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### **WHAT IS REVERSE VAT?**

International trade in goods and services has grown tremendously over the years providing a significant tax base for revenue authorities. The imposition of taxes on international trade in goods was for a long time under the control of the General Agreement on Tariffs and Trade (GATT), a worldwide multilateral trade agreement geared towards reduction and/or elimination of tariffs and quotas to spur world trade, which came into force on 30 June 1948 and ended on 1 January 1995 with the establishment of the World Trade Organisation (WTO). Currently all goods traded internationally are classified under a harmonized system (Harmonized Commodity Description and Coding System) which contains the applicable tariffs.

Given that goods imported into a country must clear customs, the collection of taxes (VAT, Customs and Excise) and levies on imported goods has always been the responsibility of the customs departments of revenue authorities all over the world. The same cannot be said with regards to the importation of services which can be consumed without seeking clearance from revenue authorities. To bring such services into the tax net, revenue authorities have applied the subrogation principle which simply means that the recipient of the service(s) is deemed to be the supplier of the service(s) and hence can account for tax (VAT) on the service(s). This VAT charge is what is referred to as reverse VAT or reverse charge VAT.

In Kenya, the reverse VAT concept has evolved over time through numerous changes in the VAT legislation. Currently, it is provided for in the VAT Act No. 35 of 2013 and is applicable only to registered persons. This was not always the case as prior to the amendment introduced to the definition of supply of imported services by the Finance Act 2015, which took effect on 12 June 2015, all persons whether registered or non-registered were required to account and pay for VAT on the services they had imported.

To further expound on who is liable for the accounting and payment of reverse VAT, Section 5(6) of the VAT Act places the responsibility on the registered person receiving the imported service(s).

Under ordinary circumstances, once the importer has paid VAT on the imported service(s) that VAT becomes input tax on which a refund claim can be made. If the registered person was making fully taxable supplies, he would be in a position to claim the entire input tax. This would result in nil revenue for the tax authority and an unnecessary negative cashflow situation for the importer.

To eliminate the above zero-sum scenario, the requirement to pay for VAT on imported services in Kenya has been limited to the extent that a person cannot claim back the VAT as input tax. This would arise in the following ways: -

- i. If a registered person is partially exempt (makes taxable and exempt supplies), he would be required to account for the portion of VAT on imported service(s) that relates to the exempt supplies (the unclaimable part);

- ii. If a registered person is fully exempt, he would be required to account for the entire VAT on imported service(s).

In addition to accounting and paying for reverse VAT, there is now a requirement brought about by Legal Notice 54, The Value Added Tax Regulations 2017, for a registered person who is liable for payment of reverse VAT and is entitled to a credit for part of the amount of input tax payable, to prepare a tax invoice with respect to the supply. The invoice should include the normal features of a valid tax invoice, the PIN of the recipient and a description of the extent to which the imported service(s) has been applied other than to make taxable supplies.

In conclusion, it is important for all registered persons in Kenya to take note of the requirements and regulations relating to the payment and accounting for reverse VAT, where applicable, to avoid crystallization of penalties and interest as a result of non-compliance.



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