



**UPPER HILL
DISTRICT
ASSOCIATION**



**ESTATE AGENTS
BOARD**



**REPUBLIC OF
KENYA**

POSITION PAPER ON WITHHOLDING TAX ON RENTAL INCOME

PRESENTED BY:

- 1) THE INSTITUTION OF SURVEYORS OF KENYA**
- 2) KENYA PROPERTY DEVELOPERS ASSOCIATION**
- 3) UPPER HILL DISTRICT ASSOCIATION**
- 4) SHOPPING CENTRE ASSOCIATIONS OF KENYA**
- 5) ESTATE AGENTS REGISTRATION BOARD**

PRESENTED TO

**COMMISSIONER, DOMESTIC TAX
KENYA REVENUE AUTHORITY**

27TH JANUARY 2017

1. Introduction

We are grateful to you for affording us this opportunity to share with you some of our insights and concerns newly introduced withholding tax on rental income.

2. Concerns

The Finance Act 2016 introduced Withholding Tax on Rental Income (WHTR) with effect from 1st January 2017 at the rate of 10% of gross rent. KRA has already begun appointing withholding rent agents, without adequate consultation with stakeholders. We find this challenging and highly damaging to the industry. As such, we wish to raise the following concerns;

a) Policy Considerations:

1. Whilst we applaud KRAs efforts to widen the tax net and share the tax burden with all who make incomes in our economy, we are saddened to note that to date the implementation of this WHTR has been targeted at compliant tax payers who have institutional tenants. More so new developments
2. In principle, it is economically unviable and unwise to charge withholding taxes on capital-intensive industries as this will discourage long term investment in the real estate sector and risk taking. Furthermore, we note that there are landlords who bought their properties through loan or have constructed with borrowed funds. It takes almost 10 years for any landlord to start earning income on their properties. Taxing them 10% is therefore a drawback to their investment.
3. The Income Tax Act and various other legislations give developers and property owners certain tax benefits including capital allowances, interest cost allowances and recovery of VAT. These are made in recognition of the high risks in property development and the negative cash flows in the early stages of development. The imposition of a 10% WHTR on rental receipts will nullify these benefits and will be a disincentive for new investment in the property sector in contradiction to the governments aims of increasing the ease of doing business and encouraging new investment including in building and construction, and particularly in more housing of whose shortfall is over 150,000 homes per annum.
4. We acknowledge that many landlords are already tax exempt or allowed to combine rental income with other sources of their income for tax purposes, key among them being insurance companies, pension funds and

REITs. These are the largest property owners and it is unclear why their income is being pre-taxed

5. A withholding tax of 10% on the gross rent assumes that properties are generating taxable profits of above 30% of the gross income. Taking into account interest costs, capital allowances, mortgage costs, property management and maintenance costs and other costs, very few if any properties enjoy such levels of profit and the withholding will create huge and controversial refund positions, if not interest costs on KRA for late refunds. In effect no new revenues will be gained but new liabilities will be created on KRA.
6. It should also be noted that most of new developments carry heavy VAT credits and are already suffering lengthier periods of wiping out the credit due to the recent imposition of withholding on VAT. Further withholding based on revenues will mean that properties are in perpetual refund positions that translates into a cost and discourages new developments.
7. The Act provides that the tenant withholds gross rent. Service charge is a reimbursement expense and should not be taxed.

b) Complications on Implementation

1. Property agents manage many commercial properties. In circumstances where both the tenant and the property agent are appointed as WHTR agents it is unclear who would deduct the tax or if both would (which would be clearly absurd)
2. There is a risk that where a few property agents are appointed many clients will terminate their contracts to avoid the WHTR with damaging effects to the industry by moving to unregistered agents. Such avoidance or non-compliance will defeat or reduce the very purpose of the intended introduction of WHTR.

3) Our Recommendations

a) General recommendations

- We propose that KRA suspends appointment of WHTR agents whilst the matters are addressed and agreed upon. Indeed there is a historical precedent from when VAT on commercial rent was initially introduced and where KRA and the Commissioner then himself engaged industry stakeholders and participants, at a meeting at Safari Park Hotel, and the

proposed introductions were first put on hold while implementation issues and concerns such as is the case now were first addressed.

- We suggest that a broad based stakeholders forum be called to deliberate the matter and come up with possible solutions.

c) Specific Recommendations

1. Exemption to landlords from over taxation in the following circumstances:
 - a. REITs, insurance companies pension schemes and other bodies with tax allowances
 - b. Landlords who have filed tax returns for the last 3 years (there is similar practice in the UK) who are already within the tax bracket
 - c. New developments not more than 10 years
2. Reduction of the rate to below 2%. The rate of 10% is extremely punitive and out of sync with other withholding taxes for resident taxpayers. In addition, the risk resistance and non-compliance is high
3. The appointment of WHTR agents needs to be made openly and only registered estate agents under the Estate Agents Act appointed to make returns on behalf of landlords
4. Definition of taxable amount as net rent only excluding service charge and other fees. Furthermore, there is need to clarify what is meant by Gross Rent, whether this includes service charge which in real terms is not a landlord income

4) Conclusion

Once again, we thank you for according us this opportunity to share our concerns. We hope that they shall be taken into consideration by your office.

Thank you!