IFRS NPO Workshop

Taxation and Tax Planning

Presentation by:

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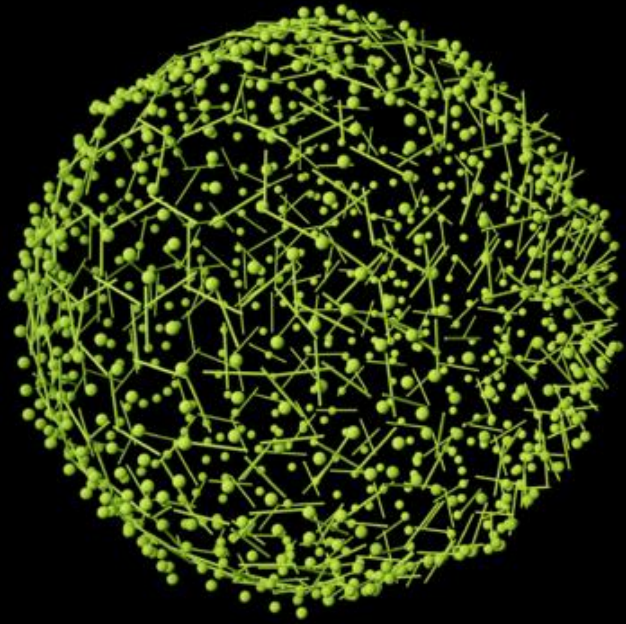
February 2019

Uphold public interest

PAYE



PAYE Content

- Residency rules
- Employee vs. Consultant
- Gross vs net income/emolument
- Taxation of non-cash benefits
- Taxation of terminal benefits

Employee

- Any holder of an office for which remuneration is payable
- Includes an individual receiving emoluments in respect of any employment, office, appointment or past employment

Appointments

- Directors – executive and non-executive
- Directors allowances and benefits – PAYE or WHT?

Casual employee

- One who is engaged for a period less than one month and emoluments are calculated in reference to the period of the engagement
- Regular casual employees are not considered to be casuals

Employer

- Any person paying remunerations
- Any agent, manager or representative of employer who is outside Kenya
- Any trust, insurance or body of persons paying pension

The Agency Burden

- PAYE is the employers responsibility
- Employee is an agent of the government
- The normal PAYE year runs from 1st January to 31st December

Employment Income

Chargeability to tax

- 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

For citizens

- Set off of foreign taxes paid on the same income

Employee Vs Consultant

- There is a thin line between consultancy and employment
- The Income Tax Act does not give much guidelines but according to international best practice, people that carry out work under contract but who are not employees are generally considered self-employed and called independent contractors or consultants.
- A self-employed person or consultant is someone who enters into an agreement for providing services to his or her clients for a fee.
- Is responsible for his or her own tax and social security affairs, and would not be subject to the controls that employed persons may have put upon them by their employer.
- Likewise, a self-employed person would not have the level of security that an employee enjoys under a contract of service.

Employee Vs Consultant

- A person is in 'employment' if he or she has a 'contract of service' with his or her employer.
- Under such an arrangement, the employer will be responsible for deducting PAYE tax from the employee's salary or wages, and remitting the tax deducted to the relevant Revenue Authority (KRA).
- In addition to a regular salary payment, a contract of employment or contract of service normally provides the employee with other cash and non- cash benefits. Such benefits include a guaranteed income, paid leave or holidays, statutory sick pay, maternity pay etc. In essence, under a contract of service, the employer has more control over the duties of the employee and at the same time the employee has a greater level of security.

Employee Vs Consultant

- Some characteristics that may be used as guidance in distinguishing between an independent-consultant from an employee:

No	Independent Consultant	Employee
1	Has control over how and when the work will be carried out and is under no supervision of the organization	Control and manner in which the work is done is dictated by the organization.
2	Not usually required to work at the organization's premises, and his hours of working are not restricted	Required to work on the entity's premises usually on a fixed time basis.
3	The individual is not considered part of the organization. For example, they are at liberty to work for other organizations.	The individual is seen to be part of the organization. He is not free to take-up any other job. They are usually provided with items that are associated with the organization e.g. business cards etc.

Employee Vs Consultant

- Some characteristics that may be used as guidance in distinguishing between an independent-consultant from an employee:

No	Independent Consultant	Employee
4	Not provided with any of those benefits provided to typical employees.	Individual is provided with benefits such as medical, life insurance, club subscriptions, motor vehicle and other such benefits. Also entitled to leave days
5	Usually provides his own tools and equipment for performance of the work.	The employer provides the tools and equipment necessary to carry out the work.
6	The frequency of work is irregular i.e. engaged on assignments basis	The work is usually continuous from one assignment to the other.

Employee Vs Consultant

Characteristics used by KRA to conclude that an employer-employee relationship exists:

- The individual is working for an organization and does not have the risks of running a business
- The employer can tell the individual what work to do, as well as how, where and when to do it
- The individual having to do their work themselves i.e. they cannot hire people to do the work for them
- The employer can move the worker from task to task
- The individual is contracted to work a set number of hours
- There is a regular wage or salary, even if there is no work available

Employee Vs Consultant

Characteristics used by KRA to conclude that an employer-employee relationship exists:

- There are benefits such as paid leave or a pension as part of the contract
- There are bonus payments or overtime pay
- The employer manages anyone else who works for the individual
- The employer provides the individual with equipment, office space and other facilities to carry out the work assigned to the individual
- The person reports to somebody in the organization
- The person holds a title in the organization

Employee Vs Consultant

On the other hand, the KRA generally consider the following characteristics as proof of a principal-consultant relationship:

- That the individual is in business on his or her own account and is responsible for the success or the failure of the business
- That the individual can hire someone else to do the work given to them, or take helpers at their own expense
- That the individual can decide where to provide his services, as well as when and how to do the work given to them
- That the individual is paid an agreed fixed price. It does not depend on how long it takes to complete the job
- That the individual invoices the principal for the services
- That the individual can make a loss or a profit.

Gross Vs Net Income/Emoluments

- Gross pay
- Employee gets a net pay
- Net Pay
- Assumes employer takes care of taxes
- Gross up has to be done correctly
- Split Pay
- Tax implications

Taxation of non-cash benefits

Taxable Income includes:

- All cash emoluments except bonus, overtime and retirement benefits to employees in the lowest tax bracket
- Non cash benefits exceeding KShs 36,000 p.a. in the aggregate, with a few exceptions such as lunch benefit
- Club Subscriptions
- Private expenditure paid by employer e.g. utility bills
- Per diems in excess of Kshs. 2,000 per day

Taxation of non-cash benefits

Fringe Benefit Tax

- Loans at concessionary interest rates
- Loans from unregistered pension or provident fund
- FBT applies even after an employee leaves employment as long as the loan remains un-paid
- Calculated using the 91 day treasury bill rates(market rates of interest)
- Benefit taxed on employer at corporation rate of tax

Taxation of non-cash benefits

Housing Benefit

- Director and a whole time service director:
- Higher of:
  - 15% of total income
  - Fair market rental value, and
  - Actual rent paid by employer
- Other employees: 15% of gains or profits from employment or rent paid by the employer (at arm's length), whichever is higher

Taxation of non-cash benefits

Housing Benefit

- Where premises are provided by a third party under an agreement at arm's length, taxable value is as above
- Where premises are provided by a third party under an agreement which is not at arm's length: Taxable value is the higher of fair market value & rent paid by the employer
- Where premises are owned by the employer: Housing benefit is the fair market rental value of the premises
- Occupied for part of the year: to be reduced proportionately
- Occupied part of premises: value to be reduced proportionately
- Rent contribution: to reduce value by amount of contribution

Taxation of non-cash benefits

Car Benefit

- Chargeable benefit for private use shall be the higher of the rate determined by the Commissioner and the prescribed rate of benefit (2% p.m. of the initial cost of the vehicle).
- Where the vehicle is leased or hired from a third party, the benefit will be equal to the cost of hiring or leasing.

Taxation of non-cash benefits

Other taxable Benefit

- Other benefits subject to higher of cost to employer or fair market value.
- Benefits taxed at prescribed rate only – by concession of CIT where the cost or fair market value cannot be determined
- Furniture – 1% of original cost p.m.
- Communal water supply – Kshs.500 p.m.
- Telephone (landline & mobile) – 30% of bills p.m.
- Communal electricity supply – Kshs.1,500 p.m.

Non-taxable benefits

- Leave passages: expatriate employees
- Medical services
- Employer's contribution to pension funds
- Exception: Contributions by non taxable employers:
  - to unregistered schemes
  - excess contribution to registered schemes
- Education fees taxed on the employer
- Reimbursement of expenses incurred by employee wholly and exclusively in production of income
- Lunch benefit subject to a maximum value of KES 4,000 per month

Allowable deductions (Against taxable income)

- Pension contribution – maximum Kshs. 20,000 p.m.
- Home ownership savings plan – maximum Shs.4,000 p.m.
- Owner occupied interest – Maximum Shs.12,500 p.m. (Shs 25,000 p.m. w.e.f. 1 January 2017)

Tax reliefs (Against tax payable)

- Personal relief, KShs 1,408 per month w.e.f 1 Jan 2018)
- Life insurance and education policy – 15% of premiums, maximum KShs 5,000 p.m.
- Exemption of bonuses, overtime and retirement benefits made to low income employees whose income falls in the lowest tax band effective 1 July 2016

Grey Areas

- Shared benefits e.g.
  - Servants
  - Housing
  - Company/Sales vans/cars.
- Benefits provided and used within the employer's premises
- Alarm
- Electricity - shared among employees & between employees and employers

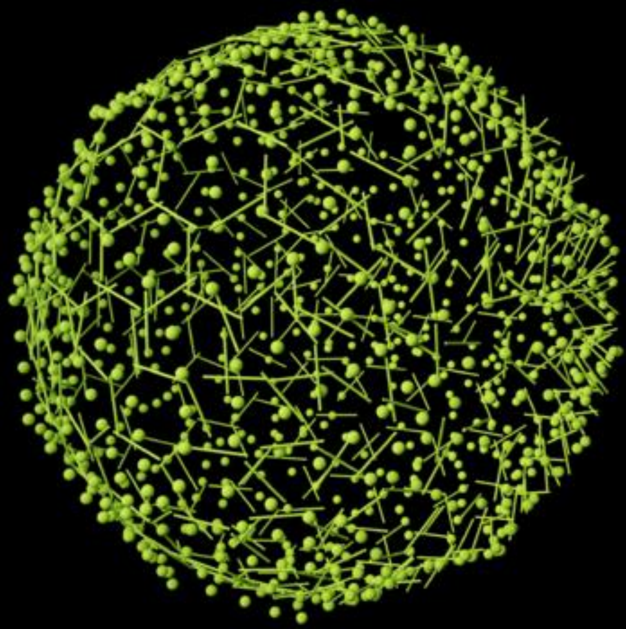
Grey Areas

- Mobile Phones
- Sale of products to staff at cost
- Benefit value is the cost or market price ?
- Employer guaranteed loans
- Employees charged at lower interest rate.
- Passages to destinations other than home country.
- Entertainment.

Tax Planning Ideas

- Maximize reliefs and deductions such as mortgage interest and insurance relief
- Mileage claim vs. car allowance
- Car loan vs. company car
- Reduced rate or motor vehicle benefit – ITA provides for a lower rate of benefit where restricted use of the vehicle can be proved. The Commissioner has also issued guidelines on the supporting information required
- Telephone benefit (scratch cards) – only 30% taxable
- Benefits below threshold
- Per Diems up to 2,000 per day. Excess to be on reimbursement basis or accounted for

Corporation Tax



Content

- Introduction
- Implications of Corporate Income Tax
- Exemptions from Corporate Income Tax
- NPOs – Tax Provisions
- Returns
- Assessments, Objections and Appeals
- Penalties and offences
- KRA in-depth Audits

Income Tax in Kenya

Administration

- Income tax in Kenya is administered by the following government agencies:
- The National Treasury (Formerly the Ministry of Finance); and
- The Kenya Revenue Authority (KRA)

Legislation that governs income tax

- Income Tax Act (ITA)
- Subsidiary legislation - Schedules, Income Tax Rules
- Tax Procedures Act, 2015 (TPA)
- Income Tax Departmental / Administrative instructions
- Case Law

Basis of 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, e.g. transporters and Kenyan incorporated companies with branches (offices) outside Kenya.

Non-Taxable Income

Exempt income under the First Schedule to the ITA; e.g.:

- Income of Govt. Ministries, exempt NPOs
- Income of County Governments
- Income of a registered pension and provident scheme/fund
- Interest earned on a savings account held with the Kenya Post Office Savings Bank
- Interest income from all listed bonds (3-year maturity or more) used to raise funds for infrastructure & social services

Exemption from Corporate Tax

- Section 13 (2) of the ITA states that the Cabinet Secretary in charge of National Treasury may by notice in the Kenya Gazette exempt certain income from tax in respect of income not listed in the First Schedule (of the ITA)
- Paragraph 10 of the First Schedule of the Income Tax Act provides that:
- the income of an institution, body of persons, or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education:-

  (a) established in Kenya; or

  (b) whose regional headquarters is situated in Kenya
- in so far as the Commissioner is satisfied that the income is to be expended either in Kenya or in circumstances in which the expenditure of that income is for purposes which result in the benefit of the residents of Kenya
- Bilateral Agreements and Double Tax Agreements may also provide for exemption of certain incomes from tax

Exemption from Corporate Tax

- Gains or profits from a business shall be exempt from tax where:
  - the gains or profits are put to use solely for the mentioned purposes and either -
    - » the business is carried on in the course of the actual execution of those purposes; or
    - » the work in connection with the business is mainly carried on by beneficiaries under those purposes; or
    - » the gains or profits consist of rents (including premiums or similar consideration in the nature of rent) received from the leasing or letting of land and chattels leased or let therewith

Exemption from Corporate Tax

- KRA issued a public notice on 16 February 2010 stating that all exemption certificates issued under Paragraph 10 of the First Schedule in the ITA that did not have expiry dates were rendered effectively invalid immediately
- The public notice stipulated that interested parties should apply for exemption certificates afresh and that these shall be valid for a period of 3 years. However, the Finance Act 2013 increased the validity period to 5 years
- Where an applicant has complied with all the requirements, he will be issued with an exemption within sixty days of the lodging of the application
- Prior exemptions covered investment incomes i.e. interest and dividend income. However the new legislation is silent in this area

Procedure for Exemption

- Review whether the exemption is covered under either:
  - Bilateral or Double Tax agreements; or
  - Paragraph 10 of the Income Tax Act
- Where one qualifies under option 1 (a) above – then there is no requirement to make the application as one automatically qualifies.
- Where you fall under category 1 (b) above – you are required to make a formal application for exemption to the relevant KRA policy unit station
- The KRA to conduct a comprehensive tax audit to ensure that the organization complies with all relevant legislation i.e. PAYE, Withholding Tax
- Where KRA is satisfied that the organization is fully complaint with all tax heads they will then issue the exemption certificate
- Application for renewal of this certificate to be done after every 5 years. In practice, this application must be made 6 months prior to the expiry of the existing exemption status

KRA Requirements First Time Applicants

KRA requires the following information for first-time applicants:

- A letter of application for Income Tax exemption status
- Returns of income and audited accounts
- Copies of the bank statements – for at least 6 months
- Constitution or Trust Deed
- A letter from the representative of Central Government stating the activities carried out by the organization
- Registration certificate
- PIN Certificate
- Evidence of the projects carried out for the last 3 years or for whatever period of operation
- Any other useful information in support of the application

KRA Requirements Renewal Cases

The following information is required for renewal cases:

- A letter of application for Income Tax exemption status
- Returns of income and audited accounts
- Copies of the bank statements
- Proof of the projects carried out for the last 3 years
- Any other useful reconfirming information in support of the application

Tax Risks for NPOs

- **Exemptions:** not understanding scope of tax exemptions or not adhering to the requirements or required processes, especially as regards KRA. Failure to lodge correct paperwork could invalidate the exemption
- **Compliance:** organizations failing to submit returns where required e.g. Corporate Income Tax returns required, even if there is no taxable income to report. VAT returns also required if you are VAT registered, even if VAT registration is done in error
- **Agency taxes:** Withholding Taxes and PAYE obligations typically not covered by exemptions, unless there is a specific provision in the ITA or government agreement. Tax not withheld becomes responsibility of withholding 'agent'. Examples of such cases:
  - Failure to account for withholding tax on payments to research consultants based in Kenya or outside Kenya
  - Failure to account for PAYE on benefits provided to staff e.g. unaccounted per diems, pension contributions made by the organization to an unregistered pension schemes etc.
- **Penalty regime:** the penalties and interest charges are onerous, even where a genuine mistake has been made. Waiver applications to the Cabinet Secretary for the National Treasury take a long time to resolve

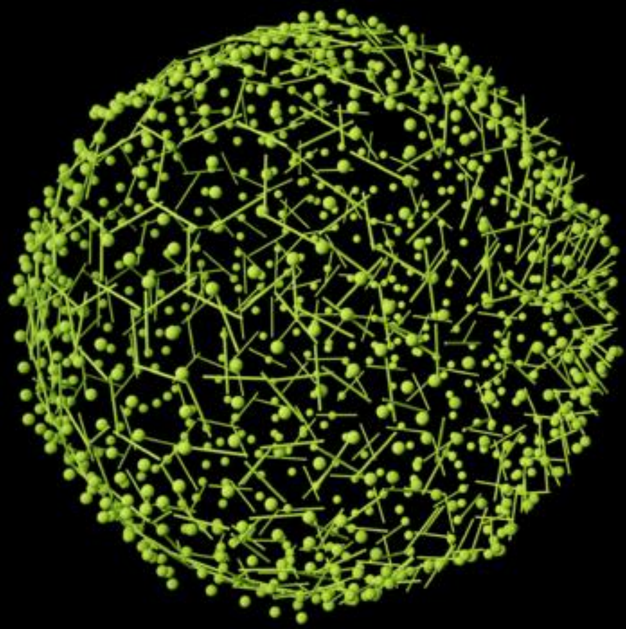
Managing your Risks

- Make sure you know ALL about your various tax obligations – it is not enough to do what others are doing. Remember items like NHIF, NITA, NSSF etc. Please obtain specific advice based on your circumstances
- Meet all tax compliance deadlines – the penalties are harsh
- Regarding prior year activities, carry out a tax health checks to identify non-compliance issues that you may not be aware of. Consider options for dealing with the tax exposure. The earlier the problem is identified, the better!
- Keep up to date on tax matters and changes to legislation that impact you e.g. on pension, schooling benefit etc.

Tax Offences and Penalties

Offences	Penalties
1. Late submission of the self assessment return	5% of Tax outstanding at the self assessment date-minimum of KES.20,000
2. Omission of income or fraud in a return	75% of the resultant tax underpayment in case of fraud or deliberate omission; or 20% of the resultant tax underpayment if the omission was not deliberate. Penalty for a second repeat offence increases by 10%. For a third or subsequent repeat offence, the penalty increases by 25%
3. Late payment penalty	20% of the tax involved
4. Late payment interest	1% per month of the tax involved
5. Penalty for failure to keep/maintain documents	10% of the tax payable or KES 100,000 where no tax is payable.
6. Late submission of a document required to be submitted other than a return	KES 1,000 for each day of delay/default subject to a maximum of KES 50,000.

Withholding Tax



Introduction – Principles of WHT

- Is an agency form of tax where a person making certain types of payments which are income subject to tax in Kenya is required to deduct tax therefrom and remit the tax deducted directly to the KRA
- The person who is required to withhold tax on a payment is called a **payer** while the person who is entitled to receive a payment which is income subject to withholding tax is the **payee**
- Withholding tax is not an additional tax. Rather, it is a payment of tax in advance on the income of the payee
- Where w/tax is not final tax, the tax should be claimable by the payee if the payee is resident in Kenya or is a PE of a non-resident person
- W/tax achieves the following:
  1. Curbs tax evasion
  2. Reduces tax administration costs, and
  3. Manages a country's cash flow

Payments subject to WHT

Payments to Residents and PE

- Management or professional fee whose value exceeds KES 24,000
- Training fee
- Dividend
- Interest and deemed interest
- Royalty and natural resource income
- Rent on commercial property
- Pension/retirement annuities

Payments to Non - Residents

- Management or professional fee
- Training fee
- Royalty and natural resource income
- Rent for use or occupation of property
- Dividend
- Interest and deemed interest
- Payment to sportsmen or entertainers
- Telecommunication service fees
- Pension/retirement annuities

Withholding Tax Rates

Description	Resident rate (%)	Non - residents rate (%)
Dividends > 12.5% voting power	Exempt	10
< 12.5% voting power	5	10
Interest - Housing Bonds	10	15
- Government bearer bonds 2 years and more	15	15
- Other interest	15	15
Insurance commission		
- Brokers	5	20
- Others	10	20
Royalties and natural resource income	5	20
Sporting or entertainment income	-	20
Pension/retirement annuities	0 to 30	5
Telecommunication service fees	-	5

Withholding Tax Rates

Description	Residents (%)	Non-residents (%)
Rent / leasing – Immovable property	10 (a)	30
- Others	-	15
Management, professional (other than contractual) & training fees	5	20 (b)
Contractual fees	3	20

a) Rent payable to resident persons for use of immovable commercial property to be liable to 10% w/tax with effect from 1 January 2017. Withholders of such tax to be appointed by KRA

b) Payment of consultancy fees to **individuals** of the EAC partner states liable to w/tax at 15% and not 20%

Withholding Tax Rates

Residency country	Dividends	Interest	Royalties	Management fees
Canada	10	15	15	15
Denmark	10	20	20	20
France	10	12	10	0 or 20% (a)
Germany	10	15	15	15
Mauritius	5 or 10 (b)	10	10	0 or 20% (a)
India	10	15	15	17.5
Norway	10	15	20	20
Sweden	10	15	20	20
South Africa	10	10	10	0 or 20% (a)
United Kingdom	10	15	10	12.5
Zambia	0 or 10 (c)	15	15	15

a) The DTT between Kenya and France/South Africa and Mauritius do not have an article on management fees. Still not very clear whether rate should be 20% or 0%

b) If the beneficial owner is a company that holds at least 10% of the paying company's capital, w/tax should apply at 5%

c) Where dividends are paid to persons resident in Zambia, no dividend w/tax should be applied if the dividends are subject to tax in Zambia

- **Need to be aware of the unilateral LOB provision – Section 41 (6) of the ITA**

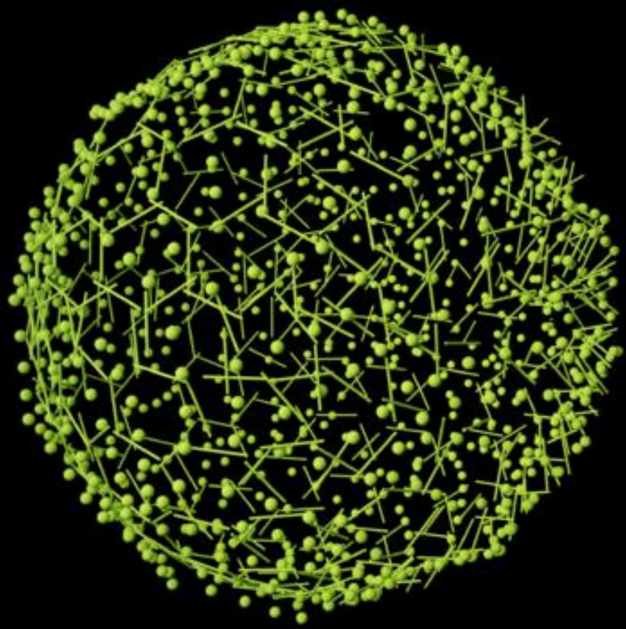
Obligation to deduct

- Section 35 of the ITA provides an obligation to the payer to deduct tax on eligible payments for payment to KRA directly
- Failure to deduct tax on an eligible payment and remittance of the

Withholding Tax Administration

- WHT is due by the 20th day of the month following the month of deduction.
- Upon deduction and payment of WHT, a person is required to keep a record of the name of the payee, PIN, gross amount paid, nature of payment and amount of tax deducted
- Withholding tax accounting is now supposed to be fully done through iTax platform
- Upon paying the tax, the iTax platform should generate a certificate that should be sent to the payee to enable the payee claim credit against income tax
- Annual w/tax return – A withholding tax return needs to be filed with KRA by the end of February of the following year. The return summarizes all payments made in the prior year

VAT



Introduction

- VAT is chargeable on taxable supplies or importation of taxable goods and services
- Applicable VAT rates; zero or 16%
- Certain items also exempt from VAT
- Registration threshold – taxable supplies of KES 5 million (app. USD 50,000)
- Registered person liable to charge and account for VAT on taxable supplies

VAT status of supplies by NPO

Exempt supplies?

- The supply of social welfare services by charitable organizations is exempt. This is on condition that:

1. The charitable organizations are registered as such; or
2. Such charitable organizations are exempted from registration by the Registrar of Societies or by the Non-Governmental Organizations Co-ordination Board and their income is exempt from VAT under Para 10 of the First Schedule to the Income Tax Act (ITA).
   - Para 10 exempts the income of an institution, body of persons or irrevocable trust, of a public character established solely for the purpose of relief of the poverty or distress of the public.
   - Generally, gains or profits from business are not exempt unless solely applied for the above referred purpose.

VAT status of supplies by NPO

Taxable supplies?

- VAT is applicable where social welfare services are rendered by way of business.

- Business defined to include:

- Trade, commerce or manufacture, profession, vocation or occupation;
- Any other activity in the nature of trade, commerce or manufacture, profession, vocation or occupation;
- Any activity carried on by a person continuously or regularly, whether or not for gain or profit and which involves in part or whole, the supply of goods or services for consideration;
- A supply of property by way of lease, license, or similar arrangement.

- Important to note that, while ITA may exempt gains or profits from business, VAT Act considers such income as subject to VAT.

VAT status of supplies by NPO

Taxable supplies or importations by the following privileged persons or institutions are zero rated for VAT:

- Goods consigned to Commonwealth and other governments for personal use or consumption by officials or men on board a naval vessel
- Diplomats and first arrival persons – household and personal effects including one motor vehicle
- Taxable supplies for the use of the United Nations or its special agencies
- Donor agencies with bilateral or multilateral agreements - mainly covering household and personal effects of entitled persons
- Supplies to international and regional organizations – including donor agencies, organizations with diplomatic accreditation or bilateral or multilateral agreements
- Relief goods supplied or imported for emergency use
- Supplies to National Red Cross Society and St. John Ambulance

Process of applying for Zero rating/Exemption

Application

- Application to relevant government ministry
- Should be in the prescribed form
- Mainly accompanied by a proforma invoice

Approval by Ministry

- Mainly the National Treasury or Ministry of Foreign Affairs approves the application

Submission to KRA

- Approved application is forwarded to KRA for verification and approval

Approval by KRA

- KRA verifies and approves application.

Potential VAT issues for NPO's

- Delayed approvals
- How to recover VAT already paid to suppliers prior to obtaining approvals
- Adoption of zero rating/exemption without proper backing of the law
- Conflict of Host Country Agreements with the provisions of the VAT law
- KRA audits and disputes?
- Any other?

Q & A

Contact details

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