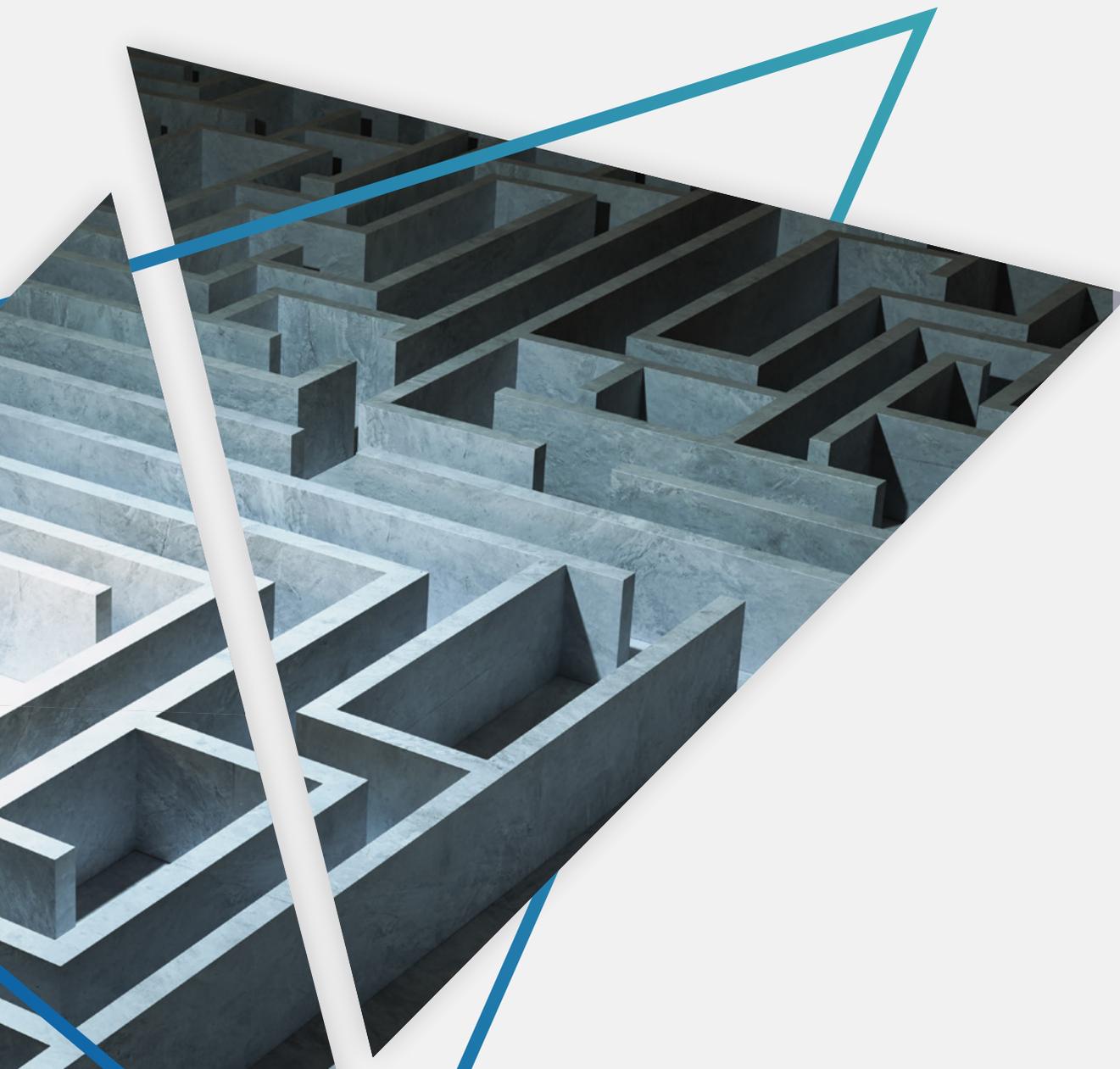


Tax & Exchange Control

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In this issue

KENYA

I am not their keeper: An analysis of the impact of non-compliance with electronic tax invoice requirements and Section 17 of the VAT Act on the part of the seller or landlord in real estate transactions



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I am not their keeper: An analysis of the impact of non-compliance with electronic tax invoice requirements and Section 17 of the VAT Act on the part of the seller or landlord in real estate transactions

Gone are the days when a buyer or tenant of real estate property only worried about the purchase price or rent. Tax compliance, on the part of the seller, now seems to be a burden that has been placed - both by statute as well as decisions of the court, on the feet of the purchaser or tenant.

From an Electronic Tax Invoice (e-TIMS) perspective, both tenants and purchasers are facing a major challenge in obtaining an e-TIMS invoice from the landlords and sellers. In the result, they have not been allowed to claim input tax when filing their Value Added Tax (VAT) returns. The question begs, why and when does the Kenya Revenue Authority (KRA) disallow such input tax? In this alert, we shall seek to address this rather pertinent question.

What is the nexus between input VAT and e-TIMS?

VAT is an indirect tax charged on consumption of taxable goods and services supplied or imported in Kenya. The amount of VAT payable is determined by the difference between output VAT (VAT charged by a business at the point of sale of goods and services to their customers) and input VAT (VAT paid for taxable purchases and imports). For input VAT to be claimed, the KRA needs to verify the same after reviewing supporting evidence and/or documentation including an e-TIMS invoice. Failure to avail an e-TIMS invoice to the KRA leads to the denial of the input VAT claim hence the significance of an e-TIMS invoice.

What are the requirements for a valid input tax claim?

Subject to Section 17 of the Value Added Tax Act, 2013 (Act), a claim for input tax deduction:

- a. Can only be in respect of payments made in respect of making taxable supplies.
- b. Cannot be allowed if the person making the claim does not hold the required documentation including an original tax invoice issued for the supply.
- c. Can only be made within six months of making the supply.

It is important to note, that when a registered supplier (including a landlord or seller of real estate property) fails to declare the sales invoice at the time of filing their VAT returns, the input VAT shall not be allowed.

Effective 1 July 2023, purchasers/tenants are not only required to provide supporting documentation in their claim for input VAT, it now seems to be their responsibility to ensure that the seller/landlord does declare that VAT in their respective returns. However, the recent decision of the Court of Appeal declaring the Finance Act 2023 as unconstitutional on 31 July 2024 has granted purchasers/ tenants some relief as one will only be required to provide an electronic tax invoice or prove that the seller/landlord declared the transaction in their VAT return. This position holds if and when the Supreme Court upholds the said decision. For further details on the Court of Appeal's judgment on the Finance Act, 2023, please access our alert from [here](#).

**TAX & EXCHANGE CONTROL
ALERT**

I am not their keeper: An analysis of the impact of non-compliance with electronic tax invoice requirements and Section 17 of the VAT Act on the part of the seller or landlord in real estate transactions

CONTINUED



What is an electronic tax invoice?

e-TIMS is not a new phenomenon as the requirement to issue e-TIMS invoices has always been there albeit for VAT-registered taxpayers only.

Subject to Section 42 of the VAT Act, a tax invoice is one of the records a person conducting business in Kenya is required to keep for a period of five (5) years. Additionally, regulation 9 of the VAT Regulations 2017—which was replaced by the VAT (Electronic Tax Invoice) Regulations, 2020 (2020 regulations) provided that a registered person who makes taxable supply shall, at the time of the supply, furnish the purchaser with a tax invoice. Moreover, the implementation of e-TIMS by VAT-registered persons is currently guided by the 2020 regulations. The recipients of taxable supplies, including the purchase or rent of commercial real estate, can only declare and claim input VAT using e-TIMS-compliant invoices.

Finance Act 2023 whilst amending both the Tax Procedures Act, 2015 (TPA) and the Income Tax Act (ITA) introduced e-TIMS requirements and prescribed the consequences of non-compliance. More specifically, Section 23A of the TPA requires any person who carries on business in Kenya to issue an e-TIMS invoice with the exemption of employee emoluments, investment allowances, interest, airline passenger ticketing, and similar payments. This provision took effect on 1 September 2023. Subsequently, the Tax Procedures (Electronic Tax Invoice) Regulations 2024 were gazetted to provide more guidance.

In the same light, from an income tax perspective, Section 16(1)(c) of the ITA provides that no expenditure or loss shall be allowed as a deduction where the invoices of the transactions are not generated from e-TIMS, except where the transactions are exempt from e-TIMS requirements under the TPA. This provision took effect on 1 January 2024. However, with the recent development declaring the Finance Act 2023 as unconstitutional, this requirement is no longer applicable.

**TAX & EXCHANGE CONTROL
ALERT**

I am not their keeper: An analysis of the impact of non-compliance with electronic tax invoice requirements and Section 17 of the VAT Act on the part of the seller or landlord in real estate transactions

CONTINUED



What is the major challenge for real estate transactions?

By a recent judgment delivered on 28 June 2024, the Tax Appeals Tribunal (Tribunal) in the case of *NML Holdings Limited (Formerly Nanyuki Mall Limited) v Commissioner of Investigation and Enforcement (Tax Appeal E129 of 2023) [2024] KETAT 865 (KLR)* highlighted the impact of failure to comply with e-TIMS and input tax deduction on the part of the seller of real estate.

The brief facts of the case are that NML Holding Limited had purchased a commercial property for an all-inclusive purchase price of KES 250,000,000. Unfortunately, the seller did not issue NML Holding Limited with the necessary tax invoice despite several reminders to do so. Upon payment of the purchase price, NML Holding Limited included this transaction in its input VAT schedule in March 2022 which the Commissioner disputed on the basis that NML Holding Limited did not provide the tax invoice for the said transaction. The Commissioner issued an assessment order of VAT amounting to KES 34,809,771.89 which NML Holding Limited objected to and the Commissioner rendered its objection decision confirming its earlier assessment, to the effect that NML Holding Limited was not entitled to claim input VAT on the real estate property purchase transaction.

NML Holding Limited then appealed the objection decision to the Tribunal. The Tribunal considered the requirements for the deduction of input VAT vis-à-vis the facts of the case. The first one was that the deduction for input tax shall not be allowed until the first tax period in which the person holds a tax invoice. The tribunal held that NML Holding Limited cannot claim the input tax until such a time that

it holds the tax invoice and went further to highlight that claiming input tax must occur within six months after the date on which the supply occurred.

The second requirement considered by the Tribunal is that the seller of the property must have declared the sale in their respective VAT returns or provided confirmation that he charged VAT for the transaction per section 17(2) of the Act. The Tribunal held that since the seller had done neither of the above, the Commissioner was correct in declining to allow the deduction claim. The Tribunal stated that Section 17(3) of the Act is couched in mandatory terms and provides that an original or certified copy of a tax invoice is one of the documents that must be produced by a taxpayer as proof of a taxable supply while making a claim for input tax.

Of great import was the Tribunal's finding that despite the fact that NML Holding Limited produced documents to prove existence of the transaction and payment, its failure to produce a tax invoice issued by the seller in support of its claim for input tax refund was fatal. The Tribunal further opined that a Sale Agreement is not sufficient for this purpose even if the Tribunal was to consider that the purchase price was indicated to be inclusive of taxes. As a result, NML Holding Limited had a mandatory obligation to comply with the provisions of Section 17(3) of the Act by availing a tax invoice in addition to the other requirements as highlighted.

**TAX & EXCHANGE CONTROL
ALERT**

I am not their keeper: An analysis of the impact of non-compliance with electronic tax invoice requirements and Section 17 of the VAT Act on the part of the seller or landlord in real estate transactions

CONTINUED

What is the way forward?

The germane question is therefore how can a buyer/tenant in a real estate transaction mitigate the risk of having their input VAT disallowed by ensuring they are compliant with the Act?

It may be difficult for a buyer/tenant to ensure and ascertain whether the seller/landlord has declared an invoice in their returns. However, the current situation in our tax laws calls for extra vigilance and advice from lawyers in such transactions. For instance, a buyer/tenant may opt not to make payment before they are issued with a tax invoice, depending on the terms of the underlying agreement. The buyer/tenant may also insist on the inclusion of a clause in the sale/lease agreement making it mandatory for the seller/landlord to issue a tax invoice and declare the sale or rent when filing their returns, failure of which they will be in breach of the underlying agreement.

As already stated herein, these are peculiar times and players in the real estate sector cannot carry on business as usual. The advice of a competent real estate lawyer as well as a tax lawyer is key to mitigate scenarios similar to the above-stated case of NML Holding Limited.

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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