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REPUBLIC OF KENYA

Report Tabled on 19/8/15

NATIONAL ASSEMBLY

ELEVENTH PARLIAMENT – THIRD SESSION

THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

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REPORT ON THE FINANCE BILL, 2015

CLERKS CHAEMBERS
DIRECTORATE OF COMMITTEE SERVICES
PARLIAMENT BUILDINGS
<u>NAIROBI</u>

<u>AUGUST, 2015</u>

V. 18

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ABBREVIATIONS

CGT	-	Capital Gains Tax
CMA	-	Capital Markets Authority
EAC	-	East African Community
ICPAK	-	Institute of Certified Public Accountants of Kenya
IPPS	-	Independent Power Producers
ITA	-	Income Tax Act
KAM	-	Kenya Association of Manufacturers
KFC	-	Kenya Film Commission
KEPSA	-	Kenya Private Sector Alliance
KOGA	-	Kenya Oil and Gas Association
KRA	-	Kenya Revenue Authority
NRI	-	Natural Resource Income
NSE	-	Nairobi Securities Exchange
PPP	-	Public Private Partnership
REIT	-	Real Estate Investment Trust
VAT	-	Value Added Tax
MOH	-	Ministry of Healthy

1.0 PREFACE

On behalf of the Departmental Committee on Finance, Planning & Trade and pursuant to provisions of Standing Order 199 (6), it is my pleasant privilege and honour to present to this House the Report of the Committee on its consideration of the Finance Bill, 2015. The Bill was committed to the Committee on 25th June, 2015 and it is on the basis of this that the Committee makes this report pursuant to Standing Order 127.

1.1 Mandate of the Committee

The Committee on Finance, planning & Trade is one of the Departmental Committees of the National Assembly established under Standing Order 216 and mandated to:-

(a) investigate, inquire into, and report on all matters relating to the mandate, management, activities, administration, operations and estimates of the assigned ministries and departments;
(b) study the programme and policy objectives of ministries and departments and the effectiveness of the implementation.
(c) study and review all legislation referred to it;
(d) study, assess and analyse the relative success of the ministries and departments as measured by the results obtained as compared with their stated objectives;
(e) investigate and inquire into all matters relating to the assigned ministries and departments as they may deem necessary and as may be referred to them by the House;
(f) vet and report on all appointments where the Constitution or any law requires the National Assembly to approve, except those under Standing Order 204 (*Committee on Appointments*); and
(g) reports and recommendations to the House as often as possible, including recommendation of proposed legislation.

1.2 Committee membership

The Committee was constituted by the House on Thursday 16th May, 2013 and comprises the following members:

1. The Hon. Benjamin Langat, MP **(Chairman)**
2. The Hon. Nelson Gaichuhie, MP **(Vice Chairman)**
3. The Hon. Jones M Mlolwa, MP
4. The Hon. Anyanga, Andrew Toboso, MP
5. The Hon. Timothy M .E. Bosire, MP
6. The Hon. Ahmed Shakeel Shabbir Ahmed, MP
7. The Hon. Joash Olum, MP
8. The Hon. Dr. Oburu Oginga, MP

9. The Hon. Patrick Makau King'ola, MP
10. The Hon. Abdullswamad Sheriff, MP
11. The Hon. SumraIrshadali, MP
12. The Hon. Ogendo Rose Nyamunga, MP
13. The Hon. Iringo Cyprian Kubai, MP
14. The Hon. Dennis Waweru, MP
15. The Hon. Tiras N. Ngahu, MP
16. The Hon. Sakaja Johnson, MP
17. The Hon. Jimmy Nuru Angwenyi, MP
18. The Hon. Ronald Tonui, MP
19. The Hon. Mary Emase, MP
20. The Hon. Joseph Limo, MP
21. The Hon. Lati Lelelit, MP
22. The Hon. Kirwa Stephen Bitok, MP
23. The Hon. Sammy Mwaita, MP
24. The Hon. Daniel E. Nanok, MP
25. The Hon. Eng. Shadrack Manga, MP
26. The Hon. Abdul Rahim Dawood, MP
27. The Hon. Sakwa John Bunyasi, MP
28. The Hon. Alfred W. Sambu, MP
29. The Hon. Sammy Koech, MP

1.3 Consideration of the Bill

The Finance Bill, 2015 was published and read a first time on 25th June, 2015 and thereafter committed to the Departmental Committee on Finance, Planning & Trade for consideration pursuant to Standing Order 127. The Finance Bill, 2015 proposes amend the following financial sector laws:

1.3.1 Value Added Tax Act

The Bill in clauses 1 – 6, proposes amendments to the Value Added Tax (VAT) Act, 2013 and the effective date is 12th June, 2015. Some of the proposed amendments include introducing timeline to lodging VAT refund claims; KRA to appoint other agents other than MDAs to withhold 6% of VAT payable at the time of paying for the supplies and remit to the Commissioner; adding in exemption list some items like aircraft parts, aid funded supplies excluding vehicles, goods imported for Kenya Film Commission, imported parts for school laptop assembly and taxable goods for construction of recreational and industrial parks.

Included in the zero rated regime, are purchases from duty free shops for departing passengers; supply of taxable services in respect of goods on transit and importation of right hand vehicles by returning residents having disposed of the left hand one.

1.3.2 Income Tax Act

Clauses 7 – 20 propose amendments to various Sections of the Income Tax Act and the commencement date for these Sections, if amended, shall be 1st January, 2016.

Some of the notable changes proposed include among others: the introduction of Residential Rental Income tax at the rate of 12% for income below KSh. 10 million and provision for amnesty thereof; extending carrying forward of losses by investors from 5 years to 10 years; removing gains from securities from Capital Gains Tax to Withholding Tax at a rate of 0.3% of gross amount payable; tax exemption threshold on transfer of land increased from KSh. 30,000 to KSh. 3 million.

Others are: abolishing investment deduction (ID) for building and installation of machinery outside the 3 main municipalities; increasing number of ships to qualify for 100% (from% previously) investment deduction on ships by reducing tonnage threshold from 495 to 125; introducing withholding tax at a rate of 7.5% on non-resident bookmakers and taxation of gains from compensation of land acquired by government for the purpose of infrastructure development.

1.3.3 Miscellaneous Amendments

Clauses 21 – 54 propose amendments to various statues in the financial sector and the effective date is provided as 1st October, 2015.

The Stamp Duty Act is proposed for amendment so as to exempt transfers under Real Estate Investment Trusts (REITs) from paying stamp duty. The Insurance Act is to be amended to transfer some functions, such as amending the Schedule, to the Authority (IRA) that have hitherto been performed by the Cabinet Secretary; streamline registration of insurance agents and the provision for minimum capital requirement. The Banking Act is proposed to be amended to streamline licensing of banking institutions; transition from the Deposit Protection Fund Board to the newly established Kenya Deposit Insurance Corporation and the provision on minimum core capital requirement for banks and mortgage finance companies. The Road Maintenance Levy Fund Act is to be amended in order to facilitate operationalization of the Road Annuity Fund established under the Public Finance Management Act. The Retirement Benefits Act is amended to reduce from 6 to 3 months, the time the scheme administrators take to submit their audited accounts to the RBA. The Proceed of Crime and Anti-Money Laundering Act is to be amended to introduce "financing of terrorism" as part of the mandate of the Financial Reporting Centre, in addition to financing of crime and money laundering.

The Kenya Deposit Insurance Act is amended to increase to 2 years from 1 year, the transition period for staff of the former Deposit Protection Fund Board to the new Corporation. The Consumer Protection Act is to be amended to exempt credit agreements between public entities and development partners from the provisions of the Act, which is posing interpretation challenges then the Tax Appeals Tribunal Act is proposed to be amended to provide for the transition of operation from the former to the new Tribunal.

In processing the Bill, the Committee invited comments from the public by placing advertisements in the Daily Nation and Standard newspapers on 26th June, 2015 pursuant to Article 118 of the Constitution. The Committee met officers from the National Treasury and several Stakeholders whose views are captured and contained in the body of the report.

1.3.4Kenya Oil and Gas Association (KOGA)

The Kenya oil and gas association submitted the capital gains tax of 37.5%/30% applicable to oil and gas industry is discriminatory since other industries are only taxed 5%. Kenyan Tax is applied on disposal of shares where 20% or more of value is derived from immovable properties in Kenya i.e. this includes gains not attributable to Kenya. This results in double taxation which is against the principle of double tax treaties and is also a major disincentive to investment. Other provisions such as adjustments for inflation available for other industries are not extended to O&G industry. Transfers in oil and gas are common practise in order to attract appropriate foreign investment & skill set required in various stages of the oil and gas life cycle. The legislation will make such transfers of ownership potentially not commercial and very difficult

1.3.5Kenya Film Commission (KFC)

The Kenya Film Commission welcomed the amendments proposed to the First Schedule Section A of Parts I &II of the VAT Act, 2013 in the Finance Bill, 2015 but submitted that it was erroneously drafted given that it is the Kenya Film Commission that will be exempted from paying VAT on imported film products and services. The correct position ought to be to exempt the Kenya Film producers and film Agents who will be acquiring the same goods.

1.3.6 Institute of Certified Public Accountants of Kenya (ICPAK)

The ICPAK submitted that whilst it appreciated Section 105 of the Income Tax Act that the Commissioner should refund the overpaid tax, the period within which the overpaid tax becomes due, the time when then interest on refundable tax should start accruing and the applicable interest rates on are missing. ICPAK therefore proposed that the due date of overpaid taxshould be capped at 6 months after which the interest on overpaid should commence accruing at a rate of 2% per month.

ICPAK further submitted that section 94 of the Income tax Act be amended to extend the in-duplum rule to incorporate the penalty imposed on unpaid tax (interest chargeable should not exceed one hundred per centum of the tax owing). This will protect financial strain on businesses likely to result from heavy burden on interest on unpaid tax. Capping of interest to the principle tax amount excludes the penalty element which forms substantial amount of penalization on unpaid tax. In this regard, the burden of penalties and interest are still very high and has the potential to adversely affect the cash flow status as well the financial stability of the businesses.

ICPAK had issues with Section 9(3) of the VAT Act, 2013 that makes tax representatives personally liable to for tax leakages pointing out some mistakes arising from tax administration could not have been caused by those tax representatives. ICPAK proposed that such tax representatives should only be held responsible upon prove that they willfully or by neglect committed the offence but not in ordinary circumstances where for instance the non-resident fails to remit tax.

Considering that Withholding VAT was introduced in 2003 to ensure that taxes reach the government, has already been overtaken by events currently. Tax collection efficiency has greatly improved with the introduction of itax. Therefore ICPAK proposed complete removal of VAT.

1.3.7PricewaterHouseCoopers(PWC)

The PWC submitted that the requirement within the ("ITA") that requires companies maintain a dividend tax account and pay compensating tax at the effective rate of 42.86% where dividends are paid out of untaxed profits discourages investments. Benefits derived from tax incentives (100% or 150%) granted on capital investments are negated by compensating tax. Compensating tax was introduced to encourage reinvestment of profits into business - PPP projects are fixed terms (i.e. 20 years) and require substantial investment upfront with limited opportunity to reinvest.

The PWC supported KOGA's concern with regard to capital gains taxation on extractive industry at a rate of 37.5%/30% against a 5% rate taxed for other industries terming discriminatory. PWC further submitted that the wording of withholding tax applied to extractive industry in the Income Tax Act is unclear-what type of transactions Natural Resource Income ("NRI") is designed to tax, and could be construed to refer to sale of hydrocarbons and/or transfer of interest in a licence. Therefore pwc proposed for amendments to section 3 of the ITA to clarify the scope and taxation of NRI.

Taxable services for direct and exclusive use in the power generation sector are too expensive currently as they are VATable. These services account for a substantial portion of the sector's construction and installation activities and therefore should be zero-rated for VAT purposes.

Medicaments and inputs / raw materials which are currently exempted from VAT should be zero-rated so that the producers can recover in put vat. Moreover, costs of locally manufactured medicaments are still high.

In respect of unprocessed (parchment and green) coffee most services (transport, warehouse, storage) are subject to VAT at 16%. This has had a negative impact on small holder farmers as they are unable to deduct the input VAT incurred due to the inability to attain the VAT registration threshold of KES 5m.

On Service Charge, PWC proposed exclusion of Service charge paid in lieu of tips and gratuity from the taxable value of restaurant and hotel services as long as the amounts are distributed wholly to the employees as part of their remuneration (and taxed through PAYE) and retain the previous threshold of the maximum percentage of service charge at 10% of the pre-service charge amount. This is because Service charges paid in lieu of tips and gratuity do not comprise consideration for the service rendered by hotelkeepers and caterers, the amounts are merely collected and distributed to employees as part of their taxable remuneration. Accordingly, the services charges should be excluded from the taxable value similarly to salaries paid to employees.

1.3.8 Kenya Association of Manufacturers (KAM)

The Kenya Association of Manufacturers submitted that all the currently exempt goods manufactured in Kenya should be zero-rated so that manufacturers can be able to claim input VAT. The KAM indicated that that imported goods are cheaper (they don't attract VAT) within the Kenyan market and therefore have a competitive advantage over the locally manufactured goods are expensive.

1.3.9 Ernst & Young

The Ernst & Young submitted that the proposed taxation of residential rental income at the rate of 12% per annum was too high and therefore needed to be reduced. It further proposed that companies which are undergoing restructuring should be exempted from capital gains tax to give time to find their footing in the market.

The Committee, arising from the presentations of the stakeholders and its analysis of the Bill identified the following pertinent issues to be addressed through amendments:-

(a) The minimum core capital requirement of Commercial Banks as proposed in clause 31 of the Finance Bill, 2015 needs to be reviewed. The Basel II banking regulation rules recognizes the weighted risk assessment of Banks as opposed to their core capital.

(b) The proposed 12% rate of taxation of residential income

(c) Implementation of the Capital Gains Tax (CGT) that will make the Kenyan Capital Markets very expensive to operate

(d) High taxation of the extractive industries (37.5%/30% against 5% of other industries

(e) Address drafting errors with regard to exempting importation of film productions goods and services that will be imported by the film producers and NOT the FILM COMMISSION

The Committee will introduce appropriate amendments during the Committee Stage of the Bill to address the above issues and any other issue that may require attention.

1.4 Acknowledgement

Mr. Speaker, Sir,

The Committee is grateful to the Offices of the Speaker and the Clerk of the National Assembly for the logistical and technical support accorded to it during its sittings. The Committee wishes to thank all the stakeholders for their participation in scrutinizing the Bill.

Finally, I wish to express my appreciation to the Honourable Members of the Committee who made useful contributions towards the preparation and production of this report.

It is my pleasant duty and privilege, on behalf of the Departmental Committee on Finance, Planning & Trade, to table its Report on the consideration of the Finance Bill, 2015 pursuant to Standing Order 127.

Signed ....Date...19th August 2015...

(HON. BENJAMIN LANGAT, MP)
CHAIRPERSON, DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

2.0 BACKGROUND INFORMATION

The Finance Bill, 2015 is one of the annual Bills that is introduced in the National Assembly Pursuant to Section 40 of the Public Finance Management Act, 2012. Its main objective is to set out the revenue raising measures for the national government together with a policy document expounding on those measures. Ideally, it proposes amendments to a variety of laws relating to various taxes and duties as well as other financial sector statutes.

Section 41 of the Public Finance Management Act, 2012 obligates the National Assembly to process and pass the Finance Bill within 90 days of its introduction in Parliament. The Finance Bill, 2015 was introduced in the National by the Chairman of the Departmental Committee on Finance, Planning & Trade on 25th June, 2015 and therefore committed to the Departmental Committee on Finance, Planning & Trade for consideration in line with Articles 114 and 118 of the Constitution and Standing Order 127. The Committee engaged a number of stakeholders whose views are contained in this report.

3.0 ANALYSIS OF THE CLAUSES OF THE FINANCE BILL, 2015

3.1 AMENDMENTS TO THE VAT ACT, 2013

Clause 4 to amends Sec. 25A on Withholding VAT (FA-2014):

Currently, MDAs are the only ones mandated to withhold 6% of payable VAT and this new proposal is aimed at allowing KRA to designate other agents (including private sector) to withhold 6% of VAT payable. This is meant to avail, to the Commissioner of the Kenya Revenue authority, information regarding all VAT taxpayers.

Clause 5 amends the First Schedule on Exemption supplies:

Some medicament like penicillin and their derivatives are removed from exemption list. Item proposed for inclusion are such as: aircraft parts; aid funded supplies; plastic bag biogas digesters; school lap top and tablet assembly parts; goods meant for construction of recreational and industrial parks. To encourage local manufacturers, perhaps, medicaments should be Zero Rated or subjected to an optimum nominal rate since the exemption creates unfair competition. Other medicaments for diseases like diabetes should also be considered. Exempting aircraft parts may encourage growth in the aviation industry, however, all the other proposed exemptions like goods for construction of recreational and industrial parks will encourage importation rather than local supply.

Clause 6 amends the Second Schedule on zero rated supplies:

Included in the list of zero rated goods are: goods purchased from duty free shops by departing passengers; goods on transit and left hand vehicles owners returning home to sell them and import right hand equivalent duty free. This will place duty free shops in the category of EPZs. For goods on transit, the proposed amendment will give the local transporters a treatment similar to their counterparts in the region and elsewhere. With regard to selling left hand and buying equal value right hand vehicle, this is a fair treatment of Kenyans returning home from countries operating left hand vehicles.

3.2 AMENDMENTS TO THE INCOME TAX ACT

Clause 8 amends Sec. 6 under income from use of property:

It proposes an introduction of a new tax to be known as Residential Rental Income tax on annual income of landlords below KSh. 10 million (at 12%). Those already paying tax on gains from property need not pay this one (seek written clearance from the KRA). It is noted that the rate of 12% is missing from the Bill. This seems not to be a fair and progressive tax, thus, may discourage investment in real estate as well as posing administration challenges. Also, there is no minimum income threshold for this tax. In addition, it appears to encroach on the county governments' property rates.

Clause 10 amends Sec. 15 (5) of the Act which provides for total income deductable when calculating total taxable income

It allows investors to carry forward loss up to 10 years. Currently, the period allowable is 5 years.

The focus here is on the recent heavy investment in the power production, manufacturing and hotel operators.

The Sub sections of Section 15 should be renumbered properly due to amendment done in the FA-2014 that introduced a new Sub-section 5 whereas there Sub-sections 5, 6 and 7 in existence.

Section 15(4) should be amended to allow utilization of losses for 9 succeeding years to reflect the proposed 10 years extension. With the current 5 year-period of loss-carry-forward, it is usually the current year of income and 4 succeeding years.

However, 10 years is a very long period for investors to carry forward losses given that most do benefit from a myriad of waivers in the course of their investment.

Clause 11 amends Sec. 34 which deals with tax rates (CGT in particular)

Currently, Capital Gains Tax (CGT) is charged on gains from property and securities at the rate of 5%. It is now proposed that gains from securities should be hived from CGT and shall be subjected to Withholding Tax at rate of 0.3% of the gross amount payable.

CGT on property shall be retained at the current rate of 5% for residents. The gains from securities shall be subjected to withholding tax for residents and non-residents (reflected in clause 18).

Clause 12 amends Sec. 35 under deduction of tax (Withholding):

The amendment exempts non-residents from paying a management, professional or training fees in respect of gains from securities. However, the reference to the Section should be given correctly as 35(1)(a) and not 35(1)

Performance fees paid by the KFC to actors and crew members are also exempted from WHT. This is meant to encourage the local art industry.

Clause 13 amends Sec. 39 on tax set–off rebate:

The proposed amendment introduces tax rebate to employers who will engage more than 10 graduates for apprenticeship for 6 – 12 months. The CS shall make regulations to operationalize this.

This incentive is meant to encourage employers to give young graduates an opportunity to obtain the on-the-job skills. However, it is not certain whether the incentive will effectively address the problem. This should also not be left for the Cabinet Secretary to determine and the graduates should be remunerated by the employers for them to benefit from the tax re-bate.

Clause 16 amends the First Schedule on tax exemptions:

The proposed amendment tax exemption on land transfer value of below KSh. 3 million and below 50 acres for agricultural land outside a municipality or a township. This provision is very old and needed to be updated. Initially it was KSh. 30 thousand and 100 acres respectively. The revised provision is likely to exempt massive land transaction from taxation hence, loss of revenue. Nonetheless, it is likely to encourage uptake of mortgages.

Clause 17 amends the Second Schedule which provides for deduction from capital expenditure (Investment Deduction – ID):

Proposes to deduct from taxable income (before tax computation) income from a building in use for training of film producers, actors and crew. Now, what will happen to a building hosting other businesses alongside the training of the specified groups? Will the owner not pay tax on that entire building on a virtue of a targeted section?

This clause also proposes to abolish the 150% investment deduction (ID) on construction of buildings or installation of machinery outside Nairobi, Mombasa and Kisumu. This provision has been in force since 2009. This kind of investment deduction will potentially spur growth of both industries and construction of building especially in counties. The proposed amendment may therefore be considered to be halted.

Further, ID for ships is proposed to be increased from 40% to 100% and reduce the tonnage from 495 to 125. This will increase the number of imported ships to enjoy investment deduction.

Clause 18 amends Head B of the Third Schedule on tax rates:

The proposed amendment introduces Corporate Tax at a rate of 25% for a company introducing shares though listing or securities exchange through introduction. This will facilitate netting of additional revenue

The non-resident bookmakers shall pay withholding tax at the rate of 7.5% of gross revenue. This will result in additional revenue to the Exchequer.

Gains on transfer of securities by non-residents shall be charged withholding tax at 0.3% of transaction value of shares. The gains on transfer of securities by non-residents were removed from CGT to WHT. However, it is noted that the 0.3% rate is not reflected for residents.

Clause 19 amends the Eighth Schedule which provides for taxation of gains from property other than shares:

Transfer of property to a spouse or former spouse as part of divorce settlement or bona fide separation agreement is not subject to tax. The amendment proposes transfer of property to the "immediate family" (children) of spouses after separation to also be exempted from tax. This may lead to mischief of tax evasion under the disguise of the transfer for the purpose of the said settlement.

Compensation for property/land acquired by the Government for infrastructure development shall be subject to tax. Recent infrastructural activities have led to this kind of massive acquisition hence, a potential for contributing to revenue.

Clause 20 amends the Ninth Schedule of taxation of extractive industries:

Training and contractual services is changed from 20% to 5.625%. Also, withholding tax for **training**, management and professional fees is 12.5%.This is to harmonize taxation in the extractive industries where currently, there is separate tax treatment for training services and contractual fees for petroleum and mining and same case applies to withholding tax for training and contractual fees.

3.3 MISCELLANEOUS AMENDMENTS TO VARIOUS FINANCIAL SECTOR STATUTES

Clause 21 amends the Stamp Duty Act Sec. 96 which provides for taxation of transfer between associated companies.

The proposed amendment exempts transfers under Real Estates Investment Trusts (REITs) form stamp duty.REITs transfers are on equity, mortgage or hybrid. Currently, Housing Finance, Coop Bank and KCB are the licensed REITs trustees whereas Centum, UAP, CIC Stanbic and Fusion hold management licenses. The exemption is meant to encourage these unique investment vehicles in the arena of real estate development.

Clause 23 amends Sec. 23 of the Insurance Act which provides for powers of the CS with regard to minimum capital requirement:

Removes the powers of amending the Schedule from the Cabinet Secretary and vests them on the Authority (IRA). This gives IRA more autonomy but then it may be counter-productive with regard to the spirit of checks and balances. The CS should retain the legal mandate to amend the Schedule for the Authority to implement.

Also, the amendment proposes the removal of the requirement of tabling in the National Assembly, the minimum asset requirement for registration. This is now left for the CS to determine. This is an administrative role and therefore the amendment is regular.

The Authority is given an expanded mandate of consider and give a directive requiring an insurer to increase paid-up capital and or capital adequacy ratio higher than the minimum requirement. This is consistent with the risk based model. However, there ought to be checks and balances (for instance, the CS to be consulted)

Clause 24 amends Sec. 28 of the Insurance Act that provides for amendment of the Schedule:

It proposes that the Schedule shall be amended by the Authority and as opposed to the Cabinet Secretary as is in the current case.This is devoid of checks and balances. It is prudent for the CS to amend the Schedule in the regulations since IRA may not have the legal authority to make regulations.

Clause 30 amends Sec. 151 of the Insurance Act which provides for requirements for registration as insurance agents:

The proposal removes the requirement for the insurer to recommend agents to facilitate their registration and instead, it requires IRA to register agents who have Certificate of Participation.This measure is geared towards ensuring increased number of registered agents from the current 5,000 to the required 25,000.

Clause 31 amends the Second Schedule of the Insurance Act which contains minimum capital requirement:

The proposed minimum capital requirement effective 2018 shall be:

General insurance business = KSh. 600 million up from KSh. 300 million

Long term insurance business = KSh. 1 billion

Long term re-insurance business = KSh. 500 million up from KSh. 300 million.

This may perhaps lead to mergers giving rise to bigger and highly capitalized insurance institution capable of withstanding financial shocks, crises and guarding against risks. There may also benefits of multiplier effects brought about by economies of scale. Nonetheless, it is likely to cause downsizing of the human capital.

Clause 33 amends Sec. 5 of the Banking Act that provides for licensing of banking institutions:

The proposed amendment abolishes the requirement for annual licensing of banks and replaces it with a perpetual licence (which can be withdrawn any time of non compliance) in line with the risk based model adopted by banks.

The risk based model, is believed to have been adopted by all banks and the implementation of this new requirement will simplify supervision and safeguard financial stability.

Clause 36 amends Sec. 34 of the Banking Act that provides for the powers of CBK to intervene in management of an institution:

It empowers the newly established Kenya Deposit Insurance Corporation (KDIC) to assume management of an institution and not any other person as stipulated in the Act currently. This function was previously carried out by the Deposit Protection Fund Board (DPFB)

Clause 43 amends the Second Schedule of the Banking Act on the core capital requirement:

Minimum core capital for banks and mortgage institutions is proposed with timelines as follows;

31st Dec. 2016 – KSh. 2 billion

31st Dec. 2017 – KSh. 3.5 billion

31st Dec. 2018 – KSh. 5 billion

This may occasion mergers giving rise to bigger conglomerates that are highly capitalized and perhaps capable of withstanding financial shocks and crises. It may also lead to reduction of interest rates due economies of scale. However, downsizing of human capital may most likely be imminent.

Clause 44 amends the Road Maintenance Levy Fund in Sec. 3:

Stipulates that an amount KSh. 3 per litre out of RMLF be paid into the Road Annuity Fund

The fund was created by the PFM Act, 2012 and it has hitherto not been operationalized. The CS mentioned an increase of RMLF by KSh. 3 but the Bill specifies that the amount shall be hived out of the existing RMLF.

Clauses 46 – 49 propose to amend the Proceeds of Crime and Anti-Money Laundering Act:

This in a bid to update the various Sections of the Act to incorporate the element of "financing of terrorism" as one of the key functions of the Financial Reporting Centre (FRC).

4.0 STAKEHOLDER VIEWS ON THE FINACE BILL, 2015

4.1 The National Treasury

The presentation, by the National Treasury, commenced by highlighting the five (5) objectives of this year's Finance Bill. These are: to;

- Facilitate private enterprise growth for job creation
- Promote industrial growth
- Promote fairness and equity in the tax system
- Reform the tax system to enhance tax administration
- To encourage growth and stability in the financial sector

Among the Acts proposed to be amended include among others:

- Value Added Tax
- Income Tax
- Banking
- Insurance

Value Added Tax (VAT) Act

Some items such as aircraft engines, parts and tyres, supplies other than vehicles for aid funded projects; primary school lap top assembly parts purchased locally for film industry; taxable supplies for the construction of recreation and industrial parks of 100 acres and above have been proposed for exemption from VAT regime. This is geared towards helping the ailing aviation industry, promote local film production, and reduce the cost of lop top assembly for primary schools children.

Further proposes for inclusion in the zero rated regime, are purchases from duty free shops for departing passengers; supply of taxable services in respect of goods on transit and importation of right hand vehicles by returning residents having disposed of the left hand one.

Income Tax Act

In the Income Tax Act, some of the proposed amendments include the following:

a. The introduction of Residential Rental Income Tax at 12% (Clause 8) and there is also a provision for tax amnesty (clause 15). This is to simplify rental income tax regime.
b. Clause 11 proposes withholding Tax of 0.3% on transfer of securities to replace the existing capital gains tax. This is meant to ease administration. The 0.3% rate is consistent with the international standards and is comparable with other jurisdictions.
c. In clause 12, the Bill proposes the withholding tax exemption for the film industry. This is geared towards encouraging and accelerating the growth of this sector
d. Tax rebate scheme for employers who engage at least 10 graduates between 6 to 12 months (Clause 13). This is toincentivize the employers to encourage them take apprentices so as to build skill and resource base in the country. The government has already initiated some programmes like the Uwezo fund and the requirement that 30% value of all government procurement target the youth among others and therefore, they should take advantage of those.

Miscellaneous Amendments in other financial sector statutes

a. Clause 21 provides for the Stamp Duty exemption granted to Real Estate Investment Trust (REIT). This is geared towards reducing the cost of and encouraging growth in this new investment vehicle especially in real estate arena
b. Clause 44, also proposes a Road Maintenance Levy of KSh. 3 per litre to be remitted to Road Annuity Fund for its operationalization so as to aid in the expansion of the road network in the country. As drafted in the Bill, it is clear that the Khs 3 that will go the Road Annuity Fund will come from the Khs 9 that is already collected per liter for Road Maintenance Levy Fund. However the thinking of Treasury was that this is over and above the Khs 9 currently collected.
c. The proposed amendment in clause 26 of the Insurance Act is to enable the margin of solvency to be determined by the Insurance Regulatory Authority.
d. Clause 43 proposes the increase of minimum core capital of banks progressively from the current KSh. 1 billion to KSh. 5 billion by December 2018to strengthen the sector. Currently, it is only one bank whose core capital is below KSh. 1 billion. Notably, 21 banks are at the KSh. 5 billion mark, 15 banks have about KSh. 2 billion, 7 banks above KSh. 1billion.

   Some of the reasons for increasing the minimum core capital were such as the need to realize the creation of big banks that will be capable of financing the Kenya Vision 2030 projects; it is part of the East African Community agreement where Kenya is dominant player in the region; among others.

e. Clause 31 proposes increment of minimum capital for general insurance from KSh. 300 million to KSh.600 million and long term (life) insurance from KSh. 150 million to KSh. 400 million.
f. Increase of minimum capital for reinsurance (general business) from KSh. 500 million to KSh. 1 billion and long term business from KSh. 300 million to KSh. 500 million. These measures are expected to promote industrial growth, enhance job creation and financial stability.

4.2Pricewaterhousecoopers (PWC)

(i) Clause 4

This Clause proposes to empower the Commissioner to appoint any person as a Withholding VAT agent without giving the Commissioner powers to revoke the same as and when need arises. This creates a lacuna that needs to be addressed by making it explicit that the Commissioner can revoke appointment of those agents.

There is lack of congruence between VAT Act and KRA's interpretation of the withholding VAT rule in section 25A of the VAT Act, 2013 – 6% of tax payable vs. 6% of the taxable value. There are those suppliers whose may prove impractical to withhold VAT. There should be and explicit refund mechanism for suppliers with enduring VAT credit positions.

(ii) Clause 17(b)

This clause proposes to delete the enhanced investment deduction allowance of 150%, available on expenditure incurred on purchase of machinery and on construction of buildings outside the cities of Nairobi, Mombasa and Kisumu. Effective date is January 1, 2016. Those companies which are already in the process of putting up qualifying investments that have factored in the original allowance will have to relook at their plans and this may discourage such investment. It will be important to defer this provision for five years or delete it completely.

(iii) Clause 10

This clause proposes to amend Section 15(5) of the Income Tax Act to provide for extension of the period of deduction for tax losses, upon application, beyond 10 years (up from the current 5 years). However, section 15(4) has not been amended to align with the proposed amendment under Section 15(5). Therefore Section 15(4) should be amended by deleting the words, **" four successive years"** and substituting therefore with the words, **"nine successive years".**Effective date of the proposal should be back dated to 1 January 2015 and not 1st January, 2016 as proposed in the finance Bill, 2015

(iv) Impact of compensating tax on Independent Power producers (IPPs) or Private Public Partnerships (PPP) infrastructure projects

The Income Tax Act("ITA") requires companies to maintain a dividend tax account and pay compensating tax at the effective rate of 42.86% where dividends are paid out of untaxed profits. Compensating tax was introduced to encourage reinvestment of profits into business - PPP projects are fixed terms (i.e. 20 years) and require substantial investment upfront with limited opportunity to reinvest. Therefore IPPs and other major infrastructure players should be exempted from compensating tax; orprovide a deferral mechanism for compensating tax until a company fully utilizes losses arising from capital investment. This is because benefits derived from tax incentives (100% or 150%) granted on capital investments are negated by compensating tax.

(v) ***Capital Gains Tax rate on disposals in the extractive sector***

The rate of Capital Gains Tax ("CGT") applicable to the extractive industry (30%/37.5%) in comparison to the rate of CGT applied to other industries in Kenya of 5% .This is discriminatory and therefore should be harmonized/aligned to the other sectors of the economy.

(vi) Natural Resource Income

From the wording of the ITA, it is unclear what type of transactions Natural Resource Income ("NRI") is designed to tax, and could be construed to refer to sale of hydrocarbons and/or transfer of interest in a licence.Section 3 of the Income Tax Act should be amended to provide this clarity by inserting the following new paragraph immediately after paragraph (c) –

- *Notwithstanding any other provision of this Act, income is not chargeable to tax under subsection (2) (h) where, and to the extent that, it is chargeable to tax under any other provision of this Act.*

(vii) Section 41(5) of Income Tax Act - Limitation of Treaty Benefits

Requirement for 50% underlying ownership to be held by **individual residents** of treaty country for tax treaty benefits to apply (Section 41 (5) of the Income Tax Act) should be treated in a similar manner as private equity funds that are exempted incases of listed entities. Investors / Limited Partners who invest in private equity funds may come from a number of countries and not just the country in which the fund is registered. Therefore, the limitation of treaty benefit provisions will hamper the funds' fundraising activities for investment in Kenya and choke off a source of growth funds for Kenyan SMEs.

(viii) Proposal to include more items in the zero rate regime

(a) Zero rate Taxable services for direct and exclusive use in the power generation sector

Justification

- Services account for a substantial portion of the sector's construction and installation activities and therefore should be zero-rated for VAT purposes.

(b) Zero rate Medicaments and inputs / raw materials

Justification

- Administratively cumbersome for local suppliers coupled with the long drawn approvals required from National Treasury, KRA and MoH.
- No revenue generation for GoK
- Costs of locally manufactured medicaments are still high. Other competing markets are granted subsidies for raw materials and other inputs.
- Non-recoverability of input tax.

(c) Zero rate Local and imported supplies to duty-free shops

Justification

- Align to Excise Duty provisions where supplies to duty free shops are not excisable.
- Align to treatment of supplies to EPZ, aircraft and ship stores.

(d) Zero rate Services in respect of unprocessed (parchment and green) coffee

Justification

- Most services (transport, warehouse, storage) in respect of unprocessed (parchment and green) coffee are subject to VAT at 16%. This has had a negative impact on small holder farmers as they are unable to deduct the input VAT incurred due to the inability to attain the VAT registration threshold of KES 5m.
- The non-recoverable VAT has eroded the profit margins available for the smallholders.
- Currently, the small holder farmer as compared to the large estate farmer is already making losses due to high input costs.

(e) VAT relief of services to extractive sector which are subject to standard VAT currently

Justification

- Services account for more than 80% of the sectors costs during the exploration and development phase and VAT at 16% significantly increases the cost of investment.
- The exemption should be extended to services or preferably both goods and services provided to the extractive sector should be zero-rated as the industry is still in the investment phase.

(ix) ***Need for exclusion of service charge paid in lieu of tips and gratuity when determining the taxable value***

The VAT Act 2013, provides for VAT on service charges paid in lieu of tips and gratuity which were previously exempt from VAT under the repealed VAT Act, Cap 476. Service charges paid in lieu of tips and gratuity do not comprise consideration for the service rendered by hotelkeepers and caterers, the amounts are merely collected and distributed to employees as part of their taxable remuneration. Accordingly, the service charges should be excluded from the taxable value similarly to salaries paid to employees. Therefore exclude service charge paid in lieu of tips and gratuity from the taxable value of restaurant and hotel services as long as the amounts are distributed wholly to the employees as part of their remuneration (and taxed through PAYE) and retain the previous threshold of the maximum percentage of service charge at 10% of the pre-service charge amount.

4.3Nairobi Securities Exchange& Capital Markets Authority

(i) Clause 18

Clause 18(a) proposes to amend Head B of the Third Schedule of the Income TaxAct to include companies introducing their shares through listing or anysecurities exchange via introduction, to enjoy twenty-five percent tax concessions. However, this provision seems to be open ended as doesn't indicate the time fiscal concession.

Proposal

Amend subparagraph 2 (g) to 2 (g)(i) which will read as follows:

"in the case of a company listing its shares via introduction on a securitiesexchange licensed by the Capital Markets Authority, twenty-five percent for the period of five yearscommencing immediately after the year of income following the date of suchlisting."

(ii) Clauses 11 and 18

These clauses introduce withholding tax on gains from securities at a rate of 0.3%. This provision should be deleted to allow the Kenyan Capital Markets to develop before such taxation measures are introduced. This will attract investments to the NSE.

(iii) New proposal not contained in the Finance Bill

There is need to amend the Stamp Duty Act to exempt payment of duty when transferring Co-operative share transfers. This will allow the common Kenyan to participate in the stock exchange though share help in a cooperative society. With this amendment, the cooperative sector will develop tremendously and transfer the lives of ordinary Kenyans that own shares in cooperative societies.

(iv) Cause 5 of the Finance Bill, 2015

That clause 5 (d)of the Finance Bill be amended by inserting the following newtwo paragraphs –
(23) Supply by way of transfer, assignment or sale of land or any othereligible investments, as specified under the Capital Markets Authority, into areal estate investment trust scheme authorized by the Capital MarketsAuthority.
(24) Supply by way of transfer, assignment or sale of assets, as defined under the Capital Markets Authority, into and from a special purpose vehicle for purposes of asset backed securities transactions.

This exempts the above transactions from VAT hence making it cheaper for such transactions to be undertaken.

4.4Institute of Certified Public Accountants of Kenya (ICPAK)

(i) Clause 10 (a) seeks to amend Section 15 of the Income Tax Act

This amendment to Section 15 (5) of the Income Tax Act (ITA) allows the Commissioner to extend the tax loss utilization period beyond 10 years. However, the loss claim period is still restricted to five years. The Cabinet Secretary through the budget speech intended to allow investors to carry forward tax losses for ten years without requiring his approval to do so. It will be important to introduce an amendment to clause 10 of the Finance Bill 2015, to amend Section 15(4) of the ITA to reflect the same period i.e nine years

(ii) Clause 10 (a) seeks to amend Section 15 of the Income Tax Act

Also, since the initial amendment was made in 2009, making the effective date for this amendment to be 1 January 2016 technically locks out tax losses accrued as at 2010 and 2011, hence the need to automatically allow tax losses as at 2010.
The new Section 15(4)(A) would thus read as follows:

"Notwithstanding subsection 4, the Minister may on the recommendation of the Commissioner extend the period of deduction beyond ten years where a person applies to through the Commissioner for such extension giving evidence of inability to establish the deficit within that period. Tax deficits expiring in 2014 and 2015 under the repealed section 15(4)(A), only require approval by the Minister after expiration of the extended 10 year period from when they arose"

(iii) Clause 12 (a) seeks to amend Section 35 (1) of the Income Tax Act to include Paragraph (ii) after Section 35(1)(i) of the Income Tax Act.
There is a drafting error:-numbering

(iv) Residential rental income

The Finance bill does not specify the tax rate applicable on residential rental Income as proposed in the budget speech under paragraph 129. Therefore Section 34 of the ITA should be amended by introducing a new paragraph (k) under subsection 1 to read as follows:

> *(k) Tax upon gross rental receipts of a person chargeable to tax under Section 6A shall be charged at the resident rate for that year of income"*

Equally the Third Schedule of the ITA should be amended by introducing a new paragraph as follows: "The tax rate in respect of residential rental income shall be twelve percent''.

(v) First schedule, section A part 1of the VAT Act, 2013: exempt goods

Clause 5(b) proposes exemption from VAT of parts imported or purchased locally for the assembly of primary school lap tops. This proposal is meant to accelerate ICT integration in schools by making it possible for companies to manufacture the school laptop tablets locally. However, the objective may not be achieved by bringing the supply under the exemption category. It means that all inputs and related services subject to VAT will not be recovered and thus will form part of the input costs and thus more costly. Such proposal will only be effective when the final tablet to school is also included in Schedule 1 part 1 list (zro-rated). Therefore paragraph 53 and 54 should be zero-rated.

(vi) Section 4A of the Income Tax Act deals with the taxation of income from business where foreign exchange gain or loss has been realized.

In particular, Section 4A (1) (ii) (a) of the Income Tax Act provides for deferment of foreign exchange loss realized by a thinly capitalized company. For thinly capitalized Companies, realized foreign exchange losses are deferred until the thin capitalization status reverses while interest expense is restricted (disallowed) as an expense in determination of the taxable income.

Based on the definition of the term "all loans" under the Income Tax Act, the suspension of foreign exchange losses and disallowance of interest expense are applied on loans sourced from both resident and non-resident persons. Suspension of foreign exchange losses and restriction of interest expense on **thinly capitalized Companies** is intended to encourage entities to seek for local financing facilities either through share capital or local debts.

Based on the foregoing, it is not fair to reprimand **thinly capitalized Companies** on debt facilities obtained from local sources since the legislation under Sections 4A and 16 (2) (j) is intended to encourage use of local financing avenues. Based on the above, the definition of the term "all loans" under Section 16(3) should be amended to only include loans sourced from overseas.

Section 7A provides for compensating tax on all companies.The recently introduced capital gains tax provides that tax paid on capital gains is final tax. This provision primarily was introduced in 1989 as a measure to ensure distribution of dividends arising out of capital gains whose tax was then suspended was brought to tax charge. Since capital gains tax has been re-introduced, Section 7A should be deleted with effect from 1 January 2015 which is the effective date when capital gain tax was re-introduced.

(vii) The Finance Act 2014 section 21 (a) (i) and (ii) made changes to the Second Schedule of the IT Act by bringing in the petroleum pipeline under paragraph 7(3)(cc)

However, it inadvertently deleted paragraph 7(3) (a) for the allowance rates;instead of deleting 7(3)(d) and replacing it with 7(3) (cc) and 7(3)(d) – this means that it effectively took away any allowance to be claimed for machinery under (3) (a) which is those for 37.5%.To correct this drafting error, the last sentence under paragraph 7(3) of the Second Schedule should be amended to read as follows;

" and the appropriate percentage shall be 37.5 per cent for the class of machinery in sub-paragraph (a) , 30 percent for the class of machinery in subparagraph (b), 25 percent for the class of machinery in subparagraph (c), and 12.5 percent for the class of machinery in sub paragraph (cc) and (d)

(viii) Section 105(1) of the Income Tax Act provides that the Commissioner is obligated to refund any tax overpaid together with interest that may have accrued thereon.

This means that where tax has been overpaid, the Commissioner should not only refund the overpaid tax but should as well pay interest that may have accrued since the overpaid tax became refundable. The interest due on unpaid tax is well stipulated under Section 94 (1) of the income Tax Act. The aforementioned section states that "In addition to the penalty under section 72D, a late payment interest of two per cent per month or part thereof shall be charged on the amount of tax remaining unpaid for more than one month after the due date until the full amount is recovered."

Whilst in Section 105 of the Income Tax Act the Commissioner is obligated to refund the overpaid tax, the period within which the overpaid tax becomes due, the time when then interest on refundable tax should start accruing and the applicable interest rates on are missing. Therefore the due date of overpaid tax should be capped at 6 months after which the interest on overpaid should commence accruing at a rate of 2% per month.

Section 94 of the Income tax Act should be amended to extend the in-duplum rule to incorporate the penalty imposed on unpaid tax (interest chargeable should not exceed one hundred per centum of the tax owing). This will protect financial strain on businesses likely to result from heavy burden on interest on unpaid tax. Capping of interest to the principle tax amount excludes the penalty element which forms substantial amount of penalization on unpaid tax. In this regard, the burden of penalties and interest are still very high and has the potential to adversely affect the cash flow status as well the financial stability of the businesses

(ix) Section 11 of the repealed Act

Where a person acquired any exempt goods, the price paid for such goods shall be deemed to be inclusive of VAT where such goods were used in providing taxable supplies. This provision has been removed. This provision needs to be re-inserted to cater for persons supplying taxable goods that have either been bought from exempt persons or where input VAT is not claimable e.g. purchase of a saloon motor vehicles by a dealer where such goods are held as stock-in-trade

(x) Making tax representatives personally liable for taxes – Section 9 (3)

While the intention is to prevent tax leakage, this provision will discourage tax representatives from taking up the role of tax representatives, or on the other hand make the process of appointing tax representatives expensive. A tax representative should only be made personally liable where it is proven that he has committed an offence willfully or by neglect or fraud, but not in ordinary circumstances where for instance the non-resident fails to remit tax.

(xi) Essential commodities

In the Finance Act 2014, KRA exempted these items from VAT.For the tax payer exemption is not an appropriate treatment for essential goods because when a commodity is exempt from VAT, it implies that the manufacturer incurs VAT on the raw materials however they are unable claim in put VAT on sales. The manufacturer is therefore forced to adjust prices of the commodities as a means of compensation, causing an increase in pricing of basic commodities. It will be important if KRA implemented a graduated VAT rate approach where the VAT rate is split into three categories namely;

1. a lower rate for basic consumer commodities set at maybe 30% of the standard;
2. a standard rate for all the other commodities
3. A higher rate for specific commodities which are viewed as harmful to the population and the environment. This could be set at 130% of the standard rate.

This will deliver price stability around the basic consumer commodities as well as safeguard the interest of manufacturers in recovering input VAT without having to adjust prices.

(xii) Withholding VAT

Withholding VAT was introduced in Kenya effective October 2003 its objective was to ensure that all the VAT charged reaches the Government. However tax collection efficiency has significantly improved with an optimal number of tax payments, efficient use of technology and simplification. The Introduction of the iTax is a step in the right direction. Implementation within a user friendly and secure platform will improve tax payer participation and reduce incentives for none compliance. Therefore withholding VAT should be removed.

4.5 Ancharwalla&Khnna

(a) Clause 18 of the Bill seeks to replace CGT on listed securities with a 0.3% withholding tax on the transaction value of listed securities. This clause has only amended paragraph 3 of the Third Schedule to the Income Tax Act (the **ITA**) which applies to non-resident persons. A similar amendment needs to be made to paragraph 5 of the Third Schedule to extend the new regime to resident persons.

(b) Paragraph 13 of the Eighth Schedule – Exemption on restructurings. The exemption requires demonstration of "public interest"

(c) Clause 19(g) of the Bill - Proposed due date for payment of CGT on land transactions is "on or before the date of application for transfer of property at the relevant lands office". With this proposal, the seller will not have funds to pay CGT until registration is finalized; the seller may not be aware whether a transfer has been lodged by the purchaser.

The UK model provides for payment of CGT by the 4th month of the end of the tax year (i.e. on the same date as the payment of the balance of tax under the Income Tax Act).

The due date for making CGT payments on all property transactions be the 20th day of the subsequent month after registration has been finalized.

Current CGT regime does not take into account inflation.Taxpayers pay tax based on paper gains. Best practice is that various mechanisms are applied to make adjustments for inflation. For example Indexation is mostly used in economies which have not experienced high inflation over the years;

(d) Clause 8 on Residential Rental Income Tax (RRIT). Residential rental income tax introduced with effect from 1 January 2016 for gross annual income of more than Khs 10 million. However, the rate of taxation on the same has not been provided. This Tax rate should be included in the Third Schedule to the ITA.

(e) Clause 10 on loss carry-forward. The Bill proposes to increase the period which the Minister may extend (upon application by a taxpayer) the deduction of tax losses from 5 years to 10 years. However, section 15(4) of the ITA which provides for deductibility of tax losses has not been amended to increase the period of deductibility from 5 years to 10 years.Section 15(4) should be amended to increase the period of deductibility to 10 years so as to align it with section 15(5).

(f) Clause 15 on rental tax amnesty. Amnesty for taxpayers who file tax returns and make tax payments with respect to the 2014 and 2015 years of income before 30 June 2016. However, this provision shall come into force on 1 January, 2016. The amnesty will not apply to taxpayers who file returns and pay tax for 2014 and 2015 before 1 January 2016. The effective date should be backdated to 12 January 2015 to ensure the amnesty is properly anchored in law.

(g) Clause 6 on exemption of tax on vehicle for returning residents: Exemption on import of a right hand drive vehicle (RHDV) of a resident returning from a left hand drive vehicle (LHDV) country from VAT.Among the conditions required is that the RHDV is similar to the previously owned LHDV in make, engine rating and year of manufacture. The combination of requirements makes it difficult for the returning resident to benefit from the amendment. Therefore Year of manufacture should be removed from requirements.

4.6 Kenya Oil and Gas Association (KOGA)

The capital gains tax of 37.5%/30% applicable to oil and gas industry is discriminatory since other industries are only taxed 5%. Kenyan Tax is applied on disposal of shares where 20% or more of value is derived from immovable properties in Kenya i.e. this includes gains not attributable to Kenya. This results in double taxation which is against the principle of double tax treaties and is also a major disincentive to investment.

Other provisions such as adjustments for inflation available for other industries are not extended to O&G industry. Transfers in oil & gas are common practise in order to attract appropriate foreign investment & skill set required in various stages of the oil and gas life cycle. The legislation will make such transfers of ownership potentially not commercial and very difficult

4.7 Kenya Film Commission (KFC)

The Kenya Film Commission welcomed the amendments proposed in **clause 5** of the Finance Bill, 2015 to the First Schedule Section A of Parts I & II of the VAT Act, 2013 in the finance Bill, 2015 but submitted that it was erroneously drafted that it is the Kenya Film Commission that will be exempted from paying VAT on imported film products and services. The correct position ought to be to exempt the Kenya Film producers and film Agents who will be acquiring the same goods.

4.8 Kenya Association of Manufacturers

(i) Zero rate all VAT exemptions for goods manufactured in Kenya
Justification

- **Exempt Rate: -** In the case of exempt goods, all inputs towards a manufactured product are subjected to a non-refundable and a non-off-settable 16% VAT which then increases the cost of the manufactured product.
- The price for VAT at 16% and exempt remain the same but zero rating is cheaper and results in refund. Zero rating is a tax incentive. For exempt supplies the input VAT becomes part of the cost.
- Goods imported into Kenya attract no tax from the country of exportation therefore when they come under exempt, they become more competitive than those manufactured in Kenya which the input raw material attract VAT.

(ii) Amend Paragraph 52 of the Finance Bill 2015 that amends Section 62 of the Consumer Protection Act to exempt the application of the provision, on foreign development financial institutions.

5 COMMITTEE RECOMMENDATION

Having listened to the stakeholders and from its own analysis, the Committee has consolidated amendments for further discussion with the National Treasury in line with Article 114 for possible introduction into the Bill during the Committee Stage. The amendments are annexed to this report.

ANNEX 1: CONSOLIDATED AMENMENTS FROM STAKEHOLDERS

KENYA OIL AND GAS

AMENDMENTS TO THE VAT, 2013

Zero rating

FIRST SCHEDULE

1. The first schedule to the Value added tax Act, 2013 be amended in Section A of Part I by deleting paragraph 30 and substituting therefor the following new paragraph-

> 30. Tax supplies, excluding motor vehicles, imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration, by a company granted prospecting license in accordance with Geothermal Resources Act (No. 12 of 1982) or mining license in accordance with the Mining Act(Cap.306), upon recommendation by the Cabinet Secretary responsible for energy or the Cabinet Secretary responsible for mining, as the case may be.

(This effectively removes any reference to the exemption of supplies made to oil and gas companies. The provisions applicable to mining companies and geothermal prospecting or explorations companies remain unchanged)

SECOND SCHEDULE

The second schedule to the Value added Tax Act, 2013 be amended in Part A by inserting the following new paragraph immediately after paragraph 8-

> 9. The supply of goods or taxable services, excluding motor vehicles principally designed for the transport of persons or goods other than special purpose motor vehicle under heading no 87.05 required for use in the field , imported or purchased for direct and exclusive use in oil or gas exploration and development, by a company granted oil or gas exploration license in accordance with a production sharing contract with the Government of Kenya and in accordance with the provisions of Petroleum(Exploration and Production)Act(Cap.308) upon recommendation by the cabinet secretary responsible for energy.

(Special purpose vehicles set out under chapter 87.05 of the East African Common External Tariff (CET) eligible for zero-rating. However, motor vehicles used for transportation of passengers and goods are specifically excluded from zero-rating.)

Exempting as a separate option

FIRST SCHEDULE

The First Schedule to the Value Added Tax Act, 2013 be amended-

a) in section A of Part I, by-

(i) deleting paragraph 30 and substituting therefor the following new paragraph-

30. Taxable supplies, excluding motor vehicles, imported or purchased for direct and exclusive use in geothermal or mining prospecting or exploration, by a company granted prospecting license in accordance with Geothermal Resources Act (No. 12 of 1982) or mining license in accordance with the Mining Act (Cap.306), upon recommendation by the Cabinet Secretary responsible for energy or the Cabinet Secretary responsible for mining, as the case may be.

(ii) inserting the following new paragraphs immediately after paragraph 30-

30A. Taxable supplies, excluding motor vehicles principally designed for the transport of persons or goods other than special purpose motor vehicle under heading no 87.05 required for use in the field , imported or purchased for direct and exclusive use in oil or gas exploration and development, by a company granted oil or gas exploration license in accordance with a production sharing contract with the Government of Kenya and in accordance with the provisions of Petroleum(Exploration and Production)Act(Cap.308) upon recommendation by the Cabinet Secretary responsible for energy.

30B. Taxable supplies, excluding motor vehicles principally designed for the transport of persons or goods other than special purpose motor vehicle under heading no 87.05 required for use in the field , imported or purchased for direct and exclusive use in oil or gas exploration and development, by subcontractors of a company granted oil or gas exploration license in accordance with a production sharing contract with the Government of Kenya and in accordance with the provisions of Petroleum(Exploration and Production)Act(Cap.308) upon recommendation by the Cabinet Secretary responsible for energy.

(Subcontractors of oil and gas companies also eligible for the exemption provided the supplies are made for oil and gas exploration and development.)

(b) in part II, by inserting the following new paragraphs immediately after paragraph 19-

20. Taxable services imported or purchased for direct and exclusive use in oil and gas exploration and development, by a company granted oil or gas prospecting license in accordance with a production sharing contract with the Government of Kenya under the provisions of Petroleum (Exploration and Production) Act (Cap.308) upon recommendation by the Cabinet Secretary responsible for energy.

21. Taxable services imported or purchased for the direct and exclusive use in oil and gas exploration and development, by subcontractors of a company granted oil or gas exploration license in accordance with a production sharing contract with the Government of Kenya under the provisions of Petroleum (Exploration and Production) Act (Cap.308) upon recommendation by the Cabinet Secretary responsible for energy.

(Supply (including importation) of taxable services to oil and gas companies (or their subcontractors) is exempt from VAT during the exploration and development stage.

INCOME TAX AMENDEMNTS

1. Section 3 of the Income tax act is amended in paragraph (c) of subsection (3) by-

(a)deleting subparagraph (ii) and substituting therefor the following new subparagraph-

(ii) "net gain", in relation to the disposal of an interest in a person, means the consideration for the disposal reduced by the adjusted cost of the interest; and

(b) deleting the word "cost" appearing in subparagraph (iii) and substituting therefor the words "adjusted cost" immediately before the word "consideration".

(The definition of net gain changed by replacing the term cost with adjusted cost to enhance the cost base in respect of share transactions. A new definition for "adjusted cost" has been suggested in the ninth Schedule)

2. Section15 (5A) of the Income Tax Act is amended by-

(a)deleting paragraph(a);

(b) deleting the words "for any other case" from paragraph (b); and

(c) Renumbering paragraph (b) as paragraph (a).

(Amendment to ensure that non-Kenyan gains not subject to tax in Kenya)

(d) inserting the following new paragraph immediately after paragraph (a)-

(aa) For purposes of determining the value of the interest under this section, reference shall be made to the market value of the interest as determined by an internationally recognized expert in the petroleum industry appointed by the contractor and the Cabinet Secretary responsible for energy.

If the contractor and the cabinet secretary fail to agree within thirty days on the appointment of such expert, then the appointment will be made by the international Chamber of Commerce. The expert shall report his determination within twenty days of his appointment and his determination shall be final and binding upon the government and the contractor.

(The provision sets out a reasonable basis for determining the value of interest when disposing interest across multiple jurisdictions. Mechanism put in place in the event of disputes arising on valuation of the interest.)

3. Section 15(5A) of the Income Tax Act is amended by inserting the following new paragraphs immediately after paragraph (b)-

Indexation allowance

(c) the amount of net gain shall be adjusted by an indexation allowance from 1 January 2015-

(i) so as to give the gain chargeable to tax for the purpose of this Act;

(ii) if the indexation allowance equals or exceed the net gain, so as to extinguish it(in which case the disposal shall be one on which, after taking account of the indexation allowance, neither a gain nor a loss accrues)

Notwithstanding anything to the contrary, sub-section© shall not apply to a disposal on which a loss accrues.

(Introducing indexation allowance provisions prior charging the gains to tax to recognise the impact of inflation. The net gains computed are reduced by the indexation allowance prior to computing tax on the same or applying any other reliefs)

Calculation of Indexation allowance

(d) (i) the indexation allowance is the aggregate of the indexed rise in each item of relevant adjusted cost; and , in relation to any such item of cost, the indexed rise is a sum produced by multiplying the amount of that item by a figure expressed as a decimal and determined, subject to paragraph (ii), (iii) and (iv) below, by the formula-

(RD-RI)/RI

where-

RD is the retail prices index for the month and year in which the disposal occurs;

and

RI is the retail prices index for January 2015 or the month and year in which the expenditure was incurred, whichever is later.

(ii) if, in relation to any item of adjusted costs, RD, as defined in subsection(1) above, is equal to or less than RI, as so defined, the indexed rise in that item is nil

(iii) if, in relation to any item of adjusted cost, the figure determined in accordance with the formula in subsection(1) above would, apart from this subsection, be a figure having more than three decimal places, it shall be rounded to the nearest three decimal place.

(iv) the Commissioner shall issue guidance on the retail price index that will be adopted for the purpose of applying indexation allowance.

(Indexation allowance computation is based on the adjusted costs incurred on the interest being disposed.)

4. Section 15 (5A) of the Income tax Act is amended by inserting the following new paragraph immediately after paragraph (d)-

(e) Subject to recommendation from the Cabinet Secretary responsible for energy, where and to the extent that, the consideration received from the disposal of an interest in a person, is wholly and exclusively utilised in a contract area by a contractor in undertaking petroleum operations approved under a petroleum agreement, within a period of twelve months prior to and thirty six months after the disposal of the interest in a person occurs or such other longer periods as will be approved by the commissioner, then the net gain chargeable to tax shall be reduced by the following amount.

$NG\times RP/P$

Where-

NG- net gain attributable to Kenya as determined under this section after applying indexation allowance;

RP-Consideration utilised in the contract area towards expenditure approved under a petroleum agreement;

P- amount or the value of consideration attributable to immovable property in Kenya.

For the purpose of applying the formula under this subsection, under no circumstances shall RP exceed the value attributed to P.

(Amendment introduced to provide relief upon reinvestment of the disposal proceeds in petroleum operations. Reinvestment relief reduces the amount of net gain that is subject to capital gain tax. Net gain used for the purpose of this relief is adjusted for inflation i.e indexed as set out under (6))

5. Section 15(5A) of the income tax is amended by inserting the following new paragraph immediately after paragraph (e)-

(f) Notwithstanding anything in this section and subject to recommendation from the Cabinet Secretary responsible for energy, no net gain shall be included in the income chargeable to tax on the disposal of an interest in a person that is necessitated by, and takes place pursuant to, a transaction involving the incorporation, recapitalization, acquisition, amalgamation, separation, dissolution, reconstruction, reorganisation or restructuring of corporate identity involving on or more group companies(to the extent otherwise permitted by law);

The recommendation from Cabinet Secretary shall not be unreasonably withheld and shall be granted or refused within thirty days of receipt by the Cabinet Secretary of notice by contractor that it intends to enter into such a transaction. Where the Cabinet Secretary fails to communicate his decision, in respect to the notice given, within the stipulated period, the recommendation shall be deemed to have been granted.

6. (a)Section 34 of the Income Tax Act is amended by deleting paragraph (i) under subsection (1) and substituting therefor the following new paragraph-

(i) Tax upon the net gain derived on the disposal of an interest in a person subject to tax under section 3 (2) (g) shall be charged at the rate specified in the Ninth Schedule.

(b) the Ninth Schedule to the Income Tax Act is amended by inserting the following new paragraph immediately after paragraph 7-

> 7A. Notwithstanding any contrary provisions, tax upon the net gain derived on the disposal of an interest in a person subject to tax under section 3(2) (g) shall be charged at the rate of five percent and shall not be subject to further taxation.

(c) Section 34 of the Income Tax Act is amended in subsection (2) by deleting paragraph (k);

(d) Section 35 of the Income Tax Act is amended in subsection (3) by deleting paragraph (j);

(e) The Third Schedule of the Income Tax Act is amended in Head B in item (3) by deleting paragraph (n);

(f) The Third Schedule of the Income Tax Act is amended in Head B in item (5) by deleting paragraph (k);

7. The ninth schedule to the Income Tax Act is amended in paragraph (1) by-

(a) deleting the definition of "cost" ; and

(b) inserting the following definition in its correct alphabetical sequence-

"adjusted cost" in relation to an interest in a person, a mining or petroleum right, or mining or petroleum information means-

(a) the total consideration given for the acquisition of the interest, right, or information, including the fair market value of any amount given in kind determined at the time the time the amount is given;

(b) the amount of any expenditure incurred on the interest, right, or information at any time after its acquisition by or on behalf of the transferor for the purpose enhancing or preserving the value of the interest, right, or information, at the time of the disposal;

(c) the amount of expenditure wholly and exclusively incurred at any time after the acquisition of the interest, right or information by the transferor establishing, preserving of defending title to, or right over, the interest, right or information; and

(d) the amount of incidentals costs to the transferor of acquiring the interest, right or information.

Provided that

(ii) where an interest in a person, a mining or petroleum right, or mining or petroleum information was acquired before 1january 2015, the adjusted cost shall constitute the fair market value of the amounts as at 1 January 2015.

(iii) the fair market value of the amount as at 1st January 2015shall be determined by an internationally recognised expert appointed by the contractor and the Cabinet Secretary responsible for energy, but if they fail to agree within thirty days on appointment of such expert, then the appointment will be made by the international chamber of commerce where the expert shall report his determination within twenty days of his appointment and his determination shall befinal and binding upon the government and contractor.

'incidental costs' for the purpose of determining the 'adjusted cost' means the costs to the person making the acquisition of the interest or of its disposal shall consist of expenditure wholly and exclusively incurred by him for the purpose of acquisition, or as the case may be, the disposal being –

(a) fees, commission or remuneration paid for the professional services of a surveyor, valuer, accountant, agent or legal adviser;

(b) cost of the disposal transfer or conveyance(including stamp duty or other similar taxes or levies);

(c) in the case of acquisition, cost of acquisition(such as interest costs) the cost of advertising to find a seller, and costs reasonably incurred in making a valuation or in ascertaining market value;

(d) in the case of a transfer, the cost of advertising to find a buyer and costs reasonably incurred in making a valuation or in ascertaining market value; and

(e) any other costs reasonably incurred

8. The Ninth Schedule to the Income Tax Act be amended-

(a) in paragraph 14 by-

(i) deleting paragraph (1) and substituting therefor the following new paragraph-

> (1) A licensee or a contractor shall, within thirty days, notify the Commissioner, in writing, if there is a ten present or more change in the underlying ownership of a licensee or contractor.
>
> Provided that the notification for the change in ownership occurring because of trade on any recognised stock exchange will only be required if the change is fifty per cent or more.

(This is to introduce time lines for reporting change in underlying ownership-30 days)

Asset sale (Farm out Transactions)

9. The Ninth Schedule to the income Tax Act is amended-

(a) in paragraph 13 by inserting the following new paragraphs immediately after paragraph (iv)-

(v) notwithstanding anything to the contrary in this paragraph and subject to recommendation from the cabinet secretary responsible for energy, the consideration arising from the transfer of interest in any petroleum agreement that is to be included in the income of the contractor chargeable to tax under section 3 (2) (a) (i) shall exclude any amounts from the said consideration which are reinvested back in the company to cover petroleum operations under any petroleum agreement, within a period of twelve months prior to and thirty six months after the transfer of the interest occurs or such other longer periods as will be approved by the Commissioner.

(vi) where this paragraph applies, and the transfer is necessitated by, and takes place pursuant to, a transaction involving the incorporation, recapitalization, acquisition, amalgamation, separation, dissolution, reconstruction, reorganisation or restructuring of corporate identity involving one or more group companies(to the extent otherwise permitted by law), the parties to the sale by notice in writing to the Commissioner can elect to account for the sale as if the sale price for the transfer of the interest in a petroleum agreement is the value of the expenditure incurred in the interest.

The recommendation from the cabinet secretary shall not be unreasonably withheld and shall be granted or refused within thirty days of receipt by the Cabinet Secretary of notice from the contractor that it intends to enter into such a transaction. Where the cabinet secretary fails to communicate his decision, in respect of notice given, within the stipulated period, the recommendation shall be deemed to have been granted

10. Section 15 of the Income Tax Act is amended in subsection 7 , by inserting the following new paragraph immediately after paragraph (ivB)-

(ivC) income of a contractor from disposing interest in a petroleum agreement in accordance with the Ninth Schedule.

Amendment Proposal

Proposal that the Ninth Schedule to the Income Tax Act is amended in Part III, paragraph (7) by inserting the following sub paragraphs immediately after subparagraph (3)-

(4) Subparagraph (3) shall not apply to gains made by a contractor on disposal of an interest in a petroleum agreement.

(5) The rate of income tax applicable to a contractor on gains made from disposal of an interestinga petroleum agreement shall be five per cent and shall not be subject to further taxation

(Gains from farm out transactions should be taxed separately from normal business income. Corporate tax should not apply to gains on farm out transactions)

11. Section 3 of the Income Tax Act is amended by inserting the following new paragraph immediately after paragraph (c) –

(d) Notwithstanding any other provision of this Act, income is not chargeable to tax under subsection (2) (h) where, and to the extent that, it is chargeable to tax under any other provision of this Act.

Other Amendment proposals to the Finance Bill

1. THAT the Ninth Schedule to the Income Tax Act be amended in Part III, paragraph 12 by inserting the words ", including dividend tax imposed on any distribution of income or profits by the contractor," immediately after the words "petroleum operations undertaken by the contractor" appearing in subparagraph (2).

(This amendment clarifies that the tax paid on behalf of the contractor by the government shall include dividend tax on distribution of profits or income)

2. THAT the Ninth Schedule to the Income Tax Act be amended in Part IV, paragraph 16 by inserting the following proviso immediately after subsection(b)-

"Provided that no tax shall be deducted in respect of deemed interest accrued during the exploration and development stage"

(deemed interest not subject to withholding tax during the exploration and development)

3. THAT section 5 of the Income Tax Act be amended by inserting a new subsection immediately after section 5-

5(1A) In computing the gains or profits for individual contractors or short term employees employed by a petroleum company, petroleum service sub-contractor, or group company or their approved agents the provisions of the Ninth Schedule shall apply.

THAT the Ninth Schedule to the Income Tax Act be amended in Part IV by inserting the following paragraph immediately after paragraph 19-

20 (1) Subject to subparagraph (3) a non-resident short term assignee or individual contractor who derives an income for provision of services to a company under section 5(1A) shall be liable to pay a non- resident withholding tax at the rate specified in subparagraph (2) on the gross amount paid or earned.

(2) The rate of withholding under subparagraph (1) is –

(a) for payments made to short term assignees, 20%; or

(b) for payments made to individual contractors, 5.625%

(3) Section 5(1) shall apply to individual contractors providing services after the first ninety days.

(4) in this paragraph "short term assignee" means employees of any company cited under section 5(1A) above providing support or expert services which are typically not available in Kenyan operations and is in Kenya for periods not exceeding one hundred and eighty three days in a calendar year.

(5) In this paragraph-

"individual contractor" means independent individuals contracting on third party basis to provide expert services and are not employees of the petroleum company or petroleum service subcontractor.

4. THAT the Ninth Schedule to the Income Tax Act be amended in Part IV, paragraph 15 as follows-

(a) by inserting the following proviso immediately after item (3) of paragraph 15;

(3A) The rate of withholding tax applicable under paragraph 2 shall be applied to the service fee but excluding-

(i) moneys actually paid by a licensee or contractor to reimburse the non-resident subcontractor for the cost of mobilisation and, where applicable, demobilisation; and

(ii) reimbursement of expenses.

(B) Payment for mobilization and demobilization shall not exceed the amounts normally paid in the international petroleum/mining industry, having regard to the circumstances of the contract, and shall not be at a level calculated to transfer a part of the taxable service fee to the non-taxable moneys referred to in subparagraph (3) (A)

In this Part-

"mobilisation and demobilization" means the movement of men and equipment to Kenya prior to operating, and from Kenya after completion thereof, including the movement of men and equipment in Kenya during provided the movement is not to a third party;

"reimbursement of expenses" means payment by a contractor or licensee to a subcontractor for payments made to a third party on behalf of the contractor or licensee in respect of goods and services which are incidental to the subcontract and would not normally, in the international petroleum or mining industry, be included in the taxable service fee, but does not include a charge for handling or administration.

5. THAT the Ninth Schedule to the Income Tax Act be amended in Part IV by inserting the following new paragraph immediately after paragraph 20-

21. For the purposes of this Schedule, the unit of currency in any such return, record or other document shall be the Kenya shilling or a convertible foreign currency provided that the consent of the Commissioner has been requested and obtained.

Proposed Amendments to the Customs and Excise Act

1. Section 117A of the Customs and Excise Act is amended by inserting the following new subsection immediately after subsection (6) (c)-

(d) for the direct and exclusive use in oil exploration and development by a company granted exploration license in accordance with production sharing contracts under the provisions of Petroleum(Exploration and Production) Act (Cap.308), upon recommendation by the Cabinet Secretary responsible for energy.

(The exemption to apply during exploration and development stages)

2. The Sixth Schedule of the Customs and Excise Act is amended by inserting the following new subparagraph immediately after subparagraph (q)-

> (r) goods intended for the direct and exclusive use in oil exploration by accompany granted exploration license in accordance with production sharing contracts under the provisions of petroleum (exploration and Production) Act (Cap. 308), upon recommendation the Cabinet Secretary responsible for energy.

ICPAK

CLAUSE 10

THAT clause 10 of the Bill be amended by inserting a new paragraph immediately after paragraph (b)-

(c) in subsection (4) by deleting the word "four" and substituting therefor the word "nine".

(The loss claim period is restricted to five years. The Cabinet Secretary through the budget speech intended to allow investors to carry forward tax losses for ten years without requiring his approval to do so)

CLAUSE 11

THAT clause 11 of the Bill be amended in subsection (1) by inserting a new paragraph (ii)-

(iii) by inserting a new paragraph immediately after paragraph (j)-

> "(k) tax upon gross rental receipts of a person chargeable to tax under section 6A shall be charged at the resident rate for that year of income."

(To clearly indicate that the tax rate applicable on residential rental income is 12 per cent)

CLAUSE 12

THAT clause 12 of the Bill be amended by deleting the proposed paragraph (a) and substituting therefor the following new paragraph-

(a) in subsection (1), by inserting the following new paragraph immediately after paragraph (j)-

"(k) gains on transfer of securities listed in any securities exchange approved under the Capital Markets Act."

(The provision in the Bill is a drafting error and should refer to (j) in the Income tax and introduce a new paragraph (K))

CLAUSE 18

THAT clause 18 of the Bill be amended by inserting the following new paragraph immediately after paragraph (c)

"(d) by inserting a new paragraph-

"The tax rate in respect of residential rental income shall be twelve per cent"

Income Tax Act Proposals

1. THAT section 105 of the Income Tax Act be amended by deleting subclause (1) and substituting therefor the following new subclause (1)-

"(1) If it is proved to the satisfaction of the Commissioner that, in respect of a year of income, tax has been paid by or on behalf of a person, whether directly or by deduction or otherwise, which is in excess of the amount payable by that person as finally determined in respect of that year of income, the commissioner shall refund the amount of the excess, together with any interest which may be payable thereon under this act, to the person entitled to the refund"

Provided that –

(a) the overpaid tax referred to under section(1) shall be due for refund at the earlier of twelve months after return date referred to under section 52B of this Act or twelve months from the date of return filing;

(b) the interest shall become due from the date the overpaid tax is due for refund; and

(c) interest of two per cent per month or part thereof shall be due on the amount of overpaid tax not refunded after more than one month after the due date until the full amount is refunded"

2. THAT section 94 of the Income Tax Act be amended in subclause (1), paragraph (a) by inserting the words "together with any penalty imposed under any section of this Act "immediately after the words "under this section"

(This will align the provisions to the in-duplum rule applicable in the financial institutions)

VAT Proposals

1.Section 11 of the repealed Act- this provision needs to be re-inserted to cater for persons supplying taxable goods that have either been bought from exempt persons or where input VAT is not claimable e.g purchase of saloon motor vehicles by a dealer where such goods are held as stock-in-trade.

2. Making tax representatives personally liable for taxes- section 9(3) – a tax representative should only be made personally liable where it is proven that he committed an offence wilfully or by neglect or fraud, but not in ordinary circumstances where for instance the non-resident fails to remit tax

3. Essential commodities- proposal to have KRA implement a graduated VAT rate approach where the VAT rate approach where the VAT rate is split into three categories namely;

a) a lower rate for basic consumer commodities which could be set at 30% of the standard;

b) a standard rate for all the other commodities; and

c) a higher rate for specific commodities which are viewed as to both the population and the environment. This could be set at 130%

4. Withholding VAT- proposal for the removal of withholding VAT and the rapid implementation of the itax as a more efficient means to ensure tax payer participation.

CAPITAL MARKETS AUTHORITY

Value Added Tax

CLAUSE 5

THAT clause 5 of the Bill be amended in paragraph (b) by inserting the following new paragraphs immediately after paragraph (22)-

(23) Supply by way of transfer, assignment or sale of land or any other eligible investments, as specified under the Capital Markets Authority, into a real estate investment trust scheme authorized by the Capital Markets Authority.

(24) Supply by way of transfer, assignment or sale of assets, as defined under the Capital Markets Authority, into and from a special purpose vehicle for purposes of asset backed securities transactions.

(The Cabinet Secretary for the National Treasury in his Budget Statement made a policy pronouncement emphasizing the need for tax neutrality of Real Estate Investment Trusts and Asset Backed Securities vis a vis other forms of debt. In order to ensure that these alternative sources of financing are successfully introduced in Kenya, the VAT exemption should be extended to the transfer of assets to REITs and ABS approved by CMA under the Capital Markets Authority.)

Income Tax Act

CLAUSE 9

THAT clause 9 of the Bill be amended in the proposed new paragraph (gg) by deleting the word "securities" and substituting therefor the word "shares"

CLAUSE 11

THAT clause 11 of the Bill be amended-

(a) in the proposed paragraph (ii) in the proposed paragraph (j) by deleting the word "securities" and substituting therefor the word "shares" ;

(b) by deleting the proposed paragraph (b) subparagraph (ii);

CLAUSE 12

THAT clause 12 of the Bill be amended-

(a) by deleting the proposed paragraph (a); and

(b) in the proposed paragraph (c) by deleting subparagraph (ii) the proposed new paragraph (k).

STATUTORY INSTRUMENTS ACT

Proposal to amend the Finance Bill

1. THAT the Bill be amended by inserting a new clause-

55. Statutory Instruments Act is amended by inserting the following new section immediately after clause 14-

14A.(1) Any statutory instrument, other than regulations, rules by-laws and tariffs, issued by any financial sector regulator, as prescribed by the Cabinet Secretary responsible for the National Treasury, shall only be required to comply with the procedure for making of subsidiary legislation as may be prescribed under the enabling Act.

(2) The penalties prescribed under any subsidiary legislation issued under any Act of Parliament enacted to regulate the financial sector shall override section 24(5) of the Statutory Instruments Act.

(The processes prescribed under the statutory instruments Act seem to claw back some of the regulatory powers available to these regulators under their respective Acts of Parliament undermining their ability to promptly respond to changing market dynamics in line with their mandates.)

KENYA FILM COMMISSION

1. The First Schedule in section A of Part I be amended by inserting the following paragraph-

"Goods imported or purchased by the Film Commission of Kenya subject to approval by the Cabinet Secretary to the National Treasury"

2. The First Schedule in section A of Part II be amended by inserting the following paragraph-

"Services imported or procured locally for use by the film producers or filming agents certified by the Film Commission of Kenya subject to approval by the Cabinet Secretary to the National Secretary."

3. **CLAUSE 12**

THAT clause 12 of the Bill be amended by deleting the proposed paragraph (b) and substituting therefor the following new paragraph-

(b) by inserting the following new subsection immediately after subsection (1)-

(1A) Subsection (1) shall not apply to payments made by film producers and filming agents approved by the Kenya Film Commission to actors and crew members approved for purposes of paragraphs (g) and (h)

SACCO SOCIETIES REGULATORY AUTHORITY

New clauses

1. The Sacco Societies Act is amended by inserting the following new section immediately after section 2-

2A. The object and purpose of this Act is to-

(a) recognize the Sacco societies as financial service providers;

(b) provide for the regulation and supervision of Sacco societies;

(c) provide for the making of prudential regulation and standards for Sacco societies;

(d) provide for the licensing of Sacco societies to carry out deposit taking business;

(e) make provisions for the implementation of policies of government with respect to Sacco societies;

(f) provide for the imposition of financial penalties or sanctions for breach of the provisions of this Act, the regulations made thereunder or for non-compliance with the requirements, guidelines or directives issued by the Authority pursuant to this Act;

(g) make provisions for the imposition of levies, fees and other charges by the Authority;

(h) provide for the performance by the Authority any other function as are conferred by ths act or by any other written law with respect to Sacco societies;

(i) make provision for the Authority to do all other things necessary for, or incidental to the performance of its objectives and functions under this Act or any other written law.

(to provide for the recognition of Saccos as financial service providers)

2. The Sacco Societies Act is amended by inserting the following new section immediately after section 48-

48A. (1) the Authority shall determine the suitability and propriety of every person seeking to serve as a Director of other officer of a Sacco Society, and may bar or prohibit a person from serving in a Sacco Society as such a Director or officer of a Sacco Society.

(2) The Authority shall in determining if a person is suitable and proper to serve as a Director or Officer of a Sacco Society consider the-

(a) financial status or solvency of the person;

(b) educational or other qualifications or experience of the person, having regard to the nature of the functions which, if the application is granted, the person shall perform;

(c) status of any other license or approval granted to the person by any financial sector regulator;

(d) ability of the person to carry on the regulated activity competently, honestly and fairly;

(e) reputation, character, financial integrity and reliability; and

(f) any other material information

(3) Without prejudice to the generality of subsection (2) the Authority may, in considering whether a person is fit and proper-

(a) take into account whether the person-

(i) has contravened the provision of any law, in Kenya or elsewhere, designed for the protection of members of the public against financial loss due to dishonesty incompetence, or malpractice by persons engaged in transacting with marketable securities;

(ii) has been convicted or is under investigation in respect of an offence involving financial impropriety or fraud of public funds, or an offence of corruption and economic crimes;

(iii) was a director of a Sacco Society which was liquidated or is under liquidation or has been placed under statutory management;

(iv) has taken part in any business practice which, in the opinion of the Authority, was fraudulent prejudicial to the market or public interest, or was otherwise improper, which would otherwise discredit the person's methods of conduction Sacco business; or

(v) has taken part or has been associated with any business practice which casts doubt on the competence or soundness of judgement of that person; or

(vi) has acted in such a manner as to cast doubt on the person's competence and soundness of judgement.

(b) take into account any information in the possession of the Authority, whether provided by the applicant or other available sources.

(4) The Authority shall, before determining that a person is not fit or proper to serve as a Director or officer of officer of a Sacco Society for purposes of this Act, give such a person an opportunity to be heard.

(5) The Authority shall prescribe mandatory continuous or minimum professional development courses, trainings and certification which every director or officer of a Sacco Society must undertake or attain before serving or seeking to serve as an officer of a Sacco Society.

(To provide a criteria for determining the suitability of officers holding positions of responsibility in Sacco)

3. The Sacco Societies Act is amended by inserting the following new section immediately after section 54-

54A (1) The Authority shall facilitate the establishment of Sacco Societies Central Liquidity Fund, in this section referred to as "the fund" which shall be operated by at least twenty deposit taking Sacco societies.

(2) The Authority shall license, regulate and supervise the Fund under this Act in the same manner as a Sacco society, unless otherwise prescribed.

(3) The objectives of the fund shall be to act as the designated liquidity manager for member Sacco societies, and may include the provision of lending services to address illiquidity need of member Sacco societies.

(4) A Sacco society which is a member of the fund shall maintain a minimum contribution with the Fund of which it is a member at such rate as may be prescribed.

(5) The fund may provide other connected financial services to its members and other Sacco societies as may be prescribed by the Authority.

(6) The money constituting the Fund may be invested in any of the following manner-

(a) loans to member Sacco societies;

(b) securities, obligations or other debt instruments issued or guaranteed by the government or any agency of the government;

(c) deposit, obligations or other accounts of deposit-taking institutions under the Banking Act;

(d) money market instruments with Institutions licensed under the Capital Markets Act;

(e) in any other such liquid assets as may be approved by the Authority.

(7) the Authority shall prescribe regulations on the licensing, governance and operations of the fund which shall include but not limited to –

(a) minimum licensing requirements for the fund including license fees, levies and other charges;

(b) governing structure of the fund;

(c) minimum prudential standards to be maintained and observed by the fund at all times;

(d) entry requirements for members and other participants in the fund;

(e) amount to be contributed by eligible Sacco societies;

(f) mandatory rules governing the fund;

(g) maximum amount to be accessed by a member or participant from the fund including circumstances under which a member or participant in the fund the facilities of the fund;

(h) interest rates;

(i) penalties applicable to any defaulting Sacco society and the date on which the facility may become operational;

(j) any other matter necessary for the efficient and prudential operation and management of the fund.

(8) Any person who operates a liquidity fund for Sacco societies in Kenya without a valid license from the Authority commits an offence."

4. Section 3 of the Sacco Societies Act is amended in subsection (1) by inserting the following new paragraph immediately after paragraph (b)-

"(c) Sacco Societies' Central Liquidity Fund"

(to promote development of deposit taking Sacco societies central finance facility as a Sacco system's liquidity management vehicle for facilitating liquidity pooling amongst Sacco societies, inter-Sacco lending and structured participation of Sacco societies in the national payment system.)

5. Section 54 of the Sacco Societies Act is amended in subsection (5) by inserting the words "performing loans and" immediately after the words "information on" appearing in paragraph (b).

6. Section 2 of the Sacco Societies Act is amended in section by inserting the following new definition in its alphabetical order-

"credit reference bureau" means a credit reference bureau duly licensed and regulated under the Banking Act.

KENYA ASSOCIATION OF STOCK BROKERS AND INVESTMENT BANKS

VAT

Clause 1

THAT clause 1 of the Bill be amended in paragraph (b) by deleting the number "18"

(Proposal to start paying the tax as early as 1st October 2015. Stockbrokers are unable to compute capital gains tax and this continues to deny the Government revenue)

Income tax

Clause 18

THAT clause 18 of the Bill be amended-

(a) by renumbering the second paragraph(a) as paragraph (b);

(b) in paragraph (b), by deleting subparagraph (iii) and substituting therefor the following new subparagraph-

"(iii) by inserting the following new paragraph-

(o) a transaction levy of 0.24 per cent of gross amount payable on transfer of shares listed on any securities exchange approved under the Capital Markets Authority constituting 0.12% on both the buy and sell sides of a share trade.

Provided that this levy shall be gradually increased to 0.3% in three years."

(A 0.3% levy on bonds would be too exorbitant especially bearing in mind that current total trading costs for bonds are 0.035%. the amendment brings clarity to the section and eradicates ambiguity

ERNST & YOUNG

INCOME TAX ACT

CLAUSE 15

That section 15 of the Income tax Act be amended in subclause (4) by deleting the word "four" and substituting therefor the word "nine"

(In order to eliminate the need for tax payers to make applications to the Cabinet Secretary, for extension of loss utilization for periods below ten years)

CLAUSE 34

That clause 34 be amended-

34 (1) (i) Tax upon the net from sale of property or shares of a resident person charged under section 3(2) (g) shall be charged as per the provisions of the ninth schedule

34 (1) (k) The net gain from the sale of property or shares in respect of oil companies, mining companies or minerals prospecting companies shall be charged as per provisions of the Ninth Schedule.

(The proposed amendments will result in simplicity in tax administration and reduce unnecessary tax controversies since the tax provisions will be easy to interpret.)

(b)by inserting a new paragraph immediately after subsection (1)-

"(1A) Tax upon gross rental receipts of a person chargeable to tax under section 6A shall be charged at the resident rate for that year of income."

(Provide clarity, ease administration of the amendment and accord fairness to various taxpayers)

CLAUSE 12

That clause 12 of the Bill be amended in the proposed paragraph (a) by deleting the proposed subparagraph (ii) and substituting therefor the following new subparagraph-

"(m) gains on transfer of securities listed in any securities exchange approved under Capital Markets Act"

THIRD SCHEDULE

1. That the Third Schedule to the Income Tax Act be amended by inserting a new paragraph-

    "The tax rate in respect of residential rental income shall be three per cent"

2. That the third schedule to the Income Tax Act be amended in paragraph (5) by inserting a new subparagraph-

"Gains on transfer of securities listed on any securities exchange approved under the Capital Markets Authority, 0.3 per cent of the gross amount payable."

(Provide clarity and ease in the administration of the proposed amendment)

3. THAT the Ninth Schedule of the Income Tax Act in the definition of "licensee" by inserting the following proviso-

"Provided that for purposes of paragraph 15 (2) (a) of this Schedule, the term licensee shall include a person holding a prospecting right under the Geothermal Resources Act"

(Brings about equal tax treatment of similar income. Simplicity in administration and enforcement of Income tax Act)

4. THAT the Eighth Schedule of the Income Tax Act be amended in paragraph 11Aby inserting the following proviso-

"Provided that the date is the 20th of the month following the month the transaction took place"

<u>VAT ACT</u>

<u>Amendment proposals</u>

1. That Section 17 of the Value Added Tax Act is amended in subclause (6) by deleting the proviso.

(Taxpayers qualifying for refund under this section may not be able to recover the excess input tax after stipulated 12 moths regardless of the circumstances delaying claim or refund)

CLAUSE 5

THAT clause 5 of the Bill be amended in the proposed paragraph (c) by deleting subparagraph (a) and substituting therefor the following new subclause-

(a) by deleting the following paragraph-

20. the supply of taxable services in respect of goods in transit.

(Editorial. The paragraph should make reference to paragraph 20 not 19)

COFFEE MEMORANDUM

That the VAT Act 2013 be amended in Part A of the Second Schedule by inserting the following new paragraph immediately after paragraph 10-

"11. The supply of taxable services in respect of unprocessed (parchment and green) coffee."

(the amendment will ensure that coffee farmers do not suffer the non-recoverable VAT which should result in higher disposal income and better livelihood for small scale farmers)

PHARMACEUTICAL MANUFACTURERS

Amendment proposal

That the Second Schedule of the VAT Act 2013 be amended by-

(a) inserting a new Part C immediately after Paragraph 9 Part B-

zero rating of medicaments of HS Codes 3002.20.00, 30002.30.00, 3003.10.00, 3303.20.00, 3003.39.00,3003.40.00, 3003.90.00, 3003.90.10, 3003.90.90, 3004.10.00, 3004.20.00, 3004.32.00,3004.39.00, 3004.40.00, 3004.50.00, 3004.90.00, 3004.90.90.

(b) inserting a new paragraph immediately after paragraph 8-

"9. Inputs or raw materials (either produced locally or imported) supplied to pharmaceutical manufacturers in Kenya for manufacturing medicaments, as approved from time to time by the Cabinet Secretary for National Treasury in consultation with the Cabinet Secretary responsible for health."

(Increased revenue to the government from finished products and the VAT refunds for the sector will be minimized. There also shall be less administrative procedures.

NAIROBI STOCK EXCHANGE

CLAUSE 18

THAT clause 18 of the Bill be amended-

(a) by deleting the proposed paragraph (a) and substituting therefor the following new paragraph-

(a) in paragraph 2, by adding the following subparagraphs immediately after subparagraph 2(f)-

"(g) in the case of a company listing its shares via introduction on a securities exchange licensed by the Capital Markets Authority, twenty-five percent for the period of five years commencing immediately after the year of income following the date of such listing."

(The provision is not framed clearly and a firm may list its shares on an exchange either via a capital raising (IPO) or through introduction).

"(h)a gain on transfer of securities listed on any securities exchange licensed by the Capital Markets Authority is notchargeable to tax under Section 3(2)(f)"

"(i)a transaction levy of 0.12% shall be imposed on both buy and sell sides of a share trade which levy shall form part of the aggregate shares transaction cost as stipulated under the Fifth Schedule of The Capital Markets (Licensing Requirements)(General) Regulations"

(c) in paragraph (b), by deleting subparagraph (iii) and substituting therefor the following new subparagraph-

"(iii) by inserting the following new paragraphs-

(o) a gain on transfer of securities listed on any securities exchange licensed by the Capital Markets Authority is not chargeable to tax under Section 3(2)(f)".

"(p) A transaction levy of 0.12% shall be imposed on both buy and sell sides of a share trade which levy shall form part of the aggregate shares transaction cost as stipulated under the Fifth Schedule of The Capital Markets (Licensing Requirements)(General) Regulations"

New clause

That the Stamp duty Act be amended by inserting the following new section immediately after section 96-

96 A1) This section shall apply only to Co-operative Societies registered by the Commissioner for Co-operative Development.

2) Stamp Duty shall not be chargeable on the transfer of Cooperative shares between persons on the condition that any such transfer is executed on a transparent and automated market platform."

POWER SECTOR INVESTORS

Clause 4

That clause 4 of the Bill be amended in the proposed amendment of Section 25A by-

(a) inserting a proviso immediately after subclause (1)-

"Provided that the Commissioner may, at any time, revoke the appointment of a withholding VAT agent, if he deems it appropriate to do so."

(b) inserting a proviso immediately after subclause (3)-

"Notwithstanding the foregoing, the Commissioner may, on application by the supplier of any goods or services to which subsection (3) applies, waive the requirements of this section in respect of tax due thereon, if satisfied that owing to the nature of the supplier's business, it is impracticable to withhold VAT in accordance with this section or that compliance with this section is likely to result in an administrative or financial burden for the supplier"

(These amendments will ensure that there is no revenue leakage, the huge VAT refund claims are reduced, and tax administration and compliance by the taxpayers is enhanced.)

Clause 6

That clause 6 of the Bill be amended-

(a) by deleting the proposed paragraph (9) in Part A and substituting therefor the following new paragraph;

"(9) Taxable goods and taxable services (excluding motor vehicles) imported or purchased for direct and exclusive use in the construction of a power generating plant by a company to supply electricity to the national grid approved by the Cabinet Secretary for National Treasury upon recommendation by the Cabinet Secretary responsible for Energy."

Amendment proposal

That section 17 paragraph (b) be deleted.

(to maintain the enhanced investment deduction of 150%.Alternatively, the proposal of a transition period of not less than 5 years before this incentive can be abolished.)

PRICEWATERHOUSECOOPERS

Clause 4

That clause 4 of the Bill be amended in the proposed amendment of Section 25A by-

(a) inserting a proviso immediately after subclause (1)-

"Provided that the Commissioner may, at any time, revoke the appointment of a withholding VAT agent, if he deems it appropriate to do so."

(b) inserting a proviso immediately after subclause (3)-

"Notwithstanding the foregoing, the Commissioner may, on application by the supplier of any goods or services to which subsection (3) applies, waive the requirements of this section in respect of tax due thereon, if satisfied that owing to the nature of the supplier's business, it is impracticable to withhold VAT in accordance with this section or that compliance with this section is likely to result in an administrative or financial burden for the supplier"

(These amendments will ensure that there is no revenue leakage, the huge VAT refund claims are reduced, and tax administration and compliance by the taxpayers is enhanced.)

Clause 10

That clause 10 of the Bill be amended-

(c) in subsection (4) by deleting the words "four succeeding years of income" and substitute therefor the words "nine succeeding years of income"

DUTY FREE SHOPS

Clause 2

That clause 2 of the VAT Act is amended by deleting the proposed definition of "duty –free shop and substituting therefor the following new definition –

"duty free shop"means "a room or premises situated in a port and licensed by the Commissioner for the deposit ofdutiable goods on which duty has not been paid and which have been entered to be warehoused foruse as ship stores or for sale to passengers departing to places outside Kenya";

Clause 6

THAT the Second Schedule to the VAT Act be amended in Part A by inserting the following new paragraph immediately after paragraph 8 -

"9.The acquisition, supply or importation of taxable supplies by duty free shops for resale to passengers departing outside Kenya, or use in the duty free shops for furtherance ofbusiness"

ANJARWALLA &KHANNA

Clause 18

THAT clause 18 of the Bill be amended in the proposed paragraph (b) by inserting the following new paragraph-

(k) gains on transfer of securities listed on any securities exchange approved under the Capital Markets Authority, 0.3 per cent of gross amount payable

Clause 21

THAT clause 21 of the Bill be amended in the proposed clause 96 subclause (1) –

(a) by deleting the word " transfer" and substituting therefor the word "allotment" in the proposed paragraph (a);

(b) by deleting the word " transfer" and substituting therefor the word "allotment" in the proposed paragraph (b);

KEPSA

Amendment proposals to Income Tax Act

1) Section 3 of the Income tax act is amended in paragraph (c) of subsection (3) by-

(a)deleting subparagraph (ii) and substituting therefor the following new subparagraph-

(ii) "net gain", in relation to the disposal of an interest in a person, means the consideration for the disposal reduced by the adjusted cost of the interest; and

(b) deleting the word "cost" appearing in subparagraph (iii) and substituting therefor the words "adjusted cost" immediately before the word "consideration".

(The definition of net gain changed by replacing the term cost with adjusted cost to enhance the cost base in respect of share transactions. A new definition for "adjusted cost" has been suggested in the ninth Schedule)

2) Section 15(5A) of the Income Tax Act is amended by –

(a) deleting paragraph (a);

(b) deleting the words "for any other case" in paragraph (b).

(Kenyan tax is applied on the disposal of shares where 20% or more of value is derived from immovable properties in Kenya. This results in double taxation which is against the principle of double tax treaties and is also a major disincentive to investment)

3) Section 17 paragraph (b) of the Income Tax Act be deleted.

(to maintain the enhanced investment deduction of 150%.Alternatively, the proposal of a transition period of not less than 5 years before this incentive can be abolished.)

4) The Ninth Schedule to the Income Tax Act is amended in paragraph (1) by inserting the following definition in its correct alphabetical sequence-

“adjusted cost” in relation to an interest in a person, a mining or petroleum right, or mining or petroleum information means-

(a) the total consideration given for the acquisition of the interest, right, or information, including the fair market value of any amount given in kind determined at the time the time the amount is given;

(b) the amount of any expenditure incurred on the interest, right, or information at any time after its acquisition by or on behalf of the transferor for the purpose enhancing or preserving the value of the interest, right, or information, at the time of the disposal;

(c) the amount of expenditure wholly and exclusively incurred at any time after the acquisition of the interest, right or information by the transferor establishing, preserving of defending title to, or right over, the interest, right or information; and

(d) the amount of incidentals costs to the transferor of acquiring the interest, right or information.

Amendment proposals to the VAT Act

Section 2 of the Value Added Tax Act is amended in the definition of the term “money” by inserting the words “or electronic payment system immediately after the words “credit card” in paragraph (c)

Section 15 of the ValuedAdded Tax Act is amended by inserting the following proviso immediately after subsection (2)-

Provided sample goods shall not be treated as taxable supplies where;

Sample goods means goods distributed free as samples by a registered person for furtherance of his business are freely available and are not limited in distribution to fewer than thirty persons in any one calendar month.

Section 16of the ValuedAdded Tax Act is amended-

(a) in subclause (1) by deleting the words “six months” and substituting therefor the words “ twelve months” appearing in the proviso;

(b) insubclause (5) by deleting the words “in the next subsequent month” and substituting therefor the words “ within six months after the end of the tax period in which the debit note was issued”

(c) insubclause (6) by deleting the words “ of name, address and personal identification number of the person to whom it was issued” and substituting therefor the words “ with the prescribed details of tax invoice as provided in section 42 (1)”

Section 17 of the ValuedAdded Tax Act is amended in subclause (2) by deleting the words “six months” and substituting therefor the words “twelve months” appearing in the proviso.

MIN.NO. DCF/216 /2015: PRELIMINARIES

The Chairperson called the meeting to order at 10:50am followed by a word of prayer from Mr. Fredrick Otieno.

MIN.NO. DCF/217/2015: CONSIDERATION OF THE FINANCE BILL, 2015

The Parliamentary Budget office informed the following:

The Finance Bill, 2015 was submitted to parliament on 11th June, 2015 during the occasion of presentation of the Fiscal Year 2015/16 highlights of the annual estimates. The Bill has a timeline of 3 months from the time of enactment of the Appropriation law, upon which it is required to be considered and approved by the National Assembly. This is in accordance with Section 40 of the Public Finance Management Act, 2012.

Value Added Tax Act

The Bill in clauses 1 – 6, proposes amendments to the Value Added Tax (VAT) Act, 2013 and the effective date is 12th June, 2015. Some of the proposed amendments include introducing timeline to lodging VAT refund claims; KRA to appoint other agents other than MDAs to withhold 6% of VAT payable at the time of paying for the supplies and remit to the Commissioner; adding in exemption list some items like aircraft parts, aid funded supplies excluding vehicles, goods imported for Kenya Film Commission, imported parts for school laptop assembly and taxable goods for construction of recreational and industrial parks.

Included in the zero rated regime, are purchases from duty free shops for departing passengers; supply of taxable services in respect of goods on transit and importation of right hand vehicles by returning residents having disposed of the left hand one.

Income Tax Act

Clauses 7 – 20 propose amendments to various Sections of the Income Tax Act and the commencement date for these Sections, if amended, shall be 1st January, 2016.

Some of the notable changes proposed include among others: the introduction of Residential Rental Income tax at the rate of 12% for income below KSh. 10 million and provision for amnesty thereof; extending carrying forward of losses by investors from 5 years to 10 years; removing gains from

ANNEX 2: MINUTES

MINUTES OF THE 50TH SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON THURSDAY 11THAUGUST, 2015 IN CONTINENTAL HOUSE, COMMITTEE ROOM, 5TH FLOOR, PARLIARMENT BUILDINGS AT 10AM.

PRESENT

1. Hon. Benjamin Langat, MP **Chairperson**
2. Hon. Eng. Shadrack Manga, MP
3. Hon. Anyanga Andrew Toboso, MP
4. Hon. Daniel EpuyoNanok, MP
5. Hon. Timothy Bosire, MP
6. Hon. Iringo Cyprian Kubai, MP
7. Hon. Abdul Rahim Dawood ,MP
8. Hon. Joseph Limo, MP
9. Hon. JoashOlum, MP
10. Hon. Patrick MakauKing'ola, MP
11. Hon. LatiLelelit, MP

ABSENT WITH APOLOGIES

1. Hon. Nelson Gaichuhie, MP **Vice-Chairperson**
2. Hon. Mary Emase, MP
3. Hon. Alfred Sambu, MP
4. Hon. AbdullswamadShariff, MP
5. Hon. Kirwa Stephen Bitok, MP
6. Hon. Sakwa John Bunyasi, MP
7. Hon. Jones Mlolwa, MP
8. Hon. Dr. OburuOginga, MP
9. Hon. Jimmy NuruAngwenyi, MP
10. Hon. TirasNgahu, MP
11. Hon. Ogendo Rose Nyamunga, MP
12. Hon. Sammy Mwaita, MP
13. Hon. SumraIrshadali, MP
14. Hon. Sakaja Johnson, MP
15. Hon. ShakeelShabbir, MP
16. Hon. Dennis Waweru, MP
17. Hon. Sammy Koech, MP
18. Hon. Ronald Tonui, MP

IN ATTENDANCE

1. Mr. Robert Nyaga Parliamentary Budget Office
2. Mr. JosphatMutonu Parliamentary Budget Office
3. Mr. ChachaMachage Parliamentary Budget Office
4. Mr. Nicodemus Maluki Third Clerk Assistant
5. Mr. Fredrick Otieno Third Clerk Assistant

Where “goods in transit “means

(a) goods for export ;or

(b) goods imported from a foreign place through Kenya to a foreign destination.

Clause 10

THAT clause 10 of the Bill be amended in the proposed section 15, in paragraph (a) by deleting the word “five” and substituting therefor the word “four”

(editorial)

Clause 19

That clause 19 of the Bill be amended by deleting the proposed paragraph (g) and substituting therefor the following new paragraph 11-

11A.The due date for tax payable in respect of-

(a) land or buildings transferred under this Part shall be on or before the date of application for transfer of the property made;

(b) any other property to a date not later than the twentieth day of the month succeeding that in which the tax became due.

<u>BETTING CONTROL AND LICENSING BOARD</u>

Clause 18

THAT clause 18 of the Bill be amended-

(i) in the proposed paragraph (3)by deleting the word “bookmakers” and substituting therefor the words “punters (players)” wherever it occurs in the proposed proviso in subparagraph (m)

(ii)) in the proposed paragraph (5) by inserting the word “betting” immediately after the words “ of the gross” in the proposed proviso in subparagraph (j)

The First Schedule of the ValuedAdded Tax Act is amended in Part II, -

(a) by inserting the words "and flower auction services" immediately after the words "coffee brokerage services" in paragraph 10;

(b) in paragraph 8 –

(i) by deleting the definition of the term "residential premises" and substituting therefor the following new definition-

"residential premises" means hospital accommodation, dwelling situated in a retirement village or rest home if the consideration paid or payable for the supply of accommodation in the dwelling is for the right to occupy the dwelling; or a convalescent home, nursing home, rest home or hospice,land or a building occupied or capable of being occupied as a residence, but not including hotel or holiday accommodation,homestay, farm stay, bed and breakfast establishment, inn, hostel, or boarding house, a serviced apartment for which services in addition to the supply of accommodation are provided and camping ground.

(ii) by deleting the words " or capable of being occupied" ;

The Second Schedule of the ValuedAdded Tax Act is amended in Part A-

(i) by inserting the word ", flowers" immediately after the words "supply of coffee"; in paragraph 4

(ii) by inserting the word ", flower" immediately after the words "export to coffee";in paragraph 4

(iii) by inserting a new paragraph immediately after paragraph 8-

"9. The supply of flowers and horticultural produce for export through export consolidators."

Amendments to the Finance Bill

Clause 5

THAT clause 5 of the Bill in paragraph (b) by inserting the following new items immediately after item 52-

52A.Biogas.

52B. Leasing of biogas producing equipment

Clause 6

THAT clause 6 be amended in the paragraph (a) by deleting the proposed new paragraph 10 and substituting therefor the following new paragraph-

10. Supply of taxable services in respect of goods in transit.

securities from Capital Gains Tax to Withholding Tax at a rate of 0.3% of gross amount payable; tax exemption threshold on transfer of land increased from KSh. 30,000 to KSh. 3 million.

Others are: abolishing investment deduction (ID) for building and installation of machinery outside the 3 main municipalities; increasing number of ships to qualify for 100% (from% previously) investment deduction on ships by reducing tonnage threshold from 495 to 125; introducing withholding tax at a rate of 7.5% on non-resident bookmakers and taxation of gains from compensation of land acquired by government for the purpose of infrastructure development.

Miscellaneous Amendments

Clauses 21 – 54 propose amendments to various statues in the financial sector and the effective date is provided as 1st October, 2015.

The Stamp Duty Act is proposed for amendment so as to exempt transfers under Real Estate Investment Trusts (REITs) from paying stamp duty.The Insurance Act is to be amended to transfer some functions, such as amending the Schedule, to the Authority (IRA) that have hitherto been performed by the Cabinet Secretary; streamline registration of insurance agents and the provision for minimum capital requirement.The Banking Act is proposed to be amended to streamline licensing of banking institutions; transition from the Deposit Protection Fund Board to the newly established Kenya Deposit Insurance Corporation and the provision on minimum core capital requirement for banks and mortgage finance companies.The Road Maintenance Levy Fund Act is to be amended in order to facilitate operationalization of the Road Annuity Fund established under the Public Finance Management Act.The Retirement Benefits Act is amended to reduce from 6 to 3 months, the time the scheme administrators take to submit their audited accounts to the RBA.The Proceed of Crime and Anti-Money Laundering Act is to be amended to introduce "financing of terrorism" as part of the mandate of the Financial Reporting Centre, in addition to financing of crime and money laundering.

The Kenya Deposit Insurance Act is amended to increase to 2 years from 1 year, the transition period for staff of the former Deposit Protection Fund Board to the new Corporation.The Consumer Protection Act is to be amended to exempt credit agreements between public entities and development partners from the provisions of the Act, which is posing interpretation challenges then the Tax Appeals Tribunal Act is proposed to be amended to provide for the transition of operation from the former to the new Tribunal.

AMENDMENTS TO THE VAT ACT, 2013

Clause 4 to amends Sec. 25A on Withholding VAT (FA-2014):

Currently, MDAs are the only ones mandated to withhold 6% of payable VAT and this new proposal is aimed at allowing KRA to designate other agents (including private sector) to withhold 6% of VAT payable. This is meant to avail, to the Commissioner of the Kenya Revenue authority, information regarding all VAT taxpayers.

Clause 5 amends the First Schedule on Exemption supplies:

Some medicament like penicillin and their derivatives are removed from exemption list. Item proposed for inclusion are such as: aircraft parts; aid funded supplies; plastic bag biogas digesters; school lap top and tablet assembly parts; goods meant for construction of recreational and industrial parks.To encourage local manufacturers, perhaps, medicaments should be Zero Rated or subjected to an optimum nominal rate since the exemption creates unfair competition. Other medicaments for diseases like diabetes should also be considered. Exempting aircraft parts may encourage growth in the aviation industry, however, all the other proposed exemptions like goods for construction of recreational and industrial parks will encourage importation rather than local supply.

Clause 6 amends the Second Schedule on zero rated supplies:

Included in the list of zero rated goods are: goods purchased from duty free shops by departing passengers; goods on transit and left hand vehicles owners returning home to sell them and import right hand equivalent duty free.This will place duty free shops in the category of EPZs. For goods on transit, the proposed amendment will give the local transporters a treatment similar to their counterparts in the region and elsewhere. With regard to selling left hand and buying equal value right hand vehicle, this is a fair treatment of Kenyans returning home from countries operating left hand vehicles.

AMENDMENTS TO THE INCOME TAX ACT

Clause 8 amends Sec. 6 under income from use of property:

It proposes an introduction of a new tax to be known as Residential Rental Income tax on annual income of landlords below KSh. 10 million (at 12%). Those already paying tax on gains from property need not pay this one (seek written clearance from the KRA). It is noted that the rate of 12% is missing from the

Bill.This seems not to be a fair and progressive tax, thus, may discourage investment in real estate as well as posing administration challenges. Also, there is no minimum income threshold for this tax. In addition, it appears to encroach on the county governments' property rates.

Clause 10 amends Sec. 15 (5) of the Act which provides for total income deductable when calculating total taxable income

It allows investors to carry forward loss up to 10 years. Currently, the period allowable is 5 years.
The focus here is on the recent heavy investment in the power production, manufacturing and hotel operators.

The Sub sections of Section 15 should be renumbered properly due to amendment done in the FA-2014 that introduced a new Sub-section 5 whereas there Sub-sections 5, 6 and 7 in existence.

Section 15(4) should be amended to allow utilization of losses for 9 succeeding years to reflect the proposed 10 years extension. With the current 5 year-period of loss-carry-forward, it is usually the current year of income and 4 succeeding years.

However, 10 years is a very long period for investors to carry forward losses given that most do benefit from a myriad of waivers in the course of their investment.

Clause 11 Amends Sec. 34 which deals with tax rates (CGT in particular)

Currently, Capital Gains Tax (CGT) is charged on gains from property and securities at the rate of 5%. It is now proposed that gains from securities should be hived from CGT and shall be subjected to Withholding Tax at rate of 0.3% of the gross amount payable.

CGT on property shall be retained at the current 5% for residents. The gains from securities shall be subjected to withholding tax for residents and non-residents (reflected in clause 18).

Clause 12 amends Sec. 35 under deduction of tax (Withholding):

The amendment exempts non-residents from paying a management, professional or training fees in respect of gains from securities. However, the reference to the Section should be given correctly as 35(1)(a) and not 35(1)

Performance fees paid by the KFC to actors and crew members are also exempted from WHT. This is meant to encourage the local art industry

Clause 13 amends Sec. 39 on tax set–off rebate:

The proposed amendment introduces tax rebate to employers who will engage more than 10 graduates for apprenticeship for 6 – 12 months. The CS shall make regulations to operationalize this.

This incentive is meant to encourage employers to give young graduates an opportunity to obtain the on-the-job skills. However, it is not certain whether the incentive will effectively address the problem. This should also not be left for the CS to determine and the graduates should be remunerated by the employers for them to benefit from the tax re-bate.

Clause 16 amends the First Schedule on tax exemptions:

The proposed amendment tax exemption on land transfer value of below KSh. 3 million and below 50 acres for agricultural land outside a municipality or a township.

This provision is very old and needed to be updated. Initially it was KSh. 30 thousand and 100 acres respectively. The revised provision is likely to exempt massive land transaction from taxation hence, loss of revenue. Nonetheless, it is likely to encourage uptake of mortgages.

Clause 17 amends the Second Schedule which provides for deduction from capital expenditure (Investment Deduction – ID):

Proposes to deduct from taxable income (before tax computation) income from a building in use for training of film producers, actors and crew. Now, what will happen to a building hosting other businesses alongside the training of the specified groups? Will the owner not pay tax on that entire building on a virtue of a targeted section?

This clause also proposes to abolish the 150% investment deduction (ID) on construction of buildings or installation of machinery outside Nairobi, Mombasa and Kisumu. This provision has been in force since 2009. This kind of investment deduction will potentially spur growth of both industries and construction of building especially in counties. The proposed amendment may therefore be considered to be halted.

Further, ID for ships is proposed to be increased from 40% to 100% and reduce the tonnage from 495 to 125. This will increase the number of imported ships to enjoy investment deduction.

Clause 18 amends Head B of the Third Schedule on tax rates:

The proposed amendment introduces Corporate Tax at a rate of 25% for a company introducing shares though listing or securities exchange through introduction. This will facilitate netting of additional revenue

The non-resident bookmakers shall pay withholding tax at the rate of 7.5% of gross revenue. This will result in additional revenue to the Exchequer.

Gains on transfer of securities by non-residents shall be charged withholding tax at 0.3% of transaction value of shares. The gains on transfer of securities by non-residents were removed from CGT to WHT. However, it is noted that the 0.3% rate is not reflected for residents.

Clause 19 amends the Eighth Schedule which provides for taxation of gains from property other than shares:

Transfer of property to a spouse or former spouse as part of divorce settlement or bona fide separation agreement is not subject to tax. The amendment proposes transfer of property to the "immediate family" (children) of spouses after separation to also be exempted from tax. This may lead to mischief of tax evasion under the disguise of the transfer for the purpose of the said settlement.

Compensation for property/land acquired by the Government for infrastructure development shall be subject to tax. Recent infrastructural activities have led to this kind of massive acquisition hence, a potential for contributing to revenue.

Clause 20 amends the Ninth Schedule of taxation of extractive industries:

Training and contractual services is changed from 20% to 5.625%. Also, withholding tax for **training**, management and professional fees is 12.5%.

This is to harmonize taxation in the extractive industries where currently, there is separate tax treatment for training services and contractual fees for petroleum and mining and same case applies to withholding tax for training and contractual fees.

MISCELLANEOUS AMENDMENTS TO VARIOUS FINANCIAL SECTOR STATUTES

Clause 21 amends the Stamp Duty Act Sec. 96 which provides for taxation of transfer between associated companies.

The proposed amendment exempts transfers under Real Estates Investment Trusts (REITs) form stamp duty.

REITs transfers are on equity, mortgage or hybrid. Currently, Housing Finance, Coop Bank and KCB are the licensed REITs trustees whereas Centum, UAP, CIC Stanbic and Fusion hold management licenses. The exemption is meant to encourage these unique investment vehicles in the arena of real estate development.

Clause 23 amends Sec. 23 of the Insurance Act which provides for powers of the CS with regard to minimum capital requirement:

Removes the powers of amending the Schedule from the Cabinet Secretary and vests them on the Authority (IRA). This gives IRA more autonomy but then it may be counter-productive with regard to the spirit of checks and balances. The CS should retain the legal mandate to amend the Schedule for the Authority to implement.

Also, the amendment proposes the removal of the requirement of tabling in the National Assembly, the minimum asset requirement for registration. This is now left for the CS to determine. This is an administrative role and therefore the amendment is regular.

The Authority is given an expanded mandate of consider and give a directive requiring an insurer to increase paid-up capital and or capital adequacy ratio higher than the minimum requirement. This is consistent with the risk based model. However, there ought to be checks and balances (for instance, the CS to be consulted)

Clause 24 amends Sec. 28 of the Insurance Act that provides for amendment of the Schedule:

It proposes that the Schedule shall be amended by the Authority and as opposed to the Cabinet Secretary as is in the current case.

This is devoid of checks and balances. It is prudent for the CS to amend the Schedule in the regulations since IRA may not have the legal authority to make regulations.

Clause 30 amends Sec. 151 of the Insurance Act which provides for requirements for registration as insurance agents:

The proposal removes the requirement for the insurer to recommend agents to facilitate their registration and instead, it requires IRA to register agents who have Certificate of Participation.

This measure is geared towards ensuring increased number of registered agents from the current 5,000 to the required 25,000.

Clause 31 amends the Second Schedule of the Insurance Act which contains minimum capital requirement:

The proposed minimum capital requirement effective 2018 shall be:

General insurance business = KSh. 600 million up from KSh. 300 million

Long term insurance business = KSh. 1 billion

Long term re-insurance business = KSh. 500 million up from KSh. 300 million.

This may perhaps lead to mergers giving rise to bigger and highly capitalized insurance institution capable of withstanding financial shocks, crises and guarding against risks. There may also benefits of multiplier effects brought about by economies of scale. Nonetheless, it is likely to cause downsizing of the human capital.

Clause 33 amends Sec. 5 of the Banking Act that provides for licensing of banking institutions:

The proposed amendment abolishes the requirement for annual licensing of banks and replaces it with a perpetual licence (which can be withdrawn any time of non compliance) in line with the risk based model adopted by banks.

The risk based model, is believed to have been adopted by all banks and the implementation of this new requirement will simplify supervision and safeguard financial stability.

Clause 36 amends Sec. 34 of the Banking Act that provides for the powers of CBK to intervene in management of an institution:

It empowers the newly established Kenya Deposit Insurance Corporation (KDIC) to assume management of an institution and not any other person as stipulated in the Act currently. This function was previously carried out by the Deposit Protection Fund Board (DPFB)

Clause 43 amends the Second Schedule of the Banking Act on the core capital requirement:

Minimum core capital for banks and mortgage institutions is proposed with timelines as follows;

31st Dec. 2016 – KSh. 2 billion

31st Dec. 2017 – KSh. 3.5 billion

31st Dec. 2018 – KSh. 5 billion

This may occasion mergers giving rise to bigger conglomerates that are highly capitalized and perhaps capable of withstanding financial shocks and crises. It may also lead to reduction of interest rates due economies of scale. However, downsizing of human capital may most likely be imminent.

Clause 44 amends the Road Maintenance Levy Fund in Sec. 3:

Stipulates that an amount KSh. 3 per litre out of RMLF be paid into the Road Annuity Fund

The fund was created by the PFM Act, 2012 and it has hitherto not been operationalized. The CS mentioned an increase of RMLF by KSh. 3 but the Bill specifies that the amount shall be hived out of the existing RMLF.

Clauses 46 – 49 propose to amend the Proceeds of Crime and Anti-Money Laundering Act:

This in a bid to update the various Sections of the Act to incorporate the element of "financing of terrorism" as one of the key functions of the Financial Reporting Centre (FRC).

The Measures mentioned by the Cabinet Secretary but are missing in the Bill

The following are some of the measure mentioned by the Cabinet Secretary during the occasion of presentation of the Fiscal Year 2015/16 Budget Policy Highlights but seem to be missing in the Finance Bill.

i) The Residential Rental Income tax was proposed at the rate of 12% for income below KSh. 10 million. However, the rate is not captured in the Bill.
ii) The CS proposed to amend the Statutory Instruments Act in order to limit the definition of statutory instruments to be laid before the House to regulations, rules, by-laws and tariffs. This was said to be meant to relieve the House from scrutinizing administrative issues of Acts. The said amendment appears to be missing from the Bill.

iii) There was a promise to amend the Retirement Benefits Act by introducing the term limit for trustees to serve a maximum of 2 terms of 3 years. This was not captured in the Bill.

iv) The CS mentioned that the Sacco Societies Act ought to be amended to allow Sacco Societies Regulatory Authority (SASSRA) to undertake the vetting of directors and key officers of the SACCOs.

v) The 0.3% withholding tax in respect of gains from securities for residents is not reflected in the Bill.

vi) Inclusion of Prisons in the Exemption Schedule to allow them import for their use, duty free goods, materials, equipment and supplies. This was meant to enable prisons to enjoy similar exemption statues as the Kenya Defence Forces and Police.

COMMITTEE OBSERVATIIONS

a) The criteria for increasing the period of carrying of losses by investors from current 5 years to 10 years: It was felt that 10 years is a long period for investors to carry losses given that most of them do not benefit from a myriad of waivers in course of their investment.
b) The proposed introduction of Residential Rental Income tax on annual income of landlords aboveKshs. 10 million may discourage investment in real estate as well as posing administration challenges. Further, the rate of taxation has not been proposed in the Bill.
c) Regarding the introduction of the 0.3% withholding tax with respect to gains from securities by residents; it was noted that this tax rate is only provided for non residents in paragraph 3 of the Third Schedule of the Income and missing from paragraph 5 of the same act for residents. Clause 11 refers the tax rate to both paragraphs. This lacuna should be corrected.

The chairperson reminded Members of the forthcoming stakeholders conference in Mombasa scheduled between 13th to 17th August, 2015 to deliberate on the 2015/16 Budget implementation Bills. He urged all Members to attend.

MIN.NO. DCF/218 /2015: ADJOURNMENT

The Chairperson adjourned the meeting at 1.00pm

Signed..date...

Chairperson