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Tax Briefly
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Income Tax Bill, 2018
Keeping you informed

Effective date: If the Bill is passed by the National Assembly, the Act will come into force upon gazettement by the Cabinet Secretary for the National Treasury.

We present below the key changes proposed through the Bill.

Key changes – Corporate Income Tax

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<tr><th>#</th><th>Proposed change</th><th>Impact</th><th>Our View</th></tr>
<tr><td>01.</td><td>A higher corporate tax rate of 35% has been introduced for companies and such rate is applicable to taxable income in excess of KES 500 million.</td><td>Currently all taxable income for resident companies is taxed at 30% whereas the rate for non-resident companies with a permanent establishment (PE) in Kenya is 37.5%.

The proposed rate will result in a higher effective tax rate for highly profitable companies whose taxable income exceeds KES 500 million.</td><td>The measure is aimed at increasing tax revenues from big players in the economy. This is likely to increase the tax burden on these companies especially considering that they are usually under KRA's spotlight at all times and therefore more compliant.

Whereas one could argue that the move is aimed at ensuring equity and is similar to the higher tax rate for high income earning individuals, it is a departure from the global trend where corporate taxes are generally being reduced to incentivize investment. One wonders if this is a case of punishing success?</td></tr>
<tr><td>02.</td><td>Tax on dividends distributed out of untaxed profits:

Where a dividend is distributed out of gains or profits on which no tax is paid, the person distributing the dividend shall be charged to tax in the year of income in which the dividends are distributed at the resident corporate rate of tax on the gains or profits from which such dividends are distributed.

This provision does will not apply to registered collective investment schemes.</td><td>This provision is similar to the compensating tax provisions, but with the following differences:

• The tax payable will no-longer depend on the balance in the dividend tax account;
• The tax will only be applicable where dividends are distributed out of untaxed profits, unlike in the current regime where compensating tax could apply if dividends are paid out of profits that have been taxed at a rate lower than 30%;</td><td>Whereas this measure attempts to simplify the compensating tax regime, we consider that it would be appropriate to repeal this measure altogether for the following reasons:

• The provision does not address the impact of accelerated capital allowances like investment allowance applicable at 100% and tax exemptions granted on certain incomes.
• With the reintroduction of capital gains tax, there is little scope for generating tax free income and therefore the relevance of such a tax which was considered an indirect capital gains tax is questionable.</td></tr>
<tr><td>03.</td><td>Imposition of presumptive income tax:
The Bill proposes to introduce a presumptive income tax to resident persons whose turnover from business is less than KES 5 million during a year of income.

The tax is only applicable to persons who are issued a single business permit by the County Governments.

Presumptive tax is final tax and is 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.

Presumptive tax is not applicable to the following:

• management and professional services; or
• rental business; or
• incorporated companies

A person may opt out of the presumptive tax upon notifying the Commissioner, after which the person will be liable to tax on his/her income in the normal way.</td><td>This measure will impact small traders operating as sole proprietors or unincorporated entities. They will be required to pay tax at the time of obtaining their annual business permits and the tax will be a percentage of their annual business permit fee. Assuming a business permit fee of KES 15,000; tax due would be KES 2,250.</td><td>In our view, this measure is intended to broaden the tax base and improve collection of taxes from the informal sector.

This measure would replace the turnover tax, currently at the rate of 3% of a person's turnover. The KRA has faced challenges in the administration of the tax, hence the proposal to introduce presumptive income tax.

The success of this measure will depend on its implementation and will require collaboration with the county governments.</td></tr>
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#	Proposed change	Impact	Our View
04.	**Thin capitalization: The Bill has revised the thin capitalization ratio of debt to equity to 2:1.** **Thin capitalization rules will not apply to licensed banking and microfinance institutions.**	The current ratio of debt to equity for thin capitalisation purposes is 3:1. The proposed ratio will result in an increase in the risk of thin capitalisation and thus the risk of interest disallowance. Microfinance institutions, which are currently subject to thin capitalization rules, will be excluded from the same provisions given the similarity of their business to that of banks.	We consider the reduction of the debt to equity ratio as punitive as it will discourage debt financing and thus punish investment through disallowing interest cost. We are of the view that early stage companies, including petroleum exploration and mining companies, as well as capital intensive businesses should be given relief from this measure as they have no realistic options but to rely more on debt to finance their investments. On a positive note, the exclusion of microfinance institutions will ensure a level playing ground for all financial institutions.
05.	**Deemed interest provisions:** **Deemed interest has been defined as "the amount by which the interest payable at market interest rate in the country of non-resident of such a loan exceeds that which is paid by a resident person in respect of any outstanding loan provided or secured by a non-resident who exercises control on the resident company, where such a loan has been provided at interest rate that is lower than the market interest rate in the country of non-resident."**	The amended definition of deemed interest implies that the provisions will apply on any loan advanced by a related controlling non-resident as long as the loan is advanced at an interest rate that is lower than the previous quarter's 91-day treasury bill rate applicable in the non-resident's country. Under the current Act, deemed interest only applies to interest-free loans.	This measure appears aimed at sealing the loophole where companies would charge a nominal interest rate to avert the deemed interest provisions. We are of the view that deemed interest provisions should be done away with given that transfer pricing provisions are in place to deal with any mispricing of loans. Where interest is not charged to the Kenyan entity, this represents an advantage to the Kenyan entity and should not be punished.
06.	**Exempt dividend: The Bill provides that a dividend received by a resident company that holds directly or indirectly more than twenty five per cent of the shares of the payer shall be deemed not to be income chargeable to tax.**	This increases the current exemption threshold from 12.5% shareholding to 25%.	In our view, this measure is aimed at increasing tax revenue.

#	Proposed change	Impact	Our View
07.	**The Bill provides that in determining the taxable income of a person, no deduction shall be allowed in respect of payments made by the taxpayer which are subject to withholding tax if the taxpayer fails to withhold tax as required.**	This will lead to higher effective tax especially as there are and will continue to be differences of interpretation as regards expenses that may be subject to withholding tax. This measure also amounts to double punishment since the revenue authority is entitled to recover such unpaid tax from the payer, including penalties and interest.	Whereas the proposed change is aimed at ensuring compliance, we believe it is too punitive considering taxpayers act as agents for purposes of collecting withholding tax on behalf of the revenue authority and given the recovery measures available to the revenue authority to ensure tax is not lost.
08.	**EPZ and SEZ income tax rates:** **The Bill removes the tax holiday for Export Processing Zones (EPZ) and replaces this with a corporate tax rate of 10% for the first 10 years and 15% for the next 10 years and thereafter 30%. This will also be the same for Special economic Zone (SEZ) enterprises.**	EPZ and SEZ enterprises will no longer enjoy a tax holiday but instead a lower tax rate for the first 20 years of operation.	With the introduction of legislation in respect of SEZs in the recent past, this measure is aimed at ensuring a uniform tax treatment of both SEZ and EPZ enterprises. It also eliminates the exemption from tax in line with the general trend of reducing tax exemptions in a bid to increase tax revenue.
09.	**Key changes to capital allowances:** • **Removal of 150% investment deduction for investments outside cities.** • **Commercial building allowance reduced from 25% to 10%.** • **Hotel Building allowance reduced from 100% to 60% in the first year and residual of 40% claimed at 25% in subsequent years in equal instalments** • **Filming equipment allowance reduced from 100% to 50%** • **Allowance for earth moving equipment set at 25%, reducing from 37.5%** • **Allowance for computers reduced from 30% to 25%** • **Allowance in respect of educational buildings reduced from 50% to 10%** • **Investment deduction and farm works, and allowance in respect of motor vehicles remain the same.** • **All other machinery now qualify for allowance at 10% per annum in equal instalments down from 12.5%.**	The capital allowances have been significantly reduced. The impact may not be significant as the tax impact is temporary except for capital intensive businesses and investors who previously received a subsidy in the form of 150% capital allowance.	This measure is aimed at simplifying the capital allowances provisions while protecting the tax base. The change to straight line will ensure taxpayers claim capital allowances over a definite period of time.

#	Proposed change	Impact	Our View
10.	**The Limitation of Benefit clause has been expanded. In addition to the 50% ownership threshold for a Double Tax Agreement (DTA) benefit to apply, a limitation of benefit has been introduced on companies which operate as holding companies, providing supervisory or administration services to a group of companies, providing financing or making or managing investments.**	This introduction seeks to limit DTA benefits by excluding companies not engaged in active business in the other contracting state.	This measure is likely to have significant impact on multinationals who receive services from related group service and financing entities. The result could be an increase in cost for the local service recipients if the increased tax burden is passed on to them.
11.	**The Bill has revised the exemptions listed in the First Schedule to the Act. Exemptions set to be removed include:** • **Exemption from tax for various parastatals; and** • **Interest on a savings account held with the Kenya Post Office Savings Bank**	Limited exemptions now apply with the schedule being reduced from a current list of more than 50 exemptions to a list of only 21.	The measure is aimed at protecting the tax base and also removing some exemptions that are no longer deemed relevant.
12.	**The Bill provides that The Cabinet Secretary may make regulations on taxation of business income arising from transactions carried out on a digital platform.**	The Cabinet Secretary for National Treasury is expected to make regulations for inter alia taxation of business income from transactions undertaken on a digital platform.	The proposed change is aimed at expanding the tax net to take advantage of increasing e-commerce transactions. Whereas this is a welcome measure and in line with global trends to institute specific tax measures that are appropriate for the digital economy, we await the detailed regulations in order to assess the possible impact.

Key changes - Capital Gains Tax (CGT)

#	Proposed change	Impact	Our View
13.	**The main changes in relation to Capital Gains Tax (CGT) are as follows:** • **Increase of CGT rate from 5% to 20%; and** • **Indexation now introduced- A formula for adjusted cost of property to take into account inflation as measured by Consumer Price Indices.**	The substantial increment in the rate of CGT on sale on property will result in higher tax liability for persons realising capital gains on disposal of property. The introduction of indexation will ensure that the effects of inflation are eliminated in determining the taxable capital gains.	Admittedly, the current rate of CGT in Kenya (5%) is relatively lower compared to other jurisdictions and could have been a temporary relief given that CGT was recently re-introduced. It therefore comes as no surprise that the rate has been adjusted upwards as the Government seeks to tap into the gains arising from especially the real estate sector which has grown significantly in the recent past. Our view is that the measure is aimed at increasing the tax revenue from the growing sector. Though the increment is quite steep, it enhances equity considering that CGT is regarded as a tax on wealth.

Key changes - Withholding Tax

#	Proposed change	Impact	Our View
14.	**Withholding tax on demurrage charges paid to non-resident shipping companies has been introduced at the rate of 20%.**	Non-resident shipping companies will suffer additional tax on demurrage charges.	This measure is likely to have a negative effect on business and make the country less competitive in terms of shipping business. It is likely that the affected taxpayers could increase the original freight charges and pass the burden to importers thus increasing cost of business.
15.	**Withholding tax on branch profit repatriation: A withholding tax at the rate of 10% has been proposed on the profits of a Kenyan branch/ permanent establishment that are repatriated. Repatriated profits will be calculated based on a formula specified in the Bill.**	With the revision of the tax rates for branches from 37.5% to 30%, it is expected that this measure will bring the effective rate of tax for branches at "par" with the effective tax for resident companies given that dividends paid by resident companies are subject to further tax at 5% and 10%.	This measure ensures equity in the taxation of companies.
16.	**Withholding tax on management and professional fees paid by licensed petroleum contractors and mining companies to non-resident mining and petroleum subcontractors has been reduced to 10% from the previous 12.5%.**	This reduces the tax impact on the sub-contractors.	A welcome move for the upstream petroleum and mining sector as it would lead to lower costs.
17.	**Withholding tax rate on rent, premium or similar considerations paid to non-residents has been set at 20% for both movable and immovable property.**	This is a reduction of the withholding tax rate in respective of immovable property from the current 30% but the rate in respect of moveable property will increase from the current 15%.	Non-resident owners of immovable property will enjoy a reduced rate on their rental income: which is more equitable given it's a tax on gross income. On the other hand, lessors of equipment will suffer higher tax charge, which is likely to make hiring/leasing equipment from non-residents more expensive if the owners insist on being paid net of tax.
18.	**5% withholding tax on dividends paid by Special Economic Zone Developer, Operator or Enterprise as well as those paid by EPZ introduced**	Foreign shareholders of such enterprises will now suffer withholding tax of 5% as opposed to the exemption under the current Act.	This ensures equity as dividends are generally taxable. The lower rate (as opposed to 10% for other foreign shareholders) provides an incentive to encourage investment in Special Economic Zones.

#	Proposed change	Impact	Our View
19.	**Withholding tax on insurance premiums paid to a non-resident person has been introduced at the rate of 5%**	Insurance premiums are currently not subject to withholding tax and therefore non-resident insurers will now incur tax on premiums received from Kenya.	The measure is aimed at expanding the tax net and may also be intended to promote the local insurance industry.
20.	**The withholding tax rate on payments to non-residents in respect of transmission of messages by cable, radio, internet, satellite and similar electronic methods has been increased from 5% to 10%.**	The non-resident telecommunication service providers carrying out business in Kenya will suffer higher tax	The proposal is aimed at increasing tax revenues from the growing telecommunications sector.
21.	**Withholding tax rate on bonus/dividends paid by co-operative societies to resident members has been increased from 5% to 10%.**	SACCO and other cooperatives' members will incur additional tax on their income from distributions by the SACCOs/ cooperatives.	This is a measure targeted at increasing revenue collections but may dampen the savings culture among many Kenyans.

Key changes - Mining & up-steam petroleum operations

#	Proposed change	Impact	Our View
22.	**Loss carry forward:** **The loss carry forward for mining operations will be allowed for up to 14 years only. Under the current Ninth Schedule there is no time limitation for the carry forward of tax losses.** **The loss carry back provisions upon cessation of petroleum operations in a license area, which was allowed for up to 3 years, has now been removed.**	Mining companies are expected to utilize losses within 14 years regardless of when extraction begins.	These measures appear aimed at protecting the tax-base. This is irrespective of the nature of prospecting/ exploration activities, which may take many years to fruition.
23.	**Extraction & development expenditure:** **This will be subject to tax amortization at the rate of 20% per annum from the year of production.** **Currently, such expenditure is deductible in the year in which it is incurred, starting with the year in which production commences.**	Amortization of extraction expenditure is now limited to 20% per annum.	This proposal is intended to enable Government receive a share of mining/ petroleum revenue as early as possible after commencement of extraction/production. The measure is also expected to stabilize the flow of tax revenues.
24.	**Farm-out transactions:** **Work obligation will not be part of taxable farm-out consideration where it is not deducted for income tax purposes.**	Work obligation on behalf of a farmor will not be deductible by the farmee unless such work obligation has been included in the computation of tax payable in a transaction.	This is intended to ensure the parties to a transaction do not obtain a double benefit, although this provision may be redundant in a tax paid PSC.

Key changes – Personal Income Tax

#	Proposed change	Impact	Our View
25.	**Introduction of new tax rate for high-income earners.** **The draft ITA introduces a new tax rate of 35% on individual incomes in excess of Kshs. 9,000,000 per annum (Kshs 750,000 per month)**	High-income earners will be taxed at the rate of 35% for incomes in excess of kshs. 750,000 per month.	This can be viewed as a measure to increase collections from personal income tax by introducing a higher tax rate targeted at high-income earners. What one would have hoped for was a general review of the bands to widen them further in line with inflation and cost of living.
26.	**Non-taxable Per diem which was previously capped at KShs 2,000 per day will now be aligned to the Public Service prescribed rates.**	Payments made to employees in relation to allowances paid in respect of a period spent outside the usual place of work while on official duty will not be taxed on the employee provided the amounts do not exceed the per diem rates prescribed by the Salaries and Remuneration Commission (SRC).	This is a welcome change as the previous allowable amount of Kshs. 2,000 was restrictive and did not reflect the cost of living. This provision may, however, pose a challenge to private sector employers in terms of aligning their per diem rates based on the job grades as provided in the SRC circular.
27.	**Taxable benefit under Employee Share Option Schemes (ESOPs) registered with the commissioner shall accrue to employee at the date of exercising the option.**	The employee will now be taxed on benefit deriving from ESOP that are duly registered with the Commissioner at the point of exercising his option to acquire the shares.	This is a favourable move as the employee will now be taxed at the point when the gain is actually realised as opposed to the provision in the current Act which deems the benefit to accrue at the end of the vesting period even though the employee may not have exercised his option. However, the Act does not clarify the tax point for unregistered schemes.
28.	**The non-resident tax rate in respect of rent, premium or similar consideration for the use or occupation of property now 20% (whether immovable or any other property)**	The applicable rate for non-residents receiving rent from immovable property has been reduced from 30% to 20% of the gross rent whereas the rate for rent from movable property has gone up from 15% to 20%.	This measure aligns the non-resident withholding tax rates and in the case of rental income from immovable property, this is a welcome move as it reduces the tax burden on non-resident individuals and ensures equity since the withholding tax applies on gross income.

#	Proposed change	Impact	Our View
29.	**Tax rate applicable to pensions or retirement annuities received by non-resident individuals has been increased from 5% to 10%.**	Non-residents receiving pensions or retirement annuities deemed to have been accrued from or derived in Kenya will now suffer tax at the rate of 10%.	This could be seen as a measure to increase tax collections.
30.	**Permanent home – now defined as the place where a person lives in or is available to him for purposes of residing while in Kenya or the place where personal and economic interests are closest**	Definition of residency status of individuals now clearer, unlike in the past where a Kenyan citizen was deemed to have a permanent home whether or not they live in Kenya by virtue of the fact that they are Kenyan citizens.	This 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. A welcome move that will reduce their compliance burden and is in line with best practice.
31.	**Draft ITA removes definitions of wife's employment, professional and business incomes.** **Subsequently, Paragraph 1A, Head B, Third Schedule of the current ITA which highlights the applicable rates of tax on wife's employment, and professional incomes has been removed.**	The current Income Tax Act provides for taxation of a wife's income on the husband in certain instances.	This amendment now implies each individual will be taxed separately on their taxable income and each individual will be required to file their own tax return. A welcome measure in the era of equality.

Key changes – Transfer Pricing

#	Proposed change	Impact	Our View
32.	**Transactions between resident entities or a Kenyan permanent establishment and a non-resident person located in a preferential tax regime whether or not such a person is associated person will be subject to transfer pricing adjustments.** **Preferential regime is widely defined to include countries whose income tax rate is less than 16% or which do not have transparency in terms of banking information or corporate structures and entity ownership.**	This imposes TP compliance requirements on transactions with independent non-resident entities if the said non-resident entity is located in a preferential tax regime.	In our view, this increases the TP compliance requirement for all entities even where the transactions are with non-associated companies. This approach may also result to TP adjustments on arm's length prices since transactions involving independent parties are arm's length. This measure appears to be targeting transactions with entities in so-called tax havens and non-cooperative jurisdictions.
33.	**Transactions with non-resident entities where the transaction or the non-resident person lacks economic substance will also be subject to Transfer Pricing.**	This imposes TP compliance requirements on transactions with non-residents persons where economic substance cannot be demonstrated.	In our view, this expands the concept of transfer pricing beyond the OECD and UN model guidelines. It now introduces an extra burden of demonstrating the substance of transactions with non-resident entities including non-related parties.
34.	**The determination of the Arm's length price of commodities, whose prices are available from public commodity markets or statistical agencies and indices will be based on the following:** • **The quoted price of the goods unless proof of appropriate adjustments is provided.** • **For goods exported from Kenya, where the price agreed upon between the group and un-associated person is higher than the quoted price, the agreed price in this case will be considered the transfer price.**	This method disregards the five transfer pricing methods under the OECD guidelines and adopts the other method introduced at the discretion of the Commissioner.	In our view this is a simplistic approach in the determination of arm's length price for commodities since it disregards the key aspects of the transaction such as the functions performed by group entities, long term contracts vis-à-vis spot prices etc. On a positive note, this measure provides greater certainty for taxpayers involved in trading of certain commodities.

#	Proposed change	Impact	Our View
35.	**Introduction of a penalty of 2% of the value of the controlled transaction for failure to maintain contemporaneous TP documentation.** **In addition, imposition of the penalty does not prevent the Commissioner from making TP adjustments.**	Taxpayers will be required to have in place TP documentation for each relevant year of income. This is a move from the current practice where taxpayers prepare and submit documentation upon request by the KRA.	The requirement to maintain contemporaneous documentation is in line with most TP regulations in the region. While there is no deadline or requirement to submit the TP documentation to the KRA, taxpayers should put in place the relevant TP documentation prior to the filing of the relevant tax return in order to mitigate the risk of penalty. What one would have wished for in this respect is that the Commissioner applies the carrot and stick approach so that for those who comply with documentation requirements, there is a reward in terms of lower penalties for any adjustments.
36.	**Country-by-country reports to be filed with the KRA within twelve months after the last day of the reporting financial year of the multinational enterprise group.**	The country by country reports will require specific information to be shared with the KRA. This will include associated parties, assets and nature and value of transactions. It is likely that this will be synchronised with the tax filing requirements.	This is in line with the action plans arising out of the Base Erosion Profit Shifting (BEPS) project. It will lead to an increase in information sharing between revenue authorities as well as possible coordination of audits between different revenue authorities. For the taxpayers who are part of a multinational group, this means additional reporting requirements.

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