INCENTIVES IN THE HOUSING SECTOR

1.0 INTRODUCTION

Housing is a basic human need that is recognized globally as a human right. In the hierarchy of needs shelter is considered third only to food and clothing. The struggle for these basic needs has increased progressively as the human race advances in numbers as well as socio-economic and cultural diversity. The Universal Declaration of Human Rights of 1948 recognizes the right to adequate housing as an important component of the right to adequate standard of living and this has been further reaffirmed by subsequent various international instruments of which Kenya is a signatory. More affirmatively the Constitution of the Republic of Kenya expressly provides for the right to "accessible and adequate housing, and to reasonable standards of sanitation" in article 43(1)(b).

In fact, housing is one of the principal sectors that would revitalize economic growth in Kenya with shelter being recognized as one of the tools of development. Investment in housing and related infrastructure and services have effects on the national income that go far beyond the direct investment itself by triggering forward and backward linkages through additional investments in building materials production, transportation, marketing and Jua Kali (fabrication of construction materials). Investment in the sector has a multiplier effect of 7 to 9 times on Kenya's economic development. What this means is that one shilling invested in housing development would generate seven shillings in the economy.

Other direct and indirect benefits from a functioning housing market in a country include employment creation, increased tax base, reduced expenditures on Health, improved Security, socially cohesive and patriotic societies and improved quality of life. An adequately housed population is also more productive and has a sense of national pride.

Despite the acknowledged importance of housing, Kenyan housing sector is characterized by deteriorating housing conditions countrywide arising from demand that far surpasses supply particularly in urban areas. This shortage in housing manifests itself through overcrowding, proliferation of slums and informal settlements in urban areas and poor quality housing in rural areas.

The annual housing demand in urban areas is estimated at over 150,000 housing units. Supply on the other hand is estimated at 40,000 units per annum resulting in a supply gap of approximately 110,000 housing units. Delivery of housing to the poor and low income citizens is further exacerbated by disparity and imbalance in housing demand mitigation among income groups. Currently, more than 80 per cent of new houses produced are for high and upper middle-income earners yet the greatest demand is for low income and lower middle income (83%).

This has been mainly due to low investment by the Government through exchequer funding while the private sector has tended to concentrate on the development of high and middle income housing This has left huge supply gap in low cost housing.

In this connection, the Government recognizes that if supported with the right incentives, the private sector has the capacity to invest more in housing and particularly low cost housing. It is for this reason that the Government has given the following incentives to the sector:

2.0 INCENTIVES UNDER THE INCOME TAX ACT

2.1 Tax Deductibility for Housing Loans

The interest paid by a person on money borrowed to purchase or improve premises (house) occupied by him is a tax-deductible expenditure against his taxable income up to a maximum of Kshs 150,000 per annum. However, the money must be borrowed from either:

- A bank or a financial institution licensed under the Banking Act
- An insurance company licensed under the Insurance Act
- A building society registered under the Building Society Act.

2.2 Contributions to Home Ownership Savings Plan (HOSP)

- A depositor who operates a registered home ownership savings plan is entitled to deduct from his taxable income an equivalent of Kshs. 4,000 per month i.e. maximum of Kshs. 48,000 per annum for a maximum period of ten years i.e. No tax (PAYE) on amounts saved to a maximum of Kshs 4000 per month or Kshs 48000 per annum
- The income of such Home Ownership Savings Plan is exempt from tax.
- No withholding tax on interest earned for balances up to Kshs 3 million

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2.3 Lower taxation of Housing bonds

The HDB is an account for individuals that allow a fixed amount of money to be saved for a period of time. The account holder declares the amount to be saved as a lump sum which is then fixed for an agreed period. It is designed for the individual saver who will not need to access the funds for the duration of the savings plan.

Benefits

- Withholding tax of only 10% compared to the 15% rate normally charged
- Special considerations when applying for a mortgage
- Flexible investment periods for as short as 1 month to suit your investment plan

2.4 Prescribed dwelling house

- A prescribed dwelling house is a house constructed for and occupied by employees of a business carried on by the person owning the dwelling house and which conforms with prescribed conditions.
- A prescribed dwelling house qualifies as an Industrial Building as defined under the income Tax Act and hence the employer is allowed a deduction against his taxable income at the rate of 1/40 of the capital expenditure per annum.
- The purpose of this incentive is to encourage employers to give decent housing to their employees

2.5 Tax deductibility for expenditures for social infrastructure

- Expenditure of a capital nature incurred by a person on the construction of a public school, hospital or any similar kind of social infrastructure and is given prior approval by the Minister for Finance is tax deductible.

2.6 Tax deductibility of interest from infrastructure and social service bonds

- Interest income accruing from all listed bonds used to raise funds for infrastructure and social services is exempt from tax provided that the bonds shall have a maturity of at least three years.

- Expenditures of a capital nature incurred with a prior approval of the Minister for Finance, by a person on the construction of a public school, hospital, road or any similar kind of social infrastructure is tax deductible.

2.7 Industrial Building

Industrial Building deduction on capital expenditure incurred on the construction of an industrial building to be used in a business carried on by a person or the lessee for any year of income in which the building is so used.

- One-tenth per annum (w.e.f.January,2007)-for a hotel which the commissioner has certified to be an industrial building
- One-tenth per annum (w.e.f. January, 2007)-For a hostel or an educational building certified by the commissioner.
- Five per cent per annum (w.e.f. January 2008) for residential rental building constructed in a planned development area, approved by the Minister responsible for housing.
- One-fortieth per annum-For other industrial buildings-includes a **prescribed-dwelling-house-** i.e. a dwelling-house constructed for and occupied by employees of a business carried on by the person owning the dwelling-house

Note:

Industrial Building does not include a building used as a retail shop, show-room or office.

"Building'' includes any building structure and where the building is used for purposes of manufacture it includes the civil works and structures deemed to be part of an industrial building.

3.0 ASSIGNEMENT OF RETIREMENT BENEFITS

It is now possible for members of the retirement schemes to assign their benefits for Mortgages as per legal Notice No.85 of 2009.

The following are some of the important issues contained in the new regulations.

1. The regulations have prescribed a proportion of 60% of the benefits accruing to a member of a Pension scheme to be assigned and used by the member to secure a mortgage loan from Institutions that are approved for purposes of providing banking, non banking institutions or those approved by RBA.

2. A member of a retirement benefit scheme can assign up to 60% of his accumulated benefits to the scheme which in turn will issue a guarantee for a similar amount to the financial institution. If the member remains in employment, the accumulated savings continue to grow through contribution and investment and so the member can, at three year intervals, revalue the amount assigned so as to allow re-financing or borrowing for home improvements and extensions.

3. No funds shall be transferred form the scheme, but the trustees of the pension plan, upon receiving instructions from the member, will

issue a guarantee to the financial institution for the amount being secured. However, the house being purchased or constructed (unless it is a rural house) will remain the primary security for such lending and that the role of such a guarantee is merely credit enhancement to enable the member access the mortgage. Guarantees are transferable from one scheme to another.

4. Guarantees shall be given for loans for four specific purposes:
    a. To acquire property outright;
    b. To construct a home;
    c. To carry out repairs, alterations and improvements or
    d. To secure financing for deposits, stamp duty, valuation fees and other incidentals associated with home ownership(excluding arrangement fees, commitment fees etc)

5. Married couples should be able to pool their retirement savings for this purpose in order to buy a family property.

6. Care must be taken to ensure that access to the member's benefits while she or he is in employment is only a last resort in the event of default, AND if the accumulated benefits will make good the balance if the realizable collateral property securing the mortgage is insufficient to repay in full the borrower's outstanding debt. The double jeopardy of a member losing both pension benefits and the house as well is to be avoided as much as possible. The scheme member should be allowed to continue building their fund for the future.

7. The introduction of these rules allows an individual to both acquire property as well as save for retirement simultaneously

4.0 INCENTIVES UNDER VAT ACT

The Minister of Finance may remit (exempt) VAT payment in respect of:-

4.1 Construction or expansion of private universities (excluding student hostel and staff housing) on the recommendation of the Minister responsible for education.

4.2 Construction of not less than twenty housing units for low income earners on the recommendation of the Minister responsible for Housing in line with regulations set –out under legal notice No. 115 of 2008 (The legal notice is annexed).

4.3 Capital goods (excluding motor vehicles) exceeding Kshs.1,000,000 for new investment or the expansion of investments may be exempted from tax and

4.4 Official aid funded projects are also tax exempt.

5.0 INCENTIVES UNDER IMPORT DUTY

In the East African Community Gazette of 29th June 2010, the following were zero rated:

5.1 Petroleum coke which is a raw material used in the production of cement

5.2 Pigments dispersed in non aqueous media, in liquid or paste form, of a kind used in the manufacture of paints

6.0 INCENTIVES UNDER STAMP DUTY

6.1 The Stamp Duty Act was amended so that the rate of penalty on the principal amount of duty was reduced from 25% to 5% in 2010. This was done in order to reduce the penalty burden on new property owners and also encourage others who have not been able to effect transfers within stipulated period to come forward.

6.2 The Stamp Duty Act was also amended to reduce the Stamp duty fees on mortgages, charges and debentures from 0.2% to 0.1%.

7.0 INCREASE IN THE MORTGAGE FINANCE PROPORTION

In the Finance Act, 2010 The Banking Act was amended to allow:-

a) Mortgage finance companies to operate current accounts so as to attract higher customer deposits that would allow them to increase mortgage lending capacity and expand their operations.

b) Raising of the threshold of core capital that banks are allowed to invest in mortgage finance from 25% to 40%.

c) The Central Bank may authorize an institution to exceed the percentage specified above up to a maximum of 70%.

The Ministry of Housing continues to work with the sector stakeholders to lobby for more incentives aimed at enhancing development of affordable housing.

ANNEX

LEGAL NOTICE NO. 115. THE VALUE ADDED TAX ACT (Cap. 476)

IN EXERCISE of the powers conferred by section 23 of the Value Added Tax Act, the Minister for Finance makes the following Order:-

THE VALUE ADDED TAX (REMISSION) (LOW INCOME EARNERS HOUSING PROJECTS) ORDER, 2008

1. This Order may be cited as the Value Added Tax (Remission) (Low Income Housing Projects) Order, 2008

2. In this Order, unless the context otherwise requires-

"Applicant" means a person making an application under paragraph 3 of this Order;

"Low income earner" means a person whose monthly gross earning amounts to thirty five thousand shillings or less;

"Low income house" means a house put up at a construction cost of not more than one million six hundred thousand shillings and of plinth area of not less than thirty square meters;

"Low income housing project" means a project of not less than twenty housing units intended for low income earners;

"Minister" means the Minister for the time being responsible for finance.

3. (1) An application for tax remission under section 23 (3) (1) of the Act shall be made in writing to the Minister through the Minister for the time being responsible for housing.

(2) An application under this paragraph shall-

(a) be submitted together with the detailed certified list of goods and services to be rendered in respect of which the application is made;

(b) include the following –

(i) the location of the project;
(ii) evidence of construction cost;
(iii) approved designs of the project;
(iv) the number of units to be constructed;

(v) the approval of the development by relevant authorities;

(vi) the Personal Identification Number (PIN) of the applicant; and

(vii) tax compliance certificate.

4. The Commissioner may require an applicant to-

(a) furnish such further information as the Commissioner may consider
necessary; and

(b) allow and facilitate the inspection of the goods or services rendered to which the application relates by a person authorized by the Commissioner.

5. (1) Except as provided in sub-paragraph (2) below. Only one application shall be made with respect to a given project.

(2) A second application in respect of the same project may be made if the applicant demonstrates that the additional application relates to a separate phase of the project or an expansion thereof.

6. A person granted tax remission under this Order shall –

(a) construct low income houses;

(b) allow and facilitate the Minister for the time being responsible for housing or the Commissioner to inspect the projects, including the goods and services rendered;

(c) avail the records of such goods and services rendered for purposes of inspection and audit to the Minister for the time being responsible housing or the Commissioner;

(d) sell, rent or lease the houses to low income earners;

(e) sell the housing units at a price which is not more than thirty per cent of the construction cost;

(f) ensure the rent charged for the houses constructed under the scheme reflect the reduced cost of construction as a result of tax remission.

7. Where the Commissioner and the Minister for the time being responsible for housing is satisfied that an applicant granted tax remission under this Order has failed to comply with the provisions of paragraph 6 above, the Commissioner shall require the applicant to refund the tax remitted.

8. An applicant shall, if he sells, leases, rents or converts a house for uses other than as provided under paragraph 6(d), before the expiry of five years from the date the construction was completed be required to refund the tax remitted or such portion thereof as the Minister may determine relating to the construction of the part so converted.

Legal Notice is dated the 2nd September, 2008

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