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Upgrade of the Tax Invoice Management System (eTIMS)

Newsletter

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Introduction

Receive our March 2023 greetings. We are pleased to release the third edition of our tax newsletter as we appreciate the favour and blessings to run our organizations. We have had a lot of feedbacks and engagements in our previous editions and we hope for the same this month

This edition covers the capital allowances and the recent important developments in Kenya's tax landscape. We are grateful for your interaction and are happy to be of service to you.

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 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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Contacts

Head Office
3rd Floor, Western Heights

Karuna Road, Westlands
P. O. Box 45390 – 00100
Nairobi, Kenya

Tel. +254(20)4443868
254 20 4448938
254 20 4446466

Fax: 254 20 4449819

Mike Mbaya | Managing Partner
Email: mike@mbaya.co.ke

Muhungi Kanyoro | Partner
Email: mkanyoro@mbaya.co.ke

Andrew Bulemi | Partner
Email: abulemi@mbaya.co.ke

Leah Nganga | Partner
Email: lwambui@mbaya.co.ke

Abner Fundi | Outsourcing Dept. Manager
Email: abner.fundi@mbaya.co.ke
Kevin Njenga | Tax Manager
Email: knjenga@mbaya.co.ke

Darlyn Mbaya | Manager and Partner

Savanna Associates

Email: darlyn@mbaya.co.ke

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Upgrade of the Tax Invoice Management System (eTIMS)

Through a public notice dated 28th February 2023, Kenya Revenue Authority (KRA) informed the public of the commencement of phase two of the Tax Invoice Management System (eTIMS).

This phase will involve rolling out of the software version of the system to provide additional ways of transmitting electronic invoices to KRA on a real-time basis. The software will be provided by KRA to taxpayers at no additional cost.

This latest version will be available through the following avenues:

- Use of an online portal to issue tax invoices and have the same transmitted to KRA on a real-time basis.
- An application to run on mobile phones through which taxpayers will issue tax invoices.
- An application that will facilitate integration with businesses that will prefer to continue using their existing billing system.

Capital Allowances

These are tax incentives offered for capital expenditures incurred by a company. They include wear and tear allowances, industrial building deduction, investment deduction and farm-works deductions.

In the recent past, we have received request on clarifications as to the rates applicable for the different tax matters. Below we have analysed the various allowances as outlined by the Finance Act 2021 which was assented on 29th June 2021. The changes below however came to effect from 1st January 2022. The current prescribed rates are listed as follows:

Investment allowance on buildings applicable to the year of income ended April 2020 onwards.	Rate
Hotel buildings	50% in the first year of use and then 25% per year on the residue on straight line basis.
Building used for manufacture	50% in the first year of use and then 25% per year on the residue on straight line basis.
Hospital Buildings	50% in the first year of use and then 25% per year on the residue on straight line basis.
Petroleum or gas storage facilities	50% in the first year of use and then 25% per year on the residue on straight line basis.

Investment allowance on buildings applicable to the year of income ended April 2020 onwards.	**Rate**
Educational buildings including student hostels	10% per year on a straight-line basis.
Commercial buildings	10% per year on a straight-line basis.

Investment allowance on machinery applicable to the year of income ended April 2020 onwards.	**Rate**
Machinery used for manufacture	50% in the first year of use and then 25% per year on the residue on straight line basis.
Hospital equipment.	50% in the first year of use and then 25% per year on the residue on straight line basis.
Ships or aircraft	50% in the first year of use and then 25% per year on the residue on straight line basis.
Motor vehicle and heavy earth moving equipment.	25% per year on a straight-line basis.
Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines.	25% per year on a straight-line basis.
Furniture and fittings.	10% per year on a straight-line basis.
Telecommunication equipment.	10% per year on a straight-line basis.
Filming equipment by a local firm producer licenced by the Cabinet Secretary responsible for filming.	25% per year on straight line basis.
Machinery used to undertake operations under a prospecting right.	50% in the first year of use and then 25% per year on the on the residue on straight line basis.

Investment allowance on machinery applicable to the year of income ended April 2020 onwards.	Rate
Machinery used to undertake exploration operations under a mining right.	50% in the first year of use and then 25% per year on the on the residue on straight line basis.
Other machinery	10% per year on a straight-line basis.
Purchase or an acquisition of an indefeasible right to use fibre optic cable by a telecommunication operator.	10% per year on a straight-line basis.

The following should be put into consideration while computing the investment allowance;

1. In the change of user of a building, the deduction should be restricted to the residual value or the unclaimed amount at the applicable rate.
2. In respect of a hotel, educational or hospital building shall be licensed the competent authority.
3. Building used for manufacture includes any structure or civil works deemed to be part of a building where the structure or civic works relates or contributes to the use of building.
4. Commercial building includes,

a. A building used an office, shop, showroom, go down, storehouse, or warehouse used for storage of raw materials for manufacture of finished goods or semi-finished goods; or

b. Civil works relating to water or electric power undertaking, but does not include an undertaking not carried on by way of trade.

5. Machinery used for manufacture means machinery used directly in the process of manufacture, and includes machinery used for the following ancillary purposes;

a. Generation, transformation and distribution of energy.

b. Clean-up and disposal of effluents and other waste products.

c. Reduction of environmental damage.

d. Water supply or disposal.

e. Maintenance of the machinery, or

f. Scientific research and development.

6. Manufacture means the making including packaging of goods from raw or semi-finished goods, or the generation of electrical energy for supply to the national grid, or the transformation and distribution of electricity through the national grid, but does not include design, storage, transport, administration or any other ancillary activity.

7. Where an item is brought in to use for a business without being purchased or ceases permanently to be used without being sold, it shall be deemed to have been purchased or sold, and the cost or the amount realized shall be deemed to be the market value.

8. Where capital expenditure exceeding three million shillings is incurred on a motor vehicle, other than a commercial vehicle, that capital expenditure shall be restricted to three million shillings.

9. Where the motor vehicle referred to in (8) above is sold, the sale price shall be deemed to be the proportion of the proceeds of sale, having regard to the original purchase price and three million shillings.

10. Where an existing building is extended by further construction, the extension shall be treated as a separate building.

11. Where capital expenditure is incurred on a construction of a building and before that building is used it is sold, the seller shall not be allowed a deduction.

12. Where a person purchases the building referred in (11) above, that person shall be deemed to have incurred capital expenditure on its construction equal to the capital expenditure actually incurred on its construction or the amount paid by him, whichever is lesser.

Tax Allowables and Disallowables

Most companies are at a period of preparing the financial statements and having them audited for the successful filing of the year 2022 returns. This is currently applicable for the companies having accounting dates ended from September 2022 to December 2022.

After the financial statements are complete, there is usually a need to compute on the taxes payable and so that the computed tax is paid after deduction of the already tax paid in advance.

The general principle in Kenya is that, unless expressly provided otherwise, expenses are tax deductible if they are incurred wholly and exclusively to generate the taxable income. In arriving at the most accurate tax payable, certain expenses needs to have a different treatment in the tax computation so as to eliminate expenses that are not incurred in generation of the income for the company.

Some of the expenses that are prone to adjustments in the tax computation are as follows:

- **Depreciation** - No deduction is allowed for accounting depreciation or impairment. However, capital allowances are permitted at varying rates (as indicated above). For certain assets used for business purposes, including buildings and machinery used in manufacturing, industrial buildings and hotels, machinery and plant, agricultural works, and mining, the rates applicable is as indicated above.

- **Start-up expenses** - There is a specific provision allowing the deduction of certain start-up expenses, provided that the required conditions have been met.

- **Interest expenses** - A deduction for interest is allowed only to the extent that the borrowings are used for the purpose of the business. The Act limits the deduction of interest expenses to a maximum of 30% of earnings before interest, tax, depreciation, and amortisation. The interest restriction provisions are not applicable to:

  - banks;
  - Financial institutions licensed under the Banking Act;
  - Micro and small enterprises registered under the Micro and Small Enterprises Act;
  - Microfinance institutions licensed and non-deposit taking microfinance businesses under the Microfinance Act, 2006 or entities licensed under the Hire Purchase Act or non-deposit taking institutions involved in lending and leasing business;
  - Companies undertaking the manufacture of human vaccines;
  - Companies engaged in manufacturing whose cumulative investment in the preceding five years from the commencement of this provision is at least KES 5 billion;
  - Companies engaged in manufacturing whose cumulative investment is at least KES 5 billion, provided that the investment shall have been made outside Nairobi City County and Mombasa County;

- Holding companies that are regulated under the Capital Markets Act.

- **Bad debts** – These are deductible in the year in which the debt has become irrecoverable. These are usually specific bad debts and there should be proof that there have been efforts to try and recover the debts which are now futile. Some of the reasons why it may not be possible to recover the debts is if the debtor has been declared bankrupt, has passed away or has become mentally incapacitated.

- **Charitable contributions** - Donations to qualifying charities and for certain public works are deductible, subject to conditions. With effect from 3 April 2017, the Finance Act, 2017 provides that expenditure incurred by a taxpayer on donations for the alleviation of distress during national disaster as declared by the President will also be deductible expenses for the taxpayer when determining taxable income. As such, the deductible donations will be those made to the red cross, county governments and any other institution responsible for the management of national disasters to alleviate the effects of a national disaster declared by the President.

- **Fines and penalties** - Generally, fines and penalties are not deductible as they are not considered to be expenses incurred for generating profits chargeable to tax.

- **Taxes** - Kenyan income taxes are not deductible while computing income tax of a person.

- **Goodwill** - Cost of acquisition of goodwill and amortisation of goodwill are not deductible as they are capital in nature.

Additionally, there are those expenses that are not automatically allowed or disallowed. The allowances on these expenses are based on the treatment and the nature. Examples are as follows:

- **Excess pension** - The amount allowed is usually Kshs 20,000 per employee per month. If the total contributions for both the employer and employee exceeds this allowance, then the excess employer contribution over and above the limit is disallowed to the employer/company in the annual tax computation.

- **Provisions** - The provisions are not considered real expenses incurred by business in generating its income. A good example is provision for doubtful debts, also referred to as provision for bad debts or the provision for losses on accounts receivable. It is an estimation of the amount of doubtful debt that will need to be written off during a given period. As these provisions are considered non real expenses, they are disallowable for tax purposes.

- Other examples are, provision for leave days, provision of the estimated loss in value of inventory due to obsolescence, provision for depreciation etc.

- **Unrealised Exchange Gain/Loss** – Mostly referred to as paper gains /losses. These are amounts that you are either gained or lost on the securities you've purchased but not yet sold. It can also be as a result of exchange rate of a currency compared to another at a given time. As they aren't realised, they are disallowed in arriving to taxable income.

Other allowable expenses are those which are incurred "wholly and exclusively" for the purposes of running the business. These are allowable for tax purposes, meaning that those costs must be incurred while performing the business. They are also known as business expenses which are deducted from the trading income when calculating the business' profits.

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

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