

AN ANALYSIS OF SELECTED AMENDMENTS IN THE
INCOME TAX ACT IN KENYA IN THE LIGHT OF
TAX EFFICIENCY CRITERION OF EQUITY

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THIS PROJECT IS MY ORIGINAL WORK AND HAS NOT BEEN PRESENTED FOR A DEGREE IN ANY OTHER UNIVERSITY.

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CHAPTER I

INTRODUCTION

1.1. BRIEF HISTORY OF THE INCOME TAX ACT IN KENYA

The Income Tax was first introduced in Kenya in 1937 through a Colonial Ordinance. It was introduced in Uganda and Tanganyika (now Tanzania) in 1940. In 1952 the three Ordinances which were similar were combined in what came to be known as the East African Income Tax (Management) Act. However, each colonial government reserved the powers to fix the rates and allowances in the particular country. The tax was administered by the East African Income Tax Department which was under the East African High Commission formed in 1948.

In 1956 a commission was set up to inquire into the administration of the Income tax in East Africa. Its report was published in 1957. To assist this commission, a select Committee was formed to further find out the nature and operation of the Income Tax Act. The two bodies came out with recommendations which resulted in the repeal of 1952 Act and the enactment of a new Act. The Act was known as the East African Income Tax Management Act (1958). The 1958 Act retained most of the main features of the 1952 Act. The 1958 Act was revised and variously amended. In 1970 the Act was revised and it became chapter twenty four of the Laws of the East African Community.

In 1961 the East African High Commission changed its name to East African Common Services Organization after Tanganyika became the first East African nation to attain independence. On 1st December, 1967 the heads of state of the three East African countries signed a treaty for East African Co-operation. The treaty became the East African Community.

In 1973 the East Africa Income Tax Department was closed and the East African Income Tax Management Act ceased to have force in Kenya and in other East African Community states. In Kenya the Income Tax Act 1973 (No. 16 of 1973) was enacted in Parliament. Its date of assent was 21st December 1973 and it commenced on 24th December of the same year. Since 1973, the Income Tax Act has been revised and variously amended. For example in 1977 and 1979 it was substantially revised and two editions were respectively published. In 1976 it was amended by an Act known as the Income Tax (Amendment) Act. This act repealed the Capital Gains Tax as a separate tax and incorporated it in the Income Tax Act 1973. This was done by adding to the 1973 Act the eighth schedule which outlined the taxation of Capital Gains.

From the brief history, it is fairly explicit that the Income Tax Act borrowed much from its predecessors;- the Colonial Ordinance and the East African Management Act. The Colonial Ordinance and the East African Management Act applied to environments that differ from the one that the Income Tax Act now applies. This is so because the economic, social, political and cultural aspects of the country change with time. Because of the dynamic nature of various aspects of the country, some of the tenets of the Colonial Ordinance and the East African Management Act adopted in the Income Tax Act are obviously obsolete. This is why the Income Tax Act has and is being amended. It should contain provisions that are relevant to the contemporary environment.

1.2. NEED FOR THE STUDY

Everybody earning income in excess of threshold income, except those whose income is exempt from tax, is required to pay a certain amount of tax according to the rules and regulations set by the Income Tax Act. This Act which became effective after the cessation of the East African Income Tax

(Management) Act, has been revised and variously amended. A need therefore arises to find out whether some of these amendments aim at establishing tax efficiency criterion of equity which is one of the generally stated criteria of a good tax system. Tax is part and parcel of our political, social and economic systems. It is therefore necessary for a tax system to be fair so that the tax payers pay tax without feeling that they are being compelled to do so due to the unfair tax system.

An analysis of the amendments in the light of equity is necessary because most of the amendments in one way or another aim at establishing, among others, equity. When the rates of capital gains tax are reduced the rationale behind the reduction is to establish fairness in the tax system. Some members of the society should not be oppressed by the high rates just because they engage in transactions generating capital gains. These gains, as was discussed in a paper on "The Development of Capital Gains Tax in Kenya" ¹, are largely due to changes in prices and thus illusory. When the individual rates are changed the underlying principle behind the changes is to establish some degree of equity. When the system of assessing wife's employment income separately is introduced the reason is to establish equity. These few examples show that equity is a major consideration underlying the amendments. The question that one interested in tax asks himself is;- do the amendments really achieve what they purport to achieve? Has the separate assessment of wife's employment income established the degree of equity it was supposed to establish? Have the changes in the individual rates of tax established equity? A need therefore arises to analyse some of these amendments and find out whether they have established some degree of equity which they purported to establish.

1 See Appendix

1.3. IMPORTANCE OF THE STUDY

This study is expected to be of interest to the following groups:-

- (i) Tax Payers: These people are very much interested in matters pertaining to tax because they are the ones interested in knowing whether the numerous amendments which are made contribute to the establishment of equity in a tax system. They would like to see a tax system that is fair to everybody, that is equitable. This study therefore reveals to them the extent to which equity has been achieved by the numerous amendments.
- (ii) Income Tax Department: This is the department which administers the Income Tax Act. It is interested in knowing the contributions made by the amendments to the attainment of a good tax system and in particular to equity. This study clearly shows to what extent equity has been achieved by the amendments. The study therefore enables the department to objectively assess its efforts towards the attainment of equity. The study opens new issues for discussion and a review of the changes which may lead to further favourable changes.
- (iii) Tax Consultants: These are the people directly involved with offering professional services pertaining to tax matters. They are interested in knowing the extent to which the amendments have achieved equity because the amendments directly affect the tax position of their clients. The study therefore reveals to them the degree of achievement and draws their attention to certain areas which need their participation with a view of improving the Kenyan tax system.
- (iv) The Institute of Certified Public Accountants (Kenya): This is a professional body faced with a task of developing standards crucial to the accounting profession in Kenya. The Institute through its Economic and Fiscal Committee sometimes makes suggestions to the Income Tax Department

with respect to certain tax issues and the Income Tax Department to a certain extent incorporates these suggestions in the amendments. The study therefore shows the extent to which the amendments, have contributed to the establishment of fairness in the tax system.

(v) Members of Parliament: These are the people who pass the laws and regulations in the country. Most of the amendments to various Acts are discussed by them. The study therefore shows them the extent to which the amendments have contributed to the establishment of fairness in the tax system.

✓ (vi) The Treasury: This department is directly involved with the amendments in the sense that representatives from the Treasury are usually members in committees that discuss the amendments to the Income Tax Act. The study therefore shows the extent to which the amendments have been useful in attaining equity in the tax system and what areas need further discussion.

1.4. OBJECTIVES OF THE STUDY

The objective of this study is to establish whether some of the numerous amendments that have been made to the Income Tax Act have actually established an equitable tax system.

1.5. METHOD OF STUDY AND ANALYSIS

The method of study has basically been a review of secondary data pertaining to the area under study such as finance bills, finance acts, Kenya gazettes, budget speeches, newspapers, journals, magazines, Income Tax Act No. 16 of 1973, Revised Edition 1977 and revised edition 1979 and various textbooks on taxation.

The method of analysis was both qualitative and quantitative. I have used numerical examples to illustrate the effects of the amendments where possible. The numerical examples mainly illustrate the tax position of the taxpayer before and after the amendments.

I considered the above method ^{of} study appropriate to this study then ^a say analysing data, ⁷ because for such a study to be useful to the interested parties a critical analysis of the extent to which the ^e amendments have achieved equity is required. In this type of study numerical examples are very requisite because they clearly show the effects of the amendments.

SELECTION OF THE AMENDMENTS ANALYSED

Chapter four contains most of the amendments in the Income Tax Act from 1973 to 1982. Due to lack of adequate time I have analysed only a few amendments in the light of equity. These amendments were not selected at random, they were selected on the basis of how well they illustrate the equity criterion. Other amendments can best be analysed in the context of other criteria such as neutrality and certainty. For instance, an amendment such as the bringing of the administration of capital gains tax under the Income Tax Department can best be analysed in the context of administrative efficiency.

1.6 SUMMARY OF THE MATERIAL COVERED IN THE REMAINING CHAPTERS

Chapter two contains a discussion of the theoretical criteria of a good tax system. The chapter makes the reader aware of the existence of other characteristics of a good tax system other than equity which is the criterion under study. These characteristics have also necessitated some changes in the Income Tax Act. For example Neutrality has been a major force behind changes in the capital gains tax. In chapter three a detailed analysis of equity criterion has been done with a view of enabling the readers to understand the material that is covered in the remaining chapters. Chapter four contains a list of most of the amendments in the Income Tax Act from 1973 to 1982 and their effects. The reader is made aware of the fact that there are numerous amendments which, if there was ample time would all be analysed in the context of various tax efficiency criteria. In chapter five and six specific

CHAPTER TWO

amendments are dealt with. They are analysed in the context of equity criterion with a view of showing the extent to which equity has been achieved. Lastly chapter seven deals with the conclusions and limitations of the study and recommendations for further study.

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2.1. DEFINITION OF THE

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CHAPTER TWO

THE THEORY OF A GOOD TAX SYSTEM

This chapter contains a definition of the term tax, a brief explanation of why taxes are imposed in a country and a discussion of the criteria of a good tax system. Each of the following efficiency criteria are discussed; neutrality, certainty, simplicity, administrative efficiency and net expenditure restraining effect.

2.1. DEFINITION OF TAX

Sommerfeld, et al define tax as follows:-

A tax can be defined meaningfully as any nonpenal yet compulsory transfer of resources from the private to the public sector, levied on the basis of predetermined criteria and without reference to specific benefits received, in order to accomplish some of a nation's economic and social objectives. 1

Some phrases of this definition will be explained further. A tax is a non penal transfer of resources because it is not devised to solely prevent a person from engaging in some specific act deemed detrimental to society. Tax is not like a fine imposed on somebody for possession of bhang or any other dangerous drug nor is it the same as a fine imposed on an individual for assaulting another person. In summary, the major difference between a tax and a penalty is the specific objective behind the exaction. The phrase "without reference to a specific benefit received" ² merely tries to distinguish between the price that must be paid before

1 Ray M. Sommerfeld, Hershel M. Anderson, Horace R. Brock, An Introduction to Taxation. Harcourt Brace Jovanovich, Inc. New York San Diego, Chicago, San Francisco, Atlanta 1980 pg. 1

2. See the definition of tax above.

anyone can receive a private good and the cost of producing a public good. Private goods and services are defined as those that can be allocated among would-be benefactors by means of a price mechanism; that is, by operation of laws of supply and demand. Thus only those who are willing and able to pay the market price can benefit from a private good or service. Public goods, on the other hand, are defined as those goods and services that cannot be allocated by means of a price mechanism. For example, it is impossible to allocate the benefits of a good police force or an army by means of a pricing mechanism. Everyone benefits from the existence of a public good, whether or not he or she has an immediate and direct need to consume that good or service.

The phrase "predetermined criteria"¹ means that tax unlike outright confiscation is levied on the basis of certain rules and procedures already set, for example, the personal rates, corporation rates and the types of income subject to taxation. The predetermined criteria make tax quite equitable because subjectivity in the determination of tax is minimized. The phrase "Economic and social objectives"² will be discussed in the next section dealing with the role of tax.

2.2. THE ROLE OF TAX

Today taxes are a major tool by which the government directs and influences the reallocation of resources necessary to achieve the nation's economic and social objectives. Some of these objectives are the redistribution of income, stabilization of the economy, and provision of public goods.

1 See the definition of tax on page 8

2 Ibid

2.2.1. Redistribution of Income

The Government taxes the rich people and redistributes the income to the less fortunate people either in the form of subsidies or by providing services such as medical facilities which the less fortunate cannot afford.

2.2.2. Stabilization of the Economy

Another important use of taxation is that of a tool aimed at improving the performance of the national economy by such means as altering the balance between current consumption and capital investment. To reduce consumption the Government can increase tax and consequently reduce disposable income. To increase investment the Government can give tax concessions to certain projects or, through reduction of rates in certain industries like mining, give tax savings.

Sometimes Governments may adversely affect the economy by taxation policies which produce the wrong redistribution of resources. However, it is extremely difficult to isolate taxation as a casual factor in any economic variation, good or bad, because so many other factors are at work and are inextricably interwoven. Attempts have been made to analyse the effect of particular taxes, on the premise that other factors remain unchanged. One fundamental weakness in these attempts has been the premise that other factors remain unchanged. It is misleading to assume that all other factors will remain unchanged because the taxation policy may be effective only when linked with these other factors.

2.2.3. Provision of Public Goods:

Public goods should be provided by the Government because their nature, to a certain extent, precludes their optimal provision by the Private sector. These goods are consumed jointly by the members of the society.

For example, every one wants defence and nobody can claim to want more or less of it than another person. These goods are indivisible hence they cannot be consumed by individuals in different amounts consequently they cannot be priced. In economic terms, there is no demand curve for these goods. However, quasi-public goods like education can be supplied by both public and private sector. This is so because, to a certain extent, they can be priced.

Where goods are consumed jointly the exclusion principle cannot operate. This means that some people cannot be excluded from consuming a public good because of lack of money. In the private sector when one has no money one is excluded from consuming a commodity. The supply characteristics of the public goods also make them inappropriate to be supplied by the private sector. They are very risky so the private sector is not willing to supply them. If they were to be supplied by the private sector they would be very expensive to the consumers.

The provision of public goods is accompanied by some other unintended effects. These effects are external to the main aim hence they are known as externalities, neighbourhood effects, or spill-overs. They exist where an individual benefits but does not meet the costs. For example, if Mr. X constructs street lights to his home he cannot prevent his neighbours from using the lights. The Government has therefore to tax all the citizens and provide for these externalities.

So far we have explained what we mean by the term tax and considered some of the reasons why taxes are imposed. We are now going to deal with the criteria for a good tax system.

2.3. CRITERIA FOR A GOOD TAX SYSTEM

Taxes should be lexied in a way that makes them efficient and serve the purposes for which they were introduced. The main aim of a taxation policy must be to impose taxes in such a way that they create the greatest possible advantage to the country as a whole. A good tax system should meet the theoretical criteria of a good tax system discussed below.

2.3.1. Simplicity

Taxes should be simple so that the tax payers understand that they are required to pay tax and are able to determine how much tax they are supposed to pay. The tax legislation should not be very complex especially in developing countries because a lot of manpower especially tax specialists, will be required to interpret it.

It is widely argued that tax systems are too complex and as a result people do not understand them, require advice to deal with them and tend to loose faith in their fairness. In the Kenyan tax system this argument can be supported by the volume and complexity of the Income tax legislation. The Income Tax Act chapter 470 Revised Edition 1979 consists of one hundred and thirty three sections subdivided into various subsections which are further divided into paragraphs and subparagraphs. There are seven schedules subdivided into various parts. Attached to the Act is also a subsidiary legislation of twenty four pages¹. The complexity is intensified by the fact that the legislation is expressed in legal language

1 The Income Tax Act Chapter 470 Revised Edition 1979 (1977)
Printed and Published by the Government Printer, Nairobi.

and is not always organized in an easily followed manner. Tax calculations should not be very complicated because financial circumstances of the majority of people to which they apply are not complex so there seems to be no reason why the tax calculations should be any more complex. These people receive a wage or salary from one employer at a time and may earn income from other sources which is not difficult to determine hence there is no complexity about the determination of income. However, in Kenya these complexities arise essentially for two reasons:-

a desire to be fair in all sorts of special circumstances and the carry-over of complexity from a British system that was originally designed for people in a much more complex financial situation. Efforts to achieve fairness are exemplified in personal reliefs for different categories of people. That is, family relief for the married people, single relief for the unmarried ones and special single relief for the unmarried people who have children. Also certain procedures used in determining tax liabilities are a measure to achieve fairness for example, assessment of wife's employment income, exemption from tax of certain income such as profits of an agricultural society, gains derived from transfer of land where the value does not exceed thirty thousand shillings.

The second reason arises because Kenya was a British colony and the first ever income tax imposed on the Kenyan people was through a Colonial Ordinance in 1937. In 1940 income tax was imposed on the people of Uganda and Tanganyika. In 1952 the three Ordinances were combined into the East African Income Tax (Management) Act. Most of the Provisions of the East African Income Tax (Management) Act were incorporated in the Income Tax Act enacted in 1973 in the Parliament of Kenya. The East African Income Tax (Management) Act borrowed much from the Colonial Ordinance thus it is a fair

conclusion to say that the Income Tax Act enacted in 1973 borrowed much from the Colonial Ordinance.

Tax avoidance adds considerably to the complexity of the tax legislation. When tax payers take advantage of a loophole an attempt will be made to close it if it is regarded as both undesirable and the source of substantial loss of revenue. In some cases it will involve only a minor amendment to the wording, in others it will involve special sections which may be as complex as the devices they are intended to counteract.

2.3.2. ADMINISTRATIVE EFFICIENCY:

In assessing whether a tax is administratively efficient or not we look at the costs of collecting such a tax and the revenue derived from it. From the point of view of the Government (i.e. collector) the revenue collected should exceed the collection costs. From the point of view of the tax payer the tax should not involve a lot of costs especially in filing the returns, keeping additional records and paying the tax. The procedure of paying should be simple enough so that the tax payer does not resort to the assistance of the consultants because he may end up spending more on consultancy fees than the tax he is supposed to pay.

Where a tax involves very high collection costs, it should be eliminated. In this respect the Graduated Personal Tax (G.P.T.) is a good example. This tax was abolished because the costs were too high especially in the rural areas. The administrative staff (Chiefs, Sub-Chiefs and their assistants) spent days chasing the tax-payers as a result they did not have enough time to devote to their office work. On the other hand the tax-payers spent days hiding from the chiefs in order not to pay the tax and this hindered them from contributing to nation building in other ways such as working on farms.

The attempt to produce fairness has led to very complex tax provisions, the administration of which absorbs high-quality brainpower which in a way increases the administration costs. The fact that high quality manpower is being directed to the administration of taxes means that the Government places high price on fairness. Attempts to achieve fairness are evident in various aspects of the taxation system especially with respect to income tax which is the area under study in this paper. Changes in the individual tax rates, and changes in personal reliefs are among the many efforts aimed at achieving fairness. If this is so then we are justified in saying that the Government indeed places high price on fairness and in doing so it cannot avoid the complexity of administering the taxes and consequently the high administration costs.

Administrative costs are to a considerable extent related to the nature of the tax base. Where tax is collected from few points such as, large and well-organized companies with detailed records of the necessary information, the administrative costs are cheaper. This is the case with taxes on tobacco and petrol. Where the collection points are widely spread a great deal depends on the clarity and ease with which the tax base can be defined. Generally taxes on goods involve less administrative costs than taxes on rather vague concepts such as income.

Complex arrangements to prevent evasion of tax also add to the cost of collection. Cases of evasion are prevalent in the enforcement of income tax. Employed as well as self-employed people always try to evade tax through numerous ways and the Income Tax Department is forced to introduce complex measures to curb these practices. For example, on the issue of deliberately falsifying the accounts, the assessors are forced to issue estimated assessments which lead to extensive communication between the tax payers and the assessors which in itself is time consuming on both parties.

2.3.3. CERTAINTY

The term certainty when applied to a tax system refers to the degree to which the following aspects can be determined; who pays tax, how much, and when to pay. Both the tax payer and the revenue authority are interested in this aspect. The tax payer would like to know how much tax he is supposed to pay and when. This knowledge helps in making the tax more acceptable to the tax payer in that he is aware of his liability. He is also able to plan his affairs well. For instance, if he knows when he is supposed to pay the tax, he will make provision for it so that it does not hinder him to attend to other commitments that require cash outflows. Infact if a tax is certain, evasion on the part of the tax payer and malpractices on the part of the officials, will be curbed.

Certainty of a tax system helps the government to plan its budget because there is certainty as to how much money will be collected in a given year. The Government is in a position to know how much revenue to allocate to various projects for example building new roads, schools and hospitals. Thus, from the point of view of the revenue authority, a certain tax is the one that has a higher chance of being raised.

So far we have briefly defined the term certainty when applied to a tax system and why it is of interest to the tax payer as well as the government. We shall now deal with specific aspects of certainty at length. The analysis of these aspects simply helps to clarify the points already highlighted above. The aspects dealt with below are: certainty of incidence, certainty of liability, Evasion ratio and lastly fiscal marksmanship.

(a) Certainty of incidence:

This refers to the certainty with which the authorities can predict the effective incidence of taxes. For instance, if the government aims at improving the health of people by reducing drinking beer, its ability to do so will be constrained by the certainty with which the effective incidence of various taxes is known. To impose a tax that will enable the government to meet its objective, knowledge of the following is required: whether the tax will be shifted backwards to the breweries by having them lower the prices, or whether it will be shifted forward to the employers of the beer drinkers in the form of higher wages so that they can still drink the quantity they were drinking before the imposition of the tax.

(b) Certainty of Liability:

From the point of view of the revenue authorities this refers to the ease and certainty with which tax liability can be determined. In this respect, sales tax ranks higher than say a wealth tax because for the latter the tax officials would have to value the tax payers' property. This would therefore involve a lot of subjectivity which would simply create chances for malpractices such as bribery on the part of the officials.

From the point of view of the tax payer, certainty of liability refers to the ease and certainty with which he can determine his tax liability. Using the above example, a tax payer is able to determine with certainty his tax liability in case of a sales tax but not in the case of a wealth tax. In the latter, he would have to know the valuation of his property by tax officials before

determining his tax liability. The tax payer would therefore, be left in anxiety and doubt about his liability.

(c) Evasion Ratio:

This ratio measures the certainty with which the government can extract the revenue from those liable to tax. In other words, to what extent can these people evade tax? In this respect, income tax is a weak tax because people often decline to disclose all their income. However, an indirect tax like tobacco duty is quite good because there is virtually no evation.

(d) Fiscal Marksmanship

This refers to the certainty with which the authorities can predict the revenue that will be collected in a specific year. This will depend on their ability to forecast the values of the macro and micro-economic variables upon which the tax revenue depends. For example, the certainty of the revenue from income tax depends on the ability of the authorities to forecast the income. Forecasting income entails determining the taxable units. The existence of tax files aids authorities in determining the taxable units. Also the employment records kept by employers assist them. In this respect, capital gains tax is a poor tax because no files exist before the transaction that generates the gains. The authorities rely on the legal documents to effect the transfer. However, where the transactions are "under-the counter" transactions, it is difficult for the authorities to determine exactly what the gains are.

2.3.4. NEUTRALITY:

Neutrality can be defined as the extent to which a tax avoids distorting the workings of the market mechanism. A tax which is neutral is the one that leaves the allocation of resources as they were before.

There are many channels through which a tax system may affect the economy's efficiency. It can have important effects on incentives and opportunities to work, to save, to invest in capital developments, to take risks and innovate, to use resources efficiently and to allocate them to uses which best serve the needs of society. Where a tax causes a reorganisation of consumers' choices, it is said to have substitution effects or announcements effects. When the tax is announced the consumer is prejudiced against the good which is taxed. The neutrality concept can therefore be said to be the search for a tax system which minimizes the substitution effects. Substitution effects take many forms. For example a wage earner may reduce his hours of work in order to substitute untaxed domestic leisure or do-it-yourself activity at home for taxed work. A housewife may substitute untaxed domestic work for taxed earnings outside home. A businessman may substitute an easy life for the energy and worry needed to improve the efficient use of his resources, because the post-tax increase in his profit makes the payoff unattractive. A saver may substitute present consumption for future consumption by himself or his heirs, because of the tax on yield from his savings.

Taxation may cause other kinds of distortion. It may lead to the substitution of one form of business organization for another. For example, differences in the tax treatment of unincorporated businesses and of incorporated businesses may lead to the choice of a form of business organisation which

is not the most appropriate and efficient for the particular purpose at hand. Or taxation may lead to the substitution of a less profitable but steady business for a more profitable but fluctuating business, because with a progressive tax system the tax burden on a given average income is higher if the income fluctuates than if it is steady.

The importance to be attached to each of these possible forms of inefficiency depends upon the extent of each relevant substitution effect. Obtaining and interpreting the relevant information is difficult, and in fact little is known about the importance of these substitution effects. But in principle it is a question of fact whether in any particular sector of economic activity these substitution effects are large or small. Prof. Meade says that "Avoidance of economic inefficiencies would involve avoidance of high marginal rates of tax where these substitution sensitivities were great".¹ He further says that "to raise a given revenue by means of low rates of tax spread over a large tax base may be assumed to cause less marked substitution distortions than to raise the same revenue by concentrating high rates of tax on a few activities."² To achieve Professor Meade's suggestion the erosion of the tax base through a multiplication of exemptions and reliefs should be resisted. In Kenya this is not the case. The tax base is being eroded by numerous exemptions and reliefs. The argument for this erosion is the attempt to achieve equity which is one of the criterion of a good tax system. Professor Meade's suggestion can also be achieved through reliance on a tax system which comprises a number of different taxes rather than reliance on only one or two taxes in order to keep down the marginal rates of tax on any one line of activity. This appears to be the case in Kenya. There are numerous taxes for example sales tax, consumption tax, Hotel accommodation through which the government raises revenue.

1 The Structure and Reform of Direct Taxation, A Report of a Committee chaired by Professor Meade, page 9

2 Ibid

An example of a tax that is nearest to a neutral tax is poll tax which is discussed below.

Poll Tax

Poll tax was a tax levied on any adult not liable to hut tax. The Native Hut and Poll Tax Ordinance No. 2 of 1910 which repealed the Hut Tax Ordinance of 1903 for the first time introduced the principle of a poll tax to co-exist with hut tax. However, in practice a poll tax had been previously levied as early as 1903. The rate was first established at three rupees per annum for every adult who was not liable to hut tax. If a tax payer had no means of paying the tax he could work on public works to settle the payment. The period of work specified was one month for every three rupees.

Poll tax was a neutral tax in the sense that it was not based on say income, number of huts or amount of goods or services consumed. It did not therefore interfere with people's decisions regarding choice between work and leisure. Poll tax was unlike hut tax which discouraged improvement of housing conditions and led to overcrowding.

NET EXPENDITURE RESTRAINING EFFECT

In the context of taxes the above criterion refers to the extent to which taxes affect expenditure. For instance, if a tax is aimed at reducing expenditures its effectiveness is assessed by the degree to which it meets this objective that is, has it effectively reduced expenditure? Establishing whether a tax has indeed reduced expenditure depends on who is being taxed. Some people who want to maintain their marginal propensity to consume will simply revert to their past savings and thus maintain their level of consumption.

This criterion has been illustrated in a paper on "The Development of Capital Gains Tax in Kenya"¹ which has been adopted as an appendix in this paper.

1 See Appendix page 8

CONCLUSION:

In this chapter we have discussed why taxes are imposed in a country and the theoretical criteria of a good tax system. This chapter has shown that there are other characteristics of a good tax system apart from equity. These characteristics have also necessitated amendments in the Income Tax Act and quite a number of amendments could be analysed in the context of each of these characteristics.

CHAPTER 3

EQUITY

This chapter deals with the theoretical aspects of equity with particular reference to the Kenyan tax system.

3.1. Meaning of Equity

Sommerfeld, et al define equity as "the equal treatment of similarly situated taxpayers".¹ The major problem encountered in implementing this criterion is that the definition fails to provide a method or basis for measurement to determine under what conditions two or more tax payers are similarly situated. However, as the term equity is used in other discussions like in politics, it seems to imply that the appropriate measure is implicit in the tax base. For example, a tax imposed on the purchase of a given commodity is assumed to be equitable so long as all buyers of the identical commodity have to pay an equivalent tax. Similarly a tax imposed on income is deemed to be equitable as long as two persons earning the same amount of income during a given time period pay the same amount of income tax.

Taxes should be equitable because if they are believed to be inequitable the consequences might be widespread discontent and evasion. The many suggestions, complaints and comments in newspapers about how inequitable the Kenyan tax system is show the extent of the discontent about the system.

A fundamental question that one asks with regard to equity is; "Is the burden of taxation tolerable and is it fairly distributed?"² This is a difficult question to

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- 1 Ray M. Sommerfeld, Hershel M. Anderson, Horace Brock; An Introduction to Taxation. Harcourt Brace Jovanovich. New York San Diego Chicago San Francisco Atlanta 1980 pg 2/10
 - 2 Davey Kenneth, Taxing A Peasant Society; The Example of graduated taxes in East Africa, London, Knight 1974, page 71

answer in a country like Kenya where the incomes of a very small percent of the population are accurately known. However, this is a crucial question in understanding equity therefore an attempt must be made to consider it at length.

A fundamental principle of equity is that "as income increases the proportion levied in tax should not decline and should, if possible, rise."¹ The individual tax rates in Kenya seem to be in line with this principle as the table below shows. The tax on earnings within each income range is at a fixed percent.

The Individual Rates of tax²

	<u>Rate in each twenty shillings</u>
On the first £1500	2.00
On the next £ 1,500	3.00
On the next £ 1,500	5.00
On the next £1,500	7.00
On the next £ 1,500	9.00
On the next £ 1,500	10.00
On the next £ 3,000	12.00
On all total income over 12,000	13.00

Within each income bracket various levels of income attract different tax liabilities. For example in the first bracket, a person earning £700 will pay less tax than a person earning £1,300 although they are in the same tax bracket.

Tax on £ 700 is shs. 1,400

Tax on £ 1,300 is shs. 2,600

1 Davey Kenneth J., Taxing A Peasant Society, page 72

2 Kenya Gazette Supplement No. 52 (Acts No. 6) Printed and Published by the Government Printer, Nairobi. Page 35

There is therefore progressive incidence within each income bracket. There is also progressive incidence between different income brackets. For instance, a person in the first bracket will pay less tax than a person in the second bracket as shown in the illustration below:-

Illustration

Mr. Yona earns £ 1,300 per annum from his shop in Mudoma village. Mr. Lubanga earns £ 1,800 per annum from his cotton farm in Mulwanda village.

Their tax liabilities will be as follows:-

Mr. Yona

Tax on the first £ 1,300 is shs. 2,600

Mr. Lubanga

Shs.

Tax on the first £ 1,500 is 3,000

Tax on the next £ 300 is 900

3,900

One tax which violated the principle that as income increases the proportion levied in tax should not decline and should if possible rise was Graduated Personal Tax (G.P.T.) which was abolished in 1973. G.P.T. violated this principle in the following respect; incidence was regressive within each income bracket and the lower limit bore high incidence than the upper limit. The table below shows the regressive incidence of G.P.T. rates.

Incidence of G.P.T. Rates

(Amounts in Shillings)

<u>Annual Income</u> ¹	<u>Annual Tax</u> ¹	<u>Percentage</u>	
		<u>From</u>	<u>To</u>
0 - 960	0	0	0
961 - 1920	48	4.99	2.50
1921 - 2880	72	3.74	2.50
2881 - 4080	108	3.74	2.64
4081 - 6240	156	3.82	2.50
6241 - 8400	240	3.84	2.85
8401 - 10,320	360	4.28	3.48
10,321 - 12,000	480	4.65	4.00
Over 12,000	600	5.00	-

Percentage incidence is computed as follows:-

$$\frac{\text{Annual Tax}}{\text{Annual Income}}$$

Regressive incidence is exemplified in the declining percentage incidence between the lower limits and the upper limits of the income brackets.

Regressive incidence within income brackets is an inevitable feature of the slab system that is levying fixed rates of tax on each range of income. This was the system being applied in levying G.P.T.

From the above discussion on G.P.T. it is clear that the tax was not equitable and although the reason often quoted for its abolition is administrative inefficiency, one can be led to infer that inequity also contributed to its abolition.

There are two classes of equity namely:- horizontal equity and vertical equity. Horizontal equity describes the equal treatment of equal people. That is if X and Y have the same taxable capacity they should bear the same tax burden. Vertical equity, describes the treatment of tax payers who are unequal with the appropriate degree of inequality. That is, if X's taxable capacity is greater than Y's, X should bear greater tax burden and vice versa. However, to define taxable capacity always turns out to be very difficult and to be a matter on which opinions differ widely. The difficulties encountered in defining taxable capacity will be considered in depth in the following sections.

3.2. HORIZONTAL EQUITY:

From the above definition horizontal equity implies that people who are equal in terms of income should bear equal tax burdens. Horizontal equity is evident in the individual tax rates. For example, two people earning same employment income pay the same tax. All people who smoke two packets of cigarettes a day pay the same tobacco tax. The assumption in these cases is that these two people are the same. However, to be more equitable should we not consider the needs of these people which might have caused hardships during the earning of the income. An obvious case is the need for a larger income to provide a given standard of living for those people who, because of incapacity of one kind or another, have greater needs for help and attention. Such people as the deaf and the blind should receive special tax treatment.

Closely related to needs is the nature of the tax units to be considered in comparing the taxable capacity. Is it the individual, the nuclear family, the extended family or the household? In Kenya, the nuclear family seems to be considered. Horizontal equity where two families have same taxable capacity is illustrated below.

Illustration

Families A and B have the same total income but earned differently.

	<u>Husband</u>	<u>Wife</u>	<u>Total Income</u>
Family A	35,000 (Employment)	15,000 (Employment)	50,000
Family B	30,000 (Employment)	20,000 (Business Income)	50,000

The tax liabilities for these couples are determined as follows ignoring any allowances:-

Family A

Total taxable income	<u>£ 2,500</u>
Tax on wife's employment income £750x2	Shs. 1,500
Tax on the remainder £ 1750	<u>3,750</u>
Total tax	<u>5,250</u>

Family B

Total taxable income	£ 2,500
Tax on total income	Shs.
On the first £ 1,500	3,000
On the next £ 1,000	<u>3,000</u>
Total tax	<u>6,000</u>

Horizontal equity is therefore violated because although two families have the same total income they bear different tax burdens.

3.3. VERTICAL EQUITY

Vertical equity describes the treatment of tax payers who are unequal, with the appropriate degree of inequality. It is therefore a very good concept, but very hard to achieve in practice because there are so many views as to what is the appropriate degree of inequality. For some, the appropriate degree of inequality of income tax will be served by a proportional tax, others prefer progressive income taxes as being more equitable.

In Kenya vertical equity is pursued through a progressive income tax. This is the tax in which the marginal rate rises as the income rises. However, a progressive tax has what is known as a minimax point and a threshold income. The minimax point is the point where the marginal rate does not rise any further. In Kenya this is at £12,000 where the rate is shs. 13 in £1 or 65%.¹ Threshold income is the level of income where the tax is zero. In Kenya the level is shs. 600 per month or shs. 7,200 per year. At this level the tax is shs. 60 per month and the allowance for a single person is the same amount and therefore it is a point of zero tax.

The greater a person's income, the greater is the proportion of it that is collected in tax. Therefore the argument for progression is partly based on the assumption that as income rises its marginal utility declines. If income were merely proportional it would result in a greater loss of utility or welfare for the poor than for the rich.

However, although the progressive tax system achieves equity to a certain extent, it is not without its drawbacks, and it is appropriate at this juncture to mention a few of these drawbacks.

1 Kenya Gazette Supplement No. 52 (Acts No. 6) Printed and Published by the Government Printer, Nairobi. Page 35.

The progressive system has some undesirable economic effects. For instance, if the aim of taxation is to transfer purchasing power from the individual to the State, increasing the tax payable by the rich however, may not reduce their actual consumption of goods and services. The rich may turn to their past savings and thus still maintain their marginal propensity to consume. A tax on the poor, however, tends to remove spending power which would have been applied to personal consumption and it can therefore be transferred directly to public consumption.

Another drawback of the progressive tax system is that the high marginal rates of tax on higher income levels can distort the choice between more income and more leisure in favour of the latter. Thus it is argued that progressive taxation reduces the gross output of the most skilled members of the working population. The high marginal rates of tax lead to other economically undesirable attitudes to risk and investment. All these negative reactions result into a reduction in national output.

Another means through which vertical equity is pursued is the giving of allowances and reliefs. Allowances and reliefs bring about vertical equity in the sense that where two people have the same income but have different obligations they are given different allowances and reliefs. For example, if two men have the same income but one of them is married their tax burdens will differ due to the reliefs available to them. The one who is married will have a family relief of Shs. 1,800 offset against his tax liability. Whereas the unmarried one will have a single relief of Shs. 720 offset against his tax liability. The rationale behind these different treatment is that the one who is married has more obligations. He has to look after his wife and children. However, this is not a fair assumption. The one who is unmarried might have more obligations than the married one. He might be having many sisters, brothers, cousins and other members of the extended family to care for. Kenya's policy

of giving allowances and reliefs is usually criticized on the grounds that there are few reliefs which cannot cater for all aspects of welfare. There should be reliefs such as the dependants' relief, relief for blind persons, and old age relief.

So far we have discussed at length horizontal and vertical equity. In the following sections we are going to discuss equity and other concepts like administration, complexity and volume of tax legislation and tax avoidance.

3.4 Equity and Administration:-

This section deals with the effect of equity on administration. The attempt to produce equity has led to very complex tax provisions, the administration of which absorbs high - quality brain power which some people think would be better employed more positively. The Income Tax Department employs many assessors who have to scrutinize the returns of various individuals and corporations so that fair assessments are made. The assessors spend time with either the individuals or tax consultants trying to get from them the information necessary for fair assessments. This is done because to a large extent individuals as well as corporations avoid tax by deliberately falsifying the accounts to reflect low income than actually earned.

3.5. Equity and Complexity and volume of tax legislation

The desire to be equitable in all sorts of circumstances has tremendously contributed to the complexity and volume of the tax legislation. The Income Tax Act is voluminous and is written in a legal language which makes it quite complex. The rationale behind the volume and complexity is to provide for all circumstances pertaining to the welfare of the tax payers as much as possible. Where issues are not clearly dealt with there is room for avoidance which as we shall see later leads

to inequity. New sections, subsections, paragraphs, etc. are added to the Income Tax Act in order to curb tax avoidance and thus achieve equity. In the 1982/83 budget speech, the Minister for Finance proposed some loopholes in order to curb tax avoidance that had been going on. The closing of these loopholes has of course added to the volume of the Income Tax Act. The fundamental reason behind all these measures is to achieve equity in the tax system. The loopholes closed by the Minister pertained to alimony and lease hire of vehicles discussed below.

(i) Alimony

Under section 3(2)(d) alimony is deductible before computing tax liability. A loophole exists here in the sense that where the recipient is a non-resident, such payments can easily escape taxation because there is no withholding tax on alimony. Alimony creates another problem in the sense that by exempting alimony from tax where the person making payment is paying tax at a higher rate than the person receiving it, the Government subsidizes the couple to the extent of the difference between what tax would have been paid and what has actually been paid. Finally, there is no limit on the amount of alimony a person can claim to have paid and with collusion of the recipient the amount can be inflated to evade tax. To close these loopholes alimony ceases to be deductible for tax purposes.

(ii) Lease-hire Payments

Lease-hire payments for non-commercial vehicles are not allowed as deductions from income for tax purposes. Some people have circumvented this prohibition by resorting to registering private cars as commercial vehicles so as to get lease-hire payments deducted from income for tax purposes. In order to close this loophole commercial vehicles which will be eligible for the deduction have been defined.¹

1 See Chapter 4 Amendment No. 113

Section 12(1)(b) makes lease hire arrangements more attractive than purchasing assets, particularly commercial vehicles. This encourages tax evasion. In order to close this loophole the law is to be amended to restrict the capital sum which can be included for calculation of tax deductions.

3.6. Equity and Tax Avoidance

Tax avoidance occurs when an individual operates within the law and reduces his tax liability by taking advantage of the loopholes in the act. Tax avoidance results in inequity because much of the tax burden is left to those people who have no means of avoiding tax such as the employed people. Those individuals/corporations who/which can take advantage of the loopholes do not hesitate to do so. The loopholes closed during the budget speech delivered on 17th June 1882^{2!!!} clearly demonstrate how equity can be achieved by eliminating or minimizing the chances of tax avoidance.

3.7. CONCLUSION

Equity is an essential characteristic of a good tax system. And in the Kenyan tax system quite a number of amendments have been made in order to achieve equity¹. As the foregoing discussion shows equity affects most of the other criteria of a good tax system while a good tax should be simple as already discussed there should be a trade-off between simplicity and complexity so that equity is attained. The Income Tax Act should be quite comprehensive so that nothing pertaining to the taxation of income is left unexplained. Where there are loopholes which allow tax avoidance, the Income Tax Act should be amended accordingly so that the loopholes are closed. Administrative efficiency is one of the characteristics of a good tax system. Sometimes administrative costs are fairly high because the Income Tax Department has to endeavour to achieve equity,² Neutrality is another criterion of a good tax system. However, there has

1 See Chapter 4

2 See discussion on Equity and Tax Avoidance

to be a trade-off between equity and neutrality. For instance although progressive tax system has some undesirable economic effects, it is adopted here in Kenya because it is one of the ways of attaining equity.

This chapter consists of a study of components of the income tax system in Kenya. It is intended to give the reader a general idea of the structure of the tax system. A detailed analysis of all these aspects is given in the chapters of this paper. However, it is to be noted that the reader will find that the system is not perfect. Although the effects may be varied, they may be equal to what the government has intended. The Treasury has tried to achieve a good balance

and for guidance.

DEPARTMENT OF STATISTICS
KENYA BUREAU OF STATISTICS

CHAPTER 4

LIST OF AMENDMENTS AND THEIR EFFECTS FROM 1973 TO 1982

4.1. INTRODUCTION

This chapter contains a list of amendments in the Income Tax Act from 1973 to 1982 and their effects. It is intended to give the reader an outline of the amendments referred to in chapter one. A detailed analysis of all these effects is outside the scope of this paper. However, it is my hope that the reader will find this chapter useful. Although the effects have been analysed briefly, they show the extent to which the Income Tax Department and the Treasury have tried to achieve a good tax system.

4.2. LIST OF AMENDMENTS AND THEIR EFFECTS

SECTIONS AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
1) Section 7 (2)(a) of Income Tax Act No. 16 of 1973	Dividend received by a company which controls directly or indirectly less than twenty-five per cent of the voting power of company paying dividends shall be deemed not to be income chargeable to tax	The words "twenty-five per cent" are deleted from the paragraph and the following words substituted "twelve and one-half per cent"	The reduction of the percentage of the voting power means that dividends chargeable to tax is increased
2) Section 8(3)(b) of Income Tax Act No. 16 of 1973	Any pension received in respect of employment by or services rendered to the community or one of its corporations shall be deemed to have accrued in or to have been derived from Kenya	Paragraph (b) is deleted and a new paragraph substituted. (b) If received by a non-resident individual if the person making payment of the pension was resident in Kenya	The amendment makes the the payment of pension under the said circumstances easier

SECTIONS AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
2)	b) If received by a non-resident individual if such individual was resident in Kenya immediately before the cessation of such employment or services		
3) Section 8(5) of Income Tax Act No. 16 of 1973	The first five thousand shillings of the total pensions derived from Kenya and paid to a non-resident person in any year of income shall be deemed to be income not charged tax	Subsection 5 is deleted	The said income is now to be taxed
4) Section 15(2)(q) of Income Tax Act No. 16 of 1973	In computing for any year of income the gains or profits chargeable to tax the following amount shall be deducted:- in case of an individual (other than an employee who carries on, whether alone or in partnership one of the professions, and who possesses the	Paragraph (q) is deleted and a new paragraph substituted: The first part of the new paragraph is same as the old paragraph. Second part of the paragraph is as follows:- provided that in the case	The housing deduction of the said person is to be reduced by the value of the premises provided by an employer which means that income chargeable to tax is increased.

SECTIONS AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
4)	relevant qualifications mentioned in the fifth schedule) a housing deduction equal to fifteen percent of the gains or profits from his profession or fourteen thousand shillings, whichever is less	of any such individual who receives income from any employment and who also occupies, for residential purposes premises provided by his employer, the housing deduction under this paragraph shall be reduced or extinguished as the case may be, by the value of such premises	
5) Section 34(2) Income Tax Act No. 16 of 1973	Tax upon the income of a non-resident person not having a permanent establishment in Kenya other than a person resident or having a permanent establishment in other Partner states which consists of any management or professional fee, any royalty, any rent, premium, dividend,	"The words "shall be charged for any year of income at the appropriate non-resident rate for such year of income" are deleted and the following words substituted "Shall be charged at the appropriate non-resident rate in force at the date of payment of such income"	The rate in force at the time of payment is to be used rather than the rate for the year of income in question. The change alleviates any problems which would arise where there has been more than one non-resident rate during the year

SECTIONS AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
	<p>interest, pension or retirement annuity shall be charged for any year of income at the appropriate non-resident rate for such year of income</p>		
6) Section 35(3)	<p>Every person shall upon payment of any amount to any person resident or having a permanent establishment in Kenya in respect of any dividends or any interest on a loan or deposit other than a loan from or deposit with any financial institution specified in the fourth schedule which is a resident or which has a permanent establishment in Kenya which is chargeable to tax, deduct there from tax at the appropriate resident withholding rate; provided that this section shall not apply to any</p>	<p>The words "four hundred shillings" and "three hundred shillings" are deleted from the proviso and the following words substituted "two hundred shillings in the year" and "one hundred and fifty shillings in the year" respectively.</p>	<p>Payments in respect of dividends and interest subject to withholding tax are increased which means that taxable income is increased</p>

SECTIONS AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
	<p>payment of less than four hundred shillings in respect of interest or of less than three hundred shillings in respect of any dividend.</p>		
<p>7) Section 92(2) (a)(ii) Income Tax Act No. 16 of 1973</p>	<p>The tax charged in an assessment other than a provisional assessment shall be due and payable in all other cases, except in the case of an individual, within thirty days from the date of the notice of such assessment or on or before 30th June in such year, whichever is the later</p>	<p>The following words are deleted "or on or before 30th June in such following year, whichever is the later." A proviso is inserted at the end of paragraph (a); Provided that where a return of income has been furnished, in accordance with section 52 of this Act, one half of such tax shall be due and payable within thirty days of the date of service of notice of such assessment and the</p>	<p>This amendment enables the tax payer to settle the tax liability in two instalments thus enabling him to meet his other financial commitments.</p>

SECTIONS AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
		other half on or before the date of expiry of a period of four months from that date.	
8) Second Schedule Paragraph 24 Income Tax Act No. 16 of 1973	Investment deduction. in respect of buildings and machinery at the rate of 20% is allowed. (i) on capital expenditure on construction of an industrial building where the construction commenced after 1st January, 1974 and which is used by him or by a lessee for the purposes of an approved business or on the purchase of machinery to be installed or used solely in such building for the purposes of such business or	Paragraph 24 is deleted and the following new paragraph substituted. Investment deduction: in respect of buildings and machinery at the rate of 20% is allowed on (a) Construction of building and on the purchase and installation therein of new machinery being used by the owner or lessee for purposes of manufacture (b) On the purchase and installation of new machinery in any part of a building other than a building	The amendment enables any any owner or lessee of a building used for manufacturing purposes to claim investment deduction irrespective of when the building was constructed. It also allows him to claim the allowance where the building has been partly used.

SECTIONS AFFECTED

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AMENDMENTS

(ii) on capital expenditure referred to above incurred by the lessee.

(iii) on capital expenditure incurred on the construction of a building subsequently in use as a hotel, where such construction or extension commenced after 1st January, 1974 and such building or extension is certified as an industrial building.

(iv) On the purchase of machinery to be installed or used solely in the hotel.

(v) On capital expenditure incurred on the purchase of machinery to be installed in a building other than an industrial building and the

or any such part previously used for the purpose of manufacture such machinery should be subsequently used for the purposes of manufacture and such machinery should not have been installed substantially in replacement of machinery previously in use in an existing business carried on by the owner of such new machinery.

(c) On the construction of a hotel building which is certified as industrial building. The deduction is only allowed in the first year of use.

Paragraph 24(2) is added and it includes the following:-

machinery is subsequently used for the purposes of an approved business and such an expenditure has not been incurred substantially for the replacement of machinery previously in use in an existing business carried on by such owner or lessee.

(a) Where under subparagraph (a) of paragraph 24(i), a building is used partly for other purposes, the capital expenditure on which the deduction in respect of the building is calculated shall be the capital expenditure attributed to that portion of the building which is used for the purposes of manufacture.

However, where the capital expenditure so attributable exceeds nine-tenths of the total capital expenditure incurred on the construction of the building the whole building shall be treated as used for the purpose of manufacture.

(b) Where an existing building is extended by further construction the extension shall be treated as a separate building.

(c) Capital expenditure incurred on the construction of a building does not include any capital expenditure on the acquisition of or of rights in or over any land.

(d) Definitions of the following words, building, installations manufacturing and new.

9) Third Schedule
Head B
Paragraph 2
Income Tax Act
No. 16 of 1973

The corporation rate of tax shall be eight shillings in each twenty shillings save in the case of:-

a) the total income of a non-resident company baring a permanent establishment in Kenya when the rate shall be ~~nine~~ shillings and ~~fifty cents~~ in each ~~twenty~~ shillings.

b) that part of the total income of a company which relates to income derived from the mining of specified minerals when the rate shall be four shillings and fifty cents in respect of each twenty shillings of such part of income.

Paragraph 2 is deleted and the following new paragraph substituted. The corporation rate of tax applicable to income for the year of income 1974 and for each subsequent year of income shall be nine shillings in each twenty shillings save in the case of

(a) the total income of a non-resident company having a permanent establishment in Kenya when the rate shall be ten shillings and fifty cents in each twenty shillings.

The amendment increased the tax payable by corporations.

Provided that the rates shall be eight shillings in each twenty shillings of such part of the total income from the fifth year and in each subsequent year, after the first year in which such company is liable or would, but for the provisions of subsection (4) of section 15 of this Act become liable to pay corporation tax.

(b) that part of the total income of a company which relates to income derived from the mining of specified minerals when the rate shall be five shillings and fifty cents in respect of each twenty shillings of such part of the total income.

Provided that the rate shall be nine shillings in each twenty shillings of such part of the total income from the fifth year and in each subsequent year after the first year, in which such company is liable or would but for the provisions of subsection (4) of section 15 of this Act, become liable to pay corporation tax.

		(c) the part of the chargeable income of a resident Insurance Company which relates to its life insurance business when the rate shall be eight shillings in each twenty shillings of such chargeable income.	
10)Third Schedule Head B Paragraph 3 Subparagraph (d) and (f) Income Tax Act No. 16 of 1973	The non-resident tax rates shall be (d)in respect of any dividend twelve and one-half per cent of the gross amount payable. (f)in respect of any pension or retirement annuity, twelve and one-half per cent of the amount payable.	The words "twelve and one-half per cent" are deleted from subparagraph (d) and the following words substituted: "fifteen per cent" The words "twelve and one-half per cent" are deleted from subparagraph (f) and the following words substituted "five per cent."	This amendment increases the tax on dividend income and reduces tax on pension or retirement annuity.

<p>11) Third Schedule Head B Paragraph 4 Subparagraph (d) Income Tax Act No. 16 of 1973</p>	<p>The interstate tax rates shall be (d) in respect of any dividend, twelve and one-half percent of the amount payable (f) in respect of any pension or retirement annuity twelve and one-half percent of the gross amount payable.</p>	<p>The words "twelve and one-half per cent are deleted from subparagraph (d) and the following words substituted "fifteen per cent" The words "twelve and one-half per cent" are deleted from subparagraph (f) and the following words substituted "five per cent."</p>	<p>Same as amendment no. 10</p>
<p>12) Third Schedule Head B Paragraph 5 Subparagraph (a) Income Tax Act No. 16 of 1973</p>	<p>The resident withholding tax rates shall be (a) in respect of any dividend, twelve and one-half per cent of the amount payable.</p>	<p>The words twelve and one-half per cent are deleted from subparagraph (a) and the following words substituted "fifteen per cent."</p>	<p>The withholding tax required on payment of dividends is increased.</p>

13)Sixth Schedule
Paragraph 7
Subparagraph (b)
Income Tax Act
No. 16 of 1973

Where under this Act (b) any sum is deemed to be an amount received under an approved pension scheme, in any year of income prior to the commencement of this Act, then an assessment in relation thereto for such year of income may be made as if such sum or portion, as the case may be, had been income charged to tax under the Management Act.

Subparagraph (b) is deleted and paragraph 11 is inserted immediately after paragraph 10.
11)Where, after the commencement of this Act, any payment is made in respect of the refund or return of contribution made or premium paid, prior to the commencement of this Act, under the approved pension scheme, approved fund, approved annuity contract, approved trust, scheme or approved provident fund mentioned in subsections (1) (2) (3) and (4) of section of the Management Act, such payment shall in the manner and to the extent provided in those sections, and in paragraph (c) of section 3 of

This amendment increases tax on dividend income and reduces tax on pension or retirement annuity from partner states.

the Management Act, be deemed to be income charged to tax under paragraph (e) of subsection 2 of section 3 of this Act.

Provided that:-

(a) references in subsection (2) of the said section 8 to any year of income shall be construed as meaning any year of income prior to the commencement of this Act

(b) references in subsection 2 of the said section 8 to "the year of income" and "the relevant year of income" shall be construed as references to the year ending 31st December, 1974.

(c) in subsection (2) of the said section 8 of the Proviso thereto shall be read and construed as if the following words were deleted namely

(i) which expired earlier than the year of income (hereinafter referred to as the relevant year of income) prior to the year of income

(i) in which it was received

(ii) in the case of a policy, in which the policy was assigned or transferred

(iii) in which the employee left the service of the employer

(iv) in which the person died whichever is the earliest and

(ii) in excess of one year of the period

(d) Subsections (3) and (4) of the said section 8 shall apply only in respect of contributions made, or in the case of paragraph (a) of subsection (4) thereof in respect of any pension right

Transitional provisions regarding refund or return of contributions made or premiums paid prior to the commencement of this Act, under an approved pension fund are elaborated. This elaboration is intended to simplify that part of the Act so that it can be understood by the reader.

		<p>accrued, prior to the commencement of this Act.</p>	
<p>14)Seventh Schedule Paragraphs 1,4 and 5 Income Tax Act No. 16 of 1973</p>	<p>1)"Community emoluments" means any gains or profits from an employment with, or services rendered to, the community, one of its corporations or institutions, or a wholly owned subsidiary of such corporation.</p> <p>4)Community emoluments shall be deemed to be derived by a community employee from the Partner State in which he is employed by or renders services to the community and shall be charged to tax in that state.</p> <p>5)When a person to whom paragraph 2 applies has income chargeable to tax in addition to any community emoluments excluded from</p>	<p>In paragraph (1) the definition of the words "Community emoluments" are deleted. Paragraphs (4) and (5) are deleted.</p>	

	<p>charge to tax under paragraph 4, the tax on such additional income shall be calculated at such rates of tax as would have been applicable if such emoluments had not been so excluded from the charge to tax.</p>		<p>The elimination of provisions relating to community employees from the Income Tax Act is aimed at reducing the volume of the Act because such provisions are irrelevant due to the cessation of the East African Community.</p>
<p>15) Section 3 Subsection 2 Income Tax Act No. 16 of 1973</p>	<p>There is no paragraph f.</p>	<p>A new paragraph (f) is inserted in subsection 2 after paragraph e. f) Income upon which tax is chargeable under this Act in respect of gains accruing in the circumstances prescribed in, and computed in accordance with the eighth schedule.</p>	<p>Gains computed in accordance with the eighth schedule is added to the list of income chargeable to tax. The amendment therefore increases the types of income chargeable to tax.</p>

<p>16) Section 10 Income Tax Act No. 16 of 1973</p>	<p>No paragraphs e and f</p>	<p>Two new paragraphs are added to section 10</p> <p>e) Where a resident person or persons having a permanent establishment in Kenya makes a payment to any person in respect of any appearance at, or performance in any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience or</p> <p>f) Any activity by way of supporting, assisting or arranging any appearance or performance referred to in paragraph (e) of this section, the amount thereof shall be deemed to be income which accrued in or was derived from Kenya.</p>	<p>The tax bracket is widened to include all those deriving income from Kenya even if for a short period. The amendment therefore increases the sources of income.</p>
<p>16) Section 10 Income Tax Act No. 16 of 1973</p>	<p>No paragraphs e and f</p>	<p>Two new paragraphs are added to section 10</p> <p>e) Where a resident person or persons having a permanent establishment in Kenya makes a payment to any person in respect of any appearance at, or performance in any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience or</p> <p>f) Any activity by way of supporting, assisting or arranging any appearance or performance referred to in paragraph (e) of this section, the amount thereof shall be deemed to be income which accrued in or was derived from Kenya.</p>	<p>The tax bracket is widened to include all those deriving income from Kenya even if for a short period. The amendment therefore increases the sources of income.</p>

<p>17) Section 15 Subsection 3 Income Tax Act No. 16 of 1973</p>	<p>No paragraph f</p>	<p>A new paragraph is inserted in subsection 3 (f) in ascertaining the total income of any person for any year of income the following shall be deducted;- any loss realized in computing in accordance with subparagraph 2 of paragraph 4 of the eighth schedule, from gains chargeable to tax under paragraph f of subsection 2 of section 3 of this Act.</p>	<p>This amendment increases the items deductible while ascertaining the total income for tax purposes.</p>
<p>18) Section 34 Subsection 2 Income Tax Act No. 16 of 1973</p>	<p>No paragraphs (vii) and (viii)</p>	<p>Two new paragraphs are added to section 34 (vii) Tax upon the income of non-resident person not having a permanent establishment in Kenya other than a person resident or having a permanent establishment in another partner state, which consists of any payment in respect of any appearance at, or performance in, any place (whether public or private) for the purpose of entertaining,</p>	<p>Same as amendment no. 16</p>

instructing, taking part in any sporting event or otherwise diverting audience or (viii) any payment in respect of any activity by way of supporting, assisting or arranging any performance referred to in paragraph (vii) of this subsection shall be charged for any year of income at the appropriate inter-state rate for such year of income and shall not be charged to tax under subsection (1) of this section.

17) Section 34
Subsection 3
Income Tax Act
No. 16 of 1973

No paragraphs (vii)
and (viii)

New paragraphs are added to subsection 3.
Tax upon the income of non-resident person resident or having a permanent establishment in another partner state which consists of
vii) any payment in respect of any appearance at, or performance in, any place, whether public or private) for the purpose of entertaining, instructing, taking part in any sporting

Same as amendment no. 16

		<p>event or otherwise diverting an audience or</p> <p>viii) any payment in respect of any activity by way of supporting, assisting or arranging any appearance or performance referred to in paragraph (vii) of this subsection shall be charged for any year of income at the appropriate inter-state rate for such year of income and shall not be charged to tax under subsection (1) of this section</p>	<p>Same as amendment no. 16</p>
<p>18) Section 35 Subsection (1) Income Tax Act No. 16 of 1973</p>	<p>No paragraphs g and h</p>	<p>Two new paragraphs are inserted in subsection (i) immediately after paragraph (f).</p> <p>Every person shall, upon payment of any amount to any non-resident person not having a permanent establishment in Kenya other than a person resident or having a permanent establishment in another partner state in respect of</p>	

		<p>g) any appearance at, or performance in, any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience or</p> <p>h) any activity by way of supporting, assisting or arranging any appearance or performance referred to in paragraph (g) of this subsection which is chargeable to tax, deduct therefrom tax at the appropriate non-resident rate.</p>	<p>Same as amendment no. 16</p>
<p>19) Section 35 Subsection 2 Income Tax Act No. 16 of 1973</p>	<p>No paragraphs (g) and (h)</p>	<p>New paragraphs are inserted in subsection 2 immediately after paragraph (f). Every person, shall upon payment of any amount to any non-resident person resident or having a permanent establishment in another partner state in respect of</p>	<p>Same as amendment no. 16</p>

		<p>g) any appearance at, or performance in, any place (whether public or private) for the purposes of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience or</p> <p>h) any activity by way of supporting assisting or arranging any appearance or performance referred to in paragraph (g) of this subsection which is chargeable to tax, deduct therefrom tax at the appropriate inter state rate.</p>	<p>Same as amendment no. 16</p>
<p>20) Section 35 Subsection 3 No. 16 of 1973</p>	<p>No paragraph C</p>	<p>A new paragraph is inserted in subsection 3 after paragraph (b). Every person shall, upon payment of any amount to any person resident or having a permanent establishment in Kenya in respect of (c) any commission paid by the insurance company to any individual for the provision, whether directly or indirectly of insurance cover to any person, which is chargeable to tax,</p>	<p>Same as amendment no. 16</p>

		deduct therefrom tax at the appropriate resident withholding rate.	
21) First Schedule Paragraph 10 No. 16 of 1973	No subparagraph (iii) in paragraph 10.	A new subparagraph is inserted in paragraph 10 immediately after paragraph (ii). 10) Subject to section 26 of this Act the income of any institution, body of persons, or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education, in so far as the Commissioner is satisfied that such income is to be expended either within Kenya or in circumstances in which the expenditure of such incomes is for purposes which result to the benefit of the residents of Kenya.	The amendment increases the types of income exempt from tax.

		<p>Provided that any such income which consists of gains or profits from a business shall not be exempt from tax unless such gains or profits are applied solely to such purposes and either:-</p> <p>(iii) Such gains or profits consists of rents (including premiums or any similar considerations in the nature of rent) received from the leasing or letting of land and any chattels leased or let therewith.</p>	
<p>22) Second Schedule Paragraph 24 Subparagraph (1)</p>	<p>See Amendment No. 8</p>	<p>The words "and where such construction, installation and use, as the case may be, occurs outside the municipalities of Nairobi and Mombasa" are inserted immediately before the words " they shall be deducted" in subparagraph (1) of paragraph 24.</p>	<p>The amendment encourages the construction of hotels in other towns and in rural areas.</p>

A new proviso is inserted at the end of subparagraph (1).

Provided that where, before 13th June, 1975 a written contract binding such person has been entered into whereby such capital expenditure has been or will be incurred in respect of such construction, installation and use, as the case may be, occurring within the municipalities of Nairobi and Mombasa which would otherwise entitle the person incurring such expenditure to an investment deduction under this paragraph, then the investment deduction shall be allowed to that person after such capital expenditure has been incurred.

<p>23) Second Schedule Paragraph 25(b) in the Proviso Income Tax Act No. 16 of 1973</p>	<p>Paragraph b - no shipping investment deduction shall be allowed in respect of the purchase and refitting of a used ship unless the expenditure on refitting represents not less than twenty five per cent of the total expenditure incurred.</p>	<p>Paragraph (b) in the Proviso is deleted.</p>	<p>The amendment enables tax payers to claim investment deduction on a wider range of items.</p>
<p>24) Third Schedule Head B Paragraph 3 Income Tax Act No. 16 of 1973</p>	<p>No paragraph (g) and (h)</p>	<p>Paragraphs (g) and (h) are inserted immediately after paragraph (f) in paragraph 3. The non-resident tax rates shall be: g) in respect of any appearance at, or performance in any place (whether public or private) for the purpose of entertaining, instructing, taking part in sporting event or otherwise diverting an audience, twenty per cent of the gross amount payable</p>	<p>Same as amendment no. 16</p>

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		h) in respect of any activity by way of supporting, assisting or arranging any appearance or performance mentioned in subparagraph (g) of this paragraph, twenty per cent of the gross amount payable.	
25)Third Schedule Head B Paragraph 4 Income Tax Act No. 16 of 1973	No paragraph (g) and (h)	Paragraphs (g) and (h) similar to (g) and (h) in amendment 24 are inserted after paragraph (f) in paragraph 4.	Same as amendment No. 16
26)Third Schedule Head B Paragraph 5 Income Tax Act No. 16 of 1973	No paragraph c	A new subparagraph (c) is inserted after subparagraph (b) in paragraph 5. The resident withholding tax rates shall be:- (c) in respect of any commission paid by an Insurance Company to any individual for the provision, whether directly or indirectly, of insurance cover to any person, fifteen per cent of the gross amount payable.	The amendment increases income on which withholding tax is to be paid.

27) Income Tax Act No. 16 of 1973	No eighth Schedule	Eighth schedule is inserted after the seventh schedule. It deals with the accrual and computation of capital gains.	Provisions with respect to the taxation of capital gains are provided for in the Income Tax Act.
28) Section 15 Subsection 2 Paragraph 2 Income Tax Act No. 16 of 1973	In the case of an individual, (other than an employee) who carries on, whether alone or in partnership, one of the professions, and who possesses the relevant qualifications mentioned in the fifth schedule, a housing deduction equal to fifteen per cent of the gains or profits from his profession or fourteen thousand shillings whichever is less is deducted.	In paragraph (q) the word "an" which appears immediately before the word "individual" is deleted and the words "a resident" are substituted. In the proviso to subsection (2) paragraph (a) (see amendment No. 4) the word "resident" is inserted immediately before the word individual.	Housing deduction is made available to only resident individuals.

29) Section 15
Subsection 3
Income Tax Act
No. 16 of 1973

See Amendment No. 17

Paragraph (f) is deleted and the following new paragraph substituted (f) any amount of any loss realized in computing in accordance with paragraph (2) of paragraph (4) or paragraph 15 A of the Eighth schedule, gains chargeable to tax under paragraph (f) of subsection (2) of section (3).

Provided that the amount of any such loss incurred in any year of income shall be deducted only from gains under paragraph (f) of subsection (2) of section (3) in that year of income and, in so far as it has not already been deducted from gains in any subsequent years of income.

The requirement that losses from a specific source of income should be offset against gains from that particular source is extended to losses realized in computing gains according to the eighth schedule.

<p>30) Section 16 Subsection 2 Income Tax Act No. 16 of 1973</p>	<p>No paragraph fa</p>	<p>Paragraph (fa) is inserted immediately after paragraph (f) in subsection 2.</p> <p>Deduction shall be allowed in respect of fa) any expenditure incurred in the production of dividend income deemed under paragraph (a) of subsection (1) of section 7 to have been derived from Kenya where such expenditure was incurred by a non-resident person not having a permanent establishment in Kenya.</p>	<p>By disallowing such expenses the non-resident persons are encouraged to own shares in companies that operate locally thus forsterring investment.</p>
<p>31) Section 27 Income Tax Act No. 16 of 1973</p>	<p>No Subsection 3</p>	<p>Subsection 3 is inserted.</p> <p>3) in the case of a partnership which makes up the accounts of its business to an accounting date other than 31st December in any year, the accounting date of the partners of the partnership in respect of</p>	<p>This amendment makes the assessment of partners easier.</p>

		<p>income other than their income from any employment or services rendered by them as individuals shall be deemed to be the same as that of the partnership.</p>	
<p>32) Section 34 Income Tax Act No. 16 of 1973</p>	<p>No section 34A</p>	<p>A new section is inserted immediately after section 34. 34A - where the Commissioner is satisfied in relation to any tax payer who is an individual, and whose total income includes income chargeable to tax under paragraph (f) of subsection (2) of section 3 (see amendment No. 15) that the tax payable in respect of that portion of the total income would exceed an amount equal to thirty-five per cent of that income, he shall allow a deduction from tax payable of the amount of that excess.</p>	<p>By allowing an individual to deduct the amount by which tax on capital gains exceeds 35% of that income, investors are encouraged to engage in transactions generating capital gains.</p>

33) Section 35
Income Tax Act
No. 16 of 1973

No Subsections 3A, 3B and 6A

New subsections are inserted in section 35. (3A) Every person shall upon payment to any person who is an individual, whether or not resident in Kenya, in respect of the gross amount or aggregate consideration of any transaction the income or proceeds from which is subject pursuant to paragraph (f) of subsection (2) of section 3, deduct therefrom tax at the appropriate rate of withholding tax.

Provided that this section shall not apply to the transfer of investment shares as defined in Part II of the eighth schedule in which event tax shall be deducted in accordance with that part.

Payment of withholding tax in respect of gains computed in accordance with the eighth schedule is provided for and the penalty imposed encourages deduction of the withholding tax.

3B) the provisions of subsection (3A) of this section shall not apply where a person entitled to chargeable property by way of security or to the benefit of a charge or encumbrance on such property deals with the property for the purpose of enforcing or giving effect to the security charge or encumbrance 6A) where any person who is required under subsection 3A) of this section to deduct tax

a) fails to make the deduction or fails to deduct the whole amount of the tax which he should have deducted or

b) fails to remit the amount of any deduction to the Commissioner within thirty days of the date on which such deduction was made or ought to have been made, any collector of stamp duties appointed under section 4 of the Stamp Duty Act shall not stamp the

	<p>instrument of which the property is the subject matter under the Stamp Duty Act, and Registrars of Title and Land Registrars appointed under any written law, shall not register the property under any written law, until such tax has been duly accounted for.</p> <p>Provided that the transferee of any chargeable property may pay such tax and be entitled to recover the amount of the tax from any consideration for the transfer in his possession, by action in court or by any other lawful means at his disposal.</p>	
<p>34) Section 37 Income Tax Act No. 16 of 1973</p>	<p>Section 37 is renumbered as subsection 37(1) and new subsections are added</p> <p>(2) If an employer paying emoluments to any employee fails</p> <ul style="list-style-type: none"> (a) to deduct tax thereon (b) to account for tax deducted thereon, (c) to supply the Commissioner with any 	<p>Provision for the penalty encourages deduction of the appropriate tax.</p>

certificate as provided by any rules prescribing such certificates the Commissioner may impose a penalty not exceeding four thousand shillings and the provisions of this Act relating to the collection and recovery of such tax shall also apply to the collection and recovery of such tax due from the employer. Provided that, for the avoidance of doubt, it is hereby declared that instead of the Commissioner imposing a penalty under this subsection, a prosecution may be instituted for an offence under paragraph (j) of subsection (1) of section 109.

3) The Commissioner may in his absolute discretion remit the whole or any part of any penalty imposed under this section.

4) Any tax deducted under this section from the emoluments of an employee shall be deemed to have been paid by such employee and shall be set-off for the purposes of collection against tax charged on such employee in

		respect of such emoluments in any assessment for the year of income in which such emoluments are received.	
35) Section 40 Subsection (1) Income Tax Act No. 16 of 1973	If any resident person chargeable to tax for any year of income accrued in or derived from another partner state proves to the satisfaction of the Commissioner that he has paid tax in such partner state for such year of income in respect of the same income, he shall be entitled to relief by way of credit from the tax so charged on such income.	Subsection (1) is deleted and the following subsection is substituted: 1) If any resident person chargeable to tax in Kenya for any year of income accrued in or derived from another partner state proves to the satisfaction of the Commissioner that he has paid interstate tax in such partner state for such year of income in respect of the same income, he shall be entitled to relief by way of credit from the tax so charged in Kenya on such income.	By stating precisely that the resident person should be charged to tax in Kenya, the amendment eliminates any ambiguities that the subsection would cause to any reader.

<p>36) Section 40 Subsection 3 Income Tax Act No. 16 of 1973</p>	<p>Double taxation credit under this section shall not exceed the amount of the tax chargeable on the income in respect of which the credit is to be allowed, or upon each part of such income, as the case may be, computed in accordance with this Act.</p>	<p>Subsection 3 is deleted and a new subsection substituted 3) credit under this section shall not exceed the lesser of the tax computed in accordance with subsection 2) of this section or the amount of the interstate tax chargeable on the income in respect of which the credit is to be allowed or upon each part of such income.</p>	<p>The amendment sets the limit of the double taxation relief at the lesser of:- i) the increase in tax ii) Tax on total income.</p>
<p>37) Section 41 Income Tax Act No. 16 of 1973</p>	<p>If arrangements have been made between the Government of Kenya and the Government of any place outside Kenya with a view of affording relief from double taxation in relation to any income tax, or any tax of a similar character, imposed by the laws of that place, then such arrangements shall, notwithstanding anything</p>	<p>Section 41 is deleted and the following new subsection substituted: 1) The Minister may from time to time by notice declare that arrangements, specified in the notice and being arrangements that have been made with the Government of any country outside of the Republic of</p>	

in this Act, have effect as if such arrangements were contained in this Act.

Kenya with a view to affording relief from double taxation in relation to income tax and any taxes of similar character imposed by the laws of that country shall, notwithstanding anything to the contrary in this Act or in any other written law, have effect in relation to income tax, and every such notice shall, subject to the provisions of this section, have effect according to the tenor.

(2) Any such arrangements may include provisions for relief from tax for periods before the commencement of this Act or before the making of the arrangements.

By declaring double taxation arrangements in a notice the public is made aware of such arrangements and therefore those affected by double taxation can claim the relief.

(3) Any notice under this section may be at any time amended or revoked by a subsequent notice and such amending or revoking notice may contain such transitional provisions or termination dates as appears to the Minister to be necessary or expedient.

(4) The Minister shall cause a copy of every notice made under subsection (1) of this section and every subsequent notice made under subsection 3 of this section to be laid, without delay, before Parliament.

<p>38) Section 42 Subsection (1) Income Tax Act No. 16 of 1973</p>	<p>This section shall effect where, under any special special arrangement, foreign tax payable in respect of <u>any</u> income is to be allowed as a credit against tax chargeable in respect of such income.</p>	<p>The following words are inserted immediately after the word "income" which appears after the word "any" "derived by a person resident in Kenya."</p>	<p>The amendment makes it explicit that foreign tax payable will be allowed as a credit only on income derived by a person resident in Kenya thus eliminating any ambiguities that could arise.</p>
<p>39) Section 42 Subsection (2) Income Tax Act No. 16 of 1973</p>	<p>The amount of tax chargeable upon income referred to in subsection (1) shall be reduced by the amount of the credit. Provided that a credit shall not be allowed against tax for any year of income unless the person upon whose income the tax is chargeable was resident in Kenya in such year of income.</p>	<p>Subsection (2) is deleted.</p>	<p>The amendment in subsection (1) takes care of the proviso. in subsection 2 therefore the latter is deleted to remove repetition.</p>

40) Section 42 Subsection 4 Income Tax Act No. 16 of 1973	A credit shall not exceed the amount of tax chargeable upon the income in respect of which the credit is to be allowed or upon each part of such income, as the case may be, computed in accordance with this Act.	Subsection (4) is deleted and the following new subsection is substituted. A credit shall not exceed the lesser of the tax computed in accordance with subsection (3) of this section or the foreign tax chargeable upon the income in respect of which the credit is to be allowed or upon each part of such income.	The amendment sets the limit of the double taxation relief to the lesser of:- (i) increase in tax (ii) total tax on foreign income.
41) Section 92 Income Tax Act No. 16 of 1973	No Subsection 4A	A new subsection is inserted immediately after subsection (4) 4A) Where a person has notified the Commissioner in writing as is required by subsection (3) of section 53 of this Act, the provisional tax shall be due and payable within thirty days after the date of service by the Commissioner of the Provisional assessment.	The amendment accords the tax payer an opportunity to pay some of his tax before final assessment thus reducing the tax burden when he is finally assessed.

42) Section 95
Subsection (1)
Income Tax Act
No. 16 of 1973

If for any year of income, the amount of tax finally assessed on the income of any person is greater by twenty per cent than the estimate of tax chargeable contained in a provisional return of income made by that person in respect of such year, interest at the rate of one per cent per month shall be payable on the whole of the difference between the tax so assessed and the tax so estimated.

Subsection 1 is deleted and the following new subsection substituted:

If, for any year of income, the difference between the amount of tax assessed on the total income of any person and the amount of estimate of the tax chargeable contained in a provisional return of income made by that person in respect of such year is greater than twenty per cent of that estimated tax, interest at the rate of one per cent per month shall be payable on the whole of the difference between the tax so assessed and the tax so estimated.

The imposition of the penalty makes the tax payers to estimate the income shown in provisional returns more accurately.

<p>Section 102 43) Section 102 Subsection (1A) Income Tax Act No. 16 of 1973</p>	<p>No Subsection 1A</p>	<p>Subsection (1A) is immediately inserted after subsection (1) (1A) For the purposes of executing any such distress the person authorized by the Commissioner under the order may, in addition to employing such servants or agents as such person may consider necessary, require any police officer to be present while such distress is being levied and any police so required shall comply with any such requirement.</p>	<p>The amendment makes the execution of a distress easier.</p>
<p>44) Section 109 Subsection (1) Income Tax Act No. 16 of 1973</p>	<p>No paragraph j</p>	<p>A new paragraph (j) is inserted immediately after paragraph (i). It states that any person who, without reasonable excuse fails to deduct and account, or fails to account for tax, as by section 37 of this Act, or fails to supply any prescribed certificates as is required by that section shall be guilty of an offence.</p>	<p>By making the failure to deduct and account for tax as per section 37 an offence The people required to deduct such a tax are compelled to deduct such tax and thus reduce tax avoidance.</p>

<p>45) Section 125 Subsection 1 Income Tax Act No. 16 of 1973</p>	<p>No Subsection 1A</p>	<p>A new subsection (1A) is inserted immediately after subsection 1. 1A) Every officer appointed under section 122 shall, on appointment make and subscribe, before a magistrate, Justice of the Peace or Commissioner for Oaths, a declaration in the prescribed form.</p>	<p>The requirement that every officer appointed under section 122 should swear before any of the mentioned people makes the officers diligent and cautious while performing their duties.</p>
<p>46) First Schedule Part I Paragraph 23 Income Tax Act No. 16 of 1973</p>	<p>The Income of the Corporations of the Community specified in Paragraph 2 of Article 71 of the Treaty for East African Cooperation is exempt from tax.</p>	<p>Paragraph 23 is deleted and a new paragraph substituted. The Income of the East African Development Bank and of Corporations established under Article 71 of the Treaty for East African Cooperation together with the Income of subsidiary companies wholly owned by the said Development Bank or by any of the said Corporations is exempt from tax.</p>	<p>By replacing the corporations of the community by the East African Development Bank and its subsidiaries and corporations established under article 71 of the said treaty, the amendment makes that part of the Act relevant. Provisions with respect to the East African Community are now irrelevant due to its cessation.</p>

<p>47) First Schedule Part I Income Tax Act No. 16 of 1973</p>	<p>No paragraphs 35, 36</p>	<p>Two new paragraphs are added to Part I immediately after Paragraph 34. 35) Interest not exceeding one thousand shillings on any deposit in the Kenya Post Office Savings Bank managed and controlled by the Director General under the East African Posts and Telecommunications Act where such interest is payable to any person other than a company in any year of income. 36) See Finance Act No. 7 of 1976 page 121 to 123.</p>	<p>The amendment encourages people to save with Kenya Post Office Savings Bank.</p>
<p>48) Second Schedule Paragraph 16 Subparagraph (1) Income Tax Act No. 16 of 1973</p>	<p>In this part except where the context otherwise requires expenditure means capital expenditure incurred in the Partner States by any person carrying on a mining operation.</p>	<p>The words "incurred in the Partner States" are deleted and the following words substituted "in Kenya"</p>	<p>The amendment makes this part of the Act relevant because from 1973 Kenya adopted its own Income Tax Act after the East African Management Act ceased to operate.</p>

<p>49) Third Schedule Income Tax Act No. 16 of 1973</p>	<p>No paragraph 6</p>	<p>A new paragraph 6 is inserted immediately after paragraph 5. 6) The rate of deduction for any transaction chargeable to withholding tax under subsection (3A) of section 35 shall be ten per cent of the gross amount or aggregate consideration of the transaction.</p>	<p>The amendment increases sources of income on which withholding tax is to be paid.</p>
<p>50) Eighth Schedule Income Tax Act No. 16 of 1973</p>	<p>See amendment no. 27</p>	<p>See The Income Tax (Amendment) Act, 1976 pg. 124-138. Kenya Gazette Supplement Acts, 1976 4th June, 1976, Page 124 to 138.</p>	<p>The eighth schedule enables the reader to understand the taxation of capital gains in Kenya.</p>
<p>51) Section 16 Subsection 2 Income Tax Act No. 16 of 1973</p>	<p>No paragraph (h)</p>	<p>A new paragraph (h) is inserted in subsection 2 immediately after paragraph (g). It states that no deduction shall be allowed in respect of any expenditure payable by any person on or after 18th June, 1976 under the contract of hiring of any</p>	<p>This amendment closes the loophole which was previously in existence.</p>

		road vehicle other than a commercial vehicle or a vehicle which is to be used by that person for the transport of persons for hire or the transport of goods.	
52) Section 2 Subsection 1 Income Tax Act Chapter 470 Revised Ediction 1977	"Child relief" means the relief mentioned in section 32 of this Act. "Married relief" means the relief mentioned in section 30 of this Act.	The definitions of "child relief" and "married relief" are deleted. The following definitions are inserted in their proper alphabetical order. "Family relief" means the relief mentioned in section 30 this Act. "Special single relief" means the relief mentioned in section 30 of this Act.	Abolition of child relief removes the discrimination which existed between families with four or more children and those with none or less than four.

<p>53) Section 30 Income Tax Act Chapter 470 Revised Edition 1977</p>	<p>A resident individual who proves that at the commencement of any year of income his wife was living with him shall be entitled to a personal relief, in this Act referred to as the married relief.</p>	<p>The word "married" is deleted and the word "family" substituted.</p>	<p>Married relief is replaced by family relief because the word family is more appropriate since it refers to married people as well as children.</p>
<p>54) Section 32 Income Tax Act Revised Edition 1977</p>	<p>32 (1) A resident individual who proves that at the commencement of any year of income he maintained any child of his (a) who was under the age of eighteen years on that date and who was either in his custody or in any other custody by virtue of an order of a competent court or (b) who was over the age of eighteen years on such date and who was</p>	<p>Section 32 is deleted and the following new section substituted: 32(1) A resident individual who qualifies for single relief under section 31 and who also proves that at the commencement of the year he maintained any child of his (a) who was under the age of eighteen years on that date and who was either in his custody or in any other custody by virtue of an order of a</p>	<p>1 85 1</p>

(i) receiving full-time education or
(ii) Serving full-time under articles or indentures with a view to qualifying in a trade or profession or
(iii) totally incapacitated either mentally or physically from maintaining himself and was resident in Kenya or in a recognized institution abroad shall in respect of each child not exceeding four in number, be entitled to a personal relief, in this Act referred to as the child relief,
Provided that no such relief shall be granted in any year of income in respect of any child who is entitled in his own right in such year of income to income

competent court or
(b) who wa over the age of eighteen years on such a date and who was:
(i) receiving full-time education
(ii) serving full-time under articles or indentures with a view to qualifying in a trade profession; or
(iii) totally incapacitated either mentally or physically from maintaining himself and was a resident in Kenya or in a recognized institution abroad shall for such year of income be entitled to a personal relief, in this Act referred to as the special single relief referred to in section 31.
(2) In this section the expression "child" includes a step-child and a child who has been legally adopted but does not include any individual who is entitled to or receives,

The introduction of special single relief enables single people with children to claim more allowance than single people without children. The relief is therefore aimed at establishing vertical equity.

	<p>exceeding eighteen hundred shillings.</p> <p>2) In this section the expression "child" includes a step-child and a child who has been legally adopted.</p>	<p>in his own right in any year of income, income exceeding eighteen hundred shillings.</p>	
<p>55) First schedule Part 1 Paragraph 4 Income Tax Act Revised Edition 1977</p>	<p>The income of :</p> <p>The Tea Board of Kenya</p> <p>The Pyrethrum Board of Kenya</p> <p>The Sisal Board of Kenya</p> <p>The Kenya Dairy Board</p> <p>The Canning Crops Board</p> <p>The Central Agricultural Board</p> <p>The Pig Industry Board</p> <p>The Wheat Board</p> <p>The Pineapple Development Authority</p> <p>The Horticultural Crops Development Authority</p> <p>The Kenya Tea Development Authority</p>	<p>The income of the Settlement Fund Trustee is added to Paragraph 4.</p>	<p>The amendment encourages people to set up the said funds.</p>

	The National Irrigation Board The Mombasa Pipeline Board.		
56) First Schedule Part I Paragraph 35 Revised Edition 1977	See amendment No. 47	Paragraph 35 is deleted and the following new paragraph substituted: Interest on a savings account held with the Kenya Post Office Savings Bank.	Reference to the "Director General under the East African Posts and Telecommunications Act" is eliminated from the paragraph because the Act no longer applies.
57) Third Schedule Head A Income Tax Act Revised Edition 1977	<p>1. <u>Married Relief</u> The amount of the married relief shall be seven hundred and twenty shillings.</p> <p>2. <u>Single relief</u> The amount of single relief shall be three hundred and sixty shillings.</p> <p>3. <u>Child relief</u> The amount of the child relief shall be one hundred and eighty shillings.</p>	<p>1. Family Relief The amount of the family relief shall be one thousand six hundred and eighty shillings.</p> <p>2. Single relief: The amount of the single relief shall be six hundred shillings.</p> <p>3. Special single relief: The amount of the special single relief shall be seven hundred and twenty shillings.</p>	Increase in the relief rates reduces the tax burdens of various categories of people.

4. Insurance Relief:

The amount of the insurance relief shall be at the rate of two shillings for every twenty shillings of the amount of the premiums paid subject to a maximum amount of premium of three thousand six hundred shillings.

4. Insurance Relief:

The amount of the insurance relief shall be at the rate of two shillings for every twenty of the amount of the premiums paid subject to a maximum amount of premium of four thousand eight hundred shillings.

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58) Third Schedule
Head B
Paragraph 1

The individual tax rates shall be:

	Rate in each twenty shillings
On the first £1,200	2.00
On the next £600	3.00
On the next £600	4.00
On the next £600	5.00
On the next £600	6.00
On the next £600	7.00
On the next £600	8.00
On the next £600	9.00

The individual rates of tax shall be:

	Rate in each twenty shillings
On the first £1,200	2.00
On the next £1,200	3.00
On the next £1,200	5.00
On the next £1,200	7.00
On the next £1,200	9.00
On the next £1,200	10.00
On the next £2,400	12.00

The individual rates of tax are changed. This reduces the tax burdens of the tax-payers.

	<p>On the next £600 10.00</p> <p>On the next £600 11.00</p> <p>On the next £600 12.00</p> <p>On the next £1800 13.00</p> <p>On all total income over £9000 14.00</p>	<p>On all total income over £9,600 13.00</p>	
<p>59) Section 2 Subsection 1 Income Tax Act Revised Edition 1977</p>	<p>Proviso to the definition of "resident": Provided that where, in relation to any year of income, a person is resident in more than one of the Partner States, he shall be deemed to be resident only in the Partner State in which he has been resident for the longest period during such year of income.</p>	<p>The definitions of the following phrases are deleted; inter-state rate, interstate tax, private company, Partner State, tax clearance certificates. The Proviso to the definition of the word resident is also deleted. The following definition is inserted in subsection 1 in its proper alphabetical order. "Kenya includes the Continental Shelf and any installation thereon as defined in the Continental Shelf Act."</p>	<p>The definitions and the Proviso are deleted from the Income Tax Act because the definition of income is now restricted to the income arising from Kenya and not partner states. The definition of Kenya now includes the continental shelf, so as to cover off shore Kenya.</p>

<p>59B) Section 3 Subsection 1 Income Tax Act Revised Edition 1977</p>	<p>Subject to, and in accordance with, this Act, a tax to be known as Income tax shall be charged for each year of Income.</p> <p>(a) In the case of a resident person, upon all the income of such person which accrued in or was derived from Partner States and</p> <p>(b) in the case of any other person, upon all the income of such person which accrued in or was derived from Kenya.</p>	<p>Subsection (1) is deleted and the following subsection substituted</p> <p>(1) Subject to, and in accordance with, this Act, tax to be known as Income tax shall be charged for each year of income upon all the income of any person, whether resident or non-resident, which accrued in or was derived from Kenya.</p>	<p>Definition of income is now restricted to the income arising from Kenya and not from the Partner States because the East African Community is no longer in existence.</p>
<p>60) Section 5 Subsection (2) Paragraph (b) Income Tax Act Revised Edition 1977</p>	<p>For the purposes of subparagraph (a) (ii) of subsection (2) of section 3 of this Act "gains or profits" includes:</p> <p>(b) Save as otherwise expressly provided in this section, the value of any benefit, advantage, or</p>	<p>In paragraph (b) the words "one thousand shillings" are deleted and the words "two thousand four hundred shillings" substituted.</p>	<p>This amendment lessens the tax burdens of the tax payers.</p>

	<p>facility of whatsoever nature of aggregate value Whereof is not less than one thousand shillings granted in respect of employment or services rendered.</p>		
<p>61) Section 5 Subsection 3 Income Tax Act Revised Edition 1977</p>	<p>No paragraph b</p>	<p>A paragraph is inserted immediately after paragraph (a) of subsection 3. 3) In paragraph (e) of subsection (2) of this section, the value of premises, excluding the value of any furniture or other contents so provided, shall be deemed to be b) In the case of an agricultural employee required by the terms of employment to reside on a plantation or farm, an amount equal to ten per cent of the gains or profits from his employment, excluding the value of such premises, and for the purposes of this</p>	<p>By reducing the housing charge to 10% the amendment encourages more people to work on farm thus boosting agriculture.</p> <p style="text-align: right;">1 8 1</p>

		<p>paragraph, "plantation does not include a forest or timber plantation.</p> <p>Paragraph b is renumbered as paragraph (c).</p>	
<p>62) Section 7 Income Tax Act Revised Edition 1977</p>	<p>a) A dividend paid by a company resident in the Partner States shall be deemed to be derived from the Partner State in which such company was resident at the date on which such dividend was payable.</p> <p>f) A dividend paid or credited in any year of income on shares held by a resident person in any building society carrying on business in the Partner States shall be deemed to be derived from the Partner State in which payment for such shares was made to or to account of such building society.</p>	<p>Paragraphs (a) and (f) deleted.</p>	<p>Same as Amendment No. 59B.</p>

<p>63) Section 14 Subsection (2) Income Tax Act Revised Edition 1977</p>	<p>2) The Minister may, by notice in the Gazette, provide that the interest payable on any loan charged on the Consolidated Fund or on the funds of the community, or on the revenues of any local authority, shall, in so far as such interest is income accrued in or was derived from Kenya, be exempt from tax, either generally or only in respect of interest payable to persons who are not resident.</p>	<p>The words "or on the funds of the community" are deleted from subsection 2.</p>	<p>The amendment omits the irrelevant provisions thus reducing the volume of the Act.</p>
<p>64) Section 15 Subsection (3) Paragraph (e) Income Tax Act Revised Edition 1977</p>	<p>In ascertaining the total income of any person for any year of income the following amounts shall be deducted (e) The amount of any loss arrived at in computing for such year of income gains or profits chargeable to tax under paragraph (a) of subsection (2) of section 3 of this Act.</p>	<p>Paragraph e is deleted.</p>	<p>Same as Amendment No. 59B</p>

	<p>Provided that the amount of any such loss incurred in another Partner State in any year of income shall be deducted only from gains or profits from that Partner State in so far as it has not already been deducted in the subsequent year of income.</p>		
<p>65) Section 15 INcome Tax Act Revised Edition 1977</p>		<p>Subsections 7 and 8 are added to section 15.</p> <p>7) Notwithstanding anything contained in this Act:</p> <p>a) the gains or profits of any person derived from any one of the four sources of income respectively specified in paragraph (e) of this subsection shall be computed separately from the gains or profits of that person derived from any other of the specified sources and separately from any</p>	<p>The amendment minimises tax avoidance.</p>

other income of that person.

b) Where the computation of gains or profits of any person in any year of income derived from a specified source results in a loss, that loss may only be deducted from gains or profits of that person derived from the same specified source in the following year and, in so far as the loss has not already been so deducted, in subsequent years of income.

c) The subparagraphs of paragraph (e) of this subsection shall be construed so as to be mutually exclusive

d) gains chargeable to tax under paragraph (f) of subsection 2 of section 3 of this Act and losses referred to in paragraph (f) of subsection (3) of this section shall not be deemed income or losses derived or resulting from specified sources for the purposes of this subsection.

e) the specified sources of income are:-

(i) rights granted to other persons for the use or occupation of any immovable property.

(ii) Employment (including former employment) of personal services for wages, salary, commissions or similar rewards (not under an independent contract or service), and any self-employed professional vocation.

(iii) agricultural, pastoral, horticultural, forestry or similar activities, not falling within subparagraphs (i) and (ii) of this paragraph.

(iv) any other sources of income chargeable to tax under paragraph (a) of this Act, not falling within subparagraph (i), (ii), or (iii) of this paragraph.

		<p>8) In the case of an individual whose income includes income chargeable to tax under paragraph (f) of subsection (2) of section 3 of this Act, only fifty per cent of the said chargeable income shall be included in the ascertainment of his total income.</p>	
<p>66) Section 66 Subsection 2 Paragraph c Income Tax Act Revised Edition 1977</p>	<p>Save as otherwise expressly provided, for the purposes of ascertaining the total income of any person for any year of income, no deduction shall be allowed in respect of c) any income tax or tax of a similar nature paid on income.</p> <p>Provided that, save in the case of interstate tax and foreign tax in respect of which a claim is made under section 40 or 41 of this Act, a deduction shall be allowed in respect of any</p>	<p>The words "inter-state tax and" and the expression "40 or" are deleted.</p>	<p>The definition of income is restricted to income arising from Kenya and not from the Partner States because provisions with respect to the latter do not apply.</p>

any such income tax or tax of a similar nature paid on income which is charged to such tax in a country outside Kenya to the extent to which such tax is payable in respect of and is paid out of income deemed to have accrued in or to have been derived from Kenya.

67) Section 18
Subsection 3
Income Tax Act
Revised Edition
1977

For purposes of ascertaining the gains or profits of any business carried on in Kenya no deduction shall be allowed in respect of any expenditure incurred outside the Partner States by a non-resident person other than expenditure in respect of which the Commissioner determines that adequate consideration has been given; and, in particular, no deduction shall be allowed in respect of expenditure

The words "the Partner States" are deleted and the word "Kenya" substituted.

Same as No. 66

a) on remuneration for services rendered by the non-resident directors (other than whole-time service directors) of a non-resident company the directors whereof have a controlling interest therein, in excess of five per cent of the total income of such company, calculated before the deduction of such expenditure, or of twenty-five thousand shillings, whichever is the greater, so, however, that in no case shall a deduction in excess of one hundred and fifty thousand shillings be allowed

b) on executive and general administrative expenses except to the extent that the Commissioner may determine such expenditure to be just and reasonable.

68) Section 24
Subsections (1) (3)
and (4)
Income Tax Act
Revised Edition
1977

(1) Where the Commissioner is of the opinion that a private company has not distributed to its shareholders dividends within a reasonable period, not exceeding twelve months, after the end of its accounting period such part of its income for that period as could be so distributed without prejudice to the requirements of the company's business, he may direct that such part of the income of the company shall be treated for the purposes of this Act as having been distributed as a dividend to the shareholders in accordance with their respective interests and shall be deemed to have been paid on the date twelve months after the end of such accounting period

The word "private" is deleted from subsection (1) and (4) subsection (3) is deleted.

Shortfall now applies to both private and public companies. Tax avoidance is thus minimized.

(3) This section shall not apply to a private company which is not controlled by a public company or to any company controlled directly or indirectly by the company.

(4) A private company may at any time before making a distribution of a dividend to its shareholders inquire from the Commissioner whether such distribution would be regarded by him as sufficient for the purposes of subsection (1) of this section, and the Commissioner, after calling on the company for such information as he may reasonably require, shall advise the company whether or not he proposes to take action under this section.

69) Section 34
Subsection (2)
Income Tax Act
Revised Edition
1977

(2) Tax upon the income of a non-resident person not having a permanent establishment in Kenya, other than a person resident or having a permanent establishment in another Partner State, which consists of:

- (i) any management or professional fee
- (ii) any royalty
- (iii) any rent, premium or like consideration for the use or occupation of property
- (iv) any dividend
- (v) any interest
- (vi) any pension or retirement annuity
- (vii) any payment in respect of any appearance at, or performance in, any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience or

The commas are delted from subsection 2 and the words "other than a person resident or having a permanent establish-ment in another Partner State are also deleted.

Same as No. 66

(viii) any payment in respect of any activity by way of supporting assisting or arranging any appearance or performance referred to in paragraph (vii) of this subsection, shall be charged at the appropriate non-resident rate in force at the date of payment of such income and shall not be charged to tax under subsection (1) of this section.

70) Section 34
Subsection (3)
Income Tax Act
Revised Edition
1977

Tax upon the income of a non-resident person or having a permanent establishment in another Partner State which consists of:

- (i) any management or professional fee
- (ii) any royalty
- (iii) any rent, premium or like consideration for the use or occupation of property
- (iv) any dividend
- (v) any interest
- (vi) any pension or retirement annuity
- (vii) any payment in respect of any appearance at, or performance in, any place (whether public or private)

Subsection (3) is deleted.

Same as no. 66

for the purpose of entertaining,
instructing, taking part in any
sporting event or otherwise diverting an
audience or

(viii) any payment in respect of any activity by way
of supporting, assisting or arranging any
appearance or performance referred to in
paragraph (vii) of this section

Shall be charged at the appropriate inter-State
rate in force at the date of payment of such
income and shall not be charged to tax under
subsection (i) of this section.

71) Section 34A
Revised Edition
1977

Where the Commissioner is satisfied in
relation to any taxpayer who is an individual, and
whose total income includes income chargeable to tax
under paragraph (f) of subsection (2) of section 3,
and the tax payable in respect of that portion of
the total income would exceed an amount equal to
thirty-five percent of that income, he shall
allow a deduction from the tax payable of the
amount of that excess.

Section 34A is repealed.

Computation of capital
gains tax is made
easier.

72)Section 35
Subsection (1)
Revised Edition
1977

Every person shall, upon payment of any amount to any non-resident person not having a permanent establishment in Kenya, other than a person resident or having a permanent establishment in another Partner State, in respect of:-

- (a) any management or professional fee
- (b) any royalty
- (c) any rent, premium or like consideration for the use or occupation of property
- (d) any dividend
- (e) any interest
- (f) any pension or retirement annuity
- (g) any appearance at, or performance in, any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience, or

The words and commas "other than a person resident or having a permanent establishment in another partner state" are deleted.

Same as No. 66

	<p>(h) any activity by way of supporting or assisting arranging any appearance or performance referred to in paragraph (g) of this subsection which is chargeable to tax, deduct therefrom tax at the appropriate non-resident rate.</p>		
<p>73) Section 35 Subsection 2 Income Tax Act Revised Edition 1977</p>	<p>Every person shall upon payment of any amount to any non-resident person resident or having a permanent establishment in another Partner State in respect of:- (a) to (h) same as in No. 72 which is chargeable to tax, deduct therefrom tax at the appropriate inter-state rate.</p>	<p>Subsection (2) is deleted</p>	<p>Inter-State rates are abolished.</p>
<p>74) Section 35 Subsection 3A Income Tax Act Revised Edition 1977</p>	<p>Every person shall upon payment to any person who is an individual, whether or not resident in Kenya, in respect of the gross amount or aggregate consideration of any transaction the income or proceeds from which is subject to tax pursuant to paragraph (f) of subsection (2) of section 3, deduct therefrom tax at the appropriate rate of withholding tax:-</p>	<p>In subsection (3A) the words "person who is an individual whether or not resident in Kenya" are deleted and the following words substituted "individual or any non-resident body of persons."</p>	<p>This section now applies to also non-resident body of persons.</p>

Provided that this subsection shall not apply to the transfer of investment shares as defined in Part II of the Eighth Schedule in which event tax shall be deducted in accordance with that Part.

75) Section 40
Income Tax Act
Revised Edition
1977

(1) If any resident person chargeable to tax in Kenya for any year of income or income accrued in or derived from another Partner State proves to the satisfaction of the Commissioner that he has paid inter-state tax in such Partner State for such year of income in respect of the same income, he shall be entitled to relief by way of credit from the tax so charged in Kenya on such income.

(2) The tax chargeable on income of any person in respect of which credit is to be allowed under this section shall be taken to be the amount by which the tax chargeable (before allowance of credit under this section) in respect of his total income is increased by the inclusion of such income in his total income:-

Section 40 is repealed.

Definition of income is to be restricted to the income arising from Kenya and not from the Partner States.

Provided that where inter-state tax is payable at different rates on different parts of such person's income, the tax chargeable on such income shall be apportioned to each such part in such amounts as the Commissioner may determine to be just and reasonable.

(3) Credit under this section shall not exceed the lesser of the tax computed in accordance with subsection (2) of this section or the amount of inter-state tax chargeable on the income in respect of which the credit is to be allowed or upon each part of such income.

76) Section 89
Subsection (1)
Income Tax Act
Revised Edition
1977

No paragraph (e)

A new paragraph is added to subsection (1) Any person aggrieved by (e) a determination by the Commissioner under paragraph 12 of the eight schedule may appeal therefrom to a local committee.

Determination of the portion of adjusted cost or transfer value by the Commissioner attributable to each property where more than one property is acquired by one bargain is added to the conditions which lead to appealing to the local committee

<p>77) Section 94(2) Income Tax Act Revised Edition 1977</p>	<p>Where any amount of tax remains unpaid after the expiration of five months after the due date, interest of five per cent shall immediately become due and payable upon the expiration of each succeeding period of five months on any amount of tax still remaining unpaid at each such expiration.</p>	<p>The words "five per cent" are deleted and the following words substituted "ten per cent".</p>	<p>By increasing the penalty to 10%, the tax payers are encouraged to pay their tax promptly.</p>
<p>78) Section 99 INcome Tax Act Chapter 470 Revised Edition 1977</p>		<p>Section 99 is repealed and the following section substituted 99(1) For the purpose of safeguarding collection of tax, any person who applies for emigration treatment under the Exchange Control Act shall submit at the same time a valid exchange control income tax certificate, and the Commissioner, upon request to him by such person shall, if he is satisfied that no tax is due and</p>	<p>Tax clearance certificates are abolished but those emigrating are still required to show proof that they have cleared their tax bills.</p>

		<p>payable or likely to become due and payable by such person issue him with such certificate</p> <p>(2) A certificate issued under subsection (1) of this section shall become invalid 45 days after the date of issue.</p>	
79) Section 108 Income Tax Act Revised Edition 1977	See Income Tax Act Revised Edition 1977 Section 108	Section 108 is repealed.	Penalties due to the infringement of provisions relating to issue of tickets are abolished
80) First Schedule Paragraph 4 Income Tax Act Revised Edition 1977	The income of:- The Tea Board of Kenya The Pyrethrum Board of Kenya The Sisal Board of Kenya The Kenya Dairy Board The Caning Crops Board The Central Agricultural Board The Pig Industry Board The Wheat Board	The words "The Wheat Board are deleted and at the end of the paragraph the following words are inserted "The Kenya Post Office Savings Bank."	The income of the Kenya Post Office Savings Bank is exempt from Tax

The Pineapple Development Authority
 The Horticultural Crops Development
 Authority
 The Kenya Tea Development Authority
 The National Irrigation Board
 The Mombasa Pipeline Board

81) First Schedule
 Paragraphs 19, 20,
 21, 24
 Income Tax Act
 Revised Edition
 1977

Income accrued in, derived from or
 received in Kenya which is exempt
 from tax:-
 19) The attendance allowances paid to
 the members and the Chairman of the East
 African Legislative Assembly and the
 allowances paid to the Ministerial
 members of the East African Legislative
 Assembly.
 20) The entertainment and housing
 allowances paid to the East African
 Ministers and Deputy East African
 Ministers.

Paragraphs 19, 20, 21 and 24 are
 deleted

Provisions relating to
 the East African
 Community are deleted
 from the Income Tax Act

	<p>21) Any fixed allowance paid to the Chairman of the East African Legislative Assembly or to the Secretary General of the Community in respect of entertainment.</p> <p>24) The income of any post office savings bank managed and controlled by the East African Posts and Telecommunications Corporation.</p>		
<p>82) First Schedule Paragraph 36(f) Income Tax Act Revised Edition 1977</p>	<p>Such part of the income of an individual, chargeable to tax under paragraph (f) of subsection (2) of section 3 as consists of gain derived from the transfer of (f) Property which is transferred or sold for the purpose of administering the estate of a deceased person where such transfer of sale is completed within two years of the death of the deceased or within such extended time as the Commissioner may allow in writing.</p>	<p>The following words are inserted after the word property "including investment shares."</p>	<p>Income derived from the transfer of investment shares for purposes of administering the estate of a deceased person is exempt from tax.</p>

83) Third Schedule
Head B
Paragraph 4
Income Tax Act
Revised Edition
1977

The interstate tax rates shall be:-
(a) in respect of any management or professional fee, twenty per cent of the gross amount payable
(b) in respect of any royalty, twenty per cent of the gross amount payable
(c) in respect of any rent, premium or like consideration for the use of or occupation of property, thirty per cent of the gross amount payable.
(d) in respect of any dividend, fifteen per cent of the amount payable
(e) in respect of any interest, twelve and one-half per cent of the gross amount payable
(f) in respect of any pension or retirement annuity, five per cent of the gross amount payable
(g) in respect of any appearance at, or performance in, any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience, twenty per cent of the gross amount payable

Paragraph 4 of Head B
is deleted

The inter-state rates
are abolished.

84) Seventh Schedule
Income Tax Act
Revised Edition
1977

(h) in respect of any activity by way of supporting, assisting or arranging any appearance or performance mentioned in subparagraph (g) of this paragraph, twenty per cent of the gross amount payable.

Special Provisions as to community employees

1. In this Schedule "Community employee" means an individual who is employed or renders services to the community, one of its institutions or corporations, or a wholly owned subsidiary of such a corporation.
2. A community employee who is a Kenya citizen shall be deemed to be resident.
3. A community employee who is a citizen of Tanzania or Uganda and who is in the service of the community in Kenya in any year of income shall be deemed to be resident for the purposes of Part V of this Act but not for any other purposes of this Act.

Seventh Schedule is deleted.

Special provisions with regard to community employees are deleted from the Income Tax Act.

85) Eight Schedule
Paragraph 12(a)
Subparagraph 2
Income Tax Act
Revised Edition
1977

Any person aggrieved by an apportionment of any amount or sum by the Commissioner under subparagraph (1) of this Paragraph may appeal therefrom to a local committee.

Subparagraph (2) of paragraph 12 is deleted.

Appeal to the Local Committee is withdrawn in the said circumstances.

86) Section 5
Subsection 3
Paragraph b
Income Tax Act
Cap 470
Revised Edition
1977

In paragraph (e) of subsection (2) of this section, the value of premises, excluding the value of furniture or other contents so provided, shall be deemed to be
(b) in the case of any other employee an amount equal to fifteen per cent of the gains or profits from his employment, excluding the value of such premises, subject to a limit of the rent paid by the employer if this is paid under an agreement made at arms length with a third party

The following words are added at the end of paragraph (b) "and agricultural employee" includes a whole-time service director but does not include any other director"

For a whole time service director 15% of gains or profits from employment is considered the value of the premises provided by the employer.

86) Section 35
Subsection 3A
Income Tax Act
Revised Edition
1977

Every person shall upon payment to any person who is an individual, whether or not resident in Kenya, in respect of the gross amount or aggregate consideration of any transaction the income or proceeds from which is subject to tax pursuant to paragraph (f) of subsection (2) of section 3, deduct therefrom tax at the appropriate rate of withholding tax. Provided that this subsection shall not apply to the transfer of investment shares as defined in Part II of the Eight Schedule in which event tax shall be deducted in accordance with that part.

Subsection 3A is deleted and the following new subsection substituted
Every person shall upon payment (a) to any individual or any non-resident body of persons in respect of gross amount or aggregate consideration of any transaction the income or proceeds from which is subject to tax pursuant to paragraph (f) of subsection (2) of section 3 or
(b) to any resident body of persons in respect of the gross amount or aggregate consideration of any land transaction the income or proceeds from which is subject to tax pursuant to paragraph (f) of subsection 2 of section 3 deduct tax therefrom at the appropriate rate.

The section is now to apply to both individuals and body of persons and withholding tax is to be deducted in respect of investment shares.

<p>87) Section 54 Subsection (1) Paragraph (b) Income Tax Act Revised Edition 1977</p>	<p>Provided that in the case of a company other than a private company, or a wholly owned subsidiary of such a company, the certificate referred to in paragraph (a) (Accountants Certificate) of this subsection shall not be furnished unless the Commissioner in any particular case so requires.</p>	<p>The Proviso is deleted</p>	<p>Both private and public companies have to furnish the certificate referred to in paragraph (a) of 54(1)</p>
<p>88) Section 72 Subsection 1 Paragraph (b) Revised Edition 1977</p>	<p>Any person who in relation to any year of income fails to furnish a provisional return of income or to give a notice to the Commissioner, as required by section 53 of this Act shall, for each month or part thereof from the commencement of such failure up to the date on which the Commissioner makes a provisional assessment for such year of income under subsection (3) of section 74 or an assessment under section 73 of this Act, whichever is the earlier, be charged with additional tax equal to</p>	<p>In subsection 1 Paragraph b the words "two per cent" are deleted and the following words substituted "three per cent"</p>	<p>The percentage of additional tax is increased to three per cent thus encouraging tax payers to furnish provisional returns.</p>

two percent of the normal tax in such provisional assessment or assessment as the case may be

89) Section 92
Subsection (2)
Paragraph (a)
Income Tax Act
Revised Edition
1977

The tax charged in an assessment other than a provisional assessment shall be due and payable

i) in the case of an individual where the date of service of an assessment made under paragraph (a) of subsection 2 of section 73 of this Act is before 31st May in the year following the year of income in respect of which the tax is charged, as to one half of the tax on or before 30th June and as to the other half on or before 30th September in such following year.

ii) In all other cases within thirty days from the date of the service of the notice of such assessment:

In paragraph (a) (i) of subsection 2 the words "31st May" are deleted and "31st August" substituted. And the words "as to one half of the tax on or before 30th June and as to the other half" are deleted.

The date of service is extended to 31st August and the requirement that half of the tax be paid on or before 30th June dropped. The entire tax is now to be paid on or before 30th September.

Provided that where a return of income has been furnished in accordance with section 52 of this Act, one half of such tax shall be due and payable within thirty days of the date of service of notice of such assessment and the other half on or before the date of expiry of a period of four months from that date.

90) Section 94
Subsection 1
Income Tax Act
Revised Edition
1977

Where any amount of tax remains unpaid after the due date interest of five percent shall immediately become due and payable thereon.

In subsection 1 the words "five percent" are deleted and the following words "fifteen per cent" substituted.

Interest on unpaid tax is increased from 5% to 15 per cent.

91) Section 94
Subsection (2)
Revised Edition
1977

Where any amount of tax remains unpaid after the expiration of five months after the due date, interest of five per cent shall immediately become due and payable thereon, and similar interests shall so become

Subsection 2 is deleted

The Proviso that interest is to be charged on amount which remains unpaid after the expiration of five months is dropped.

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due and payable upon the expiration of each succeeding period of five months on any amount of tax still remaining unpaid at each such expiration.

92) Section 2:
Income Tax Act
Revised Edition
1979

The definitions of "Contract of Service" and "wife's employment income" are inserted in section 2 in the appropriate alphabetical sequence.

Definitions relevant to the separate assessment of ~~wife's~~ employment income are included in the INcome Tax Act.

93) Section 34
Subsection 1
Paragraph (a)

Subject to this section (a) tax upon the total income of an individual shall be charged for any year of income at the individual rates for such year of income.

Paragraph (a) of subsection (1) is deleted and the following new paragraphs inserted:
(a) tax upon the total income of an individual, other than such part of the total income comprising wife's employment income, shall be charged for any year of income at the individual rates for such year of income.

Provisions relevant to the separate assessment of wives' employment income are included in the Income Tax Act.

(b) tax upon that part of total income which consists of wife's employment income shall be charged for any year of income at the wife's employment income rates for such year of income.

Paragraph b is renumbered as (c)

94) Third Schedule
Revised Edition
1979

A new paragraph is added after paragraph (1)
(1A) The wife's employment income rates of tax shall be

	Rate in each twenty shillings
On the first £1,200	2.00
On the next £1,200	3.00
On the next £1,200	5.00
On the next £1,200	7.00
On the next £1,200	9.00
On the next £1,200	10.00
On the next £2,400	12.00
On all wife's employment income over £9,600	13.00

The rates at which wife's employment income is to be taxed are provided for in the Income Tax Act.

95) Third Schedule
Head B
Paragraph 3
Income Tax Act
Revised Edition
1979

The non-resident tax rates shall be:
(a) in respect of any management or professional fees twenty per cent of the gross amount payable
(b) in respect of any royalty thirty per cent of the gross amount payable
(c) in respect of any rent, premium or like consideration for the use of or occupation of property, thirty per cent of the gross amount payable
(d) in respect of any dividend fifteen per cent of the amount payable
(e) in respect of any interest twelve and one-half per cent of the gross amount payable
(g) in respect of any appearance at, or performance in, any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience, twenty per cent of

In subparagraphs (a), (b), (g) and (h) the word "twenty" is deleted and the word "thirty" substituted.

In subparagraph (c) the word thirty is deleted and "forty" substituted. In subparagraph (d) the word "fifteen" is deleted and the word twenty substituted.

In subparagraph (e) the words "twelve and one-half" are deleted and the word twenty substituted.

The non-resident tax rates in respect of various types of income are increased.

the gross amount payable.
(h) in respect of any activity by way of supporting, assisting or arranging any appearance or performance mentioned in subparagraph (g) twenty per cent of the gross amount payable.

96) Section 15
Subsection 8
of Income Tax Act
Cap 470
Revised Edition
1979

In the case of an individual whose income includes income chargeable to tax under paragraph (f) of subsection (2) of section 3, only fifty per cent of the said chargeable income shall be included in the ascertainment of his total income.

Subsection (8) is deleted and the following new subsection substituted.
(8) In the case of a person whose income includes income chargeable to tax under Paragraph (f) of subsection (2) of section 3, only fifty per cent of the net chargeable income after deduction of any amount deductible under paragraph (f) of subsection (3) of this section shall be included in the ascertainment of his total income.

The chargeable gains included in assessable income are determined after deducting any loss computed under the eighth schedule.

97) Section 34
Income Tax Act
Revised Edition
1979

New subsections are added to section 34.

1A) Where the total income referred to in paragraph (a) of subsection (1) includes net capital gain, and the individual rates of tax payable on a part of that income exceed thirty-five per cent (which part in this subsection is called "the relevant part"):

(a) the tax payable on such portion of the relevant part as net capital gain shall, notwithstanding any other provision of this Act, be at the rate of thirty-five per cent

(b) the tax payable on the balance of the relevant part shall be computed by reference to such of the individual rates of tax above thirty-five per cent as would apply if the income referred to in paragraph (a) of this subsection had been the top slice of income.

This amendment establishes the maximum effective rates of tax payable.

		<p>1B) In subsection (1A) "net capital gain" means income chargeable to tax under paragraph (f) of subsection (2) of section 3 reduced in accordance with subsection (8) of section 15. "top slice of income" means that part of the income which attracts the highest rates of tax.</p>	
<p>98) First Schedule Part 1 Income Tax Act Revised Edition 1979</p>	<p>No paragraph 38</p>	<p>New paragraph is added to Part 7 38) The interest on a housing bond savings account held with the Housing Finance Company of Kenya Limited or with Savings and Loan Kenya Limited where the aggregate of funds of any person in both accounts does not exceed five hundred thousand shillings.</p>	<p>The said interest is exempt from tax. The public is therefore encouraged to save for housing purposes.</p>
<p>99) Second Schedule Part II Paragraph 15 Income Tax Act Revised Edition 1979</p>	<p>Where capital expenditure in excess of thirty thousand shillings was incurred on or after 1st January, 1961, in respect of a road vehicle</p>	<p>In Part II paragraph 15 the words "thirty thousand shillings" are deleted wherever they appear and the following words substituted "seventy five thousand shillings."</p>	<p>Expenditure on private vehicles on which wear and tear deductions is claimed is increased.</p>

other than a commercial vehicle or a vehicle whose purchaser is a person whose main business is the transport of goods or persons or the hire or sale of vehicles, such capital expenditure shall be deemed to be thirty thousand shillings and where any such road vehicle is sold the sale price shall be deemed to be such proportion of the proceeds of sale as the Commissioner may determine to be just and reasonable, having regard to the original purchase price and the proportion thereof deemed under this paragraph to be capital expenditure.

100) Third Schedule
Head A
Income Tax Act
Revised Edition
1979

Head A - Resident Personal Reliefs

1. Family Relief

The amount of the family relief shall be one thousand six hundred and eighty shillings.

2. Single Relief

The amount of the single relief shall be six hundred shillings

3. Special Single Relief

The amount of the Special single relief shall be seven hundred and twenty shillings.

4. Insurance Relief

The amount of the Insurance relief shall be at the rate of two shillings for every twenty shillings of the amount of the premiums paid subject to a maximum amount of premiums of four thousand eight hundred shillings.

Head A is deleted and the following inserted

Head A - Resident Personal Relief

1. Family Relief

The amount shall be one thousand eight hundred shillings

2. Single relief

The amount of the single relief shall be seven hundred and twenty shillings.

3. Special Single Relief

The amount of the special single relief shall be eight hundred and forty shillings

4. Insurance Relief

The amount of the Insurance relief shall be at the rate of two shillings for every twenty shillings of the amount of the premiums paid subject to a maximum amount of premiums of seven thousand two hundred shillings.

The resident personal reliefs are increased. The amendment therefore lessens the tax burdens of the taxpayers.

101) Third Schedule
 Head B
 Income Tax Act
 Revised Edition
 1979

be	Rate in each Twenty Shillings
On the first £1,200	2.00
On the next £1,200	3.00
On the next £1,200	5.00
On the next £1,200	7.00
On the next £1,200	9.00
On the next £1,200	10.00
On the next £2,400	12.00
On all total income over £ 9600	13.00

Paragraphs 1 and 1A are deleted and
 the following new paragraphs inserted:

1. The Individual rates of tax shall be:

	Rate in each Twenty Shilling
On the first £1,500	2.00
On the next £1,500	3.00
On the next £1,500	5.00
On the next £1,500	7.00
On the next £1,500	9.00
On the next £1,500	10.00
On the next £3,00	12.00
On the total income over £12,000	13.00

The Individual
 rates of tax and
 the wife's employ-
 ment income rates
 of tax are changed.

<p>102) Third Schedule Head B Paragraph 6 Income Tax Act Revised Edition 1979</p>	<p>The rate of deduction for any transaction chargeable to withholding tax under subsection (3A) of section 35 shall be ten per cent of the gross amount or aggregate consideration of the transaction.</p>	<p>The expression "ten per cent" is deleted and the following words substituted "five per cent."</p>	<p>The withholding tax rate on transfer of property is reduced to 5%. This encourages the public to participate in transactions generating capital gains.</p>
<p>103) Eighth Schedule Part II Paragraph 16 Income Tax Act Revised Edition 1979</p>	<p>The gain ascertained under paragraph 15 is subject to a deduction of income tax at the rate of thirty-five per cent of such gain.</p>	<p>In paragraph 16 the expression "thirty-five per cent" is deleted and the following expression substituted "fifteen per cent."</p>	<p>The withholding tax rate on transfer of Investment Shares is reduced to 15%. Same as 102</p>

104) Section 15(2)
Income Tax Act
Cap 470
Income Tax Act
Revised Edition
1979

No paragraph r

Paragraph r is added to section 15 subsection 2.
15(2) Without prejudice to subsection (1) in computing for any year of income the gains or profits chargeable to tax under paragraph (a) of subsection (2) of section 3, the following amounts shall be deducted:
r) an amount equal to one-third of the total gains and profits from employment of an individual who is not a citizen of Kenya and
(i) whose employer is a non-resident company or partnership trading for profit.
(ii) who is in Kenya solely for the performance of his duties in relation to his employer's regional office, which office has been approved for the purposes of this paragraph by the Commissioner
(iii) who is absent from Kenya for the performance of those duties for a period or periods amounting in the aggregate to one hundred and twenty days or more in that year of income and

One third of the total gains and profits from employment of an expatriate is allowed for tax purposes if the said conditions are fulfilled.

105) Section 21
Subsection 1
Income Tax Act
Revised Edition
1979

A body of person which carries on a members' club shall be deemed to be carrying on a business and the gross receipts on revenue account including entrance fees and subscriptions) shall be deemed to be income from a business
Provided that where not less than three-quarters of such gross receipts are received from the members of such club, such body of persons shall not be deemed to be carrying on a business

(iv) whose gains and profits from that employment are not deductible in ascertaining the total income chargeable to tax under this Act of his employer or of any Company or partnership which controls, or is controlled by, that employer, and in this subparagraph "control" has the meaning assigned to it in paragraph 32 of the second schedule.

In the proviso to subsection (1) the words and commas ",other than gross investment receipts," are inserted after the words "gross receipts."

Types of income subject to income tax are increased.

	and no part of such gross receipts shall be income.		
106) Section 21 Subsection 3 Income Tax Act Revised Edition 1979		The following new definition is inserted in subsection 3 "gross investment receipts" means gross receipts in respect of interest, dividends, royalties, rents, other payments for rights granted for use or occupation of property, or gains of a kind referred to in paragraph (f) of subsection (2) of section 3.	Definition necessary for the understanding of amendment no. 105 is included in the Income Tax Act.
107) Section 37 Subsection 2 Income Tax Act Revised Edition 1979	If an employer paying emoluments to any employee fails:- (a) to deduct tax thereon (b) to account for tax deducted thereon or (c) to supply the Commissioner with any certification as provided by any rules prescribing such certificate, the Commissioner may impose a penalty not exceeding four thousand	The "four thousand shillings" are deleted and the following words inserted "eight thousand shillings."	The penalty for failing to deduct and account for tax from employees is increased thus encouraging those concerned to deduct and account for such tax promptly.

shillings and the provisions of this Act relating to the collection and recovery of such tax shall also apply to the collection and recovery of such penalty as if it were tax due from the tax payer.

108) Section 3
Subsection (2)
Paragraph (d)
Income Tax Act
Revised Edition
1979

2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of:-
d) any amount received by way of alimony or allowance:
(i) under any judicial order of separation or maintenance, or under any decree of divorce or
(ii) under any written agreement of separation or
(iii) under any agreement between spouses where they are separated in such circumstances that the separation is likely to be permanent.

Paragraph d is deleted.

Alimony is not to be taxed in the hands of the recipient. This amendment closes the loophole that was in existence.

109) Section 12
Subsection 1
Income Tax Act
Revised Edition
1979

12(1) Where
(a) in computing gains or profits a deduction is allowable in respect of a payment made under a contract of hiring of an asset of any description and
(b) before, at or after the time when the payment is made the parties to the contract enter into an agreement under which the ownership of, or any interest in, the asset passes to the person who made the payment or to an associate of his in return for a capital sum which is less than the true market value of the asset at that date, the person or associate, as the case may be, shall be chargeable to tax on the amount by which the true market exceeds that capital sum.

The words "or the notional written down value of the asset, which ever is greater" are inserted in subsection (1) after the words "market value"

Where the true market value is less than the notional written down value the latter is used for purposes of section 12(1).

110) Section 12
Subsection 3
Income Tax Act
Revised Edition
1979

The following definition is added in subsection 3 "notional written down value" means the amount which would have been the written down value of the asset at the end of the period of hire, had the asset been acquired at the commencement of the contract of hire at a cost equal to the total of the rented and other payments payable under the contract, and had a deduction been made by reference to that cost at the appropriate percentage specified in paragraph 7 of the second schedule for the wear and tear of the asset during the period of hire.

Definition necessary for the understanding of amendment no. 109 is included in the Income Tax Act.

111) Section 15
Subsection (3)
Paragraph (c)
Income Tax Act
Revised Edition
1979

15(3) Without prejudice to subsection (1) in ascertaining the total income of any person for any year of income the following amounts shall be deducted:-
c) any amount paid during such year of income by such person which is chargeable under paragraph (d) of subsection (2) of section 3, or would be so chargeable if it were derived from Kenya.
Provided that, if such person was entitled during such year of income to any income which is not so charged, the deduction under this paragraph shall be such proportion of such amount as his total income under this Act ascertained before any deduction allowable under this paragraph bears to his income from all sources for such year of income.

Subsection (3) (c) is deleted.

Alimony ceases to be deductible for tax purposes.
Same as no. 108

<p>112) Section 15 Subsection 8 Income Tax Act Revised Edition 1979</p>	<p>In the case of an individual whose income includes income chargeable to tax under paragraph (f) of subsection 2 of section 3 only fifty per cent of the said chargeable income shall be included in the ascertainment of his total income.</p>	<p>In subsection 8 the words "fifty per cent" are deleted and the words "twenty-five per cent" inserted.</p>	<p>The rate of capital gains tax is reduced by half. Same as no. 102.</p>
<p>113) Section 16 Subsection 2 Paragraph (i) Income Tax Act Revised Edition 1979</p>	<p>Notwithstanding any other provision of this Act, no deduction shall be allowed in respect of: (i) any expenditure payable by any person on or after 18th June, 1976 under any contract of hiring of any road vehicle other than a commercial vehicle or a vehicle which is to be used by that person for the transport of persons for hire or the transport of goods.</p>	<p>The words "or a vehicle which is to be used by that person for the transport of persons for hire or the transport of goods" are deleted.</p>	<p>This amendment closes the loophole where some people have been registering private cars as commercial vehicles so as to have lease-hire payments deducted for income tax purposes.</p>

114) Second Schedule
Part II
Paragraph 8
Income Tax Act
Revised Edition
1979

8(1) The written down value of each class of machinery referred to in subparagraph (2) of paragraph 7 shall be calculated separately as at any time and shall be the amount still unallowed of any capital expenditure on machinery of such class as construed in paragraph 9 of the second schedule of the Management Act, with the addition of the costs of any capital expenditure on any machinery of that class purchased and the deduction of the amount realized on the sale of any machinery of that class sold in the year of income 1974, or any succeeding year of income, less: any deductions made under this Part, and where the amount realized for machinery of any class sold in any year of income exceeds that which, but for the

In paragraph 8 (1) a new proviso is added
Provided that the cost of capital expenditure of machinery acquired under an agreement referred to in section 12(1) shall be deemed to be equal to the amount chargeable to tax under the provisions of that section, and that cost shall be deemed to have been incurred in the year of income immediately succeeding the year of income in which the period of hire ends.

Proviso is added to paragraph 8(1) to cater for the cost of machinery incurred under collusive agreement of hiring.

SECTION AFFECTED	BEFORE THE AMENDMENTS	AMENDMENTS	EFFECTS OF THE AMENDMENTS
	deduction of such amount would be the written down value of machinery of that class at the end of such year of income, the excess shall not be deducted but shall be treated as a trading receipt.		
115) Third Schedule Paragraph 6 Income Tax Act Revised Edition 1979	See amendment no. 102	The words "five per cent" are deleted and the following words inserted "two and a half per cent"	Withholding tax rate on transfer of property is reduced by one half
116) Eighth Schedule Part II Paragraph 16 Income Tax Act Revised Edition 1979	See Amendment No. 103	The words "fifteen per cent" are deleted and the following words inserted "seven and a half per cent"	The withholding tax rate on transfer of investment shares is reduced by one half.

4.3. CONCLUSION

This chapter has shown that there have been quite a number of amendments in the Income Tax Act in Kenya since 1973. The rationale behind some of these amendments has been to establish a good tax system that is, a system that is fair to everybody. The effects show that some effort is being undertaken towards the establishment of a good tax system.

Chapter 5

ASSESSMENT OF WIFE'S EMPLOYMENT INCOME

5.1 INTRODUCTION:-

Prior to the amendment with respect to separate taxation of wife's employment income there were complaints that there seemed to be double taxation among the employed couples. Their tax was deducted at source as P.A.Y.E. and then after the end of the year they were required to aggregate their income for a further tax. A number of presentation were made to the income tax department but no steps were taken until late 1980.

To show the extent to which equity has been achieved, the chapter will be discussed under the following sections; before the amendment; amendment and the effects of the amendment

5.2 BEFORE THE AMENDMENT:-

Section 37(1) of the Income Tax Act Revised edition 1979 states that

"Every employer paying emoluments to any employe: shall deduct there from and account for tax thereon, to such extent and in such manner as may be prescribed" 1

Before the 1980 amendment, this was taken not as a payment of tax which cleared the tax payer of liability once and for all, but rather as a convenient way of collecting tax at source. Section 45 (1) of the Income Tax Act Chapter 470 Revised Edition 1979 states that-

"The income of a married woman living with her husband shall be deemed to be income of the husband for the purpose of ascertaining his total income, and shall be assessed on and the tax thereon charged on, the husband ----"2

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- (1) The Income Tax Act Chapter 470 Revised Edition 1979(1977)
Printed and Published by Government Printer Nairobi Pg. 57.
- (2) Ibid, pg. 61-62

Under a progressive tax system, this of course meant that a husband and wife who each had income of their own would normally pay more tax than they would have done if they had remained unmarried. Under the Pay-as-you-earn(PAYE) system, it also means that after the husband and wife had had normal monthly deductions for the year, further tax was demanded at the end of the year to complete the annual tax bill which resulted from the assessment of the aggregate income.

A numerical example will help illustrate the position before the amendment.

ILLUSTRATION 1

Mr Owino works as an engineer with Victoria Engineers Ltd. He earns Shs. 4,500 per month, Mrs. Owino works as an accounts clerk with Njoroge and Associates. She earns Shs. 2,500 per month. The couple has no any other source of income.

The assessment on this income would be as follows

<u>Mr. Owino</u>			
<u>Tax assessment</u>			
<u>For the Year 1981</u>			
	Shs.		Shs.
Husband's income	4,500 x 12	=	54,000
Wife's income	2,500 x 12	=	<u>30,000</u>
Total income of the family			84,000
		=	£ 4,200

At the beginning of 1982 the family would be assessed on this income as follows:-

settles the tax bill which has arisen as a result of the income of both of them. In most cases the wife refuses to part with her money. Some husbands force their wives to stop working because the increase in the tax bill due to the wife's income sometimes exceeds the latter and this leads to separations because the wife cannot understand why a husband who did not contribute to her education should refuse her to work.

To avoid some of the problems created by the system of aggregation, The Commissioner of Income made certain recommendations which would make income tax collection less of a burden. He said that if the married couple submitted their tax return as required by the law, assessment of the aggregate income would be raised as early as February or March, which then would be payable at the end of September. This was more than seven months' notice which gave the couple sufficient time to look for the money. The couple could buy Tax Reserve Certificate from the Treasury and earn interest at the rate of 4 per cent tax free.

There was a scheme under which the wives could pay extra sums under PAYE in readiness for the annual tax bill, by submitting their request to the department, which would advise her employer how much extra to deduct from her salary during the PAYE year.

5.2.1. Arguments for the System

The above discussion shows that the aggregation of husband and wife's income for tax purposes used to cause a lot of problems. However, the system was upheld because of some reasons to be discussed presently.

Some arguments were cited by the Commissioner of Income Tax Department, hereafter referred as the Commissioner.

He argued that on balance the system was more equitable. May be the reason for this argument was minimization of tax avoidance as will be seen later. He further argued that separate assessment system would create more problems than it would solve. Some of these problems are considered latter in the discussion.

The philosophy of taxation is that people in similar circumstances should as far as is reasonably possible pay the same amount of tax. The concept should extend to the couple as a unit so that if a certain amount of income is coming into the family, it should pay an amount of tax which should not vary because of the composition of the income. In this respect the Commissioner said that

"Kenya can operate on the basis that it is not equitable that the liability of a married couple where only one spouse has income should be greater than that of another couple where the same aggregate amount of income was divided between them." 1

The law therefore gave effect to a principle that a married couple should be treated as a single taxable unit (i.e. the system of aggregation should continue to operate).

Another argument was that the system fitted in well with the prevailing social order. Like the water and electricity bills or the home purchasing mortgage bill, there was only one bill. However, the nature of these other bills is different from the tax bill. When the couple pays for electricity and water it is paying for what it has actually consumed. As for the tax bill, the couple is paying for what it has not directly consumed. It is paying for defence, for roads, etc, but it has not directly consumed these services. As for the use of roads, some couples may argue that they pay for them in terms of road licences, etc.

1 Sunday Nation 24th February, 1980,

The system was being upheld because it was fair in the sense that it minimized tax avoidance. The Commissioner pointed out that in some countries where separate taxation was in operation, there were numerous tax avoidance tactics such as excessive wage payments to the wife for work allegedly done in the husband's business, channelling excessive shares of partnership profits to the wife when the husband provided most of the capital and managerial and expert services. Such avoidance measures are only advantageous to the wealthy people because these are the people who have the capital to invest in businesses. The not-so-wealthy people are adversely affected by the tax avoidance measures because where tax avoidance reduces revenue obtained from tax, the Government is forced to increase the rates of tax which affects both the wealthy and not-so-wealthy people.

Another advantage of the system was simplicity. Separate assessments would mean abolition of family relief, apportionment of profits and losses for those families in business and complicated amendments to the law to seal loopholes. All these would amount to more expensive machinery to combat evasion and this would in turn place more demand on the department and higher costs of collection which would have to be paid from higher taxation. Separate taxation would involve some duplicated activities such as doubling of tax files, of assessments and of tax procedures. It would also cause other social problems in the sense that most people working in the Income Tax Department are males. As The Commissioner put it "It would be interesting to see how a male department would tackle a population of wives who defaulted in tax payment...chasing them up and down the streets of Kenya towns."¹ The Commissioner added that separate assessments would mean loss of revenue and to raise the same revenue, the Government would be compelled to increase the tax rates.

1 Sunday Nation 24th February 1980.

5.3. AMENDMENT

For many years there was a considerable debate about the possibility of taxing wives separately. This was not accepted by the Income Tax Department for many years because of the reasons cited earlier. Others suggested that the assessment of wives' income separately should be held back until the Marriage and Succession bill was adopted as an act. This act would allow wives to own property as independent individuals. The bill was shelved by the previous parliament. However, it was recently passed amid nationwide opposition.

Later in 1980 Hon. Koigi wa Wamwere presented a private members motion which resulted in the 1980 amendment concerning the separate assessment of wives's income. However, the amendment concerned only the wife's employment income. The amendment was to be effective from 1st January 1980.

To effect the amendment, wife's employment income was defined and a new paragraph added to the Third Schedule specifying the special rates applicable to this income. Section 34 (1)¹ was also expanded so that instead of providing for two rates only; namely the individual rates and the corporation rates there were now specific rates for wife's employment income. Section 45 remained unchanged which meant that the concept of aggregation remained intact. By virtue of the section the wife's employment income remained the income of the husband.

The wife's employment income rates as provided by the Act were exactly the same as the individual rates which meant that where P.A.Y.E. had been deducted correctly by the wife's employer by reference to monthly P.A.Y.E. tax tables

1 See Chapter Four for details

throughout the year, there would be no further tax to pay after the end of the year. The wife was not entitled to single relief or any other form of personal relief in her own right. Where the husband was not liable to tax, his excess personal reliefs could be transferred to the wife if he completed and forwarded form P5 to his Income Tax office as was the practice in the past.

The wife's employment income was defined not only to exclude income which was otherwise chargeable to tax under section 3¹ but also employment income which was derived by the wife as an employee of:-

- (a) a partnership in which her husband was a partner
- (b) her husband
- (c) a company in which the wife and/or the husband had in the aggregate more than 12½% of the voting power at any time during the year
- (d) any settlement created by her husband in which section 25 or 26² applied.

The purpose here was to eliminate employment situations in which the husband could collude with the wife to reduce tax by dividing between them the husband's income. Only employment income derived by the wife in an arm's length situation was to be subject to the favourable treatment.

Only one return form was to be issued as in the past, which the husband was required to complete accurately including where appropriate wife's employment income. Again only one notice of assessment was to be issued to the husband, which would show, where applicable, the wife's employment income charged to tax at separate rates. In normal circumstances where husband and wife had no any

1 The Income Tax Act Chapter 470 Revised Edition 1979

2 The Income Tax Act Revised Edition 1979 Chapter 470 page 12

source of income apart from employment there could be no further tax bill at the end of the year unless benefits in kind were provided by either one or both employers. The responsibility to pay any further tax due was the husband's, similarly if tax had been overpaid under P.A.Y.E., repayment was to be made to the husband. There was no provision in the Act whereby the wife could be repaid or assessed to tax separately from the husband. Therefore the amendment refused to recognize the wife as a taxable unit.

So far, we have looked at the amendment and its implications. We shall now look at the effects of the amendment in the light of equity.

5.4. EFFECTS OF THE AMENDMENT

To assess the effects of the amendment in the light of equity, we shall use a numerical example.

Illustration

For facts see illustration on page 143

Mr. Owino's assessment will be as follows:-

Mr. Owino

Tax Assessment

	<u>£</u>	<u>Tax in shs.</u>
Husband's income	2,700	
Wife's income	<u>1,500</u>	
Total income	4,200	
Tax on wife's employment income	£1,500 ¹	3,300
Tax on the balance of £2,700 ¹		7,500
Tax on total income		10,800
<u>Less</u> Personal reliefs		
Family relief		<u>1,680</u>
Net Tax charged		9,120
<u>Less</u> tax at source		
P.A.Y.E. Husband	7,500	
Wife	<u>3,300</u>	
Total tax deducted through P.A.Y.E.		10,800
Less reliefs already deducted (Husband)		<u>1,680</u>
Actually Tax Paid		<u><u>9,120</u></u>

The couple is not required to pay any tax at the end of the year unlike in the former system where the couple would have been required to pay shs. 5,400.

The two illustrations clearly show that some equity has been achieved. Due to the separate assessment of wife's employment income, there is a tax saving which means that the tax is less burdensome on the husband who is the taxable unit in this case. The real income of the people is eroded by the high rate of

1 The rates used are the 1978 rates

inflation therefore the amendment, by reducing the tax liability, increases the disposable income of the people and consequently their social welfare. Some degree of fairness has therefore been achieved in the system. However, as will be seen later, this amendment is advantageous mostly to the husband who is employed and/or owns some businesses and whose wife is earning only employment income as defined earlier on. Infact where the wife solely derives her income from employment the husband does not bear any tax burden for her. This alleviates the domestic problems which used to arise due to the extra tax bills at the end of the year.

However, the tax saving to the family means a loss of revenue to the department which although not explicitly stated, was one of the reasons why the separate assessment of wives was resisted for a long time.

5.5. CONCLUSION

The fact that the amendment achieved some equity is clear. However, the amendment did not consider some issues which to a considerable extent affected the anticipated equity that would be achieved from the separate assessment of wives' income. The amendment ignored the income of wives derived from:

- (i) any business
- (ii) any right granted to any other person for use or occupation of any property
- (iii) dividends or interest
- (iv) any pension, charge or annuity
- (v) any amount received by way of alimony or allowance
- (vi) any gains accruing in the circumstances prescribed in, and computed in accordance with the eighth schedule.

What this means is that the income derived from the above sources is still taxed on the husband even where the wife has earned it independent of the husband. The complete separation of income

between husband and wife could not be extended to other types of income mentioned above because this would have created a major loophole in the tax law which would have led to tax avoidance as discussed in section 5.2.1. The Government would have to raise the tax rates in order to make up for the lost revenue through tax avoidance.

CHAPTER 6

INDIVIDUAL RATES OF TAX AND PERSONAL RELIEFS

6.1. INTRODUCTION

As mentioned in chapter three, equity is pursued through the progressive individual tax rates and personal reliefs. An analysis of changes in the individual rates of tax and personal reliefs is necessary in order to critically assess to what extent equity has been achieved. The chapter will be discussed into two main sections; individual rates and personal reliefs.

6.2. INDIVIDUAL RATES OF TAX

These are the progressive tax rates at which income of individuals is taxed. In order to show clearly the extent to which equity has been achieved we shall illustrate the changes in the rates with a numerical example.

6.2.1. The Amendments

For the changes in the rates see chapter 4, In this section we are going to use a numerical example below to show the effect of the amendments.

Illustration

Mr. Ademba works as an accountant with Beka and Meka Certified Public Accountants. He earns shs. 5,000 per month. Mr. Ademba owns a shop in Busia Market from which he gets on average a net profit of shs. 1,500 per month. He has been working and running the shop for the last twelve months.

M. Ademba's tax will be determined as follows (assume the 1973 rates, . Reliefs are ignored because they are irrelevant in this example).

Mr. Ademba

Computation of Tax Payable

Sources of Income	£
Employment	3,000
Business	<u>900</u>
Total Income	<u>3,900</u>

Tax on £3,900 is determined as follows:-

	Shs.
First 1,200 @ 2	2,400
Next 600 @ 3	1,800
600 @ 4	2,400
600 @ 5	3,000
600 @ 6	3,600
<u>300 @ 7</u>	<u>2,100</u>
3,900	<u>15,300</u>

Mr. Ademba will be assessed a tax of shs. 15,300.

In 1978 the rates were changed as shown in chapter 4¹. The amendment increased the tax brackets. This had the effect of reducing personal tax payable by individuals. Those in the lower tax bracket had their tax reduced by a percentage greater than that of the upper income tax brackets. This difference in percentage reductions also helped to establish equity in the tax system.

With the 1978 rates Mr. Ademba's tax liability is as shown below:-

1 See chapter 4 Amendment No. 58

Tax on £ 3,900 is determined as follows:-

	Shs.
First £ 1200 @ 2	2,400
Next £ 1200 @ 3	3,600
Next £ 1200 @ 5	6,000
Next £ <u>300</u> @ 7	<u>2,100</u>
3,900	14,100
<u> </u>	<u> </u>

Due to the new rates Mr. Ademba's tax liability is reduced by 1,200 (15,300 - 14,100).

With effect from 1st January 1982, the rates changed as shown in chapter 4. According to the 1982 rates Mr. Ademba's tax liability would be as follows:-

Total income £ 3,900

	Shs.
First £ 1500 @ 2	3,000
Next £ 1500 @ 3	4,500
Next £ <u>900</u> @ 5	<u>4,500</u>
<u>3,900</u>	<u>12,000</u>

Mr. Ademba's tax liability is reduced by shs. 2,100 (14,100 - 12,000).

6.2.2. Effects of the Amendments

To show the effects we shall use the 1978 amendments and the 1982 amendments. The changes were intended to allow for inflation and thus reduce the tax burdens on the tax payers. The aim of the amendments was therefore to establish some degree of fairness in the tax system. However, before we can draw conclusions as to whether some degree of equity was indeed achieved we should look at how inflation has affected the standard of living. According

to Nairobi upper income cost of living index, the total inflation rate was 54% from April 1977 to April 1981.¹ Let us assume the same rate for the four years 1978 to 1982. We shall use illustration on page 154 to demonstrate the effects. In 1978 Mr. Ademba's income of £3,900 attracted a tax of £705. This left him with a spendable income of £3,195 (3,900-705), In 1982, the inflation adjusted equivalent of his 1978 income is $154\% \times 3,900 = \text{£}6006$ and the equivalent spendable income will be $3195 \times 154\% = \text{£} 4,920.3$. However, in 1982 a gross income of £ 6006 will attract a net tax liability of £1277.7 determined as follows:-

	Shs.	£
First £1500 @ 2	3,000	150
Next 1500 @ 3	4,500	225
Next 1500 @ 5	7,500	375
Next 1500 @ 7	10,500	525
Next 6 @ 9	54	<u>2.7</u>
		<u>1277.7</u>

The spendable income is thus (6006 - 1277.7) £4,728.3.

Mr. Ademba has therefore lost (4920 - 4728.3) 191.7 of the spendable income. However, the loss is about $4\% \left(\frac{191.7}{4920} \right)$, so we can infer that the new rates offset the effects of inflation to a certain extent. Since the amendments partially compensate for inflation, we can conclude that some degree of fairness has been achieved in the tax system.

6.3. RESIDENT PERSONAL RELIEFS

Personal reliefs are aimed at relieving tax payers of some of the tax burden. As we saw in chapter three they are aimed at achieving vertical equity. The reliefs are given through deducting them from tax payable by an individual not from taxable income. The reliefs are received by only natural persons

1 The Accountant, The Journal of the Institute of Certified Public Accountants of Kenya volume II Number 2 June 1981. Printed by Majestic Printing Works Ltd. Page 17

not companies because the latter do not have personal responsibilities although they are legal persons. Reliefs are given according to the status of the tax payer at the beginning of the year. That is, for a couple to get family relief, they have to have been married on 1st January of the year in which they are claiming the relief.

This section will be discussed under the following subheadings: reliefs before 1st January 1978, reliefs introduced by the 1978 amendment and reliefs introduced by the 1982 amendment and lastly a numerical example to illustrate the effects of the amendments.

6.3.1. Reliefs before 1st January, 1978

Prior to the 1978 amendment the following reliefs were in operation; married relief, single relief and child relief.

Married Relief:

A tax payer who was married at the beginning of each year was entitled to the above relief at the rate of shs. 720/- per year or shs. 60/- per month. In order to get this relief the husband had to be living together with his wife at the beginning of the year and fully maintaining her.

For the married man, the threshold income was therefore 720/-. That is the point at which individuals start paying income tax.

Single Relief:

This relief was being given to all single persons resident in Kenya during the year of income. It was given at the rate of shs. 360 per year or shs. 30/- per month.

In this case single person meant unmarried persons, widows, widowers or married persons living separately by law. For a single person the threshold income was therefore at 3600/-.

Child Relief:

This relief was given to a taxpayer who had a child at the beginning of the year. The rate was shs. 180 per year per child. A family could claim child relief for a maximum of only four children, a child must have been born by 1st January and must have been below 18 years old. Where the child was over 18 years he or she must have been wholly dependable on the parents i.e. attending school, incapacitated and has no income of his own exceeding shs. 1800 per annum. Child in this case meant one's own child, step child or adopted child under a written order of the court.

Insurance Relief:

This relief was claimed by a tax payer paying premiums on a life policy for himself or the life of his wife. The life policy of a child was not considered. The insurance had to be with a company operating lawfully in Kenya and the benefit of this policy had to be payable here in Kenya and in Kenya currency. The Commissioner could require a tax payer to produce documents as evidence of the policy.

The rate was shs. 2 per every shs. 20 of premium paid upto a maximum amount of premium of shs. 3,600 per year. Where the employer paid premiums for the employee, the employee could claim relief because these premiums were taxable as income from employment.

6.3.1. Reliefs from 1st January, 1978

From 1st January, 1978 the reliefs in operation were as follows:-

Family Relief:

This relief was to be claimed by married persons with or without children. Thus, the relief combined married relief and child relief which were in existence prior to 1st January 1978. The rate was shs. 1680 per year. This relief removed the discrimination between couples with children. All couples were placed at par. The argument against this relief is that couples without children have less responsibilities than those with children hence the two should not be treated equally. This relief also dropped the requirement that child relief could be claimed for a maximum of four children. In terms of equity, this was a commendable measure. The limit of four children was discriminating against families with many children. The removal of the limit established equality between the families irrespective of the number of children.

The introduction of this relief raised the threshold income of a married man from shs. 7200 to shs. 16,800.

Single Relief:

The rate went up from shs. 360/- to shs. 600/- per year. The single person was therefore to enter the tax net at shs. 6000 per annum.

Special Single Relief:

This was a new relief introduced for the first time in Kenya. It was to be claimed by single persons with children. The rate was shs. 720 per year.

The number of single persons with children was growing tremendously. These people have almost the same responsibilities as the married people if not more.

Today it is not surprising to find a single woman with six children all from different men who do not care for them. The single woman has therefore to look after these children. Comparing this woman with a couple which has six children, the former has a heavier burden because she has to support the children all alone. The relief was therefore introduced to lessen the tax burden of single persons with children and thus create vertical equity between them and single persons without children on one hand and married persons on the other hand. The threshold income for single persons who support children was established at shs. 7200 per annum.

Insurance Relief:

The maximum amount of premium was raised from shs. 3,600 per year to shs. 4,800 per year.

6.3.2. Reliefs from 1st January, 1982

From 1st January, 1982 the reliefs were amended as shown in chapter four¹. The personal reliefs for all categories of individuals was increased by shs. 120 per year. This had the following effects on threshold income. A married man was not to become liable to income taxation until his income reached shs. 18,000 per annum or shs. 1,500 per month. The single person was to enter the tax net at shs. 7,200 per annum or shs. 600 per month. And for those single persons supporting children, the threshold was raised to shs. 8400 per annum or shs. 700 per month. The effect of these amendments was to eliminate a significant number of eligible tax-payers from taxation while giving substantial relief to those who were left in the tax net. The

1 See chapter Four Amendment No. 100

amendments were aimed at establishing vertical equity between tax payers. Those whose income was low were eliminated from the tax net thus according them an opportunity to meet their other obligations. Those with high incomes were left in the tax net but were given substantial reliefs thus relieving them of some tax burden and according them an opportunity to meet other obligations. In essence vertical equity was established between tax payers in different income categories.

The rationale behind raising the maximum insurance premium claimable from shs. 4,800 per annum to shs. 7,200 per annum was to boost savings and also counteract the rising cost of insurance premiums with a view of establishing fairness in the taxation system. A fair tax system should allow the tax payers to engage in other activities that boost their welfare such as savings. Also a fair system should try to minimize the effects of inflation e.g. the above mentioned rising costs of insurance premiums.

6.4. Effects of the Amendments Illustrated

We shall use the facts in illustration on page 154 and assume the following additional facts. Mr. Ademba is married with five children aged 2, 4, 6, 8, and 10. He has an insurance policy for himself and his wife of which he pays the following premiums per year; shs. 10,800 and 9,600 respectively.

Mr. Ademba's tax position will be as follows:-

Before 1st January, 1978

Tax on Ademba's total income		15,300 ¹
<u>Less Personal reliefs</u>		
Marriage	720	
Child relief 180x4	720	
Insurance relief	<u>360</u>	<u>1800</u>
Tax payable		<u><u>13,500</u></u>

1 See Illustration on page 155.

From 1st January 1978

We shall hold the individual tax rates constant (that is 1973 rates are used).

Tax on Ademba's Income	shs.	15,300	
<u>Less</u> Personal reliefs			
Family relief	shs.	1680	
Insurance relief		<u>480</u>	<u>2,160</u>
Tax payable			13,140

The tax payable is reduced by shs. 360 (13,500 - 13,140).

From 1st January 1982

The individual tax rates are held constant (that is 1973 rates are used).

Tax on Ademba's Income	shs.	15,300	
<u>Less</u> Personal reliefs			
Family relief		1800	
Insurance relief		<u>720</u>	<u>2,520</u>
Tax payable			<u>12,780</u>

The tax payable is reduced by 360, (13,140¹ - 12,780).

The above numerical illustration indicates clearly the reduction in the tax burden due to changes in the personal reliefs. The changes are intended to allow for inflation. However, although they do not fully compensate for inflation as the analysis of individual tax rates show, they have to a certain extent reduced the tax-payers burden. They have in a way established some degree of fairness in the tax system.

1 The tax payable after 1978 Amendment.

6.5. CONCLUSION

To conclude this chapter we shall combine the changes in individual rates and the changes in personal reliefs to clearly show how the tax payers' position has changed due to the amendments.

Using the 1973 rates and personal reliefs Mr. Ademba's tax position is as follows:-

Tax on total income	shs. 15,300
Less Personal reliefs	<u>1,800</u>
Tax payable	<u>13,500</u>

From 1st January, 1978, Mr. Ademba's tax position is as follows:-

Tax on total income	Shs. 14,100
<u>Less Personal reliefs</u>	<u>2,160</u>
Tax payable	<u>11,940</u>

From 1st January, 1982, Mr. Ademba's tax position is as follows:-

Tax on total income	shs. 12,000
<u>Less Personal reliefs</u>	<u>2,520</u>
Tax payable	<u>9,480</u>

To be fair, a tax system should adopt to the changing environment in order to be relevant to the society at large. The changes in the individual rates and personal reliefs are intended to allow for inflation. The reduction in the tax payable shows that to a certain extent this has been achieved. If we adjusted the income to its inflation adjusted equivalent there might be some loss in net spendable income as the analysis of individual rates show. However, this loss will be quite minimal and will not negate the conclusion that the changes have, to a certain extent, allowed for inflation with a view of establishing fairness in the tax system.

CHAPTER SEVEN

CONCLUSIONS AND LIMITATIONS OF THE STUDY

7.1. Introduction

Chapters five and six dealt with specific amendments in the light of equity criterion. They examined the extent to which equity has been achieved, which was the main objective of this study. This chapter gives conclusions of the study and also points out the limitations of the study. Finally it gives suggestions for further study.

7.2. Conclusions of the Study

The study has sought to show the extent to which equity has been achieved by some of the numerous amendments which have been made in the Income Tax Act. The selected amendments have shown that some fairness has been established in the tax system. The numerical illustrations have shown that there has been a reduction in the tax liability. The reduction in the tax liability has enabled the tax payers to spend their income on other commitments such as paying school fees for their children and other relatives. A tax system should not hinder the tax payers from honouring other commitments in other words it should be fair. As section 7.5 shows, further changes should be made with respect to separate assessment of wife's employment income in order to achieve a high degree of equity.

7.3. Implications to the Income Tax Department

The analysis has shown the extent to which equity has been achieved. The separate assessment of wife's employment income, in particular, has raised issues that the Income Tax Department should look into. The Income Tax Department should, in

consultation with tax experts, explore ways and means of taxing wives as separate tax units.

7.4 Limitations of the Study

The study has concentrated on only very few amendments therefore we cannot draw conclusions that the amendments whose aims were to achieve equity have indeed achieved it. If there was ample time we would have analysed all the amendments that best illustrate the equity criterion. However, the few amendments illustrate clearly to what extent equity has been achieved.

The time factor as mentioned above is a limitation. If there was sufficient time we would have considered all the amendments in the light of equity criterion and other tax efficiency criteria.

7.5. Suggestions for further Study

A study should be carried out to analyse all the amendments in the context of tax efficiency criteria of a good system. This will assist the Income Tax Department to look into the possibilities of amending further provisions of the Income Tax Act with a view of establishing a tax system that is fair to everybody.

With respect to the specific amendments selected, further study should be done on various issues, for instance taxing wives as separate taxable units i.e. considering all their income not only employment income as theirs not their husbands.

With respect to individual rates of tax a study should be done to see whether there should be further reduction in the rates which should not affect revenue substantially.

As far as the personal reliefs are concerned, a study should be done to see whether new reliefs such as dependants' reliefs, old age reliefs should be introduced. If possibilities of taxing wives as separate taxable units are explored then consideration should be made for the possibilities of dividing family relief into two so that both the husband and the wife get a portion of it. The husband and wife should be allowed to claim insurance relief on policies held by them individually.

APPENDIX

THE DEVELOPMENT OF CAPITAL GAINS TAX IN KENYA

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INTRODUCTION

Any attempt to analyse capital gains tax is seen and critically viewed as an extension of the tax base that deprives the businessman, the stock market speculator or even the multinational company of its hard earned income on transfer of its property. Definition of income for tax purposes is an area involving many problems and opinions usually differ. This is so because income can be defined from a legal point of view, economic point of view or an accounting point of view. Capital gains being part of income can also be viewed in the legal, economic and accounting perspectives. A brief discussion of gains as a legal, economic or accounting concept is an appropriate introduction of this paper.

The legal concept of gain has been defined by Lawrence Seltzer in the following quotation

"In both law and common speech, capital gains are generally regarded as the profits realized from increases in the market value of any assets that are not part of the owner's stock in trade or that he does not regularly offer for sale, and capital losses as the losses realized from declines in the market value of such assets." 1

This legal definition of a capital gain emphasizes the nature of the asset owner's trade or business or more basically the owner's intended use or disposition of a specific property. If the owner intends to hold a particular asset only until he can sell it at a price that will return a satisfactory profit, then according to the legal concept, any gain realized on sale or other provision would constitute ordinary income. Alternatively, if the owner held the asset primarily for the production of recurring income or only as a long-range

investment, with little or no intention of offering the basic asset for resale in the shortrun, even if the asset were to increase in value, the asset would constitute a capital asset and the gain realized on its sale would constitute a capital gain.

When applied to taxation, the legal definition of the capital gain creates the obvious difficulty of having the third party determine objectively the intention of a tax payer with regard to each asset owned. The intentions of the tax payer should be determined at a particular moment because an asset owner may alter his or her intentions over time. Thus an asset owner may discover that the sale of an asset originally held solely for long-range investment purposes is now so valuable that it must be reclassified as held primarily for resale. A second difficulty inherent in legal definition of the capital gain is the requirement that the asset be offered regularly for sale before it is classified as a non-capital asset. Are two, three, four or five sales necessary to categorize an asset as one that is regularly offered for sale?

In the classical economist's model of free enterprise, capital gains and losses are non-existent. Such assumed parameters as perfect competition, perfect knowledge, conditions of certainty and freedom of entry ensure rapid and perfect adjustment of costs and prices throughout the market to eliminate pure economic profit. In real world, the assumed parameters do not exist. Economists concerned with divergencies of the real world from the model sometimes define indirectly, the capital gains or losses as the gains attributable to one or more imperfect conditions. From an economist's point of view unanticipated gains or losses especially if non-recurring are often

described as 'windfall' gains and losses and as such are distinguished from ordinary income.

This concept of capital gain leaves a great deal to be desired if applied to taxation. Expectations are as difficult for courts, and tax administrators to determine as are intentions. What is more, businessmen normally have no specific expectations of gain on each and every asset they own. They believe that their operations as a whole will result in greater revenues than expenses, but they cannot identify with precision the gain anticipated on each asset. Finally this concept of capital gains presents a time specification that creates difficulties for tax assessment. If a tax payer modifies expectations over time, which moment's expectations should control for tax purposes? The economist's view that capital gains are illusory since they come about due to price level adjustments is discussed at length in the section on cases for and against capital gains tax.

To the accountant, capital gain or loss is perhaps best described as that gain or loss that occurs only, at irregular intervals and not in the ordinary course of business.

An accounting concept of capital gains was expressed by Oscar Nelson² in the following words:

In theory there is no distinction since both result from business effort i.e. the employment of labour, capital and management by an enterprise with profit as the motive. Capital gains or losses are a manifestation of imperfect income measurement and result because of the requirement of modern business for periodic computation of net profit and loss. Capital gains or losses are composites of imperfect estimates of depreciation, imperfect allocation of costs, imperfect separation of capital and revenue expenditures, disregard of or imperfect adjustment of price level changes, etc.

This accounting concept of capital gains is comparable to the economic concept in denying, in theory, the existence of a distinct thing that can be distinguished and meaningfully labelled as a capital gain. Like the economist, the accountant recognizes the imperfection of the real world and seems to define capital gain or loss loosely as those income items that are attributable to real world imperfections. Except in acting as a tax advisor, the accountant's concern of capital gain and loss is restricted to concern for representing financial information fairly to third parties. Thus in presenting data, the accountant accepts the age old notion that recurrence is a necessary condition of operating income and non-recurrence a necessary condition of capital gain. Beyond this, very little can be said to clarify the accounting concept of capital gain. And to admit that certain gain or loss occur because of imperfect knowledge and imperfect income measurement does nothing to provide a sound basis for deciding whether they ought to be excluded from income taxation, taxed at preferential rates, or taxed at equal rates.

So far, we have reviewed the legal, economic and accounting concepts of capital gains and these concepts are important because as we shall see later to some extent, they influence the changes in the capital gains tax in Kenya. The tone of these concepts suggests that capital gains should not be taxed mainly because they are illusory gains and secondly that they pose difficulties which greatly affect the tax assessment.

Despite the views expressed by the concepts, capital gains tax is levied in most countries. And for tax purposes capital gains is simply defined as profits which arise upon the sale or transfer, other than

in the ordinary course of business of any property which the seller or the transferor acquired earlier at a lower cost. This is an oversimplification which is preferred to the technical difficulties which as we have seen cannot be resolved in this paper.

The objective of this paper is to analyse the development of capital gains tax in Kenya particularly the history prior to its introduction, its introduction, arguments for and against it and finally the amendments to the act since 1975.

CASES FOR AND AGAINST CAPITAL GAINS TAX.

In discussing these cases we shall be attempting to answer this question:- suppose we wanted to raise some amount x of revenue by way of capital gains tax instead of tax on other forms of income, what will be the effect on both the tax payer, the revenue authorities and the society at large? We shall review capital gains tax in the light of efficiency criteria; equity, neutrality, administrative efficiency, certainty and net expenditure restraining effect.

1. Equity

The strongest case in favour of the tax on capital gains is that it is equitable. It catches the profits of the rich and redistributes it to the less fortunate. In most cases the capital gains come about not only by the special skills of capitalists, but because of improved economic and other conditions in the country, brought about by the combined efforts of the whole society. Therefore if capital gains should be thought of as income, whether in entirety or in part, failure to include them in the tax base means that (i) some tax payers will be receiving gifts at the expense of the rest of the community

(2) these gifts which are not distributed randomly will favour the rich more than the poor because on one hand, it is the rich who own capital rather than the poor and on the other hand it is the rich who are more likely to place their capital in investments which pay part of their returns in the form of capital appreciation. A tax should therefore be imposed on capital gains in order to attain equity among the tax payers.

2. Administrative Efficiency

The strongest argument against this tax is that it is administratively inefficient. This is particularly difficult when the majority of firms are unquoted or where the capital assets have no readily attributable market values. The gain in such cases will be determined after sale of the asset as on the appointed day and the value will have to be attributed to them, based on acquisition cost plus any other maintenance outlays during the life of the asset. Among the many administrative problems three can be identified:

- (i) There will be lack of information from tax payers on realistic figures of cost which then reduces the matter to disputable estimates.
- (ii) Assessment problems arise where the income tax department staff is either limited or unqualified.
- (iii) Assessment costs in terms of time and money may go up especially where the revenue proceeds involved are somewhat negligible.

3. Neutrality:

Another strong argument against capital gains tax revolves around the concept of neutrality. One argument in this respect is that there is a tendency for this tax to discourage efforts to undertake risky projects which as we know may lead to very high profits. The tax disturbs the stock exchange market. Speculators try to avoid gains that are subject to the tax. It has disincentive effects to companies that wish to go public and those that would like to have their stock listed. Small investors are also discouraged from purchasing shares on the stock market because after their purchases, at some juncture they would need to sell their shares but at the time of sale, whatever their profits were from investment on the stock market, such profits would be eroded by the capital gains tax.

The tax encourages corruption and "under-the-counter dealings." Transfers are made but the parties concerned do not disclose the transactions to the authorities concerned thereby defrauding the government and committing criminal offence. The seller and the buyer collude in understating the price of the property.

4. Certainty

With regard to certainty, and particularly certainty to the revenue authority, it is argued that such a tax has a very low degree of certainty. These gains are irregular and are realized at one go when in fact they have been accumulating over the years and in some cases they are even involuntary. Unlike such taxes as Income Tax, there is no basis of estimating capital gains tax.

There are no files on which estimation can be based. Consequently the government cannot rely on such a tax as a source of revenue necessary for planning public expenditure.

5. Capital Accumulation Vs Consumption Income

Capital gains tax has been blamed for encouraging capital accumulation on a continuous basis rather than income consumption. The main stream of argument⁺ is that the tax leads to a "locked-in-effect" where people will not sell their property in fear of ultimately paying tax. The importance of this argument however depends on the relative elasticity of savings with respect to the net rate of return. In other words to what extent for example will those with a high Marginal Propensity to Consume (MPC) attach importance to capital appreciation other than ordinary income resulting from it for consumption? An important side issue, here is that can this tax effectively restrain consumption in favour of capital accumulation if that were the objective of the government? Answers to these questions is a matter of opinion. Consumption and capital accumulation are not mutually exclusive since the people who wish to accumulate capital have other sources of income to enable them to maintain or increase their consumption levels. Infact these businessmen have huge savings therefore their marginal propensity to consume will not be affected substantially.

To be equitable the authorities concerned may need to tax "locked-in-profits." To determine these profits we would first determine the value of an individual's assets in year 1 and then the value of these

assets in say year 3. The excess of the value in year 3 over the value in year 1 constitutes the locked-in-profits.

6. Price Level Changes

Many economists, particularly those concerned with consumption stress the fact that capital gains should not be taxed because they are illusory gains resulting from changes in the price level. To illustrate, assume that a tax payer purchased an asset 20 years ago for shs. 50,000 and sold it this year for shs. 100,000. If during the 20 year interval the general price level has increased by 100 percent then in terms of that taxpayer's command over the world's want-satisfying goods and services, the shs. 50,000 gain realized on sale is truly illusory. That is today it would cost the full shs. 100,000 to repurchase goods and services equivalent to those that would have been purchased for shs. 50,000 20 years ago. Obviously if a tax were imposed on the illusory gain the tax payer would be worse off after the sale because the after tax proceeds would be insufficient to repurchase goods and services equivalent in value to those sold. In this case any tax imposed would constitute a tax on capital rather than a tax on income.

Those who use changing price levels as an objection to the taxation of capital gains generally fail to observe that all taxable units are affected. The retailer who discovers that the cost of replacing stock is increasing is faced with identical problems, the manufacturer with large investment in plant and equipment is in a comparable position, charges for depreciation are inadequate for replacement and therefore income is overstated and thus overtaxed. Even the wage earner who receives a cost-of-living adjustment discovers that the larger pay cheque is wholly illusory and that real after-tax income is decreased by a

progressive tax system that fails to adjust for changes in the price level. If one is to argue against the taxation of capital^{gains} on the basis of the changing price levels, it is necessary to argue that all income be similarly deflated or inflated.

Admittedly, neither of the above arguments can be supported by hard facts to justify a tax or no tax on capital gains. However, as we have seen the arguments against capital gains tax outnumber the arguments for the tax. This does not lead us to conclude that there should be no such a tax. Equity seems to be a strong criterion for every tax system hence the fact that it is present in capital gains tax supports the idea that such a tax is needed especially in a developing country like Kenya where most of those who have capital are foreigners and acquired it when Africans were barred. It is mainly because of equity that despite the opposition, the tax was finally introduced in 1975.

THE HISTORY PRIOR TO THE INTRODUCTION OF CAPITAL GAINS TAX IN KENYA

In 1920 a tax legislation was introduced in Kenya and it stated that no value of property sold or transferred would be included in the gross amount of taxable income unless such property was sold or transferred in the ordinary course of carrying on business. Although the legislation itself was never effectively implemented the principle which clearly enunciated on the non-taxability of capital gains, was to form a basic tenet of our income tax system for the next half of the century. Until 1975, a person would earn up to shs. 400,000 from the sale of his house or farm and go without paying a single shilling in tax out

of that sum because these were only capital gains and not income. Again, a company could, by proper planning, earn thousands or even millions of shillings from the sale of its share holdings yet pay no tax at all on such earnings if it could show that the sale was not made in the ordinary course of business. The dispute between the Income Tax Department and tax payers concerned simply the question whether tax payers' gains were income or capital. They would be taxable if income and go free if capital.

Even in Britain the non-taxability of capital gains was never a universally acceptable policy, but for a long time its opponents were only a minority. The same position prevailed in Kenya. In due course, however serious considerations began to be given to the possibility of taxing at least those gains which were obviously realized from speculation. When in 1962 the tax was introduced in Britain it was clear that it was only a matter of time before a similar tax would be introduced in Kenya. This is so because at that time Kenya was a British colony. On the eve of independence, the World Bank Economic Mission to Kenya stopped short of recommending the enactment of the tax only because the market values in the country at that time were for real and confidence reasons depressed.

In 1965 the famous Sessional paper No. 10 on African Socialism and its application to planning in Kenya suggested that, capital gains tax should be introduced in Kenya. Such a tax was the most feasible means of establishing the concept of equity. Tycoons were emerging and the gap between the poor and the rich was widening so to minimize such a problem, capital gains tax was to be introduced.

From the above examples one can construe that the introduction of

capital gains tax was imminent. However, it took almost ten years before the tax was introduced. The long duration was due to ^{evidence?} conflicts among members of parliament. Some members of parliament reasoned that the Income Tax Department was not capable of handling such a complicated tax. The then Minister for Finance and Economic Planning said that he would think of introducing such a tax in future but that time (1973) it was not fair to burden the Income Tax Department with a new form of taxation. The lawyers also resisted this tax because they feared the legal complications which would arise from dealing with the capital gains tax matters. They argued that such tax would delay the transfer of capital gains from the expatriates to the citizens which in my view was a cover-up for their true reason just mentioned. Despite these oppositions the tax was finally introduced in Kenya in 1975.

INTRODUCTION OF THE CAPITAL GAINS TAX IN KENYA

In 1975 a parliamentary bill was passed to introduce capital gains tax in Kenya for the first time and indeed in the whole of Eastern Africa. The bill had four points:-

- (a) a tax of 15% of the value of real property and shares was to be charged on all transfer instruments submitted to the collectors of stamp-duty for stamping when property and shares were sold.

- (b) a 15% tax was to be levied on the values of all real property and shares of deceased persons before assessment for estate duty.
- (c) Although a tax of 15% on the realization value might represent a fairly low rate of tax in the light of rise in property and share value in recent years individuals or (trustees of estates) could claim refund of the tax they paid on the transfer of property or shares, up to the extent they could demonstrate to the tax department that the tax they had paid under the initial charge of 15% was greater than an amount equal to 35% of the capital gains realized. This meant that one would be asked in the end to pay more than 35% of the gain
- (d) Arrangements were to be made to improve the tax on transactions carried out on Nairobi Stock Exchange market. This was to be charged at the rate of 35% on actual gains realized over the adjusted cost of shares whose proceeds were not reinvested.

This bill was discussed in Parliament and amendments were made to it which resulted in the capital gains tax Act of 1975. The tax was introduced in the 1975/76 Budget delivered on 13th June 1975. For companies the tax was backdated to 1st January 1975 and for individuals it was to be effective from midnight 13th June 1975. The Act clearly indicated the applicable rates, the income exempt from this tax and the

definitions of certain terms which were considered necessary in understanding the tax. We shall now consider the provisions of the Act in details.

Description of What is Taxable

The act stated clearly that gains to be taxed were the capital gains on transfer of land or property. In the case of individuals, only land was chargeable to tax. Land included buildings on land or anything permanently attached to it, it also included standing timber, crops and any other vegetation growing on land and land covered by water. All marketable securities as defined by the Stamp Duty Act were taxable. For the companies they were taxed on all gains which were not chargeable to tax under any other section of this Act.

Rates

The rates were as follows:-

- (i) a withholding tax of 10% of gross sale proceeds. For instance, if property was sold for shs. 100,000 the withholding tax would be shs. 10,000. This provision did not apply to investment shares.
- (ii) For investment shares the rate of tax was 35% of the difference between acquisition cost and sale price.
- (iii) For companies the rate was the corporation rate of 45% for resident companies and 52.5% for non-resident companies.

(iv) For individuals the rate was 35% of the chargeable gain. Here the limitation was that the incremental tax after the inclusion of the capital gains was not to exceed 35% of the chargeable gains. As such two separate assessments were to be done.

Illustration I

Mr. Okumu's chargeable income from business and employment is shs. 70,000. He has capital gains chargeable to tax amounting to shs. 68,700. His assessment is as follows ignoring any personal allowances:

(a) Tax on Income excluding gains

	<u>Shs.</u>
First £1200 @2	2,400
Next £600 @ 3	1,800
Next £ 600 @ 4	2,400
Next £ 600 @ 5	3,000
Next <u>£ 500</u> @ 6	<u>3,000</u>
£ 3,500	<u>2,600</u>

Tax income including gains

	<u>Shs.</u>
First £ 1200 @ 2	2,400
Next £ 600 @ 3	1,800
Next £ 600 @ 4	2,400
Next £ 600 @ 5	3,000
Next £ 600 @ 6	3,600
Next £ 600 @ 7	4,200

Next £ 600 @ 8	4,800
Next £ 600 @ 9	5,400
Next £ 600 @ 10	6,000
Next £ 600 @ 11	6,600
Next £ <u>335</u> @ 12	<u>4,020</u>
<u>£ 6,935</u>	<u>44,220</u>

Maximum tax payable by Mr. Okumu is determined as follows:-

	Shs.
Initial tax	12,600
35% of 68,700	<u>24,045</u>
	<u>36,645</u>

In this case he pays shs. 36,645 because when he is assessed on total income basis the tax exceeds the maximum tax payable as shown above.

Definitions

Transfer is any sale including exchange, a gift including settlement into trust, insurance proceeds in the case of destruction of the asset, except in the case where the proceeds are used to reinstate the asset in essentially the same form within one year after destruction, abandonment, surrender or cancellation of rights, this includes surrender of shares on dissolution of a company, any transfer to spouse or relative. The following do not constitute a transfer, where the asset is used as a security for loan, transfer into custody of liquidators or receivers, transfer by a personal representative of a deceased to a legatee, distribution of assets of trust by a trustee to beneficiaries.

Transfer Value or disposal value:-

This is normally the sale proceeds or the value of the consideration given in exchange of the asset. Where the asset has been exchanged or given out for consideration other than money, the market value of the asset will be considered. The market value in this case is what the asset can fetch in the open market. Where the asset is destroyed the disposal value is the insurance proceeds. We deduct any incidental costs incurred wholly and exclusively for the purpose of transferring the asset. These include fees, commission etc. paid for professional services, stamp duty and advertising expenses. These expenses are allowable as far as they have not been claimed as expenses elsewhere.

Adjusted Cost:

This is the sum of the actual cost of purchase or construction and any expenditure incurred wholly and exclusively on the property or preserving the value of the property, any costs of defending or preserving the titles; any incidental costs of acquisition such as mortgage costs, valuation costs and advertisement to find a seller.

Capital gain:

This is the difference between the transfer value and the adjusted cost.

Reducing Deduction:

For every chargeable gain an allowance known as reducing deduction is given on all property acquired before 1st January 1975 and transferred before 1st January 1985.

Investment Shares

The adjusted cost for these shares is the price they commanded on the Nairobi Stock Exchange on 12th June 1975 where they were acquired before that date. For those ones acquired after this date, the cost is the value of acquiring them. The stockholder conducting the sale of the shares is responsible for collection and remittance of the tax.

At this juncture an illustration would suffice to illustrate the above definitions.

Illustration 3:

Mr. Okumu sells his asset for shs. 150,000. The costs related to selling include agent fees shs. 2,500, advertising shs. 300, legal fees shs. 4,000 and valuation fees shs. 3,000. He had acquired this property sometime back at a cost of shs. 60,000. In securing the asset he spent shs. 5,000 on legal fees, shs. 3,000 on mortgage arrangement, shs. 2,000 on valuation and shs. 1,500 as fees to an agent. The transfer value, adjusted cost and capital gains are determined as follows:-

Sale proceeds		Shs.	150,000
<u>Less</u> Incidental costs of transfer			
Agent's fees	Shs. 2,500		
Advertising	300		
Legal fees	4,000		
Valuation fees	<u>3,000</u>		<u>9,800</u>
Transfer Value			<u><u>140,200</u></u>

	Shs.
Purchase price	60,000
<u>Add</u> Incidental costs of acquisition	
Legal fees	Shs. 5,000
Mortgage fees	3,000
Valuation fees	2,000
Agent's fees	<u>1,500</u> 11,500
Adjusted cost	<u>71,500</u>

Capital gains = 140,200 - 71,500 = shs. 68,700

Exemptions from Capital Gains Tax

For individuals the following income is exempt from capital gains tax. Income derived from:-

- (1) Government or local authority stocks
- (2) Private residence of a tax payer which has been continuously occupied for the last three years. This includes any immediate surroundings. However, no claims can be made for more than one house even where the husband and the wife own separate houses. The residence must be for dwelling purposes and where part of it is used for business purposes, the percentage used in this is taxable.
- (3) Land where the transfer value is less than shs. 30,000.
- (4) Agricultural property of less than 100 acres except where the property is within the municipality boundaries.
- (5) Land adjudicated under the land adjudication Act or under land Consolidation Act and the title registered under Registered Land Act. The transfer should be for the first time.

- (6) Property sold (transferred) for the purpose of administering the estate of a dead person where the process is completed within 2 years.

For companies the following income is exempt from tax:-

- (1) Gain accruing on any transfer or sale of machinery.
- (2) Transfer of property in exchange for other property where the transaction is a restructuring of companies where the Minister deems it to be in the interest of the public.
- (3) Gain on transfer of investment shares in an incorporated body, association of individuals of a public nature.

CHANGES FROM 1976 TO 1982

In this section we are going to deal with the changes in the capital gains tax from 1976 to 1982. We shall first of all give a summary of the amendments in a tabular form and then discuss the amendments separately. In discussing the amendments, we shall illustrate their effects by numerical examples:

Summary of the changes

<u>Year</u>	<u>Amendments</u>	<u>Section Affected</u>
1976/77	Income Tax (Amendment) Act 1976 was passed repealing the capital gains tax as a separate tax and incorporating the taxation of the gains under the Income Tax Act	8th Schedule added to the Income Tax Act of 1973
1978/79	Only 50% of the Capital gains was to be taxed	Section 34A of Income Tax Act was repealed by 8 of 1978 S. 9

Year	Amendments	Section Affected
1981/82	Rates of tax payable by both individuals and companies were effectively halved as from 1st January 1981. Withholding tax was also reduced	Section 15(8) was reworded, a new subsection (No. 1A) was added to Section 34 Section 15(8) now applies to both individuals and companies

1976/77 Amendments

In April 1976, an amendment known as the Income Tax (Amendment) Act 1976 was passed in the Parliament repealing the Capital Gains Tax as a separate tax and incorporating the taxation of the gains under the Income Tax Act 1973. This was done by adding to the 1973 Act another schedule (8th Schedule) to outline how the capital gains will be taxed as a form of income.

The argument for this amendment was that capital gains is essentially income hence it should be placed under the same administration as income. A new department which had been set up was dissolved and some of the personnel who had been hired were absorbed in the Income Tax Department which had been in existence since 1973. This measure saved some government resources. The Capital Gains Tax department would have to train new personnel to handle the tax. By transferring the administration of the capital gains tax to the Income Tax Department, the extensive training of personnel was avoided because the personnel in the latter department was fairly conversant with tax administration therefore learning how to administer capital gains tax

would take them a shorter time as compared to new personnel in the capital gains tax department. Administration of capital gains tax in the Income Tax Department was also cheaper in terms of salaries because the existing personnel would not require additional salaries to handle the tax whereas if new personnel was to be hired in the capital gains tax department the Government would have to spend more on salaries.

1978/79 Amendments

The 1978 Finance Bill introduced the following changes. For individuals the rate of the tax was now 50% of the chargeable gains. This was done by repealing section 34A of the Income Tax Act 1973. We shall use illustration 1 to show the effects of this change.

Illustration 4

Mr. Okumu's capital gains amount to shs. 68,700. The chargeable gains is:-

50% of 68,700	=	shs. <u>34,350</u>
		Shs.
Employment Income		70,000
Capital gains		<u>34,350</u>
Total taxable income		<u>104,350</u>

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First £1200 @ 2	2,400
Next £ 600 @ 3	1,800
Next £ 600 @ 4	2,400
Next £ 600 @ 5	3,000
Next £ 600 @ 6	3,600
Next £ 600 @ 7	4,200
Next £ 600 @ 8	4,800
Next £ <u>417.5</u> @ 9	<u>3,757.5</u>
£ <u>5,217.5</u>	<u>25,957.5</u>

The tax rates are those which were prevailing before 1978.

Mr. Okumu now pays shs. 25,957.50 instead of shs. 36,645.

The change was introduced to reduce the tax charged on capital gains and thus curb the reluctance of businessmen to engage in transactions generating capital gains. The then Minister for Finance and Economic Planning also considered the efficiency criteria of a good tax system. He realized that high rates of the tax would distort the economic set up of the country. People would gradually diverge their interests to other areas which would result in over-investment in those areas and under-investment in the capital market.

1981/82 Amendments

The rates of tax payable by both companies and individuals were effectively halved as from 1st January, 1981. There was also a corresponding reduction in the rates of withholding tax. This was achieved by rewording section 15(8) and by adding a new sub-section (No. iA) to section 34. Section 15(8) now applies to both companies and individuals. It reduces the chargeable gains calculated under the eighth schedule by one half. As for individuals this new subsection

34(1A) states that the chargeable capital gains are to be treated as the top slice part of an individual's total income and that the maximum rate of tax payable on those gains is 35%. Thus the maximum effective rates of tax payable on gains calculated under the eighth schedule and before they are reduced by section 15(8) are:-

Resident companies $22\frac{1}{2}\%$ ($45\% \times 50\%$)

Individuals $17\frac{1}{2}\%$ ($35\% \times 50\%$)

The new withholding tax rates are:-

Investment shares 15% of the computed gains before reduction under section 15(8)

Other property 5% of sale proceeds

Section 15(8) introduces the requirement that capital losses shall be offset against other capital gains. The reduction by one half is then applied only to the resultant net gain. While logical, this new set-off will adversely affect individuals. Their gains were previously reduced by one half before the set-off.

The effects of the changes are demonstrated by using illustration 3. In this illustration we shall compare the new method and the old method.

Employment Income	70,000.00
Capital gains	12,000.00
Total taxable income	<u>82,000.00</u>

Illustration 5

	<u>INDIVIDUALS</u>	
	<u>OLD</u>	<u>NEW</u>
	Shs.	Shs.
Purchase price	60,000	60,000
Incidental costs of acquisition	11,500	11,500
Incidental costs of transfer	<u>9,800</u>	<u>9,800</u>
	81,300	81,300
Sale proceeds	<u>150,000</u>	<u>150,000</u>
Eighth schedule gain	68,700	68,700
Reduction under section 15(8)	<u>34,350</u>	<u>34,350</u>
	34,350	34,350
Chargeable gain	<u><u>34,350</u></u>	<u><u>12,022.50</u></u> (1)

Notes

(1) 35% of 34,350 = 12,022.50

This is the same as $17\frac{1}{2}\%$ of 68,700.

Let us assume further that he has employment income amounting to shs. 70,000. Under the old system he will pay tax to the tune of shs. 25,957.50. Under the new system he will pay shs. 16,707.85 determined as follows:-

	Shs.
Employment Income	70,000.00
Capital gains	<u>12,022.50</u>
Total taxable income	<u><u>82,022.50</u></u>

	Shs.
First £ 1200 @ 2	2,400
Next £ 600 @ 3	1,800
Next £ 600 @ 4	2,400
Next £ 600 @ 5	3,000
Next £ 600 @ 6	3,600
Next £ <u>501</u> @ 7	<u>3,507</u>
<u>4101</u>	<u>16,707</u>

To show the effects of the new system with respect to companies we shall use the illustration below:-

Illustration 6

Assume that the facts in illustration 3 apply to Okumu and Company Ltd. shs. 70,000 is income from business.

	<u>Companies</u>	
	<u>OLD</u>	<u>NEW</u>
Eighth schedule gains	68,700	68,700
Reduction under Sec. 15(8)	-	<u>34,350</u>
Chargeable gain	68,700	34,350
Income from business	<u>70,000</u>	<u>70,000</u>
Total taxable income	138,700	104,350.50
Tax at 45%	<u>62,415</u>	<u>46,957.50</u>

The effects of the changes with respect to withholding tax on property is illustrated below.

Illustration 7

Assume that the sale price of a property is shs. 150,000

	<u>OLD</u>	<u>NEW</u>
10% of 150,000	15,000	7,500
5% of 150,000		7,500

Illustration 8

To illustrate the provision of section 15(8) with respect to capital losses we shall assume the following facts in addition to the ones in the above illustration. Mr. Okumu sold a second property for shs. 50,000. This property had cost him shs. 60,000.

	<u>INDIVIDUALS</u>	
Eighth schedule gain on first property	68,700	68,700
Reduction under Sec. 15(8)	<u>34,350</u>	<u> </u>
	34,350	68,700
Loss on sale of second property	<u>10,350</u>	<u>10,000</u>
	24,350	58,700
Reduction under Section 15(8)	<u> </u>	<u>29,350</u>
Chargeable gain	<u><u>24,350</u></u>	<u><u>29,350</u></u>

From this example it is clear that the new set-off system adversely affects individuals. The chargeable gains are higher under the new system consequently the tax payer pays more tax.

Illustration 9

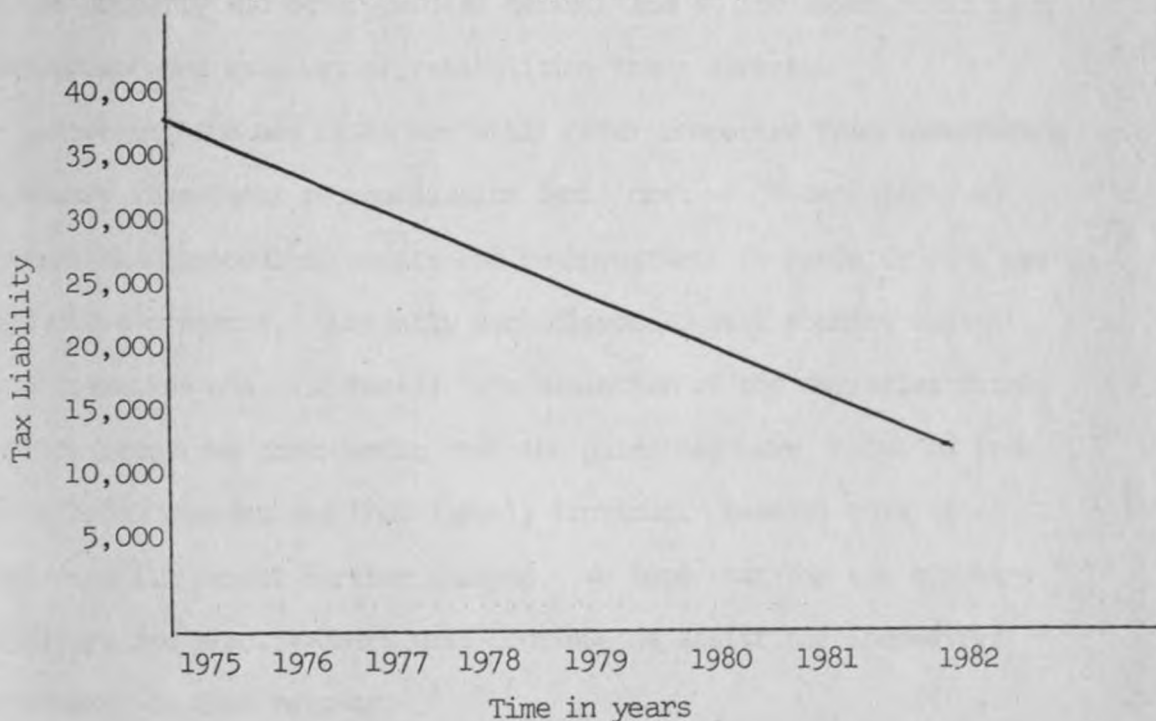
Let us assume that the above facts apply to Okumu and Company Ltd.

	<u>COMPANIES</u>	
	<u>OLD</u>	<u>NEW</u>
Eighth schedule gain on first property	68,700	68,700
Eighth schedule loss	<u>10,000</u>	<u>10,000</u>
	58,700	58,700
Reduction under Section 15(8)	<u> </u>	<u>29,350</u>
Chargeable gains	<u><u>58,700</u></u>	<u><u>29,350</u></u>

For companies the new set-off system is favourable. The chargeable gains are lower under the new system hence the tax payable is less.

Graph showing the effects of the Amendments

Year	1975	1978	1981
Tax liability	36,645	25,957.50	16,707



The graph slopes downwards showing the decreasing tax liability in respect of capital gains as a result of the declining rates. We anticipate further decline in the rates since we are strongly of the opinion that the gains are largely due to price level changes and hence fictitious.

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CONCLUSION

In the foregoing discussion we have looked at important aspects in the development of capital gains tax in Kenya. We have noted a continuous reduction in the rates and the reason cited for this reduction is that the higher rates have had a great inhibiting effect on the property and other capital markets and so the lower rates have been introduced as a way of rebitalizing these markets.

However, the new rates may still deter companies from undertaking necessary investment reorganization decisions. Such decisions may concern the disposal of assets for re-investment in large or more useful productive projects. Currently such disposals will attract capital gains taxation and will result in a depletion of the companies total capital resources considering that the gains may have resulted from price level changes and thus largely fictitious. Bearing this in mind we still expect further changes. We hope that the tax scholars, educators and practitioners will continue to assist the Income Tax Department in this respect.

FOOTNOTES

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