# Tax Alert

Issue No. 1 of 2019

The Finance Act, No. 10 of 2018 (The Act) which was assented on 21 September 2018 amended various tax laws as highlighted in our **2018 Budget Book** and **Tax Alert Issue No. 5 2018**.

Whereas most of the amendments became effective on 1 July 2018, there are a number of amendments which became effective on 1 January 2019.

This alert highlights amendments which became effective on 1 January 2019 and the recent developments with respect to Value Added Tax Auto Assessment ("VAA") among other important developments.

## Amendments effective 1 January 2019

### Presumptive Tax

This tax replaces the turnover tax regime and the tax paid will be considered as final tax. The tax is equivalent to 15% of the single business permit fees levied by County Governments. The tax is for resident persons whose business turnover does not exceed KShs 5 million during a year of income and provided that those persons are issued with a single business permit by the County Governments or are liable to be issued with a business permit.

Presumptive tax is not applicable to incomes derived from: management and professional services; rental business; and incorporated companies.

The regime is geared towards expanding the tax base and collecting information in relation to the informal sector.

### Manufacturers to enjoy additional deduction on electricity costs

Manufacturers can now claim an additional deductible expenditure equivalent to 30% of their electricity costs. This is in addition to the normal deductible electricity expense. This incentive will be applicable from the 2019 year of income.

This plays into the Big Four Agenda and is aimed at making the manufacturing sector attractive for investors. However, there is a proviso to this incentive that requires the manufacturer to meet certain conditions set by the Ministry of Energy before enjoying it. Unfortunately, the conditions have not been gazetted.

### Special tax rates for special projects

Companies engaging with the Government under special operating framework arrangements shall enjoy special corporation tax rates agreed under such arrangements. This is a wide and ambiguous provision granting customized tax rates for companies opting for this route.

Whereas the provision is viewed as an attempt to promote partnerships between the government and private companies, it might be ambiguous in the absence of proper guidelines governing it. It is therefore imperative for the government to issue guidelines in order to avoid confusion on this incentive.

## Dividend Distribution Tax

Companies will no longer be required to maintain a Dividend Tax Account ("DTA") for compensating tax purposes as was the case previously. Compensating tax was payable on distribution of untaxed gains in the form of dividends and was monitored through the Dividend Tax Account.

With effect from 1 January 2019, distribution of dividends from untaxed gains/profits will attract 30% distribution tax with an exception of registered Collective Investment Schemes. Whereas the intention is to increase tax collections, the amendment conflicts with the other Income Tax Act provisions e.g.

- will distributions realised from gains on sale of property subject to Capital Gains Tax ("CGT") at 5%, which is a final tax, be further subjected to the distribution tax? **PKF's view is that CGT paid constitutes Income Tax paid in accordance with Section 3 of the Income Tax Act ("ITA"). CGT is final tax and any dividend distributions made upon transfer of property subjected to CGT should not be subject to 30% distribution tax since these dividend distributions would be made out of taxed profits.**

- is there further distribution tax on dividends distributed to shareholders despite the fact that withholding tax applicable on qualifying dividends is final tax and certain categories of dividends are tax exempt? **PKF's view is that any dividend distributions further up to holding company's shareholders that have already been subjected to withholding tax, which is final tax on qualifying dividends, should not be subjected to the 30% distributions tax since the withholding tax paid would mean that the profits in the shareholding company are already tax paid. In the case of resident companies holding more than 12.5% of other resident companies, dividend distributions to the shareholding company would be tax exempt. PKF's interpretation in this case is that, since the dividends paid by the subsidiary Kenyan company would either be paid out of taxed profits or would have suffered distribution tax anyway there should be no further distribution tax on onward distribution of the dividends by the shareholding company to its shareholders as these would be taxed profits in the shareholding company anyway.**

- and what are the modalities of remitting the distribution tax? **iTax has to be configured to allow for remittance of the 30% distribution tax.**

As a firm, we are engaging with the Kenya Revenue Authority ("KRA") seeking clarification on the aforementioned concerns and we shall communicate as soon as we receive KRA's response.

## National Housing Development Levy

The Cabinet Secretary ("CS") for Transport, Infrastructure, Housing, Urban Development and Public Works issued the much-awaited Housing Fund Regulations, 2018 vide Legal Notice No. 238 ("Regulations") on 18 December 2018.

Effective 1 January 2019, employers and employees are expected to contribute 1.5% (each) on monthly basic salary to the National Housing Development Fund ("Fund"). The total contributions i.e. the 1.5% by the employee and the matching 1.5% by the employer should not exceed KShs 5,000 per month.

The amendment required issuance of the Regulations by the CS responsible for housing to be effective. This provision was however challenged in the Employment and Labour Relations Court ("court") by the Central Organisation of Trade Unions ("COTU"). The court issued stay orders on 21 December 2018 against implementation of the contributions until the matter is heard and determined. The hearing was set for 21 January 2019.

Early in January 2019, the Federation of Kenya Employers ("FKE") challenged appointment of the Fund's advisory board at the Employment and Labour Relations Court and was successful in obtaining an injunction order restraining the CS from proceeding with the appointments of the advisory board members. The matter was expected to be heard on 24 January 2019.

The court orders are a reprieve to both employees and employers pending hearing and determination of the cases filed by COTU and FKE to the court. It is advisable to adhere to the orders and await the court's outcome before making the contributions. We will communicate as soon as the court's outcomes are published.

# Value Added Tax Auto Assessment

## Automated Verification of VAT Returns

KRA issued a public notice on 7 January 2019 affirming its plans to continue with verification of VAT Returns using its automated returns verification module on iTax platform for the period January 2018 to date. The public notice emphasised importance of ensuring entries captured by the VAT returns reflect true and correct VAT position. Our alert (Issue No 6 of 2018) provides more details on this subject matter.

The move is part of KRA's ongoing efforts to stem out input VAT claims from missing trader and fictitious invoices in the wake of taxpayers claiming dubious input VAT. KRA has been disallowing inconsistent invoices and granting taxpayers time to resolve the inconsistencies before raising assessments.

In summary, KRA's public notice of 7 January 2019 advises taxpayers to adhere to the following:

1. Purchase invoices used for input claims should be valid and the amount thereon be correctly claimed as provided under section 17 of VAT Act 2013.
2. Sales made to taxpayers registered for VAT are declared in the detailed format prescribed in the online VAT return.
3. Only sales to taxpayers not registered for VAT should be lumped in the last row of the 'Sales' section of the VAT return in the iTax system.
4. The invoice details are correctly captured including the Invoice Number, Date of Invoice, PIN of Purchaser or seller, and the amount of Invoice.

## Status of Tax Appeals Tribunal

It is worth noting that the Tax Appeals Tribunal ("TAT") has not been in operation since April 2018 due to expiry of TAT members' terms. Since then there has been no appointment of TAT members by the Cabinet Secretary of the National Treasury as is required despite a recommendation for appointment almost being done immediately after expiry of the TAT members' terms. This has in turn increased the backlog of pending cases denying taxpayers access to justice.

We hope that the necessary appointments to TAT will be done in order to expedite resolution of tax disputes in the course of 2019.

## Extension of foreign income tax amnesty

The Finance Act, 2018 extended the foreign income tax amnesty filing deadline from 30 June 2018 to 30 June 2019. The income to be declared is for up to the year ending 31 December 2017.

The foreign tax amnesty will not apply to persons who have been assessed in relation to the tax or are under audit, investigation or is a party to ongoing litigation in respect of the undisclosed income or any matter relating to the undisclosed income.

## High Court Ruling on VAT treatment on Exported Services

The question of what constitutes an exported service is a highly litigated matter between KRA and taxpayers. The main issue is the fact that the taxpayer is expected to demonstrate that the services are used, enjoyed or consumed by a non-resident person in order for them to be categorised as exported services and hence zero rated for VAT purposes. The current provisions of VAT Act, 2013 do not define what use, enjoyment or consumption by a non-resident person involves and this lacuna is what crystallises into disputes with KRA.

The High Court delivered a judgment on 21 December 2018 dismissing an appeal filed by the Commissioner of Domestic Taxes ("CDT") on VAT treatment on exported services. The High Court held that the suitable test for qualification as an exported service is not where services are provided or performed but rather where the services are to be finally used or consumed.

The CDT was appealing a ruling by the TAT, which held that no VAT was chargeable on the supply of cooling, palletising and scanning services for horticultural products for export to Netherlands. CDT's argument was that these services were performed and consumed in Kenya by the farmers whose horticultural products were exported. However, the taxpayer argued that despite these services being provided in Kenya, the ultimate buyer of the horticultural products was the consumer of the services. These services are integral in ensuring the exported horticultural products reached foreign markets in a good and ready for sale state. This is entirely to the benefit of the non-resident person hence they constitute exported services and should be zero rated for VAT purposes.

Despite CDT appealing this decision, it gives taxpayers and practitioners clarity and also affirms that it is important for KRA to embrace international best practice on the destination principle that the High Court also relied on.

right people
right size
right solutions

For more information or assistance with this matter or any tax advisory related matters contact us:

**Michael Mburugu**, Partner, mmburugu@ke.pkfea.com

**James Mulili**, Director, jmulili@ke.pkfea.com

**Joseph Mwavua**, Manager, jmwavua@ke.pkfea.com

Tel: +254 20 4270 000 +254 732 144 000