Deloitte.

State Corporations Tax Workshop

Your questions, answered

Novermber 2018

Withholding Tax

Outline

- Introduction-principles of Withholding Tax (WHT)
- The legislation
- Payments/services subject to WHT
- Rates-residents
- Obligation to deduct
- WHT administration
- WHT penalties and interest
- Complex issues/KRA audit issues
- WHT Planning
- Finance Act 2017 changes affecting WHT

Introduction – Principles of withholding tax

- Is an agency form of tax where a person making certain types of payments which are income subject to tax in Kenya is required to deduct tax therefrom and remit/transmit the tax deducted directly to the KRA
- The person who is required to withhold tax on a payment is called a **payer** while the person who is entitled to receive a payment which is income subject to withholding tax is the **payee**
- W/tax is not an additional tax. Rather, it is a payment of tax in advance on the income of the payee
- Where w/tax is not final tax, the tax should be claimable by the payee if the payee is resident in Kenya or is a PE of a non-resident person
- W/tax achieves the following:
  1. Curbs tax evasion
  2. Reduces tax administration costs
  3. Manages a country’s cash flow

The Legislation

The following are the key provisions that govern the operation of WHT in Kenya:

- **Section 3 of the Income Tax Act (ITA)**:- stipulates that income tax should be chargeable on the income which accrued in or was derived from Kenya or on the income deemed to have been accrued in or derived from Kenya
- **Section 10 of the ITA**:- Deems the payments liable to w/tax to be income accrued in or derived from Kenya
- **Section 34** & the **Third Schedule** to the **ITA** - Provides the income tax rates
- **Section 35 of the ITA**:- Lists the payments that are subject to w/tax
- **Section 39 (1) of the ITA**:- Allows w/tax to be set off against income tax
- **Section 72D of the ITA** – Stipulates the penalty for late payment of tax
- **Section 38 of the Tax Procedures Act** – stipulates the late payment interest
- **Income Tax (Withholding Tax) Rules, 2001**:- Issued by the National Treasury CS (then Minister for Finance) pursuant to the powers conferred to the CS under Section 130 of the ITA. The rules prescribe the WHT administration procedures

Payments/services subject to withholding tax

Payments to Residents and PE

- Management or professional fee whose value exceeds KES 24,000
- Training fee
- Dividend
- Interest
- Royalty and natural resource income
- Rent on commercial property
- Winnings payable by bookmakers to punters.
- Pension/retirement annuities

Payments to Non - Residents

- Management or professional fee
- Training fee
- Royalty and natural resource income
- Rent for use or occupation of property
- Dividend
- Interest
- Payment to sportsmen or entertainers
- Winnings payable by bookmakers to punters
- Telecommunication service fees
- Pension/retirement annuities

Management or professional fees defined

- **ITA definition (Section 2)** - Payment made to a person, other than payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated
- **Contractual fee** - payment for work done in respect of building, civil or engineering works - See Section 35(3)(f) of the ITA
- **Consultancy fees** - payment made to any person for acting in an advisory capacity or providing services on an consultancy basis
- **Agency fees** – payment made to a person for acting on behalf of any other person or group of persons, or on behalf of the government, but excludes any payments made by an agent on behalf of the principal when such payments are recoverable
- **Professional fees** – not defined but recognized professions set out in the **Fifth Schedule to the ITA** – Based on the professions listed under the Fifth Schedule, professional fees should therefore include fees charged by medical practitioners, dentists, advocates, surveyors and land surveyors, architects and quantity surveyors, engineers, accountants and certified public secretaries

Training fees

- **Section 2 of ITA Definition –** "payment made in respect of a business or user training services designed to improve work practices and efficiency of an organization, and **includes** any payment in respect of incidental costs associated with the provision of such services"
- An example of training fees includes payment for this tax training
- Incidental costs in connection with training can include **accommodation**, **travel** expenses etc. incurred on behalf of facilitators/trainers

Royalty

Section 2 of the ITA definition - payment made as a consideration for the use of or the right to use:

- The copyright of a literary, artistic or scientific work
- Patent, trade mark, design or model, plan, formula or process, or
- Any industrial, commercial or scientific equipment

Examples

- Payments in respect of trade marks/brands e.g. Franchise fees, intellectual property fees including software licenses etc.

Natural resource income

Defined under Section 2 of the ITA to mean:

- An amount including a premium or such other like amount paid as consideration for the right to take minerals or a living or non living resource from land or sea, or
- an amount calculated in whole or in part by reference to the quantity or value of minerals or a living or non-living resource taken from land or sea

Examples

- Payments for quarrying
- Payments in respect of mining minerals
- Payments for the right to obtain timber
- Payments for the right to fish

Withholding tax rates

Description	Resident rate (%)	Non - resident rate (%)
Dividends > 12.5% voting power	Exempt	10
< 12.5% voting power	5	10
Interest - Housing Bonds	10	15
- Government bearer bonds 2 years and more	15	15
- Other interest	15	15
Insurance commission		
- Brokers	5	20
- Others	10	20
Royalties and natural resource income	5	20
Sporting or entertainment income	-	20
Pension/retirement annuities	0 to 30	5
Telecommunication service fees	-	5

Withholding tax rates

Description	Resident rate (%)	Non-resident rate (%)
Rent / leasing – Immovable property	10 (a)	30
- Others	-	15
Management, professional (other than contractual) & training fees	5	20 (b)

a) Rent payable to resident persons for use of immovable commercial property to be liable to **10%** w/tax w.e.f. 1 January 2017. Withholders of such tax to be appointed by KRA

b) Payment of consultancy fees to **individuals** of the EAC partner states liable to w/tax at 15% and not 20%

What kind of service payments do you pay to their suppliers? Do you withhold? What is the applicable withholding tax rate?

Obligation to deduct

- Section 35 of the ITA provides an obligation to the payer to deduct tax on eligible payments for onward payment to the KRA directly
- Failure to deduct tax on an eligible payment and non remittance of the same to the KRA is an offence under the ITA/TPA and attracts penalties and interest

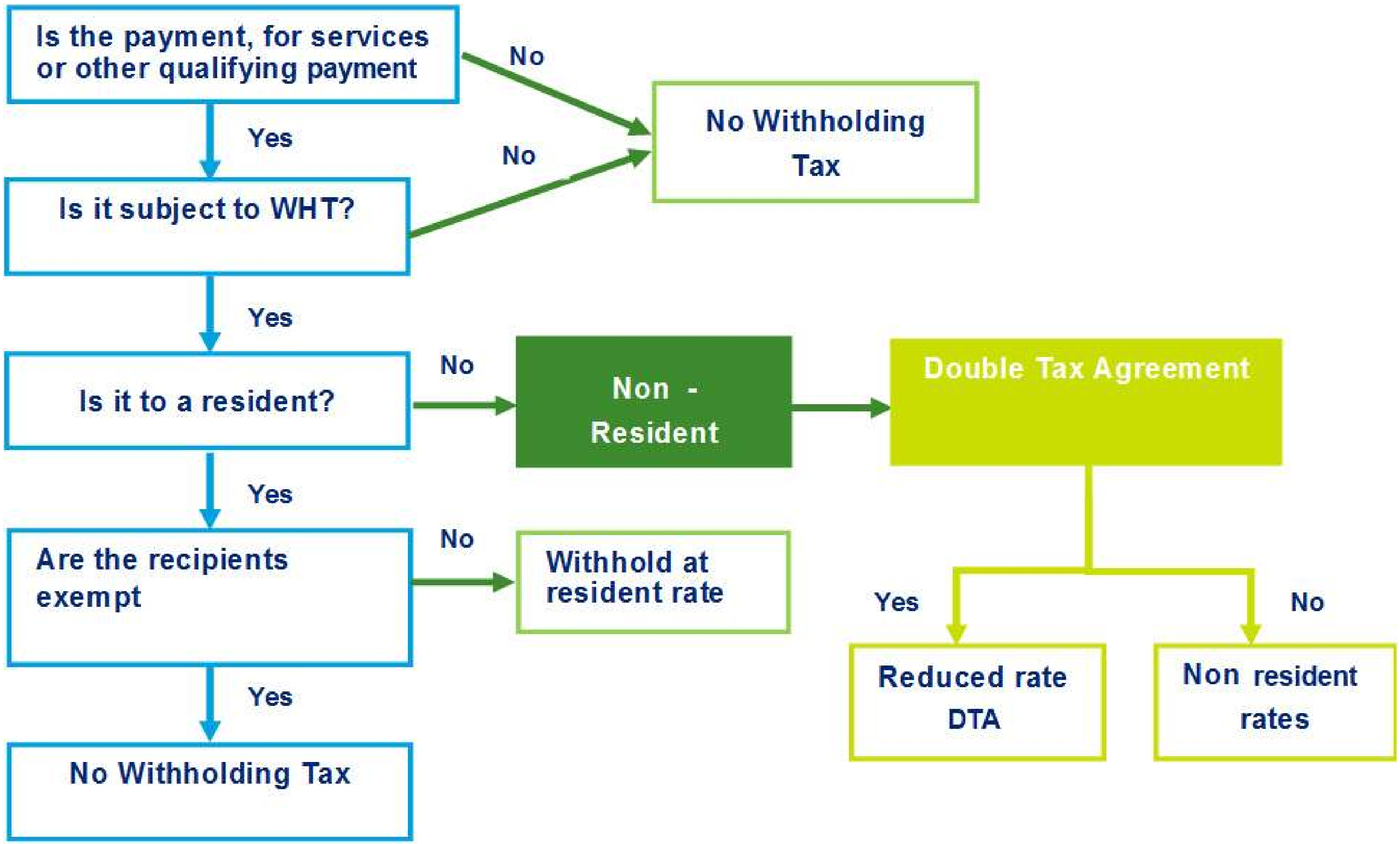
Withholding tax administration

- WHT is due by the 20th day of the month following the month of deduction
- Upon deduction and payment of WHT, a person is required to keep a record of the name of payee, PIN, gross amount paid, nature of payment and amount of tax deducted
- Withholding tax accounting is now required to be done through iTax platform
- Upon paying the tax, the payee’s ledger is credited with the amount and the iTax platform generates a certificate that is sent to the payee to enable him/her to claim credit against income tax

Penalties and interest for non-compliance

- For purposes of recovery of tax, withholding tax is demanded from the payer as though it were the tax of the payer (recall WHT belongs to PAYEE and not PAYER)
- A penalty of 20% should apply for late payment of withholding tax – up until 9 June 2016, the penalty used to be 10% but capped to KES 1 million
- Late payment interest of 1% per month is chargeable on any tax remaining unpaid after the due date – the late payment interest charged is capped to the principal tax involved (*Induplum rule*)

In a nutshell…



Complex issues / KRA audit issues

1. **Definitions** – It is important to determine whether a payment falls under the ambit of withholding tax based on the highlighted definitions. For instance, should payments to body builders be liable to w/tax?
2. **The tax point (actual payment vs accrual)** – Should w/tax be based on actual payment or accrual?
3. **Mixed supplies** – WHT applies only to services and certain payments. What happens where fees to be paid under a contract relate to both goods and services?
4. **Treaty provisions** – Where there is a DTT, careful review and application is required. DTTs have delicate provisions that must be carefully applied. The South African, French, UAE, and the Mauritian treaties are important examples
5. **Disbursements and reimbursements** – should w/tax be applied on disbursements and reimbursements? What is the difference between the two?
6. **Gross up problem** – where a contract is negotiated net of tax, should w/tax be based on the contract fee or should it be grossed up?
7. **Payment in kind** – How should w/tax be accounted if payment is made in kind? For instance on winnings

Withholding tax planning

- Compliance to avoid fines and penalties
- Payment timing
- Direct disbursements payments
- Obtaining all w/tax certificates and claiming the credit
- Double Tax Treaty provisions
- Contractual provisions
- Year-end accruals as opposed to monthly or quarterly

Finance Act 2018 changes

- Withholding tax of 20% introduced on demurrage charges paid to non-resident
- 5% withholding tax introduced on insurance premiums paid to non-resident

Q&A

VAT

Outline

1. Charge to Tax
2. Registration for VAT
3. Place and time of supply
4. Taxable value
5. Input tax deduction
6. VAT refunds
7. Invoices, records and returns
8. Trending VAT areas
9. Q&A

Charge to tax

- In Kenya, VAT is chargeable on:
  - Taxable supplies made by registered persons in Kenya;
  - Importation of taxable goods; and
  - Supply of imported taxable services.

- Applicable VAT rate for taxable supplies is; zero (for zero rated supplies) or 16%;
- Liability to tax vests on the registered person and is due at the time of supply;
- CS empowered to vary the rate of tax up or down by 25% of the VAT rate; and
- Zero rated supplies are taxable for all intents and purposes.

Registration for VAT

- Registration threshold – Taxable supplies of KES 5 million in a year;
- Sale of capital assets or sale of business excluded from registration threshold;
- Application for registration within 30 days of being liable to register;
- Option for voluntary registration;
- Commissioner empowered to register a person who fails to register;
- Registration to take effect in the first tax period after registration is due, or other date as specified in the registration certificate;
- Registration certificate to be displayed in a conspicuous place;
- ***Case for group registration? – omitted from VAT Regulations, 2017***

Place of Supply Rules

A supply of goods occurs in Kenya if:

- The goods are delivered or made available in Kenya;
- The supply of the goods involves their installation/assembly in Kenya; and
- Where goods are delivered outside Kenya, the goods were in Kenya when their transportation commenced.

Place of Supply Rules

A supply of services is made in Kenya if:

- The supplier's place of business from which the services are supplied is in Kenya; or
- The supplier is non-resident, the recipient is non-registered and the services are:
  - Physically performed in Kenya by a person in Kenya at time of supply;
  - Directly related to immovable property in Kenya;
  - Radio and television broadcasting received at an address in Kenya;
  - Electronic services; or
  - Transfer, assignment of, or grant of a right to use, a copyright, patent, trademark or similar right in Kenya.

Place of Supply Rules

Export of services (VAT Regulations, 2017):

- An exportation of service occurs when the taxable supply involves the services being provided to a recipient outside Kenya for use, consumption, or enjoyment outside Kenya.

- However, there is no export of service where;
  - Services are consumed on exportation of goods unless the services are in relation to transportation of goods which terminates outside Kenya;
  - taxable services are provided in Kenya but paid for by a person who is not a resident in Kenya.

Place of supply rules – case studies

Scenario

Kimani purchases a book from Amazon while in the comfort of his home in Kileleshwa. He pays for the book via his credit card

Question:

Is VAT applicable on the above transaction?

Who should pay the VAT?

Has a supply taken place in Kenya?

Tax Representative

Scenario

Company XYZ ltd provides financial information and news services to businesses across the world. It does not currently have a presence in Kenya (i.e. is not VAT registered).

Question:

Does company XYZ need to have a tax representative in Kenya?

Any other companies you can think of that need to have tax representatives in Kenya?

Time of supply of goods and services

Generally, the time of supply is the earlier of:

a) The date goods are delivered or services performed;

b) For construction works, the date a certificate is issued;

c) The date an invoice for the supply is issued; or

d) The date payment for the supply is received (in whole or part).

Taxable value

The taxable value of a supply is;

- Consideration for the supply; or
- In case the supplier and recipient are related; the open market value (OMV)*
- OMV defined under the VAT Regulations, 2017 as consideration for arm's length transaction;
- Consideration for a supply includes the total of;
  - amount in money paid/payable;
  - OMV at time of supply of an amount in kind paid/payable; and
  - Any taxes, duties, levies, fees and charges paid/payable (excluding VAT) on or by reason of the supply reduced by any discounts/ rebates.

Taxable value

Items to be included in consideration	Items to be excluded from consideration
• Packaging material – any wrapper, package, box, bottle, or containers	• For goods purchases under hire purchase agreement – the associated finance charge
• Goods contained in or attached to packaging material;	• Late payment interest
• Any other liability payable to the vendor on or by reason of the supply	• For accommodation/restaurant services – The tourism levy
• Incidental costs incurred by supplier to make the supply – other than disbursements	• *charges in lieu of tips also excluded through Finance Bill 2016

The taxable value of imported goods is the sum of:

- Customs value & including any customs duty/levy paid;
- To extent not included – freight and insurance costs; and
- Cost of incidental or ancillary services.

Input tax deduction

- Deduction allowed to extent that input tax is incurred on a supply/import acquired to make taxable supplies;
- Registered person to hold prescribed documentation; tax invoice, customs entry forms and receipts, credit note and debit note;
- Law allows one to deduct input tax within six months;
- Purchase, hire, repair and maintenance of passenger cars and mini buses still blocked, unless in the course of business of dealing in or hiring them.
- Entertainment, restaurant and accommodation services still blocked unless;
  - Incurred in the ordinary course of business of a person to provide such services; or
  - Provided while recipient is away from home for business purposes

Input tax deduction

Partial Exemption

Deductible input tax for a registered person who makes both taxable and exempt supplies is determined as follows:

- Full deduction of all input tax directly attributable to taxable supplies;
- No deduction of all input tax directly attributable to exempt supplies; and
- Apportionment of input tax attributable to both taxable and exempt supplies using the below formula:

$$\text{Total Input tax} \times \frac{\text{Total Taxable Supplies}}{\text{Total Supplies}}$$

- If the fraction of the formula is:
  - > 90% - total input tax is deductible;
  - < 10% - no input tax is deductible;
  - Any other fraction - Apportion.

Input tax deduction – Case study

ABC ltd is a company that manufactures and sells wheat flour. It also earns rental income from commercial property it owns within its premises. ABC ltd earned the following income in the month of March 2016.

Wheat Flour Sales- KES 10,000,0000

Rental Income – KES 500,000.

During the same month, ABC ltd outsourced transport services from Msafiri Limited. Msafiri Ltd raised an invoice of KES 1,000,000 for its services. In addition to the above, ABC Ltd received two invoices from KPLC. KES 1,000,000 related to the factory whereas KES 50,000 was incurred on the commercial property it rents. ABC ltd also requested XYZ B.V (a company based in the Netherlands) to provide it with advisory services for a proposed venture they would like to undertake in the Netherlands. XYZ B.V. billed ABC ltd KES 500,000 for the service.

Question:

Determine the VAT payable by ABC Ltd for the month of March 2016;

Would ABC Ltd be required to account for Reverse VAT?

Assuming that ABC Ltd only makes zero-rated supplies, would Reverse VAT be applicable?

Points to remember:

Sale of wheat flour was exempt in March 2016. **Status has now changed to zero rated.**

VAT Refunds

How do VAT refunds arise?

- Where a registered person makes zero-rated supplies
- Where VAT is paid in error (or overpaid) to the tax authority
- In the case of bad debts

Timelines for VAT refund claims

- Initially no timelines in VAT Act for refunds occasioned by zero rating;
- Finance Act 2015 - VAT refund claims now to be lodged within 12 months from the date when the tax became due and payable;
- No timelines on the part of KRA and the National Treasury to audit and settle refund claims.

VAT refunds status

Concerns/challenges associated with VAT refunds

- Negative impact on cash flow & cost of doing business;
- Administrative challenges to KRA – resourcing issues;
- Backlogs occasioned by complexity of repealed VAT Act;
- The VAT Act 2013 significantly reduced the list of zero-rated items to help curb the VAT refunds headache;
- VAT Audit refund is no longer a requirement under the VAT Regulations 2017. However, it is not prohibited.

Invoices and Returns

- **Invoices**
- A registered person who makes a taxable supply required to furnish purchaser with tax invoice;
- VAT may only be charged on taxable supplies;
- Contravening this is an offence and any VAT charged on non-taxable supplies to become due within 7 days of the invoice date;
- Only one original invoice, credit note or debit notes may be issued.
- The Act now allows issuance of a copy clearly marked as such to be provided to a customer for deduction of input tax
- Particulars of tax invoice now included in the VAT Regulations, 2017.

- **Returns**
- VAT returns to be filed not later than the 20th day after the end a tax period;
- Taxpayers allowed to apply for extension of time to submit a return;
- Application must be done before the due date for submission of the return;
- Granting the application at the Commissioner's discretion;
- Late filing penalty – Higher of KES 10,000 or 5% of tax payable;
- Return amendment provisions moved to the TPA.

Keeping of records

- Registered persons required to keep a full and true written record of all their transactions in Kenya for a period of 5 years;
- Such record may be kept in electronic form or otherwise and in Swahili or English;
- Records to be kept include:
  - ✓ Tax invoices issued in serial order;
  - ✓ Credit and debit notes issued in chronological order;
  - ✓ Purchase invoices, customs entries and receipts;
  - ✓ Details of imported services;
  - ✓ Tax account;
  - ✓ Periodical stock records; and
  - ✓ Such other records as may be specified.

Trending VAT areas

Key VAT areas of focus by the revenue authority include:

- VAT on export of services;
- Input tax deduction;
- Withholding VAT;
- VAT Auto Assessment;

Changes in the 2018 Finance Act

- Exemption of equipment for the construction of grain storage facilities.
- Exemption of additional raw materials for the manufacture of animal feeds.
- Exemption of parts, imported or purchased locally, for the assembly of computers.

Q&A