# Tax Alert

# Finance Act 2022

Tax Alert • June 2022

# 15%
Capital Gains Tax

## 15% WHT on derivatives

## CbCR, Master & Local Filing
International Tax filing requirements

## Special Operating Framework
companies exempted

## 16% VAT on Exported Services
BPO services are zero rated

## Locally Made Passenger Vehicles
Exempt from VAT and Excise

## 30% EBITDA
Deferment of realized foreign exchange losses for companies that apply the Interest restriction provisions

## Arm's Length Rule
Expanded to transactions with unrelated persons operating in preferential tax regimes

BDO

# Income Tax Changes

# 15% CGT

Effective from 1st January 2023, the Capital Gains Tax rate will be increased to 15% from 5%.

The 5% rate will remain applicable for investments, valued at KES 5 billion or higher, made before January 2023, by firms certified by Nairobi International Financial Centre Authority and their transfer takes place within 5 years.

## Our insight

While this increment may yield additional tax for KRA, it may discourage home ownership, and affect the pension sector and investments in real estate.

Foreign direct investments may also take a hit given that indexation allowance to adjust the effects of inflation has not been provided for.

Companies may need to review their structures within this year to manage the potential tax uplifts come 2023.

# Preferential Tax Regimes & TP

Transactions with enterprises operating in preferential tax regimes will be required to meet the arm's length standard, notwithstanding the absence of a corporate relationship.

KRA is empowered to raise a transfer pricing tax assessment if they fail the standard.

This is effective from 1st January 2023.

A preferential tax regime includes:-

- Kenyan regulations which provide a preferential rate of tax to such income or profit, including reductions in the tax rate or base e.g. EPZs, SEZs, privileged organizations, entities operating under a special operating framework, etc.
- A foreign jurisdiction which: -

1. Does not tax income or taxes at a rate lower than 20%.
2. Does not have a framework for the exchange of information.
3. Does not allow access to banking information.
4. Lacks transparency on corporate structure, ownership of legal entities located therein, beneficial owners of income or capital, financial disclosure, or regulatory supervision.

## Insights

The expansion of the scope of transactions subject to transfer pricing will put a lot of pressure on businesses when selecting corporate structures and business partners.

Nevertheless, meeting transfer pricing requirements are manageable.

# Country by Country Reporting (CbCR)

From the 2022 year of income, CbCR requirements will apply to: -

- The ultimate parent company of a multinational group with a consolidated gross turnover of KES 95 billion or more.
- A constituent company of a multinational group, where such a group has a consolidated gross turnover of KES 95 billion or more.

The filing deadline is 12 months after the financial year-end.

CbCR to contain:-

1. Names, tax residence, and main business activity of each constituent entity.
2. The groups aggregate information including: -

- Revenues.
- Earnings before income tax.
- Income taxes are paid on both cash and accrued basis (to local and other countries), including withholding tax.
- Stated capital and accumulated earnings.
- The number of local employees.
- Tangible assets (but not cash or cash equivalents).

3. Other information required by KRA.

## Insights

CbCR will increase the transparency of businesses' financial results and other metrics, leading to increased scrutiny from KRA and an increased likelihood that transfer pricing policies will be questioned.

The following risks are to be managed:-

- Increased transfer pricing risk from the availability of annual headline data across a group to each tax authority as variations of profit, or high profits with little substance, will stand out.
- Unpreparedness and inconsistency across the group.

# Master File & Local File

From the  2022 year of income and in addition, the ultimate parent companies or their resident constituent entities will file, with KRA, a Master File and Local File.

The deadline is 6 months after the close of the accounting year-end.

The Master File will contain:-

1. A detailed overview of the group.
2. The group’s growth engines.
3. It's supply chain and key products.
4. The research and development policy.
5. Description of each constituent entity’s contribution to value creation.
6. Information on intangible assets and related intercompany agreements.
7. Detailed information on any transfer of intangible assets within the group.
8. The group's financing activities.
9. The group's consolidated financial statements.
10. Tax rulings, if any, made in respect of the group; and
11. Other information requested by KRA.

The Local File will contain:-

1. Information on the resident constituent entity’s activities within the group.
2. The management structure of the resident constituent entity.
3. Business strategies including structuring, description of the material-controlled transactions, the resident constituent entity’s business, and competitive environment.
4. The international transactions and amounts paid to the resident constituent entity or received by the entity; and
5. Other information requested by KRA.

# Master File & Local File- Surrogates

Where more than one constituent entity exists in Kenya, the group may designate one as the surrogate parent company.

The surrogate may be exempted from CbCR if:

- The ultimate parent is obligated to file a CbCR report in its country of residence.
- The ultimate parent's country has an effective international agreement and a competent authority agreement ; and
- KRA has not notified the resident constituent entity in Kenya of a systemic failure if any.

The surrogate parent company will not be required to file a CbCR report if another non-resident surrogate parent company has filed the same with a competent authority in a jurisdiction with CbCR compliance requirements.

Such a jurisdiction should have an information exchange framework with Kenya without any systemic failure.

## Insights

- The scope of compliance for multinationals has increased. The process of preparing the files should be carefully undertaken in good time ahead of the deadlines.
- The Master file will be provided to numerous revenue authorities. The risk of information leaks and inconsistencies should be managed.
- Local Files should be prepared consistently with the Master File.

# Financial Derivatives

Effective from 1st January 2023, gains made by non-resident persons from financial derivatives will be subject to a 15% withholding tax.

Derivatives traded on the Nairobi Securities Exchange Derivatives Market ("NEXT") are exempted from this tax.

The Cabinet Secretary for the National Treasury is to prepare regulations to facilitate this tax.

## Insights

Nairobi Securities Exchange Derivatives Market ("NEXT") was rolled out on 4th July 2019.

It is set to be a key driver of activity in the market. Nairobi Securities Exchange ("NSE") has the only other derivatives trading market after Johannesburg Securities Exchange ("JSE").

The exclusion of derivatives traded on NEXT is a welcome development. This came in through industry and NSE lobbying efforts.

Nevertheless, international banks may cool appetites for providing hedging products to the Kenyan market. Kenyan entities may be contractually pushed to bear the tax cost or choose not to enter hedging transactions and be exposed to currency, interest, and commodity price risks.

The imposition of the tax may contradict the promotion of Nairobi International Financial Centre, as it will make Kenya less attractive as a financial hub.

Double tax treaties may provide withholding tax reliefs.

# Foreign Exchange Losses Deduction

Effective from 1st July 2022, companies whose interest expenses exceed 30% of earnings before interest, taxes, depreciation, and amortization (“EBITDA”), will defer and not claim foreign exchange losses realized in the financial year.

This restriction does not apply to banks and financial institutions licensed under the Banking Act, non-deposit-taking micro-finance businesses under Microfinance Act, and entities licensed under the Hire Purchase Act.

# ESOPs

Effective 1st July 2022, the taxable value of the shares shall be the difference between the offer price per share, as at the time the option is granted by the employer, and the market value of the shares on the date when the option is exercised by the employee.

Previously, the difference between the offer price per share and the market value per share as of the date when the option is granted was the taxable value.

This will bring to full taxation the gains made in the performance of the shares in an ESOP arrangement, taking into account the timing difference value between the date of grant and the exercise date.

# DST

Effective 1st July 2022, non-resident persons with permanent establishments (branches) in Kenya will be exempted from the 1.5% DST.

Permanent establishments are already subject to tax in Kenya.

# Off-Grid Electricity

Effective 1st July 2022, the manufacture of all electricity (not just what is supplied to the national grid) will be classified as manufacture.

The machinery and buildings will therefore enjoy a 50% capital allowance in the first year and 25% in subsequent 2 years.

# Allowable Deductions

Effective 1st January 2023, the following changes have been made to the allowable deductions listing: -

- Donations made to all charitable organizations exempted from tax by the Commissioner (Para 10) and donations to any project approved by the CS of the National treasury are allowable.

There are two departures from the repealed provisions: -

- Donations need not be in cash , in kind donations are now allowable.
- The requirement for charitable organizations to be registered or exempt from registrations under the NGO's Act is deleted
- Capital expenditure incurred on the purchase or acquisition of an indefeasible right to use a fiber optic cable by a telecommunication operator has been excluded from deduction.

This proposal will discourage telecom operators who wish to invest more in the purchase or acquisition of fiber optic cables and the consequence cost may be passed on to the end-users.

- The following institutions now enjoy interest expense deductibility without the 30% EBITDA equivalent restriction.

1. Microfinance institutions.
2. Non-deposit-taking microfinance businesses.
3. Hire Purchase Act companies.
4. Non-deposit-taking institutions are involved in the lending and leasing business.
5. Manufacturers of human vaccines.
6. Manufacturers whose cumulative investment in the preceding 5 years from January 2023 is at least KES 5 billion.
7. Manufacturers whose cumulative investment is at least 5 billion shillings, the same being invested outside Nairobi and Mombasa.
8. Holding companies that are regulated under CMA Act.

# Exemptions

Effective 1st July 2022, the following businesses/transactions will be exempted from income tax:-

- Income of human vaccine manufacturing company.
- Withholding tax on payments for imported services, dividends made by a manufacturer of human vaccines to non-resident persons.
- Deemed interest on interest-free loans advanced to manufacturers of human vaccines.
- Compensating tax accruing to a manufacturer of human vaccines.

Dividends paid by SEZ companies.

## Special Operating Frameworks ("SOF")

- Companies operating under a special framework arrangement with the Government do enjoy special tax rates outlined in those agreements.

1. Those engaged in a business under a SOF with the Government.
2. Businesses whose capital investment is at least KES 10 billion.
3. Businesses are incorporated for the purposes of manufacturing human vaccines.

- This provision will facilitate and incentivize sizable, lucrative, or vital investments in the health sector.

## Carbon Exchange & Shipping Lines

Companies operating a carbon market exchange or emissions trading system at NIFC will pay a tax of 15% for the first ten years of operation.

The same treatment will apply to shipping businesses in Kenya.

## Bearer Bonds

Interest and deemed interest on bearer bonds issued outside Kenya of at least two years duration and interest, discount or original issue discount will be subject to 7.5% withholding tax and not 15%.

# Value Added Tax

# VAT Changes

Effective 1st July 2022

| ITEM | Old Rate | New Rate |
|---|---|---|
| Liquefied petroleum gas including propane | 16% | 8% |
| Cooking appliances and plate warmers for liquid fuel-Bioethanol vapor (BEV) Stoves classified under HS Code 7321.11.00 | 16% | Exempted |
| Cooking pellets | 16% | Exempted |
| Plant and machinery of chapter 84 and 85 imported by manufacturers of pharmaceutical products or investors in the manufacture of pharmaceutical products upon the recommendation of the Cabinet Secretary responsible for matters relating health | 16% | Exemptible By the CS |
| Medical oxygen supplied to registered hospitals | 16% | Exempted |
| Urine bags, adult diapers, artificial breasts, colostomy, or ileostomy bags for medical use | 16% | Exempted |
| Inputs and raw materials used in the manufacture of passenger motor vehicles | 16% | Exempted |
| Locally Manufactured passenger motor vehicles (at least 30% local content) | 16% | Exempted |
| Taxable goods, inputs and raw materials imported or locally purchased by a company which is- (a) engaged in business under a special operating framework arrangement with the Government; and (b) incorporated for purposes of undertaking the manufacture of human vaccines; and whose capital investment is at least ten billion shillings, subject to approval of the Cabinet Secretary for the National Treasury, on recommendation of the Cabinet Secretary for health. | 16% | Exemptible By the CS |

Specialized hospitals to lose exemption status

# VAT Changes

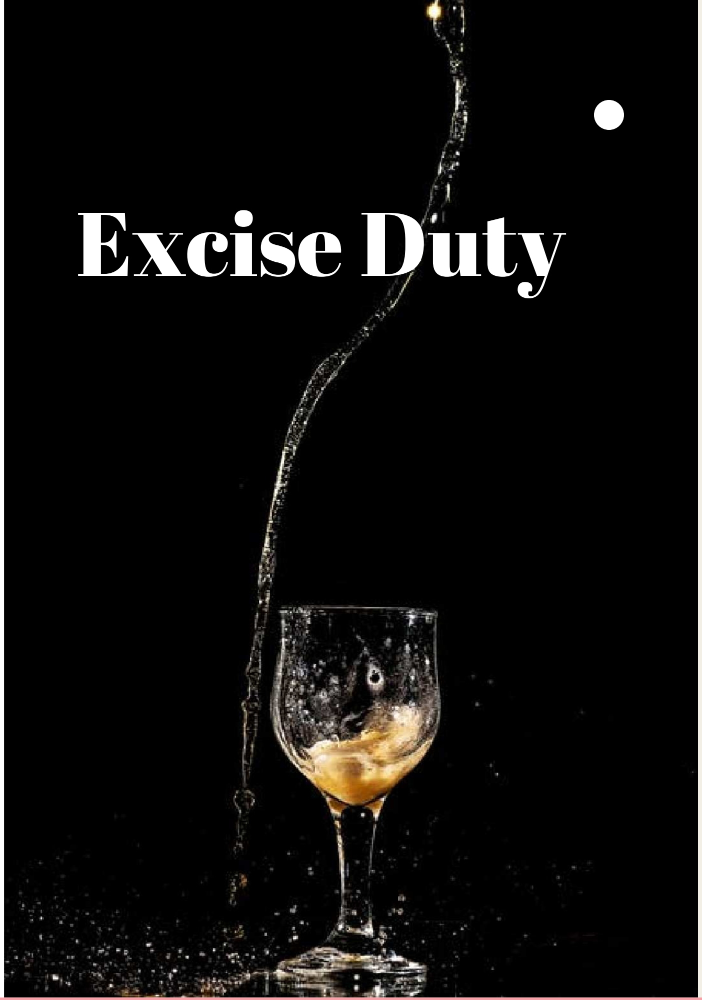
Effective 1st July 2022

Export of services becomes taxable at the standard rate on 16%.

Exported services of business process outsourcing ("BPO") businesses is exempt. No definition of BPO is provided.

| ITEM | Old Rate | New Rate |
|---|---|---|
| Capital goods exemption by the Cabinet Secretary as promoting investment in the manufacturing sector: Provided that the value of such investment is not less than two billion shillings. | 16% | |
| Taxable goods, inputs and raw materials imported or locally purchased by a company which-<br>(a) is engaged in business under a special operating framework arrangement with the Government; and<br>(b) is incorporated for purposes of undertaking the manufacture of human vaccines; and<br>whose capital investment is at least ten billion shillings, subject to approval of the Cabinet Secretary for the National Treasury, on recommendation of the Cabinet Secretary for health | 16% | Exemptible |
| Syringes, with or without needles of tariff no. 9018.31.00. | Exempt | 16% |
| Export of services by a business process outsourcing company | Exempt | Zero rated |
| Fertilizers | Exempt | Zero rated |
| Inputs and raw materials used to manufacture fertilizers approved by the CS for Agriculture | Exempt | Zero rated |
| Protective apparel, clothing accessories and equipment Articles of apparel, clothing accessories and equipment specially designed for safety or protective purposes for use in registered hospitals and clinics or by county government or local authorities in firefighting. | Zero rated | 16% |

# Excise Duty



# Excise Duty Changes

Effective 1st July 2022

Commissioner empowered to exempt specific products from inflationary adjustment

| EXCISE DUTY CHANGES | Old Rate | New Rate |
|---|---|---|
| Electronic cigarettes | KES3,787 per unit | 40% |
| Liquid nicotine for electronic cigarettes | KES2,525 per unit | KES 70 per milliliter |
| Fruit juices (including grape must), and vegetable juices, unfermented and not containing added spirit, whether containing added sugar or other sweetening matter | KES12.7 per liter | KES13.30 per liter |
| Cosmetics and Beauty products of tariff heading No. 3303, 3304, 3305 and 3307 | 10% | 15% |
| Beer, cider, perry, mead, opaque beer, and mixtures of fermented beverages with nonalcoholic beverages and spirituous beverages of alcoholic strength not exceeding 6% | KES121.85 per liter | KES 134 per liter |
| Wines including fortified wines, and other alcoholic beverages obtained by fermentation of fruits | KES208.20 per liter | KES229 per liter |
| Spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength exceeding 6% | KES278.70 per liter | KES335.30 per liter |
| Cigars, cheroots, cigarillos, containing tobacco or tobacco substitutes | KES13,906.04 per kg | KES15,296.6 per kg |
| Cigarette with filters (hinge lid and soft cap) | KES3,447.61 per mille | KES3,825.99 per mille |
| Cigarettes without filters (plain cigarettes) | KES2,502.74 per mille | KES2,752.97 per mille |

# Excise Duty Changes

Effective 1st July 2022

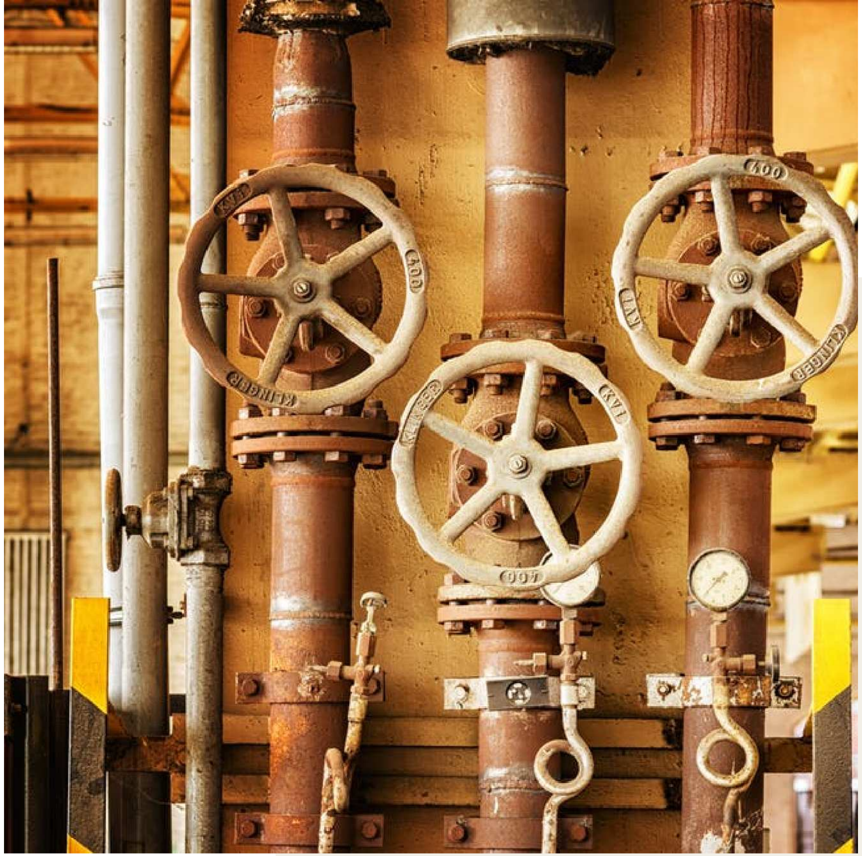
| Item | Old Rate | New Rate |
|---|---|---|
| Other manufactured tobacco and manufactured tobacco substitutes; "homogenous" and "reconstituted tobacco"; tobacco extracts and essences | KES9,734.45 per kg | KES10,707.88 per kg |
| Imported sugar confectionary of tariff heading 17.04 | KES36.74 per kg | KES40.37 per kg |
| Locally manufactured white chocolate, chocolate in blocs, slabs, or bars of tariff Nos. 1806.31.00, 1806.32.00, 1806.90.00 | KES200 per kg | None |
| Imported White chocolate including chocolate in blocks, slabs, or bars of tariff nos. 1806.31.00, 1806.32.00, and 1806.90.00 | KES200 per kg | KES 242.29 per kg |
| Jewellery of tariff heading 7113 and imported jewellery of tariff heading 7117 | 10% | 15% |
| Products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application but excluding medicinal products approved by the Cabinet Secretary responsible for matters relating to health and other manufactured tobacco and manufactured tobacco substitutes that have been homogenized and reconstituted tobacco, tobacco extracts and essences | KES1,200 per kg | KES 1,500 per kg |

# Excise Duty Changes

Effective 1st July 2022

| Item | Old Rate | New Rate |
|---|---|---|
| Imported Articles of plastic of tariff heading 3923.90.90 | None | 10% |
| Imported potatoes of tariff numbers 0710.10.00, 2004.10.00 and 2005.20.00 | None | 25% |
| Imported furniture of any kind used in offices, kitchen, bedroom, and other furniture | 25% | None |
| Locally manufactured<br>3907.91.00 Unsaturated polyester<br>3907.50.00 Alkyd<br>3905.91.00 Emulsion VAM<br>3903.20.00 Emulsion - styrene Acrylic<br>3905.19.00 Homopolymers<br>3906.90.00 Emulsion B.A.M<br>Imported ones continue to suffer the tax | 10% | None |
| Imported ready to use SIM cards | None | KES50 per SIM card |
| Fees charged by digital lenders at a rate of twenty percent. | None | 20% |
| Importation of cellular phones, shall be at ten per cent of the excisable value. | None | 10% |
| Betting on horse racing | 7.5% | None |
| Neutral spirit imported or purchased locally by registered pharmaceutical manufacturers upon approval by the Commissioner | | Exempt |
| Locally manufactured passenger motor vehicles: | | Exempt |

# Tax Procedures



# Trusts

Trusts, whether conducting a business or not, shall within thirty days of the occurrence of change, supply the commissioner with the full identity and address details of trustees and beneficiaries of the trust.

Previously, only trusts conducting a business were required to notify the commissioner of any changes.

A PIN is now mandatory for the registration of a trust.

This is effective 1st July 2022

# Amendment of Assessments

Effective 1st July 2022, input tax claims shall be restricted to those incurred within 6 months after the end of the tax period in which the supply or importation occurred.

Initially, The Tax Procedures Act did not prescribe the period over which input tax was allowable for a claim upon amendment of the VAT returns.

# Security for Tax

KRA is authorized to direct the Land Registrar, Registrar of ships, the Director-General of the Kenya Civil Aviation Authority, and any person who the Commissioner is satisfied has the authority to hold property, to register security on the title over unpaid taxes.

Where the commissioner and the taxpayer consent to a payment plan, the liability shall be cleared within the agreed period before the notice is lifted.

Upon payment of all the taxes due, the Commissioner shall discharge the property from the notice.

Where the taxpayer fails to pay the tax liability within two months of notification, the Commissioner may initiate the auctioning of the property.

This is effective 1st July 2022

# Withholding VAT agentss

Effective 1st July 2022, Manufacturers with at least 3 billion worth of investment in the three years preceding 1st July 2022 shall be eligible for appointment by the commissioner to withhold 2% of the taxable value of standard-rated supplies.

## Amendment of Assessments

A taxpayer with overpaid taxes may apply to the Commissioner for the overpaid taxes to be offset against future tax liabilities or for a cash refund of overpaid taxes within 5 years, or, 6 months for the case of VAT.

The Commissioner shall issue a decision on the application within 90 days.

Where the Commissioner fails to refund the overpaid taxes within two years from the date of application, the amount due will accrue interest at the rate of 1% per month.

This is effective 1st July 2022

## Decisions

The commissioner is obligated to inform the taxpayer that their notice objection has not been validly lodged within fourteen days.

Previously the commissioner was to inform the taxpayer immediately in case of such an occurrence.

This is effective 1st July 2022

# Othe Duties & Miscellaneous Fees

## Stamp Duty Exemption

Effective 1st July 2022, Instruments executed in favor of mortgage refinance companies are exempted from stamp duty.

## Iron Ore

Tariff 2601 for Iron ores and concentrates including roasted iron pyrites to attract an export Levy rate of USD 175 per tonne, Effective 1st July 2022

Effective 1st July 2022, specific rates of export levy on specific goods shall be adjusted for inflation on the 1st of October every financial year instead of at the beginning of the financial year.

## IDF exemptions

Effective 1st July 2022, the outlined goods are exempted from import declaration fees and the railway development levy:

- Inputs and materials imported by manufacturers of pharmaceutical products
- Goods imported for use in the construction and maintenance of human vaccine manufacturing plants
- Goods, inputs, and raw materials imported by a company which is:

1. Engaged in business under a special operating framework.
2. A manufacturer of human vaccines; and whose capital investment is KES 10 billion shillings.

## Unclaimed Assets Amnesty

Effective 1st July 2022 there shall be a Voluntary Unclaimed Financial Assets Disclosure Program that will run for a period of twelve months. The objective of the program shall be to waive all penalties and interest in unclaimed assets.

The holders of these assets will be required to disclose or deliver the undeclared asset to the Authority. This will apply to assets held up to 30th June 2022.

# BDO

## BDO Global

BDO is the world's fifth largest global accounting and advisory network. BDO's global organization extends across 167 countries and territories, with 91,054 professionals working out of 1,658 offices.

BDO is committed to delivering exceptional client service through a tailored solutions approach,
while partnering with our employees and clients globally.


## BDO in Kenya

BDO is the world's fifth largest global accounting and advisory network. BDO's global organization extends across 167 countries and territories, with 91,054 professionals working out of 1,658 offices.

BDO is committed to delivering exceptional client service through a tailored solutions approach, while partnering with our employees and clients globally.

Our team of professionals conform to the highest international standards in an extensive range of professional services, including:

- Audit and Assurance Services
- Business Services & Outsourcing
- Corporate finance and transaction advisory
- Tax services
- Financial agency & NGO/NFP services
- Secretarial services
- Risk Advisory Services
- Specialist Advisory Services

If you have any questions, comments or suggestions, please contact us. To learn more about BDO East Africa, please visit www.bdo-ea.com

# Contact Us



Sandeep Khapre
Regional CEO
sandeep.khapre@bdo-ea.com

Clifford Ah Chip
Managing Partner
clifford.ahchip@bdo-ea.com

Steve Okoth
Tax Director
steve.okoth@bdo-ea.com

Henry Sang
Tax Director
henry.sang@bdo-ea.com

Peter Mwangi
Senior Tax Manager
peter.mwangi@bdo-ea.com

Nzioka Muindi
Senior Tax Manager
nzioka.muindi@bdo-ea.com