



Tax Alert

Finance Act, 2018

Introduction

September 2018

The Finance Act, 2018 (the Finance Act) was signed into law by the President on 21 September 2018.

The Act has amended the following Tax Laws: Income Tax Act (ITA), Value Added Tax (VAT) Act, Excise Duty Act, Tax Procedures Act (TPA), Miscellaneous Fees and Levies Act, the Betting, Lotteries and Gaming Act (BLGA), Stamp Duty Act, Employment Act and the Retirement Benefits Act, 1997.

In this Alert we provide an analysis of the changes introduced by the Finance Act.

The effective date for these changes is 1 July 2018, unless specified otherwise in the sections below.



Indirect Taxes

Value Added Tax

Introduction

The Finance Act introduces a raft of changes in the VAT treatment of various supplies. The changes, which come into effect on 1 July 2018, will have significant impact on the taxpayers dealing in the affected supplies. Notably, the Finance Act has expanded the tax base for mobile cellular services to include excise duty payable on these services. Other changes include a move to exempt supplies which were previously zero rated for VAT purposes. We highlight below the changes introduced by the Act.

VAT on petroleum products

The Finance Act has introduced a new VAT rate of 8% on the taxable value of the Petroleum products effective on the date of enactment of the Supplementary Appropriation Act. The taxable value in respect of petroleum products shall exclude excise duty, fees and other charges.

The fuel marketers and other players in the fuel supply chain will now be entitled to a recovery of the VAT incurred by their businesses.

Exemption of grain storage equipment and animal feeds

The Finance Act has extended the VAT exemption on construction of grain storage to include not only materials used but also equipment for construction of such facilities.

Similarly, in a bid to reduce the cost of animal feeds, the Finance Act has exempted from VAT raw materials for production of the finished animal feeds. In addition, the Finance Act has exempted unprepared cereal straw and husks, lucerne meal, pellets and beet pulp and bassage from VAT.

Zero rating of flour

The Finance Act has introduced zero rating of maize flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more

than ten percent in weight. These products were previously exempted from VAT.

Exemption of seeds

The Finance Act has exempted from VAT wheat, meslin and barley seeds for sowing. However, maize seeds are no longer exempt from VAT.

Limiting exemptions under plant and machinery

The exemption on plant and machinery has been restricted to those used to manufacture goods. Prior to this restriction, the exemption covered all plant and machinery of Chapter 84 and 85. In our view, although this restriction may be noble to avoid general abuse of the earlier open ended exemption, there may be a need for the Government to reconsider this restriction. This is in light of the fact that besides manufacturing, there are other sectors such as agriculture that may be dependent on heavy mechanisation and would benefit from exemption of other plant and machinery under Chapter 84 and 85.

Exemption of hearing aids from VAT

The Finance Act provides for exemptions from VAT of hearing aids excluding parts and accessories of tariff No. 9021.40.00. In our view, this is a welcome move as it will reduce costs of the hearing aids making them affordable and also promote the universal healthcare agenda.

Exemption of medicaments

The Finance Act has removed medicaments of tariff 3004.40.00 from zero rating. However, the following medicaments have been added to the zero rating schedule: 3004.41.00, 3004.42.00, 3004.43.00 and 3004.49.00

Exemption of footwear and garments

The Finance Act has withdrawn the VAT exemption on garments and leather footwear manufactured in an Export Processing Zone (EPZ), on importation into Kenya. This exemption

Indirect taxes (cont'd)

(that was introduced 2 years ago) may have had the undesired consequences of rendering locally manufactured garments and leather footwear, outside of an EPZ, to be uncompetitive.

VAT base for cellular airtime

The Finance Act has increased the VAT base for the supply of mobile cellular services to include 15% excise duty on the services. This will result into a higher tax cost on mobile cellular services.

Mobile cellular service providers will need to evaluate whether to pass the additional tax burden to the consumers of such services thus rendering call rates, SMS and other mobile cellular services more expensive. Where the service providers opt not to increase prices for these services, they may have to absorb the costs themselves.

VAT on computer parts

The Finance Act provides for VAT exemption of parts imported or purchased locally for the assembly of computers. This is an extension of the earlier exemption on parts imported or purchased locally for the assembly of primary school laptop tablets.

VAT on solar equipment

Prior to the coming into force of the Finance Act, there was a general VAT exemption on all specialised solar equipment and accessories including solar water heaters. However, the term specialised equipment has not been defined in law and has been a subject of many disputes between taxpayers and the Revenue Authority. The Finance Act now restricts this exemption to specialized equipment for the development and generation of solar and wind energy only.

The implication of this amendment is that solar bulbs or lights, solar water heaters and other accessories will be now taxable at 16%. This approach may limit the adoption of clean energy.

The Government should consider exempting all solar equipment such as solar lights/bulbs, cookers/stoves and water heaters to encourage adoption of solar as an alternative source of energy especially in parts of the country that are not connected to the grid.

Zero rating of transportation of cargo to destinations outside Kenya

The Finance Act has deleted the provision in the VAT Act that exempts transportation of cargo to destinations outside of Kenya. This is on the

premise that such services should be treated as being an export of services which is taxable at 0%.

In our view, this is a welcome move by the government to clear the contradiction that has existed in the VAT legislation creating uncertainty in the transport sector.

Exemption of alcohol and non-alcohol beverages supplied to the DEFCO

The Finance Act has exempted alcoholic and non-alcoholic beverages supplied to the Defense Forces Canteen Organization (DEFCO) from VAT.

Goods and services provided to special operating framework arrangements (SOFA) in government

The Finance Act has exempted from VAT supplies to SOFA. However, we note that guidelines to establishing SOFAs have not been issued.

Postal services

The Finance Act exempts from VAT postal services like postage stamps, rental of post boxes or mail bags and any subsidiary services. This provision reduces the VAT burden on the users of such services and will lead to affordable circulation of information.

Motor vehicles imported by public officers returning from a post in a Kenyan mission abroad

The Finance Act exempts from VAT one personal motor vehicle (excluding buses and mini buses of seating capacity of more than eight seats) imported by a public officer returning from a posting in a Kenyan mission abroad and another motor vehicle by his/her spouse.

The exemption will only apply if the officer is returning to Kenya from a posting in a Kenyan mission abroad upon recall. In respect of the officer's spouse, the spouse should have accompanied the officer in the foreign mission and the vehicle is imported into Kenya within ninety days of the date of arrival of the officer or spouse from such arrival as the Commissioner may allow.

Prescription of credit and debit notes

The Finance Act has removed the requirements for credit and debit notes to be serially numbered, to include details of the name, address and PIN the person to be issued, in addition to making reference to the relevant tax invoice. Instead, the Commissioner of the KRA shall prescribe a credit/debit note form.

Indirect taxes (cont'd)

Excise Duty

1. Change of excise duty rates

Excise duty on telephone and internet data

The Finance Act, 2018 has amended the Excise Duty Act, 2015 to introduce excise duty on telephone and internet data services at the rate of 15%. The Finance Act, does not define the scope of internet data services and in our view the term 'internet data services' is broad and will include internet data services provided by internet service providers as well as internet data services provided by telecommunication companies.

Excise duty on fees charged by banks, money transfer agencies and other financial service institutions

The Finance Act has amended the Excise Duty Act, 2015 by increasing excise duty charged for money transfer by banks, money transfer agencies and other financial services from 10% to 20%.

This increase in excise duty is aimed at replacing the robin-hood tax introduced by the Finance Act, 2018 which was considered more expensive and complicated to implement.

Excise duty on fees charged for money transfer services by cellular phone service providers

The Finance Act, has increased the excise duty on money transfer services by cellular phone service providers from 10% to 12%.

Excise duty on other fees charged by financial institutions

The Finance Act has increased the excise duty on other fees charged by financial institutions from 10% to 20%.

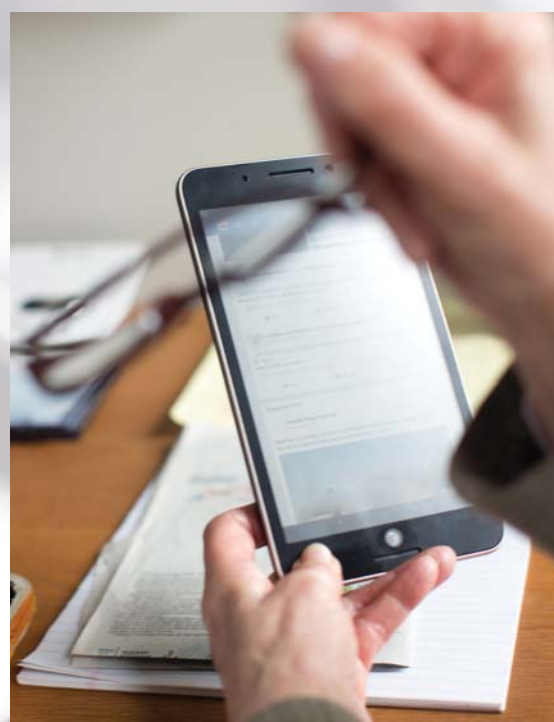
Excise duty on Illuminating kerosene

The Finance Act has increased the excise duty rate on illuminating kerosene from from KES 7.205 per litre to 10.305 per litre. This is attributed to government's intention to curb adulteration of fuel products.

This measure may however hurt the rural and low income households that rely on kerosene for heating and lighting. In addition, it may encourage low income households to opt for firewood and charcoal as an alternative presenting environmental degradation risks to the country.

Private passenger cars

The Finance Act, has increased excise duty on private passenger motor vehicles whose engine



capacity exceeds 2,500cc for diesel and 3,000cc for petrol powered vehicles from 20% to 30%.

Sugar Confectionery and chocolate

The Finance Act has introduced excise duty of KES. 20 per kilogram on sugar confectionery of tariff heading 17:04 and chocolate in blocks, slabs or bars of tariff codes 1806.31.00, 1806.32.00 and 1806.90.00.

2. Exemption from excise duty

Alcohol or non-alcohol beverages to "DEFECO"

The Finance Act, has amended the Second Schedule to the Excise Duty Act, 2015 to exempt alcohol or non-alcohol beverages supplied to the Defence Forces Canteen Organisation ("DEFECO").

Currently, the exemption applies to all goods supplied for the official use by the Kenya Defence Forces (KDF) and the National Police Service but excludes DEFECO which is an integral arm of the KDF.

Special operating framework arrangement

The Finance Act, has amended the Second Schedule to the Excise Duty Act, 2015 to provide for exemption of goods imported or purchased locally for direct use in the implementation of projects under special operating framework arrangements with government.

We expect the government to provide additional clarity on the special operating framework.

Indirect taxes (cont'd)

3. Supporting social development

The Finance Act has amended the Excise Duty Act, 2015 to allow the Commissioner to pay into the Sports, Arts and social development fund including universal health care, 16% of the excise duty paid in respect of money transfer by cellular phone providers and excise duty on telephone and internet data services.

The amendment is aimed at ring fencing funds earmarked by the government for use in supporting social development activities including universal health care.

4. Introduction of stiffer penalties

The Finance Act has increased the minimum penalty for manufacturers or importers of excisable goods who operate without licenses. Currently, the Act only prescribes a penalty of double the excise duty payable. The Finance Act has introduced a penalty of five million shillings or double the excise duty payable, whichever is higher.

In addition, any plant or excisable goods or any materials, in respect of which an offence has been established in relation to excise licensing or excise stamps could be forfeited to the State.

5. Clarity - excise duty on bottled water

The Finance Act introduces more clarity on the drinking water that is subject to excise duty. Currently, the Excise Duty Act is not very clear on the scope of water subject to excise duty. The Finance Act imposes excise duty on bottled or similarly packed water.

Clarity on exemption of services

The Finance Act has clarified the criteria for qualifying for an excise duty exemption by prescribing that for goods and services to qualify for exemption, they should not have been consumed in Kenya.



Provisions relating to suspension of licenses

The Finance Act now requires the Commissioner to give a 21 day notice to the licensee prior to suspending their license. In addition, the Finance Act has removed the avenue of Tax Appeal Tribunal which was available to an aggrieved licensee. The Commissioner now has the final say with regards to cancellation of licenses.

Besides the above, the Commissioner is now empowered to suspend a license without notice where the licensee has engaged in tax fraud, possession or use of counterfeit excise stamps or has violated any regulations relating to health and safety.

Affixing stamps outside designated areas

The Finance Act has amended the Excise Duty Act to remove the failure to comply with designated areas for affixing excise stamps from offences under section 39(1). Our view is that this was meant to give room to manufacturers to affix stamps outside their production facilities due to logistical reasons.

6. Annual adjustment for inflation

The Finance Act has introduced an annual inflationary adjustment for the specific rates for excise duty. Currently, the law provides for inflationary adjustment after every two years.

The Commissioner General on 2 July 2018 published the Excise duty (Adjustments of Rates for Inflation) Regulations (Legal Notice 164 of 2018) which rates were effective 1 August 2018. However, these Regulations were annulled by Parliament on the basis that there was no public participation in enacting the Regulations.

7. Motor vehicles imported by public officers returning from a post in a Kenyan mission abroad

The Finance Act exempts from Excise duty one personal motor vehicle excluding buses and mini buses of seating capacity of more than eight seats imported by a public officer returning from a posting in a Kenyan mission abroad and another motor vehicle by his spouse.

The exemption will only apply if the officer is returning to Kenya from a posting in a Kenyan mission abroad upon recall. In the case of an officer's spouse, the spouse should have accompanied the officer in the foreign mission and the vehicle is imported within ninety days of the date of arrival of the officer.

Income tax amendments

Withholding tax on winnings

The Finance Act has expanded the definition of 'winnings' to include winnings of any kind. This has broadened the tax base by extending the applicability of withholding tax on all winnings from betting.

The withholding tax of 20% (which was recently introduced by the Tax Laws (Amendment) Act, 2018) was only applicable to the net winnings paid out by bookmakers.

The new definition of winnings may be viewed as being punitive as punters will be unable to deduct stakes placed from winnings.

Demurrage charges and insurance premiums paid to non-residents to attract withholding tax

The Finance Act amends the ITA to subject demurrage charges charged by transporters (and in particular non-resident ship owners) to withholding tax at 20%. Difficulties may arise in respect of identifying the person whose obligation it is to withhold tax due to the operating model of such businesses.

Further, the Finance Act introduces withholding tax at the rate of 5% on gross premiums paid to non-resident insurance companies except insurance premium paid for insurance of aircraft. While the amendment may spur growth of local insurance companies, there may be some limitations in the capacity of local insurance companies to cover risks associated with certain sectors such as marine and extractive industries. In addition, this may impact the insurance business in Kenya negatively since it will lead to increase in cost when local insurance companies reinsure with non-residents reinsurance companies.

Deemed dividends

The Finance Act has expanded the definition of deemed dividends to include:

- i. Any cash or asset distributed or transferred to the shareholders or any person related to shareholders;
- ii. Any obligation measurable in monetary terms discharged from a shareholder or any person related to the shareholder by the company;
- iii. Any amount used by the company in any manner for the benefit of a shareholder or any person related to the shareholders;

- iv. Any debt owed by a shareholder or any person related to the shareholder to any third party that is settled by the company; and,
- v. Transfer pricing adjustment which results to additional taxable income or reduced assessed loss of the company by the virtue of any transaction with the shareholder or a related person to the shareholder.

Companies will need to scrutinise transactions between themselves and shareholders and any person related to the shareholders to avoid such transactions being deemed as dividends by the Kenya Revenue Authority (KRA).



New definition of "compensating tax"

The Finance Act repeals Section 7A of the current ITA and proposes a new simpler method of computing compensating tax. The Finance Act charges to tax any distribution of untaxed gains or profits by a company at the resident corporate tax rate of 30%.

The Finance Act has removed the requirement of maintaining the dividend tax account by a resident company which previously allowed for the calculation of the extent to which distributions arose from untaxed profits.

Further, it is silent on what constitutes untaxed gains or profits therefore it is unclear whether dividends received from subsidiaries of both resident and non-residents companies will be treated as untaxed gains or profits for the purposes of computing compensating tax. The above provision comes into operation on 1 January 2019.

Income tax amendments (cont'd)



Introduction of presumptive tax

In a move to widen the tax net and capture the informal business sector, the Finance Act seeks to introduce presumptive tax which will be applicable to a resident person whose turnover does not exceed five million shillings during a year of income.

It will be tied to renewal of the Single Business Permit and the rate of tax will be 15% of the cost of the business permit or trade license issued by the County Government. The due date for payment of presumptive tax shall be at the time of payment of the business permit or trade license or renewal of the same.

Presumptive tax will not be applicable to incorporated companies, rental businesses and persons offering management and professional services.

The above provision comes into operation on 1 January 2019.

Additional tax deduction on electricity cost

The Finance Act provides for an additional corporate tax deduction of thirty percent of the total electricity bill by manufacturers in addition to the normal deduction. This additional deduction is subject to the conditions to be set by the Ministry of Energy.

To date no guidelines have been issued by the Ministry of Energy on operationalising this clause. It is hoped that such guidelines will also clarify whether costs of electricity internally generated by a company (off grid) would be subject to the enhanced deduction.

The above provision comes into operation on 1 January 2019.

Tax incentives to entities operating under a special operating framework arrangement with the Government

The Finance Act grants the Government leeway to negotiate for special corporate tax rates for businesses under a special operating framework arrangement. If properly implemented, such tax incentives can be used by the Government to attract investments into priority areas under the Big Four Agenda such as the affordable housing, manufacturing sector and critical infrastructure projects.

The above provision comes into operation on 1 January 2019.

Gains from disposal of property by a general insurance business

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

Betting Lotteries & Gaming Act

Reduction of betting, prize competition lottery and gaming taxes

The Finance Act reduces the rate of tax for betting, gaming, prize competition and lotteries operators from 35% of their revenue to 15% of their revenue. Further, proceeds from the aforementioned taxes shall be paid into the Sports, Arts and Social Development Fund. The Finance Act also introduces a late payment penalty

of 5% of the tax payable and late payment interest at the rate of 1% per month. This is welcome as these taxes are in addition to the 30% corporate tax that they are currently paying and the legal requirement to dedicate 25% of their sales to social causes like sports sponsorship. The new betting tax and gaming tax rates are effective 1 July 2018, whereas the new lotteries and prize competition tax rates are effective 1 October 2018.

Stamp Duty Act

Payment of stamp duty for policies of life insurance and insurance of accident

The Finance Act amends the Stamp Duty Act to provide for monthly payment of stamp duty for policies of life insurance and insurance against accident.

Stamp duty exemptions provided to Special Economic Zones ("SEZ") and instruments executed for tax collection

The Finance Act exempts instruments relating to the business activities of Licensed Special Economic Zone enterprises, developers and operators from stamp duty. Further, the Finance Act exempts instruments executed for the purposes of collection and recovery of taxes from stamp duty.

Employment taxes and other employee statutory deductions

Introduction of a National Housing Development Fund levy

In line with the government's pivotal affordable housing agenda, the Finance Act amends the Employment Act, 2007 to introduce a National Housing Development Fund ("NHDF"). Under the Finance Act, employers and employees will each contribute 1.5% of the employee's monthly basic salary to the fund but the combined contribution is capped at KES 5,000 per month. This represents an increase from the 0.5% employer and 0.5% employee contribution rates initially proposed by the Cabinet Secretary (CS) during the budget speech.

For employees who qualify for affordable housing, the contributions will accrue to the employee for purposes of financing the purchase of a home under the affordable housing scheme.

Where employees do not qualify for affordable housing, the contributions will accrue to the employees after 15 years of making contributions or upon retirement. At that point, the contributions may be withdrawn by the employee in cash, transferred to a pension scheme, spouse or dependent children or to another person eligible for affordable housing. Contributions withdrawn in cash will be subject to tax.

Employers will be required to remit the employee and employer contributions to NHDF by the ninth of the following month. Late remittance of the contribution to NHDF will attract a penalty of 5% per month.

These provisions of the Finance Act will come into effect upon the gazettment of the regulations prescribing the requirements for qualifications to the scheme (by the Cabinet Secretary for Housing in consultation with the Cabinet Secretary of the National Treasury).

Tightening the noose on employers who delay pension contribution remittances

The Finance Act amends the Retirement Benefits Act, 1997, to give powers to the Retirement Benefits Authority (RBA) to compel non-compliant employers to pay the outstanding contributions and interest with a penalty of five percent of the unremitted contributions or a minimum of twenty thousand shillings. This is a welcome move to employees who previously did not have sufficient remedies for their non-compliant employers.

The proposed changes on the RBA Act is a welcome move to safeguard employee's pension contributions. The change is effective 1 October 2018.

Tax Procedures Act

Extension of foreign income tax amnesty to 30 June 2019

The Finance Act extends the deadline of filing for amnesty on foreign income and assets to 30 June 2019. The amnesty covers taxes, penalties and interest for repatriated foreign income earned on or before 31 December 2017 and which would have been subject to tax in Kenya. The Finance Act further exempts the declared funds from the provisions of the Proceeds of Crime and Anti-Money Laundering Act, 2009 and other Acts that relate to investigations of financial transactions. However, this exemption does not extend to money derived from terrorism, poaching and drug trafficking.

Clarity on applying for extension of time to file returns

From 1 July 2018, a taxpayer can request for extension of time to file a return at least fifteen days before the due date for monthly returns and at least thirty days for annual returns. Upon

request for extension, the Commissioner is required to respond at least five days before the due date lest the request is deemed accepted. The penalty for late submission of returns is not applicable where an extension of time to file a return is granted.

This is a welcome move for taxpayers as the lack of clarity in the existing law made it difficult to request such extensions and where extensions had been applied for in the past, the revenue authority sometimes took a long time to respond.

Late payment penalty and interest

The Finance Act proposes to introduce a late payment penalty of 5% of the tax due and has retained the 1% interest on late payments.

There is a reprieve for individuals since the Act reduces the late filing penalty for individuals' annual returns from twenty thousand shillings to the higher of 5% of the tax payable or two thousand shillings.

The Miscellaneous Fees and Levies Act, 2016

Anti-adulteration levy

The Finance Act introduces a levy of KES 18 per litre payable on importation of illuminating kerosene into the country. The proposed levy is intended to harmonise the cost of kerosene and diesel to disincentivise fuel adulteration.

The levy is however likely to unduly burden low income members of the public who rely on kerosene for cooking and lighting. The levy may also encourage the uptake of more environmentally damaging cooking fuels.

The levy will also negatively impact manufacturers who use kerosene as a raw material e.g. in the paint industry. The Government should consider a tax rebate for industrial users of Kerosene in line with the Big 4 agenda's focus on growing the manufacturing sector.

The above provision comes into operation on 1 October 2018.

Export levy/duty on copper waste and scrap metal

The Finance Act has amended the First Schedule to the Miscellaneous Fees and Levies Act, 2016

to introduce an export levy at a rate of 20% on copper waste and scrap of tariff code 7404.00.00. This measure aims at encouraging local smelting and value addition for the waste copper. This move may also be aimed at discouraging vandalism of public property by unscrupulous dealers who sell these products outside of Kenya.

The above provision comes into operation on 1 October 2018.

Exemptions to projects under special operating framework arrangement with the Government

The Finance Act has amended the Second Schedule to the Miscellaneous Fees and Levies Act, 2016 to exempt goods imported for implementation of projects under special operating framework arrangements with the Government from both Import Declaration Fee (IDF) and Railway Development Levy (RDL).

The commencement date for this amendment is 1 July 2018.

Conclusion

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