previous decisions.

100. That **Hon, Nicholas R. O. Ombija vs Kenya Commercial Bank Ltd (2009) eKLR**, as relied on by the Appellant, can be distinguished from the case at hand.

101. That the Appellant's submissions to the effect that interchange fees are exempt from VAT is erroneous.

Respondent's Prayers

102. The Respondent prayed that the Tribunal;

a) Dismisses the appeal.

b) Upholds the Respondent's objection decision and confirms the additional VAT assessments raised by the Respondent.

ISSUE FOR DETERMINATION

103. The Tribunal upon due consideration of the pleadings and the written submissions filed on the separate parts of the parties was of the considered view that the Appeal herein raises a singular issue for its determination namely:

Whether the interchange fees earned by the Appellant is subject to VAT

ANALYSIS AND DETERMINATION

Whether the interchange fees earned by the Appellant is subject to VAT at 16%

104. This dispute arose from the Respondent's assessment of VAT on interchange fees earned by the Appellant

105. The Appellant contends that the services it undertakes as an issuer based on the transaction descriptions in its pleadings are not for the benefit of the acquiring bank but rather to the benefit of the Appellant's customers to whom it owes a contractual banking operation.

106. The Appellant further argues that it earns interchange fees only when one of its cardholders, who is an account holder, carries out money transfer transaction(s) using their debit card. The whole transaction relating to the interchange fees is a supply, but to the extent that the cardholder is the recipient of this services as demonstrated in its pleadings above. Thus, the common denominator is the cardholders who consume the Appellant's services, and without whom the Appellant would not earn any interchange fees.

107. The Respondent argues that the Appellant provides a management or professional service to the acquiring bank which does not hold an account with

the Appellant and it is for this service that the Appellant earns an interchange fee.

The Tribunal understands a typical card transaction to consist of the processes below:

i. Authorization - process of approving or rejecting a transaction by the user and includes confirming the status of the user account.

ii. Clearing - process of transmitting final transaction data from acquirers to issuers for settlement.

iii. Settlement - the actual exchange of funds between issuers and acquirers.

108. In raising its demand, the Respondent computed VAT on interchange fees based on the understanding that for a card transaction to be completed, there are various checks both the issuer and acquiring banks have to undertake before the authorisation and approval of a card transaction. Even in a classic case of an "over the counter withdrawal" similar checks must be undertaken by the Appellant.

109. The Appellant contends that one cannot separate the checks from the actual transfer of money as the latter cannot happen without said checks.

110. Paragraph 1(b) of the First Schedule to the VAT Act, 2013 provides that:

> *"The supply of the following services shall be exempt supplies-*
>
> *1(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."*

111. 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 transaction is completed. These checks must also be done on any transaction and are incidental to the completion of any movement of cash from a card holder's account. ***Therefore, these checks are intrinsic components of any transactions involving the issue, transfer, receipt or any other dealing with money*** and cannot be separated from such transactions.

112. The Tribunal agrees with the findings in **Barclays Bank of Kenya Limited vs. Commissioner of Domestic Taxes, TAT Appeal No. 114 of 2014** that interchange fee is a fee paid by a merchant's bank (acquirer) to a card holder's bank (issuer) to compensate the issuer for value and benefit that merchants receive when they accept electronic payments. Further, the interchange service provided by the bank is a service to its customers and not the acquiring bank.

113. Additionally, the Tribunal considered **TAT No. 361 of 2018, NIC Group PLC and NIC Bank PLC vs. Commissioner of Domestic Taxes** where it was held that interchange fees received by issuing banks are not subject to VAT. The Tribunal has not found any reasonable and sound cause to depart from the same.

114. The Tribunal further makes reference to **High Court Case No. 8 of 2018, Barclays Bank of Kenya Ltd. vs. Commissioner of Domestic Taxes** where the Court concluded that interchange fees is exempt from VAT.

115. The Tribunal also relied on **Bank of Africa Limited vs. Commissioner of Domestic Taxes TAT No. 319 Of 2018** where the Tribunal found that the interchange fee in an identical transaction is VAT exempt

116. The Tribunal's considered view is that the checks and activities undertaken by the issuer are incidental to the provision of money transfer services and are, therefore, not distinct from the supply of money by the Appellant.

117. Consequently, the Tribunal finds that interchange fees are not subject to VAT as they are exempt under the VAT Act 2013.

FINAL DECISION

118. In view of the foregoing, the Tribunal finds that the Appeal is merited and accordingly proceeds to make the following Orders: -

a) The Appeal be and is hereby allowed.

b) The Respondent's Objection Decision dated 21st May 2021 in the sum of Kshs. 2,183,051.00 be and is hereby set aside.

c) Each Party to bear its own costs.

119. It is so ordered.

DATED and **DELIVERED** at **NAIROBI** on this **9th** day of **September, 2022.**

.....
ERIC N. WAFULA
CHAIRMAN

.....
ABRAHAM K. KIPROTICH
MEMBER

.....
GRACE MUKUHA
MEMBER

.....
JEPHTHAH NJAGI
MEMBER

.....
CYNTHIA B. MAYAKA
MEMBER