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Tax Briefly
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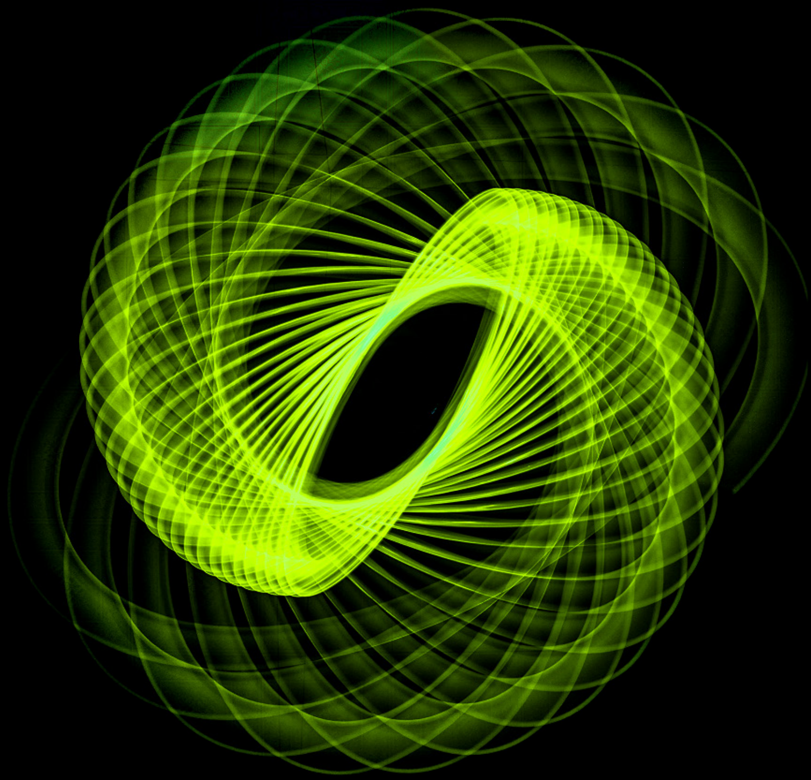

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The Finance Act 2017
Keeping you informed

The Finance Act 2017 was assented into law by the President on 21 June 2017.

The below analysis captures salient changes that have been effected to the Income Tax Act, 2015, the Tax Procedures Act, 2015, the Value Added Tax Act, 2013 and the Excise Duty Act, 2015 following the enactment of the Finance Bill, 2017. The analysis only reflects changes not originally contained in the Finance Bill and changes to some of the provisions of the Bill.

Tax Procedure Act

Definition of a tax decision

The Tax Procedures Act ('TPA') has been amended under the definitions sections with regards to the definition of a tax decision to refer to the right section that deals with refund of tax paid in error.

The measure

The amendment provides for substitution of section 49 with section 48 under the definition of a tax decision.

Who will be affected

All tax payers.

When

1 January 2018

Our view

This is a clean-up measure as it basically refers to the proper section of the Act under the definition of a tax decision.

Value Added Tax

Cost of living

Cassava flour and maize flour containing cassava flour now zero rated.

The measure

The Finance Bill 2017 sought to zero rate maize (corn) flour, wheat or meslin flour and ordinary for VAT purposes. The Finance Act has further moved to zero rate cassava flour and maize flour containing cassava flour by more than 10% in weight.

Who will be affected

The common Mwananchi and millers.

When

03 April 2017

Our view

The country has recently faced severe drought which has in turn resulted in poor harvests by farmers. Reduced supply of commodities such as maize gradually led to exorbitant prices of basic food commodities. In a bid to curb the rise in prices, the government recently introduced a raft of tax measures. Firstly, the government waived import duty on maize imports in the interim. Further, through the Finance Bill, 2017, the government proposed to zero rate maize flour, wheat or meslin flour and ordinary bread.

The move to zero rate cassava flour and maize flour containing 10% or more of cassava flour is, in our view, aimed at providing Kenyans with cheaper options for their daily diets. While better planning may be required to ensure sustainable food security in future, the expansion of the list of zero rated basic food commodities is a welcome move.

Cost of living

Items of milk and cream zero rated.

The measure

The following items of milk and cream are now zero rated for VAT purposes. Milk and cream, not concentrated nor containing added sugar or other sweetening matter, of tariff numbers-

0401.10.00—of a fat content, by weight, not exceeding 1%;
0401.20.00—of a fat content, by weight, exceeding 1% but not exceeding 6%;
0401.40.00—of a fat content, by weight, exceeding 6% but not exceeding 10%;
0401.50.00—of a fat content, by weight, exceeding 10%.

Who will be affected

Common mwananchi and the dairy sector.

When

03 April 2017

Our view

The VAT law previously exempted unprocessed milk and milk specially prepared for infants from VAT. However, the Finance Act 2017 has now zero rated the above mentioned items of milk and cream. This is likely informed by the need to make more milk products affordable to citizens in the wake of increasing milk prices.

The zero rating of these products will also enable players in the dairy sector to apply for VAT refund claims where they have excess input tax attributable to the sale of such products.

Liquefied petroleum gas (LPG) remains zero rated

The zero rated status of LPG introduced through the Finance Act 2016 is retained.

The measure

The Finance Bill 2017 had sought to move LPG from the list of zero rated goods to that the exemption schedule. This move has however been reversed following the enactment of the bill. As a result, the supply of LPG remains zero rated for VAT purposes as amended through the Finance Act, 2016.

Further, the Finance Bill 2017 had proposed to exempt from VAT *"taxable goods for use in the manufacture of LPG cylinders by licensed manufacturers upon recommendation by the Cabinet Secretary responsible for Energy and Petroleum".* However, this proposal has also been revoked following the enactment of the bill. As such, the VAT status of such goods will be as previously required under the VAT law.

Who will be affected

Petroleum sector players including; LPG dealers and manufacturers of LPG cylinders. The common mwananchi is also impacted by the reversal of the proposal to exempt taxable goods used for manufacture of LPG containers.

When

03 April 2017

Our view

A supply of goods or services may either attract VAT at 16% or at zero rate, or be exempt from VAT. Of the three options, zero rating results in the least possible price of such goods or services as no VAT is charged by sellers while they are entitled to recover input tax suffered on acquisition of taxable supplies for use in generating their supplies. Exemption follows as the more preferred option while the general rate results in the highest prices of goods or services.

Therefore, the proposal under the Finance Bill 2017 to move the VAT status of LPG from zero rating to exemption would have resulted in higher prices of LPG than is currently the case (under zero rating). The revocation of this proposal is a welcome move as the prices of LPG will be expected to remain relatively lower.

To bolster the growth of the industry, perhaps the government should have retained the proposal to exempt taxable goods used for the manufacturer of LPG cylinders as this has also been quashed following the enactment of the Bill.

Agricultural pest control products

Agricultural pest control products have been moved from the list of exempt items to the zero rating schedule.

The measure

The Finance Act 2017 has moved agricultural pest control products from the First Schedule (exemption) of the VAT law to the Second Schedule (zero rating). A move aimed at making pesticides more affordable to farmers.

However, there seems to have been some confusion on the VAT status of inputs for the manufacture of pesticides as these have, under the Finance Act 2017, been classified as both exempt and zero rated for VAT purposes.

Who will be affected

Farmers and manufacturers of pesticides.

When

03 April 2017

Our view

The move to zero rate pesticides is expected to lower the prices of such products for farmers and this will in effect result in better farming practices and higher yields.

Zero rating would ordinarily entitle manufacturers of pesticides to VAT refund for VAT suffered on their inputs and operating costs. However, as noted above, there seems to be an error by the draftsman as such inputs have, under the Finance Act, been classified as both zero rated and exempt. Perhaps the National Treasury or the Kenya Revenue Authority will issue some directive on the applicable VAT status of such inputs in the interim as we await an amendment of the law to correct the anomaly.

This said, it is important to note that pesticide manufacturing entities will still be entitled to VAT refunds for excess input tax largely arising from indirect manufacturing overheads.

Grain storage material

Exemption of materials for the construction of grain storage facilities.

The measure

Materials for the construction of grain storage facilities will, upon recommendation by the Cabinet Secretary for Agriculture, be exempt from VAT.

Who will be affected

The Agricultural sector.

When

03 April 2017

Our view

This is a new amendment which was not initially included in the Finance Bill 2017. It is likely that this change was informed by the need to attract more investors to construct grain storage facilities which in turn will ensure the country has sustainable grain reserves.

We note that the effective date of this change is 3 April 2017. Therefore, where the Cabinet Secretary for Agriculture so approves, persons constructing grain storage facilities who have incurred VAT on construction material after the effective date may request their suppliers to reverse the VAT paid by issuance of a credit note and reissuance of a VAT exempt invoice.

International cargo transport

Transportation of cargo to foreign destinations now exempted from VAT.

The measure

The transportation of cargo to destinations outside Kenya will henceforth be exempt from VAT.

Who will be affected

Importers and cargo transporters.

When

03 April 2017

Our view

Again, this is a new amendment which was not initially included in the Finance Bill 2017.

Previously, the transportation of cargo to foreign destinations was considered a zero rated supply. This was on the basis that such services are connected to export goods and that the final user or consumer of such services was the consignee of the goods in the destination country. This was in line with international best practice which bases the VAT status of goods or services traded across borders on the destination principle.

The move to exempt transportation services for cargo destined to foreign countries is not aligned to the destination principle and it is likely that this move was informed by the need to reduce cases of VAT refund claims occasioned by zero rating of such services. Transporters who have raised zero rated invoices from the effective date (3 April 2017) would be required to raise credit notes to reverse the original invoices and reissue new invoices showing the exempt status of such services. Such transporters will also be required to consider the partial apportionment rules for purposes of determining their deductible input tax.

Clean cook stoves now defined

An amendment to paragraph 66 of the First Schedule under the VAT law to define “clean cook stoves”.

The measure

The Finance Act 2016 amended the First Schedule of the VAT law by exempting inputs for the manufacture of clean cook stoves under paragraph 66 of the First Schedule to the VAT law.

The Finance Act 2017 has now defined “clean cook stoves” to include *“clean and energy saving cook stoves with tariff number 7321, as well as their parts and raw materials that are either imported or sourced locally, provided that the stoves meet ISO/IWA 11:2012 standards of tier 2-4 for fuel efficiency, as determined by the Kenya Bureau of Standards”*

Who will be affected

Local manufacturers of clean cook stoves.

When

03 April 2017

Our view

This is a welcome amendment which will clear any ambiguity in the law on the meaning of “clean cook stoves”.

Withholding Value Added Tax

Changes to withholding VAT

The Finance Act 2017 has amended the provisions relating to withholding VAT in the Tax Procedures Act, 2015 (Section 42A).

The measure

The Finance Act has introduced four new subsections under Section 42A of the Tax Procedures Act, 2015 which provide as below:

01. Subsection 4A empowers the Commissioner to, at any time, exempt any supplier from the provisions of withholding VAT if such supplier sufficiently demonstrates that due to the nature of his business, and due to the application of the provisions of Section 42A, the person is going to be in a continuous credit position for a period of not less than 24 months;
02. Subsection 4B requires that VAT withheld be remitted to the Commissioner on or before the 20th day of the month following that in which the tax is withheld;
03. Under Subsection 4C, a withholding VAT agent commits an offence if he fails to:
    - Withhold the whole amount of the tax which should have been withheld; or
    - Remit the amount of withheld VAT to the Commissioner by the due date.
04. Under subsection 4D, a withholding VAT agent who commits an offence under subsection 4C is liable, upon conviction, to a penalty of 10% of the amount involved.

Who will be affected

Appointed Withholding VAT agents and suppliers to appointed agents.

When

1 January 2018

Our view

The move to exempt suppliers who are in a continuous credit position over an extended period of time comes as a reprieve and this will in a way assist in solving the cases of suppliers whose VAT credit position has significantly risen since the commencement of withholding VAT in 2014. Such suppliers now have an option to apply to the Commissioner for exemption of their supplies from withholding VAT.

The move to clarify on the due dates for remittance of withholding VAT again comes as a welcome move as, previously, the withholding VAT guidelines issued by the Kenya Revenue Authority required appointed agents to remit VAT withheld twice a month. However, appointed agents have largely been remitting VAT withheld by the 20th day of the month following that in which VAT was withheld. The new provision will help clear any ambiguity in this regard and enhance compliance.

The prescribed penalty for failure to withhold or remit withheld VAT will also clear uncertainties surrounding the applicable penalties in cases of such offences.

Customs and Excise

Amendments of the Miscellaneous Fees and Levies Act (MFLA)

The measure

The Finance Act, 2017 has amended Part A and B of the Second Schedule to the MFLA to introduce exemption of Import Declaration Fee (IDF) and Railway Development Levy (RDL) on goods imported for the construction of liquefied petroleum gas (LPG) storage facilities on approval by the Cabinet Secretary, Ministry of Energy and Petroleum.

Who will be affected

Investors in LPG storage facilities.

When

1 January 2017

Our view

The Government has in the recent past introduced various tax incentives to promote availability, penetration and consumption of LPG including inter alia, the recent introduction of VAT exemption on supplies procured for construction of LPG storage facilities.

This measure is geared towards promoting investment in LPG storage facilities in a bid to increase supply of LPG and encourage the use of clean energy.

Inflationary adjustment on specific excise duty rates

The measure

The Finance Act has amended the period within which specific excise duty rates will be adjusted for inflation from one year to two years

Who will be affected

Manufacturers, importers and consumers of all excisable goods with a specific excise duty rate.

When

1 January 2018

Our view

The Excise Duty Act 2015 previously empowered the Commissioner to adjust specific rates of excise duty annually to take into account inflation through a gazette notice. Section 10 of the Excise Duty Act has now been amended to increase the period to two years with a view to promoting stability in the prices of goods with a specific duty rates. As this change is expected to take effect from 1 January 2018, it is expected that the Commissioner may adjust the specific excise duty rates soon thereafter.

Pay As You Earn

Subtitle (Increase of personal relief and expansion of personal income tax bands)

The personal relief and personal income tax bands have been increased by 10%.

The measure

The Third Schedule of the Income Tax Act has now been amended such that a resident person with taxable income is now entitled to a personal relief of Kshs 1,408 per month (i.e. Kshs 16,896 per annum).

With respect to the personal income the new annual individual tax bands (including those of the wife's employment, professional and self-employment income) shall be:

Rate in each shilling

On the first Shs.147,580	10%
On the next Shs.139,043	15%
On the next Shs.139,043	20%
On the next Shs.139,043	25%
On all income over Shs.564,709	30%

Who will be affected

All individual taxpayers.

When

Effective date for the above amendment is 1 January 2018

Our view

This amendment is a welcome move that serves to make up for the delay in reviewing the PAYE bands for over 10 years that subjected individuals to increased cost of living without commensurate relief for their income. However, one would have expected a more significant expansion of the tax bands to sufficiently cushion individuals from the harsh economic reality given the ever increasing inflation rates.

The effect of the increase in the tax bands and personal relief will be felt more by the low income earners who will realise a higher percentage increase in their disposable income as compared to the high income earners.

Taxation of Surplus Pension withdrawals

Personal income tax bands on pension amounts in excess of the tax free amounts withdrawn from a registered pension/provident fund or the NSSF before the expiry of fifteen years from the date of joining the fund, have been increased.

The measure

S. 5d (ii) of the Third Schedule to the Income Tax Act has now been amended for the taxation of the surplus pension withdrawals by a resident individual from a registered fund or the National Social Security Fund in a year of income to reflect the new individual tax bands.

The new tax rates applicable on such withdrawals shall be:

Rate in each shilling

On the first Shs.147,580	10%
On the next Shs.139,043	15%
On the next Shs.139,043	20%
On the next Shs.139,043	25%
On all income over Shs.564,709	30%

Who will be affected

Residents making surplus withdrawals from locally registered pension funds or schemes including the NSSF before the expiry of fifteen years after joining the scheme.

When

Effective date for the above amendment is 1 January 2018

Our view

This measure will act as an incentive for residents to make more contributions to the locally registered pension schemes and individual retirement funds irrespective of the time frame for making withdrawals as the non-deductible portion of the contribution will be subjected to lower tax rates.

In addition, it is a welcome move for the pension contributors as they will experience a much needed relief on their pension withdrawals in view of the increased cost of living.

Tax Amnesty on Foreign Income

Section 37B of the Tax Procedures Act 2015 has now been amended to provide for additional time for tax residents qualifying for the tax amnesty as per Section 39 (b) of the Finance Act 2016 which was to be effective from 1 January 2017 to declare such incomes and submit the relevant tax returns on or before the 30th June 2018. The previous deadline provided for submitting the accounts and returns was 31st December 2017.

Further to the above, the Finance Act 2017 has provided new provisions to Section 37B of the Tax Procedures Act 2015 to act as guidelines for the taxpayers wishing to apply for the tax amnesty as outlined below.

The measure

S. 37B of the Tax Procedures Act 2015 has now been amended to include a third paragraph which requires that for the Commissioner to refrain from assessing or recovering taxes, penalties or interest in respect of any year of income ending on or before the 31st December 2016, the voluntarily declared funds under the amnesty should have been transferred back to Kenya.

In addition, the Finance Act 2017 now provides that the amnesty shall not apply in respect of any tax where the person who should have paid tax:

- has been assessed in respect of the tax or any matter relating to the tax; or
- is under audit or investigation in respect of the undisclosed income or any matter relating to the undisclosed income.

In addition, where no funds have been transferred within the period of the amnesty, there shall be a five year period for remittance but a penalty of 10% shall be levied on the remittance.

Who will be affected

Taxpayers wishing to declare their foreign incomes and seek amnesty on any tax liabilities on such incomes.

When

Effective date for the above amendment is 1 January 2017
Deadline for the Amnesty Application is 30 June 2018

Our view

It is a welcome move for Tax payers who meet the above requirements as they will be forgiven the principal taxes due and any penalties and interest that would have accrued on such foreign income. One area of concern is that the amnesty does not seem to differentiate between ill gotten gains transferred abroad and those that were legitimately transferred.

However, the hope that more tax residents will declare their earnings from various sources may be quashed in light of the fact that physical repatriation of assets is mandatory before the tax amnesty is granted and where no funds have been transferred within the period of the amnesty - i.e. during the five year period for remittance provided for- a penalty of 10% shall be levied on the remittance. This thwarts the efforts to provide a relief from the taxes, penalties or interest to be waived.
In view of the above, the uptake of the amnesty by tax residents is likely to be very poor. Furthermore non-residents may opt not to repatriate their assets and especially in situations where such assets have been created or are as a result of investments outside of Kenya.

While the incentive to offer amnesty may have been to entice more investment into Kenya, the principal objective should remain that of enhancing tax compliance i.e. getting taxpayers to report taxable incomes not previously declared and conformity with the income tax act rules going forward.

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