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Tax & Exchange Control ALERT

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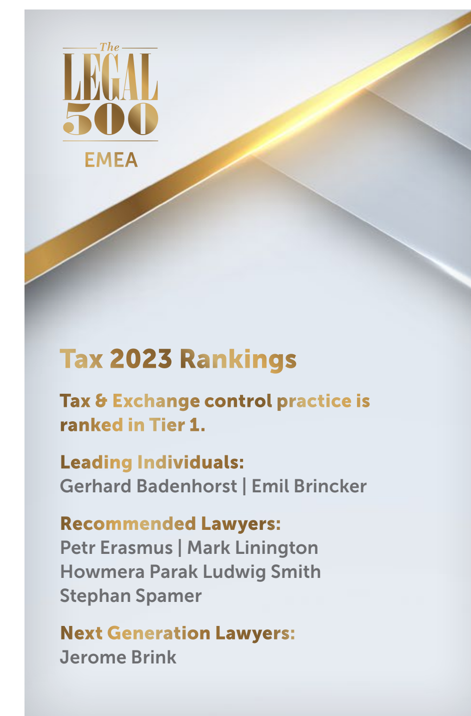
Unpacking the Affordable Housing Levy: Next steps for employers and employees?

Kenya's housing deficit has been a long-standing issue for many government regimes. The need to realise the constitutional aspirations of Article 43 on the right to accessible and adequate housing has led recent administrations to earmark housing as a key priority development area.

Under the previous regime, for example, the Government aimed to build 500,000 affordable new housing units and to subsequently reduce the low-income housing gap by 60%. Currently, housing and settlement constitutes one of the core pillars of the Government's Bottom-Up Economic Transformation Agenda (BETA). BETA seeks to increase the supply of new housing units to 250,000 per year and bolster the percentage of affordable housing supply from 2% to 50%.

It is against this background that the Finance Bill, 2023 (Bill) proposed an amendment to the Employment Act to provide for remittance of deductions into the National Housing Development Fund (Fund). The intention of the Bill was to mandate employers to remit to the Fund: an employer's contribution at the rate of 3% of an employee's monthly basic salary and the employee's contribution at the same rate. The sum of both the employer and employee contributions was, however, capped at KES 5,000 per month. The Bill had further proposed an array of benefits such as the use of the contributions to purchase homes under the affordable housing scheme for eligible employees. For the ineligible ones, they could transfer the contributions to a retirement benefits scheme or to their spouses/dependent children or to any person registered and eligible for affordable housing.

The Bill was assigned to the Departmental Committee on Finance and National Planning (Committee) for consideration of stakeholder submissions on 4 May 2023. Despite numerous concerns by stakeholders about the contributions to the Fund, the Committee did not do away with the proposal but instead made suggestions in its report for the rate to be reduced from 3% to 1,5%; for it to be made a levy instead of a mandatory contribution; and for the cap of KES 5,000 to be removed.



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Additionally, the benefits that had been proposed by the Bill to accrue to employees who are not eligible for affordable housing after seven years or attainment of the retirement age were removed. These included: the transfer of their contributions to a retirement benefits scheme or pension scheme registered with the Retirement Benefits Authority; a transfer of their contributions to any person registered and eligible for affordable housing; a transfer of their contributions to their spouse/dependent children; or to receive their contributions later in cash. The Committee's suggestion was adopted by the National Assembly and passed into law when the president assented to the Bill on 26 June 2023.

Recent court cases on Finance Act, 2023

The Bill became an Act upon the presidential assent. A few public interest litigants filed Petition No. E181 of 2023 (petition) at the High Court seeking to declare the Finance Act, 2023 (Act) unconstitutional on grounds that its enactment was contrary to the dictates of both the Constitution and the Public Finance Management Act, 2012. The applicants successfully obtained conservatory orders suspending the implementation of the Finance Act, 2023. It was the court's verdict that there was a need to preserve the substratum of the petition and prevent the imminent danger of it being rendered nugatory. For a while afterwards, the provisions of the Act could not come into force despite the Government's ambitious tax revenue targets of KES 210 billion from measures introduced in Finance Act, 2023 and the 2023/24 budget of KES 3,6 trillion.

On 11 July 2023, the Cabinet Secretary for National Treasury and Planning and the Attorney General made an application to the Court of Appeal to overturn and lift the orders issued by the High Court. After listening to both sides, the appellate court lifted the High Court's conservatory orders that had suspended implementation of the Act. The court's decision considered several factors and circumstances. First, it appreciated that members of the public could always get rebates/refunds for overpaid taxes when making subsequent tax payments. Secondly, it recognised that the applicants' application for a stay of the High Court orders had met the requisite threshold for the issuance of such orders. Furthermore, the court factored in public interest considerations and expressed hesitancy towards suspending the whole Act while underscoring that only specific provisions whose implementation have an irreversible effect ought to be suspended.

Implications of the Affordable Housing Levy

The provisions in the Finance Act, 2023 on contributions for the Affordable Housing Levy took effect on 1 July 2023. Section 31B, which has been introduced by the

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Act to the Employment Act requires employers to deduct and remit an Affordable Housing Levy as follows:

- 1,5% of the employee's gross monthly salary for the employee; and
- 1,5% of an employee's gross monthly salary for the employer.

Section 31C of the Employment Act further states that the levy is to be remitted not later than nine working days after the end of the month in which the payments are due. Section 31C (2) imposes a penalty on any employer who fails to comply with the remittance requirement timelines. It provides that such a failure attracts a liability to a penalty of 2% of the unpaid funds for each month that the payment remains unpaid.

Notably, unlike the Finance Bill that had a cap of KES 5,000, there is no such provision in the Finance Act, meaning that employees and employers will contribute more than what was initially envisaged in the Bill. It is however imperative for employers to actively remit the funds on a monthly basis and avoid unnecessary penalties.

The intention and purpose of the levy is stipulated in the newly introduced section 31B (2) of the Employment Act. According to this section, the levy will be utilised in providing funds for the development of affordable housing and associated social and physical infrastructure as well as the provision of affordable home financing to Kenyans. The Act is categorical that the levy shall not be used for any purpose other than the intended one.

Way forward

On 3 August 2023, the State Department for Housing and Urban Development issued a public notice to the effect that the Cabinet Secretary, Ministry of Lands, Public Works, Housing and Urban Development has appointed the Kenya Revenue Authority (KRA) as its collection agent for the Affordable Housing Levy. The Government has also backdated the deductions to 1 July 2023. KRA subsequently issued a notice to reiterate the effective date for the levy and clarify that the employer's contribution is a tax-deductible expense.

The notice from the state department and from the KRA may have come after employers had already paid July salaries. There is still a chance for employers to remit the levy in August when accounting for July's pay-as-you-earn (PAYE) tax. Those employers may have to recover the employee's portion of the levy from the next salaries. For employers who had already filed the return, they can file an amended return.

Questions still abound on the housing levy, including the definition of *"gross salary"* as this is not defined in the Finance Act, 2023, Income

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Tax Act or the Employment Act. It is not clear whether the levy applies to basic salaries and allowances and all non-cash benefits. It is also not clear whether the levy applies to lump sum payments such as bonuses and terminal dues. The KRA and the relevant state department are likely to adopt a broad definition that maximizes the contributions. We, however, expect that the state department and KRA will issue guidelines to respond to such questions and others that may come along.

Meanwhile, in its latest Business Transformation Notice, the KRA has made some enhancements in light of the changes brought by the Finance Act, 2023. In the notice, KRA states that the PAYE (P10) return has been enhanced to update the sheet *"Affordable Housing Levy_dtls"* for purposes of administering the levy. Additionally, the payment registration module under the iTax platform has been modified to enable taxpayers to generate a payment slip by selecting *"Tax Head"* as *"Agency Revenue"* and *"Tax Sub Head"* as *"Housing Levy"*. Most importantly, the payment slip will be generated separately from that of PAYE and other payroll levies.

Going forward, employees must now be aware that the levy has taken effect. Likewise, employers must remit the levy to the KRA in time to avoid penalties. The substantive case challenging the constitutionality of the Finance Act, 2023 will meanwhile continue at the High Court to its final determination.

Alex Kanyi and Brandon Otieno

2023 RESULTS

Chambers Global 2018 - 2023 ranked our Tax & Exchange Control practice in **Band 1**: Tax.

Emil Brincker ranked by **Chambers Global 2003 - 2023** in **Band 1**: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **Chambers Global 2022 - 2023** for Tax: Indirect Tax.

Mark Linington ranked by **Chambers Global 2017 - 2023** in **Band 1**: Tax: Consultants.

Stephan Spamer ranked by **Chambers Global 2019-2023** in **Band 3**: Tax.

SOUTH AFRICA

New proposed draft legislation published by SARS and National Treasury for public comment

After taxpayers waited patiently, National Treasury and the South African Revenue Service (SARS) published the 2023 Draft Tax Bills and Regulations on 31 July 2023. In particular, the 2023 draft Taxation Laws Amendment Bill (draft TLAB) and the 2023 draft Tax Administration Laws Amendment Bill (draft TALAB) have been published.

The proposed amendments to tax legislation will have a far- reaching impact on many business and individual taxpayers. This article provides an overview of the draft legislation and highlights some of the key announcements. The due date for comments is 31 August 2023 and taxpayers would be well advised to study the proposals and make submissions if necessary.

2023 draft Taxation Laws Amendment Bill

As per SARS and National Treasury's media statement, also published on 31 July 2023, the draft TLAB contains the more complex policy and technical amendments to the various tax acts. We discuss some of these below.

Renewable energy tax incentives

Given the urgency of the matter, the first draft legislation regarding the renewable energy tax incentives to arrest the decline in energy safety and supply in South Africa (and assisting with meeting climate change goals) was published on 21 April 2023. This legislation was welcomed in the sector and proposed a personal rooftop solar energy tax credit for individual taxpayers, as well as a separate and distinct 125% accelerated depreciation allowance for renewable energy generation assets.

Subsequent to the publication of the first draft legislation on 21 April 2023, there was a public consultation process regarding the proposed renewable energy tax incentives. The revised legislation now published in the draft TLAB factors some of those public submissions into account.

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In respect of the individual rooftop solar energy tax credit, we summarise a few key aspects below.

- While there were extensive submissions and discussions that the proposed section 6C rooftop solar energy credit was not sufficient enough (in monetary terms) to increase uptake in solar, the credit has remained at 25% of the cost of the solar PV panels with an upper limit of R15,000. National Treasury was at pains to point out during discussions that it did not have much flexibility to amend the monetary limit as this has already been factored into budgets for the 2024 financial year and it was largely confined to working within those parameters.
- The rooftop solar energy credit is limited to *"new and unused solar photovoltaic panels, with the generation capacity of each being not less than 275W"*. Furthermore, they must be brought into use for the first time by the taxpayer on or after 1 March 2023 and before 1 March 2024. The rationale behind limiting the incentive to solar panels is that the Government wants to encourage the *"generation"* of energy and for this reason (amongst others) it has not been extended to include batteries. What is interesting to note is that an inverter forms a substantial cost of any solar PV system and is a necessary requirement for operation. This is because the inverter converts the direct current (DC) received from the solar panels to alternating current (AC) so that it can be used within South African households to power appliances and lights. Without the inverter, the solar PV panels are not of much use.

In respect of the 125% accelerated depreciation allowance for renewable energy generation assets, the proposed revised section 12BA largely mirrors the existing section 12B 100% (or three-year write off) for renewable energy assets. However, there are some notable differences:

- the allowance is limited to *"new and unused"* assets and thus secondhand assets are excluded;
- the assets must be brought into use on or after 1 March 2023 and before 1 March 2025;
- there are no generating capacity thresholds for hydro power (ceiling of 30MW in section 12B);
- there is no distinction between solar PV assets generating less than or more than 1MW as assets qualify for the 125% allowance irrespective of generating capability; and
- in addition to the normal restrictions on leased assets as contained in section 12B, the proposed section 12BA provides that under a finance lease type scenario, the seller cannot claim the section 12BA allowance if it remains the owner during the period of the finance lease.

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New proposed draft legislation published by SARS and National Treasury for public comment

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Withdrawal of Practice Note 31 and introduction of section 11G

Another notable proposal relates to the intended withdrawal of SARS Practice Note 31 and the insertion of a proposed section 11G into the Income Tax Act 58 of 1962 (ITA). To replace Practice Note 31, it is proposed that a deduction will be allowed if the following requirements are met:

- expenditure not of a capital nature is incurred;
- if the expenditure is incurred by a company taxpayer in the production of its income;
- if that expenditure is incurred in the production of interest income accruing from another company that forms part of the same group of companies; or
- that interest income arises because of a loan, advance or credit advanced by that company, directly or indirectly, to that other company.

Importantly, there is a proviso that the amount allowed to be deducted under this section shall not exceed the amount of the interest income. It is interesting to note the non-capital expenditure requirement, particularly with reference to the fact that section 24J of the ITA does not refer to whether interest incurred is of a capital or non-capital nature.

Clarifying the definition of a foreign business establishment in the CFC rules

In *CSARS v Coronation Investment Management SA (Pty) Ltd* (1269/2021) [2023] ZASCA 10 (07 February 2023), the Supreme Court of Appeal (SCA) had to determine whether a controlled foreign company (CFC) of a South African resident had met the "*foreign business establishment*" (FBE) exemption from imputation of income under section 9D of the ITA. The SCA concluded that the primary operations of the relevant CFC's business was that of fund management, which comprises investment management. It was concluded that these were not conducted in Ireland but outsourced to other entities outside of Ireland and therefore, the relevant CFC did not meet the requirements for an FBE exemption in terms of section 9D(1). Given this, the SCA held that the net income of the relevant CFC is imputable to its South African tax resident shareholder.

Seemingly on the back of this case, National Treasury identified that some taxpayers are retaining certain management functions but outsourcing other important functions for which the CFC is also being compensated by its clients. The explanatory memorandum to the draft TLAB states that to qualify for the FBE exclusion, all important functions for which a CFC is compensated should be performed either by the CFC or by another CFC in the same group of companies that is located and subject to tax in the same country as the CFC's fixed place of business.

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With reference to the rationale behind the proposed amendments, it is interesting to note that the draft TLAB proposes deleting the words "*conduct the primary operations of that business*" and replacing them with "*perform all the important functions of that business for which the controlled foreign company is compensated*". There is therefore a proposed shift away from the "*primary operations*" concept towards an "*important functions*" concept. Notably, it is unclear whether additional more explicit reference will be made to the outsourcing of functions to another CFC in the same group of companies that is located and subject to tax in the same country as the CFC's fixed place of business.

Tax administration proposals

There are also some important and key tax administration proposals in the draft TALAB including the insertion of new provisions relating to advance pricing agreements for transfer pricing purposes and the removal of the distinction between resident and non-resident employers for purposes of registering for employees' tax.

Summary

There are a number of key and far-reaching tax technical and tax administrative proposed amendments and taxpayers would be well advised to study the proposed amendments and their impact on their tax positions. Comments can be submitted until 31 August 2023.

Jerome Brink

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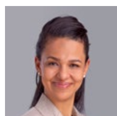

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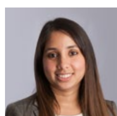

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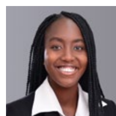

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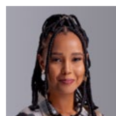

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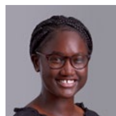

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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