

EFFECTS OF THE TAX AMENDMENT BILL, 2020 ON THE RETIREMENT BENEFITS SECTOR

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A. INTRODUCTION

The government came up with a number of fiscal measures in a bid to help support Kenyans go through the COVID19 (Coronavirus) pandemic. Some of the measures that are aimed at increasing the amount of disposable income to both businesses and individuals include:

- Interest earned from other institutions other than financial institutions now qualifies as qualifying interest and the 15% Withholding Tax is the final tax,
- Reduction of Turnover Tax for small businesses from 3% to 1%
- Reduced Corporate Tax from 30% to 25%
- Reduction of VAT tax from 16% to 14%
- Tax review for employed people in Kenya with expanded tax bands and a reduction of the highest tax rate from 30% to 25%.

The above measures are expected to create a huge budget deficit due to reduced collection amidst a slowing economy.

There are a number of measures that the government can take to help navigate through the cashflow challenges that would come with this. These include:

- i. Budget reallocation from some of the things can wait e.g. development expenditure
- ii. Increased borrowing and given that the country's debt has been on the rise, this becomes challenging. Also, given the ongoing challenges in the global markets, it might be difficult to borrow more from external sources. For this fiscal year they had sought to borrow 300.3 Bn and out of that so far they have only borrowed 217.9 Bn out of a pro-rated borrowing target of 242.6 Bn.
- iii. Donor funding: the government can approach international organizations like the World Bank to plug in the deficit. So far the government has received 5.26 bn from the World Bank to fund this
- iv. Increase tax collection avenues. This can be done by either increasing the tax base which is difficult at this point in time or taxing some of the things that were tax exempt initially.

On increasing tax collections, the government has come up with a number of measures among them:-

- Done away with the 30% electricity rebate for manufacturing companies that was introduced in 2018
- Disallowed listing expenses for companies seeking to list on the Nairobi Securities Exchange and removed the tax incentives for listing that initially ranged between 20% to 27.5% of corporate tax.

- Reduction on capital allowances rates for most sectors with the worst hit being the hospitality sector. There were enhanced incentives for investments in the health sector
- Taxation of income that was initially tax exempt like interest on infrastructure bonds, gains from investment in registered Venture Capital Funds within the first ten years and interest from Asset Backed Securities.
- Expansion of the capital gains tax bracket to include, private residencies occupied for less than 3 years, transfer of land with a value of less than Kshs 3mn and transfer of less than 50 acres of agricultural land
- Increases on withholding tax on dividends for non-residents from 10% to 15%, introduction of 5% WHT for premiums paid to non-resident re-insurance companies, payment of 20% WHT on sales and marketing income come by non-resident companies and introduction of a 20% WHT on income by nonresidents offering land transportation of goods

There were changes to the Retirement Benefits Act Regulations, and below we summarize these and their possible impact if passed into law.

B. PROPOSED CHANGES

1. Increased Taxation bands in line with the PAYE bands: In line with the changes to the PAYE bands, the Bill also proposes to enhance the tax bands for taxation of withdrawals from NSSF, Registered Pension Funds and Provident Funds.

The new tax rates are as follows: -

- a. For withdrawals after the expiry of fifteen years from the date of joining the Scheme/Fund

<u>New Tax Rates</u>		<u>Old Tax Rates</u>	
First KES 400,000	10%	First KES 400,000	10%
Next KES 400,000	15%	Next KES 400,000	15%
Next KES 400,000	20%	Next KES 400,000	20%
Above KES 1,200,000	25%	Next KES 400,000	25%
		Above KES.1,600,000	30%

- b. For withdrawals before the expiry of fifteen years from the date of joining the Scheme/Fund

<u>New Tax Rates</u>		<u>Old Tax Rates</u>	
First KES 288,000	10%	First KES 147,580	10%
Next KES 200,000	15%	Next KES 139,043	15%
Next KES 200,000	20%	Next KES 139,043	20%
Above KES 688,000	25%	Next KES 139,043	25%
		Above KES. 564,709	30%

Effect:

- In the long run, the reduction of the taxes applied on withdrawals is likely to provide an incentive to employees to save in retirement benefits schemes as their retirement benefits will be more upon withdrawal
- In the short term however and with the ongoing pandemic, employees can take advantage of the

expanded tax bands and withdrew from the schemes to provide some cushion in cases of reduced income. benefits owing to the reduced tax rates

2. Taxation of investment income into the schemes: There are a couple of changes that are also expected to negatively impact the returns of the schemes.

Below are some of the things that are no longer tax exempt:

- Income of the National Social Security Fund;
- Investment income of a pooled fund or other kind of investment consisting of retirement schemes, provided that all the constituent schemes of the pooled fund are registered by the Commissioner;
- Interest income from listed infrastructure bonds including green bonds with a maturity of three years or more;
- Interest income generated from cash flows passed to the investor in the form of asset backed securities;

Effect:

Generally, this will mean that on average the funds and hence members will get much lower returns on their investments. The average taxation for the various asset classes that schemes invest in are: Dividends on equities is at 5%, Capital Gains Tax is at 5%, Tax on government bonds is at 15% since withholding tax is final tax and Tax on rental income is at 25%.

3. Taxation of monthly or Monthly or lump sum pension granted to a person who is sixty-five years of age or more

Effect:

- This change will prove a disincentive to all retirement schemes' members who delayed their retirement with the expectation of a tax exemption
- We may see more members retiring at the Normal Retirement Age of 60 years
- The removal of this exemption may also affect the uptake of income drawdown in the country, as some retirees take up the option so that they may enjoy the tax free benefits available for over 65-year olds

4. Taxation of Income from employment paid in the form of bonuses, overtime and retirement benefits payable to the employees in the lowest tax band;

Effect:

- This reduces the disposable income of the low income earners and hence impacts on their ability to save for retirement

C. CONCLUSION:

The Retirement Benefits Industry has made significant strides over the last 20 years or so, with assets at Kshs 1.3 trillion as at December 2019. Some of the above measures may significantly impact the continuous growth and attractiveness of the industry. Our recommendation is therefore for the Treasury to relook at the taxation measures proposed above and see if some of them can be reviewed for the sake of the sector as we seek to enable people to be self-sufficient in retirement.

