KPMG

Tax Alert

The effect of late filing of VAT returns on input VAT claims

Background

This alert brings to your attention the High Court's judgment in the case of ***Highlands Mineral Water Limited (Taxpayer) vs. Commissioner of Domestic Taxes (KRA) Tax Appeal No. E026 of 2020***.

KRA disallowed the Taxpayer's input VAT on late returns filed for the period of January 2014 to April 2017. KRA's basis was that the input VAT was time-barred in accordance with Section 17(2) of the Value Added Tax, 2013. KRA assessed the Taxpayer **KES 155,402,525** which was the disallowed input VAT, penalties and interest.

The Taxpayer opposed KRA's decision and proceeded to the Tax Appeals Tribunal (Tribunal). The Tribunal dismissed the appeal and confirmed KRA's assessment and demand. The Taxpayer then appealed to the High Court.

The crux of the dispute was the interpretation and application of Section 17(1) and (2) of the VAT Act which provide as follows:

"Subject to the provisions of this section and the regulations, input tax on a taxable supply to, or importation made by, a registered person may, ***at the end of the tax period in which the supply or importation occurred, be deducted by the registered person, subject to the exceptions provided under this section****, from the tax payable by the person on supplies by him in that tax period, but only to the extent that the supply or importation was acquired to make taxable supplies."*

"If, at the time when a deduction for input tax would otherwise be allowable under subsection (1), the person does not hold the documentation referred to in subsection (3), the deduction for input tax shall not be allowed until the first tax period in which the person holds such documentation."

Provided that the input tax shall be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred. (Emphasis added).

The Tribunal held that the wording of Section 17(2) of the VAT Act was clear and unambiguous and that where a taxpayer filed its VAT return late, then the input VAT should only be allowed for deductibility to the extent that it is within 6 months at the time of filing the return. The Tribunal referred to Section 44 of the VAT Act which required the Taxpayer to have filed its VAT return not later than the 20th day of the end of a period unless the Taxpayer had sought and obtained approval from KRA for extension of time to submit the return late. In confirming KRA's assessment and demand, the Tribunal took the position that the payment of a penalty for late filing of a VAT return did not give a taxpayer a right to claim input tax outside the 6 months period unless the KRA had approved the late filing.

Dissatisfied with the Tribunal's judgement of 31 March 2020, the Taxpayer appealed to the High Court.

Taxpayer's grounds of appeal at the High Court

The Taxpayer challenged the Tribunal's decision mainly on the following grounds:

i. The input VAT was claimed in the correct tax period as prescribed under Section 17(2) of the VAT Act, notwithstanding that the return was submitted late.

ii. The only conditions provided in law for input VAT to be allowed under section 17 of the VAT Act are:

   a. That the input tax was incurred on a taxable supply or on importation by a taxpayer;

   b. That the input tax is deducted by a registered person on taxable supplies made by him; and

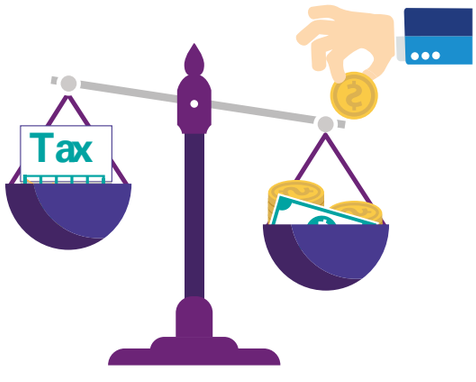
   c. That the input tax is to be allowable for deduction within 6 months after the end of the tax period in which the supply or importation occurred.

iii. The Tribunal's interpretation of Section 17(2) of the VAT Act implies that when a taxpayer files its VAT return late, the return should not reflect the taxpayer's actual VAT transactions that would have been reflected if the VAT return had been submitted on time.

iv. The Tribunal's decision to disallow recovery of input VAT incurred by the Taxpayer implies that there were no purchases made by the Taxpayer in furtherance of its taxable business for the period January 2014 to April 2017.

v. As decided in the case of ***Rabai Operation & Maintenance Limited vs Commissioner of Domestic Taxes MLTA No. 7 of 2017***, the requirement of filing VAT return was not a condition for deduction of input VAT under section 11 of the VAT Act (Repealed) that was similar to Section 17(2) of the VAT Act.

vi. There is a penalty imposed by the law for filing the VAT return late. Allowing KRA to disallow input VAT by referring to the 6-months limit from the date of the return as opposed to the tax period of the supply, the Tribunal had imposed an additional punishment for late filing which is not provided for by the law.



KRA's arguments

In rebutting the Taxpayer's arguments, the KRA contended that:

i. Section 17(2) of the VAT Act prohibits a taxpayer from claiming input tax that is more than 6 months. Since the Taxpayer had failed to file the returns on time and further made claims for deduction of input VAT beyond 6 months after the tax period, such a claim cannot be allowed.

ii. Sections 44(2) and (3) of the VAT Act requires every registered person to apply to the Commissioner (KRA) in writing for an extension of time to submit a return and the application should be made before the due date for submission of the return. The Taxpayer filed the VAT input returns in an unlawful manner because they did not seek an extension of time,

iii. "Procedure is the handmaid of justice" and the Taxpayer bypassed specific provisions of the VAT Act that provide for extension of time for filing late returns hence such returns ought to be disallowed in their entirety.

iv. The Taxpayer bears the burden of proving that it claimed for input tax within the stipulated timelines other than through VAT 3 returns. The Taxpayer did not demonstrate this at the Tribunal and at the High Court.

Issue for determination

From the parties' submissions, the High Court determined that the only issue for determination was whether a claim for input VAT would be valid if the claim is made more than 6 months from the date of supply.

The Court's findings

The High Court determined the matter in favour of the Taxpayer. In its decision, the Court observed that:

i. The right to input tax is an integral part of the VAT scheme as a taxable person who makes a transaction in respect of which VAT is deductible may deduct the VAT in respect of goods and services acquired by him provided that such goods and services have a direct and immediate link with the output transaction in respect of which VAT is deductible.

ii. Section 17(1) and (2) of the VAT Act permits the Taxpayer to claim input tax at any time provided the claim falls within 6 months from period which the supply or importation occurred notwithstanding that the VAT return is filed late.

iii. The only conditions for a taxpayer to qualify for input VAT under Section 17 of the VAT Act are:

   a. That the input tax was incurred on a taxable supply made to or on importation made by a taxpayer at the end of the tax period;

   b. That the input tax is deducted by a registered person on taxable supplies made by him; and

   c. That the input tax is to be allowable for deduction within six months after the end of the tax period in which the supply or importation occurred.

iv. The filing for VAT returns is not a condition for deduction of input tax.

v. Section 17 does not deal with or mention the filing or otherwise of VAT returns.

vi. KRA's power is limited to allowing an extension of time for filing the return whose effect is to relieve the taxpayer from the penalty or accept the return and demand the appropriate penalty.

The Court concluded by stating that KRA has no power under section 17 of the VAT Act to disallow an input VAT claim for the reason of late filing as long as the claim is made within 6 months after the end of the tax period within which the supply or importation is made. Only the input VAT claims by the Taxpayer that were made 6 months ***after*** end of the tax period can be disallowed irrespective of late filing of the VAT returns *(Emphasis added).*

Our opinion

This is a welcome decision with respect to giving clarity on the interpretation and application of Section 17 of the VAT Act, 2013. The position taken by the High Court in its judgement, not only upholds the principle of strict reading of the law but also preserves the spirit of the Value Added Tax system especially the taxpayers' right to claim input VAT to the extent that such VAT relates to purchases directly linked to the corresponding transactions.

Indeed, if it were the draftsmen's intention for the filing of a VAT return to be a condition before an input claim is allowed, the VAT Act would have expressly provided so.

Notwithstanding the decision in favour of taxpayers, businesses should assess their records to determine whether they have been wrongfully denied any input VAT on the basis of late filing of returns. Caution should be taken as the judgement does not offer any relief for claims made more than 6 months after end of the tax period in which they procured the supply.

KPMG is happy to assist on any issues arising from this decision.

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