ANALYSIS OF THE TAX LAW (AMENDMENT) ACT, 2020

The Tax Law (Amendment) Act, 2020 ("The Act") was assented by the President on 25th April 2020 in a bid to cushion against the effects of the COVID 19 pandemic on Kenyans and the economy in general. We have analysed the Act, providing insights into the implications of the various amendments.

A. INCOME TAX ACT – *(Effective 25th April 2020)*

1) Qualifying Interest

Section 2 of the ITA has been amended by introducing a new definition for ***'qualifying interest'*** to include interest from all sources received by a resident individual in any year of income. The said definition is no longer limited to interest earned from banks and financial institutions.

The implication of this is that the definition on qualifying interest has widened.

2) Withholding Tax on sales promotions, marketing and advertising

The Act introduces WHT on payments made to non-residents for services relating to sales promotion, marketing, advertising and transportation of goods but excluding air and shipping transport services.

The applicable Withholding Tax rates is **20%** of the gross amount payable. This widens the scope of WHT by subjecting more income to WHT. This will more likely increase tax revenue collected under WHT.

3) Turnover Tax

The Act amends the provisions on the turnover tax to the effect is now chargeable at a rate of 1% of the gross revenues per month. This is to be paid by resident persons whose annual turnover from the business is more than Kshs. 1 Million but not exceed Kshs. 50 Million. Moreover, incorporated companies are now under ambit of the Turnover Tax (TOT). Further, the Act has eliminated presumptive tax obligations which had become a challenge to implement.

Consequently, the scope of TOT has been widened to include income from incorporated companies and increasing tax threshold limits from Kshs 1M to Kshs. 50Million. This will essentially cushion many businesses from the economic effects of COVID-19 outbreak. The reduced rate may be more suitable for business compared to the corporation tax rate, more so where they are not in a loss position or have tax credits. However, an analysis would have to be done to select the most suitable regime between TOT at 1% of the gross revenues per month or corporation tax at 25%/37.5% per annum.

4) Allowable Expenses

The Act minimize the expenses that are allowable in computing the taxable profit by deleting Section 15(2)(ab) of the ITA. The effect of this amendment will be that normal electricity costs will still remain an allowable deduction, however the additional 30% electricity costs that was an incentive will no longer be an allowable deduction.

We note that this amendment goes against the tax incentives previously issued to boost the manufacturing industry.

5) Withholding Tax on Reinsurance premiums

WHT at the rate of 5% is now imposed on both the insurance or reinsurance premiums excluding those paid in respect of aviation insurance.

Previously, the ITA only imposed WHT on insurance premiums paid to non-residents. This has been clarified by the Act to include reinsurance premiums paid to non-residents to WHT expect for those relating to aviation insurance.

6) Reduction of Exempt Income

The Act has introduced some amendments to Part A of the First Schedule of the ITA to the effect that income that was previously exempt for tax that will be subject to Tax. The following income will no longer be exempt from imposition of income tax: -

- Income earned by various agricultural boards and various institutions namely Kenya Post Office Savings Bank and, the Settlement Fund Trustees;
- Profits of an agricultural society from any exhibition or show held for the purposes of the society which are applied solely to such purposes, and the interest on investments of such society.
- Interest on tax reserve certificates issued by Government;
- Payments of not more than 3 months' salary paid to employees of the Government as a result of a disturbance due to a change in the Constitution of the Government;
- Emoluments of officers of the Desert Locust Survey payable from public funds;
- Education grants received by public servants payable by the Government of the United Kingdom under an arrangement with the Kenyan Government;
- Remuneration received under a contract based on financial assistance received from International Co-operation Administration;
- Remuneration paid to US citizens employed by the US Department of Agriculture working in cooperation with the Kenyan Government;
- Rewards payable by the UK Atomic Energy Authority for the discovery of Uranium Ore in Kenya;
- Interest income, management and professional fees accrued in Kenya and paid to non-residents with no Permanent
- Establishments by the Tana River Development Company Limited or its successors in title;
- Income earned by the East African Power and Lighting Company;
- The income of the General Superintendence Company Limited accrued in Kenya;
- Interest on cashflows to investors on asset backed securities and on loans granted by the Local Government;
- Compensating tax payable by a power producer under a power purchase agreement; and
- Dividends paid by SEZ developers or operators to any non-resident persons;

The aim of these amendments is to clean up the First Schedule items by removing exempt items that may not be applicable to date as well as limiting the exempt income. This will increase tax revenues as taxable income will increase.

However, given the current economic situation facing the country due to the COVID-19 Outbreak, the limitation of exempt incomes may not beneficial to the affected Taxpayers.

7) Repeal of the Second Schedule

The Second Schedule of the ITA on deduction of capital expenditure has been repealed and replaced with the following amendments.

INVESTMENT ALLOWANCE

A. BUILDINGS ➢ Hotel Building ➢ Building used for manufacture ➢ Hospital Building ➢ Petroleum/gas storage facilities	50% in 1st year
➢ Residual value of the above items	25% per year on a reducing balance basis
➢ Educational building including hostels ➢ Commercial building	10% p.a. on reducing balance
B. MACHINERY ➢ Machinery used for manufacture ➢ Hospital equipment ➢ Ships ➢ Aircraft	50% in 1st year
➢ Residual value of items above ➢ Motor vehicles and Heavy Earth Moving equipment (Kshs. 3 Million restriction) ➢ Computer Hardware, peripheral equipment and Software ➢ Filming Equipment by a local film produce	25% per year on a reducing balance basis
➢ Furniture and fittings ➢ Telecommunication equipment	10% per year on reducing balance
➢ Machinery to undertake operations under a prospecting right ➢ Machinery to undertake mining operations	50% in the 1st Year and 25% per year on reducing balance basis
➢ Other Machinery **C.** Purchase or an acquisition of an indefeasible right to use fibre optic cable by a telecommunication operator	10% per year on reducing balance
D. Farmworks	50% in the 1st Year and 25% per year on reducing balance basis

These changes may be in line with the aim to overhaul the Income Tax Act and update income tax laws.

From the above, it follows that the reduction of capital allowance rates will reduce tax incentives to investors. However, investors who have already claimed capital deductions prior to the introduction of these changes will still claim the same deductions at the previous rates.

The reduction of capital allowance incentives is a move to reduce tax revenue loss through the incentives. This however may reduce the incentive to invest which is something that would be beneficial in encouraging investment and economic growth at a time like this.

8) <u>Exemptions of Capital Gains Tax on transactions by individuals</u>

Part A of Paragraph 36 of the First Schedule has been amended by imposing CGT on some of the gains previously exempted from CGT upon transfer. The gains derived from the transfer of the following now be subject to CGT: -

a) Shares or funds of the Kenyan Government, High Commission or Authority established under the East African Community;
b) Shares in the local authority; and
c) Land which has been adjudicated under the Land Consolidation Act (Cap. 283) or the Land Adjudication Act (Cap. 284) when the title to such land has been registered under the Registered Land Act (Cap. 300) and transferred for the first time.

Though the said amendments will increase tax revenues there is also an increase in the CGT tax burden for individuals carrying out the transfers outlined.

9) <u>Amendments on Pay As You Earn</u>

a) Increase in the Personal Relief

The Act has increased the personal relief to persons earning employment income from Kshs. Kshs. 16,896 to Kshs. 28,800. The tax relief has been increased so as to cushion employees in the wake of the COVID 19 pandemic.

b) Change of PAYE Tax Brackets

The individual tax rates as amended are now as follows: -

	Rate
On the first Shs. 288,000	10%
On the next Shs.200,000	15%
On the next Shs. 200,000	20%
On all income above Shs. 688,000	25%

The change in tax bands and increase in personal relief for the highest tax bracket offers a 5% tax savings for income earners. The PAYE tax bands were amended so as to cushion employment income earners from the adverse effects of the COVID 19 so as to cushion guarantee employment income earners of tax savings.

9) <u>Increase on WHT on Dividend</u>

The non-resident tax rates for dividend has increased from 10% to 15%. As such there is increased WHT liability for residents and thus increased tax revenues for the Government.

10) <u>Change of tax bands for Pension Payment or Withdrawals</u>

The tabulation of rates in respect of pension payments or Withdrawals in excess of the tax-free amounts paid ***after*** the expiry of 15 years after joining fund is now taxable as follows: -

	Rate
On the first Shs. 400,000	10%
On the next Shs. 400,000	15%
On the next Shs. 400,000	20%
On any amount above Shs. 1,200,000 of the amount in excess of the tax free amount	25%

In case of pension payments or Withdrawals ***before*** the expiry of the 15 years, the following tax band is now applicable: -

	Rate
On the first Shs. 288,000	10%
On the next Shs. 200,000	15%
On the next Shs. 200,000	20%
On all income above Shs. 688,000	25%

These adjustments have been made to ensure taxation is in line with the amended PAYE tax bands.

The applicable rate for surplus funds withdrawn by or refunded by an employer in respect of registered pension has been reduced from 30% to 25% of the gross sum payable.

11) Changes in Corporation Tax rate

The provisions of the Third Schedule previously allowing for a reduced corporation tax rate have been deleted. Consequently, the following entities are no longer reduced tax: -

a) Life insurance business owned by resident insurance business;
b) Newly listed companies with at least 30 or 40% of shares listed; and
c) Company introducing shares through listing or any securities exchange via introduction.

As such, the above entities will now be paying the corporation tax at the rate of 25% of the taxable profit for residents and 37.5% for non-residents.

B. VALUE ADDED TAX ACT

12) Taxable value for Petroleum products

The Act stipulates the inclusion of the excise duty, levies and other charges in the computation of the taxable value subject to VAT in respect to Petroleum products as enumerated under Section B Part I of the First Schedule. Previously, these charges were excluded in the computation of the taxable value of these items.

The inclusion of excise duty, fees and other charges in the computation of the taxable value will increase the taxable value and essentially the cost of these items.

13) Issuance of Credit Notes

The Act has deleted and substituted the proviso under Section 16(1) of the VAT Act with the key highlight being that the directions on issuance of Credit Notes where there is a commercial dispute in a court.

The proviso notes that a credit note may be issued within 30 days after a court decision in a dispute relating to the price payable. Moreover, a credit note many be issued within six months after the issue of the relevant tax invoice.

This will enable taxpayers to utilize credit notes to reduce effective VAT payable where there is a dispute relating to the price payable.

14) Reduction of items exempt from VAT

The following goods and services are no longer exempt from VAT in line with amendments introduced to the First Schedule: -

GOODS	SERVICES
➢ Plants and Machinery under Chapter 84 and 85 used for manufacture of goods; ➢ Taxable supplies used for direct and exclusive use in construction of power generating plant to supply electricity to the national grid approved by the CS for matters energy; ➢ Taxable supplies used for direct and exclusive use in exploration and mining prospecting as approved by the CS for matters mining; ➢ Taxable supplies used for construction of LPG storage facilities as approved by the CS for matters finance; ➢ Goods imported or purchased locally for use in manufacture of Industrial parks as approved by the CS for matters Finance; ➢ Parts imported or purchased locally for the assembly of computers as approved by the CS for matters Finance; ➢ Museum and natural history exhibits and specimens and scientific equipment for public museums; ➢ Taxable goods for direct and exclusive use for the construction of tourism facilities, recreational parks; ➢ Chemicals, reagents, films, film strips and visual aid equipment imported or purchased prior to clearance through the customs by the National Museums; ➢ Goods falling under tariff number 4907.00.90; ➢ Materials and equipment for the construction of grain storage ➢ The transfer of a business as a going concern by a registered person to another registered person; ➢ Taxable goods supplied to marine fisheries and fish processors upon recommendation by the relevant state department; and ➢ Goods and services purchased for direct and exclusive use in the implementation of projects under a special operating framework arrangement with the Government.	➢ Asset transfers and other transactions related to the transfer of assets into real estate investment trusts and asset backed securities; ➢ Services imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government; ➢ Taxable services, 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 fifteen thousand metric tonnes.

The deletion of these items under the First Schedule means that they are now subject to VAT at 14% as per the Legal Notice No. 35 of 25th March 2020.

This is a move to increase tax revenues perhaps so as to raise more funds to be used to combat the effects of COVID-19 on the economy.

However, the imposition of the said taxes means that various incentives will be withdrawn at a time when many industries need them.

These inputs will be more expensive and the costs will trickle down to the final consumers. This includes cost of materials to construct grain storage which will be beneficial to maintain food stores.

Cost of energy and VAT on plant and machinery used for manufacturing which are key sectors of the economy will increase due to introduction of VAT on key inputs highlighted above.

Further, the cost of supply of essential commodities such as LPG gas will likely increase and this cost will be borne by consumers.

12) Refund on Tax on Bad Debt

The Act has reduced the period for a refund on bad debts from 5 years to 4 years from the date of supply. In essence, the period for lodging for VAT refund on bad debts has reduced. As such taxpayers should take notes of the timelines to ensure the stipulated period does not lapse before application for refund is lodged.

13) Keeping of records

All persons both registered and non-registered are now required to maintain records of every transactions for a period of 5 years from the last transaction made.

This amendment has been introduced to ensure that taxpayers regardless of their VAT registration status maintain adequate records of their transactions particularly VAT transactions.
This inclusion follows the amendments by the Finance Act 2019 which required non-registered persons to account for reverse VAT.

14) Exemption of personal protective equipment from VAT

PPEs including facemasks, for use by medical personnel and members of public are now exempted from VAT.

The said amendment has been introduced so as to prevent the costs of these items from being inflated taking account their use in preventing the spread of COVID 19 currently affecting the country.

15) Change of vaccines and medicament from zero rated to exempt

Part C of the Second Schedule which deals with zero rating of vaccines and medicaments has been repealed. In that regard, vaccines and medicaments are now exempted from VAT under the First Schedule at Paragraph 39(3).

These changes will essentially increase the cost of these items as the suppliers will not be able to deduct input VAT thus passing the cost to the final consumer which may defeat the intended purpose of the amendment.

C. EXCISE DUTY ACT

(Effective 25th April 2020)

19) Other Fees

The scope of ***"other fees"*** has been expanded by substituting the words ***"licenced financial institutions"*** to ***"licensed activities"*** in the definition of *"other fees".*

Consequently, the imposition of excise duty on other fees now covers a broader scope and not only limited financial institutions.

20) Excise Duty on goods under Special Operating Framework

Excise Duty is now imposed on goods imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government. Previously, these goods were exempt from excise duty.

This imposition goes against various incentives previously implemented to encourage such investments. On the flip side however, this means more tax revenues for the Government.

21) Excise Duty on motor vehicle imported by a public officer

Excise duty is chargeable on motor vehicles imported by a public officer and his spouse returning from a posting of a Kenyan mission abroad. This eliminates the incentive given to public officers on such transactions.

D. TAX PROCEDURES ACT

(Effective 25th April 2020)

22) Private Ruling

The timelines within which the Commissioner is required to respond to an application for a private ruling has been increased from 45 days to 60 days. Moreover, the Commissioner is no longer required to publish a private ruling in daily newspapers.

The removal of timelines will cause unnecessary delays and uncertainties for the taxpayers when applying for private rulings. Further the removal of the need to publish such private rulings will also create uncertainty as taxpayers will not be aware of such rulings unless privy to the applications.

23) Penalty on late submission of turnover tax return

Under Section 83(1) of the TPA, the penalty for late submission of Turnover Tax return has been reduced from Kshs. 5,000 to Kshs. 1,000.

E. MISCELLANOUES FEES AND LEVIES ACT ***(Effective 25th April 2020)***

24) Import Declaration Fees

As per the amendments in the Act, the following items are no longer exempt from IDF: -

a) Gifts or donations for personal use, excluding motor vehicles, by foreign residents to their relatives in Kenya for their personal use;
b) Samples which in the opinion of the Commissioner have no commercial value
c) Raw materials for direct and exclusive use in construction of industrial parks of 100 acres or more located outside Nairobi or Mombasa; and
d) goods imported for the construction of liquefied petroleum gas storage facilities as approved by the Cabinet Secretary responsible for liquefied petroleum gas.

The reduction of IDF exemptions widens the tax scope and increases tax revenues as IDF.

25) Railway Development Levy

The Act removes exemptions of RDL on the following items:-

a) Raw materials for direct and exclusive use in construction of industrial parks of 100 acres or more located outside Nairobi or Mombasa; and
b) goods imported for the construction of liquefied petroleum gas storage

facilities as approved by the Cabinet Secretary responsible for liquefied petroleum gas

26) Introduction of Processing Fees

Processing fees of Kshs. 10,000 are now chargeable on duty free motor vehicles excluding motor cycles. This is a move to increase tax revenues. For the importer this means added cost for the importer.

F. KENYA REVENUE AUTHORITY ACT

27) Reward for information to KRA leading to enforcement of tax laws

The Act has introduced a new paragraph under Section 5(2) of the KRA Act which provides for a reward of Kshs. 500,000 for provision of information leading to enforcement of tax laws.

This will encourage compliance by incentivizing taxpayers to provide information to the Kenya Revenue Authority on non-compliance matters.

28) Appointment of agents of revenue collection

Persons registered under the Banking Act are now eligible for appointment as an agents of revenue collection by KRA.

The appointed agent will be required to transfer funds to the Central Bank of Kenya within 2 days following collection date.

A penalty will be charged for failure to transfer funds and treated as a tax debt owed by the agent. Penalty shall be 2% of tax which shall be compounded daily.

The appointment of the agents will ease the tax collection for Government.

G. RETIREMENT BENEFITS ACT

(Effective 25th April 2020)

29) Restriction on use of scheme funds

The Act has made amendments to the RBA enabling members of retirement benefit schemes to use funds from the scheme to purchase a residential house.

This will be beneficial for scheme members as it will encourage them to invest the funds from the scheme to purchase residential property.

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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