TAX ALERT | 13TH MARCH 2024

THE BUDGET POLICY STATEMENT;

SUSTAINING THE BOTTOM-UP ECONOMIC TRANSFORMATION AGENDA

A.Introduction

The draft 2024 Budget Policy Statement (BPS) was published in December 2023. The National Treasury subsequently invited comments from the public. The public participation process was scheduled to be completed by 5th January 2024. This process culminated in the Government through the Ministry of the National Treasury and Economic Planning tabling the policy in Parliament in compliance with the provisions of the Public Finance Management Act, 2012(PFMA). According to the provisions of the PFMA, the budget policy statement is expected to have been deliberated on by Parliament by 29th February 2024. However, Parliament passed a motion to have the same pushed forward by a further seven days.

The 2024 BPS aims at maintaining the current Government’s policies and strategies under the Bottom-Up Economic Transformation Agenda (BETA) while prioritizing the Fourth Medium Term Plan of Vision 2030. Amongst other policy measures, from a taxation perspective, the Government places focus on providing social security, expanding the tax revenue base, and increasing foreign exchange earnings, by targeting the value chains with significant impact on job creation and economic recovery.

As part of the pending Bills, the Government highlighted that as of 31st November 2023, the Kenya Revenue Authority(KRA) reported pending tax refund claims amounting to Ksh. 16.34 Billion, comprising of Ksh 2.75 Billion in income tax refunds and Ksh. 13.58 Billion related to Value Added Tax.

To enhance its fiscal consolidation plan, the Government intends to administer the National Tax Policy and the Medium-Term Revenue Strategy (MTRS). The National Treasury intends to redesign taxation instruments to coincide with the targets of the policy and strategy without disrupting investment incentives and the state of the market.

Objectively, the measures are poised to build upon their tax revenue mobilization efforts, by increasing the current 16% of GDP to over 20% of GDP over the medium term.

The execution of the National Tax Policy and the Medium-Term Revenue Strategy (MTRS) will be in the financial period of 2024/25 – 2026/27. The fiscal plan will additionally combat debt vulnerabilities by broadening the domestic tax base and increasing tax compliance.

From a Government perspective, a multi-agency approach is key and there is an undertaking for instance that by July 2024, the Government will have introduced deductions that enable the Unified Human Resource System (UHRS), linked with iTax to fulfill PAYE tax obligations, to remit the necessary payments and contributions to the respective corresponding entities.

II. Budget Overview

The revenue collected up to November 2023 exhibited a robust growth rate of 13.2%, surpassing the growth of 10.6% observed in November 2022. By the end of November 2023, total revenue, inclusive of Ministerial Appropriation in Aid, stood at Ksh 1,011.5 Billion, falling short of the target of Ksh 1,110.2 Billion by Ksh 98.7 Billion.

To increase revenue collection by the KRA, the Government is set to enact a blend of tax administrative and policy measures. Prioritizing domestic resource mobilization, the Government's strategies include:

1. **Implementation of the Finance Act 2023**: This initiative aims to bolster tax revenue, targeting a tax effort of 16.3% of GDP in FY 2023/24.

2. **Adoption of the National Tax Policy**: this is Intended to enhance the administrative efficiency, ensure uniformity and clarity in tax laws, and regulate tax expenditures.

3. **Introduction of the Medium-Term Revenue Strategy (MTRS)**: Spanning from FY 2024/25 to 2026/27, this strategy aims to further fortify tax revenue mobilization, targeting 20% of GDP over the medium term.

4. **Emphasis on Non-Tax Measures:** Government ministries, such as the Ministry of Land, will focus on generating revenue through the provision of services to the public.

5. **Enhancement of Tax Administration by KRA:** This entails the expansion of technological tools to plug revenue leakages, including the enhancement of iTax and the Integrated Customs Management System (iCMS), along with the adoption of the Electronic Tax Invoice Management System (e-TIMS).

III. Medium Term Revenue Strategy (MTRS) and National Tax Policy

A. Medium Term Revenue Strategy

The essence of MTRS is to enhance tax administration aspects, that is, the enforcement of tax legislation, eradicating loopholes for tax evasion, and improving voluntary compliance. The strategy raises expectations of facilitating the reduction of the fiscal deficit, enabling the EAC to achieve its target of 3% of the GDP.

The Government intends to employ a multi-sectoral approach in the execution of the MTRS strategy which is expected to occur within a 3-year period; beginning FY 2024/25 to FY 2026/27. All Government stakeholders will be included in the execution of MTRS.

Through the Finance Acts and Regulations, the tax policy reforms will be employed beginning with the Finance Act 2024 while revenue administration reforms will begin in January 2024.

Below are the intended achievements with the implementation of MTRS;

- Raise revenue to GDP ratio from 14.3% in FY 2022/23 to 20.0% by end of the FY 2026/27.
- Increase tax compliance rate from 70% in FY 2022/23 to 90 percent by FY 2026/27.
- Increase investment to GDP ratio from 19.3% in FY 2022/23 to 25.7% in FY 2026/27.

B. National Tax Policy

The National Tax Policy, as approved by Parliament in December 2023, establishes broad guidelines on matters involving tax. The objective of the policy is to facilitate the development of a progressive tax system that promotes revenue mobilization through tax administration whilst guaranteeing that the tax rates will have no impact on product demand, and the tax structure does not disrupt the market and investment incentives.

The Medium-Term Revenue Strategy together with the National Tax Policy provides a combination of tax administrative and policy measures to enhance revenue mobilization.

To achieve this, the Government proposes the below tax measures: -

I. Income Tax

Income tax is the leading source of ordinary revenue in Kenya. This underpins the importance of income tax in raising the much-needed revenue by the Government. To attain its target of improving revenue collection under this tax head, the Government proposes a raft of measures as outlined below

a) Corporate Income Tax (CIT)

Acting on a call to reduce the corporate income tax rate from 30% to 20% so as to stimulate business growth and investment, the government's proposal is to reduce the corporate rate of tax from the current 30% to 25% over the strategy period. This proposal is informed by the fact that Kenya's CIT rate is at 30% compared to the world average of 23% and the African average of 29%.

Studies have shown that high rates of CIT discourage foreign direct investments and encourage investors to lobby for lower rates or tax exemptions. Furthermore, high rates contribute to increased tax planning and reduced compliance by taxpayers, which in the case of Kenya, has contributed to a decline in income tax as a share of GDP. Acting on the backdrop of these studies, the Government made the proposal to reduce the rate of corporate income tax substantially.

Further, the Government is careful not to promptly and haphazardly phase out preferential corporate tax rates in the sectors specified in the Income Tax Act because of the need to keep promoting investment in those sectors while at the same time mitigating the erosion of the tax base and increased lobby to the Government to grant similar incentives to other sectors. Consequently the government intends to gradually phase out the preferential corporate tax rates while focusing on other investment promotion measures over the strategy period.

b) Personal Income Tax

There is a need to review the personal income tax band structure to improve progressivity and ensure a fair distribution of the tax burden considering that the current structure is not progressive since tax bands are not wide enough to cushion low-income earners.

Further, the current structure increases opportunities for tax avoidance and evasion. To address this, the Government undertakes to review the structure to improve its progressivity based on recommendations of a study to be undertaken by the KRA.

c) Monthly Rental Income Tax

On the grounds that there existed a compliance shortfall of about Ksh 27Billion in the year 2022 and taking note that there is a need for recognition of the role that affordable rents play in housing citizens, the Government intends to enhance registration of property agents, mapping of properties, and leveraging on technology. In this regard, and to ensure fairness and equity, the Government undertakes to review the taxation of residential rental income.

d) Minimum Tax

To ensure fairness in taxation, the Government proposes to redesign the minimum tax structure considering the issues raised by the High Court in the **Constitutional Petition No.E005 of 2021** on the administration of minimum tax as previously established.

e) Withholding Tax

With the Agricultural sector being the Kenya's economic giant. The Government intends to bring into the tax bracket To achieve this the Government intends to introduce withholding tax on payments made for produce delivered to cooperatives.

Despite criticism, the Government argues that the ordinary revenue contributed by this sector is scarcely 3% indicating that the sector is undertaxed. The Government maintains that withholding tax is meant to address the challenges faced by the agricultural sector such as the subsistence nature of the sector and inadequate tax literacy by the players of the sector which makes the taxation of this sector difficult. With this consideration, the Government proposes to introduce withholding tax at a rate to be set.

f) Tax Exemptions and Tax Reliefs

These are tax incentives provided by the Government as a policy tool to influence taxpayers' behavior. These exemptions however come at a cost in terms of foregone tax revenue for the Government.

In addition, the Government asserts that tax incentives increase the complexity of the tax system and reduce its effectiveness as an instrument to promote equity. Clinging further on the assertion that studies have shown that incentives may not necessarily be effective in influencing the taxpayer's behavior, the Government intends to review the tax reliefs with a view of eliminating the reliefs that are not counterproductive.

g) Taxation on Pension

As proposed in the MTRS, the Government intends to review the pension tax structure from exempt-exempt-tax to exempt-exempt-exempt by making withdrawals exempt irrespective of the taxpayer's age. However, exempt contributions to the pension scheme shall be restricted to a threshold to cushion tax planning. The Government further proposes that the tax-deductible amount for pensions be reviewed to take care of inflation.

II. Excise Duty

a) Alcoholic Products

Taxation on alcoholic products is influenced by factors such as product value, consumer behaviour, consumption levels and alcohol content. The Government has proposed a review of alcohol taxation based on alcohol content which will align with the East African Community (EAC) standards. Additionally, there is a proposal to impose excise duty based on alcohol content to discourage consumption, particularly due to associated health risks.

b) Petroleum Products

The Government has proposed a review of excise duty on petroleum products to address their adverse environmental impact. It should be noted that an increase in tax will have a direct impact on the cost of fuel and subsequently the economy at large.

c) Betting and Gaming Activities

According to the Government, betting and gaming activities have negative societal effects, particularly on the youth. To mitigate these impacts and deter participation in such activities, a review of excise duty on betting and gaming has been proposed.

III. Value Added Tax (VAT)

a) VAT Apportionment

In the BPS, the Government highlighted concerns with the VAT apportionment formula provided in the VAT Act. According to the Government, the formula allows for a deduction of all input tax when taxable supplies exceed 90% of total supplies, leading to revenue losses due to potential abuse.

b) Insurance Services

The Government cited that taxing insurance services at the standard rate would broaden the tax base and increase VAT revenue.

c) Increase of period for claiming input VAT

The Government noted that amending Sections 16 and 17 of the VAT Act to extend the period for claiming input VAT and issuing credit notes from 6 months to 12 months is a fiscal budget proposal that will be considered when drafting the Finance Bill 2024.

c) Education Services

The introduction of VAT on certain education services provided by schools not directly related to education has been proposed. According to the Government, education services are currently VAT-exempt to promote accessibility. However, this benefit is not uniform to all learners due to differences in fees and services provided necessitating a review of this exemption.

IV. Import Duty

In support of the Government's efforts to enhance food security, job creation and increase exports through dairy and livestock sectors, the Government proposes duty-free importation of raw materials for the manufacture of animal feed to reduce production costs and make feeds more affordable.

V. Proposed New Tax Introductions

a) Motor Vehicle Circulation Tax

The Government proposes introducing a new tax on all motor vehicles based on either a flat rate or engine capacity. Certain categories of motor vehicles may be exempted from this tax.

b) Carbon Tax

The Government has proposed the possibility of exploring the introduction of carbon tax on industries and greenhouse gas emitters based on fossil fuel carbon content to address environmental concerns.

VI. Conclusion

The above-stated raft measures in taxation have been expounded in the Medium-Term Revenue Strategy and the National Tax Policy which has been finalized and approved by the Cabinet. The implementation of the National Tax Policy commenced in January 2024 in order to improve the tax system's administrative effectiveness, offer uniformity and clarity in tax laws, and control tax expenditures.

Some of the proposals as indicated in the BPS statement will be introduced vide the subsequent Money Bills that will be passed by Parliament. The National Tax Policy acts as a base, for which the MTRS will expectedly build, to achieve a tax-efficient and compliant system, which will influence revenue mobilization.

This calls for vigilance from all Stakeholders to ensure they are abreast with what transpires in the Kenyan tax regime to enhance compliance and ease of operation.

LET'S TALK

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