Highlights of Tax Measures in the Finance Act 2021

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The Finance Act, 2021 was assented to by the President on 29th June 2021 and subsequently gazetted by the Cabinet Secretary; National Treasury and Planning. Below are highlights of some of the tax measures effected through the Act:

AMENDMENTS TO THE INCOME TAX ACT

Definition of "Control" reintroduced and expanded (Effective 1 July 2021)

The Act has re-introduced the definition of control and broadened the scope. Control now includes instances where a person:

a) Has direct or indirect ownership of at least 20% of the voting rights in a company;
b) Has advanced a loan to another person that constitutes at least 70% of the book value of the borrower's total assets, save for a loan from an unrelated financial institution.
c) Whose guarantee or any form of indebtedness constitutes at least 70% of the total indebtedness of the other person save for a guarantee by an unrelated financial institution;
d) Has the power to appoint more than half of the board of directors or at least one director or executive member of the governing board;
e) Owns or has exclusive rights over intellectual property on which another person wholly depends for the manufacture or processing of goods or articles or business;
f) A person or their assignee supplies at least 90% of the purchases of the other person or, in the opinion of the Commissioner, influences the pricing or other conditions relating to such supply;
g) A person or their assignee purchases at least 90% of the sales of another or, in the opinion of the Commissioner, influences pricing or conditions related to the sales; and
h) Deals or relates with another in a way which the commissioner deems to constitute control.

This has transfer pricing implications.

Definition of "infrastructure bond" (Effective 1 July 2021)

To provide clarity for tax purposes, infrastructure bond has been defined as 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 systems or a communication network.

The aim is to limit the meaning to those bonds issued by Government only. Bonds issued by private sector will therefore not qualify as infrastructure bonds for tax purposes

Definition of "Digital Market Place" (Effective 1 July 2021)

Section 3 (2) of the Act provides that income accruing from a business carried out over the internet or an electronic network including through a digital marketplace is subject to tax.

The definition of a digital marketplace has been amended to mean an online platform which enables users to sell or provide services, goods or other property to users.

This provides more clarity on income accruing through digital economy that is now subject to tax.

Minimum Tax Provisions (Effective 1 July 2021)

The Act has added more exclusions from minimum tax. The following are now exempt:

a) business whose retail price is controlled by the Government;
b) insurance business;
c) manufacturing business where cumulative investment in the preceding four years from the date of assent is at least ten billion shillings;
d) taxpayers licensed under the Special Economic Zones Act, 2015;
e) distribution business whose income is wholly based on a commission

Minimum tax is, however, on hold pending the outcome of an on-going court case.

Digital Service Tax (DST) (Effective 1 July 2021)

Digital Service Tax will be applicable to income of non-resident persons only and shall not apply to:

a) non-resident income arising from the business of transmitting messages by cable, radio, optical fibre, television broadcasting, Very Small Aperture Terminal (VSAT), internet, satellite or by any other similar method of communication chargeable under section 9(2); and
b) income subject to withholding tax under section 35 of the Income Tax Act.

A person subject to digital service tax shall submit a return and pay the tax due on or before the 20th day of the following month.

Removal of limitation on carrying forward tax losses (Effective 1 July 2021)

The provision limiting the period for carrying forward of tax losses to 10 years has been removed.

Modification of interest restriction rule (Effective 1 January 2022)

The Act repeals the current provision of debt to equity ratio and replaces it with earnings before interest ratio (EBITDA). Gross interest paid or payable to related persons and third parties in excess of thirty per cent of earnings before interest, taxes, depreciation and amortization of the borrower in any financial year shall be disallowed for tax purposes. Any income which is exempt from tax shall be excluded from the calculation of earnings before interest, taxes, depreciation and amortization;

This provision shall apply to:

i) interest on all loans;
ii) payments that are economically equivalent to interest; and
iii) expenses incurred in connection with raising the finance.

It, however, shall not apply to financial institutions licenced under the Banking Act and micro and small enterprises licenced under the Micro and Small Enterprises Act, 2012.

Country by Country Reporting for Multinational Enterprises (MNE's) (Effective 1 January 2022)

The Act introduces Country by Country Reporting (CbCR) for multinational enterprise group.

It provides that an ultimate parent entity of a multinational enterprise group shall submit to the Commissioner a return describing the group's financial activities in Kenya, where its gross turnover exceeds the prescribed threshold, and in all other jurisdictions where the group has taxable presence, not later than twelve months after the last day of the reporting financial year of the group.

The return submitted shall contain the group's aggregate information including information relating to the amount of revenue, profit or loss before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees and tangible assets other than cash or cash equivalents with regard to each jurisdiction in which the group operates.

This enables the commissioner to assess transfer pricing risks and income tax base erosion.

NHIF Contributions eligible for Insurance Relief (Effective 1 January 2022)

Premiums paid to the National Health Insurance Fund (NHIF) are now eligible for insurance relief. The relief is currently 15% of premiums paid; not exceeding Ksh. 60,000 per annum.

Set-off Rebate extended to TVET Apprenticeship (Effective 1 January 2022)

Any employer who engages at least ten university graduates for a period of 6 to 12 months during any year of income is eligible for a tax rebate in the following year. This rebate has been extended to employers who engage graduates from Technical and Vocational Education and Training (TVET) institutions.

Special Arrangements for relief from double taxation (Effective 1 July 2021)

In recognition of the fact that beneficial owners can either be legal or natural persons, Sec 41(5) of the Income Tax has been amended to read; "Subject to subsection (6), where an arrangement made under this section provides that income derived from Kenya is exempt or excluded from tax, or the application of the arrangement results in a reduction in the rate of Kenyan tax, the benefit of that exemption, exclusion, or reduction shall not be available to a person who, for the purposes of the arrangement, is a resident of the other contracting state if fifty per cent or more of the underlying ownership of that person is held by a person or persons who are not residents of that other contracting state for the purposes of the agreement".

Exemptions for Registered trusts and family trusts (Effective 1 July 2021)

The act has introduced various exemptions relating to the income of registered trusts and family trusts as follows:

a) Certain income of registered trust

   Withholding tax at a rate of 25% will apply on amounts paid out to a beneficiary of a registered trust excluding:
   i) any amount that is paid out of the trust income on behalf of any beneficiary and is used exclusively for education, medical treatment or early adulthood housing;
   ii) income paid to any beneficiary which is collectively below 10 million shillings in the year of income; and
   iii) such other amount as the Commissioner may prescribe from time to time.

b) Transfer of property to registered family trust

   The act has exempted from capital gains the following:
   i) Transfer of immovable property to a family trust
   ii) Transfer of property, including invest¬ment shares, which is transferred or sold for the purpose of transferring the title or the proceeds into a registered family trust.

c) Income of registered family trust

   Income or principal sum of a registered family trust is now exempt from tax. The income by the trust would be taxed on the respective beneficiaries once a distribution is made as noted above.

d) Stamp duty

   The Act has provided for exemption from stamp duty where there is a transfer by way of gift from a settlor to a registered family trust during the lifetime of the settlor.

Investment Allowances (Effective 1 January 2022)

The act has made the following amendments under the Second Schedule to the Income Tax Act which deals with Investment Allowances: –

a) Computation of investment allowance with be on straight line basis as opposed to the previous reducing balance method.
b) The scope of electricity generation and distribution of electricity qualifying for investment allowance has been expanded to any generation and distribution of electricity as opposed to limiting it to just electricity generated for supply and distribution through the national grid.
c) Civil works eligible for Investment Allowance include roads and parking areas; railway lines and related structures; water, industrial effluent and sewerage works; communications and electrical posts and pylons and other electrical supply works; and security walls and fencing.
d) Farm works now defined to include farmhouses, labour quarters, any other immovable building necessary for the proper operation of the farm, fences, dips, drains, water and electricity supply works and other works necessary for the proper operation of the farm
e) Investment deduction shall be 100% where:
   i) the cumulative investment value in the preceding three years outside Nairobi County and Mombasa County is at least two billion shillings. Provided that where the cumulative value of investment for the preceding three years of income was two billion shillings on or before the 25th April, 2020, and the applicable rate of investment deduction was 150%, that rate shall continue to apply for the investment made on or before the 25th April, 2020;
   ii) the investment value outside Nairobi County and Mombasa County in that year of income is at least two hundred and fifty million shillings;
   iii) the person has incurred investment in a special economic zone.

Changes for the Extractive Sector (Effective 1 January 2022)

a) The rates for claiming allowance on machinery used to undertake exploration or operations under a mining right have been aligned to the second schedule.

b) Withholding tax on payments made by licensees and contractors in mining or petroleum operations for service fees to non-residents sub-contractors will be at a rate of 10%. Same rate applies to management, training and professional fees. This provision is effective 1 July 2021.

c) The new interest restriction rules apply to a contractor or licensee in the sector as well.

AMENDMENTS TO THE VAT ACT

Supply of imported services (Effective 1 July 2021)

Both registered and non-registered persons are now required to account for VAT on imported services (reverse VAT).

Scope and definition of Digital Market place (Effective 1 July 2021)

The Act has been amended to provide more clarity that supplies carried out over the internet or an electronic network including through a digital marketplace are subject to VAT. The definition of the term "digital marketplace" is similar to that in the Income Tax Act.

Credit for input tax against output tax (Effective 1 July 2021)

Section 17(4) of the act is amended to extend the prohibition to claim input tax upon acquisition of vehicles for purposes other than those provided for in the section. Prohibition extends to cover cases where the vehicles are also leased or hired.

Exemptions (Effective 1 July 2021)

Various changes have been made to the First Schedule of the act. Some of these changes include:

a) Deletion of some exempt items to avoid duplication;
b) Clean-up to ensure correctness of tariff codes;
c) Exemptions of items related to the health sector; majority of which require approval of the cabinet secretary in charge of health;
d) Re-introduction of exempt items such as solar equipment, tractors and semi-trailers other than road tractors
e) The following have been added to the list of exempt services
    i) the exportation of taxable services. This were previously zero-rated.
    ii) the transfer of assets and other transactions related to the transfer of assets into real estate investment trust and asset-backed securities.

Zero-rated Supplies (Effective 1 July 2021)

The following have been added to the list of zero-rated supplies:

a) Transportation of goods originating from Kenya to a place outside Kenya;
b) Transportation of sugarcane from farms to milling factories;
c) The supply of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than ten percent in weight.

AMENDMENTS TO THE EXCISE DUTY ACT, 2015

Definition of possession (Effective 1 July 2021)

Possession has now been defined in the act to mean having, owning or controlling any excisable goods including:

a) having in one's possession any excisable goods;
b) knowingly having any excisable goods in the actual possession or custody of any other person;
c) having any excisable goods in any place, whether belonging to or occupied by oneself or not, for the use or benefit of oneself; or
d) having any excisable goods for the use or benefit of another person.

Provided that if there are two or more persons and any of them with the knowledge or consent of the others has any excisable goods in his custody or possession, such goods shall be deemed to be in the custody and possession of all of them.

Relief for excise duty on bulk data (Effective 1 July 2021)

Where excise duty has been paid in respect of internet data services by a licensed person who purchases the data in bulk for resale, the, excise duty paid shall be offset against the excise duty payable that person on internet data services supplied to the final consumer.

Imported glass bottles (Effective 1 July 2021)

Glass bottles imported from any of the countries within the within the East African Community (EAC) are now excluded from excise duty.

Imported sugar confectionaries and white chocolate (Effective 1 July 2021)

Rate of imported sugar confectionaries has been increased from Ksh. 20.99 to Ksh, 35 per Kg.

Locally manufactured white chocolate is now subject to excise tax at a rate of Ksh. 209.88 per Kg.

Imposition of excise duty on the following items (Effective 1 July 2021)

Jewellery	10%
Articles of plastics	10%
Imported pasta – cooked or uncooked	20%
Imported furniture of any kind	25%
Imported eggs	25%
Imported onions	25%
Imported potatoes, potato crisps and potato chips	25%
Excise duty on telephone and internet data services	Increased from 15% to 20%
Betting and gaming	7.5% of items wagered or staked
Prize competition and lottery	7.5% of amount paid or charged to participate on lottery ticket
Fees or commissions earned in respect of a loan	20%

Exemptions from excise duty (Effective 1 July 2021)

The following are now exempt from excise duty

a) Kerosene supplies to licensed or registered manufacturers of paint, resin or shoe polish.
b) Sale of ring back tunes by a mobile telecommunication service provider to a subscriber.

AMENDMENTS TO THE TAX PROCEDURES ACT, 2015

Use of convertible foreign currency by non-resident persons trading through a digital market place (Effective 1 July 2021)

This is meant to provide for use of a convertible foreign currency by non-resident persons trading through the digital marketplace who may have challenges keeping records in Kenya Shillings. The provisions do not apply to non-resident persons with tax representatives or non-resident persons with permanent establishments.

Removal of withholding VAT exemption for suppliers in continuous credit position (Effective 1 July 2021)

The act removes the exemption from withholding VAT that was accorded to supplier who were in a credit position for a period of not less than 24 months.

Offsetting of tax liabilities against verified refunds (Effective 1 January 2022)

The act introduces amendments for offset of refunds against any taxes due by from a taxpayer. Further interest or penalties shall not accrue on the amount applied to the payment of the outstanding tax from the date of the notification. Any outstanding tax after such application will continue to accrue interest and penalties in accordance with the Act.

Due date for electronic notice of objection clarified (Effective 1 July 2021)

Where a person submits a notice of objection or tax return in electronic form, the due date shall remain the date specified in the relevant tax law. The amendment enables the Commissioner to handle cases of electronic submission of tax objections which is currently not provided for.

Commissioner remedy to seek intervention of a relevant authority in the collection DST (Effective 1 July 2021)

The Commissioner can now seek the intervention of a relevant authority in the collection of tax where a person who provides services over the internet or an electronic network including through a digital marketplace has not fulfilled the person's tax obligations.

Transactions on which a PIN is required (Effective 1 July 2021)

Persons who trade through selling goods and services over a digital marketplace are now obligated to obtain the tax PINs of their customers.

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