Doing Business in Kenya

Contents

KENYAN COMPANY LAWS

Kenya has embarked on its long overdue transition to modern company laws with the recent enactment of the new Companies Act, 2015. Kenya's new Companies Act 2015 was published on 15 September 2015. The Act became fully operational in July 2016. The New Act has drawn heavily on the Companies Act, 2006 of the United Kingdom. The new Act mainly strives to improve the ease of doing business in Kenya. The Act established The Business Registration Services (BRS) to ensure effective administration of the laws relating to incorporation, registration, operation and management of companies, partnerships and firms.

Types of Legal Entities

Under the new Act the types of companies include

1. Limited Companies
   a) Limited by Shares
   b) Limited by Guarantee
2. Unlimited Companies
3. Private Companies
4. Public Companies
5. Foreign Branches

Company Formation

The following steps shall be followed when incorporating a company:-

1) Application and reservation of name.
2) Form CR 1 – This form contains the application to register a company containing the proposed name (as reserved), the registered office, liability of members (whether limited by shares or by guarantee), the nature of the company (if private or public) and the name, consent of the initial director and secretary of the company and address of the agent if an agent is used to make the application.

3) The forms which are the model memorandum of association are:-
    a. Form CR 2 – Model memorandum for a company limited by shares; or
    b. Form CR 3 – Model memorandum for a company limited by guarantee; or
    c. Form CR 4 – Model memorandum for a company whose liability is unlimited.
4) Statement of Nominal Share Capital duly stamped.
5) Form CR 8 – Notification of directors' residential address.
6) Articles of Association (if those provided in the Regulations have not been adopted).
7) Applicants should attach copies of identification documents which include an Identification (ID) card, Personal Identification Number (PIN) and a colored passport sized photo. For non-Kenyans (Foreigners), they should attach copies of passport pages with bio data and also a colored passport photo.
8) New incorporations are exempt from payment of Stamp duty.
9) Issuance of CERTIFICATE OF INCORPORATION.

Guidelines for a Foreign Company Setting Up in Kenya

Foreigners can register a business in Kenya under two options:

A branch - This would arise where a new location, division, department, or office is set up, yet still under the original company's name and is still part of that legal entity. It is a part of a company that is organized so as to conduct business on behalf of a company as opposed to carrying on business which is merely incidental to the company's business as a whole.

The corporate income tax for the branch is normally at **37.5%**.

A subsidiary - Is where a company sets up a new company and registers the legal entity with the local authority as a stand-alone company. A subsidiary is a separate legal entity from the parent, although owned by the parent corporation. A company may form a subsidiary either by purchasing a controlling interest in an existing company or creating the company itself.

A subsidiary's corporate income tax is at **30%** per annum.

SUBSIDIARY COMPANIES

This is when the parent company owns all or the majority of the shares. As the owner, it controls the activities of the subsidiary.

Advantages of setting up a subsidiary

- Considerable tax advantages and legal protections
- Taxation of the subsidiary is on the subsidiary's income alone and when properly structured and operated, the liabilities of the subsidiary are not attributable to the parent corporation.
- Ability to offset profits and losses of one part of a business with another.
- The subsidiary can file tax returns on the profits obtained.
- Liabilities and credit claims cannot be passed on to the parent company.
- Allows for joint ventures with other companies with each owning a portion of the new business operation.

Disadvantages of setting up a subsidiary

- The process of incorporation is technical. It requires notarized parent documents.
- Control also becomes an issue when a subsidiary is partially owned by another outside organization.
- The directors of the company require a local PIN for the company to acquire a PIN.

Registration Requirements and Procedure for incorporating a Subsidiary

- One has to have a local PIN (Personal Identification Number) which is obtained from Kenya Revenue Authority. To get this number, a foreigner has to have either of these:
    a. A valid Kenyan **Work Permit**.
    b. Proof of residence in Kenya i.e. have an **Alien Card**.
    c. Have a valid certificate from **Ken Invest** – an authority mandated with promoting investments in Kenya.
- Prepare and sign incorporation forms including information on share capital and directorship.
- Provide copies of passport, photos and give residential information.

(If the foreigner has no PIN they can partner with a local director who is registered on iTax, which is the Kenya Revenue Authority web portal).

If the shareholders are all foreign entities, they will provide notarized copies of their certificate of incorporation, notarized memorandum and articles of association and details of the directors from the host company.

Upon registration the company is assumed to start employing immediately so registration of NSSF (National Social Security Fund) and NHIF (National Hospital Insurance Fund) are done simultaneously and monthly contributions to begin after Certificate of Incorporation is issued. The company will also be issued with a PIN number and tax obligations to be submitted via that number.

Once all information is adequately provided, signed and lodged for incorporation, the process takes about 2 weeks and costs vary as charged by disbursements and professional service providers' fees.

FOREIGN BRANCH

A branch office is not a separate legal entity of the parent corporation. A branch is just an outlet used to carry out the business of the company.

Advantages

- The concept of "branches" is a simple registration system which removes the need for oversea companies to face complex procedure of incorporation.
- Requires at least one person resident in Kenya authorised to accept, on behalf of the company, service of notices required to be served on the company

Disadvantages

- Subjects the parent corporation to taxation on its entire corporate income (rather than just the branch's income).
- Does not shield the parent corporation from liability incurred at the branch level.
- Losses are included in the parent company's income statement.

Registration Requirements and Procedure for incorporating a Subsidiary

A foreign company can also register a branch in Kenya and these are the requirements that are needed:

1. A certified copy of the Charter, Statutes or Memorandum and Articles of Association of the Company, or other instruments defining the constitution of the company.
2. A certified true copy of the Certificate of Incorporation.

Both Certified as a true copy by a Notary Public and notarized from the Country of Origin.

3. A list of the Directors and Secretary of the Company, giving full Names, Addresses, Nationalities and Occupation of each, together with passport size photos and copies of their passports.
4. A list of other Directorships of companies held in Kenya.
5. A statement of all existing charges entered into by the company affecting properties in Kenya.
6. Names and postal addresses of one or more persons resident in Kenya authorized to accept, on behalf of the company, service of notices required to be served on the company. (**Local representative**)
7. The present physical and postal address of 'the Company'. The addresses are to be for both the Local Office and the Head Office.
8. Issuance of CERTIFICATE OF COMPLIANCE

Once all information is adequately provided, signed and lodged for incorporation, the process takes about 2 weeks and costs vary as charged by disbursements and professional service providers' fees.

BRANCH OFFICE VIS A VIS A SUBSIDIARY COMPANY

	Branch Office	Subsidiary Company
Legal	Not a separate legal entity but an extension of the parent company	Separate legal entity distinct from its parent company
Liabilities	Liabilities must extend to the parent company	Liabilities limited to subsidiary
Entity Name	Must be the same as the Parent company	Can be the same or different from the parent company
Allowed Activities	Must be the same as the Parent Company	Can be the same or different from the parent company
Validity Period	Registered until closed	Registered until closed
Taxation	Taxed as non-resident entity, local tax benefits not available	Taxed as a Kenyan resident entity, local tax benefits available
Annual Filing	Must file branch office as well as parent company's accounts	Must file accounts of the Kenya Subsidiary

Filing Requirements

Companies in Kenya are required to submit their statutory Annual Return every year after holding the Company's Annual General Meeting (AGM). This is done via the Registrar of Companies online portal.

The compliance form has the following information:

- Company Name and Number
- Registered Office Address
- Nominal, Issued, Paid & Unpaid Share Capital
- Particulars of Indebtedness
- List of shareholders and their particulars
- Particulars of Directors and Company Secretary

Foreign Branches and Companies Limited by Guarantee are required to accompany the Annual Returns with the company's Annual Financial Statement.

ESSENTIAL TAXES IN KENYA

Tax is a compulsory contribution to state revenue, levied by the government on workers' income and business profits, or added to the cost of some goods, services, and transactions. Taxes in Kenya is classified into two; **Direct** and **Indirect** taxes.

DIRECT TAXES

These are taxes directly paid to the government by the tax payer. It is a tax applied on individuals and organizations directly by the government. E.g. Personal Income Tax, Corporation Tax.

1. Personal Income Tax

This is tax levied on **resident** persons on their individual income deemed to have accrued or have been derived from Kenya.

A resident is:-

a) Person having a permanent home in Kenya and has been in Kenya for any period during a particular year of income.

b) A person not having a permanent home in Kenya but has been in Kenya for 183 days or more during a particular year of income or a person present in Kenya and in each of the two preceding years has been in Kenya for an average of 122 days each year.

The rates of tax for resident persons is calculated on a graduated scale. For the year of income 2018, the tax bands were expanded as follows: -

	Annual	**Monthly**	**Rates**
On the first	Kshs. 147,580	Kshs. 12,298	10%
On the next	Kshs. 139,043	Kshs. 11,587	15%
On the next	Kshs. 139,043	Kshs. 11,587	20%
On the next	Kshs. 139,043	Kshs. 11,587	25%
On all income over	Kshs. 564,709	Kshs. 47,059	30%

For employed persons the tax is calculated using the above monthly rates and remitted to KRA by the 9th of the month following the month of the deduction. This is done by the employer failure to which the employer is liable to a penalty of 25% or Kshs. 10,000 whichever is higher.
The employees are also entitled to a personal relief against taxes of Kshs. 1,408 per month or Kshs. 16,896 per year from 2018 year of income.
Individuals are also supposed to file their own return before the end of six months after the end of a particular year of income. Failure to submit the return in time will result to a penalty of Kshs. 20,000 or 5% of the tax due whichever is higher.

2. Corporation Tax

This is tax charged on all the income of **resident** and **non-resident** companies, which has accrued in, deemed to be or is derived from Kenya (Section 3(2) of the Income Tax Act (ITA).
An entity will be regarded as resident if it is under Kenyan laws, effectively managed and controlled or declared to be resident in Kenya by the Cabinet Secretary by way of notice in the Kenya Gazette.
The corporation tax rates in Kenya is 30% of the **profit** on residents and 37.5% on non – incorporated non-resident entities. A profit is the financial gain, especially the difference between the amount earned and the amount spent in buying, operating, or producing something.
The allowable expenditure deducted against the income should only be the ones wholly and exclusively incurred in the production of income for that year of income
The tax due is payable in four installments based on projections from previous year of income. The due dates are, 20th of the fourth month, 20th of the sixth month, 20th of the ninth month and 20th of the twelfth month for first, second, third and fourth installments respectively. Failure to pay the correct installments in time attracts a penalty of 20% of the principle amount.

If the amount spent supersedes the amount earned, then there will be a loss which is not taxable. The loss is claimable in future by deducting it from the future profits before subjecting it to tax. This loss is claimable to a maximum of 9 years until it is exhausted failure to which it is forfeited if not exhausted.

The balance of the annual corporation tax is due by the end of the fourth month after the end of the year of income while the filing of the tax return should be done by the end of the six month after the end of the year of income.

Failure to pay the tax balance attracts a 20% penalty on tax due and a 1% interest per month until the amount is settled while failure to submit the annual return in time attracts a penalty of Kshs. 10,000 or 5% of the tax due whichever is higher.

3. <u>Capital Gains Tax</u>

Capital Gains Tax is a tax chargeable on the whole of a gain which accrues to a company or an individual on or after 1st January, 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1st January, 2015.

This is a final tax paid at the rate of 5% on the net gain and cannot be offset against any other taxes. Property includes land, buildings and marketable securities.

If a loss is made, the loss may be carried forward to be offset/deducted against a gain of a similar nature (that is, a capital gain) at a future date.

4. <u>Withholding Tax</u>

This is known as **retention** tax or Tax deducted at source. This is the tax paid to the government by the payer of the income rather than by the recipient of the income. The tax is thus withheld or deducted from the income paid to the recipient/withholder. This tax is payable by the 20th day following the month in which the deduction was made.

The tax is deducted Interest, dividends, royalties, management or professional fees, commissions, pension or retirement annuity, rent, appearance or performance fees for entertaining, sporting etc. The most common rate is 5% withholding tax on professional fees and 3% on contractual fees. The other rates of withholding tax 10%, 15% and 20% and is dependent on whether a person, i.e. individual or company is a resident or not and also the nature of the service offered

5. Advance Tax

This is tax applicable to Matatus and other Public Service Vehicles. It is not a final tax, but a tax partly paid in advance before a public service vehicle or a commercial vehicle is registered or licensed. The current rates are:

For vans, pickups, trucks and Lorries Kshs.1, 500 per ton of load capacity per year or Kshs.2, 400 whichever is higher.

For saloons, station wagons, mini-buses, buses and coaches, Kshs.60 per passenger capacity per month or Kshs.2, 400 whichever is higher.

6. Residential Rental Income Tax

This is tax payable by resident persons on residential rental income accrued or derived in Kenya where the rent income is between Kshs. 144,000 **and** Kshs. 10 million per annum. The rate of tax is 10% on the gross rent received and is payable when landlords receive rent from their tenants either monthly, quarterly, semi-annually or annually. However, returns must be filed monthly. No expenses, losses or capital deduction allowances shall be allowed for deduction from the gross rent.

Rental Income is filed on or before the 20^{th} of the following month.

Persons with rental income below Kshs. 144,000 or above Kshs. 10 million per year shall be required to file annual income tax returns and declare this rental income together with income from other sources. Residential rental income is final tax therefore; persons are not required to declare the same in their annual income tax returns.

INDIRECT TAXES

These are taxes applied on the manufacture or sale of goods and services. There are initially paid to the government by the intermediary who then adds the amount of the tax paid to the goods / services and passes on the total amount to the consumer/ end user.

1. Value Added Tax (VAT)

Value Added Tax (VAT) is a tax on consumer expenditure introduced in Kenya in January 1990 to replace Sales Tax. VAT is levied on consumption of taxable goods and services supplied or imported into Kenya and is collected by registered persons at designated points who then remit it to the Commissioner.

The general rate of tax is at 16% and payable by the 20th day of the month following the month of transactions. This is done on a monthly basis where a complete sale should be accompanied by an invoice and an ETR receipt or an ESD signature. A purchase also should be accompanied by an invoice with an ETR for it to qualify to be a valid input invoice. However not all goods and services are subject to VAT at 16%. Some are VAT exempt while others are charged VAT at zero percent (zero rated)

Failure to account for, file the VAT and making of payment for the VAT due attracts a penalty of Kshs. 10,000.

With the approval of the Finance Bill 2018, VAT on petroleum products was become effective from 1st of September 2018 at a rate of 16% and from 21st September the new rate 8% become effective.

2. Excise Duty

This is a duty imposed on goods and services manufactured in *Kenya* or imported into *Kenya* as specified in the 5th. Schedule of the Customs and Excise Act Cap 472 of the 0. Laws of *Kenya*. The *Excise duty* on locally manufactured excisable goods and services is payable to the Commissioner of Domestic Taxes at the rates specified in the 5th Schedule.

Excise duty on imported goods and services is accounted to the Commissioner, Custom Services Department. All manufacturers, providers and importers of excisable goods and services should pay excise duty and must be licensed by the Commissioner, Domestic taxes upon application and payment of the prescribed fees. The licenses are renewable each year before 31st of December.

A person, who fails to file a return, is liable to a default penalty of Kshs. 10,000 or 5% of amount of duty payable, whichever is higher as provided for under section 96 of the Customs and Excise Act. This in addition to interest of 2% per month or part thereof charged on the amount that remains unpaid.

Failure to comply with the law and regulations under the Customs and Excise Act can attract a fine of up to Kshs. 1.5 Million and/or a prison term not exceeding 3 years and the goods in respect of which the offence has been committed are liable to forfeiture.

Excise duty on services

Excise duty on telephone and data services, fees charged by financial institutions and money transfer services fees were revised as follows;

	New Rate	Old Rate
Fees charged on money transfers by banks, mobile operators and other financial providers	20%	10%
Telephone and internet data	15%	10%
Other fees charged by financial institutions	20%	10%

Presumptive Tax

This is a tax payable by a resident person whose turnover from business does not exceed Kshs. 5 million during a year of income. The Income Tax Act relating to turn over tax have been repealed and replaced by presumptive tax.

Persons liable to pay a Presumptive Tax shall be -

- Resident persons whose gross turnover from business does not exceed Kshs. 5 million during a year of income; and
- Who are issued or are liable to be issued with a business permit or trade license by a County Government.

The rate of presumptive tax shall be amount equal to 15% of the amount payable for a business permit or trade license issued by a County Government and it shall be a final tax.

The due date for payment of the tax shall be at the time of payment for the business permit or trade license or renewal of the same.

Exceptions

The Presumptive Tax regime will not apply to:

- A person whose income is exempt from tax under the First Schedule of Income Tax Act and has a valid exemption certificate.
- A person who would otherwise pay tax under this regime but elects by notice in writing to the Commissioner not to be subjected to the Presumptive Tax.
- A resident person whose gross turnover from business exceeds Kshs. 5 million in a year of income
- Any income derived from -

i. Management and professional services; or
ii. Rental business; or
iii. Incorporated companies

NB:The Taxpayers under Presumptive Tax Regime are not required to file a tax return on the income from the business that qualifies under presumptive tax regime.