THAKRAR FINANCIAL CONSULTANTS

FINANCE ACT 2016

The Finance Act 2016 was assented to by the President on 13 September 2016 and passed into law. There are a number of new ammendments that were not part of the Bill. Ammendments have been made across the Board to all Tax Areas; Income Tax , PAYE, VAT and Excise duty.

Most of the ammendments came into force on 9 June 2016 and some are effective 1st January 2017.

Audit * Taxation * Advisory

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1. INCOME TAX

a. Lower Corporate Rate For Real Estate Developers

To address the current housing shortage of approximately 150,000 units per year, the Act has introduced a reduced special rate of corporate income tax of 15% for real estate developers who construct at least 400 units annually, subject to the approval of the Cabinet Secretary for Housing.

Where a developer is engaged in multiple developments, the rate of 15% shall be applied propotionately to the extent of the turnover arising from the housing developments. This is effective from 1st January 2017.

Whilst we commend the House for this amendment aimed at galvanizing the real estate development market, it would be important to clarify whether the special corporate tax rate of 15% will be applicable in the year the development completes or throughout the period of the development.

b. Sports Sponsorship Now Tax Deductible

Effective 1st January 2017 expenses incurred in sponsoring sports by a company will now be tax allowed.
This means that a company will not pay tax on the expense even though it is not wholly and exclusively used in generation of income.
However, a company interested in sports sponsorship should obtain prior approval from the Cabinet Secretary responsible for sports.

c. PAYE

i. Sports Sponsorship Now Tax Deductible

Kenyans have been lobbying for expansion of PAYE brackets for a long time.

Over time, the PAYE burden has grown heavier and heavier due to inflation and diminishing value of the Kenyan Shilling. Well the much awaited reprieve is now law.

The PAYE brackets have been expanded by 10% and the relief is increased by 10%.

Below are the applicable monthly PAYE rates:(In KShs) FROM 1ST JANUARY 2017

Monthly Relief has been amended to KShs.1,280 per month.

Income	Rate of PAYE
Below 11,181	10%
From 11,181 - 21,714	15%
21,715 - 32,248	20%
32,249 - 42,781	25%
Above 42,781	30%

ii. **Taxation of employment income for low income earners**

Earlier in the year, The President of the Republic of Kenya commented that allowances to income earners should be exempt from Pay as You Earn.

Well, this has now been effected into law. In the Finance Act 2016, bonuses, overtime and retirement benefits to low income earners is now exempted from tax. The tax free based amount would be on the employment income before the bonus and overtime allowances.

Who is a low income earner? This is anybody with a monthly basic income of Kshs.11,180 or

This exemption is effective from 1st July 2016.

d. **Withholding tax on rent paid to resident persons**

-On rental income **Effective 9th June 2016**

The Finance Act 2016 has introduced withholding tax of 10% on rent paid for the occupation or use of immovable property to resident persons having a permanent establishment in Kenya.

The commissioner will appoint in writing persons who will be allowed to deduct withholding tax on the rent expense paid.

-Increased penalty rate

Section 35(6) of the income tax act has now been deleted. The witholding tax rules legislated pursuant to section 35(6) impose a 10% penalty where a person fails to withold tax. It appears that the intention of deleting this section is to harmonize the imposition of penalties which are now contained in the Tax Procedures Act.

It could be argued that the applicable penalty for failure to withold tax is now the tax shortfall penalty of 20% and not the 10% under the witholding tax rules. However the lack of clarity in legislative drafting gives rise to uncertainty among taxpayers.

e. **Capital Gains Tax on transfer of property**

Effective 9th June 2016, Capital gains tax is not applicable on transfer of property between.

i. Spouses
ii. Former spouses as part of divorce settlement
iii. Immediate family
iv. Company where spouses or immediate family holds 100% shareholding.

Prior to this change in law, capital gain tax was applicable in transfer of property even between spouses. The only exemption was in case of inheritance.

f. **Taxation of Betting, Lotteries and Gaming Revenue**

The Finance Act has introduced a variety of taxes on the revenue realised by betting, lotteries and gaming companies.

Effective 1 January 2017, the below taxes will be applicable to the various revenue streams.

i. Betting Tax of 7.5% on the gaming revenue
ii. Lottery Tax at 5% on the lottery turnover
iii. Gaming Tax at 12% on the gaming revenue and;
iv. Prize competition tax at 15% on the cost of entry to a competition which is premium

The taxes discussed above are payable to the collector on the 20th of the following month.

g. **Taxation of Betting, Lotteries and Gaming Revenue**

Any rental income below KShs. 144,000 per annum is now exempt from residential income tax. This is effective from 9 June 2016.

h. **Mortgage interest deduction**

Under the current income tax act, an individual is entitled to claim a deduction of up to KES 150,000 per annum against taxable income for interest on mortgage of the house he occupies, provided that the mortgage is from a qualifying institution.

From 1 January 2017, the qualifying mortgage interest deduction has been increased to KES 300,000 per annum.

2. VAT ACT

i. **Tourism sector**

a. **Hotels**

The re-introduction of definition of a hotel to include service flats, service apartments, beach & holiday cottages, game lodges, safari camps, holiday villas, bandas and other premises used for similar purposes.

Hotel definition does not include;

i. Premises on which the only supply is a lease of not less than a month unless the lease agreement provides the occupier may terminate the lease on less than one month without penalty;

ii. Premises operated by an educational or training institution for staff and students with approval by the responsible CS; and

iii. Premises operated by a medical institution approved by the health CS for staff and students.

The definition is key in ascertaining what a taxable supply is eg. Short stays will be vatable where have they have hit the Kshs 5M annually threshold as well as for capital allowances applications for hotels.

Further to this the taxable value of a supply of accomodation or restaurant services shall not include service charge paid in lieu of tips. The service charge should not exceed ten percent of the price of the service and shall be paid directly to the employees based on a written agreement.

Exempted items in the tourism sector include;

i. Exemption of recreational set up in Special Economic Zones ("SEZs") of 100 acres or more;

ii. Exhibits and specimens for museums and natural history and public museums scientific equipment;

iii. Chemical, reagents, films, film strips and visual aid equipment imported or purchased prior to clearance through the customs by the National Museums of Kenya;

iv. Taxable goods and services used in construction of tourism, convention and conference facilities, recreational parks of 50 acres or more; and

v. Supplies of non in-house tours and operators and entry fee into national parks and reserves shall be exempt.

ii. Manufacturing Sector

Exempted items in the tourism sector include;

a. Inputs used to manufacture sanitary products such as pads and diapers will be exempt. This shall boost local production of these products and make these goods more affordable. Coupled with the SEZ Act, this will encourage local manufacturing of sanitary pads.

This is a major item as previously, non-resident manufacturers had an unfair advantage as they could manufacture outside the country and ship the final product into Kenya and in the EAC with no import VAT. However, a local manufacturer would import raw materials which would attract import VAT and duties. This made local manufacturing expensive and unattractive to investors.

The overall effect of this amendment is to spur investment in the sector and hopefully result in availability of affordable quality sanitary wear in the country and within the EAC.

b. Raw materials for the manufacture of animal feeds. This is to encourage local production;

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

d. Inputs used in manufacturing clean cooking stoves.

iii. Entertainment Industry

Exempted items in the tourism sector include;

a. Goods imported or purchased locally for use by the local film producers and local filming agents will now be subjected to recommendation by the Kenya Film Commission before exemption approval by the National Treasury CS;

b. The Finance Act has introduced a definition of recreational parks to include an area or building constructed for the purpose of improvement of general health. Taxable supplies for the construction of such parks of fifty acres or more are exempt from VAT subject to approval of the cabinet secretary.

iv. Other VAT Exemptions

a. Motor vehicles used in implementation of official aid funded projects.

b. All goods for official use by the Kenya Defence Forces and the National Police Service.

c. Aircraft direction-finding compasses, instruments and appliances;

d. Taxable goods and services used in construction of specialised hospitals with accomodation facilities upon Health CS recommendation; and

e. Oil and oil products will remain exempt for another two years commencing 1st September 2016. The goods include petroleum oil, kerosene, and gas products as listed in the VAT Act 2013. This is also in line with other East AfricanCommunity Patner states which have exempted the goods, maintaining a harmonious VAT treatment of the goods.

f. From 9 June 2016, the VAT act provides for exemption in relation to goods purchased or imported and used exclusively in the construction of industrial parks of one hundred acres or more.

g. Wheat seeds will be exempt from VAT from 9 June 2016. This is consistent with the exemption of other seeds such as sunflower, cotton and safflower seeds.

h. Non-electric stoves and similar appliances have been exempted from VAT. Goods that are used in the manufacture, assembly, or repair of clean cook stoves will now also be exempt.

i. Tissue papers, serviettes, polythene films, and certain types of white paper have been exempted.

v. **Zero Rated List**

a. Supply of taxable services and goods to an SEZ;

b. Supply of liquefied petroleum gas ("LPG")

c. Medicaments containing antibiotics of tariff no. 3003.20.00

vi. **Other Provisions Related to VAT**

Special Economic Zones ("SEZS")

The introduction of the SEZs through the enactment of the SEZ Act in 2015 and introduction of SEZ Regulations in 2016 have been complimented by the amendments made in the VAT Act 2013. This includes the zero-rating of goods or services supplied to SEZs, previously exempted, and the distinction of the SEZ as a seperate customs territory by including SEZ in the definition of importation and export in the VAT Act 2013. Although a lot remains to be seen as we wait the establishment of the SEZ Authority, SEZ are expected to spur investment in the manufacturing sector due to the various tax incentives such as zero import duties and lower income tax rates.

S.33 dealing with penalties for a fraudulent VAT refund claim has been deleted. This is in line with ensuring that all administration matters are covered by the TPA.

Where a person deregisters from VAT, they will be deemed to have made a taxable supply immediately before deregistration for all the trading stock that they claimed input VAT. The output VAT will be equal to the amount of the input tax credit allowed to the person on acquisition or import of the stock.

The changes are effective 9th June 2016

i. **Excise Duty on supplies to SEZs**

The Finance Act 2016 has included Special Economic Zones in the definition of exports.

Previously, Excise Duty was not applicable on exported goods and services.

Effective 1st July 2016, excise duty is not chargeable to goods and services supplied to special economic zones.

ii **Revised Excise Duty Rates:**

Cosmetic and beauty products: Excise Duty has been introduced at the rate of 10%.

Illuminating Kerosene: Excise Duty at Kes.7.205 has been introduced on every litre of kerosene.

Motor vehicles: The Finance Act 2016 has revised the excise duty on motor vehicles at a flat rate of 20%.
These revised rates are effective from 9th June 2016.

iii **Exempt items**

Effective 9th June 2016, the items listed below are exempt from excise duty:

a Locally assembled motorcycles.

b Public School Buses.

c Excisable goods used in implementation of official Aid - Funded projects.

d Excisable goods imported for direct use in manufacture of sanitary towels.

e Supplies to the Kenya Defence Forces and National Police Service.

iv **Excise on plastic bags**

The proposed provisions in the finance bill 2016 were deleted therefore the existing excise rate applicable on all plastic shopping bags of Kes.120 per kg is maintained.

v **Keg Beer**

The Finance Act has repealed Section 68 A of The Alchoholics Drinks Control Act,2010

The repealed law previously granted the remission of excise duty at the rate of 90 percent on beer made from sorghum, millet or cassava grown in Kenya.

vi Soft Drinks

The act has excluded non-bottled water of tariff no. 2201.90.00 from excise duty. Previously all 'waters' were chargeable to excise duty.

4 TAX PROCEDURES ACT

i Appointment of Tax representatives by non-resident person

A non-resident person with no fixed place of business and who might be required to register under any tax law in Kenya will now appoint a tax representative in Kenya.

Where one is required to appoint a representative and fails to do so, then the Commissioner may appoint a tax representative for the person.

There are instances where non-residents acquire income that is chargeable to tax in Kenya or have VAT credits that they can claim,such persons are the ones required to appoint taz representatives.

The representatives will take care of the necessary tax obligations on behalf of this non-resident person.

ii. Tax Assessment on rental income

The Finance Act 2016 has barred the Commissioner from assessing tax on rental income for years prior to 2013 for those who took advantage of the amnesty on rental income.

The Tax Amnesty on rental income expired on 30th June 2016. Landlords were required to declare the rental income earned in 2014 and 2015 and pay the the resultant tax penalties

iii. Appointment of VAT withholding agents

Earlier this year, a number of tax payers received notifications of their appointment as withholding VAT agents.

This move was met with a lot of critism as the Tax Procedures Act had repealed the section of the VAT Act that had enforced the appointment of VAT withholding agents.

The Finance Act 2016 has reinstated the appointment of VAT withholding agents effective 1 January 2016.

This means that any tax payer who had received the appointment notification prior to the Finance Act is legally appointed and expected to continue with the obligation.

However, anyone who did not account for withholding VAT between the dates of 19 January 2016 and 8 June 2016 may not be penalised for not doing so.

iv. Refund of overpaid tax

Effective 1 January 2017, a tax payer can apply for a refund of overpaid tax within a period of 5 years from the date which the tax was paid. Currently , a tax payer has only a period of 1 year to apply for refund of the over paid taxes.

The Finance Act 2016 has now compelled The Commissioner to notify the tax payer in writing of the decision relating to the application of refund within a period of 90 days.

The Commissioner has also been compelled to refund the overpaid tax within a period of 2 years from date of application.

Any amount not refunded within 2 years will accrue interest at the rate of 1% pm.

v. **Erroneous refund of tax**

The Tax Procedures Act currently provides that where the commissioner erroneously refunds a taxpayers money, then the tax payer will have to pay back the money together with late payment interest accruing from the date the money was received.

The Finance Act 2016 has now provided that interest of 1% per month will only accrue on the amount that the tax payer does not refund the KRA within 30 days of the date of service.

vi. **Waiver of interest**

Effective 1 January 2017, tax payers will be able to apply waiver of interests on unpaid taxes or additional assessment.

However, the Finance Act has provided that the remission of interest is only applicable where:

a There is uncertainty as to any question of the law or fact; or
a The remission is in consideration of hardship or equity; or
a It will be impossible, difficult or expensive to recover the tax.

vii. **Duty to submit third party returns**

The commissioner can require a person to submit information in a return relating to other persons including third parties. The scope of this provision however is not clear.

5. MISCELLANEOUS PROVISIONS

a. 30% Local Shareholding Requirement for foreign companies

The Companies Act 2015 has been amended by deleting Section 975 (2) (b) which provided that for a foreign company to be registered in Kenya, it had to demonstrate that atleast 30% of its shareholding was held by Kenyan citizens by birth. The provision was criticized as being impracticable and likely to drive away investors.

b. Tax Appeals Tribunal

The Tax Appeals Tribunal Act ("TAT Act") has been amended to provide the timeline within which the commissioner should serve his statements of facts on the Appellant i.e. within 2 working days. Previously, this timeline had not been provided for, an omission which led to uncertainty and which led to the Commissioner delaying or failing to serve their documents on the appellant taxpayers.

In addition to the above, the TAT Act has been amended to allow the Tribunal to consider an application for extention of time within which the Commissioner should submit and serve his statement of facts and other documents. This will allow the Commissioner to have the same chance as that given to the taxpayers by the Act for seeking for an extension of time to comply with the timelines where delay is inordinate or due to a reasonable cause.

c. Incentives Applicable to Special Economic Zones Licensed entities

The Special Economic Zones Act ("SEZ Act") has been amended by deleting provisions which provided for a blanket exemption to licensed SEZ operators, enterprises and developers from all taxes and duties payable under VAT Act, Income Tax Act, East African Community Customs Management Act and Excise Duty Act. This provision was in conflict with the Finance Act 2015 which provided for limited tax incentives in various tax statutes. This amendment has resolved the conflict by providing that licenced SEZ operators, developers and operators will only be granted tax incentives as specified in the respective tax laws.

Convention and conference facilities have been included as part of the single sector or multiple sectors special economic zones. Thus convention and conference facilities can be designated as a SEZ zone.

d. **Regulation of Online Forex Brokers**

The Act has introduced provisions aimed at bringing online trade in forex under the radar of the Capital Markets Act. This is expected to foster compliance in the sector and also ensure that the sector is well regulated.

e. **SACCOS now required to share credit information**

Institutions licensed under the Sacco Societies Act have been added on the to the list of institutions required to exchange information on non-performing loans.

d. **Penalty for failure to comply with Central Bank directions**

The penalty payable by institutions and persons who fail to comply with directions of the Central Bank under the Banking Act or the Prudential Guidelines. The penalties now stand at 20 million shillings for institutions and credit reference bureaus, 1 million shillings for natural persons and 100,000 shillings in each case for each day or part thereof that the non-compliance continues.

e. **Introduction of a commodities market**

The Finance Act has amended the Capital Markets Act by enacting new provisions whose effects is to introduce a commodities market. The market will be regulated by the CMA and it is intended to modernize the sale of commodities such as coffee, tea and sugar in the commodities exchange which has also been introduced by amendments.