



## **The Tax Laws (Amendment) Bill, 2018** Keeping you informed

The Tax Laws (Amendment) Bill (2018) ("the Bill") was gazetted on 10 April 2018.

The Bill majorly proposes the following;

- Reintroduction of withholding tax on winnings from betting and gaming;
- An increase in allowances for depositors of home ownership saving plans;
- Stamp duty exemption for first time home owners;
- Specific tax exemptions for licensed Special Economic Zone operators and developers; and
- Reclassification of certain goods and services from zero rated to exempt status.

# Withholding tax on winnings from Betting and Gaming

## The measure

The Bill proposes to introduce withholding tax on winnings from betting and gaming at a rate of 20% for both non – resident and resident persons.

## Our view

This measure reflects the Government's intention to benefit from the growing betting industry through additional tax collections. This measure was already in the Income Tax Act but was repealed due to implementation challenges and subsequent measures to tax the betting and gaming companies on their revenue.

The move to reintroduce this withholding tax is probably aimed at shifting some of the burden from the betting and gaming companies to the punters especially if one considers that the tax on the companies had to been reduced from the initial 50% that was proposed to 35% following an outcry that the tax was too punitive. However, there remains concern regarding the taxation of this sector to ensure the Government collects a fair share from the gains without stifling the growth of the sector.

# Tax allowances under Home Ownership Saving Plans (HOSP)

## The measure

The Income Tax Act permits a deduction against taxable income for deposits into registered HOSP by individuals who are not already home owners. The Bill proposes to increase from KES 48,000 per annum (KES 4,000 per month) to KES 96,000 per annum (KES 8,000 per month), for the prevailing year and nine years to follow.

## Our view

This is a positive move as it encourages savings as a means of financing home ownership. It is also in line with the current Government's Big4 Agenda item of delivering affordable housing to more Kenyans.

# Stamp duty exemption on first home purchase

## The measure

The Bill proposes to exempt from stamp duty the purchase of a house by a first time home owner under the affordable housing scheme.

## Our view

This proposition favors the purchase of homes by first-time home owners, but is limited to the affordable housing scheme which the Government is pursuing under the Big4 agenda on housing. Whereas it is a laudable move to cushion the lower income group from additional costs relating to home ownership, it is a measure that should ideally be extended to all first-time home owners given the current low level of home ownership.

# Tax exemptions for Special Economic Zone developers

## The measure

The Bill puts forward tax exemption clauses for capital gains and compensating tax accruing to licensed Special Economic Zone (SEZ) operators and developers.

Special Economic Zones are designated trading areas that enjoy favorable business and industrial conditions such as lower production costs, some tax incentives, as well as closer proximity to raw materials.

## Our view

The tax exemption on capital gains and on compensating tax (a type of tax on dividends distributed by a company that already enjoys tax incentives), ensures that SEZ investors will not lose out on the tax benefits granted to these entities through taxes on profit distributions or capital gains during transfer or disposal.

The measure is aimed at encouraging investment in SEZ and is in line with the Government's Big4 agenda of increasing the contribution of manufacturing to GDP. We believe the concerns relating to compensating tax also applies to companies operating outside SEZ's and should be addressed across the board. In particular, companies benefitting from investment deduction (mostly manufacturing entities) are likely to encounter compensating tax which effectively claws back the incentives. Furthermore, with the reintroduction of capital gains tax, one would question whether compensating tax should be retained as it was targeted at distributions of untaxed income which mostly comprised capital gains.

# Value Added Tax changes

The Bill seeks to move a number of items currently listed as zero-rated for VAT purposes to the exemption schedule. This is a move largely geared towards restricting zero rating of taxable supplies to exports. By default, it is expected that the number of VAT refund claims associated with zero rating will significantly drop.

We detail below the changes proposed through the Bill:

The measure	Initial status	Our View
<b>Exemption of taxable supplies, imported or purchased for direct and exclusive use in the construction of a minimum of five thousand housing units, by a licensed special economic zone operator, developer or enterprise upon recommendation by the Cabinet Secretary for the time being responsible for housing.</b>	Zero-rated.  Special Economic Zones are considered to be outside the jurisdiction of Kenya for tax purposes. Any taxable supplies to entities in such zones qualify as exported and therefore zero-rated.	<p>The move to exempt construction material and services supplied to SEZ operators, developers and enterprises for housing units is aimed to create more affordable housing in approved zones. Whether this is the likely impact is a matter of debate.</p> <p>SEZ entities enjoy tax incentives and from a VAT perspective, supplies to such entities are zero-rated. The effect of zero rating is that any VAT incurred by suppliers while making supplies to SEZ entities is claimable as input tax credit on the part of the suppliers.</p> <p>Such credit could either be recovered by way of offset against future tax payable or through refund. It does not form part of the suppliers' costs. As a result, this VAT is not transferred to SEZ entities as an added cost.</p> <p>Exemption on the other hand does not allow recovery of VAT incurred on taxable supplies as input tax credit. The move to exempt construction material is therefore likely to make such material more expensive as suppliers could seek to recover the added cost relating to non-deductible input VAT by including this in the prices charged to SEZ entities.</p> <p>Therefore, while the primary motive of this change seems to be incentivizing the construction of housing units in SEZs, such motive may not be achievable through exemption.</p> <p>It is also likely that, through exemption, the government seeks to curb cases of refund claims by suppliers to SEZ entities.</p>

The measure	Initial status	Our View
<p><b>Exemption of taxable supplies, imported or purchased for direct and exclusive use in the construction of a hotel and/or conference facility by a licensed special economic zone operator, developer or enterprise upon recommendation by the Cabinet Secretary for the time being responsible for tourism.</b></p>	Zero-rated.	<p>Similar to above case, questions are likely to be raised on whether the exemption of taxable supplies for construction of hotels/conference facilities made to SEZ entities will yield better results compared to zero rating.</p> <p>It is likely that exemption will result in higher prices.</p>
<p><b>Exemption of transactions relating to the transfer of a business as a going concern by a registered person to another registered person.</b></p>	Zero-rated.	<p>Exemption of transactions relating to transfers of businesses as going concerns is likely to negatively impact recoverability of input tax where the transferor has input tax credit prior to the sale.</p> <p>In addition, any VAT suffered on costs incidental to the sale such as legal fees will, upon commencement of this change, become an added cost to the transferor.</p> <p>One may also beg to ask why the two entities need to be registered for VAT if the VAT status of the transfer changes to exempt.</p>
<p><b>Exemption of natural water, excluding bottled water, by a National Government, County Government, any political sub-division thereof or a person approved by the Cabinet secretary for the time being responsible for water development, for domestic or for industrial use.</b></p>	Zero-rated.	<p>The move to exempt natural water (excluding bottled water) supplied by approved government agencies impacts the recoverability of input tax suffered by such agencies.</p> <p>Such input tax may be material where approved agencies engage in construction works for upgrade or expansion purposes. Otherwise, input tax suffered in this regard may be relatively minimal where it is only incurred on operations.</p> <p>All the same, it will be expected that such agencies expense input tax suffered on taxable purchases (whether capital or operational in nature) incurred to supply natural water.</p>
<p><b>Exemption of articles of apparel, clothing accessories and equipment specially designed for safety or protective purposes for use in registered hospitals and clinics or by county government or local authorities in firefighting.</b></p>	Zero-rated.	<p>Exempting such items may have little impact where they are imported from other countries. However, should such apparel be manufactured locally, any input tax suffered during manufacture will become non-deductible, as input tax credit, on the part of the seller.</p> <p>It is therefore likely that suppliers to qualifying institutions will factor the additional cost relating to non-deductible VAT in their pricing thereby leading to an increase in the price of these items.</p>

The measure	Initial status	Our View
<p><b>Exemption of taxable goods supplied to marine fisheries and fish processors upon recommendation by the relevant state department.</b></p>	<p>Zero-rated.</p>	<p>The zero rating of taxable goods supplied to marine fisheries and fish processors was part of the Coastal Fisheries Revival Package aimed at facilitating primary, secondary and ancillary marine fisheries processing/ production and was introduced through the Finance Act 2017.</p> <p>The move to exempt taxable goods to marine fisheries and fish processors is likely to disincentivise the sector due to added costs relating to non-recoverable VAT.</p> <p>This move however curbs cases of increased refund claims from suppliers to the fisheries and fish processing sector players.</p>
<p><b>Exemption of inputs or raw materials (either produced locally or imported) supplied to pharmaceutical manufacturers in Kenya for manufacturing medicaments, as approved from time to time by the Cabinet Secretary in consultation with the Cabinet Secretary responsible for matters relating to health.</b></p> <p><b>The Bill also proposes to delete Part C of the Second Schedule to the VAT Act, 2013 (deals with zero-rated medicaments) and move all items of medicaments listed therein to the exemption schedule.</b></p>	<p>Zero-rated.</p>	<p>Inputs or raw materials for manufacture of medicaments were zero rated with effect from 12 June 2015. Prior to this, such inputs or raw materials were subject to VAT at 16%.</p> <p>The intention behind zero rating was to bring down the cost of production of medicaments and, as a result, make medicaments more affordable to common <i>mwananchi</i>.</p> <p>This proposed move to exempt such inputs or raw materials is likely to result in increased production costs thereby increasing prices of medication. VAT costs such as; electricity, acquisition of machinery, rental costs among others will now ultimately be borne by those seeking medical treatment.</p> <p>However, the potential impact may need to be assessed as the Bill further proposes to delete all zero rated medicaments and move these items to the exemption listing.</p>
<p><b>Exemption of Liquefied Petroleum Gas (LPG).</b></p>	<p>Zero-rated.</p>	<p>Zero rating of LPG was aimed at enhancing affordability of green energy. The move to exempt the same is likely to increase market prices as suppliers seek to recover VAT suffered in packaging and on operations which will henceforth not be claimable as input tax credit.</p> <p>Once the change comes into force, the LPG may not be as affordable to the common <i>mwananchi</i>.</p>

The measure	Initial status	Our View
<p><b>Exemption of Milk and cream, not concentrated nor containing added sugar or other sweetening matter, of tariff numbers -</b></p> <ul style="list-style-type: none"> <li>- <b>0401.10.00 - of a fat content, by weight but not exceeding 1%;</b></li> <li>- <b>0401.20.00 - of a fat content, by weight, exceeding 1% but not exceeding 6%;</b></li> <li>- <b>0401.40.00 - of a fat content, by weight, exceeding 6% but not exceeding 10%; and</b></li> <li>- <b>0401.50.00 - of a fat content, by weight, exceeding 10%.</b></li> </ul>	Zero-rated.	<p>Milk forms a significant portion of the dietary needs of Kenyans.</p> <p>Initially, the VAT law exempted milk and cream of tariff numbers: 0401.10.00 and 0401.20.00 from VAT.</p> <p>However, to make milk more affordable, the government moved to zero rate these items as well as those of tariff numbers 0401.40.00 and 0401.50.00. This move was at the time aimed at lowering milk prices but the impact has been somewhat insignificant.</p> <p>While the move to exemption may result in an increase in prices due to non-recoverability of input tax, it is arguable that zero rating did not achieve the intended purpose. The move also lowers cases of VAT refund claims resulting from zero rating.</p>
<p><b>Exemption of maize (corn) flour, ordinary bread and cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than ten per-cent in weight.</b></p>	Zero-rated.	<p>Initially, maize (corn) flour, wheat or meslin flour and ordinary bread were exempt from VAT. However, due to the impact of the recently ended severe drought on food prices, the government moved to zero rate these items with the hope that zero rating would reduce food prices.</p> <p>While a move to exemption may result in increased prices for these necessities, it is likely that in the near future Kenyans will have a bounty harvest in light of the heavy rains currently experienced. Increased supply of substitutes to these products may result in a reduction of prices.</p>
<p><b>Exemption of agricultural pest control products.</b></p>	Zero-rated.	<p>The Finance Act, 2017 changed the VAT status of agricultural pest control products from exempt to zero-rated. This move was geared towards making the pest control products more affordable.</p> <p>The Bill now proposes to reinstate the VAT status of these products to exempt.</p> <p>However, the Bill does not seek to exempt raw materials for the manufacture of pest control products which are currently classified as zero-rated. This is likely to be an error and we can expect a further change in the law to either delete raw materials from the list of zero rated supplies or move such materials to the list of exempt supplies. Notably, there seems to have been a mix up in the law as such raw materials seem to have been included in both the exempt and zero-rated schedules through the Finance Act, 2017.</p>

The measure	Initial status	Our View
<b>Exemption of goods imported by returning residents now moved from zero-rated listing to exempt listing.</b>	Zero-rated.	We do not foresee a significant impact on returning residents from this change.
<b>Exemption of taxable goods for emergency relief purposes for use in specific areas and within a specified period, supplied to or imported by the Government or its approved agent, a nongovernmental organization or a relief agency authorized by the Cabinet Secretary responsible for disaster management.</b>	Zero-rated.	<p>Due to this change, local suppliers to government or its agencies for relief goods will suffer non-deductibility of input tax incurred on their taxable purchases.</p> <p>However, the impact is likely to be minimal where the relief goods are imported.</p>

## Conclusion

The changes in relation to Income Tax and Stamp Duty are targeted incentives to support the Government's Big4 Agenda relating to affordable housing and increasing manufacturing. Largely the Bill seeks to change the VAT status of a variety of products from zero-rated to exempt. While it could be contended that some of these changes are aimed at incentivizing the respective sectors, it is likely that the major intention by the government is to reduce the listing of zero rated items and therefore cases of VAT refund claims. However, VAT refund claims could be considered a necessary evil especially where such claims originate from the zero rating of essential commodities like foodstuff and medicament thereby reducing their retail prices.

Further, having noted various recent changes to the VAT status of some of these essential products through the annual fiscal budget cycles, it is perhaps in the interest of the government to ensure any changes to the VAT status of goods are guided by the necessary impact and feasibility studies. We contend that a consistent and clear VAT status of both goods and services promotes tax compliance and, as a result, enhances revenue collection.

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