THE INSTITUTE FOR SOCIAL ACCOUNTABILITY

REVIEW OF THE IMF PROGRAM DOCUMENT AND THE FINANCE BILL 2021 TO IDENTIFY POTENTIAL IMPACT OF PROPOSED TAX REFORMS ON WOMEN, YOUTH, MSMES AND JUA KALI

FINAL REPORT

JUNE 2021

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1. Background

Kenya's budget deficit has been rising in the past decade partly due to ambitious infrastructure projects by the government and tax revenues that have not grown proportionally to the growth in the economy. The Covid 19 pandemic worsened the already high budget deficit in 2020 by significantly reducing government revenues due to tax cuts introduced to cushion the private sector, lower business performance especially in the hospitality, education and manufacturing sectors as well increased government spending in the health sector and social security programmes.

To fund the budget deficits, the government resorted to heavy borrowing. Kenya's debt in 2020 increased to KES 6.7 trillion from KES 5.8 trillion in 2019.[1] High government borrowing has resulted in the country's debt being profiled as sustainable but with high risk of distress[2] which raises concerns on Kenya's ability to sustainably service its debt, while also financing essential social and economic priorities.

The projected budget deficit in 2021 is KES 930 billion which will be funded mostly through additional debt.[3] In an effort to bridge the budget deficit, the Kenyan government requested for Financing from the IMF under the under Extended Credit Facility (ECF) and Extended Fund Facility (EFF). The IMF approved a 38-month arrangement to the Kenyan Government equivalent to USD 2.34 Billion on 2 April 2021.[4] The amounts are intended to support the country's Covid 19 response, as well as address the country's urgent debt vulnerabilities.

The funds from IMF through the ECF and EFF program are conditional on the Kenyan government's commitment to implement fiscal reforms to address the current budget deficits and high debt levels. Under the IMF program, the government is required to undertake fiscal consolidation efforts which focuses on increasing tax revenues, reduce public spending while safeguarding resources to protect vulnerable groups, and implement governance reforms meant to address weaknesses in state owned enterprises and curbing corruption.

[1] The National Treasury, 2020, Budget Policy Statement 2020
[2] MF Country Report No. 21/72 - Requests for An Extended Arrangement Under The Extended Fund Facility And An Arrangement Under The Extended Credit Facility—Staff Report, April 2021.
[3] The National Treasury, *Ibid.*
[4] Ibid

This paper focuses on the fiscal consolidation reforms that the Kenyan government is required to undertake under the IMF lending program, and specifically, the tax revenue raising measures that have been proposed. It explores the extent to which the tax reforms recommended by the IMF have been adopted in the 2021 Finance Bill and the likely impact of those reforms especially on vulnerable groups such as the poor, women, the youth and MSMEs. It also explores the extent to which the reforms proposed in the Finance Bill 2021 adheres to the principles of public finance management in line with the Constitution and the Public Finance Management Act.

2. Principles of Public Finance Management

Public finance management in Kenya is governed by the Kenyan Constitution 2010 and the Public Finance Management Act, 2012. Section 201 of the Constitution outlines the principles that should guide public finance management in Kenya. Regarding revenue mobilization, the Constitution requires that the burden of taxation be shared equitably, and public participation be enforced in all public financial matters. It further requires that national taxes be imposed only through national legislation. The Public Finance Management Act, 2012 which governs the management of public finances at national and county levels requires that a reasonable degree of predictability be maintained with respect to the level of tax rates and tax bases when undertaking tax reforms.

Although Kenya is not a member of the Organisation for Economic Cooperation and Development (OECD), the Kenyan Government has actively adopted recommendations proposed by the OECD especially those aimed at preventing tax evasion and avoidance by multinational companies through abuse of tax treaties and transfer pricing arrangements. The Finance Bill 2021 contains proposals that are adopted from the OECD international best practices for curbing tax evasion and avoidance which include amending the definition of Permanent Establishment in the Income Tax Act and expanding the scope of digital service tax as discussed later in the report.

3. Tax Reforms Proposed under the IMF Program

The 2021 IMF lending program recognizes and applauds various measures already undertaken by the Kenyan government in 2020 - in line with past IMF advice[5] - as well as tax measures introduced in January 2021.

Through the tax amendment Act 2020 and the Finance Act 2020, the Kenyan government significantly reduced tax incentives by lowering the capital deduction rates contained in the Income Tax Act and eliminated several VAT exemptions.

In January 2021, the Kenyan government reversed most of the tax cuts and incentives which were introduced in April 2020 with the aim of cushioning Kenyans against the adverse impact of Covid 19. These reforms included reinstatement of corporate income tax rate to 30% (from a reduced rate of 25% in 2020), reinstatement of VAT rate to 16% (from a reduced rate of 14% in 2020) and a reinstatement of highest band rate in PAYE to 30% (from a reduced rate of 25% in 2020). In addition, the government introduced a minimum tax at 1% on turnover[6] and a digital service tax at 1.5% of gross transaction value for business conducted in a digital marketplace.

While the IMF applauds the Kenya government for the extensive reforms to increase tax revenues as noted above, the Fund is of the view that there is still potential for additional revenue of 2.6% of GDP within the VAT, by further removal of exemptions outside of agriculture and limiting the items that are zero-rated. The IMF also maintains that there is a revenue potential of 0.8% of GDP from equitable taxation of capital income and from excise taxes. In addition, the IMF supports the minimum tax introduced with effect from 1 January 2021 on the basis that it is a valuable tool to increase revenues and ensure tax equity by requiring everyone to pay a minimum tax.

The 2021 IMF program contains minimal recommendations for raising additional taxes but is supportive of measures already introduced by Kenyan Government in 2020. There is consensus that increasing tax revenues and exercising fiscal discipline is necessary to reduce the high reliance on debt financing by the Kenyan government. The point of departure however is the manner and

[5] The IMF, IMF Country Report No 18/295 (KENYA), October 2018 Available at https://www.imf.org/en/Publications/CR/Issues/2018/10/23/Kenya-Staff-Report-for-the-2018-Article-IV-Consultation-and-Establishment-of-Performance-46301

[6] Enforcement of minimum tax is currently suspended by the High Court Order as already discussed in note 5 above.

the extent to which the government should increase the taxes. Some of the tax raising initiatives that IMF program supports are positive and should be supported by TISA, others should be evaluated on a case-by-case basis, while others should be opposed as discussed below;

IMF's support on the removal of tax incentives in the Income Tax Act is a positive move which TISA should support. Tax incentives have been observed to result to tax leakages without a proportionate increase in benefits from new investments[7]. Further, tax incentives primarily benefit the rich and thus shifts the tax burden to the less wealthy and the poor.

IMF's support on the removal of VAT exemptions should be reviewed on a case-by-case basis. Removal of VAT exemptions on non-essential items is a positive move while removal of VAT exemptions on essential goods and services harms the poor by disproportionately increasing their tax burden relative to their income.

IMF's support on the introduction of minimum tax on all taxpayers regardless of their performance will negatively impact businesses that are genuinely loss making and struggling to stay afloat especially after a difficult operating environment due to Covid 19. Further, requiring all businesses to pay a standard rate of tax on turnover without regard to the different profit margins across industries goes against the principle of ensuring equity. Although the minimum tax is currently suspended, TISA should not support this initiative in its current form. We recommend that TISA actively lobbies for a threshold for the application of the tax. They can, for example propose that the tax be applied to companies that have been in losses for specific number of years. Alternatively, the tax can be applied on gross profit or EBITDA since this eliminates the indirect costs that are mainly used in tax planning and avoidance.

4. Proposed Revenue Raising Reforms contained in the Finance Bill 2021

The main objective of the Finance Bill 2021 seems to be focused on providing clarity in legislation, promoting equity and ensuring harmonization in tax administration instead of aggressively raising tax revenues. For instance, the Bill provides clarity by providing definition of various terms and

[7] Tax-Incentives_eng.Pdf', accessed 15 June 2021, https://www.un.org/esa/ffd/wp-content/uploads/2018/02/tax-incentives_eng.pdf.

amending clauses that caused ambiguity. The Bill further seeks to promote equity by aligning the withholding tax rates and capital allowances in the extractive sector to other sectors.

The 2021 Finance Bill has sought to introduce various tax raising measures key among them, by changing the VAT status of exported services from zero rated to exempt, and exempting from VAT ordinary bread instead of zero-rating, reinstatement of excise duty on betting, imposing excise duty on jewellery and nicotine products, and changing the excise duty rate for imported motorcycles (other than motorcycle ambulances) from a fixed amount to an ad valorem rate of 15%.

Below is detailed discussion on the revenue raising measures proposed in the Finance Bill 2021 and who is likely to be impacted.

4.1 Proposals in Income Tax

4.1.0 Thin capitalization rules

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 incurred in connection with raising the finance will be subject to the restricted deduction. The proposal is in line with international reforms in the area of tax 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 have an adverse impact on small and micro enterprises. Micro small and medium enterprises constitute 80% of the business in Kenya[8] with small and micro enterprises in Kenya contributing up to 40% of the GDP.[9] These entities play a major role in creating employment with the sector estimated to employ about 14 million people.[10] A majority 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 to be felt by the youth who also find themselves in the same position.

4.1.1 Withholding Tax in the extractive sector

The Finance Bill proposes to amend the withholding tax rates applicable on various payments made in the extractive sector. The proposed withholding rate on payments to subcontractors has been increased from 5.625 to 10% while the withholding tax rate on management, professional and training fees has been reduced from 12.5% to 10%.

This proposal will impact suppliers of services to companies in the mining and petroleum operations. The increase in withholding tax rates for subcontractors will raise additional revenues for the government but will increase the cost of exploration and extraction of natural resources which is highly capital intensive and involves high risk. The reduction of withholding tax rate on

[8] 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.

[9] 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/

[10] 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

management and professional fees has aligned the applicable withholding tax rate in the extractive sector to similar services in other sectors, which may be argued to be equitable.

4.1.2 Digital Service Tax

The Finance Bill has provided clarification on services that are subject to digital service tax by including income from business carried out over the internet or an electronic network as well as a through a digital marketplace. The Finance Bill further exempts resident persons from DST and also exempts from DST, income of non-residents that is already subject to taxes such as withholding tax or telecommunication tax. The exclusion of resident persons from DST is likely due to the possible accumulation of tax credits by resident persons since they are entitled to a credit against the DST paid. The exemption may also be due to the requirement for resident persons to pay minimum tax at 1% on turnover. Imposing DST in addition to minimum tax would have been punitive since both taxes are paid on turnover. It remains to be seen whether the exemption on residents will remain in case the taxpayers win the case against imposition of minimum tax.

4.1.3 New Definition of Permanent Establishment

The Finance Bill has sought to introduce an expanded definition of permanent establishment. The new definition is in line with global efforts aimed at curbing tax avoidance by multinational companies, by circumventing the PE rules. The new definition includes the concept of service PE which is contained in the UN Model Convention. While the new definition is adopted from the UN and OECD Model Conventions, it is more stringent in some cases for instance, the new PE definition does not have a period threshold for a non-resident person to create a PE through a fixed place of business, which is usually stated as either 6 months or 12 months in Model Conventions. The implication is that a non-resident may create PE from inception of business if they operate from a fixed place of business. Further, the new definition contains the concept of service PE but with a shorter period of 91 compared to UN model Convention of 183 days.

4.1.4 Definition of Control

The Finance Bill has reintroduced definition of control which had been deleted when the Tax Law Amendment Act overhauled the Second Schedule to the Income tax Act. The new definition is extremely broad and extends beyond shareholding voting rights and common directorship to include being majorly financed by a person who is not a financial institution, sole reliance on the know-how, copyright, trademark, patent, franchise of another person to conduct business, and dependence on a person as the major supplier of customer.

The definition of control is useful in establishing instances when transfer pricing should apply. An extremely broad definition creates the risk of presuming independent entities as being related thus subject to transfer pricing for instance, franchises and contract manufacturing. This will impose transfer pricing rules to independent parties which is inconsistent with international standards.

4.2.0 Proposals in VAT Act

4.2.1 Change of VAT status for exported services.

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.

4.2.2 Change of VAT status of ordinary bread.

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 on 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.[11]

4.3.0 Proposals in Excise Duty Act

4.3.1 Reintroduction of Excise Duty on betting

The Bill proposes to reintroduce Excise Duty on betting at 20% of the amount waged. Excise duty on betting was introduced in 2019 but was later removed in 2020. This proposal if adopted will impact betting companies as well as players by raising the cost of betting. Imposing excise duty on betting is a positive move and may help curb the extensive proliferation of betting especially among the unemployed youth in addition to raising tax revenues.

This proposal is consistent with the general application of Excise Duty where it is charged on among others, items that are considered moral or social hazards and extensive betting may be a social hazard when coupled with high unemployment rates among the youth.

4.3.2 Excise Duty on jewellery

The Bill proposes to introduce Excise Duty on jewellery at a rate of 10%. The proposal if adopted will impact producers and consumers of jewellery by increasing the cost of production and subsequently the selling price. Though the tax is more targeted at women who are the target consumers of jewellery, it is in line with the equity principle of taxation that states that the richer

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

should pay higher taxes. Since jewellery is considered a luxury good, it is more likely to be bought by those with disposable incomes.

4.3.3 Excise duty on Motorcycles

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[12] 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[13] which means that many new importers of bodabodas will be affected by the increase in tax.

The proposal to introduce higher excise duty on imported motorcycles may be argued to be deliberate move by the government aimed at encouraging purchase of locally assembled motorcycles. The Kenyan motorcycle assembly industry is estimated to be operating at 50% capacity and the Government intends to prioritize motorcycle assembly[14]. The decision on whether to support this proposal should be informed by comparing the cost of locally assembled motorcycles against the cost of imported motorcycles.

4.4.0 Proposals in the Tax Procedures Act

4.4.1 Extension of the statute of limitation period

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.

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

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

[14] Government of Kenya (2019) Draft National Automotive Policy accessed on 15 June 2021 at https://www.industrialization.go.ke/images/downloads/policies/draft-national-automotive-policy-february-2019.pdf

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. Small and micro enterprises that struggle with maintenance of records are likely to feel the impact of this amendment.

4.4.2 Elimination of Withholding VAT exemptions for certain suppliers

The Bill proposes to eliminate Withholding VAT exemption for suppliers with perpetual credits. The 2020 Finance Act allowed suppliers with perpetual VAT credits to apply for an exemption from withholding VAT to avoid accumulation of VAT refunds.

While this proposal does not increase government revenues, it will improve government's cashflow but result to cashflow constrains for businesses with perpetual VAT credits. Such businesses will end up accumulating VAT refunds which normally take long time to be refunded by the KRA.

5. Alignment of the Finance Bill to the IMF Proposals

Overall, the 2021 Finance Bill contains minimal revenue raising measures compared to the 2020 amendments. The main proposal that aligns with IMF recommendations is removal of exported services and ordinary bread from zero rated to exempt supplies.

The recommendation by the IMF to further reduce VAT exemptions has been implemented minimally in the Finance Bill 2021 and the items currently proposed to be subjected to VAT are not basic supplies that would adversely impact the vulnerable groups such as the poor, women and the youth. Contrary to IMF's recommendations, the 2021 Finance Bill has reinstated several VAT exemptions that were removed in 2020 and added new VAT exemptions mostly on medical supplies.

Further, Finance Bill has not proposed any reforms on taxation of capital income as recommended by the IMF. These would have included equalizing the tax rates for capital gains with that of income tax so as to curb tax avoidance through mischaracterization of income. The Bill instead includes new income tax incentives such as expanding tax rebate available to employers who provide internships to graduating students to benefit those who employ students from universities as well as other vocational institutions.

Further in a bid to reduce evasion by multinationals, the Finance Bill has expanded various definitions such as that of control and permanent establishments. This is in line with the Base Erosion and Profit Shifting (BEPs) action plans. Similarly, the Bill introduces country by country reporting. Though Kenya has few multinationals that are likely to meet the threshold, it does provide an opportunity for Kenya to view country by country reports filed by multinationals which have entities in Kenya. This is likely to create transparency and reduce avenues for tax evasion and avoidance.

6. Conclusion and Recommendations

Compliance by National Treasury with principles of taxation

On one hand, the Kenyan government has made efforts to adhere to some of the principles of taxation contained in the Constitution, the Public Finance Management Act and international best practices. For instance, the government overhauled the income tax incentives in 2020 to ensure fair distribution of the tax burden. The Finance Bill 2021 also contains proposals aimed at addressing equity concerns such as aligning tax incentives in the extractive sector to those of other sectors. On the other hand, the government introduced minimum tax on all taxpayers effective 1 January 2021[15] which is based on turnover, at a standard rate, and without regard to the performance and profit margin of businesses which goes against the principle of tax equity. This points to lack of a consistent approach by government in addressing the issue of equity in the Kenyan tax system.

Further, Kenyan tax laws are generally unpredictable which makes it difficult for business owners to make long term investment plans. For instance, the Finance Bill 2021 has proposed to reverse several tax laws that were introduced in 2020 with no justification provided to the public on the same. The seeming arbitrary introduction and removal of tax laws may be due to lack of a National

[15] The tax is currently suspended by the High Court vide Constitutional Petition No. E005 of 2021

Tax Policy which the Cabinet Secretary for Treasury indicated is under development[16]. A National Tax Policy Framework will be useful in ensuring consistency and certainty in tax legislation.

Proposals contained in 2021 Finance Bill

The removal of exported services from zero rated supplies to exempt supplies will increase the cost of doing business to exporters of services since they will not be able to recover their input VAT. This proposal is also inconsistent with the international tax practices where exports are zero rated. However, the same is unlikely to have an impact on the vulnerable segments of society. TISA can opt to lobby for this proposal though it is not necessarily in its core mandate.

Many households will be impacted by removal of ordinary bread from zero rated to exempt supply since manufacturers will pass on the tax to consumers by increasing the price. Informal workers who rely on bread for lunch since they cannot afford hotel meals will have to bear the burden of increased cost on bread. Bread is a basic commodity that is consumed even by the poor and we therefore recommend that TISA actively lobbies for this proposal to be rejected.

The youth will be impacted by the proposal to reintroduce Excise Duty on betting. This is however a positive impact since betting has been associated with several moral and social hazards, especially among unemployed youth. We recommend that TISA supports this proposal. We also recommend that TISA supports the proposal to introduce excise duty on jewellery since it is a luxury product and support the proposal to introduce excise duty on nicotine products due to the adverse health effects of nicotine and consequent impact on financing health.

The youth engaged in *bodaboda* business will be impacted by the *advalorem* Excise Duty imposed on imported motorcycles above KES 77, 308.We recommend that TISA supports this proposal, provided the cost of locally assembled motorcycles is similar to or lower than the cost of imported motorcycles. In case the cost of locally assembled motorcycles is higher, we recommend that TISA rejects this proposal and lobbies that the fixed rate continues to apply to motorcycles below KES 150,000 and the *advalorem* rate to apply to motorcycles above KES 150,000. This will protect the

[16] According to the Cabinet Secretary's (National Treasury) 2021 Budget Speech, a draft National Tax Policy is ready and will be shared with stakeholders and members of the Public. The speech is available at https://www.treasury.go.ke/speeches/ accessed on June 16, 2021

bodaboda industry that provides a means of livelihood to 5 million families, while raising revenue from importation of luxury motorcycles.

The proposal to restrict deductible interest to 30% of EBITDA will negatively impact all businesses that rely on debt financing. SMEs will be especially impacted since they are already disadvantaged in ability to access credit. Increasing the cost of financing for SME's by restricting deduction of interest is detrimental to their growth. We recommend that TISA lobbies for SMEs to be exempted from this restriction to ensure that their cost of financing is affordable. This can be done by requiring the government to set a threshold for business to whom the requirement applies.

The proposal to restrict Digital Service Tax to non-resident is equitable if minimum tax is maintained for residents after current court process is completed. In absence of a minimum tax, failure to impose DST to residents will be inconsistent with global efforts to tax the digital economy. We recommend that TISA proposes a turnover threshold should DST be reintroduced for residents to protect low-income earners from incurring high compliance cost which is disproportionate to their income.

While the introduction new PE rules and broad definition of control will curb tax avoidance, it is likely that Multinationals will lobby against some of the new provisions on the basis that they are not aligned with international standard e.g. absence of a period threshold for service PE and fixed place of business. Given that multinationals are well resourced to lobby against legislation that they find unfavourable, we recommend that TISA refrain from engaging parliament on this.

Although not contained in the Finance Bill 2021, the IMF supports implementation of the minimum tax which became effective in January 2021 but is currently suspended by the High Court. The minimum tax, which is charged at 1% of turnover is expected to curb tax evasion and raise annual revenue of KES 21 billion. While this tax was intended to ensure equity in the burden of taxation especially where some companies perpetually report taxes, it will negatively impact businesses that are in loss position and struggling to stay afloat especially after the negative impact of Covid 19. In addition, requiring all businesses with different profit margins to pay a flat rate of tax on turnover is disadvantageous to businesses with high turnover but low profit margins hence inequitable. Further, the introduction of minimum tax is ill timed. Many businesses especially SMEs need support to remain in operation after the adverse impact of Covid 19 and imposing a tax which is based on turnover is very punitive to struggling businesses. We therefore recommend that TISA actively lobbies for a threshold for the application of the tax. They can, for example propose that the tax be applied to companies that have been in losses for specific number of years. Alternatively, the tax can be applied on gross profit or EBITDA since this eliminates the indirect costs that are mainly used in tax planning and avoidance.