WITHHOLDING TAX

Presentation by:

John Kuria
Associate Tax Director, Deloitte & Touche
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Introduction – Principles of withholding tax

- 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/transmit 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.**
- W/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

The Legislation

The following are the key provisions that govern the operation of WHT in Kenya:

- **Section 3 of the Income Tax Act (ITA)**:- stipulates that income tax should be chargeable on the income which accrued in or was derived from Kenya or on the income deemed to have been accrued in or derived from Kenya.
- **Section 10 of the ITA**:- Deems the payments liable to w/tax to be income accrued in or derived from Kenya.
- **Section 34** & the **Third Schedule** to the **ITA** - Provides the income tax rates.
- **Section 35 of the ITA**:- Lists the payments that are subject to w/tax
- **Section 39 (1) of the ITA**:- Allows w/tax to be set off against income tax.
- **Section 72D of the ITA** – Stipulates the penalty for late payment of tax
- **Section 38 of the Tax Procedures Act** – stipulates the late payment interest.
- **Income Tax (Withholding Tax) Rules, 2001**:- Issued by the National Treasury CS (then Minister for Finance) pursuant to the powers conferred to the CS under Section 130 of the ITA. The rules prescribe the WHT administration procedures.

Payments/services subject to withholding tax

Payments to Residents and PE

- Management or professional fee whose value exceeds KES 24,000
- Training fee
- Dividend
- Interest
- Royalty and natural resource income
- Rent on commercial property
- Winnings payable by bookmakers to punters.
- 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
- Payment to sportsmen or entertainers
- Winnings payable by bookmakers to punters
- Telecommunication service fees
- Pension/retirement annuities

Management or professional fees defined

- **ITA definition (Section 2)** - Payment made to a person, other than payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated
- **Contractual fee** - payment for work done in respect of building, civil or engineering works - See Section 35(3)(f) of the ITA
- **Consultancy fees** - payment made to any person for acting in an advisory capacity or providing services on an consultancy basis
- **Agency fees** – payment made to a person for acting on behalf of any other person or group of persons, or on behalf of the government, but excludes any payments made by an agent on behalf of the principal when such payments are recoverable
- **Professional fees** – not defined but recognized professions set out in the **Fifth Schedule to the ITA** – Based on the professions listed under the Fifth Schedule, professional fees should therefore include fees charged by medical practitioners, dentists, advocates, surveyors and land surveyors, architects and quantity surveyors, engineers, accountants and certified public secretaries

Training fees

- **Section 2 of ITA Definition –** "payment made in respect of a business or user training services designed to improve work practices and efficiency of an organization, and **includes** any payment in respect of incidental costs associated with the provision of such services"

- An example of training fees includes payment for this tax training

- Incidental costs in connection with training can include **accommodation**, **travel** expenses etc. incurred on behalf of facilitators/trainers

Royalty

Section 2 of the ITA definition - payment made as a consideration for the use of or the right to use:

- The copyright of a literary, artistic or scientific work
- Patent, trade mark, design or model, plan, formula or process, or
- Any industrial, commercial or scientific equipment

Examples

- Payments in respect of trade marks/brands e.g.. Franchise fees, intellectual property fees including software licenses etc.

Natural resource income

Defined under Section 2 of the ITA to mean:

- An amount including a premium or such other like amount paid as consideration for the right to take minerals or a living or non living resource from land or sea, or
- an amount calculated in whole or in part by reference to the quantity or value of minerals or a living or non-living resource taken from land or sea

Examples

- Payments for quarrying
- Payments in respect of mining minerals
- Payments for the right to obtain timber
- Payments for the right to fish

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 w.e.f. 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%

Rates applicable on payments to persons resident in countries that have double tax treaties with Kenya

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 fess. 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

Obligation to deduct

- Section 35 of the ITA provides an obligation to the payer to deduct tax on eligible payments for remission to KRA directly
- Failure to deduct tax on an eligible payment and remittance of the same to KRA is an offence under the ITA and attracts penalties and interest

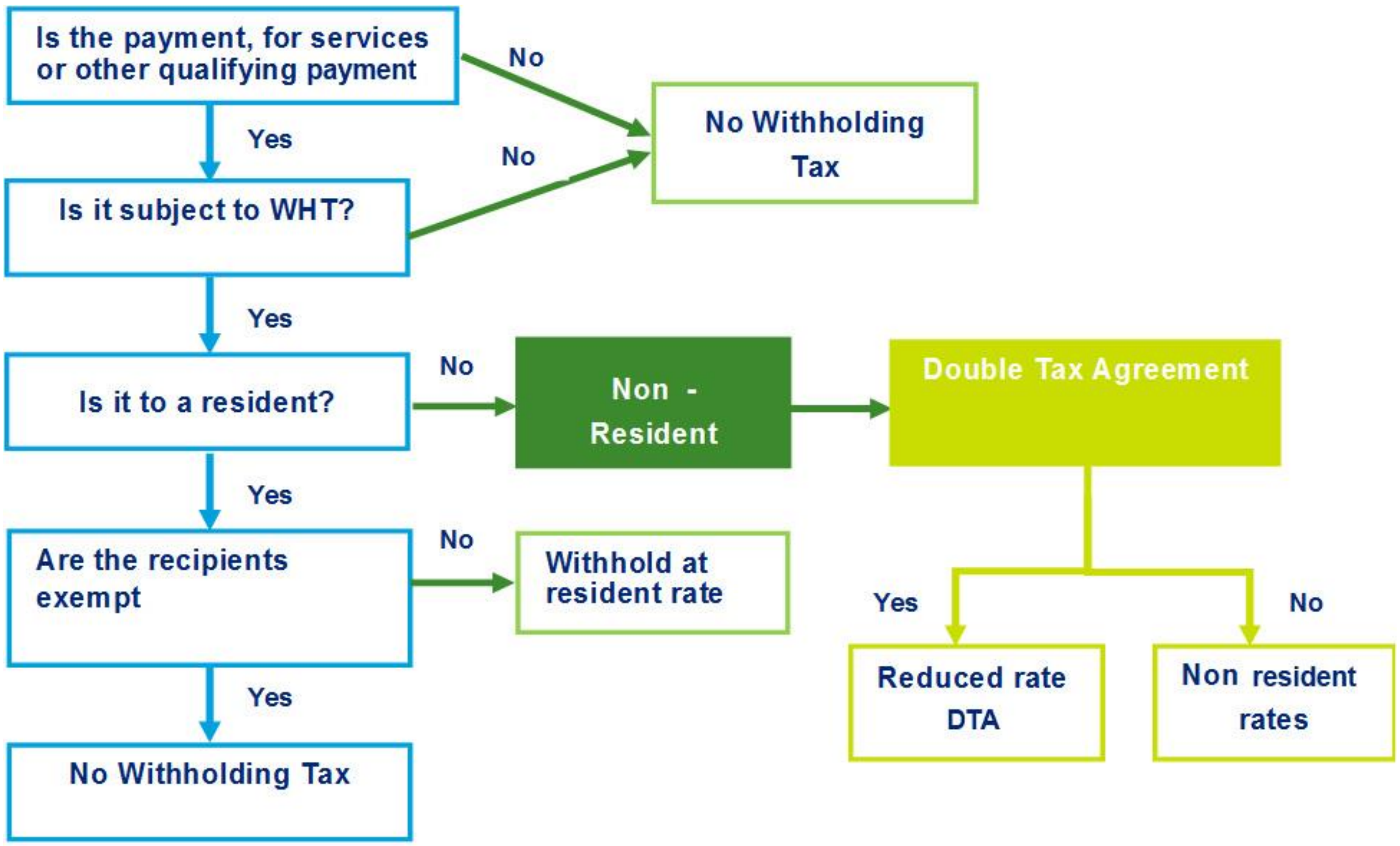
Withholding tax administration

- 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 payee, PIN, gross amount paid, nature of payment and amount of tax deducted
- Withholding tax accounting is now required to be done through iTax
- Upon paying the tax, the payee's ledger is credited with the amount and the i-Tax platform generates a certificate that is sent to the payee to enable him 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

Penalties and interest for non-compliance

- For purposes of recovery of tax, withholding tax is demanded from the payer as though it were the tax of the payer (recall WHT belongs to PAYEE and not PAYER)
- A penalty of 20% should apply for late payment of withholding tax – up until 9 June 2016, the penalty used to be 10% but capped to KES 1 million.
- Late payment interest of 1% per month is chargeable on any tax remaining unpaid after the due date – the late payment interest charged is capped to the principal tax involved (*Induplum rule*)
- Failure to file the annual return attracts a penalty of KES 100,000 or imprisonment for 6 months or less

In a Nutshell…



Complex issues/ KRA audit issues

1. **Definitions** – It is important to determine whether a payment falls under the ambit of withholding tax based on the highlighted definitions. For instance, should payments to body builders be liable to w/tax?
2. **The tax point (actual payment vs accrual)** – Should w/tax be based on actual payment or accrual?
3. **Mixed supplies** – WHT applies only to services. What happens where fees to be paid under a contract relate to both goods and services?
4. **Treaty provisions** – Where there is a DTT, careful review and application is required. DTTs have delicate provisions that must be carefully applied. The South African, French and the Mauritian treaty are important examples
5. **Disbursements and reimbursements** – should w/tax be based on disbursements and reimbursements? What is the difference between the two?
6. **Gross up problem** – where a contract is negotiated net of tax, should w/tax be based on the contract fee or should it be grossed up?
7. **Payment in kind** – How should w/tax be accounted if payment is made in kind? For instance on winnings

Withholding Tax Planning

- Compliance to avoid fines and penalties
- Payment timing
- Direct disbursements payments
- Obtaining all certificates and claiming the tax
- Double Tax Treaties
- Contractual provisions, and
- Year-end crediting as opposed to monthly or quarterly

Interactive Session