



Tax Management Workshop for PBO's

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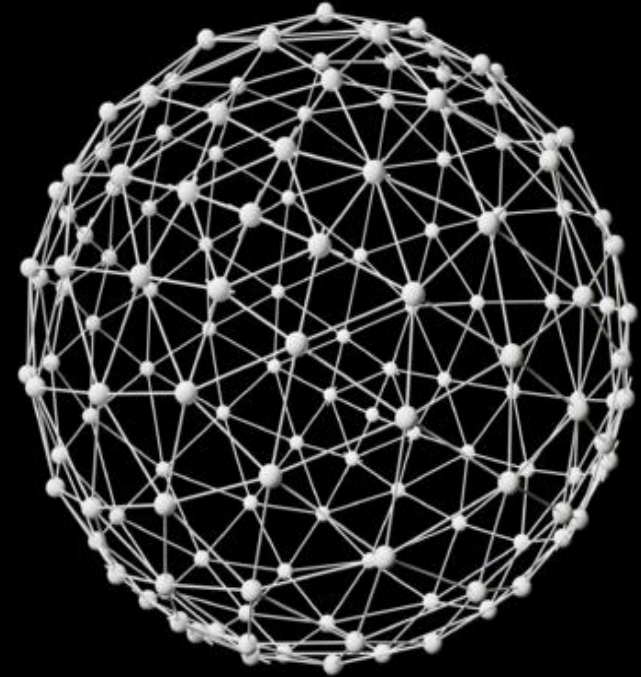
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Overview of Corporate Taxation of PBO's



PBO Definition



The PBO Act defines “public benefit organization” (PBO) in Section 5(1) as a voluntary membership or non-membership grouping of individuals or organizations, which is autonomous, non-partisan making, non-profit making and which is

- Organised and operated locally, nationally or internationally
- Engages in **public benefit** activities in any of the areas set out in the Sixth Schedule, and
- Registered as such by the Authority. Membership PBOs are those that recruit members while non-membership PBOs only have a Board and a Secretariat.

Trade unions, public bodies, religious organizations, societies, cooperative societies, saccos, micro-finance institutions and community based organizations whose objectives include the **direct benefit of its members** are not considered PBOs



PBO Act benefits



Benefits to be enjoyed by registered PBOs per second schedule to PBO Act i.e.

- Tax exemptions on members' subscriptions, income from economic activities, interest and dividend income, sale of assets, stamp duty (including on purchase of property)
- Waiver of court fees
- Preferential treatment under the VAT Act
- Incentives for donations by legal and natural persons
- Employment tax preferences

However, successful implementation will be driven by the processes at KRA level and alignment of the ITA with the PBO Act



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 charge to 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.



Overview of Income streams



Income Statement Items

1. Income – Restricted and Unrestricted Funds
 - Different reporting frameworks requires different accounting of restricted and unrestricted funds
2. Expenditure – Advances or when accounted for by the implementing partners
3. Other income
4. Donations in Kind and in cash



Non-Taxable income



- **Exempt income under the First Schedule to the ITA; e.g.:**
 - Income of Govt. Ministries, **exempt NGOs**
 - 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
 - Dividend received by a resident company from a company where it controls 12.5% or more of the voting shares



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



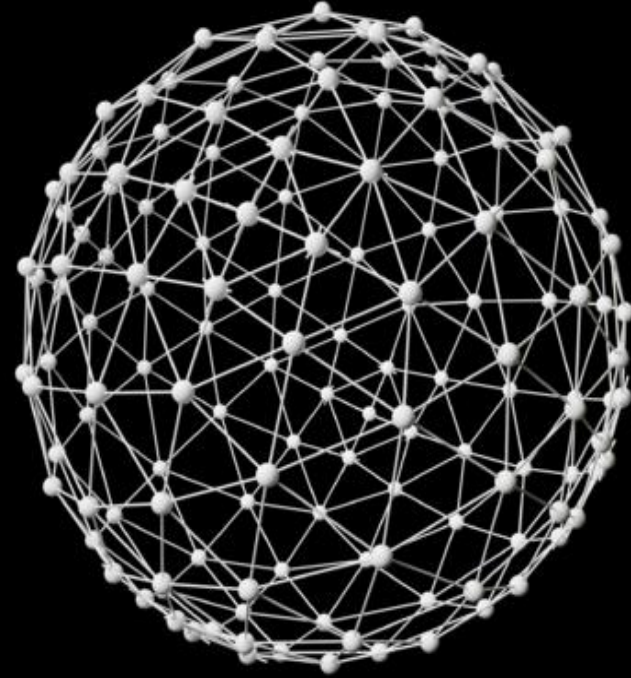
Tax returns



- Where the entity is dormant or tax exempt for a particular accounting period, it is still required to file its annual return, in this case referred to as a nil return as the entity did not trade or is exempted from tax
- **Due date for return filing is six months following the end of the income year/ accounting year**
- Currently all filings need to be done electronically through the iTax system
- The following information need to be filed together with the return:
 - Audited financial statements
 - Tax Computation, and
 - Other support documents – e.g. withholding tax certificates, etc.



Emerging direct tax Issues from the 2019/2020 budget



Capital Gains Tax



- Capital Gains Tax (CGT) to be increased from 5% to 12.5%.
- Property transferred as part of group restructuring to be automatically exempted from CGT where such reorganization does not involve transfer to a third party.
- Exemptions also available for transfers that arise due to legal or regulatory requirement or Government directive or compulsory acquisition by Government.
- Transfers deemed to be in the public interest may be exempted upon approval by CS National Treasury



- Renewed emphasis on the taxation of the digital economy.
- Income chargeable to tax defined to include income accruing through a digital marketplace.
- We expect further guidelines relating to taxation of digital transactions.
- "Compensating Tax": clarification that a distribution of any income that is exempt under the Income Tax Act is exempt from compensating tax.
- Clarification that the taxable income of a non-resident owner of ship, which docks at any port in Kenya includes demurrage charges. The charges will be taxable through the self-assessment mechanism.
- The CS alluded that the framework on the implementation of the 30% rebate on total electricity costs by manufacturers that was introduced through the Finance Act 2018 has now been developed.

- **Exemptions** - The Finance Bill proposes to exempt the following incomes from tax:
 - ✓ The income of Investee companies of Real Estates Investment Trusts (REITs).
 - ✓ The income of the National Housing Development Fund
- A company operating a plastics recycling plant to be liable to a reduced corporate tax rate of 15% for the first 5 years from the year of commencement.
- Repeal of Section 72D of the Income Tax Act, which stipulated a 20% penalty where any tax remained unpaid after the due date. This clarifies that the 5% penalty introduced through the Finance Act 2018 to apply going forward.
- **The Income Tax Bill status** – The CS indicated that the Bill is currently at advanced stages of legal drafting and will be tabled in Parliament soon.

Turnover Tax

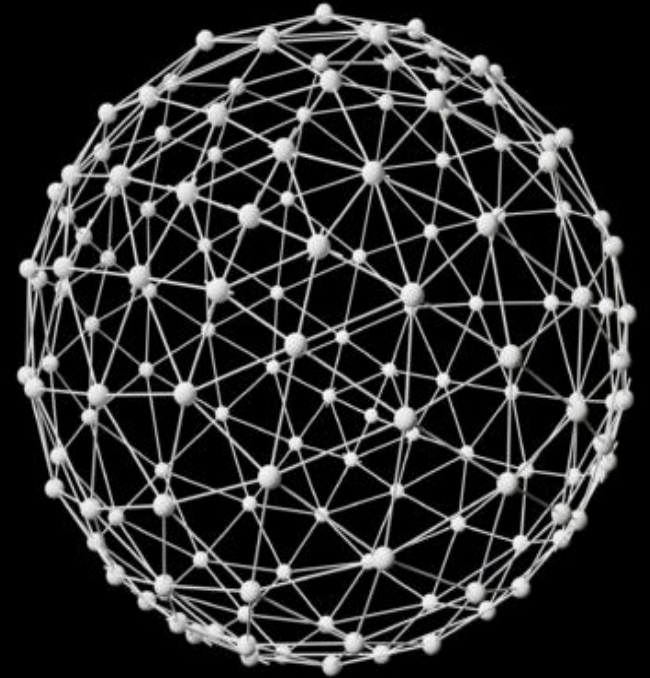
- Turnover tax re-introduced for business income of resident person not exceeding KES 5 million p.a..
- Rate of turnover tax is 3% payable monthly.
- Turnover tax not applicable to companies, rental income, management or professional fees and income subject to final withholding tax.
- Presumptive income tax (introduced through the Finance Act, 2018) will continue to apply to such income but will be an advance tax available for set-off against the turnover tax payable



Q & A



Withholding tax obligations and planning for PBOs



Introduction – Principles of w/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 the tax deducted directly to the KRA
- Where w/tax is not final tax nor additional 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 38 of the Tax Procedures Act** – stipulates the late payment interest
- **Income Tax (Withholding Tax) Rules, 2001:-** Issued by the Cabinet Secretary, National Treasury (then Minister for Finance) pursuant to the powers conferred to the Cabinet Secretary under Section 130 of the ITA. The rules prescribe the WHT administration procedures



Payments/services subject to w/tax



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



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

Elements of management or professional fee

- **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



WHT rates where Kenya does not have a DTAA



Payment subject to WHT		Resident payee or Non-Resident with a Kenyan PE	Non-resident payee without a Kenyan PE
Management fee		5%	20%
Royalties		5%	20%
Leasing equipment		N/A	15%
Dividend		5%	10%
Interest from financial institutions and Government 2 year bearer bonds		15%	15%
Interest from bearer certificates		20%	25%
Housing bond interest		10%	15%
Rents		10%*	30%
Pension and taxable withdrawals from pension/provident funds		10% - 30%	5%
Insurance commissions:	Agents	10%	20%
	Brokers	5%	20%
Contractual fees		3%	20%
Consultancy and agency fees		5%	20%
Surplus Pension fund withdrawal/s		30%	30%

*Withholding tax on rent payable to a resident person for use or occupation of immovable property was introduced with effect from 1 January 2017. It is to be noted, however, that only persons appointed to be withholding tax agents can withhold tax on the rent.

WHT rates where Kenya has a DTAA

Payment	UK	Germany & Canada	Denmark, Norway, Sweden, Zambia	India	France	South Africa	South Korea	Qatar	United Arab Emirates and Iran	Mauritius*
Management or professional fees	12.5	15	20	10	**	**	**	**	**	**
Royalties	15	15	20	10	10	10	10	10	10	10
Dividends	10	10	10	10	10	10	10	10	5	5 or 10*
Interest	15	15	15	10	12	10	12	10	10	5

***Kenya Mauritius DTAA** – the operation of the Kenya Mauritius DTAA was invalidated following a ruling by the High Court of Kenya, which noted that due process was not followed prior to the gazettelement of the DTAA.

Withholding 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



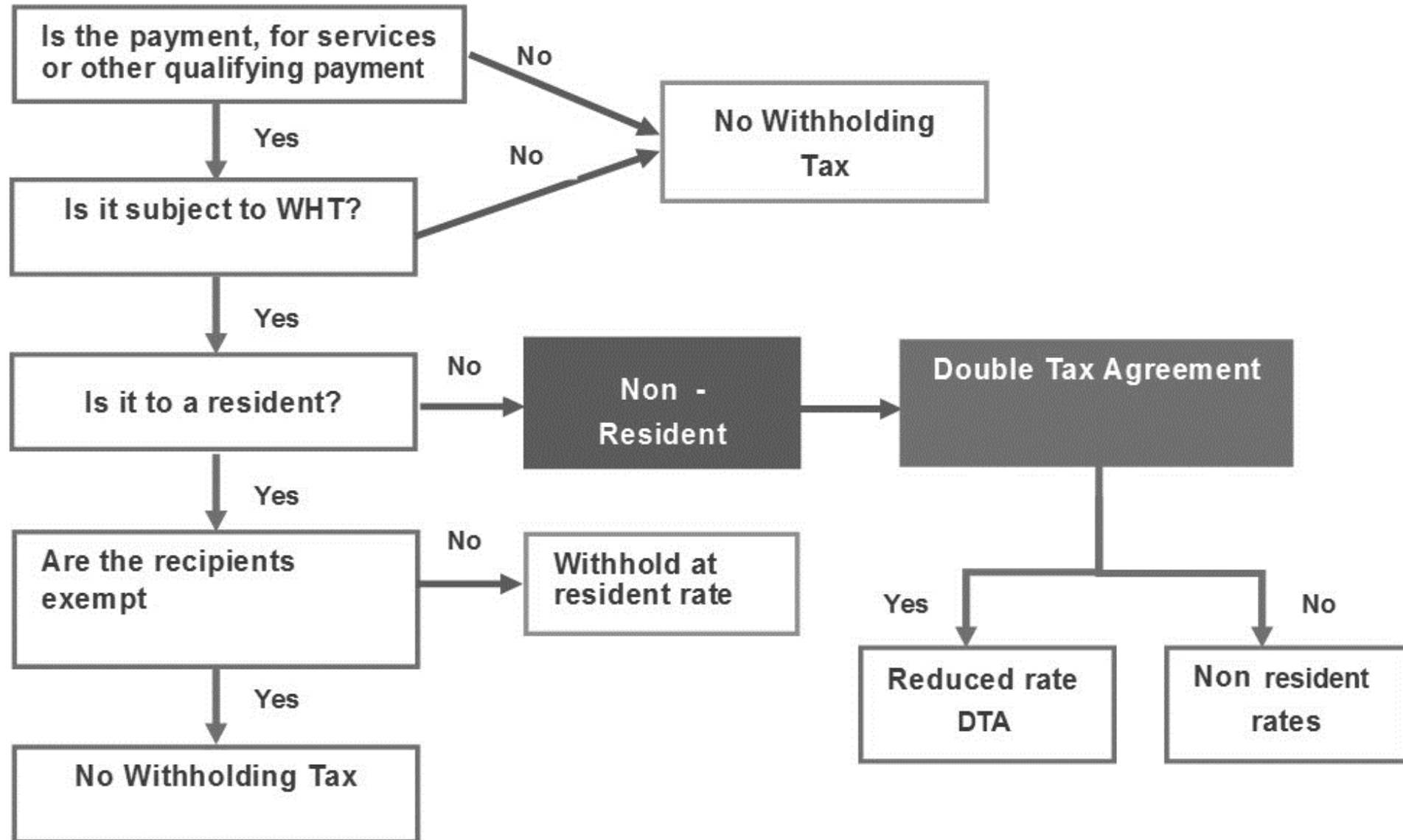
Penalties and interest for non-compliance



- For purposes of recovery of tax, withholding tax is demanded from the payer as though it were the tax of the payer (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 (*In duplum rule*)



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?



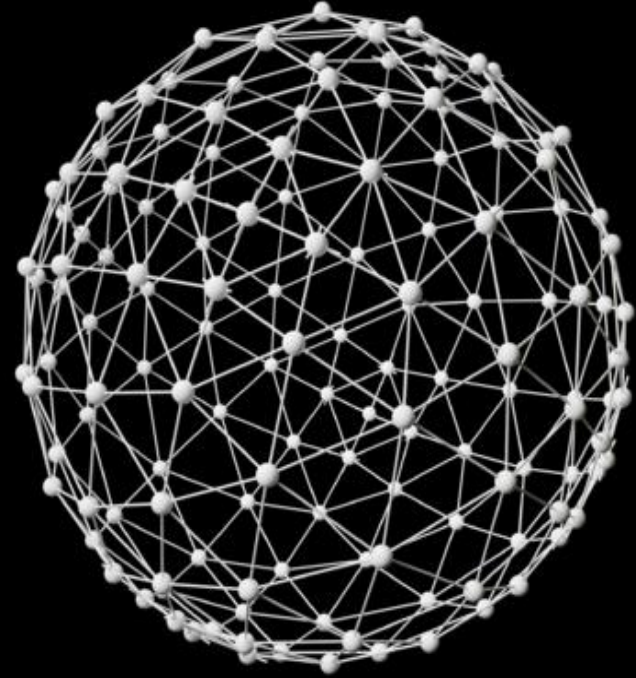
Withholding Tax Planning



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



Emerging Issues from the 2019/2020 budget



Withholding Income Tax



- Scope of qualifying services subject to withholding tax set to be expanded to include:
 - ✓ Security services;
 - ✓ Cleaning and fumigation services;
 - ✓ Catering services offered outside hotel premises;
 - ✓ Transportation of goods excluding air transport services;
 - ✓ Sales promotion; and
 - ✓ Marketing and advertising services



Withholding Income Tax



- Reinsurance premiums paid to non-resident persons to be liable to 5% withholding tax. This follows a similar move in 2018, which introduced w/tax on insurance premiums payable to non-residents.
- Demurrage charges paid to non-resident ship operators to no-longer be subject to withholding tax – to be taxed under self assessment.
- Management or professional fees, interest and royalties paid by a PE to its head-office to be liable to withholding tax to the extent that they are deductible for corporate tax purposes under a double taxation agreement (DTA).
- For purposes of recovery and collection of tax, withholding tax will be considered to be a tax of the withholder – and the amount will be liable to penalties and interest.



Q & A



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