Tax incentives for the hospitality industry

Background

Hospitality remains a key segment of the Kenyan economy.

To support this sector that is very competitive and make Kenya a more affordable and competitive destination, a number of tax incentives have been provided in our tax laws.

However, due to lack of understanding of such incentives or lack of expert advice on how to exploit such opportunities, some of these incentives remains unexploited by many players in the hospitality industry.

Tax simplified

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Let's Talk!

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Issues analysed in this publication

1. Investment deduction for capital expenditures
2. Key VAT exemptions
3. Customs duty exemption
4. Special economic zones
5. Taking advantage of the tax incentives

Investment deductions on capital expenditures

Capital expenditures are granted a depreciation charge deduction for the purposes of determining the operating profits. However, the depreciation charge is disallowed for the purposes of determining the profits that a person should be paying income tax on. In determining the taxable profits, a deduction in form of a capital allowance.

Under the Second Schedule of the Income Tax Act, a 100% investment deduction is provided as follows:

> *a building which is in use as a hotel or part of a hotel and which the Commissioner has certified to be an industrial building where such a building in use as a hotel includes any building directly related to the operations of the hotel contained within the grounds of the hotel complex, including staff quarters, kitchens, and entertainment and sporting facilities;…*

There is a key requirement to obtain a certification or approval from the Commissioner of KRA before claiming such a deduction.

A lot of players in the industry either do not claim this deduction or do not follow the set requirements before claiming. This results in higher tax payments, risk of lose of the tax incentive opportunity or costly tax disputes.

VAT incentives

The following are the VAT exemptions provided for the hospitality sector:

1) Service charge exemption – the Finance Act 2016 provided for exclusion of the service charge element from the amounts subjected to VAT in respect to a supply by a hotel or restaurant, subject to the following criteria:

   a) The service charge is distributed directly to the employees of the hotel or restaurant in accordance with a written agreement between the employer and the employee; and
   b) the service charge does not exceed ten per cent of the price of the service, excluding such service charge.

2) Exemption from VAT for services by tour operators, excluding in-house supplies.

3) Taxable goods for direct and exclusive use for the construction of tourism facilities, recreational parks of fifty acres or more, convention and conference facilities upon recommendation by the Cabinet Secretary responsible for matters relating to recreational parks.

Customs duty exemptions

A number of items purchased by hotels qualify for customs duty exemptions. These are:

a) Battery operated vehicles for use in hotels.

b) Hotel Equipment - Any of the following goods engraved or printed or marked with the hotel logo imported by a licensed hotel for its use:

   i. Washing machines
   ii. Kitchen ware
   iii. Cookers
   iv. Fridges and freezers
   v. Air conditioning systems
   vi. Cutlery
   vii. Televisions
   viii. Carpets
   ix. Furniture
   x. Linen and Curtains
   xi. Gymnasium equipment.

However, to qualify for the above exemptions, the hotel will need to follow the laid down procedures and obtain the necessary approvals.

Special Economic Zones

Tourist & recreational centres are now among the qualifying businesses under the Special Economic zones Act, 2015.

Some of tax incentives for SEZ entities includes:

- 10% corporate tax rates
- Lower withholding taxes rates or exemption
- VAT zero rating of goods and services supplied to SEZ entities
- 100% to 150% investment deduction for buildings and other capital expenditures.

It is now possible for tourist and recreational centres that can meet the set requirements to apply to be gazetted as SEZ. Alternatively, they can set up operations in existing SEZs and apply for a license to operate as an SEZ.

Taking advantage of the incentives

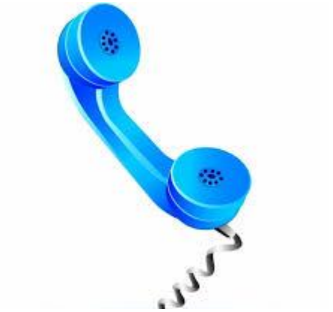
It is prudent to pursue the incentives above under advice by an expert. The practicalities are sometimes not as simple as stated in our tax laws.

Some of the considerations include:

- The ownership structure and how it affects the qualification for the tax incentives. This is especially important where the management and ownership of the hotel is different.
- Timing of the claiming of the tax incentives is critical. We expect an overhaul of the Income Tax Act and some of the incentives provided might change.
- Meeting the requirements under the tax and related laws to qualify for the tax incentives. A person applying for such incentives should be fully aware of the requirements under the tax laws and by the related regulatory agencies like Tourism Regulatory Authority and KRA.
- Projecting the tax position and simulating the implication of claiming some of the benefits. For example, VAT exemption results in disallowing of the related input VAT (VAT charged by your suppliers). This could have adverse cash flow implication.
- Seeking private ruling from KRA where the incentive is not straight forward to manage the risk.

Let's talk

For discussions on exploiting the tax incentives for the hospitality sector, pleas contact Johnson Mutuku on:



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