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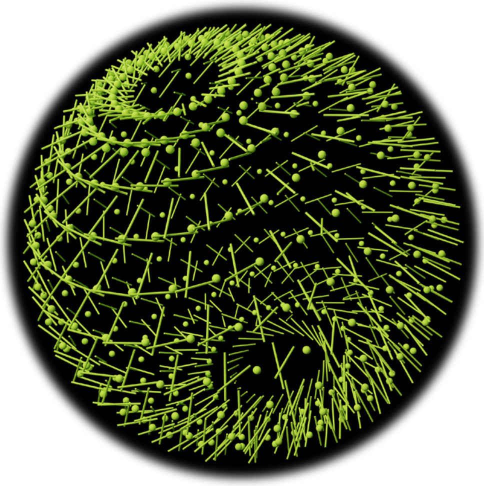
Why we need to rethink the nuts and bolts of tax changes



For the first time in the history of budget making process in Kenya, the Finance Bill 2020 is out over a month ahead of the Budget statement reading by the Cabinet Secretary to the National Treasury. Historically and prior to the High Court ruling in the Okiya Omtatah's case around Parliament's legislative role and effective date of the Finance Bills, most of the tax measures especially on transaction taxes like Valued Added Tax (VAT) and excise taxes used to take effect on the midnight of the budget day. This was irrespective of the fact that taxpayers needed to configure their systems to accommodate the changes.

As a result, the implementation of the tax changes in some cases posed significant administrative challenges culminating to disputes between the taxpayers and the Kenya Revenue Authority (KRA) and at times ending up in the corridors of justice. Undoubtedly, such disputes had far-reaching negative consequences on the ability of the KRA to meet the ambitious and ever-growing tax revenue targets.

Now Kenyans and taxpayers at large are psychologically prepared for the looming tax changes in the upcoming budget statement reading. This gives room to think through the system alterations accompanying implementation of the new changes. The National Treasury on the other hand, will have some level of certainty that the new changes will be implemented with minimal hurdles. Many have acknowledged that the change in the budget calendar is most welcome. These benefits cannot be overemphasized.

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Time to rethink a new approach to tax policy formulation in Kenya

The above said, some of the recently passed tax changes in Kenya begs the question *what really drives tax changes? Is it revenue generation, tax policy direction, investment to spur economic growth?* Arguably, some of the recent tax changes, especially tax cuts, were driven by the current global pandemic that has forced most of the governments across the globe to respond with measures to cushion citizens during these difficult and uncertain times. However, one would not struggle to conclude that some of the changes were purely driven by the pressure to increase tax revenue, perhaps to compensate for the cuts. The sad news is that many of the changes aimed at increasing revenue tend to be short-term, have inherent drafting errors and have long-term negative ramifications.

It is against the backdrop of answering the above questions that one thinks that we, as a country, still have some strides to make as far as the impetus of tax changes or tax policy is concerned. A good tax policy is key in not only raising revenue to drive the government's agenda but also supports the creation of a business-enabling environment and the wellbeing of the public at large. A poorly designed tax policy may not only discourage investment but also encourage non-compliance and thus result in revenue shortage. Therefore, policy makers should ensure that the tax policy is sound and acceptable.

Globally, there have been campaigns to relook at the tax policy with various recommendations calling for a sweeping overhaul of the tax system and change of reliance on specific types of taxes or tweaking the existing taxes. Kenya has not been an exception with the recent efforts revolving around an overhaul of various tax legislations, automation of filing and payment of taxes, titivating of tax disputes resolution mechanism among other efforts.

Having made some positive steps as far as the tax changes are concerned, it is an opportune time for us to rethink the nuts and bolts of tax changes in Kenya - a more considered approach. For instance, consultation, benchmarking from best practice, and thorough scrutiny of legislative process should be the cornerstones of this approach. The new approach should be designed to keep taxes simple, easy to comply with, transparent, stable, predictable, attributable to the benefits and with minimal distortion in decision-making.

What to rethink

A tax policy should increase predictability and exhibit certainty. Certainty goes beyond effective dates; it should speak to the bigger picture such as enabling taxpayers to make long-term plans with a relatively high degree of stability and less shock. The canon of certainty as propounded by the renowned economist, Adam Smith, implies that it should be certain to the taxpayer how much he has to pay, to whom and by what time the tax is to be paid. All the procedural information should be very clear. Certainty pre-empts any exploitation of the taxpayers by the tax authorities and reduces the cost of compliance.

A sound tax policy should exhibit some degree of simplicity. Simplicity breeds some sense of fairness among taxpayers and enhances a deeper understanding. In the recent past, there has been a tendency for the tax law being written very broadly prompting the KRA to issue public notices in response to the stakeholders' outcry. To this end, the recommendation is to draft a clear tax legislation and, where possible, avoid making tax legislation unnecessarily complex. This is achievable by ensuring that the requisite definitions are provided under the respective legislation as well as issuance of clear guidance and supporting regulations, which should take into account the taxpayers' concerns and practical challenges. A perfect candidate to a seemingly complex change is the Digital Service Tax, which the Finance Bill 2020 seeks to introduce. Though the Finance Act 2019 had alluded to some guidelines aimed at providing more clarity, the regulations are yet to be published despite the proposed changes that will, if passed, take effect soon.

To achieve its intended objective, a tax change should not be solely driven by the urge to meet revenue targets. Without ignoring the fact that the government requires revenue to finance the provision of public goods and services. We surely need to look at the tax changes from a wider perspective and consider the impact of the changes from the broader implication on the economy, such as creation of employment opportunities, attraction of foreign domestic investments, promotion of priority sectors, among other considerations. Listening to the Chairman of Departmental Committee on Finance and Budget during the second and third reading of the Tax Laws Amendment Bill, one would not fail to notice that most of the changes are purely revenue driven. The justification offered for dropping most of the recommendations from the various stakeholders was a line that "*this will lead to revenue loss*". As a result, some of the well thought-out provisions aimed at supporting the productive sectors, such as electricity rebates, were reversed barely a year after introduction.

A tax policy should be grounded on deeper consultations, keeping in mind that a tax law can be complex and technical. The time between policy formulation and enactment should be extended to create room for deeper consultation before a legislation is drafted, owing to the recent changes, which appear to be addressing this already. This will enable the stakeholders to assess the quality of the tax proposal and where necessary alert the government on any shortcomings. Let us now take it a notch higher by ensuring that the recommendations from various experts are meaningfully discussed and appropriate recommendations are adopted as far as possible.

Unless under extremely unexceptional circumstances, which would require urgent intervention through tax, sudden and unexpected changes should be avoided at all cost since they are harmful to business and susceptible to legal errors. A good example of a sudden change in tax was the attempt to introduce Robin Hood Tax (RHTT) under the Finance Bill 2018 – due to the lack of consultation, the change was ushered in by a myriad of implementation challenges prompting the National Assembly to shelf the idea. Presumptive tax has also been repealed barely two years after introduction of the same. Turnover tax has been overhauled a year after reintroduction, now a taxpayer who had registered for the obligation based on an annual turnover of KES 500,000 may be required to deregister since the lower limit has now been revised to KES 1 million. These sudden and frequent changes point to the fact that many of the changes were not well thought-out and call for greater transparency and engagement to get the best outcomes for both the government and taxpayers.

The National Assembly is the sole arm of the government charged with the responsibility of legislating. However, members of parliament may not have a deeper and technical understanding of tax law. To this end, formation of a specialized unit made up of a team of experts whose primary mandate is to offer pre-legislative scrutiny should be adopted. The unit will be responsible in reviewing tax proposals through the expert lens and properly brief the members of the National Assembly prior to the adoption and passage of a tax bill in Parliament. This will enable evaluation of the possible implications beforehand than dealing with surprises after the fact.

In conclusion, it is not in doubt that a tax policy should be based on long-term goals and not short-term revenue raising imperatives. The recommendations that stakeholders put forward are critical in shaping the tax policy in the long run and should be given serious consideration. It is encouraging to see that Kenya has made some positive steps in this direction and that considerable scrutiny and analysis by various stakeholders has been witnessed. This should be taken a step further through timely and meaningful engagement geared towards achieving a sound tax policy in the long run.

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