AOSK LEGAL OFFICE

FINANCE ACT, 2023: A DOUBLE-AGED SWORD?

The Finance Act, 2023 was assented to by the President on 26th June 2023. This will go on record as the fastest Finance bill to be signed by the President of Kenya. The Act makes changes to various legislation including: The Income Tax Act, Cap 470, The VAT Act, 2013, The Excise Duty Act, 2015, The Tax Procedures Act, 2015, The Tax Appeals Act, The Miscellaneous Fees and Levies Act, 2016, Employment Act, 2007, the Betting, Gaming and Lotteries Act, Kenya Roads Board Act, the Kenya Revenue Authority Act, Alcoholic Drinks Control Act, Unclaimed Financial Assets Act, Statutory Instruments Act 2013, Special Economic Zones Act, Export Processing Zones Act and Retirement Benefits (Deputy President and Designated State Officers) Act. However, note that the High Court issued conservatory Orders temporarily suspending the implementation of the Finance Act 2023 on 30 June 2023. The following are a few key highlights about the Finance Act, 2023.

The act has lowered the rate at which taxpayers will be required to withhold tax in respect of payments made to digital content creators from the initially proposed 15% to 5%. The Finance Act has clarified that the repatriated income will be taxed at 15%.

The Act affirms that where a payment has been made to a non-resident person, withholding tax paid thereon shall not be refundable or available for deduction against the income where an audit adjustment has been made in respect of such payment. This new provision attempts to curtail the refund or offset of such overpayments. The provision is unfair to taxpayers as they are forced to forfeit withholding tax that they have paid to the KRA despite the KRA having disallowed the same expense and demanded for additional corporate income tax. This net effect is that the same income is taxed twice (double taxation) by the KRA.

The Act has introduce Digital Assets Tax (DAT). Act provides for filing a return and paying within five days after making the deduction. The rapid growth in the adoption and trading of the cryptocurrencies in Kenya has resulted in the Government seeking to collect taxes in this area. Unlike other assets where it is the gain that is subject to tax, the Government has opted to tax the gross fair market value in the case of digital assets. This may be viewed as inequitable particularly at a time where most cryptocurrencies are losing their value as the KRA will in effect be taxing losses. The requirement to file a return and remit the payment within 5 days is still short and may heighten the risk of non-compliance.

It appears that this tax applies only to Kenyan residents trading on any platform. This would be a departure from the ITA that taxes on the basis of whether income is "accrued or derived from Kenya" rather than on residency. It may also be highly impractical for non resident operators of platforms to distinguish between Kenya residents and other traders.

The Act introduces a condition that for a business expenses to qualify for tax deduction, the invoices received in respect of such expenses must be generated from an electronic tax invoice management system unless the transaction under which the expense was incurred has been exempted from electronic tax invoice management system regulations. This provision may result in disputes between the tax authority and taxpayers. We also expect an increase in the differences between accounting profit and taxable profit. Further, the taxpayer has an additional administration burden of ascertaining whether their suppliers are exempt from electronic tax invoice management system regulations.

The Finance Act introduces section (3A) which requires a trustee resident in Kenya to maintain and avail tax records for trusts that are registered in Kenya or outside Kenya whether the trust income is generated in Kenya or not. The amendment requires resident administrators of trusts to maintain and avail records required under a tax law to the KRA.

Section 47 was proposed to be amended to provide for the offsetting of overpaid taxes against outstanding tax debts and future tax liability. This is a welcome provision for taxpayers who have in the past experienced significant delays in the payment of tax refunds. Under this provision if a refund is not paid within six months the same will be automatically applied to outstanding and future liabilities rather than be paid to taxpayers.

The Act eliminates VAT on Liquid, Petroleum and Gas, hence making the supply zero rated. The elimination of VAT on LPG will lead to a reduction in the product cost, making it affordable for more Kenyans. This is a welcome move as LPG being a cleaner source of energy, is healthy and environmentally friendly.

The law provides for Payment of Excise Duty within twenty-four hours by licensed manufacturers of alcoholic beverages. This amendment is aimed at enhancing revenue collection as well as managing cash flow amidst the cash shortages being experienced by the Government. However, this change is likely to strain the manufacturer's cash flow as the manufacturer will have to pay tax on goods removed from the stock room whereas they may not have received the payments from their customers on the same. Further, the collection of Excise Duty within twenty-four hours on alcoholic beverages, may be strenuous to the manufacturers as their systems are not automated.

The Act has introduced two additional tax bands above the current marginal tax rate of 30% i.e., 32.5% applicable to individuals earning monthly incomes between KES 500,000 and KES 800,000, and 35% applicable to individuals earning monthly incomes of more than KES 800,000. KRA will also be required to roll out a new individual income tax return template to allow individuals to file their annual self-assessment tax returns for the 2023 year of income. Further, employers will be required to update their payroll systems to align with the new PAYE rates effective 2023. Overall, this change will result in increased PAYE revenue for the government albeit marginally considering that it is a very small percentage of citizens who earn KES 500,000 or more per month. The net take home pay for the affected individuals is expected to reduce.

The Finance Act Introduced Affordable Housing Levy. The Act has amended the Employment Act, 2007 to introduce a new section 31B that provides that employers will be required to deduct and remit an Affordable Housing Levy at:

a) 1.5% of the employee's gross monthly salary for the employee; and

b) 1.5% of an employee's gross monthly salary for the employer.

Employers will be required to remit the levy not later than 9 working days after the end of the month in which payments are due.

Late remittance of the affordable housing levy will attract a penalty of 2%

of the amount due for each month. Since the new scheme is based on the employee's gross monthly salary it is likely to result in higher deductions in comparison with deductions that would have been made from the basic salary as had been proposed in the Bill. The new housing levy will be an additional salary deduction that will reduce the net take home pay of employees and increase the cost of labour for employers.

Section 5(2) of the ITA exempts from tax amounts paid to an employee as mileage reimbursement for travelling to perform official duties provided that such reimbursement is based on the standard mileage rate approved by the Automobile Association of Kenya ("AA Kenya"). Employers who pay employees mileage reimbursements at the standard mileage rate approved by AA Kenya will not be required to assess a taxable benefit on the receiving employee. However, any excess mileage reimbursements to staff based on rates that are higher than AA Kenya rates will be taxable on the employees

The Act introduces a new section 31A to provide that a resident individual who proves that in a year of income the person has contributed to a post-retirement medical fund shall for that year of income be entitled to a personal relief referred to as post-retirement medical fund relief. Resident individuals making contributions to a post-retirement medical fund will be entitled to an additional tax relief in addition to the reliefs already provided for under the ITA including personal relief and insurance relief. This is meant to encourage individuals to take up post-retirement medical insurance products to cater for old age medical services.

A new subsection 5(7) in the ITA to provide that the taxation of the benefit from shares allocated to an employee by an eligible start-up in lieu of cash emoluments payable by virtue of employment shall be deferred and taxed within 30 days. This change is expected to incentivize employees of start-ups to work longer for their companies in order to realize the full potential of share-based compensation and avoid triggering early taxes. This change is also expected to boost the government's efforts in making Kenya a start-up hub.

The Act has amended the First Schedule of the ITA to introduce tax exemption on income earned by a non-resident contractor, sub-contractor, consultant or employee involved in the implementation of a project financed through a 100% grant under an agreement between the Government and the development partner, to the extent provided for in the Agreement. The exemption shall be valid only if the non-resident is in Kenya solely for the implementation of the project. This change will enhance cooperation between the Government and international development partners and promote cost-effective mobilization of inbound skills and labour by the development partners.

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