



**LEGAL ALERT:  
CHANGES BROUGHT  
ABOUT BY THE  
FINANCE ACT, 2022**

July  
22



## Introduction

The Finance Act, 2022 (the “Act”) was assented to by the President a couple of weeks ago.

The Act introduces a raft of changes to tax and other laws some of which took effect on 1<sup>st</sup> July, 2022, while others will take effect on 1<sup>st</sup> January, 2023.

In this bulletin, we discuss these changes and highlight what they mean to all stakeholders:

### 1. INCOME TAX

#### a. Taxation of employee share ownership plans (“ESOPs”)

A share option is an offer made by an employer to an employee to purchase a fixed number of shares at a fixed price, which may be paid for at the end of the vesting period. A share option is considered a benefit taxable on the employee since they are normally used as an incentive for employees, guaranteeing the accrual of value should the employees’ efforts translate into the achievement of certain milestones.

The Income Tax Act (the “ITA”) previously provided that the taxable benefit was the difference between the market value per share and the offer price per share at the date of the option is granted by the employer. With effect from 1<sup>st</sup> July, 2022, the value of the benefit shall be the difference between the offer price per share at the date the option is granted by the employer and the market value per share on the date when the employee exercises the option. Further, the Act has changed the tax point to the date of exercising the option. This means that the benefit chargeable to tax would be deemed to have accrued to an employee and thus become due and payable at the date of exercising the option and not at the date of vesting as was set out under the ITA.

**Effective date: 1 July, 2022**

#### b. Thin capitalization rules

Realized foreign exchange losses are generally deductible for income tax purposes. However, where such loss is realized by a company which is thinly capitalized, the loss would be deferred (and therefore not deductible) until the company ceases to be thinly capitalized. A company is considered thinly capitalized where the gross interest paid or payable to related persons and third parties is in excess of 30% of the earnings before interest, taxes, depreciation and amortization (“EBITDA”). Thin capitalization rules do not apply to banks or financial institutions and micro and small enterprises registered under the Micro and Small Enterprises Act, 2012.

The Act has added that these rules will also not apply to microfinance institutions and non-deposit taking microfinance businesses under the Microfinance Act, 2006; entities licensed under the Hire Purchase Act; non-deposit taking institutions involved in lending and leasing business; holding companies that are regulated under the Capital Markets Act and companies engaged in manufacturing whose cumulative investment in the preceding five (5) years is at least KES 5B.

**Effective date: 1 July, 2022**

c. Taxation of financial derivatives introduced

With effect from 1<sup>st</sup> January, 2023, gains from financial derivatives accrued in or derived from Kenya will be taxable. A financial derivative is defined as “a financial instrument the value of which is linked to the value of another instrument underlying the transaction which is to be settled at a future date.” Where gains are earned by non-resident persons who have entered into a contract with resident persons, an obligation to withhold tax at a rate of 15% will arise.

It is important to note that gains arising from financial derivatives that are traded at the Nairobi Securities Exchange will be exempted. The Cabinet Secretary is expected to issue regulations regarding the taxation of such gains.

**Effective date: 1 January, 2023**

d. Digital service tax (“DST”)

The Act has clarified that DST will not apply to non-resident persons with permanent establishments (“PE”) in Kenya. The Finance Act, 2021, had clarified that DST would apply to non-resident persons and the exception of non-resident persons with a PE did not exist. A PE includes *inter alia* a fixed place of business through which business is wholly or partly carried on, an installation or structure used in the exploration for natural resources which exists for more than ninety (90) days and a dependent agent of a person who acts on their behalf in respect of any activities which that person undertakes in Kenya.

**Effective date: 1 July, 2022**

e. Taxation of charitable donations

Previously, any cash donation would only be considered a deductible expense in the donor’s books if: (i) made to a charitable organization registered or exempt from registration under the Societies Act or the Non- Governmental Organizations Co-ordination Act, 1990; (ii) the income of the donee is exempt from tax under the ITA. With effect from 1<sup>st</sup> July, 2022, any cash donation to any charitable organization, regardless of the law under which it is registered, will be considered a deductible expense as long as the income of the donee is exempt from tax. This provision is highly welcome especially for sponsors and donors of high value projects who are taxable in Kenya. Importantly, the donors should ensure that they comply with the Income Tax (Charitable Donations)

Regulations, 2007, which provide that a person who makes a claim for a donation to be allowed should provide proof of the donation to the Kenya Revenue Authority (the "KRA").

**Effective date: 1 July, 2022**

f. Capital gains tax ("CGT") rate increased

CGT is levied on the gain that accrues on the transfer of property situated in Kenya. The rate is currently 5% but with effect from 1<sup>st</sup> January, 2023, the rate will be 15%. There was a public outcry on the increase in the CGT rate when the Finance Bill, 2022, was subjected to public participation. It is reported that the National Treasury defied an earlier recommendation by the Finance and Planning Committee of the National Assembly that had set the rate at 10%.

**Effective date: 1 January, 2023**

g. Special operating framework agreements ("SOFA")

A company which is engaged in business under a SOFA with the Government shall be subject to the rate of tax specified in the SOFA.

**Effective date: 1 July, 2022**

h. Every resident taxpayer to qualify for insurance relief

Every person who pays a premium for an insurance made on the person's life or the life of the person's spouse or child will qualify for an insurance relief. The previous provisions of the ITA implied that only a male taxpayer considered tax resident in Kenya was entitled to the relief. The amount of insurance relief is 15% of the amount of premiums paid but should not exceed KES 60,000 annually. This relief will be enjoyed together with the relief on the NHIF contributions which was introduced earlier this year thereby giving taxpayers more reprieve.

**Effective date: 1 July, 2022**

i. Permanent home defined

One of the factors used to determine whether an individual is considered tax resident in Kenya is whether that individual had a permanent home in the year of income under consideration. The ITA did not define "*a permanent home*" and for the longest time, reliance has been had on case law. The Act has now defined it as "*a place where an individual resides or which is available to that individual for residential purposes in Kenya or where in the opinion of the Commissioner the individual's personal or economic interests are closest.*" In effect, any place available for an individual's accommodation will be considered a permanent home. This place does not necessarily have to be owned by that individual.

**Effective date: 1 July, 2022**

## 2. VALUE ADDED TAX (VAT)

### a. Services made over a digital marketplace

The Act has exempted persons supplying imported digital services over the internet or an electronic network or through a digital marketplace from VAT registration regardless of their turnover threshold being KES 5M.

In addition, reverse charge provisions will not apply to services over the internet or an electronic network or through a digital marketplace.

**Effective date: 1 July, 2022**

### b. Refund of overpaid VAT or VAT paid in error

The Tax Procedures Act, 2015, will govern VAT refunds as explained elsewhere in this alert.

**Effective date: 1 July, 2022**

### c. Exportation of taxable services

The exportation of taxable services was reclassified from a zero-rated supply to an exempt supply by the Finance Act, 2021. The Act has again deleted this supply from the list of exempt supplies meaning that any exportation of taxable services (with the exception of those in respect of business process outsourcing which will be zero rated) will be subject to VAT at a rate of 16%. This move has been faulted in many quarters due to its potential to increase the cost of taxable supplies in the service industry. The impact of the change is that suppliers will need to account for a 16% VAT charge on any exported services.

**Effective date: 1 July, 2022**

### d. VAT on various supplies

Item	Current rate	Previous rate
Liquefied petroleum gas	8%	16%
Inputs and raw materials used in the manufacture of passenger motor vehicles	Exempt	16%
Locally manufactured passenger motor vehicles	Exempt	16%
Fertilizers of chapter 31	0%	Exempt
Inputs or raw materials locally purchased or imported by manufacturers of fertilizer as approved from time to time by the Cabinet Secretary responsible for Agriculture	0%	16%

**Effective date: 1 July, 2022**

#### 4. EXCISE DUTY

a. Inflation adjustment

The Commissioner will have power to exempt specified products from inflation adjustment by notice in the *Gazette*. The approval of the Cabinet Secretary will, however, be required and the exemption will be granted after considering the circumstances prevailing in the economy at the time.

**Effective date: 1 January, 2023**

b. Excise duty on digital lenders introduced

Digital lenders will be required to pay excise duty at a rate of 20% with effect from 1<sup>st</sup> July, 2022. This tax change comes into force a few months after operationalization of the Central Bank of Kenya (Digital Credit Providers) Regulations, 2021, which require digital credit providers to apply for a licence. These laws are aimed at curbing the rise of unscrupulous digital lenders who have been accused of unethical and unscrupulous methods of recovering debt advanced to the members of the public.

**Effective date: 1 July, 2022**

c. Importation of cellular phones to be subject to excise duty

Importation of cellular phones shall attract excise duty at a rate of 10% of the excisable value.

**Effective date: 1 July, 2022**

d. Locally manufactured passenger motor vehicles exempt from excise duty

Motor vehicles for the transportation of passengers which are manufactured in Kenya and whose ex-factory value comprises at least 30% of local content will be exempt from excise duty. Local content means parts designed and manufactured in Kenya by an original equipment manufacturer operating in Kenya.

**Effective date: 1 July, 2022**

e. Excise duty rates on various items

Item	Current rate	Previous rate
Electronic cigarettes and other nicotine delivery devices	40%	KES 3,974.08 per unit
Cigars, cheroots, cigarillos, containing tobacco or tobacco substitutes	KES 15,296.6 per kg	KES 13,247.63 per kg
Cigarette with filters (hinge lid and soft cap)	KES 3,825.99 per mille	KES 3,312.96 per mille
Cosmetics and beauty products	15%	10%

**Effective date: 1 July, 2022**

## 5. TAX PROCEDURES

a. Input tax deduction

Input tax will, with effect from 1<sup>st</sup> July, 2022, be allowable for a deduction within six (6) months after the end of the tax period in which the supply or importation occurred.

**Effective date: 1 July, 2022**

b. Security for unpaid tax

Previously, the KRA had power to direct the Land Registrar to use the taxpayer's land or building as security for unpaid tax. The Act has expanded the scope of the assets that can be used as security for unpaid tax to include aircraft, ship, motor vehicle or any other property which the Commissioner may deem sufficient to serve as security for unpaid taxes. The effect is that once an asset has been used as security for unpaid taxes, the taxpayer will be restrained from disposing the said asset until the taxes are fully paid. In the event that the taxpayer does not pay the tax liability within two (2) months of being notified, the KRA may dispose of the property at the cost of the taxpayer to recover the taxes.

**Effective date: 1 July, 2022**

c. Agency notices

The Act requires that the KRA should only issue agency notices if a tax assessment has been confirmed through an objection decision and the taxpayer has not appealed against the objection decision to the Tax Appeals Tribunal within thirty (30) days. This change is highly welcome since there have been disputes in the past between the tax man and the taxpayers where the KRA has issued agency notices for taxes that have either not been confirmed or during the pendency of an appeal.

Further, the agency notices will need to be served on the tax payer at the same time they are served on the agent.

**Effective date: 1 July, 2022**

d. Exemption to withhold VAT

Registered manufacturers whose value of investment from 2012 is at least KES 3B will not be required to withhold VAT.

**Effective date: 1 July, 2022**

e. Offset or refund of overpaid tax or tax paid in error

It is now the case that where a taxpayer has overpaid tax or paid the taxes in error, an application can be made to the KRA to offset the overpaid tax against the taxpayer's future tax liabilities or to refund the overpaid tax. For all taxes, the refund should be within five (5) years with the exception of VAT which should be refunded within six (6) months. The KRA has ninety (90) days to make a determination for refund failing which the application shall be deemed to have been allowed.

**Effective date: 1 July, 2022**

f. Objection decision

The KRA will now be required to notify a taxpayer whether a notice of objection has been validly lodged within fourteen (14) days of receipt. Previously, the KRA was required to notify the taxpayer immediately which really is a question of fact open to construction and diverse interpretation. Further, the KRA has power to extend the period of filing a notice of objection if sufficient reasons are given but the KRA should likewise notify the taxpayer if the application for extension is allowed within fourteen (14) days.

**Effective date: 1 July, 2022**

g. KRA PIN will be mandatory for registration of a trust.

**Effective date: 1 July, 2022**

## 6. OTHER AMENDMENTS

a. Capital markets

The Capital Markets Act will have a broad spectrum of persons who can act as investment advisors. The advisors will not be limited to incorporated entities that have met the minimum share capital requirements but will include any legal entity as may be prescribed in the Capital Markets Regulations. Furthermore, any person (not necessarily a director) within the legal entity who satisfies the minimum licensing requirements will be approved to act as an investment advisor.

**Effective date: 1 July, 2022**

b. Unclaimed financial assets

The Act has established Voluntary Unclaimed Financial Assets Disclosure Programme which will run for a period of twelve (12) months from 1<sup>st</sup> July, 2022 for assets held up to 30<sup>th</sup> June, 2022. The purpose of the programme is to grant relief of the penalties and interest in unclaimed assets where the holder discloses, reports or delivers the assets to the Unclaimed Financial Assets Authority

**Effective date: 1 July, 2022**



Please do not hesitate to contact us in case of any questions.

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