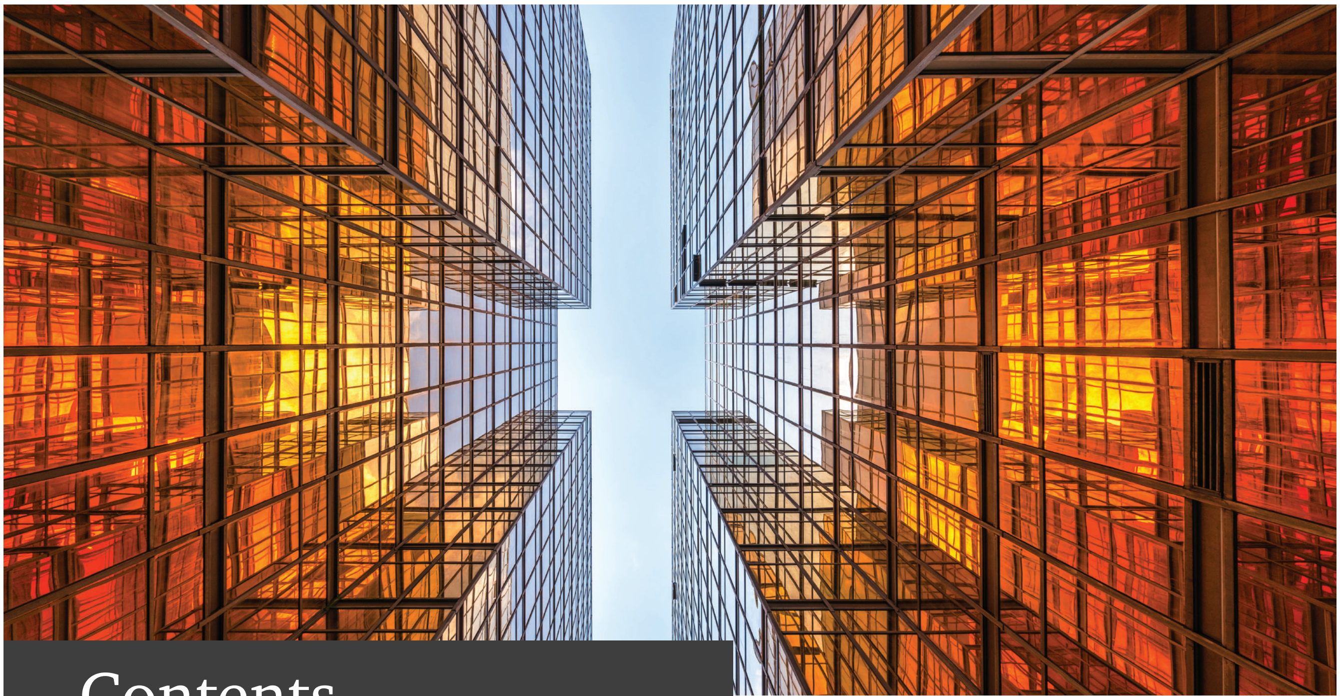
Total Tax Contribution of the Kenya Banking Sector - 2021

Kenya Bankers Association

pwc

KENYA BANKERS ASSOCIATION



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Foreword

Welcome to the third edition of the Total Tax Contribution ("TTC") study of the Kenyan Banking Sector. The TTC data, which covers participants' financial year ending December 2021, shows that the estimated Total Tax Contribution for the participating banks was KES 129.52 bn. This is a 23.59% increase compared to the 2020 contribution of KES 104.8 bn. The year 2021 was a year of economic recovery coming on the backdrop of greater access to vaccines and reopening of all sectors of the economy especially the services industry.

The 2021 Total Tax Contribution of the banks that participated in this study represents 6.82% of all government receipts compared to 6.9% in 2020 - a clear indicator that the industry continues to be a significant contributor of taxes in Kenya. This means that the tax policy of this sector must be designed carefully to ensure that the sector continues to thrive and effectively play its role in facilitating other sectors through advancement of credit.

This year's study covered 38 participants representing 97% of the market share from a net assets perspective. The 38 participants reported taxes borne of KES 63.91 bn and taxes collected of KES 65.61 bn, making a Total Tax Contribution of KES 129.52 bn in 2021.

The 2021 Total Tax Contribution is a 23.59% increase from 2020 and more importantly, greater than the Total Tax Contribution of KES 120.12 bn reported in 2019 – a clear signal that the banking sector and indeed the entire economy, was well on the recovery path in 2021. In 2021, the banking sector contributed 25.57% of total corporate taxes received by the government from all the sectors in Kenya compared to 24.20% in 2020. This is a significant contribution by the banking sector to corporate taxes.

2020 was the first year of the Covid-19 pandemic. A significant drop in economic activities across all sectors of the economy was witnessed resulting in increased loan loss provisions and lower Profits Before Tax ("PBT") for the banking sector. However, as economic growth accelerated in 2021, the industry exhibited signs of recovery as shown by an increase in PBT of 85.17%, 46.67% reduction in non-performing loans provisions and a growth in loans and advances of 9.30%.

As highlighted in the 2022 Kenya Bankers Association - State of the Banking Industry Report ("2022 KBA SBIR"), 2021 saw a reduction in operating expenses by 12.6% compared to 2020. The significant driver for this decline was a reduction in loan provisions by 46.67% which is attributed to general economic recovery and improvement in the performance of the loan book. Further, 2021 witnessed continued digitalisation which was apparent through closure of physical branches, higher volumes of digital transactions, reduction of ATMs and new ways of working such as remote working.

Now more than ever, there is greater focus by corporate organisations to report not only on the profits they generate and the returns they make to their shareholders, but also report on the broader role they play in supporting the communities they operate in by embracing Environmental, Social and Governance ("ESG") commitments and reporting.

The Central Bank of Kenya has indicated that it will now place greater emphasis on ESG and will require banks to disclose their climate risk management strategies. In this context, tax transparency of the banking industry's Total Tax Contribution will go a long way in communicating the role that the sector plays in supporting the economy and meeting broader societal commitments to government, suppliers and employees.

We thank the 38 banks and microfinance institutions that participated in this study, the Kenya Revenue Authority (KRA) (the Statistics, Analytics and Reporting division) and the Kenya Bankers Association ("KBA"), all of whom provided crucial data for use in this report.

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Executive Summary

Participating banks made a Total Tax Contribution of KES 129.52 bn representing 6.82% of total taxes collected in Kenya

The Total Tax Contribution of the 38 participating banks was KES 129.52 bn in 2021.This consists of taxes borne of KES 63.91 bn and taxes collected of KES 65.61 bn. The KES 129.52 bn is a 23.59% increase from 2020 relative to 2021.The Total Tax Contribution as a percentage of total tax revenue of KES 1,899 trillion shows that banks contributed approximately 6.82% of the total tax revenue compared to KES 6.9% of total government receipts in 2020.

The growth of the Total Tax Contribution of the study participants of 23.59% is slightly lower than the growth in total government receipts of 25.76%. Nonetheless, this is a tremendous contribution given that this tax contribution is made by 38 taxpayers that participated in this study against a background of approximately 6.1 million active taxpayers in the country[1].

From a taxes borne perspective, the increase in TTC can be attributed to a 13.15% increase in corporate tax borne by participating banks from KES 43.73 bn in 2020 to KES 49.48 bn in 2021. The increase in corporate tax borne comes from a more vibrant economy in 2021 compared to 2020 as manifested by various indicators such as the 85.17% increase in PBT in 2021 relative to 2021 as well as a decrease in loan loss provisions by 46.67% in 2021 compared to 2020.

From a taxes collected perspective, firstly, the increase is largely fuelled by a 71.88% jump on excise duty collected by banks from KES 8.32 bn in 2020 to KES 14.30 bn in 2021. This increase results from the expansion of the scope of excise duty on “other fees and commissions” brought in by the Finance Act, 2021. In addition, economic recovery in 2021 compared to 2020 resulted to higher volumes of banking transactions with the effect being a broader excise duty tax base.

Secondly, WHT collected in 2021 increased by 32.58% to KES 22.99 bn compared to KES 17.34 bn in 2020. WHT collected by the participating banks is largely determined by the interest paid by banks to deposit holders. At the end of 2021, total deposits held by banking sector had grown by approximately 11% to stand at KES 4.64 trillion from KES 4.18 trillion in 2020. This increase in total deposits results in a growth in interest expense on deposits of 6.83% to KES 135.96 bn in 2021 compared to KES 127.27 bn in 2020 which manifests itself in the growth in WHT collected.

25.57% of corporate taxes in Kenya are paid by the banking sector

Corporate tax received by KRA amounted to KES 198.24 bn in 2021 out of which KES 50.69 bn was contributed by the banking sector, representing a 25.57% share. This is compared to KES 41.28 bn collected in 2020 which was a 24.20% share of the total corporate tax received by KRA. The increase in 2021 compared to 2020 was largely driven by increase in profits with the profit before tax of the banks increasing by 85.17% in 2021 relative to 2020.

The PBT increase is aligned to increased economic activity in 2021 as reflected by the GDP growth which grew from -0.3% in 2020 to 7.5% in 2021.

23% of withholding tax paid to KRA is collected by the banking sector

In 2021, the banking sector collected KES 31.61 bn in withholding tax. This is against KES 137.51 bn collected by the KRA in the country, meaning 22.99% of all withholding tax collected by the KRA was

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[1]https://www.kra.go.ke/images/publications/tHE-7th-Annual-Tax-Summit-Report-Final.pdf

contributed by the banking sector. This contribution underscores the critical role of banks as an agent of government in collecting taxes.

Lower irrecoverable VAT against the backdrop of lower administrative expenses

Irrecoverable VAT for the study participants declined by 16.20% from 9.32 bn in 2020 to 7.81 bn in 2021. This was despite the resumption of the 16% VAT rate from 14% in 2020. This was the only category of tax analysed in this report that a reduction was noted and is the lowest irrecoverable VAT recorded since inception of this study.

Increased uptake of digital banking and investment in technology has reduced reliance on banking halls, compelling banks to close some branches and reduce their ATMs. The number of bank branches decreased from 1,502 in 2020 to 1,459 in 2021, which translates to a decrease of 43 branches and the number of ATMs decreased by 46 to 2,366 in December 2021, from 2,412 in December 2020[2]. These factors may have led to reduced administrative expenses, specifically commercial rent, hence reducing the irrecoverable VAT incurred. The reduction in irrecoverable VAT may also be an indicator that the sector's investment in the technology infrastructure required for digitalisation substantially happened in periods prior to 2021.

58.25% year-on-year increase in excise duty collected by the banking sector

The total excise duty on financial services collected by the banking sector stood at 9.27Bn and 14.67Bn in 2020 and 2021 respectively. This represents a growth of 58.25% year on year and is the most significant year-on-year growth noted in this report. The recovery in the economy in 2021 provided a broader volume and value of transactions subject to excise duty. Further, with effect from 1 July 2021, the Finance Act 2021 introduced greater scope for excise duty on fees and commissions, further contributing to the increase in the excise duty collected by the banks.

Recovery of the sector from the Covid-19 pandemic

In 2020, nine participating banks assessed themselves as having a high credit risk. In 2021, the number of participating banks who perceived themselves as having a high credit risk were only three. This suggests that the participating banks, and the sector at large, is more confident that borrowers will repay their loans which corelates with the reduction in the loan loss provisioning.

Of the 38 banks who participated in this study, 24 of them (63.16% of the participants) indicated that they have developed a specific lending strategy targeted at specific sectors of the economy to stimulate recovery in these sectors. These sectors are mainly the agriculture and agribusiness sector, manufacturing sector and tourism sector.

Value distributed by the study participants

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

The government received the largest proportion of the value distribution by the participating banks in 2021 at 54.41 % (in the form of taxes collected and borne), followed by employees (in the form of employee emoluments) at 30.65% and lastly shareholders at 14.94% (in the form of dividends).

The increase in value distributed to government in the form of taxes was on account of economic recovery which increased the Total Tax Contribution of the sector by 23.59% in 2021 relative to 2020. Returns to shareholders also increased on account of less focus by the sector on cash conservancy as a result of the economic recovery witnessed in 2021.

Value distributed by the study participants

Value distributed (%)	2020	2021
Taxes (collected and borne)	49.40%	54.41%
Employee Emoluments (net of taxes)	39.10%	30.65%
Dividends (net of taxes)	11.50%	14.94%
Total (%)	**100%**	**100%**

[2]Central Bank of Kenya: Bank Supervision Annual Report 2021

Purpose and outline of the study

Purpose of this study

The purpose of the study is to quantify the contribution made by the Kenyan Banking Sector[3] and the trends in Total Tax Contribution of the sector over time.

The study shows that the contribution by banks is broader than corporation tax, with employment taxes, withholding tax ("WHT"), withholding Value Added Tax ("withholding VAT"), irrecoverable Value Added Tax ("irrecoverable VAT") and excise duty, all adding to the total.

This study also contains data to highlight the impact of legislative amendments such as the government's reversal of the reduced tax rates introduced at the start of the Covid-19 pandemic and the increased scope of excise duty introduced by Finance Act 2021.

The data for this report was collected between May 2022 to June 2022.

Methodology

The study uses the Total Tax Contribution ("TTC") methodology designed by PwC. This framework provides a standardised methodology for companies to measure and quantify all the taxes and contributions that they pay.

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 bank's own contribution in taxes that impact their results, e.g., corporation tax, irrecoverable VAT, VAT on imported services, withholding taxes borne and other taxes borne[4].

Taxes collected are those that the bank administers on behalf of the government and collects from others, e.g., income tax deducted under Pay As You Earn ("PAYE"), withholding VAT, withholding tax collected, excise duty collected, and other taxes collected[5]. The taxes collected have an administrative cost for the bank and will invariably have an impact on the bank's operations.

The results of this study provide information which would not otherwise be available in the public domain, since this is not information companies are required to disclose in their financial reports.

Where we refer to data published by the Kenyan Government and KRA, this is clearly indicated.

Data received related to payments to the Kenyan public finances. No tax payments to foreign tax authorities were included. All "Tier One"[6] banks participated in

[3]KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

[4]Other taxes borne constitute capital gains, stamp duty borne, customs, advance tax, import duty, Railway Development Levy, Import Declaration Fees, and other people taxes (NSSF, Fringe benefits etc. excluding PAYE)

[5]Other taxes collected constitute: NEMA fees, stamp duty collected and other people' taxes (NSSF employee contribution, NHIF etc.)

[6]Tier One refers to the category of banks with over 5% market share as per the Central Bank of Kenya ranking.

38

Banks participated in the 2021 study while 32 banks participated in the 2020 study.

this study. Tier One banks represent a 74.86% market share as measured by net assets[7].

PwC has anonymized and aggregated this data to produce the study results. PwC has used the data as provided by KBA members and has not verified, validated, or audited the data and cannot give any undertakings as to the accuracy of the study results.

Participation in the Total Tax Contribution study

This study covers 35 banks and 3 microfinance institutions covering 97% of the industry by market share[8] in 2021[9].

References in the report to the term **'participating banks'** means the **35 banks and 3 microfinance institutions** that participated in the study while references to the **"banking sector"** refers to all the **commercial banks and microfinance banks in Kenya as defined by KRA**[10].

38 banks participated in the 2021 study while 32 banks participated in the 2020 study.

It is considered that the 2021 data set is broadly comparable to the 2020 data set as in both years, participants represented over 95% of the market share from a net asset perspective and all tier one banks participated in both studies.

[7]Central Bank of Kenya: Bank Supervision Annual Report 2021

[8]Market share as measured by net assets excluding banks in receivership. Total market share was calculated using data of the 38 banks that participated in the study.

[9]All banks have financial years ending in December.

[10]KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

Total Tax Contribution Analysis

The Total Tax Contribution analysis presented in this section relates to tax data of the **38 participating banks**[11] in terms of taxes borne and taxes collected.

Taxes borne

Taxes borne are those whose financial impact and tax burden is directly borne by the taxpayer and are therefore a cost to the business as these taxes directly affect a taxpayer's profitability. The participating banks bore taxes amounting to KES 63.91 bn in 2021, a 9.81% increase from the KES 58.2 bn recorded in 2020.

This increase was driven by a 13.15% increase in corporation tax - the largest component of taxes borne - from KES 43.73 bn in 2020 to KES 49.48 in 2021. The increase is largely related to a more robust economy in 2021 as evidenced by an increase in banks' profitability along with a reduction in loan loss provisions.

Further analysis of taxes borne is as follows:

a) Corporation tax forms the largest component of taxes borne by the sector, representing 77.43% of the total taxes borne in 2021. (see further detailed analysis on page 13)

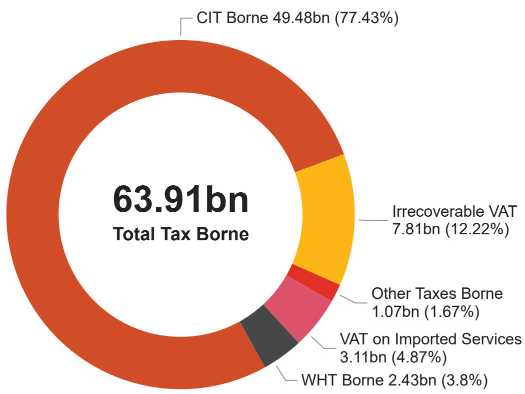
b) Irrecoverable VAT is the second largest component of taxes borne, representing 12.22% of the total taxes borne in 2021. (see further detailed analysis on page 17)

c) VAT on imported services represents 4.87% of total taxes borne in 2021.

d) Withholding tax borne represented 3.80% of total taxes borne in 2021.

e) Other taxes borne[12] represent 1.67% of total taxes borne for in 2021.

Below shows the profile of taxes borne for the 38 participants in 2021



Taxes collected

Taxes collected are those which are generated by a company's operations and are collected from others on behalf of the government, e.g., income tax deducted under PAYE, employee portion of Social Security such as NSSF, withholding taxes collected on payments to suppliers, withholding VAT and net VAT.

The banks generate the commercial activity that gives rise to the taxes and then collects and administers the taxes on behalf of the KRA. In the absence of the banks, these taxes would not have been collected. Therefore, taxes collected are a key indicator of the wider economic contribution by the sector.

[11] Participating banks mean the 35 banks and 3 microfinance institutions that participated in this study

[12] Other taxes borne constitute capital gains, stamp duty borne, customs, advance tax, property taxes and other people taxes (NSSF, Fringe benefit taxes etc. excluding PAYE)

Taxes collected by participating banks were KES 65.61 bn in 2021 and KES 46.6 bn in 2020. This is a 40.79% increase in 2021 relative to 2020. The increase is largely attributable to:

- A 71.88% increase in excise duty arising from increase on volume and value of transactions subject to excise duty as well as increased scope of income subject to excise duty brought about by Finance Act 2021;
- A 22.81% increase in PAYE which arises in part, from the resumption of the top PAYE rate to 30% as well as a year-on-year increase in employee emoluments; and
- A WHT increase of 32.58% arising from an increase in interest expense incurred by the banks.

Further analysis of taxes collected is as follows:

a) WHT collected forms the largest component of taxes collected, representing 35.05% of the total taxes collected in 2021. (see further detailed analysis on page 15)

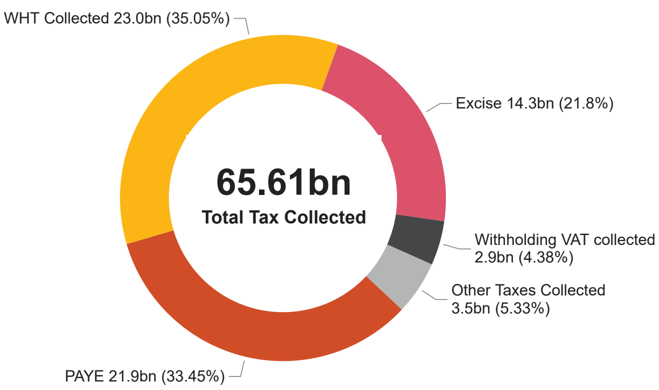
b) PAYE is the second largest component of taxes collected, representing 33.45% of the total taxes collected in 2021. (see further detailed analysis on page 16.)

c) Excise tax collected stood at 21.79% of total taxes collected in 2021. (see further detailed analysis on page 18.)

d) Withholding VAT represents 4.38% of total tax collected in 2021.

d) Other taxes collected[13] represent 5.33% of total taxes collected for 2021.

Below shows the profile of taxes collected for the 38 participating banks[14] in 2021.



Total Tax Contribution

The 38 participating banks reported taxes borne of KES 63.91 bn and taxes collected of KES 65.61 bn, making a Total Tax Contribution of KES 129.52 bn.

The banking sector's contribution to government receipts continues to be substantial. In 2021, the Total Tax Contribution of the participating banks accounted for 6.82% of all the taxes collected by the government.

This is largely similar to the 6.9% contribution in 2020. This remains a significant contribution given that this contribution is made by 38 taxpayers against a background of approximately 6.1 million active taxpayers in the country[15].

[13]Other taxes collected constitute: NEMA fees, stamp duty collected and other people' taxes (NSSF contribution, NHIF etc.)

[14]'participating banks' means the 35 banks and 3 microfinance institutions that participated in the study

[15]https://www.kra.go.ke/images/publications/tHE-7th-Annual-Tax-Summit-Report-Final.pdf

The growth of the Total Tax Contribution of the study participants of 23.59% is slightly lower than the growth in total government receipts of 25.76%.

Compared to 2020, total tax collected increased in 2021 by a larger margin, of 40.79% compared to total tax borne which increased by 9.81%. This is because excise duty and WHT both of which are taxes collected, had the highest year-on-year growth at 71.88% and 32.58% respectively.

Participating banks TTC relative to total government receipts

Description	2020 (KES bn)	2021 (KES bn)
Total Tax Borne	58.2	63.91
Total Tax Collected	46.6	65.61
Total Tax Contributed	104.8	129.52
Total government receipts[16]	**1,510**	**1,899**[17]
% of participating banks TTC relative to total government receipts	**6.9%**	**6.8%**

Tax revenue to GDP ratio in Kenya in 2020/2021[18] was 13.8%[19]. Of the 13.8%, 1.07% was contributed by the 38 banks who participated in this study. This is a strong indicator that the sector continues to be a key contributor to taxes.

The TTC profile of the participating banks as summarised below shows that corporation tax made up 38.2% of the TTC in 2021 and is the most significant tax contribution banks make to taxes. This is followed by WHT collected which represented 17.8% of the TTC for 2021 respectively. PAYE represented the third largest component of the TTC constituting 16.9%.

It is noteworthy that **three** of the **top four** contributors of Total Tax Contribution relate to taxes collected as opposed to taxes borne. This highlights the critical role that the banking sector plays not only as a government tax collection agent, but also in generating economic activity that leads to collection of the taxes. Further, this is also indicative of the fact that the sector is highly formalised and regulated, both of which factors promote tax compliance.

The major tax components of the Total Tax Contribution by the 38 participating banks are analysed in the next section of this report.

The TTC profile for participating banks

Description	2020		2021	
	Amount in KES (Bn)	% Make-up	Amount in KES (Bn)	% Make-up
Corporate Income Tax borne	43.7	41.7	49.5	38.2
WHT Collected	17.3	16.5	23.0	17.8
PAYE Collected	17.9	17.0	21.9	16.9
Excise Duty Collected	8.3	7.9	14.3	11.0
Irrecoverable VAT Borne	9.3	8.9	7.8	6.0
Others[20] Collected	3.1	3.0	3.5	2.7
VAT on imported services borne	1.9	1.8	3.1	2.4
WH VAT Collected	0.9	1.0	2.9	2.2
WHT Borne	2.4	2.2	2.4	1.9
Total	**104.8**	**100.0**	**129.5**	**100.0**

[16]This is a summation of all taxes collected by the government as reported by KRA on 07 July 2022. The government year runs from July to June while that of banks runs from January to December. Both calendars cover a 12-month period

[17]Excludes agency collections as reported by KRA 07 July 2022

[18]2021 tax revenue to GDP ratio data as provided by the draft National Tax Policy

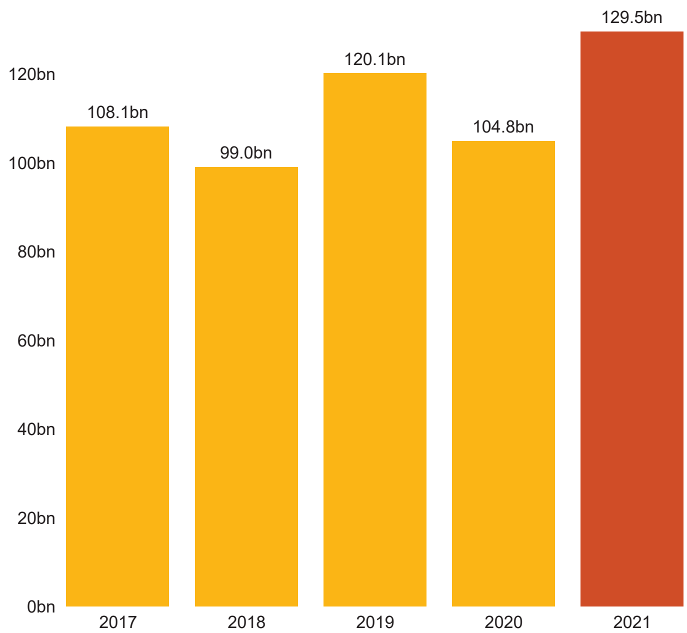
[19]https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?locations=KE

[20]Others include other taxes collected (NEMA levies, stamp duty collected, net VAT paid and other people' taxes (NSSF employee contribution, NHIF etc.)) and other taxes borne (capital gains, stamp duty borne, customs, import fees and levies, advance tax, property taxes and other people taxes (NSSF, Fringe benefit taxes etc. excluding PAYE)).

Total Tax Contribution is the highest in five years

An analysis of the Total Tax Contribution of study participants over the period 2017 to 2021 is presented below.

Year on Year Total Tax Contribution of the Participating Banks



The decline in Total Tax Contribution in the 2018 year relative to 2017 was attributable to a decline in corporate taxes paid in 2018 as a result of the impact of the interest rate capping first introduced in late 2016 and a prolonged electioneering period in 2017. Both of these factors in 2017 impacted the corporate tax balance of tax for 2017 that is payable in 2018.

2018 witnessed a stabilizing of the political environment which was witnessed through a relatively high GDP growth rate of 6.3%. In addition, 2018 being the second full year of the interest rate cap, the sector had put in place measures to protect revenue and profitability. As a result, banks' profitability in 2018 increased by 14% relative to 2017 leading to significant corporate tax payments in 2019 in the form of 2018 balance of tax (paid in April 2019).

In 2020, the Total Tax Contribution of the study participants declined by 16% as a result of -0.3% GDP contraction in the first year of the Covid-19 pandemic. This was aligned to the decline in profitability of banks by 31%, increased loan write-offs and provisions as well as the government issuance of tax reliefs through reduced tax rates on corporate tax, PAYE, and VAT.

In 2021, the Total Tax Contribution of the study participants relative to 2020 increased by 23.59%. This tax contribution of KES 129.52 bn is the highest over a 5-year period – a clear indication that the economy was on a steady path towards recovery in 2021.

The increase is driven by substantial jump in corporate tax borne, excise duty collected and withholding tax collected - all on account of the economic recovery witnessed in 2021 as a result of reopening of all sectors of the economy and greater access to vaccines. The growth in the total tax contribution is aligned to the 7.5% growth in GDP witnessed in 2021.

Although the economic outlook for 2022 appears weak on account of looming political transition, high fuel prices, failure of long rains as well as geopolitical risks, given the economic recovery witnessed in 2021, we expect that there was a substantial 2021 corporate tax balance of tax payment (due and paid in April 2022) which may drive up the 2022 total tax contribution relative to 2021.

The current economic conditions are however likely to reduce the volume and value of transactions in 2022 which will impact the 2022 tax contribution negatively.

13.8%

Tax revenue to GDP ratio in Kenya in 2020/2021

Total Tax Rate

Total Tax Rate ("TTR") is the ratio of all taxes borne as a percentage of profit before tax ("PBT") and is therefore a measure of the cost of all taxes borne relative to profitability. On an overall basis, the TTR of participating banks was 32.85%. This means that for every KES 100 of profit by the participating banks, KES 32.85 was paid to the government as taxes.

The TTR in 2021 declined from 55.5% in 2020 to 32.85% in 2021. This is attributed to significant increase in PBT in 2021 (85.17%) driven by more economic activity in 2021 relative to 2020 as well as a reduction in loan loss expense in 2021 compared to 2020.

While the profitability of the sector in 2020 was lower than the profitability in 2021, the TTR for 2020 was higher. This is because the reduction in profitability in 2020 was driven in large part by loan loss provisions expensed which are not treated as tax allowable as tax rules on tax deductibility of loan loss provisions are not aligned to IFRS 9 accounting criteria on recognising loan loss provisions.

Greater alignment between tax deductible loan loss provisions and loan loss provisions expensed in financial statements as per IFRS 9 standards would ensure that corporate tax payments are better aligned to reported profitability.

Total Tax Rate Analysis

Description	2020 (KES bn)	2021 (KES bn)
Corporation Tax	41	49.5
Irrecoverable VAT	9.3	7.8
Other taxes borne	7.9	6.6
Total taxes borne	**58.2**	**63.9**
Profits Before Tax (after exceptional items) of participating banks	104.9	194.6
Total Tax Rate (TTR)	**55.5%**	**32.85%**

The TTR in 2021 declined from 55.5% in 2020 to 32.85% in 2021

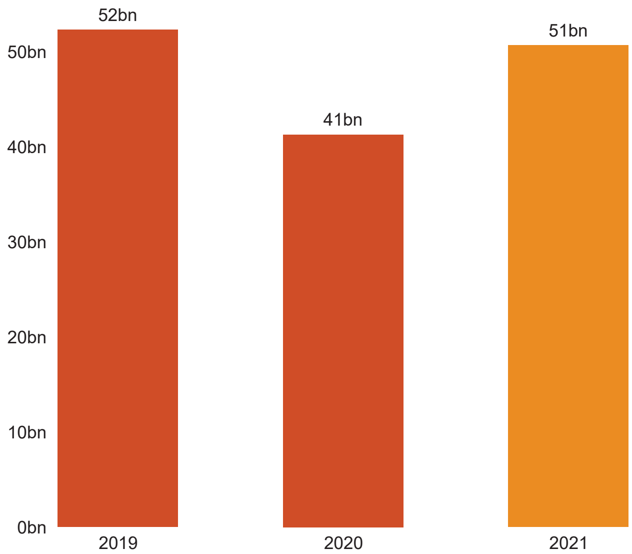
Corporation Tax

Corporation taxes paid by the banking sector

The banking sector[21] contributed KES 50.70 bn in corporation tax in the year 2021. This indicates an increase of 22.82% compared to 2020 when the sector's corporation taxes payments amounted to KES 41.28 bn.

The KES 50.70 bn contribution is close to the 2019 pre-Covid-19 pandemic corporation tax contribution of KES 52 bn pointing to an economy that was on a steady recovery path in 2021. This is illustrated in the figure below.

Corporation tax paid by the banking sector (2019 - 2021)



The 22.82% increase was largely driven by increase in profits with the profit before tax of the sector increasing by 85.17% in 2021 relative to 2020[22].

Loan loss provisions declined by 46.67% in 2021 relative to 2020. Provisions for loan loss constitute a significant component of banks' operating expenses and therefore their reduction had a significant impact on the profitability of the banking sector. The increase in profitability of banks aligns to the increased economic activity in 2021 as reflected by the GDP which accelerated from -0.3% in 2020 to 7.5%[23] in 2021.

The increase in corporation tax can also be partly explained by the increase in the corporation tax rate from 25% in 2020 to 30% in 2021. This is following the reversal of the reduced tax rates that was part of the economic stimulus programme introduced by the government in 2020 in the wake of the Covid-19 pandemic.

Corporate tax borne by the banking sector as a percentage of total government corporate tax receipts

The banking sector[24] contributed 25.57% of total corporate taxes received by the government from all the sectors in Kenya. The comparative contribution for 2020 stood at 24.20%.

This contribution is however, yet to get back to the pre-Covid-19 pandemic levels of 29.74%. The corporate tax contribution is significant given the number of taxpayers in the banking sector relative to all taxpayers in Kenya.

[21] KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

[22] Bank Supervision Annual Report 2021 by Central Bank of Kenya.

[23] https://www.knbs.or.ke/economic-survey-2022/

[24] KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

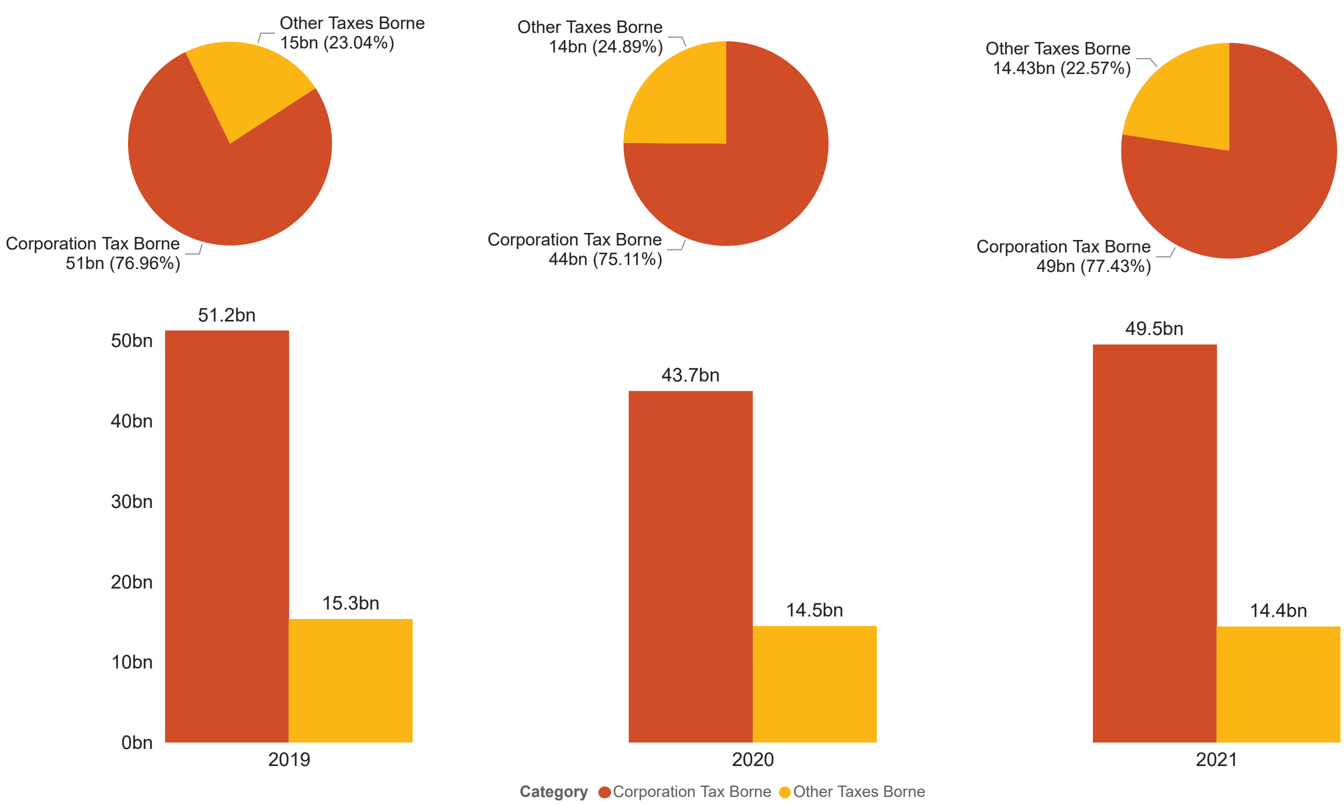
The figure below illustrates the corporation tax contributed by the banking sector.

Corporation tax paid by the banking sector between 2019 to 2021

Corporation taxes form the largest component of total taxes borne by participating banks

Corporation tax represents the largest component of total taxes borne by the participating banks[25] standing at 77.43% in 2021. In 2020, corporation tax constituted 75.11% of the total taxes borne. This increase in corporate tax as a share of total taxes borne is as a result of economic growth witnessed in 2021 as well as an increase in the corporate tax rate from 25% to 30%.

Corporation tax borne between from 2019 to 2021 by the study participants



[25] 35 banks and 3 microfinance institutions that participated in this study

Withholding Tax

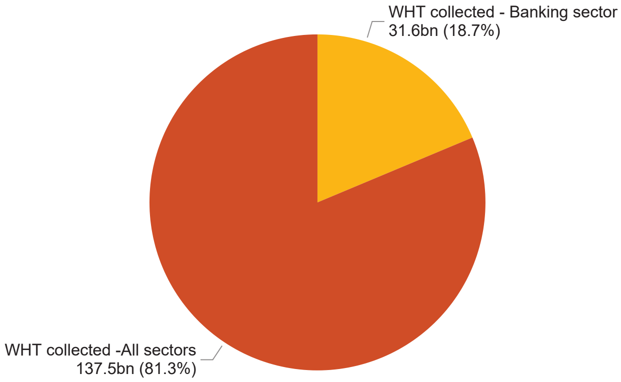
The banking sector collected more than 22% of total withholding tax collections

In 2021, the banking sector[26] collected KES 31.61 bn in withholding tax. This is against KES 137.51 bn collected by the KRA in the country. This means that 22.99% of all withholding tax collected by the KRA was contributed by the banking sector. This is an improvement from the 19.01% WHT collection that was recorded in 2020 by the sector.

WHT collected by banks is largely determined by the value of the interest paid by banks to deposit holders. At the end of 2021, total deposits of the banking sector had grown by 11% to stand at KES 4.64 trillion from KES 4.18 trillion in 2020.

This increase in total deposits resulted in a growth in interest expenses on deposits by 6.83% to KES 135.96 bn in 2021 compared to KES 127.27 bn in 2020[27]. The increase in interest expense therefore resulted in an increase in the WHT collected by banks.

WHT collected by the banking sectors vs all other sectors

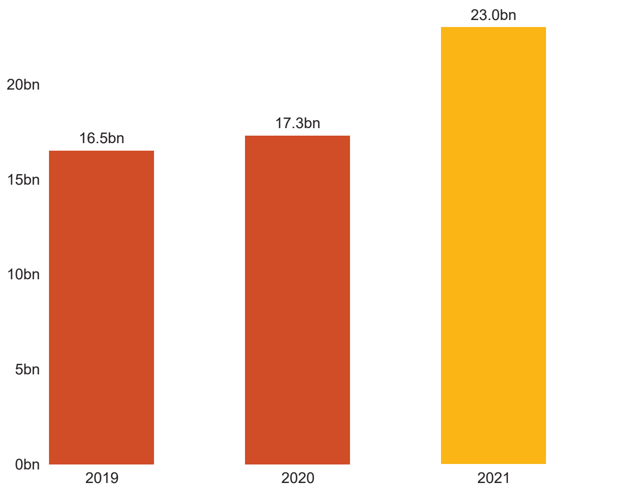


The WHT collected by participating banks continue to increase year-on-year

In 2021, the participating banks[28] collected WHT amounting to KES 22.99 bn which is a 32.58% increase compared to the KES 17.34 bn collected in 2020. It is interesting to note that the WHT collected in 2021 of KES 22.99 bn is more than the amount collected in 2019 -pre-Covid-19 pandemic which amounted to KES 16.5 bn.

As elaborated above, the increase in WHT maybe attributable to the 11% increase in deposits in 2020 relative to 2021 which resulted in an increase in interest expense on deposits by 6.83% from 2020 to 2021 thereby increasing the WHT collected by banks upon payment of interest to deposit holders.

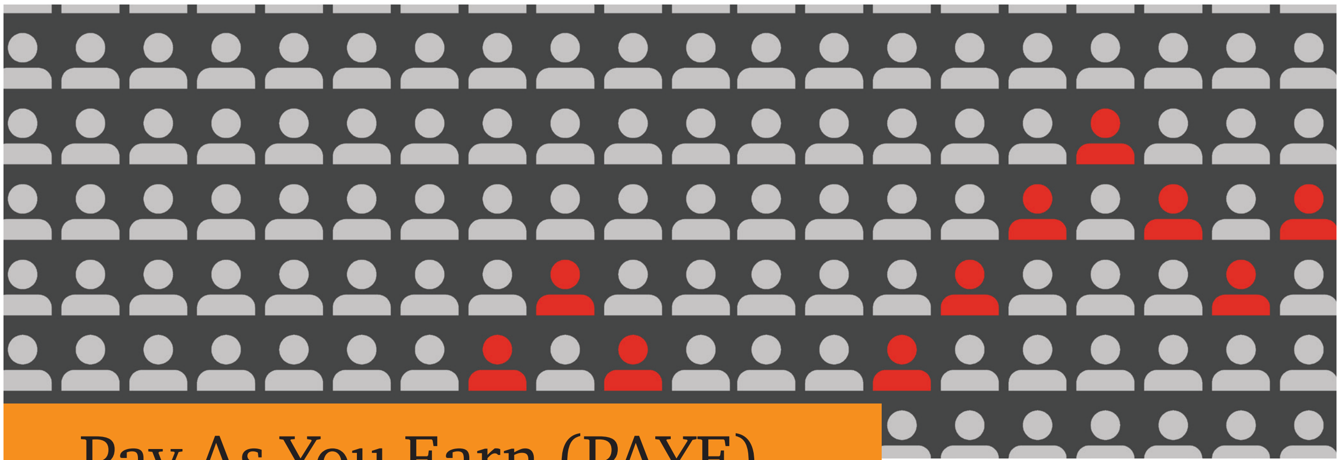
WHT collected by participating banks (bn)



[26]KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

[27]2022 Kenya Bankers Association - Status of the Banking Industry Report

[28]35 banks and 3 microfinance institutions that participated in this study

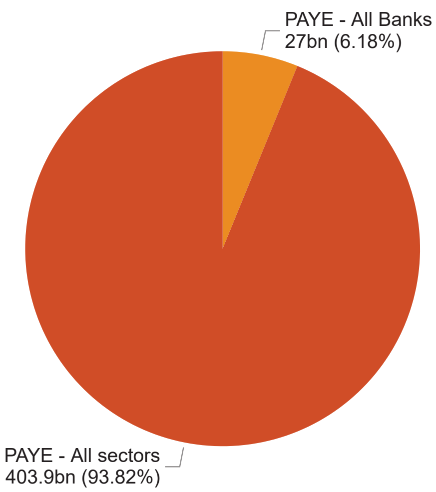


Pay As You Earn (PAYE)

The banking sector contributed 6.18% of total PAYE collected by all economic sectors in Kenya in 2021

The banking sector's[29] contribution to taxes through PAYE collected amounted to KES 26.62 bn representing 6.18% of total PAYE collected in Kenya. In 2020, PAYE contributed by the sector was KES 18.2 bn (5.3%) of total PAYE collected. The high PAYE contribution is indicative of the high regulation of the sector leading to high compliance levels that manifest through high PAYE collections.

PAYE paid by the banking sector in 2021



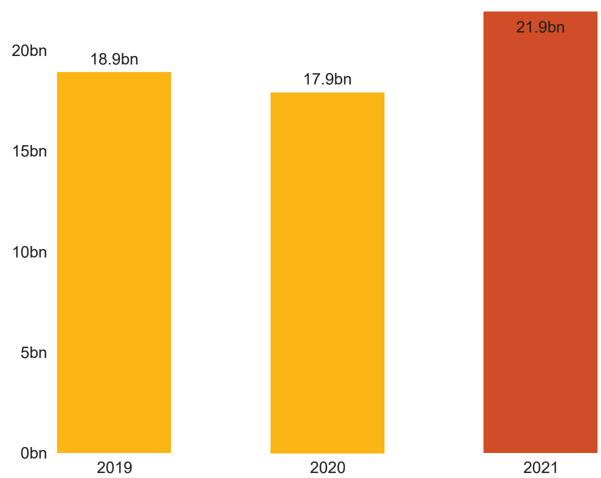
Increase in PAYE by study participants as banks hired more highly qualified staff

The PAYE collected by the participating banks[30] amounted to KES 21.94 bn in 2021 compared to 17.9 bn in 2020. This represents a 22.57% increase and is the highest PAYE record by participating banks over a three-year period. It is noteworthy that while the PAYE substantially increased, the number of employees employed by the study participants reduced slightly from 31,703 in 2020 to 30,099 in 2021. This indicates that banks are moving away from employing large numbers of lower cadre staff and moving towards employing highly qualified staff with differentiated skill set as the sector moves towards greater technology adoption.

As per the 2021 Economic Study published by the Kenya National Bureau of Statistics[31], the estimated real average annual wage earnings in 2020 per employee in the financial services sector was KES 1,889,064. This is the third highest across all sectors, only behind multilateral organizations such as the United Nations and the oil and gas sector. This is a strong indicator of the highly qualified nature of staff that banks are employing.

The increase of the top PAYE bracket rate from 25% to 30% in 2021 as the government reinstated the pre-Covid-19 pandemic marginal rate of 30% also contributed to the increase in PAYE collected.

PAYE contribution by participating banks (2019-2021)



[29]KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

[30]35 banks and 3 microfinance institutions that participated in this study

[31]https://www.knbs.or.ke/wp-content/uploads/2021/09/Economic-Survey-2021.pdf

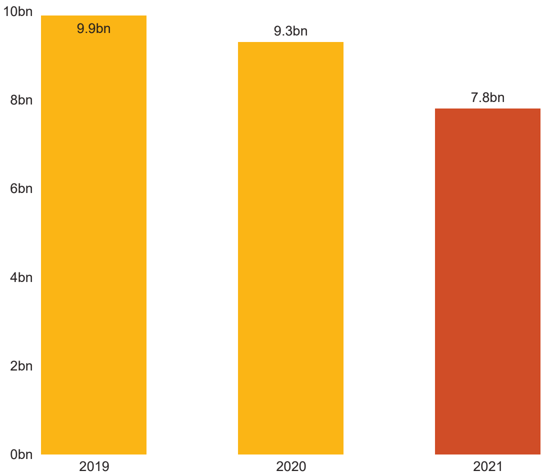
Irrecoverable VAT

Typically, when a business supplies goods and services, the VAT charged (output VAT) 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 giving rise to irrecoverable VAT phenomena. This irrecoverable VAT represents a key component of taxes borne by the banks.

Irrecoverable VAT for the study participants declined from 9.32 bn in 2020 to 7.81 bn in 2021 (16.20% decline). Irrecoverable VAT represents 12.2% of the total taxes borne. This is the only tax category analysed in this report that reported a reduction in 2021 relative to 2020 largely due to decrease in premises costs as explained below.

Premises costs form a significant component of irrecoverable VAT as commercial rent attracts VAT and a reduction in premises costs is expected to manifest in a reduction in irrecoverable VAT. Increased uptake of digital banking and investment in technology has reduced reliance on banking halls compelling banks to close some branches and reduce their ATMs. The number of bank branches decreased from 1,502 in 2020 to 1,459 in 2021, which translates to a decrease of 43 branches (2.86%) and the number of ATMs decreased by 46 to 2,366 in December 2021, from 2,412 in December 2020. Nairobi County registered the highest decrease in the number of branches by 33 branches[32].

Irrecoverable VAT borne by participating banks (2019-2021)



This is indicative of new ways of working such as remote working and minimal travel costs due to reduced physical meetings.

The reduction in irrecoverable VAT may also indicate that the sector's investment in the technology infrastructure required for digitalisation substantially happened in periods prior to 2021 which may have led to a reduction in irrecoverable VAT in 2021.

With the continued digitalisation and reduction of physical banking channels, the VAT contribution of the sector may reduce further. This trend in reduction is evident in the reduction in irrecoverable VAT from KES 9.9 bn in 2019 to KES 7.81 bn in 2021.

[32]Central Bank of Kenya: Bank Supervision Annual Report 2021

Excise Duty

Excise duty collected by the banking sector

The total excise duty on financial services collected by the banking sector[33] stood at KES 9.27 bn and KES 14.67 bn in 2020 and 2021 respectively. This represents a growth of 58.25% year on year and is the most significant year-on-year growth noted in this report.This increase is at the backdrop of a more robust economy in 2021 compared to 2020 thereby improving the consumer purchasing power and providing a broader volume and value of transactions subject to excise duty. The 2021 economic recovery is exhibited by a growth in loans and advances of 9.3% in 2021 compared to 2020 as well as an 8.1% increase in fees and commissions[34].

Further, the higher excise duty can also be attributed to the greater scope for fees and commissions subject to excise duty as introduced by the Finance Act 2021 with effect from 1 July 2021.

Excise duty collected in the financial services sector

The table below shows the excise duty collected in the financial services sector and the banking sector's relative contribution.

Excise duty collected in the financial services sector

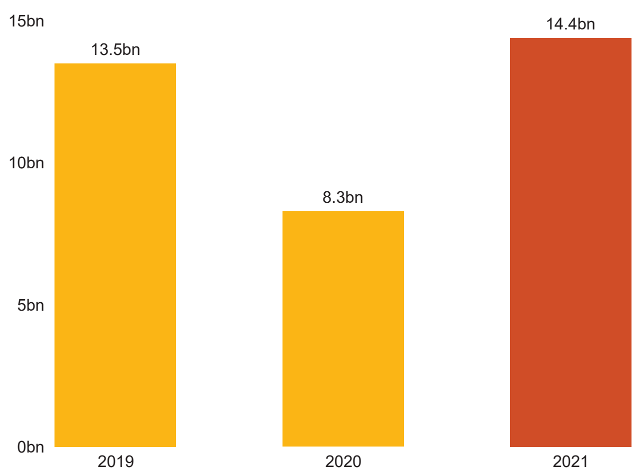
Description	2019 KES bn	2020 KES bn	2021 KES bn	Increase
Excise duty on financial services collected by banks	16.1	9.27	14.67	58.25%
Total excise collected by KRA in financial services	27.5	20.2	28.9	43.1%
Contribution by banking sector to excise	58%	46%	51%	53.7%

Of the total excise duty on financial services amounting to KES 28.90 bn collected by KRA, the banking sector paid KES 14.67 bn in 2021, representing a 50.76% share. This is largely attributed to the increase in the scope of fees and commission subject to excise duty as introduced by Finance Act, 2021 together with the growth in fees and commissions income.

Excise duty contributed by participating banks

The participating banks[35] contributed KES 14.30 bn in excise duty in 2021 compared to 8.32 bn in 2020. This is a 71.88% growth year on year. This growth is mirrored in the trend across the entire banking sector that is supported by economic recovery leading to high transaction volumes and the changes in Finance Act 2021 that increased the scope for transactions that are subject to excise duty.

Excise duty contribution by the participating banks (2019-2021)



[33]KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/Custodian banks (38); Others (47)-i.e., Bureaus, International Bank Corporations with Local Offices

[34]2022 Kenya Bankers Association - Status of the Banking Industry Report

[35]35 banks and 3 microfinance institutions that participated in this study

The Banking Sector in 2021

Introduction

In 2020, the banking sector, as did the entire country and global economy, faced a challenging economic period due the Covid-19 pandemic. In 2021, accessibility of vaccines and reopening of the economy played a significant role in the resumption of economic activity, minimising disruption in the working patterns and the day to day lives of Kenyans.

Economic recovery is evidenced by the 46.67% reduction in provisions for bad debts in 2021 relative to 2020 and the 85.17% increase profit before tax. This section of the report paints a picture of the environment that banks operated in 2021.

Loan Performance: Credit risk

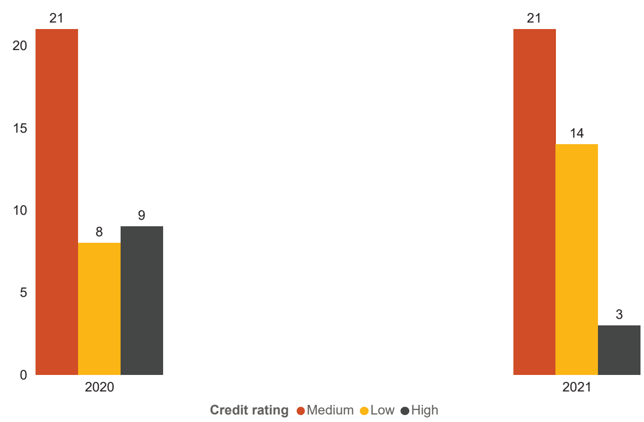
Credit risk is the measure of the possibility of default, arising from a borrower's failure to repay a loan or meet a contractual obligation. The higher it is, the more sceptical the sector is on the ability of borrowers to meet their obligations, and the lower it is the more confidence the sector has on the same.

In 2021, nine participating banks assessed themselves as having a high credit risk. In 2022, the number of participating banks who perceived themselves as having a high credit risk were only three.

This suggests that the banks, and the sector at large, is more confident and optimistic that more borrowers will afford and repay their loans and correlates with the reduction in loan provisions.

In terms of the future outlook, there is optimistic GDP growth[36] with an expected 5.5% increase in GDP in 2022[37].

Year on year trend in credit risk



Adoption of risk-based lending

A risk-based lending model would allow banks to lend and price for risk appropriately. While the adoption of risk-based lending may raise the cost of credit for some segments and borrowers, it is expected to have a positive effect on greater access to credit and the sector's earnings, hence spurring economic growth.

As a share of total industry assets, 29.6% (representing six banks) of banks since 2020 have transitioned to a risk-based pricing environment accounting for 27.0% of the industry loan portfolio[38].

[36]World Bank: Kenya Economic Update 2021

[37]https://www.worldbank.org/en/news/press-release/2022/06/07/kenya-s-growth-expected-to-slow-in-2022-due-to-ongoing-drought-ukraine-crisis#:~:text=NAIROBI%2C%20June%207%2C%202022%E2%80%94,on%20average%20in%20 2023%E2%80%9324.

[38]2022 Kenya Bankers Association - Status of the Banking Industry Report

Supporting other sectors

Of the 38 banks who participated in this study, 24 of them indicated that they have developed a specific lending strategy targeted at specific sectors of the economy to stimulate recovery in that sector.

The participating banks noted that they have offered support to specific economic sectors by developing a lending strategy targeted specifically at them to stimulate recovery from the pandemic and its effects. These are mainly the agriculture and agribusiness sectors, the manufacturing sector and the tourism sector.

With the agricultural sector being the backbone of the economy and contributing approximately 22.4% of the GDP and employing more than 11% of the total wage employment[39] – the banking sector's focus on lending to agriculture is playing a significant and vital role in the recovery of both the agricultural sector and the economy of the country at large.

The manufacturing sector is another key contributor to national output and exports. In 2020, the sector had a negative growth rate of -0.1%[40] due to the impact of Covid-19 pandemic. Similarly, the tourism sector, also was adversely affected by the pandemic with decreased revenues as a result of the pandemic. The tourism sector is already on a recovery path with a promotion of domestic and regional tourism, diversifying current offerings and the digitisation of tourism.

The banking sector is directly supporting the recovery of these key sectors by deploying tailored lending strategies.

At the onset of the Covid-19 pandemic, the banking sector supported the economy by offering loan restructuring for customers unable to meet loan commitments due to the adverse impact of the pandemic.

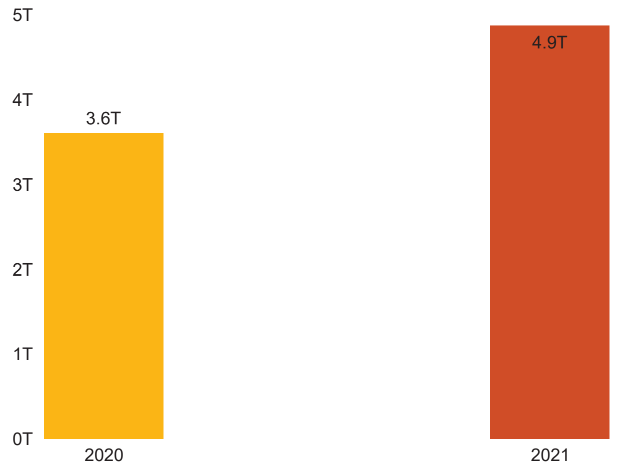
According to the 2021 CBK Bank Supervision Annual Report, as at the end of December 2021, the outstanding restructured loans amounted to KES 423.6 bn representing 13% total banking sector loans.

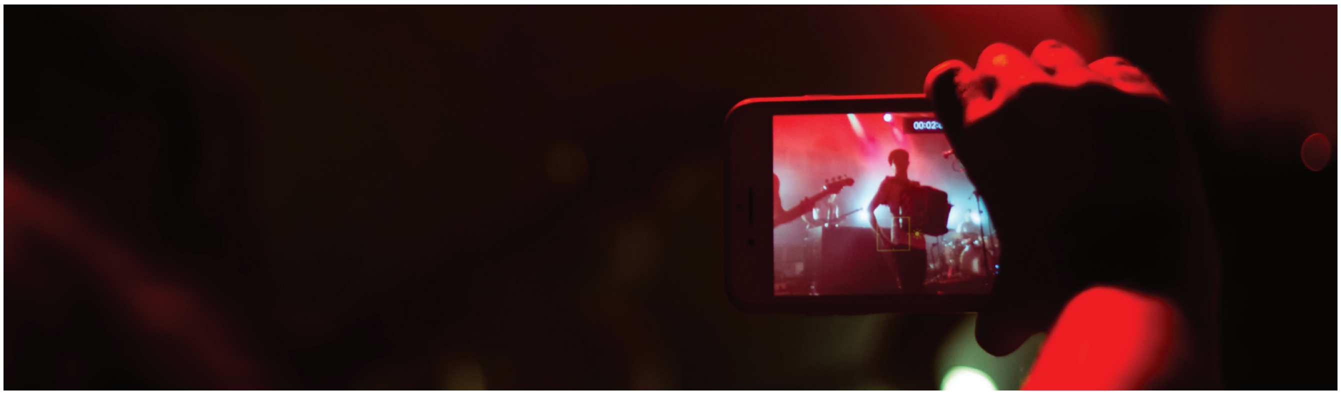
Of this amount 92.3% of the outstanding restructured loans were performing while 7.7% were non-performing. This indicates the continued support of the banking sector towards the broader economy while the low rate of non-performing restructured loans indicates economic recovery witnesses 2021.

Continued adoption of technology and digitalisation

Participating banks' value of digitally disbursed loans grew 38% in 2021 relative to 2020 (KES 3.2 trillion in 2020 compared to KES 4.8 trillion in 2021). This is an indicator of recovery of the sector as well support to the broader economy as there are now more channels that facilitate credit access.

Value of transactions and loans disbursed via digital channels





[39]https://www.knbs.or.ke/wp-content/uploads/2022/05/2022-Economic-Survey1.pdf

[40]https://www.usaid.gov/kenya/agriculture-and-food-security#:~:text=The%20agricultural%20sector%20is%20the,has%20stagnated%20in%20recent%20years.

Glossary

Term	Definition	Term	Definition
Total tax collected	Taxes that the company administers on behalf of government and collects from other taxpayers as an agent of government	**Corporation tax (CIT)**	The main tax on a company's profits
Participating Bank	35 banks and 3 microfinance institutions that participated in this study	**Banking Sector**	KRA defines the banking sector to include Listed banks (44); SACCOs (16); Microfinance (7); Investment/ Custodian banks (38); Others (47)- i.e., Bureaus, International Bank Corporations with Local Offices
Total tax borne	A company's own contribution in taxes	**Irrecoverable VAT**	VAT that a taxpayer incurs but is not offset against output VAT
Total Tax Contribution	The sum of taxes borne, and taxes collected	**Excise duty**	A tax paid on certain categories income earned by financial service providers
Value distributed	Payment made by a corporate entity to its key stakeholders-government, employees, and shareholders	**Withholding taxes**	An income tax withheld on certain kinds of qualifying payments such as management fees, royalties, and interest
Net assets	Total assets minus total liabilities	**Withholding tax borne**	Withholding tax incurred by the company making payments of the above qualifying payments that it does not pass on the supplier
KRA	The Kenya Revenue Authority	**Pay as You Earn (PAYE)**	A tax withheld from the employment income of the company's employees
KBA	The Kenya Bankers Association	**VAT on imported Services**	This is the VAT accounted for on imported services
Employment taxes	All taxes and statutory deduction arising from employment such as PAYE, NHIF, NSSF etc	**Withholding VAT**	The tax withheld from VAT charged to the company
Total government receipts	This is a summation of all taxes collected by the government as reported by KRA, excluding agency collections		

Notes

Notes

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