

ICPAK Annual Tax Conference

Income Tax Reforms: Is it time?

20 September 2013



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PRESENTER: Francis Kamau, CPA



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Corporation Tax

Determination of a PE

- ▶ Section 2 - defines a permanent establishment ('PE') as *“a fixed place of business in which that person carries on business and for the purposes of the definition, a building site, a construction or assembly project, which has existed for six months or more, shall be deemed to be a fixed place of business”*.
- ▶ Business is defined to include *‘any trade, profession or vocation, and every manufacture, adventure and concern in the nature of trade, but does not include employment*
- ▶ These definitions are not clear as to the meaning of trade and the act of carrying on business. The term, fixed place of business is also not defined.

Corporation taxation

Business tax (Income Tax Act Provisions) cont'd

- ▶ Section 4 – Income from businesses:
- ▶ For the purposes of Section 3 (2) (a) (i) (**business income**), where a business is carried on or exercised **partly within** and **partly outside Kenya** by a resident person, the **whole** of the gains or profits from that business shall be deemed to have **accrued in** or **to have been derived from Kenya**;

Corporation tax

Tax Losses

- ▶ Tax loss carry forward restricted to **four years**
 - ▶ Period **extendable** by the Minister on Commissioner's recommendation (Finance Act 2009)

Corporation tax

Capital Deductions

1. Industrial building allowance

- ▶ IBA is deductible where a person incurs capital expenditure on construction of industrial building to be used in a business carried on by him or his lessee

IBD; Qualifying expenditure	Rate (%)
Industrial buildings	10 (Prior to 1.1.2010 - 2.5%)
Hostel, Educational & Training buildings	50 (Prior to 1.1.2010 - 10%)
Rental residential building (W.E.F 12 th June 2009)	25 (Prior to 1.1.2010 - 5%)
Commercial Buildings	25% (W.e.f 1.1.2010)

Industrial Buildings Cont'

► Details:

- a building in use as a hostel or an educational building or a building used for training – **certified by the Commissioner. 2nd Sch. Para. 5 (1) (e) – 50%**
- a building in use as a rental residential building constructed in a planned developed area approved by the Minister responsible for Housing. **2nd Sch. Para. 5 (1)(f) – 25%**
- a building in use as a commercial building. **2nd Sch. Para. 6A– 25%**
Para. 1 (1) (ee) “ in a case referred to in paragraph **5(1)(f)** – rental residential building for any year of income commencing on or after 1st January 2010, where roads, power, water, sewers and other social infrastructure have been provided by the person incurring the capital expenditure”.

Corporation tax

2. Wear & Tear Allowance

Qualifying expenditure	Rate (%)
Heavy self-propelling machinery such as tractors and combine harvesters	37.5
Computer and peripheral computer hardware, calculators, copiers and duplicating machines	30
Other self propelling vehicles and aircrafts (cost of non-commercial motor vehicles is restricted to KShs. 2 million with effect from 1.1.2006)	25
All other machinery including ships	12.5
Computer software (W.E.F 1 Jan 2010) (Para 31B)	20
Indefeasible right to use a fibre Optic cable by the telecommunications operator	5
Telecommunication Equipment (W.E.F 1st Jan 2010)	20
Concession arrangements (Para 31A)	Spread over period

Corporation tax

3. Investment deduction

Investment Deduction; Qualifying expenditure	Rate (%)
Building and machinery used for manufacturing purposes and hotel buildings	100
Civil works and structures forming part of an industrial building used for purposes of manufacturing	100
Ships of 495 tons (withdrawal of allowance on sale of ship within five years)	40
Filming Equipment (W.E.F 12th June 2009)	100
Investment made outside Nairobi, Kisumu and Mombasa (W.E.F 12th June 2009)	150
Investment qualifying cost is Kshs. 200 million	

Farm Works: Definitions

▶ “Agricultural Land”

- ▶ Means land occupied wholly or mainly for the purposes of a trade of husbandry.

▶ “Farm Works”

- ▶ Means farmhouses, **labor quarters**, any other immovable buildings necessary for the proper operation of the farm, fences, dikes, drains, water and electricity supply works **other than machinery**, windbreaks, and other works necessary for the proper operation of the farm.

Farm Works Deductions Cont'

- ▶ No capital expenditure shall be taken into account for the purposes of this paragraph unless it is incurred for the purposes of husbandry on the agricultural land in question.
- ▶ Where the capital expenditure -
 - ▶ is on a **farm-house, one third** only of the expenditure shall be taken into account or, if the accommodation and amenities of the farmhouse are out of due relation to the nature and extent of the farm, such lesser proportion thereof as the Commissioner may determine to be just and reasonable.
 - ▶ is incurred on assets **other than a farmhouse**, being an asset which is to serve partly the purposes of husbandry and partly other purposes, then only such proportion thereof **as the Commissioner may determine to be just and reasonable** shall be taken into account for the purposes of this paragraph.

Clarification on deemed interest

- ▶ S. 16(2)(j): Interest in respect of thinly capitalized entities disallowed
 - ▶ Thin cap status: loans advanced by a controlling non-resident entity exceeds its equity by more than three times
 - ▶ Effective 11 June 2010, the aspect of deemed interest on interest free loans was included under S. 16(2)(j)
- ▶ New S. 16 (5) inserted
 - ▶ Commissioner to prescribe the form and manner for deemed interest computation and the period applicable
- ▶ Wef 09 June 2011, S. 35 (1)(e) amended to include deemed interest under the ambit of withholding tax

Clarification on deemed interest cont'

- ▶ Non-resident entities may not accept to incur tax liability on non-existent loan interest
 - ▶ Resident entities are therefore unable to transfer the withholding tax on deemed interest to non-resident entities hence likely to bear the 15% tax burden as their own cost
- ▶ Resident tax payer to carry the 30% corporate tax burden on the disallowed non-existent interest

▶ Challenges

- ▶ Section 18 (3) prescribes the arm's length concept which probably would supersede the Commissioner's prescribed rules
- ▶ The rates under Commissioner Guidelines should be in line with average 91 day Treasury Bill Rate as per Section 16(3)

▶ **Effective date: 09 June 2011**

Bad Debts Guidelines

- ▶ A debt shall be considered to have become bad if it is proved to the satisfaction of the Commissioner to be uncollectable.
 - ▶ A debt shall be deemed to have become uncollectible where
 - ▶ creditor loses contractual right via a court order;
 - ▶ no form of collateral is realisable or proceeds from collateral unable to cover the entire debt;
 - ▶ debtor adjudged insolvent by a court of law;
 - ▶ cost of collecting the debt exceeds the debt itself; or
 - ▶ Efforts to collect the debt abandoned for another reasonable cause.
 - ▶ Deductible as an expense if incurred in normal business course.
 - ▶ A bad debt of capital nature not an allowable expense.
- LN No. 37 (2011)**

Donations

- ▶ S.15(2)(W): Cash donations to an income exempt charitable organization or to a Minister's approved project are allowable deductions. **WEF 01 Jan 2007**
- ▶ Conditions:
 - ▶ Organization should be of a public character and established for purposes of poverty relief or education advancement.
 - ▶ A proof of donation in form of a receipt and certified by the donation recipient.
 - ▶ Proof of donation to be accompanied by exemption certificate and donee's declaration.
 - ▶ Not refundable or repayable to the donor.
 - ▶ Should not confer any benefit to the donor.

Non-distribution of Dividends to avoid Tax

- ▶ S. 24: Commissioner to direct part of a company's income to be treated as having been distributed as dividends.
- ▶ A company can enquire to the Commissioner before making a distribution of dividends, whether they are sufficient.
- ▶ Recent Development
 - ▶ An Income Tax Tribunal **set-up** in **2010** to deal with issues on S.23 and S.24) – **S.86 (1) (a), S.83, Tribunal Rules of 1974**

Capital Gains

- ▶ Thin line between Business Income and One-off event.
- ▶ KRA notice of taxation of income related to sale of property
- ▶ Controversy:
 - ▶ Determination based on frequency of sales.
 - ▶ Determination based on amount of income generated.
 - ▶ Determination based on the motive of the business
 - ▶ Back-door 'capital gains tax' through compensating tax

Compensating Tax

Balance b/fwd		XX
Dividends Paid ($X * 30\% / 70\%$)	XX	
$(t/1-t) = 30\% / (1-30\%) = 30\% / 70\%$		
Dividends Received ($X1 * 30\% / 70\%$)		XX
Tax Paid		XX
Balance C/fwd/Compensating Tax	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>

Compensating Tax (Illustration)

Balance b/fwd		50,000
Dividends Paid ($700,000 \times 30\% / 70\%$)	300,000	
Dividends Received ($210,000 \times 30\% / 70\%$)		90,000
Tax Paid		110,000
Compensating Tax payable by end of 6 month after year end		<u>50,000</u>
	<u>300,000</u>	<u>300,000</u>

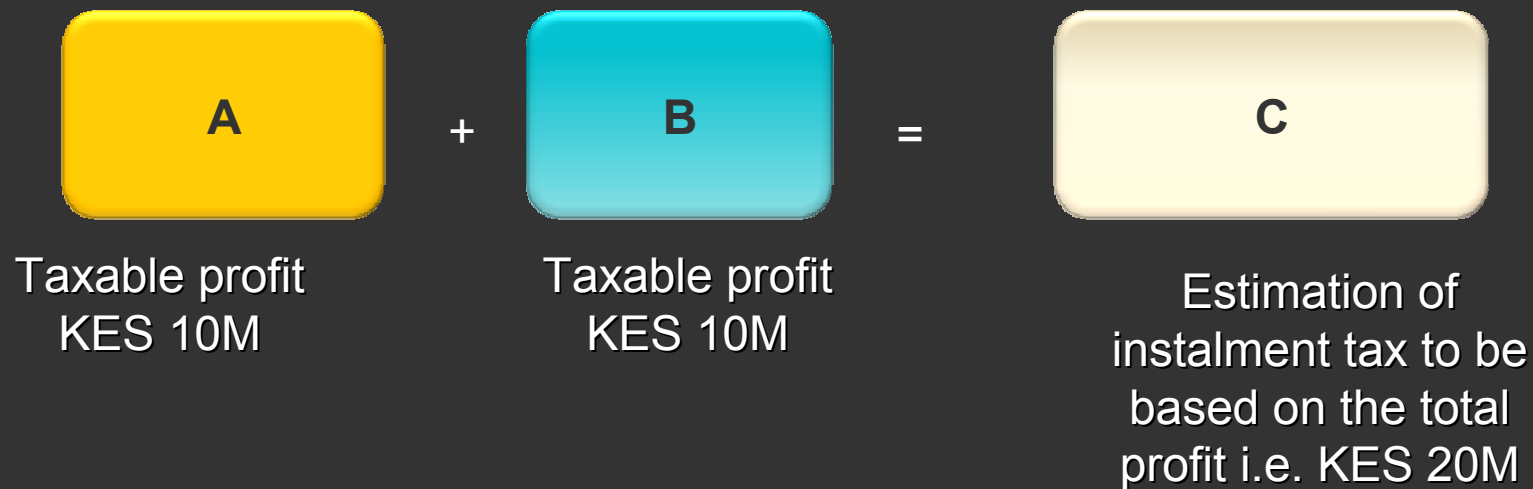
Refund of tax overpaid

- ▶ S. 105: The Commissioner should refund the amount of the excess, together with any interest which may be payable thereon under the ITA.
- ▶ Claim for repayment should be made within 7 years after the expiry of the year of income to which the income relates.
- ▶ Challenge
 - ▶ The ITA does not provide for the applicable interest rate.
 - ▶ Delay in response by KRA

Corporation tax

Tax Payable Position

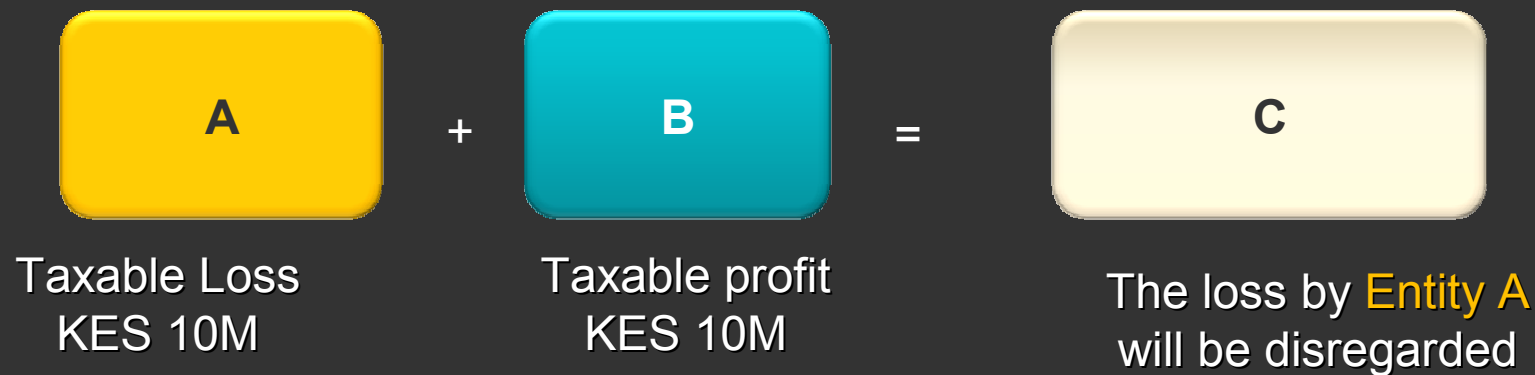
Amalgamation: Two profit making entities



Corporation tax

Tax Payable Position

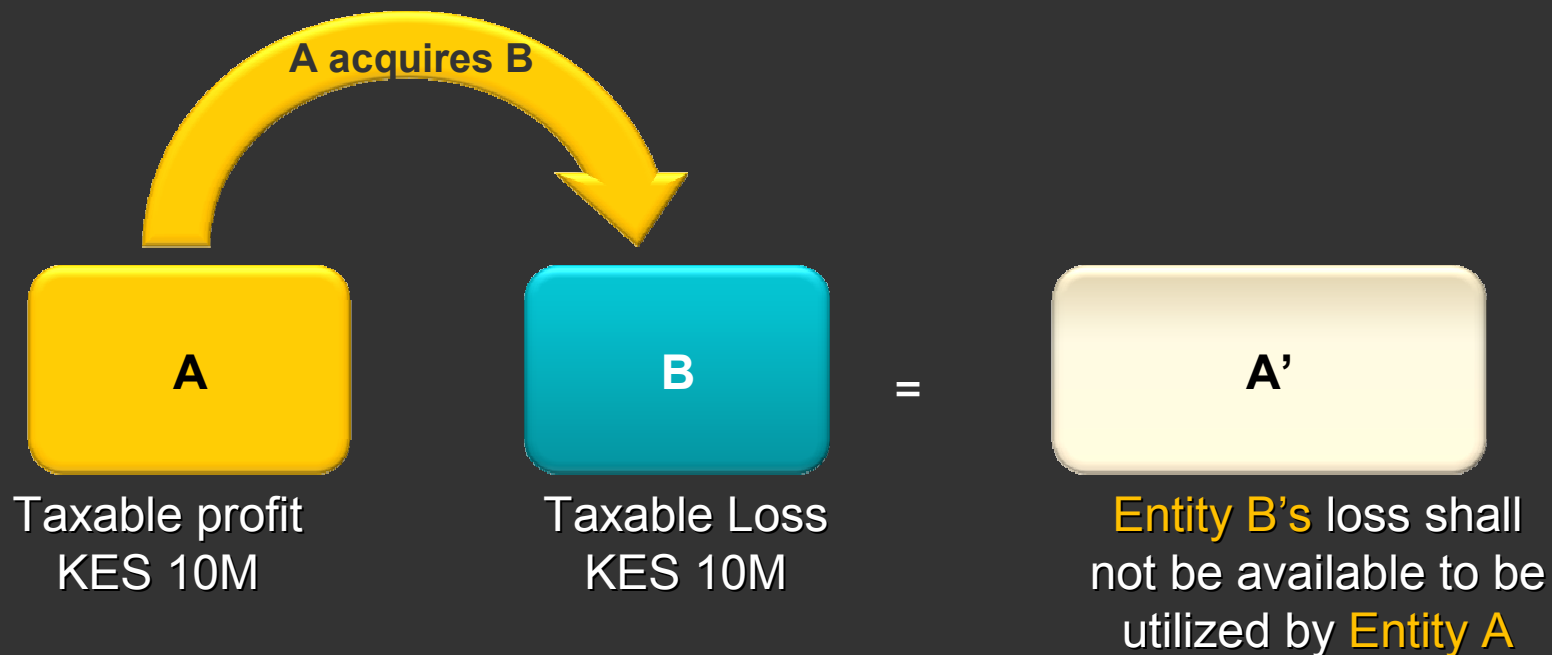
Amalgamation: Loss and profit making entities



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Tax Payable Position

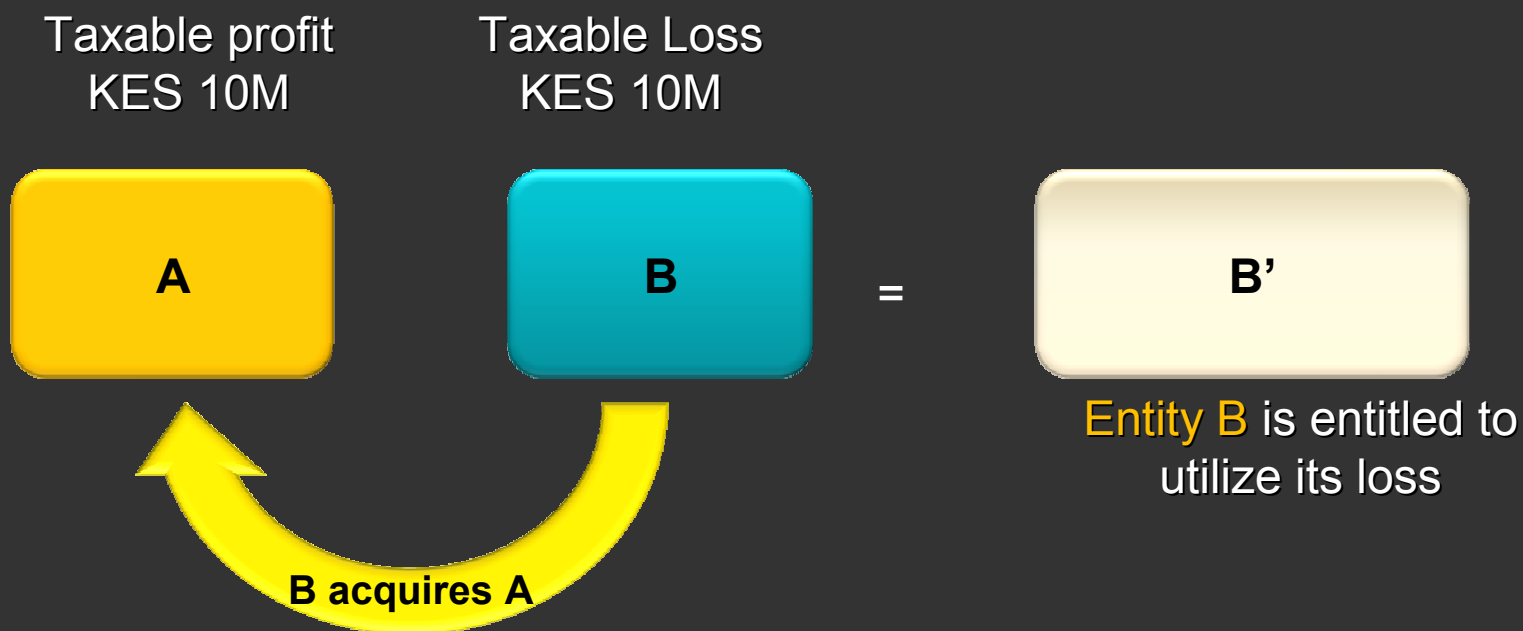
Acquisition: Loss and profit making entities



Corporation tax

Tax Payable Position

Acquisition: Loss and profit making entities



Valuation of farming stock

- ▶ S. 17 (1): Stock at the beginning and end of each period to be taken into account at the value determined by the Commissioner to be just and reasonable.
 - ▶ **"stock"** means all livestock and produce, and crops which have been harvested
- ▶ An election duly made by a farmer under section 16 of the **Management Act** shall be binding upon him for all subsequent years of income in which he carries on the business of farming

TOPIC: Withholding Tax

PRESENTER: Francis Kamau



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Withholding tax

Definition of terms

“**Agency fees**” payments to a person for acting on behalf of any other person, group of persons or the Government and excludes reimbursements;

“**Consultancy fees**” payments to any person for acting in an advisory capacity or providing services on a consultancy basis;

“**Contractual payments**” payments for work done in respect of building, civil or engineering work;

“**Management or professional fee**” payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, **technical**, agency contractual or consultancy services however calculated

Withholding tax

Contractual payments

Description	Classification
Architects fees	Consultancy fee – 5%
Civil Engineer fee	Consultancy fee – 5%
Quantity surveyor fee	Consultancy fee – 5%
Contractor fee	Contractual fee – 3%
Cost of material (unspecified)	Contractual fee – 3%
Cost of material (Specified)	No withholding tax

Withholding Taxes

Common payments not subject to WHT

- ▶ Security charges
- ▶ Advertising cost
- ▶ Cleaning services
- ▶ Payment for equipment such as machine, car, furniture

Withholding tax

Section 10 of the Income Tax Act

- ▶ For the purposes of this Act, where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of -
 - ▶ a management or professional fee or training fee;
 - ▶ a royalty;
 - ▶ interest and deemed interest;
 - ▶ Et al
- ▶ the amount thereof shall be deemed to be income which accrued in or was derived from Kenya, provided that -
 - ▶ this section **shall not apply** unless the payment is incurred in the production of income accrued in or derived from Kenya **or in connection with a business** carried on or to be carried on, in whole or in part, in Kenya.

Withholding Tax Specific Provisions

- ▶ Software
 - ▶ Payments subject to withholding tax as a royalty. **LC Ruling**
 - ▶ Software embedded in a computer disk and off the shelf purchases not subject to W/Tax
 - ▶ Leasing of Equipment
 - ▶ Payments to non-residents subject to WHT at 15%.
3rd Sch. Para. 3
- ▶ Training fees
 - ▶ Withholding tax on tuition fees – KRA Public Notice
 - ▶ Withholding tax on incidental costs.

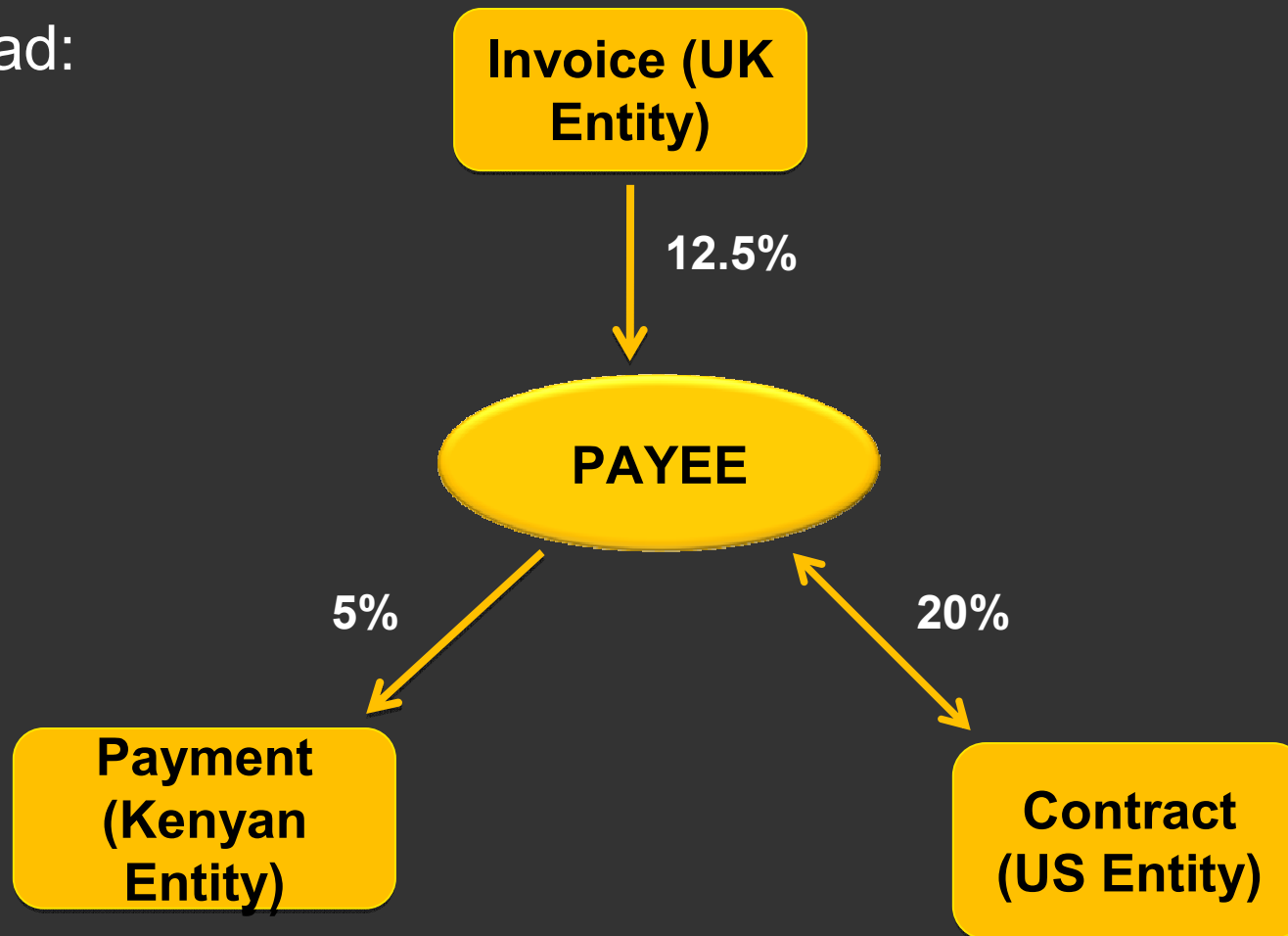
Withholding Taxes

Tax payment, returns and penalty

- ▶ Tax due date is 20th day of the month following the deduction
- ▶ Penalty for late payment is 10% on the amount due
- ▶ Penalty for failure to withhold and remit tax- 10% subject to a maximum of KShs. 1 million
- ▶ Interest - 2% per month for every month tax remains unpaid

DTA: Treaty Shopping

► Triad:



TOPIC: Employee Taxes

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Personal taxation

Residency Rules

- ▶ Individual is deemed to be resident in Kenya if:
 - ▶ One has a permanent home in Kenya and was present in Kenya for any period in a particular year of income under consideration; or
 - ▶ One has no permanent home in Kenya but was present in Kenya:
 - ▶ Aggregate period (s) of 183 days or more in a particular year; or
 - ▶ Average period (s) exceeding 122 days in a year of income and in each of the 2 preceding years.
- ▶ "Kenya" includes the continental shelf and any installation thereon as defined in the Continental Shelf Act; **S.2**
- ▶ Article 76, paragraph 8, of the United Nations Convention on the Law of the Sea - the limits of the continental shelf beyond **200 nautical miles** from the baselines from which the breadth of the territorial sea is measured.
 - ▶ The tax year for individuals runs from **1 January** to **31 December**. **s.27 (3)**

Personal taxation

Business tax (Income Tax Act Provisions) cont'd

- ▶ Under Section 3 (2), the following incomes are **not** included as chargeable:
- ▶ Incomes from **inheritance** or **Estate**
- ▶ Income of a person through **donations**
- ▶ Income received by person as a **gift**
 - ▶ Provided that the 'giver' and 'receiver, are **not** related through **employment contract**
 - ▶ Income received by a person through sale of a **capital** item

Personal taxation

Chargeable income

- ▶ For the purposes of section 3(2)(a)(ii), an amount paid to-
 - ▶ a person who is, or was at the time of the employment or when the services were rendered, a resident person in respect of any employment or services rendered by him in Kenya **or outside Kenya**; or; **S.5 (1) (a)**
 - ▶ A resident is liable to tax on worldwide employment income.
 - ▶ a non-resident person in respect of any employment with or services rendered to an employer who is resident in Kenya **or the permanent establishment in Kenya of an employer who is not so resident**, shall be deemed to have accrued in or to have been derived from Kenya. **S.5 (1) (b)**

Personal taxation

Chargeable income cont'd

- ▶ S.5 (1) (b) makes it possible for individuals who are employed by a company or branch in Kenya but whose services are performed elsewhere to be chargeable to tax in Kenya.
- ▶ Such employees include those with either a regional office in Kenya or an affiliated company but whose duties are performed wholly in another country in the region.

Personal taxation

Chargeable income – on wife

- ▶ “Wife's self-employment income” means gains or profits arising from a business of a married woman living with her husband which are chargeable to tax under section 3(2)(a)(i) and **any income chargeable under section 3(2) (a) (iii) or section 3(2) (b)**, but **does not include** any income derived from the provision of goods or services by her to a business, partnership or a company owned by or the voting power of which is held to the extent of **twelve and one half percent**, or more at any one time during the year of income by her or her husband either directly or through nominee.

Personal taxation

Chargeable income

- ▶ Taxable employment income include:
 - ▶ wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, or subsistence, traveling, entertainment or other allowance received in respect of employment or services rendered. **S.5 (2) (a)**
 - ▶ Any amount so received in respect of employment or services rendered in a year of income other than the year of income in which it is received. **S.5 (2) (a)**

Personal taxation

Per diem

- ▶ Per diems are 'per day' allowances normally given for upkeep of staff when on official travel.
- ▶ W.e.f. 16 June 2006 the first KShs 2,000 is deemed to be a reimbursement. **S.5 (2) (a) (ii)**
- ▶ Per diem amounts exceeding KShs 2,000 should ideally be supported preferably with vouchers from an arms-length source.
- ▶ Where these are not available, supporting workings preferably acknowledged by the third party supplier should be attached.
- ▶ The Act does not provide special per diem rates for overseas travel.
- ▶ See guidelines on taxation of per diem **(Appendix 6)**

Personal taxation

Per diem (Taxation guidelines)

- ▶ An employer can maintain a **documented policy** on the management of per diem to **satisfy the Commissioner** that the amounts paid are **reimbursements** of costs incurred by the employee.
- ▶ The policy shall entail:-
 - ▶ Rates applicable for different **cadres** of employees.
 - ▶ Rates applicable for **overseas duties**. Where different rates apply, should be clearly stated.
 - ▶ A **justification** for the rates used.
 - ▶ The procedure of **accounting** for per diem.
 - ▶ Employers may **seek Commissioner's opinion** regarding admissibility of proposed per diem scales prior to payment.

Personal taxation

Per diem (Taxation guidelines cont'd)

- ▶ The Commissioner may require an employer to furnish him with documentary **proof of travel** outside the work station by his employee. Such proof may include:
 - ▶ Motor vehicle work tickets.
 - ▶ Bus or air tickets.
 - ▶ Passport and immigration entries.
 - ▶ Imprest accounting documentation.
- ▶ Tax due on per diem should be **recovered in the payroll** month relating to the payment and remitted in accordance with PAYE procedures.

Personal taxation

Club fees paid by employer

- ▶ Club subscription paid by an employer on behalf of an employee are allowable expenses. **S.15 (2) (v)**
- ▶ No deduction shall be allowed in respect of club fees including entrance and subscription fees except as provided in section 15(2)(v). **S.16 (2) (a) (v)**
- ▶ Are club fees exempt from tax in the hands of the employee as per **S. 5 (4)**?

Personal taxation

Non cash benefits

- ▶ The value of all benefits, advantages or facilities of whatsoever nature are taxable on the employee.
- ▶ However, non cash benefits that in aggregate do not exceed KShs. 36,000 per annum are not taxable. **s.5 (2) (b)**
- ▶ The cost of meals served in canteens and cafeterias operated by employer for the benefit of the low income employees will be treated as a non taxable benefit. **W.e.f. 1.1.2008.**
- ▶ “Low income employee” means an employee whose taxable income is not subject to tax at the rate of more than 20%. That is KShs. 29,316. **s.5 (4) (f)**

Personal taxation

Housing benefit – S. 5 (3)

- ▶ Free housing is taxed at the higher of:-
 - ▶ actual cost to the employer, or
 - ▶ 15% of gross emoluments, or
 - ▶ the market rental value.
- ▶ If the employer pays rent under an agreement **at arm's length**, value of the benefit:-
 - ▶ 15% of gross emoluments, or
 - ▶ actual cost to the employer.
- ▶ However, if the employer pays rent under an agreement **not at arm's length**, value of the benefit is the higher of the fair market value of the premises for that year or rent paid by employer.

Personal taxation

Motor vehicle benefit

- ▶ Provision of a 'company' car is taxable at the higher of:-
 - ▶ 2% p.m. of the initial cost of the car (W.e.f 1.1.1998) or
 - ▶ Commissioner's prescribed rates. **S. 5 (2B)**

- ▶ However, w.e.f.1.1.2008, for employees who have restricted use of motor vehicles, the commissioner shall if satisfied of the fact upon proof by the employee, determine the lower rate of the benefit depending on the usage of the vehicle. **S.5 (2B)**

- ▶ W.e.f. 16.06.2006, where the car is hired or leased, the taxable benefit is the lease or hiring cost. **S.5 (2B) (a) (ii)**

- ! **Issues:**
 - 1. ICPAK submission – to use NBV or cost?
 - 2. Cases where the employee fuels and maintains the car?

- ▶ See guidelines on taxation of motor vehicle benefit (**Appendix 7**)

Personal taxation

Motor vehicle benefit (Taxation guidelines cont'd)

- ▶ Employees having access to pool vehicles shall be deemed to have received transport benefit chargeable to tax provided the aggregate value of the benefit exceeds KShs. 3,000 p.m.
- ▶ Such benefit shall be calculated based on the cost of maintenance of such motor vehicles.

Personal taxation

Passages

- ▶ Arises when an employer pays for or reimburses the cost of tickets for passages, including leave passages for his employee and family.
- ▶ The value of the passages is a non-taxable benefit of the employee if the employee is recruited outside Kenya, provided:
 - ▶ He's recruited solely for the purpose of serving his employer.
 - ▶ He is not a citizen. S.5 (4) (a)

Personal taxation

Mortgage interest relief

- ▶ Available to owners of residential houses who occupy them; no claim for more than **1 residence**'
- ▶ Applies to purchase or improvement of premises.
- ▶ Relief of up to **KShs. 150,000** p.a.
- ▶ Relief given on interest from banks, insurance companies, building societies and National Housing Corporation only.
S.15(3) (b)
- ▶ **Saccos** have been left out among the qualifying financial institutions.

Personal taxation

Set-off tax

- ▶ Restricted to employment income or income of artists taking part in any sporting event.
- ▶ Restricted to Kenyan citizens only.

S. 39 (2) W.E.F. 13.06.2008

Personal taxation

PAYE bands (Para 1, Head B of 3rd Schedule)

Income per month (KShs.)			%	Cumulative
0	-	10,164	10	1,016
10,165	-	19,740	15	2,453
19,741	-	29,316	20	4,368
29,317	-	38,892	25	6,762
Over		38,892	30	

Income per annum (KShs.)			%	Cumulative
0	-	121,968	10	12,196
121,969	-	236,880	15	29,432
236,881	-	351,792	20	52,414
351,792	-	466,704	25	81,142
Over		466704	30	

THE END!

Questions

