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Tax Alert

Fintech wins VAT exemption battle: High Court backs payment service providers

Summary

This alert brings to your attention the recent High Court decision in the case of ***Pesapal Limited v Commissioner of Domestic Taxes (Income Tax Appeal E081 of 2023) [2025] KEHC 12284 (KLR) (Commercial and Tax) (27 August 2025).***

In the decision, the High Court set aside a Tax Appeals Tribunal ruling that had subjected commissions earned by a licensed payment service provider to VAT. The Court held that the provider's activities such as receiving, transferring, and processing payments on behalf of third parties or merchants, fall within the scope of VAT exempt financial services under paragraph 1(b) and 1(m) of the First Schedule to the VAT Act. In doing so, the Court affirmed that VAT exemption depends on the nature of the service, not the provider's licensing status or the use of digital platforms and reinforced the principle that ambiguities in tax law must be resolved in favour of the taxpayer.

Background

This appeal arises from a Tribunal decision in Tax Appeal No. 13 of 2022, where the Kenya Revenue Authority assessed principal VAT of KES 76.8 million and penalties and interest of KES 33.9 million on commissions earned by a payment services provider. The taxpayer argued that the commissions earned were as a result of providing exempt financial services under the VAT Act, while KRA maintained that these commissions were merely fees for operating a payment platform licensed under the National Payment System Act. The Tribunal agreed with KRA, holding that the taxpayer was not providing exempt financial services but acting as a payment system operator. Dissatisfied with the ruling, Pesapal appealed to the High Court, challenging the Tribunal's interpretation of financial services under the VAT Act.

The Appellant's arguments

Pesapal's case was built on the argument that its commissions qualify as VAT exempt on the premise that it provided exempt financial services under the VAT Act. The Appellant's grounds of argument were as follows;

i. The Appellant pointed out that the Act does not provide a precise definition of "financial services," and argued that the activities of a payment service provider under the National Payment System Act mirror those listed as exempt under Part II of the First Schedule to the VAT Act. It maintained that its services—receiving, storing, transferring, and paying out money—fall squarely within sub-paragraphs 1(b) and 1(m) of that Schedule, and do not fall under excluded services.

ii. The Appellant criticised the Tribunal for failing to explain the distinction it drew between services under the two Acts, noting that the only real difference is that the National Payment System Act regulates the provision of such services through electronic platforms. In its view, the VAT Act does not exclude electronically rendered services from exemption, a position it argued was reinforced by the High Court's decision in ***Commissioner of Domestic Taxes v Bank of Africa Limited (Civil Appeal E127 of 2020) [2023] KEHC 1036 (KLR) (Commercial and Tax) (17 February 2023).***

iii. The Appellant also faulted the Tribunal for suggesting that VAT exemption only applies to entities registered as financial institutions under the Banking Act.

iv. The Appellant submitted that exemption depends on the type of service provided, not on the provider's legal status, and that tax statutes must be interpreted strictly with any ambiguity resolved in favour of the taxpayer. To reinforce this point, it cited both Kenyan and Indian case law supporting the principle that ambiguity in tax legislation should benefit the taxpayer.

v. On its licence, the Appellant stressed that the Central Bank of Kenya had authorised it to conduct payment services, not merely to operate a payment system as the Tribunal had found. It argued that the Tribunal wrongly conflated the two concepts, even though the National Payment System Act clearly distinguishes between system operators and service providers.

vi. The Appellant reiterated that its commissions are earned from offering financial services on behalf of third parties, a category expressly exempt under paragraph 1(m) of the First Schedule to the VAT Act. It contested the Tribunal's view that its activities amounted to provision of technology, stressing instead that its platform facilitated payments in a manner that reflected the evolution of financial services into the digital space.

vii. Finally, it pointed to proposed amendments in the Finance Bill seeking to delete commission-based financial services from the VAT exemption list, arguing that such a change implicitly acknowledges ambiguity in the current law. If the law were clear, no such amendment would be necessary.

On these grounds, the Appellant urged the court to set aside the Tribunal's decision and allow its appeal with costs.

The KRA's arguments

The Respondent's arguments focused on showing that the Appellant's commissions do not qualify as VAT-exempt financial services. It argued as follows:

i. At the outset, the Respondent reminded the Court that appeals from the Tribunal are limited to questions of law under section 56(2) of the Tax Procedures Act.

ii. On substance, the Respondent argued that the Appellant is a payment service provider (PSP) licensed by the Central Bank under the National Payment System Act and related regulations. Its role, it said, is to operate a technology platform that integrates with banking IT systems, mobile money transfer services, and other electronic payment channels that facilitates transactions between merchants and customers, earning commissions in the process. As such, the Appellant is viewed as a technology enabler rather than a financial service provider. Relying on decisions such as **Cape Brandy Syndicate v. Commissioner of Inland Revenue and Fivespot Kenya Limited v. Commissioner of Domestic Taxes, Taxes, [2023] KETAT 269 (KLR) KRA** stressed that operating a payment processing platform does not amount to delivering exempt financial services.

iii. The Respondent further contended that to qualify as "dealing with money" within the meaning of paragraph 1(b) of the First Schedule to the VAT Act, one must be an "authorised dealer" under the Central Bank of Kenya Act or be registered as a financial institution under the Banking Act. Since the Appellant holds neither status, it cannot claim exemption. Even if it were treated as a financial service provider, its activities still fall outside the list of exempt services in the VAT Act.

iv. The Respondent rejected the Appellant's claim that the list is open-ended or ambiguous, citing cases such as Stanbic Bank Kenya Limited v Kenya Revenue Authority (Nairobi Civil Appeal No. 77 of 2008) to argue for a strict, literal interpretation of tax statutes.

v. On the Appellant's licence, the Respondent explained that a Central Bank licence under the National Payment System Act merely authorises an entity to operate as a payment service provider, not to supply financial services as contemplated by the VAT Act. Being licensed as a PSP therefore does not automatically confer VAT exemption.

In conclusion, the Respondent urged the Court to uphold the Tribunal's decision, reject the Appellant's attempt to expand the scope of VAT exemption beyond what Parliament intended, and dismiss the appeal with costs.

The Court's ruling

The court found that there was only one issue for determination which is:

– Whether the Tribunal erred in finding that the Appellant's services were not VAT-exempt financial services under paragraph 1 of Part II of the First Schedule to the VAT Act.

The Court noted that the Appellant, as a licensed Payment Service Provider (PSP) under the National Payment System Act, performs functions such as receiving, storing, transferring, and processing payments. These activities, in substance, mirror those described in paragraph 1(b) of the VAT Act, which exempts dealings with money, including money transfer services. Citing authority in Commissioner of Domestic Taxes v Bank of Africa Limited (Civil Appeal E127 of 2020) [2023] KEHC 1036 (KLR) (Commercial and Tax) (17 February 2023), the Court emphasized that the language of paragraph 1(b) is broad and open-ended, capturing a wide range of financial activities beyond the explicitly listed ones.

The Court also found that the Tribunal erred by overlooking paragraph 1(m), which exempts financial services provided on behalf of another on a commission basis. Since the Appellant earns commissions from merchants for facilitating transactions, its business model fits squarely within this provision. Importantly, the Court stressed that the VAT Act does not limit exemption based on the technology used or whether an entity is licensed as a bank. The relevant test is the nature of the activity performed, not the institutional classification of the provider.

It further held that the use of digital platforms does not strip services of their financial character. On the contrary, Parliament anticipated fintech innovations when it enacted the National Payment System Act, which expressly recognises technology-enabled financial services. The Court rejected the Respondent's argument that PSPs are mere facilitators, finding instead that the Appellant is a regulated entity entrusted with handling transactions akin to those of financial institutions.

The Court concluded that the Tribunal misapplied the law by failing to consider both the broad scope of paragraph 1(b) and the clear language of paragraph 1(m), as well as the interpretive principle that tax ambiguities must be resolved in favour of the taxpayer. It therefore set aside the Tribunal's judgment and disallowed the KRA's objection decision, with each party ordered to bear its own costs.

Our Comments:

The decision has significant implications for Kenyan tax and regulatory law, particularly in the treatment of fintech and digital payment services.

By overturning the Tribunal's ruling, the High Court clarified that VAT exemption for financial services under the VAT Act is determined by the nature of the activity performed, not by the provider's licensing status or the technology used. In effect, the Court recognised that payment service providers licensed under the National Payment System Act, though not banks, still perform core financial functions such as receiving, transferring, and processing money, and are therefore entitled to VAT exemption when acting on behalf of others for a commission.

This ruling strengthens the principle that tax statutes must be interpreted strictly, with ambiguities resolved in favour of taxpayers. It also underscores that the VAT Act's exemption list is not closed; the use of the word "including" in paragraph 1(b) leaves room for evolving financial services, particularly those delivered through digital platforms. Practically, this broadens the scope of entities that may qualify for VAT exemption, offering relief to fintech firms and other payment service providers who operate in Kenya's rapidly growing digital economy.

At a policy level, the judgment signals that the courts are willing to adapt tax interpretation to reflect technological innovation in financial services, unless Parliament expressly legislates otherwise. It also places pressure on lawmakers to clarify the scope of VAT exemptions to avoid continued disputes in this area.

KPMG is happy to assist on any issues arising from this alert. You can contact our tax and regulatory team for assistance on **taxandregulatory@kpmg.co.ke** or contact Solomon Kihang'a on **skihanga@kpmg.co.ke.**

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