AUGUST 2022 | 8.86

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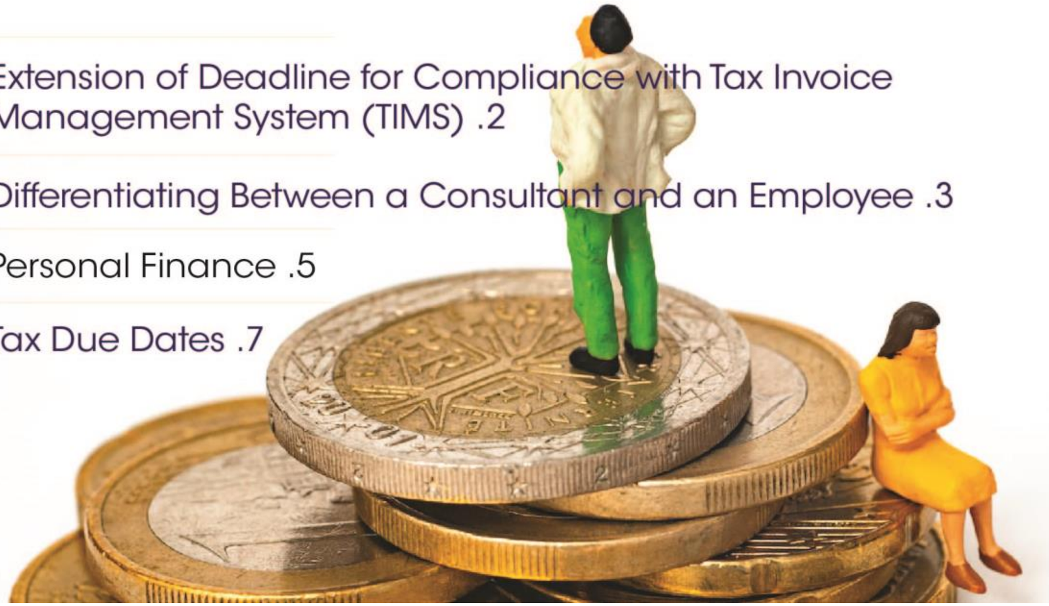
Fringe Benefit Tax and Deemed Interest Rate



Newsletter

MBAYA AND ASSOCIATES August 2022 | Issue 086 | Volume 8

Introduction

We are pleased to release the eighth edition of our tax newsletter. We appreciate the lively feedback and fruitful engagement we have had in the previous editions of our newsletters. This issue summarizes some developments in world of tax in the Kenyan regime, an update on the VAT TIMS compliance and a bit of the personal finance management.

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

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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Fringe Benefit Tax and Deemed Interest Rate

Fringe Benefit Tax (FBT) | This is a tax applicable when employers provide loans to their employees and charge an interest lower than the prescribed rate (ITA-section 12(b)). This becomes a benefit to the employee, for which the employer needs to file and pay Fringe Benefit Tax. FBT is paid by the employer at the corporate tax rate of 30 % on total taxable value each month. The tax is payable on or before the 9th day of the following month to KRA.

For the purposes of Section 12B of the Income Tax Act, the Market Interest Rate is 8%. This rate is applicable for the three months of **July**, **August** and **September 2022**.

Deemed Interest Rate | This is the amount of notional interest assumed to be payable by a resident person in relation to any outstanding loan provided or secured by a non-resident person, where such loan has been provided interest free.

For purposes of section 16(5), the prescribed rate of interest is 8%. This is applicable for the months of **July**, **August** and **September 2022**.

Please note that the rates above have been increased by 1% from the last quarter ended June 2022

Withholding tax rate of 15% on the deemed interest shall be deducted and paid to the Commissioner by the 20th day of the month following the month of computation.

Low Interest Benefit | For purposes of section 5(2A), the prescribed rate of interest is 7%. This is applicable for the months of **July**, **August**, **September**, **October**, **November** and **December 2022**. This rate remains unchanged from the past half of the year.

The above rates have been published by a notice by KRA dated 1st August 2022. We hereby urge all our clients to adhere and adjust to this rate so as to remain compliant.

An example of a Fringe Benefit Tax computation: On 1st August 2022, an employee gets a loan of Kshs 3million from his/her employer at a rate of 5%. FBT will be calculated as follows:

Loan amount	Kshs. 3,000,000
Interest charged	5% per annum
Market Interest rate for the month	8% per annum
Fringe Benefit Rate on saving by employee	8% - 5% = 3% per annum
Fringe Benefit	3, 000,000 x 3% =90,000 per Annum; that is, Kshs. 7,500 per Month

- Fringe Benefit tax payable by the employer for the month of August 2022 is therefore Kshs. 2,250 (7,500 x 30%).
- The tax should be payable by the 9th of September 2022 together with the PAYE for the same month of August 2022.
- The FBT computation should be done and tax paid monthly using the applicable rates until the loan has been cleared in full.

Extension of Deadline for Compliance with Tax Invoice Management System (TIMS)

Through a public notice dated 2nd August 2022, the Kenya Revenue Authority (KRA) has extended the deadline for the requirement by taxpayers to comply with regulations of Tax Invoice Management System (TIMS) to **30th September 2022**. The extension of deadline is an administrative decision necessitated by taxpayers' request for more time to acquire and activate their TIMS devices in compliance with Electronic Tax Invoice (ETI) Regulations that were gazetted on 25th September 2020, Legal Notice 189.

The overall objective of the introduction of TIMS vide VAT (Electronic Tax Invoice) Regulations, 2020 is to increase VAT compliance, minimize on VAT fraud and increase tax revenue.

VAT registered taxpayers are required to fully transition to use Electronic Tax Registers that meet the requirements outlined in the Regulations.

An updated list of the authorized / approved ETR suppliers can be found from the KRA website using this link https://kra.go.ke/images/publications/List-of-Approved-ETR-Suppliers--Manufacturers-as-at-JUNE-2022.pdf

We recommend that all VAT registered taxpayers to consider migrating to TIMS before the extended time lapses. Our interactions with KRA suggest that they were unwilling to extend the deadline but because of the last-minute push they had to extend it. They have intimated that they will not extend the deadline again. Let us try and comply early.

Differentiating Between a Consultant and an Employee

The Employment Act distinguishes between the contract issued to an employee and that given to a consultant. A contract of service as defined in the Act relates to the employer-employee relationship. Under such an arrangement:

- The employer controls the work to be done as well as the manner in which it is done.
- The employer defines the working hours and job description of the employee, has power of selection and dismissal, and pays the employee a regular wage or salary.
- A person working under a contract of service is deemed by law to be an employee with all the associated obligations and benefits.

On the other hand, a contract for service is issued to an independent contractor, also known as a consultant.

- Such an individual is an expert in his field and although the scope of work is clearly outlined to him.
- He is left to determine how he will carry out the assignment.
- The employer's control over his work is therefore greatly diminished.
- The consultant's fee is paid at such a time and in such a manner as will be mutually agreed upon in the contract.

Aside from the above specifications, it is also noteworthy that work that forms an integral part of the business will normally be classified under a contract of service while work that is merely an accessory to the business will be deemed to be a contract for service. The duration of the contract is not material. Granted, there is a thin line separating a contract of service from a contract for service. However, the classification under either of these categories is important because it determines the taxation of the associated income.

Taxation of Consulting and Employment Income

Under the Income Tax Act, income earned by an individual employed under a contract of service is subjected to a tax known as Pay as You Earn (PAYE) on a graduated scale if the income was derived in Kenya.

A management or professional fee is payment made to any person, other than a payment made to an employee by his employer, as consideration for professional or consultancy services rendered under a consultancy or contractual agreement. Withholding tax is charged on such income at a rate of 5% for residents and 20% for non-residents in a country that does not have a double taxation agreement with Kenya.

Implications of Treatment

An employer cannot run away from the obligations placed on him by calling a person, who in essence is an employee, a consultant. This means you cannot make a person a consultant by giving him a consultancy agreement. In this case, the Kenya Revenue Authority (KRA) will choose the substance over form of the agreement, meaning the essence of the agreement and its nature will determine its tax treatment.

This was the case in *Everett Aviation Limited v. Kenya Revenue Authority (2013)* whose ruling considered the substance of the agreement and ruled in favour of an interpretation that led to a fair computation and collection of tax, in this case, PAYE.

Personal Finance

In our sixth edition of our newsletter, we introduced this subject and discussed how to start your journey to financial freedom.

In this edition we discuss in a broader perspective the first stage to consider as you start the journey. It's called Income. We can break this into two: **Taking an honest look at your entire financial situation** and then **determine your financial goals.**

a) **Taking an honest look at your entire financial situation** | You can never take your next steps without knowing where you're starting from. A journey to financial comfort is no different. You'll need to figure out on paper your current situation. State on one side of paper what you own and on the other side what you owe so as to create your net worth.

What you own will represent your assets while what you owe will represent your liabilities or debts. Subtract your liabilities from your assets. If your assets are higher than your liabilities, you have a "positive" net worth. If your liabilities are greater than your assets, you have a "negative" net worth.

You'll want to update your "net worth statement" every year to keep track of how you are doing. Don't be discouraged if you have a negative net worth. A negative net worth will in most cases be due to debts from loans.

Having a debt-free life is a desirable dream for most individuals. There are two ways to pay off your debt fast. One way is to identify the loan with the highest interest rate and pay this off first, hence reducing the amount of interest you will need to pay in the long term.

Once this debt is cleared, you can then focus on paying off the loan with the second highest interest rate, and so on. An alternative approach is to pay off all small debts first and then focus on the larger loans.

If you follow such a plan you will get to a positive net worth position and you're doing the right thing.

b) **Determine your financial goals** | What do you want to achieve and by when? What do you want to save for? Is it

- A car?
- Education?
- A home?
- Investments?
- Medical emergencies?
- Retirement or potential loss of business or employment?...... Just to name a few.

Make your own list and think about which goals are the most important to you.

List your most important goals first and following the order of preference while still separating the long term from the short-term goals.

Decide how many years you have to meet each specific goal because when you save or invest, you'll need to find a savings or investment option that fits your time frame for meeting each goal. At this point you may engage a financial advisor for some more advice so that you can me the most well-informed decision.

Please note that if you don't know where you are going, you may end up somewhere you don't want to be.

To stay on the right course especially with the above two points, you'll need a roadmap to get there; **a financial plan, a Budget**.

In our next issue, we will further discuss on how to come up with an affordable, realistic and effective budget to help you move deeper and achieve your financial freedom. As we stated previously, the most important thing is to get started. Better late than never. START.

Keep in touch with us in our next publication and lean more on our next topic on personal financing.

You need such a service? Get in touch with us and we can begin your journey to financial freedom.

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.

Digital Service Tax (DST)

20th day of the following month

Minimum Tax

Applicable where minimum tax is higher than instalment tax payable
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