

# TAX TRAINING SEMINAR

## ICPAK Tax Seminar

29 – 30 January 2015



Building a better  
working world

# 2015 ICPAK Tax Seminar

TOPIC: **Employees' Tax**

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# Personal taxation

## Residency Rules

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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.

The tax year for individuals runs from **1 January** to **31 December**. **S.27 (3)**

# Personal taxation

## Chargeability of tax

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Taxation in Kenya is both:

**Source;** and

**Partly residence** based.

Section 3(1), brings to tax charge income of a person whether **resident** or **non-resident** if the income is **accrued in** or **derived from** Kenya.

Persons who are **resident** for tax purposes are taxed on their **worldwide employment income**.

**Non-resident** persons are taxable on any income that is **derived** or **deemed** to be derived from Kenya.

# Personal taxation

## Chargeable income

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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

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### Issues

Employee responsibility to safeguard the employee

Deduction of payroll costs

Double tax treaties

Set off of tax under Section 39(2)

# Personal taxation

## Per diem

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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.

Refer to guidelines on taxation of per diem

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.

# Personal taxation

## Per diem (Taxation guidelines)

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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.

Issues:

Slow or no response by KRA upon application

No support provided by some suppliers

Justification of rates



# Personal taxation

## Motor vehicle benefit

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Provision of a company car is taxable at 2% p.m. of the initial cost of the car

Restricted use - Commissioner may determine the lower rate of the benefit depending on the usage of the vehicle. **S.5 (2B)**

Hired or leased, the taxable benefit is the lease or hiring cost. **S.5 (2B) (a) (ii)**

Refer to guidelines on taxation of motor vehicle benefit

Issues:

- Pool vehicles and buses

- Chauffeur driven vehicles.

- To use cost or NBV?

# Personal taxation

## School fees paid by employer

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Education fees+ paid by the employer for employee's dependants are taxable on the employee. **S.5 (4) (d)**

However, where the tax is borne by the employer, through add-back in the computation, the benefit will not be taxable on the employee.

What is the case for exempt employers?

# Personal taxation

## Club fees paid by employer

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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

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Save as otherwise expressly provided in this section, the value of a benefit, advantage, or facility of whatsoever nature **the aggregate value** whereof is not less than **thirty six thousand shillings** granted in respect of employment or services rendered. **S.5 (2) (b)**

### Issues

In aggregating the values, can you consider housing benefit, motor vehicle, etc?

Is KRA justified to adopt a cap of KShs 3,000 per month?

# Personal taxation

## Non cash benefit contd

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Non-cash benefits are taxed at the higher of actual cost to the employer and the market value e.g. water, electricity, domestic help, watchmen, radio alarms.

Commissioner may, from time to time, prescribe the value where the cost or the fair market value of a benefit cannot be determined.

Provision of **'furniture'** . 1% of the cost of furniture to employer.

Telephone (**airtime for voice and data**) . 30% of bills.

# Personal taxation

## Medical benefit

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Non-taxable benefit for full time employees and whole time service directors.

Maximum limit of KShs. 1 million:

Directors other than whole time (W.e.f. 1.1.2006 through LN No. 53)

Partners in a partnership (W.e.f. 1.1.2010 through S. 4 (b))

Sole proprietors (W.e.f. 1.1.2010 through S. 15 (3) (g))

Scheme to be approved by the Commissioner

Medical Insurance/ Medical expense for employee beneficiaries, shall not be subject to tax. **S.5 (4) (b)**

**“Beneficiaries”** means the full time employees **\$ spouse** and not more than **4 children** whose age shall not exceed **21 years**.

# Personal taxation

## Housing benefit . S. 5 (3)

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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.

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.

Where premises are owned by the employer, the value of the benefit is the fair market rental value.

# Personal taxation

## Housing benefit . S. 5 (3)

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in the case of an agricultural employee required by the terms of employment to reside on a plantation or farm an amount equal to **10%** of gross emoluments.

"plantation" shall not include a forest or timber plantation

"agricultural employee" shall not include a director other than a whole time service director;

## Issues

Capping of 15%/10% where the salary is high

Case for prefabs/ semi-permanent residences

Many workers staying in one residence



# Personal taxation

## Lump sum payment (Gratuity, service payment)

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Employment income is assessable on accrual basis; that is, over the period it has been earned and become due for payment. The time the income is received is, therefore, immaterial.

Income is deemed to be income of the year of accrual.

S. 5 (2) (a) (i) - where the year of accrual is earlier than 4 years prior to the year of receipt, the income is to be treated as that of year of income which expired 5 years prior to the year in which the income is received or prior to the year of income in which employment ceased.

# Personal taxation

## Lump sum payment (Gratuity, service payment)

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The service gratuity amount is to be spread backwards and taxed together with income earned in the relevant years.

Notice pay is assessable in the period immediately after date of leaving employment.

Pay in lieu of leave should be taxed in the year to which the leave days relate.

**Example:** Mr. Bakari left employment in 2006 after 30 years of service and was paid service gratuity of KShs. 660,000. He was also paid KShs 25,000 relating to 2002 accrued leave days.

The amounts due will be taxed as follows:

<u>Year</u>	<u>Taxable Amount</u>
2005	22,000
2004	22,000
2003	22,000
2002	22,000 + 25,000
2001	22,000 + 550,000

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# Personal taxation

## Compensation for the termination of a contract of employment

Compensation received is taxable, whether or not provision was made in the contract for the payment of that compensation. **S.5 (2) (c)**

Item	Treatment of compensation
Specified term contract	The compensation to be spread over the <u>unexpired period</u> at equal amounts and taxed accordingly.
Unspecified term contract providing for terminal payment	The compensation is <u>spread forward</u> and assessed at the rate of the <u>employee's remuneration</u> p.a. immediately before termination.
Unspecified term contract that does not provide for terminal payment	The compensation is to be spread forward <u>in equal amounts for three years following the termination.</u>

# Personal taxation

## Monthly Income (Tax free remuneration)

Where employer wishes to pay employees net of tax, the tax paid by the employer on behalf of employees is in itself a benefit chargeable to tax.

The Commissioner has given a formula to compute the tax-on-tax effect. Appendix 4C and 4D of PAYE guide.

Taxable Income Range (a)	Tax on Taxable Income (b)	Marginal Tax Rate (c)	Factor <u>Without</u> <u>Housing</u> (d)	Factor <u>With</u> <u>Housing</u> (e)
0 - 10,164	1,016	10%	1.111	1.130
10,165 - 19,740	2,453	15%	1.176	1.208
19,741 - 29,316	4,368	20%	1.250	1.299
29,317 - 38,892	6,762	25%	1.333	1.404
Over 38,892		30%	1.429	1.527

# Personal taxation

## Sample computation (Tax free remuneration)

Details	Mr. A.N. Other	Mrs. A.N. Other
(1) Monthly cash income	18,000	50,000
(2) <u>Less:</u> Pension contributions	<u>(956)</u>	<u>(998)</u>
(3) Monthly cash income after deductions	17,044	49,002
(4) Monthly benefits	<u>10,000</u>	<u>15,000</u>
(5) Income including benefits	27,044	64,002
(6) Housing benefit	<u>0</u>	<u>30,000</u>
(7) Taxable income	<u>27,044</u>	<u>94,002</u>
(8) Gross tax {Based on column (b)}	3,912	23,294
(9) <u>Less:</u> Monthly tax relief	<u>(1,162)</u>	<u>(1,162)</u>
(10) Net tax	<u>2,750</u>	<u>22,132</u>
(11) Factor {From the table}	1.250	1.527
(12) Tax payable {(10) x (11)}	3,437	33,795

# Personal taxation

## Interest free or low interest loan

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Relates to loans which interest charged is below the commissioner's prescribed rate,

For old loans (taken before 11.6.1998), Low Interest Benefit (LIB) applies . the interest is taxed on employee at graduated scale rates. **S.12B**

For loans advanced after 11.6.1998: Fringe Benefit Tax (FBT) is 30% of the difference between the commissioner's interest rate and that actually charged . payable by employer. **S.12B**

### Issues

When do salary advance and unsupported claims qualify to be loans?

What if FBT is subjected to tax on the employee?

# Personal taxation

## Passages

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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 is recruited solely for the purpose of serving his employer.

He is not a citizen. **S.5 (4) (a)**

### Issues

Are dependent's passage covered under this section?

How many trips per year?

# Personal taxation

## Mortgage interest deduction

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Available to owners of residential houses who occupy them;  
no claim for more than **1 residence**

Applies to purchase or improvement of premises.

Deduction of up to **KShs. 150,000** p.a.

Deduction 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

## Insurance relief

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Relief against life insurance premiums paid by the individual or by the employer for the life of the individual, his wife or child.

Relief given of 15% of premiums paid up to a maximum of KShs 60,000 p.a. (W.e.f. 1.1.2007).

Shall apply only to life or education policies whose term commences on or after the 1.1.2003.

Education policy: maturity period of at least 10 years.

Health insurance w.e.f. 1.1.07. **S.31**

Refer to clarification on insurance relief on mortgage.

# Personal taxation

## Contributions to pension scheme

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Contributions to registered pension, provident and individual retirement schemes . Up to a maximum of KShs. 240,000 p.a. is tax allowable. **S.22A**

However, contributions by employers to unregistered schemes or excess contributions to registered schemes are a taxable benefit on employee, where the employer is not taxable. **S.5 (4) (c)**

# Personal taxation

## Allowable Contributions Limits

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### **Employer – S.22A (2) – Defined Contribution Fund**

Allowable amount is determined per individual employee & summed. Hence for each member, amount should be the lesser of ;

30% of pensionable pay;

KShs.240,000 or proportion for the year; or

Actual contributions.

# Personal taxation

## Set-off tax

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Restricted to employment income or income of artists

Restricted to Kenyan citizens only.

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

# Personal taxation

## Disabled persons

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**L/N 36** . Exemption for persons with disabilities registered with the National Council for Persons with disabilities

First KShs. 150,000 per month exempted.

Non reimbursable home care and hospital costs are allowed.

Cost of devices allowable. Maximum costs of KShs. 50,000 allowable per month.

Refer to legal Notice 36 (2010) on taxation of disabled persons

# Personal taxation

## Miscellaneous

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**Gratuity:** W.e.f. 1 Jan 2011, an amount paid by an employer as a gratuity or similar payment in respect of employment or services rendered, which is paid into a registered pension scheme is exempt from tax provided that this does not apply to any person who is eligible for deductions under Section 22A.  
**S.5(4)(g)**

# Personal taxation

## Employment . vs.- Consultancy

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Control

Independence

Intention of parties

Nature of activities

Nature of contract

Entitlement to social welfare benefits

Other rights and entitlement under employment e.g. leave, holidays etc.

Economic reality . risk of financial loss

# **Taxation of expatriates**

## **Taxable assignee benefits - specific**

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Share based compensation

Bonus

Medical benefit

Passage . tickets/ allowance

Leave allowance

Pension

School fees

Loss on disposal of an asset

Relocation & shipping services

Home search services

Relocation & settling in allowance

Repatriation allowance

Spousal assistance e.g. cost of job placement



# Taxation of expatriates

## Share Based Compensation

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### Schemes registration:

Capital Markets Authority (CMA) as a Collective Investment Scheme

Kenya Revenue Authority (KRA)

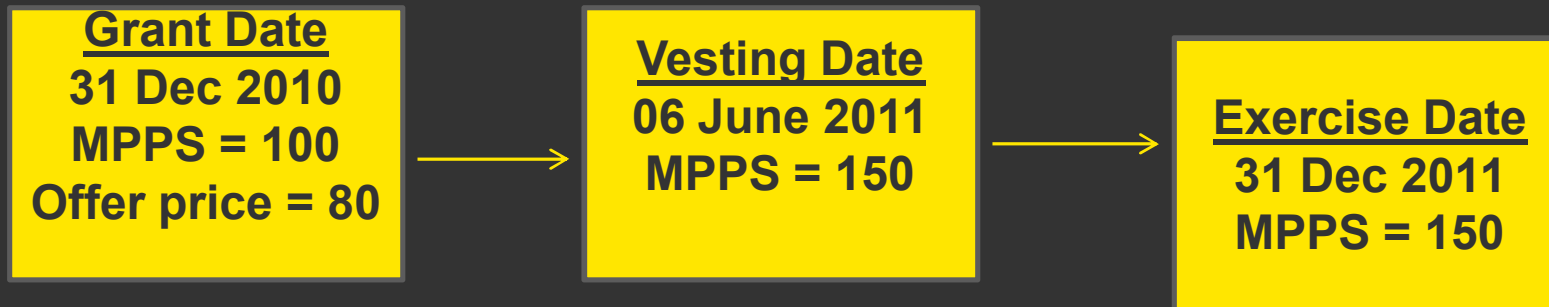
### Schemes registered in Kenya:

Tax point . date of vesting/exercise

Taxable value . Market value at date of grant less grant/option/  
exercise price

## Employee Share Ownership Plan (ESOP)

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The taxable benefit per share is **KShs 20** (100-80) if the scheme is registered

The taxable benefit per share is **KShs 70** (150-80) if the scheme is not registered

The benefit accrues at the end of the vesting period 30 June 2011

# Taxation of expatriates

## Tax Equalization & Split Payroll

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### Tax Equalization

Seeks to ensure that an assignee does not pay more or less in tax than would have been payable had the individual not gone on assignment.

In exchange the assignee agrees to a reduction in gross compensation equal to an approximation of their ~~tax~~ stay at home tax (Hypothetical Tax and social security).

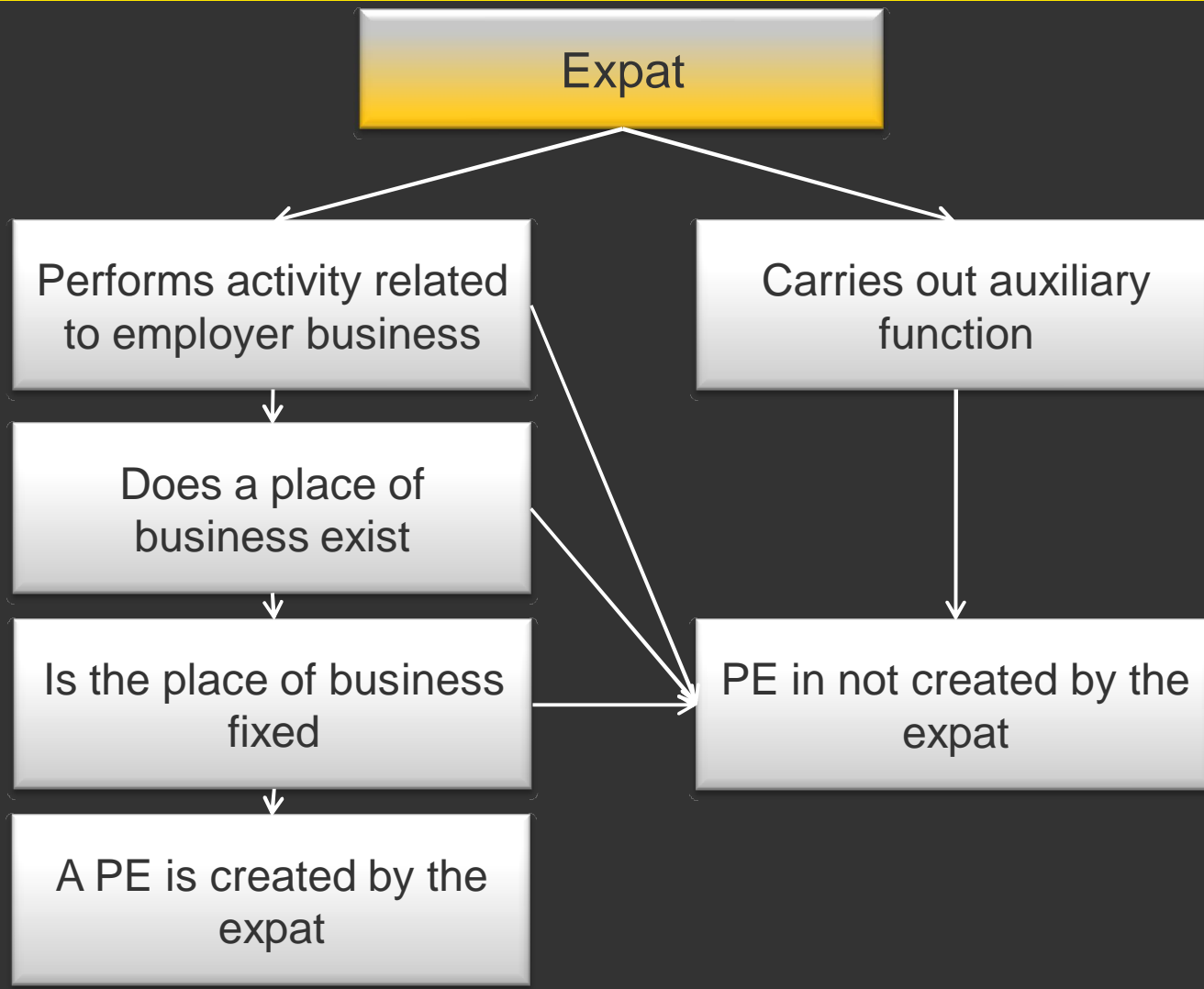
### Split payrolls

All income accrued in or derived from Kenya whether or not paid out of Kenya is taxable in Kenya.

# Taxation of expatriates

## PE summary

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# Questions

