



Kenya Revenue Authority

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DOMESTIC TAXES DEPARTMENT

**STAFF TECHNICAL  
CIRCULAR NO. 7A**

***FINANCE ACT, 2006***

***Amendments to the:***

- 1. Kenya Revenue Authority Act***
- 2. Value Added Tax Act***
- 3. Income Tax Act and***
- 4. Customs & Excise Act***
- 5. Traffic Act***
- 6. Miscellaneous***

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**STAFF TECHNICAL CIRCULAR NO.7A**  
**AMENDMENTS TO THE KENYA REVENUE AUTHORITY ACT, VALUE ADDED**  
**TAX ACT, THE INCOME TAX ACT, THE CUSTOMS AND EXCISE ACT, TRAFFIC**  
**ACT AND MISCELLANEOUS AS CONTAINED IN THE FINANCE ACT, 2006**

**Introduction**

This Staff Circular replaces the Staff Circular No.7. The Finance Act, 2006 contains various changes and amendments relating to laws governing the administration, collection and enforcement of taxes and duties. This technical circular, in particular, explains the amendments relating to the Value Added Tax Act, (Cap.476), the Income Tax Act (Cap.470) and Customs and Excise Act (Cap.472) contained in Part I, II, III, IV and V of the Finance Act, 2006 and the Legal Notices in the Kenya Gazette Supplement No.41 of 15<sup>th</sup> June, 2006. Whatever is not contained in this Circular and was in Circular No.7 was dropped at the Committee Stage of Parliament.

**1. KENYA REVENUE AUTHORITY ACT.**

**(a) Amendment to Section 16- Funds of the Authority**

Section 16(1) of the Kenya Revenue Authority Act has been amended by providing for the funds of the Authority to consist of ***“such an amount, not exceeding two percent” of the revenue estimated in the Financial Estimates to be collected by the Authority.*** In addition the said amount shall be ***“as may be determined by the Minister in each financial year”.***

The implication of this amendment is that the KRA funds will, from 1<sup>st</sup> January, 2007 be determined by the Minister for Finance. It will also be up to a maximum of 2%. Before this amendment the funding was 1.5% and was not subject to any prior determination by the Minister.

**Effective date-1<sup>st</sup> January, 2007**

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(b) **Amendment of the First Schedule**

The Kenya Revenue Authority Act has been amended in PART II of the First Schedule by inserting the following new items:-

11. **The Government Lands Act (Cap.280)**

12. **The Sugar (Imposition of Levy) Order 2002(L.N 385/2002)**

KRA will now be responsible for the *collection of land Rent* as an Exchequer item and the Sugar Development Levy on an agency basis but without entering into an agreement with the Sugar Board as was the case before.

**Effective 1<sup>st</sup> January, 2007**

**2. MISCELLANEOUS AMENDMENTS AFFECTING KRA OPERATIONS.**

**(a) Amendment to the Road Maintenance Levy Fund Act, 1993 (No.9 of 1993)**

The Road Maintenance Levy Fund (RML) has been amended *by deleting* the Schedule and inserting a new Schedule as shown below: (L.N No. 59 of 15.6.2006.)

<b>PETROLEUM FUEL</b>	<b>Amount of Levy for every 1,000 litres at 20 degrees centigrade</b>
Premium petrol	<b>Shs 9,000</b>
Regular Petrol	<b>Shs 9,000</b>
Gas oil (automotive, light, amber for high speed engines)	<b>Shs 9,000</b>

The effect of this is to increase the Road Maintenance Levy Fund (*RML*) *by Kshs 3.20 per litre or Kshs 3200, from Kshs 6,800 to Kshs 9,000 for every 1,000 litres.*

**Effective 15<sup>th</sup> June, 2006**

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### **(b) Road Licences.**

As a result of the increase on the Fuel Levy, the Minister for Transport revoked the Road Licence Rules. The implication of the revocation was that the fees collected under the Traffic Act in respect to road licence were with effect from 15<sup>th</sup> June, 2006, revoked. (L.N No. 57 of 15.6.2006.)

**Effective 15<sup>th</sup> June 2006**

### **(c) Other Traffic Licenses**

The Minister for Transport also adjusted the licence fees on the following items:

- (i) Driving School Fees were increased from Kshs10, 000 to Kshs11, 000.(L.N No. 55 of 15.6.2006.)
- (ii) Driving Licences, Dealers general licence and Public Service Vehicles (Badges for drivers & conductors) were also increased (L.N No. 56 of 15.6.2006.)

**Effective 15<sup>th</sup> June 2006**

### **(d) DISPUTE RESOLUTION BODY**

The Minister approved in principle for the formation of an independent Dispute Resolution Body, under an Act of Parliament, to handle disputes relating to VAT, Excise, Income Tax and any other revenues administered by the Authority. In order to finalise the drafting of the Act, the Minister Directed the Budget Team at the Treasury to come up with the Draft Act for his approval and onward forwarding to the Attorney General's Office for final drafting and tabling in Parliament..

### **(e) TAX POCEDURE CODE**

The Minister approved in principle the enactment of a Tax Procedure Code, as proposed by KRA, in order to bring all procedures contained in the Revenue Acts administered by KRA, into one Act.

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The DRAFT TPC prepared by KRA will form the basis of the working document and again the Budget Team at Treasury was directed by the Minister to come up with the final copy for his approval and onward forwarding to the Attorney General's Office for final drafting and tabling in Parliament.

### **(f) EXCISE BILL**

The Draft Excise Bill is currently awaiting Treasury and KRA's input before its finalization. The Minister also directed the Budget Team to fast track its finalization and onward forwarding to the Attorney General's Office for final drafting and tabling in Parliament..

### **3 AMENDMENTS AFFECTING THE CUSTOMS AND EXCISE ACT**

#### **(a) Section 2 of the Finance Act - Introduction of Section 136A – Excise stamps on wines and spirits.**

This section has been inserted to cater for the introduction of excise stamps on wines and spirits. With effect from 1<sup>st</sup> January, 2007, it is mandatory for manufacturers and importers of wines and spirits to affix excise stamps on bottles and/or any other container of wines or spirits. . The stamps are procured by KRA and provided to wines and spirits dealers.

This requirement is meant to ensure that manufacturers and importers of wines and spirits pay excise duty on all products they offer for sale

**Effective 1<sup>st</sup> January, 2007**

#### **(b) Section 3 of the Finance Act - Insertion of new section 153A -Penalties for fraudulent claim for refund or rebate of excise duty**

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A new section 153A has been inserted to provide for penalty for any manufacturer who makes a fraudulent claim for refund or rebate of excise duty. This amendment is meant to discourage any manufacturers making false/fraudulent claims for refund or rebate of duty.

**Effective 16<sup>th</sup> June 2006**

### **(c) Section 4 of the Finance Act - Amendments to the Fifth Schedule to the Customs and Excise Act – Excise duties**

**The following amendments were effected on the rates of excise duty on the specified items:**

#### **(i) Beers**

Excise duty on “**other beer made from malt**” has been raised from Kshs.42 to Kshs.48 per litre.

However in order to make beer not made from malt sold in kegs cheaper and more affordable to a larger number of consumers, the Minister enhanced the remission of this particular type of beer from 42% to 100%. This has effectively removed excise duty on this product.

**( Legal Notice No. 70 of 15<sup>th</sup> June 2006)**

**Effective 15<sup>th</sup> June 2006**

#### **(ii) wines and spirits**

A specific duty rate of **Kshs.54** has been imposed on **sparkling wine, vermouth wine and other wine of fresh grapes**. **The *ad valorem* rate has also been raised from 45% to 65%**. The objective is to raise revenue and also harmonise the treatment of these wines with products of similar nature. It also removes the prospect of misclassification.

Excise duty on spirits of Tariff Heading 2208 such as whiskies, rum, gin and vodka has been raised from Kshs.100 per proof litre to Kshs.120 per proof litre. However, the *ad valorem* rate remains unchanged at 65%.

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The Minister, through the Finance Act, 2006 removed the increased duty rate of Shs 54 per litre or 65% on “*other wine, grape must with fermentation or arrested by addition of alcohol in containers of 2litres or less*” ( tariff no. 2204.21.00) and reverted back to 45% ( Effective date 9<sup>th</sup> November 2006).

NB Tariff no.2204.21.00 attracted excise duty rate of Shs54 per litre or 65% from 15<sup>th</sup> June 2006 to 9<sup>th</sup> Nov. 2006.

The affected tariffs are as given below.

TARIFF NO.	GOODS DESCRIPTION	NEW RATE OF EXCISE DUTY
2203.00.90	Other beer made from malt	Shs.48 per litre
2204.10.00	Sparkling wine	Shs.54 per litre or 65%
2205.10.00	Vermouth and other wine of fresh grapes flavoured with plants or aromatic substances, in containers of 2 litres or less	Shs.54 per litre or 65%
2205.90.00	Vermouth and other wine of fresh grapes flavoured with plants or aromatic substances, in containers of more than 2 litres	Shs.54 per litre or 65%
2208.20.00	Spirits obtained by distilling grape Wine or grape marc.	Per proof litre Shs.120 or 65%
2208.30.00	Whiskies	Per proof litre Shs.120 or 65%
2208.40.00	Rum and Tafia	Per proof litre Shs.120 or 65%
2208.50.00	Gin and Geneva	Per proof litre Shs.120 or 65%
2208.60.00	Vodka	Per proof litre

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		<b>Shs.120 or 65%</b>
<b>2208.70.00</b>	<b>Liqueurs and cordials</b>	<b>Per proof litre</b>
		<b>Shs.120 or 65%</b>
<b>2208.90.10</b>	<b>Distilled spirits (e.g. Konyagi, Uganda Waragi)</b>	<b>Per proof litre</b>
		<b>Shs.120 or 65%</b>
<b>2208.90.90</b>	<b>Other spirits and other spirituous Beverages</b>	<b>Per proof litre</b>
		<b>Shs.120 or 65%</b>

**Effective date 16<sup>th</sup> June 2006(see NB above)**

Excise duty on undenatured ethyl alcohol of alcohol strength by volume of 80% Vol. or higher (tariff 2207.10.00) was also increased to Shs.120 or 65% per proof litre.

**Effective date 1<sup>st</sup> July 2006**

**(iii) Cigarettes**

Excise duty on Categories B and D of cigarettes was increased. The current schedule of Part II is thus amended as follows:

<b>Category</b>	<b>Retail Selling Price Per mille</b>	<b>Rate of Excise Duty Kshs. Per mille</b>
<b>A</b>	<b>Up to Shs.1,500</b>	<b>495</b>
<b>B</b>	<b>Shs.1,501 to Shs.2,500</b>	<b>715</b>
<b>C</b>	<b>Shs.2,501 to Shs.3,500</b>	<b>990</b>
<b>D</b>	<b>More than Shs.3,500</b>	<b>1,690</b>

**Effective date 16<sup>th</sup> June 2006**

**NB: Excise duty on category B cigarettes had been increased to Shs 780 on June 15<sup>th</sup> and the rate of Shs 715 was effective 9<sup>th</sup> November 2006.**



**4. VALUE ADDED TAX ACT.**

**The following are the amendments affecting the Value Added Tax**

**(a) Section 5 of the Finance Act – Amendment to Section 9 of the Act**

**Amendment of Section 9(2) (c)**

Section 9(2) ( c) has now been amended to expressly include Excise Duty in the calculation of the taxable value of local manufactured excisable goods.

Hitherto the Act was not clear whether Excise Duty should be part and parcel of the taxable value for locally manufactured excisable goods. So whereas the Act expressly provided for excise duty to be included in the case of taxable excisable goods imported into Kenya, the law was silent on the treatment of Excise Duty for Locally manufactured excisable goods. The amendment was meant to clarify what was already in place but was raising questions why the Act was not specific.

**Effective date 16<sup>th</sup> June 2006**

**(b). Section 6 of the Finance Act –Amendment to Section 12**

Section 12(1) of the Act has been amended in order to provide in the Act what Regulation 13(2) provides. Whereas this Regulation provides for a newly registered person who was not in the position to claim relief from tax on goods in stock, assets, buildings etc within the stipulated 30 days to do so within such a longer period as the Commissioner may in any particular case allow, the Act itself did not provide for this extension.

This amendment has been occasioned by the fact that authority to extend the stipulated 30 days should be provided under the provisions of the Act and not as under the VAT Regulations only.

**Effective date 16<sup>th</sup> June 2006**

**(c). Section 7 of the Finance Act – Insertion of a new Section 25A**

A new Section 25A has been inserted into the VAT Act to provide for any person who submits a fraudulent refund claim, to be liable to a penalty equal to two times the amount of the claim.

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This amendment has been made in light of the increasing cases of fraudulent refund claims submitted by taxpayers and the Commissioner could not penalize such cases, other than as a criminal case, due to lack of an adequate provision.

**Effective date 16<sup>th</sup> June 2006**

### **(d). Section 8 of the Finance Act – Amendment to Section 40**

Section 40 of the VAT Act has been amended to provide for a person who submits a fraudulent refund claim to be prosecuted and fined Kshs.400,000 or double the tax evaded, whichever is greater, or imprisoned to a period of 3 (three) years or to both. This amendment is intended to provide for custodial sentence in addition to fines.

**Effective date 16<sup>th</sup> June 2006**

### **(e). Section 9 of the Finance Act– First Schedule to the Act Repealing and Replacing a new First Schedule**

The First Schedule has been repealed and replaced with a new First Schedule to the VAT Act to provide for Restaurant, Accommodation and all other services provided by a hotel owner or operator, to be charged at the General Rate of 16%.

The 2% Catering Training and Tourism Development Levy (CTTDL) collected under the Hotels and Restaurants Act will be charged in addition to the 16% VAT. Revenue officers should now note that except for Zero Rated supplies falling under the Fifth and Eighth Schedule to the VAT Act, all taxable goods and services will be charged at the General Rate of 16%.

**Effective date 16<sup>th</sup> June 2006**

### **(f). Section 10 of the Finance Act– Second Schedule to the Act**

#### **(i) Amendment of Part 1 of the Second Schedule**

Part 1 of the Second Schedule to the VAT Act has been amended by deleting Wheat or Meslin flour of Tariff No.1101.00.00 from exempt status in order to make wheat flour zero-rated under Part C of the Fifth Schedule to the VAT Act. The exempt status of Meslin Flour has been retained under Part II of the Second Schedule.

#### **(ii) Amendment of Part 11 of the Second Schedule**

Part 11 of the Second Schedule to the Value Added Tax Act has been amended by:-

**Deleting the following item:-**

***“(iv) The treatment and supply of natural water by a local authority or a person approved by the Minister for the time being responsible for water development for domestic or for industrial use”.***

**Inserting the following item:-**

***(iv) “Meslin Flour”.***

The amendments were made in order to remove water from the exempt status and also to retain meslin flour as exempt after separating it from wheat flour with which they share a tariff line.

**Effective date 16<sup>th</sup> June 2006**

**(g) Section 11 of the Finance Act – Third Schedule to the Act**

***(i) Amendment of Paragraph 1 of the Third Schedule to the Act***

Paragraph 1 of the Third Schedule to the VAT Act has been amended to limit the exempt Financial Services to Banks and Financial Institutions only.

Any other services of a financial nature offered to the Banks and Financial Institutions by Third Parties should be charged VAT e.g. PESA POINT, KENSWITCH, transportation and restocking of money by security firms. This amendment has been made to remove issues which arise when a non-financial institution provide services which relate to financial services. With outsourcing of services becoming a common thing there was need for clarity.

***(ii) Amendment of Paragraph 2 of the Third Schedule to the VAT Act***

Paragraph 2 of the Third Schedule has been amended in order to exclude the following taxable services from being exempt under the umbrella of “Insurance and Re-insurance services”. Paragraph 2 now reads as follows:-

***“(2) Insurance and reinsurance services excluding the following-***

***(a) Management and related insurance consultancy services;***

***(b) Actuarial services; and***

***(c) services of insurance assessors and loss adjusters;”***

This amendment is intended to remove services which can be provided by non insurance bodies from the exempt status. This will create equity as well as recognize

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the fact that the said services are included under the Fourth Schedule to the VAT Act and therefore subject to registration without a threshold.

***(iii) Amendment of Paragraph 17 of the Third Schedule to the VAT Act***

Paragraph 17 of the Third Schedule has been amended, in order to promote the development of youth talented in sports, music, drama and dancing, by inserting the following new subparagraph :-

***“(e) (1) entertainment performed wholly by artistes who are resident in Kenya.***

***(2) For the purposes of this paragraph, “resident” means a person who-***

***(a) has a permanent home in Kenya; or***

***(b) has no permanent home in Kenya but-***

***(A) was present in Kenya for a period or periods amounting in the aggregate, to 183 days or more in each calendar year; or***

***(B) was present in Kenya in the calendar year of performance and in each of the two immediately preceding calendar years for periods amounting in the aggregate, to more than 122 days in each calendar year.***

This exemption is in light of the fact that whereas, “sports, games or cultural performance conducted under the auspices of the Ministry of Culture and Social Services is already exempt under the Third Schedule, Kenyan artistes whose entertainment was conducted outside the said Ministry, were required to account for VAT.

**Effective date 16<sup>th</sup> June 2006**

**(h) Section 12 of the Finance Act – Amendments to the Fifth Schedule.**

**(i) Part A of the Fifth Schedule** to the VAT Act has been amended by inserting the following new items:-

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***“16. The treatment and supply of natural water by a local authority or a person approved by the Minister for the time being responsible for water development for domestic or for industrial use, excluding the supply of bottled water.***

This amendment has been made in view of the Governments’ policy on private/public sector participation in the development of infrastructure. The zero-rating of the treatment and supply of natural water (excluding bottled water) will apply to all Local or Public Water Suppliers approved by the Minister for water.

Essentially water for domestic or industrial use will now be zero rated and suppliers of this water will become taxable persons.

***“17. The supply of transportation services in respect of unprocessed agricultural and forest produce.***

The zero-rating of transportation of unprocessed agricultural and agro-forestry produce (planting of trees on agricultural land) will eventually have a positive impact on foodstuffs by making them cheaper.

This zero rating should cover all unprocessed agricultural and agro-forestry produce. Agricultural should cover the normal meaning of agricultural, the way a common man would understand it.

**Effective date 16<sup>th</sup> June 2006**

**(ii) Part B of the Fifth Schedule has been amended by zero-rating the following goods.**

**PART B – ZERO RATED GOODS**

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<i>Tariff No.</i>	<i>Tariff Description</i>
<b>3926.90.10</b>	<b><i>Floats for fishing nets.</i></b>
<b>8418.69.10</b>	<b><i>Other refrigerating or freezing equipment for dairying or fishing.</i></b>
<b>8471.10.00</b>	<b><i>Analogue or hybrid automatic data processing machines.</i></b>
<b>8471.30.00</b>	<b><i>Portable digital automatic data processing machines, weighing not more than 10Kg, consisting of at least a central processing unit, a keyboard and a display.</i></b>

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<i>Tariff No.</i>	<i>Tariff Description</i>
8471.41.00	Other digital automatic data processing machines comprising in the same housing at least a central processing unit and input and output unit, whether or not combined.
8471.49.00	Other digital automatic data processing machines presented in the form of systems.
8471.50.00	Other digital processing units other than those of sub-heading 8471.41 or 8471.49 whether or not containing in the same housing one or two of the following types of units: storage units, input units, output units.
8471.60.00	Input or output units whether or not containing storage units in the same housing
8471.70.00	Storage units.
8471.80.00.	Other units of automatic data processing machines.
8471.90.00	Other automatic data processing machines and units not elsewhere specified as included.
8473.30.00	Parts and accessories of the machines of heading 84.71
<i>8515.21.00</i>	<i>Fully or partly automatic machines and apparatus for resistance welding of metal.</i>
<i>8515.29.00</i>	<i>Other machines and apparatus for resistance welding of metal.</i>
<i>8515.31.00</i>	<i>Fully or partly automatic machines and apparatus for arc (including plasma arc) welding of metals.</i>
<i>8515.39.00</i>	<i>Other machines and apparatus for arc (including plasma arc) welding of metals.</i>
<i>9507.10.00</i>	<i>Fishing rods.</i>
<i>9507.20.00</i>	<i>Fish-hooks whether or not snelled.</i>
<i>9507.90.00</i>	<i>Other line fishing tackle; fish landing nets, butterfly nets and similar nets; decoy "birds" (other than those of heading 92.08 or 97.05 and similar hunting or shooting requisites.</i>

This amendment was intended to zero rate computer & computer accessories, fishing equipment and welding equipment for the youth.

The above goods are specifically classified under the Customs tariff and therefore care must be exercised to zero rate those goods specifically referred to under the tariff classification.

**Effective date 16<sup>th</sup> June 2006**

**Effective date 9<sup>th</sup> Nov 2006 ( in italics)**

**(iii) Part C of the Fifth Schedule has been amended by inserting the following new items:--**

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**17. Agricultural tractors, semi-trailers for agricultural tractors and agricultural tractor tyres** (For agricultural tractor tyres. effective date is 9<sup>th</sup> Nov. 2006 and tractor tyres is 16<sup>th</sup> June, 2006)

**18. Napkins and napkin liners for babies.**

**19. Feeding bottles for babies.**

**20. Wheat Flour.**

**21. Locally assembled water pumps. (Effective date 9<sup>th</sup> Nov. 2006)**

The zero rating of the above items is intended to promote agriculture and also to reduce tax burden on food and children items.

**Effective date- 16<sup>th</sup> June 2006.**

**(i). Section 13 of the Finance Act – Amendment to the Sixth Schedule.**

Paragraph 1 of the Sixth Schedule to the VAT Act has been amended by **deleting the existing turnover thresholds and inserting a new threshold of Kshs.5,000,000.**

Any person who supplies taxable goods or taxable services, the value of which is Kshs.5 million or more in twelve months is a taxable person and is required to be registered for VAT purposes. Any person below this threshold is not a taxable person.

**This amendment does not affect registration without a turnover under Paragraph 1(c) of the Sixth Schedule.**

It should be noted that persons below the Kshs.5M turnover bracket will be allowed to register voluntarily as per paragraph 3 of the Sixth Schedule. This will ensure that traders are not penalized by firms that may insist on dealing with VAT Registered traders only.

**Effective date 1<sup>st</sup> January, 2007**

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### **(ii) Amendment of Paragraph 16.**

Paragraph 16 of the Sixth Schedule to the VAT Act is amended by deleting and replacing paragraph 16 to provide that:-

***“16. Where the value of taxable supplies made by a registered person in any period of twelve months is less than five million shillings, the registered person shall notify the Commissioner of the values of his supplies and shall be subject to the provisions of the turnover tax under section 12C of the Income Tax Act..***

***Provided that this paragraph shall not apply to a person registered under subparagraph 1(c)”***

Once a person has notified the Commissioner, the Commissioner, if so satisfied that the person should be deregistered, should deregister that person forthwith as provided under paragraph 18.

NB: The turnover tax though still provided under the Income Tax Act was made inoperational by Parliament during the Committee Stage Amendments when the Clause amending Section 34 to the ITA was deleted. The effect was that although the turnover tax and the rate of tax are provided the tax rate cannot be applied as it is not provided for under the main Act.

Although the Act now provides for one who has notified the Commissioner under paragraph 16 to be subject to turnover tax, there is nothing in the Act tying deregistration to turnover tax

**Effective date 1<sup>st</sup> January, 2007**

### **(j) Section 14 of the Finance Act – Seventh Schedule**

#### **Amendment to Paragraph 6 of the Seventh Schedule**

Paragraph 6 of the Seventh Schedule to the VAT Act is amended in subparagraph (6) by ***inserting a new proviso to provide for taxpayers to recover the cost of***



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***the Electronic Tax Register from the tax payable, upon purchase and installation of the ETR on or before the 31<sup>st</sup> December, 2006.***

Taxpayers, who purchase and install Electronic Tax Registers (ETR) after the 31<sup>st</sup> December, 2006 will not be allowed to recover the cost of ETR from the VAT payable. This is applicable to both the old and newly registered persons.

It should be noted that this amendment affects the recovery of ETR cost only and does not affect the deadline for installing ETR.. After a taxable person has purchased and installed an ETR he will be eligible for recovery of the cost and this does not provide a deadline for an application for approval of the recovery

**Effective date 16<sup>th</sup> June, 2006**

**(k) Section 15 of the Finance Act – Amendment to the Eighth Schedule**

The Eighth Schedule to the Act has been amended by inserting “**and non-commercial**” in subparagraph 1 of paragraph 7. The objective is to also zero rate non commercial fishing vessels.

**Effective date is 9<sup>th</sup> November, 2006.**

**SUBSIDIARY LEGISLATION**

**(a) Amendments to the Value Added Tax Regulations- (Legal Notice No.54)**

**(i) Regulation 4**

Regulation 4 of the Value Added Tax Regulations has been amended by requiring that a tax invoice should be:-

- Register generated or attached to an (ETR) Receipt where the tax invoice is not register generated.
- Serially numbered

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The above amendments have been occasioned by the fact that registered persons are required to use an ETR in accordance with the Seventh Schedule of the VAT Act.

The implication of this amendment is that an invoice which does not comply with this regulation is not a tax invoice as per the Seventh Schedule and therefore cannot qualify for input tax deduction under section 11.

***Therefore officers should note that no input tax will be deducted unless:-***

- a) a tax invoice is register generated; or***
- b) a tax invoice is attached onto an Electronic Tax Register receipt.***

### **(ii) Regulation 5**

Regulation 5(1) of the Value Added Tax Regulations has been deleted and a new Regulation 5(1) inserted ***to provide for a simplified tax invoice to be issued from an Electronic Tax Register as provided for under paragraph 5(e) of the Electronic Tax Register Regulations.***

The simplified tax invoice shall contain the following details:-

- (a) the name, address, VAT registration number and Personal Identification Number (PIN) of the user of the register;***
- (b) the logo and identification number of the register;***
- (c) the serial number of the receipt;***
- (d) the date and time of issue of the receipt;***
- (e) the name, quantity, unit price, unit name, tax rate chargeable on and the value of the recorded sale of goods or services;***
- (f) the tax amount payable;***
- (g) the total amount payable inclusive of tax.***

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This amendment is in accordance with the Seventh Schedule to the VAT Act which requires Registered Persons to use an ETR and also to align it with Regulation 4.

**Effective date is 15<sup>th</sup> June, 2006 for both.**

### D. INCOME TAX ACT

#### 1. Section 2 (a) **DECLARATION OF PERMANENT OR SEMI-PERMANENT CROPS**

In last year's Budget (Finance Act 2005), eucalyptus, pine, and cypress were included in the list of permanent or semi-permanent crops for purposes of section 15(2)(l) of the Income Tax Act.

The Minister has this year declared **AVOCADOES** and **MANGOES** to be permanent or semi-permanent crops (**Legal Notice No. 66 of 15<sup>th</sup> June, 2006**). Declared crops take a minimum of 2-10 years to mature.

It means that expenditure of a capital nature incurred in any year of income by the owner or tenant of agricultural land, on clearing land, or on clearing and planting thereon the declared crops shall be deductible with effect from 15<sup>th</sup> June, 2006.

**Effective Date-15<sup>th</sup> June, 2006**

#### (b) **Definition of "management or professional fee"**

There has been divergent views on the interpretation of the meaning of the term "consultancy" for purposes of applying withholding tax on residents. It has been particularly difficult to bring audit and medical services within the ambit of withholding tax.

Professional services will now be subject to withholding tax @ 5% in line with the amendment in the definition of "management or professional fee" which now covers professionals;

It means "*a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, **professional** or consultancy services however calculated*".

**Effective Date-16<sup>th</sup> June, 2006**

**2. Section 5 EMPLOYMENT INCOME**

**(a) Tax treatment of certain allowances as a benefit from employment or services rendered**

Under Section 5(2)(a), any amount received in respect of employment or services rendered in Kenya, is taxable.

However, where the Commissioner is satisfied that subsistence, travelling, entertainment or other allowance represent solely the reimbursement to the recipient of amounts expended in the production of his income from employment or services rendered, then such allowances are excluded from the gains or profits.

A new proviso (iii) has been introduced that will exclude the first Kshs. 2,000 expended per day for the duration of time spent out of work station, from the computation of taxable benefit of an employee **without the need of satisfying the Commissioner that it is a reimbursement**

In this regard, only expenditure over and above Kshs. 2,000 per day, incurred by a person, shall be subject to the test of reimbursement by the Commissioner during taxpayer audits.

**NB: This amendment is intended to address the problem of materiality of a reimbursement during audits.**

**Effective Date-16<sup>th</sup> June, 2006**

**(b) Clarification of determination of value of employee benefit from Leased or Hired Vehicles**

In last year's Budget (Finance Act 2005), a clarification was made on how to determine the benefit to an employee, where an employer leases or hires a vehicle for their employee. That amendment provided that, where a vehicle has been leased or hired from a third party, the employee shall be deemed to have received a benefit in that year of income equal to the higher of the cost of hiring or leasing and the prescribed rate of benefits.

The comparison with prescribed rate of benefit is an impossibility because it applies to cases of outright purchase, where there is

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initial capital cost of a vehicle.

This reference, has therefore been deleted and only the cost of leasing or hiring the vehicle by the employer shall be deemed to be the benefit accruing to the employee.

### **Effective Date-16<sup>th</sup> June, 2006**

#### **(c) Determination of benefit in case of ESOPS**

Employee Share Ownership Plans (ESOPS) are schemes in which employers offer shares to employees to own part of the company in which they are employed. The shares are offered to the employees at a predetermined price, but the option to take up the shares may be exercised at a future date after a vesting period of say 2 – 3 years. At the date of exercising the option, the shares may either have appreciated or dropped in price/value.

Section 5(5) has been amended to provide that the taxable benefit shall be the difference between the market value of the shares and offer price at the date of offer.

### **Effective Date-16<sup>th</sup> June, 2006**

## **3. Section 9 TAXATION OF INCOME FROM MESSAGE TRANSMISSION THROUGH CABLE, RADIO AND OTHER SIMILAR MEDIA IN RESPECT OF NON-RESIDENTS**

Lack of a specific rate of withholding tax for non-residents on income from transmission of messages using hi-tech media has caused protracted disputes.

Amendments have been made to:-

(i) Widen the scope of transmission to include transmission of messages by optical fibre, TV broadcasting, VSAT, internet, satellite or other similar methods of communication.

(ii) Make the gross amount received to be the taxable amount.

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(iii) Expand the scope of taxability to include apparatus set outside Kenya.

**Effective Date-16<sup>th</sup> June, 2006**

**4. Section 12A INTRODUCTION OF ADVANCE TAX ON DRIVERS AND CONDUCTORS OF PUBLIC SERVICE VEHICLES**

In order to address the issue of equity in taxation drivers and conductors of public service vehicles will now be subject to Advance Tax @ Kshs. 3,600 for drivers p.a. and Kshs. 1,200 for conductors p.a.

Since the Commissioner has the powers to prescribe conditions and procedures governing payment of advance tax under the existing legal framework, the collection point should be at the time of issue or renewal of driver and conductor licence.

**Effective Date-1<sup>st</sup> January, 2007**

**5. Section 12C IMPOSITION OF TURNOVER TAX**

A turnover tax has been introduced to apply to residents whose income from business in Kenya does not exceed Kshs. 5 million per annum

A provision has also been made to allow the Minister to make rules for proper implementation of this section.

The applicable tax rate shall be 3% which translates to a maximum of Ksh. 150,000 per annum.

**NB: the failure by Parliament to amend section 34 to provide for the rate placed a set back to the implementation of this section and until section 34 is amended this tax will remain not operational.**

**6. Section 15 DEDUCTIONS ALLOWED**

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### **(a) Additional incentives for listing in the stock market**

Currently, legal costs and other incidental expenses of capital nature incurred for purposes of raising capital through the general public are tax deductible. Additional incentive has been given by making legal costs and other incidental costs incurred for purposes of listing in the stock exchange without raising additional capital tax deductible.

### **(b) Treatment of Cash Donations**

Donations have always been disallowed except when made to a scientific research association approved by the Commissioner or to a university, college etc as provided for under section 15(2)(n).

A Paradigm shift has been made in this area.

Cash donations made to charitable organisations that are exempt from tax under paragraph 10 of the 1st Schedule to the Income Tax Act, or to any project approved by the Minister for Finance will now be tax deductible.

### **(c) Capital expenditure on social infrastructure, public school, hospital or road**

Capital expenditure incurred by a person on the construction of a public school, hospital, road or any similar kind of social infrastructure will also be tax deductible. However, prior approval of the Minister for Finance must be obtained.

**Effective Date-16th June, 2006 for all amendments under section 15 (2).**

## **7. Section 16 DEDUCTION NOT ALLOWABLE**

### **Restriction on the allowability of expenses of hiring non-commercial vehicles lifted.**

The provisions of section 16(2)(i) restricting expenditure incurred by a person on hiring non-commercial vehicles has been deleted. It means therefore that lease hire charges paid by a lessee to hire or lease a saloon vehicle will be tax deductible.

This has been done in order to extend asset financing through leasing to cover saloon cars. It is expected that with more people using the leasing market, revenue from lease income should increase among other economic benefits.

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To guard against abuse and to increase compliance by the lessors, a withholding tax at the rate of 3% shall apply to lease rentals.

Legal Notice No. 69 of 15th June 2006 has been published and will come into operation from 1st July 2006.

**Effective Date-1st July, 2006**

### 8. Section 18 ASCERTAINMENT OF GAINS OR PROFITS OF BUSINESS IN RELATION TO CERTAIN NON-RESIDENT PERSONS

#### Introduction of Income Tax (Transfer Pricing) Rules

Section 18 has been amended by inserting a new subsection (8) which gives the Minister authority to publish rules containing guidelines for the determination of arm's length price and to specify any other requirements he considers necessary for application of the provisions of section 18.

Consequently, the Minister has published The Income Tax (Transfer Pricing) Rules, 2006 through Legal Notice No. 67 of 15<sup>th</sup> July, 2006 to come into operation on 1<sup>st</sup> July, 2006.

In view of the growing presence of multinational enterprises operating in Kenya, the challenges posed by transactions between related enterprises that give rise to transfer pricing, are increasing.

Transfer pricing cases take long and are always a subject of litigation because of the magnitude of possible price adjustments that impact on profits. In determining what constitutes an arm's length price, the rules will bring certainty to both KRA and the Multinational enterprises which still prefer doing business in Kenya which is a regional hub.

The Draft Transfer Pricing Guidelines that were released to staff in September 2005 contain more detailed narrative and should be a useful reference.

In light of the publication of the rules that have now given legal framework, the Draft will be improved and will be an integral operational document.

**Effective Date-1st July, 2006**



9. Section 22C REGISTERED HOME OWNERSHIP SAVINGS PLAN (HOSP)

The Home Ownership Savings Plan (HOSP) was started in 1996 to assist first time home buyers to own permanent houses but has not been attractive. In the plan, a depositor may deposit funds into a HOSP and will enjoy tax deductions upto Kshs. 4,000 pm or Kshs. 48,000 p.a for period of 10 years provided that all funds held in the account are withdrawn and applied towards purchase or construction of a permanent house.

In order to encourage home ownership, the scheme has been granted additional incentives so that depositors who save for purchase or construction of a permanent house will not be taxed on interest income on deposits of upto Kshs. 3 million. Note that it is NOT interest upto Kshs. 3 million that is exempt, but rather, deposits of upto Kshs. 3 million will earn interest, and it is that interest which will be exempt from tax.

**Effective Date-1st January, 2007**

10. Section 31

**INSURANCE RELIEF**

Effective 1st January, 2003, insurance premiums paid on life and educational policies (at least 10-year maturity) give rise to tax relief of 15% of the premiums paid subject to a maximum of Kshs. 36,000 p.a.

Insurance relief has now been increased to a maximum of Kshs. 60,000 p.a. and will cover health policies whose term commences on or after 1st January, 2007.

This is intended to mobilise savings and increase penetration in the life and health insurance business.

In the event that a policy does not run its full term, and a person has enjoyed tax relief, the insurer must recoup the relief from the surrender value and remit to the Commissioner.

**Effective Date-1st January, 2007**

11. **Section 35 WITHHOLDING TAX ON HORTICULTURAL PRODUCTS**

In July, 2003, withholding tax on non-resident agents who market flowers in overseas markets were exempt from withholding tax because the incident of the tax eventually fell on the local exporters thereby making Kenyan flowers uncompetitive in the international market.

Horticultural sector that export fruits and vegetables, and has similar problems was however not considered.

A policy decision to make Kenyan fruits and vegetables equally competitive in the international market has led to extending the exemption to the horticulture sector.

Therefore, there will be no more withholding tax in respect of non-resident marketing agents of fruits or vegetables in markets outside Kenya.

**Effective Date-1st July, 2006**

12. **Sections 120 and 124 POWER TO INSPECT BOOKS AND DOCUMENTS; AND EXERCISE OF COMMISSIONER'S POWERS**

The two sections have been amended to remove all references to ranks of officers and to allow officers authorised by the Commissioner to have power to inspect books and thereby carry out audits effectively. The Commissioner may also authorise an officer to exercise his powers except the powers to compound offences (Section 114) or to abandon tax (Section 123).

**Effective Date-16th June, 2006**

13. **First Schedule INCOME TAX EXEMPTIONS**

**(Part I)** The Minister, under provisions of Section 13(1), has granted the following exemptions:

- (i) **Investment income of a pooled fund** of Retirement Benefits Schemes provided the constituent schemes are registered by the

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Commissioner;

- (ii) **Interest income accruing from all listed bonds (with maturity of at least 3-years)**, used to raise funds for infrastructure and social services;
- (iii) **Interest income generated from cash flows passed to the investor in the form of asset-backed securities.**

**Effective Date-1st January, 2007**

Income of **Policyholder's Compensation Fund** exempt from tax by the Minister under section 13(2) through **Legal Notice No. 68 of 15<sup>th</sup> June, 2006.**

Legal Notice  
No. 68 of 15<sup>th</sup>  
June, 2006

**Effective Date-15th June, 2006**

14. **Second Schedule** **DEDUCTIONS IN RESPECT OF CAPITAL EXPENDITURE (CAPITAL ALLOWANCES)**

**Part I – Industrial Building Deduction for Hostel and Educational Buildings introduced**

As an incentive for growth of the educational sector, hostels and educational buildings have been classified as Industrial Buildings and will be eligible for capital deduction (IBD) on capital expenditure on construction at the rate the rate of 10%.

The current rate for IBD in case of hotels is 4%. This has been increased to 10%, thus hotels, hostels and educational buildings have been put together.

**Part IV – Farm-works Deduction increased**

The owner or tenant of agricultural land who incur Capital expenditure on the construction of farm works will enjoy an enhanced farm works deduction of 50% in the first year and the following second year, commencing 1st January 2007.

**Effective Date-1st January, 2007**

15. **Third** The Third Schedule to the Income Tax Act has been amended to give effect to the following:-

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**Schedule  
amendme  
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- (a) increasing the resident personal relief from thirty six thousand shilling to sixty thousand shillings insurance relief under Section 31. Hence the current insurance relief shall be fifteen percent of the amount of premiums paid subject to a maximum of sixty thousand shillings per annum.
- (b) Introducing a rate applicable to the business of transmitting messages. The rate is five percent of the gross amount received by a non-resident person who is operating such a business in Kenya as provided under Section 9(2) of the Act.
- (c) Providing for withholding tax rate for lease rentals paid under Rule 3 of the Income Tax (Leasing) Rules. The rate shall be 3% of the gross amount paid to the lessor.

Note that there is no withholding tax on ordinary rents where a tenant pays rent to a landlord to acquire rights of residency. The amendment only affects leases under the leasing rules.

- (d) Introducing rates for advance tax for drivers and conductors of Public service vehicles. Drivers will pay three thousand six hundred shillings while conductors will pay one thousand two hundred shillings per annum. This is payable during renewal of licences by the relevant persons.

Nb. Rates applicable to both capital gains tax and turnover tax have been stood over until further notice due to lac of enabling law under Section 34 of the Act.

**CATHERINE BWIRE (MRS.)  
SENIOR DEPUTY COMMISSIONER  
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