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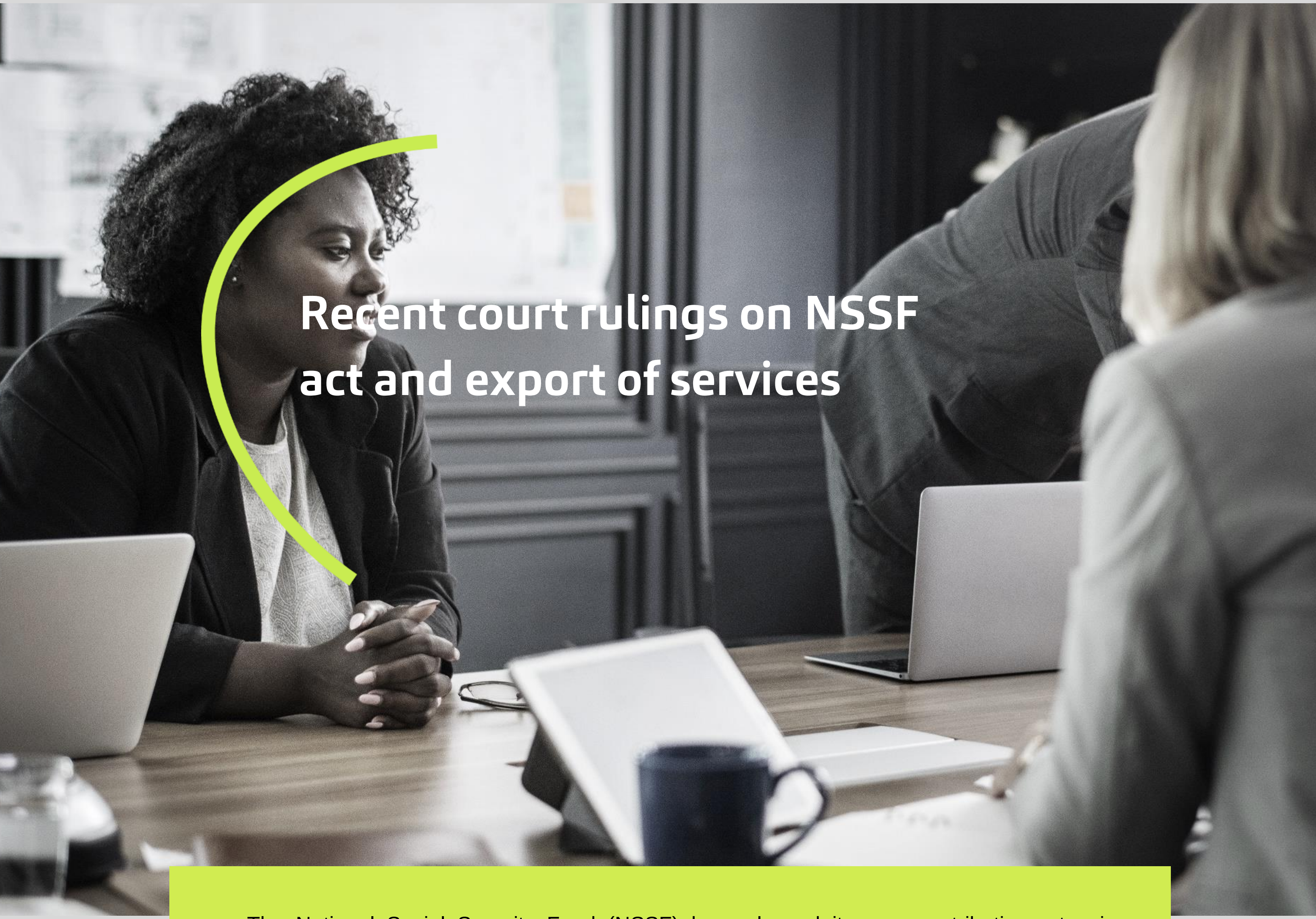

Recent court rulings on NSSF act and export of services

The National Social Security Fund (NSSF) has released its new contribution rates in compliance with the court ruling. The government agency responsible for the collection, safekeeping, responsible investment, and distribution of retirement funds of employees released the new rates in compliance with the NSSF Act No. 45 of 2013.

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TAX ALERT

RECENT COURT RULINGS ON NSSF ACT 2013 AND EXPORT OF SERVICES

A) DEMYSTIFYING THE NSSF ACT 2013

Introduction

The National Social Security Fund Act, 2013 (“NSSF Act”) was enacted in the year 2013. However, it has been a subject of protracted court battle since 2014. This led to a culmination of a judgment by the Employment and Labour Relations Court (ELRC) delivered on 19 September 2022 declaring that the Act is unconstitutional. NSSF challenged this judgment at the Court of Appeal and on 3 February 2023, the Court made its decision, making a pronouncement that the Act was validly enacted into law. In view of this, the provisions of the Act that were suspended are now in force.

Implications of the NSSF Act

The NSSF Act will now apply to all the employers, employees and self-employed individuals. The Act establishes a new Pension Fund and a Provident Fund and provides for a mode of transition where members of the Old Provident Fund that existed before 2013 shall be members of the new Pension Fund.

Mandatory Contributions to the Fund

The Act provides that from the commencement date an employer shall pay to the Pension Fund in respect of each employee in his or her employment.

- ***(a)*** the employer’s contribution at 6% of the employee’s monthly pensionable earnings; and
- ***(b)*** the employee’s contribution at 6% of the employee’s pensionable earnings deducted from the employee’s earnings.

New NSSF contributions rates

The Act has introduced new contributions which will be 12% of the monthly employee’s pensionable remuneration where 6% shall be borne by the employee and the 6% contributed by the employer.

The Act provides guidelines on how to compute the contributions where the pensionable earnings will be the lower of an employee’s actual monthly earnings and the Upper Earnings Limit (UEL). The Act has provided the UEL be KES. 18,000 while the Lower Earnings Limit (LEL) will be KES 6,000.

Computation of contributions

The Act introduces two tiers of contributions which are Tier I contributions for pensionable earnings up to LEL and Tier II contributions for pensionable earnings above the LEL. The LEL is the amount gazetted by the Cabinet Secretary as the average minimum monthly basic wage for top urban centres, second tier urban centres and rural areas for the year. A sample computation of Tier I and Tier II contributions is as indicated below.

Ref	Employee Earnings	Pensionable Earnings	Tier I Pensionable Earnings	Tier I Employee deduction	Tier I Employer Contributions	Tier I Total contributions	Tier II Pensionable Earnings	Tier II Employee deduction	Tier II Employer Contributions	Tier II Total contributions	Total pension contributions
1	3,000	3,000	3,000	180	180	360	-	-	-	-	360
2	4,500	4,500	4,500	270	270	540	-	-	-	-	540
3	6,000	6,000	6,000	360	360	720	-	-	-	-	720
4	10,000	10,000	6,000	360	360	720	4,000	240	240	480	1,200
5	14,000	14,000	6,000	360	360	720	8,000	480	480	960	1,680
6	18,000	18,000	6,000	360	360	720	12,000	720	720	1440	2,160
7	20,000	18,000	6,000	360	360	720	12,000	720	720	1440	2,160
8	100,000	18,000	6,000	360	360	720	12,000	720	720	1440	2,160
9	500,000	18,000	6,000	360	360	720	12,000	720	720	1440	2,160

The above computation is based on the provided UEL of KES18,000 while the LEL (KES6,000) is the amount prescribed by the NSSF Act for Year 1. In Year 1, the maximum amount contributed, is KES 2,160 where employee and employer would equally share the amount irrespective of the actual income of the employee.

Going forward, the UEL will be varying and will be determined by the Kenya National Bureau of Statistics in the Economic Survey for the prior year. The UEL will be equivalent to the four times the National Average Earnings per employee as published by the KNBS. That said, the implementation of the Upper Earning Limit was to be phased over a 5-year period. The progression of the UEL as well as LEL will be determined as follows:

PROGRESSION OF RATES OF CONTRIBUTIONS.		
Year	Lower Earnings Limit (KES)	Upper Earning Limits
1	6,000	50% of National Average Earnings
2	7,000	1 times National Average Earnings
3	8,000	2 times National Average Earnings
4	9,000	3 times National Average Earnings
Year 5 onwards	LEL as provided in the Act	4 times National Average Earnings

Other considerations

Contracting out by Employer

The Act gives an employer an option to opt out with respect to Tier II contributions only to a contracted- out scheme. The employer can opt out if the following conditions are met:

(a) the employer shall make written request of its intention to opt out to the Authority at least sixty days before opting to contract-out;

(b) the written request required under paragraph (a) shall clearly set out such details of the contracted-out scheme as the Authority shall require from time to time in order to ascertain that the contracted-out scheme meets the Reference Scheme Test;

(c) within thirty days from the date of receiving the written request and provided that the contracted- out scheme satisfies the Reference Scheme Test specified in the Fourth Schedule, the Authority shall respond in writing indicating its approval or otherwise to the employer and notify the Board accordingly.

(d) where such approval is received, Tier II Pension Fund Credits in respect of the employees shall be transferred from the Pension Fund to the approved contracted- out scheme; and

(e) the contracted-out scheme shall maintain an accurate record of Protected Rights which shall be paid in the same manner as for benefits in respect of Tier II Contributions as prescribed in the Act.

B) VAT-Taxation of export of services!

Background

The Finance Act 2022 (“the FA”) introduced new changes by deleting the section that provided for exemption of exported services and introduced a new paragraph zero rating of exported services with respect to Business Process Outsourcing (“BPO”). This meant that the export of services other than services under BPO are taxable at the standard rate of 16% with effect 1st July 2022. That said, the FA didn’t provide for definition or clarification of what constitutes the BPO.

In view of the above, some stakeholders went to court to challenge the imposition of VAT on exported services as introduced by the FA. This culminated in a judgement dated 31st January 2023 where the High Court of Kenya dismissed the petition.

While the law is not clear on what constitutes BPO, the judgement means that the revenue authority can start demanding taxes on exported services. We expect numerous litigations between KRA and taxpayers owing to differing interpretation of what constitutes zero rated services vis-à-vis export services offered under BPO.

Conclusion

The new NSSF contributions will have an impact on both the employer and the employee. For employer, this would be an additional business cost if they opt to adopt the new contributions without altering the current pension arrangements. For the employee, it would mean a lower disposable income, however, with increased savings for the retirement. To this end, NSSF issued a statement on 9 February 2023 advising the employers to start complying immediately.

With respect to the VAT on export of services, it our view that the Kenyan tax policies need to be aligned with international best practices where other jurisdictions don't tax exported services. Otherwise, Kenya will be considered uncompetitive and unpreferred hub for business purposes.

Get in touch.

Should you require any clarification on this, please feel free to contact any of our experts listed in below for further information.

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