The Economy

Tackling Fundamentals – Back to Basics

How has the Economy Performed?

Marginal economic growth spurred by tourism, construction, transport and communication

Kenya's GDP grew marginally by 2.6% in 2009 (2008:1.6%). Ambitious measures undertaken by the government including the economic stimulus package and austerity measures have had a moderate impact on economic growth.

This came against a backdrop of a seemingly political budget which was a necessary response to underlying political grievances. In addition, last year's budget had implementation challenges with respect to civil service austerity-resistance and limited absorption capacity of the stimulus funds.

How key sectors performed

Focus on agriculture crucial for sustained economic revival

There was no real recovery except in tourism which grew by 42.8%, construction (14.1%) and transport and communication (6.4%). Agriculture, a major contributor to GDP (24.4%), shrank by 2.6% while manufacturing and financial mediation grew by a paltry 2.0% and 4.6% respectively.

Poor weather conditions and a global recession affecting external and internal demand worked to constrain growth in 2009.

However, this year's budget has addressed food security issues and the favourable weather will see an improved performance in agriculture.

Other regional economies grew impressively - Tanzania (5.6%), Uganda (7.0%), Rwanda (5.3%) and Burundi (3.2%). The expansion of the regional market with the EAC common market protocol in July 2010 will provide Kenya with the much needed impetus to grow.

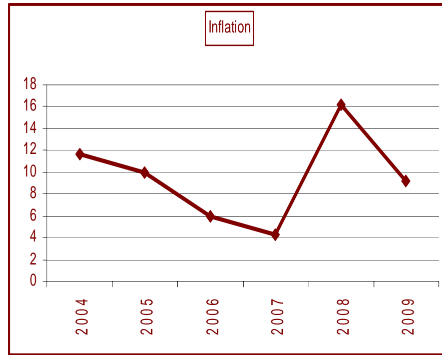
The table below outlines the GDP levels over the last three years.

EAC GDP Growth rates			
	2007	**2008**	**2009**
Kenya	7.1	1.7	2.6
Tanzania	7.1	7.4	5.0
Uganda	8.4	9.0	7.0
Rwanda	7.9	11.2	5.3
Burundi	3.6	4.5	3.2

Stable Macroeconomic Environment

During the year, the macro economic environment remained stable but there was no notable new private sector investment.

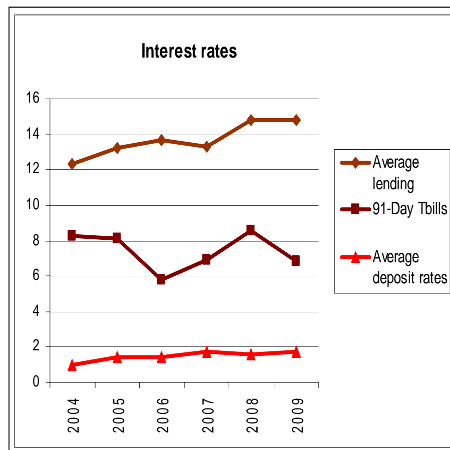
Overall Inflation



The average inflation rate was 9.1% and is set to stabilise and make the monetary policy response more predictable. The Government is targeting 5% inflation in 2010/2011.

Budget focused on addressing basic socio-economic enablers – food security, health, education and employment

Interest Rates



Commercial bank interest rates have continued to decline (5.2% in May 2010 from 8.5% in January 2009) and this is encouraging borrowing. It is important to note that Government borrowing from the domestic market in 2009 has not led to a crowding out effect, indicating the capacity for local production.

The budget is looking to reduce domestic borrowing from 5.1% to 3.8%.

Back to Basics - State Driven Economic Policies

The Minister did not have lofty ideas for the budget this year. However, he focused more on key sectors that affect food security and employment, namely agriculture and finance. This will ensure the achievement of basic needs for the nation in a sustainable manner, preparing Kenya for a step change towards achieving Vision 2030 objectives. It is apparent that without meeting the basic needs of the population, the economy will be susceptible to shocks emanating from food insecurity and unemployment and Vision 2030 will be at risk.

The Minister focused on the following:

- Agriculture - food security, rural development through improved irrigation, extension, fish farming, post harvest technology and commodity trading
- Continued focus on infrastructure investment
- Employment - Sh3.8billion was allocated to a revolving fund charged with extending credit facilities for strengthening SMEs. In addition there was a focus on enhancing vocational training and entrepreneurship.
- To tackle insecurity and development of ASALs, the budget is targeting livestock production, increased security, infrastructure, improved health and education in marginalised areas.

Although the economic stimulus package has been re-voted in this year's budget, the implementation strategies have to be reviewed to enhance the absorption of these and other government funds. The ability to absorb development budgets will be a big challenge for accounting officers and may require the private sector to provide additional capacity.

The Options Available to Finance the Budget

The government intends to spend Kshs 998.8 billion in 2010/11. Revenue is anticipated to grow in

tandem with real economic growth, as well as inflation.

The budget inspires confidence, addresses real issues and provides a stable environment for businesses

With a projected 5% growth in GDP in 2010, anticipated revenue from the growth of the economy spurred by investments and domestic consumption will provide additional revenue to finance the budget.

The government will also rely on tax collection efficiencies through enhanced tax administration and change in the mix of borrowing. The minister has the option of financing the budget deficit from both internal and external sources with a focus to reducing domestic borrowing.

The budget deficit is not an unusual phenomenon and is expected to be contained so long as the economy continues to operate within its production possibilities.

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.

It is also anticipated that the upturn of the global economy in 2010 will enhance exports. In addition the Minister highlighted the intention of improving the business environment through relevant bills and tax incentives.

The focus on food security, unemployment and other social interventions coupled with favourable weather conditions will enhance the disposable income of consumers and hence increase the aggregate demand for goods and services.

It is however important to have a stable political environment during the impending referendum to boost investor confidence.

Conclusion

The budget is consistent with the Vision 2030 pillars with the objective of achieving social equity and enhancing economic growth. It is a confident shift from crisis response to tackling fundamentals. It is real, addressing the right issues - food security and unemployment. It will bring stability since there were no major surprises or changes in policies affecting the private sector.

Direct Tax

A handful of changes will streamline administration but no dramatic transformation

No major changes, but some ambiguities clarified

Overview

No major legislative changes introduced in this year's budget

This year's budget did not introduce any new revenue raising measures to bridge the significant rise in the amount expected to be raised through direct taxes.

Electronic tax filing procedures

The budget introduced measures to enforce the use of technology for tax administrative purposes. The Minister acknowledged that the adoption of electronic tax filing procedures has been slow and the proposed changes are aimed at encouraging the use of the integrated tax management system.

A Gazette notice is to be issued by the Commissioner specifying the procedures to be carried out electronically. This has been informed by the desire to encourage greater use of technology in tax administration.

Deemed interest on inbound interest-free loans

The Minister has deemed an interest rate on interest-free loans provided by a non-resident to a thinly capitalised related Kenyan resident.

The deemed interest rate is pegged to the average 91 day Treasury Bill rate.

The intention is difficult to understand but appears to prevent the artificial "shifting" of profits from Kenya. Not only is the intention unclear, but the provision also appears to be unworkable for the following reasons:

- Interest-free loans do not result in any taxable income or tax deductible expense and therefore it is unclear what profits are being shifted or what expense needs to be added back.
- The purpose of thin capitalisation legislation is to prevent the excessive deduction of interest arising from related party loans. No interest arises from interest free loans.
- There are entirely legitimate reasons why companies may choose to capitalise their subsidiaries through interest free loans rather than share capital. This provision forces companies to

rethink entirely their long term and working capital strategies.

- The Treasury Bill rate imposed is not necessarily an arm's length rate especially where the loans are provided in foreign denominated currencies. For example a US Dollar loan would attract a US Libor rate and not a Treasury Bill rate.
- The impact of the proposed provision is three-fold:

  - A higher proportion of actual interest would be restricted under the thin capitalisation legislation;
  - Deemed interest would be disallowed; and
  - There appears to be an intention to make the deemed interest subject to withholding tax although there are no such enabling provisions in the Finance Bill.

This provision may have a wide-ranging impact on the way long term and working capital is raised by subsidiaries of multinationals. It is doubtful that this was the intention and it is important that the provision be reviewed in greater detail before application.

Transfer pricing no longer limited to an anti-avoidance approach

The Commissioner no longer has to prove that there has been a deliberate attempt to shift profits between a resident tax payer and its related non-resident.

All that needs to be proved is that the results were not aligned to the market regardless of the tax payer's intention.

Enhanced definition of "related parties" to include business controlled by related individuals

Marital and familial relationships now subject to transfer pricing

It appears that the ambit of transfer pricing regulations has been extended to include natural persons. The businesses of individuals who are related (e.g., through marriage) will now be considered to be related for transfer pricing purposes.

Withholding tax on lease rental payments

Withholding tax on lease rental payments to residents has been abolished. This will have a cash flow impact on lessors and it is aimed at promoting the domestic leasing industry. This change takes cognisance of the low revenue risk on domestic leasing as this is normally carried out by financial institutions. The change takes effect immediately.

However, it is disappointing that the withholding tax on lease payments to non-residents remains except for payments in respect of leases for aircraft engines. This is in addition to the current exemption from withholding tax on payments for the lease of aircrafts. This means that cross border leases remain unattractive.

Clarification of penalty regime

Finally, the Minster has bowed to pressure and expressly clarified that penalties levied on late payment of corporate tax do not apply to withholding tax and PAYE.

In addition to the above, all penalties in connection with income tax will no longer attract interest. This is a welcome measure as it now reduces disputes on this matter. This change takes effect immediately.

Farm works allowance increased

The rate of capital allowances on farm works has been increased from 50% to 100% with effect from 1 January 2011. This move is aimed at stimulating investments in agriculture and harmonising the allowances with those available to manufacturers.

The downside here is that the accelerated allowances may generate tax losses for some agricultural entities which can not be utilised to capping introduced in the last financial year.

Allowable capital expenditure under concession agreements specified

The effective date for the capital allowance under concession has been clarified to be the first year of use for both machinery and other concessioned infrastructure not necessarily involving machinery.

When this was first introduced the effective date specified was only for machinery leaving out concessioned infrastructure.

Clarification on capital allowances on commercial buildings

The 2009/10 budget introduced capital allowances at 25% on commercial buildings where roads, power, water, sewer and other social infrastructure have also been provided. The Minister has now clarified that the allowances are only available if the expenditure on the social infrastructure has been incurred by the investor.

Advance Taxes

Prime movers and trailers are now subject to advance tax at a minimum rate of KShs 2,400 per year.

Tractors and trailers used for agricultural purposes are not subject to advance tax.

Tax on payment to petroleum service sub-contractors

Payments of tax withheld on payments to petroleum service sub-contractors should now be remitted on or before the 20th of the month following the month of deduction. This has now been harmonised with withholding tax payments.

Personal Tax Changes

Tax free gratuities

Gratuities due to an employee will now be tax free for the employee when paid directly to a registered pension fund by the employer. The tax free amount is limited to KShs 240,000 per annum. Previously, recipients of gratuities were subject to PAYE on the full amount in the month of receipt.

This move will encourage increased saving towards retirement for the employees. For the employer it could lead to reduced employment costs.

This change continues with previous years' efforts to grant significant incentives for pension recipients.

The effective date for this change is 1 January 2011.

Tax amnesty for Kenyans in the Diaspora

Kenyan citizens living and earning income outside Kenya will now qualify for an amnesty for taxes, penalties and interest in respect of income for all years ending on or before 31 December 2010.

The conditions for the amnesty are:

- The individual must file their 2010 return and accounts on or before 30 June 2011
- The income should not have been previously assessed
- The individual must not be under audit or investigation in respect of the undisclosed income.

The rationale for this amnesty is to enable Kenyans in the Diaspora to invest in Kenya without fear of suffering tax and penalties on undisclosed income.

This amnesty is quite generous in that the tax, penalties and interest are forgiven and the amnesty is not limited to a specific number of years.

It is unclear how successful this amnesty will be in terms of incentivising the remittance of funds to Kenya which appears to be the principal objective for the proposed change.

This change is effective immediately (11 June 2010).

KRA concedes on penalty

At long last, the 2010 Finance Bill has clarified that the Section 72D late payment penalty of 20% does not apply to PAYE and Withholding Tax. Previously, this was the subject of controversy as it was unclear whether the penalty applied to the withholding tax agent or to the taxpayer from whom tax was withheld.

Our analysis has always been that this penalty should not apply to taxes recovered from the agent.

This move is part of the Minister's intention to clarify the penalty regime applicable to PAYE.

This change is effective 11 June 2010.

Interest not applicable on penalties

Good news – late payment interest of 2% per month is now applied purely to principal tax and not to any penalty charged. This is applicable for any penalties charged under the Income Tax Act.

Previously, the interest was levied on the sum of the principal tax and the penalties resulting in high tax liabilities for late payments.

Taxpayers should greet this move with relief and they can enjoy the added comfort of knowing that the interest is capped to the principal tax due.

This change is effective 11 June 2010

PAYE objections

Aggrieved employers can now object to the Commissioner regarding PAYE penalties or any other decision within thirty days of such imposition or decision.

Previously, employers were only able to appeal to the Local Committee so this is a refreshing move which allows for dispute resolution directly with the KRA.

This change is effective 11 June 2010.

Employer PAYE filing obligations reduced

PAYE employer returns

Employers have more reason to smile. In order to lower the administrative burden for employers and to encourage the use of online filing, the Minister has introduced legislation as follows;

- Where an employer files monthly PAYE returns online, they are not required to submit quarterly returns
- The requirement to submit Annual PAYE returns has been scrapped. This does not appear to be dependent on the use of the monthly online PAYE filing.

This change is effective immediately (11 June 2010).

Advance Tax on PSV

In recognition of the hardship suffered by Public Service Vehicle (PSV) drivers and conductors, the Minister has abolished Advance Tax for them.

This change is effective 11 June 2010.

Conclusion

It is disheartening to note that tax bands, tax rates and personal relief have remained static since 2005. It is very rare for any country to maintain the same tax bands over such a long period of time. At a minimum, we expect the lower bands to widen and personal relief to increase to keep up with inflation.

Other changes are simply an effort to clear up some ambiguities.

Value Added Tax

Minister focuses on administrative measures, makes minor changes in anticipation of an overhaul of the VAT legislation in the year 2011.

Overview

VAT legislation to be overhauled in the next Budget.

The Minister has focused on making some administrative changes and exempting a few supplies. He has promised to overhaul the VAT Act in the coming year.

He has committed to ensure that all audited outstanding refund claims as at June 2010 are to be settled by July 2010. In addition, KRA has been instructed, with effect from 1 July 2010, to refund all new low risk claims within 120 days of the lodgement date.

VAT refund relief at last?

It remains to be seen if this new promise will yield any fruits to the already sceptical Kenyan business community. This is because the Minister has been promising to streamline the VAT refunds settlement process in three of the Budget speeches for the last four years. It is also not clear what criteria will be used to determine low risk claims.

Kenyan airports set to remain costly.

Landing and parking services provided to aircrafts are now exempt.

VAT relief on change of status from exempt to taxable supplies clarified.

Tax relief also awarded to already registered persons for exempt supplies changing to taxable supplies.

Certain goods used in solar energy and fishing are now exempt.

Key Changes

Aircraft landing and parking fees clarified to be exempt from tax

The Minister clarified that aircraft landing and parking fees are exempt from tax. While this clears the ambiguity on the VAT treatment of these services, it would have been more appropriate if the Minister had zero-rated these services for VAT purposes in line with international practice, treatment accorded to the shipping industry and the zero-rating of international flights from Kenya and transit aircraft.

Ambiguity on VAT relief on change of tax status now clarified, while extension granted on claim of relief.

This is a welcome move by the Minister where a registered person is now allowed to claim input tax relief on change of status from exempt to taxable supply. This amendment now brings parity between newly registered persons and already registered persons whose supplies come in to the VAT bracket.

A further amendment has been made to extend the time period on recovery

Several solar energy and fishing goods exempted from VAT, but zero-rating these items would have been more effective

of input tax from twelve months to twenty four months.

More goods exempted from VAT….

A number of goods used in production of solar energy are now exempt. These include:

- Transformers having power handling capacity not exceeding 1KVA;
- Transformers having power handling capacity exceeding 1KVA but not 16 KVA;
- Electrical energy saving bulbs(fluorescent bulbs);
- Inverters; and
- Single 2 volt cell units for 300Ah and above.

Similarly, certain goods used in fishing are now exempt. These include:

- Aquaria pumps; and
- Outboard engines of 10 HP.

It is obvious that it is the Minister's intention to make these goods more affordable. However, consumers may find them more expensive as the suppliers of these items will not be able to recover VAT incurred and may have to pass the VAT to their customers.

It would have been more encouraging if the Minister had zero-rated these items to allow the dealers in these commodities to recover input VAT.

Other Administrative Changes

Contractors to enjoy reduction on Withheld VAT

The Treasury needs to commence the process of VAT reform early and consult with key stakeholders

With immediate effect, any supplies made to the Ministry of Roads shall enjoy a reduced pressure on withholding VAT since the Ministry will now only withhold 50% of the tax charged. This will go a long way in improving the cash flow position of contractors who are the major players in the construction of roads.

Use of ICT to record VAT transactions

The Commissioner has been empowered to prescribe tax formalities or procedures on information technology to assist tax payers who do not have computerised systems as well as appoint persons authorized to do so.

Provision for supplies to exporters to potentially enjoy zero-rating removed

The provision relating to the supply of goods and taxable services to gazetted exporters under conditions has been deleted. This has minimal impact on exporters as this provision has not been operational since no conditions have been prescribed in the past. There was an attempt to gazette exporters last year but this fell by the wayside due to implementation challenges.

Harmonisation with the EACCMA

The treatment of passenger baggage and personal effects for VAT purposes has been harmonised with the treatment under the East Africa Community Customs Management Act (EACCMA).

Summary

The proposals made by the Minister are a step in the right direction.

If fulfilled, the promise to settle all verified VAT refund claims in July 2010 will be welcomed by regular refund claimants. However, the Minister ought to have outlined clear measures in the VAT Act to deal with administrative challenges taxpayers face at the KRA in getting their refunds processed.

The plan to overhaul the VAT Act over the next one year is a good move in the VAT reform agenda. The Treasury now needs to commence the process early, consult widely and engage with the key stakeholders.

Customs and Excise

Towards enhancing growth of local industries and ensuring food security

Support staple foods, promote the poultry industry and encourage sourcing of raw materials locally

Will a lower duty on wheat and rice improve food security?

After maize, wheat and rice are the second and third staple foods in Kenya. To supplement local production and food security, the Minister reduced import duty on:

- wheat grain from 35% to 10%
- rice from 75% to 35%

However, this reduction will be limited to a period of one year as the country gears up for local production.

Chicken – inn!

As Kenyans become health conscious they have developed a liking for chicken. To promote growth of the poultry industry and ensure Kenyans continue eating healthier, the Minister has exempted parent stock used for chicken breeding from import duty.

Cheaper raw materials in the construction sector improving competitiveness

Energizing local manufacturers

In a move to protect and promote local manufactures of aluminium conductors and cables, the minister has increased the import duty from 10% to 25%.

Galvanizing the steel industry

In order to reduce costs of importation of intermediate raw materials in the iron and steel industry, the minister has removed import duty on these products. Further, the minister has also removed import duty on flat rolled products or non-alloy steel used in the manufacture of filters and bottle tops.

Construction sector

Cognisant of the high cost of electricity in Kenya, cement makers have resorted to petroleum coke as a source of energy. Energy costs make the price of cement quite expensive, leading to an increase in construction costs. The Minister has removed import duty on petroleum coke.

In addition, paint prices are expected to head south as the import duty on driers and pigments used in manufacturing has been waived.

Making our industries competitive in the region

In order to promote the growth of industries and make them competitive in the region, the minister has given duty remission on all industrial inputs used in the manufacture of goods which are duty free.

Energy saving

The minister removed import duty on lamps and bulbs using Light Emitting Diode (LED) technology. This will help consumers save on power bills.

The price of beer goes up, cigarettes and spirits may remain the same

Excise duty on malted beer has been increased by KShs 11 per litre and non malted beer by KShs 10 per litre. The Minister asserts the increase is a moderate adjustment to factor inflation.

Beer consumers to pay more

For the second year, the Minister has resisted increasing excise on spirits and cigarettes.

Packaging of spirits

The Minister has deleted the provision prohibiting packing or selling of alcoholic beverages in containers of less than 250 millilitres (ml). This provision was introduced in 2004 as a means to discourage packing in sachets which was considered to encourage underage drinking. The minimum packaging was set at containers of not less than 200 ml and in 2009 the Minister increased the limit to containers of 250 ml or more. The Minister has come to the realisation that packaging measurements are best dealt with under the Weights and Measures Act.

No mention of SEZ's

Clarity on returnable containers

The Minister has clarified that for the purposes of levying excise duty on carbonated soft drinks, the cost of the returnable container shall not be included in the ex-factory selling price. In the past, questions have arisen as to the treatment of the cost.

Excise Tribunal set up

Excise administration measure

Taxpayers aggrieved by the Commissioner's decision in respect of excise matters can now appeal to the Excise Tribunal and subsequently to the High Court. This move is in line with other tax acts that provide for aggrieved taxpayers to have their disputes heard by a tribunal.

A shattered or delayed dream…

Investors were looking forward to the introduction of the Special Economic Zones (SEZ) legislation as a means to spur export oriented investments to spur economic growth which the current Export Processing Zone (EPZ) regime does not provide. We hope the eagerly awaited SEZ bill will be introduced during the course of this year.

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

Sector Reforms

Is the financial services industry finally moving towards unified regulation?

Implementation date of rules restricting beneficial shareholding of insurers extended to 31 December 2011

Although the financial services sector is still far from enjoying unified regulation, the minister proposed changes to the Capital Markets Act, Insurance Act and the Central Bank Act to allow for the sharing of information between the regulatory authorities.

The minister has undertaken to fast track the enactment of a number of bills that are pending such as the Banking Bill, Companies Bill, Deposit Protection Fund Bill and the Insolvency Bill.

Insurance sector

Beneficial shareholding

In 2009, the Insurance Act was amended to restrict the beneficial shareholding by any one person of the share capital of an insurance company. However, the 2009 amendments contained certain loopholes as they were silent on indirect control and holding of shares by related parties. The 2010 Finance Bill includes definitions of 'indirect control' and 'beneficial shareholding'. These proposals are likely to significantly impact a number of Kenyan family-owned insurers and some shareholders may need to dispose of part of their shareholding to third parties once these provisions come into effect.

On a positive note, the commencement of these provisions has been pushed back from 31 December 2010 to 31 December 2011. The 2010 Finance Bill also clarifies that shareholding by listed entities in an insurer in excess of 25% is permitted.

Insurance Regulator's scope expanded

The Finance Bill proposes to amend the Insurance Act to extend the mandate and functions of the Insurance Regulatory Authority to include issue of regular supervisory and prudential guidelines.

Premium debts

The Insurance Regulator has in the recent past indicated an intention to make all premium debts inadmissible in calculating the regulatory solvency of an insurer. In what appears to be an error in the Finance Bill, the reference to premium debts has been removed from section 42 of the Insurance Act, which lists assets that are 'inadmissible' in the calculation of regulatory solvency. In doing so, the Finance Bill appears to make premium debts fully admissible. This is inconsistent with the amendments to the Insurance Regulations, which

remove premium debtors from the statement of admitted assets, which we think is what the Minister intended.

Medical insurance providers

The Finance Bill proposes to amend section 150 A of the Insurance Act to require that all persons engaged in the placement of medical insurance business with an insurer to be registered as medical insurance providers under the Insurance Act. The Finance Bill as currently drafted appears to extend the registration requirements to insurance brokers and other intermediaries who do not undertake any liability. This may not have been the intention of the drafters of the Bill.

Other proposals affecting insurers

Proposals to introduce a structured compensation scheme for motor vehicle 3rd party risks, which were mentioned in the Minister's speech, appear to have been left out of the Finance Bill.

The Finance Bill also includes proposals aimed at strengthening the regulator's role in determining the form of the annual accounts and statements and to enable electronic submission of regulatory returns. We hope that the Insurance Regulator will continue to work with interested parties such as the Institute of Certified Public Accountants of Kenya (ICPAK) to ensure that financial reporting by Kenyan Insurers remains consistent with international best practice.

The Finance Bill also proposes to increase unsecured advances to officers or employees by an insurer from Kshs 20,000 to Kshs 100,000.

Currently, the Insurance Act does not allow non Kenyans citizens or entities that are not fully owned by Kenyans to act as insurance agents. The minister has expanded ownership of insurance agencies to other East African citizens. It remains to be seen whether other EAC member states will reciprocate this gesture which would allow Kenyans to own insurance agencies in other EAC states.

In his speech, the minister indicated his intention to introduce a structured compensation scheme for third party motor injury claims. The insurance industry has been calling for structured compensation for a long time. This wait is likely to continue as the proposal in the minister's speech appears not to have been included in the Finance Bill or the subsidiary legislation.

Finally, the Insurance Act is to be amended to make directors of insurance companies who fail to remit contributions to the Policy Holders Compensation Fund severally and jointly liable for the payment of outstanding contributions and applicable interest.

Banking industry

Enhanced supervisory powers to the CBK

Broader powers to enable CBK respond to deterioration in the banking industry

The Finance Bill includes several proposals meant to strengthen the Central Bank of Kenya's (CBK) supervisory role. These include:

- CBK to be given powers to prescribe the requirements to be fulfilled by banks when opening new branches, in addition to conditions currently specified in Section 8 of the Banking Act.
- Closer monitoring of financial institutions that do not fully comply with Section 18 of the Banking Act, on minimum capital requirements or financial institutions that conduct their business in a manner contrary to the provisions of the Act. This monitoring will include such measures as intervention in the management of such institutions, prohibition of salary increment awards to management, etc.

Mortgage financing

To promote investment in housing facilities, the Minister proposes to increase the threshold that banks can lend as mortgage financing from 25% to 40% of total deposit liabilities.

The Minister also proposes to allow mortgage finance companies to offer current accounts. The move is expected to provide cheaper financing to these institutions while at the same time improving their liquidity. However, this may result in mortgage companies having to manage greater maturity mismatches between assets and liabilities as their assets are mainly long term.

Amendments to the Microfinance Act

The Minister has proposed amendments to the Microfinance Act to allow deposit taking microfinance institutions to appoint deposit taking agents.

Islamic Banking

To accommodate Islamic banking products offered under Sharia law, the Minister is proposing to accommodate Islamic banking products by introducing the concept of "return" alongside "interest".

Youth empowerment fund

The Minister is proposing the establishment of a revolving fund of Kshs 3.8 billion out of which Kshs 3 billion will be advanced to financial institutions for onward lending to SME's.

The Minister expects partner financial institutions to match Kshs 5 for every Kshs 1 invested by the Government.

Capital Markets

Demutualisation of the Nairobi Stock Exchange

In line with the expectations of various capital market players, the Minister proposed changes to the Capital Markets Act, Cap 485 A, to facilitate the demutualisation of the Nairobi Stock Exchange (NSE). The demutualisation process will involve the conversion of the NSE from a company limited by guarantee to a company limited by shares. The process is expected to result in better corporate governance at the bourse, promote investor confidence in the capital markets, while at the same time providing an opportunity for the exchange to raise capital.

If the proposed amendment is passed, the NSE has a period of three years to convert from a company limited by guarantee to one limited by shares.

Members of the NSE have already approved the demutualisation.

Anti-Money Laundering

Anti-Money Laundering Act, 2009 effective from 28 June 2010

The Minister gazetted the commencement date of the Anti-Money Laundering Act, 2009, as 28 June 2010. This Act provides for the offence of money laundering, introduces measures for combating the offence and provides for the identification, tracing, freezing, seizure and confiscation of the proceeds of crime. Under this Act, financial institutions and professionals such as accountants risk high punitive fines if they breach several provisions of the Act. Stock brokers and insurance industry players are likely to be the most affected by these requirements as the current anti-money laundering practices in these sectors are weak.

Other Miscellaneous changes

Stamp Duty Act

In a move meant to harmonise the Stamp Duty Act with other tax Acts, the Minister has proposed to reduce the penalty on failure to stamp an instrument under the Stamp Duty Act from 25% to 5%. The penalty imposed will be capped to the principal duty payable.

Further, the Collector of Stamp Duty is now required to seek approval from the Minister of Finance on waiver of penalties in excess of Kshs 1 million.

The time period for redeeming a valid stamp has been extended from 90 to 180 days.

The Minister also proposed to reduce stamp duty fees on mortgages, charges and debentures by 50%.

In line with the other tax reforms, these measures have been introduced to reduce the administrative burden and encourage development in the property market.

East African Highlights

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

Kenya's economy grew by 2.6% in 2009 and is projected to grow by 5.1% in 2010.

Tanzania's economic growth rate was 6% and is projected to be 8% in 2010.

East African economies at a glance

Kenya

The 2010/2011 budget was against a backdrop of improved economic performance. The economy grew by 2.6% in 2009 compared to 1.6% in 2008. This was mainly attributable to the growth in transport and communication, trade, and building and construction sectors coupled with the government's Economic Stimulus Programmes.

The government expects the growth to continue as indicated by the budget's theme **"Towards Inclusive and Sustainable Rapid Economic Growth"**.

Real GDP growth for 2010/2011 is projected at 5.1%. This will be driven mainly by increased investment in agriculture, services, infrastructure, health and education and targeted strategic development interventions in youth employment and marginalised areas.

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Tanzania

Agriculture continues to be a key focus area for the 2010/2011 budget with a motto of **"Agriculture First"**. Amongst the measures planned are the allocation of more resources, including agro-inputs and farm implements and certain tax concessions.

The economy grew by 6% in the calendar year 2009 compared to 7.4% in 2008. Although the growth in 2009 was lower than 2008, it is higher than the expected 5.5% which was predicted based on the expected effects of the global economic and financial crisis.

It is also in line with the IMF growth projection of between 5% and 6%.

Projected real GDP growth for 2010 is 8% and 5% for 2011.

Uganda projects economic growth of 5.6% in 2009/2010 and 6.4% in 2010/2011

Rwanda records economic growth rate of 6%

Uganda

The theme of the 2010/2011 budget is “**Strategic Priorities to accelerate growth, employment and socio-economic transformation for prosperity”** This will mark a transition from the Poverty Eradication Action Plan to the recently launched National Development Plan and aims at creating employment, raising per capita income to middle income and ultimately reducing the proportion of Ugandans living below the poverty line.

Uganda’s real GDP growth is projected to grow at 5.6% in 2009/2010 down from the earlier projection of 6.4% due to the global financial crisis and its subsequent effects. The effects of the financial crisis are projected to continue in FY 2010/2011 and the economy is projected to grow by 6.4%.

The Minister’s budget speech did not contain any major changes to tax policy. This is aimed at maintaining stability in the tax system as an incentive to investment.

Rwanda

The GDP growth rate declined to 6% from 11.6% recorded in the prior year as a result of the impact of the global recession on the tourism and mining sub sectors. The growth rate of 6% was driven by a strong performance in food crop production due to targeted interventions in the agricultural sector. However, tea and coffee exports decreased as production decreased by 18%.

The government has embarked on an ambitious investment programme to improve infrastructure and enhance productive capacity that will promote accelerated growth, increase the export base and widen the tax base. This is in line with the wider Economic Development and Poverty Reduction Strategy (EDPRS) under the Vision 2020 programme. In addition, the government seeks to attract foreign direct investment through improvement of the ‘Doing Business’ environment.

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

Positive macro - economic indicators across the region

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

	Kenya	**Uganda**	**Tanzania**	**Rwanda**
Real GDP growth	2.6% (1.6%)	6.4% (5.6%)	6.0% (7.4%)	6.0% (11.6%)
Inflation				
• Underlying	na* (9.8%)	6.9% (12.0%)	*na	*na
• Overall	3.9% (8.6%) **	9.6% (13.9%)	12.1% (10.3%)	5.7% (22.3%)
91 day TB rates	3.9% (7.3%)	3.8% (6.4%)	2.2 % (10.9%)	8.43% (*na)
	KShs	*UShs*	*TShs*	*RwF*
Exchange rate to the dollar (Local currency = $1)	79.97 (79.00)	1,989 (1,930)	1,320 (1,196)	583 (577)
Budgeted spend (billions)	996.8 (865.6)	6,372 (6,143)	11,610 (9,513)	953 (874)**
Recurring	675.6 (606.7)	3,566 (3,372)	7,791 (6,688)	517 (475)
Development	321.2 (258.9)	2,807 (2,771)	3,819 (2,825)	436 (348)

*Not available

**Revised

Customs and Excise

East African Community

Some degree of harmonisation of East African Community Common External Tariffs

All countries are committed to the Common External Tariffs (CET) that are applied to goods imported into the East African Community. There is a varied degree of implementation. Kenya and Tanzania made the following common proposals:

- Increase of duty on bare aluminium conductors and other cables of copper wire from 10% to 25%;
- Duty remission on specific inputs that are used in production of duty free finished products. EAC partners are required to submit a list of the specific inputs to the Secretariat for implementation; and
- Removal of duty on driers, petroleum coke, stamping foils, pigments used in the manufacture of paints and certain flat-rolled products of iron or non alloy steel.

Kenya increases excise duty on beer

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

Kenya

Import duty on wheat reduced from 35% to 10% for one year.

Imported duty on rice reduced from 75% to 35%.

Parent stock for chicken breeding exempted from import duty.

Import duty on energy saving LED lamps and bulbs.

Excise duty on malt beer increased from KShs 54 per litre to KShs 65 per litre and KShs 45 per litre to KShs 55 per litre on non-malt beer.

The cost of carbonated soft drinks' returnable containers shall not be included in the ex-factory selling price.

Deletion of provision prohibiting packing or selling of alcoholic beverages in containers of 250 millilitres (ml).

Establishment of Excise Tribunal for dispute resolution.

Excise duty increased by 8% in Tanzania for carbonated drinks, alcoholic drinks, petroleum products and cigarettes

Tanzania

The following were proposed under the EAC Common External Tariff (CET) and Customs Management Act:

- Remission of duty on textiles coated with gum used in manufacturing of outer book covers, on looped pile fabrics of gum boot manufacturing and to motor vehicles assemblers;
- Exemption for tractors;
- Tanzania to stay application of CET of 25% on trucks of carrying capacity of 5 tonnes and apply a duty rate of 10% for one year;
- Extension of remission of duty on trucks of carrying capacity of over 20 tonnes from 25% to 0% for one year; and
- Extension of exemption of duty on buses under Dar es Salaam Fast Track Bus project for one year.

Excise duty rates increased by 8% on the following:

- Carbonated soft drinks, beers, wines and spirits;
- Petroleum products - regular and premium motor spirits, gas oil, kerosene, heavy furnace oil and industrial diesel; and
- Cigarettes

The excise duty is reduced on HFO from TShs 97 to TShs 80 per litre so as to reduce industrial production costs. The plan is to eliminate the whole duty within three years.

Uganda

Uganda extends duty remission for one year

Duty remission for the list of Uganda industrial inputs extended for one year.

Uganda will stay application of CET of 25% on buses and trucks for one year.

Rwanda

Rwanda removes import duty on SIM cards and increases excise duty on airtime to 8%

Rwanda will remove import duty on SIM cards.

Extension of application of Common External Tariff for Rwanda for a period of one year on a number of products, including;

- Motor vehicles for public transport and goods at 10%;
- Trucks with gross vehicle weight exceeding 20 tonnes at 0%;
- Tractors at 10%;
- Construction materials imported by registered investors with projects of at least US$ 1.8 million at 5%;
- Cement at 25%; and
- Wheat grain at 0%

Taxation of petroleum changed from *ad valorem* excise duty rate to specific duty rate. The rate is RwF 250 per litre of diesel and 283 RwF per litre for petrol.

Excise duty on airtime increased from 5% to 8%.

Direct and indirect taxes

Kenya

Corporate tax

Generous capital allowances for farmers in Kenya

Capital deductions on farm works increased to 100%.

Capital deductions on expenditure on concessionary arrangements now aligned to the period of the concession.

Deemed interest on interest-free loans

Withholding tax on local lease rental payments abolished.

Withholding tax on lease of aircraft engines abolished.

Enhanced definition of "related parties" to include business controlled by related individuals

There is a change to transfer pricing legislation; the burden of proof now lies with the taxpayer not KRA. Businesses of individuals who are related (e.g., through marriage) will be considered to be related for transfer pricing purposes.

Deemed interest on interest-free loans introduced for thinly capitalised companies.

The Budget clarifies that there is no interest on tax penalties.

Faster processing of VAT refunds in Kenya

The Budget clarifies the penalty regime on late payment of withholding tax and PAYE.

Amnesty on unpaid taxes for the Diaspora for income up to 31 December 2010 provided disclosed by 30 June 2011.

The Budget revokes the exemption from income tax of the Retirement Benefits Authority's income.

Personal tax

Gratuities paid to registered pension funds are tax free for the employee and tax deductible for the employer up to Kshs 240,000 p.a.

Employers who submit online monthly PAYE returns are exempted from filing monthly returns.

VAT

The following have been exempted from VAT:

- Aircraft landing and parking fees and
- Imported electrical transformers, energy saving bulbs, inverters, aqua pumps and outboard engines.

The Budget provides relief of tax on change from exempt supplies becoming taxable supplies.

VAT refunds to be paid within 120 days.

Removal of provisions to zero rate taxable supplies to gazetted exporters introduced last year.

Treatment of passenger baggage and personal effects has been harmonized with the treatment under the East Africa Community Customs Management Act (EACCMA).

VAT exemption on agricultural related activity in Tanzania

Uganda to amend Income Tax Act to integrate petroleum activates

Rwanda removes VAT on mobile handsets

Tanzania

Corporate taxes

Introduction of ring fencing in mining to restrict deduction of losses incurred in one mine against the taxable income of another.

Withholding taxes

Extension of the application of the 2% withholding taxes on goods and services supplied by non-TIN holders (i.e., it now applies to all taxpayers rather than just the Government).

Personal taxes

There has been a reduction in the marginal tax rate for individuals from 15% to 14% for the lowest tax band.

No change to individual tax thresholds.

VAT

The following will now be exempted from VAT:

- Transportation of sugar cane, sisal and tea products to processing industry by organised farming;
- Animal feeds or seed cake, agricultural implements used in agricultural production and livestock;
- Machines and equipment used in the collection, transportation and processing of milk products;
- Airfreight charges for transportation of flowers
- Breeding services through artificial insemination; and
- Supply of packaging materials for fruit juices and milk products.

The minister has proposed to grant special relief to the following:

- Supply of equipment to registered veterinary practitioners;
- Supply of goods and services (for the purpose of building farms' infrastructure) to organised farms under registered cooperatives union and importation by or supply of green houses to growers; and
- Supply of building materials and costruction services to EPZ developers.

In addition, the Minister has proposed to reintroduce 'deemed capital goods' for the purpose of granting special relief. To avoid misuse of the relief, a list of qualifying goods will be prepared.

VAT on locally produced edible oil using local oil seeds to be zero rated.

Uganda

Direct taxes

The minister has proposed to amend the Income Tax Act to integrate procedures for the assessment and collection of petroleum revenues.

VAT

Software license fees exempted from VAT.

Rwanda

VAT

Removal of VAT on mobile handsets.

Miscellaneous

Kenya

Banking

Amendments to CMA, CBK, RBA & Insurance Acts

Amendment to section 33 of the Banking Act gives CBK more powers to regulate banks.

Mortgage financial institutions will offer current accounts.

Proposed demutualisation of the NSE

Amount that can be invested in mortgages for banks increased from 25% to 40% of total deposit liabilities.

Amendments will bring in the concept of return as opposed to interest for Islamic banking.

Ownership rules for insurance companies clarified in Kenya

An Amendment to Microfinance Act will allow agency banking.

An Amendment to deposit protection Act will allow faster winding up of institutions.

Anti-money laundering Act gazetted

Establishment of Kshs 3.8 bn revolving credit fund to be managed by the banking sector for Small and Medium Enterprises (SME) financing.

Capital markets

Capital Markets Authority (CMA) Act to be amended to allow for demutualisation of the Nairobi Stock Exchange (NSE).

Insurance

Rules on beneficial shareholding (section 23) clarified and implementation deadline extended to December 2011 from December 2010.

Beneficial shareholding rules clarified to include indirect holdings.

Related persons clarified to include defined related persons (including family).

Structured compensation introduced for third party motor insurance claims.

Policy Holders Compensation Fund - liability for failure to remit contributions extended to directors.

East African citizens given equal rights to ownership of Insurance Agencies as Kenyans.

Stamp Duty Act

Reduction of the penalty on failure to stamp an instrument under the Stamp Duty Act from 25% to 5%.

Proposed amendment will reduce stamp duty fees on mortgage charges and debentures by 50% from 0.2% to 0.1%.

Other

Amendments to the CMA, RBA, CBK Act and Insurance Acts will allow sharing of information with other regulatory authorities.

Fast tracking of a number of bills (e.g., Banking Bill, Companies Bill, Insolvency Bill and Partnership Bills) will improve the business environment.

Anti-money Laundering Act gazetted to be effective from 28 June 2010.

Proposal to reduce penalty rate in respect of outstanding land rent from 2% to 1% per month, and provide for amnesty on land rent penalties accumulated up to and including 30 June 2010.

Minor changes in Tanzania

Tanzania

Agriculture

Produce cess (Local Government tax on agriculture) to be charged between 3% and 5%.

Levy on raw cashew nuts increased from 10% to 15% (or US$ 160/MT if higher).

Property tax

Exemption for persons of above 60 years of age who have no reliable source of income, from paying property tax on one residential house.

Motor vehicles

Increase in motor vehicle registration and annual licence fees. At the same time abolishment of tax exemptions for motor vehicles aged more than 10 years old.

Gaming

Increase in gaming tax on slot machines by 100% to Tshs 32,000 and introduction of gaming tax on "forty machines site" at 13% on gross gaming revenue.

Retirement Benefits Authority Bill tabled in Uganda

Uganda

The Uganda Retirement Benefits Authority Bill tabled in Parliament recently.

Public Private Partnership (PPP) legislative policy framework approved.

Amendments to the Insurance (Amendment) Bill, Companies Bill, the Trade Marks Bill, 2009, Insolvency Bill and the Sale of Goods Bill.