

Tax & Legal Alert  
February 2023



## Tax Alert

### Income Tax (Financial Derivatives) Regulations, 2023

The Finance Act, 2022 (“FA 2022”) amended the Income Tax Act (“ITA”) to introduce withholding tax (“WHT”) on gains accruing to non-resident persons from financial derivatives contracts entered into with resident persons. The FA 2022 further provided that the provisions shall be implemented in accordance with the Income Tax (Financial Derivatives) Regulations, 2023 Regulations (“the Regulations”) made by the Cabinet Secretary for the National Treasury and Economic Planning (“CS Treasury”).

Pursuant to the above, the CS Treasury gazetted the Regulations on 27 January 2023, with the aim of operationalizing the provisions on WHT on gains accruing from financial derivatives.

In this alert, we summarise the key highlights of the Regulations and provide our view on the same. You are advised to read this alert together with [the Regulations](#) for more details.

## Background

In what is seen as an effort by the Government of Kenya to widen the tax base, Kenya introduced WHT on gains accruing to non-resident persons from financial derivatives contracts entered into with residents, effective from 1 January 2023 vide the FA 2022. The WHT rate applicable on such gains is 15%. For proper implementation of the newly-introduced WHT, the FA 2022 also empowered the CS Treasury to issue Regulations.

In compliance with the Statutory Instruments Act, 2013, the CS Treasury and the Kenya Revenue Authority (“KRA”) issued draft Regulations via a public notice dated 17 November 2022 and invited the public and stakeholders to submit their views.

Following the conclusion of the stakeholder engagement exercise, the CS Treasury gazetted the Regulations on 27 January 2023.

## The Regulations

Below, we provide a summary of salient provisions of the Regulations:

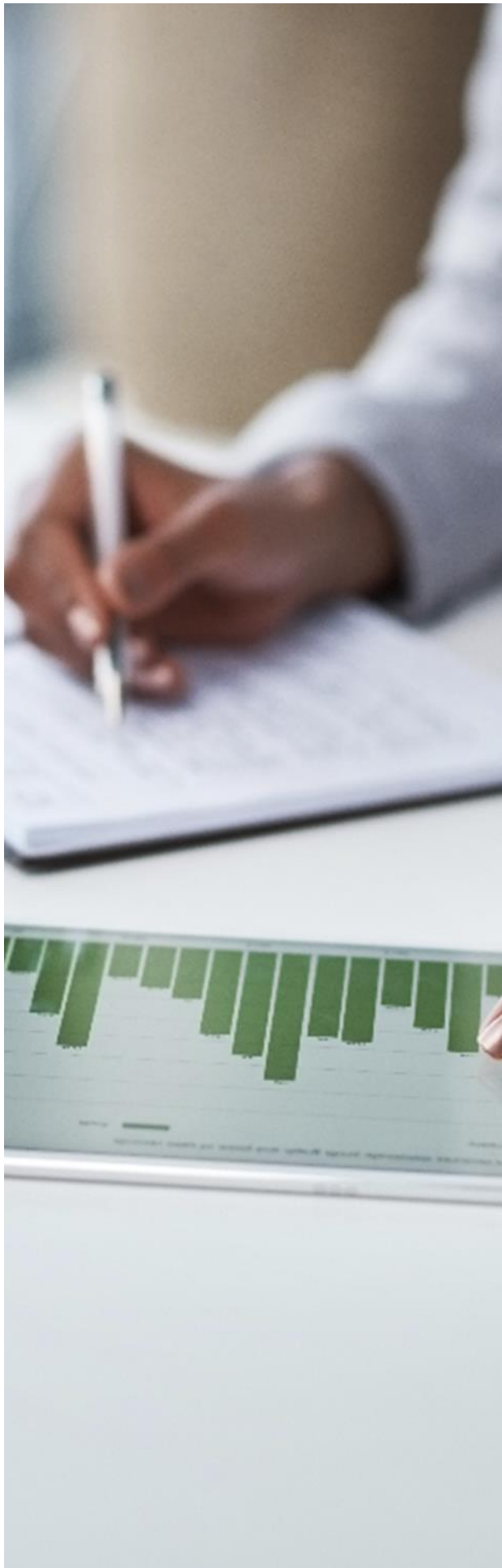
### Scope of gains from financial derivatives subject to WHT?

- The ITA defines “financial derivatives” as financial instruments whose value is linked to the value of another instrument underlying the transaction, which is to be settled at a future date.
- The Regulations define “gain” as any profit earned by a person from a financial derivative contract including any premium or fee paid in respect of an option contract.
- Regulation 3(2) seeks to provide clarity on the specific types of contracts that shall be considered to be financial derivatives contracts, to include:
  - Futures contracts
  - Forward contracts, whether cash settled or not
  - Swap contracts
  - Options contracts
  - Any other financial derivative instrument
- Accordingly, resident persons shall be required to deduct and remit WHT on any gains earned by non-residents from the above contracts/instruments.
- Important to note is that the ITA exempts gains from financial derivatives traded at the Nairobi Securities Exchange (“NSE”) from tax. Consequently, where instruments in the nature of those highlighted above are traded at the NSE, any gains accruing therefrom to non-residents shall be exempt from WHT.

### When is a gain or loss deemed to be realized?

- Under the Regulations, a gain or loss from a financial derivative will be deemed to have been realized when the:
  - Underlying asset changes hands
  - Contract is settled
  - Contract expires
- However, for options contracts, gains or losses are to be deemed as realized at the time of payment of the option premium and at the time the option is exercised.





## Tax treatment of gains and losses arising from financial derivatives

- As per the Regulations, any income from a financial derivative shall be clearly characterised as “*other income (financial derivative gains/losses)*” in the tax return for that year of income.
- In addition, incomes from financial derivatives contracts shall be treated as a separate source, similar to the treatment of other separate sources of income under Section 15(7) of the ITA, such as rental and dividend income.
- The implications of separate sourcing income from financial derivatives are as follows:
  - Income from financial derivatives shall be computed separately from any other income earned in a given year
  - Losses realised by resident persons from financial derivatives shall only be allowed as deduction against gains from financial derivatives
  - Where the separate treatment of financial derivatives gains and the deduction of any realised losses results in a tax loss, such losses can only be deducted from financial derivatives gains/profits in subsequent years

### Record keeping and filing requirements

- **Filing:** Under the Regulations, WHT shall be due and payable on the 20<sup>th</sup> day of the month after which the loss is realized by the resident person.
- **Record keeping-** the Regulations obligate all persons involved in financial derivatives transactions to keep records of all contracts and financial activities resulting from such a contracts.

### Effective date of implementing WHT

- The provisions in the FA 2022 introducing WHT on gains accruing to non-residents from financial derivatives came into operation on 1 January 2023. However, the Regulations required by law to implement the same were gazetted on 27 January 2023. The timing difference could present some uncertainty on when the affected taxpayers are required to comply.
- In our view, the Statutory Instruments Act, 2013, provides some guidance on the matter. Specifically, statutory instruments under the Act, such as the subject Regulations, come into operation on the date of publication in the Gazette, or on a date specified in the instrument itself. We note that the present Regulations do not specify the date of commencement, and hence one may persuasively rely on the Statutory Instruments Act, 2013 to conclude that the Regulations’ commencement date is 27 January 2023, being the date of publication.
- Furthermore, the requirement under the ITA that WHT on financial derivatives gains are to be implemented in accordance with regulations published by the CS Treasury is mandatory. Accordingly, it is plausible that financial derivatives gains accruing to non-residents prior to the Regulations’ gazette on 27 January 2023 would not be subjected to WHT, owing to the absence of operative Regulations to govern the imposition of WHT.

## Our View

The gazettement of the Regulations is a welcome move, as the Regulations will provide a framework for the implementation of WHT on gains accruing to non-residents from financial derivatives in Kenya.

That said, the Regulations present various challenges and considerations, which may impact on the overall success of implementation. We summarize them as follows:

- **Ascertainment of gains:** The Regulations do not specify how to ascertain “gains” accruing from financial derivatives. Given the peculiar nature of financial derivatives contracts and the diversity of their nature, this is a major omission on the draftsman’s part that steeps the rest of the Regulations in ambiguity.

In our view, it may be practically impossible for a resident person to determine a gain that accrued to a non-resident person given the fact that the non-resident may have incurred expenses that are not necessarily known to the resident. If, indeed, the intention of the draftsman was to disregard such an expense, it would be prudent to state so and, possibly, impose a rate that is relatively lower than the 15%.

It would also be prudent for the Regulations to prescribe a specific way of arriving at the gain from a tax perspective, for instance, by providing that financial derivatives gains are to be computed as the positive difference between the staked amount and the value at realization, while allowing for the deduction of any realized losses.

Until such time as the Regulations provide more certainty on the “gains”, the inherent ambiguity in the provisions as currently drafted could result in unnecessary tax controversies between the KRA and the impacted taxpayers.

- **Realization of gains or losses:** In seeking to prescribe when gains or losses are deemed to be realized, the Regulations also seemingly discount the practicalities of financial derivatives markets. For instance, by providing that for options contracts, gains or losses are to be deemed as realized at the time of payment of the option premium and at the time the option is exercised, the Regulations disregard the reality that the payment of option premium does not equate to the realization of a gain. The net effect of such provisions, therefore, would be subject to tax on unrealized gains, which would disincentivize investment and impose an unfair tax, contrary to the established tenets of taxation.
- **The impact of double taxation treaties (“DTTs”):** Kenya has concluded DTTs with other jurisdictions to afford relief from double taxation with respect to income tax and any taxes of a similar character. Such DTTs override any conflicting provisions within the ITA.

In this regard, gains accruing to non-residents of jurisdictions, which have an effective DTT with Kenya may not be subject to WHT in Kenya, depending on the terms of the treaties and the allocation of taxing rights between the contracting states.





## Conclusion

The Regulations seek to operationalize a new tax in a relatively nascent sector in Kenya. Given the critical role played by derivatives in risk management, we believe that the impact of this tax should be closely monitored with a view to address any negative consequences or challenges that outweigh the positive ones.

*Should you wish to discuss this further, kindly feel free to contact any of the contacts below or your usual Deloitte contact who will be more than glad to offer you guidance and assistance.*

## Contacts for this alert

**Fredrick Omondi**  
**Tax & Legal Leader**  
+254 719 039 318  
[fomondi@deloitte.co.ke](mailto:fomondi@deloitte.co.ke)

**Lilian Kubebea**  
**Tax & Legal Partner**  
+254 719 039 113  
[lkubebea@deloitte.co.ke](mailto:lkubebea@deloitte.co.ke)

**Walter Mutwiri**  
**Tax & Legal Partner**  
+254 719 039 253  
[wmutwiri@deloitte.co.ke](mailto:wmutwiri@deloitte.co.ke)

**Doris Gichuru**  
**Tax & Legal Partner**  
+254 719 039 454  
[dgichuru@deloitte.co.ke](mailto:dgichuru@deloitte.co.ke)

**Patrick Chege**  
**Tax & Legal Associate Director**  
+254 719 039 322  
[pchege@deloitte.co.ke](mailto:pchege@deloitte.co.ke)

**Fredrick Kimotho**  
**Tax & Legal Senior Manager**  
+254 729 031 008  
[fkimotho@deloitte.co.ke](mailto:fkimotho@deloitte.co.ke)

**Nicholas Gathecha**  
**Tax & Legal Associate**  
+254 719 039 339  
[ngathecha@deloitte.co.ke](mailto:ngathecha@deloitte.co.ke)

**Ian Mota**  
**Tax & Legal Consultant**  
+254 719 039 569  
[imota@deloitte.co.ke](mailto:imota@deloitte.co.ke)

## Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more about our global network of member firms.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our global network of member firms and related entities in more than 150 countries and territories (collectively, the “Deloitte organization”) serves four out of five Fortune Global 500® companies. Learn how Deloitte’s approximately 415,000 people make an impact that matters at [www.deloitte.com](http://www.deloitte.com).

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte network”) is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication. No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication. DTTL and each of its member firms, and their related entities, are legally separate and independent entities.