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Tax Briefly
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The Value Added Tax Regulations, 2017

Timely update

Preamble

Pursuant to Section 67 of the Value Added Tax Act, 2013, the Cabinet Secretary for the National Treasury (CS), recently published the VAT regulations through Legal Notice 54 of 2017. The current VAT Act was passed into law on 2 September 2013 and its implementation has largely been guided by the VAT regulations under the repealed VAT law albeit under transitional provisions. It was expected that new VAT regulations would have been issued much earlier especially in the wake of developing grey areas in the law. While there has been delay in publishing this new set of regulations, it is still a welcome move. The new regulations have replaced the regulations under the repealed law and with effect from 30 March 2017 will be applied by the revenue authority and taxpayers to aid the better carrying out of the provisions of the VAT Act.

We provide our analysis of the new Regulations as below:

Reg No	Title	Measure	Our View
1 & 2	**Part I of the new regulations interprets the various terms used in the regulations. This is covered under regulations 1 and 2.**	Interpretation of the terms used in the regulations.	As would be expected, this is the interpretative section of the law and it has shed light on new aspects contained in the regulations that are not expressly provided for in the VAT law. However, we note that Part I interprets the term "member" in respect of group registration while the regulations do not contain any provisions in this regard. Before being passed into law, the draft regulations contained guidance on group registration. However this has been deleted from the approved version. Perhaps an amendment will be expected from the CS to correct this anomaly, although KRA has over the years been against group registration.
3	**Open Market value**	The VAT law, under Section 13(1) requires that the taxable value of a supply between related parties be the open market value ("OMV") of the supply. However, no interpretation of OMV is provided under the law. Regulations 3 clarifies this by defining OMV as the price a supply would reasonably be expected to fetch in an arm's length transaction made at the time of the supply. An arm's length transaction is defined in the regulations as a transaction between people dealing with each other at arm's length. However, should there be instances where the OMV cannot be determined with ease, the Regulations empowers the Commissioner to objectively determine the approximate arm's length value of the supply at the time it is made. Such approximation should be based on generally accepted principles of valuation.	Regulation 3 provides much needed clarity on the determination of consideration for supplies between related parties. Regulation 16 under the VAT Regulations, 1994 of the repealed law required that the Commissioner's valuation of related party supplies be the OMV of a supply between independent parties. The new regulation now further requires that such valuation be in line with generally accepted valuation principles. Previously, it has been difficult to establish what to consider in arriving at a price that the KRA would accept as OMV. With this regulation, the criteria has been set out and it will now be simpler for taxpayers to justify their prices by applying the criteria set in the rules.
4	**Place of supply of telecommunication services**	Under the regulation, a supply of telecommunication services shall be considered as made in Kenya if the initiator of the services is in Kenya at the time of supply. This regulation only applies where: • The supply is made from a place of business outside Kenya; • The supply is not initiated by a telecommunications supplier or a person who is on global roaming while temporarily in Kenya; and • The recipient of the supply is not registered for VAT. An initiator of telecommunication services is defined as a person who; controls the commencement of the service, pays for the supply, contracts for the supply or to whom the invoice for the supply is made. Regulation 2 further defines "telecommunication services" to mean the transmission, emission, or reception of signals, writing, images, sounds, or information of any kind by wire, radio, optical, or other electromagnetic systems, and includes: a) the related transfer or assignment of the right to use capacity for such transmission, emission, or reception; or b) the provision of access to global or local information networks, but excludes the supply of the underlying writing, images, sounds, or information. A "telecommunications supplier" is also defined to mean a person who supplies telecommunications services.	The introduction of this regulation will aid the taxation of telecommunication services especially given the dynamism of global trade in services. While the VAT law, under Section 8(2) provides guidance on the taxation of services provided by non-residents to persons not registered for VAT in Kenya, the Section does not contain express provisions covering the taxation of telecommunication services. The Regulation also comes with definitions of various terms applicable to telecommunication services to clear any ambiguity in interpretation. This is a welcome move which should be applauded.

5	**Taxable value of a supply**	Under the Regulation, unless otherwise provided in the main VAT law, where a registered person makes a taxable supply without a separate amount being identified as tax, the taxable value of the supply shall be computed as follows: B = A/(1+t) Where- A is the total amount charged for the supply inclusive of VAT; B is the taxable value; and t is the tax rate.	VAT law requires that the taxable value of a supply, unless the parties thereto are related, be the consideration for the supply. However, in instances where registered persons make taxable supplies without separately identifying VAT payable, there has been varying views as to whether the value declared for the supply includes VAT payable or not. The Kenya Revenue Authority (KRA) often takes the position that in such cases the amount declared forms the taxable value and VAT should be calculated on it as the tax base. This Regulation seeks to provide guidance on how such instances should be interpreted and will harmonize the interpretation of the revenue authority with that of taxpayers.
6	**Taxable importation by a registered person for use outside the person's business**	An application of a taxable supply by a person for use outside his business shall not be treated as a taxable supply to the extent that no input tax deduction was allowed in respect of the taxable supply made to, or importation by the registered person, which is subsequently applied for use outside his business. In the event that input tax was initially deducted, the taxable value of such application for use outside the person's business is determined as follows: • For trading stock, the consideration paid or payable to acquire the trading stock; • For imported trading stock, the taxable value of importation as determined by customs; and • For any other case, the consideration paid or payable on acquisition of the goods or services or the OMV of the goods or services on the date they are first used outside the business. However, in the event that input tax was partly allowed for deduction, the taxable value of the application for use outside business shall be reduced by such amount reflecting the extent to which no deduction was allowed. Where only part of the goods or services are applied for use outside a person's business, the taxable value of such application shall be reduced by such an amount reflecting the extent to which the goods or services were not so applied.	VAT law, under Section 15 considers an application of taxable supplies by a registered person for use outside his business as a taxable supply made by the person. Regulation 6 seeks to provide guidance on the application of Section 15 and is aligned to the provisions relating to deductibility of input tax. The introduction of provisions on how to determine the taxable value of applications for use outside a registered person's business is also a sound move and will clear any ambiguity that may have existed in this regard.
7	**Deduction of input tax on registration or change in use.**	A person who incurs input tax on trading stock prior to registration is entitled to deduct thereon. Such deduction is permissible to the extent that it would ordinarily be deductible under Section 17 of the VAT law. The deduction is also contingent upon the person providing satisfactory evidence to the Commissioner that tax was paid on acquisition of the goods, and of the quantities, descriptions, or values of goods on hand at the time of registration. A registered person must apply to the Commissioner for authorization of pre-registration input tax deduction. The application should include a list of goods on hand at the date of registration and should be made within three months of becoming registered in the approved form. The Regulation further empowers the Commissioner to require an applicant for relief to furnish him with further evidence primarily consisting of: • the quantities, descriptions, or values of goods on hand at the time of registration; and • the use or intended disposal of the goods after the date of registration.	This Regulation seeks to aid the implementation of Section 18 of the VAT law, which covers deductibility of input tax prior to registration and in instances where there is a change of the VAT status of a supply from exempt to taxable. However, the regulation only seeks to provide relief where input tax is incurred on trading stock prior to registration. Section 18 extends such relief to taxable supplies acquired prior to registration that are intended for use to make taxable supplies. This was previously interpreted to allow a registered person to claim relief for pre-registration input tax where it related to acquisition of capital items as well as trading stock. It could therefore be argued that Regulation 7 is not aligned to the provisions of the principal law. Further, it seems that the Regulation was intended to cover input tax incurred prior to change in use. However, this has not come out clearly and there may be need to amend the regulation in this respect.

Paragraph 5 of the regulation seems to cover input tax deduction in cases of change in use but it may require an amendment as it is not clear in its current form.

The term “trading stock” has been defined in Regulation 2 as *“includes anything produced, manufactured, purchased, or otherwise acquired for sale or exchange, and any raw materials used in the production or manufacturing process”.*

8 **Refund**

Under this regulation, a registered person who makes taxable supplies at both the standard rate and the zero rate shall only be entitled to a refund arising from the generation of zero rated supplies.

The Regulation further provides a formula which will henceforth be applied to determine the amount refundable. This is as follows:

R = Z/T*e

Where:
R is the amount to be refunded
Z is the total amount of zero rated supplies
T is the total value of taxable supplies
e is the excess input tax for the month of supply.

In addition, where tax paid in error is refundable under Section 30 of the VAT law or a refund relates to bad debts under Section 31, the refund payable shall be applied in accordance with Section 47(4) of the Tax Procedures Act, 2015 (TPA). Section 47(4) of the TPA provides the following order of settlement of refunds:

- Firstly, the refund payable will be applied to settle any VAT outstanding from the taxpayer;
- The balance will then be applied to settle any tax outstanding from taxpayer under any other tax law; and
- Any remainder shall be refunded to the taxpayer.

Regulation 8 has further set out the criteria for refund of VAT arising from bad debts. It seems the regulation requires a registered person to only claim a refund of VAT on bad debts where he has issued the recipient of the supply with a credit note. However, there seems to have been an omission of the word “not” immediately after the word “shall” in sub-paragraph 4 of the regulation.

A reading of the regulation in its current form suggests that an applicant for refund of VAT on bad debts cannot obtain a refund if he issues a credit note to the recipient. We view this as an error that should be corrected before the regulation can be applied.

The recipient of a supply as above should then use the credit note received from the supplier (the applicant for refund of VAT on bad debts) to reduce his input tax in the month the credit note is issued and by the VAT amount specified on the credit note.

However, should the supplier subsequently recover unpaid tax from the recipient, the supplier should upon remitting the recovered tax to the Commissioner, issue the recipient with a debit note. The debit note entitles the recipient of the supply to deduct input tax on tax paid.

This Regulation has introduced new requirements in respect of refundable VAT while also deleting some of the requirements under the repealed regulations.

Firstly, the regulation now requires a registered person to apportion excess input tax where such person makes both standard rated and zero rated supplies. Perhaps this new requirement is informed by the fact that excess input tax may be partly attributed to standard rated supplies and partly to zero rated supplies.

However, to address this concern, the formula should have been devised in a way to allow full refund for excess input tax directly attributed to zero rated supplies and no refund of excess input tax directly attributed to standard rated supplies.

Input tax directly attributed to standard rated supplies would then be carried forward in a registered person’s VAT returns to offset against future VAT payable.

Refundable excess input tax which cannot be directly attributed as above could then be apportioned in line with the formula given in the regulation.

In our view, while the formula provided in the regulation is simplified, it is likely to be unfair to registered persons claiming refunds of excess input tax to which they are entitled under the VAT law.
It is also noteworthy that the regulation does not require applicants for VAT refunds of KES 1 million and above to accompany such applications with auditor’s certificates. Therefore, applicants will henceforth lodge their claims with the revenue authority without subjecting such claims to audit as was previously the case.

9	**Tax invoice**	This regulation replaces the requirements of tax invoice as set out in Regulation 4 of the repealed VAT law. Under the Regulation, a tax invoice should contain: • the words "TAX INVOICE" in a prominent place; • the name, address, and PIN of the supplier; • the name, address, and PIN, if any, of the recipient; • the individualized serial number of the tax invoice; • the date on which the tax invoice is issued and the date on which the supply was made, if different from the date of issue of the tax invoice; • the description of the goods supplied including quantity or volume or services provided; • the details of any discount allowed at the time of supply; and • the consideration for the supply and the amount of tax charged. Notwithstanding the above, a registered person may provide an electronically generated fiscal receipt as a simplified tax invoice for cash sales made from retail premises containing: • the name, address, and PIN of the supplier; • the serial number of the receipt; • the date and time of issue of the receipt; • a brief description of the goods supplied (including quantity or volume); • the tax payable; and • the total amount payable for the supply inclusive of tax.	Largely, the particulars on the face of a tax invoice remain unchanged from those set out in the repealed VAT regulations. However, there are two key changes worth noting: • The requirement to include the words "TAX INVOICE" in a prominent place on the invoice; and • Regulation 9 does not require a registered person to generate a tax invoice through a register or to be attached to a register receipt (previously under Regulation 4 of the repealed law) containing details of all the transactions as provided for in the principal VAT law. While it could be argued that the requirement to ensure tax invoices are run through electronic tax registers (ETR) has been done away with, we caution that this is likely to have been an inadvertent omission. Registered persons should, in our view, continue issuing ETR compliant invoices unless and until otherwise advised by the KRA.
10	**Tax invoice for supplies of imported services**	Regulation 10 now requires an importer of services who is entitled to a credit for part of the amount of input tax payable to prepare, in respect of a supply of imported services, a tax invoice containing: • the name, address, and PIN of the recipient; • the name and address of the supplier; • the individualized serial number of the tax invoice and the date on which the tax invoice is prepared; • a description of the services supplied and the date of the supply; • the extent to which the supply has been applied other than to make taxable supplies; and • the consideration for the supply and the amount of tax charged.	Importers of services are deemed to have made a supply of the services to themselves and are liable to account for VAT thereon. This regulation basically requires importers of services to raise a tax invoice to themselves to the extent that they make both taxable and exempt supplies. While it is not clear why this requirement has been introduced, it is likely that the move is intended to help the KRA to monitor transactions involving importation of services. Perhaps details of such invoices will be filed on iTax and may be analyzed by the revenue authority to check compliance with the provisions of the VAT law relating to imported services. Invoices raised in relation to imported services will also be kept for review by the KRA in line with the provisions relating to production of records. However, this regulation is expected to result in new administrative and compliance requirements for taxpayers and comes with associated cost implications.

11	**Credit notes**	In line with the provisions of Section 16 of the VAT law, Regulation 11 requires a registered person who for good and valid business reasons decides to reduce the value of a supply after he's issued a tax invoice and after goods are returned to him to furnish the recipient of the supply with a credit note. Further, such credit note should only be issued after the registered person has returned the excess tax to the recipient of the supply whether in cash or as credit against any amount owing to the supplier by the recipient. A credit note should contain: • the words "CREDIT NOTE" in a prominent place; • the name, address, and PIN of the supplier; • the name, address, and PIN of the recipient; • the individualized serial number of the credit note and the date on which the credit note is issued; • a brief description of the circumstances giving rise to the issuing of the credit note, including the invoice details to which the credit note relates; and • the consideration shown on the tax invoice for the supply, the correct amount of the consideration, the difference between those two amounts, and the amount of tax that relates to the difference.	The requirements of a credit note largely remain unchanged other than the requirement to include the words "CREDIT NOTE" in a prominent place on the credit note. However, we note that the Regulation has introduced the requirement to have some form of refund of the excess tax whether in cash or otherwise, a condition which was not there under the repealed regulations.
12	**Debit notes**	Regulation 12 requires a registered person who issues a debit note in respect of a further charge for a supply or any transaction associated with that supply to include the tax specified in the debit note as output tax of the person in the tax period in which the debit note is issued. A debit note should contain: • the words "DEBIT NOTE" in a prominent place; • the name, address, and PIN of the supplier; • the name, address, and PIN of the recipient; • the individualized serial number of the debit note and the date on which the debit note is issued; • a brief description of the circumstances giving rise to the issuing of the debit note, including the invoice details to which the debit note relates; • the consideration shown on the tax invoice for the supply, the correct amount of the consideration, the difference between those two amounts, and the amount of tax that relates to the difference.	The regulation will aid the implementation of the provisions relating to debit notes under Section 16 of the VAT law. However, no significant changes are contained in the regulations other than the requirement to include the words "DEBIT NOTE" in a prominent place on the debit note.

13	**Exportation of goods and services**	Under this regulation, an exportation shall be a taxable supply: • In the case of goods, when the taxable supply involves the goods being entered for export under the East African Community Customs Management Act (EACCMA) and delivered to a recipient outside Kenya at an address outside Kenya; and • In the case of services, when the taxable supply involves the services being provided to a recipient outside Kenya for use, consumption, or enjoyment outside Kenya. However, the exportation of services shall not include: • Taxable services consumed on exportation of goods unless the services are in relation to transportation of goods which terminates outside Kenya; and • Taxable services provided in Kenya but paid for by a person who is not a resident in Kenya. Documentary proof of exportation of goods and services shall be: • A copy of the invoice showing the recipient of the supply to be a person outside Kenya; • Proof of payment for the supply; • For goods, a copy of: – The bill of lading, road manifest, or airway bill, as the case may be; – The export or transfer entry certified by a proper officer of Customs at the port of exit; and – For excisable goods, the documentation shall be in accordance with the provisions of the Excise Duty law. • For services, such documents as the Commissioner may require as proof that the services had been used or consumed outside Kenya. Further, the Commissioner is empowered under the regulation to require a registered person, by notice in writing, to produce a certificate stamped by a competent authority in the destination country that the goods were duly landed and entered for home use in that country in case he has doubts that the goods were indeed exported. Such supply shall not be treated as exported pending provision to and acceptance of the certificate by the Commissioner.	This regulation seeks to provide much needed guidance on exportation of goods and services and replaces regulations 10 and 20 under the repealed VAT regulations. The regulation considers an export of goods to be as provided for under EACCMA. Under EACCMA, goods are exported where they leave an East African Community (EAC) partner state to a foreign country. However, movement of goods within the EAC partner states does not qualify as an export under EACCMA. However, VAT law considers goods as exported where they are taken out of Kenya to a foreign country. Under VAT law, foreign state is not defined and as such it is taken to be any country outside of Kenya even where such country is an EAC partner state. This is a point of divergence between EACCMA and Kenyan VAT law. It is also worth noting that Uganda and Tanzania maintain a similar distinction between export of goods per the respective VAT laws and the EACCMA. Reliance on EACCMA for guidance on export of goods in Kenya may therefore be misleading. Further, the regulation has sought to provide guidance on export of services by excluding specified services from the purview of exported services. Firstly, any services connected to export goods, other than transport services that terminate outside Kenya, will no longer be considered as exported. Further, services provided in Kenya but paid for by a non-resident will also not qualify as exported going forward. While this provides some form of clarity on the taxation of services traded across borders, it is our view that the provisions relating to export of services are not based on the destination principle provided for by the Organization for Economic Co-operation and Development ("OECD") and as such are not aligned to international best practice. The exclusion of the above noted services ignores instances where services could be provided in Kenya but for use, consumption or enjoyment outside Kenya. Due to the dynamism and growth of cross border trade in services globally, several countries have developed rules or regulations to guide the taxation of such services. Indeed, even the OECD has developed guidelines on the VAT treatment of such transactions. One would have hoped that these would be considered when formulating guidelines in respect of exported services. In view of the highlighted anomalies, it is likely that the many disputes between taxpayers and the revenue authority in relation to exported services witnessed in the past will continue to arise. Lastly, the documentary evidence required as proof of exportation remains largely unchanged from the repealed regulations. However, it is worth noting that the Commissioner is now empowered to demand additional documentary evidence as he may deem fit in the case of exported services.
14	**Documents relating to a supply to an Export Processing Zone or Special Economic Zone**	The documents required as proof of a supply to an Export Processing Zone (EPZ) or a Special Economic Zone (SEZ) shall be: • a copy of the recipient's Export Processing Zone licence; or Special Economic Zone licence; • a certificate signed by the recipient of the supply stating that the goods have been received and are for use in the approved operations of an export processing zone enterprise; and • for goods, the export entry duly certified by the proper officer of customs.	Supplies to EPZ and SEZ entities are zero rated for VAT purposes. This is on the basis that EPZs and SEZs are considered as outside Kenyan territory and supplies to entities in such zones are therefore treated as exported. To help monitor and control supplies to such entities, Regulation 14 provides the documentary evidence that is required as proof that a supply was made to an EPZ or SEZ. This regulation replaces regulation 10(2) of the repealed regulations.

15	**Tax inclusive pricing of taxable supplies to unregistered persons**	Under this regulation, a registered person who is a retailer or who otherwise primarily makes taxable supplies to persons who are not registered for VAT shall: • state prominently on his invoices that the taxable supplies are made inclusive of tax; and • disclose prominently on his invoice that the supply is a taxable or exempt supply and, if a taxable supply, the rate of tax charged. The tax payable in respect of a taxable supply for which the price is quoted as inclusive of tax shall be determined by applying the following formula: $t \times [A/((1+t))]$ where— A is the total amount charged for the supply inclusive of VAT; and t tax rate Failure to comply with sub-paragraph 1 of this regulation is an offence.	This regulation replaces regulation 19(b) of the repealed VAT regulations. The provisions of the repealed regulation have merely been moved to this regulation and largely remain unchanged. However, the regulation introduces an offence should a retailer fail comply with the requirements of sub-paragraph 1. However, as no penalty has been prescribed, it is likely that the applicable penalty for such offence is the general penalty under Section 63 of the VAT law.
16	**Manner of submitting documents**	A return, application, notice, or other document to be lodged or submitted under the Act shall be lodged or submitted in accordance with the Tax Procedures Act, 2015.	This move is geared towards moving the administrative requirements of VAT law that would otherwise have been introduced through the regulations to the Tax Procedures Act, 2015.
17	**Application of increased or reduced tax rates to successive supplies**	Regulation 17 seeks to provide guidance on the VAT status of successive supplies under Section 12(3) of the VAT law which begin and end before or after the effective date of a change in the tax rate, or when VAT on such successive supply is either imposed or withdrawn.	The VAT law allows the Cabinet Secretary of the National Treasury (CS) to vary the rate of VAT by 25% of the standard rate. While we have recently not seen appetite by the CS to vary the rate of tax, it could be possible that the government raises or reduces the general rate in future. Further, there have been quite a number of amendments to the VAT law since its enactment in 2013 aimed at exempting more items from VAT. Should such amendments affect the VAT status of successive supplies under Section 12(3) then the VAT status of such supplies should, upon the change in status, be determined in line with provisions of regulation 17.
18	**Revocation**	Regulation 18 revokes the following rules and regulations which were applicable in a transitory period pending the enactment of the VAT Regulations, 2017: • The Value Added Tax Regulations, 1994; (LN 195/1994) • The Value Added Tax (Appeals) Rules, 1990; (LN 229/1990) • The Value Added Tax (Distraint) Regulations, 1990; (LN 227/1990) • The Value Added Tax Order, 2002; (LN 95/2002) • The Value Added Tax (Tax Withholding) Regulations, 2004; (LN 3/2004) • The Value Added Tax (Electronic Tax Registers) Regulations, 2004.(LN 110/2004) The Value Added Tax (Remission) (Official Aid Funded Projects) Order, 2003 (LN 67/2003) shall continue to apply until another Regulation relating to official aid funded project is put in place. The Value Added Tax (Remission) (Low Income Housing Projects), Order 2008 (LN 115/2008) shall continue to apply to a remission granted before the commencement date while the remission remains in force.	The revoked rules/regulations were applicable in a transitory period in line with Section 68 of the VAT law. The provisions of these regulations have now been replaced by rules, regulations or provisions of law covering similar items. The remission rules relating to official aid funded projects and low income housing projects continue to apply until regulations covering similar matters have been passed into law.

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