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Global Tax Alert

Kenya proposes amendments to *Income Tax and VAT Acts*

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Executive summary

Kenya has issued a second *Tax Laws (Amendment) (No.2) Bill, 2020* (the Bill) which proposes various changes to the *Income Tax Act* and the *Value Added Tax Act*.

The Bill has been issued pursuant to a public notice which was issued by the Cabinet Secretary in charge of the National Treasury on 4 December 2020 highlighting the expected cessation of some of the tax relief measures extended by the Government at the onset of the COVID-19 pandemic.

An EY Global Tax Alert highlighting the various tax reliefs that were extended to taxpayers through the *Tax Laws (Amendment) Act (No.1) 2020* and can be accessed here.

The key changes proposed by the Bill are the reinstatement of: (i) the resident corporate income tax rate to 30% from the current 25%; and (ii) the highest individual income tax band to 30% from the current 25%.

The changes are expected to come into force on 1 January 2021.

This Alert summarizes the key tax proposals included in the Bill.

Building a better working world

Detailed discussion

Corporate income tax

Minimum tax

The Bill seeks to correct a drafting anomaly in the *Finance Act, 2020* which introduced a minimum tax. It is now clear that the minimum tax will be payable when the installment tax is lower than the minimum tax payable.

The provision that introduced the minimum tax, through the *Finance Act 2020*, specified that minimum tax would be payable, if higher than the installment tax due. This created confusion since the intent was to ensure that every taxpayer contributes a certain minimum of tax.

While the proposal has provided much needed clarity, the fact that the law does not provide some reprieve to loss-making entities either due to capital allowances or immediately following incorporation leaves room for further alignment with economic circumstances.

Additionally, the turbulent economic times as a result of the COVID-19 pandemic are likely to reduce the profitability of many high turnover but low margin organizations and the imposition of minimum tax is likely to adversely affect them.

Corporate income tax rate

The Bill proposes an increase in the corporate income tax rate for resident persons from 25% to 30%. The higher rate will apply to income earned from 1 January 2021.

This is likely to create a challenge for organizations whose financial years end on dates other than 31 December since they will earn income which will be subject to two different tax rates depending on the period in which it is accrued.

The reversal of the tax relief measure appears to come before organizations have been able to recover from the effects of the pandemic.

The Bill also indicates that the reduced corporate income tax rate of 25% applies to income that was earned from 25 April 2020. This seems to create a complication as some organizations will be required to apportion their income and expenses into the various periods due to the differing rates within the same financial year. Also, an additional balance of tax may be payable for companies which have already estimated their tax liability for the 2020 year of income using the lower corporate income tax rate.

Employment tax

Individual tax rates

The Bill has proposed to revise the individual income tax brackets by increasing the highest tax rate to 30% from the current 25% as tabulated below:

Current income band (annual) KES	Proposed income band (annual) KES	Applicable tax rate (%) (annual) KES
On the first 288,000	On the first 288,000	10
On the next 200,000	On the next 200,000	15
On the next 200,00	On the next 200,000	20
Income above 688,000	On the next 200,000	25
	Income above 888,000	30

The reversal to the tax relief will result in lower disposable income at a time when the finances of most individuals have been greatly affected and are limited due to salary cuts as a result of the COVID-19 pandemic.

Notably and in a welcome move, the increased annual personal relief of KES28,800 and the exemption from tax of monthly income below KES24,000 have been maintained. The expanded income tax bands have also been retained thereby increasing the disposable income of high-income earners.

Pension withdrawal tax rates

The Bill proposes to increase the highest tax band on pension withdrawals from the current 25% to 30% for amounts above KES1,600,000 when withdrawn after 15 years or when the other prescribed conditions are met by an individual.

For pension withdrawals before 15 years, the individual tax rates indicated above will apply. This applies to pension income after the tax-free portion.

The reversal to the higher tax rate for pension withdrawals will be challenging as many individuals including retirees may not be physically fit to engage in other income generating activities and are facing cash shortages.

Value Added Tax (VAT)

Credit for input tax

The Bill proposes to allow manufacturers who have made taxable supplies to official aid funded projects, as may be approved by the Cabinet Secretary for the National Treasury, to claim the associated input tax.

The proposal seeks to encourage manufacturers to make supplies to official aid funded projects by allowing them to claim input tax which they are currently not able to claim since the supplies are exempt and are thus the suppliers are not entitled to claim related input VAT.

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