

# Taxation of employment income

## Presentation by:

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# Presentation agenda

## Employee taxes



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# Employee taxes: basis of taxation



Section 3 & 5 of the Income Tax Act (ITA) CAP 470

Section 3(1) provides:

*‘a tax to be known as **income tax** shall be charged for each year of income upon **all the income** of a person, whether **resident** or **non-resident**, which **accrued in, or was derived from Kenya**’.*

# Employee taxes: basis of taxation



Section 3 (2) (a) (ii) provides:

*'tax is chargeable in respect of gains or profits from employment or services rendered'*

# Employee taxes: basis of taxation



Section 5 (1) (a) & (b) provides that an amount paid to:-

- a) a person who is, or was at the time of the employment or when the services were rendered, a **resident** person in respect of any **employment** or services rendered by him **in Kenya or outside Kenya**.
- b) a **non-resident** person in respect of any **employment** with or services rendered to an **employer who is resident** in Kenya or the **permanent establishment in Kenya** of an employer who is not so resident,

shall be **deemed** to have **accrued in** or to have been **derived from Kenya**.

# Who is a resident individual?

- Permanent home, present in Kenya for any day in a year of income = resident
- No permanent home, present in Kenya for aggregate of 183 days or more in a year of income = resident
- No permanent home, present in Kenya for an average of more than 122 days in current year of income and 2 preceding years of income = resident

# Income subject to tax



- As a general rule, all types of remuneration and benefit received by an employee constitute taxable income. **Sec.5 (2)**
- Emoluments can be in cash or non – cash form.
- Taxable employment income includes: wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, or subsistence, traveling, entertainment, allowance, **tax paid by employer on behalf or employee** etc.

# Non-taxable income



Benefit	Comment
Passage	Passage between Kenya and another place for an employee recruited or engaged outside Kenya and who is in Kenya solely for the purpose of serving the employer and is not a Kenyan.
Medical services and insurance	Insurer has to be approved by the Commissioner of Insurance
Employer pension contribution	Employer should be a person chargeable to tax.



# Non-taxable income cont..



Benefit	Comment
Education fees for dependant/relatives	If taxed on the employer
Interest free loans subject to fringe benefit tax	
Meals not exceeding Kshs. 48,000 p.a.	Provided at employer's or 3 <sup>rd</sup> party's premises. 3 <sup>rd</sup> party should be a registered taxpayer.
Gratuity	Paid into a registered pension scheme.

# Non-taxable income cont..



Benefit	Comment
Per-diem - when away from normal work station	First Kshs. 2,000 per day Above this to be accounted for.
Non-cash benefit	Not expressly provided for in the Act Aggregate value does not exceed Kshs. 36,000 p.a.

# Taxation on non-cash benefits cont..



- How to determine taxable value of some non-cash benefit is outlined in the ITA e.g. car, housing.
- Taxable value of those not specifically provided for is the higher of actual cost to the employer and the fair market value.

# Taxation on non-cash benefits cont..



The Commissioner may prescribe the value where the cost or the fair market value of a benefit cannot be determined.

- Provision of furniture – 1% of the cost of furniture to employer.
- Telephone (landline and mobile phone) – 30% of bills.
- Electricity (communal or from generator) – KShs. 1,500 p.m.
- Water (communal or from borehole) – KShs. 500 p.m.

# Taxation on non-cash benefit – Motor vehicle



**Company car** taxed at the higher of 2% p.m. of the initial cost of the car or Commissioner's prescribed rates. **S. 5 (2B)**

W.e.f.1.1.2008, employees who have restricted use of motor vehicles, the Commissioner may determine a lower rate of the benefit depending on the usage of the vehicle upon proof. **S.5 (2B)**

Hired or leased car - the taxable benefit is the lease or hiring cost. **S.5 (2B) (a) (ii)**

# Taxation on non-cash benefits - Housing



Employer pays rent under an agreement **at arm's length**, value of the benefit is the higher of:-

- **15%** of gross emoluments (excluding the value of the house), or actual cost to the employer.

Employer pays rent under an agreement **not at arm's length**, value of the benefit is the higher of the fair market value of the premises for that year or rent paid by employer.

Premises are **owned by the employer**, the value of the benefit is the fair market rental value.

# Taxation on non-cash benefits – Group life cover



Employer pays a premium for an insurance on the life of his employee and for the benefit of the employee or his dependants - taxable unless;

- The amount is paid to a registered or unregistered pension scheme, pension fund, provident fund or individual retirement fund;
- The cover confers a benefit to the employer.

# Taxation of terminal benefits

- An amount received in respect of employment in a year of income different from the year of accrual, such income is deemed to be income of the year of accrual.
- If the year of accrual is earlier than 4 years prior to the year of receipt, the income is spread back over 5 years prior to the year in which the income is received or employment ceased.



# Taxation of terminal benefits

- The service gratuity amount is to be spread backwards and taxed together with income earned in the relevant years.
- Notice pay is assessable in the period immediately after date of leaving employment.
- Pay in lieu of leave should be taxed in the year to which the leave days relate.

# Taxation of terminal benefits

- Where there is a specified term contract, the amount of the compensation will be spread over the unexpired period at equal amounts and taxed accordingly.
- 5 year contract terminated after 3 years.  
Compensation is Kshs. 2,000,000.

# Taxation of terminal benefits

- Where the contract is for unspecified term and provides for terminal payment, then the compensation will be spread forward and assessed at the rate of the employee's remuneration p.a. immediately before termination.
- Terminal payment is Kshs. 10,000,000, employee's remuneration prior to termination was Kshs. 2,000,000 p.a.

# Taxation of terminal benefits

- Where the contract is for unspecified term and does not provide for terminal payment, the compensation is to be spread forward in equal amounts for three years following the termination.

# Deductions – pension deduction



Contributions to **registered** pension, provident, individual retirement schemes allowable amount is the lesser of;

- 30% of pensionable pay;
- KShs.20,000 p.m.;
- Actual contributions.

Contributions by employers who are not taxable to unregistered schemes or excess contributions to registered schemes are a taxable benefit on employee. **S.5 (4) (c)**

# Deductions - mortgage



Mortgage deduction to owners of residential houses who occupy them; no claim for more than **1 residence**.

- Applies to purchase or improvement of premises.
- Deduction of interest not exceeding KShs. 25,000 p.m. (effective 01/01/2017)
- Deduction given on interest on loans from banks, insurance companies, building societies and National Housing Corporation only.
- Loans from **Saccos** do not qualify.

# Insurance relief



Relief of lesser of 15% of premiums paid up to a maximum of KShs. 5,000 p.m. Applies to:-

- Life insurance cover commences on or after 1.1.2003.
- Education policy with maturity period of at least 10 years commences on or after 1.1.2003.
- Health insurance commences on or after 1.1.07.

If policy is surrendered before its maturity, all the relief granted is recovered from the surrender value of the policy and remitted to the Commissioner by the insurer.

# Personal relief



Every tax **resident individual** is entitled to personal relief

Individuals serving several employers qualify for personal relief from only **one employer**.

- Relief effective 01 January 2017 - Kshs. 1,280 p.m
- Relief prior to 01 January 2017 - KShs. 1,162 p.m.
- Relief effective 01 January 2018 – Kshs. 1,408 p.m
- Relief effective 01 April 2020 – Kshs. 2,400 p.m



# Employee Vs. Consultant



- Control
- Exclusivity
- Nature of activities – integral
- Tools of work
- Nature of contract - social welfare benefits, leave, how & when to pay, duration of work etc.
- Economic reality – risk of financial loss or chance of profit

# Contact details



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