INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

INCOME TAX POLICY – Looking Ahead

Presentation at the 4th Annual Tax Convention

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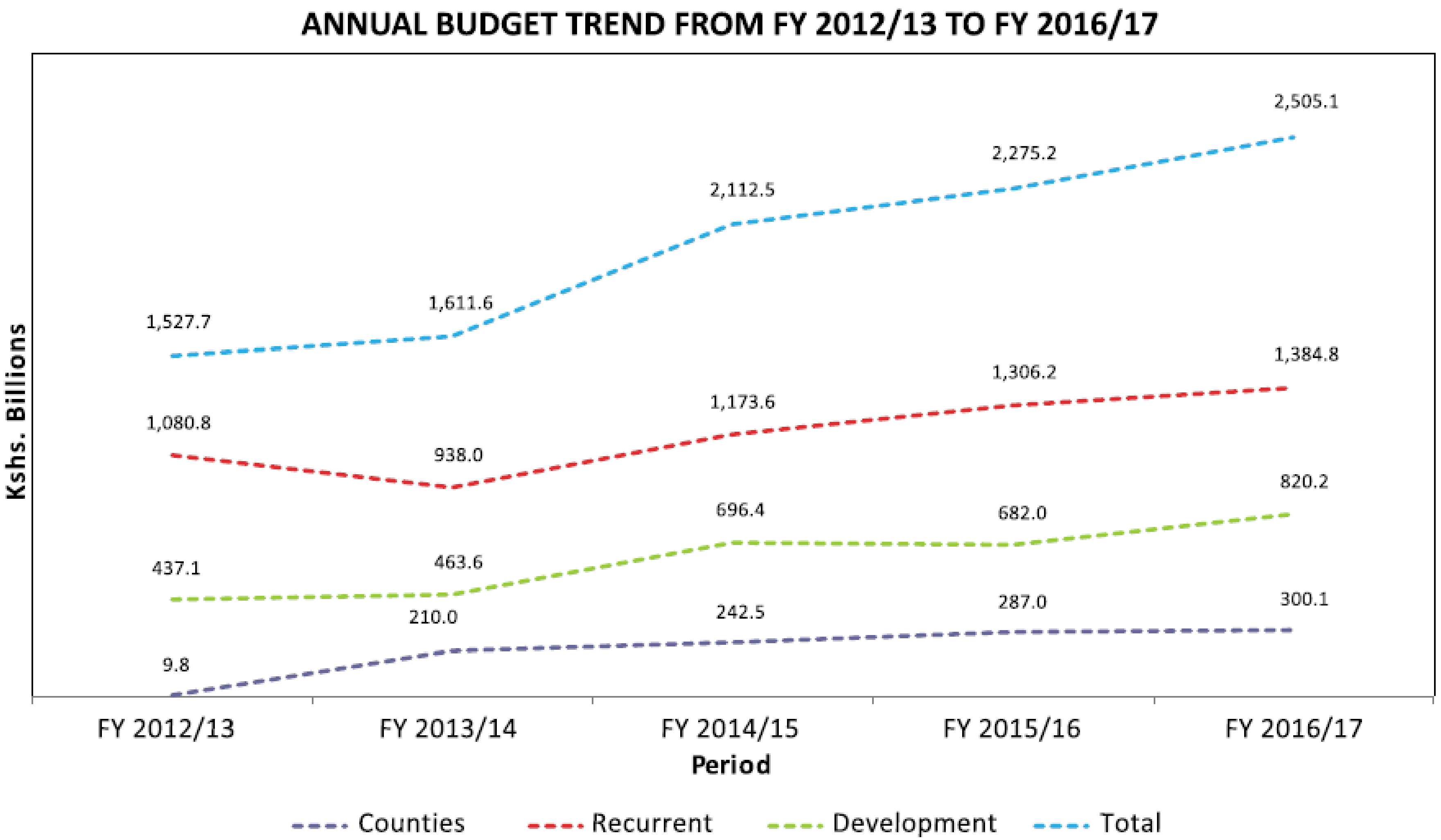
Macro Economic Environment

Macro Economic Variables	2012	2013	2014	2015	2016
Population (million)	40.7	41.8	43.0	44.2	45.5
GDP per capita (USD)	1,243	1,322	1,433	1,427	1,558
GDP (USD Bn)	50.6	55.3	61.6	63.1	70.8
Economic Growth (GDP, annual variation in %)	4.5	5.9	5.4	5.7	5.8
Consumption (annual variation in %)	5.7	8.5	4.6	5.1	4.8
Investment (annual variation in %)	12.7	1.2	14.8	6.7	-9.3
Industrial Production (annual variation in %)	4.1	5.4	5.3	6.1	6.0
Fiscal Balance (% of GDP)	-6.0	-6.8	-7.0	-9.6	-8.1
Public Debt (% of GDP)	42.1	44.5	45.9	50.4	53.5

National Budget - Trends



Overall Revenue - Performance

KSh Million

	2012/13	2013/14	2014/15	2015/16*	2016/17+
Taxes on income, profits and capital gains	**373,086.04**	**449,590.07**	**509,159.84**	**569,811.18**	**662,854.07**
Income tax from individuals (P.A.Y.E)[1]	199,847.16	249,872.80	279,795.65	286,166.16	343,772.88
Income tax from corporations (other income tax)	173,238.88	199,717.27	228,785.25	279,834.49	316,030.12
Capital gains taxes	..	..	578.95	3,810.54	3,051.08
Taxes on property	**653.73**	**0.00**	**0.00**	**88.26**	**100.00**
Immovable property	169.58	0.00	0.00	0.00	0.00
Financial and capital transactions	484.15	0.00	0.00	88.26	100.00
Value Added Tax (VAT)	**184,916.31**	**232,630.32**	**259,685.20**	**289,213.47**	**338,680.18**
VAT on domestic goods and services	90,713.83	107,737.35	127,904.57	160,389.01	191,149.88
VAT on imported goods and services	94,202.48	124,892.97	131,780.63	128,824.45	147,530.31
Taxes on other goods and services	**114,821.86**	**125,363.91**	**140,243.32**	**162,593.81**	**205,016.46**
Excise taxes	85,660.29	102,029.10	115,871.72	139,540.34	178,366.69
Taxes on use of goods and on permission to use the goods or to perform services and activities	2,458.44	4,910.49	4,650.51	5,780.10	7,751.18
Taxes on goods and services collected as AIA	26,703.12	18,424.32	19,721.08	17,273.37	18,898.59
Taxes on international trade transactions	**81,812.59**	**94,232.51**	**101,040.90**	**104,433.27**	**119,643.24**
Custom duties	57,649.68	67,554.64	74,047.72	79,187.93	90,397.91
Other taxes on international trade and transactions	24,162.91	26,677.87	26,993.18	25,245.33	29,245.33
Other taxes not elsewhere classified	**8,537.81**	**9,986.89**	**11,467.76**	**10,423.54**	**11,990.10**
TOTAL TAX REVENUE	**763,828.34**	**911,803.70**	**1,021,597.03**	**1,136,563.52**	**1,338,284.06**

Kenya's Tax Reform Path

1960's – 1980's : Public spending was financed through taxes and fees inherited from the British

- 1970 : The global oil crisis led to Kenya's first fiscal crisis triggering some reforms;
  - Introduction of Sales Taxes and trade taxes to generate extra revenue and reduce trade deficits
- 1980's : Cabinet adopted Sessional Paper 1 of 1986, to introduce the Kenya Tax Modernization Programme (TMP) to improve revenue raising capacity and tax efficiency.

Kenya's Tax Reform Path – Cont'd

ICPAK
Uphold Public Interest

1995 : Incorporation of Kenya Revenue Authority (KRA) through the KRA Act Cap 469 overhauled the legislative framework that existed since independence.

2004/2005 : Revenue Administration Reform and Modernization Program adopted by the KRA to address challenges due to the manual system. Some key reforms include;

- Integrated Tax Management System (ITMS)
- Electronic Tax Registers (ETR)
- Simba 2005 system (S2005S)
- Now the famous iTax -

Clamour to Reform ITA

- Since 1974, the year the Income Tax Act (ITA) was established, reforms surrounding income tax in Kenya have been a **“patch work”** of amendments through various Finance Acts, with minimal policy reforms.

- The increase in government spending places the discussion on **revenue generation** at the center of any development discussion. Direct Taxes drive KE’s revenue…… Some facts;
  - 96% of Kenya’s revenue is generated through taxation (FY 2010- 2015)
  - Direct taxes, being Income Tax on labour and capital, contribute an average of 45% to tax revenue (FY 2010-2015)

Clamour to Reform ITA – Cont'd

- Globalization has forced businesses to move away from **traditional approaches** to conducting business. As such, the business regulatory space and taxation laws need to be reviewed and amended accordingly.

- Information Technology (IT) remains a critical tool in facilitating business. Tax administration needs to adopt effective use of IT to improve revenue administration.

How Best to Address – the Gaps

- The ITA Regime too old….too patched so that very complex to administer;
- Need for Review **(OVERHAUL)** becomes necessary
- Develop a Income Tax Policy Framework to guide review that is to be guided by an overall goal –

ICPAK PROPOSED POLICY OBJECTIVE

" To design an income tax system that efficiently facilitates equitable revenue mobilization to enable sustainable socio economic development"

Key Issues

1. Definition of Income
   - Is the current definition of income comprehensive?

2. Economic diversification
   - What drives the Kenyan economy in 2017
   - How responsive is the act to emerging sectors

3. Tax Incentives
   - Is there an objective criteria to determine eligibility?
   - Are these aligned to the economic agenda?

4. The digital economy
   - Can we track transactions to effectively tax incomes generated from this economy?

Key Issues

5. Data Management
   - Does the framework facilitate effective data management to support data analytics?
   - Integration of various data sets ?

6. International Taxation
   - Double taxation : Is it time for a discussion on World wide Income together with unilateral tax credits?

Key Issues

7. Harmonization
   - Accounting Standards
   - Existing Statutes
   - The Constitution

8. Taxation of Gains on Capital
   - Politics and CGT?
   - A policy on exemptions of sectors
   - Indexation to determine the capital appreciation?

Key Issues

9. Inflationary adjustment
   - Impact of Inflation on disposable Incomes
   - Knock on effect on consumption

10. Definitions and terminology
   - Do the definitions give clarity for tax purposes?
   - Unified interpretation (KRA vs Tax payer)
   - Standardized interpretations (Global practice)

Guiding Principles

- **SIMPLICITY -** Enables taxpayers readily understand and determine their tax obligations
- **EQUITY -** Addresses the issues of progressivity, redistribution
- **NEUTRALITY -** Treats similar activities the same
- **CERTAINTY -** clarity on the various aspects of taxation
- **PRODUCTIVITY -** ensures that the tax system yields adequate revenues
- **EFFICIENCY -** ensures that revenue collection is undertaken economically

Some Key Considerations

- **Simplify it!**

The simplification of Kenya’s ITA should enable both tax payers and tax advisors to readily understand and determine their tax obligations, thereby improving the level of tax compliance.

- **Harmonize with existing laws**

The review should therefore endeavor to align provisions in the ITA with current legislations as well as old revenue acts, in order limit inconsistencies that would hamper implementation of the Act.

Cont'd

- **Neutrality**

- The tax system that treats all income similarly achieves neutrality over the form in which income is received **minimizing distortions** over people's choices and behavior such as choices between debt and equity finance.

- A neutral income tax regime will reduce incentives to engage in **tax avoidance** activities in order to reduce their tax liability

Cont'd

Uphold Public Interest

- **Broaden the tax base**

Move beyond revenue generation through the "low hanging fruits" (PAYE & Corporation Tax); taxing the <u>Informal Sector</u> depends heavily on formalization as businesses.

- **Align tax incentives to the overall economic agenda of the county**
  - Tax Incentives to boost economic activity, should reflect the overall development agenda of the Country (Vision 2030, MTEF etc)
  - Prioritize measures to broaden the tax base in order to reduce the incentives
  - Design incentives with emphasis on the analysis of the costs and benefits prior to their adoption

Our Recommended Approach

Develop and Income Tax Policy as a precursor to the overhaul of the ITA.

This approach allows the Country to identify the appropriate policy priorities and recommend the best approach to addressing Direct Taxation in Kenya

- Problem definition – You cant legislate to cure something you have not identified.
- Possible solutions - Policy development provides an avenue to explore all possible solutions to a problem.
- Reference point for subsequent review – the policy framework

OBJ 1: SIMPLIFIED INCOME TAX SYSTEM

OBJECTIVE

To create a **simplified income** tax system that enables tax payers to **understand, compute and comply** with their tax obligations

ACTIONS

1. Review complexities to design a responsive regime
2. Harmonize taxation of sectors with IFRS
3. Facilitate identification and tracking of economic activity through **the single identifier**

RISKS

1. The law making process is time consuming and requires political good will
2. Oversimplification creates room for varied interpretations.

OUTCOMES

- Enhanced ownership of the tax process by tax payers
- Increased tax payer compliance
- Enhanced revenue collection.

OBJ 2: EQUITABLE, NEUTRAL & PREDICTABLE INCOME TAX SYSTEM

OBJECTIVE

To enhance **stability in revenue collection** by **broadening the tax base** while facilitating **equity** in the tax burden

ACTIONS

1. **Incentive schemes** : support the dev' agenda.

2. Harmonize taxation system & promote stability in the business environment.

3. **Exemptions, deductions and exclusions** : Clear definition, Targeted, measurable and transparent criterion

5. Taxation of worldwide income and unilateral tax credit

RISKS

1. Political will

2. Inadequate resources

3. Changes in the political environment

OUTCOMES

- Redistribution of resources within the economy;
- Reduction of inequalities within the population
- Increase in the level of public and private sector investment
- Reduced incentives for tax avoidance, thus an increase in revenue.

OBJ 3: STABILITY IN REVENUE COLLECTION

OBJECTIVE

To facilitate an **equitable neutral and predictable** tax regime

ACTIONS

1. Integration of systems
2. Technology for data management
3. Optimal Tax rate : Best practice
4. Revenue forecasting : Appropriate models for accuracy.
5. Public awareness on value of paying taxes
6. Tax prosecutors to enhance enforcement capability

RISKS

1. Corruption and resistance by stakeholders
2. Integration of revenue data
3. Mobile nature of the informal sector

OUTCOMES

- Increased number of taxpayers
- Stability in revenue collection
- Certainty in revenue forecasting

OBJ 4: EFFICIENCY IN TAX ADMINISTRATION

OBJECTIVE	ACTIONS	RISKS
To enhance efficiency in tax administration through integration of the identification of individuals and businesses	1. Harmonize various laws to facilitate the registration of a **single identifier**	1. Harmonization of law is time consuming and may face resistance by stakeholders.

OUTCOMES

- Holistic view of the tax payer to monitor all economic activities of residents
- Increased revenues arising from a broadened tax base and enhanced taxpayer compliance
- Enhanced efficiency in tax administration through proper controls and monitoring of taxpayer activities

OBJ 5: ACCOUNTABLE AND TRANSPARENT INCOME TAX SYSTEM

OBJECTIVE

To promote accountability and transparency by the tax payer, government and tax administrator

ACTIONS

1. Review the penalty system on tax evasion
2. Leverage on simplified IT to enhance integration of info
3. Incorporate tax courses in the school curriculum

RISKS

1. Cyber attacks on IT infrastructure
2. Low uptake of technology

OUTCOMES

- Transparent and accountable tax system
- Reduced revenue leakages
- Reduced dishonesty through tax planning
- Limited discretion in granting exemptions
- Reduced cost of tax administration

OBJ 6: ENABLING SUSTAINABLE ECONOMIC DEVELOPMENT

OBJECTIVE	ACTIONS	RISKS
To promote sustainable economic development in Kenya.	1. Periodically align Income Tax policy to development agenda 2. Progressivity for wealth redistribution 3. Environmental sustainability for development	1. Political will in implementing policy actions 2. Corruption – loss of resources and derail econ agenda.

OUTCOMES

- Sustained economic growth rates in line with the broader economic policy
- Reduced inequality facilitated by redistribution
- Reduced poverty levels through equitable employment of factors of production
- Sustained environmental responsibility in economic development

CONCLUSION

- An optimal direct tax system balances the following;

  1. Equity
  2. Efficiency
  3. Yield optimal utility to all participants in the economy.

- Direct tax is a tool, the intention is to facilitate economic development – NOT revenue collection.
- Policy making is an executive function of the national government, our prayer is that this would be adopted as a National Policy to tax Income in Kenya.

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