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NEWSFLASH KENYA

FINANCE BILL, 2021

Issue:
11 June 2021

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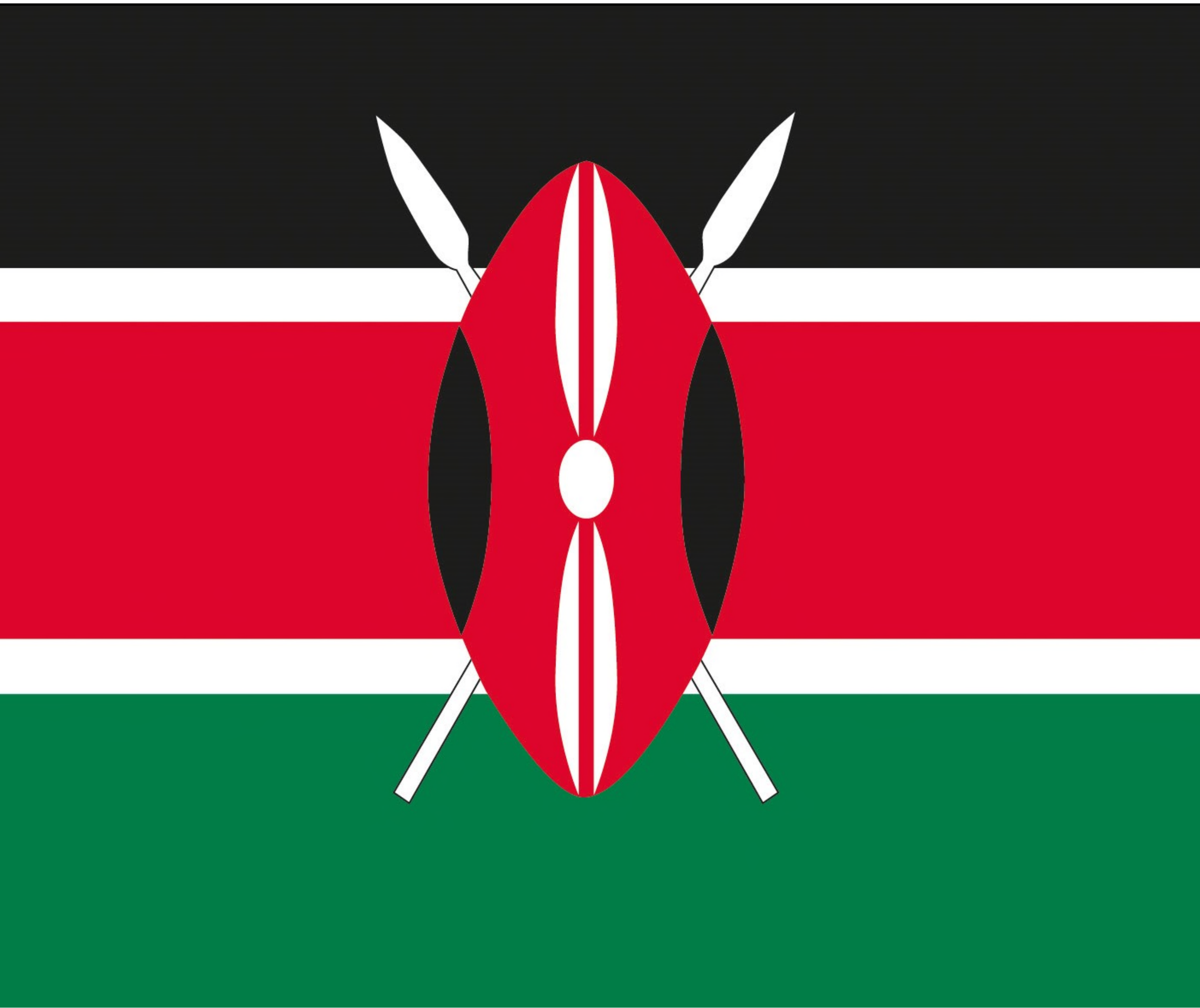

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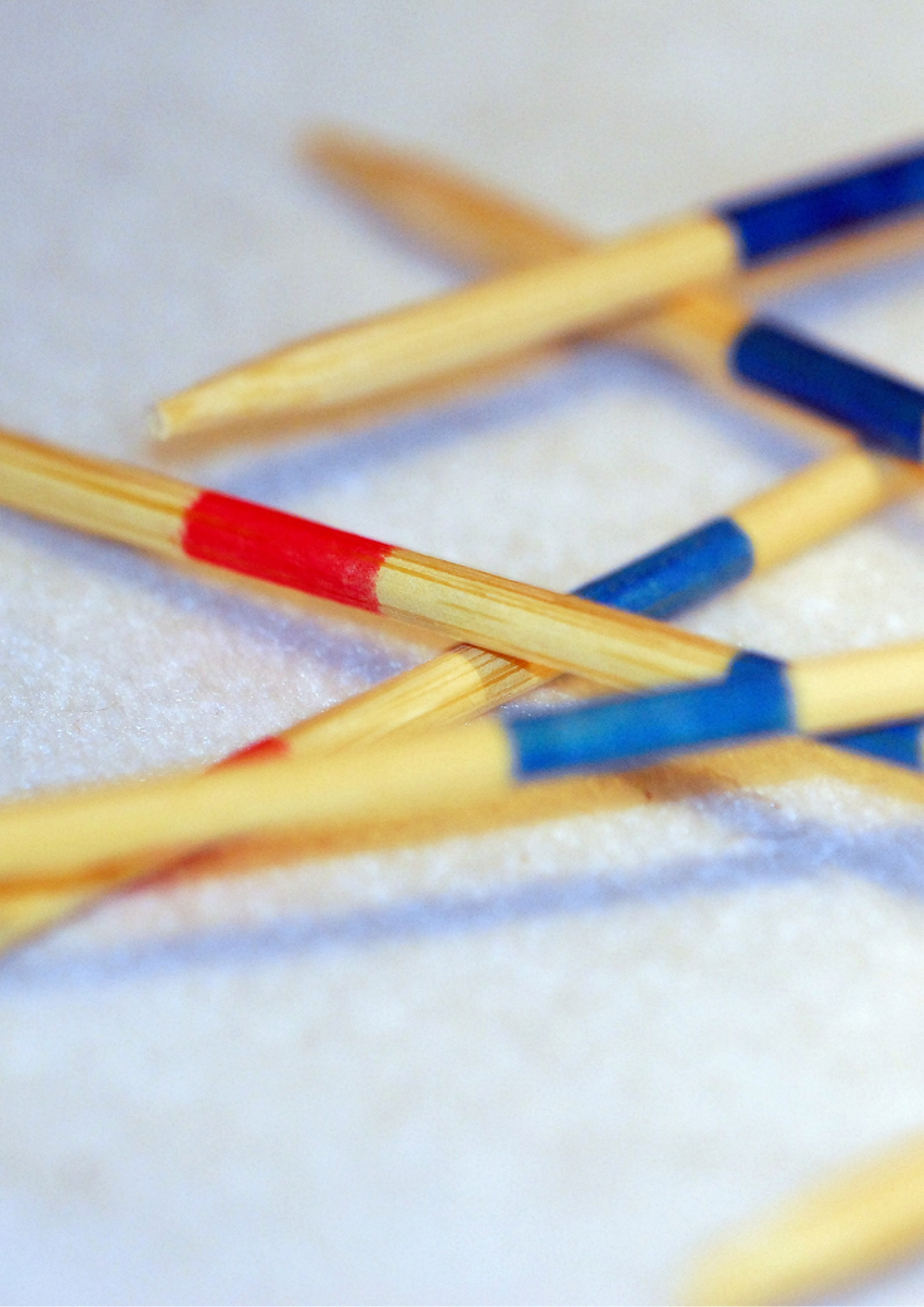


→ Background

The Finance Bill 2021 has been submitted to the National Assembly as set out under the Public Finance Management Act (PFM Act) and in readiness for assent by 30 June 2021. According to the PFM Act the National Assembly is allowed to make recommendations on the tax proposals consistent with the following principles:

a. the proposed changes on the composition of the tax revenue with reference to direct and indirect taxes;
b. domestic, regional and international tax trends; and
c. the taxation and other tariff arrangements and obligations that Kenya has ratified, including taxation and tariff arrangements under the East African Community Treaty.

In this issue we have discussed various proposals in the Finance Bill 2021 (The Bill).

→ Corporate tax change

Revision of thin capitalization rules

The Bill proposes to amend section 16(2) of the Income Tax Act (ITA). This Section prohibits foreign controlled entities from deducting interest in excess of the debt-to-equity ratio of 3:1. In its place, the Bill proposes to include a provision that prohibits the deduction of interest payable to third parties in excess of 30 percent of earnings before interest, tax, depreciation and amortization (EBITDA). The EBITDA amount should exclude income exempt from tax. This proposed new limitation rule shall also apply to contractors or licensees in the extractives sector.

Comment: This proposal raises the bar in discouraging use of interest deductions as a means of eroding taxable income. It is adopted from recommendations in Action 4 of the BEPS (Base Erosion and Profit Shifting) Action Plan that seek to limit base erosion via interest deductions and other financial payments from related party and third party debt.

Utilization of tax losses

The time cap limit for utilizing of tax losses within 10 years is set to be lifted under the Bill.

Comment: This has been necessitated by the introduction of minimum tax that seeks to collect revenue from loss-making entities, which are mostly (fixed) asset intensive.

Extension of apprenticeship rebate to students in TIVETs

The Bill proposes to extend tax rebates (which apply to employers) to include students from technical and vocational training institutions. If this proposal is passed the rebate is applicable when they are hired as apprentices.

Comment: The tax rebate was gazette at a rate of 50 percent of the amount of salaries and wages paid to at least ten apprentices. It will be important for Legal Notice No. 97 of 2016 to be replaced by a piece that includes TIVET students.

New definitions

The Bill seeks to define the following terms:

- *“infrastructure bond”* means a bond issued by the Government for the financing of a strategic public infrastructure facility including a road, hospital, port, sporting facility, water and sewerage system, or a communication network;

- “civil works” include
  1. roads and parking areas;
  2. railway lines and related structures;
  3. water, industrial effluent and sewerage works;
  4. communications and electrical posts and
  5. pylons and other electrical supply works;
  6. security walls and fencing.

- *“digital marketplace”* means an online platform which enables users to sell or provide services, goods or other property to other users.

Comment: These definitions all seek to provide clarity and scope in their respective provisions under the ITA.

Digital service tax updates

The Bill seeks to expand and clarify the scope of digital services tax (DST) to cover the different pillars of the digital economy. For instance it will affirm that all businesses carried over an electronic network and the internet qualify as digital services.

In addition, DST is recommended to only apply to non-resident providers of digital services, and will be due on or before the 20th day of the month following that which the digital service was offered. Finally, DST will be excluded from services whose payments are subject to withholding tax, and those in the business of transmitting messages by cable, radio, optical fibre, television broadcasting, VSAT, internet, satellite or by any other similar method of communication.

Comment: These recommendations are consistent with the guidelines under Action 1 of the BEPS Action Plans that require set up of a new nexus focusing on non-resident enterprises with significant economic presence delivered via technology and other automated tools.

Thereafter the Bill has opted for an equalization levy on the non-residents as opposed to a withholding tax in order to ensure equal treatment of foreign and domestic suppliers. It is noteworthy that all resident digital service players will be exempted from DST but automatically be subjected to minimum tax.

Investment allowance updates

There is a proposal to switch the capital deduction rates from reducing balance basis to straight line basis.

The definition of manufacture in the context of power production has been widened to include other producer such as mini-grid producers, among others.

Comment: The application of straight line basis is a welcome move considering the great reduction in capital allowance rates last year. It's also good news for various investors in the renewables sector who were missed out in last year's overhaul of the capital allowance regime.

→ Changes in employment taxes

Insurance relief to apply on NHIF contributions

The Bill has a proposal to extend the insurance relief of 15 percent to contributions made to the National Hospital Insurance Fund (NHIF).

Comment: This move will encourage increased contributions especially from individuals who are unable to afford private medical schemes.

→ Withholding tax changes

The main changes here focus on the extractive sector:

- Service fees in respect of mining and petroleum operations to be increased to 10 percent from 5.625 percent
- Management, training and professional fees paid by persons in the extractives sector decreased from 10 percent to 12.5 percent.

→ Transfer Pricing changes

New definition of "Control"

The meaning of 'Control' has been expanded to include other elements such as procurement control, royalty ownership, guarantorship among others.

Comment: This new proposed definition of control embraces Action 2 of the BEPS Action Plan that seeks to curb creation of affiliated non-resident taxpayers and routing the income of a resident enterprise through the non-resident affiliates.

New definition of "Permanent Establishment"

The definition of 'Permanent Establishment (PE') is proposed to be amended to be line with international standards and to match recent tax treaties signed by Kenya.

Comment: The PE definition adopts the recommendations under Action 7 of the BEPS Action Plan that prevents the artificial avoidance of PE status including through the use of commissionaire arrangements. It also addresses profit attribution issues by excluding activities of a preparatory or auxiliary character.

Country-by-country reporting requirements

The Bill proposes the submission of a return by an ultimate parent entity of a multinational enterprise (MNE) group describing the group's financial activities in Kenya within 12 months after close of the group's financial year. The return shall include the group's aggregate information such as:

a. Amount of revenue, profit or loss before income tax
b. Income tax paid
c. Income tax accrued
d. Stated capital
e. Accumulated earnings
f. Number of employees
g. Tangible assets other than cash or cash equivalents

Comment: This is a global requirement under Action 13 of BEPS Action Plan that will provide governments with needed information on MNEs' global allocation of their economic activity and taxes paid among countries according to a common template.

Recognition of multilateral agreements and treaties

The Bill ultimately ushers in the admission of Kenya into the OECD's (Organization for Economic Cooperation and Development) Inclusive Framework (IF) through adoption of multilateral instruments (agreements and treaties).

This proposal complements the various recommendations adopted from the OECD's BEPS Action Plans that have characterized majority of the changes in this Finance Bill 2021.

Comment: This proposal will achieve Action 6 of the BEPS Action Plan that seeks to adopt model treaty provisions that prevent the granting of treaty benefits in inappropriate circumstances. The Inclusive Framework is a forum (under Action 15) that will also enable Kenya to be part of jurisdictions that will be able to provide an innovative approach to international tax matters reflecting the rapidly evolving nature of the global economy.

Exchange of information and common reporting standards

Finally, the Bill proposes the adoption of common reporting standards (CRSs) by Kenyan financial institutions. CRSs refers to reporting and due diligence standards prepared for the automatic exchange of financial account information.

Comment: This is in line with Action 12 of the BEPS Action Plan that seeks to design and put in place enhanced models of information sharing for international tax schemes between tax administrations.

→ VAT changes

Extension of reverse charge to VAT unregistered persons

The Bill reaffirms the reintroduction of reverse charge to unregistered persons that took effect back in the year 2019.

Comment: The clarifications ensure that VAT on imported services will apply to persons who make mixed supplies (taxable and exempt supplies) and exempt supplies only.

Restriction of input VAT on leasing or hiring of prohibited items

The Bill proposes to restrict input VAT on the leasing or hiring of the prohibited items under the VAT Act:

a. Passenger cars or mini buses
b. Entertainment, restaurant and accommodation services

Comment: The clarification here seeks to ensure that input VAT on leasing or hiring of passenger cars or mini buses remains prohibited unless the registered person is in the business of selling, hiring or dealing in passenger cars or mini buses.

Changes in VAT and excise duty status

Refer to table in appendix.

→ Other changes in tax laws

Tax Procedures Act: Inclusion of the Miscellaneous and Levies Act 2016

The Bill proposes to add the Miscellaneous Fees and Levies Act, 2016 as part of the taxes administered under the Tax Procedures Act, 2015 (“TPA”).

The Miscellaneous Fees and Levies Act, 2016 governs the imposition and collection of levies known as the export levy, Import Declaration Fees (IDF) and the Railway Development Levy (RDL).

Tax Procedures Act: Record keeping and document retention

The Bill proposes to amend the timeline for document retention from five to seven years. Where a proceeding commences before the seven years lapses, the document should be retained to the end of the proceedings.

This change implies that tax payers will have to retain documents for longer periods in case of KRA audits or assessments that may occur later after financial reporting. This will translate to an extended compliance burden for the tax payer.

Tax Procedures Act: Unit of currency to be used by non-residents

The Bill proposes to allow nonresident persons conducting a business in the digital market place to present their books of accounts in a convertible unit of currency as approved by the Commissioner. However, this will not apply to non-residents with permanent establishments or non-residents who files and pays taxes through a resident tax representative.

Tax Procedures Act: Allowable period for amendment of an assessment by the commissioner

The Bill proposes to change the timeline the commissioner is allowed to amend an assessed return from five years to seven years. The proposal will allow KRA more time to collect funds from the tax payer by increasing the window for tax assessments.

It will eventually cause a tax burden to the tax payer in the event that they are required to pay the Commissioner additional obligations raised from such assessments.

Tax Procedures Act: Abandonment of unrecoverable taxes

The Bill proposes to empower the commissioner by allowing him to abandon any unrecoverable taxes in the event that they have any other reason to do so.

The commissioner will also be expected to present a report to the Cabinet secretary on a semi-annual basis (on or before 30th June and 31st December) detailing the amount of abandoned taxes and the reasons for such waivers.

Tax Procedures Act: Provisions for exemptions of Withholding VAT

The Bill proposes to delete section 42A (4A) of the TPA which allows the commissioner to exempt a supplier from Withholding VAT if the supplier can demonstrate that he will be in continuous credit for a period not less than 24 months.

Tax payers who will be in a continuous VAT credit will not be able to enjoy exemption from Withholding VAT, however they can still apply to the commissioner and claim excess VAT credits as a result of Withholding VAT.

Tax Procedures Act: Offset of refunds

The Bill proposes to amend the TPA by stating that when a refund has been ascertained by the commissioner, and the refund is applied to the payment of an outstanding tax, then interest and penalties shall not accrue on the payment made on the outstanding tax.

However, if there is an outstanding tax after such an application the outstanding tax will accrue penalties and interests.

Tax Procedures Act: Due date for Submission of an objection notice

The Bill proposes to provide better clarity on the due date for submitting an objection notice electronically. When the due date of submission falls on a Saturday, Sunday or a public holiday the submission date will still hold.

Tax Procedures Act: Penalties for fraudulent refund claims and non-compliance with common reporting standard obligations

The Bill aims to quantify the penalty amount for making fraudulent claims and failing to report financial reports. The proposed penalties are;

1. KShs 100,000 for each false or omitted statement or a jail term not exceeding 3 years.
2. Financial institutions that fail to file their return shall be liable to pay a penalty of KShs 1,000,000
3. Where no other penalty is prescribed, a penalty of KShs 20,000 will apply plus an additional KShs 20,000 for each day of non-compliance not exceeding 60days.

Tax Procedures Act: Failure of tax compliance in the Digital marketplace

The Bill proposes to empower the commissioner to seek the intervention of a relevant authority when someone providing a service over a digital market place fails to fulfill their tax obligations.

Tax Procedures Act: Civil and Criminal cases occurring concurrently

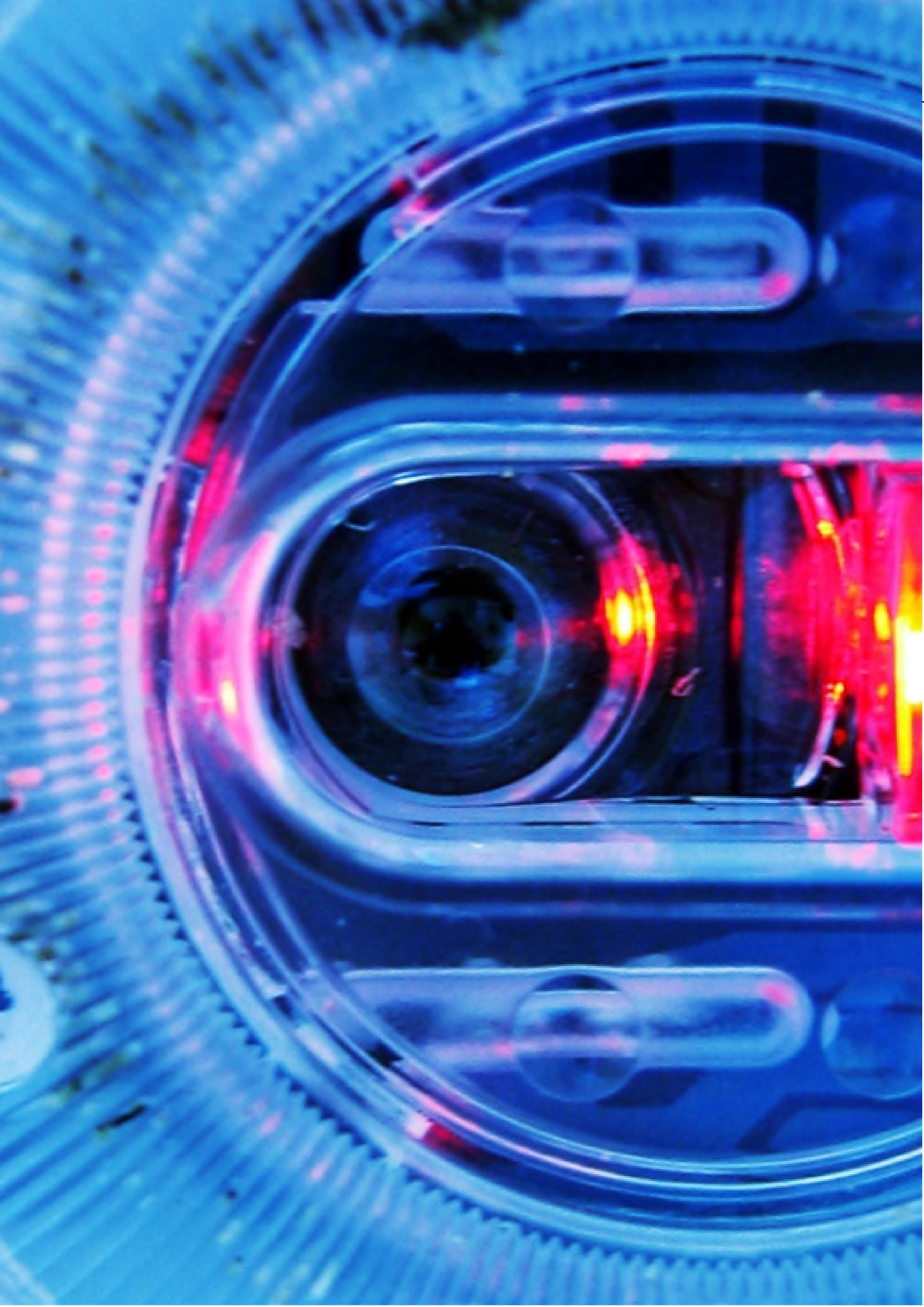
The Bill proposes to amend the TPA by inserting a new section that stipulates;

"Where any matter under a tax law is in issue in any ongoing criminal case and is also directly or substantially in issue in any pending civil case, that fact shall not be a ground for any stay, prohibition or delay of either the criminal or civil case."

This will allow for concurrent prosecution of civil and criminal cases of the same matter.

Tax Procedures Act: Transactions for which a PIN is required

The Bill will amend the First schedule to the TPA by adding selling of goods and services over a digital market place as a transaction that will require a PIN. This amendment will ensure suppliers operating within the digital market place comply with digital tax requirements.



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→ Appendix

VAT changes under the finance bill 2021

Tariff Number	Description	New rate	Old rate
3001.90.10	Heparin and its salts.	16 percent	Exempt
3001.90.90	Other human or animal substances prepared for therapeutic or prophylactic uses, not elsewhere specified or included.	16 percent	Exempt
3002.10.00	Antisera and other blood fractions and modified immunological products, whether or not obtained by means of biotechnological processes.	16 percent	Exempt
0402.99.10	Milk, specially prepared for infants.	16 percent	Exempt
0402.91.10	Other not containing added sugar or other sweetening matters specially prepared for infants.	16 percent	Exempt
0402.21.10	Other milk in powder, granules, or other solid forms, of a fat content, by weight, exceeding 1.5 percent.	16 percent	Exempt
2106.10.00	Protein concentrates and textured protein substances.	Exempt	16 percent
2106.90.10	Food preparations specially prepared for infants.	Exempt	16 percent
2106.90.99	Other - Food preparations not elsewhere specified or included.	Exempt	16 percent
2936.27.00	Vitamin C and its derivatives.	Exempt	16 percent
3001.90.00	Other - Heparin and its salts.	Exempt	16 percent
3001.90.00	Other - Other human or animal substances prepared for therapeutic or prophylactic uses, not elsewhere specified or included.	Exempt	16 percent
3002.11.00	Malaria diagnostic test kits.	Exempt	16 percent
3002.12.00	Antisera and other blood fractions.	Exempt	16 percent
3002.13.00	Immunological products unmixed, not put up in measured doses or in forms or packings for retail sale.	Exempt	16 percent
3002.14.00	Immunological products, mixed, not put up in measured doses or in forms or packings for retail sale.	Exempt	16 percent
3002.15.00	Immunological products put up in measured doses or in forms or packings for retail sale.	Exempt	16 percent

3002.19.00	Other - Antisera, other blood fractions and immunological products, whether or not modified or obtained by means of biotechnological processes.	Exempt	16 percent
3003.31.00	Insulin.	Exempt	16 percent
3004.43.00	Other medicaments, containing alkaloids or derivatives containing norephedrine or its salts.	Exempt	16 percent
3004.60.00	Other, containing antimalarial active principles.	Exempt	16 percent
2106.90.91	Food supplements.	Exempt	16 percent
0402.21.00	Milk in powder, granules or other solid forms, of a fat content, by weight, exceeding 1.5 percent, not containing added sugar or other sweetening matter.	Exempt	16 percent
0402.29.00	Other milk in powder granules or other solid forms, of a fat content, by weight, exceeding 1.5 percent.	Exempt	16 percent
0402.91.00	Other not containing added sugar or other sweetening matter.	Exempt	16 percent
0402.99.00	Other milk.	Exempt	16 percent
9021.10.00	Orthopaedic or fracture appliances.	Exempt	16 percent
9021.50.00	Other artificial parts of the body: Pacemakers for stimulating heart muscles, excluding parts and accessories.	Exempt	16 percent
9025.19.00	Hydrometers and similar floating instruments, thermometers, pyrometers, barometers, hygrometers and psychrometers, recording or not, and any combination of these instruments, thermometers and pyrometers, not combined with other instruments.	Exempt	16 percent
9019.20.00	Airway Guedel and Ambu bags.	Exempt	16 percent
9018.90.00	Blood giving set and infusion sets.	Exempt	16 percent
Par.112	Taxable goods, excluding motor vehicles, imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration by a company granted a prospecting or exploration license in accordance with the Energy Act, 2019, production sharing contracts in accordance with the Petroleum Act, 2019, or a mining license in accordance with the Mining Act, 2016, upon recommendation by the Cabinet Secretary responsible for matters relating to energy, the Cabinet Secretary responsible for matters relating to petroleum, or the Cabinet 553 Secretary responsible for matters relating to mining, as the case may be.	Exempt	16 percent

Par.113	Specialized equipment for the development and generation of solar and wind energy, including photovoltaic modules, direct current charge controllers, direct current inverters and deep cycle batteries that use or store solar power, upon recommendation to the Commissioner by the Cabinet Secretary responsible for matters relating to energy.	Exempt	16 percent
Par.114	Taxable goods supplied to persons that had an agreement or contract with the Government prior to 25th April 2020 and the agreement or contract provided for exemption from value added tax: Provided that this exemption shall apply to the unexpired period of the contract or agreement and upon recommendation by the Cabinet Secretary responsible for matters relating to energy	Exempt	16 percent
Par.115	Medical ventilators and the inputs for the manufacture of medical ventilators upon recommendation by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.116	Medical ventilators and the inputs for the manufacture of medical ventilators upon recommendation by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.117	Dexpanthenol of tariff number 3304.99.00 used for medical nappy rash treatment by licensed hospitals upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.118	Medicaments of tariff numbers 3003.41.00, 3003.42.00, 3003.43.00, 3003.49.00, 3003.60.00 (excluding goods of heading 30.02, 30.05 or 30.06) consisting of two or more constituents which have been mixed together for therapeutic or prophylactic uses	Exempt	16 percent
Par.119	Diagnostic or laboratory reagents, of tariff number 3822.00.00 on a backing, prepared diagnostic or laboratory reagents whether or not on a backing, other than those of heading 30.02 or 30.06, certified reference materials upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.120	Electro-diagnostic apparatus, of tariff numbers 9018.11.00, 9018.12.00, 9018.13.00, 9018.14.00, 9018.19.00, 9018.20.00, 9018.90.00 upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.121	Other instruments and appliances, of tariff number 9018.41.00, used in dental sciences, dental drill engines, whether or not combined on a single base with other dental equipment, upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent

Par.122	Other instruments and appliances, including surgical blades, of tariff number 9018.49.00, 9018.50.00 9018.90.00 used in dental sciences upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.123	Ozone therapy, oxygen therapy, aerosol therapy, artificial respiration or other therapeutic respiration apparatus upon approval by the Cabinet Secretary responsible for matters relating to health	Exempt	16 percent
Par.124	Other breathing appliances and gas masks, excluding protective masks having neither mechanical parts nor replaceable filters upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.125	Artificial teeth and dental fittings of tariff numbers 9021.21.00, 9021.29.00 and artificial parts of the body of tariff numbers 9021.31.00, 9021.39.00, 9021.50.00 and 9021.90.00 upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.126	Apparatus based on the use of x-rays, whether or not for medical, surgical or dental of tariff numbers 9022.12.00, 9022.13.00, 9022.14.00 and 555 9022.19.00 upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.127	Apparatus based on the use of alpha, beta or gamma radiations, whether or not for medical, surgical or dental of tariff numbers 9022.21.00, 9022.29.00, 9022.30.00 and 9022.90.00, upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.128	Discs, tapes, solid-state non-volatile storage devices, "smart cards" and other media for the recording of sound or of other phenomena, whether or not recorded, of tariff number 8523.80.10, including matrices and masters for the production of discs, but excluding products of Chapter 37; software upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.129	Weighing machinery of tariff number 8423.31.00, including weight operated counting or checking machines; weighing machine weights of all kinds upon approval by the Cabinet Secretary responsible for matters relating to health	Exempt	16 percent
Par.130	Fetal Doppler-Pocket (Wgd-002) Pc and pulse oximeter-finger held (Gima brand) Pc of tariff number 9018.19.00 upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent

Par.131	Sterilizer Dry Heat (Wgd-001-Grx-05A) Pc, autoclave steam table tops of tariff number 8419.20.00 upon approval by the Cabinet Secretary responsible for matters relating to health.	Exempt	16 percent
Par.132	Needle holders and urine bags, of tariff heading 3926	Exempt	16 percent
Par.133	Tourniquets of tariff number 3926.90.99 for use by licensed hospitals upon approval by the Cabinet Secretary responsible for matters relating 556. (b) in Part II, by adding the following new paragraphs immediately after paragraph 31	Exempt	16 percent
13A	The supply of ordinary bread.	16 percent	0 percent
32	The exportation of taxable services	Exempt	0 percent
33	The transfer of assets and other transactions related to the transfer of assets into real estate investment trusts and asset-backed securities.	Exempt	16 percent
13A	The supply of ordinary bread.	16 percent	0 percent
32	The exportation of taxable services	Exempt	0 percent
33	The transfer of assets and other transactions related to the transfer of assets into real estate investment trusts and asset-backed securities.	Exempt	16 percent

Excise duty changes under the Finance Bill 2021

Description	Old rate	Proposed rate
Sugar confectionary of tariff heading 17.04 (other than imported)	Shs. 20 per kg	0
White chocolate, chocolate in blocs, slabs or bars of tariff Nos. 1806.31.00, 1806.32.00 and 1806.90.00 (other than imported)	Shs. 200 per kg	0
Motorcycles of tariff 87.11 other than motorcycle ambulances and locally assembled motor cycles	11,608.23 per unit	15 percent
Jewellery of tariff heading 7113 and imported jewellery of tariff heading 7117	0	10 percent
Products containing 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	0	Shs. 5,000 per kg
4A. Excise duty on betting	0	20 percent of the amount wagered or staked