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Prudent adoption of international tax policies good for Kenya's growth

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The impact of international tax policies on Kenya's tax regime cannot be downplayed especially now that digitalization has made it necessarily for countries worldwide to fortify their tax laws as a response to dynamic business models. Kenya has increasingly continued to rely on international best practices as the country strives to introduce tax rules aimed at expanding the tax base and reducing tax leakages. In fact, the 2021 Finance Bill recently gazetted is awash with proposals which are mainly borrowed from the Organisation for Economic Co-operation and Development (OECD) led Base Erosion and Profit Shifting (BEPS) project.

These proposals in the Finance Bill 2021 speak to Kenya's desire to domesticate internationally accepted tax principles. With the outcomes of the BEPS project at the OECD quickly gaining traction around the world, and with Kenya being a member of the OECD's Inclusive Framework, Kenya's reliance on such international tax policies can only increase. How has Kenya's efforts to introduce unilateral tax measures anchored on the BEPS project been? What lessons can be learnt?
The BEPS project, which commenced in 2013, contains fifteen measures aimed at mitigating tax avoidance, improving the coherence of international tax rules and ensuring a more transparent tax environment. It is noteworthy that these fifteen action plans are aimed at providing guiding principles upon which countries should model their unilateral tax policies. It is not expected that countries will adopt them verbatim but rather incorporate some relevant variations.

Closer home, the African Tax Administration Forum (ATAF) is providing a platform for Africa's tax authorities to collaborate from a tax policy perspective. Equally, ATAF has issued various guiding principles and blueprints to help African governments implement unilateral tax policies. Both the OECD and ATAF are championing adoption of modern tax policies in a clear and coherent manner across the world.
One of the unilateral tax measures that Kenya has borrowed from the OECD is the taxation of the digital economy as envisaged in the 2019 and 2020 Finance Acts. Digital Services Tax (DST) came into effect in 2021 albeit with a myriad of implementation issues. For instance, the DST Regulations expanded the scope of DST to include non-digital marketplace services that were not anchored in the provisions of the Income Tax Act. Subsequently, the government has moved to introduce additional legislative provisions aimed at sanitizing the DST legal framework. Evidently, the initial introduction of DST may have been fast-tracked before debating and fine tuning the relevant legal framework. This is evidenced by the fact that the Finance Bill 2021 still contains weighty changes to DST.

In addition to DST, the Finance Act 2020 introduced the minimum tax concept which is significantly different from the OECD's minimum tax proposal. Kenya's concept of minimum tax is based on gross turnover as opposed to the OECD's concept which is based on profits. Minimum tax in Kenya is equally facing its own fair share of challenges given that is was recently held in abeyance by the High Court.

The Finance Bill 2021 equally has various proposals that are anchored on the OECD's BEPS project. Key among them is the introduction of interest deduction rules aimed at determining the permissible level of interest deductibility for income tax purposes. This proposal is anchored on BEPS Action 4 and seems to have been adopted with little regard to Kenya's economic framework. For illustration purposes, it does not exempt banks from interest restriction rules as a result of the nature of their operations. If enacted in its current form, this proposal is bound to have significant negative implications to the banking sector. Further, there is no transition clauses for the loans currently being subjected to interest restriction.

The Bill further proposes to introduce common reporting standards for the purpose of providing automatic exchange of financial banking information between the Kenya Revenue Authority (KRA) and tax authorities outside Kenya. This proposal saddles financial institutions with the obligation to identify reportable for purposes of aiding the KRA to share financial banking information with other tax authorities. There is however a lifeline given that we expect Regulations to be drafted for better implementation of this proposal. To avoid implementation issues of the proposals under the Bill, the government should be keen to listen to public views on how to efficiently localize these internationally borrowed tax policies. The Bill is currently under consideration by the National Assembly. The public participation process yields a chance for the government to incorporate changes suggested by taxpayers and tax practitioners to enable a smooth implementation.

Stability of Kenya's tax policy framework is a key determinant of the ease of doing business and attracting investment. To this extent, the government should strive to ensure proposed tax reforms are subjected to rigorous analysis to avoid unintended consequences and frequent changes such as cases where recently introduced tax reforms are significantly revised or repealed shortly after enactment.

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