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The Tax Laws (Amendment) (No.2) Act, 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 layoffs and salary reductions.

Amid these competing needs, on **27 November 2020**, the government published The Tax Laws (Amendment) (No.2) Bill 2020 which was later assented to **on 23 December 2020** and published on **24 December 2020**. The Tax Laws (Amendment) (No.2) Act, 2020 (The Act) has reinstated the tax concessions that the government had provided to mitigate the impact of Covid-19. Critical changes include reinstating corporation tax to 30%, the VAT rate to 16% and the top PAYE band to 30% among other measures.

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

Income Tax

Effective from 1 January 2021

Clarification on Minimum Tax

Enacted Provision: The Tax Laws (Amendment) (No.2) Act, 2020 has amended section 12D(1)(c) of the Income Tax Act, making it a requirement for persons whose instalment tax is lower than the minimum tax to pay minimum tax . The old provision provided for the payment of minimum tax by persons whose instalment tax is higher than minimum tax which was not consistent with the expected operation of minimum tax.

Further, the Act has introduced an amendment to expressly include businesses whose retail prices are controlled by the Government and insurance businesses in the list of taxpayers required to pay minimum tax under Section 12D(1).

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

The second amendment appears to be a contradiction of the 22 December 2020 National Assembly deliberations as captured in the day's Hansard, which documents the intention to exempt income from products whose retail price is regulated and insurance businesses from minimum tax. We believe that the wording of the amendment under Section 12D(1) is an error. On 04 January 2021, KRA issued a Public Notice to the effect that the two categories of businesses are exempt from minimum tax, despite the wording in the Act. We anticipate that the error will be rectified in the Finance Act 2021.

Reinstatement of 30% corporation tax

Enacted Provision: The Act has reinstated the 30% corporation tax rate for resident companies for the year of income 2021 and subsequent years.

Further, the Act has included a proviso to the effect that the 30% corporation rate shall apply to income earned from 01 January 2021.

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

Further, the new proviso will introduce challenges during the computation of the 2021 annual tax liability for companies with non-December year-ends; they will be required to make separate computation for income earned in the calendar year 2021 and that earned in 2020.

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 foreign investors in Kenya..

Pay As You Earn

Effective from 1 January 2021

Reinstatement of 30% rate of tax for individuals

Enacted provision : The Tax Laws (Amendment) (No. 2) Act, 2020, has amended the Individual PAYE bands as follows:

Old Tax Bands (Pre-covid)		Old Tax Bands (Covid Period)		Proposed Bands in the Tax Laws (Amendment) (No.2) Bill		New Tax bands in the Act	
First KES 147,580	10%	First KES 288,000	10%	First KES 288,000	10%	First KES 288,000	10%
Next KES 139,043	15%	Next KES 200,000	15%	Next KES 200,000	15%	Next KES 100,000	25%
Next KES 139,043	20%	Next KES 200,000	20%	Next KES 200,000	20%	Above KES 388,000	30%
Next KES 139,043	25%	Above KES 688,000	25%	Next KES 200,000	25%		
Above KES 564,079	30%			Above KES 888,000	30%		

The new tax bands no longer have the 15% and 20% tax bands that existed in the Pre-Covid period. Further, there has been a revision of income subject to 30% from income above KES 888,000 to income above KES 388,000.

While the changes to the tax bands were not within the Bill, and therefore not subjected to public participation either, the National Assembly's intention (according to the Hansard) was to make the tax banding simpler by not having so many bands and also to protect those who earn KES 24,000 and below .

Implication: The Act has not amended personal relief which currently stands at KES 28,800 which therefore means that individuals earning less than KES 24,000 monthly will continue to be exempt from income tax. The maintenance of the personal relief at KES 28,800 is a welcomed position to tax payers.

Despite the changes to the tax bands in the Act, the net effect to tax payers is similar to the Pre-Covid time. Individuals will pay a slightly reduced amount of PAYE compared to Pre-Covid times. The individual tax in the Act is however higher when compared with the Old Bands in the Covid period.

Pay As You Earn

Effective from 1 January 2021

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

Enacted provision: In line with the changes to the PAYE bands, the Act 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 of the amounts in excess of the tax-free amount.	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 100,000	25%	Next KES 200,000	15%
Above KES 388,000	30%	Next KES 200,000	20%
		Above KES 688,000	25%

Implication: As is the case with the PAYE Bands, the Act has reinstated the 30% tax on withdrawals from pension schemes.

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

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Value Added Tax

Effective from 1 January 2021

Supplies by manufacturers to aid funded projects

Enacted provision: The Act has introduced an amendment to 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 been approved as VAT exempt projects.

The enacted provision allows for the making of a deduction for input tax and does not constitute eligibility for a refund because the VAT Act allows for a refund only where the Commissioner is satisfied that such excess arises from making zero rated supplies.

The above notwithstanding, the change will allow local manufacturers to claim input tax therefore improving their cashflows.

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 provisions in the Tax Laws (Amendment) (No.2) Act, 2020 discussed in this alert.

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