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1st March 2017

To: **Principal Secretaries, Ministries**
Principal Secretaries, State Departments
CEOs, Government Agencies
County Secretaries, County Governments
All other employers

TECHNICAL CIRCULAR ON TAXATION OF EMPLOYMENT INCOME (PAYE) – FINANCE ACT 2016 – INCOME TAX ACT CAP. 470

This Technical Circular is issued with amendments to the earlier one dated **3rd November 2015** which was to address County Governments. The legal amendments contained in the Finance Act 2016 affecting Payroll Taxes have been highlighted as well. The Circular therefore should serve as a Guide for Computing and Accounting for PAYE on Remunerations paid to Employees by Employers as provided for in **Section 3 (2) (a) (ii)** of the Income Tax Act, Cap. 470 – ***"on gains or profits from employment or services rendered"***.

PAYE is a tax charged on employment income and the employer is required by law to compute, deduct, account and remit the tax to Commissioner of Domestic Taxes on a monthly basis. The tax deducted must be paid by **9th of the month** following the deduction.

This Circular **DOES NOT** apply to remunerations paid to consultants for services rendered to an Employer, otherwise subjected to Withholding Tax under Section 35 of the Act.

The following is a guide on what constitutes employment income and against which tax should therefore be charged:

1. Remuneration:
Wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commissions, bonus, gratuity and allowances paid for subsistence, travelling, entertainment or any other in respect of employment and services rendered.

2. Allowances:
The following allowances, however described, are deemed to be employment income and are therefore chargeable to tax under PAYE;

(i) House allowance
(ii) Sitting allowance
(iii) Medical allowance
(iv) Mileage allowance
(v) Entertainment allowance.
(vi) Special duty allowance
(vii) Transport allowance
(viii) School fees paid by employer for an employee's dependent(s)

3. Exemptions
With effect from 1st July, 2016, **overtime allowances** and **bonuses** paid to low income employees, whose taxable income (before taking into account these payments) from employment falls within the First tax band, are exempted from tax. The first tax band is **Kshs. 11,180 per** month or **Kshs. 134,164** per annum.

4. Benefits:

The chargeable value of a benefit, advantage, facility granted or services rendered to a person by virtue of employment should be charged to tax at **the higher of cost to the employer,** or **fair market value,** or **the Commissioner's prescribed rate.**

The following benefits are subject to tax as indicated:-

a. **Motor Vehicle Benefit**

   Where The County Government (employer) has provided a motor vehicle to an employee for his/her own use, the chargeable benefit shall be the higher of the prescribed rate by the Commissioner or the cost of hiring or leasing the vehicle by the employer. Currently the Commissioner's prescribe rate is **2%** per month of the cost of the vehicle.

b. **Fringe Benefit**

   This should be paid by the employer in respect of loans provided to an employee at an interest rate lower than the market rate. The value of the fringe benefit is the difference between the interest that would have been payable on the loan at the market interest rate and the actual interest paid

c. **Insurance Cover Benefit**

   An amount paid to an insurance company by an employer for the cover of an employee where there is no group insurance policy scheme is taxable.

d. **Domestic Servants Benefit**

   An amount paid for the servants of an employee by the employer are chargeable to tax on the employee as a benefit.

e. **Security Services Benefit**

   An amount paid for the security of an employee by an employer are chargeable to tax on the employee as a benefit accruing from office of employment.

f. Housing

The value of housing provided to County Officers, Executives and any other employee should be taxed at the higher of;

i) 15% of total employment income (including allowances and other benefits)

ii) fair market rental value of the premises

iii) rent paid by the employer

g) Commissioner's Prescribed Rates of Benefits:

The following is a summary of current prescribed rates of benefits for various utilities:-

Benefit	**Prescribed rates per month (Kshs)**	**Prescribed rate per year(Kshs)**
Electricity (communal or from generator)	1,500	18,000
Water (communal or borehole)	500	6,000
Furniture	Higher of amount paid per month if hired or 1% of actual cost	Higher of amount paid per year if hired or 12 % of actual cost
Telephone (landline or mobile)	30% of monthly bills	30% of annual bills

The following amounts are not subject to tax:-

a. The first Kshs.2,000 of daily per diem. Any amount in excess of Kshs.2,000 is chargeable unless there is evidence that the amount paid is a re-imbursement of expenses

b. Where a benefit is below Kshs.3,000 per month or Kshs.36,000 per year

c. Meals provided to employees up to Kshs.48,000 per employee per year

5. Other Pay Roll Changes Brought about by Finance Act, 2016

i. Residents' personal relief has been increased from **Kshs.13,944** per annum (Kshs.1,162 per month) to **Kshs.15,360** per annum (Kshs.1,280 per month);

ii. Mortgage relief has been increased from **Kshs.150,000** per annum (Kshs.12,500 per month) to **Kshs.300,000** per annum (Kshs.25,000 per month).

iii. The new tax bands and rates are as follows:

	Annual	***Monthly***	***Rates***
On the first	Kshs.134,164	11,180	@10%
On the next	Kshs.126,403	10,534	@15%
On the next	Kshs.126,403	10,534	@20%
On the next	Kshs.126,403	10,534	@25%
On all income over	Kshs.513,373	42,782	@30%

6. Retirement Benefits

i) Upon attaining retirement age, retirement benefits could be paid in either lump sum or monthly pensions

Lump Sum

The first Kshs.60,000 per year of pensionable service to a maximum of ten years (or Kshs.600,000 is exempt from tax).

Monthly Pensions

The first Kshs.25,000 per month is exempted from tax.

The balance in either case is taxable as follows;

Lump sum	Monthly	Rate
1st 400,000	13,333	@10%
Next 400,000	13,333	@ 15%
Next 400,000	13,333	@ 20%
Next 400,000	13,333	@ 25@
Balance		@ 30%

ii) Any lump sum withdrawals of benefits before attaining retirement age is also taxable as above if the member has attained 50 years of age, or has been a member of the scheme for not less than 10 years or is leaving due to ill health.

iii) Any lump sum received in any other circumstances is taxed at the following rates

10% on the first Shs.121,968

15% on the next Shs.114,912

20% on the next Shs.114,912

25% on the next Shs.114,912

30% on any amount over Shs.466,704

7. Important Notes:-

(a) The employer is required to submit and make payment on a monthly basis through the i-Tax System.

(b) Employers who may require further guidance on how to calculate tax on these benefits can contact the relevant Domestic Taxes Stations nearest to them.

(c) Further details on Domestic Taxes iTax Compliance requirements can also be accessed from the KRA Website,

or

(d) Domestic Taxes Department, Head Office Policy Co-ordination, telephone **No. +254 281 7094/ 281 7095 / 281 5013.**

Benson Korongo, OGW

COMMISSIONER OF DOMESTIC TAXES DEPARTMENT