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Kenya Budget Highlights

Navigating new realities

June 2021

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Foreword

Joe Eshun
Chief Executive
Deloitte East Africa

Around June last year at a time like this, we were 3 months into the COVID-19 global pandemic, uncertain of what the future held and what that meant for ourselves, our loved ones, our colleagues and the world. Despite the challenges faced, we have been able to adapt to new ways of thinking, working and living, in order to survive through the pandemic. Human resilience has persevered.

As we close out what has been a very challenging financial year for the country, it is important that we retrospect on the year that has been. Most of us were optimistic that the pandemic would be short term and that the national measures implemented would enable us to return to 'normalcy' sooner than expected. This has hardly been the case.

Multiple waves of the coronavirus placed us in a "start –stop" environment, where emergency lockdowns and stricter containment measures have made it difficult for many businesses to stay afloat.

In line with the pandemic, the Kenya government's expenditure in 2020/2021 was focused on stimulating the economy to safeguard livelihoods, jobs, businesses and industrial recovery. However, the pandemic constrained the collection of revenues which led the government to result to debt to offset the revenue shortfalls, leaving Kenya's public debt as sustainable but with a high risk of debt distress.

The 2021/22 Budget has been prepared against the background of this precarious economic situation, as the country continues to address the challenges associated with the COVID-19 pandemic. The distribution of vaccines is expected to significantly improve the situation however, it is clear that there is no linear progression to recovery.

Looking at global and local headlines today, what remains true in all narratives is that the coronavirus and its impact on our day to day lives and businesses has an unknown end. COVID has shaped a new normal for us to contend with over the next year and beyond.

I believe that the new normal should not be an excuse for us to stand in place. Recovering from the economic impact of COVID-19 is not about returning to where we left off, rather it is about navigating new realities using a different map. A map that equips us with the right policies and systems to recover from the pandemic, and thrive beyond today's realities.

Fred Omondi
Tax & Legal Leader
Deloitte East Africa

Our budget highlights present an overview of the measures and allocations contained in the 2021/22 Budget Statement as presented by the Cabinet Secretary for the National Treasury and Planning, Hon. (Amb.) Ukur Yatani.

Unlike the previous year where notable new taxes were introduced, the major changes this year seek to increase the tax collected from multinationals by domesticating some of the reforms brought about by the global initiative to address Base Erosion and Profit Shifting. The reforms seek to broaden the key provisions governing taxation of multinationals that may not have physical presence in Kenya (Permanent Establishments), tighten the rules governing debt financing or capital structure and enhance transparency through adoption of Common Reporting Standards and Country by Country reporting.

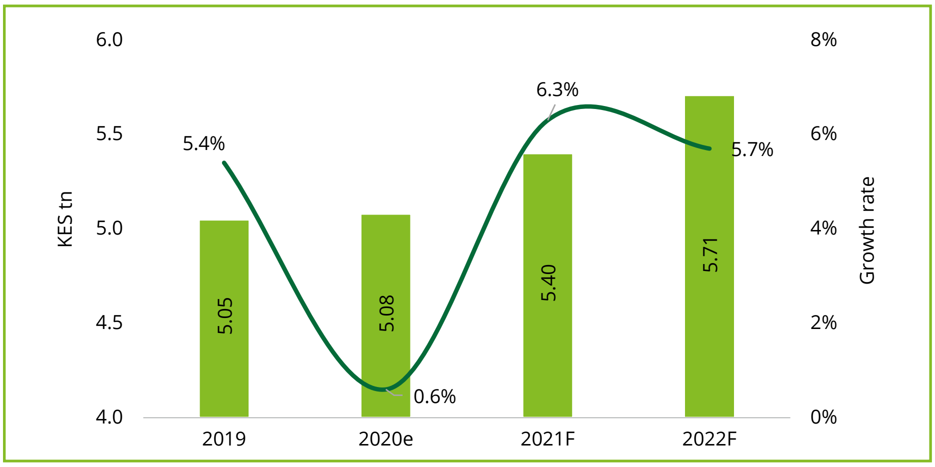
This financial year, the government projects to collect KES 1,7T in tax revenue compared to KES 1.4T in financial year 2020/21 representing a 16% increase. The additional revenue is expected to come from recently introduced taxes such as Digital Services Tax and minimum tax, reductions in exemptions and zero rating, reductions in allowances and adjustment in excise duties. On the administrative side, the increased revenue target means the revenue authority will be unrelenting in its compliance and enforcement efforts.

It remains the case that unless the pace of economic growth accelerates much faster (remember the double digit growth envisaged under Vision 2030?), taxpayers will likely continue to be bear a greater burden as the budget grows to record levels each year."

Economic overview

Kenya's economy at a glance

Economic outlook



Source: EIU, IMF, National Treasury

Kenya recorded a decline in GDP growth from 5.4% in 2019 to 0.6% in 2020 owing to a 1.4% contraction in the industry sector as a result of the decline in manufacturing activities at the onset of the pandemic and a 2.5% contraction in the service sector due to the 68.9% decline in tourist arrivals following the global ban on international travel and national lockdowns.

Kenya's GDP is projected to grow by 6.3% and by 5.7% in 2021 and 2022 respectively due to the successful implementation of the Post Covid-19 Economic Recovery Strategy, full re-opening of the economy, increased agricultural output on account of favourable weather patterns and the resumption of international travel which will stimulate tourism.

The fiscal deficit is expected to increase from 5.6% of GDP in 2020/2021 to 8.2% in 2021/2022 as 66% of revenues are expected to go into debt repayment.

Inflation

Source: Kenya Narional Bureau of Statistics

Inflation in 2020 remained subdued at 5.6% mainly due to the crash in world oil prices, as well as consumer and business tax relief measures implemented by the government which saw the reduction of VAT, PAYE, turn-over and corporate tax.

Inflation is projected to remain within the Central Bank of Kenya's target range of 2.5% to 7.5%. These low inflation rates are expected to be supported by lower food prices and muted demand pressures despite the recent increase in fuel prices, while fiscal and current account deficits are forecasted to narrow as a result of improved revenue collection following the reversal of the emergency tax cut measures.

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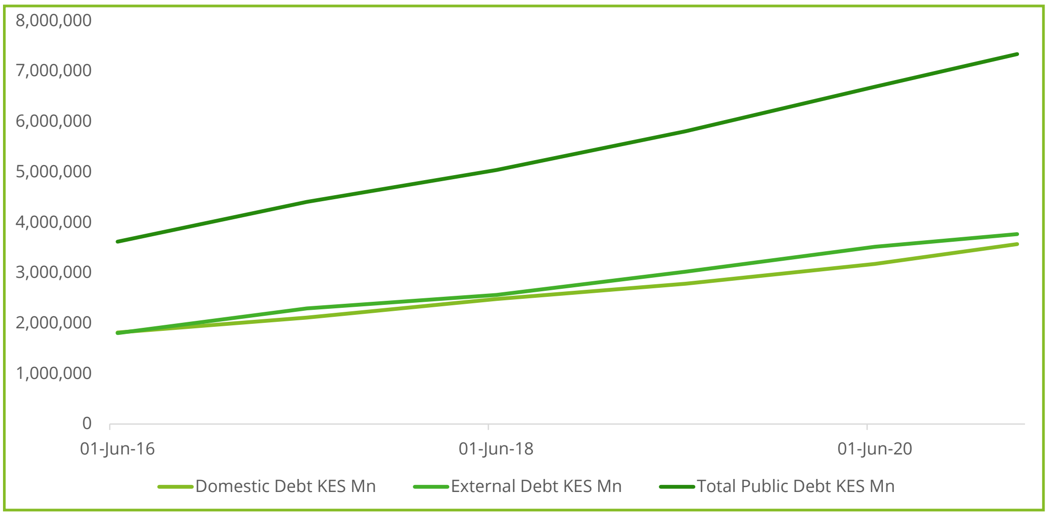
Growth of Public Debt (KES mn)



Source: Central Bank of Kenya public debt analysis

Commentary

Public debt has risen significantly from KES 3.619 Trillion as at 30 June 2016 to KES 7.340 Trillion as at 31 March 2021. This is largely as a result of the Government of Kenya's reliance on debt financing options purposed at financing ongoing infrastructure development.

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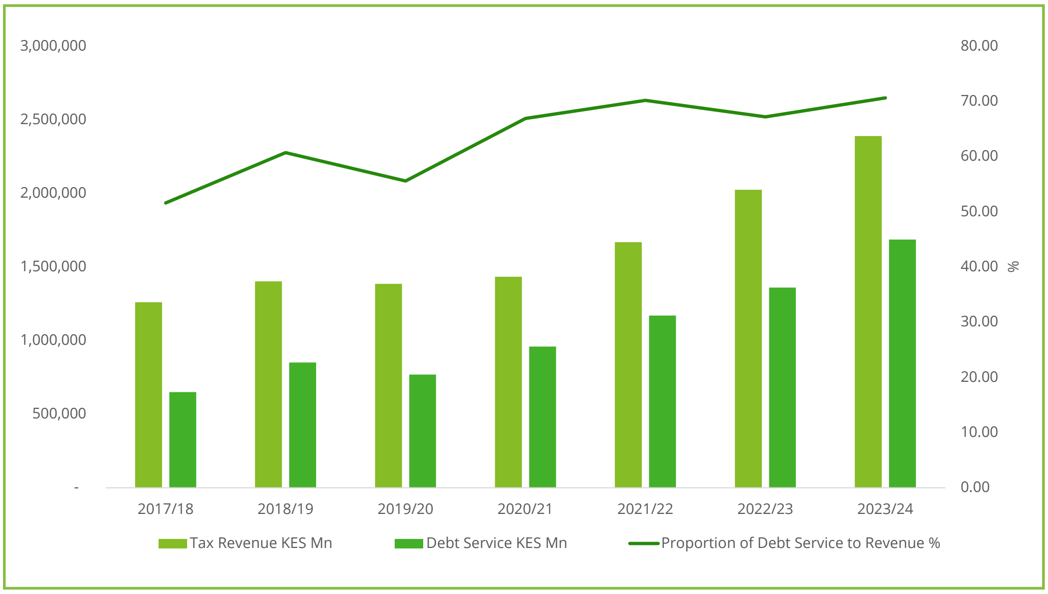
Proportion of debt service to revenue



Source: FY2021/22 Parliamentary Budget Office Report

Commentary

Debt servicing commitments apply increasing pressure on the revenue kitty, with both external and domestic debt commitments expected to consume up to 70% of the revenue targets set for the financial year FY21/22, there is little left for other obligations.

Whereas debt may be beneficial to the extent that it allows for accelerated development, particularly with respect to infrastructure projects that are expected to catalyse economic growth, the same may also result in adverse consequences. This is particularly true where the growth in debt is not matched by the growth in revenue and therefore increased debt servicing commitments eat into revenues purposed at development.

In our view, increased public debt incurred by the Government of Kenya, which translates to increased annual debt servicing commitments, ought to be balanced with other revenue imperatives as well as containment and efficient management of expenditure.

Alternative financing options to fund developmental ambitions, such as Public Private Partnerships also come into play, although these may be costly.

Similarly, expansion of the tax base and promoting increased tax compliance would aid in providing headroom to support increased debt servicing commitments.

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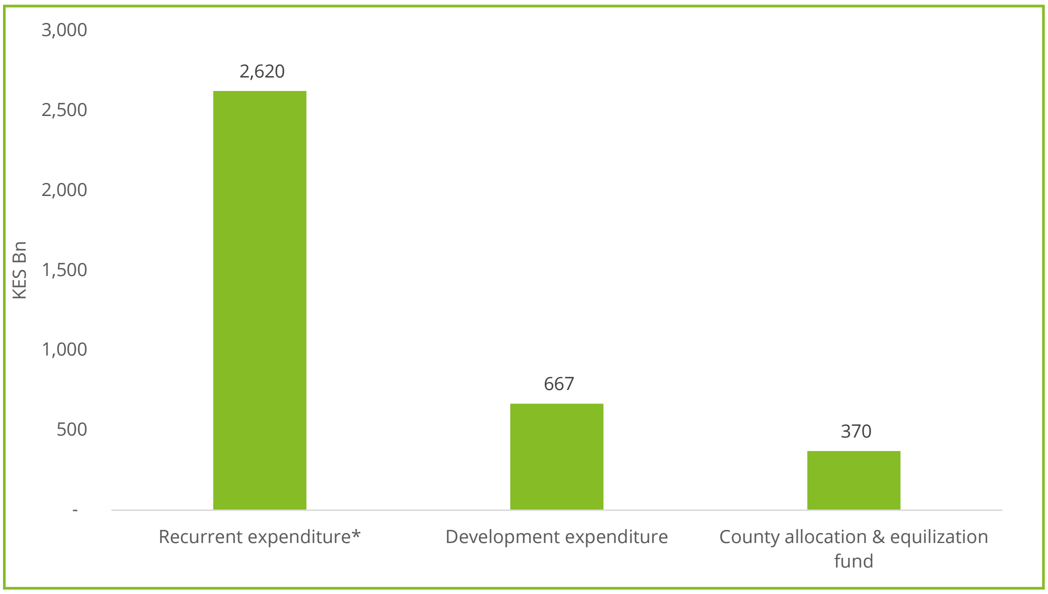
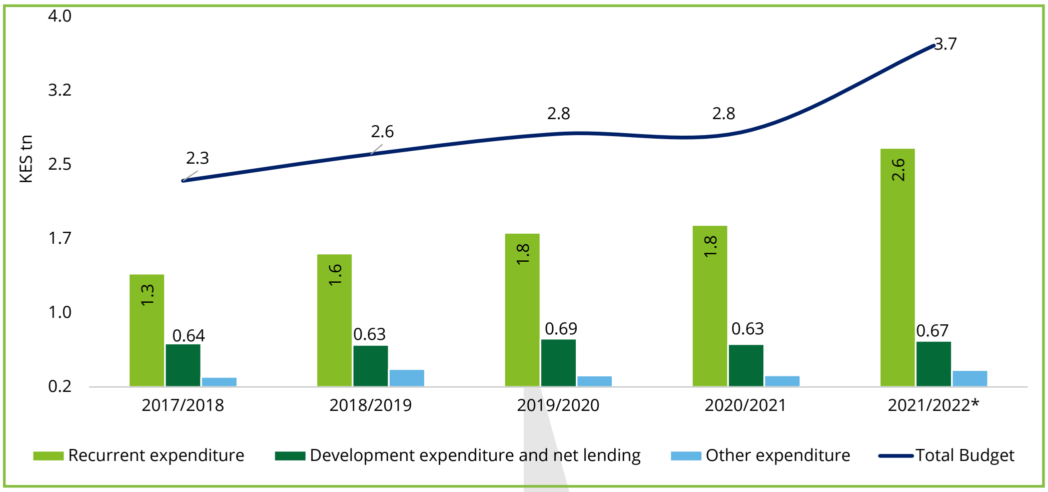
FY21/22 Budgetary allocation



Source: Parliamentary Budgetary Office (PBO) Report FY21/22

Kenya's Budget trend for the period 2017/18 to 2021/22



Source: National Treasury, Parliament of Kenya

2021/22 Estimated Budget	Recurrent Expenditure Accounts`	Development Expenditure Accounts	Increase from 2019/20 Budget
KES 3.66tn	KES 2.6tn	KES 0.67tn	9%

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Commentary Budget overview and trend

Kenya's budget has grown at a Compound Annual Growth Rate (CAGR) of 12.4% between 2017/2018 and 2021/2022. The overall budget for 2021/2022 is estimated at KES 3.7tn. Recurrent expenditure continues to take the largest share of the budget at 72%, with development expenditure taking a rather meagre share of 18% of the budget.

This is explained by the increased salaries and wages and interest payments as the government endeavors to sustain a fairly expensive governance machinery. This position is not expected to reverse soon since the interest payments on the ever-increasing public debt is expected to bloat the recurrent expenditure further.

Approximately KES 1.2tn in recurrent expenditure is allocated to public debt related expenses comprising domestic and foreign interest payments and debt redemptions. The increase in debt servicing expenses outpaced the allocations for development expenditure by over 200%.

This implies that borrowing for development expenditure financing might no longer be viable as the government may be unable to service any additional debt. According to the Central Bank of Kenya, when adjusted for the FY 2021/22 fiscal deficit, total debt stock will amount to KES 8.4tn by June 2022, leaving only 7% before we reach the KES 9.0tn debt ceiling.

In our view, while recurrent expenditure helps in increasing the level of aggregate demand in the economy there is need for Kenya to tame the appetite of spending on recurrent expenditure both at national and county governments level in order to realize real growth.

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Trend in tax revenues

Source: Parliamentary Budgetary Office (PBO) Report FY21/22

Commentary

There is an upward trend in the revenue collections over the last five years from KES 1.3 Trillion in the financial year 2017/18 to projected revenue of KES 1.7 Trillion in the financial year 2021/22.

Income tax continues to be the main revenue generator with a projected revenue of KES 835 Billion in the financial year 2021/22, accounting for approximately 50% of the tax revenue.

However, from a tax revenue growth perspective, excise duty is projected to achieve the highest growth in revenues at 24%, followed by VAT at 20%, import duty at 15% with income tax trailing at 14%.

The projected increase in tax revenues can be attributed to the expected economic recovery post COVID-19 which is expected to spur economic growth as well as new tax measures such as digital tax, excise on additional products/services and minimum tax (though currently in limbo).

Further, the Kenya Revenue Authority is intensifying compliance and enforcement efforts. Other ongoing measures include fast-tracking dispute resolution and Voluntary Tax Disclosure Programme.

Moreover, the reversion of the corporation tax rate for resident companies from 25% to 30%, as well as the Pay As You Earn (PAYE) top marginal rate from 25% to 30% may also boost revenue collection.

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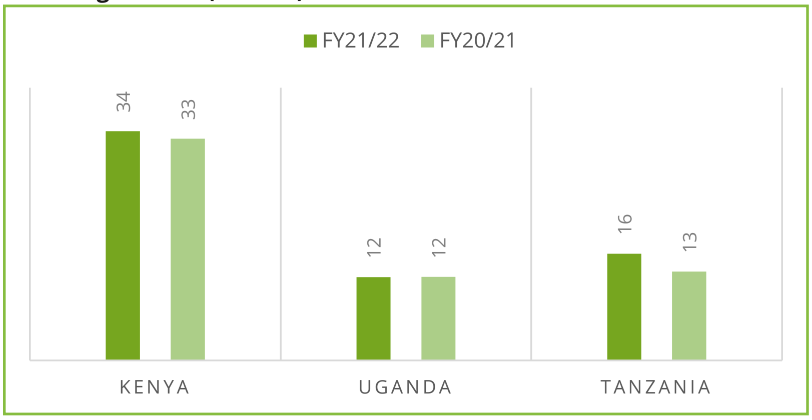
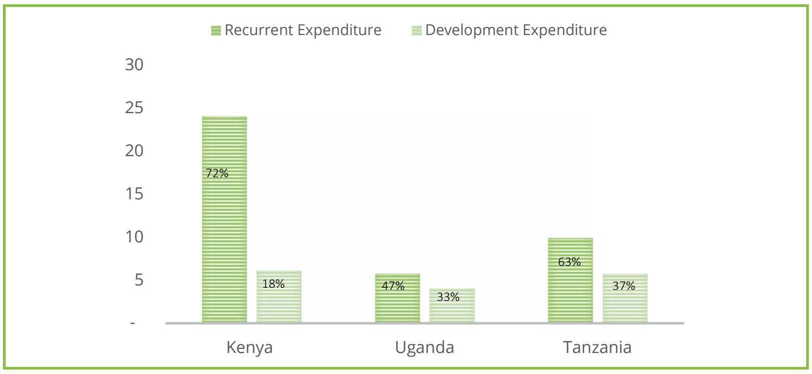
East Africa Budget Overview

EAC Budget trend (USD Bn)



Source: National Treasury, Parliament of Kenya and Uganda and Tanzania Budget Statements

EAC Expenditure Allocation (USD Bn)



Source: National Treasury, Parliament of Kenya and Uganda and Tanzania Budget Statements

Commentary

The East Africa Community (EAC), primarily comprising Kenya, Uganda and Tanzania, announced their budgets for the 2021/22 financial period on 10 June 2021. Per the announced budgets, Kenya, Uganda and Tanzania estimate a combined resource purse of USD 61 Billion for the upcoming financial year.

Kenya leads the pack at USD 34 Billion, with Tanzania and Uganda at USD 16 Billion and USD 12 Billion, respectively.

This represents a marginal growth in the region's resource purse by USD 4 Billion, compared to prior year, representing a 6.4% increase. This is largely driven by Tanzania and Kenya.

From a budget split perspective, recurrent expenditure exceeds the development expenditure across the region with Kenya leading the pack on the ratio of recurrent expenditure to the total budget at 72%.

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Tax Measures

Corporate Tax

- The current interest limitation rule that is based on thin capitalisation is set to be replaced with an EBITDA-based interest limitation rule (Effective 1 January 2022).
    - Based on the current interest limitation rule, a foreign controlled entity, except a bank, is not allowed to claim interest corresponding to excess debt. Excess debt is the debt above the debt to equity ratio of 3 to 1. For extractive sectors (mining and petroleum sectors), excess debt is the debt above the debt to equity ratio of 2 to 1.
    - In the proposed EBITDA-based interest limitation rule, only interest up to 30% of the Earnings Before Interest, Depreciation and Amortization (EBITDA) shall be allowed as a deduction. Any amount above 30% of EBITDA shall be disallowed. The proposed interest limitation rule shall apply to all persons (including individuals, banks, locally controlled entities, and branches of foreign entities).
    - The EBITDA-based interest limitation rule shall also apply to entities that are taxable under the Ninth Schedule, i.e., entities operating in the extractive sectors.

As currently worded, the introduction of the EBITDA-based interest limitation rule will likely discourage borrowing and punish early stage capital intensive businesses that have significant finance costs to fund their investments. In the long run, this could adversely affect investment in the country, as investors may consider diverting their investments to other countries. There is need to revise the provisions to reduce the adverse impact of the interest limitation rule and to exempt lending institutions and start-ups, among other justifiable cases.

- The tax loss carry-forward limitation is set to be repealed (Effective 1 July 2021).
    - The tax loss carry-forward limitation was introduced by the Finance Act, 2009. The limitation came into force on 1 January 2010.
    - The tax loss utilisation period was initially set at 4 years. However, the Finance Act, 2015 extended this period to 9 years, with effect from 1 January 2016.

The proposed removal of the tax carry-forward restriction/ limitation may have been informed by the introduction of minimum tax, effective 1 January 2021, as minimum tax would still be expected to apply regardless of whether a person is in tax losses or not.

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- An expanded definition of "control" is set to be introduced (Effective 1 July 2021).
    - The new definition will capture businesses such as dominant financiers, franchises or licensed manufacturers and businesses with one dominant customer or supplier, which may be dealing with completely independent parties.
    - In the case of a company, a person would be considered to be in control if he/ she directly or indirectly owns at least 20% of the company's voting rights. Currently, the control threshold is 25%.

The definition is too wide and would result to a widened scope of application of the controlled company rules upon which transfer pricing regulations on parties who are otherwise independent apply in respect to transactions with related enterprises. The definition will also have an impact on the deductibility of realised foreign exchange losses on loans advanced to the controlled entity. Such entities shall only be allowed to claim a deduction of the foreign exchange losses when their debt-to-equity ratio is 3 to 1 or lower.

- The "permanent establishment" definition is set to be expanded (Effective 1 July 2021).
    - The expanded definition has now recognised the concept of service permanent establishments (PEs) in the local legislation with a lower threshold of 91 days.
    - Exploration activities continuing for 91 days or more will also constitute a PE.
    - Activities of a preparatory or auxiliary character will be excluded.

The expansion of the definition aligns, to a large extent, the domestic legislation with international best practice, as captured in Article 5 of the UN and OECD Model Tax Conventions, which are widely used as the basis for negotiating tax treaties.
However, there is a bit of divergence with the UN and OECD Model Tax Conventions on the time thresholds for creating a PE. The Model Tax Conventions normally use a threshold of 12 months (OECD) or 6 months (UN). However, the proposed law has lower time thresholds of 91 days for services and exploration activities.

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- Kenyan headquartered multinationals will be required to comply with Country-by-Country (CbCR) reporting (Effective 1 July 2021).
  - Multinationals headquartered in Kenya shall be required to file a return of the group's activities in Kenya and any other jurisdiction where the group has taxable presence. The return will be due within 12 months of the group's financial reporting period.
  - The return will contain the group's aggregated information relating to the amount of revenue, profit or loss before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees and tangible assets other than cash or cash equivalent regarding each jurisdiction that the group operates.

> *If adopted, the CbCR requirements will enable the Kenya Revenue Authority to have visibility of financial and related information that will aid in assessing the transfer pricing risk or any BEPS-related risk and make determinations on how to allocate tax audit resources. For the taxpayers who are part of a multinational group, this means additional transfer pricing reporting requirements. There is need to set a threshold for reporting to avoid overburdening smaller entities.*

- Capital allowances will now be computed on a straight-line basis with effect from 1 January 2022 Currently, the allowances are computed on a reducing balance basis.

> *Computation of capital allowances on straight-line basis is simple and reduces the period of recovery of capital costs.*

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- Plant and machinery used for generation, transformation, and distribution of off-grid electricity to be eligible for an accelerated investment allowance in the first year of use, currently at 50% (Effective 1 January 2022).
  - Currently, this allowance is restricted to plant and machinery for generation, transformation, and distribution of electricity to/through the national grid.

This measure will encourage investment in off-grid electricity generation, transformation, and distribution and will create the impetus for investment in off grid power generation and expanding access to electricity.

- Capital allowance rates on machinery used to undertake mining prospecting and petroleum exploration operations to be aligned to the rates provided in the Second Schedule (Effective 1 January 2022).
  - The proposed rate is 50% in the year of first use and the remainder at 25% p.a.
  - Previously, the allowance was claimable at 100% in the year of first use.

Investment allowance is a key incentive for investment especially in capital intensive businesses such as the upstream Oil & Gas and the mining sectors. However, the continued reduction of such allowances is driven by the objective of enhancing collection through reduction of tax incentives and exemptions. While some argue that such moves may slow down investment in such sectors, proponents of the move argue that investment decisions are not primarily driven by tax incentives.

- The Finance Bill proposes to amend Section 41(5) of the Income Tax Act and replace the words an individual or individuals with a person or persons. Section 41(5) provides that the benefits of a tax treaty shall not be available to a resident of the treaty partner state if 50% or more of the underlying ownership of a non-resident is held by an individual or individuals who are not residents of the treaty partner state.

Considering that entities may be held by individuals or other persons such as corporate entities, this is an amendment that aligns to the legal realities. The amended limitation of benefit rule will therefore apply widely to include entities that are ultimately held by body corporates such as governments.

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Digital Service Tax

- Resident persons to be exempted from the digital service tax (DST) regime. The tax has been in effect since 1 January 2021 and was applicable on the income of both resident and non-resident persons from the provision of services through a digital marketplace (Effective 1 July 2021).

> *This is a positive move as the imposition of DST on resident entities would have increased the backlog of refunds, as residents are currently entitled to an offset of the digital tax paid against their income tax liability. This exemption should also be extended to non-residents with permanent establishments in Kenya who would be required to account for tax through the self-assessment and instalment tax mechanism.*

- The due date for paying digital service tax is to be aligned with the due date for filing the digital service tax return. The law currently requires digital service tax to be paid at the point of paying the digital service provider. Under the proposed law, a person may defer the payment of DST up to 20th of the following month (Effective 1 July 2021).

> *We believe this is intended to align the due date of paying digital service tax and filing of the digital service tax return. It is a positive move, as it reduces the administrative burden of accounting for tax at each payment date.*

- Income that is taxable under Section 9(2) and section 35 of the Income Tax Act to be exempt from digital service tax (Effective 1 July 2021).
    - Section 9(2) brings to charge the income of a non-resident person who carries on the business of transmitting messages by cable or radio communication, optical fibre, television broadcasting, Very Small Aperture Terminal (VSAT), internet or any other similar method of communication while Section 35 lists the incomes that are liable to withholding tax in Kenya.

> *The exemption of income taxable under Section 9(2) or Section 35 from digital service tax is already provided for in the Regulations. The introduction of the exemption in the Income Tax Act is meant to avert any inconsistencies with the Regulations.*

- The scope of application of digital service tax is set to be expanded to any income from a business carried over the internet or an electronic network, including through a digital marketplace. Currently, digital service tax only applies on the income accruing through a digital marketplace. The definition of "digital marketplace" is also set to be expanded in order to cover any "online platform which enables users to sell or provide services, goods or other property to other users".

> *This is an attempt to widen the scope of income subject to digital service tax with a view to sealing any leakages that may exist from the current definition.*

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Withholding Tax

- Withholding tax on service fees payable to non-resident service subcontractors operating in the extractive industries to be increased from 5.625% to 10% (Effective 1 July 2021).

> *This move is aimed at increasing tax collection from the extractive sector since a large portion of technical services is normally subcontracted to specialist service companies.*

- Withholding tax on management, training, and professional fees payable to non-resident subcontractors operating in the extractive sectors to reduce from 12.5% to 10% (Effective 1 July 2021).

> *This move removes the confusion that existed between the scope of service fees and fees relating to management, training and professional services paid to non-resident subcontractors.*

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Personal Income Tax

- Effective 1 January 2022, individuals making contributions to the National Hospital Insurance Fund ("NHIF") will qualify for a tax relief equivalent to 15% of the contributions made up to a maximum of KES 5,000 per month. Currently, only policyholders of education, life and health insurance enjoy an insurance relief on the premiums paid.

> *• By allowing a tax relief on the NHIF contributions, individuals will enjoy a maximum relief of KES 255 per month based on current rates of contribution. Albeit minimal, the relief is bound to encourage more NHIF remittances, especially in the informal sector where NHIF membership is low and voluntary. In addition, the measure will aid the government in attaining its Universal Health Coverage ('UHC") agenda as stipulated in the Big 4 Agenda. In the recent past, in a bid to fund UHC, there have been proposals to increase NHIF contributions and it is possible that this amendment may be a precursor to higher NHIF rates.*

- Employers who engage at least ten graduates of technical and vocational training institutions will be eligible to claim a tax rebate equal to 50% of salaries paid to these graduates subject to meeting the criteria stipulated in the Income Tax (Set-Off Tax Rebate for Graduate Apprenticeships) Regulations, 2016. This will be effective from 1 January 2022. Currently, only employers who engage university graduates are eligible for this rebate.

> *The government appears to have recognised the importance of creating opportunities for not just university graduates, but also other institutions that train individuals to acquire skills for the job market. However, the uptake of this apprenticeship program has been low since its introduction in 2016. It would be important for the government to consider relaxing the strict requirements set out in the Income Tax (Set-Off Tax Rebate for Graduate Apprenticeships) Regulations, 2016.*

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Value Added Tax (VAT)

- Export of services to be exempt from VAT. Currently, this is zero-rated. If this proposal is passed, input tax attributable to exported services shall not be claimable. (Effective 1 July 2021)

> *This move is likely aimed at reducing VAT refund claims, which arise due to zero-rating. Recent court decisions on the matter of export of services have not favoured the revenue authority, and it is likely that these may have informed the move to change the VAT status. We contend that this move not only negates the generally accepted VAT principles relating to international trade but also makes the country unfavourable as an outsourcing or shared services hub.*

- Persons who are not registered for VAT will be required to account for VAT on imported services through the reverse VAT mechanism. This is not a new proposal. In 2019, various substantive provisions of the VAT law on imported services were amended so as to bring persons not registered for VAT within the purview of reverse VAT. The changes back then were not holistic, and a few provisions of the VAT law still only referred to registered person on the matter of imported services. The proposal to now align the provisions of the VAT law is a clean-up of the relevant provisions so that they are harmonised. (Effective 1 July 2021)
- Input tax incurred on hiring and leasing of passenger cars and minibuses will not be allowed for deduction unless the vehicles are exclusively applied in the business of selling or hiring of vehicles. Currently, the restriction on deductibility of input tax only applies to the acquisition, spare parts, maintenance and repairs of passenger vehicles and minibuses. (Effective 1 July 2021)

> *This move is likely aimed at giving legal effect the previously erroneous interpretation of Section 17 (4) of the VAT Act, 2013 regarding hiring or leasing of passenger motor vehicles. Affected taxpayers should therefore carefully ensure input tax incurred in this regard is either expensed or capitalised. It may also be important to consider the impact of this change on subsequent sub-leases or where one hires such vehicles and subsequently provides the vehicles for hire to another person*

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- The scope of application of VAT on digital marketplace supplies is to be expanded to capture any supply made over the internet or an electronic network. Currently, the scope only captures supplies made through a digital marketplace. The VAT law defines a digital marketplace as a "*platform that enables the direct interaction between buyers and sellers of goods and services through electronic means*". It is proposed that this definition be amended to mean "an online platform which enables users to sell or provide services, goods or other property to other users."

> *We view this as an attempt to widen the scope of digital marketplace supplies with a view to sealing any perceived leakages that may exist from the current definition. For instance, based on the existing definition, one may argue that VAT should not be applied where there is no direct interaction between buyers and sellers.*

- The supply of ordinary bread is to be removed from the zero-rating schedule. Technically, this would imply that ordinary bread will henceforth be subject to VAT at the standard rate. However, we understand that the KRA has indicated that ordinary bread will fall within the exemption schedule if the proposed change is effected. This said, we hold the view that if the intention is to move the supply of ordinary bread to the exemption schedule, the same should be expressly stated by an insertion into the First Schedule through the Finance Bill. Therefore, if not corrected, ordinary bread would become taxable at the standard rate and prices are likely to be revised upwards.
- Entities will no-longer be able to register for VAT as a group. Group registration allows two or more corporate entities to be treated as a single taxable person. This can be an effective way for managing VAT for corporate groups and reducing the administrative burden. However, there are certain complexities that require proper guidelines. The Cabinet Secretary for National Treasury (CS) is required under the provisions of Section 34(9) of the VAT Act to publish regulations on group registrations, but this has not been done. Therefore, implementation would present challenges without proper guidelines. In addition, KRA in practice prefer dealing with each group entity separately, which perhaps informs the proposed deletion.
- There is a proposal to remove the requirement for VAT Regulations to be tabled before the National Assembly before they become law.

> *Regulations made under the VAT Act, 2013 fall under the purview of the Statutory Instruments Act, 2013 (SIA), which requires regulation making authorities to seek the appropriate consultation before making statutory instruments. This process is necessary to ensure the proposed regulation considers relevant implications and complies with Constitutional requirements. This proposal, if passed, may expose such regulations to challenges from a constitutional perspective.*

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Customs

- Duty remission is to be extended on the following products for a further period of one year (Effective 1 July 2021):
  - Inputs used to manufacture essential medical products and supplies including masks, sanitizers, ventilators and personal protective equipment at 0%;
  - Various inputs used in the manufacture of baby diapers at 0%; and
  - Inputs used in the manufacture of roofing tiles at 0%.

The extension of duty remission on inputs used for manufacture of protective gear is aimed at reducing the cost of the protective gear in a bid to support the fight against COVID 19 pandemic. Further, the extension of duty remission on inputs for manufacture of diapers and roofing tiles is geared towards promoting local manufacture of these products by reducing the cost of inputs. Ultimately, the reduction in the cost of inputs will boost the competitiveness of the affected local manufacturers.

- Stay of application of the Common External Tariff (CET) rates has been extended for a further period of one year on the following products (Effective 1 July 2021):
  - Imported iron and steel to apply a hybrid rate of 25% or a specific rate instead of 25%;
  - Leather and footwear products to apply a hybrid rate of 25% or a specific rate instead of 25%;
  - Furniture to apply a rate of 35% instead of 25%.
- Stay of application of the CET rate is to be granted on various vegetable products including potatoes, peas, tomatoes etc at the rate of 30% (Effective 1 July 2021).

The stay of application of the CET rate has been extended on the above products to impose a higher import duty rate on importation of the said products in a bid to increase the landed cost of the products and hence protect local manufacturers of these products from unfair competition arising from imported goods.
The increase in import duty on vegetable products will promote growth of the agricultural sector and protect farmers from cheap imports.

- The Customs clearance processes by maritime stakeholders has been digitised through the introduction of a Maritime Single Window System under the Tradenet System. The system will allow shipping agents in Kenya to electronically submit vessel pre-arrival and pre-departure declarations to Government Agencies. (Effective 1 July 2021)

The Maritime Single Window System is expected to simplify the clearance processes for shipping agents which will increase the turnaround time for vessels and ultimately reduce costs associated with delays in the clearance process.

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Excise Duty

- Licensed suppliers of data services are to be allowed to offset excise duty paid on purchase of internet data against the excise duty payable on resale of the internet data to final consumers (Effective 1 July 2021).

> *This measure is in line with a similar relief provided for locally manufactured excisable goods and will avert double payment of excise duty on internet data and ultimately reduce the cost of providing internet data services.*

- Excise duty is set to be re-introduced on betting at 20% of the amount wagered or staked (Effective 1 July 2021).

> *The re-introduction of excise duty on betting may be driven by the need to shore up government revenue as well as curb the negative social impacts caused by betting.*

- Excise duty is to be reintroduced on the following items (Effective 1 July 2021):
  - locally manufactured sugar confectionery of tariff heading 1704 at KES 20.99 per Kg; and
  - locally manufactured white chocolate, chocolate in blocs, slabs, or bars of tariff codes 1806.31.00, 1806.32.00 and 1806.90.00 at KES 209.88 per Kg.

> *This measure is intended to curb discrimination against imported sugar confectionery and chocolate, which are currently subject to excise duty.*

- Excise duty is to be introduced at 10% on jewellery of tariff heading 7113 and imported jewellery of tariff heading 7117 (Effective 1 July 2021

> *Excise duty has traditionally been imposed on luxurious goods and jewellery made of precious metals would fall in this category. Whereas there are no negative effects associated with jewellery, the price elasticity of these products provides an easy avenue for government to generate revenue.*

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- Excise duty is to be introduced on the following products at KES 5,000 per kg (Effective 1 July 2021):
    - products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application but excluding medicinal products approved by the CS responsible for health matters; and
    - other manufactured tobacco and tobacco substitutes that have been homogenized and reconstituted tobacco, tobacco extracts and essences.

This move is geared towards discouraging consumption of these products to protect the population from the negative health effects associated with their consumption. In addition, this measure is intended to impose excise duty on newly introduced products containing nicotine such as nicotine pouches to be in line with tobacco products, which currently attract excise duty.

- Imported glass bottles shall no-longer attract excise duty. The bottles currently attract duty at 25% (Effective 1 July 2021).

Excise duty on imported glass bottles was introduced in March 2020 through the Business Laws (Amendment) Act, 2020. This measure is geared towards curing discrimination against imported glass bottles particularly bottles imported from the East African Community Partner States.

- The rate of excise duty on motorcycles is set to be amended from KES 11,608.23 per unit to 15% of the excisable value (Effective 1 July 2021).

This measure appears to be purely driven at shoring up government revenue, as duty at 15% on the average retail price of motorcycles seem to be higher than the current rate of KES 11,608.23. The price of motorcycles is expected to increase as traders will likely push the tax to buyers.

- Fees or commissions earned in respect of a loan to be deleted from the scope of items that are excluded from excise duty (Effective 1 July 2021).

The proposed deletion of the words "fees or commissions earned in respect of a loan", in our view, creates ambiguity on the scope interest exempted from excise duty in the absence of a definition of "interest" in the Excise Duty Act. In the past, the KRA has held that the term interest does not include loan processing fees and therefore sought to charge excise duty on the fees. However, the Tax Appeals Tribunal has ruled, in a number of cases that, in the absence of a definition of interest in the Excise Duty Act, the definition of interest in the Income Tax Act, which includes loan processing fees, may be relied upon. If the spirit of the law is to charge excise duty on loan processing fees, the Government should expressly state it as such in the law. However, introduction of excise duty on loan processing fees is likely to increase the cost of accessing credit and should be shelved.

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Miscellaneous Fees and Levies

- Application for refund of fees and levies to be based on Section 47 of Tax Procedures Act, 2015 (Effective 1 July 2021). The provisions of Section 47 of the TPA shall be relied on for purposes of:
  - Application for refunds, ascertainment and repayment of fees and levies overpaid or paid in error under the Miscellaneous Fess and Levies Act; and
  - The determination by the Commissioner of penalties and interests on fees that remain unpaid.

The Miscellaneous Fees and Levies Act does not provide for refund of fees and levies covered under the Act. In practice, however, refunds for Import Declaration Fee (IDF) and Railway Development Levy (RDL) paid in error are processed as though they are import duty under Section 144 of the East African Community Customs Management Act (EACCMA). Bringing the Miscellaneous Fees and Levies Act under the Tax Procedures Act is welcome, as it provides a legal basis for refund of fees and levies paid in error.

- Exemption of IDF and RDL to be reintroduced on goods, the exemption of which the CS may determine is in the public interest, or is intended to promote investment of a value not exceeding KES 5 billion (Effective 1 July 2021).

This is a welcome proposal that if adopted will reduce the cost of qualifying projects. The threshold of investments eligible for this exemption has been increased from KES 200 million to KES 5 million perhaps in a bid to limit the number of projects eligible for this exemption and to attract high value investments in Kenya.

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Tax Administration

- All financial institutions resident in Kenya and branches of non-resident financial institutions will be required to adhere to the Common Reporting Standards Regime (CRS) to effect the automatic exchange of financial accounting information on tax matters. The Cabinet Secretary for the National Treasury is expected to publish the CRS regulations that will provide the due diligence procedures and record keeping requirements, guide on how to identify reportable accounts, the date and manner of filing and any other relevant information. Non-compliance will attract punitive penalties and sanctions (Effective 1 July 2021).

> *The proposal demonstrates Kenya's resolve to join global tax transparent jurisdictions in relation to exchange of information on foreign accounts for tax purposes. We expect the Regulations to provide more details on how the CRS regime will be implemented. In the meantime, Kenyan tax residents should consider reviewing their tax compliance status.*

- The statute of limitation for taxes is set to be increased from 5 years to 7 years (Effective 1 July 2021). This effectively means that:
  - A taxpayer may be able to apply for amendment of a self-assessment within 7 years from the date of the original self-assessment;
  - The Kenya Revenue Authority may audit the affairs of a taxpayer if it is within 7 years from the date the return was submitted or the end of a reporting period (where no return was submitted); and
  - Tax records will need to be kept for at least 7 years.

> *This proposal is likely to increase the administrative burden of record keeping and uncertainty in tax matters.*

- Implementation of international tax agreements that the Government has concluded relating to international tax compliance, prevention of tax evasion and exchange of tax information will only be done in the manner prescribed in such agreements. Disclosure of any information obtained pursuant to the agreements will also be governed by the provisions of the said agreements (Effective 1 July 2021).
- Non-resident persons who file returns and make payments through a resident tax representative or a non-resident person with a permanent establishment will be exempt from maintaining financial records in Kenya Shillings. Non-residents carrying on business through the digital marketplace may also maintain financial records in convertible foreign currency as may be approved by the Commissioner for domestic taxes (Effective 1 July 2021).

> *The administrative burden of maintaining parallel records in a currency that is different from the currency used by the Group will be removed. The change may, however, not have a major impact given that such persons will still be required to file their returns in Kenya shillings. In addition, the requirement that records maintained in convertible currency are in accordance with the approval by the Commissioner may pose unnecessary hurdles since the approval criteria is not set out in the law.*

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- The Commissioner will be allowed to abandon taxes if there is any other reason occasioning inability to recover unpaid tax other than the reasons stipulated in the Tax Procedures Act. However, the Commissioner will be required to file biannual reports containing the details and amount of taxes abandoned by 30th June and 31st December (Effective 1 July 2021).

This is a welcome move especially where the Commissioner has justifiable grounds to abandon tax. The proposal requiring the Commissioner to submit reports to the Cabinet Secretary is also welcome, as it will enhance accountability. However, it is unlikely to be widely applied given recent experience with regard to applications for waivers and abandonment.

- Persons with perpetual VAT credits will no-longer be able to apply for exemption from withholding VAT (Effective 1 July 2021).

This proposal may have been informed by the fact that there is currently a provision that entitles persons in VAT credit positions as a result of withholding VAT to a refund of the credit or set-off of the VAT credit against other taxes. However, there is likelihood that this proposal will lead to a backlog of VAT refunds, as all taxpayers with perpetual VAT credits due to withholding VAT will be forced to lodge VAT refunds.

- The Tax Procedures Act is set to be amended to provide that where a taxpayer applies for refund of a tax overpayment and the refund is used to offset outstanding tax, penalties or interest shall only stop accruing from the date the taxpayer is notified that the application for refund has been ascertained. Any amount that remains outstanding after the offset shall continue to accrue penalties and interest (Effective 1 July 2021).

Given that taxpayers have no control of how long it will take for the Commissioner to process and notify the taxpayer that the application has been ascertained, it would be unfair to impose penalties.

- Electronic submission of an objection on a weekend or public holiday will be allowed where the due date falls on such days. Currently, where a notice of objection falls due on a Saturday, Sunday or public holiday in Kenya, the due date is taken to be the previous working day (Effective 1 July 2021).

This proposal will be of great convenience to taxpayers and will accelerate the digitalization of the tax administration process. It comes at a time when the KRA has been accepting objections filed electronically due to the restrictions arising from the Covid-19 pandemic.

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- The Commissioner will be allowed to seek the intervention of relevant authorities to enforce compliance with the provisions of taxes from persons who provide services over the internet or an electronic network including through a digital marketplace (Effective 1 July 2021).

This will enable KRA to collaborate with other authorities especially on enforcement of the recently introduced Digital Service Tax (DST) and VAT on supplies made through a digital marketplace. The term "relevant authorities" is not defined. This implies that KRA may work with a wide range of third parties to enforce the tax. Enforcement of taxes may include restriction of access to the digital marketplace in Kenya.

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Other Measures

- The Miscellaneous Fees and Levies Act is set to be included among the tax laws that are governed by the Tax procedures Act (Effective 1 July 2021).
- Failure by a person to appear before the Commissioner will be a punishable offence with effect from 1 July 2021. Currently, failure to appear before the Commissioner is only an offence to the extent that the Commissioner or an authorized person had notified the person being summoned in writing to attend at the time and place specified for purposes of giving evidence in relation to a tax matter (Effective 1 July 2021).
- Effective 1 July 2021, civil and criminal cases on the same tax dispute may run concurrently and none shall act as a ground for stay, prohibition or delay of the other (Effective 1 July 2021).
- KRA officers are set to be protected from being personally liable for acts or omissions done or committed in performing their functions under a tax law to the extent that they acted in good faith (Effective 1 July 2021).
- Digital service providers, including non-resident persons without permanent establishment in Kenya, will be required to have a Personal Identification Number (PIN). This move will render the option of digital services providers appointing a tax representative to help in filing and paying of taxes in Kenya redundant (Effective 1 July 2021).
- The Tax Appeals Tribunal Act, 2013 is set to be amended vide the Tax Appeals Tribunal (Amendment) Bill, 2021, which has already been submitted to the National Assembly for consideration. According to the CS, the amendments are aimed at strengthening the Tribunal and allowing members to expeditiously hear and conclude cases.

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Agriculture and Food Security

- The sector was the largest driver of economic growth in 2020, registering a 5.1% growth from 2019.
- The sector has been allocated KES 69.7bn in the 2021-22 budget, an increase from KES 63.2bn in 2020-21.
- The increased budgetary allocation as well as increased international demand is expected to support the projected 4.1% growth of the sector in 2021.
- The Government has set aside KES 60 billion for relevant programs in the Agriculture and Food Security sector. The key allocations are as follows:

Key allocations

- KES 7 billion to the National Agricultural and Rural Inclusivity Project;
- KES 2.7 billion for Kenya Cereal enhancement programme;
- KES 1.8 billion for the Emergency Locusts Response;
- KES 1.5 billion for the National Value Chain Support Programme;
- KES 1.5 billion for the Agricultural Sector Development Support Programme II;
- KES 1.5 billion for the Small-Scale Irrigation and Value Addition Project;
- KES 3.2 billion for the Aquaculture Business Development Project;
- KES 3.4 billion for the Kenya Marine Fisheries & Socio-Economic Development Project;
- KES 2.1 billion for Exploitation of Living Resources under the Blue Economy;
- KES 1.0 billion for construction of Fish Processing Plant in Lamu;
- KES 8.9 billion for the Climate Smart Agricultural Productivity Project; and
- KES 1.1 billion to enhance drought resilience and sustainable livelihood.

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Energy, Infrastructure and ICT

- The energy and infrastructure sectors recorded a slow down in growth from a five year average of 7.8% to 1.3% in 2020 as a result of the pandemic.
- The energy and infrastructure sectors have been allocated KES 182.5bn and 71.9bn respectively.
- Further, the Finance Bill has proposed VAT exemptions for taxable goods excluding motor vehicles imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration and specialised equipment for the development and generation of solar and wind energy.
- The factors above are expected to complement growth of up to 5.0% in the sector that will primarily be driven by the resumption of large-scale infrastructure projects such as the Jomo Kenyatta International Airport (JKIA)-Nairobi railway line.

Key allocations

Energy

- The Government has set aside KES 71.9 billion for the development of reliable and affordable energy.
  - KES 50.1 billion will cater for transmission and distribution of power;
  - KES 11.3 billion for development of geothermal energy;
  - KES 6.4 billion for electrification of public facilities; and
  - KES 1.3 billion for development of nuclear energy as well as exploration and mining of coal.

Infrastructure

- The major allocations towards the infrastructure sector include:
  - KES 182.5 billion to support the construction of roads and bridges as well as rehabilitation and maintenance;
  - KES 1.3 billion for rehabilitation of the Railways Metro Lines within the Nairobi Metropolitan Area;
  - KES 27.2 billion for Phase II of the Standard Gauge Railway;
  - KES 2.0 billion for construction and rehabilitation of the Naivasha Inland Container Depot-Malaba Line;
  - KES 2.0 billion for the construction and rehabilitation of the Riruta/Lenana-Ngong Railway; and
  - KES 1.1 billion to complete the rehabilitation of the Nairobi-Nanyuki Meter Gauge Railway;
  - KES 700 million to complete the rehabilitation of the Nakuru-Kisumu Meter Gauge Railway;
  - KES 2.0 billion for the Kenya National Ship Yard;
  - KES 7.5 billion for the Mombasa Port Development Project;
  - KES 7.5 billion for the LAPSSET Project;
  - KES 603 million for construction and expansion of airports and airstrips.

ICT

- The government has set aside KES 20.9 billion to fund initiatives in the ICT Sector. KES 1 billion for Government Shared Services;
  - KES 670 million for the Digital Literacy Program;
  - KES 1.2 billion for maintenance and rehabilitation of the National Optic Fibre Backbone Phase II Expansion Cable;
  - KES 1.1 billion for installation and commissioning of the Eldoret-Nadapal Fibre Optic Cable;
  - KES 16.2 billion to fast track the development of the Konza Technopolis.

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Tourism and Hospitality

- The hospitality sector was significantly affected by the COVID-19 pandemic in 2020.
- Despite the persistence of the pandemic in 2021, the sector is expected to leverage off the KES 71.3bn allocation in the 2021-22 budget for the development of recreational facilities.
- These allocations in conjunction with increased marketing, easing of international travel restrictions and mass global vaccinations are expected to boost the sector's performance in 2021.

Key allocations

- KES 1.7 billion for the Tourism Fund; and
- KES 643.0 million for Tourism Promotion Fund

Environment

- To expand access to clean and adequate water for domestic and agricultural use, the government made the following allocations;

Key allocations

- KES 38 billion for water and sewerage infrastructure development;
- KES 16.4 billion for water resources management;
- KES 10.8 billion for water storage and flood control;
- KES 10.5 billion for irrigation and land reclamation;
- KES 1.6 billion for water harvesting and storage for irrigation;
- KES 9.6 billion for forests and water towers conservation;
- KES 3.3 billion for environmental management and protection;
- KES 1.4 billion for Meteorological Service; and
- KES 8.2 billion for wildlife conservation and management

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Education

Key allocations

- KES 12 billion for Free Primary Education;
- KES 2.5 billion for recruitment of teachers;
- KES 62.2 billion for Free Day Secondary Education including insurance under NHIF for secondary school students;
- KES 4 billion for examination fees waiver for all class eight and form four candidates;
- KES 1.8 billion for the School Feeding Programme;
- KES 1 billion for the Competency Based Curriculum;
- KES 4.2 billion for Primary and Secondary schools' infrastructure;
- KES 1.8 billion for construction and equipping of Technical Training Institutes and Vocational Training Centres;
- KES 1.1 billion to increase access and improve the quality of Technical and Vocational Education and Training programmes under the East Africa Skills Transformation and Regional Integration Project
- KES 281.7 billion to Teachers Service Commission;
- KES 76.3 billion for University Education;
- KES 15.8 billion to the Higher Education Loans Board;
- KES 5.8 billion for Kenya Secondary Education Quality Improvement Project;
- KES 5.2 billion for capitation for Technical Vocational Education Training (TVET) students;

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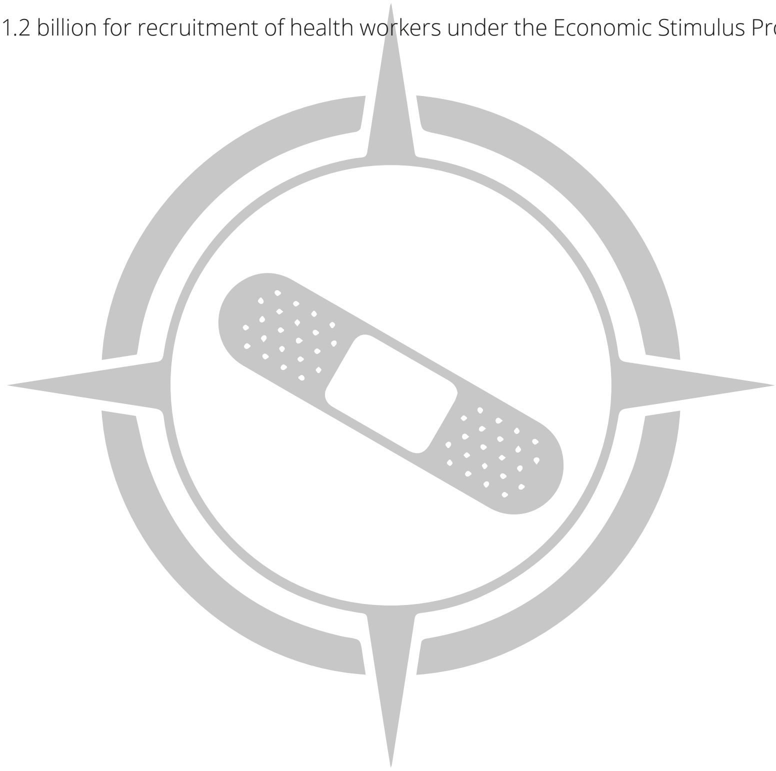
Healthcare

- 2020-21 was characterised by significant government spend on the healthcare sector as a result of the novel coronavirus.
- The government has allocated KES 121.1bn to the healthcare sector in 2021-2022 of which KES. 3.9bn is for the procurement of COVID vaccines while KES 9.5bn is for the engagement of COVID-19 specialists and the supplying of 28 hospitals with equipment. Though a step in the right direction, this is unlikely to make any significant dent given that the estimated cost of vaccinating 30% of the population is KES 34bn.
- Increased government support in the sector is likely to attract private investment, thereby boosting efficiency and quality of healthcare services.
- Further, the Finance Bill has proposed VAT exemptions for various medical inputs such as ventilators, physiotherapy accessories, treadmills for cardiology therapy, Diagnostic or laboratory reagents, Electro-diagnostic apparatus, some instruments and appliances used in dental sciences, some medical instruments and appliances, breathing appliances etc.
- These exemptions are expected to result in increased affordability of medical services.

Key allocations

- KES 47.7 billion to fund activities and programmes for the attainment of UHC;
- KES 5.8 billion towards lowering cases of HIV/AIDS, Malaria and tuberculosis;
- KES 3.9 billion towards enhancing vaccines and immunizations programme;
- KES 14.3 billion for purchase of COVID-19 vaccines;
- KES 39.8 billion to various health facilities, medical training institutes, research centres and specialised care facilities; and
- KES 1.2 billion for recruitment of health workers under the Economic Stimulus Programme.



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Housing

- As part of the Affordable Housing initiative contemplated under the Big 4 agenda, the government has set aside KES 13.9 billion for the Affordable Housing Programme

Key allocations

- KES 3.5 billion to Kenya Mortgage Refinance Company (KMRC);
- KES 8.2 billion for construction of Affordable Housing Units; and
- KES 500 million for construction of Social Housing Units.
- Other key allocations to the Housing, Urban Development and Public Works sector include:
- KES 3.5 billion for the Kenya Informal Settlement Improvement Project-Phase II;
- KES 1.0 billion for construction of markets; and
- KES 1.0 billion for maintenance of Government Pool Houses.

Manufacturing

- In line with the Big 4 Agenda, the Government's efforts are geared towards scaling up reforms to encourage investment in the manufacturing sector and to support and protect local industries.

Key allocations

- KES 20.5 billion under various implementing Ministries, Departments and Agencies;
- KES 210.4 million for coffee industry revitalization;
- KES 59.2 million for modernization of cooperative cotton ginneries; and
- KES 50 million for the Cotton Development as subsidy and extension support.
- KES 1.4 billion for the Kenya Industry and Entrepreneurship Project;
- KES 800 million for the Kenya Youth Employment and Opportunities Project;
- KES 448 million for Industrial Research Laboratories; and
- KES 199.5 million for Constituency Industrial Development Centers.

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Financial sector

Capital markets

- In order to provide room for investments by individuals as well as collective group investments, Central Depositories is set to allow owning of omnibus investment accounts by proxy investors in the securities market. This measure will enable individuals who are not able to invest in personal capacity to raise capital and invest as a group.
- Capital Markets Tribunal (CMT) is set to hear and determine any appeals within 90 days in a bid to improve efficiency and ensure fair administrative action. Currently, the law does not provide for a specific period within which a matter should be heard and determined.
- An Over-The-Counter secondary market platform for Government securities is set to be introduced by June 2022. The intention is to further deepen the domestic debt market while improving pricing efficiency and transparency in securities trading. According to the budget speech, the move is likely to lower yields and cost of credit in the economy as well as make this market more lucrative.

Insurance

- Similar to local insurance brokers, foreign insurance brokers are set to be regulated by the Insurance Regulatory Authority. Currently, foreign insurance brokers are not regulated. This move is aimed at shielding local policyholders from the risk posed by non-regulation of the foreign insurance brokers and providing a level playing ground with the local insurance brokers.
- To cushion policyholders against the negative impacts of overestimating or underestimating management expenses by insurers, the Insurance Regulations are set to be amended to provide for the maximum permitted expenditure for every insurance category.

Retirement benefits

- The Government is set to introduce a National Retirement Policy to collapse all the pension scheme laws into one by December 2021. The objective is to have one comprehensive pension coverage across both formal and informal sectors. This is expected to protect the interests of beneficiaries and rights of pension contributors.
- Corporate trustees are set to be registered and regulated to provide services to pension schemes. The Current law does not allow registration of corporate trustees. This will improve the corporate governance structure of pension schemes while increasing the accountability levels of the same.
- The Government is set to introduce a National Informal Sector Pension scheme to cater for the informal sector players. Arguably, the informal sector has for long been neglected as a potential pension niche.
- Retirement Benefits Act and mortgage regulations will be amended to allow members use part of their accumulated benefits up to 40 percent or maximum of KES 7 million of their accrued benefits to purchase residential houses.

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Banking

- The government has submitted a Central Bank of Kenya (Amendment), Bill, 2021 to the National Assembly. The bill proposes to provide for licensing of digital credit service providers.
- The measure comes at a time when the personal mobile lending business is growing exponentially, albeit without any form of regulations. Licensing under the Central Bank of Kenya Act implies that interest and other fees and charges by the lenders are likely to be regulated.

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Our insights can help you navigate the new realities of this year. If you're looking for fresh ideas to address your challenges, we should talk.

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