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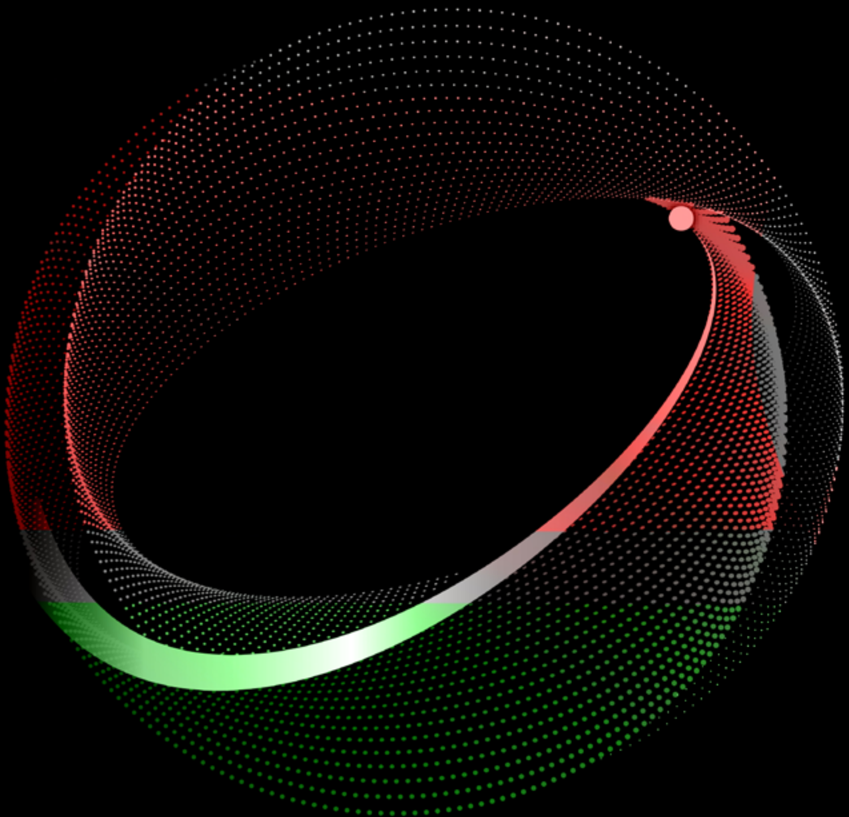

Kenya Budget Highlights 2023/24

Navigating headwinds for inclusive growth

JUNE 2023

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Message from the CEO

The Kenyan economy has had both highs and lows in the past year. Global supply chain disruptions, rising inflation, currency depreciation and drought were a damper on the economy, but in the same period, we witnessed faster growth in the digital economy, and a return to normalcy following the recovery from the pandemic.

For the first time in five years, the inflation rate in Kenya was above the government target range due to shortages on the supply side which were further exacerbated by the drought we experienced. The increases in the price of food and fuel resulted in increase in the cost of living putting further strain on households. The increased rainfall over the last few months will likely improve agricultural productivity and reduce food inflation.

"The 2023/24 budget has attracted a lot of public commentary which is a positive development as it shows that more Kenyans are interested in how our national resources are managed."

On the plus side, tourism has bounced back and the benefits of technology adoption during the pandemic continue to bear fruit. The tourism industry experienced a significant upturn, with visitor traffic rising by 70% in 2022 over the previous year, boosting growth in the Kenyan economy. Kenya registered a 72% recovery towards the 2019 post-pandemic figures which was higher than the global recovery of 63%. Kenya's digital economy also witnessed accelerated growth over the past year. The pandemic catalysed the adoption of digital technologies, transforming various sectors such as e-commerce, fintech, and online service delivery. The rise of mobile money platforms, increased internet penetration, and entrepreneurial initiatives have contributed to financial inclusion and created new avenues for business growth and employment.

The 2023/24 budget has attracted a lot of public commentary which is a positive development as it shows that more Kenyans are interested in how our national resources are managed. This budget is the first to be released under the current Government. According to the 2023 budget policy statement, this is geared towards an economic turnaround and inclusive growth and aims to increase investments in five sectors, i.e. Agriculture Transformation, Micro Small and Medium Enterprises (MSME), Housing and Settlement, Healthcare, Digital Superhighway and Creative industry. Over the short term, the government is looking to shore up its tax revenues by widening the tax base and increasing tax rates.

Headwinds notwithstanding, there is an opportunity to ensure inclusive economic growth for all through expanding the tax base, maintaining fiscal discipline, and all the while ensuring that Kenyans are not worse off on the whole. As always, our optimism, resilience and innovativeness as Kenyans will carry us through economic recovery.

Anne Muraya
CEO
Deloitte East Africa

Foreword

The Balancing act

The 2023/24 budget is the current administration's maiden budget and therefore it presents the administration's priority reform areas, policies, and programs in pursuit of its Bottom-Up Economic Transformation Agenda. The 2023/24 budget comes against the backdrop of significant challenges. On the domestic front, the economy is experiencing significant macroeconomic challenges, including declining agricultural production, decline in consumer purchasing power due to high inflation, dwindling forex reserves, a weakening Kenya shilling, rising cost of living and an increasingly vulnerable debt position. As such, the 2023/24 budget bears the weighty responsibility of carefully balancing between the revenue and spending pressures while addressing the above domestic concerns.

Enhanced revenue targets

In the 2023/24 fiscal year, the Government aims to collect KES 2.571 trillion in ordinary revenue (of which tax revenue is KES 2.4T), representing an increase of KES 429 billion from the KES 2.142 trillion in the 2022/23 budget. To meet this target, the budget contains various tax policy and administrative measures aimed at boosting revenue collection by the Kenya Revenue Authority (KRA). Such include administrative measures to grow Value Added Tax (VAT) collections through the full roll-out of the electronic tax invoice management system (eTIMS) and extending similar invoicing requirements to Income Tax. There are also increases in taxation including higher individual tax rates of 32.5% and 35% ; increase in turnover tax rates; increased VAT and excise duty rates on multiple products, most notably VAT on petroleum products; and tax base expansion into income derived from monetization of digital content as well as tax on transfers of digital assets. The budget also proposes to introduce a tax on employees towards the National Housing Development Fund.

Perhaps reflecting the liquidity crunch faced by the Government, there are several proposals to bring forward the due dates for various taxes, with initial proposals seeking to collect withholding taxes within 24 hours (now revised to 5 days).

Some welcome measures that address concerns raised by taxpayers have also been put forward. Among them is the exclusion of interest on local loans from interest deduction restrictions. Others include the zero-rating of liquified petroleum gas (LPG); the proposed reclassification of exported services and transfer of a business as going concern (TOGC) to exempt supplies; the repeal of annual inflationary adjustment of excise duty rates; reduced railway development levy and import declaration fees among others.

Impact on taxpayers

Overall, the 2023/24 budget reflects the Government's goal to finance its policy objectives whilst enhancing fiscal consolidation. However, the dilemma that arises is whether fiscal consolidation should be driven more through containment of expenditure or through growing revenues by way of increased taxation. It is arguable that pursuit of revenue growth by increasing the tax burden on taxpayers in less-than-ideal economic conditions could have a counterproductive effect on the economy.

Furthermore, some of the measures appear to place a heavier burden on a specific segment of taxpayers (read employees) thus raising questions of equity. One would ask why, for instance, tax on rental income would be lowered, while increasing tax on wage income or even increasing the rate of turnover tax. The proposed abolition of waivers of penalties and interest also heralds an era of increased costs for taxpayers as it disregards the circumstances that could give rise to additional tax, which in many cases arises from differences in interpretation of tax legislation.

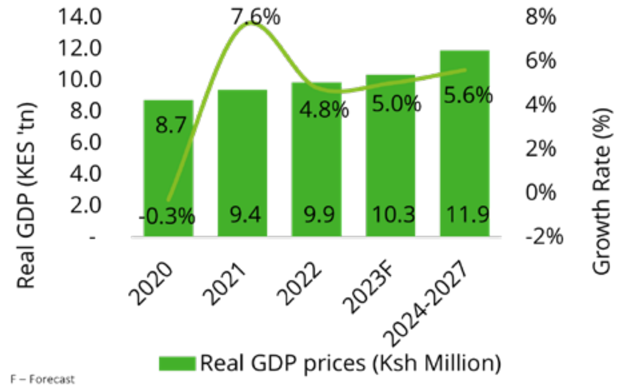
Going forward, it is hoped that there will be increased focus on stimulating economic growth as a means to growing tax yield without the need to constantly increase tax rates. Empirical studies have demonstrated that higher-income countries generate higher taxes as a percentage of GDP compared to lower-income countries.

Fred Omondi
Tax & Legal Leader
Deloitte East Africa

Economic Outlook

Economy at a Glance

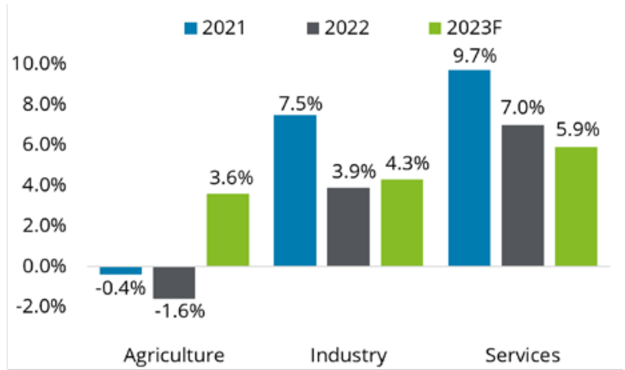
GDP Growth



F – Forecast
Source: Central Bank of Kenya, EIU

- Kenya's GDP growth declined to 4.8% in 2022 from 7.6% in 2021, mainly driven by weaker global growth attributed to the Russia-Ukraine war, tightened domestic fiscal policies and negative growth in the agriculture sector following a long regional drought.
- GDP growth in 2023 is expected to remain muted at 5.0% attributable to further tightening of monetary policies and higher borrowing costs, which are expected to reduce domestic spending and public investment.
- GDP growth is expected to strengthen to a 5.6% year-on-year average in the 2024/2027 Medium Term Plan period driven by reduced inflation, cheaper oil imports, growing digitalisation and improved regional integration and trade.

Sectoral Growth Rate



F – Forecast
Source: EIU

- The agriculture sector contracted by 1.6% in 2022 mainly due to the long regional drought and increased fertiliser costs resulting from supply chain shocks arising from the Russia-Ukraine crisis. The projected 3.6% growth in 2023 will be driven by increased agricultural output owing to improved weather conditions.
- Growth in the industry sector slowed down to 3.9% in 2022, due to the normalisation of activities in the manufacturing sub-sector following a strong rebound in 2021. In 2023, industry is expected to grow by 4.3% mainly due to a full resumption of construction activities and the completion of on-going capital projects.

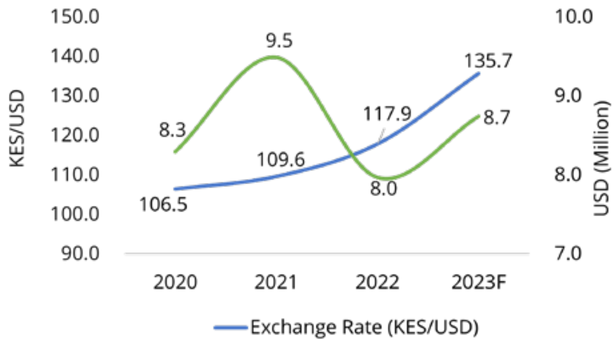
- In 2022, the services sector was significantly impacted by the rising food and commodity prices as well as the cost of imports, which adversely affected the sector's growth. Growth in 2023 is expected to be driven by tourism recovery, regional integration and growing intra-regional trade.

Inflation

F=Forecast
Source: Kenya Bureau of Statistics, Central Bank of Kenya, EIU

- Inflation increased from 5.6% in 2021 to 7.7% in 2022 owing to the increase in the cost of food and fuel mainly driven by:
  - » The regional drought experienced in 2022 adversely affected agricultural yields and consequently resulted in reduced supply of food products. This led to an increase in prices of key food items particularly beans, Irish potatoes and maize; and
  - » Sanctions against Russia, which led to a global surge in oil and gas prices. This was further exacerbated by the government's removal of the fuel subsidy.
- Despite the ongoing inflationary pressures arising from local currency depreciation against the US dollar, inflation is expected to decline to 6.9% in 2023 owing to aggressive tightening of the domestic monetary policy and declining global commodity prices following the easing of global demand.

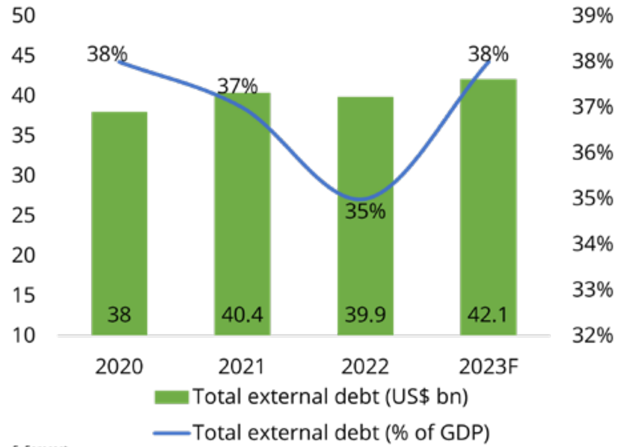
Exchange rate



F=Forecast
Source: Central Bank of Kenya, EIU

- The Kenya Shilling (KES) is expected to weaken against the US Dollar by 15.1% from KES 117.9/USD in 2022 to KES 135.7/USD in 2023, mainly due to the tightening of the US monetary policy by the Federal Reserve Bank.
- Furthermore, Kenya's constrained ability to raise new debt in the international market, and increased demand for US Dollars to meet debt repayments will worsen the depreciation of the Kenya Shilling.
- Kenya's foreign-exchange reserves have also been eroded and currently stand at less than four months of import cover as at May 2023, compared to the 4.17 months of import cover as at December 2022. The continued depreciation of the Kenyan Shilling is expected to erode the benefits of lower global oil prices and keep import price pressures high.

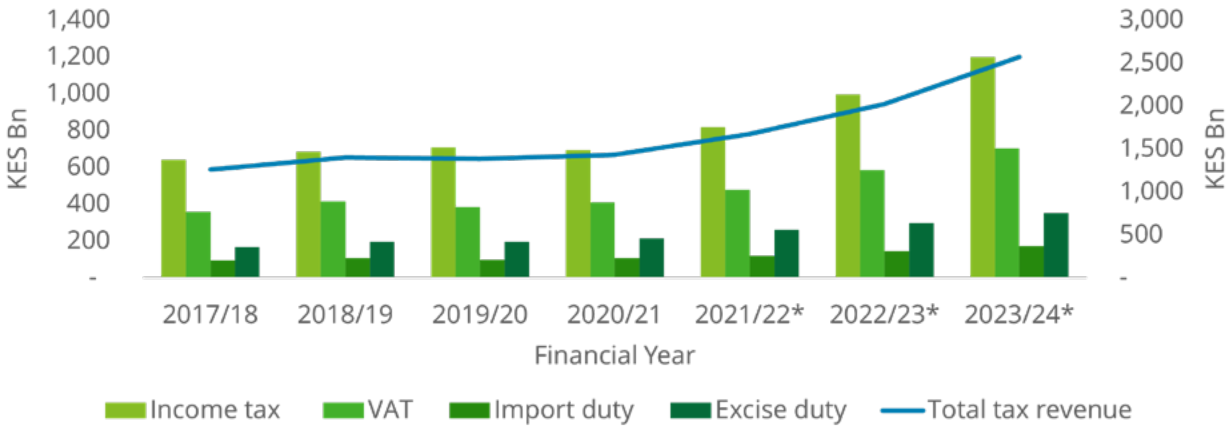
Debt



F=Forecast
Source: EIU, Deloitte Analysis

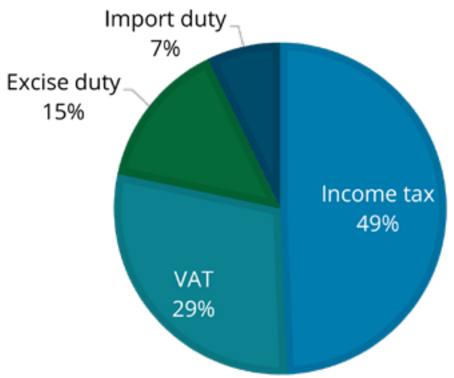
- Public debt is expected to increase to KES 9.5tn in June 2023 from KES 8.59tn in June 2022. This is 0.5tn shy of Kenya's public debt ceiling, which stands at KES 10.0tn.
- The external debt stock is expected to increase to 38% in 2023 from 35% in 2022 owing to a USD 1bn budget support loan approved by the World Bank in May 2023.
- The foreign debt repayment burden is expected to increase due to the unprecedented depreciation of the Kenya Shilling against major foreign currencies, considering 51.1% of Kenya's external debt stock is denominated in foreign currency.
- If constrained access to external financing continues, a large stock of external debt and current-account deficit could expose Kenya to balance-of-payments pressures.

Revenue Trends



- Income tax and VAT are projected to achieve the highest growth in revenues at 20.2%, followed by import duty at 19.5%, with excise duty close behind at 18.8%.
- The projected increase in tax revenues can be attributed to tax base expansion initiatives, increase in tax rates and the Kenya Revenue Authority's intensified compliance and enforcement efforts.
- Other tax related initiatives include roll-out of e-TIMS and other automation measures, finalization of tax policies including the National Tax Policy and Medium-Term Revenue Strategy, proposals in the Finance Bill 2023, among other initiatives.

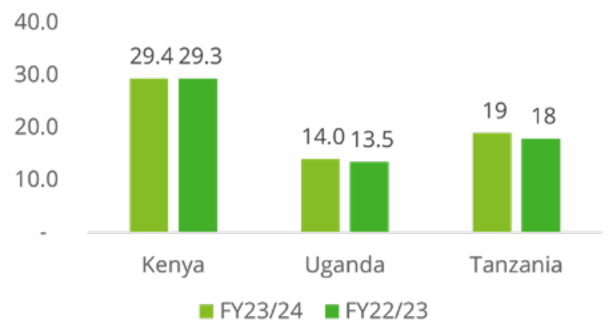
- Generally, there has been a steady increase in in the revenue collections over the last seven years from KES 1.3 Trillion in FY 2017/18 to projected revenue of KES 2.4 Trillion in FY 2023/24.
- This represents growth of 104% in revenue projections over six years, with 20% growth expected from revenue projections for FY 2022/23.
- The projected growth in tax revenues is however largely offset by the increase in expenditure in FY 2023/24.
- With maturing debt obligations in 2024 (such as the Eurobond), there is an urgent need to exercise fiscal discipline and boost domestic revenues to avoid falling into a 'debt trap'.
- Income tax is expected to continue generating the highest revenues, with projected revenues of KES 1,199 Billion in FY 2023/24, i.e., approximately 49% of the total projected tax revenue.



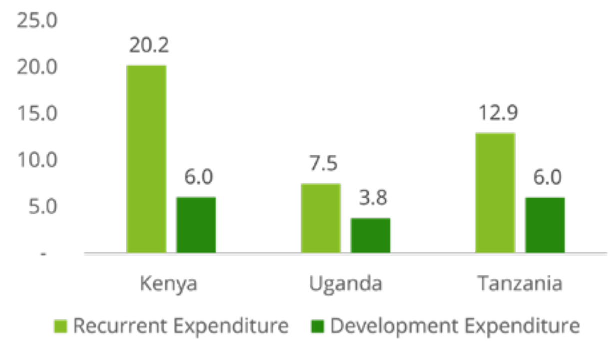
Source: Kenya Budget Statement 2023/24

East Africa Budget Overview

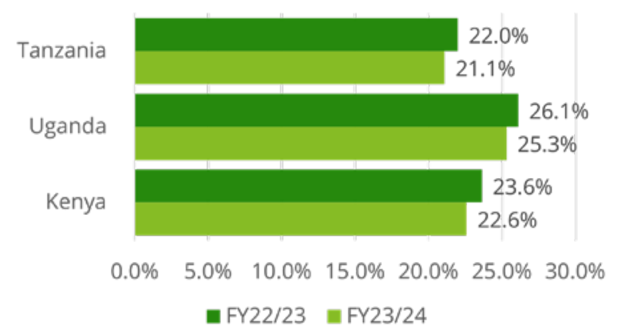
EAC Budget Trend (USD Bn)



Expenditure Allocation (USD Bn)



% of EA Budget to GDP



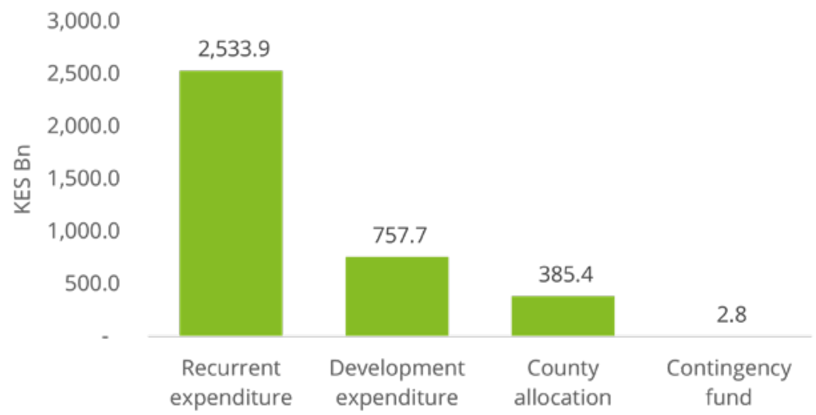
- The East African Community ("EAC"), primarily comprising Kenya, Uganda and Tanzania, announced their budgets for the 2023/24 financial period on 15 June 2023. Per the budgets, the EAC estimates a combined resource purse for the upcoming financial year of USD 62 Billion.
- While the budgets have increased in local currency, in US Dollar terms, there is a marginal increase in the region's resource purse by USD 1.6 Billion. The above marginal increase is largely due to the strengthening of the US Dollar against the local currencies.

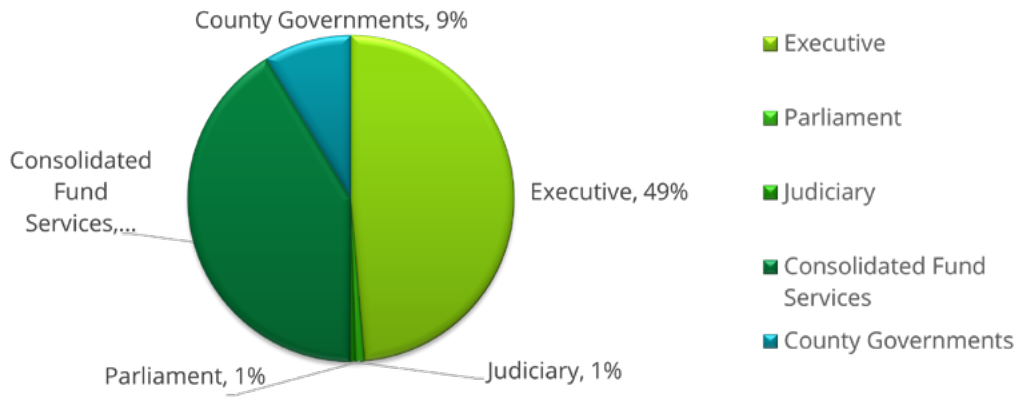
- From an expenditure perspective, recurrent expenditure exceeds developmental expenditure throughout the region.
- This is particularly the case for Kenya whereby recurrent expenditure amounts to 69% of the FY 2023/24 resource purse, whilst developmental expenditure amounts to 21%.

- The proportion of East Africa budgets to GDP has declined in FY23/24.
- This may be attributed to the projected growth in GDP in FY23/24 across the region, which surpassed the budgetary increment.

Source: Budget statements from respective East Africa Countries 2023/24

Kenya Budget Overview





- The proportion of the national budget earmarked towards recurrent expenditure has recorded a marginal increase from 67% in the financial year 2022/23 to 69% in the financial year 2023/24.
- Developmental expenditure has recorded a marginal decrease from 22% in the financial year 2022/23 to 21% in the financial year 2023/24. Similarly, the budgetary allocation towards county governments has reduced from 12% in the financial year 2022/23 to 10% in the financial year 2023/24.
- These reductions are indicative of the fiscal pressure faced by the country resultant of increased debt obligations.

Source: Kenya Budget Statement 2023/24

- From a distribution standpoint, the Executive and Consolidated Fund Services consume the largest portion of the national budget at 49% and 41%, respectively.
- Notably, of the portion allocated to Consolidated Fund Services, 89% is earmarked towards debt servicing inclusive of interest payments of KES 775Bn.
- This further emphasizes the revenue pressure occasioned by the country's current debt position, despite the reduction in the fiscal deficit in the current year from 5.7% of GDP in the financial year 2022/23 to 4.1% of GDP in the financial year 2023/24.

Tax Changes

Our View on Income Taxes

- Income taxes currently account for the largest percentage of tax revenue to the government. In the financial year 2021/2022, income tax amounted to KES 876.7 billion, contributing 46% of the total ordinary revenue of KES 1,917.9 trillion for the year. The projected income tax revenue for financial year 2022/2023, which ends on 30 June 2023, is KES 1,004.3 trillion compared to the total projected ordinary revenue of KES 2,191.9 trillion.
- In the budget for the financial year 2023/2024, the government targets to increase income tax collection by about 19% to KES 1,198.5 trillion. This will represent a 47% contribution of the KES 2,571.2 trillion projected ordinary revenue for the financial year 2023/2024. To achieve this, the government has proposed various policy reforms that are to be implemented by the Kenya Revenue Authority (KRA) to boost revenue collection such as the integration of the KRA tax system with telecommunication companies, expansion of the tax base in the informal sector based on the MSME survey which shows that the potential taxable base in the sector is KES 2.8 trillion, and implementation of Rental Income Tax measures by mapping rental property.
- Through the Finance Bill 2023, the government has proposed various tax measures aimed at expanding/ widening the tax base, increasing income tax rates, sealing revenue leakages, and boosting tax collection through tax administration reforms.
- Among the measures that are aimed at expanding/ widening the tax base include the proposed introduction of digital asset tax on the income derived by a person on transfer or exchange of digital assets, introduction of capital gains tax on indirect transfers, elimination of various tax exemptions and expansion of the withholding tax scope to include payments made to digital content creators, marketers, advertising businesses and sales promoters who are resident in Kenya.
- The proposal to introduce additional tax bands for income above KES 6 million per year (or KES 500k per month) and the proposal to triple the turnover tax rate are among the proposals the government is counting on to increase income tax rates.
- The government is also keen to seal any tax leakages to boost tax collection. Among the proposals that have been considered to seal tax leakages is the proposal that prohibits a deduction of expenditure or loss where invoices of the transactions are not generated through an electronic tax invoice management system (eTIMS) established by the KRA. To this end, the Tax Procedures Act, 2015 (TPA) is to be amended to compel all taxpayers carrying on business in Kenya to issue invoices through an electronic system. Another measure that is expected to seal revenue leakage is the proposal to introduce anti-tax avoidance provisions on transactions that qualify for capital gains tax (CGT).
- There is also an increased focus by the government for tax collections to be almost real-time. It is proposed that withholding tax shall be remitted within 5 days after deduction. In our view, such measures will increase the administrative burden on taxpayers, as taxpayers will be forced to deploy additional resources to ensure compliance.

Walter Mutwiri
Partner, Tax & Legal
Deloitte East Africa

Key Income Tax Changes

Corporate Income Tax

- Interest limitation rules to apply **only on loans from non-residents.**
- Interest disallowed under the Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA)-based limitation rule **to be allowed for deduction** if the interest to non-residents will have reduced to within 30% of the EBITDA within 5 years of disallowing the interest.
- Realised foreign exchange losses shall only be **deferred for deduction** if the interest to non-resident persons exceeds 30% of EBITDA.
- The deferred foreign exchange loss shall be **allowed in equal proportion** in the subsequent 3 years of income.
- Expenditure or loss shall not be allowed for deduction where invoices of the transactions are **not generated from e-TIMS.**
- A branch of a foreign company in Kenya to be **taxed at 30%, down from 37.5%.** The branch will however be required to pay a tax on its **repatriated profit at the rate of 15%.**
- **Joining fees, welfare contributions and subscriptions** for a members' club and trade association to be exempt from tax.

Personal Income Tax

- Proposal to introduce a **new tax band of 32.5%** for income between KES 6 million (or KES 500,000 per month) and KES 9.6 million per year (or KES 800,000 per month) and **35% for income above this band.**
- Employees to contribute **1.5% of their basic salary to the National Housing Development Fund**, with the employer matching the contribution. There is no cap to the contributions.
- The tax-free threshold in respect of travelling allowance for employees when out on official duties to be pegged on the **standard mileage rates approved by the Automobile Association of Kenya.**
- Benefits from **shares issued in lieu of cash to employees of an eligible start up to be taxed at the earlier of 5 years** after the year in which the award is given to the employee, the date the employee disposes the shares or the date the individual ceases to be an employee of the eligible start up.
- **Club entrance and subscription fees** paid by the employer on behalf of an employee to be treated as taxable employment benefits on the employee where such costs have been allowed as an employment cost by the employer.
- Contributions to a post-retirement medical fund to entitle the contributor to a **tax relief at the rate of 15% of the contribution** but capped at KES 60,000 per year.
- Payments or reimbursements made to public officers for expenses incurred in the performance of official duties to be exempted from tax, notwithstanding the ownership or control of any assets purchased.

Rental Income Tax

- The residential **rental income tax rate to reduce from 10% to 7.5%,** effective 1 January 2024.
- The **withholding tax on the rent paid** or payable to a resident person in respect of immovable property is also to be **reduced from 10% to 7.5%**.

Capital Gains Tax

- The CGT scope to be **expanded to include indirect transfers.**
- CGT exemption on an internal restructuring within a group to be **restricted to groups that would have only existed for at least 24 months** is to be introduced.
- The adjusted cost of property that would have qualified for CGT exemption and then subsequently transferred before expiry of 5 years **will be based on the original** adjusted cost as determined in the first transfer.

Withholding Tax

- Payments in respect of **digital content monetization to be subject to withholding tax at 5%.**
- Withholding tax to apply at 5% on payments to resident persons or non-resident persons operating in Kenya through permanent establishments (PE) in respect of **sales promotions, marketing, and advertising services.**
- Withholding tax deducted from a payment to be **remitted to KRA within 5 days of the deduction**.
- Withholding tax that may have been paid on a payment to a non-resident **will not be refundable or claimed as a deduction** where an audit adjustment is made in respect of that payment.
- The calculation of withholding tax on **winnings to be based on the payouts** made without deducting the amount staked or wagered.

Other Income Tax Highlights

- A tax known as "Digital Asset Tax" to be introduced on the income derived by a person on transfer or exchange of digital assets. The tax shall apply at **3% of the transfer or exchange** value of a digital asset and shall be payable by the owner of the platform or the person who facilitates the exchange or transfer of a digital asset.
- Advance tax on **commercial motor-vehicles** set to increase.
- The **advance tax on vans, pick-ups, trucks, prime movers, trailers and lorries to increase** from KES 1,500/ ton of load capacity per year or KES 2,400 per year, whichever is higher to KES 3,000/ ton of load capacity per year or KES 5,000 per year, whichever is higher.
- **The advance tax on saloons, station-wagons, mini-buses, buses and coaches to increase** from KES 60 per passenger capacity per month or KES 2,400 per year, whichever is higher to KES 100 per passenger capacity per month or KES 5,000 per year, whichever is higher.
- Turnover tax to apply to persons wit**h income between KES 1 million to KES 25 million**. Currently, the tax applies to persons with income between KES 1 million to KES 50 million.
- The turnover tax rates are also to be increased from 1% to 3%.

Our View on Indirect Taxes

Indirect taxes as a means of raising government revenue has over the last few years gradually increased and has been key in driving the Kenyan economy. The government collected Value Added Tax (VAT) of KES 523.1 billion in FY 2021-22, with the amount increasing to KES 587.7 billion in the budget for FY 2022-23. The tax is further expected to increase by 20% in the FY 2023-24 budget to KES 703.3 billion. Excise duty, on the other hand, amounted to KES 252.1 billion in FY 2021-22 with the amount rising to KES 297.2 billion in the budget for FY2022-23. The government targets to raise KES 352.7 billion in excise duty in FY2023-24, representing a growth of 19%. Import duty collected in FY2021-22 amounted to KES 118.3 billion, with the amount increasing to KES 145.9 billion in the budget for FY2022-23. The government targets to increase import to KES 173.3 billion in the FY 2023-24 budget, representing a 19% increase over the budget for FY2022-23.

As the Kenya Kwanza government lays down its first budgetary plans, indirect taxes mainly including domestic VAT, domestic excise duty, customs duties and miscellaneous fees and levies will be pivotal to realization of revenue targets. The government proposes a raft of indirect tax measures to realize the ambitious budget of KES 3.6 trillion.

Key proposed changes including the move to increase the VAT rate on petroleum products from the current 8% to 16% will, expectedly, increase VAT collected from importation and local sale of fuel which plays an essential role in the running of the economy. However, the gains of this increased rate must be weighed against the drawbacks that increased cost of petroleum products may have on prices of commodities and, as a result, the cost of living.

From an excise duty front, the proposal to introduce excise duty on imported products such as cement, paints, varnishes, lacquers, test liners may, in the short term, lead to increased revenue collection. However, the impact of these new taxes on prices of affected goods may suppress demand in the market. Ultimately, such changes may negatively impact the welfare of mwananchi and potentially reduce government revenue in the medium to long term.

On a positive note, the move to exempt Liquefied Petroleum Gas (LPG) from the current rate of 8% is a positive measure that should bring down the otherwise high prices of LPG. Other key VAT changes include the proposals to exempt exported taxable services, and transfer of business as a going concern. Additionally, one of the most salient excise duty proposals is the repeal of the powers granted to the Commissioner General to make annual inflationary adjustments on specific rates of excise duty, a good move that would be viewed as providing certainty on the applicable rates. The Bill also proposes to reduce the rates of Import Declaration Fee (IDF) from 3.5% to 2.5% and Railway Development Levy (RDL) from 2% to 1.5%. These reductions will positively impact the importation of goods perhaps to supplement local supply and will help reduce the total landed cost of imported goods.

Administratively, the government proposes a rather counterproductive measure requiring withholding VAT agents to account for VAT withheld within three days of deduction. Similarly, the Bill proposes to introduce a requirement for bookmakers to remit excise duty on betting and gaming within 24 hours from the closure of transactions of the day. This is expected to make compliance more cumbersome and may occasion non-compliance. It offends the fabric of a good tax regime that should be simple and easy to administer.

Overall, while the government moves to introduce a raft of indirect tax measures to increase revenue collection, it should consider the impact of these changes not only on the already ailing economy but also on the compliance burden placed on taxpayers. Importantly, the government should foster compliance by ensuring ease of administration of taxes, certainty, fairness and stability of the indirect tax regime.

Lilian Kubebea
Partner, Tax & Legal
Deloitte East Africa

Key Indirect Tax Changes

Value Added Tax (VAT)

- **Increase VAT rate on petroleum products** from the current 8% to 16%.
- **Exemption of LPG from VAT**. The Departmental Committee on Finance and National Planning (Committee) has recommended the zero-rating of LPG as is the Cabinet Secretary for National Treasury and Economic Planning (CS) in his Budget Statement.
- **Exemption of the Transfer of Business as a Going Concern (TOGC).** While the Committee recommended standard rating of TOGCs, the CS has proposed exemption.
- **Change of the VAT status of exported taxable services from 16% to exempt**. This position has been affirmed by the CS.
- Requirement to base input tax deduction not only on the availability of supporting documents such as tax invoices but also to ensure corresponding vendors have declared output tax on the supply.
- **Exclusion of non-resident providers of digital services** from the usual VAT registration threshold.
- Change of the current monthly declaration and payment of withholding VAT to a more regular periodicity of **within three days** of deduction of the tax. The Committee recommended amendment of this period to five days.
- Clarification that a taxpayer aggrieved by a **VAT refund decision** should file an appeal at the Tax Appeals Tribunal as opposed to lodging a notice of objection to the Commissioner for such decisions.
- **Exemption of tea sold for value addition** from VAT prior to exportation. The Committee has further recommended amendment of this proposal to also cover coffee sold under similar circumstances.
- **Zero-rating of international sea freight** offered by a VAT registered person. The CS has affirmed this position in his Budget Statement.
- Several inclusions, deletions, and changes to clean-up both the zero-rating and exemption schedules.

Excise duty

- Repeal of the powers of the Commissioner General to make annual **inflationary adjustments** to specific excise duty rates.
- Requirement of bookmakers to remit excise duty on betting and gaming offered through a platform or other medium to the Commissioner **within 24 hours** of closure of transactions of the day.
- **Reduction of the excise duty rate** on:
  - Telephone and internet services from 20% to 15%.
  - Fees earned on money transfer services provided by banks, money transfer agencies and other financial service providers from 20% to 15%.
  - Fees charged for money transfer services provided by cellular phone services providers or payment service providers licensed under the National Payment System Act, 2011 from 12% to 10%.
- Increase of excise duty rate on **betting, gaming, price competition and lottery** from 7.5% to 12.5%.
- **Introduction of excise duty** on various goods and services as follows:
  - Locally manufactured sugar confectionary of Tariff Heading 1704 at KES 42.91 per kg. The Committee recommends removal of this proposal.
  - Locally manufactured pasta of Tariff Heading 1902 at 20%. The Committee recommends removal of this proposal.
  - Imported fish at KES 100,000 per metric tonne or 20%, whichever is higher. The Committee has recommended for amendment of the excise duty rate to 10%.
  - Powdered juice at KES 25 per kg.
  - Sugar excluding sugar imported or locally purchased by a registered pharmaceutical manufacturer at KES 5 per kg. The Committee recommends exclusion of locally manufactured sugar.
  - Human hair, wigs, false beards, eyebrows, eyelashes, switches and artificial nails at 5%. The Committee recommends deletion of this proposal.
  - Imported cement at 10% of the value or KES 1.50 per kg.
  - Imported furniture excluding furniture originating from the East African Community (EAC) at 30%.
  - Imported paints, varnishes and lacquers at 15%.

   - Imported test liner and fluting medium at 25%. The Committee recommends that proposed excise duty is restricted to non-virgin test liners and fluting medium.
   - Fees charged on advertisement on television, print media, billboards and radio stations on alcoholic beverages, betting, gaming, lotteries and prize competitions at 15%.
- We further note that the Committee has recommended for amendment of the Bill to introduce excise duty on the following additional items:
   - Imported cartons, boxes and cases of corrugated paper or paper board and imported folding cartons, boxes and case of non-corrugated paper or paper board and imported skillets, free-hinge lid packets excluding companies gazetted under the duty remission scheme at 25%.
   - Imported plates of plastic at 25%.
   - Imported paper or paper board, labels at 25%.
- Amendment of the definition of **"other fees"** to delete "related to their licensed activities". The Committee recommends deletion of this proposal.
- The Committee recommends inclusion of the following additional proposals:
   - **Exemption of excise duty** on the following items:
      - **Electric motorcycles.**
      - Disassembled or unassembled kits for local assembly or manufacture mobile phones.
- Increase of excise duty on imported glass bottles (excluding imported glass bottles for packaging of pharmaceutical products from 25% to 35%.
- Advance payment of excise duty on **alcoholic beverages** to curb trade of illicit alcoholic beverages.

Miscellaneous fees and levies

- Reduction of the rate of **RDL from 2% to 1.5% and that of IDF from 3.5% to 2.5%.**
- Deletion of provisions in the Miscellaneous Fees and Levies Act (MFLA) that provide for reduced RDL and IDF rates of 1.5% on the following:
   - Raw materials and intermediate products imported by approved manufacturers.
   - Inputs for the construction of houses under an affordable housing.
   - Goods imported under the EAC Duty Remission Scheme.

   (The committee recommends deletion of this proposal)
- Introduction of **Export and Investment Promotion** Levy (EIPL) on specified goods when imported into Kenya including paper and paperboard products, iron and steel products and cement clinker at 10% of the customs value. The Committee recommends increase of the EIPL rate on cement clinker and semi-finished products of iron and steel from 10% to 17.5%.
- Reduction of export levy on various raw hides and skins from 80% or USD 0.52 per Kg to 50% or USD 0.32 per Kg whichever is higher.
- **Introduction of export levy at 20%** on the following products:
   - Cobalt mattes and other intermediate products of cobalt metallurgy; cobalt and articles thereof, including waste and scrap of Tariff Heading 8105.
   - Other waste and scrap of Tariff Code 8109.39.00.
   - Molasses resulting from the extraction or refining of sugar of Tariff Heading 1703.
- Amendment of various paragraphs under the IDF and **RDL exemption schedule to**:
   - Exempt IDF and RDL on goods for official use by diplomatic and consular missions, the United Nations and its agencies, and institutions or organizations exempted under the Privileges and Immunities Act.
   - **Expand the scope of aircrafts and helicopters** exempted from IDF to include all aircraft, spacecraft, and parts thereof of Chapter 88.
   - Introduce RDL exemption on all aircraft, spacecraft, and parts thereof of Chapter 88.
   - Expand the scope of goods imported by the Kenya Defence Forces and National Police Service exempted from IDF and RDL to include all goods including material supplies for official use.
   - Introduce IDF and RDL exemption on goods imported for official use by international and regional organizations that have bilateral or multilateral agreements with Kenya; and **LPG.**
- The Committee recommends exemption of the following additional items from IDF and RDL:
   - Any **other aircraft spare parts** including aircraft engines.
   - Goods for construction and maintenance of manufacturing plants for all manufacturing activities including refining.
   - Denatured ethanol.
   - Bioethanol vapour stoves.

Customs changes

- **Stay of application** of the East African Community Common External Tariff (EACCET) rates is to be granted on the following products for a period of one year:
  - » Rice at 35% instead of 75%.
  - » Paper and paper products at 35%.
  - » Imported furniture at 45%.
  - » Plastic and rubber products at 35% instead of 25%.
  - » Billets for manufacture of wire rods and other similar products at 10%.
- **Stay of application** of the EACCET rates has been **extended** for a further period of one year on the following products:
  - » Iron and steel products at 35% with corresponding specific rates.
  - » Vegetable products at 35% with corresponding specific rates.
  - » Inputs for manufacture of baby diapers at 0%.
  - » Baby diapers at 35% instead of 25%.
  - » Leather and footwear products at 35%.
  - » Raw materials and inputs for manufacture of footwear products at 0%.
  - » Inputs for the manufacture of roofing tiles at 0%.
  - » Smartphones and other telephones for cellular networks or other wireless networks at 25% instead of 0%.
  - » Safety matches, particleboards, plywood and other articles of timber at various ad valorem rates and corresponding specific rates ranging from USD 120 per Metric Tonne to USD 200 per Metric Tonne
- **Duty remission** is to be extended on the following products for a further period of one year:
  - » Wheat at 10% instead of 35%.
  - » Inputs for manufacture of animal feeds at 0%.
  - » Raw materials for manufacture of parts used in the assembly of motor vehicles especially leaf springs, radiators and wiring harness.
  - » Completely Knocked Down (CKDs) kits for assembly of motorcycles at 10%.

Our View on Tax Administration

Tax administration is the bedrock of any country's taxation system, through which tax laws are enforced, and taxes collected and accounted for. It is also the avenue through which tax-related disputes between revenue authorities and taxpayers are resolved.

In the 2023/24 budget, the government anticipates boosting revenue collection to at least KES 2.571 trillion in ordinary revenue. To attain this aim, this year's budget contains various tax policy measures cutting across various taxes. The government has also proposed tax administration reforms to further enforce compliance with the tax legislation amid growing revenue pressures.

Key proposed changes from a tax administration perspective include the requirement to deposit 20% of the disputed tax as security before appealing against a judgement of the Tax Appeals Tribunal (TAT). This would have a negative impact on taxpayers' rights to access justice. Ironically a similar measure was proposed in the past and withdrawn due to the understanding that it was unconstitutional. It is therefore hoped that the current proposal will be reversed.

In line with the government's intent to enhance its visibility of transactions, the Finance Bill also proposes to require all taxpayers carrying on a business in Kenya to issue electronic tax invoices through the electronic tax invoice management system (eTIMS) and to mandate resident trustees to maintain and produce records for the KRA's inspection upon request.

In what is seen as a bid to disincentivize non-compliance to tax laws and regulations, the government also proposes to increase the penalty for failing to comply with the KRA's electronic systems from KES 100,000 to the higher of 10 times of the tax due or KES 1 million whichever is higher. There is also a proposal to increase the tax shortfall penalty from 7.5% of the shortfall to double the amount of the shortfall. At the same time, the budget also proposes to abolish the granting of tax reliefs like waivers of penalties and interest and abandonment of tax. While aimed at improving tax compliance, the removal of tax reliefs and the increased penalty rates may prove to be needlessly punitive, especially to taxpayers whose non-compliance may be non-deliberate or occasioned by extraneous factors.

Among the positive measures include the introduction of an amnesty of interest, penalties or fines on unpaid tax accruing before 31 December 2022, the proposal allowing taxpayers to apply for the offset of overpaid tax against their outstanding tax debts, as well as the proposal to repay overpaid tax within 6 months of refund applications. The budget also proposes to increase the timelines for the settlement of tax disputes via Alternative Dispute Resolution (ADR) from the current 90 days to 120 days, which will likely encourage more amicable tax dispute resolution between taxpayers and the KRA.

Taken as a whole, the proposed tax administration measures could portend an era of increased compliance obligations and stringent penalties against non-compliance. However, taxpayers are also encouraged to take advantage of the positive measures in the Finance Bill, should they eventually receive a nod from Parliament and ultimately get signed into law.

Doris Gichuru
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Please **click here** for more insights on the proposed changes

Foreword | Economic Outlook | Tax Changes | Sectoral Highlights

Income Taxes | Indirect Taxes | Tax Administration

Key Tax Administration Changes

Tax Appeals Tribunal Act

- Taxpayers required to **deposit 20% of the disputed tax** as security before appealing against a judgement of the TAT to the High Court. The Committee on Finance and National Planning proposes to delete this proposed change on the basis that it is likely to limit the right to access justice.

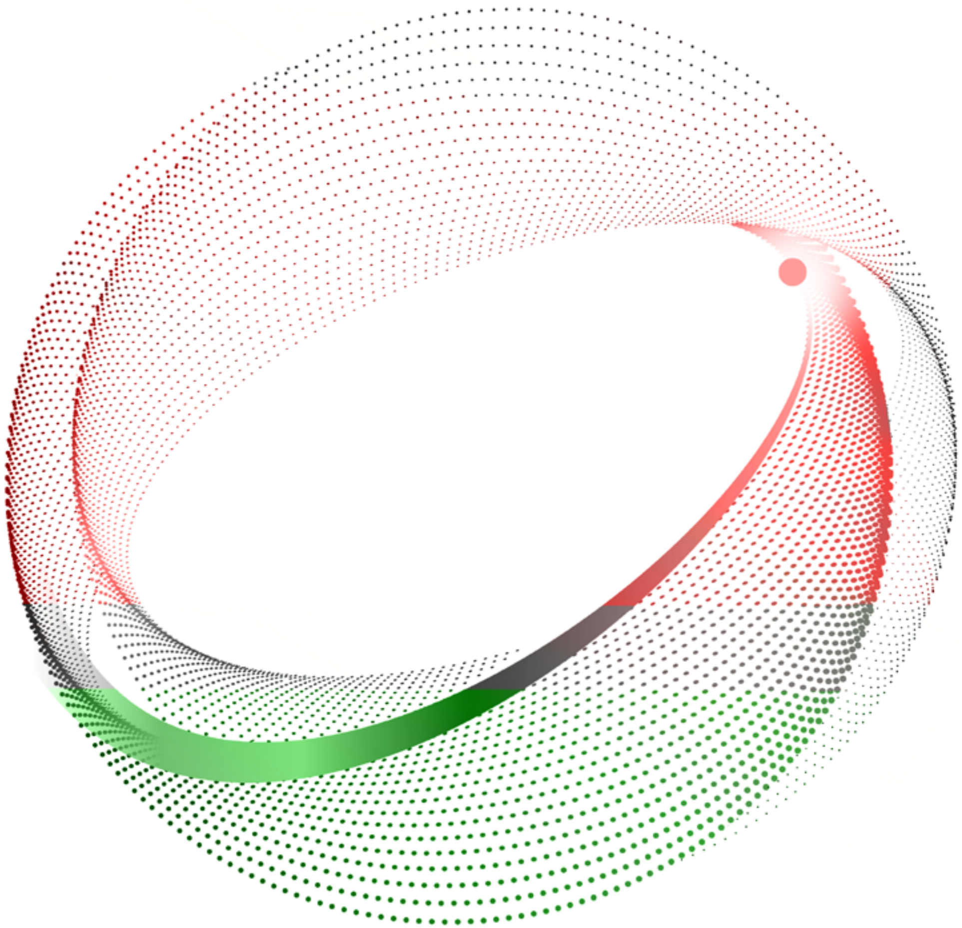
Tax Procedures Act

- Introduction of a **general tax amnesty** of interest, penalties or fines for all taxpayers where the underlying principal tax had been paid before 31 December 2022.
- Introduction of an amnesty of interest, penalties or fines on unpaid taxes that were due before 31 December 2022 provided that the principal taxes are paid by 30 June 2024
- The **abolition of waivers of penalties and interest** and abandonment of tax.
- Clarification of circumstances under which the Commissioner can issue an **agency notice.**
- Introduction of record-keeping requirements for resident trustees.
- Requirement for taxpayers carrying on a business in Kenya to **issue electronic tax invoices through eTIMS.**
- The Commissioner to notify a taxpayer that their property will be used as security after the actual registration of the security. Presently, a taxpayer ought to be notified before the **registration of the security**. The Committee recommends that this proposed amendment be deleted.
- **Withholding VAT to be remitted within 3 days** of deduction. The Committee has recommended this to be increased to 5 working days.
- Taxpayers are allowed to apply for the **offset of overpaid tax** against their outstanding tax debt. Currently, the law only allows taxpayers to apply for an offset against future tax liabilities
- The KRA is to **repay overpaid tax within 6 months** of refund applications. Where the Commissioner does not pay the money within 6 months, the refund amount shall be used to offset the taxpayer's tax liabilities.
- Commissioner is required to request a taxpayer to submit the information specified in an objection invalidation notice within 7 days.
- **Refund decisions to be appealed directly before the TAT**. Currently, taxpayers can object to a refund decision prior to filing an appeal at the TAT.
- The KRA to be empowered to assist other revenue authorities in collecting taxes due in their respective countries.

Requirement to deposit 20% of the disputed tax as security before appealing against a judgement of the TAT to the High Court dropped.

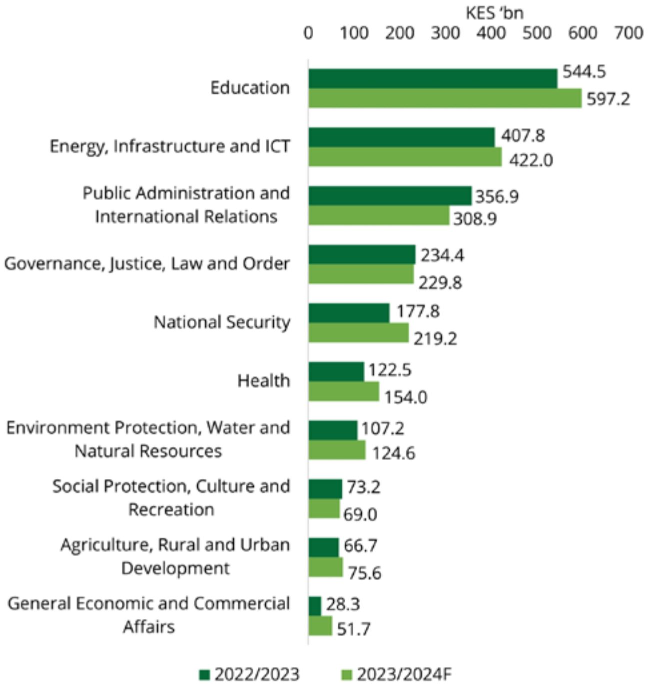
- Timelines for the settlement of tax disputes via ADR **increased from the current 90 days to 120 days**.
- Taxpayers to be prevented from adducing additional grounds at the TAT or court, other than those contained in their **objection**. The Committee recommends this proposal to be dropped.
- KRA to establish a **Data Management and Reporting System** ("DMRS") for the submission of electronic documents such as invoices.
- Increase in the penalty for failing to issue an invoice, tax return or make a payment electronically via the KRA's systems from KES 100,000 to the higher of **10 times of the tax due or KES 1 million whichever is higher**. The Committee recommends this proposal be amended to cap the penalties to double the amount of tax due.
- Increase in the tax shortfall penalty **from 7.5% of the shortfall to double the amount** of the shortfall. The Committee has recommended the amendment of the penalty to an amount equivalent to the shortfall.

Sectoral Highlights



Sectoral Overview

- The FY2023/24 budget is the first budget prepared under the new administration based on its "Bottom-up Economic Transformation Agenda" (BETA). The core pillars of the BETA that the current administration will focus on are as follows:
  - » Agricultural transformation and inclusive growth;
  - » Micro, Small and Medium Enterprises Economy;
  - » Housing and settlement;
  - » Healthcare; and
  - » Digital superhighway and creative industry.
- Three of the pillars (agricultural transformation, housing and healthcare) tie into the previous administrations' Big Four Agenda priority programmes which were designed to be completed by 2022.



F=Forecast
Source: 2023 Budget Policy Statement

The largest winners in the 2023/2024 budgetary allocation include:

Education

- The education sector has been allocated KES 597.2bn to facilitate the enrolment of 1,936,895 students in universities, the allocation of loans to 1,329,311 students in universities and Technical and Vocational Education and Training (TVET) and support 431 research projects. The allocated amount is also budgeted to support the Teachers Service Commission's plan to recruit 30,000 teachers for primary and secondary school and 60,000 intern teachers.

Energy, Infrastructure and ICT

- The Energy, Infrastructure and ICT sector has been allocated KES 422.0bn to facilitate the implementation of 26 programmes that are tailored to prompt inclusive growth that aligns to the government development agenda of the Kenya's Vision 2030, Fourth Medium Term Plan and Bottom–Up Agenda.

Public Administration and International Relations

- Public administration and International Relations has been allocated KES 308.9bn to facilitate the implementation of 41 programmes, with 107 sub-programmes that are expected to support job creation and poverty reduction, which aligns to the Post COVID 19 Economic Recovery Stimulus programme (PCERS), Bottom – Up Economic Transformation Agenda and Fourth Medium Term Plan of Kenya Vision 2030.

Sectoral Allocations

Agriculture

- The projected 3.6% growth in the agriculture sector in 2023 will be supported by a budgetary allocation of KES 49.9bn in 2023/2024.
- The budgetary allocation is targeted at implementing programmes to support the government's interventions of ensuring food security, climate change adaptation and reducing the cost of living.
- Some of these programmes include:
  - The National Agricultural Value Chain Development Project (NAVCDP);
  - The Small Scale Irrigation and Value Addition Project;
  - The Kenya Cereal Enhancement Programme;
  - The National Agricultural and Rural Inclusivity Project;
  - The Climate Smart Agricultural Productivity Project;
  - The Enhance Resilience for Food Production and Nutrition security Programme; and
  - The Blue Economy Priority Projects.
- Agriculture occupies key focus in the Kenya Kwanza Agenda. Another key intervention is the provision of subsidised inputs such as seeds and fertiliser.
- As part of the country's long term food security plan the government has made fertiliser available at a lower cost of KES 3,500 and is also collaborating with the private sector to continue subsidising fertiliser in order to make it available and improve agricultural productivity in counties.

KES 10.9B

Micro, Small and Medium Enterprise (MSME)

- The government has allocated a total of KES 10.9bn in the 2023/2024 budget to the Micro, Small and Medium Enterprises (MSME), aimed at supporting the Hustler Fund.
- The Hustler Fund was established in 2022/2023 and is aimed at lifting those at the bottom of the economy, through structured products in personal finance that include savings, credit, insurance and investment.
- The government also plans to deploy a macroeconomic framework and growth strategy that will leverage off Kenya's well advanced SACCO system. The framework will enable the government to develop a tier three financial system that will facilitate the distribution of affordable credit through the Hustler Fund.
- The framework will mainly target MSMEs and small traders who are currently being affected by the aggressive commercial lending rates.
- Furthermore, in order to increase credit access to MSMEs, the government has put in place various interventions such as:
  - The Youth Fund, which is aimed at promoting employment creation for the youth;
  - The Uwezo Fund, which is aimed at enabling women, youth and persons with disabilities to access finances to promote their businesses and enterprises;
  - The Women Enterprise Fund, which is aimed at enabling women to access cheaper loans; and
  - The Credit Guarantee Scheme, which is aimed at supporting MSMEs in securing credit from formal lending institutions.

KES 35.3B

Housing & Settlement

- The government has allocated a total of KES 35.3bn in the 2023/2024 budget to the housing and settlement sector.
- The budgetary allocation is targeted at implementing administrative reforms and policies to improve access to affordable housing finance and lower the cost of construction, while creating jobs and entrepreneurial opportunities to all Kenyans.
- The housing gap in Kenya is mainly as a result of the high cost of housing, which presents a heavy burden to majority of Kenyans. The government's plans to close the housing gap include:
    - » Creating jobs for over 100,000 youth in the construction sector and through the production of building material.
    - » Facilitating development and construction of 250,000 houses per year;
    - » Restructuring the affordable long-term housing finance scheme, including a National Housing Fund and Cooperative Social Housing Schemes that will guarantee off-take of houses from developers; and
    - » Reducing the cost of mortgages to KES 10,000 and below is expected to grow the number of mortgages from 30,000 to 1,000,000.

Healthcare

- The allocation to the healthcare sector has increased to KES 141.2bn in the 2023/2024 budget from KES 122.5bn in 2022/2023.
- The budgetary allocation is targeted at facilitating the implementation of projects aimed at achieving improved accessibility, affordability of health services, reduction of health inequalities and optimal utilisation of health services across the sector.
- The key priorities for 2023/2024 include:
    - » Supporting universal health coverage;
    - » Supporting the Kenya COVID-19 emergency response project;
    - » Providing free maternity health care;
    - » Supporting the managed equipment services;
    - » Proving medical cover for the elderly and disabled persons;
    - » Lowering the cases of HIV/AIDS, malaria and tuberculosis; and
    - » Enhancing the vaccines and immunization programme.
- The government plans to restructure the National Health Insurance Fund (NHIF) from an occupational scheme for salaried people into a social insurance scheme, changing the contribution structure from an individual contribution model to a household contribution model.

KES 141.2B

KES 141.2B

Digital superhighway and creative industry

- The government has allocated a total of KES 15.1bn in the 2023/2024 budget to the Information, Communication and Technology ("ICT") sector.
- The budgetary allocation is targeted at enhancing productivity and overall competitiveness through providing quick access to the market, reducing information asymmetry and improving risk management.
- The key initiatives in the ICT space include:
    - » Construction of Kenya Advanced Institute of Science and Technology ("KAIST") at Konza Technopolis;
    - » Horizontal infrastructure Phase 1 – EPCF for Konza;
    - » Konza Data Centre and Smart City Facilities;
    - » Maintenance and rehabilitation of National Optic Fibre Backbone Phase II Expansion Cable
    - » Government Shared Services;
    - » Construction of Konza Complex Phase 1 B; and
    - » Maintenance and rehabilitation of Last Mile County Connectivity Network.

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