TAX UPDATES AND REMINDERS FIRST QUARTER 2019

Introduction

Following the enactment of various tax laws in 2018 and other subsequent developments affecting tax we highlight here below key ones that may impact on your business tax operations. Included are three recently decided court cases please feel free to contact us in case of clarifications required. You will be receiving our updates on quarterly basis.

Withholding Tax

Demurrage charges – (Penalty for delay in taking delivery of goods beyond the period allowed or returning equipment used for transportation of goods) is now subject to 20% withholding tax but only when paid to non-resident shipping companies. In addition insurance premiums except those paid for insurance of aircraft suffers withholding tax at 5% if paid to a non-resident while winnings withholding tax rate is 20%. Winnings has been defined to include winnings of any kind. Previously it was limited to winnings paid by bookmakers to punters licensed under Betting, Lotteries and Gaming Act.

Dividends Payout

Previously withholding tax was applicable on dividends paid out in cash to the principal shareholder. From January 2019 benefit in any form accruing to the shareholder and his/her relatives is treated as dividends. The benefits are: cash and assets in any form, discharge from any obligations, amounts used by the company to benefit shareholder and relatives and any transactions that increase the companies' tax liabilities or reduce losses.

New Dividend Distribution Tax

Dividend distribution tax introduced with effect from 1 January 2019. Any dividends distributed out of untaxed profits or gains now taxable at corporate tax rate of 30%. Untaxed gains or profits arise where a company has not paid income tax on the gains due to any form of reliefs, waivers, exemptions incentives etc. If a company takes advantage of investment deductions with accelerated investment deduction allowance of 100% or 150% in cases of investments outside the three main cities, a business may make accounting profits but make taxable business losses. If profits are distributed it will be out of untaxed profits and will be liable to tax at 30%. Such scenario then defeats the purpose of investment deduction allowances. Preparation of Dividend Tax Account (DTA) which previously taxed such gains is now deleted.

Enhanced Claim on Electricity Expenses

To lessen the tax burden arising out of high electricity expenses an additional 30% expense will be granted but only to manufacturers but subject to conditions set by the Ministry of Energy. However no conditions have been released we hope the Ministry will soon issue now that 2018 tax returns are due for filing.

Tax Disputes

A tax dispute filed with the Tax Appeals Tribunal (TAT) must be concluded in 90 days. The amendment in 2018 provides that parties to a dispute may apply in writing to settle the matter out of the Tribunal and the time taken out of the Tribunal will not affect the 90 days required to conclude the case.

Housing Development Fund

Housing Development Levy is still a subject of dispute between government on one hand and COTU and FKE on the other. The case is scheduled for hearing on 4 April 2019. The rate of contribution is 1.5% employer and employee capped at KES 5,000 (USD 50) per month. Until the case is determined its implementation remains suspended.

Presumptive Tax

With effect from January 2019 Presumptive Tax previously known as Turnover Tax (TOT) is payable at 15% of the local county single business permit fee. This applies to small businesses with turnover not exceeding KES 5 million. The tax paid is final but does not apply to incorporated businesses, professionals and rental income.

Amnesty

Application for amnesty on foreign income expires on 30 June 2019. Applicants will be exempted from the Proceeds of Crime and Anti-Money Laundering Act and any other Acts relating to reporting and investigation of financial transactions. However proceeds from terrorism, poaching and drug trafficking will not be exempted.

Extension of Time to File Tax returns

Application for extension of time to file monthly and annual tax returns is now permitted provided the application is submitted to the Commissioner at least 15 days and 30 days for monthly and annual returns respectively. In case of anticipated delays please take advantage of this provision to avoid late submission penalties.

Court of Appeal Ruling - Withholding Tax

A landmark ruling that will drastically change the withholding tax regime in Kenya has just been delivered by the Court of Appeal on 5 February 2019. On 5 February 2012 (exactly seven years ago) the High Court had rendered a judicial judgment confirming that withholding tax is payable upon actual payment or settlement in any form of the transaction giving rise to withholding tax.

The Appeal Court has overturned this decision and affirmed that the word *'paid'* as defined in the Income Tax Act has a technical connotation and not an ordinary one. In their judgment they upheld that '*in the context of the Income Tax Act, payment is deemed to have been made even when no money has been passed over*'. The upshot of this is that with effect from February 2019 withholding tax will become due and payable on accrued liabilities irrespective of when the creditor will be paid.

High Court Ruling - Exported Services

Good s and services exported are zero rated for VAT. However for a long time KRA and exporters of services have had different views and interpretations of what constitutes an exported service. The VAT Act defines a service exported out of Kenya to mean ***'a service provided for use or consumption outside of Kenya'*** but it does not provide a clear interpretation of what use or consumption is. Tax Appeals Tribunal gave its opinion that to 'consume' is 'to use up' while 'to use' is 'to put to a particular use'.

In December 2018 the High Court rendered a decision on what constitutes an export of service by clarifying the issue of who consumes a service and where the service is consumed. In this case Judges decisions was also guided by internationally accepted principles of business especially the ***'destination principle'*** in the OECD guidelines with the main rule being that – the jurisdiction where the customer is located has the taxing rights over a service or intangibles supplied across international borders. The upshot of the guidelines is that the services are said to be used or consumed in the jurisdiction of the final consumer i.e. where the supply to the final consumer occurs. This is the jurisdiction which has the right to tax the services according to the rules of the jurisdiction where consumption occurs. With the application of destination principle with respect to VAT achieves neutrality in international trade and all revenue accrues to the jurisdiction where the supply to the final consumer occurs.

High Court Ruling – Kenya – Mauritius Double Tax Treaty

Kenya and Mauritius had already signed a Double Tax Treaty Agreement (DTA) but had not come into force because of a pending court case filed by Tax Justice Network Africa - an advocacy group that challenged the treaty citing several grounds among them: lack of public participation and parliamentary process, non transparency and offering no benefits to Kenya.

Although the Judges disagreed with most of the grounds of appeal the Court has just rendered its judgement by observing that the legal notice giving effect to the Treaty was not tabled before parliament as a procedural requirement. The judgement did not per se invalidate the Treaty, but by not laying it down before Parliament means it does not have legal effect. This may be remedied by the action of the Cabinet Secretary for National Treasury issuing a legal notice afresh complying with timelines and all other required documents and information for parliamentary scrutiny.

SACCOS Withholding Tax

Of late the media has been awash with comments about increased taxation of Cooperative Societies (SACCOS). Kenya has one of the largest and vibrant SAACO movement in Africa perhaps this is the reason it has become a target for revenue raising through the Income Tax Bill 2018. SACCOS pay interest and dividends to members both of which are taxed withholding tax at 5% when paid to residents and 10% to non-residents. The Bill proposes to double the resident rate to 10% and has received negative comments from the wider public. The Bill has not been enacted into law and through the public participation requirement one may petition Parliament or Treasury for rejection.

NSSF

NSSF had in 2013 raised the rate of contributions from KES 200 to 12% of gross salary split equally between employer and employee. Workers union (COTU) and Federation of Kenya Employers (FKE) successfully obtained court orders suspending the new rates. NSSF in a media briefing recently announced a possible agreement with stakeholders including COTU and FKE in the next few months to increase contributions to KES 720 per month.

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