TAXATION OF EMPLOYEES – PAYE CONSIDERATIONS

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Uphold public interest

Presentation agenda

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

Taxation of Terminal Dues

Type of Payments Covered

- Gratuity pay
- Severance pay
- Leave Pay
- Notice pay
- Ex-gratia
- Other considerations

Gratuity Pay

Definitions/Explanations

- These are bonus, salary arrears etc. payments relating to current and past years' service. These lump sum payments usually apply to retirees.
- The employer may wish to consider several approaches in arriving at the gratuity amounts. E.g. a rate of 15 days wages for each year of service or a one month's pay for each year of service.

Tax treatment

- The income is spread backwards for up to a maximum of five years from the current year and taxed together with income earned in the prior years, with the balance taxed in the fifth year. E.g. for an employee whose terminal dues are paid in 2018, the gratuity payments should be spread backwards through the calendar years 2018, 2017, 2016, 2015 and 2014.
- In spreading backwards the employer is required to take into consideration the length of time such an employee has been in service and spread only as far back as the number of years in employment where such employment has been less than 5 years.
- NB: The tax rates to be used in computing gratuity payments should be the rates that were applicable in the respective calendar years.

Severance Pay

Definitions/Explanations

This is a lump sum payment made by an employer to an employee as compensation for loss of office. It relates to retrenchment and redundancy.

Tax treatment

- The income is divided into three equal portions and spread forwards for a maximum of three years from the current year for tax purposes.
- For the current year portion, the income is taxed together with income earned in that year at the applicable tax rate, depending on the employee's tax bracket. Reference is made on the cumulative earnings for the current year in determining the tax brackets.
- The income portions for the subsequent two years are taxed at the annual individual tax rates.
- NB: Personal relief should not be granted in advance before commencement of any year of income.

Other payments – Leave Pay, Notice Pay and Ex-gratia

Definitions/Explanations

- Leave Pay- Payment for the number of outstanding/unutilized leave days as at the last working date of the employee.
- Notice Pay- Payment in lieu of notice. Usually depends on the terms in the employment contract.
- Ex-gratia- Payment made to an individual to help them or as a gift and not because the payer has a legal duty to make it. E.g. an employer making an ex- gratia payment to an employee who has retired or whose contract of service has been terminated or who has suffered loss of office.
- NB: The payer (in this case the employer) has no legal liability to pay such compensation but does it as a gift/favour to the payee.

Taxation

- **Leave Pay**- assessed in the year to which it relates.
- **Notice Pay**- assessable in the period immediately after the date of termination of employment i.e. it is taxed in the month/year it is paid.
- **Ex-gratia**- assessed in the year of receipt.

Other Considerations

These are matters that the company (employer) needs to take into account at the point of making terminal dues payments. They include:

- **Recoveries** - of amounts that may be owing to the company at the point of settlement. They include loans, salary advances, leave days owing to the firm etc. The recovery of such amounts should be done after tax.
- **Court orders** - specifics relating to amounts to be paid as instructed by say an industrial court or a tribunal.
- Settlements made out of court.

Interactive Session