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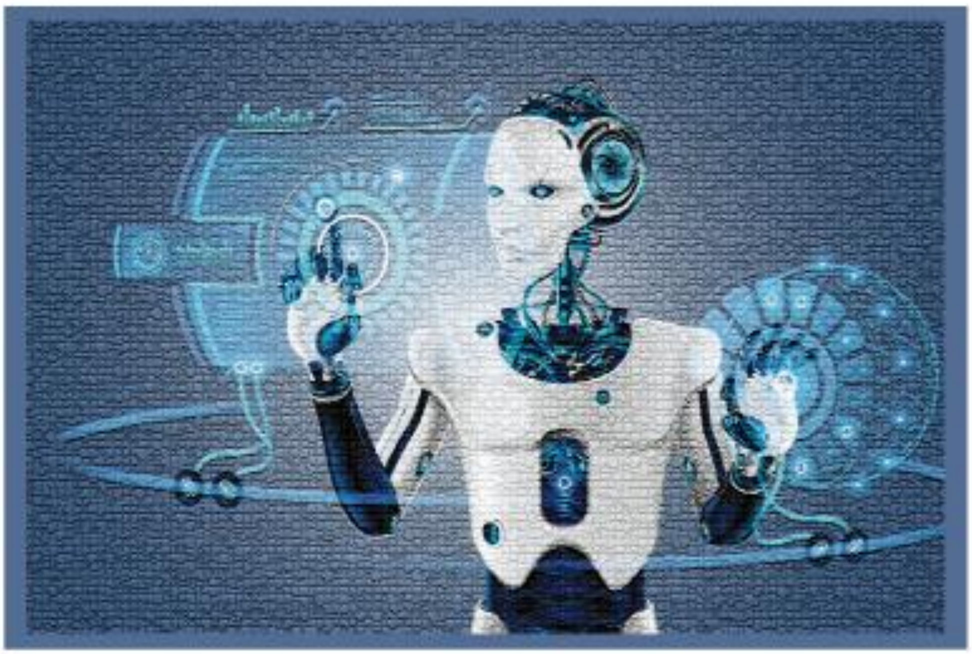

THIN CAPITALIZATION.1

FILING
Nil Returns.1

AUTOMATING
The Companies Registry .1

HOW MACHINE LEARNING
Artificial Intelligence affects
your Bookkeeping & Accounting .4

Newsletter

MBAYA AND ASSOCIATES March 2018 | Issue 033 | Volume 4

Introduction

We welcome you to our third edition of our newsletter this year.

On the right column of the newsletter you will find contact details for the senior members of our team who can help answer any questions you may have about the issues highlighted in this newsletter or any other questions.

We are interested in your feedback on the items covered and what topics you would like covered in the future. Please provide any feedback at **tax@mbaya.co.ke**

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It is high time for every accountant to reflect on their job, identify the opportunities machine learning could offer to them, and focus less on the tasks that can be automated and more on those inherently human aspects of their jobs

» HOW MACHINE LEARNING, ARTIFICIAL INTELLIGENCE AFFECTS YOUR BOOKKEEPING & ACCOUNTING

In this issue

From the Tax Desk

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M&A Newsletter
MBAYA AND ASSOCIATES March 2018 Issue 033 | Volume 4

From the TaxDesk

Thin Capitalisation

Thin Capitalization rules in Kenya apply where financial assistance is granted to a resident company by a related non-resident company, which either by itself (non-resident company) or together with no more than four other persons, controls the resident company, and the loan exceeds the three times the revenue reserves.
The relevant sections of Income Tax Act (ITA) which deal with thin capitalization are in sections 4A(a), 16(2)(j) and 16(3). These sections of the ITA provide guidance on the treatment of thin capitalization in the Kenyan context basing it on two main areas;

I. Control

i. Company A, which is not resident in Kenya, either directly or indirectly, controls at least 25% or more of the voting powers of Company B, which resides in Kenya.

ii. In the case of a partnership, the foreign partner(s) has the right to a share of more than one-half of the assets or of more than one-half of the income of the partnership.

II. Degree of Leverage

i. Thin capitalization rules apply where financial aid is granted to a resident company by a related non-resident company, which alone or together with no more than four other persons controls the resident company. The loan must exceed the greater of three times the sum of the revenue reserves and the issued and paid-up capital of all classes of shares of the company (i.e. debt-to-equity ratio ≥ 3:1).

ii. The ITA looks at debt as any loan a company has whether local or foreign and includes ordinary trade debts, overdrafts, overdrawn current accounts or any other form of indebtedness for which the company is paying a financial charge, premium, discount or interest.

iii. For companies in the extractive industry (mining, geothermal & petroleum), the debt-to-equity ratio for thinly capitalized firms is 2:1

iv. This rule however does not apply to licensed financial institutions such as banks.

A company that is thinly capitalized cannot claim a deduction on the interest expense incurred by the company on loans in excess of three times the sum of revenue reserves and issued and paid up capital of all classes of shares of the company.
The company also cannot claim a deduction for any foreign exchange loss realized by the company with respect to any loans from its shareholders in the period within which the company remains thinly capitalized.
These laws were introduced when the government noted that most multinationals have been applying the Thin Cap (TC) model to evade tax, by shifting of profits to low tax jurisdiction countries. This is by charging inflated interest deduction in the Profit & Loss (P&L) of the related entity based in the high tax rate country.

As a means to put this into check and also stamp out this **tax evasion** technique, most tax jurisdictions **limit** the amount of interest expense allowable for tax purposes where related parties are involved.

In determining the maximum deductible interest for tax purposes, there are two methods used globally. This are;

i. **The "Arms-length Approach"** - Under this approach, the maximum amount of allowable debt is the amount of debt that an independent lender would be willing to lend to the company; that is, the amount of debt that a borrower could borrow from an arm's length lender. The arm's- length approach can also be regarded as the determination of the amount of debt that a borrower would have borrowed if the lender had been an independent party acting at arm's -length.

ii. **The Ratio Approach** - Under this approach, the maximum amount of debt on which interest may be deducted for tax purposes is established by a pre-determined ratio, such as the ratio of debt to equity. The ratio or ratios used may or may not be intended to reflect an arm's length position.

In Kenya the "Ratio Approach" method is applicable and it is usually on a predetermined ratio of 1:3.

Illustration

Company X, a corporation resident in UK, establishes group affiliate **Company Y** in Kenya with an investment of KES 10 Million in equity capital and a loan of KES 90 Million from Company X at a 10% interest rate. Company Y generates pre-tax and pre-interest income of KES 15 Million for year 2017, and must pay interest to Company X at 10%; that is, a total interest payment of KES 9 Million. In Kenya thin capitalization rules, a deduction for payments of interest is limited by reference to a debt: equity ratio of 3:1. That is, interest on any debt that is in excess of three times (3) the level of equity will not be allowable for tax purposes. On a simple application of the rules, then, interest on debt in excess of three times the level of equity will be denied. That is, debt in excess of KES 30 Million (3 x 10). In such case, interest on debt of KES 60 Million (90 - 30) will be disallowed; that is, 60 x 10% = KES 6 Million. This leaves interest of KES 3 Million as allowable.

Filing of Nil Returns

The Kenya Revenue Authority (KRA) through a public notice dated 16th February 2018 did wish to inform taxpayers who intend to file nil annual tax returns. That they won't be able to file since they are experiencing some technical problems with the system and thus they should be patient as their technical team is sorting out the issue.

Automating the Companies Registry

The Business Registration Services Act was signed into law on 11th September 2015. The Act established BRS to ensure effective administration of the laws relating to incorporation, registration, operation and management of companies, partnerships and firms. This service was established in order to improve efficiency and serve its clients better.

The Registrar of Companies has since closed most of its manual processes and introduced a records clean-up process for all business entities via Business Registration Service (BRS). The BRS has been automating the companies registry to carry out all registrations, maintenance of registers, data and company records.

All companies will now be required to update their records on the ecitizen online platform and maintain all its processes and compliance online. The application themed 'Link a Business', is currently being completed, updated and accessed by the company's Directors and Company Secretary.

Companies are advised to be linked as soon as possible to avoid delays in acquiring crucial documents such as CR12 and filing of annual compliance forms.

This is a step in the right direction for the registry and a reprieve for companies as digitizing the services will enhance service delivery, accuracy and transparency.

We are at hand to assist our clients in this process of system-related compliance and onward maintenance of their companies. Do reach us through **savanna@mbaya.co.ke** to start the automation today.

How Machine Learning, Artificial Intelligence affects your Bookkeeping & Accounting

By Bernard Marr

Take a deep breath!

Robots are NOT going to replace all human accountants or bookkeepers (at least not anytime soon).

White-collar workers who are part of the knowledge economy are beginning to experience what manual labourers have in the past when new technology made their jobs obsolete. Given the improvements we have recently seen in computing, many professionals fear for their future as machines threaten to overtake them.

Rather than fear changes that machine learning will have on accounting tasks, it's an opportunity for accounting professionals to be excited. The profession is going to become more interesting as repetitive tasks shift to machines. There will be changes, but those changes won't completely eliminate the need for human accountants, they will just alter their contributions.

Let's take a look at how machine learning will change accounting.

What is machine learning?

Machine learning is the leading edge of artificial intelligence (AI). It's a subset of AI where machines can learn by using algorithms to interpret data from the world around us to predict outcomes and learn from successes and failures. As machines infiltrate accounting tasks to take over the more mundane and repetitive tasks, it will free up accountants and bookkeepers to spend more time using their professional knowledge to analyse and interpret the data to provide recommendations for their clients.

Machine learning will propel innovation in accounting

When accounting software companies eliminated desktop support in favour of cloud-based services, accounting firms were forced to adapt to life in the cloud. Similarly, accounting departments and firms will be forced to adopt machine learning to remain competitive since machines can deliver real-time insights, enhance decision making and catapult efficiency.

Accounting tasks that machines can learn to do

Rather than eliminate the human workforce in accounting firms, the humans will have new colleagues – machines - who will pair with them to provide more efficient and effective services to clients. Currently, there is no machine replacement for the emotional intelligence requirements of accounting work, but machines can learn to perform redundant, repeatable and oftentimes extremely time-consuming tasks. Here are some of the possibilities:

Auditing of expense submissions: Machines could learn a company's expense policy, read receipts and audit expense claims to ensure compliance, and only identify and forward questionable claims to humans for approval. Otherwise, machines could handle the bulk of this task.

Clear invoice payments: Today, when customers submit payment that might combine multiple invoices or that don't match any invoices in the accounting system, it's time-consuming for accounts receivable staff to apply payment correctly without making a call to the client or trying to determine the right combination of invoices. However, smart machines could analyse the possible invoices and can match the paid amount to the right combination of invoices, clear out short payments or automatically generate an invoice to reflect the short payment without any human intervention.

Risk assessment: Machine learning could facilitate risk assessment mapping by pulling data from every project a company had ever completed to compare it to a proposed project. This very comprehensive assessment would be impossible for humans to do on this scale and under a similar timeline.

Analytics calculation: The accounting department is continuously barraged with questions similar to, "What was our revenue for this product in third quarter last year?" or "How has this division grown over the last 10 years?" Given the data, machines can learn to answer these questions very quickly.

Siri-type interface for business finance: Pegg, an app that works with the messaging app, Slack, is already showing what's possible in terms of creating invoices, responding to questions about revenue projections and status of expense accounts. This app as well as other conversational interfaces have huge potential to disrupt accounting and make some tasks as simple as chatting.

Automated invoice categorization: Accounting software firm Xero is deploying a machine learning automation system that will be able to learn over time how to categorize invoices, something that currently requires accountants to do manually.

Bank reconciliation: Machines can learn how to completely automate bank reconciliations.

As accounting firms and departments begin to rely more heavily on machines to do the heavy lifting of calculating, reconciliations and responding to inquiries from other team members and clients about balances and verifying info, accountants and bookkeepers will be able to deliver more value to their clients and handle more clients than ever before.

It is high time for every accountant to reflect on their job, identify the opportunities machine learning could offer to them, and focus less on the tasks that can be automated and more on those inherently human aspects of their jobs

Tax Due Dates

Withholding Tax | 20th Day of the following month

Pay as You Earn | 9th Day of the following month

VAT | 20th Day of the following month

Balance of Tax on Self-Assessment | 4th Month after year end

Monthly Rental Income | 20th Day of the following month

KENYA REVENUE AUTHORITY

Instalment Tax

1st Instalment |20th day of the 4th month after year end

2nd Instalment | 20th day of the 6th month after year end

3rd Instalment | 20th day of the 9th month after year end

4th Instalment | 20th day of the 12th month after year end

Kindly note that all the returns must be filed on I tax while the payments e-slips must be generated from the I-Tax platform.

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