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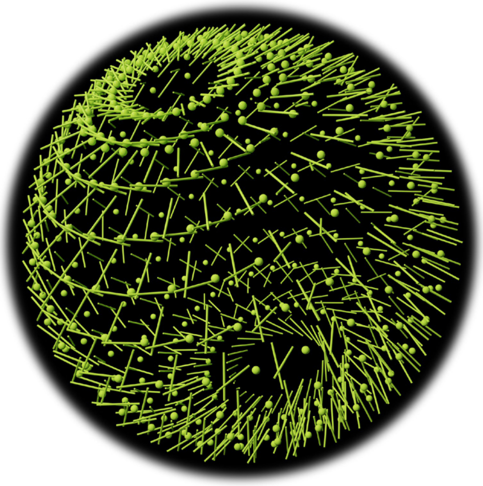
A glance at some of the key tax measures to expect in Budget 2020/21



The 2020/21 National Budget (the Budget) is expected to be read sometime in June 2020. The Budget will, undoubtedly, be very unique as the Government grapples with balancing the response to the global pandemic of COVID-19, and implementation of policies and programs geared towards realizing the "Big Four Agenda". Like other countries globally, Kenya is expected to face significant financial challenges partly arising from the negative impact of COVID-19 on the economy. The Government is therefore expected to design policies which will support recovery and investment to aid in economic turnaround.

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Besides other sources of revenue such as grant and borrowings, tax revenue is the main source of income for the Government. It is on this basis that every budget is accompanied by a raft of tax measures aimed at enhancing mobilization of tax revenue. These measures are introduced through the Finance Bill, a legislative instrument proposing changes to taxes, levies, tax administration among other measures.

Prompted by a recent Court ruling which barred the Government from collecting taxes prior to enactment of the relevant tax laws, this year's Finance Bill (the Bill) was published on 5 May 2020, slightly over a month ahead of the reading of the National Budget. It is expected that the Bill will be signed into law by 1 July 2020.

As expected, the Bill has only introduced a few changes, given that a number of tax measures were already introduced through the Tax Laws Amendment Act 2020 in April. This article focuses on some of the proposed "key" tax measures that will impact many taxpayers.

The tax measures

The Bill proposes to introduce a minimum tax at a rate of 1% of gross turnover to be paid in four instalments, the same dates as the current instalment tax obligations. There is a drafting error that effectively means a taxpayer would pay both instalment and minimum tax. This change does not affect income from employment, residential rent, capital gains, mining, upstream oil and gas activities and income taxable under the turnover tax regime. Minimum tax is not unique to Kenya as a number of countries, including our immediate neighbour, Tanzania, already has it in place. The aim of minimum tax is usually to collect tax from entities which report continuous losses occasioned by several factors such as tax benefits, avoidance schemes and management inefficiencies which significantly reduce a taxpayer's taxable income. It ensures that no taxpayer with substantial economic income is able to completely avoid paying tax by using exclusions, deductions and credits. Countries with immense tax incentives and deductions deploy this tax to achieve the objective.

As currently drafted, the proposed minimum tax is a good example of a poorly drafted tax law. For instance, the minimum tax law, seeks to tax persons in the first year of making a tax loss, and ignores the fact that some businesses may have very low margins. It does not give a room for startups to even breakeven. It punishes taxpayers who genuinely report losses even in unique economic times such as the current downturn caused by COVID-19. In many jurisdictions, minimum tax applies if tax losses are reported for 3 to 5 years consecutively. With the recent repeal of accelerated capital allowances in Kenya, which is one of the main reasons of a tax loss, an astute bystander is left wondering on whether the minimum tax will really achieve the intended objective. The proposed tax appears to be a glorified form of turnover tax save for the fact that it will be paid in instalments and by taxpayers who fall outside the ambit of turnover tax. The provisions for minimum tax should be critically reviewed before it is passed. Preferably, it should be shelved until the economy recovers fully from the impact of COVID-19.

The Bill also seeks to introduce a Digital Service Tax at the rate of 1.5% of the gross transaction value. The tax is expected to be paid by persons who derive or accrue income from Kenya on provision of services through a platform that enables direct interaction between buyers and sellers of goods and services through electronic means. The number of businesses that would be trapped within this tax, as currently drafted, is unimaginable given that every business has some element of delivery of services through an electronic platform. Taxation of the digital economy is very challenging due to the amorphous nature of digital transactions. Indeed, there are ongoing multilateral efforts to address the tax challenges arising from this but no consensus has been arrived at yet. That said, the Finance Act 2019 required the Cabinet Secretary to issue guidelines on taxation of digital businesses – the guidelines are yet to be published demonstrating the difficulties of implementing this tax. It is expected that the guidelines will be published and ample time allocated for stakeholder participation before this tax is implemented.

On the VAT front, the Bill proposes to introduce an additional requirement to ensure that a purchaser only claims input VAT where the supplier has declared output VAT on the sale to the Kenya Revenue Authority (KRA). This requirement is, notwithstanding, the fact that the purchaser can only claim input VAT within a period of 6 months i.e. if the supplier does not declare the sale within 6 months, the input VAT can no longer be recovered. Simply put, if this law is passed in its current form, purchasers will be left at the mercy of the sellers and will incur huge administrative costs (unless the process is automated by the KRA) to follow up with the sellers to remit the VAT to KRA. This is tantamount to the KRA pushing its administrative role to businesses. It is a basic principle of law that law cannot command an impossibility. This proposed law is clearly commanding an impossibility and imposes monumental hardship to taxpayers by subjugating buyers to sellers. It will be unfortunate if this law passes in its current form.

It is noteworthy that the Bill proposes to re-introduce a couple of tax measures that were rejected by the National Assembly under the Tax Laws Amendment Act barely a month ago. Such tax measures include but are not limited to: taxing the income of National Social Security Fund, income of pensioners aged sixty-five years and above, bonuses and overtime paid to low income earners and introduction of VAT on LPG cylinders, tractors, solar equipment. These proposals may not pass in view of the Parliamentary Standing order which explicitly prohibits re-introduction of issues previously debated within six months.

Finally, the Bill seeks to introduce a Voluntary Tax Disclosure program (VTDP), a platform for taxpayers to voluntarily disclose tax liabilities, which accrued within a period of five years prior to 1 July 2020, to the Commissioner for the purpose of being granted relief of penalties and interest on the taxes disclosed. The proposed percentage of relief is 100%, 50% and 25% for taxpayers who make the disclosure and pay the tax liability in the first, second and third years of the program respectively. If properly implemented, this is a welcome move and will greatly enhance compliance. However, some of the conditions imposed should be reviewed to avoid unnecessary controversy e.g. the program requires the taxpayers to disclose “all material facts” – this condition is too broad and creates uncertainty and could be susceptible to abuse.

In the words of Margaret Mitchell, there is never a convenient time for death, **taxes** and childbirth. Where there is an opportunity to adopt some of the recommended changes for the good of all of us, the government should seize the opportunity and run with it. However, some of the changes would have adverse effects on an already depressed economy and should be revised. We can only hope that the government will seriously consider views from various stakeholders prior to signing of the Bill into Law as this will be a sure way of cushioning the already distressed businesses and individuals.

The views expressed herein are those of the author and do not necessarily represent the views of Deloitte.