ALL BASES COVERED - ANALYSIS OF THE FINANCE ACT, 2019

The Finance Act 2019 ("The Act") was assented by the President on 7th November 2019. We have analysed the Act, providing insights into the implications of the various changes.

A. INCOME TAX ACT

1. Taxation of the Digital Economy

Section 3 of the ITA is amended to include taxation of income accruing from a digital market place. A digital market place is defined as "***a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means***"

The Act also introduces Section 3 (2A) which mandates the Cabinet Secretary to establish Regulations to assist in the implementation of the taxation of the digital economy.

This has been in a bid to align Kenya to *Action 1 of BEPS (Base Erosion and Profit Shifting) Action Plan.* This includes addressing the challenges of the digital economy and identification of applicable rules to enhance the existing international tax rules.

Examples of companies that are operating in this digital space include taxi hailing companies, online malls and other companies that promote and sell their goods and services on social media platforms.

It remains to be seen the practicality of this given the grey area that is profit attribution attributable to suppliers within the digital space who have no taxable presence in Kenya. Key questions will be how the taxable presence will be established in Kenya given that the major players in this industry have no permanent establishments (PE) in Kenya and how profit will be taxed under Kenyan jurisdiction.

Without the Regulations from the Cabinet Secretary, taxation of the digital economy will still follow the current rules where if an entity does not physical presence in Kenya under the PE rules, the income of that entity is not income that has accrued or been derived from Kenya; thus not taxable in Kenya.

We wait to see whether the Policy units in KRA and National Treasury will adopt the OECD policy proposal under the "***Unified Approach*"** that seeks to provide a multi-lateral solution to the taxation of the digital economy. It is significant for the National Treasury & KRA to understand how the digital economy works before coming up with any drastic tax measures. It will be interesting to see how these pertinent questions will be addressed.

Effective Date: 7th November 2019

2. Dividend distributed out of untaxed gains

The Act introduces a new proviso under Section 7A that excludes income that is exempt from tax.

The Finance Act 2018 had previously introduced a 30% tax on dividends distributed out of untaxed gains. However, it was unclear on whether this provision applied to exempt income. This clarifies that dividends paid out of exempt income shall not be subject to tax at 30%.

Therefore, exempt income such as interest earned from tax exempt infrastructure bonds and which is distributed to the shareholders will not be considered as income from untaxed gain. This clarification will prevent operation of the law in a lacuna without the clarification which shall ease the implementation and collection of the taxes.

This offers clarity and confirms Taxwise Africa own interpretation in last year's analysis on the same topic. Can find our previous analysis on our website under the tax hub.

Effective Date: 7th November 2019

3. **Clarification of Taxable Income of Non-resident Ship owners**

Section 5 of the Act introduces a proviso under Section 9 (1) of the Income Tax Act with the effect that all income of a non-resident shipping line including income from delay in taking delivery of goods or returning any of the equipment used for the transportation of goods shall be deemed to be income derived from Kenya.

This reverses the amendments introduced in the Finance Act 2018 that levied withholding tax at the rate of 20% on demurrage and detention. The amendments in the Finance Act 2018 were in direct conflict with Section 9. The 2019 amendment treats demurrage as part of freight as per international best practice.

It should be noted that Section 2, 10 (i), 34 (n) and 35(m) of the ITA on demurrage charges have been deleted by the Act.

Currently at the High Court there are various cases on taxation of demurrage and detention (D&D). As the cases are still ongoing, we reserve our comments until the judgment is published expected in early 2020.

Effective Date: 7th November 2019

4. **Clarity on WHT on reinsurance premiums paid to non-residents**

The Act recognizes the reinsurance premiums as income derived from Kenya and subject to WHT.

Previously, the Finance Act 2018, only imposed WHT on insurance premiums paid to non-residents. However, it was unclear whether the same applied to reinsurance.

This has been clarified by the Act specifically subjecting reinsurance premiums paid to non-residents to WHT.

Effective Date: 7th November 2019

5. **WHT on payments made by a Permanent Establishment to its Head Office**

The Act now subjects WHT on payments made by a branch to its head office, where the expenses are deductible under the provisions of a Double Taxation Agreement (DTA).

Previously, the non-deductible expenses paid by a branch to its head office were not subject to WHT even where the deduction was allowable by the DTA.

The implementation of this provision however raises eyebrows considering that most of the DTAs that Kenya has entered and the Articles of the Model Convention with respect to Taxes on Income and on Capital (OECD Model) contains the Non- Discrimination Clause.

This Clause stipulates that the nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances.

The introduction thus of the WHT on branches under the DTAs will be discriminatory considering that they will have to withhold tax and yet other branches not covered in DTAs will be exempted from such Withholding. This is essence means that taxation for the branches under DTA will be more burdensome as compared to other branches under the same circumstances.

Effective Date: 7th November 2019

6. **Re-introduction of Turnover Tax**

The Act re-introduces the turnover tax at a rate of 3% of the gross receipts of the business to be paid by resident persons whose annual turnover does not exceed Kshs. 5 Million. The tax will be payable on or before the twentieth day of the following month.

However, this does not eliminate the presumptive tax initially introduced through Finance Act 2018. Presumptive tax will be maintained at a rate of 15% of the business permit/trading license fee and will be offset against the amount of tax payable.

This will regulate tax collection and promote equitable taxation by ensuring that taxes paid are proportionate to the taxpayer's revenues. Further, the retention of presumptive tax will provide information to the Commissioner hence easing verification of tax compliance.

Effective Date: 1 January 2020

7. **Thin Capitalization**

The Act excludes the payment of tax on interest on loans advanced to thinly capitalized company that is implementing a project under a housing scheme upon recommendation by the Cabinet Secretary. This is in line with the government's Big Four Agenda to provide affordable housing.

Effective Date: 1 January 2020

8. **Exemption of Investee companies under collective investment schemes**

The Act introduces Section 20 (1) (d) of the ITA with effect that the investee companies of a real estate investments trust (REITs) shall be exempt from payment of income tax. This is an extension of tax incentives to REITs. This encourages investments in REITs as a way of the Government supporting investors in real estate.

Effective Date: 7th November 2019

9. **Regulation of Home Ownership Saving Plan (HOSP)**

Under Section 22C of the ITA an individual is entitled to deductions on funds deposited under a registered Home Ownership Savings Plan.

The Act diversifies the scope of regulation of HOSP by introducing Capital Markets Authority (CMA) as one of the regulators. Moreover, the scope of approved institutions has been widened to include a fund manager or investment Bank registered under the CMA Act.

Effective Date: 1 January 2020

10. **Removal of penalties**

The Act has deleted Section 72D which provided for penalty on late payment of tax at a rate of 20%. This is informed by the fact that penalty on late payment is provided for under Section 83A of the TPA at the rate of 5%. This is aimed at eliminating ambiguity in the interpretation of the law by harmonizing its application with the provisions of the Tax Procedures Act.

Effective Date: 7th November 2019

11. **Exemption under the National Housing Development Fund**
The Act exempts from tax, the income of the National Housing Development Fund. This move will ensure that the Fund has enough revenue to facilitate the affordable housing project which is part of by the government's Big Four Agenda.

Further, the amounts withdrawn from the Fund to purchase a house by a contributor who is a first time owner is also exempt from taxation.

Effective Date: 1st January 2020

12. **Income from individuals under the Ajira Digital Program**
Ajira Digital program is an initiative by the government to ensure job creation for the youth through an online portal that enables them access online job opportunities. As such, through the introduction of this program, the Act exempts individual registered members from income tax. However, they shall be required to pay an annual fee of **Kshs 10,000** for the first 3 years.

This move is aimed at incentivizing the youth to opt for online jobs by joining the platform without fear of taxation at the wake of taxation of the digital economy. It is consensus that the **Kshs 10,000** registration fees are high for unemployed persons in Kenya. It therefore remains to be seen how effective the Ajira Digital Program will be.

Effective Date: 1st January 2020

13. **Exemption of Income Tax on listed bonds, notes and similar securities**
The Act exempts from income tax interest income accruing from listed bonds, notes and similar securities intended to raise funds for infrastructure, projects and assets under the Green Bonds Standards and other social services with a maturity of at least 3 years.

A Green Bond is a bond specially earmarked to be used for climate and environmental projects e.g. those related to clean water, renewable energy and mitigation of climate change impacts. This exemption is aimed at promoting investment in ventures that minimize degradation.

Effective Date: 1st January 2020

14. **Reduction of Corporation Tax Rate for Plastic Recycling Plants**
The Act lowers the rate of Corporation tax for any investor operating a plastic recycling plant to 15% in the first 5 years of operation.

This will promote recycling of plastics which is in line with the Sustainable Development Goals and will aid in ensuring that the Environment and Natural resources are preserved accordingly for sustainable development.

Effective Date: 7th November 2019

15. **Exemption of Transfer of Property from Group Restructuring from CGT**
The Act exempts from CGT, the transfer of property necessitated by restructuring of corporate entities where such transfer is:

- A legal or regulatory requirement;
- As a result of directive or compulsory or compulsory acquisition by the government;
- An internal restructuring within a group which does not involve transfer of property to a third party; or
- In public interest and approved by the cabinet secretary.

This exemption will foster restructuring aimed at enhancing efficiency and certainty.

Effective Date: 7th November 2019

B. TAX PROCEDURES ACT (TPA)

1. **Exemption from PIN requirement**

The TPA to empowers the Commissioner to exempt persons from the requirement to obtain a PIN before performing any transactions under the First Schedule of the Act for instance opening bank accounts, where there is reasonable cause to do so.

Previously, every individual, including foreigners were required to provide PIN details before transacting in respect to the activities under the First Schedule.

This move aims at facilitating and promoting business as the PIN acquisition process is at times lengthy and hinders business, especially by foreign investors.

Effective Date: 7th November 2019

2. **Tax Amnesty for SMEs that List on the Growth Segment**

The Act introduces a three-year tax amnesty on all penalties and interest incurred in any year prior to listing for companies that list on the growth segment of a securities exchange in Kenya. However, this is on the condition that the company pays the principal tax in full and makes full disclosure of its past income, assets and liabilities for the two years immediately preceding the date of listing.

The amnesty shall not extend to cases where the company has been assessed or is under audit or investigation in respect of the undisclosed income. Additionally, the Act proposes that should a company choose to delist before expiry of a 5-year period, all taxes prior to being listed in the securities exchange shall become payable.

Effective *Date: 7th November 2019*

3. **Recovery of Taxes**

The Finance Act introduces a new Section under the TPA which empowers the Commissioner to recover taxes from a person who fails to deduct or withhold tax under a tax law. This will see an increase in the level of tax compliance as persons liable to deduct and remit taxes will be more vigilant to avoid incurring undue taxes, penalties and interest.

Effective Date: 7th November 2019

4. **Reduction of Withholding VAT rate**

The Act reduces the rate of Withholding VAT from 6% to 2%. Moreover, it excludes the zero-rated supplies from Withholding VAT. This will reduce withholding VAT credit.

Effective Date: 7th November 2019

5. **Departure Prohibition Order (DPO)**

The Act widens the scope of Section 45 of the TPA to include tax representatives of companies. Consequently, the Commissioner may issue a person with a DPO for taxes owned in a company where they are a tax representative.

Effective Date: 7th November 2019

6. **Objection Decision Period**

The Act has amended Section 51 of TPA with the effect that the period within which the Commissioner is required to issue an objection decision to be 60 days of receiving the notice of objection or any additional information the Commissioner may require from the taxpayer.

The difficulty with this Section is that the precise period within which the Commissioner may seek additional information is not limited. As such this may impede timely determination of tax disputes to the detriment of the taxpayer.

Effective: 7th November 2019

7. **Determination of Late Submission Penalty**
The TPA is amended under Section 83 with the effect that the calculation of the late penalty payable shall be based on the amount payable after deducting the tax already paid and any tax credits due.

Effective: 7th November 2019

8. **Tax Shortfall Penalty**
Section 84(2)(b) of the TPA has been deleted to exclude shortfall penalty on unintentional omission by a taxpayer. This will ensure that the penalty shall be justifiably excluded where the taxpayer had no intention to mislead the Revenue Authority and its officers.

Effective: 7th November 2019

9. **Expansion of transactions requiring PIN**
The First Schedule of the TPA is amended by introducing further transactions that will require the presentation of a PIN. Professional bodies and licensing agencies are now required to demand for PINs from its members during registration and renewal of membership.

Further, telecommunication operators are also required to demand PIN details during registration of mobile cellular pay bill and till numbers.

This will enhance compliance and ensure that all taxpayers are duly registered making it easier for KRA to monitor and collect taxes.

Effective: 7th November 2019

C. MISCELLANEOUS FEES AND LEVIES ACT

1. **Import Declaration Fee (IDF)**

The Act increases the rate of IDF on imported finished goods from 2% to 3.5% of their customs value. The Act also reduces the rate of IDF on raw materials imported by approved manufacturers and input for construction of houses under an affordable housing scheme approved by the Cabinet Secretary to 1.5% of their Customs Value from the previous 2%.

Effective: 7th November 2019

2. **Railway Development Levy (RDL)**
The Act has also increased the rate of RDL on imported goods from 1.5% to 2%. However, the RDL rate on raw materials is retained at 1.5%.

Effective: 7th November 2019

3. **Refund of Anti-adulteration levy**
The Act amends Section 8A of the Act, making importers of illuminating kerosene used by licensed and registered manufacturers of paint, resin or shoe polish, eligible for a refund of adulteration levy upon the approval of the Commissioner.

The adulteration levy was introduced by the Finance Act 2018 to curb fuel adulteration. However, this has had a negative effect on businesses that use illuminating kerosene as a raw material in manufacturing. This will reduce the cost of production and that of finished products while ensuring that legitimate businesses are not penalized for the misuse by others.

Effective: 7th November 2019

D. MISCELLANEOUS

The Finance Act, 2019 also amends the following Acts as follows **effective 7th November 2019**;

1. The Privileges and Immunities Act (Cap. 179)

The Act amends the Fourth Schedule to exempt imported or locally purchased goods/services by privileged organizations for their official use from taxes.

2. The Capital Market Act (Cap. 485)

The Act introduces financial penalties as civil debts by the Capital Markets Authority. They are mandated to recover debts according to recovery of decretal sums. The amendment is intended to enhance enforcement and recovery of financial penalties imposed by the Authority.

3. The Banking Act (Cap. 488)

Section 33B of the Banking Act has been repealed to remove the cap on interest rates charged on loans offered by commercial banks. The import of this is that commercial banks are now at liberty to self-regulate in terms of setting interest rates on loans issued by them.

4. The Retirements Benefits Act (No. 3 of 1997)

The Act sets a time limit on transfer of scheme funds to guaranteed funds from 3 years to 1 year over a transfer period. This reduces exposure to low returns.

5. The Employment Act (No. 11 of 2008)

The Act deletes the definition of "employee's earnings" and introduces the definition of "basic salary" defined as the employee's gross salary excluding allowances and benefits, to guide on the base amount for computing the levy payable to the National Housing Development Fund.

6. The Accountants Act (No. 15 of 2008)

The Act removes the requirement for accounting students to register with ICPAK before qualifying as accountants.

7. Housing Act (CAP 117 Laws of Kenya)

The Act is amended by deleting the words "Housing Fund" and substituting the same with "National Housing Development Fund." Where a person is convicted for loss of money under thus Fund, such person shall be liable to a penalty equivalent to twice the amount lost.

Further, a person convicted of an offence under the said Act shall be liable to a fine not exceeding Kshs. 1M or a term not exceeding 3 Years imprisonment or both.

8. The Stamps Duty Act, (CAP 480 Laws of Kenya)

In line with ensuring there fulfilment of the Big Four Agenda on Housing, the Stamp Duty Act has been amended with the effect that transactions involving transfer of houses from developers to the National Housing Corporation are exempted from stamp duty.

9. The Standards Act (CAP 496 Laws of Kenya)

The Act introduces the definition of a consolidator as a person who assembles cargo belonging to various persons to form one consignment at the country of supply which may be declared as belonging to one importer. Under the introduced Section 14C of the Standards Act, The Kenya Bureau of Standards (KEBS) in consultation with KRA will vet and register all consolidators prior to importation.

E. VALUE ADDED TAX ACT

1. Definition of supply of imported services

The Act defines “supply of imported services” to include supplies made to any persons. Previously the definition was limited to supplies made by a non-registered person to a registered person. As such the new definition includes the payment of reverse VAT by a non-registered person.

The implication of this is that the revenue base is broadened by ensuring that all persons importing vatable services have to pay VAT. This is a huge hit for non-registered entities including financial institutions and residential real estate entities

Effective: 7th November 2019

2. Official aid funded projects

The Act introduces definition of a concessional loan as a loan with at least 25% grant element. Concessional loan is used to define what constitutes an official aid funded project. This is set to limit the projects that would qualify as official aid funded projects to those that are financed through grants or concessional loans with at least 25% grant element.

This therefore means that not all projects will qualify for tax exemptions as official aid funded projects unless the set threshold is met and approval for exemption granted. Similar proposals have been made in the Excise Duty Act with regard to official aid projects.

Effective: 7th November 2019

3. Clarification of chargeability to tax for transactions in the digital economy

The Act also brings the digital economy under the its ambit with the introduction of VAT on supplies made through a digital platform. A digital platform is defined as a platform enabling buyers and sellers to transact through electronic means. This is a general definition set to capture taxpayers transacting through a digital platform.

The taxation of the digital economy is in line with BEPS initiatives to prevent tax erosion. This is by ensuring that tax measures are able to adapt with evolving business models. This will essentially create a need for operators within the digital economy to be registered and account for VAT locally.

While the taxation of the digital economy may be vague under income tax, for VAT there are provisions for a non-resident appointing a tax representative to account for VAT applicable in Kenya.

That said, the National Treasury and KRA need to provide clear guidelines and regulations to ensure compliance.

Effective: 7th November 2019

4. Tax Point for Special Economic Zone’s supply

The Act includes the interpretation of Time of supply of imported goods and services to cover the SEZ. This definition has been broadened to include the time goods are removed from an SEZ for local/home use. As such the tax point for a supply by an SEZ to a person not within the SEZ, will be at the point of importation.

Effective: 7th November 2019

5. Changes in VAT Act *(Effective: 7th November 2019)*

Item	Amendments	Rationale
Supplies of specialized equipment for the development and generation of solar and wind energy	Limit exemption to supplies approved by the Energy CS	Limits exemption to supplies approved and recommended by Energy CS.
Tractors	Supply of tractors excluding road tractors used for semi-trailers.	Limit exemption to tractors for agricultural use.
Supplies of inputs or raw materials for electric accumulators and separators including lead battery separator rolls whether rectangular or square supplied to manufacturers of automotive and solar batteries in Kenya	Exempt	Streamline zero rated supplies and reduce VAT refund claims.
Agricultural pest control products	Exempt	Agricultural pest control products more affordable to farmers for agricultural production. This is in line with the Big 4 pillar of enhancing food security.
Supplies of locally manufactured motherboards and inputs for manufacture of motherboards	Exempt	Locally manufactured motherboards to be competitive in the market and inputs to be affordable.
Supplies of plant, machinery and equipment used in construction of plastics recycling plant	Exempt.	Incentivizes recycling of plastics.
Supply of maize, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than 10% weight	Exempt	To ensure food security
Goods imported or purchased locally for the direct & exclusive use in the construction of houses under an affordable housing scheme approved by the CS	Limited exemption on recommendation by the CS Housing	Promotion of the affordable housing
Musical instruments and other musical equipment imported or purchased locally for exclusive use by educational institutions	Limited exemption on the recommendation by CS - Education	To ensure that educational institutions receive music equipment at lower prices to facilitate the promotion of music in schools.
Supplies of stock exchange brokerage services	“Stock” replaced with “securities” as the term securities has a wider coverage compared to stock.	Expansion of scope of application of exemption of brokerage services for securities other than stocks.
Supply of denatured ethanol	Zero rated	Encouraging use of clean energy stoves.

F. Excise Duty

1. Excise duty on betting transaction

In a bid to discourage betting activities, the Act introduces a 20% excise duty on amount wagered or staked.

The amount wagered or staked means the amount of money place by a person for an outcome in a betting transaction.

Previously excise duty was imposed only on the winnings. The introduction of the taxing point broadens the tax base to anyone who engages in betting regardless of the outcome.

Effective: 7th November 2019

2. General penalty

The Act introduces a general penalty of a fine not exceeding 2 million shillings or imprisonment for a term not exceeding 2 years or both. The general penalties seek to cover offences under the Act or Regulations that no specific penalty has been prescribed. This proposal seeks to ensure that there are no offences that will go unpunished. Consequently, this will promote compliance.

Effective: 7th November 2019

3. Excise duty on other fees

The Act defines "other fees" by noting that premium based or related commissions are those specified under Insurance Act or other regulations. The amendment brings clarity on which premium based or related commissions are exempt to avoid any ambiguity and abuse.

Effective: 7th November 2019

4. Inflationary adjustment date

The Act provides that the adjustment day for the annual inflationary adjustment will be 1st October of every year. Previously, the same has been 1st July. This change is geared towards giving the Commissioner ample time to comply with all the legal requisites before publishing the legal Notice on inflationary adjustments. This will ensure the rates come into force concurrently with the provisions of Finance Act.

Effective: 7th November 2019

5. EXCISABLE GOODS MANAGEMENT AMENDMENT

First Schedule: Rates for Excisable Goods

Section 26 of the Finance Act introduces the following changes:-

Description	Excise Duty Rate
Cigars, cheroots, cigarillos, containing Tobacco or tobacco substitutes	Shs.12,624 per Kg.
Electronic Cigarette	Shs.3,787 per unit
Cartridge to be used on electronic cigarette	Shs.2,525 per unit
Cigarettes with filters(Hinge lid and soft cap)	Shs.3,157 per mile
Cigarettes without filters(Plain cigarettes)	Shs.2,272 per mile
Other manufactured tobacco and manufactured tobacco substitutes 'homogeneous 'reconstituted 'tobacco extracts and essences	Shs.8,837 per Kg.
Wines including fortifies wine and other alcoholic beverages obtained through fermentation of fruits	Shs.189 per litre
Spirits of undenatured ethyl alcohol, spirits, liquors and other spirituous beverages of alcoholic strength exceeding 10%	Shs.253 per litre
Motor vehicles of tariff heading 87.02.87.03 excluding i. Locally assembled motor vehicles ii. School buses for use by public schools iii. Motor vehicles of tariff no.8703.24.90 and 8703.33.90 iv. Imported motor vehicles of cylinder capacity exceeding 1500cc	20%
Imported motor vehicle of cylinder capacity exceeding 1500cc and of tariff head 87.02,87.03,87.04	25%
Motor vehicles of Tariff head 8703.24.90 and 8703.33.90	35%
100% electric powered motor vehicles of tariff no.8702.40.19,8702.40.22,8702.40.91,8702.40.99 and 8703.80.00	10%
Plastic shopping bags	Deleted
Imported sugar confectionary	Kshs. 20 per Kg
Imported white chocolate in blocs, slabs or bars	Kshs. 200 per Kg

G. Proposal In The Finance Bill Rejected In The Finance Act

A. INCOME TAX ACT

Capital Gains Tax

The Parliament rejected the proposal to increase the rate of CGT payable from 5% to 12.5**%.**

Withholding Tax

The proposal to expand the scope of withholding tax to cover the following services; security, cleaning and fumigation, outside catering, transportation of goods, sale promotion and marketing and advertising was rejected.

B. MISCELLANEOUS FEES & LEVIES ACT

Export Duty Levy

The proposal to amend the first schedule of the Act by reducing the export duty levy from 80% to 10% in respect of tanned and crust hides and skins was rejected by Parliament.

C. MISCELLANEOUS

Proceeds of Crime and Anti-Money Laundering Act (Act No. 9 of 2009)

The proposal to amend the definition of designated non-financial businesses and professions to include advocates, notaries and independent legal practitioners was disallowed.

D. EXCISE DUTY ACT

Betting Transactions

Parliament rejected the proposal to have the excise duty chargeable on stakes and wagers of a betting transaction at 10%. The same was increased to 20%.

Let's talk

For further information on how the proposed tax provisions will affect your business or assistance on any other matter kindly contact your regular Taxwise Africa analyst or the contacts below.

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