Key Changes Introduced by the Finance Act, 2021

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Introduction

The Finance Act, 2021 (the **Act**), which was assented into law by the President of Kenya on 29 June 2021, makes a raft of changes to Kenya's tax regime including the Income Tax Act, the Value Added Tax Act, the Tax Procedures Act, the Miscellaneous Fees and Levies Act and the Excise Duty Act, among others. Most amendments proposed under the Finance Bill, 2021 (the **Bill**) were approved by Parliament as set out, while others amendments we approved with modifications.

While we note that some proposed amendments have been rejected by Parliament, such as the proposed increase of the look back period for tax audits and tax assessments from the current 5 years to 7 years and the proposed increase of excise duty on imported motorcycles, certain new provisions that were not set out in the Bill have been introduced under the Act. The new provisions and amendments which do not relate to amendments proposed under the Bill raise constitutional concerns of lack of public participation, including participation by the relevant stakeholders, in the law-making process.

In this alert, we provide a comprehensive analysis of the key amendments that have been introduced by the Act as well as their potential impact on businesses in Kenya. We have also highlighted the key proposals that were set out in the Bill which have been rejected by Parliament or partially adopted.

1. AMENDMENTS TO THE INCOME TAX ACT

Application of Digital Service Tax Refined

Effective Date: 1 July 2021

Digital service tax (**DST**) was first introduced in the Income Tax Act by the Finance Act 2019 and further refined by the Finance Act, 2020. The Act has further amended the provisions relating to DST as proposed by the Bill as follows:

i. Resident Persons Excluded from the Application of DST

As proposed under the Bill, the Act has limited the application of DST to non-resident persons. Previously, DST applied to both resident and non-resident persons. The amendment is a welcome move as subjecting resident persons to administrative and compliance requirements relating to DST would significantly increase the cost of doing business in Kenya. Even though the Income Tax Act provided that DST was an advance tax for resident persons and non-resident persons with permanent establishments in Kenya, the cashflow implications, administrative and compliance costs associated with DST resulted in an additional burden on resident companies.

ii. Casting a Wider Net on Income Subject to DST

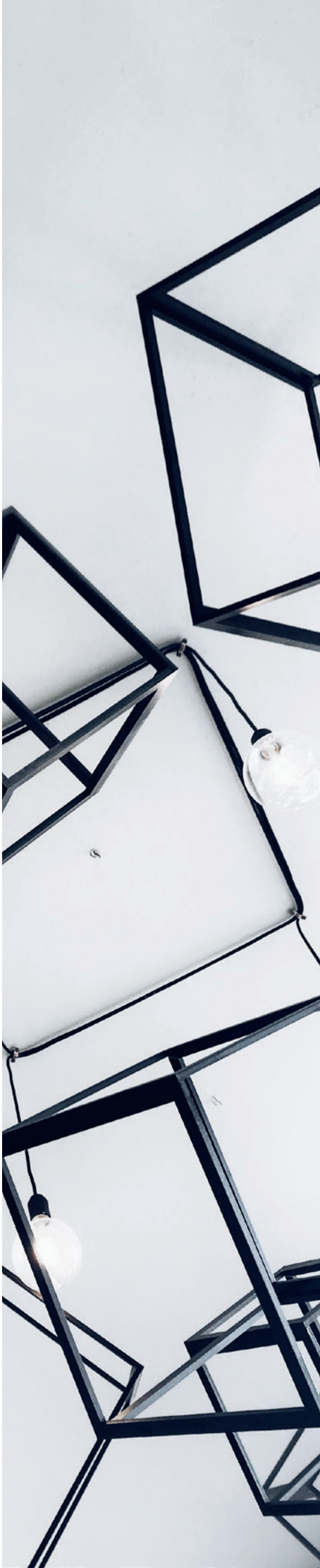
As proposed by the Bill, the Act has amended the scope of income that is subject to DST to include income accruing from a business carried out over the internet or an electronic network including through a digital marketplace. Previously, there was a lack of clarity on whether non-resident providers of electronic services who were not undertaking business through a ''digital marketplace'' were within the scope of DST. The wider definition introduced under the Act is intended to clarify that any income accrued in or derived from Kenya by a non-resident person in relation to services provided over the internet or an electronic network is subject to DST in Kenya.

iii. Clarity on Due Date for DST

Under the previous provisions of the Income Tax Act, DST was due at the time the payment of the service is made to the service provider. The Income Tax (Digital Service Tax) Regulations, 2020 (the DST Regulations) however subsequently clarified that DST is due and payable on the 20th day of the month following the month in which the digital service was supplied, as it would have been impractical for DST to be accounted for ''at the time of payment'' since most providers of electronic services would usually have multiple transactions daily. As proposed under the Bill, the Act has amended the provisions of the Income Tax Act to be aligned with the DST Regulations.

iv. Definition of a "Digital Marketplace" Refined

As proposed under the Bill, the Act has amended the definition of a digital marketplace in the Income Tax Act to mean "an online platform which enables users to sell or provide services, goods or other property to other users." A digital marketplace is currently defined as "a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means". The amendment is aimed at making it clear that an online platform constitutes a digital



marketplace if the users can sell or provide goods and services to other users through such a platform.

v. Income Not Subject to DST

As proposed under the Bill, the Act has exempted from DST, income that is derived from Kenya by non-resident persons who carry on the business of transmitting messages by cable, radio, optical fibre, television broadcasting, Very Small Aperture Terminal (VSAT), internet, satellite or by any other similar mode of communication. Corporate tax is applicable on such gross income. The Act has also exempted from DST, income that is subject to tax through the withholding tax regime such as, management or professional fees, royalties, interest payments, dividends, rental income, winnings, pension and insurance or reinsurance premiums.

The above exemptions are currently set out under the DST Regulations and the amendment is therefore aimed at legislating the exemptions under the principal law, as opposed to the subsidiary legislation, for the exemptions to have force of law.

Definition of the Term 'Control' Expanded for Tax Purposes

Effective Date: 1 July 2021

Previously, the term 'control' in relation to a body corporate, was defined in the Second Schedule to the Income Tax Act to mean, the holding of shares or voting power of 25 percent or more. The Second Schedule was deleted by Tax Laws (Amendment) Act, 2020, effective 25th April 2020 and replaced by a new Second Schedule, but the definition of the term 'control' was not set out in the Income Tax Act.

The Act has inserted the definition of the term 'control' in the Income Tax Act, as proposed in the Bill, to include instances where a person:

a. holds more than 20 percent of the voting rights of a company;

b. advances a debt or gives a debt guarantee of at least 70 percent of indebtedness of a company;

c. has power to appoint more than 50 percent of the board of directors of a company or at least one director or executive member of the governing board of that company;

d. owns or has exclusive right to the intellectual property rights that a company is dependent on for the manufacture or processing of goods for its business;

e. supplies or purchases at least 90 percent of the purchases or supplies of a company or has influence on the supply of goods, prices or markets of a company; or

f. has any other relationship, dealing or practice with another person which the Commissioner may deem to constitute control.

The expanded definition of the term 'control' will have far-reaching impact on business dealings between resident and non-resident persons. Kenyan entities that undertake business based on franchise models and exclusive supplier/dealer licences, such as the motor business sectors, may be deemed to be controlled by the non-resident principals/franchisors for tax purposes. In this regard, the resident and non-resident parties will be required to put in place a transfer pricing policy to govern their business dealings. Businesses whose purchases from one supplier or supplies to one purchaser constitute at least 90 percent of the purchases or supplies will also need to ensure that their dealings comply with the transfer pricing rules under the Income Tax Act.

Strict Rules on Deductibility of Interest for Tax Purposes

Effective Date: 1 January 2022

The Act has adopted the changes relating to thin capitalisation restrictions which were contained in the Bill. Previously, the thin capitalisation restriction was based on a debt-to-equity ratio of 3 to 1. Thin capitalisation will, from the effective date, be based on a percentage of earnings before interest, taxes, depreciation, and amortization (**EBITDA**). The new thin capitalisation restrictions require that the gross interest paid or payable to related persons and third parties in excess of 30 percent of the EBITDA of a resident borrower in any financial year will not be deductible for tax purposes. It should be noted however that, any income which is exempt from tax will be excluded from the calculation of EBITDA for the relevant entity. Furthermore, banks or financial institutions licensed under the Banking Act and micro and small enterprises registered under the Micro and Small Enterprises Act have been exempted from the thin capitalisation restrictions.

In addition to the thin capitalisation restrictions being applicable to interest on all loans, the thin capitalisation restriction will now apply to payments that are economically equivalent to interest and expenses incurred in connection with raising the finance. For instance, where preference shares that are structured as debt have a fixed dividend/coupon obligation, the coupon may be deemed to be economically equivalent to interest and therefore subject to thin capitalisation restrictions, to the extent that the coupon is treated as an expense in the books of the company.

Since companies are currently structured to meet the thin capitalisations thresholds from a capital structure perspective (i.e. ratio of debt to equity), the debt burden and interest expense of the companies should be reconsidered to mitigate the impact of the thin capitalisation restriction being based on EBITDA. We also note that the new EBITDA test will now cover all companies including branches of non-resident companies which were not covered under the previous thin capitalization rules.

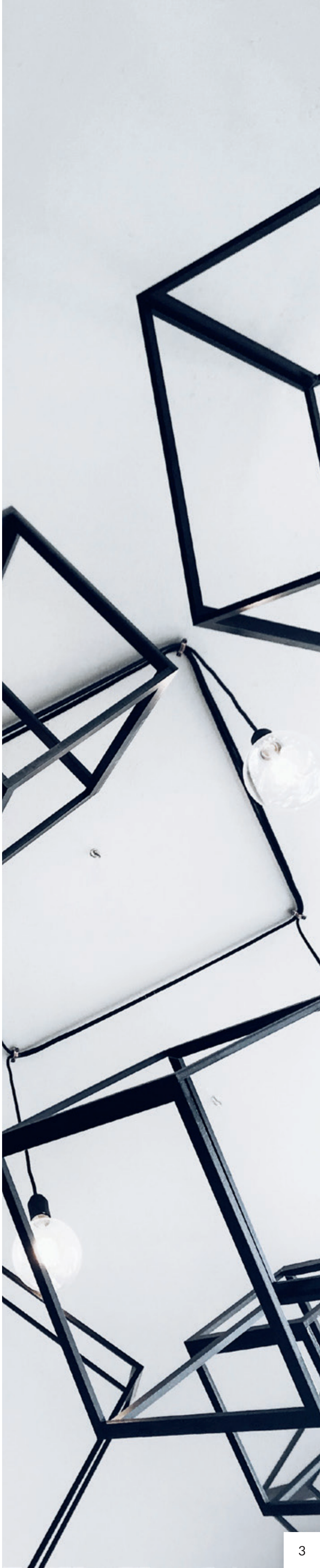
We point out that the new thin capitalisation rules will adversely impact Kenyan businesses who continue to be highly geared owing to the impact of Covid-19 on their cash flow. The gross interest amount in excess of 30 percent of the EBITDA of the companies will be disallowed for tax purposes, which further puts more financial pressure on the companies because the 'excess' interest will be subject to corporate tax, increasing the effective tax rate for such companies.

Since thin capitalisation is intended to avoid flight of capital from Kenyan companies by non-resident persons by way of interest, it would be expected that the thin capitalisation restrictions would only apply to companies that are under the control of a non-resident person as it was previously provided under the Income Tax Act.

Additional Exemptions from Minimum Tax

Effective Date: 1 July 2021

The Act has introduced additional exemptions from the application of the minimum tax to include persons engaged in manufacturing businesses whose cumulative investment from 2017 to 2021 is at least Kenya Shillings 10 billion, persons engaged in distribution businesses whose income is wholly based on a commission and persons licensed under the Special Economic Zones Act. In our view that there may be ambiguity arising as to the businesses that would be entitled to these exemptions, noting the broad drafting of the provision. We point out that this amendment was not set out in the Bill and it is therefore a new amendment introduced by the Finance and National Planning Committee.



It is worth noting that the collection of the minimum tax is currently suspended pending the hearing and determination of ***Constitutional Petition Number E005 of 2021, Kitengela Bar Owners Association vs Commissioner General of the Kenya Revenue Authority & 2 Others.*** The Kenya Association of Manufacturers (KAM) has also been enjoined in the case owing to the adverse impact on various manufacturing businesses operating in Kenya. Since its inception, the minimum tax regime has now been amended twice, through legislative amendments set out in the Tax Laws (Amendment) No. 2 Act, 2020 and the Finance Act, 2021, to expand the exemptions from minimum tax. In addition, by way of a specific legal notice, the national carrier has recently been exempted from minimum tax. The number of amendments to this recently introduced regime may bolster an argument that greater consideration should have been given before the introduction of this regime to remove some of the uncertainties and ambiguities that are now being addressed.

The suspension of the collection of minimum tax has temporarily abated its far-reaching impact on businesses, noting that most businesses are currently in financial distress due to the adverse effects of the COVID-19 pandemic. Entities with high revenues but low margins would also have been adversely affected as they would have either paid a lower tax or not been in a tax-paying position from a corporate tax perspective. Further, entities in tax loss position arising out of reliance on various capital allowances would also have been required to pay the minimum tax thereby eroding any benefits realised from the capital allowances.

Tax Losses to be Carried Forward Indefinitely

Effective Date: 1 July 2021

As proposed in the Bill, the Act has amended the carry forward period of tax losses from a period of 10 years (including the year in which the losses were incurred) to an indefinite period until the tax losses are fully exhausted. The amendment is a welcome move as businesses are now able to utilise the tax losses incurred in the ordinary course of business until they are exhausted.

We understand that the amendment is designed to cushion businesses in a tax loss position as these businesses would also be required to pay minimum tax of 1 percent on their gross revenue. It is however not clear how the amendment cushions businesses against minimum tax, given that a company will be unable to utilise its tax losses against minimum tax paid. However, as highlighted above, the collection of the minimum tax is currently suspended pending the hearing and determination of the constitutional petition.

Kenya Introduces Country-by-Country Reporting for Multinationals Resident in Kenya

Effective Date: 1 January 2022

As proposed in the Bill, the Act has introduced a requirement for ultimate parent entities for multinational companies' (**MNE**) resident in Kenya to submit returns, on an annual basis, of their group's financial activities in Kenya and all other jurisdictions where any of the group entities have a taxable presence. The return is required to contain 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. This requirement will apply to companies whose turnover exceed the prescribed threshold which will be set out in the regulations that are expected to be published in relation to the implementation of this new requirement.

The amendment is based on the Organisation for Economic Co-operation and Development (**OECD**) framework on Base Erosion and Profit Shifting (**BEPS**) Project Action Point 13 (Transfer Pricing and Country by Country Reporting) which requires all large MNEs to prepare country-by-country (**CbC**) reports containing aggregate data on the global allocation of income, profit, taxes paid and economic activity. The CbC report to be shared with the Kenya Revenue Authority (the **KRA**) is aimed at increasing international tax transparency and improve access to information regarding the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the relevant MNE Groups operate through the automatic exchange of annual CbC reports. The CbC reports are expected to assist the KRA in assessing high-level transfer pricing risks and other base erosion and profit shifting related risks, as well as for economic and statistical analysis.

The rules and procedures for Competent Authorities of jurisdictions implementing BEPS Action Point 13 are set out in the Multilateral Competent Authority Agreement on the Exchange of CbC Reports (**CbC MCAA**). Bilateral relationship between jurisdictions under the CbC MCAA becomes effective only if the respective jurisdictions have filed the required notifications and have listed each other as participating countries. Kenya is expected to imminently give notice on the implementation of the CbC MCAA and sign it once it puts in place the relevant domestic laws on implementation of the CbC reporting.

Off-grid Independent Power Producers to Qualify for Investment Allowance

Effective Date: 1 January 2022

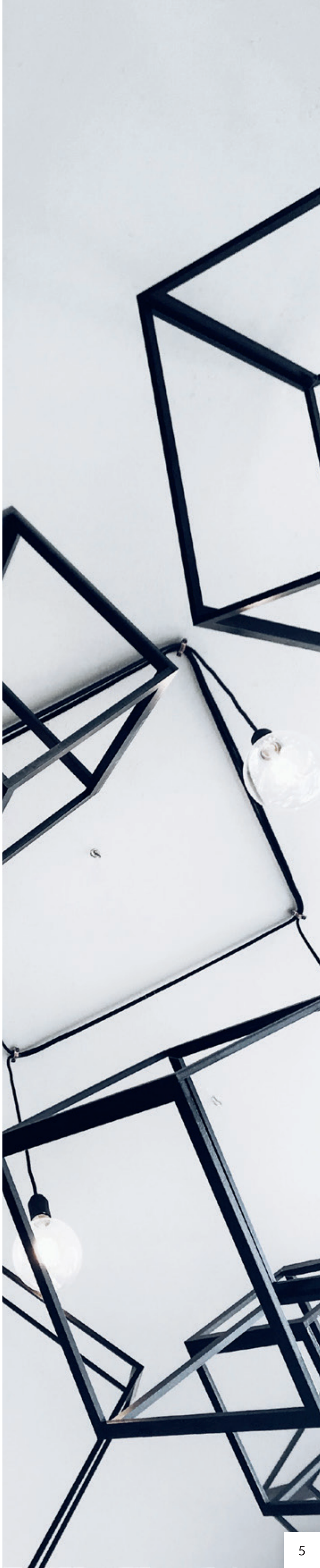
Under the provisions of the Second Schedule to the Income Tax Act, machinery used for manufacture qualifies for Investment Allowance at the rate of 50 percent in the first year of use and the balance at 25 percent per year on a reducing balance. The term "manufacture" was defined in the Income Tax Act to include the transformation and distribution of electricity through the national grid. This provision therefore only applied to power-producing companies that are involved in the generation/ transformation and distribution of electricity through the national grid.

As proposed in the Bill, the Act has deleted the words "through the national grid" which means that the investment allowance will also be available to independent power producers involved in transformation and distribution of electricity to commercial and industrial clients or rooftop photovoltaic systems for home use. The proposed amendment is welcome as the growing number of off-grid players in the energy sector had been left out in relation to investment incentives.

Investment Allowances to be Claimed on a Straight-line Basis

Effective Date: 1 January 2022

The provisions of the Second Schedule to the Income Tax Act previously provided that the balance/residue of investment allowance after the first year of use was deductible on a reducing balance basis in subsequent years. The effect of the reducing balance method was that the residual investment allowance would be



deducted indefinitely and therefore, the investment allowance would not be fully exhausted. As proposed in the Bill, the Act has amended the Second Schedule by deleting the reducing balance method and introduced the straight-line method which means that after the effective date, the residual investment allowance will be deductible in equal instalments, after the first year of use. The amendment is a welcome move as capital expenditure incurred can now be fully utilised within a relatively shorter period.

Risk of Creating a Permanent Establishment in Kenya is Now Higher

Effective Date: 1 July 2021

As proposed in the Bill, the Act has enhanced the definition of the term 'Permanent Establishment' under the Income Tax Act to include additional criteria as set out under the United Nations Model Double Taxation Convention 2017 (**UN Model Convention**) which is based on the OECD Model Tax Convention 2017 with some modifications.

Under the new definition, a non-resident enterprise would create a permanent establishment in Kenya where the provision of services, including consultancy services, by the enterprise through employees or other personnel engaged by it are undertaken in Kenya for a period aggregating 91 days in any 12-month period commencing or ending in the relevant year of income. The proposed provision is borrowed from the UN Model Convention, which sets out 183 days within any 12-month period, in contrast to a period of 91 days introduced by the Act.

In our view, foreign enterprises providing services in Kenya, including consultancy services, through personnel physically present in Kenya, would need to review their engagements considering the reduced timelines to avoid the personnel creating a permanent establishment in Kenya. Where a foreign enterprise is deemed to have created a permanent establishment in Kenya, the KRA will use transfer pricing principles to ascertain the income and profits which would be attributable to the permanent establishment in Kenya and demand tax on the taxable income.

Various Amendments Relating to Taxation of Trusts

Effective Date: 1 July 2021

The Act has introduced various provisions relating to the taxation of income of trusts including tax exemptions for certain income. These amendments were not set out in the Bill and therefore the public has seen them for the first time in the Act.

We understand that these amendments are part of larger amendments to the trusts regime that are currently underway through the Trustees (Perpetual Succession) Amendment Bill, 2021 and the Perpetuities and Accumulations Amendment Bill, 2021 which are currently in Parliament for debate. A summary of the key tax amendments is set out below.

i. Certain Income of a Registered Trust is Now Exempt from Tax

Section 11 of the Income Tax Act provides for taxation of trust income and income which is deemed to be an income of a trustee or a beneficiary. Section 11 (3) provides that income that is paid by a trustee to a beneficiary (which would be chargeable to tax on the trustee) shall be deemed to be an income of the beneficiary that is chargeable to tax on the beneficiary. The Act has introduced a new section 11 (3A) which, in our understanding, is intended to exempt the following categories of income paid to beneficiaries of ''registered trusts'' from tax:

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.

Noting that the Act has also introduced an income tax exemption for ''registered family trusts'' (discussed further below), the intention of the amendments set out above appears to be for any income which would otherwise be subject to tax on the trustees, pursuant to section 11, to be taxed in the hands of the beneficiaries, unless the income is exempt pursuant to the provisions of the Income Tax Act. This provision would be relevant where a ''registered family trust'' owns hard assets such as real estate, which generate rental income and such income is distributed to the beneficiaries by the trustees. Distribution of such income would be taxed in the hands of the beneficiaries at the rate of 25 percent, unless the distribution meets the criteria set out above, in which case it would be exempt from tax.

Where a trust holds trust assets such as shares in private and listed companies and liquid assets such as fixed deposits, the income earned by the trust is likely to be classified as qualifying dividends or qualifying interest, on which withholding tax is final tax. Such income would be deemed to be tax paid and no further taxes would apply on such income in the hands of the trustee or the beneficiary, pursuant to section 11(4) of the Income Tax Act.

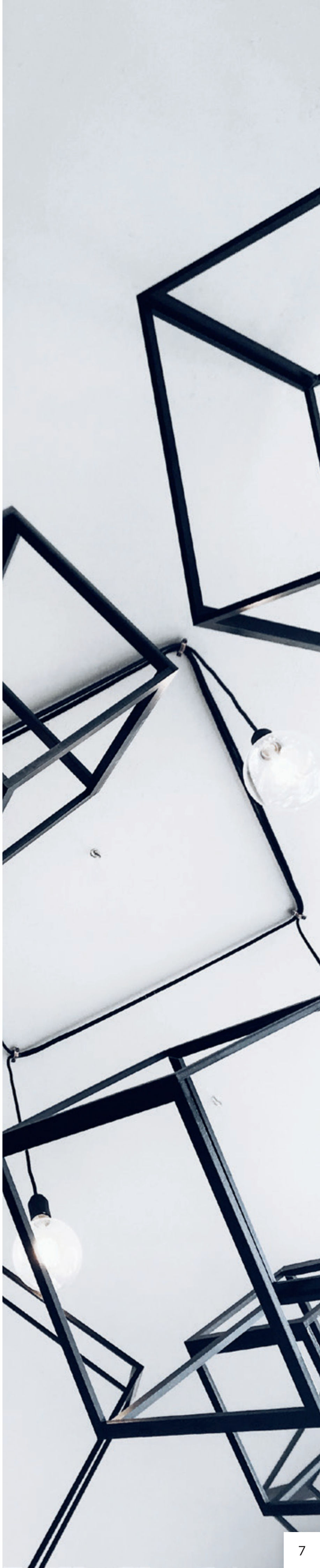
In light of the new amendments introduced by the Act, the nature of income earned by a trust and the structure adopted for the assets which will be held by the trust should be considered carefully to ensure that the tax position of the beneficiaries is optimized.

ii. Transfer of Property to a Family Trust is Now Exempt from Capital Gains tax

The Act has amended paragraph 36 of the First Schedule to the Income Tax Act by inserting a new provision granting an exemption from capital gains tax on income derived by an individual upon transfer of property, including investment shares, which is transferred or sold for the purpose of transferring the title or the proceeds into a registered family trust. We understand this exemption applies where a settlor transfers his / her property to a registered family trust or to a third party where the proceeds from the sale are transferred to a registered family trust.

We note that the term 'registered family trust' has not been defined in the Act or under the existing provisions of the Income Tax Act but the Trustees (Perpetual Succession) (Amendment) Bill, 2021 (**the Trustees Bill**) has defined a ''family trust'' as ''a trust, whether living or testamentary, partly charitable or non-charitable, that is registered or incorporated by any person or persons, whether jointly or as an individual, for the purpose of planning or managing their personal estate''. While it is expected that further clarity may be issued by the KRA on what constitutes a ''registered family trust'', it would be expected that the definition of this term under the Trustees Bill will be helpful for purposes of relying on the exemptions introduced by the Act, as and when the Trustees Bill comes into force.

In addition, the Act has introduced a new paragraph 58 of the First Schedule to the Income Tax Act which grants an exemption from capital gains tax on any gains derived from the transfer of title of immovable property to a family trust. Based on the wording of this exemption, the income of any person who transfers immovable property to a family trust would be exempt from capital gains tax. It is noteworthy



that the provision does not refer to a 'registered family trust' but a 'family trust' and therefore the exemption could be interpreted to apply to both registered and unregistered family trusts.

iii. Income of a Registered Family Trust is Now Exempt from Tax

The Act has introduced a new paragraph 57 of the First Schedule to the Income Tax Act which provides for an exemption from tax on the income or principal sum of a registered family trust. Previously, except in the case of qualifying dividends and qualifying interest (on which withholding tax is final) the income of a trust would be assessed on the trustees and beneficiaries would not be subject to further tax on the distribution. Based on the exemption introduced by the Act, trustees will not be subject to tax on the income earned by the trust but the income would be taxed on the respective beneficiaries once a distribution is made.

In this regard, the Act has introduced a new sub-paragraph under Paragraph 5 of the Third Schedule to the Income Tax Act which provides that any disbursement of deemed income to a beneficiary is subject to tax at the rate of 25 percent save where such income is exempt from tax (such as payments to beneficiaries highlighted under paragraph (a) above).

iv. Exemption from Stamp Duty

Under section 52 of the Stamp Duty Act, any voluntary disposition, conveyance, or transfer of property by way of gift to any person is subject to stamp duty as if it were a conveyance or transfer on sale based on the market value of the property, unless the relevant transfer is exempt from stamp duty. The Act has amended this provision to provide for an 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. As is the case with stamp duty exemptions, it would be expected that an application for stamp duty exemption would need to be made to the Collector of Stamp duty for the stamp duty exemption to be granted.

Tax Rebate for Employers Engaging Apprenticeships

Effective Date: 1 January 2022

Under the provisions of the Income Tax Act, any employer who engages at least ten university graduates as apprentices for a period of 6 to 12 months during any year of income is eligible for a tax rebate in the year after the year of such engagement. As proposed in the Bill, the Act has included employers who engage graduates from technical and vocational education and training institutions to also qualify for the tax rebate. The amendment is meant to encourage the employment of fresh graduates from various tertiary institutions to equip them with the experience required in the job market.

Higher Investment Allowance for Investments Outside Nairobi and Mombasa

The Act has introduced a higher investment allowance of 100 percent for investments made outside Nairobi City County and Mombasa County. This is a new amendment that was not set out in the Bill. An investor qualifies for 100 percent investment allowance where:

a. the cumulative investment value in the preceding three years of income for investments outside Nairobi City County and Mombasa County was at least KES 2 billion (approx. USD 19 million). The Act has clarified that where the cumulative value of investments for the preceding 3 years of income was KES 2 billion (approx. USD 19 million) on or before 25 April 2020 and the applicable rate of investment allowance was 150 percent, that rate shall continue to apply until the investment allowance is fully utilised;

b. the investment value outside Nairobi City County and Mombasa County in the relevant year of income is at least KES 250 million (approx. USD 2 million); or

c. the person has incurred investment in a special economic zone.

The introduction of higher investment allowances is a welcome move as it will promote investment in capital intensive sectors such as the energy and manufacturing sectors.

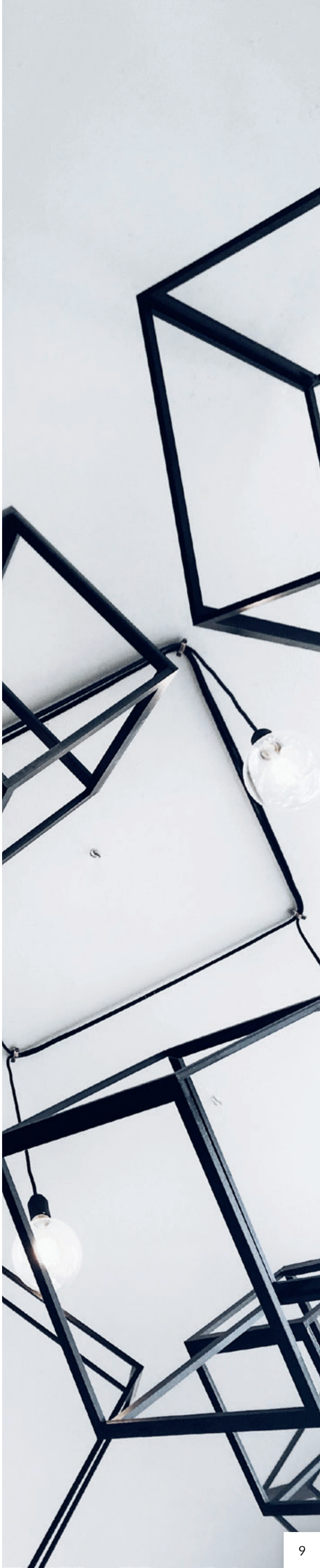
Proposed Amendments to the Extractives Industry

Effective Date: 1 January 2022

As proposed in the Bill, the Act has made various changes to the rates applicable to the extractive sector as follows:

Description	Previous Rate	New Rate	Effective Date
Withholding tax on service fee paid by a contractor to a non-resident subcontractor in respect of mining or petroleum operations	5.625%	10%	1 July 2021
Withholding tax on service fee paid by a licensee to a non-resident subcontractor in respect of mining or petroleum operations	5.625%	10%	1 July 2021
Withholding tax on service fee paid by a contractor to a non-resident person in respect of management, training or professional fees	12.5%	10%	1 July 2021
Deductibility of interest / thin capitalisation threshold	Debt to equity of 2 to 1	30% of EBITDA	1 January 2022

The new rates are subject to the lower rates that may be provided in double tax treaties that may be in force between Kenya and the country of residence of the recipient of the fees.



2. AMENDMENTS TO THE VALUE ADDED TAX ACT

Effective date of all amendments: 1 July 2021

VAT Exemptions in the Energy Sector Reintroduced

The Act has re-introduced the VAT exemptions relating to the energy sector that had been withdrawn by the Tax Laws (Amendment) Act, 2020 and the Finance Act, 2020. The supply of the following goods is now exempt from VAT:

- Taxable goods supplied to persons that had an agreement or contract with the Government prior to 25th April 2020 and the Agreement or contract provided for exemption from VAT.
- We understand that this exemption is primarily intended to cover projects that had entered into power purchase agreements with Kenya Power and had received letters of support from the Government of Kenya, in addition to other infrastructure projects where the Government is a party. While our interpretation of this exemption is that these projects can apply for exemption from VAT in respect of the goods procured locally or imported for the implementation of the projects, irrespective of whether the relevant enabling provisions are available in the law, we expect that more clarity will be provided by the National Treasury and the KRA in the coming days.
- Specialised equipment for the development and generation of solar and wind energy, including photovoltaic modules, direct current charge controllers, direct current inverters and deep cycle batteries that use of store solar power.
- Taxable goods, excluding motor vehicles, imported, or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration by a company granted a prospecting or exploration license.
- The amendments are welcome as the energy sector had been thrown into uncertainty when the various exemptions were deleted last year by the Tax Laws (Amendment) Act, 2020 and the Finance Act 2020. Anjarwalla & Khanna was actively involved in lobbying for the re-introduction of the tax
- exemptions on behalf of the key stakeholders in the energy sector.

Exportation of Services Exempt from VAT (previously Zero-Rated)

The Act has amended the VAT Act by exempting the exportation of services from VAT as proposed in the Bill. Exportation of services was previously a zero-rated supply which meant that input VAT incurred in making the supply could be set off against output VAT received in making other taxable supplies and a VAT refund could be applied for from the KRA in respect of the excess portion of input VAT credit incurred in making zero-rated supplies.

The amendment to have exported services exempt from VAT means that input VAT incurred in making exported services will be restricted if the exempt supplies exceed 90 percent of the total supplies made by that person. The impact of this amendment is that suppliers of services may have to dig deeper into their capital to fund the tax cost relating to the restricted input VAT on the exportation of services. Some suppliers will have no choice but to increase the fees payable in respect of exported services to cover the cost of input VAT incurred in making the supplies.

The amendment will certainly have a negative impact on the competitiveness of the services sector in Kenya in providing services to non-resident clients as the cost of doing business will increase. It is a globally accepted principle that exportation of both goods and services are zero-rated supplies for VAT purposes or similar taxes and therefore the amendment is contrary to globally accepted principles.

Exemption on Transfer of Assets into REITs Re-introduced

As proposed in the Bill, the Act has re-introduced the exemption from VAT in respect of transfer of assets and other transactions related to the transfer of assets into real estate investment trusts and asset-backed securities. This exemption had been introduced in 2018 but deleted two years later via the Tax Laws (Amendment) Act, 2020.

Supply of Ordinary Bread is Now Zero Rated

The supply of ordinary bread was previously listed as an exempt supply under the First Schedule and a zero-rated supply under the Second Schedule to Value Added Tax Act. This had brought confusion on the treatment of ordinary bread for VAT purposes. The Act has deleted the provision under the First Schedule to the Value Added Tax Act which means that it is now clear that the supply of ordinary bread is now zero-rated.

Additional Exemptions Relating to Fishing Industry and Bioenergy sources

The Act introduced additional exemptions from VAT that were not set out in the Bill. The following supplies are now exempt from VAT:

a. local purchase or importation of taxable supplies including fish feeding and handling, water operations, cold storage, fish cages, pond construction and maintenance, and fish processing and handling;

b. local purchase or importation of prefabricated biogas digesters;

c. supply of biogas; and

d. supply of sustainable fuel briquettes for household and commercial use.

In addition to the above, the importation/purchase of tractors other than road tractors for semitrailers and the supply of denatured ethanol have also been exempted from VAT.

Proposal under the Bill to Delete the Requirement for Regulations to be Tabled in the National Assembly for Approval Rejected

Parliament has rejected a proposal under the Bill to amend the Value Added Tax Act, 2013 to delete the requirement for Regulations made under the Value Added Tax Act to be tabled before the National Assembly for approval before they take effect. If the proposed amendment were to be approved, the Cabinet Secretary for National Treasury would have had powers to make regulations under the Value Added Tax Act without the approval of the National Assembly. This would have been inconsistent with the provision of the Statutory Instruments Act, 2013, which requires all statutory instruments, such as legal notices and regulations, which are made pursuant to powers granted to a Cabinet Secretary under a written law, to be tabled in Parliament within 7 days after the publication of the relevant statutory instrument. This is a welcome move by the National Assembly.

3. AMENDMENT TO THE TAX PROCEDURES ACT, 2015

Common Reporting Standards Introduced under Domestic Law

Effective Date: 1 July 2021

As proposed under the Bill, the Act has introduced provisions relating to Common Reporting Standards (**CRS**) obligations by financial institutions located in Kenya on the exchange of financial account information in tax matters, under the Tax Procedures Act, 2015. The provisions are part of the efforts employed by Kenya to join global tax transparent jurisdictions in connection with the exchange of information on foreign accounts for tax purposes.

By way of background, Kenya signed the Convention on Mutual Administrative Assistance in Tax Matters (the **Convention**) on 8 February 2016 becoming the 12th African country to sign the Convention and the 94th jurisdiction to join it (a total of 141 countries have signed the Convention). Kenya deposited the instrument of ratification of the Convention on 22 July 2020 which entered into force in Kenya on 1 November 2020. Having ratified the Convention, Kenya is expected to imminently sign and activate the Common Reporting Standards Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (the **CRS Agreement**). The CRS Agreement will come into effect in Kenya on the date Kenya will provide a notice to the OECD Secretariat stating that Kenya has put in place the necessary laws to implement the CRS Agreement. Once the notice is provided, Kenya will then request to sign the Agreement and set out the date it will commence the exchange of information with participating countries.

The CRS Agreement is a multilateral framework agreement that is based on Article 6 of the Convention. It sets out the rules governing the automatic exchange of financial account information in tax matters developed by the OECD to tackle tax evasion and improve tax transparency and compliance. It further sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions to ensure maximum compliance. It also specifies the details of what information will be exchanged and when.

As Kenya will implement the Convention and the CRS Agreement, it will avoid the need to conclude bilateral agreements between exchanging jurisdictions. Kenya will be required to provide a list of jurisdictions with respect to which it intends to exchange information and put in place domestic laws to implement the CRS. In this regard, Kenya is expected to pass new laws to implement the CRS regime which will include provisions relating to reporting obligations for local financial institutions to provide information regarding reportable accounts to the KRA, the reporting and due diligence procedures required to fully implement CRS and confidentiality and personal data protection safeguards to ensure that personal data is used for the intended purposes under CRS. The introduction of the provisions relating to CRS under the Tax Procedures Act 2015 and the recent enactment of the Data Protection Act, 2019 are part of the efforts being undertaken by Kenya towards the implementation of the CRS framework.

Once the CRS Agreement is signed and the relevant domestic laws are put in place to implement the CRS, the KRA will receive information relating to income received abroad by persons who are tax residents in Kenya. Financial institutions will need to develop systems that will review their existing customer base and introduce new client onboarding procedures to identify reportable accounts. Since Kenya applies a source-based taxation system, income earned from foreign sources, although reportable under CRS, would not be expected to be automatically taxable in Kenya, save for employment income (which is taxed on a worldwide basis for Kenyan tax resident persons) and taxable income which was repatriated from Kenya without payment of tax.

KRA PIN Mandatory in Digital Transactions

Effective Date: 1 July 2021

As proposed under the Bill, the Act has amended the Tax Procedures Act to require transactions that involve the supply of goods and services over a digital marketplace to require a tax person identification number (**PIN**) of the customer. The requirement appears to be aimed at providing the KRA with information on transactions that require payment of DST to enable the KRA to reconcile the DST that will be remitted by the supplier. This move could increase the compliance burden for non-resident suppliers of electronic services, as they would now be required to request their existing customers for PINs as well as include PINs as a mandatory requirement during the onboarding process.

Proposal to Increase Limitation Period for Tax Assessments Rejected

Parliament has rejected a proposal under the Bill to increase the period within which the Commissioner may amend a tax assessment from five years to seven years. Under the proposed amendment, the Commissioner would have been permitted by law to investigate/look into the affairs of a taxpayer within seven years from the date the Commissioner serves notice of intention to audit the tax affairs of a taxpayer. Additionally, the Bill had proposed to increase the period within which a taxpayer would be required to retain records under a tax law from five years to seven years from the end of the reporting period to which the records relates. This would have increased the compliance burden on taxpayers as they would have been required to keep records for a longer period. The rejection of the proposed amendment by Parliament is a welcome move.

4. AMENDMENTS TO THE EXCISE DUTY ACT, 2015

Effective date of all amendments: 1 July 2021

Internet Data Service Providers to Offset Input Tax against the Output Tax Charged to Final Consumers

Under the provisions of the Excise Duty Act, excise duty paid on excisable goods that are used as raw materials in the production of finished excisable goods is offset against the excise duty payable on the finished goods. The Act has inserted a new provision that allows excise duty paid in respect of internet data services by a licensed person who purchases the data in bulk for resale, to be offset against the excise duty payable by that person on internet data services supplied to the final consumer.

Locally Manufactured Chocolate and Imported Sugar Confectionary to be Subject to Excise Duty

Under the provisions of the Excise Duty Act, imported sugar confectionary and imported white chocolate, chocolate in blocs, slabs or bars are subject to excise duty. The Bill proposed to amend the paragraph by deleting the word 'imported' which would mean that both locally manufactured and imported sugar confectionary and chocolate would be subject to excise duty at the rate of KES 20 (approx. USD 0.2) per kilogram and KES 200 (approx. USD 1.9) per kilogram, respectively.

However, the Act has partially adopted the proposed amendments under Bill by deleting the word 'imported' with regard to imported white chocolate meaning that local white chocolate bars are now subject to excise duty at the rate of KES 200 (approx. USD 1.9) per kilogram. The Act also maintained the application of excise duty on imported sugar confectionery albeit at a high rate of KES 35 (approx. USD 0.3) per kilogram.

The amendment is likely to have a negative impact on the competitiveness of the local chocolate industry against imported chocolate as the retail prices will increase due to the excise duty cost that will be passed to final consumers. This will reverse the gains that the Government had made in promoting local food processing and the manufacturing sector in general.

Excise Duty Not Chargeable on Imported Glass Bottles from East African Community

The Bill had proposed to delete the charging provision for excise duty on imported glass bottles which had been introduced by the Business Laws (Amendment) Act, 2020. The Act has however amended the charging provision for excise duty on imported glass bottles by excluding its application to glass bottles imported from any of the countries within the East African Community, which is a welcome move.

The introduction of excise duty on imported glass bottles was the subject of a petition filed at the East African Court of Justice (EACJ) against the Government of Kenya by Kioo Limited (represented by Anjarwalla & Khanna). The EACJ had suspended Kenya's decision to impose a 25 percent tax on imported glass bottles until the matter is heard and determined.

Excise Duty on Betting, Gaming and Price Competition

The Bill had proposed to reintroduce excise duty on betting at a rate of 20 percent of the amount waged or staked by punters. Excise duty on betting was first introduced in November 2019 by the Finance Act, 2019 and deleted a few months later, July 2020, by the Finance Act, 2020, following intensive lobbying by the betting industry.

The Act has however spread the proposed introduction of excise duty to gaming and price competition activities as set out below.

The amendments are aimed at expanding the tax base and collection of revenue by the KRA. The 7.5 percent percent excise duty will be in addition to the 20 percent withholding tax applicable on winnings by punters.

Activity	Applicable Excise Duty Rate
Betting	7.5% of the amount wagered or staked
Gaming	7.5% of the amount wagered or staked
Price Competition	7.5% of the amount paid or charged to participate
Lottery (excluding charitable lotteries)	7.5% of the amount paid or charged to buy the lottery ticket

Fees or Commissions Earned in Respect of Loans will be Subject to Excise Duty

Under the provisions of the Excise Duty Act, other fees charged by financial institutions are subject to excise duty at the rate of 20 percent of their excisable value. 'Other fees' are defined to include any fees, charges or commissions charged by financial institutions relating to their licensed activities but does not include "… fees or commissions earned in respect of a loan".

As proposed under the Bill, the Act has deleted the words 'fees or commissions earned in respect of a loan' from the definition of the term 'other fees'. This therefore means that fees or commissions earned in respect of a loan will not be excluded from the definition of 'other fees' and will therefore be subject to excise duty at the rate of 20 percent. Excise duty on fees charged by financial institutions has been the subject of many tax disputes between financial institutions and the KRA and based on the new amendments introduced by the Act, such disputes will likely increase in the coming months.

Assorted additions to excisable goods and services

The Act has amended the excise duty rate applicable on telephone and internet data services from the previous rate of 15 percent to 20 percent. The amendment which took effect on 1 July 2021 has resulted in higher charges of telephone and internet data services which are considered key resources in the modern digital economy. Since excise duty has historically been applied as a ''sin tax'', the higher rates of excise duty on telephone and data services are unwarranted as they will adversely impact the growth of the digital economy.

The Act has also introduced excise duty on the following items:

Item	Excise Duty Rate
Jewellery of tariff heading 7113 and imported jewellery of tariff heading 7117	10%
Products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application	KES 1,200 (approx. USD 11) per Kg
Articles of plastic of tariff heading 3923.30.00	10%
Imported pasta of tariff 1902 whether cooked or not cooked or stuffed (with meat or other substances) or otherwise prepared, such as spaghetti, macaroni, noodles, lasagne, gnocchi, ravioli, cannelloni, couscous, whether or not prepared	20%
Imported furniture of any kind used in offices, kitchen, bedroom and other furniture of tariff number 9403	25%
Imported eggs of tariff heading 04.07	25%
Imported onions of tariff heading 07.03	25%
Imported potatoes, potato crisps and potato chips of tariff heading 07.01	25%
3907.91.00 unsaturated polyester	10%
3907.50.00 Alkyd	10%
3905.91.00 Emulsion VAM	10%
3903.20.00 Emulsion-styrene Acrylic	10%
3905.19.00 Homopolymers	10%
3906.90.00 Emulsion B.A.M	10%

Additional Exemptions from Excise Duty

The Act has introduced additional exemptions from excise duty that were not proposed under the Bill. The following items are now exempt from excise duty:

- Illuminating kerosene supplied to licenced or registered manufacturers of paint, resin or shoe polish in such quantities as the Commissioner may approve.
- Excisable services supplied in Kenya by a mobile telecommunication service provider on the sale of a ring back tune to a subscriber. This amendment is aimed at ensuring that local artists get more revenue from ring back tunes.

Proposed Increase of Excise Duty on Motorcycles Rejected

Parliament has rejected the proposed increase of excise duty on imported Motorcycles of tariff 87.11 from the current standard rate of KES 10,000 (approx. USD 93) per unit to a rate of 15 percent per unit. The rejection of the proposed amendment is a welcome move as motorcycles are now the widely used means of transport which has created self-employment for many unemployed youths. The proposed increase of excise duty would have increased the cost of purchasing motorcycles which would have limited access to the motorcycles.

5. AMENDMENTS TO THE MISCELLANEOUS FEES AND LEVIES ACT, 2016

Re-introduction of Exemption from Import Declaration Fee (IDF) and Railway Development Levy (RDL) to promote investments

Effective Date: 1 July 2021

The Finance Act, 2020 had deleted exemption from IDF and RDL on importation of goods which the Cabinet Secretary would determine to be in the public interest, or to promote investments and whose value was not less than KES 200 million (approx. USD 2 million). The Act has re-introduced the exemption from IDF and RDL on importation of goods which the Cabinet Secretary may determine to be in the public interest, or to promote investments of not less than KES 5 billion (approx. USD 46 million).

The amendment is a welcome move as it will incentivise high-value capital investments, especially in the energy and manufacturing sectors.

Key contacts

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