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The home stretch...

Kenya's 2016/17 National Budget

PwC insight and analysis

June 2016

Welcome

This newsletter is the third in our series of 2016/17 budget highlights and analysis.

The analysis is based primarily on the 2016 national budget speech as presented by the CS National Treasury to Parliament on 8 June 2016.

We hope that you will find it insightful, and look forward to your comments.

In this bulletin

Direct taxes

New Income Tax Act…still a waiting game

During his budget statement for 2015/16, the Cabinet Secretary (CS) promised an overhaul of the current Income Tax Act by introducing a bill for a modern tax code, and this bill was expected to be ready by September 2015. One year down the road, the CS has yet again made a similar promise to table a bill in the parliament in the next financial year.

This therefore provides sufficient time for stakeholders to provide their input before the draft bill is presented to the National Assembly.

Perhaps in view of the expected new income tax act, the CS in his budget statement proposed few amendments affecting direct taxes which we discuss below.

Corporate income tax changes

Tax incentive for graduate apprenticeship

In the Budget Statement for 2015/16, the CS introduced a tax incentive for employers who engage apprentices. However, no guidelines were provided to operationalise this incentive. In the Budget Statement for 2016/17, the CS now proposes to Gazette Regulations that will provide clarity to employers who engage university graduates on apprenticeship.

Employers will now get an additional tax deduction of 50% of the cost of the apprenticeship emoluments. This translates to a tax benefit to the employers of about 15% of the cost of emoluments of the apprentices. In order to enjoy the incentive, employers must engage at least 10 graduates.

While the regulations are a welcome move, it is not clear from the CS budget statement whether the incentive would extend to companies that engage apprentices from other tertiary institutions such as technical colleges. Further, the incentive may not be have a significant impact for a company that has significant tax losses.

Lower corporate tax rate for residential estate developers

With the current annual housing supply gap in Kenya standing at about 150,000 units per year especially in the low cost housing market, the CS proposes to reduce the corporate tax rate from 30% to 20% for housing developers who construct at least 1,000 units per year.

Though a welcome move, the incentive may not yield immediate desired benefits to the developers. This is because such projects are capital intensive with significant financing costs and tend to have tax losses during the initial years. In addition, construction projects have long lead times and therefore the requirement for 1,000 units per year may pose a practical challenge for the uptake of this incentive.

The investors that the incentive targets face cash flow challenges and high interest costs. Perhaps a tax rebate on other taxes that the developers incur in the course of construction such as VAT would have been more effective.

Tax incentives for all employees

Proposal to expand income tax bands and increase personal relief

An attempt to expand tax bands

For over a decade, the PAYE brackets have remained unchanged despite the year-on-year increase in the cost of living.

In a move to address the plight of the country's employees, the Government has proposed to expand the tax brackets by 10% and increase the personal relief from the current KES 13,944 per annum (KES 1,162 per month) to KES 15,338 per annum (KES 1,278 per month).

This proposed review will be formalised once the Income Tax Act Cap. 470 is overhauled.

The proposed increase is a welcome move but may have little impact on majority of the employees considering the prevailing high inflation rates.

Relief for low income employees

Government exempts from tax bonuses, overtime and retirement benefits for low income employees

Enhance tax free income for low income earners

Following the President's announcement recently, the Government has confirmed the proposal to exempt the following from tax: bonuses, overtime and retirement benefits paid to employees whose earnings do not exceed KES 121,969 per annum.

The proposal is meant to cushion the low income earners from the high cost of living. However, this is bound to be a challenge administratively in ensuring that only those who are genuinely low income earners benefit from the tax exemption.

To achieve more impact, the alternative would have been to consider raising the monthly tax free income to approximately KES 20,000 from the current KES 11,135.

This would have provided much needed relief across all employees.

Amnesty

Tax amnesty for diaspora investors

Government's proposal for tax amnesty remains unclear

The Cabinet Secretary has proposed a tax amnesty for persons with investments outside the country provided they submit their returns and accounts for the year of income 2016, between 1st January 2017 and 31st December 2017. This is a generous amnesty since those who take up this amnesty shall have all principal taxes, interests and penalties for the year of income, 2016, and the prior years waived in full.

It remains unclear how the tax amnesty will be implemented to achieve the Government's objective of attracting re-investment of income from foreign assets and businesses.

Simplified taxation of rental income

Government to gazette rules to enhance tax compliance among landlords

KRA to appoint withholding tax agents for collection of tax on rental income

The Finance Act 2015 introduced a simplified tax on residential rental income for landlords whose annual gross rental income is KES 10 million or less. The landlords falling under this category are required to pay residential rental income tax at a flat rate of 10% on the gross rental income. The new tax regime took effect on 1st January 2016.

To enhance compliance amongst landlords, the Cabinet Secretary has introduced a minimum taxable threshold of KES 12,000 per month. Based on our interpretation of the Budget speech, this means that gross income of less than KES 12,000 will not be taxable. We await further clarification once the Finance Bill is issued.

Under the new proposals, the Commissioner will also have the power to appoint withholding tax agents for rental tax.

Despite efforts by KRA to address tax compliance in the real estate sector, the level of compliance has remained low. We still await the gazettement of regulations to facilitate the implementation of this law.

More powers to collect tax data

Tax Procedures Act, 2015 to be amended to grant KRA more powers to gather information in advance

Proposed amendment of Tax Procedures Act, 2015

The Government proposes to amend the new Tax Procedures Act, 2015 to grant KRA more powers to collect information in advance, from "identified persons" for purposes of pre-populating the information in the i-Tax System.

This is meant to simplify tax administration by making it easier for taxpayers to submit tax returns via i-Tax since their information will be pre-populated online.

This is a measure to enhance compliance and improve on tax collection. We await further guidelines to be provided on the implementation of this proposal.

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Indirect taxes

Value Added Tax (VAT)

Introduction

The Cabinet Secretary (CS) for the National Treasury has introduced a raft of changes in an attempt to spur growth of industries, employment creation and enhance equity and fairness in tax administration.

The CS seems to rely on a VAT exemption policy to achieve the stated objectives. However, three years since the implementation of the VAT Act, 2013, the government needs to re-assess whether this approach is still a viable option in achieving its economic growth agenda given the hidden costs associated with VAT exemption.

We set out below some of the salient VAT changes proposed by the CS:

1. Supply of garments and leather footwear by EPZ exempted

As part of the government's initiative to create employment as well as enhance the role of Export Processing Zones (EPZs) in growing the Kenyan economy, the CS proposes to exempt from VAT the supply of made-up garments and leather footwear supplied by EPZs.

While it is expected that Kenyans will have access to new clothes and shoes at affordable prices, one wonders what will happen to the so called "mitumba" industry.

2. A shot in the arm for the ailing tourism sector?

Park Entry fees now exempted

The CS has proposed to exempt from VAT park entry fees to National Parks in a bid to boost the ailing tourism sector and promote local tourism.

While this exemption is a welcome move, perhaps it should have been extended to cover privately owned and managed game parks as well.

Commissions earned by tour operators

Currently, commissions earned by tour operators are subject to VAT at 16%. However, in a deliberate effort to make our tourism industry more competitive and also promote creation of employment; the CS proposes to exempt from VAT commissions earned by tour operators.

It will remain to be seen if the exemption will lead to a reduction in prices charged by the tour operators and if this will attract more tourists into Kenya given the other challenges such as travel advisories that currently plague the sector.

3. Raw materials used in the manufacture of animal feeds exempted from VAT

Under the VAT Act, 2013, most animal feeds are exempt from VAT while some of the raw materials used in their manufacture are taxable at the standard rate of 16%. This results in high prices of animal feeds since the non-recoverable VAT incurred by the manufacturers of the feeds is passed on to the farmers.

The CS has proposed to exempt all raw materials used in the manufacture of animal feeds from VAT. This, it is hoped, will result in lower prices of animal feeds and spur growth in the agricultural sector.

4. Reintroduction of Withholding VAT?

The Tax Procedures Act,2015 (TPA) which was enacted with effect from 19 January 2016 deleted the provisions governing the appointment of withholding Value Added Tax (WH VAT) agents and the administration of WH VAT.

However, the government continues to view WH VAT as a critical measure in enhancing VAT revenue collections. In his speech, the CS emphasized that the appointment of county governments as WH VAT agents is one of the ways that KRA has adopted to seal revenue leakage. It is therefore likely that the Finance Bill 2016 will reintroduce the WH VAT provisions.

The WH VAT system has faced various headwinds owing to the challenges that have been faced by taxpayers in relation to compliance with the system. We await to see how the reintroduction of this system will address these challenges.

5. Transitional exemption period extended for petroleum products

The exempt status of petroleum products, which had a transitional period of three years up to September 2016 has been extended for one more year. This is a welcome move as it guarantees stable prices of petroleum products, which in turn helps contain the cost of living and infation for the consumers.

6. VAT exemption for liquefied petroleum gas (LPG)

In an effort to make clean, safe and efficient household energy accessible to Kenyans, the CS proposes to exempt LPG from VAT. The proposed change is aimed at reducing the reliance on wood and charcoal, which are perceived to be unhealthy.

Expectations not met

The changes proposed by the CS to exempt a number of items from VAT are largely aimed at reducing the cost for the consumers of the goods and services. However, in reality, VAT exemptions result in added costs for the "mwananchi" as the non-recoverable VAT associated with exemption is ultimately passed on to the consumers in the form of higher prices for goods and services. We had hoped for a policy change in favor of zero-rating.

Additionally, we had expected that measures to address delays in the payment of VAT refunds would be introduced as part of the proposed changes. However, these measures remain elusive and the challenges around VAT refunds are bound to persist!

Lastly, access to quality and affordable books and learning materials has been a challenge for many Kenyans partly due to VAT being levied at 16% on such materials. We had hoped that the CS would offer reprieve to the learners by abolishing VAT on books but alas, our wish remains a wish.

Promoting growth of industries and employment creation

Customs and Excise duty

Customs duty

Introduction

The Government's proposals are aligned towards protecting local industries and creating employment. This will is to be achieved by increasing import duty on importation of specific finished products and introduction of duty remission schemes to encourage importation of raw materials for local manufacture.

These initiatives notwithstanding, the Government must find ways to ensure that the quality of the locally manufactured products is up to international standards for investors to stop importing and "buy Kenya".

Further, the Cabinet Secretary's remarks comprise proposals to the East Africa Community (EAC) Council and the changes will be ratified through the EAC Gazette and are expected to take effect from 1 July 2016.

Protecting the local iron and steel industry

The Government has proposed to introduce a specific import duty rate of USD 200/MT on iron and steel products, which are manufactured in the region.

This is in a bid to cushion local manufacturers from unfair competition and create more jobs in the iron and steel sector.

Local production of aluminum cans

To encourage and protect the local production of aluminium cans, the Government has proposed to:

- Remit, under the EAC duty remission scheme, import duty on aluminium plates and sheets used in the manufacture of aluminium cans. Previously, these sheets were subject to import duty at the rate of 10%; and
- Increase import duty on importation of aluminium cans from 10% to 25% making the import of these products into Kenya more expensive.

Affordable equipment for the pharmaceutical industry

In order to encourage compliance with good manufacturing practices as dictated by the World Health Organization, the Government has proposed to exempt from import duty heating, ventilation and air conditioners (HVAC) for the pharmaceutical industry. This will make the equipment more affordable and accessible to manufacturers of pharmaceutical products.

Growth of EPZ Industries

With a view to encouraging growth of industries in the Export Processing Zones (EPZ) and enhance employment creation, the Government has proposed to stay application of import duty (at the rate of 0%) on the purchases of made up garments and leather footwear from the zones. This should allow Kenyans local access to affordable clothes and shoes.

Protective role of Customs

The Cabinet Secretary has proposed to introduce legislation that will streamline the training, licensing and regulation of Kenya clearing agents. This is aimed at strengthening controls in the import supply chain in an effort to curb the increasing inflow of contraband products, threats of terrorism, drug trafficking and related cross-border criminal activities.

Fast-tracking of cargo clearance

The Government has reiterated its commitment to moderniz-ing the port of Mombasa through expansion of its container terminals and the on-going implementation of the 'Single Window System' is expected to facilitate faster, efficient, competitive clearance of cargo and position the port of Mombasa as a preferred hub in Eastern and Central Africa.

Energy efficient stoves

In order to encourage use of energy efficient stoves, the Government has proposed to reduce import duty from 25% to 10%. This is intended to promote use of safe energy.

Customs and Excise duty

Excise duty

Introduction

The Excise Duty Act 2015 has been in force for 7 months since its enactment on 1 December 2015. The Act is viewed as a modern and simplified tax legislation and was aimed at yielding more revenues for the Government. However, the Government has faced a revenue shortfall in the current fiscal year, which possibly informs the proposed changes aimed at increasing excise collections and eliminating inequities caused by past changes in law. The proposed changes include the following.

Excise duty on motor vehicles

The Cabinet Secretary has proposed to amend the excise duty on motor vehicles from the current specific duty rates of KES 150,000 and KES 200,000 dependent of the age of the vehicle to an ad-valorem rate of 20% based on the value of the vehicle. The change is aimed at promoting equity amongst importers/purchasers of both low and high end vehicles.

Promoting growth of industries and employment creation

Excise duty on illuminating kerosene

The Cabinet Secretary has proposed to re-introduce excise duty on illuminating kerosene at a rate of KES 7,205 per 1000 litres. It is hoped that the introduction of the duty, and by extension an increase in the price of kerosene, will discourage harmful practices such as its use in adulteration of other petroleum products, which has been prevalent following excise duty removal on the product in 2011.

Excise duty on cosmetics and beauty products

The Cabinet Secretary has proposed an introduction of excise duty at 10% on cosmetics and beauty products with effect from 1 July 2016. This proposal is aimed at harmonization of the excise duty regime in the EAC region.

Unmet expectations

In his 2015 budget presentation the Cabinet Secretary alluded to the elimination of excise duty on mineral water but this was not effected. We had hoped that this proposal would be revisited and implemented this year alongside the exclusion of fruit juices from the ambit of excise duty. Unfortunately, the change remains elusive!

Other Levies

From the budget statement, the Cabinet Secretary for the National Treasury (CS) has proposedmeasures aimed at spurring growth in various sectors.

It is noteworthy that the CS has proposed to abolish several levies including the Sugar Development Levy (SDL), the National Environmental Management Authority (NEMA) and the National Construction Authority (NCA) levies.

The proposed changes include:

Ad valorem levy on tea

Removal of ad valorem levy on tea

Since 2012, tea farmers in the country have been required to pay a 1% percent ad valorem levy on the sale price of each kilo of tea sold at auction hence the abolishment will come as reprieve to farmers.

> In what is a positive move for the country's tea farmers, the ad valorem tea levy has been scrapped.

The 1% is unlikely to have a major positive impact on the earnings of small scale farmers who rely on tea farming for their livelihood. However, in the long run, the move may result in the improved competitiveness of Kenyan tea in the international markets if the savings are reinvested towards improving yields and quality.

Sugar Development Levy

Sweet news for the sugar industry

The ex-factory price paid by wholesalers incorporates the cost of sugarcane as the raw material input, milling, processing, packaging, factory operations, the factory's margin, and government levies, which include a 4 percent sugar development levy and a 16 percent Value Added Tax (VAT).

This move will only benefit sugarcane farmers if the savings from the abolishment of the levy are actually passed on to them by the manufacturers. It will also be interesting to see if the move will result in reduced costs to end consumers.

> Sugar Development Levy which applied at the rate of 4% on the net price of sugar has been abolished

Levies charged by NEMA and NCA

No more NEMA and NCA levies!

In a move aimed at reducing the cost of doing business and eliminating administrative hurdles, the Cabinet Secretary has done away with all other levies including those charged by the National Environmental Management Authority and the National Construction Authority.

It remains to be seen how this will be implemented and whether all levies charged under different legislation will be done away with.

To encourage tourism in the country, the CS has proposed the establishment of a Special Tourism Promotion Fund to be financed by Air Passenger Service Charges.

Air Passenger Service Charges

Increase in Air Passenger Service Charges paid by external travellers

To secure adequate financing for the Special Tourism Promotion Fund, the Air Passenger Service Charges have been increased by 25% for external travellers from $40 to $50 and for internal travel by 20% from KES 500 to KES 600, the latter move appears to contrary to the government's policy objective of encouraging domestic tourism.

Roads Maintenance Levy

The Roads Maintenance Levy has been increased by 50% from KES 12 to KES 18

Users of petroleum products are set to fork out more at the pump following a 50% increase in the RML.

This will not only affect road users but also other heavy users of these products including train operators and power generators.

These increased costs will be passed on to end consumers which is likely to increase the cost of transporting goods and people within the country which will ultimately affect headline inflation.

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Economic Overview

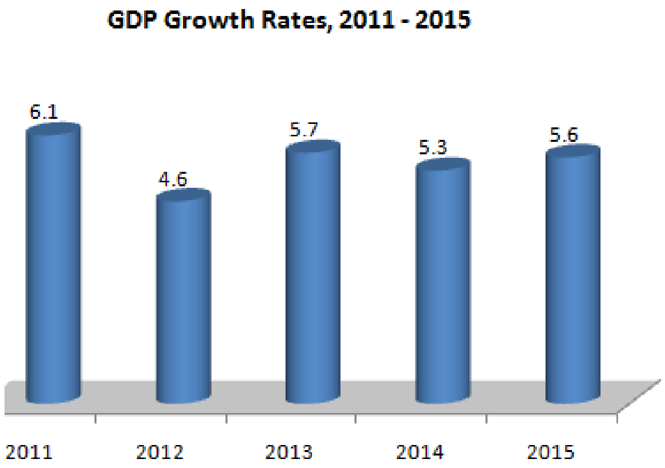
Kenya's optimistic growth

Economic overview

Modest Growth

With a 5.6% GDP growth in 2015, the Kenyan economy is holding up. This was supported by stable macroeconomic environment and improvement in outputs of agriculture, construction, finance and insurance and real estate.

We also have had the benefit of sound fiscal and monetary policies, a resilient private sector, prosperous trading partners, favourable weather conditions, improved terms of trade for agriculture – the economy's pivotal sector – and the impact of ongoing reforms in the public sector.



Growth is also driven by several key factors including a reasonably well-educated labour force, diverse natural resources, the port that serves as an entry point for East African and Central African countries and a relatively stable political environment and devolution.

Macroeconomic stability

Sound fiscal and monetary policies and a resilient private sector have been key in maintaining macroeconomic stability. The average annual inflation rate was 6.6% in 2015 largely due to reduced costs of petroleum products, electricity and tightening of the monetary policy.

Kenya's GDP accounts for 40% of the region's GDP, followed by Tanzania at 28%, Uganda at 21%, Rwanda at 8%, and lastly Burundi at 3%.

Facts (2015)	Kenya	Uganda	Tanzania	Rwanda
Real GDP growth (%)	5.6	5.0	7.0	7.2
Population (Millions)	44.2	38.8	55.0	11.9
GDP per capita (USD)	1,588	422.0	600.6	695.7
Inflation rate (%)	6.6	4.9	5.6	4.5
Fiscal Deficit as a percentage of GDP	8.7	4.5	3.5	4.7
Public debt as a percentage of GDP	48.6	34.8	36.9	33.7
Taxes as a percentage of GDP	16.8	13.2	14.82	21.9

Regional Outlook

The economic outlook for 2015 across the EAC region was largely positive with growth expected to rise to around 6.8 per cent this year, driven by Kenya and Uganda. Inflation in the region was expected to increase to 7.6% where in Tanzania this would be driven by a weakening shilling and rising electricity prices. The region has also seen major investments in both national and regional infrastructure.

According to the World Bank, future growth for the East African Community is expected to hinge on domestic resource mobilization and transformation in driving private sector-led growth. With a positive growth trajectory predicted over the medium term, the EAC shows great potential for reaching a developmental tipping point.

Keeping up with the pace

Rapid urbanization

Urbanisation and GDP

Kenya is urbanizing at a rate of about 4.3% per year and has an estimated 27% of its population living in urban areas. Urban economic growth in Kenya has been established around population centers and productive agricultural regions along the Northern Corridor, which connects Mombasa through Nairobi to Malaba, with a branch line to Kisumu.

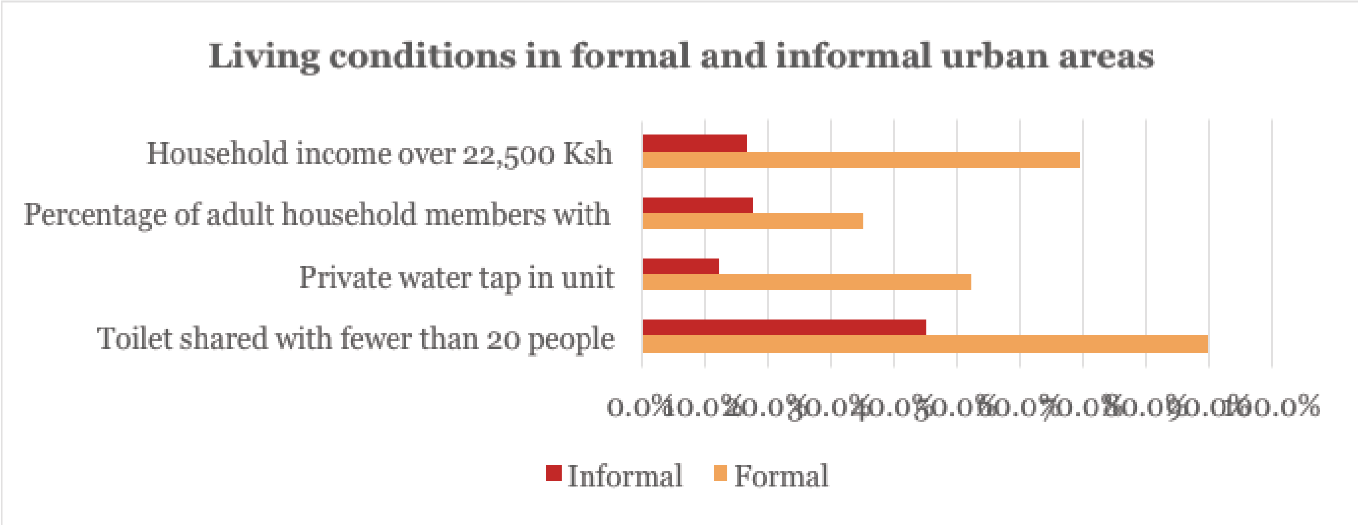
More than 85% of urban dwellers live in remote towns within a 35 kilometers radius of this Northern Corridor. This also forms the bulk of major consumers of goods and services.

> For Kenya to reach a GDP per capita comparable to East Asia's when that region reached the 50% urban population mark, its economy would have to show real GDP growth of 8.9 percent a year from now to 2050. Source: World Bank Urban Review Kenya, 2016.

Good connectivity between Nairobi and its satellite towns remains the main driver of population and economic growth. Of the 25 largest urban areas in Kenya, 10 (including Nairobi itself) are within the Nairobi metropolitan area. These 10 cities have about 5.77 million people and nearly 40 percent of Kenya's urban population. Nairobi City County alone contributes about 60% to the National GDP.

Failing to keep the pace

Over the past years, Kenya has made major strides in developing its infrastructure. However, the services required to accommodate the large population in the cities have not kept pace with the urbanization rate. The investment in network infrastructure is failing to keep up with demand in urban areas, generating a large infrastructure deficit.



Housing Market

The demand for urban housing will continue to grow as Kenya urbanizes. In 2010 the demand for urban housing was estimated at around 80,000 units a year, with demand projected to increase to nearly 300,000 units a year by 2050. By comparison, in 2013 only 15,000 housing construction permits were issued in Nairobi, where most demand exists, and most of these were for high-income apartments.

Only 2% of formally constructed houses are targeted to the lower income segments of the market. The high cost of formal housing means that home ownership is out of reach for most urban Kenyans.

This has lead to 91% of Kenya rent houses. This presents an opportunity for mortgage providers to be innovative in tapping this market.

Creating jobs for all

Employment

Employment by Industry and Sector

The economy generated a total of 841,600 new jobs in 2015 with 85% in the informal sector. The private sector employment growth was higher at 5.4% compared to public sector employment growth at 2.5%, while self-employment grew at 19.6%. Youth have been particularly affected by weak formal job creation. In particular, in 2012, youth aged 15 to 24 accounted for less than 19% of total employment, whereas they made up over 35% of the working-age population.

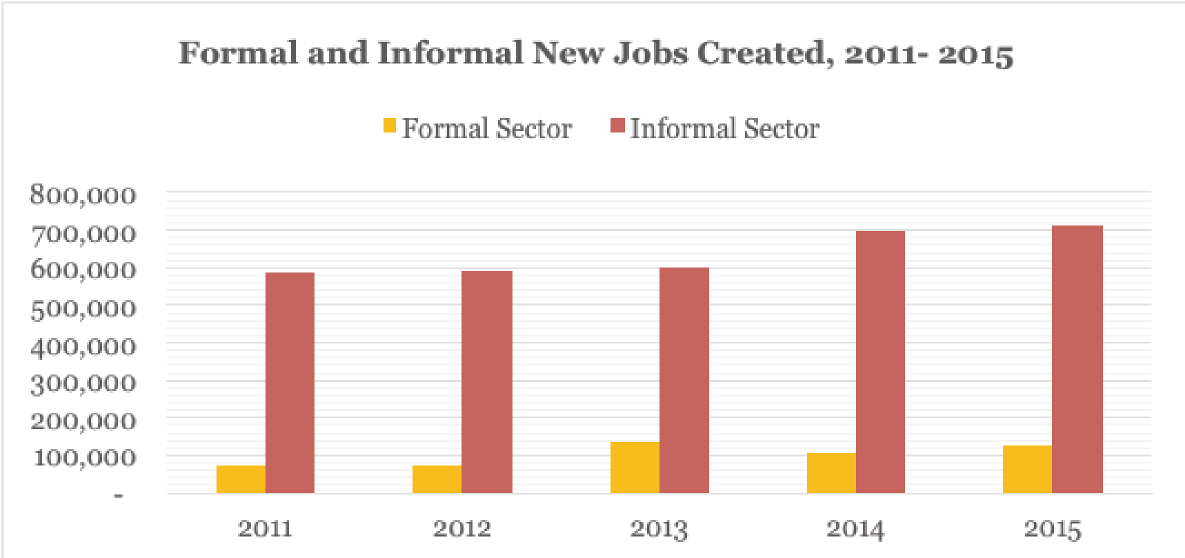
Employment in the modern sector registered an increase of 107,800 in 2015 compared to 87,100 in 2014. There has been a slow down in public sector employment (2.5% in 2014 and 2015) attributed to restricted recruitment mainly to essential services and replacement of those leaving the service through natural attrition in an effort to contain the public sector wage bill.

In 2015, the largest contributors to wage employment were education, agriculture, manufacturing and wholesale and retail trade. The sectors with the highest growth in employment in 2015 were Mining and Quarrying (12.5%), Construction (11.3%) and Water Supply (10.6%).

A key concern is the sustainability and productivity of the jobs created. According to the World Bank (Kenya Economic Update, March 2016), Kenya is short of high productivity jobs. The jobs generated in the informal sector are low-productivity jobs. Formal sector jobs are more productive and higher paying than informal sector jobs, but the economy is generating fewer of these jobs.

The government planned investment in the youth through the Youth Fund and Uwezo Fund and also investments in Technical and Vocational Education and Trainin is a step in the right direction, towards broadening the skills of the youth entering the jobs market beyond formal education.

There is also a need for active policies to promote enterprise such as by reducing the cost of doing business and providing opportunities for growth of small household enterprises to expand and to enter local and global value chains and creating linkages between the formal and informal sectors. These policies will improve productivity.



Looking ahead

Sector highlights

Tourism

Tourist arrivals and earnings from tourism continued a downward trend in 2015; the sector contributed Kshs 84.5 billion in earnings, compared to Kshs 87.1 billion in 2014.

There is optimism that the sector will rebound in 2016 on the back of reduced security incidences and relaxed travel advisories by Western nations. KSh 4.5 billion has been allocated for tourism promotion activities.

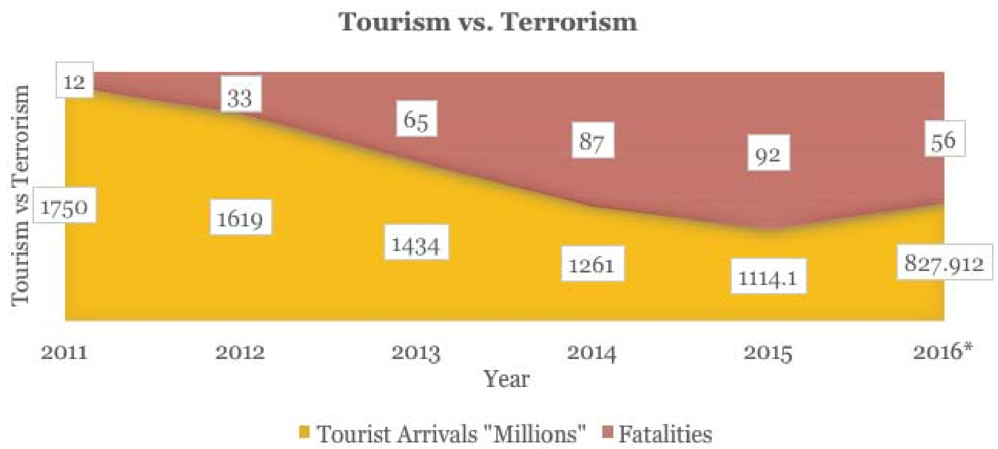
Kenya is susceptible to terrorism and radicalism. The Government will focus this year on improvement of the police to population ratio, police welfare, adaption of modern technology and security interventions. The Government will allocate Ksh 124 billion to make these improvements.

To boost local tourism, the Government introduced incentives such as the exemption of VAT on entry fees of National Parks; commissions of tour operations are also exempt from VAT.

Tourism key Facts:

Decrease in international visitors from 1.35m in 2014 to 1.18 m in 2015

Security concerns, negative travel advisories, health concerns on Ebola



Agriculture

Agriculture and manufacturing have the highest contribution to the GDP. The Government intends to move away from rainfed agriculture and focus on irrigated agriculture to build resilience in the economy.

Drawing from the lessons learned from 10,000 acres pilot phase in Galana-Kulalu, the programme will expand to cover at least 100,000 acres in Galana-Kulalu and other designated suitable schemes throughout the country involving the private sector. Ksh 20.8 billion is allocated for on-going irrigation projects countrywide including the Galana-Kulalu Irrigation Project interventions to transform agriculture from subsistence to productive commercial farming.

However, the budgetary allocation remains relatively low given the significance of the sector and has decreased by 12.9 billion compared to FY 15/16. There is need for a more concerted effort by the government (at both levels) to allocate more resources to this sector given its penetration in the society and contribution to sustained economic growth.

Housing

Low cost housing is steadily growing particularly in the urban centres. Currently demand for housing is estimated at about 200,000 units annually with only 50,000 new units constructed every year thereby occasioning a shortage of 150,000 units annually.

To bridge this gap and also ensure decent low cost housing, incentives have been introduced to encourage investors to enter into this sector by reducing the corporate rate of tax from 30% to 20% for developers who construct at least 1,000 units per year. This is however a challenge for many developers.

Looking ahead

Sector highlights

Manufacturing

The manufacturing sector is a key driver of economic growth particularly in the agricultural sector through the growth of exports and job creation. For this reason, the government is keen to establish industrial and technology parks to catalyze innovation and value addition.

The government will also establish green industrial parks under the Special Economic Zones along the SGR line from Mombasa to Western Kenya (including the shores of Lake Victoria) and within the proximity of geothermal wells to provide cheaper and faster transport and logistics, access to near free steam and water, cheaper geothermal power and leverage other by-products for industrial, livestock and agricultural development.

The initiatives include the revival and support of the companies which have the potential to make significant contributions to the growth of the economy and spur job creation. These companies include Mumia Sugar Company, Rivatex, Pan Paper Mills, New KCC and Kenya Airways.

The government is also focused on stimulating local inputs to spur the development of SMEs in Kenya. In addition to reviving Rivatex, the Government is supporting the export processing zones to make the products more competitive in the local market by exempting VAT for locally made garments, clothes and shoes.

Construction

The Government has continued to develop an efficient and effective infrastructure for rapid and sustained economic growth as well as enhancing national, regional and international integration and trade facilitation.

In 2015, the country witnessed a thriving construction industry registering a growth of 13.6 per cent compared to an expansion of 13.1 per cent recorded in 2014 (Economic Survey, 2016).

Formal sector employment in the Building and Construction industry grew by 11.4 per cent in 2015, to stand at 148.0 thousand up from 132.9 thousand in 2014. The majority of these jobs were created in the private sector.

Infrastructure development

The Government will continue with the on-going public investments in roads, rail, ports, energy and water supplies in order to propel Kenya's economy towards prosperity.

The Government will continue to enhance road network connectivity across the country with the aim of enhancing trade, commerce, agricultural productivity and regional trade. In recent years, the increase of infrastructure projects has had a positive impact on the job market.

An effective railway system will significantly reduce the cost of transport, facilitate faster and cheaper movement of freight and passengers and enhance competitiveness of the economy thereby positioning Kenya as a regional business hub. Developing industrial parks along the railway will increase the industrial development.

Looking ahead

Business Environment – slowly getting there

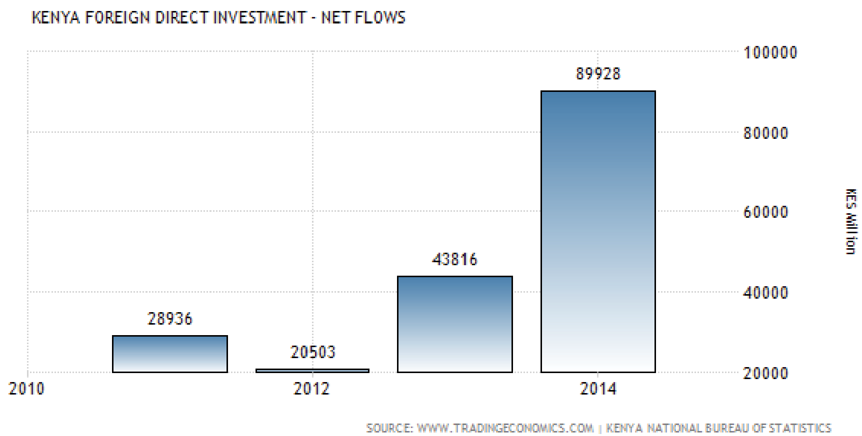
Ranking business environment

According to the World Bank's ease of doing business indicator for 2016, Kenya is ranked 108 out of 189 and recorded a notable improvement of 21 places from the previous year.

The improvement is mainly due to the introduction of the Business Registration Services Act 2015, the creating of 40 Huduma centers, the introduction of mobile banking and the automation of services needed to start or run a business.

The formation of a financial centre authority as well as an arbitration centre, the Nairobi International Finance Center, are expected to enhance Nairobi's appeal to investors. garments, clothes and shoes.

Indicators that determine ease of doing business	2016 rank	2015 rank
Starting a Business	151	148
Dealing with Construction Permits	149	152
Getting Electricity	127	141
Registering Property	115	121
Getting Credit	28	118
Protecting Minority Investors	115	114
Paying Taxes	101	99
Trading Across Borders	131	131
Enforcing Contracts	102	102
Resolving Insolvency	144	145



Looking ahead

What Does This Mean for Business?

Macro economic indicators are expected to remain stable in 2016 to support growth; inflation is expected to be contained with the target of between 2.5% to 7.5%.

Higher lending rates increased non-performing loans from 5.4% of total loans in December 2014 to 6.1% in 2015 (World Bank, Kenya Economic Update, March 2016).

If not checked, domestic deficit financing could lead to an increase in lending rates, with the high cost of credit tempering growth in key sectors; a shift to external financing will increase access to credit by the private sector, and boost private consumption and investment.

To address this deficit and reduce the 'crowding out' effect, government needs to expeditiously adopt the Treasury Single Account to streamline cash flow management with increased visibility of cash deposits and ensure absorption of development funds is accelerated.

The Monetary Policy Committee (MPC) has maintained the benchmark interest rate at 11.5% since July 2015. According to the MPC Perception Survey conducted in March 2016, the private sector has maintained its optimism for improved business conditions and high growth in 2016.

There were no shifts in the government's policy direction in this budget. This is important for businesses to continue operating within a predictable, consistent and stable policy environment.

The completion of infrastructural projects, continued reform in public service and deepening of devolution will provide incentives for more investments.

The government's capacity to spend, enhanced by more outsourcing of implementation to the private sector, and alignment of cash flow management for sustainable debt management and toning down of pre-election rhetoric will be critical to the success of the budget execution and uninterrupted economic activities.

On the other hand, businesses have to be smart and innovative. We need to exploit fully the knowledge capital at our disposal. Prudent investments and robust cost control measures– including a review and streamlining of business process and digitization—will be important for benefits to be realized.

Devolution

Focus on efficiency for sustainable devolution

Commitment to Devolution

Devolution is rated the biggest gain from the August 2010 constitution, which ushered in a new political and economic governance system. It is transformative and is expected to strengthen accountability and public service delivery at local levels.

With the current proposal, over 1 trillion will have been transferred to counties over a period of 4 years. The focus should now shift towards determining whether value for money objectives have been met. This may be a main scorecard through which the elected leaders will be measured, especially as we approach elections.

Previously, there was no recognition of Counties as procuring entities. For this reason, the proposed amendment to the Public Private Partnership (PPP) Act shall allow counties to independently enter into agreements with private sector entities in the provision of services through PPP projects. This is aimed at accelerating development and service delivery.

Additionally , the development of the retirement benefits framework is expected to help spur mobility of the county workforce.

Enhancement of own revenue

The new revenue frontiers

Although counties continue to rely heavily on their share of the national revenue, there are positive steps towards raising revenue from other sources such as donor funding and local revenue generation.

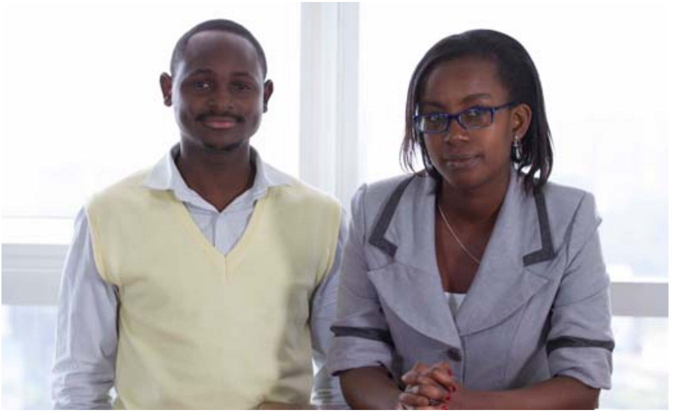
The budget proposes the following measures to enhance revenue at county levels.

National Treasury, jointly with all the relevant state agencies as well as the Council of Governors, has commenced a process to develop a National Policy and Legal Framework to guide County Governments' revenue raising measures particularly on own-source revenue and enhance their own-source revenues, reduce the tax gap and improve the alignment between county budgets and policy priorities.

County governments must institute austerity measures, reducing wastage, and moving more resources from recurrent to development expenditure.

Although this is not the first time that the counties are acting as withholding VAT agents, there is renewed focus towards sealing revenue leakage through non-compliance by targeting suppliers to county governments.

We invite our clients to assess the impact of the above described legislation on their businesses and to anticipate on whether this could affect their business going forward.



Although counties continue to rely heavily on their share of the national revenue, there are positive steps towards raising revenue from other sources such as donor funding and local revenue generation. As the counties spend their allocation, we expect them to reflect a cautious balance between the need to diversify revenue sources, and maintaining a conducive business environment devoid of punitive business rates, levies and taxes.

Sectoral Approach to Devolution

Allocations to County Governments amounting to KSh 280.3 billion as the equitable share of revenue raised nationally: What impact does this make on counties?

33% of national revenues has been allocated to counties which is more than double the minimum threshold of 15%. There is however a challenge in the absorption of these funds which is largely caused by a lack of appropriate structures and internal control mechanisms to support the absorption of funds. Counties must have structures in place that can run through an entire procurement cycle more efficiently and in a timely manner.

The national government is keenly supporting the health and infrastructure sectors and to this end has allocated KSh 23.9 billion as additional conditional funding to counties. The larger proportion of this funding will support the health sector, with remaining funding going towards road maintenance in counties. Development partners continue to play a key role in these initiatives.

Decongesting urban centers in counties will be among the major focus areas in the coming days. For example the success of Nairobi's implementation of Mass Rapid Transit (MRT) systems, if well implemented, can be rolled out to other urban centers that have been earmarked as growth poles.

Counties have an opportunity to attract investors in the real estate sector by providing incentives to facilitate developers of low cost housing for them to provide necessary housing which ordinarily would be the responsibility of both levels of government.

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Sectoral reforms

A strong and stable banking sector

Tightening supervision

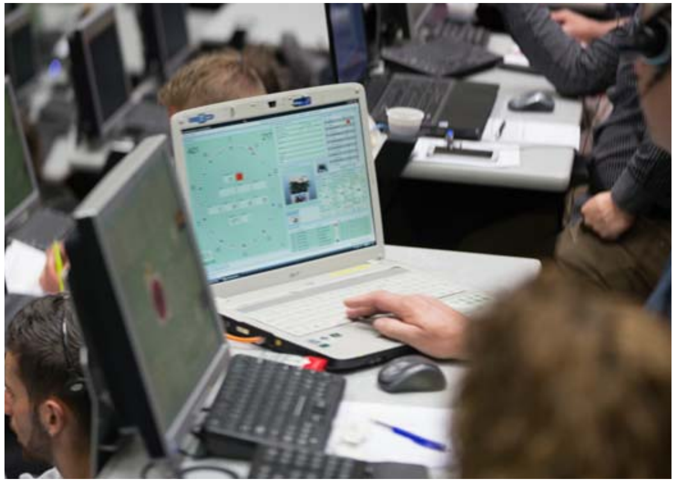
Following the recent crisis in the sector, the Cabinet Secretary announced measures to strengthen supervision and increase stability.

In response to the root causes linked to the recent failure of three banks, there are proposed measures to increase Central Bank of Kenya's (CBK's) supervisory capacity, with specific emphasis on ICT and forensics expertise. We now await to see the rigour with which the CBK will undertake its supervisory role.

Similarly, the Cabinet Secretary has indicated he intends to strengthen corporate governance practices in banks. Failure in governance has been cited as the biggest reason for the recent bank failures.

The CS proposes to increase the maximum penalty for violation of the Banking Act or CBK Prudential Guidelines

Revised penalty levels may still not be a sufficient deterrent.



from the current Shs 5 million to Shs 20 million, with additional penalties for each day that the violation continues.

The global market has seen significant penalties being levied by regulators for violations. While the increased penalties are an improvement, they may still not be punitive enough to act as a deterrent, especially for larger banks.

The Cabinet Secretary also made a proposal to enhance the Banking Act and the Kenya Deposit Insurance Corporation (KDIC) Act to provide for prompt resolution for banks in distress in line with the new Insolvency Act. This is out of the learnings from the 3 banks recently put under receivership.

Only half of the players meet the proposed minimum core capital level.

Further, the CBK will work with other agencies to ensure prompt investigation and prosecution of financial fraud cases.

Care needs to be taken in implementing the proposed publication of enforcement actions on banks by the CBK. Disclosure of sensitive information could easily be misinterpreted and cause panic.

Capital

The Cabinet Secretary has re-introduced the prior year proposal to progressively increase the minimum core capital requirement for banks from the current Shs 1 billion to Shs 5 billion. Only 22 out of the 44 banks met the higher core capital requirement at 31 December 2015. This is expected to trigger discussions around mergers and acquisitions and to create larger, better funded and more stable banks.

Other changes

The Central Bank Bill, which was initially released in draft in 2014, will be presented to Parliament shortly. The Bill is expected to improve the governance and operations of the CBK.

Aligning the insurance industry towards global best practice

Policy makers are continuing to drive the insurance industry towards global best practice with the implementation of advanced provisioning / reserving techniques, more stringent capital requirements and speeding up of claims processes.

While these changes will present significant challenges to the industry, they will bring much needed discipline to the insurance industry and result in better capitalised businesses. In addition, they are likely to promote inward foreign investment due to adoption of internationally accepted practice.

> The new measures will continue to put pressure around capital and investment in new systems and processes.

Proposed amendments to the Insurance Act continue to enhance the risk based capital regime

Following the introduction of the risk based capital model in 2015, the Cabinet Secretary proposes to bring additional amendments. In particular he proposes to expand the allowable forms of capital.

We await to see the wording of the bill to confirm whether this will be in line with what is available for the banking sector where tier 2 capital can be deployed to boost the overall capital position. This will provide flexibility into how funding of insurance companies can be achieved.

He further proposes that life insurance companies apply the new gross premium valuation methodology.

> More flexibility provided in the funding of insurance companies through provision of other forms of capital.

This significantly changes the basis of measurement of liabilities.

Though a more practical approach, significant investment will be required around systems, data clean up and experienced actuarial teams.

This basis will also align the basis with which companies will undertake stress testing under the new risk based regime and also prepare them for the upcoming IFRS 4 Phase 2.

Maximum time for claim settlement reduced to 30 days

The Cabinet Secretary proposed a reduction in the maximum time for claim settlement from 90 days to 30 days. While this is good news for policyholders, it will be a practical challenge for players that write long-tail business.

Most notably, it will put significant pressure on the cash flows of insurance companies, especially given the failure of the "cash and carry" system for premiums. Most intermediaries continue to be slow at remitting premiums to underwriters.

> Insurance companies will have to be smarter in managing their working capital to enable them to comply with the requirement.

Enforcement of regulations around freight insurance on imports and introduction of regulations to govern Takaful insurance

To further support the insurance industry, the Cabinet Secretary directed KRA to work with the relevant stakeholders to ensure the implementation of Section 20 of the Insurance Act, which prohibits placement of "Kenyan Business" with non-Kenyan or foreign insurance markets except for certain circumstances.

The challenge around this in respect of freight for imports will be overcoming the current practice where goods are insured at the port of loading.

The other amendment to the Insurance Act is to anchor Sharia compliant or Takaful insurance products which may result in further penetration of insurance. It will be interesting to see what regulations and exemptions, if any, are issued on these types of products and whether there would be any flexibility around risk based capital for such entities.

Other Sectoral Reforms

Transforming Kenya into a Financial Hub

The Cabinet Secretary stated his intention to soon table the Financial Services Authority Bill, Nairobi International Financial Centre Bill, and the Movable Property Securities Bill.

The long anticipated Bills are expected to bring reform and deepen the financial sector. They have now been circulated for public comment and are expected to be tabled in Parliament early in the next financial year.

The passing of the FSA Bill will harmonise regulation in the financial sector outside banking and enhance efficiency of licensing and oversight of players who are presently overseen by multiple financial services regulators by virtue of the diversity of their business.

The Act when passed will need to ensure that valuable sector-specific knowledge and expertise is not lost, through the creation of merged regulation as opposed to divisions of expertise under one roof.

The NIFC Bill will aid Nairobi's transformation into a financial hub for the region and encourage capital flows. However, more will need to be done to address impediments including corruption, security, market discipline and stability in order to create incentives for development of a robust headquarter regime.

The Movable Property Security Bill ease the registration and charging of securities and build confidence in the securitisation process.

Widening Opportunities for Investment of Pension Savings

The Investment Guidelines for retirement benefit schemes are to be amended to allow for investments in new products. A legal notice will also be gazetted to allow the National Social Security Fund to invest in alternative financial vehicles for development of affordable housing.

The REITS regulations have long been in force but there has been limited issuance of these financial products. Recently, the CMA approved new products, including exchange traded derivatives. The Cabinet Secretary intends to encourage the listing and subscription for these instruments by easing the investment in these by retirement benefit schemes.

The NSSF, which has long invested in property but has exceeded its statutory limits, will be granted an additional window for indirect property investment.

The new investment guidelines will be aimed at these funds being directed towards the derivative market by widening the pool of allowable investments by these funds.

The NSSF, one of the country's largest funds, and which regularly invests in property but has exceeded its statutory limits, will be granted an additional window which will allow them to invest in other vehicles specialising in low cost housing. This will also help ease the current shortfall of 150,000 residential units per annum.

In recognition of the volume of online forex trading taking place in the country with intermediaries based overseas, The Cabinet Secretary proposes to introduce amendments of the CMA Act to regulate this business.

This will check the possibility of this being an avenue for money laundering. Formalisation will also make steps towards the realisation of the Nairobi International Financial Centre. In future, consideration should be made to extend similar regulation to cryptocurrency trading, for which there are known Kenyan participants.

In line with the theme of increasing the stock of housing, the Government has been in discussion with various development partners to aid in the creation of a Mortgage Liquidity Facility. The mechanics of this will likely involve the extension funds to banks and SACCOs to allow for the issuance of long-term mortgages.

These development partners have the capacity to provide longer tenor facilities and at cheaper rates than traditional deposits or lines from other commercial banks, which may be able to lower the cost of mortgages.

By extension, this could also encourage investment into the development REIT market by developing a wider buyer network for residential property.

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Infrastructure, capital projects and energy

The continuing focus on infrastructure development projects is an important and well balanced allocation in this years budget.

It focuses on major large scale plans such as the SGR and the other Transportation and Logistics projects (ports, roads, etc). The prioritisation is in line with achievement of Vision 2030.

Kenya's challenge now is the implementation and prioritization of infrastructure development projects. Implementation will require additional focus on the PPP model to ease financing burdens and the acceptance of user charges for the various assets.

In other cases, such as LAPSSET, the crude pipeline being the key project needs to be addressed given the recent routing decision by Uganda. In this particular case it is not just a project but an entire new industry that is at stake, namely the development of the upstream oil sector. Additional resources and decisions will be required in this case.

In the longer term the question will become one of prudent and cautious debt management versus the possibility of a larger growth rate in GDP through fast tracking of infrastructure projects and the reaping of benefits from the multiplier effect.

With infrastructure providing the highest economic multiplier effect, the faster these projects get off the ground the sooner they can add to the overall economic performance. The adherence to the macroeconomic debt to GDP ratios as envisioned will continue to limit the amount of funding available.

Standard Gauge Railway

The construction of the Standard Gauge Railway (SGR) from Mombasa to Nairobi has progressed well and is expected to be launched by June 2017. Some of the immediate benefits expected include reduction of transport cost and facilitation of faster and cheaper movement of freight and passengers.

The budget allocation for the remainder of the rail is Kshs 154.4 billion of which KSh 118.2 billion is external financing from China and KShs 36.2 billion is the government's contribution. Construction of phase II (Nairobi-Naivasha) is set to start in FY 2016/17.

In a bid to boost economic growth, the manufacturing sector is expected to expand through development of industrial parks along the railway line. Despite this being a progressive initiative on the government's part, it was conspicuously notable that the plans to develop the parks do not provide for specific incentives.

Another obvious gap is on the approach the government will take to finance these parks and the timelines when the parks become a reality on the ground.

Effective and efficient transportation infrastructure is important for the growth of the economy, diversification and poverty reduction.

Effective and efficient transportation infrastructure is important for the growth of the economy, diversification and poverty reduction. Although the idea seems to be in its formative stages, creation of these parks could play a role in achieving Vision 2030 objectives.

There is a continuous challenge in financing such infrastructure projects and a key factor to unlocking these opportunities is better project preparation including assessing the costs and economic benefits of the projects. This needs to be considered to enable authorities to better prioritise their budget spending.

Public private partnerships

An attractive funding option

Infrastructure finance

An infrastructure debt trap not only slows down infrastructure development but could have adverse effects when fiscal deficit needs to be financed by expensive debt.

African countries face the risk of getting into infrastructure debt traps that could worsen the fiscal deficit in the face of expensive financing. The Kenya government has recognised this given the rate at which it is fast approaching its debt ceiling and the fact that it did not meet its revenue budget in the last financial year.

Borrowing from the local market will stifle economic growth which is meant to be driven by the same infrastructure. In order to meet its 2016/17 budget of Ksh1.5T with a financing deficit of Ksh 690B, different infrastructure funding options need to be explored.

> African nations need the right balance when developing infrastructure projects to contain debt …David Lipton, IMF.

PPPs underway

Infrastructure finance

Public-Private-Partnerships (PPPs) have seen great success in other countries. The KU Hostels development through PPP is the most likely to achieve financial close soon.

Successful development of infrastructure by private investment through PPPs is one such option to cushion public sector resources that are under pressure from competing with critical needs. Kenya has been successful in attracting private investment in all sectors including transport, telecoms, energy, water and sewage.

Some of the projects currently underway through the PPP structure include the KU hostels, geothermal power, development of 500kms of roads using the annuity approach, planned development of seaports in Kisumu, expansion of Mombasa-Nairobi-Malaba highway and construction of the second Nyali Bridge in Mombasa.

Notable is the planned commencement of construction for the first batch of roads using annuity funds. The Annuity Fund which is partly funded from the Fuel Levy currently has over Ksh9.5B. Increasing car ownership will lead to an increase in levy collection to the advantage of the fund.

There is no doubt that PPPs will accelerate infrastructure development in Kenya. The government needs to be aware that it takes a long time to raise infrastructure financing due to the complexity of the PPP model. A case in point is the high bids that were submitted for the roads annuity programme which delayed the road projects.

> Borrowing from the local market will stifle economic growth which is meant to be driven by the same infrastructure.

The PPP legislation still needs refinement and has seen many local banks shying away from participating in the programme.

This reality will inform the number of infrastructure projects that can be implemented in a year. Prioritization of projects will need to align with planned economic development to ensure that Kenya meets its projected 7% growth in 2017.

Mombasa port is being positioned as the preferred hub in East and Central Africa through modernisation of the port.

Roads and Ports

The budget highlights the government's continued focus on investing in roads and ports to enhance trade, commerce, agricultural productivity and regional trade with the ultimate aim of improving Kenya's economy.

By focusing on decongestion and rehabilitation of roads and key projects such as Northern Corridor Transport Improvement Project (NCTIP) and LAPPSET, the government aims to enhance the road network connectivity across the country.

To open up rural areas and farmlands, Ksh 30 billion has been budgeted for construction of 3,800km of Low Volume Seal Roads (LVSR) across the country. This will be financed through the normal ministerial roads budget and the Equalization fund.

The government also aims to boost regional trade through construction of the East Africa road network, the Kisumu-Kakamega road and 600KM South Sudan link road.

Mombasa port is being positioned as the preferred hub in East and Central Africa through modernisation of the port by expansion of container terminals and integration of the Single Window System.

The Mombasa Port Development Project which will be financed by Development Partners has been allocated Ksh 5.5 billion. In addition, an allocation of Ksh 0.5 billion will be used to acquire 2 ferries for the Likoni Channel.

Construction of a second runway at JKIA is expected to commence and will be completed by end of 2018.

Isiolo and Kisumu airports are undergoing expansion and rehabilitation while major rehabilitation works are going on at five airstrips in Nanyuki, Ikanga, Lodwar, Embu and Malindi.

A planned expansion of Eldoret airport to enable landing of cargo planes will also help position it as a transport hub.

Affordable electricity

Increased allocation to projects

Increasing access and expanding transmission infrastructure

The Government has significantly increased its allocation to energy projects from KES 40 bn in 2015/16 to KES 120 bn for the next financial year.

The funding will be largely applied towards measures aimed at increasing access to electricity and also expanding transmission infrastructure in the country. Since the inception of the 5000 MW program, 615 MW has been added to the grid and this is expected to increase as projects that are currently under development reach completion.

The ability of the country to utilise the electricity generated will have a significant bearing on the affordability of the same as the cost of generation is passed to the users.

In terms of electricity generation, the Government continues to invest in geothermal energy as the preferred technology. This is in line with its commitment towards renewable and sustainable energy sources.

The ability of the country to utilise the electricity generated will have a significant bearing on the affordability.

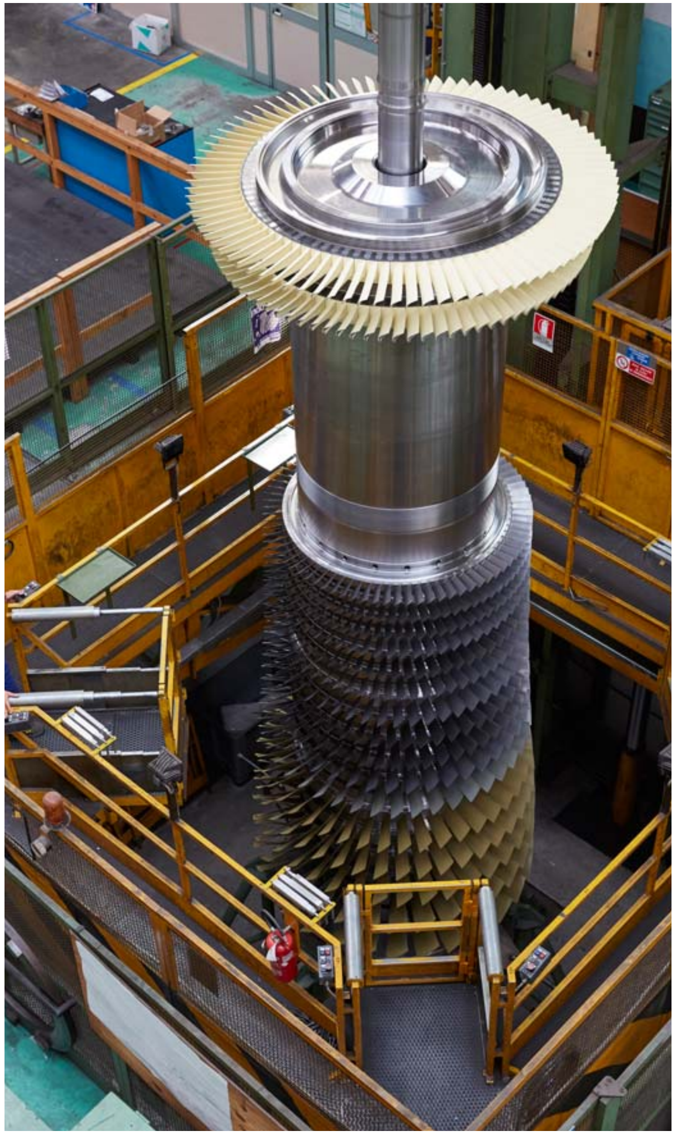
Oil and Gas

Exploration and distribution

Allocation towards financing airborne physical surveys will aid in assessing the resource potential of different parts of Kenya. This is especially important as Kenya has recently created new exploration blocks and intends to auction them in a licensing round scheduled to take place in 2017.

The oil and gas sector in Kenya is at a critical stage. Discoveries in the Kerio Valley basin and the revision of the reserve size (1.6 Bn barrels) in the Lokichar basin provide a positive outlook.

Significant investment is still required to actualise the discoveries and undertake further exploration activity. A larger discovered reserve size could provide an additional boost to the Government in its plans to go it alone on the crude oil pipeline.



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East Africa at a Glance

THE ECONOMY

Kenyan economy

Steady growth

Kenya's GDP grew by 5.6% in the 2015/2016 financial year as compared to 5.3% in 2014/2015 financial year. This was lower as compared to GDP growth in neighbouring countries such as Tanzania (6.9%), Rwanda (6.5%) and Ethiopia (10.2%) during the same period. However, growth in mining and quarrying; information and communication; and wholesale and retail trade decelerated during the same period.

Growth in the economy was mainly driven by ongoing infrastructural investment, increased investor and consumer confidence and improved agricultural production. Kenya is ranked amongst the 7 best countries for investments and the 2nd biggest market for retail investors in Africa.

Increased investor confidence in the economy.

Performance per sector

Highlights

Highlight by sector is as follows;

- The agricultural sector grew from 3.5% in 2014/15 financial year to 6.2% in 2015/16 financial year. This was largely achieved through improved crop and livestock production over the review period.
- Manufacturing sector grew by 3.5% in 2015 /16 financial year as compared to a slower growth of 3.2% in 2014/15. This was attributed to reduced production costs arising from lower cots of petroleum and electricity inputs.
- Building and construction sector in 2015 /16 financial year registered a growth of 13.6%.
- Tourism went down to Kshs 84.6b in 2015 /16 financial year as compared to Kshs 87.1b in 2014/15 financial year. The suppressed performance was on account of security concerns, particularly in the coastal region and restrictive travel advisories from some European source markets.
- The energy sector witnessed a steady rise in global crude oil and other liquid inventories.
- The Capital market performance was depressed in 2015. The Nairobi Stock Exchange (NSE) 20-share index recorded a high of 5,346 points during first quarter of year but dropped by 24% at the end of the year. The total number of shares traded also reduced by 16%

GDP growth of 5.6% in the financial year compared to 3.8 % growth in Sub-Saharan Africa.

Uganda economy

Summary

The economy is estimated to have grown at a rate of 4.6% during the financial year 2015/2016 in comparison to a projected growth of 5.8%.

The decline in the growth rate was due to a sharp fall in international commodity prices such as coffee, tea and minerals; a decline in private sector credit growth as a result of high interest rates and strengthening of the US dollar which made imports more expensive and caused domestic inflation.

The real GDP is projected to continue to grow to an average of 6.3% per annum over the medium term.

Uganda's headline inflation has increased to 5.4% as of May 2016 in comparison to 3.1% in the financial year 2015/2016

The budget deficit for the financial year 2015/2016 is estimated at 6.4% of GDP largely financed by external borrowing through concessional, non-concessional loans and to a less degree by domestic borrowing equivalent to 1.6% of GDP.

Budget Theme FY 16/17:
Enhanced productivity for job creation

In terms of revenue performance, total tax collections in the financial year 2016/17 are projected at UGX 12,914.3 billion up from financial year 2015/16 financial year projected outturn of UGX 11,598 billion.

The projected increase is to be achieved by gradually formalizing the large informal sector, improving efficiency in tax collection and compliance.

The priority areas highlighted in the 2016/17 financial year budget are:

- Agriculture production and productivity;
- Unlocking Uganda's tourism potential;
- Effective development and maintenance of infrastructure;
- Human capital and skills development;
- Improving good governance.

Tanzanian economy

Past performance 2015/2016 financial year

The economy of Tanzania is estimated to have attained real GDP growth of 7.0% in the 2015/16 financial year. GDP is expected to grow by 7.2% in the 2016/17 financial year.

Performance in key sectors of the economy was as follows:

- The construction industry grew by 16.8% in the 2015/16 financial year (2014/15 : 14.1%) due to increased government spending on infrastructure projects.
- Information, communication and technology grew by 12.1% in the 2015/16 financial year due to increased mobile penetration.
- The financial services sector grew by 11.8% in 2015/16 financial year (2014/15: 10.8%) due to higher lending to the private sector.
- Mining and quarrying grew by 9.1% in the 2015/16 financial year and the agricultural sector recorded a reduced growth of 2.3% in the 2015/16 financial year (2014/15 : 3.4%)

The average in flation rate in the 2015/16 financial year was 5.6% compared to 6.1% in the 2014/15 financial year. The reduction in in flation is due to a large extent to the fall in global petroleum prices.

The priority areas mentioned in the budget speech for 2016/17 financial year include the following:

- Focus on industrial growth and construction of basic industry through the implementation of specifically identified projects and creating industrial clusters;
- Integration of economic development and human resources by improving school environment, vocational training and health initiatives;
- Improving business environment through improvement of infrastructure relating to power, water, roads, ports and railway and reducing bureaucracy; and
- Focus on effective implementation.

Macro-economic objectives for 2016/2017 include:

- Real GDP growth: 7.2%
- Tax revenue to GDP ratio: 13.8%
- Contain inflation to single digits: range of 5% to 8%.

Rwandan economy

Rwanda's economy is projected to grow 6% in the 2016/17 financial year from 7% in 2015/16. The agriculture sector is expected to grow 4.3% from 5%, industry 5.6% from 7% and services 7.1% from 7%.

Rwanda's real GDP growth rate decreased to 6.9% in 2015/16 as compared to 7.0% achieved in 2014/15. Performance highlights include 5% agricultural sector growth; 7% industry sector growth; and 7% services sector growth. The strongest growing sub sectors were information and communication, financial and cultural, domestic and other services growing at 15.9%, 10.1% and 10.8% respectively.

Inflation continues to be well contained with an average of 2.5% in 2015 and it is projected at 4.7% in 2016 and at or below 5% for the next three years. This is attributed to the projected drop in import prices in foreign currency.

Both exports and imports declined in the 2015 /16 financial year as compared to the 2014/15 financial year. The decline in exports was mainly attributed to minerals impacted by the fall in international commodity prices. The decline in imports is attributed to a fall in the value of energy and lubricants as a result of a fall in prices.

The forex market has been under pressure mostly resulting from increased imports to support high economic growth. The strengthening of the US Dollar, the effect from high depreciation of regional currencies and associated speculative behaviour resulted in annual depreciation of 7.6%.

Rwanda's financial sector remains solvent and with sufficient capital buffers. The capital adequacy ratio for banks was 22.5% in December 2015 while for MFIs was 31.1%. The liquidity ratio for banks stood at 45.9% in December 2015 while for MFIs was 89.6%.

The allocation of resources in the 2016/17 financial year has been made taking into account the Economic Development and Poverty Reduction Strategy (EDPRS2) priorities. The main areas of focus under EDPRS 2 are :-

- Economic transformation – 27%
- Rural development – 13%
- Productivity and youth employment – 6%
- Accountable governance – 10%
- Foundational issues – 45%

Common themes across the region

Transport Infrastructure

Transport Infrastructure development continues to be a key growth factor anticipated to spur economic development in the region. Kenya is on track to deliver the first phase of the SGR from Mombasa to Nairobi by June 2017 while plans are underway for the second phase.

On the other hand, Uganda is expected to commence construction of their Eastern Standard Gauge Railway from Kampala – Malaba. This is expected to be synchronized with the construction by Kenya of the Nairobi – Kisumu – Malaba railway.

Governments across the region are prioritizing improvements of roads especially in cities and urban areas. Kenya's government has highlighted highways expected to be completed in the current year including Outer Ring Road while Uganda's government has highlighted roads such as the Kampala- Entebbe express way.

Cross border trade

Kenya's government has proposed streamlining the training, licencing and regulation of clearing agents to help address increasing threats from terrorism, drug trafficking and related cross border criminal activities.

Kenya plans to seek input from the EAC countries to achieve a harmonised approach.

Key highlights- EAC

	Kenya	Tanzania	Uganda	Rwanda
Real GDP growth	5.6% (5.3%)	7.0% (7.2%)	4.6% (5.3%)	6.0% (7.0%)
Overall inflation	6.6% (6.9%)	5.6%(6.1%)	5.4% (3.1%)	4.4% (2.1%)
91 day TB rates	10.8% (8.9%)	18.25 (15.73)	14.76 (14.13)	6.0 (4.1%)
	KSHS	**TSHS**	**UGX**	**RWF**
Exchange rate to the dollar (Local currency = US$1)	98.2 (87.9)	1,985(1,653)	3,352 (3,115)	747 (716)
Total budgeted spend (billions)	2,265 (2,002)	29,450 (22,495)	18,666 (18,133)	1,949 (1,848)
Budgeted recurrent (billions)	1,456 (1,280	17,719 (16.576)	8,773.02 (8,716)	973 (893)
Budgeted development (billions)	809 (721)	11,821 (15,919)	9,892.98 (6,802)	770 (776)

*Note – Comparatives in brackets

TAXATION IN THE REGION

Customs and Excise Duty

Kenya

Customs

Proposed amendments include:

- Introduction of specific duty rate of USD 200 per Metric Ton on a range of iron and steel,
- Increase of import duty from 10% to 25% on Aluminium Cans,
- Remission of the import duty on aluminium plates and sheets,
- Increase of import duty from 10% to 25% on aluminium cans,
- Duty exemption on Heating, Ventilation and Air Condition (HVAC),
- Proposed legislation to the streamline, training, licensing and regulation of Kenya clearing agents and
- Reduction of import duty from 25% to 10% on energy efficient stoves.

Promoting growth of industries and employment creation.

Excise duty

- Introduction of excise duty on kerosene at KES 7,205 per 1000 litres.
- Introduction of ad valorem rate of 20% on the value of the vehicle.
- Introduction of excise duty at the rate of 10% on cosmetics and beauty products.

Enhancing Equity and Fairness.

Uganda

Excise duty

Proposed amendments include the increase in excise duties on:

- *Diesel and petrol by UGX 100;*
- *Soft cup cigarettes to UGX 50,000 per 1000 sticks and Hinge Lid cigarettes to UGX 80,000 per 1000 sticks*
- *Sweet and confectionaries to 20%*

- Introduction of excise duty at the rate of 80% on ready to drink spirits.
- Exemption of specialised hospital furniture from the 10% excise duty.

Tanzania

Customs

Proposed increase of import duty rate on:

- Cement (from 25% to 35% for one year)
- Certain iron or non-alloy steel products (from 0% to 10%)
- Made up fishing nets (from 10% to 25%)
- Oil and petrol filters and intake air filters (from 10% to 25%)
- Aluminium milk cans (from 10% to 25%)

Excise duty

Proposed amendments include:

- 5% increase on fixed tariffs on non-petroleum excisable products
- Increase in ad valorem rate for imported furniture (on specific HS codes) from 15% to 20%
- Extending the application of 10% excise duty on mobile money charges
- Abolition of the use of plastic bags of less than 50 microns to protect environment

Direct and Indirect taxes

Kenya

Income tax

- Proposed regulations to facilitate implementation of the apprenticeship tax incentive for employers;
- Reduction of corporate tax rate from 30% to 20% for developers who construct at least 1,000 units per year;
- Proposed rules to facilitate implementation of simplified residential rental income less than ten million shillings per year;
- Introduction of a minimum taxable residential rent income threshold of KES 12,000 per month;
- Proposal to empower the Commissioner to appoint withholding tax agents for rental income;
- Tax amnesty for tax payers who own assets and businesses outside the country provided they submit their return for the year 2017;
- Proposal to expand tax bands and increase personal relief by 10% and
- Proposal to exempt bonuses, overtime and retirement benefits for low income employees from tax.

Expecting more amendments in the income tax bill.

Uganda

Income tax

- Tax relief awarded to taxpayers who merge or acquire loss-making businesses and continue to operating the business after merger transaction;
- Clarity has been provided as to when a non-resident person is entitled to benefit from a tax exemption or reduced tax rate under a Double Taxation Agreement (DTA) and
- Government has developed a new policy to guide DTAs and will be commencing on renegotiating DTAs that do not comply with this policy.

Tanzania

Income tax

- Reduction in the marginal tax rate by 2% (from 11% to 9%) for individuals on the lowest tax band;
- Removal of tax exemption on disposal of DSE listed shares and
- Powers to Commissioner to determine rental income for purpose of withholding tax.

Kenya

Value Added Tax

Proposal to exempt the following from VAT:

- Made up garments and leather footwear procured from the Export Processing Zones,
- Raw materials for manufacture of animal feeds,
- Parks entry fees charged,
- Commissions earned by tour operators and
- Liquefied petroleum gas.

Proposed extension of the transitional period of VAT exempt status on petroleum products by one year.

Uganda

Value Added Tax

- VAT relief to solar, wind and geothermal energy producers;
- VAT imposed on imported services used by Business Process Outsourcing (BPO) companies to be refunded at the time of export or offset if the services are consumed in Uganda and
- VAT relief on supplies procured from domestic market for aid funded projects.

Tanzania

Value Added Tax

Proposed introduction of VAT on:

- Tourism services (including supplies of tourist guiding, game driving, water safaris, animal or bird watching, park fees and ground transport services) and
- Bank charges in the form of fees charged by banks.

Introduction of VAT at 0% on the cross-union supplies of goods (i.e. between Zanzibar and Tanzania mainland)

Proposed VAT exemptions include:

- Aviation insurance,
- Bitumen products and
- Certain agricultural products.

Tax - Rwanda

The Minister did not make any pronouncements on tax measures. The Income Tax legislation is under review and currently before the parliament for deliberation.

Some of the proposed changes under the draft law cover the following:

- A new provision on capital gains tax to address the sale or disposal of shares;
- Introduction of 5% tax on the disposal or transfer value of immovable property;
- Restriction of management fees to be paid to non-resident persons;
- Introduction of transfer pricing guidelines and
- Clarification on basis for taxation of housing and motor car benefit provided to employees by employer.

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