

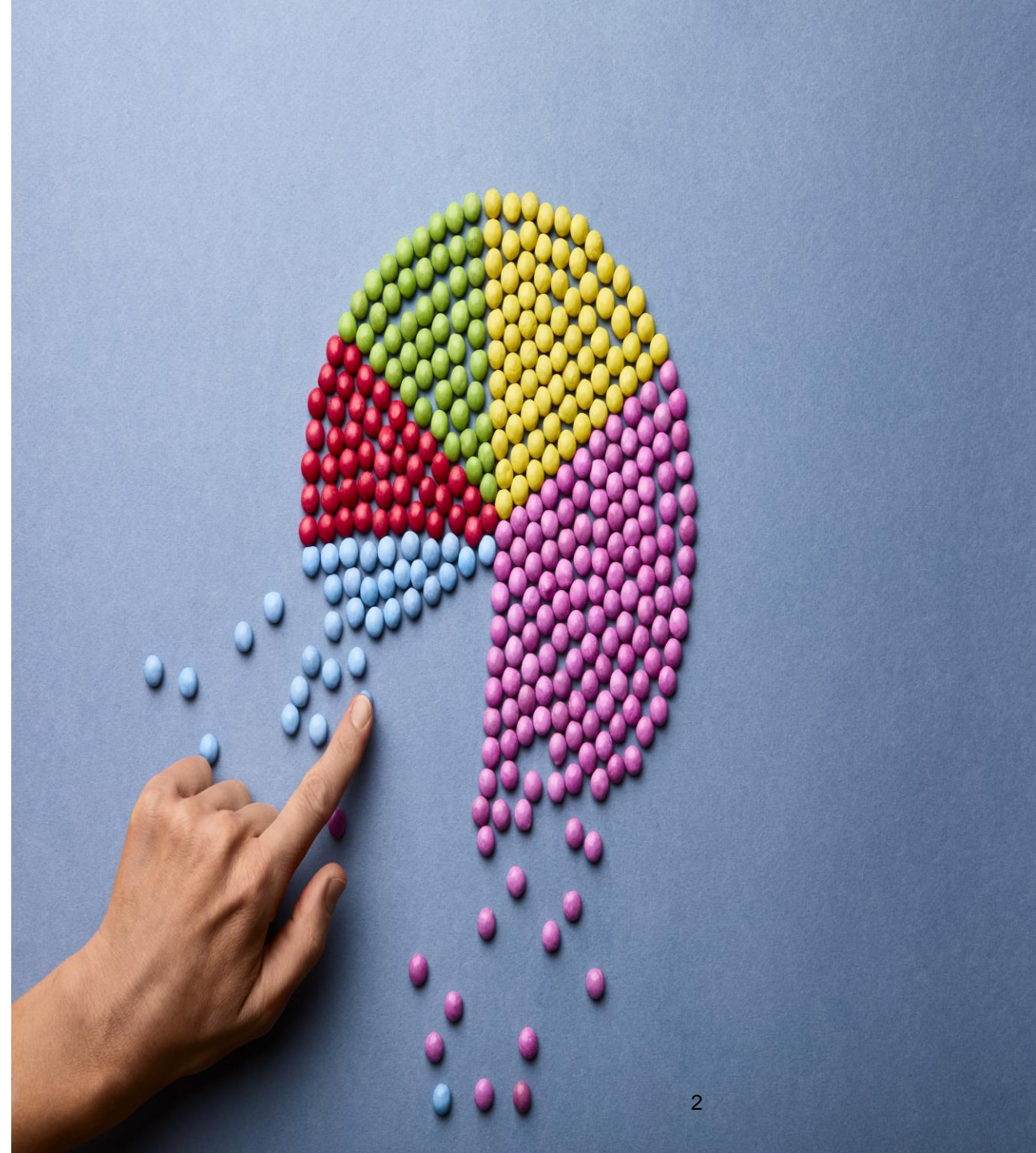
Value Added Tax (VAT) in Kenya

Principles of a VAT system

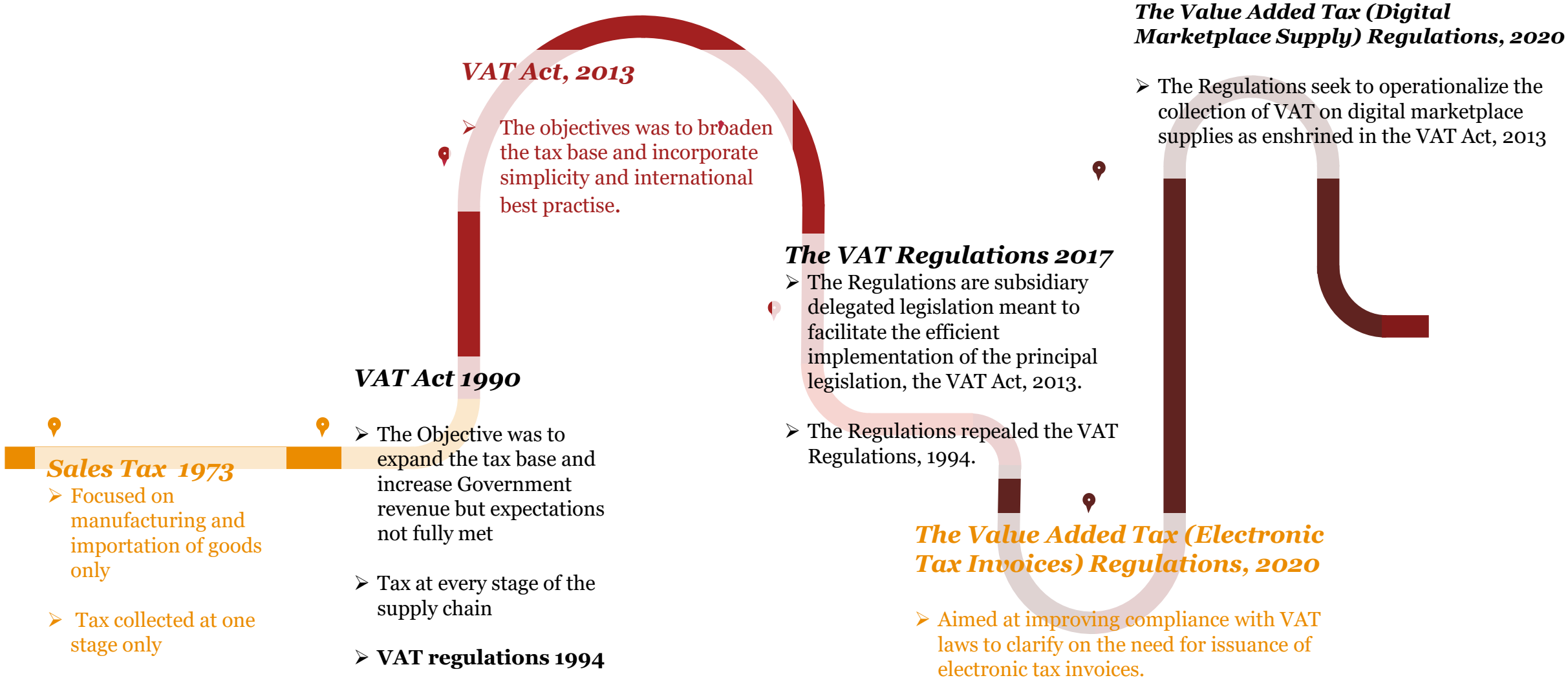
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Learning objectives

- ✓ Evolution/History of VAT in Kenya
- ✓ Overview of the VAT legislation in Kenya
- ✓ Input-Output mechanism
- ✓ VAT and WH VAT compliance requirements
- ✓ Entitlement to VAT refund claims
- ✓ VAT Auto Assessments (VAA's)
- ✓ Imported and exported services
- ✓ Destination Vs Origin principles in VAT
- ✓ Other VAT guiding principles



Evolution of VAT in Kenya



Overview of the VAT legislation in Kenya

Value Added Tax (“VAT”) is a consumption tax borne by the final consumer at the end of the supply chain.

The tax is levied on the ‘Value Added at each stage of the supply chain. In Kenya, supplies are either taxable or exempt from VAT.

VAT is charged on:

- Taxable supplies made in Kenya;
- Importation of taxable goods; and
- Imported taxable services

The rates applicable on taxable supplies are:

- 16% for standard rated supplies
- 8% for specific petroleum products
- 0% for zero rated supplies.



Overview of the VAT legislation in Kenya

Zero rating of goods and services means that such supplies are actually taxable but at the rate of 0%.

Exemption from VAT means such supplies are not taxable.

VAT is a wash through tax as the amount of tax payable on a taxable supply, if any, is recoverable by the registered person from the recipient of the supply, in addition to the consideration.

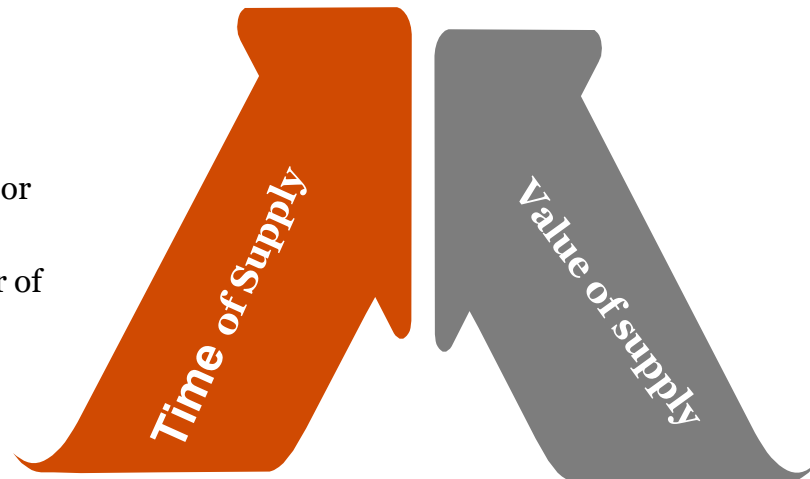
The earlier of the date:

- Goods are delivered or services performed;
- Certificate is issued by an architect;
- Invoice for the supply is issued;
- Payment for the supply is received, in whole or in part

The time of each successive supply is the earlier of the date on which payment for the successive supply is due or received.



Charge to Tax



Goods are supplied in Kenya:

- If delivered or made available in Kenya.
- For goods delivered outside, if the goods were in Kenya when transportation commenced.

Services are supplied in Kenya:

- If place of business of supplier is in Kenya.
- If place of business is outside Kenya and the recipient is not VAT registered:
 - Physically performed in Kenya;
 - Directly related to immovable property in Kenya;
 - The supply is a transfer or assignment of, or grant of a right to use, a copyright, a patent, trademark or similar right;
 - Electronic services delivered to a person in Kenya.

Taxable value of a supply is:

- the 'consideration' for the supply; or
- open market value ("OMV") for related parties.

Consideration is

- Amount of money paid or payable for the supply; or
- OMV of payment in kind – barter transaction; and
- Taxes, duties, levies, fees and charges excluding VAT.

Registration for VAT

- Registration threshold – Taxable supplies of KES 5 million in a year;
- Sale of capital assets or sale of business excluded from registration threshold;
- Application for registration within 30 days of being liable to register;
- Option for voluntary registration;
- Commissioner empowered to register a person who fails to register;
- Registration to take effect in the first tax period after registration is due, or other date as specified in the registration certificate;
- Registration certificate to be displayed in a conspicuous place;
- Case for group registration? – VAT Regulations

Appointment of a tax representative – Tax Procedures Act (TPA)

- A non-resident providing above referred services to a non-registered Kenyan citizen is deemed to have made a supply of services in Kenya;
- The non-resident is liable to register for VAT should the value of the services supplied reach the registration threshold;
- Due to non-residency status, the non-resident would, under the TPA, be required to appoint a tax representative;
- Appointed representative assumes all duties and obligations of the non-resident under the VAT law;
- No guidelines as yet on the qualifications and criteria of appointment of tax representatives;

Examples of VAT status of supplies

| Taxable at 0% | Taxable at 16% | Exempt supplies |
|---|--|--|
| Exportation of goods or taxable services. | Professional services e.g. audit and tax advisory services | Financial services |
| Supply of goods or taxable services to Export Processing Zones and Special Economic Zones | Transfer of business as a going concern (TOGC) | Vaccines for human and veterinary medicine and various medicaments |
| Supplies to privileged persons and institutions e.g. UN bodies, Red Cross Society | Commercial rental premises (By default, if a supply is not taxable at zero per cent or exempt, there are high chances it is standard rated) | Residential rental premises |

Examples of supplies outside the scope of the VAT system

- Employment services rendered by an employee to an employer in consideration for a wage or salary;
- Disbursements to a third party of incidental costs incurred in the course of making a supply.

Illustration of VAT at each stage of the supply chain

| Stages in the supply chain | Selling price | Initial value created/Value added | Tax on Value Add |
|---|----------------------|--|-------------------------|
| Farmer - sales produce from his farm | 100 | 100 | 16 |
| Producer - transforms the raw material to products and sells the products to wholesaler | 120 | 20 | 3.2 |
| Wholesaler - Buys from producer, repackages products and sells to the retailer | 150 | 30 | 4.8 |
| Retailer - Buys from Wholesale, unbundles and sells to final consumer | 200 | 50 | 8 |
| Total tax on the value added | | | 32 |
| Check | | | |
| Price paid by final consumer | 200 | | |
| VAT at 16% | 32 | | |

Input and output tax mechanism in VAT Accounting

Input tax

- Tax paid or payable by a registered person on the acquisition of goods or services for making taxable supplies
- Tax paid on importation of goods for making taxable supplies

Output tax

- Tax charged by a registered person on the supply of taxable goods and/or services

OUTPUT – INPUT = TAX PAYABLE/CREDIT

Illustration on calculation of VAT position

Assume in a given month Company Z has the following data:

Taxable sales = KES 100M

Taxable purchases = KES 50M

Net VAT position for the month will be as follow:

Output tax = $100M * 16\% = 16M$

Input tax = $50M * 16\% = 8M$

Net VAT payable = $KES 16M - 8M = 8M$

Deductibility of input tax

- Deduction allowed to extent that input tax is incurred on a supply/import acquired to make taxable supplies;
- Deduction of input tax is restricted to within a period of six (6) months after the end of the tax period (calendar month) in which VAT is incurred for the supply subject to either of the below conditions:

a) Availability of the following supporting documents:

- An original tax invoice or a certified copy of the same.
- A customs entry duly certified by a proper customs officer and a receipt for the payment of the import tax.
- Credit notes and debit notes where applicable. Ensure the credit notes make reference to the corresponding invoices and they are properly declared in the VAT return.

b) the registered supplier having declared the sales invoice in a VAT return.

- Input tax directly attributable to taxable supplies is **deductible** in full;

➤ Input tax directly attributable to making of exempt supplies is not deductible; and

➤ Remainder of input tax is apportioned using the formula below

$$\frac{\text{Taxable supplies}}{\text{Total supplies}} \times \text{Total input tax} = \text{Deductible input tax}$$

Where the fraction of the formula is **greater than 90%**, **all** input tax is deductible.

Where the fraction of the formula is **less than 10%**, **all** input tax is not deductible.

| Taxable Supplies % | Exempt Supplies % | Input VAT claimable |
|--------------------|-------------------|---------------------------------------|
| 100 | 0 | Fully deductible |
| >90 | <10 | Fully deductible |
| 10-90 | 10-90 | Apportion |
| <10 | >90 | None – e.g. Banks, Insurance business |

Restricted items for input tax deductibility

- The VAT Act restricts input VAT deduction in relation to **acquisition** of:
 - passenger cars or mini buses, and the repair and maintenance thereof including spare parts, unless the passenger cars or mini buses are acquired by the registered person exclusively for the purpose of making a taxable supply of that automobile in the ordinary course of a continuous and regular business of selling or dealing in or hiring of passenger cars or mini buses; and
 - Entertainment, restaurant and accommodation services unless incurred in the ordinary course of the business of a person who provides such services or provided while the recipient is away from home for business purposes.

No VAT should be charged on the supply where no input tax deduction was allowed on that supply under these restrictions.

- ❑ The term 'acquire'/'acquisition' is not defined in the Kenyan VAT legislation.
 - *This has led to different interpretations, e.g. some people interpret the term 'acquisition' to include **purchasing, hiring and/or leasing** of the passenger cars.*
- ❑ Similarly, the term 'home' is not defined in the Kenyan VAT legislation.
- ❑ The lack of clarity as highlighted above leaves room for varied interpretations leading to unwarranted assessments by the KRA.

VAT compliance requirements

VAT accounting requirements

- A registered person is required to file VAT returns and pay any VAT due for the month no later than the 20th of the following month alongside the filing of VAT returns.
- The penalty for failure to file a return within the set deadlines is 5% of the tax payable or KES 10,000, whichever is higher.
- There is a late payment penalty for not paying VAT due within set deadlines of 5% of the tax due.
- There is also a 1% late payment interest per month or part of the on the tax due for the period the tax remains unpaid.

Requirement to issue a tax invoice

- A registered person who makes a taxable supply is required to furnish the purchaser with a valid tax invoice at the time of the supply.
- Every person is required to keep records of their business transactions in English or Kiswahili for a period of five (5) years.
- The unit of currency in books of account, records, paper registers, tax returns or tax invoices shall be in Kenya shillings.



Amendment of VAT returns

- A taxpayer is allowed to amend their VAT returns within five years of filing the return.
- Input tax not claimed within the return being amended cannot be deducted at the point of amending the return.

Entitlement to VAT refunds

- In principle, businesses should not bear the burden of the VAT itself and so there are mechanisms in place that allow for a refund or credit of the tax levied on transactions between businesses.
- A taxpayer is entitled to apply for VAT refunds in relation to:
 - Refund of excess tax arising from zero rated supplies should be lodged within twenty-four (24) months from the date the tax becomes due and payable;
 - Refund of excess tax arising from WHVAT should be lodged within twenty-four months (24) from the date the tax becomes due and payable;
 - Refund of tax paid in error should be lodged within twelve (12) months from the date the tax became due and payable; and
 - Refund of tax paid on bad debts should be lodged after 3 years from the date of the supply or where the person becomes legally insolvent. Note that the refund cannot be lodged after the expiry of 4 years from the date the supply was made.

Input tax relief claim

- A registered person is entitled to input VAT relief claim in relation to:
 - a. Change in VAT status of exempt supplies to taxable; and
 - b. Where a person becomes registered
- Input VAT claimed should be made within three (3) months of the change in status of supplies or registration in the prescribed form (on iTax).
- The input VAT eligible for relief should have been incurred within twenty-four (24) months immediately preceding the date of change in VAT status or registration.

No mechanism to recover excess credit if you are providing standard rated supplies only

WHVAT Compliance

- Withholding VAT regime is a mechanism of VAT deduction at source where the invoice payer is required to deduct 2% of the taxable value at the time of making the payment and remit the deducted amount directly to the KRA.
- Only WHVAT agents appointed by the KRA are required to withhold VAT when making payments and remit the same to KRA on or before the 20th day of the month following the month in which the deduction was made.
- There is a 10% penalty for a person who fails to remit all the tax withheld by the due date.
- Once the withholding VAT agent makes the payments, the agent is required to generate a Payment Registration Number (“PRN”) and quote the PRN while issuing instructions to the bank to remit the VAT withheld to the KRA.
- Upon receipt of payment of the WHVAT, the iTax simultaneously generates the WHVAT certificate.
- The WHVAT certificate is posted on the iTax platform of both the WH VAT agent and the supplier.
- The WHVAT certificate shows the amount withheld by the agent and allows the vendor from whom the amount has been withheld to claim VAT credits in the subsequent month following the month the VAT was withheld.

WH VAT exemption

- Finance Act, 2017 amended WHVAT provisions by allowing the Commissioner for KRA to exempt a supply from the application of WHVAT regime.
- Further, the WHVAT Regulations 2017 provided the conditions stated below for a supplier to qualify for WH VAT exemption.
 - Proof that WHVAT leads to a continuous VAT credit position to the entity for the next 24 months.
 - Provide the projections of VAT for the following 24 months after application.
 - Exemption lasts for 24 months upon which it can be renewed
 - Any time the tax payer gets into a payable position within the exemption, there is need to alert the Commissioner.
 - Required to submit the exemption letter to the suppliers who then will not withhold VAT on payments to the exempted entity.

Key provisions moved to the TPA

Major VAT administrative provisions moved to the TPA w.e.f 19 January 2016 include:

- Functions and powers of the Commissioner to enforce the provisions of the VAT law;
- Appointment of tax representatives;
- Interest on late payment;
- Withholding VAT provisions;
- Collection and recovery of tax;
- Assessments and amendment of assessments;
- Enforcement provisions; security for tax, production of records, and power to inspect;
- Provisions relating to objection;
- Forfeiture and seizure of goods;
- Settlement of cases and rulings by the Commissioner; and
- Provisions relating to offences and penalties

Trending VAT areas

Key VAT areas of focus by the KRA include:

- VAT Auto Assessments (VAA's)
- VAT on exported services;
- VAT on e-commerce / VAT on digital market place;
- VAT refunds and documentation;
- Reconciliation of sales per financial statements and sales declared in VAT returns; and
- Input tax deduction

VAT Auto Assessments (VAA's)

VAA is a system based solution that:

- Detects inconsistencies between purchase and sales invoices which have been declared in the VAT returns;
- Communicates the inconsistencies to both the buyer and the seller; and
- Automatically disallow input tax relating to unresolved inconsistencies.

VAA uses the invoice number and date as declared by the buyer to check the corresponding sale by the seller hence it is not necessarily a month to month matching between sellers and buyers.

VAA has given rise to a number of tax disputes – TAT and ADR processes.

VAT Auto Assessments (VAA's)

| Issues Identified | KRA response/feedback |
|---|---|
| Amending of invoice details for input tax in returns where return period is past six months | KRA has enabled filing of amended Provision to file amended returns with validated invoice details (number, supplier PIN, date) through back office (Data Correction) for VAA cases where taxpayers are not able to amend the same through their profile as the system considers them to be time barred (6 month-rule: Section 17 of VAT Act, 2013) |
| Limited entries in the VAT Excel return (50,000 for the different sheets) | Increase in the limit of entries in the VAT excel return to 75,000 entries for sheets 'B' and 'F' |
| Special characters in invoice numbers | A wider range of special characters are now allowed as part of invoice numbering |
| Generation of inconsistencies where invoice number has leading and lagging spaces in the invoice number | Invoices with leading and lagging spaces as captured by either buyers and sellers will be considered as matching and will therefore not form part of the generated inconsistency report |
| Rounding off errors | Invoice entries with inconsistencies relating rounding off errors will be validated and will therefore not form part of the generated inconsistency reports |
| Limited length of invoice number (maximum of 20 characters)- | Number of characters for the invoice column have been increased to 4 |

VAT on imported goods and services

VAT on imported goods

- Importation means to bring or cause to be brought into Kenya from a foreign country, a special economic zone enterprise or from an export processing zone;
- Time of supply of imported goods shall be:
 - Time of customs clearance for goods cleared for home use at the port of importation or at an inland station;
 - At the time of final clearance from a warehouse for home use;
 - At time of removal of goods from an export processing zone for home use; and
 - At the time goods are brought into Kenya, in any other case.

VAT on imported services

- VAT on imported services is a tax liability on any person, not just registered persons.

This is accounted for based on the nature to which the imported service is used:

- a) *Fully taxable persons* – no tax
- b) *Partially taxable persons* – tax payable on exempt supplies
- c) *Non-registered persons*: The non-resident supplier of electronic services is required to appoint a tax representative to meet his/her obligations

Accounting for VAT by registered persons

- This will be accounted for as follows:
 - a) *Fully taxable persons* :-Will get credit for full input tax payable by having the taxable value of the imported services reduced to zero
 - b) *Mixed supplies persons*:- Registered persons will get credit for the part of input tax that relates to taxable supplies.

$$\frac{\text{Exempt supplies}}{\text{Total supplies}} \times \text{VAT on imported service} = \text{VAT payable}$$

VAT on exported services

- Services exported out of Kenya means: *‘a service provided for use or consumption outside Kenya.’*
- VAT treatment of export of services is a contentious subject since the VAT legislation does not define *‘use or consumption’*.

Who reserves the taxing rights?

a. VAT Act 2013

- Paragraph 1 of the Second Schedule to the VAT Act, 2013 provides that exported services shall be taxable at the rate of zero percent.

b. OECD guidelines

- OECD VAT/GST guidelines adopt the ‘destination principle’ and provide that, as a general rule, the country with taxing rights over internationally traded services should be the country of the customer’s location

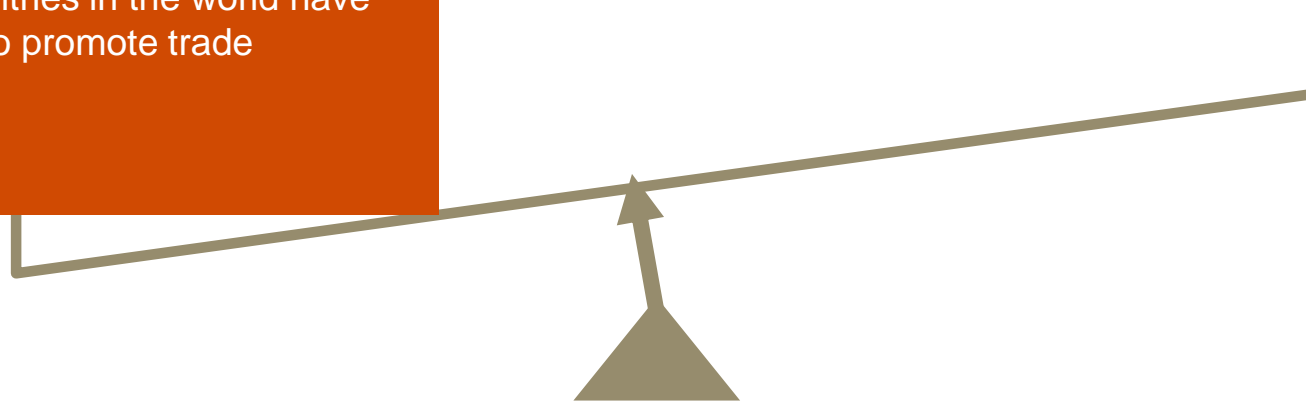
Justification for Zero rating exported services

- ❑ Harmonisation with international best practice and hence facilitating and encouraging international trade;
- ❑ Increases competitive power of Kenyan businesses in the world markets;
- ❑ Facilitates and encourage investment into the Country;
- ❑ Eliminate tax disputes, encourage compliance and boost revenues

Destination Vs Origin Principles in VAT

- ❑ The Organization for Economic Co-operation and Development (OECD) has developed VAT guidelines on international trade in goods and services based on the 'destination' principle
- ❑ The destination principle provides for neutrality on cross border supply of services.
- ❑ This is to ensure that tax on cross border supplies is ultimately levied only in the jurisdiction where the final consumption occurs.
- ❑ Therefore, most countries in the world have adopted this model to promote trade facilitation.

- ❑ Origin-based taxation of goods means either that the goods are taxed in the production state or in the state where the supplier is established.
- ❑ Applying this model of taxation can lead to economic distortions in case of tax rate differences between countries contributing to trade barriers across jurisdiction.



Other VAT guiding principles

Principle of Transparency

- The VAT is a transparent tax. It is an account-based tax system that should make the tax system transparent. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to risks involved.

Principle of Neutrality

- Neutrality means not to discriminate one to another in the sense that it should not discriminate between similar businesses and businesses should not bear disproportionate or inappropriate compliance costs that could distort their economic decisions So, in this regard, VAT is neutral.

Principle of Destination and Zero Rating

- Under this principle, goods and services are taxed at consumption point, but based on production. Goods and services that are exported are taxed at zero rates (i.e the taxpayers get a refund of VAT earlier paid in purchasing raw materials and interrelated goods but they should not pay tax on added value.)

Principle of Efficiency

- Compliance costs for businesses and administrative costs for the tax authorities should be minimized as far as possible. Is this the case in the Kenyan context?

In Summary

- In Kenya VAT is a destination based consumption tax.
- VAT has proved to be an efficient tool for revenue collection; its performance, therefore, has direct impact on fiscal mobilization, macroeconomic stability, and development.
- Compared with alternatives in indirect taxation such as customs and excise, VAT has more revenue potential: it is generally more broad-based and entails a trail of invoices that helps improve tax compliance and enforcement – you spur economic activity and the VAT base broadens.
- It is less risky in terms of revenue leakage (the invoice-based matching mechanism/system in administering VAT facilitates collection and enforcement; even if revenues are missed in one stage, they are still collected in other stages).

Q&A



Thank you