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Tax Alert
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The Tax Laws (Amendment) (No. 2) Bill, 2020

Keeping you in the loop

In April 2020, the Government of Kenya introduced measures that were aimed at cushioning individuals and businesses from the impact of Covid-19. Some of the measures comprised of lowering of the income tax and Value Added Tax (VAT) rates.

The National Treasury has now published the Tax Laws (Amendment) (No.2) Bill, 2020 ("the Bill"), which seeks to reverse the major tax concessions introduced in April 2020. The Bill was published on 27th November 2020 in the Kenya Gazette Supplement No.216 (National Assembly Bills No.48). It seeks to amend the Income Tax Act (Cap 470) and the Value Added Tax Act, 2013 (No. 35 of 2013). The Bill is currently undergoing public participation and is expected to come into force on 1st January 2021. Although the National Assembly is currently on recess until February 2021, it is possible that the Speaker of the National Assembly will convene a special sitting in the course of December 2020 in order to debate the Bill and pave the way for the President to assent to it so it can become law in January 2021.

In this alert, we highlight the proposed amendments and their impact.

Income Tax Highlights

Reinstatement of the resident corporate tax rate of 30%

The Bill proposes to amend the Income Tax Act by:

a) Reinstating the resident corporate tax rate of 30% with effect from 1st January 2021; and

b) Introducing a proviso, which states that the reduced corporate tax rate of 25% introduced in April 2020 only applies to income earned after 25th April 2020.

The implication of this amendment is that a Kenyan resident entity shall be expected to be taxable as follows:

- At 30% for income earned before 25th April 2020;
- At 25% for income earned between 25th April 2020 and 31st December 2020; and
- At 30% for any income earned after 1st January 2021.

The above would require an entity to prepare more than one tax computation in a given year of income and apply the different rates of tax on each of the tax computations. For instance, a company with a March year end would have to determine taxable income for the period April 2020 potentially taxable at 30% and taxable income for the period May to December 2020 at 25% and then taxable income for January to March 2021 at 30%. This would be quite cumbersome and, in our view, the proviso is an unnecessary complication given the well informed practice of keeping income tax rates stable for each year of income.

It would also be important to point out that the proviso that aims to restrict the applicability of the 25% rate of tax to income earned between 25th April 2020 and 31 December 2020 will, if passed in its current raise questions of retroactive application of the law. This may be open to litigation, as there are only limited instances where a law can apply retrospectively.

In conclusion the short-lived reduction of income tax rate indicates that Kenya is still heavily reliant on a few taxpayers and is not yet prepared to follow global trends which have witnessed reductions in corporate tax rates and instead a focus on measures to widen the tax net and reduce opportunities for aggressive tax planning or avoidance. The increasing budgetary pressure and concerns on growing debt seem to have been a key factor in this policy reversal.

Reinstatement of the 30% top rate for individuals

The Bill proposes to amend the individual rates of tax so that income above KES 888,000 will be taxable at 30%.

The new rates shall also apply to pension withdrawals (in excess of the tax free amounts) made before expiry of 15 years from joining the fund.

The tabulation of the new rates is as below:

Income	Rate of tax
First KES 288,000	10%
Next KES 200,000	15%
Next KES 200,000	20%
Next KES 200,000	25%
Any income above KES 888,000	30%

With the new individual rates of tax, the monthly Pay As You Earn (PAYE) rates shall be as follows:

Income	Rate of tax
First KES 24,000	10%
Next KES 16,667	15%
Next KES 16,667	20%
Next KES 16,667	25%
Any income above KES 74,000	30%

It is worth noting that although the 30% top tax rate will be reinstated, the enhanced tax relief of KES 28,800 introduced in response to Covid-19 will be retained. In effect this means that any individual with taxable income of up to KES 24,000 per month will not pay income tax. This is a positive measure to cushion those with very low income.

Further, whereas the relief in terms of low rates will have been short-lived if the Bill is passed into law, the widened tax bands introduced in April 2020 will largely remain unaffected. The only change would be that another band will be introduced above which any additional income will be taxable at 30%. An individual earning up to KES 74,000 per month (or KES 888,000 in a year) should therefore not be affected by the proposed measures. This is a welcome relief for many taxpayers as the majority of Kenyans are in the lower income category.

Reinstatement of the 30% top rate on pension withdrawals

The Bill also proposes to re-introduce the 30% top tax rate on pension withdrawals (in excess of the tax free amounts) made after expiry of 15 years from joining the fund, or on attainment of 50 years, or upon early retirement on grounds of ill health or infirmity of body and mind. The 30% rate shall kick-in on amounts above KES 1,600,000. The table below shows the proposed rates on the pension withdrawals:

Income	Rate of tax
First KES 400,000	10%
Next KES 400,000	15%
Next KES 400,000	20%
Next KES 400,000	25%
Any income above KES 1,600,000	30%

Correction of a legislative error on minimum tax

The Finance Act, 2020 introduced the Minimum Tax regime, with an effective date of 1st January 2021.

The tax shall be computed at the rate of 1% of the gross turnover and shall be payable whether a person has taxable profits or not.

Minimum Tax shall be payable in instalments and shall be due on the 20th day of each period ending on the 4th, 6th, 9th and 12th month of the year of income.

The following incomes are exempted from Minimum Tax:

- Any income exempted by the Income Tax Act;
- Employment income;
- Income that is subject to Residential Rental Income Tax;
- Income that is subject to Turnover Tax;
- Income that is subject to Capital Gains Tax; and
- Income of the extractive sector

Minimum tax was intended to apply where a person's instalment tax is lower than minimum tax. However, there was a drafting error in the Finance Act, 2020, as the Act provided that minimum tax would apply where instalment tax is higher than minimum tax. The Tax Laws (Amendment) (No2) Bill, 2020 now proposes to amend this anomaly.

While the amendment is welcome to capture the correct intention of the legislature, minimum tax as currently structured is punitive for businesses with low profit margins and should be amended to only cases of "perpetual" loss making entities.

Value Added Tax Highlights

Reinstatement of the 16% standard rate

The Value Added Tax Act, 2013 ("VAT Act") empowers the Cabinet Secretary (CS) to alter the VAT rate upwards or downwards by an amount not exceeding 25% of the prevailing rate. Any rate changes should be published in the Kenya Gazette.

To this effect, the CS has made an order, through Legal Notice 206 published in the Kenya Gazette supplement no 214 of 2nd December 2020, that the standard rate of VAT be changed from 14% to 16%. The new rate shall take effect from 1st January 2021.

The reinstatement of the 16% VAT rate, with effect from 1st January 2021, will undoubtedly make taxable goods and services pricier. Considering that most Kenyans are still struggling to make ends meet due to the impact of Covid-19, the timing of the VAT rate reinstatement is questionable.

It would also be important to note that the reduction of the VAT rate from 16% to 14% in April 2020 prompted the government to amend the VAT law and change the status of most basic necessities that were exempt or zero-rated to standard-rated. With the reinstatement of the 16% rate, one would hope that the government would also reverse these changes.

Input tax incurred by manufacturers with respect to taxable supplies to official aid-funded projects to be deductible

The Bill proposes to introduce an amendment under Section 17 of the VAT Act that will allow manufacturers to claim input tax with respect to official aid-funded projects.

Supplies to official aid-funded projects are currently listed as exempt under the VAT Act.

According to the input tax deductibility criteria stipulated under Section 17 of the VAT Act, any input tax incurred to make such exempt supplies should not be allowable. The amendment therefore seeks to give manufacturers an exception by allowing them an opportunity to deduct input tax with respect to sales to official aid-funded projects.

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