

Expanding the Tax Base in Kenya: A Case for Innovation

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Introduction

Introduction



- Taxation is the largest source of government revenue in Kenya
- The expansion of the economy has seen an increase in the National Budget to *KES 2.287 Tn* for FY 2017/18
- Revenue collection targets for Kenya Revenue Authority (KRA) - *KES 1,549.4 Tn* in FY 2016/17
- Revenue collection increased by 13.8% between FY 2016/17 and FY 2015/16

Broadening the tax base vis à vis raising taxes

An ambitious plan...



Growth Rates of Revenue Estimates and Actuals



Actual vs Estimated Revenues – the gap.

Source PBO, Aug 2017

Broadening the tax base



- Identifying the ideal tax base
- Eliminating tax loopholes
- Remove preferential regimes
- Revenue-neutral tax reform
- Is everyone paying their fair share of taxes?
 - ✓ Oxfam's "Taxing for a more equal Kenya" report
 - ✓ Progressive vs regressive tax
 - ✓ Direct or Indirect tax?

What
does it
entail?



Why broaden the tax base?



- Reduce distortion in the economy (tax should not influence business decisions - inversions)
- Increase revenue collection
- Promote economic growth and Foreign Direct Investment (FDI)
- Reduce opportunities for evasion and avoidance
- Equitable distribution of tax burden amongst citizens



Introduction



Why do we need to expand the tax base?

- Efficiency – tax distortions impede economic growth, tax systems should be neutral!
- Equity – income redistribution through taxation, horizontal equity vs vertical equity
- Simplicity and compliance – complexity introduces compliance risks!

Does the Kenyan system respond effectively to the above?



Trends in Taxation

Global Trends...BEPS



Address the
tax
challenges of
the digital
economy

1

Neutralise the
effects of
hybrid
mismatch
arrangements

2

Strengthen
CFC rules

3

Limit base
erosion
via interest
deductions &
other financial
payments

4

Counter harmful
tax practices more
effectively, taking
into account
transparency
and substance

5

Prevent
treaty
abuse

6

Prevent the
artificial
avoidance of
PE status

7

Global Trends...BEPS



Develop rules to prevent BEPS by moving *intangibles* among group members 8

Develop rules to prevent BEPS by *transferring risks* among, or allocating excessive capital to, group members 9

Develop rules to Prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties 10

Establish methodologies to collect and analyze data on BEPS and the actions to address it 11

Require taxpayers to disclose their aggressive tax planning arrangements 12

Re-examine transfer pricing documentation 13

Make dispute resolution mechanisms more effective 14

Develop a multilateral instrument 15

Global Trends...MLI



A) Multilateral Instrument (MLI)

- Action 15 of the Base Erosion and Profit Shifting (BEPS) Action Plan introduced the Multilateral Convention
- Objective - to swiftly implement the international tax rules to bilateral tax treaties
- The Multilateral Convention is aimed at implementing Tax Treaty Related Measures to Prevent profit shifting.
- The signing ceremony of the Multilateral Convention took place in June 2017
- 70 countries have signed the MLI including Mauritius, Nigeria and Cameroon

Global Trends...MLI



- Objectives of the MLI
 - Inhibit treaty abuse
 - Neutralize effect of hybrid mismatch agreements,
 - Prevent artificial avoidance of PE status; and
 - To make dispute resolution mechanisms more effective
- Expected to increase the tax base for developing countries
 - ✓ BEPS looks to address these frictions in a way that respects tax sovereignty and resolves existing gaps

Other Global Trends



B) Carbon Emissions Tax / Environment Tax

- A carbon emission tax on emissions encouraging, people, businesses and governments to produce less CO₂ and other greenhouse gases
- The carbon tax burden would fall most heavily on energy-intensive industries and lower-income households
- Policymakers could use the revenue to offset the impact of the gases, invest in clean energy, and climate adaption or for other uses
- Carbon emission tax could raise a substantial amount of revenue while still helping in the eradication of global warming

Other Global Trends



C) The EU tax regime

➤ **Trend towards consumption taxes**

- Lower proportion from taxes on labour and other direct taxes
- VAT typically accounts for 54% and 75% of the Implicit Tax Rate (ITR) on consumption
- In Sweden, VAT represents just over 75% of the ITR which is the highest in the EU
- Energy taxes make up approximately 17% of the ITR consumption
- Tobacco and alcohol taxes account for 7% of the ITR on average across Europe

Global Trends...the EU



- High VAT rates with the highest being in Hungary at 27% followed by Croatia, Denmark and Sweden all at 25%
- The lowest rate is Luxembourg at 17% and Malta at 18%.
- The EU average top rate of tax on corporate income fell from 22.5% in 2016 to 21.9% in 2017
- The EU countries have shown a general trend towards reducing the corporate tax and increasing the indirect taxes such as VAT
- Environmental tax revenue as a percentage of the GDP has seen a steady rise since 2009 now at a rate of 2.4% of the GDP

Should we reduce corporate income tax? Or introduce a graduated scale to encourage SMEs?

Local Trends...KRA is watching



- Some of the measures being taken by the KRA to prevent tax avoidance and evasion include:
 - Implementation of BEPS action plans – sharing of information, Tax Inspectors Without Borders (TIWB)
 - Changes in legislation – countering aggressive tax planning?
 - Deactivation of inactive PINs
 - Withholding rental income agents
 - Limitation of benefits rules
 - Taxation of foreign assets
 - Re-write of tax treaties eg Kenya - India DTA

Local Trends...KRA is watching



- Increased and intelligence driven tax audits
- Income Tax overhaul
- Re-organisation at the KRA: Customs & border control and ITO department

Greater:

- regulation of tax agents
- revenue pressures - more stringent application of penalties
- convergence of regulation
- swing towards transactional taxes

Identifying new or un-taxed bases

Expanding the base



Important factors to consider

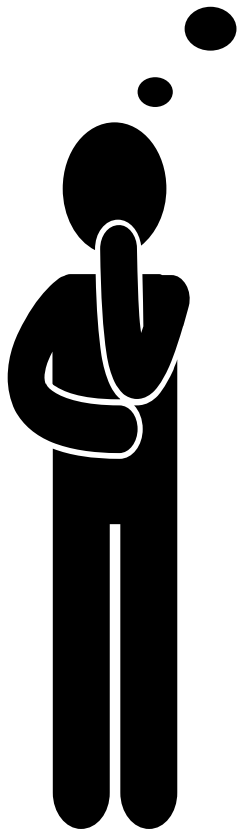


- What are the virgin revenue bases – wealth tax?
- Increasing tax rate may not translate into a direct increase in the tax base in Kenya
- Do tax incentives help or hurt – USD 1.1bn p.a. lost to incentives?
- Tax Reform should broaden the tax base and minimize tax avoidance opportunities
- Tax reform should encourage economic growth...to spur consumption and result in more tax revenues

Expanding the base



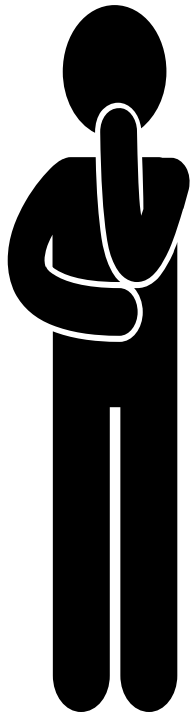
- Environment taxes
- Increase indirect tax rate and scope
- Zero rate more basic goods to ensure equity
- Taxation of the informal sector
- Increase CGT rate?
- Tax the capital gains on listed securities – holding provisions?
- Reintroduce inheritance tax
- Super tax bands for higher taxable-income thresholds to better match the skewed distribution of income – graduated CIT?



Expanding the base



- Alternative Minimum Tax (AMT) for loss making entities?
- Introduce a Stamp Duty Land Tax on the purchase of an additional home - UK introduced an SDLT in 2016 at a graduated scale in addition to Stamp Duty
- Can we make a case for tax credits for growing families and lower income households?
- Greater focus on taxing consumption over investment – money spent now vs money spent later
- Increase accountability – public resource distribution reports to justify tax collection...a *quid pro quo*?



Expanding the base



The role of policy making

- Evaluate the trade offs between growth and equity – what are the effects of reform on the fiscal regime?
- Are individual taxes progressive or regressive?
- Can tax benefits increase the disposable income of poorer households rather than reduced VAT?
- Technocrats vs experts? How can we influence policy making?

Expanding the base



Taxation of Informal Sector

- In 2012 it was estimated that the informal sector in Kenya contributes in excess of 35% to the GDP and employs close to 80% of the workforce
- The KRA estimates that tax losses from the sector amount to between *KES 60 billion* to *KES 80 billion* a year
- Turnover tax – applicable to persons whose turnover from business does not exceed *KES 5 million* during any year of income.

❖ Practicality of the turnover tax?

Expanding the base



Indirect taxation

- Generally goods consumption has gotten smaller while service consumption has increased (Netflix vs VHS or DVDs)
- If a country is taxing a small number of things, the rate has to be higher to make up for it, increase the base of consumption taxes while reducing the income taxes
- Often politically easier to increase rate than to add traditionally exempt transactions to the base
- Countries are moving towards the expansion of indirect taxes

Redefining the current tax base

Redefining the current base



- ❑ Broadening the tax base should include:
 - ✓ Establishing a simpler and more equitable tax code
 - ✓ Ending preferential tax regimes for certain economic activities
 - ✓ Eliminating distortionary provisions – high rate of CIT for large and small taxpayers
 - ✓ Efficient resource allocation
 - ✓ Harmonizing taxes – CIT, VAT, PAYE, Customs and Excise should complement one another
 - ✓ Review our policy making objectives – tax

Redefining the current base



- ✓ Transparency and accountability will be key to identifying opportunities for taxation
- ✓ Develop taxpayer knowledge – KRA tax alerts and guides?
- ✓ Transparency about expenditure of tax revenue
- ✓ Efficiency and equity should be at the centre!

Broadening the tax base requires boldness

INTERACTIVE SESSION

