

**REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO.54 OF 2016**

DIAMOND TRUST BANK KENYA LIMITED APPELLANT

-VERSUS-

COMMISSIONER OF DOMESTIC TAXES RESPONDENT

BACKGROUND

1. The Appellant is a listed entity licenced under the Banking Act of Kenya carrying out banking operations for over 70 years with over 100 branches across East and Central Africa. The Appellant also has 28 Corresponding Banks in 17 countries and is a registered taxpayer, holding Personal Identification Number (PIN) P000607298L.
2. The Respondent is an Agency of the Government of Kenya established under Section 5 of the Kenya Revenue Authority Act, Cap 469 Laws of Kenya and charged with the duty of assessing and collecting taxes on behalf of the Government.
3. The Respondent carried out a normal tax audit at the Appellant's premises covering the years of income 2011 to 2013.
4. As a result of the audit, the Respondent issued a notice of additional assessment on 5th June 2015 amounting to KSh.11,969,942 Corporate Tax and KSh.12,178,203 on account of Withholding Tax.
5. The Appellant, through its tax consultants PricewaterhouseCoopers, filed an objection to the assessment on 3rd July 2015.
6. After reviewing the objection, the Respondent confirmed the assessment on 31st March 2016 for Withholding Tax amounting to KSh.12,178,203 (inclusive of penalties) on Nostro Accounts held by

the Appellant. The issue relating to the Corporate Tax was mutually resolved and hence does not form part of the appeal.

7. Being aggrieved by the assessment, the Appellant filed a Notice of Appeal to the Tax Appeals Tribunal on 12th May 2016. The Appellant also filed its Memorandum of Appeal together with the Statement of Facts on the same day.
8. The Respondent filed its response on 17th June 2016.

GROUND OF APPEAL

9. The Appellant maintains Nostro Accounts with Citi Bank New York, Citi Bank London and Standard Bank London among others.
10. A Nostro Account is defined as “foreign exchange accounts maintained by a non-local correspondent bank with a local bank in local currency”.
11. For the local bank it is termed as Nostro Account.
12. The local banks use the funds in Nostro Account for settlement of payments to foreign banks in relation to the foreign exchange transactions undertaken by them on behalf of their customers.
13. To undertake transactions in such Nostro Accounts, the foreign banks debit various charges like telegraphic transfer charges, tracer charges, ledger charges etc.
14. The Appellant’s contention is that the charges paid by the foreign banks did not amount to interest payment and hence shall not be liable to withholding tax.
15. The Respondent’s contention is that all such charges shall attract withholding tax at applicable rates without limiting such withholding tax to only interest payment.

ISSUE FOR DETERMINATION

16. There is only one issue for determination “Whether the charges levied

by the foreign banks on various transactions undertaken through the Nostro Accounts attract withholding tax”.

APPELLANT’S ARGUMENTS

17. Appellant cited Section 35(1)(e) of the Income Tax Act, which says “that a person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of interest and deemed interest, including interest and deemed interest arising from a discount upon final redemption of a bond, loan, claim, obligation or other evidence of indebtedness measured as the original issue discount which is chargeable to tax deduct therefrom tax at the appropriate non-resident rate”.
18. The Appellant also cited Section 2 of the Income Tax Act, which 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”.
19. The Appellant further argues that the above definition, the term interest is directly connected with a loan, indebtedness, credit, deposit or debt.
20. The Appellant confirms that there was no form of indebtedness or credit in the Nostro Accounts maintained by the Appellant and the charges in question are transactional in nature and not interest.
21. According to the Appellant, Section 35(1) of the Income Tax Act only brings to withholding tax any interest or charges in the nature of interest in respect of a loan or credit.
22. The Appellant brought to the attention of the Tribunal, the case of *R - vs- The Commissioner of Domestic Taxes ex-parte Barclays Bank of Kenya Ltd*. In the said case, Justice Majanja ruled that “the duty of

KRA in assessing tax is to identify transactions or payments that attract tax liability especially where there are objections to such categorization". The learned Judge further observed that "Section 35(1)(a) of Income Tax Act identifies specific types of payments that attract tax, the KRA is obligated by law to state with clarity its claim and state how the transaction falls within the terms of the statute". He further ruled that "KRA cannot exercise its duty like a trawler in the deep seas expecting to catch all the fish by casting its net wide".

RESPONDENT'S ARGUMENTS

23. The Respondent, in its submissions, relied on Section 35(1)(e) of Income Tax Act to charge withholding tax on other charges levied under the Nostro Accounts. The Respondent argues that the definition of Interest is not narrow but has been widened to cover the other charges, claims and obligations that are levied on the Nostro Accounts.
24. The Respondent also cited the judgement of **Income Tax Appeal 14 of 2007 (Kenya Commercial Bank Limited -vs- Kenya Revenue Authority)**, wherein, Justice Lesiit, J expressed her opinion that "*withholding tax on Nostro Accounts means that credit interest is withheld for foreign banks and remitted to the taxing authority*". Justice Lesiit proceeded to say that "*in my view, the above definition covers the charges paid by the Appellant on the Nostro Accounts. That being my view of the charges, I hold that the Respondent was entitled to levy the tax in respect of the same*".
25. Aggrieved by the above judgement, the Bank appealed making reference to **Civil Appeal No. 184 of 2009** where the Panel of Judges led by Justice E.M. Githinji upheld the High Court Judgement stating that "*from the provisions of the Act, we have come to the conclusion*

that payment for interest and incidental expenses on Nostro accounts to the correspondent bank is indeed taxable income to the correspondent bank for services rendered to the Appellant for foreign exchange transactions". The judgement further states *"in the premises, we agree with the finding of the High Court that the liability to pay, deduct withholding tax on Nostro account is based on the income tax law*".

FINDINGS

26. On careful consideration of the submissions by both parties, the Tribunal noted that Section 35(1)(e) of Income Tax Act deals with "interest and deemed interest, including interest and deemed interest arising from a discount upon final redemption of a bond, loan, claim, obligation or other evidence of indebtedness measured as the original issue discount". The terminology in the definition relates to some sort of indebtedness.
27. The Tribunal is of the opinion that the incidental charges referred to in the above Judgement relate to the charges incidental to any form of indebtedness.
28. The case relating to "Kenya Commercial Bank Limited" (KCB) as cited by the Respondent talks about the Royalty payable to *Infosys* and does not relate to any sort of transactional bank charges incidental to foreign currency transactions. *In this case, Kenya Revenue Authority demanded withholding tax in respect to the payments made by KCB to a foreign company (Infosys Technologies Ltd) as Royalty. The Court also observed that the Interest and other charges levied under Nostro Accounts were also found to attract withholding tax.*
29. It is important to note that the Appellant was not a borrower but it maintained its own funds in the Nostro Accounts and hence there can

be no interest payment applicable and also there can be no charges incidental to any sort of indebtedness as it is clear that there is no indebtedness in this particular case.

30. It is also important to note that the charges levied by the foreign banks do not form part of the income derived in Kenya as defined under Section 35(1) of the Income Tax Act, although the local banks debit these charges to their customers' accounts locally as these local customers do not maintain any overseas accounts to facilitate debiting these charges outside Kenya. These charges relate to the transactions outside Kenya while the local bank separately levies charges locally to its customers to the extent of the transaction within the country. When the income was earned by the non-resident foreign banks outside Kenya and when the same cannot be considered as the income derived in Kenya, such income cannot be subjected to tax in Kenya. Hence the incidence of withholding tax does not arise.

In view of the foregoing facts, the Tribunal dismisses the Respondent's demand for Withholding Tax amounting to KSh. 12,178,203 (incl. penalties) on Nostro Accounts held by the Appellant and allows the Appeal with no Orders as to Costs.

THESE ARE THE ORDERS OF THIS HONOURABLE TRIBUNAL.

DATED AND DELIVERED AT NAIROBI THIS ^{12th} DAY OF July, 2017.

In the presence of:- Kenneth Njuguna.....for the Appellant

Raphaela Mureka.....for the Respondent

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GEOFFREY KATSOLEH
CHAIRPERSON

.....
DANIEL TANUI
MEMBER

.....
PONANGIPALLI V. R. RAO
MEMBER

.....
FRANCIS K. KIVULLI
MEMBER

.....
GABRIEL KITENGA
MEMBER