Tax Alert

Draft Income Tax Bill, 2018

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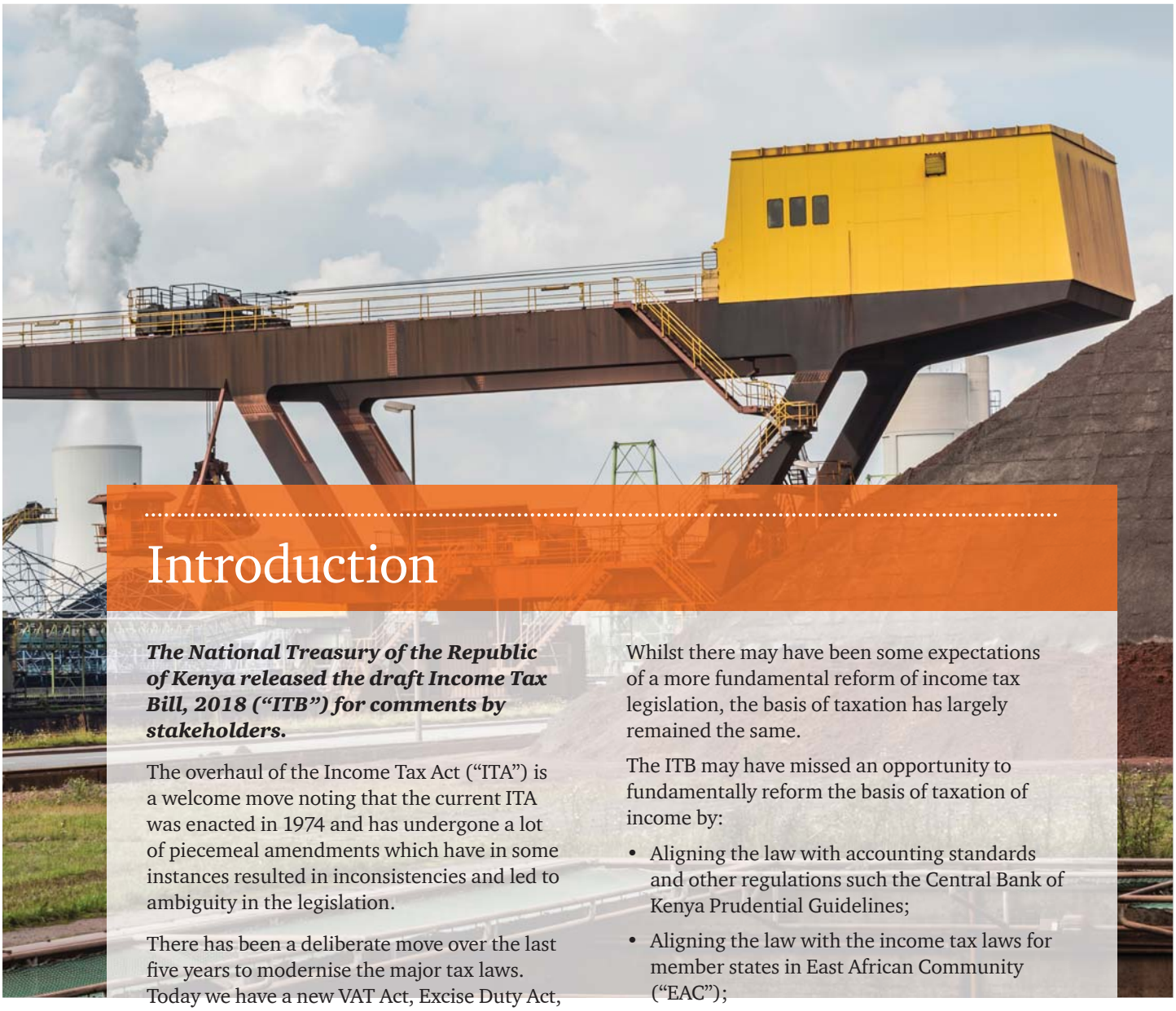

Introduction

The National Treasury of the Republic of Kenya released the draft Income Tax Bill, 2018 ("ITB") for comments by stakeholders.

The overhaul of the Income Tax Act ("ITA") is a welcome move noting that the current ITA was enacted in 1974 and has undergone a lot of piecemeal amendments which have in some instances resulted in inconsistencies and led to ambiguity in the legislation.

There has been a deliberate move over the last five years to modernise the major tax laws. Today we have a new VAT Act, Excise Duty Act, Miscellaneous Levies Act, Tax Procedures Act and the Tax Appeals Tribunal Act. Hence, the overhaul of the ITA was long awaited.

The ITB has achieved the following:

- It has done away with the confusion created by the previous piecemeal amendments and provided greater clarity; and
- It has made the legislation simple and easy to comprehend.

Despite realisation of the above milestones, some stakeholders may contend that the ITB's primary focus appears to be the increase in income tax revenue through:

- the increase of various tax rates and the removal of tax exemptions;
- the tightening of restrictions on expense deductions for the determination of taxable income; and
- the broadening of provisions that deem income derived by a non-resident from Kenya to be taxable in Kenya.

Whilst there may have been some expectations of a more fundamental reform of income tax legislation, the basis of taxation has largely remained the same.

The ITB may have missed an opportunity to fundamentally reform the basis of taxation of income by:

- Aligning the law with accounting standards and other regulations such the Central Bank of Kenya Prudential Guidelines;
- Aligning the law with the income tax laws for member states in East African Community ("EAC");
- Incorporating international best practice from global bodies such as the Organisation for Economic Cooperation and Development (the "OECD") and in particular the implementation of the four minimum standards of the OECD Inclusive Framework on Base Erosion and Profit Shifting ("BEPS"); and
- Realigning the taxation of services and intellectual capital to take into account their key role in a modern Kenyan business environment.

The Invitation by the National Treasury for Stakeholders to give their comments on the ITB is a positive step and it is expected that the final outcome of such consultation will be a tax law that aligns closer to international tax norms and modern day commercial realities that will promote Kenya as a competitive player in the global economy.

We analyse below the key sections of the ITB.

Proposed tax rates

The ITB proposes to increase the rates of taxation, remove certain tax exemptions and increase the restrictions around the deductibility of certain expenses. We have summarised below the main proposals under the ITB.

Item	Current Rate	Proposed Rate	Comments / Impact
Corporate Tax Rate for taxable income over Ksh 500 million	30%	35%	Kenyan resident companies whose taxable income exceeds Ksh 500 million will be subject to an enhanced rate of 35% on the excess above Ksh 500 million. This is a departure from the current trend where most of the OECD member countries are reducing their corporate tax rates to be competitive in the world. According to the Tax Foundation, the average corporate tax rate in Africa is 28.5%, while the global average is 22.5%.
Tax rate for branches / Permanent Establishments	37.5%	30%	The corporate tax rate for branches / permanent establishments is reduced by 7.5% while the deemed repatriation of profits of such branches is now taxable at the rate of 10%. It is not expected that the effective tax rate of branches / permanent establishments will vary significantly.
Repatriated profits by branches / permanent establishments	0%	10%	
Export Processing Zones ("EPZ") enterprises corporate tax rate for the first ten years from the date of first operation	0%	10%	EPZ enterprises will now be subject to a corporate tax rate of 10% (in its first ten years of operations) consistent with the corporate tax rate for Special Economic Zones ("SEZ's").
EPZ enterprises corporate tax rate for the next ten years	20%	15%	The corporate tax rate for EPZ enterprises for the next ten years has been reduced from 20% to 15% to be consistent with that of SEZ enterprises.
Highest individual income tax rate	30%	35%	A higher rate of 35% has been introduced for individuals earning more than Kshs 750,000 per month (Kshs 9 million per annum). The threshold of KES 9 million annual income is low compared to other countries with comparable income levels.
Withholding tax exemptions for dividends	Shareholding of more than 12.5%	Shareholding of more than 25%	Where a Kenyan resident company receives dividends from a company in which its shareholding is 25% or more, such dividends will be exempt from tax. The previous threshold was 12.5%. More companies will now be subject to withholding tax on dividends especially in the insurance sector.
Threshold on the difference between the value in which ordinary shares, debentures or preference shares are issued in comparison with their nominal/market/ redeemable value	5% threshold	No threshold	Any difference between the value in which ordinary shares, debentures or preference shares are issued and their nominal/market/redeemable value will be considered as dividend and therefore subject to withholding tax at the prevailing rates.

Item	Current Rate	Proposed Rate	Comments / Impact
Distribution of dividends from dividends received from subsidiaries and investments	N/A	"Compensating" tax rate of 42.86%	Under the current ITA, a tax credit is given for dividends paid out by a company from dividends received from its subsidiaries and other investments. Under the ITB, such dividends received will now be considered to be untaxed income and any distribution of such dividends may trigger additional tax, though the subsidiary had already paid corporate tax. This section will also in effect tax dividends received from a non-resident entity that were not accrued or derived from Kenya and hence not subject to tax in Kenya. This proposal makes Kenya particularly unsuitable as a holding company location and will materially increase the effective tax rates for companies that hold their subsidiaries through a Kenyan holding company.
Thin capitalization	Ratio of 3:1	Ratio of 2:1	The thin capitalisation ratio has been aligned to the ratio for extractive industries which will result in a higher restriction on the deductibility of interest payments. This change does not align with the current global trend to use fixed profit ratios to determine the permissible level of interest deductibility rather than the use of fixed equity ratios.
Shareholding threshold to determine when a company is considered to control another company	25% shareholding	20% shareholding	The ITB proposes to reduce the threshold level of determining when thin capitalisation would be applicable. This will increase the number of companies that will be subject to interest restrictions under the more restrictive thin capitalisation ratio of 2:1. Further, the new definition of control will bring to the fold of thin capitalisation, companies that would not have been captured by the existing ITA thin capitalisation rules.
Deductions in respect of expenditure on building and machinery, subject to certain conditions	150%	100%	The Investment Deduction allowance of 150% under the ITA has been reduced to 100%. The 150% Investment deduction allowance in the ITA is the key tax incentive available to investments outside Nairobi, Mombasa and Kisumu and its proposed removal does not align with devolution.
Taxation of gains from transfer of property	5%	20%	The ITB increases the capital gains tax rate to 20% and proposes the introduction of an indexation allowance on the acquisition cost which is pegged to the Consumer Price Indices published by the Kenya National Bureau of Statistics. While the effect of the increased tax rate on capital gains may be mitigated by the indexation of the acquisition cost, the proposed changes do somewhat increase the complexity relating to the calculation of capital gains tax.

Item	Current Rate	Proposed Rate	Comments / Impact
Transmission of information by a non resident to Kenya via satellite, internet and other telecom equipment	5% on gross receipts	10% on gross receipts	The ITB proposes to double the gross tax payable by non resident broadcasters. While this section of the Act has historically been in place to tax non-resident businesses that may have little activity in Kenya due to the nature of the business (digital content), such a significant hike in the gross tax rate assumes a level of profitability of the non resident entity that may be disconnected to the actual profitability of such businesses.
Demurrage charges paid to non-residents	No WHT	WHT 20%	Under the ITB, demurrage charges charged by transporters (and in particular non resident shipowners) are now subject to withholding tax at 20%. The Kenya Revenue Authority ("KRA") has previously contended that demurrage charges were subject to withholding tax under unclear provisions of the law. It is now explicitly provided in the ITB that demurrage charges by non resident transporters will be subjected to withholding tax. Difficulties may arise in respect of identifying the person whose obligation it is to withhold due to the operating model of such businesses.
Insurance premium payable to non residents	No WHT	WHT - 5%	The introduction of withholding tax on insurance premiums payable to non resident companies will increase the cost of insuring with non resident companies and it is likely that this cost will simply be passed on the Kenyan customers. While it could spur growth of local insurance companies, there may be some limitations in the capacity of local insurance companies having to cover risks associated with certain sectors such as aviation, marine and extractive industries. The definition of insurance business under the ITB is cross referenced to the definition under the Insurance Act which includes "reinsurance business".
Presumptive tax	3% (Turnover Tax)	15% of single business permit fee	The ITB seeks to replace the turnover tax with presumptive tax to persons who are issued with a single business permit by a County Government. This move is expected to widen and deepen the tax net especially for the informal business sector as the tax payment will be tied to renewal of the Single Business Permit.
Insurance commissions to agents	WHT 10%	WHT 5%	The reduction of the withholding tax payable to resident insurance agents is likely to be welcomed by the insurance industry and may spur penetration of insurance in Kenya.
Service fees charged by oil and gas subcontractors	WHT 5.625%	WHT 10%	The increase in withholding tax rate will affect the sector negatively since the cost will be passed on to the contractors.

Item	Current Rate	Proposed Rate	Comments / Impact
Rent and leases of property by non-residents	WHT 30%	WHT 20%	The reduction of the withholding tax rate will harmonize the withholding tax rate for non-residents.
Commissions paid to non-resident agents in respect of horticultural products exported from Kenya	WHT 0%	WHT 20%	The re-introduction of withholding tax on commissions paid to non-resident agents may not be welcomed by the horticultural industry given that the industry had historically engaged the Government to exempt such commissions from withholding tax. This re-introduction of the withholding tax will still face the same challenges in collection of withholding tax since most agents deduct their commissions upfront and pay the net proceeds to horticultural producers.
Commissions paid by resident air transport operator to a non-resident agent	WHT 0%	WHT 20%	Similar to above, the collection of withholding tax may pose a challenge and also may lead to increase in airline ticket prices in Kenya which may affect competitiveness of local airlines.
Fees paid to a non-resident in respect of rents and leases of rolling stock and locomotives	WHT 0%	WHT 20%	The leasing of rolling stock and locomotives was previously exempt from withholding tax together with leasing of aircraft and aircraft engines. While aircraft and aircraft engines are still exempt, the exemption for rolling stock and locomotives has been dropped.

Capital gains tax

The ITB proposes to increase the capital gains tax ("CGT") rate from 5% (final tax) to 20%. The ITB is silent as to whether CGT is final tax or not.

However, it does provide for indexation allowance which cushions sellers from paying CGT on inflationary increases in prices. The indexation allowance is based on the Consumer Price Indices published by the Kenya National Bureau of Statistics. The ITB proposes to grant CGT exemption for internal business re-organisations that are necessitated by a legal or regulatory requirement or compulsory acquisition by the Government.

It however does not grant any exemption for other internal re-organisations unless approved by the Cabinet Secretary of National Treasury and where such internal re-organisations are in the public interest.

The requirement for approval and the public interest threshold remain a barrier for businesses to carry out internal re-organisations that are not driven by legal or regulatory requirements.

Taxation of dividends

a) Repatriation income tax

The ITB has introduced a new tax for permanent establishments known as repatriated income tax at the rate of 10% (and has also decreased the corporate tax rate for permanent establishments to 30%). It is expected that the effective rate for permanent establishments should not significantly change as a result of these amendments.

b) Deemed dividends

The ITB has expanded the definition of deemed dividends to include ordinary shares, debentures or redeemable preference shares sold to shareholders at a discount. The discount will be subject to withholding tax at the resident or non-resident rate.

The ITB proposes to deem transfer pricing adjustments as dividend distribution and is subjecting such adjustments to withholding tax.

c) Non-distribution of dividends

Similar to the current ITA, the ITB grants the Commissioner of Taxes the powers to deem distributions from retained earnings of a company and to levy withholding tax on such deemed distributions. However, the ITB now prescribes that the Commissioner must deem a minimum of 60% of the accounting profits where the Commissioner opts to deem a distribution. It is unclear why this threshold was introduced particularly given that it is for the taxpayer to demonstrate the extent to which the retained earnings are required for the operations of the business.

d) 'Compensating' tax on dividends

The ITB retains the concept of a 'compensating' tax on dividends that are distributed out of untaxed profits. The ITB appears however to have removed the requirement of maintaining the dividend tax account by a resident company that allows for the calculation of the extent to which distributions arose from untaxed profits. It is probably advisable for taxpayers to continue to maintain a form of the dividend tax account to be able to establish with precision whether distributions arose from untaxed profits.

Under the current ITA, a tax credit is given for dividends paid out by a company from dividends received from its subsidiaries and other investments. Under the ITB, such dividends received may now be considered to be untaxed income and any distribution of such dividends may trigger 'compensating' tax. This additional tax will be payable on the dividends even though such dividends would have been subject to corporate income tax in the originating subsidiary.

Further, this provision will in effect tax dividends received from a non-resident entity where such dividends were not accrued or derived from Kenya and hence not subject to tax in Kenya. This will make Kenya particularly unsuitable as a holding company location and will materially increase the effective tax rates for companies that hold their subsidiaries through a Kenyan holding company.

Taxation of debt

a) *Thin capitalisation*

- The ITB has lowered the thin capitalisation ratio from 3:1 to 2:1. The ratio is now aligned with the Extractive sector. This reduction of the debt to equity ratio will lead to a higher interest expense restriction and result in higher taxes for companies that have debt arrangements with their related parties.
- This change does not appear to align with the current global trend of using fixed profit ratios to determine the permissible level of interest deductibility rather than the use of fixed equity ratios.
- Financial institutions will still not be subject to thin capitalisation rules. We note that entities licensed under the Microfinance Act have now been included under the category of financial institutions and will also not be subject to thin capitalisation rules.

b) *Interest payments to microfinance institutions*

The ITB now has an explicit provision exempting interest payments to microfinance institutions from withholding tax.

c) *Interest on infrastructure loans from non-residents*

Currently, interest payable to non-residents on loans relating to infrastructure projects are exempt from withholding tax. Under the ITB, this exemption will continue for three years after the commencement of the ITB. The exemption will however expire if not renewed by the Cabinet Secretary, Finance.

d) *Deemed interest*

Deemed interest is applicable where the interest charged is lower than the market rate. Under the ITA, the deemed interest rate is prescribed by the commissioner.

The ITB proposes to compute deemed interest as the difference between interest payable at the market rate in the country of the non-resident where the loan was issued from and the interest rate paid by a resident person in respect of any outstanding loan provided or secured by a non-resident.

The proposed change is welcome since non-resident loans are denominated in foreign currency and the interest applicable is lower than the Ksh interest rates.

Loss carry forward period

The ITA provides for a tax loss utilisation period of ten (10) years. At the expiry of the period, the Cabinet Secretary, National Treasury, has powers to extend the tax loss utilization period indefinitely.

The ITB has retained the ten year tax loss utilisation period. It however has limited the powers of the Cabinet Secretary, National Treasury, to extend the tax loss utilization period to a maximum of a further two years.

Given that the ITB does not provide for the 150% investment deduction that has in the past generated significant losses to be carried forward, it is expected that most companies would be able to utilise their tax losses within the period of ten to twelve years.

The ITB now prohibits the carry forward of taxable losses where the ownership of the company changes more than fifty percent or where the business activities of the company change subsequent to the incurring of the taxable loss.

The prohibition of losses may be viewed as an 'anti-avoidance' provision. However, this will penalise genuine acquisitions especially where the acquisition is of a group of companies and the Kenyan company just happens to be one of the few loss making companies in the group.

Income tax exemptions

Similar to the ITA, the ITB provides the Cabinet Secretary, National Treasury the powers to grant tax exemptions where it is in the public interest to do so. In addition, the ITB proposes to reduce the current income tax exemptions listed in Part I of the First Schedule to the ITA from forty eight to twenty two.

One of the key impact is that the ITB has updated the exemptions to take into account recent developments. For instance, the merging of the various Government regulatory bodies into one. We note that most of the exemptions listed under Part II of the First Schedule to the ITA relate to specific loans which may be have since been settled and therefore omitted from the ITB.

Notable exemptions that have been dropped under the ITB include:

i) Income tax exemptions granted under any other Acts such as government bodies exempted under Public Finance Management Act;

ii) Dividends received by a registered venture capital company, SEZ enterprises, developers and operators licensed under the SEZ Act which will now attract 5% withholding tax;

iii) The income of investment bankers and stock brokers arising from trading in shares listed at the Nairobi Securities Exchange will now be subject to corporate tax. This may have a negative impact on the growth of the capital markets in Kenya;

iv) The income of a registered home ownership savings plan. This move is contrary to the Big 4 Agenda on affordable housing and also the recent proposed amendments contained in the Tax Amendment Bill, 2018 which sought to increase the tax deduction from Kshs. 4,000 per month to Kshs. 8,000 per month; and

v) The income of Export-Import Bank of the United States of America.

According to the ITB transitional provision, the exemptions deleted by the ITB will continue to be valid for a period not exceeding three years.

Tax incentives for listing at the Nairobi Securities Exchange (NSE)

The ITB has reduced tax incentives available to companies listing their shares at the NSE.

The table below summarises the proposed changes in the corporate tax rate for companies newly listed on the NSE.

Percentage of shares listed	Corporate tax rate under the ITA	Proposed corporate tax rate under the ITB
20%	27% for 3 years	30%
30%	25% for 5 years	30%
≥ 40%	20% for 5 years	25% for 5 years

Taxation of management or professional fees

The ITB has broadened the definition of management or professional fees to include payments incidental to the provision of such services.

Withholding tax will now be applicable on incidental costs relating to management or professional fees. This has been a grey area and the subject of a number of withholding tax disputes.

Withholding tax on professional and management fees paid to non- residents by power producers

Currently, management and professional fees paid by power producers to non-residents are exempt from tax. Under the ITB, this exemption will continue for three years after the commencement of the ITB.

Capital allowances

The highest capital allowance under the ITB is 100% as compared to the ITA which provides for 150% investment allowance for investment of more than KES 200 million outside the cities of Nairobi, Kisumu and Mombasa.

The other changes proposed in the ITB in respect of capital allowances are as shown in the table below.

Capital expenditure incurred on	Capital allowances under the ITA	Capital allowances under the ITB
Commercial buildings	25% per annum on straight line	10% per annum on straight line
Petroleum gas storage	150% in the first year of use	60% in the first year of use, 25% per annum in subsequent years
Hotel building	100% in the first year of use	60% in the first year of use, 25% per annum in subsequent years
Hospital building	-	100% in the first year of use
Educational buildings	50% per annum on straight line	10% per annum
Ships and aircraft	Purchase of new ship of 125 tons gross- 100% in the first year of use. Other ships- 12.5% per annum on reducing balance Aircraft-25% per annum on reducing balance	60% in the first year of use, 50% in subsequent years on straight line
Telecommunication equipment	20% per annum on straight line	10% per annum on straight line
Filming equipment	100% in the first year of use	50% per annum on straight line
Motor vehicle and earth moving equipment	Heavy earth moving equipment- 37.5% on reducing balance Other motor vehicles- 25% on reducing balance	25% per annum on straight line
Computer and peripheral computer hardware, calculators, copiers and duplicating machines.	30% per annum on reducing balance	25% per annum on straight line
Software	20% per annum on straight line	25% per annum on straight line
Furniture and fittings, pipeline and other machinery	12.5% per annum on reducing balance	10% per annum on straight line
Purchase or acquisition of an indefeasible right to use fibre optic cable by telecommunication operator.	5% per annum on straight line	10% per annum on straight line
Farm works	100%	100%
Rental residential building constructed in a planned development area approved by Cabinet Secretary	25% per annum on straight line	–
Pipeline	12.5% on reducing balance	10% per annum on straight line

Related party transactions

- The ITB has expanded the transactions that are required to be dealt with at arm's length under the transfer pricing provisions to include:
  - Transactions between a resident taxpayers and non-resident entities located in preferential tax regime even though such non-resident entities are not related parties; and
  - Transactions between a resident entity and non-resident entity (not necessarily a related party) where the non-resident person or the transactions lacks economic substance.

  This represents a significant expansion of the arm's length principle to include entities that are independent parties and by definition transactions with such entities would be considered to be arm's length. Given that the ITB requires a taxpayer to use data of transactions with independent persons to support the arm's length nature of the transaction, it is unclear how this provisions would be applied as the transaction in question would be one with independent persons.

  Most affected by these provisions will be any transaction entered into by a Kenyan company with companies located in Mauritius (most likely to be considered a preferential tax regime) which is a popular holding company location for companies investing into Kenya and the rest of Africa.

  Although it is understood that these provisions are in the nature of "anti-avoidance" provisions to capture situations where the KRA is unable to provide evidence that the independent company is under the control of the Kenyan resident entity, the scope of these provisions is extremely broad and will result in significant compliance requirements for Kenyan resident companies dealing with offshore companies.

- Under the ITB, Kenyan resident companies transacting with associated companies would be required to have contemporaneous transfer pricing documentation for each financial year. The ordinary understanding of the term "contemporaneous" means that transfer pricing documentation would be required to be in place at the time of entering into the transaction.

  Failure to disclose the documentation will be punishable by a penalty equal to 2% of the transaction value.

  Given the significant penalty arising from the lack of transfer pricing documentation, there is need for clarity on the specific time the documentation should be in place e.g at the time of filing the income tax return.

- The Commissioner has been granted powers to request for information on foreign entities where they have been selected as the "tested entity". It is noted however, that resident companies may have limited powers to compel their related non-resident entities to provide such information and this section may have the unintended consequence of taxpayers selecting the local resident entity as the "tested entity".

- The ITB states that the price for commodity transactions shall be determined by reference to exchange market prices, government set prices or other indices for unrelated parties. It however provides that in relation to export of commodities the ultimate price shall be determined by reference to contract prices between the group and the ultimate purchaser.

  The ITB does not provide any definition of what constitutes a "commodity". Even where it is assumed that the category of goods that fall under the definition of "commodity" may be non- contentious, the pricing of imports of commodities into Kenya in a different manner to exports of commodities from Kenya, is in itself non-compliant with the arm's length principle. The basis of pricing of a similar commodity cannot be determined by the destination of the commodity.

- The ITB recognises the interquartile range as the arm's length range and that the median shall be used as the reference point. While this has generally been the case in practice, this clarity is welcomed even though it contradicts the OECD Transfer Pricing Guidelines that provides the taxpayer the discretion to justify where in the range it should fall.

- The ITB proposes to deem transfer pricing adjustments as dividend distribution and is subjecting such adjustments to withholding tax.

Double tax agreements provisions

The ITB has further increased the restrictions of the application of double tax agreements in Kenya through a further enhancement of the 'Limitation of Benefits' (LoB) provisions to include the requirements that the company in the counterparty country cannot be either a holding company, an administration company or a financing company.

The impact of the above amendment is to make Kenya's double tax treaty network even more inaccessible and render Kenya's double tax treaties practically redundant.

Taxation of the financial sector

a) *Insurance sector*

The ITB proposes to introduce withholding tax at the rate of 5% on gross premiums paid to non-resident insurance companies. The change could be aimed at promoting local insurance companies.

Further, the ITB proposes to limit negative transfers in case of a deficit in a life fund to five years. The five year cap is a departure from the current ITA which is open ended. The limitation of five years will be punitive to the life insurance businesses.

The ITB has now clarified that gains arising from transfer of property under the general insurance business will be taxed as capital gains.

b) *Banking sector*

The ITB has no specific changes relating to the banking sector. One of the key issues that the sector hoped would be addressed is the provisioning for bad and doubtful debts.

Currently, the sector has to comply with International Financial Reporting Standard No. 9, Central Bank Prudential Guidelines and the Commissioner's Tax Guidelines.

This has resulted in significant complexity which the sector had hoped would be addressed in the ITB.

Taxation of extractive sector

The ITB introduces a number of changes to the taxation of the extractive sector. We will issue a detailed alert on these changes.

Taxation of employees

The definition of employer now clearly includes the concept of an 'economic employer' who bears/ books the costs of employment.

Under the ITB "permanent home" means a place where a person lives in or is available to him for purposes of residing while in Kenya or the place where personal and economic interests are closest. The long overdue definition of a permanent home will enable individuals (especially Kenyans in the diaspora) to determine their Kenyan tax residency status.

a) *Per diems*

The removal of the KES 2,000 per day cap is a welcome move since it was a very low limit considering the prevailing inflation rates and economic situation. The tax-free per diem threshold is now in line with the public service prescribed rates – a relief for all those in the public sector.

b) *Non cash benefits*

All non-cash benefits provided to an employee by the employer will be subject to tax regardless of the amount paid. This is a retrogressive move and will increase employer's administrative costs of monitoring benefits provided to employees even where the value of the non-cash benefits is low.

c) *Taxation of termination compensation*

The ITB proposes that an amount received as compensation for the termination of a contract of employment or service, whether or not provision is made in the contract for the payment of that compensation, shall be deemed to have accrued evenly over the unexpired period of the contract.

The ITB has simplified the taxation of termination compensation. However, it is not clear what happens when the unexpired period of the contract is open ended such as a permanent employment contract. It may be worthwhile to consider providing a cap to the accrual period e.g. 3 years or 5 years.

d) *Employee share options*

The tax point for taxation of employee share options has moved to the point of exercise i.e. when the employee realizes the cash with which he/she can use to pay the tax payable. Previously, the benefit was taxable on vesting even though no monetary benefit may have accrued to the employee at this point. It is noted that "exercise" for purposes of share options has not been defined and it may be worthwhile to consider inserting a definition for this concept. Unfortunately, the ITB still does not provide any guidance on taxation of unregistered share options schemes.

e) *Leave passages*

The tax free home leave passages for expatriates is now open to all non-citizens. Accordingly, there is no longer a requirement for the expatriate to have come to Kenya solely to serve that employer.

f) *Pension earned in EAC states*

Pension earned in respect of employment services offered in other EAC states will not be deemed to be pension accrued or derived from Kenya and therefore will not be taxable in Kenya.

g) *Medical benefits*

All medical benefits paid by the employer on behalf of a full-time employee or his beneficiaries are now tax exempt regardless of whether the insurance provider is approved by the Commissioner of Insurance in Kenya or not. This is particularly relevant for multinationals in Kenya whose expatriate employees may have medical cover provided by a foreign insurer.

The age limit for tax free medical services provided to an employee's children (by the parent's employer) has been increased from twenty-one to twenty-four. This ensures children are covered up to when they complete tertiary education.

h) *Meal benefits*

The Commissioner no longer has power to specify conditions on the tax-free meal benefit. The requirement to have a canteen or cafeteria has also been removed.

Government and public institutions to account for taxes

The ITB now explicitly provides that Government and public institutions have an obligation to account for withholding taxes and employee taxes.

Transitional provisions

Any tax exemptions granted under the ITA will be applicable for three years from the commencement of the ITB. There are various categories that may be considered to constitute exemptions including:

- Exemptions provided under a legal notice by the Treasury CS such as withholding tax on interest payable on loans provided for infrastructure.
- Exemptions provided under the ITA and which the ITB explicitly states will continue indefinitely for those entities granted such exemptions under the ITA. This particularly relates to the EPZ enterprises where the ITB expressly states that such enterprises licensed prior to the enactment of the ITB will continue to enjoy the tax exemptions for the periods specified under the ITA.

Further clarity will be required as to which of the above categories will constitute an exemption.

Consistent with the Interpretation and General Provisions Act, the ITB provides that subsidiary legislation under the ITA such as the Income Tax (Leasing) Rules and the Guidelines on the allowability of bad debts will continue to be applicable to the ITB if not replaced by similar rules.

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