REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL No.114 OF2015

BARCLAYS BANK OF KENYA LIMITED.....APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. Barclays Bank (hereinafter referred to as the Appellant) carries on the business of banking and financial services. In respect to this Appeal, the Appellant is a member of networks established by various credit card companies such as VISA, MasterCard Inc. and American Express Limited (hereinafter referred to as the Card Companies). The networks enable banks, which issue their customers with credit, debit and pre-paid cards to make payments for services and goods purchased from contracted retail outlets using their credit, debit or pre-paid cards. The Appellant is one of the banks that issues the said cards to its customers and is referred to within the said network as an Issuing Bank or Issuer.
2. The said contracted retail outlets are referred to within the networks as Merchants and the Appellant which facilitates the said payments is referred to or known as an Acquiring Bank or Acquirer. In Kenya, there are a number of other Issuing Banks which issue credit or debit cards to their customers.

There are three major acquiring banks, namely, the Appellant, Kenya Commercial Bank (KCB) and Equity Bank. The Appellant operates as both an Issuer and an Acquirer in the market.

3. The Kenya Revenue Authority Act Cap 469 establishes Kenya Revenue Authority (hereinafter known as the Respondent). Its principal activities are to levy and collect taxes as provided by the Act, the Constitution and all other relevant Statutes.

4. The Respondent pursuant to its statutory obligations carried out an in-depth audit on the Appellant covering the period 2007 to 2010 years of income covering the following heads.:

    - Accounts Audit (Corporation Tax) 2007 to 2010
    - Pay As You Earn (PAYE) January 2007 to September 2011
    - Withholding Tax January 2007 to September 2011
    - VAT January 2007 to September 2011

    The Audit revealed inter-alia, that the Appellant entered into agreements with various card companies namely Visa International Services Association (VISA), Master Card incorporated (MASTER CARD) and American Express limited (AMEX). It also revealed that the Appellant was paying interchange fees to issuing banks without operating Reverse VAT on payments made to the card companies contrary to Section 6(6) and 19A of the now repealed VAT Act Cap 476.

5. The Respondent raised and communicated its assessments to the Appellant in a letter dated 5th July 2012. The Appellant objected to the Assessments in a letter dated 2nd August 2012. The Respondent

confirmed the assessments on 27th December 2012. The Appellant filed an Appeal against the confirmed assessment on 8th February 2013. The Respondent filed its Statement of Facts on 1st of March 2013.

6. The parties subsequently entered into a consent dated 10th March 2016 in respect to the Assessment covering the period January 2007 to 12th June 2009. In that Consent, the assessment for the said period amounting to Kshs.141,627,728/= as well as penalty and interest were marked as withdrawn. The Consent is contained in a letter addressed to the Tribunal dated 10th March 2016 and signed by N.S. Malik for the Appellant and Patrick Chege for the Respondent.

THE APPELANT'S CASE

7. The Appellant filed its Memorandum of Appeal and its Statement of Facts on 8th February 2013 through the Firm of Kaplan and Stratton Advocates on 8th February 2013 with the Tribunal. In its Memorandum of Appeal, the Appellant listed eleven (11) grounds of Appeal which revolve around the provision of **Sections 33(1), paragraph one of the Third Schedule, paragraph 1(b), 1(c) and subsection d, Section 6(6) and 6(7) of the Value Added Tax Act Cap 476.**

8. The Grounds of Appeal can be summarized as follows;

   i. The Respondent erred in law in holding that the fees paid by the Appellant to the Card companies are royalties.

   ii. That the Respondent's decision to treat the said fees paid by the Appellant to the said card companies as royalties had no legal basis and was null and void in light of the High Court decision in

HC Judicial review Misc. Application 1223 of 2007, Barclays Bank of Kenya v Commissioner of Domestic Taxes.

iii. The Respondent erred in law in holding that the fees paid by the Appellant to the said Card companies are not exempt from payments of VAT under paragraph 1 of the third schedule to the ACT.

iv. Payments made to card companies and Interchange fees are similarly exempt under **paragraph 1(b), 1(c), and (d) of the third schedule to the ACT** and it does not attract payment of VAT thereof.

v. Paragraph 1 of the third schedule which was in force prior to June 2009 provided that the only financial services that were not exempt from Vat were;

- Financial and management advisory services
- Safe custody services
- Executorship and trusteeship services

The Appellant was therefore wrong in holding that the fees paid by it to the Card Companies between 2009 and 12th June 2009 are not exempt from VAT.

vi. The Respondent misdirected itself in holding that payments made to the issuers by the Appellant as Interchange fees constituted a payment for taxable services.

vii. The Respondent further erred in failing to appreciate that even if the Interchange remittances paid to Issuers constituted payment

for a service, the service is exempt under the current Paragraph 1 (c) of the third schedule to the ACT.

viii. The Respondent erred in assessing the Appellant on account of either to withhold VAT on the Interchange international commission contrary to Section 6(6) as tax on imported services is payable by the person receiving it and not by the person providing the service.

ix. The Respondent misdirected itself in failing to realize that the period from the year 2007 to 11th June 2009 payments made by the Appellant were exempt as they were payments for Financial services under Paragraph 1 of the Third Schedule to the ACT.

x. The Respondent erred in law in failing to appreciate that the local Interchange fees were paid to Kenyan banks and were not imported services within the meaning of Section 6(6) of the ACT.

vi. The Respondent erred in assessing the Appellant under Section 6 (7) of the ACT as it had not appointed in writing the Appellant as its agent to collect and remit tax on behalf of unknown resident person who makes taxable supplies in Kenya.

9. The Appellant therefore urged the Tribunal to annul the Respondent's assessment.

10. In support of the above grounds of the Appeal the Appellant in its Statement of Facts dated 8th February 2013, stated that it is a limited liability company incorporated under the relevant law in the Republic of Kenya that it is licensed to carry on the business of banking and

financial services and that it has entered into agreement with VISA, MasterCard and Amex (the Card Companies) for provision of credit card services. These card companies are incorporated in the United States of America whose primary purpose is to administer a worldwide consumer system for its members which would enable its members to provide its customers with means for making payments for purchase of good and services by way of credit cards, travelers cheques and debit cards which are convenient and secure.

11. The said Card Companies operate international networks linking all their members around the world, which are variously designated **"Visanet"** for VISA, **"Mastercard Interphase Processor" (MIP),** and Amex. The Appellant further stated that the said Card Companies provide for two types of membership, which are an Issuer and an Acquirer. According to the Appellant, an Issuer is a financial institution that issues a credit or debit card to its customers whilst an Acquirer is the institution, which honors payment to a Merchant in respect to credit transactions of customers effected by way of credit or debit card.

12. The Appellant further defines a Merchant as any establishment that allows payments for its goods or services provided by the use of a Credit or Debit card. Obvious examples are Supermarkets, Petrol Stations and Restaurants. According to the Appellant a member can be both an Issuer and an Acquirer in respect of systems operated by the Card Companies and urges the Tribunal to consider it both as an Issuer and an Acquirer in the networks provided by VISA, Amex and

MasterCard with which it has entered into relevant agreements to operate the said networks.

13. The Appellant in their Statement of Facts detailed the relevant steps that are followed in carrying out a transaction using a credit or debit card.

    These steps are as follows;

    a) A customer applies to an Issuer for a credit or debit card and on successful scrutiny of the application the Issuer (in this case the Appellant) issues a VISA, Amex or MasterCard to its customer.

    b) Once the Cardholder wishes to purchase goods or services, he presents himself before a contracted retail outlet and upon purchase of goods and services, he swipes the card on a machine configured to accept VISA, Amex and/or MasterCard.

14. By swiping the card the Merchant seeks authorization through the Acquirer who in turn seeks authorization through one of the said international networks. Upon receipt of the request for authorization, the network switches the transaction from the Acquirer to the Issuer in order to enable the latter to verify the Cardholders data and credit status before issuing an authorization message back to the Acquirer.

15. Upon confirmation that all is well and that there funds in the cardholders bank account, the Acquirer sends authorization to the Merchant who generates a payment slip in duplicate with the Merchant retaining one slip while the Cardholder is furnished with his goods together with a copy of the slip.

16. To ensure that the Merchant is paid, the Merchant uploads the transaction to the Acquirer who in turn send the transaction details to any of the relevant network which information is subsequently transmitted by the network to the Issuer who sends a statement to the Cardholder.

17. The Appellant argues that the networks operated by the Card companies enable the flow of the transaction by enabling a clearing and settlement process. Visa and the other card companies ensure that the network is secure and reliable to enable efficient authorization and switching and for the clearing and settlement operations between its members.

18. The Appellant pays the card companies transactions fees in order to access and use the networks operated by the card companies. It receives invoices from the card companies in respect of which it makes payments. It alleges that the Respondent categorized the fees as royalties

19. The Appellant argues that in its letter dated 5th July 2012, the Respondent was of the view that, pursuant to Section 6(6) and Section 6(7) of the VAT Act (Cap 476), VAT was payable on the interchange fees paid by the Appellant to the Issuers.

20. The Appellant in its reply to the Respondent's letter dated 2nd August 2012, drew the attention of the Respondent to the fact that the fee paid to the card companies and the interchange fees paid to the Insurer were financial services which were exempt under the Third

Schedule of the VAT Act (cap 476) and that a decision was pending before the High Court in this respect.

21. By its letter dated 27th December 2012, the Respondent replied to the Appellant's letter dated 2nd August 2012, reiterating its position that VAT was chargeable on the Appellants payment to the card companies pursuant to Section 6(6) and section 6(7) of the Act, and for local interchange remittances and the international interchange remittances.

22. The Appellant submitted that the Respondent failed and/or neglected to explain its rationale for its decision to respond to the issues raised by the Appellant in its letter dated 2nd August 2012.

    It avers that in its letter dated 21st January 2013, the Respondent informed the Appellant that it had inadvertently omitted additional taxes from its assessment of 27th December 2012

23. The Appellant submits that the fees paid by the Appellant to the credit card companies are not royalties. The same was upheld by the High Court in **Judicial Review Misc. Application No 1223 of 2007-Barclays Bank of Kenya v Commissioner of Domestic Taxes.**

24. The Appellant submitted further that the payments made to the card companies are fees, which are exempt under the current Third Schedule of the VAT Act, and that the Third Schedule was in existence prior to 12th June 2009.

25. It was the Appellant's argument that the payments it makes to the Issuers do not constitute payment for the Issuer was providing taxable services as no service. The payments are paid as a subsidy to reduce

the cost of issuing a credit or a debit card and act as an incentive to the Issuer irrespective of whether they are local or international Issuers

26. It is the Appellant's considered opinion that the Respondent wrongfully and unlawfully claimed payment of VAT in respect of the previously mentioned payments and the Appellant is entitled to have the amended assessment dated 27th December 2002 and amended assessment dated 21st January 2003, set aside and subsequently annulled.

THE RESPONDENT'S CASE

27. The Respondent filed its statement of facts together with its bundle of documents on 1st March 2013. According to the Respondent the points at issue in this Appeal are:

    i. Whether assessment fees paid by the Respondent to VISA International Mastermind and American Express to facilitate a debit/credit card transaction are royalties and therefore chargeable to VAT.

    ii. Whether Interchange Local Commissions and Interchange fees on international commissions, that is payments made to other banks which issue credit cards, are management or professional fees for which VAT and reverse VAT respectively are chargeable

    iii. Whether assessment fees and Interchange Commissions mentioned above are financial services and as such exempted from VAT.

28. In its facts, the Respondent confirmed having undertaken the in-depth audit on the Appellant as stated above. To buttress its position, the Respondent has offered a detailed explanation from its perceptive. In this respect, it has stated as follows;

29. The card business flow audit revealed, inter alia, that the Appellant entered into agreements with various card companies, namely Visa International Services Association, MasterCard Incorporated and American Express Limited (hereinafter referred to as the Card companies). The said audit also revealed that the Appellant did not operate reverse VAT on payments made to the card companies contrary to the provision of Section 6(6) of the VAT Act.

30. The Respondent subsequently confirmed the assessment on the 27th December 2012 and thereafter the Appellant communicated its intention to appeal the decision therein.

31. The Respondent herein illustrated from their own point of view how the card business is transacted in order to give a full appreciation of the nature of services offered by the card companies and other parties involved in the transactions as follows;

    a) Issuers are banks, which are authorized to issue credit/debit cards to their customers thereby agreeing to provide the customers with credit facilities up to a certain limit and assume the risk of the bad debt.

    b) Acquirers are banks, which are authorized to enter agreements with merchants for the acquisition of credit/debit card transactions. These banks provide the merchants with their point

of sale swipe machine and will authorize the merchants to accept and honor such cards (such as a VISA card) issued by any member

c) Merchant is a business that has contracted with an acquirer for card processing services and accepts credit cards as a method of payment for goods or services.

d) Signing up and Underwriting Merchants to accept card-based payments is a key marketing function of an acquirer. This starts with soliciting merchants to accept the network-branded payment cards. The next step is the underwriting process, which ensures that the merchant meets the network requirements for financial stability and other conditions.

e) Authorization and Capture, Operationally, a critical function of the acquirer is facilitating the authorization for purchase transactions. From a merchant's perspective, authorization means that, barring future disputes, payment is guaranteed for authorized purchases.

32. The Respondent argued before the Tribunal that when a payment card is swiped at the merchant's terminal, a request for authorization along with the cardholder information and the transaction amount is transmitted to the merchant acquirer which information is forwarded through the network, which in turn queries the cardholder's issuing bank.

33. The cardholder's bank either approves or rejects the transaction based on credit or funds availability whereby if the transaction is approved, the issuing bank confirms by issuing an authorization code which is sent to the network of the merchant acquiring bank and then on to the merchant's terminal which allows the sale to proceed upto the point the customer gets their goods.

34. The Acquirer transmits the transaction data to the appropriate payment, which in turn directs the transaction to the respective card issuing banks. The issuing banks charge their customer's card account and remit funds through the network to the acquiring bank less the issuing bank fees. The fee associated with the transaction processing is called the merchant discount, which is usually 1.5% to 3.5% of the purchase amount.

35. The merchants' discount, which is paid of the total transaction for their services are made up of three components namely, the issuer, the acquirer and the payment network. The acquirer to the card-issuing bank pays the first fee called the interchange fee which is 1.5%. The second fee called dues and assessments is paid to the payment networks for their network and authorization expenses and is approximately 0.01%. The third fee, which is 0.40%, is paid to the Acquirer for their services. The Acquirer then completes the transaction by sending the remaining amount to the Merchant.

36. The Respondent has presented before the Tribunal by "**appendix 1**" a diagrammatic presentation of the above process and at "**appendix 2**" it

has shown the authoritative sources both of the definition which it has adopted and the process above.

37. The Respondent further outlined the Appellant's case, which we need not repeat as we have covered it earlier in this judgment.

THE RESPONDENT'S CONTENTION

38. The Respondent's contentions can be summarized as follows;

    i) The global network system consists of the aggregate of services established, the operational and service delivery systems together with the infrastructure that supports the system.

    ii) The clearing and settlement cost are costs incurred for use of the trademark such as VISA which facilitates the payment and expenditure between the card companies and the Appellant and the clearing and settlement between the Issuer and Acquirer.

39. It argues that a perusal of Appendix 3 in its bundle of documents which is a trademark license agreement between the owner and the Appellant and Appendix 4 which is a copy of the Mastercard license agreement together with Appendix 5 means that payments for clearing, settlement fees, returned item fees, risk monitoring non-compliant fees are all payments for the use of the trademark. On this basis the Respondent argues that those payments are royalties which is defined according to it by the ITA as follow;

    'a payment made as a consideration to use or the right to use:

    a) The copyright of a literary, artistic or scientific work; or

    b) A cinematography film, including film or tape for radio or television broadcasting; or

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

d) Any industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific equipment or experience, and gain derived from the sale or exchange of any rights or property giving rise to that royalty.'

40. It is the Respondent's argument that the above payment made to the card companies are royalties and service fees which are payments for the right to use the Global payment services which link the services to users.

41. The Respondent then proceeds to distinguish the decision of the High Court in Judicial **review case R v Commissioner of Domestic Taxes ex parte Barclays Bank of Kenya Limited (Misc. Application number 1223 of 2007)** where it was held ***"payment of the kind made by the bank to VISA International...cannot constitute royalties"*** on the basis that the facts of this case are different from the facts in the above decision.

42. The Respondent then reiterates that the Interchange fees is in the nature of management services provided by the Issuer and the Acquirer since the Issuer manages the process by confirming to the Acquirer the credit worthiness of the card holder and that therefore those services are subject to VAT and the Appellant is required to charge reverse VAT for International interchange commission and local interchange commission under Section 6(6) of the Withholding Tax Rules.

43. The Respondent wraps up its contention by urging this Tribunal to find that the assessment fees paid to the card companies is in the nature of royalties and not exempt financial services and is therefore subject to VAT and that the interchange fees paid to the Acquirer by the Issuer is a payment in relation to management fees provided by the Issuer. It finally urges this Tribunal to dismiss this Appeal and the assessment the subject matter of this Appeal to be confirmed and upheld.

THE HEARING

44. The hearing of this appeal commenced on 27th December 2015 when a Mrs. Opiyo held brief for Miss Malik for the Appellant and Mr. Patrick Chege appeared for the Respondent. Both parties requested the Tribunal to adjourn the hearing for one month in order to pursue an out of court settlement. The Tribunal then ordered that the matter proceeds to hearing on 22nd February 2016 and in the event of any settlement the parties were ordered to file a Consent thereto.

45. The parties did not record any Consent as anticipated on 22nd February 2016, they however entered a Consent which has been alluded to earlier in this judgment before the Tribunal on 11th March 2016 as a consequence of which the Respondent withdrew its claims in respect to the years of income 2007 to 12th June 2009. The withdrawal was on the basis that in the Local Committee preceding the current Tribunal VAT Appeal No.11 of 2007 between the same parties the Appellant had received a favorable judgment in respect to the claim for the same period.

46. Therefore, this Tribunal will only deal with the claim as respects the rest of the period. By consent of the parties, it was agreed that this Appeal be disposed off by way of written submissions subsequent upon which the parties will highlight those submissions.

47. In obedience to the order of this Tribunal and as confirmed by the Tribunal in its sitting of 12th July 2016 when both Miss Malik and her Team and Patrick Chege and his Team confirmed that the Appellant had filed its written submission on 29th March 2016 having filed earlier on 19th February 2016 its bundle of authorities.

48. The Appellant further filed a further bundle of authorities on 11th March 2016 and finally filed its Appellants second list of authorities on the 18th April 2016.

49. The Respondent filed its written submission on 12th April 2016 having earlier filed its bundle of authorities on 11th March 2016. The Appellant then filed a reply to the Respondent's written submissions on 11th July 2016.

50. From the above it is quite clear that the Appellant filed a lot of documents without leave of this Tribunal and though an objection was raised by Mr. Chege for the Respondent, and in our view quite rightly so we exercised our discretion in allowing the parties to proceed on the basis of all the documents on record and extended that discretion to the Respondent to respond if it elected to.

51. In its submission of 29th March 2016, the Appellant basically captures the background and process in respect of the business of banking and financial services which has been sufficiently captured earlier in this

judgment. The Appellant's perspectives of the issues in dispute in this Appeal are as follows;

a) Did the Respondent, in its demand dated 27th December 2012 specify the services in respect of which it was claiming payment of VAT?

b) If the answer to (a) above is no, did the Respondent achieve the clarity required in making a tax demand?

c) Notwithstanding and without prejudice to the above, was the interchange fees retained by the Issuing Banks a payment for provision of services to the Appellant?

d) If any services were provided by the Issuing Banks to the Appellant, were such services in any event under the provisions of the Third Schedule to the VAT Act?

e) Could interchange fees retained by local banks be subject to VAT under Section 6(6) and 6(7) of the Act?

f) Could the Appellant have withheld VAT pursuant to Section 19(A) of the Act when VAT was not chargeable and was not in fact charged by the Issuing Banks?

52. The Appellant then proceeds to capture its submissions under the above headings as follows;

a) Did the Respondent specify the service it was claiming payment of VAT?

It is not in dispute that the demand letter by the Respondent to the Appellant did not give any explanation whatsoever in respect

of the VAT demanded on interchange fees to local and international banks.

Section 5 of the VAT Act Cap 476 (now repealed) which was the Act in force at the time states that ***"A tax to be known as Value Added Tax shall be charged in accordance with the provisions of this Act on the supply of goods and services in Kenya and on the importation of goods and services into Kenya."***

53. That being the case it was incumbent upon the Respondent to clearly state which services were being supplied by the Issuing Banks to the Appellant for VAT to be chargeable on interchange fees and to clearly state which services were being imported by the Appellant from foreign Issuing Banks for VAT to be chargeable on interchange fee retained by foreign banks.

54. It is very apparent from the demand that no explanation or reasoning was provided by the Respondent. In the case of **R v Commissioner of Domestic Taxes ex parte Barclays Bank of Kenya Limited (Misc. Application number 1223 of 2007)** the Honorable Justice Majanja **Held** at paragraph 39 (page 19 of the Appellant's bundle of authorities filed on 19th February 2016) that in assessing tax, the Respondent was under a duty to identify the transactions or payments that attract tax, the Respondent is obligated by law to state with clarity its claim and how the transaction falls within the terms of the statute. The Honorable Judge concluded by stating at paragraph 39 that the Respondent's decision could not be said to fall within the statutory definition of the tax.

55. It is humbly submitted that applying the reasoning of Justice Majanja in the said decision, the Respondent's demand did not state the service in which it had demanded payment of VAT on interchange fees and that being the case VAT cannot be chargeable if the service has not been specified. As per Section 5 of the Act, VAT is charged on a supply of a service and it cannot be assumed that a service has been supplied unless it is specifically identified by the Respondent.

56. It was noteworthy that Justice Majanja's decision was in respect of interchange fees, which is the same fee that is the subject matter of this Appeal.

57. **Similarly in the case of R v Commissioner of Domestic Taxes ex parte Barclays Bank of Kenya Limited (Misc. Civil Application Number 46 of 2013),** Honorable Justice Odunga relied on Justice Majanja's decision as cited above and concluded that *"It is therefore my view that the manner in which the Respondent arrived at its decision did not meet the level of clarity required in taxation."* **(Pages 115 and 116 of the Appellant's bundle of authorities filed on 19th February 2016).** It is humbly submitted that on this ground alone, the Respondent's demand must be set aside for failing to achieve the required standard of clarity.

b) Was the interchange fees retained by the Issuing Banks a payment for provision of services to the Respondent?

The only written explanation provided by the Respondent to explain the nature of the services allegedly provided by the Issuing Banks to the Appellant is contained at Paragraph 6.18 of its Statement of Facts

where it stated that the interchange fees was in the nature of management services provided by the Issuing Banks to the Appellant.

58. In the course of the Hearing, however, before the Honorable Tribunal, the Respondent abandoned this explanation claiming that the law had been amended so the basis cited in its Statement of Facts was no longer applicable.

59. It is humbly submitted that the Respondent's reason for abandoning the basis for its claim as stated in its Statement of Facts is not credible as the Third Schedule to the VAT Act was amended on 12th June 2009. Well before the Respondent filed its Statement of Facts on 4th March 2013. Therefore, the law had already been amended by the time the Respondent filed its Statement of Facts.

60. As it stands, the nature of the services which are the subject matter before this Tribunal was not set out in the demand letter nor has it been set out in the Respondent's Statement of Facts.

61. During the hearing of the matter, the Respondent sought instead to rely on a discussion paper titled ***"The Merchant- Acquiring Side of the Payment Card Industry: Structure, Operations and Challenges"*** The Discussion paper is attached to the Respondent's Statement of Facts.

62. It must be emphasized at the outset that the paper focuses on the relationship between the Merchant and the Acquiring Bank. The Respondent, during the hearing referred to paragraph B on page 3 of the Discussion paper. The third line of the paragraph states as follows ***"In essence these activities may be seen as the services rendered by the***

Acquirer to enable Merchants to accept their customer's payment cards at the point of sale."

63. The functions performed by the Acquirers to enable the Merchants, for example, supermarkets to accept payment by credit card are set out in the said paragraph. For example, one of the services by the Acquirers (as stated in the paper) is signing up and underwriting Merchants to accept networked-branded cards. There is no mention whatsoever of Issuing Banks in the entire paragraph. This is because the services stated in the said paragraph are provided by the Acquiring Bank and not the Issuing Bank.

64. The flow chart on page 2 of the same Discussion Paper makes a distinction between the Acquiring Bank and the Issuing Bank and sets out the roles played by each bank. Similarly, Chart 2 on page 6 of the Discussion Paper also sets out the roles played by the different banks. It is therefore apparent from the Respondent's attempt to pass off the services set out at paragraph B (provided by the Acquiring Bank) as having been provided by the Issuing Bank that the Respondent has not appreciated the different roles played by the Issuing Bank and the Acquiring Bank.

65. The interchange fees that it seeks to subject to VAT is fees retained by the Issuing Banks. If the Respondent's claim is that the interchange fees is retained by the Issuing Banks to provide services to the Appellant (the Acquiring Bank) then it has to demonstrate which services are provided by the Issuing Banks to the Appellant.

66. It must also demonstrate why the Issuing Bank would provide services to the Acquiring Bank yet the person paying for the services is the Merchant and not the Acquiring Bank.

67. It cannot rely on the services set out in paragraph B of the Discussion Paper as these are clearly stated as services provided by the Appellant (Acquiring Bank) itself to Merchants.

68. The Respondent also referred to page 4 of the Discussion Paper and specifically the paragraph titled "Authorization and Capture". The last three lines of the paragraph state ***"The merchant acquirer then forwards the request through the network, which in turn, queries the cardholder's issuing bank. The cardholder's bank either approves or rejects the transactions based credit or funds availability. If the transaction is approved the issuing bank confirms the transaction with an authorization code, and the amount of the authorization is set aside from the available credit or available funds in the cardholder's account. The authorization code is sent through the network from the issuing bank to the merchant- acquiring bank and then on to the merchant's terminal.***

69. It is humbly submitted that it not stated anywhere in the entire discussion paper that the approval of the transaction by the Issuing Bank by checking its own customer (cardholders) bank account amounts to services provided by the Issuing Banks to the Appellant.

70. It is very clear that in checking its own customers account, the Issuing Bank is simply enabling its own customer to whom it has issued a credit, debit or prepaid card to complete the purchase of goods using

the said card. If these were services provided by the Issuing Bank to the Appellant, then the Discussion Paper would have clearly said so.

71. The Respondent stated that these were services that the Appellant ceded to the Issuing Bank. Firstly, the Respondent did not point out where in the Discussion Paper it states that the Appellant ceded the provision of these services to the Issuing Banks nor did it produce any agreement signed between the two banks to demonstrate that services had been ceded as alleged.

72. Secondly, and more importantly, the Respondent's argument would imply that the Appellant could have performed these alleged services itself but instead ceded them to the Issuing Banks. This is factually incorrect as the Appellant could not have performed such services.

73. The Appellant could not have checked availability of funds in the cardholder's account as the cardholder is not its customer. It is reiterated that the Charts on page 2 and 6 of the Discussion Paper clearly set out the role of each bank.

74. It is humbly submitted that the Respondent has completely failed to identify what services, if any, were provided by the Issuing Banks to the Appellant in respect of which the said Issuing Banks retain the Interchange fees.

75. There are no agreements between the Issuing Banks and the Appellant regarding the payment of interchange fees. The interchange fee is determined by the card companies themselves, for example, Visa and MasterCard.

76. The impact of the retention of interchange fees which is payable by the Merchant is only felt by the latter (Merchant) and not by the Appellant. It is the Merchant who is paid lesser money than the price of the goods he sold which is why most authorities refer to interchange fees as payment by the Merchant.

77. In the Fact Sheet on Interchange Myths and Facts (page 75) it states that, ***"Interchange is a component of the merchant discount fee, which merchants pay for the extraordinary benefits they receive when they choose to accept payment cards."*** Again in the Respondent's Bundle page 76 it is stated that, ***"Interchange fee is not paid by consumers. It is a fee paid between banks to balance costs in the payment system and is a component of the fees merchants pay".*** From the above it is clear that the interchange fee is paid by merchants because of the benefits they receive from accepting cards.

78. It is humbly submitted that given that there is no agreement between the Issuing Banks and the Appellant for provision of services, and the interchange fee is paid by the Merchant who bears the impact, no services were in fact and law provided by the Issuing Bank to the Appellant.

79. The Discussion Paper attached to the Respondent's own Statement of Facts states at page 20 that ***" The interchange fee is passed through the acquirer to the card issuing bank"*** **S.9 (3) of the VAT Act** states that ***"In calculating the value of any services for purposes of subsection (1), there shall be included any incidental costs incurred by the supplier of the services in the course of making his supply to his client provided***

that, if the Commissioner is satisfied that the supplier has merely made a disbursement to a third party as an agent, then such a disbursement shall be excluded from the taxable value."

80. It is humbly submitted that if, as stated in the Discussion Paper, the interchange fee is merely passing through the Appellant (Acquiring Bank) to the Issuing Banks then the Appellant is merely making a disbursement to the Issuing Bank on behalf of the Merchants and therefore VAT is not chargeable.

81. A service is defined in Section 2 of the VAT Act as *"any supply by way of business that is not a supply of goods or money."* Therefore, the fact that the Issuing Bank eventually enables money to be moved from its customer's account to the Merchant cannot in any event amount to a service as the supply of money is specifically excluded from the definition of a service under Section 2 of the Act.

82. Other than explanations from card companies themselves, there are also independent authorities that explain the purpose of interchange. In a paper titled *"Interchange Fees in the Courts and Regulatory Authorities"* by Howard H. Chang, it is stated at page 25 of the Appellant's bundle of authorities filed on 19th February 2016 at the last paragraph that *"The interchange fee was thus designed to perform a balancing function."*

c) If any services were provided by the issuing banks to the Appellant, were such services in any event exempt under the provisions of the Third Schedule to the VAT Act?

83. In the Discussion Paper attached to the Respondent's Statement of Facts, the Respondent referred to the services as follows ***"The cardholder's bank either approves or rejects the transactions based on credit or funds availability. If the transaction is approved the Issuing Bank confirms the transaction with an authorization code, and the amount of authorization is set aside from the available credit or available funds in the cardholder's account. The authorization code is sent through the network from the issuing bank and then on to the merchant's terminal,".***

84. The Appellant submits that even if these were services provided by the Issuing Banks to the Appellant, which is denied, the services would be exempt under paragraph 1 (a) and 1 (b) of the Third Schedule to the VAT Act. Paragraph 1 of the Third Schedule to the Act lists the financial services that are exempt.

d) Could interchange fees retained by local banks be subject to VAT under Sections 6(6) and 6(7) of the Act?

85. Notwithstanding and without prejudice to the foregoing, the Respondent in its demand has claimed payment of VAT on interchange fees to local banks on the basis of Sections 6(6) and 6(7) of VAT Act. Section 6 (6) states that *"tax on services imported into Kenya shall be payable by the person receiving the taxable service."* The Appellant submits that the application of this section to local banks is wrong in law and fact as services could not be imported from a local bank that was based in Kenya.

e) **Could the Appellant have withheld VAT pursuant to Section 19 (A) of the Act when VAT was not chargeable and was not in fact charged by the Issuing Banks?**

86. During the Hearing of the Appeal, the Respondent submitted that the Appellant ought to have withheld VAT on the interchange fee. The Appellant humbly submits that firstly, this would be practically impossible given the illustration contained in the Discussion Paper annexed to the Respondent's Statement of Facts which shows that the interchange fee is retained by the Issuing Bank from the amount that it transfers from its customer's account and therefore no amount is actually paid out by the Appellant to the Issuing Banks.

87. Under Section 5 of the VAT Act Cap 476, the person who is required to charge VAT is the supplier and not the recipient of the service. The Appellant would allegedly be a recipient of service (which is denied) and cannot be expected to charge itself VAT or withhold VAT where none has been charged.

88. Further, under Regulation 4 of the VAT Regulations, a supplier is required to issue a VAT invoice against which VAT is then withheld by the withholding agent at the point of payment. No such invoices were ever issued by the Local Issuing Banks as no services were provided by them. Section 19A(3) of the Act is very clear that the supplier of goods or services would still have to account for tax in accordance with the Act and Regulations and therefore if the Issuing Banks were providing services, they would have charged VAT and issued invoices in the manner prescribed in the Act.

RESPONDENT WRITTEN SUBMISSION

89. The Respondent in its written submission filed on 12th April 2016 details the background facts to this Appeal and reiterated the issues in dispute which were set out in this judgment earlier. The Respondent then proceeded to urge the Tribunal to consider its case as follows;

f) Was the Interchange Fee retained by the Issuing Bank a payment for provision of services to the Appellant?

90. During the Audit the Respondent established that the Appellant had entered into agreements with various Merchants for the use of card services at the Merchant's point of sale terminals and in the course of providing the services to the Merchants, the Appellant consumed services provided by other banks (herein after referred to as Issuing Banks)

The parties to a Card purchase transaction;

91. To explain the service giving rise to interchange, we begin with a description of the five parties to a typical credit or debit card purchase transaction under either the Visa or MasterCard system.

92. **Card Holder** - This is the person possessing and using a debit or a credit card. The card holder maintains a bank account with the Issuing Bank. To facilitate operation of the bank account, the Issuing Bank provides various services to the card holder and in turn charges various fees namely, Joining fees, Additional card fees, Annual fees, Replacement fees, Cash advance fee and Statement retrieval fee. It is important to note that interchange fees is not in the list of fees charged by the Issuing Bank to the card holder.

93. **The Issuing Bank** – These are banks that issue cards to cardholders. The Banks do not maintain a bank account with the acquirers. The Issuing Bank renders the following services:

- Receives the transaction information from the Acquiring Bank through the association network.
- Checks to ensure, among other things that the transaction information is valid.
- Checks to ensure the cardholder has sufficient balance to make the purchase.
- Checks to ensure that the account is in good standing.
- Responds to approving or declining the transaction.
- Reimburses the Acquiring Bank by sending funds to the Acquiring Banks.

All Issuing Banks operate under the rules provided by the respective card associations.

94. An Issuing bank issues debit or credit card to the cardholder specifying the following:

- Card association involved
- Issuing Bank's identity
- Tenure of the credit card
- An embedded electronic chip to facilitate transactions through the card
- An identification code (PIN No.)

95. **The Acquiring Bank** – This is the bank that recruits, screens and accepts merchants into the association's card systems. An Acquiring Bank

enters into Merchant agreements with merchants regarding the merchants' acceptance of cards. The banks provide services to the merchants including deployment of credit card terminals at the point of sale, back – end customer service, risk management and marketing services. These banks undertake the liability to settle payments for goods or services provided by the merchant and consumed by the card holder, irrespective of the Acquiring Bank's ability to recover such amount from the Issuing bank.

96. **The Merchant** – A merchant sells goods or services to the card holder. With respect to a card purchase transaction, the merchant has no contact with the Issuing bank. A merchant is not a customer of the Acquiring Bank in the banking business sense but merely pays a fee by way of Merchant Service Commission to such a bank

97. **The Association** (Visa, American Express or MasterCard)
These are card companies that provide infrastructure which enables credit and debit card transactions to take place. They process transactions between Acquiring and Issuing banks, allowing purchases to be authorized. Further, the associations provide the infrastructure which allows the parties to clear and settle millions of card transactions.

What is Interchange Fees and how does it arise?

98. Interchange fee is a fee paid by a Merchant's bank (Acquirer) to a card holder's bank (Issuer) to compensate the Issuer for the value and benefit that merchants receive when they accept electronic payments.

99. A card holder makes a purchase at a merchant's outlet and completes the transaction by swiping his card, employing the swipe machine provided to the merchant by the Acquiring Bank; and signs a transaction slip generated by the swipe machine. This is the point of sale (POS).

100. The network platform facilitates authentication of the card employed at the merchant and clears the use of the card for concluding the transaction. The card association network generates reports for merchant settlement and forwards these to the Acquiring Bank. The Acquiring Bank settles account with the merchant after deducting a small percentage towards discount/commission amount (ranging from 3% to 5%). This amount is called Merchant Service Commission (MSC).

101. A settlement report is forwarded to the issuing bank via the interchange network maintained by the card association, for the reimbursement to the Acquiring Bank. Out of the MSC retained by the acquiring bank, a percentage is shared with the Issuing Bank as **"interchange fee"** and with the card association as dues and assessment fees.

102. The Issuing Bank accounts for the transaction and sends the card holder monthly or periodical statements. The card holder is thereupon liable to make payment to the issuing bank, of the full value of his transaction with the Merchant.

103. After analyzing the transactional flow, it is apparent that an issuing bank, an acquiring bank and the card association network receive consideration for the participation in and facilitation of several

obligations inherent in the sequence of events contributing to successful culmination of a transaction involving the use of a card.

104. The Respondent argues that the transactional flow described above makes him conclude that this was a service and therefore brought it to charge under the now Repealed VAT Act.

g) **Was the Interchange fee retained by the Issuing Bank a payment for provision of Services to the Appellant?**

Section 2 of the Repealed VAT Act Cap 476 (VAT Act) states as follows:

"a *service is anything which is not a supply of goods but is done for a consideration"*

105. The Respondent argues that the service provided by the Appellant was a financial service. In **Barclays Bank of Kenya v the Commissioner of Domestic Taxes (VAT Appeal No.11 of 2007) (Page 9 referenced as Appendix 126 of the Appellant's Bundle of Authorities)**, the VAT Tribunal held:

"we find as a fact that the services provided by the Appellant was a financial service.."

106. Although the Tribunal found that the interchange fee was in respect of a financial service, the Tribunal did not bring the same to charge under the VAT Act because at the time the VAT Act did not define exempt financial services and therefore it was construed that all financial services were exempt. However, subsequently an amendment to the law through the Finance Act 2009 was brought in and the effect of the amendment was that any services not listed under exempt financial

services are subject to VAT. It is imperative to note that the card service has remained the same despite the various changes in the legal regime.

107. The Respondent argues that all the three parties to the transaction are paid for services they offer. MasterCard Inc. noted as follows:

".....not only that interchange fees do not undermine competition but that, in fact, they enhance it by facilitating the offering of products and services that otherwise would not exist in the market place." *(See the 1st paragraph of page 77 of Respondent's Statement of Facts Appendix 2 - The Merchant - Acquiring Side of the Payment card Industry; Structure Operations and Challenges).*

108. The Respondent further cites the case of Standard Chartered Bank and others versus CST Mumbai (See the Respondent's Bundle of Authorities) at paragraph 9 at page 6, paragraph 11 at page 11, paragraph 21 at page 41, paragraph 33 at page 55 and paragraph 38 at page 60. In all these cases the interchange fee and ME discount are considerations relatable to services provided by an Issuing bank and an Acquiring Bank. All these services are intermediary, ancillary and interdependent integers for effective use of credit cards. Services provided by an Acquiring Bank to the Merchant, and an Issuing Bank to the Acquiring Bank and are essential to the conclusion of transactions employing credit cards.

109. It is the Respondent's further Submission that Interchange fees represent compensation paid by the Acquiring Bank to the Issuing Bank as evidenced by the information contained in the Appellant's Bundle of

Authorities in paragraph 10 at page 33, paragraph 12 page 34, paragraph45 page 53 and paragraph 153 pages 116 to 117.

h) What is the Characterization of the service offered by the Issuing Banks to the Appellant?

From the Respondent's Statement of Facts at page 4 and 5 of Appendix 2, the Respondent argues that Issuing Banks perform the following activities:

110. **Authorization and Capture.** The Acquirer facilitates the authorization for purchase transactions as a guarantee for authorized purchase.

111. **Clearing and Settlement.** This is the process of collecting the funds from the Issuing Bank and reimbursing the merchant.

112. The Respondent submits that an Issuing Bank performs the following transactions in relation to effectuation of card purchase transactions:

- Receipt for request for authorization
- Approval or rejection
- Checking Credit or funds availability
- Confirmation of transaction with authorization code
- Setting aside the amount authorized
- Sending authorization code through the network on the merchant's terminal
- Agreeing to future settlement with Acquiring Bank and merchant customer
- Remittance of Funds

i) **Does the Authorization, Clearing and Settlement Service described above fall under Paragraph 1(a) or (b) of Third Schedule of the Repealed VAT Act and hence an exempt service?**

The Respondent observed that the Appellant keeps shifting their grounds of objection. In their Statement of Facts, the Appellant had relied on the **Third Schedule Paragraph 1(b), (c) and (d).** It is apparent from the written submissions that the Appellant has shifted their grounds to **paragraphs (a) and (b)** only and therefore introducing (a) as a new basis.

113. During the hearing, the Respondent submitted that Authorization, Clearing and Settlement service is a composite service which commences when an authorization request is sent to the Issuing Bank and is completed when the Issuing Bank settles the account with the Acquiring Bank.

114. The Respondent argues that **Paragraph 1 of the Third Schedule** to the now Repealed VAT Act provides for exempt financial services from VAT. Subparagraph (a) provides the following services as exempt:

The following financial services-

The operation of current, or deposit or savings accounts, including the provision of account statements:

This paragraph appears to cover operations of a bank account (Current, savings and fixed deposit).

115. The Respondent notes that the Acquirer does not maintain a bank account in the nature set out above with the Issuer. Services associated with operation of such bank accounts can only therefore be

consumed by an account holder. Interchange fees is neither a charge on an account holder nor a service consumed directly or indirectly by an account holder. In addition, there are no account statements issued by the Issuing Bank to the Acquirer of the nature stipulated under Paragraph 1(a).

116. As articulated above, the service provided by the Issuing Bank to the Acquiring Bank is a composite service encompassing a series of elements of services which together constitute the service. The Respondent submits that the composite service for which Interchange fee is paid cannot in any way fall under financial services associated with operation of a Bank account.

117. According to the Respondent, Section 1(b) of the Third Schedule of the now Repealed VAT Act provides that the following financial services are exempt:

> (a).....
>
> (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).....

118. This subparagraph deals with the issue, transfer, receipt or any other dealing with money. The services rendered by the Issuing Bank are not in the nature of issuing of money, transfer or receipt of money to the Appellant. The service involved distinct elements of services all of which must be completed to constitute the service. The Phrase *"dealing*

with money" should be interpreted *ejusdem generis* and therefore does not mean anything more than issue, transfer and receipt of money. The Appellant did not pay the Issuer for services involving issue, transfer or receipt of money.

119. The Respondent submits that authorization, clearing and settlement service cannot fall under services enumerated under paragraph 1(a) or (b) of the Third Schedule to the Repealed VAT Act. It is therefore clear that the services upon which interchange fees are paid is subject to VAT.

RESPONDENT'S RESPONSES TO APPELLANT'S SUBMISSIONS.

120. The Appellant at paragraph 11 alleges that the Respondent did not specify the service that was being subjected to VAT.

j) Did the Respondent in its Demand Letter dated 27th December 2012 specify the Service in respect to which it was claiming payment of VAT?

121. It is the Respondent's humble submission that in its letter dated 27th December 2012, the Respondent set out the issue on paragraph 4.3 headed *" VAT on Card Business"* It is not in doubt that interchange fees is payment arising out of card business and this is a fact that is not disputed by the Appellant. The letter dated 27th December 2012 was a confirmation of an assessment following an objection by the Appellant. It is instructive to note that this was not the first time the issue of interchange fee was being discussed between the Appellant and the Respondent.

122. The issue had been raised in the initial assessment by the Respondent dated 5th July 2012 at Paragraph 4.7 (See Annexure C on page 35 to the Appellant's Statement of Facts).

- The tax decision which we have referred to earlier dated 27th December 2012 and as annexed "A" in the Memorandum of Appeal and running from page 10 to 28 is the Tax Decision which is appealed from and the Appellant has not raised any issue with the Tax Decision with regard to clarity in respect to the tax, which the Respondent demands from it. Furthermore, the amount of tax demanded by the Respondent from the Appellant is derived from the Appellant's own Books of Accounts and Records which the Appellant interrogated during the Audit that it had carried out earlier.

123. We note that the Appellant has not in its Memorandum of Appeal and Statement of Facts, orally and in written submissions assailed the said Tax Decision for vagueness or lack of clarity with the result that the decision of the High Court in **Judicial Review Misc. Application 1223 of 2007 - Republic V Commissioner of Domestic Taxes Large Tax Payer's Office - Ex-Parte Barclays Bank of Kenya [2012]eKLR** does not apply to the current case.

- In our respective determination, the argument between the Appellant and the Respondent is predicated upon the type of tax, which the Respondent demands from the Appellant. The Respondent maintains that the assessment fees paid to the Appellant and any other card companies is in the nature of

royalties and therefore not exempt financial services and it is therefore subject to VAT.

124. It reinforces its position by stating that interchange fees paid to the Acquirer by the Issuing Banks is a payment in relation to management fees provided by the Issuing Bank.

125. This Appeal is not concerned with issue of payment and taxation on management fees on card business as this issue was settled at the High court between the same parties.

126. The Appellant's contention is that the fee paid by it to card companies is not royalties and therefore cannot be subjected to VAT. It argued in the alternative that payment to card services is financial services, which are exempt from payment of VAT in the Third Schedule of the repealed VAT Act.

127. On the other hand in support of its argument, the Respondent has annexed to its Statement of Facts – Appendix "B" which contains the following documents;

- Application for membership for Visa International
- Sponsorship by principal or associate member
- trademark licensee agreement duly executed by and between the Appellant and the Visa International Services

128. In addition, in Appendix "4" has exhibited;

- card member licensee agreement between the Appellant and MasterCard International
- A copy of MasterCard trademark and its description

- Other documents that have persuaded us that the Appellant enjoyed the rights and privileges of a trademark which is a royalty within the meaning of section 2(1) of Income Tax Act

129. On the other hand, the Appellant insists that the fee earned by it, is as a result of it's role as an Acquirer in the global card network system which has been defined as ***"the aggregate of services establishment that accept cards and the operational service delivery system and marketing infrastructure that support them***" which does not amount to a royalty.

APPELLANT'S REPLY TO THE RESPONDENT'S SUBMISSIONS

130. On the 11th July 2016, the Appellant filed with the Tribunal its response to the submission by the Respondent. These submissions are substantially the same as its earlier submissions. The Response can be summarized as follows.

131. The Appellant submitted that it was incumbent upon the Respondent to prove that the interchange fees was payment for a service which the Respondent should have clearly defined and that in its submission, the Respondent had failed to discharge this burden. It further submitted that it had been able to demonstrate using annexure two of the Respondent's Statement of Facts, that it is the Merchant who bears the brunt of the interchange fees as it receives payment less the interchange fees.

132. The Appellant further submitted that it had shown that the interchange fees are retained by the issuing banks.

133. Finally it submitted that it had proved that even if the interchange fee is in respect of the provision of services to the Appellant, the said services are exempt under **paragraph one (a) and (b) of the Third Schedule of the Act** and that the Respondent has not proved that those services are not exempt. It therefore urged the Tribunal to allow its Appeal.

ISSUES FOR DETERMINATION

134. Having considered all the documents and written submissions together with the parties oral presentation, the Tribunal summarizes the issues for determination as follows;

i) Were the fees paid by the Appellant to the Card companies for facilitating a debit/credit transaction royalties, which attract payment of VAT in accordance with the applicable law?

ii) Was the Respondent's assessment dated 27th December 2012 which is the subject of this Appeal couched with such clarity to warrant the Respondent to levy tax upon the Appellant?

iii) Are interchange local commission and interchange fees an international commission, management or professional fees for which VAT and reverse VAT respectively are chargeable?

FINDINGS AND ANALYSIS

135. Having considered all the materials before it, the Tribunal's response to the above interrogations is as follows:-

k) **Were the assessment fees paid by the Appellant to the Card companies for facilitating a debit/credit transaction royalty,**

which attract payment of VAT in accordance with the applicable law.

The Tribunal makes a definite finding that the use of the debit/credit card is essentially and effectively enabled by the global network system which is the ***"aggregate of services establishing the operational, and service delivery systems together with the infracture that support the system".***

The clearing and settlement costs are the costs incurred for use of the trademark such as visa, which facilitate the payment and expenditure between the cards companies and the Appellant and the clearing and settlement between the Issuer and Acquirer. There is sufficient evidence in support of the Respondent's claim that the payment for clearing, settlement fees, returned item fees, risk monitoring noncompliance fees are payments for the use of the trademark.

136. The Appellant does not dispute the fact that there is a formal trademark license agreement between the card companies and itself, which are appendices 3, 4, & 5 of the Respondent's Bundle of Documents.

137. For a Trademark to be valid, it could be either registered or not. Its clear that this trademark belongs to the global card companies. In intellectual property law, the use of this trademark attracts a payment, which is defined as a royalty in law. Collins dictionary defines a royalty as;

"Payment made to someone whose invention, idea or property is used by commercial companies"

138. This begs the question as to whether a trademark is a royalty within the provision of the Income Tax Act which by Section 2(1) defines it as;

'a payment made as a consideration to use or the right to use:

a) The copyright of a literary, artistic or scientific work; or

b) A cinematography film, including film or tape for radio or television broadcasting; or

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

d) Any industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific equipment or experience, and gain derived from the sale or exchange of any rights or property giving rise to that royalty.'

139. The Tribunal is hereby satisfied that in the absence of the use by the Appellant of the trademark license between it and the card companies, it would not be entitled to use the global payment services which link it to other users and therefore payment made to the Appellant in this regard is a royalty in law.

140. **Was the Respondent's Assessment dated 27th December 2012 which is the subject of this Appeal couched with such clarity as to warrant the Respondent to levy tax upon the Appellant.**

141. The Tribunal acknowledges that the Respondent issued the Appellant with a Notice under Section 85 of the Income Tax Act (ITA) dated 27th December 2012 which was making reference to the Objection to

the assessment No.03052007001865 for the year of income 2007, whereby the Respondent gave Notice of Confirmation of the Amended Assessment amounting to Kshs.761,797,375/= as per the attached worksheet which was payable on or before 30th April 2008. In addition, the Respondent also served Notices as shown in appendices 31, 33 and 35.

142. The Tribunal, from the records availed to it has noted that the Appellant alleges that the said notices did not give any explanation whatsoever in respect of the VAT demanded on the interchange fees, but a quick look at the said notice, reveals that the Respondent did indicate the legal authority under section 6(6) and 6(7) bestowed upon it as the basis for demanding the said VAT.

143. Interestingly, the Appellant still held that the Respondent failed to explain the nature of services that the Appellant offers to warrant the levying of taxes, either in the demand letter or in its Statement of Facts.

144. Furthermore, the Appellant wanted to dismiss the position held by the Respondent during the hearing where it shifted to base its argument to a discussion paper titled ***"The Merchant-Acquiring Side of the Payment Card Industry: Structure" Operations and Challenges'*** which according to the Appellant, focused on the relationship between the Merchant and the Acquiring Bank. This authority was misplaced as it did not discuss issuing Banks under which the Appellant falls.

145. It is the evidence of the Appellant that the impact of the retention of the interchange fees from the price payable for the purchase is felt by

the Merchant and not the Appellant and no services were in fact or in law provided by the Issuing Banks to the Appellant. Further, the Appellant submitted that there was no agreement between the Issuing Banks and the Appellant for the provision of services

146. The dispute therefore revolves around the clarity of the said notice which according to the Appellant, did not elaborate as to what kind of services the Appellant had offered to attract VAT as per the Act then.

147. The Tribunal notes that the Appellant relied on the case of **R v Commissioner of Domestic Taxes ex Parte Barclays Bank of Kenya Limited (Misc. Application no 1223 of 2007)** whereby J. Majanja stated that in assessing tax, the Respondent was under a duty to identify the transactions or payments that attract tax liability and that the Respondent is obligated by law to state with clarity its Claim and how the transaction falls within the terms of the Statute.

148. Again, the Appellant relied on the case **of R v Commissioner of Domestic Taxes ex Parte Barclays Bank of Kenya Limited (Misc. Application no 46 of 2013)** whereby Odunga J. relying on Justice Majanja's decision concluded that;

"It is therefore my view that the manner in which the Respondent arrived at its decision did not meet the level of clarity required in taxation"

149. On the other hand the Tribunal notes that the Respondent relied on **Section 2 of the VAT Cap 476 (repealed) which defines "services" to mean;**

(a) any supply by way of business that is not a supply of goods or money; or

(b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right), but does not include a service provided by an employee to his employer for a wage or salary which read together with Section 6(6) on services imported into Kenya shall be payable by the person receiving the taxable service.

Section 6(7) provides that Notwithstanding the provisions of subsection (6), where the supplier of a service to which that subsection applies is normally resident outside Kenya, the Commissioner may, by notice in writing, appoint a person who is normally resident in Kenya, as an agent for collecting the tax payable on the service and remitting it to the Commissioner.

149. The Respondent submitted that, it was able to establish during the Audit that the Appellant had entered into agreements with various merchants for the use of card services at the merchant's point of sale terminals. In the course of providing the services to the merchants the Respondent was able to determine that the said services provided by other banks were consumed by the Appellant as the ***"Issuing Bank".***

150. Both parties are in agreement as to the steps taken in the card transactions which have already been captured hereinbefore.

151. It is imperative now for the Tribunal to analyze from the steps outlined above whether they meet the specifics or qualifications for services as

defined under Section 2 of the VAT Act Cap 476 (repealed) as read together with Section 6(6) of the same Act.

152. There is no dispute from both sides that services were truly rendered by the Appellants in the course of discharging or operating its business. The argument being advanced by the Appellant is that the Respondent's letter dated 27th December 2012 did not specify the service with clarity in respect of which it was claiming payment of VAT as shown in Appendix A from page 7 to 39 of which on Page 38, there is an item for interchange International and local commissions under clause 14 and 15 of the spreadsheet.

153. In the same letter at page 4 of Appendix A page 10, the Respondent had tried to outline the kind of services the Appellant was offering to its customers in terms of its business. The Tribunal wishes at this junction to cite part of the said letter which provides that;

"BBK entered into contractual arrangements with Visa, American Express and MasterCard companies to define the mode of operation between the card companies and BBK. Fees are charged mostly based on the volume of transactions going through the companies' system at any given time. BBK makes payments to the card companies for use of their systems, for facilitating transactions ...".

154. Therefore, when the Appellant complains that the said letter did not have any clarity as to what was being levied in terms of VAT, then one wonders whether they expected the Respondent to keep on repeating the same for each head of tax it was levying as this then, would leave the letter untidy, clumsy and repetitive.

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

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

157. Having determined that the payment made to the Appellant for the use of the global service network are in the form of royalty it is therefore not necessary to decide on whether those payments are management or professional fees.

158. Before concluding, we wish to commend Ms Malik for the Appellant and Mr Chege for the Respondent for a stellar performance, industry and labour in their articulate presentation of their respective positions in this appeal. Indeed, the voluminous documents presented by them to the Tribunal has greatly assisted it in demystifying and addressing the issues before it with considerable clarity.

159. The upshot therefore is that the Respondent's assessment contained in a letter to the Appellant dated 27th December 2012, is hereby upheld and the Appeal is therefore dismissed.

This was a complex appeal involving extensive research, attention to detail and considerable effort and industry by both parties and we therefore find that it is only fair that each party bears its costs of this Appeal.

160. It is so Ordered.

161. Right of Appeal explained.

DATED and DELIVERED at NAIROBI this 16th day of March 2018

In the Presence of:-

Nazima Malik ..... **for the Appellant**

Raphaela Muluka ..... **for the Respondent**

.....
A.G.N. KAMAU
CHAIRPERSON

.....
GEOFFREY K.C. KATSOLEH
MEMBER

.....
WILFRED N. GICHUKI
MEMBER

.....
PHILOMENA N. KIROKEN
MEMBER