

THE CONCEPT OF RESIDENCE

The concept of residence is relevant for tax purposes because it determines the income that's chargeable to tax, the rates of tax to be used, granting of personal relief to individual and determining the incomes to be taxed in Kenya.

Residence is defined from two perspectives i.e.:

- ❖ In relation to individual
- ❖ In relation to body corporate

Residence in relation to individuals

An individual is considered to be a resident if:

- ❖ He has a permanent home in Kenya and was present for any period during the year of income under consideration.
- ❖ He has no permanent home in Kenya but was present in Kenya for an aggregate of 183 days or more during the year of income under consideration.
- ❖ He has no permanent home in Kenya but was present for an average of more than 122 days during the year of income under consideration and in each of the two preceding years.

Meaning of a permanent of home

The following are considered in determining a permanent home:

- ❖ An individual could have more than one home and one of the homes could have been outside the parent state.
- ❖ A home need not necessarily mean a house, bungalow or flat, it may also mean a hotel.
- ❖ A home may either be owned by the person or it may be a rented house.
- ❖ The individual must have full control of the home
- ❖ In the home one would expect to find a family or the personal belonging of a person
- ❖ The home is to a substantial degree usually occupied by the individual or family. It must be available to the person.

QUESTION

Consider individual persons with no permanent home in Kenya to determine their residence

<u>Barrack</u>	<u>Hussein</u>	<u>Obama</u>	<u>Boston</u>
2009 – 60 days	2009- 150 days	2009 – 0	2009 – 180 days
2008 – 120 days	2008 – 180 days	2008 - 200days	2008 – 100 days
2007- 186 days	2007 – Nil	2007 – 200 days	2007 – 200 days
$60+120+186/3 =$	$150+180+0/3$	Non resident	$80+100+200/3 =$
122days	=110 days		127 days
Non resident	Non – resident		resident

RESIDENCE IN RELATION TO BODY CORPORATE

A company is considered to be a resident in any in any year of income if:

- ❖ Its incorporated in Kenya under the laws of Kenya.
- ❖ The management and control of the affair of the company was exercised in Kenya in the year of income under consideration.
- ❖ It has been declared by the minister for finance to be a resident company in the year of income through a notice in the Kenya gazette.

Importance of the concept of resident:

The importance of resident is seen in the tax treatment of taxable income for resident and non-resident. These are summarized below:

RESIDENT:

- ❖ Individuals are granted personal relief a deduction against their tax liability
- ❖ Employment income of individual is taxed in Kenya whether it arises in Kenya or from any other country.
- ❖ Company profits are taxed at a resident corporate rate of 30%
- ❖ Commercial rental income – the income net of allowable expenses is taxed using graduated scale.

NON-RESIDENT:

- ❖ Individuals cannot claim personal relief as a deduction from their tax liability
- ❖ Only employment income arising in Kenya is taxed for individual.
- ❖ A company profits are taxed at a non – residential corporation tax rate of 37.5%
- ❖ The gross rental income derived from Kenya taxed at a withholding tax rate of 30% as the final tax.

TAXATION OF EMPLOYMENT INCOME

Definition of terms:

Employer –

- ❖ Any person having control over employment and remuneration.
- ❖ Any paying office of the government or other public authority.
- ❖ Any trust/insurance company or other bodies paying pension to individuals.

Employee – This is any holder or an appointment office whether public or otherwise for which remuneration is payable thus employee include: company CEO, minister, ordinary public servants etc.

Paying point – is the place where remuneration is paid.

MONTHLY PAY

1. CASH BENEFITS

- ❖ Cash receipts from employment e.g. salaries, leave pay, overtime, gratuity etc.
- ❖ Cash allowances such as housing, entertainment, hardship etc.
- ❖ Private expenditure incurred by the employee which is paid for by the employer e.g. grocery bills
- ❖ Contribution made by the employer on behalf of the employee for insurance, mortgage payment etc.

2. NON-CASH BENEFITS

- (a) Facilities - where an employee enjoys a benefit, advantage or facility in connection with employment it shall be taxable benefit, however the minimum taxable aggregate value Of the facility is ksh. 60,000 pa i.e. ksh. 5000pm.
Facilities include: free transport, company products and free meals.
- (b) Servants – Where the employee is provided with servants whose salaries are paid for by the employer it shall be a taxable benefit.
The taxable value of the benefit shall be the actual cost to the employer.
- (c) Services – Where the employee is provided with electricity, water, alarm system etc. the taxable value of the benefit shall be the higher of:
The prescribed amount by the commissioner of domestic taxes (CDT). And
The actual bill /amount paid.
- (d) Furniture - If the employee is provided with furniture for his private use, the taxable Value of the benefit shall be 1% per month of the cost of the furniture.
- (e) Telephone – if the employee is provided with telephone services, the taxable value of Benefit shall be 30% of the bill.

- (f) Car benefit – Where the employee is provided with a car, for his private use by the employer, the taxable benefit shall be the higher of:
- (i) The quantified amount based on the cc ratings of the car
 - (ii) The prescribed rate of 2% per month of the initial cost of the car
- If the car is hired from a third party, the taxable benefit shall be the hiring charges.

(g) Housing benefit

Employees are categorized into four classes for purposes of housing benefit. This includes:

- (i) Ordinary employees and whole-time service directors. If the housing is provided by the employer, the value of the housing benefit shall be the higher of:
 - 15% of total gain from employment or the fair market rental value of the house
 - Nominal rent contributed by the employee is deducted from the housing benefit.
 - Whole time service director is one who: devotes a significant amount of his time as a director in the company and he doesn't own/control more than 5% of the share capital or voting power of the company.
- (ii) Agricultural employees: An agricultural employee is one whose terms and conditions of employment requires that he resides within the farm. Housing benefit shall be 10% of the total gain from employment.
- (iii) Directors other than whole time service directors: These are directors who fall outside the definition of whole-time director. Housing benefit shall be the higher of: 15% of the total income from all sources or fair market rental value of the house.
- (iv) Employee provided with both accommodation and meals: In case the employer provide both accommodation and meals to the employees the taxable benefit shall be 20% of the gain from employment

Exemption of housing benefit from taxation.

Housing benefit provided by the employer maybe non- taxable benefit in the following cases:

- (i) Where its necessary due to the nature of work of the employee e.g. a caretaker of a building.
 - (ii) Where housing is provided for better performance of work e.g. doctors residing in a hospital.
 - (iii) Where housing is provided for security reasons such as for game wardens in game parks.
- (h) Fringe benefits: A fringe benefit arises where the employee is granted a loan by the employer at an interest rate that's lower than the market rate of interest or prescribed interest rate. The fringe benefit is determined as follows

Fringe benefit = amount of loan * (prescribed/market interest rate – low interest rate)

Fringe benefit tax (FBT) is paid by the employer at the corporate tax rate of 30% on a monthly basis i.e.

FBT/ month = fringe benefit (FB) * corporate tax * 1/12

Illustration: Mr. Ayaya was granted a loan of KShs. 2million by his employer of 1st April 2009 at an interest rate of 5% p.a. The rate prescribed by the commissioner was 10% p.a. calculate the FB tax paid by the employer

Solution: FB = Amount of Loan (prescribed interest rate – Low interest rate)

$$= 2000,000 (10 - 5)9/12$$

$$= \text{ksh. } 75,000$$

FBT/month = FB*corporation tax * 1/9

$$= (75,000*30%*1/9)$$

$$= \text{ksh. } 2,500$$

(i) Gifts and Rewards: Are taxable where:

The gifts are paid in relation to services rendered and the gifts are paid by the employer in the course of employment.

(j) Wife 's incomes: The income of a married woman living together with her husband is deemed to be that of the husband for tax purposes: A married woman is deemed to be living with her husband unless:

- ❖ They are separated under a court of competent jurisdiction.
- ❖ They are separated in such a manner that the separation is likely to be permanent.

However, the income tax Act identifies four types of income which are assessed separately on a married woman. These

Are:

(i) **Employment income derived at arm's length**

Employment income is derived at arm's length unless:

- ❖ The wife is an employee of the husband.
- ❖ She's employed by a partnership in which the husband is also a partner.
- ❖ She is an employee of a trust/settlement created by her husband.

- ❖ She is employed by a company in which the couple controls 12.5% or more of the total share capital either jointly or separately.
- (ii) **Professional income:** The wife's professional income is assessed separately on her unless the husband is also a partner in the practice.
- (iii) **Business or self-employment income:** The wife's business income is assessed separately on her.
- (iv) **Rental income:** The wife rental income from property is assessed separately.

Note: In case the husband has more than one wife, if all incomes of the wives are not derived at arm's length the incomes are combined with that of the husband in one assessment. However, only one personal relief is deducted for the husband. In case a married woman is assessed separately on any income she's granted a personal relief separate from that of the husband.

COLLECTION OF TAX FROM A SPOUSE

Where the husband and wife are living together it's the husband responsibility to account for tax, however the wife may be held responsible where:

- The husband is declared bankrupt.
- The husband is of unsound mind.
- The wife is the main bread winner.
- The husband cannot be traced.

- (k) Share options: where an employee is offered shares by the employer it shall a taxable benefit the benefit depends on the type of shares offered:
- (i) shares offered for no consideration i.e. offered for free – The value of the taxable benefit to the employee shall be: The number of shares offered multiplied by the market price per share.
 - (ii) Shares offered at a low price than the market price: The taxable benefit to the employee shall be the:
No. of shares offered * (market price per share – low price per share)

Non-Taxable Employment Benefits

1. Fringe benefits – this arises where the employer provides a loan to the employee at an interest rate which is lower than the prescribed rate.

The employer will be required to pay the fringe benefit tax computed as $30\% \times \text{loan} \times (\text{prescribed interest rate} - \text{actual interest rate})$.

2. Passages for expatriate employees – this is the amount for transport between Kenya and another country for non-citizen employees.

For the benefit to be exempted, the following conditions must be fulfilled:

- a) The person must be a non-Kenyan citizen.
 - b) The person must be in Kenya only to service the employer.
 - c) The person must have been recruited from outside Kenya.
 - d) The amount must have been used for transport between Kenya and the country of origin.
3. Pension contribution by the employer on behalf of the employees to a registered pension scheme.
 4. Non-discriminatory medical services.
 5. School fees as long as it's treated as a non - deductible expense by the employer.
 6. Meals provided by the employer in the canteen for up to kes 60,000 p.a
 7. The 1st kes 150,000 p.m. paid to a disabled employee registered with national council of people with disabilities.
 8. $\frac{1}{3}$ of employment benefits to a non-citizen resident employee who is outside Kenya for more than 120 days in a given year of income.
 9. Payment of subscription fees: where the employer pays subscription fees of the employee to a professional association.
 10. Per Diem – is a cash allowance to an employee while working out of office to cater for expenses incurred. The first sh. 2000 per day is tax free any excess amount is taxable.

Allowable deductions against employment income

1. Employees contribution to a registered ** pension fund. The deductible amount shall be the lower of
 - Actual contribution
 - 30% employment income
 - Set limit of kes 360,000 p.a or 30,000 p.m.
2. Contributions to a registered home ownership saving plan up to a maximum kes 8000 per month or 96000 per annum.
3. Owner occupies mortgage interest of up to kes 360,000 per month or 300,000 per annum.
4. Subscription to professional association by the employee.

GRADUATED SCALE OF TAX RATES FOR INDIVIDUAL

MONTHLY INCOME	KSHS	ANNUAL KSHS.	RATES OF TAX
FIRST	1 – 24000	1 – 288000	10%
NEXT	24001 – 32333	288001- 388000	25%
NEXT	32334- 500000	388001 – 6000000	30%
NEXT	500001 – 800,000	6000001 – 9600000	32.5%
Excess of	800000	Excess if 9600000	35%

SET- OFF

These are amounts which are deducted from the gross tax payable and this include:

- a) P.A.Y.E – Deducted by the employer
- b) Withholding tax: Deducted on non-qualifying income
- c) Personal relief: Every resident person is entitled to deduct personal relief of sh. 2400 per month or 28,800 pa
- d) Insurance relief – Where an employee has a life cover or an education policy, he/she is entitled an insurance relief of 15% of the premium paid subject to maximum of 60000 per annum

Taxation of Dividends

- Dividends is a distribution of profits of a company or corporation they are taxed in the year they are received rather than the year they are earned.
- Dividends can be categorized as following:
 1. **Qualifying dividends** – dividends earned from:
 - a) Companies both private and public
 - b) Savings and credit cooperative societies SACCOS

They are subjected to withholding tax of 5% which is final.

2. **No-qualifying dividends** – they are dividends earned from cooperatives societies other than SACCOS. They are subject to withholding tax at the rate of 15% which is not final. The gross amount is added together with other income and subjected to tax using the graduated scale of tax rate for individuals and 30% corporate tax rate for corporations However, a tax relief is provided for withholding tax paid in advance.
3. **Non-taxable dividends(exempt)** – they are dividends received from:
 - i) Foreign or no-resident companies.

- ii) Companies where the recipient controls 12.5% or more of the share capital (up to .
- iii) Dividends received by insurance companies from their investments in life assurance firm.

INTEREST INCOME

Interest income is any amount paid by borrower of funds and received by the lender. Its payable by the borrower in respect of a loan, debt, deposit or a claim. The interest income is taxed on cash basis i.e. when cash is received and not when interest is earned.

Interest income is classified into three categories for purposes of tax.

1. Qualifying interest income – Its interest income received by individuals and not body corporates. Its subject to a withholding tax which is final tax. The individual interest income is qualifying if received from the following sources:

SOURCE	WITHHOLDING TAX RATE
Banks and other certified financial institutions	15%
Housing financing bonds e.g. Housing finance corporation of Kenya (HFCK)	10%
Bearer instruments/Treasury bill and bonds issued by the government	15%

Note: Interest received from housing development bonds issued by the building societies is taxed as follows: The first ksh. 300,000 is exempt from tax and any excess amount is taxed at 10% withholding tax which is final.

2. Non qualifying interest income: Its interest income received by body corporates. The gross interest amount is subject to corporation tax rate, however the withholding tax paid at 15% is given as a set off against total tax liability.
3. Exempt interest income: Interest income received from the following sources is fully exempted from tax.
 - ❖ Interest income received from abroad.
 - ❖ Interest income from a registered pension scheme e.g. NSSF
 - ❖ Interest income from Home Ownership Saving Plans (HOSP)
 - ❖ Interest on savings account held with Post bank.
 - ❖ Interest income from bonds or securities issued to raise funds for in fractures or other social services.

PENSION INCOME

Pension income include retirement benefits received from pension funds, provident funds and individual retirement funds.

Pension and provident funds are created by way of contribution by both the employee and the employer for purposes of securing benefits to the employee. There are two types of funds:

1. Contributory funds – Its where both the employee and the employer contribute to the funds
2. Non – contributory funds – It's only the employer who makes the contribution.

Pensions and provident funds may or may not be registered with the commissioner. Some advantages will accrue to a registered scheme in contribution and receipt of the contribution. Pension funds are created with the purpose of **providing payments to employees on retirement** while provident funds provide lump sum payment to employees when he/she **exists from work not necessarily on retirement.**

Individual Retirement funds/ schemes – They are established to cater for: persons who are self-employed and wish to save for retirement benefits and employees whose employer may not have formed a pension fund. An individual who contributes to an individual retirement fund and wish to receive a retirement benefit at a particular date may indicate it to be the retirement date.

Withdrawals from retirement schemes

Receipts of an individual from a retirement scheme whether a resident or a non-resident is taxable in Kenya. When an individual receives pension in form of annuities the first Ksh. 360,000 is exempt from tax any excess amount shall be subject to tax with other incomes. However, pension annuities received from unregistered schemes the whole amount is taxable.

In case of lump sum pension receipt, the first Ksh. 60,000 multiplied by the number of years of service up to a maximum of sh. 600,000 is exempt from tax. The entire lump sum receipt from unregistered schemes will be taxed.

TAXATION OF RENTAL INCOME

Rental income: is income received by the taxpayer for allowing another person's use of the tax payers property.

Residential rental income tax – This is tax charged at the rate of 7.5% for residential rental income and charged on Landlords whose annual rental income is between 288000 -15 million pa. There are no allowable expenses. The tax is paid on monthly basis and the Landlord shall not be required to file any other return in relation with the rental income.

Commercial rental income and residential rental income exceeding 15 million pa – The net rental income after allowable deductions is subjected to graduated scale rate of tax for individuals and corporation tax rate of 30% for corporations.

ALLOWABLE DEDUCTION ON RENTAL INCOME

- ❖ Expenses incurred on structural alterations to the premises where such alteration are necessary to maintain the existing rent.
- ❖ Maintenance expenditure on the up keeps of the property which includes land rent and rates, salary and wages insurance, repair e. t. c
- ❖ Bad debts in form of unrecoverable rent.

- ❖ Interest on mortgage taken to set up the property
- ❖ Legal costs in respect of acquisition of a lease for a period of not more than 99 years.
- ❖ Capital allowances related to the use of the building.
- ❖ Management fees or commission paid to property agents.
- ❖ Expenditure incurred in the regular inspection of premises by the landlord or his agent.

NOTE: capital expenditure such as property extension costs, major renovations and repairs, purchase of water tank are generally not allowable.