KENYA TAX CHANGES FOR 2021

Preamble

The COVID-19 has had a devastating impact on people's health and livelihoods both in Kenya and in the rest of the world. All sectors of the economy were affected and many people and businesses alike are still grappling with the resulting social and economic impact. The Kenyan government is coming to terms with widening tax deficits because of shutdowns of critical sectors of the economy such as tourism, reduction in VAT rate and payroll taxes due to layoffs and salary reductions.

On 23 December 2020, the President assented to the Tax Law Amendment Act (No. 2) of 2020 (the Act). The Act amended the Income Tax Act and the Value Added Tax (VAT) Act of Kenya.

The key amendments made through the Act include the reinstatement of:

(i) the resident corporate income tax rate to 30% from 25%; and
(ii) the highest individual income tax band to 30% from the 25%. Additionally, the VAT rate was reinstated to 16% from 14% through a legal notice in accordance with the law.

Year 2020 was characterized by several major and far-reaching tax changes in Kenya. Some of the notable introductions into the tax landscape is the minimum tax at the rate of 1% of the gross turnover and a digital services tax at the rate of 1.5% of the transaction value which become effective in January 2021. Also, the introduction of a Voluntary Tax Disclosure Program, which will run for a period of three years beginning 1 January 2021, provides the opportunity for organizations to rectify any past gaps in tax declarations and payments.

This bulletin summarizes the tax proposals contained in the Act and insights into the other critical tax changes that took effect on 1 January 2021.

DETAILED REVIEW

1.0 Corporate income tax

1.1 Minimum tax

The Act has rectified a drafting anomaly in the Finance Act, 2020 which introduced a minimum tax by ascertaining that the minimum tax is payable when the installment tax is lower than the minimum tax payable.

Minimum tax is payable at 1% of gross turnover of an entity.

The following categories of persons are exempted from the 1% minimum tax:

- Persons engaged in business whose retail price is controlled by the Government
- Persons engaged in insurance business

Minimum tax will be payable in four installments by the 20th day of the fourth, sixth, ninth and twelfth month of the year of income.

1.2 Corporate income tax rate

The Act has reinstated the corporate income tax (CIT) rate for locally incorporated companies to 30%. The higher rate will be applicable on income earned from 1 January 2021. The reduced CIT rate will apply to income earned in 2020 year of income. Many companies have reported challenges when filing their tax returns for year of income (YOI) 2020 as they have not been able to apply the reduced rate of CIT but KRA is yet to respond.

1.3 Individual income tax

Individual Tax Rates

The Act has revised the individual income tax brackets by increasing the highest tax rate to 30% from 25%. The revised tax bands have also eliminated two tax bands that were previously available, that is, 15% and 20%.

COVID-19 Tax band (annual) KES	Covid 19 Tax rate (%) Rate (w.e.f 25/04/2020)	Revised tax band (annual) KES	Applicable tax rate (%) Rate
On the first 288,000	10	On the first 288,000	10
On the next 200,000	15	On the next 100,000	25
On the next 200,000	20	Income above 388,000	30

Income above 688,000	25		

1.4 Pension withdrawal tax rates

The highest pension withdrawal tax rate has been reinstated to 30% for amounts above KES 1,600,000 when withdrawn after 15 years or when the other prescribed conditions are met by an individual. The following tax band will apply to such income:

Pension band KES	Applicable tax rate (%)
On the first 400,000	10
On the next 400,000	15
On the next 400,000	20
On the next 400,000	25
Income above 1,600,000	30

For pension withdrawals before 15 years, the normal individual income tax bands will apply. The rates will apply to pension income after the tax-free portion.

2.0 Value Added Tax (VAT)

The Act has amended the VAT Act, 2013 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 amendment seeks to encourage manufacturers to make supplies to official Aid funded projects by allowing them to claim input tax which they were previously not able to claim since the supplies are exempt and as such the suppliers were not entitled to claim related input VAT.

3.0 Voluntary Tax Disclosure Program (VTDP)

The Finance Act 2020 introduced a Voluntary Tax Disclosure Program (VTDP). The program, which will run for a three-year period with effect from 1 January 2021, will cover income taxes, VAT and excise duty. Under the amnesty:

A taxpayer will need to make an application (in the prescribed form) to the KRA, disclose all related material facts, and pay the principal tax due.

A waiver of penalties and interest will be granted to taxpayers at a rate of 100%; 50% and 25% for disclosures made within the first, second and third year of the program running respectively, provided that the relief granted does not result in a refund to the taxpayer.

Income of a taxpayer under audit (or in receipt of an intention to audit) by the KRA will not be eligible for the program.

Upon granting of the relief, the taxpayer and Commissioner will enter into an agreement setting out the terms of the payment. The Commissioner will also have a right to withdraw the relief if he establishes that not all material facts were disclosed, and this could lead to prosecution.

The program provides organizations an opportunity to review and correct any tax compliance oversights that may have occurred over the past five years.

4. Digital services tax (DST)

Digital services tax has two fronts; an income tax front and VAT front.

The Finance Act 2020 introduced a digital services tax (DST) on income from services provided through a digital marketplace in Kenya at the rate of 1.5% on the gross transactional value. This was followed by the issuance of the Income Tax (Digital Service Tax) Regulations, 2020 which became effective on 2 January 2021.

The DST shall be payable by the digital service provider or the digital marketplace provider or the tax representative. A person liable to pay DST must submit a return in the prescribed form and remit the tax due by the 20th day of the month following the end of the month in which the digital service was offered. The Commissioner may appoint a taxpayer as a DST agent to withhold and remit the tax to the KRA.

DST paid by a non-resident person without a permanent establishment in Kenya is a final tax. On the other hand, tax paid under this regime by a resident person or a permanent establishment of a non-resident person, shall be offset against the income tax payable for that year of income.

A non-resident person without a permanent establishment in Kenya who provides a digital service to a user in Kenya may register under the simplified tax registration framework or alternatively appoint a tax representative in accordance with the Tax Procedures Act.

It is noteworthy that online services which facilitate payments, lending or trading of financial instruments, commodities or foreign exchange carried out by licensed financial institutions or approved financial service providers are exempt from DST.

From a VAT perspective, Value Added Tax (Digital Marketplace Supply) Regulations, 2020 were issued in September 2020 with suppliers of digital services expected to register within six months of the publication of the Regulations.

The Regulations stipulate that VAT is chargeable on taxable services supplied in Kenya through a digital marketplace under a Business to Customer (B2C) transaction. Business to Business (B2B) supplies are treated as imported services, which are subject to reverse charge VAT.

Taxpayers who operate in the digital space and those who render services digitally should review how the introduction of DST will impact their operations.

5.0 Abolishment of incentives under Home Ownership Savings Plans (HOSP)

The Finance Act 2020 repealed exemptions previously granted on incomes accruing to a registered Home Ownership Savings Plan (HOSP).

Additionally, contributions by individuals to a HOSP will not qualify as an allowable deduction when determining the taxable income. Interest income earned on deposits in a HOSP will also be subject to tax as opposed to previously where the initial Shs. 3 million was exempt from tax.

6.0 Capital allowances/tax depreciation

The Act has repealed the Second Schedule to the Income Tax Act (ITA) and replaced it with a new schedule. Under the new schedule:

Capital allowances will be claimed over a longer period.

The attractive investment deduction of 150% of capital investment outside certain municipalities has been abolished.

The table below outlines the key highlights:

Type of asset	Previous rate (%)	New rate (%)	Additional comment
Hotel building	100	50	Residual value to be claimed at 25% on reducing balance in the subsequent years. Hotel building is required to be licensed by the competent authority.
Building used for manufacture	100	50	Residual value to be claimed at 25% on reducing balance in the subsequent years Building used for manufacture includes any structure or civil works deemed to be part of a building where the structure or civil works relates or contributes to the use of the building
Hospital buildings	0	50	Residual value to be claimed at 25% on reducing balance in the subsequent years Hospital building is required to be licensed by the competent authority
Educational buildings including student hostels	50	10	Claimable on reducing balance Educational building is required to be licensed by the competent authority

Commercial building	25	10	Claimable on reducing balance Commercial building includes: A building used as an office, shop, showroom, go-down (warehouse), storehouse, or warehouse used for storage of raw materials for manufacture of finished or semi-finished goods Civil works relating to water or electric power undertaking, but does not include an undertaking not carried on by way of trade
Machinery used for manufacture	100	50	Residual value to be claimed at 25% on reducing balance in the subsequent years This also includes machinery used for: Generation, transformation and distribution of electricity Clean-up and disposal of effluents and other waste products Reduction of environmental damage Water supply or disposal Maintenance of the machinery Scientific research and development Manufacture means the making, including packaging, of goods from raw or semi-finished goods, or the generation of electrical energy for supply to the national grid, or the transformation and distribution of electricity through the national grid, but does not include design, storage, transport, administration or any other ancillary activity
Motor vehicles and heavy earth moving equipment	37.5%/25%	25%	Claimable on reducing balance Claimable value restricted to KES3 million except for commercial vehicles which have no restriction
Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines	30/20	25	Claimable on reducing balance
Furniture and fittings	12.5	10	Claimable on reducing balance

Telecommunications Equipment	20	10	Claimable on reducing balance
Farm works	100	50	Residual value to be claimed at 25% on reducing balance in the subsequent years The Act has however not defined farm works and this could provide an avenue for the misinterpretation of the term by both taxpayers and Kenya Revenue Authority (KRA)
Other machinery	12.5	10	Claimable on reducing balance