



ORARO & COMPANY
ADVOCATES

LEGAL ALERT

The Finance Act, 2018

Introduction

Amidst controversy and recriminations across board, the Finance Bill, 2018 (**the Bill**), was eventually passed at a special sitting of the National Assembly on 20th September, 2018. The President assented to it on 21st September, 2018.

While the political branches were considering the Bill, a Constitutional Petition challenging its propriety on multiple grounds including whether or not it had been presented to Parliament in time, as well as the constitutionality of bringing some of its provisions into force before its enactment, was being litigated before the Courts. A day before the Finance Act, 2018 (**the Finance Act**) was passed, the High Court delivered its decision upholding two of the grounds the redoubtable Mr. Omtatah had pressed. One was the headline-grabbing invalidation of the Provisional Collection of Taxes Act which allowed the Cabinet Secretary (**CS**) Finance, to enforce provisions of the Finance Act before it was enacted. Lady Justice Okwany held that under Article 94 of the Constitution, only Parliament could pass legislation, and it had to be done within the stipulated process which included such fundamental issues such as effective public participation in law-making. By allowing prior enforcement of provisions of a bill by way of orders issued by a Minister, however temporarily, not only does the Executive unlawfully usurp the exclusive non-delegable powers of Parliament but also undermined the salutary inclusive law-making process. As the Provisional Collection of Taxes Act was invalidated, the CS's orders which had sought to implement various provisions of the Bill before it was enacted were also invalidated. The inevitable fall-out of such nullification is yet to be fully worked out.

Less remarked upon, but surely potentially more consequential or, at any rate, should be more consequential, is the High Court's finding that the Bill was presented late as that should have been done by 30th April, 2018 as required by Section 37 of the Public Finance Management Act, 2018. That section does not set out what happens in the event its provisions are not met. Lady Justice Okwany did not state what followed from her finding of contravention. There has always been controversy as to the consequence of breaches of mandatory statutory timelines. With notable exceptions, the traditional approach of most Kenyan Courts has been that such violation should lead to annulment of challenged action. We shudder to think what would happen if that approach was reflexively applied in this case. Would it follow that for the year 2018/2019, there would be no Finance Act at all and public fisc frozen until the new financial terms if hopefully the 2019 Finance Bill is presented in time?

While we do not pursue these and other allied issues such as whether or not as passed, the contents of the Finance Act are in conformity with the constitutionally set values upon which the burden of taxation should be distributed or the impact on the changes it has introduced or failed to introduce, they do provide part of the framework within the swirling controversies relating to the Finance Act should be considered.

In this Alert we look at some of the issues introduced by the Finance Act.

THE INCOME TAX ACT		
Measure	Changes	Effective date
Definition of Winnings	<p>Section 2 of the Income Tax Act (CAP 470) has been amended by expanding the definition of “winnings” beyond the previous limit of net payments from a bookmaker licensed under the Betting, lotteries and Gambling Act to now capture all payments that are classified as “winnings.”</p> <p>This amendment seeks to expand the tax base to cover all aspects of licensed fortune based winnings.</p>	1 st July, 2018
Dividend Payment	<p>Section 7(1) of the Income Tax Act has been amended to include the definition of what amounts to a dividend payment. More specifically a dividend will be deemed to have been paid in when:-</p> <ul style="list-style-type: none"> • Any cash or asset is distributed or transferred by that company to or for the benefit of that shareholder or any person related to that shareholder; • The shareholder or any person related person to that shareholder is discharged from any obligation measurable in money which is owed to that company by that shareholder or related person; • The amount is used by that company in any other manner for the benefit of the shareholder or any related person to that shareholder; • Any debt owed by the shareholder or any person related to that shareholder to any third party is paid or settled by that company; and • The amount represents additional taxable income or reduced assessed loss of that company by virtue of any transaction with the shareholder or related person to such shareholder, resulting from an adjustment. <p>Effectively, where a shareholder and the company that involves the transfer of assets or cash (including debt), then the same will be deemed to be a</p>	1 st July, 2018

	dividend distribution triggering withholding taxes.	
Compensating Tax	<p>Section 7A of the Income Tax Act which provides for compensating taxes on dividends distributed out of gains or profits on which no tax is paid has been amended. The company distributing such dividends will now be subjected to tax at the resident corporate rate of tax on the gains or profits from which such dividends are distributed. This provision will however not apply to registered collective investment schemes.</p> <p>There has been a considerable reduction from the effective compensating tax rate of 42.8% to the corporate tax rate of 30%.</p>	1 st July, 2018
Presumptive Tax	<p>In an effort to widen the tax base and to bring the informal sector into the tax net, Section 12C (on turn- over tax) of the Income Tax has been repealed and replaced with provisions on presumptive tax.</p> <p>Presumptive tax is due from businesses issued with business permits or trade licences by the county governments and with a turnover of less than 5 million shillings per annum. The tax is computed at the rate 15% of the business permit or trading licence fees and is due at the time of payment for the business permit or renewal of the same. This will definitely ensure compliance on the part of the businesses.</p>	1 st January, 2019

Reduction in Operating Costs	In an effort to reduce operating costs and as part of fostering the Government's 'big four' agenda, a new Section 15 (ab) has been introduced to the Income Tax Act effectively allowing manufacturers to deduct a further 30% of the electricity cost incurred when determining their taxable income. This will however be on the basis of guidelines to be provided by the Ministry of Energy.	1 st January, 2019
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THE BANKING ACT		
Measure	Changes	Effective date
Interest Rate Cap	<p>The amendment of the Banking Act by the inclusion of Section 33B, which effectively capped interest rates on loans and credit from banks and financial institutions in August of 2016, filled the majority of players in the banking industry with trepidation over the future of a banking sector which had grown in leaps and bounds over the past decade. The amendment may well be recounted as a deleteriously defining milestone of the industry in the recent past.</p> <p>The challenge that the provision presented, not only to free-market principles but also to the notion of more availability of credit to diverse strata of the Kenyan population, the latter being a scourge which it was ironically introduced to cure but may have exacerbated instead by the reticence of financial institutions to give high risk cheap credit, has been a hot topic of discussion amongst industry professionals since its passing in 2016.</p> <p>The Finance Act seems to have brought finality to the diverse opinion on whether the provision brought financial inclusion or to the contrary was a banal attempt at achieving financial inclusion which had been tried and failed in other jurisdictions. The Bill has tabled a provision seeking repeal of Section</p>	1 st October, 2018

	<p>33B effectively reverting loan pricing by banks and financial institutions to free market principles.</p>	
<p>Mortgage Re-Finance</p>	<p>The Finance Act seeks to foster one of the Government’s big four agendas being provision of housing. The proposed amendment to Section 2 of the Central Bank of Kenya Act introduces in its definitions non deposit taking companies which will be licensed under the Companies Act, 2015 to conduct the business of mortgage refinance and a proposed Section 4A 1 (g) which provides for licensing of mortgage refinance companies.</p> <p>The provision seeks to provide an accessible framework for Kenyans to refinance existing mortgages on favorable terms in order to achieve the objective of better credit terms for aspiring home owners. The amendment seeks to provide access to financing for primary mortgage lenders and can be viewed as an alternative way of enhancing wider overall accessibility to credit without the use of interest rate capping.</p> <p>The introduction of mortgage refinance business has also necessitated the introduction of licensing and regulatory measures with the Finance Act proposing amendments by way of Section 33P and 33Q to the Central Bank of Kenya Act which effectively provide for licensing, regulation and liquidity control measures that seek to curb abuse of the business by unscrupulous players. The Finance Act also proposes amendment to Section 43 to ensure that mortgage refiners comply with reporting standards applicable to financial and microfinance institutions.</p>	<p>1st October, 2018</p>

THE EMPLOYMENT ACT

Measure	Changes	Effective date
<p>National Housing Development Fund</p>	<p>The Employment Act, 2007 has been amended by the inclusion of Section 31A which provides for the deduction of 1.5% of an employee's monthly basic salary, an amount to be matched by the employer, provided that the sum of the employer and employee contributions shall not exceed KES 5,000.</p> <p>This Act further provides that the contributions highlighted above shall be used to finance the purchase of a house under the affordable housing scheme for employees who qualify for the scheme. Employees who do not qualify shall have the following options upon the expiry of fifteen years from the date of the start of making the contributions, or after the attainment of retirement age, whichever is sooner:</p> <ol style="list-style-type: none"> I. to receive their contributions in cash; II. a transfer of their contributions to a pension scheme registered with the Retirement Benefits Authority; III. a transfer of their contributions to their spouse or dependent children; or, IV. a transfer of their contributions to any person registered and eligible for affordable housing under the National Housing Development Fund. 	<p>Upon the gazettelement of regulations prescribing the requirements for qualification to the scheme by the Cabinet Secretary responsible for housing in consultation with the Cabinet Secretary responsible for finance.</p>

THE EXCISE DUTY ACT

Measure	Changes	Effective date
Duty on Confectionaries	<p>Part I of the First Schedule of the Excise Duty Act, 2015 which sets out the rates of Excise Duty applicable on goods, has been amended by the inclusion KES 20 per kg duty on sugar and confectionary (including white chocolate).</p> <p>This amendment has essentially been reintroduced as it was part of the Finance Bill that was initially debated by parliament; the national assemble however chose to exclude it from the Bill they initially passed.</p>	1 st July, 2018
Excisable Services	<p>Part II of the First Schedule of the Excise Duty Act, 2015 which covers excisable services has been amended by the increase of Excise Duty on the following services:</p> <ol style="list-style-type: none"> I. Telephone and Internet data shall be charged Excise Duty at the rate of 15% of the excisable value. This is an increase of 5%; II. Money Transfer Services by banks, money transfer agencies and other financial services providers shall be charged Excise Duty at the rate of 20% of the excisable value. This is an increase of 10%; III. Money Transfer Services by cellular phone service providers shall be charged Excise Duty at the rate of 12% of the excisable value. This is an increase of 2%; and IV. Other fees charged by financial institutions shall be charged Excise Duty at the rate of 20% of the excisable value. This is an increase of 10%. 	1 st July, 2018
Exempt Goods	<p>Section 7 of the Excise Duty Act, 2015 which provides for goods that are exempt from Excise Duty, has been amended by the inclusion of a requirement that an exemption under that section will be issued where the Commissioner is satisfied that:</p> <ol style="list-style-type: none"> a) Goods that meet the requirements set out in the Second Schedule of 	1 st July, 2018

	<p>the Excise Duty Act,2015 were received and consumed by the exempt person, and</p> <p>b) Excisable goods that are meant for export are not consumed in Kenya.</p> <p>Section 23 of the Excise Duty Act, 2015 has been replaced with a new Section 23 which is to the effect that the Commissioner may suspend a license after giving a Notice of 21 days in writing setting out circumstances which to be remedied failure of which the Commissioner may proceed to suspend the license. The Act has been amended to allow the Commissioner to suspend a licence without Notice where the licensee:</p> <p>a) has engaged in tax fraud;</p> <p>b) has been found in possession of, or using, counterfeit stamps on excisable goods;</p> <p>c) has been found in possession of goods bearing counterfeit stamps; or</p> <p>d) has violated any regulations relating to health and safety, standards or packaging of goods.</p> <p>Section 38 has been amended effectively capping the penalty for undertaking excisable activities to be the higher of the double the excise duty that would have been payable if the person were licensed or KES 5 million.</p>	
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THE BETTING, GAMBLING AND LOTTERIES ACT		
Measure	Changes	Effective date
Split Burden on Gambling Companies	Sections 29A, 44A, 55A, and 59B in respect of Betting Tax, Lottery Tax, Gaming Tax, and Prize Competition Tax respectively have been amended by the reduction of the tax rate from 35% to 15%.	1 st July, 2018

	<p>Under the Income Tax Act winners are taxed at 20% of their winnings, the above highlighted decrease from 35% to 15% is targeted at splitting the total 35% tax burden between the winners and the companies.</p>	
<p>Fit and proper criteria for casinos</p>	<p>The Betting Control and Licensing Board (the board) is tasked to consider applications from persons desiring to obtain, renew or vary a betting license. Criteria which the board will be required to consider include:</p> <ul style="list-style-type: none"> • The financial status or solvency of a person; • education qualifications or other experience of the applicant considering the nature of the functions, if the application will be granted, the person shall be required to perform; • status of any other license or approval granted to the applicant by any financial sector regulator; • ability of the applicant to carry out on the betting, gaming or lottery activity competently, honestly and fairly; • reputation, character, financial, integrity and reliability of a person or in the case of a company applying for a license, the reputation, character, integrity and reliability of its chairperson, directors, CEO, management and all its personnel. <p>In deciding if an applicant is fit and proper, the board will also consider:</p> <ul style="list-style-type: none"> • whether the applicant has contravened any Kenyan or foreign law which is designed to protect the public against financial loss due to dishonest practices; • whether the applicant was a director of a licensed person who has been liquidated or is under liquidation or statutory management; • whether the applicant has engaged in business which in the opinion of the board was fraudulent, prejudicial to the public interest and to the market; • whether the applicant took part or was associated with any business practice which cast doubt on the competence or soundness of 	<p>1st July, 2018</p>

	<p>judgment of that applicant;</p> <ul style="list-style-type: none"> • any person employed by, associated with, or who shall be acting for or on behalf of the applicant for the purpose of a regulated activity including an agent; and • whether the applicant has set up effective internal control procedures and risk management systems to ensure compliance with all applicable regulatory requirements. <p>Making false statements or declarations in the application for, or a renewal of, or variation of a license is an offence which attracts a fine not exceeding KES. 5,000 or to imprisonment for a term not exceeding six (6) months, or to both.</p>	
<p>New Taxes</p>	<p>a) Betting tax Gaming revenue shall attract a Betting Tax of 15%.</p> <p>b) Lottery Tax Lottery turnover shall attract a Lottery Tax of 15%.</p> <p>c) Gaming Tax Gaming revenue shall attract a Gaming Tax of 15%.</p> <p>d) Prize competition Tax This tax shall be chargeable on the cost of entry into a competition at 15% of the total gross turnover.</p> <p>These new taxes become due to the Kenya Revenue Authority on the 20th day of the month following the month of collection. The funds from these taxes will then be paid to the Sports, Arts and Social Development Fund.</p>	<p>1st July, 2018</p> <p>1st October, 2018</p> <p>1st July, 2018</p> <p>1st July, 2018</p>

<p>Late Payment Penalty + Interest</p>	<p>Late payment of the new taxes above attract a penalty of 5% of the tax payable, and also a Late Payment Interest (the interest) at a rate equal to 1% per month or part of the month on the amount unpaid for the period until the tax is paid in full.</p> <p>The interest shall be payable to the collector and shall be treated as a tax payable by the person liable to the tax. The accrued interest shall not, in aggregate, exceed the principal tax liability.</p> <p>Persons liable to late payment penalty or interest may apply to the Commissioner General of the Kenya Revenue Authority (the Collector) for the remission of the penalty or interest payable and the application shall include the reasons for the application.</p> <p>The Collector may remit in whole or in part, the late payment penalty or interest if satisfied that the remission is by reason of:</p> <ul style="list-style-type: none">• consideration of hardship or equity; or• impossibility or undue difficulty or expense, of recovery of tax provided that:-<ul style="list-style-type: none">- where the penalty or interest payable exceeds KES 1,500,000 the Commissioner General shall seek prior approval of the Cabinet Secretary responsible for finance; and- make quarterly reports to the Cabinet Secretary responsible for finance on the remissions granted.	<p>1st July, 2018</p>
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TAX PROCEDURES ACT

Measure	Changes	Effective date
Tax Amnesty	<p>Section 25 of the Tax Procedures Act has been amended effectively introducing a time period within which a tax payer may make an application for extension of time for filing tax return to 15 days before the date in the case of a monthly return and 30 days before the due date in the case of annual returns. It has further provided that the Commissioner shall grant the application for extension of time and notify the tax payer within (5) days before the due date provided that where no notification is received then the Application shall be deemed to have been granted and only one extension shall be granted to an applicant in respect of a tax period.</p> <p>Section 37B of the Tax Procedures Act on Tax Amnesty has also been amended. The initial provision was to the effect the Commissioner will not assess or recover tax or penalty earned on or before 31st December, 2017 so long as the income has been declared for the year 2017 by a person earning taxable income outside Kenya. The Finance Act has not only extended the period of filing the returns and accounts to 30th June, 2019 but it has now made it a requirement that the funds declared voluntarily have been transferred back to Kenya.</p> <p>In addition, the provision is to the effect that where no funds have been transferred within the period of the amnesty, there shall be a five year period for remittance but a penalty of ten percent shall be levied on the remittance.</p> <p>More importantly, the amnesty extends to the provisions of Proceeds of Crime and Anti-Money Laundering Act, 2009 or any other Act relating to reporting and investigation of financial transactions, to the extent of the source of the funds excluding funds derived from proceeds of terrorism, poaching and drug trafficking.</p>	1 st July, 2018

THE VALUE ADDED TAX ACT

Measure	Changes	Effective date
Value Added Tax (VAT) on Oil and Gas Products	<p>Section 5 of the Value Added Tax Act, 2013 has been amended by inserting Clause 18A which places VAT at the rate of 8% on the goods listed in Section B Part I of the First Schedule of this Act. Amongst the goods affected include petroleum oils and oils obtained from bituminous minerals, crude; motor vehicle fuel; spirit and kerosene based jet fuel; illuminating kerosene; natural gas in gaseous state etc.</p> <p>The taxable value of the goods mentioned above shall specifically exclude excise duty, fees and other charges.</p> <p>The national assembly had initially chosen to once again postpone the imposition of VAT at rate of 16% on the products highlighted above, the president's memorandum instead proposed the rate that is now in place.</p>	Upon enactment of the Supplementary Appropriation Act.

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