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Withholding tax payment on accrual of expenses

The Court of Appeal in its judgement of 15th February 2019 in the case **Kenya Revenue Authority v Republic (Ex-parte Fintel Limited)**, ruled on the issue of the tax point of withholding tax.

This matter has previously been dealt with by the High Court that held that Sections 35(1) and (3) Income Tax Act ("ITA") clearly state that tax is withheld "upon payment" and payment is a necessary prerequisite for the withholding tax to apply.

The Court of Appeal overturned the above precedent and in its interpretation found that "deduct" in the context of Section 35(5) of the ITA is used as an accounting term referring to the act or process of subtracting an item or expenditure from gross income to reduce the amount of income subject to income tax. This need not be done physically but as a book entry.

Implications of the ruling

1. Taxpayers shall be required to deduct and remit WHT on applicable payment (including those for royalties, interest, professional, management and training fees) at the point of accrual in the books of accounts, as opposed to the actual payment;
2. Greater administrative burden on taxpayers to reconcile the year when income is earned (supplier) and the year when the customer accrues the expense, deducts and remits the WHT on iTax;
3. Taxpayers shall need to ensure that accruals accurately reflect the contractual payment obligation to safeguard from underpaying or overpaying WHT;
4. Where services have not been rendered, it would be advisable to make a general provision which is not claimable for tax purposes.

Double Tax Agreement (DTA) with Mauritius

The High Court of Kenya, in its judgement dated 15th March 2019 in **Constitutional Petition No. 494 of 2014** found that the Legal Notice No. 59 of 2014 that was intended to domesticate the Mauritius-Kenya DTA is void. This is due to the fact that the legal notice was not tabled before Parliament within seven (7) days of being published, as required by the Statutory Instruments Act.

Implications of the judgement

- 1) As the DTA had not yet come into force, the judgement does not affect related companies operating in Kenya and Mauritius as the applicable WHT rate shall still be the non-resident rates stipulated in the ITA;
- 2) The judgement does not invalidate the DTA. The Cabinet

Secretary for National Treasury and Planning could still make the DTA effective in Kenya by issuing a new legal notice and tabling it before Parliament within the statutory stipulated timelines.

Value Added Tax Auto Assessments (VAA)

KRA introduced the VAA in October 2018 by upgrading the iTax system to match the invoices declared in customer's VAT returns correspond to the declaration in the supplier's VAT returns.

The VAA initially was rolled out in the January 2018 VAT returns. Any inconsistencies were flagged and taxpayers required to amend their tax returns within 30 days from the receipt of the VAA notice. However, it was impossible to amend the purchase invoices inconsistencies.

On 29th March 2019, KRA notified taxpayers that they needed to amend the purchases details for the January 2018 VAT return and to visit their tax stations within 60 days for assistance in filing. The 60 days granted lapses on 27th May 2019.

Manual Withholding Tax Credits

KRA has now started enquiring on manual withholding tax credits declared under Section 42 of the corporate income tax returns for the previous years for taxpayers. Majority of these manual withholding tax credits are from financial institutions such as banks for deduction of withholding tax on interest income.

We advise that you contact your banks or customers who withhold taxes on your payments to pay withholding tax using iTax (not manually) so that the withholding tax credits reflect correctly on your iTax ledger to claim these in time upon submission of the tax return.

Caveat

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