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FINANCE BILL, 2016

Finance Bill 2016 – Key tax changes

The National Budget was presented by the Cabinet Secretary to the National Treasury (**CS**) on 8 June 2016. The Finance Bill 2016 (the **Bill**) has subsequently been published, pending tabling before the National Assembly for debate and approval. We analyse the key changes that have been proposed for introduction to the taxation regime by the Bill.

It is expected that the Bill will be enacted into law later in the year. It should be noted that most of the amendments introduced by the Bill are in force as of 9 June 2016 with a few exceptions which come into force on 1 July 2016 and 1 January 2017. We have indicated the dates of entry into force, where these differ from 9 June 2016.

Changes to the Income Tax Act

The CS has promised to overhaul the current Income Tax Act (**ITA**) which has been in existence since 1974 by tabling an Income Tax Bill in Parliament in the next financial year commencing 1 July 2016. A new, modern Income Tax Act is intended to complement the new tax legislation such as the Excise Duty Act, the Tax Procedures Act and the VAT Act, 2013.

Tax incentives for employees

The current income tax brackets have not been reviewed for over 10 years. The Government has proposed to expand the tax brackets and increase the personal relief by 10% from the current KES 13,944 per annum (KES 1,162 per month) to KES 15,360 per annum (KES 1,280 per month). Although this is a welcome move, these changes are marginal and do not keep track of rising inflation.

The Bill proposes to replace the current tax brackets with the following individual rates of tax:

Rates of tax %	Old monthly taxable pay (KES)	New monthly taxable pay (KES)
10%	1 – 10,164	1 - 11,180
15%	10,165 – 19,740	11,181 - 21,714
20%	19,741 – 29,316	21,715 - 32,248
25%	29,317 – 38,892	32,249 - 42,781
30%	Excess over 38,892	Excess over 42,781

Any employee who earns less than KES 12,254 will not be liable to Pay As You Earn Tax (**PAYE**) on account of the personal relief of KES 1,280 per month.

The new individual rates of tax and personal relief will come into force on 1 January 2017.

Big wins for low income employees

The Bill proposes to exempt low income employees (employees earning KES 11,180 per

month or less) from tax on bonuses, overtime and retirement benefits in order to cushion them from the high cost of living. Upper thresholds on the employment income which would qualify for this scheme should however be introduced to prevent abuse of this exemption through innovative emolument schemes. This provision comes into force on 1 July 2016.

Taxation of rental income revisited

The Finance Act 2015 introduced a new tax known as a residential rental income tax at the rate of 10% on gross rental income of not more than KES 10 million which is accrued in or derived from Kenya. The Bill proposes to amend the provision to introduce a lower rental income threshold of KES 12,000 per month (KES 144,000 per annum). Income below this threshold will therefore be exempt from tax.

In the Budget Speech for the 2015/2016 year of income, the Government proposed to introduce an obligation for tenants and real estate agents (upon being appointed by the Commissioner) to withhold tax on the residential rental income paid to landlords and then remit this to the Kenya Revenue Authority (the **KRA**) in accordance with the withholding tax regulations. This however was not enacted by the Finance Act 2015. The Bill has now proposed to amend section 35 of the ITA to introduce a requirement for appointed agents to withhold tax on rent before the same is paid to landlords. The rate of withholding tax will be 10% on payments made to resident landlords. The Government continues to focus on the real estate sector in a bid to increase tax collections, but the proposal increases the compliance burden for taxpayers who will now be required to make monthly payments to the KRA in addition to their current tax obligations.

Lower corporate tax rate for real estate developers

To address the current housing shortage of approximately 150,000 units per year, the Bill proposes to introduce a reduced special rate of corporate income tax of 20% for real estate developers who construct at least 1,000 units annually, subject to the approval of the Cabinet Secretary for Housing. Most real estate developments will normally be undertaken over a period of 2 – 3 years and it would therefore be important for the Government to provide clarity on whether the special corporate tax rate of 20% will be applicable in the year the development will be completed or across the period of the development. In addition, the threshold of 1,000 units per year may be too high and might be beyond the scope of most medium scale developers. Where the requisite clarifications are provided and the regime is practically workable and beneficial, this change may galvanise the real estate development market.

Revisiting exemptions from Capital Gains Tax (CGT)

The CGT regime which was introduced with effect from 1 January 2015 grants limited exemptions, which has led to tax neutral transactions being subject to CGT. The Bill proposes to amend Paragraph 6(h) of the Eighth Schedule to exclude from the definition of a ''transfer''. The transfer of assets between spouses, to immediate family, or to a company where spouses or a spouse and immediate family hold 100% shareholding. This is a welcome move but the Government should also exempt corporate restructurings from the realm of CGT by introducing exemptions to mirror those available under the Stamp Duty Act. Currently, an exemption from CGT on a corporate restructuring can only be granted at the discretion of the CS where he considers the restructuring to have been undertaken in the public interest.

Tax rebates for employment of graduates

The Finance Act 2015 introduced a new section, 39B, which grants a tax rebate to

employers who employ new graduates. In the Budget Speech for the 2016/2017 financial year the CS indicated that employers who employ at least 10 graduates per annum will qualify for a 150% deduction on the total employee costs incurred as a result of engaging the graduates. We understand that the regulations governing this scheme will be gazetted imminently.

Proposed Amendments to the Tax Procedures Act, 2015 (the TPA)

The Bill has proposed various changes to the TPA, which are highlighted below:

Tax amnesty for income earned outside Kenya

The Bill has proposed a tax amnesty relating to income earned outside Kenya, provided the taxpayer has filed accounts for the year 2016 by 31 December 2017. The Government will grant a waiver of all taxes, penalties and interest and in addition, will not follow up on the sources of income under the amnesty.

Appointment of tax representatives

The proposed amendments to the TPA will make provision for and provide clarity on the appointment of tax representatives by non-residents with no fixed place of business. Where no tax representative has been appointed, the Commissioner will have the power to appoint a tax representative. This amendment is intended to provide a mechanism for non-resident persons who are taxable in Kenya to appoint a representative to handle their tax obligations in Kenya.

This is particularly relevant in the context of capital gains tax legislation where the owner of Kenyan shares or property resides out of the country. This provision comes into force on 1 July 2016.

Greater independence in licensing of Tax Agents

The Bill also proposes to establish a Tax Agents Committee which will be mandated to consider applications for licensing of Tax Agents. Generally, a Tax Agent prepares tax returns, notices of objection and otherwise transacts business with the Commissioner on behalf of a tax payer.

This move is aimed at enhancing the independence of the process of appointment of Tax Agents. Applicants seeking to be licensed as Tax Agents will now be registered by the Commissioner upon recommendation by the Tax Agents Committee.

Enhanced powers of the Commissioner in tax administration

In order to simplify tax administration by making it easier for taxpayers to submit tax returns via iTax and to facilitate tax compliance management, the Bill proposes to grant the KRA greater powers to collect information from any person. Such information is required to be furnished in such form, manner and within such time as prescribed by the Commissioner. This provision appears to be very wide and care needs to be taken in its implementation to strike a balance between taxpayer’s rights and the KRA’s tax collection mandate. This provision comes into force on 1 July 2016.

Withholding VAT re-introduced

The Bill proposes the reintroduction of the withholding VAT system through insertion of a new section 42A in the TPA. The TPA had previously done away with the withholding VAT provisions when it was enacted earlier this year, but we understand that the deletion was inadvertent. We note that the new provision has been backdated to 19 January 2016. From a legal perspective, any withholding VAT agents appointed after 19 January 2016 via the repealed section 25A of the VAT Act 2013 were not appointed procedurally and the ideal position would be for the Withholding VAT Agents to be re-appointed under the provisions of the new section 42A of the TPA

once it is passed into law. The withholding VAT system increases the compliance burden for taxpayers, the majority of whom have to incur additional expenses in reconfiguring their systems and hiring additional resources to handle the compliance aspects of the withholding VAT system.

Further, this system negatively impacts the cash flow position of many businesses as they no longer have access to the withheld output VAT of 6%.

From this perspective, the necessity of the Withholding VAT regime should be carefully considered.

Commissioner's response required within a prescribed period

The timelines for which the Commissioner has to respond to applications by taxpayers and agents under an agency notice from the KRA have now been codified in order to ensure expeditious decision making by the KRA. The Commissioner is now required to respond within 30 days of an application for extension of time to pay tax or a notification of inability to honour agency notices. The Commissioner is also required to respond to an application for a tax refund within 90 days of receiving the application for a refund. We however note that the Bill is silent on the consequences of the Commissioner's failure to respond within these timelines; a diligent but aggrieved party may have legal recourse in court. These provisions come into force on 1 January 2017.

Period for claiming tax refunds extended

The Bill proposes to amend section 47 of the TPA which provides that an application for tax refund can only be made within a period of one year. Taxpayers will now be allowed to apply for a tax refund within a period of five years from the date when the tax was overpaid. This will ensure that a taxpayer can be refunded overpaid tax for a period similar to that which the Commissioner can demand for underpaid taxes. However, VAT refunds will continue to be processed in accordance with the VAT Act, 2013 which prescribes more stringent timelines for applying for a VAT refund. This provision comes into force on 1 January 2017.

Changes to the Tax Appeals Tribunal Act, 2013 and the Tax Appeals Tribunal (Procedure Rules), 2015

The Bill has proposed various changes to the Tax Appeals Tribunal Act, mostly relating to extension of time and time limits when the Tribunal conducts its hearings. The amendments to the Tax Appeals Tribunal Act come into force on 1 January 2017.

The Bill has also introduced mandatory qualifications for the Secretary including academic qualifications and a minimum number of years of experience. In addition, the Bill proposes to grant the power to appoint the Secretary to the Tribunal, instead of the CS as is currently the case.

Amendments to the various provisions of the Tax Appeals Tribunal Act are to be made in order to provide for an extension of time for filing a notice of appeal and for the Commissioner to file a statement of facts to the Tribunal. In addition, it has been proposed that the Tribunal should determine the number of copies to be submitted to the Tribunal as opposed to a determination being made by the Clerk, which is the current position.

It has been proposed that the Commissioner should serve an appellant with a statement of facts within two working days of lodging the same at the Tribunal. Currently, there is no timeline within which the Commissioner is required to serve the appellant after filing the statement of facts and other documents with the Tribunal, although the appellant is

required to serve the Commissioner with a copy of the appeal documents within two days of filing the same with the Tribunal. The Bill also proposes to grant the Tribunal powers to allow an extension of time to the Commissioner to submit the statement of facts to the Tribunal upon application, in certain circumstances.

The Bill also seeks to introduce a provision allowing an appellant to appear through an Advocate. This buttresses the position that Advocates are not required to register as a tax agent to appear at the Tribunal.

The Secretary will now be required under the Bill to submit a copy of the Tribunal's ruling to the Editor of Kenya Law reports for publication within 14 days of the ruling.

Value Added Tax (VAT) changes

The Bill has proposed various amendments to the Value Added Tax Act, 2013 (the **VATA**), particularly introducing VAT exempt status for a number of goods and services, including liquefied petroleum gas, raw materials used in the manufacture of animal feeds, garments and leather footwear manufactured in Export Processing Zones at the point of importation, taxable supplies used in the construction of recreational parks and direction-finding compasses for use in aircraft among other things.

The Bill also proposes to exempt from VAT ''any service charge made in lieu of tips'' provided that the service charge is distributed equally to all employees in accordance with a written agreement between the employer and employees and that the service charge does not exceed 10% of the price of the service. This is in a bid to promote tourism and ensure that junior employees are well remunerated. Additionally, the Bill has proposed a broader definition of the term "hotel" to include serviced flats, serviced apartments, beach cottages, holiday cottages, game lodges, safari camps, *bandas* or holiday villas and similar premises. The effect of this proposed amendment is that a VAT registered proprietor of such an establishment would be required to charge VAT at the rate of 16% on the services rendered. This definition however excludes premises for use by staff and students at medical and educational facilities, as well as premises under a lease or license for a period in excess of one month. This provision comes into force on 1 July 2016.

The Bill also seeks to amend the First Schedule to the VATA to grant an exemption from VAT on motor vehicles used in the implementation of Official Aid-Funded Projects, upon approval by the CS.

The Bill also proposes to delete section 33 of the VATA which imposed an onerous penalty for a tax payer making a fraudulent VAT refund claim. An alternative penalty is however not provided.

Amendments to the Excise Duty Act

Excise duty has been reintroduced on Kerosene at KES 7,205 per 1,000 litres at 20 degrees centigrade in order to dissuade low income persons from using kerosene in the home and preventing persons from gaining from the adulteration of diesel and petrol. In addition, duty has been reintroduced on cosmetics and beauty products at the rate of 10%. These include perfumes and toilet waters, beauty and make-up preparations, shampoos and hair lacquers, pre-shave, shaving and after-shave, deodorants and bath preparations.

In relation to importation of passenger motor vehicles, the Bill seeks to introduce an *ad valorem* rate of 20% on their value. This is in contrast with the previous specific rate of excise duty pegged on the age of the motor vehicle, which was said to be disadvantageous for importers of older vehicles.

The First Schedule to the Excise Duty Act has

also been amended to exclude faucet and natural water from excise duty and subsequently limiting it to mineral and aerated water, including sweetened and flavoured water. The definition of plastic shopping bags for which excise duty may be imposed has been clarified and now applies to "plastic sacks and bags except vacuum bags for packing food, juice tea and coffee" where excise duty of KES 120 per kg is imposed.

Lastly, the Bill proposes to exempt goods imported or purchased locally for direct and exclusive use in the implementation of an Official Aid-Funded Project to the extent provided under a financing agreement.

Other tax changes

The Bill has also proposed the following changes:

- exemption from tax on interest on bonds issued by the East African Development Bank;

- the Bill proposes to amend the VATA to provide that a supply to a Special Economic Zone (**SEZ**) enterprise from outside the SEZ is a zero-rated export for VAT purposes. We however note that the proposed amendment does not extend to supplies made to SEZ operators and developers and the implication is that supplies to SEZ operators and developers will continue to be subject to VAT at the standard rate of 16%; and

- The Bill has also proposed to amend section 35(1) of the Special Economic Zones Act, 2015 to ensure that the exemptions and incentives available for different SEZ enterprises, developers and operators are aligned.

A&K will prepare an update as soon as the Finance Act 2016 is published, or any other relevant information that may impact on the information set out in this alert.

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For more information about Kenya's tax regime, check out our chapter in Chambers and Partners' Corporate Tax Guide 2016. [Click **here** to view]

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