



The Institute of Certified Public Accountants of Kenya

POSITION PAPER

ON

THE INTRODUCTION OF THE MINIMUM TAX IN KENYA

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BACKGROUND

The Finance Act 2020 introduced minimum tax payable at the rate of 1% of gross turnover effective 1 January 2021. Minimum tax is intended for taxpayers who are carrying out business in Kenya but their corporate tax payable is lower than 1% of their gross turnover. Minimum tax is not applicable to:

- (i) a person whose income is exempt from tax under the Income Tax Act;
- (ii) income that is subject to Capital Gains Tax;
- (iii) residential rental income;
- (iv) Upstream oil and gas and mining operations and
- (v) income that is subject to turnover tax (gross turnover is less than KES 50 million).

The government's basis of introducing minimum tax is that there are several taxpayers enjoying infrastructure provided using taxpayer's money, yet these taxpayers do not contribute to the exchequer since they are loss making. Further, minimum tax bridges the differences in taxation that may arise between the turnover tax applicable to medium and small business and other businesses.

In addition, Kenya's post Covid-19 economic recovery plan dubbed *"Rebuilding the Kenyan Economy Post-COVID-19"* notes that *"...with the emergence of COVID-19, economic growth projections for 2020 have been modest and the rising debt levels are a cause for alarm. Before the pandemic, Kenya's debt to GDP ratio was 61%, six percentage points higher than the IMF target debt for developing countries. The impact of the crisis has led to increased government borrowing, placing Kenya at high risk, with the potential rise of the debt to GDP ratio to at least 70%."*

Further, in the 2018/2019 revenue performance report, Kenya Revenue Authority ("KRA") noted that corporate tax had declined from 2.7% of Gross Domestic Product ("GDP") in 2013/14 to 1.7% in 2018/19 mainly because of corporate tax deductions.

With the high debt to GDP ratio, declined contribution of corporate tax to the tax pool and the reduced tax rates provided for in the Tax Laws Amendment Act, 2020, there was need for the government to supplement its eroded tax base through introduction of minimum tax. It can therefore be viewed that minimum tax is alluring to the government since it promises to broaden the tax base, it is simpler to administer, and it is envisaged to address the perennial tax shortfalls.

However, introduction of minimum tax is neither a promise nor a guarantee that the government will achieve all its intended benefits. As discussed in this paper, taxes based on gross turnover have been tried, tested and they have failed to achieve the intended effects in the long run. In addition, minimum tax may result to adverse economic distortion effects that could reduce Kenya's competitiveness.

OVERVIEW OF MINIMUM TAX FROM A GLOBAL PERSPECTIVE

HISTORY OF MINIMUM 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.¹ This form of taxation gained popularity during the era of the Great Depression as revenue authorities witnessed dwindled tax collections as a result of many businesses plummeting into losses. Turnover based taxes proved easy to administer and collect and assured the revenue authorities of increased revenues.

After the global economy stabilized, the pioneers of gross receipt tax (as it was known then) realized the detrimental capabilities of taxes on gross turnover. Firstly, there was a realization that turnover-based taxes were discriminative and went against the equity canon of taxation since they disadvantaged low-margin business. As such, turnover based taxes did not tax according to the affluence of the businesses which is measured by a company's bottom-line.

In addition, turn-over based taxes had negative albeit unintended economic ramifications since they made companies taxed under this regime uncompetitive in the global market. The negative effects in the domestic economies were compounded by reduced direct foreign investments.

Due to these negative effects, turnover based taxes were gradually phased out and replaced with other forms of profit-based taxes and consumption taxes such as Value Added Tax ("VAT"). Consequently, government's return to the turnover based taxes in the form of minimum tax is not a welcome move as this regime has been previously tried in other jurisdictions and it did not yield the intended effects in the long run.

OECD'S VIEW ON MINIMUM TAX

The Organisation for Economic Cooperation and Development ("OECD") has over the past five years championed changes in tax policies aimed at ensuring all taxpayers pay their fair share of taxes. Part of the proposals by OECD is introduction of a global minimum tax on Multi-National Enterprises ("MNEs"). It is noteworthy that the minimum tax proposed by the OECD is completely different to the minimum tax regime that the government has imposed as elaborated below.

In 2015, there was a global awakening and realization that MNEs were untaxed or undertaxed in various jurisdictions. As a remedial action, the OECD developed the OECD Pillar 2 known as the Global Anti-Base Erosion ("GloBE") proposal as part of its Base Erosion and Profit Shifting

¹ Tax Foundation - Resisting the Allure of Gross Receipts Taxes: An Assessment of Their Costs and Consequences <https://taxfoundation.org/gross-receipts-tax/>

(“BEPS”) project.² The main focus on Pillar 2 – which is still work in progress – is giving countries 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. Pillar 2 is therefore looking to introduce an effective minimum tax rate which every MNE must pay on its profits worldwide.

Consequently, the concept of minimum tax as envisaged by the OECD and the minimum tax concept as adopted by Kenya’s government are like chalk and cheese. 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. Another divergent view is that the 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. At the moment, it is still unclear whether Kenya, being a member of OECD’s Inclusive Framework, will repeal its minimum tax after OECD confirms its view.

ATAF’S VIEW ON MINIMUM TAX

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.

² OECD/G20 Inclusive Framework on BEPS Progress report July 2019 – July 2020

<https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf>

³ Media Statement on The Outcomes of the Inclusive Framework Meeting 29 to 30 January 2020

<https://www.ataftax.org/media-brief-inclusive-framework-jan-2020>

CASE STUDIES OF COUNTRIES THAT HAVE INTRODUCED MINIMUM TAX

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.
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.	

In summary, Kenya's minimum tax is not favourable compared to other benchmarked jurisdictions and international organizations since:

- i) ***Kenya's minimum tax regime substantially differs with the minimum tax regime proposed by the OECD, the UN and ATAF*** – While the minimum tax regime being advanced by international organisations targets non-residents with an aim of taxing MNEs income in countries where the income is generated, Kenya's minimum tax targets resident entities with an aim of increasing the tax revenues.
- ii) ***Taxes based on turnover have been tried, tested and they failed*** – The US abolished its 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 thereby underscoring the need for Kenya's government to critically think of the proposed minimum tax. Further, the transition from turnover based taxes to net income-based taxes in the twentieth century is a clear indication that turnover based taxes do not yield the desired income in the long run.
- iii) ***Kenya's minimum tax rate is higher compared to the other countries*** – Other comparable jurisdictions such as Nigeria, Tanzania and Ivory Coast all have minimum tax rates which are less than or equal to 0.5%.
- iv) ***Kenya does not have minimum tax holidays***– While jurisdictions such as Tanzania and Nigeria exempt new businesses and provide a different minimum tax rate for different sectors, Kenya's minimum tax regime does not provide for this.
- v) ***Kenya's minimum tax is a final tax and is not available for utilization against future corporate tax liabilities*** – As a final tax, minimum tax disadvantages loss making companies since it increases the cost of doing business. It thus creates an opportunity for minimum tax to become a consumption tax borne by companies whereby companies operating as monopolies will pass on the additional cost to consumers. Whereas, for companies operating in a perfect competition market, the cost may be absorbed resulting in exit of financial strained companies.
- vi) ***Kenya's minimum tax exemptions are not comprehensive*** –While the government has provided for exemptions from minimum tax for incomes stipulated in the earlier sections of this paper, these exemptions are not comprehensive. Capital intensive companies such as those in the power sector are not exempted. Further, low margins volume-based entities such as those in the e-commerce sector are equally within the ambit of minimum tax notwithstanding that their profit margins are meagre – taxing their turnover may have negative ramifications including clouding out the e-commerce sector.

ENVISAGED EFFECTS OF KENYA'S MINIMUM TAX TO THE ECONOMY

Kenya's post Covid-19 economic recovery plan notes that "...Kenya was already experiencing economic decline with a GDP growth of 5.4% recorded in 2019 compared to 6.3% in 2018." The above position is worsened by the Covid-19 pandemic where the World Bank notes that "GDP could contract by 1.0% in 2020, and see a delay in the projected recovery to 5.2% growth in 2021."⁴ Consequently, now more than ever, Kenya's tax policies must be geared towards favouring foreign direct investment whilst maintaining Kenya's attractiveness as an economic hub in the Sub-Saharan region.

In fact, the Covid-19 economic recovery plan has listed key initiatives that the government is banking on as means of economic recovery. Some of the initiatives include strengthening Kenya's productivity and competitiveness and improving the business environment. It is therefore important to critically evaluate the interplay of minimum tax and the government's economic agenda, which is as below:

- (i) **Introduction of minimum tax will lead to increased tax revenues at the expense of Kenya's long-term economic gains** – Kenya's tax to GDP ratio has been declining over the past few years from 16.87% in 2014 to 15.09% in 2018 according to the World Bank.⁵ On the other hand, the World Bank reports that Kenya's GDP has increased 5.3% to 6.3% over the same period. The expectation is that the increase in tax revenues should increase in tandem with the increase in the GDP. Evidently, this is not the case. The decline in the tax-to-GDP ratio despite an increase in the GDP could be attributed to two main factors:
 - It is arguable that the growth in GDP may not be attributable to taxpaying entities. For instance, the GDP growth may be occasioned by increased economic activities in the informal sector which has largely remained untaxed; and
 - There is a significant erosion of the tax base due to tax incentives and exemptions.
 - Consequently, the downward trend of the ratio is poised to continue since introduction of minimum tax will increase the tax revenues but result to lower economic activities.
- (ii) **Minimum tax will reduce Kenya's attractiveness as a Sub-Saharan economic hub** – It is highly unlikely that a new business would be profitable in the first few years of operation. Consequently, adding a tax burden on an unprofitable business will make Kenya's economic environment uncondusive for start-ups and businesses whose break-even period is long.

Where avoiding minimum tax is inevitable, businesses could load minimum tax to their pricing policies thereby increasing the cost of consumer goods and services. Consequently, minimum tax becomes a consumption tax as opposed to an income tax. The increase in the cost of goods and services will also make Kenya uncompetitive in the global market.

- (iii) **Minimum tax is an additional tax on a company's topline** – Currently, there are already several taxes based on turnover such as Value Added Tax ("VAT") and excise. Even though the principles and mechanisms of VAT and excise duty are different compared to minimum tax, introduction of a new tax based on turnover will have a negative impact on a company's financial wellbeing such as creating cash flow constraints.

⁴ The World Bank in Kenya <https://www.worldbank.org/en/country/kenya/overview>

⁵ Tax revenue % GDP

<https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?end=2018&locations=KE&start=2014>

Further, profitability ratios are used by companies as an assessment of their profitability thereby underscoring the fact that profit should be the base of income tax as this is the true reflection of a company's income.

Kenya's minimum tax is not economic neutral. Introduction of minimum tax is bound to raise revenue but simultaneously distort economic decisions made by businesses. It interferes with the functioning of a competitive market as it focusses more on the taxes collected and not the growth of the economy.

PROPOSED TAX POLICY CHANGES

As demonstrated above, Kenya's minimum tax policies ought to be reviewed to enhance the efficiency and improve its envisaged impact.

#	Issue	Details	Proposal and Justification
1	Is the timing of introduction of minimum tax, right?	Businesses have largely been affected by covid-19 which has forced them to lay off most of their employees due to cashflow issues. Introduction of minimum tax at the time when businesses are struggling and hoping for a quick economic recovery appear ill-timed. Considering that the GoK instituted measures to cushion taxpayers from the effect of covid-19, introducing minimum tax at this time of uncertainty is counteractive.	Defer the introduction of minimum tax from 2021 to 2023 to give businesses and the economy at large an opportunity to recover from the negative effects of the Covid 19 pandemic.
3	Change in tax base	Change of minimum tax base from gross turnover to Earnings Before Interest and Tax ("EBIT")	<ul style="list-style-type: none"> ▪ 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.
4	Carry forward of minimum tax as tax credits	Minimum tax paid should be available for offset against future tax liabilities	<ul style="list-style-type: none"> ▪ 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.
5	Enhanced exemptions from minimum tax	<p>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.</p> <p>In addition, agricultural companies should also be exempted from minimum tax.</p>	<ul style="list-style-type: none"> ▪ Capital intensive projects generally have a longer payback period and imposing additional taxes on them discourages investments in the country. ▪ Further, low margin businesses are largely dependent on volumes and taxing their gross turnover is eating into their paltry margins.
6	Tax holidays for newly registered businesses	Newly established businesses should be exempt from minimum tax in the first five years of incorporation.	<ul style="list-style-type: none"> ▪ 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

#	Issue	Details	Proposal and Justification
			important to exempt newly established businesses as this encourages entrepreneurship.
7	Tax loss carry forward period should not be restricted with minimum tax in place.	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.	<ul style="list-style-type: none"> ▪ Delete Section 15(4) of the ITA. ▪ 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.
8	Interplay between minimum tax and compensating tax	With introduction of minimum tax, is compensating tax redundant	<ul style="list-style-type: none"> ▪ Delete Section 7A of the ITA. ▪ Where a company is on minimum tax, compensating tax should not arise since all the income was taxed under minimum tax.
9	Reduction of minimum tax rate	Reduction of the tax rate from 1% to 0.5%	<ul style="list-style-type: none"> ▪ The 0.5% rate is at par with other comparable jurisdictions and will also give the government a chance to increase its tax base.

ISSUES REQUIRING ADDITIONAL CLARIFICATIONS

#	Issue	Grey area	Proposed position
1	What is gross turnover?	There is no definition for gross turnover under the Income Tax Act ("ITA") and in other Kenya Tax Act.	Gross turnover for tax purposes should be gross proceeds as per IFRS 15 and should exclude third party revenue aspects e.g government's levies and taxes.
2	Specified sources of income	Section 15 (7) (e) provides for taxation of certain incomes streams as if they were separate businesses. The ITA has not provided whether minimum tax will be applicable on each line of income or on the total income of a business.	Only business income should be subject to minimum tax.
3	Impact to other life insurance companies and agricultural companies	<p>As per Section 12D of the ITA, all other sectors other than the ones expressly exempted are subject to minimum tax.</p> <p>Sectors which are taxed differently such as life insurance companies and agricultural companies do not have specific provisions governing application of minimum tax.</p>	<p>The ITA should provide taxation principles of other life insurance companies by providing the meaning of "gross turnover" in the context of life insurance companies.</p> <p>Clarity is also required for agricultural companies since their instalment tax payments are only two in a year.</p>

CONCLUSION

Even though introduction of minimum tax was projected to earn the government tax revenues to bridge the borrowing gap, minimum tax could yield undesired economic effects. Consequently, there is need to re-look at the tax policy relating to minimum tax and tweak this to suit Kenya's economy. That said, we recommend the abolition of the tax and staying its implementation as the country addresses the underlying considerations.