Tax Alert

Oil & Gas and Mining – a new withholding tax introduced

After several public pronouncements of the intention to focus on the taxation of the extractive sector which is made up of the oil and gas and the solid minerals sector the government has finally made good the policy shift. The Finance Act 2012 has introduced a withholding tax on the gross proceeds arising from the transfer of shares or transfer of property in the extractive sector.

February 2013

When the Minister of Finance read his Budget Speech in June 2012, he did not include any amendment to the withholding tax provisions in the Finance Bill 2012. However, given the public proclamations of intentions to tax the extractive sector it was not a complete surprise that the Government decided to introduce such drastic changes after June 2012 without fully engaging this nascent but important sector.

While the pre mature introduction withholding tax will enhance Government revenues in the short run, the impact on Kenya's extractive industry which is still in the exploration phase (albeit with a yet to be confirmed commercial discoveries in the oil and gas sector) is unclear but could at the least prove disruptive.

The withholding tax is based on "the amount or value of the consideration from the sale of property or shares in respect of oil companies, mining companies or mineral prospecting companies".

The sale of property or shares "includes the assignment of rights, sale of companies and businesses, and takeovers or any other non-inventory asset" We have assumed that "oil companies" refers to companies with a Production Sharing Contract with the Government (upstream) and not companies involved in retail and distribution of petroleum companies.

The changes are far-reaching and seek to tax the gross proceeds from sale of property or shares without any deduction of attributable costs which makes the incidence of the withholding tax more punitive than would have been the case were the amendment to be in the nature of a capital gains tax.

The original intention was actually to effect the change as a capital gains tax, however, the idea was dropped as this would have required the removal of the suspension of capital gains tax that has been in place since 1985.

For qualifying transactions, the withholding tax rate applicable to non-residents divesting is 20% of the amount or value of the consideration from the sale of property or shares.

For tax resident persons, the withholding tax rate is 10%. The withholding tax charged will be a final tax. In short this amendment applies a tax on investments and not the fruits of the investment which is the essence of corporation tax and good tax policy and international best practice.

The proposed amendments has also been overlaid onto the existing provisions of the Income Tax Act that already deals with the taxation of the assignment of rights thus creating a conflict.

The existing provisions for the taxation of assignment of rights requires the consideration to be taxed but less attributable expenditure such as unutilised qualifying expenditure (as defined) and other tax deductible costs.

However, as afore-stated the recent change requires tax to be withheld on the gross proceeds. Which one of the provisions reigns supreme? The old or the new?

The conflict notwithstanding, this amendment is punitive for the following main reasons:

a) No costs are taken into account in computing the tax on the proceeds. This is not equitable and is indeed discriminatory if one compares companies in oil & gas and mining with other companies which are not taxed because capital gains tax was suspended in 1985.

b) Given that Kenya is still in the exploratory phase of the extractive industry, the amendments may significantly reduce the number of transactions involving transfer of property and shares (which are intended to share the significant risks that oil & gas and mining companies are faced with) and may make investment in the extractive sector less attractive for Kenya.

c) Kenya's ability to attract the large extractive industry players (the majors) will be reduced since the tax costs to the juniors (i.e. the non-majors) of effecting the transactions could be punitive. The juniors will be less inclined to seek additional investors into the exploration activities thus slowing down Kenya's quest to be an oil producer.

The effective date of this amendment is the date of publication of the Finance Act which is listed as being 9 January 2013.

Please speak to any one of us for guidance and clarity

Steve Okello
Partner
steve.x.okello@ke.pwc.com
+254 20 285 5116

Rajesh Shah
Partner
rajesh.k.shah@ke.pwc.com
+254 285 5326

Osborne Wanyoike
Senior Manager
osborne.wanyoike@ke.pwc.com
+254 20 285 5133

Duncan Onduru
Senior Manager
duncan.onduru@ke.pwc.com
+254 20 285 5365

Sunny Vikram
Manager
sunny.vikram@ke.pwc.com
+254 20 285 5211