THE FINANCE ACT 2023: BUSINESS IMPLICATIONS 6 MONTHS ON

Since the Finance Act was assented to in June 2023 and as the various provisions have come into force, the implications for businesses in Kenya have become ever more apparent. Meanwhile, the Kenya Revenue Authority (KRA), the government agency responsible for the assessment, collection, and accounting of all taxes, has adjusted its operations to ensure greater tax compliance, further presenting novel challenges for businesses. The main purpose of this article is thus to highlight some of the emergent effects brough about by virtue of the changes enumerated under the Act, from a tax law perspective.

Good Tidings

The **lowering of the corporate tax rate** from 37.5% to 30%, ordinarily remitted within six months following a company's financial year end, has presented a noteworthy relief to companies. Vaccine manufacturers enjoy an even steeper reduction, from 30% to 10%, but major pharmaceutical companies such as Germany's Bayer and Britain's GSK have scaled back their domestic operations, instead opting to outsource. Indeed, business activity remains depressed, with the Purchasing Manager's Index (PMI) – a key indicator of economic health – reading below 50, i.e. demonstrating contraction, for four consecutive months, despite some recovery in December 2023.[1]

For start-ups, considered as tech-based innovative entities, their financing models which may include funds sourced from crowdfunding, grants etc. are still liable to income tax deductions. Tax incentives may however be on the horizon when the Start-Up Bill, in the works since late 2020, becomes law.[2] Nevertheless, such entities with annual revenues exceeding KES 100 million are catered for in the Act, which provides a **tax relief for employees in eligible start-ups** who receive shares given in lieu of cash emoluments, within certain criteria. Such start-ups can benefit from the concurrent retention of skilled personnel and all without incurring extra costs, in terms of capital expenditure. Certainly, this bodes well for Kenya and could see the country retain its leading position on the continent in attracting start-up funding for the foreseeable future.

On **value added tax (VAT)** the shift from standard-rated to 0% VAT for exported services, removing the controversial 2022 provision, has eased concerns among key players, such as consultancies and others, who provide services internationally, and who were previously liable to pay 16% VAT. The new provisions also **zero-rate value addition** for tea and coffee processed for export, a priority area of the Kenya Kwanza regime. Solar, electric mobility, and mobile phone assembly, are some other notable segments currently benefitting from zero-rated tax. A sustained trend in this direction could help spur job creation, industrialisation, and lower the national import bill, further reducing the pressure on the country's forex reserves and boosting the attractiveness of the local economy.

Another key relief for many players in the tech space, and companies across the board procuring digital services, is the lowering of **digital service tax (DST)** from 15% to 3%. This has offset the rising costs modern-day businesses incur on cloud services, web hosting, social media marketing, and much more, at a time service providers have raised their fees to mitigate against the depreciating shilling.

Finally, it should not go unnoticed that corporates or private individuals now enjoy 120 days to conclude the **alternative dispute resolution (ADR)** process with the tax man, up from 90 days, previously.

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1 Stanbic Bank Kenya PMI Report for December 2023 | Stanbic Bank Kenya
2 14-The startup Bill, 2022 formatted (parliament.go.ke)

Making matters worse

For businesses operating in multiple jurisdictions but based in Kenya, **repatriated profits** or foreign earned profits or assets that are returned to the company's home country, are now subject to tax as per provisions in the Act which introduced a new amendment to the Income Tax Act CAP 470. Effective 1st January 2023, re2patriated tax is calculated at the rate of 15% as follows:

$$R=A^1 + (P-T)-A^2$$

> Where R Is the repatriated profit, A^1 represents the company's assets at the beginning of the year, P is the net profit for the year of income, T is the tax payable on the chargeable income and A^2 represents the company's net assets at the end of the year.

An additional pain-point for businesses has been the shift to **advance payment of annual tax on commercial vehicles**, with only agricultural vehicles being spared, on top of the **doubling of VAT on petroleum products**. Notably here, Buzeki Enterprises Ltd, one of the largest local-owned business-to-business (B2B) logistics firms in the region, significantly downsized operations in January 2024, citing the direct negative impact the punitive tax measures were having. Vehicle and Equipment Leasing Ltd (Vaell) is now under administration after defaulting on KES 1.1 billion in debt, following the likes of logistics firm Sendy, placed under administration in mid 2023, and the country's only 'indigenous' tobacco company, Mastermind Tobacco (K) Ltd, which went under in December 2023, affecting over 1,000 workers. African e-commerce giant Jumia Technologies, also shut down its subsidiary food delivery business, Jumia Food, in December 2023, as it did in other African markets, all of which face similar policy and economic headwinds.

Capital gains tax (CGT) has not been left untouched, either. The new Act provides that gains accrued by an individual or a partnership on the transfer of property situated in Kenya or alienation of shares or comparable interests shall be subject to tax if the gains derived from the said alienation of shares or comparable interests is directly or indirectly more than 20 % of the value of immovable property in Kenya, which in itself has been broadened in definition.

Moving on, **non-resident companies** are now affected by the realignments to international standards have seen subsidiaries or constituent entities (CEs) based in Kenya become liable for submitting country-by-country reports on behalf of the ultimate parent entity (UPE). Although subsidiaries are considered part of the parent/holding company and are subject to the same tax procedure as the parent company, they are treated as a separate entity for taxation purposes. Non-resident companies are also subject to Kenya's corporate tax but only based on profits acquired through a permanent establishment within the country. A permanent establishment is created when a non-resident person conducts business activities within Kenya over a given period leading to a significant economic presence in the country.[3]

With the stringent provisions in section 44 of the Finance Act 2023, amending Section 36 of the Excise Duty Act, 2015, the requirement that **alcohol manufacturers** remit excise duty within twenty-four hours, as opposed to the 20th day of every month has disrupted the industry. Reports have emerged of such players put in the awkward and untenable position of borrowing to fulfil their daily tax obligations.

Turnover tax (ToT) has also been revised upwards to 3%, affecting businesses with turnover in excess of KES 1 million a year.

Unsurprisingly, the tax regime, in addition to the high debt burden, has been cited as a key constraint on economic recovery.[4]

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[3] https://www.rsm.global/kenya/insights/tax-insights/permanent-establishment-and-tax-implication-kenya

[4] East Africa Macroeconomic Outlook Volume IV (deloitte.com)

The Road Ahead

It is worth noting corporations and partnerships may be required to remit a variety of other taxes depending on the business they engage in, therefore the types of taxes enumerated above are not exhaustive. Further, given some of the provisions we highlight are only a month old, the scale of impact of for businesses will only become clearer with time.

Admittedly, the impact of these new provisions cannot be said to be the sole driver of the economic malaise currently gripping Kenya, but the cumulative effect is not insignificant, and moreover further disincentivises foreign direct investment (FDI). And while double taxation agreements (DTAs) exist to limit the impact of this for repatriated tax, by either lowering or altogether eliminating one's tax liabilities in the second jurisdiction, the effect is not all-encompassing.[5]

The increase in deductions for housing, social health insurance, as well as fresh tax raids in the form of new levies on Sacco savings, have, in addition to the already suppressed economy, dented purchasing power in the immediate term, further impacting on transaction volumes. The net effect is clear – job openings are significantly down, and layoffs are resurgent. Although revenue collection has been streamlined, it is yet to be seen what impact, if any, this will have on provision of quality services to businesses and consumers, alike. Fundamentally, the unpredictability of the tax regime, the increasing administrative costs of compliance, as well as comparatively higher rates driven by external pressures to lower the country's debt burden, do not portend good fortunes in the medium term.

To end on a positive note, it should be mentioned that the businesses poised to come out ahead of this turbulent economic period will be those with leaner, greener, more tax-efficient structures & operations. Tech start-ups that successfully mobilise the requisite levels of capital for tax benefits, along with exporters of services nimble enough to be globally competitive, will likely prosper. Furthermore, we expect entities that can leverage on the numerous import tariffs raised by the new Act as part of efforts to protect domestic manufacturing and drive job growth, to succeed. **To explore any of the issues covered, please contact us and we will be glad to advise.**

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[5] For a list of countries with which Kenya has double taxation agreements, follow the link to the National Treasury database [Double Taxation Agreements – The National Treasury]