

Excise Duty on M-pesa Transactions, Interchange Fees and Income from Credit cards



Summary

This alert brings to your attention the Tax Appeals Tribunal's ("the TAT" or Tribunal") judgement in the case of Sidian Bank Kenya Limited (Appellant) vs. Commissioner of Domestic Taxes (Respondent) on the imposition of Excise Duty on M-pesa transactions, interchange fees and income from credit cards.

Facts

The Respondent conducted an audit of the Appellant's tax affairs which included an audit of Excise Duty returns for the period January 2016 to September 2018. Following the audit, the Respondent issued an assessment demanding unpaid Excise Duty amounting to KES 48,130,740. The Appellant acknowledged underpayment of KES 29,910,488 settled the same and lodged an objection on the balance. The Respondent confirmed the assessment of KES 10,000,058 as follows:

1. Excise duty amount of KES 2,529,548 relating to commission income from M-pesa on the basis that the commission was earned from the provision of transacting infrastructure in line with the Appellant's licensed financial services and hence fell within the purview of "other fees" subject to Excise Duty.
2. Card interchange fees amounting to KES 532,777 on the basis that the fees fall under the ambit of "other fees" as defined in the Excise Duty Act hence subject to Excise Duty.
3. Credit card cash advance fee of KES 38,028 on the basis that the fees fall under the scope of "other fees" as defined by the Excise Duty Act hence subject to Excise duty.
4. Management fees from Sidian Bank Insurance Agency Ltd (SIAL) of KES 18,062 on the basis that management fees are subject to Excise Duty.
5. The balance of KES 6,881,643 as the penalties and interest charged by the Respondent.

The Appellant being dissatisfied with the objection decision, appealed to the TAT on Excise Duty on M-pesa commission, interchange fees and interest on credit cards.

The Appellant's key arguments before the Tribunal were that:

- i. Excise Duty on M-pesa commission- Commission earned from the provision of transacting infrastructure was outside the purview of 'other fees' chargeable to Excise Duty because the bank was acting as a 'super-agent' on Safaricom M-pesa platform. The provision of the transacting infrastructure by the Appellant did not qualify as a licensed activity for banks under the Excise Duty.
- ii. Excise Duty relating to card interchange fees - the Appellant contended that the card fees earned from international transactions with non-resident banks related to exported services and were therefore exempt from Excise Duty. Charging of Excise Duty

on the interchange fee would amount to double taxation as such fees had already been deducted by the acquirer banks (the customer facing banks) and Excise Duty, if any, accounted for in line with global practice.

- iii. Excise Duty on interest earned from credit cards - the Appellant contended that interest on loans was excluded from the definition of 'other fees' under the Excise Duty Act and therefore was not subject to Excise Duty.

In response to the Appellant's arguments the Respondent submitted as follows:

- i. Excise Duty on M-pesa commission- All activities carried out by the Appellant were licenced and authorised therefore the M-pesa services constituted the Appellant's core business. In addition, the commissions earned by the Appellant were from services that fell within the definition of commission and agency services relating to money transfer services under the Excise Duty Act and were therefore subject to Excise Duty. Further in response to allegations of double taxation, the Respondent asserted that its role was confined to the implementation of tax and the fact that the main item was subject to the same tax when passed through different hands, did not exempt it from taxation unless the law provided that the tax was final.
- ii. Excise Duty relating to card interchange fees - the Respondent asserted that the Appellant recognized the interchange fees earned as income in its own financial statements under the category of 'other fees' and it was on that basis that it sought to charge Excise Duty.
- iii. Excise Duty on interest earned from credit cards- the Respondent contested that interest income from credit cards forms part of 'other fees' hence subject to Excise Duty. According to the Respondent, the definition of other fees includes "any fees, charges or commissions charged by a financial institution but does not include interest on loan or return on loan".

Issues for determination

The Tribunal examined the submissions of both parties and determined that the following were the issues for determination:

- a. Whether the amount demanded in the Respondent's letter of Objection Decision was erroneous;
- b. Whether commissions earned by the Appellant from M-pesa transactions are subject to Excise Duty;
- c. Whether card interchange fees are subject to Excise Duty; and
- d. Whether interest income from credit cards is subject to Excise Duty.

Findings

a. Whether the Amount demanded in the Respondents Objection Decision was erroneous

The Tribunal reconciled the amounts as demanded by the Respondent against the amounts that the Appellant claimed to be due and the difference was determined to be the penalties and interest charged by the Respondent.

As no evidence of the grant of waiver for the penalties and interest had been presented by the Appellant, the Tribunal assumed that such waivers were not granted and therefore adopted the figure of KES. 10,000,058 being the balance outstanding after the Appellant had paid the taxes that were not in dispute.

b. Whether commissions earned by the Appellant from M-pesa Transactions are subject to Excise Duty.

To determine this issue, the Tribunal relied on its decision in the case of African Banking Corporation V Commissioner of Domestic Taxes Tax Appeal No 29 of 2019 where it determined commissions earned by banks from M-pesa transactions are other fees and are subject to Excise Duty.

c. Whether card interchange fees earned by the Appellant were subject to Excise Duty

The Tribunal upheld its ruling in Appeal No. 246 of 2019 Barclays Bank of Kenya Ltd vs Commissioner of Domestic Taxes where it determined that VISA commissions and interchange fees earned from international card transactions are exported services and therefore exempt from Excise Duty in so far as the consumers of the services are located outside Kenya. The Tribunal further clarified that interchange fees earned in respect of local transactions are however subject to Excise Duty.

d. Whether interest income from credit cards is subject to Excise Duty

On this issue, the question then before the Tribunal was whether interest income from credit card interest/return on a loan or in the context of a fee is "other fees" as envisaged in the Excise Duty Act.

The Tribunal relied on Black's Law Dictionary definition of the term "loan" as follows:

"anything furnished for temporary use to a person at his request, on condition that it shall be returned, or its equivalent in kind, with or without compensation for its use; or

"the creation of debt by the lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor."

In applying the two definitions, the Tribunal held that interest income from credit cards was more in the nature of an interest on loan or return on loan than a fee, charge, or commissions charged by financial institution.

Noting that interest on loan is exempt from Excise Duty, the Tribunal determined that the Respondent erred in charging Excise Duty on interest from credit cards.

Our opinion on the judgement

This judgement reinforces the Tribunal's past consistent pronouncements on chargeability of Excise Duty on the various bank transactions.

To illustrate this consistency, the finding that exported services provided to merchants outside Kenya are not chargeable to Excise Duty reaffirms the Tribunal's position in **Barclays Bank of Kenya Limited v Commissioner of Domestic Taxes Appeal Number 137 of 2016**. In the Barclays case, the Tribunal determined that exported services were not subject to Excise Duty under the Repealed Customs and Excise Duty Act and that taxation could only be done on the premise of clearly worded and unambiguous provisions which were absent in the matter at hand.

Further, the reliance of the Tribunal on its decision in **African Banking Corporation V Commissioner of Domestic Taxes Tax Appeal No 29 of 2019** to determine that commissions earned by banks from M-pesa transactions are other fees and are subject to Excise Duty also points to the consistency mentioned above.

This judgement also gives significant clarity on the recurring contentious issue around the definition of the term "loan" in the context of the scope of lending fees and bank charges under the Excise Duty Act. The judgement clarifies that interest on loans is not subject to Excise Duty. The position in this judgement affirms the recent decisions of the Tribunal in the **Cooperative Bank** and **National Bank** cases.

It is not a surprise that the Finance Bill, 2021 now seeks to amend the definition of "other fees" by deleting the words "fees or commissions earned in respect of a loan." The proposed amendment will hopefully clarify with finality that such fees and commissions are not subject to Excise Duty.

KPMG is happy to assist on any issues arising from this decision.

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