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HIGHLIGHTS OF FINANCE ACT 2022



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Newsletter

MBAYA AND ASSOCIATES

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Introduction

We are pleased to release the seventh edition of our tax newsletter. We appreciate the lively feedback and fruitful engagement we have had in the previous editions of our newsletters. This issue will summarize the key aspects of the Finance Act 2022 and the TIMS regulations for all VAT registered persons.

On the right column of the newsletter, you will find contact details for the senior members of our team who can help answer any questions you may have about the issues highlighted in this newsletter or any other matter.

We are interested in your feedback on the items covered and what topics you would like covered in the future. Please provide any feedback at tax@mbaya.co.ke

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Highlights of Finance Act 2022 »

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» From the **TaxDesk** »

Highlights of Finance Act 2022

The Finance Act 2022 ("Act") was assented into law on 21st June 2022 by his Excellency, the President of Republic of Kenya. Below are some of the key highlights;

Income Tax Act ("ITA")

Capital Gains Tax

The Finance Act, 2022 has increased the tax rate on capital gains from 5% to 15% through the amendment of Section 34(1)(j) of the ITA. The new tax rate will be effective from 1st January 2023.

Charitable Donations

Finance Act 2022 has amended Section 15(w) of the ITA. Previously, this section provided for deduction from taxable income any cash donations to a charitable organization registered under or exempt under the Societies Act or the Non-Governmental Organizations Coordination Act. The amendment now allows as a tax-deductible expense, any donations to all charitable organizations that are registered under the Companies Act, 2015, or as Trusts or under other applicable legislation where these entities are exempt from tax under Paragraph 10 of the First Schedule of the ITA or to any project approved by the Cabinet Secretary for Finance. This is effective from 1st July 2022.

Digital Service Tax on persons with a Permanent Establishment in Kenya

Digital service tax as provided for by the Section 12E, is a form of tax payable by a non-resident person whose income from the provision of services is derived from or accrues in Kenya through a business carried out over the internet or an electronic network including through a digital marketplace.

This amendment now clarifies that the digital service tax is only applicable to non-residents who do not have a permanent establishment in Kenya. The rate for digital service tax at 1.5% has been retained. This is with effect from 1st July 2022.

Special Economic Zones

The Finance Act 2022 has amended the First Schedule of the ITA by introducing tax exemption on dividends paid out by Special Economic Zones as follows:

- i. No tax on dividends paid by Special Economic Zone enterprises, developers and operators licensed under the Special Economic Zones Act.
- ii. No tax on dividends paid by Special Economic Zones enterprises, developers and operators to any non-resident person. This is effective from 1st July 2022.

Gains or Profits of Business in a Preferential Tax Regime

The finance Act 2022 has replaced the existing provision on gains or profits of business in a tax preferential regime with a new provision as follows:

Where: -

- a) A resident person carries on business with a related resident person operating in a tax preferential regime; or
- b) A resident person carries on business with;
 - i. A non-resident person located in a preferential tax regime; or
 - ii. An associated enterprise of a non-resident person located in preferential tax regime; or
 - iii. A permanent establishment of a non-resident person operating in Kenya where the non-resident person is located in a preferential tax regime.

And the business produces no gains or produces less gains than those which would have been expected to accrue from that business if the business activity was not with a party in a preferential tax regime, the gains of that resident person from that business shall be deemed to be the amount which would have been expected to accrue if that business had

been conducted by an independent person dealing at arm's length, or if none of the parties were located in a preferential tax regime. This is effective from 1st January 2023.

Additionally, the definition of preferential tax regime has been amended to read as follows:

"Preferential Tax Regime" means: -

- a) Any Kenyan legislation regulating or administrative practice which provides a preferential rate of tax to such income or profit including reductions in the rate or the tax base; or
- b) A foreign jurisdiction which;
 - i. Does not tax income
 - ii. Taxes income at a rate that is less than twenty per cent
 - iii. Does not have a framework for the exchange of information
 - iv. Does not allow access to banking information
 - v. Lacks transparency on corporate structure, ownership of legal entities located therein, beneficial owners of income or capital, financial disclosure or regulatory supervision.

Deferring of Foreign Exchange Losses

A foreign exchange gains or loss realized in a business carried on in Kenya shall be taken into account as a trading receipt or deductible expense in computing the gains and profits of that business for the year of income in which that gain or loss was realized; provided that

- i. No foreign exchange gain or loss shall be taken into account to the extent that taking that foreign exchange gain or loss into account would duplicate the amounts of gain or loss accrued in any prior year of income; and
- ii. The foreign exchange loss shall be deferred (and not taken into account)- where the foreign exchange loss is realized by the company whose gross interest paid or payable to related persons and third parties exceeds 30% of the company's earnings before interest, taxes, depreciation and amortization (EBITDA) in any financial year.

This amendment is effective from 1st July 2022 and now aligns the treatment of foreign exchange losses to the thin capitalization treatment.

Other Income Tax Act Changes

- a) **Definition of permanent home:** - means a place where an individual resides or which is available to that individual for residential purposes in Kenya, or where in the opinion of the Commissioner, the individual's personal or economic interests are closest.
- b) **Definition of fair market value:** - means the comparable market price available in an open and unrestricted market between independent parties acting at arm's length and under no compulsion to transact, which is expressed in terms of money or money's worth.
- c) **Change to employee share ownership plan:** - the value of the benefit shall be the higher of the cost to the employer or the fair market value of the benefit, provided that- in the case of an employee share ownership plan, the value of the benefit shall be the difference between the offer price per share, at the date the option is granted by the employer, and the market value, per share on the date when the employee exercises the option. Additionally, the employee share ownership plan does no longer need to be registered with the Commissioner as a collective investment scheme within

the meaning of Capital Markets Authority Act and will now be deemed to have accrued on the date the employee exercises the option and not at the end of the vesting period.

Prior to this amendment under the employee share ownership plans, the taxable benefits used to be the difference between the market value and the offer price at the date the option is granted.

Value Added Tax Act

Treatment of Imported Services

The Finance Act 2022 exempts the applicability of reverse VAT provision on taxable supplies made over the internet or an electronic network or through digital marketplace.

Section 10 (1) of the VAT Act states that if a supply of imported taxable services is made to any person, the person shall be deemed to have made a taxable supply to himself (reverse VAT). This is with effect from 1st July 2022.

Application of VAT Refunds

The Finance Act 2022 has expanded the scope of VAT refunds to include any VAT credits arising from input tax incurred by a manufacturer in respect to taxable supplies made to an official aid funded project approved by the Cabinet Secretary in accordance with the First Schedule of the VAT Act. If such VAT credits arose from input VAT incurred before 1st July 2022, the taxpayer is required to apply for such refund within 12 months. This amendment is effective from 1st July 2022.

Refund of Tax Paid in Error

The provision relating to refund application of tax paid in error has been deleted and moved to the Tax Procedures Act, 2015.

A taxpayer will be required to apply for refund of the tax paid in error within 6 months, in relation to VAT, and 5 years for other taxes. This is with effect from 1st July 2022.

Definition of Digital Marketplace

The Finance Act 2022, refers to *digital marketplace* as: - an online platform which enables users to sell goods or provide services. Previously, digital marketplace was referred to an online platform which enabled users to sell or provide services, goods or other property to other users.

Excise Duty Act

Annual Inflationary Adjustment

The Finance Act, 2022 has amended Section 10 of the Excise Duty Act, 2015 to empower the Commissioner to exempt from this inflation adjustment requirement, certain products depending on the prevailing economic circumstances facing them.

The amendment is a welcome addition as it will cushion against price increases of certain products that the Commissioner may exempt from inflationary adjustments of excise duty. This effective from 1st January 2023.

Definition of Ex-factory Selling Price

The Finance Act, 2022 has amended section 11 of the Excise Duty Act as follows:

Ex-factory selling price of excisable goods shall be the price payable by the purchaser if the excisable goods are sold by the manufacturer in an arm's length transaction.

Tax Procedures Act, 2015

Supply of Information upon change in particulars of Trusts

The Finance Act, 2022 has amended Section 9(1)(b) of the TPA, 2015 to require the notification of change of particulars of trusts, whether the trust is carrying out any business or not. This is with effect from 1st July 2022.

Amendments of Assessments

The Finance Act, 2022 has amended Section 31(4) of the TPA, 2015. The new proviso requires that in case of VAT, the input tax shall be allowable for a deduction within 6 months after the end of the tax period in which the supply or importation occurred. This aligns with the VAT Act provisions. This is effective from 1st July 2022.

Offset or Refund of Overpaid Tax (Effective 1st July 2022)

The Finance Act, 2022 has amended Section 47 of the TPA, 2015 to allow taxpayers with overpaid taxes to make an application requesting the Commissioner to:

- i. Offset the overpaid taxes against future tax liabilities; or
- ii. Issue cash refund of the overpaid taxes.

Once such application has been made, the Commissioner will have up to 90 days to make a determination. Where the Commissioner fails to issue a decision within the 90 days, such an application will be deemed ascertained and approved. Where a refund is due, the Commissioner will be required to issue the cash refund within 2 years from the date of application, failure to which an interest of 1% per month will accrue on the amount due.

VAT refund application has also been reduced from 2 years to 6 months.

Additionally, where an application to a refund has been made, the Commissioner shall apply the overpayment in the following ways;

- i. Payment of any other tax owing by the taxpayer under the specific tax laws.
- ii. Payment of a tax owing by the taxpayer under any other tax law.
- iii. Any remainder shall be refunded to the taxpayer.

Where the Commissioner has applied the overpaid tax to offset an outstanding tax liability, any outstanding tax after such application shall accrue interests and penalties.

However, with the new amendment, a taxpayer cannot apply for a refund of overpaid instalments taxes. Where a person overpays an instalment tax due under Section 12 of the ITA, the Commissioner shall apply the overpaid tax to offset the taxpayer's future instalment tax liability.

Refund of tax paid in error.

The Finance Act, 2022 has amended Section 47A of the TPA, 2015 by introducing a new provision where a person may be allowed to apply for a refund of taxes paid in error.

According to the new provision, a person will be allowed to apply for a refund of tax paid in error in relation to a zero-rated or exempt supply and such refund was not processed within the specified period due to circumstances beyond the control of the taxpayer.

The timeline for the application for the above refund of tax paid in error will be;

- i. 6 months in relation to VAT;
- ii. 5 years in relation to other taxes.

The tax credits relating to tax paid in error can be utilized in settling future tax liabilities due to the KRA. "Tax paid in error" according to this section has been defined as: - any tax paid which the Commissioner is satisfied ought not to have been paid. This is with effect from 1st July 2022.

Expansion of Definition of Security on Property for Unpaid Tax

The definition of "property" for which the Commissioner may use as security of unpaid taxes has now been expanded to include land or building, aircraft, ship, motor vehicle or any other property. Prior to this amendment, only land and buildings were available as security.

A taxpayer will be required to settle the outstanding taxes within 2 months after the Commissioner has notified the taxpayer that he has attached the property as security for unpaid tax failure to which the Commissioner will be allowed to auction the property at the taxpayer's cost to collect the unpaid taxes.

Where such outstanding amounts of taxes have been settled, the Commissioner shall then direct the registrar to cancel such notification to have the asset as security for unpaid taxes. This is effective from 1st July 2022.

Objection to Tax Decision

The Finance Act, 2022 now extends the time in which the Commissioner shall notify the taxpayer on the validity of the objection lodged to 14 days instead of immediately.

Further, the Commissioner shall provide an objection decision within 60 days from the receipt of a valid notice of objection. Taxpayer dissatisfied with the decision of the Commissioner may appeal to the Tribunal within 30 days after being notified of the decision. This takes effect from 1st July 2022.

Tax Invoice Management System (TIMS)

In a Public Notice issued on 13 July 2021, the Kenya Revenue Authority ("KRA") indicated that all VAT registered taxpayers are expected to comply with the requirements of the Regulations within 12 months from the commencement date; that is, by 31 July 2022.

Where a VAT registered person is unable to comply within the set timelines, the person can apply to the Commissioner for Domestic Taxes for an extension of time to comply, which shall not exceed six months.

The application for extension was supposed to be made at least thirty (30) days before expiry of the specified period of 12 months; that is, before 30 June 2022 but approval of this extension will be at the discretion of the Commissioner of KRA. KRA recently adopted the use of the Tax Invoice Management System ("TIMS") as an enhancement of the current Electronic Tax Register ("ETR") machine.

To comply with the Regulations, a VAT registered taxpayer should acquire a compliant tax register from an approved ETR supplier as published on 14 December 2021 on the KRA's website.

The approved manufacturers and suppliers have various ETR models that have been categorized into four types as follows:

- **Type A** for manual invoicing applicable for small businesses without an accounting software;
- **Type B** for retail outlets like supermarkets or restaurants with Point of Sale ("PoS") terminals;
- **Type C** for businesses with an automated invoicing system (ERP software) and are currently using an Electronic Signature Device ("ESD").
- **Type D** which is suitable for any type of business entity has the ability to connect to any of the invoicing systems (i.e., ETR, PoS or ERP).

We recommend that all VAT registered taxpayers consider migrating to TIMS before the time lapses.

Tax Due Dates

- Withholding Tax | 20th Day of the following month
- Pay as You Earn | 9th Day of the following month
- VAT | 20th Day of the following month
- Balance of Tax on Self-Assessment | 4th Month after year end
- Monthly Rental Income | 20th Day of the following month



Instalment Tax

- 1st Instalment | 20th day of the 4th month after year end
- 2nd Instalment | 20th day of the 6th month after year end
- 3rd Instalment | 20th day of the 9th month after year end
- 4th Instalment | 20th day of the 12th month after year end

Kindly note that all the returns must be filed on I tax while the payments e-slips must be generated from the I-Tax platform.

Digital Service Tax (DST)

20th day of the following month

Minimum Tax

Applicable where minimum tax is higher than instalment tax payable

- 1st Instalment | 20th day of the 4th month after year end
- 2nd Instalment | 20th day of the 6th month after year end
- 3rd Instalment | 20th day of the 9th month after year end
- 4th Instalment | 20th day of the 12th month after year end

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