

# The TaxPoint

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Large Taxpayers Office

## NEWS DESK

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#### Board appointment

The KRA acquired a new Board of Directors in April 2010 with the appointment of four new members to replace those whose terms expired in December 2009. The team joins another four continuing Board members in the middle of an ambitious modernisation programme whose cornerstone is the automation of the KRA's operational and administrative systems.

The new Board is chaired by Major (rtd) Marsden Madoka, a former Cabinet Minister and Member of Parliament. Its new entrants are Kibuga Kariithi, (former CEO, Nairobi Stock Exchange), Phyllis Kandie, and Zebedeo John Opre.

Among the reconstituted Board's first acts was the confirmation of Alice Owuor as Commissioner at the Domestic Revenue (DR) division which deals with small and medium taxpayers.

#### Transfer pricing

Recent developments have further strengthened the drive to combat the transfer pricing menace among Kenyan companies. Formal contact has been established between the Kenya Revenue Authority and Flora Holland, the world's biggest flower marketer based in The Netherlands. This follows a visit in May by a delegation of KRA officials seeking to understand the workings of the fresh flower market. The officials observed the workings of the highly automated auction trading system in addition to studying the business process involved in product handling.

It transpired during the discussions that Kenya accounts for a quarter of all the foreign flowers traded in Holland, this being the largest imported component. In gross terms Kenyan flowers account for one eighth of the entire market raking in a staggering 250 million US dollars. Kenya also accounts for three quarters of all the roses traded by Flora Holland. The revelations underscore the importance of fresh flower producers who have become of major focus especially within the LTO

given the sector's poor performance in corporation tax remittances. Conversely the sector continues to outdo others in the generation of VAT refunds meaning that on balance, the fresh flower producers are a net consumer of Kenyan taxes!

During the visit which was led by John Njiraini, Commissioner in charge of large taxpayers, discussions also touched on collaboration between the Dutch Tax and Customs Administration and the KRA, aimed at strengthening local capacity in the handling of transfer pricing issues. Negotiations on double taxation and information exchange will form part of future collaboration activities between the two revenue agencies. Initiatives are also in progress to negotiate information exchange agreements with other selected jurisdictions with the aim of providing further support in cases where funds diversion, a common practice in transfer pricing, occurs.

#### Excise Tax study visit

A delegation of four KRA officials recently visited Brazil to gain familiarisation with the country's internationally renowned processes for the management of alcohol and cigarette taxation. The team, led by the Commissioner General, visited Federal Revenue Agency offices in Sao Paulo, Brasilia and Brazil's main port at Santo.

A key learning point during the visit was about the use of high-end technology solutions to monitor the production and sale of alcohol and cigarettes. The technology which is integrated into production lines of all manufacturers monitors and transmits data to the revenue authority at 15 minute intervals in addition to performing digital stamping. In the case of cigarettes, it also vets paper excise stamps for authenticity and undertakes reconciliations between

stamps received and those used.

The lessons learnt in Brazil will inform the KRA's future strategy for the management of cigarette and alcohol taxation. Measures are already in progress to enforce the use of production metering equipment in the spirits industry with the country's two main distillers having installed technology compatible measurement devices. Concurrently legal changes proposed will further underpin the use of technology in replacement of the outmoded practice of physically stationing KRA staff to man excise factories. Further expansion will see the initiative extended to other alcoholic spirit manufacturers and ultimately to the cigarette industry.

Brazil has perfected e-government practice by consolidating public sector automation under one government controlled agency that provides both software and hardware solutions. The KRA plans to deepen the engagement with the Brazilian authorities through the formalisation of a cooperation agreement.

#### Combating illicit tobacco trade

The fourth session of the Intergovernmental Negotiating Body on a Protocol on Illicit Trade in Tobacco Products' (INB-4) took place in Geneva in February 2010 with significant progress achieved in certain areas.

Part of the agreement mandates the development of processes to control the supply chain for tobacco products, including their tracking and tracing as well as the licensing of manufacturers and other players involved in the tobacco trade. Follow up talks will take place in Montevideo, Uruguay in November 2010.

The Program Director Laurent Huber observed the need to enhance linkages with governments in order to identify effective tools to help curb illicit trade in tobacco products, a global malaise that robs countries of tax cash flows besides promoting consumption which in turn impairs human health.

Kenya was represented at the conference by officials from the KRA, the Ministry of Trade and the Attorney General Office.

### KRA Online progress

The corporation tax online filing module was launched in April 2010 marking another key milestone in the automation programme for domestic taxes. The new facility comes hot on the heels of the March 2010 launch of the individual income tax filing module which it is hoped will mitigate the annual 30th June nightmare occasioned by the large influx of taxpayers seeking to file their returns on the last day.

The corporation tax form has an inbuilt calculator that automatically computes the tax liability thereby minimizing the risk of costly errors. Further enhancements in progress will support transfer pricing declarations and also the tagging of tax incentives, the latter with the objective of assisting in the collation of data on the impact of tax expenditures.

Meanwhile the second phase of the domestic taxes automation project kicked off with the identification in April of five qualifying bidders who have been invited to quote with a target to identify the winning bidder by 30th June 2010.

### VAT refund notifications

Following queries from taxpayers, we wish to clarify that our VAT refund claim status advice does not constitute funds that may be immediately applied to settle other tax obligations. The notification is given primarily to update taxpayers when their claim becomes ready for payment but the actual payment depends on the funding available month-to-month.

Presently claims are settled on first-come, first served basis meaning that processed claims join a queue based on the claim's date of filing. The position on the queue may change from month to month depending on the number and quantum of new claims processed within the current month.

We advise taxpayers therefore to always make alternative arrangements for the settlement of current taxes unless there is written communication from us confirming that a refund would be utilized to fund current tax obligations.

### Tax Compliance Certificates

The Kenya Revenue Authority has developed a generic Tax Compliance Certificate that will serve as confirmation of tax compliance for a variety of purposes.

Henceforth the new Tax Compliance Certificate, a specimen copy of which is available at [www.kra.go.ke/compliance\\_certificate](http://www.kra.go.ke/compliance_certificate) will be issued to confirm tax compliance status in all instances. No specifically tailored Tax Compliance Certificates will be issued with effect from the date of this notice.

The Authority is also developing a database to host details of all Tax Compliance Certificates issued with a view to enabling interested parties confirm authenticity of documents submitted to them.

Other procedures relating to the issuance of Tax Compliance Certificates including application formalities remain unchanged.

## TECHNICAL BRIEFS

### TECHNICAL RULINGS

#### Income Tax exemptions

In the last issue of "The Taxpoint". the question of the dating of an exemption issued under paragraph 10 of the First Schedule to the Income Tax Act was discussed and a commitment given to provide a response on the matter. The primary contention was about whether the exemption once approved operated from the date of issue or from the date when the applicant qualified.

It is valid for three years from the date of issue and is subject to renewal upon expiry of the period. All previously issued certificates without expiry dates are therefore invalid.

Any person in possession of a certificate, whose validity has expired, is not eligible to be treated as a tax-exempt person. Such a person should reapply to the Commissioner for a new certificate.

Any person making payments to tax-exempt person or entity, with respect to income subject to withholding taxes, must confirm the date on the Exemption Certificate to ascertain its validity before

refraining from deducting taxes on those payments.

#### Taxation of severance emoluments

##### Point at issue

What out-of-court settlements in respect of employment severance (salary, allowances, damages and interest) are taxable.

##### Ruling

Remunerative payments (salary, allowances and interest thereon) are taxable as gains from employment under Section 3(2) (a) (ii) of the Income Tax Act. On the other hand, general damages as well as court costs do not qualify as gains from employment and are therefore not subject to tax.

#### Offset of tax

##### Point at issue

Whether income tax credits arising under section 105(1) of the Income Tax Act can automatically be set off against tax payable in a subsequent year.

#### Ruling

Section 105 (1) of the Income tax Act envisages that tax paid in excess of the amount due has to be verified prior to its application either for refund or set off purposes. A person wishing to utilize a credit under Section 105(1) should therefore seek the Commissioner's concurrence prior to doing so.

#### Expenses attributable to exempt income

##### Point at issue

Whether expenses related to the earning of income exempt from tax should be allowed as deduction from income of the same enterprise subject to tax.

##### Ruling

Section 15(1) and 16(1)(a) of the Income Tax Act allow deduction only of expenditure incurred wholly and exclusively in the production of the income subject of tax. Under Section 2 of the statute the definition of "total income" specifically excludes income exempt from tax. It follows therefore that expenses related to the earning of exempt income cannot count in the determination of taxable income.