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CLIENT ALERT: KEY PROPOSALS IN THE FINANCE BILL, 2020.

INTRODUCTION

The Finance Bill, 2020 (the **Bill**) was published in the Kenya Gazette on 5th May, 2020, a few days after the enactment of the Tax Laws (Amendment) Act, 2020.

The Bill contains proposed amendments to tax and other laws. Most of the amendments had been included in the Tax Laws (Amendment) Bill, 2020 (the **TLAB**) but were later dropped during the legislative process.

On 11th June, 2020, the Cabinet Secretary for Treasury and National Planning (the **CS**) presented the Budget Statement for the Fiscal Year 2020/21 in the National Assembly. In the Budget Statement, the CS outlined the proposed legislative changes contained in the Bill amongst other proposals.

In this alert, we highlight the key proposals in the Bill and the Budget Statement.

KEY HIGHLIGHTS IN THE BILL

INCOME TAX ACT (ITA)

Rental income

The Bill proposes to raise the threshold of rental income that is subjected to residential rental income tax of 10% from Kenya Shillings Ten Million to Kenya Shillings Fifteen Million. If this amendment is passed, rental income between KES 144,000 to KES 15M per year will be chargeable at the rate of 10% and more landlords will enjoy the simplified tax regime.

Minimum tax

The Bill proposes to introduce a minimum tax payable by a person at the rate of 1% of their gross turnover. This tax shall be applicable to persons:

a) whose income is not exempt under the ITA;
b) whose income is not from employment, residential rent, capital gains or subject to turnover tax or tax under the extractive sector; or
c) if the minimum tax payable is lower than the instalment tax payable.

This tax is to be paid on the 20th day of the 4th, 6th, 9th and 12th month.

The CS pointed out that the justification for this proposal is that some companies continually declare losses while they enjoy infrastructure that is serviced by the Government through tax. This amendment will ensure all companies pay taxes and is a sure way to increase revenue collection. On the other hand, companies, especially those with huge tax losses, will be affected if this proposal is implemented because they will be required to pay this tax based on turnover.

Currently, a taxpayer is not 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. The Bill proposes to amend this provision by providing that a taxpayer shall not be required to pay the instalment tax if the minimum tax payable is higher than the instalment tax.

Digital service Tax (DST)

DST has been proposed to be levied at the rate of 1.5% on the gross transaction value. This tax will target business transactions that are carried out through a digital market place and will be due at the time the payment is transferred to the service provider. A digital marketplace is defined as *"a platform that enables direct interaction between buyers and sellers of goods and services through electronic means."*

According to the Bill, the tax shall be offset against the tax payable for that year of income for resident persons or non-resident persons with a permanent establishment in Kenya.

The Tax Procedures Act, 2015 is proposed to be amended to give the Commissioner the power to appoint an agent for the purpose of collection and remittance of DST.

Concerns have been raised on the type of transactions that will be subject to this tax owing to the amorphous definition of what a digital marketplace is. The Kenya Revenue Authority (**KRA**) recently published the Draft Value Added (Digital Marketplace Supply) Regulations, 2020 which set out the scope of taxable supplies for VAT purposes to include, *inter alia*:

i. Downloadable digital content including downloading of mobile applications, e-books and movies;
ii. Subscription-based media including news, magazines, journals, streaming of TV shows and music, podcasts and online gaming; and
iii. Software programs including downloading of software, drivers, website filters and firewalls.

The Draft Regulations recently underwent public participation and it is expected that they will shed more light on the administration of DST not only for VAT purposes but also for income tax purposes.

Allowable deductions

The Bill proposes to do away with the following allowable deductions for the purposes of computing taxable income for a particular year of income:

i. Expenditure of a capital nature incurred on legal or other incidental costs relating to authorization and issuance of shares and other similar securities offered for purchase by the general public.
ii. Expenditure of a capital nature incurred on legal and other incidental costs relating to 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.

The above proposed amendments shall be a big blow to companies that are desirous of listing on the Nairobi Securities Exchange or offering their shares publicly as the legal and related costs for such services amount to significant amounts which, if deducted, offer great relief to such companies.

iv. Entrance fee or annual subscription payable to trade associations that have elected with respect to a year of income to carry out a business charged to tax.
v. Club subscription paid by an employer on behalf of an employee.
vi. Expenditure of a capital nature incurred in that year of income, with the prior approval of the CS, by a person on the construction of a public school, hospital, road or any similar kind of social infrastructure. This proposal has the potential of discouraging organizations from engaging in corporate social responsibility activities of the above nature. These activities attract high costs which if deducted, grant relief to organizations.

Pension income

The Bill proposes to delete the paragraph exempting pension income paid to persons who are sixty-five years of age and above. In the event that this proposal is passed, pensioners will be required to pay their fair share of taxes on pension income. The result will be that they will receive lower monthly or lump sum payments thus lowering their disposable income.

Currently exempt income proposed to be taxed

There is a proposal for the following incomes accrued in, derived from or received in Kenya to no longer be exempt from tax. These include the income of:

i. Registered Home Ownership Plans (HOSPs)

   The Bill proposes to delete Section 22C which allows tax deduction of HOSP contributions up to a limit of KES 96,000 per year availed to individuals who are saving to own a house under a HOSP. Currently, interest income earned by a depositor up to a maximum of KES 3M is exempt from tax. The Bill however proposes to do away with this exemption.

   This amendment, if passed, shall discourage acquisition of residential homes using HOSPs and will counteract the Government's efforts towards affordable housing which is part of the Big Four Agenda.

ii. Income of the NSSF

   The taxation of the income of the NSSF will have a negative impact on pensioners' funds. This will erode the gains contained in the Tax Laws (Amendment) Act, 2020 which widened the taxation bands for pension withdrawals. It is curious to note that this amendment had been proposed in the TLAB but later dropped.

Pay as You Earn (PAYE)

The Bill contains a proposal to do away with tax exemption of income from employment paid in the form of bonuses, overtime and retirement benefits to employees whose income does not exceed the lowest tax band.

This proposal, if adopted, will result to taxation of the low income earners in the event that they receive bonuses or overtime payments hence reducing their disposable income. At a time where the Government seeks to increase people's disposable income owing to the economic impact of Covid-19, this proposal should be reconsidered.

VALUE ADDED TAX Act, 2013

VAT Auto Assessments

Currently, in order for a person to claim for input VAT, they are only required to provide documentation to support their claim, such as original tax invoices or customs entries. The Bill proposes to include further requirements to the effect that taxpayers will also be required to have proof that the supplier declared the amount of input VAT being claimed in their VAT return and that such VAT return has been filed with the KRA. This therefore increases the compliance requirements for taxpayers as they would need to follow up with their suppliers to ensure they include the invoices issued in their VAT return filings.

Change of the VAT Status of Goods and Services

<u>Exempt to taxable</u>

- Specialized equipment for the development and generation of solar and wind energy, including deep cycle batteries which use or store solar power;
- Tractors other than road tractors for semitrailers;
- Goods of tariff No. 4011.30.00;
- 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;
- Stoves, ranges, grates, cookers (including those with subsidiary boilers for central heating) barbeques, braziers, gas-rings, plate warmers and similar nonelectric domestic appliances, and parts thereof, or iron or steel of specified tariff numbers;
- 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 VAT;
- Plant, machinery and equipment used in the construction of a plastics recycling plant.

This means that VAT on these products shall be charged at a rate of 14% and suppliers will pass this tax to the consumers. This amendment will lead to an increase in prices of these products.

Taxable to exempt

- Ambulance services – This is a welcome move especially during this time when the country is directing its efforts towards flattening the Covid-19 curve.

Zero-rated to taxable

- Supply of liquefied petroleum gas (LPG) including propane - The proposed VAT charge on LPG will also increase the price of cooking gas and erode the effort towards clean energy;
- Inputs of 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.

EXCISE DUTY ACT, 2015

Definition of the word "licence"

The Bill seeks to expand the definition of licence to include the certificate of registration for excisable services.

Alcohol content

The Bill proposes to alter the scope of alcoholic beverages that will be subject to excise duty to:

a) Beer, cider, perry, mead, opaque beer and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages of alcoholic strength not exceeding 8% as opposed to the current 10%;
b) Spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength exceeding 8% as opposed to the current 10%.

This means that more drinks with spirits specified above will be brought under the tax net.

TAX PROCEDURES ACT, 2015 (TPA)

Voluntary tax disclosure programme

A voluntary disclosure programme that allows Kenyans who may have made omissions in their returns in the last five (5) years to voluntarily declare such omission and pay the tax due has been introduced. The programme will run for a period of three (3) years and allow individuals to pay the principal amount and have the penalties and interests waived as an incentive.

If a person voluntarily opts to participate in this programme, they shall be granted remission of the interests and penalties as follows:

- In the first year – 100% remission of the interest and penalty;
- In the second year – 50% remission of the interest and penalty;
- In the third year – 25% remission of the interest and penalty.

Where the Commissioner is satisfied with the facts disclosed, he may grant a person the relief applied for as long as the relief does not amount to payment of a refund to such person.

The Commissioner may enter into an agreement with a person stating the terms of the agreement and the period for repayment. In the event that a person breaches such terms, they shall be liable to pay the full interests and penalties remitted under the agreement.

A person who participates in this programme is shielded from prosecution and loses their rights to seek any other remedy including their right to appeal.

On the other hand, if a person is found to have failed to disclose a material fact, the Commissioner may:

a. withdraw any relief granted;
b. assess and collect any balance of the tax liability; or
c. commence prosecution.

The taxpayer may appeal the decision to withdraw a relief.

Notably, taxpayers under audit or who have been notified of a pending audit will not qualify for the programme.

The programme is a welcome move that will assist taxpayers in compliance without additional penalty and interest costs and it will also assist KRA in collection of outstanding taxes

TAX APPEALS TRIBUNAL ACT, 2013

The Bill proposes to limit the grounds of appeals filed at the Tax Appeals Tribunal to grounds stated in the appeal or documents to which the decision relates. The amendment could prevent an appellant from introducing new grounds of appeal or submitting new documents to support the appeal after lodging the appeal documentation.

MISCELLANEOUS FEES AND LEVIES ACT, 2016

East African Community Duty Remission Scheme

The Bill proposes to increase the Import Declaration Fee (**IDF**) for goods imported under the East African Community Duty Remission Scheme from KES 10,000 to 1.5% of the customs value. The current rate provides a standard amount of tax payable regardless of the value of goods.

The proposal to peg tax on customs value will cause an increase in taxes payable. This may help curb cheap imports from the EAC community.

Duty on goods from Export Processing Zones (EPZ)

Goods imported for home use from an EPZs are proposed to be charged an additional duty at the rate of 2.5% of the customs value.

Exemption from IDF

The Bill proposes to clarify IDF exemption on aircrafts to include: Aircrafts excluding aircraft of unladen weight not exceeding 2,000 kg and helicopters of heading 8802.11.00 and 8802.12.00.

The Bill also proposes to include the following item under the list of exemptions: All goods, including materials supplies, equipment, machinery and motor vehicles for the official use by the Kenya Defence Forces (**KDF**) and National Police Service (**NPS**).

The following goods are proposed to be removed from the list of goods exempt from payment of IDF when imported or purchased before clearance through customs:

a. Any other goods as the CS may determine are in public interest, or to promote investments which value shall not be less than KES 200M;
b. Goods imported for implementation of projects under special operating framework arrangement with the Government.

Railway Development Levy (RDL)

The Bill proposes to do away with the exemption on goods imported for public interest projects worth KES 200M or more.

On the other hand, the following items will enjoy the RDL exemption:

a. Currency notes and coins imported by the Central Bank of Kenya (**CBK**);
b. All goods for the official use by the KDF and NPS.

OTHER STATUTORY CHANGES

Kenya Revenue Authority Act

The Bill proposes to introduce a time limit for suing the KRA to 12 months from the date an action arose or 6 months from the cessation of a continuing damage or injury.

The Bill seeks to additionally introduce a requirement for aggrieved persons to give the KRA a month's notice prior to instituting a suit. Such notice ought to be served on the Commissioner General before instituting legal proceedings against KRA. This amendment is aimed at protecting the KRA and minimizing suits against it.

Capital Markets Act

The CMA does not exercise regulatory oversight over private equity and venture capital companies. The proposed amendments seek to bring private equity and venture capital companies that access public funds under the regulatory oversight of the CMA.

The Bill also proposes to remove payment of beneficiaries from collected unclaimed dividends from the roles of the Investor Compensation Fund under the Capital Markets Act.

This amendment is welcome as it shall do away with multiplication of roles between the Capital Markets Authority and the Unclaimed Financial Assets Authority.

Insurance Act

The Bill proposes to limit the period within which a complainant may appeal against the decision of the Insurance Regulatory Authority to 30 days.

This amendment will ensure that appeals are lodged within a timely manner and avoid a situation where matters drag for long periods of time. Persons should therefore take notice of the new timelines to avoid having their matters being defeated on the basis that they were filed out of time.

Retirement Benefits Act

The proposed amendments seek to introduce new provisions relating to actuarial evaluations. It is proposed that a trustee who fails to submit a copy of the actuarial report to the Chief Executive Officer by the due date specified in the Regulations shall pay a penalty of KES 100,000. Further, if the report has not been submitted, the trustee, in addition to the KES 100,000 penalty, shall pay a further penalty of KES 1,000 for each day during which the report remains unsubmitted.

The proposed amendments seek to enhance the supervisory role of the Retirement Benefits Authority on pension schemes by providing powers to charge a penalty for failure to submit actuarial evaluations within the period specified in the Regulations

Insolvency Act

The Bill proposes for the KRA to be ranked as a preferred debtor in the event of liquidation or receivership of a bank which was appointed as a revenue banking agent. The priority shall apply solely to money that was collected by the agent on behalf of the KRA.

This follows changes introduced by the Tax Laws (Amendment) Act, 2020 which empowered the KRA to appoint banks as revenue collection agents and further introduced a 2% daily penalty for late payment of the revenue collected. This amendment will cushion the KRA against loss of revenue collected on its behalf by its agent in the event of liquidation or receivership of such agent.

KEY HIGHLIGHTS IN THE BUDGET STATEMENT

Customs Duty

Import duty on imported iron and steel products has been maintained at 35% together with the specific corresponding rates on a wide range of the above mentioned products. This shall have a positive effect on the local manufacturers of the steel and iron products as it will make their products more attractive due to lower prices. On the other hand, importers of steel and iron products shall continue to face high import duty thus making importations unattractive.

Import duty on paper and board products has been maintained at the rate of 25% for another year. This shall encourage local consumption while discouraging importation of these products thus boosting the local industry. The flip side of this is that a thriving local paper manufacturing industry may spell doom to tree conservation efforts if not adequately regulated.

Inputs used in the manufacture of diapers, assembly & manufacture of mobile phones and the textile & apparel sector shall forthwith be imported duty free under the East African Community Duty Remission Scheme. This shall promote the local manufacture of diapers, apparel and mobile phones as well as make these products competitive.

Leather and footwear imports shall be subjected to a 25% import duty in addition to the specific rates of duty in order to support the local industry and curtail flooding of the local market with low quality imported leather. This should encourage local manufacturers as well as boost consumption of locally manufactured leather products.

Import duty on electrical parts and accessories shall be increased from 25% to 35% for a period of one year. This amendment has been put in place for the purpose of protecting the local producers of such products.

The EAC has agreed to grant remission on raw materials and inputs for manufacturers of masks, sanitizers, ventilators and personal protective equipment. This is aimed at strengthening the fight against the Covid-19 as well as supporting the local manufacture of these equipment.

In the long term, the EAC has agreed to amend the East Africa Community Customs Management Act, 2004 in order to exempt supplies for diagnosis, prevention, treatment and management of pandemics and health hazards in order to deal with future occurrences of such nature.

ABOUT US

Simba & Simba Advocates is one of Kenya's leading full-service law firms, with a rich professional history built over a period of over twenty-nine (29) years.

In case of any questions in relation to this client alert, please contact Dorcas Wamaitha – Gichamba (dorcas@simba-advocates.com) or write an email to info@simba-advocates.com.

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