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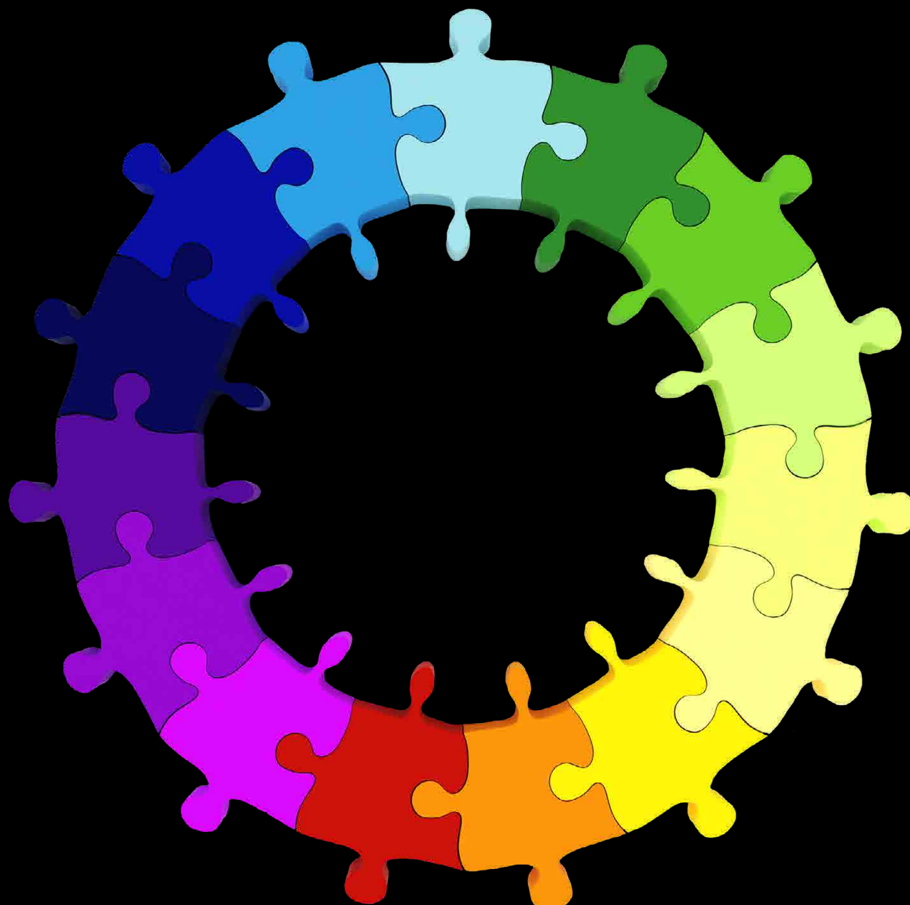

Kenya Budget Highlights 2019/20

Unravelling the Puzzle

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Preamble

Our budget highlights presents a brief description of the main tax and related regulatory changes contained in the 2019/20 Budget speech as presented by the Cabinet Secretary for the National Treasury, Henry Rotich. A more detailed analysis, incorporating our views, will follow as soon as the Finance Bill 2019 and related Bills tabled by the Cabinet Secretary are published.

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Tax Measures

Capital Gains Tax

- The rate of Capital Gains Tax (CGT) is set to be increased from 5% to 12.5%. There is no indication that indexation will be introduced to take into account the effects of inflation over time.
- Property transferred by corporates as part of group restructuring to be exempted from CGT to allow for seamless restructuring for operational efficiency and encourage business growth.

Corporate Tax

- Framework on the implementation of the 30% rebate on total electricity costs by manufacturers introduced through the Finance Act 2018 has now been developed.
- Investors operating plastic recycling plants to enjoy a reduced corporate tax rate of 15% for the first five years.
- Introduction of amnesty covering penalties and interest, on any outstanding tax for two years prior to listing, for SMEs under the Growth Enterprise Market Segment (GEMS) program at the Nairobi Securities Exchange (NSE).
- The Cabinet Secretary (CS) indicated that measures aimed at the taxation of income generated from the digital economy would be introduced. The measures were not specified by the CS.
- The Income Tax Bill introduced in 2018 is currently at advanced stages of legal drafting and will be tabled in Parliament soon.

Personal Income Tax

- Exemption of Income earned under Ajira Program: The Government through the Ministry of Information, Communications and Technology in partnership with academia, civil society and the private sector has set up a program known as "Ajira Digital Program" whose aim is to bridge the gap between skills available and skills demand. A major objective of the program is to enable over one million youths annually to be engaged as digital freelance workers.
- The Government has proposed that the youth registered for the program pay a registration fee of ten thousand Kenya shillings for the next three years in lieu of income tax with effect from 1st January 2020.
- The Cabinet Secretary has proposed to amend the Income Tax Act to exempt registered members from regular taxation for the specified period.

Turnover Tax

- Turnover tax, which was replaced by Presumptive Income Tax in 2018, is to be reintroduced.
- Turnover tax will apply to taxpayers whose business income does not exceed KShs 5 million per annum.
- Tax rate of 3% on the gross turnover accounted for every month.
- Turnover tax will apply in addition to presumptive income tax, which was introduced through the Finance Act 2018.

Withholding Tax

- The scope of qualifying services subject to withholding tax set to be expanded to include:
  - 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.

Value Added Tax (VAT)

- Reduction of the withholding VAT rate from 6% to 2%.
- The Cabinet Secretary for The National Treasury to constitute a taskforce which will validate outstanding VAT refund claims for settlement within the next two months.
- Adjustment of the VAT refund formula introduced through the VAT Regulations, 2017 to ensure a full refund of input tax credit relating to zero-rated supplies.
- Zero rating of denatured ethanol.
- Introduction of VAT exemption on the following:
  - Locally manufactured motherboards and all inputs used in their manufacture.
  - The supply of machinery and equipment used in the construction of plastic recycling plants as well as all services offered to these plants.
  - Agricultural pest control products.
  - Electric accumulators and separators used in the manufacture of automotive and solar batteries.

Customs Duties

- Extension of stay of application of the CET rate on a wide range of iron and steel products at 25% or the corresponding specific rates.
- Application of 25% import duty on paper and paperboard instead of 10%.
- Reduction of import duty on raw timber from 10% to 0%.
- Proposal to retain import duty on finished timber products at 25%.
- Detailed Customs measures to be communicated through the East African Community (EAC) Gazette effective 1 July 2019.
- Kenya Electronic Single Window System Bill to be tabled in Parliament.

Excise Duties

- Introduction of excise duty on betting activities at 10% of amounts staked.
- Reduction of excise duty on fully-powered electric motor vehicles from 20% to 10%.
- Increase in excise duty on motor vehicles of engine capacity exceeding 1500cc to 25%.
- Increase in excise duty rates on cigarettes, wines and spirits by 15%.

Miscellaneous Fees and Levies

- Manufacturers of paints and resins to receive a refund of anti-adulteration levy paid on kerosene used as their input.
- Reduction of Import Declaration Fee (IDF) on raw materials and intermediate goods from 2% to 1.5%.
- Increase in IDF on finished goods from 2% to 3.5%.
- Increase in Railway Development Levy on finished goods from 1.5% to 2%. Remission available for approved manufacturers.
- Introduction of export levy on tanned or crust hides and skins at 10%.
- Continuation of Revenue Enhancement Initiatives (REI) such as:
  - Scanning of containers to detect concealment;
  - Regional electronic cargo tracking system;
  - New debt collection strategy;
  - Resolution of tax disputes; and
  - Enhanced investigative capacity.

Sectoral Highlights

Manufacturing

- Under the Big Four Agenda, the government's goal is to increase the manufacturing sector's contribution to GDP to 15% by 2022, create jobs annually, increase foreign direct investment and improve ease of doing business.
- Special focus will be on scaling up reforms to encourage investments in industrial sheds and parks. The Cabinet Secretary noted that the completed revival of the Eldoret based Textile Company, RIVATEX is expected to employ 3000 employees when fully operational.
- Ministries, Departments, Agencies and other Public entities required to give exclusive preference in procurement of motor vehicles and motorcycles from companies that have assembly plants in Kenya.
- Proposed allocations targeted at the manufacturing sector include:
  - KES 1.1 billion for the development of the textile and leather industrial park, Naivasha Industrial Park and Cotton Development Subsidy;
  - KES 1.7 billion to support the growth of SMEs in the manufacturing sector; and
  - KES 1.0 billion to modernise facilities at the Kenya Industrial Research and Development Institute (KIRDI).

Health

- The government has prioritised the achievement of Universal Health Coverage (UHC) as part of its Big Four Agenda. The UHC pilot phase was launched in December 2018 in four counties; Kisumu, Isiolo, Machakos and Nyeri.
- To support UHC, the Cabinet Secretary allocated KES 47.8 billion for interventions such as scaling up universal health coverage to the rest of the counties and NHIF cover for the elderly and severely disabled.
- Other allocations to improve health service delivery include:
  - KES 2.9 billion for doctors, clinical officers and nurses internship programme;
  - KES 14.4 billion for Kenyatta National Hospital;
  - KES 9.2 billion for Moi Teaching and Referral Hospital;
  - KES 2.3 billion for Kenya Medical Research Institute;
  - KES 7.4 billion for Kenya Medical Training Centres (KMTC); and
  - KES 1.2 billion for Health Workers' internship programme.

Poverty and inequality

- Various proposed budgetary allocations to reduce poverty and to empower vulnerable members of society. Significant ones include:
  - Ksh 41.7 billion for the National Government Constituency Development Fund.
  - Ksh 2.3 billion for Affirmative Action Fund for Social Development.
  - Ksh 5.8 billion for the Equalization Fund to finance programmes in the marginalised areas.
  - Kshs 93.1 billion for the Universal Health Coverage initiatives.

- KShs 74.2 billion for Affordable Housing programmes to cover construction of affordable housing units, National Housing Development Fund.
- Kshs 209 billion for programmes geared towards Reforming the Education Sector.
- Ksh 33.5 billion for initiatives to support the elderly persons, youth, women and persons living with disabilities.

Agriculture

- Enhancing food and nutrition security to all Kenyans is one of the big four agenda items.
- The government has allocated the following funds to the agricultural sector:
  - Ksh 1.0 billion for crop diversification and to revitalise the Miraa industry;
  - Ksh 0.8 billion for the rehabilitation of Fish Landing Sites;
  - Ksh 0.7 billion for small-holder dairy commercialisation.
  - Ksh 7.9 billion for ongoing irrigation projects.
  - Ksh 2.0 billion for the National Value Chain Support Programme
  - Ksh 3.0 billion for setting up the Coffee Cherry Revolving Fund which is aimed at implementing prioritised reforms in the coffee sub-sector.
  - Ksh 0.7 billion to pay outstanding debts to sugar farmers for cane deliveries to public mills.

Energy & Resources

- The Government's plans to establish a Sovereign Wealth Fund, whose purpose is to effectively manage revenues generated from the extraction of natural resources, is underway with the Kenya Sovereign Wealth Fund Bill expected to be tabled before Parliament shortly.
- The purpose of the Sovereign Wealth Fund is to build a savings base for purposes of national development, facilitate the stabilisation of the economy and enhance intergenerational equity.
- The Bill designates the sources of funds to be deposited into the fund, including Government share of profit oil, petroleum and mining royalties, bonuses, annual licence fees and any other revenue as shall be designated by Gazette notice.
- The Fund is divided into three components that is, the stabilisation component (15%, subject to a maximum of 20% of GDP), infrastructure development (60%) and the *Urithi* Component (10%). Excesses within the stabilisation component and from windfall revenue are to be used for other stated purposes including to service national debt, transferred to stabilisation and development component and transferred directly to citizens by way of tax cuts, in that order of priority.

Environment

- To foster a sustainable environment, the government is committed to expanding the forest cover from 7.2 per cent to the 10 per cent target.
- In addition, a ban that will be effective from 5th June 2020 has been issued on single-use plastics in all protected areas, including National Parks, beaches, forests and conservation areas.
- The government will promote plastic waste management by encouraging the recycling of plastic waste.
- The proposed tax measures in relation to environmental protection include:
  - Exemption from VAT on all services offered to plastic recycling plants and supply of machinery and equipment used in the construction of these plants; and
  - Reduction of corporation tax to 15 % for the first five years for investors operating a plastic recycling plant.

ICT

- ICT sector output grew by an average of 10.8% between 2014 and 2018, mainly on account of continued investments in mobile telephony, increased uptake of e-commerce platforms and internet penetration. The mobile telephony segment has been the main driver of the ICT sector growth.
- To support the ICT sector and take advantage of the digital dividend, the following allocations have been proposed:
  - KES 3.2 billion for the Digital Literacy Programme;
  - KES 2.9 billion for Government Shared Services;
  - KES 2.8 billion for National Optic Fibre Backbone Phase II expansion; and
  - KES 1.1 billion for installation of an internet-based 4000 network;
  - KES 7.2 billion for the on-going construction of Konza Technopolis Complex; and
  - KES 5.1 billion to support the Konza Data Centre and Smart City Facilities Project.

Capital Markets

- Capital Markets Authority to be empowered to enforce penalties and sanctions on market players who violate laid down rules and procedures.
- The introduction of amnesty on penalties and interest on any outstanding tax for two years prior to the listing of SMEs under the GEMs program. This is expected to encourage listing of SMEs on the NSE.

Financial sector

Banking

- Interest rates cap to be removed: proposal to repeal section 33B of the Banking Act in a bid unlock credit to the private sector and in particular to the MSMEs and arresting the shrinking of the loan books of small banks. This is the second attempt after it was rejected by parliament last year.
- Tax Procedures Act to be amended to empower the Commissioner to grant exemption from the PIN requirement, in certain circumstances, when opening a bank account.
- Retirement Benefits Act to be amended to reduce the period of transfer by Retirement Benefits Schemes that invest in guaranteed funds to one year from the current requirement to withdraw funds in instalments spread over three years.
- Proposed launch of an SME Credit Guarantee Scheme to deepen access to credit by SMEs without being subjected to complex application procedures and collateral requirements.
- Continuous recapitalisation and restructuring of banks that are partially or wholly owned by the Government to create stronger Banks and Development Financial Institutions

Insurance

- The Insurance Act and the Regulations to be amended to enable the Policy Holder's Compensation Fund to be utilised to compensate claimants. As currently constituted, the Act is ambiguous and only confers benefits to the claimant if the insurer becomes insolvent.
- Proposed amendment to the Insurance (Motor Vehicle Third Party Risks) (Certificate of Insurance) Rules to require all passenger carrying boda-bodas and tuk-tuks to have an insurance cover for passengers and pedestrians.

Administration

- Information sharing through Memorandum of Understanding (MoU) with other tax jurisdictions
- Establishment of the legal framework for the operation of the National Electronic Single Window System to formalise issuance of electronic certificates and permits

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