

THE INCOME TAX (AMENDMENT) ACT, 1984**No. 18 of 1984***Date of Assent: 28th December, 1984**Date of Commencement: Section 5—1st January, 1984**Rest—28th December, 1984***An Act of Parliament to amend the Income Tax Act to provide for the taxation of petroleum companies and their subcontractors**

ENACTED by the Parliament of Kenya as follows:—

- 1.** (1) This Act may be cited as the Income Tax (Amendment) Act, 1984. Short title.
- (2) This Act shall come into force or be deemed to have come into force as follows—
- (a) section 5 on 1st January, 1984;
- (b) all other provisions, on the date of publication of this Act in the Gazette.
- 2.** Section 4 of the Income Tax Act, in this Act called the principal Act, is amended by inserting after paragraph (e) the following new paragraph—
- (f) in computing the gains or profits of a petroleum company or of a petroleum service subcontractor, as those expressions are defined in the Ninth Schedule, the provisions of that Schedule shall apply. Amendment to section 4 of Cap. 470.
- 3.** The principal Act is amended in section 15 (2) by inserting the following new paragraph immediately after paragraph (b)—
- (bb) amounts to be deducted under the Ninth Schedule in respect of that year of income; Amendment to section 15 of Cap. 470.
- 4.** The principal Act is amended in section 18 by inserting the following new paragraph at the end thereof—
- (6) For the purposes of ascertaining the gains or profits of a petroleum company, as defined in the Ninth Schedule, paragraph (b) of subsection (3) shall not apply; but paragraph 5 (2) (f) of that Schedule shall apply instead. Amendment to section 18 of Cap. 470.

Amendment to
First Schedule
to Cap. 470.

5. Part I of the First Schedule to the principal Act is amended by deleting paragraph 38 and inserting the following new paragraph—

38. (1) Such part of the interest receivable in any year of income by any person in respect of a housing bond savings account held by that person with—

- (a) the Housing Finance Company of Kenya Limited; or
- (b) the Savings and Loan Kenya Limited; or
- (c) the East African Building Society; or
- (d) the Kenya Savings and Mortgages Limited; or
- (e) the Home Savings and Mortgages Limited; or
- (f) the Pioneer Building Society,

as does not exceed sixty thousand shillings.

(2) For the purposes of this paragraph, "person" does not include a partnership or any of the institutions specified in subparagraph (1).

Amendments to
Second
Schedule to
Cap. 470.
Cap. 308.

6. The principal Act is amended in paragraph 16 (1) of the Second Schedule by deleting the expression "or is mineral oil obtained either under a licence granted under section 3 of the Oil Production Act or from the continental shelf," appearing in the definition of "mineral".

Amendments to
Third Schedule
to Cap. 470.

7. The principal Act is amended in the Third Schedule—

(a) by deleting paragraph 3 (a) and inserting—

(a) in respect of management or professional fees, other than management or professional fees deductible under paragraph 5 (2) (g) of the Ninth Schedule, twenty per cent of the gross sum payable;

(b) by deleting paragraph 3 (e) and inserting—

(e) in respect of interest, other than interest which is deductible under paragraph 5 (2) (h) of the Ninth Schedule, twelve and a half per cent of the gross sum payable;

(c) by inserting the following new subparagraph in paragraph 3—

in Cap. 470.

(i) in respect of any management or professional fees deductible under paragraph 5 (2) (g) of the Ninth Schedule, twelve and a half per cent of the gross sum payable;

(j) in respect of any interest which is deductible under paragraph 5 (2) (h) of the Ninth Schedule, ten per cent of the gross sum payable.

8. The principal Act is amended by inserting the following new Schedule immediately after the Eighth Schedule—

NINTH SCHEDULE (ss. 4 (f), 15 (2) and 18 (6))

Insertion of
Ninth Schedule

PART I—INTERPRETATION

1. In this Schedule, unless the context otherwise requires—

Interpretation.

“affiliate” means a person directly or indirectly controlling or controlled by, or under direct or indirect common control with, another person;

“control” has the meaning ascribed to it in paragraph 32 of the Second Schedule;

“crude oil” means—

(a) all hydrocarbons regardless of gravity which are produced at the wellhead in liquid state at atmospheric conditions of temperature and pressure;

(b) asphalt and ozokerites; and

(c) the liquid hydrocarbons known as distillate or condensate obtained from natural gas by condensation or extraction;

“intangible drilling costs” means expenditure that has no salvage value, including expenditure on labour, fuel, repairs, maintenance, hauling, mobilization and demobilization and supplies and materials, other than supplies and materials for

well casings or other well fixtures, which is for or incidental to drilling, cleaning, deepening, completing or abandoning wells and is incurred in respect of—

- (a) the determination of well locations, geological and geophysical studies, and topographical and geographical surveys preparatory to drilling;
- (b) the drilling, shooting, testing and cleaning of wells; and
- (c) the clearing, draining and levelling of land, road-building and the laying of foundations;

“natural gas” means hydrocarbons that are in a gaseous phase at atmospheric conditions of temperature and pressure, including wet mineral gas, dry mineral gas, casinghead gas and residue gas remaining after the extraction or separation of liquid hydrocarbons from wet gas, and non-hydrocarbon gas produced in association with liquid or gaseous hydrocarbons;

“petroleum” means mineral oil and includes crude oil, natural gas and hydrocarbons produced or capable of being produced from oil shales and tar sands;

“petroleum agreement” means an agreement, contract or other arrangement between the Government and a petroleum company entered into under the Petroleum (Exploration and Production) Act, 1984;

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“petroleum company” means a corporate body that carries out, in addition to any other activities, operations under a petroleum agreement entered into under the Petroleum (Exploration and Production) Act, 1984;

“petroleum service subcontractor” means a non-resident person who provides services in Kenya to a petroleum company;

“production” means the quantity of petroleum produced, saved and not used in the operations to which a petroleum company is entitled under a petroleum agreement;

“production expenditure” means the day-to-day expenditure on the operations of a petroleum company, but does not include the other costs deductible under paragraph 5 (2);

“qualifying expenditure” means capital expenditure, other than intangible drilling costs, incurred in the operations of a petroleum company on—

- (a) plant, machinery or fixtures in Kenya, but where the expenditure is of the kind referred to in paragraph 15 of the Second Schedule, the provisions of that paragraph shall apply;
- (b) pipelines and storage tanks in Kenya and installation thereof;
- (c) the erection of rigs and tankage assembly in Kenya;
- (d) the construction of industrial buildings in Kenya, as defined in paragraph 5 of the Second Schedule, and structures of works of a permanent nature, but excluding a building in use as a retail shop, showroom, office or dwelling house, and the provisions of paragraph 5 (4) of the Second Schedule, where part of the use is excluded, shall apply;
- (e) subject to paragraph 7 (5), the acquisition of, or of rights in or over, petroleum deposits in Kenya, and
- (f) searching for, discovering and testing petroleum deposits in Kenya, or gaining access thereto;

“well” means an opening in the ground or seabed, other than a seismic hole, through which petroleum may be obtained, or which is made for exploration purposes or for the injection of a fluid into an underground deposit.

PART II—TAXATION OF PETROLEUM COMPANIES

2. (1) In determining the gains or profits of a petroleum company for a year of income for the purposes of this Act there shall be brought into account the value of the production to which a petroleum company is entitled under a petroleum agreement in that year of income.

Determination
of income.

(2) For the purposes of subparagraph (1), the value of production shall be the total of—

- (a) the price receivable for that production disposed of by a petroleum company in sales at arm’s length; and
- (b) the market value, calculated in accordance with paragraph 3, of production not disposed of by a petroleum company in sales at arm’s length.

Sales of
petroleum at
arm's length.

3. (1) For the purposes of this Schedule, a sale of petroleum is a sale at arm's length if the following conditions are satisfied—

- (a) the price is the sole consideration for the sale;
- (b) the terms of the sale are not affected by any commercial relationship, other than that created by the contract of sale itself, between the seller or an affiliate and the buyer or an affiliate; and
- (c) the seller or an affiliate do not have, directly or indirectly, an interest in the subsequent resale or disposal of the petroleum or any product derived therefrom.

(2) For the purposes of this Schedule, the market value of petroleum shall be determined in accordance with the petroleum agreement entered into with the petroleum company but where the terms of the petroleum agreement do not in any case provide a valuation, the market value shall be—

- (a) where petroleum is disposed of to third parties at arm's length, the amount actually receivable for that sale, at the FOB point of export, or at the point that title and risk pass to the buyer;
- (b) in any other case—
 - (i) if there have been sales to third parties at arm's length during the current calendar quarter, the weighted average per unit price paid in those sales, at the FOB point of export, or at the point that title and risk pass to the buyer, adjusted for quality, grade and gravity, and any special circumstances;
 - (ii) if there have been no sales to third parties at arm's length during the current calendar quarter, the weighted average per unit price at the FOB point of export, or at the point that title and risk pass to the buyer, paid elsewhere in arm's length sales of petroleum of a similar quality, grade and quantity, adjusted for any special circumstances of those sales.

Disposal of
petroleum.

4. Where a person disposes of petroleum and, for the purposes of ascertaining the gains or profits of that person, the market value of the petroleum is calculated in accordance

with paragraph 3, the consideration for the acquisition of that petroleum, for the purposes of ascertaining the gains, profits or losses of the person acquiring that petroleum, shall be that market value.

5. (1) For the purposes of ascertaining the gains or profits for a petroleum company for a year of income, there shall be deducted the expenditure referred to in subparagraph (2) incurred in that year, but this shall not prevent other deductions authorized by this Act, and where an item of expenditure is specifically deductible under a provision of this Schedule, that item shall not be deductible under another provision of this Act.

Allowable
deductions.

(2) For the purposes of subparagraph (1), there shall be deducted—

- (a) intangible drilling costs;
- (b) geological and geophysical costs;
- (c) payments to the Government, or any agency thereof, pursuant to the provisions of the petroleum agreement entered into with the petroleum company;
- (d) production expenditure;
- (e) executive and general administrative expenses wholly and exclusively incurred in Kenya by a petroleum company;
- (f) where a non-resident petroleum company operates in Kenya through a permanent establishment in Kenya, only those reasonable executive and general administrative expenses incurred outside Kenya by that person, including management or professional fees, but limited to the amount that is attributable to the permanent establishment in Kenya and is fairly and reasonably allocated thereto;
- (g) management or professional fees, including those paid to persons outside Kenya, limited to the amount that is attributable to the petroleum company and is fairly and reasonably payable thereby; and
- (h) interest paid, including interest paid by a non-resident petroleum company and fairly and reasonably allocated to a permanent establishment maintained

in Kenya by that company, but no interest paid shall be deductible unless—

- (i) the payment does not exceed the amount that would have been payable on a loan concluded at arm's length where the loan, repayment thereof, and the interest payable constitute the only consideration for the making of the loan;
- (ii) the loan, in respect of which interest is paid, is applied for operations by the petroleum company in Kenya, but where only part of the loan is applied in accordance with this paragraph only the interest payable in respect of that part shall be deductible;
- (iii) tax on interest paid has been deducted and paid to the Commissioner under section 35:

(3) Where expenditure is incurred on an asset representing qualifying expenditure, there shall be made, in ascertaining the gains or profits for the year of income in which that asset is first brought into use in Kenya, or in which production commences, whichever is the later, and the four following years of income, a deduction equal to one-fifty of the expenditure.

(4) Where a well which fails to discover petroleum is drilled and abandoned, the expenditure incurred in drilling the well, which has not been deducted under another provision of this Act, shall be deducted in the year of income in which the well is abandoned.

(5) Where in ascertaining the gains or profits of a petroleum company in a year of income, there results a deficit, the amount of that deficit shall be an allowable deduction in ascertaining the gains or profits of the previous year of income but the deficit may only be carried back—

- (a) from a year of income which the petroleum company has ceased permanently to produce petroleum; and
- (b) for not more than three years of income from the year in which the deficit occurred.

6. Where a transaction takes place between a petroleum company and an affiliate, the income chargeable, or the deduction allowable to that company, shall be deemed to be

the amount that might have been expected to accrue if that transaction had been conducted by independent persons dealing at arm's length.

7. (1) An assignment of a right under a petroleum agreement shall not give rise to a chargeable gain under the Eighth Schedule but, subject to this paragraph, the consideration for the assignment shall be treated as a receipt of the petroleum company, and tax shall be charged accordingly.

Assignment of a petroleum agreement and disposal of assets.

(2) Where an assignment of a right under a petroleum agreement involves the disposal of assets which represent qualifying expenditure, there shall be deducted from the consideration for the assignment the amount of the qualifying expenditure not yet allowed against income.

(3) Where the assignment is of part only of the rights held by a petroleum company, or where not all the assets which represent qualifying expenditure are included in the assignment, the amount of qualifying expenditure not yet allowed against income which is to be deducted from the consideration for the assignment shall be apportioned by the Commissioner.

(4) The amount to be treated as a receipt for the purposes of subparagraph (1) shall be, in the case of an assignment at arm's length, the consideration therefor, and in any other case, the market value of that which is assigned, but where part of the consideration consists of the undertaking by the assignee of a work obligation, no amount in respect thereof shall be taken into account under this paragraph.

(5) Where a right under a petroleum agreement is assigned, the assignee shall be treated as having incurred, at the date of the assignment, qualifying expenditure equal to the lesser of the total amount of the consideration paid for the assignment and the market value of the rights and assets representing qualifying expenditure assigned.

(6) Subject to paragraph 6, where a petroleum company sells, disposes or removes from Kenya an asset which represents qualifying expenditure, otherwise than on an assignment of a right under a petroleum agreement, and the net proceeds of the sale are—

(a) less than the qualifying expenditure not yet allowed against income, a deduction, in this Schedule referred to as a "balancing deduction", shall be made to

the company, in the year of income in which the sale or disposal takes place, equal to the difference;
or

(b) more than the qualifying expenditure not yet allowed against income, a charge, in this Schedule referred to as a "balancing charge", shall be made to the company, in the year of income in which the sale or disposal takes place, equal to the difference.

(7) Subject to this Part, where an asset representing qualifying expenditure is brought into use without being purchased, or, without being sold, ceases permanently to be used, by a petroleum company, it shall be deemed to have been purchased or sold at market value.

PART III—TAXATION OF PETROLEUM SERVICE SUBCONTRACTORS

Petroleum
service
subcontractors.

8. Notwithstanding any other provision in this Act, profits or gains of a petroleum service subcontractor in respect of services provided in Kenya to a petroleum company shall be deemed to be income derived from Kenya and payment of tax by the petroleum company in accordance with this Part shall release the petroleum service subcontractor from liability for tax arising on that part of his income, profits or gains which derive from those services.

Assumed
profit rate.

9. (1) Petroleum service subcontractors shall be deemed to have made a taxable profit equal to fifteen per cent, in this paragraph referred to as the "assumed profit rate", of the moneys referred to in subparagraph (2) which profits shall be taxed at the rate set out in the Third Schedule applicable to non-resident companies which have a permanent establishment in Kenya.

(2) The assumed profit rate shall be applied to all moneys paid by a petroleum company to a petroleum service subcontractor, hereinafter referred to as the "taxable service fee", but excluding—

(a) moneys actually paid by a petroleum company to reimburse the petroleum service subcontractor for the cost of mobilization and, where applicable, demobilization; and

(b) reimbursement of expenses.

(3) Payment for mobilization and demobilization shall not exceed the amounts normally paid in the international petroleum industry, having regard to the circumstances of the contract, and shall not be at a level calculated to transfer a part of the taxable service fee to the non-taxable moneys referred to in subparagraph (2) (a).

(4) In this Part—

“mobilization and demobilization” means the movement of men and equipment to Kenya prior to operating, and from Kenya after completion thereof, provided the movement is not to a third party, but does not include movement of men and equipment in Kenya during operations;

“reimbursement of expenses” means payment by a petroleum company to a petroleum service subcontractor to reimburse that subcontractor for payments made to a third party on behalf of the petroleum company in respect of goods and services which are incidental to the subcontract and would not normally, in the international petroleum industry, be included in the taxable service fee, but does not include a charge for handling or administration.

10. (1) A payment shall not be made by or on behalf of a petroleum company to a petroleum service subcontractor unless an invoice has been issued therefor and a petroleum service subcontractor shall issue distinct and separate invoices to the petroleum company in respect of—

Payments.

(a) the taxable service fee;

(b) the amounts payable for mobilization and demobilization; and

(c) the reimbursement of expenses.

(2) The invoice for reimbursement of expenses shall have attached copies of the invoices to which it relates and further copies of those invoices shall be kept with the records required by paragraph 12.

(3) When paying a taxable service fee the petroleum company shall—

(a) deduct an amount of tax equal to the sum produced by applying the income tax rate referred to in paragraph 9 (1) to the assumed profit;

(b) issue to the petroleum service subcontractor a certificate showing the gross amount of the invoice, the amount deducted for tax and the net amount payable; and

(c) retain a copy of the invoice and certificate for a period of three years.

(4) Where a person is required to deduct tax under this Schedule and fails to deduct the whole or part thereof, or fails to remit the amount deducted to the Commissioner in accordance with this Schedule, the provisions of this Act relating to the collection and recovery of tax and the payment of interest thereof shall apply as if the tax were payable by that person on the day when it should have been remitted to the Commissioner.

Returns.

11. (1) The tax collected by a petroleum company under this paragraph in a month shall be remitted within thirty days to the Commissioner with a return of amounts paid and tax deducted, hereinafter referred to as the "subcontractors return" showing in respect of the month—

(a) the total taxable service fee paid;

(b) the total tax deducted and remitted;

(c) the total amount paid for mobilization and demobilization; and

(d) the total amount paid for reimbursement of expenses.

(2) Before making a first payment to a petroleum service subcontractor, a petroleum company shall deliver to the Commissioner a summary of the terms of the contract with that subcontractor including the terms and rates for operating, mobilization and demobilization and reimbursement of expenses, and shall deliver a summary of any change in those terms within fourteen days thereof.

(3) A petroleum company shall, if required, deliver to the Commissioner a copy of the contract with the subcontractor in substantially the same terms as the summary referred to in subparagraph (2).

Records.

12. A petroleum company shall keep up-to-date records, referenced to the invoices of the petroleum service subcontractor and agreeing with the subcontractors return avail-

able for inspection at all reasonable time by the Commissioner and showing in respect of each payment made to a petroleum service subcontractor—

- (a) the name and address of the subcontractor and the services provided;
 - (b) the date and amount of the invoice showing separately the totals for the items set out in paragraph 10 (1);
 - (c) the tax deducted; and
 - (d) the monthly total of tax deducted and remitted to the Commissioner.
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