The Tax Laws (Amendment) (No.2) Act, 2020

The National Treasury had previously on 27 November 2020, published the Tax Laws (Amendment) (No.2) Bill, 2020 ("Bill") vide the Kenya Gazette Supplement No.216 (National Assembly Bills No.48). We had analyzed the same for your ease of understanding and a copy of the same can be found here for your perusal.

As formerly highlighted, the Bill mostly sought to reintroduce a raft of measures and more specifically claw back certain tax incentives that were previously granted to cushion Kenyans from the effects of the COVID 19 pandemic. The measures are set to take effect as from 1st January 2021 and can be seen to have been treated with high urgency considering that even though the National Assembly is currently on recess until February 2021, the Speaker of the National Assembly convened a special sitting on 22nd December 2020 in order to debate the Bill and pave the way for the President to assent to it.

The process was completed with the President assenting to the Bill on 23rd December 2020 and the same being gazetted vide Kenya Gazette Vol. CXXII – No. 240 of 31st December 2020 through Supplement No. 235. The Act seeks to amend provisions of the Income Tax Act (Cap.470) and The Value Added Tax Act, 2013. We highlight these amendments below.

Minimum Tax

The first provision seeks to amend the drafting error that was causing a contradiction to another provision introduced in the Finance Act, 2020 that sought to bring minimum tax within the realm of taxation in Kenya. We must brace ourselves to now pay this tax. As you are aware, minimum tax is chargeable at the rate of 1% of the gross turnover. The tax became effective from 1st January 2021 and is payable in instalments which shall be due on the twentieth day of each period ending on the fourth, sixth, ninth and twelfth months of the year of income.

We await subsidiary legislation or administrative guidelines by the Kenya Revenue Authority to further guide how this tax will be administered and shall keep you updated as soon as this is in the public domain. Until then, the only information availed is what was covered in the Finance Act 2020 which specifically covers the rate of tax, due date, chargeability on turnover and the exclusions from minimum tax. It is important to note that The Tax Laws (Amendment) (No.2) Act, 2020 ("The Act") has now expanded the scope of exclusions to the following two categories:

1. person engaged in a business whose retail price is controlled by the Government;
2. person engaged in insurance business.

Price controlled products usually have no leg room for manoeuvre. A classic example being the Petroleum sector whose price is strictly regulated by the Government. Pricing is regulated by the Government (Energy and Petroleum Regulatory Authority (EPRA) through Legal Notice No 196. The Legal notice determines the pricing formulae and Oil Marketing Companies (OMCs) have no role in determination of the pricing. The current EPRA pricing formula awards OMCs a margin which while the EPRA has not availed a breakdown of this margin, it can be assumed that the margin is intended to compensate for the operational costs. An additional 1% minimum tax would be a deterrent to investment in such a key sector.

This sector is also highly regulated in its operations with strict guidance on procurement and sale of the product. The commodities are imported through the Open Tender System (OTS) that works to regulate competition amongst the players. This restraint makes this a low margin industry with high risks. In most instances margins for players in OTS system are currently very minimal. The introduction of minimum tax could therefore lead to a collapse of the OTS system thereby eroding the benefits of OTS systems that immensely assisted in regulating the industry since introduction of this system. Multiple players importing the commodity will only translate to increased costs of the commodity.

Minimum Tax is chargeable on the gross turnover of the entity. It is important to appreciate that a significant element, approximately over 60% of the turnover actually constitutes taxes and levies. Minimum Tax will translate to be a tax on tax considering that a significant portion of the turnover constitutes taxes and levies. Furthermore, we must appreciate the additional taxes already introduced in the year 2020. The Tax Laws Amendment Act, 2020 enacted in April 2020, amended the taxable value of petroleum products which was adjusted to include taxes, levies and other charges. In July 2020, the Government increased the Petroleum Development Levy (PDL) on products such as petrol, diesel, heavy fuel oil, jet fuel amongst other from KES 0.40 to KES 5.40 per litre. The increase of PDL was made vide Legal Notice No. 124 of 10th July 2020. On 1st October 2020 specific rates of excise duty on certain excisable goods including petroleum products was again revised. The new rates have been adjusted for inflation at the rate of 4.94%. All these taxes only work to make costs of petroleum products higher which we all understand plays a very significant role in keeping our economy fueled.

Prevailing high petroleum pump prices witnessed in the country in the past have caused a lot of distress to both households and firms across the national economic spectrum. When fuel pump prices rise uncontrollably, they push the cost of production and cost of living beyond the purchasing power of majority of the population. This therefore can be viewed as a necessary exemption, not only for the suppliers but critically the consumers of these products, most of whom are already struggling to stay afloat.

We also appreciate the extension of the exemption to also include the insurance sector. This is also a welcome move considering that this industry is also taxed in a unique manner as set out above. The insurance industry is also, just like the petroleum industry already subjected to numerous levies. Insurance companies contribute a sum equivalent to 0.25% of the premiums paid by the respective policyholders every month to the Policyholders Compensation Fund; Insurance premium levy paid by insurers for financing the operations of the Insurance Regulatory Authority (IRA) at 1% of gross direct premiums written; and Insurance training levy charged on policy holders and collected by insurance companies at a rate of 0.35% of gross direct premiums written in the general insurance business. An additional 1% minimum tax would be detrimental to this industry that is yet to grow to its full potential in this country.

Change in Tax Rates

The Tax Laws (Amendment) (No.2) Act,2020 reinstates the pre COVID 19 corporation tax rate with the rate reverting from 25% to 30%. This rate is set to apply to income earned from 1st January 2021. While most taxpayers saw this coming, there is an unforeseen amendment that has been made to the Pay As You Earn (PAYE) tax bands that has now been introduced through The Tax Laws (Amendment) (No.2), Act 2020.

New Tax Bands		Tax Bands COVID		Tax Bands Pre COVID	
On the First KES 288,000	10%	On the First KES 288,000	10%	On the First KES 147,580	10%
On the Next KES 100,000	25%	On the Next KES 200,000	15%	On the Next KES 139,043	15%
On all income above KES 388,000	30%	On the Next KES 200,000	20%	On the Next KES 139,043	20%
		On all income above KES 688,000	25%	On the Next KES 139,043	25%
				On all income above KES 564,709	30%

As you will note from the above, the tax bands have been changed as from what existed pre COVID 19. We analyze the same for you through an illustration whereby we assume a per annum income of KES 800,000. We analyze how much tax the individual would have paid pre COVID, during COVID and how much they will be required to pay going forward.

Pre-COVID tax rates

Income (KES)	Tax Rate	Tax (KES)
First 147,580	10%	14,758
On the Next 139,043	15%	20,856
On the Next 139,043	20%	27,809
On the Next 139,043	25%	34,761
On all income above 564,709	30%	70,587
PAYE Due		**168,771**
Personal Relief		(16,896)
Total Tax Due Before Other Deductions		151,875

COVID tax rates

Income (KES)	Tax Rate	Tax (KES)
First 288,000	10%	28,800
On the Next 200,000	15%	30,000
On the Next 200,000	20%	40,000
On all income above 688,000	25%	28,000
PAYE Due		**126,800**
Personal Relief		(28,800)
Total Tax Due Before Other Deductions		98,000

Effective 1 January 2021

Income (KES)	Tax Rate	Tax (KES)
First 288,000	10%	28,800
On the Next 100,000	25%	25,000
On all income above 388,000	30%	123,600
PAYE Due		**177,400**
Personal Relief		(28,800)
Total Tax Due Before Other Deductions		148,600

	Pre COVID	COVID Rates (2020)	COVID Rates (2021)
Salary (KES)	800,000	800,000	800,000
PAYE	151,875	98,000	148,600

As evident from the above illustration, where you have been accounting for tax of KES 98,000 under the Tax Laws (Amendment) Bill, 2020 you will now be subjected to tax amounting to KES 148,600.

From the onset we must appreciate the Legislators for not clawing back the additional personal relief granted earlier in April 2020 from KES 16,896 to KES 28,800 which translates to one paying slightly lower taxes than they were during Pre COVID times. However, considering that COVID 19 is still with us today is KES 50,600 (148,600-98000) increment justifiable in today's economic situation where most people have lost their jobs or are on pay cuts in a bid to keep their companies afloat. Reduction in disposable income will significantly affect the spending power of the taxpayers thereby have a circular effect on collection of other consumption taxes such as VAT and corporation tax. This may after all not be a win-win situation for the National Exchequer.

Please note that this is a simple illustration that does not factor in other reliefs available to taxpayers. Please feel free to contact your Relationship Manager at Westminister should you require assistance in calculating the revised PAYE amounts.

Payment or Withdrawal from Pensions

In line with the changes to the PAYE bands, the Tax Laws (Amendment) Act, 2020 also enhanced the tax bands for taxation of withdrawals from NSSF, registered pension funds and provident funds where the withdrawals are in the excess of the tax free amounts specified under Section 8 (4) and 8 (5) of the Income Tax Act (providing for imposition of tax on Income from Pensions), in any one year.

For withdrawals after the expiry of fifteen years from the date of joining the fund:

New Tax Bands		Tax Bands COVID		Tax Bands Pre COVID	
On the First KES 400,000	10%	On the First KES 400,000	10%	On the First KES 400,000	10%
On the First KES 400,000	15%	On the First KES 400,000	15%	On the First KES 400,000	15%
On the First KES 400,000	20%	On the First KES 400,000	20%	On the First KES 400,000	20%
On the First KES 400,000	25%	On all income above KES 1,200,000 of the amount in excess of the tax –free amount	25%	On the First KES 400,000	25%
On all income above KES 1,600,000 of the amount in excess of the tax –free amount	30%			On all income above KES 1,600,000 of the amount in excess of the tax –free amount	30%

For withdrawals before the expiry of fifteen years from the date of joining the fund:

New Tax Bands		Tax Bands COVID		Tax Bands Pre COVID	
On the First KES 288,000	10%	On the First KES 288,000	10%	On the First KES 147,580	10%
On the next KES 100,000	25%	On the First KES 200,000	15%	On the First KES 139,043	15%
On all income above KES 388,000	30%	On the First KES 200,000	20%	On the First KES 139,043	20%
		On all income above KES 688,000	25%	On the First KES 139,043	25%
				On all income above KES 564,709	30%

While there has been no change to what was laid out in the Tax Laws (Amendment) (No.2) Bill, 2020 for withdrawals after the expiry of fifteen years from the date of joining the fund, the rates for withdrawals before the expiry of fifteen years from the date of joining the fund have been amended in line with above mentioned changes to the PAYE bands. Furthermore, any surplus funds withdrawn by or refunded to an employer in respect of registered pension or registered provident funds, will now be taxed at thirty percent of the gross sum payable. This is a return to the Pre – COVID position.

VAT on Taxable Supplies made to Official aid funded projects

The Tax Laws (Amendment) (No.2) Act, 2020 enacts the introduction of an amendment to the VAT Act that will enable a registered person who is a manufacturer to claim a deduction for input tax with respect to taxable supplies made to an official aid funded project as may be approved by the Cabinet Secretary in accordance with the First Schedule of the VAT Act.

We urgently need to promote development of our local manufacturers to enhance domestic market access of Brand Kenya products and also encourage this through these Government and Private Sector procurement programs. Such measures will work as a remedy for the following ailments significantly affecting our economy:

1. Lack of competitiveness for our local manufacturers occasioned by inefficient trade facilitation infrastructure;
2. Weak and fragmented supply chains from producers to suppliers and consumers that have only worked to further downgrade our industrialization aspirations as a country;
3. The National Government has been failing to protect its domestic market and industries from unfair trade practices and threats that are arising from dumping and subsidies from the foreign companies looking to satisfy demand of these projects that our local manufacturers could otherwise satisfy but are unable to do so due to high cost of production;
4. We lose more employment opportunities that could have been created by these manufacturing entities, some of which are also enhancing the skill set of our youth through their advanced technological production processes; and
5. "Central Bank loses grip on the Kenyan shilling" the headline to an article in one of the leading newspaper on Wednesday, September 23, 2020. The article further states that the "Kenyan Shilling continues to weaken as KES 108 is the amount that the Central Bank of Kenya has quoted the shilling at against the US dollar". A quick fix to this matter would be to export more than we import into the country. Best way to do this would be to support our local manufacturers to satisfy our internal requirements and build our Brand Kenya by promoting "Buy Kenyan Build Kenyan".

The introduction of such measures is definitely a step in the right direction and will also aid in The President's Big Four agenda driving the nation to achieving the vision with specific focus on amongst others, enhancing manufacturing from 9.2% to 20% of GDP by 2022.

Conclusion

The Act brings with it several amendments, some positive some unrealistic in our view. The main amendment that has been seen to attract a lot of public attention and dismay is the change of PAYE bands. It is understandable that the National Budget is in a significant deficit position but the mwananchi is also already struggling. The National Treasury could have sought for some other mechanisms to bridge this deficit gap.

It is also imperative to appreciate that Pursuant to Article 118(1)(b) of the Constitution of Kenya and pursuant to Standing Order 127(3), The Departmental Committee on Finance and National Planning, are required to engage the public for their stakeholder input. The provisions specifically states

"Public access and participation (1) Parliament shall— (a) conduct its business in an open manner, and its sittings and those of its committees shall be open to the public; and (b) facilitate public participation and involvement in the legislative and other business of Parliament and its committees. (2) Parliament may not exclude the public, or any media, from any sitting unless in exceptional circumstances the relevant Speaker has determined that there are justifiable reasons for the exclusion."

While we appreciate this process was carried out, the change for PAYE was not communicated and has come out as a surprise with the Tax Laws (Amendment) (No.2) Act, 2020. The public should have been given a chance to put forward their views on this legislative provision before its enactment.

For more details on this advisory note or any other trade or tax related matter, please do not hesitate to contact your Relationship Manager at Westminister Consulting.

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