Africa Clean Energy
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An analysis of the provisions of the proposed Finance Bill, 2020 and various sections that impact the off-grid sector.

May 2020

Introduction

The Kenya Renewable Association requested the support of ACE TAF to analyse initially the proposed Tax (Amendment) Bill 2020 and subsequently the Finance Bill 2020 which was published on 5th May 2020.

In particular, the sector was apprehensive of the impact of the proposed removal of the Value Added Tax (VAT) exemption on equipment for the development, generation and storage of solar equipment which would see the introduction of the tax at a rate of 14%.

This analysis examines all the proposals that would impact a business within the off-grid sector whether the impact is positive or negative.

Historical background on the treatment of Solar equipment under the VAT Act

Prior to the VAT Act 2013, the repealed VAT Act (cap 476) under Part C of the Fifth schedule provided for Solar equipment at the rate of zero percent.

The VAT Act 2013 later came into effect and solar equipment and accessories were not included under the exemption or zero rating schedules which in effect meant that solar equipment and accessories were subject to VAT at 16%. In the Finance Act of 2014, paragraph 45 was created under Part I of the First Schedule to the VAT Act to exempt:

"Specialised solar equipment and accessories, including solar water heaters and deep cycle-sealed batteries which exclusively use or store solar power".

A further amendment was later done to introduce paragraph 48 in the same schedule to exempt:

"Inputs or raw materials supplied to solar equipment manufacturers for manufacture of solar equipment or deep cycle-sealed batteries which exclusively use or store solar power as approved from time to time by the Cabinet Secretary for the National Treasury, upon recommendation by the Cabinet Secretary responsible for energy and petroleum."

Additionally, to support the solar energy sector, there was an attempt to gazette solar under duty remission for solar manufacturers therefore, in 2014 solar was placed under the exemption regime.

Disputes arose resulting to paragraph 45 being amended further by the Finance Act 2018 and 2019 to exempt:

"Specialized equipment for the development and generation of solar and wind energy, including deep cycle batteries which use or store solar power upon the recommendation of the Cabinet Secretary responsible for matters relating to energy."

This is a replica of what is covered under paragraph 26 of the Fifth schedule of the East Africa Community Customs Management Act 2004.

I. The Tax Laws (Amendment) Bill, 2020

The Tax Laws (Amendment) Bill, 2020 was assented into law on the 25th April 2020.The Bill had proposed to delete paragraphs 45 and 48 from the exemption schedule of the VAT Act which in effect would mean that solar equipment and accessories are subject to VAT at 16%. However, the proposed amendments were not passed into law when the Tax Laws (Amendment) Act, 2020 was assented, which meant that the goods covered under paragraphs 45 and 48 are still exempt.

The Bill had also proposed to delete paragraphs 65 and 66 from the first schedule which provided as follows respectively:

Supplies	***New rate***	***Old rate***
Taxable goods locally purchased or imported by manufacturers or importers of clean cooking stoves for direct and exclusive use in the assembly, manufacture or repair of clean cook stoves approved by the Cabinet Secretary upon recommendation by the Cabinet Secretary for the time being responsible for matters relating to energy.	*14%*	*Exempt*
Inputs or raw materials locally purchased or imported by manufacturers of clean cook stoves approved by the Cabinet Secretary upon recommendation by the Cabinet Secretary for the time being responsible for energy.	*14%*	*Exempt*

These proposals were also rejected at the Parliamentary discussions stage and therefore the items have maintained their exempt status.

Other provisions in the Tax Laws (Amendment) Act, 2020 that impact the off-grid sector

a) Income Tax Act

Reduction of corporate income tax from 30% to 25%

Following the President's directive to reduce corporate tax rate for resident entities from 30% to 25% to cushion companies against the adverse economic conditions brought by the COVID-19 pandemic, the Act has provided for a reduction of the same in line with the directive.

This change will result in a reduction in corporate tax paid by resident companies subsequently increasing distributable profits which will enable companies including those in the off grid sector to remain afloat during and after the COVID-19 pandemic.

Turnover Tax

The Act has increased the threshold for Micro, Small and Medium Enterprises qualifying for turnover tax from turnover of more than one million shillings but not exceeding fifty million shillings during any year of income.

The Act has reduced turnover tax rate from 3% to 1% for Micro, Small and Medium Enterprises.

This is intended to enhance compliance from both informal and formal sector. The amendment will significantly simplify the tax compliance requirements of small businesses in all spheres including the off grid sector.

Overhaul of the Second Schedule

The Act has decelerated the rate at which previous capital allowances were claimable. The highest capital allowance in the Act has been reduced to 50%.

The reduction of capital allowances has a net impact on taxpayers paying higher taxes. This amendment will impact all sectors of the economy including the off grid sector especially considering the effects of the COVID-19 pandemic.

This overhaul of the Second Schedule erodes the gains of the reduction in corporation tax.

Increase in the resident personal relief

The Act has increased the personal relief available to resident individuals from the current KES 16,896 per year (or KES 1,408 per month) to KES 28,800 per year (or KES 2,400 per month). The Act has also expanded the tax bands and reduced the marginal rate of tax from 30% to 25%

All employees as a result will enjoy reduced tax liability on their income consequently increasing the employees' disposable income.

II. The Finance Bill, 2020

Despite the assent of Tax Laws (Amendment) Act, 2020, most of the proposed amendments that were not passed into law have been brought back under the Finance Bill, 2020 among them being the deletion of paragraph 45 of the First Schedule to the VAT Act.

Impact of the proposed deletion of paragraph 45 from the First Schedule (Exemption Schedule) of the VAT Act 2013

I. Affordability

The introduction of VAT at the rate of 14% will result in the increase in price of the solar equipment which will then be transferred to the consumer. This will have a significant impact on the use of solar power by low-income households in Kenya as it will increase the price of all solar powered equipment including basic solar powered lights.

II. Increased costs resulting from a higher VAT rate

The deletion of paragraph 45 from the exemption schedule will result in a higher VAT rate on solar equipment compared to other sources of energy. While solar equipment will be charged at a higher rate of 14%, fossil fuels including the toxic kerosene is charged at the rate of 8%. This in turn will have a ripple effect on the price of end products and likely to see consumers opting for kerosene for lighting which will be a step back from all the gains that have been achieved.

III. Administrative burden

The administration of VAT will require the customers to be provided with ETR receipts at the point of sale. It is important to note that most of the local solar companies aim to provide solar power at affordable prices. Some of the companies sell solar panels, solar systems and solar lamps to communities through local women's groups, offering loans or a subsidized price system. The consumers also access the products through the innovative Pay-As-You-Go model that allows the consumer to pay for the products slowly over time while continuing to utilize the service until payment in full.

The administration of the tax will be burdensome to the companies as they do not receive the full payment from their customers upfront.

IV. Marginalised communities

The Kenya Off-Grid Solar Access Project (K-OSAP) is a flagship Project of the Ministry of Energy, financed by the World Bank and jointly implemented by the Ministry of Energy (MoE), Kenya Power and Lighting Company (KPLC) and Rural Electrification and Renewable Energy Corporation (REREC).

The project aims to increase access to modern energy services in 14 underserved Counties of West Pokot, Turkana, Marsabit, Samburu, Isiolo, Mandera, Wajir, Garissa, Tana River, Lamu, Kilifi, Kwale, Taita Taveta and Narok. These counties represent 72 % of the country's total land area.

When completed the project targets 277,000 households (approximately 1.3 million people from the 14 Counties and 1,100 public facilities community facilities i.e. schools, health facilities, administrative offices and 380 boreholes that have remained un-electrified. The Project also expects to facilitate the provision of 150,000 clean cooking stoves in West Pokot, Turkana, Marsabit, Samburu and Isiolo.

The project is part of the Ministry's to objective to achieve universal electrification by 2022 and economic growth under the Vision 2030 will consequently be thwarted by the increased cost on the off grid sector.

V. Health and environmental gains

The use of clean energy through exclusively solar powered equipment which has health benefits as well as environmental benefits like reduction in pollution, to low income households who largely rely on kerosene lamps, charcoal and firewood will be hampered.

The push for clean energy is based on the fact that consumers have over the ages been exposed to polluting sources of energy which negatively impact the quality of life. Firewood and kerosene are a major cause of indoor air pollution (IAP) in households, which cause respiratory illnesses, eye infections, heart conditions, brain damage, cancers and premature deaths. The Ministry of Environment indicates that about 14,300 Kenyans die every year due to IAP.

Rural schools, health facilities and communities which are unable to access the national electricity grid will be hindered from accessing affordable solar energy and subsequently derail the government goal on accessibility of affordable energy in rural settings and Kenya's development agenda to achieve universal electricity access by 2022.

VI. Loss of employment

The Off grid sector has created a lot of employment opportunities especially for the workforce used in the installation and maintenance of solar panels and the women groups used to sell solar lamps and other accessories to the communities. The rising costs in production may result into loss of employment for some of the workforce in order to mitigate costs.

Other provisions in the Finance Bill, 2020 that impact the off-grid sector

a) Income Tax Act

The Bill has proposed to introduce minimum tax which shall be chargeable at the rate of 1% of the gross turnover. The tax is payable by a person if:

a) that person's income is not exempt under the Income Tax Act;

b) the person's income is not chargeable to tax under employment income, residential rental income, capital gains, persons undertaking mining or upstream oil and gas activities and persons subject to turnover tax.; and

c) the instalment tax payable by that person is higher than the minimum tax.

The minimum tax shall be payable in instalments which shall be due on the twentieth day of each period ending on the fourth, sixth, ninth and twelfth month of the year of income.

The introduction of the minimum tax may result in unintended economic effects in respect of businesses especially where it represents an additional cost to the business rather than a tax on actual income earned by the business.

The provision requires payment even where the instalment taxes are higher than the minimum tax paid. The imposition of this tax in addition to the amendments to the Second Schedule in the recent Tax Laws (Amendment) Act, 2020 does not promote Kenya as an investment destination. The 1% rate is high and punitive for persons with high turnovers and in financial distress.

Digital service tax

The Bill proposes to introduce guidelines on taxing income from the digital market place at the rate of 1.5% of the gross transaction value as follows:

- Digital service tax shall be payable by a person whose income from services is derived from or accrues in Kenya through a digital market place.
- A resident person or non-resident person with a permanent establishment in Kenya shall offset the digital service tax paid against the tax payable for that year of income.
- The tax shall be due at the time of the transfer of the payment for the service to the service provider.
- The tax shall be payable through a withholding tax system.

The off grid sector may be affected in the case where the current mode of delivery of services is deemed to be an E-commerce platform.

In the absence of a clear legal frame work to operationalize this provision it will be a fertile ground for tax disputes. It will be prudent for the Kenya Revenue Authority (KRA) and National Treasury to prescribe the regulations as envisaged by Finance Act, 2019. It is unclear whether these provisions are effective in the absence of such regulations.

b) Value Added Tax Act

Deduction of Input

The Bill proposes to introduce another condition under which deduction of input tax shall not be allowed where the registered supplier has not declared the sales invoice in a return.

Previously the only condition was that for deduction of input tax to be allowable, the person had to hold the necessary documentation required under the provision.

This will pose challenges to business since they may not have the capacity to know when and whether suppliers will declare/have declared their sales invoices in the VAT returns.

This proposal negates the principal of VAT of input tax claim and creates grounds for tax disputes. With the implementation of electronic invoicing, the requirement to have output tax declared by the supplier as a condition to allow the input tax deduction is not necessary as it is punitive to the persons claiming input tax. This may result in cash flow implications for companies as they will not be able to claim input VAT in time.

Zero rated supplies to standard rated supplies

Supplies	***New Rate***	***Old Rate***
Inputs or raw materials for electric accumulators and separators including lead battery separator rolls whether or not rectangular or square supplied to manufacturers of automotive and solar batteries in Kenya	*14%*	*0%*

The proposed change in the VAT status of the item from zero-rated to standard rated will increase the prices charged to the final consumers. This may result in some consumers resorting to alternative sources of energy such as kerosene, charcoal and firewood. This will have negative effects on the environment and consequently negate the government's effort to ensure use of clean energy.

Conclusion

As noted above, the proposed deletion of paragraph 45 of the first schedule of the VAT Act 2013 and other various amendments under the Finance Bill, 2020 will have an adverse impact on the off grid sector. It is therefore crucial to appeal to the relevant Ministries to support the withdrawal of the proposed amendment and have paragraph 45 of the VAT Act No. 35 of 2013 retained.