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Indirect Tax Alert

Kenya's Tax Appeals Tribunal holds interchange fees received by issuing banks are exempt from VAT

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Executive summary

Kenya's Tax Appeals Tribunal (TAT) on 31 March 2020, following an appeal filed by NIC Group PLC and NIC Bank PLC against the Commissioner of Domestic Taxes, made a determination that interchange fees received by issuing banks are not subject to value-added tax (VAT).

Detailed discussion

NIC Group PLC and NIC Bank PLC appealed to the TAT based on an objection decision received on 5 October 2018 demanding KSh84,837,281 relating to VAT on interchange fees. The key issue for determination by the Tribunal was whether interchange fees are subject to VAT as per the *Value Added Tax Act, 2013* (VAT Act, 2013).

The Appellant argued that the interchange fees received are not consideration for a service provided by the Appellant to either the acquiring bank or the merchant. To resolve this dispute, the Tribunal had to determine three main questions:

1. What is an interchange fee?
2. For what service was this fee received?
3. Is it a taxable service?

1. What is an interchange fee?

The Tribunal relied on the case of ***Barclays Bank of Kenya Limited v Commissioner of Domestic Taxes TAT Appeal No 114 of 2014*** where the Tribunal determined that an interchange fee is a fee paid by a merchant's bank (acquirer) to a card holders' bank (issuer) to compensate the issuer for value and benefit that merchants receive when they accept electronic payments.

2. For what service was this fee received?

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

3. Is it a taxable service?

Receipt of interchange fees by the Appellant falls outside the scope of a royalty payment. There is no justification for the Appellant to receive a royalty from acquiring banks since it does not own the Visa platform. Therefore, the service provided is a money transfer-related service undertaken for the Appellant's customer, which is an exempt service under the First Schedule of the VAT Act, 2013.

Based on the findings above, the Tribunal granted the appeal and made the following orders:

i) Interchange fees received are not subject to VAT as they are exempt under the *VAT Act 2013*.

ii) The cardholder verification process is not distinct from the supply of money by the Appellant.

iii) The interchange fees received by the Appellant is not a royalty payment.

Next Steps

This determination is a positive development for many issuing banks that receive interchange fees for card transactions. It is a precedential decision that should be considered in the future treatment of interchange.

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