



ORARO & COMPANY
ADVOCATES

An Affiliate Member of AB & DAVID AFRICA

LEGAL ALERT

AN OVERVIEW OF THE FINANCE ACT, 2022

Background

This Alert contains a summary of the major tax law changes brought about by the Finance Act, 2022. The amendments come into force with effect from 1st July, 2022 save for the following amendments which will take effect from 1st January, 2023:

- Capital gains tax;
- Financial derivatives;
- Ascertainment of gains and profits from a preferential tax regime; and
- Inflation adjustment;

1. INCOME TAX ACT

The Finance Act, 2022 has amended the Income Tax Act (Cap. 470) Laws of Kenya (“**ITA**”) to provide for definitions of the terms “financial derivative” and “permanent home”.

a. Financial Derivatives

From 1st January 2023, the definition of financial derivatives in the ITA shall be instruments whose value is linked to the value of an underlying instrument. Gains from derivatives, except gains resulting from trading at the Nairobi Securities Exchange, shall now be subject to income tax. Gains earned by non-residents shall be subject to withholding tax at fifteen percent (15%). The Act now empowers the Cabinet Secretary for matters relating to finance to make regulations on the taxation of these derivatives.

Further gains from such transactions in derivatives will be subject to tax at fifteen percent (15%).

b. Permanent home

A permanent home, for income tax purposes, now means a place where an individual resides or a place available for them to reside. Further, if the Commissioner of Domestic Taxes (“**the Commissioner**”) is now empowered to deem one to have a permanent home in Kenya based on where the individual’s personal or economic interests are closest. This new definition will increase the scope of individuals deemed to be Kenyan tax residents thus widening the tax base.

c. Foreign exchange losses

Prior to the Finance Act 2022, section 4A of the ITA limited foreign exchange losses claimable by entities to the extent that the loan(s) exceed three (3) times the entity’s capital and retained earnings if the loan(s) are from a person whom (alone or with four (4) or fewer persons) controls the entity.

Under the amended law, the forex losses a business can claim as deductible expenses are limited to a maximum of thirty percent (30%) of the entity’s earnings before interest, taxes, depreciation and amortization. However, with the amendment, in addition to banks, other microfinance entities, entities licenced under the Hire Purchase Act (Cap. 507) Laws of Kenya, are now also exempt from this limitation.

d. Employee share ownership plans

Pursuant to the amendment, the ITA now defines the value of employee share ownership schemes as the difference between the offer price at the date the benefit is granted and the market value when the employee



takes up these shares. Prior to the amendment, the benefit was calculated as the difference between the market value per share and the offer price per share at the date the employer grants this benefit.

Previously, such benefits were deemed to have accrued to the employee at the end of the vesting period. Now, the date of accrual is the date the employee exercises the stock option.

e. Digital Service Tax

Digital Service Tax (“DST”) is a tax applicable to income of non-resident persons offering services over the internet derived in Kenya. Non-resident entities that have a permanent establishment in Kenya will now be exempt from DST as resident tax taxpayers are not subject to DST. The proposal to increase the DST rate from the current one and half percent (1.5%) to three percent (3%) did not pass and the previous prevailing rate is retained.

f. Allowable deductions

Donations (in any form) to charitable organizations whose income is exempt from income tax as well as donations to projects approved by the Cabinet Secretary responsible for matters relating to finance shall now be allowed as deductions in the calculation of a person’s taxable income. Previously, only cash donations to charitable Non-Governmental Organizations and Societies were allowable as deductions in the calculation of taxable income.

Previously, telecommunications operators were only allowed to deduct a maximum of five percent (5%) of the acquisition costs of the right to use a fibre optic

cable per annum. This provision has been deleted and resultantly now prohibit telecommunications operators from deducting expenses relating to the acquisition of rights to use a fibre optic cable.

g. Thin capitalization

Entities that have a total gross interest paid or payable to related persons and third parties in excess of thirty percent (30%) of earnings before interest, taxes, depreciation and amortization in any financial year are deemed to be thinly capitalized thus are subjected to a limitation on the amount of interest they can expense.

The following types of entities shall now be exempt from thin capitalization rules:

1. microfinance institutions;
2. non-deposit taking microfinance institutions;
3. non-deposit taking institutions involved in lending and leasing;
4. entities licensed under the Hire Purchase Act;
5. vaccine manufacturing companies;
6. manufacturing companies whose cumulative investment outside Nairobi and Mombasa counties is at least KES 5 billion;
7. manufacturing companies whose cumulative investment in the five (5) years preceding 1st July 2022 is at least KES 5 billion; and
8. holding companies regulated under the Capital Markets Act.

h. Ascertainment of profits in a preferential tax regime

From 1st January 2023, the ITA shall have more

stringent provisions on determination of profits and gains earned by a business operating in a preferential tax regime. Currently, the ITA regulates the determination of gains by resident entities operating in a preferential tax regime resulting from transactions with related resident entities not operating in a preferential tax regime. The amendment expands this scope to include transactions by a resident person with:

1. Non-resident persons operating in a preferential tax regime;
2. An associated enterprise of a non-resident person operating in a preferential tax regime;
3. A permanent establishment in Kenya of a non-resident person operating in a preferential tax regime

In other words, if a resident businesses' gains from transactions with any of the above businesses results in the resident earning no or less gains than it would have earned if the transaction was done with an independent entity at arm's length or if none of the parties was in a preferential tax regime, the gains shall be deemed to be the amount which would have been expected in an arm's length transaction.

From the effective date, the definition of preferential tax regime shall include:

1. Any Kenyan law that provides for a preferential tax rate or smaller tax base;
2. A foreign jurisdiction with a tax rate lower than twenty percent (20%), does not have an information sharing framework, does not allow

access to banking information or a jurisdiction that lacks transparency in the structure and ownership of entities in that jurisdiction.

i. Multinational group reporting

Prior to the amendment, only ultimate parent entities resident in Kenya were subject to the country-by-country ("CbC") reporting requirements. For the years of income 2022 onwards, multinational groups with a turnover in excess of KES 95 billion will be required to provide significantly more detailed reports to the Commissioner.

These reports will include details of all the group's entities and their respective activities. Entities will also be required to submit a master file that contains the group's overview, growth engines, supply chain description of all key products, the group's research and development policy, each constituent's contribution to the value chain, information on intangible assets and the group's intercompany agreements on the same, information on the transfers of intangible assets within the group, the group's financing activities, the group's consolidated financial statements, tax rulings made in respect of the group and any other information required by the Commissioner.

Where the ultimate parent entity is required to file a master and local file, all other resident related entities will not be required to do the same.

Further, resident entities will not be subject to the ("CbC") reporting requirements if a non-resident surrogate parent entity is required to and files a similar

report in its jurisdiction and that jurisdiction has an information sharing agreement with Kenya.

j. Unique tax rates

The Finance Act, 2022 has introduced provision to cover businesses under special operating framework arrangement with the Government.

Companies incorporated for production of vaccines for humans doing business under a special operating framework arrangement with the government that have invested at least KES 10 billion will be subject to a tax rate specified in the special operating framework.

Carbon markets and emissions trading systems certified by the Nairobi International Financial Centre Authority (“NIFCA”) will enjoy a corporate income tax rate of fifteen percent (15%) for the first ten (10) years of their operations. Companies operating a shipping business in Kenya will also enjoy the fifteen percent (15%) tax rate for the first ten (10) years of operation.

Interest and deemed interest on bearer bonds issued outside Kenya for a period of at least two (2) years and interest, discount or original issue discount are now subject to tax at seven and a half percent (7.5%).

k. Insurance relief

Previously, the insurance relief provision was biased towards men as it allowed claiming of insurance relief on premiums paid on their wives. The amendment now introduces gender neutral terms to ensure non-discrimination in the enjoyment of insurance relief.

l. Capital gains

From 1st January 2023, Capital Gains Tax (“CGT”) shall be increased to fifteen percent (15%) from the current rate of five percent (5%).

However, firms certified by NIFCA that invest KES 5 billion and transfer such investment after five (5) years will be subject to the CGT rate applicable at the time the investment was made.

m. PAYE

Prior to the enactment of the Finance Act, 2022 the Commissioner had the power (upon written approval of the Cabinet Secretary responsible for matter relating to finance) to remit penalties up to KES 500,000 per annum for employers resulting from an employer’s failure to deduct and remit employment taxes. The Finance Act, 2022 has revoked this power effective 1st July 2022.

n. Exemptions

From 1st July 2022, the following types of income will be exempt from income tax:

1. Income of human vaccine manufacturers;
2. Payments made to non-resident for services rendered to human vaccine manufacturers;
3. Dividends paid by a vaccine manufacturer to non-resident person;
4. Deemed interest on an interest free loan advanced to a human vaccine manufacturer;
5. Compensating tax accruing to a vaccine manufacturer;



1. Dividends paid by Special Economic Zone enterprises, developers and operators (to residents or non-residents)

o. Investment deductions

In 2020, entities that constructed bulk storage and handling facilities to support operations of the standard gauge railway capable of handling at least 100,000 tonnes of cargo were entitled to a one-off investment deduction of one hundred and fifty percent (150%) of the amount spent in construction of such facilities. This incentive was valid until 31st December 2021 but was extended to 31st December 2022. The Finance Act, 2022 has extended the application of this benefit to 31st December 2023.

Currently, investment deduction of one hundred percent (100%) is allowable on investments outside Nairobi and Mombasa Counties if cumulatively above KES 2 billion for the last three years, at least KES 250 million within the year of income or within a special economic zone. As a result of the amendment, investment deduction of one hundred and fifty percent (150%) will be allowable for investments outside Nairobi and Mombasa counties that have a cumulative investment of KES 2 billion in the four (4) years preceding or three (3) years succeeding 1st July 2022.

2. STAMP DUTY ACT

a. Exemptions

From 1st July 2022, instruments executed in favour of a mortgage refinance company will be exempt from stamp duty.

3. VALUE ADDED TAX

a. Liquified petroleum gas (LPG)

Liquified petroleum gas ("LPG") including propane will now be subject to value added tax ("VAT") at eight percent (8%).

b. Transactions in a digital marketplace

A digital marketplace, for VAT purposes shall be restricted to the provision of goods and services. Prior to the amendment, a digital marketplace included selling of other property. Further, services offered in a digital marketplace shall be exempted from treatment as imported services. As a result, reverse VAT would not be applicable to such services.

In addition, suppliers of imported digital services over the internet are now not subject to the KES 5 million VAT registration threshold.

c. Input VAT credits

The Finance Act, 2022 now prescribes the documents required by an oil marketing company ("OMC") to claim input VAT relating to petroleum products imported under the Open Tender System. These include:

- A custom entry indicating the name and KRA personal identification number ("PIN") of the tender winner
- The name of the other OMCs participating in the tender

d. Refunds

Manufacturers may now, within twelve (12) months of supply, apply for refund of excess input VAT arising

from making supplies to official aid funded projects that are approved by the Cabinet Secretary responsible for matters relating to finance.

e. VAT on imports

The Finance Act, 2022 now applies penalty and interest rates as per the Tax Procedures Act, 2015 (“TPA”) to the offence of non-declaration of goods to a customs officer. It further limits interest payable to a maximum of the principal tax.

f. Tax paid in error

Refund of taxes paid in error will be governed by the TPA as opposed to the Value Added Tax Act, 2013.

g. VAT exemptions & zero-rating

Fertilizers (Under Chapter 31 of the Harmonized System) have been reclassified from exempt to zero rated. Further, purchases for manufacturing fertilizer may be periodically zero rated by the Cabinet Secretary responsible for matters relating to agriculture.

Exportation of taxable services will no longer be exempt. However, exportation of taxable services in respect of business process outsourcing is now zero rated.

Taxable supplies used in the construction and equipping of specialized hospitals are no longer exempt. However, any exemptions granted prior to the repealing will apply until supply of the exempted goods is made in full.

Fire safety equipment purchased by hospitals and clinics and firefighting equipment purchased by county governments are no longer zero rated.

The following supplies are now exempt from VAT:

1. Bioethanol vapour stoves;
2. Sustainable fuel pellets (previously, only briquettes were exempt);
3. Plant and machinery for manufacture of pharmaceutical products upon recommendation of the Cabinet Secretary responsible for health matters;
4. Medical oxygen supplied to registered hospitals;
5. Urine bags, adult diapers, artificial breasts, colostomy/ileostomy bags;
6. Inputs used in the manufacture of passenger motor vehicles; and
7. Locally manufactured passenger motor vehicles;
8. Imports and purchases by a business engaged in a special operating framework with the government;
9. Imports and purchases by a manufacturer of human vaccines whose capital investment is at least KES 10 billion (subject to approval by the Cabinet Secretary responsible for matters relating to health); and
10. Capital goods which the Cabinet Secretary

responsible for matters relating to finance deems promote investment in manufacturing where the value of investment is at least KES 2 billion.

4. EXCISE DUTY

a. Inflation adjustments

The Commissioner is now empowered to exempt specific excisable products from the annual inflation adjustment upon the approval of the cabinet secretary

depending on the economic circumstances in the relevant year.

b. Goods under customs control

The Finance Act, 2022 now applies the penalty and interest rates as per the TPA to customs-related

offences and limits interest payable to a maximum of the principal tax.

c. Increments in excise duty rates

The Finance Act, 2022 now provides the following increments in excise duty rates:

No	Item(s)	Previous rate	New rate
1	Fruit juices	KES 12.17 per litre	KES 13.30 per litre
2	Perfumes, makeup, hair products, aftershave & deodorant	10%	15%
3	Beer & ciders	KES 121.85	KES 134 per litre
4	Wines	KES 208.20 per litre	KES 229 per litre
5	Spirits exceeding 6% alcohol content	KES 278.70 per litre	KES 335.30 per litre
6	Cigars	KES 13906.04 per kg	KES 15,296.60 per kg
7	Cigarettes with filters	KES 3,447.61 per mille	KES 3,825.99 per mille
8	Cigarettes without filters	KES 2,502.74 per mille	KES 2,752.97 per mille
9	Other manufactured tobacco products and manufactured tobacco substitutes	KES 9,734.45 per kg	KES 10,707.88 per kg



No	Item(s)	Previous rate	New rate
10	Imported sugar confectionary	KES 36.74 per kg	KES 40.37 per kg
11	White chocolate	KES 200 per kg	KES 242.29 per kg
12	Jewellery made from or coated with precious metals & imported imitation jewellery	10%	15%
13	nicotine gum & vaporizers	KES 1,200 per kg	KES 1,500 per kg
14	Plastic under HS code 3923.90.90	N/A	10%
15	Imported frozen/preserved potatoes, potato crisps & potato chips	N/A	25%
16	E-cigarettes	KES 3,787 per unit	40%
17	Liquid nicotine for e-cigarettes	KES 2,525 per unit	KES 70 per ml
18	Imported furniture	25%	N/A
19	Locally sourced unsaturated polyester, alkyd, emulsion VAM, emulsion BAM, emulsion styrene acrylic, homopolymers	10%	N/A
20	Imported ready to use SIM cards	N/A	KES 50
21	Betting on horse racing	7.5% of staked amount	N/A
22	Fees charged by digital lenders	N/A	20%
27	Importation of mobile phones	N/A	10%



d. Exemptions

The following products shall now be exempt from excise duty:

1. Neutral spirit imported by pharmaceutical manufacturers upon the Commissioner's approval;
2. Locally manufactured passenger motor vehicles;

5. TAX PROCEDURES ACT

a. Security for unpaid taxes

Before 1st July 2022, the Commissioner was empowered to instruct the Registrar of Lands to place a restriction on a defaulting taxpayer's land. The scope of that power has been expanded to include restrictions on aircrafts, ships, motor vehicles and any other property. However, it is subject to pre-existing restrictions on the property. Further, the Commissioner may dispose of such property within two months after notifying the defaulting taxpayer and any other person if the taxpayer fails to settle the disputed taxes. Such a restriction shall be lifted if the taxpayer settles the undisputed taxes due or upon settlement of the final instalment based on an agreed payment plan.

b. Agency notices

The Commissioner is now prohibited from issuing an agency notice unless it has confirmed its assessment and the taxpayer has not appealed to the Tax Appeals Tribunal within the statutory timelines. In addition, the Commissioner is under an obligation to serve a taxpayer affected by an agency notice at the same time the agent is served.

Persons served with an agency notice now have a fourteen (14) days' window within which to give reasons to the Commissioner if they are unable to comply with the agency notice. Prior to the amendment, the window was only seven (7) days long.

c. Refund or setoff of overpaid taxes

The window for applying for refund of overpaid VAT is now six (6) months from the date of overpayment which was not the case before the amendment.

If the Commissioner fails to verify and determine a refund application for overpaid taxes within ninety (90) days, the refund application shall be deemed to be approved. Further, if the Commissioner fails to refund an approved refund within two (2) years from the refund application date, the refundable amount shall accrue interest at one percent (1%) per month on the unpaid amount.

d. Invalidly lodged Objections

If the Commissioner determines that a Notice of Objection has not been validly lodged, they will have fourteen (14) days from the date of receipt of the Objection to notify the taxpayer that the objection is invalid. Prior to this amendment, the Commissioner was to do so "immediately" which was an ambiguous timeframe.

e. PIN requirement for trusts

Persons seeking to register a trust will be required to adduce their PIN during the registration of the same.

6. MISCELLANEOUS FEES AND LEVIES

a. Export levy annual adjustment

Annual adjustments to export levies shall now be done by 1st October of every financial year. Previously, it was at the beginning of each financial year.

b. Import Declaration Fees (IDF) and Railway Development Levy (RDL) exemptions

The following goods are now exempt from IDF and RDL:

1. Inputs for the manufacture of pharmaceutical products upon the recommendation of the Cabinet Secretary responsible for matters relating to health;
2. Goods for the construction and maintenance of a human vaccine manufacturing plant as approved by the Cabinet Secretary to the National Treasury upon recommendation by the Cabinet Secretary responsible for matters relating to health; and
3. Goods imported by a company manufacturing human vaccines under a special operating framework that has invested at least KES 10 billion on recommendation of the Cabinet Secretary responsible for matters relating to health and approval of the Cabinet Secretary to the National Treasury.

Disclaimer

This alert is for informational purposes only and should not be taken to be or construed as a legal opinion. If you have any queries or need clarification, please do not hesitate to contact [Renee Omondi](mailto:renee@oraro.co.ke) (renee@oraro.co.ke), [Nzioka Wang'ombe](mailto:nzioka@oraro.co.ke) (nzioka@oraro.co.ke) or your usual contact at our firm.



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