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Taxwise

Supreme Court Demystifies Taxes on Card Payments and Interchange Fees

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In Petition No. E014 of 2022, the Supreme Court of Kenya ruled on a dispute between Absa Bank Kenya PLC (formerly Absa Bank of Kenya Ltd) and the Kenya Revenue Authority (KRA) regarding withholding tax on payments to international card companies (Visa, MasterCard, American Express) and interchange fees between banks, covering the audit period 2007-2011.

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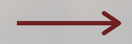

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Background

- **Case Overview:** In Petition No. E014 of 2022, the Supreme Court of Kenya ruled on a dispute between Absa Bank Kenya PLC (formerly Absa Bank of Kenya Ltd) and the Kenya Revenue Authority (KRA) regarding withholding tax on payments to international card companies (Visa, MasterCard, American Express) and interchange fees between banks, covering the audit period 2007-2011.

- **Key Issues:** KRA demanded withholding tax, classifying card company payments as royalties under Sections 2 and 35 of the Income Tax Act, and interchange fees as management or professional fees. The ruling, delivered on December 5, 2025, was certified as a matter of general public importance for the banking sector.

- **Broader Context:** The decision addresses ambiguities in taxing digital payment ecosystems, emphasizing statutory precision and preventing double taxation in Kenya's financial services industry.

Key Arguments

KRA argued that payments to card companies were royalties under Section 2(d) of the Income Tax Act, as they granted the right to use trademarks and access global networks. It maintained that software license fees and service charges fell within this definition and were subject to withholding tax under Section 35(1)(b). KRA further contended that interchange fees were payments for managerial and professional services, including transaction authorization, clearing, and settlement, thus attracting withholding tax under Section 35(1)(a).

Absa objected, maintaining that payments to card companies were transaction facilitation fees, not royalties, and that agreements expressly excluded royalty payments. The fees covered access to payment networks, not trademark use. Regarding interchange fees, Absa argued that these fees compensate issuing banks for transaction costs and risks, not for managerial or professional services. It emphasized that the fees form part of income already taxed at 30% corporate tax, so imposing withholding tax would result in double taxation.

Judicial History

The High Court initially ruled in favor of Absa, finding that KRA had failed to clearly identify the nature of services allegedly rendered by issuing banks or provide a statutory basis for classifying the payments as royalties or management fees. Consequently, the Court quashed the withholding tax demands and issued orders of prohibition.

KRA appealed, and the Court of Appeal overturned the High Court's decision. It held that transaction fees paid to card companies amounted to royalties because they involved the right to use trademarks and card network infrastructure. Additionally, interchange fees were deemed management or professional fees, as issuing banks performed coordination and verification functions within the card payment system.

Absa then sought certification to appeal to the Supreme Court on grounds of general public importance. Although the Court of Appeal initially denied certification, Absa successfully moved the Supreme Court for review. The Supreme Court granted certification, recognizing that the question of whether interchange fees and card scheme payments attract withholding tax is of significant public and industry-wide importance.

The Legal Issue

The Supreme Court was tasked with determining whether:

- Payments made by acquiring banks to card companies constitute royalties and therefore subject to withholding tax.
- Interchange fees paid by acquiring banks to issuing banks can be classified as management or professional fees and therefore subject to withholding tax.

Supreme Court's Determination

The Court found that agreements between Absa Bank and the card companies expressly excluded royalty payments. The fees paid were for transaction facilitation rather than trademark exploitation. Therefore, payments to card companies do not qualify as royalties and are not subject to withholding tax.

Regarding interchange fees, the Court observed that these fees compensate issuing banks for transaction costs and risks, not for specialized services. They already form part of banking income taxed under corporate tax at 30%, and imposing withholding tax would result in double taxation without clear statutory authority. Consequently, interchange fees are not management or professional fees and are not liable to withholding tax.

Implications for the Banking Sector

This decision provides certainty for banks and payment service providers by:

- Eliminating ambiguity on the tax treatment of card network fees and interchange charges.
- Preventing potential cost escalation in card transactions, which could have undermined Kenya's digital payment ecosystem.
- Reinforcing the principle that tax authorities must articulate claims with precision and statutory backing.

Conclusion

The Supreme Court's ruling provides clear guidance on the tax treatment of payments to card companies and interchange fees. By confirming that these payments do not constitute royalties or management/professional fees under the Income Tax Act, the Court reinforced the principle that taxation must be based on explicit legislative authority. This decision resolves a long-standing dispute, prevents double taxation, and supports the integrity of Kenya's digital payment ecosystem.

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