AN OVERVIEW OF THE TAXATION OF SAVINGS AND CREDIT CO-OPERATIVES SOCIETIES (SACCOS) IN KENYA

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ABSTRACT

SACCOs play a central role in Kenya's national development agenda. This is evident from the growing number of SACCOs in Kenya today. Their important role in the economy therefore, augments the need to understand the origin and the tax implications of SACCOs. This overview has three goals. First, it seeks to briefly introduce the cooperative movement in Kenya and to analyze its legal, regulatory and supervisory framework. Second, the overview aims to show how SACCOs are taxed under the current Income Tax Act. Finally, it reviews the proposed changes to the taxation of SACCOs under the Income Tax Bill, 2018 and makes a case for SACCOs to be exempt from the income tax.

Keywords: Cooperatives, tax, Kenya, SACCOs.

1. INTRODUCTION

The SACCOs sector in Kenya is nascent yet critical in the financial system. Acknowledging its impact in the economy, the government through the Ministry of Industry, Trade and Co-Operatives (MoITC) is formulating a policy paper titled "Promoting Co-operative Societies for Industrialization" aimed at transforming co-operatives in a dynamic and competitive global environment. Underscoring the important role that SACCOs play in community development and to economic growth, this paper seeks to discuss how they are taxed under the current income tax regime.

The rest of this overview is structured into 4 parts. Part 2 reviews the cooperative movement in Kenya, Part 3 assesses the role that SACCOS play in economic development. Part 4 discusses the legal, regulatory and supervisory framework governing SACCOs. Part 5 highlights the proposed changes to the taxation of SACCOs under the Income Tax Bill. Part 6 offers conclusion.

2. BACKGROUND TO THE COOPERATIVE MOVEMENT

Robert Owen (1771-1858) is often regarded as the founder of the cooperative movement, however, cooperation has a longer history in practice.[1] Cooperation is historic and has been fundamental to any social grouping whose members cooperate for a specific purpose or activity. By the definition approved by the International Co-operative Alliance[2] and the International Labour Organization[3], a cooperative

[1] Mary Mellor and others, *Worker Cooperatives in Theory and Practice* (Open University Press, 1988) 1.
[2] ICA, Bylaws, April 11 2013, art 5
[3] ILO, 'Cooperatives' < https://www.ilo.org/global/topics/cooperatives/lang--en/index.htm> accessed 5 March 2019.

is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. Claudia S Bajo and Bruno Roelants[4] observed that the word *through* in the definition indicates that the '*enterprise*' character of a cooperative is subordinated to its character of '*association of persons*' which imply that the decision-making system is based on persons and not on capital. Hence, in Kenya, taxation has focused on dividends earned by the members instead of their contributions towards the capital of the cooperative. Further, the associations of persons develop its activities through an enterprise that is '*jointly owned and democratically controlled*'[5] The volunteer aspect is oriented to enhancing the services of the organization for its membership.[6] However, members must adhere to values of the cooperative and accept any responsibilities assigned to them.

The cooperative movement in Kenya began during the colonial era and was exclusively reserved for white settlers who established the first cooperative society called the Lumbwa Rift valley in 1908.[7] In 1931, the colonial government enacted the Cooperative Societies Ordinance which established the Office of Registrar of cooperatives to oversee the registration, supervision and dissolution of cooperatives. The Ordinance did not allow the participation of Africans in cooperatives. However, this changed in 1945 with the enactment of a new Cooperative Societies Ordinance which encouraged the formation of African owned cooperatives. During this period, the cooperative sector was divided between black owned cooperative which catered for small scale farmers and were often economically weak and white owned cooperatives whose members were large scale farmers.[8]

Following independence in 1963, the government embraced the cooperatives sector as a strategy for achieving "African Socialism" through the Sessional Paper No. 10 of 1965 – 'African Socialism and its Application to Planning' which incorporated principles that would drive the countries development agenda. The first post-independence statute was the Cooperatives Societies Act (cap 490) enacted in 1966 and later revised in 1972 together with the Cooperatives Societies Rules 1969. The Act stamped

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[4] Claudia Sanchez Bajo and Bruno Roelants, *Capital and the Debt Trap: Learning from Cooperatives in the Global Crisis* (Palgrave Macmillan, 2011) 116.
[5] Ibid.
[6] Laurie Mook and others, *What Counts Social Accounting for Nonprofits and Cooperatives* (2nd edn Sigel Press, 2007) 30. See e.g. s 4 of the Cooperative Societies Act No. 12 of 1997 which states that a society may be registered under the Act if it incorporates in its bylaws the principles of voluntary and open membership.
[7] Ministry of Industry, Trade and Cooperatives. Historical background of Cooperatives in Kenya. <http://www.industrialization.go.ke/index.php/downloads/123-history-and-organization-of-cooperative-development-and-marketing-sub-sector-in-kenya> accessed 7 May 2019.
[8] Andrew Emmanuel Okem (eds), *Theoretical and Empirical Studies on Cooperatives: Lessons for Cooperatives in South Africa* (Springer 2016), 56.

governments control over the affairs of cooperatives. For instance, the Commissioner, who was appointed by the president, had powers to register and deregister cooperatives, approve annual budget and authorize borrowing and expenditure amongst others.[9]

In 1970, the Sessional Paper No.9 was introduced whose aim was to improve the overall management of cooperatives. Its revision in 1975 recognized the vital role cooperatives play in national development. It was in 1997 that the government's control over cooperatives was limited and independence of cooperative emphasized following the introduction of Sessional Paper No. 6 of 1997 and the subsequent enactment of Cooperatives Societies Act No.12 of 1997 (the current Act) which provided for the constitution, registration and regulations of cooperatives. These reforms aligned the sector with the internationally recognized principles and values of the cooperative movement.

3. SACCOS: A BRIEF INQUIRY INTO THEIR DEVELOPMENT IMPACT IN KENYA

The economic role of cooperatives is widely recognized.[10] Indeed, its primary role is to meet its member's needs as it provides higher income and social protection. Thus, cooperatives yield to its members an opportunity that uplifts them from poverty.[11] In Kenya, it is a major contributor to national development.[12] MoITC, State Department of Co-operatives states that by the end of 2016, there were more than 18,573 registered co-operative societies cutting across all sectors of the economy and spread all over the country with a total membership of over 14 million members.[13]

In terms of assets, five SACCOs had accumulated assets above kshs 150 billion by the year ending 31 December 2018. These are; Mwalimu National SACCO with accumulated assets worth kshs 46 billion, followed by Stima SACCO with kshs 32 billion. Others are Kenya Police Service SACCO with 29 billion,[14] Harambee SACCO with 26 billion, a 2% increase from the previous year[15] and Afya SACCO

[9] Ibid, 57.
[10] (n 6), 13.
[11] Dogarawa Ahmad Bello, 'The Role of Cooperative Societies in Economic Development' MPRA Paper No. 23161 (2009) <https://mpra.ub.unimuenchen.de/23161/1/The_Role_of_Cooperatives_in_Economic_Development.pdf> accessed 7 May 2019.
[12] See the Kenya vision 2030, a blueprint for the country's development programme which recognizes cooperatives as institutions that facilitate the growth of the agricultural sector, at p.51.
[13] Ministry of Industry, Trade and Co-Operatives, 'Co-operative Development Policy: "Promoting Co-operative Enterprises for Industrialization"' <file:///C:/Users/User/Downloads/Revised%20National%20Cooperative%20Policy%20%20%20040620171.pdf> accessed 5 March 2019.
[14] Kenya Police Service SACCO limited, Annual Report and Financial Statement 2018.
[15] Harambee SACCO Limited, Annual Report and Financial Statement 2018 <https://www.harambeesacco.com/wp-content/uploads/2019/04/ANNUAL-REPORT-AND-FINANCIAL-STATEMENTS-FOR-THE-YEAR-ENDED-31-DECEMBER-2018.pdf> accessed 4 June 2019.

which amassed kshs 17 billion. The total comprehensive income for Kenya Police SACCO and Mwalimu National SACCO in the same period was kshs 1.7 billion and 613 Million respectively.[16] Around the world, the turnover of the top 300 cooperative and mutual enterprises topped $2,018.02 billion according to the World Cooperative Monitor 2018.[17] The report collected data from 2,575 organizations distributed in 26 countries showed that not only do cooperatives generate income for their members, but they also contribute to achieving sustainable development goals.[18]

Although the Cooperative Societies Act No. 12 of 1997 is silent on the types of cooperative societies, several types of cooperative enterprises have emerged as matter of practice over the years.[19] One of which is the SACCOs[20] whose objective is to transact the business of mobilization of savings, and advancement of credit facilities to their members.[21] In Kenya, there has been a rapid growth of SACCOs following the formation Kenya Union of Savings and Credit Cooperatives in 1973, an umbrella of all SACCOs societies in the country.[22] Generally, SACCOs are categorized by the nature of savings and deposits that they mobilize from their membership. The first category consists of the deposit-taking SACCOs (DT-SACCOs)[23], while the second consists of the non-deposit-taking SACCOs (non-DT-SACCOs).24

DT-SACCOs are significant players in providing credit to households.[25] According to the 2017 SASRA Annual Report[26] the total assets for DT-SACCOs increased to reach Kshs 442.27 billion in 2017 reflecting a growth rate of 12.4% from the previous year. The total loans on the other hand grew to reach Kshs 331.2 billion reflecting a growth rate of 11.29% from the previous year; while deposits grew to reach Kshs 305.3 billion reflecting a growth rate of 12% from the previous year.

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[16] Mwalimu National SACCO Limited, Audited Financial Statements <https://www.mwalimunational.coop/images/docs/2019/2018-MNS-Financials.pdf >

[17] ICA and Euricse, World Cooperative Monitor: Exploring the Cooperative Economy, 2018. <https://www.ica.coop/sites/default/files/publication-files/wcm2018-web-1542524747.pdf> accessed 7 May 2019.

[18] Ibid, 43.

[19] The SACCO Supervision Annual Report 2017, 19. <file:///C:/Users/User/Downloads/SaccoSupervisionReport2017.pdf> accessed 5 March 2019.

[20] Others types include: the marketing and/or consumer cooperative enterprises; b) the production cooperative enterprises; c) the housing and/or investments cooperative enterprises and the transport cooperative enterprises.

[21] (n 11), 12.

[22] UN Habitat, The Organization, Management and Finance of Housing Cooperatives in Kenya (2010)

[23] DT-SACCOs are those that take demand deposits while non-DT-SACCOs mobilize deposits from their members; which utilized as collateral for credit facilities advanced to its members.

[24] (n 9), 22.

[25] Ibid.

[26] (n 19), 9.

Moreover, the 2019 Financial Access Household Survey[27] reported that the credit uptake through SACCOs increased from 4.2% in 2006 to 5.1% in 2019. The Survey findings also showed that the overall access to formal financial services and products which include DT-SACCOs improved from 75.3% in 2016 to 82.9% in 2019.[28]

Since SACCOs are capable of earning income in their own right, the question then arises on how this income is taxed. Therefore, the following part will discuss the legal, regulatory and supervisory framework governing their operations and thereafter the taxation of SACCOs will be considered.

4. LEGAL, REGULATORY AND SUPERVISORY FRAMEWORK FOR SACCOS AND THEIR TAXATION

Until 1997, cooperatives were governed by the Cooperative Societies Act No. 12 of 1997.[29] The first statute enacted specifically to govern SACCOs was the SACCO Societies Act No. 14 of 2008 (SSA) which provides for their licensing, regulation, supervision and promotion. The SSA delineates the core mandates of SACCOs as follows;

> "Sacco business" means financial intermediation and any other activity by a Sacco society based on co-operative principles and in accordance with this Act, or in compliance with Islamic law by way of—
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> a) receipt of withdrawable deposits, domestic money transfer services, loans, finance advances and credit facilities; or
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> b) receipt of non-withdrawable deposits from members and which deposits are not available for withdrawal for the duration of the membership of a member in a Sacco society and may be used as collateral against borrowings providing finance and domestic money transfer services;

The regulation governing DT-SACCO business was enacted in 2010. It delineates, amongst others, licensing and minimum capital requirements as well as provisions on shares, savings and deposits and

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[27] FinAccess Household Survey: Access, Usage, Quality and Impact, April 2019. <https://www.centralbank.go.ke/wp-content/uploads/2019/04/2019-FinAcces-Report.pdf> accessed 7 May 2019

[28] Ibid, 8.

[29] Although this may appear to be the case, SACCOs must be registered as cooperatives under the CSA. See section 2 of the SSA.

credit management. Following the enactment of the Constitution in 2010, cooperative societies falls to be governed by county governments.[30] However, this is not reflected in the current legal framework. Instead, SACCOs are supervised by Sacco Societies Regulatory Authority,[31] which licences, regulate and supervise SACCO societies; hold, manage and apply the general fund of the Authority; levy contributions and perform other functions assigned to it by the cabinet secretary for Industry, Trade and Cooperatives. The board of the authority also established under SSA performs the oversight and management functions. Against the foregoing background, this overview will now focus on the taxation of SACCOs.

The CSA and SSA are the main statutes governing cooperative societies in Kenya. Per contra, the Income Tax Act (ITA),[32] which generally provides for the administration of income tax, covers the tax base, tax paying unit and how to tax[33] with respect to SACCOs.[34] The Constitution of Kenya however sets the foundation and commands that the burden of taxation shall be shared fairly.[35] It introduced a two-tier system of government, national and county government, both of which have power to impose taxes and charges. For the national government, it may impose income tax VAT, excise tax and customs duties and other duties on import and export goods.[36] A county may impose property rates, entertainment taxes and any other tax that is authorized to impose by an Act of Parliament.[37]

The ITA was enacted in 1973 replacing the East Africa Income Tax (Management) Act of 1958 (EAITA), which had served the East African Community. Under the EAITA, cooperative societies were tax exempt if their gross income for an accounting period divided by the number of members did not yield over 150 British pounds.[38] Following the enactment of the ITA, the taxation of cooperatives remained the same as they were under the EAITA. However, the government initiated reforms for the taxation of cooperatives in the budget speech delivered on 23rd June 1983. The government stated that the confusion in the taxation of cooperatives necessitated the need to harmonize the tax treatment.[39] Thus the Finance Act

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30 Constitution of Kenya 2010, art 186, Fourth Sch.
31 SACCO Societies Act No. 14 of 2008, s 4.
32 Chapter 470 Laws of Kenya.
33 This includes choices relating to rates, credits and deductions, and special provisions such as exemptions.
34 For prerequisites in the design of a tax system, See Patrick Emerton and Kathryn James, 'The Justice of the Tax Base and the Case for Income Tax' in Monica Bhandari (eds), *Philosophical Foundations of Tax Law* (1st edn, Oxford University Press, 2017), 125.
35 (n 30) art 201(b) (i).
36 Ibid, art 209(1).
37 Ibid, art 209 (3)
38 East Africa Income Tax (Management) Act 1958, 5th Sch.
39 Bosire Nyamori, 'Taxing Cooperative Societies', 20 Derivatives & Financial Instruments IBFD (2018),5.

1985 was enacted two years later amending section 19 of the ITA[40] by including section 19A, which is still applicable today. This section provides for the taxation of cooperatives societies as well as SACCOs.

Section 19A (4) delineates the manner in which SACCOs are taxed. It provides that the income for SACCOs on which tax shall be charged, shall be its total income for the year of income which is the aggregate of 50% of the gross income other that interest from its members which is tax exempt.[41] Since the primary source of income for SACCOs is the interest from loans, the tax liability on that interest depends on whether it is earned from members or non-members. Therefore, whilst interest from members is tax exempt as stated above, 50% of the interest from non-members will be subject to tax.[42]

The total income within the meaning of section 19A (4) also covers income subject to tax such as rents, gains, dividends or interest, capital gains and commissions which are subject to taxation under specified sources of income in the Income Tax Act.[43] The qualifying dividend rate of tax applying to dividends paid by SACCOs to resident persons is set at the resident withholding tax rate of 5%. They are categorised as qualifying dividends because they are not listed under Section 2 of the ITA which provides that a qualifying dividend is "that part of the aggregate dividend that is chargeable to tax under section 3(2)(b) and which has not been otherwise exempted under any other provision of this Act, but shall not include a dividend paid by a designated co-operative society subject to tax under section 19A (2) or 19A (3)."[44]

As pointed above, interest from loans to members is tax exempt, this is based on a well-established principle of mutuality.[45] However, SACCOs are liable to pay taxes such as rents, capital gains and dividends which is at the withholding tax rate of 5%. Part 5 will discuss the status of this withholding tax rate in light of the proposed Income Tax Bill.

[40] Finance Act No. 8 of 1985, s 20.
[41] Ibid, s 19A (4) a.
[42] Nyamori, (n 39), 8.
[43] (n 32) see generally s 3(2) and the Eighth sch.
[44] Section 19A (2) and (3) provides for the dividends paid by apex societies and primary societies respectively. These dividends are not 'qualifying dividends'.
[45] According to this principle, no income accrues when a common group of persons contributes to and participates in a common fund with an expectation that the amount would be spent for a common good or on objectives that will benefit all the contributors. See EY Tax Alert, 'SC upholds the principle of mutuality in case of transactions between members and co-operative societies' <https://www.ey.com/Publication/vwLUAssets/prin_Mutual/$FILE/prin_Mutual.pdf> accessed 6 June 2019.

5. PROPOSED CHANGES TO THE TAXATION OF SACCOS

The Kenyan government, through the National Treasury has proposed for enactment the Income Tax Bill 2018 (ITB) which seeks to overhaul the ITA in order to support the government's Big Four Agenda[46] and to take into account the international best practice in relation to income tax laws.[47]

The new provision on SACCOs in the ITB seeks to increase the resident withholding tax rates on dividends from 5% to 10% of the amount payable.[48] Notably, the income on which tax shall be charged shall be its total income for any year of income; which is the aggregate of all income except interest from its members.[49] Although it was widely reported by the Kenyan media in February 2019[50] that the proposed changes had taken effect, research shows that the reports were inaccurate since the ITB has not yet been enacted. The media reports elicited indignations among Kenyans, some of who termed the move as 'punitive'.[51] In light of these reactions, the question then arises whether the proposed changes are necessary. In other jurisdiction such as Tanzania SACCOS are tax exempt.[52] Comparably, in Uganda, SACCOS are tax exempt for 10 years from 1 July 2017 until 30 June 2027.[53] Therefore, law makers should consider the views of the public and the role that SACCOs play in development and shelve the proposed changes. At best, law makers should emulate the practice in Uganda and Tanzania and exempt SACCOs from paying income tax.

6. CONCLUSION

The Cooperative sector in Kenya is recognized as one of Africa's most successful cooperative movement. SACCOs are instruments in socio-economic development of its members and communities

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[46] The Big Four Agenda is the government's strategic agenda projected to spur economic growth over the next five years. The four action plans include; enhancing manufacturing, food security and nutrition, universal healthcare coverage and affordable housing,
[47] The National Treasury, Public Notice on the Draft Income Tax Bill, 2018 < http://www.treasury.go.ke/media-centre/news-updates/478-the-draft-income-tax-bill-2020.html> accessed 5 June 2019.
[48] Income Tax Bill 2018, Third sch s6 (a) ii.
[49] Ibid, s 28(3).
[50] The Star, 'Sacco savers dividends drop as tax takes effect' 19 February 2019 <https://www.the-star.co.ke/news/2019/02/19/sacco-savers-dividends-drop-as-tax-takes-effect_c1896528>; see also,
The Star, 'Outrage as new sacco tax burden hits savers' 20 February 2019 <https://www.the-star.co.ke/news/2019/02/20/outrage-as-new-sacco-tax-burden-hits-savers_c1897168>.
[51] In response to a tweet by the Star Newspaper on 19 February 2018, Zablon Mbogo (@64081da2fa1b447) tweeted "Blatantly day light theft, this is too punitive to sacco savers".
[52] Income Tax Act 2004, s 24 of the 2nd Schedule.
[53] See s 4 of the Ugandan Income Tax (Amendment) Act 2017 which amended s 21 of the Income Tax Act CAP 340.

as it encourages savings, create employment opportunities, improves member's income and living conditions. Thus, if law makers desire to advance the growth of SACCOS, it is imperative to exempt them from paying income taxes. After all, SACCOs pay taxes on real estate, employment, utilities just like all other businesses.

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