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Newsletter

MBAYA AND ASSOCIATES February 2019 | Issue 044 | Volume 5

Introduction

We welcome you to our second edition of year 2019 tax newsletter. The newsletter covers a variety of the recent developments in **tax** and **accounting** regime in Kenya to keep you current and updated on tax matters and the latest in business trends.

On the right column of the newsletter you will find contact details for the senior members of our team who can help answer any questions you may have about the issues highlighted in this newsletter or any other questions.

We are interested in your feedback on the items covered and what topics you would like covered in the future.

Please provide any feedback at **tax@mbaya.co.ke**

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» TAX ALERT, P3

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From the TaxDesk

Principles of Taxation & their Relevance Today

What is Taxation?

A **tax** is a financial charge or other levy **imposed** upon a taxpayer (an individual or legal entity) by a **state** or the functional **equivalent** of a state to fund various public expenditures.

A failure to pay, or evasion of or resistance to taxation, is usually punishable by law.

Why Tax?

The main purpose of taxation is to accumulate funds for running governments all over the world. Administrative systems and development agendas require funds and taxation is the main system of generating these funds. It is therefore the urge of any tax administration to widen the **tax base** so as to be able to finance all its projects.

Tax Base - The tax base is the measure or value upon which a tax is levied. It is a pool whereby taxes are levied. To widen the tax base, a tax administration need to as much as possible reduce both the **average tax rate** and **marginal tax rate**. This will motivate the population as the tax rates are low and will reduce chances of tax evasion.

Average tax rate: This is the total amount of tax you pay divided by your total income.

Marginal tax rate: This is the tax rate you pay on any additional income you earn.

Taxation is guided by two theories: The **four Rs** & the **four Canons** of Taxation.

The Four R's of Taxation

Taxation has four main purposes or effects:

Revenue: Though tax, the government collects the revenue which is used to spend on services.

Redistribution: The income received through taxation is distributed entirely. This helps to bridge the gap between the wealthy and the poor

Repricing: Taxation encourages/discourages consumption by imposing more or less tax on a commodity.

Representation: Those elected to rule impose the tax on the citizens, who then demand accountability of the resources

The Four Canons Taxation

Canons of taxation simply mean the characteristics or qualities, which a good tax system should possess. The four are canons of **equity, certainty, economy** and **convenience**.

Equity: This states that persons should be taxed according to their ability to pay taxes.

Certainty: The time of payment, the manner of payment and the amount to be paid should be clear to every tax payer and not arbitrary.

Economy/Efficiency: Every tax has a cost of collection. The canon of economy implies that the cost of tax collection should be very minimal.

Convenience: The mode and timings of tax payment should be convenient to the tax payer. This means that the taxes should be imposed in such a manner and at the time which is most convenient for the tax payer.

VAT Planning and Current Issues

VAT is a tax on consumption.

Incidence and impact of VAT is borne by the final consumer of goods and services.

Transactions entered into prior to 2nd September 2013 are governed under the repealed VAT Act

Tax point is the main point of reference

Generally, input tax qualifies for deduction against output tax and special consideration required for business with mixed sales.

Exempt businesses are not required to register/account for VAT

VAT Planning Tips/Ideas

- Speedy collection of debts since the tax point is not based on cash received
- Claim for relief of VAT on Bad debts
- Acceleration of input tax
- Deferral of input tax
- Compliance to minimize possible penalties by KRA

VAT Current Issues

- Introduction of VAT Auto Assessment (VAA).

- Introduction of VAT on petroleum products previously on transition period.
- Massive recruitment of Withholding VAT Agents.
- Aggressive audits by KRA

Tax Alert

Reprieve for Taxpayers as the High Court rules on VAT on Exported Services

The Value Added Tax ("VAT") treatment on exported services from Kenya is a contentious topic that has been the subject of numerous disputes between the Kenya Revenue Authority ("KRA") and Taxpayers engaged in cross-border business.

The High Court of Kenya sitting in Nairobi delivered a judgment on 21 December 2018 dismissing an appeal by the Commissioner of Domestic Taxes ("the Appellant"). The High Court held that in establishing whether or not services have been exported out of Kenya, the guiding factor should be the location of the consumer of the services and not the place where the services are performed.

The High Court also went further to determine that the taxing rights in relation to VAT on cross border supply of services are vested in the jurisdiction of the final consumer. We provide below a brief summary of the facts of the case and our analysis of the judgment.

Background Facts of the Case

The case in question was an appeal filed by the Commissioner against a decision of the VAT Appeals Tribunal, a predecessor of the current Tax Appeals Tribunal established under the Tax Appeals Tribunal Act, no. 40 of 2013. The appeal at the Tribunal was occasioned by an adverse tax decision by the Commissioner that had sought to reverse an earlier private ruling issued to the Taxpayer in 2011.

In the private ruling, the Commissioner had guided that the scanning, cooling and palletizing services provided to a non-resident company by a local airfreight handling company were taxable at 16%. Aggrieved by the adverse tax decision issued by the Commissioner, the Appellant, a limited liability company incorporated and resident in Netherlands filed an appeal before the Tribunal challenging the Commissioner's position.

The Tribunal delivered its ruling on 17 September 2013 in favour of the Appellant holding that no VAT was chargeable on the supply of the services in question on account that these were exported out of Kenya. KRA appealed the Tribunal ruling leading to the current referenced case at the High Court.

During the hearing of the case, the Commissioner contended that the services in question were services provided within Kenya and thus taxable at 16% as they did not qualify as exported services. The Commissioner was of the view that what was being exported was the horticultural produce and not the services provided by the airfreight company.

The Commissioner submitted that in determining the '**user**' or '**consumer**' of a service as envisaged in the VAT legislation, the party who pays for the service is irrelevant; what matters is where the service is provided, who provides the service and the place of use or consumption of the services.

According to the KRA, the consumers of the services provided by the airfreight company were the flower farmers in Kenya whose produce (cut flowers) was certified as fit for exportation. On the other hand, the Taxpayer/Respondent submitted that the services offered to it by the airfreight company were intended to ensure that the horticultural produce acquired from Kenya arrived in Europe in a fresh state suitable for consumption and use by its European buyers.

In this regard, the benefits of these services accrued to the Respondent in Holland and its consumers who were based outside Kenya and therefore VAT was only applicable in the Netherlands and not in Kenya.

Determination and Judgement of the High Court

The main issue for determination by the court was whether the services rendered by the airfreight company were exported services as envisaged in the VAT legislation. **The High Court in dismissing the Commissioner's appeal held that the services offered by the airfreight company to the Respondent were in fact exported services and that the location where services are provided does not determine the question of whether the services are exported or not.**

We highlight below some of the observations made by the High Court in arriving at its judgment and our views on the same:

a) The High Court held that for a service to qualify as an 'exported service', it matters not whether that service was performed in Kenya or outside Kenya. This is in accordance with the provisions of **Section 2 of the repealed VAT legislation – Cap 476**. The determining factor is the location where that service is to be finally used or consumed.

b) The court held that the user and consumer of the scanning, cooling and palletizing services though performed in Kenya, was the Respondent and its European customers based outside Kenya. The court alluded to the fact that the word 'use' or 'consume' cannot be equated with the word 'performed'.

c) The court held that there was no evidence or even suggestion by the Appellant/Commissioner as to the existence of any contractual arrangements between the Kenyan farmers alleged to be the consumers of the services and the airfreight company. The only service contract existed between the airfreight company and the Respondent.

d) The court also held that the services provided by the airfreight company were consumed by the Respondent (a foreign-based company) and its European customers, thus the said services were ultimately enjoyed or used outside Kenya.

Conclusion

In our view, in determining the consumer of the services, one needs to look beyond the perceived beneficiaries and evaluate the party that ultimately benefits from the intrinsic value of the services rendered and contracts those services. It is our understanding that the KRA has filed a notice of appeal to the High Court decision before the Court of Appeal. However, in the absence of a successful appeal by the KRA, the High Court judgment remains binding on the KRA and taxpayers alike. We will continue monitoring the developments on this matter and keep you updated.

From Risk to Opportunity – Accountants Need to Lead Enterprise Risk Management

Courtesy of Stathis Gould, Head of Professional Accountants in Business and Integrated Reporting,

Professional accountants have an opportunity to enable more effective ERM within their organizations. To seize the opportunity, they must be seen as risk experts who are outward-looking and provide valuable insights to manage opportunity and risk in a way that supports their organizations create as well as preserve value.

Long term value creation and success ultimately depends on the quality of decisions made. ERM is about enabling informed decisions across the organization in the context of increasing uncertainty driven by a myriad of factors, including geopolitical events, volatile financial markets, technology developments, cybersecurity, data privacy concerns, and climate change. Better decisions are generally the result of superior insight into the drivers of opportunity and risk. For a bank, these sources of value creation might be quite different than for a consumer products company. That said, despite different business models, the ability to navigate uncertainty and manage issues will determine whether an organization thrives in the future.

A key challenge is that many organizations do not have an integrated risk management process in place.

A survey of mainly US-based reveals that there is pressure to increase management involvement in risk oversight. According to the survey, the volume and complexity of risks is increasing extensively, and most companies struggle to integrate risk management. The survey found, for example, that less than 20 percent of respondent organizations views their risk process as being integrated with strategy and objectives. This suggests risk management remains siloed in many organizations, and we believe that the story is the same in most countries.

ERM is critical for CFOs and finance teams to provide additional value to the business

The accountant's contribution to ERM will help improve decision making by enhancing the insights and information available to boards and management as they respond to uncertainty. However, ERM can only help them to better deal with uncertainty if information is comprehensive, connected and insightful. Better "risk intelligence" ultimately means a better understanding of opportunity and risk in the context of what is happening externally to the organization, such as changing customer expectations and preferences, new competitors, and resource constraints.

CFOs and their finance teams will be trusted ERM leaders if they provide rich insights that draw on data and activities across different parts of an organization, and act as a "spider in the web" to bring together a holistic understanding of risk and opportunity. CFOs and accountants with clear risk management responsibilities are in a better position to make individually and functionally greater contributions to ERM.

Fortunately, there's an increasing trend of CFOs being tasked with risk management as a functional responsibility according to McKinsey's latest CFO survey. To effectively lead in ERM requires investment in the finance function, as well as in the finance professional skillset.

IFAC's report provides three key recommendations for CFOs and finance functions to help enhance their contribution to ERM and to ensure that ERM sits at the heart of not only every organization, but also the professional accountant skillset.

These recommendations include:

1. Relating risk management to value creation and preservation - The CFO and finance function needs to support boards and management to fully understand risk and the issues that really matter, helping to evolve and transform business models to ensure resilience. This involves capturing and measuring data on critical intangible assets and value drivers, including brand and reputation, people and culture, data, access to resources, intellectual capital, and innovation.
2. Driving insights and enabling decisions - An effective contribution to ERM involves providing insights to decision makers. ERM activity can be overly focused on identifying risks in different areas and recommending defensive actions. This approach may serve to curb innovation and discourage the pursuit of opportunities, particularly related to key areas of transformation such as digital transformation and resource scarcity. Producing high-quality information about opportunities and risks and their implications requires scenario and risk modelling and analytics.
3. Enabling integration and interconnectivity – Because risk management is often locked in siloes, it is difficult to see whether opportunities and risks are managed on an integrated "end to end" basis. The CFO and finance function have an important role in connecting the dots and in integrating risk across functions and processes within a holistic ERM framework. An enterprise-wide risk management approach structured around an ERM framework, such as the Committee of Sponsoring Organizations of the Tread way Committee (COSO) framework, ensures a holistic approach that develops the culture, capabilities and practices for organizations to effectively manage risk.

ERM must be a core competence of professional accountancy education and training moving forward. The report also provides recommendations on the skillset needed by professional accountants to be effective in risk management, and how IFAC members can better support accountants enhance their role.
As accountants in business provide ever-more strategic roles within their organizations, ensuring resilience and risk awareness in times of heightened uncertainty is a key area where our global profession can make significant progress.

Tax Due Dates

Withholding Tax | 20th Day of the following month
Pay as You Earn | 9th Day of the following month
VAT | 20th Day of the following month
Balance of Tax on Self-Assessment | 4th Month after year end
Monthly Rental Income | 20th Day of the following month

KENYA REVENUE AUTHORITY

Instalment Tax

1st Instalment |20th day of the 4th month after year end
2nd Instalment | 20th day of the 6th month after year end
3rd Instalment | 20th day of the 9th month after year end
4th Instalment | 20th day of the 12th month after year end
Kindly note that all the returns must be filed on I tax while the payments e-slips must be generated from the I-Tax platform.