

# Tax Alert

## VAT on Land and Commercial Buildings and Excise Duty on “other fees”



### Summary

This Alert brings to your attention the High Court's judgment in the case of **the National Bank of Kenya Limited (NBK) vs Kenya Revenue Authority (KRA) (Income Tax Appeal Nos E155 & 533 of 2020)**.

KRA initially demanded **KES 573,384,525** relating to Capital Gains Tax (CGT), Value Added Tax (VAT) and Excise Duty from NBK. It later revised the demand and issued a notice of additional assessment for **KES 430,356,551**.

NBK raised an objection against the additional assessment and subsequently KRA issued its objection decision. In the decision, KRA confirmed the VAT assessment on land and commercial buildings and Excise Duty on loan processing fees (Other Fees).

NBK appealed to the Tax Appeals Tribunal (Tribunal) and a decision was issued on 23 October 2020. The Tribunal decided in favour of KRA that VAT applies on land and commercial buildings. The Tribunal on the other hand decided in favour of NBK that Excise Duty was not payable on Other Fees.

KRA and NBK disagreed with the Tribunal's decision and filed appeals at the High Court. On 26 May 2022, the High Court ruled that VAT applies on commercial buildings and the land on which the buildings were erected. The High Court also determined that Excise Duty was applicable on Other Fees from 18 June 2013.

### Background

KRA carried out an audit on NBK for the period January 2013 to December 2015 and assessed NBK for the period audited. NBK objected to the tax assessment but the KRA dismissed the objection on the grounds that it was invalid.

KRA argued that the objection did not meet the provisions of Section 51 (3) of the Tax Procedures Act, 2015 (TPA) which provides that taxpayers can only lodge a valid tax objection application if they settle the tax liabilities that are not in contention. NBK rebutted this argument, arguing that they had applied for an extension of time to settle their tax liabilities in instalments under the provisions of Section 33 (4) of the TPA.

KRA also demanded VAT on disposal of NBK's property amounting to **KES 58,868,988.08** based on paragraph 8 of Part II of the First Schedule of the VAT Act, 2013 (VAT Act). KRA argued that VAT applied on commercial premises and the land on which the premises were built. NBK countered this interpretation, arguing that the transaction was exempt from VAT.

Furthermore, KRA demanded **KES 405,677,877.60** relating to Excise Duty on loan processing fees (Other Fees) on the basis that the fees were subject to tax with effect from 9 January 2013 in line with the provisions of the **Finance Act, 2012**. NBK contended that the **Finance Act, 2012** did not define **other fees** and **financial institutions** and hence there was ambiguity. NBK was of the opinion that the tax came into effect on 18 June 2013 through the **Finance Act, 2013** which defined these terms.

NBK and KRA were each partly successful when the case was determined by the Tribunal on 23 October 2020. The parties appealed against the aspects that they were unhappy with at the High Court.

### NBK's grounds of appeal at the High Court

NBK argued that:

1. It lodged a valid objection to the additional assessment raised by KRA. NBK reiterated that taxpayers can be allowed an extension of time within which they are to pay the tax due. KRA technically agreed to receive the taxes due in instalments since they generated the Payment Registration Numbers (PRNs) for NBK to use in making the payments.
2. Disposal of commercial property was exempt from VAT based on paragraph 8 of Part II of the First Schedule to the VAT Act. Further, VAT on commercial land and buildings had been stayed in **David Mwangi Ndegwa vs Kenya Revenue Authority (2018) eKLR**; and
3. Excise Duty on Other Fees was not applicable for the period 9 January 2013 to 31 July 2013. This is because the Finance Act, 2012 which introduced the Excise Duty on Other Fees did not define the term “other fees” and the term “financial institutions” hence causing ambiguity.
4. Additionally, NBK argued that the Other Fees which included commitment fees and loan processing fees were incidental costs in advancing loans and therefore constituted interest as defined by the Income Tax Act. Interest is exempt from Excise Duty.

### KRA's grounds of appeal at the High Court

KRA argued that:

1. NBK's additional assessment objection was invalid since it contravened Section 51 (3) of the TPA that requires all taxpayers to pay taxes that are not in dispute before lodging an objection;
2. VAT was chargeable on the sale or letting of commercial property. The same is a taxable supply under Section 2 (1) and Section 13 (3) of the VAT Act. There is no ambiguity in paragraph 8 of Part II of the First Schedule of the VAT Act since sale or letting of commercial buildings is not expressly exempted from VAT; and,
3. Excise Duty was due on other fees charged by financial institutions for the period 9 January 2013 to 31 July 2013 with effect from 9 January 2013 as introduced by the **Finance Act, 2012**.

### Issues for determination

The High Court observed that there were three matters for determination, namely:

1. Whether NBK's objection application was valid;
2. Whether VAT was chargeable on sale or letting of commercial buildings; and
3. Whether Excise Duty was applicable on Other Fees.

## High's Courts determination

The High Court decided the above issues as follows:

1. NBK's objection application was valid. KRA did not expressly decline NBK's request to pay the undisputed tax in instalments. KRA agreed to accept the instalments by its own conduct of generating PRNs and receiving the payments.
2. VAT is chargeable on sale or letting of commercial land and buildings since these supplies are not expressly listed as exempt supplies in the VAT Act. Parliament was deliberate in excluding commercial properties from VAT exemption. The **David Mwangi Ndegwa vs Kenya Revenue Authority (2018) eKLR** case had no effect since that decision had been stayed awaiting appeal.
3. Excise Duty on Other Fees was not applicable for periods prior to 18 June 2013. This was premised on the fact there was an ambiguity on the meaning of "other fees" and "financial institutions" until 18 June 2013 when Finance Act, 2013 clarified the ambiguity. The Court also held that commitment and appraisal fees (Other Fees) did not constitute interest therefore were not exempt from Excise Duty. One does not need to refer to the Income Tax Act to define interest when there is a plain and literal meaning of interest.

## Our opinion

The decision of the High Court was a mixed bag of good and bad news for banks and KRA. The decision increases the uncertainty on the imposition of VAT on sale or letting of commercial property given that the High Court had in the case of **David Mwangi Ndegwa vs Kenya Revenue Authority (2018) eKLR** ruled that VAT was not applicable on the sale of land which had a commercial property built thereon. .

Taxpayers will need to revisit instances where they did not account for VAT on commercial land and buildings by relying on the David Mwangi case.

The Court also vacated the TAT ruling on Excise Duty on Other Fees by stating that these fees do not constitute interest and hence are not exempted from Excise Duty. This effectively means that Excise Duty on other fees charged by financial institutions will be applicable for periods after 18 June 2013.

The Finance Act, 2019 amended the Excise Duty Act by clarifying that 'fees and commissions earned in respect of a loan or any share of profit' are not subject to Excise Duty. The definition of Other Fees was further amended by the Finance Act 2021. Currently "Other Fees" means:

*Any fees, charges or commissions charged by financial institutions relating to their licensed activities but does not include interest on loan or return on loan or any share of profit or an insurance premium or premium based or related commissions specified in the Insurance Act or regulations made thereunder.*

The Court was of the opinion that one should look at the literal meaning of interest which means consideration payable for keeping one away from his money or from using someone else's money. The Court was of the view that interest is the main consideration that is charged for a loan while loan processing fees are expenses incurred in obtaining the loan. The Court asserted that one does not need to look at the Income Tax Act to define interest when there is a plain meaning. The effect of this position by the Court is that Excise Duty will apply on loan processing fees because they are not part of interest.

The position taken by the Court is however contrary to the definition of interest under the Income Tax Act. While Excise Duty Act does not define interest, the Income Tax Act defines it as *interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes any premium or discount by way of interest and any commitment or service fee paid in respect of any loan or credit or an Islamic finance return (Emphasis ours).*

The Income Tax Act defines interest to include loan processing fees (i.e. commitment or service fee in respect of any loan).

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

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