SEPTEMBER 2022 | 8.87

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Income Tax Audits & Compliance Checks

Newsletter

MBAYA AND ASSOCIATES September 2022 | Issue 087 | Volume 8

Introduction

We are pleased to release the ninth edition of our tax newsletter. We appreciate the lively feedback and fruitful engagement we have had in the previous editions of our newsletters. This issue will summarize VAT regulations, the recent corporate Income Tax Audits and compliance checks conducted by KRA and the continued article on Personal Finance.

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

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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Deadline for Compliance with Tax Invoice Management System (TIMS)

As indicated in our last edition of our newsletter, the Kenya Revenue Authority (KRA) extended the deadline for the requirement by taxpayers to comply with regulations of Tax Invoice Management System (TIMS) to **30th September 2022**. The extension of deadline is an administrative decision necessitated by taxpayers' request for more time to acquire and activate their TIMS devices in compliance with Electronic Tax Invoice (ETI) Regulations that were gazetted on 25th September 2020, Legal Notice 189.

The overall objective of the introduction of TIMS vide VAT (Electronic Tax Invoice) Regulations, 2020 is to increase VAT compliance, minimize on VAT fraud and increase tax revenue.

VAT registered taxpayers are required to fully transition to use Electronic Tax Registers that meet the requirements outlined in the Regulations.

We recommend that all VAT registered taxpayers to consider migrating to TIMS before the extended time lapses which is in the next three weeks. Given the rush for the TIMS kits, we ask all taxpayers who have not gotten one to do so immediately. The system will require some set up and therefore plan for some onboarding lags.

Exemption of Non-Resident Suppliers of Digital Services from the VAT (Electronic Tax Invoice) Regulations, 2020

Kenya Revenue Authority through a notice issued on 19th August 2022 clarifies to the public and all VAT registered taxpayers that the Value Added Tax (Digital Marketplace Supply) Regulations, 2020 exempts registered non-resident suppliers of digital services from issuing electronic tax invoices as required under the Value Added Tax (Electronic Tax Invoice) Regulations, 2020.

However, the non-resident suppliers of digital services are required to issue invoices or receipts showing the value of the supply and the tax charged.

VAT registered taxpayers in Kenya who import such services may claim the input tax so charged at the end of the tax period in which the importation occurs in line with the provisions of the VAT Act, 2013. The necessary enhancements have been made to the iTax system to support this compliance framework.

Finally, our interactions with KRA suggest that there may not be another extension to the deadline and so let us try and comply early.

Income Tax Audits and Compliance Checks

The Kenyan tax system is a self-assessment system where a taxpayer assess himself or herself and makes payment to KRA on the tax due. This is a responsibility bestowed on each Kenyan citizen with a registered KRA PIN. In the recent years, Kenya Revenue Authority ("KRA") have established that some corporates or individuals have failed to discharge the duty bestowed on them by either under declaring or not declaring at all. In return, KRA have conducted numerous Income Tax Audits and Compliance checks for various taxpayers. The aggression demonstrated by the revenue authority is directed at achieving ever increasing revenue targets. KRA is keen on nabbing any form of tax evasion by the individuals or corporates.

It is now, more than ever, prudent that taxpayers become proactive and take all the necessary measures to minimize non-compliance risks and the resulting tax exposure.

KRA Compliance Check

These are high level reviews conducted by the KRA compliance officers through the review of the filed tax return. Where tax gaps are identified leading to tax liability, the taxpayer is informed both orally and in writing. Moreover, the taxpayer is requested to respond to the issues before an assessment or demand is issued.

How does Non-Compliance come about?

Non-compliance arises when a tax payer information as declared in the year end income tax return is inconsistent with the monthly tax return filed during the year. Tax payers are supposed to ensure the following tax areas, amongst others, are reconciled in the year end income tax return.

Tax Head	**Monthly tax return**	**Proposed course of action.**
Pay As You Earn (PAYE)	Monthly PAYE returns. Bonuses	Total monthly PAYE expense should be reconciled with the payroll expense in the final accounts. Reconcile bonus expense in the final accounts with bonus as declared in the relevant PAYE returns.
Income Tax (Company/ Individual)	Monthly VAT returns	Total monthly income as per VAT return should be reconciled with income as declared in the final accounts.
Wear and Tear	N/A	Ensure balances are brought forward and correct rates are used.
Withholding Tax	Professional fees	Ensure professional fees are subjected to withholding tax where applicable at the prevailing tax rate.

Tax Head	Monthly tax return	Proposed course of action.
Individual/Corporate Income Tax	Instalments and balance of tax	Ensure instalments and balance of tax are paid by the due date where applicable.

Measures to Curb Non-Compliance by Tax Payers

i. Submitting the relevant tax returns or any other document on time as guided by the tax law.
ii. Payment of tax due on time.
iii. Engaging competent professional for advice on tax matters, where necessary.
iv. Adhering to the tax laws.
v. Ensuring that the information contained in the tax returns is accurate.
vi. Timely application for registration, deregistration or cancellation of either registration and/or obligation as required under a tax law.
vii. Timely provision of information or documentation for examination as required by the KRA commissioners.

How to Manage Tax Audits?

It is in the interest of every taxpayer to understand how to respond to an ongoing tax audit. The following measures are recommended.

i. Upon receipt of the KRA letter prepare a response within the stipulated timeframe. It's advisable to confirm receipt of the letter through email were sent through electronic form.
ii. Address the issue adequately as raised by the KRA officers.
iii. Serve the Commissioner with the response either by hand or through the email. Where possible, the KRA will acknowledge receipt of the response.
iv. Request for additional time to gather the requested documentation where likely to take more time than the stipulated timeframe.
v. Seek professional help where necessary.
vi. Make consistent follow up.

The above tax audit can be solved at the interest of the taxpayer. However, there are instances where taxpayer is issued with additional tax assessments and/or demand notice. The taxpayer is informed of his or her right to object to the demand or the assessment. The taxpayer has an option of paying the taxes or objecting to the assessment and thereafter lodging an appeal to the Tax Appeal Tribunal. Where the taxpayer opts to pay the additional tax, he or she can negotiate and enter into a payment plan with KRA. Additionally, taxpayers should endeavour to keep or retain the records for at least five years after the submission of the relevant tax return.

Personal Finance

In our last edition of our newsletter, we discussed the first stage to consider as you start the journey of financial freedom. In this issue, we discuss the roadmap to get there; making **a Financial Plan, a Budget**. A budget is **an estimation of revenue and expenses over a specified future period of time and is usually compiled and re-evaluated on a periodic basis**. financial planning tool that allows you to plan how much you will spend or save each month. It also allows you to track your spending habits. It's an important part of keeping your financial house in order. That's because budgets rely on balance. If you spend less in one area, you can spend more in another, save that money for a large purchase, build a "rainy day" fund, increase your savings, Budgets can be made for a person, a group of people, a business, a government, or just about anything else that makes and spends money.

There are six simple steps which guides the planning of a personal budget.

1. **Gather Your Financial Paperwork** » Gather up all your financial statements including Bank statements, investment accounts, credit card bills, Loan statements, receipts for at least the last 3 months, recent utility bills etc. By this, you want to have access to any information about your income and expenses.
2. **Calculate Your Income** » How much income can you expect each month? If your income is in the form of a monthly pay where taxes are automatically deducted, then using the net income (or take-home pay) amount is fine. If you are

self-employed or have outside sources of income, such as child support or Social Security, include these as well. Record this total income as a monthly amount.

3. **Create a List of Monthly Expenses** » Write down a list of all the expenses you expect to have during a month. This list could include, mortgage payments or rent, Car payments, Insurance, Groceries, Utilities, Entertainment, Transportation costs, Personal care etc. Use your bank statements, receipts, and credit card statements from the last three months to identify all your spending.
4. **Determine Fixed and Variable Expenses** » Fixed expenses are those mandatory expenses that you pay the same amount for each time. Include items like mortgage or rent payments, car payments, set-fee internet service etc. If you pay a standard credit card payment, include that amount and any other essential spending that tends to stay the same from month to month. If you plan to save a fixed amount or pay off a certain amount of debt each month, also include savings and debt repayment as fixed expenses. Variable expenses are the type that will change from month to month, such as: Groceries, Entertainment, etc. Start assigning a spending value to each category and Then, estimate how much you'll need to spend per month on variable expenses.
5. **Total Your Monthly Income and Expenses** » If your income is higher than your expenses, you are off to a good start. This extra money means you can put funds towards areas of your budget, such as retirement savings or paying off debt. If your expenses are more than your income, that means you are overspending and need to make some changes. If not sure of the best model, you can consider adopting the "**50-30-20**" budgeting philosophy where "needs," or essential expenses, should represent half of your budget, wants should make up another 30%, and savings and debt repayment should make up the final 20% of your budget.
6. **Make Adjustments to Expenses** » If you're in a situation where expenses are higher than income, find areas in your variable expenses you can cut. Look for places you can reduce your spending, like eating out less, eliminate some wants like canceling your gym membership. Aim to have your income and expense columns to be equal. This equal balance means all of your income is accounted for and budgeted toward a specific expense or goal.

After you have set up your budget, you must monitor and continue to track your expenses in each category, ideally every day of the month. As you use your budget, keep an eye on how much you have spent. Once you have reached your spending limit in a category, you will need to stop that type of spending for the month or move money from another category to cover additional expenses.

Once in a while, make an appointment with yourself every few months to sit down with your budget and make sure it's working for your current goals and realities. If you've already got your numbers plugged into a program or website, it's easy to play around with your budget categories to see where you can create extra room or prioritize one thing over another. Remember, your budget needs to work for you, not the other way around.

Additionally, it's also proper to note that the better you manage your expenses and maintain or increase the income, the higher the amount you remain with as reserves for either investments or savings. Before you plan on the best way to either invest or save from the reserves, it is important to put into consideration the tax aspect. For employed individuals, this you will not have to worry as the tax has/had already been deducted at source but for business ventures, you will need to account for 30% of the reserves for tax payments.

This will reduce the strain that can come with failure to accommodate the tax element from your reserves especially when KRA comes knocking at your doorstep.

« In our subsequent issues, we will in details advice you on how best to factor in the tax element, savings and investments on your personal finance matters. Keep in touch with us in our next publication and lean more on our next topic on personal financing. You need such a service? Get in touch with us and we can begin your journey to financial freedom. »

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

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.

Digital Service Tax (DST)

20th day of the following month

Minimum Tax

Applicable where minimum tax is higher than instalment tax payable
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