# WITHHOLDING TAX SYSTEM OF TAXATION

- Å The withholding tax system encompasses withholding taxes and other withholding systems of taxation e.g. PAYE, VAT, WHT.
- Å There is a large deficiency of PAYE because of over the counter payments.

# Entitlements to be subjected to PAYE

ÅSick Leave

ÅAnnual leave

ÅGratuity

ÅEx gratia payments

ÅSalaries and wages

ÅMonthly allowances and other allowances-entertainment, travelling and entertainment

ÅCommissions

ÅBonus

# Benefits of Withholding System of Taxation

Å1. It decreases collection costs

Å2. Govt. can use the money sooner and thus can fund its programs steadily throughout the year

Å3. There is no need to save a gigantic payment in June of every year.

Å4. Withholding increases compliance and decreases evasion and underpayment.

Å5. People don’t notice how much tax they are paying in a withholding system hence there is less sense of anger.

# Criticisms of withholding System

1. The system penalizes wage earners- self employed people don’t have to pay taxes on a regular basis
2. Tax payer apathy sets in which leads to high levels of government spending which is not necessary.
3. Tax payers cannot protest by refusing to pay taxes
4. The system imposes costs on employees, businesses have to hire additional staff to deal with tax withholding and spend time and money on compliance.

# Theoretical Foundations of Tax Payer Behaviour Which has Led to Introduction of Withholding System of Taxation

ÅTaxpayer decision of whether or not to pay taxes tend to reflect the following schools of thought:

a) **Social Influence**-Human behavior is influenced by social interactions. If a tax payer knows many people in groups important to him who evade taxes, his commitment to comply will be weaker and vice versa.

b) **Comparative Treatment**-Individuals are more likely to comply with rules if they perceive the system that determines those rules to be impartial. If the state treats certain businesses preferentially, this may negatively affect business relationships with the state and the group receiving favors. This highlights the importance of equity theory in the study of taxpayer behaviour.

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c) **Political Legitimacy**-Legitimacy is the belief or trust in the authorities, institutions and social arrangements which are appropriate, just and work for the common good. Tax compliance is positively related to perceptions about the government, in particular the tax authority trustworthiness. National pride increases compliance.

# WITHHOLDING VAUE ADDED TAX

- Pursuant to Section 25A of the VAT Act 2013 on Withholding VAT, Kenya Revenue Authority advised government Ministries, departments and agencies as follows:
- That they should Withhold VAT with effect from 19th September 2014 in line with the respective provision of the Finance Act 2014.
- The list of Withholding VAT Agents, Withholding VAT return (VAT 32), Withholding VAT return schedule (VAT 32B) and Withholding VAT guidelines are now available on the KRA Website www.kra.go.ke for information and download respectively

# Contd…WHT-VAT

Å Remittance of withheld VAT is to be done Bi-monthly through Commercial Banks to the withholding VAT collection Account number **1000220023** at the Central Bank of Kenya.

It is only the listed Withholding VAT Agents are authorized to withhold.

Withholding VAT Certificate booklets will be issued during the sensitization forums which will be held as per the schedule found on the KRAôs website.

Å The following are categories of Withholding tax agents in Kenya; County Governments, Government Ministries, Departments, Commissions, Independent offices, State Corporations, banks, Universities and other Agencies.

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# Guidelines on the Withholding of VAT

ÅThe Finance Act 2014 has re-introduced WH VAT system at the rate of 6% with effect from 19th September 2014. This is a measure to ensure that all VAT due to the government is paid. The system involves declaration of VAT by both the supplier and purchaser who has been appointed as a WH VAT agent.

ÅThe Withholding of VAT by a Withholding Agency shall not relieve a supplier of the obligation to file returns in accordance with the VAT Act 2013.

# Illustration

ÅEACC purchased goods worth Kshs. 100,000

ÅVAT value Kshs. 16,000

ÅThe Withholding VAT will be calculated on 100,000 * 6% = Kshs. 6,000

ÅIt is presumed that the balance of 10% to be submitted when processing returns or cater for input tax. The Withholding VAT agent is expected to pay for supplies less the Withholding VAT. The agent will then issue a supplier a Withholding VAT Certificate to the supplier to entitle him/her to offset the withheld VAT when filing the next VAT3 return.

ÅFailure by the appointed agent to withhold VAT on payment applicable to taxable supplies constitutes an offence.

# REFUND OF EXCESS CREDIT

ÅA taxpayer is authorized to claim back the withheld VAT on subsequent VAT 3 return(s) provided he is in possession of withheld VAT certificate (s). Where the excess arising from the system becomes a perpetual feature, the taxpayer has a right to claim it from the Commissioner by lodging a claim on form VAT 4.

ÅSuppliers of taxable Supplies who are not already registered for VAT are advised to register in order to benefit from claiming back withheld VAT.

# OFFENCES UNDER WITHHOLDING VAT SYSTEM

Offences under the System are as follows:

- Failure by the appointed Agents to withhold VAT.
- Failure to remit the withheld VAT or to Submit a return where there is no payment to make.
- Failure to issue withholding VAT certificates.
- Purporting to be a withholding VAT Agent.
- A withholding VAT Agent who commit the above offences is liable to a penalty of Kshs 10,000 or 10% of the Tax due **whichever is higher**.

# Emerging Issues on CGT

Å The tax is to be paid by the person (resident or non-resident) transferring the property, that is, the transferor. The transferor can either be an individual or a corporate body.

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ÅFor investment shares, while the tax incidence is on the transferor, the responsibility to collect and account for the tax will be on the stockbrokers. **(*Paragraph 18 of the Eighth Schedule of the Income Tax Act)***

# Emerging Issues on CGT

- It is a transaction based tax and should therefore be paid upon transfer of property but not later than the 20th day of the month following that in which the transfer was made.
- Where a transfer date is different from the settlement date then the transfer date will be the tax point in line with International Accounting Standards.
- The Tax shall be paid through Commercial Banks into the **Capital Gains Collection Account No. 1000223577** at the Central Bank of Kenya. Penalties and interest charges will apply in cases of default and in accordance with the provisions of the Income Tax Act, Cap 470.

# Cont…

ÅThe transferor shall complete the relevant declaration form (CGT form), upon transfer of any property, compute the gain and pay the tax thereon accordingly. **Form CGT 1** will be used upon transfer of land and buildings while **Form CGT 2** will be used in the case of marketable securities.

ÅThe taxpayer will do a self-assessment to determine the gain upon which tax is computed. The computations are subject to Commissioner's confirmation of correct gain as the basis of tax computation

# Other Emerging Trends-Tax Incentives

Defn- A deduction, exclusion or exemption from a tax liability offered as an enticement to engage in a specified activity such as investment in capital goods for a certain period.

Tax incentives are a fiscal form of investment incentives.

Kenya provides an array of tax incentives. Most prominent ones concern th EPZ. Currently there are 42 EPZ zones country wide, majority being foreign and only 14% being Kenyan owned.

Incentives granted include tenure corporate income tax holiday followed b 25% rate for the next 10 years. A ten year exemption from all withholding taxes, exemption from import duties on machinery, raw materials and inputs.

# Disadvantages of Tax Incentives

1. Revenue losses- a study by KRA estimated that the total amount of revenue losses to tax incentives in Kenya over a six year period(2004-2009) at 220 billion. Thus incentives waste government resources that can be used to eradicate poverty.
2. Invesment- A study by the World Bank Investment Climate Advisory Services shows that for many developing countries, tax incentives do not effectively counter balance unattractive investment climate conditions such as poor infrustructure, weak governance, small markets, macro economic instability, insecurity etc. Thus countries which wish to invest do so irrespective of the tax incentives provided.

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3. Corruption as a development tool. Tax incentives score poorly in terms of transparency and accountability. The cash value of incentives stimulates political manipulation and corrupt practices since the granting of incentives is at the discretion of the cabinet secretary for finance.
4. Distortion- Tax differentials can introduce serious economic distortions that reduce efficiency and productivity. Since certain tax payers are favoured it undermines general compliance
5. Administrative burden eg KR audits

# Advantages

1. Tax competition- tax incentives are necessary for responding to tax competitions from other jurisdictions e.g medicine, geothermal power.
2. Linkages- incentives stimulate investment in other areas eg infrustructure, employment
3. Easy to target- the government can easily target sectors to develop and offer incentives only for companies coming into that sector eg hospitals being constructed behind Kenyatta University will be the biggest referral hospital.
4. It improves political relations-incentives have been successfully used in countries such as Mauritius,Malaysia, Ireland and the technological transfer to the citizens have had a good long term impact to the country.