

10th July 2020

Dear Esteemed Client,

REF: HLB CEZAM ANALYSIS OF THE FINANCE ACT, 2020

The Finance Bill, 2020 was passed by Parliament on 23rd June 2020 and assented into law by H.E. the President on 30th June, 2020. We provide in this letter, an analysis of the changes introduced by the Finance Act 2020 that have direct effects to your business;

AMENDMENTS TO THE INCOME TAX ACT CAP 470

1. Introduction of Minimum Tax – Section 12D

This is a new base income tax that has been introduced by the Act. The minimum tax is payable by all companies regardless of whether or not they make profit. The tax is charged at a **rate of 1 % of the gross turnover** payable in instalments and shall be due on the 20th day of each period ending on the fourth, sixth, ninth and twelfth month of the year of income. However, where the corporation tax (25%, 30% or 37.5% of the profits, as applicable) payable by a person is higher than the minimum tax, then the person shall pay the corporation tax and where the minimum tax is higher than the corporation tax, then the minimum tax shall be payable.

The minimum tax shall not apply to;

- Income that is exempt under the First Schedule of the Income Tax Act (ITA);
- Employment income chargeable under section 5 of the ITA ;
- Income subject to residential rental income tax chargeable under Section 6A of the ITA;
- Income subject to Turnover Tax under Section 12C of the ITA;
- Income subject to Capital Gains Tax under the Eight Schedule of the ITA;
- Income of extractive sectors taxable under the Ninth Schedule of the ITA.

The minimum tax intends to expand the tax base by incorporating companies that are in a loss making position and / or that have corporation tax liability below 1% of their gross turnover to a minimum tax. The new development borrows from provisions in other countries where companies that are in loss making position are subject to a minimum tax. The minimum tax is **effective from 1st January 2021**. What this implies to companies that are in a loss making position is that they are supposed to make the first quarterly instalment for the minimum tax by 20th April 2021.

www: czmkenya.com

Mercantile House, Koinange Street, 2nd Floor

P.O. Box 4979 00200 NAIROBI - KENYA

TEL: +254 (20) 2214180, 3342841/2 **FAX:** +254 (20) 3342277 **EMAIL:** cezam.info@czmkenya.com

HLB Cezam is an independent member of HLB, the global advisory and accounting network

2. Introduction of Digital Service Tax – Section 12E

The Act has introduced a Digital Service Tax (DST) which shall be payable by a person whose income from services is derived from or accrues in Kenya through a digital market place. Residents and non-residents with a permanent establishment will be entitled to offset the digital service tax paid against their income tax payable for that year of income. The **rate of tax is 1.5% of the gross transaction value** and shall be due at the time of transfer of the payment for the service to the service provider.

The new development intends to address the changing business models by ensuring equity, fairness and neutrality in taxation between traditional methods of doing business and transactions carried over digital platforms. The new tax is **effective from 1st January 2021**.

3. Residential Rental Income Tax – Section 6A

The Act has increased the upper threshold of Residential Rental Income. The upper threshold has been increased from Kshs 10 million to Ksh 15 Million per annum and the lower threshold has increased from Kshs 144,000 to 288,000 per annum in order to align with the current lower individual tax band.

The amendment provides an opportunity for more landlords to comply with the simplified regime which has minimal compliance costs. The changes are **effective from 1st January 2021**.

4. Deletion of Allowable Expenses – Section 15 (2)

The following items have been removed from the list of allowable deductions under section 15 (2):

- an entrance fee or annual subscription paid during that year of income to a trade association;
- expenditure of a capital nature incurred on legal costs and other incidental expenses relating to the authorization and issue of securities offered for purchase by the general public;
- expenditure of a capital nature incurred on legal costs and other incidental expenses, for the purposes of listing on securities exchange operating in Kenya, without raising additional capital;
- expenditure of a capital nature incurred in that year of income by a person on rating for the purposes of listing on any securities exchange operating in Kenya; and
- club subscriptions paid by an employer on behalf of an employee.

The deletions are meant to ensure that expenses not wholly and exclusively incurred in the production of income are not deductible for tax. Deletion of these allowable expenses implies that businesses' are expected to report more taxable income. The deletion is **effective from 1st January 2021**.

5. Elimination of Exemption on Bonus for Low Income Earners – First Schedule

The Tax Laws (Amendment) Act, 2020 expanded the first PAYE band from Ksh 147,580 p.a. (Ksh 12,398 p.m.) to Ksh 288,000 p.a. (Ksh 24,000 p.m.), subsequently, the Finance Act, 2020 has eliminated the exemption introduced by Finance Act, 2016 on income from employment paid in the form of bonuses, overtime and retirement benefits to employees whose taxable employment income before bonus and overtime allowances does not exceed the lowest tax band.

The amendment means that all bonuses, overtime allowances and retirement benefits including those payable to the low income tax earners, earning below Ksh 24,000/= p.m., are now taxable. The amendment is **effective from 30th June 2020**.

AMENDMENTS TO THE VALUE ADDED TAX (VAT) ACT, 2013

1. Additional Requirement for Claiming Input VAT – Section 17(2)

The Act has introduced a new procedure for claiming input VAT through a new provision, whereby a taxpayer will not be allowed to claim input VAT, where the registered supplier has not declared the respective sales in their VAT return and filed the same via the iTax system.

KRA has been issuing VAT Auto Assessments (VAA) through the iTax system for the past two years. The VAA is a compliance check by the iTax system which identifies inconsistency between the input VAT claimed by a taxpayer and the output VAT declared by a seller. The inconsistencies are referred to the buyer and supplier for reconciliation. In cases where the inconsistencies are not reconciled and the relevant returns amended, KRA disallows the input VAT and issues assessments to the buyers.

The amendment seeks to bring to an end the inconveniences that have been caused to buyers by the VAA by ensuring that input VAT claimable by a buyer is only that which has already been declared as output VAT by the seller. Implementing the changes in the initial periods shall be marred by challenges and will require more administrative efforts from the buyers' side since most sellers have been lumping sales in the section provided for "Sales to Customers not registered for VAT". The additional requirement is **effective from 30th June 2020**. This affects the filing of June's VAT return that is due on 20th July.

2. Zero-rated Supplies – Second Schedule

The following items have been deleted from the list of zero rated items under the VAT Act:

- Inputs or raw materials for electric accumulators and separators including lead battery separator rolls whether or not rectangular or square supplied to manufacturers of automotive and solar batteries in Kenya. **(Effective from 30th June 2020)**

- The supply of liquefied petroleum gas including propane. **(Effective from 1st July 2021)**

This means that the items above are now subjected to VAT at the prevailing rate.

AMENDMENTS TO THE TAX PROCEDURES ACT, 2015

1. Introduction of Voluntary Disclosure Programme (VDP) – Section 37D

The Act has introduced a Voluntary Tax Disclosure Programme for a period of three years. Under the VDP, persons disclosing tax liabilities that were previously undisclosed to KRA shall be granted immunity from prosecution and shall be granted penalty and interest waivers on tax arrears arising from inadvertent instances of non-compliance between 30th June 2015 and 1st July 2020 as follows;

- 100% remission of penalty and interest for applications made in 2021;
- 50% remission of penalty and interest for applications made in 2022; and
- 25% remission of penalty and interest for applications made in 2023.

Taxpayers who are under audit, investigation, party to ongoing tax liability litigation or have received notification of a proposed tax audit will not be eligible for the programme. Based on KRA's current capacity, they are not able to carry out tax audits on all taxpayers and the program will help to bridge this compliance gap. The programme is **effective from 1st January 2021 to 31st December 2023**.

2. Appointment of Digital Service Tax (DST) Agent – Section 42B

The Act has introduced a new provision to empower KRA to appoint an agent for the purposes of collection and remittance of the 1.5% digital service tax introduced under the Income Tax Act. This provision shall result in more tax administration efforts by persons operating digital market places and selling products on such platforms. The provision is **effective from 1st January 2021**.

This is a simplified version of the changes introduced by the Finance Act 2020; please do not hesitate to revert should you require any further clarification on the letter and / or the Act.

Yours faithfully,

For: HLB Cezam



Moses M Mwendwa

Director