Banking Sector Overview
EY is committed to doing its part in building a better working world. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

**EY Eastern Africa Tax Services**

EY has been in Eastern Africa for over 87 years and has acquired a unique perspective and experience on the region’s business practice. This experience, pooled with our global resources, adds immense value to our clients.

EY’s tax professionals in the Eastern Africa region provide you with deep technical knowledge, global and local, combined with practical, commercial and industry experience. The firm has a network of six (4) offices in the region: Kenya, Uganda, Rwanda, Tanzania with over 500 professionals. Clients in South Sudan, Ethiopia, Somalia and Djibouti are served from Nairobi while clients in Burundi are served from Kigali, Rwanda.

Our talented people, consistent methodologies and unwavering commitment to doing our part in building a better working world, help you to build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its ambitions.
EY Global Tax Services

In Tax, we have more than 50,000 people globally who help our clients understand and manage their tax compliance and reporting obligations responsibly and proactively. We help them assess, improve and monitor their tax function’s processes, controls and risk management and maintain effective relationships with the tax authorities.

Tax has six sub-service lines which cover a wide range of issues: Business Tax Services, Global Compliance and Reporting, Indirect Tax, International Tax Services, People Advisory Services and Transaction Tax.

What we stand for

Our positioning, the difference to which we aspire, is to be known for having the highest performing teams, and delivering exceptional client services, worldwide.

Our positioning | What we stand for

• At EY we are committed to helping our people, our clients, and our wider communities achieve their potential. It’s how we make a difference.

• It’s about 230,000 people working together to help each other develop and succeed professionally and personally. It’s about helping our clients deliver on their promises to their markets and shareholders. And it’s about making a difference in the communities.

Our values | Who we are

• People who demonstrate integrity, respect and teaming.

• People with energy, enthusiasm and the courage to lead.

• People who build relationships based on doing the right thing.

Quality as a constant | Building a better working world

• Every day, every EY person is part of building a better working world - for their clients, their families, their communities and themselves. Everything they do - every audit, every tax return, every interaction with a client or colleague - contributes to making the working world better than it was. But, we aspire to do more. And we believe, that through a shared agenda with our clients and stakeholders, we can achieve more together.
Our promise to our clients

We believe that through collaboration with clients and stakeholders we can more effectively address the challenges the working world faces and together be part of the solutions.

Banking sector in Kenya

There are currently 44 commercial banks, 12 deposit taking microfinance banks, 30 non-regulated credit-only microfinance institutions, 199 registered savings and credit cooperatives (Saccos) and 6 mobile money operators in Kenya. The country also has a large number of community-level services providers such as village banks, financial services associations (FSAs) and savings groups and a growing number of start-ups in fintech looking to build a new generation of financial services.

The Central Bank of Kenya (CBK) develops the laws, regulations and guidelines that govern commercial banks, microfinance banks, credit reference bureaus, mortgage finance companies and others in the banking sector. In addition to ensuring the financial system’s stability and efficiency, CBK is also mandated to focus on access thus bringing financial inclusion into the mainstream.

The Banking industry has in the recent past experienced tremendous growth and especially with the increased development of mobile money facilities.
Recent developments in the sector

- The emergence of both the agency banking and the design of digital financial services which are built on the foundation of mobile money have enabled banks to offer services to additional users at lower cost which has subsequently widened customer base for banks in Kenya.

- The continued economic growth experienced in Kenya over the years and especially the emergence of new business models has also sparked growth in the banking sector. With more people implementing new business innovations, the demand for loans to raise capital for new ventures for instance has had a positive impact on the need for banking services which has resulted in growth of the banking sector.

- The enactment of the Banking (Amendment) Act, 2016 introduced the following changes;
  
  (a) Capping on lending rates at 4.0% above the Central Bank Rate (CBR)
  
  (b) The minimum interest rate chargeable on a deposit held interest earning should be at least 70% of the base rate set and published by the CBK
  
  (c) Every bank or financial institution is required to disclose all the charges and terms relating to a loan before granting the same to a borrower
  
  (d) The Chief Executive Officer of a bank or financial institution is liable to imprisonment for a term not less than one year or a fine of not less than one million shillings if he contravenes any the above provisions.

- The International Financial Reporting Standards 9 (IFRS 9), which became effective from 1 January 2018, require banks to set aside funds in advance to mitigate loan defaults. This has the effect of significantly increasing the provisions for bad & doubtful debts and consequently reducing profits.

  The provisions of the new standard is also viewed by many banks as a costly affair as pertains to compliance. This is in light of the fact that banks will be required to maintain three sets of records; one for impairment according to Central Bank of Kenya rules, one for the Kenya Revenue Authority to calculate taxes on profit after impairment, and another for impairment according to IFRS 9.

  IFRS 9, coupled with the interest capping law are no doubt having an implication on the profitability of the banks in Kenya.

- Introduction of excise duty 'other fees' which was defined to mean all fees charged by a financial institution other than interest, return on loan, premium or premium-based commission.
Below are some of the taxes that a bank would be exposed to:

(1) **Excise duty**

The Finance Act 2012 introduced a 10% excise duty on fees charged for money transfer services by cellular phone service providers, banks, money transfer agencies, other financial service providers and other fees charged by financial institutions.

‘Other fees’ is an item that has elicited a lot of reactions especially in the banking sector. Excise duty on other fees charged by financial institutions was introduced in Kenya in 2012 through amendments to the now repealed Customs and Excise Duty Act Chapter 472 of the Laws of Kenya. However, the amendments introduced by the Finance Act, 2012 brought significant uncertainty on the scope of institutions and transactions subject to excise duty as well as the commencement date.

Various stakeholders engaged the KRA on a number of forums in a bid to resolve these uncertainties which resulted in KRA making changes to the Customs and Excise Act through the Finance Act, 2013. Whereas the Finance Act, 2013 addressed some of the ambiguous provisions brought about by the Finance Act 2012, some of the fundamental issues remained unanswered. The enactment of the Excise Duty Act, 2015 resolved a number of issues that were previously controversial.
With the enactment of Excise Duty Act, 2015 further amendment were made where other fees were defined to includes any fees, charges or commissions charged by financial institutions relating to their licensed financial institutions, but excludes interest on loan or return on loan or an insurance premium or premium based or related commissions.

The KRA has been actively monitoring the compliance or lack thereof by various financial institutions. This has attracted a lot controversy particularly in regard to loan related charges/fees/commissions.

(2) Corporation tax

a) Corporation tax return
Corporate tax self-assessment return should be filed with KRA by the 6th month after year end. A tax return should be accompanied by audited financial accounts - if this is a requirement for such entities under the Companies Act.

b) Payment of tax
Instalment tax is payable by the 20th day of the 4th, 6th, 9th and 12th month in that year of income. The instalment tax is based on the lower of preceding year’s tax liability multiplied by 110% or the current year’s estimated tax. Tax balance is payable by the last day of the 4th month after the end of the financial year.

c) Specified sources of income
Gains or profits of a person from specified sources of income should be computed separately.

Any loss realized from a specified source of income can only be deducted against future gains or profits from the same source of income.

Specified sources of income under the ITA include; rental income, employment income, income from agricultural activities (including pastoral, horticultural and forestry), surplus funds withdrawn from registered pension/provident funds, disposal of interest in a person in the case of immovable property, natural resource income and other sources relating to business income but not relating to sources listed above.

d) Tax losses
In the event that the results of the above computation is a tax loss, the losses can be offset against future taxable profits. Tax losses can be carried forward for a maximum of nine years, however, the period could be extended, on application, to the Commissioner.
(3) Employee Taxes

Income from employment can be cash or non-cash benefits. All cash allowances to employees are generally liable to tax.

Any non-cash benefit or advantage an employee receives by virtue of employment whose aggregate value is more than KES. 36,000 per annum is taxable.

All benefits received by bank employees are subject to Pay As You Earn (PAYE). One of the most common characteristics of banking businesses is that they have a large number of employees due to the fact that most commercial banks operate branches across the country. Utmost compliance is important and this can be achieved through various ways, for instance, by maintaining an effective payroll processing and management system. This consequently ensures that payroll data is properly maintained and hence proper accounting and payment of the PAYE taxes.

Allowances or non-cash benefit paid to or for directors are also taxable. Where the employer pays employees net of tax, the tax paid by the employer on behalf of employees is in itself a benefit chargeable to tax.

Banks often advance loans to its employees at interest rates lower than the commissioner’s prescribed rate. The prescribed interest rates are availed by KRA on a quarterly basis.

Such advances would be subject to Fridge Benefit Tax (FBT) that is due on a monthly basis by the 9th of the following month. FBT is payable by the employer.

PAYE should be remitted by the employer by the 9th of the month following payroll month. The employer is also required to file monthly PAYE returns by the same date.

Late payment of tax attracts a penalty of 25% of the tax due and interest at 1% per month for the period the tax remains unpaid.

Non-filing of PAYE return is subject to a penalty of 25% of the tax due or a minimum of KES. 10,000.
**Tax deductions**

The following constitute allowable deductions when determining the taxable pay of an individual:

Contributions to a registered pension or provident fund, up to a maximum of KES. 240,000 per year

Interest, up to a maximum of KES. 300,000 p.a., on borrowings to finance the purchase of owner-occupied residential property effective 01 January 2017.

Contributions to a home ownership savings plan, up to a maximum of KES. 48,000 per year

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**Reliefs**

Resident taxpayers are granted the following reliefs against tax payable:

Personal relief in the amount of KES. 16,896 per year, effective 01 January 2018.

Insurance relief (including education and health insurance) in the amount of 15% of premiums paid, up to a maximum relief of KES. 60,000 per year.

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**Tax Rates**

The following tax rates apply for employment, self-employment (sole proprietorship) income effective 01 January 2018 (annual basis):

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate</th>
<th>Tax due</th>
<th>Cumulative tax due</th>
</tr>
</thead>
<tbody>
<tr>
<td>KES</td>
<td>%</td>
<td>KES</td>
<td>KES</td>
</tr>
<tr>
<td>First 147,580</td>
<td>10</td>
<td>14,758</td>
<td>14,758</td>
</tr>
<tr>
<td>Next 139,042</td>
<td>15</td>
<td>20,856</td>
<td>35,614</td>
</tr>
<tr>
<td>Next 139,042</td>
<td>20</td>
<td>27,808</td>
<td>63,422</td>
</tr>
<tr>
<td>Next 139,042</td>
<td>25</td>
<td>34,761</td>
<td>98,183</td>
</tr>
<tr>
<td>Above 564,710</td>
<td>30</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
(4) Withholding tax

Withholding tax (WHT) is deducted on specific payments such as management and professional fees, agency fees, consultancy and contractual fees, royalties, dividend, interest etc.

The party making the payment should withhold tax at the relevant withholding tax rate and pay it to KRA.

Withholding tax is a tax paid in advance by the party offering the service and can be used to offset the final tax liability on the income. There are, however, instances where tax withheld is a final tax.

Withholding tax is deductible upon payment of a taxable amount and should be paid by the 20th day of the month following that in which payment is made. The term payment has been subject to legal interpretation and accrual constitutes payment particularly for related parties.

With mandatory online filing effective 1 August 2015, one can only utilize withholding tax to offset a final tax liability if the withholding tax certificate is reflected on their iTax ledger.

Bank interest on customer deposits forms one of the most crucial items for banks in terms of withholding tax. It is important that banks undertake regular reconciliations of the total amount of interest payments made to customers vis a vis the amount of WHT paid to KRA as pertains to the said interest payments to avoid non-compliance and the related tax risk.

Whether or not the payments are subject to withholding tax depends on the nature of the payment and whether they would fall under the above classification. The withholding tax rates applicable are detailed under the Third Schedule to the ITA. Lower rates for withholding tax are applicable on some payments to residents of countries that have a double tax agreement with Kenya. Kenya has double tax treaties with Canada, Denmark, Germany, India, Norway, Sweden, United Kingdom, Zambia, South Africa, France, Korea Republic, Iran, Qatar and UAE. The treaty provisions are automatically applicable and no consent or approval is required from KRA in order to use the rates.

Failure to make WHT payments to KRA by the due date attracts a penalty of 10% of the amount of tax involved subject to a maximum of one (1) million Kenya Shillings and interest at a rate of 1% per month.
For excisable services, the tax is due when the services are rendered (earlier of the date services are performed, issuance of invoice or when payment is received in whole or part). The return for the same should be submitted on or before the 20th of the subsequent month following that of the tax point.

Fines and penalties for non-compliance

(1) Late Filing - 5% of the unpaid tax amount or KShs 20,000 whichever is higher

(2) Late payment - Simple interest at 1% monthly rate on amount due

(3) A person who undertakes an activity which requires a license without being licensed - Double the excise duty that would have been payable
(5) Customs Duty

Customs duties are charged on imported and some exported goods. Goods are imported in the country either for home consumption, warehousing, transit, temporary importation, Export processing Zone or re-export. If the goods are entered for home consumption, all applicable import taxes will be paid at the Customs Service Department. The duties applicable are categorized into:

- Import Duty
- Excise Duty
- VAT on imports
- Import Declaration fee (IDF)
- Railway Development Levy (RDL)

Import duty on goods originating outside EAC is charged at varying rates as per EAC Common External Tariff, 2012. The basis of charging duties are ad valorem (on price of the goods so declared) and specific units (on quantity, weight, number of measurement). Generally customs duty rates ranges from 0% to 25%. However, for goods regarded as sensitive including sugar, wheat flour, rice, milk among others, the duty rates are higher than the normal 25% ranging from 35% to 100%.

Reduced rates are applicable on imports from countries in the COMESA region ranging from 0% to 1%. It is important to have a certificate of origin for the reduced rates to apply.
The value of imported goods is determined in accordance with the General Agreement on Trade and Tariffs (GAAT) Valuation rules adopted in Kenya from January 2000. The value is based on Cost, Insurance and Freight (excluding air freight).

Goods liable to import duty may on first importation be warehoused without payment of duty in a government warehouse or a bonded warehouse, after which they may be entered for home consumption, exportation, removal to another warehouse, as stores for aircraft/vessel, re-warehousing, removal to an EPZ or removal to a free port.

Several goods are exempt from customs duty. These are as listed under Part A and B of the Fifth Schedule of the EACCMA.

KRA audits have been on the rise as regards to the transaction value used in establishing the duty payable on debit/credit cards commonly referred to as ATM cards imported by banks. It is paramount that banks ensure proper maintenance of documents including vendor agreements and invoices in a bid to ensure sufficient support for the transaction value applied for customs purposes.

“It is paramount that banks ensure proper maintenance of documents including vendor agreements and invoices in a bid to ensure sufficient support for the transaction value applied for customs purposes.”
(6) Value Added Tax (VAT)

a) Registration

Any person who in the course of business has supplied, or expects to supply taxable goods or services or both with a value of KES. 5 million or more in a period of 12 months should apply for registration within thirty days. VAT registration is currently done online by adding a VAT obligation which must be reflected in the taxpayer’s registration certificate or Personal Identification Number (PIN).

However, a person who makes or intends to make taxable supplies but does not meet the turnover threshold of KES. 5 million may apply to the Commissioner for voluntary registration.

b) VAT obligation

VAT is payable by the 20th of the following month and a return should be submitted by the same day.

Registered suppliers are required to charge VAT (output tax) at the rates indicated below:

<table>
<thead>
<tr>
<th>Status</th>
<th>VAT Rate</th>
<th>Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable</td>
<td>16%</td>
<td>All supplies not listed as zero-rated or exempt</td>
</tr>
<tr>
<td>Zero-rated</td>
<td>0%</td>
<td>All supplies listed in the 2nd Schedule of the VAT Act, 2013</td>
</tr>
<tr>
<td>Exempt</td>
<td>-</td>
<td>All supplies listed in the 1st Schedule of the VAT Act, 2013</td>
</tr>
</tbody>
</table>
Majority of the services offered by banks are exempt from VAT. Examples of such services include the operation of current, deposit or savings accounts, the provision of account statements among many others. However, there are services offered by banks that should be subjected to VAT such as the provision of safe depository locker services to customers.

Banks also often enter into leasing businesses where they take up the rights and the obligations of the lessors that they finance in certain ventures. These services are also taxable. With the advent of bancassurance, some financial institutions now offer advisory services in addition to their core banking services. These are also subject to VAT at the standard rate of 16%.

It is therefore paramount that every financial institution closely scrutinizes each and every transaction independently with a view of determining if the same is taxable to ensure compliance.

Due to the exempt nature of most of the services rendered by financial institutions they are required to account for VAT on imported services. This is accounted for by the financial institution as a self-supply.

Registered suppliers are required to issue their customers valid tax invoices. On the other hand, input tax is tax paid on supply to a registered person to be used by him for the purpose of his business. Input tax is claimable by a registered person provided that:

- The person is in possession of valid documentations such as a tax invoice, a certified copy of original tax invoice or a valid import document.
- Not more than 6 months have lapsed after the input tax became due and payable.
- Tax is not restricted (e.g. input tax on repairs of passenger vehicles is restricted).
- Tax does not relate to exempt supplies either directly or upon apportionment with taxable supplies.

c) Deregistration

Where the value of taxable supplies made by the institution in a period of 12 months is less than KES. 5 million, the institution may apply in writing to the Commissioner for cancellation of the registration.

Where the institution ceases to make taxable supplies, the institution shall apply in writing to the Commissioner, for cancellation of the registration.

d) Common non-compliance issues

- Lack of proper documentation in support of taxable supplies and input tax.
- Failure to register, account or charge VAT.
- Non-declaration/payment of VAT on taxable imported services where applicable.
- Erroneous claim of restricted/non-deductible input tax.
- Failure to complete the VAT returns correctly.
- Lack of valid tax invoices.
### Issues

<table>
<thead>
<tr>
<th>Transfer pricing (TP)</th>
<th>This is a common point of controversy with KRA since a substantial number of banks in Kenya have regional or international presence. Banks should ensure compliance with TP regulations as provided for in the ITA, regarding their transactions with non-resident related parties.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits to inbound and outbound employees</td>
<td>Banks are often faced with instances where its employees are seconded to various countries across the globe. In most of these cases, the employer bears the tax burden for the inbound or outbound employees on secondment. Banks should ensure that they monitor the residency status of such employees as well as properly account and remit any taxes and benefits due from the said employees.</td>
</tr>
<tr>
<td>Voluntary Early Retirement (VER) package</td>
<td>This package often confers indirect employment benefit to the employees separating from the bank. The bank should ensure compliance with the relevant employment tax law regarding the taxation of cash and non-cash benefits.</td>
</tr>
<tr>
<td>Imported Services</td>
<td>To enhance efficiency in operations, banks often import services to complement their systems. Importation of services has cross cutting tax implications such as reverse charge VAT and WHT. There is need to ensure compliance.</td>
</tr>
<tr>
<td>Fringe Benefit Tax (FBT)</td>
<td>Banks are known to extend credit to employees’ at rates lower than the Commissioner’s prescribed rate. Tax on the resulting benefit (FBT) should be established and remitted to ensure tax compliance.</td>
</tr>
<tr>
<td>Group Recharges</td>
<td>There is tendency by banks to centralize some functions, for instance, the head office could be undertaking certain key functions on behalf of the entire group and recharging the costs incurred to all its subsidiaries, benefiting from the centralized functions. There is need to analyze the tax implications of the said recharges to ensure compliance.</td>
</tr>
<tr>
<td>Leasing Business</td>
<td>Some banks have ventured into the leasing business. The banks usually takes the position of the lessor after the rights are novated to the bank. Banks should ensure compliance with the Income Tax (Leasing) Rules 2002 as well as with provisions of the VAT Act, 2013.</td>
</tr>
<tr>
<td>Repossessed Collaterals</td>
<td>This is forms a common point of controversy for banks. The issue is mainly on whether repossessed collaterals are subject to VAT at the point of disposal to recover amounts owed by loan defaulters. KRA’s position on this is that the said transactions are subject to VAT.</td>
</tr>
<tr>
<td><strong>Corporate Social Responsibility / Donations</strong></td>
<td>Donations should only be expensed if they meet the deductible criteria provided under Section 15 (2) (w) and The Income Tax (Charitable Donations) Regulations, 2007.</td>
</tr>
<tr>
<td><strong>Employee share Ownership plan (ESOP)</strong></td>
<td>This is a common practice in the banking sector. Banks should be keen on ensuring compliance with the relevant tax law provision in regard to taxation of the benefit accruing from the ESOP’s.</td>
</tr>
<tr>
<td><strong>Reconciliations</strong></td>
<td>Reconciliations are the most commonly used tests by KRA during KRA audits. For instance in the event of a KRA audit on excise duty paid, KRA would be looking at the total bank receipts from excisable services and checking if 10% of this total amount equals the excise duty amount paid by the bank in the period under review. Banks should therefore undertake regular reconciliations on such transactions to ensure that they are in a position to explain any variance in case of an audit.</td>
</tr>
<tr>
<td><strong>Wear and Tear - Capital Renovation of leased branches</strong></td>
<td>There is often controversy as to whether the costs of renovating leased branch offices are capital or revenue in nature. Further, there are divergent views as to whether or not the said costs qualify for capital allowances for tax purposes.</td>
</tr>
<tr>
<td><strong>Excise Duty on financial transactions</strong></td>
<td>The absence of the meaning of the term “interest” in the Excise Duty Act, 2015 has resulted in controversy between most of the banks in Kenya with the KRA. KRA has aggressively demanded additional tax on loan-related transactions. Various banks are currently at different objection and dispute resolution stages and it will be interesting to see how the Tax Appeals Tribunal will rule on this matter.</td>
</tr>
<tr>
<td><strong>Deduction of interest on Non-Performing Loans (NPL’s) for corporate tax purposes</strong></td>
<td>NPL’s is currently a key area of controversy for banks in Kenya. KRA has in the recent past demanded for additional taxes by analyzing the loan book vis-à-vis the provisions and write offs to determine if they meet the provisions of Section 15 (2) (a) (read together with Legal Notice number 37 of 2011) on the deductibility of the said expenses for tax purposes. This remains a contentious matter and while it is mainly a timing issue the KRA has been adamant that only provisions and write-offs that meet the Commissioners’ guidelines are allowed for tax purposes.</td>
</tr>
</tbody>
</table>
Financial Institutions around the world often operate under an organizational structure that consists of a Non-Operating Holding Company (NOHC) or parent company that owns one or several operating companies, including at least one regulated bank or broker-dealer.

NOHC’s do not primarily undertake direct revenue-generating operations themselves, but own legal entities that do. The assets of a NOHC typically consist of equity and debt invested in operating subsidiaries. NOHC revenues are primarily dividends and interest payments from subsidiaries. The NOHC often exists for regulatory, legal, or tax considerations.

The NOHC often is the principal issuer of long-term debt (including subordinated debt), regulatory capital securities, and equity for the group. A central NOHC typically allows greater flexibility in rising and channeling funds and capital to subsidiaries as needed. In some jurisdictions, operating companies are regulated, while holding companies are not.

In Kenya the scenario is not any different. The Banking Act was amended in that it now recognizes Non-Operating Holding Companies (NOHCs) and Banking Groups. The amendment was passed to provide an avenue for banks to operate without restrictions imposed by the Banking Act.

Several banks in Kenya are have undertaken or are in the process of undertaking this reorganization in line with the provisions of the Banking Act. This re-organization entails the creation of a NOHC and the hive down of the bank’s various operating activities to the various subsidiaries.

It is noteworthy that the Paragraph 13 of the Eighth Schedule exempts from Capital Gains Tax (CGT), gains from group restructuring/re-organization upon approval by the Cabinet Secretary in charge of Finance. This area has, however, attracted controversy with the KRA and there is need to ensure that all the tax implications are factored into before and during the re-organization.
(c) Key case laws on banks in Kenya

Case 1  Whether withholding tax is payable on accrual or payment of interest:

In this case that went before the High Court, the taxpayer (a commercial bank in Kenya) had entered into a contract with a service provider that set out the fees for the services provided and had a provision setting an interest penalty on the amount due in the event that the taxpayer failed to make the payment in time. The taxpayer experienced economic difficulties and was unable to pay the fee due to the service provider resulting in interest accruing on a monthly basis. The taxpayer went on to make a provision for the interest penalty in its books (Debited interest amount due and credited the Supplier with the liability due). The KRA issued an assessment on the taxpayer for withholding tax on the interest accrued. KRA based their argument on the provisions of Section 2 of the Income Tax Act, and precisely on the definition of the term “Paid” The said Section defines “paid” as including “distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person.” KRA indicated that by the appellant crediting the supplier in its books with the interest amount, withholding tax was due from the appellant. The Court held that Sections 35(1) and (3) that requires a person to deduct withholding tax ‘upon payment’ to another person implies that the delivery of money or a valuable thing was a necessary condition. The Court concluded that the mere entry of an expense in its books without any further benefit to the intended recipient did not constitute payment.

Another case before the High Court, however, observed that accounting entries amounted to payment in case of related parties and hence withholding tax was due and payable.

Case 2  Are payments to international card companies under the ambit of royalties and hence subject to WHT:

In this case, KRA held that payments made to international credit card companies such as VISA, American Express and MasterCard which administer worldwide consumer payment system amounted to royalties and were thus subject to withholding tax. It was also the KRA’s position that payments referred to as interchange fees made by the taxpayer to other banks (issuers) constituted “management and professional fees” and thus subject to withholding tax.

The tax payer opined that it only had access over a network where it paid a fee to access the said network, whilst the process of clearing and settlement was carried out by the network owner itself. Consequently, the tax payer did not acquire a right/royalty but rather access to a network. Further, the tax payer opined that it had no such agency relationship with the issuers, as regards to the interchange fees queried by the KRA.
The taxpayer also argued that the issuers did not provide any management or professional fee, neither did they have any control over the issuers since the issuers did not perform any services on behalf of the taxpayer. The court held that payments made to international credit card companies did not constitute royalties. It was also held that there is no agency relationship between the appellant and the issuers as each party in an interchange transaction acts independently and therefore was no management or professional fee paid to warrant withholding tax.

Case 1 Is Withholding tax payable on incidental costs

The KRA raised an assessment demanding for withholding tax on incidental costs from a local bank as regards a contract performed by an overseas consultant on behalf of the bank.

The bank argued that withholding tax ought not to be deducted in respect of incidental costs incurred in fulfilling the contract by the consultant. KRA based their argument on the definition of the term management and professional fees as per the Income Tax Act (ITA) which defines management and professional fees as “payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated”. KRA argued that the inclusion of the phrase, “however calculated” in the law leaves no room for ambiguity on what constitutes management and professional fees. Therefore, the only payments that could be excluded from management and professional fees were those payments made by the employer to his employee.

The Local Committee, in its determination held that in the absence of a contractual relationship, to render the services to the appellant, there could never have been payments in the present circumstances. It was thus held that withholding tax on incidental costs was payable.

Case 4 Whether payment to a non-resident company who provides online subscription services qualifies to attract withholding tax

In this case the bank in question had entered into a contract with a non-resident company for the provision of:

- Information which includes still, moving and sound recordings,
- Materials, hardware and or software and related documentation
- The non-resident’s business information products
- Other services including support and maintenance
The main points of contention was whether:

- Payments made to the non-resident company were subject to withholding tax under the ITA,
- Whether the information supplied by the non-resident company was of a technical or consultancy nature and within the definition of management and professional fees
- Whether between 1996-1999 the ITA defined the terms management or professional fees
- Whether the payments made by the appellant were in recognition of the technical or consultancy services offered by the supplier.

The bank (Appellant) contended that the payments were not subject to withholding tax as the services were not technical and were thus available online to all willing users.

KRA on the other hand argued that the information provided was not the kind that the said bank would ordinarily access through the internet as it was tailored in such a manner that it was of great value to the bank in the making of critical financial decisions.

The Court, by a majority decision, dismissed the appeal ordering the Appellant to pay withholding tax to the KRA for subscriptions made by the appellant to the foreign company for the provision of online information.

**Case 5** Whether VAT is payable in the instance of a self-supply of a commercial building:

The Appellant in the case at hand was a financial institution whose services are exempt from payment of VAT. The Appellant was the owner of a certain commercial building within the city, part of which it occupies and uses in the conduct of its core business, while the other part it leases out to several tenants.

The appellant pays VAT on the rent attributable to the space which is occupied by the tenants. However, the appellant does not pay VAT on the space it occupies. The KRA opined that VAT was payable on the rent which is self-occupied by the Appellant.

The Appellant however, was of the opinion that the VAT was on rent received or charged on non-residential buildings and not applicable to the self-supply.

The court proceeded to allow the appeal on the basis that a supply becomes a self-supply if input tax is excluded, and the input tax is excluded if it is provided for under the Value Added Act Order, 2002.

Therefore, it was determined that there was no self-supply of commercial buildings by the appellant to himself and that he had not appropriated taxable goods or services for his own use.
Case 6 Withholding tax on software license and interest on nostro accounts subject to withholding tax in Kenya

The matter related to an appeal case before the High Court. A local bank in Kenya (the appellant) disputed the decision by the Local Committee that withholding tax was due on payments made by the appellant to a supplier on account of purchase of software packages for use in the banks’ services. The Appellant was also disputing the Committee’s decision that interest paid by the bank on nostro accounts was subject to withholding tax.

As regards to the first case, the appellant opined that payments made to the software provider was for software packages supplied to the appellant for use in its banking services and thus did not comprise royalty.

KRA (the respondent) submitted that payments made by the bank were for software products and licensing fees which were not tangible and hence amounted to royalties. Further, the agreement between the appellant and said supplier involved the provision of banking software packages and allied services to the appellant. Under the said agreement, whereas the title in the software remained with the supplier of the service, the Appellant had access to the supplier’s trademark subject to the polies and procedures of that supplier.

The Court upheld the decision of the Local Committee rule on the grounds that the bank was not paying the supplier in order to access information from the supplier’s website but rather for the license to use its software packages.

As regards to the second case (whether withholding tax is payable on interest charged on nostro accounts). The case at hand involved a matter where the appellant paid interest on nostro accounts without deducting and paying withholding tax to KRA on this transaction. The appellant argued that it was impossible for it to comply with the local legislation of withholding tax on interest charged outside the country. The court however agreed with KRA’s argument that business impossibility to effect a lawfully imposed tax cannot be a basis of lifting the said tax.

The court observed that in the absence of proof as to why the payment of interest was exempt from withholding tax, the said tax was due from the tax payer. The decision of the Local Committee on this matter was consequently upheld by the Court.
Case  The impact of retirement age on the taxation of severance pay:

The case before the court for determination was on what constitutes specified vs unspecified time of employment. It is noteworthy that severance amounts payable in the event of a specified employment contract is taxed differently from severance pay in an unspecified term of employment. The KRA (respondent) relied on a clause in the contract that provided the retirement age of the employee in question to arrive at the conclusion that the said contract related to one of a specified term. In arriving at this conclusion, KRA ignored other terms of this contract such as the fact that either party had a right to terminate the contract at their own discretion. The Court of Appeal in determining what constituted specified and unspecified employment held that the inclusion of age of retirement in an employment contract does not make the contract a specified time contract. This is because at any time during the employment, either party to the employment had the option of terminating the contract having given a 3 month notice, in lieu of which the party was required to pay 3 months’ notice salary. Having determined the contract as one of unspecified time contract, the Court of Appeal held that the applicable section was the one used by the appellant (a commercial bank in Kenya). The Court of Appeal subsequently granted the appellant orders sought for, including issuing a prohibitory order to stop the respondent from demanding for further taxes from the appellant on this matter.

Case  Capital Gains Tax on repossessed collateral:

The High Court of Kenya, on 13 March 2018, quashed an administrative action that required simultaneous payment of stamp duty and CGT on sale of land by a chargee pursuant to a chargee’s power of sale. The case was brought by Kenya Bankers Association (the Applicant) against the Kenya Revenue Authority (the respondent).

The Applicant’s argued that:

- CGT should be paid by the owner(s) of the property since the bank was acting as a nominee for the owner(s) pursuant to the security or the charge.
- Under the Eighth Schedule to the Income Tax Act, it would be difficult to ascertain the taxable gain on the banks.
- Under the i-Tax portal, it is not possible for banks to pay stamp duty without having to pay CGT.
- KRA argued that the banks, as the transferors, should pay the CGT.

The High Court ruled that:

- It was unfair and unreasonable for the KRA to demand CGT from the banks on the sale of the land without first ascertaining whether there was, in fact, a capital gain.
- The administrative action by the KRA requiring simultaneous payment of stamp duty and CGT by the banks was unreasonable and unfair.
- Upon the sale of the land by the banks, the CGT would be payable at the time of registration of the transfer by the chargor (owner of the property) unless the bank realizes a surplus over and above the loan borrowed. In such a case, the bank would be required to account for CGT on the surplus in its capacity as a trustee of the charger.
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