



# KRA DEFAULTER NOTICES SCARE

VAT Auto Assessment (VAA) and  
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# Newsletter

MBAYA AND ASSOCIATES

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## Introduction

We have our eleventh edition of newsletter this year. This month's issue focuses on recent developments on Income Tax and VAT. These developments have brought about some panic to taxpayers and we found it fit to shed some light and provide solutions where possible.

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 you may have.

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](mailto:tax@mbaya.co.ke)



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» KRA DEFAULTERS NOTICE SCARE

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## From the **TaxDesk**

### Introduction

From last month, the KRA has been sending defaulter notification emails to tax payers. KRA argues that it's a way of tidying up the taxpayer's ledgers in its systems.

In case a tax payer's iTax ledger is not balanced, there is a probability that they have received or will receive the defaulter notices any time soon.

KRA introduced the use of VAA system in their bid to upgrade their system. This has greatly improved and eased ways of catching up with taxpayers who are under declaring or not declaring at all the incomes and expenses.

In case a taxpayer is caught up in this kind of a situation, what should they do? Below we discuss various options the taxpayer can employ.

### KRA DEFAULTER NOTICES SCARE

A few weeks ago, in an effort to collect more taxes, the KRA sent out tax defaulter notices to all tax payers who had not submitted their tax returns or had unpaid tax balances on their accounts as reflected on the I-Tax system.

The notices have caused a lot of panic and uneasiness amongst thousands of taxpayers. In some instances, the tax demanded related to periods dating back over 20 years. In cases where the taxpayer disputes such a tax, section 23(i)(c) of the Tax Procedures Act 2015 states that subject to subsection (3), taxpayers should retain relevant documents for a period of five years from the end of the reporting period to which it relates. This would create a conflict between the taxpayer and the KRA as to whose rights would be infringed.

The demand notification issued taxpayers with a 15 day window to pay the outstanding taxes failure to which KRA would impose interest on the amounts due and further institute enforcement measures.

However, there appears to have been a general failure to accurately transfer taxpayers' information from the old manual or semi-automated platforms to the current iTax system. This inaccurate migration of data led to many cases where there were differences between the KRA and taxpayer's records.

### What Next?

If as a taxpayer you received the defaulter notice, don't panic. First, establish the period which the default relates to.

For that period, check whether the tax is actually due and payable. To check a taxpayer needs to log into iTax and:

- a. Confirm if they filed the return for the said period. If not, then file the return based on the income for the period in consideration. Pay the taxes due using the iTax portal and you are done.
- b. If the return is filed, check when it was done. If the return was done late, this is the reason for the default notice. A taxpayer can then pay the late filing penalty before interest is imposed and/or apply for waiver of any penalty.
- c. How can a taxpayer apply for waiver? This is normally done via I-Tax but a taxpayer needs to have valid reasons as to why there is need to apply for the waiver of penalties. A taxpayer needs to write a letter to KRA indicating the above reasons, sign the letter and have it scanned and attached to the waiver application on iTax.

If a taxpayer ever applied for a waiver earlier and it is still unresolved, the system will not allow them to apply again until the one in consideration is either granted or rejected.

After the waiver application process is complete, it goes through different stages of approval, from the tax station level all the way to commissioner general's office or even to the Ministry of Finance at Treasury. However, this is dependent on the amount of waiver requested and the circumstances under which the waiver application is being requested.

It is not guaranteed that the waiver requested, irrespective of the amount, will be granted. It is good to note that the commissioner can grant the waiver of penalties if fully convinced that a taxpayer has valid reasons to be granted the waiver request.

The commissioner can reject the waiver but will also notify the taxpayer the reasons for rejecting the waiver. If the waiver of penalties has been rejected, there is no room to re-apply afresh. The taxpayer can seek alternative means to settle the dispute or seek extension of time to settle the taxes due.

## VAT AUTO ASSESSMENT (VAA) AND WITHHOLDING TAX MISMATCH NOTICES

VAA is a system based solution that will:

- Detect inconsistencies between purchase and sales invoices which have been declared in the VAT returns,
- Communicate the inconsistencies to both the buyer and the seller, and
- Raise auto assessments on the buyer on any outstanding inconsistencies.

### How VAA Works

- System checks buyer's return for the corresponding sale declared by the seller
- If the system identifies inconsistencies, notification is sent to both the buyer and the seller
- The taxpayer has 15 days to amend the affected return
- The system runs another check after the 15 days and if the identified inconsistencies remain outstanding, a reminder notice is sent to both buyer and the seller.
- If after a further 15 days the inconsistency is still outstanding, the system issues an auto assessment on the buyer.
- If after 30 days, the assessed amount remains unpaid, a task is created for a debt officer.
- If the taxpayer disputes the assessment, they have the option to object. A task is then created for a Policy Unit Tax officer.

### An example:

Customer A is in the business of buying furniture from suppliers' B & C. Customer A and the two suppliers are all registered for VAT and customer A is a registered VAT withholding agent.

In a particular month, customer A buys furniture from all the two suppliers and paid them less the 6% withholding VAT amount. In the following month, customer A files their VAT return and declares the two transactions in their input for the month. In their VAT return, Supplier B declares the income while supplier C fails to declare. Supplier C will receive a VAT mismatch notice informing them that they have failed to declare an income of which the respective expense has been claimed.

Such a supplier will be given a 15 days' window to amend the return and declare the income else an auto assessment will be sent and enforcement measures initiated. The reverse happens where a sale has been declared but the respective VATable expense cannot be traced from the customers' VAT return.

## Why VAA?

- To avert claiming of fictitious and or unsupported inputs by taxpayers
- To help with the data cleaning process and ensure proper return filing by the taxpayers
- Actualizing data driven compliance in line with the transformation agenda
- To broaden the tax base
- Increase Tax revenues

## Challenges of the System

This automated system of checking the mismatched invoices was piloted in October 2018 with January 2018 being the first focus month for the pilot.

1. The system for now can only check invoices for only one month however input VAT can be claimed to a maximum of six months. The iTax system developers need to increase the months upon which the system can be able to check.
2. The system doesn't have a means of verifying if the invoices claimed are the correct ones. Also, if an invoice number is erroneously entered when filing the return, then the system will treat this as a separate invoice which is inaccurate.

The tax man is aware of these two challenges which have been raised by many taxpayers and audit firms and they are working to resolve the issues raised.

If a taxpayer receives such a VAT or withholding tax mismatch notice, he should re-examine the facts of the notice. If the mismatch notice is accurate (undisclosed incomes or over claimed inputs), then the solution to this is to amend the return as soon as possible or before the expiry of the fifteen days' window. This will help a taxpayer in avoiding a receipt of an auto assessment from the I-Tax portal.

However, if a taxpayer receives a mismatch notice and the invoices in question don't need to be amended as they were declared and fall within the six months' period as per the law, KRA proposes the following key steps to follow:

- Ignore the mismatch email and wait for the auto assessment email.
- On receipt of the auto assessment email from KRA on expiry of the fifteen days, log into iTax and object to the assessment.
- Write to your tax station giving your reasons for the objection. Attach the assessment, objection notification, and proof of your objection.
- Forward the written communication to your tax station and they will look into it and remove it from their systems.

## *Know these Basic Business Fraud Warning Signs*

### Accountants and business owners should watch for these common fraud red flags. By Sarah Ovaska-Few | August 20, 2018

From hourly employees skimming the cash register to top executives fudging their revenue numbers, fraud is an unfortunate fixture of the business landscape. But while fraud may be a constant concern, falling victim to it isn't inevitable. Here are some red flags that experienced forensic accountants look for, and advice for ways to ferret out and prevent wrongdoing.

#### *Living beyond means*

Signs that employees are living well beyond their means can be an initial clue that they're helping themselves to the company's assets.

Want to avoid being the victim of this type of fraud? Make sure there's not just one person in charge of payroll or purchasing and reconciling the books.

Make it clear as well that routine audits and inspections of expenditures will be done. Just knowing they could be caught is enough to shut down many employee thefts.

"Send a signal to people inside the company that someone is checking,"

#### *Unusual email*

Emails that are out of character for the sender, or with directives outside the company's normal practices, could be another sign that a scam is underway.

Recently there was a case where the email account of a business's CFO was hacked, unbeknownst to anyone. Then, the company's controller received an email from the CFO's account requesting several hundred thousand dollars be wired to a foreign bank.

The large sum and the request to send money to a country the company doesn't do business in gave the company controller pause. She delayed filling the request and asked the CFO directly if the transaction was legitimate. It wasn't, and the transaction never went through.

In this case, a transaction that was an aberration from normal procedures was a red flag that got picked up in time. Being aware of inconsistencies and noticing emails written differently from how the sender normally communicates could help thwart online fraud schemes.

#### *Loose controls*

Another red flag that fraud could be afoot is significant staff resistance to tighter controls.

When employees are used to skimming off the top, whether it's an unsecured cash register or an open supply closet loaded with pricey items, companies might experience significant losses.

For example, a golf club installed a new keypad on a gas tank employees used to fuel company maintenance vehicles. The keypad required staff to enter individualized codes each time they filled up.

There were grumblings from staff about the new system, and within a few months, gas costs dropped by nearly a third under the new system. It turned out that golf club employees had been filling their personal vehicles at the pump and driving off with the company's assets almost every day.

Small to midsize companies can easily be targets of this type of asset fraud, especially businesses that have grown quickly and haven't taken time to closely scrutinize their processes.

"A lot of times they're more susceptible because fraud's not on the foremost of their minds,"

Company leaders should sit down with their CPAs and evaluate internal controls closely to make sure best practices are in place.

## *Not-so-friendly kickbacks*

Overly close relationships between employees in key purchasing positions and vendors could be a sign of a kickback scheme at work.

In kickback scenarios, an employee inside the company can have a deal with a friend, family member, or just a vendor he or she has gotten to know to overcharge the company. The vendor gets more cash from the company, and the insider gets a kickback as a reward.

This can be the toughest type of fraud to uncover, because the fraud is happening outside of the company's sight. The company's records simply show a purchase, not that the company paid twice what it should have.

Adopting purchasing policies to obtain several bids for large purchases can help minimize the risk associated with vendor kickback schemes,. Contracts with vendors should also be routinely reviewed.

Specialized software can now compare vendor addresses with employee home addresses, to make sure there's not a close relationship the company is unaware of.

This is also where internal whistleblower hotlines or a company culture that emphasizes the need to speak up when something is amiss can also help.

Statistics show most fraud schemes are discovered because of tips or whistleblowers.

"It's rare that internal controls, management review, internal audits, or external auditors uncover fraud,"

## *Exceptional performance or cooked books*

Another red flag to look out for is when things seem to be too good to be true, from startups reporting profit margins well above competitors' to sales forecasts way above the norm. Companies that are always exceeding analyst expectations - pulling in 15% profit margins while competitors see no more than 5% - may deserve some scrutiny. There could be some unique, even illegal, accounting moves behind the success.

Drilling down and asking for specifics, or for an outside forensic accountant to comb the books, can help uncover this high-level fraud. But clean audit opinions alone shouldn't assure boards, investors, and managements that all is OK. "An audit is not a gold standard that fraud isn't present."

Audits, after all, are only as good as the information provided. If a corporate officer is neck-deep in a fraudulent scheme, and smart enough to know how to clean up his or her tracks, the wrongdoing may not be detected as part of a properly planned and executed audit engagement performed by an independent accounting firm.

But the more internal controls and best practices in place, the harder it will be for fraudulent schemes to grab a foothold.

## 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.

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