

Tax Alert

Finance Act, 2016

The Finance Act, 2016 (“the Finance Act”) was assented into law on 13 September 2016. The Act has introduced some new provisions that were not contained in the Finance Bill, 2016 (“the Finance Bill”) and provided clarification on some issues that were potentially confusing as contained in the Finance Bill.

This alert provides a summary of the key provisions and effective dates. The alert also contains changes relating to the Miscellaneous Fees and Levies Act, 2016.

The alert is structured according to the tax heads and sectors affected and provides an insight on how the changes introduced could impact your business.

Income tax measures

Gaming Industry

From 1 January, 2017, winnings payable by bookmakers (both resident and non-resident) to punters (players) will no longer be subject to withholding tax.

The legislation that required winnings to be subject to withholding tax was impractical given it was unclear how non-resident and resident bookmakers would be required to comply with the provisions. It is however unclear whether bookmakers will be required to demonstrate compliance with the provisions prior to 1 January 2017.



Notwithstanding the above, the Betting, Lotteries and Gaming Act has introduced new taxes in this sector. The new taxes were initially proposed by the Betting, Lotteries and Gaming (Amendment) Bill 2015. These are:

| Tax type | Rate/Tax base | Due date |
|-----------------------|-----------------------------|--|
| *Betting tax | 7.5% of the gaming revenue | 20th day following the month of collection |
| Lottery tax | 5% of lottery turn-over | 20th day following the month of collection |
| Gaming tax | 12% of the gaming revenue | 20th day following the month of collection |
| Prize competition tax | 15% of total gross turnover | 20th day following the month of collection |

Sports sponsorship

Expenditure incurred by a person sponsoring sports, with the prior approval of the Cabinet Secretary responsible for sports will be tax deductible. It is unclear whether this provision should be interpreted as simply introducing

a new requirement to obtain approval for tax deduction for sports sponsorship from the Cabinet Secretary sports as previously there was no bar in the Income Tax Act prohibiting companies from deducting such costs as long as they could demonstrate that they were incurred

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**It appears that there is a drafting error in the definition of the tax base for betting tax. Ideally, betting tax should be based on betting revenue and not gaming revenue. We expect this error to be rectified in future tax legislation amendments.*

for the production of income. *Effective 1 January, 2017.*

Real Estate Sector

Reduced corporation tax rate

Where a company constructs at least four hundred residential units annually, the corporation tax rate shall be reduced from 30% to 15% for that year of income i.e. the taxable profit in that year would be subject to tax at 15%. This will be subject to approval by the Cabinet Secretary responsible for housing. Where a company is engaged in multiple activities, the rate of 15% shall be applied proportionately to the extent of the turnover arising from the housing activity. It is however unclear in which year of income the 15% corporate tax would be applicable, as the life cycle of selling residential unit would be spread over a number of years. *Effective from 1 January 2017.*

Though the Finance Bill, had proposed a similar change, the threshold for the number of residential units a company has to construct has been reduced from one thousand to four hundred and the tax rate has also been reduced from the proposed 20% in the Finance Bill, to 15%.

Withholding tax

Increased penalty rate

Section 35 (6) of the Income Tax Act has now been deleted. The withholding tax rules legislated pursuant to section 35 (6) contained in the Income Tax Act impose a 10% penalty where a person fails to withhold tax. This rule has however not been deleted.

It appears that the intention of the amendment is to harmonize the imposition of penalties which are now contained in the Tax Procedures Act. It could be argued that as from 9 June 2016, the applicable penalty for failure to withhold tax is now the tax shortfall penalty provided for under the Tax Procedures Act of 20% and not the 10% under the withholding tax rules. However, the lack of clarity in the legislative drafting gives rise to uncertainty amongst tax payers.

Withholding tax on rental income

Payments made in respect of rent, premium or occupation of immovable property to persons who are resident or who have a permanent establishment in



Kenya shall be subject to withholding tax at a rate of 10% subject to appointment in writing by the Commissioner. *Effective 1 January, 2017.*

Low rental earnings exempt from tax

Any rental income below KES 144,000 per annum is now exempt from residential income tax. *Effective 9 June, 2016.*

Exempt interest income

From 9 June, 2016, interest income from bonds issued by the East African Development Bank shall be exempt from income tax.

Human Resources

Expanded tax bands and personal relief for all employees

Effective 1 January 2017, annual tax bands shall be expanded by 10% and personal relief increased from the current KES 13,944 per annum (KES 1,162 per month) to KES 15,360 per annum (KES 1,280 per month). The revised rates of tax shall be as follows;

| Annual Bands of taxable Income (KES) | Tax Rate (%) |
|--------------------------------------|--------------|
| 0 - 134,164 | 10% |
| On the next 126,403 | 15% |
| On the next 126,403 | 20% |
| On the next 126,403 | 25% |
| Over 513,373 | 30% |

Relief for low income employees

From 1 July 2016, bonuses, overtime and retirement benefits paid to employees whose earnings do not exceed KES 121,968 per annum (or KES 11,164 per month) are tax free. The tax free based amount would be on the employment income before the bonus and overtime allowances.

Mortgage interest deduction increased to KES 300,000 per annum

Under the current Income Tax Act, an individual is entitled to claim a deduction of up to KES 150,000 per annum against his/her taxable income for interest on mortgage for the house he occupies. The mortgage/house loan should be from a qualifying financial institution.

With effect from 1 January 2017, the qualifying mortgage interest deduction has been increased to KES 300,000 per annum (or KES 25,000 per month).

Clarification on definition of "tax returns" under Tax Procedures Act

For the avoidance of doubt and in order to enforce compliance, the Finance Act 2016 has clarified that the definition of a "tax return" under the Income Tax Act includes the monthly employer PAYE returns (P10 return).

The PAYE monthly return is required to be submitted online via iTax by 9th of the month following the payroll month.

Failure to submit the return by the due date attracts a penalty of 25% of the tax due or ten thousand shillings whichever is higher.

Value Added Tax (VAT) measures

Infrastructure Sector

Official Aid Funded projects

From 9 June, 2016, motor vehicles purchased or imported for the direct and exclusive use in Official Aid Funded Projects are exempt from VAT. Before this change, only other taxable supplies for such projects were exempt from VAT while motor vehicles were taxed at the standard rate of 16%.

Industrial Parks

From 9 June 2016, the VAT Act provides for exemption in relation to goods purchased or imported and exclusively used in the construction of industrial parks of one hundred acres or more. The exemption was previously only granted to parks in special economic zones but has now been extended to cover parks outside special economic zones.

Agriculture Sector

Raw materials for animal feeds exempt from VAT

The Finance Act has broadened the VAT exemption in relation to raw materials used in the manufacture of animal feeds. The exemption is aimed at making animal feeds affordable to farmers and to attract investment from potential animal feeds manufacturers. *Effective from 9 June 2016.*

Wheat seeds exempt from VAT

The VAT exemption is consistent with the exemption of other seeds e.g. sunflower, cotton and safflower seeds. *Effective from 9 June 2016.*

Tourism, Hospitality and Entertainment Industry

Tourism

Museum equipment exempted

From 9 June, 2016, chemicals, reagents, films, film strips and visual aid equipment imported or purchased prior to clearance through customs by the National Museums of Kenya are exempt from VAT in line with exemptions provided under East African Community Customs Management Act.

From 9 June, 2016, specimens and scientific equipment for public museums and exhibits of museum and natural history are exempt from VAT.

Park entry fees exempted

Entry fees into the national parks and national reserves will now be exempt from VAT with the view to reducing the cost of entry to the parks and consequently boost tourism. *Effective from 9 June 2016.*

Tour operator fees exempted

From 9 June, 2016, services offered by tour operators are exempt from VAT with a view to promoting tourism and creating employment opportunities for youth.

Hospitality industry

Hotel defined

The definition of a “hotel” provided in the VAT legislation has now been introduced to include service flats, service apartments, beach cottages, holiday cottages, game lodges, safari camps, bandas, holiday villas and other similar establishments. The definition, however, excludes educational, training and

medical institutions as well as premises on which the only supply is under a lease or license of not less than one month.

This definition broadens the hotel definition to include other establishments that offer similar services thus expanding the VAT net as supplies by these establishments will no longer be exempt from VAT. *Effective from 1 July 2016.*

Service charge not Vatable

From 1 January, 2017, service charge paid in lieu of tips shall be excluded from the ambit of VAT, subject to set conditions. This implies that service charge will not form part of taxable value for accommodation and restaurant services and hence a good relief to hotel employees who are the beneficiaries of services charge.

Entertainment industry

Film equipment

In addition to obtaining VAT exemption approval from the Cabinet Secretary to the National Treasury, local film producers and local filming agents are now required to seek recommendation from the Kenya Film Commission in order to qualify for VAT exemption in relation to imports or local purchases for the film industry. *Effective from 9 June 2016.*

Recreational Parks

The Finance Act has introduced a definition of recreational parks in the VAT Act to include an area or a building constructed for the purpose of improvement of general health, wellbeing and development of skills.

Taxable supplies for construction of such parks of fifty acres or more are exempt from VAT subject to recommendation of the Cabinet Secretary responsible for matters relating to recreational parks. In addition, supplies for construction of tourism facilities, convention facilities and conference facilities are exempt from VAT. *Effective from 9 June 2016.*

Energy, Oil and Gas sector

Liquefied Petroleum Gas zero rated

In order to promote the use of clean, modern and environmentally safe energy, Liquefied Petroleum Gas (LPG) has been zero rated for VAT purposes. Effective from 9 June 2016. However, this might cause a bit of confusion, owing to the fact that the Finance Bill had proposed to exempt as opposed to zero-rating LPG from VAT with the same effective date.



Fuel exemption extended

Further, the VAT exempt status of specified petroleum products such as gas oil, which was scheduled to expire in September 2016 has been extended for two more years. This is a welcome move and a relief to motorists. *Effective from 9 June 2016.*

Stoves exempted

Non-electric stoves and similar appliances have been exempted from VAT.

Similarly, goods that are used in the assembly, manufacture or repair of clean cook stoves are exempt from VAT. *Effective from 9 June, 2016.*

Consumer Products

The tissue papers, serviettes, polythene films, and certain types of white paper have been exempted from VAT. *Effective from 9 June, 2016.*

Healthcare sector

Hospitals

From 9 June, 2016, supplies used in construction of specialized hospitals with accommodation facilities are exempt from VAT subject to obtaining recommendation from the Cabinet Secretary responsible for health who shall issue guidelines for the criteria to be used for eligibility for the exemption. This is meant to make the construction of these facilities cheaper.

Medicaments

From 9 June, 2016, medicaments classified under tariff code 3003.20 (medicaments containing other antibiotics) are now zero rated from VAT. This is a welcome move as it seeks to harmonize the VAT status of this type of medicaments with other medicaments.

Security industry

Equipment, machinery including specialised motor vehicles imported or purchased locally for official use by the Kenya Defense Forces, National Police Services and military supplies are now exempt from VAT. *Effective from 9 June 2016.*

Special Economic Zones and Export Processing Zones

Special economic zones

In order to harmonize the zero rating of goods or taxable services supplied to Export Processing Zones (EPZs) and



those supplied to Special Economic Zones (SEZs), the Finance Act has zero-rated goods or taxable services supplied to the Special Economic Zones. *Effective from 9 June 2016.*

From 1 July, 2016, supplies to and from SEZs shall be treated as exports and imports respectively. This means that goods or taxable services supplied by a registered person to a SEZ enterprise, shall be zero-rated for VAT purposes. On the other hand goods or taxable services supplied by Special Economic Zone enterprise to territory outside the SEZ, shall be deemed to be imported into Kenya and therefore chargeable to VAT at the applicable rate.

Garments and leather footwear

Further, garments and leather footwear manufactured in EPZs are exempt from VAT when sold to the local market. *Effective from 9 June 2016.*

Withholding VAT reinstated

The Finance Act has reinstated the Withholding VAT regime that was repealed by the Tax Procedures Act. The effective date for this provision has been back dated to 19 January 2016. This is contrary to the basic legal principles against retrospective application of laws.

In our view, the retrospective application of the withholding VAT regime is bound to cause confusion amongst taxpayers who prior to the present amendment were expected to have complied with non-existent law.

Excise duty measures

We set out below excise duty changes which are all effective from 9 June 2016.

Excise duty inflation adjustment

Section 10 of the Excise Duty Act, 2015 has been amended to correctly make reference to the correct part of the Excise Duty Act which contains the inflationary adjustment formula. The implication of this section is that the excise duty rates on commodities which are charged specific rates of excise duty will automatically increase annually based on the annual inflation rates. This is likely to create a greater burden on tax payers especially in cases of high inflation.

Cosmetics and beauty products

The Act has introduced a 10% excise duty on the cosmetics and beauty products of tariff No.3303, 3304, 3305 and 3307. This move is likely to make cosmetic and beauty products more expensive.

Petroleum Industry

Excise duty on illuminating kerosene

The Act has introduced excise duty on illuminating kerosene at the rate of KES 7,205 per 1000 litres. This change is aimed at discouraging harmful practices such as the use of kerosene in adulteration of other petroleum products.

Automotive industry

Locally assembled motor cycles and school buses

The Finance Act has amended the Excise Duty Act to exclude locally assembled motorcycles and school buses used by public schools from excise duty. This is a welcome move as it helps to support the industries that deal with the local assembly of these motor cycles and school buses.

Exclusion of locally assembled vehicles?

The Finance Act has amended the excise duty rates for motor vehicles from KES 150,000 and KES 200,000 to 20% *ad valorem* rate across board. Further, there is a mention of exclusion of locally assembled vehicles from excise duty.

In our view, the intention was to reintroduce an *ad valorem* rate of 20% for all motor vehicles of tariffs 87.02, 87.03 and 87.04 excluding those assembled locally. However, the law



as presently drafted is open to varied interpretation and the exclusion of locally assembled vehicles from excise duty may be open to challenge.

Soft drinks

Exclusion of non-bottled water from excise duty

The Act has excluded non-bottled water of tariff no. 2201.90.00 from the ambit of excise duty. In our view this is aimed at eliminating the debate on the scope of water chargeable to excise duty. Previously all “waters” were chargeable to excise duty.

Changes to the Second Schedule

The following goods have been exempted from excise duty by this Act:

- Goods imported or purchased locally for direct and exclusive use in the implementation of an official Aid-Funded Project, to extent provided for under the financing agreement;
- Excisable goods imported for direct use in the manufacture of sanitary towels; and
- All goods including materials, equipment, machinery and motor cycles for the official use by the Kenya Defense Forces and the National Police Service.

Alcoholic Drinks Control Act Excise amendment

The Finance Act has repealed Section 68 of the Alcoholic Drinks Controls Act, 2015 taking away the Cabinet Secretary’s [National Treasury] power of implementing tax policies and possible remission of duty on locally manufactured alcoholic drinks. The deletion of this section further removes the 90% excise duty remission provided for beer made from sorghum, millet or cassava grown in Kenya.

Overview on excise changes

These amendments are welcome as they bring clarity in the application of the law. The amendments have also cleaned up previous drafting errors. In addition, the Government has

listened to the plight of taxpayers who were adversely affected by the law; notably local assemblers of motor vehicles and motor cycles among others.

Tax Procedures Act Changes

Waiver of interest re-introduced

From 1 January, 2017, the Commissioner may, subject to certain conditions, upon an application or on his/her own motion and with the approval of the Cabinet Secretary [National Treasury], remit, in whole or in part, any penalty or interest payable by a person.

While the Commissioner previously had powers to waive penalty, this authority did not extend to interest. This amendment remedies the misalignment.

Interest on erroneous refund of tax

Effective 1 January, 2017, where any tax has been refunded in error and a person does not pay the erroneously refunded amount to the Commissioner within 30 days from the date when the erroneous refund is demanded, an interest equal to 1% per month or part thereof of such unpaid amount shall be due and payable.

This change merely clarifies that the interest rate applicable (1%) as the law was previously silent on rate.

Refund of overpaid tax

With effect from 1 January 2017, the Commissioner for Kenya Revenue Authority (“KRA”) is required to respond to taxpayers’ applications for refund within 90 days of receiving the application.

Further, any overpaid tax that KRA does not settle within two years from the date of application for a refund shall attract interest at the rate of 1% per month. While this is a welcome move, perhaps the 2 year period should have been reduced to a shorter period as it is still too long to wait for refunds to be paid.

Response timelines

Effective 1 January, 2017, the Commissioner must respond to the taxpayer's application as follows:

| Section | Provision | Timeline |
|---------|--|----------------|
| 33 | Application for extension of time to pay tax | Within 30 days |
| 42 | Notification by an agent of inability to pay tax on behalf of another taxpayer | Within 30 days |
| 47 | Application for refund of overpaid tax, excluding VAT refunds' | Within 90 days |

- Commissioner's response time after an application for extension of time to pay tax is submitted
- Effective 1 January 2017, KRA will be required to respond to a taxpayer who submits an application for extension of time to pay tax under a tax law within 30 days of receiving the application.

Registration of tax agents

From 1 January, 2017 applications for registration of tax agent licenses will have to be recommended by the Tax Agents Committee prior to grant of approval by Commissioner for KRA.

Duty to submit third party returns

Effective 1 July 2016, the Commissioner can require a person to submit information in a return relating to other persons including third parties. This provision could allow the Commissioner to obtain tax returns of third parties from other persons e.g. tax agents. The scope of this provision is not clear and could pose challenges where such requests breach confidentiality laws.

Appointment of tax representatives by non-residents

From 1 July, 2016, non-residents without a fixed place of business in Kenya can appoint tax representatives to fulfil their tax obligations in Kenya.

Tax amnesty on rental income

Effective 19 January, 2016, a tax amnesty granting waiver of the principal tax, penalties and interest on undeclared

rental income earned by an individual landlord in 2013 and prior years came in to force. In respect to 2014 and 2015, the waiver only extends to the penalty and interest upon payment of the principal tax and tax returns submitted by June 2016.

Tax amnesty on investment income earned outside Kenya

Effective 1 January, 2017, a person who earned taxable income outside Kenya shall be eligible for a tax amnesty, most likely on the principal tax, penalties and interest provided that they submit their returns and accounts for the year of income 2016 by 31 December 2017. The amnesty is however not applicable to persons who have been assessed with respect to taxes relating to the said years or persons under investigation in respect of undisclosed income.

Generally speaking the scope of this tax amnesty is not very clear and perhaps the provisions could have been better drafted.

Tax Appeals Tribunal Act Changes

Effective 1 January, 2017, the Tax Appeals Tribunal Act, 2013, has been amended as follows:

- Upon application, the Tribunal may extend the time for the appellant to file the notice of appeal;
- The Commissioner for KRA is required to serve the appellant/taxpayer with a statement of facts and other

documents within 2 working days of submitting them to the Tribunal; and

- Upon application, the Tribunal may extend the time for the Commissioner to submit and serve the appeal documents, provided there is reasonable cause and the delay.

Other Key Changes

Deletion of the 30% local shareholding requirement

Effective 1 January 2017, section 975 of the Companies act 2015 has been amended by the deletion of subsection 2(b) which required Kenyan branches of foreign incorporated companies to cede 30% of their total shareholding to Kenyan citizens by birth.

Credit Reference Bureaus

Effective 1 January 2017, the banking act has been amended allowing the below listed entities to supply citizen's credit history to Credit Reference Bureaus whose consequence may be the denial of credit facilities access by the institutions.

The institutions are;

- Public utilities institution-KPLC/ Nairobi water and the rest;
- Institutions licensed under the Sacco Societies Act;
- Institutions licensed under the Cooperative Societies Act; and
- Any other institution mandated to share credit history information under any written law.

Miscellaneous Fees and Levies Act, 2016

Introduction

The Miscellaneous Fees and Levies Act, 2016 came into effect on 21 September 2016. Prior to this, the Miscellaneous Fees and Levies Bill had been awaiting enactment since June 2015 when it was first published.

The Act provides the legal framework for charging of Export Duty, Import Declaration Fees (IDF) and Railway Development Levy (RDL). These fees and levies previously resided in the Customs and Excise Act, Cap 472 (C&E Act) alongside the Customs and Excise duty provisions.

The Customs provisions were transferred to the East African Community Customs Management Act, 2004 (EACCMA) while the Excise duty provisions were transferred to the Excise Duty Act, 2015 with effect from 1 December 2015.

The C&E Act was however not repealed because it still hosted these miscellaneous fees and levies.

Accordingly, the C&E Act can now be repealed as all the matters the Act dealt with are now dealt with under other statutes.

However, regulations under the C&E remain in force pending the enactment of new regulations under the various statutes. We highlight below the salient changes introduced under this Act as follows;

Export levy/duty

The Act retains the imposition of export duty on certain goods (mainly, hides, skins, waste and scrap metal) leaving Kenya to a foreign territory or to an export processing zone with the exception of goods destined to the East African Community Partner States of Burundi, Rwanda, Uganda and Tanzania.

The rates of export duty are prescribed under the First Schedule to the Act. However, the Act has now introduced a provision that will allow for automatic upward adjustment of the specific rates of export duty annually to take into account inflationary trends.

Import Declaration Fees

The Act has reduced the rate of Import Declaration Fee (IDF) from 2.25% to 2% of the customs value for all imports into the country unless the goods are specifically exempted. The reduction of IDF rate is a welcome move to tax payers as it lowers the cost of doing business in Kenya.

Further, the Act has introduced IDF of KES.10,000 to all goods that are imported under the East Africa Community (EAC) Duty Remission scheme.

Railway development Levy (RDL).

The provisions relating to RDL have now moved to this Miscellaneous Fees and Levies Act. The RDL is aimed at providing funds for the construction of the standard

gauge railway aimed at facilitating the ease in internal and regional transport of both goods and passengers.

The levy is chargeable on all imports at the rate of 1.5% of the customs value and is payable at the time of entering the relevant goods for home use. The proceeds shall be deposited in the Railway Development Fund.

Overview

The consolidation of the miscellaneous fees and levies into one Act eases compliance with regard to the relevant fees and duties.

For further information on the 2016 Finance Act, please contact any of the people below or your usual PwC contact.

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