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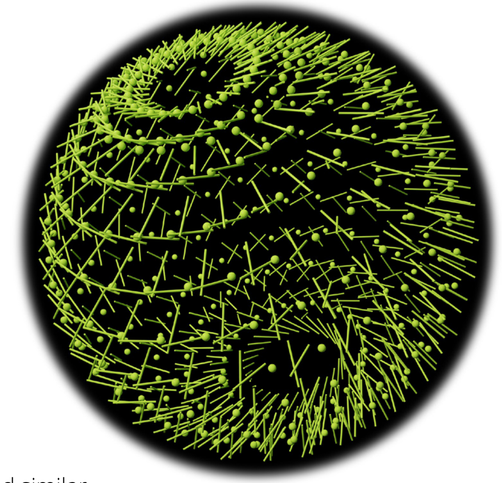
Changes in PAYE, corporation tax rates set to increase refunds



The year 2020 will go down in history as the year the whole world spontaneously faced similar challenges occasioned by the attack of corona virus popularly known as COVID-19. The absence of an immediate solution prompted governments to react in various ways to mitigate the adverse effects of the pandemic. Kenya, like other countries designed a raft of measures to contain the spread of the virus on one hand while on the other hand proposed measures meant to cushion its people from the adverse economic effect. To this end, radical fiscal measures were proposed through the Tax Laws (Amendment) Bill 2020 (The Bill), which was discussed in Parliament and passed with some amendments.

The President assented to the Bill on April 25, 2020, giving it the force of law. This law introduced amendments to the Income Tax Act, Value Added Tax Act, 2013, Excise Duty Act, 2015, Tax Procedure Act, 2015, Miscellaneous Fee and Levies Act, 2016, Kenya Revenue Authority Act, 1995 and the Retirement Benefits Act, 1997.

Patrick Chege is an Associate Director at Deloitte East Africa and he can be reached at *pchege@deloitte.co.ke*

Controversy

The new law undoubtedly has benefited individuals and resident corporations in terms of reduced tax rates and expanded tax relief. However, it seems there are varied views in relation to the effective date of the law, effecting the reduced Pay-As-You-Earn (PAYE), and corporation tax rates. This has generated a debate that is not likely to end any time soon.

Importance of an effective date

The effective date of a law sets out the date the law begins to be applied. A law like this one that confers advantage to taxpayers should be drafted in a manner that is clear to both the taxpayers and the tax administration. Regardless of the intention of the law, taxpayers tend to interpret the law liberally, to confer maximum benefit to them, by pushing the effective date as early as possible. The Kenya Revenue Authority (KRA) on their part, faced with shrinking sources of revenue, low profitability of businesses, retrenchments, and the resultant widening of tax shortfall, would prefer

an interpretation that reduces the period affected by the reduced tax rates. This was evident when the KRA issued a public notice on May 7, 2020, seeking to clarify the effective date for PAYE. Based on the public notice, it appears as if the position being advanced is that PAYE is a monthly tax and therefore, the reduced rate is not available in the period of January to March 2020. Contrary to this view and that of many tax practitioners is that the law, properly covers the period of January to March 2020, and that upon filing of the income tax return for the year of income 2020, the KRA will have to refund taxpayers the overpaid PAYE, owing to the reduced tax rates. Should the revenue authority adopt a different interpretation of this law, it is likely to give rise to tax disputes, which may end up in the Tax Appeals Tribunal and even the Courts.

Upon the signing of the Bill into law on April 25, 2020, the first dilemma was how to determine PAYE for the month of April 2020. This is because part of the month appeared to be covered by the repealed law, which provided for a maximum rate of 30% while the other part of the month appeared to fall under the new rate of 25%. This issue was subsequently resolved, and the public notice issued by the KRA confirmed that the rate applicable for the entire month was the new rate of 25%. This was only a partial solution and did not resolve the question of the rate covering the period January to March 2020.

This leads us to the question that begs an answer: What is the legal position on the period to which the changes apply?

What does the law say?

Section 1 of the Tax Laws (Amendment) Act, 2020 states in its material part that the law, except for VAT shall come into operation on the date of assent. The other amendment was the replacement of the annual rates contained in the Third Schedule Head B. The other sections of the law governing PAYE largely remains the same. Section 34(1)(a) of the Income Tax Act provides that the total income of an individual shall be charged for a year of income at the individual rates for that year of income. The term "year of income" is defined in section 2 of the Income Tax Act to mean the period of twelve months commencing on January 1 in any year and ending on December 31 in that year. Therefore, tying this statement to the annual tax rates provided under the new law, then it follows that the new rates applies for the period January 1, 2020 to December 31, 2020.

Based on the above analysis of the applicable law, the proposition that PAYE is a monthly tax does not affect the applicability of the new tax rates to the period January to March 2020. Employees will still file their self-assessment tax returns on employment income at the end of the year. However, PAYE is payable by employers on a monthly basis on account of employees, like withholding taxes paid on account of suppliers of designated services. This is informed by the fact that if employees were to be paid monthly gross emoluments and expected to remit tax the end of the year the compliance rate would be very low because employees would most likely spend all the money including tax by the end of the year. The requirement that employers deduct, and remit PAYE monthly, does not make personal income tax a monthly tax. Rather, it is a way to ensure tax is recovered at source to maintain high compliance levels.

Like PAYE, corporation tax for resident entities under the new law enjoys a reduced tax rate of 25%. The relevant provision is the amendment to paragraph 2 of the Second Schedule Head B. The new sub-paragraph (viii) states that the new rate applies for the year of income 2020 and each subsequent year of income. In a situation where the accounting period of a company ends on December 31, 2020, there is no challenge in finding that the new rate applies. However, where the end of the accounting period falls on a day other than December 31, say January 31, the rule as provided for under section 27 of the Income Tax Act is that the year of income is tied to the date the accounting period falls. Section 27 (1) on accounting periods not coinciding with year of income, states *"Where any person usually makes up the accounts of his business for a period of twelve months ending on any day other than December 31, then. for the purpose of ascertaining his total income for any year of income, the income of any such accounting period ending on such other date shall, subject to such adjustment as the Commissioner may consider appropriate, be taken to be income of the year of income in which the accounting period ends—"*

Therefore, corporations whose accounting period ends in any day of year 2020 should be able to benefit from the reduced rates notwithstanding that the accounting period ended before the law came into operation or that the bulk of the income was earned in the 2019 calendar year. Consequently, companies whose years of income ended on January 31, February 28, or March 31, 2020 are entitled to the reduced corporation tax rate of 25%.

Options open to taxpayers and revenue authority

Regarding personal income tax, and being an annual tax, employees/taxpayers may have to wait until individual tax returns for the year of income 2020 to be filed and then proceed to determine the amount of tax overpaid and seek for refund from the KRA. The alternative would be for the KRA to allow employers to determine the PAYE overpaid for January to March 2020 and offset the same against PAYE for subsequent months of year 2020. The second approach is more attractive because it saves the KRA time and resources for processing numerous applications for refund at the end of the year and at the same time allow employees to harvest from the generosity of the new law at the earliest. We believe the KRA should adopt the second approach in the spirit of easing taxpayers' economic pain during the COVID-19 pandemic as this is in line with the intention of the changes introduced by the government.

The corporation tax is also likely to result to refunds especially for companies that were in profit and tax paying position. This would be as a result of instalment tax paid during the year, based on a higher tax rate of 30%. The KRA should allow such taxpayers to offset the overpaid tax against future instalment tax and not to insist that the affected taxpayers must apply for refund and separately continue paying instalment tax. Obtaining refund from the KRA has been a tall order in the past and adversely affects cash flow for business. Therefore, it would be a welcome move for the KRA to be flexible in allowing offsets to avoid worsening the cash flow challenges that many taxpayers are facing at his time when most businesses have taken a significant hit on their revenues and earnings in the aftermath of COVID-19. This is the time to be supportive of taxpayers so they can get through this very difficult time as we look forward to better days ahead.

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