Tax Alert

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The Tax Laws (Amendment) Bill, 2020

On 25 March 2020, President Uhuru Kenyatta announced various measures ‘to cushion every Kenyan from the shocks arising from COVID-19’, with the principle aim of providing certainty to both employees and employers. Subsequently, The Tax Laws (Amendment) Bill, 2020 was Gazetted on 30 March 2020 detailing out these and various other fiscal proposals. This is in addition to the reduction of the Value Added Tax (VAT) rate to 14% which was effected on 1 April 2020.

The Bill is open for public participation up to Monday 6 April 2020 and PKF Taxation Services Limited has made detailed submissions in relation to the same. It is important to note that the proposals contained in the Bill are not effective until enacted by Parliament and receive presidential assent. The effective date for each proposal will be specified in the Act, and we shall issue a follow up alert to notify you of the final position.

INCOME TAX ACT PROPOSALS

Changes of corporation tax rate

The President proposed a reduction in the corporation tax rate for resident companies to 25% (currently 30%). Whilst the bill seeks to establish this change, we note that the rate is not specified in the Bill which we expect is a drafting error that will be corrected prior to enactment.

This is a welcome move that will spur growth in the economy.

Withholding tax on dividends paid to non-residents

The non-resident rate of withholding tax on dividends is proposed to be increased to 15% (previously 10%). Effectively, this change would increase the tax charges for non-resident shareholders of companies upon distribution of dividends.

This is likely to reduce the attractiveness of Kenya as a destination for foreign investment.

Withdrawal of tax exemptions

The Bill proposes the removal of tax exemptions to various bodies and organisations previously available in The First Schedule of the Income Tax Act. Such exemptions included some state corporations that no longer exist or a moribund such as The National Social Security Fund (NSSF), venture capital companies amongst others.

Other notable changes are:

- Withdrawal of tax exemption previously available on capital gains tax (CGT) in respect of personal residences and low value and agricultural land of up to 50 acres
- Removal of tax exemption on interest income on Government issued infrastructure bonds.

The withdrawal of tax exemptions to the NSSF is likely to widen the overall Kenyan pension deficit. In addition, given that residential property and agricultural real estate are generally not held for capital appreciation purposes, the withdrawal of CGT on such assets is likely to load additional tax burden on the rural communities.

Expenses deductible for tax purposes

The Bill proposes to discontinue/disallow the following incentives/expenses from tax deductibility:

- The recently introduced 30% electricity rebate for manufacturers;
- Trade association fee and subscriptions;
- Expenditure related to public issue of securities;
- Expenditure related to club subscriptions for employees;
- Expenditure on approved public social infrastructure.

The electricity rebate was introduced to provide the much needed relief to manufacturers from the high cost of power to improve their competitiveness. By scrapping this incentive, the cost of manufacturing will remain high. This will directly impact post Covid-19 recovery plans.

Trade associations similarly play an important part in promoting a better and efficient business environment in the respective sectors hence disallowing members' contributions is tantamount to killing these associations. There is no known philosophy as to why a government would discourage trade associations whereas the role they play in economic prowess of a country is undisputed.

Tax deductibility of costs related to public issue of securities was introduced to entice companies to list shares and debt on the Nairobi Securities Exchange. This incentive does not seem to have paid off in recent times as the NSE has largely remained dormant on new listings over the last couple of years. Just like in the private equity space, such costs are better capitalised as there is no known philosophy to justify a skewed incentive for public issue of securities whereas thousands of private equity deals do not enjoy similar tax benefits.

With increasing need for private sector participation in improving public social infrastructure and amenities, especially in a post Covid-19 era, the proposed changes will be counterproductive.

Capital deductions

The Bill proposes to replace The Second Schedule in entirety with a proposed transition date of 31 August 2020. Key highlights are as follows:

Investment Deduction Allowances (IDA)		
	Old rate	New rate
Buildings and machinery used in manufacture	100% or 150% (for investments outside Nairobi, Mombasa and Kisumu that exceed Shs. 200 million)	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Commercial buildings including hotels constructed outside Nairobi, Mombasa and Kisumu that exceed Shs. 200 million	150%	-
Film equipment used by local film producer, buildings used for training film producers, actors and crew	100%	-
Ships over 125 tonnes	100%	-

Industrial Building Allowances (IBA)		
	Old rate	New rate
Hotel buildings	100% or 150% (for investments outside Nairobi, Mombasa and Kisumu that exceed Shs. 200 million)	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Hospitals	-	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Petroleum and gas storage	-	Year 1: 50% Year 2 onwards: 25% per annum on a reducing balance basis

	Old rate	New rate
Education buildings, hostels and schools	50% per annum, straight line basis	10% per annum on a reducing balance basis
Eligible factory buildings	10% per annum, straight line basis	-
Commercial buildings with provision of certain social amenities	25% per annum, straight line basis	-
Commercial buildings (a building used as an office, shop, showroom, godown, storehouse, or warehouse used for storage of raw materials for manufacture of finished or semi-finished goods or civil works relating to water or electric power undertaking)	-	10% per annum on a reducing balance basis

Wear and Tear Allowances		
	Old rate	New rate
Tractors, lorries over 3 tonnes, heavy self-propelled equipment and earth moving companies	37.5% per annum on a reducing balance basis	25% per annum on a reducing balance basis
Computer hardware, calculations, copiers and duplicating machines	30% per annum on a reducing balance basis	25% per annum on a reducing balance basis
Motor vehicles	25% per annum on a reducing balance basis	25% per annum on a reducing balance basis
Aircrafts	25% per annum on a reducing balance basis	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Ships	12.5% per annum on a reducing balance basis (ships below 125 tonnes)	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Hospital equipment	12.5% per annum on a reducing balance basis	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Furniture, fittings, equipment and other machinery	12.5% per annum on a reducing balance basis	10% per annum on a reducing balance basis
Telecommunications equipment	20% per annum on a straight line balance basis	10% per annum on a reducing balance basis
Film equipment used by local film producer	-	25% per annum on a reducing balance basis
Machinery used to undertake operations under a prospective right or exploration under a mining right	12.5% / 37.5% per annum on a reducing balance basis	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis

Other allowances		
	Old rate	New rate
Software	20%	25% per annum on a reducing balance basis
Farm works	100%	**Year 1:** 50% **Year 2 onwards:** 25% per annum on a reducing balance basis
Right to fibre optic cable by a telecommunications operator	10%	5% per annum on a reducing balance basis

We welcome the simplification of The Second Schedule of the ITA, including the introduction of allowances for hospitals.

However, the more generous allowances that are available at present have been significant inducement for capital investment and enhancement of capacity in Kenya. In particular:

- 100% investment deduction allowances have helped make Kenya a destination of choice for manufacturers and therefore and therefore significantly improve both employment and our overall balance of payments.
- 150% allowances outside the municipalities of Nairobi, Mombasa and Kisumu have encouraged investment in and development of other parts of the country.
- 100% farm works allowances encourage investment into farming and enhance both food security and export earnings of the country.

Investments spurred by such allowances in a post Covid-19 recovery environment will be much needed and removal of these allowances is likely to reduce the level of investments companies take up going forward, thereby deterring the Big 4 agenda on manufacturing.

Qualifying interest:

Definition of qualifying interest proposed to include all forms of interest paid to an individual.

Currently, qualifying interest is restricted to interest paid by financial institutions licensed under the Banking Act, Building Societies Act and the Central Bank of Kenya.

The proposed amendment encourages investment in non-financial institutions in the form of debt.

Withholding tax on marketing, sales promotion and advertising

The Bill proposes to introduce withholding tax on services (provided by both residents and non-residents) related to sales promotion, marketing, advertising and transportation of goods (excluding air and shipping). The proposed tax rate for residents is 5%, whilst for non-residents is 20% (subject to the application of any Double Tax Treaties).

The proposed amendment is aimed at widening the tax net. Some of these sectors have historically operated at very low margins and it is likely that many businesses will find themselves in tax refund positions.

Turnover tax

The Bill proposes to extend the applicability of turnover tax to an annual turnover of between Shs. 500,000 and Shs. 50,000,000 and is now available to incorporated entities. The Bill further proposes a reduction of the tax rate for turnover tax from 3% to 1%. The proposed changes also repeal presumptive tax in its entirety.

Turnover tax is currently only available to un-incorporated persons having an annual turnover of up to Shs. 5,000,000. Presumptive tax of 15% of the business permit or trading license is payable as a minimum by persons eligible to pay turnover tax.

The changes to turnover tax are welcome as it reduces the tax burden on such businesses. However, the current VAT threshold should also be considered for expansion in line with this proposed change.

Pay As You Earn (PAYE):

The Bill proposes to amend:

- Personal relief to Shs. 28,800 from Shs. 16,896 per annum.
- Each of the tax bands with the highest band taxing income over Shs. 688,000 at a rate of 25% (previously Shs. 564,709 at a rate of 30%) as follows

Old PAYE bands		New PAYE Bands	
Band	Tax rate	Band	Tax rate
First Shs. 147,580	10%	First Shs. 288,000	10%
Next Shs. 139,043	15%	Next Shs. 200,000	15%
Next Shs. 139,043	20%	Next Shs. 200,000	20%
Next Shs. 139,043	25%	Over Shs. 688,000	25%
Over Shs. 564,709	30%		-

- Increase the tax bands for pension withdrawals in line with above as follows:

Withdrawals before expiry of fifteen years of joining the pension

Old tax bands		New Tax Bands	
Band	Tax rate	Band	Tax rate
First Shs. 147,580	10%	First Shs. 400,000	10%
Next Shs. 139,043	15%	Next Shs. 200,000	15%
Next Shs. 139,043	20%	Next Shs. 200,000	20%
Next Shs. 139,043	25%	Over Shs. 688,000	25%
Over Shs. 564,709	30%		

Withdrawals after expiry of fifteen years of joining the pension

Old tax bands		New Tax Bands	
Band	Tax rate	Band	Tax rate
First Shs. 400,000	10%	First Shs. 400,000	10%
Next Shs. 400,000	15%	Next Shs. 400,000	15%
Next Shs. 400,000	20%	Next Shs. 400,000	20%
Next Shs. 400,000	25%	Over Shs. 1,200,000	25%
Over Shs. 1,200,000	30%		

These proposed changes will bring a respite to employed Kenyans whose disposable income will increase. We hope this helps spur the economy into a growth mode as consumer spending will rise.

THE VALUE ADDED TAX ACT PROPOSALS

Goods exempted from VAT

The Bill proposes to exempt the following goods (these were previously zero-rated):

- Ordinary bread
- milk and cream (not concentrated nor containing added sugar or other sweetening matter)
- Vaccines and medicaments

This is likely to increase prices as producers will pass on the cost of unclaimed VAT (which was previously refunded through VAT claims) to consumers. Given that the above are largely essential supplies for the population at all levels, this change is contrary to the objective of the proposed tax measures.

Goods chargeable to VAT

The Bill proposes that the following goods be subject to VAT at the standard rate (previously either exempt or zero-rated):

- The supply of liquefied gas and propane
- Inputs to manufacturers of agricultural pest control products
- Inputs for manufacture of solar and automotive batteries
- Agricultural pest control products
- Fertilisers (under Chapter 31 of the EAC Common External Tariffs)
- Plant and machinery used by manufacturers (under Chapter 84 & 85 of the EAC Common External Tariffs)
- Supplies (excluding motor vehicles) used in the construction of an approved power generating plant
- Supplies (excluding motor vehicles) used in geothermal, oil or mining prospection and exploration
- Supplies (excluding motor vehicles) used in the construction of approved liquefied petroleum gas storage facilities
- Helicopters, light aircraft, spare parts, simulators and related accessories
- Man-made fishing nets
- Mosquito nets
- Materials wastes, residues and by-products used in animal feeds
- Specialised solar equipment and accessories, including raw materials and inputs for the manufacture of solar equipment and deep-cycle sealed batteries
- Tractors
- Aircraft tyres
- Biogas, plastic bag biogas digesters and leasing of biogas equipment
- Parts for assembly of primary school laptops
- Good for the construction of industrial parks exceeding 100 acres
- Inputs and raw materials for manufacture of agricultural machinery and implements
- Museum and natural history exhibits, equipment and chemicals, films a used by National Museums

- Goods for use in construction of approved recreational parks exceeding 50 acres
- Good and inputs in the assemble, manufacture and repair of clean cooking stoves
- Stoves, cookers, barbeques, gas rings and related non-electric products
- Inputs used for the manufacture of pesticides
- Materials used for the construction of grain storage
- The transfer of business as a going concern
- Supplies to marine fisheries and fish processors
- Goods for the implementation of projects under a special operating framework with the Government
- Motor vehicle importation exemption for returning public officers on foreign missions
- Plant and machinery used in the construction of plastic recycling plants

Fertilisers and pesticides used by farmers, many of whose produce is exempted from VAT. These changes will lead to an increase in prices and add to inflationary pressures as farmers are likely to pass on the added cost to the end-consumers. This change is also contrary to the food security priority of the Government.

Taxing products such as LPG, biogas and solar are not in tandem with environmental and forestry protection objectives of the Government.

Transfer of business as a going concern is a mechanism used worldwide and is normally exempt from VAT. Bringing this to tax is likely to have an impact on mergers and acquisitions in the economy and the much needed amalgamation in certain sectors.

Services chargeable to VAT

The Bill proposes that the following goods be subject to VAT at the standard rate (previously either exempt or zero-rated):

- Insurance agency, insurance brokerage, stock exchange brokerage services;
- Hiring, leasing and charters of helicopters
- Services for the construction of industrial parks exceeding 100 acres
- Entry fees into national parks and reserves
- The services of tour operators
- Services for use in construction of approved recreational parks exceeding 50 acres
- Services used in the construction of approved liquefied petroleum gas storage facilities
- Asset transfers and other transactions related to transfer of assets into real estate investment trusts (REITs) and asset backed securities.
- Services for the implementation of projects under a special operating framework with the Government

The above changes assume that are aimed at increasing the VAT base for government. These changes will slow down the post-Covid-19 economic recovery plans.

Definition of ordinary bread

Definition of 'ordinary bread' (bread containing only the following ingredients: wheat flour, sugar, salt, yeast, fat or oil, bread improver, preservatives and water) proposed to be inserted into the VAT Act.

Introduction of the definition in the VAT Act now clarifies that any bread, including speciality bread that has any other ingredient other than specified in the definition will be chargeable to 14% VAT.

Calculation of taxable value for petroleum, natural gas and related products

The Bill proposes that excise duty, fees and other charges for petroleum, natural gas and related products (as included in Section B, Part I of the First Schedule) should no longer be excluded from the calculation of VAT as is currently the case.

This will increase the price of fuel and in turn the price of transportation of people and products and add to inflationary pressure to the economy. This change will no doubt erode the benefits that was intended by reduction of VAT rate to 14%.

VAT refunds on bad debts

The Bill proposes to reduces the maximum period in which a taxpayer can apply for a VAT refund on bad debts to within four years of the date of supply (currently five years from date of supply).

This provides a window of only 12 months during which a refund application can be made given that the bad debt needs to be at least 3 years old before being eligible for refund.

Credit notes

The proposed amendment seeks to allow for the issuance of a credit note in the event of a dispute, within 30 days after the determination of the dispute.

This is a welcome proposal as it will provide much needed relief in cases of long term disputes that are a characteristic of our judicial system.

Record keeping

The Bill proposes to extend the requirement of keeping records for a five-year period to every person (individual, company, partnership, association of persons, trust, estate, the Government, a foreign government, or a political subdivision of the Government or foreign government).

This is likely to place additional administrative burden on all taxpayers.

THE TAX PROCEDURES ACT PROPOSALS

Appointment of financial institutions licensed under the Banking Act to act as agents for revenue collection services

The Bill proposes to empower the Commissioner to appoint a person registered under the Banking Act to act as an agent for revenue banking services through an agreement, including proposing the introduction of penalties for non-timely remittances of taxes collected. Currently, no legal basis for the same exists.

This will enhance enforcement measures by the government on collection of tax revenues. However, such agents would be penalized for late remittances to the government which might be a disincentive for them.

Response timeframes for private rulings

The Bill proposes to delete the current timeframe (45 days) in which the Commissioner is required to respond to requests for Private Rulings.

Given the ever increasing complexity of tax treatments and legislation, and ever increasing number of taxpayers rely on private rulings as part of normal business practise as a method to ensure tax compliance and particularly prior to making investment decisions. Elimination of the time limit and uncertainty of a response time would be counterproductive.

Publication of private rulings

The Bill proposes to repeal the requirement for the Commissioner to publish private rulings in the local newspapers. This proposed amendment now disallows taxpayers to use these published rulings as binding.

Whilst it is clear that this requirement was near impossible to comply with given the number of such rulings and the volume in certain cases, the lack of an alternative publication process (e.g. online), it takes away a wider benefit to taxpayers in general.

Turnover Tax penalties reduced

The Bill proposes to reduce the late return submission penalty for Turnover Tax to Shs. 1,000 as opposed to Shs. 5,000.

This will ease the burden on small businesses.

THE EXCISE DUTY ACT PROPOSALS

Excise duties on local products

The Bill proposes to apply excise duty following whether imported or not:

- Sugar confectionery of tariff 17.04
- White chocolate in blocs, slabs or bars of tariff 1806.31.00, 1806.32.00, 1806.90.00

Previously, this was only applicable to imports.

If adopted there will be excise duty on locally manufactured sugar confectionery and chocolate products which would affect the competitiveness of the local market since there will be no difference in pricing with similar imported products.

Withdrawal of exemptions

The Bill proposes the removal of the following exemptions:

- Goods imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government.
- One personal motor vehicle imported by a public officer returning from a mission abroad and another one by their spouse

This is in line with other amendments throughout the Bill.

THE MISCELLANEOUS FEES AND LEVIES ACT PROPOSALS

Import Declaration Fees (IDF):

The Bill proposes to remove the preferential rate of IDF at 1.5% (normal rate 3.5%) accorded to the importation of raw materials and intermediate products imported by approved manufacturers.

This increase in rate will no doubt increase costs of doing business, which will be passed on to the end consumers.

Import Declaration Fees (IDF) and Rail Development Levy (RDL) exemptions withdrawn

The Bill proposes to remove exemptions for:

- gifts or donations, excluding motor vehicles, by foreign residents to their relatives in Kenya for their personal use;
- samples which in the opinion of the Commissioner have no commercial value;
- Aircraft of un-laden weight not exceeding 2,000kg and helicopters of heading 8802.11.00 and 8802.12.00
- raw materials for direct and exclusive use in construction by developers or investors in industrial parks
- goods imported for the construction of liquefied petroleum gas storage facilities
- goods imported for implementation of projects under the special operating framework arrangement with the government

This is aimed at enhancing revenue collection.

Processing fees for duty free motor vehicles:

The Bill proposes to introduce a fee of Shs. 10,000 on all motor vehicles excluding motorcycles imported or purchased duty free prior to clearance by certain privileged persons.

This is aimed at enhancing revenue collection.

right people
right size
right solutions

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