



# CORPORATION TAX

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# Presentation Outline



- ☐ Taxation of corporate entities
- ☐ Allowable and disallowable expenses
- ☐ Thin capitalization and deemed interest
- ☐ Excess pension contributions
- ☐ Case studies
- ☐ Recent changes and emerging issues



# Taxation of corporate entities

# Charge to Tax



All the income of a person, whether resident or non-resident, which accrued in, or was derived from Kenya

# Income subject to Tax



1. Gains or profits from business and royalty
2. Dividends or interest
3. Pension, charge or annuity, withdrawals of schemes
4. Rental income
5. Agricultural income
6. Amount deemed to be the income of a person
7. Capital gains
8. Net Gain from disposal of interest in a person if the interest derives more than 20% of its value from immovable property
9. Natural resource income

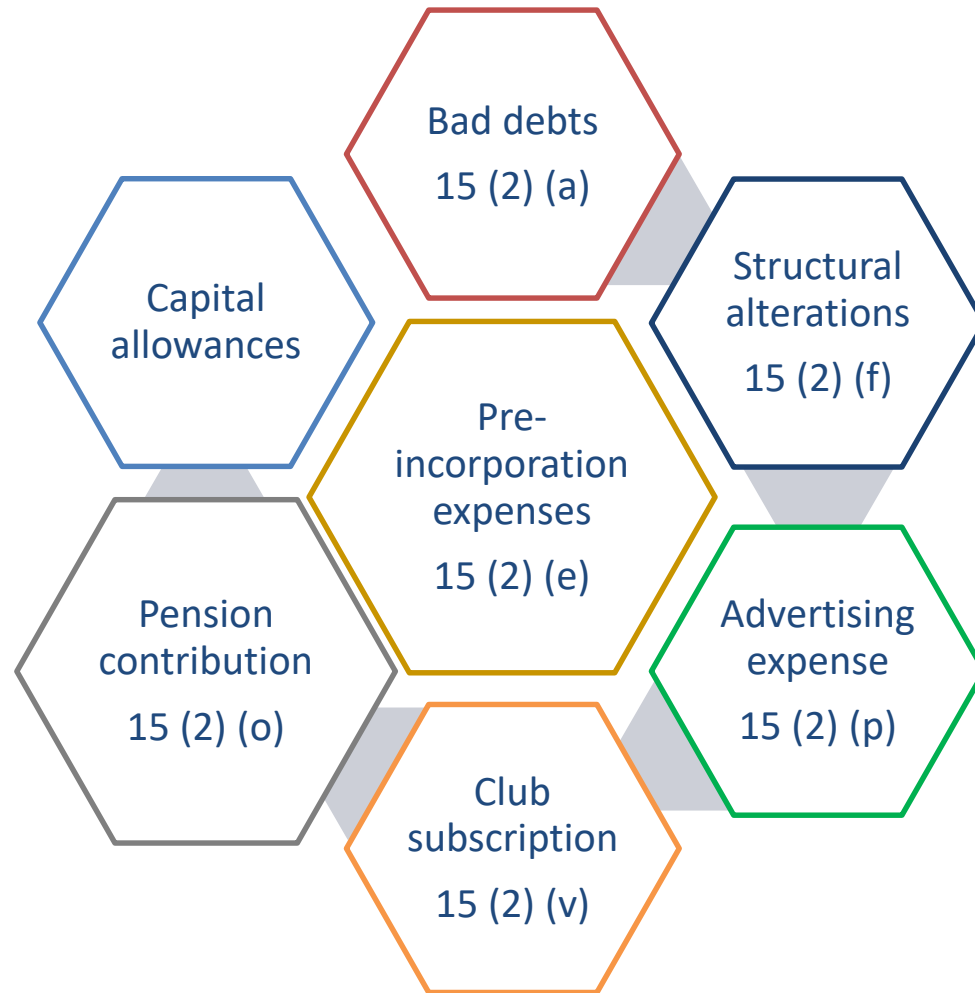


# Allowable and Disallowable Expenses

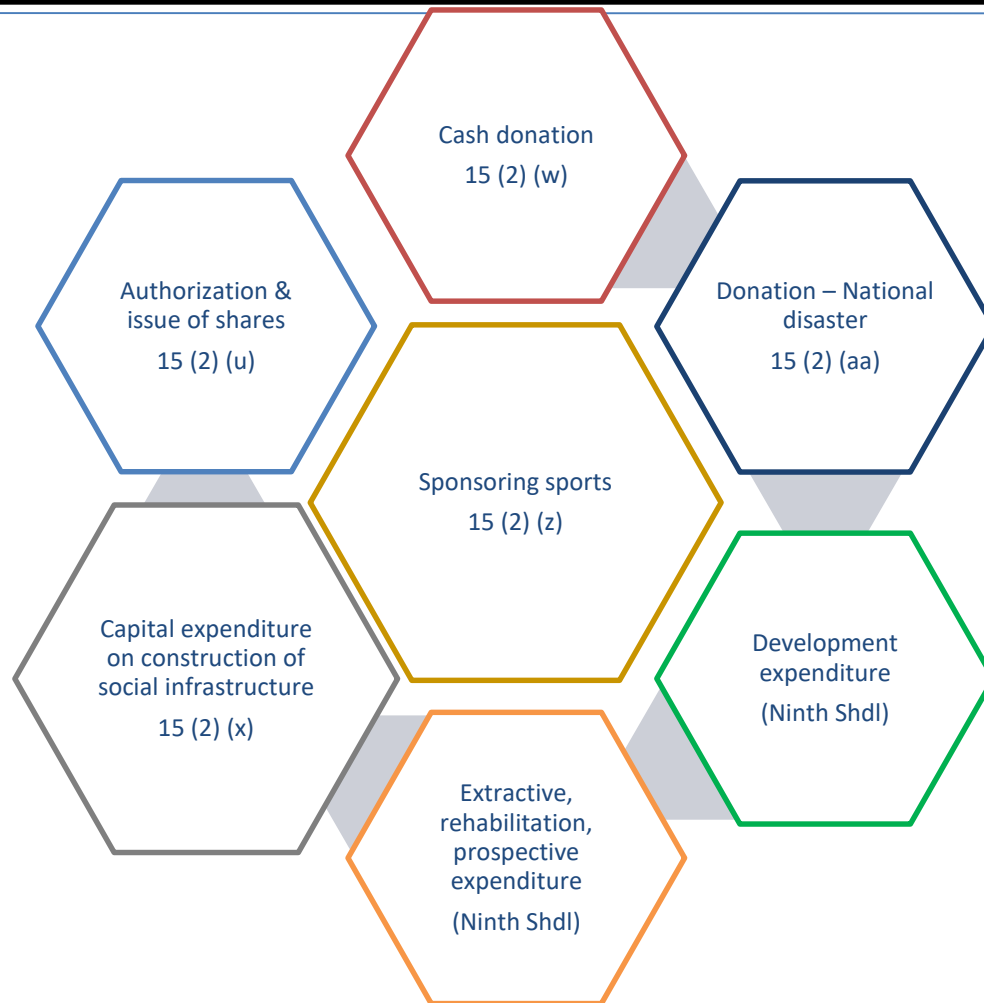
# Allowable Expenses (Sec 15)



Expenditure wholly  
and exclusively  
incurred in the  
production of  
income



# Allowable Expenses (Sec 15)





# Allowable Expenses (Sec 15)

## Guidelines on bad debts



A bad debt shall be deemed uncollectible where:

- ☐ The creditor loses the contractual right that comprises the debt through a court order;
- ☐ No form of security or collateral is realizable;
- ☐ The securities or collateral have been realized but the proceeds fail to cover the entire debt;
- ☐ The debtor is adjudged insolvent or bankrupt by a court of law;
- ☐ The costs of recovering the debt exceeds the debt itself;
- or,
- ☐ Efforts to collect the debt are abandoned for another reasonable cause

# Disallowable Expenses (Sec 16)



# Capital Allowances (Investment Deduction)



## Qualifying costs

Construction of a building & installation of new machinery

Installation of new machinery in a building  
– does not apply if replacement

Lease of building or machinery for purposes of manufacture

# Capital Allowances (Investment Deduction)



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

# Capital Allowances (Industrial Building Allowance)



**A building  
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

# Capital Allowances (Industrial Building Allowance)



Civil works  
for IBA  
include:

Roads and parking areas

Railway lines and related structures

Water, industrial effluent, sewerage works

Communication/ electrical posts/pylons and other  
electrical supply works

Security walls and fencing

# Capital Allowances (Industrial Building Allowance)



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

# Capital Allowances (Wear & Tear Allowance)



Qualifying expenditure	Rate (%)
Heavy self-propelling machinery	37.5
Computer and peripheral computer hardware, calculators, copiers and duplicating machines	30
Other self propelling vehicles and aircrafts (cost of non-commercial motor vehicles is restricted to KShs. 2 million)	25
All other machinery: includes ships and Petroleum pipeline	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)	20
Concession arrangements (Para 31A) – spread over the period	



# Farm Works Deduction



## Conditions

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%



# Thin Capitalization & Deemed Interest

# Thin Capitalization



## Arises where:

An entity is controlled by a non-resident

The ratio of debt to equity exceeds 3:1

## Consequences

Interest restriction – Disallow excess interest expense

Deferral of foreign exchange losses till the thin cap situation reverses

# Deemed Interest



## Arises where:

An entity is controlled by a non-resident

The entity receives interest free loan from the non-resident related party

## Consequences

The entity is required to compute deemed interest based on the Commissioners' prescribed quarterly deemed interest rates.  
**Deemed interest is not an allowable expense**

# Excess Pension

# Excess Pension Contribution



## Arises where:

Where the total pension contribution by the employee and the employer exceeds the annual maximum allowable limit of **KES 240,000**

## Consequences

The **excess pension** contribution by the employer is disallowed in arriving at the taxable income.

## Example

Staff	E'er Cont	E'er NSSF	E'ee Cont	E'ee NSSF	Total	Tax E'ee	Excess
W	237,600	2,400	237,600	2,400	480,000	Nil	240,000
X	300,000	2,400	300,000	2,400	604,800	62,400	302,400

# Tax Incentives



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

# Income Exempt from Tax



- ☐ Income of county government/some public entities
- ☐ Income of the National Social Security Fund
- ☐ Income of insurance company from the investment of an annuity fund
- ☐ Income of institution of public character for relief of poverty/distress or advancement of education or religion
- ☐ Income of a registered pension/trust scheme
- ☐ The income of a registered pension/provident/individual retirement fund
- ☐ Investment income of a pooled fund registered with the Commissioner
- ☐ Host Country Agreements/ Bilateral Agreements/ DTTA



# Instalment Taxes



Based on:

110% of prior year corporate income tax paid. However, a taxpayer may choose to use current year basis

## Due dates

1st

Due by 20<sup>th</sup> of the 4<sup>th</sup> month following year end

2nd

Due by 20<sup>th</sup> of the 6<sup>th</sup> month following year end

3rd

Due by 20<sup>th</sup> of the 9<sup>th</sup> month following year end

4th

Due by 20<sup>th</sup> of the 12<sup>th</sup> month following year end



# Case Law

# Specified sources of income



Income Tax Appeal No 15 of 2007 MEA Ltd vs KRA

The company lumped together all its income including interest income which ought to be taxed separately

The High Court ruled that interest from fixed deposit accounts is a specified source of income which ought to have been taxed separately



# Recent Changes and Emerging Issues

# Deemed Dividends – Fin Act, 2018



Where the following transactions occur with shareholders or related persons to the shareholder, it shall be deemed to be a distribution of dividends:

- ❑ Assets or cash transferred to shareholders;
- ❑ Company discharges the obligations of the shareholders;
- ❑ Money is spent for the benefit of the shareholder;
- ❑ Debts owned by shareholder is settled by the company; and,
- ❑ Where a Transfer pricing adjustment is done

# Compensating Tax– Fin Act, 2018



- ❑ Previously compensating tax was at the rate of 42.86%
- ❑ There was a requirement to maintain a dividend tax account
- ❑ Compensating tax has been set at the rate of 30% with no requirement to maintain a dividend tax account

# Key Highlights of the Income Tax Bill, 2018



## Tax Losses

### ITB

- ☐ Carry forward for 10 years with an extension for two years
- ☐ Loss can be forfeited if shareholding changes by 50% or a change of business activity

### ITA

- ☐ Carry forward for 10 years
- ☐ Request for indefinite extension
- ☐ No forfeiture of tax loss

# Key Highlights of the Income Tax Bill, 2018



## Thin Capitalization

ITB

- ☐ Loans include only debt provided by non-residents
- ☐ Debt to Equity (2:1)

ITA

- ☐ Loans include debt provided by residents and non-residents
- ☐ Debt to Equity (3:1)



# Key Highlights of the Income Tax Bill, 2018



## Permanent establishment

### ITB

- ☐ Tax rate at 30%
- ☐ No deduction for expenses to head office and affiliates
- ☐ Tax on Repatriated Income 10%

### ITA

- ☐ Tax rate 37.5%
- ☐ No deduction for expenses to its head office

# Key Highlights of the Income Tax Bill, 2018



## Taxation of member clubs & associations

ITB

- ☐ Business income, entrance fees and subscriptions from members are taxable

ITA

- ☐ May elect not to be taxable

# Key Highlights of the Income Tax Bill, 2018



## Investment Allowances

Description	Current Rate	Proposed Rate
Commercial buildings	25%	10% p.a
Hotel buildings	10%	60%
Petroleum gas storage facilities	150%	60%
Educational buildings	50%	10%
Hospital buildings	Nil	100%
Hospital equipment	Nil	100%
Restriction for Non-Commercial Vehicles	KES 2,000,000	KES 3,000,000
Investment deduction on Manufacturing outside Nairobi, Mombasa and Kisumu	150%	100%

# Interactive Session

