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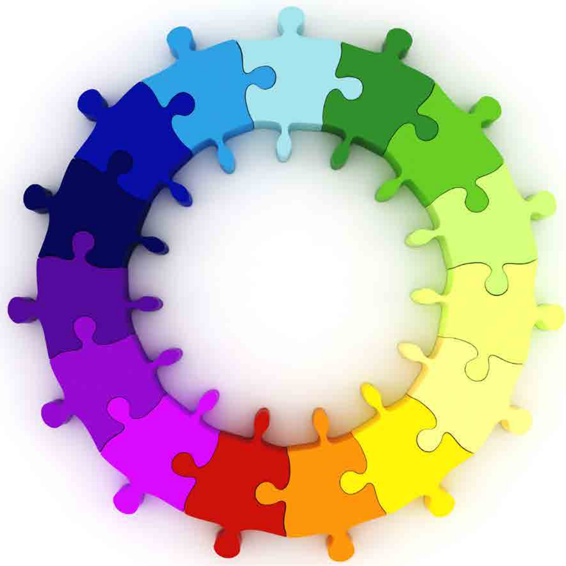

Government needs to legislate clear VAT guidelines on the taxation of services

Charles Musyoka is a Manager with Deloitte. He can be reached at *cmusyoka@deloitte.co.ke.*

One of the canons of taxation is certainty. Certainty demands clarity and simplicity in tax legislation, administration and procedures. Through certainty, taxpayers are able to pay their rightful taxes, within set procedures and timelines. In Kenya, the VAT treatment of services, especially those traded across borders remains unclear. Partly, the lack of clarity is occasioned by the lack of proper guidance in the Kenyan VAT law on how internationally traded services should be taxed. This is also created by the varying interpretations taken by taxpayers and the Kenya Revenue Authority (KRA) on the VAT status of services especially traded across borders.
Under the Kenyan VAT law, exported services are those that are provided for use or consumption outside Kenya. Therefore, the key consideration when determining whether services qualify as exported in nature is the place they are used or consumed. However, the law falls short in defining what constitutes use or consumption and how one would determine the place of use or consumption. This legislative vacuum has created uncertainty in the administration and/or interpretation of the VAT law.

The government has previously made attempts to provide guidance on the VAT treatment of services traded across borders. In 2017, the government released the current VAT Regulations. The basic purpose of these regulations was to provide guidance on the application of certain provisions of the main VAT law, the VAT Act, 2013. The said regulations sought to provide some clarity on the VAT treatment of exported services. While this was a step in the right direction, we note that the guidance provided through the VAT Regulations has only created further confusion.

For instance, Regulation 13 under the VAT regulations excludes taxable services provided in Kenya but paid for by a person who is not resident in Kenya from the purview of exported services. The regulation further excludes taxable services consumed on the exportation of goods, other than transport services, from the scope of exported services.

The above exclusions clearly negate the provisions of the main VAT law which only require that services be used or consumed outside Kenya for them to qualify as exported. For instance, in this digital age, it is possible for persons in Kenya to remotely provide services to clients abroad. An information technology (IT) expert in Kenya could develop an application or software locally for a non-resident. Similar other examples exist across professions. Lawyers, for example, could provide a legal opinion to non-residents regarding certain legal matters in Kenya. Applying the guidance provided in the VAT regulations would mean that such services cannot be considered as exported. Therefore, the guidance in the VAT regulations in respect of exported services is not aligned to the provisions of the main VAT law. Arguably therefore, and in line with the canons of interpretation of statute, these exclusions could be considered to be null and void to the extent of their inconsistency.

Due to Kenya's attractive position as a foreign investment destination, quite a number of multinational entities have been setting shop in the country. Largely, the companies that set up in Kenya are service entities. In the same vein, there are Kenyan entities that have set up offices in various countries within Africa. The management and operation of such entities is mainly run centrally from Kenya. This necessitates cross border trade in services. Inevitably therefore, the VAT treatment of the services provided by such entities will be called to question.

Consider the case of a multinational company that sets up a shared service centre in Kenya. Such office is expected to provide managerial services to related entities located across various countries in Africa. It is not in doubt that the supply of management services falls within the scope of services supplied in Kenya for VAT purposes. However, whether to subject such services to VAT at the zero rate or at 16% is a contentious matter. It is likely that the multinational company would consider its management services as provided for use or consumption outside Kenya (by the related entities). This is of course backed up by sound legal and practical arguments. However, based on the general position that the KRA has taken in the recent past on cross-border services, it is likely that the revenue authority will take a contrary view and seek to subject such services to VAT at 16%.

VAT is a consumption tax collected through a multi-staged process which should be borne by the final consumer. There is a principle in VAT referred to as the neutrality principle. Under the neutrality principle, business decisions should be influenced by economic and not tax considerations. Simply put, VAT should largely not be a cost borne by businesses as this would end up influencing business decisions. It is on this basis that the burden of VAT is pushed to the final consumer through the multi-stage collection process. In-cross border trade, neutrality is achieved by applying another principle referred to as the destination principle. The destination principle places taxing rights on cross-border supplies in the country where the recipient of the supplies is located. Therefore, an exporter zero rates his/her supplies. However, the importer is expected to self-charge and account for VAT either through customs (for goods) or through the reverse charge mechanism (for services).

VAT paid on importation of goods may be claimed back as a credit on the part of the importer. This way, VAT is not double charged on the same supply and does not become a cost to either the exporter or importer. However, in the above example of management services, where the KRA demands that the local office charges VAT at 16% and accounts for the same, the non-resident related entities would also be expected to self-charge and account for VAT on the services, as VAT on imported services. This creates a double incidence of VAT. Where the same supply is subjected to VAT twice, the VAT charged by the Kenyan entity would be borne by the non-resident entities and would ultimately become a business cost to them. As a result therefore, you will find that increasingly, VAT in Kenya has become a key consideration for multinationals which want to set up or continue operations in Kenya.

Public participation is a key requirement of the Kenyan Constitution more so in the legislative process. There is therefore need to allow the participation and engagement of stakeholders in the legislative process to ensure that tax laws capture the views of all those that would be affected before such laws are enacted. Specifically, regarding the matter of export of services, continued disputes and differences in interpretation of the law on the VAT status of services are not only resource consuming but also indirectly foster non-compliance. It is in the interest of all affected stakeholders including the revenue authority and affected taxpayers to ensure there is sound legislation to aid the taxation of services in Kenya.

It is therefore necessary that the government considers making changes to the VAT Regulations, 2017 to not only provide a clearer perspective on the taxation of services traded across borders but also to ensure the regulations are aligned to internationally accepted VAT principles and best practice. This would be achieved where the government invites participation from affected stakeholders and positively considers their contribution towards developing such regulations. Well thought out regulations in this regard will free up resources at the KRA to focus on fostering compliance while also making it easier for taxpayers to comply.

Ultimately, where we have clear, simple and predictable laws based on sound principles, we will have a win-win position which will go a long way in protecting Kenya's preference as a foreign investment destination.

The views expressed herein are those of the author and do not necessarily represent the views of Deloitte.