Tax Alert
The Finance Act 2017

The Finance Act 2017

The Finance Act, 2017 was assented into law on 21 June 2017 ("the Finance Act"). The Finance Act has introduced some new provisions that were not contained in the Finance Bill, 2017 ("the Finance Bill"), provided clarification on some issues in the Finance Bill that were potentially confusing and dropped some proposals contained in the Finance Bill.

This alert provides an analysis of the new tax provisions introduced by the Finance Act and provides a recap of the key tax changes introduced by the Finance Bill and subsequently confirmed by the Finance Act.

Income Tax

New provisions introduced by the Finance Act

Petroleum industry

Effective 1 January 2018, capital expenditure incurred on the construction of transportation and storage facilities for petroleum products by the Kenya Pipeline Company Limited (KPC) will now qualify for investment deduction at either 150% or 100%. Currently, the petroleum pipeline is eligible for wear and tear allowance at 12.5%.

As the pipeline may traverse counties that are subject to either the 150% or 100% rate, there may be a need for KPC to apportion the capital costs accordingly.

Special Economic Zones (SEZ's)

The Finance Act has introduced 150% Investment Deduction allowance for capital expenditure on buildings and machinery by an SEZ enterprise located outside Nairobi and Mombasa.

This change harmonizes the investment deduction allowance granted on qualifying capital expenditure incurred outside the

Nairobi and Mombasa counties. **Effective 1 January, 2018.**

Local motor vehicle assemblers

The Finance Bill introduced a reduced corporate tax rate of 15% for companies whose business is the local assembly of motor vehicles for the first five years from the year they commence operations.

The Finance Act has now included a proviso stating that the 15% rate shall be extended for a further period of five years if the company achieves a local content equivalent to 50% of the ex-factory value of the motor vehicles. No definition of the term "local content" has been provided. **Effective 1 January, 2018.**

June 2017

Tax Procedures Act

Tax Amnesty on income earned outside Kenya

The Finance Bill had extended the period for the repatriation of funds that are subject to the tax amnesty to **30 June 2018.**

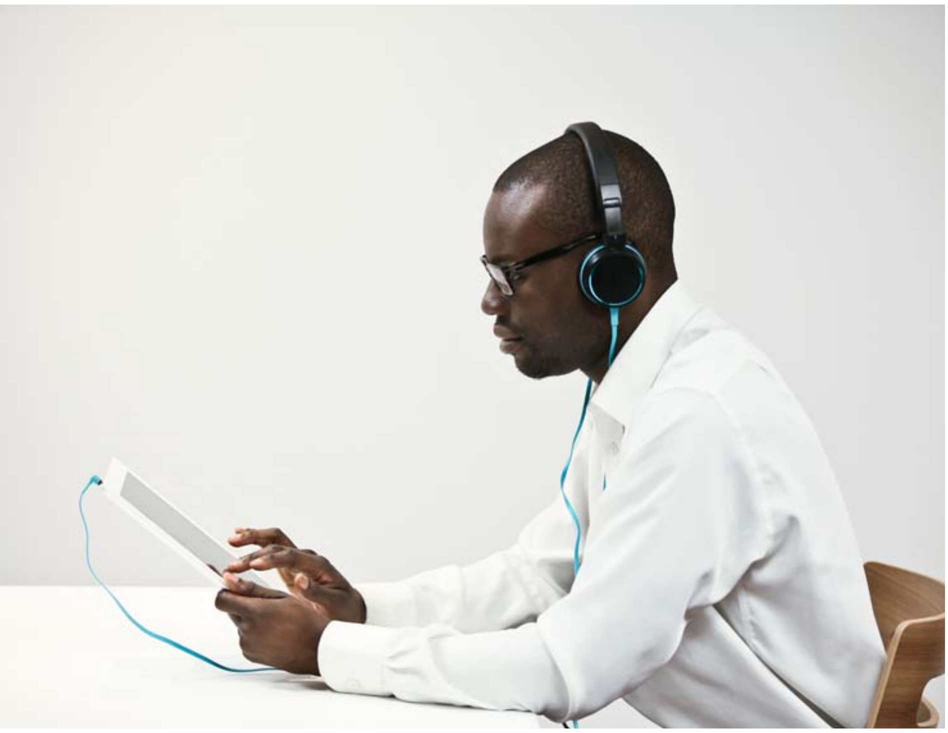
The Finance Act has clarified that where no funds have been transferred within the period of the amnesty (period up to 30 June 2018) there shall be a five year period for remittance but a penalty of 10% shall be levied on the remittance.

It is unclear from which date the five year period would begin especially since the period within which the KRA can assess a taxpayer generally prescribes after five years.

Tax representatives

Effective 1 January 2018, the registration of tax representatives shall be in the name of the non-resident person being represented.

In addition, a person may be a tax representative for more than one non-resident person, in which case the person shall have a separate registration for each non-resident person. The Commissioner shall also issue a PIN to the tax representative.



Betting, Lotteries and Gaming Act

Increased tax rate for betting, gaming and lottery operators

The Finance Act has increased the amount of betting, lotteries and gaming taxes with effect from **1st January 2018** as follows:

Tax Type	Current Rate/Tax base	New Rate/ Tax Base
Betting Tax	7.5% of the gaming revenue	35% of the gaming revenue
Lottery Tax	5% of the lottery turn-over	35% of the lottery turn-over
Gaming Tax	12% of the gaming revenue	35% of the gaming revenue
Prize Competition Tax	15% of the total gross revenue	35% of the total gross revenue

While the 35% rate is a reduction of the 50% rate that was previously introduced by the Finance Bill it still represents a significant increase in taxes for the sector.

Other Sectoral Reforms

Receivership period extended

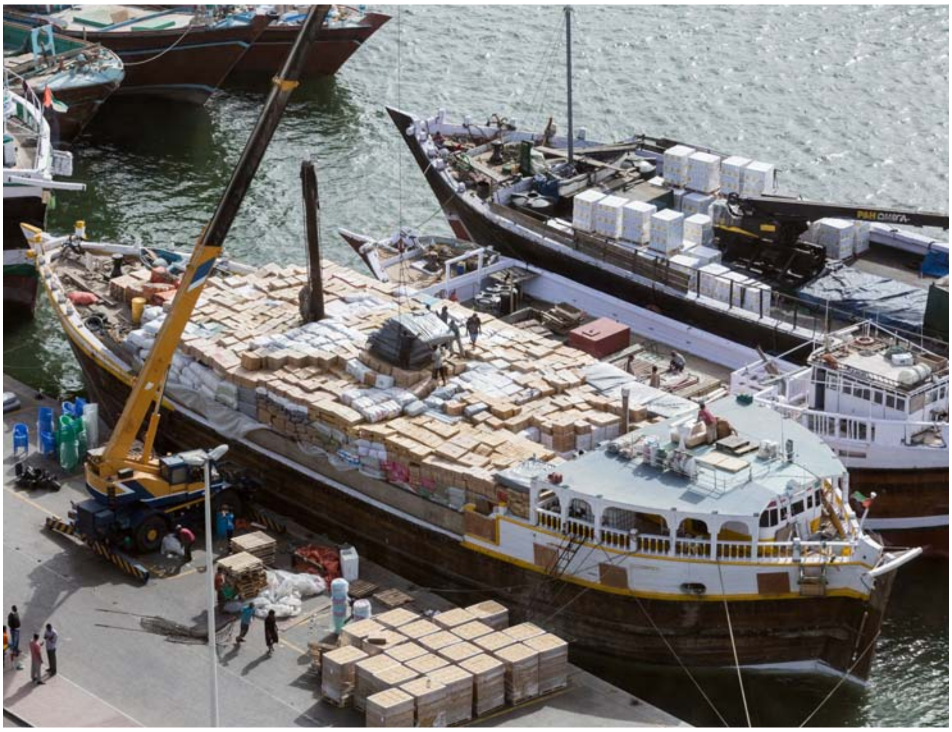
Effective 1 January 2018, the Kenya Deposit Insurance Act 2012 has been amended to give the Cabinet Secretary the power, under exceptional circumstances, to extend the term of receivership for a further period not exceeding twelve months. Currently, the receivership period can only be extended for a period not exceeding six months.

Recap of key changes contained in the Finance Bill

In this section, we provide a summary of the proposed key tax changes introduced by the Finance Bill (see attached alert) in respect of the Kenya Income Tax Act which were assented to without any further amendments in the Finance Act. More details in respect of the changes were provided in the PwC Tax Alert.

- Expenditure incurred by a taxpayer on donations for the alleviation of distress during national disaster as declared by the President will be deductible expenses for the taxpayer when determining taxable income. **Effective 3 April 2017.**
- A resident entity operating in a preferential tax regime, such as an SEZ, is required to carry out business with a related resident person on an arm's length basis. **Effective 3 April 2017.**
- Dividends payable to non-residents by SEZ enterprises, developers and operators have been exempted from withholding tax. Management fees, professional fees, training fees and royalties payable by SEZ enterprises, developers and operators to a non-resident person shall be subject to withholding tax at the rate of 5%. Interest payments payable by SEZ enterprises, developers and operators to a non-resident person shall be subject to withholding tax at the rate of 5%. 100% Investment Deduction allowance has been granted on capital expenditure on buildings and machinery by an SEZ enterprise. **Effective 1 January 2018.**
- **Effective 3rd April 2017,** Kenya Revenue Authority (KRA) officers have the power to enter and search any premises or vessels and seize, collect and detain evidence and produce such evidence in any proceedings before a court of law or tax appeals tribunal.

- **With effect from 3 April 2017,** the Finance Bill has extended the tax amnesty deadline by which untaxed income earned outside Kenya needs to be declared to 30th June 2018.
- The current individual tax brackets will be expanded by 10% and personal relief will increase from the current Shs. 15,360 per annum (Shs. 1,280 per month) to Shs. 16,896 per annum (Shs. 1,408 per month). The revised tax bands and personal relief are **effective from 1 January 2018.**
- **With effect from 1 January 2018,** the resident withholding tax rates for pension withdrawals have been aligned with the expanded tax bands. The proposed tax bands will apply in respect of pension withdrawals made before the expiry of 15 years from the date of joining the fund from a registered pension fund, registered provident fund, the National Social Security Fund or a registered individual retirement fund in excess of the tax free amounts as specified under the Income Tax Act.



Value Added Tax

Introduction

We observe from the Finance Act that the Government has continued to acknowledge the ills of exemption by zero-rating other basic foods and other goods as a way of ensuring that basic foodstuffs enjoy reprieve from VAT.

The change in the taxable status of some supplies from exempt to zero rate, especially basic food commodities is a sign of an appreciation by the Government that VAT exemption is laden with hidden sticking costs and rarely delivers the desired tax reprieve.

New provisions introduced by the Finance Act

Zero rating of milk and cream

Milk and cream, not concentrated nor containing added sugar or other sweetening matter are now zero rated. Previously, milk and cream of fat content by weight not exceeding 1% and exceeding 1% but not exceeding 6%was exempt from VAT. The Act has provided for zero rating of milk and cream of all fat contents. **Effective 3 April 2017.**

Zero rating of LPG

The Act has deleted the proposal contained in the Bill that sought to exempt supply of Liquefied Petroleum Gas (“LPG”). Prior to the proposed amendment, LPG was zero rated under the VAT Act, 2013. Therefore, in our view, the supply of LPG is now back to being zero rated. **Effective 3 April, 2017.**

Further, the Act has deleted the proposal contained in the Bill that sought to exempt taxable goods for use in the manufacture of LPG cylinders by licensed manufacturers. In our view, such a supply is now standard rated at 16%. **Effective 3 April, 2017.**

Zero rating of cassava flour

Cassava flour, as well as maize flour containing cassava flour by more than ten per cent (10%) in weight, is now zero rated. The zero rating of cassava flour is in addition to the zero-rating of food commodities such as maize (corn) flour, wheat or meslin flour, ordinary bread, as proposed by the Finance Bill. **Effective 3 April, 2017.**

Zero rating of pest control products

The Act has zero rated agricultural pest control products, and all inputs and raw materials, whether produced locally or imported, supplied to manufacturers of agricultural pest control products. This will however be subject to recommendation from the Cabinet Secretary for the time being responsible for matters relating to agriculture. **Effective 3 April, 2017.**

This will allow local farmers to be more competitive and also promote the agricultural sector by reducing the cost of crop production.

A boost to exporters

Transportation of cargo to destinations outside Kenya is *exempt* from VAT. Whilst this exemption is a welcome move, in our view, the exemption raises confusion as it conflicts with the VAT Regulations, 2017 which provide that services in relation to transportation of goods which terminates outside Kenya is considered as an export of service, and thus *zero-rated.* **Effective 3 April, 2017.**

Exemption of grain storage facilities

Materials for the construction of grain storage are now exempt. However, this is upon recommendation by the Cabinet Secretary for the time being responsible for agriculture. This move is aimed at ensuring that there is sufficient and affordable grain storage facilities for better food security. **Effective 3 April, 2017.**

Definition of clean cook stoves

The Act has provided a definition of ‘clean cook stoves’, which is currently exempt upon recommendation by the Cabinet Secretary for the time being responsible for energy.

Clean cook stoves includes clean energy saving cook stoves, as well as their parts and raw materials that are either imported or sourced locally. However, the stoves must meet ISO/IWA 11:2012 standards of tier 2-4 for fuel efficiency, as determined by the Kenya Bureau of Standards. **Effective 3 April, 2017.**

Recap of key changes contained in the Finance Bill

In this section, we provide a summary of the proposed key VAT changes introduced by the Finance Bill (see attached alert) which were assented to without any further amendments in the Finance Act. More details in respect of the changes were provided in the PwC Tax Alert.

- Zero rating of ordinary bread, maize (corn) flour, wheat flour, meslin flour. **Effective 3 April, 2017.**
- **Promoting the blue economy**

  Taxable goods supplied to marine fisheries and fish processors are zero rated, subject to recommendation by the relevant state department. It is hoped that the proposed change will revive the fisheries sector and ensure increased utilization of marine resources as part of economic growth agenda. **Effective 3 April, 2017.**
- **Left hand drive vehicles**

  Due to the challenges experienced by returning individuals on replacing their left hand vehicles with right hand vehicles, the Act has simplified the conditions. The returning resident may now import under zero-rate, a right hand vehicle as long as its current retail selling price does not exceed that of the previously owned left hand- drive vehicle. **Effective 3 April, 2017**.
- **Zero rating of services supplied to International and Regional organizations**

  Services imported by or supplied to donor agencies, international and regional organizations with diplomatic accreditation or bilateral or multilateral agreements with Kenya for their official use, are be zero rated. **Effective 3 April, 2017.**
- **Zero rating of services supplied for provision of relief services**

  Services imported or supplied for official use in the provision of relief service supplied to the National Red Cross Society and St. John Ambulance are zero rated. **Effective 3 April, 2017**.
- **VAT exemption for Sharia compliant finance products**

  'Sukuk' and Islamic finance return which is treated as interest is now exempt from VAT. While the general assumption is that interest is treated as exempt from VAT under the first schedule to the VAT Act, the VAT Act does not assign a definition to the term interest. **Effective 3 April, 2017.**

- **VAT exemption for disabled persons**

  Exemption of materials, articles and equipment, including motor vehicles intended for the educational, scientific or cultural advancement, will apply to all disabled persons. **Effective 3 April, 2017.**
- **VAT exemption for medical equipment**

  Medical equipment and apparatus for use in specialized hospitals with a minimum bed capacity of 50 is exempt from VAT. This will however be subject to recommendation from the Cabinet Secretary responsible for health. **Effective 3 April, 2017.**
- **VAT exemption for postage and revenue stamps**

  Unused postage, revenue or similar stamps are exempt from VAT and will reduce the burden on licensed manufacturers who bear the cost of excise stamps. **Effective 3 April, 2017.**
- **VAT exemption for aircraft spare parts**

  Over and above the current VAT exemption provided to aeroplanes, other aircraft, and other parts of aeroplanes or helicopters, the Act exempts aircraft spare parts imported by aircraft operators or persons engaged in the business of aircraft maintenance. This will however be subject to recommendation from the Cabinet Secretary responsible for civil aviation. **Effective 3 April, 2017.**
- **VAT exemption for inputs for the manufacture of pesticides**

  This will however be subject to recommendation from the Cabinet Secretary for the time being responsible for matters relating to agriculture. **Effective 3 April, 2017.**
- **VAT exemption for locally assembled tourist vehicles**

  *T*he supply of locally assembled tourist vehicles shall be exempt from VAT. This is a positive move towards promoting local assemblers as well as the tourism sector. However, these must be purchased before clearance through Customs by tour operators upon recommendation by the competent authority responsible for tourism promotion, provided the vehicles meet specified conditions. It is important to note that tax shall become payable upon change of use or disposal of the vehicle for other use. **Effective 3 April, 2017.**
- **Indirect taxation of REITS and ABS**

  Asset transfers and other transactions related to the transfer of assets into Real Estates Investment Trusts ("REITs") and Asset Backed Securities ("ABS") are exempt from VAT. This is in line with the Government's policy to increase sources of financing for infrastructure projects by increasing the uptake of alternative infrastructure financing products. This exemption will reduce the overall cost of setting up REITS and ABSs. **Effective 3 April, 2017.**

Tax reforms under the Tax Procedures Act, 2015

Withholding VAT

The Act has amended the Tax Procedures Act, 2015 (TPA) by introducing the following new provisions in regards to Withholding VAT, **Effective 3 April, 2017.**

- VAT withheld under the withholding VAT regime shall be remitted to the Commissioner on or before the twentieth (20) day of the month following the month in which the withholding was made. Previously, the Finance Bill proposed that withholding VAT was to be payable within fourteen (14) days after the tax was withheld.
- A person who fails to remit all the tax withheld by the due date is liable on conviction to a penalty of ten per cent (10%) of the tax involved.

Further, the Act has retained provisions exempting any supplier from the provisions of Withholding VAT where the supplier has sufficiently demonstrated that due to the nature of his business, these provisions may cause such a taxpayer to be in a continuous credit position for a period of not less than twenty-four months.

In our view, these changes have addressed challenges currently experienced by taxpayers. The requirement to remit the tax on or before the twentieth (20) day of the month following the month in which the withholding was made has greatly reduced the administrative burdens to taxpayers, and also aligns Withholding VAT administration to other taxes such as VAT and Withholding tax.

Excise Duty changes

Introduction

The Finance Act 2017 has introduced amendments to the Excise Duty Act, 2015. Some of the changes to the Excise Duty Act had been captured under the Finance Bill, 2017 while others are new provisions that have been introduced into law.

New changes

Inflationary adjustment

Effective 1 January 2018, the Finance Act provides for an inflationary adjustment to the rates of excise duty every two years instead of the provision for an annual adjustment as was provided for in the Excise Duty Act, 2015. This is a welcome move specifically for business planning purposes.

Confirmed changes as per the Finance Bill, 2017.

The following changes **with effect from 3 April 2017** were introduced under the Finance Bill, 2017 and confirmed by the Finance Act, 2017.

- Paint and resin manufacturers who use illuminating kerosene to manufacture paint and resin are now required to be registered with the KRA in order to be entitled to a refund of the excise duty already paid for this purpose.
- The excise duty rate for spirits and other spirituous beverages of alcoholic strength exceeding 10% has increased from KES 175 to KES 200 per litre.
- There has been an introduction of a two tier excise duty structure for cigarettes from the current single rate of KES 2,500 per mille. Cigarettes without filters are now chargeable to excise duty at the rate of KES 1,800 per mille while cigarettes with filters are chargeable at KES 2,500 per mille.
- Powdered beer has been defined to mean any powder, crystals or any other dry substance, which after being mixed with water or any other non-alcoholic beverages ferments to or otherwise becomes an alcoholic beverage.
- Excisable goods supplied to St. Johns Ambulance for official use in the provision of relief supplies in Kenya have been exempted from excise duty.
- A new requirement with regards to left hand drive motor vehicles previously owned by returning residents has been introduced. The requirement, now, is that the “retail selling price” of the right hand drive replacement motor vehicle shall not exceed that of the previously owned left hand drive vehicle. Previously, the replacement

motor vehicle was required to be of "equivalent value" and of the same make, engine rating and year of manufacture as the left hand drive motor vehicle. It is worth noting that "current retail selling prices" are determined by the KRA.

- The exemption of excisable goods purchased locally for use in the manufacture of sanitary towels. This amendment creates uniformity in the treatment of these raw materials by exempting local raw materials in line with the exemption already in place for imported raw materials.

Excise Duty Regulations

- The Excise Duty Remissions Regulation, 2017 provide for 80% remission of excise duty on beer made from sorghum, millet or cassava or any other agricultural produce grown in Kenya.
- **Effective 3 April 2017,** the Excisable Goods Management Regulations (EGMS), 2017 were introduced to address the administrative and other compliance obligations of excisable persons and repeal EGMS Regulations of 2013.Among other administrative matters, the regulations set the price of excise stamps for various excisable products.

The Miscellaneous Fees and Levies Act (No. 29 of 2016).

Export levy/duty

- **Effective 1 January 2018,** The Act has exempted from payment of export duty, goods exported to the Special Economic Zones (SEZs).

  In addition, imports by enterprises licensed under the SEZs Act will also be exempt from payment of Import Declaration Fee (IDF) when imported or purchased before clearance through customs.

Conclusion

These changes took effect on **3 April 2017** with the exception of the inflationary adjustment of excise duty rates which takes effect on **1 January 2018.** While the spirits manufacturers might feel the impact of the increased excise duty on their products, most of the other changes are welcome as they streamline and clarify the excise duty provisions while aiming to bring relative stability in excise duty rates by limiting any upward adjustment to every two years.