

CORPORATION TAX

Presentation by:

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Presentation Outline



- ❑ Taxation of Corporate Entities
- ❑ Allowable & Disallowable Expenses
- ❑ Thin Capitalization & Deemed Interest
- ❑ Recent Emerging Issues

Chargeable Income



Chargeability to Tax

Tax Charging Clause – Sec 3 (1)



“Subject to, and in accordance with, this Act, 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**”.

Income Subject to Tax



- (a) • Gains or profits from business and royalty
- (b) • Dividends or interest
- (c) • Pension, charge or annuity, withdrawals of schemes
- (d) • Rental income
- (e) • Agricultural income
- (f) • Amount deemed to be the income of a person
- (g) • Capital gains
- (h) • Income from disposal of immovable property(gain is more than 20%)
- (i) • Natural resource income

Tax Residency Status



Case 1

- Incorporation

Case 2

- Management and control

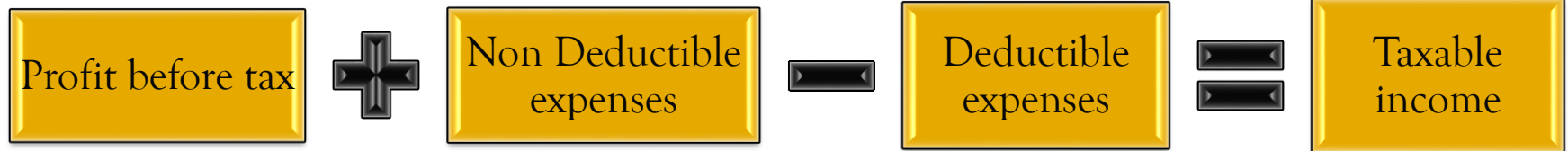
Case 3

- Declaration by the Minister

Determining Taxable Income



Computing Taxable Income



Deductible Expenses – Section 15



Bad debt: if considered to have become bad to the satisfaction of the Commissioner;

15 (2)(a) Commissioner Vs Kenya Maltings Ltd (Commercial Civil Case 2 of 2010)
Accounting for bad debts by banks

15(2)(b) Capital allowances under the 2nd schedule

15 (2)(c) Capital Expenditure for prevention of soil erosion

15 (2)(d) Capital Expenditure on legal costs/stamp duties in lease acquisition

Deductible Expenses – Section 15



15 (2)(e)

Pre Incorporation Expenditure

15 (2)(f)

Structural alterations to premises to maintain existing rent

15 (2)(g)

Diminution in value

15 (2)(h)

An entrance fee/annual subscriptions to a trade association

Deductible Expenses – Section 15



15 (2)(l) Capital expenditure on Scientific Research

15 (2)(o) Employers contribution to a registered pension scheme

15 (2)(p) Reasonable advertising and promotional expenses

15 (2)(s) Capital expenditure on legal/other incidental costs for authorization and issue of shares/debentures to the public

Deductible Expenses – Section 15



15 (2)(v)

Club Subscriptions paid by an employer

15 (2)(w)

Cash donations to an income exempt charitable organization

15 (2)(x)

Expenditure of capital nature on construction of social infrastructure *with prior approval of the Minister*

15 (2)(z)

Expenditure incurred for sponsoring sports with prior approval of the Cabinet Secretary for sports

Deductible Expenses – Section 15



15 (2)(aa)

Donations towards declared **national disasters** and channeled through prescribed recognized bodies

15 (3)(a)

Interest on money borrowed

15 (4)

Tax Losses

Capital Allowances



Wear & Tear Allowance



Qualifying expenditure	Class	(%)
Heavy self-propelling machinery(tractors , combine harvesters.	I	37.5
Computer and peripheral computer hardware, calculators, copiers and duplicating machines.	II	30
Other self propelling vehicles and aircrafts (cost of non- commercial motor vehicles is restricted to KShs. 2 million).	III	25%
All other machinery: includes ships and Petroleum pipeline.	IV	12.5
Computer software (W.E.F 1 Jan 2010) (Para 31B)		20
Indefeasible right to use a fibre Optic cable by the telecommunications operator		5
Telecommunication Equipment (W.E.F 1st Jan 2010) “telecommunication operator” a person licensed under the Kenya Information and Communications Act, 1998;		20

ID – Investment Deduction



- ▶ Construction of building and installation of new machinery for manufacture
- ▶ Installation of new machinery in a building – It should not be a replacement
- ▶ Lease of building or machinery for purposes of manufacture

Investment Deduction - Rates



Description	Rate (%)
Building and machinery used for manufacturing purposes and hotel buildings	100
On construction of building and installation of machinery for use in SEZ (The rate is <u>150%</u> where SEZ is located outside Nairobi and Mombasa)	100
Civil works and structures forming part of an industrial building used for purposes of manufacturing	100
Ships of 495 tons (withdrawal of allowance on sale of ship within five years). WEF 01 Jan 2016 – 125 tons	40 100
Filming Equipment (W.E.F 1 January 2010)	100
Investment made outside Nairobi, Kisumu and Mombasa (W.E.F 12th June 2009)	150
Construction of transportation and storage facilities for petroleum products by Kenya Pipeline	100

IBD – Industrial Building Deduction



Relates to Buildings in use for:-

Mill, factory or other similar premises

Manufacture of goods or materials

Storage pre or post for manufacturing or arrival by sea or air

Business of ploughing (Para 22), prescribed dwelling house and welfare of workers

Transport, dock, bridge, tunnel, inland navigation, water, electricity or hydraulic power

IBD – Rates



Description	Rate (%)
Industrial building/hotel	10
Hostel/educational/training building (certified by the Commissioner)	50
Rental residential buildings in planned development areas (approved by the Minister of housing)	25
Commercial building	25
Building in use for the training of film producers, actors or crew (approved by the Minister)	100

Farm work Deduction



Entity must be engaged
for purposes of
husbandry on the
agricultural land

Granted on
construction of **farm
works** by a farmer

The rate granted is
100%

“Farm Works” - mean farmhouses, **labor quarters**, any other immovable buildings necessary for the proper operation of the farm, fences, dips, drains, water and electricity supply works **other than machinery**, windbreaks, and other works necessary for the proper operation of the farm.

Bad Debts Guidelines



A debt shall be considered to have become bad if it is proved to the satisfaction of the Commissioner to be uncollectable.

A debt shall be deemed to have become uncollectible where

- ☐ Creditor loses contractual right via a court order;
- ☐ No form of collateral is realisable or proceeds from collateral unable to cover the entire debt;
- ☐ Debtor adjudged insolvent by a court of law;
- ☐ Cost of collecting the debt exceeds the debt itself; or
- ☐ Efforts to collect the debt abandoned for another reasonable cause.

LN No. 37 (2011)

Guidelines on Allowability of Bad Debts

Donations Guidelines



S.15(2)(W): Cash donations to an income exempt charitable organization or to a Minister's approved project are allowable deductions. WEF 01 Jan 2007

Conditions,

- ☐ Organization should be of a public character and established for purposes of poverty relief or education advancement.
- ☐ A proof of donation in form of a receipt and certified by the donation recipient.
- ☐ Proof of donation to be accompanied by exemption certificate and donee's declaration.
- ☐ Not refundable or repayable to the donor.
- ☐ Should not confer any benefit to the donor.

*The Income Tax (Charitable Donations) Regulations,
2007 - LN. No. 101 (2007)*

Non-Deductible Expenses – Sec 16

Expenditure not
incurred in the
production of the
income

Personal expenses

Capital expenses/loss

Expenditure/loss
recoverable under
insurance contract

Income tax/ tax of
similar nature

Interest expenses in
case of thin cap

**Should all the different
income earned in a company
be taxed together?**

Specified Sources of Income



Summary	Details
Rent income	Rights granted for use or occupation of immovable property
Personal income	Employment income/ self employment
	Wife's employment income/ wife's self-employment income
Farming income	Agricultural, pastoral, horticultural, forestry or similar activities
Pension	Surplus funds to an employer in respect of registered pension or registered provident funds
Extractive sector	Income of a licensee from one licence area or a contractor from one contract area as determined in accordance with the Ninth Schedule.
Other business income	Other sources of income chargeable to tax and have not been taxed in charging sections

Court ruling – MEA vs KRA: Interest is a separate source of income

Tax Rates



Tax Rates



Description		Tax rate (%)
Resident		30
Non-resident		37.5
Newly listed	• 20% issued shares (first 3 years after listing)	20
	• 30% issued shares (first 5 years after listing)	
	• 40% issued shares (first 5 years after listing)	30
		40

Tax Incentive Rates



	Description	Tax rate (%)
Special Economic Zones	<ul style="list-style-type: none">• For the first ten years• For the next ten years• Thereafter	10 15 30
Export Processing Zones	<ul style="list-style-type: none">• First ten years• Next ten years• Thereafter	0 25 30
New company for local assembly of motor vehicles	<ul style="list-style-type: none">• First five years	15
Company that has constructed 400 residential units	<ul style="list-style-type: none">• That year of income	15

Instalment Tax Estimation



Current year
basis {Sec 12
(2) (a)}; or

- the amount equal to the tax that would be payable by that person if his total income for the current year was an amount equal to his instalment income; or

Prior year
basis {Sec 12
(2) (b)}

- the amount specified in the preceding year assessment multiplied by one hundred and ten percent.

Instalment Tax Payment



Instalment Tax	Due Date	% of Tax Payable
1st	20th of the 4th month during the year of income	25
2nd	20th of the 6th month during the year of income	25
3rd	20th of the 9th month during the year of income	25
4th	20th of the 12th month during the year of income	25
Tax Balance	End of the 4th month after the year end	
Self Assessment Return and Compensating Tax	End of the 6th month after the year end	

Thin Capitalisation



Under the ITA, a company is said to be thinly capitalized when it is under the control of a non-resident person, with four or fewer other persons and the ratio of total debt (all loans) exceeds its shareholder equity by more than three times.

Implications of Thin Cap

1. Interest expense is restricted
2. Deferment of foreign exchange losses

Interest expense is restricted for deduction in proportion to the extent to which the company is thinly capitalized as provided under Section 16 (2) (j) of the Income Tax Act (ITA).

Claim of foreign exchange losses arising with respect to a loan from a person who, alone or together with four or fewer other persons is in control of the company, should be deferred until the thin capitalization status reverses.

“all loans” means loans, overdrafts, ordinary trade debts, overdrawn current accounts or any other form of indebtedness for which the company is paying a financial charge, interest, discount or premium;

Thin Cap Illustration



Illustration 1

Loans		Share capital and reserves	
Loan 1	250,000,000	OSC	90,000,000
Loan 2	150,000,000	R. Earnings	10,000,000
Total	400,000,000	Total	100,000,000

Illustration 2

Loans		Share capital and reserves	
Loan 1 (IB)	250,000,000	OSC	100,000,000
Loan 2 (IF)	0	R. Earnings	(150,000,000)
Total	250,000,000	Total	(50,000,000)

Deemed Interest



“....an amount of interest equal to the average ninety-one day Treasury Bill rate, deemed to be payable by a resident person in respect of any outstanding loan provided or secured by the non-resident, where such loans have been provided free of interest.”

Withholding Tax on Deemed Interest

- Rate of Interest is provided by KRA on A quarterly basis
- WHT is computed at the rate of 15%

Sample Tax Computation



2017	KShs	KShs
Profit (loss) per accounts		338,971,000
Add: Depreciation	42,845,592	
Donations	452,500	
Amortisation of lease rentals	38,000	
Pension/ provident fund costs	8,000	
Increase in general provisions (leave, debts)	79,755,273	
Advance tax and Fringe Benefit Tax	229,238	
Tax penalties	23,894	
Capital expenditure	<u>624,642</u>	<u>126,446,224</u>
Less: Wear and Tear allowance	(10,182,219)	
Software allowance	(3,697,086)	
Industrial building allowance	(386,211)	
Investment deduction	<u>(22,437,235)</u>	<u>(36,702,751)</u>
Taxable profit (current year)		<u>428,714,473</u>
Tax thereon (30%)		<u>128,614,341</u>

Recent Emerging Issues



- ☐ Automation, Robotics and Block chain
- ☐ Overhaul of the Income tax Act

Interactive Session



Contacts



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