

Kenya's Tax Appeals Tribunal issues landmark ruling on chargeability of Excise Duty on various income streams

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration [here](#).

Also available is our [EY Global Tax Alert Library](#) on ey.com.

Executive summary

Kenya's Tax Appeals Tribunal (TAT) issued a ruling, on 30 July 2020, that certain fees and commissions are not subject to excise duty following an appeal by a Kenyan financial institution represented by its tax agent, Ernst and Young LLP (Kenya). The ruling was recently released to the general public.

Detailed discussion

Background

Excise duty on "other fees" was introduced through the *Finance Act 2012*, and the term "other fees" was defined to include, any "fees, charges, or commissions charged by a financial institution relating to their licensed financial institutions but does not include interest on loan."

This definition was, however, lacking in the sense that it did not provide a definition of the term "interest." This omission resulted in different financial institutions adopting the definition provided by the *Income Tax Act (ITA)*, the literal interpretation among other sources.

The Kenya Revenue Authority (KRA), on the other hand, adopted a very strict interpretation and went ahead to assess any financial institution whose tax treatment did not conform to its interpretation.

The KRA in 2016 assessed the appellant on various "fees" including moratorium fees and flexi charges, which the revenue authority deemed ought to have been subject to excise duty. The taxpayer (Appellant) did not agree with the position that was adopted by KRA and appealed to the TAT.

Appellants' position

The Appellant argued that the items on which the Respondent had levied excise duty were interest in nature and as such were exempt from excise duty as per the provisions of the Paragraph 4 of Part II of the First Schedule to the *Excise Duty Act (EDA), 2015* and Paragraph 7 of Part III of the Fifth Schedule to the *Customs and Excise Duty Act (now repealed)*.

The Appellant's positions were based on the following grounds:

- a) The *Excise Duty Act, 2015* and the *Customs and Excise Duty Act (now repealed)* do not define "interest." This being the case, the Appellant relied on the definition provided in the ITA.
- b) The income in contention was derived from loans extended to customers and its substance was such that it was a return on a credit facility in the nature of interest.
- c) The definition provided by the ITA implied that interest incorporated all charges incidental to advancing any loan or credit facilities.
- d) In the absence of an express definition in the local tax jurisdiction, a taxpayer can rely on an internationally accepted definition such as the Organisation for Economic Co-operation and Development Guidelines which define "interest" as, inter alia, "income from debt claims or every kind, whether or not secured by mortgage or whether or not carrying a right to participate in the debtor's profits."

KRA's position

The KRA, on the other hand, relied on the following grounds to support its position:

- a) The said fees were categorized under "fees and commissions" in the Appellant's Audited Financial Statements (AFS).
- b) The income was deducted upfront at the loan processing stage and was therefore not deemed to be interest.

- c) Interest can only accrue after a loan has been granted which implied that the "fees" in contention did not meet this criterion.
- d) The categorization of the income in the AFS under "fees and commissions" implied that the "fees" were not interest.
- e) The "fees" were not based on the prevailing interest rates as published by the Central Bank of Kenya (CBK).
- f) That the definition of various categories of incomes earned by financial institutions is provided in the CBK Prudential Guidelines.
- g) The ITA is a different tax legislation and could not be relied upon in determining the definition to be applied under the EDA.

Tribunal's ruling

The Tribunal determined that:

- a) The *Finance Act, 2012*, which introduced excise duty on other fees by financial institutions was marred by ambiguity.
- b) The CBK Prudential Guidelines do not provide definitions but instead provide categories of income for purposes of the preparation of AFS.
- c) The KRA which has the sole mandate of administering all taxes in Kenya cannot purport that the same item of income can be interpreted differently under different tax legislations yet there was no unique definition provided in each tax legislation.
- d) The explanations provided by the Appellant made it clear that the said "fees" were of interest in nature.

Implications

In conclusion, the Tribunal allowed the appeal and set aside the Respondent's objection decision.

This is a landmark ruling that has set a firm ground on the interpretation of tax statutes and the importance of clear and express definitions in the relevant tax legislations. It has also highlighted the importance of understanding the underlying nature of items of income and expenses in deducing the appropriate tax treatment.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (Kenya), Nairobi

- ▶ Francis Kamau francis.kamau@ke.ey.com
- ▶ Christopher Kirathe christopher.kirathe@ke.ey.com
- ▶ Hadijah Nannyomo hadijah.nannyomo@ke.ey.com
- ▶ Ann Magondu ann.magondu@ke.ey.com
- ▶ David King'ori david.kingori@ke.ey.com
- ▶ Robert Maina robert.maina@ke.ey.com
- ▶ Grace Muchiri grace.muchiri@ke.ey.com

Ernst & Young Société d'Avocats, Pan African Tax - Transfer Pricing Desk, Paris

- ▶ Bruno Messerschmitt bruno.messerschmitt@ey-avocats.com
- ▶ Alexis Popov alexis.popov@ey-avocats.com

Ernst & Young LLP (United Kingdom), Pan African Tax Desk, London

- ▶ Byron Thomas bthomas4@uk.ey.com

Ernst & Young LLP (United States), Pan African Tax Desk, New York

- ▶ Brigitte Keirby-Smith brigitte.f.keirby-smith1@ey.com
- ▶ Dele Olagun-Samuel dele.olaogun@ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Indirect Tax

© 2020 EYGM Limited.
All Rights Reserved.

EYG no. 006528-20Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com