

Insights and Commentary from Dentons

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The Finance Act 2017

received Presidential assent on 21 June 2017. In this brief, we highlight the key tax amendments this has introduced.



A. Income Tax

1. Recognition of Islamic financial products

The Income Tax Act ('ITA') has been amended to take into account Islamic Finance products. Specifically, an Islamic finance arrangement has been defined to mean all financial arrangements, including transactions, instruments, products or related activities that are structured in accordance with Islamic Law.

The definition of 'interest' has also been widened to include an Islamic finance return. Such amounts will therefore be subject to Withholding tax at the same rate as interest.

Effective date: 3 April 2017

Section 2 of the ITA

2. Deductibility of donations made towards alleviation of national disasters

Taxpayers will now be able to take deductions of amounts donated to the Kenya Red Cross, County Governments or any other institution responsible for the management of national disasters to alleviate the effects of a national disaster declared by the President.

Effective date: 3 July 2017

Section 15(2) of the ITA

3. Transfer Pricing requirements for entities in preferential tax regimes

Kenyan-resident entities operating in preferential tax regimes will have to ensure that they transact on an arm's length basis when transacting with their related entities that do not operate within preferential tax regimes.

A 'preferential regime' in this context has been defined as any legislation, regulation or administrative practice which provides a preferential rate of taxation to such income or profit, including reductions in the tax rate or the tax base.

This move will curb aggressive tax planning carried out by Kenyan resident entities which results in profits being shifted to related entities located in low-tax regimes such as Export Processing Zones ('EPZ') or Special Economic Zones ('SEZ').

Effective date: 3 April 2017

Section 18A of the ITA

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4. Incentives for SEZ's

(a) Preferential WHT treatment

SEZ Enterprises, Developers and Operators are set to benefit from the following preferential tax rates:

- Dividends paid to non-residents are exempt from Withholding tax
- Royalties paid to non-residents will be subject to withholding tax at a reduced rate of 5%;
- Interest payable to a non-resident person will be subject to withholding tax at the reduced rate of 5%; and
- Management fees, professional fees, and training fees will be subject to withholding tax at a reduced rate of 5%.

Effective date: 3 April 2017

Third Schedule to the ITA

(b) Capital allowances

SEZ Enterprises will also be entitled to claim Investment Deduction ('ID') at the rate of 100% on capital expenditure incurred on construction of buildings or on the purchase/ installation of machinery.

ID will apply at the rate of 150% where an SEZ enterprise incurs expenditure on buildings and machinery in SEZ's that are located outside Nairobi and Mombasa Counties.

Effective date: 3 April 2017

Second Schedule to the ITA

(c) ... and some clarifications

The Act clarifies that the reduced Corporate Income Tax rates (10% in the first 10 years of operation and 15% in the subsequent 10 years) will apply to SEZ enterprises regardless of whether they sell their products to markets within Kenya or internationally.

Effective date: 1 January 2018

Third Schedule to the ITA

5. ID for costs incurred in transport and storage facilities for petroleum products

Expenditure incurred in the construction of transportation and storage facilities for petroleum products by the Kenya Pipeline Company Limited will now also qualify for capital allowances in form of Investment Deduction.

Effective date: 1 January 2018

Second Schedule to the ITA

6. PAYE Bands expanded by 10%

Lightening appears to have struck twice for employees who will benefit from an expansion of the PAYE bands by 10% for the second year in a row. The revised bands are as follows:

Annual taxable Income (KShs)	Applicable tax rate
147,580	10%
Next 139,043	15%
Next 139,043	20%
Next 139,043	25%
Income over 564,709	30%

The above tax bands will also apply to pension withdrawals made before the expiry of 15 years from the date of joining the National Social Security Fund, a registered pension fund, registered provident fund or a registered individual retirement fund in excess of the tax free amounts as provided for in the ITA.

Additionally, the rate of personal relief has also been increased by 10% to KShs 16,896 from the current KShs 15,360.

Effective date: 1 January 2018

Third Schedule to the ITA

7. Reduced CIT rate for new assemblers of motor-vehicles

Local assemblers of motor vehicles are set to benefit from a reduced Corporate Income Tax rate of 15% for their first 5 years of operations.

The reduced rate of 15% shall also be extended for an additional 5 years where the vehicle assembler achieves a local content equivalent to 50% of the ex-factory value of the motor vehicles.

Effective date; 1 January 2018 Third Schedule to the ITA

8. Streamlining of provisions on penalties

In a move to harmonize the imposition of penalties for non-compliance under the Tax Procedures Act, 2015, the provisions on additional penalties contained in the ITA have been deleted.

Effective date: 3 April 2017 Section 108 of the ITA

B. Value Added Tax

1. Recognition of Islamic products

As with the Income Tax Act, the VAT Act, 2013 has been amended to recognize Islamic Finance products. Services offered in connection with Islamic Financial Products are now VAT exempt.

Effective date: 3 April 2017 Section 2 and the First Schedule to the VAT Act, 2013

2. Clarification of the place of supply of goods

Goods are deemed to have been supplied in Kenya where any of the below 3 conditions are met:

- (a) The goods are delivered or made available in Kenya
- (b) The supply of goods involves their installation or assembly at a place in Kenya; or
- (c) Where the goods are delivered outside Kenya, the goods were in Kenya when their transportation commenced.

The previous wording required that all three conditions had to be met, which was impractical.

Effective date: 3 April 2017 Section 11 VAT Act, 2013

3. Amendments to the Withholding VAT regime

KRA may now exempt a 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 them to be in a continuous credit position for a period of not less than 24 months.

The administrative burden of making withholding VAT remittances has also been eased by streamlining this date with the regular VAT compliance date. Withholding VAT will now have to be remitted on or before the 20th day of the month following that in which it is withheld.

In addition to this, a specific penalty of 10% has been provided for in instances where a taxpayer fails to meet its Withholding VAT obligations.

Effective Date: 3 April 2017 Section 42A of the TPA, 2015

B. Value Added Tax (Continued)**4. Rate changes****(a) VAT exempt supplies**

The following supplies are now VAT exempt:

• Supplies used for the advancement of persons with disabilities

Persons with disabilities are set to benefit from the exemption on materials articles and equipment intended for their educational, scientific or cultural advancement. Previously, this exemption only applied to blind people.

• Materials used in the construction of specialized hospitals

Equipment and apparatus used in the construction of specialized hospitals with a minimum bed capacity of 50 are now exempt from VAT.

However, what exactly constitutes a 'specialized hospital' is yet to be defined.

• Imported aircraft spare-parts

Aircraft spare parts imported by aircraft operators or persons engaged in the business of aircraft maintenance upon the recommendation of the authority responsible for civil aviation.

• Inputs used to manufacture pesticides

Inputs for the manufacture of pesticides are now VAT exempt based on the recommendation of the Cabinet Secretary responsible for agriculture.

• Locally assembled tourist vehicles

Locally assembled vehicles for transportation of tourists by tour operators are VAT exempt provided that the vehicles:

- a) Are registered and operated by a company licensed under the Tourism Vehicle regime.
- b) Are used exclusively for the transportation of tourists;
- c) Have provisions for camping, rescue and first aid equipment, luggage compartments and communication fittings; and
- d) Satisfy any other conditions that the Commissioner may impose.

VAT will be payable in instances in which the vehicles are disposed of or put to other uses.

• Transportation of cargo to destinations outside Kenya

The transportation of cargo to destinations outside Kenya is now VAT exempt. This service falls within the definition of an export hence the move contradicts the general principal that exports are zero-rated for VAT.

• Materials used to construct grain storage

In an apparent attempt to address the food shortages, materials for the construction of grain storage have now been exempted from VAT.

• The transfer of assets into Real Estate Investment Trusts and Asset Backed Securities

This should encourage uptake of more sophisticated financial products which is a necessity if the envisioned Nairobi International Financial Centre is to become a reality

• Inputs used for the manufacture of clean cook stoves

Inputs and raw materials used in the manufacture of clean cook stoves are zero rated. Whilst this position has not been altered, the Act now clarifies that clean cook stoves include *'clean and energy saving cooking stoves, their parts and raw materials, whether sourced locally in Kenya or imported, provided that the stoves meet ISO/ IWA standards of tier 2-4 for fuel efficiency.'*

• Unused postage and revenue stamps

Effective date: 3 April 2017 First Schedule to the VAT Act, 2013

B. Value Added Tax (Continued)

4. Rate changes (Continued)

(b) Zero rated supplies

- **Basic foodstuffs**

The supply of maize flour, ordinary bread and cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than 10% in weight has been zero-rated. Similarly, milk and cream, not concentrated nor containing added sugar or other sweetening matter has also been zero-rated.

This will make it cheaper for *mwananchi* to put food on the table.

- **Agricultural pest control products**

Agriculture is set for a boost following the move to zero- rate agricultural pest control products, which had previously been Exempt. However, there is need for a coherent policy in this area given the move to exempt inputs used to manufacture these items.

- **Supplies to the blue economy**

Taxable goods supplied to marine fisheries and fish processors upon recommendation of the relevant state department.

- **Services supplied to international & regional organizations**

Previously only goods and equipment supplied to these organizations were zero-rated but now the scope of the zero-rating has been expanded to include services.

- **Services supplied to the Kenya Red Cross and St. John Ambulance**

In a bid to boost the country's emergency response preparedness, the supply of services to the Kenya Red Cross and St. John Ambulance has been zero-rated. Zero-rating previously only applied to the supply of goods to these institutions.

- **Vehicles for returning Kenyan residents**

Returning Kenyan residents will now be permitted to import right hand drive vehicles to replace their left hand drive vehicles provided that the current retail selling price does not exceed that of the previously owned left hand- drive vehicle.

Effective date: 3 April 2017 Second Schedule to the VAT Act, 2013

C. Excise Duty

1. Reviews to be done biennially

Reviews of the applicable Excise Duty rates will now be done every two years as opposed to on an annual basis.

Effective date: 3 April 2017 Section 10 Excise Duty Act, 2015

2. Incentivizing the local paint manufacturing industry

In a boost to the paint and resin industry, Excise Duty paid on illuminating kerosene by licensed manufacturers that are subsequently used to manufacture unexcisable goods is now refundable. Such manufacturers will however be required to make an application for a license to the Commissioner prior.

Effective date: 3 April 2017 Sections 15 & 29 Excise Duty Act, 2015

C. Excise Duty (Continued)

3. More taxes on booze, greater equity in taxation of 'ciggies'

Below are the rate changes introduced by the Act:

Particulars	Applicable rate
Spirits of undenatured ethyl alcohol; spirits, liqueurs, and other spirituous beverages of alcoholic strength exceeding 10%	KShs 200 per litre
Cigarettes - with filters	KShs 2,500 per mille
- without filters	KShs 1,800 per mille

Whilst the increase of Excise Duty on alcohol has almost come to be expected as an annual ritual, the two tier approach on the taxation of cigarettes will result in greater equity in the taxation of these products.

As a clarification, powdered beer has also 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.'

Effective date: 3 April 2017

First Schedule to the Excise Duty Act, 2015

4. Purchases by St John's Ambulance now exempt from Excise Duty

In a move to support and improve emergency response within the country, excisable goods imported or purchased by St John's Ambulance for official use in the provision of relief services in Kenya will now be exempt from Excise Duty. The exemption previously only applied to purchases by the Kenya Red Cross.

Effective date: 3 April 2017 Paragraph 5 of Part A of the Second Schedule to the Excise Duty Act, 2015

5. Taxation of vehicles imported by returning residents

Returning residents will be entitled to replace left hand drive vehicles with a right-hand side vehicle whose value does not exceed that of the previously owned left hand drive vehicle.

This is a much simpler criteria as compared to the previous regime which required that replacement vehicles were of similar make, engine rating and year of manufacture.

Effective date: 3 April 2017 Paragraph 6 of Part A of the Second Schedule to the Excise Duty Act, 2015

6. Cheaper sanitary towels

Raw materials purchased locally for the manufacture of sanitary towels have been exempted from Excise Duty. Previously, the exemption only applied to imported raw materials.

The move should lead to a further reduction in the cost of sanitary towels and which in turn should also translate to greater access to these essential items, especially amongst the less privileged.

Effective date: 3 April 2017 Paragraph 10 of Part A of the Second Schedule to the Excise Duty Act, 2015

D. Tax Procedures Act and Tax Appeals Tribunal

1. Power of authorized officers to search and seize

KRA officers have been granted powers to search any premises or vessels and seize, collect and detain any evidence, and produce such evidence in any proceedings before a court of law or tax appeals tribunal.

How these powers measure up against the constitutional rights to property, privacy and fair administrative process remains to be seen.

Effective date: 3 April 2017

Section 7 of the Tax Procedures Act, 2015

2. Registration of tax representatives

Tax representatives acting for non-resident persons:

- (a) Are to be registered in the name of the non-resident person they represent;
- (b) May act as tax representative for more than one non-resident person, in which instance they will have to obtain separate registration for each non-resident person;
- (c) Will have a PIN issued to them by Commissioner.

Effective date: 1 January 2018

Section 15A of the Tax Procedures Act, 2015

3. Penalties as part of 'tax liability'

The definition of 'tax liability' previously only included a principal tax liability and late payment interest. This has now been expanded to include any applicable penalties.

Effective date: 3 April 2017

Sections 16, 17 & 18 of the Tax Procedures Act, 2015

4. Tax amnesty on declaration of offshore income

The deadline for the tax amnesty on income earned outside Kenya has been extended to 30 June 2018. Where funds are not transferred back to Kenya during the duration of the amnesty, there will be a 5-year window in which to do so, but this will be subject to a 10% penalty.

Effective date: 3 April 2017

Section 37B of the Tax Procedures Act, 2015

5. TAT can no longer extend the statutory timeline to hear and determine appeals

The Tax Appeals Tribunal no longer has the power to extend the 90 day timeline provided for in law for it to hear and determine appeals. This timeline could previously be extended by up to 60 days.

In theory, this should lead to matters being concluded expediently before the TAT. However, this is unlikely as the Tax Appeals Tribunal Act does not contain any provisions explicitly setting out the implications of the failure to hear and determine cases within the set out timeline.

Effective date: 1 January 2018

Section 13(7) of the Tax Appeals Tribunal Act, 2013

E. Other amendments

1. Taxation of the betting and gaming industry

The gambling industry will be subject to taxes at the following rates

Tax type	New rate	Old rate
Betting tax	35% of gaming revenue	7.5% of gaming revenue
Lottery tax	35% of lottery turn-over	5% of lottery turn-over
Gaming tax	35% of gaming revenue	12% of gaming revenue
Prize competition tax	35% of total gross turn over	15% of total gross turnover

Effective date: 1 January 2018 Sections 29A, 44A, 55A and 59B of the Betting, Lotteries and Gaming Act

2. No Export levy on goods to SEZ's

Goods destined for approved SEZ's will not attract Export Levy.

Effective date: 1 January 2018 Paragraph (ii) of the Second Schedule to the Miscellaneous Fees and Levies Act, 2016

3. IDF and RDL exemption for materials for construction of LPG storage facilities

Goods imported for the construction of LPG gas storage facilities may also qualify for exemption from Import Declaration Fees and Railway Development Levy. This is subject to the approval of the Cabinet Secretary responsible for Energy.

Effective date: 1 January 2018 Part II of the First Schedule and item (ii) of Part A of the Second Schedule to the Miscellaneous Fees and Levies Act, 2016

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