

The Economy

Measures to stimulate the economy with increased government spending and fiscal devolution

Slow economic growth – shocks leading to collapse of private consumption

Economic performance

Against an expenditure of more than Kshs 760 billion, the GDP grew at a paltry 1.7%, compared to 7.1% in the prior year. This was due to a reduction in private consumption, occasioned by post election disruptions, unfavourable weather conditions, high cost of food and fuel, a dysfunctional coalition government and global financial crisis.

The government could not meet its revenue target. This was initially projected to be Kshs 512.7 billion but only Kshs 501.9 billion is expected.

Socio-political stability crucial for economic growth

How did key sectors perform?

Kenya's economy relies primarily on the performance of agriculture which contributes 23.4% of the GDP. Hence its contraction has significant implications to the national economy. Last year this sector contracted by 5.1%. Tourism was also affected as it contracted by 36.1%.

The continued focus on infrastructural development saw an increase of 8.3% by the building and construction sector. This is a right step in the reduction of cost of production and distribution of goods and services.

No changes in government's fiscal policies

Kenya's edge in the region with respect to human capital has seen the continued investment and growth in the education sector which was 5.8%.

Our more 'stable' neighbours – Tanzania (7.5%) and Uganda (9.8%) performed impressively. The Minister seems to have taken socio-political stability into consideration and has prepared a budget aimed at equitable distribution of wealth to address some of the social issues that culminated in the political instability of last year.

Macroeconomic stability

One of the key constraints to private consumption has been the high inflation as a result of high cost of food and fuel.

Overall inflation (%)



The Minister's pronouncement to bring inflation down to 5% did not provide any significant policy measures to address this. The overall inflation of

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26% will continue to hurt the economy in the medium term.

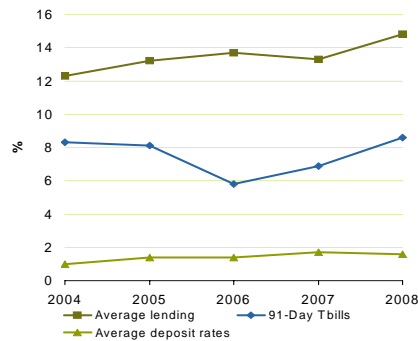
If inflation continues at the high rates then any economic growth may reflect an inflationary boom, an artificial recovery created primarily by 'easy credit' by the government, in order to balance the budget.

High inflation rate needs to be checked

This year, the government did not increase taxes. However, one would wonder if by allowing high inflation, increasing monetary growth is a tax increase, no different in ultimate effect than directly raising marginal income tax rates. The Minister might have preferred the high inflation to politically unpalatable direct tax increases.

Interest rate increase was more stable and predictable throughout the year. Coupled with inflation, real average earnings continue to be eroded. Even with a stable and predictable interest rate regime, the investors could not afford to finance expansion with high costs of production.

Interest rates (%)



Fiscal devolution to the constituency level to spur economic growth

What the Budget means

The government intends to spend Kshs 865.6 billion in 2009/10, with development expenditure being 30% (Kshs 258.9 billion). This will be financed by a revenue target of Kshs 569.6 billion. Revenue is anticipated to grow in tandem with real economic growth, as well as inflation.

Absorption capacity crucial to enhanced growth

For a stable macroeconomic environment government has to spend. How effective and efficient this will be in the next financial year remains to be seen.

Closer to the people

The Minister tried to address the issue of low growth. It seemed to be a basis of the cleverly crafted devolution of resources to the constituency level to spur the collapsed private consumption.

The budget was made more comprehensible – what it really means at the constituency level. This would enhance more accountability and auditing of its implementation at the constituency level.

There was a deliberate move towards fiscal devolution through the Constituency Development Fund (CDF) and enhanced devolution of funds to the constituency through line ministry conditional grants.

This has an effect of achieving equitable distribution of resources and efficiency in spending, albeit varied, by enhancing absorption rates at local levels. It remains to be seen how the structures at CDF level will be bolstered to manage the increased funding.

The minister outlined some measures to increase the absorption capacity of budgeted donor funds from the current 40% to 80%. With emphasis on procurement planning and quick outflow of domestic borrowing back to the economy, a 'crowding out' effect may not materialize as has been presumed by some analysts.

Domestic borrowing – not that bad

If government, which intends to borrow Kshs 109 billion domestically, absorbs by spending the borrowed funds immediately and coupled with adequate liquidity in the financial market, economic growth will be enhanced without necessarily increasing the cost of credit.

The anticipated Debt:GDP ratio increase from 40% to 44% will not be bad for an economy that releases the borrowed funds back to the economy for development.

Ambitious allocation to infrastructure – absorption capacity will be a challenge

There were some measures to boost food production through increased allocation to irrigation-fed agriculture and funds to boost fish farming at the constituency level. This would boost supply and reduce the effect of high inflation.

Much needed infrastructure development

The government is aiming to reduce the cost of doing business through increased spending in infrastructural development – road, rail, ports and broadband. Notable, although low, is the Kshs 3 billion for a new railway line from Mombasa to Kampala.

Government has to spend, businesses have to be smart to improve performance

In addition, the development of a light commuter rail system in Nairobi, construction of bypasses and modern interchanges that will ensure easy movement of goods and people will benefit from Kshs 140 billion allocated to infrastructure. The absorption capacity of these funds could be a challenge.

On the social and governance fronts, more development funding was allocated to education and health sectors, including employment of more personnel. This would enhance the availability of affordable quality education and healthcare and hopefully increase funds available for private consumption.

Social spending and governance

There was more allocation to social protection, including the food subsidy scheme and other revolving funds – fund for the physically challenged, continuing financing of the youth and women funds, Green Energy Facility and Tourism fund. This could increase employment in these sectors.

With regard to governance, the budget has allocated Kshs 2 billion towards realization of Agenda 4 of the National accord, Kshs 3.1 billion towards the judiciary and the judicial reforms. There was also emphasis on security through enhanced community policing.

A bold and different budget that shifts focus to outputs rather than inputs

What does it mean for businesses?

Just like last year, there were no shifts in the government's policy direction. This is important for businesses to continue operating within a predictable, consistent and stable policy environment.

The business environment proposals will provide incentives for more investments. However, external factors such as global economic downturn will weigh heavily on new or expanded investments locally.

The government's capacity to spend, equitable distribution of resources, fast tracked infrastructural development, austerity measures and coalition government's cohesion will be critical to the success of the budget execution. How effective and sincere the government is, will be seen in the levels of aggregate demand for goods and services next year.

Government has to bring in the private sector to enhance the absorption capacity of funds and continue its own reform agenda. On the other hand businesses have to be smart. Prudent investments, robust cost control measures, including a review and streamlining of business process will be important for benefits to be realized. Some of these steps are painful, but the benefits realized during these difficult times will provide a launch pad for the good times ahead. Indeed the theme of this year's budget is 'Overcoming Today's Challenges for a Better Kenya Tomorrow'.

Conclusion

The budget is consistent with the Vision 2030 pillar of achieving social equity. The political pillar needs to be addressed by the government for the economic pillar to hold.

The budget is bold, different and shifts focus to outputs rather than inputs. This is crucial for the economy to grow. The challenge is to ensure that, for once the budget is executed fully.

Kenya Budget Review: The Economy

Direct Tax

Stimulating economic development

Time limit imposed on tax losses

Business Tax

This change affects businesses that rent property outside of Kenya.

Overview

The Minister gave moderate tax incentives to encourage investment in capital expenditure in order to improve the productive capacity of various businesses. To this end, the budget did not introduce any new revenue raising measures.

This would increase the cost of business, because the resident person would be required to gross up such rental payments, as it is unlikely that the property owner would wish to bear the Kenyan tax.

Withholding tax on property now expanded

Additionally, training fees now include incidental costs associated with the provision of such services. This definition introduces further ambiguity and did not shed light on the clarifications sought by taxpayers.

A spanner in the works!

Traditionally one of the biggest tax incentives for investors into Kenya was the ability to carry forward tax losses indefinitely. This incentive has now been restricted, as losses can now only be carried forward for a maximum of four years. This amendment comes into effect from 1 January 2010. The restriction also applies to individuals.

Bearer bonds

A reduced withholding tax rate of 10% (as opposed to the general 25%) on interest on arising on bearer bonds is now applicable on bearer bonds with a maturity of 10 years or more.

Definition of training fees still ambiguous

The Minister of Finance can however extend the period in which the losses may be carried forward.

While this amendment is intended to encourage investment in long term bonds, the reduction is more of a cash flow, rather than a tax saving to the investor. The effective date is 12 June 2009.

Expanding the net

With effect from 12 June 2009, withholding tax is applicable on payments made for the use of property owned by non-residents that is located outside of Kenya.

It was about time...

The import duty credit ("IDC") scheme allowed investors who paid import duty on equipment to offset such duty

Kenya Budget Review: Direct Tax

Investment deductions now 150% if incurred in satellite towns

against corporation tax upon approval by the Minister. This scheme has now been scrapped.

The Government has argued that the IDC scheme is not necessary since most capital goods are currently duty free. This argument applies to manufacturers, however non-manufacturers such as telecommunication companies stand to suffer greatly.

This change is effective immediately.

The silver lining

A welcome move by the Minister has been the introduction of measures that will enhance capital expenditure incentives.

- The construction of a building or the purchase and installation of machinery where such an investment is located in satellite towns adjoining Nairobi, Mombasa, and Kisumu which will attract a 150% investment deduction;
- investment deduction of 100% will be applicable on the construction of a building or purchase and installation of machinery where the capital investment exceeds KShs 200 million;
- an Industrial Building Allowance has been introduced at the rate of 25% where capital expenditure is incurred on the construction of a new building that is to be used for commercial purposes;
- capital allowances on telecommunications equipment has been enhanced from 12.5% to 20%;
- it has now been clarified that the costs of purchase or acquisition of rights in respect of computer software are subject to tax deductions. With effect from 1 January 2010 this allowance will be capped at 5% per annum. Whereas this clarification is welcomed it is noted that the allowance period of 20 years does not match the three year average useful life of most computer software; and
- the Minister has also introduced allowances on film equipment, planned housing, schools and training facilities.

Investment deduction for investments in excess of KShs 200million

Cost of right to use fibre optic cable an allowable deduction

Higher capital allowances for telecoms

With the exclusion of the capital allowances on software, the changes in respect of the above allowances take effect immediately.

Industry specific amendments

Concessionaire arrangements

Capital deductions on a straight line basis are available on the cost of machinery bought under a concessionaire arrangement with the Government. The deductions shall be spread over the period of the agreement.

Non-resident airline agent commissions

Commissions paid by a resident airline operator to a non-resident ticketing agent will no longer be subject to withholding tax. This change is in line with the global practice.

Fibre optic cable

Prior to the Finance Bill, capital expenditure incurred on the acquisition of an irrevocable right to use a fibre optic cable by a telecommunication operator was not deductible for income tax purposes. Effective 12 June 2009, a 5% deduction of the costs incurred, spread over a 20 year period, is now deductible against the income earned.

While it is clear that there are efforts to update the legislation to keep up with developments in the ICT sector, it may have been preferable to match the deduction period with the contractual terms of the fibre optic cable arrangements.

Insurance

Finance Act 2008 introduced an amendment in the Income Tax Act that brought to tax 30% of management and commission expenses in excess of the maximum amounts allowed in the Insurance Act. This change, understandably, did not augur well with the Insurance Industry, hence the Government, following representations, agreed to rectify this anomaly.

Further amendments to the Income Tax Leasing rules

However, the changes contained in the 2009 Finance Bill will not have the desired effect of rectifying this anomaly.

All is not lost though. The draftsman has one last chance to get it right before the bill is enacted into law. If he fails to do so insurance companies should brace themselves to pay tax on expenses that they will have incurred wholly and exclusively in chasing for the ever-competitive premium income.

Mitigating point on claw back rule

Prior to the Finance Bill, the Commissioner could claw back deductions for lease rentals previously enjoyed by the lessee in a leasing arrangement, without granting the lessee any capital allowance.

The claw back principle is applicable where the lessee acquires the leased asset at less than market value upon termination of the leasing arrangement.

The Finance Bill now allows the lessee to claim capital allowances on the previously leased assets.

Personal Tax

Overview

Wananchi eagerly awaited Minister Kenyatta's budget speech. Optimists may have hoped that the Minister would borrow a leaf from his South African counterpart and widen the tax brackets applicable to individuals. Doing this would have meant more money in the pocket, enabling additional spending and perhaps ultimately stimulate the desired growth from increased economic activity. As it is, the tax rates and brackets in Kenya have remained unchanged for the last 5 years. Businesses will continue to contend with decreased demand from consumers hard-pressed to cut expenses.

Gold for the Old

Tax free monthly pension

The tax free portion of monthly pensions has been increased from KShs 15,000 per month to KShs 25,000 per month. A welcome move aimed at providing relief to pensioners who are an admittedly vulnerable group in these tough economic times. Given that pensioners over 65 years of age are already exempt from tax on their monthly annuities, this change will only impact pensioners who are below this age threshold. The amendment is effective from 1 January 2010.

Tax free portion of lump sum pension payments

For lump sums commuted from a registered pension or individual retirement fund, the tax free amount has been increased from the first KShs 480,000 to KShs 600,000. In a similar vein, where withdrawals are made from a registered pension, or individual retirement fund, upon termination the tax free amount has been increased to the lesser of:

- The first KShs 60,000 (previously KShs 48,000) per full year of pensionable service relating to that lump sum; or
- the first KShs 600,000 (previously KShs 480,000).

This positive measure is intended to reduce the tax burden on those who opt to commute their pensions on retirement. The effective date is 1 January 2010.

Medical expenses capped

Some years ago a change was introduced to allow a tax deduction for medical expenses and medical insurance premiums paid for non whole time service directors up to a ceiling cap KShs 1,000,000 per annum. This treatment has now been extended to partners in a partnership and to sole proprietors. This move is in line with the Minister's stated objective of equity. The change is effective from 1 January 2010.

Additional tax relief for retirees.

Medical expenses and Mpremiums tax deductible for partners and sole proprietors subject to a limit

The long arm of the law

In the event that there is some risk of non-payment of taxes, either due to the imminent departure of a natural taxpayer, or the impending liquidation of a corporate taxpayer, the taxman has the power to issue a notice demanding payment of tax within a specified period of time, even if the due date has not arrived. Failure to pay the taxes in a timely fashion will constitute an offence. Although there is some self-evident justification for this change, there needs to be controls in place to prevent its abuse. The change is effective 12 June 2009.

Additional yoke...

Quarterly PAYE returns

The Minister has introduced a new rule which requires employers to submit quarterly payroll returns indicating the total remuneration paid as well as the taxes (PAYE) paid for all their employees. Presumably the intention is to improve compliance, but it may not be justified, given that it will impose additional administrative costs on employers. This change is effective 11 June 2009.

Due date for PAYE on directors

The due date for PAYE on directors' income is now the earlier of:

- The ninth day of the month following the month in which payment (of remuneration) is made; and
- the ninth day of the month following the fourth month after the accounting date.

This appears to be a move to ensure that remittance of PAYE attributable to directors' emoluments is not deferred indefinitely. It also ensures that the PAYE is paid on an accrual basis. This change is effective 11 June 2009.

Deadline for year end obligations

The new PAYE rules clarify that the deadline for year end return filing obligation is two months after year end i.e. 28/29 February following the tax year. This has been the practice as provided in the KRA PAYE guide. The rules had earlier specified the due date to be one month after year end. This change is effective 11 June 2009.

Disabled employees

Disabled persons were key beneficiaries in this year's budget speech. An amendment has been made to the Persons with Disabilities Act allowing the Minister for Finance to grant exemptions. However, no changes have been proposed to the Income Tax Act to accomplish this.

Conclusion

While the measures adopted by the Minister were intended to rationalise procedures and stimulate economic development there were disappointments for those who hoped for lower tax rates. The Minister could have provided some direct additional incentives to the working cadre in the form of wider tax bands to allow for a higher level of disposal income. This could have been channelled towards fuelling consumption and thus further stimulating the economy.

Value Added Tax

Minister provides further clarity on key VAT areas, introduces administrative changes to manage the VAT refunds backlog and zero rates goods and services to certain growth sectors.

Overview

The Minister has committed to introduce a lasting solution to the problem of VAT refunds. However, he has introduced immediate changes which are expected to reduce the growing backlog of VAT refunds by automatically zero rating taxable supplies to gazetted exporters.

There are also positive steps taken to provide further clarity on two key areas that have been unclear. The most notable one is the amendment affecting what constitutes services deemed supplied in Kenya. This is expected to reduce the controversy regarding what constitutes an export of service. There is also significant change on what constitutes financial services.

The Minister has zero rated goods and services provided to agricultural sector and film industry in an attempt to stimulate the growth of these sectors.

The effective date of the above changes is 12 June 2009.

Key Changes

More clarity on services deemed supplied in Kenya

Regulation 20, which was introduced last year and caused a lot of confusion, has been clarified. Services supplied in Kenya are now determined by the 'use and consumption test' and the physical location of supplier.

Therefore, where the supplier has a fixed physical establishment in Kenya and services are physically used and consumed in Kenya, the services will be deemed to be supplied in Kenya irrespective of the location of the payer.

This means that export of services arise where the services are used and consumed outside Kenya in accordance with the definition of export of services under the VAT Act.

This is a welcome change and has resolved the previous contradiction between the Regulation and the VAT Act.

Export of services clarified

VAT refund backlogs to reduce

Minister gives incentives to growth sectors

Financial services defined

However, in order to provide more certainty we expected the Regulation to give a clearer definition of what constitutes “use and consumption”. The emphasis on “physically used or consumed” may also create more confusion.

It is critical that clarification is provided to give business more certainty as Kenya seeks to be a regional hub.

Financial services exempt regardless of supplier

An end to great debate on financial services

The Minister has introduced a significant change by providing a comprehensive list of what constitutes financial services.

This will resolve the great debate that has been raging on regarding the definition of financial services. It is a bold move that will have positive implications in the taxation of financial services in Kenya and go along way in resolving the ambiguity that existed relating to this.

Zero rating of taxable supplies to gazetted exporters introduced

Previously, only financial services provided by banks, financial institutions and Postal Corporation of Kenya were exempt from VAT. This restriction has been removed.

Financial services are now exempt from VAT irrespective of the supplier. This is intended to provide equity to non- financial institutions who provide such services.

Cash flow impact of refunds to ease

However, the services of carriage of cash, restocking of cash machines, sorting or counting of money and supply of automated teller machines are excluded from the above exemption and will be subject to VAT.

VAT number replaced by PIN number

Supplies to gazetted exporters to be automatically zero rated

In order to address the perennial problem of outstanding VAT refunds, a significant amendment has been introduced which will allow suppliers to zero rate taxable goods and services provided to gazetted exporters.

In his speech, the Minister mentioned horticultural and floricultural sectors as the potential beneficiaries of this change. However, this initiative will only be successful if the Commissioner gazettes exporters who are regular VAT refund claimants by using an appropriate criterion to determine the exporters to be gazetted.

Zero rating to stimulate growth

Goods and services supplied to certain sectors have been zero rated to stimulate growth. This includes the following:

- Taxable goods and services for construction of grain silos upon approval by the Director of Agriculture ;
- taxable goods and services to a film producer approved by Minister for Information;
- items used for film production such as photographic film rolls, video recording or reproducing apparatus;
- generators and generating sets;
- bicycles; and
- refrigerated trucks and insulated milk tankers.

Other changes

Humanitarian relief zero rated

- Taxable goods and services provided to Kenya Red Cross Society and
- taxable goods for emergency relief purposes

Administrative changes

There are a number of administrative changes intended to legislate the developments under Integrated Tax Management System ('ITMS').

The VAT number has been replaced by single number for all tax obligations. The Regulations has been amended to remove the mandatory requirement to have a VAT number in a tax invoice or a credit note. The single taxpayer number will be the Personal Identification Number.

Mobile handsets exempt – will they be cheaper?

A tax invoice is now required to be issued immediately the supply is made. Previously this was to be done within 14 days.

Mobile phone handsets and sale of buildings made VAT exempt

Sale of buildings exempt from VAT – VAT recovery restricted

Mobile phone and wireless handsets are now exempt goods for VAT purposes. Whilst it was the Minister's intention to make these items cheaper, consumers may find them more expensive as the dealers in these items will not be able to claim VAT costs that they incur and may have to pass it on to the final consumers. It would have much better if these items were zero rated to allow for input VAT recovery.

There has been lack of clarity on whether sale of buildings is exempt or outside the scope of VAT. A change has been introduced under the Third schedule to confirm that it is exempt from VAT. This means that input VAT recovery will be restricted. This will affect property developers and other persons who sell buildings.

VAT to be levied on value including import duty paid

Determination of taxable value

The taxable value for VAT purposes will now include import duty actually paid and exclude import duty that has been remitted. This is an important development as it affects the base upon which VAT will be computed.

Newly VAT registered entities have more time to lodge the claim

Previously, the taxable value for VAT purposes included import duty payable or remitted.

Period for lodging a claim on VAT relief extended

The period within which to lodge a claim for VAT incurred on pre-registration has been extended from thirty days to six months. This will provide newly registered taxpayers with adequate time to lodge their claim.

However, we expected a change to confirm that the opportunity for claiming input VAT relief is available,

where the tax status of goods and services has changed from exempt to taxable. This is the international best practice.

Summary

The changes made by the Minister are positive and we hope that it will create conducive environment for the administration of VAT.

Although major attempt has been made to resolve the ambiguity on export of services, we feel that more work needs to be done to make the legislation clear. Kenya should adopt international best practice, for example Organisation for Economic Cooperation and Development (OECD) guidelines. These emphasise that taxation should be in the jurisdiction where the customer is located.

Customs and Excise

Incentives for film industry and energy exploration

Economic growth the key focus of the budget

Overview

The Minister resisted the temptation to increase excise duty on cigarettes, beer and spirits and surprised everyone by reducing excise duty on spirits and non-alcoholic drinks.

A shot in the arm for manufacturers

The Minister introduced duty exemptions on a broad range of raw materials and industrial spare parts.

Specific changes introduced are targeted at reducing input costs of paper and packing material manufacturers and manufacturers of sanitary towels. These inputs will enjoy duty remission.

Other changes included the introduction of duty remission on industrial spare parts, which were previously subject to import duty and removal of duty on raw materials used in the manufacture of brake linings and brake pads.

Agriculture on the go...

The dairy industry should breathe a sigh of relief from changes proposed by the Minister. In addition to other tax incentives introduced in previous budgets, aluminium cans and

insulated milk tanks will now be exempt from import duty.

Wheat farmers will also have a reason to smile. In his speech the Minister proposed to peg the import duty on wheat imported by gazetted millers to 25% up from 10% or US\$50 per tonne. Affected millers and ultimately the final consumers will now have to shoulder this increase.

Juiced up

The Government has lent an ear to an industry that is volume driven and survives on thin margins.

Effective 12 June 2009, juices and carbonated drinks will be subject to 7% excise duty, down from 10%, while bottled water will be subject to 5%, down from 10%.

It remains to be seen whether the effect of these incentives to manufacturers and tax reduction on certain commodities will trickle down to *Wanjiku*.

Resuscitating tourism

The Minister pledged KShs 1.2 billion to the tourism sector to protect jobs and market Kenya as a tourist destination. This move should shield the sector from some of the effects of the global economic downturn and the post elections violence.

No change on cigarettes and beer

SDL removed

Relief on four wheel drive cars for tourism

To further boost this sector the Minister has proposed duty exemption on four wheel motor vehicles specifically designed and built for tourism purposes.

The Minister however acknowledged these measures are insufficient to restore the sector to its former glory.

Lights...Camera...Action!

While the Minister did provide some incentives for the film industry, he fell short of meeting some of their expectations. They expected a tax rebate of 20% and zero rating of film equipment brought into the country.

In an attempt to compete with other film markets in the region, the Minister removed duty and zero-rated cameras and other film production equipment. This should help Kenya become a more attractive film-making destination after having lost out to other destinations like South Africa who offer more attractive tax incentives.

Oil, Gas & Geothermal

With the discovery of oil in Uganda and natural gas reserves in Tanzania, there is renewed optimism for additional discovery across the region. Thus the EAC has introduced additional incentives for explorers.

Equipment and inputs used for the exploration of oil, gas and geothermal will now be exempt from import duty. This is a move to harmonise the EAC Customs Management Act with the previous Customs & Excise Act.

Wines & Spirits

The taxation of wines and spirits will revert back to a hybrid system. Spirits will now be subject to the higher of KShs 120 per litre or 65% of the value; while wines will be subject to the higher of KShs 70 per litre or 50% of the value.

These changes are geared towards eliminating the disparity of excise rates across the EAC and reduce the consumption of unhygienic and dangerous illicit spirits.

In addition, from 1 January 2010 manufacturers will only be allowed to pack alcoholic beverages in containers of 250ml or more. The current limit is 200ml.

Sugar Development Levy (SDL)

The 4% SDL applicable on industrial sugar imported by gazetted manufacturers has been repealed.

However this change might not go down well with local farmers. Previous attempts to reduce or eliminate this levy have faced fierce opposition from farmers. It remains to be seen whether the Minister will be successful this time round.

To be or not to be...?

With all the changes in this year's Budget, some anticipated developments seem to have escaped the Minister's mention.

Burundi and Rwanda join the EAC on 1 July 2009. Hon. Kenyatta however, did not mention this in his maiden speech. Businesses are full of expectations to harness the opportunities that these two markets present.

With the EAC Common Market expected to take effect in 2010 and the COMESA Customs Union coming into force soon, it will be interesting to see how the two bodies will come together.

Businesses were also expecting the coming into force of Special Economic Zones (SEZ) legislation. These are envisaged to accommodate more commercial activities under a liberalised and vibrant business environment that has not been enabled by the Export Processing Zones.

The Customs changes proposed by the Minister are subject to confirmation by the East Africa Legislative Assembly.

Sector Reforms

The Minister set out to harmonise regulatory framework and stabilise capital markets

Reforms expected in the Financial Services sector to check turbulence

The sector reforms in the 2009 budget followed the past pattern of focusing on financial services. It was expected that the Minister for Finance would take some action on this important sector given the recent turbulence caused by stock brokers and the need to restore investor confidence in the stock exchange.

30 million respectively to Shs 50 million and Shs 250 million respectively by 31 December 2010. This could see consolidation of existing players, entrance of foreign investors to boost capital and even closure of some of the existing businesses.

Increased reporting and corporate governance requirements

In a move to promote transparency and strengthen monitoring of stock brokers, dealers and investment banks in the Capital Market, the minister has proposed more stringent reporting requirements including:

- Publishing of half year and full year financial statements in at least two daily newspapers with national circulation and display of the audited accounts in a conspicuous position;
- monthly reporting to the Capital Markets Authority (CMA) and submission of quarterly portfolio reports;
- a requirement to designate a compliance officer;
- stock broking agents have been restricted to one stock broker who will ensure the agent conducts

The changes proposed in the budget have borrowed significantly from current regulation in the banking industry and for this reason the significant impact is in Capital Markets, the Insurance Industry and Pension Schemes.

This is a step in the right direction. However, it is yet to meet the expectation that ultimately there will be a single Financial Services Authority/Regulator.

Capital Markets

Significant increase in capital requirements

In line with the reforms taking place in the Capital Markets, the Minister proposed significant increases to the minimum share capital requirement for stockbrokers and investment banks from the current Shs 5 million and Shs

Capital market players to come under heavy regulation similar to banks

Stock brokers and investment banks required to have professional indemnity cover

- business with integrity and professionalism; and
- approval will have to be sought before changes in Shareholders, Directors, Chief Executive and key personnel.

Operationally, this will be more onerous for sector players and will require additional investment in personnel and management information systems. Stock broking firms and investment banks will have to comply or face sanctions by the regulator.

Professional indemnity insurance

In a bid to limit losses by investors arising from irregularities, the Minister has proposed that stock brokers and investment banks secure an amount not less than five times their daily average turnover.

Whilst this is a positive move, the stipulated cover is low. Given the stock brokerage claims we have seen in the recent past, five times the daily turnover will fall short of the exposure to the public by a sector player.

Listing incentive and withholding tax on bonds

The Minister proposes to reduce the listing fee from 0.3% to 0.15% of the value of the issue in a bid to encourage companies to list on the Stock Exchange.

In addition, withholding tax on long term bonds of 10 years maturity has been reduced from 15% to 10%.

These measures are aimed at stimulating activity at the stock markets, but they are unlikely to do so. The general down turn in the stock market is unlikely to react to these incentives.

Increasing corporate governance in the insurance industry

Pension Schemes

Potential for returns of certain pension schemes curtailed

The Minister introduced measures that could see the elimination of risky investments by schemes that receive statutory contributions. All new investments by these schemes will now be limited to government securities and infrastructure bonds issued by public institutions. The government will be creating demand for government paper by doing so and could use this to influence interest rates. However, this move is also likely to limit the ability of these schemes to generate higher returns in years where capital assets rapidly appreciate in value.

Elimination of funding gap

The Minister proposed to eliminate the 20% funding gap by requiring that defined benefit schemes match their assets and liabilities on a continuous basis.

This measure is aimed at protecting members of the schemes in times of economic downturn and will result to increased funding pressures on the sponsor.

Insurance Industry

The Minister recognised the need to improve corporate governance in the insurance industry, as well as harmonise regulation across financial services. He proposed to restrict beneficial shareholding to 25% for any one person and to restrict shareholders with more than 20% from participating in the day to day management.

However, this regulation does not apply to the following entities:

- A corporate entity licensed by an insurance, banking, pension or securities regulator in Kenya;
- a foreign corporate entity licensed by an insurance, banking, pension or securities regulator in Kenya;

Kenya Budget Review: Sector Reforms

Have we found the solution to the unbanked population?

- the Government of Kenya; and
- a state corporation within the meaning of the State Corporations Act.

It is not clear how the Minister intends to deal with holding companies which were set up to own the separate life and general businesses.

Other Changes

Branchless banking to be introduced

In recognition of the huge unbanked population, the Minister has proposed measures that allow for wider distribution of banking products. He has proposed an amendment to the Banking Act to allow for branchless banking through agencies with wide distribution networks. Regulatory rules will need to be developed to deal with the new channels of distribution.

Amendments to the Micro Finance Act

The Minister proposed amendments to the Micro Finance Act to allow exchange of information on non-performing loans from time to time and to allow the Central Bank of Kenya to issue directions and guidelines to institutions to allow them to carry out of their functions better. This could result in the micro finance institutions being better able to manage their non-performing loans.

Pyramid schemes

The Minister proposes to outlaw the operation of pyramid schemes and non genuine multi-level marketing operations.

Business licensing

In a bid to create a competitive business environment and reduce the number of licences required to do business, the Minister proposes to table before Parliament the Business Regulation Bill, which will provide a regulatory framework for vetting and recommending proposed new levies,

operationalise an e-Registry for business licensing and fast-track implementation of ongoing licensing reforms. There is currently a bill in final stages and if enacted will remove red tape in venturing into business.

Traffic Act reforms

The Minister proposes to amend the Traffic Act by encouraging the use of the new generation logbooks and a requirement for the registration of imported commercial vehicles within thirty days of release by the Customs Office.

These measures are aimed at enhancing security, discouraging the use of unregistered commercial vehicles on the roads and allow expeditious disposal of traffic misdemeanours.

In addition he proposed to amend the Traffic Act to provide for spot fines for minor traffic offences. We will wait and see the impact if the proposals will be implemented.

East Africa Highlights

A synopsis of the salient features in the budget speeches delivered by the Finance Ministers of Kenya, Tanzania, Uganda and Rwanda

Kenya records a decline in economic growth from 7% to 1.7% p.a.

Kenya Constituency Development Funds allocated more money

Tanzania records a 7.4% economic growth rate in 2008

East Africa economies at a glance

Kenya

The economy experienced a downturn in 2008, growing by 1.7% compared to 7% in 2007. The reduced growth was due to the adverse effects of the events that followed the December 2007 general elections, sharp increase in the international prices of oil and fertiliser and the drought conditions following failed short-rains.

The expected growth for 2009 is only 3% due to the effects of the global recession.

The theme of the 2009/2010 budget is **“Overcoming today’s challenges for a better Kenya tomorrow”** and aims at providing economic stimulus. It also provides for more devolution of expenditure compared to prior years, with more funds being channelled through the Constituency Development Fund (CDF). This is aimed at achieving greater equity and increasing the efficiency of spending.

The budget is expansionary, with increased expenditure in infrastructure and social projects. There will be no increase in taxes and the Government expects to finance the shortfall through savings from rationalisation of government expenditure and increased domestic borrowing.

Infrastructure is the key priority area with an allocation of KShs 140 billion, but there are doubts about its absorption.

Tanzania

Agriculture is a key focus area for the 2009/2010 budget with a motto of **“Agriculture First”**. Amongst a number of the measures planned are the allocation of more resources, including agro-inputs and farm implements, and the establishment of an Agricultural Bank.

The economy grew by 7.4% in the calendar year 2008 compared with 7.1% in 2007. However, in view of the current global economic and financial crisis, the Minister projects a reduced growth of 5% for the calendar year 2009. This in line with

Uganda projects a decline in economic growth in 2009/10 to 6% from 7% in the previous year

Rwanda records an impressive 11% economic growth rate in 2008

an IMF projection of a growth of between 5% and 6%.

Uganda

Uganda Government continued to pursue its macro-economic objectives and achieved an economic growth rate of 7% per annum, ensuring a competitive exchange rate and maintaining adequate foreign exchange reserves.

The effects of the global financial crisis are expected to continue in FY 2009/2010 and the growth projection is estimated to be 6%.

Rwanda

This was the first Government budget that conforms to the East African Community (EAC) budget calendar.

The economy grew by 11.2% mainly due to good performance in agriculture, growth in the industry sector with improvement in electricity supply and growth in the financial services, transport and logistics sectors.

The current global economic environment is expected to reduce demand for exports such as tea and coffee and reduced income and revenues from tourism.

Key highlights from the Kenya, Uganda, Tanzania and Rwanda economies

Key indicators of the performance of the East Africa economies are set out below. Where applicable, prior year comparatives have been included in brackets.

	Kenya	Uganda	Tanzania	Rwanda
Real GDP growth	1.7% (7%)	7.0% (8.9%)	7.4% (7.1%)	11.2% (*na)
Inflation				
● Underlying	9.8% (5.7%)	12.6% (8.6%)	*na	*na
● Overall	26.07% (9.8%)	13.5% (11.2%)	10.3% (7%)	*na
91 day TB rates	7.3% (6.87%)	7.4% (8.2%)	10.99% (11.4%)	*na
	<i>KShs</i>	<i>UShs</i>	<i>TShs</i>	<i>RwF</i>
Exchange rate to the dollar (Local currency = US\$1)	79 (66)	2,216 (1,679)	1,196 (1,244)	577 (589)
Budgeted spend (billions)	865.6 (759.8)	*na (6,143)	9,513 (7,216)	823 (657)
Recurring	606.7 (563.6)	*na (3,372)	6,688 (4,726)	475 (395)
Development	258.9 (196.2)	*na (2,771)	2,825 (2,489)	348 (262)

*Not available

Import duty rates in EAC removed on certain goods

Kenya removes duty on inputs for use by paper manufactures

Tanzania to apply 10% duty on imported wheat

Uganda extends duty exemption on hotel construction

Rwanda introduces three tariff bands for import duty

Customs and Excise

East African Community

There are Common External Tariffs that are applied to goods imported into the EAC. The following are some of the proposals made in respect of these tariffs that are common to all the EAC countries:

- Exemption of import duty on all industrial spare parts to be managed through the duty remission scheme;
- exemption of import duty on all four wheel drive vehicles specially designed for tourist purposes;
- import duty on television cameras, digital cameras and video camera recorders removed;
- Import duty exemption on equipment used in oil, gas or geothermal exploration and development; and
- exemption of import duty on heat insulated milk tanks.

However, there were some changes unique to each of the East Africa Community countries as follows:

Kenya

Import duty on wheat increased from 10% (or US\$ 50 per tonne) to 25%.

Import duty on raw materials for manufacture of paper packaging and sanitary towels removed.

Import duty on all synthetic yarns, acrylic yarn, polyester yarn and high ferocity yarn reduced from 10% to 0% in the cotton industry.

Goods, including materials supplies, equipment and motor vehicles for official use in the provision of relief services by the Kenya Committee of Red Cross exempted from duty.

Tanzania

Changes specific to Tanzania to conform to the EAC Customs Management Act and Common External Tariff and as agreed by the EAC Ministers for Finance, include:

- Tanzania to remove the 10% import duty on pharmaceuticals and start applying the CET rate of 0% and
- dispensation to Tanzania to apply a 10% duty rate on imported wheat grain instead of the 35% CET rate.

Uganda

Proposal to extend the exemption of import duty on construction materials for hotels, health and educational institutions for another one year.

Reduction of import duty from 25% to 10% for trucks of a carrying capacity of over five tons, for one year.

Reduction of import duties on trucks of 20 tons or more have been reduced from 20% to 0%.

Rwanda

Excise duty on airtime increased from 3% to 5% as initially agreed with the players in the sector to progressively adjust upwards the rate rather than a one-off shift in the tax rate.

The Government of Rwanda committed to start implementing the EAC Common External Tariff with effect from 1 July 2009. This implies that the customs tariff band will change from four tariff bands to three tariff bands with the highest tariff rate of 25% from 30% for finished products, 10% from 15% for intermediate goods and 0% from 5% raw materials. The 0% for capital equipment will no longer be applicable.

The following tax policy measures have been agreed at the EAC level and have been proposed to in the 2009/2010 budget:

- Remission of Common External Tariff (CET) on wheat grain at 0% for one year;
- CET rate for asbestos fibres reduced from 25% to 0%;
- import duty for yarn reduced from 10% to 0%;
- Rwanda to stay application of CET of 75% on rice and apply a duty rate of 30% for a period of two years;
- import duty reduced from 25% to 10% for trucks of carrying capacity of five tonnes and above for one year;
- import duty reduced from 25% to 0% on trucks of carrying capacity of over 20 tonnes for one year; and
- CET for kerosene stove to be reduced from 25% to 10%
Exportation of scrap aluminium, steel, copper wires and cables banned.

Direct and indirect taxes

Kenya

Corporate tax

100% investment deduction on capital expenditure incurred by a film producer on purchase of filming equipment.

Wear and tear allowance on telecommunication equipment increased from 12.5% to 20%.

Tax deduction of 5% on computer software.

150% investment allowance on substantial investment in satellite towns around Nairobi, Mombasa and Kisumu.

Tax losses claimable, but not to exceed a five year period, unless approval is provided by the Commissioner.

With the landing of the undersea cables in Kenya, the Minister has proposed that the cost incurred in acquiring the right to use fibre optic cable be offset against taxable income over 20 years.

Personal tax

Tax exempt limit for pension increased from KShs 15,000 to KShs 25,000 per month.

Quarterly filing of PAYE returns in addition to the one filed in February each year.

Excise duty

Excise duty on water reduced from 10% to 5%, while on carbonated soft drinks and juices the rate reduced from 10% to 7%.

Excise duty on spirits changed from KShs 7 per 1% of alcohol to KShs 120 or 65% whichever is higher.

Excise duty on wines changed from KShs 7 per 1% of alcohol to KShs 70 or 50%, whichever is higher.

VAT

The following have been zero rated for VAT purposes:

- Taxable goods and services offered to film producers;
- power generators and generating sets; and
- refrigerated trucks and parts for agricultural, horticultural and forestry machinery.

The following have been exempted from VAT:

- Mobile phone sets and
- financial services, regardless of supplier.

Given the problem faced by traders, VAT withholding agents are now required to issue a VAT withholding certificate to their supplier at the time of making payment.

Claim period for relief of tax paid on goods in stock for newly registered taxpayers for VAT purposes extended from 30 days to six months.

Exporters who qualify for zero rated supplies to get supplies zero rated.

Tanzania

Corporate taxes

Reduction in threshold to qualify for reduced 25% corporate tax rate for companies listed on the Dar es Salaam Stock Exchange – in particular, criterion for qualification is shares issued to the public for at least 30% of share capital (instead of previous 35%).

Personal taxes

No change to individual tax thresholds.

Generous capital allowances introduced in Kenya

Tax losses in Kenya will now be carried forward for five years only

Excise duty on water reduced from 10% to 5% while on carbonated soft drinks and juices the rate reduced from 10% to 7%.

Mobile phones now zero rated for VAT in Kenya

Excise duty

Excise duty rates on non petroleum products have been increased by 7.5%, which was considered to be the average inflation rate for the period.

Abolition of excise duty exemption granted to the mining companies.

VAT

Reduction of the VAT rate from 20% to 18%.

VAT special relief given to mining sector now limited to cover only prospecting and exploration activities.

Removal of the VAT exemption for leased residential buildings (except for leases by NHC and the Registrar of Buildings) and serviced apartments. In addition, VAT exemption on processed tea and tobacco has been removed.

Uganda

Direct taxes

Exemption for all agro processing investments.

Amendment of the Income Tax Act to cater for Petroleum Transactions.

Excise duty

In order to promote growing and malting of barley in Uganda, the Minister has proposed to reduce excise duty on beer produced from barley grown and malted in Uganda from 60% to 40%.

VAT

To ease the challenges associated with counterpart funding, donor funded projects in agriculture, education and health sectors have been exempt from VAT and all VAT arrears relating to these projects are to be written off.

The Minister also proposes to extend the VAT exemption on construction materials for hotels and health and educational institutions for another year.

All lease transactions relating to items that are VAT exempt will also be VAT exempt. Prior to this, the VAT exemption only applied to the outright sale of assets and not to the lease of the same assets.

VAT of 5% applied on sale of houses has been abolished and house sales will be exempted from VAT.

Concept of branchless banking introduced in Kenya

Cost of listing on NSE reduced

Ownership rules for insurance companies amended in Kenya

405 Government licences in Tanzania revoked

Miscellaneous

Kenya

Banking

Proposed amendment to the Kenya Post Office Savings Bank Act to allow Postbank to transact in foreign exchange business in accordance with the CBK rules and regulations.

Branchless banking proposed, where banks will now be able to operate through agencies with wide distribution networks.

Capital markets

Minimum share capital for stock brokers and investment banks to be increased from KShs 5 million and KShs 30 million to KShs 50 million and KShs 250 million respectively.

Institutions under the Capital Markets Authority required to secure professional indemnity insurance.

Withholding tax on interest on bonds maturing within 10 years or more reduced from 15% to 10%.

Listing fee reduced from 0.3% to 0.15% for new public offers of equity.

Stock brokers and investment bankers now required to publish half year financial statements.

Agents restricted to one stock broker.

Insurance

Shareholding by a single person in an insurance company restricted to 25%.

Any person owning more than 20% of the shares in an insurance company restricted from day to day management of the company.

Tax on life business now based on the sum of the recommended surplus to be transferred arising from an actuarial valuation less any previous actuarial deficits. It also now excludes the 30% 'excess' management expenses that was previously chargeable.

Other

Sugar development levy on industrial sugar removed under the duty remission scheme.

Ban on exportation of scrap aluminum, steel and copper wires and cables.

Amendment of the penal code proposed to outlaw the operations of pyramid schemes including non-genuine multi-level marketing operations.

Minimum funding for defined benefit schemes increased from 80% to 100% of the value of accrued liabilities.

New investments by pension schemes that receive statutory contributions to be put in Government securities and infrastructure bonds issued by public institutions.

Tanzania

Abolition of the fuel levy exemption for mining companies entering into Mining Development Agreements from 1 July 2009. Government initiating contract negotiations with existing mining companies to remove the specific provisions granting this exemption in existing Mining Development Agreements.

Cap on "cess" (local Government taxes on agriculture) to reduce to 3% from current 5%, but not until 2010/2011.

Revocation of 405 Government notices which grant tax exemptions.

Reduction of visa fees for all categories of visitors to US\$50.

Environmental levy on other plastics of 120%.

Uganda

Total ban on plastic bags as a means for conveyance of goods and liquids is imposed to protect the environment. Six months will be given to the general public to find alternative means of packaging.

Imposition of a ban on importation of old computers, freezers and refrigerators. A three month period allowed to enable goods in transit and in bonded warehouses to be cleared.