Emerging tax implications issues and compliance

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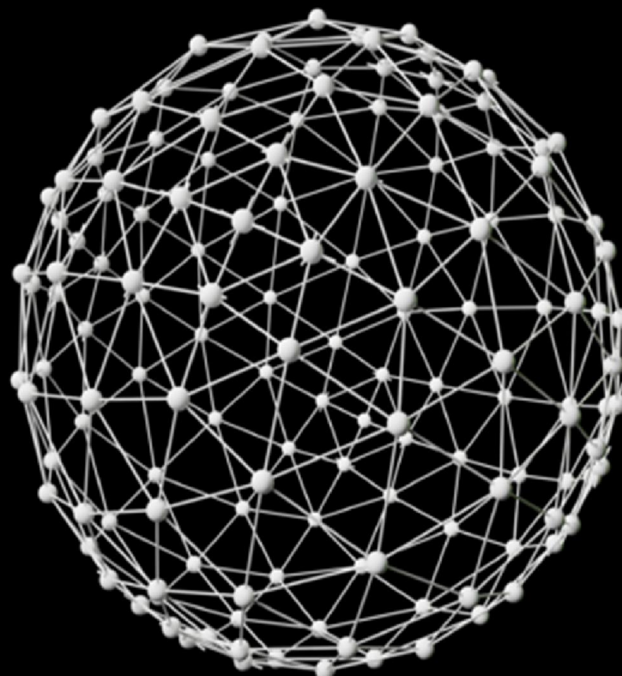
Finance Bill 2018



Corporate Income Tax

- Manufacturers to be eligible to claim an additional 30% of their electricity bills subject to conditions set by the Ministry of Energy.
- Clarification that transfer of property by general insurance companies to be taxed as capital gains.
- Deemed dividends to include distribution of any cash or assets to a shareholder or person related to the shareholder, discharge of any obligation or settlement of debt on behalf of a shareholder or use of any amount for the benefit of the shareholder or related person.
- Replacing the compensating tax provisions with corporate tax on dividends paid out of untaxed profits.

Withholding Tax

- Withholding tax of 20% introduced on demurrage charges paid to non-residents.
- 5% withholding tax introduced on insurance premiums paid to non-residents excluding insurance premiums paid for insurance of aircrafts

Presumptive Income Tax

- Presumptive tax of 15% of the business permit or license fee introduced for businesses whose turnover is below KES 5 Million per annum.
- Does not apply to corporate entities; rental income or income from management and professional services.

PAYE

- The proposal to introduce a 35% tax rate on individuals earning more than KES 750,000 per month under the draft Income Tax Bill 2018 has been dropped. The current top rate of 30% will be maintained.
- Amendment of the Employment Act to introduce a 1.0% contribution on employee's gross monthly salary and a matching contribution by the employers to go into the National Housing Development Fund.

Tax Amnesty

- The period of tax amnesty on foreign incomes has been extended from 30 June 2018 to 30 June 2019.
- Under the tax amnesty, only income accrued up to 31 December 2017 is eligible. The returns and accounts for the year 2017 have to be filed before the deadline and the income declared must be transferred back to Kenya.
- Funds declared under the amnesty will be exempt from provisions of the Proceeds of Crime and Anti-Money Laundering Act or any other act relating to reporting and investigation of financial transactions. The exemption will not apply to proceeds of terrorism, poaching and drug trafficking.

Tax Dispute Resolution

- Tribunal proceedings shall not be adjourned where a panel member is not available or ceases to be a member.
- Settlement of tax disputes outside the Tribunal is now set to be embedded in law. The time to be taken in such an arrangement shall be excluded from the 90 day period allowed for a Tribunal to issue a ruling.

Tax Administration

Tax Procedures Act

- Late payment interest increased from 1% to 2%.
- Late payment penalty of 20% re-introduced.
- Late filing penalty for individuals reduced to 5% of tax due or KES 2,000 whichever is higher.
- Applications for extension of due dates for tax returns filing to be made at least 15 days before due date for monthly returns and 30 days for annual returns and Commissioner to respond at least 5 days before due date.

Tax Administration

Tax Procedures Act

Late filing penalty for income tax returns:

- For corporate bodies, the penalty will be 5% of tax payable or KES 20,000, whichever is higher, whereas for individuals, the penalty will be 5% of tax payable or KES 2,000, whichever is higher.
- Limited grounds for waiver of penalty or interest, i.e. hardship or equity, impossibility or undue difficulty or expense of recovery.

Tax Administration

Tax Procedures Act

- Objection to an assessment to remain valid where a person applies for extension to pay tax not in dispute.
- Obligations of tax representatives restricted to the specific taxes for which they are appointed.
- New provisions and penalties introduced in relation to unauthorized access or improper use of computerized tax systems.

Stamp Duty

- The Stamp Duty Act to be amended to include exemption from stamp duty on instruments executed for purposes of collection and recovery of tax.
- The Stamp Duty Act to be amended to exempt stamp duty from instruments relating to activities of Special Economic Zones.

Other Key Changes

- The Banking Act to be amended by repealing Section 33B thus lifting the capping of interest rates.
- A Robin Hood Tax at the rate of 0.05% to be introduced on any amounts of KES 500,000 or more transferred through banks and other financial institutions.
- Proposed increase of the capital gains tax rate from 5% to 20% in the Income Tax Bill, 2018 to be dropped.

Value Added Tax

VAT exemption introduced on the following items

- Equipment for the construction of grain storage facilities.
- Additional raw materials for the manufacture of animal feeds.
- Parts imported or purchased locally for the assembly of computers.

Value Added Tax

- Taxable value of mobile cellular to be determined in accordance with the VAT Act.
- Late filing penalty to be moved from the VAT Act to the Tax Procedures Act but penalty remains the same.
- Wheat and barley seed which are currently VAT-able to be exempt.
- Maize (corn) seed to be subject to VAT.
- Garments and leather footwear manufactured in an EPZ to be VAT-able upon importation.
- Transportation of cargo to destinations outside Kenya to be deleted from exempt schedule.
- Alcoholic and non-alcoholic beverages supplied to DEFCO to be exempt.
- Exemption of goods and services for direct and exclusive use in projects under special operating framework with the Government.
- Exemption of postal services (postage, rental of post boxes and mail bags).

Miscellaneous Fees & Levies

- Introduction of export levy on copper waste and scrap at 20%.
- Exemption of goods imported for implementation of projects under special operating framework arrangement with the Government from RDL and IDF.

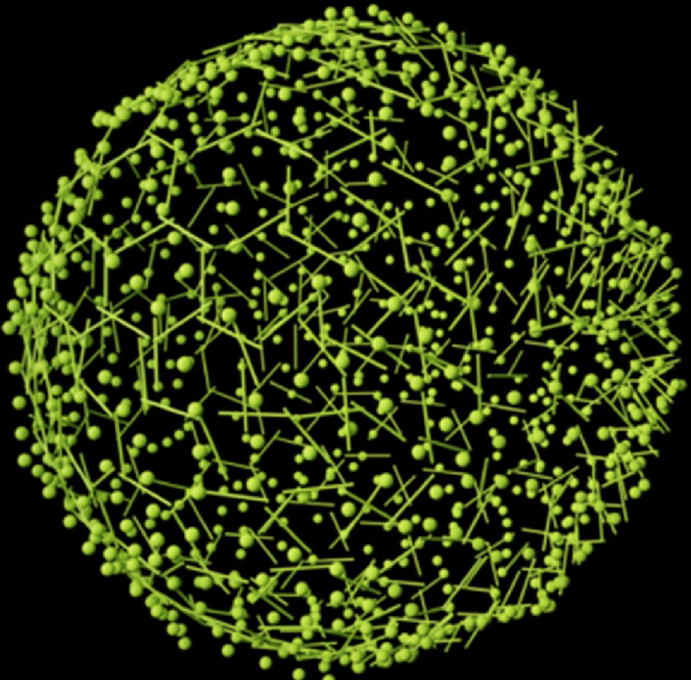
Excise Duty

- Increase of excise duty on:
  - private passenger motor vehicles (diesel powered of above 2500cc and petrol powered of above 300cc) from 20% to 30%.
  - fees charged for money transfer services by cellular phone service providers from 10% to 12%.
  - kerosene from Kshs. 7,205 per 1000 litres to Kshs. 10,305 per 1,000 litres.
- Introduction of a Robin Hood Tax of 0.05% on any amounts of KShs 500,000 or more transferred by banks, money transfer agencies and other financial service providers.
- Introduction of excise duty on sugar confectionery and chocolate at Kshs. 20 per Kg
- Inflationary adjustment of specific rates to be effected annually.

Excise Duty

- 16% of excise duty collected on money transfer services by cellular phone service providers to be paid into the Sports, Art and Social Development Fund.
- Clarification of excise duty on bottled or similarly packaged water.
- Exemption of:
  - Alcoholic and non-alcoholic beverages supplied to DEFCO.
  - Goods procured for direct and exclusive use in the implementation of projects under the special operating framework arrangements with the Government.

Income Tax Bill 2018



Corporate Income Tax

Corporate Income Tax

Rates of Taxation

- Body corporates to be taxed at two rates as below:
  - 30% for taxable income up to KES 500million; and
  - 35% for any income above KES 500 million
- EPZs and SEZs will no-longer enjoy a tax holiday for the initial 10 years/ 20 years. Under the proposed law, EPZs and SEZs will be taxed @10% for the first 10 years, @15% for the next 10 years and @30% thereafter
- A lower rate of tax of 25% to be applied to a newly listed company for the 5 years immediately after listing, provided that the shares listed account for at least 40% of the company’s issued share capital.

Corporate Income Tax

Taxation of Branch

- A branch of a foreign company to be taxed in the same way as a local company. That's, @30% for taxable income up to KES 500 million; and @35% for income above KES 500 million.
- A branch will also be required to pay a 10% tax on the repatriation income, which is a summation of the after-tax profits and any reduction in the net assets of the PE.

	Current Law	Proposed- 2018 tax bill	
Branch taxable income	100,000	100,000	P
Tax rate	37.5%	30.0%	
Tax payable	37,500	30,000	T
Net after tax	62,500	70,000	P
Repatriated tax (assuming the net assets at the beginning of the year is the same as end of the year)		7,000	
Total tax	37,500	37,000	A
Net return to head office	62,500	63,000	
Effective tax rate	37.5%	37.0%	A/P

Corporate Income Tax

Carry forward of tax losses

- The following are the proposed changes with regards to the carry forward of tax losses:
- Extension of the carry forward of tax losses beyond the stipulated period to be capped to 2 years.
- The carry forward of tax losses will not be allowed in the following instances:
  - Where the control of a company changes by more than 50% from the period the tax loss arose; and
  - Where the business changes (whether wholly or in part) in the subsequent periods

Corporate Income Tax

Taxation of a savings and credit cooperative society

- Currently, the income tax law provides for the taxation of the income of a SACCO as below:
  - 50% of the SACCO’s gross income from interest (other than interest from its members);
  - Rental income from use or occupation of immovable and movable property;
  - Capital gains; and
  - Any other taxable income (excluding royalties) not mentioned above.
- Under the ITB , only interest arising from members loans earned by a savings and credit cooperative society (SACCO) shall be exempt from tax.
- In addition to the taxation of a SACCO, the dividends distributed to members will be subject to 10% withholding tax and not 5% as it is currently.

Corporate Income Tax

Deductibility of certain expenses

The following are the key changes regarding the deductibility of expenses:

- No expense shall be deducted if the equivalent amount has not been declared by the beneficiary as income. It is unclear how a taxpayer will determine whether the beneficiary has declared the amount as income or not.
- No deduction shall be allowed in respect of payments made by a taxpayer, which are subject to withholding tax if the taxpayer fails to withhold tax on them as required.
- Donations will only be allowed if made to an institution responsible for the management of a national disaster to alleviate the effects of a national disaster declared by the President or to a person sponsoring sports upon approval by Cabinet Secretary (CS) following recommendation by CS for sports. Donations made in cash to exempt charitable institutions removed.

Corporate Income Tax

Deductibility of certain expenses

- Carry forward of tax losses will not be allowed if there is a change of control by more than 50% or if there is a change of business (whether wholly or in part)
- Disallowable interest due to thin capitalisation to be based on a debt equity ratio of 2:1 as opposed to the 3:1 ratio that applies currently.
- Disallowable foreign exchange losses due to thin capitalisation to be permanently disallowed as opposed to being deferred until the thin capitalisation situation changes.

Corporate Income Tax

Thin capitalisation (further details)

- The following changes have been introduced with regards to thin capitalisation:
- Definition of **"all loans"** has been changed to mean loans only advanced by a non-resident person. This implies that only loans from non-resident persons will be considered while determining whether a Kenyan company is thinly capitalized or not.
- Microfinance institutions to be exempt from the thin capitalization rules
- The definition of **"control"** has been expanded beyond holding of shares or voting rights in a company.
- In the case of holding of shares or voting rights, the threshold reduced from 25% to 20% shares or voting rights in the company. Other added aspects include
  - Advanced a loan of not less than 75% of the book value of the total assets of the other person excluding loans from unrelated financial institutions;
  - Has guaranteed a loan of not less than 75% of the total indebtedness of the other person excluding guarantees from unrelated financial institutions;
  - Is the owner of intellectual property, which the other person wholly depends on for the manufacture, processing or carrying out of business;
  - Supplies 90% or more of the purchases or influences atleast 90% of the sales of the other person and in addition influences the prices and other conditions related to the supply.

Corporate Income Tax

Deemed interest provisions

- Any loan from a non-resident who controls a company will be subject to the deemed interest provisions as long as the interest rate is lower than the market interest rate applicable in the lender's country.
- "Market interest rate" has been defined as the average 91-day Treasury bill rate of interest for the previous quarter.

Corporate Income Tax

Taxation of dividends

- The scope of deemed dividends has been greatly expanded;
- KRA can deem at least 60% of accounting profits as having been distributed if the company does not pay them as dividends
- Payments of dividends to a resident company to be exempt from withholding tax only if the recipient of the dividends owns at least 25% of the paying company.
- Distribution of untaxed profits to be subject to 30% tax.

Corporate Income Tax

Presumptive income tax

- Presumptive income tax on businesses with a turnover of less than KES 5 million has been introduced to replace turnover tax.
- The tax will only be applicable to persons who are issued a single business permit by the County Government.
- It will not apply on incorporated companies, rental businesses or businesses which provide management and professional services.
- Presumptive tax will be final tax and will be payable at the time of payment of the single business permit or renewal of the same.
- The rate of the presumptive tax is 15% of the single business permit fee.
- Replaces turnover tax of 3% of the gross receipts.

Corporate Income Tax

Capital allowances on buildings

Type of building	Allowance under the current law	Proposed allowance
Building used for manufacture	• 100% in the first year of use where the investment is located within Nairobi, Kisumu or Mombasa	• 100% in the first year of use
Commercial buildings	• 25% per annum on straight line. However, the allowance is only available if social infrastructure such as roads, electricity, water and sewerage works are provided	• 10% per annum on straight line. There is no requirement to provide social infrastructure
Petroleum gas storage facilities	• 150% in the first year of use	• 60% in the first year of use and 25% per annum of the residual value in the subsequent four years
Hotel building	• 100% in the first year of use	• 60% in the first year of use and 25% per annum of the residual value in the subsequent four years
Educational buildings	• 50% per annum on straight line	• 10% per annum on straight line
Hospital buildings	• N/A	• 100% in the first year of use

Corporate Income Tax

Capital allowances on machinery and equipment

Type of machinery/ equipment	Allowance under the current law	Proposed allowance
Machinery used for manufacture	• 100% in the first year of use where the investment is located within Nairobi, Kisumu or Mombasa	• 100% in the first year of use
Hospital equipment	• 12.5% per annum on reducing balance	• 100% in the first year of use
Telecommunication equipment	• 20% per annum on straight line	• 10% per annum on straight line
Filming equipment	• 100% in the first year of use	• 50% per annum on straight line
Motor vehicle and earth moving equipment	• 37.5% for heavy earthmoving on a reducing balance • 25% on other self-propelling vehicles including aircrafts on a reducing balance • Restricted cost of private vehicles -KES 2 million.	• 25% per annum on straight line • Restricted cost of private vehicles -KES 3 million
Ships and aircrafts	• 25% on aircrafts on a reducing balance • 12.5% on ships on a reducing balance	• 60% in the first year of use and 50% per annum on the residual value in the subsequent two years.
Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines.	• 30% for Computer and peripheral computer hardware, calculators, copiers and duplicating machines on reducing balance • 20% for software on straight line	• 25% per annum on straight line

Corporate Income Tax

Capital allowances on machinery and equipment – cont'd

Type of machinery/ equipment	Allowance under the current law	Proposed allowance
Furniture and fittings	• 12.5% on reducing balance	• 10% per annum on straight line
Other machinery	• 12.5% on reducing balance	• 10% per annum on straight line
Purchase or an acquisition of an indefeasible right to use fibre optic cable	• 5% per annum on straight line	• 10% per annum on straight line
Farmworks	• 100% on farmworks • 33.3% on farmhouse	• 100% in the first year of use
Rental residential building constructed in a planned development area approved by the Cabinet Secretary	• 25% per annum on straight line	• 25% per annum where roads, power, water, sewers and other social infrastructure have been provided by the person incurring the capital expenditure; and • 5% per annum on straight line where the social infrastructure has not been provided
Implement, utensil or similar article, not being machinery or plant	• 33.3% per annum on straight line (although the law does not specify this rate)	• 25% per annum on straight line.

Corporate Income Tax

Tax on capital gains

The Bill proposes the following key changes in respect of tax on capital gains:

- Increase of the rate of tax on capital gains from 5% to 20%;
- Introduction of indexation, which eliminates the effects of inflation in the computation of capital gains;
- Use of the First-In-First-Out (FIFO) rule while determining capital gains arising from the transfer of shares.
- Expanding the provisions relating to tax on capital gains to members clubs and trade associations, which are only taxable if certain conditions are fulfilled;
- Capital gains arising from the transfer of property to a real estate investment trust (REIT) to be exempt from tax; and
- Removal of the requirement to apply for the exemption from tax on capital gains where a transfer of property is necessitated by restructuring of corporate entity, where such transfer is:
  - A legal or regulatory requirement; or
  - as a result of a directive or compulsory acquisition by the government

Corporate Income Tax

Tax on capital gains- worked example- Indexation

	Current Law	Proposed- 2018 tax bill	
Acquisition Cost in 2012	100,000.00	100,000.00	
Indexation		800,073.44	AC=(MP*CPIA)/CPIT
Adjusted cost	100,000.00	800,073.44	
Sales proceeds April 2018	1,000,000.00	1,000,000.00	
Gain	900,000.00	199,926.56	
CGT	45,000.00	39,985.31	

	AC	Adjusted cost
	MP	Transfer Value
152.51	CPIA	Consumer Price Index for the month prior to acquisition- Dec 2014 for property acquired prior to January 2015
190.62	CPIT	Consumer Price Index for the month prior to transfer- March 2018

Corporate Income Tax

Provisions relating to exemption of income from tax

- The income of a person shall only be exempt from tax if the exemption is provided under the proposed law. (The current income tax law recognizes exemptions provided under any other law).
- The list of income that is exempt from tax has also been greatly reduced in the proposed law. Some of the exemptions in the current law that have been removed in the proposed law include:
  - Exemption from tax for various parastatals;
  - Interest on a savings account held with the Kenya Post Office Savings Bank; and
  - Interest income arising under the financial arrangements made or guaranteed by the Export-Import Bank of the United States, an agency of the United States of America.

Corporate Income Tax

Limitation for the application of a double tax treaty

- The Bill proposes to expand the limitation for application of a double tax treaty and entirely exclude the below persons (in the other treaty partner state) from benefiting from a double tax treaty:
- A person operating as a holding company;
- A person providing overall supervision or administration of a group of companies;
- A person providing group financing (including cash pooling); or
- A person making or managing investments.

Corporate Income Tax

Transitional provisions

- The following key transitional clauses have ben provided in the proposed law:
- Any exemption granted under the current income tax law shall remain in force for up to 3 years from the date of commencement of the proposed law.
- Any unclaimed capital expenditure/ tax written down value immediately prior to the commencement of the proposed law shall be deemed as the residue for the purposes of the new Act.
- All subsidiary legislations under the current income tax law (such as rules) will remain in force as long as they do not contradict the main sections of the new law until such time that new subsidiary legislations are made.

Pay As You Earn

(PAYE)

Permanent Home

- The Income Tax Bill introduces the definition of 'permanent home' as the place where a person lives in or is available to him for purposes of residing while in Kenya, or the place where his personal and economic interest lie.

- This definition implies that Kenyan citizens can now break residency for tax purposes if they are deemed not to have a permanent home in Kenya and no personal and economic interests.

- Implication - Kenyan citizens who do not qualify as tax residents will not be required to file tax returns or pay tax for income derived from outside Kenya.

Taxation of per-diems and ESOPs

Tax Bill seeks to align non-Taxable per-diems to Public Service Prescribed Rates

- Current Income Tax Act, caps the non-taxable subsistence allowance to KES 2,000 per day

Tax bill clarifies taxable benefit for Employee Share Options will accrue at date of exercising the option

- Current Income Tax Act provides for taxation of the benefit at the end of the vesting period

Non-Resident taxation on rent, pension and retirement annuities

Non-resident tax rate in respect of rent, premium or similar consideration for the use or occupation of moveable or immovable property will be at 20%

- Under the Current Income Tax Act, the rate of tax for rent, premium or similar consideration for the use or occupation of moveable or immovable property is set at 15% and 30% respectively.

Taxation of non-resident individuals pension or retirement annuities increased at 10%

- The current Income Tax Act provides for taxation of the pension or retirement annuities for non-resident individuals at 5%

Termination Compensation and Non-Cash benefits

Termination compensation pay to be taxed by spreading it evenly over the unexpired period of the contract, whether or not this is provided for in the contract.

- Current Income Tax Act provides for different tax treatment depending on contractual terms as follows:
- Specified term: compensation is spread equally over the unexpired period;
- Unspecified term :compensation is spread evenly based on last payment

The Income Tax bill introduces the taxation of all non-cash benefits without any minimum threshold by removing the provision under section 5(2)(b) of the Current Income Tax Act.

- Section 5(2)(b) of the current Income Tax Act sets the tax-free non-cash benefits at KES. 3,000 per month

Exempt Bonuses and overtime payments

Exempt bonuses and overtime payments have been capped in the Income Tax Bill to the individual's earnings before the incorporation of bonuses and overtime.

- Current Income Tax Act has no cap on bonus and overtime payments, hence employer's can use this as a tax planning opportunity to avoid/reduce taxes.

Taxation of Foreign Pension and Medical Insurance Cover

Pensions earned in respect of employment services offered in other EAC states will not be taxable in Kenya.

Additionally, medical benefits under cover of non-resident insurance schemes not registered with Insurance Regulatory Authority (IRA) Insurance will not be a taxable benefit.

The age limit for medical cover benefit for an employee's dependents has also been increased from 21 years to 24 years.

- The current Income Tax the Act is unclear on the taxation of Pensions earned in respect of employment from outside Kenya
- Medical benefits under cover by insurance schemes not registered with the Insurance Regulatory Authority (IRA) are also considered a taxable benefit; and
- The age limit for medical cover beneficiaries is 21 years

Home Ownership Saving Plan (HOSP) removed

The new bill has removed this incentive. It is not clear what motivated the removal considering that affordable housing is part of big 4 agenda. The change comes at a time when there is a proposal to double the amount to KES 96,000 per annum.

- The Current Income Tax Act provides for deduction of up to KES 48,000 per annum or KES 4,000 per month into an approved HOSP by a depositor. Plan should run for 10 years and the deposit should be with an approved institution. In addition, from 2007, interest of up to KES 3,000,000 earned on the deposits is tax exempt.

Withholding Tax (WHT)

Proposed changes on WHT…

Important definitions that will impact withholding tax accounting

- “consultancy fees” definition now explicitly excludes payment made under contract of service - It aims to clarify that PAYE as opposed to withholding tax should be applied on such payments.
- “management or professional fees” now includes any other payments incidental to the provision of the services giving rise to the fees.
- “paid” defined to include amount accrued –KRA normally insist that payment is usually the earlier of accrual or actual payment. In a 2012 High Court ruling, it was held that the term “paid” means actual payment and not accrual. This definition appears to reverse the ruling (informally).

Proposed changes on WHT…

- Demurrage charges -The bill defines it as penalty paid for exceeding period allowed for taking delivery of goods or returning of any equipment used for transportation of equipment.The proposed rate is 20% of the gross amount payable;
- Payments by Special Economic Zone (SEZ) Enterprise, Developer or Operator or Export Processing Zone Enterprise to non-residents increased from 0% to 5%;
- Payments by Licensee or contractor to non-resident mining and petroleum subcontractors reduced from 12.5% to 5%;
- The exemption from withholding tax provided to non-resident agents of horticultural exporters for auction and audit fees to a non-resident laboratory or auditor has now been removed and will now be taxed at 20%;
- Commissions paid to non-resident ticketing agent which will now be subject to withholding tax at 20%;
- Distributions of investment income to unit or shareholders of a collective investment scheme, whether resident or non-resident will be subject to withholding tax at 5% and 10% respectively;
- This clarifies the matter and considering that the tax is at favorable rates of 5% for residents and 10% for non-residents, it should be seen as a welcome move.

Proposed changes on WHT…

- Changes affecting payments of royalty, dividends and interest to non-residents by EPZs and SEZs
  - Royalty or natural resource income: 5% from 0%;
  - Dividends: 5% from 0%;
  - Interest: 5% from 0%.
- The threshold for exemption from tax in respect of dividends paid by subsidiaries to local parent Companies increased from 12.5% to 25%.
- Withholding tax on bonus/dividend paid by co-operative societies to resident members increased from 5% to 10%.
- Withholding tax on rent, premium and similar considerations paid to non-residents in respect of both moveable and immoveable property harmonized at 20%;Previously the rates were 30% for immoveable and 15% for moveable;
- Exemption in respect of leasing of locomotives or rolling stocks removed and will now be taxed at 20%.

Proposed changes on WHT…

- The threshold for a payment subject to withholding tax to qualify for withholding tax deduction that was KES 24,000 per month for resident persons has been removed;
- Payments made by a taxpayer subject to withholding tax, if the business failed to withhold tax is now a disallowable expense against corporate tax;
- The withholding tax rate for payments to non-resident television, radio, internet and satellite operators is to be increased from 5% to 10% on the gross amount.
- The threshold for a payment subject to withholding tax to qualify for withholding tax deduction that was KES 24,000 per month for resident persons has been removed;
- Payments made by a taxpayer subject to withholding tax, if the business failed to withhold tax is now a disallowable expense against corporate tax;

Q & A

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