Corporate & Commercial

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CDH INCORPORATED

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KENYA

Tax stability and predictability for economic sustainability

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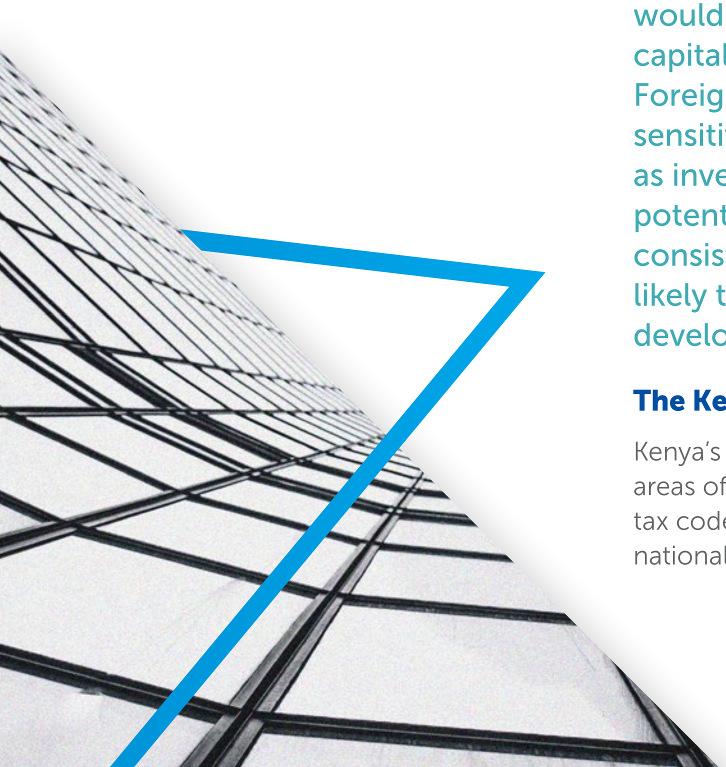
Tax stability and predictability for economic sustainability

Prior to deciding to introduce or redomicile a business in any country, an investor must always consider how favourable, stable, and predictable the country's tax system is. The primary rationale for this is the need for certainty and guarantee regarding the future sustainability of investment in the host country. This predictability ensures that the investor can plan for their business, which includes planning ahead for tax liabilities and allocating resources appropriately and efficiently. On the other hand, a tax regime that is unstable and unpredictable has the opposite effect, that is, it hinders an investor's power to consciously make investment decisions, which would ultimately be a deterrent, leading to capital flight and reduced economic activity. Foreign direct investment (FDI) is particularly sensitive to tax stability and predictability, as investors weigh the risks associated with potential changes in tax laws. Countries with consistent and transparent tax regimes are more likely to attract FDI, contributing to economic development and job creation.

The Kenyan context

Kenya's tax regime has been viewed to have three major areas of concern: lack of clear tax policy objectives, erratic tax code changes, and lastly, multiple taxation both at the national and county levels of government.



To give context, every year Kenya's National Treasury submits a Finance Bill to Parliament that proposes amendments to various tax laws. There have been instances where new taxes and rules introduced by a Finance Act are significantly changed or completely reversed by the subsequent year's Finance Act.
For instance, the Finance Act, 2022 amended the Income Tax Act to increase the capital gains tax rate to 15% from the previous 5%. The Finance Act, 2023 further amended the Eighth Schedule of the Income Tax Act by deleting the previously existing provisions, which only subjected direct gains to capital gains tax, and specifying that capital gains tax will also apply on indirect transfers. Such frequent revisions have had an adverse effect on investors who rely on predictability and stability for tax planning. The unpredictability has further occasioned non-compliance on the part of taxpayers. The ripple effect of this unpredictability has always been inhibition of economic growth and reduced revenue.

Recently, in November 2023, the Report by the Departmental Committee on Finance and National Planning on the consideration of the National Tax Policy (Report) observed that the National Tax Policy that was presented in Parliament on 27 April 2023 missed key aspects, including policy concerns, policy objectives, policy outcomes, and policy risks, which in turn stifled flexibility to deal with emerging issues should there be unforeseen changes in Kenya's economy.

The Report further recognised that Kenya's tax laws, for instance the Income Tax Act CAP 470 (1973), were enacted long ago, a fact that has led to misalignment and unpredictability of taxes. Lastly, the review of tax laws by

Tax stability and predictability for economic sustainability

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Willem Jacobs | David Pinnock

Recommended Lawyers:
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Roxanna Valayathum | Njeri Wagacha

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the Government was considered to not be supported by a comprehensive economic impact assessment and a legal audit report that is conscious of the impact on tax revenue, economic growth, investment, development, and employment.

The way forward

As recommended by both the International Monetary Fund and the G20, there is a need for a collaborative tri-partite approach that involves the ministry in charge of finance, the tax authority, and external stakeholders to ensure a well-crafted tax law design. Public consultations and participation, legislative approval, and post-implementation monitoring are also critical for enhancing the effectiveness and certainty of tax policies.

Further, the Government should implement a comprehensive review of the tax laws programme, which can be conducted every five years to align them with other government policies, as was recommended by the Departmental Committee on Finance and National Planning in November 2023 (Departmental Committee). To accommodate emerging trends in the business environment and the Government's agenda, there should be periodic review of the existing tax laws.

Moreover, the Government should prioritise long-term economic goals over short-term gains. While occasional adjustments to tax policies may be necessary, a consistent commitment to stability fosters a positive economic environment. The Government's move regarding the introduction of the Medium-Term Revenue Strategy (MTRS) for the period FY 2024/25 to FY 2026/27, which aims to increase revenue collection by an additional 5% to the GDP ratio, is a step in the right direction since this signifies a four-year commitment. Further, the MTRS will receive anchorage following the recommendation for harmonisation through reconciling disparities and conflicts with the National Tax Policy, as was recommended by the Departmental Committee.

Conclusion

Tax stability and predictability are foundational elements for economic sustainability. A stable and predictable tax environment encourages businesses to invest, innovate and expand, leading to increased economic activity and job creation. Investors, both domestic and foreign, are more likely to commit capital when they can accurately assess the risks associated with tax policies.

Such a predictable tax system is essential for enabling the Kenyan Government to meet its goals, which include enhanced private investment and revenues. Other than fostering long-term private investments, such a system would also increase taxpayers' confidence in the system, encourage voluntary compliance, and further support effective tax administration, the net effect of which would be enhanced revenue mobilisation.

The Government plays a pivotal role in ensuring tax stability by involving stakeholders, implementing comprehensive reviews of tax laws, and prioritising long-term economic goals. By fostering a stable and predictable tax environment, the Government would contribute to the overall economic sustainability of the nation, thus creating a foundation for long-term prosperity.

Alex Kanyi and Billy Oloo

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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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