Overview of Taxation of Income & Capital
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Imposition of Income Tax

Imposition of Income Tax

- Tax is charged on the basis of source and/or residence
- Income Tax is charged on all income of a person whether resident or non-resident which accrues in or is derived from Kenya
- For business carried on partly within and partly outside Kenya, the whole of the profit from that business is taxable in Kenya

Charge to tax

Resident companies

A company is resident for any year of income if:

- It is incorporated under a Law in Kenya
- Management and control is exercised in Kenya
- It has been declared resident by a notice in the Kenya Gazette by the Cabinet Secretary for the National Treasury

Charge to tax

Non-resident companies

Non-resident company with a permanent establishment in Kenya:

– A permanent establishment is a fixed place of business e.g. a branch or a Liaison office. A building site, a construction or assembly project which has existed for six months or more is deemed to be a fixed place of business

– Tax on income of such an entity will be determined at the prevailing non-resident tax rate

– The significance of resident and non-residence is that the rates of corporate tax are 30% and 37.5% respectively

– There are other favorable rates to incentivize

Charge to tax

Chargeability to tax – Individuals

- Non-residents - income paid by a resident employer or permanent establishment of a non resident employer
- Resident individuals – Kenya and worldwide employment income

Residence rules for individuals

- Permanent home and presence in Kenya in that year of income
- No permanent home, but:
  - 183 days presence in Kenya in that year of income.
  - 122 days or more in that year and each of the two preceding years

Taxable income constitutes

Gains or profits from:

- Any business
- Use or occupation of property – rent
- Capital gains (effective 1 January 2015)
- Dividends
- Interest

Sundry Income:

- Insurance claims
- Releases from provisions
- Trading receipts
- Balancing charges (business ceased)
- Any other deemed taxable income

- What are your sources of income? Do they constitute taxable income?

- Do you generate any exempt income? And how do you currently treat the exempt income and related expenses for tax purposes?

Ascertainment of Total Income-deductions allowed and deductions not allowed

General rules

- Wholly and exclusively incurred in the production of chargeable income - allowable business expenses
- Not wholly and exclusively incurred in the production of income - non-business expense disallowed
- Revenue expenditure – allowable
- Capital expenditure – not allowable

Allowable deductions

- Bad and doubtful debts (specific)
- Capital deductions
- Advertisements
- Losses of business income brought forward from prior years (carry forward limited to four years from 2010)
- The period for carrying forward tax losses now extended to ten years from the current five years. Taxpayers with huge capital investment had faced a risk of losing the benefit due to the short period of tax loss utilization
- Pre-trading expenses

Allowable deductions

- Repairs and maintenance
- Lease rentals
- Diminution in value of implement, utensil or similar article employed in production of gains or profits (plant and machinery not included)
- Legal costs & incidental expenses for purposes of listing in NSE without raising additional capital
- Manufacturers to be eligible to claim an additional 30% of their electricity bills subject to conditions set by the Ministry of Energy.

Allowable deductions

- Contributions to a registered pension or provident fund
- Legal and incidental costs relating to authorization and issue of shares and securities to the public
- Legal costs and stamp duty relating to leases for premises if the lease does not exceed 99 years
- Non-resident branch taxes where the income is taxable in the hands of the Kenyan parent company
- Cash donations to registered charitable organizations whose income is exempt from tax or any project approved by the Cabinet Secretary for the National Treasury

Allowable deductions

- Capital expenditure on the construction of public schools, hospitals, roads or any similar social infrastructure (CS's prior approval required)
- Expenditure on sponsoring sporting activities with the prior approval of the Cabinet Secretary responsible for sports
- Tax rebate of 50% of the amount of salaries and wages to employer who engages at least 10 university graduates as apprentices for a period of 6 to 12 months
- Donations towards national disasters to be deductible for tax purpose. The donation should be to Kenya Red Cross, County Governments or any other organizations that deal with national disasters. This takes effect from 3rd April 2017 and is meant to address the challenges of famine and drought that the country was facing earlier in the year;

Deductions not allowed

- Capital Expenditure
- Software
- Provisions
- Expenses of personal nature
- Depreciation and amortization
- Contributions to unregistered pension schemes or funds
- Income taxes

Deductions not allowed

- Excess interest under thin capitalization (from 12 June 2010 includes deemed interest on interest free loans)
- Subsidiary or related entity costs
- Trade subscriptions made to trade associations that are not taxed
- Staff medical insurance expenses paid to insurance companies that are not registered with IRA
- Shareholders costs
- Bad debts that do not meet the commissioners guidelines

Capital Deductions

Capital deductions

These are deductions/incentives provided to businesses under the Income Tax Act

They include:

- Investment Deduction
- Industrial Building Deductions
- Commercial Building Deductions
- Mining Deductions
- Farming Deductions
- Wear & Tear Deductions including software deductions

Capital deductions

Wear & Tear deductions

- Capital Deductions on machinery. Machinery includes:
  - Vehicles
  - Ship
  - Aircraft
  - Plant & machinery
  - Software
  - Furniture and fittings
  - Office equipment

Capital deductions

Classes of machinery	Rates (%)
1) Tractors, combine harvesters, heavy earth moving equipment, other self-propelling machines of similar nature (including buses and lorries)	37.5
II) Computer and related hardware, calculators, copiers and duplicating and fax machines	30
III) Other vehicles and aircrafts	25
IV) All other machinery, including ships	12.5

Software

- Prior to 2009 there was uncertainty on claiming capital deductions on software
- Finance Bill 2009 introduced a rate of 5% period between 12 June 2009 and 31 December 2009
- Finance Act 2009 set the rate to 20% but effective from 1 January 2010

Capital deductions

Commercial Building Deductions (CBA)

- commercial building includes a building for use as an office, shop or showroom but does not include a building which qualifies for any other deduction
- Available effective from 1st January, 2013
- Entails capital expenditure on the construction of a commercial building including roads, power, water, sewers and other social infrastructure
- Capital allowance rate -25% applied on a straight line basis

Tax on Residential rental income

Residential rental income

- This is tax payable by resident persons on residential rental income accrued or derived in Kenya where the rent income is between Kshs. 144,000 and Kshs. 10 million per annum.
- The rate of tax is 10% on the gross rent received and is payable when landlords receive rent from their tenants either monthly, quarterly, semi-annually or annually. However, returns must be filed monthly.
- No expenses, losses or capital deduction allowances shall be allowed for deduction from the gross rent.
- Rental Income is filed on or before the 20th of the following month.
- Persons with rental income below Kshs. 144,000 or above Kshs. 10 million per year shall be required to file annual income tax returns and declare this rental income together with income from other sources.

Residential rental income

- Residential rental income is final tax therefore, persons are not required to declare the same in their annual income tax returns.
- For any month that the landlord does not receive any rent he/she shall file a NIL return.
- Date: Returns are filed and tax payable on or before the 20th of the following month.
- Penalty on filing: Whichever is higher of, Kshs. 20,000 or 5% of the due tax is charged.
- Penalty of late a payment: 5% of the tax due and a late payment interest of 1% per month on the unpaid tax until the tax is paid in full.
- There is an option to opt out of this system of paying tax on rental income

Taxation of Capital Gains

Capital Gains Tax

- Capital Gains Tax - Tax chargeable on the ***whole of a gain*** which accrues to a company or an individual on or after 1st January, 2015 on the ***transfer of property situated in Kenya***, whether or not the property was acquired before 1st January, 2015.
- Property includes land, buildings and marketable Securities
- CGT is chargeable at 5% of the ***net gain***, which is a ***final tax***;
- The net gain is the excess of the transfer value over the adjusted cost of the property that has been transferred.
- It is this excess that is subjected to tax at 5%.

Capital Gains Tax

- Incidental costs in making the transfer deductible
- Where no amount is ascertainable as the transfer value, the transfer value shall be the market value as determined by the Commissioner.

The adjusted cost of property is –

- the amount of or value of the consideration for the acquisition or construction of the property;
- the amount of expenditure wholly and exclusively incurred on the property at any time after its acquisition by or on behalf of the transferor for the purpose of enhancing or preserving the value of the property at the time of the transfer;
- the amount of expenditure wholly and exclusively incurred at any time after the acquisition of the property by the transferor establishing, preserving or defending the title to, or a right over, the property, and
- the incidental costs to the transferor of acquiring the property.

Capital Gains Tax

- The adjusted cost computed shall be reduced by amounts allowed as deductions under Section 15(2)
- Incidental Costs - Constitutes expenditure wholly & exclusively incurred by the person acquiring the property or the transferor for purposes of the acquisition or transfer.
- Costs already allowed as deductions in determination of other incomes, are not allowable for CGT.
- Proof of the incidental costs must be provided.

Capital Gains Tax

Capital Loss - If the adjusted cost exceeds the transfer value, a capital loss is incurred.

- This loss can only be offset against a gain from a similar source i.e, another capital gain

Market Value

Where property is acquired or transferred -

  – not at arms length or
  – by way of a gift in whole or in part or
  – for a consideration that cannot be valued or
  – as a result of a transaction between persons who are related, then: -

Capital Gains Tax

- consideration for the transfer = the market value of the property at the time of the transfer OR
- consideration for the acquisition = market value of the property at the time of the acquisition or to the amount of consideration used in computing stamp duty payable on the transfer by which the property was acquired, whichever is the lesser.
- Upon transfer of property, transferor shall complete the relevant CGT declaration form and compute and pay the tax thereon.
- Capital Gains Tax will only be payable after the successful transfer of property on the actual gain realized from a sale.

A transfer

What constitutes a transfer?-para 6 (1) of 8thSch

(a) where a property is sold, exchanged, conveyed or disposed of in any manner (including by way of a gift whether or not for consideration); or

(b) on the occasion of loss, destruction or extinction of property whether or not compensation is received or not ; or

(c) on the abandonment, surrender, cancellation or forfeiture of, or the expiration of rights to property.

No transfer

*Para 6 (2)*outlines situations that do not constitute a transfer for CGT purposes:

(a) transfer only as security to secure a debt or a loan; or

(b) Issuance by a company of its own shares or debentures; or

(c) vesting of property of a deceased person in the personal representative by operation of law ; or

(d) transfer of property by a personal representative to a person as a legatee in the course of the administration of the estate of a deceased person ; or

No transfer

(e) vesting in the liquidator by an order of a court of the property of a company under section 240 of the Companies Act ; or

(f) vesting in the official receiver or other trustee in a bankruptcy of a bankrupt undersection 57 of the Bankruptcy Act ; or

(g) transfer by a trustee of property, to a beneficiary on his becoming absolutely entitled thereto; or

(h) transfer between spouses and immediate family members

Exclusions and exemptions

Exclusions

- Income that is taxed elsewhere as in the case of property dealers- Para 3 (3);
- gain on transfer of machinery including motor vehicles - para 3 (2);

Exemptions

- disposal of property for purpose of administering the estate of a deceased person – para 36 (f) of 1st Schedule
- transfer of individual residence occupied by the transferor for at least three years before the transfer - para 36 (c) of 1st Schedule;

Exemptions

- sale of land by an individual where the transfer value is not more than Kshs. 3m;
- sale of agricultural land by individuals outside a municipality, gazetted townships of less than 50 acres
- exchange of property necessitated by : incorporation, recapitalization, acquisition, amalgamation, separation, dissolution or similar restructuring involving one or more corporate companies which is certified by the Cabinet Secretary to have been done in the public interest
- transfer of investment shares by a body exempted under Paragraph 10 of the 1st Schedule – para 21 (1) of 8th Sch.
- transfer of investment shares by retirement benefits scheme registered with Commissioner (excluding foreign schemes)

Q & A

ICPAK
Uphold Public Interest

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