The Legal Framework of Taxation in Kenya

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History of taxation in Kenya

- Taxation in Kenya dates back before the colonization by Britain.
- The Arabs who colonized East Africa in the Seventh Century taxed the local coast region of East Africa on the basis of Islamic law. The taxes imposed were mainly based on trade.
- The British introduced direct taxation since external trade was minimal and customs dues would not raise enough taxes.
- The 1937 legislation remained in effect until 1952 when the Income Tax Act (ITA) was enacted. The 1952 ITA laid down the basis of liability, assessment, collection and management.
- In 1973, a new ITA was legislated and it came into effect in January 1974.

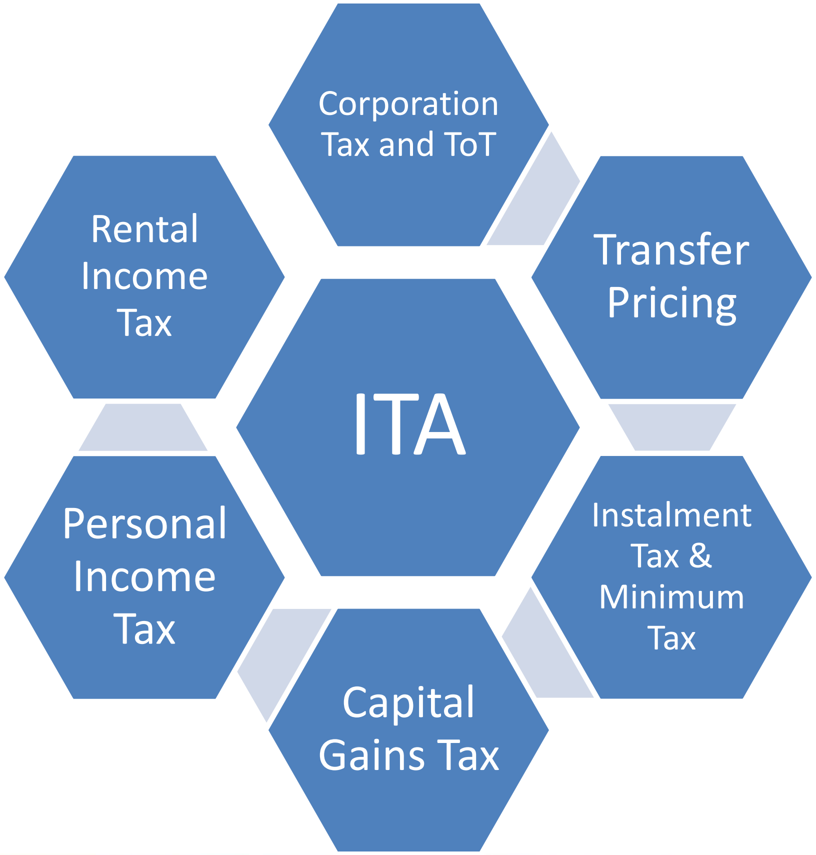
The Income Tax Act Cap 470

Some of the key provisions of the Income Tax Act are as follows:

- Section 3 – The income chargeable to tax;
- Section 15 – Allowable deductions;
- Section 16 – Disallowable deductions;
- Section 35 – Withholding tax;
- First Schedule – Income which is exempt from Tax;
- Second Schedule – Allowances;
- Eighth Schedule – Capital Gains Tax

The Income Tax Act

The types of taxes imposed under the Income Tax Act are as follows:



The Income Tax Act Cap 470

- The imposition of taxes under the ITA is also affected by public policy.
- Article 201 of the Constitution which details the principles of public finance provides that there shall be openness and accountability including public participation in financial matters.
- Every year, the budget making process involves calls to the public to participate in which we as the public get to make proposals on what should be included in the upcoming Finance Bill.
- The Bill is published and if passed by the Parliament, assented to by the President.

Challenges of implementation of Income Taxes

Challenges

- Kenya operates a self-assessment tax system where tax payers evaluate their business operations, report taxable income and compute tax liability.
- While significant improvements have been made to improve the tax system, the following key challenges have arisen and most particularly:

1) Failure to provide transition provisions on the recently introduced second schedule on capital/Investment allowances

2) Update of the iTax platform to effect changes in legislation

3) Offset of the tax overpayments

4) Lack of knowledge among taxpayers

Challenges cont'd

5) Time frame within which the Commissioner to supposed to issue objection decision.

6) Delay by the Commissioner to issue private rulings despite clear timelines being provided in the Tax Procedures Act for the issue of the same

7) Introduction of minimum tax

International tax rates & best practice

Uphold public interest

International tax rates

The local corporate income tax rate stands at 30%. Below is a comparison with other countries:

Country	Tax rate
Nigeria	30%
South Africa	28%
United States	27%
Ghana	25%
United Kingdom	19%
Singapore	17%

East Africa countries tax rates

- The East Africa Countries have same rate of 30%, with few exemptions
- For Example , in Tanzania and Rwanda there are reduced tax rates for newly listed companies;

  a)Tanzania- 25% for the first 5 years

  b) Rwanda- 20% -28% for the first 5 years depending on percentage of shares listed

- Ethiopia has corporate tax of 30% for all entities apart from Mining and Petroleum companies which are taxed at 25%

Best practices in taxation

Following have been identified as critical aspects to best practice:

- Attention to cost efficiency and effectiveness; Ease of complying?
- Responsive engagement with all stakeholders;
- Clarity – Taw laws should be as simple as possible; and
- Flexibility – Tax systems should be flexible and dynamic to keep up with technologies.

Recent developments

Common Reporting Standards

- Kenya is stepping up in an effort to join the global tax transparency initiative.
- On 5 December 2019, Kenya ratified the Convention on Mutual Administrative Assistance in Tax Matters.
- Kenya is expected sign the Common Reporting Standards Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (the CRS Agreement).

New definition of control

- Control now includes among others:

✓ Direct or indirect ownership of at least 20% of the voting rights in a company

✓ Person has advanced a loan to another person and that constitutes at least 70% of the book value of the borrower's total assets

✓ Guarantee by a person constitutes at least 70% of the total indebtedness of the other person

✓ A person or their assignee supplies at least 90% of the purchases or sales of the other person or influences pricing or supply/sale

Overhaul of thin cap rules

- Deductible interest will be capped at maximum of 30% of Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) – Fixed profit ratios
- Disallowed interest = Any interest paid in excess of 30% of EBITDA
- Applicable on all entities whether controlled by resident or non-resident (branches and subsidiaries).
- Under the new provision the following are exempted;

✓ Banks or financial institutions licensed under the Banking Act; and

✓ Micro and Small Enterprises registered under the Micro and Small Enterprises Act

Taxation of the digital economy

Uphold public interest

OECD Two-Pillar Approach
Pillar one blueprint

Scope

- Covers businesses that can participate in a "sustained and significant manner" in the economic life of a market country with or without physical presence.
- Two broad groups of businesses;
  - ✓ Automated digital services; and
  - ✓ Consumer-facing businesses.

Digital Service Tax in Kenya: Scope

Scope

- Digital Marketplace (DM) provider - a person who provides a digital marketplace platform
- Digital Service (DS) provider - a person who provides digital services through a digital Marketplace
- DST in Kenya is computed at 1.5% on the gross transaction value (GTV), exclusive of VAT.

OECD Two-Pillar Approach
Pillar Two

Global anti-base erosion (GloBE) proposal

- Rules to permit countries to tax Multinational Enterprises (MNEs) where income is subject to no or very low taxation
- Will ensure a minimum level of tax is paid MNEs.
- Levels the playing field between traditional and digital companies.

Minimum tax in Kenya: Drawn from Pillar two?

- Minimum tax was introduced with effect from 1 January 2021 and is payable at the rate of 1% of the turnover.

- However, it remains currently suspended due to a High Court ruling pending the hearing and determination of the case.

Note; The Minimum tax proposed by Pillar two is an effective tax rate of 15% to paid in each jurisdiction

INTERACTIVE SESSION

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