NEWS ALERT

HIGHLIGHTS OF THE FINANCE ACT, 2019

The Finance Bill, 2019 was finally assented into law on the 7th of November, 2019. The Act expands the Government's revenue base through the introduction of tax on income raised from the digital economy, re-introduction of turnover tax, expanding the scope of VAT among others. We extensively analysed the Act as follows:

1. **Taxation of Digital Economy**

   The Finance Act, 2019 amends Section 3 of the Income Tax Act, Cap 470 by introducing Tax on income accruing from the digital marketplace. The government targets the increased use of internet and electronic devices in marketing of businesses, and effective the 7th of November, 2019 levies tax on income accruing from the Digital marketplace. Under the Act, income chargeable to tax now includes income accruing through a digital marketplace. The Act defines digital marketplace as a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means. Even as taxation of digital economy is a welcome move and necessary, it is not very clear which kind of digital businesses are targeted as most of them do not have physical places of business. The Cabinet Secretary has been tasked to provide regulations on the mechanisms through which the taxation will be effected.

2. **Extension of Tax exemption to investee Company of Real Estate Investment Trust (REIT)**

   The Income Tax Act exempts a REIT from all taxes except for withholding tax on interest and dividends. The Finance Act, 2019 extends the exemption to an investee company of a REIT. An investee company of REIT is a company fully owned or controlled by that REIT. REITS hold property through such companies and its income flows directly to the REIT. This additional incentive effective the 7th of November, 2019 will enable REITs to acquire properties with minimal capital gains tax cost on the part of investors, and therefore will attract more investors to REIT. This will in turn boost growth of REITS in Kenya.

3. **Capital Gains Tax.**

The Finance Bill 2019 proposed to increase Capital Gains Tax rate from 5% to 12.5% in order to align it with that of East African region. The proposal was rejected and the initial rate of 5% retained under the new Act. This is comforting to the property sellers and developers who would have paid more tax on the sale of their property.

4. **CGT exempt for property transferred in the course of group restructuring/reorganization.**

A transfer of property that is necessitated by a transaction involving the incorporation, recapitalization, acquisition, amalgamation, separation, dissolution or similar restructuring of a corporate entity, where such transfer is:

(a) legal or regulatory requirement; (b) as a result of a directive or compulsory acquisition by the government; (c) an internal restructuring within a group which does not involve transfer of property to a third party; or (d) in the public interest and approved by the Cabinet Secretary; is exempted from capital gains tax.

The exemption from the tax encourages business growth and smoothens such entities' operations. This provision, an amendment to the eight schedule of the Income Tax Act, is effective from the 7th of November, 2019.

5. **Turnover tax**

Turnover tax was repealed by the Finance Act 2018 and replaced with the presumptive tax to persons issued with a single business permit by the county government at 15% of the single business permit fee in order to widen revenue range in the informal sector. The Finance Bill, 2019 proposed to re-introduce turnover tax at 3% for businesses whose turnover does not exceed Kshs 5 million. The Finance Act 2019 retains this proposal. Therefore, as from the 1st of January 2020, Turnover Tax shall be levied simultaneously with Presumptive Tax despite the latter's low yields and implementation challenges since its introduction.

However, turnover tax shall not apply to rental income; management or professional or training fees; the income of incorporated companies; or any income which is subject to a final withholding tax under the Finance Act, 2019.

6. **Withholding Tax**

- The Finance Bill, 2019 proposed to expand the scope of Withholding taxes expanded to include security service, catering services offered outside hotel premises, transportation of goods other than air transport services, sales promotion, marketing and advertising services. The Finance Act, 2019 rejected the proposal. This comes as a relief to providers of these services targeted under the Bill.
- The 20% withholding tax on demurrage charges introduced through the Finance Act, 2018 is removed. Effective the 7th of November, 2019, the tax point is shifted to the shipping lines whereby demurrage shall be taxed as part of shipping lines' incomes at the rate of 30%.
- The Act clarifies on the provision of the Finance Act 2018 on withholding tax on insurance premiums paid to non-residents companies by stating that the same Withholding tax is applicable to re-insurance premiums paid to non-resident companies.
- The Bill proposed introduction of Withholding tax on all foreign payments by a branch to its foreign based head office where double taxation agreements provide for it as allowable expenses. Currently, such payments are exempt from Withholding tax.

7. **Withholding VAT rate reduced**

Withholding VAT was re-introduced in 2014 after it was suspended in 2011. The government withholds 6% of the taxable valuable of the supplies. Through the Finance

Act, 2019, effective the 7th, November, 2019 the Government reduced the rate from 6% to 2% following financial flow concern by the taxpayers. This move will improve the cash flow problems and create jobs for Kenyans.

8. **VAT Scope expanded**

Under the Act, the definition of "supply of imported services" includes supplies made to any persons. This means that non-registered persons will also be liable to account for reverse VAT on imported services. Currently, just VAT registered persons are targeted. This is effective from the 7th of November, 2019.

9. **Time of supply of good and services**

The Finance Act amended VAT Act to include Special Economic Zones (SEZ) in the definition of time of supply of goods and services. As a result, the time of supply of imported goods will include the time the goods are removed from the SEZ.

10. **VAT EXEMPT**

- income earned by brokerage services;
- specialized equipment used for the development and generation of solar and wind energy (subject to the CS Energy's approval);
- tractors;
- Supply of maize flour, cassava flour containing cassava by more than 10% in weight;
- Goods imported or locally purchased for construction of houses under the affordable housing scheme;
- plants and machinery used in the construction of plastic recycling plants;
- Musical instruments or equipment imported or purchased locally;
- Locally manufactured motherboards and all inputs used in their manufacture;
- Agricultural pest control is now zero rated supply;

- Official aid funded projects (restricted to concession loan).

11. **Definition of Concession loan amended**

The VAT Act exempts taxable services and goods, imported or purchased, for direct and exclusive use in the implementation of official aid funded projects, upon approval by the Cabinet Secretary, National Treasury. An official aided project is a project funded by a grant or concessional loan in accordance with an agreement between the government and any foreign government, agency, institution, foundation, organization or any other aid agency. A concessional loan is defined as a loan with at least 25% grant element. The definition makes it clear what official aid funded projects are, for purposes of granting tax exemptions.

12. **Corporation tax**

- Capital Markets Authority is empowered to enforce penalties and sanctions on market players who violate laid down rules and procedures.
- The introduction of amnesty on penalties and interest on any outstanding tax for two years prior to the listing of SMEs under the Growth and Enterprise Market Segment (GEMs) program. An incentive to facilitate growth in the number of listed SMES under the GEMS. This is expected to encourage listing of SMEs on the NSE. This provision will spur the growth of SMEs because they will be in a position to access cheap capital and ultimately accelerate Kenya's economic growth. This provision had been made effective from the 1st of October, 2019.
- Corporation Tax rate for investors in plastic recycling industry has been reduced from 30% to 15% for the first five years' effective the 7th of November, 2019. This is government's move to reduce environmental pollution and encourage recycling of plastic.

13. **Excise duty**

- 20% excise duty on betting activities on the amount wagered or staked
- Increase of 15% excise duty on all Alcoholic and tobacco products.
- Excise duty on Motor vehicles of tariff heading 87.02, 87.03 and 87.04 increased 20% excluding:
  - (i) locally assembled motor vehicles;
  - (ii) school buses for use by public schools;
  - (iii) motor vehicles of tariff no.8703.24.90 and 8703.33.90; and
  - (iv) imported motor vehicles of cylinder capacity exceeding1500cc.
- Reduction of excise duty on fully-powered electric motor.
- Increase in excise duty on imported motor vehicles imported motor vehicles of cylinder capacity exceeding 1500cc of tariff heading 87.02, 87.03 and 87.04 to 25%.
- 35% excise duty on Motor vehicles of tariff no. 8703.24.90 and 8703.33.90.
- 10% excise duty on 100% electric powered motor vehicles of tariff no. 8702.40.11, 8702.40.19, 8702.40.21, 8702.40.22, 8702.40.29, 8702.40.91, 8702.40.99 and 8703.80.00.
- 35% excise duty imposed on imported gas cylinders.

14. **Custom duty**

- In a bid to conserve Kenya's forest reserve, the government reduced Custom duty on timber from 10% to 0%. However, the import duty is maintained at 25% to protect timber and furniture industry.
- Application of 25% import duty on paper and paperboard instead of 10%.

15. **Amendment of the Long title of Housing Act, cap 117**

The long title to the Housing Act is amended by deleting the words "a Housing Fund" and substituting with the words "the National Housing Development Fund".

16. **Housing relief**

The Tax Laws Amendment Act (2018) introduced affordable housing relief at 15% of gross emoluments, not exceeding Kshs. 108,000. The Finance Act, 2019 has amended the base of the relief from "gross emoluments" to "employee's contribution". This amendment is to ensure that the relief is the lower of 15% of the gross emoluments or the actual contribution subject to a limit of KShs 108,000

17. **National Housing Development Fund(NHDF) tax incentives**

In a bid to promote affordable housing the government introduced NHDF through the Finance Act, 2018. The NHDF is a fund set up to receive contributions from employers and employees for the development of affordable housing in Kenya in line with the Government's Big Four agenda on housing. The Finance Act, 2019 the following tax incentives for the housing sector:

- Exempts the income of NHDF from income tax. Effective 1st of January 2020
- Exempts from Stamp duty transfer of a house constructed under an affordable housing scheme from the developer to the National Housing Corporation. Effective 7th November 2019.
- Contributions withdrawn by a contributor who is first time home buyer from the National Housing Development Fund to purchase a house is exempt from tax. Effective 1st of January 2020.
- Foreign controlled companies implementing projects under affordable housing schemes will not be subject to thin capitalization rules. This is effective 1st of January 2020
- VAT exemption on goods imported or purchased locally for direct and exclusive use in construction of houses under an affordable housing scheme approved by the CS Treasury on the recommendation of the CS Housing. Effective 7th November 2019.

18. **Standard penalty**

The Act provides 5% penalty for late payment of Tax as provided for under the Tax Procedures Act and repeals the provision of Income Tax Act providing for 20% penalty effective the 7th of November, 2019. This is done to create uniformity between the legislations, and clarity to tax payers.

19. **Departure Prohibition Order(DPO)**

Scope of persons to whom DPO can issue has been expanded to include tax representatives who now include CEOs, managing directors, company secretaries, trustees. This is to ensure that the non-resident taxpayers do not leave Kenya before fulfilling their tax obligations.

20. **Banks Interest rate cap repealed**

The Act repealed section 33B of the Banking Act which provided for capping of bank interest rates. This however does not affect loan agreements entered into prior to the effective date which is the 7th of November, 2019.

21. **Exemption of income earned under Ajira Digital Programme**

The Finance Act exempts from tax income earned by persons registered under the Ajira Digital Program for three years beginning 1st of January 2020. The Ajira Digital Program is a government initiative to empower over one million young people to access digital job opportunities. The main objectives are to raise the profile of digital work; Promote a mentorship and collaborative learning approach to finding digital work; Provide Kenyans with access to digital work, and finally Promote Kenya as a destination for online workers. Access to digital work will build wealth and grow the middle class across the country. A larger middle class means more opportunities for businesses and direct growth of GDP.

The Cabinet Secretary, in consultation with the Cabinet Secretary for the ministry responsible for information communication technology, shall issue regulations for the better carrying out of this provision of the Act.

22. **Waiver for KRA Pin**

It is now the Commissioner General's discretional powers to waive the requirement of having KRA pin before having a bank account. The requirement of having KRA pin has been tedious especially for visiting foreigners.

23. **Commissioner's power to enforce payment of Withholding Tax**

The Act gives the Commissioner the power to take any measure under the Tax Procedures Act to collect and recover unpaid withholding tax together with penalties and accrued interests as if it was tax due and payable by that person in default. This proposal is a direct enforcement procedure by the Commissioner against taxpayers who fail to remit withholding tax.

24. **Objection Decision period**

The Act extends the period to consider additional information from a tax payer before an objection decision is made to 60 days.

25. **Inflationary Adjustments**

The Kenya Revenue Authority can now adjust taxes annually instead of the former bi-annual increment. This is a result of the High Court of Kenya's ruling stating that tax measures cannot be implemented before the Finance Bill is assented into law. The ruling further rendered the Provisional Collection of Taxes and Duties Act No. 44 of 1959 unconstitutional. Therefore, the effective date of all tax measures is now the date after the assent of the Finance Act. The adjustments are to be done every 1st October.

26. **Transaction Requiring Pin**

The Tax Procedures Act provides for a list of transactions for which a PIN is required. The following two transactions were added:

- Registration and renewal of membership by professional bodies and other licensing agencies
- Registration of mobile cellular paybill and till numbers by telecommunication operators

These will give Kenya Revenue Authority access to data on active professionals and self-employed taxpayers to expand its revenue base.

27. **Miscellaneous**

- Paints and resins manufacturers are given a refund of anti-adulteration levy paid on kerosene used as their input.
- Import Declaration Fee (IDF) on raw materials and intermediate goods reduced from 2% to 1.5% while IDF on finished goods increased from 2% to 3.5%.
- Railway Development Levy on finished goods increased from 1.5% to 2%.
- Export levy is introduced on tanned or crust hides and skins at 10%.

28. **Treatment of unclaimed benefits**

The Act provides that if within a period of two years from the completion of winding up proceedings in respect of a scheme under the Retirement Benefits Act, the liquidator is unable to trace any member of the scheme, the accrued benefits due to such member shall become unclaimed assets within the meaning of section 13 (1) of the Unclaimed Financial Assets Act, 2011, at the end of that period.

The Tax team is always available to provide more insight to the provisions of this Act. Should you have any queries or need clarifications on the contents of this alert, please contact Ms. Hanifa Galgallo the Tax Associate or Mr. Silas Gitari, the Managing Partner.

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