# The Legal Framework of Taxation in Kenya

Presentation by:
Sandeep Singh Main
Associate Director, KPMG
March 2021

# TABLE OF CONTENTS

# History of taxation in Kenya

- Taxation in Kenya dates back before the colonization by Britain.
- The Arabs who colonized East Africa in the Seventh Century taxed the local coast region of East Africa on the basis of Islamic law. The taxes imposed were mainly based on trade.
- The British introduced direct taxation since external trade was minimal and customs dues would not raise enough taxes.
- The 1937 legislation remained in effect until 1952 when the Income Tax Act (ITA) was enacted. The 1952 ITA laid down the basis of liability, assessment, collection and management.
- In 1973, a new ITA was legislated and it came into effect in January 1974.

# Imposition of Income Tax

a) Corporation tax is imposed on the taxable income, which is the accounting profit adjusted for allowable and disallowable expenses.

b) The corporation tax rate for resident companies is 30%. In Kenya, residency for a legal entity may arise through incorporation, management and control of said entity.

c) Non-resident companies with a permanent establishment (PE) in Kenya are taxed on the income earned or derived from within the country at the rate of 37.5%, with some restrictions on deductible expenses.

d) Section 10 to the Income Tax Act provides for the exemption of certain income.

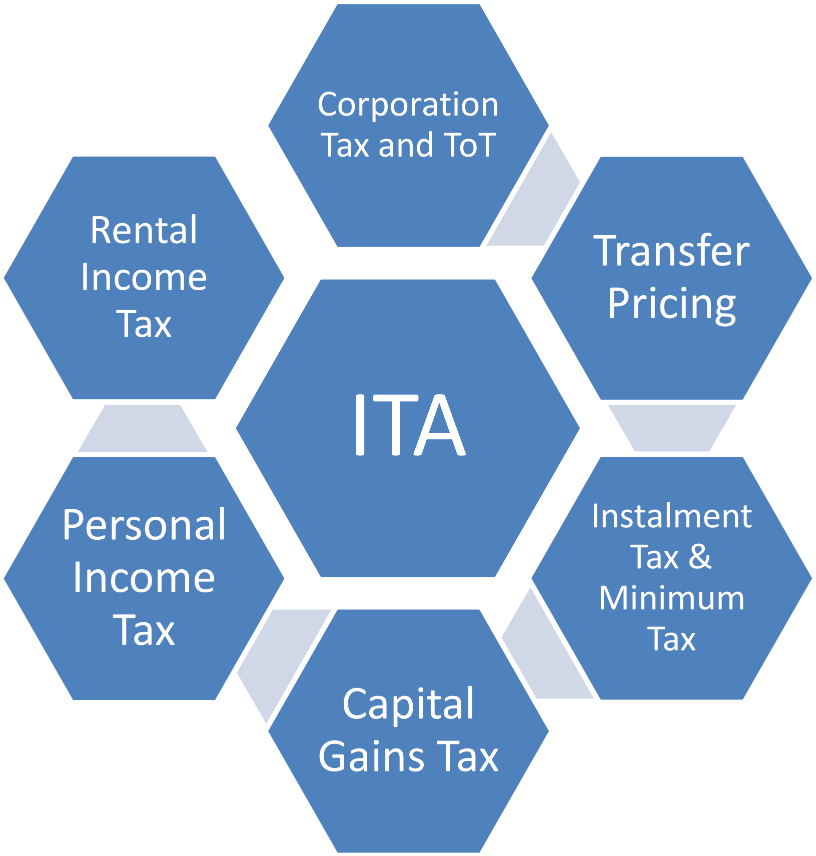
# The Income Tax Act Cap 470

Some of the key provisions of the Income Tax Act are as follows:

- Section 3 – The income chargeable to tax;
- Section 15 – Allowable deductions;
- Section 16 – Disallowable deductions;
- Section 35 – Withholding tax;
- First Schedule – Income which is exempt from Tax;
- Second Schedule – Investment Allowances;
- Eighth Schedule – Capital Gains Tax

# The Income Tax Act

The types of taxes imposed under the Income Tax Act are as follows:



# Which income is taxed?

- Section 3 (1) of the Income Tax Act – taxes all the income of a person, whether resident or non-resident, which is accrued or derived from Kenya.
- Income tax is chargeable to income in respect of:

1) Gains or profits from business, employment or rent;
2) Dividends and interests;
3) Pension, charge or annuity;
4) Income deemed to be accruing in Kenya;
5) Capital gains; and
6) Natural resource income.

# The Income Tax Act Cap 470

ICPAK
Credibility. Professionalism. Accountability

- The imposition of taxes under the ITA is also affected by public policy.
- Article 201 of the Constitution which details the principles of public finance provides that there shall be openness and accountability including public participation in financial matters.
- Every year, the budget making process involves calls to the public to participate in which we as the public get to make proposals on what should be included in the upcoming Finance Bill.
- The Bill is published and if passed by the Parliament, assented to by the President.

# What are allowable expenses (Sec 15)

## What deductions are allowed?

- All expenditure incurred wholly and exclusively in the production of the income of a person.
- Some of the common deductions which are allowed:

1) Bad debts incurred;
2) Capital deductions;
3) Legal costs and stamp duties in connection with leases;
4) Capital allowances; and
5) Expenditure on scientific research.

# What are disallowable expenses (Sec 16)

## What deductions are not allowed?

- No deduction is allowed for expenditure or loss not wholly and exclusively incurred in the production of the income.
- Some of the common disallowed deductions:

1) Expenditure incurred by a person in maintenance of himself;
2) Expenditure recoverable under any insurance, contract or indemnity;
3) Any income tax or tax of a similar nature paid on income; and
4) Fines and penalties.

# Contentious issues in disallowable expenses

Deductions recently done away with by the Finance Act 2020:

- Entrance fee or subscription fee paid during an year of income;
- Legal costs and incidental fees incurred on authorisation and issue of shares, debentures or any securities for the purpose of listing the same, raising additional capital or whether they are offered for purchase to the public;
- Club subscriptions paid by an employer on behalf of an employee;

# Contentious issues in disallowable expenses

Further contentious issues arising:

- The issue of the meal benefit whereby a benefit below KES 4,000 is an allowable deduction but a figure above KES 4,000 is taxed in whole and not just the amount over and above;
- Allowability of airtime in times of COVID-19 period? and
- Allowability of donations in times of COVID-19 period?

# Key dates to note

Below are critical dates to note from a tax compliance perspective.

| Obligation | Due date |
| --- | --- |
| First Instalment | 20$^{th}$ of the fourth month after year end |
| Second Instalment | 20$^{th}$ of the sixth month after year end |
| Third Instalment | 20$^{th}$ of the ninth month after year end |
| Fourth Instalment | 20$^{th}$ of the twelfth month after year end |
| Balance of Tax | 30$^{th}$ of the fourth month after year end |

Instalment taxes are computed either on a prior year basis; or on a current year basis.

# Changes to the Second Schedule

The local corporate income tax rate stands at 30%. Below is a comparison with other countries:

| Country | Old rate | New rate |
|---|---|---|
| Heavy earth moving equipment | 37.5 | 25 |
| Motor vehicle | 25 | 25 |
| Computer & computer peripheral hardware, calculators, copiers | 30 | 25 |
| Software | 20 | 25 |
| Furniture & Fittings | 12.5 | 10 |
| Commercial Buildings | 25 | 10 |
| Investment Deduction | 100 | 50* |

# Challenges of implementation of Income Taxes

# Challenges

- Kenya operates a self-assessment tax system where tax payers evaluate their business operations, report taxable income and compute tax liability.
- While significant improvements have been made to improve the tax system, the following key challenges have arisen and most particularly:

1) Failure to provide transition provisions on the recently introduced second schedule on capital/Investment allowances;

2) Update of the iTax platform to effect changes in legislation;

3) Offset of the tax overpayments;

4) Lack of knowledge among taxpayers;

# Challenges cont'd

5) Time frame within which the Commissioner to supposed to issue objection;

6) Delay by the Commissioner to issue private rulings despite clear timelines being provided in the Tax Procedures Act for the issue of the same;

7) The lack of clarity on the application of minimum tax especially for non-December year ends;

8) WHT on manpower companies?

# International tax rates & best practice

# International tax rates

The local corporate income tax rate stands at 30%. Below is a comparison with other countries:

| Country | Tax rate |
|---|---|
| Nigeria | 30% |
| South Africa | 28% |
| United States | 27% |
| Ghana | 25% |
| United Kingdom | 19% |
| Singapore | 17% |

# Best practices in taxation

Following have been identified as critical aspects to best practice:

- Attention to cost efficiency and effectiveness; Ease of complying?
- Responsive engagement with all stakeholders;
- Clarity – Taw laws should be as simple as possible; and
- Flexibility – Tax systems should be flexible and dynamic to keep up with technologies.

# INTERACTIVE SESSION


**Sandeep Singh Main**
**Associate Director, KPMG**
**March 2021**
**Email: sandeepmain@kpmg.co.ke**