ANCHINGA AND ASSOCIATES
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KENYA FINANCE ACT 2017/ 2018 UPDATE

The Finance Act 2017 was assented to by the President on 21st June 2017 after being passed by the National Assembly, with some amendments made to the Finance Bill 2017, which was tabled in the National Assembly by the CS (Cabinet Secretary) for the National Treasury in March 2017. This year, the budget was read two months early because Parliament had to be dissolved at least 60 days before the General Elections slated for August 8th 2017.

The Kenya Finance Bill is a proposed statute introduced every year in the National Assembly immediately after the presentation of the Budget Statement by the Treasury CS, to give effect to the financial proposals of the Government for its upcoming fiscal year. When the proposals are introduced to Parliament, it is called a Finance Bill. Once the Bill is passed by Parliament and assented to by the President, the Finance Bill becomes the Finance Act for that year and **made law.** It is through the Finance Act that amendments are made to the various Tax Acts like the Income Tax Act, VAT Act etc.

Some measures not initially included in the Finance Bill 2017l have now been added in the Act, while others have been removed.

Below are some of the amendments to the Income Tax Act ("ITA"), the Excise Duty Act 2015 ("Excise Act"), Value Added Tax 2013 ("VAT Act"), the Tax Procedures Act 2015 ("TPA") & various other Acts, the dates they become effective and our views.

<table>
<tr><th colspan="3">INCOME TAX ACT (ITA) EFFECTIVE CHANGES</th></tr>
<tr><th>MEASURE</th><th>CHANGES</th><th>EFFECTIVE DATE</th></tr>
<tr>
<td>PAYE changes

(3rd Schedule)</td>
<td>Further to the changes effected in the Finance Act 2016 (effective 1st Jan. 2017), there are amendments to the ITA through Finance Act 2017 to expand Pay-As-You-Earn (PAYE) bands by a further 10%.

PAYE changes to take effect from 1st Jan. 2018 are as follows:

<table>
<tr><th><u>Current</u> Monthly Taxable Pay (KES.)</th><th><u>Revised</u> Monthly Taxable Pay (KES.)</th><th>Tax Rate (%)</th></tr>
<tr><td>Up to 11,180</td><td>Up to 12,298</td><td>10</td></tr>
<tr><td>Next 10,534</td><td>Next 11,587</td><td>15</td></tr>
<tr><td>Next 10,534</td><td>Next 11,587</td><td>20</td></tr>
<tr><td>Next 10,534</td><td>Next 11,587</td><td>25</td></tr>
<tr><td>Above 42,781</td><td>Above 47,059</td><td>30</td></tr>
<tr><td>Monthly Relief: KES. 1,280</td><td>Monthly Relief: KES. 1,408</td><td></td></tr>
</table>

The expansion of income tax bands, together with the exemption of bonuses, overtime and retirement benefits of low income earners will marginally reduce the PAYE burden. Even though this doesn’t translate to a 10% PAYE reduction, this will increase the take home income for employees, with a significant impact on low income workers, thus marginally improving their purchasing power and helping mitigate the effects of inflation.</td>
<td>1st January 2018</td>
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</table>

Pension Fund Withdrawals ***(3rd Schedule)***	Tax bands have also been expanded for the taxation of withdrawals from registered pension funds, provident funds and the National Social Security Fund (NSSF) (before the expiry of fifteen years from the date of joining the fund), for withdrawals in excess of the tax free amounts specified in the Income Tax Act, in a given year. The same expanded tax bands as those revised for PAYE above shall apply.	1st January 2018
Islamic Financial Products ***(Section 2)***	With a view to providing uniform application of incentives in the financial sector, the Act has been amended to formally recognize Islamic financial products and to provide for the same treatment of Islamic financial products with the normal non-Islamic products. The Act amends **both** Section 2 of the VAT Act and Section 2 of the ITA to include the following definitions relating to Islamic Finance: • *Islamic finance arrangement* to refer to all financial arrangements structured in line with Islamic law. • *Islamic finance return* to refer to amounts received or paid in relation to *Sukuk* or an Islamic finance arrangement. • The definition of *interest* is to include *Islamic finance return*. Islamic finance is fast growing, both locally and regionally. Clarity on the treatment of Islamic Finance products and harmonization of the ITA & VAT treatment in line with the other financial products will spur uptake of existing funding, both by the private and public sector.	3rd April 2017
Allowable Donations ***(Section 15(2))***	Tax deductions are now allowable for expenditure incurred in a year of income on donations to the Kenya Red Cross, county governments or any other institution responsible for the management of national disasters to alleviate the effects of a national disaster declared by the President. This move will encourage more donations to be channeled to needy causes, for instance the current drought being faced in some parts of the country.	3rd April 2017
Transfer Pricing Measures - Preferential Tax Regimes ***(Section 18A)***	The ITA has been amended further to provide for a new section on the ascertainment of gains or profits of business in a preferential tax regime in light of the growth of Special Economic Zones (SEZs), expected to have dealings both within and outside the zones. Where a resident entity operating in a preferential tax regime carries on business with a related resident person not operating in a preferential tax regime and the business produces to the resident person not operating in a preferential tax regime either no profits or less than the	3rd April 2017

	ordinary profits which would have been expected to accrue from that business if there had been no such relationships, then, the gains or profits of that resident person from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length. *Preferential tax regime* with respect to an item of income or profit, means any legislation, regulation or administrative practice which provides a preferential rate of taxation to such income or profit, including reductions in the tax rate or the tax base. This therefore introduces transfer pricing provisions from SEZs, in trade where one entity is in a preferential tax regime and the other one isn't. Entities will have to ensure that transactions with related parties are on an *arm's length basis.*	
Special Economic Zones (SEZs) ***(1st, 2nd & 3rd Schedules)***	To encourage more investment and also employment opportunities in this sector, the Act makes the following provisions: • Dividends paid by SEZs, developers or operators to any non-resident person, currently at 10%, shall be exempt from Withholding Tax. *(1st Schedule)* • Reduced Withholding Tax rates shall also be applicable to payments made to non-residents as follows: - Management, professional & training fees (from 20% to 5%) *(3rd Schedule)* - Royalties (from 20% to 5%) *(3rd Schedule)* - Interest (from 20% to 5%) *(3rd Schedule)* • Capital Expenditure by SEZs on buildings and machinery shall qualify for a 100% investment deduction in the year in which the building or machinery is first used. *(2nd Schedule)* • For investments outside Nairobi and Mombasa counties, SEZs are entitled to claim investment deductions at 150% in the first year of use. *(2nd Schedule)* • Furthermore, SEZs shall enjoy lower corporate income tax rates of 10% for the first 10 years and 15% for the following 10 years regardless of whether products are sold locally or abroad.	1st January 2018
Investment Deductions – Kenya Pipeline Co.	The construction of transportation and storage facilities for petroleum products by the Kenya Pipeline Co. shall also qualify for investment deductions.	1st January 2018

(2nd Schedule)		
Corporation Tax on Motor Vehicle Assemblers *(3rd Schedule)*	Corporation tax for companies assembling motor vehicles has been reduced from 30% to 15%, applicable for the first five years from the year of commencement of operations. Furthermore, the 15% rate shall be extended for a 5-year period if the company achieves a local content equivalent to 50% of the ex-factory value of the motor vehicles. This incentive will boost investor profits and provide more employment opportunities to Kenyans.	1st January 2018
Penalty Provisions *(Section 108)*	Due to the provisions imposed under the Tax Procedures Act 2015, Section 108 of the ITA, with provisions on additional penalties for non-compliance, has been repealed.	3rd April 2017

VALUE ADDED TAX (VAT) ACT EFFECTIVE CHANGES		
MEASURE	**CHANGES**	**EFFECTIVE DATE**
Place of Supply of Goods *(Section 11B)*	Finance Act 2017 amends the VAT Act recognition criteria on the *place of supply of goods.* Currently, the following three conditions have to be met, for a supply of goods to be considered as made in Kenya: • The goods are delivered or made available in Kenya by the supplier; • The supply of the goods involves their installation or assembly at a place in Kenya; **and** • For goods delivered outside Kenya, the goods were in Kenya when their transportation commenced. Finance Act 2017 deletes the word "and" and replaces it with "or" and therefore a supply of goods will be deemed to be made in Kenya if it meets *any* of the above three criteria. This will widen the VAT tax base for the Kenyan government.	3rd April 2017

VAT Zero-rating ***(2nd Schedule)***	The Act makes changes to the Second Schedule of the VAT Act to zero-rate: • Supply of maize (corn) flour, cassava flour, wheat or meslin flour and ordinary bread. Currently VAT-exempt, zero-rating status for these will mean that manufacturers will be able to claim input VAT, thus reducing the VAT payable and improving the bottom-line. • Taxable goods supplied to marine fisheries and fish processors upon recommendation by the relevant state department. Currently VATable at 16%, this incentive will stimulate the development of the *blue economy*, identified as a key potential for untapped economic opportunities. • Milk and cream products (currently VAT-exempt), not concentrated nor containing added sugar or other sweetening matter, of specified tariff numbers as per the VAT Act. • Both local and imported inputs for the manufacture of agricultural pest control products, currently VATable, upon recommendation by the CS, Agriculture. • Agricultural pest control products, currently VAT-exempt. • *Both* goods and services imported by or supplied to donor agencies, international and regional organisations with Diplomatic accreditation or bilateral or multilateral agreements with Kenya, for their official use. • *Both* goods and services supplied to the Kenya Red Cross and St. John Ambulance. • For returning Kenyans in the diaspora, the importation of right-hand drive vehicles to replace their left-hand drive vehicles, on condition that the current retail selling price shall not exceed that of the previously owned left-hand drive vehicle.	3rd April 2017
VAT Exemptions ***(1st Schedule)***	For taxable medical equipment and apparatus for the direct and exclusive use for construction of specialized hospitals with a minimum bed capacity of 50, the Act specifies the qualifying bed capacity for the exemption. This is meant to encourage more investments in the healthcare sector, which is currently in need for more qualified personnel and aptly equipped facilities. The 1st Schedule of the VAT Act has also been amended to exempt materials, articles and equipment for the educational, scientific or cultural advancement of the disabled (not just the blind, as was previously exempted) for the use of an organisation approved by Government for purposes of exemption.	3rd April 2017

Unused postage, revenue or similar stamps with a recognised face value, stamp-impressed paper, bank-notes, cheque forms, stock, share or bond certificates and similar documents of title, currently VATable, shall be exempt from VAT.

Spare parts imported by aircraft operators or persons carrying on the business of aircraft maintenance upon recommendation by the Kenya Civil Aviation Authority (KCAA). Currently, propellers and related parts and aircraft under-carriage together with related parts are VATable and the Finance Act makes them VAT exempt.

Inputs for the manufacture of pesticides, currently VATable, shall be exempt, upon recommendation by the Cabinet Secretary for Agriculture.

Further, the Act exempts specially designed locally assembled motor vehicles for transportation of tourists, purchased before clearance through Customs by tour operators upon recommendation by the competent authority responsible for tourism promotion, provided the vehicles meet the following conditions:

- the vehicles shall at all times be registered and operated by a company that is licenced under the Tourism Vehicle Regime;
- the vehicles shall be used exclusively for the transportation of tourists;
- the vehicles shall have provisions for camping, rescue and first aid equipment, luggage compartments and communication fittings; and
- any other condition the Commissioner may impose.

The tax on the vehicle shall become applicable upon change of use or disposal of the vehicle for other use. This is intended to revive the tourism industry, which has been in economic doldrums in the recent past. However, clarity will be needed on this exemption, as the vehicles are locally assembled yet the provisions refer to imported units. It is our view that the exemption applies to parts imported for the local assembly of vehicles to be used in the tourism sector.

VAT Exemption for Islamic financial products:

With a view to providing uniform application of VAT incentives in the financial sector, the Act imposes the same treatment of Islamic financial products with the normal non-Islamic products. Therefore, *Sukuk* and *Islamic Finance Return* (treated as interest) will now be VAT exempt. The

Act introduces changes to *both* Section 2 of the VAT Act and Section 2 of the Income Tax Act to include the following definitions relating to Islamic Finance:

- *Islamic finance arrangement* to refer to all financial arrangements structured in line with Islamic law.
- *Islamic finance return* to refer to amounts received or paid in relation to Sukuk or an Islamic finance arrangement.
- The definition of *interest* to include *Islamic finance return*

Islamic finance is fast growing, both locally and regionally. Clarity on the treatment of Islamic Finance products and harmonization of the VAT treatment in line with the other financial products will spur uptake of existing funding, both by the private and public sector.

The Act also exempts from VAT asset transfers and other transactions related to the transfer of assets into Real Estates Investment Trusts (REITs) and Asset Backed Securities. This incentive is meant to create tax neutrality in the alternative means that firms may use to raise funds for infrastructure projects.

Other VAT exemptions:

- Transportation of cargo to destinations outside Kenya.
- Materials for the construction of grain storage, upon recommendation by the CS, Agriculture.
- Materials for the manuafacture of *clean cook stoves*. The Act has clarified these to include clean and energy saving cooking stoves, as well as their parts and raw materials that are either imported or sourced locally, provided that they meet ISO/ IWA standards of tier 2-4 for fuel efficiency as determined by KeBS (Kenya Bureau of Standards).

EXCISE DUTY ACT EFFECTIVE CHANGES		
MEASURE	**CHANGES**	**EFFECTIVE DATE**
Excise Rate Inflationary Adjustments ***(Section 10)***	Reviews of the applicable Excise Duty rates for inflation adjustments will now be done every two years rather than the current annual basis, based on the average monthly inflation rate of the just ended 12 months before the review. The inflationary adjustments have never been implemented since the Excise Act was passed in 2015 as Treasury was avoiding increasing the prices of basic commodities. It's anticipated that price adjustments every two years will reduce the rate at which prices of the goods increase since there will be no price adjustments for some of the years.	1st January 2018
Licencing of Illuminating Kerosene Usage ***(Section 15(1)(d))***	Finance Act 2017 amends the Excise Duty Act to include the use of illuminating kerosene in the manufacture of un-excisable goods as one of the activities requiring an excise licence in Kenya. This measure is meant to regulate the use of this kerosene and curb the adulteration of other fuels using the kerosene.	3rd April 2017
Excise Duty refund for Spirits and Illuminating Kerosene ***(Section 29 (b))***	The Act further makes provisions allowing for the refund of excise duty paid for spirits or illuminating kerosene by registered manufacturers in the manufacture of un-excisable goods upon application to the taxman (before-hand). This is meant to incentivize the local manufacture of paints and resins.	3rd April 2017
Excise Rate Changes ***(1st Schedule)***	The rate of Excise duty on alcoholic spirits has been increased from KES. 175 per litre to KES. 200 per litre. This is commensurate with the alcohol consumption trends in the country where the demand for spirit is ever increasing. However, this might inadvertently lead to increased consumption of illicit liquor amongst low income consumers, as manufacturers pass the additional tax burden on to them. The rate of excise duty on cigarettes has been reviewed from the single rate of KES. 2500 per mille to a two tier tax structure follows:	3rd April 2017

<table>
<tr>
<td></td>
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<table>
<tr><th>Description</th><th>Rate of Duty (KES./Mille)</th></tr>
<tr><td>Cigarettes with filters (hinge lid and soft cap)</td><td>2500</td></tr>
<tr><td>Cigarettes without filter (plain cigarettes)</td><td>1800</td></tr>
</table>
This will enhance equity in the excise taxation of the tobacco industry.
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<tr>
<td>Other Excise Duty Changes

(1st & 2nd Schedules)</td>
<td>
The Excise Duty Act has also been amended to define powdered beer as follows: any powder, crystals or any other dry substance which, after being mixed with water or any other nonalcoholic beverage, ferments to, or otherwise becomes an alcoholic beverage.
Goods imported or purchased locally by both the Kenya Red Cross and St. John Ambulance for official use in the provision of relief services in Kenya shall be exempt from Excise Duty. Initially granted to the Kenya Red cross, the inclusion of St John Ambulance in the exemption is meant to recognize the importance of these relief services and facilitate the same.
As an exempt excisable good, returning residents will now be allowed to buy a new right hand vehicle whose current retail selling price shall not exceed that of the previously owned left-hand drive vehicle in a foreign jurisdiction. This is meant to address the challenges faced by Kenyans in the diaspora when replacing their vehicles upon returning to the country.
The Act has also been amended to include both imported and locally purchased goods, for the direct use in the manufacture of sanitary towels, as exempt from excise duty. This is aimed at cushioning local manufacturers from undue competition from imported products.
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<td>3rd April 2017</td>
</tr>
</table>

TAX PROCEDURES ACT (TPA) EFFECTIVE CHANGES		
MEASURE	**CHANGES**	**EFFECTIVE DATE**
Tax Amnesty Extension on Voluntarily Declared Offshore Income ***(Section 37B)***	Through the Finance Act 2016, taxpayers were granted an amnesty for 2016 and prior years of income on principal taxes, penalties and interest on undeclared foreign income, on condition that they file their 2016 return, with full declarations, by 31st December 2017. The government, through the Finance Act 2017, has subsequently extended the amnesty deadline from 31st December 2017 to 30th June 2018 and issued ***revised*** guidelines on the operationalization of the amnesty. Finance Act 2017 provides that there will be a 5-year window if funds aren't transferred back to Kenya during the amnesty period, but subject to a 10% penalty. Through this initiative, the taxman will be able to widen the tax base by bringing other taxpayers into the tax net, thus helping the government meet its revenue targets.	3rd April 2017
Taxpayer's Tax Representative ***(Section 15A)***	A taxpayer's tax representative shall be registered in the name of the non-registered person being represented and a KRA PIN shall be issued to the representative. Further, a person may be a tax representative for more than one non-resident person in which case the person shall have a separate registration for each non-resident person.	1st January 2018
Enhancing powers of KRA Officers ***(Section 7)***	The powers of KRA officers have been enhanced by introducing a section which gives them power to enter and search any premises or vessels and seize, collect and detain evidence and produce such evidence in any proceedings before a court of law or tax appeals tribunal. As per the current law, the Tax Procedures Act does not offer the officers the power to use evidence obtained, in a court of law and this is meant to ease the initiation and speedy conclusion of cases investigated, without having to involve the police. However, it remains to be seen whether these enhanced powers are in violation of constitutional rights and more clarity is expected, going forward.	3rd April 2017
Amendments to Withholding VAT (WHVAT) ***(Section 42A)***	The Act makes the following changes on WHVAT: • A supplier may be exempted from WHVAT requirements if they sufficiently demonstrate that due to the nature of business, and due to the WHVAT application, they are going to be in a continuous credit position for a period of more than twenty-four (24) months. • WHVAT withheld shall be remitted to the KRA on or before the 20th day of the month after it's withheld.	3rd April 2017

	• Failure to withhold the whole amount due or failure to remit by this date shall now constitute an offence attracting a penalty of 10% of the withheld amount	
Meaning of *tax liability* ***(Sections 16, 17, 18)***	The current definition of a *tax liability* in the TPA excludes penalties relating to the same liability and the Act now includes *penalty* as part of the same.	3rd April 2017

<table>
<tr><th colspan="3">MISCELLANEOUS EFFECTIVE CHANGES</th></tr>
<tr><th>MEASURE</th><th>CHANGES</th><th>EFFECTIVE DATE</th></tr>
<tr><td>Betting, Lotteries & Gaming Taxes

(Sections 29A, 44A, 55A & 59B of the Betting, Lotteries and Gaming Act)</td><td>Finance Act 2017 amends the current taxation of betting, lotteries, gaming and prize competitions as follows:
<table>
<tr><th>Tax Head</th><th><u>Current</u> Tax Rate</th><th><u>Revised</u> Tax Rate</th></tr>
<tr><td>Betting Tax</td><td>7.5% of the betting revenue, with betting revenue being gross turnover minus the amount paid out as winnings.</td><td>35% of the betting revenue, with betting revenue being gross turnover minus the amount paid out as winnings.</td></tr>
<tr><td>Lottery Tax</td><td>5% of a lottery's turnover.</td><td>35% of a lottery's turnover.</td></tr>
</table>
</td><td>1st January 2018</td></tr>
</table>

	Gaming Tax 12% of gaming revenue 35% of gaming revenue **Prize Competition Tax** 15% of the turnover 35% of the turnover This taxation, in addition to the corporate taxation at 30% of taxable income, has been met with harsh criticism from the industry players as the taxman aims to get a bigger slice of the exponentially growing sector whilst other related stakeholders have influenced the increased taxation as a means of mitigating against the societal ills of partaking in these competitions. The tax shall also be channeled into a fund for promoting sports in the country.	
Other Miscellaneous Changes	Finance Act 2017 further makes changes to the following Acts, amongst others: • The Tax Appeals Tribunal Act to remove the power of the Tribunal to extend the 90-day timeline for hearing and determining appeals. • The Stamp Duty Act, Public Finance Management Act, Co-operative Societies Act and the Sacco Societies Act, to allow for the recognition of Islamic Financial products. • The Retirement Benefits Authority (RBA) Act to increase the powers of the RBA and introduce new compliance requirements. • The Public Procurement and Asset Disposal Act to bolster the Public Procurement Regulatory Review Board. • The Marine Insurance Act to align provisions with the Insurance Act. • The Kenya Deposit Insurance Act to extend receivership terms for financial institutions under the statutory management of the Kenya Deposit Insurance Corporation. • The Miscellaneous Fees & Levies Act to: - Exempt SEZs from export levies and import declaration fees. - Exempt goods imported for the construction of LPG (Liquefied Petroleum Gas) storage facilities, from import declaration fees and the railway development levy.	Various

This publication incorporates changes based on the Kenya Finance Act 2017. Dates effective vary, as indicated on each pertinent change.

TALK TO US TODAY

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