

OPERATIONS OF VAT IN KENYA AT A GLANCE

We wish to highlight some of the points, which are of paramount importance to note for any VAT registered person as per the VAT Act Cap 476. You are advised to refer to the Act for detailed information and interpretations as this document only highlights the key points.

1. Introduction

VAT is a consumption tax charged on both local sales and importation of taxable goods and taxable services. VAT is paid by Consumers of taxable goods and taxable services. It is collected by registered taxpayers (traders) who act as the agents of the Government. VAT on imported goods is collected by the Commissioner of Customs Services Department while local VAT and that on imported services is paid to the Commissioner of Domestic Taxes.

- ❖ A registered person for purpose of VAT is a person who is obliged to charge VAT on all taxable supplies made by him. A registered person is one who has supplied or expects to supply in the course of his business taxable supplies exceeding the value of Shs. 5 million in a twelve month period.
 - ❖ Prior to June 2007, for designated goods and services the suppliers were required to registered for VAT irrespective of whether or not the exceeded the Shs. 5 million threshold, however, the requirement has been removed.
 - ❖ A registered person should file VAT 3 i.e. monthly return by the 20th day of the month following the tax period. Where the 20th day falls either on a weekend or a public holiday, the return must be submitted on the last working day prior to the weekend or public holiday.
 - ❖ The return must always be submitted whether there is tax payable or not. Failure to submit a return, late filing or submission of payment returns without payment of the tax due is liable to a default fine of Shs. 10,000 or 5% of the tax due, whichever is the higher. An additional compounded interest of 2% per month is also levied on the tax due.
 - ❖ As per the VAT regulations, the VAT Registration Certificate must be displayed in a prominent place on the business premises. Where there is more than one place of business, certified copies of the Certificate must be displayed at each premise. Copies may be certified by the Commissioner. Failure to do this attracts a default penalty of Shs. 20,000 and a fine of up to Shs. 200,000 and/or imprisonment for up to two years.
 - ❖ A registered person should issue his clients with a tax invoice which should have the following details:
 - ✓ The name, address, PIN and VAT registration number of the supplier
 - ✓ The serial number of the invoice
 - ✓ The date of the invoice
 - ✓ The date of supply, if different from the date of the invoice
 - ✓ The name, address, PIN and VAT registration number of the person to whom the supply was made, if this is known to the supplier
 - ✓ The taxable value of the supply, if different from the price charged
 - ✓ The rate and amount of tax charged on each of the supply
 - ✓ Details of whether the supply is a cash or credit sale, and details of cash or discount, if any
 - ✓ The total value of the supply and the total amount of VAT charged
 - ✓ A logo unique to the business, if available
 - ✓ The unique identification number of the electronic tax register, printer or special secure fiscal device for record signing.
- Effective 16th June 2006, a tax invoice issued under the VAT Act should be serially numbered and either generated through an ESD or attached to an ETR receipt containing details of the transaction.
- ❖ As per the VAT regulations, input VAT can only be claimed on an original tax invoice from a supplier. Therefore, one can only claim the input VAT if one is possession of an original supplier's tax invoice reflecting details as enumerated above.

- ❖ A VAT control account should be maintained in the ledger showing totals of the output tax and input tax in each period and the tax payable or refundable. Apart from being a legal requirement, this provides an additional financial control to aid in detection of any error. The VAT control account should be reconciled monthly with the VAT return and where differences arise, these should be immediately investigated and reconciled.

The VAT payable/ claimable per month is usually the difference between the Output VAT and the Input VAT. Output VAT refers to the VAT charged by the company to its clients, while Input VAT is the VAT charged to the company by its suppliers.

2. VAT Rates

- ✓ **16%:** this is the general rate of tax applicable to all taxable goods and services other than those that are Zero rated.
- ✓ **0%:** this applies to certain categories of goods and services, which include exports, agricultural inputs, pharmaceuticals and supplies to privileged persons. The purpose of zero rating is to make the supplies cheaper as dealers in these goods and services can claim input tax incurred in the course of their business. Zero rated supplies are taxable supplies but since the rate of tax is 0%, output tax is charged at 0%.
- ✓ **Exempt Supplies:** These are goods and services that are not taxable. Persons dealing exclusively in such supplies are not required to register for VAT. However, if a trader deals in both taxable and non-taxable supplies, he should register for VAT if he meets the registration requirement on taxable supplies. Input tax incurred in production of exempt supplies is not deductible.

3. What is a Supply?

Supply includes:

- ✓ The sale, supply or delivery of taxable goods to another person;
- ✓ The sale or provision of taxable services to another person;
- ✓ Gifts of any taxable goods or services;
- ✓ Letting of taxable goods on hire, leasing or other transfers;
- ✓ Contractor supplying taxable services to himself if constructing a building or related civil engineering works for his own use, sale or renting to other persons;
- ✓ The appropriation by a registered person of taxable goods or services for his own use inside of the business where if supplied by another registered person, the tax charged on such goods or services is excluded from the deduction of input tax e.g. a saloon car taken by a motor dealer for use in the business;
- ✓ The appropriation by a registered person of taxable goods or services for his own use outside the business e.g. removal of goods from one's shop for home use; and
- ✓ Any other disposal of taxable goods or provision of taxable services.

VAT is charged on the supply of goods or services and on the importation of goods or services into Kenya; and

- ✓ The supply is a taxable supply; and
- ✓ The supply is made by a taxable person; and
- ✓ The supply is made or provided in Kenya; and
- ✓ The supply is made or provided in the course of the furtherance of a business carried on by the taxable person.

The value of taxable services must include any incidental costs incurred by the supplier of the service in the course of making his supply, excluding any disbursements which the supplier has made to a third party as an agent of his client.

4. Tax Point

VAT is due and payable on the TAX POINT, which is earlier of:

- ✓ Supply of the goods or services to the customer;
- ✓ The issue of an invoice in respect of the supply (Invoices must be raised within 14 days of completion of the supply and the date of supply should be stated if this is different from the invoice date.);
- ✓ A certificate is issued, by an architect, surveyor or any person acting as a consultant or in a supervisory capacity, in respect of the service; or
- ✓ The receipt of payment for all or part of the supply.

For an imported taxable service, the TAX POINT is earlier of:

- ✓ Date the imported service is received;
- ✓ Date an invoice is received; or
- ✓ Part or full payment is made.

VAT charged should be paid irrespective of whether or not the supplier has been paid for the goods or not. However, a registered taxpayer may claim as bad debt any VAT declared to the Commissioner if the debtor fails to pay him within a period of three years from the date of the supply or becomes legally insolvent. The debt should however not be more than five years old. Other conditions set out in the VAT Act must be fulfilled.

5. Deductible Input Tax

Tax paid on the supply for any goods or services used in the production of taxable services can be claimed as input tax. VAT Order 2002 specifies the following items on which input VAT cannot be claimed unless they are stock in trade:

- ✓ Fuel and oils to be used in motor vehicle, ships and other vessels;
- ✓ Passenger vehicles and mini buses (except where used for leasing, hiring or redesigned to supply taxable supplies);
- ✓ Bodies, parts and repairs of passenger vehicles and mini buses (except where used in supply of taxable supplies);
- ✓ Leasing or hiring of passenger vehicle and mini buses;
- ✓ Furniture and fittings and ornaments except those permanently attached to buildings or for use in hotels and restaurants (subject to approval from Commissioner);
- ✓ Household or domestic electrical appliances other than those approved by the Commissioner for use in manufacture of other taxable goods or supply of taxable services;
- ✓ Entertainment services;
- ✓ Restaurant services;
- ✓ Accommodation services; and
- ✓ Taxable supplies for staff housing and welfare (including office tea, mineral water, staff canteen, staff transport etc).

In instances where a person makes both taxable and exempt supplies, only part of the tax attributable to taxable supplies would qualify as input tax. Taxable supplies include zero-rated supplies. Where tax in respect of exempt supplies exceeds 5% of the whole tax, then the registered person is required to apportion the tax by securing a fair and reasonable attribution of tax to taxable supplies. Either of the following methods can be used to determine the amount of deductible input tax:

- ✓
$$\frac{\text{Value of taxable supplies}}{\text{Value of total supplies}} \times \text{Input tax} = \text{Deductible input tax}$$

- ✓ Deduction of input tax attributable to taxable goods purchased and sold in the same state and not deducting any input tax directly attributable to exempt supplies. The remainder of the input tax is apportioned using the above formula i.e.
 - 1) full deduction of all the input tax attributable to taxable goods purchased and sold in the same state and no deduction of any input tax which is directly attributable to exempt outputs, and
 - 2) deduction of the input tax on overheads using the above formula.

6. Changes Affecting Registration

A registered person is required to notify details to the Commissioner within fourteen days of the following changes:

- ✓ Change of address of the place of business; or
- ✓ Additional premises are, or will be used for the purpose of the business; or
- ✓ Premises used for the business cease to be so used; or
- ✓ Business or trading name is changed; or
- ✓ An interest of more than thirty percent of the share capital of a limited company has been acquired by a person or group of persons; or
- ✓ The person authorised to sign returns is changed; or
- ✓ The partners in a partnership are changed; or
- ✓ A change occurs in the trade classification of the goods or services supplied.

7. Record Keeping

- ❖ Paragraph 7 of the VAT Regulations and the Seventh Schedule to the Act prescribe the records to be kept, which include:
 - ✓ Copies of all invoices issued in serial number order i.e. ETR generated tax invoices;
 - ✓ A VAT account showing totals of the output tax and input tax in each period and the tax payable or refundable;
 - ✓ Copies of all credit and debit notes issued, in chronological order;
 - ✓ Original purchase invoices - ETR generated and/or supported by ETR receipts, original copies of customs entries, receipts for the payment of customs duty or tax, original credit and debit notes received, all to be filed chronologically;
 - ✓ Details of the amounts of tax charged on each supply made or received;
 - ✓ Totals of the output and the input tax in each period and a net of the tax payable or the excess input tax at the end of each period;
 - ✓ Details of goods manufactured and delivered from the factory;
 - ✓ Details of each supply of goods and services from the business premises;
 - ✓ Copies of stock records kept in a chronological order;
 - ✓ Journals, ledgers, cash/petty cash books, audited accounts, bank statements.
- ❖ All records must be kept in the Kiswahili or English language and for a period of five years from the date when the last entry was posted.
- ❖ A VAT 3A form analysing the input tax incurred within the month should accompany any credit returns. A VAT 3A form should also be completed for any payment return where the input tax incurred is Shs. 3 million or more for a Nairobi trader or Shs. 1.5 million in other Districts. The VAT 3A form should be completed and submitted to the nearest Domestic Tax Department by 30th.
- ❖ A VAT 3B form analysing all zero rated supplies should also be submitted where zero-rated sales are made.
- ❖ The Commissioner is empowered to issue a notice requiring a taxable person to keep such records or take such action as the Commissioner may specify.
- ❖ The Commissioner is empowered to allow a taxpayer to file returns and receive other information electronically.
- ❖ The Commissioner is empowered to require any person to use an electronic tax register for purposes of accessing information that may affect the tax liability of that person.

- ❖ Any person required to use an electronic tax register may recover the total cost of acquisition from the VAT payable, within the pre-determined period, subject to prior approval by the Commissioner.

8. Imported Goods and Services

For taxable goods imported into Kenya, the taxable value is the value for duty (whether duty is payable or not) plus the duty (whether or not a remission of the duty has been issued). VAT on imported goods is collected by the Commissioner of Customs Services Department on clearance of goods.

The taxable value in respect of imported services is the price charged for the supply i.e. the price charged on the supplier's invoice. VAT on imported service is payable by the importer of the service using forms VAT7 and VAT 28. VAT on imported services is paid to the Commissioner of Domestic Taxes. Input VAT, where eligible, should be claimed in the next VAT return following the payment.

9. VAT Audit

The Kenya Government has in the recent few years shifted emphasis of taxation from direct to indirect taxation. VAT has therefore, grown to be one of the major revenue earners for the government. During the same period the Kenya Revenue Authority has also embarked on extensive audit procedures for taxpayers as part of their tax modernisation programmes whose emphasis has again been shifted to VAT. Unlike Income Tax audits where they usually audit two consecutive years and then may give you a breather for three to four years, VAT audits are done on a continuous basis. The subsequent audit will therefore pick up from where the previous audit ended.

The audit will usually focus on:

- ✓ Compliance with VAT laws and regulations
- ✓ Assessment of VAT not correctly charged.
- ✓ Disallowance of input tax incorrectly claimed.
- ✓ Identification of other offenses and errors.
- ✓ Levying of penalties and interest for the defaults and errors.
- ✓ Educating taxpayers thereby ensuring better compliance in future.

Additional Circumstances Triggering VAT Audits

Whilst most taxpayers will be subjected to annual or bi-annual VAT audits, the following circumstances can trigger an audit as well:

- ✓ Audit of related companies.
- ✓ Sales in accounts different from VAT 3 figures.
- ✓ Imported goods figures not tallying with customs records
- ✓ Persistent refunds for non-export entities.
- ✓ Information from competitors, employees, etc.
- ✓ Persistent late submission of returns.
- ✓ Transactions requiring PIN

10. Offences and Penalties

OFFENCE	PENALTY	REFERENCE
Late payment of tax	Interest at 2% per month compounded	Section 15 (1) & (2)
Failure to comply with the commissioner's notice to pay money owed to a taxable person from whom tax was due or furnish a return showing monies held or due to a person from whom tax is due	Fine not exceeding Shs. 15,000 and/or up to six months imprisonment and liability to pay the amount discharged	Section 19 (6)
Failure to produce books, records or provide information as required by an authorized officer	Fine not exceeding Shs. 15,000 and/or up to six months imprisonment	Section 30 (2)
Failure to produce books, records, statements or other documents or to attend summons or to answer questions put by the VAT tribunal	Fine not exceeding Shs. 15,000 and/or up to two years imprisonment	Section 35
Making false statements, producing false documents, providing false information, involvement in fraudulent evasion of tax, a non-registered person who holds himself out as a registered person	Fine up to Shs. 400,000 or double the tax evaded, whichever is the greater. In addition, any taxable goods connected with the commission of the offence may be forfeited	Section 40
Failure to display registration certificate in a visible place in the business premises	Default penalty of up to Shs. 20,000 and a fine of up to Shs. 200,000 and/or imprisonment for up to two years	Sixth Schedule Paragraph 10 (2)
Late submission of application for registration	Penalty of Shs. 20,000	Sixth Schedule Paragraph 11
Failure to apply for registration	Penalty of Shs. 100,000	Sixth Schedule Paragraph 12
Failure to issue a tax invoice as required	Penalty of between Shs. 10,000 and Shs. 200,000. Any goods connected with the offence liable to forfeiture	Seventh Schedule Paragraph 5
Failure to keep proper books or records	Penalty of between Shs. 10,000 and Shs. 200,000	Seventh Schedule Paragraph 6
Failure to submit a return	Penalty of Shs. 10,000 or 5% of the tax due, whichever is the higher	Seventh Schedule Paragraph 9
General penalty for offences under the Act for which no specific penalty is prescribed	A maximum fine of Shs. 200,000 and/or up to three years imprisonment	Section 43
Failure to withhold VAT, remit withheld VAT, or submit withholding VAT return	Penalty of Shs. 10,000 or 10% of the tax due, whichever is the higher	Seventh Schedule Paragraph 10
Withholding VAT without being appointed as a withholding VAT agent	Penalty of Shs. 10,000 or 10% of tax due, whichever is higher	Seventh Schedule Paragraph 10

OFFENCE	PENALTY	REFERENCE
Making a fraudulent claim for VAT refund	Penalty of double the amount claimed or to imprisonment for a period not exceeding three years or both	Section 40

- ❖ Where an employee or agent commits an offence, the employer shall also be guilty of the offence unless one proves innocence.
- ❖ Where a company commits an offence, every director, general manager, secretary and officer of the company concerned with the management of the company shall also be guilty of the offence unless he proves his innocence.
- ❖ The Commissioner is empowered, subject to specified conditions, to compound offences under the Act. The order issued by the Commissioner in such a case can be enforced as if it were a decree or order of the High Court. The taxpayer whose offences have been compounded is not liable to prosecution except with the express consent of the Attorney General.
- ❖ The Commissioner is empowered, in instances of taxpayers' failure to remit tax due, to charge the taxpayers land and building as security upon notice to the taxpayer. With effect from June 2007 the Commissioners powers have been extended and he is now empowered to sell the land and building prior charged to recover any tax due.

We hope that the above will guide you in dealing with the company's VAT matters. Please note that the above are only simple guidelines to enable you understand the simple requirements of a VAT registered trader. Where in doubt, please do not hesitate to contact us.

CAVEAT

This tax bulletin is designed to familiarise clients with some of the provisions of VAT Act. It constitutes only a brief guide and is not a comprehensive summary of the Act. While every care has been exercised in ensuring the accuracy and completeness of the information, RSM Ashvir and its associates will not accept any liability for any errors or omissions contained herein whether caused by negligence or otherwise, or for any loss, however caused or sustained by anyone who places reliance on the contents.

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