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The President assented to the Finance Act 2022 on 21st June 2022. We have highlighted some of the key changes introduced by the Finance Act 2022 in relation to Income Tax and Value Added Tax.

Income Tax

Taxation of gains from financial derivatives

The Act has amended the Income Tax Act by introducing tax on gains accruing to non-residents from financial derivatives. The Act defines a financial derivative as:

“A financial instrument the value of which is linked to the value of another instrument underlying the transaction which is to be settled at a future date”

The gains accruing to non-residents shall be subject to withholding tax at 15% subject to Regulations to be issued by the Cabinet Secretary National Treasury.

It is important to note that the gains accruing to non-resident persons from derivatives listed on the NSE shall be exempt from the tax.

The Financial derivatives market went live on 4th July 2019 in Nairobi making it the second derivatives market in Sub-Saharan Africa after the Johannesburg market. The desk has traded over KES 168M since its launch making it a soft target for the taxman.

This amendment took effect on 1st July 2022.

Relief from DST for non-resident with PE in Kenya

The Act has introduced an amendment to the Income Tax Act to the effect that a non-resident person with a permanent establishment in Kenya shall be exempt from DST.

Non-resident persons with a PE in Kenya shall no longer be required to account for DST on services rendered through a digital market place.

This amendment took effect on 1st July 2022

Capital Gains Tax

The Act has increased the capital gains tax (CGT) rate from 5% to 15%. Kenya has enjoyed a lower CGT rate compared to its counterparts in the East African region. The sharp increase has elicited an outcry from real estate industry players who are struggling with reduced spending due to increased inflation.

The amendment is set to take effect on 1st January 2023.

Transfer Pricing

Transfer-Pricing implications for entities operating in a preferential tax regime

The Act has amended section 18 (A) of the Income Tax Act (ITA) to include within the ambit of transfer pricing (TP) transactions between resident persons and the following persons located in a preferential tax regime;

- A related resident person;
- A non-resident person;
- An associated enterprise of a non-resident person; and
- A permanent establishment of a non-resident person.

The Act defines a preferential tax regime as:

- Any Kenyan legislation, regulation or administrative practice which provides a preferential rate of tax to such income or profit, including reductions in the tax rate or the tax base; or

A foreign jurisdiction which:

- Does not tax income;
- Taxes income at a rate that is less than 20%;
- Does not have a framework for exchange of information;
- Does not allow access to banking information; or Lacks transparency on corporate structure, ownership of legal entities located therein, beneficial owners of income or capital, financial disclosure or regulatory supervision.

The amendments will not only expand the tax scope to net in non-residents operating in preferential tax regimes but is also in line with the implementation of the global minimum tax provisions under Pillar 2 of the BEPs Action Plan.

The amendments are set to take effect on 1st January 2023.

Enhanced reporting for Multi National Enterprises

The Income Tax Act currently provides that a reporting Multi National Enterprise shall provide key financial information concerning each jurisdiction in which the group operates. In addition, the Income Tax, (Transfer Pricing), Regulations 2006, impose a requirement to provide transfer-pricing documentation, upon request by the Commissioner. Such information will usually contain the master and/or local file and other financial reports.

The Act has introduced a requirement to file a master file and local file on an annual basis as opposed to the current on request basis. The master file and local file shall include the following information:

The master file shall contain;

- A detailed overview of the group;
- The group's growth engines;
- A description of the supply chain of the key products and services;
- The group's research and development policy;
- A description of each constituent entity's contribution to value creation;
- Information about intangible assets and the group intercompany agreements associated with them;
- Information on any transfer of intangible assets within the group during the tax period, including the identity of the constituent entities involved, the countries in which those intangible assets are registered and the consideration paid as part of the transfer;
- Information about financing activities of the group;
- The consolidated financial statements of the group;
- Tax rulings, if any, made in respect of the group; and
- Any other information that the Commissioner may require.

The Local File shall contain:

- Details and information on the resident constituent entity's activities within the multinational enterprise group;
- Management structure of the resident constituent entity;
- Business strategies including structuring, description of the material-controlled transactions, the resident constituent entity's business and competitive environment
- The international transactions and amounts paid to the resident constituent entity or received by the entity; and
- Any other information that the Commissioner may require.

The reporting requirements are aimed at aligning Kenya to international standards as outlined in the OECD Transfer Pricing Guidelines, 2022.

Value Added Tax

Value Added Tax on Digital Supplies

The Act has introduced a series of amendments in relation to VAT on digital supplies as follows:

Definition of digital market place

- Amend the definition of a digital market place by deleting the expression "sell or provide services, goods or other property" and substituting it with the words "sell goods or provide services"

The amendment shall provide clarity on the scope of the tax on digital supplies as it removes the ambiguity created by the broad use of the term other property

VAT on imported digital service

- Exclude an import of services made over the internet or an electronic network or through a digital marketplace from Reverse VAT under Section 10 of the VAT Act

The exemption from reverse VAT means that all non-resident persons shall be required to register and account for VAT irrespective of the recipient of the goods or services is.

Registration threshold for digital supplies

- The Act has amended the VAT Act by excluding persons supplying imported digital services over the internet or an electronic network or through a digital marketplace from meeting the KES 5 million VAT registration threshold.

The exemption from the registration threshold means that all persons providing digital supplies over a digital market place shall be required to register and account for VAT on the digital supplies regardless of the value of the supplies made to persons located in Kenya.

The amendments took effect on 1st July 2022.

VAT on Export of Service

The Finance Act has amended the VAT Act by deleting the provision on exemption of export of service and introducing a provision on zero rating of an export of service in respect of business process outsourcing.

This means that any service, which does not fall within the definition of business process outsourcing, shall be subject to VAT at the standard rate of 16%.

The Finance Act does not define what shall be classified as business process outsourcing. We expect that the Kenya Revenue Authority shall release guidelines to this effect.

The amendment took effect on 1st July 2022