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Global Tax Alert

Kenya enacts *Finance Act, 2018*

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Executive summary

Kenya's Finance Act, 2018 (the Act) was assented into law by the President on 21 September 2018.

The objective of the Act is to provide clear regulations on all procedural aspects and provisions relating to income tax, value added tax, and excise duty, among other changes. The Act introduces amendments to existing provisions in the different tax laws. The Act also streamlines and clarifies various provisions as set forth in the Finance Bill, 2018.

This Alerts summarizes the key changes. Unless noted otherwise, the effective date for these amendments is 1 July 2018.

Detailed discussion

Corporate income tax

Taxation of dividend income

The definition of dividends has been expanded in the Act to include any amount paid by a company on behalf of its shareholder or a person related to the shareholder. Such payments deemed as a distribution would include a debt owed by the shareholder or its related person that is settled by the company.

Building a better working world

Transfer pricing adjustments that result in additional income/reduced losses will also be deemed to be dividends.

Compensating tax

While the Act proposes to maintain compensating tax which is payable on the distribution of dividends from untaxed income, the applicable rate has been reduced from the punitive 43% to 30%, aligning it with the current corporation tax rate for resident companies. Compensating tax however shall not be applicable to collective investment schemes.

Effective date: 1 January 2019

Presumptive tax

The Act has introduced a presumptive tax on resident persons with an annual turnover that is below KES5m. This replaces the existing turnover tax. The tax will apply to persons issued or liable to be issued with a business permit or a trade license by a county government in a year of income. The tax will not apply to income from management or professional services, rental income or incorporated entities. The tax will be payable at 15% for the amount payable for a business permit or trade license. The tax will be due at the time of payment of the business permit or trade license or renewal of the same.

The tax seems to be geared towards the Government's objective of expanding its tax base through taxation of the informal sector.

Effective date: 1 January 2019

Deductibility of electricity expenses

In a bid to reduce the cost of manufacturing in Kenya, the Act has provided that manufacturers will be allowed to claim an additional 30% of their electricity expense in addition to the normal allowance for electricity expense. The deductibility of the additional 30% will be subject to the conditions set by the Ministry of Energy.

Effective date: 1 January 2019

Withholding tax on demurrage and insurance premiums

The Act has introduced withholding tax on demurrage charges and insurance premiums payable to a nonresident person. The withholding tax rates shall be 20% and 5% for the demurrage charges and insurance premiums respectively. Insurance premiums paid for the insurance of an aircraft will be exempt from withholding tax.

Personal tax

Contributions of the National Housing Development Fund (NHDF)

Section 31 of the *Employment Act* has been amended to introduce contributions to the NHDF.

Under the new provision, all employers and employees will each be required to contribute 1.5% of the employee's gross monthly earnings subject to a maximum limit of KES5k to the NHDF. Guidelines on how these remittances will be made are yet to be issued.

Value Added Tax (VAT)

Modifications to *VAT Act, 2013*

The *VAT Act, 2013* has modified the manner in which VAT is levied on mobile cellular transactions from using a tax base of the value of supply exclusive of excise taxes to now include excise duties as part of the taxable value for purposes of applying the standard rate of 16%.

VAT on petroleum products

The Act has introduced a concessionary 8% VAT rate on petroleum products which over the transition period from September 2013 to August 2018, were previously exempt. Determination of the taxable value of these goods shall exclude excise duty, fees and other charges.

Effective date: 21 September 2018

Other taxable goods

The Act has also changed the tax status of the following items from exempt to a standard 16% rate:

- Garments and leather footwear manufactured in an Export Processing Zone at the point of importation

VAT-exempted products

The following items are now exempt from VAT effective 1 July 2018:

- Seeds of barley (1003.10.00) and seeds of wheat (1001.11.00, 1001.91.00)
- Animal feeds comprising:
  - Unprepared cereal straw or husks (1213.00.00)
  - Lucerne (alfalfa) meal and pellets (1214.10.00)
  - Waste of sugar manufacture (2303.20.00)
- Emphasis on coverage of solar and wind equipment where the items are intended for use in the development and generation of solar and wind energy

- Approved equipment for the construction of grain storage
- Qualifying vehicle of eight seats or less capacity imported by a returning public servant or his/her spouse

VAT-exempted services

The following services are now exempt from VAT effective 1 July 2018:

- Asset transfers and other transactions related to the transfer of assets into Real Estate Investment Trusts (REITs) and asset-backed securities
- Postal services provided through the supply of postage stamps, including rental of post boxes or mail bags and any subsidiary services thereto
- Services imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangement with the Government

Zero-rated products

The following items are now zero-rated effective 1 July 2018:

- The supply of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than 10% in weight
- Medicament of tariff 3004.41.00, 3004.42.00, 3004.43.00 and 3004.49.00 containing alkaloid active principles or equivalent

Excise duty

The Commissioner has been given the power to:

- Ascertain excise duty exemption provided the qualifying goods have been consumed by an exempt person and where the items have been entered for export, are not consumed in Kenya. If unsatisfied, the Commissioner may reject the exemption.
- Suspend an excise license without notice in certain circumstances comprising tax fraud, using counterfeit stamps, possession of goods affixed with counterfeit stamps or violation of regulations relating to sanitary and phytosanitary standards.

The Act has increased the penalty for offenses relating to operation or importation of goods requiring an excise stamp without an excise license to a minimum of KES5m. It has also provided that such goods may be forfeited to the Commissioner.

Inflation rate adjustment

The Act has amended Section 10 of the *Excise Duty Act, 2015* which provided for an adjustment of the excise duty rates every two years to an adjustment at the beginning of every financial year.

The excise duty rates have changed as follows:

- Increment of the excise duty rate on illuminating kerosene from KES7,205 to KES10,305 per 1,000 liters.
- Introduced a higher excise duty rate of 30% on motor vehicles of tariff 8703.24.90 and 8703.33.90.
- Imposition of excise duty on telephone and internet data services at a rate of 15% up from 10% rate charged on mobile cellular services.
- The Act introduced a 20% excise duty rate on fees charged on money transfer services by banks and other fees charged by financial institutions.
- It also increased excise duty on fees charged on similar money transfer services by cellular mobile phone service providers to 12% up from 10%.
- Introduced excise duty on sugar confectionary and chocolate products of tariff heading 1704 and tariffs 1806.31.00, 1806.32.00 and 1806.90.00 at a rate if KES20 per kilogram.

Amendments to the *Miscellaneous Fees and Levies Act*

- In addition to revised excise duty rates on illuminating kerosene, the Act has introduced an anti-adulteration levy of KES18 per liter to be levied at the point of importation.

Effective date: 01 October, 2018

- The Act has introduced an exemption from the railway development levy (RDL) and import declaration fee (IDF) on goods imported for implementation of projects under a special operating framework arrangement with the Government.

Amendments to the *Tax Procedures Act, 2015* (TPA)

Extension to file a tax return

A person required to submit a tax return under a tax law may apply in writing to the Commissioner for an extension of time to submit the return. The TPA has been amended to provide specific timelines for making this application:

- Monthly returns: 15 days before the return is due

- Annual returns: 30 days before the return is due
- The Commissioner is now obliged to respond to applications within reasonable time and at least five days before the return is due, failing which such an application is deemed successful

Only one extension to an applicant is allowed in respect of a tax period. The grant of an extension shall not alter the date for payment of any tax due but shall exempt the taxpayer from penalties.

Amendment of assessments

The Commissioner will now be required to furnish a taxpayer with the reasons for rejecting an amended return within 30 days of receiving the application.

Assessment of tax for income earned outside Kenya

The Act has repealed Section 37B of the TPA thereby extending the period of filing returns under tax amnesty from 30 June 2018 to 30 June 2019. The extension also covers income received in the year 2017.

The new Section 37B also proposes an amendment which provides that the Commissioner shall not question the source of the funds unless the funds are from terrorism, poaching or drug trafficking.

Further, repatriated funds are to be excluded from provisions of the *Proceeds of Crime and Anti-Money Laundering Act, 2009* and other Acts relating to investigation of financial transactions.

Objections to tax assessments

The TPA has been amended to allow a taxpayer to apply for an extension to pay any undisputed tax amount where an additional assessment is issued by the tax authority. An objection to a tax assessment is only valid where a taxpayer has paid the undisputed tax.

Interest and penalty on late payment of tax

A late tax payment penalty of 5% of the tax due and payable has been introduced for persons who fail to pay tax on the due date. Interest on the late payment of tax has also been increased from 1% to 2% from per month.

Late submission penalty

The TPA has been amended to provide for new penalty rates on late submission of tax returns as follows:

- VAT and Excise Duty returns – the higher of 5% of the tax due or KES10k
- Non-individual returns – the higher of 5% of the tax due or KES20k
- Individual returns – the higher of 5% of the tax due or KES2k

Remission of penalties and interest

Section 89 of the TPA has been amended to clarify that the Commissioner can only waive penalties and interest to a limit of KES1.5m. Where the application exceeds this amount, the Commissioner is to seek prior approval from the Cabinet Secretary (CS) in charge of the National Treasury. In addition, the Commissioner is to make quarterly reports to the CS on the remissions granted.

Unauthorized access or improper use of and interference with computerized tax system

The Act introduces two new sections to the TPA imposing penalties for unauthorized access or improper use of and interference with computerized tax system.

Section	Offense	Penalty
103A	Unauthorized access or improper use of a computerized tax system	Natural person – imprisonment for a term not exceeding two years or a fine not exceeding KES400k or both Corporate person -a fine not exceeding KES1m
103B	Interference with the computerized tax system	A term not exceeding three years or a fine not exceeding KES800k or both

Amendments to the *Tax Appeals Tribunal Act* (TAT)

Time for alternative dispute resolution

The TAT Act provides for disputes to be heard and resolved within 90 days. The Act has been amended to take into consideration settlements out of the tribunal such as the Alternative Dispute Resolution (ADR) mechanism. The time taken to engage in such deliberations will not form part of the 90-day time limit.

Implications

The Government expects that the additional revenue generated by these proposals will support the development of both social and physical infrastructure in the country which will ultimately benefit the citizens of Kenya. There are various measures that apply retroactively as of 1 July 2018. It remains to be seen how these will be implemented.

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