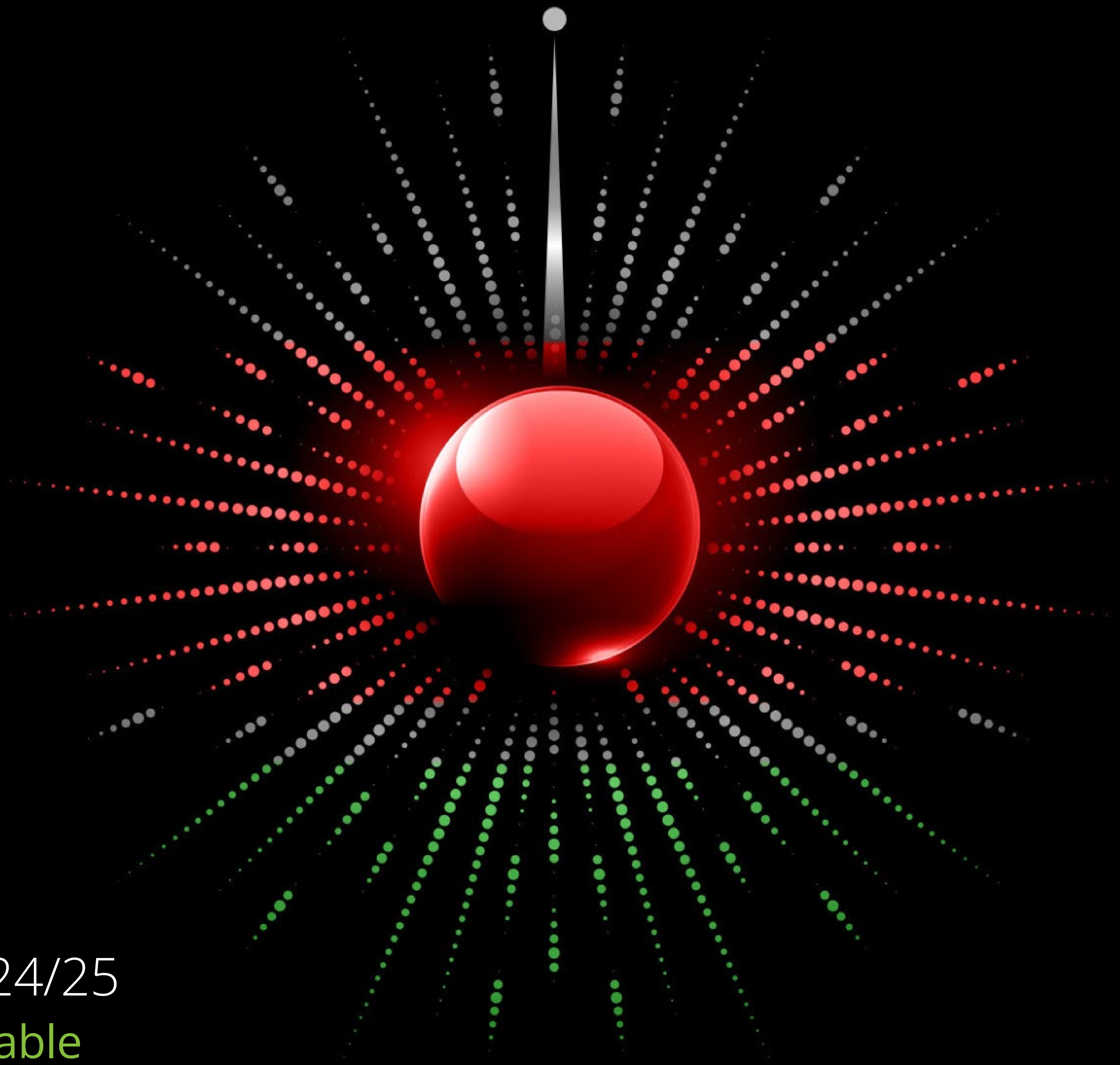
Deloitte.



Kenya Budget Highlights 2024/25

Balancing Priorities for Sustainable Economic Growth

June 2024

MAKING AN IMPACT THAT MATTERS since 1845

Message from the CEO

"Looking back at the year, the inflation rate reduced from 7.7% to 5.6%, supported by improved agricultural performance, which led to lower food prices."

The Kenyan Economy is expected to grow by 5% in 2024 compared to 2023, mainly due to the strong performance of the agriculture sector following increased rainfall levels and general growth across most of the economic sectors. However, the past year has also been characterised by the depreciation of the Kenyan shilling, increased borrowing costs, significant losses and damage due to frequent extreme weather events, reduced disposable income for the average citizen, and reduced business margins due to rising taxes and levies.

Looking back at the year, the inflation rate reduced from 7.7% to 5.6%, supported by improved agricultural performance, which led to lower food prices. The Central Bank's monetary tightening has seen a steady increase in the central bank rate from 7% in March 2022 to the current 13%. While the monetary tightening eased inflation, it also led to higher borrowing costs, which increased the interest burden for existing borrowers and has made it harder for businesses and individuals to access credit.

In February 2024, the successful Eurobond issue eliminated the unease caused by the possibility of debt default, improving the exchange rate of the Kenya Shilling against the US dollar from a high of KES 162.5 to the current rate of about KES 128.5. While strengthening the Kenya shilling reduced the pressure on spending following the decrease in the cost of importation and import goods, it also reduced the value of goods exported. In addition, while exporters should have seen significant gains from the depreciation of the currency, it was undermined by the increased borrowing costs.

The 2024 Budget Policy Statement (BPS) stated, "The policy measures outlined in the 2024 BPS are expected to improve economy-wide efficiencies, create an enabling environment that supports growth in businesses and investment, reduce the cost of living, and enhance the well-being of all Kenyans." While this is the intent, there is a need to assess the effectiveness of increasing taxes to meet revenue targets, as that tends to have an inverse correlation. We have already seen a reduction in revenue collection following the tax increases in the previous fiscal year. There have been no significant efforts to increase the tax base, but instead, we keep seeing an increase in taxes on the existing base.

I am encouraged that this year has had even more public participation and commentary on the budget policy than last year. In response, policymakers should continue to engage with the public, considering feedback from its stakeholders while seeking to understand all the effects of the proposed policies.

We are all stakeholders in this country and should stay involved and actively engage in the impact of these initiatives because the nation's long-term prosperity benefits us all.

Anne Muraya
CEO
Deloitte East Africa

Foreword

Tax policy framework

The FY 2024/2025 budget comes at a time the Government is facing considerable pushback on its tax measures, with the main concern being the increasing tax burden on taxpayers.

To its credit, the Government has put in place a National Tax Policy which provides guidelines for taxation and forms the basis for development, administration, and review of tax legislation. The Government also released its Medium-Term Revenue Strategy ("MTRS") for FY 2024/25 to FY 2026/27 which seeks to increase tax revenues over this period. The key features of the policy and the MTRS include the drive to increase tax revenue collection with the goal of attaining a tax-to-GDP ratio of at least 20%, increasing tax compliance, eliminating tax exemptions, and expanding the tax base through tax measures targeting the "hard to tax" and emerging sectors such as the informal sector and the digital economy.

While the overall goal of raising tax revenue and reducing the fiscal deficit is appropriate, the real challenge lies in the choice of measures that should be adopted to achieve this without causing too much pain to taxpayers and without jeopardising sustainable economic growth. The other concern is whether the tax burden is proportionately distributed across all economic players. As taxpayers are called upon to contribute more to the government coffers, there is also a growing call for greater accountability on the part of the government in terms of what the public gets in return. Seeking to increase Tax-to-GDP ratio to 25% without corresponding increase in quantity and quality of public goods and services will certainly not endear the Government to the citizens.

Tax revenue measures

In the 2024/25 fiscal year, the Government plans to collect KES 2.948 trillion in ordinary revenue (of which tax revenue is KES 2.7T), representing an increase of KES 323 billion from the KES 2.625 trillion in the 2023/24 budget. This is quite a steep climb and calls into question the achievability of the budget targets.

The key tax measures to raise this revenue include introduction of Motor Vehicle Tax at the rate of 2.5%, increases in excise duty rates, proposed introduction of VAT on financial services, expansion of taxes on players in the digital economy, introduction of withholding tax on payments for goods supplied to public entities as well as new levies (eco levy) and increased fees and levies. While these measures may generate additional tax revenue, they may also lead to changing consumer and business behaviour due to reduced disposable incomes, increased cost of living and cost of business, thereby limiting the success from a tax revenue growth perspective.

Fred Omondi
Tax & Legal Leader
Deloitte East Africa

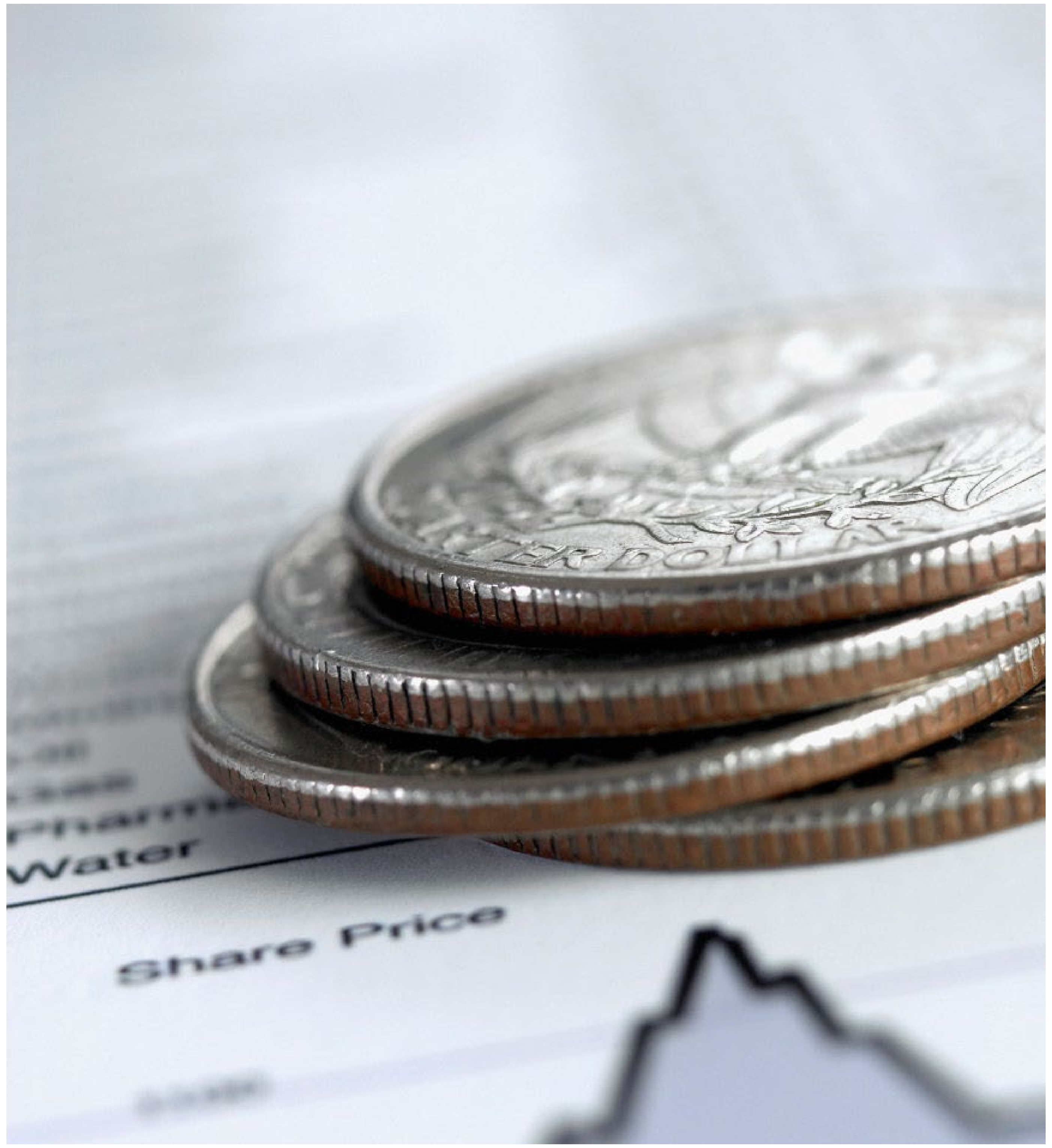
There are some limited giveaways in terms of increased reliefs for taxpayers such as increased threshold for deductibility of pension contributions and mortgage interest, reducing capital gains tax rate from 15% to 5% for certain category of investors, exempting transfer of business as a going concern from VAT and increasing VAT registration threshold from KES 5 million to KES 8 million. These measures are aimed at encouraging savings, investments, relieving small business from VAT compliance burden, and supporting business reorganizations and mergers and acquisitions.

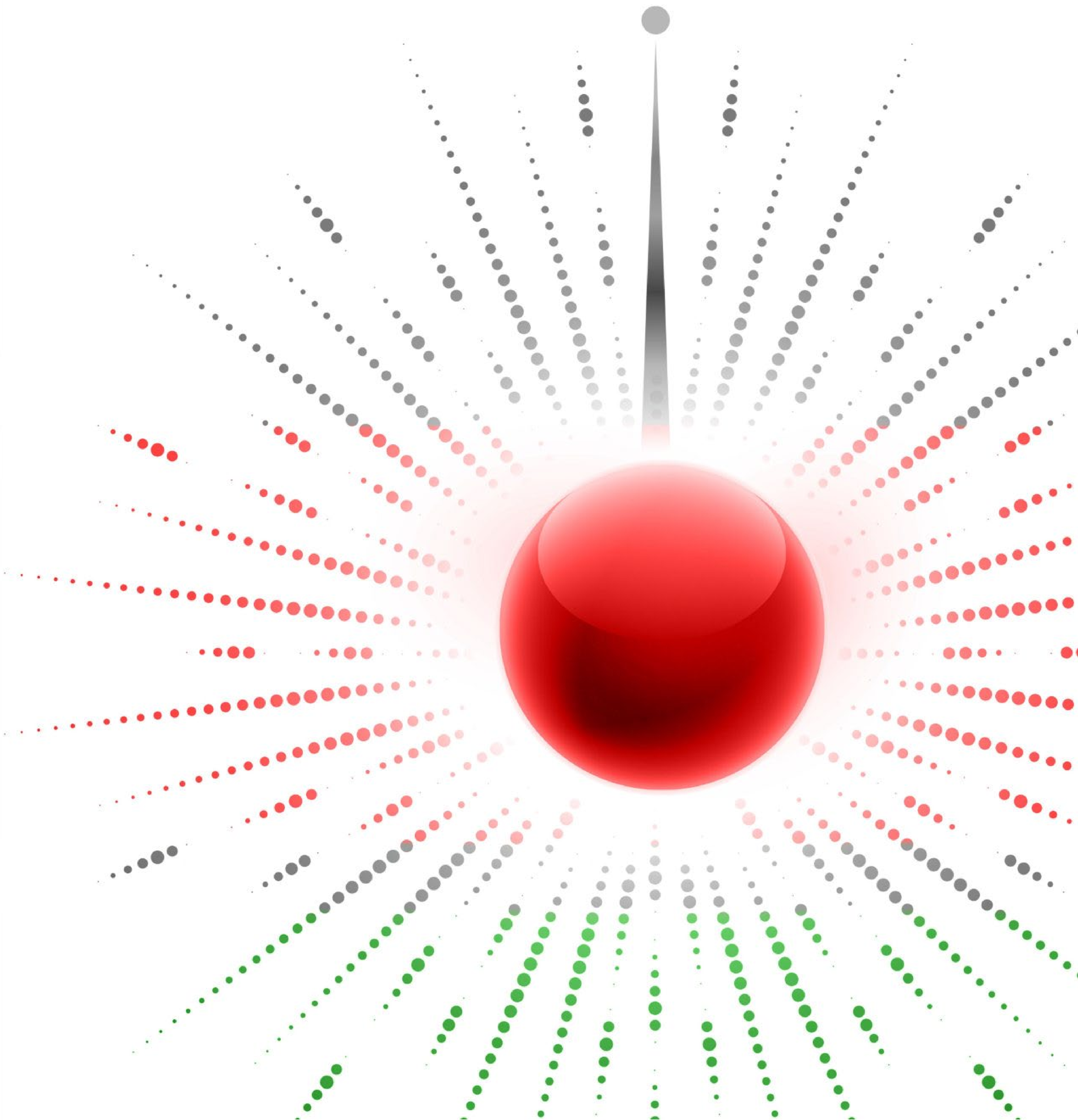
Impact on taxpayers

The 2024/25 budget continues the Government's stated aspiration of increasing tax revenue collection through introduction of new taxes, curtailing exemptions and incentives and broadening the tax base. It reflects the delicate balance the Government must strike in generating more revenues to finance its debt obligations, other recurrent and development expenditures on the one hand, and on the other hand addressing the growing cost of living and cost of doing business to encourage investments and grow the economy.

On balance, the measures place a heavier burden on businesses and individual taxpayers and will significantly reduce disposable incomes and affect investment choices – which may hamper economic growth. When all is said and done, the primary focus should be on measures to spur greater investment, grow businesses, create more quality jobs and increase the level of economic activities in order to generate a larger pool of taxable income rather than continuing to extract more taxes from the limited pool of taxpayers.

"While the overall goal of raising tax revenue and reducing the fiscal deficit is appropriate, the real challenge lies in the choice of measures that should be adopted to achieve this without causing too much pain to taxpayers and without jeopardising sustainable economic growth."



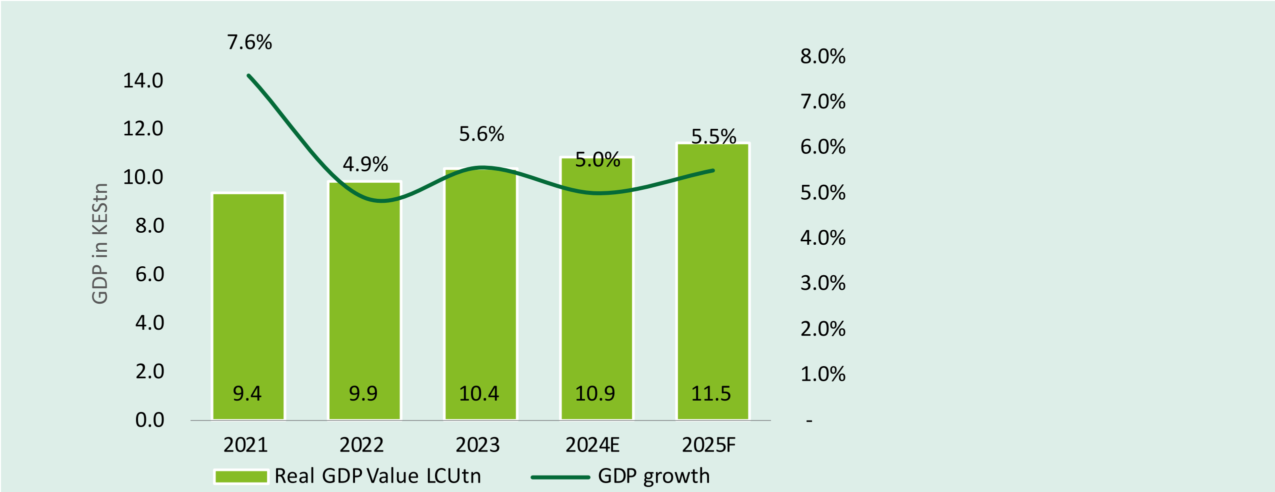


Economic Outlook

Economy at a Glance

GDP Growth

Real GDP and Real GDP Growth



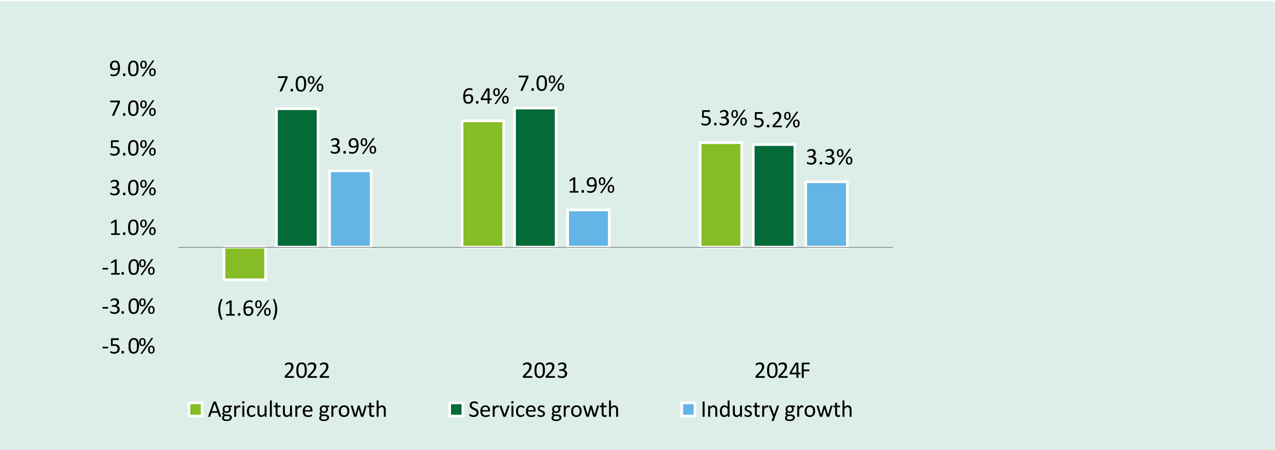
Source: Central Bank of Kenya, EIU

GDP Growth

- Kenya's GDP growth slightly accelerated to 5.6% in 2023 from 4.9% in 2022 driven by a robust rebound in agricultural sector and continued strong performance in the services sector.
- In 2024, we expect growth to reduce to 5.0% due to expected decline in private consumption on the back of introduction of new taxes and a tighter monetary policy stance. However, we expect continued robust agricultural performance and gradual increase in foreign direct investments to drive the GDP growth.
- The government plans to spend KES 3.9tn in fiscal year (FY) 2024/25, a 2.3% increase from FY 2023/24. However, expenditure as a share of GDP is expected to decline to 22.1% in FY24/25 from 24.2% FY23/24 reflecting a tighter fiscal environment.

Sectoral Growth Rate

Sectoral Growth



E: Estimate F: Forecast
Source: EIU

Sectoral Growth

- Agriculture: The sector is expected to record a strong growth of 5.3% in 2024, albeit a slight decline from 6.5% in 2023. The expected growth will be supported by adequate rainfall and continued access to cheaper fertiliser supplied under the government fertiliser subsidy program. Nevertheless, this sector continues to face downside risks due to the adverse effects of extreme weather conditions such as the recently witnessed floods attributable to climate change in the country.

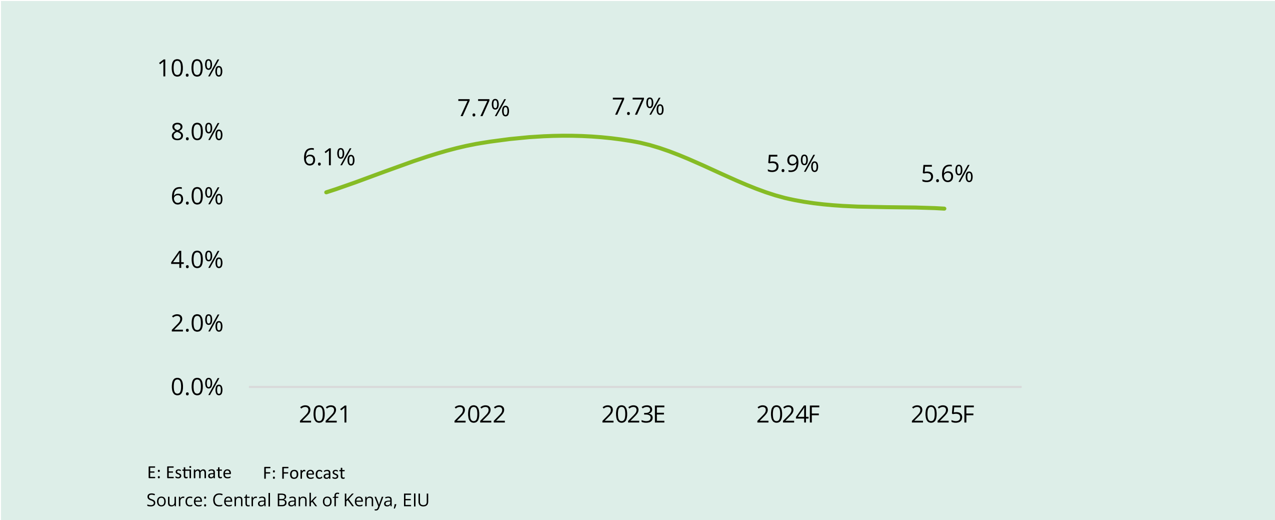
Source: Kenya Budget Policy Statement

- Industry: Growth is expected to accelerate to 3.3% in 2024 from 1.9% in 2023, hinged on improved performance in manufacturing and construction subsectors. This improvement will be underpinned by lower input costs, private consumption, and the gradual resumption of infrastructure projects.
- Services: Growth is expected to ease to 5.2% in 2024 from 7.0% in 2023 due to an anticipated deceleration in consumption driven by higher taxes and interest rates, which may weigh down consumer spending especially on non-essential services.

Economy at a Glance

Inflation

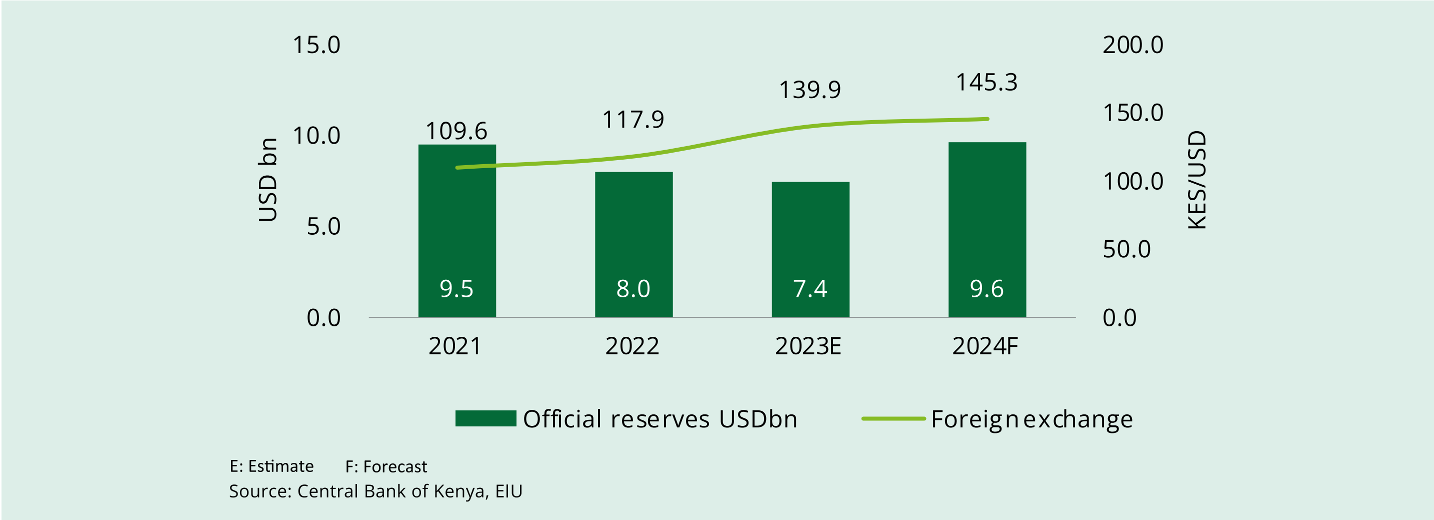
Inflation



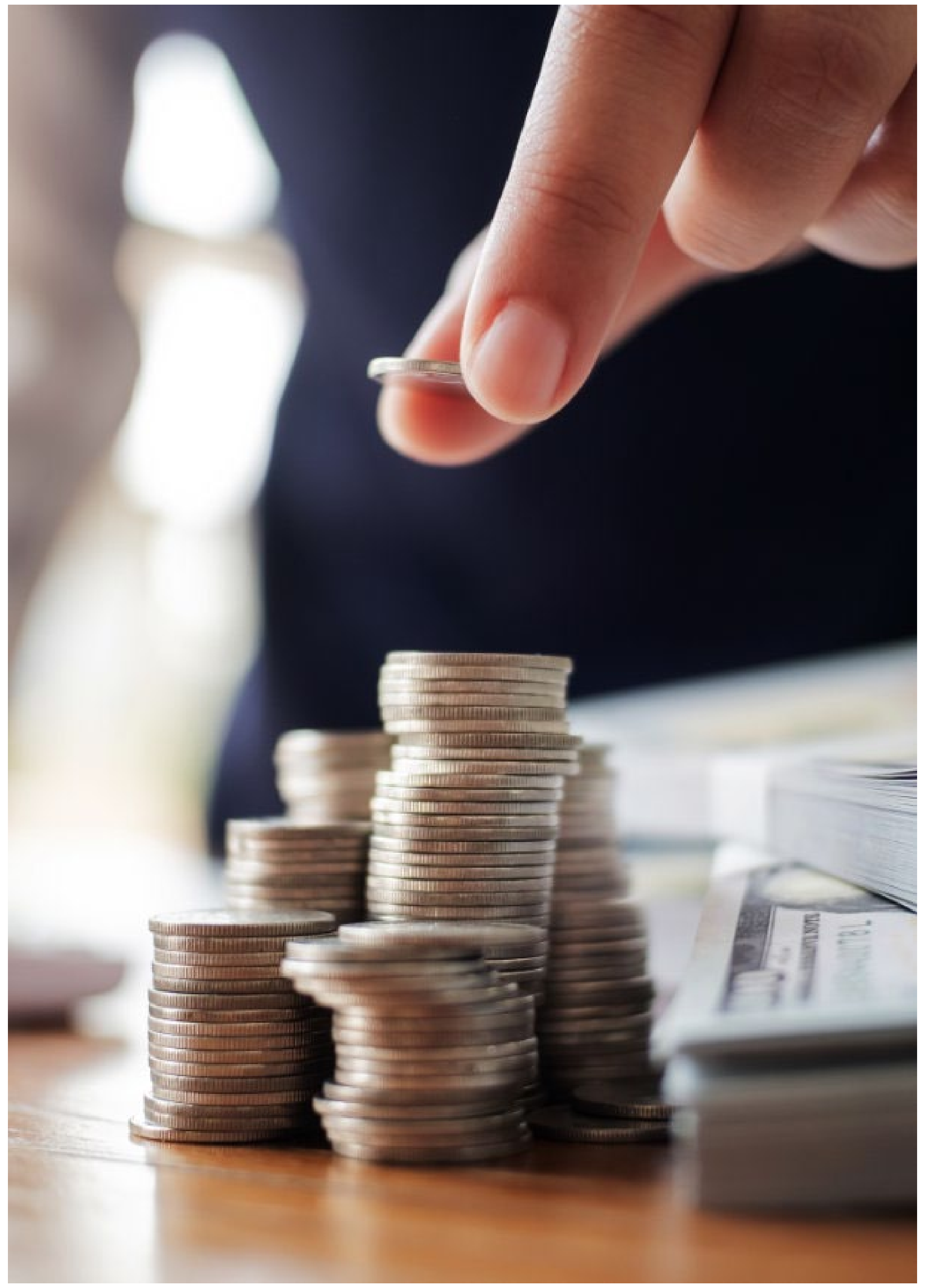
- Inflation averaged 7.7% in 2023, consistent with 2022, driven by higher food prices in the first half of 2023 and persistent fuel inflation throughout the year.
- Inflation is expected to decline to 5.9% in 2024 mainly owing to;
  - Lower food prices due to improved agricultural performance; and
  - Decelerated consumption growth owing to continued monetary tightening by the Central Bank, coupled with reduced purchasing power due to the proposed amendments in the Finance Bill of 2024.
- Expected reduction in global oil and input prices and a slower pace of the shilling depreciation against major currencies will further contribute to the country's reduced inflation levels in 2024.

Foreign exchange and forex reserves

Sectoral Growth

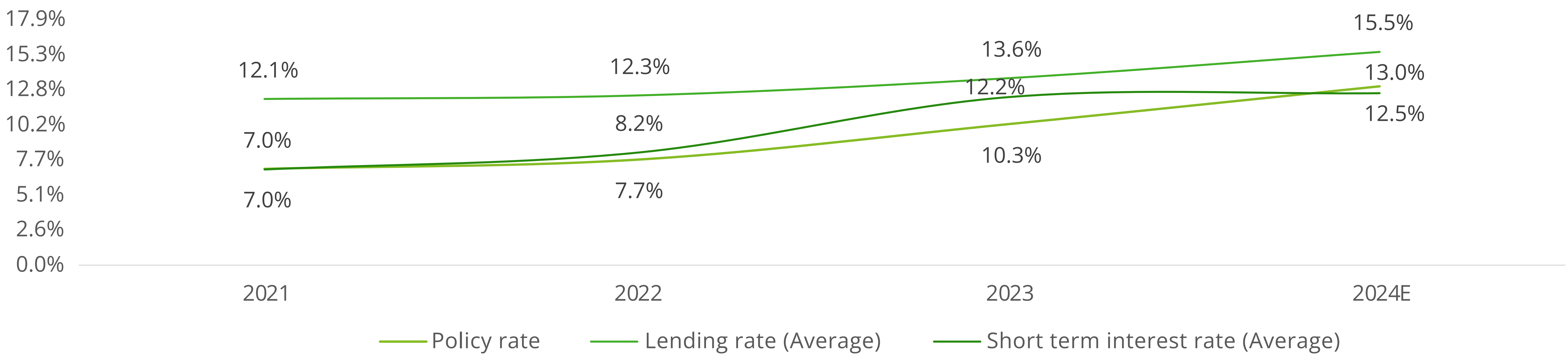


- The Kenya shilling depreciated by 18.7% against the US dollar, from KES 117.9/USD in 2022 to KES 139.9/USD in 2023, due to increased demand for the US dollar over the KES. This was primarily driven by sustained monetary tightening in the US and reduced investor confidence due to speculation of Kenya's default on its maturing Eurobond. Higher demand for the US dollar further contributed to depletion of the country's foreign exchange reserves from an average of USD 8.0bn (3.9 months worth of import cover) in 2022 to USD 7.4bn (3.6 months worth of import cover) in 2023.
- The shilling exchanged at above KES 160/USD in early 2024 but strengthened to an average of KES 131.6/USD in April following increased foreign currency supply in the country. This was supported by Kenya's successful buyback of the matured Eurobond and subsequent issuance of a new one, in addition to the receipt of US dollar denominated loans from World Bank and the International Monetary Fund.
- The shilling is expected to moderately depreciate through 2024, to average KES 145.3/USD on account of sustained trade deficit in the country.



Economy at a Glance

Interest rate



E: Estimate
Source: Central Bank of Kenya, EIU

Interest rate

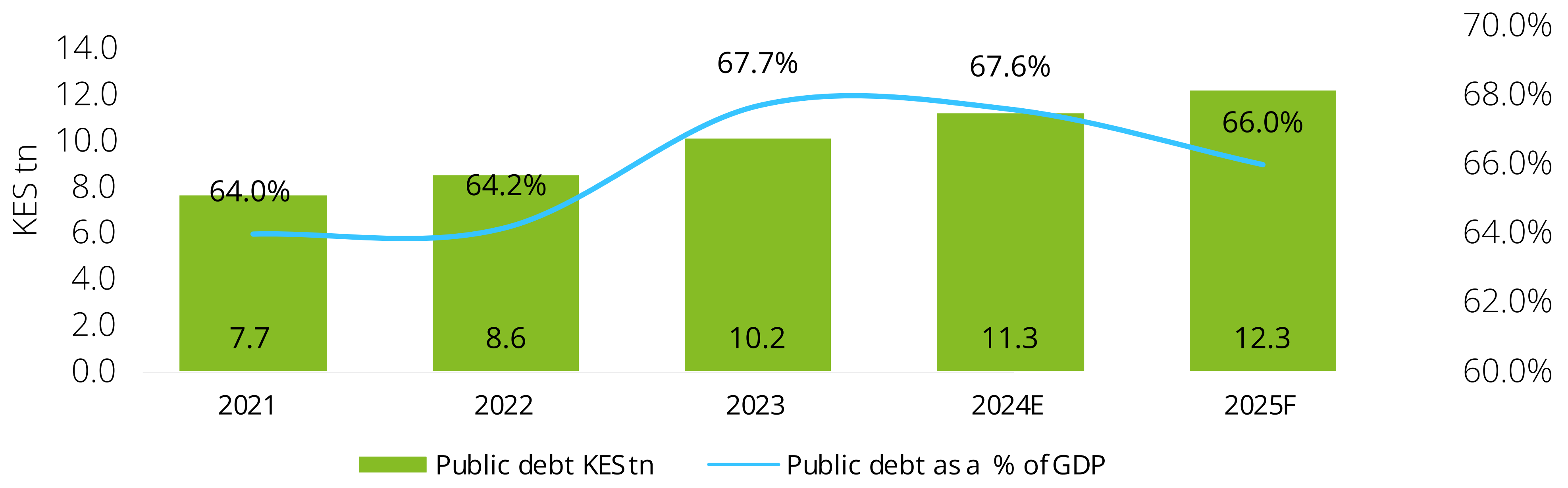
- The lending rate remained steady at 12% in 2022, while the policy rate was increased in 2022 to tackle rising inflation reaching 7.5% in May, 8.3% in September, and 8.8% in November. Short-term interest rates increased to 8.2%, reflecting tighter liquidity conditions in the market.
- Driven by higher inflation and increased risk perceptions, the lending rate increased to 13.6% in 2023. The policy rate continued to increase in 2023 reaching 9.5% in March, 10.5% in June and 12.5% in December as the CBK intensified efforts to curb inflation. Short-term interest rates surged to 12.2%, indicating significant liquidity constraints.
- On the back of persistent inflation, the lending rate is projected to reach 15.5% in 2024. The policy rate is expected to average 13.0% following an upward revision in February, showing the CBK's aggressive stance on inflation control. Short-term interest rates are forecasted to remain high at 12.5%, highlighting ongoing liquidity challenges.

Implications

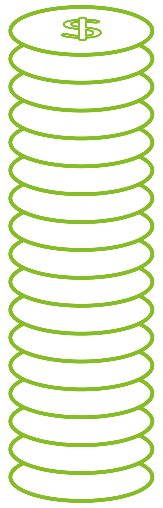
- The rising lending rates suggest increased costs for borrowers, potentially slowing down investment and consumption.
- The upward trend in policy rates indicates the CBK's commitment to controlling inflation and ensuring economic stability.
- Persistent high short-term interest rates reflect tight liquidity conditions, necessitating careful monetary management to support economic growth and stability amidst ongoing inflationary pressures.

Economy at a Glance

Public debt



E: Estimate F: Forecast
Source: Central Bank of Kenya, EIU



2023 Public Debt as % of GDP
67.7%

2023 Debt service costs as % of GDP
3.6%

Source: Fitch, EIU

Debt

- Kenya's total public debt surged by 19.8%, from KES 8.6tn in June 2022 to KES 10.3tn in June 2023. This increase has pushed the debt-to-GDP ratio from 64.2% in 2022 to 67.7% in 2023 over the same period, primarily due to heightened government borrowing to cover the budget deficit for the 2023/24 fiscal year.
- The cost of servicing debt, as a percentage of GDP, rose from 2.9% in 2022 to 3.6% in 2023. This was driven by the higher total public debt, elevated international and domestic interest rates and a weaker local currency. Between July 2023 and March 2024, the government spent KES 1.2tn on debt service costs, exceeding the KES 1.1tn spent by the government on development projects and recurrent expenditures.
- Looking ahead, debt is projected to further increase, reaching KES 11.3tn by June 2024. This is necessitated by the need to borrow additional funds to finance an anticipated budget deficit of KES 597.0 billion for FY2024/25 attributable to Kenya's shortfall in revenue collection. The projected fiscal deficit in FY 2024/25, will be financed by net external financing of KES 333.8 billion and net domestic borrowing of KES 263.2 billion.
- In line with the objective of minimising the costs and risks associated with public debt, the government plans to prioritise borrowing from multilateral and bilateral development partners, with a greater emphasis on concessional loans.
- However, the government recognises the potential challenges posed by illiquid international capital markets and a shallow domestic market, which may impact the availability of resources to finance the FY24/25 budget. Should these challenges materialise, the government expects to undertake expenditure rationalisation to manage the budget effectively.

Source: Kenya Budget Policy Statement

Managing Fiscal Risks | Other Fiscal Risks

National government pending bills

- The national government will continue to face a significant fiscal risk arising from pending bills. The total outstanding pending bills as at 31 March 2024 amounted to KES 486.9bn owed by state corporations (SCs) (83.3%), ministries department and agencies (16.7%).
- To reduce pending bills the government will undertake verification of pending arrears as well as a root cause analysis that will help avoid re-occurrence in the future.
- To this end, the government set up a verification committee that reviewed and cleared KES 110.0bn of bills as at May 2024.

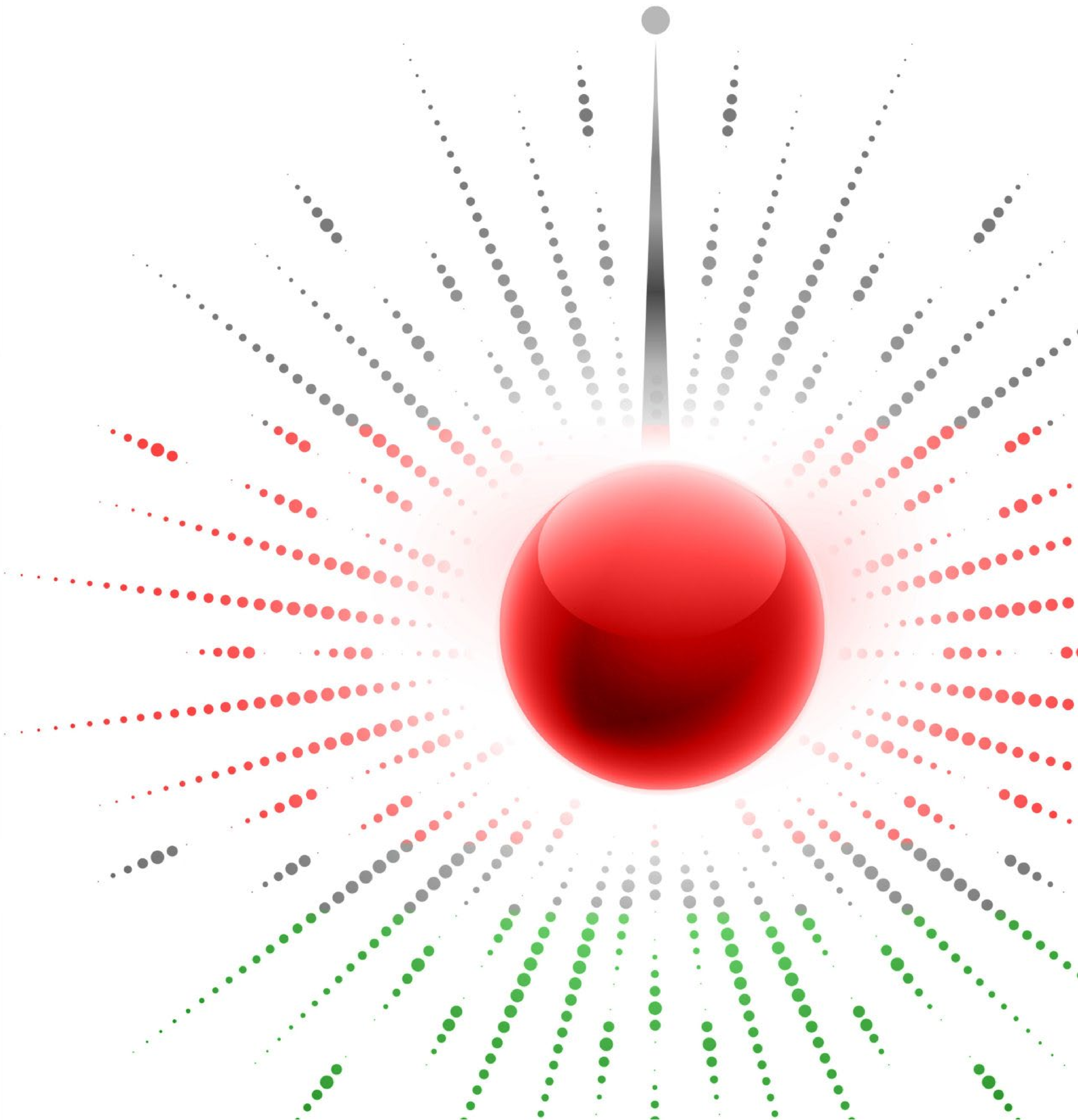
Climate related fiscal risks

- Kenya is experiencing the adverse effects of climate change evidenced by increasing temperatures, increased rainfall variability, and extreme weather conditions, which present direct physical and transition risk to the country.
- To mitigate these risks, the government has set a target to plant 15 billion trees by 2032, developed a framework that promotes green infrastructure, and prioritised low emission power sources in the country.
- Combined, the government expects these initiatives to help reduce emissions, build resilience, and support Kenya to meet Nationally Determined Contribution (NDC) targets under the Paris Agreement.

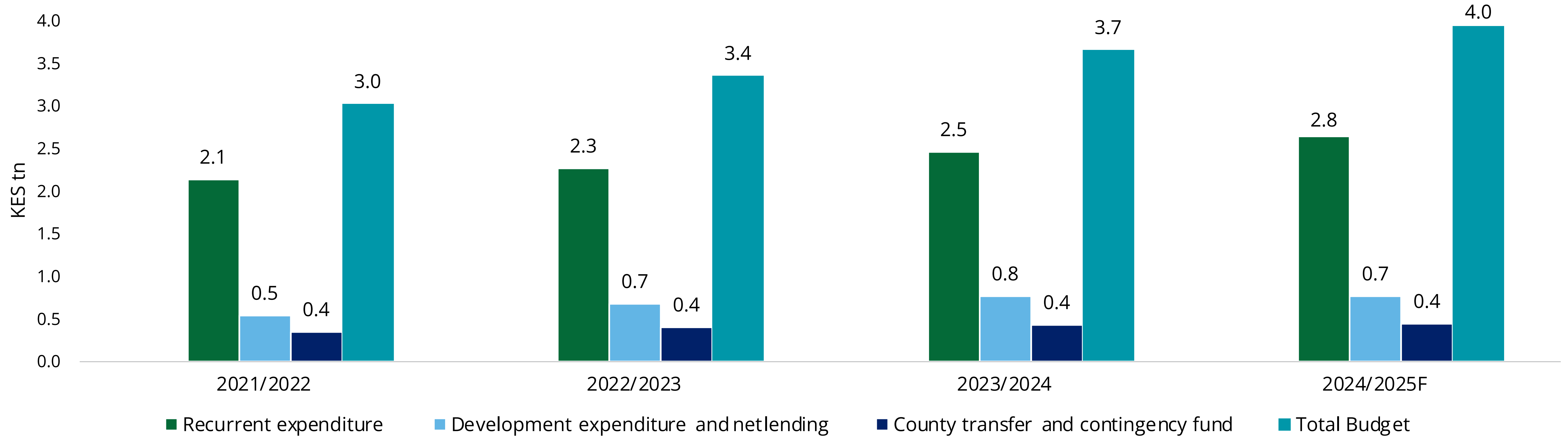
Crystallisation of contingent liabilities

- The government had guaranteed loans amounting to approximately KES 183.1bn as at 31 December 2023,majorly owed by Kenya Airways (KQ), Kenya Electricity Generating Company (KENGEN), and Kenya Ports Authority (KPA). Additionally, the government has identified 14 severral States Corporations (SCs) that have accumulated sizeable arrears and at risk of default.
- With many of these States Corporations experiencing financial distress, the government might be forced to assume the burden of repaying any loans that may be in default.
- As a risk mitigation strategy, the government plans to pursue public private partnerships (PPPs), fast-track privatisation efforts, and strengthen governance in these entities.

Budget Overview



Budget Overview



F: Forecast
Source: 2024 Budget Policy Statement

- Government expenditure as a percentage of GDP is projected to decline to 22.1% in FY24/25 from 24.2% in FY23/24, mainly due to the government's plan to eliminate non-priority expenditures, rationalize tax expenditures, and increase the use of public-private partnerships (PPPs) to reduce the burden on development spending.

- Development expenditure as a percentage of GDP is projected to decline to 3.9% in FY24/25 from 4.7% in FY23/24, reflecting the government's shift of focus to implementing capital projects through public-private partnerships.

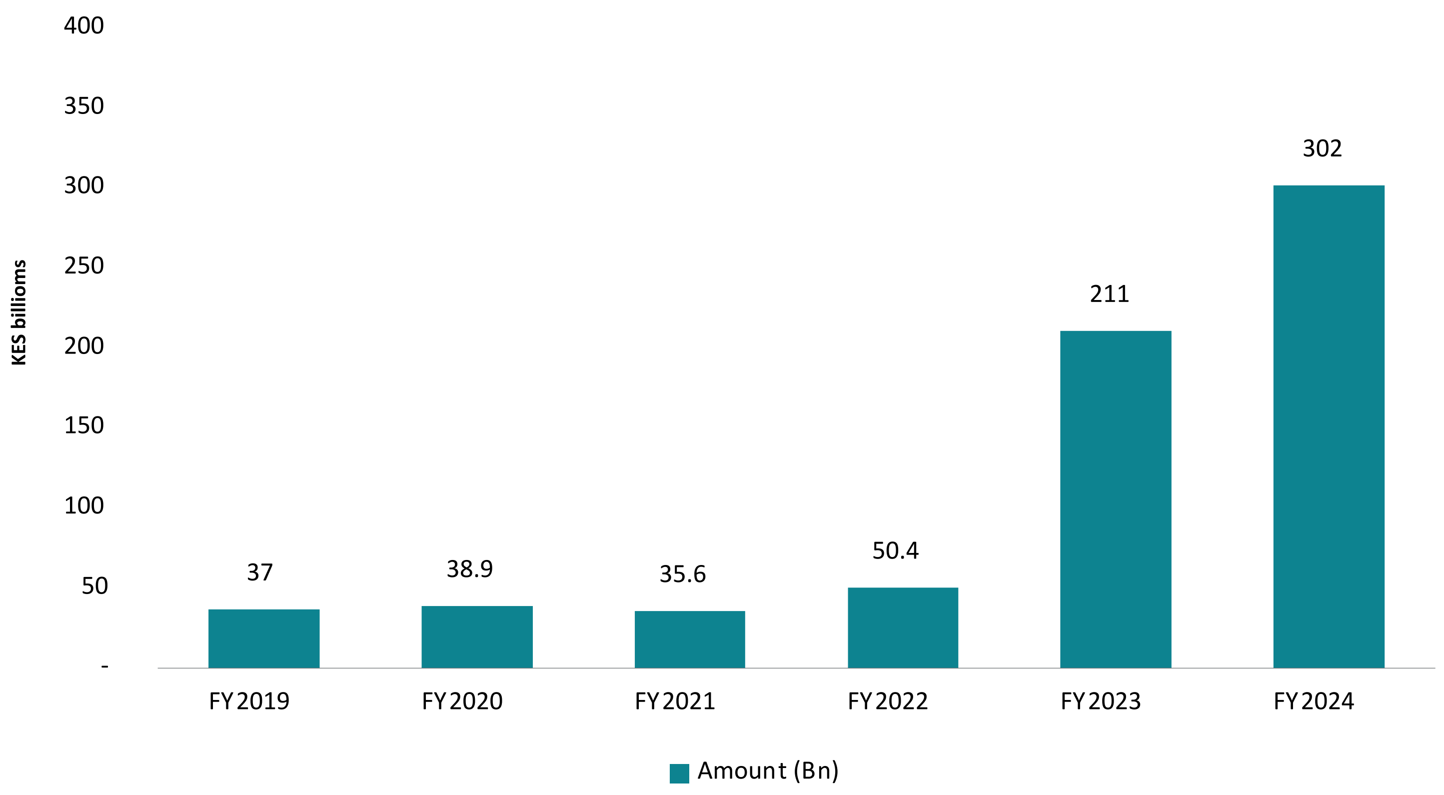
Source: Kenya Budget Policy Statement

- The equitable share of revenue for county governments will increase to KES 400.1bn in FY24/25, supporting increased expenditure for county government initiatives

- The fiscal deficit, inclusive of grants, is projected to decline to KES 597.Obn (3.3% of GDP) in FY24/25 from 785.0bn (4.9% of GDP) in FY23/24, supported by:
  - Total revenue collection (including appropriations in aid) of KES 3.3tn equivalent to 18.5% of the GDP; and
  - A decline in total expenditure to 22.1% of GDP in FY24/25 from 24.2% in FY23/24.
- The reduction in the fiscal deficit reflects the government's commitment to improving the country's debt sustainability position.

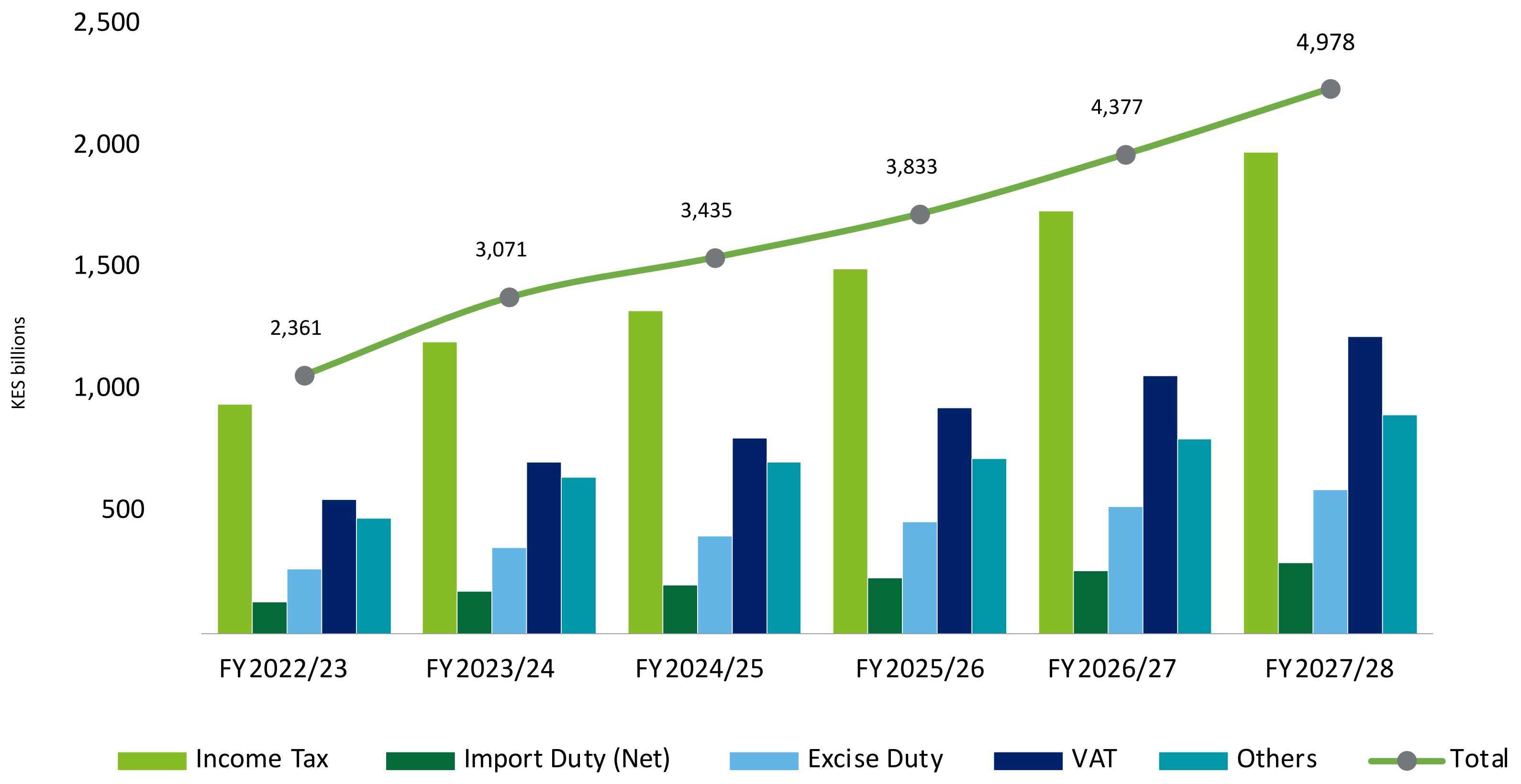
Additional tax revenue arising from Finance Bill measures

- The Finance Bill, 2024 targets to collect additional taxes of KES 302 billion in the coming fiscal year.
- Measures proposed under the Bill seek to expand the tax base by incorporating the digital economy, increasing excise duties on certain goods, adjusting the VAT rates of certain supplies and reducing tax incentives.
- Similar to last year's Finance Bill, additional taxes expected to be raised through the tax measures in this year's Finance Bill are significantly high compared to prior years.



Source: The National Treasury's 2024 Budget Policy Statement

Trend in actual revenue collections



Source: The National Treasury's 2024 Budget Policy Statement

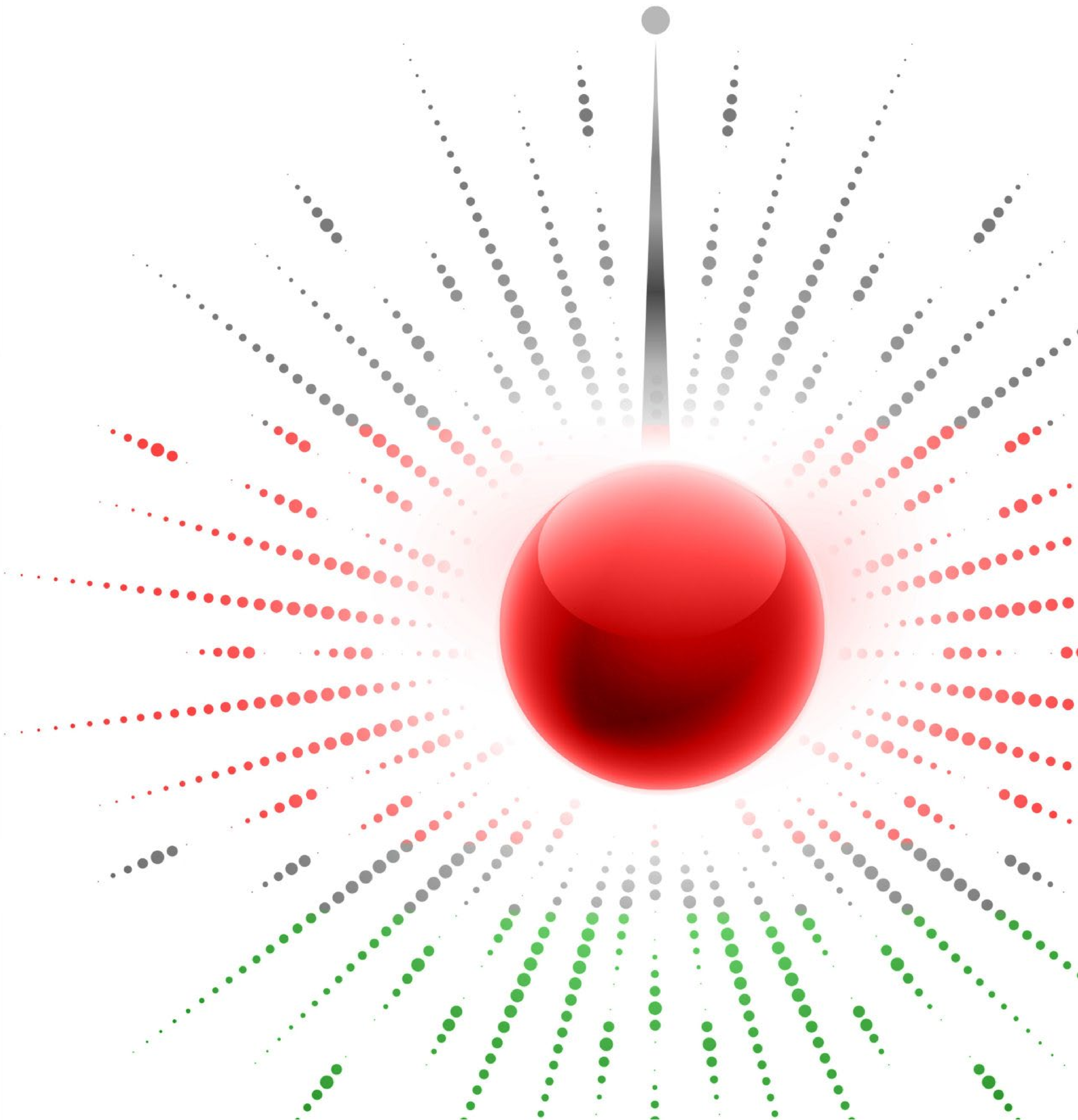
Revenue performance as at 31 March 2024			
Tax Head	**FY23/24 Target as at Q3**	**FY23/24 Actual as at Q3**	**Shortfall as at Q3 (%)**
Income Tax	829,764.00	704,070.00	15%
Import Duty (Net)	128,177.00	98,436.00	23%
Excise Duty	258,672.00	204,170.00	21%
VAT	516,509.00	481,095.00	7%
Others	107,590.00	97,882.00	9%
Total	**1,840,712.00**	**1,585,653.00**	**14%**

Source: Q3 2023/24 QEBR Report

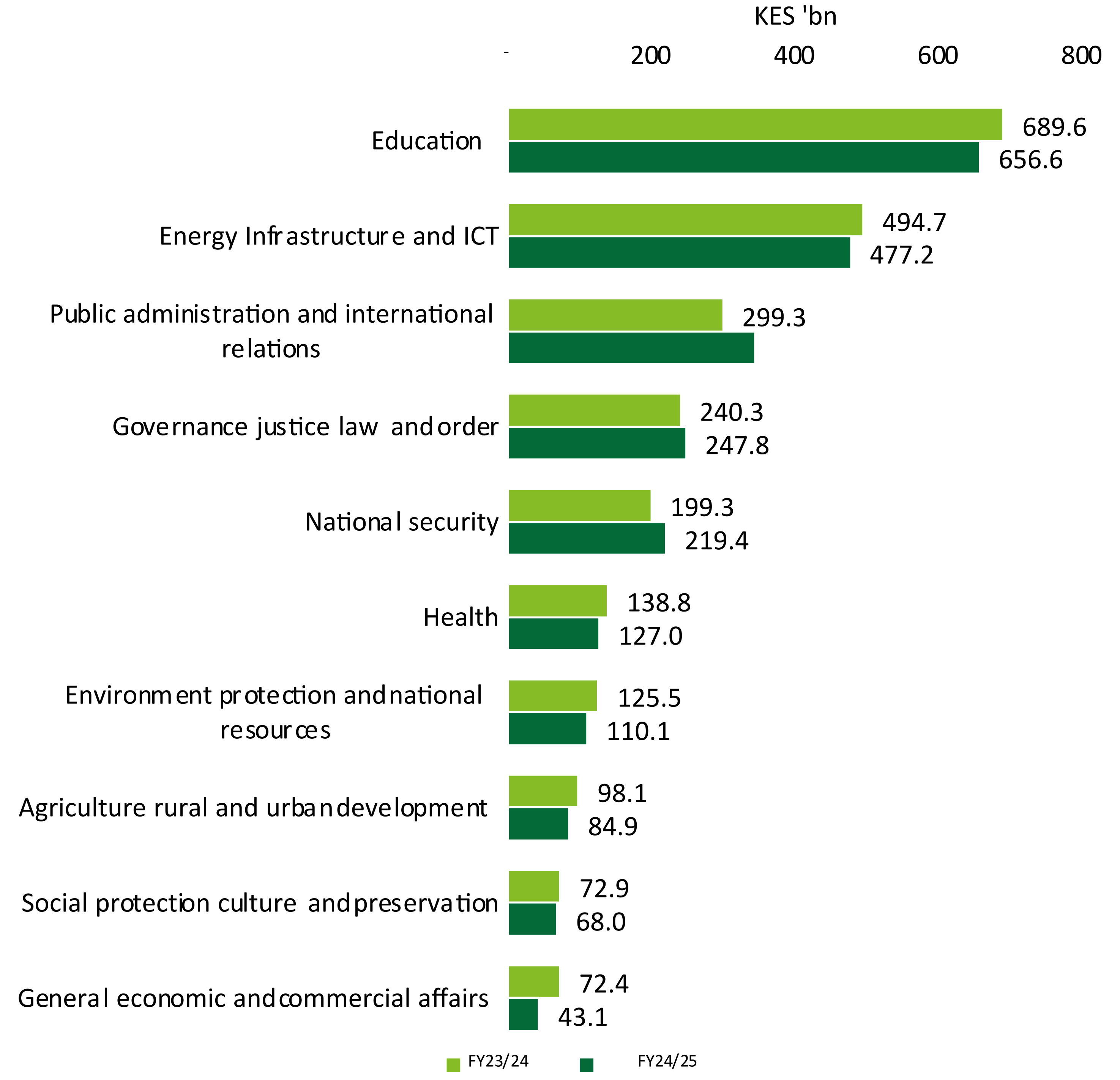
- In FY 2024/25, the KRA intends to collect an impressive KES 2.9 trillion, mainly driven by improved income tax, VAT and excise duty collections. Government targets to increase its tax revenue-to-GDP ratio from 13.5% to 20% by the end of the financial year 2026/27.

- Despite the tax measures introduced via the Finance Act, 2023, revenue performance in FY 2023/24 has been lower than expected with the KRA reporting a shortfall of KES 208 billion as at 31 March 2024.

Sectoral Highlights



Sectoral Allocations



Source: The Mwananchi Guide, FY 2024/25

The largest winners in the 2024/2025 budgetary allocation include:

Education

- The education sector has been allocated KES 656.6bn in FY24/25 a 4.8% decline from KES 689.6bn in FY23/24. Despite this decline, the sector received 27.6% of the total sectoral allocation, aimed at promoting quality and inclusive education for sustainable socio-economic development.
- The government is keen on building capacity to ensure smooth student transitions to junior secondary schools under the competency-based-curriculum (CBC) system and to facilitate increased student intake in technical and vocational education and training institutes.

Energy, Infrastructure and ICT

- The Energy, Infrastructure, and ICT sector has been allocated KES 477.2bn in FY24/25, a 3.5% decline from KES 494.7bn in FY23/24, making up 20.1% of the total sectoral allocation.
- The sectoral allocation will be critical for creating employment opportunities, especially within the affordable housing program, and enhancing the transport sector through the construction and maintenance of roads and ports.

Public Administration and International Relations

- This sector has been allocated KES 344.4bn in FY24/25, a 15.1% increase from KES 299.3bn in FY23/24, representing 14.5% of the total allocation.
- The funding will support programs aimed at achieving the Bottom-Up Economic Transformation Agenda.

Source: The Mwananchi Guide, FY 2024/25

Sectoral Allocations

Education

- The government recognises education as a key driver of the Bottom-Up Economic Transformation Agenda (BETA) and continues to place special focus on the sector.
- Key priorities for FY24/25 include
  - Increasing enrolment in pre-primary, public primary, secondary schools, technical vocational education and training (TVET), and universities ;
  - Building classrooms, particularly in junior secondary schools;
  - Constructing classrooms and laboratories in public secondary schools;
  - Recruiting and promoting teachers and trainers across education levels; and
  - Awarding student loans (HELB) to university and TVET students.
- These initiatives aim to build a knowledge-based economy and promote sustainable political, social, and economic development.

KES 656.6bn

↓ 4.8%

Energy, infrastructure, and ICT

- The energy, infrastructure, and ICT sector has received the second highest allocation in FY24/25 budget reiterating its crucial role in Kenya's socio-economic progress.
- Key priorities for FY24/25 include:
  - -Construction and maintenance of roads, bridges, railways, and ports;
  - -Building affordable housing units and social housing units;
  - -Connecting additional customers to electricity;
  - -Installing on-grid and off-grid standalone solar home systems to enhance electricity access;
  - -Laying kilometres of fibre cables; and
  - -Providing internet connectivity to public institutions.
- To address fiscal constraints, the government willl continue to explore public-private partnerships (PPPs) as a funding alternative due to diversification, risk mitigation, and off-balance sheet benefits.

KES 477.2bn

↓ 3.5%

Source: The Mwananchi Guide, FY 2024/25

Sectoral Allocations

Health

- The government has increased budgetary allocation to the health sector due to its significant role in national economic growth by ensuring all Kenyans are productive and live a healthy life.
  Priority programs for FY24/25 include:
  - Enhancing national referral and specialised services;
  - Providing curative and reproductive health services for maternal neonatal, child, and adolescent health;
  - Facilitating health innovations and research;
  - Supporting general administration and health services;
  - Promoting preventive and promotive health services; and
  - Developing health resources.
- The government's interventions aim to provide publicly financed primary healthcare, and emergency fund, and health insurance coverage for all Kenyans, aligned with achieving universal health coverage (UHC). This has led to the enactment of four new laws: the Social Health insurance Act, 2023; Primary Healthcare Act, 2023; Facility Improvement Financing Act, 2023; and Digital Health Act, 2023.

KES 127.0bn

↓ **8.5%**

Agriculture

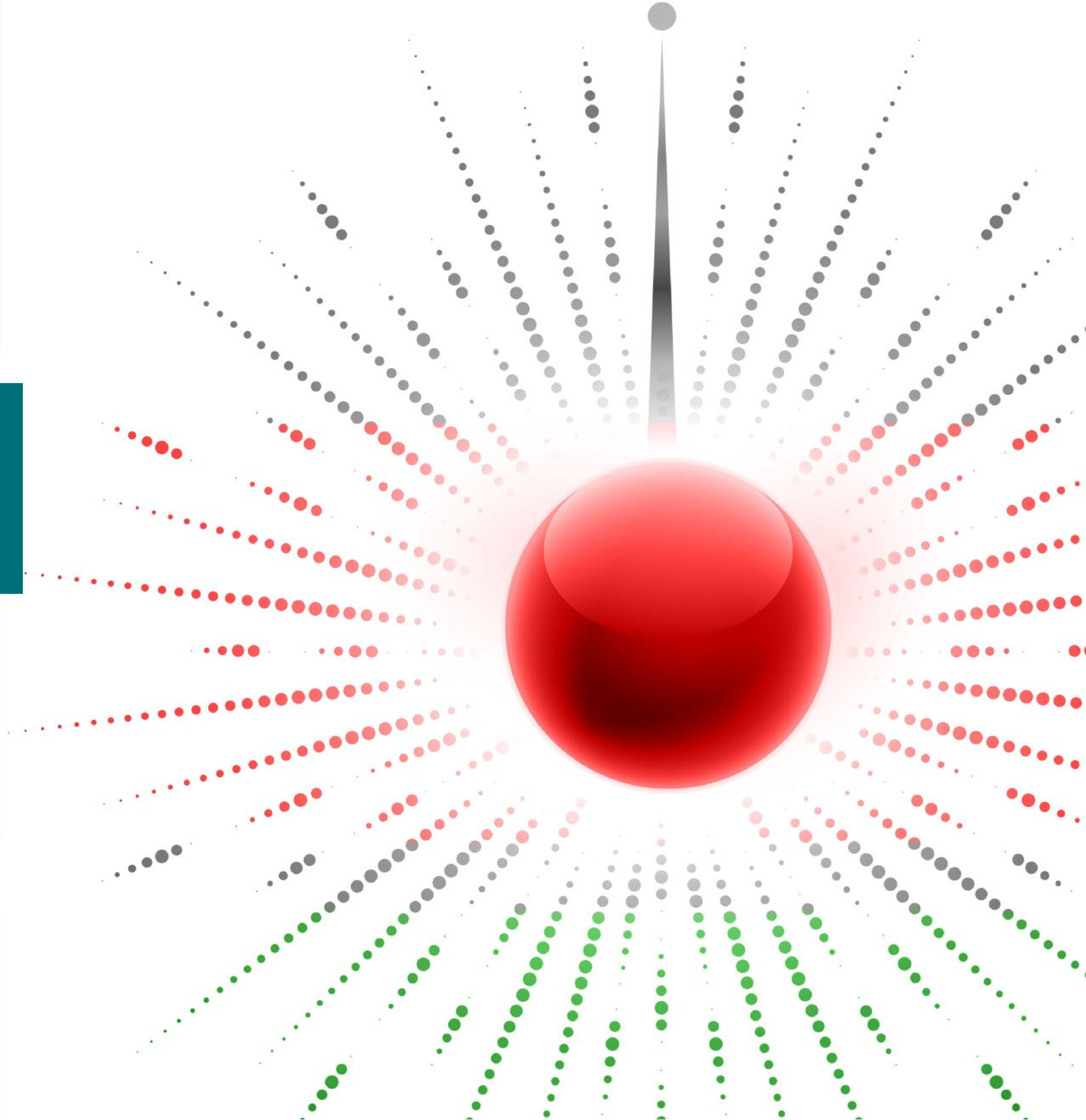
- Agriculture is crucial to Kenya's economy, contributing 20.0% of GDP and employing 40.0% of the population and 70.0% of rural residents.
- The government has allocated 84.9bn (3.6 % of the total allocation) in FY24/25, reflecting its commitment to using agriculture to create jobs and improve livelihoods under the Bottom-Up Economic Transformation Agenda.
- Key priorities in the FY24/25 agricultural budget include:
  - Issuing title deeds and landless households;
  - Producing and distributing of assorted livestock vaccines, doses of semen, and improved embryos;
  - Distributing milk coolers to counties;
  - Completing the Kenya Industrial Leather Park at Kenanie;
  - Constructing fish landing sites, fish ports, and a fish processing plant at Kalokol;
  - Providing 1.5m metric tonnes (MT) of subsidised fertiliser; and
  - Distributing assorted seeds for oil crops cotton maize potatoes and rice.
- These initiatives are expected to drive 5.0% growth in agriculture by 2025, boost food production, enhance smallholder productivity, and lower food costs. Nevertheless, this sector is confronted with potential drawbacks stemming from the adverse consequences of unusually high rainfall recorded during the nation's long rainy season, resulting in crop destruction.

KES 84.9bn

↓ **13.4 %**

Source: Kenya Budget Policy Statement
: The Mwananchi Guide, FY 2024/25

Proposed Tax Measures



Overview of Income Taxes

"Despite leading East Africa in ordinary revenue collection with KES 2.948 trillion, Kenya consistently faces budget deficits driven by excessive spending."

The Finance Bill, 2024 ("the Bill") has ignited substantial opposition and scrutiny across various sectors, underscoring the delicate and complex balance of fiscal policy and the socio-economic impact. This critical examination highlights the challenges inherent in formulating a budget that addresses immediate revenue needs while fostering long-term economic growth and sustainability and social welfare.

The proposed Bill introduces several pivotal business income tax measures, including the replacement of the digital services tax ("DST") with a significant economic presence tax ("SEPT"), the introduction of a motor vehicle tax and minimum top up tax, taxation of income from infrastructure bonds ("IFB") investments, and broadening the scope of withholding tax to include payments for off-the-shelf software and goods supplied to a public entity. These measures, among others, aim to raise an ambitious total revenue of KES 3.343 trillion for the 2024/25 National Budget, marking a 12.9% increase from the 2023/2024 National Budget. Out of this amount, KES 2.948 trillion is expected to come from ordinary revenue.

Given the challenges facing Kenya's economy, which include, inter alia, increased cost of doing business, declining export competitiveness, astronomical interest rates, volatile exchange rates, increased inflation rates and heavy public debts, the Government should ensure fiscal neutrality so that the proposed tax measures do not further negatively impact the economy. A regime of aggressive tax measures will suppress economic growth and drive away foreign direct investment.

A deeper look at Kenya's fiscal landscape arguably reveals that the country has a bigger expenditure problem as compared to a revenue one. Despite leading East Africa in ordinary revenue collection with KES 2.948 trillion, Kenya consistently faces budget deficits driven by excessive spending. A considerable portion of the revenue is allocated to servicing the public debt, projected to reach KES 11.3 trillion by the end of the financial year 2023/24, alongside recurrent expenditures which primarily constitute the burgeoning public wage bill. Worryingly, a significant proportion of the Government revenue is lost through corruption, wastage and illicit trade.

The Government must address the issue on expenditure especially in light of the Auditor General's reports on public financial mismanagement, misuse and unaccounted for monies in order to facilitate fiscal sustainability.

As for the Bill, the frequent changes in tax policies create uncertainty for investors and anxiety among taxpayers. To build a robust, stable and predictable tax system that supports sustainable economic growth, especially in these uncertain times, Kenya's Finance Bills should align with the Medium-Term Revenue Strategy ("MTRS") and the National Tax Policy ("NTP") as initially intended.

In conclusion, the National Budget for the fiscal year 2024/25 presents a crucial opportunity for Kenya to tackle its fiscal challenges while laying the foundation for sustained economic growth. By balancing immediate revenue needs and controlling spending, alongside making long-term strategic investments and maintaining a stable fiscal policy environment, Kenya can navigate its current challenges and chart a course for a prosperous future.

Walter Mutwiri
Partner, Tax & Legal
Deloitte East Africa

Income Tax Measures

Corporate Income Tax

- Interest income on infrastructure and social services bonds, notes and similar securities with maturity periods of at least 3 years issued on or after 1 July 2024 to be taxable. Withholding tax shall also apply on the interest at 5% and 15% on resident and non-resident payments, respectively.
- The period within which a person may claim a deferred foreign exchange loss deduction due to interest on foreign debt exceeding 30% of EBITDA to be reduced from 5 years to 3 years.
- Spectrum license fees paid by telecommunication operators to qualify for investment allowance at 10% p.a.
- Advance Pricing Agreements (APAs) to be introduced. APAs will allow taxpayers to agree the arm's length pricing criteria for future-controlled transactions with the Kenya Revenue Authority ("KRA") for up to 5 years.
- Entities in Kenya that are part of a multinational group with consolidated annual turnover of at least 750 million Euros in at least two of the four previous years of income will be required to pay a top-up tax to KRA if their effective corporate tax rate from Kenya is below 15%. This proposal is aligned with Pillar 2 of the Global Anti-Base Erosion Rules, which aim to ensure that multinationals pay a minimum effective corporate tax rate of 15% in all the countries they operate.
- The freight tax applicable on the income of non-resident shipowners or operators of ships or aircraft that call at any port or airport in Kenya to be increased from 2.5% to 3%.
- Income of non-residents involved in the implementation of projects that are fully funded by grants under an agreement between the government and a development partner shall only be exempt to the extent the income is directly related to the project. Any other income shall be taxable.
- Deductibility threshold in respect of contributions to registered pension and provident schemes to be increased from KES 240,000 to KES 360,000 per annum.

Personal Income Tax

- Insurance relief on health policies (including NHIF and post-retirement medical fund contributions) and the Affordable Housing Relief to be removed and replaced with deductions.
- The allowable contributions to pension, provident and individual retirement schemes to be increased from KES 240,000 per year (KES 20,000 per month) to KES 360,000 per year (KES 30,000 per month).
- Owner-occupied mortgage interest deduction to increase from KES 300,000 per annum to KES 360,000 per annum.
- The non-taxable per diem of KES 2,000 per day to be replaced with an amount equal to 5% of monthly gross earnings of the employee per day where the employer has a policy on payment and accounting for these allowances.
- The cost of meals provided to employees up to KES 60,000 per year to be exempt from tax. The current limit is KES 48,000 per year.
- Non-cash benefits not expressly covered in the ITA up to KES 48,000 per year to be exempt from tax. The current threshold is KES 36,000 per year.
- Reimbursements to public officers for expenditure incurred to perform official duties, regardless of the ownership or control of the assets purchased to be exempt from tax.
- Withdrawals from registered pension, provident and individual funds or the NSSF to be exempt from tax upon attainment of the retirement age determined in accordance with the rules of the fund, retirement due to ill health or after 20 years from the date of membership registration.
- The requirement for registered individual retirement funds, registered pension funds, and registered provident funds to be registered with the Commissioner to no-longer apply.
- Employees working remotely outside Kenya for Kenyan employers to be required to have Personal Identification Numbers (PINs).

Income Tax Measures

Withholding Tax

- Public entities to withhold tax on payments for supply of goods at 3% and 5%, for residents and non-residents, respectively. The amounts shall be deemed to be income of the suppliers of the goods in the year the payments are made.
- Owners or operators of digital platforms through which payments for digital content monetisation, goods, property or services would be made or facilitated will be required to withhold tax on the payments at 5% and 20%, to residents and non-residents, respectively.
- The withholding tax regime on digital content monetization, which currently applies at 5% for residents and 20% for non-residents, to be extended to payments for creative works, or for creating or sharing the material or any other material that is offered electronically.
- All software-related payments shall qualify as royalties, therefore, subject to withholding tax at 5% and 20%, for resident and non-resident payments, respectively.
- The monthly threshold of KES 24,000 for applicability of withholding tax on management, professional or training fees to residents to be removed.

Capital Gains Tax

- Firms certified by the Nairobi International Financial Centre Authority that invest at least KES 3 billion in one or more entities in Kenya within 2 years to qualify for a reduced capital gains tax (CGT) rate of 5% if they transfer their investments after 5 years.
- CGT exemption relating to the transfer of title of immovable property to a family trust to be removed.
- The CGT exemption on property transfers within a Special Economic Zone (SEZ) to be limited to transfers made by licensed SEZ entities.

Other Income Tax Highlights

- Proposed introduction of motor vehicle tax at 2.5% of the value of qualifying motor vehicles. The minimum amount to be paid shall be KES 5,000 and the maximum shall be KES 100,000. Ambulances and vehicles owned by the County and National Government, Kenya Defence Forces, Kenya Police Service, National Intelligence Service, or persons exempt from tax by the Privileges and Immunities Act shall be exempted from the tax.
- Digital Service Tax (DST), which currently applies at 1.5% of the income of non-residents from businesses carried out over the internet or electronic networks to be abandoned and replaced with a tax known as Significant Economic Presence Tax (SEPT), that shall apply at an effective tax rate of 6% of the gross turnover of non-residents from the provision of services through a digital marketplace. Digital marketplace has been defined to include platforms that provide ride-hailing services, food delivery services, freelance services, professional services, rental services, and task-based services.
- Income tax exemptions to be removed on the income of a registered trust scheme, income or principal sum of a registered family trust, and the income of an amateur sporting association.

Overview of Indirect Taxes

The National Treasury presented the Budget Estimates for the financial year 2024/2025 (FY25) that project an expected increase in expenditure from prior year. The government expects to increase its revenue by about 16% in FY25 where ordinary revenue from tax is expected to grow and is projected to be 16% of GDP. The government's goal aims to reduce the fiscal deficit and stabilize growth in public debt while ensuring debt sustainability through a combination of revenue enhancement initiatives and expenditure rationalization.

Indirect taxes have over the last few years gradually increased and have been key in driving the Kenyan economy. According to the Economic Survey, 2024, provisional tax revenue from indirect taxes for the financial year 2024 is expected to total KES 1.23 trillion by end of June 2024. This is broken down to Value Added Tax (VAT) of KES 703 billion, excise duty of KES 357 billion and customs duties of KES 173 billion. The projected revenue collection presents a steep rise of 30% from the prior year collections of KES 946 billion. Indeed, the trend points to a notable year-on-year increase in indirect tax collections since the financial year 2020.

The budget estimates indicate that the government is set to cut back on borrowing, and instead opt for higher taxation, widening the tax base and sealing tax leakages by incorporating the informal sector in tax collection to cover projected expenditure. These enhanced measures come against the backdrop of fiscal pressure in the current prevailing economy situation. These include external shocks that have resulted in high prices of imported commodities, rise in interest rates globally and high debt service burden amplified by exchange rate instability and a tough business environment.

The 2024 Finance Bill introduces several significant changes to the country's tax landscape, focusing on enhancing revenue collection and broadening the tax base. 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 3.9 trillion.

Key proposed changes in VAT include the move to introduce VAT at 16% on a number of financial services which have previously been exempt. This will increase the cost of these services. While the proposal is aimed at raising additional tax revenue, this, coupled with the increased excise taxes on some financial transactions may drawback the gains made in financial inclusion.

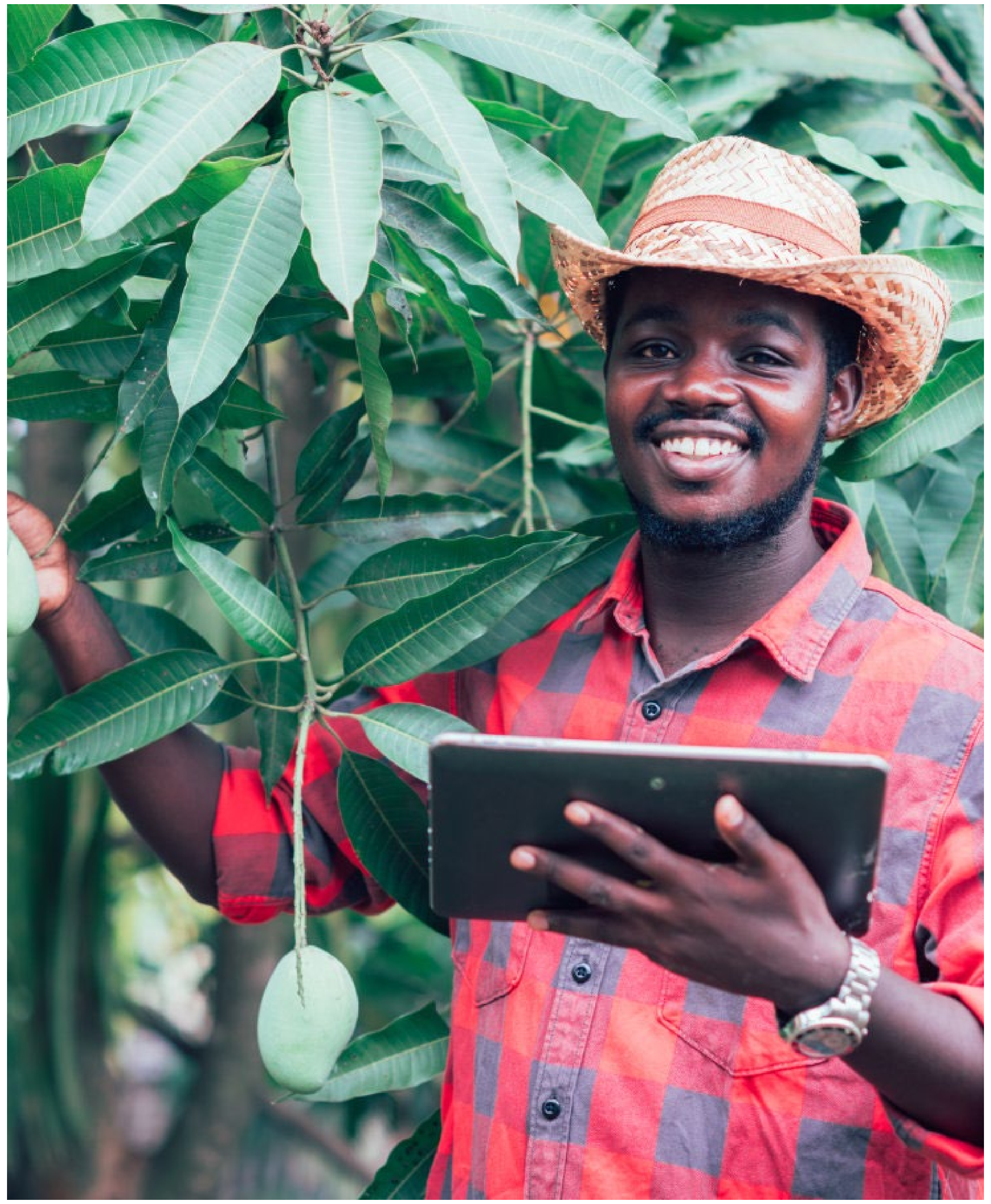
There is also a proposal to charge VAT on bread which is an essential product to the ordinary mwananchi.

The Finance Bill also proposes a raft of changes to the Excise Duty Act including introduction of excise duty on various products such as vegetable oil, imported electric motorcycles, increase of excise duty rates on various goods and services and removal of relief on excise duty on raw materials. These changes will increase prices of affected goods which may suppress demand in the market and potentially reduce government revenue in the medium to long term.

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

Indirect Tax Measures



Value Added Tax (VAT)

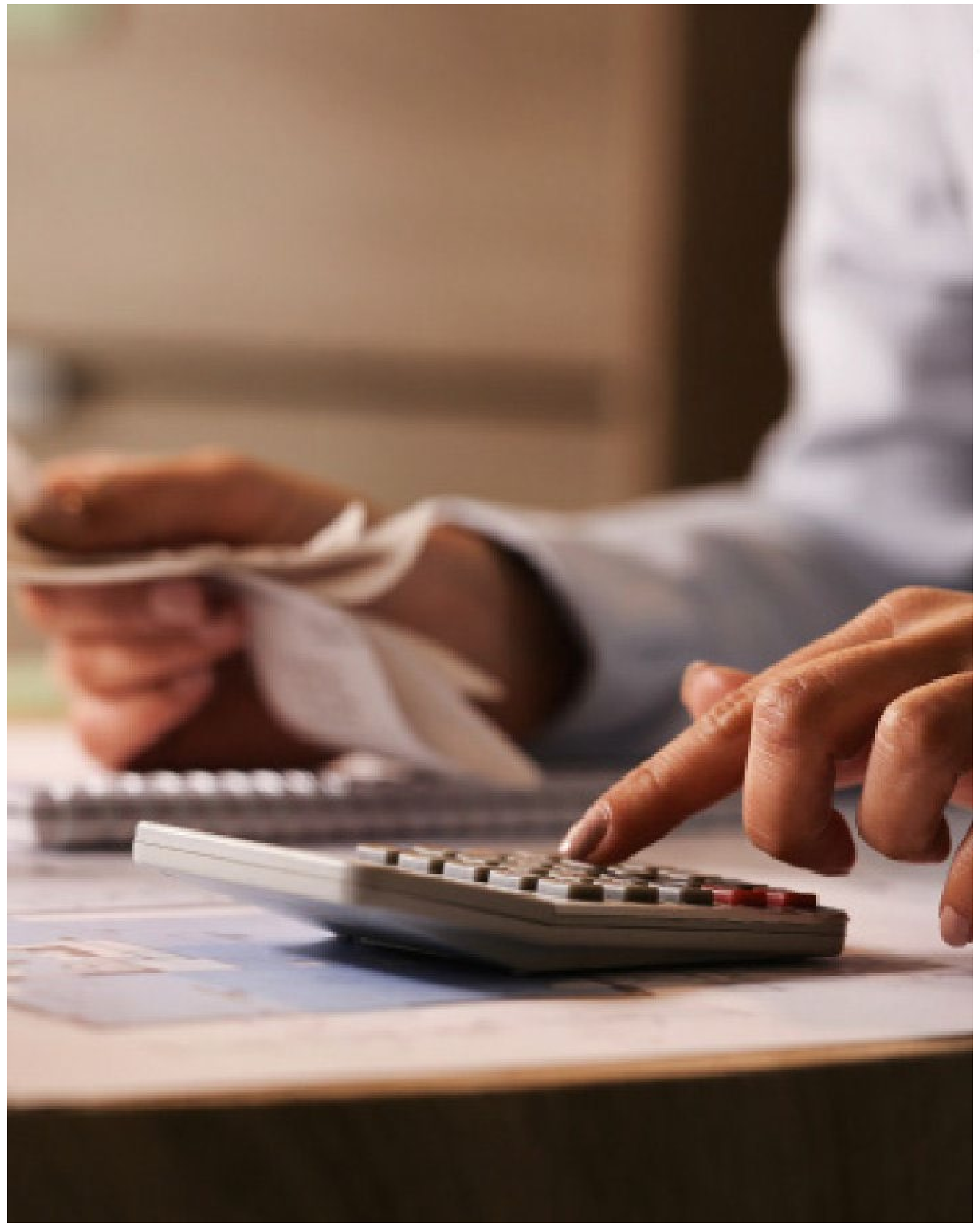
- Change of the VAT status of bread from zero rate to 16%.
- Change of VAT status on various financial services from the exempt status to taxable at standard rate of 16%.
- Change of the VAT status of insurance services. The proposal seeks to limit the scope of exempt insurance services to only underwriting services for which either an insurance or reinsurance premium is earned.
- Exemption of the transfer of business as a going concern.
- Change of the VAT status of gaming and betting from exempt to 16%.
- Change of the definition of a tax invoice. The proposal defines a tax invoice to include an electronic tax invoice issued in accordance with the Tax Procedures Act (TPA).
- Increase of the VAT registration threshold from the current KES 5 million to KES 8 million.
- Reduction of timeline in which a taxpayer should lodge a VAT refund by deleting the twenty-four months window under the VAT Act. This implies that refunds should be lodged within six months under Section 47 of the Tax Procedures Act (TPA).
- Abolishment of the 90 – 10 input tax apportionment rule.
- Removal of VAT refunds relating to excess input VAT incurred in the provision of taxable supplies to official aid funded projects.
- Removal of the deduction of input tax relating to supplies to official aid funded projects.
- Change of the VAT status of inbound freight to 16%.
- Several inclusions, deletions and changes to clean-up both the zero-rating and exemption schedules.

Excise Duty

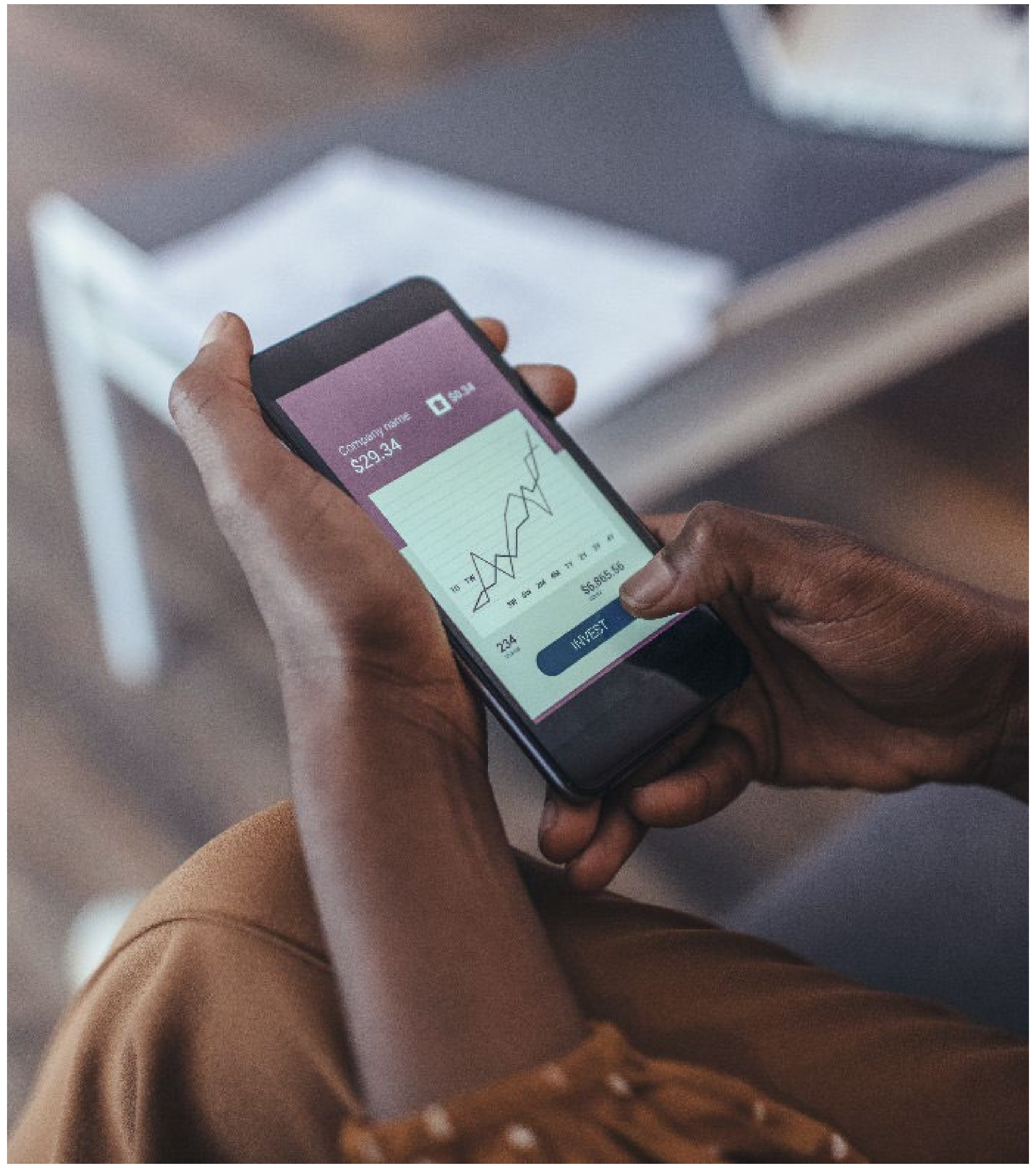
- Clarification that excisable goods in the Excise Duty Act shall be classified in line with the East African Community Common External Tariff.
- Introduction of excise duty on services offered by a non-resident through a digital platform.
- Introduction of excise duty remission on spirits made from any agricultural products grown in Kenya, excluding barley.
- Introduction of a 14-day timeline, after receipt of all requisite documents, within which the Commissioner should consider and respond to an application for an excise duty license.
- Increase of the period within which excise duty on alcoholic beverages should be remitted to the Commissioner from 24 hours to five working days upon removal of the goods from the stockroom.
- Repeal of excise duty relief on raw materials used to manufacture excisable goods and purchase of bulk data for resale by licensed internet data providers.
- Removal of excise duty on petrol engine motorcycles and introduction of excise duty on imported electric motorcycles other than motorcycle ambulances.
- Amendment of excise duty on motorcycles from a specific rate of KES 12,952.83 to a hybrid rate of 10% of the unit's value or KES 12,952.83, whichever is higher.

Indirect Tax Measures

- Removal of excise duty on the following goods originating from the EAC:
  - Imported cartons, boxes and cases of corrugated paper or paper board and imported folding cartons, boxes and cases of non-corrugated paper or paper board and imported skillets, free-hinge lid packets of tariff heading 4819.10.00, 4819.20.10 and 4819.20.90.
  - Imported eggs of tariff heading 0407.
  - Imported onions of tariff heading 0703.
  - Imported potatoes, potato crisps and potato chips of tariff heading 0701 and imported potatoes of tariff codes 0710.10.00, 2004.10.00 and 2005.20.00.
- Clarification that cement clinker is not subject to excise duty.
- Introduction of excise duty on locally manufactured articles of plastics of tariff codes 3923.30.00 and 3923.90.90 at 10%.
- Amendment of excise duty rate on the following products:
  - Imported sugar confectionary of tariff heading 1704 from KES 42.91 per kg to KES 257.55 per kg.
  - Wines including fortified wines, and other alcoholic beverages obtained by fermentation of fruits from KES 243.43 per liter to KES 22.50 per centiliter of pure alcohol.
  - Beer, cider, perry, mead, opaque beer, and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages of alcoholic strength not exceeding 6% from KES 142.44 per liter to KES 22.50 per centiliter of pure alcohol.
  - Spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength exceeding 6% from KES 356.42 per liter to KES 16 per centiliter of pure alcohol.
  - Cigarette with filters (hinge lid and soft cap) from KES 4,067.03 per mille to KES 4,100 per mille.
  - Cigarette without filters (plain cigarettes) from KES 2,926.41 per mille to KES 4,100 per mille.
  - Products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application but excluding medicinal products approved by the Cabinet Secretary responsible for matters relating to health and other manufactured tobacco and manufactured tobacco substitutes that have been homogenized and reconstituted tobacco, tobacco extracts and essences from KES1,595 per Kg to Shs 2,000 per Kg.
  - Liquid nicotine for electronic cigarettes from KES 70 per milliliter to KES 100 per milliliter.
  - Increase in excise duty on the following services:
  - Telephone and internet data from 15% to 20%.
  - Fees charged for money transfer by banks, money transfer agencies and other financial service providers from 15% to 20%.
  - Betting (excluding horse racing), gaming, price competition and lottery (excluding charitable lotteries) from 12.5% to 20% of amount wagered or staked.
- Introduction of excise duty on the following products:
  - Coal at 5% of the value or KES 27,000 per metric ton whichever is higher.
  - Vegetable oils of Tariff Headings 1511, 1512, 1515 and 1517 at 25%.
- Introduction of excise duty on fees charged on advertisements via the internet and social media in relation to alcoholic beverages, betting, gaming lotteries and prize competitions at 15%.
- Exemption of all goods including materials supplies, equipment, machinery, and motor vehicles for the official use by the National Intelligence Service.



Indirect Tax Measures



Miscellaneous Fees and Levies

- Increase in Import Declaration Fee (IDF) rate from 2.5% to 3%.
- Exemption of the following goods from IDF and Railway Development Levy:
  - All goods including material supplies, equipment, machinery, and motor vehicles for official use by the National Intelligence Service (NIS).
  - Inputs, raw materials, and machinery used in the manufacture of mosquito repellents on recommendation by the Cabinet Secretary responsible for matters relating to health.
- Introduction of Export and Investment Promotion Levy (EIPL) on alcoholic beverages and spirits, leather articles, footwear, furniture, motorcycles, mattress supports, milk and cream, cooking stoves for liquid fuel etc.
- Reduction of EIPL on clinker from 17.5% to 10% and kraft liner from 10% to 3%.
- Introduction of eco levy on specified imported and locally manufactured goods, including office machines, smart phones, transmission apparatus for radio broadcasting or television, batteries or dry cells, rubber tires, diapers etc.

Customs

- Stay of application of the Common External Tariff (CET) rates has been extended for a further period of one year on the following products:
  - Rice at 35% or USD200/MT instead of 75% or USD345/MT.
  - Various iron and steel products at 35% with corresponding specific rates.
  - Imported leather bags at 35%.
- Stay of application of the East African Community Common External Tariff rates is to be granted on the following products for a period of one year:
  - Prime movers at 25% instead of 10%
  - Trailers at 35% instead of 10%
  - Selected fabric products at 25% with corresponding specific duty rates
  - Textile products at 35%
- 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 and assembly of smart telecommunication devices including mobile phones, laptops and tablets.
  - Raw materials for manufacture of parts used in the assembly of motorcycles including leaf springs and wiring harness.
  - Completely Knocked Down (CKDs) kits for assembly of motorcycles at 10%.
  - Inputs for manufacture of animal feeds at 0%.

Overview of Tax Administration

Tax administration provides a mechanism through which the government collects revenue based on the enacted tax laws. Consistency and efficiency in the tax administration plays a significant role in facilitating compliance and revenue collection. The budget proposes to strengthen tax administration to enhance compliance by leveraging on technology to revolutionize the tax processes and seal tax leakages. Consequently, various tax administration reforms geared towards enhancing tax compliance have been proposed in this budget.

For instance, the Finance Bill 2024 seeks to empower the Commissioner to require a person to integrate their electronic tax system to the Commissioner's data management and reporting system. This will facilitate submission of electronic documents, including detailed transactional data. This proposal is aligned to international tax practises as there is a rapid shift towards digital tax administration, driven by the digital transformation wave. Across the world, revenue authorities are implementing digital solutions and regulation that require real-time data access to taxpayer information. The requirement to integrate taxpayer systems with the Commissioner's electronic invoicing system may present a myriad of challenges in relation to the administrative burden on taxpayers as well as in instances of incompatibility or breakdown of any one or both systems involved. As a result, the proposed penalties of KES 2,000,000 per month as per the Finance Bill 2024 is overly excessive.

The Finance Bill also proposes to amend the Tax Procedure Act (TPA) to disallow any objections as not validly lodged where a taxpayer fails to provide information requested by the Commissioner. Notably, the Finance Act, 2023 had amended the TPA to grant taxpayers a grace period of 7 days to provide information required in the course of the Commissioner's review of the taxpayers' objection. Considering the extensive nature of information requested by the Commissioner during the audits, there is need to relook at this provision as it is likely to be abused especially where the Commissioner requests for information that is practically impossible to obtain.

Another administrative change is the proposal to increase the time within which the commissioner makes an objection decision from 60 to 90 days. This proposal may offer some leeway to the Commissioner in terms of offering more time for the deliberation of objection decisions and result in decisions that are well thought-out. Arguably, the period within which the taxpayer is required to object to an assessment should also be increased from the current 30 days for equity.

There is also a proposal to empower the Commissioner to enforce collection of tax once the decision of the Tribunal or the Court is made in favour of commissioner even if the rights of appeal have not been fully exhausted. This proposal is likely to inconvenience many taxpayers who may have valid and strong grounds of objection.

On a positive note, deadlines for tax obligations will consider weekends and public holidays. In this case, the timelines for tax obligations will exclude Saturdays, Sundays, and public holidays.

Overall, the proposed amendments are stringent, and taxpayers will be required to remain vigilant to avoid increased costs of non-compliance.

Doris Gichuru
Partner, Tax & Legal
Deloitte East Africa

Tax Administration

Tax Procedures

- Commissioner to issue agency notices even where the right of appeal has not been fully exhausted.
- Invalidly lodged objections to be disallowed where a taxpayer fails to cure invalidity within 7 days of notification.
- Objection decisions to be issued within 90 days, up from 60 days.
- Weekends and public holidays to be excluded in computing the time for performing an action under a tax law, such as submitting or lodging a tax return, payment of tax, etc.
- The Commissioner to be granted discretion to abandon tax in instances of impossibility, undue difficulty, hardship, or any other reason subject to written approval by the Cabinet Secretary for the National Treasury and Economic Planning.
- Validity of agency notices to be limited to one year.
- Adoption of electronic tax invoice requirements in the TPA to align with the Tax Procedures (Electronic Tax Invoice) Regulations, 2024.
- The Commissioner may require taxpayers' systems to be integrated with KRA's electronic tax system, failure to which penalties of KES 2,000,000 per month would apply.
- The 10% penalty for failure to withhold or remit tax will no-longer be pegged on conviction.
- Recommendation by the Tax Agents Committee required before the Commissioner can cancel a tax agent's license.
- The KES 2,000 late return submission penalty per day for entities that operate within Export Processing Zones (EPZs) to be replaced with a KES 20,000 monthly penalty.
- Employees working remotely outside Kenya for employers in Kenya to be required to register with KRA and possess a Personal Identification Number (PIN).

Other Measures

Data Protection Act
Processing of personal data to be allowed where disclosure is necessary for the assessment, enforcement or collection of any tax or duty under a written law.

Industrial Training Act
The provisions of the Tax Procedures Act to apply on collection of the training levy.

Kenya Revenue Authority Act
Revenue administration and collection under the Civil Aviation Act to be excluded from the jurisdiction of the KRA.

The Kenya School of Revenue Administration ("KESRA") to be allowed to collaborate with institutions of higher learning to develop tax curricular, asses, examine and award certificates to students

Affordable Housing Act
Beneficiaries of affordable housing to be allowed to sell their units.

Public Finance Management Act
Provisions for implementation of accrual accounting in Government to be introduced.

Contacts

Publication team

Fred Omondi
Tax & Legal Leader
fomondi@deloitte.co.ke

Walter Mutwiri
Partner, Tax & Legal
wmutwiri@deloitte.co.ke

Lillian Kubebea
Partner, Tax & Legal
lkubebea@deloitte.co.ke

Doris Gichuru
Partner, Tax & Legal
dgichuru@deloitte.co.ke

Gladys Makumi
Financial Advisory Leader
gmakumi@deloitte.co.ke

David Mwiti
Associate Director, Tax & Legal
dmwiti@deloitte.co.ke

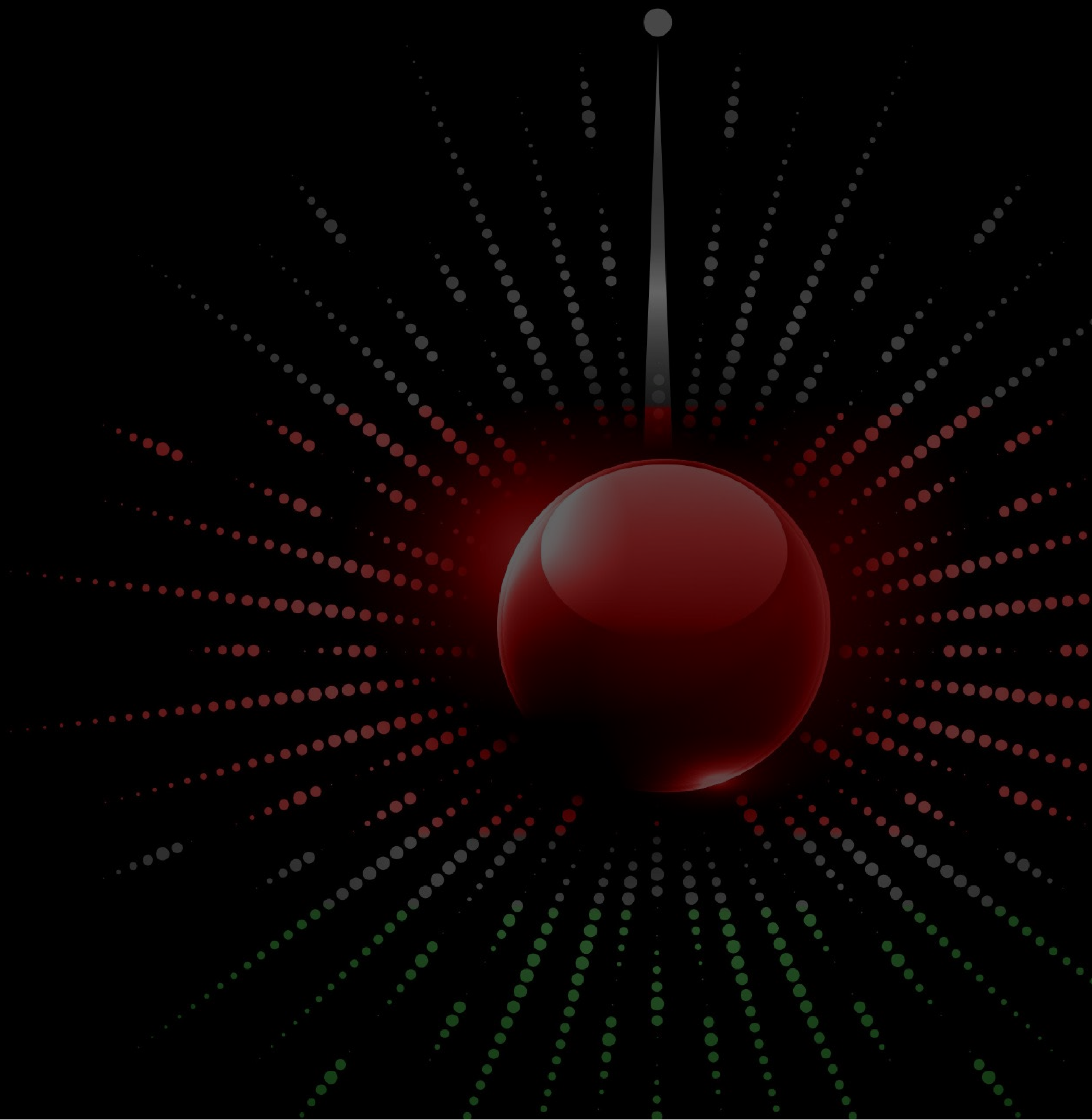
Fred Kimotho
Associate Director, Tax & Legal
fkimotho@deloitte.co.ke

Peter Njenga
Associate Director, Tax & Legal
pnjenga@deloitte.co.ke

Maurice Lugongo
Associate Director, Tax & Legal
mlugongo@deloitte.co.ke

Charles Musyoka
Senior Manager, Tax & Legal
cmusyoka@deloitte.co.ke

Kennedy Okoyo
Senior Manager, Tax & Legal
kokoyo@deloitte.co.ke



Deloitte East Africa

Offices

Kenya
Deloitte Place
Waiyaki Way, Muthangari
Nairobi
Tel: +254 719 039 000

Uganda
Rwenzori House
3rd Floor, 1 Lumumba
Avenue, Kampala
Tel: +256 41 7 701000

Tanzania
Aris House
3rd Floor, Plot 152, Haile Selassie Road,
Oysterbay, Dar es Salaam
Tel: +255 22 2169000

Ethiopia
Minaye Corporate Office Park
2nd Floor
Addis Ababa, Ethiopia

Leadership

Anne Muraya
Deloitte East Africa CEO
amuraya@deloitte.co.ke

Fortunatus Kibiki
Tanzania Managing Partner
fkibiki@deloitte.co.tz

Paul Ssali
Uganda Managing Partner
pssali@deloitte.co.ug

Service line leaders

Fred Okwiri
Audit Leader
fokwiri@deloitte.co.ke

Pam Maharaj
Consulting Leader
pammaharaj@deloitte.co.ke

Gladys Makumi
Financial Advisory Leader
gmakumi@deloitte.co.ke

Fred Omondi
Tax & Legal Leader
fomondi@deloitte.co.ke

Urvi Patel
Risk Advisory Leader
ubpatel@deloitte.co.ke

Charles Luo
Growth Office Leader
cluo@deloitte.co.ke