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Income Tax Bill, 2018 Workshop

Excellence through initiative

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Corporate Income Tax

Corporate Income Tax
Rates of taxation

- Body corporates to be taxed at two rates as below:
  - 30% for taxable income up to KES 500million; and
  - 35% for any income above KES 500 million.
- A lower rate of tax of 25% to be applied to a newly listed company for the 5 years immediately after listing, provided that the shares listed account for at least 40% of the company’s issued share capital.
- EPZs and SEZs will no-longer enjoy a tax holiday for the initial 10 / 20 years. Under the proposed law, EPZs and SEZs will be taxed @10% for the first 10 years, @15% for the next 10 years and at 30% thereafter.

Corporate Income Tax
Taxation of a branch

- A branch of a foreign company to be taxed in the same way as a local company. 30% for taxable income up to KES 500 million and 35% for income above KES 500 million.
- In addition to the corporate tax, a branch will also be required to pay a 10% tax on the repatriation income, which is a summation of the after-tax profits and any reduction in the net assets of the PE.

	Current Law	Proposed- 2018 tax bill	
Branch taxable income	100,000	100,000	P
Tax rate	37.5%	30.0%	
Tax payable	37,500	30,000	T
Net after tax	62,500	70,000	P-T
Repatriated tax (assuming the net assets at the beginning of the year is the same as end of the year)		7,000	
Total tax	37,500	37,000	A
Net return to head office	62,500	63,000	
Effective tax rate	37.5%	37.0%	A/P

Corporate Income Tax
Carry forward of tax losses

The following are the proposed changes with regards to the carry forward of tax losses:

- Extension of the carry forward of tax losses beyond the stipulated period to be capped to 2 years.
- The carry forward of tax losses will not be allowed in the following instances:
  – Where the control of a company changes by more than 50% from the period the tax loss arose; and
  – Where the business changes (whether wholly or in part) in the subsequent periods.

Corporate Income Tax
Newly listed companies

Under the current law, newly listed companies are taxable at the following rates:

- 27% for a period of 3 years commencing after the year of listing if the listed issued share capital is between 20% and 30% of the total issued share capital;
- 25% for a period of 5 years commencing after the year of listing if the listed issued share capital is between 30% and 40% of the total issued share capital;
- 20% for a period of 5 years commencing after the year of listing if the issued share capital is at least 40% of the total issued share capital; and
- With effect from 1 January 2016, 25% for a period of 5 years commencing after the year of listing in the case of a company introducing its shares through listing or any securities exchange via introduction.

The Bill proposes a uniform tax rate of **25%** for the **first 5 years** for all newly listed companies as long as at least 40% of the share capital is listed on an approved securities exchange.

Corporate Income Tax
Taxation of a life insurance business

- Under the current law, negative transfer as recommended by an actuary is limited to the actuarial surplus recommended by the actuary to be transferred from the life fund for the benefit of shareholders in the preceding years of income. A taxpayer could go backwards indefinitely in determining the negative transfers amount for tax purposes.
- Under the ITB, the amount of negative transfers in respect of life insurance business to be limited to the actuarial surplus recommended in the preceding 5 years of income.
- Capital gains arising from the transfer of property connected to life insurance business to be exempt from capital gains tax.

Corporate Income Tax
Taxation of a registered retirement benefit scheme

- Currently, the income tax law exempts from tax the income of a registered pension scheme, registered trust scheme, registered pension fund and registered provident fund.
- Under the bill, only the income of a registered pension, provident or individual retirement fund that is attributable to the tax deductible contributions will be exempt from tax.
- The provision means the only income, which will be exempt from tax, is the income derived from the allowable limit of KES 240,000. The income generated from employer/employee contributions in excess of the KES 240,000 would therefore be taxable.
- The pension scheme in arriving at the taxable income will therefore need to split or apportion income from members savings into what relates to the allowable limits and what relates to the excess.

Corporate Income Tax

Taxation of a member's club and trade association

- Members clubs and trade associations will be carrying on business and thus taxable.
- For the purposes of the tax, the business income of a members club or trade association will comprise entrance fees and subscriptions paid by the members.

Current treatment

- Currently, members clubs are only taxable if less than three-quarters of the gross receipts, other than gross investment receipts, are received from the members of the club.
- A trade association on the other hand is only taxable if it has elected to be taxable, by notice in writing to the Commissioner.

Corporate Income Tax
Taxation of a savings and credit cooperative society

- Currently, the income tax law provides for the taxation of the income of a SACCO as below:
  - 50% of the SACCO's gross income from interest (other than interest from its members);
  - Rental income from use or occupation of immovable and movable property;
  - Capital gains; and
  - Any other taxable income (excluding royalties) not mentioned above.
- Under the ITB , only interest arising from members loans earned by a savings and credit cooperative society (SACCO) shall be exempt from tax.
- In addition to the taxation of a SACCO, the dividends distributed to members will be subject to 10% withholding tax and not 5% as it is currently.

Corporate Income Tax
Deductibility of certain expenses

The following are the key changes regarding the deductibility of expenses:

- No expense shall be deducted if the equivalent amount has not been declared by the beneficiary as income. It is unclear how a taxpayer will determine whether the beneficiary has declared the amount as income or not.
- No deduction shall be allowed in respect of payments made by a taxpayer, which are subject to withholding tax if the taxpayer fails to withhold tax on them as required.
- Donations will only be allowed if made to an institution responsible for the management of a national disaster to alleviate the effects of a national disaster declared by the President or to a person sponsoring sports upon approval by Cabinet Secretary (CS) following recommendation by CS for sports. Donations made in cash to exempt charitable institutions removed.
- Carry forward of tax losses will not be allowed if there is a change of control by more than 50% or if there is a change of business (whether wholly or in part).
- Disallowable interest due to thin capitalisation to be based on a debt equity ratio of 2:1 as opposed to the 3:1 ratio that applies currently.
- Disallowable foreign exchange losses due to thin capitalisation to be permanently disallowed as opposed to being deferred until the thin capitalisation situation changes.

Corporate Income Tax
Thin capitalisation (further details)

The following changes have been introduced with regards to thin capitalisation:

- The definition of **"control"** has been expanded beyond holding of shares or voting rights in a company.
- In the case of holding of shares or voting rights, the threshold reduced from 25% to 20% shares or voting rights in the company. Other added aspects include:
  - Advanced a loan of not less than 75% of the book value of the total assets of the other person excluding loans from unrelated financial institutions;
  - Has guaranteed a loan of not less than 75% of the total indebtedness of the other person excluding guarantees from unrelated financial institutions;
  - Is the owner of intellectual property, which the other person wholly depends on for the manufacture, processing or carrying out of business;
  - Supplies (by himself or by persons specified by him) 90% or more of the purchases of the other person and in addition influences the prices and other conditions related to the supply;
  - Influences at least 90% of the sales of the other person or persons specified by the other person and the price and conditions relating thereto; and
  - Is deemed by the Commissioner to control the other person by any other form.

Corporate Income Tax
Thin capitalisation (further details)

- Definition of **“all loans”** has been changed to mean loans only advanced by a non-resident person. This implies that only loans from non-resident persons will be considered while determining whether a Kenyan company is thinly capitalized or not.
- Microfinance institutions to be exempt from the thin capitalization rules.

Corporate Income Tax
Deemed interest provisions

- Any loan from a non-resident who controls a company will be subject to the deemed interest provisions as long as the interest rate is lower than the market interest rate applicable in the lender's country.
- "Market interest rate" has been defined as the average 91-day Treasury bill rate of interest for the previous quarter.

Corporate Income Tax
Taxation of dividends

- The scope of deemed dividends has been greatly expanded.
- KRA can deem at least 60% of accounting profits as having been distributed if the company does not pay them as dividends.
- Payments of dividends to a resident company to be exempt from withholding tax only if the recipient of the dividends owns at least 25% of the paying company.
- Distribution of untaxed profits to be subject to 30% tax.

Corporate Income Tax
Presumptive income tax

- Presumptive income tax on businesses with a turnover of less than KES 5 million has been introduced to replace turnover tax.
- The tax will only be applicable to persons who are issued a single business permit by the County Government.
- It will not apply on incorporated companies, rental businesses or businesses which provide management and professional services.
- Presumptive tax will be final tax and will be payable at the time of payment of the single business permit or renewal of the same.
- The rate of the presumptive tax is 15% of the single business permit fee.

Corporate Income Tax
Capital allowances on buildings

Type of building	Allowance under the current law	Proposed allowance
Building used for manufacture	• 100% in the first year of use where the investment is located within Nairobi, Kisumu or Mombasa; and • 150% in the first year if use where the investment is located outside Nairobi, Mombasa and Kisumu and the value of the investment is at least KES 200million	• 100% in the first year of use
Commercial buildings	• 25% per annum on straight line. However, the allowance is only available if social infrastructure such as roads, electricity, water and sewerage works are provided	• 10% per annum on straight line. There is no requirement to provide social infrastructure
Petroleum gas storage facilities	• 150% in the first year of use	• 60% in the first year of use and 25% per annum of the residual value in the subsequent four years
Hotel building	• 100% in the first year of use	• 60% in the first year of use and 25% per annum of the residual value in the subsequent four years
Educational buildings	• 50% per annum on straight line	• 10% per annum on straight line
Hospital buildings	• N/A	• 100% in the first year of use

Corporate Income Tax

Capital allowances on machinery and equipment

Type of machinery/ equipment	Allowance under the current law	Proposed allowance
Machinery used for manufacture	• 100% in the first year of use where the investment is located within Nairobi, Kisumu or Mombasa; and • 150% in the first year if use where the investment is located outside Nairobi, Mombasa and Kisumu and the value of the investment is at least KES 200million	• 100% in the first year of use
Hospital equipment	• 12.5% per annum on reducing balance	• 100% in the first year of use
Telecommunication equipment	• 20% per annum on straight line	• 10% per annum on straight line
Filming equipment	• 100% in the first year of use	• 50% per annum on straight line
Motor vehicle and earth moving equipment	• 37.5% for heavy earthmoving on a reducing balance • 25% on other self-propelling vehicles including aircrafts on a reducing balance • Restricted cost of private vehicles -KES 2 million.	• 25% per annum on straight line • Restricted cost of private vehicles - KES 3 million
Ships and aircrafts	• 25% on aircrafts on a reducing balance • 12.5% on ships on a reducing balance	• 60% in the first year of use and 50% per annum on the residual value in the subsequent two years.
Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines.	• 30% for Computer and peripheral computer hardware, calculators, copiers and duplicating machines on reducing balance • 20% for software on straight line	• 25% per annum on straight line

Corporate Income Tax
Capital allowances on machinery and equipment – cont'd

Type of machinery/ equipment	Allowance under the current law	Proposed allowance
Furniture and fittings	• 12.5% on reducing balance	• 10% per annum on straight line
Other machinery	• 12.5% on reducing balance	• 10% per annum on straight line
Purchase or an acquisition of an indefeasible right to use fibre optic cable	• 5% per annum on straight line	• 10% per annum on straight line
Farmworks	• 100% on farmworks • 33.3% on farmhouse	• 100% in the first year of use
Rental residential building constructed in a planned development area approved by the Cabinet Secretary	• 25% per annum on straight line	• 25% per annum where roads, power, water, sewers and other social infrastructure have been provided by the person incurring the capital expenditure; and • 5% per annum on straight line where the social infrastructure has not been provided
Implement, utensil or similar article, not being machinery or plant	• 33.3% per annum on straight line (although the law does not specify this rate)	• 25% per annum on straight line.

Corporate Income Tax
Tax on capital gains

The Bill proposes the following key changes in respect of tax on capital gains:

- Increase of the rate of tax on capital gains from 5% to 20%;
- Introduction of indexation, which eliminates the effects of inflation in the computation of capital gains;
- Use of the First-In-First-Out (FIFO) rule while determining capital gains arising from the transfer of shares;
- Expanding the provisions relating to tax on capital gains to members clubs and trade associations, which are currently only taxable if certain conditions are fulfilled;
- Capital gains arising from the transfer of property from a real estate investment trust (REIT) to be exempt from tax; and
- Removal of the requirement to apply for the exemption from tax on capital gains where a transfer of property is necessitated by restructuring of corporate entity, where such transfer is:
    - A legal or regulatory requirement; or
    - as a result of a directive or compulsory acquisition by the government.

Corporate Income Tax

Tax on capital gains- worked example- Indexation

	Current Law	Proposed- 2018 tax bill	
Acquisition Cost in 2012	100,000.00	100,000.00	
Indexation		800,073.44	AC=(MP*CPIA)/CPIT
Adjusted cost	100,000.00	800,073.44	
Sales proceeds April 2018	1,000,000.00	1,000,000.00	
Gain	900,000.00	199,926.56	
CGT	45,000.00	39,985.31	

	AC	Adjusted cost
	MP	Transfer Value
152.51	CPIA	Consumer Price Index for the month prior to acquisition- Dec 2014 for property acquired prior to January 2015
190.62	CPIT	Consumer Price Index for the month prior to transfer- March 2018

Corporate Income Tax

Provisions relating to exemption of income from tax

- The income of a person shall only be exempt from tax if the exemption is provided under the proposed law. The current income tax law recognizes exemptions provided under any other law.
- The list of income that is exempt from tax has also been greatly reduced in the proposed law. Some of the exemptions in the current law that have been removed in the proposed law include:
  - Exemption from tax for various parastatals;
  - Interest on a savings account held with the Kenya Post Office Savings Bank; and
  - Interest income arising under the financial arrangements made or guaranteed by the Export-Import Bank of the United States, an agency of the United States of America.

Corporate Income Tax
Limitation for the application of a double tax treaty

The Bill proposes to expand the limitation for application of a double tax treaty and entirely exclude the below persons (in the other treaty partner state) from benefiting from a double tax treaty:

- A person operating as a holding company;
- A person providing overall supervision or administration of a group of companies;
- A person providing group financing (including cash pooling); or
- A person making or managing investments.

This means that the DTA will not apply where a company is formed to just provide financing or administration support e.g. a shared service centre (SSC).

Corporate Income Tax
Other relevant provisions

- Withdrawals from registered home ownership saving plans will no-longer be subject to tax;
- The period within which KRA is required to respond when a taxpayer applies to change the year end has been reduced from 6 months to 3 months. Where KRA does not respond within such period, they will be deemed to have accepted the application;
- The cap on the general penalty for a person who is guilty of an offence for which no specific penalty is stipulated to be increased from KES 600k or imprisonment of up to 6 months to KES 1 million or imprisonment of up to 3 years;
- The definition of permanent establishment has been expanded and aligned to international law; and
- The Cabinet Secretary for the National Treasury is expected to make regulations for the taxation of e-commerce transactions.

Corporate Income Tax
Transitional provisions

The following key transitional clauses have ben provided in the proposed law:

- Any exemption granted under the current income tax law shall remain in force for up to 3 years from the date of commencement of the proposed law.
- Any unclaimed capital expenditure/ tax written down value immediately prior to the commencement of the proposed law shall be deemed as the residue for the purposes of the new Act. However, it is unclear whether capital allowances on expenditure that was incurred prior to the commencement of the proposed law will be computed by reference to the residue or the historical cost. The transitional provisions do not mention the basis for computing this.
- All subsidiary legislations under the current income tax law (such as rules) will remain in force as long as they do not contradict the main sections of the new law until such time that new subsidiary legislations are made.

Extractives – mining and upstream O&G

Extractives – mining and upstream O&G
Introduction

- Changes to the Ninth Schedule (Sixth Schedule in the Bill) are in addition to those in the substantive legislation;
- Where the provisions in the Schedule are inconsistent with those in the main body of the Act, the provisions of the Schedule prevails;
- In respect of mining and upstream O&G several clauses have been included in the bill to clarify how the Schedule interacts with the other provisions of the act e.g. deductions under the Sixth Schedule are in addition to other deductions under Section 24.

Extractives – Mining and upstream O&G
Tax Losses – Mining Operations

Carry forward of tax losses

- Tax losses incurred by a mining company may only be carried forward for up to fourteen years;
- Currently there is no time limitation for the carry forward of tax losses.

Utilisation of losses at cessation of operations in a license

- Under the current Ninth Schedule, where a mining operator obtains a mining right to operate a license that is within another license in which he has ceased operators, he may utilize the tax losses in the first license area in which he has ceased operations against the subsequent license;
- This provision has been deleted and ring fencing by Licence is required without exception.

Extractives – Mining and upstream O&G

Tax Losses – O&G operations

Loss Carry back

- Under the current Ninth schedule, the amount of loss from petroleum or mining operations can be carried back as a deduction against income to a maximum of three previous years of income from the year of income in which the loss arose and the operations ceased, subject to application and approval by the Commissioner.

- This provision has been deleted.

Extractives – Mining and upstream O&G

Allowable Expenditure

Amortization of extraction/production expenditure

- Subject tax amortization at 20% per annum from the year of commercial production;
- Under the current Ninth Schedule extraction expenditure and production expenditure is deductible in the year in which it is incurred, from the year in which production commences;
- Similar provisions are contained in the proposed Model PSC for petroleum operations.

Extractives – Mining and upstream O&G
Mining rehabilitation fund

Income from the rehabilitation fund

- The proposed Sixth Schedule provides that interest income or investment income from the rehabilitation fund is exempt from income tax;
- Withdrawals not utilized for approved rehabilitation plan are considered as income of the licensee and charged to tax;
- It is interesting that this benefit has not been provided for income from funds for decommissioning deposited in an escrow account by a petroleum company.

Extractives – Mining and upstream O&G
Farm-out transactions

Work Obligation as consideration

- Under the current Ninth Schedule, work obligation does not form part of consideration for purposes of computing tax on farm-out transactions;
- The revised schedule proposes to restrict this, so that work obligation would not be part of farm out consideration only where it is not deducted for income tax purposes.

Extractives – Mining and upstream O&G
Taxation of sub-contractors

- Under the current Ninth Schedule, service fees paid to subcontractors is subject to a special rate of 5.625%;
- This is proposed to be increased to 10% of the gross amount payable.

Extractives – Mining and upstream O&G
Social Infrastructure expenditure

- The definition of social infrastructure expenditure – capital expenditure incurred on the construction of public school, hospital, roads or similar social infrastructure has been deleted.
- Instead, under the substantive provisions expenditure of a capital nature incurred, with the prior approval of the Cabinet Secretary, by a person on the construction of a public school or hospital is an allowable expense.

Pay As You Earn (PAYE)

Individual PAYE Tax Bands

New tax rate for high income earners

Employees earning in excess of KES 9,000,000 per annum (KES 750,000 per month) will be taxed at 35% in relation to any income in excess of the KES 9,000,000 annual threshold

Income (KShs)	Tax Rate
0 – 147,580	10%
147,581 – 286,623	15%
286,624 – 425,666	20%
425,667 – 564,709	25%
564,710 – 900,000	30%
Over 900,000	35%

Individual PAYE Tax Bands

Monthly salary (KES)	2018 PAYE band(KES)	Tax rate %	Currently KES	Proposed KES
1000,000	0 – 12,298	10	1,230	1,230
	On the next 11,587	15	1,738	1,738
	On the next 11,587	20	2,317	2,317
	On the next 11,587	25	2,897	2,897
	On the next 952,941/852,941	30	285,882	255,882
	147,059	35		87,500
Total			**294,064**	**315,534**

Incremental tax payable = Kshs 21,740

Permanent Home
New Definition

- The Income Tax Bill introduces the definition of ‘permanent home’ as the place where a person lives in or is available to him for purposes of residing while in Kenya, or the place where his personal and economic interest lie.

- This definition implies that Kenyan citizens can now break residency for tax purposes if they are deemed not to have a permanent home in Kenya and no personal and economic interests.

- Implication - Kenyan citizens who do not qualify as tax residents will not be required to file tax returns or pay tax for income derived outside Kenya.

Taxation of per-diems and ESOPS

Tax Bill seeks to align non-Taxable per-diems to Public Service Prescribed Rates

- Current Income Tax Act, caps the non-taxable subsistence allowance to KES 2,000 per day

Tax bill clarifies taxable benefit for Employee Share Options will accrue at date of exercising the option

- Current Income Tax Act provides for taxation of the benefit at the end of the vesting period

Non-Resident taxation on rent, pension and retirement annuities

Non-resident tax rate in respect of rent, premium or similar consideration for the use or occupation of moveable or immovable property will be at 20%

- Under the Current Income Tax Act, the rate of tax for rent, premium or similar consideration for the use or occupation of moveable or immovable property is set at 30%

Taxation of non-resident individuals pension or retirement annuities increased at 10%

- The current Income Tax Act provides for taxation of the pension or retirement annuities for non-resident individuals at 5%

Termination Compensation and Non-Cash benefits

Termination compensation pay to be taxed by spreading it evenly over the unexpired period of the contract, whether or not this is provided for in the contract.

- Current Income Tax Act provides for different tax treatment depending on contractual terms as follows:
- With specified term: compensation is spread equally over the unexpired period; and
- Unspecified term :compensation is spread evenly over 3 years

The Income Tax bill introduces the taxation of all non-cash benefits without any minimum threshold by removing the provision under section 5(2)(b) of the Income Tax Act, 2014.

- Section 5(2)(b) of the Income Tax Act, 2014 sets the minimum taxable value of non-cash benefits at Kshs. 3,000 per month

Exempt Bonuses and overtime payments

Exempt bonuses and overtime payments have been capped in the Income Tax Bill to the individual's earnings before the incorporation of bonuses and overtime.

- Current Income Tax Act has no cap on bonus and overtime payments, hence employer's can use this as a structuring arrangement to avoid taxes

Taxation of Foreign Pension and Medical Insurance Cover

Pensions earned in respect of employment services offered in other EAC states will not be taxable in Kenya.

Additionally, medical benefits under cover of non-resident insurance schemes not registered with the Commissioner of Insurance will not be a taxable benefit.

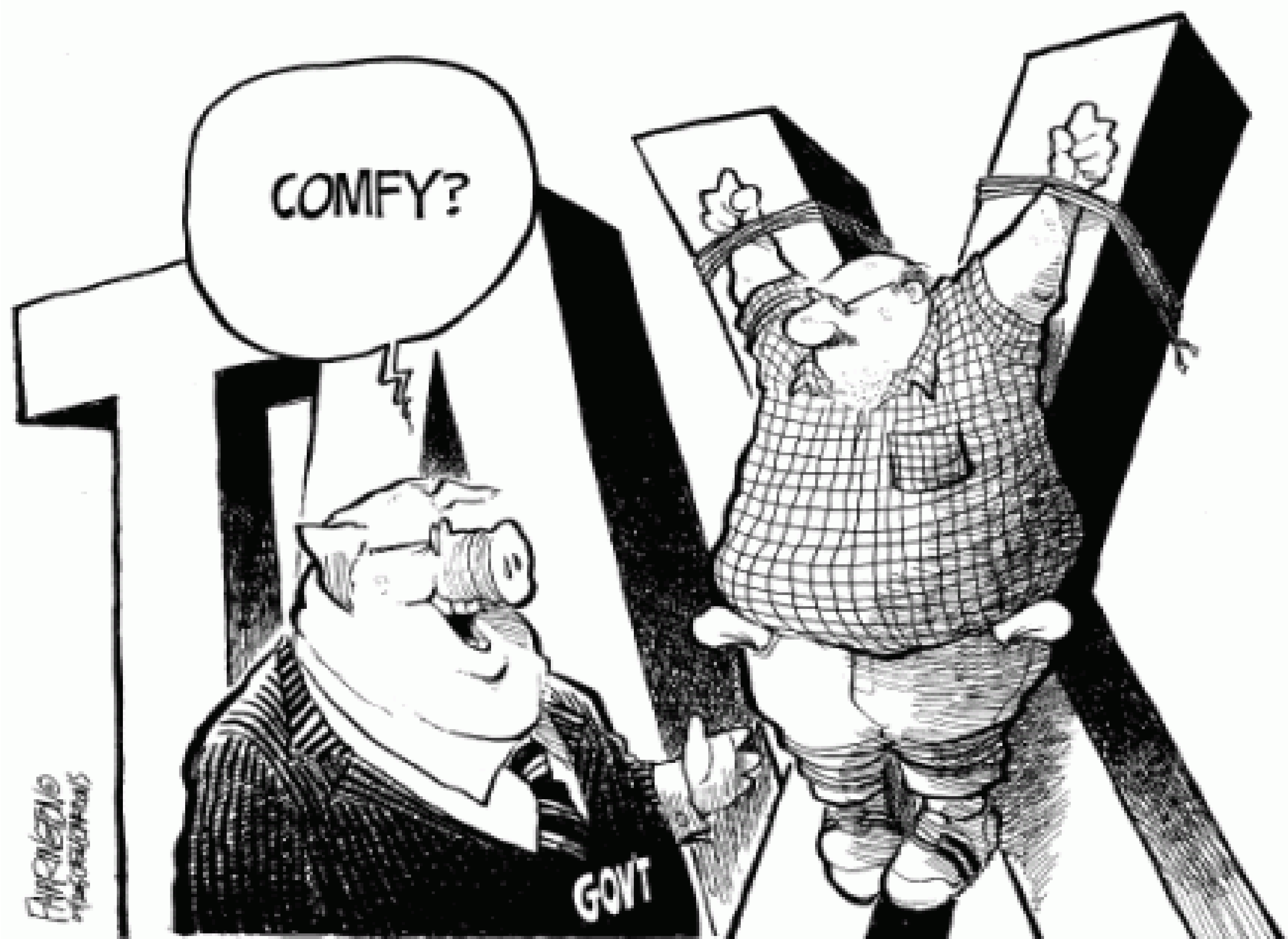
The age limit for medical cover benefit for an employee's dependants has also been increased from 21 years to 24 years.

- The current Income Tax the Act is unclear on the taxation of Pensions earned in respect of employment from outside Kenya
- Medical benefits under cover by insurance schemes not registered with the Commissioner of Insurance are also considered a taxable benefit; and
- The age limit for medical cover beneficiaries is 21 years

Deductibility of interest on HOSP

The Income Tax Bill provides for deduction of interest by an individual in respect of borrowings for purposes of home ownership savings not exceeding KES 300,000. Such borrowings must be from one of the institutions as provided in the Fourth Schedule of the Tax Bill.

- The current ITA provides for deduction of interest not exceeding KES 100,000 paid in respect of that year of income upon money borrowed from one of the first three financial institutions specified in the Fourth Schedule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Withholding Tax

Withholding Income Tax

Important definitions that will impact withholding tax accounting

- **“consultancy fees”** definition now explicitly excludes payment made under contract of service - It aims to clarify that PAYE as opposed to withholding tax should be applied on such payments.
- “**management or professional fees”** now includes any other payments incidental to the provision of the services giving rise to the fees.
- **“paid”** defined to include amount accrued –KRA normally insist that payment is usually the earlier of accrual or actual payment. In a 2012 High Court ruling, it was held that the term “paid” means actual payment and not accrual. This definition appears to reverse the ruling (informally).

Demurrage charges

- This is a new introduction to the list of payments subject to withholding tax;
- The bill defines it as penalty paid for exceeding period allowed for taking delivery of goods or returning of any equipment used for transportation of equipment;
- The proposed rate is 20% of the gross amount payable;
- This will affect shipping operators as any demurrage charges for either waiting time beyond the agreed time for offloading the cargo or for keeping containers would be subject to withholding tax;
- There is risk of the operators increasing freight charges in lieu of the demurrage to avoid the tax;
- This is the second change affecting shipping operators considering that the tax on their income in respect of passengers or cargo that embarked in Kenya has been increased from 2.5% to 3% of the gross amount received;
- Inefficiencies at the points of entry or clearance and handling process contributes to the quantum of these charges.

Management & professional fees

- Payments by Special Economic Zone (SEZ) Enterprise, Developer or Operator or Export Processing Zone Enterprise to non-residents increased from 0% to 5%;
- Payments by Licensee or contractor to non-resident mining and petroleum subcontractors reduced from 12.5% to 5%;
- This reduces the tax burden for the subcontractors and thereby improving their cash flow;
- The exemption from withholding tax provided to non-resident agents of horticultural exporters for auction and audit fees to a non-resident laboratory or auditor has now been removed and will now be taxed at 20%;
- Also affected by the bill is the commissions paid to non-resident ticketing agent which will now be subject to withholding tax at 20%;
- Implementation of this proposal is difficult as the ticketing agents are the one who collect and remit the cash after deducting their commission.
- Is this an added cost to tax residents or tax residents should negotiate with ticketing agents to bear the tax?

Management & professional fees

- Distributions of investment income to unit or shareholders of a collective investment scheme, whether resident or non-resident will be subject to withholding tax at 5% and 10% respectively;
- Even though the current Income Tax Act provided for taxation of distributions in form of interest and dividends, there has been confusion among the industry players on the taxability of the distributions.
- This clarifies the matter and considering that the tax is at favorable rates of 5% for residents and 10% for non-residents, it should be seen as a welcome move.

Dividends and interest

- **Changes affecting payments of royalty, dividends and interest to non-residents by EPZs and SEZs**
- Royalty or natural resource income: 5% from 0%;
- Dividends: 5% from 0%;
- Interest: 5% from 0%.
- The removal of the exemption will contribute to the tax revenue which the affected businesses should find manageable considering that the rate is still low.
- The threshold for exemption from tax in respect of dividends paid by subsidiaries to local parent Companies increased from 12.5% to 25%.
- Withholding tax on bonus/dividend paid by co-operative societies to resident members increased from 5% to 10%. This could impact negatively on the saving culture among the members.

Rent, premium and similar considerations

- Withholding tax on rent, premium and similar considerations paid to non-residents in respect of both moveable and immoveable property harmonized at 20%;
- Previously the rates were 30% for immoveable and 15% for moveable;
- Exemption in respect of leasing of locomotives or rolling stocks removed and will now be taxed at 20%.
- This will impact on cross-border leasing and could make it more expensive if the lessors negotiate the leases on net of taxes basis.

Insurance premiums & commissions

- Insurance premiums paid to non-resident persons now subject to withholding tax at 5% of the gross premium;
- The measure is aimed at expanding the tax net and at the same time to promote local insurance industry. As the definition of insurance includes re-insurance, it seems this change is targeting overseas reinsurance premiums;
- This may increase the cost of insurance particularly where foreign reinsurance Companies choose to insist that the premiums being paid to them are net of tax thus shifting the burden to the resident tax payer;
- Withholding tax on insurance commissions to resident persons is now 5% for both agents and brokers. Agents used to pay 10%. The non-resident rate remains at 20%;
- For resident agents, this is an advance payment and they will still be required to declare the commissions in their tax returns.

Income of ship or air transport operators, charterers or owners

- The rate of tax on the income of non-resident aircraft or ship owners, operators or charterers increased from 2.5% to 3%;
- This proposal is meant to increase tax revenue. Together with the withholding tax on demurrage might make our port less competitive in terms of shipping business particularly since similar tax regime does not prevail in neighboring tax jurisdiction such as Tanzania;
- Non-resident shipping lines in Kenya normally have agents who will account for the tax.

Income of non-resident telecommunication companies

- The withholding tax rate for payments to non-resident television, radio, internet and satellite operators is to be increased from 5% to 10% on the gross amount.
- The proposal is aimed at increasing tax revenues from the growing telecommunications sector.
- However, doubling of the tax rate will be viewed as punitive given it is tax on gross income.
- Most non residents negotiate a net of tax contract. Increase of WHT is likely to be borne by tax residents and therefore it’s likely to increase the business cost

Other changes affecting withholding tax

- The threshold for a payment subject to withholding tax to qualify for withholding tax deduction that was KES 24,000 per month for resident persons has been removed;
- Payments made by a taxpayer subject to withholding tax, if the business failed to withhold tax is now a disallowable expense against corporate tax;
- This is in addition to the recovery of unaccounted WHT, late payment penalty and interest. Double jeopardy?
- This is to enforce tax compliance. The issue that arises is whether this covers accrued expense considering the wide definition of payment which includes payable;
- May be targeting non-compliant taxpayers when it comes to withholding tax as well as related parties accruing expenses such as management fees, royalties and interest but no withholding tax is accounted for when no payment has been made;
- Under transitional provision, any exemption under the current Income Tax Act shall remain in force for a period not exceeding 3 years from the commencement of the new Income Tax Act.

Repatriated Income

- This is not a withholding tax but an additional tax on income of branches and permanent establishments;
- This is in addition to any tax imposed on the entity on the chargeable income;
- They are required to pay tax on what is described as repatriated income;
- The income determined based on a formula that has net profit, movement in the net assets and tax payable on chargeable income;
- Seems to penalize reduction in net assets of the entity and also disregards tax loss utilization when determining the income;
- There is also a question of practicality of how the tax will work in practice. For instance, the formula may result in a negative balance in which case, is tax still payable?

Transfer pricing

TP scope expanded

- Transactions between resident entities or PE and a non-resident person located in a preferential tax regime whether or not the non-resident is an associated person.

  Preferential regime is defined to include countries:

  - Whose income tax rate is less than 16%;
  - Lacks transparency do not have an effective exchange of information arrangement; or
  - Do not allow access to banking information.
- Transactions with non-resident entities where the transaction or the non-resident person lacks economic substance.

Implications

- TP compliance requirements on entities transacting with independent non-resident entities
- Extra burden on substance of transactions with non-resident entities including non-related parties.

Transactions subject to TP

List of transactions subject to TP:

- The purchase, sale, transfer, lease or use of tangible or intangible property;
- Provision of services;
- Financing transactions: borrowing, lending or guarantee, purchase or sale of marketable securities or advance payments or deferred payment or receivable or any other debt arising during the course of business;
- Insurance and re-insurance transactions;
- A transaction of business restructuring or reorganization entered into by a person with an associated person;
- Cost contribution arrangements;
- Any other transaction which may affect the profit or loss of the persons involved.

Choice of related party

- Tested party defined: A party to the controlled transaction for which a financial indicator is tested.
  - **OECD definition**: Party to which a TP method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. often the entity with less complex functional analysis.
- Where the tested party is a foreign entity, information shall be availed to the Commissioner upon request.

Implications

- Powers to the commissioner to request for information on foreign entities where they are selected as the tested entity.
- In line with BEPS actions for increased transparency on the operations of MNEs.
- Information requested is excessive or not available/ difficult for resident entities to obtain the information from the non-resident related parties
- Testing of local entities even if it is the complex entity.

Arm’s length price of Commodities

- Commodities traded in public commodity markets or prices available in statistical agencies and indices
- Arm’s length price = quoted price of the goods on the date on which the goods are shipped unless proof of appropriate adjustments is provided
- Source of quoted or public price data:
  - International or domestic commodity exchange market; or
  - Recognized price reporting statistical or
  - Governmental price setting agencies; or
  - Any other index that is used as a reference by unrelated parties.
- If prices are not available on the shipment date: use of average of the prices five days before and after the shipping date.
- For goods exported from Kenya: if price agreed upon between the group and un-associated person is higher than the quoted price use of agreed price.

<u>Implications</u>

- Certainty while setting the transfer prices
- Disregards the key aspects e.g. functions & risk assumed by non-resident related parties. Long-term contracts & spot prices

Determination of the arm’s length range

- Interquartile as the arm’s length range
- Median shall be used as the reference point.
- TP adjustments would be computed in reference to the median.
- No adjustment shall be made on the controlled transaction shall be made to decrease the taxable profits or increase allowable losses.

Implications

- Current trends in tax revenue audits.
- Adjustments on a year-by-year basis & disregard of the years where the returns are above the median.

TP Documentation

- Put in place contemporaneous TP documentation for each relevant year of income.
- Penalty of 2% of the value of the controlled transaction for failure to maintain contemporaneous TP documentation.
- Imposition of the penalty does not prevent the Commissioner from making TP adjustments

Implications

- Have in place TP documentation for each relevant year of income.
- No deadline or requirement to submit the TP documentation to the KRA- (prudent approach by filing of tax return)

Country-by-Country Reports (CbCR)

- CbCR reports to be filed by each ultimate parent entity or a constituent entity (resident for tax purposes in Kenya)
- Not later than twelve months after the last day of the reporting financial year of the multinational enterprise group.
- A constituent entity" means:
  - Any separate business unit of a multinational enterprise group that is included in the consolidated financial statements;
  - Any such business unit that is excluded from the multinational enterprise group's consolidated financial statements due to materiality grounds;
  - Any PE of any separate business unit of the multinational enterprise group included in (i) or (ii) above provided the business unit prepares separate financial statement for such PE.

A model template for the Country-by-Country Report

Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group: Fiscal year concerned:										
Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated capital	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Table 2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group: Fiscal year concerned:																
Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organisation or incorporation if different from Tax Jurisdiction of Residence	Main business activity(ies)													
			Research and Development	Holding or Managing intellectual property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to unrelated parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Dormant	Other[2]
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														

[2] Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

Services

- Services charges by associated persons are NOT arm's length unless, there is proof that
  - Service are actually rendered; and
  - The service provides an economic or commercial value to enhance commercial position; and
  - Its amount corresponds to that which would have been agreed between independent persons

Implications

- Very general and no practical guidance to taxpayers on how the recharges should be analysed.
- Example – low value services under BEPS

Capital rich and low function person

- Capital rich and low function person is a person that is capitalized with a relatively high amount of equity (or equity-equivalent) capital, but which have limited capacity to carry out risk-management functions.
- Entitled to no more than a risk-free return.

Implications

- In line with BEPS
- Appropriation of returns to holding companies that do not undertake essential functions.
- Affect entities with holding companies located in Mauritius, UAE and Netherlands (popular routes for investing in Kenya) where the holding company provides financing and does not perform any substantive functions.

Questions & answers