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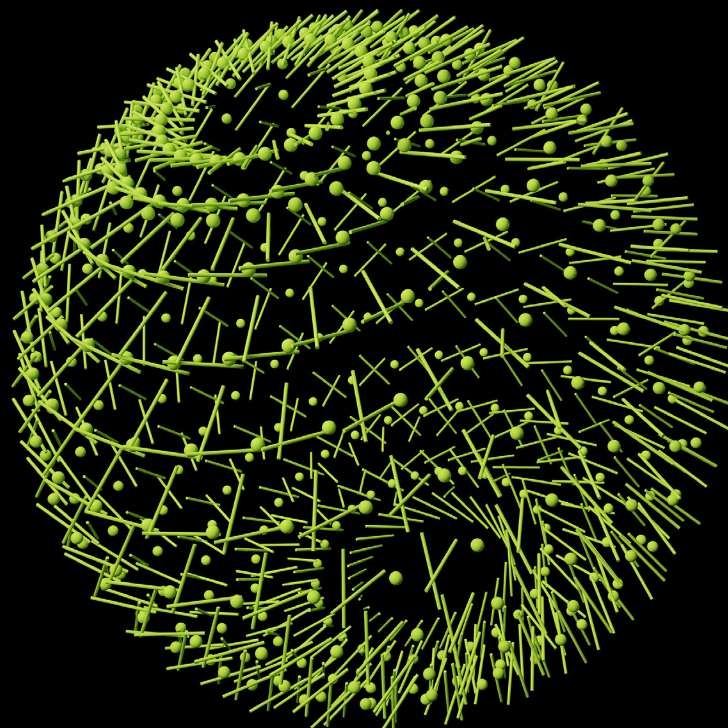

Kenya Budget Highlights 2020/21

Resilience in extraordinary times

June 2020

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Preamble

The national Budget was presented against the backdrop of the adverse effects of the COVID-19 pandemic which necessitated a revision of projections and a focus on measures to cushion the most affected sectors and individuals. The theme of "stimulating the economy to safeguard livelihoods, jobs, businesses and industrial recovery" aptly captured the priority for supporting recovery.

There is still significant uncertainty in the days ahead which will impact the budget out-turn.

Our budget highlights presents a brief description of the main tax and related regulatory changes contained in the 2020/21 Budget speech as presented by the Cabinet Secretary for the National Treasury, Ukur Yattani.

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Tax measures

Corporate Tax

- The maximum income threshold subject to residential rental income is to be increased from KES 10m to KES 15m **(Effective 1 January 2021)**. Residential rental income tax, which is a simplified regime, applies at the rate of 10% on the gross rental receipts of a resident person in respect of residential property. The tax is payable on a monthly basis. *Considering that many residential rental income earners are individuals, we would recommend that the Government considers reviewing the minimum taxable rental income to KES 288,000 per year to align it with the personal tax threshold as recently amended.*
- A new tax known as "minimum tax" is to be introduced with effect from **1 January 2021**. The tax shall be applicable at 1% of the gross turnover and shall be paid through a quarterly instalment tax system by the 20th of the fourth, sixth, ninth and twelfth months. Minimum tax shall not be applicable in the following instances:
  - On income that is exempt from tax under the Income Tax Act;
  - On employment income;
  - On income that is taxable through either the residential rental income tax or the turnover tax regime;
  - On capital gains computed in accordance with the Eighth Schedule;
  - On income derived from extractive industries, as prescribed under the Ninth Schedule; and
  - In instances where minimum tax would be lower than instalment tax. *This appears to be a drafting error, as the Finance Bill has also proposed to amend Section 12 of the Income Tax Act to exempt persons from payment of instalment tax if minimum tax would be higher than instalment tax. Minimum tax should only be applicable where instalment tax payable is lower than minimum tax and we expect this to be amended before the Bill is enacted. As many entities are likely to report losses under the current adverse conditions, this measure should be reviewed and aligned to best practice where minimum tax applies where an entity reports consecutive tax losses for at least 3 or 5 years.*
- A "digital service tax" is to be introduced with effect from **1 January 2021**. The tax shall be applicable at the rate of 1.5% of the gross transaction value of a person whose income from provision of services is derived from or accrues in Kenya through a digital market place. In the case of residents and non-residents with permanent establishments in Kenya, the tax shall be offset against their income tax liability for the year. *Without adequate guidelines and thresholds, the measure will pose administrative challenges. Ideally it should be targeted at non-resident persons without taxable presence whose income/ sales arising from Kenya exceed a specified threshold. Though a global trend, there is still lack of consensus on the application with certain countries contesting the unilateral measures adopted by those that have introduced this tax.*
- With effect from **1 January 2021**, no deduction in respect of the following expenditure shall be allowed when ascertaining a person's taxable income:
  - Entrance fees or annual subscriptions paid to a trade association that has elected to be taxed;
  - Club subscriptions paid by an employer on behalf of an employee;
  - Legal costs and other incidental expenses relating to authorisation and issue of securities for purchase by the public;

- Legal costs and other incidental expenses incurred to list on any securities exchange operating in Kenya, without raising additional capital;
- Expenditure incurred on rating for the purposes of listing on any securities exchange operating in Kenya; and
- Expenditure incurred on the construction of a public school, hospital, road or any similar kind of social infrastructure subject to approval by the Minister.

These measures are in line with the policy direction of reducing tax incentives in a bid to increase tax revenues.

- The following incomes, which are currently exempt from tax, shall become taxable (with effect from **1 January 2021**):
  - The income of a registered Home Ownership Savings Plan (HOSP); and
  - The income of the National Social Securities Fund (NSSF)

These appear to run counter to the Housing agenda and the need to boost retirement savings for enhanced social security.

Personal Income Tax

- Deposits into registered HOSPs shall no-longer be deductible while ascertaining an individual's taxable income **(Effective 1 January 2021)**. Currently, a person is eligible for a deduction of up to KES 96,000 per year (equivalent to KES 8,000 per month) on deposits made to a registered HOSP.
- Interest income earned by a HOSP depositor shall be fully taxable **(Effective 1 January 2021)**. Currently, any interest income earned by a depositor on deposits of up to KES 3 million to a registered HOSP is exempt from tax.
- The following incomes, which are currently exempt from tax, shall become taxable (with effect from **1 January 2021**):
  - Monthly or lump sum pension granted to a person who is 65 years of age or more; and
  - Bonuses, overtime and retirement benefits paid to low-income employees

These measures are intended to increase tax revenue. One that raises immediate concern is the move to tax pensions paid to senior citizens.

VAT

- Input tax to be claimable by the purchaser only if the supplier has declared the same in the VAT return.
  This measure will give legal force to the recently introduced VAT auto-assessment practice. We consider it a retrogressive measure that if passed, will place a huge administrative burden for purchasers to ensure all their vendors confirm that they have declared sales in their VAT returns before input tax on related invoices can be claimed.
- The supply of the following goods, which are currently listed as exempt from VAT, will be taxable at the general rate (currently 14%):
  - Helicopters of tariff numbers 8802.11.00 and 8802.12.00;
  - Aircrafts of tariff numbers 8802.20.00 and 8802.30.00;
  - Aircraft launching gear and parts thereof; deck-arrestor or similar gear and parts thereof of tariff number 8805.10.00;

- Air combat simulators and parts thereof of tariff number 8805.21.00;
- Other ground flying trainers and parts thereof of tariff number 8805.29.00;
- Specialised solar equipment and accessories, including solar water heaters and deep cycle-sealed batteries which exclusively use or store solar power;
- Tractors;
- New pneumatic tyres of tariff number 4011.30.00 for use in aircrafts;
- Taxable goods locally purchased or imported by manufacturers or importers of clean cooking stoves for direct and exclusive use in the assembly, manufacture or repair of clean cook stoves approved by the Treasury Cabinet Secretary (CS) upon recommendation by the CS in charge of Energy;
- Stoves, ranges, grates, cookers (including those with subsidiary boilers for central heating) barbeques, braziers, gas rings, plate warmers and similar non-electric domestic appliances, and parts thereof, or iron or steel of tariff numbers 7321.11.00, 7321.12.00, 7321.19.00, 7321.81.00, 7321.82.00, 7321.83.00 and 7321.90.00;
- One personal motor vehicle, excluding buses and minibuses of seating capacity of more than eight seats, imported by a public officer returning from a posting in a Kenyan mission abroad and another motor vehicle by his spouse, which is not exempted from VAT under the First Schedule;
- Plant, machinery, and equipment used in the construction of a plastics recycling plant; and
- Hiring, leasing and chartering of helicopters of tariff numbers 8802.11.00 and 8802.12.00.

- The supply of the following goods will be taxable at the general rate (currently 14%). The goods are currently zero-rated for VAT purposes:
  - The supply of liquefied petroleum gas; and
  - Inputs or raw materials for electric accumulators and separators, including lead battery separator rolls, whether or not rectangular or square, supplied to manufacturers of automotive and solar batteries in Kenya.

- The supply of the following goods and services shall be exempt from VAT:
  - Ambulance services;
  - Maize (corn) seeds of tariff number 1005.10.00.

The above measures are driven by the need to reduce the scope of exemptions with the aim of increasing tax revenue. Questions have also been raised regarding the effectiveness of exemptions and whether any benefit is passed on to the final consumer. Therefore, it is expected that going forward, we are likely to see less exemptions. However, we believe some targeted exemptions may be necessary where the benefit is demonstrable.

Customs

- Extension of stay of application of the East African Community Common External Tariff (EAC CET) rate on the following products:
  – A wide range iron and steel products to apply a rate of 35% or corresponding specific rates;
  – Paper and paperboard products to apply a rate of 25%;
  – Leather and footwear to apply a rate of 25% or the corresponding specific rates.
- Introduction of a stay of application of the EAC CET rate on electrical parts and accessories from 25% to 35%.
- Introduction of the following products into the EAC Duty Remission Scheme at 0%:
  – All inputs used for manufacture of baby diapers;
  – Inputs for manufacture of textile and apparel;
  – Inputs for assembly or manufacture of mobile phones;
  – Raw materials and inputs for manufacture of masks, sanitizers, ventilators and personal protective equipment including coveralls and face shields.
- Introduction of import duty exemption on supplies for diagnosis, prevention, treatment and management of epidemics, pandemics and health hazards.

The above measures are primarily intended to protect and/or promote local manufacturing as well as to reduce the cost of critical supplies for the management of the pandemic.

Excise Duty

- The definition of "license" in the Excise Duty Act is to be amended to mean:
  – in the case of excisable services, the certificate of registration;
  – in the case of excisable goods, the licence issued under section 17; or
  – in the case of any activity under section 15 (1) (e), the licence required thereunder.
- The Finance Bill has proposed a re-introduction of excise duty on locally manufactured sugar confectionery of tariff heading 1704 at KES 20 per Kg; and white chocolate, chocolate in blocs, slabs or bars of tariff Nos. 1806.31.00, 1806.32.00 and 1806.90.00 at KES 200 per Kg.
- The alcoholic strength threshold for the following excisable spirituous beverages is to be reduced from 10% to 8%:
  – Spirituous beverages subject to excise duty of KES 110.62; and
  – Un-denatured ethyl alcohol, spirits liqueurs and other spirituous beverages subject to excise duty of KES 253 per litre.

The proposal to re-introduce excise duty on confectionary products seems to be driven by the need to generate additional tax revenue but may adversely affect the industry where cheaper imports are available.

The increase in excise duty on alcoholic products may affect demand and defeat the aim of generating additional revenue.

Miscellaneous Fees and Levies

- Revision of import declaration fee (IDF) on goods imported under the East African Community (EAC) Duty Remission Scheme from a fixed fee of KES 10,000 to 1.5% of the customs value.
- Goods entered for home use from an Export Processing Zone Enterprise to be subject to an additional duty at the rate of 2.5% of the customs value.
- Removal of IDF exemption in respect of the following goods:
  - Aircraft of unladen weight not exceeding 2,000Kg and helicopters;
  - Goods determined by the CS Treasury to be in public interest or for promotion of investments above KES 200 million; and
  - Goods for implementation of Special Operating Framework Agreement projects.
- Removal of Railway Development Levy (RDL) exemption on goods determined by the CS Treasury to be in public interest, or for promotion of investments above KES 200 million.
- Exemption of IDF and RDL on goods, including materials, supplies, equipment, machinery and motor vehicles, for the official use by the Kenya Defence Forces (KDF) and the National Police..
- Exemption of RDL on currency notes and coins imported by the Central Bank of Kenya (CBK).

The proposal to amend the IDF rate to 1.5% of the customs value seems geared towards harmonsing the IDF rate applicable on raw materials and intermediate goods whereas the move to charge additional duty on goods from EPZs is aimed at discouraging the sale of goods manufactured in EPZs within the EAC territory, in line with the primary objective of EPZs of promoting exports from Kenya.

The removal of IDF and RDL exemption on the items above will significantly increase the cost of high value items such as aircrafts and high value investments.

Tax Administration

- A tax amnesty programme is to be introduced with effect from 1 January 2021. The amnesty is expected to run for 3 years and shall apply to tax liabilities that accrued within a period of five years prior to 1 July 2020. A taxpayer who voluntarily discloses to the Commissioner their tax liabilities (including material facts) will be granted relief from penalties and interest on the tax disclosed as follows:
  - A full remission of the interest and penalty where the disclosure is made and tax paid within the first year of the programme;
  - A remission of 50% of the interest and penalty where the disclosure is made and tax paid in the second year of the programme; and
  - A remission of 25% of the interest and penalty where the disclosure is made and tax paid in the final year of the programme.

  The tax amnesty programme shall not apply to a taxpayer who is under audit, investigation or is party to an ongoing litigation or who has been notified of a pending audit or investigation by the Commissioner

- The Tax Procedures Act, 2015 is to be amended to allow the Commissioner to appoint persons as agents for purposes of collection and remittance of digital service tax and/ or revoke their appointment at any time.
- The Tax Appeals Tribunal Act, 2013 is to be amended to bar the appellant from introducing new documents to support an appeal after filing the original appeal. Currently, the law only bars an appellant from introducing new grounds of appeal after filing the original appeal.

The amnesty is a welcome move to encourage voluntary compliance. However, to increase its effectiveness, we believe that the amnesty should not exclude persons who have been notified of a tax audit/ investigation from the programme. As long as the audit has not commenced, the taxpayer should be allowed to apply for the amnesty. In addition, the period covered by the amnesty should be aligned to the commencement date i.e. 1 January 2021.
Taxpayers are advised to review their tax affairs to take early advantage of the amnesty, as the revenue authority will likely increase the intensity of audits to make up for revenue shortfalls expected to arise due to the adverse economic effect of COVID-19.

Sectoral Highlights

Tourism and hospitality sector

- To help the sector recover from the ravaging effects of the COVID-19 pandemic, the government has set aside KES 3 billion to fund renovation of facilities and restructuring of business operations in the hospitality sector, KES 1 billion for hiring 5,500 wildlife scouts and KES 1 billion for game parks and conservancies.

Manufacturing

- To boost the local manufacturing sector the Government has made the following allocations to the sector:
  - KES 600 million to purchase locally assembled vehicles
  - KES 712 million to provide credit to micro, small and medium enterprises (MSMEs) in the manufacturing sector.
  - KES 1.4 billion for the Kenya Industry and Entrepreneurship Project;
  - KES 3.6 billion for the development of Special Economic Zones in Naivasha, Kenanie and Athi River.
  - KES 843 million to support the modernization of RIVATEX;
  - KES 800 million for the development of various MSMEs;
  - KES 715 million for the Kenya Youth Empowerment and Opportunities Project;
  - KES 500 million to support dairy processing; and
  - KES 3 billion for the Dongo Kundu Special Economic Zone

Health

- The government has made the following allocations towards achievement of the Universal Health Coverage (UHC):
  - KES 50.3 billion to activities and programmes for the attainment of Universal Health Coverage by the Driver and Enablers;
  - KES 19.2 billion to address and lower cases of HIV, Malaria and tuberculosis in the country;
  - KES 6.2 billion for the managed equipment services;
  - KES 5.3 billion to transform the health care systems for Universal Health Coverage;
  - KES 4.1 billion to cater for free maternity health care; and
  - KES 1.8 billion to provide medical cover for the elderly and severely disabled in our society; and
  - Allocations to various referral and county hospitals

Capital Markets

- The Capital Markets Act (Cap 485A) is to be amended in order to allow the Capital Markets Authority to license, approve and regulate private equity and venture capital companies that have access to public funds.

- The National Treasury is in the process of fully operationalising the Nairobi International Financial Centre. The Centre will play an important role in attracting investments and private capital to support economic growth as well as mobilising additional financing for "Big Four" projects and further providing new financing options for Kenyan businesses.

Financial sector

Insurance

- The Insurance Act (Cap 487) is to be amended in order to limit the period within which to appeal against a decision of the Commissioner Insurance, on a dispute between an insurance customer and regulated entity to 30 days.

Retirement benefits

- The Retirement Benefits Authority Act, 1997 is to be amended in order to introduce penalties where a trustee fails to submit a copy of the actuarial report to the Chief Executive Officer of the Retirement Benefits Authority. A penalty of KES 100,000 will immediately be imposed in case of delay and a further penalty of KES 1,000 shall be charged for each day or part thereof during which the report remains un-submitted.
- The Government is currently working on establishing a National Micro-Pension Scheme with a sustainable model that combines long-term saving with short term needs that will be open to all marginalized informal sector workers who constitute over 80 percent of Kenya's labour force.
- There is a proposal to develop a National Retirement Benefits Policy that will harmonize all the pensions laws.
- There is also a proposal to establish an umbrella retirement scheme for county governments.

Infrastructure

- The government has made the following allocations towards energy and infrastructure:
  - KES 172.4 billion to improve and expand the existing infrastructure;
  - KES 18.1 billion towards SGR Phase II (Nairobi to Naivasha);
  - KES 6 billion for the LAPSSET Project;
  - KES 5 billion for the Mombasa Port Development Project; and
  - KES 328 million for insurance of ferries for the Likoni channel.
- Various amendments to the Roads Toll Act (Cap 407) and the Road Maintenance Fund Act, 1993 in order to facilitate the expected establishment of the National Roads Toll Fund, under the Roads Toll Act (Cap 407), to receive all toll levies.

Energy

- To support generation of adequate and affordable energy, the Government has allocated KES 63.3 billion to the sector. Out of this, KES 50.8 billion will cater for transmission and distribution of power; KES 9.3 billion for development of geothermal energy; KES 6.8 billion for electrification of public institutions; and KES 900 million for provision of transformers in constituencies, development of nuclear energy, and exploration and mining of coal.

Security

- The government has made the following allocations in order to strengthen security agencies:
  - KES 167.9 billion has been allocated to security agencies; Defence, and National Intelligence Service; leasing of police motor vehicles; National Communication and Surveillance System; police modernization, and the equipping of the National Forensic Laboratory.
  - KES 3.4 billion for medical insurance;
  - KES 2.2 billion for group personal insurance for the National Police and Prisons services; and
  - KES 1.0 billion for the National Integrated Identity Management System (NIIMS).

Housing

- The government has proposed an allocation of KES 15.5 billion to the housing, urban development and public works sector. KES 6.9 billion will cater for the Affordable Housing Programme, KES 7.5 billion for the Kenya Urban Programme while KES 1.1 billion for the ongoing construction of Gikomba, Githurai, Chaka, Kamukunji and Dagoretti markets.

Agriculture and food security

- The government has allocated KES 8 billion to projects such as Kenya Climate Smart Agricultural Project, National Agricultural and Rural Inclusivity Project, Kenya Cereal Enhancement Programme, irrigation and land reclamation among others.
- The following additional allocations have been made to the sector:
  - KES 3 billion to subsidize the supply of farm inputs to reach 200,000 small scale farmers through the e-voucher system;
  - KES 3.4 billion for expanded community household irrigation;
  - KES 1.5 billion to assist flower and horticultural farmers access international markets;
  - KES 1.8 billion to enhance aquaculture business development project;
  - KES 1.4 billion to support small-scale irrigation and value addition;
  - KES 1.3 billion to enhance resilience of pastoral communities;
  - KES 1.1 billion to enhance drought resilience and sustainable livelihood;
  - KES 1.6 billion to support processing and registration of title deeds; and
  - KES 500 million to advance agricultural loans through the Agricultural Finance Corporation

Environmental, water and natural resources

- Some of the key allocations towards this sector include:
  - KES 1 billion to support flood control;
  - KES 42.6 billion for development of water and sewerage infrastructure;
  - KES 10.9 billion for management of water resources;
  - KES 8.6 billion for water storage and flood control;
  - KES 82.7 billion to support environment and water conservation;
  - KES 10.9 billion to support conservation of forests and water towers;
  - KES 10 billion for irrigation and land reclamation;
  - KES 10.8 billion for wildlife conservation and management;
  - KES 2.7 billion for environmental management and protection; and
  - KES 1.6 billion for the meteorological service.

Education

- The government has made the following allocations towards the education sector:
  - KES 2.1 billion for construction of additional classrooms;
  - KES 1.9 billion for provision of locally fabricated desks for secondary and primary schools;
  - KES 700 million for capitation and improvement of infrastructure in boarding schools in ASAL areas;
  - KES 2.4 billion for recruitment of 10,000 intern teachers to support 100% transition in schools;
  - KES 300 million for recruitment of 1,000 ICT interns to support digital learning in public schools.

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