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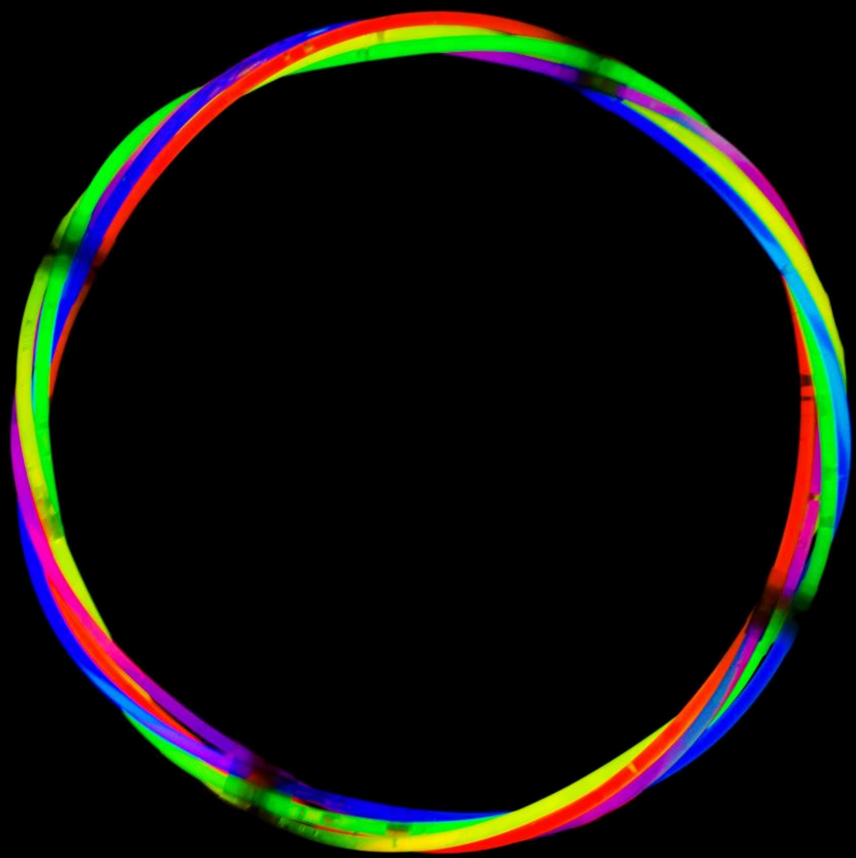

Kenya Tax Alert
Finance Bill, 2021

May 2021

MAKING AN IMPACT THAT MATTERS since 1845

Introduction

The Finance Bill, 2021 was published on 5 May 2021 and tabled in Parliament on 11 May 2021. Based on the Public Finance Management Act, 2012, the Bill should be assented into law by the end of June 2021.

The Bill has proposed amendments to the following statutes:

1. The Income Tax Act;
2. The Value Added Tax Act, 2013;
3. The Excise Duty Act, 2015;
4. The Tax Procedures Act, 2015;
5. The Miscellaneous Fees and Levies Act, 2016;
6. The Tax Appeals Tribunal Act, 2013;
7. The Capital Markets Act;
8. The Insurance Act;
9. The Kenya Revenue Authority Act, 1995;
10. The Retirement Benefits Act, 1997; and
11. The Central Depositories Act, 2000.

This publication summarizes our analysis of the amendments proposed by the Bill and their impact.

Corporate Income Tax

Introduction of an EBITDA-based interest limitation rule to replace the thin capitalisation interest limitation rule

The measure

The Bill proposes to delete Section 16(2)(j) of the Income Tax Act, which prohibits a foreign controlled entity from claiming a deduction of interest in excess of the debt-to-equity ratio of 3:1.

In its place, the Bill proposes to introduce a provision that prohibits a deduction of interest paid/ payable to related and third parties in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA).

For the purposes of determining the deductible interest, the following will need to be considered

- The EBITDA amount should exclude any income which is exempt from tax; and
- The amounts that are subject to these rules include interest on loans, payments that are economically equivalent to interest and expenses incurred in connection with raising finance.

Who will be affected

All persons with relying on debt financing.

When

Effective 1 January 2022

Our view

The proposed interest deductibility limitation provision is generally consistent with the OECD's 2015 recommendations of "best practices" for rules to limit base erosion caused by interest deductions and other financial payments (published as part of action 4 of the OECD/G 20 BEPS project). The OECD notes that, as a best practice, thin capitalization rules should not be included as a general interest limitation rule, because they may be relatively easy to manipulate through an increase in the level of equity. (continued next page)

Corporate Income Tax

Introduction of an EBITDA-based interest limitation rule to replace the thin capitalisation interest limitation rule …..cont.

Several countries have already implemented the EBITDA-based interest limitation rules, including the UK, US, Australia, Canada and Uganda. By 2019, the OECD notes that 30 members of the OECD Inclusive Framework had had implemented the EBITDA-based interest limitation rules. Kenya, if it prepares to go down the same path, will surely want to consider these countries' experiences.

If passed in its current state, the measure is expected to have far-reaching implications on businesses. The introduction of the EBITDA-based interest limitation rule may lead to the following:

- Capital flight, since investors may consider diverting their investments to other countries, thereby stifling development;
- Switch to equity financing, as debt financing could prove costly; and
- Switch to interest free-debt- financing

The government should consider introducing provisions intended to reduce the impact of the interest limitation that pose less BEPS risk. For instance:

- Exclusion of companies that are not foreign controlled, financial institutions licensed under the Banking Act, start-ups, Special Purpose Vehicles (SPVs), real estate firms and businesses operating in capital heavy sectors from the EBITDA-based interest limitations;
- Introduction of carry-forward or carry-back rules for disallowed interest or unused interest capacity; and
- Introduction of a grandfathering clause that will exclude interest on existing debt from the scope of debt whose interest would be subject to the EBITDA-based interest limitation rule.

Corporate Income Tax

Removal of the tax loss carry forward limitation

The measure

The Bill proposes to delete Section 15(4) of the Income Tax Act, which caps the carry forward of tax losses to 9 years, or such other longer period that may have been approved by the Minister. In its place, the following provision is to be introduced:

"Where the ascertainment of the total income of a person results in a deficit for a year of income, the amount of that deficit shall be an allowable deduction in ascertaining the total income of such person for that year and the succeeding years of income."

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

The introduction of minimum tax with effect from 1 January 2021 is likely to have influenced the proposal to remove the capping of the period to carry forward tax losses. This is because minimum tax, which is applicable at 1% of the gross income, would still be expected to apply regardless of whether a person is in tax losses or not. However, considering that there is currently a petition in Court against minimum tax, it remains to be seen if the government will re-introduce the tax loss carry-forward restriction should the petition succeed.

The proposal to remove the capping of the tax loss utilisation period is welcome. However, it may be worthwhile to introduce a transitional provision that provides guidance on how losses that arose in prior periods should be treated.

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Corporate Income Tax

Introduction of an expanded definition of 'control'

The measure

The Bill proposes to introduce an expanded definition of 'control' under Section 2 of the Income Tax Act. Should the Bill be passed as currently phrased, a person will be in control of another person, if:

- That person, directly or indirectly, holds at least 20% of the voting rights in a company;
- That person, other than a financial institution not related to that person, has advanced loans to the other person which constitute at least 70% of the book value of the total assets of the other person;
- That person, other than a financial institution not related to that person, has guaranteed at least 70% of the total indebtedness of the other person with respect to any form of indebtedness of the other person;
- That person has the authority and mandate to appoint more than half of the board of directors of the other person or at least one director or executive member of the governing board of the other person;
- That person is the owner or has the exclusive rights over the know-how, patent, copyright, trademark, licence, franchise or any other business or commercial right of a similar nature that the other person is wholly dependant on for the manufacture or processing of goods or articles or business carried on by the other person;
- That person, or a person designated by that person, supplies at least 90% of the supply of the purchases of the other person or, per the discretion of the Commissioner, influences the prices or other conditions relating to the supply of purchases of the other person;
- That person purchases or designates a person to purchase at least 90% of the sales of the other person, or per the discretion of the Commissioner, influences the price or any other condition of the sales of the other person;
- A person has any other relationship, dealing or practice with the other person which the Commissioner may deem to constitute control.

Corporate Income Tax

Introduction of an expanded definition of 'control' (…cont.)

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

The proposal to reintroduce a definition of control is welcome, particularly given that the previous definition was inadvertently deleted by the Tax Laws (Amendment) Act No. 1, 2020, which repealed the Second Schedule to the Income Tax Act.

The expansion of the "control" definition widens the scope of application of the controlled company rules upon which transfer pricing ("TP") regulations then apply in respect to transactions with related enterprises. The expanded definition will also have an impact on the deductibility of foreign exchange losses on loans advanced to persons under control. The exchange loss shall be deferred and not allowed until the debt-to-equity ratio of such persons falls below 3 to 1.

Some of the measures introduced under the new definition are too far reaching and will capture businesses such as franchises or licensed manufacturers and businesses with one dominant customer or supplier, which may be dealing with completely independent parties.

In our view, this would impose TP compliance requirements and limitations on deductibility foreign exchange losses on entities transacting with independent non-resident entities where the commercial arrangements fall within the new definition. Furthermore, this expands the concept of transfer pricing beyond what is recognized under the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "OECD Guidelines") and questions the applicability of the arm's length principle since transactions involving independent parties are at arm's length.

Corporate Income Tax

Definition of “control” in section 4A of the Income Tax Act updated

The measure

The Bill proposes to delete the following definition of “control” in Section 4A of the Income Tax Act:
“control" shall have the meaning ascribed to it in paragraph 32 (1) of the Second Schedule
This means the new definition of control introduced by the Finance Bill 2021 under Section 2 of the Income Tax Act will apply.

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

The definition of “control” under the Second Schedule was inadvertently deleted by the Tax Laws (Amendment) Act, 2020, which came into effect on 25 April 2020. Any reference of “control” to the Second Schedule was therefore redundant.

As the Finance Bill 2021 is proposing to introduce an expanded definition of “control "in Section 2 of the Income Tax Act, taxpayers will need to assess the impact of this change on the deductibility of foreign exchange losses arising from loans advanced by persons who control the taxpayers.

Corporate Income Tax

New definition of permanent establishment

The measure

The Bill proposes to delete the current definition of permanent establishment ("PE") captured in the Income Tax Act and introduce a new definition.

Based on the proposed definition, a PE in Kenya includes:

a. A fixed place of business through which business is wholly or partly carried on and includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction or exploitation of natural resources, a warehouse in relation to a person whose business is providing storage facilities to others, a farm, plantation or other place where agricultural, forestry plantation or related activities are carried on and a sales outlet;

b. A building site, construction, assembly or installation project or any supervisory activity connected to the site or project, but only if it continues for a period of more than 183 days;

c. The provision of services, including consultancy services, by a person through employees or other personnel engaged for that purpose, but only where the services or connected business in Kenya, continue for a period of, or periods exceeding in the aggregate, 91 days in any 12-month period commencing or ending in the year of income concerned;

d. An installation or structure used in the exploration for natural resources where the exploration activities continue for periods not less than 91 days;

e. A dependent agent of a person who acts on their behalf in respect of any activities which that person undertakes in Kenya including habitually concluding contracts or playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the person.

Corporate Income Tax

New definition of permanent establishment (..cont.)

Who will be affected

Non-resident persons who conduct business in Kenya

When

Effective 1 July 2021

Our view

The expansion of the definition of PE aligns, to a large extent, the domestic legislation with international best practice, as captured in Article 5 of the UN and OECD Model Tax Conventions, which are widely used as the basis for negotiating tax treaties. However, there is a bit of divergence with the UN and OECD Model Tax Conventions on the time thresholds for creating a PE. The Model Tax Conventions normally use a threshold of 12 months (OECD) or 6 months (UN). However, the proposed law has lower time thresholds of 91 days for services and exploration activities.

The introduction of the new PE definition is likely aimed at preventing the use of certain common tax avoidance strategies that have been used to circumvent the existing PE definition. The change will also prevent the exploitation of the specific exceptions to the existing PE definition; an issue which is particularly relevant in the case of digitalized businesses.

In addition to capturing the concept of a service PE in domestic legislation, the expanded definition proceeds a step further and excludes certain activities of a preparatory or auxiliary character from the being regarded as a PE. The express recognition of services of a preparatory or auxiliary character is laudable as this had not been captured in the current definition and has been a source of conflict between the Kenya Revenue Authority and taxpayers. Notably, all the subparagraphs for exception of PE are subject to a “preparatory or auxiliary” condition, which is in line with the recent updates to Article 7 of the OECD Guidelines.

Corporate Income Tax

Introduction of a definition for "infrastructure bond"

The measure

The Bill proposes to introduce the following definition in Section 2 of the Income Tax Act:

"infrastructure bond" means a bond issued by the Government for the financing of a strategic public infrastructure facility including a road, hospital, port, sporting facility, water and sewerage system, or a communication network.

Who will be affected

Persons who invest in government bonds.

When

Effective 1 July 2021

Our view

There is currently an exemption from tax on interest income accruing from listed bonds, notes or other similar securities used to raise funds for infrastructure and other social services, where such bonds, notes or securities have a maturity of at least three years.

The term "infrastructure" has not been defined in the Income Tax Act making it open to varying interpretations. We therefore believe that the introduction of the definition is meant to address this lacuna. However, since the exemption provision uses different terminology, it may be necessary to update the exemption provisions.

Corporate Income Tax

Introduction of Country-by-Country reporting on Kenyan headquartered MNEGs

The measure

The Bill proposes to introduce a Country-by-Country reporting (CbCR) requirement on a Kenyan headquartered multinational enterprise group (MNEG), referred to in the proposed legislation as an "ultimate parent entity" (UPE).

The specific definition given to a UPE is "*an entity that is resident in Kenya for tax purposes, is not controlled by another entity, and owns or controls an MNEG.*"

An MNEG has been defined to mean *"a group that includes two or more enterprises which are resident in different jurisdictions including an enterprise that carries on business through a PE or through any other entity in another jurisdiction."*

A UPE will be required to file a return of its financial activities in Kenya and any other jurisdiction where it has taxable presence. The return will be due within 12 months of the MNEGs financial reporting period.

Who will be affected

MNEGs headquartered in Kenya.

When

Effective 1 July 2021

Corporate Income Tax

Introduction of Country-by-Country reporting on Kenyan headquartered MNEGs ……cont.

Our view

The proposed introduction of the CbCR requirement comes at a time when the taxation of multinational enterprises ("MNEs") poses a challenge to most taxing authorities worldwide.

The Bill proposes to introduce the requirement for a return to be filed by Kenyan based ultimate parent entity not later than twelve months after the last day of the reporting financial year of the multinational enterprise group. The return will contain the Group's aggregated information relating to the amount of revenue, profit or loss before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees and tangible assets other than cash or cash equivalent regarding each jurisdiction that the MNEG operates.

This is in line with the OECD's BEPS Action 13, which is aimed at increasing the transparency of operations of MNEs and information sharing between tax authorities as well as possible coordination of audits between revenue authorities.

If adopted, the CbCR requirements will enable the Commissioner to have visibility to financial information that will aid in assessing the transfer pricing risk or any BEPS-related risk and make determinations on how to allocate tax audit resources. For the taxpayers who are part of a multinational group, this means additional transfer pricing reporting requirements.

Corporate Income Tax

Changes to limitation of benefit rules in respect of double taxation agreements

The measure

The Bill proposes to amend Section 41(5) which provides that the benefits of a tax treaty shall not be available to a resident of the treaty partner state if 50% or more of the underlying ownership of a non-resident is held by an individual or individuals who are not residents of the treaty partner state.

The amendment replaces the words an individual or individuals with a person or persons.

Who will be affected

Non-resident entities based in countries that have double taxation agreements with Kenya.

When

Effective 1 July 2021

Our view

Considering that entities may be held by individuals or other persons such as corporate entities, this is an amendment that aligns to the legal realities. The amended limitation of benefit rule will therefore apply widely to include entities that are ultimately held by body corporates such as governments.

Corporate Income Tax

Change of investment allowance basis from reducing balance to straight-line

The measure

The Bill proposes to amend the Second Schedule to the Income Tax Act in order to change the basis of calculating investment allowance from reducing balance to straight-line.

Who will be affected

All taxpayers

When

Effective 1 January 2022

Our view

The proposal to change the investment allowance basis from reducing balance to straight-line is welcome, as it simplifies the computation of capital allowances and reduces the period of recovery of capital costs. In addition, it reflects the views submitted by various stakeholders regarding the amendments to the Second Schedule that were introduced through the Tax Laws Amendment Act 2020.

However, the Bill has not introduced a transitional provision that would provide guidance on the treatment of the tax written down value that will be existing as at the date the change will come into effect. This should be addressed to avoid uncertainty and potential disputes.

Corporate Income Tax

Off-grid electricity supply to qualify for investment allowance

The measure

The Bill proposes to amend the definition of "manufacture" in the Second Schedule to the Income Tax Act to include generation, transformation and distribution of electricity (whether to the national grid or not). Currently this is limited to generation, transformation and distribution of electricity to/through the national grid.

Who will be affected

Persons who incur capital expenditure on buildings and machinery used for generation, transformation and distribution of off-grid electricity.

When

Effective 1 January 2022

Our view

By amending the definition of "manufacture" to cover transformation and distribution of off-grid electricity, persons who incur capital expenditure on buildings and machinery for purposes of transformation and distribution of off-grid electricity will be entitled to an accelerated investment allowance at 50% of the cost in the first year of use. We expect that this amendment will encourage more investment in off-grid electricity generation, transformation and distribution.

Persons who incur capital expenditure for purposes of generating, transforming and distributing electricity for own consumption in business would also benefit from this amendment.

Corporate Income Tax

Definition of "civil works" introduced in the Second Schedule

The measure

The Bill proposes to introduce the definition of civil works in the Second Schedule to the Income Tax Act. Civil works will include:

i. roads and parking areas;

ii. railway lines and related structures;

iii. water, industrial effluent and sewerage works;

iv. communications and electrical posts and

v. pylons and other electrical supply works; and

vi. security walls and fencing.

Who will be affected

Persons who incur capital expenditure on buildings used for manufacture, electricity undertaking and water undertaking.

When

Effective 1 January 2022

Our view

The definition of civil works will guide taxpayers on the allowances to be granted when they incur expenditure on civil works as part of buildings or other investment qualifying for investment allowance.

Where the civil works contributes to the use of a "building used for manufacture", an accelerated investment allowance at 50% shall be applicable in the first year of use and the remainder depreciated at 10% p.a. in the subsequent periods. On the other hand, where the civil works relate to water or electricity undertaking, the same qualifies as a commercial building, which is liable to investment allowance at 10% p.a.

Corporate Income Tax

Capital allowances applicable to entities operating in the extractive industries

The measure

The Bill proposes to amend Paragraph 4(3) & 9(3) of the Ninth Schedule to align the capital allowance rates on machinery used to undertake mining prospecting and petroleum exploration operations to the rates provided in the Second Schedule. The proposed rate is 50% in the year of first use and the remainder at 25% p.a. Previously, the allowance was claimable at 100% in the year of first use.

Who will be affected

Companies carrying out mining and petroleum operations.

When

Effective 1 January 2022

Our view

This proposed amendment aligns the rates in the Ninth Schedule to those provided to other sectors in the Second Schedule and appears to be aimed at enhancing equity following the overhaul of the Second Schedule via the Tax Laws Amendment Act 2020 in April 2020.

Investment allowance is a key incentive for investment especially in capital intensive businesses such as upstream oil & gas and mining. However, the continued reduction of such allowances is driven by the objective of enhancing collection through reduction of tax incentives and exemptions. While some argue that such moves may slow down investment in such sectors, proponents of the move argue that investment decisions are not primarily driven by tax incentives.

Corporate Income Tax

Limitation of interest deductibility for entities operating in the extractive sectors

The measure

The Bill proposes to delete the thin capitalization interest limitation rule applicable to contractors and licensees operating in the extractive industries and introduce a provision that limits interest deduction to 30% of earnings before interest, taxes, depreciation and amortization (EBITDA).

Currently, contractors and licensees are prohibited from claiming a deduction in respect of interest attributable to debt in excess of the debt-to-equity-ratio of 2:1.

This measure, if passed, will align the interest limitation rule for entities operating in the extractive sectors with the those operating in other sectors.

Who will be affected

Companies carrying out mining and petroleum operations.

When

Effective 1 January 2022

Our view

Whereas the amendment will align the proposed interest restriction rule with that proposed for other sectors, we believe that entities in the extractive sector may be disadvantaged due to the higher level of debt required and the long lead time before (successful) projects are brought to full production. Therefore, there may be need to review this restriction especially its application during the pre-production phase.

Digital Service Tax

Expansion of the scope of digital service tax

The measure

The Bill proposes to delete Section 3(2)(ca) of the Income Tax Act, which brings to charge *"Income accruing through a digital marketplace".* In its place, the Bill proposes to introduce the following provision:

"income accruing from a business carried out over the internet or an electronic network including through a digital marketplace."

The Bill also proposes to replace the definition of *"digital marketplace"* appearing in Section 3(3)(ba) with the following definition:

"digital marketplace" means an online platform which enables users to sell or provide services, goods or other property to other users.

Who will be affected

Persons who derive their income through an electronic network or over the internet

When

Effective 1 July 2021

Our view

With the introduction of digital service tax (DST), effective 1 January 2021, the government appears keen to bring more businesses that derive income over the internet or through an electronic network into the tax net. Although the DST Regulations issued by the Cabinet Secretary for National Treasury and Planning may have covered such businesses in the DST scope, the inconsistency with the charging section of the Income Tax Act [Section 3(2)(ca)] presented challenges in compliance. The proposed amendment is therefore meant to address this issue and cure any inconsistencies between the charging provision and the Regulations.

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Digital Service Tax

Resident persons to be exempted from digital service tax

The measure

The Bill proposes to amend Section 12E(1) of the Income Tax Act and explicitly provide that digital service tax shall only be payable by a non-resident person whose income from the provision of services is derived from or accrues in Kenya through a digital marketplace.

The Bill also proposes to delete the proviso under Section 12E(1). The proviso entitles a resident person or a non-resident person with a permanent establishment in Kenya to an offset of the DST paid against their income tax liability for the year.

Who will be affected

Resident persons who derive their income through an electronic network or over the internet.

When

Effective 1 July 2021

Our view

DST was intended to shore up revenue by broadening the tax base. However, several stakeholders have raised the issue that the tax will likely lead to a build up of tax credits by resident persons and non-resident persons with permanent establishments in Kenya since they are entitled to credits of the DST paid. The proposed amendment, is in our view, meant to address this issue and avert a backlog of refunds. It is welcome move in view of the cash flow impact of advance taxes and the difficulties in obtaining refunds for overpaid tax.

Although welcome, we note that the amendment has not excluded non-residents with permanent establishments in Kenya from the DST regime, despite the deletion of the proviso that entitled them to an offset of the DST paid. We believe this could be an error and we expect the same to be corrected before enactment.

Digital Service Tax

Extension of the due date for payment of digital service tax

The measure

The Bill proposes to delete Section 12E(2) of the Income Tax Act, which requires DST to be paid at the time of the transfer of the payment for the service to the service provider. In its place, the Bill proposes to introduce the following provision:

"A person subject to digital service tax shall submit a return and pay the tax due to the Commissioner on or before the twentieth day of the month following the end of the month in which the digital service was offered."

Who will be affected

Persons subject to digital service tax.

When

Effective 1 July 2021

Our view

This amendment is intended to align the due date of paying DST and filing of the DST return. It is a positive move as it reduces the administrative burden of accounting for tax at each payment date.

The amendment is also meant to introduce the return filing requirement in the main legislation. The requirement was introduced through the DST Regulations but there was none in the main legislation (the Income Tax Act).

However, it is important to note that the online filing platform (iTax) is yet to be updated to allow filing of a DST return. As currently configured, iTax only allows payment of the DST. The expectation is that iTax will be aligned with the law.

Digital Service Tax

DST exemption for income subject to WHT and income of telecommunication/ broadcasting operators

The measure

The Bill proposes to introduce a subsection under Section 12E that explicitly exempts income chargeable under section 9(2) or section 35 from the DST regime.

Section 9(2) brings to charge the income of a non-resident person who carries on the business of transmitting messages by cable or radio communication, optical fibre, television broadcasting, Very Small Aperture Terminal (VSAT), internet or any other similar method of communication while Section 35 lists the incomes that are liable to withholding tax in Kenya.

Who will be affected

Non-resident persons whose income is taxable under Section 9(2) or Section 35 of the Income Tax Act.

When

Effective 1 July 2021

Our view

The exemption of DST on income taxable under Section 9(2) or Section 35 is already provided for in the DST Regulations. However, given that this provision was not explicitly provided for in the main legislation, the applicability of the same could be challenged in case of inconsistencies between the main legislation and the Regulations. The proposed introduction of the provision in the Income Tax Act is therefore meant to avert any inconsistencies. It is a positive move to avoid multiple taxation of the same income.

Withholding Tax

WHT on service fees paid to non-resident subcontractors increased from 5.625% to 10%

The measure

The Bill proposes to increase the rate of withholding tax upon payment of service fees to non-resident subcontractors operating in the extractive industries from 5.625% to 10%. This applies to non-resident subcontractors who do not have a Kenyan permanent establishment (PE). Those with a PE are required to pay tax under the self-assessment regime applicable to resident companies.

Who will be affected

Non-resident mining and petroleum subcontractors without a Kenyan permanent establishment.

When

Effective 1 July 2021

Our view

This move is aimed at increasing tax collection from the extractive sector since a large portion of technical services is normally subcontracted to specialist service companies. Although the increase is significant, the rate is still lower compared to the WHT rates generally applicable to other non-resident service providers.

Withholding Tax

Rate of WHT on management fees paid to non-resident subcontractors reduced 12.5% to 10%

The measure

The Bill proposes to reduce the rate of withholding tax upon payment for management, training and professional fees to non-resident subcontractors operating in the extractive sectors from 12.5% to 10%.

Who will be affected

Non-resident mining and petroleum subcontractors.

When

Effective 1 July 2021

Our view

This proposed amendment removes the confusion that existed between the scope of service fees and management, training and professional fees paid to subcontractors. This is because service fees is defined broadly and appeared to include management, training and professional fees so long as these were paid to a subcontractor.

The proposed amendment aligns the rates applicable to such fees and removes the differentiation.

Personal Income Tax

Introduction of insurance relief on NHIF contributions

The measure

The Bill proposes to introduce a tax relief on individuals who make contributions to the National Hospital Insurance Relief ("NHIF"). The amount of insurance relief to be claimed is equivalent to 15% of the premiums paid with a cap of KES 5,000 per month. Currently, only policyholders of education, life and health insurance enjoy an insurance relief on the premiums paid.

Who will be affected

Given that NHIF contributions are mandatory for employed persons, all employees are bound to enjoy this relief. In addition, self employed individuals who make voluntary contributions will equally benefit.

When

Effective 1 January 2022

Our view

By allowing a tax relief on the NHIF contributions, individuals will enjoy a maximum relief KES 255 per month (being 15% of KES 1,700 which is the maximum monthly NHIF contribution). Albeit minimal, the relief is bound to encourage more NHIF remittances and simultaneously aid the government in attaining its Universal Heath Coverage ('UHC") agenda as stipulated in the Big 4 Agenda. In the recent past, in a bid to fund UHC, there have been proposals to increase NHIF contributions. However, the fear of increased cost of employment and overburdening the already overtaxed employees may have hindered this increase. With the introduction of the NHIF relief, taxpayers may wonder whether this is a precursor to new NHIF rates.

Personal Income Tax

Tax rebates for graduate apprenticeship extended to cover graduates of technical and vocational institutions

The measure

The Bill proposes to expand the applicability of tax rebate to employers who engage apprentices to cover graduates of technical and vocational training institutions. Currently, only employers who engage university graduates as apprentices enjoy this tax rebate.

Who will be affected

Employers who absorb graduates of technical and vocational training institutions.

When

Effective 1 January 2022

Our view

Since 2016, employers have been eligible to enjoy a tax rebate equal to 50% of salaries paid if they hire at least ten apprentices who are university graduates for a period of 6-12 months. By extending this to include graduates of technical/vocational education programs, the government is recognising the importance of creating opportunities for not just university graduates, but also other institutions which train individuals to acquire skills for the job market.

However, there has been dismal uptake of this incentive due to the stringent conditions imposed by the Income Tax (Set-Off Tax Rebate for Graduate Apprenticeships) Regulations, 2016. To increase uptake, the Cabinet Secretary for the National Treasury ("the CS") should consider relaxing these strict requirements. Some of the measures that could be revised include reducing the minimum number of the apprentices as well as the period of engagement to encourage more uptake given the current difficult environment.

Value Added Tax

Treatment of imported services

The measure

The Bill proposes to amend Section 10 of the Value Added Tax Act, 2013 (VAT Act) by:

a) Deleting the word "registered" under subsection 1;

b) Deleting the expression "a registered person" under Subsection 2 and replacing it with "the person referred to in subsection 1 is a registered person and"; and

c) Deleting the definition of the words "by any person" under subsection 3.

The effect of the above amendments would be to align the treatment of imported services as provided under Section 10 with the proposed amendment of the definition under Section 2.

Who will be affected

All entities and individuals receiving services from non-resident persons.

When

Effective 1 July 2021

Our view

The proposed amendments to Section 10 would remove ambiguities with regard to accounting for VAT on imported services. The amendments clarify that reverse charge would be applicable to:

a) Any person who is not registered for VAT and imports a service into the country. Reverse charge VAT in this case would be payable based on the full value of the imported service; and

b) If the person who imports a service is registered for VAT, then reverse charge VAT would be applicable to the extent that the imported service is attributable to exempt supplies.

Value Added Tax

Supplies made through a digital marketplace

The measure

The Bill proposes to amend Section 5 (7) of the Value Added Tax Act, 2013 to clarify that supplies made over the internet or an electronic network or through a digital marketplace are chargeable to VAT. The provision as currently worded only refers to supplies made through a digital marketplace. The Bill also proposes to amend the definition of the term "digital marketplace" to mean "*an online platform which enables users to sell or provide services, goods or other property to other users.*"

Who will be affected

Entities that supply goods or services through an electronic network or over the internet.

When

Effective 1 July 2021

Our view

There has been an increased focus on taxation of supplies made through a digital marketplace and it is expected that this will continue to be an area that KRA will leverage on to boost revenue collection. The VAT (Digital Marketplace Supply) Regulations, which operationalized the collection of VAT on digital marketplace supplies came into effect on 9 October 2020. With the notable upward trend in the growth of the digital economy with numerous businesses selling goods and services to consumers through the digital marketplace, the proposed amendment to the definition is aimed at widening the scope of taxable supplies that would be subject to VAT.

Value Added Tax

Deduction of input tax

The measure

The Bill proposes to amend Section 17(1) by replacing the word 'section' with 'Act'. In addition, the Bill proposes to amend Section 17(4), which currently prohibits a registered person from claiming input tax on the acquisition of passenger cars or minibuses, and the repair and maintenance thereof including spare parts. The proposed amendment to subsection 4 will now include leasing or hiring of passenger cars or minibuses.

Who will be affected

Taxpayers claiming input tax.

When

Effective 1 July 2021

Our view

The proposal if passed, will prohibit registered persons from claiming input VAT relating to hiring or leasing of passenger cars or minibuses, unless the vehicles are acquired exclusively for the purpose of making taxable supplies in the ordinary course of the business of dealing in or hiring of the vehicles. Currently, input tax relating to hiring or leasing of passenger vehicles is deductible although we have seen instances where the revenue authority have taken the view that acquisition includes hiring or leasing of passenger vehicles. It would therefore follow that the proposal is aimed at giving legal effect the previously erroneous interpretation of Section 17 (4) of the VAT Act, 2013 regarding hiring or leasing of passenger motor vehicles.

Value Added Tax

Exported services

The measure

The Bill proposes to change the VAT status of the exportation of taxable services from zero-rated to exempt.

Who will be affected

Persons dealing with exported services.

When

Effective 1 July 2021

Our view

The proposed amendment is aimed at reducing the cases of VAT refund claims arising from the zero-rating of the exported services.

The VAT Act defines "a service exported out of Kenya" as "a service provided for use or consumption outside Kenya". However, the VAT law does not provide sufficient guidance on determination of the place of consumption. This gap has led to varying interpretation of the law.

Over the years there have been numerous disputes as a result of the position taken by KRA on the interpretation of what qualifies as a service exported out of Kenya and this has in turn affected the processing and payment of VAT refund claims arising from exported services.

The proposed amendment fails to resolve the controversy around the definition of exportation of services. Further, the proposal is a departure from international norms as guided by the OECD on zero rating of exported taxable services. Should the proposal be adopted, taxpayers currently engaging in exportation of services are likely to suffer from negative cashflows since the input tax attributed to such exported services would have to be disallowed.

Value Added Tax

Change of VAT status from exempt to standard rated

The measure

The Bill proposes to remove the following items from the exemption schedule:

1. Airlid paper without super absorbent polymer 180gsm/67 of tariff number 4803.00.00(Par 73)
2. Airlid paper without super absorbent polymer 80gsm/67 of tariff number 4803.00.00(Par 74)
3. Plain polythene film/PE of tariff number 3920.10.10.(85)
4. PE white 25-40gsm/release paper of tariff number 4810.99.00

Who will be affected

Various industries and consumers.

When

Effective 1 July 2021

Our view

The government has over the years aimed at reducing the list of exempt goods and services with the aim of increasing tax revenue.

Value Added Tax

Exemption of some goods and services

The measure

The Bill proposes to exempt the following goods and services:

1. Taxable goods excluding motor vehicles imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration by accompany granted a prospecting or exploration license in accordance with the Energy Act 2019, production sharing contracts in accordance with the Petroleum Act,2019 or a mining license in accordance with the Mining Act, 2016 upon recommendation of the Cabinet Secretary responsible;
2. Specialised equipment for the development and generation of solar and wind energy upon recommendation to the Commissioner by the Cabinet Secretary responsible;
3. Taxable goods supplied to persons that had an agreement or contract with the Government prior to 25 April 2020 that provided for exemption from VAT. This shall only apply to the unexpired period of the contract and upon recommendation by the Cabinet Secretary for Energy;
4. Medical ventilators and inputs from the manufacture of medical ventilators upon recommendation of the Cabinet Secretary for Health;
5. Physiotherapy accessories, treadmills for cardiology therapy and treatment of tariff number 9506.91.00 for use by licensed hospitals upon approval the Cabinet Secretary for Health;
6. Dexpanthenol of tariff number 3304.99.00 used for medical nappy rash treatment by licensed hospitals upon approval the Cabinet Secretary for Health;
7. Medicaments of tariff numbers 3003.41.00, 3003.42.00, 3003.43.00, 3003.49.00, 3003.60.00 (excluding goods of heading 30.02, 30,05 or 30.06) consisting of two or more constituents which have been mixed for therapeutic or prophylactic uses;

Value Added Tax

Exemption of some goods and services (…cont.)

8. Diagnostic or laboratory reagents of tariff number 3822.00.00 on a backing, prepared diagnostic or laboratory reagents whether or not on a backing other than those of heading 30.02 or 30.0, certified reference materials upon approval by the Cabinet Secretary for Health;
9. Electro-diagnostic apparatus of tariff numbers 9018.11.00, 9018.12.00, ,9018.13.00, 9018.14.00, 9018.19.00, 9018.20.00 , 9018.90.00 upon approval by the Cabinet Secretary for Health;
10. Other instruments and appliances of tariff number 9018.41.00 used in dental sciences, dental drill engines, whether or not combined on a single base with other dental equipment upon approval by the Cabinet Secretary for Health;
11. Other instruments and appliances including surgical blades of tariff number 9018.49.00, 9018.50.00, 9018.90.00used in dental sciences upon approval by the Cabinet Secretary for Health;
12. Ozone therapy, oxygen therapy, aerosol therapy, artificial respiration or other therapeutic respiration apparatus upon approval by the Cabinet Secretary for Health;
13. Other breathing appliance and gas masks, excluding protective masks having neither mechanical parts nor replaceable filters upon approval by the Cabinet Secretary for Health;
14. Artificial teeth and dental fittings of tariff numbers 9021.21.00, 9021.29.00 and artificial parts of the body of tariff numbers 9021.31.00, 9021..00, 9021.50.00 and 9021.90.00, upon approval by the Cabinet Secretary for Health;
15. Apparatus based on the use of x-rays, whether or not for medical, surgical or dental of tariff numbers 9022.12.00, 9022.13.00, 9022.14.00 and 9022.19.00 upon approval by the Cabinet Secretary for Health;

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Exemption of some goods and services (…cont.)

16. Apparatus based on the use of alpha, beta or gamma radiations, whether or not for medical, surgical or dental of tariff numbers 9022.21.00, 9022.29.00, 9022.30.00 and 9022.90.00 upon approval by the Cabinet Secretary for Health;
17. Discs, tapes, solid state non-volatile storage devices, smart cards and other media for the recording of sound or of other phenomena whether or not recorded of tariff number 8523.80.10 including masters and matrices for the production of discs but excluding products of Chapter 37; software upon approval by the Cabinet Secretary for Health;
18. Weighing machinery (excluding balances of sensitivity of 5cg or better) of tariff number 8423.31.00 including weight operated counting or checking machines; weighing machine weights of all kinds upon approval by the Cabinet Secretary for Health;
19. Fetal Doppler-Pocket (Wgd-002) Pc and pulse oximeter-finger held (Gima brand) PC of tariff number 9018.19.00 upon approval by the Cabinet Secretary for Health;
20. Sterilizer Dry Heat (Wgd-001-Grx-05A) Pc, autoclave steam tabletops of tariff number 8419.20.00 upon approval by the Cabinet Secretary for Health;
21. Needle holders and urine bags of tariff heading 3926;
22. Tourniquets of tariff number 3926.90.99 for use by licensed hospitals upon approval by the Cabinet Secretary for Health;
23. The transfer of assets and other transactions related to the transfer of assets into real estate investments trusts and asset-backed securities.

Value Added Tax

Exemption of some goods and services (..cont.)

Who will be affected

Industry players and consumers largely in the Petroleum, Mining, Energy and Health Sectors.

When

Effective 1 July 2021

Our view

The proposal to exempt medical equipment is a welcome move given the need by the Government to improve healthcare services for its citizens. The cost of some of medicaments and medical equipment is expected to reduce given the proposed exemption from VAT, especially as the country deals with the COVID-19 pandemic.

It will be noted that the proposed items to be included in the exemption schedule in the VAT Act has increased considerably as compared with the prior years, with the possibility of reinstatement of the exemption to the previously exempted critical supplies to players in the Petroleum, Mining and Energy Sector. There is also a proposal to include transitional provisions to allow for VAT exemption on supplies relating to contracts executed prior to 25 April 2020 for the approved duration of the contracts. This is aimed at ensuring that the previously exempted supplies under ongoing projects continue to enjoy the exemption status.

It is evident that the Government has continuously shifted the VAT status for various supplies from exempt to standard rate and back to exempt especially regarding certain industries or critical sectors. It would therefore be imperative that prior to implementing changes to effectively subject supplies used by critical sectors to tax , the resultant effects should be carefully considered in consultation with the stakeholders to ensure that the proposed amendments yield the desired effects and do not discourage investment into these key sectors.

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VAT status of ordinary bread to change from “zero-rated” to “standard rated”

The measure

The Bill proposes to delete the supply of ordinary bread from the zero-rating schedule.

Who will be affected

Consumers and suppliers/ manufacturers of ordinary bread.

When

Effective 1 July 2021

Our view

The proposal to remove the supply of ordinary bread from the zero-rating schedule will imply that ordinary bread becomes taxable at the general rate. If passed, the cost of ordinary bread is likely to go up.

Given that bread is a basic commodity, which is consumed by many households in Kenya, keeping it under the zero-rating schedule will be more beneficial to ensure it remains affordable to the local mwananchi.

Value Added Tax

Change of VAT status from standard rated to exempt

The measure

The Bill proposes to exempt medicaments, other food preparations and medical equipment of the following tariff numbers: 2106.10.00, 2106.90.10, 2106.90.99, 2936.27.00, 3001.90.00, 3002.11.00, 3002.12.00, 3002.13.00, 3002.14.00, 3002.15.00, 3002.19.00, 3003.31.00, 3004.43.00, 3004.60.00, 2106.90.91, 0402.21.00, 0402.29.00, 0402.91.00, 0402.99.00, 9021.10.00, 9021.50.00, 9025.19.00, 9019.20.00 and 9018.90.00.

Who will be affected

Importers, manufacturers and consumers of the products.

When

Effective 1 July 2021

Our view

The proposal to exempt the above listed items will hopefully reduce the prices of the items, thereby making them more affordable.

Value Added Tax

Proposed changes to align tariff numbers in the Act with EAC CET

The measure

The Bill proposes to delete items of the following tariff numbers from the exemption schedule: 3001.90.10, 3001.90.90, 3002.10.00, 0402.99.10, 0402.91.10, 0402.21.10 since these tariff numbers do not exist in the EAC CET, 2017.

Also affected by the clean up are disposable plastic syringes tariff No. 9018.31.10, other syringes with or without needles of tariff No. 9018.31.90 and 12-16 gsm spunbound piyropo non-woven coverstock/15gsm spunbound PP non-woven SSMMS hydrophobic leg cuffs of tariff number 5603.11.90; whose tariff numbers do not exist in the EAC CET. The Bill proposes to delete these items from the exemption schedule.

The Bill further proposes to make changes to the exemption schedule to correct typographical errors on tariff numbers that had been captured wrongly in the schedule. Some of the tariff numbers that have been proposed to be amended include the following: - 3906.90.00, 4703.21.00, 3921.90.00, 5603.11.00, 4803.00.00, 3506.91.00, 3921.19.10, 4811.49.00, 5402.44.00, 5603.11.00 and 3919.90.10.

Who will be affected

Taxpayers who deal in the above goods.

When

Effective 1 July 2021

Our view

The proposal is aimed at cleaning up the exemption schedule to include the correct HS codes to enable taxpayers who deal in the items to benefit from the exemptions as intended by the law.

Value Added Tax

Due date for VAT payment

The measure

The Bill proposes to amend the provision relating to the due date for VAT payment to allow anyone who is liable to VAT to defer payment of the VAT to the 20th day of the month following the period in which the tax became due.

Who will be affected

Taxpayers who make taxable supplies and those who import services into the country.

When

1 July 2021

Our view

The proposed amendment is aimed at aligning the section on the payment due date with the other proposed changes relating to the definition and treatment of imported services. The change clarifies that the due date for payment of VAT i.e., 20th of the month following the month the tax becomes due, applies to both registered persons making taxable supplies and to anyone who has imported a service into the country and is liable to reverse charge VAT.

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Value Added Tax

Group VAT registration

The measure

The Bill proposes to delete the provision relating to group VAT registration.

Who will be affected

Taxpayers who operate many entities and would like to benefit from group registration from a VAT perspective.

When

1 July 2021

Our view

Group registration allows two or more corporate entities to be treated as a single taxable person. This can be an effective way for managing VAT for corporate groups and reducing the administrative burden. However, there are certain complexities that require proper guidelines. The CS is required under the provisions of Section 34(9) of the VAT Act to publish regulations on group registrations, but this has not been done. Therefore, implementation would present challenges without proper guidelines. In addition, KRA in practice prefer dealing with each group entity separately, which perhaps informs the proposed deletion.

Value Added Tax

Provisions relating to regulations made under the Act

The measure

The Bill proposes to delete the requirement for regulations made under the VAT Act, 2013 to be tabled before the National Assembly before such regulations can take effect.

Who will be affected

Taxpayers in general

When

1 July 2021

Our view

The proposed deletion of the requirement to have regulations made under the VAT Act to be first tabled before the National Assembly is possibly aimed at giving the CS power to introduce and gazette regulations without going through the approval process by Parliament.

Regulations made under the VAT Act, 2013 would fall under the purview of the Statutory Instruments Act, 2013 (SIA), which requires regulation making authorities to seek the appropriate consultation before making statutory instruments. This process is necessary to ensure the proposed regulation considers relevant implications and ensure that it follows the Constitution. This proposal, if passed will not allow for the scrutiny required to ensure the law abides by the principles of good governance, rule of law and meets the conditions as set out under the SIA. In our view, it appears that the proposed deletion is aimed at fast tracking the implementation of regulations. However, this is likely to result in the imposition of arbitrary, unjust or discriminatory laws.

Excise Duty

Definition of “compound” introduced

The measure

The Bill proposes to define the term “compound” in the Excise Duty Act (“EDA”) to have the meaning assigned to it in Section 2 of the Compounding of Potable Spirits Act.

The Compounding of Potable Spirits Act defines “compound” to mean *communicate any flavour to, or to mix any ingredient or material with, spirits, but not so as to denature the spirits*.

Who will be affected

Manufacturers, importers and consumers of alcoholic beverages.

When

Effective 1 July 2021

Our view

The First Schedule to the EDA provides for Excise Duty on spirits.

Spirit is defined in Section 2 of the EDA as *“spirits of any description and includes all liquor mixed with spirits and all mixtures and compounds or preparations made with spirits but does not include denatured spirits.”*

The Bill has further defined the term “compound” within the meaning of spirits to provide further clarity on spirits which fall within the ambit of excise duty.

Excise Duty

Definition of ”possession” introduced

The measure

The Bill proposes to introduce a definition of the term “possession” in the EDA.

The term possession will mean “*having, owning or controlling any excisable goods including:*

a) *having in one’s possession any excisable goods;*

b) *knowingly having any excisable goods in the actual possession or custody of any other person;*

c) *having any excisable goods in any place, whether belonging to or occupied by oneself or not, for the use or benefit of oneself; or*

d) *having any excisable goods for the use or benefit of another person.*

Who will be affected

Manufacturers, importers and consumers of excisable goods.

When

Effective 1 July 2021

Our view

Section 39(5) of the EDA imposes a penalty of KES 5 million on any person who has in the person’s possession, any excisable goods that have been manufactured contrary to the provisions of the EDA, or which have been removed from the place where they ought to have been charged with excise duty before such duty has been charged and either paid or secured. Based on the proposed definition, excisable goods manufactured and/or held on behalf of another person will be deemed to be possessed by either party and either party may be held liable for any offences committed with respect to the goods. In our view, this proposal is aimed at enhancing enforcement of excise duty compliance by the Commissioner, particularly where contract manufacturers are involved.

Excise Duty

Relief of excise duty on bulk internet data purchased for resale

The measure

The Bill proposes to amend Section 14 of the EDA to allow for offset of excise duty paid by licensed persons on purchase of bulk internet data against excise duty payable on resale of the internet data to final consumers.

Who will be affected

Suppliers of internet data services.

When

Effective 1 July 2021

Our view

The EDA currently provides for offset of excise duty paid on excisable raw materials used for manufacture of excisable goods to avoid double payment of excise duty. The proposal to allow for offset of excise duty paid on bulk data against excise duty payable on resale of internet data to final consumers is in line with the above-mentioned treatment on excisable goods and if adopted will avoid double payment of excise duty on internet data and ultimately reduce the cost of providing internet data services.

Excise Duty

Re-introduction of excise duty on locally manufactured sugar confectionary and chocolate

The measure

The Bill proposes to re-introduce excise duty on locally manufactured sugar confectionery of tariff heading 1704 at KES 20.99 per Kg and white chocolate, chocolate in blocs, slabs or bars of tariff codes 1806.31.00, 1806.32.00 and 1806.90.00 at KES 209.88 per Kg.

Who will be affected

Local manufacturers and consumers of confectionery and chocolate.

When

Effective 1 July 2021

Our view

Excise duty on confectionary and chocolate was introduced in 2018 to discourage consumption of confectionary and chocolate products, which are associated with negative health effects. In 2019, the Government removed excise duty on locally manufactured sugar confectionary and chocolate with a view to cushion local manufacturers from cheap imports.

The proposal to re-introduce excise duty on these products seems to be driven by the need to generate additional tax revenue for the government. We note that the CS had proposed a similar amendment through the Tax Laws (Amendment) Bill, 2020 but the proposal was not approved by the National Assembly. It remains to be seen whether the National Assembly will adopt the proposal.

Excise Duty

Re-introduction of excise duty on betting

The measure

The Bill proposes to re-introduce excise duty on betting, at 20% of the amount wagered or staked.

Who will be affected

Bookmakers and stakers

When

Effective 1 July 2021

Our view

In 2019, the Government introduced excise duty on betting to curb the negative social effects caused by betting particularly amongst the youth. However, the Finance Act 2020 removed excise duty on betting activities following lobbying by betting companies to the National Assembly . The removal of the duty was effective 30 June 2020.

On 2 July 2020, the National Treasury issued a statement indicating that it was never the government's intention to remove excise duty on betting services and that it would be proposing a reintroduction of the same within 6 months.

It remains to be seen whether the National Assembly will adopt the reintroduction of excise duty on betting activities.

Excise Duty

Imposition of excise duty on jewellery

The measure

The Bill proposes to introduce excise duty on jewellery of tariff heading 7113 and imported jewellery of tariff heading 7117 at the rate of 10%.

Who will be affected

Importers, local manufacturers and consumers of jewellery.

When

Effective 1 July 2021

Our view

According to the Harmonised System Explanatory Notes for Tariff Heading 7113, Jewellery of tariff heading 7113 include small objects of personal adornment such as rings, bracelets, necklaces, brooches, ear-rings, neck chains, watch-chains etc and articles of personal use normally carried in the pocket, in the handbag or on the person e.g., cigar or cigarette cases, snuff boxes, spectacle cases, powder boxes, lipstick holders. Jewellery of this heading are wholly, or partly precious metal or metal clad with precious metal.

On the other hand, jewellery of tariff heading 7117 only covers small objects of personal adornments as noted above not incorporating precious metal or metal clad with precious metal.

Excise duty has traditionally been imposed on luxurious goods and jewellery would fall in this category. Whereas there are no negative effects associated with jewellery, the price elasticity of these products provides an easy avenue for government to generate revenue.

Excise Duty

Introduction of excise duty on products containing nicotine or nicotine substitutes

The measure

The Bill proposes to introduce excise duty, at the rate of KES 5,000 per Kg, on products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application but excluding medicinal products approved by the CS responsible for health matters and other manufactured tobacco and tobacco substitutes that have been homogenized and reconstituted, tobacco, tobacco extracts and essences.

Who will be affected

Importers and local manufacturers of products containing nicotine or nicotine substitutes.

When

Effective 1 July 2021

Our view

The EDA currently provides for excise duty on cigarettes and other manufactured tobacco and tobacco substitutes due to the negative health effects associated with consumption of these products. The tobacco products are consumed through chewing or inhalation by combustion. The proposal to impose excise duty on products containing nicotine or nicotine substitutes intended for inhalation without combustion is geared towards discouraging consumption of these products to protect the population from the negative health effects.

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Excise Duty

Removal of excise duty on imported glass bottles

The measure

The CS has proposed to remove the 20% excise duty on imported glass bottles.

Who will be affected

Importers of glass bottles.

When

Effective 1 July 2021

Our view

On 18 March 2020, the Government introduced excise duty on imported glass bottles (excluding imported glass bottles for packaging of pharmaceutical products) at 20% through the Business Laws (Amendment) Act in a bid to protect local manufacturers of glass bottles from competition by importers of glass bottles.

The CS for the National Treasury has now proposed to remove excise duty on imported glass, perhaps due to lack of capacity by local manufacturers of glass bottles to meet the local demand.

Excise Duty

Amendment of the definition of other fees charged by financial institutions

The measure

The bill proposes to amend the definition of "other fees" in Part III of the First Schedule of the EDA by deleting the words "fees or commissions earned in respect of a loan". The proposed definition of "other fees" will read as follows:

"any fees, charges or commissions charged by financial institutions relating to their licensed activities, but does not include interest on loan or return on loan or any share of profit or an insurance premium or premium based, or related commissions specified in the Insurance Act or regulations made thereunder."

Who will be affected

Financial Institutions

When

Effective 1 July 2021

Our view

The Finance Act 2020 amended the definition of "other fees" to expressly exclude fees or commissions earned in respect of a loan from the ambit of fees subject to excise duty. The amendment was meant to provide clarity on the scope of interest that is exempt from excise duty, particularly due to the absence of a definition of interest in the EDA. The amendment implied that loan processing and commitment fees should not be subject to excise duty. The proposed deletion of the words "fees or commissions earned in respect of a loan" is, in our view a step in the wrong direction, as it will lead to ambiguity on the scope of interest that is exempt from excise duty.

Excise Duty

Change of excise duty rate on motorcycles from specific to ad valorem

The measure

The CS has proposed to amend the rate of excise duty on motorcycles from KES 11,608.23 per unit to 15% of the excisable value.

Who will be affected

Importers and local assemblers of motorcycles, and consumers.

When

Effective 1 July 2021

Our view

The Bill proposes to amend the excise duty rate on motorcycles from a specific rate to an ad valorem rate perhaps in a bid to generate additional revenue on high value motorcycles. The value of a motorcycle that would give rise to excise duty of KES 11,608.23 where an ad valorem rate of 15% is applied would be KES 77,386.67. This implies that excise duty on a motorcycle of a value exceeding KES 77,386.67 would be higher if an ad-valorem rate of 15% is applied as compared to the current specific rate.

Based on our research, the current retail selling prices of 100cc to 150cc motorcycles commonly used as *boda bodas* in Kenya are above KES 77,386.67. The proposal to amend the excise duty rate on motorcycle to an ad valorem rate of 15% will therefore result in a higher excise duty for *boda bodas,* which is a source of livelihoods for a considerable proportion of low-income earners in Kenya.

Miscellaneous Fees & Levies

Application for refunds based on Section 47 of Tax Procedures Act, 2015 (TPA).

The measure

The Bill proposes to introduce Section 9B in the Miscellaneous Fees and Levies Act ("MFLA") that provides for application of the provisions of Section 47 of the TPA for purposes of:

a) Application for refunds, ascertainment and repayment of fees and levies overpaid or paid in error under the MFLA; and

b) The determination by the Commissioner of penalties and interests on fees that remain unpaid.

Who will be affected

Importers and exporters

When

Effective 1 July 2021

Our view

The MFLA does not provide for refund of fees and levies covered under the Act. In practice, however, refunds for Import Declaration Fee (IDF) and Railway Development Levy (RDL) paid in error are processed as though they are import duty under Section 144 of the East African Community Customs Management Act (EACCMA)

Section 47 of the TPA provides for application for refund of overpaid tax to the Commissioner of Domestic Taxes within 5 years from the date the tax was paid. Further, Section 47 of the TPA requires the Commissioner to refund the amounts due within a period of 2 years from the date of application failure to which the amount due shall attract an interest of 1% per month. This is a welcome move that provides a legal basis for refund of fees and levies paid in error under the MFLA. The proposal will also allow importers to seek for refund of fees and levies paid in error over a period of 5 years as opposed to the 1-year period allowed for import duty under the EACCMA.

Miscellaneous Fees & Levies

Introduction of additional items into the IDF and RDL exemption schedules

The measure

The Bill proposes to reinstate the goods, which the CS may determine is in the public interest, or to promote investment of a value not exceeding KES 5 billion, in the IDF and RDL exemption schedule.

Who will be affected

Investors and importers of goods of public interest.

When

Effective 1 July 2021

Our view

In 2020 the CS deleted the foregoing goods from the IDF and RDL exemption schedule which implied that ongoing projects which were previously exempted from IDF and RDL were subject to IDF and RDL. Some of the projects exempted under the above provision are governed by contracts with the Government that contain clauses which provide for exemption of IDF and RDL. This implied that in the absence of enabling exemption provisions, the Government risked contravening its obligations under the executed contracts.

The proposal to reinstate the exemption of IDF and RDL on goods determined by the CS for public interest or to promote investment whose value exceeds 5 billion is a welcome proposal that, if adopted, will reduce the cost of qualifying projects. We note that the threshold of investments eligible for this exemption has been increased from KES 200 million to KES 5 billion perhaps in a bid to limit the number of projects eligible for this exemption and to attract high value investments in Kenya.

Tax Procedures

Implementation of the Common Reporting Standards regime in Kenya

The measure

The Bill proposes to introduce the Common Reporting Standards (CRS) regime in Kenya to effect automatic exchange of financial accounting information on tax matters. The reporting is to be done by all financial institutions resident in Kenya, including Kenyan branches of non-resident financial institutions but excluding foreign branches of Kenyan financial institutions.

The reporting will be done by way of filing returns, including "nil", where applicable, with the Commissioner on reportable accounts. The Bill requires the Cabinet Secretary to publish Regulations prescribing the common reporting standards. The Regulations are expected to provide;

- Due diligence procedures and record keeping requirements;
- Guide on how a reporting financial institution will identify reportable accounts;
- The date and the manner of filing the information or "nil" returns; and
- Any other relevant information.

The Bill proposes punitive penalties and sanctions for non-compliance with common reporting standards obligations as summarized below:

Offence	Penalty
Making a false statement or omission of any information from the return	*KES 100,000 for each false statement/omission or imprisonment for a term not exceeding three years or both
Failure to file a return by a reporting financial institution	KES 1,000,000 for each failure
Failure to comply with a duty or obligation where no other penalty is prescribed	KES 20,000 and KES 20,000 for each day(up to a maximum of 60 days) that the non-compliance continues

*Not applicable in the case of information required in respect of another person where it can be seen that a reasonable effort was made by the person to obtain the information from the other person.

Tax Procedures

Implementation of Common Reporting Standards (CRS) regime in Kenya (…cont.)

Who will be affected

Financial institutions operating in Kenya and specified persons with accounts with the financial institutions.

When

Effective 1 July 2021

Our view

The proposal is a step towards implementing the CRS regime in Kenya, following ratification of the Convention on Mutual Administrative Assistance in tax matters (the Convention) on 5 December 2019. Under the CRS regime, financial institutions located in participating countries will be required to enhance due diligence procedures to their account holders with the aim of establishing the tax residence of the account holders including the beneficial owners of such accounts.

Subsequently, details of the financial accounts will be automatically exchanged on an annual basis between the tax authority of the participating countries. Any inconsistencies would be flagged and subjected to further investigations.

The proposal demonstrates Kenya's effort in joining global tax transparent jurisdictions in relation to exchange of information on foreign accounts for tax purposes. The Regulations will provide more details on how the CRS regime will be implemented in Kenya.

In the meantime, a Kenyan tax resident should take note of:

- Increased pressure internationally on verification of tax residency of account holders;
- Automatic exchange of information on accounts held in the participating countries thus such information will be accessible to KRA; and

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Implementation of Common Reporting Standards (CRS) regime in Kenya (…cont.)

- Need to review compliance on tax matters regarding income and assets held abroad. Where one did not take advantage of the tax amnesty that had been introduced in 2016, it may be prudent to consider the current amnesty that commenced in January 2021.

This measure is in line with the current global drive to increase transparency for purposes of combatting tax evasion among other crimes. It is a noble move and one of the avenues for increasing compliance and tax revenue.

Implementation of the CRS regime is likely to be faced by a number of challenges, among them:

- The increased administrative burden on the financial institutions coupled with punitive penalties may act as a disincentive to the financial institution;
- Limited resources, especially among the developing countries, to ensure that the CRS regime works;
- Lack of political goodwill from countries that perceive the initiative to be pro-developed countries. The success of the CRS regime is dependent on the number of participating countries; and
- Though the Bill proposes to disregard any arrangement or practice aimed at avoiding an obligation under the CRS regime, there exists a possibility that individuals could still establish 'fictitious' residencies in non-participating jurisdictions.

We will keep a close eye on the Regulations and provide further updates on the developments relating to its full implementation.

Tax Procedures

Statute of limitation to be increased from 5 to 7 years

The measure

The Bill proposes to make the following changes:

- Extend the period taxpayers are required to maintain tax records from five years to seven years;
- Extend the period the commissioner is allowed to amend a tax return where there is no evasion, fraud or wilful neglect, from five years to seven years; and
- Extend the period within which a taxpayer can lodge an application for amendment of a self assessment to seven years.

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

Though the tax law recognizes documents stored in electronic format, most taxpayers largely transact using physical documents, especially when dealing with the Government. This proposal will, therefore, increase the administrative burden on taxpayers to maintain tax records for a longer period and further increase the cost of doing business in relation to renting and maintaining of physical storage space. Regarding tax audits, the amendment will leave taxpayers exposed to audits for a longer period and increase uncertainty in tax matters. It may be driven by the revenue authority's desire to increase the scope of tax audits.

The above amendments are retrogressive given that the periods were recently reduced in order to ensure closure of tax matters within a reasonable timeframe, to enhance efficiency in tax audits and enhance certainty in tax matters.

Tax Procedures

Miscellaneous fees and levies to be governed by the Tax Procedures Act, 2015

The measure

The Bill proposes to include the Miscellaneous Fees and Levies Act 2016 ("MFLA") and any Regulations or other subsidiary legislation made under it within the definition of tax law under the Tax Procedures Act 2015.

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

The MFLA covers levies and charges that were previously covered under the repealed Customs and Excise Act Cap 472. The MFLA empowers the Commissioner to control, collect and account for the Railway Development Levy (RDL), Import Declaration Fees (IDF) and export levies subject to the control and direction of the Cabinet Secretary, National Treasury.

The amendment will bring the procedural issues relating to the MFLA under the ambit of the Tax Procedures Act (TPA) and provide them with the legal backing that applies in relation to implementation of other taxes. Any procedures that are unique to the administration of the MFLA and already provided for under the MFLA will not fall within the ambit of the TPA.

This is a welcome move as it seeks to enhance consistency and efficiency in administration of the levies and other charges.

Tax Procedures

Implementation of tax agreements and treaties to be governed by the provisions of the specific agreements

The measure

The Bill proposes to clarify that implementation of the multilateral agreements and treaties entered into by or on behalf of the Government of Kenya should be effected as stipulated in such agreements or treaties.

The Bill further proposes that any information obtained pursuant to such agreement shall only be disclosed in accordance with the conditions specified in such agreements.

Who will be affected

Any person (including the Commissioner) who relies on international tax agreements.

When

Effective 1 July 2021

Our view

The proposal seeks to ensure clarity that the provisions of international tax agreement should supersede the provisions of any other tax law (including the TPA) in relation to implementation of such agreements and maintaining confidentiality.

This is a good move as it will ensure clarity of mind as far as administration of international tax agreements is concerned. This proposal may have been motivated by the proposed coming into force of the Common Reporting Standards (CRS) in Kenya, which requires utmost confidentiality and personal data protection.

Tax Procedures

Requirement to maintain financial records in Kenya Shillings relaxed for non-residents

The measure

The Bill proposes to amend the Tax Procedures Act, 2015 to exempt non-resident persons who file returns and make payments through a resident tax representative or a non-resident person with a permanent establishment from maintaining financial records in Kenya Shillings.

For non-resident persons carrying on business through a digital marketplace, the Bill proposes that the financial records should be maintained in convertible foreign currency as may be approved by the Commissioner.

Who will be affected

Non-resident taxpayers

When

Effective 1 July 2021

Our view

The proposal to relax the requirement to maintain financial records in Kenya Shillings is welcome since it removes the administrative burden of maintain parallel records in a currency that is different from the currency used by the Group. The change may not have a major impact given that such persons will still be required to file their returns in Kenya shillings.

The requirement to have non-resident persons carrying out business through a digital marketplace maintain their tax records in a convertible currency as may be approved by the Commissioner may require further clarification to ensure certainty. As currently, drafted, it is unclear what is the approval criteria.

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Tax Procedures

Grounds for abandonment of taxes by the Commissioner to be widened

The measure

The Bill proposes to amend the Tax Procedures Act, 2015 and include *"any other reason occasioning inability to recover unpaid tax"* as a ground that the Commissioner can rely on to abandon taxes.

In addition, the Bill proposes to introduce a requirement for the Commissioner to submit biannual reports by 30th June and 31st December to the Cabinet Secretary containing details and amounts of taxes abandoned for purposes of enhancing accountability.

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

This proposal is expected to enable the Commissioner exercise his discretion in abandoning tax if there is any other justifiable basis. The proposal requiring the Commissioner to submit reports to the Cabinet Secretary is welcome, as it will enhance accountability.

Tax Procedures

Repeal of the tax amnesty on rental income

The measure

The Bill proposes to repeal Section 37A of the Tax Procedures Act, which had been introduced vide the Finance Act 2016. The section provided for a tax amnesty granting waiver of the principal tax, penalties and interest on undeclared rental income earned by an individual in 2013 and prior years. The Section also extended waiver of penalties and interest in respect of the years of income 2014 and 2015 where the principal tax and tax returns were submitted by June 2016.

Who will be affected

Persons who earn rental income from immovable property.

When

Effective 1 July 2021

Our view

Given that the tax amnesty relating to 2014 and 2015 years of income was pegged on condition of filing the return by 30th June 2016 and that the years of income leading to 2013 are outside the statute of limitation, this section was redundant. In our view, the move to repeal it is a clean up exercise. However, this amendment could impact persons who did not take advantage of the tax amnesty where KRA can demonstrate that there was evasion, fraud or gross or wilful neglect and therefore reopen such years for assessment.

Tax Procedures

Removal of the withholding VAT exemption for suppliers with perpetual credits

The measure

The Bill proposes to delete the provision that allowed suppliers with perpetual VAT credits for at least 2 years to apply for exemption from withholding VAT.

Who will be affected

VAT registered persons and withholding VAT agents.

When

Effective 1 July 2021

Our view

The provision that allowed suppliers with perpetual VAT credits to apply for exemption from withholding VAT was introduced at a time when taxpayers could not claim a refund of VAT arising from withholding VAT. In 2020, the VAT Act was amended in order to allow taxpayers with VAT credits arising from withholding VAT to either apply for refund or use the credits to offset against other taxes. This may have informed the proposed amendment.

However, we believe that due to the negative cash flow impact of the withholding provisions, the exemption measure should still be retained. This is especially the case due to the persistent problem of refund backlogs.

It would be ideal if such exemption measures can be applied to motivate complaint taxpayers by exempting them from withholding tax (both VAT and withholding income tax) as is the practice in some countries such as Uganda.

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Clarification on accrual of penalties and interest in relation to offset of tax due against refund amount

The measure

The Bill proposes to clarify that where a taxpayer has applied for a refund of overpaid tax and the Commissioner applies the credit to offset against unpaid tax, penalties or interest shall stop to accrue on the amount applied to offset the outstanding tax from the date the taxpayer is notified that the application for refund has been ascertained.

The proposal further seeks to clarify that any amount that remains outstanding after the offset shall continue to accrue penalties and interest in accordance with the provisions of the Tax Procedures Act.

Who will be affected

Taxpayers who are in a refund position.

When

Effective 1 January 2022

Our view

While the clarification is welcome, we are of the view that the penalties and interest should stop accruing at the date when the tax refunded was paid to the KRA. This is important because the taxpayer has no control of how long it will take for the Commissioner to process and approve a tax refund. In any event, the tax approved for refund was already in the custody of KRA.

As currently drafted, the Tax Procedures Act requires the Commissioner to notify taxpayers the refund application decision within ninety days of receiving the application. However, this section does not provide any prescription to the taxpayer should the Commissioner fail to respond within the required time frame. In practice, it is common for the Commissioner to delay such decisions through requests for information or other contentions. We recommend a further amendment to provide that the Commissioner's failure to respond within the ninety days period would imply that the Commissioner has ascertained the refund claim to be correct and therefore approved.

Tax Procedures

Notice of objection in electronic form to be submitted even on weekends or public holidays

The measure

The Bill proposes to allow for electronic submission of an objection on a weekend or public holiday where the due date falls on such days. Currently, where a notice of objection falls due on a Saturday, Sunday or public holiday in Kenya, the due date is taken to be the previous working day.

The law currently allows for electronic submissions of returns and electronic payment of tax over the weekend or public holidays.

Who will be affected

All taxpayers.

When

Effective 1 July 2021

Our view

This proposal will be of great convenience to taxpayers and is line with the aim of digitalization of the tax administration processes. It comes at a time when the KRA has been accepting objections filed electronically due to the restrictions arising from the Covid-19 pandemic.

Tax Procedures

Commissioner empowered to seek the intervention of relevant authorities in enforcement of taxes from persons who provide services over the internet (including through a digital marketplace)

The measure

The Bill proposes to allow for the Commissioner to seek the intervention of relevant authorities to enforce compliance with the provisions of taxes from persons who provide services over the internet or an electronic network including through a digital marketplace.

Who will be affected

Digital services providers

When

Effective 1 July 2021

Our view

This will enable KRA to collaborate with other authorities especially on enforcement of the recently introduced Digital Service Tax (DST) and VAT on taxable services supplied through a digital marketplace. The term relevant authorities is not defined, and this implies that KRA may work with a wide range of third parties to enforce the tax.

Enforcement of taxes may include restriction of access to the digital marketplace in Kenya.

Tax Procedures

Offence for failure to appear before the Commissioner broadened

The measure

The Bill proposes to amend the Tax Procedures Act by including the failure by a person to appear before the Commissioner to be an offence. Currently, failure to appear before the Commissioner is only an offence to the extent that the Commissioner or an authorized person had notified the person being summoned in writing to attend at the time and place specified for purposes of giving evidence in relation to a tax matter.

Who will be affected

All taxpayers

When

Effective 1 July 2021

Our view

This proposal is unnecessary and would be prone to be abuse. As currently proposed, the provision will be unnecessarily broad and ambiguous as it does not even specify the circumstance under which a person may be summoned by the Commissioner.

Tax Procedures

Criminal and civil proceedings on the same tax dispute to run concurrently

The measure

The Bill proposes to entrench in law the fact that civil and criminal cases on the same tax dispute can run concurrently and none shall act as a ground for stay, prohibition or delay of the other.

Who will be affected

All taxpayers with tax disputes.

When

Effective 1 July 2021

Our view

This is aimed at enhancing collection of taxes by minimising hurdles that could arise in enforcement of tax collection. However, we believe the courts should be left to determine appropriate remedies depending on the facts of the case.

Tax Procedures

Protection of officers acting in good faith

The measure

The Bill proposes to amend the provision relating to protection of officers from being personally liable for acts or omissions done or committed in performing their functions under a tax law by including the words "in good faith".

Who will be affected

Officers acting for the KRA.

When

Effective 1 July 2021

Our view

The amendment indicates that revenue officers need to act in good faith in order to enjoy protection under the law. It is a welcome measure to ensure officers exercise reasonableness and care while performing their work.

Tax Procedures

Digital service providers required to register for tax in Kenya

The measure

The Bill proposes to impose a requirement for digital service providers to have a Personal Identification Number (PIN). This implies that all digital service providers who have income accrued in Kenya, including non-residents will have to be registered for tax in Kenya.

Who will be affected

Persons who derive their income through an electronic network or over the internet.

When

Effective 1 July 2021

Our view

The requirement for persons selling goods and services over the digital marketplace may negate the option of digital services providers appointing a tax representative to help in filing and paying of taxes in Kenya. In addition, requirement may be administratively cumbersome for entities that do not have a physical presence in Kenya.

Other measures

In addition to the tax measures, the Bill has also proposed changes to the Capital Markets Act (Cap 485A), The Insurance Act (Cap 487), The Kenya Revenue Authority Act, 1995, The Retirement Benefits Act, 1997 and The Central Depositories Act, 2000. We summarise the proposed changes below.

The Capital Markets Act (Cap 485A)

The Bill proposes to set a 90-day period commencing on the date of filing of an appeal for the Capital Markets Tribunal to hear and determine that appeal. Currently, save for maintaining the status quo for a matter that is subject to appeal until the appeal is determined, the law does not provide for a specific period that a matter should be heard and determined.

This is expected to improve efficiency in resolving disputes by the Tribunal.

The Insurance Act (Cap 487)

The Bill proposes to amend the Insurance Act in order to:

a. Repeal the current definition of the term “broker” and replace it with a new definition that includes foreign reinsurance brokers who do not undertake insurance business or have no place of business in Kenya. In effect, foreign reinsurance brokers will now be regulated by the Insurance Regulatory Authority;

b. Repeal the transitional provision that exempted, in the case of treaty insurance, an insurer, broker, agent or other person seeking to place any reinsurance of Kenya business with an insurer not registered under the Insurance Act from the requirement to seek approval from the Commissioner to the treaty;

c. Introduce a new section (Section 21A), which will govern the administration of closed fund business. The Section provides the meaning of a closed fund business and provides for the penalties applicable should a person contravene the provisions governing closed fund business;

d. Introduce a prescribed annual fee to be paid by a registered insurer. This will be effective 1 January 2022.

Other measures

The Kenya Revenue Authority Act, 1995

The Bill proposes to amend the Kenya Revenue Authority Act in order to increase the maximum reward to any person who provides information leading to the;

- Identification of unassessed tax from KES 100,000 to KES 500,000; and
- Recovery of unassessed taxes from KES 2,000,000 to KES 5,000,000.

The move is expected to enhance tax compliance and increase revenue collection by encouraging the public/informers to provide intelligence information to the Commissioner. To ensure success, there may be need to amend the law to provide mechanisms for protection of informers.

The Retirement Benefits Act, 1997

The Bill proposes to amend the Retirement Benefits Act, 1997 ("the Act") in order to:

- Expand the definition of retirement benefit schemes to also include any arrangement under which persons are entitled to benefits in the form of post-retirement medical cover, effective 1 January 2022. This is in recognition of the modernisation of the structure of retirement benefits products.
- Provide a definition of post-retirement medical fund as follows:

  "a fund established within a scheme into which contributions are made and from which the costs of medical benefits can be met as may be determined in accordance with the medical fund rules."
- Empower the Retirement Benefits Authority ("the Authority") to extend the timeline for the submission of audited accounts during extraordinary times. Currently, the trustees are expected to submit audited accounts within six months after the end of each financial year.
- Introduce the registration and regulation of corporate trustees that provide services to pension schemes. The definition of corporate trustee has been provided. Corporate trustees will be required to apply for registration to the Authority.

Other measures

The Retirement Benefits Act, 1997 (..cont.)

For a corporate trustee to be registered, the applicant must:

a) Have minimum paid up share capital as prescribed by the Authority;

b) Be capable of meeting members' and sponsors' obligations as specified in the rules of the scheme;

c) Have professional and technical capacity including operations systems to enable the performance of its functions;

d) Have never been a trustee of a previously deregistered or wound-up scheme fund;

e) Have met the requirements of the Authority regarding Board of Directors and senior management, such as the number and professional qualifications; and

f) Meet any other requirement that may be set by the Authority.

The Authority has a right to refuse an application or deregister a corporate trustee for reasons provided for under the Act. Upon successful registration, the corporate trustees will be issued with a certificate and expected to act in accordance with the provisions of the Act.

Other measures

The Central Depositories Act, 2000

The Bill proposes to amend the Central Depositories Act, 2000 in order to:

- Introduce the concept of beneficial and legal owner in the capital markets. This is aimed at enhancing the regulation of investors in the capital markets.
- Allow opening of an omnibus account by a person investing on behalf of others in the securities market. An omnibus account is defined to mean "an account held by an authorized nominee on behalf of two or more beneficial owners or legal owners.

The proposal may have been motivated by the enactment of The Statute Law (Miscellaneous Amendments) Act No. 12 of 2019, which provided that every company incorporated or registered in Kenya is required to keep two separate registers:

a) a register of members; and

b) a register of beneficial owners; and coming into effect of the Companies (Beneficial Ownership Information) Regulations, 2020.

If passed, the proposed changes will take effect on 1 January 2022.

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