Business Income Taxation

CPA Martin Gitau
Presentation Outline

- Taxable Incomes
- Allowable and disallowable expenses
- Capital deductions
- Returns and timelines
- Tax Planning Schemes
- Overview of the Tax Procedure Act
- Questions
Preamble

- “Business” is defined to include any trade, profession or vocation and every manufacture, adventure and concern in the nature of trade.
- Business does not include employment.
- The dictionary definition of “trade” is the act of buying and selling goods and services.
- Examples of business activities; retail activities, manufacturing & marketing services etc.)
The hardest thing to understand in the world is the income tax.
Taxable Income

- Section 3(2) of the Income Tax Act (ITA)

- Income tax is charged on all the income of resident and non-resident companies, which has accrued in, deemed to be or is derived from Kenya.

- An entity will be regarded as resident if it is incorporated under Kenyan laws, effectively managed and controlled or declared to be resident in Kenya by the Cabinet Secretary by way of notice in the Kenya Gazette.

- The corporation tax rates in Kenya is 30% of the profit on residents and 37.5% on non-resident entities.
Turnover tax

- Introduced with effect from the 1 January 2007 in respect of businesses with a turnover of more than KShs 500 000 and less than KShs 5 million per annum.
- The applicable rate is 3% on gross sales.
- Not applicable to incorporated companies or on professional, management and training fees or rental income.
- Payable by the twentieth day of the following month of every quarter.
## Corporation tax rates – Incentives

<table>
<thead>
<tr>
<th>Special rates</th>
<th>Rate</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly listed companies through IPO</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At least 20% of issued share capital listed</td>
<td>27.5%</td>
<td>3 years</td>
</tr>
<tr>
<td>At least 30% of issued share capital listed</td>
<td>25%</td>
<td>5 years</td>
</tr>
<tr>
<td>At least 40% of issued share capital listed</td>
<td>20%</td>
<td>5 years</td>
</tr>
<tr>
<td>Listing through Introduction*</td>
<td>25%</td>
<td>5 years</td>
</tr>
<tr>
<td>Export Processing Zone</td>
<td>0%</td>
<td>First 10 years</td>
</tr>
<tr>
<td></td>
<td>25%</td>
<td>The Next 10 years</td>
</tr>
<tr>
<td>Special Economic Zone**</td>
<td>Exempt</td>
<td></td>
</tr>
</tbody>
</table>

* Introduced by the Finance Act, 2015

**There is a conflict between the ITA and the SEZ Act. SEZ Act exempts from tax SEZs
Tax Losses

- Before, 1 Jan 2016, the carrying forward of losses was limited to 4 years

- Finance Act 2015 amended this to 9 years commencing 1 Jan 2016

- What happens to the losses expiring in 2014 and 2015?
Separating sourcing

Section 15(7)(e) of the ITA

- Rent
- Farming
- Business
- Interest
- Employment

- Ecobank vs KRA case
Advance Tax

- Section 12A of the ITA

- This is a tax in advance and is used as a tax credit to offset the corporation tax that is payable on commercial vehicles.

- The rate is the higher of KShs 2,400 or KShs 1,500 per ton for load carrying vehicles or the higher of KShs 2,400 or KShs 60 per passenger per month for passenger carrying vehicles.

- Due date 20th day of the first month after the financial year end. E.g. for Dec year ends, the due date is 20 Jan.
Instalment taxes

**Basis of estimation**

- Current year
- Prior year (25% of 110% of tax assessed for the previous year)

**NB:**

Current year basis is more appropriate where the operating results fluctuate substantially

In case of variance of 10% or more, penalties and interest are levied
Instalment taxes…cont’d

Estimated tax for the financial year be paid by way of instalment as follows:

25% by 20th day of the 4th month in the accounting period (AP)
25% by 20th day of the 6th month in the AP
25% by 20th day of the 9th month in the AP
25% by 20th day of the 12th month in the AP

Any balance of tax payable by the last day of the 4th month after the AP
“In this world nothing is certain but death and taxes.”

- Benjamin Franklin
Sample Tax computation

<table>
<thead>
<tr>
<th>Description</th>
<th>KShs</th>
<th>KShs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit per accounts/ ledger for a source</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td><strong>ADD</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-allowable expenses for the source</td>
<td>XX</td>
<td>-</td>
</tr>
<tr>
<td>Expenses relating to exempt income</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td><strong>LESS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other deductible expenses for the source</td>
<td>(XX)</td>
<td></td>
</tr>
<tr>
<td>Capital allowance</td>
<td>(XX)</td>
<td></td>
</tr>
<tr>
<td>Exempt Income</td>
<td>(XX)</td>
<td>(XX)</td>
</tr>
<tr>
<td>Adjusted Profit/(Loss) for Tax</td>
<td></td>
<td>XX</td>
</tr>
</tbody>
</table>
Allowable expenses

- Expenditure wholly and exclusively incurred in the production of income for that year of income
- Legal expenses and stamp duties on acquiring a lease on premises not exceeding 99 years
- Legal and other costs in publicly issuing shares and debentures
- Capital allowances
- Expenses incurred prior to the commencement of business that would have been deductible if incurred after the date of commencement
Allowable expenses…cont’d

- Expenditure on agricultural land clearance and planting of semi/permanent crops.
- Cost of structural alterations to premises, incurred by a landlord to maintain the rent (non-capital).
- Expenses incurred by a lessee, in leasing transactions.
- Interest paid on borrowings made to generate investment income (but restricted to the amount of investment income earned).
- Expenditure on scientific research.
Allowable expenses...cont’d

- Donations to approved charitable organisations
- Bad debts written off which satisfy the following Commissioner’s guidelines: The debt was wholly and exclusively incurred in the normal course of business;
  - The debt is not of a capital nature; and
  - The debt has become uncollectable
Disallowable expenses

- Expenditure not wholly and exclusively incurred in the production of income
- Capital costs and losses
- Income tax, compensating tax and similar taxes
- Personal expenses, other than those incurred specifically in the course of business
- Expenses of non-resident persons relating to certain types of income – interest, management fees, royalties etc.
- Pension contributions to unregistered pension schemes
A fine is a tax for doing wrong.

A tax is a fine for doing well.
# Capital Deductions

<table>
<thead>
<tr>
<th>Capital allowance</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Deduction</td>
<td>100/150%</td>
</tr>
<tr>
<td>Industrial Building Allowance</td>
<td>10%</td>
</tr>
<tr>
<td>Wear &amp; Tear Allowance</td>
<td></td>
</tr>
<tr>
<td>Class I (tractors, combine harvesters, heavy earth-moving equipment and such other heavy self-propelling machines)</td>
<td>37.5%</td>
</tr>
<tr>
<td>Class II (computers and peripheral computer hardware, calculators, copiers and duplicating machines)</td>
<td>30%</td>
</tr>
<tr>
<td>Class III (other self-propelling vehicles, including aircraft)</td>
<td>25%</td>
</tr>
<tr>
<td>Class IV (all other machinery, including ships)</td>
<td>12.5%</td>
</tr>
</tbody>
</table>
## Capital allowance…cont’d

<table>
<thead>
<tr>
<th>Capital allowance</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 15 2(g) (diminution in value of any implement, utensil or similar article</td>
<td>33.33%</td>
</tr>
<tr>
<td>Farm works deduction</td>
<td>100%</td>
</tr>
<tr>
<td>Software deductions</td>
<td>20%</td>
</tr>
<tr>
<td>Telecommunications allowance</td>
<td>20%</td>
</tr>
</tbody>
</table>
RETURN
## Returns and timelines

<table>
<thead>
<tr>
<th>Tax Head</th>
<th>Filing of Return date</th>
<th>Payment date</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT</td>
<td>20(^{th}) day of the following month</td>
<td></td>
</tr>
<tr>
<td>PAYE</td>
<td>9(^{th}) of the following month</td>
<td></td>
</tr>
<tr>
<td>Withholding Tax</td>
<td>No monthly Return</td>
<td>20(^{th}) of the following month</td>
</tr>
<tr>
<td></td>
<td>Annual return to be filed by end of February</td>
<td>No annual payment</td>
</tr>
<tr>
<td></td>
<td>of the following year</td>
<td></td>
</tr>
<tr>
<td>Corporation tax</td>
<td>SAR due by the end of the 6(^{th}) month</td>
<td>Balance of Tax due by the end of the 4(^{th}) month of the financial year</td>
</tr>
<tr>
<td>Excise Duty</td>
<td>20(^{th}) day of the following month</td>
<td></td>
</tr>
</tbody>
</table>
Things overlooked

- **Advance Tax** – Omission of paying/accounting for advance tax

- **NITA levy** - Every employer should pay KShs 50 for every employee every month to the National Industrial Training Authority

- **NCA Levy** – Every person with a construction above KShs 5 million should deduct 0.5% and remit the same to the National Construction Authority
Tax Planning
Tax Planning Schemes

- **Section 42 Excise duty Act, 2015** prohibits any tax avoidance (note, not tax evasion)

- **Section 23 of the Income Tax Act** prohibits transactions designed to avoid tax liability

- **Tax Procedure Act 2015** imposes hefty penalties on tax avoidance (double the tax avoided)

- However, there are numerous court rulings that provide that a taxpayer can lawfully avoid tax by planning and this is legal
Tax Planning Considerations

- Capital allowance (Investment deductions outside the Cities)
- Listing in the Stock exchange
- Profit repatriation mechanism
- Timing of payment (e.g. VAT payment on 1st and 19th are both compliant)
- Taking advantages of DTAs – LOB (Finance Act, 2014)
- Tax Havens (Mu & SA)
- Consolidated pay (Employees)
- Internship programmes
Employers with internship

- Finance Act 2015 amended the ITA by introducing a new section (39B) that provides, “Any employer who engages at least ten university graduates as apprentices for a period of six to twelve months during any year of income shall be eligible for tax rebate in the year subsequent to the year of such engagement.”

- CS yet to issue the guidelines

- This incentive is meant to create employment

- Possible benefits may include reduced corp tax rates
Overview of the Tax Procedure Act

- Was assented to on 15 December 2015 and is to come into force via a legal notice
- The Act shall become the reference point for all tax procedures in Kenya unless a particular tax law is exempted from the procedures by virtue of having its own specified procedures
- The Act gives KRA officers the powers and privileges of a police officer
- De-registration shall be done in writing. Where the CG does not respond within 6 months, the taxpayer is deemed to be de-registered
- PIN shall now be a requirement in opening a bank account in Kenya
Overview of the Tax Procedure Act…Cont’d

- Directors and senior management to be held jointly and severally liable for tax avoidance schemes
- Introduction of default and advance assessment
- The Act states that in the event of liquidation (the following taxes should be paid before any distribution, VAT, excise and WHT)

Conflict with Insolvency Act

Rank of payment: Principal tax, Penalties, Interest

- Powers of the Commissioner to offer tax relief
Overview of the Tax Procedure Act…Cont’d

- Late payment of simple interest of 1% per month of the amount of tax outstanding (currently it is 2%)

- Tax refunds for overpaid taxes should be within 1 year

- Where the CG has ascertained that indeed tax was overpaid, the CG shall apply the overpayment in the following order:
  - In payment of any other tax owning by the taxpayer under the tax law;
  - In payment of a tax owing by the taxpayer under any other tax law; and
  - The remainder shall be refunded to the taxpayer
Overview of the Tax Procedure Act…cont’d

- **Rulings** – The Act gives the Commissioner powers to make both private and public rulings

- **Private rulings** to be determined within 45 days from the date of application
<table>
<thead>
<tr>
<th>Offence</th>
<th>Penalty</th>
</tr>
</thead>
</table>
| Failure to apply for registration or licensing or deregistration       | KShs 100,000 for each month not complied  
The penalty shall not exceed KShs1,000,000.                                                                 |
| Failure to keep documents                                              | Higher of;  
  - 10% of tax payable under the tax law to which the documents relate; or  
  - KShs 100,000                                                                 |
| Late Submission penalty                                                | PAYE return- KShs 10,000 or 25% of amount due, whichever is higher.  
  Turnover Tax return – KShs 5,000  
  Others; Higher of;  
  - 5% of amount of tax payable  
  - KShs 20,000                                                                 |
| Failure to submit a document                                           | KShs 1,000 for each day of default subject to a limit of KShs 50,000.                                                                 |
| Tax Shortfall as a result of misleading statement or material omission made to authorized tax officer |  
  - 75% of shortfall for deliberate statement or omissions  
  - 20% if statement is not deliberate  
  - NB: This penalty can be varied upwards by 10% if this is the second time and 25% where it is the third time.  
  - However, on self-disclosure the shortfall tax is reduced by 10%. |
## Penalties under the Act

<table>
<thead>
<tr>
<th>Offence</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax avoidance</td>
<td>Double the amount of tax that has been avoided</td>
</tr>
<tr>
<td>Failure to comply with electronic tax system</td>
<td>KShs 100,000</td>
</tr>
<tr>
<td>Failure to honour the Commissioner’s summons</td>
<td>KShs 10,000 for an individual and KShs 100,000 for a company</td>
</tr>
<tr>
<td>Fraudulent claim for tax refund</td>
<td>Double the amount claimed</td>
</tr>
<tr>
<td>Use of false PIN or PIN obtained fraudulently</td>
<td>Fine not exceeding KShs 1,000,000 or 3 years imprisonment or both</td>
</tr>
<tr>
<td>Aiding or abetting an offence</td>
<td>Same sanction as imposed for the principal offence</td>
</tr>
<tr>
<td>Offences by officers and staff of the KRA, by Tax advisers</td>
<td>Fine not exceeding KShs 2,000,000 or imprisonment of a term not exceeding 5 years or both</td>
</tr>
</tbody>
</table>
Burning Question
Caveats

- The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity.

- Although I have endeavoured to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future.

- No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.