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ICPAK Tax Training

The role of tax incentives and tax compliance – a brief look at the Kenya tax incentive regime

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Agenda

1. Introduction
2. General overview of tax incentives
3. Highlights of the available tax incentives in Kenya
4. Q&A

Overview of tax landscape in Kenya

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Tax incentives – what comes to mind?

What is a tax incentive?

Issue	Comments
What is a tax incentive?	❑ A **tax incentive** is an aspect of a country's tax code designed to incentivise or encourage a particular economic activity by reducing the liability of taxpayers in a given area. (Wikipedia) ❑ Tax incentives can also be defined as measures that provide for a more favorable tax treatment of certain activities or sectors compared to what is granted to general industry/sector/economy.
Which tax heads are covered	❑ Tax incentives cover almost all tax heads including • Corporate income tax (CIT) • Capital gains tax (CGT) • Personal taxes • Values Added Tax (VAT) • Customs and Excise Duty etc.

Forms of tax incentives

- Tax holidays and reduced tax rates (CIT)
- Exemptions
- Deductions
- Credits

Objectives of tax incentives

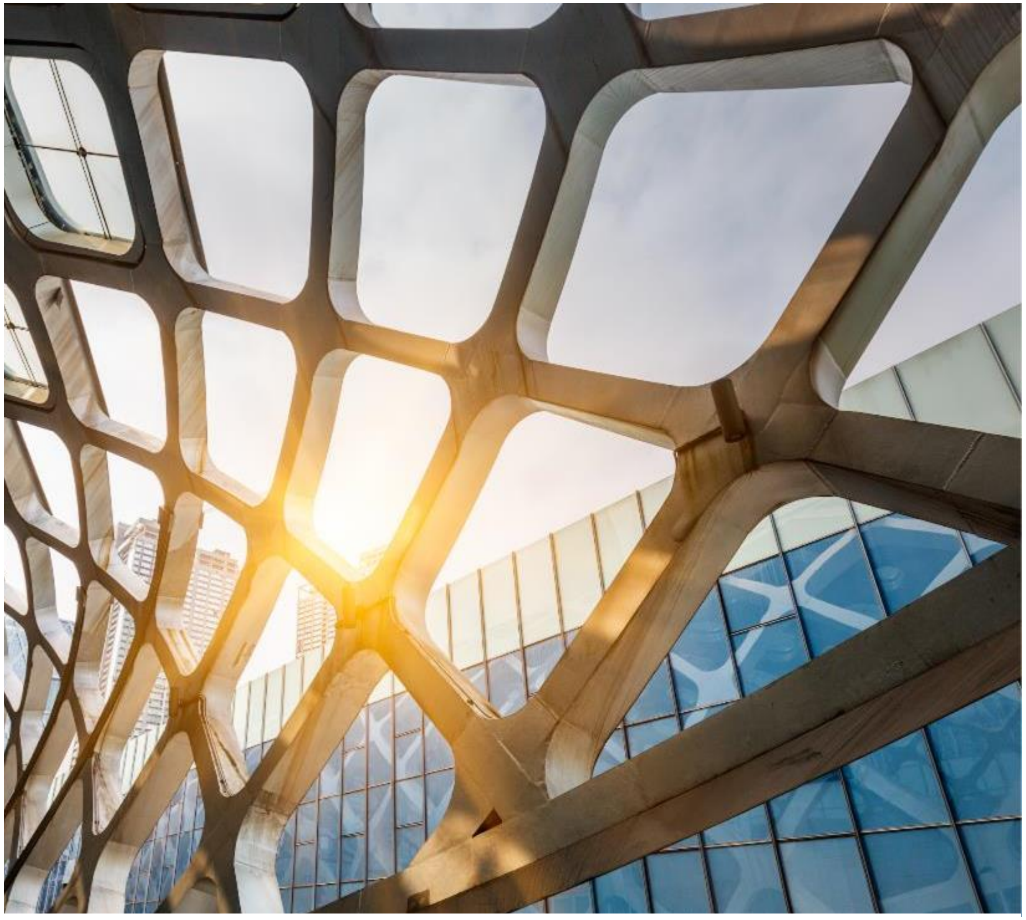
- Tax incentives can have both positive and negative impacts on an economy. Some of the objectives for tax incentives include:

  - ✓ Attract foreign investments
  - ✓ Promote investment/capital inflows in certain sectors/industries
  - ✓ Improve social outcomes – encouraging education, savings, poverty reduction etc.
  - ✓ Discourage certain activities to protect local industries

- Why preference for tax incentives?

  - ✓ Much easier to provide than to correct deficiencies in given sectors
  - ✓ Do not require an actual expenditure of funds or cash subsidies to investors – foregone revenue
  - ✓ Are politically easier to provide than funds

Tax incentives – Income Taxes



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Tax holidays and reduced CIT rates

#	Entity	Comments
1	Export Processing Zone (“EPZ” entities)	▪ EPZ entities are exempt from paying CIT for the first 10 years of operation ▪ Thereafter, CIT is payable at the rate of 25% for the next 10 years.
2	Special economic zone (“SEZ”) entities	▪ SEZ entities pay CIT at the rate of 10% for the first 10 years of operation ▪ Thereafter, CIT is payable at the rate of 15% for the next 10 years.
3	Companies engaged in local assembly of motor vehicles	▪ CIT is payable at the 15% for the first 5 years of operation ▪ The reduced rate of 15% can be extended for a further 5 years if the ex-factory value includes local content of 50% of more.

Tax holidays and reduced CIT rates – cont’d

#	Entity	Comments
4	Construction of residential houses	▪ Reduced CIT rate of 15% is applicable for companies that construct at least 100 residential units annually ▪ This is subject to approval by the Cabinet Secretary responsible for housing.
5	Companies engaged in local assembly of motor vehicles	▪ CIT is payable at the 15% for the first 5 years of operation ▪ The reduced rate of 15% can be extended for a further 5 years if the ex-factory value includes local content of 50% of more.

Tax exemptions

#	Income	Comments
1	Dividends from resident subsidiaries	▪ Qualifying dividends received by a resident company that controls more than 12.5% of the paying company are exempt from income tax.
2	Interest income from infrastructure bonds	▪ Interest income exempt provided that the bonds have a maturity period of 3 years of more.
3	Income of charitable institutions	▪ Exempt from CIT provided that they have a valid tax exemption certificate.
4	Gains from sale of securities traded on the a securities exchanges	▪ Exempt from CGT as provided third schedule
5	Exemptions on transfer of property	▪ No gain or loss for is applicable for CGT purposes where property is transferred due to legal or regulatory requirement, internal re-organisation or acquisition by the government

Deductions

#	Expense	Comments
1	Deductibility of expenses	▪ Expenses incurred wholly and exclusively in the generation of income are deductible for CIT purposes. ▪ Taxpayers paying residential rental tax, ToT and MT will not get to enjoy this benefit
2	Investment allowances	▪ Investment allowances are granted at different rates on qualifying capital expenditure (Discussed in detail below).
3	Charitable donations	▪ Cash donations made to charitable organizations registered under the Societies Act or exempt from registration under the Societies or the NGOs Co-ordination Act or institutions responsible for are tax deductible.
4	Tax losses	▪ Tax losses incurred in a year of income are available for deduction in that year of income and the next 9 succeeding years of income. ▪ Taxpayers can apply for period extension to utilise tax losses where these are not utilised within the 9 year period.

Deductions – investment allowances

#	**Capital expenditure**	**Investment allowance rate**
1	Buildings and machinery used for manufacture, hotels, hospital buildings and equipment, petroleum and gas storage facilities, ships and aircrafts, farmworks	▪ 50% in the first year of use and 25% of the residual value per year on reducing balance.
2	Commercial buildings and educational buildings including student hostels	▪ 10% per year on reducing balance
3	Motor vehicles and heavy earth moving equipment, computer and peripheral computer hardware and software, calculators, copiers and duplicating machines	▪ 25% per year on reducing balance
4	Other machinery, furniture and fittings, telecommunications equipment, right to use fibre optic cable by a telecommunication operator, filming equipment by a local film producer	▪ 10% per year on reducing balance
5	Machinery used to undertake and explorations operations under a prospecting or mining right	▪ 50% in the first year of use and 25% of the residual value per year on reducing balance.

Double Tax Agreements (DTA) - reduced tax rates and credits

#	Benefits	Comments
1	Reduced tax rates on certain payments	▪ Kenya has concluded DTA various countries. ▪ Most of the DTAs provide a reduced rates of withholding tax on payments to non-residents subject to stipulated conditions
2	Tax credits under a DTA	▪ A resident person may be entitled to a tax credit on income taxed in a foreign country that has a DTA with Kenya. ▪ Where there s no DTA, the foreign tax paid is tax deductible.

Tax incentives - VAT

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Tax incentives – VAT

#	Item	Comments
1	Registration	• Business whose turnover is less than KES 5 million in year are exempt from VAT registration and related compliance obligations
2	Reduced rate – zero rated supplies	• Zero rated supplies (goods and services) are detailed in the Second Schedule to the VAT Act.
3	Exemption – VAT exempt supplies	▪ Exempt supplies (goods and services) are detailed in the First Schedule to the VAT Act.
4	Deduction of input tax	• A supplier of taxable goods is entitled to claim VAT paid (input tax) on importation or purchase of goods and services, except where such input tax is prohibited. • The claim is made through the monthly returns by reducing the output VAT payable and should be made within 6 months from the date of the invoice.
5	VAT on pre-registration costs	▪ Newly registered business can claim VAT on set-up costs and other expenses incurred prior to VAT registration.

Tax incentives – VAT

#	Item	Comments
6	VAT on pre-registration costs	▪ Newly registered business can claim VAT on set-up costs and other expenses incurred prior to VAT registration.
7	VAT refund due to zero-rated supplies	▪ Taxpayers can apply for VAT refunds on excess input tax arising from making zero-rated supplies.
8	VAT paid on bad debts	▪ Taxpayers can apply for VAT refund relating to VAT paid to KRA, but the payment was not received from the customer.

Tax incentives – Excise and Customs Duty

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Tax incentives – Excise Duty

Tax incentives – Excise Duty

#	Item	Comments
1	Excise duty relief on raw materials	• Manufacturers of excisable are entitled to offset the excise duty incurred on excisable purchases used as inputs in the production process.
2	Excise duty refunds on damaged, stolen or returned goods.	• Manufacturers can apply for a refund of excise duty paid on these goods
3	Excise duty refunds on bad debts	• Suppliers of excisable goods and services can apply for refund for supplies made and where payment remains outstanding for more than 3 years.
4	Excise duty drawback on exports	• Exporters who import excisable goods which are subsequently exported are entitled to claim duty drawback in relation to such goods provided that such an application is made within 12 months.

Tax incentives – Customs Duty

Tax incentives – Customs Duty

Some of the tax incentives relating to customs duty include:

- Exemption or reduced rates for certain imports – for instance raw materials are subject to duty at 0% while semi-finished materials are subject to duty at 10%.
- Duty drawbacks on imported goods for export,
- Customs duty refunds and rebates on goods destroyed under voyage or customs control.
- Duty exemptions for qualifying goods.
- Duty remissions schemes for manufacturers.
- Various incentives for manufacturers under bond, EPZs and SEZs
- Free Trade Agreements ("FTA") and preferential tariff concessions on import duties and other levies e.g. AfCFTA, COMESA.

Other tax incentives

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Other tax incentives

Some of these incentives include:

- ✓ Voluntary Tax Disclosure Program

Q&A

Thank you