

RECENT UPDATES ON TAX CASE LAW

Presentation by:

CPA Adelaide Waithera
Senior Tax Consultant, EY
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Withholding tax



R v Ex Parte Fintel Limited & KRA Misc. Appl. No. 1768 of 2004

Tax question addressed:

- Does s.35 of the Income Tax Act require actual payment to be made for withholding tax to be deductible?

Facts of the case:

The taxpayer was unable to pay the fee due to the service provider resulting in interest accruing on a monthly basis. The taxpayer went on to make a provision for the interest penalty in its books. KRA issued an assessment for WHT on the interest by relying on Section 2 of the ITA which defines “paid” as including “distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person.”

Withholding tax



R v Ex Parte Fintel Limited & KRA Misc. Appl. No. 1768 of 2004

Decision:

High Court Decision

Payment is a necessary prerequisite for the withholding tax to apply as the s.35 states that tax is to be withheld “upon payment”

Court of Appeal decision

“paid” as defined in s.2 of the Income Tax Act includes “ distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person and “pay”, “payment” and payable have corresponding meanings”

Withholding tax



R v Ex Parte Fintel Limited & KRA Misc. Appl. No. 1768 of 2004

Decision:

- Court held that the Income Tax Act gives the word “paid” a technical meaning
- The High Court Judge was wrong in insisting that “upon payment” can only mean that money or some valuable thing was delivered
- Even though s.35(5) requires a tax payer to deduct an amount – the word deduct is used as an accounting term ‘Deduct’ refers to subtracting expenditure from gross income and need not be done physically. A book entry will suffice.

?

An accrual would also amount to payment

Income earned from Tax exempt bodies



James Kamau Gitothu Njendu v Commissioner of Domestic Taxes [2019] eKLR

Tax question addressed:

- Whether an organization's tax exemption extends to parties contracted by the organization

Facts of the case

The tax payer when submitting own Tax Assessment omitted income earned from the consultancy contract with Kenya Wildlife Services for which reason the KRA issued an additional assessment to reflect the amount omitted to be declared. The tax payer had entered into a consultancy agreement with the KWS which purported payments to be exempts from tax supposedly because the payments were made from funds from International Development Association. KWS was exempted from tax on funds from IDA.

Income earned from Tax exempt bodies



James Kamau Gitothu Njendu v Commissioner of Domestic Taxes [2019] eKLR

Decision:

High Court Decision

The consultancy fees earned by the Appellant was taxable income which was never exempted by the competent authority under the law. The Kenya Wildlife Services is not vested with power to grant tax exemption. But, even then, the agreement between the KRA and Kenya Wildlife services which is said to have granted the tax exemption leaves no doubt as to who the exemption was to benefit

An organization's exemption does not extend to its contracted parties

Retrospective application of the law



Kenya Bankers Association v Attorney General & another [2018] eKLR

Tax impact:

- This case may affect how amendments to tax law are effected

Facts of the case:

Petitioner challenged the introduction of the 'Robin Hood' Tax through Finance Bill 2018 i.e. excise duty on the transfer of money in excess of Kshs 500,000. The applicant's case was that the Tax Laws (Amendment) Act, 2018, gazetted on 25th July 2018, yet the effective date of some amendments 1st July 2018.

Retrospective application of the law



Kenya Bankers Association v Attorney General & another [2018] eKLR

Court's order:

The court gave initial ruling giving conservatory orders suspending the implementation of the excise duty until such a time as proper definition of 'money transferred by banks' is provided.

Retrospective application of the law



Keroche Industries Ltd v Kenya Revenue Authority [2007] eKLR

Tax matter:

When do tax changes become effective?

Facts of the case:

The applicant paid duty under wrong tariff heading until KRA communicated that the heading was wrongly classified, thereby attracting a higher rate of duty.

Keroche paid duty under tariff 22.04 from 1997 to 2006. A decision to change tariff was communicated in November 2006 that Keroche's fortified wine products should have been classified under tariff 22.06 which attracted higher duty of 60% instead of 45%. By the same letter, KRA issued an assessment of 1.1B based on new tariff from 2002 to 2005

Retrospective application of the law



Keroche Industries Ltd v Kenya Revenue Authority [2007] eKLR

Decision

The court held that the retrospective application of law in this case was unfair, arbitrary and abuse of power amounting to a violation of rights

The decision also points out that changing the tariff in order to block or not to pay a refund due to the applicant reveals ill motive, are a threat to the rule of law and the principle of legitimate expectation and constitute an abuse of power

Capital Gains Tax



Law Society of Kenya v Kenya Revenue Authority & another [2017] eKLR

Tax issue addressed:

- When does liability to pay Capital Gains Tax accrue?

Facts of the case:

Itax was configured in such a way that before a purchaser can pay stamp duty on i-Tax, the vendor must pay CGT.

On i-Tax portal, you cannot pay stamp duty without the acknowledgement number generated from payment of CGT.

LSK argued that Paragraph 11A of the Eighth Schedule of the Income Tax Act, which imposes a requirement that tax is to be paid 'before the property is transferred', contradicts various statutes and the Constitution. The LSK argued that CGT should only apply when registration is successful.

Capital Gains Tax



Law Society of Kenya v Kenya Revenue Authority & another [2017] eKLR

Issues:

- Paragraph 11A of the eighth schedule of the ITA ‘ The due date for tax payable in respect of property transferred under this part shall be on or before the date of application of transfer of property is made at the relevant lands office.
- Land Registration Act deems property to have passed once transfer forms have been filed and the transferee has been registered as the proprietor of the land.
- The provision of the ITA infringes on right to dispose property if a person cannot pay the tax affront

Capital Gains Tax



Law Society of Kenya v Kenya Revenue Authority & another [2017] eKLR

Decision:

- The court held that the collection of the CGT before successful registration of the transfer is unconstitutional since agreements to sell provide that payment of the purchase price is made upon successful registration of the transfer.

Capital Gains Tax



Kenya Bankers Association v KRA [2018]

Tax Matter:

CGT on transfer of land held as security

Facts:

KBA argued that CGT is only payable upon registration of the transfer by the charger, because, when banks create a charge over land, the lender doesn't qualify as owner of the charged land. Therefore, transferring the land upon default should not attract CGT.

Capital Gains Tax



Kenya Bankers Association v KRA [2018]

Decision:

The High Court of Kenya, on 13 March 2018, quashed an administrative action requiring commercial banks to pay stamp duty and CGT on all land sold to recover bad loans. Upon the sale of the land by the banks, the CGT would be payable at the time of registration of the transfer by the chargor (owner of the property) unless the bank realizes a surplus over and above the loan borrowed. In such a case, the bank would be required to account for CGT on the surplus.

Power of search, seizure and forfeiture of goods



Robert K. Ayisi v Kenya Revenue Authority & another [2018] eKLR

Facts:

KRA sought details of transactions between the petitioner & a third party confiscated by EACC.

The Petitioner challenged the constitutionality of sections 44(1) & (2) and 60(1)(3) of the TPA, 2015 which empowers KRA to unilaterally and arbitrarily exercise the power of search, seizure and forfeiture of goods was challenged.

Power of search, seizure and forfeiture of goods



Robert K. Ayisi v Kenya Revenue Authority & another [2018] eKLR

Decision:

Court held that Sections 44(1) and (2), 60(1) and (3) and 59(4) of the TPA, 2015 are not in compliance with the Article 31 of the Constitution 2010 which provides for the right to privacy.

Tax disputes and appeal procedures



Republic v KRA Ex Parte M-Kopa Kenya Limited [2018] eKLR

Facts:

KRA issued a Private Ruling to M-Kopa under section 65(1) of the Tax Procedures Act, 2015 to the effect that television sets were exempt from VAT.

Thereafter, KRA reversed its position and assessed taxes.

Tax disputes and appeal procedures



Republic v KRA Ex Parte M-Kopa Kenya Limited [2018] eKLR

Decision:

Court stated that validly issued Private Ruling creates a legitimate expectation which can only be withdrawn where rational grounds of the intention to withdraw the same have been communicated to the beneficiary of the expectation in clear terms and he has been given an opportunity to comment thereon.

VAT on services exported out of Kenya



Coca Cola Central East and West Africa Ltd vs Commissioner of Domestic Taxes Appeal No 11 of 2013

Facts:

Coca Cola was paid to carry out the promotion of various local brands in a number of African countries by a US resident company, Coca Cola Export Corporation. KRA assessed VAT on these amounts on the basis that the services provided were used and consumed in Kenya.

VAT on services exported out of Kenya



Coca Cola Central East and West Africa Ltd vs Commissioner of Domestic Taxes Appeal No 11 of 2013

TAT decision:

The consumption of a service was neither determined by the payer of the service nor by the person requisitioning the service but by the location of the final consumer of the service. Consumption was therefore to be determined by anybody who puts a service to any use. As such even parties that were not privy to the transaction could be found to be the ultimate consumers of services.

Employment benefit – Tax assistance



BMW South Africa (Pty) Ltd v The Commissioner for the South African Revenue Service (1156/18) [2019] ZASCA 107 (6 September 2019)

Tax matter:

Payment by employer to tax consultants to render assistance to expatriate employees – whether a taxable ‘benefit or advantage’ as contemplated in the definition of ‘gross income’

Facts:

BMW objected to tax assessment on fees paid to external consultants for tax services to its expatriates. In the case, BMW argued that the company procured tax services because taxation of expatriates is complex, and it used the services to ensure that the company paid correct taxes for its tax equalized expatriates. The SARS argued that payment by an employer for tax services for its employees constitutes a taxable benefit.

Employment benefit – Tax assistance



BMW South Africa (Pty) Ltd v The Commissioner for the South African Revenue Service (1156/18) [2019] ZASCA 107 (6 September 2019)

Decision:

The court held that the tax services covered the expatriate's personal obligations to the revenue authority and therefore payment for tax services by the employer constitutes a taxable benefit from employment.

Legislative process – Public Participation



Pevans East Africa Limited & another v Chairman Betting Control and Licensing Board & 7 others [2017] eKLR

Tax matter addressed:

Importance of public participation on tax legislation

Facts of the case:

Petitioner (Sportpesa) challenged the constitutionality of the 50% Betting, Gaming & Lotteries Tax introduced in Finance Bill, 2017.

Legislative process – Public Participation



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Legislative process – Public Participation



Pevans East Africa Limited & another v Chairman Betting Control and Licensing Board & 7 others [2017] eKLR

Decision:

The court held that public views ought to be considered in the decision making process and as far as possible the product of the legislative process ought to be true reflection of the public participation so that the end product bears the seal of approval by the public.

Withholding Tax Highlights and Recent Developments

Presentation by:

CPA Adelaide Waithera
Senior Tax Consultant, EY
17th October 2019

Outline



- ❑ Withholding Tax Defined
- ❑ WHT in the local context
- ❑ Emerging Trends
- ❑ Appendix

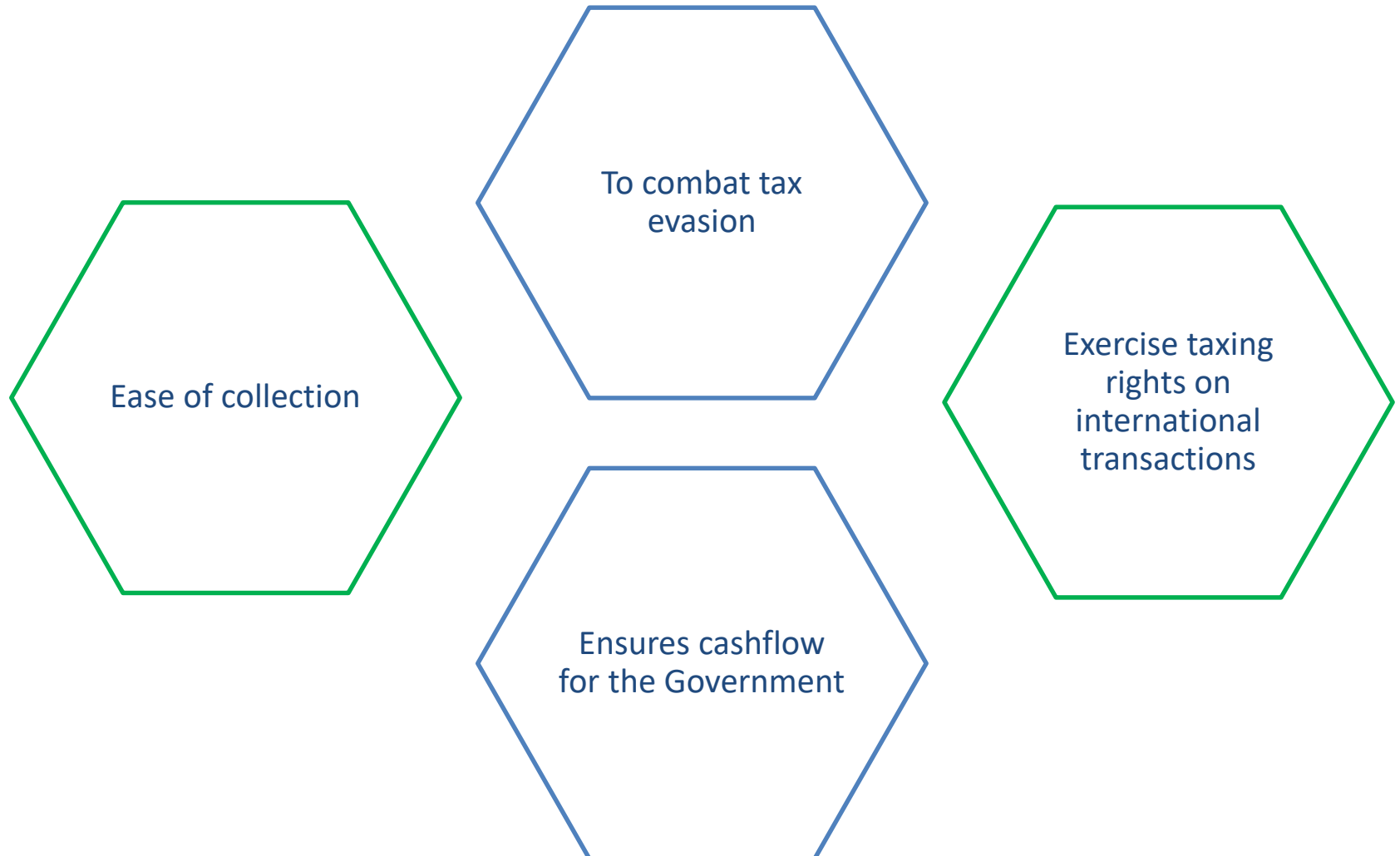
What is withholding tax (WHT)?



- ▶ Withholding tax is an income tax that is paid to the government by the payer of the income rather than by the recipient of the income

The tax is thus withheld or deducted from the income due to the recipient

Purpose of WHT



Income subject to WHT



**Management,
Professional &
Training Fees**

Royalty

**Insurance
Premium**

Rent

Dividend

Interest

Winnings

Pension

Increased scope of Income subject to WHT



Finance Bill 2019 Update

Security Services

**Cleaning &
Fumigation
services**

**Catering services

**Transportation
of goods

Sales Promotion

**Marketing &
Advertising
Services**

* Catering services offered outside the hotel premises

** Excludes air transport services

Emerging trends



Net Of Tax Contracts (grossing up)

**Foreign
suppliers of
professional
services**

Contract

**Local
recipient of
the service**

Negotiates
contracts Net of tax
making them
appear cheaper

Key Risk

**Underpayment
of WHT**

The WHT burden is borne
by the local entity.
The local entity should
**gross up the negotiated
amount for WHT
purposes**

Emerging Trends



Net Of Tax Contracts (grossing up) – Example

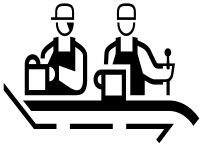
- ▶ An Indian company has entered into a contract with a Kenyan company for the supply of software. The contract fee is KES 15m net of any applicable Kenyan taxes
- ▶ What is the amount of WHT payable?

Description	Ref	Amount (KES m)
Fee net of tax	a	15
WHT rate (10%)	b = 10%	
Grossed up fee	$c = (a/100\% - b)$	16.7
WHT payable	$(b * c)$ or $(c - a)$	1.7

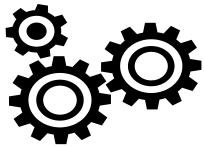
Emerging Trends



Turnkey Contracts (EPC Contracts)



Contractor completes the project...



...then hands it over to the client



The client sets the project in motion “Turn Key”

Key Benefits

Timely completion of Projects

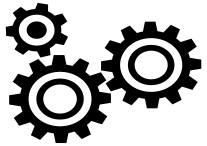
Avoids cost overruns

Ease of implementation

Emerging Trends



Turnkey Contracts (EPC Contracts) Cont'd



Projects involve designing, manufacturing, sale or supply of the goods AND installation, testing, and commissioning.

Executed as below:

Offshore

Design & Engineering
Supply of Equipment

Onsite

Installation &
Commissioning

Emerging Trends Cont'd



Turnkey Contracts (EPC Contracts) Cont'd

Ways of Contracting

1

Separate contracts for:

- ▶ the design, sale and supply of equipment (offshore)
- ▶ for installation, commissioning, etc (onshore)

2

- ▶ Composite contract with a fixed lump sum price for all the activities

Emerging Trends Cont'd



Turnkey Contracts (EPC Contracts) Cont'd



In case of a lumpsum price for works relating to design, manufacture, supply, testing and commissioning, what component of the total cost relate to services that are normally expected in such projects e.g. civil works, engineering services, technical fees?



Should you withhold on the lump sum contract price? If so, at what rate?



Can the KRA demand that the lumpsum contract price is divided into various sub-components so that you withhold on service related fees?

Final or advance tax



Final Tax

No further assessment of tax on that income

Examples

WHT on all payments to **non-resident persons without a PE** are final from the perspective of the source country

Dividends (other than from a designated co-operative society)

Pension (on retirement, after 15 years from joining, on attaining 50 years)

Winnings – betting; chomoka na gari/plot

Interest by an individual OR joint a/c by husband and wife - from a bank, building society or CBK
If a housing bond @ 10% up to KES 300,000

Advance Tax

Income is subjected to tax normally but withholding tax is taken as a tax credit. Reduces your tax liability or is refundable if there is an overpayment

Food for thought



1. How do you withhold on non-cash winnings?
2. Should you declare income subject to final WHT in your annual individual self-assessment return (SAR)?

Appendix – The latest DTA's



Payee Resident in	Dividends	Interest	Royalties	Management & Professional Fees
Iran	5	10	10	20
United Arab Emirates	5	10	10	20
Korea	8 or 10*	12	10	20
Qatar	5 or 10**	10	10	20
Special Economic Zone (SEZ)***		5	5	5



Appendix – The latest DTA's

- ▶ * 8% if beneficial owner is a company (other than a partnership) and owns directly at least 25% of the paying company. Else, 10%.
- ▶ ** 5% if beneficial owner is a company (other than a partnership) and owns directly or indirectly more than 10% of the paying company. Else, 10%.
- ▶ SEZ***Reduced withholding tax rates on payments made to foreign investors: (as per the Finance Act 2017) which came into w.e.f 01/01/2018
- ▶ Where the treaty rate is higher than the non-treaty rate, the lower rate applies

Interactive Session

