WESTMINISTER CONSULTING

Tax Advisory Note on The Finance Bill, 2020

On the 5th of May 2020, the National Assembly published the Finance bill, 2020 ("**Bill**").

This Bill has strict timelines in which it must be passed by the National Assembly and assented to by the president by 30th of June 2020.

In this Tax Advisory Note, we provide an analysis of the proposals introduced by the Bill.

The Income Tax Act (Cap. 470)

- **Residential rental income**

The Bill proposes to increase the rental income limit subject to tax from 10 million to 15 million.

This will encourage more property owners to declare rental income and increase tax compliance.

- **Instalment tax**

The Bill proposes to delete the provision that a taxpayer shall not be required to pay the instalment tax if to the best of his judgement and belief he will have no income chargeable to tax for that year of income other than emoluments.

This is punitive and retrogressive as it will compel taxpayers to base payments only on previous year payments even when the performance of current year is lower resulting to overpayments and refunds.

- **Introduction of minimum tax**

The Bill proposes to introduce minimum tax which shall be chargeable at the rate of 1% of the gross turnover. The tax is payable by a person if:

a) that person's income is not exempt under the Income Tax Act;
b) the person's income is not chargeable to tax under employment income, Rental income from residential property, turnover tax, capital gains and income from the extractive industry; and
c) the instalment tax payable by that person is higher than the minimum tax.

The minimum tax shall be payable in instalments which shall be due on the twentieth day of each period ending on the fourth, sixth, ninth and twelfth month of the year of income.

The proposal to introduce alternative minimum tax is not in line with basic principles of section 3 of Income Tax Act in which gains or profits are deemed taxable. This tax is payable whether or not a person has made any gains / profits.

The provision requires payment even where the instalment taxes are higher than the minimum tax paid. We are of the opinion that the word 'higher' used in the bill should have read 'lower'.

The principal of alternative minimum tax is based on levying taxes on persons with perpetual tax losses which is not addressed by this Bill.

The imposition of this tax in addition to the amendments to the second schedule in the recent Tax Laws (Amendment) Act, 2020 does not promote Kenya as an investment destination.

The 1% rate is high and punitive for persons with high turnovers and in financial distress.

The Bill did not provide exemptions to critical sectors such as Aviation, agriculture, health and education.

➢ Digital service tax

The Bill proposes to introduce guidelines on taxing income from the digital market place at the rate of 1.5% of the gross transaction value as follows:

- Digital service tax shall be payable by a person whose income from services is derived from or accrues in Kenya through a digital market place.
- A resident person or non-resident person with a permanent establishment in Kenya shall offset the digital service tax paid against the tax payable for that year of income.
- The tax shall be due at the time of the transfer of the payment for the service to the service provider.
- The tax shall be payable through a withholding tax system.

In the absence of a clear legal frame work to operationalize this provision it will be a fertile ground for tax disputes. It will be prudent for KRA and National Treasury to prescribe the regulations as envisaged by Finance Act, 2019.

➢ Listed Companies at the Nairobi Stock Exchange

The Bill proposes to disallow for tax purposes the following expenses incurred by listed entities and companies looking to list at the Nairobi Stock Exchange:

i. Expenditure of a capital nature incurred in that year of income by a person on legal costs and other incidental expenses relating to the authorization and issue of shares, debentures or similar securities offered for purchase by the general public.
ii. Expenditure of a capital nature incurred in that year of income by a person, on legal costs and other incidental expenses, for the purposes of listing on any securities exchange operating in Kenya, without raising additional capital.
iii. Expenditure of a capital nature incurred in that year of income by a person on rating for the purposes of listing on any securities exchange operating in Kenya.

This proposal removes the incentives made earlier in encouraging investments in the stock market.

➢ Allowable deductions now subject to tax

The Bill also proposes to disallow the following expenses which were previously allowable expenses:

i. Annual subscriptions and entrance fees made to trade associations which have made an election for their income to be treated as taxable.
ii. Club subscriptions paid by an employer on behalf of an employee
iii. Expenditure with the prior approval of the Minister on the construction of a public school, hospital, road or any similar kind of social infrastructure.

The deletion of expenditure on the construction of public schools, hospitals and similar social infrastructure will impact negatively on communities that benefit from such amenities as donors will be dissuaded from investing in such projects.

- **Removal of the House Ownership Saving Plan (HOSP) tax relief**

The Bill proposes to remove the tax relief available to individual who are saving to own a house under a House Ownership Saving Scheme.

This goes against the Big Four Agenda of encouraging home ownership in Kenya by the Government.

- **Exempt income now subject to tax**

The following previously exempt income under the First Schedule will now be subject to tax:

1. The income of a registered home ownership savings plan.
2. Income of the National Social Security Fund.
3. Monthly or lump sum pension granted to a person who is sixty five year of age or more.
4. Income from employment paid in the form of bonuses, overtime and retirement benefits to employees whose income is below the lowest tax bracket

The effect of this is to increase the tax base. Considering the effects of the Covid19 pandemic, it would be prudent to retain the tax exemptions on bonuses and overtime benefits to low income earners.

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The Value Added Tax Act

- **Deduction of Input Tax**

The Bill proposes to introduce another condition under which deduction of input tax shall not be allowed where the registered supplier has not declared the sales invoice in a return.

Previously the only condition was that for deduction of input tax to be allowable, the person had to hold the necessary documentation required under the provision.

This proposal negates the principal of VAT of input tax claim and creates grounds for tax disputes. With the implementation of electronic invoicing, the requirement to have output tax declared by the supplier as a condition to allow the input tax deduction is not necessary as it is punitive to the persons claiming input tax. This is due to the fact that they have no control over the suppliers who may choose whether or not to declare the output tax.

Notable changes under the First Schedule of the VAT Act

- **Zero rated supplies to standard rated supplies**

Supplies	New Rate	Old Rate
The supply of liquefied petroleum gas including propane.	14%	0%
Inputs or raw materials for electric accumulators and separators including lead battery separator rolls whether or not rectangular or square supplied to manufacturers of automotive and solar batteries in Kenya	14%	0%

This will make LPG Expensive as the extra cost will be passed to the consumer and may result to use of alternative sources of energy such as kerosene, charcoal and firewood.

- **Exempt supplies to Standard rated supplies**

Supplies	New Rate	Old Rate
8802.11.00 Helicopters of an unladen weight not exceeding 2,000 kg.	14%	Exempt
8802.12.00 Helicopters of an unladen weight exceeding 2,000 kg.	14%	Exempt
8802.20.00 Aeroplanes and other aircraft, of unladen weight not exceeding 2,000 kg.	14%	Exempt
8803.30.00 Other parts of aeroplanes and helicopters.	14%	Exempt

Supplies	New Rate	Old Rate
8805.10.00 Aircraft launching gear and parts thereof; deck-arrestor or similar gear and parts thereof	14%	Exempt
8805.21.00 Air combat simulators and parts thereof.	14%	Exempt
8805.29.00 Other ground flying trainers and parts thereof.	14%	Exempt
Materials, waste, residues and by-products, whether or not in the form of pellets, and preparations of a kind used in animal feeding of tariff numbers 1213.00.00, 1214.10.00, 2308.00.00, 2309.10.00, 2309.90.10, 2309.90.90, 2302.10.00, 2302.30.00, 2303.20.00, 2303.30.00, 2304.00.00, 2306.10.00, 2306.20.00, 2306.30.00, 2306.41.00, 2306.49.00, 2306.50.00, 2306.60.00, 2306.90.00, 2835.25.00 and 2835.26.00.	14%	Exempt
Specialized equipment for the development and generation of solar and wind energy, including deep cycle batteries which use or store solar power upon the recommendation of the Cabinet Secretary responsible for matters relating to energy.	14%	Exempt
Tractors other than road tractors for semitrailers.	14%	Exempt
Goods of tariff No. 4011.30.00.	14%	Exempt
Taxable goods locally purchased or imported by manufacturers or importers of clean cooking stoves for direct and exclusive use in the assembly, manufacture or repair of clean cook stoves approved by the Cabinet Secretary upon recommendation by the Cabinet Secretary for the time being responsible for matters relating to energy.	14%	Exempt
Stoves, ranges, grates, cookers (including those with subsidiary boilers for central heating) barbeques, braziers, gas-rings, plate warmers and similar non-electric domestic appliances, and parts thereof, or iron or steel of tariff numbers 7321.11.00, 7321.12.00, 7321.19.00, 7321.81.00, 7321.82.00, 7321.83.00 and 7321.90.00.	14%	Exempt
One personal motor vehicle, excluding buses and minibuses of seating capacity of more than eight seats, imported by a public officer returning from a posting in a Kenyan mission abroad and another motor vehicle by his spouse and which is not exempted from Value Added Tax under the First Schedule.	14%	Exempt
Plant, machinery and equipment used in the construction of a plastics recycling plant.	14%	Exempt

Supplies	New Rate	Old Rate
Hiring, leasing and chartering of helicopters of tariff numbers 8802.11.00 and 8802.12.00.	14%	Exempt

The proposal to make certain aircrafts and aircraft parts chargeable will have a negative impact in the aviation industry in light of the COVID19 pandemic which has had adverse effects on the travel industry. The potential risk is that Kenya might lose its competitiveness as an aviation hub in the region.

The imposition of tax on materials and by-products used in the manufacture of animal feeds, and the imposition of tax on tractors will have adverse effects on agriculture and livestock production which is the bedrock of the Kenyan economy.

The imposition of VAT on specialized equipment on solar and wind energy will make investment on solar energy expensive and goes against the Government agenda in promoting the use of clean energy especially to low income households. The net effect of this amendment is that rural households will result to use of alternative sources of energy e.g. kerosene, firewood and charcoal. The same effect will be on clean cooking stoves.

Other changes in VAT

- The Bill proposes to introduce Maize (corn) seeds of tariff no. 1005.10.00. under the first schedule as exempt goods.
- The Bill proposes to introduce under part II of the first schedule, exempt services 'ambulance' as part of Medical, veterinary, dental and nursing services.

The inclusion of ambulance services as an exempt service is a welcome move in light of the COVID19 Pandemic.

Excise Duty Act

- **License**

The Bill seeks to expand the definition of license by including 'a license required in the carrying out of any other activity in Kenya for which the Commissioner, by notice in the Gazette, may impose a requirement for a license.'

This will bring more clarity on excise license in respect of excisable goods and services.

- **Sugar confectionery**

The Bill proposes to amend the Excise Duty Act by reintroducing Excise Duty on locally manufactured sugar confectionary and white chocolate.

Currently, only imported sugar confectionery of tariff heading 17.04 is subject to excise duty. As a result, the revised description will be as follows:

Particulars	Rate
Sugar confectionary - not containing cocoa	KES 20/kg
White chocolate (blocs, slabs or bars) – containing cocoa	KES 200/kg

This will bring uniform treatment for both imported and local confectionary.

- **Alcoholic strength of Beer and Spirits**

The Bill proposes to reduce the percentage of alcoholic strength from 10% to 8 % for Beers and spirits. As a result, the revised description will be as follows:

Particulars	Rate
Beer, Cider, Perry, Mead, Opaque beer and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages of alcoholic strength not exceeding 8%	Shs. 110.62 per litre
Spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength exceeding 8%	Shs. 253.00 per litre

The effect of this is to levy Excise duty on beer and spirituous beverages with lower alcoholic strength. We opine that there is need to include:

a) Beer, Cider, Perry, Mead, Opaque beer and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages of alcoholic strength exceeding 8%. This will bring Excise Duty to imported Spirituous fermented beverages that are covered under HS Code 2203,2205 and 2206.

b) "Spirits of un denatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength not exceeding 8%. This will bring this beverage covered under HS Code 2207 and 2208 within the realm of Excise Duty.

This in effect will protect local manufacturers from unfair competition from imported spirituous beverages.

Tax Procedures Act

- **Voluntary Tax Disclosure Programme.**

The Bill seeks to introduce a Voluntary Tax Disclosure programme which shall be for a period of three years with effect from the 1st January, 2021.

Voluntary tax disclosure programme means a programme where a taxpayer discloses the taxpayer's tax liabilities to the Commissioner for the purpose of being granted a relief of penalties and interest on the tax disclosed.

A person with a tax liability may apply to the Commissioner for relief in the prescribed form with respect to tax liabilities that accrued within a period of five years prior to the 1st July, 2020. The application shall be voluntary and disclose all material facts.

Where the Commissioner is satisfied with the facts disclosed in the application, the Commissioner shall grant the relief provided that the relief shall not result in the payment of a refund to the taxpayer.

If a tax payer is granted relief under the programme they shall not be prosecuted with respect to the tax liability disclosed and shall be granted a remission of the interest and penalty due on the tax liability as follows:

- where the disclosure is made and tax liability paid in the first year of the programme, a full remission of the interest and penalty.
- where the disclosure is made and tax liability paid in the second year of the programme, remission of fifty per cent of the interest and penalty.
- where the disclosure is made and tax liability paid final year of the programme, remission of twenty-five per cent of the interest and penalty.

Where the Commissioner has granted the relief, the Commissioner shall enter into an agreement with the taxpayer setting out the terms of payment of the tax liability and the period within which the payment shall be made which shall not exceed one year from the date of the agreement.

Where a taxpayer fails to disclose all the material facts they shall be liable to pay the full interest and penalty that had been remitted under the agreement

A taxpayer granted relief under the programme shall not seek any other remedy including the right to appeal with respect to the taxes, penalties and interest remitted by the Commissioner.

Where, before the expiry of the agreement between the Commissioner and the taxpayer, the Commissioner establishes that the taxpayer failed to disclose a material fact in respect of the relief granted under this section, the Commissioner may:

- withdraw any relief granted.
- assess and collect any balance of the tax liability.
- commence prosecution.

A taxpayer may appeal against a decision of the Commissioner.

The Voluntary Tax Disclosure programme shall not apply to a taxpayer if the taxpayer:

- is under audit, investigation or is a party to ongoing litigation in respect of the tax liability or any matter relating to the tax liability.
- has been notified of a pending audit or investigation by the Commissioner.

This tax amnesty opens a window for persons who may not have been compliant and are willing to comply but feel that the penalties and interest are punitive. It is a welcome move.

- **Appointment of digital service tax agent**

The Bill seeks to introduce a provision whereby the Commissioner may appoint an agent for the purpose of collection and remittance of digital service tax to the Commissioner.

The provision also grants the commissioner the power to revoke an appointment.

Due to complexity and technicality of E-commerce transactions, the commissioner is being enabled to appoint agents to collect and remit the taxes on his behalf. There is need to amend this further to provide the same appointment for VAT, Excise and other taxes arising from E-Commerce transactions.

Miscellaneous Fees & Levies Act

Import Declaration Fee (IDF)

Description	Current Rate	Proposed Rate
Goods imported under the East African Community Duty Remission Scheme	Ksh. 10,000	1.5% of the customs value
Additional import duty payable in respect of goods entered for home use from an export processing zones enterprises	N/A	2.5% of the customs value
Aircraft of unladen weight not exceeding 2,000 kg and Helicopters of Heading 8802.11.00 and 8802.12.00	Exempt	3.5%
Any other goods as the Cabinet Secretary may determine are in public interest, or to promote investments which value shall not be less than two hundred million shillings	Exempt	3.5%
Goods imported for implementation of projects under special operating framework arrangement with the Government	Exempt	3.5%
Goods including materials supplies, equipment, machinery and motor vehicles for the official use by the Kenya Defense Forces and National Police.	3.5%	Exempt

The amendment on IDF for goods imported under the East African Community Duty Remission scheme creates consistency and equity among all manufacturers.

The proposal to levy additional duty for home use goods from EPZ is to discourage EPZ goods from accessing the local market and ensuring that they exported as required.

The proposed changes in respect of aircrafts affects the aviation industry that is already ailing considering the Covid 19 pandemic. The change is counterproductive and will affect Kenya as an aviation hub in the region. Further, the changes create an ambiguity as aircrafts and helicopters have been classified together and will be subject to different interpretations and thus grounds for disputes.

The deletion of the powers of the minister to exempt IDF in public interest is not progressive considering that there are situations like COVID 19 and the Locust crisis that may require discretionary exemption powers of the minister.

Railway Development Levy (RDL)

Description	Current Rate	Old Rate
Currency notes and coins imported by the Central Bank of Kenya	3.5%	Exempt
Goods, including materials supplies, equipment, machinery and motor vehicles for the	3.5%	Exempt
Goods as the Cabinet Secretary may determine are in public interest, or to promote investments whose value exceeds KES 200 million	Exempt	3.5%

The deletion of the powers of the minister to exempt RDL in public interest is not progressive considering that there are situations like COVID 19 and the Locust crisis that may require discretionary exemption powers of the minister.

Tax Appeals Tribunal Act 2013

- **Procedure for an appeal**

The Bill proposes to amend tax appeals tribunal Act to allow the appellant to rely on the grounds stated in the documents to which the decision relates. Previously it only allowed the appellant to be limited to the grounds stated in the appeal to which the decision relates.

This is for clarity and to avoid ambiguity.

The Roads Tolls Act (Cap. 407)

The Bill introduces the definition of a toll collector to include private or public toll collectors. It also includes transit toll stations under the first schedule of this Act. It removes further the requirements for the approval by the National Assembly of agreements entered into by the minister with qualified persons to plan design or manage a public road.

The effect of this proposal is to allow privatisation of roads Tolls.

The Capital Markets Act (Cap. 485A)

The Bill seeks to amend section 11 (3) of the Act to bring private equity and venture capital firms that access public funds (pensions scheme funds) under the regulatory oversight of the Capital Markets Authority in line with the Cabinet Secretary's policy pronouncement and intention in the financial year 2015/16 budget speech. The Bill further seeks to amend section 18 of the Act to remove the function of payment of beneficiaries from collected unclaimed dividends when the resurface since this is a function currently domiciled under the Unclaimed Financial Assets Authority.

It also seeks to expand the application of the Investor Compensation Fund (IFC) to activities such as whistle blowing, forensic audits and other related activities that are proactive in nature as far as protection is concerned.

The Standards Act (Cap. 496)

The Bill proposes to amend the definition of "consolidator" in section 2 of the Act to facilitate visibility of individual consignees for the purpose of customs declaration.

"Consolidator" *means a firm that is licensed to consolidate goods belonging to different consignees at the country of export, which shall be under one Master Bill of Lading or Master Airway Bill, and breaks the consignment into smaller consignments at the port of destination for the different consignees for the purpose of individual customs declaration.*

This definition of consolidator amends the earlier definition of the standards Act which was in the Finance Act of 2019 to give more clarity on what a consolidator entails.

The Kenya Revenue Authority Act (No. 2 of 1995)

The Bill seeks to amend the Act to provide for a legal framework for the establishment of an institution to offer capacity building and training on tax, customs and revenue administration. The Bill further proposes to amend the Act to include commissions earned by the Kenya Revenue Authority on collections made on behalf of government agencies or county governments as a source of funding for the Authority capped at 2% of the revenue collected. The Bill also seeks to amend the Act by providing for specific timelines within which the Authority can be sued to enable the Authority to effectively manage its disputes.

This amendment is meant to give legal status to Kenya school of revenue Administration. (KESRA)

The limitations of actions against KRA is in line with the section 3 of the Public Authorities Limitations Act cap 389 laws of Kenya. However, tax disputes are catered for under specific tax statutes including Tax Procedures Act and Tax Appeal Tribunals Act

The Retirement Benefits Act, 1997(No. 3 of 1997)

The Bill seeks to amend the Retirement Benefits Act, 1997 to enhance supervisory role of the Authority on pension schemes by providing powers to charge a penalty of Ksh 100,000 for failure to submit actuarial valuation reports within the period specified in the Regulations and a further penalty for Kenya shillings 1000 each day the report remains outstanding.

The effect of this amendment is to enhance supervisory role of the Retirements Benefit Authority.

The Insolvency Act (No. 18 of 2015)

The Bill proposes to amend the Second Schedule to the Act to reduce the risk exposure on the tax revenues held by commercial banks before transfer to Central Bank by declaring them preferential claims in the order of priority in the event of insolvency.

The effect of this proposal is to place taxes to rank in the second priority claims with the first priority claims being those of secured creditors.

Insurance Act (Cap 487)

The Bill proposes a 30-day timeline for an aggrieved party to file an appeal with the insurance tribunal on the decision of the commissioner of insurance in a dispute.

Disclaimer:

This Tax Advisory Note was prepared from Finance Bill,2020 which was gazetted on 5th May 2020. Where there is any variance between the Tax Note Advisory Note and the actual text in the published Finance Bill by the government printers, the Bill prevails.

This advisory note is provided for general information and not intended to address the circumstances of any particular individual or entity nor a substitute for any tax advisory or professional advice.

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