AN OVERVIEW OF THE MINIMUM TAX PROVISIONS

OUTLINE

- Background
- Global Perspectives
- Impact to Kenya's Economy
- Policy changes
- Constitutional petition

LEGISLATIVE BACKGROUND

- **Section 12D** of the ITA provides:
- Notwithstanding any other provisions of this Act, a tax to be known as minimum tax shall be payable by a person if:
- (a) That person's income is **not exempt** under this Act;
- (b) That person's income is **not chargeable** to tax under section 5, 6A,12C, the Eighth or Ninth Schedule;
- (c) The instalment tax payable by that person under section 12 is **lower** than the minimum tax.
- (d) That person is not engaged in business whose retail price is controlled by the Government; or
- (e) That person is not engaged in insurance business.

LEGISLATIVE BACKGROUND

- Section 5, 6A,12C, the Eighth or Ninth Schedule refers to:
- (i) Pay As You Earn (PAYE) (section 5 of the ITA);
- (ii) Residential Rental Income Tax (Section 6A of the ITA);
- (iii) Turnover Tax (section 12C of the ITA);
- (iv) Capital gains subject to capital gains tax under the Eighth Schedule to the ITA; and
- (v) Income from companies in the extractives industry subject to specific taxation regime under Ninth Schedule to the ITA

LEGISLATIVE BACKGROUND

- On 29 January 2021, the KRA issued guidelines on minimum tax (Minimum Tax Guidelines), which define:

- (i) gross turnover to mean gross receipts, gross earnings, revenue, takings, yield, proceeds, sales or other income chargeable to tax under section 3(2) excluding a person's income which is chargeable to tax under sections 5, 6A, 12C, the Eighth or the Ninth Schedules and exempt income under any provision of the ITA;

- (ii) person to include an individual, company, partnership, limited partnership, association of persons or a trust;

LEGISLATIVE BACKGROUND

The Minimum Tax Guidelines also:

- confirm that minimum tax shall not apply to income:
- which is subject to **withholding tax**, including digital service tax, provided that at the end of the accounting period, the tax payable on taxable income exceeds minimum tax payable.
- However, there is no provision in the ITA exempting this income from minimum tax.

Practical implications

- Minimum Tax is a base income tax payable by **all persons** regardless of whether they make a profit or not
- ‘Persons’ include, individuals, companies, partnerships, and trusts
- Tax Rate – **1%** of the **gross turnover** of the entity
- Minimum Tax is paid in instalments due on the **20^{th} day of the 4^{th}, 6^{th}, 9^{th} and 12^{th} month** of year of income
- Minimum Tax shall apply where it higher than Instalment Tax
- Balance of Tax (on the last day of the 4^{th} month following the accounting year end) is due where the Minimum Tax/ Instalment Tax is less than the tax payable at the end of accounting period

Sample computation

Assuming this is Ali's tax liablity for the 2020 year of income				
For Ali				
	Amount (Ksh)	Rate (%)	Taxable Income (Ksh)	Tax liability (Ksh)
For the first	288,000	10	288,000	28,800
On the next	100,000	25	100,000	25,000
Above	388,000	30	2,612,000	783,600
			Total Tax liability	**837,400**
			Tax payable based on Prior Year basis (110% of Tax Liability)	921,140
			Instalment tax equally divided in four (4) equal instalments	230,285
		Instalment tax	**Due date**	
		1st instalment tax	20/04/2021	230,285
		2nd instalment tax	20/06/2021	230,285
		3rd instalment tax	20/09/2021	230,285
		4th instalment tax	20/12/2021	230,285
				921,140

Minimum Tax versus Instalment Tax

Minimum Tax versus Instalment Tax				
** Assuming the average quaterly gross legal fees is KES 35 Million*				
	Due Date	**Instalment Tax Due**	**Minimum Tax (1% on Gross Legal Fees)**	
1st instalment tax	20/04/2021	230,285	350,000	
2nd instalment tax	20/06/2021	230,285	350,000	
3rd instalment tax	20/09/2021	230,285	350,000	
4th instalment tax	20/12/2021	230,285	350,000	
		921,140	**1,400,000**	
* Minimum Tax will be payable over Instalment Tax since it is higher than Instalment Tax				
* At the end of the accounting period, Ali will compute actual tax payable and compare with Minimum Tax				
* If the actual tax payable is higher, than Minimum Tax, the balance is paid as BoT due on 31 April 2022				
* If the actual tax liability is less than Minimum Tax, Minimum Tax will be the final tax				

AFFECTED INDUSTRIES

(i) **Startup, MSMEs and new businesses.** It is highly unlikely that a new business would be profitable in the first five years of operation. There is need for such companies to be protected.

(ii) **Low margin businesses and capital-intensive businesses with tax incentives.**

(iii) **Genuine loss-making companies in both the public and private sector.**

(iv) **Public/Government companies in loss making situations will be greatly affected.** Currently, public companies continue to be making losses such as in the Aviation industry, telecommunications, sugar among others.

(v) **Manufacturing & Retail Sectors:** Our estimates indicate for Kshs 1Billion sales, the effective tax rate on profit under minimum tax is 46.56% as opposed to 30% corporation tax.

(vi) **Innocent taxpayers who are law abiding and dutifully paying taxes.**

AFFECTED INDUSTRIES

(vii) Aviation Industry:

(i) Adversely affected by the Covid-19 pandemic.

(ii)3-year recovery period needed as estimated by The International Air Transport Association (IATA) affecting Charter, Cargo, passenger services amongst others.

(iii)As example, passenger service operators' gross revenues include ticket cost and passenger service taxes. For instance, based on its 2019 reported financial statements, the turnover for Kenya Airways was:

→ **2019 Turnover = Kshs 121.6 billion**

→ **2019 Net Loss = Kshs 12.98 billion**

→ **1% Minimum tax = Kes 1.216 billion.**

HISTORY OF MIN TAX

- Imposition of income taxes based on an entity's gross revenue, similar to minimum tax, traces its way back to the 1930s with France and Germany as the main pioneers and partakers

LIMITATIONS

- Discriminative and went against the equity canon of taxation since they disadvantaged low-margin business.
- Turnover based taxes did not tax according to the affluence of the businesses which is measured by a company's bottom-line.
  Companies taxed under this regime became uncompetitive in the global market.
- Reduced direct foreign investments in domestic economies

OECD VIEW

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- OECD champions changes in tax policies aimed at ensuring all taxpayers pay their **fair share of taxes**.
- OECD Proposes introduction of a global minimum tax on **Multi-National Enterprises** as part of its Base Erosion and Profit Shifting ("BEPS") project.2
    - *Countries have a right to tax the profits of an MNE that has not been taxed elsewhere or where the profits have been taxed at a low rate of tax.*
- Whilst the proposal by OECD relates to introduction of minimum tax on MNEs, the government's view is that minimum tax is due from resident entities.
- OECD's minimum tax is based on profits while Kenya's view is to tax a resident company's gross turnover.
- The OECD has committed to confirming its position BEPS Action 1, which includes minimum tax by end of 2020

ATAF'S VIEW

- The African Tax Administration Forum ("ATAF") is an organisation established by African revenue authorities in 2009 with the aim of improving the performance of tax administrations in Africa. Kenya is an ATAF member country.
- ATAF's view on introduction of minimum tax is in sync with the OECD's view.3 Consequently, the KRA's view is inconsistent with ATAF's position.

TREATMENT IN OTHER COUNTRIES

Parameter	United States of America	Nigeria	Tanzania	Cameroon	Ivory Coast	Madagascar
Rate	20% of alternative minimum taxable income in excess of a USD 40,000	Minimum tax payable is calculated as 0.5% of gross turnover less franked investment income	0.5% of the turnover	2.2% or 5.5% minimum tax in Cameroon based on turnover and depending on the tax regime of the taxpayer.	Minimum tax is based on total turnover and is calculated at the rate of 0.5%, with a minimum tax of USD 5,409.	0.5% of gross turnover and a fixed amount of USD 83.
Thresholds	Generally applicable to corporations with three year average annual gross receipts not exceeding USD 7.5 million	Companies with less than USD 64,000 gross turnover are not subject to minimum tax	None	None	None	0.5% and a fixed amount of USD 26 for on agricultural, transportation, industrial, hotel, or mining businesses.

TREATMENT IN OTHER COUNTRIES

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Parameter	USA	Nigeria	Tanzania	Cameroon	Ivory Coast	Madagascar
Tax holidays	N/A	Companies in their first 4 calendar years of business	Companies in their first 3 calendar years of business	None	None	None
Tax exemptions	Corporations with 100 or fewer eligible shareholders that meet certain requirements	Companies carrying on agricultural business Companies with less than USD 64,000 gross turnover	Agricultural companies and those engaged in provision of health or education.	None	None	None
Advance or final tax?	Advance tax	Final	Final	Advance	Final	Final
Other comments	This was repealed in 2017.	Non-life insurance companies - 0.5% of gross premium Life insurance companies - 0.5% of gross income			Currently suspended.	

SUMMARY OF KEY CONCERNS

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Kenya's minimum tax regime substantially differs with the minimum tax regime proposed by the OECD, the UN and ATAF.

Taxes based on turnover have been tried, tested and they failed – The US abolished it's minimum tax regime in 2017, Ivory Coast has currently suspended implementation of minimum tax while Nigeria is constantly reviewing its minimum tax framework quite often

Kenya's minimum tax rate is higher compared to the other countries

Kenya does not have minimum tax holidays

Kenya's minimum tax is a final tax and is not available for utilization against future corporate tax

IMPACT TO THE ECONOMY

- Will lead to increased tax revenues at the expense of Kenya's long-term economic gains
- environment.
- The tax will deter any start-up business.
- The proposed tax implications will go against the Big Four Agenda that seeks to grow the manufacturing sector and spur more growth into the sector.
- The tax will lead to capital flight to favorable tax regimes in the region.
- Lead to the taxation of capital for loss making companies where losses have reduced the retained earnings.
- Potentially reduce Kenya's attractiveness as a Sub-Saharan economic hub
- Its an additional tax on a company's topline
- It is not economic neutral

WAY FORWARD

- Either a change of legislation; or
- Litigation action to challenge constitutionality of minimum tax

PROPOSED POLICY CHANGES

Issue	Details	Rationale
Reduction of minimum tax rate	Reduction of the tax rate from 1% to 0.5%	The 0.5% rate is at par with other comparable jurisdictions and will also give the government a chance to increase its tax base.
Change in tax base	Change of minimum tax base from gross turnover to Earnings Before Interest and Tax ("EBIT")	Taxes based on turnover are retrogressive and have adverse effects on the economy. EBIT is an appropriate base since it allows a company to pay tax based on its income as opposed to turnover and it is therefore in line with the equity canon of taxation.
Carry forward as tax credits	Minimum tax paid should be available for offset against future tax liabilities	To avoid minimum tax becoming a consumption tax and to cushion the economy against reduced foreign direct investments, minimum tax should be utilized against future taxable profits as some companies pay tax.
Enhanced exemptions	Low margin businesses such as oil marketing companies, e-commerce platforms and retailers as well as capital intensive entities such as power companies should be exempted from minimum tax.	Capital intensive projects generally have a longer payback period and imposing additional taxes on them discourages investments in this sector. Further, low margin businesses are largely dependent on volumes and taxing their gross turnover is eating into their paltry margins.

PROPOSED POLICY CHANGES

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Issue	Details	Rationale
Tax holidays	Newly established businesses should be exempt from minimum tax in the first four years of incorporation.	Newly established businesses need a few years as a foundation and more often than not, these first few years are usually loss-making years. It is therefore important to exempt newly established businesses as this encourages entrepreneurship.
Recoverability of tax losses	The current provisions in the ITA require a taxpayer to forfeit their tax losses if they are not utilized within nine years after they occur. Introduction of minimum tax means that all qualifying corporates will pay income tax through minimum tax.	Considering that minimum tax is a sunk cost and impacts a company's profitability, taxpayers may find themselves being hit twice since they may also lose their tax losses. Consequently, the ten-year cap of tax losses should be repealed since all taxpayers will pay income tax.

Litigation filed against GOK

A **constitutional petition** has been filed

- The petitioner (e.g. KMA) would have a right to present a case in court on behalf of its members based on the Constitution and several Kenyan case law precedents.
- ***Article 22 of the Constitution:*** *<u>any person can institute proceedings under the Bill of Rights, on behalf of another person</u> …, <u>or as a member of</u>, or in the <u>interest of a group or class of persons</u>, or in the public interest.*

Constitutional provisions

– ***Article 40 of the Constitution:*** *protects against arbitrary deprivation of property*

– ***Article 47 of the Constitution***: gives citizens right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.

– ***Article 201 of the Constitution***: the public finance system shall promote an equitable society, and in particular, the burden of taxation shall be shared fairly.

THANK YOU