31 May 2021

The Clerk, Kenya National Assembly

Parliament Buildings

P.O. Box 41842-00100

Nairobi Kenya

Email: clerk@parliament.go.ke

Dear Sir,

RE: CIVIL SOCIETY SUBMISSIONS ON NATIONAL GOVERNMENT FINANCE BILL FOR FY 2021/22

This submission is made by members of *Okoa Uchumi* Coalition, an initiative of civil society organizations interested in Kenyan public finance management issues. More specifically, *Okoa Uchumi* is interested in tax matters as proposed by the Finance Bill 2021, published on 5 May 2021, which sets out the National Treasury's revenue raising measures for the financial year 2021/2022.

The East African Tax and Governance Network (EATGN), National Taxpayers Association (NTA), The Institute for Social Accountability (TISA), Tax Justice Network Africa (TJNA) and Oxfam Kenya worked to analyse the bill and are therefore giving their proposals in this joint memorandum to the National Assembly's Departmental Committee on Finance and National Planning, herein attached to this correspondence.

The Finance Bill 2021 has been analysed in the context of the fiscal consolidation program and its linkage to public debt. Our analysis has also focused on the need for fair taxation, thereby making the following considerations, namely:

1. The impact of proposed tax amendments should be clearly set out to ensure that gains made by increasing tax revenues are not reversed by reduction in economic activity.
2. Taxes should be equitable so that an increasingly unjustified burden should not be placed on the poor.
3. Tax exemptions should not be arbitrary and discretionary as this increases the scope for tax abuse and reduced government revenue.

Thank you for your consideration,

Yours sincerely,

Leonard Wanyama, Coordinator, EATGN,

on behalf of *Okoa Uchumi* Coalition

Date: 31 May 2021

REPUBLIC OF KENYA

THE NATIONAL ASSEMBLY- FIFTH SESSION

FINANCE BILL, 2021 (NATIONAL ASSEMBLY BILL NO. 18 OF 2021)

FINANCE BILL, 2021 (NATIONAL ASSEMBLY BILL NO. 18 OF 2021)

NO.	**CLAUSE** *(as it is in the Bill)*	**PROPOSED AMENDMENT**	**JUSTIFICATION**
1.	**Clause 7** Section 16 of the Income Tax Act is amended in subsection (2) by— (a) deleting paragraph (j) and substituting therefore the following new paragraph-- (j) gross interest paid or payable to related persons and third parties in excess of thirty per cent of earnings before interest, taxes, depreciation and amortization of the borrower in any financial year: Provided that - (i) any income which is exempt from tax shall be excluded from the calculation of earnings before	Include new provision. This paragraph shall not apply to micro small and medium size enterprise.	The Finance Bill proposes to expand the thin capitalization rules to henceforth apply to all businesses using debt financing. Prior to this, thin capitalization rules were limited to foreign controlled entities. Under the proposed rule, where a business obtains debt financing, the amount of interest expense that it can deduct is limited. The new proposal seeks to limit the amount of interest expense allowed as a deduction to 30% of the Earnings Before Interest, Taxes, Depreciation and Amortization (EBITD). Further, any payment that is economically equivalent to interest and expenses

	interest, taxes, depreciation and amortization; and (ii) this paragraph shall apply to— (A) interest on all loans; (B) payments that are economically equivalent to interest; and (C) expenses incurred in connection with raising the finance.		incurred in connection with raising the finance will be subject to the restricted deduction. The proposal is in line with international reforms in taxation which are aimed at reducing the avenues for tax evasion through structuring of financing arrangements. This proposal will impact all business that rely on debt financing, by restricting how much interest expense they can deduct and consequently, increase the cost of financing businesses using debt. Though informed by the need to curb tax leakages through employment of complex tax structures, this proposal is untimely, considering that many businesses are debt laden following difficult environment in 2020. It is also likely that businesses that were adversely affected will need to acquire additional financing for their operations and limiting how much interest can be deducted is punitive. The proposal is likely to particularly to have an adverse impact on small and micro enterprises. Micro small and medium enterprises constitute 80% of the business in Kenya[1] with small and micro

[1] Kaberia, S. K., & Muathe, S. M. (2020). Effect of Covid-19 Pandemic on Performance of Women Owned Micro, Small and Medium Enterprises in Kenya. International Journal of Social Science Studies, 9(1), 7. doi:10.11114/ijsss.v9i1.5089.

			enterprises in Kenya contributing up to 40% of the GDP.[2] These entities play a major role in creating employment with the sector estimated to employ about 14 million people.[3] Most of these enterprises are owned by women with the International Finance Corporation estimating at one in three are owned by women globally. As it stands, micro and small enterprises face challenges in obtaining credit from the formal sector. Thus, they are often forced to get credit at much higher interest rates. The Covid 19 pandemic exacerbated the situation since most of the businesses were adversely impacted and had reduced or no revenues in some cases. Accordingly, since most financial institutions base interest rates on past performance, most are unlikely to qualify for financing or when they do qualify, the loans are offered at much higher interest rates. Thus, by limiting the amount of interest that they can deduct, this provision is likely to have an adverse impact on their already repressed revenues. The same is likely

[2] Wakiaga, P. (n.d.). The Focus on SMEs is a welcome Intervention [Web log post]. Retrieved May 28, 2021, from https://kam.co.ke/the-focus-on-smes-is-a-welcome-intervention/

[3] Kaberia, S. K., & Muathe, S. M. (2020). Effect of Covid-19 Pandemic on Performance of Women Owned Micro, Small and Medium Enterprises in Kenya. International Journal of Social Science Studies, 9(1), 7. doi:10.11114/ijsss.v9i1.5089

			to be felt by the youth who also find themselves in the same position.
2.	**Clause 21 (b)** *21. The First Schedule to the Value Added Tax Act, 2013 is amended—* *(b) in Part II, by adding the following new paragraphs immediately after paragraph 31- 32. The exportation of taxable services.*	Delete proposal on removal of exported services from zero rated supplies to exempt supplies by deleting Clause 21(b) from the Finance Bill 2021.	The Finance Bill proposes to change the VAT status of exported services from zero rated to exempt. This is likely intended to deter accumulation of VAT refunds which remain unpaid to exporters. This proposal will impact exporters of taxable services who previously could claim back all input tax incurred on their purchases. Should this proposal be adopted, exporters of taxable services will be required to absorb the cost of input VAT which will increase their cost of doing business. This proposal is a departure from international best practices as guided by the OECD, where exports are zero-rated.
3.	**Clause 22 (b)** *22.The Second Schedule to the Value Added Tax Act, 2013 is amended— (b) by deleting paragraph 13A.*	Delete proposal on the removal of ordinary bread from zero rated to exempt by deleting Clause 22(b) from the Finance Bill 2021.	The Finance Bill proposes to change the status of ordinary bread from zero rated to exempt. This will increase the retail cost of ordinary bread as manufacturers shift the tax to final consumers. Where goods are exempted rather than zero-rated, it means that input VAT incurred cannot be deducted. Thus, where the manufacturers have incurred input

			VAT on things like electricity and obtaining other supplies, these costs will be absorbed by the manufacturer who will likely pass it on to the consumer. Whereas in the case of zero-rating, the input VAT would be deductible and thus, the government would refund the manufacturer the cost of input VAT incurred along the chain. Bread is widely consumed by many households in Kenya as it is an affordable option for breakfast for many households and lunch option for many informal sector workers who cannot afford to buy hotel food. Removal of ordinary bread for zero rated supply to exempt, and consequent increase in its price will impact many households including the poor and informal sector workers. The move is inequitable as it is likely to impact the poor more as they will spend a larger portion of their income on purchasing bread as compared to those with greater income. This is likely to have an even greater impact of women and youth who comprise a greater percentage of the poor in Kenya. 48 percent of the youth in Kenya are deemed to be poor with female led households comprising a greater percentage of

			the poor and vulnerable in Kenya. According to data from USAID, external shocks are more likely to impact the already vulnerable with 44% of the poorest households reducing their food consumption when faced with such shocks.[4]
4.	**Clause 25 (a) (iv)** *25. The First Schedule to the Excise Duty Act, 2015 is amended— (a) in paragraph 1 of Part 1—* *(iv) by deleting the expression "11,608.23 per unit" appearing against the description "Motorcycles of tariff - 87.11 other than motorcycle ambulances and locally assembled - motor cycles" and substituting therefor the rate"15%"*	A fixed rate should continue to apply to motorcycles below KES 150,000 and the *advalorem* rate to apply to motorcycles above KES 150,000.	The Bill proposes to amend the rate of excise duty on imported motorcycles from a fixed amount of KES 11,608, per unit to 15% of the excisable value. The impact of this change will be felt by anyone purchasing a motorcycle worth more than KES 77,308. This proposal will result to increased government revenues from high value motorcycles but will however potentially impact the *bodaboda* industry which currently provides a means of livelihood to approximately 5 million Kenya households directly or indirectly[5] and is a source of employment especially for the youth. The current retail price of a *bodaboda* is estimated to be between KES 58,000 and 150,000[6] which means that many

[4] : Hyun, Mia – Senior Gender Expert; Okolo, Wendy – Senior Gender Expert; Munene, Aurelia – Gender Expert. USAID/Kenya Gender Analysis Report. Prepared by Banyan Global. 2020.

[5] https://www.businessdailyafrica.com/bd/lifestyle/society/boda-boda-industry-is-key-cog-in-our-economy-2253802

[6] https://www.businessdailyafrica.com/bd/corporate/shipping-logistics/the-good-fast-growing-boda-boda-transport-3293654

			new importers of *bodabodas* will be affected by the increase in tax. A fixed rate should continue to apply to motorcycles below KES 150,000/-. This will protect the *bodaboda* industry that provides a means of livelihood to 5 million families, while raising revenue from importation of luxury motorcycles. The youth engaged in *bodaboda* business will be impacted by the *advalorem* Excise Duty imposed on imported motorcycles above KES 77, 308.
5.	**Clause 29** Section 31 of the Tax Procedures Act, 2015 is Amendment of section 31 of No. amended— 29 of 2015 (a) in subsection (4)(b), by deleting the words "five years" and substituting therefor the words "seven years"; (b) in subsection (6)(a), by deleting the words "five years" and substituting therefor the words "seven years".	Provision to be included that exempts this provision from applying to small and micro enterprises.	The Bill proposes to extend the statute of limitation from 5 years to 7 years. This proposal aims to provide more time for the KRA to carry out its audits and potentially generate more revenues. The statute of limitation was revised from 7 years to 5 years to increase efficiency by requiring the revenue authority to close on tax audits within a reasonable period. The proposal will impact all businesses by imposing an administrative requirement for business to maintain records for longer period. This may increase cost of administration where a business has high volume of transactions and may be forced to

			higher storage facilities. Proposal should not apply to small and micro enterprises that struggle with maintenance of records and are likely to feel the impact of this amendment.
6.	2(a) a fixed place of business through which business is wholly or partly carried on and includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction or exploitation of natural resources, a warehouse in relation to a person whose business is providing storage facilities to others, a farm, plantation or other place where agricultural, forestry plantation or related activities are carried on and a sales outlet; s. 2(e) (vi) A dependent person who works on their behalf in respect of any activities which that person undertakes in Kenya including habitually concluding contracts, or playing the principal	In sub-paragraph (a) include the following words after the words natural resources: "*including from offshore drilling sites*" Addition of the following words to paragraph (e) as follows: "(e) or *the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but habitually maintains in that State a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise.*" Addition of the following words after paragraph (e) *"(f)Notwithstanding the preceding provisions of this section, an insurance enterprise of a*	This is a welcome change that aligns with international best practice by widening the scope of the definition. This is bound to increase tax revenues for the government and will reduce tax avoidance. It is however proposed to include insurance permanent establishments, stock agent permanent establishments and offshore drilling for completeness.

	role leading to the conclusion of the contracts that are routinely concluded without material modification by the person,	*Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.*"	
7.	s.2 (a) "control", in relation to a person, means— (f) the person or a person designated by that person— (i) supplies at least ninety per cent of the supply of the purchases of another person; (ii) in the opinion of the Commissioner, influences the prices or other conditions relating to the supply of the purchases of another person;	Deletion of provision (f)(i) (ii) and (g) (ii)	Whilst this follows the trend in certain emerging economies such as Brazil, India, and China whereby control is determined on not only de jure relationships based on company law, such as shareholding and managerial relationships but also on economic relationships, this departs from the prevailing OECD and UN principles and increases administrative complexity. Gains to be made from

	(g) (ii)in the opinion of the Commissioner, influences the price or any other condition of the sales of another person;		increased tax revenue may be marginal if any and could be overshadowed by increased administrative costs. Due care should be taken to estimate revenue gains to be made. In addition, provisions granting the Commissioner unrestrained powers to determine control increase uncertainty amongst taxpayers who may be genuinely conducting their affairs in accordance with the law.
8.	Section 39B of the Income Tax Act is amended in subsection (1) by inserting the words “or technical and vocational education and training” immediately after the word “university”.	Amend by deleting the words *'six to twelve months'* and inserting the words *'three months'* in definition of graduate apprentice in paragraph 2 of the Income Tax Act (Set-Off Tax Rebate for Graduate Apprenticeships) 2016. Delete the words *'six to twelve months'* in paragraph 5 (i) of the Income Tax Act (Set-Off Tax Rebate for Graduate Apprenticeships) 2016 Delete the words *'ten employees'* and insert the words *'two employees'* in section 39B(1) of the Income Tax Act Cap 470	This is a welcome proposal. However, to increase the update of this scheme, the stringent requirements of the (Set-Off Tax Rebate for Graduate Apprenticeships) Regulations, 2016 should be amended. Reducing the number of apprentices and the duration of the apprenticeship would increase uptake as smaller employers who can only take up a few apprentices would also be able to participate. This would have a direct impact on increase in employment rates.

		Delete the words *'six to twelve months'* and inserting the words *'three months'* in section 39B(1) of the Income Tax Act Cap 470	
9.	The Second Schedule to the Miscellaneous Fees and Levies Act, 2016 is amended— (a) in Part A, by inserting the following new item immediately after item (xxv)— (xxvi) such other goods the exemption of which the Cabinet Secretary may determine is in the public interest, or to promote investment and the value of which shall not be less than five billion shillings. (b) in Part B, by inserting the following new item immediately after item (ix)— (x) such other goods the exemption of which the Cabinet Secretary may determine is in the public interest, or to promote investment and the value of which shall not be less than five billion shillings	Delete proposal and include the following provision in Part A by inserting the words: Such other goods the exemption of which was determined to be in the public interest or promotion of investment prior to 30th June 2020.	While this may reduce the risk of breach of government contracts with IDF and RDL exemption clauses, (given the removal of this exemption in 2020) it allows for wide discretion in the exemption of IDF and RDL and the unjustified reduction of tax revenue for the government. It is instead proposed that transitional provisions be included to allow for IDF and RDL exemption on supplies relating to contracts executed prior to 30 June 2020 for the approved duration of the contracts.
10.	The First Schedule to the Excise Duty Act 2015 is amended a) in paragraph 1 of Part I–	Delete proposed amendment	While this move may increase revenues for the government, given that this has previously had the effect of increasing competition for domestic manufacturers, a cost benefit analysis is

	(i) by deleting the word "imported" appearing in the description "Imported sugar confectionary of tariff heading 17.04";		recommended before the implementation of the provision.
11.	Section 34 of the Value Added Tax Act, 2013 is amended by deleting subsection (9).	Delete the words: *''The Cabinet Secretary may, in regulations, provide for the registration of a group of companies as one registered person for the purposes of the Act*'' And replace with *''A group of companies may be registered as one person for the purposes of the Act''*	There is a lack of clarity in the interpretation of the proposed amendment. A direct reading of the provision implies that group VAT registrations will no longer be possible. It has however been suggested elsewhere that the deletion of the provision is necessary as the Cabinet Secretary is already provided with a general power to make regulations under section 67 of the Act. This former interpretation would increase compliance costs for VAT groups and reduce the ease of doing business. The proposed amendment should be clarified.