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Global Tax Alert

Kenya enacts *Tax Laws (Amendment) Act, 2020*

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Executive summary

On 25 April 2020, the President of Kenya assented to an Act of Parliament, the *Tax Laws (Amendment) Act, 2020* (the Act). For background on the Bill, see EY Global Tax Alert, *Kenya proposes Tax Laws Amendments Bill, 2020*, dated 16 April 2020.

The Act makes various changes to the prevailing tax laws in Kenya. The following tax laws have been amended: *The Income Tax Act (ITA)*, *Value-Added Tax (VAT)*, *Excise Duty Act*, *Tax Procedures Act*, *Miscellaneous Fees and Levies Act* and the *Kenya Revenue Authority Act*.

Some of the amendments are aimed at cushioning the public and the economy at large against the economic ramifications of the COVID-19 pandemic. This follows Presidential pronouncements issued on 25 March 2020.[1] It is important to note that the reduction of the rate of VAT from 16% to 14% became effective on 1 April 2020 pursuant to a legal notice issued by the Cabinet Secretary in charge of the National Treasury.

This Alert summarizes the key changes included in the Act. Unless noted otherwise, the provisions are effective as of 25 April 2020.

Building a better working world

Detailed discussion

Corporate income tax

Reduced corporate income tax rate

Following the President's pronouncements on 25 March 2020, the Act has reduced the corporate income tax rate for resident companies from 30% to 25%. This will apply from the 2020 year of income. It is notable that the reduced rate does not apply to permanent establishments or branches with the rate being retained at 37.5%.

The Act also has repealed the reduced corporate income tax rates in relation to:

- Companies whose shares are listed on the Nairobi Securities Exchange (NSE) which were subject to tax at rates ranging from 20% to 27% for a defined period following the listing of the shares.
- Companies operating a plastics recycling plant which were subject to tax at the rate of 15% effective 2019.

Corporate tax rates applicable to companies in a special operating framework arrangement agreed between a company and the Government remain in force until expiry of such arrangements.

Expansion of the definition of qualifying interest

Qualifying interest refers to interest received by a resident individual from commercial banks or a financial institution licensed under the *Banking Act*, the Central Bank of Kenya (CBK) and a registered Building society. Withholding tax on qualifying interest is final. The Act has expanded the definition to include all interest received by a resident individual.

This is a positive development as it will encourage investment by individuals in various interest-bearing instruments.

Withholding tax

The Act has introduced withholding tax on payments made to a nonresident person on account of:

- Sales, promotion, advertising and marketing services
- Transportation of goods excluding air and shipping transportation services
- Reinsurance premiums except for reinsurance premiums in respect of aircraft

The withholding tax rate applicable for sales, promotion, advertising and transportation services is 20% on the gross fees while reinsurance premiums are to be taxed at 5%.

In addition, the Act has increased the withholding tax rate for dividends paid to a nonresident person from 10% to 15%.

These changes aim to increase government revenue by taxing income that was previously untaxed. While the measures may raise revenue for the Government in the short term, in the long run the measures could dissuade nonresident investors thereby resulting in reduced revenue for the Government.

Deductibility of expenses

The Act repeals the 30% electricity rebate that was introduced in January 2019 by the *Finance Act, 2018*. This was an incentive to manufacturing companies which have had to contend with high cost of power over the years.

It's unfortunate that this has been repealed when the Government is seeking to improve the contribution of the manufacturing sector to the overall Gross Domestic Product (GDP).

Exempt income

In a bid to sustain revenue collection, the Government has repealed exemptions previously granted to incomes of several Government parastatals, certain diplomats, as well as on other sources. Below are some notable ones:

Deletion from exemption list	Impact
Dividends paid by a Special Economic Zone (SEZ) enterprise, developer or operator to a nonresident person	This might discourage investments into the SEZs, which is against the spirit of this legislation, and at a time when the country is experiencing an economic slowdown.
Dividends paid to a registered venture capital company, SEZ enterprise, developer or operator registered under the *SEZ Act*	
Compensating tax accruing to a power producer under a power purchase agreement	This may discourage investments by the private sector since the usefulness of the tax incentive which is granted to them is reduced by tax on income whenever dividends are paid out of income in which tax is not paid.

Capital allowances/tax depreciation

The Act has repealed the Second Schedule to the *Income Tax Act* (ITA) and replaced it with a new schedule. Under the new schedule:

- Capital allowances will be claimed over a longer period.
- The attractive investment deduction of 150% of capital investment outside certain municipalities has been abolished.

The table below outlines the key highlights:

Type of asset	Previous rate (%)	New rate (%)	Additional comment
Hotel building	100	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years. ▸ Hotel building is required to be licensed by the competent authority. The Act has not however defined who is the competent authority.
Building used for manufacture	100	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years ▸ Building used for manufacture includes any structure or civil works deemed to be part of a building where the structure or civil works relates or contributes to the use of the building
Hospital buildings	Not provided for	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years ▸ Hospital building is required to be licensed by the competent authority
Petroleum or gas storage facilities	100	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years
Educational buildings including student hostels	50	10	▸ Claimable on reducing balance ▸ Educational building is required to be licensed by the competent authority

Type of asset	Previous rate (%)	New rate (%)	Additional comment
Commercial building	25	10	▸ Claimable on reducing balance ▸ Commercial building includes: – A building used as an office, shop, showroom, godown (warehouse), storehouse, or warehouse used for storage of raw materials for manufacture of finished or semi-finished goods – Civil works relating to water or electric power undertaking, but does not include an undertaking not carried on by way of trade
Machinery used for manufacture	100	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years ▸ This also includes machinery used for: – Generation, transformation and distribution of electricity – Clean-up and disposal of effluents and other waste products – Reduction of environmental damage – Water supply or disposal – Maintenance of the machinery – Scientific research and development *Manufacture* means the making, including packaging, of goods from raw or semi-finished goods, or the generation of electrical energy for supply to the national grid, or the transformation and distribution of electricity through the national grid, but does not include design, storage, transport, administration or any other ancillary activity
Hospital equipment	12.5	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years
Ships or aircrafts	100/ 25	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years
Motor vehicles and heavy earth moving equipment	37.5/ 25	25	▸ Claimable on reducing balance ▸ Claimable value restricted to KES3 million except for commercial vehicles which have no restriction
Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines	30/20	25	▸ Claimable on reducing balance
Furniture and fittings	12.5	10	▸ Claimable on reducing balance
Telecommunications Equipment	20	10	▸ Claimable on reducing balance

Type of asset	Previous rate (%)	New rate (%)	Additional comment
Filming equipment by a local film producer licensed by the Cabinet Secretary responsible for filming	100	25	▸ Claimable on reducing balance
Machinery used to undertake operations under a prospecting right	100	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years ▸ This allowance needs to be aligned with the 100% currently provided for in the Ninth Schedule to avoid conflict
Other machinery	12.5	10	▸ Claimable on reducing balance
Purchase or an acquisition of an indefeasible right to use fiber optic cable by a telecommunication operator	5	10	▸ Claimable on reducing balance
Farmworks	100	50	▸ Residual value to be claimed at 25% on reducing balance in the subsequent years ▸ The Act has however not defined farmworks and this could provide an avenue for the misinterpretation of the term by both taxpayers and Kenya Revenue Authority (KRA)

Employment tax

Individual tax rates

The individual tax rates bands have been expanded with the minimum monthly taxable income rising to amounts above KES24,000. The new graduated tax bands are as follows:

Previous income band (annual) KES	Current income band (annual) KES	Applicable tax rate (%)
On the first 147,580	On the first 288,000	10
On the next 139,043	On the next 200,000	15
On the next 139,043	On the next 200,000	20
On the next 139, 403	Income above 688,000	25
Income over 564,709	N/A	30

The Act has also increased the individual annual tax relief from KES16,896 to KES28,800.

The widened tax bands and increased relief are welcome moves for individuals as it will translate to a higher disposable income in the wake of the COVID-19 pandemic that has resulted in cash constraints for most people.

However, income accrued in prior periods but paid out now will still be taxable using the graduated tax bands and rates applicable in the year of accrual.

Pension withdrawal tax rates

The Act has reduced the highest tax band on pension withdrawals from registered retirement funds after 15 years to 25%, for amounts exceeding KES1,200,000 per annum.

In addition, the Act has widened the tax bands on income withdrawals from retirement funds before the expiration of 15 years in line with the individual tax rates highlighted above.

These changes will go a long way in increasing the disposable income available to retirees and a welcome measure in combating the financial hardships occasioned by the COVID-19 pandemic.

Turnover and presumptive tax

The Act has introduced several changes in relation to turnover tax as highlighted below:

- The annual income threshold for turnover tax has been set at between KES1 million and KES50 million.
- Turnover tax will also apply to incorporated companies. Previously turnover tax was only payable by unincorporated persons.
- The turnover tax rate has been reduced from 3% to 1%.
- The penalty for late submission of a turnover tax return has been reduced from KES5,000 to KES1,000.
- Presumptive tax previously payable at 15% has been repealed.

The above changes will help in managing the cashflow issues being experienced by small and medium enterprises in view of the COVID-19 pandemic.

The inclusion of incorporated entities is a positive development since most small and medium enterprises set up legal entities for certain legal and financial reasons.

Amendments to tax procedures

Private rulings

The Act has increased the time limit for the Commissioner to issue a private ruling from 45 days to 60 days on receipt of an application by a taxpayer. The Act has also repealed the requirement by the Commissioner to publish a private ruling.

The law has, however, not provided for clear implications where the Commissioner does not respond within the stipulated timeline. This leaves the Commissioner with a lot of discretion with respect to taxpayers.

Value-added tax

VAT base for selected petroleum products

The Act amends the definition of the value of supply of petroleum products to include excise duty, fees and other charges. The change will increase the taxable value of the products and hence the VAT amount.

The new tax measure will result in a price increment of petroleum products and similar price increases on downstream products and services. This measure is counterproductive to the main objective of the Act to cushion Kenyans against the economic effects of the COVID-19 pandemic.

Effective date: 15 May 2020

Additional criteria for issuance of a credit note

The Act allows businesses to issue a credit note within 30 days after the determination of a commercial dispute in court relating to the price payable.

Previously, the *VAT Act* only allowed businesses to issue credit notes within six months after the issuance of the relevant tax invoice. This provision aims to provide relief to businesses in cases where the court resolution of disputes ordinarily takes longer than the prescribed period.

Reduction in period within which to apply for VAT refunds arising from bad debts

The Act has reduced the period within which businesses can apply for VAT refunds arising from bad debts from five to four years if the debt remains unpaid for a period of three years from the date the supply was made. The change will require businesses to be prompt in seeking refunds, relating to bad debts, from the KRA as the window for claim has been reduced by one year.

Change to require all persons to maintain records of their transactions

Previously, only VAT-registered persons were required to maintain records. Going forward, all persons conducting business in Kenya will be required to maintain records of their business transactions for a period of five years and be ready to provide such records to authorized officials at all reasonable times for inspections.

Amendment of status of various VAT supplies

The Act amends the VAT status of the following products from taxable (14%) rate to exempt:

Description	Previous rate	Current rate
Personal protective equipment, including facemasks, for use by medical personnel in registered hospitals and clinics, or by members of the public in the case of a pandemic or a notifiable infectious disease	14%	Exempt

The Act amends the VAT status of the following services from exempt to taxable (14%) rate:

Description	Previous rate	Current rate
Insurance agency, insurance brokerage and securities brokerage services	Exempt	14%

The Act amends the VAT status of the following products from zero rate to exempt:

Description	Previous rate	Current rate
Vaccines for human and veterinary medicine	0%	Exempt
Medications	0%	Exempt

The Act amends the VAT status of the following products from exempt to standard rated:

Description	Previous rate	Current rate
Plants and machinery of Chapter 84 and 85 used for the manufacture of goods	Exempt	14%
Taxable supplies, excluding motor vehicles, imported or purchased for direct and exclusive use in the construction of a power generating plant, by a company, to supply electricity to the national grid approved by Cabinet Secretary for National Treasury upon recommendation by the Cabinet Secretary responsible for energy	Exempt	14%
Taxable supplies, excluding motor vehicles, imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration, by a company granted prospecting or exploration license in accordance with *Geothermal Resources Act*, production sharing contracts in accordance with the provisions of *Petroleum (Exploration and Production) Act* (Cap. 308) or mining license in accordance with the *Mining Act* (Cap. 306), upon recommendation by the Cabinet Secretary responsible for energy or the Cabinet Secretary responsible for mining, as the case may be	Exempt	14%
Taxable supplies procured locally or imported for the construction of liquefied petroleum gas storage facilities with a minimum capital investment of four billion shillings and a minimum storage capacity of 15,000 metric tons as approved by the Cabinet Secretary for National Treasury upon recommendation by the Cabinet Secretary responsible for liquefied petroleum gas	Exempt	14%
Plastic bag biogas digesters	Exempt	14%
Biogas	Exempt	14%
Leasing of biogas producing equipment	Exempt	14%
Parts imported or purchased locally for the assembly of computer, subject to approval by the Cabinet Secretary for the National Treasury, on recommendation by the Cabinet Secretary responsible for matters relating to information technology	Exempt	14%
Taxable goods purchased or imported for direct and exclusive use in the construction and infrastructural works in industrial parks of one hundred acres or more including those outside special economic zones approved by the Cabinet Secretary for the National Treasury	Exempt	14%
Museum and natural history exhibits and specimens and scientific equipment for public museums	Exempt	14%
Chemicals, reagents, films, film strips and visual aid equipment imported or purchased prior to clearance through the customs by the National Museums of Kenya	Exempt	14%
Goods falling under tariff number 4907.00.90 "Unused postage, revenue or similar stamps of current or new issue in the country in which they have, or will have, a recognised face value; stamp-impressed paper; bank-notes; stock, share or bond certificates and similar documents of title"	Exempt	14%
Materials and equipment for the construction of grain storage, upon recommendation by the Cabinet Secretary for the time being responsible for agriculture	Exempt	14%
The transfer of a business as a going concern by a registered person to another registered person	Exempt	14%

Description	Previous rate	Current rate
Taxable goods supplied to marine fisheries and fish processors upon recommendation by the relevant state department	Exempt	14%
Goods imported or purchased locally for direct and exclusive use in the implementation of projects under a special operating framework arrangement with the Government	Exempt	14%
Taxable services provided for direct and exclusive use in the construction and infrastructural works in industrial parks of one hundred acres or more on the recommendation by the Cabinet Secretary responsible for Industrialization including those outside special economic zones approved by the Cabinet Secretary for the National Treasury	Exempt	14%
Taxable services procured locally or imported for the construction of LPG storage facilities with a minimum capital investment of four billion shillings and a minimum storage capacity of a total value of fifteen thousand metric tons as approved by the Cabinet Secretary for National Treasury upon recommendation by the Cabinet Secretary responsible for LPG	Exempt	14%
Asset transfers and other transactions related to the transfer of assets into real estate investment trusts and asset backed securities	Exempt	14%
Services imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangement with the Government	Exempt	14%

Excise duty

Amendment of the definition of "other fees" as per the *Excise Duty Act*

The Act has amended the definition to provide clarity that only other fees as defined in the Act which relate to licensed activities are subject to excise duty. This makes it clear that fees earned from non-financial activities are not subject to excise duty.

Imposition of excise duty on exempt goods

The Act has introduced excise duty on the following products which were previously exempt:

Description	Previous rate	Current rate
Goods imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government	Exempt	Excisable depending on the specific tariff
One personal motor vehicle, excluding buses and minibuses 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 the spouse and which is not exempted from Excise Duty under the Second Schedule	Exempt	Excisable depending on the specific tariff

Miscellaneous fees and levies

Amendment of scope of the Railway Development Levy fund

The Act has amended scope of utilization of the funds raised through collection of Railway Development Levy (RDL) on imported goods to include operation of the standard gauge railway network to facilitate transportation of goods.

Previously, the funds were ring-fenced towards the construction of the standard gauge railway network.

Imposition of a processing fee on duty free motor vehicles

The Act has introduced KES10,000 (≈ USD 100) processing fees of on motor vehicles excluding motorcycles imported or purchased duty free prior to clearance through customs under the Fifth Schedule to the *East African Community Customs Management Act, 2004*.

Introduction of a processing fee on duty free items is intended to be a recovery measure of the costs of customs clearance of duty-free motor vehicles.

Imposition of Import Declaration Fees (IDF)

The Act amends the *Miscellaneous Fees and Levies Act* to introduce IDF on the following items which were previously exempt:

- Gifts and donations by foreign residents to their relatives in Kenya for their personal use
- Samples which in the opinion of the Commissioner have no commercial value
- Raw materials for direct and exclusive use in construction by developers or investors in industrial parks of one hundred acres or more located outside the municipalities of Nairobi and Mombasa
- Goods imported for the construction of liquefied petroleum gas storage facilities

Imposition of Railway Development Levy (RDL)

The Act amends the *Miscellaneous Fees and Levies Act* to introduce RDL on the following items which were previously exempt:

- Raw materials for direct and exclusive use in construction by developers or investors in industrial parks of one hundred acres or more located outside the municipalities of Nairobi and Mombasa
- Goods imported for the construction of liquefied petroleum gas storage facilities
- Goods imported for implementation of projects under special operating framework arrangements with the Government

Kenya Revenue Authority Act

Appointment of enforcement agencies

The Act has amended the *Kenya Revenue Authority Act* to empower the Commissioner to appoint a person registered under the *Banking Act* to act as an agent for revenue banking services through an agreement. Such a person will be required to submit the funds collected to the designated CBK account within two days. Failure to submit the funds collected within the stipulated two days will result in a penalty of 2% of the amount collected compounded daily for the period the funds are not submitted to the Central Bank. This is meant to enhance the collection of revenue for the Government.

Business Laws Amendment Act, 2020

Introduction of excise duty on selected imported glass bottles

The *Business Laws Amendment Act* made an amendment to Paragraph 1 of Part I of the First Schedule to the *Excise Duty Act* that prescribes the rates of excise duty on excisable goods. The amendment included imported glass bottles (excluding those for packaging of pharmaceutical products) in the list of excisable goods at an excise duty rate of 25%.

This change is expected to encourage the local manufacture of glass bottles by levying excise duty tax on imported glass bottles.

Effective date: 18 March 2020

Exemption of certain goods from Import Declaration Fee and Railway Development Levy

The *Business Laws Amendment Act, 2020* has also exempted goods which are imported or purchased for the construction of bulk storage facilities for supporting the standard gauge railway operations (with a minimum storage capacity of one hundred thousand metric tons of supplies) from both RDL and import declaration fee.

Effective date: 18 March 2020

Endnote

1. See EY Global Tax Alert, *Kenyan Government introduces tax measures in response to COVID-19*, dated 26 March 2020.

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