15 November 2019

Global Tax Alert

Kenya enacts *Finance Act, 2019*

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

Executive summary

The President of Kenya assented to an Act of Parliament, the *Finance Act, 2019* (the Act) on 7 November 2019.

The Act proposes key amendments to various tax legislation in Kenya including: *The Income Tax Act*, *Value Added Tax*, *Excise Duty Act*, *Tax Procedures Act* and *Miscellaneous Fees and Levies Act*. Other Acts of Parliament that have been amended through the Act include: *Capital Markets Act*, *Banking Act*, *Standards Act*, *Retirement Benefits Act*, *Employment Act* and the *Housing Act*.

While the Act largely retains most of the provisions contained in the Finance Bill, there are some major provisions in the Bill, such as the increase in the capital gains tax rate, imposition of withholding tax on a wider range of services and the introduction of withholding tax on repatriation of income from a branch to head office that were eliminated by the National Assembly.

This Alert summarizes the key changes included in the Act. Unless noted otherwise, the provisions are effective as of 7 November 2019.

Building a better working world

Detailed discussion

Corporate income tax

Taxation of the digital economy

The Act includes income accruing through a digital marketplace within the ambit of income which is chargeable to tax in Kenya. A digital marketplace has been defined in the Act as *a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means*. The Cabinet Secretary (CS) in charge of Finance is expected to issue regulations to provide the mechanisms for implementing the provision.

Taxation of the digital economy remains a challenge for revenue authorities globally. It will be interesting to see the guidelines that the Cabinet Secretary will issue given the sensitivity of the issue and the fact that even some of the most developed countries are yet to formulate and implement domestic guidelines for taxing the digital economy.

Dividends distributed out of untaxed gains or profits

The Act has clarified that income which is exempt under the *Income Tax Act* is not subject to further tax where dividends are distributed out of such income.

Income of nonresident persons deemed to be income derived from Kenya

The Act has expanded the scope of what constitutes income of a nonresident person that is taxable in Kenya. The income of a nonresident shipping line including income from delay in taking delivery of goods or returning any of the equipment used for transportation of goods will now be subject to tax.

Income of a resident person or a nonresident person with a permanent establishment (PE) in Kenya

The Act has amended the type of income deemed to have accrued or been derived from Kenya by removing demurrage charges and adding a reinsurance premium.

The Act has also been amended so that deductions which are allowable under a Double Taxation Agreement on payments made by the PE in Kenya of a nonresident person to that nonresident person are now deemed to be income which is accrued or derived from Kenya.

Turnover tax

The Act has re-introduced the turnover tax which was repealed by *Finance Act, 2018*. Turnover tax will be payable by any resident person whose annual turnover is below KES5 million at the rate of 3 % of the gross receipts of the business.

The tax as well as the corresponding return is due on or before the 20th day of the following month. Further, a person who is liable to pay turnover tax will be required to pay a presumptive tax equal to 15% of the amount payable for a business permit or trading license issued by a county government. Presumptive tax paid shall be offset against the turnover tax payable by a person.

The re-introduction of the turnover tax is geared towards ensuring payment of taxes by the informal sector.

Effective date: 1 January 2020

Thin capitalization

The Act has exempted companies that implement projects under an affordable housing scheme upon recommendation by the CS responsible for housing from thin capitalization provisions.

This is meant to encourage nonresident persons to invest into the affordable housing scheme which is one of the four agendas of the Government. Increased investment in the affordable housing schemes will promote affordable housing for the average Kenyan citizen.

Effective date: 1 January 2020

Real estate investment trusts (REITs)

The Act has exempted investee companies of a REIT from income tax except for payment of a withholding tax on interest income and dividends to the extent that the shareholders are not exempt from income tax.

This is meant to promote investments into REITs and to align the previous exemption of REITs with that of the investee companies.

Home Ownership Saving Plans (HOSPs)

The Act has added the Capital Markets Authority as one of the bodies in addition to the Central Bank of Kenya that can issue guidelines or regulations regarding investing deposits in a HOSP. Additionally a fund manager or investment bank registered under the *Capital Markets Act* can hold deposits under a registered HOSP.

Fund managers and investment banks can now develop and register a HOSP.

Effective date: 1 January 2020

Income tax exemptions

The Act has introduced the following exemptions:

- Income of the National Housing Development Fund
- Income earned by an individual who is registered under the Ajira Digital Program for three years beginning 1 January 2010 upon meeting the set criteria
- The amount withdrawn from the National Housing Development Fund to purchase a house by a contributor who is a first-time home owner
- Interest income from all listed bonds and notes or other similar securities used to raise funds for an infrastructure projects and assets defined under the Green Bonds Standards and Guidelines and other social services. The bonds, notes or social securities should have a maturity of at least three years in order for the associated interest income to qualify for exemption

Effective date: 1 January 2020

Affordable housing relief

The Act has been amended to the effect that the amount of affordable housing relief shall be 15% of the employee's contribution but shall not exceed KES108,000 per annum.

Reduced corporate income tax rate

Companies operating a plastics recycling plant will be entitled to a reduced corporate income tax rate of 15% for the first five years upon commencement of its operations.

The reduced corporate tax rate is aimed at attracting companies to the plastic recycling business to fast-track environmental conservation.

Capital gains tax exemptions

The Act has widened the scope of the existing capital gains tax exemptions. Capital gains tax will not be payable in the case of a transfer of property that is necessitated by a transaction involving the incorporation, recapitalization, acquisition, amalgamation, separation, dissolution or similar restructuring of a corporate entity, where such transfer is one of the following:

- A legal or regulatory requirement
- As a result of a directive or compulsory acquisition by the Government
- Internal restructuring within a group that does not involve transfer of property to a third party
- In the public interest and approved by the CS in charge of National Treasury

Value Added Tax (VAT)

Imposition of VAT on imported services (Reverse charge VAT)

The *Value Added Tax Act, 2013* has been amended to extend the reverse charge VAT liability to non-VAT registered recipients of taxable imported services. The requirement to account for reverse charge VAT does not take into consideration the KES5 million threshold. Previously accounting for VAT on imported services was imposed only on registered persons. The Kenya Revenue Authority (KRA) within its iTax system may therefore need to develop a form/template for use by non-registered recipients of imported services.

Reduction of withholding VAT rate**

Appointed withholding VAT agents are now required to withhold VAT at the rate of 2% as opposed to 6% of the taxable value on purchasing taxable supplies. This withholding is done at the time of paying for the supplies by the appointed withholding tax agents.

The Act also clarifies that withholding VAT shall not apply to the taxable value of zero-rated supplies implying that if an appointed VAT withholding agent is paying for an invoice for zero-rated supplies there will be no VAT withholding done. This reduces the VAT refund burden for that supplier of zero-rated supplies.

** *This amendment is provided under the TPA*

Definition of concessional loan

Concessional loan has been defined to mean a loan with at least a 25% grant element. This will clarify the definition of official aid funded projects that are exempt from VAT.

Taxation of Digital Market Place

VAT will be applicable to supplies made through a digital market place. The Act has defined a digital market place as a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means.

Administrative application of the provision will need to be clarified e.g., how nonresident suppliers will account for VAT such as appointing a tax representative.

Amendments relating to VAT-exempt supplies

- Specialized equipment for the development and generation of solar and wind energy will only be exempt upon recommendation of the CS in charge of Energy.
- Exempt tractors will not include road tractors for semitrailers which will now be taxable goods at the standard rate of 16%.
- VAT-exempt stock exchange brokerage services have been broadened to cover securities brokerage services.

The following items are now VAT exempt effective 7 November 2019:

- Locally manufactured motherboards
- Inputs for the manufacture of motherboards approved by the CS in charge of Information Communication Technology
- Plant, machinery and equipment used in the construction of a plastics recycling plant
- The supply of maize (corn flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than 10% weight (this is no longer zero rated)
- Goods imported or purchased locally for the direct and exclusive use on the construction of houses under the affordable housing scheme approved by the CS in charge of Finance upon the recommendation of the CS responsible for Housing – further guidance will be required on the procedures to follow to benefit from this exemption
- Musical instruments and other musical equipment imported or purchased locally, for exclusive use by educational institutions, upon recommendation by the CS in charge of Education – further guidance will be required on the procedure to follow to benefit from this exemption

The following will now be zero-rated supplies

- Agricultural pest control products
- Liquefied petroleum gas, including Propane

Excise duty

Increment/introduction of excise duty rates on the following items:

Description	From (prior to 7 November 2019)	To (Effective 7 November 2019)
Cigars, cheroots, cigarillos, containing tobacco or tobacco substitutes	Shs. 11,061.78 per kg	Shs. 12,624 per kg
Electronic cigarettes	Shs. 3,318.53 per unit	Shs. 3,787 per unit
Cartridge for use in electronic cigarettes	Shs. 2,212.36 per unit	Shs. 2,525 per cigarettes unit
Cigarette with filters (hinge lid and soft cap)	Shs. 2,765.45 per mille	Shs. 3,157 per mille
Cigarette without filters (plain cigarettes)	Shs. 1,990.49 per mille	Shs. 2,272 per mille
Other manufactured tobacco and manufactured tobacco substitutes; "homogenous" and "reconstituted tobacco"; tobacco extracts and essences	Shs. 7,743.25 per kg	Shs. 8,837 per kg
Wines including fortified wines, and other alcoholic beverages obtained by fermentation of fruits	Shs. 165.93 per liter	Shs. 189 per liter
Spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength exceeding 10%	Shs. 221 per liter	Shs. 253 per liter

Description	From (prior to 7 November 2019)	To (Effective 7 November 2019)
Imported white chocolate, chocolate in blocs, slabs or bars of tariff Nos. 1806.31.00, 1806.32.00,1806.90.00	Shs. 20 per KG	Shs. 200 per KG
Imported motor vehicles of cylinder capacity exceeding 1500 cc of tariff no. 87.02, 87.03 and 87.04	20%	25%
Motor vehicles of tariff no. 8703.24.90 and 8703.33.90	30%	35%
Imported gas cylinders	N/A	35%
Betting – i.e., on amount wagered or staked	N/A	20%

Reduction/removal of excise duty on the following items:

Description	From	To
100% electric powered motor vehicles of tariff no. 8702.40.11, 8702.40.19, 8702.40.21, 8702.40.22, 8702.40.29, 8702.40.91, 8702.40.99 and 8703.80.00	20%	10%
Locally produced sugar confectionary of tariff heading 17.04	Shs. 20 per kg	- *
Locally produced white chocolate, chocolate in blocs, slabs or bars of tariff Nos. 1806.31.00, 1806.32.00,1806.90.00	Shs. 20 per kg	- *

* *Entities dealing in locally produced sugar confectionery and white chocolates will have to de-license the manufacturing premises and extinguish any obligations related to accounting for excise duty on these products, e.g., filing excise returns, excise control, etc. In the event of importing the same products, registration for importation should be undertaken with KRA.*

It will be important to clarify the treatment of imports of the items from within the East African Community (EAC) since goods moving from one EAC country to another are technically "transfers" and NOT imports.

Other amendments

- The Act redefines "other fees" to exclude fees or commissions earned in respect of a loan or any share of profit or an insurance premium or premium based or related commissions specified in the *Insurance Act* or regulations made thereunder.
- The Act defines "betting," "bookmaker" and "amount wagered or staked" in relation to excisable betting services.
- The Act defines "concessional loan" to mean a loan with at least 25% grant element and "official aid funded project" for purposes of determining exempt excisable goods imported or purchased locally for direct and exclusive use in the implementation of an Official Aid-Funded Project.
- The Act introduces a general penalty for offenses where a specific penalty has not been provided. The offense shall be liable, on conviction, to a fine not exceeding two million shillings or to imprisonment for a term not exceeding two years, or to both.
- The Act has revised the annual inflation adjustment day of *specific* excise duty rates from July to October.

Tax Procedures Act, 2015 (TPA)

Exemptions from the requirement of a Personal Identification Number (PIN)

The Commissioner has been empowered by the Act to exempt any person or class of persons from the requirement of a PIN for any of the transactions specified in the TPA upon application by the person.

Amnesty on penalties and interest from companies listed on the growth segment of the securities exchange

Penalties and interest will not be recovered from a company that lists on the growth segment of a securities exchange in Kenya, in respect to any year of income prior to the date of listing.

This will only apply where the company makes full disclosure of its past income, assets and liabilities for the two years immediately preceding the date of listing and the principal tax is paid in full.

This reprieve will only apply if the taxpayer has not been already assessed (and/or) is not under a tax audit or investigation. It will also only apply up to 7 November 2022.

A company that delists before the lapse of five years after listing will be assessed all taxes, penalties or interest for the years it was in operation prior to listing.

Failure to deduct or withhold tax

Any person who does not deduct or withhold tax and remit the tax to the KRA as required by a tax law shall be liable to pay the principal tax, penalties and interest thereon as if it were tax due and payable by that person.

This is an express provision which empowers the KRA to collect withholding tax from taxpayers.

Reduction of withholding VAT rate

Appointed withholding tax agents are now required to withhold VAT at the rate of 2% as opposed to 6% of the taxable value on purchasing taxable supplies at the time of paying for the supplies and remit the same to the KRA.

The Act has also clarified that withholding VAT shall not apply to the taxable value of zero-rated supplies.

Issuance of a departure prohibition order

The law has been amended to include a tax representative as one of the persons that the KRA can issue a departure prohibition order if they have reasonable ground to believe that a person may leave Kenya without paying tax that is due or will become due from them or a company for which they are tax representative.

Under the TPA, a tax representative is the person responsible for performing any duty or obligation imposed by a tax law on the taxpayer, including submission of returns and the payment of tax. Tax representatives include trustees of a trust, the person in Kenya in charge of a nonresident person, the accounting officer in the National Government or County Government or the person in charge of accounting for a partnership or an association.

Objection to a tax decision

The KRA was previously expected to respond to an objection within 60 days from the date the taxpayer filed a notice of objection.

This has been amended to allow the KRA to make the objection decision within 60 days of the receipt of the notice of objection or any further information that the KRA may require from the taxpayer. In the absence of the above, the objection shall be deemed to be allowed. This amendment gives the KRA the ability to extend the period beyond 60 days.

Late submission penalty

Late submission of a tax return was subject to a penalty which was equal to a percentage of the tax due or payable under the return or a fixed penalty. This was punitive to taxpayers who had paid the principal tax but failed to submit the tax return on time.

The Act has been amended to allow taxpayers to reduce the amount of tax payable or due under the return by the amounts already paid and withholding tax credits when determining the late submission penalty.

Tax shortfall penalty

The Act has expunged the tax shortfall penalty where the same was not a result of deliberate omission or false statement.

Transactions requiring a PIN

The transactions for which a PIN is required have been expanded to include registration and renewal of membership by professional bodies and other licensing agencies. Additionally, it also includes the registration of mobile cellular pay bill and till numbers by telecommunication operators.

Miscellaneous Fees and Levies Act

- The Act defines “concessional loan” to mean a loan with at least a 25% grant element.
- The Act increases the Import Declaration Fee (IDF) from 2% to 3.5% of the customs value of goods imported for home use.

- The Act also reduces the IDF to 1.5% to be charged on custom value of:
  - Raw materials and intermediate products imported by approved manufacturers.
  - Raw materials and intermediate products imported by manufacturers approved by CS on the recommendation of the CS responsible for matters relating to industry.
  - Input for construction of houses under an affordable housing scheme approved by CS on the recommendation of the CS responsible for housing.
- The Act increases the Railway Development Levy (RDL) from 1.5% to 2% of the customs value of goods imported for home use.
- The Act retains RDL at the rate of 1.5% on the custom value of:
  - Raw materials and intermediate products imported by manufacturers approved by CS on the recommendation of the CS responsible for matters relating to industry.
  - Inputs for the construction of houses under an affordable housing scheme approved by the CS on the recommendation of the CS responsible for housing.
- *Finance Act 2018* introduced an anti-adulteration levy on all illuminating kerosene imported for home use at the rate of 18 shillings per liter of the customs value. The Act has now been amended to provide for a refund on the written application of an importer where it was paid by a licensed or registered manufacturer to manufacture paint, resin or shoe polish.

Privileges and Immunities Act

The Act amends the *Privileges and Immunities Act* to exempt payment of taxes from goods and services imported and locally purchased by privileged organizations for their official use.

Previously, this applied to goods that were directly imported by privileged organizations for their official use.

Implications

The Government expects that the additional revenue generated by these proposals will support the development of both social and physical infrastructure in the country.

There are also various measures that are geared towards enabling the Governments' Big Four Agenda.

For additional information with respect to this Alert, please contact the following:

Ernst & Young (Kenya), Nairobi

- Francis Kamau francis.kamau@ke.ey.com
- Christopher Kirathe christopher.kirathe@ke.ey.com
- Hadijah Nannyomo hadijah.nannyomo@ke.ey.com
- Robert Maina robert.maina@ke.ey.com
- Alex Ngingo alex.ngingo@ke.ey.com

Ernst & Young Advisory Services (Pty) Ltd., Africa ITTS Leader, Johannesburg

- Marius Leivestad marius.leivestad@za.ey.com

Ernst & Young LLP (United Kingdom), Pan African Tax Desk, London

- Rendani Neluvhalani rendani.mabel.neluvhalani@uk.ey.com
- Byron Thomas bthomas4@uk.ey.com

Ernst & Young LLP (United States), Pan African Tax Desk, New York

- Brigitte Keirby-Smith brigitte.f.keirby-smith1@ey.com
- Dele Olagun-Samuel dele.olaogun@ey.com

EY | Assurance | Tax | Transactions | Advisory

EYG no. 005157-19Gbl

1508-1600216 NY
ED None