Implementation of 'Minimum Tax' to commence in January 2021 amid a gloom economy

The 'Minimum Tax' introduced by the Finance Act, 2020 (the Act) will take effect on 1 January 2021.

The tax seeks to ensure that each company registered and operating in Kenya pays income tax regardless of whether it makes profit or not. Minimum tax will be implemented parallel to the normal corporation income tax and will be charged at 1% of a company's gross business revenue.

Corporation income tax for a locally incorporated company is currently levied at 25% of the company's taxable profit. This though is likely to go back to 30% in January 2021. This tax is payable in installments on the 20th day of the fourth, sixth, ninth and twelfth month of a company's accounting year. These quarterly tax payments are referred to as installment taxes.

Prior to 1 January 2021, a company in losses is not required to pay corporation income tax since the tax base (the amount upon which tax is calculated) is the company's profit. As such, by declaring losses, companies would end up paying no corporate income taxes. It's against this backdrop that the government introduced minimum tax.

Minimum tax will be payable where 1% of the company's gross turnover is less than the C payable for a particular quarter. In this line, effective 1 January 2021, the quarterly tax to be paid by any company operating in Kenya will be the higher of the installment tax or minimum tax.

The Kenya Revenue Authority (KRA) targets to raise billions in annual taxes following the implementation of minimum tax. This will help ease the perennial fiscal deficit Kenya has been exposed particularly in the last five fiscal years. In the current financial year, the KRA has already missed revenue target for quarter one (July to September) by Kshs. 50.2 billion.

At a time when businesses globally are grappling with the effects of the stubborn, and now possibly persistent, COVID-19 pandemic, the implementation of 'minimum tax' on loss making companies is akin to twisting the knife in a stab wound. The pandemic has already caused immeasurable economic and social damage. It now jeopardises the viability of many businesses based on their operating models. Even Post-COVID-19, the recovery process may be slow and such a proposal would still be generally unwelcome.

The above notwithstanding, minimum tax is likely to face implementation controversies owing to some deficiencies in the provisions of the Act and some business factors it overlooked. While the Act provides that minimum tax will be calculated based on gross turnover, it does not define 'gross turnover'. In addition, the Income Tax Act (ITA) which form the basis for all income taxes in Kenya does not provide any definition for gross turnover. Neither does the Tax Procedures Act, 2015.

While the term 'gross turnover' may appear straightforward, it has significant varying interpretations and implications for businesses in different sectors. For instance, consider a distributor or agents who earn a commission on the goods sold. Ideally, the actual revenue of such a distributor or agent is the commission received and not total sales proceeds realised from the goods sold. However, in the absence of a clear definition of 'gross turnover', the KRA is likely to assume that the distributor's/agent's gross turnover in this scenario is the total sales proceed. Such a move would be punitive to the distributor/agent and might drive them in to significant losses and eventually out of business.

The retail sector in Kenya which accounts for a large part of the economy, is a high volume, low margin business. The Kenya Association of Manufacturers (KAM) estimates the sector makes a profit margin of less than 2%. In the context of the current Covid-19 pandemic, the margins are even lower. Considering a corporation tax rate of 25%, the highest tax payable by businesses in this sector would be at most 0.5% of their gross turnover. Implementing a minimum tax of 1% of gross turnover for these businesses is likely to cripple them. These firms might be forced to borrow to pay taxes.

Implementation of minimum tax is also likely to water down capital allowances thus repelling investments in the country.

The ITA introduced capital allowances to accelerate investments in the country by extending a tax relief to companies on the capital expenditure they incur in each accounting year.

Such a tax relief is effected by allowing companies to expense their capital expenditure in the annual pre-tax income. The relief is different depending on the type of capital expenditure. Most start-up firms particularly in the agri-business and manufacturing sector are capital intensive. Such firms usually report losses during their infancy stage of operation majorly by expensing capital expenditure. Implementation of minimum tax will overlook this fact and levy taxes on such start-ups based on gross revenue thus negating the intention of the capital allowances.

For low-margin businesses, minimum tax is further likely to conflict with section 15(4) of the ITA. This section allows businesses to carry forward business losses for

10 years. Currently, a company can take a tax relief for losses reported in previous 10 years in a year it reports a profit. However, minimum tax will be a final tax. Low margin businesses are unlikely to report significant profits higher than minimum tax that can enable them recover previous years' operating losses. As such, it will be meaningless for these companies to carry forward business losses. In consequence, these businesses will bear an additional burden since the minimum tax cannot be set off against future tax liabilities.

Based on the above evaluations, implementation of the minimum tax appears to be deficient of the spirit of the economy. Any type of tax should consider both the welfare of the government and that of the taxpayer. However, it seems minimum tax only considers additional government revenue while failing to protect the survival of most businesses in Kenya.

The implementation of minimum tax, as a new tax, also comes at a time when the government is planning to reverse the Covid-19 tax reliefs on the turn of the new year, 2021. This move will see reinstatement of corporate income tax rate to 30% from the current 25% for resident companies. Value Added Tax (VAT) rate will be reverse to the former rate of 16% from the current rate of 14%.

In the middle of one of the biggest health and economic crisis that has seen various firms scaling down their operations or even shutting down, implementation of minimum tax is likely to hurt most businesses. There is definitely a larger call to consider more than the immediate revenue targets by the Government. The KRA should consider providing a mechanism to exempt companies in low margin sectors and those in infancy stages of operations from minimum tax to safeguard their survival.

Samuel Maina
Tax advisor
KPMG Advisory Services Limited
E: samuelmaina@kpmg.co.ke

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