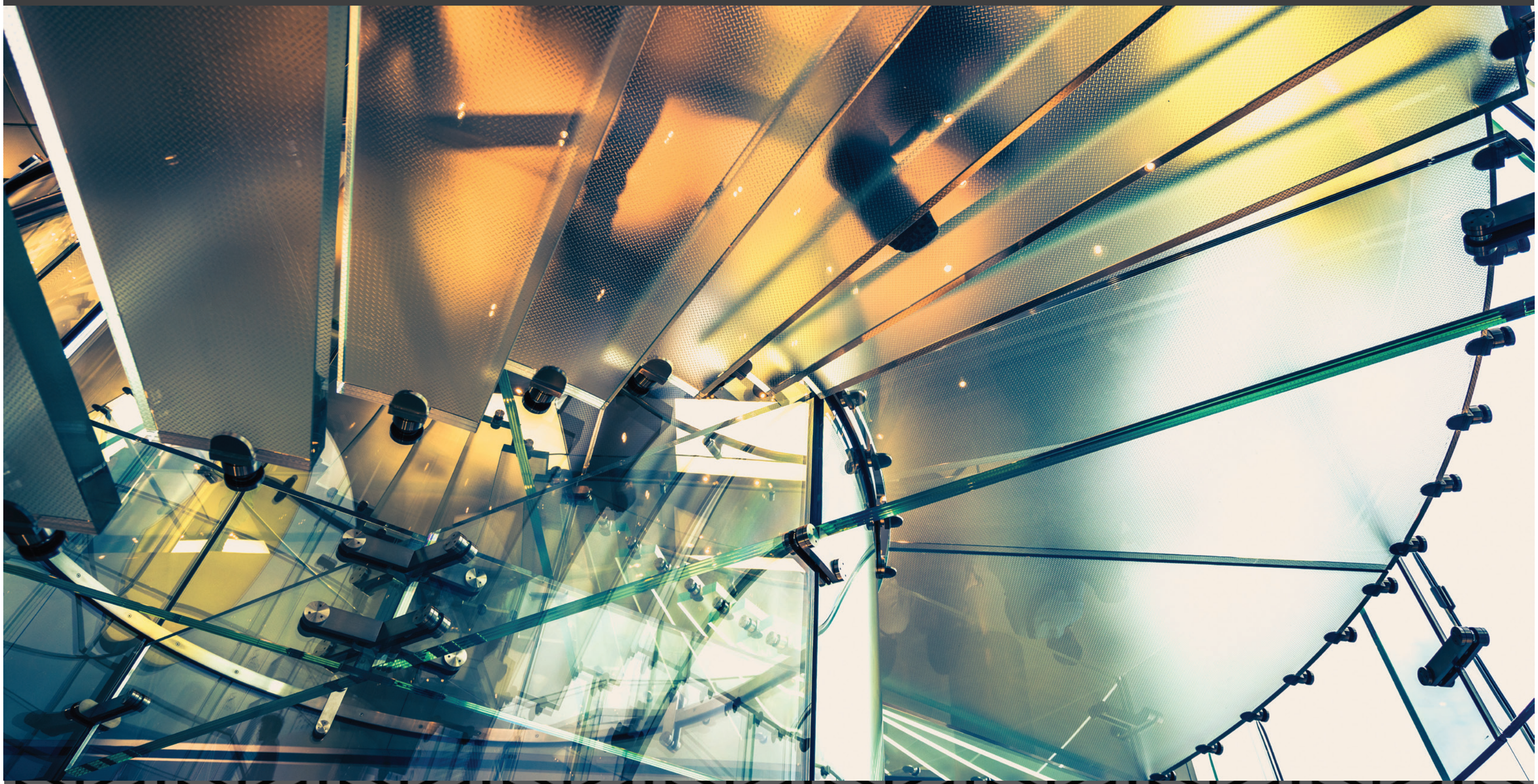
Total Tax Contribution of the Kenya Banking Sector

Kenya Bankers Association

Periods ending 31 December 2019
and 31 December 2020



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KENYA BANKERS
ASSOCIATION

Contents

Foreword

For PricewaterhouseCoopers Limited

Welcome to the second edition of the Total Tax Contribution (TTC) study of the Kenyan banking sector. The first TTC study for the sector produced in 2019 covered the 2017 and 2018 financial periods. Beyond corporate taxes, the tax contribution of the industry includes aspects such as excise duty paid, irrecoverable VAT, employment taxes and others. The study highlighted the sector's significant contributions in corporation tax and PAYE contributing 26% and 5.2% of total corporation tax and PAYE receipts in Kenya in 2017 and 2018.

At the time of the first study, the prominent issue facing the industry was the interest rate capping introduced in September 2016 which was subsequently repealed in November 2019. This second study covering the 2019 and 2020 financial periods is produced against the background of the Covid-19 pandemic - the most disruptive social and economic event of our times. It is hoped that the data collated will produce additional context and insights regarding the effects of the Covid-19 pandemic in the banking sector.

In the current operating environment, the role of the private sector in supporting economic growth and recovery is critical. This is in the form of payment of taxes, provision of employment and continued investment in the economy. For the banking sector, credit intermediation as a path to economic recovery cannot be overstated.

This report is an important piece of information on the critical role played by the sector and the need to ensure its continued resilience and ability to support economic recovery. The report offers an opportunity for the tax contribution of the banking sector to be quantified and analysed so that policy makers can assess whether the operating environment is supportive of the sector.

It is also interesting that this year's study is produced against the backdrop of a greater focus on sustainability, with stakeholders increasingly interested in how companies perform from an environmental, social and governance perspective (ESG reporting). Tax contribution reporting is a critical aspect of sustainability reporting. We hope that this TTC report will ignite conversations in the market around improvement in sustainability of the sector from a social and governance perspective as well as improve tax transparency.

This year's study covering 32 participants shows that the participants made an estimated Total Tax Contribution of KES 120.1 bn and 104.8 bn in the 2019 and 2020 financial periods respectively. This represents a 12.7% decline in 2020 relative to 2019. The combined Total Tax Contribution of the sector in 2019 and 2020 periods represents a 9% growth compared to the combined 2017 and 2018 period. Greater insights on this growth are contained in this report.

We thank the 32 banks that participated in this study, the Kenyan Revenue Authority (KRA) (in particular 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

Purpose and scope

The purpose of the study is to quantify the tax contributions made by the Kenyan banking sector. The study analyses the correlations between tax contribution by the sector and industry-wide developments such as lifting of the interest rate cap and the impact of the Covid-19 pandemic in 2020.

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 a direct cost 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 taxes.

This study covers 32 banks representing 96% of the industry by market share[1] in relation to the 2019 and 2020 calendar years[2]. On a year on year basis, the 32 banks represent 95.2% of the industry in 2019 and 96.2% of the industry in 2020.References in the report to the term **"participating banks"** means the **32** banks that participated in the study while references to the **"banking sector"** refers to the **39** banks licensed by the Central Bank of Kenya.

The data for this report was collected in the period April 2021 to May 2021.

The key findings from the second Total Tax Contribution study of the Kenyan banking sector are outlined below.

Banks' Total Tax Contribution in 2019 and 2020 was KES 224.9 bn - 7.5% of total taxes collected in Kenya

The Total Tax Contribution of the 32 participating banks was KES 224.9 bn in 2019 and 2020.

This can be further broken down into taxes borne and taxes collected.

The details of each are provided in the table below.

Description	2019 (KES bn)	2020 (KES bn)	Total (KES bn)
Total Tax Borne	66.5	58.2	124.7
Total Tax Collected	53.6	46.6	100.2
Total Tax Contribution ("TTC")	**120.1**	**104.8**	**224.9**
Total government receipts[3]	1,477	1,510	2,987
% of TTC relative to total government receipts	8.1%	6.9%	7.5%

[1]Market share as measured by net assets excluding banks in receivership. Total market share was calculated using data of the 32 banks that participated in the study.

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

[3]This is a summation of all taxes collected by the government. The government year runs from July to June while that of banks runs from January to December. Both calendars cover a 12-month period. *https://www.kra.go.ke/en/media-center/press-release/916-annual-revenue-performance-fy-2019-2020*

There was a 12.7% decrease in the overall tax contribution by the banking sector from 2019 to 2020. This is partly attributable to reduced tax rates, specifically - reduction of corporate tax rate from 30% to 25%, reduction of the top PAYE rate from 30% to 25% and the reduction of VAT rate from 16% to 14%. The aim of these measures was to provide relief to taxpayers against adverse economic effects of the Covid-19 pandemic.

The decline in tax contribution between 2019 and 2020 was substantially driven by declines in corporate tax borne and PAYE collected. These two categories represent the two largest contributors of total tax contribution by the sector standing at 42.5% and 16.5% respectively of the total tax contribution.

On top of the decline in tax rates, the Covid-19 pandemic lead to declined economic activities which lead to a reduction in banking profits which manifested itself in decline in the tax contribution of the banks. The key drivers to declined profits in 2020 included reduced income due to loan payment holidays offered by banks to their customers, waived transactions charges and increased loan write offs and provisions in 2020 relative to 2019.

The banking sector remains a key contributor of all taxes collected by the government. In the two-year period, the Total Tax Contribution of the participating banks accounted for 7.5% of all the taxes collected by the exchequer. This remains a significant contribution given that this contribution is made by 32 taxpayers against a background of approximately 6 million active taxpayers in the country. The contribution of the participating banks declined by 1.2% in 2020 relative to 2019. This is attributable to the effects of the pandemic.

Tax to GDP ratio is a measure of ability of government to collect tax revenue from economic activities taking place in the country. Tax revenue to GDP ratio in Kenya in 2019[4] was 15.9%[5]. Of the 15.9%, 1.3% was contributed by the 32 banks who participated in this study. This buttresses the point that the banking sector is a key contributor to taxes in Kenya.

The government receipts increased by 2% from 2019 to 2020 while in comparison, the Total Tax Contribution by the participating banks declined by 13% from 2019 to 2020. This decline in participating banks' tax contribution is attributable to the decline in the two largest tax components- corporation tax and PAYE. On the other hand, the increase in total government tax receipts is due to an increased tax base manifested through enrolment of new taxpayers, reduction of tax incentives offered in other sectors and standard rating of certain goods and services that were previously VAT exempt.

For every KES 100 of profits, banks bore taxes of KES 48.5

The ratio of taxes borne to profit of the participating banks cumulatively for 2019 and 2020 was 48.5%. This represents the Total Tax Rate (TTR) of the participating banks. A cumulative TTR of participating banks of 48.5% means that for every KES 100 of profits, banks bear taxes of KES 48.5.

Taxes borne include categories of taxes paid by banks such as corporate tax, irrecoverable VAT and withholding tax (WHT) borne. Irrecoverable VAT and WHT borne are incurred by banks when they incur expenditure and not necessarily when they make profits. The table below illustrates the Total Taxes borne and the Total Tax Rate of participating banks.

Description	2019 KES bn	2020 KES bn	Total
Total taxes borne	66.5	58.2	**124.7**
Profits Before Tax (after exceptional items) of participating banks	153	103.9	**257**
Total Tax Rate (TTR)	43.5%	56%	**48.5%**

Irrecoverable VAT, which is the VAT that a taxpayer incurs but cannot offset against output VAT, is primarily driven by the VAT exempt status of the industry's major income categories. It is expected that irrecoverable VAT expenses for banks will continue to be high due to the continued investment in technology by banks.

[4]As at the time of this publication the 2020 GDP figures were yet to be released by the Kenya National Bureau of Statistics ('KNBS') and we have relied only on 2019 figures.

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

The banking sector contributed 27% of all corporate taxes paid in Kenya

As in preceding years, the banking sector continues to make significant tax contributions in the form of corporate tax. Corporate tax paid by the sector represented 27% of all corporate taxes paid in Kenya.

The breakdown is illustrated in the table below.

Description	2019 KES bn	2020 KES bn	Total (KES bn)	Increase / (decrease)
Corporate Tax paid by banking sector	52.3	41.2	93.5	(21.2%)
Total Corporate Tax paid in Kenya	175.9	170.5	346.4	(3.1%)
Contribution by banking sector (%)	29.7%	24.1%	27%	(5.6%)

2020 was occasioned by declined profits on account of reduced income due to loan payment holidays granted by banks to customers, waived transactions charges, increased loan write offs and provisions relative to 2019 as well as the reduction of the corporate tax rate from 30% to 25%. All these factors contributed to the 21.2% decline in corporate tax.

The 27% contribution to corporate taxes (2019 and 2020) was achieved despite the reduction of 21.2% in corporation taxes paid by the sector in 2020 relative to 2019. This is very likely indicative of the high compliance levels of the banking sector.

Banking sector PAYE per capita is five times higher than the PAYE per capita in the country

The study participants' PAYE per capita was KES 545k in 2019. Similar to the findings for the preceding period 2017/18, this was five times higher than the country's PAYE per capita. The high PAYE per capita is indicative of the relatively higher wages of bank employees and high compliance levels demonstrated in the industry. It is however noted that the PAYE per capita reduced by KES 55k compared to the previous study that covered 2017 and 2018.

Description	PAYE 2019 KES million[6] (A)	Number of Employees/taxpayers who filled PAYE returns (B)	PAYE per capita (KES'000) (A/B)
Study Participants	18,856	34,581	545
Kenya PAYE data	412,637	3,600,000	114

27%

The banking sector contribution of all corporate taxes paid in Kenya

[6]2020 data was not included as the data was collected before the 30th June return filing deadline.

42% decline in excise duty taxes year on year

There was a 42.2% decline in excise duty collected by the banking sector in 2020 relative to 2019.

Description	2019 KES bn	2020 KES bn	Increase/(decrease)
Excise duty collected by banks	16.1	9.3	(42%)
Total excise duty collected by KRA in financial services	27.5	20.2	(27%)
Contribution by banking sector to excise duty in financial services	58%	46%	(12%)

The reduction is attributable to the directive issued by the Central Bank of Kenya for banks to waive fees on transfer of money between bank accounts and mobile phone wallets and also waive balance enquiry charges as a measure to mitigate the Covid-19 pandemic.

This is also aligned to the 8% decline in fees and commissions income earned by the banking industry in 2020 relative to 2019. Further, the drop in fees and accompanying excise tax may also be attributable to reduced transactions as a result of a decline in business activities and reduced consumer purchasing power during the Covid-19 pandemic which meant that banks had less opportunities to charge transaction fees in 2020 relative to 2019.

Value Distribution

“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 organization.

For both 2019 and 2020, at 48.9% and 49.4% respectively, the government was the greatest beneficiary of the value distributed by the participating banks (in the form of taxes collected and borne) followed by employees (in the form of employee emoluments) and lastly, shareholders (in the form of dividends).

While the value distributed follows the same trend from the 2017 and 2018 report, the value distributed to shareholders in 2020 at 11.5% is the lowest since the inception TTC study. The lower contribution of dividends as an indicator of value distributed is due to the measures put in place by most banks to reduce dividend payments during the Covid-19 pandemic.

This was also in compliance with a directive from the Central Bank of Kenya for Banks to reassess their Internal Capital Adequacy Assessment processes including measures being taken to preserve capital and liquidity.

Value distributed (%)	2019	2020
Government Taxes (collected and borne)	48.9%	49.4%
Employee Emoluments (net of taxes)	34.3%	39.1%
Dividends (net of taxes)	16.8%	11.5%
Total (%)	100%	100%

Purpose and outline of the study

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

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, all adding to the total.

This study also contains data to highlight the impact of legislative amendments such as the government's measures during the Covid-19 pandemic and adoption of technology have had on the performance of the industry.

The study collected data from 32 Kenya Bankers Association (KBA) members operating in the banking sector related to taxes borne and collected in the accounting periods ending 31 December 2019 and 31 December 2020.

The analysis provided by this study provides a valuable resource for the Kenyan banking sector, government and other stakeholders such as employees and investors. The report allows the banking sector to quantify its contribution to public finances in the form of taxes and analyse the trends in contribution over time. Further, the report will allow the government to assess the tax contribution of the sector which may inform future policy around bank taxation. Overall, the study is a significant contributor to promoting tax transparency of the sector.

Methodology

The study uses the Total Tax Contribution methodology 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 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, VAT on imported services, withholding taxes borne and other taxes borne[7].

Taxes collected are those that the company administers on behalf of the government and collects from others, e.g., income tax deducted under PAYE, Withholding VAT, withholding tax collected, excise duty collected, and other taxes collected[8]. 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.

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

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

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 available 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 KRA, this is clearly indicated.

PwC has anonymised 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 TTC study

32 KBA members participated in the study, providing data on their taxes borne and taxes collected for their accounting periods ending 31 December 2019 and 31 December 2020.

This study covers 32 banks representing 96% of the industry by market share[9] in relation to the 2019 and 2020 calendar years[10]. On a year on year basis, the 32 banks represent 95.2% of the industry in 2019 and 96.2% of the industry in 2020.

Data received related to payments to the Kenya public finances. No tax payments to foreign tax authorities were included. All “Tier One”[11] banks participated in this study.

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

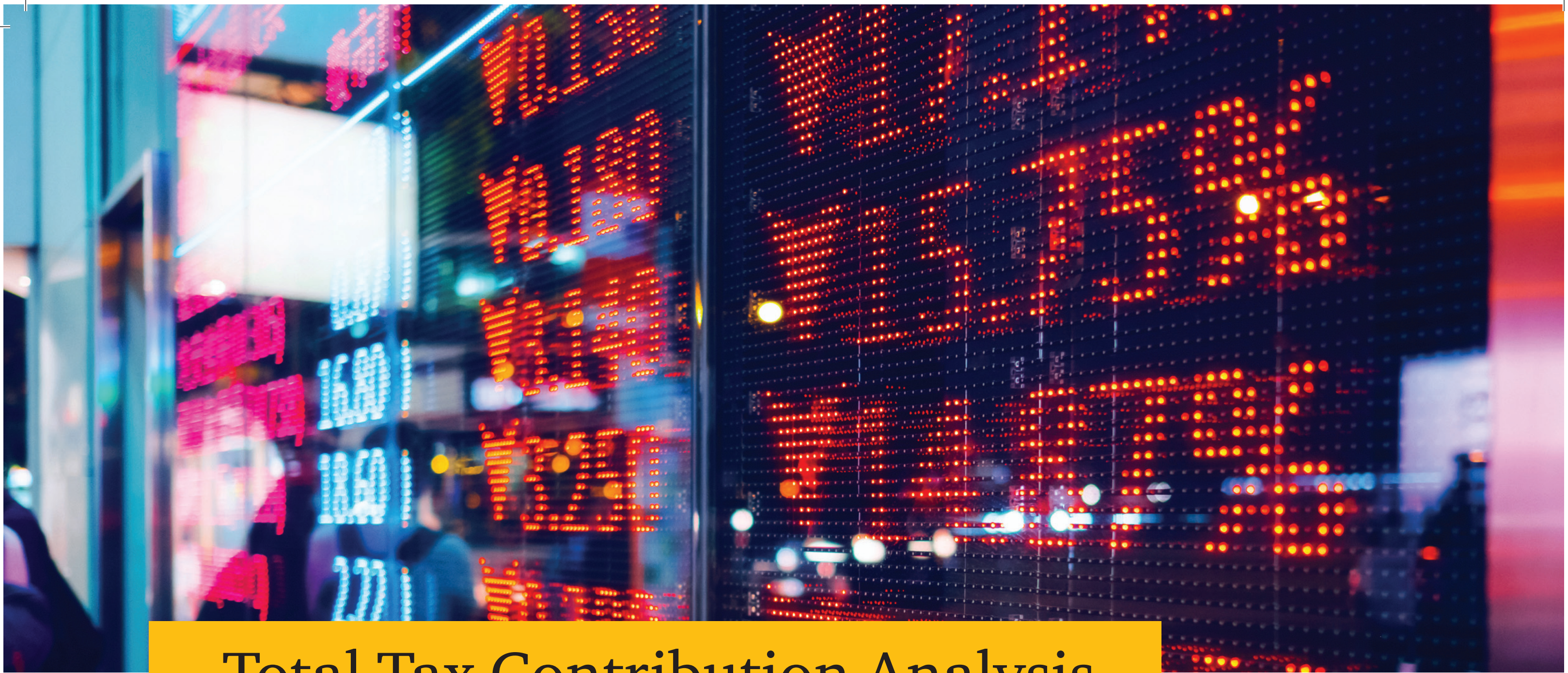
32

KBA members participated in the study, providing data on their taxes borne and taxes collected for their accounting periods ending 31 December 2019 and 31 December 2020.

[9]Market shares as measured by net assets excluding banks in receivership. Total market share was calculated using data of the 32 banks that participated in the study.

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

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



Total Tax Contribution Analysis

The total tax contribution analysis presented in this section relates to data of the 32 participating banks in terms of taxes borne and taxes collected. In some instances, we obtained sector wide data and analysed the data from an overall banking sector perspective.

References in the report to the term **"participating banks"** means the **32** banks that participated in the study while references to the **"banking sector"** refers to the **39** banks licensed by the Central Bank of Kenya.

The data for this report was collected in the period April 2021 to May 2021.

Taxes borne

Taxes borne are those whose financial impact is directly on the taxpayer and are therefore a cost to the business as these taxes directly affect a company's financial results. The 32 participating banks bore taxes amounting to KES 66.5 bn in 2019 and KES 58.2 bn in 2020.

There was a decline in the taxes borne by 12.5% from 2019 to 2020. This was driven by a decline in corporation tax - the largest component of taxes borne - from KES 51 bn in 2019 to KES 44 bn in 2020. The decline is largely attributed to the reduction of the corporation tax rate from 30% to 25% in 2020 as a Covid-19 cushion measure and the decline in banks' profitability due to the pandemic.

From the above data, the following was noted:

a) Corporation tax forms the largest component of taxes borne by the sector, representing 77% and 75.1% of the total taxes borne in 2019 and 2020.

b) Irrecoverable VAT is the second largest component of taxes borne, representing 14.8% and 16% of the total taxes borne in 2019 and 2020.

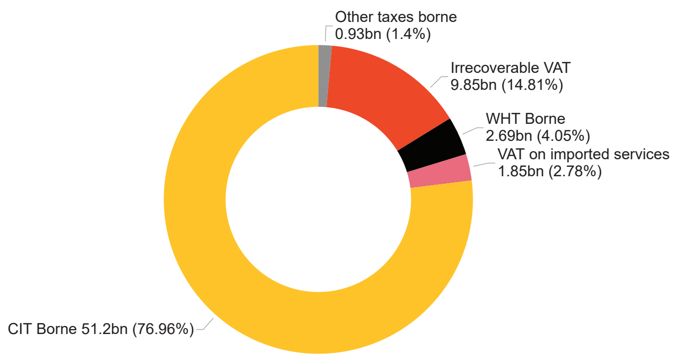
c) Withholding (WHT) tax borne represented 4.1% and 4.1% of total taxes borne in 2019 and 2020 respectively.

d) VAT on imported services represents 2.8% and 3.2% of total taxes borne in 2019 and 2020 respectively.

e) Other taxes borne[12] represent 1.4% and 1.7% of total taxes borne for in 2019 and 2020 respectively.

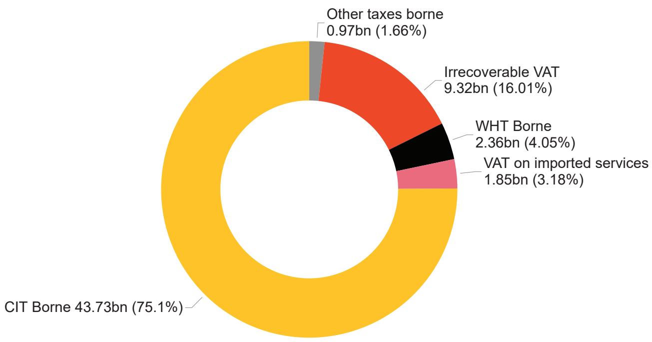
The breakdown of the various taxes borne is illustrated below.

Trend in taxes borne 2019



[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)

Trend in taxes borne 2020



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. Therefore, taxes collected are a key indicator of the wider economic contribution generated by the sector.

Taxes collected by the 32 participating banks were KES 53.6 bn and KES 46.6 bn in 2019 and 2020 respectively. This is a 13.1% year on year decline.

The decline was largely attributable to the 42% decline in excise duty from KES 16.1 bn in 2019 to 9.27 bn in 2019. This is as a result of reduction in fees and commissions income by the banks in compliance with a Central Bank of Kenya directive to waive these fees in order to promote use of mobile money and discourage use of cash as a Covid-19 pandemic containment measure.

Further, this decline is also attributable to the 5% PAYE decline in the top bracket PAYE rate as well as a reduction in staff numbers in the sector in 2020.

Other highlights of the taxes collected data are as follows:

a) PAYE forms the largest component of taxes collected, representing 35.9% and 39% of the total taxes collected in 2019 and 2020.

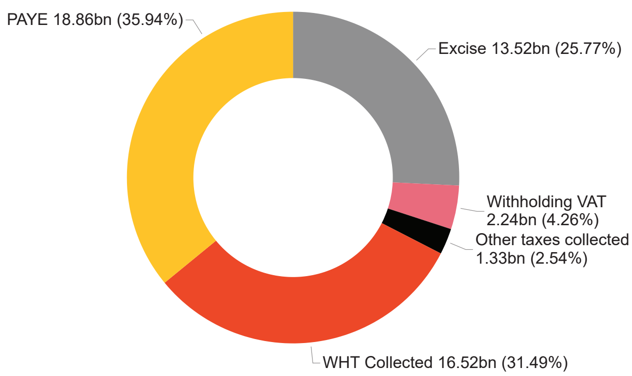
b) WHT collected is the second largest component of taxes collected, representing 31.5% and 37.8% of the total taxes collected in 2019 and 2020.

c) Excise tax collected stood at 25.8% and 18% of total taxes collected in 2019 and 2020 respectively.

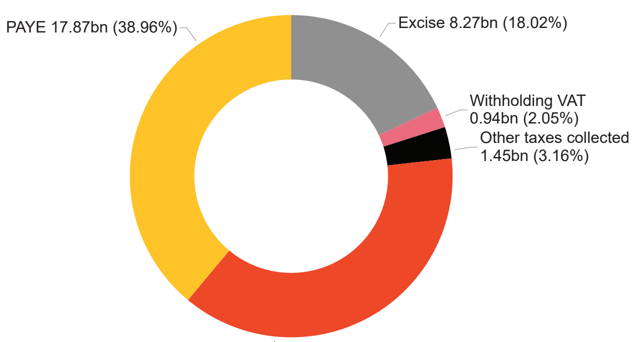
d) Withholding VAT represents 4.5% and 2.1% of total taxes collected for in 2019 and 2020 respectively.

e) Other taxes collected[13] represent 2.3% and 3.2% of total taxes borne for in 2019 and 2020 respectively.

Profile of taxes collected for the participating banks in 2019



Profile of taxes collected for the participating banks in 2020



[13]Other taxes collected constitute: NEMA levies, stamp duty collected, net VAT paid and other people' taxes (NSSF employee contribution, NHIF etc.)

Total Tax Contribution

The participating banks reported taxes borne of KES 124.7bn and taxes collected of KES 100.2 bn. This resulted in a total tax contribution of KES 224.9 bn during the study period. This is a significant contribution as it represents 8.1% (2019) and 6.5% (2020) of all government receipts. The breakdown is provided in the table below.

Description	2019 (KES bn)	2020 (KES bn)	Total
Total Tax Borne	66.5	58.2	124.7
Total Tax Collected	53.6	46.6	100.2
Total Tax Contributed ("TTC")	**120.1**	**104.8**	**224.9**
Total government receipts[14]	1477	1510	2987
% TTC relative to total government receipts	8.1%	6.9%	7.5%

The total tax contribution (TTC) tax of the participating banks as summarised below shows that corporation tax made up 43% and 42% the TTC in 2019 and 2020 and is the most significant contribution banks make. This is followed by PAYE which represented 16% and 17% of the TTC for 2019 and 2020 respectively.

Withholding taxes collected represented the third largest component of the TTC constituting 14% and 17% for 2019 and 2020 respectively.

Structurally, the tax contribution by banks has remained broadly comparable to the previous study period. This is largely due to the fact that the income structure of the banks remains unchanged especially with regard to the minimal tax incentives provided to banks and strict oversight from regulators.

The banking sector remains a key contributor of all taxes collected by the government. In the two-year period, the Total Tax Contribution of the participating banks accounted for 7.5% of all the taxes collected by the exchequer. This remains a significant contribution given that this contribution is made by 32 taxpayers against a background of approximately 6 million active taxpayers in the country. The contribution of the participating banks declined by 1.2% in 2020 relative to 2019. This is attributable to the effects of the pandemic.

Tax revenue to GDP ratio in Kenya in 2019[4] was 15.9%[5]. Of the 15.9%, 1.3% was contributed by the 32 banks who participated in this study. This buttresses the point that the banking sector is a key contributor to taxes in Kenya.

The government receipts increased by 2% from 2019 to 2020 while in comparison, the Total Tax Contribution by the participating banks declined by 13% from 2019 to 2020. This decline in participating banks' tax contribution is attributable to the decline in the two largest tax components- corporation tax and PAYE. On the other hand, the increase in total government tax receipts is due to an increased tax base manifested

[14]This is a summation of all taxes collected by the government. The government year runs from July to June while that of banks runs from January to December. Both calendars cover a 12-month period.
https://www.kra.go.ke/en/media-center/press-release/916-annual-revenue-performance-fy-2019-2020

[15]As at the time of this publication the 2020 GDP figures were yet to be released by the Kenya National Bureau of Statistics ('KNBS') and we have relied only on 2019 figures.

through enrolment of new taxpayers, reduction of tax incentives offered in other sectors and standard rating of certain goods and services that were previously VAT exempt. The breakdown of the total tax contributions is illustrated in the table below.

The TTC profile for participating banks

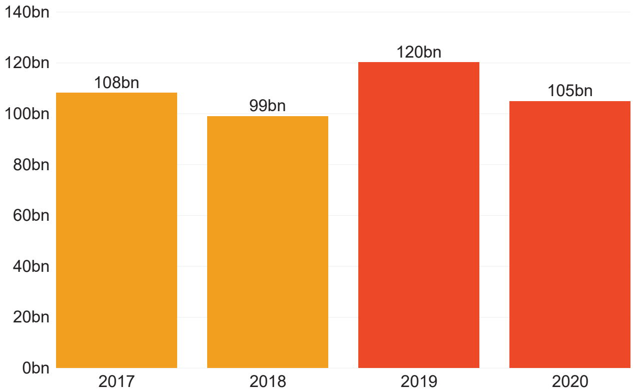
Description	2019 (KES bn)		2020 (KES bn)	
	Amount in KES (Bn)	%	Amount in KES (Bn)	%
Corporate Tax	51.2	43%	43.7	42%
PAYE	18.9	16%	17.9	17%
WHT Collected	16.5	14%	17.3	17%
Excise	13.5	11%	8.3	8%
Irrecoverable VAT	9.9	8%	9.3	9%
WHT Borne	2.7	2%	2.4	2%
VAT on imported services	1.9	2%	1.9	2%
Withholding VAT	2.2	2%	0.9	1%
Others[16]	3.3	2%	3.1	2%
Total	**120.1**	**100%**	**104.8**	**100%**

[16]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, advance tax, property taxes and other people taxes (NSSF, Fringe benefit taxes etc. excluding PAYE)).

Total Tax Contribution over the last four years

An analysis of the total tax contribution of participating banks over the period 2017 to 2020 is presented below[17].

Total tax contribution of the Kenyan banking sector 2017 - 2020



The decline in total tax contribution in the 2018 year relative to 2017 is attributable to a decline in corporate taxes paid in 2018 due to the impact of the interest rate capping first introduced in late 2016 and a prolonged electioneering period in 2017. This is evidenced by the 9.69% drop in profit before tax of the sector in 2016 relative to 2017.

2018 witnessed a stabilizing of the political environment which was witnessed through a relatively high GDP growth rate of 6.3%[18]. In addition, this being the first full year of the interest rate cap, the sector had put in place measures to protect revenue and profitability.

As a result of all these factors, 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).

The total tax contribution of the study participants declined by 16% in 2020 relative to 2019 as a result of the Covid-19 pandemic. This is aligned to the decline in profitability of banks by 31% due to reduced income, loan payment holidays, increased loan write offs and provisions relative to 2019 as well as the government issuance of tax reliefs through reduced tax rates on corporate tax, PAYE and VAT.

The total tax contribution of the study participants declined by 16% in 2020 relative to 2019 as a result of the Covid-19 pandemic

[17]Although 38 banks participated in the 2017/2018 study and 32 banks participated in the 2019/2020 study, it is not expected that this would have a material impact on the study results because in both survey periods, participating banks represented approximately 95% of the market share as measured by net assets. Further, all Tier One banks participated in both surveys.

[18]www.knbs.or.ke

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 a cumulative basis for the 2019 and 2020 periods, the TTR of participating banks was 48.5%. This means that for every KES 100 of profit of participating banks, KES 48.5 represented taxes borne.

TTR increased from 43% to 56% between 2019 and 2020. The key driver for the high TTR in 2020 was the decline in profits in 2020 as a result of the difficult operating environment during the Covid-19 pandemic.

This led to an increase in TTR by 12.5% in 2020 relative to 2019. A key contributor to declined profits in 2020 was reduced income due to loan payment holidays, waived transactions charges, increased loan write-offs and provisions relative to 2019.

The decline in profits was not compensated by significant reduction in taxes borne such as irrecoverable VAT and WHT borne which contributed to the high TTR of 56% in 2020.

Corporate tax which is calculated on profit contributed to 78% of total taxes borne.

Description	**2019 (KES bn)**	**2020 (KES bn)**	**Total (KES bn)**
Corporation tax	52	41	**93**
Irrecoverable VAT	9.9	9.3	**19.2**
Other taxes borne	**4.6**	**7.9**	**12.5**
Total taxes borne[19]	66.5	58.2	**124.7**
Profits Before Tax (after exceptional items) of participating banks	153.1	104.9	**258**
Total Tax Rate (TTR)	43.4%	55.5%	**48.3%**

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 major income categories. It is expected that irrecoverable VAT continues to be high due to the continued investment in technology by banks.

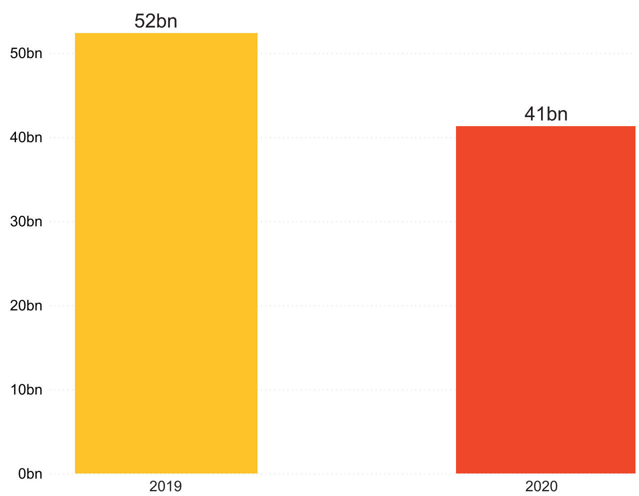
[19]Other taxes borne includes VAT on imported services, WHT borne and other taxes borne.

Corporation tax

Corporation taxes paid

Corporation tax payments made by the banking sector in the years 2019 and 2020 stood at KES 52 bn and KES 41 bn respectively. This is illustrated in the figure below.

Corporate tax paid by the banking sector in 2019 & 2020



Corporate tax paid by the sector declined by 21.1% from 2019 relative to 2020. This was largely drive by decline in profits with the profit before tax of study participants declining by 32.1% in 2020 relative to 2019.

Increase in loan loss provisions as a percentage of profit before tax from 25.4% in 2019 to 103.2 % in 2020 is manifested in the reduced profitability of the sector. While corporates taxes paid by the sector declined by 21.1%, the decline in profitability of the participating banks was higher at 32.1%. This is because the banking sector has strict criteria for tax deductibility of loan loss provisions meaning that provisions leading to the declined profits are not fully allowed for tax purposes.

This decline in profitability of banks aligns to the slowdown in the economy in Kenya with GDP decelerating from 5.4%[20] in 2019 to a predicted rate of 1.4%[21] in 2020.

[20]www.knbs.or.ke

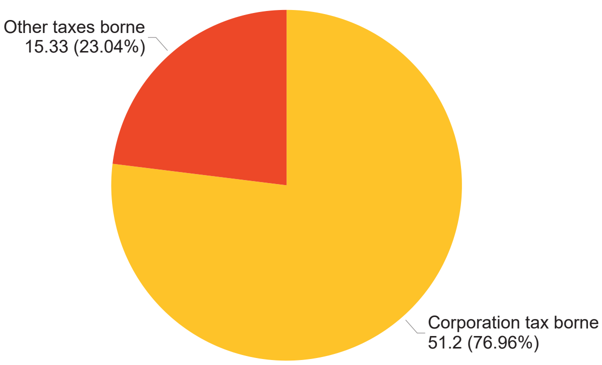
[21]https://www.afdb.org/en/countries-east-africa-kenya/kenya-economic-outlook#:~:text=Kenya's%20economy%20has%20been%20hurt,have%20had%20a%20dampening%20effect.

In addition to the decline profits, the government's measures to cushion taxpayers from economic effects of the Covid-19 pandemic resulted in a reduction in the corporate tax rate from 30% to 25% also contributed to the 21.1% decline in corporation tax in 2020 relative to 2019.

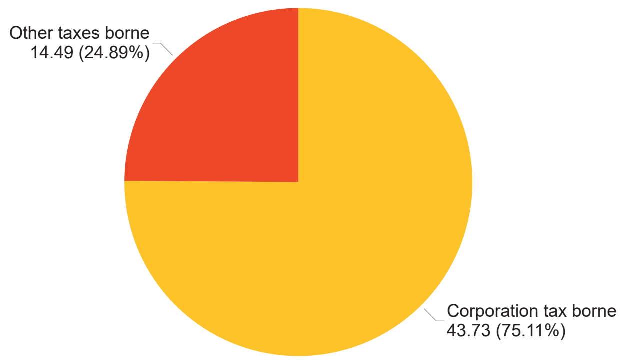
Corporation taxes form the largest component of total taxes borne

Corporation tax represents the largest component of total taxes borne by the participating banks standing at 76.96% in 2019 and 75.11% in 2020 as illustrated below.

Corporation tax borne in 2019 by study participants



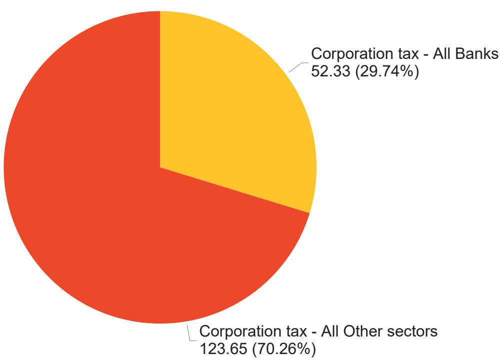
Corporation tax borne in 2020 by study participants



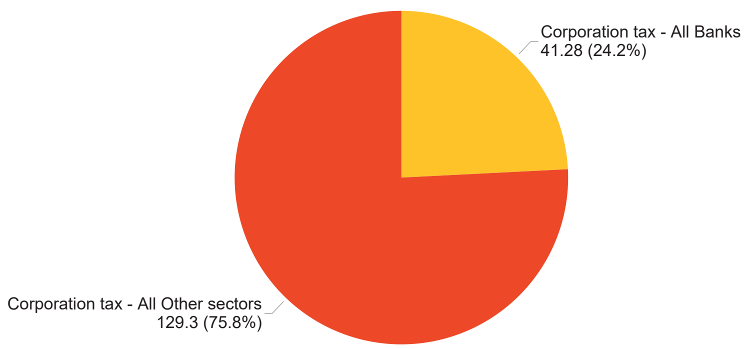
Corporate tax borne as a percentage of total government corporate tax receipts

The corporate tax paid by all banks in Kenya represents 29.7% and 24.2% of the total corporate taxes paid in Kenya in 2019 and 2020 respectively. This is a substantial contribution in light of the fact that there were only 38 banks in Kenya in 2020.

Corporate tax paid by the banking sector in 2019



Corporate tax paid by the banking sector in 2020

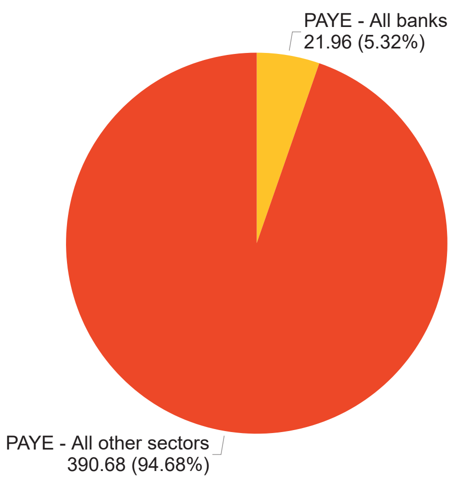


Pay As You Earn (PAYE)

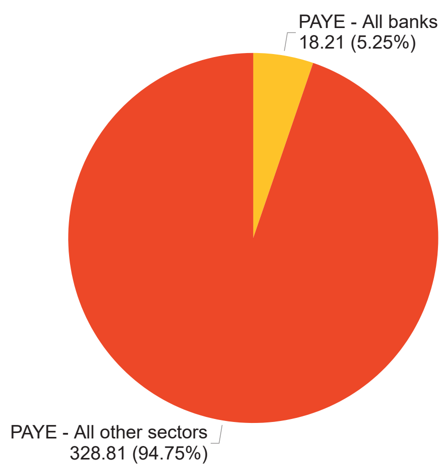
PAYE in the banking sector

The banking sector's contribution to taxes through PAYE collected amounted to KES 21.96 bn and KES 18.2bn for 2019 and 2020 respectively. This represents 5.3% of total PAYE collected in Kenya in both years.

PAYE paid by the banking sector in 2019



PAYE paid by the banking sector in 2020



Decline in PAYE by participating banks is in line with reduced employee numbers

The PAYE collected by participating banks amounted to KES 18.9 bn in 2019 and KES 17.9 bn in 2020 representing a 5.3% decline.

The decline can be attributable to a decline in the number of employees employed by the study participants from 34,581 in December 2019 to 31,703 as of December 2020.This represents a reduction of about 8.3% in the workforce. This continues the trend in the previous report that saw a decline in staff employed as banks shifted to digital channels. This trend accelerated in 2020 as a result of the Covid-19 pandemic and the work from home further resulted in the release of non-essential staff.

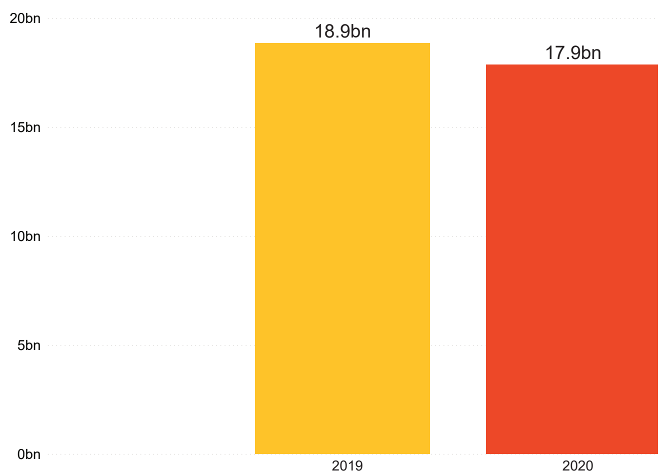
In addition, the reduction of the top PAYE bracket rate from 30% to 25% in 2020 as a result of the government's initiative to cushion taxpayers against Covid -19 pandemic also contributed to the decline in PAYE collected.

The study participants’ PAYE declined at a much lower rate (5.3%) compared to the decline in staff number (8.3%). This may be attributable to the fact that most staff laid off may have been lower cadre employees in the lower PAYE brackets.

The cost to income ratio for the industry increased from 60% in 2019 to 74% in 2020. This is primarily as a result of the reduced income in 2020 relative to 2019.

With the reduced income, banks may continue to take measures in future years to further reduce staff numbers which will have a corresponding impact in the reduction of wages costs and reduction in PAYE.

PAYE contribution by participating banks in 2019 & 2020



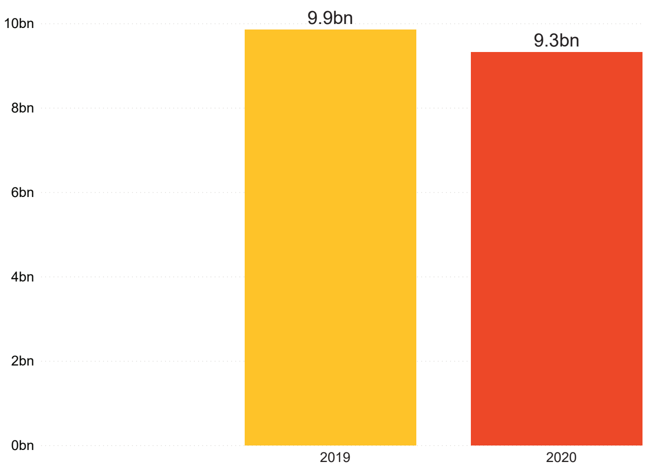
The cost to income ratio for the industry increased from 60% in 2019 to 74% in 2020

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. This irrecoverable VAT represents a key component of taxes borne by the banks.

Irrecoverable VAT for the study participants declined by 6% from KES 9.9bn in 2019 to KES 9.3 bn in 2020. In both years, this represents 16% of the total taxes borne.

The figure below shows the amount of irrecoverable VAT borne by participating banks in 2019-2020



The 6.1% decline in irrecoverable VAT in 2020 compared to 2019 could be attributed to reduced spending as a result of the cash conservancy measures instituted by most banks to cope with the Covid-19 pandemic. This could also be attributable to the reduction in the VAT rate in 2020 from 16% to 14%.

This reduction in irrecoverable VAT is also aligned to the increase in cost to income ratio of 74% in 2020 relative to 60% in 2019. With suppressed income manifested in higher cost to income ratio, banks are likely to have curtailed spending in order to conserve cash which led to a decline in the irrecoverable VAT.

Irrecoverable VAT for the study participants declined by 6% from KES 9.9bn in 2019 to KES 9.3 bn in 2020

Excise Duty

The total excise on financial services collected by all banks stood at KES 16.1 bn and 9.27 bn in 2019 and 2020 respectively. This represents a 42.2% decline year on year.

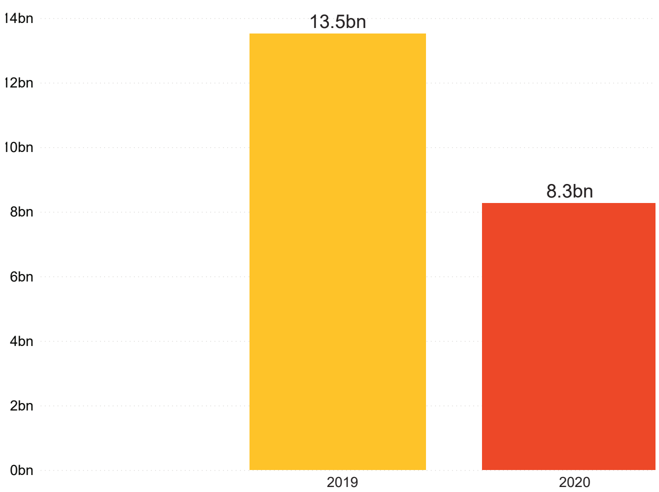
The 42.2% decline in excise on financial services collected by banks in 2020 relative to 2019 is likely to be as a result of the waiver on fees on transfer of cash between accounts and mobile phone wallets that was as a result of the CBK initiative to protect Kenyans against the Covid-19 pandemic and arrest the spread of coronavirus infections by encouraging Kenyans use of mobile money compared to physical cash. The waiver of fees is reflected in the 8% drop in total fees and commissions collected in 2020 relative to 2019. Fees and commissions are charged on corporate and consumer transactions which include electronic banking fees, ledger administration fees, inter-bank transactions among other charges.

The drop in fees may also be attributable to reduced transactions from a decline in business activities and reduced consumer purchasing power during the Covid-19 pandemic as evidenced in the drop in GDP growth rate from 5.4% in 2019 to a predicted rate of 1.4% in 2020. The drop in fees for the participating banks ranged between 15-20%.

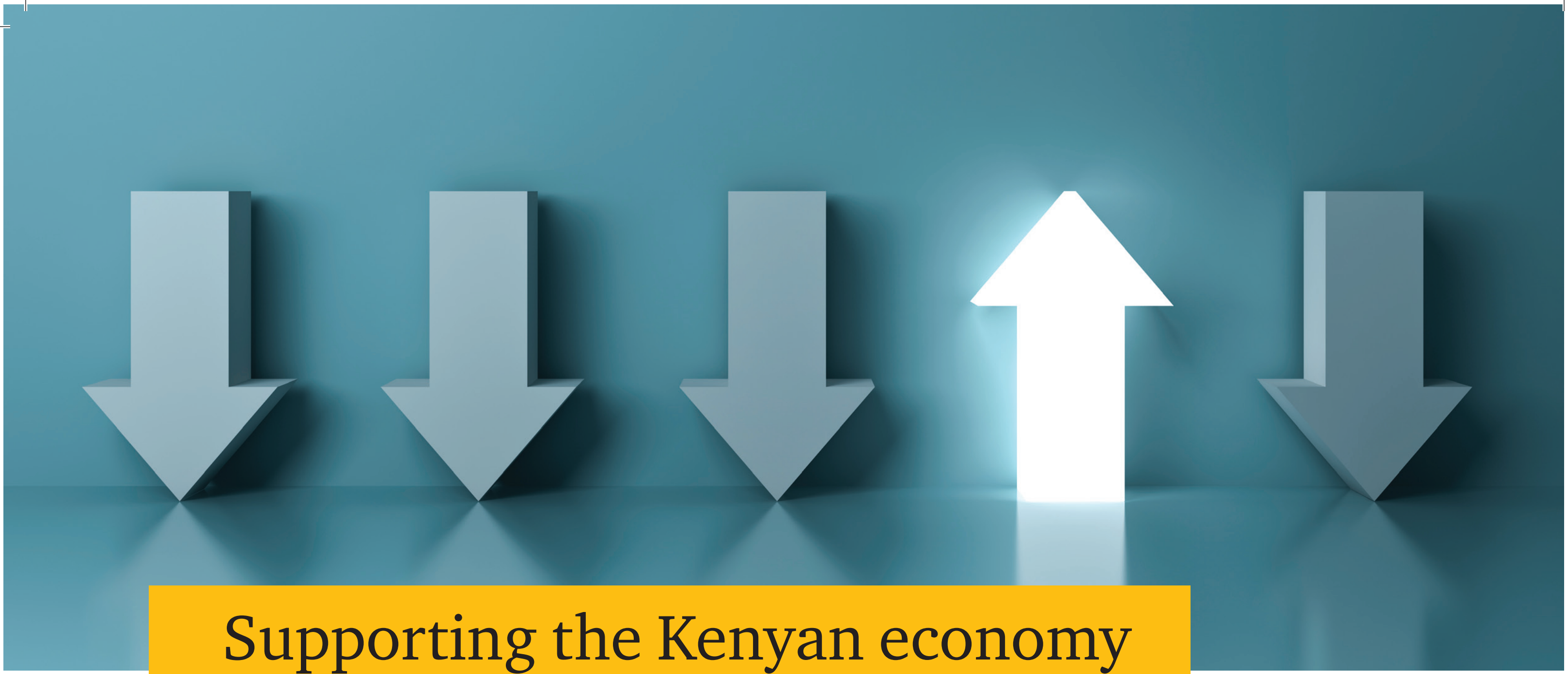
Despite the drop in excise collected, the banking sector still contributed 58.5% and 46% of the total excise collected for the financial services sector in 2019 and 2020 respectively. This is a significant portion of the excise duty collected by the financial services industry.

Description	2019	2020	% Point change (decrease)/increase
Total excise duty on financial services collected by the banking sector	16.1	9.3	(42%)
Total excise duty collected on the financial services sector	27.5	20.2	(27%)
Contribution by the banking sector	58%	46%	(12%)

Excise duty contribution by the participating banks in 2019 & 2020



The participating banks contributed KES 13.5 bn and KES 8.3 bn in 2019 and 2020 respectively in excise taxes. Similar to the trend across the entire banking sector, this decline was as a result of the waiver of fees on transfers between bank and mobile wallets as well as suppressed economic activities meaning there were fewer opportunities for banks to charge transaction fees.



Supporting the Kenyan economy through a pandemic

Introduction

Throughout this challenging period, the Kenyan banking sector has played an important role in facilitating trade and minimising the disruption to the economy and people's lives through measures such as loan moratoriums and others like foregoing fees on money transfers for the better part of 2020.

The crisis has dealt the Kenyan banks with several challenges. Across the industry, profit before tax declined by 31% in the period 2019 to 2020 while provisioning on non-performing loans increased. This has severely impacted on profitability and consequently, tax contribution of the sector.

This section of the report presents data on the general economic environment that banks have operated in and how they have responded to the Covid-19 pandemic. It also seeks to air the participants' views around recovery of the sector post-pandemic.

Performance of loans

Many businesses and households experienced cash flow and income disruption owing to the restrictive measures introduced by the National Government to mitigate the spread of the coronavirus. The Kenyan banking sector provided support for moratoriums on principal and interest loan payments to cushion against negative economic effects of the Covid-19 pandemic impact.

Data released by the CBK indicated that since the Covid-19 pandemic started in March 2020, loans amounting to Ksh.1.7 trillion were restructured by end February 2021 which accounts for 57% of the banking sector's gross loans. Following the resumption of repayments and some pay-offs, the outstanding restructured loans as at end February 2021 amounted to KES 569.3 bn, or 19% of the total gross loans with over 95% of the outstanding restructured loans are being repaid in accordance with the restructured terms[22].

Notwithstanding the significant portion of loans restructured by the banks, 94% of survey participants noted an increase in loan write offs, bad loans and defaults on loan repayments during the Covid-19 pandemic. This is evident from loan payment holidays and increased loan write offs and provisions.

Employment

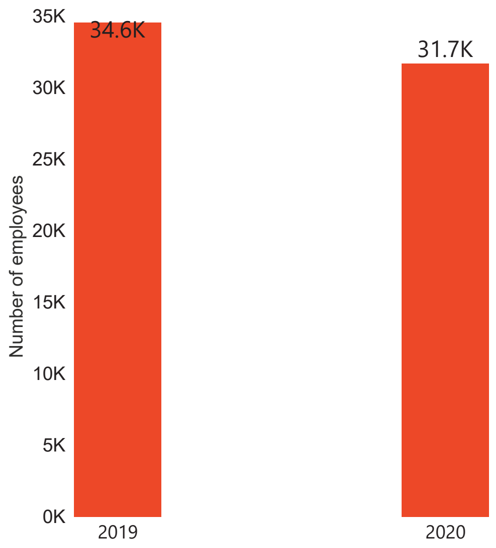
Redundancies have been one of the major adverse effects of the Covid-19 pandemic as the unemployment rate in Kenya has almost doubled compared to its pre pandemic level. Unemployment rate rose sharply from 5% in the last quarter of 2019 to 21% at the beginning of June 2020[23]. The marked increase in unemployment is evident in the year on year decline in the total PAYE collected in the economy from KES 412 bn in 2019 to KES 347 bn in 2020 representing a 16% decline. The banking industry reported a far lesser decline of 5.2%, perhaps indicative of the sector's commitment even in challenging times, to retain jobs and preserve livelihoods as indicated by the survey responses where 90% of participants indicated that they had not laid off staff as a result of the Covid-19 pandemic.

Although 90% of study participants stated that they have not laid off staff as a result of the Covid-19 pandemic, their total reported full-time employees between 2019 and 2020 declined by 8.3%, showing a decrease of over 3,000 employees during the study timeline. Some participants stated that the decline in staff numbers is attributable to exits through Voluntary Exit Programs and natural attrition.

[22]*https://www.centralbank.go.ke/uploads/press_releases/661657861_Press%20Release%20-%20Expiry%20of%20Emergency%20Measures%20on%20 Restructuring%20of%20Loans%20for%20Bank%20Borrowers.pdf*

[23]World Bank: Kenyan Economic Update November 2020 Edition No.22

Full time employees of participating banks in 2019 & 2020



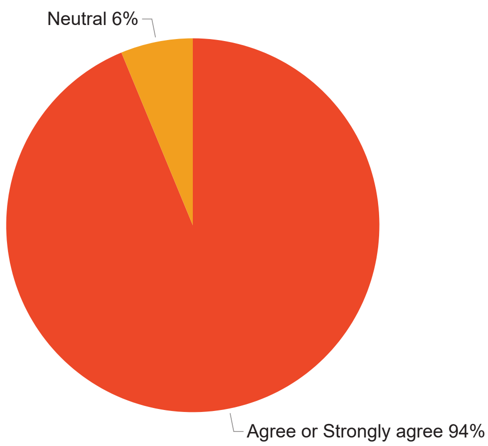
Banks' response to the Covid-19 pandemic

The Covid-19 pandemic occurred at a time when the banking sector marked growth in non-performing loans in the period through 2017 to 2019. It presented banks a threat as well as an opportunity to demonstrate their problem-solving capabilities.

94% of the study participants agreed or strongly agreed that banks developed a strategy on managing Covid-19 pandemic and recovery. Participants noted that banks have deployed adequate strategies to respond, restore and rebound from the crisis and get back to normal business activities.

In addition, the participants stated that they have in total donated KES 409 million to the Kenya Covid-19 Fund or other activities in relation to Covid relief. It is unfortunate that there are currently no tax reliefs available to taxpayers to incentivise support towards the Kenya Covid-19 fund or other similar funds.

Has the bank developed a strategy on managing Covid-19 pandemic and for recovery?

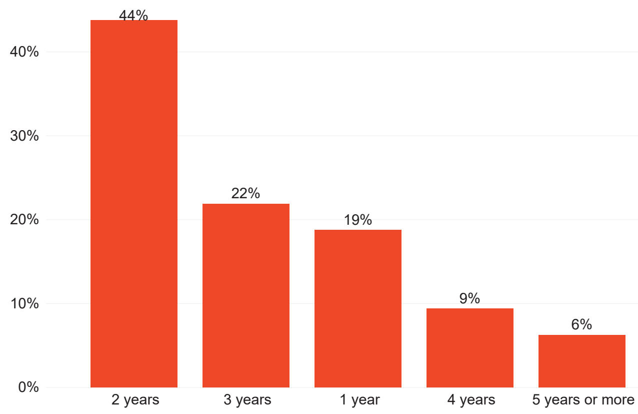


Post pandemic recovery

Given the uncertain trajectory of the Covid-19 pandemic, the industry faces a challenging path to recovery threatened by the non-performing loans, subdued demand and increasing credit risk as a result of suppressed demand in the market. The key challenge for the banks will be how to manage credit risk while at the same time continuing to play their role as intermediaries of credit particularly to SMEs. One of the catalysts for post pandemic growth will be recovery of SMEs which can only happen where the SMEs have access to credit.

This year's survey asked participants their expected timeline for banks to recover and 44% of participants stated that they expected recovery in 2 years.

We expect the banks to recover in a period of?



Some of the comments from participants

"The Bank expects to be above its pre-Covid profit by the end of the year 2022."

"We expect improvement in economic activity in the next 12 months largely due to expected flattening of the Covid-19 pandemic curve, the anticipation of further relaxation of restrictions and the reopening of more businesses after introduction of vaccines in the country."

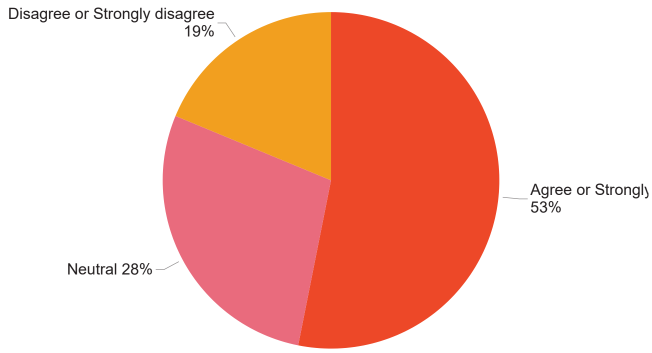
"The Bank expects easing of measures to contain coronavirus as mass vaccination is achieved. This will automatically open up businesses, people to return to work and businesses hiring people. The bank projects the phasing out of containment measures over one year period, with the economy bouncing back to its potential a year later."

Government support

53% of participants agreed or strongly agreed there is adequate government support, programs and risk mitigation to navigate the path to recovery post pandemic.

This was noted through government initiatives such as the credit guarantee scheme and tax reliefs such as reduction of corporate tax and PAYE scale.

There is adequate government support programs and risk mitigation to navigate the path to recovery



Some of the comments from participants

"The government gave tax reliefs (Corporate tax rate to 25% and reduction of PAYE scale with increase in personal relief) to curb the impact of Covid. Further, the monetary policy committee reduced the CBR rates during the year 2020."

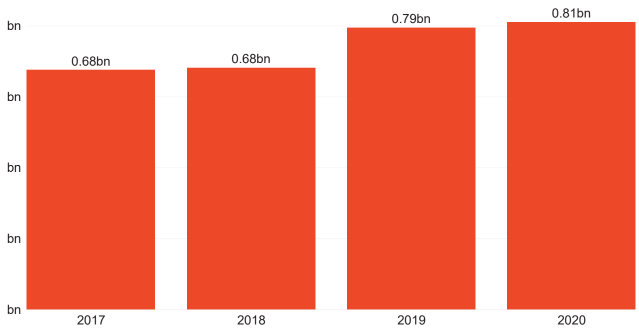
"The Government, through the CBK, instructed banks to update their business continuity plans, formulate pandemic response, conduct self-assessment of risks posed by the Covid-19 pandemic and report on their progress. The government also lowered the CRR ratio requirement from 5.25% to 4.25% and lowered the CBR rate to 7.00% to boost liquidity."

Investment in technology

As highlighted in our first study, the need for digitization was apparent in the banking sector well before the Covid-19 pandemic hit. Now with Covid-19 pandemic underway, banks' investments in technology in a sustainable manner, is one of the key pillars of recovery by the sector. Technological investments significantly impact and raise irrecoverable VAT as banks are not able to recover input VAT incurred on payments to suppliers for technology related services.

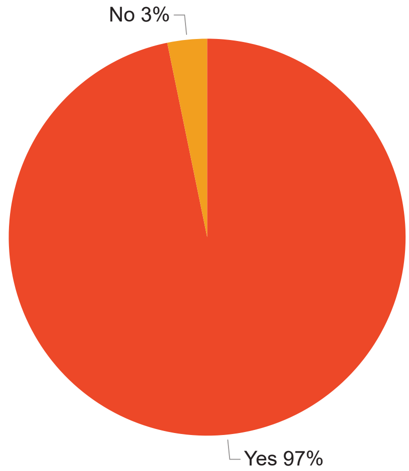
Investment in technology by banks has been increasing year on year whereby in 2019 and 2020 the technology investment for participating banks amounted to KES 794 mil and KES 809 mil respectively, representing an overall growth of 2%. Looking at the data over the last four years for the participating banks, there was a significant increase of 17% in technology investment in 2019 relative to 2018. This means that to a large extent, prior to the Covid-19 pandemic, banks had already started the process of digitising their operations.

Average technology cost year on year



93% of the participants agreed that banks have increased spending on cybersecurity, AML & KYC functionalities/software. Participants noted that the technological investments were targeted to enhance cybersecurity and ensure compliances.

The bank increased spending on cybersecurity, AML & KYC functionalities/software



Some of the comments from participants

"This is to better manage risks emanating from cybercriminals looking to exploit systems to swindle funds from customers, and also ensure compliance with regulations and avoid penalties."

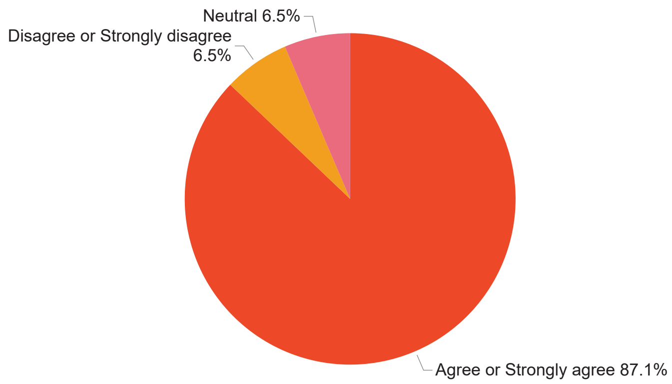
"There is increased risk of financial crime and increased reporting and compliance obligations. This has necessitated more investments in the fight against financial crime."

"The bank continues to invest in antivirus software for prevention of cyber-crime."

Challenges from digitalization

84% of participants agree or strongly agree there are challenges arising from digitalization. Most notable among the issues raised were risks arising from cybersecurity, fraud and impersonation presenting high threats to their customers, operation and overall business activities.

There are challenges arising from digitalization (e.g of key banking processes such as account opening, cyber fraud...)

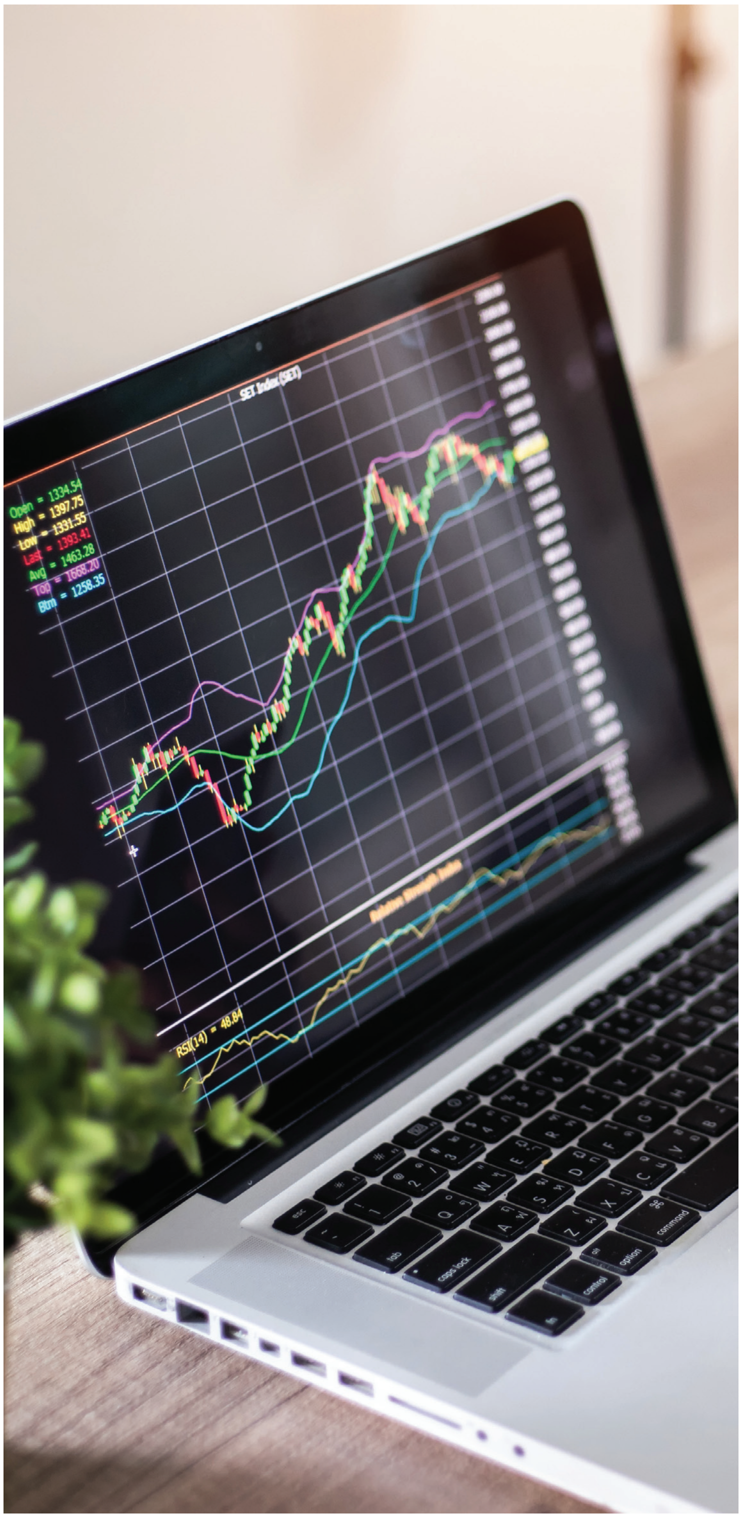


Some comments from study participants:

"Digitization has improved the way of doing business but has also brought new risks such as cyber risks."

"The challenges emanate from sometimes dealing with a person virtually as opposed to the tradition one on one thus KYC sometimes becomes an issue."

"The advancement of online transactions and account openings, the risk of impersonation and hacking is high."



Glossary

Taxes	Definition	Taxes	Definition
Total tax collected	Taxes that the company administers on behalf of the government and collects from others, e.g., income tax deducted under PAYE, Withholding VAT, withholding tax collected, excise duty collected, and other taxes collected[24].	**Corporation tax (CIT)**	The main tax on a company's profits
Total tax borne	A company'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[25].	**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 a company

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

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

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