KENYA BUDGET HIGHLIGHTS 2019/2020

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ECONOMIC OVERVIEW

- The Kenyan economy grew by 6.3% and 4.9% in 2018 and 2017 respectively. It is expected to grow at the same level of 6.3% in 2019. This will be driven by improved business environment, good weather, public infrastructural investments, stable macroeconomic environment and strong service sector.

- The average economic growth for sub Saharan Africa region and the global economy was 3% in 2018 and 3.6% in 2017.

- Inflation is expected to remain within the target of 5% in 2019.

- The proposed 2019/2020 budget stands at KES 2.8 trillion. This will be financed by revenue collection of KES 2.1 trillion and the deficit of KES 608 billion to be financed by external and domestic borrowing of KES 324 billion and KES 284 billion respectively.

- The focus of the 2019/2020 budget is to fulfill the big four agenda of universal health coverage, affordable housing, increasing manufacturing contribution to the economy and food and nutrition security. KES 451 billion has been allocated to the big four planned drivers and enabling sectors.

- **Universal health coverage (UHC):** A total amount of KES 48 Bn has been allocated to UHC with allocation to Kenyatta and Moi referral hospitals, internship programmes, Kenya Medical Research Institute and Kenya Medical Training Centres.

- **Affordable housing:** KES 10.5 Bn has been allocated to cater for the construction of affordable housing units. The Kenya Mortgage Refinance Company has also received capital injection of KES 37.6 Bn from various development partners to assist in meeting the affordable housing agenda.

- **Increasing manufacturing contribution to GDP:** Government has completed the revival of RIVATEX expected to employ over 3,000 persons. To further support the manufacturing agenda, the government has allocated KES 4.2 Bn for the development of textile and leather parks, the growth of SMEs, Constituency Industrial Development Centers and Kenya Industrial Research and Development Institute (KIRDI). Further electricity rebates will be given to manufacturers.

- **Improving food and nutrition security:** The agricultural sector has been allocated KES 18.2 Bn to enhance food security in the country with irrigation being allocated the highest amount of KES 7.9 B.

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- The other enablers of the big four agendas which have been allocated significant fund are the following: critical infrastructure (KES 338.5 Bn), security (KES 326.5 Bn), education (KES 209.8 Bn), fight against corruption (KES 79.34 Bn), digital economy (KES 22.3 Bn), protection of vulnerable members of society (KES 33.5 Bn) and equitable regional development (KES 49.8 Bn)

Budget estimates

	FY2018/2019 KES (Billion)	FY2019/2020 KES (Billion)
Total Revenue	1,901	2,154
Total expenditure	2,509	2,762
Deficit	(608)	(607)
Funded by: External borrowing	287	324
Domestic borrowing	321	283

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- The total public debt requirement for FY 2019/2020 is expected to decline by 0.03% to KES 607.8 bn from KES 608 bn in FY 2018/19. In FY 2019/2020 there will be more foreign borrowing than domestic borrowing compared to last fiscal year.

- There will be an increase in foreign borrowing by 13% and a decrease in domestic borrowing by 11.7%. A decrease in domestic government borrowing is welcome to reduce the crowding out of the private sector funding.

- The public debt to GDP ratio is currently at 60.0% (inclusive of the USD 2.1bn Eurobond issued in May 2019). This is 10% above the EAC Monetary Union protocol, the World Bank Country Policy and Institutional Assessment Index, and the IMF threshold of 50%.

- The country ought to focus to other non-debt financing arrangements such public-private partnerships (PPPs) to fund infrastructural projects.

- The budget this year is focused on improving expenditure efficiency. A zero-based budget has been adopted to weed out non-priority expenditures. No new projects can start unless ongoing projects are completed.

- Other expenditure reduction areas include public sector wage bill, domestic and foreign travel, government office leasing, procurement and pension reforms.

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New income tax bill

- The Cabinet Secretary has indicated that the new Income Tax Bill is at its advanced stage of legal drafting and will soon be submitted to Parliament for enactment. The bill is expected to modernize the Income Tax Legislation and replace the current one that has been in operation since 1974. Because of the expected comprehensive overhaul of the Income Tax Act (ITA) in the same way the VAT Act was overhauled and repealed in 2013, there are minimal changes to the current Income Tax Act as outlined below.

Capital Gains Tax ("CGT")

- Proposal to increase the rate of CGT from 5% to 12.5% aimed at harmonizing the rate with other jurisdictions, including the East Africa Community region, where the rates range between 20% to 30%.

- Transfer of property that is necessitated by the restructuring of corporate entities to be exempted from Capital Gains Tax.

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Withholding Tax

❑Scope of the application of withholding tax has been expanded to include the following services:

- Security services;
- Cleaning and fumigation services;
- Catering services offered outside hotel premises;
- Transportation of goods excluding air transport services;
- Sales promotion; and
- Marketing and advertising services.

Incentive for investment in plastic recycling

❑Proposal to lower the corporate tax rate to 15% for the first five years for any investor operating a plastic recycling plant. See other incentives covered under VAT.

Dividends distributed out of untaxed gains

❑The bill proposes to amend provisions of Section 7A by excluding income that is exempt from tax. It clarifies that dividends paid out of income that is exempt from tax under the Act shall not be subjected to the 30% tax rate.

Taxable income of non-resident ship owners

❑The scope of taxable income of non-resident ship owners has been expanded to include all income of a non-resident shipping line derived from Kenya. Agents of the non-residents ship owners will be liable for accounting for the tax on such income.

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Repeal of the provisions relating to WHT on demurrage charges

❑Proposal to delete provisions relating to withholding tax on demurrage charges so as to align it with the provisions for taxation of non-resident ship owners under section 9(1) of the ITA. WHT on demurrage charges was introduced last year under the Finance Act, 2018.

Withholding tax for reinsurance premiums paid to non- residents

❑The bill clarifies that the reinsurance premiums paid to non-residents are subject to withholding tax.

WHT to apply on payments made by a Permanent Establishment (“PE”) to its Head Office

❑Expenses which would be allowable for a branch as provided for by a DTA will now be subject to withholding tax. The proposal is aligned with the provisions of Section 10 and Section 3 of the ITA which requires that all income accrued or derived from Kenya are taxable.

Reintroduction of Turnover Tax ("TOT")

- The Bill proposes to reintroduce TOT at the rate of 3% of the gross receipts of the business, now payable monthly. This will apply to any resident person whose turnover does not exceed or is not expected to exceed KES 5 million shillings per annum. The presumptive tax introduced in January 2019 will be maintained as a minimum tax meant to enable the Commissioner to obtain information.

Removal of Section 72D of ITA

- The section provides for a 20% penalty for late payment of tax. The bill proposes to have it deleted since the same penalty is provided under Section 83 A of the Tax Procedures Act at 5%. This is basically a cleanup of the Act.

Exemption of investee companies of Real Estate Investment Trusts (REITS)

- Proposal to expand the exemption of income of REITS to include the investee companies of the REITS. This will enable REITS to achieve its objectives given that it will exempt the income of investee companies.

National Housing Development Fund ("NHDF")

- The bill proposes to exempt income of the NHDF. This will maximize the funds available for implementation of one of the Big 4 Agenda of providing affordable housing to Kenyans.

Ajira Digital Program

- Program set up by the government through the ministry of ICT in partnership with Academia, Civil Society and the Private Sector with an aim to bridge the gap between skills available and skills demand. The Project targets to enable over one million youths annually to be engaged as digital freelancers.

- The government proposes that youth registered in the program pay a registration fee of KES 10,000 for the next three years in lieu of income tax with effect from 01 January 2020. Accordingly, the ITA will be amended in order to exempt registered members from regular taxation for the specified period.

Affordable Housing Relief

- Proposal to amend the base of the affordable housing relief from 'gross emoluments' to 'employee's contribution'. The affordable housing relief was introduced by the Tax Laws (Amendment) Act, 2018 that provided that the relief shall be 15% of the gross emoluments but with a capping of KES 108,000.

- However, using the gross emolument as the base may result in individuals getting relief in excess of their contribution hence the amendment.

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Framework for energy relief to the manufacturing sector

- The Income Tax Act was amended last year to provide for an additional 30% deduction of the cost of electricity subject to the conditions to be set by the Ministry of Energy. The framework to be used has now been developed by the Ministry of Energy in consultation with the Ministry of Industry, Trade and Cooperative Development.

- It is expected that the incentive will lower the cost of electricity to manufacturers and make products competitive in the region.

- The country ought to focus to other non-debt financing arrangements such public-private partnerships (PPPs) to fund infrastructural projects.

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Digital Economy

- Section 3 of the ITA has been expanded to include income accruing through a digital market place. The term digital market place has been defined to mean *“A platform that enables, by electronic means, direct interaction between buyers and sellers of goods and services.”*

- The CS has proposed a raft of tax measures aimed at creating a platform for taxation of income generated from digital economy. This has been triggered by the unequalled reliance on intangibles, the massive use of data, the widespread adoption of multi sided business models as well as the difficulty in determination of the jurisdiction in which value creation occurs.

- Supplies made through a digital market place are subject to VAT. “Digital market place” means a platform that enables; by electronic means direct interaction between buyers and sellers of goods and services. The proposal makes it clear that transactions on the digital platform are subject to VAT.

- Section 12 has been amended to define time of supply of imported goods to include the time the goods are removed from the Special Economic Zone (SEZ). This is meant to clarify that the time of supply of imported goods shall include the time the goods are removed from the SEZ.

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Definitions

- Supply of imported services has been redefined to apply to non-registered persons in addition to registered persons. The amendment will expand the revenue base by ensuring that persons importing vatable services pay VAT.

- Concessional loan has been defined to mean a loan with at least 25% grant element.

- The definition brings clarity as to what amounts to a concessional loan for the purpose of an official aid funded project which is eligible for VAT exemption.

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VAT regulations

- Regulation 8 - VAT refund formula to determine amount due as a refund for registered persons supplying both zero rated and standard rated supplies has been amended as follows:

R=Z/T*i

R - is the value of input tax relating to zero rated supplies.

Z - is the total value of the zero rated supplies.

T - is the total value of the taxable supplies; and

I - is the deductible input tax for the month of supply

- Regulation 13(1) - Exported services do not depend on where the payment is made from. This is meant to bring clarity.

Value Added Tax Withholding

- The tax rate has been reduced from 6% to 2% of the taxable value. This will counter build-up of huge VAT credits which are not refundable as per the VAT Act and enhance the cash flows of businesses.

First Schedule of VAT Act

- Locally manufactured motherboards and all inputs used in their manufacture have been proposed to be exempted from VAT subject to the approval of the Cabinet Secretary responsible for Information communication Technology.

First Schedule of VAT Act

- This will enable motherboard products of local manufacturers to become more competitive in the market.

- Services offered to plastic recycling plants and supply of plant, machinery and equipment used in the construction of these plants will now be exempt from VAT. This will promote plastic waste management by encouraging recycling of plastic waste thus protecting our environment.

- Cabinet Secretary responsible for energy has been mandated to guide or recommend entities for the specific exemption in relation to Specialized solar equipment and accessories, including solar water heaters and deep cycle-sealed batteries which exclusively use or store solar power.

- Only tractors used for agricultural purposes will be exempt from VAT.

- Agricultural pest control products will now be exempt from VAT. This is meant to make pest control products affordable to farmers for agricultural productions thus enhance food security.

First Schedule of VAT Act

- 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 upon recommendation by the Cabinet Secretary for the time being responsible for industrialization have been moved from zero rated to exempt.

- The word stock has been replaced with securities. The VAT exemption now relates to securities brokerage services.

Second Schedule of VAT Act

- Denatured ethanol has now been moved from Standard rate to zero rated for VAT purposes.

- Large accumulation of VAT Refunds will be processed and paid within two months to enhance cash flow of the export sector and other suppliers of zero rated goods and services

Administrative changes

Pre-Import Verification

- In a move aimed at reducing delays and demurrage charges at the ports of importation (such as ICD Nairobi), the CS has committed to have Pre-Verification of Conformity (PVOC) undertaken in the countries of origin to be tentatively conclusive.

- Local verification to take place only where non-compliance is suspected.

- Red tape at the Inland Container Depot to be reduced to basic essential steps.

- KRA to Implement Integrated Customs Management System (ICMS)

- ICMS system is a new customs management system which is geared toward greater efficiency of cargo clearance, reduction in manual interface and improving integration with external platforms such as those of other EAC revenue authorities.

Customs duties

Metal and Allied Sectors

- Kenya to retain the ad valorem rate of import duty at 25% on a wide range of products to protect local industry from competition arising from cheap and subsidized imports.

Paper and Timber

- A 25% duty rate on imported products is to apply for one year to protect local industry from competing products. The CET rate is 10%.

- Import duty on raw timber is reduced from 10% to 0%.

- Duty rate on finished timber products to be increased to 25%.

Excise duty

Items	Current Rate	Proposed Rates
Betting Stakes	0%	10%
Electric Powered cars	35%	10%
Cigarettes ,Wines & Spirits	Specified	15% Increase
750 ml Bottle of Wine	118	136
750 ml Bottle of Whisky	158	182
20 Cigarettes Packet	53	61

Tax Amnesty

- Small and Medium Size Enterprises (SME's) were offered favourable listing conditions under a Government initiated Growth and Enterprise Market Segment (GEMS). The listing has not been impressive due to tax liabilities the SME's may have accrued in the past and which has not been disclosed to the tax authorities. As a further incentive to encourage listing, a tax amnesty to waive penalties and interest for any year prior to the date of listing where it makes a full disclosure for the immediate past two years and pays the principal tax in full. A company that delists before expiry of five years will pay taxes, penalties and interest for the years prior to listing.

Tax Registration

- Foreign investors and privileged persons investing in Kenya especially in the financial markets have had difficulties when opening local bank accounts because of the requirement to obtain a tax registration certificate (KRA PIN). To ease this challenge the Commissioner of Domestic Taxes will have powers to grant exemptions from the KRA PIN requirement under such circumstances.

Recovery of Taxes from Principal officers

- The proposed law provides that for any person who fails to deduct or withhold taxes, the Commissioner may recover the tax, penalties and interest as if it was tax due from them. This provision therefore shifts the burden to an officer of the company.

Departure Prohibition Order (DPO)

- A person who has committed tax crimes may be prohibited from departing from the country. The Bill proposes to include the following persons: CEO, managing director, company secretary, treasurer, trustee, director or a similar officer acting in such position.

Commissioner's Objection Decision,

- The current practice is that upon objection to a tax decision by a taxpayer the Commissioner is under obligation to respond within 30 days. This timeline has now been extended to 60 days to ensure the Commissioner has adequate time to engage the taxpayer and make informed decisions.

Transactions Mandatory with KRA PIN

- The following transactions will be conducted with PIN as a requirement:

- Registration and renewal of membership by professional bodies and other licensing agencies; and
- Registration of mobile cellular pay bill numbers and till numbers by telecommunication operators.
- The intention of this requirement is to give KRA access to data on active professionals and other self employed persons.

Fuel Adulteration Levy

- Through the 2018 Finance Act, illuminating kerosene was charged anti-adulteration levy to discourage adulteration of fuel. This has had the effect of increasing costs to manufactures of paint, resins and shoe polish that use this kerosene as primary input. To mitigate against the cost increase manufacturers affected will be eligible to seek refund on the levy paid.

Import Declaration Fees (IDF) and Levies

- IDF on intermediate goods and raw materials used by manufacturers reduced from 2% to 1.5% while the rate for finished goods increases from 2% to 3.5%. In addition railway development levy (RDL) currently charged at 1% increases to 2% but applicable to finished goods only.

- The above fees and levies make finished products expensive while cushioning local manufacturers.

Export Levies

- Currently raw hides and skins are subject to export levy but not tanned and crust hides and skins. The later will now attract export levy of 10% the intention being to enhance value addition and promote manufacturing of local leather products.

Insurance

❑The Insurance (Motor Vehicle Third Party Risks) (Certificate of Insurance) was amended to require all passenger carrying motor cycles (commonly referred to as boda bodas) and Motorized Rickshaws (tuk-tuks) to have an insurance cover for passengers and pedestrians. This is intended to improve road security and safety.

Retirement Benefits

❑Retirement Benefits Schemes that invest in guaranteed funds will be permitted to reduce the period of transfer from three years to one year so as to allow members to access better returns.

❑Occupational Benefits Regulations and Retirement Benefits Regulations have also been amended to ensure that the exiting members receive their equitable share of the reserve funds. Previously, the schemes were not required to make provisions for distribution of the reserve funds in their rules.

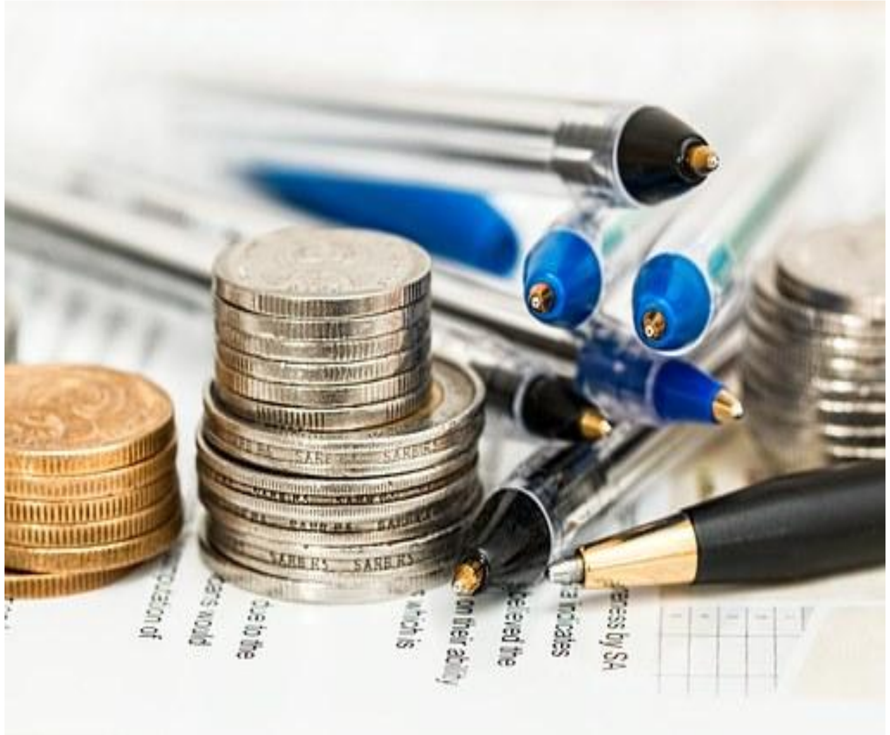
Banking

❑The minister proposed to remove interest rate capping by an amending Section 33B of the Banking (Amendment) Act, 2016. This is intended to unlock credit to the private sector and in particular to the Micro Small and Medium Enterprises. It is also in line with the cry by the Banking sector industry players to remove interest rate caps which have hitherto been seen as hindering growth of credit.

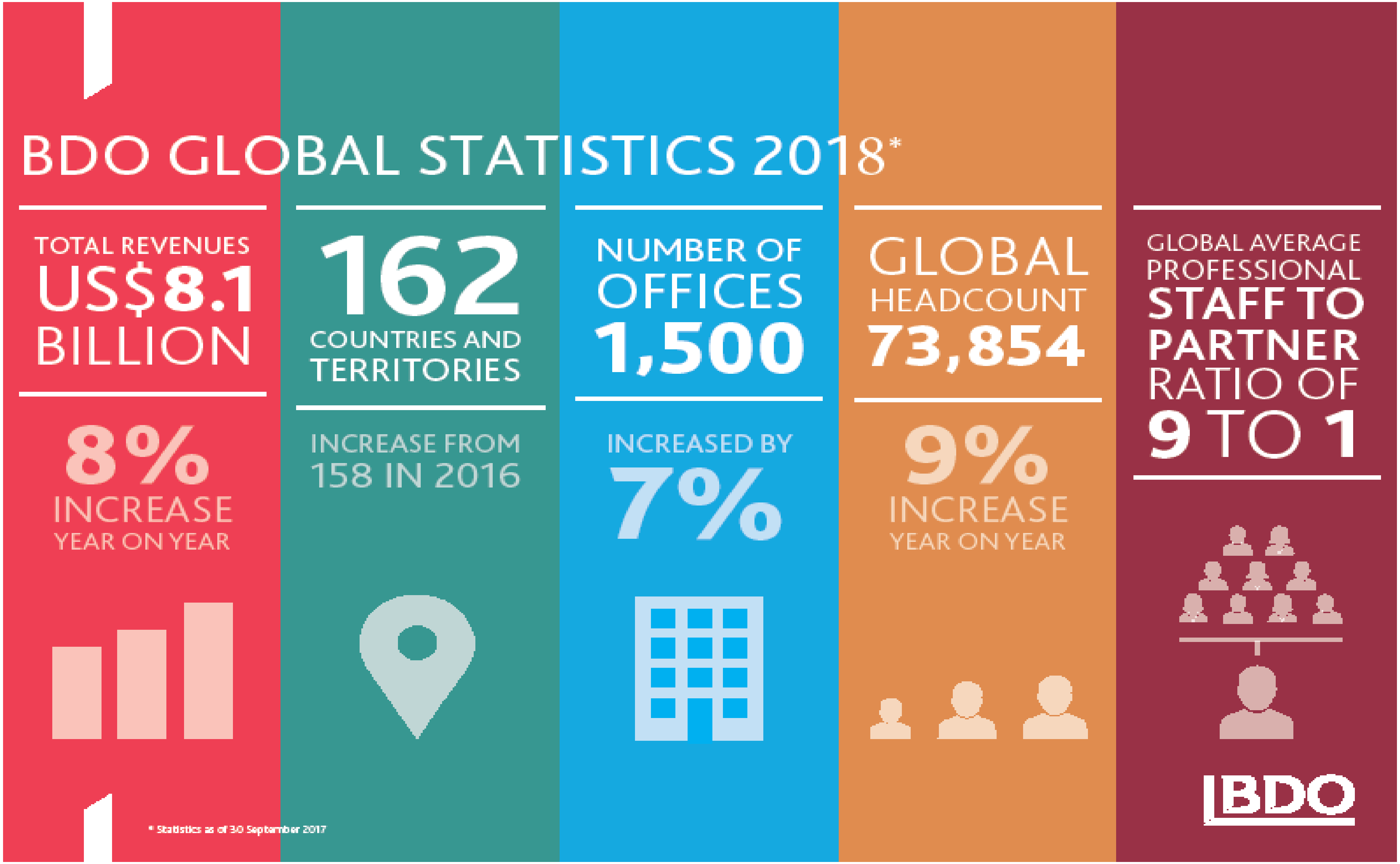
Banking Contd.

It is also intended to reduce the demand for loans from shylocks as well as reduce the non-performing loans given by the banks.

❖Further, treasury will launch an "SME Credit Guarantee Scheme" to deepen access to credit by SMEs without being subjected to complex application procedures and collateral requirements by the banks. This, together with Biashara Kenya and SME Funds also announced by the Minister, will address the very reason why interest rate caps were introduced.



ABOUT BDO


BDO GLOBAL STATISTICS 2018*
TOTAL REVENUES
US$8.1
BILLION
8%
INCREASE
YEAR ON YEAR
162
COUNTRIES AND
TERRITORIES
INCREASE FROM
158 IN 2016
NUMBER OF
OFFICES
1,500
INCREASED BY
7%
GLOBAL
HEADCOUNT
73,854
9%
INCREASE
YEAR ON YEAR
GLOBAL AVERAGE
PROFESSIONAL
STAFF TO
PARTNER
RATIO OF
9 TO 1
* Statistics as of 30 September 2017
BDO

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