Achieving Effective Stakeholder Engagement

A Case Study of VAT Refunds Formula

Kenya Revenue Authority

Tulipe Ushuru, Tujitegemee!

Table of Contents

Introduction & Objective

The Kenya Revenue Authority (KRA) has been a trailblazer in Stakeholder Engagement in modern public management in Kenya. This follows institutionalization of a corporate wide Stakeholder Engagement framework in 2015. So far, a Stakeholder Engagement Secretariat has been established, a corporate structure of engagement and communication developed that guides engagements with a single and central view of stakeholders, and a mechanism put in place to ensure centralized monitoring and escalation of stakeholder issues to gauge corporate commitment to resolution of issues.

Stakeholder engagement in KRA is premised on providing platforms to ensure compliance with the set laws and guidelines in public engagement and ensure all stakeholders have the right of information and opportunity for engagement and feedback. This is achieved by:

- Ensuring public participation is adhered to by involvement of stakeholders in tax administration.
- Continuously improving the quality of engagement with the public and all its stakeholders and seek to align external views with internal business processes.
- Putting in place structures to encourage the public to share their views on tax policy and procedures.
- Coordinating a structured platform to engage, collate and resolve issues of stakeholders as may arise from time to time.

This case study aims at showcasing innovative stakeholder engagement measures taken by KRA to resolve tax administration challenges. It highlights how influencing in a multi-stakeholder decision-making process from a stakeholder engagement perspective can result in positive outcomes that lead to overall stakeholder trust and improved relationship health. The case study focuses on how KRA helped resolve the challenge of VAT refunds to taxpayers by working together with key stakeholders to amend the formula for working out VAT refunds, resulting in enhanced efficiency of the refunds process and guarantee for exporters of VAT taxable goods business liquidity by full recovery of their share of input tax relating to zero rated supplies.

We specially wish to thank the Kenya Association of Manufacturers who were key partners in these discussions.

The Case of VAT Refunds Formula

The VAT Act introduced in 2013 moved most of the goods and services from zero rated to taxable at 16% this is the rate of VAT. The overall expected net effect was to expand the revenue base, as well as reduce the amount of VAT claims. However, various policy and legal amendments aimed at economic growth and domestic investment has overtime reversed this, effectively rendering a significant number of goods and services zero-rated. As a result, this has led to a significant growth in VAT refund claims.

To address this challenge, the Value Added Tax (VAT) Regulations 2017 published on 30th March 2017 under Gazette Legal Notice No. 54 introduced a formula to determine the amount due as a refund to a registered person who makes taxable supplies at both the general and zero rates. This is stipulated under Regulation 8 – a cited/referenced section of the law showing where the changes have been effected.

The Regulation 8 states;

8(1); A registered person who makes taxable supplies at both the general rate and zero rate, shall only be entitled to a refund arising from making zero rated supplies.

8(2) in determining the amount due as a refund to a registered person who makes taxable supplies at both the general rate and zero rate, the Commissioner shall use the following formula;

R = Z/T × **e**, where —

- R is the amount to be refunded
- Z is total value of the zero rated supplies
- T is the total value of the taxable supplies
- e is excess input tax for the month of the supply.

Challenges of Formula Implementation:

Implementation of the formula raised a number of concerns from a variety of stakeholders - especially the manufacturers who are mainly exporters. The key issues raised included:

a. The formula had greatly affected manufacturers who were mainly making sales for exports - Any claimant, who consistently exports, will continue carrying forward credits as increased export sales increases VAT3 credit. Such a taxpayer would need to stop exporting to utilize the extra credits built-up. The formula therefore discourages export sales. Moreover, in cases where the taxpayer is always in monthly refund position, it leads to accumulation of VAT credits hence the taxpayer shall never be able to utilize the credited amounts leading to short and long-term cash flow deficiencies **(see - Illustrations 1, 2 and 3 below).**

b. The below scenario (a) is further compounded in situations where the taxpayer has Withholding VAT since there is no provision for refund of Withholding VAT.

Challenges of Formula Implementation:

c. That it is not clear whether the formula addresses the issue of credit attributable to exempt supplies under “e”

d. That the formula **R=Z/T×e** (where R = amount to be refunded, Z = value of zero rated supplies, T = value of total supplies and e = excess input tax for the month of the supply), e (excess input tax) is by itself computed after deduction the output VAT, the formula further restricts the refund tax by applying the formula Z/T.

e. The delay in recovering the credits adversely affects businesses cash flows.

Stakeholder sentiments are also highlighted below:

“As a result, some manufacturers have stopped exporting in order to reduce the impact of non-refunded excess VAT on their cash flows.”

“Liquidity challenge as a result of VAT refund delays had forced the firm with operation in 11 countries to resort to borrowing from banks.”

“Effectively, what’s happening is the portion of money that would have been paid to us as a refund is actually lying as credit there (at KRA) because they said we couldn’t claim and it’s lying in our account.”

“This VAT contributes 3-4 percent of the cost of funding and then there’s liquidity that is tied up that you still have to go and borrow from the bank and, in today’s environment, to borrow from the bank is not easy.”

VAT Refunds Formula Case Scenarios

Scenario 1:

- Client purchases 50items of product A each @ 75/- plus VAT and sells 20 items as local and 30 items as exports. The selling price of each product is 100/- plus VAT.

Product A Purchase	**Product A Sale**	**VAT implications**			
Net Value 75	Net Value 100	**Local sales**	20 items	@ 16	320
VAT @16% 12	VAT @16% 16	**Export sales**	30 items	@0	
Gross 87	Gross 116	**Total sales**	50 items		320
		Purchases	50 items	@12	600
Refund = $\frac{\text{Excess input tax x Zero rated supplies}}{\text{Taxable supplies}}$		**Amount Refunded by KRA** = (168)			
$=\frac{320-600 \text{ x } 3000}{5{,}000}$		**Amount refunded by i-Tax** = (112)			
$= \frac{(280) \text{ x } 3{,}000}{5{,}000}$		**Total VAT** = (280)			

VAT Refunds Formula Case Scenarios

Case Scenario 2:

- Where the client splits the company into two branches i.e. one for selling locally and the other one for exports only.

Purchased 20 items and sold locally	Purchased 30 items and exported
VAT implications= Output VAT – Input VAT= 20 items (16-12) VAT payable to KRA (A)= 80	VAT implications =Output VAT – Input VAT =30 items (0-12) VAT refundable by KRA (B) = (360) Net VAT effect = A – B Net VAT refundable by KRA (A +B) = (280)

Case Scenario 3:

- Suppose the formula was amended to include restriction on input and not on e (excess input tax).

RE/FUND	
= Input tax x Zero rated supplies / Taxable supplies	
= (600) x	3,000 / 5,000
	= (360)
Output VAT on 20 items	= 80
Net VAT to be refunded by KRA	= (280)

- From the above case scenarios, it is evident that the case scenario 1 is deficient on its own and will lead to accumulation of VAT for the unforeseeable future.

- Case scenarios 2 and 3 indicate that the client shall not suffer if he splits his company's sales regions wise and/or if the formula is amended to restrict on input VAT rather than e (excess input tax).

These challenges presented a need to engage the industry players to develop solutions for ensuring effectiveness of the refund formula and ensure its favorability to all players.

Stakeholder Engagements: The Superstructure

KRA held fifteen (15) engagements with key players in Government, Private sector, National Assembly for a favorable solution that would support the business community and champion a tax policy that specifically addresses VAT problems and resolve the refund challenge.

The Structure of engagements/approach included the following;

1. **Sector/Technical Consultative Forums e.g. manufactures, exporters, Business Member Organizations:**
   - These were held on a monthly basis to review submissions from working groups for briefing to the Commissioners on various proposals.

2. **Working Groups:**
   - These were held on a weekly basis with various technical teams to simulate the impact of the formula and work out favorable solutions.

3. **Commissioner's Roundtable:**
   - This entailed presentation of a report to the Commissioner on the formula challenges for administrative intervention, and onward escalation of policy matters and actions taken to the Commissioner General.

4. **Commissioner General Roundtable:**
   - These were held on a quarterly basis issues to highlight to the Commissioner General and Board of Directors the pain areas on the refund formula and possible policy solutions and options.

5. **Consultations with the National Treasury:**
   - This entailed face-to-face policy submission by KRA & Industry players - The Budget and policy team which incorporated members from the KRA Corporate Tax Policy and Tax Advisory units presented and supported the policy submissions and proposed options/solutions for resolving the formula challenge.

6. **Parliamentary Engagements:**
   - This entailed engagement with the National Assembly Committee on Delegated Legislation to demonstrate the need for a review of the formula and present evidence of how the status quo affected various stakeholders.

Stakeholder Engagements: The Superstructure

The engagements are summarized as follows:

S/No.	Engagement	Number	Frequency	Hours/Meeting
1.	Sector Consultative Forums	3	Monthly	3hrs
2.	Working Groups	5	Weekly	5hours
3.	Round Tables	2	Quarterly	2hours
4.	National Treasury Budget Committee	3	Weekly during the budget cycle	2hours
5.	National assembly	2		3hours

Fixing the Winning Deal: Route to Consensus Making

Through the highlighted engagements, the following proposals were put forth to resolve implementation challenge of the formula;

1. A review to allow taxpayers to be able to claim VAT refund in full in cases where there is excess input arising from both zero-rated and standard rated supplies. This would ease cash-flow pressure faced by manufacturers and other taxpayers in Kenya.
2. Amendments for claims to be allowed to be set-off against other tax payable i.e. PAYE, customs duty, excise and corporate taxes.
3. Alternatively, law should be amended to allow for refund claim for output tax credits
4. WHVAT rate to be reduced from the current 6% to 2%

Implementation of some of these proposals would require amendment of the VAT law via National Treasury and Parliament through the National Budget cycle. KRA committed to make submissions to the National Treasury to support review of the formula as evidenced above.

Introduction of VAT (Amendment) Regulations, 2019

Following these engagements and concurrence with the National Treasury, the Cabinet Secretary National Treasury published the Kenya Gazette as Legal Notice 86 of 2019 on the 13th June, 2019.

The regulations aimed to amend Regulation 8 (2) of VAT Regulations 2017 which contains the formula. Key to this formula is that the earlier formula calculated the amount allowed as refund of input value added tax whereas the revised formula calculates the share of input value added tax to be allowed. The revised formula guarantees the exporters of VAT taxable goods full recovery of their share of input tax relating to zero rated supplies.

The amended regulation gave birth to a new formula:

$$\mathbf{R} = \frac{\mathbf{Z}}{\mathbf{T}} \times \mathbf{I}; \text{ where}$$

R = value of input tax relating to zero rated supply;

Z = total value of zero -rated supplies;

T = total value of taxable supplies;

I = deductible input tax for the month of supply.

This aimed to cure implementation challenges of the VAT Regulations 2017. The amendment sought to adjust the refund formula in order to ensure that taxpayers are able to fully recover the portion of input tax relating to zero-rated supplies.

The action also led to reduction of withholding VAT from 6% to 2%.

The Miscellaneous Amendments 2019 has provided for Credit Utilization where taxpayers are able to utilize credits relating to VAT Withholding to settle tax liability in other tax heads. This simply ensures if one has tax credits they can offset tax liabilities in the different tax heads.

Engagement Challenges:

The deployment of stakeholder engagement strategy to resolve the refund formula problem had its challenges.

First, there was limited involvement of policy players (e.g. Treasury) in the initial discussions and engagement processes aimed at reviewing implementation challenges of the formula. Their significance was pulled in place at the agenda-setting stage. Had the latter happened, the issue resolution would have been quicker.

Second, given the highly sensitive nature of taxation, there is bound to be diversity in opinion on how to resolve such a complex policy challenge. This would result in polarizing and protracted discussions and debates that would take clinical and multitrack diplomatic efforts to build consensus around. This requires heavy investment in time, which prolongs the life of the challenge and further dissatisfaction of the taxpayers.

Building Stakeholder Trust: Lauding the KRA Approach

Following the developments described above, KRA has earned a reputation for enhancing efficiency in tax administration through proactive relationship building. In some quarters, the Authority been branded the "Kenya Relationship Authority":

- The Kenya Association of Manufacturers (KAM) through their *Manufacturing Priority Agenda 2020* documented the VAT refund formula as a key enabler and recognized the role of KRA stakeholder engagement process in unlocking the industry's challenges.
- KRA has also received memoranda from the private sector applauding the policy changes through stakeholder engagement processes; and articulated its commitment in working with KRA to resolve any business challenges due to their confidence in the Authority's stakeholder engagement process.
- The *5th KRA Annual Tax Summit* lauded KRA's stakeholder engagement process as one of the key institutional achievements emanating from recommendations of the 4th Tax Summit.
- KRA conducted a *Stakeholder Relationship Health Survey* to gauge the relationship health of KRA with its stakeholders. The survey scored KRA at 61.4%, with insights of the level of trust and confidence that stakeholders have in the Authority's engagement processes.

Conclusion & Lessons Learnt:

1. Stakeholder engagement is critical to ensure buy in major tax compliance initiatives.
2. Policy issues of national interest like taxation require a holistic and multi-stakeholder approach to ensure buy-in.
3. Public Participation (collaboration, consultations and partnerships) is key to unlocking challenges and disputes of policy nature, especially taxation. A stakeholder engagement strategy, implemented at the highest level of corporate governance, is a worthwhile investment towards achieving this.
4. Public participation, when executed in abroad-based and non-adversarial manner, can elicit innovation in identifying policy solutions.
5. Stakeholders in tax administration hold the key to successful implementation of national resource mobilization strategies.


TIMES
TOWER

Website: www.kra.go.ke **Physical Address:** Times Tower, Haile Selasie Avenue, Nairobi, **Contact Centre:** +254 (020) 4 999 999, +254 (0711) 099 999, Email: callcentre@kra.go.ke

@KRACare

Kenya Revenue Authority

Kenya Revenue Authority

Kenya Revenue Authority

KENYA REVENUE AUTHORITY

Tulipe Ushuru, Tujitegemee!