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Tax Alert

Excise duty on additional interest charged on late repayment of loans

The Tax Appeals Tribunal (TAT), vide its judgement in the matter of SBM Bank Limited (the Appellant) v Commissioner of Legal Services and Board Co-ordination ("the Respondent"), Tax Appeal No. E419 of 2024, delivered on 21 February 2025 ("the ruling"), held that excise duty is not applicable on additional interest charged on the late payment of loans.

In the judgement, the TAT confirmed the jurisprudential position that interest, howsoever termed, inclusive of additional interest applied on the late payment of loans, ought not to be subject to excise duty by virtue of the definition of 'other fees' provided under Part III of the Third Schedule to the Excise Duty Act (EDA) and further, as guided by Section 9(6) of the EDA.

In this alert, we discuss the salient arguments advanced by the Appellant and the Respondent and our view on the ruling by the TAT.

Background

The Appellant is a commercial bank licensed by the Central Bank of Kenya and whose principal activity involves the provision of financial services such as debt facilities, checking, savings options, and investment banking.

After conducting a review of the Appellant's tax affairs for the period 2018 to 2023, the Respondent noted that the Appellant had not accounted for excise duty on additional interest charged on late repayment of loans.

Per the Respondent, additional interest charged on the late repayment of loans, over and above the interest levied on the facility, ought to be considered as 'other fees' and therefore subject to excise duty at 20% as guided by Part II, Paragraph 4 of the First Schedule to the EDA.

Aggrieved by the Respondent's decision, the Appellant lodged an appeal before the TAT.

Appellant's Case

The Appellant advanced the following arguments in support of its case:

- Per the Appellant, 'default interest' levied on the late payment of loans constitutes additional interest and is recognised as such in its books, as opposed to a fee / fine / penalty as argued by the Commissioner and therefore ought to be considered exempt from excise duty.
- The Appellant relied on the definition of 'other fees' provided under Part III of the First Schedule to the EDA, which expressly excludes, inter alia, *'interest on loan or return on loan'* from the ambit of excise duty in Kenya.
- The Appellant acknowledged that while the EDA is silent on the definition of 'interest' and 'return on loans', the literal rule of statutory interpretation ought to apply as guided by the Courts in numerous determinations, including but not limited to the determination of the High Court (HC) in *Primarosa Flowers Limited v The Commissioner of Income Tax*.
- The Appellant relied on the International Accounting Standards (IAS) 18 and the OECD guidelines to define 'interest', concluding that default interest charges on loans are not 'other fees' as construed by the Respondent.
- Accordingly, the Appellant concluded that interest charged on default interest is not subject to excise duty, and the Respondent had no legal basis to demand excise duty.

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Respondent's Case

The Respondent advanced the following arguments in rebuttal:

- That one of the clauses in the letter of offer provided by the Appellant indicated that a fine is charged if the borrower fails to pay the sum payable on the due date over and above the agreed interest and that this fine ought to be distinguished from interest and instead classified as 'other fees' subject to 20% excise duty under Part II, Paragraph 4 of the First Schedule to the EDA.
- That while the EDA defines 'other fees' to include any fees, charges or commissions charged by financial institutions relating to their financial services, excluding interest on loan or return on loan or insurance premium or premium based or related commissions, the classification of these default charges as interest was meant to mislead the Tribunal.

TAT's Determination

The TAT, in its analysis, determined the issue in dispute as follows:

- That the EDA defines 'other fees' to include: *"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 ..."*
- That the definition of 'other fees' expressly excludes 'interest and return on loans' which gives rise to the conclusion that interest income earned by financial institutions is excluded from the ambit of excise duty.
- The TAT reiterated its position as outlined in its judgement in ***Key Microfinance Bank Limited v Commissioner of Domestic Taxes, TAT 251 of 2020***, wherein it held that additional interest levied for late payment of loans falls within the ambit of interest and therefore should not be subject to excise duty. The TAT concluded that in the absence of a definition of interest in the Excise Duty Act, the Income Tax Act (ITA) definition of interest would apply. The ITA, defines 'interest' as "Interest (other than interest charged on tax) means 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."
- Further, the TAT associated itself with the determination of the HC in ***Commissioner of Domestic Taxes v Key Microfinance Bank Limited, Tax Appeal No. E031 of 2022,*** an appeal against the TAT's position in TAT No. 251 of 2020, wherein the HC confirmed the TAT's position that interest charged on late repayment of loans is not subject to excise duty.
- In conclusion, the TAT held that the appellant was justified not to account for excise duty on extra interest charged on late repayment of loans.

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Conclusion and our View

The TAT's judgement is consistent with the HC's judgement in ***Commissioner of Domestic Taxes v Key Microfinance Bank Limited, Tax Appeal No. E031 of 2022,*** which relied on the ITA definition of "interest" in concluding that late payment interest fell within the scope of interest.

However, we note that the HC in ***National Bank v Commissioner of Domestic Taxes Income Tax Appeal No. E155 & 533 of 2020***, concluded that the term "interest" should be given the plain and literal meaning before seeking its legal meaning or definition in other statutes. The term "interest" is not a technical term to warrant looking for its legal definition. Before going out of the Excise Duty Act to look for the definition of interest, there should have been difficulty first as to Parliament's intention. The HC held a similar position in ***Commissioner of Domestic Taxes v Equity Bank Kenya Limited, Tax Appeal 045 of 2022; and Commissioner of Domestic Taxes v Cooperative Bank Limited, Tax Appeal 045 of 2020.***

Despite the variance in opinion by the HC in the Key microfinance case and the three above-mentioned cases, our view is that late payment interest falls within the scope of interest and aligns with the broader or literal meaning of interest.

The above notwithstanding, the Kenya Revenue Authority (KRA) retains its right of appeal before the HC. If the KRA chooses to exercise this right, the HC will review the matter and make its judgement, and ultimately, the Court of Appeal will be involved if either party is dissatisfied with the HC's determination and proceeds to appeal. In the meantime, interest charged on late repayment of loans is not subject to excise duty.

Should you wish to discuss this further, kindly feel free to contact any of the contacts listed or your usual Deloitte contact, who will be more than glad to offer you guidance and assistance.

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