Taxation in the Agriculture Sector

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Tax Planning

Tax Planning - Definition

- It is the advanced assessment of the tax implications on various decision alternatives with the objective of minimizing the burden or maximizing the benefits

Objective of Tax Planning

- Tax compliance to avoid unnecessary penalties
- Taking advantage of tax incentives
- Tax amnesty
- Timing of tax payments to avoid lateness
- Training
- Engage tax professionals
- Use of lobbies for review of tax laws
- Appeal to tax arbitration bodies
- Internal tax function
- Review of policies and contracts by tax advisors

Why Plan?

- Tax is a major expense in company's P&L; - 30% of company's profits are paid to KRA as corporate taxes
- To take advantage of the available tax incentives;
- To minimize tax penalties and interest;
- The be ready for KRA recent aggressiveness in collecting taxes;
- To improve cash management and forecast;-
  1. Practically, most taxes are paid in advance even before the estimated profits crystallize as liquid cash.
  2. Short term planning required for some taxes e.g. VAT, PAYE
  3. Tax refunds to be used to sort out cash flow problems

Tax Incentives

- Farm work allowances;
- Tax losses used to reduce taxable income;
- Tax refunds used to reduce tax payable;
- Lower tax rate on listing at NSE

General format

Profit before tax				XXXX
Add: Disallowable expenses		XXX		
Write backs/ realized income	XXX	XXX		
Less:				
Non taxable income			(XXX)	
Unrealized income and capital gains		(XXX)		
Capital deductions		(XXX)	XXX	
Taxable profit (TP)				XXX
Tax thereon 30%				XXX

General format

- Example of Disallowed Expenses
  - Depreciation
  - Amortisation
  - Donations
  - Legal Fees
  - Fines and Penalties

- Example of Allowable Expenses
  - Wear & Tear
  - Farm Work Allowances

Pitfalls to Avoid

- On Cash flows

    a) Proper cash budgeting is required to enhance timely payment of all taxes so as to avoid penalties and interest;

    b) Finance manager should prepare a calendar or a diary listing all taxes due for the year;

    c) Taxes under consideration include VAT, PAYE, corporate instalment tax, withholding tax, customs and excise, among others

- On Compliance issues

    a) To pay all taxes by the due date to avoid late payment penalties;

    b) Tax compliance audits;

    c) Tax consultants to be involved while making decisions likely to have tax implications e.g. capital budgets, contracts, etc.

Pitfalls to Avoid – Cont'd

- Allowable costs
  a) Capital expenditure, loss, diminution, exhaustion of capital;
  b) Cost classification and analysis;
  c) Legal costs and other incidental expenses relating to authorization & issue of shares, debentures or similar securities offered for purchase by the general public;
  d) Capital expenditure on rating for purposes of listing on security exchange;
  e) Personal entertainment expenses;

Pitfalls to Avoid – Cont'd

- Provisions and accruals
  a) All expenses, write offs and provisions should be supported or have a proper reconciliation;
  b) General provisions for debtors are not allowable for tax;
  c) Specific provisions for debtors should be supported
- Withholding Tax
  a) Invoices should correctly describe the service provided;
  b) Confirm whether tax should be withheld while paying;
  c) Tax to be withheld at appropriate rates;
  d) Reconcile interest expense and tax withheld;
  e) A copy of the exemption certificate to be obtained if a payment is made to an exempt body;
  f) Filing of the withholding tax return

Pitfalls to Avoid – Cont'd

- VAT ISSUES
  a) VAT should be loaded on the taxable goods and services;
  b) An invoice should meet the requirement of a tax invoice;
  c) Reversal VAT is to be paid on paying for an imported service;
  d) The company may set off the VAT refunds against other taxes;
  e) Reduce debt collection period;
  f) Input tax to be claimed on a timely basis;
  g) Lodge claim for refund of VAT on bad debts

Pitfalls to Avoid – Cont’d

- Double Tax Agreements.
  a) Lower rates for withholding tax are applicable for countries that have DTA with Kenya;
  b) Entities to consider DTA while importing any service;
  c) Entities to seek tax consultant’s advise before signing treaties;
  d) Tax clauses in treaties should be critically reviewed;
  e) Consider engaging locally based entities rather than the non-resident head office for multinationals.

Pitfalls to Avoid – Cont’d

- Customs & VAT Issues
  a) Company, and not the clearing agent, to be the custodian of customs records;
  b) Confirmation of the correct tariff codes and duty rates of items prior to importation;
  c) Proper timing on payment of customs to avoid penalties and demurrage charges;
  d) Confirmation of the VAT status of a service or a good before raising an LPO
- Allowances
  a) Reimbursable expenses should be treated as non-taxable benefits;
  b) Support all expenses incurred;
  c) Personal entertainment is taxable on the employee;
  d) Entertainment of clients is tax allowable;
  e) Provision of a car for personal use is a taxable benefit.

Tax Crimes

Why Tax crimes?

- Tax systems are designed on the basis /assumptions of voluntary compliance. Voluntary compliance means that taxpayers are responsible for filing required tax returns and paying correct amounts of tax.

Tax Crimes - Cont’d

Sole Proprietorships

- Income tax evasion on:
  - Real estate sales.
  - Automobile sales.
  - Restaurants taking unreported cash receipts.
  - Farm Produce sales
- False income tax returns.
- Failure to file tax returns.
- Deliberate underreporting/omitting of income.
- Keeping two sets of books.
- Claiming false deductions

Tax Crimes - Cont'd

Sole Proprietorships - Cont'd

- Hiding or transferring assets or income.
- Inflated personal/business expenses.
- Transferring unreported income to tax havens.
- Using business funds for personal expenses.
- Paying employees in cash and not remitting statutory deductions.

Tax Crimes – Cont'd

- **Tax Avoidance**

  Tax avoidance is the arrangement of a person's financial affairs so as to **legitimately** reduce tax liability.

- **Tax Evasion**

  Tax evasion is the illegal arrangement of financial affairs so as to minimize tax burden.

Tax Crimes – Cont'd

Incorporated Entities

- Failure to keep records even though they are prescribed by the Income Tax Act and the Companies Act.
- Maintenance of parallel records with regards to virtually all the items in accounts i.e. purchases, sales, bank statements, etc
- Inflation of expenses
- Creation of huge provisions of specific bad debts.
- Creation of tax losses and abuse of their roll over.
- Treatment of private expenses as allowable business expenditure and these are craftily concealed

Tax Crimes – Cont'd

Incorporated Entities Cont'd

Examples

- Travel allowances.
- Company cars allocated to private use by employees treated as pool vehicles.
- Untaxed housing benefit.
- Over expenditure on business entertainment that is allowable.

Tax Crimes – Cont'd

Anti-Evasion Legislation

- Anti-evasion legislation reduces the scope for tax evasion.
  - The most important and general anti-evasion provision under Kenya Income Tax Act is covered in Sec.23.
  - The Commissioner of Income Tax has powers to direct that adjustments should be made as respects liability to tax to counteract the avoidance or reduction of liability to tax.
  - This is done where the Commissioner is of the opinion that the main purpose or one of the main purposes for which a transaction was effected was avoidance or reduction to tax.

? Time!