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Analysis of Excise duty act, 2015

Tax alert

KPMG East Africa

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Excise Duty Act, 2015

Why you need to read this

The Excise Duty Act, 2015 (New Act) which comes into effect today **(1 December 2015)** repeals the Customs and Excise Act, Cap 472 of the Laws of Kenya that previously administered excise duty in Kenya. The new Act provides for the management, administration, charging, assessment and collection of excise duty in Kenya going forward.

Background

In the 2015 budget speech, the Cabinet Secretary for Finance, promised to introduce a simple and modern excise duty legislation that would align local excise duty administration with international best practice.

This would be a departure from the past where excise duty was administered under the Customs and Excise Act, Cap 472 of the Laws of Kenya (C&E Act) which also included customs duty before it was taken over by the East Africa Community Customs Management Act (EACCMA).

The C&E Act which was initially geared towards the taxation of goods had become unreliable and subject to differing interpretations due to changes in the transactions that were subject to excise duty.

The ongoing restructuring at the Kenya Revenue Authority (KRA) to create a separate customs body also made it imperative to separate excise duty from customs and align the excise duty administration with other domestic taxes such as value added tax.

The new Act provides clarity on a number of issues but raises a number of concerns especially given that it will result in an increase in taxes and prices on a number of products even after the President promised not to increase taxes.

The burden on industries such as tobacco and beverages (alcoholic and non-alcoholic) will also increase, putting pressure on profit margins with a potential downward spiral effect on businesses that rely on these industries across the production and distribution chain.

We have summarized the key features of the new Act in this alert.

Coming into force

The Legal Notice No. 245 issued on 25 November 2015, provides that the Excise Duty Act, 2015 shall come into operation from 1 December 2015.

However a number of provisions in the Excise Duty Act refer to the Tax Procedures Act which is yet to be passed by Parliament. These provisions will be deferred until the relevant legislation is enacted with potentially detrimental impact on the implementation of the new Act.

This is likely to result in disputes especially where there are interpretational disagreements between taxpayers and the KRA on issues that are dependent on the Tax Procedures Act

Features

The new Act contains 41 pages, 9 parts, 2 Schedules and 46 Sections which is fairly small compared to other revenue acts

Key Definitions

a) Time of supply of exercisable services

The C& E Act did not define the time of supply for services. This has now been defined as the earlier of the following dates:

a) Service performance;

b) Invoicing; or

c) Payment for the service.

b) Other fees in relation to financial services

The C&E Act as amended by the Finance Act 2013 defined other fees to include any fees, charges or commissions charged by financial institutions, excluding interest.

The new Act amends this definition to include in the exclusion interest on loan or return on loan or an insurance premium or premium based or related commissions.

Commissions on insurance premiums have now been excluded from excise duty. This is a welcome relief to the insurance industry which had lobbied against the levying of excise duty on insurance commissions on the basis that it was difficult to administer and would derail efforts to extend insurance coverage in the country.

Licensing

The new Act requires persons who intend to supply various excisable to apply to the Commissioner for an excise duty license. The supplies include:

a) Manufacture of excisable goods in Kenya;

b) Importation of excisable goods that are specified by the CS and require an excise stamp;

c) Supply of excisable services;

d) The use of spirits to manufacture goods in Kenya that are not excisable goods; or

e) Carrying out of any other activity in Kenya for which the commissioner by notice in the Gazette may impose a requirement for a license.

The Commissioner can refuse to issue an excise duty license to an applicant on the following grounds:

a) The applicant is convicted of an offence under the excise duty Act, the Tax Procedures Act, 2015.

b) The applicant is convicted of an offence involving dishonesty or fraud under any law.

c) The applicant is or has been declared bankrupt or insolvent or is in the process of liquidation or receivership.

d) The applicant has not kept proper records as required under any tax law or has failed to comply with its obligation under any tax law.

e) For a manufacturer of excisable goods, the factory, plant or equipment is not adequate to manufacture or secure the said excisable goods.

f) If the first four conditions apply to a person related to the applicant of the license and is reasonably expected to be involved in the conduct of the activity to which the application relates.

While the conditions are largely similar to those under the C & E Act, the requirement will be new for financial institutions and other organizations supplying excisable services and amounts to an additional huddle to doing business locally.

Liability for excise duty

The new Act provides that excise duty is chargeable on:

a) Excisable goods manufactured in Kenya by a licensed manufacturer;

b) Excisable services supplied in Kenya by a licensed person; and

c) Excisable goods imported into Kenya

The excise duty liability for a licensed manufacturer crystallizes upon removal of excisable goods from the manufacturer's warehouse.

Consumption of excisable goods within the manufacturer's factory is treated as a removal for excise duty purposes. This will affect industries such a refineries will use the products they refine in their operations and have previously been exempted from excise on such consumption.

Excisable value of goods and services

The excisable value of excisable goods manufactured in Kenya is the ex-factory selling price. This is defined to exclude the cost of returnable containers. This is a welcome relief especially for manufacturers of excisable goods that are packaged in returnable containers such as sodas.

For services, the excisable value is the fee, commission, or charge payable for the services in an arm's length transaction. In any other case, the value is the open market value of the services.

Remission

The Cabinet Secretary can through a Notice in the Gazette grant remission of excise duty, wholly or partially in respect of beer or wine made from sorghum, millet or cassava or any another agricultural products (excluding barley), grown in Kenya.
This is aimed at encouraging the growth of these products as a source of livelihood for Kenyan smallholder farmers in those areas where these products are widely grown.

Excise Duty on packaging materials

The new Act provides that where the excise duty computations are made by reference to a quantity measured by volume or weight, the package weight should be included in the computations in the following circumstances:

- Where the package is not marked or labelled with a net weight;
- The package is not commonly sold as containing or is not commonly reputed to contain a specific quantity or weight; and
- The owner is unable to satisfy the Commissioner of the correct net weight of the package.

It would be useful for taxpayers to ensure that the weight of the package is indicated where possible to avoid overpayment of excise duty since the little excise duty per package can quickly lump up to huge exposures especially where the products volumes are high.

Relief for excise duty paid on raw materials

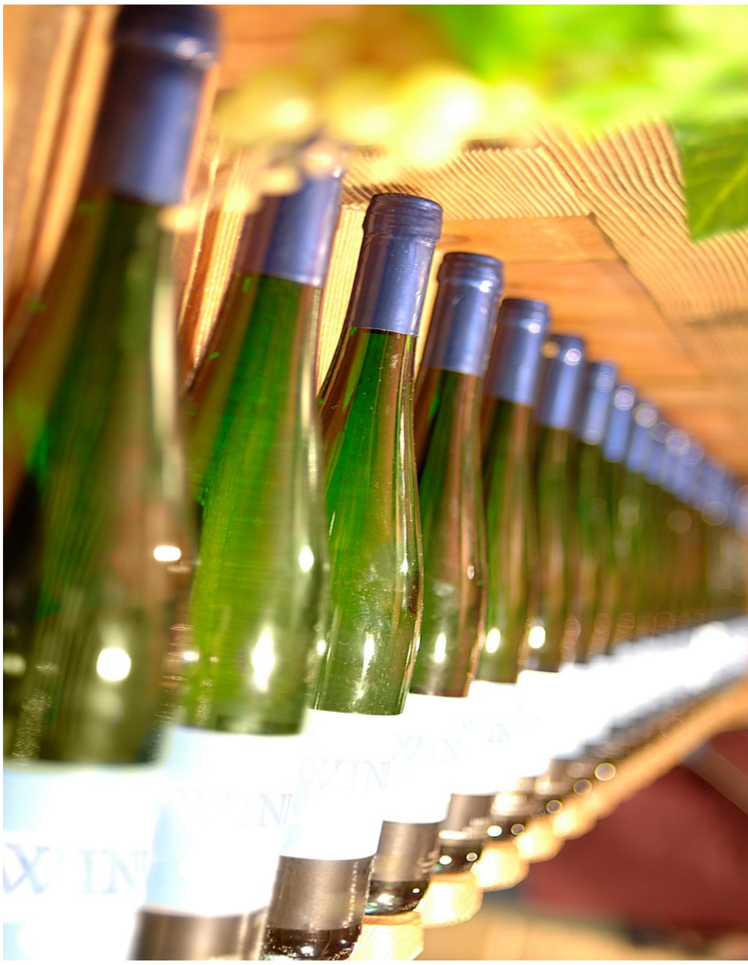
The new Act provides that where excise duty has been paid on raw materials used to manufacture excisable goods, the excise duty shall be off-set against the excise duty payable on the finished goods.

However, the set-off is limited to manufacturing operations and excise duty on goods, which disenfranchises suppliers of excisable services and limits the deduction of excise duty on purchases of services. This presents an opportunity to lobby for changes in the legislation to make it more equitable.

Refunds

The new Act provides for refund of excise duty paid by a person on excisable goods manufactured in or imported into Kenya which are subsequently destroyed or returned by the buyer or the excise duty paid in respect of spirits that have been used to manufacture goods that are not subject to excise duty.

Further, excise duty may be refunded where a person accounted for excise duty on goods or services but has not received any payment in respect of the same. However, the refund can be made on application after the expiry of three years from the date of the sale or such earlier period where the purchaser has become insolvent.
The application for the refund must be done within twelve months from the date the above conditions are fulfilled.



Tax avoidance schemes and penalties

Where the Commissioner is satisfied that a taxpayer has entered into or carried out a scheme that results in less tax, the Commissioner may determine the excise duty liability of the taxpayer and issue an assessment for the same.
The Act also imposes stiff penalties on various offences such as carrying out an activity that requires licensing without obtaining a license (200% of the duty payable). Violation of the provisions of the Act exposes the taxpayer to other penalties imposed under the Tax Procedure Act.

Increased excise duty rates

The Act has largely replaced the previous ad valorem duty rates with specific rates. While creating a uniform basis for taxation of similar goods, the impact of the ensuing increase in prices will be higher on lower value goods resulting in a higher tax burden on the low income persons. For instance, excise duty on cigarettes, alcohol, juices and motorcycles has increased significantly.

The change of the excise duty basis on motor vehicles from the ad valorem rate of 20% to a specific rate of *KShs 150,000* for vehicles less than 3 years or *KShs 200,000* for those over three years will favour importers of high end vehicles.
For instance an 8 year vehicle costing *KShs 5,000,000* (after customs duty) will suffer excise duty of KShs 200,000 down from *KShs 1,000,000* while a *KShs 600,000* vehicle of a similar age will suffer excise duty of *KShs 150,000* up from *KShs 120,000* under the previous regime.

Excise duty on services

Excise duty on telecommunication services, airtime and financial services has been retained at 10%. A notable change however is the exclusion of insurance premiums and premium based or related commissions from the definition of fees subject to excise duty.
However, the new Act has not provided for setting-off of excise duty incurred on purchases against excise duty on sales, a concession which has been given to manufacturers.

Services exported out of Kenya

The new Act provides that excisable services exported from Kenya shall not be subject to excise duty.
Section 7(4) of the new Act further provides that excisable services shall be deemed to be exported from Kenya if the services are supplied from a place of business in Kenya for use or consumption outside Kenya.

On the other hand, Section 13 of the new Act provides that a supply of excisable services shall be deemed to be made in Kenya if the services are supplied from a place of business of the supplier in Kenya.

From the provisions of these two sections, it is not clear as to what constitutes an export of service. Although section 7(4) provides the place of consumption of the services as the determinant of whether the services is deemed an export, Section 13 is silent on the place of consumption for a local supply. This is likely to result in differences in interpretation between the KRA and taxpayers.

Items no longer excisable

Previously imported used computers older than 3 years were subject to excise duty at the rate of 25% while cosmetics and perfumes were excisable at 5% and 10% respectively. These items are now exempt from excise duty.

Annual excise duty adjustments

The new Act provides that the rates of excise duty on excisable goods shall be adjusted for inflation at the beginning of every financial year (1 July). This means that the duty rate will automatically increase each year without debate of the increments in Parliament. In years of high inflation, the excise duty rate increase will also be higher subjecting taxpayers to additional tax on a shrinking income base.

Repeals and transitional provisions

Although the new Act effectively repeals the C&E Act, the following provisions in the C&E Act shall remain operational during the transitional period:

- Railway Development Levy (RDL) and Import Declaration Fee (IDF) shall continue to apply until they are provided for under a separate legislation.
- Export duty on the goods provided for under the Fourth Schedule to the C&E Act shall continue applying until Export Duty is imposed in another legislation.
- Subsidiary legislation made under the C&E Act shall remain in force provided it is not inconsistent with the new Act.
- Any tax due to be paid or refunded under the C&E Act that is outstanding at the commencement of the Act shall be paid or refunded as if it were tax due to be paid or refunded under the new Act.
- Any person who is registered or licensed under the C&E Act shall be treated as registered or licensed under the new Act unless the Commissioner provides otherwise.

Exempt excisable goods and services

Under the new Act, the following goods and services are exempt from excise duty:

- Excisable goods exported under customs control;
- Excisable goods that the manufacturer has destroyed, with the prior written permission of the Commissioner, under supervision of an authorised officer;
- Denatured spirits for use in the manufacture of gasohol or as a heating fuel;
- Excisable goods that have been lost or destroyed by accident or other unavoidable cause before or in the course of removal from the factory, aircraft or vessel;
- Goods for use in ships or aircraft for consumption by passengers or crew in international traffic;
- Goods imported by and excisable services supplied to privileged persons e.g. diplomats, foreign government, international organizations, Aid agencies, Kenya Red cross among others.
- One motor vehicle for use by a disabled person (once every year 4 years);
- Excisable goods imported by a person changing residence or returning resident;
- Excisable goods imported by and in possession of a passenger; and one motor vehicle previously owned and used by a deceased person outside Kenya.
- Excisable services supplied in Kenya to privileged persons e.g. diplomats, foreign government, international organizations, Aid agencies, Kenya Red cross among others

Excise duty rates

Administrative provisions relating to management of the excise duty regime remain largely the same. However, in a bid to increase revenue, the new Act has increased excise duty rates on some commodities. Further, the new Act has simplified the schedule providing for the various rates by collapsing many of the related tariff heads into one sub-head. We tabulate below a brief comparison between the old rates and the new excise duty rates for some of the excisable products

Item	New rates (Excise Duty Act)	Old rates (Cap 472)
Fruit juices	KShs 10 per litre	7%
Food supplements	10%	7%
Waters and other non-alcoholic beverages not including fruit or vegetable juices	KShs 5 per litre	KShs 3 per litre or 5% & 7%
Beer, and alcoholic beverages not exceeding 10%.	KShs 100 per litre	KShs 65 per litre
Powdered beer	KShs 100 per kg	Not provided for
Wines and other alcoholic beverages obtained by fermentation of fruits	KShs 150 per litre	KShs 70 or 35% per litre
Spirits of alcoholic strength exceeding 10%	KShs 175 per litre	KShs 120 or 35% per litre
Cigars, cheroots, cigarillos, containing tobacco or tobacco substitutes	KShs 10,000 per kg	130%
Cigarettes containing tobacco or tobacco substitutes	KShs 2,500 per mille	KShs 700- KShs 2500 per mille depending on class
Other manufactured tobacco and manufactured tobacco substitutes; "homogenous" and "reconstituted tobacco"; tobacco extracts and essences	KShs 7,000 per kg	130%
Motor vehicles of tariff heading 87.02, 87.03 and 87.04	Less than three years old from the date of first registration KShs 150,000 per unit	20%
	Over three years old from date of first registration KShs 200,000 per unit	
Motor cycles of tariff 87.11 other than motor cycle ambulances	KShs 10,000 per unit	Not provided for
Plastic shopping bags	KShs 120 per kg	50% of excisable value

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