Tax Alert
The Finance Act 2015

The Finance Act, 2015 was assented into law on 11 September 2015 ("the Finance Act"). The Act has introduced some new provisions that were not contained in the Finance Bill, 2015 ("the Finance Bill"), provided clarification on some issues that were potentially confusing as contained in the Finance Bill and dropped some proposals that are considered harmful to the economy and businesses.

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In this Tax Alert, we provide a comparative analysis of the changes between the Finance Bill and Finance Act and provide insights on how the changes could impact your business.

Income tax

Capital gains on sale of listed securities

Due to operational challenges in accounting for tax on capital gains tax on sale of listed securities following the re-introduction of capital gains from 1 January 2015, the Finance Bill had introduced changes requiring stockbrokers to account for a levy/withholding tax of 0.3% on the transaction value of listed securities.

The Finance Act scrapped the proposed levy/withholding tax of 0.3% and there will be no tax on gains from sale of listed securities. However, the Finance Act still retained some of the changes on the withholding tax/levy on sale of listed shares which however become superfluous.

Investment deduction allowance of 150% retained

The Finance Bill had proposed to abolish the 150% investment deduction allowance granted for investments of KES 200million or more outside the cities of Nairobi, Mombasa and Kisumu.

The Finance Act has retained the 150% investment deduction allowance and this will continue being an incentive for businesses to invest outside the main Kenyan cities and promote development, urbanization and industrialization in the Counties.

Carry forward of tax losses

The Finance Act has now clarified that tax losses may be carried forward for the next nine succeeding years of income from the year the tax losses arise. The tax losses may be extended beyond ten years upon application to the Treasury Cabinet Secretary.

This a welcome move because the earlier limitation period of five years was extremely short for companies engaged in capital intensive projects especially in infrastructure, energy and manufacturing businesses. However, it is noted that for tax losses that were incurred in 2010 and prior years, an application to the Treasury Cabinet Secretary for the carry forward of the tax losses would still be required.

Tax on residential rental income

The Finance Bill proposed to introduce a simplified tax on residential rental income for resident persons with rental income of KES 10m or less. Persons eligible for this could still elect to continue being subject to tax under the general tax provisions.

To give effect to the proposal simplified tax on residential rental income, the Finance Act has provided for a rate of 10% of the gross rental receipts.

Withholding tax on consideration for use of immovable property

The Finance Bill proposed to introduce withholding tax on consideration for use of immovable property by persons paying the consideration or agents appointed by the

Commissioner. However, no rate was prescribed.

The Finance Act has deleted the provision enabling the application of WHT and appointment of agents but has at the same time introduced WHT at a rate of 12%. This should also have been deleted if the intention was to remove the WHT provisions.

Tax amnesty on rental income extended to enterprises

The Finance Bill proposed to grant 100% tax amnesty on principal taxes, penalties and interest in respect of rental income for the year 2013 and earlier and 100% amnesty on penalty and interest for the years 2014 and 2015. This amnesty was restricted to individuals. The Finance Act has extended the same amnesty to enterprises including companies.

The Finance Bill had proposed to allow a deduction of 40% of expenses relating to rental income where a person seeking to benefit from the amnesty does not have supporting documentation. The Finance Act has changed this proposal and provided that in determining the taxable rental income, a person seeking to benefit from the amnesty on rental income will be allowed a deduction of 40% of the gross rent as opposed to 40% of the expenses. The proposal in the Finance Bill would have encouraged fictitious and non-existent expenditure to the extent of wiping out taxable income especially for the 2014 and 2015 year of income where principal tax has not been waived. The changes introduced by the Finance Act mitigate this.

Incentives for businesses operating in Special Economic Zones ("SEZ")

The Special Economic Zones Act, 2015 ("SEZ Act") was assented into law on the same date with the Finance Act.

The SEZ Act contains a general tax exemption for all licensed SEZ enterprises, developers and operators on all taxes and duties payable under the Excise Duty Act, Income Tax Act, East African Community Customs Management Act and the Value Added Tax Act on all SEZ transactions.

The Finance Act has amended the Income Tax Act and the VAT Act, 2013 and introduced tax incentives for SEZ. The tax incentives for SEZ enterprises, developers and operators introduced by

the Finance Act are as follows:

- The supply of taxable goods and services to SEZ enterprises, developers and operators licensed under the SEZ Act are exempt from VAT;
- SEZ enterprises, developers and operators will be subject to a reduced corporate tax rate of 10% for the first 10 years of operation and 15% for the next 10 years; and
- The applicable WHT rate for payments for services and interest to non-residents (other than payments for dividends) by SEZ enterprises, developer and operators shall be 10%.

The limited tax incentives introduced by the Finance Act seem to be inconsistent with the SEZ Act which grants a blanket exemption on all taxes. The Income Tax Act provides that tax exemptions provided in other acts of parliament are legally valid. This conflict will need to be resolved prior to licenses being issued under the SEZ Act.

Tax incentive for companies listing on the securities exchange by introduction

The Finance Bill introduced a reduced tax rate of 25% for companies listing on a securities exchange by way of introduction. The Finance Bill was silent on the duration of the reduced rate.

The Finance Act has clarified that the reduced tax will be for a period of five years following the date of such listing.

Wear and tear allowance on petroleum pipeline

The Finance Act 2014 had introduced a wear and tear allowance for petroleum pipeline. However, the changes were not properly implemented due to typographical errors. As a result, it appeared as if the wear and tear allowance for petroleum pipeline should be 37.5%.

The Finance Act 2015 has corrected the typographical errors and clarified that the applicable wear and tear rate for petroleum pipeline should be 12.5% as opposed to 37.5%. The Finance Bill 2015 had not rectified the errors.

Withholding tax on bookmakers

The Finance Act introduces a definition of winning in respect of betting and gaming that restricts the withholding tax provisions to payments by bookmakers to punters (players).

Whilst the intentions of the changes introduced by the Finance Act are understood, the changes regarding the applicable withholding tax rates and the persons to whom the withholding tax rates are applicable are less clear.

It appears that payments by bookmakers to non-resident players will not be subject to withholding tax whilst the winnings of non-resident bookmakers will be subject to withholding tax at 7.5% of gross profits. The use of terms winnings in the context of a bookmaker are contradictory to the definition of winnings provided in the Finance Act and it is unclear how withholding tax on the gross profit of a non-resident book maker will be determined and enforced.

Payments by bookmakers to resident players will be subject to 20% withholding tax whilst the winnings the winnings of resident bookmakers will be subject to withholding tax at 7.5% of gross profits. Similarly, the use of terms winnings in the context of a bookmaker are contradictory to the definition of winnings provided in the Finance Act and again it is unclear as to the purpose of a withholding tax on gross profits of a resident bookmaker who is subject to Kenya income tax.

Valued Added Tax

The Finance Act, 2015 has retained all the changes proposed in the Finance Bill, 2015 but also includes several amendments not included in the Finance Bill, 2015. As general observation, the Finance Act, 2015 has kept with the National Treasury's recent trend of VAT exemptions being preferred over zero-rating as the means to VAT reprieve for deserving products/sectors.

The above said, we reiterate our view that VAT exemptions do not necessarily translate to the desired cost savings for the end consumers of the affected goods and services; VAT exemptions have a distortive effect on the supply chain and result in non-recoverable VAT for the suppliers as opposed to VAT being borne by the end users. The 'sticking' VAT is ultimately passed on to the consumers in the form of increased prices.

Broadening the definition of "money"

The Finance Act has expanded the definition of money to include any amount paid through an 'electronic payment system'. This change provides further clarity on what constitutes 'consideration' in the determination to the taxable value for VAT purposes.

Clarity on Withholding VAT and revocation of already appointed agent

The Finance Act has now clarified that the tax base for the calculation of withholding VAT is 6% of the taxable value as opposed to 6% of the tax payable. The change is aimed at removing ambiguity in the implementation of withholding VAT obligations.

Additionally, the Finance Act has empowered the Commissioner for Domestic Taxes to appoint any 'other person' apart from government ministries, departments and agencies as a withholding VAT agent. This amendment will expand the withholding VAT net to persons who were not previously within scope and we have already witnessed several such appointments by the Commissioner. Similarly, the Commissioner has been granted discretionary powers to revoke the appointment of any withholding VAT agent. This is welcome amendment as it will allow for the exclusion from withholding VAT agents who face implementation challenges owing to factors such as complexity of business systems.

Exemption of plastic bag biogas digesters, biogas and leasing of biogas producing equipment

While the Finance Bill 2015 only proposed to exempt from VAT plastic bag biogas digesters, the Finance Act has expanded the VAT exemption scope to include biogas and the leasing of biogas producing equipment. The change will encourage the use of clean and affordable biogas energy system for cooking and lighting for rural households.

Exemption of inputs or raw materials for use in manufacture of agricultural machinery and implements

The Finance Act has, subject to approval by the Cabinet Secretary responsible for Industrialization, exempted from VAT the inputs or raw materials locally produced or imported by manufacturers of agricultural machinery and implements. This amendment will hopefully encourage the set-up of industries for the manufacture of agricultural machinery and implements.

Exemption of supply of sewerage services

The Finance Act has exempted from VAT the supply of sewerage services by the national government, a county government, any political subdivision thereof or a person approved by the Cabinet Secretary responsible for water development. This is a welcome move as it will encourage the development of sewerage infrastructure and lower the cost of sewerage related services which will improve on the waste disposal initiatives meant to preserve the environment.

Exemption of taxable supplies to film industry

While the Finance Bill proposed to exempt from VAT goods and services acquired by the Kenya Film Commission, the Finance Act has amended this proposal by replacing Kenya Film Commission with local film producers and local film agents. This amendment will retain the initial intention of providing incentives to the film industry to spur its growth. This is a welcome amendments as it focuses the VAT exemption on the actual taxpayers in the film industry as opposed to their umbrella organization, the Kenya Film Commission.

Exemption of taxable supplies to Special Economic Zone (SEZ) enterprises

The Finance Act exempts from VAT any taxable goods and services supplied to the SEZs entities, developers and operators licensed under the Special Economic Zones Act. This is amendment was not included in the Finance Bill 2015, which meant the VAT exemptions envisaged in the SEZ Bill did not have force of law. The amendment now ensures a harmonized position in both the VAT and the SEZ legislation. It is hoped that the certainty around tax exemption will encourage the set-up of industries in the specially designated zones which will in turn spur economic growth.

Zero rating of inputs or raw materials for manufacture of medicaments

Inputs or raw materials for manufacture of medicaments were VAT exempt under the current VAT Act.

The Finance Act has zero-rated raw materials (either produced locally or imported) supplied to pharmaceutical manufacturers in Kenya for the manufacture of medicaments as approved by the Cabinet Secretary for the National Treasury in consultation with the Cabinet Secretary responsible for matters relating to Health. The shift from exemption to zero rating will help reduce the cost of the medications.

Zero rating of medicaments

Medicaments which were previously exempted have now been zero-rated under the Finance Act.

Some of medicaments that now enjoy the zero-rated status include vaccines for human medicine, vaccines for veterinary medicine, medicaments containing hormones, alkaloids, penicillin and other antibiotics, vitamins and medicaments for therapeutic or prophylactic use among others.

The shift from exemption to zero-rating will help reduce the cost of the medications.

Customs and Excise Duty

The Finance Act did not make any amendments in the existing Customs and Excise Act, the excise duty changes are expected to come through the Excise Duty Act, 2015 currently awaiting President assent while the Customs duty changes were already effected through the East African Community (EAC) Gazette dated 19 June 2015 issued by the EAC Secretariat in Arusha, Tanzania.

Other Sectoral Reforms

The minister's proposal to increase minimum core capital for banks and mortgage finance companies has been excluded from the act. This is in line with CBK's view that a risk-based approach should be applied when determining capital requirements for these institutions on an ongoing basis.

Other sectoral reforms highlighted in the PwC Budget Bulletin following the budget reading were retained in the Finance Act *(see previous PwC Budget Bulletin)*.

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