

Withholding tax

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Agenda

- ✖ General introduction and overview
- ✖ The withholding tax matrix
- ✖ Double taxation agreements
- ✖ Legal jurisprudence
- ✖ Tax planning opportunities

Introduction

Introduction

- ✖ Withholding tax" is deducted on **specific payments** in accordance with the provision of the Income Tax Act
- ✖ The payer acts as an agent for KRA
- ✖ Withholding tax is an advance tax but can be a final tax in other cases.
- ✖ Why withhold tax?
 - ✖ Cash flow to Government
 - ✖ Compliance issues
 - ✖ More cost effective
 - ✖ Non resident payees

The legal basis – Income Tax Act

✖ Section 3 – general charging section

- ✖ A tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in, or was derived from Kenya

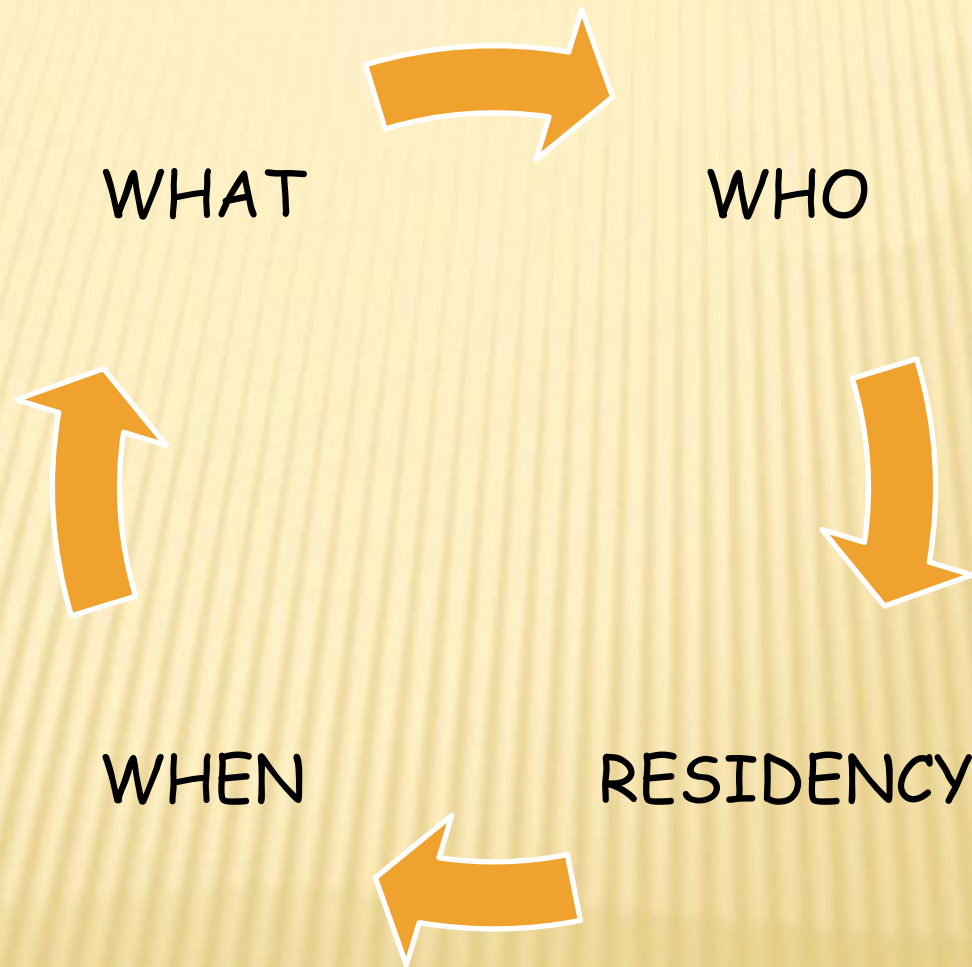
✖ Section 10 –

- ✖ Where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of, the specific payments the amount thereof shall be deemed to be income which accrued in or was derived from Kenya

✖ Section 35 (1) and (2)

- ✖ A person shall, upon payment of an amount to a non-resident person not having a permanent establishment (suin Kenya in respect of the specific payments
- ✖ Subject to subsection (3A), a person shall, upon payment of an amount to a person resident or having a permanent establishment in Kenya in respect of -

Withholding tax matrix



The What question

The WHAT question

✦ The **specific payments** subject withholding tax

Management or
professional fee
or training fee

Royalty

Interest and
deemed interest

Use of property
(Rent)

Dividend

Agency fees

Contractual fees

Commission

Definitions of the “WHAT”

Agency fees: Payments to a person for acting on behalf of any other person, group of persons or the Government and excludes reimbursements

Management or professional fee: payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency contractual or consultancy services however calculated

Consultancy fees: payments to any person for acting in an advisory capacity or providing services on a consultancy basis

Contractual payments: payments for work done in respect of building, civil or engineering work.

Definitions of the “WHAT”

Rent: payments for the right to occupy or use immovable property

Interest: (other than interest charged to tax) means interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes a premium or discount by way of interest and a commitment or service fee paid in respect of any loan or credit or an Islamic finance return;

Definitions of the “WHAT”

Royalty: a payment made as consideration for the use of or the right to use-

- a) The copyright of a literary, artistic or scientific work; or cinematograph film, including film or tape for radio or television broadcasting; or
- b) A patent, trade mark, design or model, plan, formula or process; or
- c) Any industrial, commercial or scientific equipment; or for information concerning industrial, commercial or scientific equipment; or
- d) Experience, and gains derived from the sale or exchange of any right or property giving rise to that royalty;

Consultancy vs. Contractual payments

Description	Classification
Architects fees	Consultancy fee
Civil Engineer fee	Consultancy fee
Quantity surveyor fee	Consultancy fee
Contractor fee	Contractual fee
Cost of material (unspecified)	Contractual fee
Cost of material (Specified)	No withholding tax

The WHAT question – specific payments

× Software

- × Payments subject to withholding tax as a royalty. [LC Ruling](#)
- × Software embedded in a computer disk and off the shelf purchases not subject to W/Tax

× Leasing of Equipment

- × Payments to non-residents subject to WHT at 15% (3rd Sch. Par. 3)
- × Leasing of aircrafts & aircraft engine; and locomotives & rolling stocks from non-resident exempt from withholding tax
- × No WHT on local leasing

× Training fees

- × Withholding tax on tuition fees - KRA Public Notice
- × Withholding tax on incidental costs

The WHAT question – Rent

- ✗ Withholding tax is due on rent paid to a **resident person**, on both the **residential and commercial property**.
- ✗ Withholding Tax on rent took effect on **01 January 2017**.
- ✗ Why withholding tax on rental income:
 - ✗ To meet Government's increased expenditures, the govt. is implementing various measures to ensure landlords contribute their fair share of taxes including;
 - ✗ Broadening the tax base.
 - ✗ Facilitating the normalisation of the tax affairs by all landlords.
 - ✗ Increasing and improving the tax compliance culture.
 - ✗ Facilitating participation of public corporations and private firms in revenue enhancement

The WHAT question – Rent

- ✗ The public notice by KRA indicated that the withholding tax would be collected by **appointed agents via iTax system**, to be notified of such appointment (through iTax and manually).
- ✗ One must be an appointed withholding tax agent to deduct withholding tax on rent.
- ✗ KRA is prioritizing the following for appointment as agents:
 - ✗ Private Institutions - supermarkets, banks, insurance companies, micro-financial institutions, advertising firms, telecom. companies
 - ✗ Public Institutions - government ministries, agencies and departments, universities, parastatals, county governments
 - ✗ Others - property/estate agents

The WHAT question – Rent

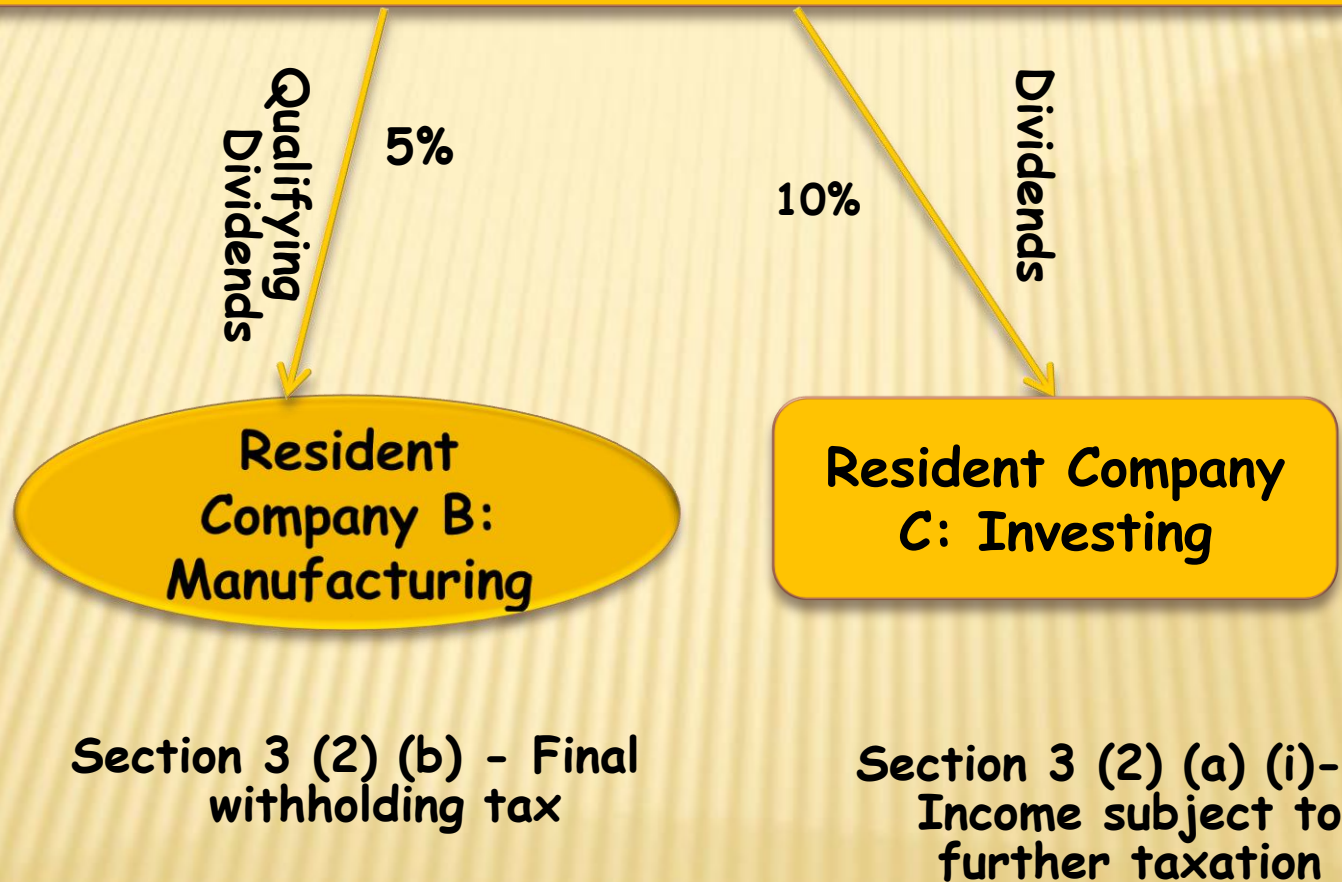
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 - ✗ Others - property/estate agents

The WHAT question – Interest

- ✗ Section 35 of the Income Tax Act
 - ✗ (1) A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya
 - ✗ (3) person shall, upon payment of an amount to a person resident or having a permanent establishment in Kenya...
- ✗ in respect of interest and deemed interest, including interest and deemed interest arising from a discount upon final redemption of a bond, loan, claim, obligation or other evidence of indebtedness measured as the original issue discount;
- ✗ Exemptions
 - ✗ Payments to persons exempted under the 1st Schedule
 - ✗ Payments to Financial Institutions specified in the 4th Schedule

The WHAT question – dividends

Company A: Paying dividends



The WHAT question

- ✗ Common payments not subject to WHT
 - ✗ Security charges
 - ✗ Advertising cost
 - ✗ Cleaning services
 - ✗ Payment for equipment such as machine, car, furniture

The WHAT question - exemptions

- ✗ Recipient of the income is exempted from tax
- ✗ The payment is not eligible for withholding tax purposes where the Minister certifies that a payment is required to be paid free of tax by the terms of an agreement to which the Government a principal or guarantor and that it is in the public interest that the income shall be exempt from tax (Para 11 of 1st Sch. and Sec. 13 of ITA).
- ✗ Instances where there is a double tax treaties or Host Country Agreements exempting tax deduction on specific line items
- ✗ Commission paid to a non resident agent in respect of flowers, fruits or vegetables exported from Kenya and auctioned in any market outside Kenya.
- ✗ Commission paid by a resident air transport operator to a non resident agent in order to secure tickets for international travel
- ✗ Payments by filming agents and filming producers approved by the Kenya Film Commission to non resident actors and crew members

Who / residency question

The WHO question

- ✗ The "Who" question is two-pronged:
 - ✗ "Who" in reference to the payer, and his obligations
 - ✗ "Who" is the recipient of the payments, his residency status and consequently, the tax implications
- ✗ With effect from 1 July 2003, certain specific payments to a **resident person** of value above KShs. 24,000 per month are subject to WHT
 - ✗ This applies to training, management & professional fees only

The WHO/Residency questions

Description		Notes	Residence Status	
			Residents	Non-Residents
Dividends		(a)	5%	10%
Interest	- Housing Bonds	(b)	10%	15%
	- Other sources	(c)	15%	15%
	Deemed Interest	(d)	-	15%
Commission				
	- Insurance brokers		5%	20%
	- Others	(e)	10%	20%
Royalties			5%	20%
Real estate rent			10%	30%
Lease of equipment			-	15%

The WHO/Residency questions

Description	Notes	Residence Status	
		Residents	Non-Residents
Sporting or entertainment income		-	20%
Pension and retirement annuities	(h)	0 to 30%	5%
Management, professional & training fees	(f)	5%	20%
Contractual fees		3%	20%
Telecommunication service fees	(g)	-	5%
Natural resource income		5%	20%
Winning payables by bookmakers to punters		5%	7.5%

The who/residency questions - notes

- a) Withholding tax rate on dividends for East African citizens is 5%
- b) Qualifying interest in respect of Housing Bonds is limited to KShs 300,000 per year
- c) Withholding tax on interest received by a resident individual from the following sources is final:
 - ✦ Banks or financial institutions licensed under the Banking Act;
 - ✦ Building societies licensed under the Building Societies Act;
 - ✦ Central Bank of Kenya
- d) Deemed Interest refers to an amount of interest equal to the average 91 day T- Bill rate, deemed to be payable by a foreign controlled resident person in respect of any outstanding loan provided or secured by the non resident, where such loans have been provided free of interest.

The who/residency questions - notes

- e) Commissions payable to non-resident agents for purposes of auctioning horticultural produce outside Kenya are exempt from withholding tax
- f) Non-resident rate in respect of consultancy fees payable to citizens of the East African Community Partner States is 15%
- g) The tax is subjected to payments made to non-resident telecommunication service providers and is based on gross amounts
- h) Withholding tax is final on withdrawals from provident and pension schemes in excess of the tax-free amounts
 - ★ after expiry of fifteen years, or
 - ★ on the attainment of the age of fifty years, or
 - ★ upon early retirement on medical grounds

Who and When

Payer's obligations

The When question

- ✗ Withholding tax is deductible **upon payment** of a taxable amount.
 - ✗ "Payment" defined to include accrual/crediting of the amount payable.
 - ✗ High court ruling: **Payment implies delivery of money or some other valuable thing, that is actual payments. R VS KRA EXPARTE FINTEL LTD - JUDGMENT (paid definition).pdf**
 - ✗ It is the responsibility of the withholding tax agent to:
 - ✗ Compute and deduct the tax at the appropriate rate; and
 - ✗ Remit the tax deducted to the Commissioner, Domestic Taxes by the 20th day of the month following that in which tax is deducted

Payments, return and due dates

Due Date

- 20th day of the month following the month of deduction

Penalty

- 10% of the amount subject to a maximum of KShs 1 million

Interest

- 1% per month subject to a maximum of the principal tax payable.

Payments, return and due dates

- ✖ A certificate of withholding tax in the prescribed form should be issued to the person on whom tax has been withheld.
- ✖ With migration to iTax, claim of WHT is only possible if the tax deducted is remitted through the online system by the payer
 - ✖ In absence of such certificate, any claim of such advance tax will be disallowed by KRA.

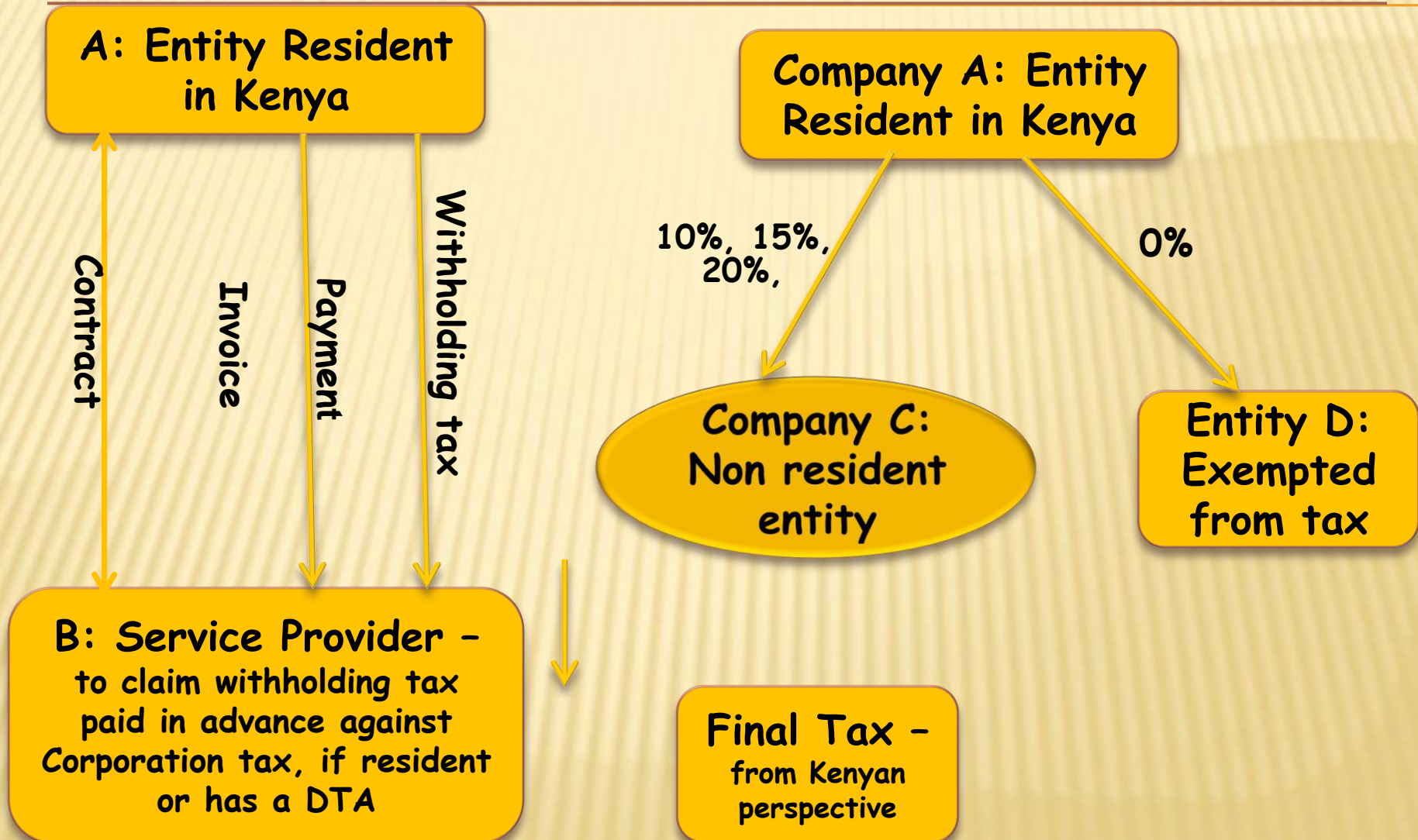
Basis of withholding tax computation

- ✖ The tax is based on gross fees before other charges such as VAT
 - ✖ Assume a company is paying to a resident person KShs.250,000 in fees and KShs.40,000 in VAT;
 - ✖ The tax would be Kshs. 12,500 being 5% of Kshs.250,000 and not Kshs. 14,500 being 5% of Kshs.290,000
- ✖ Where fees are negotiated net off taxes the amounts should be grossed up

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How withholding tax works



Maintenance of withholding tax records

- ✖ The company should keep proper records on making payment of withholding tax. The records required to be maintained are in respect of:
 - ✖ Name of Payee
 - ✖ Address of Payee
 - ✖ Personal Identification Number (PIN)
 - ✖ Gross amount paid
 - ✖ Nature of payment and
 - ✖ Amount of tax deducted

Double taxation Agreement

Double taxation agreement /treaty (DTA)

- ✗ Corporate Income Tax (CIT) & Government
 - ✗ Revenue 16% of developing country revenue (8% in OECD)
- ✗ The world has evolved:
 - ✗ Global trade where businesses trade in multiple jurisdictions /countries,
 - ✗ Individuals become employees of multinational entities and thus may be posted in multiple locations at any time
- ✗ In such circumstances, the risk of the business incomes being subject to double taxation is more real.

Double taxation agreement /treaty (DTA)

- ✖ There are basically two types of double taxations that may arise
 - ✖ Economical double taxation
 - ✖ The inclusion, by more than one state's tax administration, of the **same income** in the tax base when the income is in the **hands of different taxpayers**
 - ✖ Juridical Double Taxation
 - ✖ The imposition of income taxes in two (or more) states on the same taxpayer in respect of the same income
- ✖ Effects of double and sometimes multiple taxation
 - ✖ Harmful to the development of economic relations between countries in the exchange of goods and services as well as movement of capital and persons

Double taxation agreement /treaty (DTA)

- ✗ Some of the means that the international community has sought to alleviate problems of double taxation is through the negotiation of double taxation agreements (DTAs)
- ✗ Tax Treaty System Allocates tax rights -
 - ✗ includes right not to tax to prevent 'double taxation' and encourage foreign investment,
- ✗ Tax conventions reduce juridical double taxation
 - ✗ by allocating taxing rights between residence and source states on various categories of income
 - ✗ by establishing criteria for determining an exclusive residency status for taxpayers

How double taxation is eliminated

- ✗ DTAs typically eliminate double taxation through two major approaches
 - ✗ The exemption method:
 - ✗ The State of residence does not tax the income which according to the DTA may be taxed by the Source State or PE/Fixed Base
 - ✗ The credit method:
 - ✗ The State of residence calculates its tax basis of the taxpayer's total income including the income from the other State.
- ✗ It then allows a deduction from its own tax for the tax paid in the other State

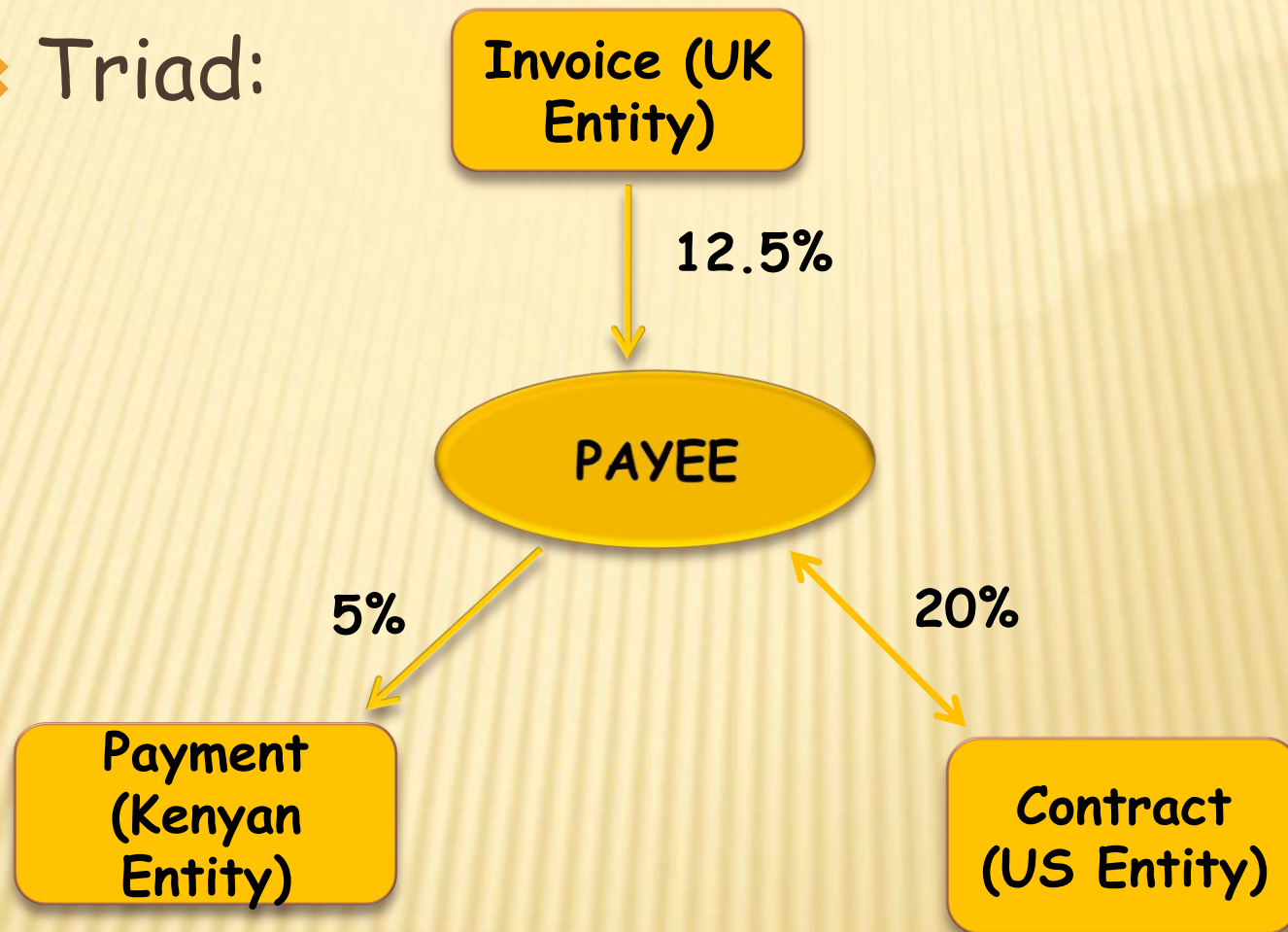
The who/residency questions

✗ Double taxation agreement rates

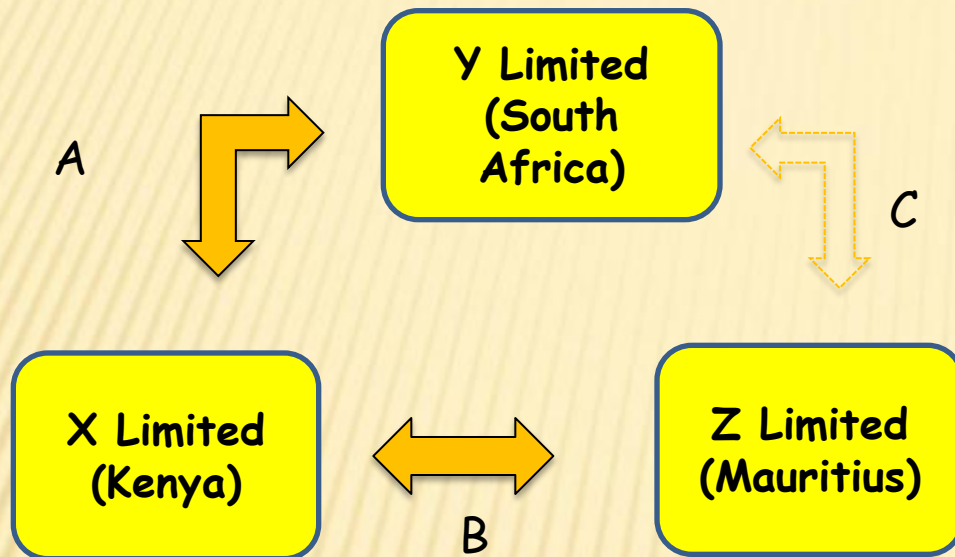
Payee Resident in	Dividends	Interest	Royalties	Management, Professional & training Fees
	%	%	%	%
Canada	10	15	15	15
Denmark	10	20	20	20
France	10	12	10	20
Germany	10	15	15	15
India	10	15	20	17.5
Norway	10	15	20	20
Sweden	10	15	20	20
South Africa	10	10	10	0
U.K	10	15	15	12.5
Zambia	0	15	15	15

Treaty shopping

✗ Triad:



Limitation of benefit – section 41



- A. No tax transaction.
- B. Z has entered into a contract to supply management services to X
- C. Y limited (listed under JSE) owns 40% of Z Limited.

Subject to subsection (6), where an arrangement made under this section provides that income derived from Kenya is **exempt** or **excluded from tax**, or the application of the arrangement results in a **reduction in the rate of Kenyan tax**, the benefit of that exemption, exclusion, or reduction **shall not be available** to the person who, for the purposes of the arrangement, is a resident of the other contracting state if **fifty per cent or more** of the underlying ownership of that person is held by an individual or individuals who are **not residents** of that other contracting state for the purposes of the agreement

Limitation of benefit rule – the Uganda

- ✗ Ugandan law amended in 2016: treaty benefits would therefore be available to a recipient of payments from Uganda if the following three conditions are met,
- ✗ Namely the non-resident recipient:
 - ✗ Is the beneficial owner of the income, and
 - ✗ Has full and unrestricted ability to enjoy that income and to determine its future uses; and
 - ✗ Has economic substance in the treaty country.

Limitation of benefit rule – the Uganda

- ✗ Similar provisions as Kenya
- ✗ However, the application of this restriction created a number of practical challenges:
 - ✗ Conflict with the concept of 'beneficial ownership' as applied in the treaties
 - ✗ General question as to the precedence of treaties over domestic law.
 - ✗ Further, there was a specific difficulty in establishing the underlying ownership of third-party suppliers.

Legal jurisprudence

Incidental cost in Consultancy contracts

Provision of the Income Tax Act

Section 2 of the Income Tax Act defines, "management or professional fee" as *"means a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated"*.

Tax payer's position

The tax payer (bank) argued that withholding tax should not be deducted in respect of incidental costs relating to costs incurred in fulfilling a contract by an overseas consultant

The phrase 'however calculated' cannot be interpreted to include incidental costs

Training fees are clear on incidental costs - the same would have been extended to management and professional fees by the Minister if he ever had such intentions

KRA position

incidental costs relating to costs incurred in fulfilling a contract by an overseas consultant

The phrase 'however calculated' should be interpreted to include incidental costs

Incidental cost in Consultancy contracts

Local Committee ruling

Section 2 of the Income Tax Act defines, "management or professional fee" as *"means a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated"*.

Implications

Withholding tax: KRA may demand banks to withhold tax against consultants' costs relating to hotel costs, taxi costs, etc

Value Added Tax: KRA may demand banks to compute and pay reverse charge VAT on consultants' costs relating to hotel costs, taxi costs, etc - despite VAT having been charged and paid by the service provider

Tax planning

consultant to organize his own travel/ accommodation

Costs incurred on acquisition of software

Provision of the Income Tax Act

- Section 2 of the Income Tax Act defines, "royalty" as *"means a payment made as a consideration for the use of or the right to use..... the copyright of a literary, artistic or scientific work; or.... a cinematograph film, including film or tape for radio or television broadcasting; or.... a patent, trade mark, design or model, plan, formula or process; or..... any industrial, commercial or scientific equipment,.... or for information concerning industrial, commercial or scientific equipment or experience, and gains derived from the sale or exchange of any right or property giving rise to that royalty."*

Key facts

- The vendor "shall at all times retain all title, copyright and other proprietary rights in software, any modifications thereto and translations thereof. Bank does not acquire any rights in software other than those specified in the agreement".

High Court ruling

- This is a royalty transaction which attracts withholding tax

Definition of the term “paid”

Provision
of the
Income
Tax Act

Section 2 of the Income Tax Act defines, “paid” as including *“distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person”*.

Key
facts

A tax payer entered into a contract with a service provider that set out fees for the services provided and a provision setting an interest penalty on the amount due in the event that the tax payer failed to make payment on time. The taxpayer, due to economic difficulties, was unable to make the payment on time and went ahead to make a provision for the interest in its books

KRA
argument

By creating a provision for the interest, the tax payer had credited the amount meaning that the interest had been deemed to have been paid (Sec 2).

Definition of the term “paid”

Tax payer's position

The tax payer disputed the assessment on the basis that it did not make any payment meaning withholding tax could not arise. No money was transferred or anything of value to the service provider to discharge its interest debt. Further, the provisions created was merely an accounting requirement for recognizing a liability

High Court Ruling

Considering the rules of interpretation, the court stated that, "paid" in Sec 2 assumes its ordinary meaning and the use of the word "include" is merely illustrative of the kinds of activities that constitute payment. **Payment implies delivery of money or some other valuable thing (necessary condition)**

The court reinforced the position by stating that Section 35 (1) and 35 (3) requires one to deduct withholding tax when making the relevant payments

Court concluded that the mere entry of an expense in the books without any further benefit to the intended recipient did not constitute payment

Status

KRA has appealed to the Court of Appeal

Tax planning opportunities

Tax planning opportunities

- ✗ Paying withholding tax due on time will save the company tax penalties
- ✗ Utilization of double tax treaties
- ✗ In house tax resource
- ✗ Annual Tax Health Checks and implementing tax consultant's advice
- ✗ Seeking tax advice before major business decisions
- ✗ Review agreements and contracts - integrate tax into all aspects of business
- ✗ Tax Training

Recent charges

Finance Act 2016 / Finance Bill 2017

- ✖ Reduced withholding tax on payments made by Special Economic Zone enterprises, developers or Operators to non-residents in respect of:
 - ✖ Interest - from 20% to 5%
 - ✖ Royalty - from 20% to 5%
 - ✖ Management or professional or training fee - from 20% to 5%
- ✖ Payments to citizens of the East African Community Partner States of consultancy fee shall be 15%
- ✖ Exemption of withholding tax from dividends paid to non-residents by SEZ Enterprises, developers and operators from payment of dividends.

Questions/ Comments

