



VAT on rental income is back!

Rental income on non-residential buildings (commonly referred to as commercial property) will attract VAT at the standard rate of 16%. This is effective from January 2008. This change will have an impact on developers and owners of property including insurance companies, banks and pension funds who are among the major property owners in Kenya. It will also have an impact on tenants. According to the Minister of Finance, this amendment is aimed at encouraging further expansion of commercial buildings, which has been brought about by increased economic activities.

This is not the first time that such an amendment has been proposed. In 2001 the Finance Bill tried to introduce VAT on commercial buildings but the proposal was not ratified by the members of Parliament. The Kenyan economy (especially the commercial property development sector) is now performing much better than it was in 2001. Parliament is currently debating the Finance Bill 2007 and this time round we are not aware of any serious opposition to the proposal by the Minister to suggest that it will not be passed.

What does this change mean for you?

This change has a number of implications for various categories of businesses as discussed below:

- If you are already a VAT registered business owning commercial property, you will be required to charge VAT on renting, leasing or hiring of the commercial building. If you are not currently registered for VAT, and expect a turnover of KShs 5 million per year, then you will be required to register for VAT with effect from 1 January 2008. The good news is that as a commercial property owner, you will be entitled to recover VAT incurred on your expenditure. This is currently not deductible because rental income is exempt. This is particularly attractive to landlords who rent their premises to businesses that are registered for VAT

and who will be able to recover VAT charged on rent. With the current boom being experienced in the country, input tax deduction is a major opportunity that will result in cash savings for the property developers.

- If you are a VAT registered tenant then you will be able to claim VAT charged by your landlord on the rent you pay. However, for tenants who are not registered for VAT, the VAT charged on rent will be an additional cost as it is non-recoverable. This category may include educational institutions, medical institutions or other charitable organisations.
- If you own commercial property and also engage in a mix of taxable and exempt VAT supplies, then you have an opportunity of increasing the amount of input VAT you can recover.

You have 30 days...

It is important for businesses that will be affected by the new change to start preparing well before 1 January 2008. Let this change not catch you by surprise as many VAT saving opportunities may be lost. You need to manage potential financial and reputation risks that may arise as a result of delaying in complying with the new law.

As an example, immediately the change becomes effective, you have only 30 days to claim back the input VAT incurred on construction costs or purchased assets over the last 12 months. This applies to businesses that will be required to register after 1 January 2008. This is an opportunity that as a business, you must take advantage of. The period of twelve months for which the VAT can be recovered can be extended to 24 months with prior approval from the Commissioner of Domestic Taxes. For many businesses, especially those that incurred VAT on construction costs during that period, this will represent substantial VAT savings.

Other existing opportunities

Many commercial property owners may also want to review their current systems to optimize on VAT savings. For example, the timing of when expenditure is incurred could result in higher recoveries of input VAT.

Apart from the tax savings opportunity, it is also critical to ensure that the business fully complies with VAT legislation from onset. A number of businesses will be registering for the first time and will need to implement VAT accounting procedures. They will also be expected to immediately comply with other legislative requirements such as on invoicing and filling of the VAT returns. If this is done properly, it will minimise future VAT risks.

Once VAT registered, a review of all business transactions is necessary to ensure that the business achieves maximum recovery of input VAT. This is relevant for partially exempt business, which deal in both taxable and exempt supplies. A partial exemption review can result in significant savings for the business.

Early dialogue with tenants is also important so that they do not see this as an incremental cost

and are able to claim back the VAT charged on rent where appropriate.

But there are still few unclear areas

As with all new legislation, there remain areas of uncertainty relating to the practical application of the changes which require clarification from the Kenya Revenue Authority (KRA). We are currently in consultations with KRA to have these matters clarified. We understand that KRA may issue rules to provide guidance with the implementation of this new law.

It is, however, important that you start reviewing the impact of this new legislation on your business as soon as possible so as to maximise on any opportunities and also ensure that you are ready to comply with effect from January 2008.

How can PricewaterhouseCoopers help?

We would be happy to provide you with assistance in reviewing the impact of the new legislation on your business, and planning for this. Certain planning opportunities will be lost with the passage of time and hence the need to be proactive on this and not to wait till December 2007. If you require further information or assistance please call your usual PwC contact or one of the following:

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