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Tax Training for Non Governmental Organisations

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Financial Reporting for NGOs

PBO Act Briefs

Refined summary

NGO Act requirements

- The NGO Act is being replaced by the PBO Act
- Filing of returns with the NGO Board 3 months after the end of the financial year using the statutory Form 14 (F-14)
- NGOs with receipts > 1M KES should submit audit accounts to the Board
- Audits Should be conducted by ICPAK practicing members
- Accounts Must be in KES
- Accounts must be in compliant with relevant reporting framework

? What determine the framework which the entity will adopt

Reporting Frameworks

- International Financial Reporting Standards (IFRS)
- International Financial reporting Standards for Small and Medium Enterprises (IFRS for SMES)
- International Public Sector Accounting Standards (IPSAS) – Accrual
- International Public Sector Accounting Standards (IPSAS) Cash Basis
- Special Purpose Framework Financial Statements

All for the organizational reporting

- For Projects/Specific Donor funded Financial Statements special purpose framework should be used for reporting
- Including other reports such as reports on Compliance, Internal Controls and other requirements

Financial Statements Components

For Organizational financial statements the basics should be (depending on the requirement of the financial reporting framework)

- Statement of Income and expenditure
- Statement of financial position
- Statement of changes in reserves/funds
- Statement of cashflows
- Statement of comparative between actual and budget
- Notes to the FS – Significant Accounting Policies and detailed notes

Key Balances and Transactions and accounting Treatment

Income Statement Items

1. Income – Restricted and Unrestricted Funds
 - Different reporting frameworks requires different accounting of restricted and unrestricted funds
2. Expenditure – Advances or when accounted for by the implementing partners
3. Other income
4. Donations in Kind and in cash

Key Balances and Transactions and accounting Treatment

Statement of financial position/Balance sheet items

- Property and Equipment
 - Organizational
 - Projects Assets
 - Donated assets
- Intangible assets
- Investments
- Bank and cash balances
- Receivables
- Unexpended grants/funds – represented by Cash and advances
- Deferred income
- Payables

Key Balances and Transactions and accounting Treatment

Statement of changes in reserves/Funds

- Accumulated fund balances
- Any special fund maintained by the entity
- Assets replacement reserve

Other Requirements

Depending on how the NGO is registered, relevant compliance is necessary:

- If registered under the Companies Act – Limited by shares or Guarantee
- Should file returns with the Registrar of companies annually
- Any change of directors should also be filed with the registrar of companies

Where can we assist

- Review of financial statements to confirm compliance with the appropriate reporting framework
- Assist in preparation of financial statements that are in accordance with the applicable reporting framework
- Review organization's compliance with agreement terms and conditions with the development partners
- Review internal controls to confirm effectiveness of the design and whether operating effectively
- Assist the organization's with conversion from one reporting framework to another

Where can we assist

- Develop finance manuals that are compatible with the applicable reporting framework
- For entities with Sub grantees – we can assist in assessing the capacity of the implementing partners as well as pre-disbursements assessment
- Manage disbursement of funds to implementing partners
- Train on key donors requirements such as EU, USAID, DANIDA etc.

PBO Act

Objective of the PBO Act: To advance a new legal, regulatory and institutional framework for Public Benefit Organisations (PBOs) in Kenya.

- Presidential assent – 14th January, 2013
- Commencement date - by notice
- Repeals NGO Coordination Act of 1990
- Applies to all PBO operating in Kenya
- Administrative and regulatory framework for public benefits organizations to be placed under the Ministry of Planning and Devolution
- PBO Act not yet operational

PBO Act - Benefits

Benefits to be enjoyed by registered NGOs i.e.

- Tax exemptions on members' subscriptions, income from economic activities, interest on dividend income, sale of assets, stamp duty (including on purchase of property)
- Waiver of court fees
- Preferential treatment under the VAT Act
- Incentives for donations by legal and natural persons

PBO Act - Benefits

- Employment tax preferences
- Special tax incentives for donations from endowments, etc
- Direct government financing via subsidies, grants for specific purposes and contracts to perform certain work
- Preferential treatment in public procurement procedures
- Provision of information for policy making
- Access to training courses offered by Government Institutions

PBO Act – Other Issues

- Previous registrations null and void
- NGOs registered under the repealed law deemed to be registered under the new law and have up to 1 year to seek registration as a PBO under the new law
- Former NGO Co-ordination Board to be transformed into PBO Authority
- An NGO registered under the repealed Act shall be bound by the provisions of the new Act

PBO Act – Other Issues

- NGOs exempted from registration under the repealed law must seek registration under the Act within 3 months of the commencement of the Act
- For international NGOs, proof of registration in another country required
- International NGOs to have at least one third of governing body comprising Kenyans who reside in Kenya ---
- no longer 1 Kenyan
- Filing of annual reports with the Authority within 6 months after the end of financial year

PBO Act – Other issues

- PBOs expressly allowed to engage in lawful economic activities provided the income is applied solely to the PBO's public benefit purposes (e.g. investment in real estate for not-for-profit purposes)
- Until such time as the Tax statutes are amended to bring them in line with the PBO Act; the Kenya Revenue Authority (KRA) will continue to apply the existing exemption framework

New Tax Exemption Applications under the PBO Act

- Firstly, an applicant would first have to qualify for registration and register as a PBO
- The Tax benefits would not be automatic, we expect there to be a process through which the tax exemptions are sought and confirmed
- Specific guidelines have not been issued and the challenge is that the Tax Acts have not been amended to incorporate the changes in the PBO Act
- Until such time as the Tax statutes are amended to bring them in line with the PBO Act; the Kenya Revenue Authority (KRA) will continue to apply the existing exemption framework

PBO tax incentives compared to existing tax incentives

- PBO tax incentives are broader e.g. inclusion of employment tax aspect
- The tax incentives apply to a wider list of organizations i.e. not just for relief of distress or advance of religion or education
- They are contained in the same piece of legislation. It would be neater if the Tax Acts then referred to the PBO Act so that all PBO exemption information is available in a single Act
- However, successful implementation will be driven by the processes at KRA level

Key messages

- The PBO Act has been passed into law and needs to be complied with and benefitted from ***when it becomes operational***
- Please seek professional support to understand the specific nature of your obligations under the PBO Act given your activities in Kenya
- Further guidance expected on a number of issues e.g. Tax exemption procedures so keep checking with us for an update

How we can support PBOs

PBO specific support:

- More detailed legal review to assess requirements, risks and benefits of registration as a PBO
- Registration as a PBO
- Tax exemption applications
- Tax review to identify non-compliance as well as any tax planning opportunities

Other services:

- Regulatory review to ascertain compliance with Kenyan regulatory regime
- Labour law advice including drafting compliant employment contracts
- Litigation services in respect of any suits brought on the basis of Kenyan law
- Commercial services such as review of contracts with suppliers, service providers, landlords etc
- Tax compliance services including Payroll processing

Questions & Answers



PAYE

P.A.Y.E.



Employee

- Any holder of an office for which remuneration is payable
- Includes an individual receiving emoluments in respect of any employment, office, appointment or past employment
- **Appointments**
- Directors – executive and non-executive
- Directors allowances and benefits – PAYE or WHT?
- **Casual employee**
- One who is engaged for a period less than one month and emoluments are calculated in reference to the period of the engagement
- Regular casual employees are not considered as casuals

Employer

- Any person paying remunerations
- Any agent, manager or representative of employer who is outside Kenya
- Any trust, insurance or body of persons paying pension

The agency burden

- PAYE is the employers responsibility
- Employee is an agent of the government
- The normal PAYE year runs from 1st January to 31st December

Taxable income

- All emoluments in cash
- Non cash benefits exceeding KShs 36,000 p.a. in the aggregate, with a few exceptions
- Club Subscriptions
- Per diems in excess of Kshs. 2,000 per day (Local/Foreign Travel)

Fringe Benefit Tax (FBT)

- Loans at concessionary interest rates
- Loans from unregistered pension or provident fund
- FBT applies even after an employee leaves employment as long as the loan remains un-paid
- Calculated using the 91 day treasury bill rates(market rates of interest)
- Benefit taxed on employer at corporation rate of tax

Other taxable benefits

- Other benefits subject to higher of cost to employer or fair market value
- Benefits taxed at prescribed rate only – by concession of CIT where the cost or fair market value cannot be determined
- Furniture – 1% of original cost p.m.
- Communal water supply – Kshs.500 p.m.
- Telephone (landline & mobile) – 30% of bills p.m.
- Communal electricity supply – Kshs.1,500 p.m.

Non – taxable benefits

- Leave passages: expatriate employees
- Medical services
- Employer's contribution to pension funds
- Exception: Contributions by non taxable employers:
 - to unregistered schemes
 - excess contribution to registered schemes
- Education fees taxed on the employer
- Reimbursement of expenses incurred by employee wholly and exclusively in production of income
- Lunch benefit subject to a maximum value of KES 4,000 per month

Tax reliefs

(Against tax payable)

- Personal relief, KShs 1,162 per month (KES 1,280 w.e.f 1 Jan 2017)
- Life insurance and education policy – 15% of premium, maximum KShs 5,000 p.m.

PAYE forms/returns

- Remittance of monthly PAYE is before the 9th of the following month
- Online filing of monthly PAYE or Nil return submission to the Commissioner of Domestic Taxes via iTax
- Quarterly returns no longer required due to online filing

National Security Social Fund (NSSF)

- Objective is to provide retirement benefit to members
- Rate of Contribution -10% of the employee's wages subject to a maximum of KShs 400 per month of which half is contributed by the member
- Special contributions (casual workers)-KShs 1 for each complete KShs 20 of wages. Contribution is by employer only
- Under the NSSF Act 2013, each employer must pay to the Pension Fund in respect of each of his employees:
 - employer's contribution at 6% of the employee's monthly pensionable earnings, and
 - employee's contribution at 6% of the employee's monthly pensionable earnings
- The value of the pensionable earnings has a lower limit and an upper limit, both of which will gradually increase over a 5 year period. The new rates are yet to be effected due to ongoing litigation

National Hospital Insurance Fund (NHIF)

- Objective is to provide health insurance coverage for members and their dependents
- Rate of Contributions vary from a minimum of KES 150 to a maximum of KES 1,700 per month with respect to salaried employees
- Informal sector - Voluntary contributions
- Contribution is by the employee only. The employer only acts as an agent to collect and remit

NHIF Rates

Gross income (KES)	Monthly premium (KES)
0-5,999	150
6,000 - 7,999	300
8,000 - 11,999	400
12,000 - 14,999	500
15,000 - 19,999	600
20,000 - 24,999	750
25,000 - 29,999	850
30,000 - 34,999	900
35,000 - 39,999	950
40,000 - 44,999	1,000
45,000 - 49,999	1,100
50,000 - 59,999	1,200
60,000 - 69,999	1,300
70,000 - 79,999	1,400
80,000 - 89,999	1,500
90,000 - 99,999	1,600
100,000 and above	1,700
Self employed (special)	500

National Industrial Training Authority (NITA)

- Subject to approval by NITA, employers who are registered with NITA and are up to date on levy payments can get a reimbursement of training costs if:
 - The employer makes an application to NITA two weeks before the training i.e. for local training and one month for overseas training
 - The training provider is registered with the NITA and is up to date with the annual registration renewal
 - The employer can prove that the training is relevant to the employees' duties/work, and
 - The reimbursement claim must be supported with receipts of payment of training costs and the approval letter from NITA

Penalties for non-compliance

Failure to pay the training levy attracts a penalty of 5% on the amount of levy due to the authority

Penalties and offences

- Tax recovered from employer
- Failure to operate PAYE system satisfactorily: 25%, minimum 10,000
- Interest thereon, 1% per month on the principal tax underpaid
- General penalty, where no other penalty is prescribed: KES 100,000, six months imprisonment

Objections & appeals

- An employer can object against a PAYE tax computation to the Commissioner for Domestic Taxes (CDT)
- An employer has right of appeal to the Tax Appeals Tribunal against imposition of penalty or any other decision taken by the Commissioner under the provisions of the Tax Procedures Act
- Appellant required to pay all tax due and the penalty prior to making the appeal

KRA in-depth tax audit

- KRA selects taxpayers for in-depth examination
- Enforce tax compliance, full income disclosure, enhance collection and taxpayer education
- Taxpayer Charter has provided for procedure for audit and rights of a taxpayer

Procedure

- Letter from KRA for in-depth examination
- Mutually agreed date for commencement
- Tax agent to review/be involved
- Limit of time of audit specified in the Charter
- Audit to cover two years plus current

KRA in-depth tax audit

Tips:

- Don't give the KRA more than they ask for
- Skeletons in cupboard- advance planning required
- Cultivate mutually beneficial relationship
- Check the accuracy of KRA findings
- Discuss risk/potential liability with tax consultants

Tax Returns

- Annual self assessment returns from 1992 plus:
 - P9
 - Mortgage certificate
 - Insurance relief certificate, and
 - Other support documents – withholding tax certificates, etc.
- Due date for return is six months following the end of the income year
- Issues:
 - Kenyan citizens working abroad
 - Expats
 - Tax credits

Immigration Issues

- All non – Kenyan citizens coming to work in Kenya must have an entry permit, usually referred to as a “work permit”.
- WP’s are dependent on the period of time an individual will require to work in Kenya.

Special Passes – “Temporary work permits”

These are issued to persons who come to the country for specific assignments for a period not exceeding 90 days. The passes are renewable for an additional 90 days in any one calendar year.

Work Permits

These are issued to persons who come to work in the country for periods in excess of 183 days. Work permits are valid for one year or a maximum period of two years at any one time. They are renewable for a further period of one or two years as may be required. There are several classes of work permits depending on the nature of work an individual will be performing in Kenya as follows:

Immigration Issues

Class A:

Given to persons offered specific employment by a specific employer in Prospecting and Mining.

Class B:

A person who is offered specific employment or is engaging in Agriculture and Husbandry.

Class C:

A person who is offered specific employment for any prescribed profession.

Class D:

A person who is offered specific employment in by a specific employer and who is qualified to undertake that employment.

Immigration Issues

Class F:

A person who is offered specific employment in specific manufacturing.

Class G:

A person who is engaging in specific trade, business or consultancy.

Business Visa:

These are issued to business travellers coming into the country to attend meetings, training seminars, conferences and other business forums. They DO NOT entitle the holder of such visa to perform or engage in work in Kenya.

Immigration Issues – Tax Implications

Tax Considerations of Entry Permits

- Sponsorship: All work permit applications must be sponsored by an employer who is locally registered in Kenya.
- Duration of assignment: employer's must consider the duration of the individual in the country when determining the type of entry permit to take up. Employers can do some tax planning for Special Pass holders.
- Tax Registrations: Tax Registrations are dependent on the Entry Permit type. Holders of Work Permits/alien cards are entitled to tax registrations. Special Pass holders must obtain approval from the Commissioner to register for the tax PIN upon proof of taxable income in Kenya.
- Alignment of Work Permit and Employment Contract: For tax planning purposes employer's require to align their expatriate employment contracts to the work permits.

Grey areas - general

- Shared benefits e.g.
 - Servants
 - Housing
- Sales vans/cars
- Benefits provided and used within the employer's premises
 - Alarm
 - Electricity - shared among employees & between employees and employers

Grey areas

- Mobile Phones
- Sale of products to staff at cost
 - Benefit value is the cost or market price?
- Employer guaranteed loans
 - Employees charged at lower interest rate
- Passages to destinations other than home country
- Entertainment
- Consultancy vs. employment

2016 Budget changes affecting individuals

- Exemption of bonuses, overtime and retirement benefits made to low income employees whose income falls in the lowest tax band (KES 10,164) effective 1 July 2016.
- Increase of personal relief to KES 1,280 per month (15,360 per annum) effective 1 January 2017.
- Individual tax bands have been increased by 10% as summarized below effective 1 January 2017:

Rate in each shilling	%
On the first 134,164	10
Next 126,403	20
Next 126,403	25
Over 513,373	30

Tax planning ideas

- Maximize reliefs and deductions such as mortgage interest and insurance relief
- Mileage claim vs. car allowance
- Car loan vs. company car
- Reduced rate or motor vehicle benefit – ITA provides for a lower rate of benefit where restricted use of the vehicle can be proved. The Commissioner has also issued guidelines on the supporting information required
- Telephone benefit (scratch cards) – only 30% taxable
- Benefits below threshold
- Per Diems up to 2,000 per day. Excess to be on reimbursement basis or accounted for

Questions & Answers



Corporation Tax

Income Tax in Kenya

Administration

Income tax in Kenya is administered by the following government agencies:

- The National Treasury (Formerly the Ministry of Finance); and
- The Kenya Revenue Authority (KRA)

Legislation that governs income tax

- Income Tax Act (ITA)
- Subsidiary legislation - Schedules, Income Tax Rules
- Tax Procedures Act, 2015 (TPA)
- Income Tax Departmental / Administrative instructions
- Case Law

Basis of charge to Tax

- Tax is charged on the basis of source and/or residence
- Income Tax is charged on all income of a person whether resident or non-resident which accrues in or is derived from Kenya
- For business carried on partly within and partly outside Kenya, the whole of the profit from that business is Taxable in Kenya, e.g. transporters and Kenyan incorporated companies with branches (offices) outside Kenya.

Non-Taxable income

- **Exempt income under the First Schedule to the ITA; e.g.:**
 - Income of Govt. Ministries, exempt NGOs
 - Income of County Governments
 - Income of a registered pension and provident scheme/fund
 - Interest earned on a savings account held with the Kenya Post Office Savings Bank
 - Interest income from all listed bonds (3-year maturity or more) used to raise funds for infrastructure & social services
 - Dividend received by a resident company from a company where it controls 12.5% or more of the voting shares

Exemption from Corporate Tax

- Section 13 (2) of the ITA states that the Cabinet Secretary in charge of National Treasury may by notice in the Kenya Gazette exempt certain income from tax in respect of income not listed in the First Schedule (of the ITA)
- Paragraph 10 of the First Schedule of the Income Tax Act provides that:

the income of an institution, body of persons, or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education:-

(a) established in Kenya; or

(b) whose regional headquarters is situated in Kenya

in so far as the Commissioner is satisfied that the income is to be expended either in Kenya or in circumstances in which the expenditure of that income is for purposes which result in the benefit of the residents of Kenya

- Bilateral Agreements and Double Tax Agreements may also provide for exemption of certain incomes from tax

Exemption from Corporate Tax

- **Gains or profits from a business shall be exempt from tax where:**
 - the gains or profits are put to use solely for the mentioned purposes and either -
 - the business is carried on in the course of the actual execution of those purposes; or
 - the work in connection with the business is mainly carried on by beneficiaries under those purposes; or
 - the gains or profits consist of rents (including premiums or similar consideration in the nature of rent) received from the leasing or letting of land and chattels leased or let therewith

Exemption from Corporate Tax

- KRA issued a public notice on 16 February 2010 stating that all exemption certificates issued under Paragraph 10 of the First Schedule in the ITA that did not have expiry dates were rendered effectively invalid immediately
- The public notice stipulated that interested parties should apply for exemption certificates afresh and that these shall be valid for a period of 3 years. However, the Finance Act 2013 increased the validity period to 5 years
- Where an applicant has complied with all the requirements, he will be issued with an exemption within sixty days of the lodging of the application
- Prior exemptions covered investment incomes i.e. interest and dividend income. However the new legislation is silent in this area

Procedures to apply for a tax exemption certificate

1. Review whether the exemption is covered under either:
 - a) Bilateral or Double Tax agreements; or
 - b) Paragraph 10 of the Income Tax Act
2. Where one qualifies under option 1 (a) above – then there is no requirement to make the application as one automatically qualifies.
3. Where you fall under category 1 (b) above – you are required to make a formal application for exemption to the relevant KRA policy unit station
4. The KRA to conduct a comprehensive tax audit to ensure that the organization complies with all relevant legislation i.e. PAYE, Withholding Tax
5. Where KRA is satisfied that the organization is fully compliant with all tax heads they will then issue the exemption certificate
6. Application for renewal of this certificate to be done after every 5 years. In practice, this application must be made 6 months prior to the expiry of the existing exemption status

KRA requirements – First time applicants

KRA requires the following information for first-time applicants:

- A letter of application for Income Tax exemption status
- Returns of income and audited accounts
- Copies of the bank statements – for atleast 6 months
- Constitution or Trust Deed
- A letter from the representative of Central Government stating the activities carried out by the organization
- Registration certificate
- PIN Certificate
- Evidence of the projects carried out for the last 3 years or for whatever period of operation
- Any other useful information in support of the application

KRA requirements – Renewal cases

The following information is required for renewal cases:

- A letter of application for Income Tax exemption status
- Returns of income and audited accounts
- Copies of the bank statements
- Proof of the projects carried out for the last 3 years
- Any other useful reconfirming information in support of the application

PBOs Act – Tax provisions

PBOs receive benefits of registration as set out in the Second Schedule, namely:-

- Tax exemptions from:
 - a) Income tax on sums received as membership subscription, donations and grants
 - b) Income tax on the PBOs income generating activities if the income is wholly used to support the purposes of which the PBO was established
 - c) Income tax on interest and dividends on investments and gains earned on assets or the sale of assets, and
 - d) Stamp duty
- Preferential treatment under the VAT and customs duties legislation in relation to the importation of goods and services

PBO Act – Tax provisions (Cont.)

- Incentives for donations by legal and natural persons
- Employment tax preferences
- Special tax incentives for donations to form endowments, prudent investment policies, etc.

PBO Act – Tax provisions (Cont.)

Challenges:

- Provisions are vague – it refers to “preferential treatment”, “preferences”, “incentives” etc. What do these terms mean since they have been used instead of “exemption”?
- Process is not provided for – tax exemptions usually require a vetting process with the Tax Commissioner or Finance Minister having the power to confirm or deny the exemption
- Conflict between existing provisions and new ones
- PBOs Act 2013 not yet in force

Tax Risks for PBOs

Exemptions: not understanding scope of tax exemptions or not adhering to the requirements or required processes, especially as regards KRA. Failure to lodge correct paperwork could invalidate the exemption

Compliance: organizations failing to submit returns where required e.g. Corporate Income Tax returns required, even if there is no taxable income to report. VAT returns also required if you are VAT registered, even if VAT registration is done in error

Agency taxes: Withholding Taxes and PAYE obligations typically not covered by exemptions, unless there is a specific provision in the ITA or government agreement. Tax not withheld becomes responsibility of withholding 'agent'.

Examples of such cases:

- Failure to account for withholding tax on payments to research consultants based in Kenya or outside Kenya
- Failure to account for PAYE on benefits provided to staff e.g. unaccounted per diems, pension contributions made by the organization to an unregistered pension schemes etc.

Penalty regime: the penalties and interest charges are onerous, even where a genuine mistake has been made. Waiver applications to the Cabinet Secretary for the National Treasury take a long time to resolve

Managing your tax risks

- Make sure you know ALL about your various tax obligations – it is not enough to do what others are doing. Remember items like NHIF, NITA, NSSF etc. Please obtain specific advice based on your circumstances
- Meet all tax compliance deadlines – the penalties are harsh
- Regarding prior year activities, carry out a tax health checks to identify non-compliance issues that you may not be aware of. Consider options for dealing with the tax exposure. The earlier the problem is identified, the better!
- Keep up to date on tax matters and changes to legislation that impact you e.g. on pension, schooling benefit etc.

Tax returns

- Where the entity is dormant or tax exempt for a particular accounting period, it is still required to file its annual return, in this case referred to as a nil return as the entity did not trade or is exempted from tax
- **Due date for return filing is six months following the end of the income year/ accounting year**
- Currently all filings need to be done electronically through the iTax system
- The following information need to be filed together with the return:
 - Audited financial statements
 - Tax Computation, and
 - Other support documents – e.g. withholding tax certificates, etc.

Assessments, objections & appeals

Assessments

- Self-assessment-Self-declared Tax
- Additional assessments are issued by the Commissioner of Income Tax after audit
- Amended assessment after objection/appeals
- Estimated assessments issued in case no return is filed

Objections

- Taxpayer may object against an assessment issued by Commissioner within 30 days
- A late objection may be lodged after the specified time on grounds of absence from the country, sickness or other reasonable cause

Appeals

- Where the Commissioner does not agree with the objection, a taxpayer can file an appeal to the Tax Appeal Tribunal then the High Court in that order

Tax offences and penalties

Offences	Penalties
1. Late submission of the self assessment return	5% of Tax outstanding at the self assessment date-minimum of KES.20,000
2. Omission of income or fraud in a return	75% of the resultant tax underpayment in case of fraud or deliberate omission; or 20% of the resultant tax underpayment if the omission was not deliberate. Penalty for a second repeat offence increases by 10%. For a third or subsequent repeat offence, the penalty increases by 25%
3. Late payment penalty	20% of the tax involved
4. Late payment interest	1% per month of the tax involved
5. Penalty for failure to keep/maintain documents	10% of the tax payable or KES 100,000 where no tax is payable.
6. Late submission of a document required to be submitted other than a return	KES 1,000 for each day of delay/default subject to a maximum of KES 50,000.

Income Tax in-depth audit

- KRA selects Taxpayers for in-depth examination in order to enforce tax compliance, full income disclosure, enhance collection and Taxpayer education
- Taxpayer Charter has provided for procedure for audit and rights of a Taxpayer

Procedure

- Letter from KRA for in-depth examination
- Mutually agreed date for commencement
- Tax agent to review/be involved
- Limit of time of audit specified in the Charter
- Audit to cover two years plus current

Income Tax in-depth audit

Tips:

- Don't give the KRA more than they ask for
- Skeletons in cupboard- advance planning required
- Cultivate mutually beneficial relationship
- Check the accuracy of KRA findings
- Discuss risk/potential liability with Tax consultants

Questions & Answers



Withholding Tax

Introduction – Principles of w/tax

- Is an agency form of tax where a person making certain types of payments which are income subject to tax in Kenya is required to deduct tax therefrom and remit the tax deducted directly to the KRA
- The person who is required to withhold tax on a payment is called a **payer** while the person who is entitled to receive a payment which is income subject to withholding tax is the **payee**
- Withholding tax is not an additional tax. Rather, it is a payment of tax in advance on the income of the payee
- Where w/tax is not final tax, the tax should be claimable by the payee if the payee is resident in Kenya or is a PE of a non-resident person
- W/tax achieves the following:
 1. Curbs tax evasion
 2. Reduces tax administration costs, and
 3. Manages a country's cash flow

The Legislation

The following are the key provisions that govern the operation of WHT in Kenya:

- **Section 3 of the Income Tax Act (ITA)**:- stipulates that income tax should be chargeable on the income which accrued in or was derived from Kenya or on the income deemed to have been accrued in or derived from Kenya
- **Section 10 of the ITA**:- Deems the payments liable to w/tax to be income accrued in or derived from Kenya
- **Section 34 & the Third Schedule to the ITA** - Provides the income tax rates
- **Section 35 of the ITA**:- Lists the payments that are subject to w/tax.
- **Section 39 (1) of the ITA**:- Allows w/tax to be set off against income tax
- **Section 72D of the ITA** – Stipulates the penalty for late payment of tax
- **Section 38 of the Tax Procedures Act** – stipulates the late payment interest
- **Income Tax (Withholding Tax) Rules, 2001**:- Issued by the Cabinet Secretary, National Treasury (then Minister for Finance) pursuant to the powers conferred to the Cabinet Secretary under Section 130 of the ITA. The rules prescribe the WHT administration procedures

Payments/services subject to w/tax

Payments to Residents and PE

- Management or professional fee whose value exceeds KES 24,000
- Training fee
- Dividend
- Interest and deemed interest
- Royalty and natural resource income
- Rent on commercial property
- Pension/retirement annuities

Payments to Non - Residents

- Management or professional fee
- Training fee
- Royalty and natural resource income
- Rent for use or occupation of property
- Dividend
- Interest and deemed interest
- Payment to sportsmen or entertainers
- Telecommunication service fees
- Pension/retirement annuities

Management or professional fees defined

- **ITA definition (Section 2)** - Payment made to a person, other than payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated

Elements of management or professional fee

- **Contractual fee** - payment for work done in respect of building, civil or engineering works - See Section 35(3)(f) of the ITA
- **Consultancy fees** - payment made to any person for acting in an advisory capacity or providing services on an consultancy basis
- **Agency fees** – payment made to a person for acting on behalf of any other person or group of persons, or on behalf of the government, but excludes any payments made by an agent on behalf of the principal when such payments are recoverable
- **Professional fees** – not defined but recognized professions set out in the **Fifth Schedule to the ITA** – Based on the professions listed under the Fifth Schedule, professional fees should therefore include fees charged by medical practitioners, dentists, advocates, surveyors and land surveyors, architects and quantity surveyors, engineers, accountants and certified public secretaries

Training fees

- **Section 2 of ITA Definition** – “payment made in respect of a business or user training services designed to improve work practices and efficiency of an organization, and **includes** any payment in respect of incidental costs associated with the provision of such services”
- An example of training fees includes payment for this tax training
- Incidental costs in connection with training can include **accommodation, travel** expenses etc. incurred on behalf of facilitators/trainers

Royalty

Section 2 of the ITA definition - payment made as a consideration for the use of or the right to use:

- The copyright of a literary, artistic or scientific work
- Patent, trade mark, design or model, plan, formula or process, or
- Any industrial, commercial or scientific equipment

Examples

- Payments in respect of trade marks/brands e.g. franchise fees, intellectual property fees including software licenses etc.

Natural resource income

- Defined under **Section 2 of the ITA** to mean:
 - An amount including a premium or such other like amount paid as consideration for the right to take minerals or a living or non living resource from land or sea, or
 - an amount calculated in whole or in part by reference to the quantity or value of minerals or a living or non-living resource taken from land or sea

Examples

- Payments for quarrying
- Payments in respect of mining minerals
- Payments for the right to obtain timber
- Payments for the right to fish
- Sand harvesting

Interest

- Defined under **Section 2 of the ITA** to mean
 - interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and **includes a premium or discount by way of interest and commitment or service fee paid in respect of any loan or credit**

Examples

- All costs associated with borrowing including:
 - The stipulated interest cost
 - Negotiation fee
 - Commitment fee
 - Insurance cost etc.

Deemed interest

- Defined under **Section 2 of the ITA** to mean:
 - An amount of interest equal to the average ninety-one day Treasury Bill rate, deemed to be payable by a resident person in respect of any outstanding loan provided or secured by the non-resident, where such loans have been provided free of interest

Dividend

- Defined under **Section 2 of the ITA** to mean:
 - any distribution (whether in cash or property, and whether made before or during a winding up) by a company to its shareholders with respect to their equity interest in the company, other than distributions made in complete liquidation of the company of capital which was originally paid directly into the company in connection with the issuance of equity interests

Dividend also includes:

- Deemed dividend as per Section 7 of the ITA:
 - ✓ Discount of more than 5% on issuance of redeemable preference shares and debentures
 - ✓ Issue of ordinary shares to existing shareholders in a ratio not proportionate to their shareholding
- Deemed distribution as per section 24 of the ITA – where a company has sufficient revenue reserves and does not distribute

Withholding Tax Rates

Description	Resident rate (%)	Non - residents rate (%)
Dividends > 12.5% voting power	Exempt	10
< 12.5% voting power	5	10
Interest - Housing Bonds	10	15
- Government bearer bonds 2 years and more	15	15
- Other interest	15	15
Insurance commission		
- Brokers	5	20
- Others	10	20
Royalties and natural resource income	5	20
Sporting or entertainment income	-	20
Pension/retirement annuities	0 to 30	5
Telecommunication service fees	-	5

Withholding Tax Rates

Description	Residents (%)	Non-residents (%)
Rent / leasing – Immovable property	10 (a)	30
- Others	-	15
Management, professional (other than contractual) & training fees	5	20 (b)
Contractual fees	3	20

- a) Rent payable to resident persons for use of immovable commercial property to be liable to 10% w/tax with effect from 1 January 2017. Withholders of such tax to be appointed by KRA
- b) Payment of consultancy fees to **individuals** of the EAC partner states liable to w/tax at 15% and not 20%

Rates applicable on payments to persons resident in countries that have Double Tax Treaties (DTTs) with Kenya

Residency country	Dividends	Interest	Royalties	Management fees
Canada	10	15	15	15
Denmark	10	20	20	20
France	10	12	10	0 or 20% (a)
Germany	10	15	15	15
Mauritius	5 or 10 (b)	10	10	0 or 20% (a)
India	10	15	15	17.5
Norway	10	15	20	20
Sweden	10	15	20	20
South Africa	10	10	10	0 or 20% (a)
United Kingdom	10	15	10	12.5
Zambia	0 or 10 (c)	15	15	15

- a) The DTT between Kenya and France/South Africa and Mauritius do not have an article on management fees. Still not very clear whether rate should be 20% or 0%
 - b) If the beneficial owner is a company that holds at least 10% of the paying company's capital, w/tax should apply at 5%
 - c) Where dividends are paid to persons resident in Zambia, no dividend w/tax should be applied if the dividends are subject to tax in Zambia
- **Need to be aware of the unilateral LOB provision – Section 41 (6) of the ITA**

Obligation to deduct

- Section 35 of the ITA provides an obligation to the payer to deduct tax on eligible payments for payment to KRA directly
- Failure to deduct tax on an eligible payment and remittance of the same to KRA is an offence under the ITA and attracts penalties and interest

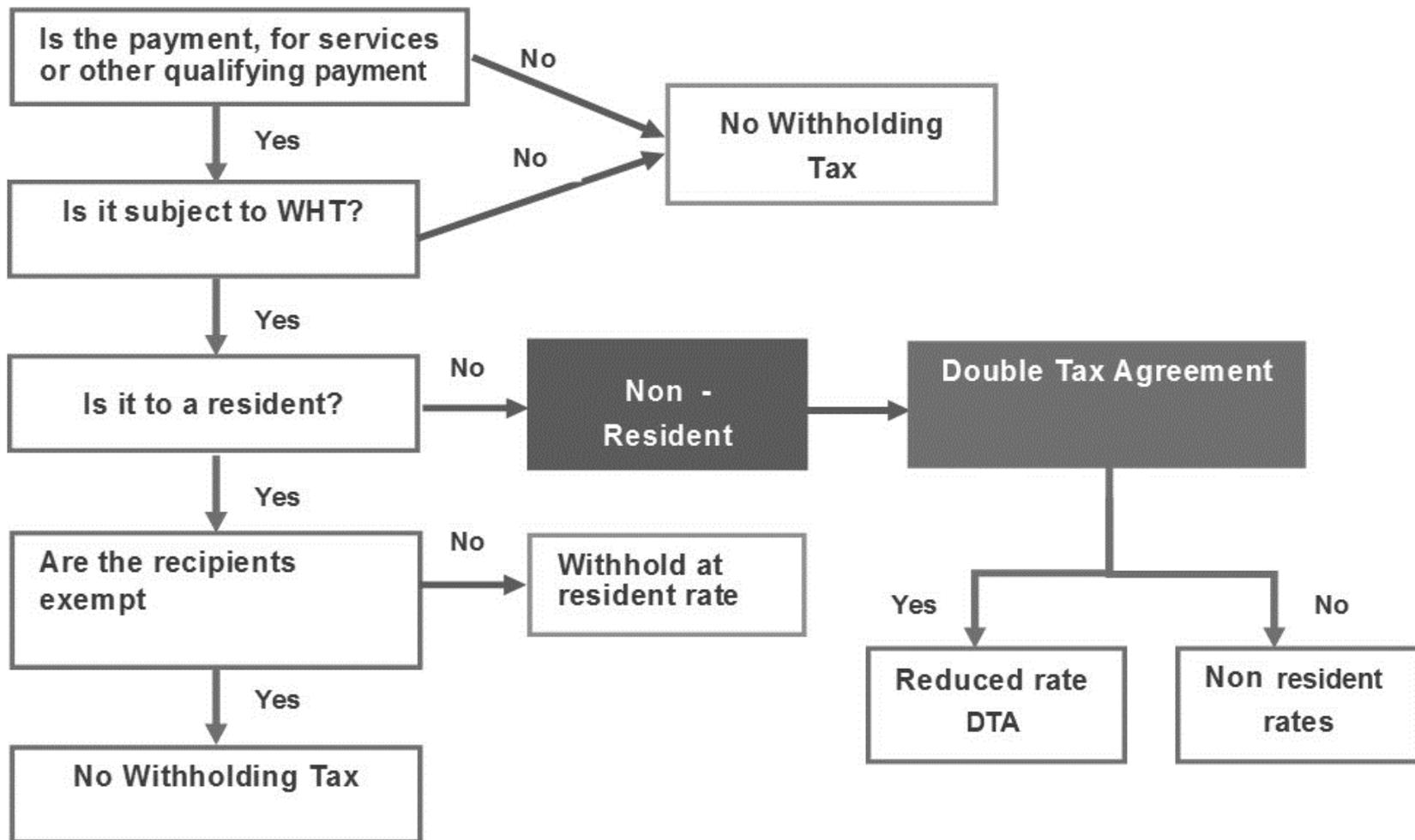
Withholding administration

- WHT is due by the 20th day of the month following the month of deduction.
- Upon deduction and payment of WHT, a person is required to keep a record of the name of the payee, PIN, gross amount paid, nature of payment and amount of tax deducted
- Withholding tax accounting is now supposed to be fully done through iTax platform
- Upon paying the tax, the iTax platform should generate a certificate that should be sent to the payee to enable the payee claim credit against income tax
- Annual w/tax return – A withholding tax return needs to be filed with KRA by the end of February of the following year. The return summarizes all payments made in the prior year

Penalties and interest for non-compliance

- For purposes of recovery of tax, withholding tax is demanded from the payer as though it were the tax of the payer (recall WHT belongs to PAYEE and not PAYER)
- A penalty of 20% should apply for late payment of withholding tax – up until 9 June 2016, the penalty used to be 10% but capped to KES 1 million
- Late payment interest of 1% per month is chargeable on any tax remaining unpaid after the due date – the late payment interest charged is capped to the principal tax involved (*In duplum rule*)
- Failure to file the annual return attracts a penalty of KES 100,000 or imprisonment for 6 months or less

In a Nutshell...



Complex issues/ KRA audit issues

- 1. Definitions** – It is important to determine whether a payment falls under the ambit of withholding tax based on the highlighted definitions. For instance, should payments to body builders be liable to w/tax?
- 2. The tax point (actual payment vs accrual)** – Should w/tax be based on actual payment or accrual?
- 3. Mixed supplies** – WHT applies only to services. What happens where fees to be paid under a contract relate to both goods and services?
- 4. Treaty provisions** – Where there is a DTT, careful review and application is required. DTTs have delicate provisions that must be carefully applied. The South African, French and the Mauritian treaty are important examples
- 5. Disbursements and reimbursements** – should w/tax be based on disbursements and reimbursements? What is the difference between the two?
- 6. Gross up problem** – where a contract is negotiated net of tax, should w/tax be based on the contract fee or should it be grossed up?
- 7. Payment in kind** – How should w/tax be accounted if payment is made in kind?

Withholding Tax Planning

- Compliance to avoid fines and penalties
- Payment timing
- Direct disbursements payments
- Obtaining all certificates and claiming the tax
- Double Tax Treaties
- Contractual provisions
- Year-end crediting as opposed to monthly or quarterly

Finance Act 2016 changes

- Repeal of withholding tax on winnings from gaming and betting.
- Deletion of the 10% penalty (that was capped at KES 1 million) – effective 9 June 2016. This effectively implies that the penalty for WHT non-compliance should now be 20% but not capped
- W/tax in respect of commercial property rent paid to resident persons clarified – rate to be 10% and not 12% as per the Finance Act 2015. In addition, enabling provisions now introduced – effective 1 January 2017

Questions & Answers



Indirect Taxes

VAT

Contents

- Introduction
- VAT status of supplies by NGOs
- VAT status of supplies to NGOs
- Process of applying for zero rating/exemption
- Potential VAT issues for NGOs

Introduction

- VAT is chargeable on taxable supplies or importation of taxable goods and services
- Applicable VAT rates; zero or 16%
- Certain items also exempt from VAT
- Registration threshold – taxable supplies of KES 5 million (app. USD 50,000)
- Registered person liable to charge and account for VAT on taxable supplies

VAT status of supplies by NGOs

Exempt supplies?

The supply of social welfare services by charitable organizations is exempt. This is on condition that:

1. The charitable organizations are registered as such; or
2. Such charitable organizations are exempted from registration by the Registrar of Societies or by the Non-Governmental Organizations Co-ordination Board and their income is exempt from VAT under Para 10 of the First Schedule to the Income Tax Act (ITA).
 - Para 10 exempts the income of an institution, body of persons or irrevocable trust, of a public character established solely for the purpose of relief of the poverty or distress of the public.
 - Generally, gains or profits from business are not exempt unless solely applied for the above referred purpose.

VAT status of supplies by NGOs

Taxable supplies?

VAT is applicable where social welfare services are rendered by way of business.

Business defined to include:

- Trade, commerce or manufacture, profession, vocation or occupation;
- Any other activity in the nature of trade, commerce or manufacture, profession, vocation or occupation;
- Any activity carried on by a person continuously or regularly, whether or not for gain or profit and which involves in part or whole, the supply of goods or services for consideration;
- A supply of property by way of lease, license, or similar arrangement.

Important to note that, while ITA may exempt gains or profits from business, VAT Act considers such income as subject to VAT.

VAT status of supplies to NGOs

Taxable supplies or importations by the following privileged persons or institutions are zero rated for VAT:

- Goods consigned to Commonwealth and other governments for personal use or consumption by officials or men on board a naval vessel
- Diplomats and first arrival persons – household and personal effects including one motor vehicle
- Taxable supplies for the use of the United Nations or its special agencies
- Donor agencies with bilateral or multilateral agreements - mainly covering household and personal effects of entitled persons
- Supplies to international and regional organizations – including donor agencies, organizations with diplomatic accreditation or bilateral or multilateral agreements
- Relief goods supplied or imported for emergency use
- Supplies to National Red Cross Society and St. John Ambulance

Process of applying for zero rating/exemption



Potential VAT issues for NGOs

- Delayed approvals
- How to recover VAT already paid to suppliers prior to obtaining approvals
- Adoption of zero rating/exemption without proper backing of the law
- Conflict of Host Country Agreements with the provisions of the VAT law
- KRA audits and disputes?
- Any other?

Customs

Applicable legislation

- The EAC Customs Management Act
- The Miscellaneous Fees and Levies Act
- The VAT Act 2013

Privileged persons and institutions

- United Nations or its specialized agencies
- Commonwealth high commissions
- Foreign embassies
- Consulates
- Diplomatic missions
- Donor agencies with bilateral or multilateral agreements with Kenya
- International and regional organizations
- Entitled personnel and their dependents

Import duty exemptions – 5th Schedule of the EAC CMA

- Household and personal effects imported by entitled personnel and their dependents
- 1 motor vehicle
- Goods for official use of the privileged institutions and their high officials
- Goods for the UN or any of its specialized agencies for the support of a project
- 1 replacement motor vehicle in case of a write off due to an accident theft or fire
- Household, personal effects and 1 motor vehicle of an employee of the privileged institutions where the employee is not engaged in any other business or profession in Kenya
- Goods and equipment imported by donor agencies, international and regional organizations with Diplomatic accreditation or bilateral or multilateral agreements with Kenya for their official use

Conditions on importation of household goods, personal effects and motor vehicles

- Goods purchased prior to clearance through customs within 90 days of their first arrival Kenya. The Commissioner may extend the period to a period not exceeding 360 days from the date of arrival
- Entitled personnel arriving for a new contract should have a contract of a term not less than 2 years
- Taxes are payable on disposal of the motor vehicle
- Only once every 4 years where there is an ongoing project
- Additional motor vehicle where there is a bilateral agreement between the Government and aid agency entered into prior to the coming into force of the EAC CMA

Import Declaration Fee

Levied at 2% of the customs value on goods imported into Kenya for home-use subject to a minimum of KShs 5,000

Exemptions

- Household goods, personal effects and motor vehicles exempted from import duty under the EAC CMA
- Gifts and supplies for diplomatic and consular missions and to the UN missions
- Gifts by foreign governments and international organizations to charities and foundations

Railway Development Levy

RDL is levied at 1.5% of the customs value of goods imported into Kenya for home-use

Exemptions

- Goods for official use of a diplomatic mission, institution or organization gazetted under the Privileges and Immunities Act
- Goods imported by the UN and its agencies

Questions & Answers



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