

Kenya enacts *Finance Act, 2020*

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Executive summary

On 30 June 2020, the President of Kenya assented to the *Finance Act, 2020*. This was a culmination of the budgetary process which began with the introduction of the Finance Bill, 2020 to Parliament on 6 May 2020.

The Act follows the enactment of the *Tax Laws (Amendment) Act, 2020* on 25 April 2020. The *Tax Laws (Amendment) Act, 2020* amended various tax laws and was aimed at responding to the COVID-19 pandemic.

The *Finance Act, 2020* (the Act) makes changes to tax laws, but also provides for other miscellaneous amendments to the *Insurance Act*, *Retirement Benefits Act*, *Insolvency Act*, *Kenya Revenue Authority Act*, *Capital Markets Authority Act* and *Public Roads Toll Act*.

The Act also introduces some of the not-business-friendly changes that were initially rejected by Parliament when the *Tax Laws (Amendment) Act, 2020* was enacted.

This Alert summarizes the key changes contained in the Act. Unless specifically noted, all of the changes came into effect on 30 June 2020. Provisions under corporate income tax and the *Tax Procedures Act* are effective 1 January 2021.

Detailed discussion

Corporate income tax

Introduction of a minimum tax

In a radical policy shift, the Act has introduced a minimum tax regime, with minimum tax payable at 1% of gross turnover. The tax will be payable by the following categories of persons whose:

- ▶ Income is not specifically exempt under the *Income Tax Act* (ITA)
- ▶ Source of income does not include employment, rent from residential property, capital gains, taxpayers in the extractive sector and taxpayers whose income is subject to turnover tax
- ▶ Installment tax payable in any year of income is lower than the minimum tax

The minimum tax will be payable in four installments by the 20th day of the 4th, 6th, 9th and 12th month of the year of income.

In addition to guaranteeing that enterprises pay a base tax thus expanding the tax base, the tax creates an obvious disincentive for enterprises to take venture risks. The timing is also unfortunate for businesses already operating in a difficult economic environment due to the COVID-19 pandemic. Of concern is the fact that companies which report tax losses due to investment incentives granted by the Government will suffer the minimum tax which claws back the intended benefit to investors.

The Government has certainly borrowed from other countries (such as Tanzania) which have minimum tax regimes. This is also in line with the Base Erosion and Profit Shifting (BEPS) action plans that seek to ensure that every organization pays a certain minimum level of tax in the various jurisdictions it operates in.

It is imperative that the governments consider industries which operate with very low margins and consider providing a "safe period" within which an entity is not required to pay minimum tax after incorporation.

Introduction of a digital services tax

The Act has introduced a digital services tax (DST) on income from services provided through a digital marketplace in Kenya at the rate of 1.5% on the gross transactional value. The DST shall be payable via a withholding tax system i.e., DST shall be payable at the time of the transfer of payment

to the service providers. The Commissioner may appoint a taxpayer as a DST agent to withhold and remit the tax to Kenya Revenue Authority (KRA).

The tax paid under this regime by a resident person or a permanent establishment of a nonresident person, shall be offset against the income tax payable for that year of income.

The digital economy has experienced tremendous growth across the globe in recent years. The COVID-19 pandemic has led to a full-blown adoption of the new trend hence leading to an increase in the volume of transactions concluded via digital marketplaces (e.g., online shops). This trend is expected to continue as digitization becomes more pronounced in the economy.

The taxation of the digital economy is a key action point under the BEPS project as governments appreciate the changing business landscape. There have, however, been calls for a consensus-based unanimous approach to the taxation of the digital economy to avoid double taxation.

Attempts to unilaterally introduce forms of digital taxes have faced resistance and attracted trade restrictions to some of the affected countries. It is notable that Kenya is currently negotiating critical trade deals with major economic powers. It therefore remains to be seen if the postponement of the introduction of the tax will be put as a condition precedent before the signing of the trade agreements.

Increase of income threshold qualifying for residential rental income tax

The Act has increased the threshold for income qualifying for residential rental income tax from KES10 million to KES15 million. Further, the amendment increased the tax-free amounts to KES288,000 annually which is consistent with the Pay As You Earn (PAYE) bands.

The amendment is geared towards broadening the tax net by encouraging more landlords to enroll into the simplified tax regime. It also cushions the landlords whose income is below KES288,000 from the effects of the COVID-19 pandemic.

Deductibility of expenses for corporate income tax

The Act has amended Section 15 to treat the following expenses as non-deductible:

- ▶ Entrance fees or annual subscriptions to eligible trade associations and club subscriptions paid by an employer on behalf of an employee

- Capital expenditure incurred on legal costs and other incidental expenses relating to rating, authorization and issue of shares, debentures or similar securities offered for purchase by the general public, as well as listing on the Nairobi Securities Exchange (NSE)

The *Tax Laws (Amendment) Bill, 2020* sought to introduce these provisions, but this was rejected by the National Assembly. However, barely a month later and in disregard of Standing Order 49, the Finance Bill, 2020 introduced the same changes and they have been assented into law other than the deductibility of capital expenditure incurred on the construction of a public school, hospital, road or any similar kind of social infrastructure. This will be a relief to enterprises that need to participate in the infrastructure development of local communities.

The enactment of the other changes less than six months since they were rejected puts into question the adherence of the National Assembly to house rules.

The amendment is likely to lead to a reduction in the membership of clubs and trade associations. At a time when companies are reviewing costs, this will be an extra cost to employers who pay the cost of club subscriptions for their employees and subscriptions to trade associations.

The move to treat legal and other incidental costs incurred during a listing on the NSE or where a company is looking to raise additional capital on the NSE as non-deductible for tax purposes will discourage listing at a time when there are very minimal activities on the NSE.

Abolishment of incentives under Home Ownership Savings Plans (HOSP)

The Act has repealed exemptions previously granted on incomes accruing to a registered Home Ownership Savings Plan (HOSP).

Additionally, contributions by individuals to a HOSP will not qualify as an allowable deduction when determining the taxable income. Interest income earned on deposits in a HOSP will also be subject to tax as opposed to previously where the initial KES3 million was exempt from tax.

The repeal of the tax exemption of a HOSP and deductions on contributions will discourage the use of such plans for home ownership which is not in line with an objective of the Government's Agenda to increase access to housing.

Review of tax exemptions

The Act has removed the previous exemption on bonuses and overtime paid to employees whose taxable employment income, before the mentioned benefits, was at the lowest tax band.

On the other hand, payment of a lump sum pension to persons of 65 years or more will be subject to tax. The Act now only exempts monthly pensions paid to persons of 65 years or more.

Tax Procedures Act

Introduction of a Voluntary Tax Disclosure Program

Similar to 2004, the Act has introduced a Voluntary Tax Disclosure Program (VTDP). The program, which will run for a three-year period with effect from 1 January 2021, will cover income taxes, value-added tax and excise duty. Under the amnesty:

- A taxpayer will need to make an application (in the prescribed form) to the KRA, disclose all related material facts, and pay the principal tax due.
- A waiver of penalties and interest will be granted to taxpayers at a rate of 100%; 50% and 25% for disclosures made within the first, second and third year of the program running respectively, provided that the relief granted does not result in a refund to the taxpayer.
- Income of a taxpayer under audit (or in receipt of an intention to audit) by the KRA will not be eligible for the program.
- Upon granting of the relief, the taxpayer and Commissioner will enter into an agreement setting out the terms of the payment. The Commissioner will also have a right to withdraw the relief if he establishes that not all material facts were disclosed, and this could lead to prosecution.

This is welcome move as the KRA tries to encourage the informal sector which mainly comprises micro, small and medium enterprises (MSME's) to contribute to the national treasury.

It also provides organizations with a chance to correct any oversights by reviewing their compliance over the past five years and where gaps are identified take advantage of the amnesty provided over the three-year period. The relief provided is cascaded as to incentivize full payment in the first year of the program. In addition, as an equity program, the principle is "to come with clean hands."

Appointment of DST agents

Further to the introduction of the DST, the Act now grants the Commissioner the power to appoint and revoke the appointment of DST agents.

The agents will be responsible for the deduction and remittance of DST in line with the law.

The administration of the DST should be aligned with the Value-Added Tax regulations on the supply of digital services to ensure that there is harmony in the implementation of the taxes related to the digital economy.

Tax Appeals Tribunal Act

The Act has expanded the scope of the admissible records that can form the grounds of the appeal to other documents which accompanied the appeal.

This makes it clear that a taxpayer can refer to documents accompanying an appeal in making his case even where such a ground may have been inadvertently left out in the appeal.

Value-Added Tax (VAT)

The declaration of output VAT by the supplier is now a condition precedent to the deduction of input VAT

Taxpayers will now be entitled to deduct input VAT upon meeting two conditions:

- ▶ The seller has declared the output VAT.
- ▶ The purchaser has received a valid tax invoice.

The advent of the VAT Automated Assessments (VAAs) by the KRA heralded a new era of reducing VAT fraud and associated leakages. The VAAs arise as a result of the tax system matching VAT declared by a seller to that being claimed by the respective purchaser in a specific transaction leading to the claimants being demanded to amend the VAT returns by removing the input VAT claims as a result of the sellers not declaring the corresponding output tax. This has been challenging as taxpayers have been providing proof that the input VAT deducted in their VAT returns was valid and in line with the *VAT Act, 2013* and that the demand by the KRA to match input VAT to output VAT has not been supported by law.

The "missing trader" case which brought to the fore the challenges that the KRA was facing in the verification of genuine input VAT or refund claims appears to have triggered the KRA into action and with the support of technology this has become a reality.

The KRA is expected to roll out an integrated tax system (TIMS - Tax Invoice Management System) which will be real time or near real-time. The implementation of TIMS will be key in ensuring that the amendment will not face legal hurdles.

VAT exemption of existing projects being undertaken under a Special Operating Framework Arrangement (SOFA)

Supplies to projects being undertaken under a SOFA with the Government will now be subject to VAT. The Act has, however, provided a relief to existing projects by providing a transitional clause that allows the existing projects to enjoy the previous exemption for the remaining period of the agreement.

Public-private partnerships have been on the rise in the recent past as the Government seeks to reduce the public debt as well as tap into the expertise and efficiency of the private sector. The success of these projects in a cost-effective manner is partly driven by the various tax incentives extended by the Government.

The transitional clause is a welcome move since it provides predictability and allows the respective parties to implement the projects in line with the initial budgets.

Change in the VAT status of various supplies

Standard rate to exempt

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

- ▶ Maize (corn) seeds of tariff no. 1005.10.00
- ▶ Ambulance services

Exempt to zero rate

In an apparent acknowledgement by members of the National Assembly that zero-rating of goods is a more ideal status when trying to reduce the cost of basic necessities. Accordingly, the supply of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than 10% in weight have been zero-rated for a period of six months until 31 December 2020.

Zero-rate to standard rate

The Act has also amended the VAT status of the following products from zero rated to the standard rate of 14%:

- ▶ The supply of liquefied petroleum gas (LPG) including propane

- Inputs or raw materials for electric accumulators and separators including lead battery separator rolls, whether rectangular or square, supplied to manufactures of automotive and solar batteries in Kenya including lead battery separator rolls (also whether rectangular or square) supplied to manufacturers of automotive and solar batteries in Kenya

The effective date of the change in the VAT status of the supply of LPG including propane is 1 July 2021.

Exempt to standard rate

The Act has also amended the VAT status of the following products from exempt to the standard rate of 14%:

Description
8802.11.00; Helicopters of an unladen weight not exceeding 2,000kg
8802.12.00; Helicopters of an unladen weight exceeding 2,000kg
8802.20.00; Airplanes and other aircraft of an unladen weight not exceeding 2,000kg
8803.30.00; Other parts of airplanes or helicopters
8805.10.00; Aircraft launching gear and parts thereof; deck-arrestor or similar gear and parts thereof
8805.21.00; Air combat simulators and parts thereof, and
8805.29.00; Other ground flying trainers and parts thereof
8309.90.90; Aluminum pilfer proof caps with EPE liner
Specialized equipment for the development and generation of solar and wind energy, including deep cycle batteries which use or store solar power upon the recommendation of the Cabinet Secretary responsible for matters relating to energy
Goods of tariff no.4011.30.00 (New pneumatic tires of rubber of a kind used on aircrafts)
Taxable goods locally purchased or imported by manufacturers or importers of clean cooking stoves for direct and exclusive use in the assembly, manufacture or repair of clean cook stoves upon recommendation by the Cabinet Secretary for the time being responsible for matters relating to energy
Stoves, ranges, grates, cookers (including those with subsidiary boilers for central heaters) barbeques, braziers, gas-rings, plate, warmers and similar non-electric domestic appliances, and parts thereof, of iron or steel of tariff numbers 7321.11.00, 7321.12.00, 7321.19.00, 7321.81.00, 7321.82.00, 7321.83.00 and 7321.90.00
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 his spouse and which is not exempted from VAT under the First Schedule
Hiring, leasing and chartering of helicopters of tariff numbers 8802.11.00 and 8802.12.00
Goods imported or purchased locally for direct and exclusive use in the implementation of projects under a special operating framework arrangement with the Government - This will apply to projects only

Excise Duty Act

Clarification on the definition of an excise license

The Act has clarified the definition of a license to include a license issued for any activity in Kenya for which the Commissioner by notice in the gazette may impose a requirement for a license. This change gives the Commissioner powers to prescribe additional activities requiring an excise license through a gazette notice. This amendment may be abused and does not make the excise duty regime consistent and predictable.

Amendment of thresholds for excise duty – alcoholic beverages

The Act amended the threshold for excise duty on Beer, Cider, Perry, Mead, Opaque beer and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages to apply based on their alcoholic strength percentage not exceeding 6%.

Previously, excise duty was only applicable on the such products at a rate of KES110.62 per liter provided the alcoholic strength is not in excess of 10%.

Additionally, the threshold for excise duty on spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages has also been lowered from 10% to 6%.

The amendment has lowered this threshold in order to align excise duty treatment of ready to drink alcoholic beverages with best practice.

Removal of excise duty on betting

The Act has removed excise duty applicable on betting at a rate of 20% of the amount waged or stake payable by bookmakers and passed on to punters.

This amendment is a reversal of Government policy which was initially geared towards the collection of revenue from licensed bookmakers and while at the same time to discourage betting activities by punters in Kenya due to the negative effects betting was deemed to have on the younger members of the citizenry.

Adjustment of excise duty rates for inflation

The *Excise Duty Act* empowers the Commissioner General to adjust specific excise duty rates once every year to take into account inflation.

The Act has amended this provision to provide the procedure that should be followed to make the changes:

- ▶ The Commissioner should seek approval from the Cabinet Secretary, National Treasury.
- ▶ The Cabinet Secretary shall table before the National Assembly the gazette notice within seven days from the publication date.
- ▶ The National Assembly shall consider and approve the gazette notice within 28 days sitting days from the date it was tabled.
- ▶ If a resolution is passed to disapprove the gazette notice, it ceases to have effect.

This is a welcome move as it will give more transparency and justification to the process of adjustment of the excise duty rates.

Effective date: 1 January 2021

Miscellaneous Fees and Levies Act

The Act has amended various fees and levies charged under the *Miscellaneous Fees and Levies Act* as follows:

Import Declaration Fees (IDF)

The Act has removed the following exemptions from the *Miscellaneous Fees and Levies Act*. The elimination of the IDF exemptions take effect from 30 June 2020 with the exception of aircrafts where the current exemption will continue to apply until 1 July 2021.

Description	Previous rate	Current rate
Aircraft of unladen weight not exceeding 2,000kg and helicopters of Heading 8802.11.00 and 8802.12.00	Exempt	3.5% of the customs value
Any other goods as the Cabinet Secretary may determine are in public interest, or to promote investments which value shall not be less than KES200 million	Exempt	3.5% of the customs value
Goods imported for implementation of projects under special operating framework arrangement with the Government	Exempt	3.5% of the customs value

The removal of exemptions will increase the cost of the imported items and increase revenue collections by the Government.

The Act has, on the other hand, introduced an exemption from IDF on goods including materials supplies, equipment, machinery and motor vehicles for the official use by the Kenya Defense Forces and National Police with the intention of reducing the cost of providing security services.

Goods imported under the East African Community (EAC) Duty Remission Scheme will now be subject to IDF at an ad valorem rate of 1.5% of the customs value, as opposed to the previously fixed rate of KES10,000.

Additional import duty on goods entered for home consumption from Export Processing Zones (EPZ)

The Act has introduced an additional import duty at a rate of 2.5% of the customs value payable in respect of goods entered for home use from EPZ enterprises.

The additional import duty is supplementary to import duties (i.e., Import Duty, Excise Duty, VAT, IDF, RDL) on goods declared for home use levied in accordance with Section 171 of the *EAC Customs Management Act* at rates specified in the EAC Common External Tariff and is intended to discourage the local sales of goods produced by EPZ which are meant for export outside the EAC.

Railway Development Levy (RDL)

The Act has introduced the following RDL exemptions with an aim of reducing their cost upon importation:

Description	Current rate	New rate
Currency notes and coins imported by the Central Bank of Kenya	2% of the customs value	Exempt
All goods, including material supplies, equipment, machinery and motor vehicles for the official use by the Kenya Defense Forces and National Police	2% of the customs value	Exempt

The Act has, on the other hand, removed the RDL exemption on goods as the Cabinet Secretary (CS) may determine are in the public interest, or to promote investments whose value exceeds KES200 million. Projects that the CS has already granted exemptions with a fixed duration of implementation will remain exempt from RDL per the conditions of the exemption.

Other miscellaneous amendments

The changes made in the following miscellaneous legislation will take effect from the date of assent of the *Finance Act, 2020*.

Insurance Act

The Act has introduced a 30-day time limit for parties that are dissatisfied with a decision of the Commissioner of Insurance in any dispute to file an appeal with the Insurance Appeals Tribunal.

The introduction of a timeline will enhance timely resolution of disputes.

Retirement Benefits Act

Under this act, the Retirement Benefits Authority Board may require the trustees of a scheme to be evaluated by an actuary and to present the actuarial report to the Chief Executive Officer of the Retirement Benefits Authority at such regular intervals as the Board may specify. The *Finance Act* has amended this act by instituting more stringent measures requiring that:

- ▶ A trustee who fails to submit a copy of the actuarial report to the Chief Executive Officer by the due date specified in the regulations shall pay a penalty of KES100,000.
- ▶ Where the report remains unsubmitted, the trustee, in addition to the penalty specified under subsection (2), shall pay a further penalty of KES1,000 for each day or part thereof during which the report remains unsubmitted.

Insolvency Act

The Act has amended the *Insolvency Act* to include as second priority claims all amounts that are held on behalf of the KRA by a person who is licensed under the *Banking Act* and who has been appointed as an agent for revenue banking services by the Commissioner at the point of receivership or liquidation of the bank or institution.

This is meant to safeguard funds held in collection accounts by banks at the point of receivership or liquidation. This is possibly due as a response to the difficulties in recovering such funds from the financial institutions that have been put under receivership in the past few years.

Capital Markets Authority Act

The Act has amended the *Capital Markets Authority Act* to bring private equity (PE) and venture capital (VC) companies that have access to public funds under the ambit of the Capital Markets Authority (CMA). This will allow the CMA to license, regulate and supervise their operations.

PEs and VCs have over the years been seeking a piece of the massive funds held by pension schemes. Lack of a legislative framework to enable pension schemes to invest in PEs and VCs has hampered this endeavor.

The Act has further amended the CMA Act to clarify that the investors who suffer pecuniary loss resulting from the failure of a licensed stockbroker or dealer to meet his contractual obligations will be granted compensation through the Investor Compensation Fund, but this compensation shall not include unclaimed dividends. This amendment could be intended to have the unclaimed dividends to be managed under the Unclaimed Financial Assets Authority.

The Public Roads Toll Act

The Act has introduced several changes to the *Public Roads Toll Act*. Some of the key changes are:

- ▶ Inclusion of private players as toll collectors upon appointment;
- ▶ Establishment of a Fund into which all tolls collected by appointed persons shall be remitted; and
- ▶ The Minister, or a roads authority, was required to obtain approval from National Assembly before they entered into an agreement with a suitably qualified person to plan, design, construct and manage a public road or any portion thereof which has been declared to be a toll road for the purposes of the Act. The approval from National Assembly will no longer be a requirement.

The operationalization of the *Public Roads Toll Act* will create the enabling legal framework to introduce tolls on these projects.

Kenya Revenue Authority Act

The Act has amended the *Kenya Revenue Authority Act* to provide for conditions that should be met for any legal action that is to be instituted against the KRA, that is:

- ▶ They must commence within three years after the act, neglect or default complained
- ▶ For continuing injury or damage, within six months after the cessation of the act
- ▶ At least one month written notice specifying the particulars of the claim and intention to commence the action or legal proceeding must be served upon the Commissioner General

The Act has also been amended to anchor the Kenya School of Revenue Administration (KESRA) in the law.

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EYG no. 004661-20Gbl

1508-1600216 NY
ED None

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