

Total Tax Contribution of the Kenya Banking Sector

Kenya Bankers Association

**For the calendar years ending 31 December 2017 and
31 December 2018**





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1. Foreword

This Total Tax Contribution report is the first of its kind in Kenya. The report outlines the tax contribution of the banking sector. The tax contribution is both in the form of taxes borne by the banks such as corporation tax and irrecoverable VAT, and taxes collected as an agent of government such as PAYE, excise duty and withholding taxes.

It is our hope that an evaluation of the banking industry's total tax contribution will lead to more informed policy discussions around tax policy required for the banking sector and the contribution of the banking sector to the Exchequer.

The last few years have seen increased budgetary deficits which have in turn led to changes in the tax landscape geared towards increasing the taxes collected. The banking sector has been at the heart of targeted reforms aimed at increasing tax revenues.

The banking sector currently faces considerable challenges ranging from fast-paced technological changes leading to shifts from brick and mortar distribution channels to technology enabled channels and increased focus by stakeholders on improving cost to income ratios and improving returns for shareholders. These changes are happening within the environment of an interest rate cap regime which has limited the level of interest rates that banks can charge. It is important that the tax contribution of the banking sector to taxes is evaluated in the context of this operating environment.

This study covers the 2017 and 2018 financial years and shows that the 38 banks that participated in this study made a total tax contribution of KES 108.1bn and KES 99bn for 2017 and 2018 respectively. This demonstrates the critical contribution of the industry to taxes.

It is our hope that an increased understanding of the full contribution of the banking sector to the government finances, will inform policy discussions over the taxation of the industry.

We thank the 38 banks that participated in this study and the Kenya Revenue Authority (KRA) which provided crucial data for use in this report.

For PricewaterhouseCoopers Limited

A handwritten signature in black ink, appearing to be 'TM' with a flourish.

Titus Mukora
Director Tax Services

2. Executive Summary

2.1. Purpose and Scope of the study

The purpose of the study is to quantify the tax contribution made by the Kenyan banking sector. The study draws connections between taxes and economic developments such as the interest rate caps and the adoption of technology by banks.

Our analysis uses the Total Tax Contribution framework, where tax contribution is segmented into taxes borne and taxes collected. Taxes borne are those which are direct costs to a business such as corporation tax and irrecoverable VAT. Taxes collected are those that a business collects from taxpayers on behalf of the government such as PAYE and withholding tax. This study covers the 2017 and 2018 calendar years.

38 banks and microfinance institutions participated in this study. Using net assets as a market share indicator, this represents approximately 95.1% of the market share. The key findings of the report are outlined below.

2.2. In the two years, banks contributed 207.2bn in taxes

The Total Tax Contribution of the study participants over the two years of the study (2018 and 2017) was KES 207.2bn. The breakdown in terms of taxes borne and taxes collected in each of the years is shown below.

| | 2017 (KES bn) | 2018 (KES bn) | Total |
|-------------------------------|------------------|------------------|-------|
| Total Tax Contribution | 108.1 | 99.0 | 207.2 |
| Tax Borne | 62 | 48.4 | 110.4 |
| Tax Collected | 46.1 | 50.7 | 96.8 |

The decline in tax contribution from 2017 to 2018 is attributable to reduction in taxes borne by banks, and in particular a reduction of corporation tax paid. This was a result of low profits reported in 2017 relative to 2016.

The reduction in 2017 profits corresponds with the first full year of the interest rate cap coupled with a prolonged electioneering period.

The result was large corporate tax over-payments in 2017 were utilized against 2018 corporate tax due leading to a decline in corporate taxes paid in 2018.

The decline in taxes arising from declined profitability in 2017 is reflected in the reported year on year decline of the industry's net income (of - 4.79%) for the period 2016 to 2017. This is also reflected in the decline in growth of net assets in the sector in 2017 of 6.8% down from an 11% growth in the previous year.¹

Taxes collected grew by 10% from 2017 to 2018 (46.1bn to 50.7bn). This growth was largely due to a 40% increase in excise duty which resulted from an increase in excisable fees and commissions charged by banks to

¹ State of the banking industry, 2018, Kenya Bankers Association, Chapter 2

customers as well as an increase in the excise duty rate charged by the sector from 10% to 20% within 2018.

2.3. 1 in every 4 KES of corporate taxes in Kenya is paid by banks

The study revealed that, for every KES 4 of corporation tax paid in Kenya, approximately KES 1 was paid by the banking sector. This translates to 26% of the corporate taxes collected by KRA in Kenya. In 2018, the financial services sector's contribution to GDP growth ranged from 0.1% to 0.2%.² Having in mind that the sector is not a significant driver of GDP growth, the high corporate tax contribution is also an indication of high levels of regulation and compliance in the industry.

The industry's high contribution to corporate taxes can also be attributed to the fact that unlike other industries such as manufacturing that enjoy a raft of tax incentives, there are hardly any corporate tax incentives for banks. On the contrary, one of the industry's core expenses, (bad debt expense) has very strict requirements for deductibility which invariably leads to the high corporate taxes paid by the sector.

| Description | 2017 (KES bn) | 2018 (KES bn) | Total |
|--|------------------|------------------|-------|
| Banking industry's corporate tax | 52 | 39 | 91 |
| Total corporate tax paid in Kenya | 185 | 162.4 | 247.4 |
| Banking sector's contribution to taxes | 28% | 24% | 26% |

² 2019 Budget Policy Statement: GDP growth drivers, Q1 to Q3 2018

³ Exclusive of PAYE

2.4. Government is the largest beneficiary of value distributed

"Value distributed" consists of the sum of taxes paid, employee salaries paid³ and dividends paid to shareholders. These categories of persons – government, employees and shareholders – represent the key stakeholders in any corporate organisation.

For both 2017 and 2018, at 52.2% and 49.8% respectively, the government was the greatest beneficiary of the value distributed by banks (in the form of taxes) followed by employees (in the form of employee emoluments) and lastly, shareholders (in the form of dividends).

The value distributed in 2017 and 2018 is depicted below.

| | 2017 | 2018 |
|------------------------------------|-------------|-------------|
| Taxes (collected and borne) | 52.2% | 49.8% |
| Employee emoluments (net of taxes) | 21.3% | 22.7% |
| Dividends (net of taxes) | 26.5% | 27.5% |
| Total (%) | 100% | 100% |

2.5. 43.5% of banks' operating profits was spent in taxes

The ratio of taxes borne by banks to profits was 43.5% for the 2017 and 2018 years. Taxes borne include categories of taxes that are not necessarily computed based on profitability such as irrecoverable VAT and withholding tax borne. These taxes are incurred by banks when the banks incur expenditure and not necessarily when they make profits. Reliance on consumption taxes as a tax collection avenue may not be sustainable in

the long run as banks will inevitably reduce expenditure, where such taxes are increased.

Irrecoverable VAT, which is the VAT that a taxpayer incurs but does not offset against output VAT, is primarily driven by the VAT exempt status of the industry's income categories. The ratio of irrecoverable VAT to total taxes borne increased from 10.5% in 2017 to 14.1% in 2018.

One of the activities that gives rise to significant irrecoverable VAT is investment in technology. In this way, the tax policy is not supportive of the digitalisation of the sector.

2.6. Banking sector's PAYE per capita is five times higher than the PAYE per capita in the country

Over the period, the banking sector's PAYE per capita was KES 660k. This is over five times higher than the country's PAYE per capita. The high PAYE per capita is reflective of the high compliance levels by banks as a result of being in a highly regulated industry. This is also indicative of relatively high value jobs and higher wages in the sector compared to other sectors of the economy.

| Description | PAYE – 2017 & 2018 average (KES million) | Taxpayers who filled PAYE returns | PAYE per capita (KES '000) |
|-------------|--|-----------------------------------|----------------------------|
| Bank PAYE | 18,950 | 28,705 | 660 |
| Kenya PAYE | 364,450 | 2,977,881 | 122 |

In 2017, banks contributed 6% of all PAYE receipts collected in Kenya. This compares to 5% of PAYE collected in 2018.

⁴ State of the banking industry report – 2019, section 4.1, Kenya Bankers Association, figure 11

2.7. 42% increase in excise taxes!

There was a 42% increase in excise taxes collected by banks in 2018 as compared to the prior year. This corresponds to the rising prominence of excisable non-funded income. In 2018, there was a 2% rise in fees and commissions charged by the banking industry⁴. In addition, in 2018, the excise duty rate for non-funded income increased from 10% to 20%. This also contributed to the high growth of excise duty collected by banks.

| Description | 2017 (KES bn) | 2018 (KES bn) |
|---|---------------|---------------|
| Excise collected by banks | 5.9 | 8.3 |
| Total excise collected in the financial services sector | 13.7 | 18.8 |
| Contribution by banking sector | 43% | 44% |

Banks contributed 6% of all PAYE receipts collected in Kenya

3. Purpose and outline of the study

The purpose of the study is to generate robust data to quantify the tax contribution made by the Kenyan banking sector. Such data has been collected in accordance with a credible and well understood framework.

The study shows that the contribution by banks is broader than corporation tax, with employment taxes, withholding income tax, withholding VAT, irrecoverable VAT, excise duty and other taxes deducted at source adding to the total.

This study also contains data to highlight the impact of legislative amendments such as the interest rate cap and the impact of technology on the industry and invariably, on the tax contribution of the industry.

3.1. Methodology

The study uses the Total Tax Contribution designed by PwC United Kingdom. This framework provides a standardised methodology for companies to measure and communicate all the taxes and contributions that they pay.

The study collected data from 38 Kenya Bankers Association (KBA) members operating in the banking sector relating to all Kenya taxes borne and collected in the accounting periods ending 31 December 2017 and 31 December 2018.

PwC has anonymised and aggregated this data to produce the study results. PwC has not verified, validated or audited the data and cannot give any undertakings as to the accuracy of the study results.

The TTC framework is straightforward in concept, not tax technical and therefore relatively easy for stakeholders to understand. The framework makes a distinction between taxes borne by the company and taxes collected.

Taxes borne are the company's own contribution in taxes that impact their results, e.g. corporation tax, irrecoverable VAT and withholding taxes borne.

Taxes collected are those that the company administers on behalf of government and collects from others, e.g. income tax deducted under PAYE and excise duty collected. Taxes collected have an administrative cost for the company and will invariably have an impact on the company's business operations. Taxes collected do not include payments of taxes to the KRA made by banks' customers through banking channels.

The results of this study are a measure of the taxes paid by members, covering both taxes borne and taxes collected. The results provide information which would not otherwise be in the public domain, since this is not information the companies are required to disclose in their financial reports. Where we refer to data published by the Kenyan government and Kenya Revenue Authority, this is clearly indicated.

3.2. Participation in the TTC study relative to Kenya Banking Sector receipts

Thirty-eight KBA members participated in the study, providing data on their taxes borne and taxes collected for their accounting periods ending 31 December 2017 and 31 December 2018. Data received related to payments to the Kenya public finances. Using net assets as a market share indicator, the 38 institutions represent approximately 95.1% by market share of the banking industry.

No tax payments to foreign tax authorities were included. All “Tier One” banks participated in this study.

Data was also obtained from the KRA in respect of the following taxes: Corporation tax, PAYE, net VAT, withholding VAT, withholding tax collected, withholding tax on rental income, excise duty on financial services and others⁵.

Thirty-eight KBA members participated in the study, providing data on their taxes borne and taxes collected for their accounting periods ending 31 December 2017 and 31 December 2018



⁵ Others consist of: advance tax, capital gains tax, stamp duty and land rent

4. The profile of taxes borne and collected

4.1. Taxes borne

Taxes borne are a cost to the business and therefore directly affect a company's financial results.

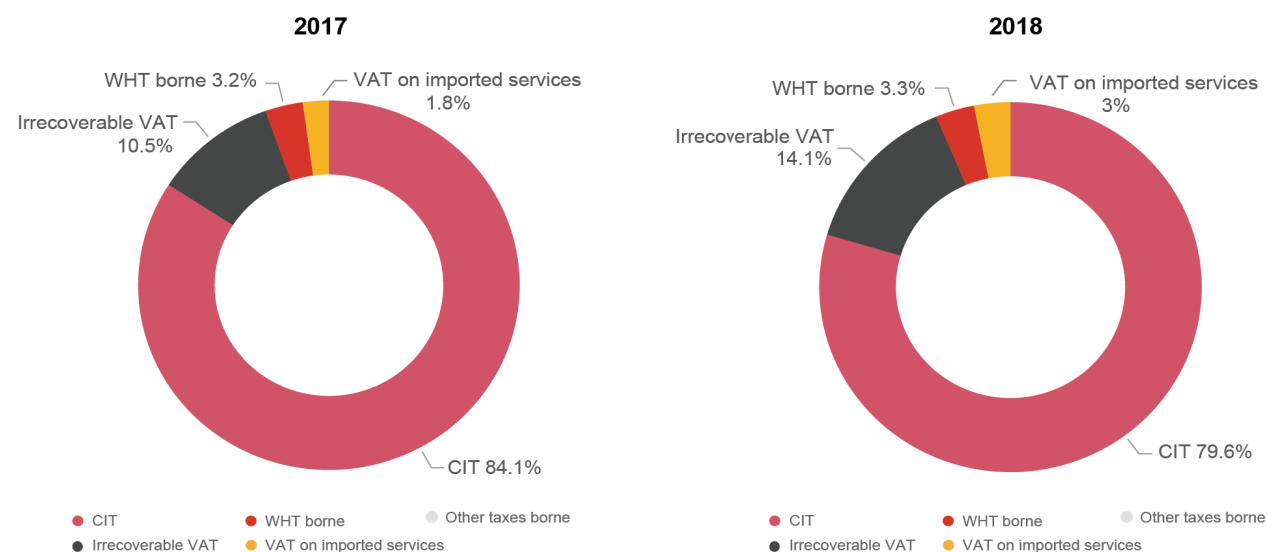
From the above data, the following trends can be seen:

- Corporation tax forms the largest component of taxes borne, representing 84.1% and 79.6% of the total taxes borne by participating banks in 2017 and 2018.
- Irrecoverable VAT is the second largest component of taxes borne representing 10.5% and 14.1% of the total taxes borne by participating banks in 2017 and 2018.
- VAT on imported services represents 2.2% and 3.1% of total taxes borne in 2017 and 2018 respectively.
- Withholding tax borne formed 3.2% and 3.3% of total taxes borne in 2017 and 2018 respectively.

4.2. Taxes collected

Taxes collected are those which are generated by a company's operations, but are collected from others on behalf of the government, e.g. income tax deducted under PAYE, employee Social Security, withholding taxes, withholding VAT and net VAT. The companies generate the commercial activity that gives rise to the taxes and then collect and administers the taxes on behalf of the KRA.

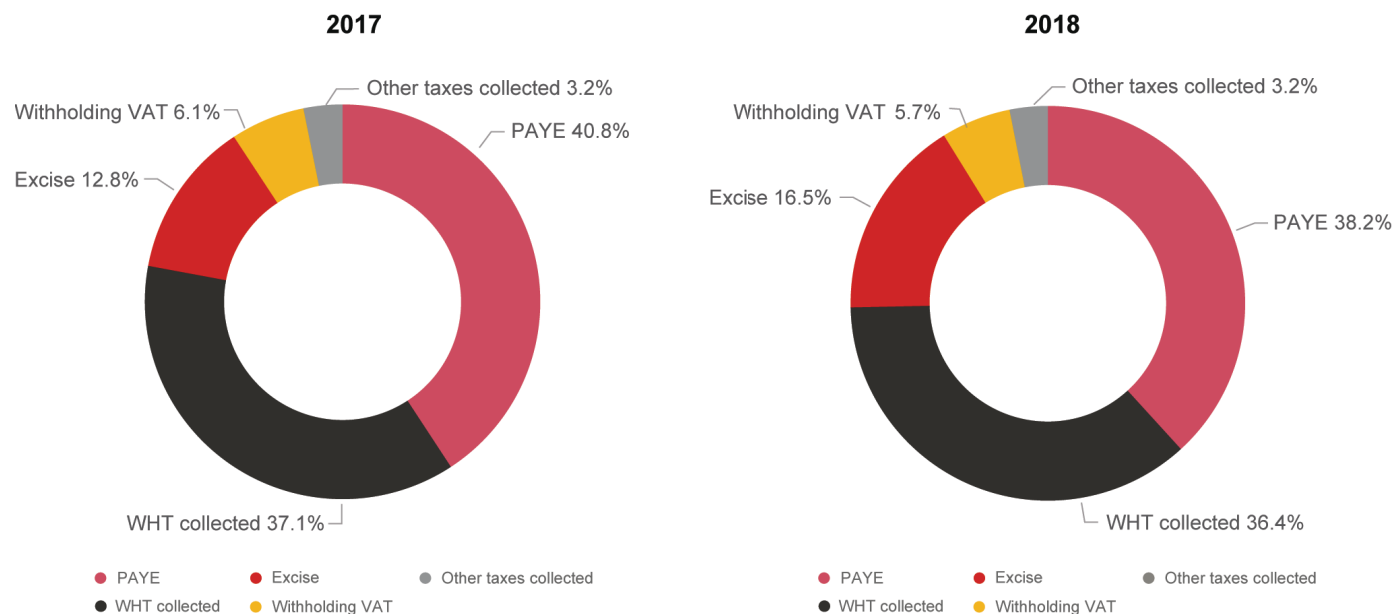
Figure 5 – Taxes borne profile for participating banks



Taxes collected reflect approximately half of the industry's total tax contribution. This is a significant burden imposed by KRA on the banks having in mind that collection of taxes comes with administrative burdens and time constraints.

Corporation tax forms the largest component of taxes borne

Figure 6 below shows the profile of taxes collected for the thirty-eight participating banks.



PAYE was the most significant tax collected making up 40.8% and 38.2% of total taxes collected in 2017 and 2018 respectively.

Withholding taxes collected was the second largest tax collected, coming to 37.1% and 36.4% of total taxes collected for 2017 and 2018.

Excise duty collected was KES 5.9 bn and KES 8.3bn representing 12.8% and 16.5% of the total taxes collected in 2017 and 2018 respectively.

Withholding VAT collected was KES 2.8bn and KES 2.9bn in 2017 and 2018, representing 6.1% and 5.7% of the total taxes collected by banks.

4.3. Total Tax Contribution

The total tax contribution (TTC) profile – the sum total of taxes borne and taxes collected – shows that corporation tax made up 48.4% and 39.0% the TTC in 2017 and 2018 and is the most significant tax contribution that banks make to taxes.

This is followed by PAYE which represented 17.3% and 19.4% of the TTC for 2017 and 2018 respectively. Withholding taxes collected represented the third largest component of the TTC constituting 15.8% and 18.5% for 2017 and 2018.

Other taxes such as excise duty, irrecoverable VAT, property taxes and other payments to government constituted the remaining portion of the TTC.

Total Tax Contribution of the banking sector

| | 2017 (%) | 2018 (%) |
|-------------------------------|-------------|-------------|
| Corporation tax | 48.4% | 39% |
| PAYE | 17.3% | 19.4% |
| Withholding tax collected | 15.8% | 18.5% |
| Irrecoverable VAT | 6.1% | 6.9% |
| Excise duty | 5.5% | 8.5% |
| Withholding VAT | 2.6% | 2.9% |
| Other taxes | 4.3% | 4.8% |
| Total Tax Contribution | 100% | 100% |



Taxes collected reflect approximately half of the industry's total tax contribution

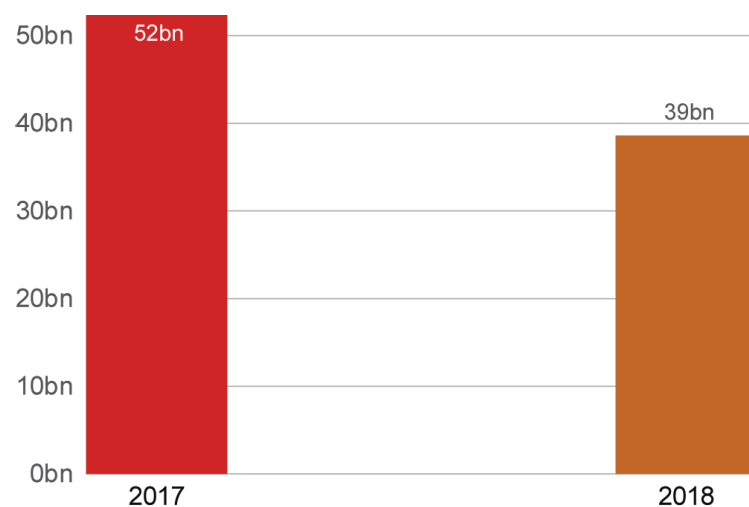
5. Corporation tax

Corporation tax payments from study participants totalled KES 52.4bn and KES 38.6bn in 2017 and 2018 respectively.

5.1. Corporation taxes paid

Corporation tax payments made by banks in the years 2017 and 2018, stood at KES 52bn and KES 39bn.

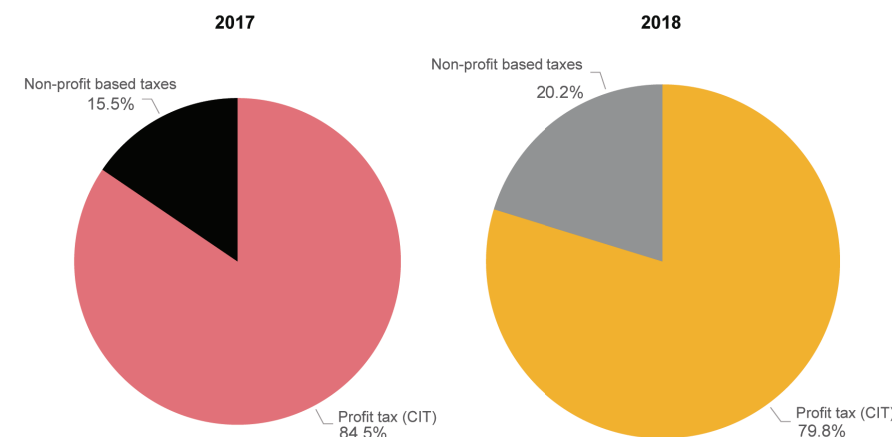
Figure 8 – Corporation tax borne



5.2. 26% of corporate taxes paid in Kenya are from the banking industry

In both 2017 and 2018, corporate tax represented the highest component of taxes borne by banks. This was 84.1% in 2017 and 79.6% in 2018.

Figure 9 – Corporate tax as a percentage of total tax borne



KES 1 in every KES 4 of corporate tax is paid by the banking sector

Over the period 2017 and 2018, for every KES 4 of total corporation tax collected by the KRA from all taxpayers, approximately KES 1 was paid by the banking sector. The corporate tax paid by the 38 banks in this study represented 28% and 23% of total corporate taxes paid in Kenya in 2017 and 2018.

The decline in tax contribution is attributable to reduction in taxes borne by banks and in particular a reduction of corporation tax paid. This was a result of low profits reported in 2017 relative to 2016.

The reduction in 2017 profits corresponds with the first full year of the interest rate cap coupled with a prolonged electioneering period. The result was large

corporate tax over-payments in 2017 which were utilized against 2018 corporate tax leading to a decline in corporate taxes paid in 2018.

The decline in taxes arising from declined profitability in 2017 is reflected in the reported year on year decline in the industry's net income of -4.79% for the period 2016 to 2017. This is also reflected in the decline in growth of net assets in the sector in 2017 of 6.8% down from 11% growth in the previous year.⁶

In 2018, the financial services sector's contribution to GDP growth ranged from 0.1% to 0.2%.⁷ Having in mind that the sector is not a significant driver of GDP growth, the high corporate tax contribution is an indication of high levels of regulation and compliance in the industry.

| Description | 2017 (KES bn) | 2018 (KES bn) | Total |
|--|------------------|------------------|-------|
| Banking industry's corporate tax | 52 | 39 | 91 |
| Total corporate tax paid in Kenya | 185 | 162.4 | 247.4 |
| Banking sector's contribution to taxes | 28% | 24% | 26% |

The industry's high contribution to corporate taxes is also as a result that unlike other industries like manufacturing that enjoy a raft of tax incentives, there are hardly any corporate tax incentives for banks. On the contrary, one of the industry's core expenses, bad debt expense, has very strict requirements for deductibility which invariably leads to the high corporate taxes paid by the sector.

⁶ State of the banking industry, 2018, Kenya Bankers Association, Chapter 2

⁷ 2019 Budget Policy Statement: GDP growth drivers, Q1 to Q3 2018

One of the industry's core expenses, bad debt expense, has very strict requirements for deductibility which invariably leads to the high corporate taxes paid by the sector

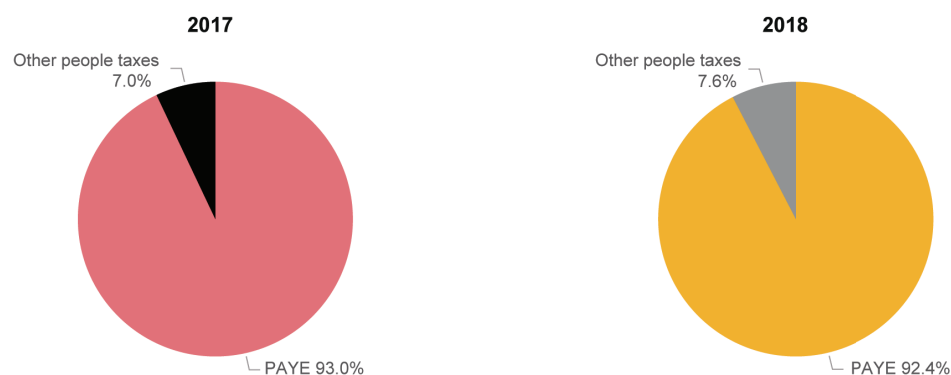


6. Employment taxes

6.1. Employment in the banking sector

Employment taxes (PAYE, employer and employee NSSF contributions and employee NHIF contributions) contributed by the sector in 2017 and 2018 amounted to KES 20.1bn and KES 20.8bn respectively. This represented a modest growth of 3.5% year on year. The largest component of employment taxes is PAYE.

Figure 11 – Contribution of PAYE to total employment taxes



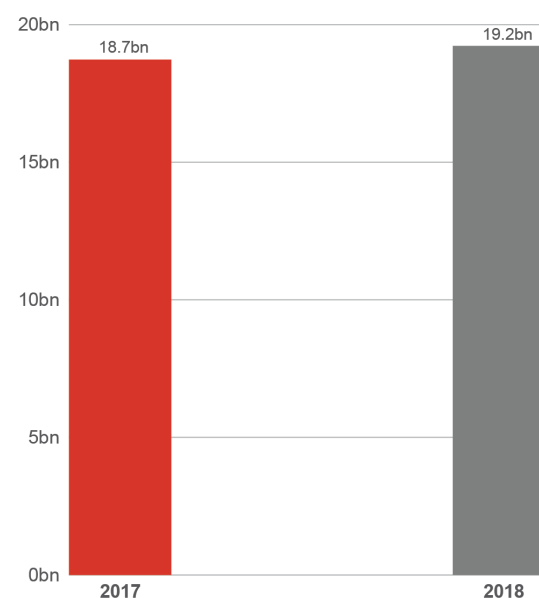
6.2. PAYE increased despite decline in employee numbers

The number of employees employed by the study participants reduced from 29,058 in 2017 to 28,352 in 2018. This represents a marginal reduction of 2.4%. The decrease in employment numbers was due to restructuring activities within the industry over the period due to the challenges banks have been facing since the introduction of the interest rate regime as well as migration by banks to digital distribution channels away from the traditional

'brick and mortar' channels. The reduction in employee numbers is in tandem with overall reduction in operating expenses of banks by 4% over the period 2017 to 2018.⁸

Despite the decline in employee numbers, the amount of PAYE collected by participating banks grew from KES 18.7bn in 2017 to KES 19.2bn in 2018. This trend is due to the increase in wages paid to higher cadre employees in the sector and the continued replacement of lower cadre jobs within banks as the sector increasingly adopts technology.

Figure 12 – Trend in PAYE 2017 – 2018



⁸ State of the banking industry report – 2019, section 4.1, Kenya Bankers Association, Section 4.3

6.3. Banking sector's PAYE per capita is five times higher than the PAYE per capita in the country

Over the two-year period, the banking sector's PAYE per capita was KES 660k. This is five times higher than the country's PAYE per capita. The high PAYE per capita is reflective of the high compliance levels by banks which operate in a highly regulated industry as well as the relatively higher wages of bank employees compared to other sectors.

| Description | PAYE 2017 & 2018Average (KES million) | Taxpayers who filled PAYE returns | PAYE per capita (KES '000) |
|-------------|---------------------------------------|-----------------------------------|----------------------------|
| Bank PAYE | 18,950 | 28,705 | 660 |
| Kenya PAYE | 364,450 | 2,977,881 | 122 |

In 2017, banks contributed 6% of all PAYE receipts collected in Kenya. This compares to 5% in 2018.

Despite the decline in employee numbers, the amount of PAYE collected by participating banks grew



7. Irrecoverable VAT

Typically, when a business supplies goods and services, the VAT charged will be offset against the VAT it has incurred on purchases used to run the business (input VAT). Where the supplies of a company are exempt from VAT, as is often the case for banks, VAT is not charged to customers and the company cannot recover its input VAT. This irrecoverable VAT is paid by the banks to the government.

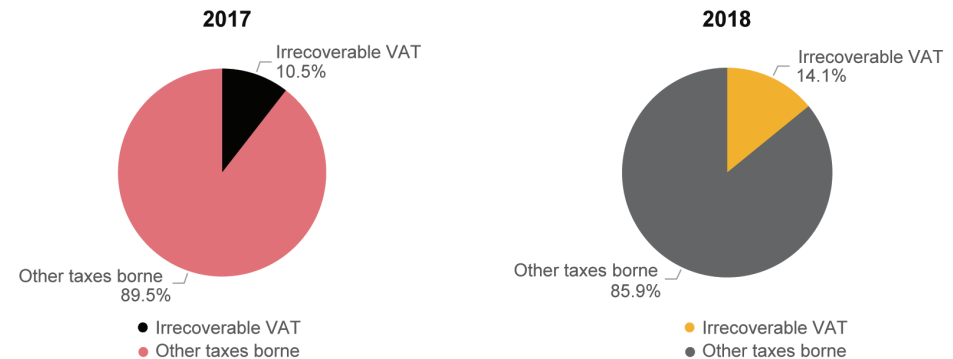
Such irrecoverable VAT rose from 10.5% to 14.1% of total taxes borne in 2017 and 2018 respectively for the study participants.

The increase in irrecoverable VAT over the period 2017 to 2018, is most likely due to increased spending by banks on technology infrastructure which grew by 4% over the period.

Spending on technology infrastructure increases the banks' cost base and level of irrecoverable input VAT as there is no corresponding increase in output VAT to offset the input VAT against.

The irrecoverable VAT cost that accompanies adoption of technology can be viewed as a tax measure that disincentivises digitalisation in sectors like banking whose income is largely VAT exempt compared to sectors where income is VATable as the VATable sectors are able offset VAT incurred on technology against their output VAT.

Figure 13 – Irrecoverable VAT proportion of total taxes borne



The irrecoverable VAT cost that accompanies adoption of technology can be viewed as a tax measure that disincentivising digitalisation in sectors like banking

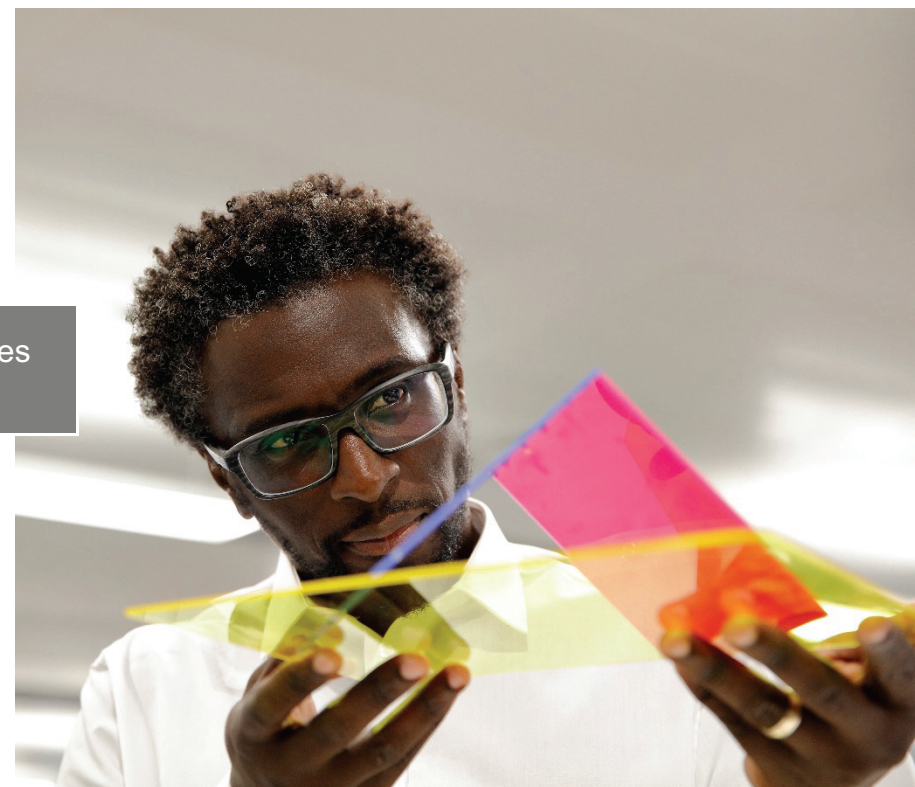
8. Excise duty

There was a 40.7% increase in excise taxes collected by banks in 2018 as compared to the prior year.

This is in tandem with the overall increase of excise taxes collected by KRA from the financial services sector of 37.2%. This corresponds to the rising prominence of excisable non-funded income as reflected by a 2% rise in fees and commissions charged by the banking industry⁹. In addition, in 2018, the excise duty rate for non-funded income increased from 10% to 20%. This also contributed to the high growth in excise duties collected. In 2017 and 2018, the banking sector collected 43% and 44% of the total excise taxes collected in the financial services sector.

There was a 40.7% increase in excise taxes collected by banks

| Description | 2017 (KES bn) | 2018 (KES bn) |
|---|------------------|------------------|
| Excise collected by banks | 5.9 | 8.3 |
| Total excise collected in the financial services sector | 13.7 | 18.8 |
| Contribution by banking sector | 43% | 44% |



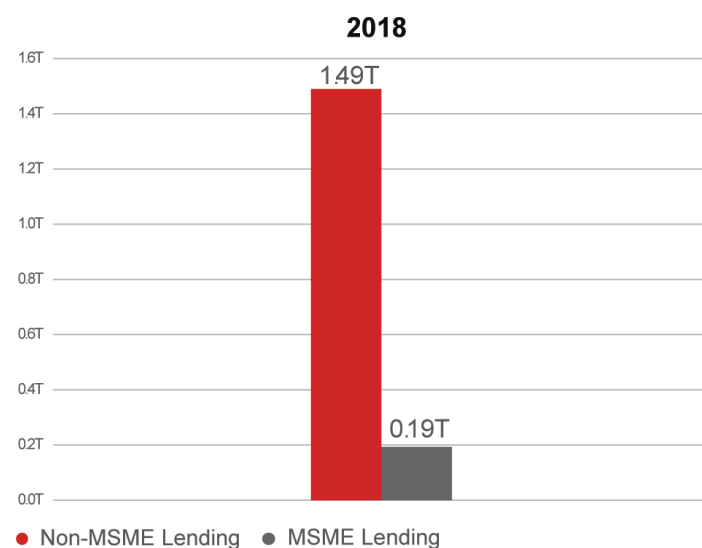
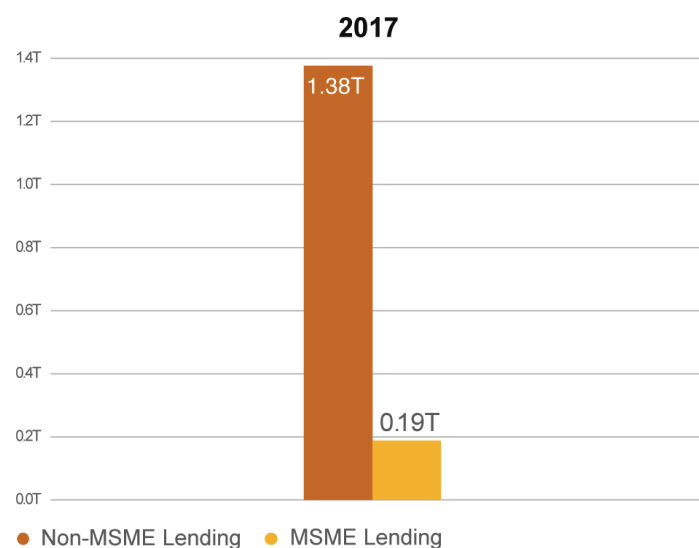
⁹ State of the banking industry report – 2019, section 4.1, Kenya Bankers Association, figure 11

9. Contribution to Micro Small and Medium Enterprises (MSME)

Loans advanced by banks to MSMEs were KES 190bn in both 2017 and 2018. This is compared to a loan book value of KES 1.4trn and KES 1.5trn in 2017 and 2018. Accordingly, MSME lending represented 14% and 13% of total loan book of participant banks in 2017 and 2018 respectively.

The lack of growth in MSME loan book is attributed to the interest rate cap which has made banks shy off from lending to MSME as a result of the higher risk profile of MSMEs.

KBA-MSME Lending



MSME lending represented 14% and 13% of total loan book of participant banks

10. Investment in technology

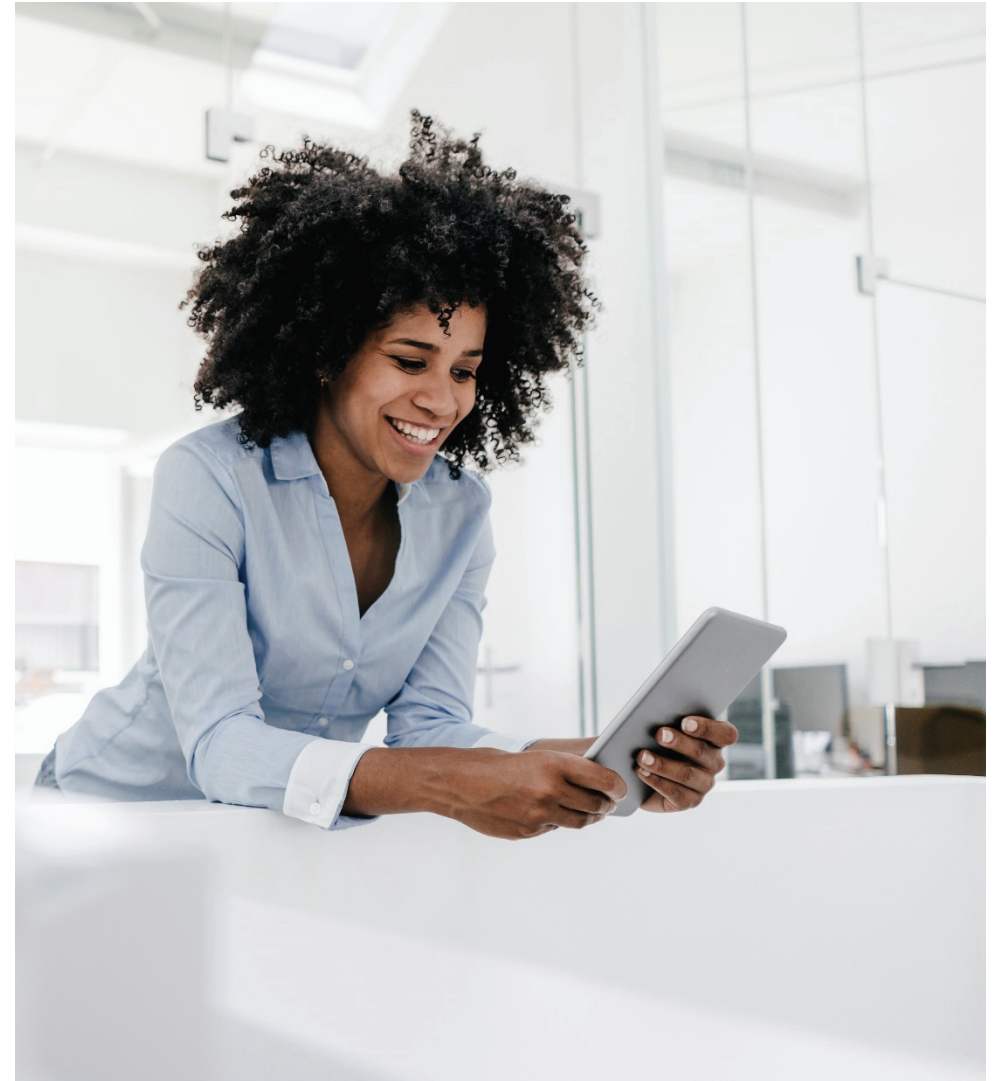
Investment in technology by banks was KES 23.2bn and KES 24.2bn in 2017 and 2018, representing an overall growth of 4%. Out of the total technology investment, KES 18.5bn and KES 19.6bn was contributed by Tier One banks in 2017 and 2018 showing a growth of 6%.

These technological investments give rise to significant irrecoverable VAT. This additional cost is not supportive of the digitalisation of the sector.

It is expected that investments in technology will with time lead to lower employee costs which will inevitably lead to a lower growth in PAYE contribution by the sector. However, this should translate to higher corporate profits, higher corporate taxes and withholding tax on dividends.

Withholding taxes borne and collected increased from KES 19bn in 2017 to KES 19.9bn in 2018 representing an increase of 4.7%. This increase is aligned with the 4% increase in technology investments year on year. This is indicative of significant withholding taxes that accrue on payments to suppliers of technology who are often based abroad. Banks will tend to bear the 20% withholding taxes on payments made to them.

As highlighted, expenditure-based taxes such as irrecoverable VAT and withholding taxes disincentivise digitalization within the sector and result in the slower transformation of banks.



11. Banks opine – current tax policy not supportive of the industry

11.1. Survey participants feel excluded from the tax policy setting

81.1% of the survey participants either disagreed or strongly disagreed with the statement that there is predictability in the process of making changes to the tax framework and inclusion of industry stakeholders in the process.

Participants noted that stakeholder opinion if at all solicited, is not considered in the process of making changes to the tax framework. This lack of engagement of the stakeholders is evident from numerous tax proposals over the last few years that have either been blocked by the courts or dropped all together. Examples include the housing levy which is currently facing a challenge in court and the Robinhood¹⁰ tax which was contained in the Finance Bill 2018 but was not legislated as part of Finance Act 2018.

Some of the responses:

“There is limited consultation and inclusion on tax policy changes. Most of the changes are heard when the Finance Bill or Budget is presented at the National Assembly”.

“Surprises are introduced in the Finance Bill which necessitates lobbying or court processes for KBA members' position to be considered. This causes disruptions in the business environment and impacts investment.”

¹⁰ Proposed to levy excise taxes on bank transfers

“The proposal to tax businesses whose profits exceed Kshs 500 mn in year at 35% is also punitive, and is likely to have serious implications to the inflows of proposed investments in the long term.”

One of the survey participants however noted attempts by KRA to include industry stakeholders in policy making.

“Based on experience in 2018 and 2019 Finance Bill/Act, the government is making [a] genuine attempt to include industry stakeholders in the process of amending/introducing new/existing laws”

11.2. Misalignment in accounting and tax definitions

83.8% of bank participants either disagreed or strongly disagreed with the statement that there is alignment between accounting and tax definitions which makes the tax framework easy to implement.

In particular, the survey participants expressed reservations on the treatment of provisions for Non-Performing Loans (NPLs) and bad debts provisions.

Some of the comments from survey participants:

“This is largely lacking with huge negative impact on the banking industry. A case in point is the introduction of IFRS 9 and the huge impact it has on the tax numbers. An alignment between accounting and tax in this direction will be a huge relief to the industry.”

“IFRS guidelines and Tax guidelines are not aligned leading to adjustments when computing the tax. Key among them is on allowability of bad debts provisions, IFRS9 provisions and WHT on accrued interest.”

“There's limited alignment between accounting and tax definitions leading to disputes and higher compliance costs e.g. under IFRS 9 NPL provisioning and tax computations differ quite significantly.”

The lack of alignment between deductibility for bad debt provisions for tax purposes and IFRS 9 provisioning requirements was a recurring concern raised by survey participants which is indicative of the tax costs and complexity associated and with this misalignment.

11.3. Banks believe more could be done by the government to encourage regional expansion

55.5% of survey participants either strongly disagreed or disagreed with the statement that the tax framework supports expansion into the region. 45.5% of the participants agreed that the tax framework supports expansion into the region.

Most notable among the issues raised with regard to regional expansion was the lack of double tax treaties among East African member states and the lack of tax incentives for entities setting up in the region.

Some of the survey comments from participants that thought that tax policy does not currently support regional expansion:

“There is no known tax incentives for entities intending to set up shop in the region or regional entities coming into the country.”

“The Income Tax Act, and its proposed amendments, do not give enough importance to this agenda and do not speak to it. Harmonising various laws and enabling further cross border trade would greatly assist in increased business opportunities that can be exploited by businesses.”

“We haven't observed an initiative to harmonise the tax laws across East Africa. There are still challenges in taking advantage of the advantage of the East African market trade agreements.”

“The Kenyan tax framework does not support regional expansion. Each of the COMESA member states have their own tax framework.”

Some participants indicated that there were some identifiable efforts being made by government which were geared towards facilitating regional expansion. One of the participants stated:

“But for a few hitches, Kenya Tax Framework support regional expansion. The issue of PIN for all customer[s] opening an account in Kenya was really has a negative impact in terms of facilitating regional integration. With the proposed PIN exemption in the Finance Act for specific cases, I see the government trying to remove this bottleneck. Kenya taxes and rates are also not significantly different to those charged by countries in the Region. In some instances like VAT, Kenya has the lowest rate. Also, the position of Kenya on the East Africa Tax Treaty is [a] huge step toward supporting regional expansion”

Glossary of Terms

| Terms | Definition |
|-------------------------------|--|
| Total tax collected | Taxes that the company administers on behalf of government and collects from other taxpayers as an agent of government |
| Total tax borne | A company's own contribution in taxes |
| Total tax contribution | The sum of taxes borne and taxes collected |
| Value distributed | Payments made by a corporate entity to its key stakeholders – government, employees and shareholders |
| Net assets | Total assets minus total liabilities |
| Non-funded income | Non-interest income |
| Bad debt expense | A portion of loans advanced that is expensed through the income statement either as a provision for bad debts or a write off of the debt |
| MSME | Micro, small and medium sized enterprises as defined by Financial Sector Deepening Kenya ¹¹ |
| KRA | The Kenya Revenue Authority |

| Taxes | Definition |
|---------------------------------|---|
| Corporation tax (CIT) | The main tax on a company's profits |
| Irrecoverable VAT | VAT that a taxpayer incurs but is not offset against output VAT |
| Excise duty | A tax paid on certain categories income earned by financial service providers |
| Withholding taxes | An income tax withheld on certain kinds of qualifying payments such as management fees, royalties and interest. |
| Withholding tax borne | Withholding tax incurred by the company making payments of the above qualifying payments that it does not pass on to the supplier |
| Pay as You Earn (PAYE) | A tax withheld from the employment income of the company's employees |
| VAT on imported services | This is the VAT accounted for on imported services |
| Withholding VAT | The tax withheld from VAT charged to the company |
| Employment taxes | All taxes and statutory deductions arising from employment such as PAYE, NHIF, NSSF etc. |

¹¹ <https://s3-eu-central-1.amazonaws.com/fsd-circle/wp-content/uploads/2016/05/30092940/160426-SME-banking-in-Kenya-report.pdf>



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