KPMG

Tax Alert

Presidential Memo on the Finance Bill 2018

21 September 2018

The National Assembly passed the Finance Bill, 2018 on 30 August 2018. In approving the Bill, the National Assembly rejected most of the revenue raising measures that the National Treasury had proposed including the now infamous 'Robin Hood tax'. In addition, the National Assembly sought to defer for a further two years the effective date for introduction of VAT on petroleum products.

The Speaker of the National Assembly presented the bill to the President for his assent on 13 September 2018. The President, exercising powers under Article 115 of the Constitution refused to assent to the Bill and sent it back to the National Assembly for reconsideration. His main reasons were that the changes would disrupt important government programs whose budget the National Assembly had already approved. In addition, it would force the government which is reeling under debt to borrow more.

On 20 September, 2018 the National Assembly deliberated and approved the President's memorandum of changes. The President assented to the revised Finance Bill, 2018 on 21 September 2018.

While the introduction of VAT on petroleum products has dominated public debate, the changes present an unprecedented disruption of the tax regime that will impact the economy and citizenry for years to come.

Below is our summary of the revenue measures and their implications:

1. Excise duty on services

Approved Provision:

The Approved Finance Bill has proposed a significant increase of the excise duty on charges for telephone and data services, money transfer services and other fees charged by financial institutions.

The new rates are as follows:

Item	New Rate	Old Rate
Telephone and internet data services	15%	10%
Fees charged on money transfer services by banks, money transfer agencies and other financial providers	20%	10%
Other fees charged by financial institutions	20%	10%

Our perspective on the implications:

The President accepted the National Assembly's decision to drop the Robin Hood Tax of 0.05% on money transfers above KES 500,000. The Robin Hood tax initially targeted the well off, with the National Treasury saying that the proceeds would be utilized to provide universal health care.

The new provision has now doubled the tax applicable on money transfers and other fees charged by financial institutions and increased the tax on telephone and internet services by 50%.

The new taxes will have a negative impact on the growth of the mobile money services which have been critical in growing financial inclusion. In implementing the tax, the government has sought the easier way out, increasing the tax burden on one of the few growing sectors of the economy.

2. National Housing Development Fund (NHDF) levy/contribution

Approved provision:

The Approved Finance Bill introduces an employee and employer housing levy/contribution of 1.5% of the employee taxable income to be used to finance the Government's Big 4 Agenda of affordable housing. The combined contributions are capped at a maximum of KES 5,000 per month.

Where the employee qualifies for affordable housing their portion of the contributions will be used to offset the purchase cost of the houses. Employees who do not qualify for affordable housing will be eligible to receive their portion of the contribution at the end of 15 years.

Our perspective on the implications:

The housing levy and affordable housing are often misunderstood mainly because the components that are critical for the success of this initiative such as the National Housing Development Fund (NHDF) are still under formation. However, with the passing of the levy, the issue of funding is now resolved.

Based on the 2017 Statistical Index from the Kenya National Bureau of Statistics, the country's wage bill in 2016 was KES 1.6trillion. This means that the government can potentially collect KES 48Billion annually from the levy. Of this, KES 24Billion is collections from the employers which goes to subsidise affordable housing while the balance is contributors' funds which will go towards the cost of the house or is refundable at the end of 15 years.

By all means, this is a massive accumulation of resources when compared to the NSSF which in 2016 received only KES 12.8Billion in collections. The need is also massive considering that out of the 2.48million Kenyans in employment in 2016 only 77,000 earned over KES 100,000 which is the threshold for affordable housing. Therefore, potentially 2.4million Kenyans qualify for affordable housing against the government target of 500,000 housing units in five years.

The contributions are to be remitted on or before the **9th** day of the following month to the NHDF. Failure to remit the contributions on time attracts a penalty of **5%** of the contributions payable by the employer for each month or part thereof that the amounts remain unpaid.

The contributions will commence after the publications of the regulations for qualification to the affordable housing scheme.

3. VAT on petroleum products

Approved provision:

The approved Finance Bill, 2018 reduces the VAT rate on petroleum products from 16% which was introduced in the Value Added Tax Act, 2013 (VAT Act) but deferred for 5 years to 8%.

The National Assembly had initially proposed that VAT on petroleum products be deferred for a period of two years to September 2020.

Our perspective on the implications:

The overhaul of the VAT legislation was to reduce the number of products that were classified as exempt or zero-rated as one way of increasing tax collections and reducing the cost of administering the VAT legislation. A significant part of the incremental government tax collections for the 2018/2019 financial year were dependent on VAT collections from petroleum products which explains the government's insistence on implementing the tax.

VAT is a tax on the final consumer of the VATable products and in this case, the cost of petroleum products will reduce following the reduction of VAT from the 16% rate which has been in effect from 2 September 2018 to 8%.

The cost of taxable products that use petroleum products in their manufacture or distribution should ideally not increase as a result of the imposition of VAT. This is because the sellers of such products are allowed a deduction of the VAT paid on the petroleum products. Persons who supply exempt services and goods such as passenger transport and fresh agricultural produce are not allowed a deduction of VAT on their purchases. For persons in these industries, the VAT is therefore a cost which they may be forced to pass on to their customers through increase in prices of their products/services.

Unlike other products where the taxable value includes all other taxes such as excise duty, the taxable value for petroleum products will exclude excise duty and all other levies, which together with the reduction from 16% to 8% will provide a significant reduction in current pump prices.

The new rate will take effect from the date of the enactment of the Supplementary Appropriation Act.

4. Anti-adulteration levy

Approved Provision:

The Approved Finance Bill introduces a new levy under the Miscellaneous Fees and Levies Act to counter the adulteration of Diesel with illuminating kerosene.

The levy of KES 18/litre which seeks to harmonise the cost of kerosene to that of diesel is to be paid by the importer at the time of entering the illuminating kerosene into the country. The importer will then pass on the cost to the consumers.

Our perspective on the implications:

Illuminating kerosene is used as the primary fuel by low income households and therefore the levy of KES 18/litre will hit them hard. It is important to note that this levy is in addition to the 8% VAT on petroleum products, which means that even with the reduction of VAT from 16% to 8%, the cost of illuminating kerosene will go up.

The increase will be compounded by the cost cutting measures before the National Assembly, where the government has proposed to reduce the budget allocation for the last mile electricity connection and the subsidy for low income household gas cylinders which were all intended to move the low income households to cleaner energy sources.

5. Interpretation – winnings

Approved provision:

The approved Finance Bill, 2018 amends the definition of "winnings" under section 2 of the Income Tax Act (ITA) to include winnings of any kind, with references to the amount or to the payment of winnings being construed accordingly.

Our perspective on the implications:

The Tax Laws (Amendment) Act, 2018 replaced the definition of winnings with a new definition based on the positive difference between pay-outs made and stakes placed for each player in a given month on bets placed with bookmakers licensed under the Betting, Lotteries and Gaming Act. This allowed punters a deduction of bets placed when determining their tax base for purposes of levying the tax.

The change of the tax base to the net winnings significantly reduced the tax base and introduced complexities in the computation the tax as it required betting companies to maintain records of bets placed by all punters. Further, the definition excluded lotteries, prize competitions and gaming.

The amendment effectively imposes a 20% tax on winnings from betting, prize competitions and gaming. Punters will not receive deductions for bets placed.

6. Taxation of betting, gaming and lottery companies

Approved provision:

The Approved Finance Bill reduces the betting tax, gaming tax and lotteries tax from the 35% rate introduced with effect from 1 January 2018 to 15%.

Our perspective on the implications:

Previously only the betting companies bore the tax on gaming, lottery and betting activities. Following the introduction of the 20% on winnings, the reduction of the gaming, betting and lotteries tax spreads the tax burden to both the punters and gaming companies.

However, the proposed changes will reduce the tax collections from the industry where previously the 35% tax applied on the turnover of the companies which has now been reduced to 15%. While the industry whose survival was at stake will welcome

the changes, the move will disappoint those who have been pushing to curtail the growth of betting and gaming activities in the country.

7. Excise duty on confectionary

Approved Provision:

The Approved Finance Bill reinstates excise duty on sugar confectionery (including white chocolate) containing and not containing cocoa at the rate of 20 per kilogram.

Our perspective on the implications:

This was part of the tax measures proposed by the National Treasury which the National Assembly had initially rejected following intense lobbying by industry players.

This is a continued measure by the government to raise funds through the taxation of items deemed to be luxurious in nature. The price of sugar confectionary will go up as a result of the new tax.

For the industry in general, this appears to be the start of the introduction of a sugar tax, which like in many developed countries is meant to address emerging lifestyle diseases.

We are happy to assist with any matters that may arise as a consequence of the above tax changes or any other queries.

Regards

Peter Kinuthia
Partner, Tax and Regulatory Services
KPMG Kenya
E: pkinuthia@kpmg.co.ke

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