FINANCE

Key Highlights Of The 2021 Finance Act

By CPA Peter Kinuthia

A Finance Act promulgates measures that the National Treasury has put in place to mobilize funds through several avenues including collecting taxes to finance the Government expenditures for the following year of income, in this instance, 2021/22 fiscal year. The Finance Act 2021 (the Act), was assented into law by the President on 29 June 2021.
The Act amends various tax laws including: the Income Tax Act, The VAT Act, 2013, Excise Duty Act, Tax Procedures Act, 2015, and the Miscellaneous Fees and Levies Act. It also makes various amendments to other miscellaneous amendments to the Insurance Act, Capital Markets Authority Act and Retirement Benefits Act. Hereunder is a highlight of key amendments of the Finance Act, 2021!

Business Income Tax

Tax Losses to be carried forward indefinitely - Effective 1st July 2021
The Income Tax Act is amended to allow business tax losses to be carried forward indefinitely. This is a welcome move because under the previous provisions, tax losses could only be carried forward for a period of ten years. Thereafter the same were abandoned or forfeited if the business did not generate enough profits to absorb them.

This is a welcome move as it affords an important tax shield because the tax losses will be offset against any future taxable profits until fully exhausted.

However, the relevance and usefulness of this proposal will only be confirmed once the case challenging the constitutionality of the minimum tax provision is heard and determined. This is because under the minimum tax regime, a business is required to pay taxes whether or not it reports a profit.

Interest restriction on thinly capitalized entities - Effective 1st January 2022

Under the previous provisions of the Income Tax Act, an entity was thinly capitalized where debt to equity ratio was greater than 3:1. Interest as a tax deductible expense was restricted to that ratio.

The current Finance Act has tightened the thin capitalization interest restriction from the 3:1 ratio, to 30% of Earnings Before Interest, Depreciation and Amortization (EBITDA).

Interest paid or payable to related persons and third parties will be restricted to 30% of EBITDA. For this purposes, interest includes Interest on all loans, payments that are economically equivalent to interest and expenses incurred in connection with raising the finance.

The taxman is seeking to protect the erosion of taxable profits by disallowing interest expense thus having a higher tax yield.

It is worth noting that this restriction does not apply to banks or financial institutions licensed under the Banking Act and micro and small enterprises registered under the Micro and Small Enterprises Act, 2012.

Legislation of Country by Country Reporting (CbCR) - Effective 1st July 2022

Multinational enterprise groups (MEGs), whose ultimate parent is based in Kenya, are now required to submit returns giving information on their activities in other jurisdictions. The annual return should be filed within 12 months after the last day of the financial reporting year. This is only applicable where the groups' gross turnover exceeds a prescribed threshold. The threshold has not yet been defined.

A MEG is defined as a group that includes two or more enterprises which are resident in different jurisdictions including an enterprise that carries on business through a permanent establishment or through any other entity in another jurisdiction.

The following information will have to be disclosed in the said return with respect to each jurisdiction in which the group operates: Total revenue; Profit or loss; Corporate income tax paid; Accrued income tax; Stated Capital; Accumulated earnings; Number of employees; and Tangible assets other than cash and cash equivalents.

The Income Tax Act is amended to require multinational enterprise groups (MEGs), whose ultimate parent is based in Kenya, to submit returns giving information on their activities in other jurisdictions. The annual return should be filed within 12 months after the last day of the financial reporting year.

The objective is to enable KRA to get more information and thus greater visibility on MEG's offshore activities whose ultimate parent companies are tax resident in Kenya. This will also foster information sharing across different jurisdictions for proper monitoring.

Definition of Control re-introduced, made more comprehensive - Effective 1st July 2021

The Act is amended to provide a more comprehensive and stricter definition of control, wherein it will now include; A person holding at least 20% voting rights in a company, directly or indirectly; A loan advanced that constitutes at least 70% of the book value of the borrower's total assets excluding loans from financial institutions not associated with the person; A guarantee of at least 70% of a person's indebtedness of any form excluding a guarantee provided by financial institutions not associated with the guarantee; A person who has power to appoint more than half of the board of directors of another person or at least one director or executive member of the governing board of that person; The person is the owner of or has exclusive rights over the know-how, patent, copyright, trademark, license, franchise or any other business or commercial right of a similar nature, on which another person is wholly dependent for the manufacture or processing of goods or articles or business carried on by the other person; The person or their designate supplies at least ninety per cent of the purchases of another person and for which the Commissioner opines that the person influences the prices or any condition of the sale; and Any other relationship, dealing or practice that the Commissioner may deem to constitute control.

The definition empowers KRA to impute control in business transactions. The main impact is on the transfer pricing provisions.

Exemption from the ambit of Minimum Tax - Effective 1st July 2021

Minimum Tax was introduced last year at the rate of 1% on the turnover but currently suspended pending the hearing and determination of a Court case challenging its constitutionality.

The Income Tax Act has been amended to exclude the following persons from the ambit of minimum tax: A person is exempted, if that person is; engaged in a business whose retail price is controlled by the Government such as fuel; engaged in insurance business; engaged in manufacturing and that person's cumulative investment in the preceding four years from assent is at least ten billion shillings; is licensed under the Special Economic Zones Act, 2015; or is engaged in distribution business whose income is wholly based on a commission.

This is a welcome reprieve and incentive to those businesses, more so the manufacturers, who have been exempted should the operations of minimum tax resume.

Widening of the digital market place definition - Effective 1st July 2021

The widening of the definition now encompasses income accruing from a business carried over the internet and electronic network. A digital market is now defined to be "an online platform which enables users to sell or provide services, goods or other property to other users". The objective is to expand the scope of digital service tax in order to net more taxpayers and widen the tax base.

Personal Income Tax - Effective 1st January 2022

The Act is amended to introduce insurance relief on payments made by resident individuals to the National Health Insurance Fund (NHIF). The relief will be 15% on the annual premiums paid towards NHIF and other medical insurance premiums capped at KShs. 60,000.

Value Added Tax - Effective 1st July 2021

Taxation of digital marketplace supplies: In a bid to expand the tax base, the definition of the digital marketplace has been widened to include supplies made over the internet or an electronic network. Restriction on deductibility of input tax: The Act is amended to restrict claiming of input VAT on leasing or hiring of passenger cars or minibuses, their repairs and maintenance thereof unless they are acquired, exclusively for the purposes of making taxable supply in the ordinary course of the business.

Change of VAT status of various supplies: The Act is amended resulting in change of status of various supplies including; (below is a sample) From Exempt to standard rated: Airlid paper without super absorbent polymer 80gsm/67 of tariff number 4803.00.00, **From Exempt to zero-rated:** The supply of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than ten percent in weight: From standard rated to exempt: Biogas, Tractors other than road tractors for semi trailers; From Standard rated to zero-rated: Transportation of goods from Kenya to a place outside Kenya.

Excise Tax - Effective 1st July 2021

The Act is amended to effect the following amongst other measures: allow a licensed person who purchase data for resale to offset input excise tax against output excise tax on internet data services supplied to the final consumer; Reintroduction of excise tax at 7.5% on betting on amounts wagered or staked; and increase excise tax rates on telephone and internet data services from 15% to 20% and fees and commissions earned on loans from 15% to 20%.

Tax Procedures Act - Effective 1st July 2021

Abandonment of Exemption from withholding VAT: Under the previous provisions of the law, if a taxpayer could demonstrate to the Commissioner that due to the nature of his business and as a result of withholding VAT he was to be in a continuous VAT credit for a period of not less than 24 months, on application, the Commissioner could exempt such a taxpayer from the withholding VAT regime.

The Act is amended and has taken away the power of the Commissioner to exempt any Tax Payer from withholding VAT ambit. This is a punitive proposal and will negatively impact cash-flows of taxpayers who are in perpetual VAT credit position as there is delay in processing and settlement of VAT refunds claims.

I trust the above draft has given you snippets of some of the measures as proposed in the Finance Act, 2021. For a full and detailed highlight, please visit our website, **www.resoluteadvisory.co.ke.**

CPA Peter Kinuthia is a Tax Director at Resolute Business Advisory Limited. You can commune with him on this and other tax related issues via email on: Peter.Kinuthia@resoluteadvisory.co.ke.