Tax & Exchange Control
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Draft Medium-Term Revenue Strategy

On 15 September 2023 the Government of Kenya published the draft Medium-Term Revenue Strategy (MTRS) for the financial years from 2024/25 to 2026/27, which aims to raise sufficient resources for the implementation of the Government's priority programmes under the Bottom-Up Economic Transformation Agenda by providing a comprehensive approach of undertaking effective tax system reforms to boost tax revenues and improving the tax system over the medium term.

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An anticipated revenue shortfall: Will it affect tax rates and policy?

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The specific objectives of the MTRS are to: raise the tax revenue to GDP ratio from 13,5% in the financial year (FY) 2022/23 to 20% by the end of FY 2026/27; increase the tax compliance rate from 70% in FY 2022/23 to 90% by FY 2026/27; promote investment through removing market distortions through the rationalisation of tax expenditures and reviewing the tax rate; and align tax policy with government priorities.

Income tax

Corporate income tax

The draft MTRS proposes to:

1. Reduce the corporate rate of income tax from the current 30% to 25%

The draft MTRS states that according to a corporate income tax (CIT) gap study by the Kenya Revenue Authority (KRA) in 2022, the gap between the CIT collected and the potential is high and on a rising trend. It also notes that the gap is attributed to low compliance and tax expenditures among other factors. The Government is therefore proposing to reduce the CIT rate so as to narrow this gap.

2. Review residential rental income tax so as to ensure fairness and equity

To address compliance challenges in rental income taxation, the Government will enhance registration of property agents, mapping of properties and leveraging technology. In addition to this, in order to ensure fairness and equity, the Government will review the taxation of residential rental income and implement either or both of these options: tax residential income at the corporate rate and allow for expenses; or retain the simplified tax regime but progressively increase the rate and allow deduction of at least 40% of the revenue as expenses.

3. Re-introduce minimum tax

The draft MTRS provides that the rationale for this re-introduction of minimum tax is due to the fact that some entities prepare their accounts to depict a perpetual loss position, thus evading taxation. The re-introduction of minimum tax contradicts the Court of Appeal's decision in *Kenya Revenue Authority v Stanley Waweru and Six Others (Civil Appeal No. E591 of 2021*)

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whereby the Court of Appeal upheld the High Court's decision that declared the minimum tax unconstitutional and the minimum tax guidelines void. However, the Government stated that it will redesign the minimum tax considering the issues raised by the court on the previous minimum tax.

4. Review and rationalise exemptions on entities to expand the tax base

The Government proposes to review the exemption regime during the MTRS period to more efficient and pro-investment *"cost-based"* incentives.

Personal income tax

The draft MTRS proposes to:

1. Review the personal income tax band structure to improve progressivity

The draft MTRS notes that the current income tax structures are not wide enough to cushion low-income earners and increase opportunities for tax avoidance and evasion. In this regard, the Government intends to align the personal income tax rate with the corporate tax rate. This is good news for taxpayers that are now subject to personal income tax above 30% (the corporate rate) as the draft MTRS indicates a plan to reduce the personal income tax rates.

2. Review taxation of pensions

The draft MTRS plans to restructure all pensions to be exempt for those who withdraw their pension, even before the age of 65, as only those above that have been exempt, while those below are taxable.

3. Review and rationalise exemptions on individuals' income to expand tax base

The draft MTRS notes that these exemptions erode the tax base and therefore during its review the Government will take into consideration exemptions that are granted on a reciprocal basis and in accordance with international conventions which Kenya is a party to.

4. Review tax reliefs

During the medium-term strategy period, the Government will review the tax reliefs with a view to eliminating the reliefs that are counterproductive. Among the reliefs that the Government intends to eliminate is the insurance relief. It is not clear how this will impact the insurance industry considering the low uptake of insurance.

Value-added tax

The draft MTRS notes that the value-added tax (VAT) threshold has been significantly eroded over time due to inflation, hence the need for review. Therefore, during the MTRS period, the Government will review upward the registration threshold for VAT, which is currently taxable supplies worth KES 5 million or more in a year.

The Government states that the current VAT rate in Kenya of 16% is among the lowest within the East African Community (EAC) member states and the

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EAC Common Market Protocol foresees harmonization of taxes before the EAC Monetary Union. The Government will therefore review the VAT rates as well as VAT exemptions and zero rating. It is not clear in the draft MTRS whether the Government will increase the VAT rate to 18%, which is similar to Uganda, Tanzania and other countries in East Africa.

The draft MTRS proposes applying VAT on certain education services which were previously exempt in order to "*make education accessible to all learners*". The Government notes that the exemption is not uniformly applied and therefore to remove this discrimination, there is a need to impose VAT on services provided by schools that are not directly related to education.

On insurance services, the draft MTRS proposes to introduce VAT on insurance services which have been exempt from VAT. The rationale for this being that this will expand the tax bases and hence raise VAT revenue as a percentage of GDP. This measure could be counter-productive unless the Government has other incentives to encourage taxpayers to take insurance.

Excise duty on petroleum products, tobacco products, alcohol products and sugary juices

The draft MTRS proposes a review of the excise duty on petroleum products and coal as they contribute to negative externalities within the environment. The Government will further review the basis of taxation on the alcohol content of a product. These reviews will take into consideration the ongoing harmonization of excise duty structures within the EAC region.

At the same time, the Government intends to increase the excise duty on tobacco to discourage tobacco use and apply an excise duty on sweet non-alcoholic drinks.

Customs duty

Kenya will request that other EAC partner states review the structure of the EAC Common External Tariff with a view to having a common duty rate for all imported goods and no duty on primary raw materials/inputs.

Carbon tax and excise tax (green fiscal incentives)

In the medium-term strategy period, the Government plans to explore the possibility of introducing a carbon tax based on the carbon content of fossil fuels, while reviewing green incentives to promote the use of green energy. The draft MTRS proposes incrementally charging excise duty on fossil-fuel powered vehicles as the Government evaluates whether to introduce the same on tractors,

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forklifts, excavators and earthmovers, among others. The Government will further review the current taxes on electric vehicles with a view to encouraging their affordability and hence support the transition to a green economy.

Motor vehicle circulation tax

The draft MTRS proposes the introduction of a motor vehicle circulation tax as a form of wealth tax. It proposes that this tax be paid at the point of acquiring annual insurance cover. The tax will be graduated starting off with a minimum tax and moving up based on the engine capacity of the vehicle.

Withholding tax

Agricultural produce

The draft MTRS notes that the agriculture sector is highly informal, cash based and characterised by the notion that the incomes generated from the sector are meagre and should not be taxed. Therefore, to address these challenges, the Government will:

- introduce a final withholding agricultural produce tax at a rate not more that 5% of the value of the produce delivered to co-operatives or other organised groups; and
- intensify taxpayer education to ensure that taxpayers understand their role in nation building and the need to pay taxes.

Imports

The draft MTRS notes that the greatest challenge in taxation of the informal sector is lack of visibility of taxpayers' transactions by the KRA. Therefore, to address these challenges the Government will introduce a creditable withholding tax on all imports at a minimal rate of the import's value.

Comment

From our review, the draft MTRS is a comprehensive and ambitious plan that aims to achieve sustained economic growth, create jobs and reduce poverty. The focus on investing in the five key sectors of agriculture, micro-, small- and medium-sized enterprises, housing, healthcare, and the digital economy, is well-placed, as these sectors have the potential to generate significant economic growth and create jobs. The draft MTRS is well-aligned with the Sustainable Development Goals. This is important, as it shows that Kenya is committed to global and regional development goals.

However, one might argue that Kenya is currently experiencing high inflation and low disposable incomes, which means that many Kenyans are struggling to make ends meet.

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Introducing new taxes at this time could place an additional burden on households and businesses. An increase in taxes in a depressed economy could be an incentive to evade tax and therefore may not necessarily result in an increase in tax collection. The Government needs to weigh the costs and benefits of the proposals in the draft MTRS.

The Government could introduce new taxes that are targeted at high-income earners and corporations, while also providing relief to low-income households and businesses, and also invest in programmes to help people improve their skills and find jobs, which would increase their disposable incomes and make them better able to afford taxes.

Overall, the draft MTRS is a good starting point. It is, however, important to get feedback from the public and stakeholders to ensure that the final document is as comprehensive and practical as possible.

The Government has set a deadline of 6 October 2023 for stakeholders to present their views on the draft MTRS. We encourage everyone to participate.

Alex Kanyi and Joan Kamau

Cliffe Dekker Hofmeyr

2023 RESULTS

Chambers Global 2018 - 2023 ranked our Tax & Exchange Control practice in **Band 1**: Tax.

Emil Brincker ranked by **Chambers Global 2003 - 2023** in **Band 1**: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **Chambers Global 2022 - 2023** for Tax: Indirect Tax.

Mark Linington ranked by **Chambers Global 2017 - 2023** in **Band 1**: Tax: Consultants.

Stephan Spamer ranked by **Chambers Global 2019-2023** in **Band 3**: Tax.

SOUTH AFRICA

An anticipated revenue shortfall: Will it affect tax rates and policy?

In the past few weeks, it has been widely reported that South Africa's public finances are not in the best state and that a tax revenue shortfall is anticipated for the current fiscal year. Inevitably, a question has arisen around how Government will respond to this.

On the one hand, expenditure cuts have been mooted, but another potentially more pressing issue for taxpayers is whether tax rates will be increased. It has been reported in the media that according to some senior National Treasury officials, there is little scope to raise taxes as South African tax rates are already uncompetitive and that other options need to be considered to stabilise Government's finances.

Tax rates

The comment that South Africa's tax rates are uncompetitive and are unlikely to increase is positive news for the South African business community, amongst others, given the research that has been done on South Africa's corporate tax rate. According to research published by the Organisation for Economic Co-operation and Development in 2022, the average statutory corporate tax rate (headline tax rate) amongst more than 100 jurisdictions was 20%, compared to South Africa's corporate tax rate of 27% (which was announced in the 2022 Budget). Prior to this, the rate was 28%. When it comes to tax on individuals, our highest marginal tax rate is also comparatively high at 45%, more than the highest marginal tax rate in some developed countries. Then, of course, there is also value-added tax (VAT), which currently stands at 15%. While this is not necessarily that high (some African countries have higher rates of VAT), VAT is often seen as a regressive tax in that it taxes all consumers the same, irrespective of their socio-economic situation or income. Furthermore, on the environmental front, although South Africa's carbon tax rates were recently increased and will continue increasing annually until 2030, Government has explained that this is to encourage companies to make changes within their businesses to reduce their greenhouse-gas emissions and thereby their carbon tax liability.

Tax policy

While tax rates are a more obvious way of trying to increase Government's tax revenue, changes in tax policy can also have this effect. For example, this can be done by including specific rules in tax legislation which result in a particular amount being taxed at a higher rate or, in the case of a company, for example, by limiting the amount that a

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company can deduct from its income, thereby increasing the amount of its taxable income. Some examples of these are:

- The introduction of rules in income tax legislation, stating that the amount of assessed losses a company may claim annually is limited. This change came into effect with the corporate tax rate reduction, with Government indicating that the intention of this amendment was to increase the tax base. In many instances, the likely result of this amendment is that a larger portion of a company's income will be subject to tax. Thus, it is not the rate that has increased, but the amount that is taxed at the reduced rate of 27%.
- The amendment to the foreign employment income exemption (section 10(1)(o)(ii) of the Income Tax Act, 58 of 1962), which was amended a few years ago to indicate that a maximum of R1,25 million of foreign sourced remuneration earned in a tax year could be exempt, whereas the amount of foreign sourced remuneration that could qualify for exemption was previously unlimited. In this case, it meant that a South African resident working abroad and earning more than R1,25 million in remuneration, would now potentially be subject to tax on the excess amount, in accordance with the marginal income tax tables.
- The proposal in the draft 2023 Taxation Laws Amendment Bill that income of South African resident trusts vested in non-resident beneficiaries would be taxed in the hands of the trust, at the rate of 45%. While this change is currently merely a proposal and it remains to be seen whether it will come into effect, if implemented, it would result in the income vested in the non-resident beneficiary being taxed at 45%, as opposed to in accordance with the marginal income tax tables, where only income in the top bracket is taxed at 45%.

The future

It remains to be seen whether there will be changes to tax rates or tax policy in the foreseeable future. One hopes that the tax rates discussed in this article (and the rates applicable to other taxes not mentioned here) will not increase, but the Minister of Finance's (Minister) Medium-Term Budget Policy Statement (MTBPS) on 1 November will potentially provide some insight into this.

In our Tax and Exchange Control Alert of 12 January 2023, we discussed the annual cycle that takes place in amending South Africa's tax legislation. We are currently in the middle of the 2023 cycle and changes to tax policy (in the form of amended tax legislation) will also likely be known when the Minister gives the MTBPS, as tax amendment bills are often tabled before Parliament at the same time.

All South Africans will hope that the country's fiscal position improves, without changes to tax rates or changes to tax policy that lead to substantially increased tax liabilities.

Louis Botha

OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:

Emil Brincker
Practice Head & Director:
Tax & Exchange Control
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Mark Linington
Director:
Tax & Exchange Control
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

Gerhard Badenhorst
Director:
Tax & Exchange Control
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com

Jerome Brink
Director:
Tax & Exchange Control
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com

Petr Erasmus
Director:
Tax & Exchange Control
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director:
Tax & Exchange Control
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Alex Kanyi
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E alex.kanyi@cdhlegal.com

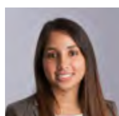
Heinrich Louw
Director:
Tax & Exchange Control
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Howmera Parak
Director:
Tax & Exchange Control
T +27 (0)11 562 1467
E howmera.parak@cdhlegal.com

Stephan Spamer
Director:
Tax & Exchange Control
T +27 (0)11 562 1294
E stephan.spamer@cdhlegal.com

Tersia van Schalkwyk
Tax Consultant:
Tax & Exchange Control
T +27 (0)21 481 6404
E tersia.vanschalkwyk@cdhlegal.com

Louis Botha
Senior Associate:
Tax & Exchange Control
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com



Varusha Moodaley
Senior Associate:
Tax & Exchange Control
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com

Abednego Mutie
Senior Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E abednego.mutie@cdhlegal.com

Nicholas Carroll
Associate:
Tax & Exchange Control
T +27 (0)21 481 6433
E nicholas.carroll@cdhlegal.com

Joan Kamau
Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E joan.kamau@cdhlegal.com

Puleng Mothabeng
Associate:
Tax & Exchange Control
T +27 (0)11 562 1355
E puleng.mothabeng@cdhlegal.com

Esther Ooko
Associate Designate:
Tax & Exchange Control
T +27 (0) 11 562 1778
E esther.ooko@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

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KIETI LAW LLP, KENYA