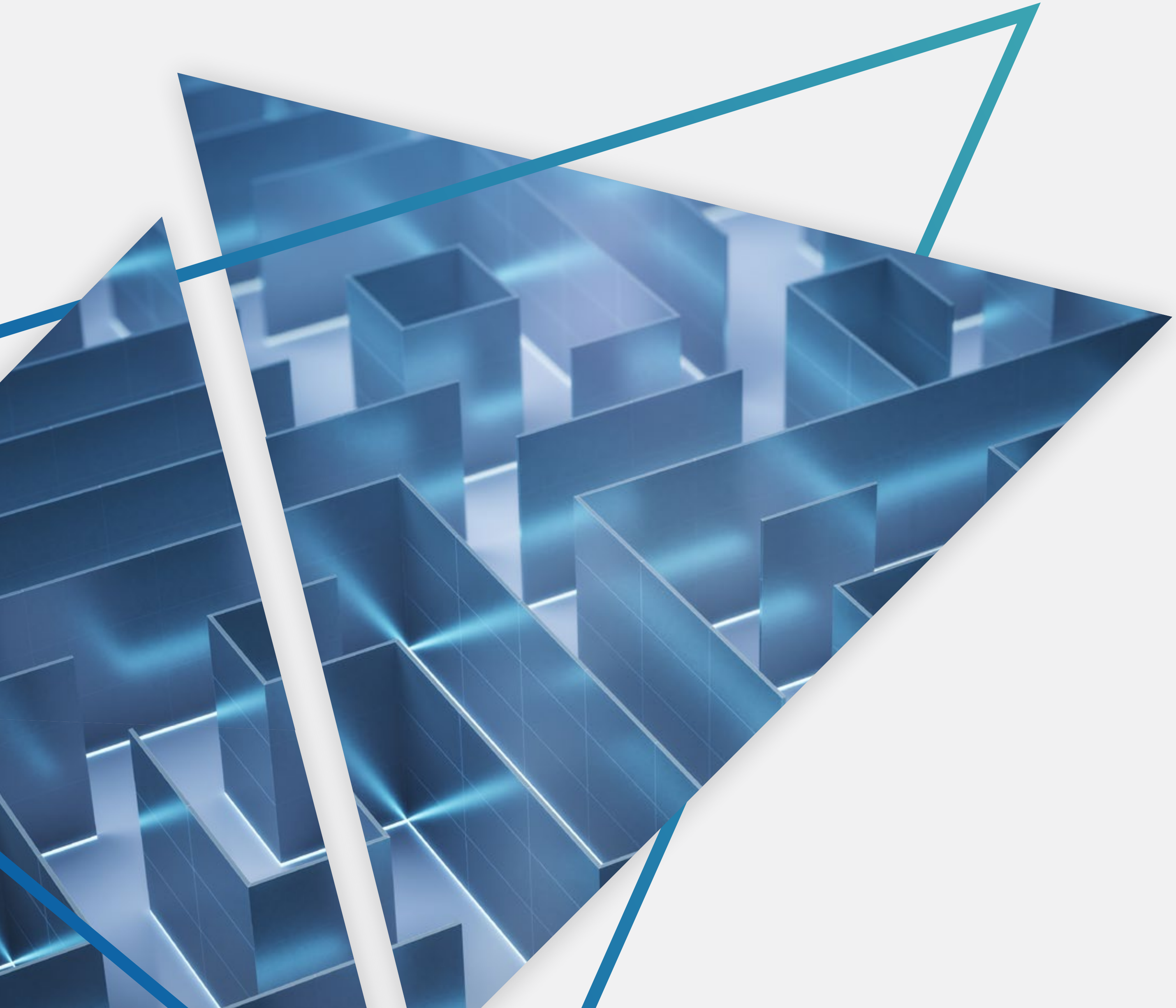
Tax & Exchange Control

ALERT | 4 July 2024

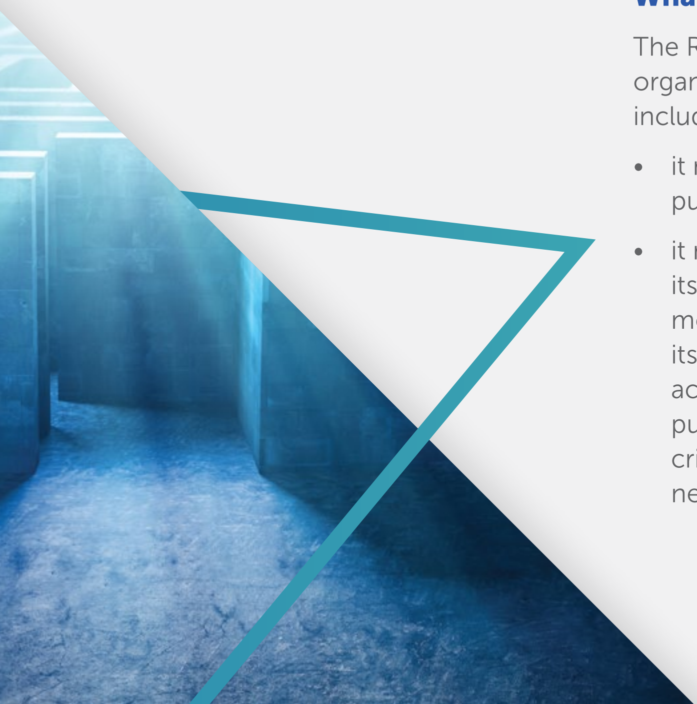
CDH INCORPORATED



In this issue

For more insight into our expertise and services

Kenya ushers in a new era: Income tax exemptions on charitable organisations and donations



The Income Tax Act (Charitable Organisations and Donations Exemptions) Rules 2024 (Rules) were gazetted on 18 June 2024. The Rules revoke the Income Tax (Charitable Donations) Regulations, 2007. The Rules serve two primary purposes: (i) they outline the requirements to be met by a charitable organisation to qualify for a tax exemption on its income; and (ii) prescribe the procedure for determining the allowability of donations made to a charitable organisation for income tax purposes.

In this alert, we summarise the key highlights of the Rules and provide our view on them. This alert follows on from our earlier alert on the tax treatment of charitable activities, which you can find here.

What is a charitable organisation?

The Rules outline the requirements to be met for an organisation to qualify as a charitable organisation, including that:

- it must be established for one or more charitable purposes and for public benefit to residents in Kenya;
- it must meet the organisational test, being that its founding document (trust deed, constitution, memorandum or articles of association) should state its primary charitable purpose, specify the charitable activities it intends to carry out to achieve the charitable purpose, specify the targeted beneficiaries and the criteria for identifying and selecting them in an open and needs-based manner; and
- it must meet the operational test, i.e. the charitable organisation must engage in activities that accomplish the charitable purpose and must not engage in unlawful activities.

Charitable purpose

A charitable purpose is one that leads to relief of poverty, relief of distress of the public, advancement of religion and advancement of education. The Rules break down what each purpose entails. For example, charitable organisations set up to advance education that are fee-charging educational institutions, must ensure that at least 10% of the students have full scholarships and are from poor or needy backgrounds. A similar provision under the mandate for relief of distress for public benefit is that for fee-charging healthcare services, the charitable organisation must offer free outpatient and inpatient treatment to at least 10% of the total patient population from the poor and most vulnerable members of the society per accounting period.

Procedure for making an application for exemption from income tax

The application for exemption is to be made by a charitable organisation to the Commissioner of the Kenya Revenue Authority (Commissioner) in the prescribed form and be accompanied by:

- a certified copy of the governing documents of the charitable organisation;
- a certified copy of the registration documents of the charitable organisation;
- audited financial statements of the charitable organisation for the period of three years immediately preceding the application;

Kenya ushers in a new era: Income tax exemptions on charitable organisations and donations

CONTINUED

- a schedule of assets of the charitable organisation, including the corresponding values of the assets;
- certified copies of bank statements of the charitable organisation for the period of three years immediately preceding the application;
- an introduction letter detailing the name, nature and principal activities of the charitable organisation from the office of the county commissioner of the county where the head office of the organisation is located;
- the charitable organisation's impact report describing in detail its past, present and future activities and how the activities are intended to or have benefited the residents of Kenya;
- the charitable organisation's criteria for defining and selecting beneficiaries;
- an itemised summary of the payments made by the charitable organisation showing the payee, amount and purpose of payment;
- certified copies of identity documents of all the relevant office bearers of the charitable organisation;
- proof of the charitable organisation's physical address;
- a copy of a valid tax compliance certificate and, in the case of an application to renew an exemption, a copy of the previous tax exemption certificate of the charitable organisation; and
- a letter of authority, power of attorney or appointment letter for the representative of the charitable organisation.

Charitable organisations applying for an exemption for the very first time are required to have been in operation for a period of at least one year. An application for renewal of exemption should be made at least six months before the expiry of the current exemption.

Within 60 days of making an application a charitable organisation will receive a tax exemption certificate (Certificate) if the Commissioner is satisfied that all requirements have been met. The Certificate will be valid for a period of five years from the date of approval for new applications and for a renewal, from the date of application or expiry of the earlier certificate, whichever is later. On the contrary, an application for exemption can be rejected by the Commissioner, who will give the reasons for the rejection in writing.

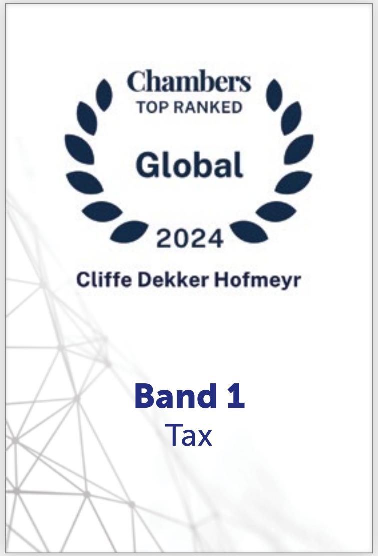
An exemption shall not be given to a charitable organisation that exclusively funds, donates or supports other charitable organisations without undertaking a charitable purpose or that has been exempted from tax under any other tax law.

Treatment of surplus funds

Surplus funds refer to the excess of income over expenditure in any given accounting period. The Rules provide that a charitable organisation shall accumulate and retain surplus funds of not more than an average of 15% of its funds in a period of three succeeding years without applying the surplus funds to its charitable purposes.

Kenya ushers in a new era: Income tax exemptions on charitable organisations and donations

CONTINUED



Revocation of an exemption

An exemption can be revoked if the Commissioner is satisfied that a charitable organisation has materially or continuously failed to comply with the Rules or its governing documents. Once a decision is made, the Commissioner will serve a notice to the charitable organisation of the intention to revoke the exemption, stating the reasons why, and provide 30 days' notice for the charitable organisation to respond.

If the charitable organisation responds to the notice to revoke the exemption, it must state the reasons for non-compliance and the steps it has put in place to rectify them. Depending on this response, the Commissioner might withdraw the revocation. If the Commissioner is not satisfied with the response or if the charitable organisation does not respond within the notice period, the Commissioner will proceed to revoke the exemption and communicate in writing to the organisation.

A revocation will take effect from the beginning of the year of income in which the grounds for the revocation arose, or a later date determined by the Commissioner, and the accumulated funds will be subject to income tax in the year in which the exemption is revoked.

Appeals

A person aggrieved by a decision of the Commissioner under the Rules may appeal within 30 days of the decision to the Tax Appeals Tribunal upon giving a notice to the Commissioner.

How the exemption will work

The fact that a Certificate has been issued does not exempt a charitable organisation from filing an income tax return. It must file an income tax return in accordance with the Tax Procedures Act. This serves to ensure that there is separation of any gains or profits made from related and unrelated business.

Any gains or profits from unrelated business are not covered under the exemption and the charitable organisation is mandated to have a Personal Identification Number with which it must pay income tax and file returns.

Allowability of donations for income tax

A donation means a benefit conferred on a person in kind, cash, promissory note, mobile money or money transfer in any form. The Rules provide that a person making donations out of a taxable income must ensure that the donation does not result to a taxable loss and that no more than 50% of the donations in any year of income are to unrelated entities.

Kenya ushers in a new era: Income tax exemptions on charitable organisations and donations

CONTINUED

Chambers Global 2024 Results

Tax & Exchange Control

Chambers Global 2018–2024 ranked our Tax & Exchange Control practice in: **Band 1**: Tax.

Emil Brincker ranked by Chambers Global 2003–2024 in **Band 1**: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in Chambers Global 2022–2024 for Tax: Indirect Tax.

Stephan Spamer ranked by Chambers Global 2019–2024 in **Band 3**: Tax.

Jerome Brink ranked by Chambers Global 2024 as an "**Up & Coming**" tax lawyer.

Chambers TOP RANKED Global 2024 Cliffe Dekker Hofmeyr

A donation will qualify for a tax deduction under the Income Tax Act if the donor provides proof of the donations. Proof includes (i) evidence of receipt of the donation by the exempt person; (ii) approved project proposals and budgets submitted by the charitable organisation and approved by the donor; (iii) a copy of the donee's tax exemption certificate; (iv) approval by the Cabinet Secretary, where the project requires such approval; and (v) a declaration from the donee that the donation will be used exclusively for charitable purposes.

Commentary and conclusion

The Rules provide a clear framework on what amounts to a charitable organisation, a charitable purpose, the procedure for application for exemption, and guidelines on donations, among other things. However, the downside to this is that it does not provide flexibility and, more so, it has imposed stringent criteria for charitable organisations to qualify for exemptions, as well as for donations to qualify as allowable deductions for tax purposes.

Charitable organisations will also need to re-evaluate how they manage their financial plans because the Rules propose to limit the amount of funds that a charitable organisation may hold over a three-year period. Specifically, a charitable organisation will not be able to retain more than an average of 15% of its funds over three consecutive years without directing them towards a charitable purpose. This calls for proper planning to minimise wastage and ensure the purposes of the organisation are met

Overall, the Rules signal the revenue authority's intent to limit the income tax exemption enjoyed by organisations claiming to be engaged in charitable activities, as well as to control the deductions claimed by donors in the form of donations. This is in line with the Government's stated aims to increase revenue collection and rationalise tax exemptions in Kenya's tax regime.

Alex Kanyi and Charity Muindi

OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:

Emil Brincker
Practice Head & Director:
Tax & Exchange Control
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Gerhard Badenhorst
Director:
Tax & Exchange Control
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com

Jerome Brink
Director:
Tax & Exchange Control
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com

Petr Erasmus
Director:
Tax & Exchange Control
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director:
Tax & Exchange Control
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Alex Kanyi
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E alex.kanyi@cdhlegal.com

Heinrich Louw
Director:
Tax & Exchange Control
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Lena Onyango
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E lena.onyango@cdhlegal.com

Howmera Parak
Director:
Tax & Exchange Control
T +27 (0)11 562 1467
E howmera.parak@cdhlegal.com

Stephan Spamer
Director:
Tax & Exchange Control
T +27 (0)11 562 1294
E stephan.spamer@cdhlegal.com

Tersia van Schalkwyk
Tax Consultant:
Tax & Exchange Control
T +27 (0)21 481 6404
E tersia.vanschalkwyk@cdhlegal.com

Louis Botha
Consultant:
Tax & Exchange Control
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

Varusha Moodaley
Senior Associate:
Tax & Exchange Control
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com

Abednego Mutie
Senior Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E abednego.mutie@cdhlegal.com

Nicholas Carroll
Associate:
Tax & Exchange Control
T +27 (0)21 481 6433
E nicholas.carroll@cdhlegal.com

Jacques Erasmus
Associate:
Tax & Exchange Control
T +27 (0)11 562 1191
E jacques.erasmus@cdhlegal.com

Nicholas Gathecha
Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E nicholas.gathecha@cdhlegal.com

Puleng Mothabeng
Associate:
Tax & Exchange Control
T +27 (0)11 562 1355
E puleng.mothabeng@cdhlegal.com

Brandon Otieno
Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E brandon.otieno@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE
This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com