

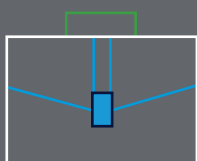
RSMEA Kenya Tax Alert

High Court clarifies VAT exemption for fintech services

On 27th August 2025, the High Court of Kenya delivered a significant ruling in Income Tax Appeal No. E081 of 2023 – Pesapal Limited vs Commissioner of Domestic Taxes. The Court set aside the earlier decision of the Tax Appeals Tribunal (TAT), which had held that Pesapal's services were not VAT-exempt financial services.

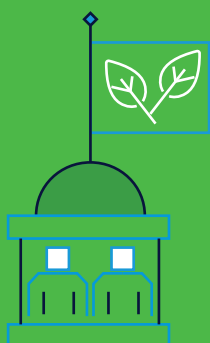
In its judgment, the Court held that Pesapal's activities fall within the scope of Paragraph 1(b) (issue, transfer, receipt or dealing with money) and Paragraph 1(m) (financial services provided on a commission basis) of Part II of the First Schedule to the VAT Act. This decision is a turning point for fintechs, payment service providers (PSPs) and merchants in Kenya.

Who Will Be Impacted?



- **Fintechs and PSPs:** Licensed PSPs can now confidently argue that their commission-based financial services qualify for VAT exemption. This provides a stronger compliance footing and could ease ongoing disputes with the KRA.
- **Merchants and Businesses:** Merchants who pay commissions to PSPs for payment processing may benefit from cost reductions, as VAT should not apply to these commissions. This may improve margins and reduce the cost of doing business.
- **Kenya Revenue Authority (KRA):** The ruling curtails KRA's ability to classify PSPs as mere IT platforms. KRA will need to adapt its enforcement strategies to align with the High Court's technology-neutral interpretation of financial services.
- **Lawmakers and Regulators:** The judgment may drive Parliament or regulators to revisit the VAT Act or issue guidelines clarifying exemptions in the digital financial services space to ensure consistency in application.
- **Consumers:** Although not directly addressed, the exemption may indirectly lower transaction costs that are passed down to consumers through merchants.

What Was Decided?



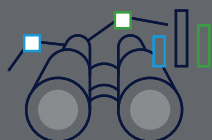
The High Court made several important findings:

- **Financial services broadly defined:** The Court clarified that "issue, transfer, receipt or any other dealing with money" under Paragraph 1(b) was deliberately broad to cover a wide array of financial operations, including those facilitated digitally.
- **Commission-based exemption confirmed:** Pesapal's model of earning commissions from merchants aligns with Paragraph 1(m), which exempts financial services provided on a commission basis.
- **Nature over institutional status:** The Court emphasized that exemption depends on the nature of the service, not the provider's classification. Being a bank or an authorised dealer under the CBK Act is not a prerequisite for exemption.
- **Technology-neutral approach:** The VAT Act does not distinguish between traditional and digital delivery of financial services. Use of IT platforms does not disqualify services from exemption.
- **Regulatory framework considered:** The Court acknowledged that the NPSA was enacted to regulate new forms of financial services, including fintech. It would be inconsistent with Parliament's intent to exclude PSPs from VAT exemption.

When is the effective date?

The decision took effect immediately on 27th August 2025 and applies to all relevant services offered by PSPs and fintechs that fall within the exemption categories under the VAT Act. Businesses may also consider seeking retrospective relief where VAT was previously applied to such services.

Our view



This ruling is a landmark development for Kenya's digital economy:

- **For fintechs and PSPs:** It strengthens legal certainty and reduces compliance risks by confirming that VAT exemptions apply to their commission-based financial services.
- **For merchants:** It offers relief on costs associated with payment processing, potentially lowering the overall cost of transactions.
- **For regulators and KRA:** It signals the need to adopt a technology-neutral approach when interpreting tax laws in a rapidly evolving digital economy.
- **For the financial ecosystem:** It underscores the recognition that fintechs are legitimate players in delivering financial services and should be treated on par with traditional financial institutions.

However, there is still a possibility of legislative or regulatory responses to refine the scope of VAT exemptions for fintechs. Stakeholders should remain alert to potential policy shifts.

Practical Implications

- PSPs and fintechs should review their VAT compliance position and ensure their services are appropriately classified under the VAT exemption framework.
- Businesses should reassess past VAT payments and consider pursuing refunds where VAT was wrongly applied to exempt services.
- Contracts between merchants and PSPs may need to be updated to reflect the VAT exemption, ensuring clarity in pricing and invoicing.
- Companies should prepare for potential follow-up audits or queries from KRA as it re-aligns its enforcement approach.



Should you need further specific guidance on how the above changes impact your business, kindly feel free to contact any of the below or your usual RSM contact who will be always available to offer guidance and assistance that you need.

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