KENYA BUDGET BRIEF 2018/2019

BDO

KENYA ECONOMIC OVERVIEW

Economic Performance Overview

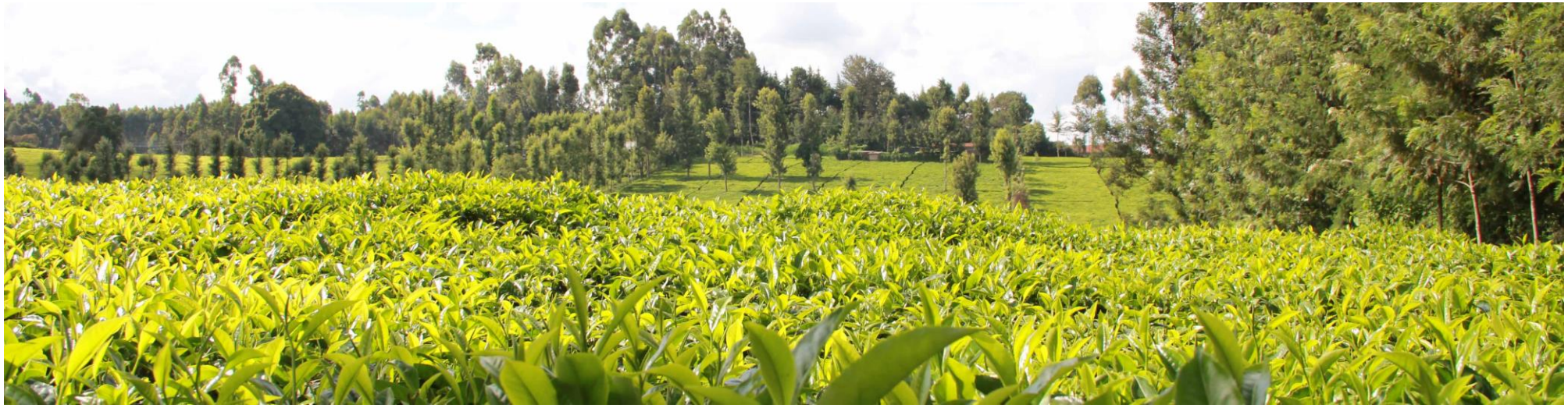
- The theme for this year's budget is creating jobs, transforming lives and sharing prosperity. It is geared towards achieving the Big Four Agendas (Big Four) of the Government namely, Manufacturing, Food Security, Universal Health Care and Affordable Housing. Resources have been allocated to ensure this is achieved.

- Kenyan economy has expanded by an average rate of 5.6% outperforming the rate of previous five years.

- The Kenyan Economy is projected to grow by at least 5.8% in 2018. This will majorly be supported by improved investor confidence, demand for our exports as a result of global and regional growth, public investments and improved agricultural activities due to favorable weather. There has been an additional creation of 898,000 jobs in 2017 up from 833,000 in 2016.

- Global growth is projected to grow to 3.9% in 2018 – 2019 up from 3.8% in 2017 whereas the Sub Saharan Africa Economy is projected to grow to 3.4% up from 2.75% in 2017. The improved global and regional economic prospect will benefit Kenya exports and further strengthening the manufacturing sector.

- Under the big four agenda manufacturing sector is poised to increase its contribution to the GDP by 15% by 2020 thereby adding US dollar 2 to 3 billion to the country's GDP and creating 800,000 additional jobs in the process. The proposed implementation of the big four will see the economy grow to at least 7.0%. We have highlighted below the steps the government is taking to achieve the Big Four.



KENYA ECONOMIC OVERVIEW (CONTINUED)

Manufacturing

- Establishing leather parks and textile industries;
- Reviving and transforming the blue economy and manufacturing of construction materials;
- Re-establishing the automobile industry which will make new vehicles more affordable;
- Tailor made incentives to investors who will invest in specific areas. Designated regions will be under Special Economic Zones (SEZ). This will attract tax at lower rates. Dongo Kundu in Mombasa is such a zone;
- Do away with non-trade barriers , implement the EAC Non-Tariff Barriers Act, 2017 and reviewing Common External Tariff together with other EAC member countries; and
- Cutting down production costs through affordable energy, expand infrastructure and land access to manufacturing zones and is working to seize and destroy counterfeit goods. Illicit and counterfeit trade robs the country tax revenue collections.

Food Security

- Placing 700,000 acres of land through PPP (Public Private Partnership) to enhance large scale farming;
- Promoting investments in post harvest handling and adoption of contract farming;
- Support development of agro parks or hubs to serve as markets; and Insurance arrangements and availing affordable credit facilities.

Universal Healthcare

- Reconfiguring National Hospital Insurance Fund (NHIF) and reforming the governance of private insurance companies;
- Launch of a comprehensive NHIF medical scheme for secondary students;
- Provision of specialized medical equipment and mobile health services; and
- Extending free maternity programme to mission and private hospitals.

KENYA ECONOMIC OVERVIEW (CONTINUED)

Affordable Housing

- Develop homes in service land in partnership with private sector;
- Providing reforms in property registrations;
- Access to affordable financing and adoption of new low-cost building technologies; and
- Offering long term loans to financial institutions through the Kenya Mortgage Refinance Company (KMRC).

Revenue, expenditure and fiscal deficit

- **Revenue**: With the revenue enhancement measures put in place, revenue is expected to rise by 17.5% to KES 1,949.2 billion from KES 1,659.6 billion collected in the financial year 2017/2018. This represents an equivalent of 20% of the GDP.

- **Expenditure**: The total expenditure projected for the 2018/2019 financial year is KES.2, 556.6 billion. Out of this, transfer to County Government will be KES 376.4, development expenditure will be 625.1 and recurrent expenditure will take the lion's share at KES 1,550.0 billion.

- **Fiscal deficit**: The fiscal deficit for the year 2018/2019 will be KES 558.9 billion which is equivalent to 5.7 percent of GDP. This will be financed by net external financing and domestic financing amounting to KES 287 billion and KES 271.9 billion respectively.

Inflation rate, interest rate and Exchange rate

- Macroeconomic stability was largely maintained in 2017 with inflation rate, interest rate and exchange rate remaining stable throughout the year.

National Debt

- The national debt is set to hit the KES 5 trillion mark. It continues to be a cause of concern to many Kenyans as the public debt to GDP ratio is expected to hit 56% by end of 2018 which is way above the recommended threshold of 50%.

DIRECT INCOME TAX

Changes

High Income Earners

The earlier proposal contained in the Income Tax Bill 2018 to tax individual incomes above KES 750,000 per month at 35% has been overruled by public opinion. The current provisions of the Income Tax Act of 2014 are therefore upheld.

Amnesty

The amnesty period has been extended by one year to 30th June 2019 and the year of declaration to be 2017 instead of 2016 as earlier indicated. In addition to this, funds transferred under the amnesty are to be exempt from the provisions of the Proceeds of Crime and Anti-Money Laundering Act or any other Act relating to transparency. Proceeds from terrorism, poaching and drug trafficking are however not shielded from exposure.

Tax Administration Measures

A penalty of 20% and simple interest at 2% per month on late payment of taxes has been proposed in an endeavor to enhance tax compliance among taxpayers and boost revenue from taxes. A proposal has also been made to allow taxpayers to amend self assessment returns.

The Kenya Revenue Authority ("KRA") Act and the Public Finance Management Regulations have been amended to allow KRA to collect 90% of the surplus made by regulatory authorities and forward to the Consolidated Fund.

Non-resident Insurers

Capital gains tax has been expanded to include gains on transfer of property by general insurance companies. In addition, 5% withholding tax will be charged for insurance premiums paid to non-resident persons. Premiums paid for insurance of aircraft has been excluded from these provisions.

DIRECT INCOME TAX (CONTINUED)

Changes

Manufacturing Sector

Subject to conditions to be set by the Ministry of Energy, manufacturers are to enjoy a further deduction of 30% of the total electricity expense. This is in addition to the normal deduction provided for under the Income Tax Act.

Presumptive Tax

The turnover tax is to be replaced with presumptive tax at a rate of 15% of the business permit or trading license fees.

Demurrage charges

Withholding tax at 20% on payments for demurrage charges paid to non-resident persons has been proposed.

Dividend Taxation

The scope of amounts deemed to be dividends and as such subject to WHT has been expanded to include the following items:

- any cash or asset distributed or transferred by a company to or for the benefit of a shareholder or any person related to that shareholder
- an obligation measurable in money from which a shareholder, or any person related to him, is discharged
- the amount is used by that company in any other manner for the benefit of the shareholder or any related person to that shareholder;
- any debt owed by the shareholder or any person related to that shareholder to any third party is paid or settled by that company;
- the amount representing additional taxable income or reduced assessed loss of that company by virtue of any shareholder, resulting from an adjustment transaction with the shareholder or related person to such;

DIRECT INCOME TAX (CONTINUED)

Changes

Housing

In the spirit of achieving the "Big Four", an amendment has been made to the Employment Act to introduce a contribution to be directed to the National Housing Development Fund in a bid to develop affordable housing for Kenyans. An employer will contribute 0.5% of an employee's monthly gross earnings subject to a maximum of KES 5,000. The employee will also contribute 0.5% of their monthly gross earnings to this fund.

More low-cost housing developers are also set to benefit from the incentive of 15% corporate tax rate as the qualifying threshold has been reduced from 400 units to 100 units per year. The definition of low-cost housing however remains vague.

Betting Companies

20% penalty and 2% simple interest on late payments of taxes in the Betting, Lotteries and Gaming Act has been introduced to boost compliance in remission of these taxes.

The use of the withholding tax on winnings has also been clarified to be for the development of sports, arts and cultural activities for the youth.

Our take

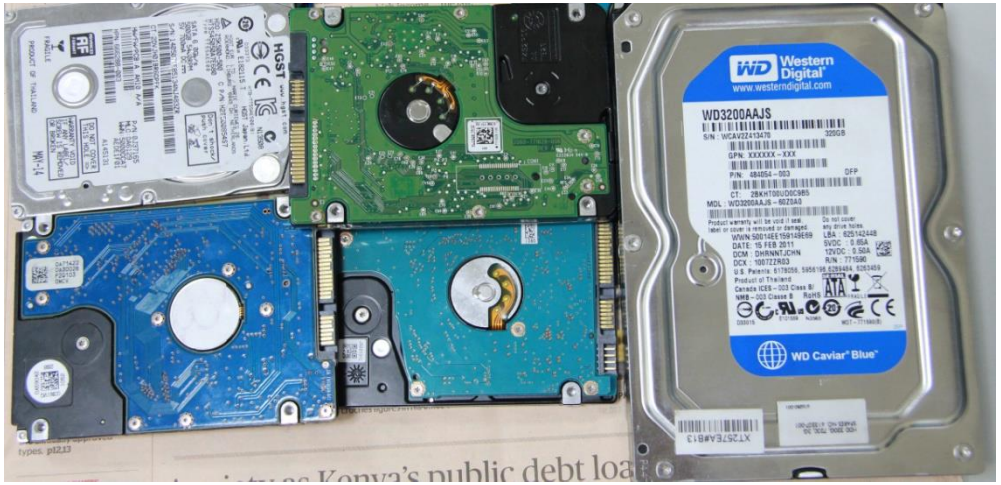
- Most of these measures are aim at increasing the tax collections in order to fund the increase budgetary allocations and reduce the budget deficit.
- The proposal on housing is a welcome measure for the long term provided that funds will be managed transparently.
- The measure proposed concerning Amnesty will encourage more citizens to voluntarily declare their assets held abroad without fear of prosecution under the Proceeds of Crime and Anti-Money Laundering Act or any other Act relating to transparency.

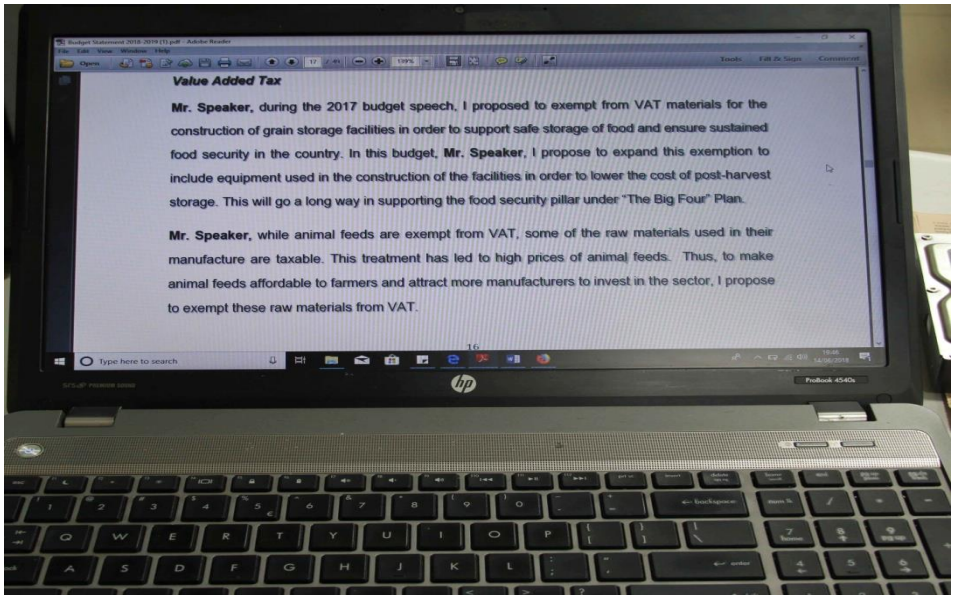
VAT

Changes

- Raw materials used in the manufacture of animals' feeds will now be VAT exempt. This will make animal feeds affordable to farmers and attract more manufacturers to invest in the sector.

- Parts imported or purchased locally for the assembly of laptops used in the primary schools program are currently exempt from VAT. This exemption has now been expanded to include parts imported or purchased locally for the assembly of computers.





- Exemption was granted in 2017 on materials for the construction of grain storage facilities. This has now been expanded to include equipment used in the construction of such facilities in order to lower the cost of post-harvest storage.

Our take

This will have positive impact on the information technology sector and will further all business as well as students to use computers. Farmers will also be able to purchase animal feeds at a lower price to increase food production and boost farmers' incomes.

CUSTOMS DUTY

Changes

The EAC partner states is working on a framework to remove non-trade barriers through the implementation of the EAC Non- Tariff Barriers Act 2017.

A review of the Common External Tariffs has commenced to enhance protection of local industries. This is expected to be concluded in the next one year but meanwhile sensitive and strategic industries will be affected in the following ways with effect from July 2018. This is primarily intended to promote industrialisation, encourage investments, make our products more competitive, protect local industries from unfair competition and generate employment.

The EAC Common External Tariff is undergoing a comprehensive review intended to enhance protection of industries in the region and create conducive business environment.

In addition the EAC Customs management Act 2004 (EACCMA 2004) is also undergoing review to incorporate new developments and address challenges in its implementation. We are therefore likely to have in the near future an overhauled Customs Act similar to the VAT, Income Tax and Excise Act which have undergone major revisions in the recent past.

The following are the imports duties changes.

1	Import duty on a wide range steel and iron products increased from 25% to 35%
2	Paper and paper board duty increased from 25% to 35% for one year.
3	Specific rate of import duty on new and second hand textiles and footwear – USD 5 per unit or 35% whichever is higher. This will guard against undervaluation.
4	Specific duty rate of between USD 110 to USD 230 per metric tonne on timber products (particle board, medium density fibre board, plywood and block boards), or 35% whichever is higher.
5	Specific duty rate of USD 500 per metric tonne or 35% whichever is higher on refined edible oil products for one year.
6	Raw materials and inputs used to manufacture pesticides and acaricides will enjoy duty exemption under EAC duty remission scheme. This is intended to promote local production and reduce dependence on imports.
7	To promote tourism duty exemption has been expanded to include sightseeing buses and overland trucks imported by licensed tour operators.
8	Inputs and raw materials used for assembly of clean energy cooking stoves imported by local manufactures will enjoy duty remission 100%.

Our take

The Government will collect more taxes and the cost of these products will most likely increase as Kenya is a high cost producing country and importers will pass on the duty increase to the local consumers.

EXCISE DUTY

Changes

- Transfer of money amounting to KES 500,000 or more through banks and other financial institutions will now attract excise duty at the rate of 0.05%.

- Money transfer services by cellular phone service providers now to attract excise duty at the rate of 12% from 10% where the extra funds will be used to fund Universal Health care.

- Private passenger motor vehicles of high engine capacity exceeding 2500cc for diesel powered vehicles and 3000cc for petrol powered vehicles will now attract excise duty at 30% from 20% in order to bring equity (previously it was uniform for all private passenger vehicles at 20%).

- Illuminating kerosene will now to attract excise duty at KES 10,305 per 1000 litres from KES 7,205 per 1000 litres in order to harmonise the rate to that of gas oil and reduce incidences of fuel products adulteration and loss of revenue.

Our take

Price motor vehicle (both locally assembled and imported) is expected to increase. Cost of electronic fund transfer will increase and the economically disadvantaged households especially in the rural areas will be more affected by price increase in kerosene.

	Current duty rate	Proposed duty rate
Private passenger vehicles exceeding 2500cc for diesel	20%	30%
Private passenger vehicles exceeding 3000cc for petrol	20%	30%
Money transfer via banks and other financial institutions of KES 500,000 or more	0%	0.05%
Mobile money transfer by cellular phone service providers	10%	12%
Illuminating kerosene	KES 7,205 per 1000 litres	KES 10,305 per 1000 litres

- Goods and services not liable to customs duty have been defined to include goods consumed by exempt persons.
- Excise duty rates will now be reviewed annually at the beginning of every financial in order to adjust for inflationary changes from previous two years.
- The commissioner shall have powers to suspend a license without notifying the licensee if the licensee:
  - Engaged in tax fraud;
  - Is found in possession of, or using, counterfeit stamps on excisable goods;
  - Is found in possession of goods bearing counterfeit stamps; or
  - Violates any regulations relating to health and safety, standards or packaging of goods.
- The commissioner shall be required to pay:
  - sixteen percent of the excise duty in respect of money transfer by cellular phone service providers to Sports, Arts and Social Development Fund established under the Public Finance Management Act, 2012 to support social development including universal health care; and
  - All the excise duty payable in respect of excise duty on money transferred by banks, money transfer agencies and other financial service providers at 0.05% of the amount transferred in case of money transfer of five hundred thousand shillings or more.
- Penalty for dealing with excisable goods without a license has been reviewed to the higher of either 5 million shillings or double the amount of excise duty payable.

MISCELLENEOUS ITEMS

Changes

Banking Act

The Banking Act has been amended to remove the capping on interest rates to enable banks and other lenders to provide more credit for borrowers considered to be riskier.

Proceeds of Crime and Anti-Money Laundering Act ("PCAMLA")

- PCAMLA to be amended to address money laundering and terrorism financing risks associated with non-face-to-face businesses and transactions.
- Sacco Societies Regulatory Authority has been included as a supervisory body in the prevention of money laundering and combating financing of terrorism.
- A legal framework is to be introduced to enable the Betting control and Licensing Board ("BCLB") to tighten the vetting requirements for licensing of operators in order to adhere to global standards on anti-money laundering measures.

Financial Sector

- Capital Markets Act has been amended to introduce enhanced financial controls and provide for investor protection in order to boost investment growth in the country.
- Retirement Benefits Act is amended to enable the authority to intervene against any employers who fail to remit pension contributions to respective retirement benefit schemes.
- A post retirement medical cover is to be introduced as a portion of their retirement benefits for members who are unable to build medical funds during their employment period. This is in support of the Universal Healthcare under "The Big Four" Plan. This fund will be exempt from retirement benefit levy.

Insurance

Index based insurance has been introduced to replace indemnity based insurance in order to encourage higher uptake of insurance by farmers.

Insurance intermediaries have been eliminated to enable the insured to pay premiums directly to the insurer through digital platforms.

SACCOs

Sacco Societies Regulatory Authority ("SASRA") Act has been amended to allow SACCOs submit statutory reports through electronic means.

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

BDO

* Statistics as of 30 September 2017

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BDO East Africa operates in Kenya, Tanzania, Uganda, Ethiopia and Rwanda. For further details and contacts kindly visit our website www.bdo-ea.com.

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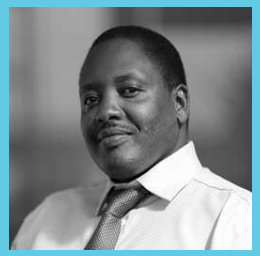

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