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THE TAX LAWS (AMENDMENT) (No.2) ACT, 2020

EFFECTIVE DATE

On 23rd December 2020, H.E. President Uhuru Kenyatta signed into law the Tax Laws Amendment (No. 2) Bill 2020 which was passed by the members of the National Assembly on 22nd December 2020.

The Act focuses on returning the tax rates in relation to personal income and corporation tax to pre-April 2020 rates. The Act also makes amendments to the VAT Act. **The amendments will come into effect on 1st January 2021.**

CORPORATION TAX

The Act has restated the corporation tax rate to 30% from 25% on income earned from 1st January 2021.

The Bill previously had a proviso that the rate of 25% would only be applicable on income earned after 25th April 2020 which was deleted by the Act. This effectively means that if a person had a year of income that ended on 30th April 2020 to 31st December 2020, our interpretation is that, the tax rate applicable to the 12-month ended to that date would be 25%.

The Income Tax Act ("ITA") defines a year of income as *"the period of twelve months commencing on 1st January in any year and ending on 31st December in that year"*.

Section 27 (1) of the ITA provides that *"where a person usually makes up the accounts of his business for a period of twelve months ending on a day other than 31st December, then, for the purpose of ascertaining his total income for a year of income, the income of an accounting period ending on that other date shall, subject to such adjustment as the Commissioner may consider appropriate, be taken to be income of the year of income in which the accounting period ends."*

For companies with year ending in 2021, our view is that the rate applicable should be 30% as the change in the rate is effective from 1st January 2021. However, clarification on the application is being awaited from KRA.

The Act introduces a provision that the rate of 30% is applicable on income earned after 1st January 2021 onwards, indicating that there would be different rates applicable in respect of an accounting period. If this is the case, there is uncertainty as to:

- How is the profit to be apportioned, as the above change means that one needs to calculate the taxable profit in relation to the period prior to 25th April 2020, profits earned between 25th April 2020 and 31st December 2020 and the profit after that. How does one apportion profit? Is it taking the annual profit and allocating it to each period or does one need to calculate the annual profit actually earned during these periods and having 2-3 different computations?
- How does one claim investment allowances for each of these periods?

Moreover, iTax returns will also need to be configured with the new rate changes.

As a tax protection measure, while reducing the income tax rates to 25%, a corresponding change was made to increase the withholding tax rate on dividends paid to non-residents to 15% from 10%. With no reversal being proposed on this, the effective tax rate for non-resident shareholders which at 24th April 2020 was 37%, reduced to 36.25% on 25th April 2020 and will increase to 40.5% from 1st January 2021.



PERSONAL TAX – NEW PAYE TAX THRESHOLDS

The Act has reduced the PAYE thresholds to only three thresholds, previously the PAYE thresholds used to be five thresholds. This will lead to individuals earning more than KShs 32,333 per month to be taxed at the top marginal tax rate of 30%. The thresholds are as highlighted below:

NEW TAX BAND RATES		
Individual Tax and Tax on Wife's Employment, Professional and Self-Employment Income – KShs	Rate – %	Cumulative Tax – KShs p.a.
On the first KShs 288,000	10%	28,800
On the next KShs 100,000	25%	53,800
On all income above KShs 388,000	30%	

The tax relief granted under the Tax Laws (Amendment) Act, 2020 increased from KShs 16,896 pa. (KShs 1,408 pm.) to KShs 28,800 pa. (KShs 2,400 pm.). The Act does not propose any change to the relief effectively meaning that those earning KShs. 24,000 pm. and below will continue to be exempt from income tax.

PERSONAL TAX – NEW PENSION WITHDRAWAL TAX THRESHOLDS

The Act also intends to align the rates of tax thresholds for withdrawal of funds from a registered pension/provident scheme or the NSSF.

Where a withdrawal from a pension fund is done before the expiry of 15 years, the rates will be as below:

NEW TAX BAND RATES	
WITHDRAWALS MADE BEFORE EXPIRY OF FIFTEEN YEARS	Rate – %
On the first KShs 288,000	10%
On the next KShs 100,000	25%
On all income above KShs 388,000	30%

Where a withdrawal from a pension fund is done after the expiry of 15 years, the rates will be as below:

NEW TAX BAND RATES	
WITHDRAWALS AFTER EXPIRY OF FIFTEEN YEARS	Rate – %
On the first KShs 400,000	10%
On the first KShs 400,000	15%
On the first KShs 400,000	20%
On the first KShs 400,000	25%
On all income above KShs 1,600,000 of the amount in excess of the tax free amount	30%

MINIMUM TAX

The Finance Act 2020 introduced a tax to be known as minimum tax under the ITA, effective 1st January 2021 which will be payable at a rate of 1% of the gross turnover. Minimum tax would then be applicable to all persons except in the following scenarios:

- Where income exempt from tax under the ITA;
- Where income is subject to employment taxes;
- Persons paying residential rental income tax;
- Persons paying turnover tax;
- Where capital gains tax has been paid;
- Where taxes are due and payable from mining and petroleum activities;
- Persons in the insurance sector – this will be mainly insurance companies and reinsurance companies (insurance brokers not included);
- Businesses whose retail prices are controlled by the government for example oil/fuel marketers whose prices are controlled by EPRA.

The Finance Act 2020 erred in stating that a person is liable to pay tax equal to 1% of gross turnover if the person's instalment tax is higher than 1% of gross turnover. The Tax Law (Amendment) (No. 2) Act seeks to correct this by amending the provision as follows:

Section 12 D (1) (c) the instalment tax payable by that person under Section 12 is lower than the minimum tax.

Thus, where the instalment tax liability is lower than 1% of the gross turnover of a company, a tax of 1% of the gross turnover shall be paid as minimum tax. The tax is payable quarterly on 20th of the fourth, sixth, ninth and twelfth months.

It is our considered view that minimum tax should have been compared to one's final tax liability and not instalment tax liability as this would take into account where all tax may have been collected at source and no instalment taxes would be due. This needs to be clarified by KRA as it would result in double taxation.

Further guidelines are yet to be issued by KRA on minimum tax. More details will be communicated by RSM in due course.

VALUE ADDED TAX (VAT)

Section 17 under the VAT Act focuses on the deduction of input tax. The Act introduces a new provision as outlined below:

(8) 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.

This provision is specifically targeting local registered manufacturers. Currently, official aid funded projects are specified to have an exempt VAT status as provided for under Paragraph 51 of Section A of Part 1 of the First Schedule to the Act. With the new provision, a registered manufacturer can now claim the input VAT on supplies to official aid funded projects, allowing our local manufacturers to have competitive pricing as currently the high cost to making such supplies encourages importation of cheaper products.

In our view, this is a welcome provision in line with the President's Big Four Agenda to stimulate the nation's manufacturing sector.

However, any tax change should be fair and this provision should have been availed to all sectors supplying to such aid funded projects.

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