MANAGING KRA AUDITS

UHY Kenya

What are KRA Audits?

From a practical perspective, ignorance, recklessness, carelessness and deliberate tax evasion as well as weak tax administration are among the factors contribute to non-compliance of tax obligations. When Taxpayers are clear and have a good understanding on their obligations, they are more often than not likely to mitigate compliance risks.

In this Article, we address;-

what constitutes a Tax Audit, what triggers an Audit, the Tax payers' rights during the Audit and how to manage an Audit from KRA .

In Kenya, the Kenya Revenue Authority (KRA) is a creature of statute whose main task is collection of revenue in its capacity as an agent of the Government of Kenya.

The functionality of the above mandate facilitates the Government to meet its recurrent budget and have money for massive developments to meet it promised agendas. To steer the revenue collection, KRA has rolled out programs to audit tax payers subject to the provisions of the Tax Procedures Act (2015) wherein audits are restricted to a period of Five (5) years. This period is not absolute.

Simply put, an audit by the Kenya Revenue Authority (KRA) is mainly a tool of verification of the Taxpayer's compliance. It seeks to ascertain and reconcile the Taxpayer's declarations and detect any divergence between the declarations made during the self-assessment and the supporting documentation.

Strictly speaking, audit activities today extend beyond the scope of raising undeclared revenue. The outcome of the Audit is accompanied by sanctions (penalties and interests), criminal proceedings against a Taxpayer and not to mention unmasking the Taxpayer as a non-compliant citizen which is bad for business.

In Kenya where the tax regime is changing and evolving to accommodate different emerging structures of businesses, KRA has intensified the frequency with which it has been conducting tax audits and investigations so as to ensure that every taxpayer is "paying unto Caesar" so to speak.
We have therefore thought it prudent to share some insight on what the taxpayer should expect during one of these audits.

What triggers a KRA Audit?

KRA Audits are triggered by a multitude of factors dependent on the industry/business of taxpayers. Nonetheless, there are general KRA Audit triggers that are seen across the board. For instance:-

1. Late filing or failure to file your returns;
2. Unhappy employees or moles within your company who set you up for a KRA Audit;
3. Related party transactions;
4. Inconsistencies and variances between declared tax returns and financial statements and accounts, i.e. VAT, PAYE, exercise duty;
5. Information from third parties e.g. Suppliers VAT returns;
6. Tax refund claims e.g. VAT refunds, Income Tax refunds etc;

7. Tax remission applications;
8. Significant fluctuations in PAYE and corporation tax payments;
9. Perpetual loss-making status;
10. Business websites, advertising and upstream declaration of profits;
11. Declaring expenses without a corresponding income;
12. Restructuring of companies may invite tax clearance audits;
13. Reputation of auditors or tax agents;
14. Director's incomes versus standard of living also known as lifestyle audit;
15. The itax system – the recently introduced VAT Automated Assessments;
16. Amended returns;
17. Tax scandals i.e. triggers by a scam;
18. Constant filing of nil returns;
19. Application to cancel PIN, or tax obligations i.e. PAYE & VAT;
20. Variance between tax return and industry margins for gross profit/net profit;
21. Publicity in the media and TV shows;

The Audit Period

KRA in rendering its Assessment pursuant to an Audit, the Commissioner under Section 29 should not issue a default assessment after expiration of five years immediately following the last date of the reporting period to which the assessment relates. Further, Section 31 provides that the Commissioner should not issue an additional assessment after expiration of five years after the date the taxpayer submitted the self-assessment return.

Notably, the above Five year (5) time period does not apply where in cases of gross or willful neglect, evasion or fraud by a taxpayer. In which case, KRA bears the burden to prove that there was an element of fraud, evasion, gross or willful neglect necessitating it to audit over and above the statutory 5-year period.

Therefore, if you are audited for periods exceeding the 5-year period, it is your right to question KRA.

Retention of documents –

Similarly, section 23 of the TPA requires a taxpayer to maintain and retain any document required under a tax law for a period of five years from the end of the reporting period to which it relates unless a shorter period is specified in a tax law.

The Audit Process

The audit process follows a particular procedure which is entrenched in both the tax statutes and general rules of practice.

- **The Notice of Intention to Audit**

Once KRA elects to audit a taxpayer due to one of the triggers listed above, the Commissioner will issue a Notice of Intention to Audit informing the taxpayer that they have been selected for a tax audit.

This Notice specifies the particular ***tax areas*** for which it intends to audit eg. VAT, Withholding Tax, Corporation Tax, Pay-As-You-Earn, Rental Income Tax, Customs Taxes among others.

The Notice also informs the taxpayer of the ***date*** the audit is set to commence, the ***venue*** of the audit (usually at the taxpayers' premises) and further require the taxpayer to provide the audit team with information and tax/accounting ***records and documents*** to facilitate the audit.

At this stage, it is advisable to engage the services of tax -advisor to assist in analyzing the taxpayer's records and ensure that all the relevant documents are submitted to KRA during the audit process.

NB: The taxpayer should make sure to notify KRA of any appointment of external tax advisors that all communication on the tax audit is channeled through and/or copied to them.

Note that failure to fully submit all relevant documents could lead to issuance of additional assessments.

If for any reason, the taxpayer does not have any of the documents requested, they should promptly inform the Commissioner and provide sufficient reason why the said documents are not in their possession. Incidentally, failure to keep, retain or maintain a document that may be required to be kept, retained or maintained without reasonable excuse during a reporting period is an offence under the law (Section 93, TPA).

It is also important to note that where a taxpayer refuses to provide certain documents, the Commissioner can obtain a warrant for search and seizure and in this case the Commissioner has the right to freely access the taxpayer's building, place, property, documents, and data storage devices for which the warrant relates to.

- **The Audit Findings**

Upon conclusion of the audit process, the Commissioner issues a preliminary audit report to the taxpayer highlighting its findings from the audit process and the expected tax liability arising.

The Commissioner may also ask the taxpayer to provide additional information/ documents to explain and/or clarify certain concerns emerging from the audit process before an official assessment is issued.

In some cases, after receipt of the preliminary audit report, the Commissioner or the taxpayer may call for a meeting to discuss these issues to gain or offer some insight into the taxpayer's operations and business. The taxpayer should ensure that all such meetings are attended by its tax advisor for the sake of accountability.

This stage offers the taxpayer an opportunity to discuss and clarify any issues with the Commissioner and is often regarded as the first opportunity for dispute resolution whereby the taxpayer can negotiate and close on all non-contentious matters.

- **The Notice of Assessment**

Once the audit findings stage is complete and all non-contentious matters are settled, any open items will go into the Notice of Assessment.
The Notice of Assessment is done both online (iTax) and in writing. A Notice of Assessment will contain the following:-

1. the amount assessed as tax;
2. the amount assessed as penalty payable in respect of the tax;
3. the amount of any interest payable in respect of the tax assessed;
4. the reporting period to which the assessment relates;
5. the due date for payment of the tax, penalty, and interest; and
6. the manner of objecting to the assessment.

The Objection

The Notice of Assessment marks the end of the audit process and heralds the objection stage which is governed by Section 229 of the East African Community Customs Management Act (EACCMA) for customs taxes and Section 51 of the TPA for all other domestic taxes.

The Objection stage is the second opportunity for dispute resolution.

Once a taxpayer is issued with a Notice of Assessment which he does not agree with, he is entitled to lodge an objection in writing within Thirty (30) days of being notified of the Assessment.

An objection shall only be valid if;-

1. It states precisely the grounds of objection,
2. It states the amendments required to be made to correct the decision, and the reasons for said amendments;
3. The taxpayer has paid the entire amount of tax due under the assessment that is not in dispute or has applied for an extension of time to pay the tax not in dispute; and
4. All the relevant documents relating to the objection have been submitted.

Therefore, it is absolutely vital that any outstanding taxes not in dispute are paid before the objection is lodged. Where the taxpayer is not able to settle the taxes in lump sum, he may apply in writing to the Commissioner for an extension of time to pay the taxes (Section 33, TPA).

When a taxpayer applies for an extension the Commissioner may, if satisfied that there is reasonable cause;

1. Grant the taxpayer an extension of time for payment of the tax; or
2. Require the taxpayer to pay the taxes in such instalments as the commissioner may determine.

A recent amendment to the Tax Appeals Tribunal Act now confines documents presented by an appellant to the Tax Appeals Tribunal to those which had been provided to the Commissioner during the objection process. Therefore, it is vital for the taxpayer to provide all relevant documents at this stage exhaustively.

Where the Commissioner determines that an objection lodged by a taxpayer has not been validly lodged, the Commissioner shall immediately notify the taxpayer in writing that the objection has not been validly lodged in which case the taxpayer should immediately rectify the same.

If the taxpayer is not able to lodge the objection within the requisite thirty (30) day period, he may make an application, in writing, to the Commissioner for an extension of time to lodge an objection.

There are certain conditions that the Commissioner has to consider before allowing this application. These conditions are provided for at Section 51(7) as follows;-

1. The taxpayer was prevented from lodging the objection within the 30-day period because of;

- **an absence from Kenya,**
- **sickness**
- **or other reasonable cause; *AND***

2. The taxpayer did not unreasonably delay in lodging the objection.

The question of what constitutes “other reasonable cause” has been a question of much discussion in the corridors of justice with most agreeing that this question is a question to be considered on a case-by-case basis.

The Objection Decision

Once a taxpayer lodges a valid objection, the Commissioner is required to carefully consider the objection and issue an Objection Decision within sixty (60) days from the date the objection was lodged. The Commissioner may vide this Objection Decision, elect to either;

1. Allow the objection in whole or in part, or
2. Disallow it

The Commissioner should then notify the taxpayer of his decision in writing and the Objection Decision shall contain;-

1. A statement of findings on the material facts; and
2. The reasons for the decision.

   Section 51 (11) provides that where the Commissioner has not made an objection decision within the requisite sixty (60) days, the objection is deemed to be allowed.

The Appeal

If the taxpayer is dissatisfied with the Commissioner's Objection Decision the only recourse available to him is an Appeal to the Tax Appeals Tribunal (TAT).

An Appeal to the TAT is commenced by lodging a Notice of Appeal within thirty (30) days upon receipt of the Objection Decision. This Notice of Appeal shall be only be valid if the taxpayer has paid the tax not in dispute or entered into an arrangement with the Commissioner to pay the tax not in dispute at the time of lodging the Notice.

Within fourteen days from the date of filing the Notice of Appeal the taxpayer is expected to submit enough copies as directed by the Tribunal of its Memorandum of Appeal, the Statements of Facts, and the tax decision to which the Appeal relates.

Once the Commissioner is served with the Appeal documents, he is expected to submit the statement of facts including the reasons for the tax decision and the documents he wishes to rely on within thirty (30) days.

The Appeal to the Tribunal is considered the third opportunity for dispute resolution because once this Appeal is lodged, the parties may apply to the Tribunal to resolve the dispute through the KRA's Alternative Dispute Resolution Framework ("ADR").

If the parties arrive at an agreed resolution, it is transcribed into writing, signed by both parties and witnessed by the ADR facilitator. The ADR Agreement is a full & final settlement and is binding upon both parties.

Not to worry, if these ADR process fails, the parties are at liberty to refer the dispute back to the Tribunal for determination.

The Conclusion

Today, the interaction between KRA and the Taxpayers has greatly metamorphosed. With the strategic level understanding and with the involvement of professionals, one can challenge an Audit process together with the outcome.

Flowing from above, below is a summary of the checklist to summarize the management of KRA Tax Audit.

- Notice of Intention to Audit highlighting the specifications of the Audit
- Period of the Audit (5 years)
- Minutes of the Audit meeting (if there was a meeting)
- Audit findings
- Notice of Assessment
- The Objection
- The Objection Decision
- The Appeal.