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Happy Holidays

TAXATION OF RESIDENTIAL RENTAL INCOME

Newsletter

MBAYA AND ASSOCIATES December 2018 | Issue 042 | Volume 4

Introduction

Welcome you to our twelfth and final edition of year 2018 tax newsletter. The newsletter covers a variety of the recent changes in the tax regime in Kenya to keep you current and updated on tax matters and the latest in business trends.

On the right column of the newsletter you will find contact details for the senior members of our team who can help answer any questions you may have about the issues highlighted in this newsletter or any other questions.

We are interested in your feedback on the items covered and what topics you would like covered in the future.

Please provide any feedback at **tax@mbaya.co.ke**

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Being our final edition for the year, allow us to thank you for your continued support over the year. Despite a difficult macro-economic environment, we have plenty to be thankful for. We also take this opportunity to wish you and your loved ones a merry Christmas and a pleasant festive season.

» MBAYA & ASSOCIATES

In this issue

From the Tax Desk

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From the TaxDesk

Taxation of Residential Rental Income

KRA have stepped up efforts to bring all landlords into the tax net. Rental income is taxable under section 3(2)(a)(iii) of the Income Tax Act, cap 470 laws of Kenya.

Rental Tax: Brief History

The law has been in existence though most taxpayers have been reluctant to disclose their rental income. However, in the year 2015, KRA gave a tax amnesty to landlords. For a taxpayer to qualify for this amnesty, they needed to fulfil the following conditions:

- Correctly declare the rental income and pay the principal tax for 2014 year of income.
- Correctly declare the rental income and pay the principal tax for 2015 year of income.

If the taxpayer correctly declared the income and paid the principal Tax, the taxman would waive all the penalties and interests for the two years (2014 & 2015) and would give amnesty to the taxpayer's undeclared income for years 2013 and prior.

The taxpayer would then be allowed to proceed and declare the rental tax on a monthly basis from January 2016 going forward

Residential Rental Income Tax: KRA Perspective

Although the amnesty period expired, KRA is strongly encouraging taxpayers to voluntarily continue disclosing their rental income. Failure to disclose the income will lead to imposing of estimated assessments by KRA. This is usually coupled with interests and penalties which are enforceable by law.

How is Residential Rental Income Taxed?

The Finance Act 2015 introduced the Rental Income Tax effective January 2016, the tax payable is at a flat rate of 10% on the gross rent. This is a final tax and the income is not subject to any other form of tax.

The income should be disclosed on a monthly basis and the tax paid on or before the 20th day following the month of disclosure.

This form of tax applies to all residential rental incomes below Kshs. 10 Million per year. If a taxpayer receives such an income but prefers not to migrate to the new platform, they are supposed to notify the Commissioner in writing. The Commissioner should approve or reject the request in sixty days' failure to which he shall be deemed to have accepted the request.

Note: For residential rental income tax of Kshs. 10 Million and over, the income should be declared using the old regime where expenses are claimable and a tax rate of 30% for companies and graduated scale for individuals applies.

Residential rental income tax is not subject to VAT. VAT only applies to Commercial rental income at a rate of 16%. Disclosure, filing and payment processing of this tax are done on iTax. The payment is completed either through the bank or Mpesa.

Tax Evasion & Avoidance

Tax evasion is an **illegal** practice where taxpayers deliberately give misrepresenting information which does not reflect the true state of their affairs to the tax authorities. This practice aims to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts earned, or overstating deductions.

This practice is mostly associated with the informal sector. One measure of the extent of tax evasion is the amount of unreported income, which is the difference between the amount of income that should be reported to the tax authorities and the actual amount reported.

In contrast, tax avoidance is the legal use of tax laws to reduce one's tax burden. It is the use of legitimate methods to reduce the amount of income tax one owes the tax authorities.

Common examples of tax avoidance include:

- Contributing to a retirement fund
- Taking advantage of tax free employment benefits like per diems, meals, medical, mileage etc.
- Contributing to home ownership savings plan - 48,000 per year for first ten years.
- Contributing to life, health & education insurance policies
- Taking advantage of mortgage relief.

Assets and Liabilities

The normal definition of an asset is a resource with economic value that an individual, corporation or company owns and controls with the expectation that it will provide a future benefit.

On the contrary a liability is defined as a company's legal financial debts or obligations that arise during the course of business operations. These are settled over time through the transfer of economic benefits including money, goods or services.

Is there another way of looking at an asset / a liability?

Certainly there is. Let us look at this from a different angle and we will introduce this by way of few simple questions.

- Is your home an asset?
- Is your car an asset?
- Why is it that you can find someone who owns a property in a prime area by virtue of the value of the land can become bankrupt when a deadly disease kicks in?

> The answer is simple. A person can be rich in paper but poor in cash flow.
>
> Therefore, the simple but controversial difference between an asset and a liability is that **an asset puts money in your pocket while a liability takes money from your pocket**. This means if an asset is taking money from your pocket without giving back the same or more

in returns; it is therefore reducing your cash flow, and then qualifies to be a liability - Robert T. Kiyosaki

Accountants and auditors always do their best to make thousands and millions of shillings' balance in the statements of financial position, comprehensive income the cash flow.

However, most of the taxpayers pay little attention to the cash flow, though this is what speaks the loudest when it comes to flow of cash in an organization. In fact, most of the investors check on the cash flow statement before making a decision on which organization to invest in.

Cash Flow Management

Cash flow forecasting is the modelling of a company or entity's future financial liquidity over a specific timeframe. Cash usually refers to the company's total bank balances, but often forecast is the treasury position which is cash plus short-term investments minus short-term debt. Cash flow is the change in cash or treasury position from one period to the next period.

This is a key aspect of financial management of a business, planning its future cash requirements to avoid a crisis of liquidity. It is important because if a business runs out of cash and is not able to obtain new finance, it will become insolvent. Cash flow is the life-blood of all businesses particularly start-ups and small enterprises.

In summary, the lag between the time you have to pay your suppliers and employees and the time you collect from your customers is the problem, and the solution is cash flow management.

Points to Consider on Cash Flow Management

- Managing Payables: - One should take note of anytime the expenses grow faster than sales, examine costs carefully so as to find places to cut or control them.
- Improving Receivables: - This involves improving the speed with which you turn materials and supplies into products, inventory into receivables, and receivables into cash.
- Measure your cash flow: - an accurate cash flow projection can alert you of the trouble well before it strikes.

Benefits of Cash Flow Management

a) **Liquidity**; with cash in hand, you'll have access to the liquidity you need to handle fluctuations in your day-to-day business needs.

b) **Productivity**; when cash flow is under control, you'll actually spend less time managing business finances such as accounts receivable, accounts payable, and bank deposits. This can free up more time to devote to key accounts, customer service, and new business development opportunities.

c) **Re-invest in your Business**; improved cash flow can help you put more of your hard-earned money back into your business. You'll have more opportunities to add employees, expand current assets, build new facilities, and invest in new processes and technologies to make your business more productive, profitable and competitive.

d) **Reduce Debt**; more cash in hand allows you to pay down debt, reducing monthly financial commitments such as high-interest rates and potential late-payment fees.

e) **Peace of Mind**; meeting the needs of clients, employees and vendors is stressful enough. Knowing you have available cash can give you the peace of mind to know your business finances are ready for whatever opportunities or challenges lie ahead.

Conclusion

Even though a business may be trading profitably, it can still fail as a result of poor cash management.

Therefore, businesses need to manage their cash flow since it's an instrument that provides information about the magnitude and composition of a company's cash generating power.

Top 10 Advantages of Outsourcing Accounting and Bookkeeping Services

Do you feel like your market competitors are growing faster than you are in the areas of information technology support, skills, education, and knowledge of resources or overall economic situation? They may be on the edge of snatching your clients!

Profit is definitely one of the key aspects of business growth and expansion, but it is not the only aspect. Growth changes your life and everyone else's who are in one way or another associated with the business and it gives your business an improved status and brand image in the market.

Outsourcing accounting and bookkeeping services is not just about cost-saving. Here are the top 10 advantages of outsourcing accounting and bookkeeping services from Mbaya & Associates

1. You can grow and sustain your firm faster and stronger by outsourcing accounting services.

One of the major reasons to hire M&A is that you can have more time on your hands to increase your efficiency, grow your firm and operations, and maximize your return on investment (ROI) on the core competencies of your business. You can use this extra time to try to bring in more clients, by improving your marketing efforts and customer services, as you won't have to worry about hiring, training, managing, reviewing, firing, and more. Outsourcing CPA or accounting services is most likely to reduce your costs

2. You won't lose any new projects or clients due to being overburdened.

The best part about outsourcing accounting and bookkeeping services is that you now have a team of highly-qualified and experienced accountants on your call. Therefore, your ability to deliver services is no longer limited to how much time you can personally put in around the clock. Hence, you can now entertain new projects and clients coming your way with all the help you are getting.

3. You don't have to pay obnoxious overheads; you can just pay for the actual work you need to get done.

When you are outsourcing accounting and bookkeeping services, you are naturally signing up to pay only for the actual work you need to get done. In your business operations, it means that you no longer have to pay for the overhead, vacation, sick leaves, payroll taxes, training and other expenses of the accounting department. Hence, you can significantly increase your profit margin and also enable yourself to get more work done at any point in time.

4. Outsourcing your accounting and bookkeeping services helps you lessen the risk of suddenly losing your employees.

If you have been running your business long enough, you may have found yourself in a situation where your staff had left suddenly. Most small and medium businesses cannot afford to have a buffer staff in case of such incidents. Luckily, when you hire accounting or bookkeeping services, you don't have to worry about such situations, as their business nature requires them to have an expert, qualified and experienced team that is reliable and ready with an effective backup. We check and then double-check each other's work before forwarding it to you, which makes certain that you continue to get the same standard quality of work.

5. Improve your work productivity and enjoy a standard quality check.

Many businesses feel frustrated with the delays, errors and review requirements of their in-house accounting team, which they believe is money and time wasted for no reason. However, outsourcing such services helps change this, as you can be more stringent with your service provider and demand quality and efficient work, which were mutually agreed upon. This will even help you grow your operational productivity and business profit.

6. Enable yourself to provide your clients better quality services.

We have much-diversified experience by working for multiple companies. Outsourcing services from us means getting some of the best CPA brains working for your interest and training your employees can be the best thing you can hope for. These benefits can turn out to be the reason for your competitive edge in the market.

7. Outsourcing CPA and accounting services allows you to introduce some new services to your customers.

If you had always wanted to introduce some new services to your customers but could never take the initiative because of lack of time and expertise available, hiring outsourced services can really help you change that. You can introduce new services to your customers, which is just like adding new sources of revenue and making the best use of your in-house and outsourced capabilities and expertise.

8. Easily adjust your outsourced workload to fit your business structure and cycles.

Usually, businesses have accounting and bookkeeping workloads during their specific business cycles that depend on their business structure. Outsourcing such services allows you to easily cut back or increase the staff working for you, depending on what time of the business year it is. It enables you to enjoy the flexibility that is otherwise pretty hard to achieve.

9. You get to earn more without having to work more yourself.

The basic idea of outsourcing accounting and bookkeeping services is that you get to make more money by cutting back expenses, without having to put in more work and effort from your side. First, you save money by cutting down expenses like paying part-time or full-time wages and additional benefits to the staff and other department overheads. Moreover, you earn more and enjoy efficiency by utilizing the time and expertise of a complete team.

10. You get to increase your firm's valuation because of higher profitability.

When businesses are bought and sold, the involved parties carefully determine the value and profitability of the business being bought. Firms that are outsourcing their accounting and book keeping services are likely to be more profitable than other firms that don't outsource. It basically increases a firm's valuation, which can be very helpful for them in various situations such as when trying to raise borrowed funds from banks.

Tax Due Dates

Withholding Tax | 20th Day of the following month
Pay as You Earn | 9th Day of the following month
VAT | 20th Day of the following month
Balance of Tax on Self-Assessment | 4th Month after year end
Monthly Rental Income | 20th Day of the following month

KENYA REVENUE AUTHORITY

Instalment Tax

1st Instalment |20th day of the 4th month after year end
2nd Instalment | 20th day of the 6th month after year end
3rd Instalment | 20th day of the 9th month after year end
4th Instalment | 20th day of the 12th month after year end
Kindly note that all the returns must be filed on I tax while the payments e-slips must be generated from the I-Tax platform.