THE LITERAL INTERPRETATION RULE IN TAX STATUTES: THE BARCLAYS AND THE COMMISSIONER OF DOMESTIC TAXES CASES

Abdullahi Ali*

Traditionally, tax statutes have been interpreted in a literal and strict manner. Proponents of the literal interpretation of tax statutes approach (also referred to as the 'traditional approach') have in principle carried sway for the basic reason that the punitive nature of a tax law demands that the taxpayer ought to know in unambiguous and clear terms whether and how exactly they are liable for tax. This issue was addressed by the High Court and the Court of Appeal in the cases between Barclays Bank of Kenya Limited and the Kenya Revenue Authority's Commissioner of Domestic Taxes. This case review assesses these cases and the impact of the resulting jurisprudence on the interpretation of tax statues in Kenya.

Key words: literal interpretation of statutes, purposive interpretation of statutes, interchange fee, royalty, withholding tax, interpretation of punitive law

* Abdullahi Ali is an advocate of the High Court of Kenya. He holds an LLB from Strathmore University and is currently completing his ACCA qualification. He is an Associate at ALN Kenya| Anjarwalla and Khanna LLP where he specialises on tax and corporate matters. He was previously editor at Strathmore University Press and has published in various academic journals.

1.0 Introduction

> ...in a taxing Act, one has to look merely at what is clearly said. There is *no room for intendment* as to a tax. There is no equity about tax. There is no presumption as to a tax. *Nothing is to be read in*, *nothing is to be implied* (emphasis added). One can only look fairly at the language used... If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, *cannot bring the subject within the letter of the law*, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.[1]

The debate on the extent to which a tax statute can be interpreted in a literal manner has been a long one.[2] Proponents of the literal interpretation of tax statutes approach (also referred to as the 'traditional approach')[3] have in principle carried sway for the basic reason that the punitive nature of a tax law demands that the taxpayer ought to know in unambiguous and clear terms whether and how exactly they are liable for tax. This question was a key point of contention in the case *Tanganyika Mine Workers Union v the Registrar of Trade Unions*,[4] where the Court held that punitive laws (that is, tax statutes) must be construed strictly and in such circumstances one ought not to do violence to its language in order to bring people within it. Rather, the court ought to take care that no one is brought within the statute without express language. Additionally, it is an accepted maxim within the traditional approach in the interpretation of tax statutes that where there is an ambiguity, it ought to be construed in favour of the taxpayer.[5]

Contrastingly, Lord Russel CJ in *Attorney-General v Carlton Bank*,[6] in support of the purposive rule of interpretation described the court's duty with

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[1] Rowland J, in *Cape Brandy Syndicate v Inland Revenue Commissioners* (1920) 1 KB 64.

[2] Kerry Harnish, 'Interpreting the Income Tax Act: Purpose v plain meaning and the effect of uncertainty in the tax law' 35(3) *Alberta Law Review* (1997), 688.

[3] Stephen Bowman, 'Interpretation of tax legislation: The evolution of purposive analysis', 43(5) *Canadian Tax Journal* (1995).

[4] *Tanganyika Mine Workers Union v Registrar of Trade Unions* (1961) EA 629.

[5] Bowman, 'Interpretation of tax legislation: The evolution of purposive analysis'.

[6] *Attorney-General v Carlton Bank* (1899) 2 QB 158, para 164 (CA).

regard to any statute including a tax statute as the duty '…to give effect to the intention of the legislature as that intention is to be gathered from the language employed having regard to the context in connection with which it is employed.' Evidently, the norm that should be followed in the interpretation of tax statutes has been contested but has traditionally fallen in favour of a literal/strict interpretation.

This case review assesses the application of the literal interpretation of tax statutes approach in the cases between Barclays Bank of Kenya Limited (Barclays) and the Kenya Revenue Authority's (KRA) Commissioner of Domestic Taxes before the High Court in *R v Commissioner of Domestic Taxes (Large Taxpayers Office) ex parte Barclays Bank of Kenya Ltd*,[7] and the Court of Appeal in the appeal by the KRA from the High Court decision in *Commissioner of Domestic Taxes (Large Taxpayers Office) v Barclays Bank of Kenya*.[8] As at June 2022, there was an appeal pending before the Supreme Court brought by ABSA Bank, (previously Barclays) challenging the decision of the Court of Appeal which reversed the decision of the High Court.[9]

The first part is the introduction above. This case review, in the second part, lays out the factual background to the dispute between Barclays and KRA highlighting in detail the contentious issues between the parties. The third part provides an analysis of the issues that were set for determination before both courts, their *ratio* and how each court's decision differed from the other. This review concludes by assessing what the Barclays cases decisions mean for the applicability of the literal approach in the interpretation of tax statutes.

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[7] *R v Commissioner of Domestic Taxes Large Taxpayers Office ex parte Barclays Bank of Kenya Ltd*, Miscellaneous Civil Application No 46 of 2013, Judgment of the High Court at Nairobi, 20 May 2015 (eKLR).

[8] *Commissioner of Domestic Taxes (Large Taxpayers Office) v Barclays Bank of Kenya,* Civil Appeal No 195 of 2017, Judgment of the Court of Appeal at Nairobi, 6 November 2020 (eKLR).

[9] Bowman, 'Interpretation of tax legislation'.

2.0 Factual background to the dispute

Barclays is a member of card payment networks – also known as card associations – which membership grants it access to a global network that enables digital payments. These card associations (hereinafter card companies) own and operate their networks (hereinafter card companies network) independently albeit in a very similar manner. The major card associations include VISA and MasterCard.

The card companies' primary purpose is to administer a worldwide consumer payment system for its members. This enables its members to provide their customers with the means of making payments for goods and services with the use of credit cards, travellers' cheques and debit cards in a convenient and secure manner. In order to provide the consumer payment system, the card companies operate networks that link all their members around the world.

The networks provide for two types of members: an issuer and an acquirer. An issuer is a financial institution that issues a credit card to its customers whereas an acquirer is a financial institution that honours payments to a merchant based on the credit transactions made by a customer. A merchant is any establishment that allows payment for goods or services with the use of a credit card. A member can be both an issuer and an acquirer with regard to any transaction. In Kenya there are three main acquirers: Barclays, Kenya Commercial Bank and Equity Bank.

The sequence of steps that are followed in a typical credit card transaction was submitted to the courts as follows:

a) A customer applies to an issuer for a credit card and the issuer issues either a VISA or MasterCard to its customer. The card holder goes to a merchant and uses the card to make a purchase. The merchant swipes the card through the Point of Sale (PoS) terminal configured to accept a VISA card or MasterCard.

b) By swiping the card, the merchant seeks authorisation through the acquirer who then seeks authorisation through the card company network (for example VISANET if the card is a VISA card or MIP if it is a MasterCard).

c) Since it is only the acquirer that has an agreement with the merchant, once the merchant seeks authorisation, the acquirer through the network sends a verification request to the issuer. The request's objective is to verify the card holder's data and credit status.

d) The issuer then receives and responds to the verification request.

e) The acquirer then receives the response of the verification request via the card company network from the issuer.

f) The acquirer sends authorisation to the merchant.

g) Once the merchant receives authorisation, a charge slip is generated in duplicate and the customer signs the slip and thereafter takes possession of the goods and leaves with a copy of the slip.

h) The merchant then initiates banking by uploading the transactions to the acquirer.

i) The acquirer then pays the merchant.

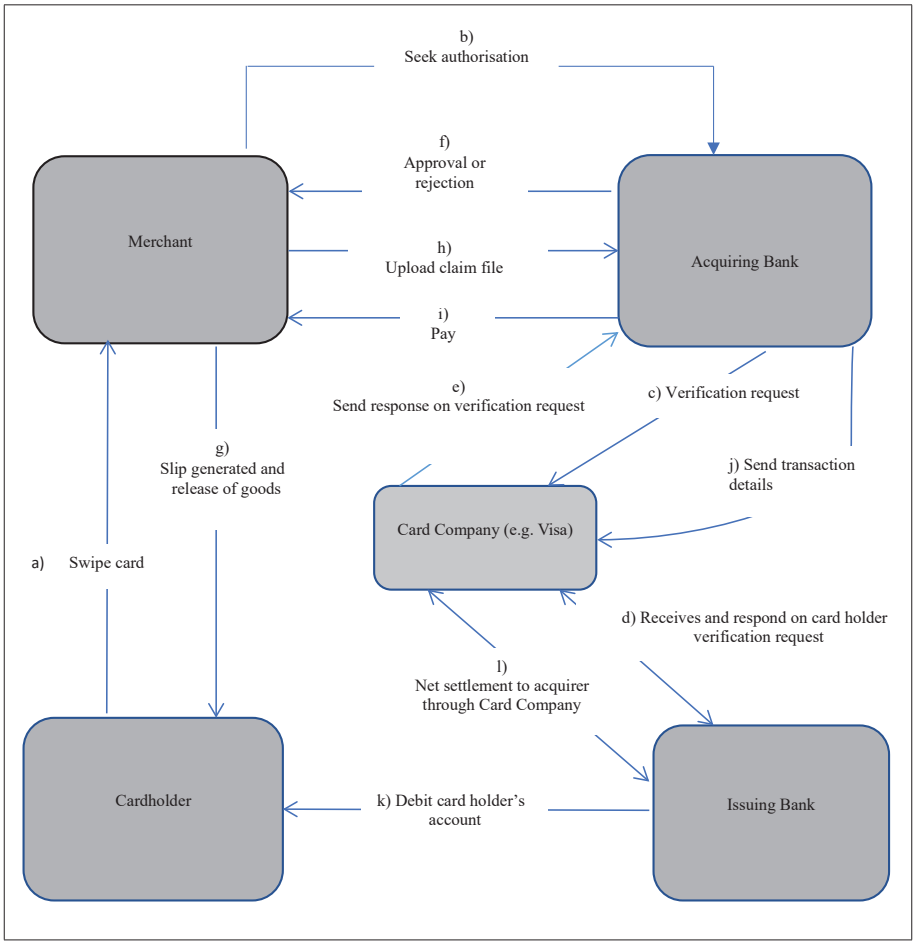
j) The acquirer then sends the transaction details to the card company network depending on which card has been utilised.

k) The information is then transmitted by the network to the issuer who debits the card holder's account.

l) The issuer then settles the net amount to the acquirer through the card company network.

The above sequence known as the four-party card payment system is illustrated in the figure below.

Figure 1: Flow of a four-party card payment transaction



Barclays submitted that the networks enable the flow of the transactions described above by enabling a settlement and clearing process such that the card companies ensure that the network is secure and reliable. This enables efficient authorisation and switching, as well as the settlement and clearing operations between its members.

2.1 Contention between the parties

There were two contentious issues between the parties. First, was whether certain payments constituted royalty as defined under Section 2 of the Income Tax Act. Secondly, was whether the payment referred to as interchange fees constituted management and professional fees as defined under the Income Tax Act.

Regarding the first issue, Barclays paid transaction fees which fell into numerous sub-categories in order to access and use the networks operated by the card companies. In the case of VISA, the sub-categories included access fees, authorisation fees, switching fees, PIN verification fees, clearing and settlement fees, amongst others. As an acquirer, Barclays submitted that it merely configures its own computers and systems to enable it to access the card company networks. It did not have control over the card company networks or systems. Further, it did not at any time have access to card company software to process the payments. It claimed that it does not buy the software of the card companies or sell it to anyone else.

Contrastingly, KRA submitted that Barclays paid for the facility to have access to the card company network through its systems. Therefore, Barclays was granted access to knowhow, formula or process by which it carries out in its own business transactions and as such the payment for the access amounted to a royalty and was thus subject to withholding tax. The term 'royalty' under the Income Tax Act is defined to encompass four distinct payments that include the following:[10]

a) the copyright of a literary, artistic or scientific work; or
b) a cinematograph film, including film or tape for radio or television broadcasting; or
c) a patent, trademark, design or model, plan, formula or process (emphasis added); or
d) any industrial, commercial or scientific equipment.

[10] Income Tax Act, (No 16 of 1973), Section 2.

Barclays maintained that the term 'royalty' is specifically defined in the Income Tax Act and KRA's contention that fees payable to the card companies to access information and facilitate communication between the various operators constituted royalty was inaccurate. Moreover, it contended that all the transaction fees paid to the card companies constituted fees for various services and not royalty. Further, Barclays submitted that the Trademark Licence Agreements did not contain any clause for payment of royalties for use of a trademark and neither did KRA exhibit any invoices from VISA or MasterCard to prove that it was paying royalties for use of a trademark.

Regarding the second issue, Barclays submitted that once a transaction is concluded and the merchant presents the bills to the acquirer, the acquirer settles the bill less the agreed commission for running the merchant's account. Subsequently, the acquirer presents the bill for settlement by the issuer and the payments are cleared and settled as follows:

a) The issuer is debited with the transaction amount and the amount is credited to the acquirer who honoured the amount to the merchant.

b) The acquirer is then debited with interchange fee that is credited to the issuer.

c) Both the acquirer and the issuer are debited with the transaction fees payable to the card company for the use of card company network.

d) Accounts are prepared, invoices are issued, and settlement effected.

Barclays submitted to the courts that a credit card system is a four-party system involving the card holder, the issuer, the acquirer and the merchant. A specific payment referred to as an interchange fee is paid by the acquirer to the issuer. The interchange fee performs a balancing act and seeks to influence acquirers' and issuers' decisions so that they contribute more than they would otherwise do to achieve the full potential of the credit card system. The collective setting of the interchange fee aims at promoting the coordination of the decisions and the activities of the issuers and acquirers in a four-party system to ensure maximum benefit for the system holistically.

Moreover, Barclays submitted to the courts that the interchange fee is not a payment in respect of any service provided by the issuers but is paid by acquirers to subsidise the cost of issuing the cards. The interchange fee is a bal-

ancing mechanism which operates to the benefit of the card system as a whole. Further, Barclays maintained that the interchange fee is based on the value of each individual transaction itself and not on the volume of transactions and is not a payment for services provided by the card companies.

In contrast, KRA submitted that the interchange fee that was paid by Barclays constituted management and professional fees as defined under the Income Tax Act. Management and professional fees are defined under the Income Tax Act as follows:[11]

> any payment made to any person, other than a payment made to an employee by his employer, as consideration for any *managerial, technical, agency, contractual, professional or consultancy services* however calculated (emphasis added).

Additionally, KRA maintained that in the clearing and settlement process, the interchange fee is earned from the acquirer and the issuer is deemed to be 'paid' according to the definition of 'paid' under Section 2 of the Income Tax Act. It submitted that 'paid' includes distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person.

Barclays did not contest that there was indeed a payment. However, it maintained that in order to impute withholding tax liability as a management or professional fees, it was incumbent upon KRA to show whether the service was either a managerial, technical, agency, contractual, professional or consultancy service. In its view, KRA failed to identify with specificity and certainty the service provided for the payment of the interchange fee.

3.0 Courts' analysis of the issues

Given the foregoing factual background to the dispute, two issues arose for determination before both the High Court and the Court of Appeal:

a) Whether the transaction fees paid to the card companies constituted royalty for the right to use the card companies' trademarks and logos; and

[11] Income Tax Act, (No 16 of 1973), Section 2.

b) Whether the interchange fees paid by Barclays to issuing banks in the payment ecosystem were management or professional fees liable to withholding tax under Sections 35 (1)(a) and 35 (3)(f) of the Income Tax Act.

3.1 Whether the transaction fees paid to the card companies constituted royalty for right to use the card companies' trademarks and logos

3.1.1. Determination of the High Court

Quite significantly, this case turned on the question of ambiguity with respect to the interpretation of tax statutory provisions. Odunga J, while relying on authority, found that taxation can only be done on clear words and cannot be on intendment. Linked to this is that a penalty must be imposed in clear words. Finally, even where the inclination of the legislature is not clear or where there are two or more possible meanings, the inclination of the court should be against a construction or interpretation which imposes a burden, tax or duty on the subject.[12]

On whether the payments constituted royalties, the High Court disagreed with KRA's position. It provided that instead of KRA relying on the various payments made to the card companies (of which no specific payment was categorised as royalty) as a guide to establish tax liability, it should rely on clear and unambiguous tax statutory provisions to impute that the payments were indeed royalty and thereafter charge a tax liability.

3.1.2. Determination of the Court of Appeal

The Court of Appeal reiterated the position that tax statutes must be clear in the manner in which they impose a tax liability. It however provided that the determination of whether there is clarity or ambiguity in the legislation or whether a tax demand is precise and within the terms of the legislation, is not

[12] Some of the cases Odunga J relied on include, *Cape Brandy Syndicate v Inland Revenue Commissioner*, (1921) 1 KB 64 and *Keroche Industries Limited v Kenya Revenue Authority & 5 Others,* Miscellaneous Civil Application 743 of 2006, Judgment of the High Court at Nairobi, 6 July 2007 (eKLR).

an abstract or pedantic exercise. It is based on the evidence and the circumstances of each case.

By taking VISA as an example, the Court of Appeal found that the two agreements between Barclays and VISA and Barclays and MasterCard are headed 'Trademark License Agreement'. Whilst the agreement with VISA was silent on payment for use of VISA's trademarks and logos, those with MasterCard expressly provided that no royalty would be payable.

In the view of the Court of Appeal, determining whether the payments made by Barclays to the card companies constituted royalty was to be done by considering the terms of the statute, the written agreements, and the totality of the relationship between Barclays and the card companies, including the actual dealings between the parties. The Court of Appeal provided that without the use of credit and debit cards bearing those specific trademarks and logos from the authorising card company, Barclays could not access or use the networks. In the Court of Appeal's view, KRA was able to identify with clarity the basis upon which it was claiming withholding tax from Barclays based on payment of royalty, however disguised. It found that the transaction fee constituted, in the circumstances, payment for the right to use the card companies' trademarks and logos. The payment, the Court of Appeal held constituted royalty for trademark under Section 2(c) of the Income Tax Act.

The Court of Appeal held that it did not perceive any ambiguity in the statute that would require legislative intervention. Additionally, it was not satisfied from the totality of the evidence on record that Barclays did not understand the basis of KRA's demand for withholding tax as royalty for its use of the credit cards' trademarks and logos.

3.2. Whether the interchange fees paid by Barclays to issuing banks in the payment ecosystem were management or professional fees liable to withholding tax

3.2.1. Determination of the High Court

The High Court reiterated the principles laid out in part 3.1.1 above. In its view, it was unacceptable for KRA to resort to 'professional or manage-

ment fee' when the said phrase encompasses a host of other services such as managerial, technical, agency, contractual, professional or consultancy services. Therefore, resorting to a term which encompasses a host of services without distinguishing which category the service falls into was, in its considered opinion, unacceptable.

The High Court held that the way KRA arrived at its decision did not meet the level of clarity required in taxation. KRA ought to have clearly identified the category in which the tax it sought fell into.

3.2.2. Determination of the Court of Appeal

The Court of Appeal, in direct contrast to the High Court held that management and professional fees did not have to fall within only one of the service categories defined as constituting management and professional fees under Section 2 of the Income Tax Act. It could cover one or more. In the Court of Appeal's view, it was critical to look at the totality of the evidence on record and determine whether there was a clear explanation of what KRA alleged to constitute management or professional fees, and whether that payment made by Barclays reasonably fell within the terms of the statute (emphasis added). The Court of Appeal held that this could not be answered by considering only how the parties had described or rationalised the payment.

In respect of the interchange fees, the Court of Appeal held that there was clear coordination, managerial, professional, and contractual services rendered by the issuer to the acquirer, for which the latter pays. Therefore, this in its view satisfied the definition of management and professional fees as required under the Income Tax Act.

4.0 Analysis and conclusion

As provided in the analysis of the issues before the courts, both the Court of Appeal and the High Court recognised the importance of the literal interpretation rule in tax statutes. However, the Court of Appeal departed from the High Court's determination by assessing the totality of the relationship between Barclays and the card companies and whether the payments made by Barclays reasonably fell within the terms of the statute.

Quite evidently, a payment of transaction fees had been made. The Income Tax Act in Section 3 anticipates that all income accrued from or derived in Kenya, whether by a resident or a non-resident person is chargeable to tax. Further, the Income Tax Act anticipates that payment of an amount to a non-resident without permanent establishment in Kenya as well as payment of an amount to a resident person with a permanent establishment along the categories specified in Section 35(1) and (3) should attract withholding tax at the prescribed rates.

The competing contentions between the taxpayer (Barclays) and the tax authority (KRA) can be succinctly stated as follows: For the taxpayer, the category of payment that constitutes interchange fees as well as whether royalties are payable under the circumstances is not clearly and unambiguously provided for under the Act and therefore should not attract tax. Consequently, the taxpayer maintains that this is a lacuna in the law that can only be remedied by way of legislation. Contrastingly, the tax authority provides that the legislation is not ambiguous and anticipates the character of payment categories made by the taxpayer.

The Court of Appeal, in essence, extended the applicability of the doctrine of 'substance over form' by taking a purposive interpretation of the relevant tax statutory provisions. In its view, the totality of evidence on record and the facts, however disguised, could be deemed to constitute royalty and interchange fees in their respective circumstances.

The jurisprudence developed as a result of this dispute has had significant consequences not only for the banking industry but for all taxpayers in Kenya. Furthermore, the determination that will be arrived by the Supreme Court in the pending appeal will no doubt have a considerable impact on the way judges ought to interpret tax statutes in Kenya. In May 2022, the Supreme Court agreed to hear and determine the appeal.