

Analysis and Comments on the Draft National Tax Policy

4th Aug 2022

What mischief does the National Tax Policy
(NTP) seek to address??

Challenges of Kenya's tax system/1

- Existence of hard to tax sectors (dominated by agriculture and large informal sector)

Table 3.1: Total Recorded Employment¹, 2017 - 2021

	2017	2018	2019	2020	2021*
					'000
Modern Establishments					
Wage Employees	2,792.7	2,859.7	2,928.4	2,742.6	2,907.3
Self-employed and unpaid family workers	139.4	152.2	162.7	156.1	163.7
Sub -Total	2,932.1	3,011.9	3,091.1	2,898.7	3,071.0
Informal Sector ²	13,539.6	14,283.6	15,051.6	14,508.0	15,261.8
TOTAL	16,471.7	17,295.5	18,142.7	17,406.7	18,332.8

** Provisional*

Refers to employment stock as at 30th June and excludes small scale agriculture and pastoralist activities.

Estimated

Informal sector share



82.2%



83%



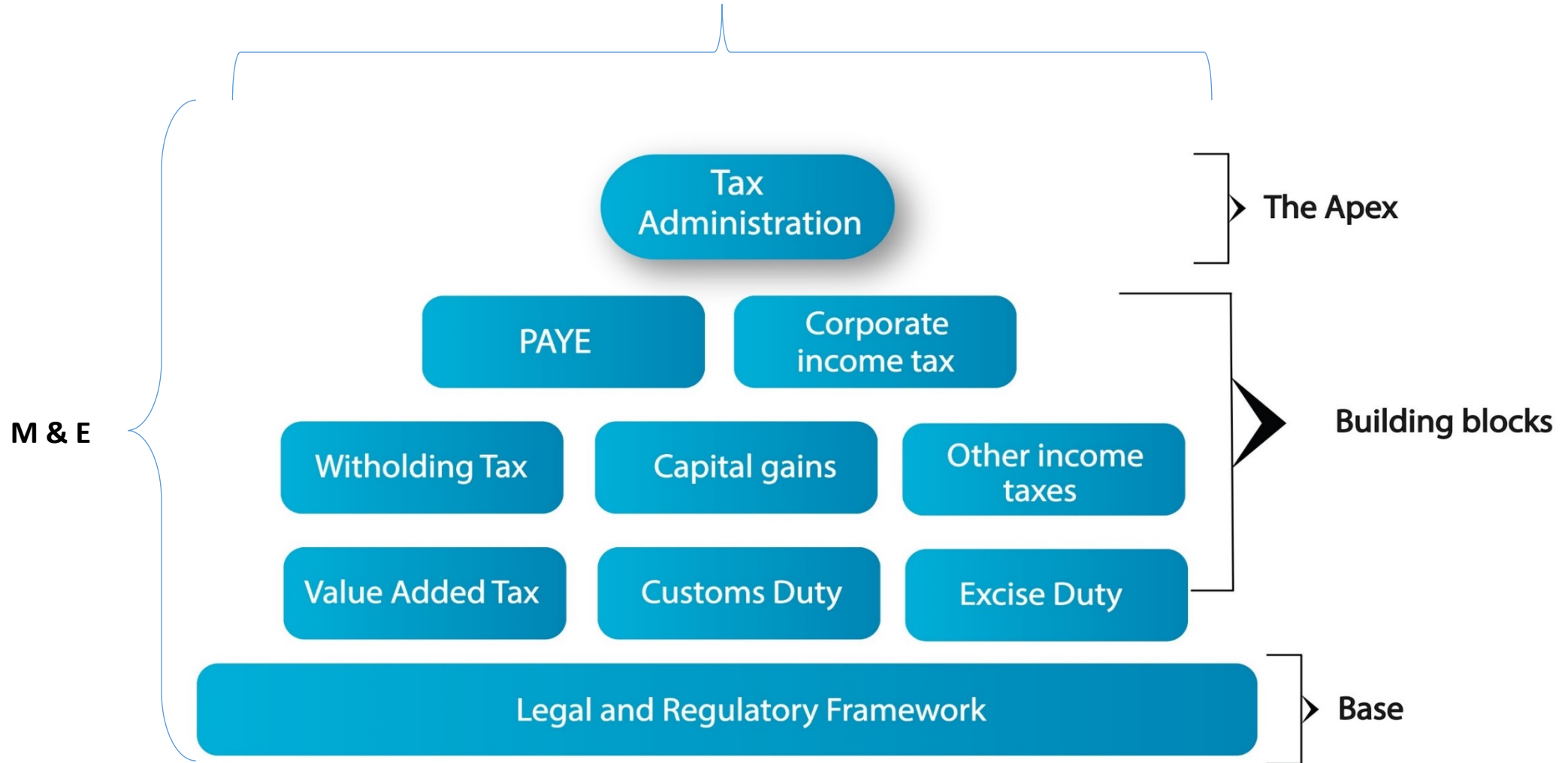
83.2%



Challenges of Kenya's tax system/2

- Tax incentives
- Low tax compliance (filing tax returns - 68% and payment of tax - 88% in FY 20/21)
- Complexity in taxing emerging digital economy
- VAT – high tax expenditure (2.2% of GDP by 2020) and multiple rates
- Customs administration
- Tax administration
- Dispute resolution
- International taxation and tax treaties
- Any other important challenge you think is missing??

Implementation Framework



Goal of the National Tax Policy

- To have an efficient and fair tax system that promotes equity in tax administration and predictable tax environment for business to operate
- The objective is to expand the tax base so as to enhance fairness and equity in tax system as well as

Rationale of the NTP

- Grow tax revenue
- Provide legal framework for introducing tax incentives
- Provide guidance, ensure certainty and establish in light on any amendments to national tax law
- Enhance structures for information gathering and sharing
- Efficiently manage tax refunds
- Address complexities in tax legislation and administration

Guiding Principles

Equity and Fairness

Flexibility

Neutrality

Sustainability

Transparency and
accountability

Administrative
efficiency

Simplicity, certainty
and clarity

Economic growth
and efficiency

Comments for the Introduction Section of the NTP

- The draft NTP is not explicit on the focus of the design of Kenya tax system :
 - Reliance on direct taxes (taxation of income) vis a vis shift to indirect taxes (taxation of consumption) –
 - Principles of equity vs efficiency (whether tax enhances or diminishes taxpayers welfare)
- Area for further research work (assess economic consequences for shifting one way or another)
- No mention of intergovernmental fiscal transfer system
 - Implications of national revenue collection on functionality of intergovernmental fiscal system
 - Double taxation at the county level

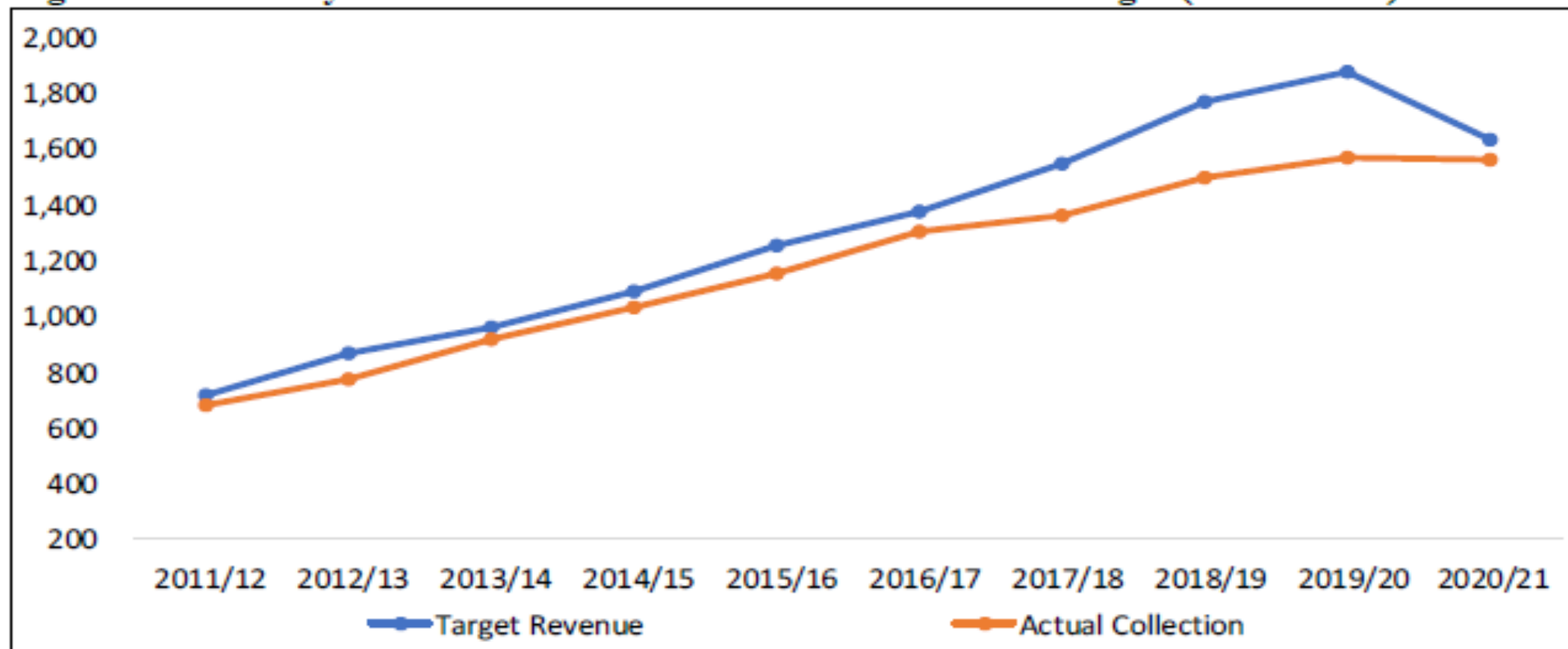
Rise in PAYE component vs Plateaued VAT component

Table A3: Tax Revenue Collections (Ksh Million)

Actual Collections (Kshs million)											
Tax Head	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Corporate Income Tax	86,352	94,643	10,626	135,971	126,541	152,407	180,162	160,059	168,783	175,843	182,387
PAYE	143,785	175,141	211,061	252,974	358,424	386,002	443,524	470,068	525,338	510,630	624,776
VAT Domestic	103,300	93,371	101,446	123,068	143,922	174,051	206,545	219,499	244,748	228,515	217,687
VAT Imports	1,395	94,352	94,685	125,177	135,637	131,473	143,491	151,678	179,179	167,914	211,072
Import Duty	46,023	52,153	58,137	66,896	74,033	81,266	87,161	93,917	105,413	98,342	108,607
Excise Duty Imports	45,876	41,743	45,855	53,968	60,262	72,108	81,698	85,927	89,176	89,434	106,457
Excise Duty Domestic	28,573	30,878	33,260	35,855	38,246	48,986	55,499	53,011	59,509	55,721	62,405
Others	64,883	88,817	104,441	125,073	84,908	90,539	74,979	106,088	104,826	183,352	30,777
Total	600,187	671,098	759,511	918,982	1,021,974	1,136,833	1,273,060	1,340,248	1,476,972	1,509,751	1,544,168
Share of Exchequer Revenue (%)											
Corporate Income Tax	14.4	14.1	14.6	14.8	12.4	13.4	14.2	11.9	11.4	11.6	11.8
PAYE	24.0	26.1	27.8	27.5	35.1	34.0	34.8	35.1	35.6	33.8	40.5
VAT Domestic	17.2	13.9	13.4	13.4	14.1	15.3	16.2	16.4	16.6	15.1	14.1
VAT Imports	13.6	14.1	12.5	13.6	13.3	11.6	11.3	11.3	12.1	11.1	13.7
Import Duty	7.7	7.8	7.7	7.3	7.2	7.1	6.8	7.0	7.1	6.5	7.0

Comments on the Situational Analysis Section

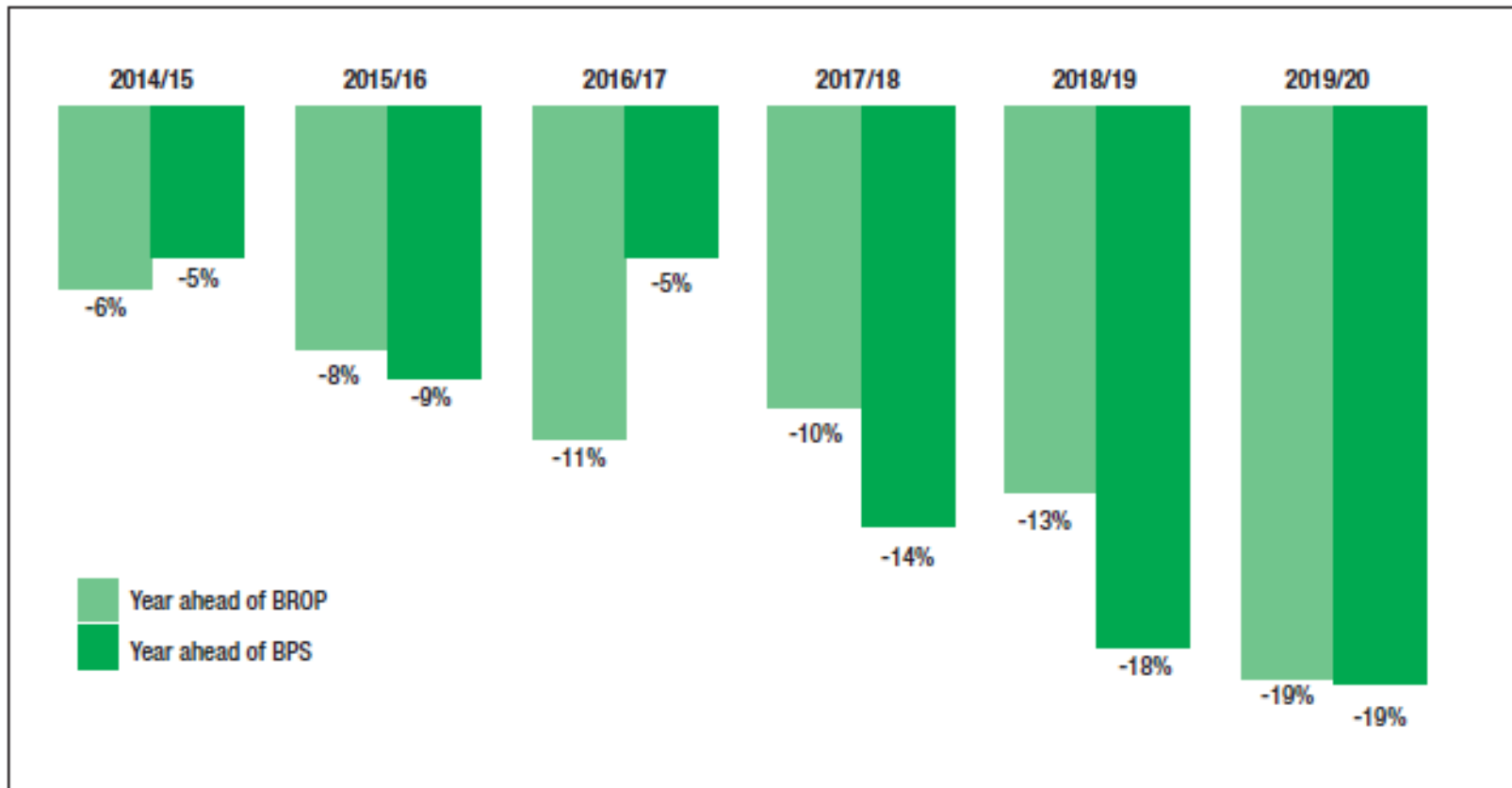
Figure 5: Ordinary Revenue Performance in Relation to Set Target (Ksh Billion)



- Widening gap – save for a near convergence in FY 2020/21. This has something to do with accuracy in revenue projections
- Report does not bring out, comprehensively, revenue projection issues to guide development of the national tax policy.

#1: The NTP should acknowledge that there is need to improve accuracy and integrity of revenue projection

Figure 3.3: Percentage Forecasting Errors in Estimating National Tax Revenue



- Revenue forecasting is not so much a question of capacity/technical but more a political economy question.
- #2: Need to publicize for regular reports on revenue forecasting to facilitate more meaningful public participation

Source: Various issues of National Treasury Budget Review and Outlook Papers and Budget Policy Statements 2014/15-2019/20

<https://ieakenya.or.ke/download-category/research-papers/>

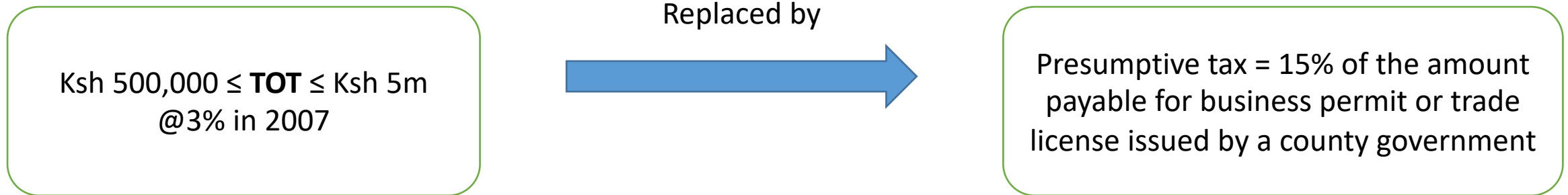
Comments on Policy Guidelines Chapter

3.1 Predictable Tax rates and Tax bases

- The policy states that analysis should be undertaken to assess the impact of proposed tax law changes on tax revenue, development, investment, employment and economic growth.
- **Guideline does not capture welfare indicators and impact on different social groups that will arise given that government revenue raising measures and expenditure affect the groups differently.**
- The policy further states that the National Treasury will submit annual report to the cabinet on the implementation of the tax policy. There is need to capture implicit biases that arise during implementation to ensure principles of equity and fairness are upheld.

3.2 Hard to tax sectors- agriculture and informal sectors

- Objective is to broaden tax base, overreliance on the formal sector and to progressively increase tax yields



- Question of how to curb tax induced behavior:-
 - under reporting of receipts,
 - cases of evasion of payment of business permits or
 - under reporting of receipts by formal business to align to presumptive and evade corporate tax

3.3 Tax Incentives

- Basis for granting tax incentives – promote investments and relief to vulnerable groups
- The draft NTP provides a correct diagnosis of twin challenge of tax incentives. The need for a coherent legal framework and erosion of tax base (foregone revenue has reduced from 5.15% of GDP in 2017 to 2.96% of GDP in 2020).
- **The National Treasury should publicize reports with comprehensive tax expenditure analysis and estimates as part of the Budget Policy Statement and Budget Estimates for improved budget transparency**

3.4 Increase in tax compliance level

- The draft NTP focus to progressively increase tax compliance by enhancing public tax education and awareness and administrative reforms
- **Need for a Specific programme with dedicated resources to ensure continuous taxpayer engagement, education and awareness**
- Evidence that improved service delivery is correlated to rise in tax compliance level
- **IEA-Kenya, therefore proposes the need for adequate focus and commitment by the government towards prudent utilization of revenue**