TAX PLANNING

11Th March, 2017

Table of Contents

Cytonn INVESTMENTS

I. Introduction

Introduction

Reducing Tax Liability

- There is nothing which hurts more than payment of taxes. One question that goes through every tax payer’s mind is “how can I reduce my tax liability?” Reducing tax liability is not always a bad or illegal exercise.
- There are legitimate ways to reduce taxes through proper tax planning and such methods are always encouraged. But unfortunately, there is also a tendency to reduce tax through illegal methods. They are not accepted practice and can invite problems.
- Today as we are living in a very busy world we tend to overlook at the tax planning and hurry things when the due date is fast approaching whereas if there is a proper tax plan then we would have reduced the tax liability.

Cytonn INVESTMENTS

Introduction

Reducing Tax Liability

There are three methods which are commonly used by the taxpayers to reduce their tax liabilities-

- Tax Evasion,
- Tax Avoidance and
- Tax Planning

Introduction

Tax Evasion

- Dishonest taxpayers try to reduce their taxes by concealing income, inflation of expenses, falsification of accounts and willful violation of the provisions of the Income-tax Act.
- Such unethical practices often create problems for the tax evaders.
- The Kenya Revenue Authority not only imposes huge penalties but also in some cases initiates prosecution in such cases.

Introduction

Tax Avoidance

- Tax avoidance is minimizing the incidence of tax by adjusting the affairs in such a manner that although it is within the four corners of the laws, it is done with a purpose to defraud the Kenya Revenue Authority.
- It is the act of dodging without directly breaking the law.
- In summary tax avoidance is the legal exploitation of the tax regime by taxpayers by applying atypical structures to reduce tax whilst making a full disclosure of the material information to the tax authorities.
- It is an indirect violation of the law if the sole objective of the structure is to reduce or eliminate the tax burden. Although not normally illegal, tax avoidance can still result in heavy penalties if the Kenya Revenue Authority adjudge one to have been avoiding paying tax.

Introduction

Tax Planning

- Tax planning is arrangement of financial activities in such a way that maximum tax benefits, as provided in the income-tax act are availed of.
- It envisages use of certain exemption, deductions, rebates and reliefs provided in the Income Tax Act.
- Tax planning is not at all a complex process provided the assesse knows the relevant provisions of the Income Tax Act. The complete knowledge is not necessary all he needs to know is the correct tax slabs and the various deductions allowed.
- Tax planning is different from Tax Avoidance and Tax Evasion as it is a systematic and scientific planning of company's operation to attract minimum tax liability.

Introduction

Tax Planning

- Tax planning is arrangement of financial activities in such a way that maximum tax benefits, as provided in the income-tax act are availed of.
- It envisages use of certain exemption, deductions, rebates and reliefs provided in the Income Tax Act.
- Tax planning is not at all a complex process provided the assesse knows the relevant provisions of the Income Tax Act.e. The complete knowledge is not necessary all he needs to know is the correct tax slabs and the various deductions allowed.

II. Real Estate Investment Income

Real Estate Investment income

What is Income?

- Gains or profits from: business, employment or services**, rent** or lease
- Dividends or interest
- A pension, charge or annuity, withdrawals, etc.
- An amount deemed to be the income of a person
- Capital gains in accordance with the 8th Schedule
- Extractive sector: Net gain upon disposal of an interest which is 20% or more of its value
- A natural resource income

Real Estate Investment Income

What is Income From Real Estate Investment?

Real Estate Development/Management

- This is a business of developing, owning, managing and selling property.
- Tax chargeable on taxable profits after deducting allowable expenses.

Rental Income

- All rent, premium or any other consideration for use or occupation of property.
- Taxable on all persons in receipt of rental income unless exempted specifically under any laws.

Real Estate Investment Income

What is Income From Real Estate Investment?

Real Estate Agents

- This is a business of managing property for a fee.
- Tax chargeable on taxable profits/management fee after deducting allowable expenses.
- WHT paid in advance is creditable against corporation tax payable on the income.

III. Areas of tax planning in context of Real Estate Investments

1. Home Ownership Savings Plan

Contributions to a Registered Home Ownership Savings Plan

- The Income Tax Act provides that contributions to registered schemes designed can be deducted from gross income up to a maximum of KES 4,000 per month.
- A depositor (employee) shall in any year of income commencing on or after 1st January, 1999 be eligible to a deduction up to a maximum of Kshs. 4,000 /- (Four thousand shillings) per month or Kshs. 48,000/- per annum in respect of funds deposited in “approved Institution” under "Registered Home Ownership Savings Plan", in the qualifying year and the subsequent nine years of income.

2. Mortgage

Mortgage Interest Deduction

- Interest incurred on personal mortgages is deductible from gross income before arriving at taxable income, subject to a limit of Ksh 12,500/= per month or Ksh 150,000/= per annum. Section 15(3)(b) provides that In ascertaining the total income of a person for a year of income interest paid on amount borrowed from specified financial institution shall be deductible.
- The amount must have been borrowed to finance either:- The purchase of premises or Improvement of premises - which he occupies for residential purposes. If any person occupies any premises for residential purposes for part of a year of income the allowable deduction shall be limited to the period of occupation
- The amount of interest allowable under the law must not exceed Kshs.150,000 per year (equivalent to Kshs.12,500 per month).

3. Capital Gains Tax

What is Capital Gains Tax?

- Capital Gains Tax is a tax on the profit when you sell or dispose of property that has increased in value. It's the gain you make that's taxed, not the amount of money you receive.
- Example You bought a painting for KES5,000 and sold it later for KES25,000, there will be a tax on the gain of KES20,000. The gain is calculated as the difference between the cost at which the property was bought and the price at which the property is sold, this is after deducting any costs of improvement to the property and any incidental costs incurred on the transfer of the property for example advertising fees and lawyer costs.
- It is charged at the rate of 5%.

Capital Gains Tax Cont…

Computation of Capital Gains Tax

TRANSFER VALUE Minus ADJUSTED COST = CHARGEABLE GAIN

Capital Gains Tax Cont…

Capital Gains and Tax Planning

EXEMPTIONS

- Income is not chargeable to tax under section 3(2)(f) where, and to the extent that, it is chargeable to tax under any other provision of law
- A gain accruing to a company on a transfer of machinery classified in paragraph 7 of the Second Schedule is not chargeable to tax under section 3(2)(f).
- The gain which is exempt from tax under Paragraph 36 of the First Schedule is not chargeable to tax under Section 3 (2)(f)
- The gain arising from group reorganisation deemed to be of public interest by the Cabinet Secretary

Capital Gains Tax Cont…

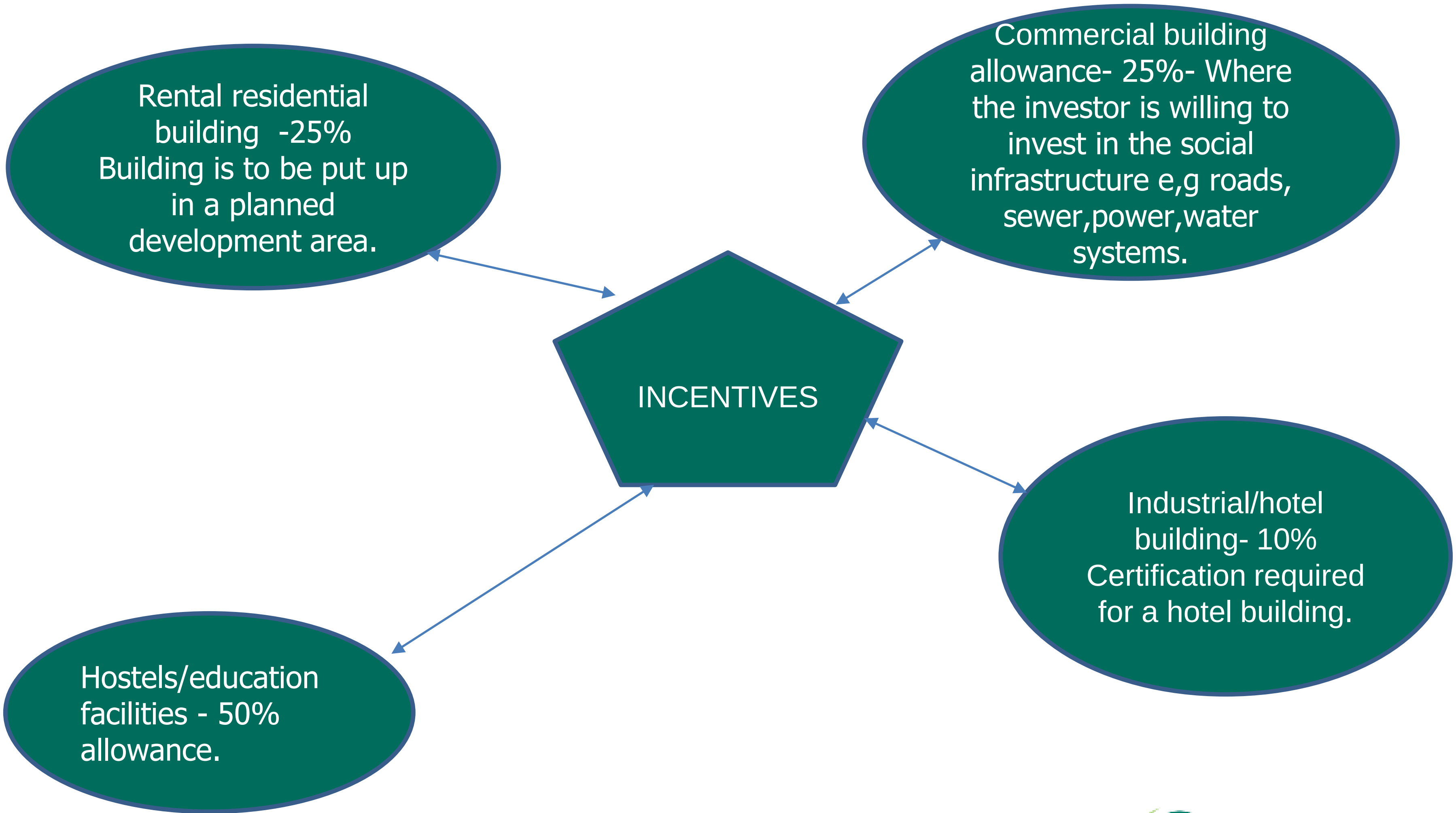
Capital Gains and Tax Planning Exemptions Cont..

Capital gains realized by individuals from under the following instances are exempt from CGT: Para 36 of 1st Sch.

- Transfer of land whose value does not exceed KES.3 Million
- Transfer of agricultural property having an area of less than 50 acres where that property is situated outside a municipality, gazetted township or an area that is declared by the Minister, by notice in the Gazette, to be an urban area for the purposes of this Act;
- Transfer of property which is transferred or sold for the purpose of administering the estate of a deceased person where the transfer or sale is completed within two years of the death of the deceased or within such extended time as the Commissioner may allow in writing. For a court case, 2 years after the case.
- Transfer of private residence occupied continuously for a period of three years or more prior to the transfer

4. Other Tax Incentives

Allowances and reduced Income Tax Rates..



IV. Conclusion

Conclusion

Key points to be remembered :-

- Keeping Complete and Accurate Records
- Proper record keeping enables individuals and companies, to support allowable deductions from their gross income. Accurate records will also help in the event of a tax audit or other proceedings against the taxpayer.

- Getting Timely, Competent Tax Advice
- Working with a competent tax consultant enables individuals and corporate entities to conduct their affairs in compliance with existing tax laws.

Conclusion

Key points to be remembered :-

- Challenging Tax Assessments in Legal Tribunals
- The tax statutes provide avenues for individuals and companies to challenge tax assessments made upon them by tax authorities in courts.
- Compliance
- Taxpayers can avoid exposure to tax problems (stiff penalties, interest, possible shutdown of business, and distractions from usual activities) by complying with established laws and requirements. However, it is not illegal to arrange one's affairs in such a manner as to minimize their tax burden.

Q&A