Taxation in the Agricultural Sector : Key considerations

1

CPA DR. ISAAC K. NAIBEI

Introduction

- The agricultural sector is the mainstay of the economy of Kenya contributing significantly to the GDP (30%) and nearly 80% of employment in Kenya
- It contributes to about 60% of export earnings
- Contributes about 45% of government revenue
- Supplies most of countries food requirements

Introduction cont'd

- Therefore, while taxation is a necessary evil, there should be a good balance between the need to raise funds for the economy but also keeping the sector vibrant

Key tax considerations in agricultural sector

- What is the scope of agricultural sector from the tax point of view?
- What are the taxes applicable in the agricultural sector?
- What tax management strategies are available in agricultural sector?
- What tax liabilities and penalties to watch out for the sector?

Scope of agricultural sector

- Raising livestock, fish or poultry
- Stud farms (for example, breeding horses or cattle)
- Forestry
- Cultivating vineyards, orchards or plantations
- Floriculture

Horticultural sub-sector: matter of emphasis

- This is the most vibrant and fastest growing subsector within agriculture
- Majority of the government revenue and exports from agriculture is actually derived from horticultural sector!

Taxes to watch out for

- Corporate taxes – for agricultural entities operating as companies
- Income taxes for agricultural entities operating in other ownership forms other than body corporates
- PAYE (employment income)
- VAT
- Sales tax for small agricultural entities
- Excise and custom duties

Income taxes (self assessment)

- The self assessment return should be filed by the end of the sixth month after the accounting period.
- 30 June in Kenya is a popular date because majority of companies have their yearend as 31 December.

In arriving at taxable income what are allowable expenses?

- Expenditure of a capital nature incurred during that year of income by the owner or occupier of farm land for prevention of soil erosion (you need to properly document this)
- Capital expenditure on clearing agricultural land or on clearing and planting permanent or semi permanent crops e.g. cashew nuts, coco nuts, tea, coffee etc.

Allowable expenses cont'd

- Capital deductions…to be discussed shortly
- Other expenses incurred wholly and exclusively for the generation of taxable farm incomes.

Provisions and accruals

- All expenses, write offs and provisions should be supported or have a proper reconciliation
- General provisions for debtors are not allowable for tax
- Specific provisions for debtors should be supported

Allowable expenses cont'd

- Capital expenditure, loss, diminution, exhaustion of capital;
- Legal costs and other incidental expenses relating to authorization & issue of shares, debentures or similar securities offered for purchase by the general public;
- Capital expenditure on rating for purposes of listing on security exchange;
- Personal entertainment expenses;

When should the taxes be paid?

- Companies in the Agriculture sector, pastoral and horticultural have the following due dates:
- 75% in the ninth month after the year end
- 25% in the 12th month after the yearend

Pay as you earn (PAYE)

- Agricultural employee is an employee working for agricultural sector including ranches and plantations
- "plantation" includes a forest or timber plantation:
- "agricultural employee" shall not include a director other than a whole time service director:

PAYE

- Are there any serious difference in the way PAYE is administered for agricultural sector?
- No!

PAYE: How do we determine house benefit for agricultural employees?

- The value of premises, excluding the value of any furniture or other contents so provided, for an agricultural employee required by the terms of employment to reside on a plantation or farm shall be deemed to be an amount equal to 10% of the gains or profits from his employment is a taxable benefit

PAYE: Allowances

a) Reimbursable expenses should be treated as non taxable benefits;
b) Support all expenses incurred;
c) Personal entertainment is taxable on the employee;
d) Entertainment of clients is tax allowable;
e) Provision of a car for personal use is a taxable benefit

VAT cont'd

- Check for **Exempt goods** and services in the Agriculture sector listed under the First Schedule Not required to register but input VAT for these goods may actually be a cost.
- Lodge claim for refund of VAT on bad debts
- Confirm VAT status of service or good before raising LPO

Witholding tax

a) Invoices should correctly describe the service provided;
b) Confirm whether tax should be withheld while paying;
c) Tax to be withheld at appropriate rates;
d) Reconcile interest expense and tax withheld;
e) A copy of the exemption certificate to be obtained if a payment is made to an exempt body;
f) Filing of the withholding tax return

Customs and excise duty
General exceptions

a) Seeds for Sowing: All seeds spores and cut plants, imported specially treated, which the relevant authority in the Ministry of agriculture/or relevant in Partner State.

b) Chemically defined compounds used as fertilisers (Upon recommendation of the authority responsible for agriculture in the Partner State.

Customs duty.. General exceptions cont'd

(c) Horticulture, Agriculture, Floriculture inputs (Imported inputs by persons engaged in horticulture, agriculture or floriculture which the Commissioner is satisfied are for use in horticulture, agriculture and floriculture sector)

Note on customs duty

- Confirm correct tariffs codes and duty rule be items before importance
- Proper timing on payment of customs to avoid penalties and demurrage charges
- The company (NOT THE CLEARING AGENT) should be the custodian of custom records.

Double taxation agreements

1. Lower rates for withholding tax are applicable for countries that have DTA with Kenya;
2. Entities to consider DTA while importing any service;
3. Entities to seek tax consultant’s advise before signing treaties;
4. Tax clauses in treaties should be critically reviewed;
5. Consider engaging locally based entities rather than the non-resident head office for multinationals.

Sales tax

- For small businesses 3% of gross revenues is payable as sales tax
- This is paid 20th of the month after a quarter.

Tax planning

- Definition….is the advance assessment of the tax implications on various decision alternatives with the objective of minimizing the burden or maximizing the benefits

Tax planning considerations

- Capital allowances & tax incentives
- Avoiding penalties by compliance & sticking to KRA datelines
- Tax amnesty
- Training
- Engage tax professionals
- Use of lobbies for review of tax laws
- Appeal to tax arbitration bodies
- Review of policies and contracts by tax advisors

Capital deductions: Three key allowances

- Farm works deductions
- Wear and Tear Allowance (WTA)
- Diminution of value of loose tools

Farm works deductions: Definition

- **Farm Works Deductions**: "farm works" means
- farmhouses,
- Labour quarters, and
- 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 .

Farm works deduction: QE

- Farm houses only one third of the initial cost qualifies,
- Other farm works entire expenditure qualifies
- The rate of deduction is 100% on the cost in the year the expenditure is incurred.

Wear and tear deductions

- **Wear and Tear Deductions**:
- This applies to all capital expenditures excluding farm works and loose tools
- WTA for farming entities are classified and treated in same way as in any other business/industry.
- For example tractors are classified as class I and WTD of 37.5% reducing balance allowed as an expense.

Diminution of loose tools

- **Diminution in value of loose**
- **tools**: Reduction in value of tools such as pangas, slashers, rakes, forks shears and others is an allowable expense.

- Question? How do you tell how much of the value has dimished?

Other tax incentives

- Tax losses used to reduce taxable income;
- Tax refunds used to reduce tax payable;
- Lower tax rate on listing at NSE

Carry forward of losses

- Losses from farm operations can be carried forward to reduce tax liability to a maximum of 5 years.

Finally, avoiding penalties

- Tax is a punishment for doing good penalty is a punishment for doing wrong.
- They are all payments BUT you can avoid the later!

Tax crimes

- Tax systems are designed on the basis /assumptions of voluntary compliance.
- Voluntary compliance means that taxpayers are responsible for filing required tax returns and paying correct amounts of tax.

Tax crimes

1. Income tax evasion on unreported cash receipts Farm Produce sales
2. False income tax returns.
3. Failure to file tax returns.
4. Deliberate underreporting/omitting of income.
5. Keeping two sets of books.

Tax crimes

1. Claiming false deductions
2. Hiding or transferring assets or income.
3. Inflated personal/business expenses.
4. Transferring unreported income to tax havens.
5. Using business funds for personal expenses.
6. Paying employees in cash and not remitting statutory deductions.

Tax crimes

- Failure to keep records as prescribed by the Income Tax Act and the Companies Act.
- Maintenance of parallel records with regards to virtually all the items in accounts i.e. purchases, sales, bank statements, etc
- Inflation of expenses
- Creation of huge provisions of specific bad debts.
- Creation of tax losses and abuse of their roll over.

Tax crimes ..

Treatment of private expenses as allowable business expenditure and these are craftily concealed

- Travel allowances.
- Company cars allocated to private use by employees treated as pool vehicles.
- Untaxed housing benefit.
- Over expenditure on business entertainment that is allowable.

Tax crimes

- It is good to know what constitutes a crime so you know how to commit it and possibly be able to appreciate the consequences

Bonus for thought

Taxation issues at county level

- The Public Financial Management Act allows Counties to set up finance bills that cover revenue generating activities of the county.
- The scope of what taxes they may levy on agriculture is not clear.

Conclusion

- Agriculture is a very important sector of Kenyan economy. It should be promoted to thrive through fiscal and other policies.
- This should be done in such a way that it does not compromise government revenues through taxes.
- **How should both the National and County Government use tax to promote Investment inAgriculture in Kenya?**

See what I think

- Reduce the tax rate of 30% to say 25%
- Have more zero rated than exempt inputs and agricultural products
- Harmonize all the taxes both at national and county
- Offer more incentives on imports for agriculture, farm machinery
- Promote export of agricultural produce

- Q&A

Who is he

- Dr. CPA Kiprotich Isaac Naibei
- Is a Senior Lecturer of Accounting at the University of Kabianga and HOD of Accounting Finance and Economics Department
- 0721520089/073295400
- inaibei@kabianga.ac.ke

- THANK YOU!