

IAS 12 Corporation Tax

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Agenda



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- 01** Introduction
 - 02** Taxation of Corporate entities
 - 03** Transfer pricing
 - 04** Thin Cap and Deemed Interest
 - 05** Tax Planning
 - 06** Consequences and penalties



Introduction



Introduction



Pharisees tested
Jesus...
Is it lawful to pay taxes
to Ceasar?

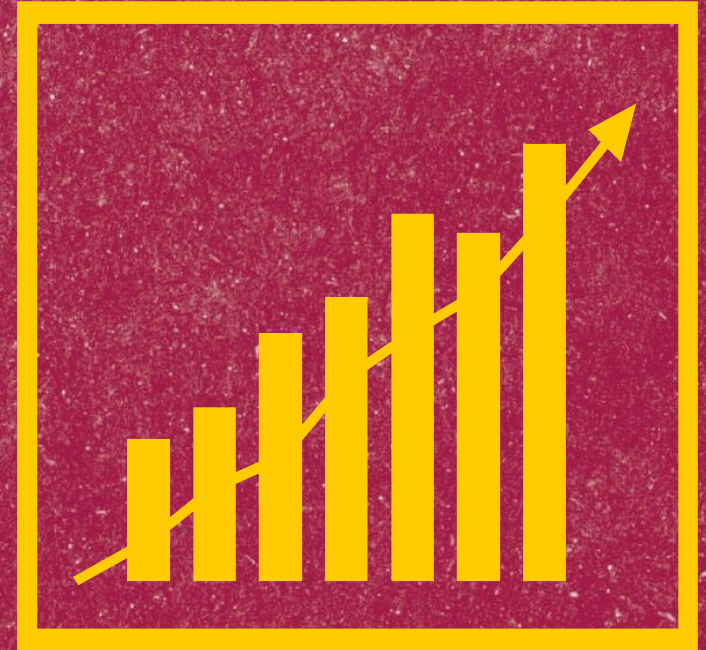


Introduction



Taxation of Corporate Entities

Thoughts?



Taxation of Corporate Entities



Resident	30%*
Non-resident	37.5%

*Reduced corporation tax rates for newly listed companies, approved under the Capital Markets Act (CMA), are available as follows:

Shareholding	Timelines	Rates
With 20% issued shares listed	First 3 years after listing	27%
With 30% issued shares listed	First 5 years after listing	25%
With 40% issued shares listed	First 5 years after listing	20%

Taxation of Corporate Entities



Corporation tax rates for Special Economic Zones Entities

Period	Rate (%)
First 10 years	10
Next 10 years	15
Thereafter	30

Industries



Other rates

1

Export processing zone



2

15% Car manufacturing



3

15% 400 housing units



Payment of taxes

Two methods

1

– **Current year:**

Four quarterly instalments
based on expected profits
Penalty if estimation is
under 10% of actual profits



2

– **Prior year:**

110% of last years taxes
Into four instalments



Computation of taxable income



	Ksh	Ksh
Net profit per accounts/ ledger for a source		XX
ADD		
Non-allowable expenses for the source	XX	-
Expenses relating to exempt income	XX	XX
LESS		
Capital Allowances		
Other deductible expenses for the source	(XX)	
Exempt Income	<u>(XX)</u>	<u>(XX)</u>
Adjusted Profit/(Loss) for Tax		XX

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



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



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

Bad debts



A debt is uncollectable where:

- ✓ The creditor loses the contractual right of a debt through a court order;
- ✓ No form of security or collateral is realizable;
- ✓ The securities or collateral realized are unable to cover the entire debt;
- ✓ The debtor is adjudged insolvent or bankrupt by a court of law;
- ✓ The costs of recovering the debt exceeds the debt itself; or
- ✓ Efforts to collect the debt are abandoned for another reasonable cause

Capital Allowances



Capital Allowances	Rate (%)
Investment Deduction	100/150*
Industrial Building Allowance	10
Wear & Tear Allowance	
Class I (tractors, combine harvesters, heavy earth-moving equipment and such other heavy self-propelling machines)	37.5
Class II (computers and peripheral computer hardware, calculators, copiers and duplicating machines)	30
Class III (other self-propelling vehicles, including aircraft)	25
Class IV (all other machinery, including ships)	12.5
Section 15 2 (g) (diminution in value of any implement, utensil or similar article)	33.33
Farm works deduction	100
Software allowance	20
*150% rate applies to investments outside Kisumu, Nairobi & MSA	

Disallowable



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

Corporation taxes



- Current year
- Prior year
- Estimation of current years tax
- 25% of 110% of tax assessed for the previous year

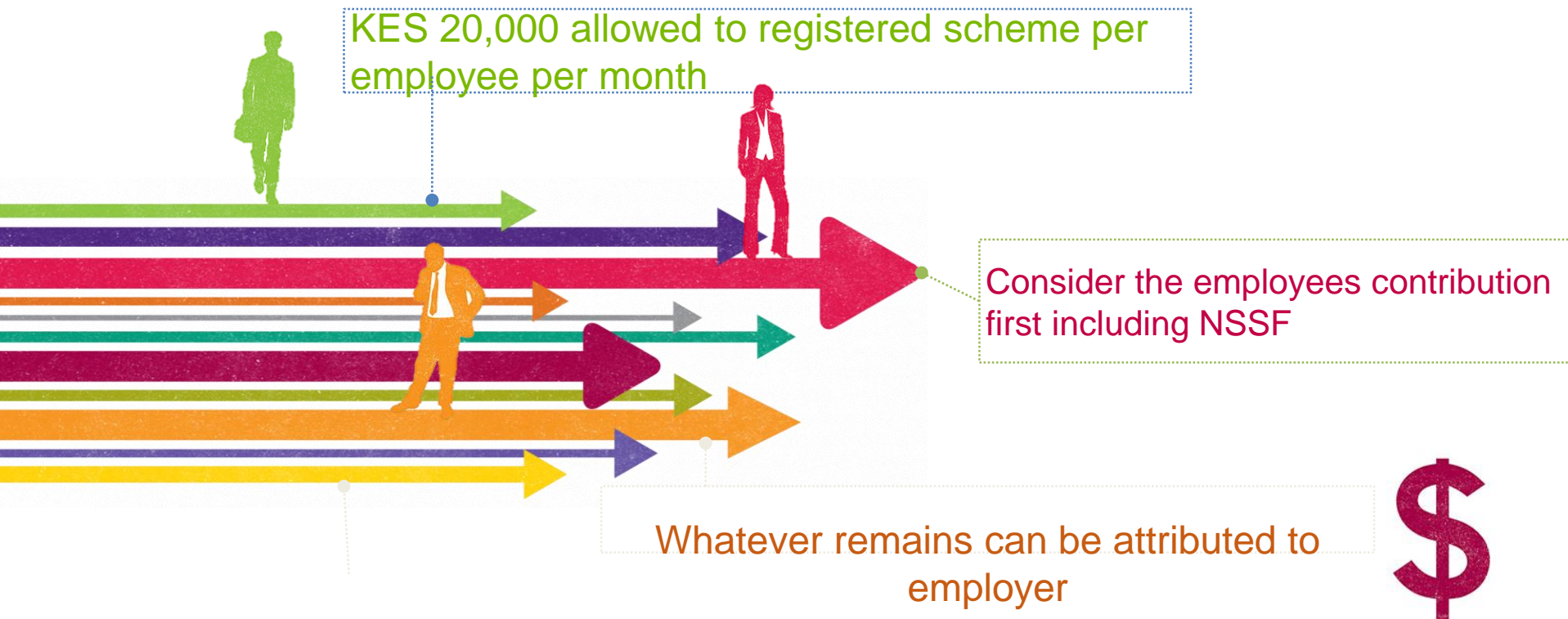


“Current year basis is more appropriate where the operating results fluctuate substantially. In case of variance of 10% or more, penalties and interest are levied”



Excess pension

– Section 22A of the ITA...



Transfer Pricing

“Updates”



Transfer Pricing



Definition:

“the setting of the **price** for goods and services sold between controlled (or related) legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the **transfer price**.”



Transfer Pricing



Arm's length price

[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly

Focus under BEPS

Value creation

BEPS Developments

Work on harmful practices **Action 5**



Tax treaty abuse **Action 6**

Action 13 Country by Country Reporting

Dispute resolution mechanisms **Action 14**

Thin Cap & Deemed Interest



Thin Cap & Deemed Interest

Thin Cap

- When a company's* capital is made up of a much greater proportion of **debt** than **equity**, i.e. its gearing or leverage, is too high it is said to be thinly capitalised.

*Not applicable to financial institutions licensed under Banking Act



Thin cap provisions



Section 16(2)(j) For purposes of ascertaining the total income of a person, no deduction shall be allowed **in respect of interest payments** in proportion to the extent that the highest amount of all loans held by the company at any time during the year of income exceeds the greater of:

three times the sum of the revenue reserves and the issued and paid up capital of all classes of shares of the company;



Deemed interest



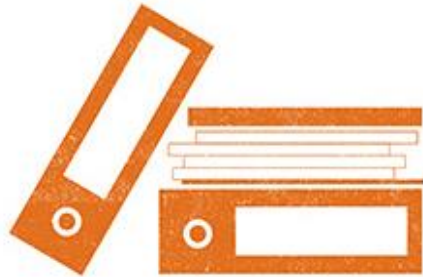
or an amount of deemed interest where the company is in the control of a non-resident person alone or together with four or fewer other persons and where the company is not a bank or a financial institution licensed under the Banking Act

Provided that this paragraph shall also apply to loans advanced to the company by a non-resident associate of the non-resident company controlling the resident company



Thin Cap Deemed interest

Implications:



Mutually exclusive



loans, overdrafts,
ordinary trade debts,
overdrawn current
accounts or any other
form of indebtedness



Restrict interest
Restrict forex losses.



Pay withholding tax



Capital gains tax



Gain = Consideration – Adjusted cost

CGT = 5% of gain

Incidental costs may include

fees, commission or remuneration to surveyor, valuer,
accountant, agent or legal adviser

Costs of transfer including Stamp duty and advertising costs

*Payable on 20th day after transfer of property

Recent Changes



Special economic zones

- Exempt Withholding Tax on dividends to non – residents
- Reduced Withholding tax on interest from 15% to 5%
- Reduced management fees and royalties from 20% to 5%
- Building costs and machinery – 100% allowance
- Exemption from Export duty and Import Declaration Fees
- Transfer Pricing introduced for transactions between resident entities of the SEZ / EPZ and related entities outside SEZ / EPZ

Recent Changes



Betting, gaming and Lotteries



- Gaming tax – from 12% to 50%
- Betting tax – 7.5% to 50%
- Lottery tax – from 5% to 50%
- Prize competitions tax – from 15% to 50%

Tax planning



Tax planning



Debt as a tool for tax planning

	Share Capital	Debt Capital
PBIT	150,000	150,000
Interest on shareholder's loan	-	100,000
Taxable profit	150,000	50,000
Tax @30%	45,000	15,000
Dividends	105,000	35,000
Interest	-	100,000
Total Shareholders return	105,000	135,000

Tax planning

€

£

\$

	Managem ent fees	Dividends	Royalties	Interest
UK	12.5%	10%	15%	15%
Germany &Canada	15%	10%	15%	15%
Denmark Norway Sweden Zambia	20%	10%	20%	15%
India	17.5%	10%	20%	15%
France	nil	10%	10%	12%
Netherlands	nil	nil*	10%	10%
Mauritius^	nil	5%*	10%	10%
South Africa	nil	10%	10%	10%
Italy	nil	10%	20%	15%

Consequences and penalties of non-compliance



Cost of getting it wrong



Offense	Penalty
• Person liable to tax for failing to register for taxes	• KES 100,000 per month subject to a maximum of KES 1 million
• Failure to keep documents	• KES 100,000 or 10% of the amount of tax payable to which the document relates to
• Late submission of tax return on account of employment income	• The higher of 25% of the tax due or KES 10,000
• Late submission of tax return (individuals and corporates)	• The higher of 5% of the tax due or KES 20,000
• Late submission of tax return on account of Turnover tax	• KES 5,000
• Failure to comply with electronic tax systems	• KES 100,000
• Tax Avoidance	• Double the amount of tax
• Tax refund fraud	• Two times the amount of the claim

Definitions



Tax evasion

- Intentionally failing to disclose taxable income to tax authorities

Tax avoidance

- **tax avoidance** is the **legal use** of **tax** laws to reduce one's **tax** burden.

Tax shortfall Penalty



- 75%
 - If omission is made deliberately
- 20%
 - In any other case
- 10%
 - Increase if second time
- 25%
 - Increase if third time
- 10%
 - Decrease on self declaration

Q&A



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