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10 RISKS MITIGATION MEASURES FOR SMEs

Newsletter

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Introduction

We welcome you to the ninth edition of our tax newsletter. In this issue we share with you some key highlights on changes in the issuance of Tax Compliance Certificates, Verification of Exempt Capital Gains Tax transactions, capital allowances and some top six ways of building meaningful business relationships.

You will find our contact details on the right column. Senior members of our team will assist you by offering clarity on the issues highlighted in this newsletter or any other questions.

We are interested in your feedback on the items covered and please let us know the topics you would like us to cover in the coming days.

Feel free to provide any feedback at **tax@mbaya.co.ke**

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» VERIFICATION OF EXEMPT CAPITAL GAINS TRANZACTIONS

In this issue

From the Tax Desk

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From the *Tax***Desk**

Changes in the issuance of Tax Compliance Certificates

In the May edition, we highlighted the changes that KRA have put in place to improve the issuance of the Tax Compliance Certificates (TCC). The changes included an automatic issuance of the TCC where the ledger for the taxpayer showed no tax balances. This position still stands but applies only to taxpayers who have applied and received the PINs under the iTax system only.

If the PIN was applied and received prior to the iTax system, the application has to go through several bureaucratic stages. KRA checks the company and its' directors i-Tax accounts to make sure all taxes are paid. KRA also checks the old (legacy) system for both the company and its directors and if any returns were not filed and taxes paid, the taxman now insists that the returns be filed and taxes paid before the issuance of the Tax Compliance Certificate.

Where there is proof of filing/payment through manual returns, the taxpayer is supposed to furnish KRA with proof of return/payment to be used for data correction.

The changes above have resulted in delays in issuance of the certificates which has led to a public outcry due to the missed business opportunities. We urge all our clients to confirm the validity of their Tax Compliance Certificates (TCC) apply for the TCC's in good time to avoid the last minute rush.

Verification of Exempt Capital Gains Tax Transactions

KRA has implemented various changes in the process of applying for an exemption from paying Capital Gains Tax (CGT) for purposes of transparency and efficiency.

Previously, there was no way of verifying the information given by an individual when applying for an exemption from payment of CGT. The system relied entirely on the personal assessment made by the taxpayer. KRA recently announced a new move in a bid to streamline the process and avoid fraudulent declarations.

Going forward, a KRA official must physically verify all transactions where an exemption from CGT has been applied for on the following grounds:

a) Value of the land not being above three million shillings (Kshs. 3,000,000)
b) Agricultural land which measures less than fifty (50) acres
c) Transfer of property from the estate of a deceased person.

Stamp duty will not be paid before verification by the KRA official and the verification will involve physical attendance to the KRA office by the Vendor or the Purchaser or the Advocates acting on their behalf in that transaction.

The verifying KRA official may require further supporting documents which may include transfer or sale agreement, copies of the Vendor's National Identity Card or Passport ID, utility bills and tenant rental agreements (if any).

This process is expected to take upwards of three (3) days assuming the taxpayer complies in time. The payment of Stamp duty will subsequently be made after which the normal registration process will follow.

It is worth noting that the said verification may unearth other tax non-compliance issues on the part of the Vendor/Transferor which may require the Vendor/ Transferor to clear with KRA before payment of Stamp Duty by the purchaser. The requirement to physically visit the KRA offices, the verification of documents and any unresolved tax issues on the part of the vendor may delay the process further beyond the anticipated three (3) plus days.

Currently, CGT is taxed at the rate of five percent (5%) but there is a proposal under the Finance Bill 2019, which is before the National Assembly to revise the CGT upwards to twelve point five percent (12.5%).

Capital Allowances

This is the amount of expenditure that a business may claim against its taxable profit under the Income Tax Act. The general principle is that, unless expressly provided otherwise, expenses are tax deductible if they are incurred wholly and exclusively to generate taxable income.

Depreciation is a non-allowable expense under the act for tax purposes, instead capital allowances are claimable on most assets purchased for use in the business, and the classification of these assets determines whether full or partial value can be claimed.

Some of the objectives of granting capital allowance include attracting investments, encouraging growth of industry and creating employment among others. Capital allowances include **Industrial building deductions**, **Investment deductions**, **Wear & tear allowance**, **Farm works deduction** and **Diminution in value**.

In this issue, we will discuss the Industrial building deductions and Investments deductions. We will also look at the few differences between the two allowances.

a. Industrial Building Deductions

This is an incentive on capital expenditure on the construction of industrial buildings to be used in the production of income. Some civil works also qualify to be part of the industrial building. They include Effluent and sewage works, Water and industrial fencing, Communications and electrical posts including other electricity supply works, Security walls and roads including parking areas, Railway line and related structures & Water and industrial fencing

In connection to the above:

1. Dwelling house for employees is also an industrial building
2. Construction of an industrial building includes the expansion, substantial renovation or rehabilitation of an industrial building, but does not include routine maintenance or repair.
3. Offices, retail shops, showroom are not part of an industrial building but if the cost of construction of this part is less than 10% of the total cost of construction then the whole building becomes an industrial building.

The businesses in the following fields enjoy Industrial Building Allowance at the following rates

i. **Educational Institutions:** Hostel or an educational building, or building in use for training, provided such building has been certified by the commissioner. The applicable rate is **50%**

ii. **Hotels:** Hotels certified by the Commissioner to be an industrial building including any building directly related to the operations of the hotel contained within the grounds of the hotel, including staff quarters, kitchen, entertainment and sporting facilities. The applicable rate is **10%**

iii. **Mill/Factory/Storage Facility:** Factory building used solely for the manufacture or storage of manufactured goods. The applicable rate is **10%**

iv. **Film Industry:** Building in use for the training of film producers, actors or crew and purchase of filming equipment by a local film producer licensed by the Minister responsible for matters relating to communication. The applicable rate is **100%**

v. **Construction:** Rental residential building constructed in a planned development area approved by the Minister where roads, power, water, sewers and other social infrastructure have been provided by the person incurring the capital expenditure. Capital expenditure on the construction of a commercial building, where roads, power, water, sewers and other social infrastructure have been provided by the person incurring the expenditure.

vi. The applicable rate for both the residential and commercial buildings as stated above is **25%**

b. Investment Deductions

This is an allowance extended on buildings and machinery used for manufacture and certain hotels. The deduction is given only once during the year of first use of the qualifying asset. **Manufacturing** includes making of goods from raw or partly manufactured material or other goods. This does not extend to activities such as design, storage, transport or administration.

Just like Industrial Building Deduction (IBD), civil works such as Water and industrial fencing, Communications and electrical posts including other electricity supply works, Security walls and roads including parking areas, Railway line and related structures & Water and industrial fencing also qualify.

''**Machinery**'' means machines and equipment used directly in the process of manufacturing, and includes machinery and equipment used in Generation, transformation and distribution of electricity, Clean up and disposal of effluent and other waste product, Reduction in environmental damage and Water supply or disposal.

The rate of Investment deductions eligible for building and machinery used for manufacture is **100%.** For qualifying investments exceeding **200** million, the rate of Investment deductions is **150%** provided the investment are outside the municipalities of Nairobi, Mombasa and Kisumu.

Below are some differences between the two capital allowances highlighted above.

	Industrial Building Deductions	Investment Deductions
1.	The deduction is allowed on buildings only.	The deduction is allowed on both buildings and machinery.
2.	The deduction is allowed at the rate provided until the 100% is exhausted.	The deduction is allowed at the rate provided only once on the first year of use on qualifying asset.
3.	The maximum allowance granted is 100% all over the country.	The maximum allowance granted is 100% but investments of over 200 million outside Nairobi, Mombasa & Kisumu; the allowance is extended to 150%.

Ten Risk Mitigation Strategies for SMEs

Each enterprise should have risk mitigation strategies to prepare in case of death, loss or injury of a key person.

1. Document Sensitive Information

It is important to document and keep in safe place critical information that is necessary for the effective running and operation of the firm. This information may include:

a. Client agreements and arrangements;
b. Employee agreements and arrangements;
c. Supplier agreements and arrangements;
d. Personal guarantees provided and to whom;
e. Bank and finance arrangements;
f. Lawyer's name and contact details;
g. Intellectual property residing within or developed by the firm; and
h. Recommendations for ongoing management of the firm.

2. Maintain Adequate Insurance

It is important to maintain adequate insurance to cover the firm. It is prudent to ensure that the firm has adequate insurance to cover each partner and to provide the funds to pay out the estate for the partner's share of the firm in the event of their death. The prudent firm will insure their key human assets just as they do their physical assets.
Important insurance coverage to hold includes:

a. "Key person" insurance;
b. Partnership/shareholder insurance (this provides for payment to the survivors of the partner);
c. Business equity insurance (it is important that the business equity insurance policy is supported by a "buy/sell agreement," as discussed below).

3. Ensure there is a Valid "Buy/Sell Agreement"

If there are partners in the firm, it is important to ensure there is a legally drawn and valid "buy/sell agreement." This outlines the terms and conditions agreed upon between the partners for the purchase or sale of their share in the firm. It should be confirmed that it has been reconciled with the partnership/shareholder insurance coverage to ensure there is no shortfall.

4. Inform Bankers and Suppliers

It is important to consider beforehand what might be the reaction of bankers, other lenders and suppliers to the death or incapacitation of a partner of the firm. For instance, would they be prepared to continue with their financial arrangements, or would they call up their debt? Consideration would need to be given to whether the firm has sufficient financial reserves to cover such a situation.

5. Ensure Adequate Training of Staff

Appropriate training should be provided to staff in the key areas of management and the operation of the firm so that it is not totally dependent on one partner. The PM Guide includes a whole module 'People Power: Developing a People Strategy', which covers leadership, managing and retaining employees, recognition, training and development.

6. Ensure Procedures Manual Written and Maintained

It is vital to the ongoing operation of the firm that a procedures manual has been prepared which fully documents the procedures, processes and operations of the practice. It needs to be maintained and kept current. This means the firm is able to continue to operate during the death or incapacitation of the practitioner until certainty as to its future is known. The procedures manual also becomes a key document in any valuation process which is undertaken, as it tends to add value to the firm by reducing reliance on one partner.

7. Ensure Job Descriptions Are Completed

It is important that job descriptions have been completed for all roles within the firm and that each staff member is clear on the tasks they are to perform.

8. Undertake Regular Staff Appraisals

Regular staff appraisals allow staff to stay informed of their progress and development within the firm and provides the opportunity to provide feedback on their performance. It also provides the opportunity to advise the staff member of the steps that should be taken if a partner were to die or become incapacitated.

9. Partnership Issues

If there are partners within the firm, it is important they clarify what will happen in the event of either their death or their incapacitation.

10. Other Business Relationships

It is important to understand whether the untimely death or incapacitation of a partner would unduly affect any other business relationship that the firm has. There should be a documented succession and continuity plan in.

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 | 20^{th} 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.