

Kenya enacts significant tax measures for 2021

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Executive summary

On 23 December 2020, the Kenyan President assented to the *Tax Law Amendment Act (No. 2) of 2020* (the Act). The Act amends the *Income Tax Act* and the *Value Added Tax (VAT) Act* of Kenya.

The key amendments made through the Act include the reinstatement of: (i) the resident corporate income tax rate to 30% from 25%; and (ii) the highest individual income tax band to 30% from the 25%. Additionally, the VAT rate was reinstated to 16% from 14% through a legal notice in accordance with the law. These rate changes became effective on 1 January 2021.

This year has been characterized by several major and far-reaching tax changes in Kenya. Some of the notable introductions into the tax landscape is the minimum tax at the rate of 1% of the gross turnover and a digital services tax at the rate of 1.5% of the transaction value.

Also, the introduction of a Voluntary Tax Disclosure Program, which will run for a period of three years beginning 1 January 2021, provides the opportunity for organizations to rectify any past gaps in tax declarations and payments.

This Alert summarizes the tax proposals contained in the Act and insights into the other critical tax changes that took effect on 1 January 2021. An EY Global Tax Alert that summarizes all the tax changes enacted by the *Finance Act, 2020* can be found [here](#).

Detailed discussion

Corporate income tax

Minimum tax

The Act has rectified a drafting anomaly in the *Finance Act, 2020* which introduced a minimum tax by ascertaining that the minimum tax is payable when the installment tax is lower than the minimum tax payable.

Minimum tax is payable at 1% of gross turnover of an entity.

However, in an apparent drafting error, the Act has expressly included into the ambit of persons who are subject to minimum tax the following categories of persons:

- ▶ Persons engaged in business whose retail price is controlled by the Government
- ▶ Persons engaged in insurance business

Based on the Parliamentary records, it was the intention of the legislature to exempt these categories of persons from minimum tax. The Kenya Revenue Authority (KRA) has in a subsequent public notice indicated that the above categories of persons are exempt from minimum tax. It is expected that the drafting error will be corrected in the subsequent *Tax Laws (Amendment) Act* or the *Finance Act 2021*.

Minimum tax will be payable in four installments by the 20th day of the fourth, sixth, ninth and twelfth month of the year of income.

The introduction of minimum tax is aimed at boosting government revenue but has received criticism from various quarters due to the likely negative impact on some sectors.

Corporate income tax rate

The Act has reinstated the corporate income tax (CIT) rate for locally incorporated companies to 30%. The higher rate will be applicable on income earned from 1 January 2021.

The Bill had proposed a restriction of the period within which the reduced CIT rate of 25% would apply but this was dropped by the National Assembly. The reduced CIT rate will apply to income earned in 2020 year of income.

The effects of the COVID-19 pandemic are still present and the reinstatement of the rate is likely to slow down the recovery of certain organizations.

Individual income tax

Individual Tax Rates

The Act has revised the individual income tax brackets by increasing the highest tax rate to 30% from 25%. The revised tax bands have also eliminated two tax bands that were previously available, that is, 15% and 20%.

Post COVID-19 tax band (annual)	Applicable tax rate (%)	Revised tax band (annual)	Applicable tax rate (%)
KES		KES	
On the first 288,000	10	On the first 288,000	10
On the next 200,000	15	On the next 100,000	25
On the next 200,000	20	Income above 388,000	30
Income above 688,000	25		

The revision of the individual income tax bands has an immaterial effect on the net income of individuals as compared to the pre-COVID-19 individual income tax bands. The increased disposable income under the post-COVID-19 tax bands will, however, be reversed and this will adversely affect individuals who had taken salary cuts in the period.

Pension withdrawal tax rates

The highest pension withdrawal tax rate has been reinstated to 30% for amounts above KES1,600,000 when withdrawn after 15 years or when the other prescribed conditions are met by an individual. The following tax band will apply to such income:

Pension band	Applicable tax rate (%)
KES	
On the first 400,000	10
On the next 400,000	15
On the next 400,000	20
On the next 400,000	25
Income above 1,600,000	30

For pension withdrawals before 15 years, the normal individual income tax bands will apply. The rates will apply to pension income after the tax-free portion.

Value Added Tax (VAT)

The Act has amended the *VAT Act, 2013* to allow manufacturers who have made taxable supplies to official aid funded projects, as may be approved by the Cabinet Secretary for the National Treasury, to claim the associated input tax.

The amendment seeks to encourage manufacturers to make supplies to official aid funded projects by allowing them to claim input tax which they were previously not able to claim since the supplies are exempt and as such the suppliers were not entitled to claim related input VAT.

Other critical tax changes that became effective on 1 January 2021

Voluntary Tax Disclosure Program

The *Finance Act 2020* introduced a Voluntary Tax Disclosure Program (VTDP). The program, which will run for a three-year period with effect from 1 January 2021, will cover income taxes, VAT and excise duty. Under the amnesty:

- ▶ A taxpayer will need to make an application (in the prescribed form) to the KRA, disclose all related material facts, and pay the principal tax due.
- ▶ A waiver of penalties and interest will be granted to taxpayers at a rate of 100%; 50% and 25% for disclosures made within the first, second and third year of the program running respectively, provided that the relief granted does not result in a refund to the taxpayer.

- ▶ Income of a taxpayer under audit (or in receipt of an intention to audit) by the KRA will not be eligible for the program.
- ▶ Upon granting of the relief, the taxpayer and Commissioner will enter into an agreement setting out the terms of the payment. The Commissioner will also have a right to withdraw the relief if he establishes that not all material facts were disclosed, and this could lead to prosecution.

The program will give organizations an opportunity to review and correct any tax compliance oversights that may have occurred over the past five years. Taxpayers are encouraged to participate in this program.

Digital services tax

Kenya has introduced tax on digital services from two fronts; an income tax front and VAT front.

The *Finance Act 2020* introduced a digital services tax (DST) on income from services provided through a digital marketplace in Kenya at the rate of 1.5% on the gross transactional value. This was followed by the issuance of the *Income Tax (Digital Service Tax) Regulations, 2020* which became effective on 2 January 2021.

The DST shall be payable by the digital service provider or the digital marketplace provider or the tax representative. A person liable to pay DST must submit a return in the prescribed form and remit the tax due by the 20th day of the month following the end of the month in which the digital service was offered. The Commissioner may appoint a taxpayer as a DST agent to withhold and remit the tax to the KRA.

DST paid by a nonresident person without a permanent establishment in Kenya is a final tax. On the other hand, tax paid under this regime by a resident person or a permanent establishment of a nonresident person, shall be offset against the income tax payable for that year of income.

A nonresident person without a permanent establishment in Kenya who provides a digital service to a user in Kenya may register under the simplified tax registration framework or alternatively appoint a tax representative in accordance with the *Tax Procedures Act*.

It is noteworthy that online services which facilitate payments, lending or trading of financial instruments, commodities or foreign exchange carried out by licensed financial institutions or approved financial service providers are exempt from DST.

From a VAT perspective, *Value Added Tax (Digital Marketplace Supply) Regulations, 2020* were issued in September 2020 with suppliers of digital services expected to register within six months of the publication of the Regulations.

The Regulations stipulate that VAT is chargeable on taxable services supplied in Kenya through a digital marketplace under a Business to Customer (B2C) transaction. Business to Business (B2B) supplies are treated as imported services, which are subject to reverse charge VAT.

Taxpayers who operate in the digital space and those who render services digitally should review how the introduction of DST will impact their operations.

Abolishment of incentives under Home Ownership Savings Plans (HOSP)

The *Finance Act 2020* repealed exemptions previously granted on incomes accruing to a registered Home Ownership Savings Plan (HOSP).

Additionally, contributions by individuals to a HOSP will not qualify as an allowable deduction when determining the taxable income. Interest income earned on deposits in a HOSP will also be subject to tax as opposed to previously where the initial KES3 million was exempt from tax.

The repeal of the tax exemption of a HOSP and deductions on contributions will discourage the use of such plans for home ownership which is not in line with an objective of the Government's Agenda to increase access to housing.

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EYG no. 000182-21Gbl

1508-1600216 NY
ED None

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