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2018 Finance Act Analysis

Striking a balance

Introduction

The Finance Act 2018 has been ratified and assented into Law.

Following the public reading of the Budget Statement for the fiscal year 2018/2019, and subsequent release of the Finance Bill 2018, matters taxation in Kenya attracted a lot of public interest, with two Court cases challenging various provisions of the Bill and injunctions obtained effectively stopping the operation of the Finance Bill 2018. This follows the Cabinet Secretary for the National Treasury, Henry Rotich, placing reliance on an Act of Parliament known as the Provisional Collection of Taxes and Duties Act, to effectively make the Finance Bill 2018 operational, prior to the President's assent. The ruling will affect the implementation of the Finance Act in respect of legality of effective dates, some of which take effect on 1 July 2018.

Furthermore, the Parliamentary deliberations culminated in the removal of certain tax measures contained in the Finance Bill 2018. However the proposed amendments were rejected by the President of Kenya and sent back to the National assembly for reconsideration.

Noting the increased taxation burden required to finance Kenya's Kshs 2.5 Trillion budget, the National Treasury opted to downsize the budget for the fiscal period 2018/2019. This, however, coincided with increased revenue raising measures contained in the President's Memorandum to Parliament, which sought to increase, inter alia, excise duty on money transfer services, data and airtime, as well as introduce Value Added Tax (VAT) on petroleum products at a reduced rate of 8%.

With the Finance Act 2018 now operational, the 2018/2019 fiscal year offers a bigger challenge across most economic classes and sectors. Contained herein, please find our analysis of the Finance Act 2018, highlighting the various changes to the tax legislation in Kenya.

Corporate Tax

Definition of 'winnings'

The measure

The Finance Act 2018 has amended the definition of 'winnings', as contained in the Income Tax Act 2014, to read as below:

'Winnings' includes winnings of any kind and a reference to the amount or the payment of winnings shall be construed accordingly.

Previously, the definition of winnings was amended by the Tax Laws (Amendment) Act 2018 to refer to 'the positive difference between payouts made and stakes laced in a given month, for each player, payable to punters by bookmakers licenced under the Betting, Lotteries and Gaming Act'.

Who will be affected

Companies that run Betting, Lotteries and Gaming.

When

1 July 2018.

Our view

The move to amend the definition of 'winnings', for the purposes of the Income Tax Act, is likely as a result of the narrow definition introduced by the Tax Laws (Amendment) Act (TLAA) 2018, which sought to limit the tax charged on winnings to net winnings. Additionally, the definition of winnings introduced in the TLAA 2018 seems to limit the definition of winnings to winnings from betting only. The now amended definition seeks to capture not only winnings from betting, but other types of winnings as well, including winnings from lotteries, prize competition and gaming, thereby widening the taxable base.

Clarification of applicability of Capital Gains Tax on insurance companies

The measure

Section 19 of the Income Tax Act is to be amended by introduction of a provison that specifies that gains from transfer of property by general insurance companies are subject to Capital Gains Tax (CGT), while that of life assurance companies are exempt.

This proposal, initially contained in the Finance Bill 2018, has now been passed into law through the Finance Act 2018.

Who will be affected

Insurance companies.

When

1 July 2018.

Our view

Initially, the issue of CGT on transfer of property by insurance companies was not clear and led to protracted disputes between Kenya Revenue Authority (KRA) and insurance companies.
This measure is therefore meant to clarify that CGT is applicable on capital gains arising from the transfer of property by general insurance companies while the same are exempt for life assurance companies.
While a welcome measure, the provisions relating to taxation of insurance companies needs to be revisited in light of the proposed changes under International Financial Reporting Standards (IFRS 17).

Manufacturers to benefit from additional 30% deduction for electricity

The measure

The Finance Act 2018 has amended Section 15 of the Income Tax Act to provide for an additional deduction of 30% of the electricity bill incurred by manufacturers, in addition to the normal deductible electricity costs. Effectively, manufacturers would get a 130% deduction in respect of electricity bills subject to the conditions to be set by the Ministry of Energy.

Who will be affected

Manufacturers.

When

1 January 2019.

Our view

This measure aligns to one of the Government's Big Four agenda of increasing the contribution of the manufacturing sector to the Gross Domestic Product (GDP) to 15% by 2022. This is a welcome relief for manufacturers as electricity/ energy is one of the highest costs incurred in the manufacturing industry and is relatively high compared to other countries in the continent. If well implemented, this should enhance the competitiveness of local manufacturers and encourage growth and investment in the sector. However, it is hoped that the conditions to be set by the Minister will not be too restrictive as to limit the benefit and work against the noble objective. In the long run, concerted measures to reduce the cost of energy in the country will be required, as subsidies are intended to be short-term.

15% Presumptive Income Tax introduced for traders

The measure

The Finance Act 2018 has replaced turnover tax with a presumptive tax ("PIT") of 15% of the business permit or licence fee for businesses whose turnover is below Kshs. 5 Million per annum. PIT shall not apply to incorporated companies, and income from management or professional services.

Who will be affected

Unincorporated businesses that operate on single business permits issued by County Governments.

When

1 January 2019.

Our view

For businesses that have a turnover of upto Kshs 5 Million, the 15% charge on business licence permit fees that averages Kshs. 15,000 is quite an insignificant amount, as compared to the turnover tax currently levied at 3% of turnover. This, in our view, may be an attempt to bring the target businesses within the tax net and thereafter come up with a more effective taxation measure after the implementation of the existing turnover tax mechanism proved ineffective.

This measure will require cooperation with County Governments to effectively collect the tax.

Repeal of Compensating Tax and introduction of tax on dividends distributed from untaxed profits

The measure

The Finance Bill 2018 proposed to repeal the compensating tax provisions under Section 7A of the Income Tax Act and replace them with a corporation tax on distributions made out of untaxed profits. This proposal has now been crystallized into law through the passing of the Finance Act 2018.

Who will be affected

All companies paying dividends, except registered collective investment schemes.

When

1 January 2019.

Our view

This provision is in essence similar to the current compensating tax regime, save for the fact that per the new provisions, companies may no longer be required to maintain a dividend tax account for purposes of determining the tax due on untaxed profits. This therefore simplifies the tax regime.

Additionally, under the new provision, tax will only be applicable where a dividend is distributed out of untaxed profits. This is unlike the system under the prevailing regime where compensating tax could apply where profits have been taxed at a rate lower than the prevailing corporation tax rate.

However, the provision does not define what constitutes untaxed profits and this will present significant challenges in interpretation and could impact a number of taxpayers negatively. For example, holding companies which receive dividends from subsidiaries and distribute the same to shareholders would be negatively impacted if their dividend income were to be treated as untaxed income, since it would have been taxed in the hands of the subsidiaries but exempt in the hands of the holding company, under the current income tax provisions. There is therefore an urgent need to clarify the extent of this provision.

Similar to concerns regarding compensating tax, this new provision could also claw back tax incentives. For instance, income that was hitherto exempt from tax, such us interest from infrastructure bonds, would be subject to tax upon dividend payment. We believe this provision should be done away with as it introduces significant uncertainty in taxation.

Expansion of the scope of deemed dividend

The measure

The Finance Act 2018 has amended Section 7 of the Income Tax Act by expanding the scope of deemed dividends to include the following:

A. Distribution of any cash or assets to a shareholder or person related to the shareholder;
B. Discharge of any obligations or settlement of debt on behalf of a shareholder or a connected/ related party to the shareholder;
C. Use of any amount for the benefit of the shareholder or related party; and
D. Transfer pricing adjustments – i.e. amounts representing additional taxable income or reduced tax losses arising from adjustments by virtue of any transactions with a shareholder or a shareholder's related party.

Who will be affected

All companies making relevant distributions and/ or payments to their shareholders or parties related to the shareholders.

When

1 January 2019.

Our view

This provision significantly widens the scope of deemed dividend provisions to cover various dealings with shareholders of a company. The provision will have a negative impact on companies and shareholders, as their dealings will likely trigger adverse tax consequences.

One would have expected a threshold on the value of benefits to minimise the administrative burden on accounting for insignificant benefits, such as the promotional items issued to shareholders during Annual General Meetings.

Special tax rates under a special operating framework with the government

The measure

The Finance Bill 2018 proposed to amend the Third Schedule to the Income Tax Act to provide for a special corporation tax rate for Companies engaged in business, under a special operating framework arrangement with the Government.

The rate of corporate tax shall be to the extent provided in the arrangement rather than the normal set of corporate tax rates.

This proposal has now been passed into law by virtue of the ratification of the Finance Act 2018.

Who will be affected

Companies working under special agreements with the Government.

When

1 January 2019. It is worth noting that the effective date for the special operating framework exemptions under Value Added Tax (VAT), Excise, Import Declaration Fee (IDF) and Railway Development Levy (RDL) provisions is on 1 July 2018.

Our view

This measure is likely aimed at entities that partner with the government to carry out specific flagship projects under the Public-Private Partneship ("PPP") model or as part of the Big Four agenda.

If well packaged, this should enhance the attractiveness of PPP projects and mobilise investment in projects that contribute to the Big Four agenda, such as affordable housing.

Withholding Tax

Introduction of 20% withholding tax on demurrage charges

The measure

The Finance Act 2018 has introduced withholding tax at the rate of 20% on demurrage charges paid to a non-resident ship operator. The Act defines "demurrage charges" as the penalty paid for exceeding the period allowed for taking delivery of goods or returning any equipment used for transportation of goods.

Who will be affected

Non-resident shipping lines/ operators and their customers.

When

1 July 2018.

Our view

This measure is likely to have a negative effect on business and could make the country less competitive in terms of the shipping business. It is likely that the affected taxpayers could either pass on the impact of the tax by increasing the demurrage charge or increasing the original freight charges in lieu of the demurrages, to avoid the tax.

The importers will bear the burden if the ship owners take this approach. It does not also help that in most cases, demurrage charges arise out of inefficiencies within government agencies. While the revenue authority may be looking at bringing demurrage charges into the tax net, it would have been more appropriate to capture demurrage under Section 9 of the Income Tax Act, which imposes tax on the income of non-resident shipping operators.

Introduction of withholding tax on insurance premiums paid to non-resident persons

The measure

The Finance Bill 2018 proposed to charge withholding tax on insurance premiums paid to non-residents at the rate of 5% of the gross amount of premium payable, excluding insurance premiums paid for insurance of aircrafts.

This proposal has now been passed into Law though the Finance Act 2018.

Who will be affected

Non-resident insurance companies receiving premiums from Kenya.

When

1 July 2018.

Our view

The measure is aimed at expanding the tax net and may be intended to promote the take up of insurance with local insurance companies. However, it is not clear if this is also intended to cover reinsurance premiums. If this is the case, there will be an impact on insurance businesses in Kenya if the foreign reinsurance companies quote their premiums net of tax, thereby shifting the burden to the resident taxpayer.

Pay As You Earn (PAYE)

New contribution by employees and employers to the housing fund

The measure

The Finance Act 2018 amends the Employment Act to introduce a contribution of 1.5% of an employee's gross monthly emoluments and a matching contribution by the employers towards the National Housing Development Fund, subject to a maximum of Kshs. 5,000.

The initial proposal, as contained in the Finance Bill 2018, stipulated a contribution of 0.5% of an employees gross monthly emoluments by both the employer and employee, amounting to a total of 1% of an employee's gross emoluments.

Who will be affected

All employers and employees.

When

1 July 2018.

However, the Finance Act 2018 states that the Housing Development Levy will become effective upon the gazettement of regulations to be published by the Cabinet Secretary responsible for housing.

Our view

Whereas the purpose for the contribution is noble; i.e. to ensure that Kenyans have access to affordable housing, there is still lack of clarity on how this Fund will operate.

It is also unclear whether the Fund will benefit contributors only or both contributors and non-contributors and the nature and extent of the benefits.

In addition, it is not clear whether or not the contribution will be allowable for tax in the hands of the employees.

It is therefore proposed that the detailed framework for this fund be put in place sooner, rather than later, and stakeholders' input be obtained to avoid pitfalls that would make this move ineffective.

This contribution amounts to an additional tax for employees and increases the cost of employment for employers. One would expect that if the beneficiaries will not be limited to employees, then measures to expand the contributor base should be put in place.

Further to the above, it is noted that the Finance Act 2018 specifically defines 'employee earnings' as 'the taxable amount determined under the Income Tax Act for purposes of levying income tax on the employee emoluments'. However, in relation to the National Housing Develoment Fund, it is noted that the additional levy of 1.5% will be based on the employee's basic salary. This is likely to create confusion as to which amount is subject to the 1.5% National Housing Development levy. Clarity would be required to ensure that the section is correctly interpreted.

Tax Amnesty on foreign income extended

The measure

The period of tax amnesty on foreign incomes has been extended from 30th June 2018 to 30th June 2019. In addition, the amnesty will include income accrued up to the period 31 December 2017.

Furthermore, the funds declared under the amnesty will be exempt from provisions of the Proceeds of Crime and Anti-Money Laundering Act or any other Act relating to reporting and investigation of financial transactions.

Who will be affected

Taxpayers earning taxable foreign income.

When

1 July 2018.

Our view

This is a move by the Government to encourage the uptake of the amnesty, which has previously been slow. It also serves as assurance to the taxpayers taking advantage of the amnesty that the repatriated funds will be exempt from further investigations with regards to possible crimes or scrutiny under other laws. Fear of investigations or prosecution was cited as one of the possible reasons for the slow uptake of the amnesty.

However, the amendments fail to address other critical questions with regard to the amnesty, including the requirement for repatriation of funds where such income would have been consumed or where such income was invested in illiquid assets, as well as the limited scope of the amnesty, considering the extent of foreign incomes that are taxable in Kenya.

While it is expected that the uptake will increase due to the changes contained in the Finance Act 2018, the above challenges will limit the success of this amnesty.

Late Filing Penalty for individual Tax Returns

The measure

The penalty for late filing of tax returns by individuals has been introduced at 5% of principal tax due, subject to a minimum of Kshs. 2,000.

Who will be affected

Individual Taxpayers.

When

1 July 2018.

Our view

This reduction of the minimum penalty applicable on late filing of tax returns to Kshs 2,000 (from Kshs. 20,000) is a welcome move, as high penalties discourage filing by those who may have missed the deadlines.

Excise Duty

Amendment of license suspension provisions

The measure

The Finance Act 2018 has amended Section 23 of the Excise Duty Act on suspension of excise duty licenses as follows:

- Deleting the provision on the period within which a licensee is required to take remedial action required by the Commissioner and the period within which the Commissioner should acknowledge the action taken.
- Deleting the provision providing for appeal of the Commissioner's decision to suspend a license to the Tax Appeals Tribunal.
- Deleting the provision requiring the Commissioner to give prior notice where the Commissioner seeks to revoke, cancel or not renew a license.

In addition, the Finance Act 2018 has granted the Commissioner powers to suspend an excise license without notice where the licensee:

- Has engaged in tax fraud;
- Has been found in possession of, or using, counterfeit stamps on excisable goods;
- Has been found in possession of goods bearing counterfeit stamps; or
- Has violated any regulations relating to health and safety, standards or packaging of goods.

Who will be affected

Manufacturers of excisable goods.

When

1 July 2018.

Our view

The removal of timelines that were provided for licensees to remedy the action of the Commissioner on suspension of excise licenses will lead to uncertainty on the suspension process and may create room for the Commissioner to impose unreasonable timelines.

Amendment of Part VIII of the Excise Duty Act on offences and penalties

The measure

The Finance Act 2018 has made the following amendments to the offences and penalties provisions under the Excise Duty Act:

- Introduction of a minimum penalty of Kshs 5 million on persons who manufacture excisable goods or import excisable goods requiring stamps, without being licensed.
- Introduction of powers by the Commissioner to seize any plant or excisable goods in respect of which an offence has been committed with regards to:
  - Carrying out activities requiring a license without a license;
  - Contravention of licensing obligations; and
  - Contravention of excise stamps obligations.

Who will be affected
Manufacturers of excisable goods.

When
1 July 2018.

Our view
Section 38 of the Excise Duty Act currently imposes a penalty of double the excise duty payable on persons carrying out activities requiring an excise license without a license. The Finance Act 2018 has introduced a minimum penalty of Kshs 5 million to further discourage undertaking of the aforementioned activities without a license. This measure coupled with powers granted to the Commissioner to seize goods related to this offence, is expected to enhance compliance and bring more manufacturers of excisable goods under the Commissioner's control.

Introduction of excise duty

The measure

The Finance Act has introduced excise duty on the following items:

- Sugar confectionery of tariff heading 1704 and chocolate of tariff codes 1806.31.00, 1806.32.00 and 1806.90.00 at Kshs 20 per Kg; and
- Internet data services at 15% of the excisable value.

Who will be affected
Importers, manufacturers and consumers of sugar confectionery; and internet service providers and consumers of internet data services.

When
1 July 2018.

Our view
This measure is aimed at generating additional revenue for the Government and discouraging the consumption of sugar confectionery which are high in sugar content. Excise duty was also previously applicable on certain confectionery products in Uganda but this was recently removed through the Excise Duty (Amendment) Act 2018. It remains to be seen whether Kenya will eventually follow suit.

Increase in excise duty

The measure

The Finance Act 2018 has increased excise duty on the following goods and services:

- Private passenger cars of tariff code 8703.24.90 (Petrol powered cars with an engine rating exceeding 3000cc) and 8703.33.90 (Diesel powered cars with an engine rating exceeding 2500cc) from 20% to 30%.
- Money transfer services by cellular phone service providers from 10% to 12%.
- Illuminating kerosene from Kshs 7,205 per 1,000 litres to Kshs 10, 305 per 1,000 litres.
- Money transfer services by banks, money transfer agencies and other financial service providers from 10% to 20%.
- Other fees charged by financial institutions from 10% to 20%.
- Telephone services from 10% to 15%.

Who will be affected

Importers and consumers of motor vehicles and kerosene, service providers and consumers of the affected services.

When

1 July 2018.

Our view

The increase in excise duty on the aforementioned goods and services is primarily driven by the Government's appetite for revenue to finance the budget deficit. The increase in excise duty on the more expensive high engine rating motor vehicles is intended to promote equality by ensuring excise duty is paid based on a person's purchasing power. The Government's objective here is to collect more revenue from individuals who can afford the high engine rating motor vehicles. The prices of the affected motor vehicles is expected to soar due to the increase in excise duty and the indirect increase in VAT. As a result, the Government risks losing revenue due to a possible reduced demand on the high end motor vehicles.

In his budget speech, the CS indicated that the additional revenue collected on mobile money transfer services will be used to fund the Universal Health Care. The Finance Act 2018 has further provided that 16% of excise duty paid on money transfer by cellular phone service providers will be paid to the Sports, Arts and Social Development Fund. The cost of mobile money transfer services is likely to increase since service providers are expected to pass on the additional excise duty to the consumers.

The increase in excise duty on money transfer services by banks and other financial service providers, telephone services and other fees charged by financial institutions has been effected without public participation as is prescribed in the Constitution. The High Court has in the recent past revoked various tax legislation such as the Excisable Goods Management System (EGMS) Regulations due to lack of public participation. In this regard, the Government is likely to face challenges in implementing the increments in excise duty due to possible legal action by the interested parties.

The CS introduced excise duty of Kshs 7,205 per 1,000 litres on kerosene through the 2016 Finance Act to discourage adulteration of fuel. Adulteration of fuel is motivated by the relatively low price of kerosene as compared to diesel and petrol. The Finance Act, 2018 has harmonised the excise duty applicable on kerosene with that of diesel to further bridge the gap between the price of kerosene and diesel and discourage adulteration. This measure coupled with the introduction of 8% VAT on petroleum products (including Kerosene) will significantly increase the price of kerosene and may render kerosene out of reach to the common mwananchi.

Amendment of the exemption schedule

The measure

The Finance Act, 2018 has included the following items in the excise duty exemption schedule:

- Alcoholic or non-alcoholic beverages supplied to Defence Forces Canteens Organization (DEFCO).
- Goods procured for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government.
- One personal motor vehicle, (excluding buses and minibuses of seating capacity of more than eight seats), imported by a public officer returning from a posting in a Kenyan mission abroad and another motor vehicle by his or her spouse and which is not exempted from excise duty under item 6 of Part A of the Second Schedule. This exemption will however apply under the following conditions:
  - The officer should be returning to Kenya from a posting in a Kenyan mission abroad upon recall;
  - The spouse must have accompanied the officer in the foreign mission and return with the officer;
  - The officer/spouse must not have enjoyed a similar privilege within the previous four years from the date of importation.
  - The officer/spouse must not have imported a motor vehicle free of duty as a returning resident as provided for under item 6 of Part A of the Second Schedule.
  - The vehicle is imported within 90 days of the date of arrival of the officer or spouse or such longer period, not exceeding 360 days from such arrival as the Commissioner may allow; and
  - The exemption will not apply to a state officer.

Who will be affected

DEFCO and suppliers of beverages to DEFCO, Public officers & their spouses returning from a posting in a Kenyan mission abroad.

When

1 July 2018.

Our view

The Excise Duty Act 2015 repealed the provision for exemption of excise duty on supplies made to the Kenya Defence Forces (KDF) and DEFCO that was previously provided for in the repealed Customs and Excise Act. Subsequently, the Finance Act 2016 re-introduced the exemption but only on supplies to KDF and the National Police Service to reduce the operation costs of the security forces. There have been debates amongst suppliers, the Government and KDF as to whether the exemption applied to DEFCO since DEFCO is considered to be an extension of KDF. This measure is therefore aimed at clarifying the position. It is worth noting that whereas supplies to KDF are generally exempted from excise duty, this measure only exempts beverages supplied to DEFCO.

In the recent couple of years, the Government has focused on infrastructure development projects. Generally, most of the contracts signed between the Kenyan Government and the contractors provide for tax exemptions on the project activities albeit there have been no supporting legislation in some instances. The exemption of goods used in implementation of projects under special operating framework arrangements with the Government, is therefore aimed at supporting the exemption of excise duty on goods acquired for implementation of the projects and is line with proposals to exempt other indirect taxes on similar projects. It is expected that the National Treasury will draft a framework that is expected to provide clear guidelines on projects that will be covered under this exemption.

Change to the inflationary adjustment period

The measure

The Finance Act 2018 has amended the period within which the Commissioner may adjust the specific excise duty rates to take into account inflation, from 2 years to 1 year.

Who will be affected

All consumers, manufactures, importers of excisable goods.

When

1 July 2018.

Our view

Last year, the Government changed the inflationary adjustment period from 2 years to 1 year to promote stability in the prices of goods with a specific duty rate. The Finance Act, 2018 has reversed the change made last year and the Commissioner will be expected to adjust the specific excise duty rates by the average inflation for the previous financial year on 1st July of every year. The Commissioner has already adjusted the specific excise duty rates for inflation through Gazette Notice No 164 of 2018 with an effective date of 1 August 2018. The National Assembly has challenged the gazettement of the revised rates and requested the Commissioner General to re-issue the gazette addressing the raised issues. In the meantime, tax payers are still expected to apply the revised rates pending re-gazettement of the revised rates.

Excise duty on bottled water

The measure

The Finance Act 2018 has amended the scope of water subject to excise duty to only cover bottled and similarly packaged water.

Who will be affected

Manufacturers, importers and consumers of bottled water.

When

1 July 2018.

Our view

The Finance Act 2016 excluded ordinary water of tariff code 2201.90.000 from waters subject to excise duty which implied that only mineral water of tariff code 2201.10.00 was subject to excise duty. The aim of that move was to exempt ordinary tap water from the ambit of excise duty while imposing excise duty on bottled water. However, it has been argued by some industry players that purified water is classified as ordinary water and therefore not subject to excise duty.

This measure is aimed at bringing clarity on waters falling under the realm of excise duty and avoid potential disputes with water bottling companies.

Robin Hood Tax on money transfers

The measure

The Finance Bill 2018 had proposed to introduce excise duty of 0.05% on transfer of money by banks, money transfer agencies and other financial institutions where the amounts transferred exceed Kshs 500,000.

This proposal was however not adopted in the Finance Act 2018.

Our view

Further to the proposal by the Finance Bill 2018 to impose excise duty on transfer of money by banks and financial institutions, the High Court on 19 July 2018 issued a conservatory order delaying the implementation of this proposal until such a time as a proper definition of "money transferred by banks" was provided and sufficient time allowed for alteration of computer systems operated by banks to charge excise duty.

This proposal was expected to increase the cost of doing business in Kenya and was not passed into law. Perhaps in a bid to replace the revenue that would have been collected through the robin hood tax, the Government has now doubled the excise duty on money transfer and other fees charged by Financial institutions.

Miscellaneous Fees and Levies

Definition of Special Economic Zones (SEZ)

The measure

The Finance Act has adopted the definition of SEZs contained in the SEZ Act 2015.

Who will be affected

SEZ enterprises.

When

1 October 2018.

Our view

The SEZ Act defines an SEZ as a designated geographical area where any goods introduced are regarded as being outside the customs territory, in so far as import duties and taxes are concerned.

This implies that goods imported into an SEZ will be considered as being outside the realm of fees and levies imposed by the MFLA since the fees and levies apply to goods imported for use in Kenya. The Second Schedule of the MFLA exempts goods destined for an SEZ from Import Declaration Fee (IDF). However, the MFLA does not provide for exemption of Railway Development Levy (RDL) and the newly introduced adulteration levy. The definition of an SEZ in our view means that goods imported into an SEZ will now be exempted from RDL and adulteration levy.

Proposed introduction of export duty on copper waste and scrap

The measure

The Finance Bill 2018 had proposed to introduce export levy of 20% on copper waste and scrap metal.

This proposal has however not been included in the Finance Act 2018.

Our view

This measure was initially intended to discourage the exportation of copper scrap which is used by local manufacturers as raw materials and to discourage vandalism of public infrastructure.

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IDF and RDL exemption on goods for implementation of projects under special operating framework arrangement with the Government

The measure

The Finance Act 2018 exempts from IDF and RDL goods imported for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government.

Who will be affected

Companies executing projects under special operating framework arrangements with the Government.

When

1 July 2018.

Our view

This measure has been put in place to streamline the Miscellaneous Fees and Levies Act to avoid the need for the CS to make amendments to the Act each time the Government intends to grant exemption of IDF and RDL on specific projects that will qualify under the framework.

Introduction of anti-adulteration levy

The measure

The Finance Act 2018 has introduced an anti-adulteration levy on kerosene imported for home use at Kshs 18 per litre.

Who will be affected

Importers of kerosene.

When

1 October 2018.

Our view

This measure seeks to reduce the variance in price between kerosene and diesel to curb against the adulteration of diesel.
The increase in the price of kerosene will negatively impact the ordinary citizen who rely on kerosene as a source of energy for cooking and lighting.

Value Added Tax (VAT)

VAT on petroleum products

Petroleum Products

The measure

Section 5 (2) of the VAT Act, 2013 has been amended to introduce VAT at 8% on petroleum products which have previously been exempt, under transition, since the enactment of the VAT law in September 2013.

Specifically, the introduced paragraph states:

(aa) in the case of goods listed in Section B of Part I of the First Schedule, eight percent of the taxable value, effective from the date of assent:

Provided that –

i. The taxable value in respect of these goods shall exclude excise duty, fees and other charges; and
ii. Despite Section I of the Finance Act, 2018, this paragraph comes into effect upon enactment of the Supplementary Appropriation (No. 2) Act, 2018.

Who will be affected

All taxpayers and consumers of petroleum products.

When

Upon enactment of the Supplementary Appropriation (No. 2) Act, 2018.

Our view

Upon the change from the repealed VAT Act (CAP 476) to the current VAT law, the following petroleum products were classified as exempt from VAT for a transitional period of three years:

2709.00.00 - Petroleum oils and oils obtained from bituminous minerals, crude.
2710.12.10 - Motor spirit (gasoline) regular.
2710.12.20 - Motor spirit (gasoline), premium.
2710.12.30 - Aviation spirit.
2710.12.40 - Spirit type jet fuel.
2710.12.50 - Special boiling point spirit and white spirit.
2710.12.90 - Other light oils and preparations.
2710.19.10 - Partly refined (including topped crudes).
2710.19.21 - Kerosene type jet fuel.
2710.19.22 - Illuminating kerosene (IK).
2710.19.29 - Other medium petroleum oils and preparations.
2710.19.31 - Gas oil (automotive, light, amber, for high speed engines).
2710.19.39 - Other gas oils.
2711.21.00 - Natural gas in gaseous state.
2711.29.00 - Other natural gas in gaseous state.

The three year transitional period would have expired at the start of September 2016. However, through the Finance Act, 2016, it was extended by an additional two years. This extension expired at the start of September 2018.

The Finance Act, 2018 therefore brings the above mentioned petroleum products to tax, but at a reduced VAT rate of 8%. It is worth noting that, the taxable value of these products will exclude other government levies and taxes.

This is largely seen as a revenue raising measure with Treasury expected to collect an additional Kshs 35 Billion in revenue from VAT on these products. However, it is expected that this measure will increase the average cost of living in Kenya, particularly in relation to the attendant knock-on effect due to increased transportation and electricity generation costs.

Big four agenda

Food security

The measure

Zero rating of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava.

Who will be affected
Local mwananchi, millers, bakers etc.

When
1 July 2018.

Our view
The above mentioned products qualify as basic food commodities for the normal mwananchi. A move to zero rate these products obviously makes them more affordable. The positive impact on pricing for these commodities is as explained below:

- When a zero rate is applied, no VAT would be charged on these products; and
- Zero rating entitles the seller to claim a credit for VAT suffered on purchases acquired to manufacture these products. Therefore, VAT on inputs is not a cost to the seller and does not get transferred to the end user.

The move to zero rate these products is therefore welcome.

However, the government needs to ensure that any tax legislative changes are well thought-out to avoid incidences of confusion and non-compliance by taxpayers. The VAT status of these products has changed from exempt to zero-rate to exempt and now back to zero-rate in a span of approximately one year.

In this case for example, the effective date for the zero rate is 1 July 2018. Coincidentally, the Tax Laws Amendment Act, 2018 which bestowed an exempt status on these products also cites an effective date of 1 July 2018. To change the VAT status of these products from exempt to zero rate for the period from July 2018 to the date when the Finance Act was gazetted means that affected taxpayers would be required to not only start raising tax invoices to their customers but also to amend their VAT returns.

Keeping abreast with such changes may be burdensome on taxpayers and could possibly result in cases of inadvertent non-compliance.

Food security

The measure

Exemption of equipment to be used in the construction of grain storage facilities.

Who will be affected

Consumers, players in the grain storage sector, suppliers of construction equipment for grain storage facilities and farmers.

When

1 July 2018.

Our view

The exemption of construction equipment for grain storage facilities follows the initial exemption of construction materials, which was introduced through the Finance Act, 2017. This is aimed at further incentivising investment in grain storage facilities with a view to arrest post-harvest grain losses and to curb an already high cost of storage.

Ultimately, this is expected to enhance food security and reduce the prices of basic food commodities such as maize flour.

Manufacturing - ICT

The measure

Exemption of parts, imported or purchased locally for the assembly of computers.

Who will be affected

Players in the ICT sector and computer users.

When

1 July 2018.

Our view

To encourage local assembly of computers, innovation and job creation in the ICT sector, the proposal to exempt parts imported or purchased locally in this regard would be a welcome move. It is worth noting that this exemption initially only covered parts imported or purchased locally for the assembly of primary school laptop tablets.

Manufacturing – Growing the local textile industry

The measure

Importation of garments and leather footwear manufactured in an EPZ to be subject to VAT.

Who will be affected

EPZ entities and wananchi.

When

1 July 2018.

Our view

Domestic sales by EPZ entities are considered as importation of goods from a customs perspective and should ordinarily be subjected to VAT. However, such sales were previously exempt from VAT to encourage wananchi to access high quality garments and leather footwear at affordable prices.

Perhaps the move to subject garments and leather footwear to VAT is targeted at encouraging the establishment of local leather and textile industries. The intention would be to provide an even playing ground between EPZ entities and those established locally when competing for the local market.

However, questions remain as to whether this move will yield the intended results. Locally made garments and leather footwear tend to be more expensive than imported ones. As such, exemption remains key to enhancing affordability for such items.

Manufacturing

Clarification on exemption of machinery of chapter 84 and 85

The measure

Exemption of plant and machinery of Chapters 84 and 85 to be restricted to those used for manufacture of goods.

Who will be affected

Manufacturers and suppliers of machinery.

When

1 July 2018.

Our view

Restriction of machinery under the above mentioned chapters to those used in the manufacture of goods is a measure aimed at clarifying the provision relating to this exemption. Taxpayers previously relied on guidance by the KRA on the tariff headings that the KRA deemed to qualify for exemption under the said privision. The move may however have an adverse effect on the taxpayers who import or purchase machinery classifiable under chapters 84 and 85 which are not used in manufacture of goods.

Further, it is important that clarity is provided on what constitutes *"manufacture of goods"* in this regard.

Administrative VAT changes

The measure

Late filing penalty moved from the VAT Act to the Tax Procedures Act.

Who will be affected
All taxpayers.

When
1 July 2018.

Our view
The measure to move the late filing penalty to the Tax Procedures Act is meant to harmonize the application of tax laws. Most administrative penalties covering domestic taxes have been moved to the Tax Procedures Act.
The penalty however remains at the higher of 5% of the tax payable or Kshs 10,000.

Computation of taxable value for cellular services

The measure

Taxable value of mobile cellular services to be determined in accordance with the VAT Act.

Who will be affected
Telecommunication companies and wananchi.

When
1 July 2018.

Our view
This amendment will change the taxable base of mobile cellular services by including excise duty in the taxable value. This move is a departure from the previous practice where the value of mobile cellular services was determined in accordance with the Excise Duty Act, implying that the taxable value for VAT excluded excise duty.

This measure, coupled with the increase in the excise duty rate of telephone and internet data services from 10% to 15%, will definitely result in higher costs of cellular services.

Other VAT changes

Cross border transportation

The measure

Transportation of cargo to destinations outside Kenya removed from the exemption schedule.

Who will be affected
Transporters and exporters.

When
1 July 2018.

Our view
Transportation to destinations outside Kenya is currently exempt under the VAT Act. The VAT Regulations however provide that where transportation begins in the country and ends outside the country, such a service should be considered as exported and hence zero-rated.

We are therefore of the considered view that this move is aimed at aligning the VAT Act with the VAT regulations with a view of clarifying that where transporation begins in the country and ends outside the country then the transport service is considered as an export of service and therefore zero rated. This position would be welcome and in line with best practice.

Exemption of beverages supplied to DEFCO

The measure

Exemption of alcoholic and non-alcoholic beverages supplied to DEFCO.

Who will be affected
DEFCO and suppliers to DEFCO.

When
1 July 2018.

Our view
Supplies to DEFCO were exempt from VAT under the repealed VAT Act but became taxable at 16% with the enactment of the VAT Act, 2013. The move to exempt from VAT alcoholic and non-alcoholic beverages supplied to DEFCO therefore restores the privildege that was available to the defence forces.

Exemption of goods and services for special projects

The measure

Exemption of goods and services for use in projects under special operating framework with the GoK.

Who will be affected

Suppliers and implementers of the projects under GoK's Special Operating Framework.

When

1 July 2018.

Our view

Goods and services intended for exclusive use in projects implemented under the Special Operating Framework with the GoK will be exempt from VAT. While it is not immediately clear the projects that qualify, we believe that these would include projects under Public-Private Partnerships (PPPs) and other flagship projects under arrangments similar to official aid funded projects.

Exemption of hearing aids, excluding parts and accessories, under tariff No. 9021.40.00

The measure

Exemption of hearing aids, as under tariff No. 9021.40.00, from VAT, excluding parts and accessories.

Who will be affected

Suppliers, importers, and consumers of hearing aid products.

When

1 July 2018.

Our view

The exemption of hearing aids from VAT is likely targeted at making hearing aid products more affordable to persons with disabilities in Kenya.

However, it is to be noted that this will likely cause an imbalance in the cost of hearing aids produced locally and those imported. In relation to hearing aids produced locally, manufacturers of the same will no longer be able to claim input VAT, following the exemption of the product. This may have a knock-off effect whereby the manufacturers will likely transfer the added costs of non-recoverable input VAT to the final consumer, thereby making locally produced hearing aids more expensive than imported ones.

Exemption of personal motor vehicles imported by a public officer returning from a Kenyan mission abroad

The measure

Public officers returning to Kenya from an official mission abroad may import at least one personal motor vehicle, excluding buses and minibuses of seating capacity of more than eight, exempt from VAT. Similarly, the benefit is extended to their spouse who may also import at least one personal motor vehicle, excluding buses and minibuses of seating capacity of more than eight, exempt from VAT.

However, the paragraph notes that the exemption so granted shall not apply:

- Unless the officer is returning to Kenya from a posting in a Kenyan mission abroad upon recall;
- Unless, in the case of an officer's spouse, the spouse accompanied the officer in the foreign mission and is returning with the officer;
- If the officer or the spouse has either enjoyed a similar priviledge within the previous four years from the date of the importation or has imported a motor vehicle free of duty under item 6 of Part A of this Schedule;
- Unless the vehicle is imported within ninety days of the date of arrival of the officer or spouse or such longer period, not exceeding three hundred and sixty days from such arrival as the Commissioner may allow; and
- To a State Officer.

Who will be affected

Public officers and their spouses returning to Kenya from an official mission abroad.

When

1 July 2018.

Our view

The exemption from VAT of one personal motor vehicle by a public officer returning to Kenya from an offial mission abroad is, in our view, a welcome move. This will assist in ensuring that public officers returning to Kenya have a smooth relocation back into the country.

It is also worth noting that some of the conditions required of returning residents have been waived and will not apply to returning public officers. For instance, it would seem that even where an official mission abroad does not last over 12 months, a returning public officer may still enjoy this exemption. The 12 month condition would however apply for returning residents who do not qualify as public officers.

Perhaps more clarity is needed on who qualifies as a public officer returning from an official mission abroad.

Exemption for postal services

The measure

Exemption from VAT of postage using stamps and rental of post boxes and mail bags.

Who will be affected

Postal Corporation of Kenya and consumers.

When

1 July 2018.

Our view

This measure may be aimed at making postal services more affordable, perhaps with the intention of wooing the public to reconsider taking up postal services that have been affected by the advent of internet and other technology.

However, since exemption of these services will imply that the Postal Corporation will not be in a position to deduct related input tax, this measure could lead to an increase in their operating costs and ultimately an increase in the cost of their services contrary to the intention of making the services cheaper.

Perhaps a better option would be zero rating the postal services.

Changes to the list of zero rated medicaments

The measure

Deletion of medicaments of tariff number 3004.40.00 from the schedule of zero rated items. Medicaments of tariff numbers 3004.41.00, 3004.42.00, 3004.43.00 and 3004.49.00 have however been added to the schedule of zero rated items.

Who will be affected

Pharmaceuticals, health care centres and those in need of health care.

When

1 July 2018.

Our view

Tariff number 3004.40.00 does not exist in the East African Community Common External Tariff (EAC CET), 2017. It would therefore seem that it's deletion and the inclusion of the above mentioned tariff numbers in the list of zero-rated medicaments is aimed at aligning the tariff numbers under the Second Schedule of the VAT law to those under the EAC CET, 2017.

Tax Administration

Alternative Dispute Resolution now anchored in the law

The measure

The parties to an appeal may apply, in writing, to the Tribunal to settle their dispute out of the Tribunal. In such a case, the time taken to resolve or conclude the settlement out of the Tribunal shall be excluded when calculating the period of 90 days within which the dispute should be determined by the Tribunal, as provided under section 13 (7) of the Tax Appeals Act.

Who will be affected

All taxpayers.

When

1 July 2018.

Our view

This measure reinforces the current practice where taxpayers and the Kenya Revenue Authority ('KRA') have been settling disputes out of the Tribunal. This is a plausible move as it strengthens the Alternative Dispute Resolution mechanisms that have been ongoing between disputing parties.

Responsibilities of tax representatives

The measure

The Tax Procedures Act has been amended to specify that where a taxpayer has more than one tax representative, each tax representative shall be responsible for the tax obligations for which the tax representative has been appointed.

Who will be affected

Taxpayers and their tax representatives.

When

1 July 2018.

Our view

This measure is aimed at clarifying the obligations of each tax representative and is aimed at achieving a greater level of compliance for tax representatives. It is a positive move, considering tax representatives would not want to bear additional obligations or risks in respect of tax obligations for which they are not engaged.

Guidelines for application for extension of time to submit tax returns

The measure

The Finance Act 2018 has set out the guidelines below for application of the extension of time to file returns;

- The extension shall be made at least fifteen days and thirty days before the due date, in the case of a monthly return and annual return respectively;
- The Commissioner may grant an application if satisfied that there is a reasonable cause, and shall notify the applicant accordingly at least five days before the due date;
- Where no notification is received at least five days before the due date, the application shall be deemed to have been granted;
- Only one extension may be granted in respect of a tax period;
- The grant of an extension shall not alter the date for payment of any tax due under the return, as specified in the tax law under which the return has been made; and
- Provisions relating to penalties for late submission shall not apply where an extension to submit a return has been granted in accordance with this section.

Who will be affected

Taxpayers.

When

1 July 2018.

Our view

This provides clarity regarding the process and timelines for application for extension of time to file tax returns. This should assist taxpayers in planning and therefore avoid incurring late filing penalties. It also commits the revenue authority to respond within a particular timeline and therefore removes the exposure and uncertainty currently experienced, where a taxpayer does not receive a reponse from the revenue authority before the due date.

Amendments of self-assessment returns

The measure

The Finance Act 2018 has deleted the current provision on amendment of self-assessment returns and substituted it with the following;

'Where an amended self-assessment return has been submitted, the Commissioner may accept or reject the amended self-assessment return and where he rejects, he shall furnish the taxpayer with reasons for such rejection within thirty days of receiving the application'.

Who will be affected

Taxpayers who have filed returns and wish to make amendments.

When

1 July 2018.

Our view

Under the deleted provision, the taxpayer would make an application to the Commissioner and the Commissioner would amend the self-assessment return or refuse application to make the amendment and communicate the refusal within thirty days.

While the initial proposed amendment did not provide a time limit for the Commissioner to communicate the rejection of the amendment, the final provision ratified into law expressly provides that the Commissioner has thirty days to provide a response to the tax payer with respect to the above application.

In our view, the proposed provision is a step forward towards making compliance easier for taxpayers. This observation is strengthened by the fact that now that the Commissioner has a set timeline to respond to a taxpayer's application for the amendment of self-assessment returns.

Late payment interest rate increased

The measure

The Finance Bill 2018 proposed to increase the late payment interest rate from 1% to 2%.

However, this proposal has been dropped in the Finance Act 2018. Consequently, the late payment interest rate remains at 1%.

Our view

The move to maintain the late payment interest rate at 1% is seen as a welcome move. The previously proposed increase was largely seen as punitive.

Notice of Objection to tax decision

The measure

The Finance Act 2018 has amended the provisions on validity of a notice of objection;

- By allowing a taxpayer to apply for an extension of time to pay the tax that is not in dispute, based on section 33 (1) of the Tax Procedures Act; and
- Requiring that all relevant documents relating to the objection have been submitted when submitting the objection.

Who will be affected

Taxpayers lodging a notice of objection.

When

1 July 2018.

Our view

This is a good move since the taxpayer may not be in a position to settle tax not in dispute, where it is significant, before filing of the notice of objection.

Late submission penalty for tax returns

The measure

The Finance Act 2018 has effected the following changes with regard to late submission penalties;

A person who submits a tax return after the due date shall be liable to a penalty of;

- 5% of the amount of tax payable under the return or Kshs. 10,000 , whichever is the higher, in the case of Value Added Tax (VAT) or excise duty;
- In any other case;
  - 5% of the amount of tax payable under the return or Kshs. 20,000, whichever is the higher, in respect of a person other than an individual; and
  - 5% of the amount of tax payable under the return or Kshs. 2,000, whichever is the higher, for an individual.

Who will be affected

Taxpayers who submit the tax returns after the due date.

When

1 July 2018.

Our view

This reduced late filing penalty for VAT, Excise duty and for individuals is welcome. The Kshs 20,000 penalty previously applicable to individuals was punitive and out of reach for a majority of the individuals.

Late payment penalty

The measure
A person who fails to pay tax on the due date shall be liable to pay a late payment penalty of 5% of the tax due and payable.

Who will be affected
Taxpayers who fail to pay tax within the stipulated timelines.

When
1 July 2018.

Our view
The re-introduction of the 5% penalty provides clarity by distinguishing the late payment penalty from the tax shortfall penalty, which has been a subject of debate between taxpayers and the KRA.

Application for waiver of penalties and interest

The measure
The Finance Act 2018 has excluded the application for waiver of interest and penalties on the ground of uncertainty as to any question of law or fact. As a result, the reasons upon which the Commissioner may remit, in whole or in part, the penalties and interest following an application by a taxpayer have been reduced to;

- Consideration of hardship or equity; or
- Impossibility or undue difficulty or expense, of recovery of the tax.

Who will be affected
Taxpayers who are making applications for waiver of penalties and interest.

When
1 July 2018.

Our view
The measure narrows down the scope of application for waiver of interest and penalties by a taxpayer.

Unauthorized access or improper use or interference with the computerized tax system

The measure
The Finance Act 2018 has described the below as an offence in relation to unauthorized access or improper use of the computerized tax system;

- Knowingly and without lawful authority, by any means, gains access to or attempts to gain access to any computerized tax system;
- Having lawful access to any computerized tax system, knowingly uses or discloses information obtained from such a system, for a purpose that is not authorised; and
- Knowing that he is not authorized to do so, receives information obtained from any computerized tax system, and uses, discloses, publishes, or otherwise disseminates such information.

The above offences are punishable by imprisonment for a term not exceeding two years or a fine not exceeding four hundred thousand shillings or both, in the case of a natural person, and a fine not exceeding one million shillings for a body corporate.

A person commits an offence relating to interference with a computerized tax system when the person;

- Falsifies any record or information stored in any computerized tax system;
- Damages or impairs any computerized tax system; and
- Damages or impairs any duplicate tape or disc or other medium, on which any information obtained from a computerized tax system is held or stored otherwise, than with the permission of the Commissioner;

A person who commits the above offence is liable to imprisonment for a term not exceeding three years, or to a fine not exceeding eight hundred thousand shillings, or to both.

Who will be affected
Persons who gain unauthorized access or improperly use or interfere with the computerized tax system.

When
1 July 2018.

Our view
This move is aimed at safeguarding the information that is stored in the computerized tax system. Currently, data protection is key to the digital world, hence, this is a welcome move.

Offences relating to recovery of tax and offences by officers and staff of the KRA

The measure
The Finance Act 2018 has amended section 104 of the Tax Procedures Act by reducing the punishment of offences relating to recovery of tax, and offences by officers and staff of the KRA, from a fine not exceeding two million shillings and imprisonment for a term not exceeding 5 years, to either a fine not exceeding two million shillings or imprisonment for a term not exceeding five years or both.

Who will be affected
Persons convicted to offences relating to recovery of tax or officers and staff of the KRA convicted of offences.

When
1 July 2018.

Our view
The punishment was severe and hence the reduction of the same to one or the other is reasonable.

Betting, Lotteries and Gaming

The measure

The Finance Act 2018 has introduced a late payment penalty of five per cent of the tax payable and simple interest at a rate of one per cent per month, or part of a month, on the amount unpaid of betting tax, lottery tax, gaming tax and prize competition tax. These penalties and interest shall be payable to the Collector.

A person liable to a late payment penalty or interest may apply in writing to the Collector for the remission of the penalty or interest payable, and such application shall include the reasons for the application.

In addition, the Finance Act 2018 has enumerated the reasons the Collector may remit in whole or in part the penalties and interest following an application by a taxpayer as below;

- Consideration of hardship or equity; or
- Impossibility, undue difficulty or expense of recovery of the tax.

The Collector can only remit penalties and interest that are less than one million five hundred thousand shillings. For amounts greater than this, he has to seek prior approval of the Cabinet Secretary responsible for Finance. The Collector is also required to make quarterly reports to the Cabinet Secretary on remissions granted.

Who will be affected

Taxpayers who are in the Betting, Lotteries and Gaming industry.

When

1 July 2018.

Our view
This is aimed at increasing the collection of revenues and is likely to increase compliance.

Exemption from stamp duty

The measure

The Finance Act 2018 has exempted from stamp duty an instrument executed for purposes of collection and recovery of tax and an instrument relating to the business activities of Special Economic Zone (SEZ) enterprises, developers and operators licenced under the Special Economic Zones Act, 2015.

Who will be affected

Taxpayers and persons engaged in business activities of Special Economic Zones.

When

1 October 2018.

Our view
This incentive will encourage investment in SEZs. The exemption of the stamp duty in relation to instruments executed for purposes of recovery of tax will ease the process of recovery of tax by the KRA.

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