LEGAL ALERT:

CHANGES BROUGHT ABOUT BY THE FINANCE ACT, 2023

July 23

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Introduction

The Finance Act, 2023 (the "**Act**") was assented to by the President a couple of days ago. It is important to highlight that the Finance Bill, 2023 (the "**Bill**") had proposed some changes which were, however, dropped during the parliamentary sessions.

The Act introduces immense changes to tax and other laws most of which take effect on 1 July, 2023. In light of the far-reaching effects of the Act, a petition (the "**Petition**") was filed in the High Court of Kenya at Nairobi to stop the implementation of certain provisions of the Act (the effective dates for those provisions are highlighted in green). A conservatory order was consequently issued on 30 June, 2023. The matter will be mentioned on 5 July, 2023.

In this bulletin, we discuss the changes introduced by the Act and highlight what they mean to taxpayers.

1. INCOME TAX

a. Introduction of digital asset tax at a rate of 3%

Under the Act, a digital asset is defined to include anything of value that is not tangible and cryptocurrencies. The Kenyan tax laws previously did not have a specific framework dealing with the taxation of digital assets including crypto currencies. With effect from 1 September, 2023, these assets will be subject to taxation at a rate of 3% of the transfer or exchange value of the digital asset. The tax will be deducted and remitted to the Kenya Revenue Authority (the "**KRA**") by the owner of the platform or by the person who facilitates the exchange of the asset. Important to note is that cryptocurrencies are not recognised by the Central Bank of Kenya ("**CBK**") as a legal tender and it will be interesting to observe if regulations will be enacted by the CBK to govern the dealings with such assets.

Effective date: 1 September, 2023

b. Turnover tax reverted to 3%

The Act has altered the scope of persons liable to payment of turnover tax. Previously, the scope was any resident person whose business turnover was between KES 1M and KES 50M. The upper limit has been reduced to KES 25M. The rate has reverted to the pre-covid rate of 3%. Accordingly, small business owners with annual turnovers between KES 1M and KES 25M will be required to remit this tax.

Effective date: 1 July, 2023

c. Withholding tax ("**WHT**")

i. <u>Digital content monetization</u>

In the information era, content creation has become a lucrative business. Whilst the obligation to pay taxes on income accrued in or derived from Kenya is not new, the Act has introduced the requirement to withhold tax on payments made to digital content creators at a rate of 5% and 20% for resident and non-resident creators respectively. This provision aligns with the other provisions of the Income Tax Act (the "**ITA**") to withhold tax and remit to the KRA. All WHT payments should be remitted to the KRA within five (5) working days.

Effective date: 1 July, 2023

ii. <u>Rental income</u>

The KRA has power to appoint agents to withhold tax on rental income. The applicable WHT rate for resident persons has been reduced from 10% to 7.5% on the gross rental receipts.

Effective date: 1 January, 2024

iii. <u>Submission of WHT</u>

Pursuant to the Act, WHT should be remitted within five (5) days. Businesses should take note of this provision when making payments subject to WHT and arrange their affairs accordingly to avoid penalties and interest on any unpaid taxes.

Effective date: 1 July, 2023

d. <u>Reimbursement of travel allowances to be excluded in computing employment gains</u>

Where an employee receives an amount as payment of travelling allowance to perform official duties, the standard mileage rate shall be deemed to be reimbursement of the amount expended and shall not be taken into account in the calculation of the employee's gains and profits. Of note is that the milage rate should be as approved by the Automobile Association of Kenya.

Effective date: 1 July, 2023

e. <u>Taxation of club entrance and subscription fees</u>

Club entrance and subscription fees which have been treated as allowable expenses in the books of the employer will be considered employment income and be subject to pay as you earn ("**PAYE**") in the hands of the employee. Further, for member clubs and trade associations, the gross receipts on revenue account (excluding joining fees, welfare contributions and subscriptions) shall be deemed to be income from a business and subject to taxation.

Effective date: 1 July, 2023

f. <u>Taxation of employee share ownership plans (“**ESOPs**”)</u>

i. <u>The value of the benefit</u>

With effect from 1st July, 2022, the value of the benefit for ESOPs was 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. The Act proposes to tax the difference between the *offer price per share at the date the option was exercised* by the employee and *the market value per share on the date when the employee exercises the option*. In essence, the prices that will be used in computing the benefit will be the values at the time the employee exercises the option.

Effective date: 1 July, 2023

ii. <u>Eligible start up</u>

The Act proposes to tax ESOPs for an eligible start up in such a way that when an employee is offered company shares in lieu of cash emoluments, the taxation of the benefit from the shares allocated shall be deferred and taxed within thirty days of the earlier of:

(a) the expiry of five (5) years from the end of the year of the award of the shares;

(b) the disposal of the shares by the employee; or

(c) the date the employee ceases to be an employee of the eligible start-up.

An eligible start-up company is defined as one that (a) has an annual turnover of not more than KES 100M; (b) does not carry on management, professional or training business; (c) has not been formed as a result of splitting or restructuring of an existing entity; and (d) has been in existence for a period of not more than five (5) years.

Effective date: 1 January, 2024

g. <u>Family trusts to pay taxes on trust income paid to beneficiaries</u>

The Trustee (Perpetual Succession) (Amendment) Act, 2021, and the Finance Act, 2021, brought about legal changes allowing for registration of family trusts. A family trust is a trust that is registered or incorporated by any person(s) for the purposes of planning or managing their personal estate. It is an invaluable vehicle to preserve family wealth for posterity owing to its numerous legal and tax advantages. Some of the tax benefits introduced by the Finance Act, 2021, were tax exemptions on the following items:

i. amount that is paid out of the trust income on behalf of any beneficiary and is used exclusively for the purpose of education, medical treatment or early adulthood housing; and

ii. income paid to any beneficiary which is collectively below KES 10M in the year of income.

The Act has deleted this provision meaning the above items will now be subject to taxation.

Effective date: 1 July, 2023

h. Expenditure not supported by eTIMS invoice to be disallowed

Generally, all expenditure wholly and exclusively incurred in the production of income is allowed as a deduction for tax purposes. However, specific expenditure outlined under section 16 of the ITA is not allowable. With effect from 1 January, 2024, any expenditure or loss where the invoices of the transactions are not generated from an electronic tax invoice management system ("**eTIMS**") will not be allowed for tax purposes. Similarly, for purposes of the VAT Act, effective 1 September, 2023, businesses shall be required to issue tax invoices through eTIMS and maintain a record of stocks. The KRA has been rolling out the eTIMS and onboarding persons for the better part of 2023 and it is critical that businesses liaise with their tax stations to understand the functionalities of the system.

Effective date: 1 January, 2024

i. Thin capitalization rules

   i. Local loans to be disregarded

   A company is considered thinly capitalized where the gross interest paid or payable to a non-resident person is in excess of 30% of the earnings before interest, taxes, depreciation and amortisation ("**EBITDA**"). In calculating the thin capitalization ratio, local loans would be taken into account. The Act has deleted this provision and effectively, only foreign loans will be taken into account when determining whether a company is thinly capitalized or not.

   Effective date: 1 January, 2024

   ii. Foreign exchange losses to be deferred and claimed within five (5) years

   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. The deferred forex losses will need to be claimed within five (5) years by a person who is considered thinly capitalized.

   Effective date: 1 July, 2023

j. Country by country reporting

An ultimate parent entity ("**UPE**") and a constituent entity that is resident in Kenya is required to file a country-by-country report with the KRA in accordance to the provisions of the Act. A UPE is defined as an entity that is not controlled by another entity and owns or controls, directly or indirectly, one or more constituent entities of a multinational enterprise group. The country-by-country report shall apply to a multinational enterprise group whose total consolidated group turnover is at least KES 95B during the financial year.

The Act specifies that the resident constituent entity shall only be required to file the country-by-country report if:

i. the UPE is not obligated to file the report in its jurisdiction of tax residence;
ii. the jurisdiction in which the UPE is resident has a current international tax agreement which Kenya is a party to but does not have a competent authority agreement with Kenya at the time of filing the report for the reporting financial year; or
iii. there has been a systemic failure of the jurisdiction of tax residence of the UPE that has been notified by the KRA to the constituent entity.

Effective date: 1 July, 2023

k. Taxation of post-retirement medical fund

The investment income from post-retirement medical funds will be exempt from tax regardless of whether the funds are part of retirement benefits schemes. A post medical insurance relief of 15% of the amount of the contribution paid or KES 60,000/- per year (whichever is the lower) will also be available to resident persons who contribute to such a fund.

Effective date: 1 January, 2024

l. Exemption of the income of charitable entities

The income of charitable entities i.e. institution, body of persons or irrevocable trust of a public character is exempt from tax. The Act seeks to clarify that "*institution, body of persons or irrevocable trust of a public character*" should be interpreted to mean an entity established to benefit the public in a transparent and accountable manner without restriction or discrimination regardless of the level of charges or fees levied for services rendered, and which utilises its assets or income exclusively to carry out the purpose for which the entity was established without conferring a private benefit to an individual. Charitable entities will need to align their activities and the provisions of their constitutive documents to ensure they do not fall foul of the requirements for income tax exemption.

Effective date: 1 July, 2023

m. <u>Extra tax burden on employment income</u>

From 1 July, 2023, all persons earning between KES 300,000/- to KES 800,000/- per month will be subject to the graduated PAYE rate of 32.5%. Any person earning employment income above KES 800,000/- will be subject to a rate of 35%. This is an increase from the previous 30% and will ultimately reduce the disposable income for persons in that income bracket particularly noting the introduction of the housing levy and increased NSSF rates.

The affordable housing levy (whose implementation has been challenged by the Petition) will be a monthly contributory levy payable at a rate of 1.5% of the employee's gross monthly salary. The Bill had initially proposed 3% but this was reduced by the Act. Conspicuously missing in the Act are the mechanisms for payment of the levy. For instance, it does not specify to whom the levy should be paid and whether employees would access the contributions upon retirement.

Assuming an employee earns KES 300,000/- per month, their net pay will be tabulated as follows:

Pay slip-June 2023	
Employee:	XXXX
Basic pay	300,000.00
DEDUCTIONS	
P.A.Y.E	81,804.35
N.H.I.F	1,700.00
N.S.S.F	1,080.00
Total Deductions	**84,584.35**
SUMMARY	
Gross pay	300,000.00
Less Deductions	84,584.35
Net pay	**215,415.65**

Pay slip-July 2023	
Employee:	XXXX
Basic pay	300,000.00
DEDUCTIONS	
P.A.Y.E	88,469.03
N.H.I.F	1,700.00
N.S.S.F	1,080.00
Housing Levy	4,500.00
Total Deductions	**95,749.03**
SUMMARY	
Gross pay	300,000.00
Less Deductions	95,749.03
Net pay	**204,250.98**

Effective date: 1 July, 2023

n. <u>Taxation of non-resident companies</u>

As is the case with tax resident companies, non-resident companies will be taxed at a rate of 30%. Currently, the applicable rate is 37.5%. Further, the non-resident companies will be required to pay tax on repatriated income at a rate of 15% using a formula prescribed by the Act. This tax shall be in addition to tax chargeable on any income that is deemed to be accrued in or derived from Kenya by the non-resident company.

Effective date: 1 January, 2024

o. Changes to the capital gains tax ("**CGT**") regime

i. Internal restructuring

The Act has amended the law to limit the CGT exemption to an internal restructuring which does not involve a transfer of property to a third party within a group which has existed for at least twenty-four months. In effect, for an internal restructuring which involves transfer of property within the group, the companies will need to have existed for more than two (2) years for such transfers to qualify for CGT exemption.

Effective date: 1 July, 2023

ii. Determination of the adjusted cost

Where property is transferred in a transaction that is not subject to CGT, and the property is subsequently transferred within a period of less than five (5) years, then the adjusted cost in the subsequent transfer shall be based on the original adjusted cost as determined in the first transfer. This provision will mean that the CGT payable on such a transfer will be higher than it would have been if the adjusted cost for the second transfer was considered particularly in light of the property appreciation rate within that period.

Effective date: 1 July, 2023

iii. Due date of payment of CGT

Previously, the due date for payment of CGT was upon transfer of property but not later than the 20th day of the subsequent month in which the transfer was made. The Act has outlined that CGT is payable on the earlier of receipt of the full purchase price by the vendor or registration of the transfer.

Effective date: 1 July, 2023

2. VALUE ADDED TAX ("VAT")

a. Rate of VAT for petroleum products increased from 8% to 16%

For the longest time, petroleum products were exempt from VAT. In 2018, VAT was introduced at a rate of 8%. This rate has been applicable until 30 June, 2023. The Act has increased the rate to 16% and this will apply from 1 July, 2023. It is expected that this will increase the general cost of living.

Effective date: 1 July, 2023

b. Exportation of taxable services reverted to zero rated supplies

The exportation of taxable services (with the exception of business process outsourcing) were reclassified from an exempt supply to a vatable supply by the

Finance Act, 2022. The Act has listed these services as zero rated which is a welcome move especially for players in the service industry. The impact of the change is that suppliers will claim input VAT on any exported services. This will effectively reduce the cost of exported services.

Effective date: 1 July, 2023

c. Insurance compensation to be subject to VAT at a rate of 16%

Where an owner of taxable supplies who has deducted input VAT receives compensation for loss of such supplies, the compensation will be treated as a taxable supply and VAT will need to be accounted for accordingly. This provision aligns with the principle of indemnity in insurance law as it will ensure that the insured only gets back the value of the taxable supply with no extra benefit from the input VAT claimed before the loss.

Effective date: 1 July, 2023

d. Refund of VAT

The time frame to make an application for refund of VAT in instances of bad and written off debts, for which VAT has been accounted and paid for, has been increased from four (4) years to ten (10) years. The debt must have remain unpaid for three (3) years. The impact of this amendment is that a person wishing to claim refund of VAT must do so between three (3) and ten (10) years from the date of the supply since no refund application will be entertained after ten (10) years. Where the debt is recovered, any VAT refunded should within sixty (60) days be paid to the KRA failing which interest at a rate of 2% per month will apply.

Effective date: 1 July, 2023

e. Supply of imported digital services

The turnover threshold for VAT registration is ordinarily KES 5M. However, a person who is in the business of supplying imported digital services over the internet, an electronic network or through a digital marketplace will be required to register for VAT despite not meeting the turnover threshold.

Effective date: 1 July, 2023

f. Record keeping can be made outside Kenya

The VAT Act previously required all persons to keep a full and true written record of every transaction they make and the records kept in Kenya for a period of five (5) years from the date of the last entry made therein. The Act has done away with the keeping of records in Kenya and therefore records can be kept outside Kenya.

Effective date: 1 July, 2023

g. Transfer of business as a going concern dropped

The Bill had proposed to make a transfer of a business as a going concern ("**TOGC**") exempt for tax purposes. This proposal, however, did not see the light of day and was deleted from the Act. For that reason, a TOGC will continue to be subject to VAT at a rate of 16%.

h. VAT on various supplies

Item	Current rate	Previous rate
Supply of maize (corn) flour, cassava flour and wheat flour	16%	Zero rated
Liquefied petroleum gas	0%	8%
Electric bicycles	0%	16%
Locally manufactured mobile phones	0%	16%

Effective date: 1 July, 2023

3. EXCISE DUTY

a. Inflation adjustment repealed

Previously, the KRA had power to adjust the specific rate of excise duty once every year or exempt specified products from inflation adjustment by notice in the Gazette with the approval of the Cabinet Secretary. This provision has been repealed. Accordingly, there will be certainty in the excise duty rates of the goods specified in the Excise Duty Act.

Effective date: 1 July, 2023

b. Offenses relating to excise stamps

The Act has introduced offences and penalties relating to excise stamps to the effect that any person convicted of those offences will be liable to a fine not exceeding KES 5M or imprisonment for a term not exceeding three years, or to both. The penalty prior to 1 July, 2023, was KES 2M or to imprisonment for a term not exceeding two years, or to both.

Effective date: 1 July, 2023

c. Payment of excise duty on alcoholic beverages betting and gaming

For alcoholic beverages, excise duty shall be payable to the KRA within 24 hours upon removal of the goods from the stockroom. For betting and gaming, offered through a platform or other medium, excise duty shall be remitted within 24 hours from midnight of that day. The KRA will also exercise its discretionary powers to, by notice in the Gazette, require taxpayers in any sector to remit excise duty collected on certain excisable services within 24 hours from midnight of that day.

Effective date: 1 July, 2023

d. Excise duty rates on various items

Item	Current rate	Previous rate
Imported sugar	KES 5 per kg	N/A
Imported fish	10%	N/A
Imported furniture	30%	25%
Imported cellular phones	15%	10%

Effective date: 1 July, 2023

e. Excise duty rates on services

Service	Current rate	Previous rate
Telephone and internet data services	15%	20%
Fees charged for money transfer services	15%	20% & 12%
Betting, gaming, price competition and lottery	12.5%	7.5%
Fees charged on advertisement on alcoholic beverages, betting, gaming, lotteries and prize competitions	20%	N/A

Effective date: 1 July, 2023

4. TAX PROCEDURES

a. Obligation of trustees to maintain and avail records upon request

Effective 1 July, 2023, a trustee resident in Kenya who administers a trust, whether registered in Kenya or not, shall maintain and avail to the KRA records required under a tax law, whether the income generated is subject to tax in Kenya or not.

Effective date: 1 July, 2023

b. Tax amnesty for taxes up to 31 December, 2022

A tax amnesty has been introduced on penalties or interest on tax debts where a person had paid all the principal tax due before the 31 December, 2022. Where all the principal tax debt had not been paid by that date, a person shall apply to the KRA for an amnesty of interest or penalties on the unpaid tax, and propose a payment plan for the outstanding amount. The amnesty shall only be granted once if a person applies for amnesty and pays all the outstanding principal taxes not later than 30 June, 2024, does not incur a further tax debt and signs a commitment letter for the settlement of all outstanding taxes. Any amount of principal tax as at 31 December, 2022, that will remain unpaid on the 30 June, 2024, will attract interest and penalties for which no amnesty shall be granted. The amnesty will not apply on any penalty relating to tax avoidance.

Effective date: 1 September, 2023

c. Agency notices

The scope for issuance of agency notices by the KRA has been expanded to include the following in addition to failure by the taxpayer to appeal against the objection decision within the prescribed period:

i. Where the taxpayer has defaulted in paying an instalment where the KRA has allowed an extension of time to pay due taxes in instalments;
ii. Where the KRA has raised an assessment and the taxpayer has not objected to or challenged the validity of the assessment;
iii. Where the taxpayer has made a self-assessment and submitted a return but has not paid the taxes due; and
iv. Where the taxpayer has not appealed against a decision of the Tribunal or court.

Effective date: 1 July, 2023

d. Withholding VAT to be paid within five (5) working days

Similar to withholding tax under the ITA, withholding VAT will need to be deducted and submitted to the KRA within five (5) working days. This provision applies to all appointed withholding VAT agents.

Effective date: 1 July, 2023

e. Refund of overpaid tax

It is 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 two (2) years instead of six (6) months as was previously the case.

Effective date: 1 July, 2023

f. Objection decision

The KRA is required to notify a taxpayer whether a notice of objection has been validly lodged within fourteen (14) days of receipt and request the taxpayer to submit the information specified in the notice within seven (7) days after the date of the notice. If the taxpayer fails to provide the information required within the specified period, the KRA may make an objection decision within sixty (60) days after the date on which the notice of objection was lodged.

Effective date: 1 July, 2023

g. Disputes out of the Tribunal to be settled within 120 days

Where a Court or the Tribunal permits parties to settle a dispute out of Court or the Tribunal, the settlement should be made within one hundred and twenty (120) days from the date the Court or the Tribunal permitted the settlement.

Effective date: 1 July, 2023

h. Submission of electronic documents

With effect from 1 September, 2023, it will be possible to submit documents to the KRA electronically. The Act provides that the KRA may establish a data management and reporting system for the submission of electronic documents including detailed transactional data relating to those documents.

Effective date: 1 September, 2023

5. OTHER AMENDMENTS

a. Export and investment promotion levy

A new levy to be known as the export and investment promotion levy shall apply on certain goods specified in the Miscellaneous Fees and Levies Act, 2016 (including Cement Clinkers of Tariff 2523.10.00) imported into the country for home use. The levy shall be paid by the importer of such goods at the time of entering the goods into the country. Goods originating from East African Community Partner States that meet the East African Community Rules of Origin will be exempt from the levy.

Effective date: 1 July, 2023

b. Retirement benefits
One of the requirements to register as an administrator is that the company should have at least sixty percent of its paid-up share capital owned by Kenyan citizens unless the applicant is a bank or an insurance company. The Act has reduced the threshold to 33% meaning such a company can have up to 66% of its paid-up share capital owned by non-Kenyan citizens.

Effective date: 1 July, 2023

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

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