Total Tax Contribution of the Kenya Banking Sector - 2022

Continued Resilience in Turbulent Times

Kenya Bankers Association

pwc

KENYA BANKERS ASSOCIATION

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Foreword

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Welcome to the fourth edition of the Total Tax Contribution ("TTC") study of the Kenya Banking Sector. The TTC data, which covers the financial year ending 31 December 2022, shows that the estimated TTC for the 39 banks that participated in this study was KES 181.27 bn. This is the highest TTC amount recorded since the commencement of this study in 2019.

From a net assets perspective, the 39 study participants represented 97.65% of the market share. 39 banks participated in the 2022 study while 38 banks participated in the 2021 study. Accordingly, the 2022 data set is comparable to the 2021 data set given that in both years, participants represented over 97% of the market share and all the 9 tier-one banks (who controlled more than 75% of the market share in both years), participated in both studies.

The year 2022 was one of resilience against a challenging environment characterised by increased inflation, prolonged drought, depreciation of the Kenyan shilling against major currencies, geopolitical pressures arising from the Russia-Ukraine conflict and election related uncertainties. All these manifested in a reduction of Gross Domestic Product ("GDP") growth rate to 4.8% in 2022 compared to 7.6% in 2021.

Within this environment, the TTC of the participating banks still grew by 39.94% in 2022 relative to 2021. The 39.94% increase is far greater than the post pandemic growth of 23.59% recorded in 2021 relative to 2020. Corporate Tax ("CT") was the biggest driver to the significant increase in the 2022 TTC.

CT increased from KES 49.48 bn in 2021 to KES 87.71 bn in 2022, a 77.26% increase. The increase was due to a growth in balance of tax (a form of corporate tax) paid in 2022 and a growth in 2022 instalment taxes (another form of corporate tax), both on account of year on year growth in profitability of the sector in 2021 and 2022.

The 2022 TTC of the 39 banks that participated in this study represents 8.93% of all government receipts compared to 6.82% in 2021- a solid indication that the industry is a substantial contributor of taxes in Kenya. Financial activities (including banking) contributed close to 7% to Kenya's nominal GDP in 2022.

This underlines the government's continued reliance on the sector to not only spur economic growth but also pay its own taxes. Given this context, it is crucial for the tax policy framework of the sector to be designed in a way that facilitates sustainable growth.

Tax continues to increasingly be viewed as a key aspect of sustainability given the potential impact of taxes to achieve social economic cohesion and drive long term prosperity. The Global Reporting Initiative ("GRI") now has a standard for tax reporting known as GRI 207 which provides guidance on public tax reporting.

In addition, the Principles of Responsible Banking, Nairobi Securities Exchange ESG Disclosures Guidance Manual (for listed banks) also provides a framework for public tax reporting. Given the significance of taxes paid by banks in Kenya, there is sufficient impetus for individual banks to embark on the public tax transparency journey.

We thank the 35 banks and 4 microfinance institutions that participated in this study, the 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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Introduction

We are pleased to present the Total Tax Contribution Report for the banking sector for the year 2022. This is the fourth edition of this report, which has continued to outline significant contributions made by the Kenya Bankers Association (KBA) member banks to the national economy through taxes over the past four years.

In this regard, we would like to express our sincere gratitude to each of our member banks for the continued commitment to transparency and compliance in tax matters. The banking industry plays a crucial role in driving economic growth and supporting various initiatives that benefit communities and the nation.

As you will note from this report, some of the highlights of the Total Tax Contribution Report for the year 2022 are.

- **Corporate Income Tax:** The banking sector collectively contributed KES 87.71bn in corporate income taxes, representing a 43.59% increase compared to the previous year.
- **Employee Taxes:** KBA member banks' workforce contributed KES 23.00bn in personal income taxes, reflecting their substantial role in nation-building.
- **Other Taxes:** Additionally, the industry contributed KES 70.56bn through various other taxes, such as Withholding Tax excise duties, and Value Added Tax.

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It is imperative to note that the banking sector's consistent compliance with tax regulations demonstrates the banking sector's commitment to uphold ethical practices and corporate responsibility.

These tax contributions have a far-reaching impact on the development of critical infrastructure, social welfare programs, and the overall improvement of the quality of life for citizens. Without doubt, this report provides insights that will be of benefit to a broad range of stakeholders in the banking industry, including shareholders, employees, and customers.

The banking industry will continue to highlight tax contributions, recognizing that transparency is vital in fostering trust and building stronger relationships with all partners. As an industry, we commit to continue working together with all stakeholders towards driving sustainable economic growth and contributing positively to the national socio-economic development agenda.

Thank you for your continued support, dedication, and commitment to excellence.

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Executive Summary

Participating banks made a Total Tax Contribution of KES 181.27 bn representing 8.93% of total taxes collected in Kenya

In 2022, the TTC of the 39 participating banks[1] was KES 181.27 bn. This consists of taxes borne of KES 103.28 bn and taxes collected of KES 77.99 bn. The KES 181.27 bn represents a year-on-year increase of 39.94% from 2021 relative to 2022. The TTC as a percentage of total exchequer tax revenue[2] collected in the financial year ended June 2023[3] of KES 2,030 trillion shows that the participating banks contributed approximately 8.93% of total tax revenue compared to 6.82% of total government revenue in 2021[4]. This is a tremendous contribution given that it is made up of 39 banks against approximately 6.4 million active taxpayers in the country. The growth of the TTC of the study participants of 39.94% is significantly higher than the growth in total government revenue of 6.90%. This indicates that the growth in taxes was more concentrated within the banking sector compared to other sectors.

From a taxes borne perspective, the increase in TTC is primarily driven by a 77.26% increase in Corporate Tax from KES 49.48 bn in 2021 to KES 87.71 bn in 2021. The increase was due to a growth in balance of tax (a form of corporate tax) paid in 2022 and a growth in 2022 instalment taxes (another form of corporate tax), both on account of year-on-year growth in profitability of the sector in both 2021 and 2022.

From a taxes collected perspective, the banking sector witnessed a significant rise in Excise Duty. Between 2021 and 2022, Excise Duty experienced a remarkable growth rate of 60.13%. This can be attributed to an increase in non-funded income (including fees and commissions) and an increase in the volume and value of digital transactions given the continued investments in technology. The growth in Excise Duty is also attributed to the introduction of Excise Duty on fees and commissions on loans by the Finance Act, 2021 with effect from 1 July 2021 meaning that fees and commissions on loans were subject to Excise Duty for the entire 2022 financial year - compared to only half of the 2021 financial year.

35.92% of Corporate Taxes in Kenya are paid by the banking sector

The banking sector's[5] Corporate Tax payments amounted to KES 98.55 bn, representing a remarkable 94.38% increase compared to 2021. In 2022, the banking sector contributed 35.92% of the total Corporate Taxes received by the government. This shows the government's over reliance on banks to pay Corporate Taxes compared to other sectors of the economy.

25.24% of withholding tax paid is collected by the banking sector

Withholding Tax ("WHT") collected by the banking sector in 2022 increased to KES 37.31bn which translates to a year-on-year growth of 18.03%. On the other hand, WHT collected by participating banks[6] in 2022 increased by 15.49% to KES 26.56 bn compared to KES 22.99 bn in 2021.

At the end of 2022, total deposits held by the banking sector had grown by approximately 8.7% to stand at KES 5.0 trillion from KES 4.64 trillion in 2021[7]. This increase in total deposits results in a year-on-year increase in interest expense on deposits of 12.53% from KES 136.31 bn in 2021 to KES 153.14 bn in 2022. Given that interest expense is the main driver of withholding tax in the banking sector, the 12.53% increase in interest expense resulted in the growth in WHT collected by both the entire banking sector and the participating banks.

[1]Participating banks are the 35 banks and 4 microfinance institutions that participated in this study
[2]Exchequer revenue constitutes all the mainstream Government revenues, i.e., Taxes on International Trade and Transactions, Excise taxes, Taxes on Income, Profits and Capital gains, Taxes on goods and services, and Property taxes.
[3]The government's financial year runs from 1 July to 30 June
[4]https://kra.go.ke/news-center/press-release/1956-kra-sustains-revenue-growth-despite-economic-shocks
[5]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
[6]Participating banks are the 35 banks and 4 microfinance institutions that participated in this study
[7]Bank Supervision Annual Report 2022 by Central Bank of Kenya.

The banking sector collected 7.85% of total PAYE paid

In 2022, the banking sector contributed KES 37.23 bn, accounting for 7.85% of total PAYE collected in Kenya, compared to KES 26.62 bn (6.18%) in 2021. The growth is a result of an 11.3% increase in the number of employees in 2022 compared to 2021 as well as a 13.31% growth in employment costs[8]. The increase in employee numbers and costs is aligned to an increase in bank branches across the country in 2022 relative to 2021.

It is worth noting that of all the taxes analysed, the PAYE contribution by the banking sector relative to the other sectors shows the lowest sectoral contribution, indicating there are more taxpayers in Kenya that contribute to PAYE compared to other taxes such as Corporate Tax, WHT and Excise Duty which are heavily reliant on the banking sector. Participating banks experienced a 5.02% increase in PAYE collections, with KES 23 bn collected in 2022 compared to KES 21.9 bn in 2021.

Irrecoverable VAT incurred by participating banks grew by 5.99% as a result of new branches opening

Irrecoverable VAT for participating banks grew by 5.99% to KES 8.28Bn in 2022, representing 8.01% of total taxes borne. Premises costs, including VAT on commercial rent, contribute significantly to irrecoverable VAT. Despite a decrease in ATMs by 65 in 2022 as compared to 2021, the number of bank branches increased by 16, which led to an increase in irrecoverable VAT as a result of an increase in commercial rent.

The banking sector contributed 63.29% of financial services Excise Duty

The banking sector accounted for 63.29% of the total Excise Duty collected in the financial services sector. Excise Duty collected by participating banks showed a 60.13% increase in 2022 compared to 2021, nearly tripling since 2020. The increase in Excise Duty was driven by a rise in non-funded income and increased digital transactions due to investment in technology. Introduction of Excise Duty on fees and commissions on loans in July 2021 also contributed to this growth.

Credit Guarantee Scheme to facilitate credit to SMEs

The Credit Guarantee Scheme ("CGS") implemented by the Government of Kenya through the National Treasury & Planning has been a vital initiative in supporting the growth and development of Micro, Small, and Medium Enterprises ("MSMEs"). We asked the study participants the main challenges they face when lending to MSMEs and the most common challenge was lack of collateral (38.50% of participating banks).

Through the CGS, a total of KES 2.3 billion has been disbursed by the participating banks, effectively enabling MSMEs to obtain the much-needed financing for their business operations, expansion and innovation. It would be expected that access to credit by SMEs would with time, stabilise their businesses to enable MSMEs make their own contribution to taxes. This underlines the banking sector's contribution not only through the taxes it pays but also facilitating growth to allow other taxpayers enter the tax net.

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 2022 at 57.05 % (in the form of taxes collected and borne), followed by employees (in the form of employee emoluments) at 29.58% and lastly shareholders at 13.37% (in the form of dividends).

The increase in value distributed to the government was on account of a 39.94% increase in the TTC in 2022 relative to 2021. On the other hand, dividends to shareholders decreased due to a deceleration in the rate of increase of PBT in 2022 of 22% compared to an increase of 85.17% in 2021.

Figure 1 – below shows the value distribution by the study participants

Value distributed (%)	2021	2022
Taxes (collected and borne)	54.41%	57.05%
Employee Emoluments (net of taxes)	30.65%	29.58%
Dividends (net of taxes)	14.94%	13.37%
Total (%)	**100%**	**100%**

[8]Bank Supervision Annual Report 2022 by Central Bank of Kenya.

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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 and the trends in Total Tax Contribution of the sector over time.

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

The data for this report was collected between March 2023 and April 2023.

Methodology

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

The TTC framework is simplified in concept, not tax technical and therefore relatively easy for stakeholders to understand and interpret. 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 in form of a tax expense, e.g., Corporate Tax, irrecoverable VAT, VAT on imported services, withholding taxes borne and other taxes borne[9].

Taxes collected are transactional taxes 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[10]. The taxes collected have an administrative and compliance cost for the bank and will invariably have an impact on the bank's operations. Taxes collected represent an additional responsibility and a compliance obligation for banks.

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

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

[9]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)

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

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Banks participated in the 2022 study while 38 banks participated in the 2021 study.

Data received related to payments to the exchequer. No tax payments to foreign tax authorities were included.

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 study

This study covers 35 banks and 4 microfinance institutions covering 97.65% of the industry by market share in 2022.

References in the report to the term 'participating banks' means the 35 banks and 4 microfinance institutions that participated in the study while references to the "banking sector" refers to the commercial banks, microfinance institutions and other financial institutions as defined by KRA[11].

39 banks participated in the 2022 study while 38 banks participated in the 2021 study. The 2022 data set is comparable to the 2021 data set given that in both years, participants represented over 97% of the market share from a Net Asset Perspective and all tier-one banks who control approximately 75% of the market share, participated in both studies.

[11]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

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Total Tax Contribution of the Study Participants

The Total Tax Contribution analysis presented in this section relates to tax data of the **39 participants**[12] 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 103.28 bn, a 61.62% increase from the KES 63.91 bn recorded in 2021.

This increase was driven by a 77.62% increase in Corporate Tax - the largest component of taxes borne - from KES 49.48 in 2021 to KES 87.71 in 2022. The primary driver for the increase in Corporate Tax was a 263.35% increase in the balance of tax paid in April 2022 compared to the balance of tax paid in April 2021 as well an increase in corporate instalment taxes paid in 2022 from KES 68.85 bn compared to KES 47.19 bn in 2021, a 45.90% increase.

The increase in balance of tax was driven by an 85.17% increase in profitability in 2021 relative to 2020 while the increase in instalment taxes was driven by the 22% increase in profitability of the sector in 2022 relative to 2021 where the instalment taxes were paid on a current year basis.

Further analysis of taxes borne is as follows:

a) Corporate Tax forms the largest component of taxes borne by the sector, representing 84.92% of the total taxes borne in 2022. (See further detailed analysis on page 16)

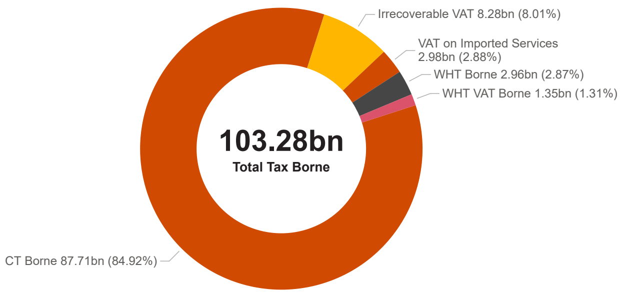
b) Irrecoverable VAT is the second largest component of taxes borne, representing 8.01% of the total taxes borne in 2022. (See further detailed analysis on page 21)

c) VAT on imported services represents 2.88% of total taxes borne in 2022.

d) Withholding tax borne represented 2.87% of total taxes borne in 2022. (See further detailed analysis on page 17)

e) Other taxes borne[13] represent 1.31% of total taxes borne in 2022.

Figure 2 - below shows the profile of taxes borne for the 39 participants in 2022



Taxes collected

Taxes collected are those which are generated by a bank's operations and are collected from others on behalf of the government, e.g., income tax deducted under PAYE, the employee portion of 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.

Taxes collected by participating banks[14] were KES 77.99 bn in 2022 and KES 65.61 bn in 2021. This is a 18.82% increase in 2022 relative to 2021. The increase is largely attributable to:

[12]Participating banks are the 35 banks and 4 microfinance institutions that participated in this study

[13]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)

[14]Participating banks are the 35 banks and 4 microfinance institutions that participated in this study

- A 60.13% increase in Excise Duty arising from an 18.19% increase in fees and commissions which are subject to Excise Duty in 2022 relative to 2021. It should be noted that the Finance Act, 2021 introduced an amendment effectively subjecting to Excise Duty, fees and commissions earned in respect of loans. This amendment was effective for the entire 2022 financial year, whilst it was applicable for only 6 months in 2021 thereby explaining the 60.13% jump in Excise Duty.
- A WHT increase of 15.49% arising from an increase of 12.3% in bank deposits which resulted to a 12.53% increase in interest expense incurred by the banks.
- A 4.83% increase in PAYE which arises from an 11.3% increase in employee numbers and employee costs for the banking sector[15] in 2022 relative to 2021.

A further analysis of taxes collected is as follows:

a) WHT collected forms the largest component of taxes collected, representing 34.05% of the total taxes collected in 2022. (See further detailed analysis on page 18)

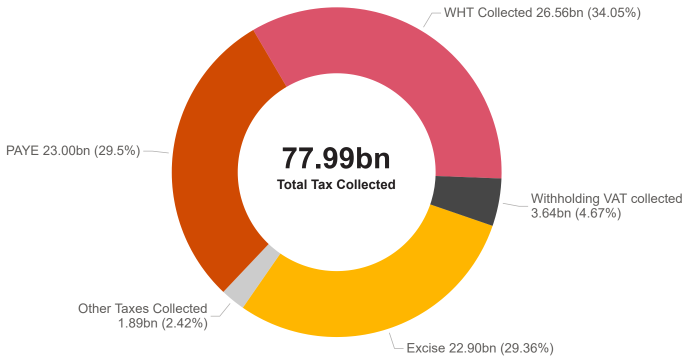
b) PAYE is the second largest component of taxes collected, representing 29.5% of the total taxes collected in 2022. (See further detailed analysis on page 19)

c) Excise Duty collected stood at 29.36% of total taxes collected in 2022. (See further detailed analysis on page 22)

d) Withholding VAT represents 4.67% of total tax collected in 2022.

e) Other taxes collected[16] represent 2.42% of total taxes collected for 2022.

Figure 3 – below shows the profile of taxes collected for the 39 participating banks[17] in 2022



Total Tax Contribution of Study Participants

The 39 participating banks reported taxes borne of KES 103.28 bn and taxes collected of KES 77.99 bn, making a Total Tax Contribution of KES 181.27 bn.

The banking sector's contribution to government receipts continues to be substantial. In 2022, the Total Tax Contribution of the participating banks accounted for 8.93% of all the taxes collected by the government. This remains a significant contribution given that this contribution is made by 39 taxpayers against a background of approximately 6.4 million active taxpayers in the country.

Compared to 2021, total tax borne increased in 2022 by a larger margin, of 61.62% (largely driven by the increase in Corporate Tax) compared to total tax collected which increased by 18.82%.

Figure 4 – below shows the study participants' contribution to total government receipts

Description	2021 (KES bn)	2022 (KES bn)	YOY Increase
Total Tax Borne	63.91	103.28	61.60%
Total Tax Collected	65.61	77.99	18.87%
Total Tax Contributed	**129.52**	**181.27**	**39.96%**
Total government receipts[18]	**1,899**	**2,030**[19]	**6.90%**
% of participating banks TTC relative to total government receipts	**6.8%**	**8.93%**	**31.32%**

[15]Bank Supervision Annual Report 2022 by Central Bank of Kenya.

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

[17]'Participating banks' means the 35 banks and 4 microfinance institutions that participated in the study

[18]The government year runs from July to June while that of banks runs from January to December. Both calendars cover a 12-month period

[19]https://kra.go.ke/news-center/press-release/1956-kra-sustains-revenue-growth-despite-economic-shocks

Tax revenue to GDP ratio in Kenya in 2021/2022 was 15.1%[20]. Of the 15.1%, 1.84% was contributed by the 39 banks who participated in this study. The sector's contribution to the tax to GDP ratio increased from 1.07% in 2021 to 1.84% in 2022.

This indicates the government's continued over reliance on the banking sector to ramp up tax collections. Further, the TTC growth of 39.94% compared to the growth in government receipts of 6.90% indicates that banking sector taxes were growing at a much faster pace compared to other sectors.

The TTC profile of the participating banks[21] (as summarised below) shows that Corporation Tax made up 48.39% of the TTC in 2022 and is the most significant tax contribution banks make to taxes. This is followed by WHT collected which represented 14.65% of the TTC for 2022. PAYE represented the third largest component of the TTC constituting 12.69%.

Corporation Tax, which accounted for almost half of the TTC, is heavily influenced by social economic factors that affect profitability such as interest rate capping, the Covid-19 Pandemic and political transition.

The government's reliability on Corporate Tax paid by the banking sector is aligned with OECD's proposition that developing countries have a high proposition of Corporate Taxes as a percentage of total revenues compared to developed countries.

According to the OECD Corporate Tax Statistics report[22], Corporation Tax revenues in Africa (30 jurisdictions) were 18.8% of overall tax receipts in 2019, demonstrating the importance of Corporate Tax revenues in developing economies.

Figure 5 – below shows the corporate tax revenues as a percentage of total tax revenues.

Description	Africa	Asia and Pacific	Latin America	OECD
Corporate Tax revenues as a share of total tax revenues	18.8%	18.2%	15.8%	9.6%

[20]https://www.treasury.go.ke/wp-content/uploads/2023/02/2023-Budget-Policy-Statement.pdf

[21]'Participating banks' means the 35 banks and 4 microfinance institutions that participated in the study

[22]https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-fourth-edition.pdf

Three of the **top four** contributors of the 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 through aspects such as payment of salaries and engagement with suppliers. Further, this is also indicative of the fact that the sector is highly formalised and regulated, both of which factors promote tax compliance.

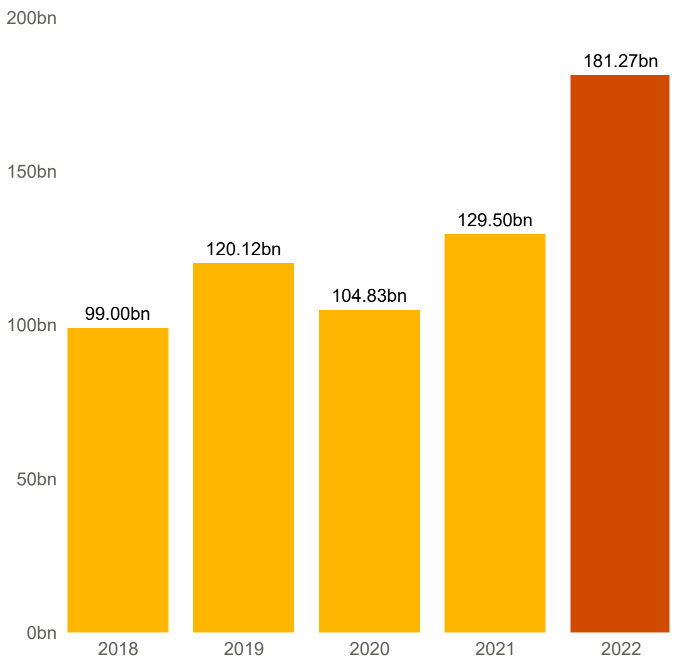
Figure 6 - The TTC profile for participating banks

Description	2021		2022	
	Amount in KES (Bn)	% Make-up	Amount in KES (Bn)	% Make-up
Corporate Tax borne	49.48	38.20	87.71	48.39
WHT Collected	22.99	17.75	26.56	14.65
PAYE Collected	21.94	16.94	23.00	12.69
Excise Duty Collected	14.30	11.04	22.90	12.63
Irrecoverable VAT Borne	7.81	6.03	8.28	4.57
WH VAT Collected	2.90	2.24	3.64	2.01
VAT on imported services borne	3.11	2.40	2.98	1.64
WHT Borne	2.43	1.88	2.96	1.64
Others[23] Collected	3.50	2.70	1.89	1.04
WH VAT Borne	**1.07**	**0.83**	**1.35**	**0.75**
Total	**129.53**	**100.00**	**181.27**	**100.00**

Total Tax Contribution is the highest in five years

A summary of the Total Tax Contribution of study participants over the period 2018 to 2022 is presented below.

Figure 7 – Year on year Total Tax Contribution for the participating banks (2018 - 2022)



[23]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)).

The year 2018 witnessed a stabilizing of the political environment which led to a relatively high GDP growth rate of 6.3%. In addition, 2018 being the second full year of the interest rate cap regime, 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%. The increase was driven by a substantial jump in Corporate Tax, 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 on the backdrop of greater vaccine access.

In 2022, the Total Tax Contribution of KES 181.27 bn is the highest over a 5-year period – a clear indication of the banking sector's resilience, despite the social economic headwinds experienced in 2022. The 39.94% year on year growth is driven by a 48.39% increase in Corporate Tax due to a growth of 263.35% in 2021 balance of tax paid in 2022 which was driven by an 85.17% increase in profitability in 2021 relative to 2020.

Further, the 39.94% growth is also driven by 60.13% increase in Excise Duty as a result of increase in fees and commissions. In addition, Excise Duty applied on transactions for the full 12 months in the 2022 tax year as compared to the prior period where Finance Act 2021 was enacted in July and therefore, the tax applied for half (only 6 months) the financial year.

Total Tax Contribution – 5 year trend

Figure 8 – Trend in TTC between 2018 and 2022

Description	Tax Borne/ Collected	2018	2019	2020	2021	2022	Total
Corporate Tax	Tax Borne	38.61	51.20	43.73	49.48	87.71	323.05
PAYE	Tax Collected	19.21	18.86	17.87	21.94	23.00	119.58
WHT Collected	Tax Collected	18.32	16.52	17.34	22.99	26.56	118.81
Excise Collected	Tax Collected	8.42	13.60	8.32	14.30	22.90	73.48
Irrecoverable VAT	Tax Borne	6.83	9.85	9.32	7.81	8.28	48.69
WHT Borne	Tax Borne	1.56	2.69	2.36	2.43	2.96	13.95
Others	Tax Collected	1.98	3.30	2.20	3.50	1.89	13.95
VAT on imported services	Tax Borne	1.36	1.85	1.85	**3.11**	2.98	12.67
Withholding VAT borne	Tax Borne	**2.87**	**2.24**	**0.94**	**1.07**	**1.35**	**11.28**
WHT VAT collected	Tax Collected	***-**	***-**	**0.90**	**2.90**	**3.64**	**7.44**
Total Tax Contribution		**99.15**	**120.12**	**104.83**	**129.52**	**181.27**	**742.89**
% year-on-year growth			**21.15%**	**(12.73%)**	**23.59%**	**39.94%**	

The above data is in KES 'bn

** The study did not track WHT VAT collected separately in 2018 and 2019*

Looking forward into 2023

- **Expected moderate growth in Corporate Tax** – It is expected that the balance of tax paid in April 2023 will not be as high as the balance of tax paid in April 2022 given that the year-on-year growth in PBT in 2022 of 22.0% was much lower than the year-on-year growth of 85.17% in 2021. Further, Kenya's projected economic growth of 5.5%[24] in 2023 is close to the 4.8% growth witnessed in 2022 meaning that the economic activities may largely remain the same.
- Impact of the amendments in the **Finance Act, 2023**[25]:
  - Increase in the marginal PAYE rate for top income earners is likely to lead to an increase in PAYE collected by the sector especially given the sector's high contribution to top income earners in Kenya[26].
  - The amendment to require both employees and employers to pay 1.5% monthly gross wages contribution to the National Housing Development Fund is likely to increase both taxes collected and taxes borne.
  - The amendment to disallow costs where the supplier has not issued an invoice under the tax invoice management system proposal may increase taxes borne which would result in an increase in the Total Tax Rate.

[24]https://www.treasury.go.ke/wp-content/uploads/2023/01/How-Kenya-is-preparing-for-global-economic-shocks.pdf

[25]On 29 June 2023, the petitioners in Constitutional Petition E181 of 2023 filed a notice of motion seeking a conservatory order suspending the Finance Act, 2023 pending the hearing and determination of the application and/or the Petition. On 10 July 2023, the High Court issued a conservatory suspending the Act pending the hearing and determination of the petition by a three (3) judge bench constituted by the Honourable Chief Justice

[26]KNBS 2022 Economic Survey, Estimated Real Average Wage Earnings per Employee, 2017 – 2021

6

Total Tax Rate of Participating Banks

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 43.09%. This means that for every KES 100 of profit by the participating banks, KES 43.09 was paid to the government as taxes.

The TTR increased from 32.85% in 2021 to 43.09% in 2022. The 31.18% increase in the TTR was driven by a significant balance of tax payment (a form of Corporate Tax) made in 2022 which was triggered by a 85.17% increase in profits in 2021 relative to 2020. This arose because the 2022 balance of tax payment is calculated in reference to the increase in profitability in 2021 relative to 2020. Further, the 5.99% increase in irrecoverable VAT in 2022 relative to 2021 also contributed to the increase in the TTR rate.

In comparison, the TTR for the participants in the UK's TTC study undertaken by PwC UK in 2022 was 32.4% while banks in Dublin and New York had a TTR of 32.1% and 27.4% respectively in the same period[27]. This demonstrates that Kenyan banks are bearing higher taxes which may be attributable to fewer tax incentives available for the banking sector and misalignment of the treatment of Non-Performing Loan ("NPL") provisions as per the tax legislation on one hand, and IFRS 9 together with CBK Prudential Guidelines on the other hand.

Figure 9 – below shows the TTR for the study participants

Description	2021 (KES bn)	2022 (KES bn)
Corporate Tax	49.48	87.71
Irrecoverable VAT	7.81	8.28
Other taxes borne	6.61	7.30
Total taxes borne	**63.90**	**103.28**
Profits Before Tax (after exceptional items) of participating banks	194.56	239.70
Total Tax Rate (TTR)	**32.85%**	**43.09%**

[27]https://www.ukfinance.org.uk/system/files/2022-10/UK%20Finance%202022%20TTC%20report.pdf

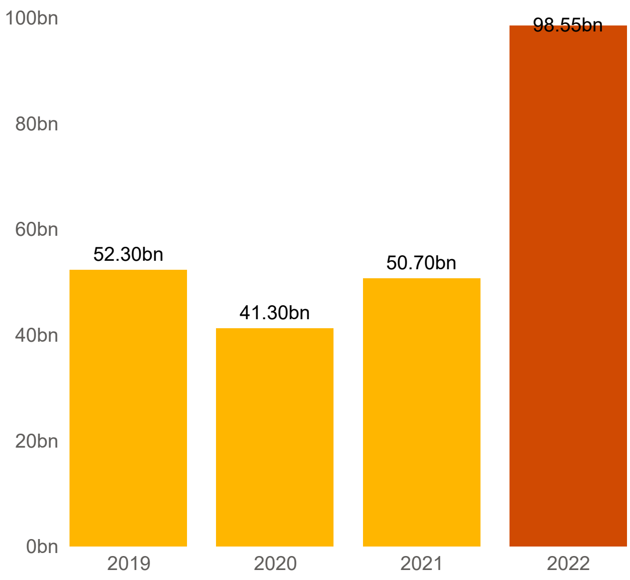
7

Corporate tax

Corporation taxes paid by the banking sector

The banking sector[28] contributed KES 98.55 bn in Corporation Tax in the year 2022. This indicates an increase of 94.38% compared to 2021 when the sector's Corporation Tax payments amounted to KES 50.7 bn. The KES 98.55 bn contribution is almost double the contribution for 2021 and is the highest contribution pre- and post-Covid-19 pandemic.

Figure 10 – Corporate Tax paid by the banking sector (2019 - 2022)



The 94.38% increase in the Corporate Tax paid by the banking sector was due to a number of factors. First, there was a tremendous increase in the balance of tax payment (a form of Corporate Tax) for 2021 paid by the banks in 2022.

This amounted to KES 18.76 bn compared to KES 5.16 bn paid in April 2021, representing a year-on-year increase of 263.35%. This was expected as the profitability of sector increased by 85.17% in 2021 relative to 2020.

Secondly, the instalment taxes (another form of Corporate Tax) paid in 2022 amounted to KES 68.85 bn compared to KES 47.19 bn in 2021, a 45.90% increase. This increase was driven by the recovery of the profitability of the sector in 2021 relative to 2020 as most banks estimated their 2022 instalment taxes based on the 2021 profitability which grew by 85.17%.

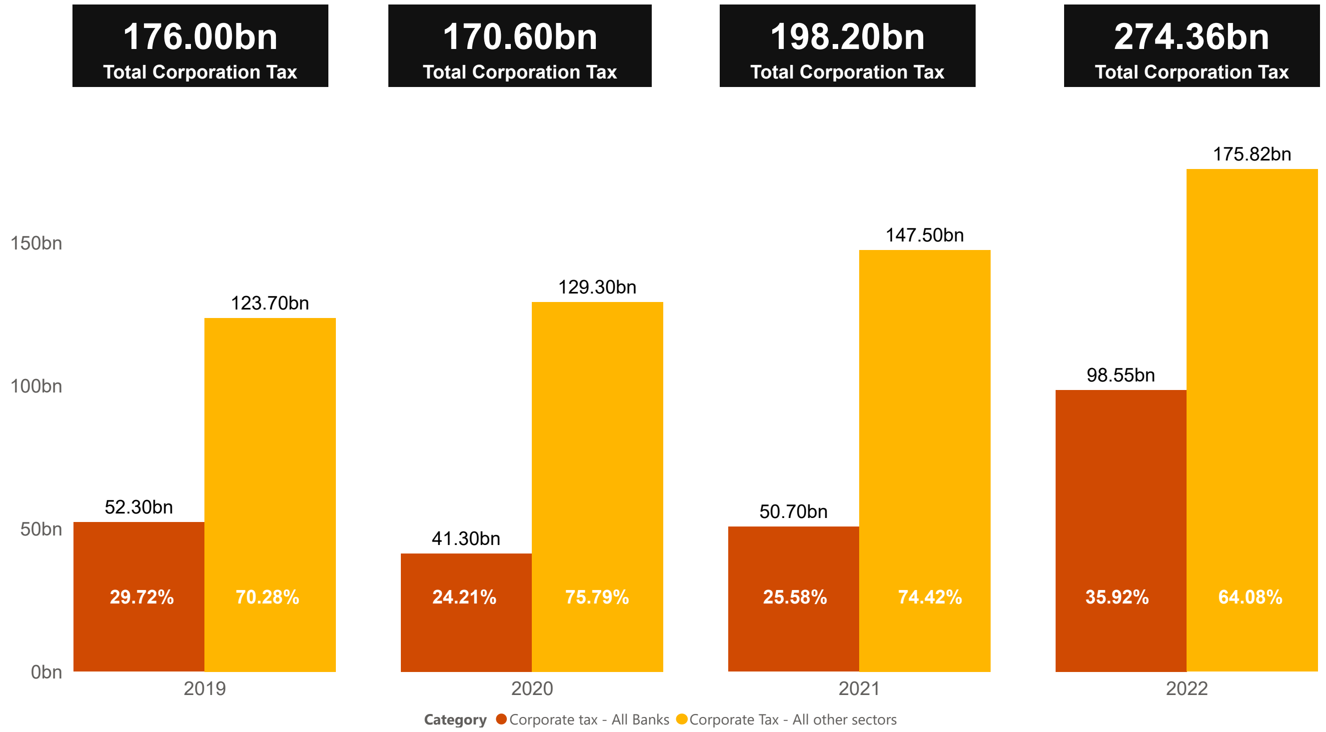
Corporate Tax borne by the banking sector as a percentage of total government corporate tax receipts

The banking sector[29] contributed 35.92% of total Corporate Taxes received by the government from all the sectors in Kenya. The comparative contribution for 2021 stood at 25.57%. This contribution is more than a third of the total Corporate Taxes received by the government in 2022, an indication of the government's continued over reliance on the banking sector for Corporate Tax payments.

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

[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

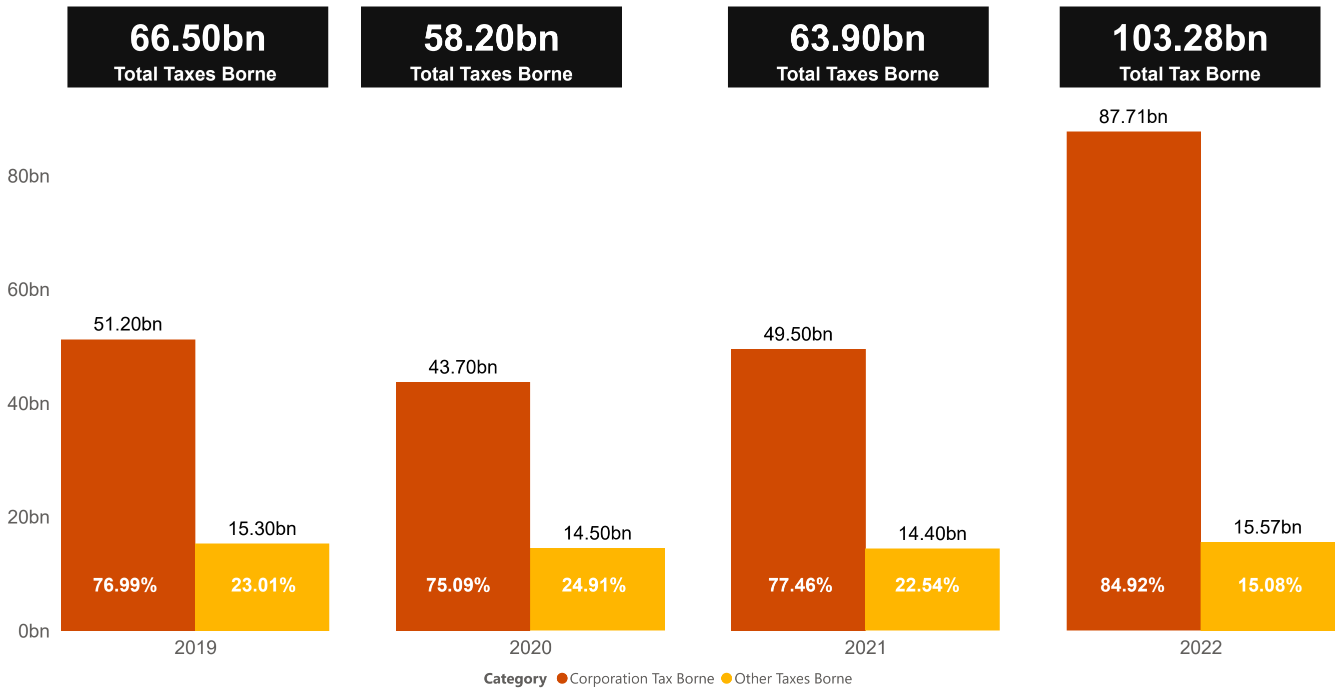
Figure 11 – Corporate Tax borne by the banking sector as a percentage of total government corporate tax receipts



Corporate Taxes form the largest component of total taxes borne by participating banks

Corporate Tax represents the largest component of total taxes borne by the participating banks[30] standing at 84.92% in 2022. In 2021, Corporate Tax constituted 77.43% of the total taxes borne. This increase in Corporate Tax as a share of total taxes borne is as a result of the increase in balance of tax for the year 2021 that was paid in 2022.

Figure 12 - Corporate Tax borne by the study participants as a percentage of total taxes borne



[30] 34 banks and 5 microfinance institutions that participated in this study

8

Withholding Tax

The banking sector collected 25.24% of total withholding tax collections

In 2022, according to the KRA, the banking sector collected KES 37.31 bn in withholding tax. This is against KES 147.79 bn collected by the KRA in the country. This means that 25.24% of all withholding tax collected by the KRA was contributed by the banking sector. This is an improvement from the 19.01% and 22.99% collection that was recorded in 2020 and 2021 respectively, showing a year-on-year sustained growth in WHT collections by the sector.

WHT collected by banks is largely determined by the value of the interest paid by banks to deposit holders and other providers of debt financing. At the end of 2022, total customer deposits of the banking sector had increased by 12.3% from KES 4.5 trillion in December 2021, to KES 5.0 trillion in December the market in 2022 compared to 2021. This increase in total deposits resulted in a growth in interest expense on customer deposits by 12.53% to KES 151.55 bn in 2022 compared to KES 134.78 bn in 2021. The increase in interest expense therefore resulted in an increase in the WHT collected by banks.

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

In 2022, the participating banks[34] collected WHT amounting to KES 26.56 bn which is a 15.49% increase compared to the KES 23bn collected in 2021.

As elaborated under 7.1 above, the increase in WHT maybe attributable to the sustained increase in customer deposits and attendant interest expense thereby increasing the WHT collected by banks upon payment of interest to deposit holders.

Figure 13 – below compares the WHT collected by the banking sector to the WHT collected by all the other sectors

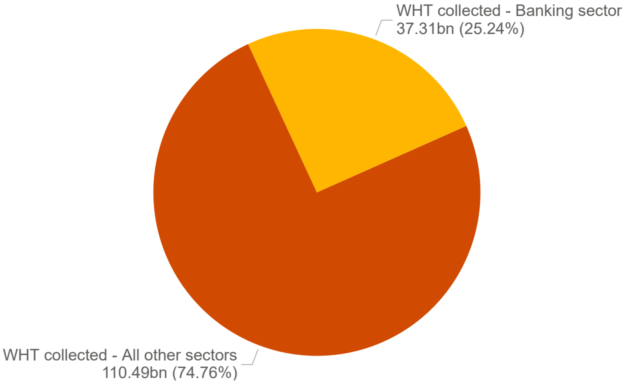
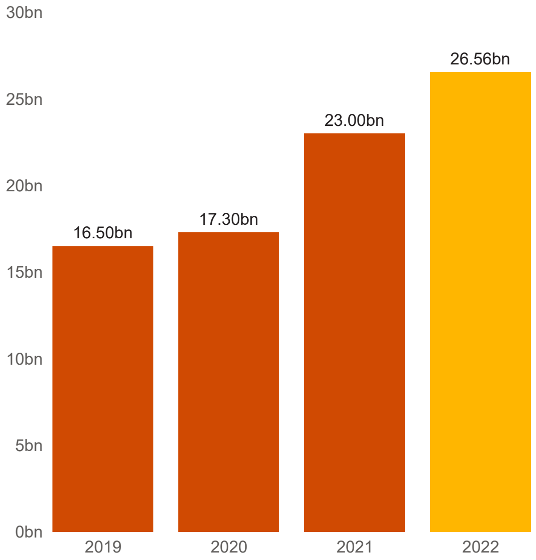


Figure 14 – below shows the year-on-year increase in WHT collected by participating banks



[31]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
[32]Bank Supervision Annual Report 2022 by Central Bank of Kenya.
[33]Bank Supervision Annual Report 2022 by Central Bank of Kenya.
[34]34 banks and 5 microfinance institutions that participated in this study

9

Pay As You Earn (PAYE)

The banking sector contributed 7.85% of total PAYE collected by all economic sectors in Kenya in 2022

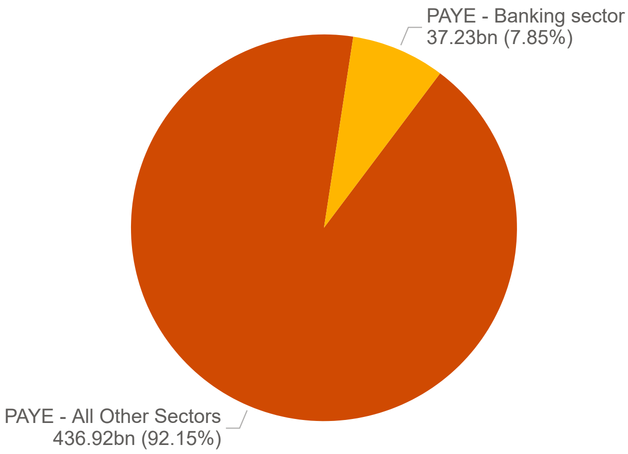
The banking sector's[36] contribution to taxes through PAYE collected amounted to KES 37.23 bn representing 7.85% of total PAYE collected in Kenya. In 2021, PAYE contributed by the sector was KES 26.62 bn (6.18%) of total PAYE collected.

The increase in PAYE arises from a 11.3% increase in employee numbers for the banking sector between 2021 and 2022. In addition, employment costs increased by 13.31% over the same period.

The banking sector's contribution to Corporate Tax, Withholding Tax and Excise Duty in 2022 was 35.92%, 25.24% and 63.29%[37] respectively. In contrast, the banking sector's relative contribution to PAYE is 7.85%.

This indicates that there is a broader base of taxpayers who pay PAYE and a smaller base of taxpayers in the wider economy that pay Corporate Tax, withholding tax and Excise Duty, indicating the government's over reliance on the banking sector for these categories and the need to mobilise more taxpayers.

Figure 15 - below compares the PAYE collected by the banking sector to the PAYE collected by all the other sectors



[36]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

[37]This is banking sector's excise contribution to Excise Duty on financial services

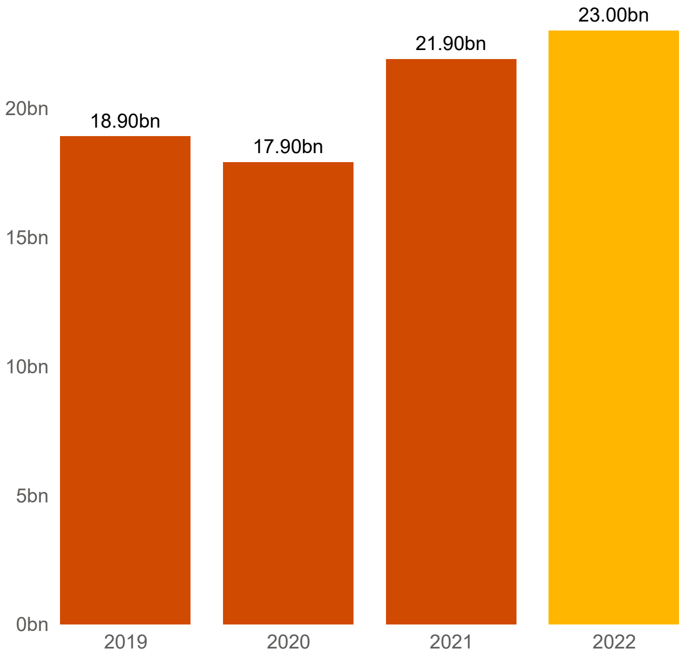
[38]GlobalEconomy.com

[39]Bank Supervision Annual Report 2022 by Central Bank of Kenya.

Increase in PAYE by study participants as banks established more branches

The PAYE collected by the participating banks[40] amounted to KES 23 bn in 2022 compared to KES 21.9 bn in 2021. This represents a 4.83% increase and is the highest PAYE recorded by participating banks over a three-year period. The number of employees employed by the study participants increased against the backdrop of banks setting up 16 more branches across the country as they sought to tap into emerging growth locations.

Figure 17 - PAYE contribution by participating banks (2019 - 2022)



[40]34 banks and 5 microfinance institutions that participated in this study

10

Irrecoverable VAT

When a business provides goods and services, it will charge Value Added Tax ("VAT") on those transactions (referred to as output VAT). This amount is then offset against the VAT the business has paid on purchases made for its operations (known as input VAT). However, in situations where a company's supplies are exempt from VAT, such as in the case of banks, customers are not charged VAT, and the company cannot reclaim the input VAT it has paid. This leads to a situation where the VAT becomes irrecoverable, which becomes a significant portion of the taxes that banks must bear as an expense.

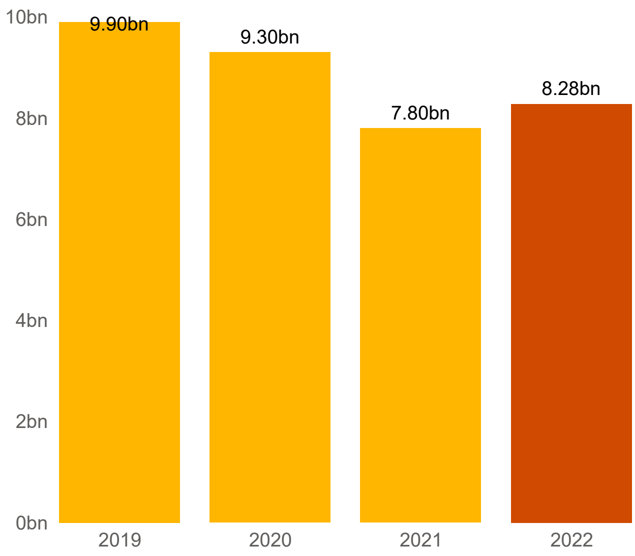
Premises costs represent a substantial portion of irrecoverable VAT, primarily due to the imposition of VAT on commercial rent. Any escalation in premises costs is anticipated to correspondingly raise the amount of irrecoverable VAT. There was an increase in the number of bank branches from 1,459 in 2021 to 1,475 in 2022, signifying an overall increase of 16 branches. Even with the decrease in number of ATMs by 65 in 2022 when compared to 2021 as a result of technological advancements in digital and mobile banking, this growth in physical branches can be primarily attributed to the establishment of commercial banks in emerging high growth locations[41].

Notably, while Nairobi County experienced the largest reduction in the number of branches in 2021, in 2022, it observed the highest increment with an additional 9 branches.

Physical branches will remain an important feature for wholesome banking and customer satisfaction for the foreseeable future given the current extent of digital exclusion in Kenya. Even in the long term, banks need to be careful to carry customers along on the digital transformation journey by providing support and retaining some face-to-face branch network. This is especially so given that cash is still used in 90% of transactions in Africa, with electronic or digital channels accounting for just 5-7%[42]. In Kenya, cash remains an important payments channel for medium, small, and micro enterprises, representing 80% of all their transactions[43].

As a result of the expected increase in commercial rent due to opening of more physical branches, irrecoverable VAT for the participating banks increased by 5.99% from KES 7.81 bn in 2021 to KES 8.28 bn in 2022, representing 8.01% of total taxes borne in 2022.

Figure 18 – Irrecoverable VAT borne by the participating banks (2019 - 2022)



[41]Bank Supervision Annual Report 2022 by Central Bank of Kenya.

[42]https://african.business/wp-content/uploads/2023/05/Backbase_Report23_Digital.pdf

[43]https://www.businessdailyafrica.com/bd/economy/cbk-fails-to-implement-uhuru-cash-directive-three-months-on-3694130

11

Excise Duty

Excise Duty Collected by the Banking Sector

The banking sector witnessed a notable surge in the total Excise Duty on financial services, making a remarkable 76.41% growth from KES 14.67 bn in 2022 to KES 25.88 bn in 2021. This is the only tax analysed in this report that has nearly tripled over the past three years.

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 between 2019 and 2022.

Figure 19 – Excise duty collected by the financial services sector vs excise duty collected by the banking sector

Description	2019 KES bn	2020 KES bn	2021 KES bn	2022 KES bn	Increase ('22/'21)
Excise on financial services collected by banks	16.1	9.27	14.67	25.88	76%
Total excise collected by KRA in financial services	27.5	20.2	28.9	40.89	41%
Contribution by Banking sector to excise	**58.55%**	**45.89%**	**50.76%**	**63.29%**	

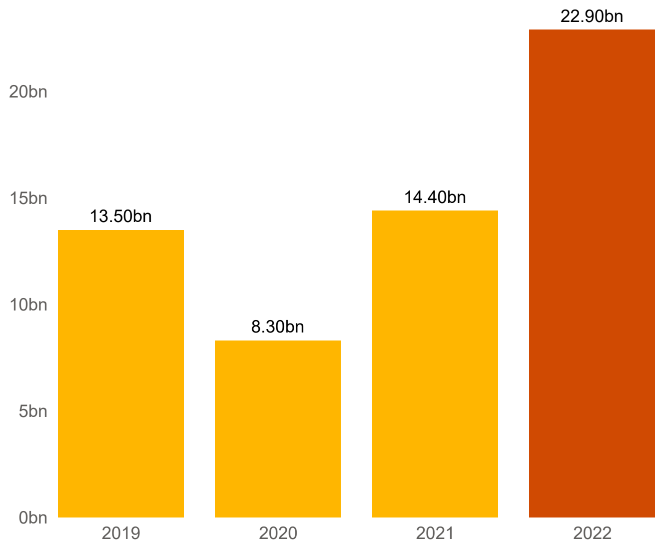
In 2022, the total Excise Duty collected by the KRA from the financial services sector amounted to KES 40.89 billion with the banking sector contributing 63.29% of this amount. This substantial contribution mirrors the trends observed in 2021 and is primarily influenced by two main factors.

Firstly, the expansion of fees and commission subject to Excise Duty, as mandated by the Finance Act, 2021 and secondly, the growth of 10.42% in income from fees and commissions which are subject to Excise Duty.

Excise Duty contributed by participating banks

In a similar trend to the wider banking sector, participating banks contributed KES 22.90 bn in Excise Duty in 2022 compared to KES 14.30 bn in 2021. This is a 60.13% increase driven by a wider scope for Excise Duty as well as a growth in fees and commissions.

Figure 20 – Excise duty contribution by the participating banks (2019 - 2022)



12

Continued resilience in turbulent times

Introduction

The year 2022 presented a myriad of new challenges for the banking sector, both domestically and globally. On the local front, the country dealt with political transition and the impact of a depreciating shilling. On the international stage, the escalation of the Russia-Ukraine War and the surging inflation rates added further complexities to the operating environment.

Despite these factors, the 22% increase in Profit before Tax showcases the resilience and adaptability of the banks. Not only have they weathered these challenges, but they have also sustained profitability, delivering commendable financial performance.

Moreover, this success translates into a significant contribution to the national economy, as the banking sector recorded a record-high amount of tax payments, reinforcing its role as a substantial contributor to the country's fiscal framework.

Credit Guarantee Scheme as a catalyst to increased SME lending

The Credit Guarantee Scheme ("CGS") implemented by the Government of Kenya through the National Treasury & Planning has been a vital initiative in supporting the growth and development of Micro, Small, and Medium Enterprises ("MSMEs"). Established under the Public Finance Management (Amendment) (No. 2) Act of 2020 and the Credit Guarantee Scheme Regulations, 2020, the CGS aims to address the challenges faced by banks when lending to MSMEs.

We asked the participants in this study the main challenges they face when lending to MSMEs. The common theme of inadequate collateral (38.50% of participating banks) and difficulty in pricing the risk of MSMEs (28.20% of the participating banks) emerged as the primary barriers to lending to MSMEs.

Participating banks disbursed approximately 28% of their total new loans in 2022 to MSMEs. The CGS plays a crucial role in facilitating credit flow to MSMEs. This scheme encourages banks to provide loans to borrowers they might otherwise turn away by offering a guarantee backed by the government. Through the CGS, a total of KES 2.3 billion has been disbursed by the participating banks, effectively enabling MSMEs to obtain the much-needed financing for their business operations, expansion and innovation.

To further support MSMEs in accessing credit, various innovative interventions have been implemented. One notable strategy involves accepting non-traditional assets as collateral. Traditionally, assets such as furniture and fittings or livestock were not regarded as preferred collateral for securing loans.

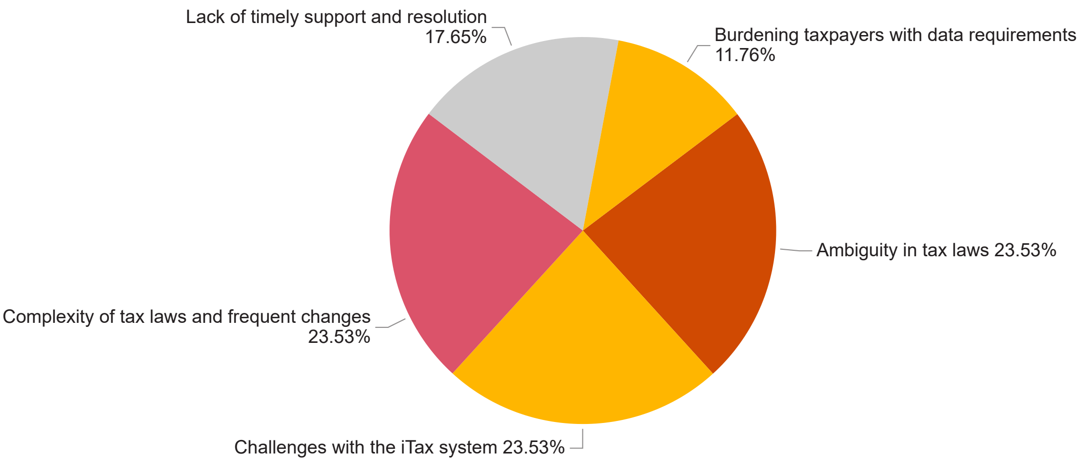
Additionally, programs such as the Inuka Enterprise Program have been established to empower MSMEs by providing them with the necessary knowledge and skills to improve their business proposals and effectively communicate their plans to lenders.

By enhancing their financial literacy and business acumen, SMEs are better equipped to navigate the lending process and secure the necessary funds for their ventures.

Access to credit by MSMEs would with time stabilise their business leading them to engage in more business transactions, pay their employees, engage with suppliers, and ultimately enter the tax net. By providing credit access, banks therefore indirectly support mobilisation of tax revenues from MSMEs.

Challenges the banking sector faces in a bid to become tax compliant

Figure 21 – below shows the major challenges faced by the participating banks



The most recurring challenges faced by many of the participating banks include complex tax laws, penalties, and fines, challenges in resolving disputes, and the requirement for additional expertise to ensure compliance.

These issues highlight the need for improved support, clear regulations, alignment of tax policies with the economic environment and efficient tax administration processes for key taxpayers such as those in the banking sector.

22%

increase in Profit before Tax showcases the resilience and adaptability of the banks

13

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

www.pwc.com/ke