The Kenyan tax landscape

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When setting up an investment in a foreign country, an understanding of the tax landscape is often the difference between a profitable venture and one that is not. In Kenya, the tax regime is comprised of four main tax heads: income tax, value added tax (VAT), excise duty and customs duty.

Income tax

Income tax is charged on all income that accrues in or is derived from Kenya. The income tax regime is both source-based (meaning all income that was earned from Kenya will be subject to tax in Kenya) and residency-based (meaning income of a person who is considered to be tax-resident in Kenya will be taxed even though such income may not have been earned in Kenya).

The tax provisions are contained in the Income Tax Act (ITA). Types of tax under the ITA include corporation tax, which is charged at the rate of 30 percent of the tax adjusted profits of resident companies, and 37.5 percent of those of branches of foreign companies; employment income tax, which is computed on a graduated scale ranging from 10 to 30 percent; and capital gains tax, at the rate of 5 percent of the gain realized on disposal of certain assets.

Kenya operates a self-assessment tax regime that requires a person subject to tax to compute the tax payable and remit the same to the Kenya Revenue Authority (KRA) on or before the due date. There are, however, certain instances in which tax or a portion thereof must be withheld from payments made by a person:

- Tax on an employee's income is withheld and remitted by the employer under the pay as you earn (PAYE) system.
- Certain payments for which withholding tax (WHT) must be deducted at the prescribed rate and remitted to the KRA. The withholding tax rates range from 3 to 30 percent of the amount that is payable, depending on the nature of the payment and the residency status of the person being paid. Examples of payments that would be subject to withholding tax include management and professional fees, interest and dividends.

Tax rates that are set out in the ITA may be varied by a double tax agreement (DTA) that Kenya is party to and has been operationalized. One of the main aims of DTAs is to prevent the double taxation of the same income in more than one jurisdiction. Kenya has entered into DTAs with 14 countries, and is currently negotiating DTAs with a number of other countries.

VAT

VAT is charged on the supply of taxable goods or services made in Kenya by a registered person. A person who makes or anticipates making taxable supplies in excess of KES5 million annually (US$50,000) is required to register for VAT. The burden of the tax is borne by the final consumer of the goods or services. For VAT purposes, supplies are categorized into five categories:

- Standard-rated supplies, which are supplies made in Kenya that are subject to VAT at the standard rate of 16 percent
- Select fuel products which are subject to VAT at 8 percent
- Zero-rated supplies, which are taxable supplies subject to VAT at the rate of zero percent
- Exempt supplies, which are not subject to VAT at all
- Supplies not made in Kenya, which are outside the scope of the VAT legislation

The tax provisions regarding VAT are contained in the Value Added Tax Act 2013 and regulations issued under it. The Act lists all zero-rated and exempt supplies. All other supplies made in Kenya that are not specifically listed in the schedules of exempt or zero-rated supplies are considered standard rated, and are subject to VAT at 16 percent.

Excise duty

Excise duty is administered by the Excise Duty Act 2015. The duty is charged on the following categories of items:

- Excisable goods manufactured in Kenya by a licensed manufacturer
- Excisable services supplied in Kenya by a licensed person
- Excisable goods imported into Kenya

It has often been referred to as a "sin" tax, because it has traditionally been imposed on goods the consumption of which the government seeks to discourage, such as alcohol and tobacco. However, this is no longer the case, as in recent times excise duty has also been introduced on goods and services that would not be considered taboo, but are taxed with the intention of generating revenue for the government. These include cosmetics and fees charged by banks and other financial service providers.

Excise duty is charged on a specific or ad valorem basis, depending on the particular goods or services that are subject to excise duty, as set out in the schedules to the Excise Duty Act 2015.

Customs duty

Customs duty is tax paid on importation of goods into the country. The East African Community (EAC) - which comprises Kenya, Rwanda, Uganda, Tanzania, South Sudan and Burundi - operates as a single customs union. The customs laws for the EAC Customs Union are administered under the EAC Customs Management Act 2004. The customs duty as determined under the Act ranges from zero to 25 percent of the value of the imported goods as determined under the Act, and is payable on importation of goods by the importer.

Tax incentives

To encourage investment in certain sectors that are a key focus of the government, the tax laws contain a number of tax incentives. For instance, businesses engaged in manufacturing stand to benefit from an investment deduction allowance (IDA) on the construction of buildings and the purchase and installation therein of machinery used for manufacturing. The businesses can claim IDA as a tax-deductible expense at the rate of 100 percent of the capital expenditure incurred. Where a building is constructed or machinery is installed in a building situated outside the cities of Nairobi, Kisumu and Mombasa and the investment is in excess of KES200 million (US$2 million), the IDA available would be at the rate of 150 percent of the capital expenditure incurred.

The government has also sought to promote investment in infrastructure and energy through tax incentives. The Cabinet Secretary for National Treasury and Planning has exempted, from income tax, payments made to non-residents for services rendered under a power purchase agreement, and interest payments on loans from foreign sources for investing in energy or water sectors, roads, ports, railways or aerodromes.

Export processing and special economic zones

There are also a number of tax benefits available to companies that are set up in designated export processing zones (EPZs) and special economic zones (SEZs). EPZs are designated areas for the manufacture of goods for export, whereas SEZs are designated areas where business-enabling policies, integrated land uses and sector-appropriate on- and off-site infrastructure are provided to support businesses. Tax incentives that EPZs enjoy include exemption from payment of income tax for the first ten years of operation, and a reduced rate of 25 percent for the subsequent ten years, after which the standard 30 percent corporation tax rate will apply. During the time that it is exempt from tax, any payments made by the EPZ to non-resident persons shall also be exempt from tax.

Goods and services that are purchased by enterprises operating within an EPZ are are not subject to VAT, excise duty and customs duty. The EPZ regime has been in place for almost 30 years, but has not been a complete success, as EPZ enterprises are precluded from selling more than 20 percent of the manufactured goods within the EAC, which would be a natural market for the manufactured goods. This limitation is one of the main reasons why EPZs in Kenya are unattractive to investors.

SEZ companies enjoy a reduced tax rate of 10 percent in the first ten years of operation, and 15 percent in the subsequent ten years, after which the standard 30 percent corporation tax rate will apply. SEZ businesses are exempt from payment of withholding tax on dividends. Management or professional fees or training fees, consultancy, agency or contractual fees, royalties, interest and technical service fees paid by SEZ businesses to non-residents enjoy a reduced withholding tax rate of 5 percent. Any other payments made to non-residents that are subject to WHT are taxed at a maximum rate of 10 percent.

Goods and services that are purchased by enterprises operating in an SEZ are not subject to VAT and excise duty. The EAC is still formulating regulations with respect to the customs treatment, but it is understood that, in principle, goods entering SEZs will be exempt from customs duty and, unlike the case for EPZ businesses, SEZ companies will be at liberty to sell in the EAC. However, the concept of SEZs is in its nascent stages, and the customs treatment of goods leaving the SEZ to the EAC countries will be important in determining the success of the SEZ regime. The risk is that if goods sold within the EAC are subject to customs duties, they may end up being too expensive and therefore uncompetitive.

Challenges

Notwithstanding the array of attractive tax incentives, investors face a number of challenges when investing in Kenya. The relatively low number of DTAs that Kenya has operationalized is a particular challenge, as it exposes investors to higher tax rates and, potentially, to double taxation.

Kenya has recently been overhauling its tax regime, which undoubtedly creates a level of uncertainty for investors. Since 2013, Kenya has enacted new laws for VAT and excise duty and on tax procedures, and is currently revising the income tax laws. Not all of the changes in the new laws are desirable for investors. In fact, many investors have chosen a wait-and-see approach until the new Income Tax Act has been passed, to assess the impact it would have on their investment. Many tax challenges can be foreseen and effectively managed if an investor takes the initiative to understand the tax landscape when planning to invest in Kenya. The introduction of new tax laws is meant to modernize and promote investment, to ensure that Kenya remains one of the more attractive investment destinations in Africa today.

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