CLIFFE DEKKER HOFMEYR

WEBINAR

Comments on the Draft Medium-Term Revenue Strategy (MTRS)

12 October 2023

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

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Tax Amnesty for Interest and Penalties
&
Introduction to the Draft MTRS

WEBINAR | 12 October 2023

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Outline

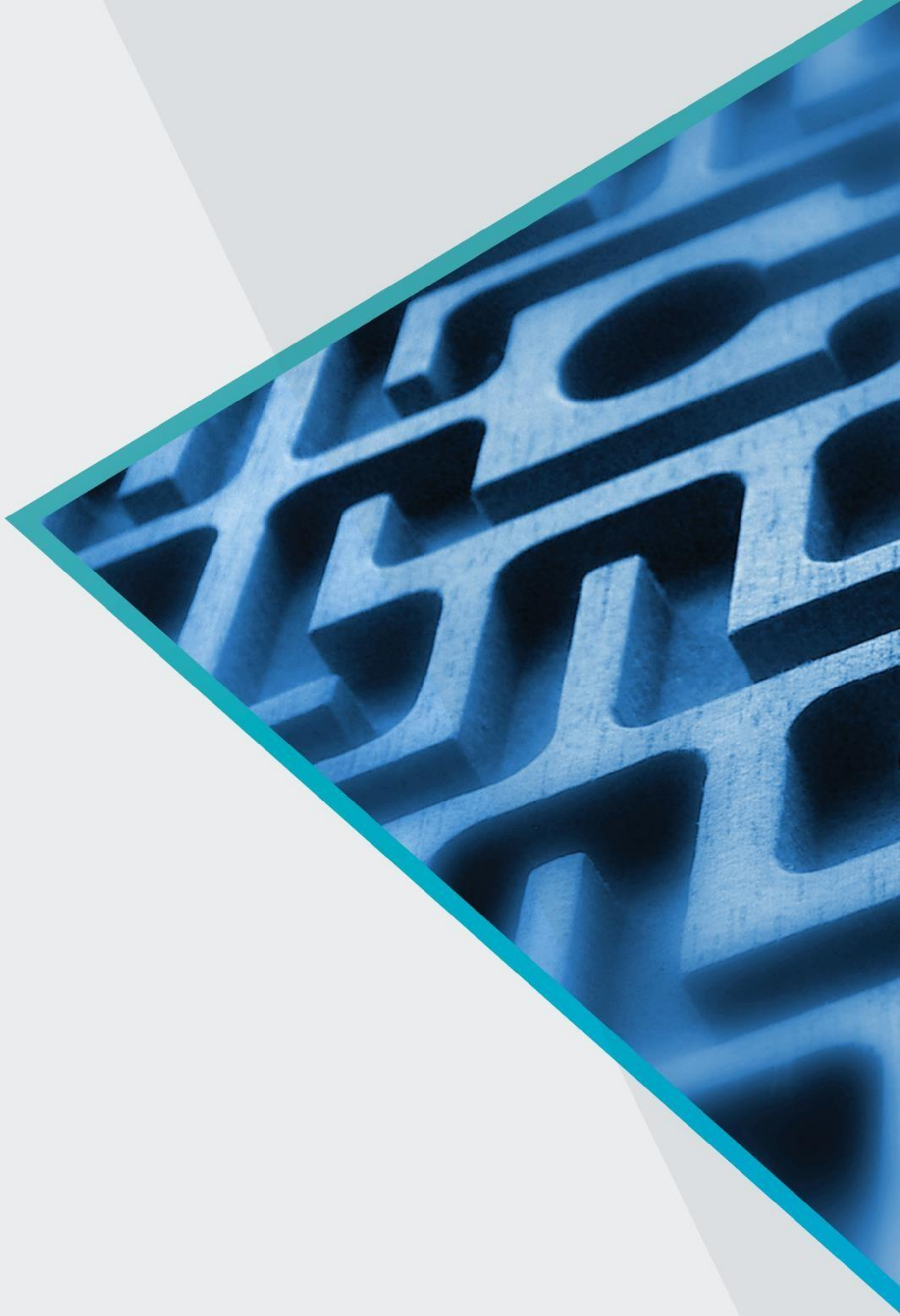
1. About CDH

2. Tax Amnesty Introduction

3. Guidelines on Tax Amnesty

4. Draft MTRS

5. Q & A



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Brent Williams
Chief Executive Officer

Tim Fletcher
Chairperson

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Our practice areas

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- Banking and Finance
- Corporate and Commercial
- Dispute Resolution,
- Employment Law
- Environmental Law
- Real Estate Law
- Trusts and Estates
- Intellectual Property

The Firm received recognition for outstanding standards of practice and legal service delivery, having been ranked as 1st Runners up in the Large Law Firm of the Year Category at the Nairobi Legal Awards 2022.

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Introduction

- CDH proposed an amnesty programme in the Finance Bill 2023;
- Programme introduced by the Finance Act 2023;
- Provided in S37E of Tax Procedures Act, 2015;
- Replaces tax waivers and abandonment provisions.

Applicability

- Persons with penalties and interest but no principal taxes owing for up to 31/12/2022; &
- Persons with principal tax accrued up to 31/12/2022 but pay the outstanding principal tax debt by 30/06/2024.

Eligibility

- Automatic qualification where no principal tax is due up to 31/12/2022 but with penalties and interests due- not required to apply.
- Where all principal tax due is unpaid before 31/12/2022, amnesty is only granted if the person:

  a. applies and pays all outstanding principal taxes by 30/06/2024;
  b. does not incur further tax debt; and
  c. signs a commitment letter for settlement of all outstanding taxes.

Application for Amnesty

- Apply in the system.
- System displays debt status with all tax heads. Taxpayer required to select the periods and tax heads qualifying for the amnesty.
- Taxpayer may make full payment of the principal tax due or enter into a payment plan agreement with Commissioner.
- Where settlement in installments is chosen, taxpayer must indicate the payments frequency in the system embedded payment plan agreement.

Application for Amnesty- Cont'd

- Payment plan agreement shall not extend beyond 30/06/2024. Any penalties and interest remaining unpaid after 30/06/2024 do not qualify for amnesty.
- By accepting the terms and conditions of the amnesty, the taxpayer commits to honoring the payment plan agreement.
- Amnesty is granted upon the payment of the final instalment as per the payment plan agreement.

Implications

- ✓ The programme will help taxpayers clean up their tax ledgers.
- ✓ Taxpayers who applied for penalties and interest waivers and cleared their principal tax up to 31/12/2022, to expect KRA to automatically remove the same from its iTax system.
- ✓ The programme is also ideal for taxpayers to pay principal tax for the periods up to 31/12/2022 by June 2024 to get a waiver of penalties and interest.

Draft MTRS

Background

- ✓ Concept launched in 2016 to enhance countries' revenue mobilization efforts.
- ✓ A recommendation of the Platform for Collaboration on Tax to the G20 Finance Ministers.
- ✓ Intended to:
  - ❑ provide a comprehensive strategy for increasing tax revenues over the medium term; and
  - ❑ aligning tax policy, revenue administration, and legal reforms around a coherent plan

Steps in development of a MTRS

1. Understanding the MTRS approach to tax system reform;
2. Taking stock of ongoing policy, administration and legislative reform initiatives;
3. Undertaking MTRS gap analysis; and
4. Addressing the gaps by formulating an MTRS.

Kenya's draft MTRS

- Art 210(1) CoK 2010- no tax or licensing fee may be imposed, waived, or varied except as provided by legislation.
- S 12(1) Public Finance Management Act, 2012- Mandates National Treasury to formulate, implement, and monitor economic and financial policies.
- Treasury Circular No. 7/2022 of 30/08/2022- communicated Government's intention to develop Kenya's first MTRS.
- To cover remaining period of Vision 2030, two MTRS proposed:
  a. covering FY 2023-24 to FY 2026-27; and
  b. covering FY 2027-28 to FY 2029-30.

Good Practices

- ✓ Progressing beyond interest in an MTRS, to actually developing one;
- ✓ Strong political will and leadership;
- ✓ Broader across-government ownership;
- ✓ Involving business and civil society;
- ✓ Propose specific policy reforms; and
- ✓ Propose realistic tax reform agendas

Speaker

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THE MEDIUM TERM REVENUE STRATEGY

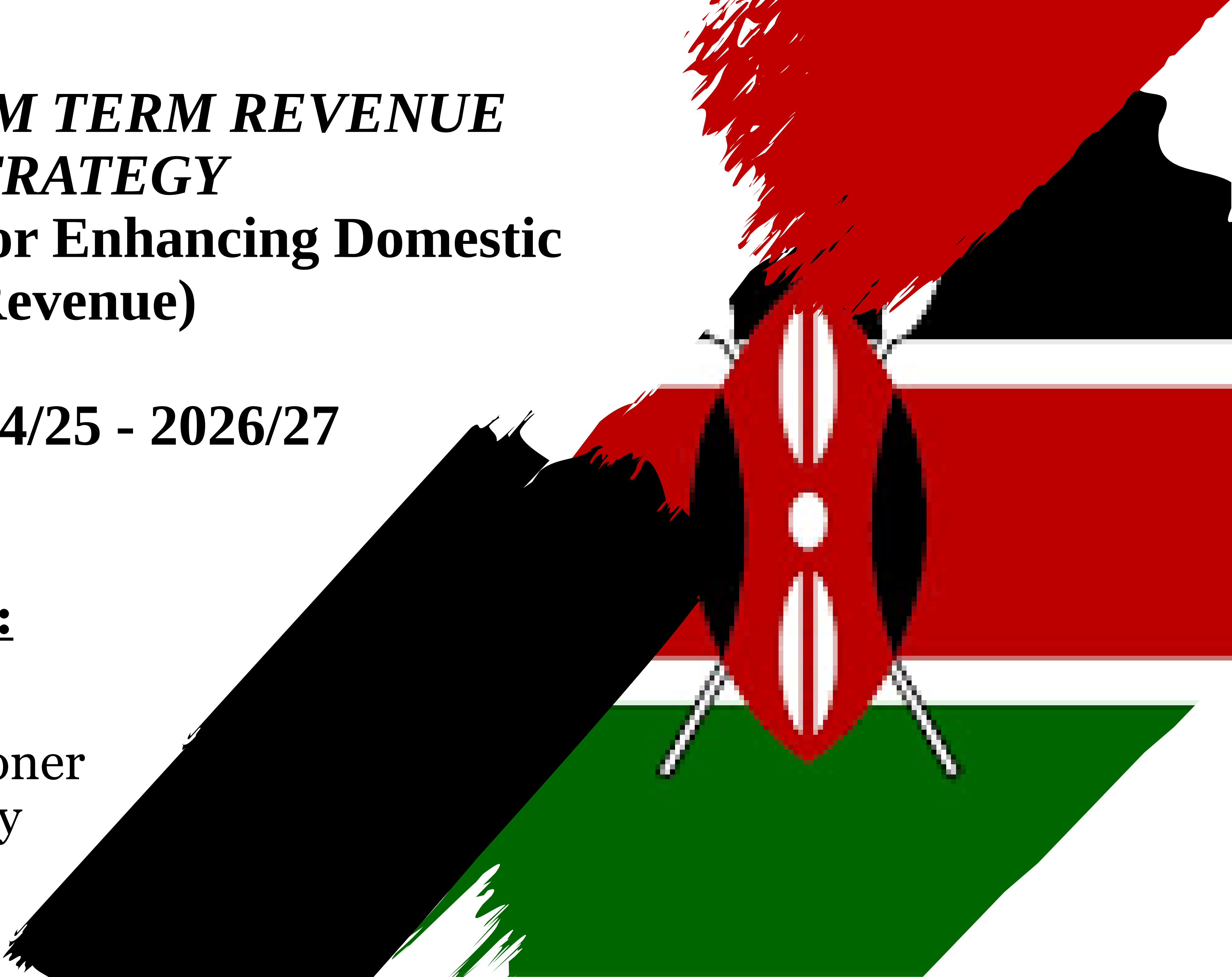
(An Approach for Enhancing Domestic Revenue)

FY 2024/25 - 2026/27

Presented by:

Maurice Oray

Deputy Commissioner Corporate Policy



Outline

01 Objectives of MTRS

02 Policy Measures

03 Levies and Non-Tax Revenues

04 Revenue Administrative Measures

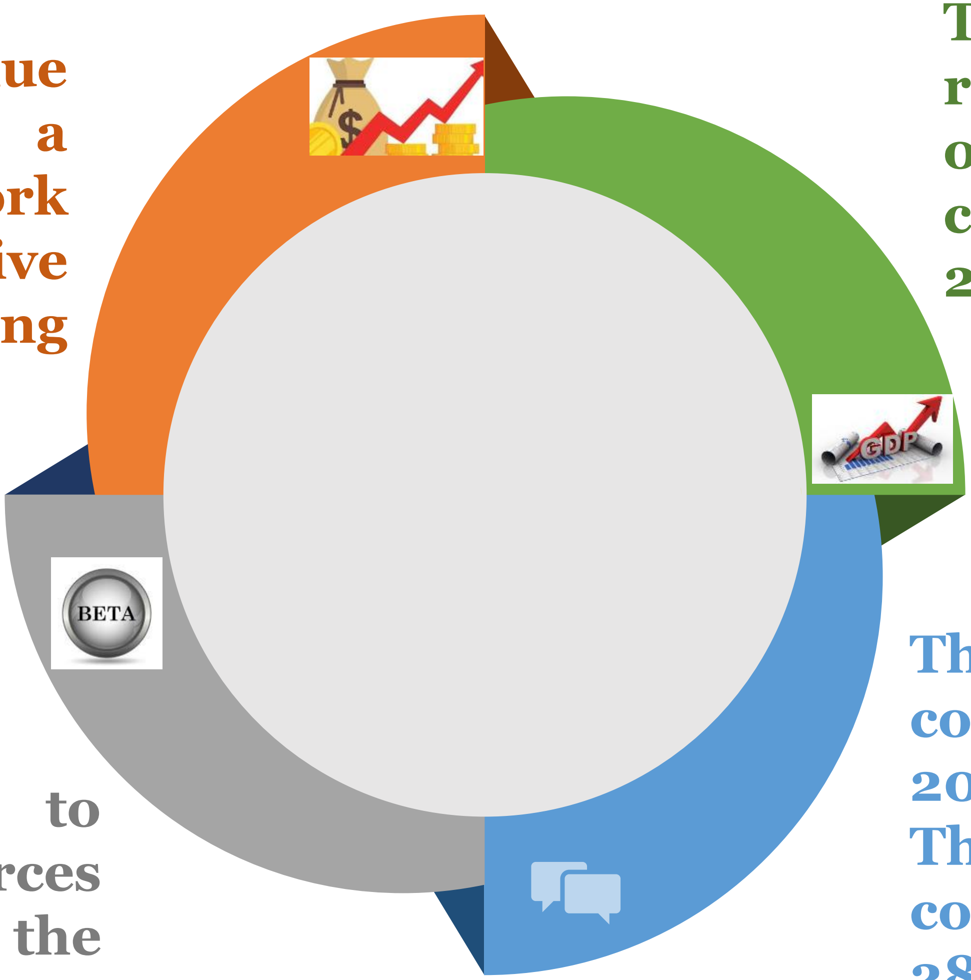
05 Compliance Improvement

06 Critical Stakeholders

Introduction

The Medium-Term Revenue Strategy (MTRS) is a comprehensive framework for tax and administrative reforms aimed at boosting domestic revenues.

This Strategy targets to raise the ratio of ordinary revenue collections to GDP to 20%



This is the first MTRS covering the period FY 2024/25 to FY 2026/27. The second MTRS will cover the period FY 2027-28 to FY 2029-30.

The Strategy is meant to mobilize additional resources for implementation of the Government's BETA.

Objectives of MTRS

Raise the tax revenue to GDP ratio from 13.5 percent in FY 2022/23 to 20 percent by end of the FY 2026/27.

Increase tax compliance rate from 70% in FY 2022/23 to 90% by FY 2026/27.

Promote investment through removing market distortions by rationalizing tax expenditures and review of tax rates.

Align tax policy with government priorities

Policy Measures – Income Taxes

The CIT tax gap is on a rising trend from 25.5% in 2018, 26.7% in 2019 & 32.2% in 2020. *To address this, the following measures will be undertaken:*

- Reduce the corporate rate of income tax from the current 30% to 25% during the Strategy period;
- Align the WHT rate applicable to income earned by non-residents with the corporate tax rate;
- Gradual phasing out of preferential corporate tax rates while focusing on other investment promotion measures;
- Residential rental income – Taxation of the residential rental income at the corporate rate then allow for expenses; retain the simplified tax regime but progressively increase the rate then allow deduction of at least 40 percent of the revenue as expenses.
- Review the exemption regime to a more efficient and pro-investment "cost-based" incentives.
- Re-introduce minimum tax;
- Review the tax bands to improve progressivity and harmonize PIT top rate with the corporate income tax rate;
- Review pension tax structure from exempt-exempt-tax to exempt-exempt-exempt;
- Review and rationalize the exemptions on personal income;
- Eliminate reliefs such as person relief, insurance relief, relief for PLWD, mortgage relief – a zero PIT rate will be granted to cushion low income earners.

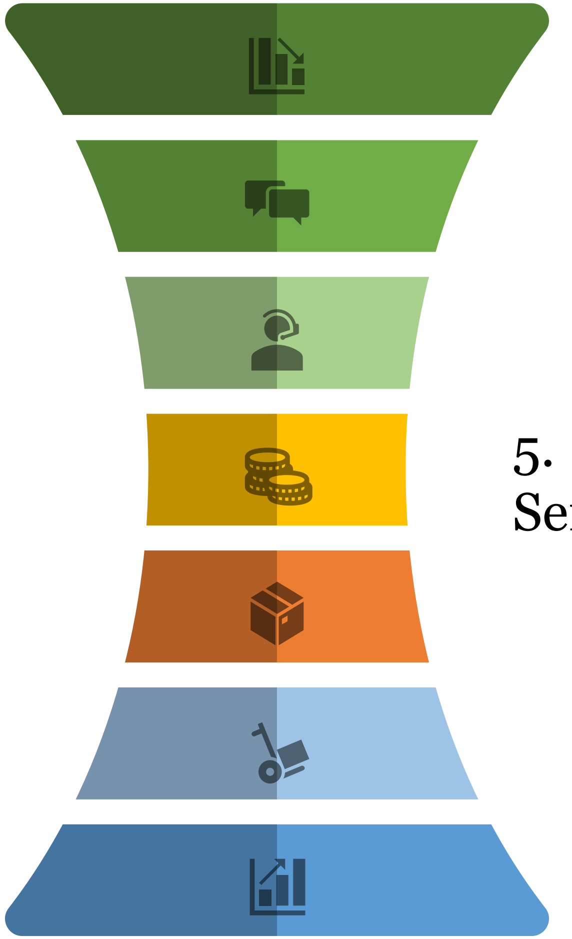
Policy Measures - VAT

The VAT performance has been below its potential with a gap of 39.8% in FY 2021/22. To improve this, the following measures will be undertaken during the period -

1. Review upward the VAT threshold to take into account inflation over the years;

2. Review the VAT rate

3. Introduce VAT on education services provided by schools which are not directly related to education



4. Review the VAT exemption/zero rated supplies to align the VAT system to the destination principle as well as other international best practices

5. Introduce VAT on Insurance Services

6. Review of the VAT Input tax apportionment formula to remove the threshold above which the apportionment of input tax does not apply.

Policy Measures – Excise taxes

Excise duty is imposed on certain products with negative externalities and also to generate revenue. *The policy measurers to be implemented during the period include -*

1. Review the excise duty on petroleum products to fully address the negative externalities

2. Introduce excise duty on coal

3. Review the basis of taxation of alcoholic products by basing it on alcohol content of the product

4. Review the tax regime of sugar - based non-alcoholic beverages to take into account their sugar content.

Policy Measures - Indirect Taxes

Customs Measures:

- The rates of import duty applicable to the EAC region are 0%, 10%, 25% and 35%. These multiple rates provide differential protection to industries. They however create classification disputes.
- To address the challenge of multiple rates, Kenya will request the EAC partner states to provide for duty free for all primary raw materials/inputs and capital goods and one common duty rate in the range of 15 to 20 percent for all other imported goods for consideration by the EAC Council.

Other tax measures include:

- The possibility of introducing carbon tax on fossil fuels by increasing excise duty on vehicles and other equipment that use fossil fuels;
- **Review the Excise duty on betting and gaming to fully address the negative externalities;**
- Introduce a surcharge tax (tax on tax) to address any shortfall that may arise from the implementation of the reforms;
- **Introduce motor vehicle circulation tax based on the vehicle insurance premium.**
- **Develop a Tax Expenditure Governance Framework.**

Levies and Non-Tax Revenues

Non-tax revenue consists of Government revenue receivable from all other sources excluding taxes.

They include - investment income, traffic revenue, land revenue, fines and forfeitures, interest, social contributions and administrative fees charged on Government services.

Non-tax revenue contributes on average 0.7% of GDP, with investment income contributing the highest at 0.5% of GDP followed by administrative fees with 0.16% of GDP.

Factors contributing to low performance of non-tax revenue include:

- Lack of coherent policy;
- Long period between reviews of fees/levies
- Semi-automated collection system.

Levies and Non-Tax Revenues

Fees

- Fees imposed on services provided by Government entities are either submitted to the Exchequer or retained to meet operational costs.
- There are transparency and accountability concerns regarding retained fees;
- Though they are prescribed in various legislation, there is no standardized criteria for imposition & review of the fees;
- *The Government will* develop guidelines on the imposition and management of fees to ensure standardization.

Levies

- The Government imposes levies such as - RDL, Export Levy, PDL, Road Maintenance Levy, Export and Investment Promotion Levy;
- These levies affect other tax revenues, particularly income tax since they are deductible;
- There are also multiple exemptions provided which have distortionary effect;
- The Government will therefore:
  - review and rationalize the imposition and management of levies to limit their adverse impact on other tax collections;
  - the exemptions provided to some entities with a view to minimizing those exemptions.

Dividends & Surplus Funds from SOEs

- SOEs are the largest source of non-tax revenue mainly from dividends and surplus funds from regulatory authorities;
- The performance of SOEs has been below expectation with some requiring Government bailout;
- The Government will:
  - Improve oversight of SOEs and review the dividend policy to streamline payment of dividends;
  - Initiate legal reforms necessary to anchor the new ownership arrangements;
  - Develop regulations to provide more effective financial oversight of Government investment in SOEs.

Non-Tax Revenues

To enhance the non-tax revenue collection, administration, accountability and reporting, the Government will:

- adopt a collaborative approach in collection of non-tax revenue and leverage the use of ICT
- Strengthening the framework for reporting and monitoring of non-tax revenue collection by enforcing the use of IFMIS
- review the fees charged for government services every five years to take into account inflation and ensure they are commensurate to services received

Revenue Administrative Measures

Taxpayers Audit

Non-Tax Revenues

Tax Administration Measures

Staffing of Tax Administration

Improved efficiency in the management of tax refunds

Compliance improvement

Tax Administration Measures

Continuous modernization of KRA's business operations by implementing IT tax management systems

Full roll out of e-TIMS to restrict income tax and input VAT deductions to compliant invoices and enable real time monitoring of transactions

Enhance rental Income tax collection by - mapping rental properties, appointing of rental tax collection agents, integration of iTax with the lands management system and use of a mobile App for payment of tax

Review of administrative procedures for customs duties and other taxes on imported goods. The specific measures will include:

- Installation of additional scanners on exit points;
- Enhance capacity of transit monitoring through additional personnel, vehicles and tracking equipment;
- Enhance staff capacity in tariff and valuation;
- Enhance capacity on application of rules of origin to enable ascertainment of origin of goods and qualification to preferential treatments; and
- Implement the 24hr operation through a whole-of-Government approach at cargo ports.

Tax Administration Measures Con'd

Enhance monitoring of excisable goods manufacturers to prevent under-declaration of excisable goods and tax evasion:

a) use of metering and monitoring tools;
b) close monitoring of payments to ensure correct taxes are declared and paid;
c) Establishment of a Production Monitoring Command Centre to monitor production in real time; and
d) Providing strict time lines for factories to meet requirements.

Combat counterfeit excisable products and stamps in the market :

a) strengthening of the multi-Agency Team to investigate source of counterfeits and take necessary action;
b) robust and effective market surveillance; and
c) regular reviews and upgrades of the security features of stamps.

Establish a special tax court with relevant tax law expertise to improve the turnaround time of tax litigation

Tax Administration Measures Con'd

Integrate tax administration systems internally and with other Government systems. Specific integrations include

a) All the systems within the tax administration;

b) Tax administration systems with the Integrated Population Registration System;

c) Tax administration system with all betting and gaming systems; and

d) Integration tax system with third party data producers such as Telcos and banks.

Improve tax debt management through the following:

a) encourage use of alternative dispute resolution mechanism to resolve disputes to avoid lengthy litigation process;

b) enhance capacity in data cleaning to improve data accuracy; and

c) implement a complete view of taxpayer debt status from Customs and Domestic taxes.

Compliance Improvement

Compliance gap is one of the key factors contributing to declining trends of tax revenue. Measures to boost compliance will include the following;

01

Adoption of a strategic and collaborative approach to Compliance Risk Management:

- enhancing the capacity of the CRM to promote compliance improvement plannings;
- strengthening the CRM Committee to oversee all aspects of CRM by promoting collaboration across departments;
- using environmental scanning and research studies to support top-down identification and prioritization of strategic risks.

02

Supporting voluntary compliance:

- intensifying taxpayer education about the links between taxes and services provided by Government;
- improving staff integrity; and
- enforcing sanctions to deal with tax malpractices.

03

Supporting voluntary compliance through improved taxpayer services:

- sending periodic electronic reminders for returns and payments to the taxpayers;
- enhancing cooperation with private sector stakeholders

Compliance Improvement con't..

Tax Refunds

- Delayed payment of tax refunds affects the cash flow of taxpayers,
- delays in payment of has been partly due to insufficient allocation of funds ;
- To improve management of tax refunds the Government will:
- regularly review the allocation for refunds;
- ensure prompt payment or offsetting of validated refunds;
- enhance the capacity of processing refunds; and
- review the framework for processing refund

Staffing of Tax Administration

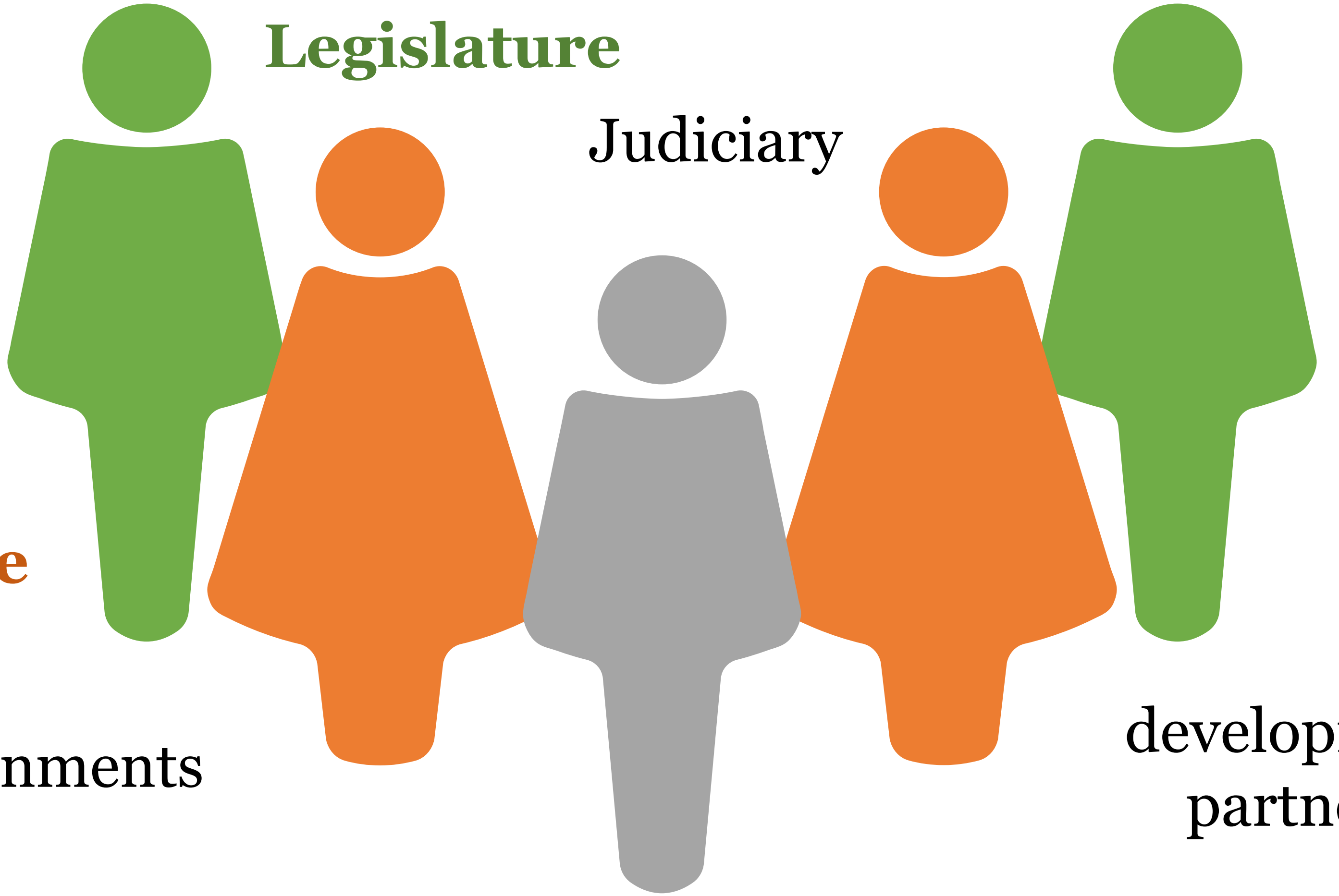
Revenue collection requires adequate and well-trained staff;
KRA is currently understaffed and there is high staff turnover;
To address this, the following initiatives will be implemented:
comprehensive skills gap analysis to inform recruitment;
training of staff on specific skills; and
Develop measures to facilitate staff retention.

Taxpayers Audit

- Taxpayer's audit helps KRA to know whether taxpayers comply with tax laws; There has been a weakness in this area. The following measures will be implemented:
- Strengthening taxpayers audit function through staff training/recruitment leveraging on technology;
- Increase the number of audits across all tax heads and all taxpayer segments;
- Establish a designated post audit technical committee that monitors tax audit quality

Critical Stakeholders

The Strategy has identified critical stakeholders whose input will be key during the implementation phase - Includes



Questions and Answers

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