



The Institute of Certified Public Accountants of Kenya

**SUBMISSION
ON
THE TAX LAWS (AMENDMENT) (NO.2) BILL, 2020**

DECEMBER 2020

Background

The publication of the Tax Laws (Amendment)(No.2) Bill, 2020, (The Bill) comes seven months after the President assented to the Tax Laws (Amendment) Act, 2020 which introduced far reaching changes to the tax legislation aimed at cushioning the taxpayers from the brunt of the pandemic.

The Institute is cognizant that COVID19 shocks continue to affect Kenya in many ways including contraction of the economy, productivity losses, and welfare losses. Millions have been pushed into extreme poverty by the economic shocks — and disruptions to health, nutrition, and education systems – have multiplied the devastation of the pandemic well beyond the direct impact of illness from the virus. The spread of the Corona virus as well as measures introduced to slow the spread of the disease have been a significant shock to the economy. An immediate impact has been the closing down of many establishments, resulting in widespread job losses, hours and income. Moreover, it has directly affected international trade resulting in a decline in the performance of key sectors such as hospitality, aviation, capital markets and retail trade among others.

Normally, crises are associated with unemployed labour and excess productive capacity, making it relatively easy to restart economies by boosting demand. But now, industries cannot easily be restarted until the crisis is over. In the near term, given considerable uncertainty, businesses and households are unlikely to behave as if the future was known with certainty. This makes spending choices more heavily dependent on current conditions rather than future expectations.

The Institute Makes the following observations and recommendations with regard to the provisions of the Tax Laws (Amendment) (No.2) Bill, 2020:

Table 1: SUMMARY OF ICPAK PROPOSALS ON THE TAX LAWS (AMENDMENT) (NO.2) BILL, 2020

	Clause Reference	Proposal	Justification
1.	Section 12 D (1)c Minimum tax Delete the word “Higher” and substitute therefor the word ‘Lower’	Delete Section 12 D of the Income Tax Act. Even though introduction of minimum tax is projected to earn the government tax revenues to bridge the borrowing gap, minimum tax could yield undesired economic effects.	The Finance Act 2020 introduced the minimum tax payable at the rate of 1% of gross turnover effective 1 January 2021. We propose deletion of the entire Section 12D for the following reasons: A. Adverse effects of the ongoing Covid – 19 pandemic <ul style="list-style-type: none"> Various businesses across the Country have been adversely affected by the Covid – 19 pandemic. A number of them are struggling to meet their fixed costs of operations such as salaries and other overheads. Some businesses have resulted to salary cuts and in extreme cases laying off of employees. This is all in a bid to cushion the businesses from the negative effects of the pandemic.

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		<p>Instead of introducing minimum tax we propose collection of additional revenue through the increase in the VAT rate from the current 14% to 16%. This has a less distortionary effect in the economy.</p>	<ul style="list-style-type: none"> Introduction of minimum tax on 1 January 2021 will introduce an additional fixed cost to the already struggling business. This is likely to lead to massive job losses and increase the unemployment rate in the country. <p>B. Minimum tax will reduce Kenya's attractiveness as an investment destination</p> <ul style="list-style-type: none"> Many businesses are likely to pass on minimum tax to the final consumers. This will lead to an increase in the cost of services goods produced in Kenya. Investors may therefore prefer to channel their investments in more favorable tax jurisdictions. Ultimately, this is likely to lead to a decrease in the employment opportunities in the country and in the long run, a significant reduction in the tax revenues collected. <p>C. Best practice</p> <ul style="list-style-type: none"> Turnover based income tax regimes have been tried, tested and failed in other jurisdictions due to the economic distortions created. Turnover based income tax regimes were first introduced in the 1930's during the era of the great depression. However, soon after, there was realization that turnover-based taxes are discriminative and go against the equity canon of taxation since they disadvantage low-margin business. As such, turnover based taxes do not tax according to the affluence of the businesses which is measured by a company's bottom-line. Due to the above 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"). <p>In addition, the USA 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.</p>
2.	Third Schedule Item 2 A	<p>Delete the proviso to sub-paragraph (Viii) that reads:</p> <p>"Provided that this provision shall apply to the income earned from the 1st January 2021"</p>	<p>Taxpayers should enjoy the reduced tax rate for at least one year of income</p> <p>The proviso in the Bill will complicate tax compliance for companies since they will be required to prepare at least two or more tax computations. i.e for companies whose year-end is March, they will be required to prepare three sets of tax computations as follows:</p> <p>a) 1st April 2020 – 24th April 2020 – Applicable rate – 30%</p>

	Clause Reference	Proposal	Justification
			<p>b) 25th April 2020 – 31st December 2020 – Applicable rate – 25%</p> <p>c) 1st January 2021 – 31st March 2021 – Applicable rate – 30%</p> <p>Tax law should be easy to implement and comply with. The proviso in the Bill will make tax compliance difficult and likely result in lower rates of full compliance.</p>
3.	Third Schedule Item 2 A	<p>Similar, Delete the proviso “Provided that this provision shall apply to the income earned from the 25th April 2020”</p> <p>And Replace with..</p> <p>“Provided that this provision shall apply for the year of income commencing on or after 1st January 2020”</p>	<p>As noted above, Taxpayers should enjoy the reduced tax rate for at least one year of income.</p> <p>Introduction of the proviso implies that taxpayers only enjoy the benefit for 8 months.</p>
4.	VAT Act, 2013 new subsection (8) immediately after subsection (7)	Amend VAT Act Sec 17 subsection (8) to read Notwithstanding the provisions of this section, a registered person who is a manufacturer may make a deduction for input tax with respect to taxable supplies made to an official aid funded project as may be approved by the Cabinet Secretary in accordance with the First Schedule	The right to claim input VAT should not be restricted only for manufacturers, especially because other traders may exist in the value chain between manufacturers and the users of the products in the official aid funded projects.
5.	VAT Act, 2013 Amendment of Section 17 (2)(b) of No. 35 of 2013 (b) the registered	The initial amendment under Clause 17(2)(b) is punitive to the purchaser/supplier by unconstitutionally putting the onus on the taxpayers to provide full details of sales	<p>The essence of the proposed amendment is that KRA will require the taxable person wishing to exercise the right to deduct VAT to ensure:</p> <p>(a) that the issuer of the invoice relating to the goods and services in respect of which the exercise of the right to deduct input tax, has the capacity of a taxable person, that he was in possession of the goods at issue and was in a position to supply</p>

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	<p>supplier has not declared the sales invoice in a return, the deduction for input tax shall not be allowed until the first tax period in which the person holds such documentation: Provided that the input tax shall be allowable for a deduction within six months after the end of the tax period in which the supply or importation occurred.</p>	<p>invoices for the buyer to be allowed to claim the input against their output VAT.</p> <p>The Kenya Revenue Authority to enhance the linkages between the electronic tax registers and the iTax Platform to allow for automatic offsetting of input and output VAT for enhanced compliance and reduced claims.</p>	<p>them and that he has satisfied his obligations as regards declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction or,</p> <p>(b) second, to be in possession of documents in that regard.</p> <p>This requirement is extremely complex from a practicability perspective as the taxpayer who has a right to claim the input VAT, has no way of confirming that the supplier has declared the sales, information which, is only available to the supplier and the tax administrator.</p> <p>It is KRA's statutory obligation to carry out the necessary inspections of taxable persons in order to detect VAT irregularities and fraud as well as to impose penalties on the taxable person who has committed those irregularities or fraud. As provided under both the VAT Act and the Tax Procedures Act, KRA has the mandate to check taxpayers' returns, accounts and other relevant documents.</p> <p>Part IV of the Tax Procedures Act (Record Keeping) imposes, an obligation on every taxable person to keep accounts in sufficient detail for VAT to be applied and its application checked by KRA.</p> <p>In order to facilitate the performance of that task by KRA, Part VI of the Tax Procedures Act provide for the right of the KRA to access the invoices which the taxable person is obliged to store under Part IV of the Act.</p> <p>It follows that, by imposing on taxable persons, in view of the risk that the right to deduct may be refused, the measures listed in Section 10 of the Finance Bill, KRA would, contrary to the above provisions of the Tax Procedure Act, be transferring its own investigative tasks to taxable persons.</p> <p>It is useful to note that for payment of output of tax on sales, a supplier is expected to declare the sales before receiving payment from the purchaser.</p> <p>Changing the requirements for claiming input by a supplier and continue expecting the supplier to account for output at the earlier of invoice date, payment or issuing of a certificate, significantly increases the cost of doing business</p>