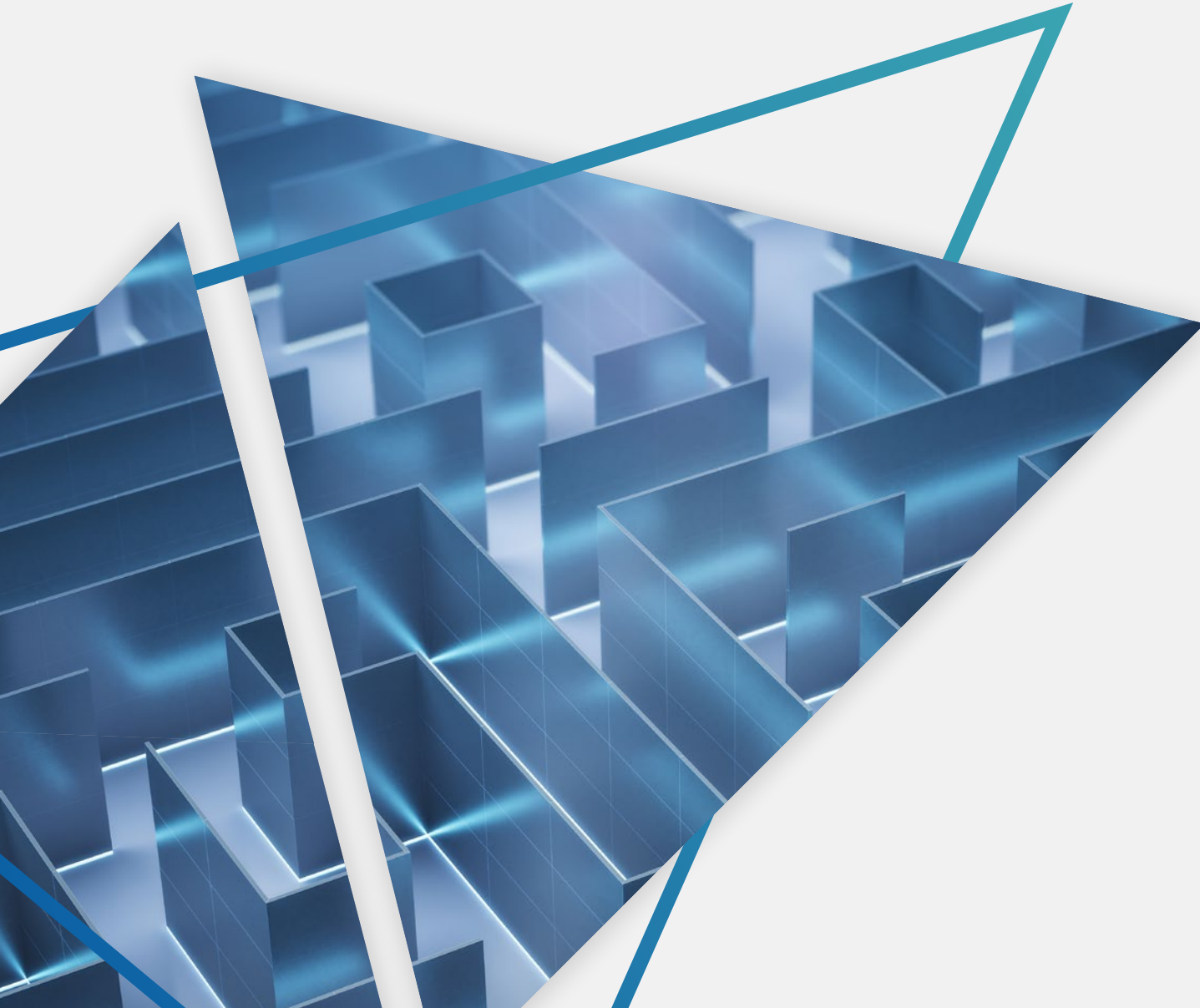


# Tax & Exchange Control

ALERT | 18 January 2024



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## Exploring the impact of the Finance Act's top eight tax changes that took effect in January 2024

The past year, CDH Kenya's Tax & Exchange Control practice participated in Kenya's tax reform process. We continue to take pride in the success of our key and distinctive proposal that was incorporated into the Finance Act, 2023 (Act) – the tax amnesty programme.

The amnesty programme seeks to motivate taxpayers in Kenya to pay all their principal taxes for periods up to December 2022 in exchange for a waiver of penalties and interest. The deadline for applying for a waiver and paying the outstanding principal tax is 30 June 2024.

In addition to the amnesty programme, the Act ushered in a myriad of other changes, the majority of which took effect from 1 July 2023. Some began to be implemented beginning 1 September 2023 and others began to be operationalised on 1 January 2024.

This alert highlights the tax changes that took effect from 1 January 2024.

### 1. Taxation of employee share ownership plans offered by start-ups

From 2024, where an employee is offered company shares in lieu of cash emoluments by an eligible start-up, the benefits from the shares allocated to that person will be deferred and taxed within 30 days of the earlier of: (i) the expiry of five years from the end of the year of the award of

the shares; (ii) the disposal of the shares by the employee; or (iii) the date the employee ceases to be an employee of the eligible start-up. The taxable benefit shall be the fair market value of the shares on the date the tax is due, and where it is not available it shall be assessed based on the last issued financial statements.

The Act clarifies that an eligible start-up is a business incorporated in Kenya whose annual turnover does not exceed KES 100 million; which does not carry out management, professional or training services; that has not been formed as a result of splitting or restructuring an existing entity; and which has been in existence for a period of not more than five years.

**Implication:** Currently, employees pay taxes on the gains accrued upon exercising the options to acquire the shares. The gain being the change in the value of the shares from the time they were granted and the time when the employee exercised their option to take the shares.

The change to subject the gains to tax for employment ownerships plans for start-ups to a later date is meant to encourage start-ups to offer the shares to employees and also make Kenya an attractive business destination of start-ups. Start-ups tend to fail in the early years and often offer shares to employees so that the employees can help with the growth journey. It would be unfair to tax employees at an early stage for a start-up as the start-up and the employee need time to build on the value of the company and, by extension, its shares.

# Exploring the impact of the Finance Act's top eight tax changes that took effect in January 2024

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## 2. Taxes on repatriated income and reduced tax rates for branches of foreign companies

Profits repatriated by non-resident persons carrying on business in Kenya through permanent establishments are now subject to tax at the rate of 15%. The computation formula for repatriated income is  $R = A1 + (P-T) - A2$ .

Where: **R** is the repatriated profit, **A1** is the net assets at the beginning of the year, **P** is the net profit for the year of income calculated in accordance with generally accepted accounting principles, **T** is the tax payable on the chargeable income, and **A2** is the net assets at the end of the year.

The corporation tax rate for branches of foreign companies is now on par with that of resident companies, both being subject to 30% corporation tax.

**Implications:** The tax to be charged on repatriated income is part of the Government's plan to expand the tax base and is expected to result in an increase of the revenue levels generated by the Government. It also has the potential to influence businesses and individuals to re-invest rather than repatriate their income, thus contributing to economic growth and job creation in the country.

On the other hand, the reduced corporation tax rate for branches of foreign companies is welcome. However, more expenses ought to be allowed as tax deductible considering that repatriated income is now subject to tax. As it is, it is tax-inefficient to operate through a branch.

## 3. The requirement to use the electronic tax invoice management system (eTIMS)

Expenses that are not supported by eTIMS-compliant invoices are now not allowed, except where the transactions have been exempted in accordance with the Tax Procedures Act. The National Treasury recently published the Tax Procedures (Electronic Tax Invoice) Regulations, 2023 (Regulations) to exempt certain businesses from eTIMS requirements, including businesses that do not meet the annual turnover threshold of KES 5 million. There are continuing engagements on whether the exemptions as drafted in the Regulations are practical and at the time of writing this alert, the official gazette copy of the Regulations has not been published by the government printers.

**Implication:** The move to introduce eTIMS will enhance tax compliance because the revenue authority can auto-assess a taxpayer's records and query instances where there are gaps in the taxpayer's tax declaration. The move is also likely to widen Kenya's tax base and bring on board taxpayers who were not accounting for their taxes before.

## Exploring the impact of the Finance Act's top eight tax changes that took effect in January 2024

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### 4. Reduced tax rates for residential rental income tax

The rate of monthly residential rental income tax (RIT) is now 7.5% of the gross rental receipts from the previous 10%. The tax is payable either monthly or annually, with eligible taxpayers having the option of electing not to pay the tax by notifying the Commissioner in writing. Electing not to be subject to RIT places one under the annual income tax regime. Property owners with yearly rental income that exceeds KES 15 million are excluded from the RIT regime because they are required to declare their rental income together with all other income (if any) while filing their annual income tax returns.

In our tax alert of 27 October 2022, which you can find [here](#), we discussed RIT at length, highlighting the enforcement mechanisms that were being considered by the Kenya Revenue Authority at the time, as well as options for landlords and tenants.

**Implications:** This is a welcome change, with the potential to enhance tax compliance. However, we note that in the Medium-Term Revenue Strategy 2024/25–2026/27 (MTRS) the Government has plans to review the RIT rate by either taxing it at the corporate rate and allowing for expenses or retaining a simplified regime and progressively increasing the rate to the corporate rate, then allowing deduction of at least 40% of the revenue as expenses. The MTRS also highlights the plans to be implemented to address compliance, which include registration of property

agents, mapping of properties (already ongoing) and leveraging technology in the whole mapping and collection process. It will be interesting to see what will ultimately be implemented in the intended review of the RIT.

### 5. Post-retirement medical fund relief

Resident taxpayers who contribute to a post-retirement medical fund will now be entitled to personal relief known as the post-retirement medical fund. The amount of relief will be calculated at the rate of 15% of the amount of contribution paid, or KES 60,000 per annum, whichever is lower.

**Implications:** This is a positive move, and we expect more people to contribute towards their post-retirement medical schemes to guarantee access to healthcare in retirement. However, the Government intends to carry out an overview of all tax reliefs and abolish others as per the MTRS. It is not clear if this new relief will still be there in the long term.

### 6. Reduced corporation tax rate for companies manufacturing vaccines

Unlike other companies that are subject to the 30% standard corporation tax rate, those that manufacture vaccines for humans can now pay corporation tax at the reduced rate of 10%.

**Implications:** This will contribute to the growth of Kenya's pharmaceutical industry by promoting the manufacturing of vaccines in Kenya.

# Exploring the impact of the Finance Act's top eight tax changes that took effect in January 2024

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## 7. Increase in the rates for advance tax

Advance tax payable on commercial vehicles such as vans, pick-ups, trucks, prime movers, trailers and lorries has now risen from KES 1,500 per ton of load capacity per year or KES 2,400 per year, to KES 2,500 per ton of load capacity per year or KES 5,000 per year; whichever is higher. For passenger vehicles such as saloons, station wagons, minibuses, buses and coaches, the rate has similarly gone up from KES 60 per passenger capacity per month or KES 2,400 per year to the higher of KES 100 per passenger capacity or KES 5,000 per year.

**Implications:** The upward adjustment of the advance tax rates, whether per tonnage, passenger capacity or the fixed annual amount, will enable the Government to collect additional revenue to finance its projects.

## 8. The restriction on interest rule now only applies to non-residents

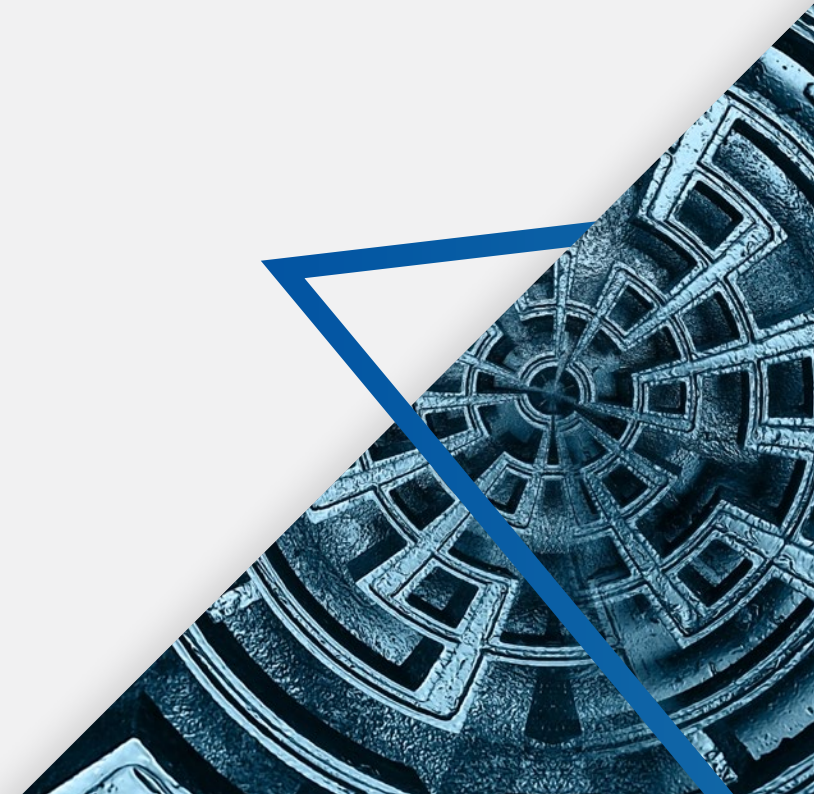
Kenya's interest restriction rule has been that the interest expense that exceeds 30% of a company's earnings before interest, tax, deductions and amortization is not tax deductible. From January 2024, this rule will only apply to interest from loans obtained from non-resident lenders. This means that interest restriction no longer applies to interest on loans obtained from local banks and lenders.

**Implication:** This move will be a relief for taxpayers who are funded from locally sourced loans. It will further limit entities that fall outside of the restriction threshold from deducting realised foreign exchange losses while computing their corporation tax.

## Conclusion

The current fiscal year in Kenya will be significant, as the concluding phase of the tax reforms introduced through the Finance Act, 2023 unfolds. The Government remains committed to widening its tax net to collect as much revenue as it can, for the purpose of financing its budget. In particular, we will monitor the progress of the new tax reforms outlined in the MTRS.

**Alex Kanyi and Judith Jepkorir**



## Sealing the loopholes? An analysis of the Affordable Housing Bill, 2023

The High Court of Kenya, in its decision of 28 November 2023 in *Okiya Omtatah Okoiti and 51 Others V The Cabinet Secretary for the National Treasury and Planning and 6 Others, Constitutional Petition No. E181 of 2023 (Consolidated)*, held that the housing levy as framed in Finance Act, 2023 (Finance Act) was unconstitutional. Consequently, the Government gazetted the Affordable Housing Bill, 2023 (Bill) on 7 December 2023 as an attempt to cure the issues that were raised by the High Court in its decision. This alert analyses the Bill vis-à-vis the issues that were identified by the High Court.

### **Lack of a comprehensive legal framework**

The High Court held that the introduction of the housing levy through the amendment of the Employment Act, 2007 (Employment Act) lacked a comprehensive legal framework in violation of Articles 10, 201, 206 and 210 of the Constitution of Kenya, 2010 (Constitution). The introduction of the Bill therefore serves to provide the legal framework for the housing levy. Clause 3 (2) of the Bill expressly provides that the implementation of the Affordable Housing Act shall be guided by the national values and principles of governance under Article 10 (2)(b) of the Constitution, the principles of public finance under Article 201 of the Constitution, and the values and principles of public service under Article 232 of the Constitution.

### **The discriminatory nature of the housing levy**

The High Court further determined that the imposition of the housing levy against persons in formal employment to the exclusion of other non-formal income earners to support the national housing policy was without justification, was unfair, discriminatory, irrational and arbitrary, and was in violation of Articles 27 and 201 (b)(i) of the Constitution.

In an attempt to remedy this, the Bill, in clause 4, imposes the affordable housing levy at the rate of 1,5% of the gross salary of an employee; or in the alternative, the gross income of a person received or accrued which is not

# Sealing the loopholes? An analysis of the Affordable Housing Bill, 2023

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subject to the levy in the first instance. This provision therefore seeks to rope in other non-formal income earners to support national housing, as an attempt at sealing the discrimination loophole. However, it does not stipulate how this will be effected.

Clause 6 of the Bill empowers the Cabinet Secretary with the discretionary right to exempt any income or class of income, or any person or category of persons from the payment of the affordable housing levy. This could be an avenue for the Cabinet Secretary to later exempt non-formal income earners due to the imminent difficulty in effecting the collection of the housing levy.

## Defining the housing levy

It was the High Court's finding that the amendment of the Employment Act to introduce the affordable housing levy did not contain a legal definition of the housing levy, nor did it even define the term "levy" as used in the amendment. The court therefore held that the lack of certainty in a matter as important as the definition of the housing levy was a major defect in the impugned amendment. To cure this, clause 2 of the Bill defines "affordable housing" as housing that is adequate and costs not more than 30% of a person's income per month to rent or acquire, and "levy" as the affordable housing levy imposed under section 4 of the Affordable Housing Bill, 2023 (the Bill).

## Administration of the housing levy

The other major issue that was pointed out was that section 84 of the Finance Act does not set out how the levy will be administered once it is collected, and more importantly, the legislation does not state how it supports the housing policy function of the national Government.

Consequently, Part III of the Bill has established the Affordable Housing Fund, which is vested in and managed by a board. The provision comprehensively outlines the collection, purpose and allocation of the fund. It further stipulates the role of the board in overseeing the development of affordable housing and associated social and physical infrastructure.

## Conclusion

The High Court temporarily stayed the implementation of its decision revoking the implementation of the affordable housing levy to enable the Government to appeal, and the Court of Appeal has further ordered the maintenance of the status quo until 26 January 2023, when it will issue a substantive ruling on five appeals regarding whether it should lift the High Court's stay order or grant a further extension on the collection of the levy pending the hearing and determination of the appeals.

## Sealing the loopholes? An analysis of the Affordable Housing Bill, 2023

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**Tax 2023 Rankings**

**Tax & Exchange control practice is ranked in Tier 1.**

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**Recommended Lawyers:**  
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Ludwig Smith | Stephan Spamer

**Next Generation Lawyers:**  
Jerome Brink

The introduction of the Bill seems to be a bid to avert the possible revocation of the levy by the superior courts. The Bill emerges as a response to the constitutional concerns that were raised by the High Court, striving to rectify the deficiencies identified. By introducing a comprehensive legal framework, attempting to address the discriminatory nature of the levy, providing a definition for “*affordable housing*” and “*levy*”, and establishing the Affordable Housing Fund with clear guidelines for administration, the Government is seeking to ensure adherence to constitutional principles.

However, as this alert has analysed, certain aspects of the Bill, such as the applicability of the levy to non-formal income earners and the discretionary power granted to the Cabinet Secretary in clause 6, warrant careful scrutiny. While clause 4 attempts to bridge gaps in discrimination, the effectiveness of its application remains unclear. Similarly, the discretion vested in the Cabinet Secretary raises questions about the potential for future exemptions and the impact on the levy’s overall objectives.

Next, the Bill will undergo its second reading and be sent to the designated committee, and it will then be subjected to public participation before it is presented for a third reading with amendments and, the subsequent presidential assent.

The National Assembly was expected to start on the public hearing on the Bill from 17 January 2024. The High Court in Kisumu has however issued temporary orders to stop the hearings until a case challenging the notice for public hearings is heard and determined.

While the Bill progresses through the legislative channels, it is essential for stakeholders, policymakers, and the public to engage in thoughtful deliberation to ensure that the final legislation not only addresses the constitutional concerns raised by the High Court but also aligns with the broader goals of national housing policy.

**Alex Kanyi and Billy Oloo**



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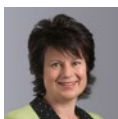
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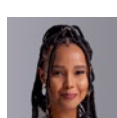
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**BBBEE STATUS:** LEVEL ONE CONTRIBUTOR

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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