

# ICPAK's Tax Management for PBOs Workshop

KRA In-depth Audits

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# 1. Introduction

- Tax audits are an integral part of any self assessment regime.
- The main objectives of an audit are twofold: -
  1. To educate taxpayers in a bid to reduce the knowledge gap. This is the primary objective.
  2. To confirm that all taxes due were paid by the subject, not a penny more, not a penny less. This would entail refunding any taxes found to have been paid in excess.

## 2. Legislation

- Domestic Taxes Audits are anchored under the the Tax Procedures Act (TPA). This Act prescribes common procedures for Value Added Tax (VAT), Income Tax and Excise Tax.
- Section 58 of TPA gives the Commissioner powers to inspect goods, records etc.
- Section 59 of the same Act gives the Commissioner powers to demand for production of records through a notice in writing.

# Legislation Cont...

- Section 31 of the TPA grants the Commissioner powers to amend an original (self assessment) return submitted by a taxpayer by making alterations or additions, from the available information and to the best of the Commissioner's judgement.

# 3. Types of Audits

- ❖ *There are two main categories of audits that form the basis for the other sub categories*

## A. Comprehensive Audits

- Comprehensive audits will cover several initiatives (Income Tax, VAT , PAYE, WHT and Excise) and tackle single or several issues under each tax initiative.

## B. Single Initiative Audits

- Single initiative audits will tackle a single initiative in a single tax initiative. For example, verification of input VAT claimed in a certain period.
- The following subcategories of audits will take either of the above main types depending on the audit notification letter contents.

# Types of Audits Cont...

## *a. Risk Based Audits*

- These form the bulk of audit cases selected.
- Currently *iTax* has been programmed to select cases based on a minimum threshold of risk parameters inherent in tax returns filed.
- Some of the risk parameters include, but are not limited to, return data inconsistencies, low profit margins (benchmarked against similar firms), return filing pattern and tax payment trends.

# Types of Audits Cont...

## *b. Refund Audits*

- These are conducted on tax refund claims that are more than or equal to Kshs 1,000,000. Smaller amounts can still be audited based on perceived risk.

## *c. Investment Deduction/Capital Deduction Audits*

- Income Tax Investment deduction claims *must* be verified in light of Second Schedule provisions.



# Types of Audits Cont...

## *d. Third Party Information Audits*

- Some audits are initialized based on information provided by third parties such as informers and other government institutions.

## *e. Post Clearance Audits (PCA)*

- These are undertaken by Customs Department to verify that correct import duties were declared and paid by importers at the port of entry.

# 4. Scope of Audit

- Period covered by Audits is governed by statutes.
- Section 31 (4) of TPA limits amendment of returns by the Commissioner to 5 years from the date the taxpayer filed self a assessment return. The same section allows the commissioner to amend any self assessment return without a time limit in case of gross or wilful neglect, evasion, or fraud by, or on behalf of, the taxpayer.

# Scope of Audit Cont...

- Scope of audit could also refer to the initiatives to be covered.
- A Domestic Taxes audit could cover a single initiative or a mix of initiatives depending on the risk parameters identified.
- Domestic Taxes audits are limited to Income Tax (corporate and individual), PAYE, WHT, WHVAT, VAT, Excise Tax and CGT.

# 5. Audit Procedure

- KRA has a documented procedure for audit conduct to enhance consistency and fairness.
- All audits follow the following procedure: -
  - i. Case selection
  - ii. Preliminary considerations
  - iii. Taxpayer/Agent notification
  - iv. Case commencement

# Audit Procedure Cont...

v. Audit conduct

vi. Explanation, reconciliations and adjustments

vi. Issue of agreed/non agreed assessments and  
Case closure

# 6. Post Audit Procedure

- Some adjustments made during the tax audit might necessitate future period adjustment of financial statements or adjustment of VAT credit to be carried forward.
- Tax periods succeeding the audit scope period and where returns had already been filed need to be reviewed independently in light of lessons learnt in the audit and amended returns filed.

# Post Audit Procedure Cont...

- Disputes arising out of the audit have to be resolved in line with statutory provisions. This would entail: -
  - i. A timely objection
  - ii. An appeal to the Tax Appeals Tribunal (TAT) if dissatisfied with Commissioner's objection decision.
  - iii. An appeal to the High Court if dissatisfied with the TAT ruling.

# 7. Audit of PBOs

- It is expected that PBOs will apply for exemption under section 13 of the Income Tax Act as read with paragraph 10 of the first schedule to that Act. In the event that exemption is not applied for then corporation tax is payable at the ruling rates and the PBO in question will be subject to audits to ascertain that correct taxes have been paid.



# Audit of PBOs Cont...

- PBOs (Whether income tax exempt or not) have agency tax obligations. Audits will be conducted from time to time to educate them and to ascertain that correct taxes were paid. Audits may cover the following: -
  - i. Payroll taxes – Pay as you earn (PAYE)
  - ii. VAT including WHVAT
  - iii. Withholding Income Tax
  - iv. Excise Duty
  - v. Income Taxes (subject to extent of exemption) including taxes on rental income, capital gains, interest income and business income.

# 8. Rights and Obligations

- The taxpayers rights and obligations as specified in KRA's Taxpayers' Charter apply during audits.
- For example, the taxpayer has an important obligation of producing all records requested for.
- Rights applicable to the taxpayer include the right to fair treatment, right to object, right to appeal any commissioner's decision etc.

## 9. KRA-ICPAK Areas of Collaboration

- ICPAK members who double as tax agents must register with the Commissioner in line with Section 19 of TPA as read with Legal Notice No. 138 of 2018 – The Tax Procedures (Tax agents) Regulations, 2018.
- ICPAK members acting in the capacity of a registered tax agent should give taxpayers sound advice that is up to date and consistent with the provisions of revenue acts.

# 10. Emerging Issues

- Audit has lately been enhanced by technological advancement and availability of electronic data.
- Alternative Dispute Resolution (ADR) is being encouraged for speedy resolution of disputes and is preferred due to time and cost efficiency.

# 11. Challenges

- Incomplete records
- Uncooperative taxpayers
- Delays occasioned by unavailability of taxpayers/agent
- Slow production of books and records
- Unregistered tax agents
- Unwarranted disputes

# Challenges Cont...

- Time barred objections
- Tax knowledge gap
- Frequent change in tax laws

END

Q&A