PROPOSED LEGISLATION / TAX REFORMS

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Uphold public interest

CRITICAL AREAS

- Gaps in the Income Tax Act
- Review or rewrite?
- Proposed policy reforms
- Proposed administrative reforms
- Proposed amendments
- Proposed additions to the legislation
- Conclusion

FEATURES OF A FUNCTIONAL TAX SYSTEM

Simplicity-helps taxpayers better understand the taxsystem and reduce cost of compliance

Transparency–taxpayers and leaders can easily find information of how the tax money is being utilized

Elasticity–should be able to adapt to change in the economy

Diversity–there should be more than one type of tax to ensure fair collection and equitable tax burden

Gaps in the Income Tax ACT

Complexity the language in the ITA is ambiguous and difficult to interpret

Lack of proper regulations in specific sectors and/or transactions such as derivatives

Conflict between different Acts such as the IncomeTax Act and Companies Act 2015 and theTax Procedures Act

Relevance of the laws– Some laws are nolonger relevant due to the changing economic at mosphere

REVIEW OR REWRITE?

Rewrite

- To promote international best practice and clear current ambiguity
- Revamping of the ITA’s structure to facilitate chronological flow of legislation
- To encourage proper declaration of tax by taxpayers
- Will lead to the harmonization of tax legislations

REVIEW OR REWRITE

Review

- To incorporate emerging issues;
- To enhance equity;
- To respond to the ever changing tax world;
- To increase the tax base;
- To increase tax compliance; and

To spur development and economic growth

PROPOSED POLICY REFORMS

CURRENT TAX REGIME

- Kenya operates as a territorial tax system –all income derived in Kenya is taxed in Kenya except in situations where exemptions are allowed under Double Tax Agreements (DTA)
- Recommended policy reforms include:

Tax incentives for Permanent Establishments (Branches) in Kenya

- Reduction of corporation tax from **37.5%** to **30%** to encourage foreign investments –other EAC countries have maintained uniform taxation of 30%
- Taxation of the increase in branch assets at 10% to mitigate the loss of tax on distribution after tax profits

PROPOSED POLICY REFORMS

Unilateral tax credit on foreign income

- Kenya has entered into a limited number of DTAAs which means that Kenyan taxpayers receiving foreign income from countries that are not covered under a DTAA are subjected to double taxation
- Proposed change: unilateral tax credit on foreign tax paid on income which is subject to tax in Kenya.

PROPOSED POLICY REFORMS

Taxation of inheritance and review of the CGT rate

- To ensure equitable redistribution of resources and increasing the tax revenue, the following reforms are proposed:
- Repeal of CGT exemption on inheritance to facilitate taxation of wealth as opposed to income; and
- Review of CGT rate from 5% to 15% to raise revenue

PROPOSED POLICY REFORMS

Implementation of inflation index

- The Finance Act 2016 introduced new PAYE bands and a new annual relief with the aim of lowering the tax burden for individuals in Kenya. The 2017 Finance Bill proposes a further expansion of the bands and an increase in the relief.
- An annual inflation index is preferable as PAYE bands and reliefs will automatically be adjusted based on inflationary changes.

PROPOSED POLICY REFORMS

Review of capital allowance

- Allowances for intangible assets such as license agreements at 20%
- 100% Investment Deduction for companies in the health care industry
- Change of the wear and tear basis from the reducing balance to the straight line method

Proposed Administrative Reforms

To widen the current tax base, the following administrative reforms may be considered:

- 'Proper' taxation of the informal sector -Shift in focus to the informal sector through integration of *iTax*, and other platforms existing platforms such as county governments business registration, e-Citizen, *inter alia*
- Harmonization of ITA and the TPA -There is a disconnect in the provisions of the two Acts.
- The proposed review should consider having all administrative functions under the TPA .

Other Proposed Ammendments

a) Taxation of Motor Vehicles

- A taxpayer is taxed at a rate of 2% of the initial cost of the vehicle which is punitive.
- Proposed change: 2% of the prevailing market value of the car.

b) Taxation of Housing Benefit

- The current provisions require that the housing benefit is based on the percentage of the employment emolument
- Proposed change: Computation of the benefit on the actual rent paid or payable by the employer.

Other Proposed Ammendments

c) Provision for bad debts –Financial and Related Institutions

- The provisions for bad debts do not adequately capture the nature of provisions set up by financial institutions.
- Financial institutions are governed by different bodies with different standards and regulations concerning provisions of bad debts (CBK, IFRS, SASRA, ITA).
- Proposed change: Inclusion of a clause in the ITA stating that banks may deduct nay increase in the provisions for non performing loans required by the CBK prudential guidelines on bad debt provisioning.

Other Proposed Ammendments

d) Taxation of dividends

- Distribution of dividends from a foreign subsidiary is subject to double taxation at source and in Kenya upon distribution to shareholders.
- Consideration? Dividends received from foreign companies be exempt from tax at the point of distribution to shareholders.

e) Compensating tax

- Currently, compensating tax is hurting investors who receive deductions from the government as it is tantamount to a claw-back
- Consideration? Removal of compensating tax from the ITA

Other Proposed Ammendments

f) Tax treatment of derivative transactions

- The current tax legislation does not address the issue of derivatives
- Due to the complex nature of these transactions, we recommend that a new law is drafted to govern the treatment of derivatives.
- This will spur investment in the Kenyan market and subsequently, revenues

PROPOSED ADDITIONS

Proposed additions to the Transfer Pricing Rules, 2006

a)Implementation of the OECD's Action plans on Base Erosion and Profit Sharing (BEPS)

With the release of the Action plans, Kenya needs to adopt the BEPS action plans and introduce the three tier TP documentation

b) Establish method of carrying out audit, circumstance that may give rise to adjustments and negotiating settlements

There have been an increased number of TP audits carried out by KRA. It is necessary that a clear guideline is set out to clearly define the expectations of the taxpayer and the KRA.

PROPOSED ADDITIONS

c) Introduce service regulations

Kenya ought to adopt service regulations that clearly outline the low value services and the appropriate mark-up on these services

d) Introduce provisions on financial transactions

Inclusion of TP rules that specify the definitions of intragroup financing, guidance on how to carry out a comparability test and guidelines on how to determine arm’s length price for intra-group financing transactions.

CONCLUSION

- Kenya relies heavily on taxes for government revenue. There is therefore need to streamline our systems and legislation to maximize on the collection.
- Emerging market trends necessitate the need for new regulations. These include e-commerce and transfer pricing.
- The revised tax bands and new provisions on transfer pricing are positive steps towards improving the Income Tax Act.
- The Budget also emphasized the governments intents on the revision of the ITA which we expect will capture some of the main concerns.