Sustaining the Momentum

National Budget Bulletin 2019/20

June 2019

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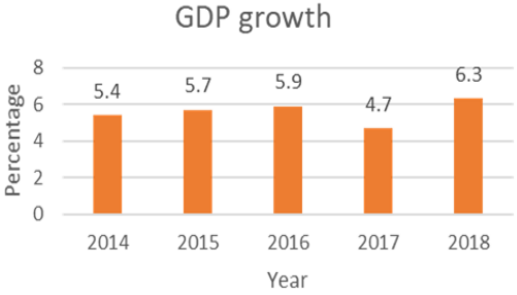
In this bulletin…

Economy

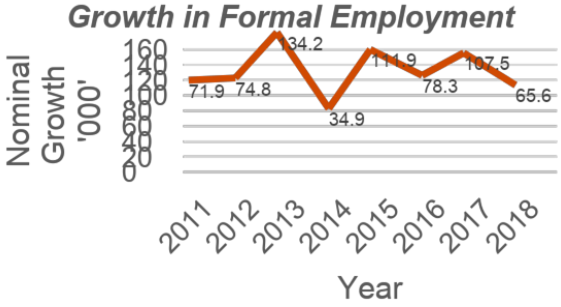
Unlocking the Gridlocked Economy

State of the Economy

This year's budget is anchored on the Government's focus on creating jobs, transforming lives to harness the Big Four plan. Published statistics indicate that the economy grew by 6.3% in 2018 up from 4.9% in 2017, and the highest rate recorded for the past 8 years. The expansion was anchored on strong macroeconomic fundamentals and driven by agricultural production, accelerated manufacturing activities, sustained growth in transportation and vibrant service sector activities.



Source: KNBS Economic Survey 2014, 2019



Source: KNBS Economic Survey 2014, 2019

In addition, inflation decreased from 8% in 2017 to 4.7% in 2018, while interest rates dropped as a result of the downward review of the Central Bank Rate due to the easing of monetary policy.

The ease of doing business in Kenya moved up 19 places to rank 61 out of 190 Countries surveyed in the latest World Bank annual ratings.

On this backdrop, the government aims to achieve its targets by continued implementation of prudent fiscal and monetary policies in order to achieve a low rate of inflation, low sustainable interest and a competitive exchange rate.

The Paradox

Notwithstanding the aforementioned positive macroeconomic indicators and the sustained growth in budgetary allocations to above KES. 2.8 trillion mark; there has been no corresponding growth for businesses and households.

This can be attributed to expenditure lags. While there is a recorded improvement in ease of doing business, the private sector is facing challenges such as delays in payment of suppliers by the government and lengthy port clearance processes.
Interest rate caps and government's increased appetite for commercial loans which has crowded out the private sector from accessing credit.

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Economy

Unlocking the Gridlocked Economy

Despite the decrease in inflation from 8% in 2017 to 4.7% in 2019, households have continued to complain of increased cost of living. This is evidenced by the marginal decrease in growth in formal employment from 107,500 to only 65,600 thousand formal jobs

Unlocking the Gridlock

The 2019/20 budget seeks to unlock the economic potential by improving the business environment for MSMEs, enhance access to finance and market liquidity. It has also provided incentives to increase movement of goods and seeks to strengthen the governance framework.

To address the **access to finance barrier**, the government seeks to operationalise the Biashara Kenya Fund which will enhance participation in the economy by marginalised groups.
In addition, it aims to unlock the potential of small enterprises by providing access to unsecured loans through a mobile loan product - Stawi loans. This will be further buoyed by the proposed SME Credit Guarantee Scheme.

At the household level

- To stimulate job creation the government has set aside KES 1 billion as seed capital to Ajira Digital Program. Similar employment programs have been initiated in countries like South Africa, Yemen, India and Scotland in partnership with development partners. The Government is focused on stimulating growth of the informal sector which created about 83% of new jobs in 2018.
- To increase the disposable income at household level, the government seeks to increase participation of youths, women and people living with disabilities in the economy through incentives such as fast tracking payment of KES 10.9 billion pending bills owed to those vulnerable groups.

In conclusion

The following factors need to be considered to ensure that proposed measures to stimulate economic growth yield the desired results;

- A commitment by the government to pay suppliers within 60 days taking into consideration the liquidity position of government and exchequer releases to MDAs and counties.
- An appropriate legal and accounting policy framework to address the perennial issue of pending bills at the end of the financial year and the budgeting cycle.
- The efficiency in the operations of the Stawi loan, Biashara Kenya Fund and SME Credit Guarantee Scheme to achieve the intended objective of access to finance.

Corporate Income Tax

The following were the proposals made the Cabinet Secretary (CS) National Treasury in his Budget Speech on 13 June 2019:

Increase in capital gains tax rate

- The Cabinet Secretary has increased the rate of capital gains tax (CGT) on transfer of property from 5% to 12.5%.
- This brings the rate closer to that of other EAC jurisdictions such as Uganda, Tanzania and Rwanda that have a CGT rate of 30%.
- While the Kenyan rate is still low, there are no indexation provisions and this will result in taxation of gains arising from inflation.

Reprieve from CGT on corporate restructuring

Currently, an exemption from CGT is granted by the CS in relation to a reorganisation deemed to be undertaken in public interest.

- The CS now proposes to exempt from CGT the transfer of property and shares during restructuring of corporate entities.
- The proposed change is a welcome move given that group reorganisations will now be possible without incurring additional tax costs particularly where there is no change in beneficial ownership.
- This will also make Kenya an attractive holding company location.

Widening scope of services subject to withholding tax

- In a bid to expand the tax base and increase revenue collection, additional services have been brought under the scope of withholding tax (WHT).
- These services include security services, cleaning and fumigation services, catering services offered outside hotel premises, transportation of goods excluding air transport services, sales promotion, and marketing and advertising services.
- Whilst this measure is likely to enhance tax compliance by bringing more persons into the net, it will however increase the administrative burden of collecting and remitting the WHT.
- Given that these are routine services, there is need to have a minimum threshold amount similar to the one applicable to management or professional fees.
- Experience from similar provisions regarding rental income shows that the KRA may need to simplify the return filing and tax payment processes to make it easy for persons to comply.

Corporate Income Tax

Tax incentives to boost the green economy; but will it work

To encourage investment in plastic recycling, investors operating plastic recycling plants will enjoy reduced corporate income tax rate of 15% for the first five years.

- This is aimed to help reduce pollution and provide a clean environment. The attractiveness of this incentive will be limited by the fact that businesses make losses in initial years.

Tax amnesty for SME's listing on GEMS

The Capital Markets Authority (CMA) introduced the Growth and Enterprise Market Segment (GEMS) on the NSE to encourage the listing of SMEs on the segment and help them raise capital from the capital markets.

However, only few entities are currently listed on the segment.

- To spur growth of the segment, the Cabinet Secretary has proposed a tax amnesty on penalties and interest on outstanding taxes for two years prior to listing.
- The principal taxes outstanding will however be payable in full.
- Given the five year statutory limitation period, the CS should have considered extending the tax amnesty to five years prior to listing in order to enhance the effectiveness of the amnesty.

New Income Tax Bill still a waiting game

In the 2018 budget statement, the Cabinet Secretary had indicated that the draft Income Tax Bill, 2018, would be submitted to Parliament for enactment following earlier failed promises.

- This did not happen and the CS has yet again promised that the bill is now in its final stages of drafting.
- Businesses should watch out for the bill as it is expected to contain substantial changes from the current law.

A new focus on taxation of the digital economy

In order to keep up with technological advancements, the Cabinet Secretary proposes to introduce a raft of tax measures aimed at taxing income generated from the digital economy.

- While the proposed changes should provide clarity on the taxation of income from the digital economy, care must be taken to avoid double taxation of companies or increasing the costs of doing business. This is a complex area to tax and one hopes that the CS has made sufficient consultations.

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Employment and Personal Taxes

Tax exemption for members of "Ajira Digital Program"

- The Cabinet Secretary is proposing a one-off registration fee for members of KES 10,000 payable from 01 January 2020 in lieu of income taxes.
- Once registered, the youth will enjoy a tax exemption on income generated from the program for the subsequent three year period.
- ''Ajira Digital Program'' is a government initiative to create employment opportunities.
- Under this project, the youth are engaged as freelance (self-employed) workers to earn income from online work and access relevant training and mentorship.

Affordable Housing Scheme

- The government proposes to allocate KES 5 billion to the Affordable Housing Scheme as a contribution for its employees.
- Currently, the High Court has suspended the implementation of the housing levy pending the hearing of cases relating to petitions filed by various organisations opposing the levy.
- Whether the injection of the allocation will inspire the private sector to embrace the fund will depend on the outcome of the court cases, which may have a defining impact on the implementation of the program and the realisation of objectives under this program.

Employment and Personal Taxes

Exemption from PIN requirements for foreigners

- The Government proposes to exempt foreigners from the requirement to supply a Personal Identification Number ("PIN") issued by the Kenya Revenue Authority (''KRA'') when opening bank accounts in Kenya. Such exemption must be approved by the Commissioner.
- However, where such a foreigner is not exempt from income tax, he or she may still be required to obtain a PIN.

Expectations not met

- With ever increasing inflation, one would have expected the government to review the various incentives granted to individual taxpayers, in order to align them with prevailing inflation and cost of living indices.

Some of these incentives which have not been reviewed for over 10 years include:

a) Tax exempt staff meals amount of KES 48,000 per annum per employee.

b) Insurance relief at 15% of premiums capped at KES 60,000 per annum.

c) Pension deduction of KES 240,000 p.a.

d) Tax free pension withdrawal amount lesser of the first KES 60,000 p.a. or the first KES 600,000.

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Value Added Tax

- The Cabinet Secretary has proposed minimal amendments to the Value Added Tax Act, 2013 in this year's budget statement.
- The Cabinet Secretary also promised changes in the taxation of the digital economy, which we expect to come through Finance Bill,2019.
- We expect VAT to feature prominently as part of the promised changes.

Promoting the manufacturing sector

- In a welcome move to promote local manufacturing, the Cabinet Secretary has proposed to exempt from VAT, inputs for the local manufacture of computer motherboards as well as all services and inputs for use in the set up and operation of plastic recycling plants.

Administrative measures to ease cash flow pains

- To alleviate taxpayers' cash flow burden, the Cabinet Secretary intends to reduce withholding VAT (WH VAT) rate from 6% to 2%.
- This comes against a backdrop of another Bill before Parliament to allow cash refunds of accumulated VAT credits emanating from the WH VAT regime.
- Similarly, the Cabinet Secretary has proposed to amend the current VAT refund formula per the VAT Regulations in a bid to ensure excess credits arising from zero rated supplies are fully refunded. Unfortunately, the proposal does not address historically underpaid VAT refunds.
- We expect the funds freed from the above measures to spur economic growth and yield more taxes for the exchequer.

2%

WH VAT rate reduced from 6% to 2%

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Customs duty

Incentivising manufacturers under the Big Four agenda!

The Cabinet Secretary has proposed the introduction of duty remission on:

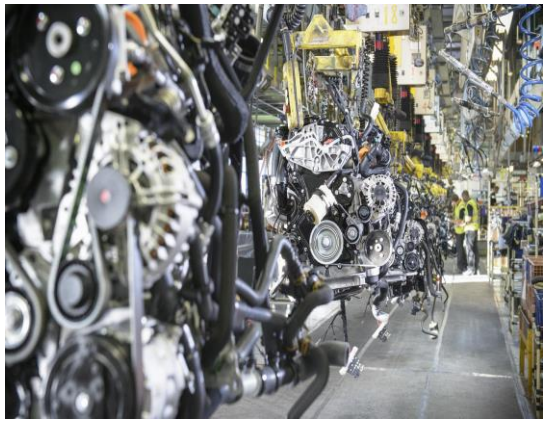
- Raw materials of tariffs 7304.31.00 and 9401.90.00 for the manufacture of motorcycle components and motor vehicle seat recliners.
- Iron and steel products (7213.99.00) which are not available locally; and
- Raw materials used for manufacture of radiators.

Additionally, the Cabinet Secretary proposed an extension of duty remission on the following products for a period of one year:

- Wheat grain – Gazetted millers to apply a duty rate of 10% instead of 35%.

Proposed customs changes to become effective 1 July 2019 following publication of EAC Gazette Notice

- Completely Knocked Down ("CKD") motorcycle kits – Gazetted motorcycle assemblers to apply a rate of 10%.
- Industrial sugar – import duty rates to be maintained at a reduced rate of 10%.
- Roofing tiles coated with acrylic paint – duty on inputs used in the manufacture of roofing tiles to be maintained at a rate of 0%.
- Aerosol cans used in packaging of insecticides and acaricides to be imported at a rate of 0%.
- Inputs and raw materials for energy saving stoves – Gazetted manufacturers to enjoy a duty rate of 0% on inputs for assembly, manufacture or repair of clean energy cooking stoves; and
- Materials used in the manufacture of leaf springs to be imported at a duty rate of 0%.



Customs duty

Measures to protect local industry

The Cabinet Secretary has granted stays of application of import duty rates per the East African Community Common External Tariff (EACCET) as highlighted below for a period of one year:

- Paper and paper board – 25%.
- Textiles and apparels – 35% for all items under chapter 60, 61 and 62.
- Skillets, Free Hinge Lid Packets - 25%.
- Metal and allied sector – various rates rangingfrom 10% or USD 125/MT to 35% or USD 250/MT, whichever is higher.
- Leather and footwear – various rates ranging from 25% or USD 2.5/ pair to 25% or USD 5/ pair.
- Refined edible oil products - 25% or USD 500/MT whichever is higher.
- Raw timber – 0%; and
- Finished products of wood – various rates ranging from 25% or USD 110/MT to 35%.

Separately, the Cabinet Secretary proposes an *extension of stays* of application of import duty rates for a period of one year on the following:

- Road tractors or semi-trailers - 25%.
- Safety matches – 25% or USD1.35/Kg whichever is higher.
- Polymers of Styrene Acrylic – 10%.
- Rice - 35% or USD 200/MT whichever is higher.
- Polymers of Vinyl Acetate – 0%.
- Worn Clothing - 35% or USD 0.2/Kg; and
- Prefabricated Buildings - 35% or USD 250/MT.

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Excise duty

Introduction of excise duty on betting activities

- The Cabinet Secretary has proposed an introduction of excise duty on betting activities at the rate of 10% of the amount staked.
- This measure is aimed at curtailing the negative social effects of betting activities on the nation's youth and other vulnerable members of society.

Reduced excise duty rate on importation of electric powered motor vehicles

- Electric powered motor vehicles will now be imported at an excise duty rate of 10% down from 20%. This is a move aimed at embracing green energy technology to safeguard the environment.

Excise duty on cigarettes, wines and spirits goes up by 15%

- The Cabinet Secretary noted with concern the gradual decline of excise duty revenue through the years. In a bid to address this, he proposed to increase excise duty on cigarettes, wines and spirits by 15% in addition to the inflationary increase effective 1 July 2019.
- Assuming an inflation rate of 5.2% that is similar to last year's, the highlighted excisable products will suffer additional excise duty of +/- 20%, which in our view contravenes the 10% rate increase/decrease allowed in law. We therefore expect the proposed changes to face legal headwind.

Unrealised expectations

- We expected the Cabinet Secretary to address legislative ambiguity with regards to the contentious 'other fees' charged by financial institutions but clarity remains elusive!

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Tax reform agenda

Taxing digital economy

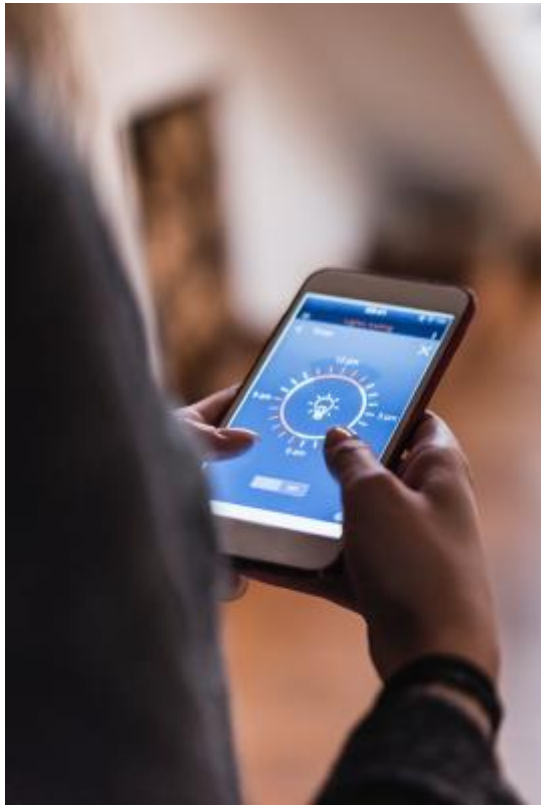
Bringing the digital economy into the tax net

The Cabinet Secretary took note of the importance of bringing the digital economy into the tax net while acknowledging that the current tax laws are not adequately equipped to deal with the digital economy.
It is interesting that he has proposed a raft of tax measures to deal with the digital economy while this still remains an evolving issue at the Organisation for Economic Co-operation and Development (OECD).

Some of the challenges that the proposals will need to address include:

- Those faced in taxing a non-resident digital supplier of services such as online streaming of media content given that the non-resident is unlikely to have a physical presence in-country.
- The fact that countries where the digital activity that generates economic value such as actions of social media users which create opportunities for online advertising revenue do not have a right to tax the value created.

If the proposals are not carefully thought out, the proposed measures may either result in double taxation or the tax costs inevitably being passed on to Kenyan consumers.



Tax reform agenda

Tax and fiscal reforms

Fiscal Policy and reforms

- Tax administrative reforms are intended to enhance revenue collection and to seal revenue loopholes. Domestic revenue mobilisation is key to the reduction in the fiscal deficit.

Systems overhaul

- The Cabinet Secretary has proposed the strengthening of ICT systems, the roll out of the integrated customs management system and the implementation of the Regional Electronic Cargo Tracking system. The objective is to seal tax leakages.

Policy reforms

He has also proposed the following policy reforms focusing on revenue collection, dispute resolution and ease of business:

- Partnerships for information sharing with other jurisdictions to increase cross-border tax transparency. There has however been little actual movement towards ratifying information exchange agreements which were mooted a few years ago.
- Stringent verification of import and export consolidators to reduce delays during importation, tax evasion and illegal importation of contraband and counterfeit goods.
- Streamlining the process of Pre-Verification of Conformity (PVOC) to enhance faster clearance of cargo.

Tax reform agenda

Other fees and levies

Incentives for local manufacturers

The Cabinet Secretary has proposed the following measures to create an enabling environment for local manufacturers, cushion them from cheap imports and make locally manufactured products competitive:

Anti-adulteration levy

- Refund of anti-adulteration levy paid on illuminating kerosene to manufacturers of paint and resin. This is expected to reduce the cost of manufacture.

IDF and RDL

- Reduction of the import declaration fee (IDF) on intermediate goods and raw materials from 2% to 1.5% and an increase of the IDF rate on finished goods from 2% to 3.5%.
- Increase the Railway Development Levy (RDL) for finished products from 1.5% to 2%.

These initiatives are expected to facilitate growth of local industries.

Export levy

- Imposition of export levy of 10% on tanned and crust hides and skins in order to discourage export of these products and promote local value addition.

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Other legislative reforms

The Budget proposes a range of legislative reforms, some of which are set out below:

The following Bills have been submitted to the National Assembly for approval:

- **The Competition (Amendment) Bill 2019,** which empowers the Competition Authority to impose penalties for abuse of buyer power and ensures prompt payment of suppliers.
- **The Insurance Act (Amendment) Bill 2019,** which brings clarity on the operations of the Policy Holder's Compensation Fund and enables the Fund to be used to compensate claimants.
- **The County Governments' Revenue Raising Process Bill 2018,** which regulates the introduction of levies by County Governments.

The following Bills are in advanced stages of legal drafting:

- **The National Electronic Single Window Bill 2019,** which formalises the issuance of electronic permits through the National Single Window System.
- **The Sovereign Wealth Fund Bill 2019,** which establishes a fund for the investment of revenues from oil, gas and mineral resources.

The Cabinet Secretary has proposed changes to the following legislation:

- **The Capital Markets Act 2013**, to grant the Capital Markets Authority power to enforce penalties on players in the market violating rules and procedures.
- **The Banking (Amendment) Act 2016,** to repeal section 33B of the Act that introduced interest rate capping.
- **The Retirement Benefits Act, 1997, the Occupational Benefits Regulations and the Retirement Benefits Regulations** to reduce the transfer period for Retirement Benefit Schemes that invest in guaranteed funds to one year so as to allow members to access better returns.

The Cabinet Secretary gave an update on the following Regulations:

- The Government is in the final stages of issuing the **Public Procurement and Asset Disposal Regulations**, which will fully operationalise the Public Procurement and Asset Disposal Act, 2015.
- **The Public Finance Management (Biashara Kenya Fund) Regulations 2019,** has been submitted to the National Assembly. This consolidates three affirmative action funds; the Uwezo Fund, the Youth Enterprise Development Fund and the Women Enterprise Development Fund.

Counties

6 years on…have the benefits of devolution trickled down to the mwananchi?

The journey of the counties...

6 years on and over 2 trillion shillings allocated to counties; will the addition in FY 19/20 of 371 billion shillings make a difference?

- Counties development expenditure uptake as a proportion of the total expenditure remains below the expected level of at least 30% as per the PFM Act indicating that the budget largely is absorbed by recurrent expenditure (e.g. wages, overheads etc.).

Bills yet unsettled

- Significant pending bills at the counties remain unpaid, this has negatively impacted economic spending activities and thus economic growth.
- It is hoped that the directive to pay suppliers within a maximum of 60 days will be adopted by counties to solve this impasse.

Standing on their own two feet

- There is need for counties to reverse the trend of over-reliance on the national government revenue allocation, it is however noted that the national government is making deliberate efforts to help counties improve their performance in generating revenue locally.
- It will be interesting to see how the Integrated Revenue Management System for internal county revenues and the proposed bill to regulate county levies will impact county revenues.

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Healthcare

UHC; a priority that only gets a small pie

KES 47.8B

UHC allocation

- The Constitution of Kenya 2010 *strives for* the highest standard of health*care* as a basic right, whilst devolving governance *to the counties*, *so as* to ensure improved service delivery, greater accountability, improved citizen participation and equity in the distribution of resources.
- Kenya's vision 2030 aims *to* transform the country into a globally competitive and prosperous *one* with a high quality of life by 2030, and improved *healthcare* is a critical driver to the achievement of this vision.

- The Government of Kenya has committed to providing Universal Health Coverage under the "Big Four" agenda as part of its socio-economic transformation by providing equitable, affordable and quality healthcare of the highest standard to all its citizenry.
- This will be achieved through implementation of appropriate policies and programmes that the health sector will undertake.

From a budget perspective

- There is no increase of the FY19/20 budgetary allocation of UHC from the previous financial year.
- The current allocation of KES 47.8billion is meant to scale up the UHC initiatives to all the 47 counties.

0% increase

- The successes and lessons of the UHC agenda for the 4 pilot counties (Isiolo, Makueni, Kisumu and Nyeri) has not been evaluated and hence, the budget allocation in the current year may not be well informed.
- Meanwhile, NHIF is key to the implementation of UHC and it is meant to catalyse the outcomes. The reforms have however taken too long and have not been addressed in the current budget statement.

Healthcare

UHC; a priority that only gets a small pie

- Attainment of UHC has remained elusive due to lack of access to different healthcare services, poor distribution and use of resources.
- Poverty is a major contributor to poor health especially among the vulnerable members of the society, the government allocation of KES 25.6billion to protect this group will contribute towards improving their living standards.

- In terms of preventive and promotive measures, the government has allocated KES 7.6billion towards the hunger safety net programme and sports, culture and arts activities, which contribute to having a healthy society.

- The proposition to further amend the Umbrella Retirement Schemes Regulations to allow members to contribute towards Post-retirement Medical Fund will contribute towards the achievement of Universal Health Coverage.

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For the UHC to be a success, there is need for;

- Proper coordination with the county governments given that delivery of UHC is implemented through the primary health care facilities.

- Evaluation of the pilot phase of the 4 counties is also very critical to inform the strategic direction on the roll out into the other counties as mentioned in the budget statement; and

- Assessment of the viability and sustainability of the UHC agenda.

- There is still political goodwill and infrastructure to catapult the achievement of the UHC vision.

Financial services

Low access to credit for micro, small and medium enterprises (MSMEs) as a result of rate capping

Interest rate capping, three years later

The Cabinet Secretary acknowledged the negative effect the interest rate capping introduced in September 2016 continues to have on access to credit for the micro, small and medium enterprises (MSMEs).

- Lenders have opted to invest in low risk financial assets, majorly government securities, reducing the credit available to MSMEs.
- The Cabinet Secretary has proposed in the Finance Bill, 2019 to repeal Section 33B (Amendment) Act, 2016 which introduced interest rate capping.
- It remains to be seen whether the cabinet secretary will succeed, with the proposal having been rejected by Members of Parliament, in the Finance Bill, 2018.

Other measures to increase access to credit by MSMEs include;

- the launch of an "SME Credit Guarantee Scheme", to deepen access to credit by SMEs without being subjected to complex application procedures and collateral requirements.
- Consolidation of Uwezo Fund, Youth Enterprise Development Fund and Women Enterprise Development Fund into one fund to be known as Biashara Kenya Fund that will give special priority to businesses owned by youths, women and people living with disabilities; and
- Endorsement of a mobile loan product known as "Stawi" loans which will offer unsecured loans to small enterprises.

State-Owned Enterprises Reforms

The Government plans to continue with its initiatives to recapitalise and restructure the banks that are partially or wholly owned by the state with a view to creating stronger banks and Development Financial Institutions. In this regard, the government as a shareholder is supporting the merger of:

- The National Bank of Kenya and the Kenya Commercial Bank; and
- The Tourism Finance Corporation, IDB Capital and the Industrial & Commercial Development Corporation (ICDC) to form the Kenya Development Bank.

13% - The current interest rate on loans and advances

Financial services

Expanding the insurance base…

Insurance

Comprehensive insurance cover on the informal transport system

To mitigate the risks associated with boda-boda travel, the Cabinet Secretary has proposed an amendment to the Insurance rules requiring all passenger-carrying boda-bodas and tuk-tuks to have an insurance cover for passengers and pedestrians.

- This will aid in providing financial assistance for victims of boda-boda accidents.
- The main challenge would be the enforcement of the rule given that the boda-boda business is largely informal. It is likely to contribute to high loss ratios as experienced by the current motor insurance business.

The Cabinet Secretary has also proposed amendments to the Insurance Act to bring clarity on the mandate of the Policy Holder's Compensation Fund (PHCF) which was set up in 2004 to cushion holders of insurance policies in instances where companies are declared insolvent.

- The fund has never been utilised despite insurers such as Blue Shield and United Insurance being placed under statutory management. The proposed amendments will help in protecting policyholders.

Retirement Benefits

The Cabinet Secretary has proposed the following amendments to the Retirement Benefits Act:

- Reduction in the period required to transfer funds invested by Retirement Benefits Schemes in guaranteed funds from the current three years to one year; and
- Allowance for existing members of Defined Contribution Schemes to access their share of the scheme's reserve funds in addition to their contributions.

These amendments safeguard the interests of pensioners and will see members enjoy higher benefits on exit.

Zero policyholders paid since inception of PHCF

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Agriculture

Are we on course towards food and nutrition security?

The Agriculture, Livestock, Fisheries and the Blue Economy sub-sectors contribute approximately 52% to GDP directly and indirectly (Kenya Economic Survey, 2019). The sectors further account for approximately 57 percent of Kenya's total exports and 60 percent of employment in the rural areas.

This clearly demonstrates the significance of the sector in all the spheres of the economy and underscores the need for the government to spur growth in this sector.

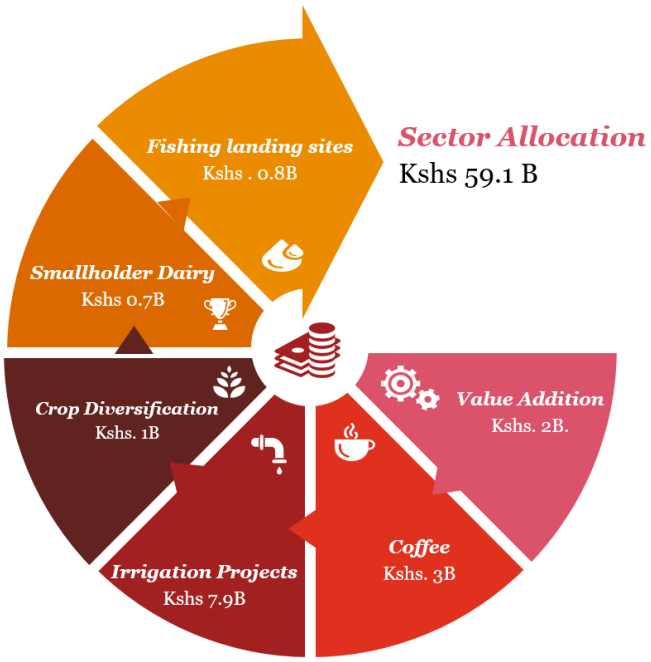
GoK Strategy

The sector is identified as one of the six sectors under the Vision 2030 and the government has identified it as one of its Big Four Agenda.

To implement these strategies, the government has largely been expanding irrigation schemes, increasing access to agricultural inputs, implementing programmes to support smallholder farmers, fishing and pastoralist communities to produce and market their commodities.

2019/20 allocation

The total allocation is KES 59.1 B with the key allocations depicted below;



Agriculture

Are we on course towards food and nutrition security?

The current allocation is equivalent to 2.2 % of the total budget. This may not be considered adequate because of the following:

- One of the key focus for this year's budget is "creating jobs". The agricultural sector employs over 70% of the population, yet the allocation is not commensurate;
- The manufacturing sector heavily relies on this sector, therefore limited efforts in scaling up, may hamper manufacturing;
- Should risks related to weather shocks materialise, these risks have not been adequately funded;
- Kenya is a signatory to the 'African Union (AU) Malabo Declaration which requires the sector to be funded up-to at least 10% of national budget.

Being one of the Big Four, food and nutrition security is very important to the government.

At the same time, agriculture is one of the devolved functions, and therefore there is need to coordinate with the county governments to ensure optimal allocation of resources to spur growth and realise food security.

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Energy

Power for Big Four Growth

Access to stable, reliable and affordable energy supply is critical to the realisation of the Big Four agenda.

- In an effort to reduce the cost of electricity to manufacturers, the government has developed a framework to grant income tax rebates on power costs.
- The incentive is expected to decrease the cost of electricity to manufacturers by about 20%.
- This will make our products competitive in the region and spur economic growth.

Power for all

- The government has made significant progress in enhancing the electrification rate by connecting 73% of households to the national grid as at June 2018, compared to 29% five years ago.
- In line with achieving it's 100% electrification target by 2022, it has allocated KES 5.5billion towards the last mile connectivity initiative. This is a reduction of 18% compared to last year's allocation.

KES 69.8b

Total budget amount allocated for energy:

- **KES 8.6b** – Geothermal development
- **KES 61.2b** – Power transmission & distribution development including:
  - **KES 4.5b –** Electrification of public institutions.
  - **KES 5.5b –** Last mile connectivity.
  - **KES 1.3b –** Connectivity subsidy.
  - **KES 1.0b –** Street lighting.
  - **KES 1.5b –** Transformers installation in constituencies.

Development of Green Energy

The government continues to focus on the development of green energy and has allocated KES 8.6billion towards the geothermal development.

- There was no budgetary allocation for other renewable energy sources such as wind and solar. This is an opportunity for private players to invest in this space.

To promote the green energy technology, the government has reduced the excise duty on motor vehicles that are fully powered by electricity from 25% to 10%.

- However, it should put measures that will ensure the necessary infrastructure is in place to support the technology.

Energy

Transmission of electricity

The government has budgeted for the construction of 1,432 km of transmission lines in the next three years.

- Private sector players are expected to play a crucial role in the development of transmission infrastructure under the Public Private Partnership (PPP) framework.

Oil and Gas

According to the 2019 Budget Policy Statement, the sector expects:

- To drill 270 oil wells.
- Produce 600,000 barrels.
- Distribute 20,482 metric tonnes of oil and gas; and
- Construct Kipevu Oil Terminal (KOT) in the next three years.

However, there was no budgetary allocation to support these initiatives in contrast to 2018 where the Cabinet Secretary allocated KES 4.8billion for exploration and distribution of oil and gas.

The Sovereign Wealth Fund (SWF) Bill

The SWF bill proposes the creation of a fund and provides a legal framework to guide investment of revenues from oil, gas and mineral resources.

- This legislation should be in place before commercial production of oil and gas.
- In the 2018/19 Budget Statement, the Cabinet Secretary noted that the SWF Bill was to be tabled in Parliament.
- However, from last year there has been minimal progress as the Cabinet Secretary indicated that the Bill is yet to be submitted to Parliament for approval.

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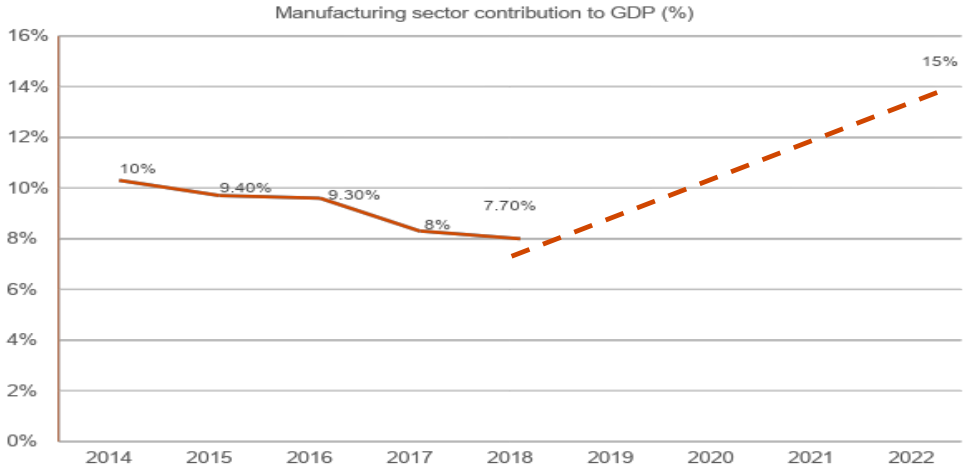
Manufacturing

Noble intentions, slow progress

With an aspiration of increasing the contribution of the manufacturing sector to 15% of Gross Domestic Product (GDP) by 2022, the Cabinet Secretary has laid out several measures to boost manufacturing in Kenya. But despite his noble intentions, questions abound on whether the measures are effective and if there is tangible/ real progress on the ground.

Growth in the manufacturing sector continues to be depressed due to a combination of local macro-economic factors and increasing direct imports of finished goods.



Source: KEBS Economic Survey 2019

The liquidity challenge

A combination of slowed payments from the government, delayed VAT refunds, and a general credit squeeze arising from interest rate cap has created a substantial liquidity challenge in the economy.

- This has generally depressed consumption, slowing down the growth of the manufacturing sector.

The government has issued a directive that pending bills be settled before end of June 2019 and KES 10.9 billion has been allocated for this. In addition, a team is to be set up to clear outstanding VAT refunds in the next two months.

- While these measures are welcome, they are reactive, short term in nature and unlikely to address the liquidity challenge. Their implementation tends to be sluggish, hence not achieving the desired effect.

Manufacturing

Noble intentions, slow progress

Illicit trade and counterfeits

- Illicit and counterfeit products continue to pose a big challenge to manufacturers in Kenya that results in loss of a significant portion of revenue and an unfair competitive landscape. In addition, the government loses tax revenue.
- Direction has been given to ensure all import and export consolidators undergo strict vetting, registration and gazettement before they are allowed to operate at all the ports of entry and clearance which is expected to reduce tax evasion, curb the illegal importation of contraband and counterfeits goods in addition to reducing delays in cargo clearance into the country.

Delays in policy implementation

- A number of policy measures included in this year's budget are a continuation of prior year promises, such as lowering the cost of electricity to manufacturers and, the revival of Rivatex. Not much seems to have been achieved in the past 12 months.
- Unless the government works on speeding up policy implementation, realisation of the targeted goal of growing manufacturing to 15% of GDP by 2022 will remain elusive.

Manufacturing

Noble intentions, slow progress

Ease of doing business in Kenya

- It is commendable that there are plans for Kenya to continue with its ambitious business reform initiatives.
- According to the World Bank's Ease of Doing Business Report released in 2018, Kenya's global ranking has improved to position 61 from 80. However, is this improvement in ranking being felt by the manufacturing sector?

With challenges posed by numerous licence requirements (at both the national and county government levels) and an aggressive revenue authority, the ease of doing business still remains a pertinent issue in the manufacturing sector.

But are the proposed policies enough?

It is encouraging to hear that in order to further cushion our local manufacturers and facilitate growth of the sector, certain fees on importation and levies on transport of intermediate goods and raw materials used by manufacturers were reduced and on the other hand, the rates were increased for importers of finished goods.
These proposed changes though welcome, are not significant enough to cause an industrial revolution...which is what we need to cope with the prevailing youth unemployment.

Ultimately, the government should consider deep tax incentives to spur real investment in the manufacturing sector for both local consumption and exports. These should be coupled with aggressive implementation of policy measures, and fight against corruption that oils illicit trade and counterfeiting.

Conclusion

Once again, a demonstration of noble intentions but slow implementation and pervasive challenges!

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Affordable housing

Kenya's urban centres face a significant shortage of housing, which is expected to rise based on current construction rates.

- The government undertook, as part of its Big 4 agenda, to construct a total of 500,000 housing units within a period of 5 years, translating to an average of about 100,000 housing units annually. Such housing was primarily targeted at citizens earning below KES 100,000 per month.

Budget allocations

In the FY 19/20 budget, the Cabinet Secretary Treasury made the following allocations with regard to the affordable housing project:

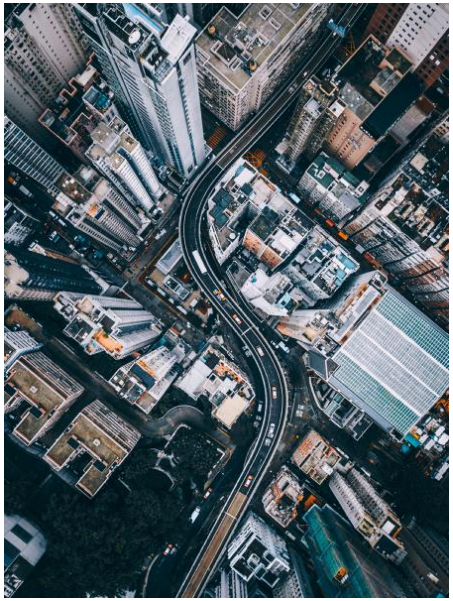
- KES 10.5billion was allocated toward the construction of Social Housing units, including housing units for the National Police Service and the Kenya Prisons Service.
- KES 5billion was set aside as the government's contribution to the National Housing Development Fund (NHDF) on behalf of its employees.
- KES 2.3billion for the Public Servants' Housing Mortgage Scheme.
- KES 1.0billion as the government's injection of capital into the Kenya Mortgage Refinance Company (KMRC).

National Housing Development Fund

The NHDF has been envisioned as the key driver of the supply side within the Affordable Housing ecosystem. It is the offtaker of housing in accordance with the government's policy.

- As a purchaser of housing, however, its ability is limited by its access to finance. With a court case pending regarding the employee contributions into the fund and the ambitious targets that the government set, it was expected that alternative funding options or
- additional allocations be made to the NHDF during the address.

Affordable housing



Kenya Mortgage Refinance Company

The KMRC is a key cog in the demand side of the affordable housing framework and will be jointly owned by the government, Private sector and select development partners to create long-term liquidity in the mortgage market.
The increased access to financing for banks that would result from this is intended to lower the cost of mortgage financing to house buyers.

The KMRC, launched in May 2019 has attracted interest from local and international investors as can be seen from the total of KES 37.2billion already committed by the government, World Bank, AfDB and other private shareholders with an expected KES 400million from other Development Financial Institutions.

- Once operational, it is expected to lower interest rates for mortgages leading to a higher uptake of the mortgage facilities by Kenyans.

Conclusion

The following need to be considered to ensure that the affordable housing project achieves its intended objectives:

- The government needs to ensure continued and enhanced public participation and stakeholder involvement to increase buy-ins and avoid future disputes which could derail the project.
- Though we have witnessed ground breaking ceremonies for several projects in the country, there is still no completed project. There is therefore need to fast-track the projects to ensure that the benefits are felt by the public.
- The government should come up with mitigating measures should the High Court rule in favor of the petitioners/applicants such as engaging with private investors to scale up the financing.

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Technology

Significantly more investment in ICT will be required to realise the vision of the recently launched digital economy blueprint

Digital economy blueprint

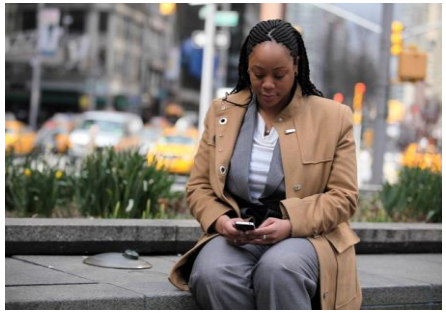
In May 2019 the government launched the digital economy blueprint which sets out the Government's priorities in development of ICT. The blueprint defines five key pillars namely continued digitisation of government services, facilitation of a digital businesses, improvement of infrastructure, innovation driven entrepreneurship and enhancement of digital skills. Key budget allocations in line with this blueprint are;

- Government Shared Services – **2.9billion.**
- Digital Literacy Programme - **3.2billion.**
- Internet- Based Network - **1.1billion.**
- NOFBI Phase II - **2.8billion.**
- Konza Technopolis - **7.2billion.**
- Konza DC & Smart Cities - **5.1billion.**

Significantly more investment is however required to achieve the vision of the blueprint.

Additional investments needed include:

- Expected funding for some of the digital economy initiatives through Public Private Partnerships.
- Capacity building through enhanced digital skills to supplement the Ajira Digital Program.
- Continued enhancement of the e-Citizen portal by making available other services online.
- Creation of an inclusive monitoring framework for the various implementations.
- Partnership with private sector in the analysis of data in the numerous government systems, which will create valuable insights for informed decision making.



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Technology

The government is also seeking to use technology to enhance revenue collection and increase transparency and accountability in the public sector

Revenue enhancement

- National treasury to implement an integrated revenue management system for counties.
- KRA is expected to continue to upgrade ICT systems including full roll out of the integrated customs management system.
- The government also intends to implement Regional electronic cargo tracking system to track transit diversions.

In our view integration of systems across government and use of data and analytics has the potential to support expansion of the tax base, seal loopholes and support enhanced revenue collection

Transparency and Accountability

- The Government intends to support the cleansing of the wage bill to root out ghost workers by fast tracking migration from the current Integrated Payroll and Personnel Database System to IFMIS HR system.
- Plan for an end to end solution for procurement integrated to IFMIS to enhance efficiency, transparency and accountability.
- Recognition of the role data and analytics can play in helping to detect anomalies in public procurement.

Other highlights

- VAT exemption on all locally manufactured motherboards to encourage local assembly
- Endorsement of Stawi loans, a mobile loan product to offer unsecured loans to small enterprises
- All projects funded by the government will be available in a public investment management system portal
- Measures to be put in place to tax income generated from the digital economy. Remains to be seen how this will be achieved and impact on growth of ecommerce

East Africa highlights

Kenya

Summary of growth in 2019

Kenya registered economic growth of 6.3% in 2018 compared to 4.9% in 2017.This growth is the highest recorded for the past 8 years.

- The growth was anchored on a relatively stable macroeconomics and was attributable to increased agricultural production, accelerated manufacturing activities, sustained growth in transportation and vibrant service sector activities.
- Inflation remained low at 4.8% in 2018 compared to 8% in 2017 majorly as a result of considerable decline in prices of food.
- Growth of economy is projected to remain strong in 2019 at almost same level as in 2018, with 7% growth expected over medium term.

Economic drivers in 2018

- Increased agro-processing activities during the year.
- Favourable weather conditions for both crops and livestock production due to long rains in 2018; and
- Stable political environment, withdrawal of travel advisories, improved security and investor confidence in the country.

Government priorities for the year

The government plans to prioritise its spending towards laying the foundation for the Big Four agenda.

The identified key initiatives to achieve the agenda and accelerate economic growth are:

- Creating an enabling environment for business.
- Prudent and efficient spending.
- Mobilisation of domestic resources to fund priority projects / programmes.
- Stabilising and reducing debt; and
- Implementing reforms that will enhance efficiency and competitiveness.

East Africa highlights

Kenya key tax highlights

Income Tax

- Increase of Capital Gains Tax rate from 5% to 12.5%.
- Exemption of CGT on gains arising from group reorganisations.
- Expansion of the scope of services attracting withholding taxes other than management and professional fees.
- Reduced corporate tax rate to 15% in the first five years for companies engaged in recycling plastics.
- Tax exemption on the income earned from housing funds; and
- Tax exemption on income earned by individuals under the Ajira Digital program.

VAT

- Adjustment of the VAT refund formula to ensure that inputs relating to zero-rated supplies are factored in the refund process.
- Reduction of the Withholding VAT rate from 6% to 2%.
- Introduction of VAT exemption for locally manufactured motherboards and all inputs used in their manufacture.
- VAT exemption on all services offered to plastic recycling plants and supply of machinery and equipment used in the construction of the plants.

Customs

- Retention of the import duty rate on iron and steel products at 35% with the corresponding specific duty rate for the products produced in Kenya; and
- Reduction of import duty on raw timber from 10% to 0%.

Excise Duty

- Introduction of Excise duty on betting activities at a rate of 10% of the staked amount.
- Reduction of the excise duty rate on motor vehicles which are purely electric from 20% to 10%; and
- Increase of excise duty on tobacco products, wines and spirits by 15%.

East Africa highlights

Uganda

Summary of growth in 2019

The economy recovered in 2018, growing by 6%. The economy is projected to grow by 6.1% in 2019 and continues to bounce from the low growth of 3.9% in 2017, mainly driven by growth across all sectors.

Inflation remained stable in 2018 at 3.4%, due to the increased food supplies in the markets, relatively stable exchange rate and effective co–ordination of monetary and fiscal policies.

Government priorities

- Expanding the industrial base of the economy.
- Exploiting natural resource endowments with environmental protection in mind; and
- Providing affordable financing for production and business.

Economic drivers, 2019

The government has identified the economic drivers to include:

- Peace, security, good governance and an efficient judicial system.
- Reliable, efficient and affordable electronic supply.
- Water transport and communications infrastructure.
- A healthy, well educated and skilled workforce; and
- An effective government machinery.

Key tax highlights

Excise Duty

- Amendment to provide registration of manufacturers, importers and providers of excisable goods and services.

VAT

- Introduction of 6% withholding VAT; and
- VAT Exemption on agro-processing, rice mills and agricultural sprayers.

Income tax

- Exemption of income derived from leasing or letting facilities in industrial parks for 10 years.
- Reduced withholding tax rate on long term bonds from 20% to 10%.

Stamp duty

- Proposed amendment to provide for a uniform stamp duty payable on bank guarantees, insurance performance bonds, indemnity bond.

Customs duty

- Increase in import tariffs on products which are locally manufactured.

East Africa highlights

Rwanda

Summary of growth in 2019

Rwanda's economy is estimated to grow by 8.6% by the end of the fiscal year FY18/19 which is 1.4% above the government's initial projected target of 7.2%. Industry and services sectors are the main contributors to this growth.

Economic drivers, 2019

- Industry sector-This grew by 10%, much higher than its 5 years' average, and accounted for 16% of the total GDP. The industry was boosted by the recovery of the construction sector, which grew by 14%, as well as recovery in beverages and tobacco industries.
- Continuing good performance in textile production also contributed to the positive growth of the sector.
- Services sector- The service sector grew by 9%, mainly driven by a recovery in wholesale and retail trade and continuing expansion of the air transport segment.
- The agriculture sector- This grew by 6% following favourable weather conditions and various government measures to increase food and other agricultural production.

Government priorities

- Economic Transformation Pillar**:** Accelerate inclusive economic growth and development founded on the private sector, knowledge based economy and Rwanda's natural resources.
- Social Transformation Pillar: Develop Rwandans into a capable and skilled people with quality standards of living and a stable and secure society.
- Transformational Governance Pillar: Consolidate good governance and justice as, building blocks for equitable and sustainable National Development.

Key tax highlights

No major changes were proposed, except for a reiteration that increased tax collection will mainly be supported by continued improvement in tax administrative measures including:

- Revision of the law on tax procedures requiring every person carrying out commercial activities to use the new "EBM for all" expanding coverage to non-VAT registered persons;
- Revision of the consumption tax law aimed at increasing tax collection while at the same time discouraging consumption of some unhealthy products; and
- Fiscal incentives will be granted to some strategic sectors in a bid to support "Made in Rwanda" initiative and the development of a cashless economy.

East Africa highlights

Tanzania

Summary of growth

Tanzania recorded real GDP growth rate in 2018 of 7.0% compared to 6.8% in 2017. The GDP growth was driven by increased investment especially in infrastructure, stable supply of electricity, improvement in transport services and favourable weather conditions that resulted in an increased food harvest and other crops.

Government priorities

The priority for 2018/19 will be on flagship infrastructure projects and in creating a conducive environment for investment and business by implementing the Blueprint for Regulatory Reforms to improve the business environment.

The focus will be on the following priority areas:

- Agriculture.
- Industries.
- Livestock and fisheries.
- Economic growth and human development.
- Improvement of enabling business environment and investment climate.

Revenue policies

The government is committed to increasing and strengthening domestic revenue collections by pursuing the following policies:

- Increase efficiency in administration and collection of domestic revenue.
- Widen the tax base through identification and registration of new tax payers and formalisation of the informal sector.
- Strengthen capacity for monitoring and controlling of transfer pricing.
- Enhance administration of tax exemptions; and
- Improve efficiency in domestic revenue collection.

East Africa highlights

Tanzania key tax highlights

Value added tax

Exemptions proposed include:

- Imported refrigeration boxes, grain drying equipment, aircraft lubricants by domestic operators, National Air Force and Airlines recognised under bilateral air service agreement.

Zero rating proposed:

- Supply of electricity from Tanzania mainland to Zanzibar.

Exemptions abolished: Sanitary pads

Income tax

- Reduction of the CIT rate for new investors in the production of sanitary pads from 30% to 25%.
- Increase in minimum turnover required for a taxpayer to prepare audited financial statements to TZS 100m.
- Changes in presumptive tax rates and now applies to taxpayers with annual turnover upto TZS 100m.

Withholding tax

Proposed changes includes:

- Exemptions on fees charged to Government on loans received from non residential banks and other international financial institutions.

Excise duty

Proposed impositions

- 10% on locally made artificial hair and 25% on imported ones.
- 10% on pipes and plastics materials.
- Exemptions-Aircraft lubricants by domestic operators, National Air Force and airlines.

Customs

- To protect local industries, duties have been increased on the following imported products: roasted coffee, flat-rolled products of iron or non-alloy steel ,flat-rolled products of iron or non-alloy steels, reinforcement bars and hollow profiles, horticultural products and monofilament.
- Duties have been decreased/remitted on the following products: baby diapers, equipment and appurtenant used for polishing and heat treatment of gemstones, papers used as raw materials for manufacturing of packaging materials for export of horticulture products, agricultural seeds packaging materials and aluminium alloys used as raw materials to manufacture aluminium pots.

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Thank you

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