Income Tax Bill, 2018 Analysis

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1. Taxation of Business Income

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<tr><td>New corporation tax bands</td><td colspan="2">
<table>
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<tr><td></td><td>Resident</td><td>Branch</td><td>Resident</td><td>Branch</td></tr>
<tr><td>0 – 500m</td><td>30%</td><td>30%</td><td rowspan="2">30%</td><td rowspan="2">37.5%</td></tr>
<tr><td>Above 500m</td><td>35%</td><td>35%</td></tr>
</table>
</td><td>This proposal will see a uniform corporate tax rate applying to both subsidiary and branch companies in Kenya.

However, the higher corporation tax will result in Large Taxpayers incurring an additional tax cost of 5%.</td></tr>
<tr><td>Lower corporation tax rate for listed entities</td><td>A company listed on the Nairobi Securities Exchange (NSE) which has 40% of its issued share capital listed shall be taxed at 25% for the first 5 years</td><td>A NSE listed company enjoys preferential rates as follows:
▪ 20% of its issued share capital listed is taxed at 27% for the first 3 years;
▪ 30% of issued share capital listed is taxed at 25% for the first 5 years; and
▪ 40% of its issued share capital listed is taxed at 20% for the first 5 years.</td><td>The proposal reduces the tax incentive for listing while increasing the threshold from 25% to 40%.

This will reduce the impact of taxation as an incentive to list.</td></tr>
<tr><td>Export Processing Zone (EPZ) enterprises</td><td colspan="2">
<table>
<tr><th>Period</th><th>Proposed Rate</th><th>Current Rate</th></tr>
<tr><td>First 10 years</td><td>10%</td><td>0%</td></tr>
<tr><td>Next 10 years</td><td>15%</td><td>25%</td></tr>
<tr><td>21 years and above</td><td>30%</td><td>30%</td></tr>
</table>
</td><td>The proposal aligns the tax rates applicable to EPZ entities to those of Special Economic Zone (SEZ) entities.</td></tr>
<tr><td colspan="4">Thin capitalisation</td></tr>
<tr><td>Increase of Thin Capitalization Ratio</td><td>The Bill proposes to revise the thin capitalization ratio of debt to equity to 2:1.</td><td>The thin capitalisation ratio of debt is currently at equity to 3:1.</td><td>Thinly capitalised companies have restrictions on the interest expense they can take as a tax deduction.

The higher ratio will significantly reduce Kenya's attractiveness as an investment destination.</td></tr>
<tr><td>Definition of all loans</td><td>Loans for purposes of thin capitalisation computation will now exclude debt from resident persons.</td><td>Loans from both resident and non-resident persons are considered for purposes of calculating thin capitalisation.</td><td>Companies will be encouraged to take loans locally, but will have to contend with significantly higher interest rates.</td></tr>
<tr><td>Presumptive tax</td><td>The Bill introduces tax on individuals with an annual turnover below KES 5 Million.

The tax is only applicable to persons who are issued with a single business permit by County Governments at the rate of 15% of the business permit fee.

Rental and professional services income are not eligible for presumptive tax.</td><td>The ITA provides for Turnover Tax at the rate of 3%.</td><td>The change co-opts the County Governments in the enforcement of the law but still does not capture traders that do not require business permits such as farmers.</td></tr>
</table>

Taxation of Business Income cont….

Subject	Proposed Provision	Current Provision	Our Comments
Definition of control	The Bill proposes to expand the definition of control to include instances where: ▪ one person holds, directly or indirectly, shares carrying not less than 20% of the voting power in the other person or a third person holds such shareholding in the two persons; or ▪ loan or guarantee advanced by one person to the other person constitutes not less than 70% of the book value of the total assets of the other person excluding loans or guarantees from financial institutions where the person and the financial institution are not associated; or ▪ more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one person, are appointed by the other person or a third person appoints more than half of the directors in the two entities; or ▪ the manufacture or processing of goods or articles or business carried out by one person is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, of which the other person is the owner or in respect of which the other person has exclusive rights; and ▪ 90% or more of the purchases or sales by one person are supplied by or sold to the other person, or by persons specified by the other person, and the prices and other conditions relating to the supply are influenced by such other person.	The ITA defines control to mean, with respect to a body corporate, the holding of shares or voting power of 25% or more, unless otherwise expressly provided for by the articles of association or other documents regulating it.	The proposal seeks to lower the threshold for control in relation to a body corporate from 25% of the voting rights to 20%. It also expands the concept of control to include: ▪ indebtedness; ▪ intellectual property transactions even between unrelated parties; and ▪ related party transactions even when transacted on an arm's length basis. This proposal will have a direct impact on the determination of thin capitalisation and the deductibility of realised foreign exchange losses and interest.

Taxation of Business Income cont....

Subject	Proposed Provision	Current Provision	Our Comments
Permanent Establishments	The definition of a PE will be expanded to include: ▪ a warehouse, in relation to a person providing storage facilities to others; ▪ farming; ▪ sales outlets; and ▪ provision of consultancy services within Kenya for a periods exceeding an aggregate of 91 days in a year.	A PE is limited to a place of management, a branch, a factory, a mine or a construction site which has existed for six months.	There is significant expansion of the PE definition to include: a) Third party warehouses; and b) Reduction of PE qualification period for services from a continuous period of 183 days to an aggregate of 91 days in a year. This will require non-resident persons doing business in Kenya to re-think their operational models.
Partnerships	The Bill defines a person to exclude *any form of partnership*		This clarifies the existing confusion on the tax status of Limited Liability Partnerships.
Pension funds	The Bill has clarified that only income attributable to the allowable contribution received by the registered pension/provident scheme is exempt from tax.	The Act provides for a general exemption on income from registered pension/provident schemes.	The change aligns legislation to current industry practice but is silent on the treatment of pensions paid out of the taxed portion of the scheme which is tax exempt under current industry practice.
General insurance companies	Under general insurance business, the allowable deduction is now defined as either the lower of: (i) a reserve for unexpired risks relating to that business at the percentage adopted by the company at the end of that year of income and adding thereto the reserve deducted for unexpired risks at the end of the previous year of income; and (ii) the reserve for unexpired risks estimated on the basis of actuarial principles, including discounting of ultimate costs.	The general insurance business allowable deduction is only an account of a reserve for unexpired risks relating to that business at the percentage adopted by the company at the end of that year of income and adding thereto the reserve deducted for unexpired risks at the end of the previous year of income.	The Bill proposes an additional consideration in the reduction of costs, which is likely to increase administration costs.
Life insurance companies	Transfers from shareholders to the life fund will be limited to surpluses recommended for transfer from the life fund to shareholders over the preceding 5 years.	There is no limit on the number of years of surpluses to be considered.	This provision is punitive to life insurance companies.
Member's clubs and trade associations	Clubs and associations will now be taxed on gross receipts including entrance fees and members' subscriptions.	The taxable income includes gross receipts, including entrance fees and members' subscriptions, but where 75% of revenue comprises members' subscriptions and entrance fees, the clubs are exempt from tax.	Members' clubs and trade associations will now be fully taxed on member contributions, even though most of these entities are not for profit.

Taxation of Business Income cont….

Subject	Proposed Provision	Current Provision	Our Comments
List of Financial Institutions	The new legislation has included Micro Finance Institutions in the list of Financial Institutions but excluded Building Societies and Hire Purchase Institutions.		Micro Finance Institutions will be subject to the following rules; ▪ They will not be subjected to thin capitalisation rules; and ▪ Interest paid to the institutions will be exempt from WHT. Mortgage holders with loans from building societies will no longer enjoy Mortgage Interest Deduction.
Co-operative Societies	A Co-operative Society carrying on business as a Savings and Credit Cooperative Society (SACCOs) shall be taxed on the aggregate of all income except interest income from its members	SACCOs are taxed on specific incomes which include: ▪ 50% of interest incomes other than interest income from member loans; ▪ Gross income from the right of use of property, other than royalties; ▪ Capital gains; and ▪ Any other income, other than royalties, not falling under the first three categories above	The new provision seeks to increase taxes obtained from SACCOs, as interest income from other sources other than interest income from member loans, shall have to be taxed in its entirety. Effectively, the tax rate at which interest income from non-members is taxed will increase from 15% to 30%.
Collective Investment Schemes	Under the Bill, distribution of investment income to unit holders or shareholders of a Collective Investment Scheme (CIS) will be subject to tax at a flat rate of 10% for non-resident unit holders/ shareholders and 5% for resident unit holders/shareholders. The Unit Trust will withhold and remit that tax at the point of distributing income to the unit holders/ shareholders.	Under the ITA, distribution of income, and all payments for redemption of units of sale of shares received by unit holders or shareholders shall be deemed to have been already tax paid. The tax is withheld at the point of making payment to the CIS, hence at the point of distribution to the unit holders/ shareholders, tax is already deemed paid.	The provisions of the Bill brings clarity on the taxation of distributions received by unit holders through the introduction of a harmonized tax rate. The Bill clarifies that the CIS will bear the responsibility of withholding upon distribution of the investment income to unit holders/shareholders. While the resident rate for taxing distributions to resident unit- holders has been provided as 5% in the Third Schedule, the income has been excluded in the withholding tax charging section which will impact its implementation.
Corporation tax relief for property developers	A company that develops at least 100 low cost residential units annually shall be taxed at 15% for that year of income in respect of gains or profits from the development of such units. Prior approval is required from the Cabinet Secretary responsible for housing.	The threshold is 400 residential units per year.	This is a welcome move for developers as it reduces the qualification threshold to a more achievable target. However, the Bill does not define "low cost residential houses" and could be exploited.

Taxation of Business Income cont….

Subject	Proposed Provision	Current Provision	Our Comments
Tax losses	The period of utilisation of tax losses has been maintained at 10 years. This period may now be extended for a further period of two years upon application. However, this will not apply where: a) there has been a change in at least 50% of the directorship; or b) where the business activity has changed. The period that mining companies may utilise tax losses has been capped to 15 years with no provision for extension.	The Cabinet Secretary for the National Treasury may approve a request for extension of the period for carry forward of tax losses upon recommendation from the Commissioner. The period to be extended is not limited.	The Bill caps the loss utilization period to 10 years. Mining companies will have a reduced period of 15 years to utilise losses while petroleum companies will continue to enjoy an indefinite period of loss utilisation. There is also certainty in the maximum period of carrying forward of losses after application for extension. Persons seeking to invest in loss making entities will now have to exclude the losses from business valuations.
Approval for change of year end	The Commissioner shall communicate his decision regarding a Taxpayer's application for change of year – end within 3 months, failure to which the application shall be deemed to have been granted. A person carrying out an unincorporated business may apply to the Commissioner to alter their accounting year end.	Under the ITA, the Commissioner is to communicate his decision regarding a Taxpayer's application for change of year –end within 6 months. However the ITA, is silent on the implications of the Commissioner not responding within the stipulated time.	The provision per the Bill reduces the time within which the Commissioner is supposed to approve year-ends. Further, unincorporated business are no longer under obligation to work with a 31 December year – end, but may apply for an accounting period that best suits their operating environment. This provision provides clarity especially where there are delays in approval of applications.
Update of exemption list under the First Schedule	The Bill proposes to include the Income of the National Hospital Insurance Fund (NHIF) to the exemption list but excludes: ▪ The income of the various parastatals listed in the Act. ▪ Interest on a savings account held with the Kenya Post Office Savings Bank ▪ Income of a registered Home Ownership Savings Plan (HOSP); and ▪ Profits or gains of an agricultural societies.	N/A	The exclusion of some entities is an avenue to enhance tax revenues.
General penalty	The Bill provides that the general penalty will be *KES 1,000,000* or imprisonment for a term not exceeding three years or both.	The ITA outlines the general penalty to be a fine not exceeding *KES 100,000* or imprisonment of a term not exceeding six months or both.	The Bill increases the general penalty to reflect current economic conditions and to provide a stern deterrent measure to enhance compliance.

Taxation of Business Income cont….

Subject	Proposed Provision	Current Provision	Our Comments
Allowable deductions			
Scientific research	A deduction of sums paid to a recognized university, college, research institute, association or other similar institution for scientific research purposes will now be allowed.	Currently, deduction of sums paid to a university, college, research institute or other similar institution for scientific research must be approved by the Commissioner.	The elimination of the requirement to seek approval from the Commissioner eases the flow of funds to higher institutions of learning on scientific research.
Rebate for university apprenticeships	A rebate of 150% of payments made to university graduate apprentices where an employer has engaged at least ten such graduates for a period of six to twelve months during that year of income	Legal Notice No. 97, read together with the Finance Act, 2015 provides for a rebate of 50% of payments to university graduate apprentices where an employer has engaged at least ten such graduates for a period of six to twelve months during that year of income.	The deduction on payments to university graduate apprentices has been increased from 50% to 150% encouraging the uptake of university graduate apprentices.
Disallowed Expenses			
Fines and penalties	The Bill proposes that fines, penalties or similar charges imposed for non-compliance with any obligations shall not be deductible.	The ITA only disallows tax penalties.	This is a new clause that prohibits deduction of any inadvertent omissions. This provision may be punitive especially for the financial sector, where non-compliance with Central Bank of Kenya Regulations results in enormous penalties, which are currently allowable for tax purposes.
Fines and withholding tax non-compliance	The Bill does not allow deduction of expenditure if the taxpayer failed to withhold tax on that payment as required. Similarly, any consideration made to a person is not an allowable deduction to the extent that the equivalent amounts are not included in the income of the beneficiary.	N/A	The provisions are punitive and seek to punish taxpayers on non-compliance of either an oversight or their trading partner. Essentially, should these provisions be enacted, the taxpayer will be penalised from both withholding tax as well as corporation tax perspective. The provision shifts the burden of securing compliance from the KRA to the business, which is not progressive.

Capital allowances

Asset	Proposed Rate (S.L[1])	Old Rate (R.B)[2]
Commercial buildings	10% p.a	25% p.a
Educational buildings	10% p.a	50% p.a
Hotel buildings	60% - first year, balance in 4 years	10% p.a
Petroleum gas storage facilities	60% - first year, balance in 4 years	12.5% p.a
Ship vessels	60% - first year, balance in 2 years	100%
Aircraft	60% - first year, balance in 2 years	25%p.a
Motor vehicles and earth moving vehicles[3]	25% p.a	37.5% p.a for heavy earth moving vehicles
Investments outside Nairobi, Mombasa and Kisumu (exceeding *KES 200 Million*)	As above	150%
Computer hardware, calculators, copiers, duplicating machines	25%p.a	30% p.a
Software	25% p.a	20% p.a (S.L)
Furniture & fittings and other machinery	10% p.a	12.5%p.a
Telecommunications equipment	10%p.a	20%p.a (s.l)
Filming Equipment by local film producers licensed by the Cabinet Secretary for communication	50% p.a	100%
Indefeasible right to use fibre optic cable by a telecommunications operator	10%p.a	5% p.a
Diminution value	25%p.a	33.3%p.a

"The restriction of non-commercial vehicles has been increased from KES 2,000,000 to KES 3,000,000"

2. Withholding Tax

<table>
<tr><th>Subject</th><th>Proposed Provision</th><th>Current Provision</th><th>Our Comments</th></tr>
<tr><td>Deemed Interest</td><td>The Bill proposes that deemed interest is based on the country of residence of the financier and the interest rates charged to the resident person.</td><td>The Act provides that deemed interest rates shall be provided by the Commissioner.</td><td>This provision may be difficult to implement as it requires knowledge of interest rates in different countries where different financiers are domiciled.

The KRA can address this issue in a more effective manner through Transfer Pricing.</td></tr>
<tr><td>Insurance premiums</td><td>WHT on insurance premiums paid to a non-resident person has been introduced at the rate of 5%.</td><td>N/A</td><td>This measure will make it more expensive for non-resident insurers to operate in the local market.</td></tr>
<tr><td>Commissions paid by insurance companies to non-residents</td><td>WHT on commission paid by Insurance companies to non-resident has been introduced at the rate of 20%.</td><td>N/A</td><td>This measure is meant to increase the tax base by netting all commission or fees paid by insurance companies</td></tr>
<tr><td>WHT on payments by EPZs to non-resident persons</td><td colspan="2">
<table>
<tr><th>Details</th><th>New Rate</th><th colspan="2">Previous Rate</th></tr>
<tr><td></td><td></td><td>First 10 years</td><td>After 10 years</td></tr>
<tr><td>Management/professional fee</td><td>5%</td><td>0%</td><td>20%</td></tr>
<tr><td>Royalties</td><td>5%</td><td>0%</td><td>20%</td></tr>
<tr><td>Interest</td><td>5%</td><td>0%</td><td>15%</td></tr>
<tr><td>Dividends</td><td>5%</td><td>0%</td><td>10%</td></tr>
</table>
</td><td>The proposal aligns the rates applicable to EPZs to those applicable to SEZs.</td></tr>
<tr><td>Taxation of non-resident ship/aircraft operators and transmitters of messages</td><td colspan="2">
<table>
<tr><th>Details</th><th>New Rate</th><th>Previous Rate</th></tr>
<tr><td>Demurrage charges</td><td>20%</td><td>0%</td></tr>
<tr><td>Cargo/passengers embarked in Kenya</td><td>3%</td><td>2.5%</td></tr>
<tr><td>Transmission of messages</td><td>10%</td><td>5%</td></tr>
<tr><td>Dividends</td><td>20%</td><td>0%</td></tr>
</table>
</td><td>The increase in WHT on transmission of messages is likely to increase the costs associated with telecommunications, such as internet connectivity.</td></tr>
<tr><td>Limitation of Benefit (LoB) clause for application of Double Tax Agreements (DTAs)</td><td>The LoB clause has been refined to:

▪ The 50% underlying ownership to have been held by the residents of the other contracting state for at least 183 days in the year the DTA tax relief is sought; and
▪ The entity in the other state must be engaged in active business. This means that entities operating as follows cannot enjoy DTA benefit: holding companies, providing management services to the group, providing group financing and making or managing investments.</td><td>The LoB clause applied to the effect that DTA benefits could only be accessed by companies owned by at least 50% of residents of the other contracting state or those companies which are listed in a stock exchange in the other contracting state.</td><td>Through the newly proposed LoB clause, the Government is looking to tighten the rules in a bid to limit treaty shopping. The proposal to require entities to be actively trading in the other contracting state will make it difficult for dormant or non-trading entities to enjoy treaty benefits.</td></tr>
</table>

Withholding Tax cont…

Subject	Proposed Provision	Current Provision	Our Comments
Management and professional fees			
Definition of paid	The Bill has amended the definition of paid to include accrual, making the tax point of WHT the earlier of the date of payment or the date of accrual.		The proposed change in definition of paid seeks to remedy recent Court rulings that barred the KRA from collecting tax on accruals. The proposal to drop the WHT threshold will however increase the administration burden by subjecting small payments to tax.
Payments by a petroleum contractor	Payments to a non-resident person will attract WHT at 20% up from the current rate of 12.5%.		
WHT Threshold	The *KES 24,000* per month threshold for deduction of WHT on payments to resident persons has been eliminated.		

3. Taxation of Employment Income

<table>
<tr><th>Subject</th><th>Proposed Provision</th><th>Current Provision</th><th>KPMG Comment</th></tr>
<tr><td>New tax bands for employment income</td><td colspan="2"><table><tr><th>Income per annum (KES)</th><th>Proposed Rate</th><th>Current Rate</th></tr><tr><td>546,709 – 9,000,000</td><td>30%</td><td>30%</td></tr><tr><td>9,000,001 and above</td><td>35%</td><td>30%</td></tr></table></td><td>The Government is looking to introduce a new tax bracket as a way to increase revenue</td></tr>
<tr><td>Bonus and overtime payments for low income earners</td><td>Exempt bonuses and overtime payments have been capped to the individual's earnings before the incorporation of bonuses and overtime.</td><td>There is no cap on bonus and overtime payments.</td><td>The introduction of the additional limit aims at sealing the loophole where employers could structure the emoluments to have more of income for the low earning employees in form of bonuses and allowances to minimize the tax payable by the employee.</td></tr>
<tr><td>Taxation of per diem</td><td>The subsistence amount for working outside the usual place of work is now proposed not to exceed the "public service prescribed rates".</td><td>The subsistence amount for working outside the usual place of work was capped at KES 2,000 per day</td><td>This is a welcome proposal as the current limit of KES 2,000 is not sufficient. It also eliminates a lot of administration work involved in accounting for per diem.</td></tr>
<tr><td>Taxation on termination of contract of employment</td><td>Compensation for termination of a contract is deemed to have accrued evenly over the unexpired period of the contract for tax purposes.</td><td>There are different tax treatment as follows:
▪ With specified term: compensation is spread equally over the unexpired period; or
▪ Unspecified term :compensation is spread evenly based on the last payment;</td><td>The Bill does not provide clarity on the period over which compensation should be spread. This is fully addressed under the current provisions.</td></tr>
<tr><td>Tax point of ESOPs</td><td>Benefit taxable at date of exercising</td><td>Benefit taxable at the end of the vesting period</td><td>Currently, tax is paid at the point of vesting regardless of whether the employee exercises the option.</td></tr>
<tr><td>Housing Benefit on income in excess of KES 50,000 p.m.</td><td>Where an employee earns income in excess of KES 50,000 p.m. the taxable housing benefit will be the higher of:
a) rent paid by employer and market rental value, where the agreement is not at arm's length; or
b) fair market value where the premises is owned by the employer</td><td>N/A</td><td>Employees in this category may be disadvantaged by this tax treatment.</td></tr>
<tr><td>Definition of beneficiaries for medical benefit</td><td>The Bill defines the term beneficiaries to mean the full time employee's spouse and not more than four children whose age shall not exceed twenty four years</td><td>The age limit for beneficiaries is 21 years</td><td>The Bill has expanded the age bracket of the children who are covered as beneficiaries to 24 years.</td></tr>
</table>

3. Taxation of Employment Income

Subject	Proposed Provision	Current Provision	KPMG Comment
Deductibility of interest expenses on HOSP	The Bill provides for deduction of interest not exceeding *KES 300,000* paid by an individual in respect of borrowings for purposes of home ownership from one of the first four financial institutions specified in the Fourth Schedule.	The ITA provides for deduction of interest not exceeding *KES 100,000* paid in respect of that year of income upon money borrowed from one of the first three financial institutions specified in the Fourth Schedule	The Bill raises the deduction of interest incurred for home ownership from *KES 100,000* to *KES 300,000* per annum.

4. Dividend & Branch Profit Repatriations….

Subject	Proposed Provision	Current Provision	KPMG Comments
Increase in threshold of exempt income	Dividends received by a resident company that holds directly or indirectly more than 25% of the shares of the payer will be exempt from tax	Dividend received by a resident company that holds directly or 12.5% of the shares of the payer are exempt from tax	The increase of the current exemption threshold from 12.5% to 25% shareholding is aimed at widening the tax revenue base.
Compensating tax	A tax of 30% on dividends distributed out of untaxed profits.	Compensating tax at 42.85%	This proposal reduces the compensating tax rate but still penalises persons in a tax loss position as a result of capital allowances.
Withholding tax on dividends paid by SEZs to non-resident persons	Exempt/5%	Exempt	The Bill provides two different rates for dividends paid to non-residents by SEZ entities. The Seventh Schedule provides that it is exempt while the Third Schedule provides for a rate of 5%. This requires clarification from the National Treasury.
Branch repatriation tax	Income repatriated by a non-resident company having a PE in Kenya shall be taxable at 10%.	N/A	This will harmonise taxation of subsidiaries and branches.
Shortfall Distribution	Under the Bill, the Commissioner can deem a distribution of an amount not less than 60% of the accounting profits, where a company has not distributed dividends to its shareholders within a period, not exceeding twelve months after the end of its accounting period and it has been deemed that a part of its accounting profits was distributable without prejudice to the requirements of the Company's business.	Under the ITA, the distribution is not prescribed.	The proposal is a measure to increase taxes to the government by preventing companies from failing to distribute dividends where applicable. Under the ITA, the Commissioner only directs the distribution of only that portion that is distributable, while under the Bill, the Commissioner will direct distribution of not less than 60% of the accounting profits, which will be punitive as it will more often than not be higher than the distributable amount under normal business circumstances.

5. Taxation of Capital Gains

Subject	New Provision	Old Provision	Comment
Rate of CGT	20%.	5%.	Comparatively, Kenya enjoys a lower CGT rate than other East African countries. In addition to enhancing revenue collections, the considerable increase of 15% brings some parity in the region.
Indexation	The new provision introduces indexation for assets purchased before 1st January 2015. The indexation reference is the Consumer Price Index (CPI). The formula for calculating the transfer value will be; **(MP*CPIA)/CPIT** Where; **MP** = Transfer Value. **CPIA** = Consumer Price Index for the month prior to acquisition of the asset. **CPIT** = Consumer Price Index for the month prior to the transfer.	N/A	With indexation for properties acquired before 1 January 2015 pegged to the December 2014 CPI, this provision is in tandem international best practice. At a practical level, taxpayers will no longer pay CGT on inflation. This is likely to mitigate the sharp rise in CGT rates.
Changes to deductible cost	The Bill does not provide for deduction of costs in relation to preservation and improvement of property	The ITA permitted deduction of these costs	The Bill does not expressly permit deduction of costs incurred in preservation and improvement of the property giving rise to the capital gain. This is likely to claw back the gains from indexation.

6. Transfer Pricing

Subject	New Provision	Old Provision	Comment
Beneficial and preferential tax regime	The Bill extends the scope of transactions subject to the provisions of the Eighth Schedule on the taxation of cross-border transactions to cover: ▪ Transactions carried out between a resident person in a beneficial tax regime (SEZ/EPZ) and a resident person not in a beneficial tax regime; ▪ Transactions between resident persons entered into with both **associated and unrelated non-resident persons** in preferential tax regimes offered by foreign countries. ***new** ▪ Transactions with non-resident persons that lack economic substance will also be considered for transfer pricing adjustments. ***new**	A resident related person carrying on business with non-resident related person in a preferential tax regime is subject to the arm's length principle, under Section 18(a)(1) of the ITA.	The provision is aimed at countering harmful tax practices more effectively, taking into account transparency and substance. Based on the Bill, **transactions between independent parties** are now covered under the transfer pricing regime. The provision is in line with Action 5 of the OECD BEPS Action Plan which contains guidance on countering harmful tax practices more effectively, taking into account transparency and substance.
Transactions subject to a transfer pricing adjustment	Paragraph 5 of the Eighth Schedule provides the transactions that shall be subject to a TP adjustment. In addition to normal related party transactions, the Bill now includes the following items under the ambit of transfer pricing; a) An expanded coverage of financial transactions; b) insurance and reinsurance transactions; c) business restructurings; and d) cost contribution	Paragraph 6 of The Income Tax (Transfer Pricing) Rules, 2006 (TP Rules) provides the transactions subject to adjustment of prices under the Rules.	The Bill seeks to expand the scope of transactions subject to a TP adjustment to include a range of transactions, especially cost contribution arrangements in line with BEPS action 8-10 aligning the transfer pricing outcomes with value creations. However, on the financial transactions, we would have expected the Bill to consider safe harbour provisions on interest charges and do away with deemed interest provisions.
Determining the arm's length price of commodities	Paragraph 8 of the Bill prescribes the method to be used in commodity transactions. The proposed provision indicates that transfer price will be determined at the shipping date and is expected to reflect the price at; a) international or domestic commodity exchange market; b) recognized price reporting statistical or government price-setting agencies; or c) Any other index used by independent entities Additionally, the provision places the burden of proof of appropriate adjustments made to the prices on	N/A.	This provision prescribes a specific method for determining the arm's length price for commodities recognizing the uniqueness and the role of commodity exchange market in the world trade. Interesting to note is that the Bill also provides for a 10 day window within which the prices are acceptable, but references this to a shipping date. We note that this prescription does not take into account price volatility associated with the commodity market and more specifically where goods are not purchased and shipped within a short time period. Even though there is an attempt to deal with this issue through placing the burden of proof on the taxpayer, we note that this is likely to contentious.

Subject	New Provision	Old Provision	Comment
	he taxpayer should the prices vary from the above		
Arm's Length range	The provision defines the **median**, in the interquartile range of financial indicators obtained from comparable uncontrolled transactions, as the basis for determination of the arm's length price and reference for computation of taxable gains and profits.	N/A.	The new provision predisposes all relevant taxpayers to a transfer pricing adjustment even where the financial indicators fall within the interquartile range of comparable uncontrolled transactions. In our opinion, this provision disregards the issue on the lack of reliable comparable data for use in the determination of the arm's length financial indicator in developing countries, and specifically, Kenya. Further, this provision opens up a debate on use of the full range and reliability of various third party databases in determining the appropriate arm's length financial indicator.
`Transfer Pricing Documentation	Paragraph 10 of the Eighth Schedule introduces the requirement to prepare contemporaneous transfer pricing documentation for the relevant year of income. Additionally, it imposes a penalty of **2% of the value of the controlled transaction** involved, for failure to maintain contemporaneous TP documentation.	Paragraph 9 of the TP Rules provides that a person who avers the application of arm's length pricing develops an appropriate transfer pricing policy and avails the same upon request by the Commissioner.	Taxpayers will be required to have an existing transfer pricing policy in place for each year of income. In our opinion, the provision is onerous as it places a burdensome penalty without regard for the size of the transactions in question. An impartial penalty directed towards procedural compliance, such a fixed amount, would therefore mitigate the imposition of excessive penalties on taxpayer. Furthermore, the Bill has not defined the term "contemporaneous" and especially with regards to the comparable to be used in each and every year. The acceptable practice has been use of weighted average multiple year data.
Country by country reports	Paragraph 11 provides that – each ultimate parent entity or a constituent entity which is not the ultimate parent entity of a multinational enterprise group that is resident for tax purposes in Kenya to file a country-by-country report with the Commissioner not later than twelve months after the last day of the reporting financial year of the multinational enterprise group.	N/A.	The new provision introduces the requirement to file a CbyC report, in line with Action 13 of the OECD BEPS Action on Transfer Pricing Documentation and Country-by-Country Reporting. For purposes of compliance, we anticipate further guidance on filing of the CbyC report, such as implementation instructions, templates and samples.

Subject	New Provision	Old Provision	Comment
Services between associated persons and transactions involving intangible property	Paragraph 12 provides guidance on services between associated persons. Such transactions provide the recipient with economic or commercial value to enhance its commercial position. Paragraph 13 provides that the determination of arm's length conditions for controlled transactions involving the exploitation of an intangible must take into account the contractual arrangements in respect of the development, enhancement, maintenance, protection and exploitation (DEMPE) of the asset.	N/A.	These provisions provide specific guidance on intragroup services and consideration of functions relating to development, enhancement, protection, exploitation and maintenance of intangibles. This is in line with Action 8-10 of the OECD BEPS Action Plan and once again demonstrates the country willingness to adopt global best practice We anticipate enhanced scrutiny from the tax administration with regards to intragroup service transactions and transactions involving intangible property. We also expect additional guidance on the adoption of this provision.
Capital rich and low function person	Paragraph 14 contains provision relating to a capital rich and low function person. A capital rich and low function person is defined as a person that is capitalized with a relatively high amount of equity (or equity equivalent) capital but which has limited capacity to carry out risk management functions. Controlled transaction involving a capital rich and low function person which does not control the financial risks associated with its funding activities, for tax purposes, shall not be allocated the profits associated with those risks and shall be entitled to no more than a risk-free return.	N/A.	The new provision is aimed at ensuring that companies that are incorporated solely for purposes of providing capital, but do not exercise control over the investment risks that may give rise to premium returns should only receive no more than a risk-free return.

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