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

KPMG analysis

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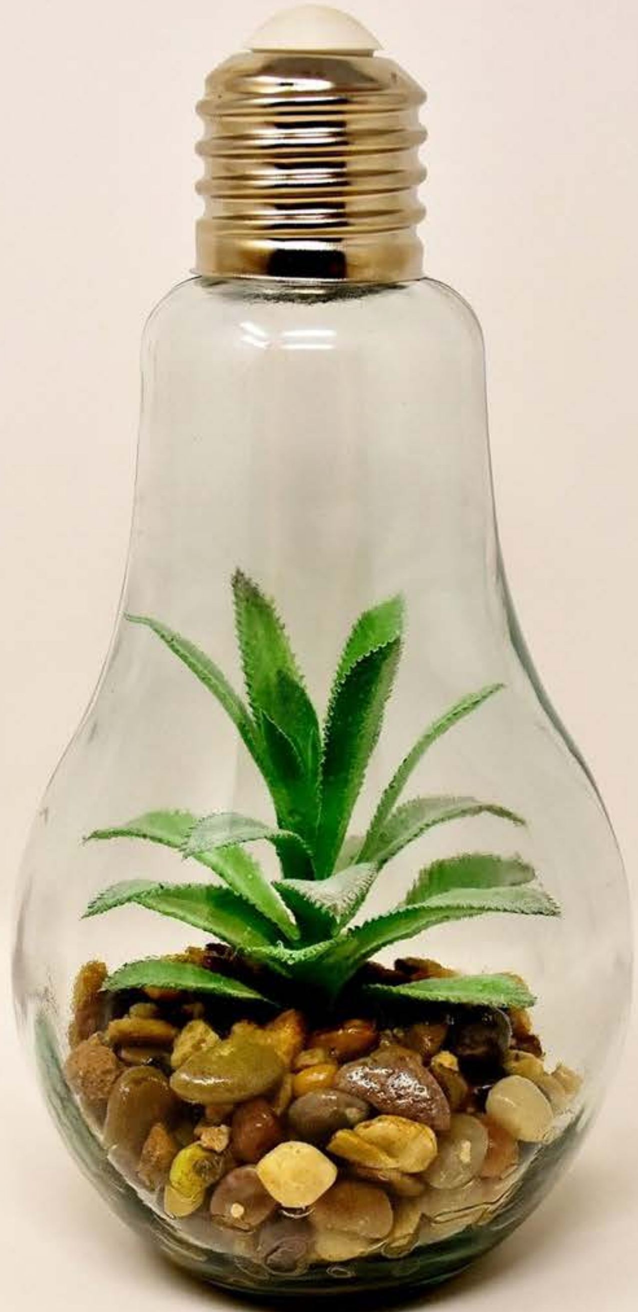


Preamble

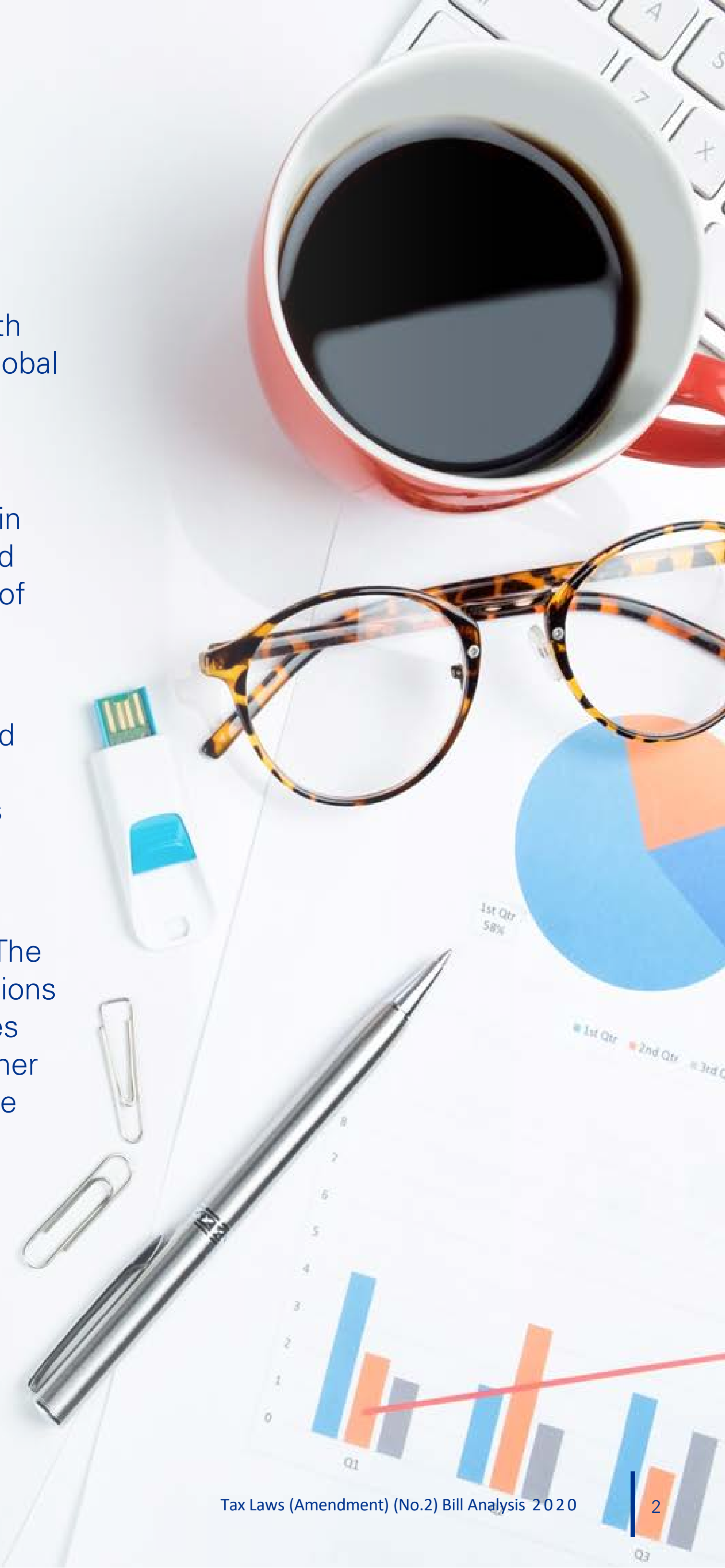
The Coronavirus disease (COVID-19) has had a devastating impact on people's health and livelihoods both in Kenya and in the rest of the world since it was declared a global pandemic. Almost a year later, businesses and people are still grappling with the resulting social and economic impact.

The survival of individuals and business is threatened by the continued supply chain disruptions, weakening of the Kenyan Shilling against the major currencies, reduced consumer spending and the ever present threats to health in light of a resurgence of COVID-19 infections.

As businesses continue adapting to the new operating environment, the Kenyan government is coming to terms with the widening budget deficits due to increased demand for funding for the Covid-19 mitigation measures amid declining tax collections on the back of declining demand, shutdowns of critical sectors such as tourism and reduction in payroll taxes due to increased lay-offs and salary reductions.

Amid these competing needs on **27 November 2020**, the government published The Tax Laws (Amendment) (No.2) Bill 2020. The Bill seeks to reinstate the tax concessions that the government had provided to mitigate the impact of Covid-19. Critical changes include reinstating corporation tax to 30% and the top PAYE band to 30% among other measures. The Government has also gazetted it intention to return the VAT rate to the pre-Covid-19 rate of 16%.

We provide in the ensuing pages our analysis of the proposed changes which take effect from **1 January 2021.**



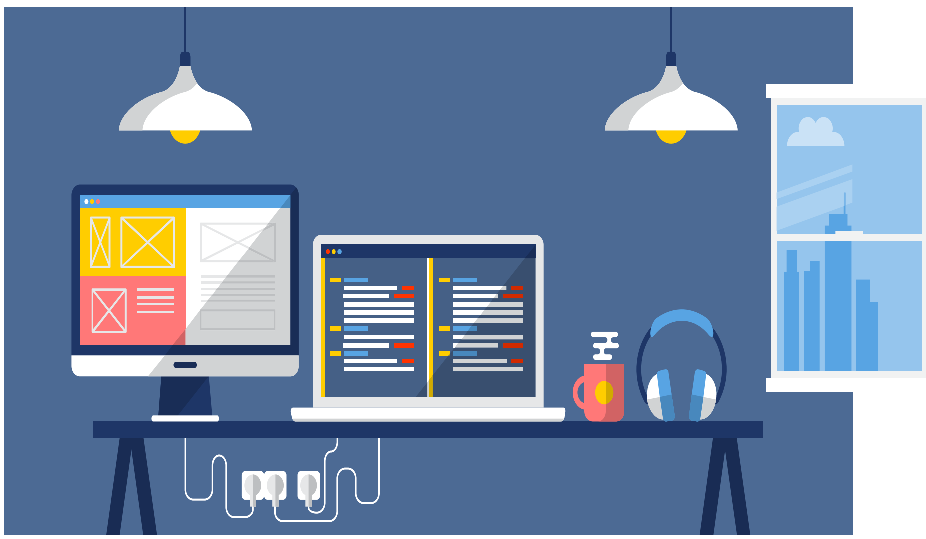
Income Tax

Effective from 1 January 2021

Clarification on Minimum Tax

Proposed Provision: The Tax Laws (Amendment Act) (No.2) Bill, 2020 proposes to amend section 12D (1) (c) so as to make it a requirement to pay minimum tax for persons whose instalment tax is lower than the minimum tax. The current provision provides for the payment of minimum tax for persons whose instalment tax is higher than minimum tax which is not consistent with the proposed operation of minimum tax.

Implication: This is a correction of a drafting error in the Finance Act, 2020, and provides clarity that a minimum tax is payable where the instalment tax is lower than the minimum tax.



Reinstatement of 30% corporation tax

Proposed Provision: The Bill proposes to reinstate the 30% corporation tax rate for resident companies for the year of income 2021 and subsequent years.

Further, the Bill proposes to include a proviso to the effect that the 25% corporation rate shall apply to income earned from 25th April 2020.

Implication: The proposed increase in the corporation rate will mean that despite the current economic challenges, companies will need to dig deeper to settle their tax liabilities.

Further, the proposed proviso will introduce challenges during the computation of the 2020 annual tax liability and filing of tax returns given that it is expected that resident companies will be required to apportion their income prior to determining the annual tax position.

The proviso also appears to retrospectively change the application of the 25% rate especially for taxpayers who have already filed their tax returns based on the 25% tax rate.

It is important to note that when reducing the corporation tax rate the government also increased the withholding tax on dividends to non-resident from 10% to 15%. There is no mention of the reversion of the withholding tax rate to the pre-Covid-19 level, significantly increasing the tax burden on businesses.

Pay As You Earn

Effective from 1 January 2021

Reinstatement of 30% rate of tax for individuals

Proposed provision : The Tax Laws (Amendment) (No 2) Bill, 2020, proposes to amend the Individual PAYE bands as follows:

New Tax Bands		Old Tax Bands	
First KES 288,000	10%	First KES 288,000	10%
Next KES 200,000	15%	Next KES 200,000	15%
Next KES 200,000	20%	Next KES 200,000	20%
Next KES 200,000	25%	Above KES 688,000	25%
Above KES 888,000	30%		

Implication: The proposed bands provides for relatively lower tax burden compared to the bands in the Pre-COVID period due to the expansion of the tax bands.

The Bill does not propose to amend the personal relief which currently stands at KES 28,800 which therefore means that individuals earning less than KES 24,000 monthly (KES 288,000) continue to be exempt from income tax.

The maintenance of the personal relief at KES 28,800 is also a welcome proposal to tax payers in the other tax bands as it will also lead to a reduced income tax despite the reinstatement of 30% tax on incomes above KES 688,000.

Reinstatement of 30% rate of tax in respect of payments or withdrawals from pensions

Proposed provision: In line with the changes to the PAYE bands, the Bill has enhanced the tax bands for taxation of withdrawals from NSSF, registered pension funds and provident funds where the withdrawals are in excess of the tax-free amounts specified under Sections 8(4) and 8(5) of the Income Tax Act.

i. For withdrawals after the expiry of 15 years from the date of joining the fund:

New Tax Rate		Old Tax Rates	
First KES 400,000	10%	First KES 400,000	10%
Next KES 400,000	15%	Next KES 400,000	15%
Next KES 400,000	20%	Next KES 400,000	20%
Next KES 400,000	25%	Above KES 1,200,000	25%
Above 1,600,000	30%		

ii. For withdrawals before the expiry of 15 years from the date of joining the fund:

New Tax Rate		Old Tax Rates	
First KES 288,000	10%	First KES 288,000	10%
Next KES 200,000	15%	Next KES 200,000	15%
Next KES 200,000	20%	Next KES 200,000	20%
Next KES 200,000	25%	Above KES 688,000	25%
Above KES 888,000	30%		

Implication: As is the case with the PAYE Bands, the Bill also seeks to reinstate the 30% tax on withdrawals from pension schemes.

However, as is the case with the PAYE Bands, the proposed expanded bands for withdrawal before the expiry of 15 years provides for relatively lower tax burden compared to the bands in the Pre-COVID period.

Value Added Tax

Effective from 1 January 2021

Supplies by manufacturers to aid funded projects

Proposed provision: The Act proposes to amend Section 17 of the VAT Act by expressly providing that a registered manufacturer may make a deduction for input tax with respect to taxable supplies made to an official aid funded project as may be approved by the Cabinet Secretary in accordance with the First Schedule to the VAT Act.

Implication: This will translate to a huge win for local manufacturers who make taxable supplies to official aid funded projects which have approved as VAT exempt projects.

The VAT Act exempts goods purchased for the implementation of official aid funded projects. Therefore, in addition to the goods being exempt, the above proposal will allow manufacturers to claim input tax therefore improving cashflows for local manufacturers.

VAT rate reverts to 16% effective 1 Jan 2021

Provision: In exercise of his powers under Section 6(1) of the VAT Act, the Cabinet Secretary has published Legal Notice No. 206 of 2020 (dated 23 November 2020) to the effect that the standard VAT rate shall revert to 16% (from 14%) effective 1 January 2021.

This is in line with the sunset provisions in the Tax Laws (Amendments)(No.2) Bill discussed in this alert

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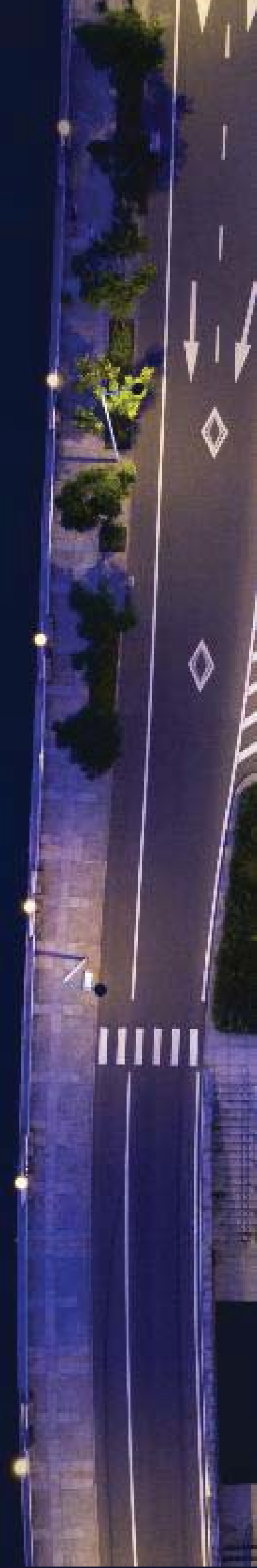

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