Taxation of employment income Presentation by:

CPA KARAYA MOKAYA

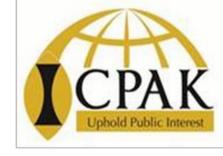
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Presentation agenda Employee taxes



- Basis of taxation
- * Residence rules
- Income subject to tax
- ❖ Non-taxable income
- Taxation of non-cash benefits
- Taxation of terminal benefits
- Available deductions and reliefs
- * Employee Vs. Consultant dilemma

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, <u>all types of remuneration</u> 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 rd party's premises. 3 rd 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 <u>higher</u> of <u>actual cost</u> to the employer and the <u>fair market value</u>.

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 <u>1%</u> of the cost of furniture to employer.
- Telephone (landline and mobile phone) <u>30%</u> 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 <u>restricted use</u> 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 <u>owned by the employer</u>, 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.



- 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.



- The <u>service gratuity</u> amount is to be <u>spread</u> <u>backwards</u> 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.



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



- Where the contract is for <u>unspecified term</u> and provides for <u>terminal payment</u>, then the compensation will be <u>spread forward</u> and assessed at the rate of the <u>employee's remuneration</u> 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.



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

Deductions - pension deduction

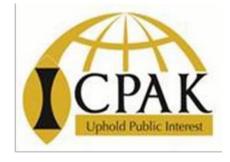


Contributions to registered pension, provident, individual retirement schemes allowable amount is the lesser of;

- 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)

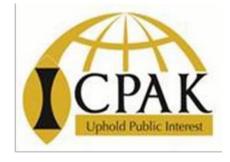
Deductions - mortgage



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 <u>10 years</u>
 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



Karaya Mokaya

Tax & Business Advisory Services | SKM Africa P O Box 28727-00100, Ambassadour Court, Milimani, Nairobi, Kenya

kmokaya@skm.co.ke | www.skm.co.ke

Direct Line: +254 722 323 926