

**INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA**

# **INCOME TAX POLICY UPDATES**

*The Context, Objectives, Strategies & Risks of the proposed tax legislation*

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**By**

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# OBJECTIVE



Share  
information  
on progress,  
so far, in the  
reform of  
Income Tax

Source for  
views on  
review of  
Income Tax  
Act

# OUTLINE



1. —————→ KENYA'S TAX HISTORY
2. —————→ KENYA'S TAX REFORM PATH
3. —————→ THE CLAMOR TO REFORM ITA
4. —————→ THE GUIDING PRINCIPLES
5. —————→ STRATEGIC POLICY OBJECTIVES
6. —————→ KEY SECTOR PRIORITY AREAS
7. —————→ POTENTIAL RISKS TO REFORM

# BACKGROUND



- ❑ ICPAK's Analysis of Kenya's revenue portfolio(FY 2010-2015) reveals 96% reliance on taxation;
  - ❑ Income tax contributes an average of 45% of tax revenue in Kenya;
- ❑ Thus, tax reforms must target & prioritize the income tax regime in order to ensure sustainability in revenue generation;
- ❑ The CS-National Treasury identified reform of the Income Tax Act(ITA) as a priority in his Budget Statement in FY 2017/18

## ■ Taxation in Kenya has always existed **BEFORE 1897**

- Taxation in Kenya started way before colonial rule, however this was mainly informal.
  - Community Level
  - Religious Influence
  - Capitation Tax – Trading of humans for slavery
  - *Commodities*
  - *Customs*

## POST 1897

- 1897 was the year Kenya was annexed from the Imperial British East African Company (IBEACO) to the Crown.
- They immediately introduced Direct taxation

# Cont'



1900's : Kenya adopted its first tax laws

1. The Hut Tax
2. Land Tax
3. Graduated Personal Tax: **1933**
4. Income Tax : 1921 & 1954

# 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 - Lead to Kenya's first fiscal crisis. This triggering some reforms;
- 1980's :Sessional Paper 1 of 1986.

Introduced the Kenya Tax Modernization Programme (TMP)



- ❑ 1995 : Incorporation of Kenya Revenue Authority (KRA)
- ❑ 2004/2005 : Revenue Administration Reform and Modernization Program adopted by the KRA
- ❑ Post 2010 – VATA(2013), TPA(2015), EDA(2015), TATA (2015)

# THE CLAMOUR TO REFORM ITA



- ❑ “Patch work” of the law in addressing challenges to taxing income in Kenya.
- ❑ The increase in government spending.
- ❑ Impact of Globalization
- ❑ Information Technology

# APPROACH: REWRITE OR REVIEW?



Different jurisdictions have adopted varied approaches when amending & simplifying their tax laws:

- ❑ **Rewrite:** Some have simplified tax statutes through a “rewrite” of the law retaining underlying core principles.
- ❑ **Review:** Others have gone deeper by reviewing the policy principles surrounding the tax law
- ❑ Review further entails addressing substantive policy & conceptual issues to promote progressivity of the tax law, eliminate distortion & ensure equity

# ICPAK PROPOSAL ON REFORM OF INCOME TAX



## RE-WRITE

- Incorporate tax policy reform essential to the review of the Act and not merely reorganizing and redrafting the law
- Prioritize development of an Income Tax Policy to guide the review process
- Consolidate all matters related to Income Tax law, excluding matters addressed by the Tax Procedures Act
- Utilize exposure drafts to invite professionals and the public for views on both policy and law
- Adopt international best tax practices(OECD, UN Model Convention), accounting & auditing principles
- Utilize case law that has been determined to shape various provisions of the ITA

# KEY CONCERNS

**SITUATIONAL**

**ANALYSIS**



# 1. DEFINITION OF INCOME



- ❑ Definition of income a primary pillar in development of the income tax policy. - **The current framework does not accurately define income for taxation purposes**
- ❑ Should be guided by an appropriate criterion that facilitates the taxation of all sectors

## **Policy Measure(s)**

❖ *Treatment be simplified in accordance with accounting standards ---- Income should be taxed; expenditure allowable*

## 2. ECONOMIC DIVERSIFICATION



- ❑ Current ITA is framed around an economy driven by Agriculture & Manufacturing.
- ❑ However, the Kenyan economic environment has significantly changed since 1974.

### **Policy Measures**

- ❖ *Modernize the act to facilitate taxation of other sectors*
- ❖ *Review to facilitate the recognition of Income captured outside the traditional financial system*

### 3. TAX INCENTIVES



- ❑ The bulk of amendments touching on tax incentives have been primarily driven by political and private interest

#### Policy Measures

- ❖ *Define broad parameters and sectors that require incentives*
- ❖ *Facilitate reliefs across the value chain, motivate investment into innovation, research & development and align to the country's overall economic agenda*



# 4. INTERNATIONAL TAX



## ❑ Double Taxation

- ❑ Globally, countries tax income based on both residence & source.
- ❑ Due to this, cross border transactions risk being taxed twice- both in the source country & in the country of residence

## ❑ DTAs and Limitation of Treaty Benefits

### Policy Measures

- ❖ *Review policy interventions around development & ratification of treaties to facilitate implementation of DTAs.*
- ❖ *Provide for unilateral tax credits on foreign tax paid on income that would be subjected to taxation in Kenya.*

## 5. DIGITAL ECONOMY



- ❑ Digital business models have disrupted traditional trade flows, posing significant challenges to the collection of taxes in the current tax regime.

### Policy Measures

- ❖ *Due to the global nature of the digital economy, consider utilizing the BEPS Action 1:*
  - ❖ *BEPS Action 1 -recommends that profits are reported where the economic activities that generate them are carried out;*
- ❖ *Develop an overarching policy to guide the taxation of intangibles & provide guidelines for transfer pricing*

## 6. DATA MANAGEMENT



- The increased demand for tax transparency has necessitated Data management involves effective procedures to facilitate the acquisition, validation, storage & protection of data.

### **Policy measure(s)**

- ❖ *Develop an economy wide data management policy*
- ❖ *Enhance digitization of information gathering, to facilitate ease of access, management & consolidation of data.*

# 7. HARMONIZATION WITH ACCOUNTING STANDARDS



- ❑ Kenya adopted International Financial Reporting Standards(IFRS) in 1999 providing set of rules to abide by when preparing an entity's accounts

## ❑ Policy Measures

- ❖ *Basic accounting principles such as revenue recognition should be adapted in the tax legislation*

- ❖ *Utilize the definitions provided in IFRS's to define various taxation aspects including leasing, marketing instruments and other provisions in scheduled 2.*

## 8. TAXATION OF CAPITAL GAINS



- ❑ Taxation on Capital gains was first incorporated within the Kenyan income tax legislation in 1975;
- ❑ In 1985, the tax was suspended, reintroduced through the Finance Act 2014

### Policy Measures

- ❑ *Incorporate a clear policy to guide the exemption of various sectors in line with the development agenda of the Country.*
- ❑ *Incorporate a policy on indexation to determine the Capital Gain.*

# 9. INFLATIONARY ADJUSTMENT



- ❑ Inflation is the increase in prices of goods or the loss in purchasing value of money.
- ❑ As the cost of living goes up, income taxes(e.g Pay As You Earn (PAYE)), often grow faster than incomes.
- ❑ If these fixed income levels aren't adjusted periodically, taxes can go up substantially simply because of inflation.

## Policy Measures

- ❖ *Incorporate inflationary indexation in the taxation of all incomes.*
- ❖ *The index should capture overall economic environment of the nation to enhance the disposable income.*

# 10. INCOME TAX DEFINITIONS



- ❑ Certain definitions in the ITA have become obsolete;
- ❑ Need to enhance the understandability & unified interpretation of the income tax law

## Policy Measures

- ❖ *Include an Income Tax Dictionary to provide a glossary of terms & concepts for clarity;*
- ❖ *Consider globally accepted standards in defining various terms & concepts.*
- ❖ *Consider definitions provided in various legislative instruments for consistency in the application of the law.*

# 11. HARMONIZATION WITH CONSTITUTION OF KENYA



- ❑ Kenya is operating under a new constitutional dispensation
- ❑ Further, several statutes that have been enacted to modernize the regulatory environment for businesses- Tax Procedures Act, Companies Act etc.

## Policy Measures

- ❖ *Facilitate meaningful public participation at all stages of the review of the act.*
- ❖ *Align with the provisions of the Companies Act 2015*
- ❖ *Align with existing revenue statutes, to address the duplication and inconsistencies*



# STRATEGIC POLICY



**OBJECTIVES**

# GUIDING PRINCIPLES IN THE REVIEW OF ITA



## 1. Simplicity

- Readability, underlying concepts, layout, legibility and length

## 2. Equity

- Facilitate wealth redistribution within the economy

## 3. Widen the Tax Base

- Bring the Informal Sector in

## 4. Neutrality

- Minimize distortions over people's choices and behavior

# STRATEGIC POLICY OBJECTIVES



To create a simplified income tax regime;

To facilitate an equitable, neutral and predictable tax regime;

To enhance stability in revenue collection

To enhance efficiency in tax administration

To promote accountability and transparency

To promote the realization of Kenya's economic development agenda

# KEY POLICY PROPOSALS



**SO1:-  
Simplified  
Income Tax  
Regime**

- Complexity of the tax regime
- Erroneous computations
- Abuse of administrative procedures

**SO2:  
Equitable,  
neutral &  
Predictable  
Tax Regime**

- Design of incentives- Not targeted, quantifiable, abuse
- Lack of double taxation treaty policy

**SO3:  
Stability in  
revenue  
collection**

- Narrow tax base
- Erosion of the tax base – Digital economy
- Instability of the tax rate

# KEY POLICY PROPOSALS



## SO<sub>4</sub> : Efficiency in Tax Administration

- Lack of precision in the identification of tax payers
- Limited access to tax payer transactional information.



## SO<sub>5</sub> : Accountability & Transparency



- Revenue leakages
- Eliminate erroneous determination of tax liability



## SO<sub>6</sub>: Promote economic development agenda

- Retrogressive income tax policy
- Economic growth and development
- Equality

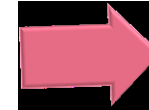
# POTENTIAL RISKS

## SO<sub>1</sub>: Simplified Income Tax System



- Review of legislation and process is time consuming.
- Over simplification could create room for varied interpretation and this could lead to disputes.

## SO<sub>2</sub>: Equitable, neutral &

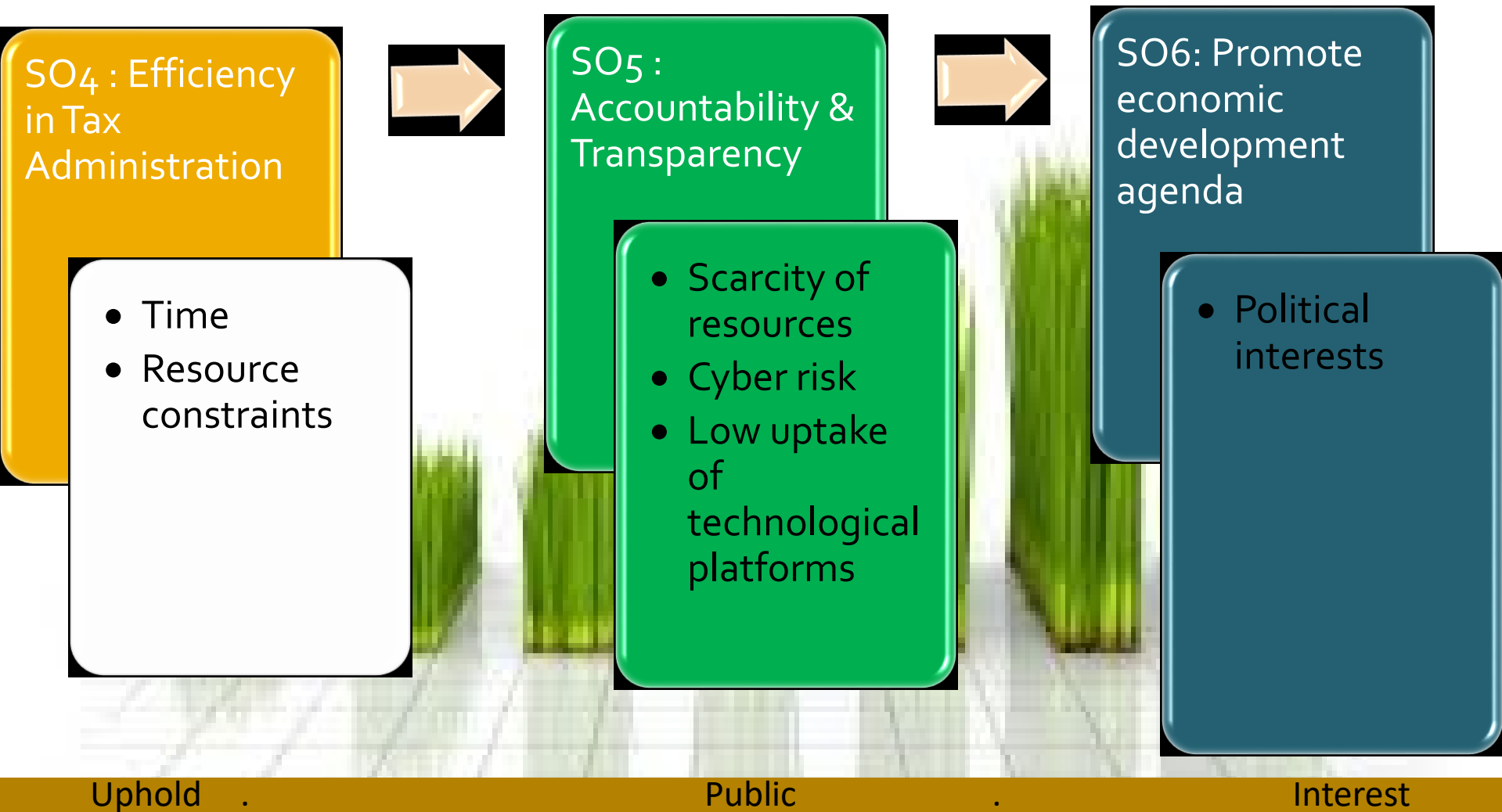


- Securing political will Complexity of taxation matters.
- Resource constraints to facilitate benchmark
- Change in political environment that could trigger change in development agenda

## SO<sub>3</sub>: Stability in revenue collection

- Corruption could impair implementation.
- Resistance from various stakeholders
- Lack of comprehensive revenue data to enable accurate forecasting
- Sufficiency of resources

# POTENTIAL RISKS...CONTD



# Key priority areas / Sectors





# AGRICULTURE



Simple taxation regime for the sector to facilitate the computation of tax in accordance with international standards.

Harmonization of the legal framework relating to agriculture.

Definition of Agricultural Income.

Aggregation of Small scale farmers to formalize this sector

Eliminate Middle men exploiting Small Scale Farmers

# MINING OIL AND GAS..



Design a taxation regime that reflects the investment characteristics of the industry.

Facilitate accurate verifiable & reporting of costs and income.

Harmonize taxation of the sector within one instrument.



# FINANCIAL SERVICES



Design a taxation regime that is flexible and responsive to emerging services within the sector.

Harmonize the taxation of financial services in line with IFRS & other relevant legal instruments.

Facilitate information sharing across jurisdictions for taxation purposes.

# REAL ESTATE



Recognition  
of income  
and expenses

Differential  
taxation for  
various  
regions

Facilitate reporting  
of all approvals for  
construction plans  
to the revenue  
authority.

# MANUFACTURING



Design targeted incentives that would encourage manufacturing for value addition and encourage exports.

Design a taxation regime that facilitates stability for the business environment

Cooperatives, member's clubs and trade associations

- Certainty and harmonization in the taxation of the sector.



# EXEMPTIONS



Design targeted incentives that would encourage manufacturing for value addition and encourage exports.

Design a taxation regime that facilitates stability for the business environment

Cooperatives, member's clubs and trade associations

Certainty and harmonization in the taxation of the sector.





**ON**

**WHAT'S  
YOUR VIEW**



# CONCLUSION



- ❑ An optimal direct tax system is one that strikes a balance between equity and efficiency concerns, while yielding optimal utilities to all the participants involved in the economy.
- ❑ All factors need to be appropriately considered to ensure that the design of the Income Tax regime facilitates an enabling environment for business, while promoting economic growth.



