
ICPAK Seminar
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Taxation

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Personal taxation

Overview

- ▶ The tax year for individuals runs from **1 January** to 31 December (S.27(3)).
- ▶ **Chargeable income**: Income tax is chargeable for each year of income upon all income of a person whether resident or non-resident, which **accrued in** or was **derived from** Kenya (S.3(1)).

Personal taxation

Overview cont'

- ▶ Taxable employment income include:
 - ▶ wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus, gratuity, or subsistence, traveling, entertainment or other allowance received in respect of employment or services rendered.
S.5 (2) (a)
 - ▶ Any amount so received in respect of employment

Personal taxation

Overview cont'

- ▶ **Employment income for a non-resident person in relation to services rendered to an employer who is resident in Kenya or a P.E in Kenya of an employer who is not so resident is deemed to have accrued in or to have been derived from Kenya. S.5 (1) (b)**
- ▶ **S.5 (1) (b) makes it possible for individuals who are employed by a company or branch in Kenya but whose services are performed elsewhere to be chargeable to tax in Kenya.**
 - ▶ **Such employees include those with either a regional office in Kenya or an affiliated company but whose duties are performed wholly in another country in the region.**

Personal taxation

Residency rules

- ▶ An Individual is deemed to be resident in Kenya if:
 - ▶ One has a permanent home in Kenya and was present in Kenya for any period in a particular year of income under consideration, or;
 - ▶ Was present in Kenya:
 - ▶ Aggregate period (s) of 183 days or more in a particular year
 - ▶ Average period (s) exceeding 122 days in a year of income and in each of the 2 preceding years.
- ▶ A resident is liable to tax on worldwide employment income (S.2).
- ▶ A non-resident is taxable on income which is accrued in or is derived from Kenya (S.3(1)).
- ▶ The Income Tax Act does not define what constitutes a permanent home for the purposes of determining residency. This creates a serious ambiguity and may lead taxpayers to wrongly conclude on their residency status.

Personal taxation

Taxable income

- ▶ As a general rule, all types of remuneration and benefit received by an employee for services rendered constitute taxable income (S.5(2)).
- ▶ Any amount not paid in cash but credited to an employee's account with the employer is to be treated as income and tax deducted accordingly.
- ▶ The two forms of emoluments subject to tax are:
 - ▶ Cash emoluments;
 - ▶ Non – Cash benefits:

Personal taxation

Per diems

- ▶ Per diems are ‘per day’ allowances normally given for upkeep of staff when on official travel.
- ▶ W.e.f 16 June 2006 the first KShs 2,000 is deemed to be a reimbursement (S.5(2)(a)(ii)).
- ▶ Should ideally be supported preferably with vouchers from an arms-length source.
- ▶ Where these are not available, supporting workings preferably acknowledged by the third party supplier should be attached.
- ▶ The Act does not provide special per diem rates for overseas travel.

Personal taxation

Tax free remuneration

- ▶ Where employer wishes to pay employees net of tax, the tax paid by the employer on behalf of employees is in itself a benefit chargeable to tax.
- ▶ The Commissioner has given a formula to compute the 'tax-on-tax' effect – Appendix 4C and 4D of PAYE guide.

Personal taxation

School fees paid by employer

- ▶ “Education fees” paid by the employer for employee’s dependants are taxable on the employee (S.5(4)(d)).
- ▶ However, where the tax is borne by the employer, through add-back in the computation, the benefit will not be taxable on employee.
- ▶ What is the case for non-taxable employers?

Personal taxation

Club fees paid by employer

- ▶ Club subscription paid by an employer on behalf of an employee are allowable expenses. (S.15(2)(v)).
- ▶ No deduction shall be allowed in respect of club fees including entrance and subscription fees except as provided in section 15(2)(v). (S.16(2)(a)(v)).
- ▶ Are club fees exempt from tax in the hands of the employee as per S. 5 (4)?

Personal taxation

Lump sum payment (Gratuity, service payment and Bonuses)

- ▶ Employment income is assessable on accrual basis; that is, over the period it has been earned and become due for payment. The time the income is received is, therefore, immaterial.
- ▶ Where an amount is received in respect of employment or a service rendered in a year of income different from the year of accrual, such income is deemed to be income of the year of accrual.
- ▶ However Section 5(2)(a)(i) states that where the year of accrual is earlier than 4 years prior to the year of receipt, the income is to be treated as that of year of income which expired 5 years prior to the year in which the income is received or prior to the year of income in which employment ceased.

Personal taxation

Lump sum payment (Gratuity, service payment and Bonuses)

- ▶ The service gratuity amount is to be spread backwards and taxed together with income earned in the relevant years.
- ▶ Notice pay is assessable in the period immediately after date of leaving employment.
- ▶ Pay in lieu of leave should be taxed in the year to which the leave days relate.
- ▶ Example: Mr. Peter Bakari left employment in 2006 after 30 years of service and was paid service gratuity of KShs. 660,000. He was also paid KShs 25,000 relating to 2002 accrued leave days. The amounts due will be taxed as follows:

▶ 2005	22,000
▶ 2004	22,000
▶ 2003	22,000
▶ 2002	22,000 + 25,000
▶ 2001	22,000 + 550,000

Personal taxation

Compensation for the termination of a contract of employment

- ▶ Compensation received is taxable, whether or not provision was made in the contract for the payment of that compensation (S.5(2)(c)).
- ▶ Where there is a specified term contract, the amount of the compensation will be spread over the unexpired period at equal amounts and taxed accordingly.

Personal taxation

Compensation for the termination of a contract of employment

- ▶ Where the contract is for unspecified term and provides for terminal payment, then the compensation will be **spread forward** and assessed at the rate of the **employee's remuneration** p.a immediately before termination.
- ▶ Where the contract is for unspecified term and does not provide for terminal payment, the compensation is to be spread forward **in equal amounts for three years following the termination.**
- ▶ **Leave** payment is taxable in the year it was earned.

Personal taxation

Non cash benefit

- ▶ The value of all benefits advantages or facilities of whatsoever nature are taxable on the employee.
- ▶ However, non cash benefits that in aggregate do not exceed **KShs 36,000** per annum are not taxable. (S.5(2)(b)).
- ▶ The cost of meals served in canteens and cafeterias operated by employer for the benefit of the low income employees will be treated as a non taxable benefit. W.e.f. 1.1.2008.
- ▶ **“Low income employee”** means an employee whose taxable income is not subject to tax at the **rate of more than 20%**. That is **KShs 29,316**. (S.5(4)(f)).

Personal taxation

Non cash benefit cont'

- ▶ All non cash benefits are taxed at the **higher** of **actual cost** to the employer and the **market value** e.g. water, electricity, domestic help and watchmen, radio alarms.
- ▶ Powers of the Commissioner to prescribe the value of the benefits were removed W.e.f. **12.06.03 (S.5(5))**.
- ▶ However, the Commissioner may, from time to time, prescribe the value where the cost or the fair market value of a benefit cannot be determined.

Personal taxation

Medical benefit

- ▶ Where an employer provides free medical services to his employees, the value of such medical services is a non-taxable benefit of full time employees and whole time service directors.
- ▶ This has been expanded to include the following with an allowed maximum limit of **KShs 1 million**:
 - ▶ **Directors** other than whole time (W.e.f. 1.1.2006 through **LN No. 53**)
 - ▶ **Partners** in a partner ship (W.e.f. 1.1.2010 through **S. 4 (b)**)
 - ▶ **Sole proprietors** (W.e.f. 1.1.2010 through **S. 15 (3) (g)**)
- ▶ W.e.f. 1.1.2008, medical insurance provided by the insurance provider approved by the Commissioner of Insurance and paid by the employer on behalf of a fulltime employee shall not be subject to tax. (**S.5(4)(b)**).
- ▶ **Issues:** Medical Insurance: **KRA interpretation**? Medical expense for employee **dependants**, are they taxable?

Personal taxation

Non-cash benefit (commissioner prescribed rates)

- ▶ Provision of '*furniture*' – 1% of the cost of furniture to employer.
- ▶ Telephone (*landline and mobile phone*) – 30% of bills.

Personal taxation

Housing benefit – S. 5 (3)

- ▶ Free housing is taxed at the higher of actual cost to the employer or 15% of gross emoluments. However:
 - ▶ If the employer pays rent under an agreement not at arm's length, value of the benefit is the higher of the fair market value of the premises for that year or rent paid by employer, and;
 - ▶ Where premises are owned by employer, the value of the benefit is the fair market value.

Personal taxation

Housing benefit cont'

- ▶ In calculating the housing benefit the employer is required to deduct rental charges recovered from the employee or director.
- ▶ If the premises are occupied for part of the year only, the value is reduced relative to the period of occupation less any rental paid by employee or director.
- ▶ Where only part of the premises is provided, the Commissioner may reduce the value to an amount he considers just and reasonable.
- ▶ Issue: Housing for doctors, headmasters, children homes?

Personal taxation

Housing benefit cont' – agricultural employee

- ▶ **Agricultural Employee** - Includes a Whole-Time Service Director who is required by terms of employment to reside on a plantation or farm.
- ▶ The value of housing is taken as **10%** of his gains or profits from employment (i.e. monthly cash pay plus benefits), minus amount of rent charged by the employer.

Personal taxation

Car benefit

- ▶ Provision of a 'company' car is taxable at the higher of 2% per month of the initial cost of the car (W.e.f 1.1.1998) or commissioner's prescribed rates (S.5(2B)).
- ▶ However, w.e.f.1.1.2008, for employees who have restricted use of motor vehicles, the commissioner shall if satisfied of the fact upon proof by the employee, determine the lower rate of the benefit depending on the usage of the motor vehicle. (S.5(2B)).
- ▶ W.e.f . 16 June 2006, where the car is hired or leased, the taxable benefit is the lease or hiring cost (S.5(2B)(a)(ii)).
- ▶ Issue 1: ICPAK submission – to use NBV or cost?
- ▶ Issue 2: Cases where the employee fuels and maintains the car?

Personal taxation

Interest free or low interest loan

- ▶ Relates to loans which interest charged is below the commissioner's prescribed rate, which are published quarterly (half yearly for low interest on loans taken before 11.6.98).
- ▶ For old loans (taken before 11 June 1998), low interest benefit applies – the interest is taxed on employee at graduated scale rates (S.12B).
- ▶ For loans advanced after 11 June 1998: Fringe benefit tax is 30% of the difference between the commissioner's interest rate and that actually charged – payable by employer.

Personal taxation

Contributions to pension scheme

- ▶ Contributions to registered pension, provident and individual retirement schemes – Up to a maximum of **KShs 240,000** per annum is tax allowable (S.22A) .
- ▶ However, contributions by employers to **unregistered schemes** or excess contributions to registered schemes are a taxable benefit on employee, where the employer is **not** taxable. (S.5 (4)(c)).

Personal taxation

Retirement benefit schemes

- ▶ Wef 1 January 2010, withdrawals by an employee from a registered pension scheme/provident fund amounting to **KShs 60,000** per year up to a maximum of **10 year** is exempt from tax. Previously it was KShs 48,000 (S.8(5)).
- ▶ Wef 1 January 2010, Pension income of up to **KShs. 300,000** per year is exempt from tax. Previously it was KShs.180,000 (S.8(4)).
- ▶ Monthly or lumpsum pension granted to persons over 65 years is tax exempt from 14 June 2007 (Par.53 of 1st Schedule)

Personal taxation

Passages

- ▶ Arises when an employer pays for or reimburses the cost of tickets for passages, including leave passages for his employee and family.
- ▶ The value of the passages is a non-taxable benefit of the employee if the employee is recruited outside Kenya, provided:
 - ▶ He's recruited solely for the purpose of serving his employer.
 - ▶ He is not a citizen. (S.5(4)(a)).

Personal taxation

Home ownership savings plan

- ▶ A depositor (employee) is eligible to a deduction of a maximum of **KShs. 48,000** per annum up to a maximum of 10 years in respect of funds deposited in approved institutions, provided;
 - ▶ The employer has evidence to confirm that the approved Institution is registered by the Commissioner.
 - ▶ The employer will be the one to deduct and remit the amount to the Institution on behalf of the employee.
 - ▶ Employer will attach to form P9A (HOSP) a declaration duly signed by the eligible employee.
 - ▶ “Approved Institution” – means a licensed financial institution or a licensed Insurance Company. **(S.22C(2)).**
- ▶ Wef 1 January 2007, interest earned on deposits to registered home ownership savings plan (HOSP) of up to **KShs 3,000,000** deposit is exempt from tax. **(S.22C(2)).**

Personal taxation

Mortgage interest relief

- ▶ Available to owners of residential houses who occupy them; no claim for more than 1 residence
- ▶ Applies to purchase or improvement of premises.
- ▶ Relief of up to **KShs 150,000** p.a
- ▶ Relief given on interest from banks, insurance companies, building societies and National Housing Corporation only (S.15(3)(b)).
- ▶ **Saccos** have been left out among the qualifying financial institutions.

Personal taxation

Insurance relief

- ▶ Relief against life insurance premiums paid by the individual or by the employer for the life of the individual, his wife or child;
- ▶ Relief given of 15% of premiums paid up to a maximum of KShs 60,000 p.a (w.e.f 1.1.07).
- ▶ Shall apply only to life or education policies whose term commences on or after the 1.1.03.
- ▶ Education policy: maturity period of at least 10 years.
- ▶ Health insurance w.e.f 1.1.07 (S.31).

Personal taxation

Miscellaneous

- ▶ **Gratuity:** Wef 1 Jan 2011, an amount paid by an employer as a gratuity or similar payment in respect of employment or services rendered, which is paid into a registered pension scheme is exempt from tax. (S.5(4)(g)).

- ▶ **Transfer Pricing:** Wef 11 June 2010, for the purposes of subsection (3) a person is related to another ifan individual, who participates in the management, control or capital of the business of one, is associated by marriage, consanguinity or affinity to an individual who participates in the management, control or capital of the business of the other. (S.18(6)(c)).

Personal taxation

PAYE bands (Para 1, Head B of 3rd Schedule).:

	Kshs	Applicable Rate
On the first	10,164	10%
On the next	9,576	15%
On the next	9,576	20%
On the next	9,576	25%
On all income over	38,892	30%

Personal taxation

Personal relief

▶ Relief Against Tax

	Kshs
Annual	13,944
Monthly	1,162

- ▶ In other words, tax free emoluments in Kenya is **KShs 11,135** per month (NB. Tax free limit arises because of personal relief).
- ▶ This uniform relief replaced single and family relief.
- ▶ Individuals serving several employers qualify for personal relief from only one employer (S.30).

Personal taxation

Statutory deductions

National Hospital Insurance Fund (NHIF)

- ▶ Individuals earning more than KShs. 1,000 per month are required to contribute towards NHIF. (Monthly contributions depends on monthly income and ranges from Kshs. 30 per month to KShs. 320.)
- ▶ NHIF is payable by 1st day of the month following the month of deduction. (In practice, the fund accepts payment before 9th of the following month.)
- ▶ Late payment of any contribution attracts a penalty equal to five times the amount of the unpaid contribution.

Personal taxation

Statutory deductions cont'

National Social Security Fund (NSSF)

- ▶ Contribution- Employee - 5% of their salary to a maximum KShs. 200 per month while the employer contributes an equivalent amount for each employee.
- ▶ A new legislation w.e.f from 2009 made it compulsory for all employers regardless of number of employees. (Previously it was limited to at least five employees.)
- ▶ Casual employees, 5% of gross wages - compulsory contribution by employer as a special contribution.
- ▶ Payable by 15th of the month following the month of deduction.
- ▶ General Penalty of 5% per month or part thereof

Personal taxation

Employer responsibilities

- ▶ Deduct and remit PAYE to the KRA as an agent (Cheques drawn payable to the pay master General Kenya) **(S.37(2))**.
- ▶ Complete and file PAYE monthly return by 9th of month following the month of deduction (Form p11 (P.A.Y.E credit slip paying in book)). **(Para 10, Income Tax (PAYE) Rules)**.
- ▶ File quarterly PAYE returns by 10th of month following end of 1st, 2nd, 3rd & 4th quarter of a year of income.
- ▶ File annual PAYE return by end of February of the year following the year of deduction. **(abolished wef 11.06.10)**
- ▶ Employers filing online returns on monthly basis are not required to furnish quarterly returns.

Personal taxation

Employee responsibilities

- ▶ Obtain PIN (S.132).
- ▶ Complete and file SAR by due dates (S.52B(a)).
- ▶ Complete own taxes and pay the KRA especially on change of jobs.
- ▶ A resident employee of a non-resident employer should declare his income to the tax authorities. Such an employee is required to pay the tax in 4 equal instalments within the calendar year and any tax balance by 30 April of the following year (S.12).

Personal taxation

Common PAYE Problems

- ▶ Employers are agents of government without any benefits - more procedural work.
- ▶ Lack of tax payers/agent education.
- ▶ Some areas are quite technical.
- ▶ Lack of clear definition of certain provisions.
- ▶ No legislation to cover emerging issues.

Personal taxation

Penalties for Non-compliance

- ▶ Failure to deduct and account for tax from employment emoluments.
 - ▶ **S.37**: 25% non compliance penalty.
 - ▶ **S.72D**: 20% late payment penalty (abolished wef 11.06.10)
 - ▶ **S.94**: 2% interest per month.
- ▶ Payment of an employee who has no PIN: KShs 2,000 per omission (**S.132(7)**).

Personal taxation

Dispute Resolution

- ▶ Wef 11 June 2010, a person aggrieved by the imposition, by the Commissioner, of a penalty under this section may, by notice in writing to the Commissioner, **object** to the imposition within thirty days of the date of service of the notice of the imposition. (S.37(6D)).
- ▶ Wef 1 July 2004, a person aggrieved by the imposition by the Commissioner of a penalty may appeal against such imposition to the local committee within thirty days after the date of service of the notice of imposition provided that the person shall, **prior** to making the appeal, **pay all the tax due and the penalty** imposed. (S.37(6B)).

Withholding Tax

Withholding tax

- ▶ WHT is tax deducted at source on payments for income arising from various sources.
- ▶ Currently a major source of Revenue for KRA
- ▶ Why withhold tax?
 - Cash flow to KRA & taxpayer
 - Compliance issue
 - More cost effective
 - Non resident issue
- ▶ Withholding tax versus withholding VAT
(The law, Agents, Goods or services?)

WHT... Pertinent issues

- ▶ Which services are subject to WHT? – Cap 470 defines payments subject to WHT instead
- ▶ Suppose you don't withhold but the supplier of services is tax compliant? – Compliance issue
- ▶ WHT on disbursements
- ▶ When is WHT final and when is it advance tax?

WHT... The Legislation

Income Tax Act – CAP 470...

- ▶ **Section 2 – Definitions**
- ▶ **Section 35 – Incomes subject to WHT**
- ▶ **Section 130 – WHT Rules**
- ▶ **3rd Schedule – Rates of tax**

Withholding tax

- ▶ Withholding tax is deductible upon payment of a taxable amount.
- ▶ Tax point ...
“Payment” is deemed to include the date of accrual/crediting of the amount payable.
- ▶ Whose responsibility?

Exemptions

- ▶ Withholding tax is not deductible on payments to exempt persons who are in possession of a tax exemption certificate
- ▶ Examples of exempt persons
 - POSB – Interest on savings accounts
 - Local Authority
 - Registered pension/provident schemes
 - EA Dev Bank
 - NSSF

Dividends

- ▶ Dividends could be cash, stock, redeemable preference shares, debentures, or payments during winding up
- ▶ Classified as exempt, qualifying or non-qualifying
- ▶ Qualifying – WHT is final, non-qualifying – WHT not final
- ▶ Rates – 5% (Residents); 10% (Non-residents)
- ▶ Exempt dividends – Paid to exempt persons listed on 1st Schedule or those received by a resident co. controlling >12.5% - S7(2)
- ▶ Non-qualifying dividends – Paid by a designated co-op society (Taxed under section 19A) - S2
- ▶ Qualifying dividends – All the others

Interest

- ▶ Classified as:
 - Exempt - 1st Schedule
 - Qualifying – Interest received by individuals from bank or fin inst., housing bonds [max: 300,000/-, CBK) or
 - Non-qualifying - all the rest

- ▶ Qualifying – WHT is final, non-qualifying – WHT not final

- ▶ Rates – 15% (Bank interest and other sources); 25% (on bearer instruments)

WHT Rates

Nature of payment	Resident	Non Resident
Management or professional fees: - consultancy, managerial, technical, agency fees	10%	20%
Royalties - payment for use of or right to use a copyright patent, trademark, design, formula.....	5%	20%
Contractual fees - building, civil and engineering works	3%	20%
Lease rentals - equipment	0%	15%
Lease rentals – Immovable property	0%	30%
Pension & provident fund withdrawals	10-30%	5%

Double Tax Agreements

Nature of payment	UK	Germany & Canada	Denmark Norway Sweden Zambia	India	EAC
	%	%	%	%	%
Management or professional fees	12 ½	15	20	17 ½	20
Royalties	15	15	20	20	20
Consultancy fees to individuals	12 ½	15	20	17 ½	15

Penalties

- ▶ Late payment penalty of 20%
- ▶ 10% penalty (subject to a maximum of KShs 1 million) for failure to withhold or remit tax to KRA
- ▶ Interest charged at 2% per month or part thereof, on the principal WHT and penalties.

THE END

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