

Kenya's Tax Appeals Tribunal rules VAT is applicable on sale of commercial property, loan-related fees are not subject to excise duty

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Executive summary

On 23 October 2020, the Kenyan Tax Appeals Tribunal (TAT), ruled that excise duty on financial services was not applicable prior to July 2013. The TAT also ruled that loan appraisal and loan commitment charges fall within the definition of interest and are not subject to excise duty and that Value Added Tax (VAT) is applicable on the sale of commercial property.

Detailed discussion

Background

The Appellant, a local financial institution filed an appeal at the TAT against the Kenya Revenue Authority (KRA) following an assessment that was preceded by an audit of its financial records. The following matters were in dispute:

1. Applicability of excise duty on "other fees" between January and June 2013
2. Whether loan-related charges fall within the ambit of excise duty
3. Whether VAT was applicable on the sale of commercial property

The Appellants' position

Excise duty

The Appellant submitted that the Respondent erred in its assessment of the excise duty liability due to the following positions:

- ▶ The *Finance Act 2013* did not provide a definition of interest or other fees. The Appellant therefore relied on the definition of interest as provided for in the *Income Tax Act* (ITA). Section 2 of the ITA defines interest as:

“Interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes a premium or discount by way of interest and commitment or service fee paid in respect of any loan or credit.”

- ▶ Commitment and loan processing fees fall within the ambit of the legal definition of interest based on the ordinary meaning of the word and are therefore not subject to excise duty.

The Appellant thus contended that it is incorrect and inequitable for the Respondent to attempt to assess excise duty on the Appellant.

VAT on sale of buildings

The Appellant asserted that buildings attached to land are part and parcel of the land and are therefore exempt from VAT as provided in Paragraph 8 of Part II of the First Schedule of the *VAT Act*.

This assertion was supported by the ruling in a similar matter at the High Court of Kenya. See *David Mwangi Ndegwa v Kenya Revenue Authority [2018] eKLR*.

The Respondent's position

Excise duty on interest and interest-related fees

The Respondent contended that the law was explicit that any fees, commissions or charge that did not comprise interest earned by a financial institution should be subject to excise duty.

The Respondent further highlighted that the effective date for the collection of excise duty on financial services as envisaged by the Finance Bill, 2012 was 1 January 2013 and therefore the Respondent had no power to modify that date.

VAT on sale of commercial buildings

The Respondent also contended that VAT on the sale of commercial properties was charged in accordance with the provisions of the *VAT Act, 2013*.

In the Respondent's reasoning, the sale of commercial properties is a taxable supply as defined in the *VAT Act*. Furthermore, the commercial premises used in the furtherance of the Appellant's business do not fall under Part II of the First Schedule of the *VAT Act* which states:

The supply of the following services shall be exempt supplies:

8. Supply by way of sale, renting, leasing, hiring, letting of land or residential premises;

“residential premises” means land or a building occupied or capable of being occupied as a residence, but not including hotel or holiday accommodation.

The Respondent further stated that the Appellant should not refer to the ITA on the distinction between land and buildings and infer the interpretation for purposes of determining the chargeability to VAT.

Tribunal's Decision

Whether Respondent erred in applying excise duty on interest and interest-related fees prior to July 2013

The Tribunal found that the Respondent erred in applying excise duty on interest and interest-related fees prior to the introduction of the *Finance Act, 2013*. The *Finance Act, 2012* failed to provide a clear definition of “other fees” creating ambiguity and such ambiguity must be interpreted in favor of the Appellant.

Whether Respondent erred in applying excise duty on interest and interest-related fees post July 2013

The Tribunal found that the Respondent erred in assessing excise duty on these fees since the definition of other fees introduced through the *Finance Act, 2013* excludes interest from the ambit of excise duty. The Tribunal relied on the case of *Co-operative Bank of Kenya Limited versus Commissioner of Domestic Taxes in Tax Appeal No. 45 of 2017* and held that in the absence of a definition of the term “interest” under the *Excise Duty Act*, inference of an operational definition is found in the ITA.

Whether Respondent was justified in charging VAT on the sale of commercial property

The Tribunal ruled that the Respondent was justified in charging VAT on the sale of the commercial property. This is because, despite the decision in *David Mwangi Ndegwa v Kenya Revenue Authority* [2018] eKLR, in which the court held that VAT is not payable on sale of land with commercial property, the Tribunal noted that there was a stay of execution of the declaratory orders by the High Court pending determination by the Court of Appeal.

Next steps

This is a landmark ruling that has set precedent on the interpretation of tax statutes and the importance of clear and express definitions in the relevant tax legislation.

Furthermore, the TAT has clearly ruled that loan-related charges are a component of interest therefore not subject to excise duty.

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