Reimagine the possible

Budget

2018/2019

Welcome

PwC Kenya's Budget Bulletin provides insight and analysis on the 2018/19 budget speech and other relevant materials. We hope that you will find it insightful, and look forward to your comments.

In this bulletin

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Corporate tax

With the expected overhaul of the Income Tax Act (ITA) through the Draft Income Tax Amendment Bill (ITB) that is undergoing the legislative processes, the CS has proposed minimal changes to the current Income Tax Act (ITA).

The CS has dropped some proposals from the Draft ITB and brought forward a number of proposals in the Draft ITB to the Finance Bill 2018 which has just been tabled in Parliament. This may be an indication that the CS does not expect the ITB to be enacted into law soon.

Bowing to pressure

Owing to pressure from the public, the CS has dropped the following two proposals initially introduced in Draft ITB:

Reprieve for individuals not corporates

The 35% tax rate on income of individuals who earn more than KES 750,000 per month has been dropped. However, it appears that the proposal contained in the ITB to tax companies with annual taxable income exceeding KES 500 million at the higher rate of 35% has been retained.

This would be unfortunate as it is a departure with international trends, like in the OECD countries, where income tax rates have been declining.

CGT back to 5%

The proposed increase in Capital Gains Tax (CGT) to 20% has been dropped in favour of the existing rate of 5%.

However, it is unclear whether the proposal for indexation - which allows for the effects of inflation when calculating capitals - has been retained. The Treasury previously argued that at a lower tax rate of 5%, indexation was unnecessary.

Expanding the tax base

In proposals geared towards expanding the tax base, the CS has fast-tracked the following proposals contained in the ITB and included them in the Finance Bill so as to accelerate collection of taxes:

Sea freight to increase

Demurrage charges paid to non-resident ship operators will now be subject to withholding tax at the rate of 20% on the gross amount. In practice, it is unlikely that the ship operators who are non-resident will agree to bear this tax, leaving the local importers or their agents to bear the tax costs, hence increasing the cost of freight.

Although this proposal brings this previously untaxed income into the Kenyan tax net, it would appear suboptimal, as it will only increase the cost of sea freight and therefore the cost of goods imported into Kenya.

Foreign Insurance targeted

Withholding tax at a rate of 5% on insurance premiums payable to non-residents has also been introduced into the Finance Bill.

This taxation measure is likely to increase the cost of insuring certain risk overseas, as foreign insurers or reinsurers are unlikely to accept this tax as they have no taxable presence in Kenya, leaving Kenyan customers to bear the tax cost. This will only increase the cost of insuring certain specialised risks that cannot be insured in Kenya.

Presumptive Income Tax is back

The largely unsuccessful Turnover Tax (ToT) has been replaced by Presumptive Income Tax (PIT). The collection of PIT on acquisition or renewal of Single Business Permits from the County Government is intended to bring more taxpayers, mainly in the informal sector, into the tax net as well as improve their level of compliance.

CGT on insurers clarified

It is now clear that CGT on transfer of property applies to general insurance companies (GICs) and not to life insurance counterparts, and hopefully it will bring to rest disputes between the KRA and insurance companies.

Token of incentive

Energy relief to the manufacturing sector

In keeping with the Big Four agenda, the CS has proposed an additional deduction of 30% on electricity costs incurred by manufacturers, subject to certain conditions to be set by the Ministry of Energy. While this measure would provide relief the high power costs incurred by manufacturers, it may not be sufficient to alleviate the high cost of production in Kenya.

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Personal tax

Relief for high income earners

Government bows to pressure and drops the proposed top tax rate of 35%

Under the draft Income Tax Bill 2018 issued by the National Treasury for public comments in May 2018, the government proposed a higher rate of 35% for income in excess of KES 750,000 per month (KES 9 million per annum) for individuals.

The government has bowed to pressure from stakeholders and has reverted to the current top tax rate of 30%.

This is a welcome move, given the general income levels in Kenya and considering that the income tax bands are not well expanded and therefore most individuals hit the top tax rate of 30%

5.9%

Informal sector employment increased by 5.9% to 13.3 million persons in 2016.

Extension of tax amnesty on foreign income

Government extends deadline again to 30 June 2019

In 2016, the Tax Procedures Act was amended to provide for tax amnesty for people who repatriated taxable income into Kenya and the deadline was set for 31 December 2016. In the Finance Act 2017, the deadline was extended to 30 June 2018.

However, despite the extensions, the uptake of the amnesty has been very low. This is mainly because of the uncertainty as to whether other arms of government would query the source of the repatriated funds.

In a move to encourage the uptake of the tax amnesty and clarify questions raised by tax payers, the Cabinet Secretary (CS) has extended the deadline of filing the amnesty to 30 June 2019 for income earned up to 31 December 2017.

The CS has additionally exempted repatriated income from the provisions of various Acts relating to reporting and investigation of financial transactions. However, these exemptions do not cover funds resulting from drug trafficking, poaching and terrorism.

Taxing the elusive informal sector

Government moves to directly tax the informal sector

Beginning January 2019, the Finance Bill 2018 proposes to introduce a presumptive tax of 15% on the value of a single business permit or trading license fee for resident businesses whose turnover does not exceed KES 5 million in a year of income. This seeks to replace the 3% Turnover Tax (ToT) which was introduced in the Finance Act 2006.

This move is expected to widen and deepen the tax net especially for the informal business sector as the tax payment will be tied to the renewal of the Single Business Permits or trading licenses.

The major challenge that the government has experienced in the turnover regime is in the implementation.

The question remains if the presumptive tax is the most efficient way of taxing the informal sector considering that consumption taxes are already high.

2.1 million

More than 2.1 million Kenyans filed their 2016 tax returns according to the KRA.

Enhancing compliance by individual taxpayers

Increased interest for late payment but lower late filing penalty

In a move to increase compliance, the CS has introduced a late payment penalty of 20% and increased the late payment interest from 1% to 2%. However, it is unclear whether this penalty is an addition to the penalty charged for tax payment shortfall under Section 84(2)(b) in the current Tax Procedures Act (TPA, 2015). In addition, the CS has proposed to reduce the late filing penalty for individuals from KES 20,000 to KES 2,000 effective 1 July 2018.

The increase in the late payment interest from 1% to 2% may compel individual taxpayers to make payments on time.

Clarity on extension of time to file returns

Starting 1 July 2018, a taxpayer requiring an extension to file a return should make a request for the extension application to the Commissioner 15 days before the deadline if the tax return is a monthly return or 30 days before the deadline if the return is an annual return.

The Commissioner should respond at least five days before the deadline lest the request is presumed to be accepted.

Affordable housing

Establishment of a National Social Housing Development Fund

The government is proposing to establish a National Social Housing Development Fund (the Fund). The Fund, in conjunction with a strengthened National Housing Corporation (NHC), will be expected to spearhead attainment of the affordable housing agenda.

Employers and employees will each contribute to this Fund 1% of the employee's gross monthly earnings up to a maximum of KES 5,000.

However, in his speech, the CS proposed the employer's contribution to the Fund to be 0.5% of the employee's gross monthly earnings capped at KES 5,000 and matched by the employee's contribution of 0.5%. The change is effective 1 October 2018.

This is likely to increase the cost of employment and be counter-productive considering the government is looking to reduce the high levels of unemployment.

The Fund seems to replace the Home Ownership Savings Plan (HOSP) which has been dropped under the draft Income Tax Bill, 2018. Under the HOSP regime, all first time owners qualify for a deduction of up to KES 4,000 per month on savings.

However, the Fund has now introduced an obligation for the employers and the employees but with no apparent direct benefit for the contributors.

Other changes impacting employees

Zeroing in on employers who fail to remit pension contributions

The CS has proposed to amend the Retirement Benefit Act to give the Retirement Benefits Authority (RBA) the power to levy penalties to employers who fail to remit employees' pension contributions promptly.

Resourcing the Big Four Agenda

In a move to meant to incentivize foreign nationals working in Kenya, the government will be reviewing work permits to accommodate expatriates whose skills are essential in attaining the country's development agenda. There is the possibility that a skills inventory will be done and priority given to the skills that help actualize the development agenda of the government.

Expectations not met

The government has been increasing the minimum wage over the last few years and there is a need to cushion low income earners from tax so as to retain their disposable income.

We would have expected the government to increase the minimum taxable income from the current KES 12,278 per month to at least KES 20,000 per month.

In line with the expanded tax bands, increased personal relief and the inflationary pressures in the recent years, we would have expected the CS to increase the following limits:

- For tax allowable pension contributions currently at KES 20,000 per month which has been stagnant for over ten years.
- Insurance relief at current 15% of the premiums paid capped at KES 5,000 per month which has been stagnant for the last over ten years.
- Tax-free pension withdrawals currently at KES 60,000 per year capped at KES 600,000.
- Tax-free pension annuity payments currently at KES 300,000 per year.

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Value Added Tax

Introduction

In line with the recent Tax Laws Amendment Bill, 2018 which is currently lined up for a second reading in Parliament, the government continues to rely on VAT exemption to incentivise the delivery of its Big Four agenda.

The Cabinet Secretary (CS) proposed minimal amendments to the Value Added Tax Act, 2013 in this year's budget statement.

A majority of the expected amendments to the VAT Act 2013 are included in the Tax Laws Amendment Bill, 2018. That said, we have set out below our analysis of the VAT changes proposed by the CS Treasury in his speech, our expectations and surprises.

a) Prioritizing the Agriculture sector

As a way of promoting the Agriculture sector and enhancing food and nutrition security, the CS has proposed the following key changes.

i) VAT exemption of equipment to be used in the construction of grain storage facilities

The Government via the Finance Act of 2017 introduced exemptions from VAT on materials for the construction of grain storage facilities. The CS has proposed to extend this exemption to include equipment used in the construction of such facilities. The extension is intended to encourage construction of more facilities for proper food storage and to reduce the wastage of post-harvest agricultural produce.

For the government to achieve this goal, we would have wished for more robust VAT incentives around the tax treatment of storage bags/hematic bags that are currently taxable at 16% and the exemption of post harvesting services beyond horticultural and agricultural services. Further, we would have wished for VAT incentives around water drilling services, water reservoir tanks and irrigation pipes that create an alternative to relying on rain fed agriculture.

ii) VAT exemption of raw materials for animal feeds

The CS has proposed to extend VAT exemptions in the animal husbandry sector to cover materials used to make animal feeds. Currently, only the finished animal feeds are exempt from VAT.

This proposal is aimed at attracting local investment in the animal feed sector thus creating jobs and growth in both the agriculture and manufacturing sectors.

b) ICT sector

i) VAT exemption on parts for the assembly of computers

The government continues to promote issuance of free laptop tablets to primary schools. In line with this, the CS has proposed exemption from VAT on parts imported or purchased locally for the assembly of computers. This will encourage local assembling of computers thereby creating jobs, spurring innovation and propelling Kenya into being an ICT regional hub as envisioned in Vision 2030.

VAT exemptions yet again!

Whereas the Government continues to prefer exemptions to zero rating, it is our view that VAT exemptions do not necessarily translate to the desired objectives of reduction in costs for the end consumers. VAT exemptions result in non-recoverable VAT for the suppliers which is ultimately passed on to the final consumers in the form of increased prices. If the government is indeed keen to achieve its Big Four agenda, zero rating of basic commodities and inputs is the way to go.

Expectations not met

Transitional exemptions on petroleum, oil and gas products

VAT at the standard rate of 16% on fuel products including petrol, diesel, kerosene and jet fuel was introduced in the VAT Act in 2013, with a three-year grace period that would have VAT on these products come into force in September 2016.

However, pursuant to an intensive lobby by the petroleum sector, the Government extended the exemption for a further two years effective 1 September, 2016. Accordingly, effective 2 September 2018 these petroleum products will become taxable at the standard rate of 16%.

The price of fuel is a key determinant of the cost of goods and service and we therefore expect the lifting of the VAT moratorium to lead to an immediate increase in commodity and service prices.

This in our view is contrary to the government's commitment to reducing the cost of doing business to spur economic growth. It therefore came as a surprise that the CS did not make any mention of the potential 16% increase in the price of petroleum with effect from 1 September 2018!

No more VAT remission for oil exploration companies - perhaps!

Remission of VAT on services purchased by oil exploration companies granted under the repealed VAT Act will lapse on 1 September 2018. These supplies will thereafter be subject to VAT at the standard rate, 16%.

Oil exploration companies' activities require significant investments in services especially at the exploration stage.

As such, taxing services supplied to companies engaged in oil exploration or oil prospecting will lead to increased exploration costs for the companies and by extension to the Government of Kenya.

It is our hope that this was not an oversight on the part of the CS and we will see an extension of the remission in the Finance Bill!

Withholding VAT

Withholding VAT (WH VAT) continues to be an administrative burden for taxpayers and we note specifically that some taxpayers have been in perpetual VAT credits owing to the application of the regime.

It would be a welcome incentive if the government were to consider a reduction of the withholding VAT rate from 6% to a lower rate or better, introducing provisions in the VAT legislation to allow taxpayers to apply for cash refunds or set-off of the WH VAT credits against other taxes.

Conclusion

We expect the anticipated change in the VAT status of petroleum products from exempt to taxable at 16% to significantly contribute to the revenue collection by the Government given the key role petroleum products play in the economy.

On the other hand, if there are no measures put in place by the relevant agencies to mitigate the likely increase in prices because of the VAT on petroleum products, then households and companies should be prepared for increased commodity prices.

Further, the proposed VAT exemption in relation to various goods and services is likely to push up the final prices of the items associated with these exemptions. Accordingly, the CS's bullish outlook on the macroeconomic indicators might be short lived!

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Excise duty

The Cabinet Secretary for the National Treasury ("CS") has proposed a number of measures under the Excise Duty Act, 2015 which are aimed at boosting tax revenues, achieving universal healthcare and environmental protection amongst other priority areas for the government. The measures affect a range of goods and services as the highlights below attest:

Curbing adulteration of fuel products

The CS has proposed to harmonize the excise duty rates on illuminating kerosene and gas oil by increasing the rate on kerosene from KES 7,205 per litre to KES 10,305 per litre. This measure is aimed at discouraging the use of kerosene as a contaminant in other fuels.

Although this is a welcome move for motorists and the exchequer, this increase is bound to hurt the rural and low income households that rely on kerosene for heating and lighting.

Increased excise duty on private passenger cars

The CS has proposed to increase excise duty on private passenger motor vehicles whose engine capacity exceeds 2,500cc for diesel and 3,000cc for petrol powered vehicles from 20% to 30%. Currently, excise duty is charged uniformly on these categories of motor vehicles irrespective of the engine rating.

The proposed change aims at ensuring progressivity which is a cardinal principle of taxation. It is arguable whether the proposed change will create equity and help curb harmful emissions, which we believe are the desired goals.

A Robin Hood tax on cash transfers

The CS has proposed to introduce a Robin Hood tax of 0.05% on transfer of sums of money, in excess of KES 500,000, through banks and other financial institutions. The proposed change seeks to allow the government to earn a share of revenue from these financial activities while availing a pool of funds that would be used to finance critical government projects.

While the government will collect more revenue from this measure, it appears to be a shift from the established and accepted norm of excise duty as a tax on consumption. We expect the proposal to have an incremental impact on the cost of financial services and perhaps dampen the pace of investment.

Increase of excise duty on mobile money transfer

The CS has proposed to increase excise duty on fees charged on money transfer services by cellular phone service providers from 10% to 12%. In his speech, the CS indicated that this proposed amendment is aimed at enabling the government to raise revenue to fund universal health care. However, similarly to the Robin Hood tax, we expect this measure will further drive up the cost of money, which may result in adverse knock-on effects on investment.

Export levy

The Cabinet Secretary has proposed to introduce export duty of 20% on copper waste and scrap of tariff code 7404.00.00. This move aims at encouraging local smelting and value addition for the waste copper. The move may also be aimed at discouraging vandalism of copper cables and wires by unscrupulous dealers who sell these products outside of Kenya.

Other expected changes

Excise duty on Sugar Confectionary & Chocolates

Consumption of sugar has been linked to lifestyle related diseases. There has been a debate in government circles regarding the introduction of excise duty on products high in sugar content in a move aimed at ensuring a healthier population. It is expected that excise duty or similar duty may be introduced by the Finance Bill.

Exemption of supplies to 'DEFCO'

Historically, excisable supplies to the Defense Forces Canteen Organisation ("DEFCO") have been subject to preferential excise duty treatment.

However, duty exemption was omitted from the Excise Duty Act, 2015 and The National Treasury has expressed a desire to re-introduce Excise Duty exemption in harmony with the exemptions under the Value Added Tax and customs duty laws.

Annual adjustment of excise duty rate

With the increased pressure on revenue collection, there is also a likelihood that the National Treasury will enforce the inflationary adjustment of Excise Duty rates as enshrined in the Excise Duty Act and perhaps consider making it an annual adjustment instead of the current bi-annual adjustment.

Penalties and fines

Based on the CS's emphasis on the initiatives that the government has put in place to combat illicit trade and counterfeits, including the formation of a multi-agency team, we expect closer compliance scrutiny and perhaps higher penalties and fines for non-compliance with excise duty.

Conclusion

Excise duty continues to evolve from its traditional role of taxing luxurious and harmful products to being a revenue earner for the government.

In addition, the scope of goods and services subject to excise duty keeps expanding while the excise duty rates for those already in the net keep going up. Given the recent trend, what is the next product or service to fall under the excise tax net?

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Customs duty

Introduction

The Government has adopted an ambitious approach in line with its 'Big Four' agenda which focuses on food security, affordable housing, manufacturing and affordable healthcare. Accordingly, the budget proposals made by the Cabinet Secretary for National Treasury (CS) are aimed at stimulating industrialization and revitalizing local investments.

From a customs duty perspective, the CS's remarks comprised proposals made by Kenya's National Treasury to the East Africa Community (EAC) Council of Ministers (the Council), which it is hoped will be ratified by the Council through the EAC Gazette to be published later this month (June 2018). Some of the key proposals made by the National Treasury to the EAC Council include measures aimed at the following:

Protection of the textile industry

The CS noted the decline in performance of the textile industry and in an effort to boost the industry, he proposed an increase of import duty at the higher of USD 5 per kg or 35% for textiles and the higher of USD 10 per pair or 35% for footwear. The CS also proposed an allocation of KES 2.2 billion to develop the textile and leather industries.

Further, he proposed an amendment to the EAC Common External Tariff (CET) to reduce import duty on polyvinyl alcohol, a raw material used in the textile fabrication, from 10% to 0%.

These are welcome proposals which will lead to the reduction of costs of manufacturing textiles and by extension the cost of the final products. Further, these proposals will potentially enhance employment.

Duty remission on inputs for the manufacture of pesticides, fungicides, insecticides and acaricides

The CS has proposed remission of import duty on inputs used in the manufacture of pesticides, fungicides, insecticides and acaricides. Gazetted manufacturers of these products will import the inputs at a duty rate of 0% therefore reducing the cost of pesticides as a measure to boost food security.

In addition, Kenya has also made a proposal to the EAC Council for remission on aerosol cans used in the packaging of insecticides and acaricides. If the proposal is passed, these cans will be imported at a duty rate of 0% instead of 10% for a period of one year.

Import duty remitted on inputs/raw materials for the manufacture of energy saving stoves

The CS has proposed remission of import duty on inputs and raw materials for direct and exclusive use in the assembly, manufacture or repair of clean energy cooking stoves. Gazetted manufacturers will import these inputs at a duty rate of 0%.

Further incentives for the tourism sector…

In a bid to stimulate the tourism sector, the CS has proposed an exemption from import duty of sightseeing buses and overland trucks imported by licensed tour operators. This move complements efforts by the Kenya Tourism Board (Brand Kenya initiative) to market Kenya as a tourist destination.

Protection of the local steel and iron industry

The CS has proposed an increase in the rate of import duty of steel and iron products from 25% to 35%. This move seeks to protect the local industries from competition from imported cheap and on occasion subsidized iron and steel products.

Whilst the proposal is a welcome move in enhancing the local industry, it is debatable whether Kenya's iron and steel production is able to sustain the immediate market demand for and the requisite quality of steel and iron products.

Timber, furniture, paper and paperboard duties go up!

In a bid to protect the timber and furniture industry from proliferating cheap timber products

and to enhance local production, the CS has introduced a specific rate of import duty at USD 110 per metric tonne (MT) on particle boards, USD 120 per MT on medium density fiber board, USD 230 per cubic metre on plywood and USD 200/MT on block boards, or an ad valorem duty rate of 35%, whichever is higher. This proposal is in conjunction with a proposed increase in the rate of import duty from 25% to 35% on paper and paper board products for a period of one year.

Although the above proposals are intended to spur growth in the local manufacturing sector, these may lead to increased degradation of the environment due to a scramble for the scanty timber resources from our forests. It is therefore critical that the Government agencies responsible for our forest resources remain awake to the potential risk posed by an increase in demand for local timber.

Metal & Allied Sector

The CS also made mention of a proposal for a stay of execution of the current Custom External Tariff (CET) rates on flat-rolled metal products, metal bars, electrodes and prefabricated buildings, and an application of the higher duty rates for different categories of bars and rods of steel. This is in order to protect local manufacturers from external competition.

Further, the CS proposed the imposition of an export levy of 20% on copper waste and scrap metal to encourage the retention and use of scrap metal within Kenya and reduce the rampant vandalism of metal structures. It is hoped that this move will boost the production of steel products and encourage the recycling of scrap metal.

Increased tariffs on vegetable oil

A proposal was made to protect local oil manufacturers by introducing a specific import duty rate of USD 500/MT or 35%, whichever is higher, for imported vegetable oils.

While it may seem to be a welcome move, it is worth noting that the amount of this product produced in Kenya may not be sufficient to meet the market demand.

Other proposals shared with the EAC Council for consideration that were not mentioned in the CS's speech include:

Duty remission on motorcycle kits

Gazetted motorcycles assemblers to be granted a duty remission on importation of completely knocked down (CKD) kits at a rate of 10% for a period of one year. This is a further extension after expiry of the current year's remission period. The measure is meant to encourage local manufacturing and assembly of motorcycles.

Boosting food security

There is a proposal to introduce a remission of duty on wheat grain with the applicable rate being 10% instead of 35% for one year. This is meant to ease food prices and enhance food security.

Duty remission on industrial sugar

The EAC Member States have jointly made a proposal to retract from an earlier Gazette provision, passed in June 2016, to reduce duty remission levels on industrial sugar. The proposal is based on an acknowledgement that there is no local production of industrial sugar within the EAC region yet and hence the proposal to maintain the import duty rate on industrial sugar at the rate of 10% for another one year. This is meant to incentivise manufacturers who use industrial sugar as a raw material.

Duty remission on gum base

There is a proposal to boost local manufacture of chewing gum within the EAC by granting import duty remission on importation of gum base. The Gazetted manufacturers will import the raw material at an import duty rate of 0% for a period of one year. The measure is meant to encourage local manufacturing of chewing gum.

Remission on inputs for the manufacture of toothbrushes

A proposal was made to grant remission of import duty on inputs for the manufacture of toothbrushes. The Gazetted manufacturers will import the inputs at a rate of 0%. The measure is meant to encourage local manufacture and boost dental health.

Roofing tiles coated with acrylic paint

There is a proposal to grant remission of import duty on inputs used in the manufacture of roofing tiles coated with acrylic paint. The Gazetted manufacturers will import the inputs at a rate of 0% for one year.

Split of tariff covering boats, canoes and other vessels for pleasure or sports

This is a proposal to split the tariff code 8903.99.00 (covering yachts, vessels for pleasure or sports, rowing boats and canoes), to cater for motor boat ambulances in addition to sports/recreational vessels. There is a possibility of allocation of a lower import duty rate on motor boat ambulances in promotion of the healthcare agenda.

Dealing with the rice production deficit

In order to deal with the rice production deficit, there is a proposal to extend the current stay of application of import duty rates per the CET. In its place, the proposal seeks to apply the higher of 35% or USD 200/MT for a period of one year.

This is a welcome temporary measure by the government to enhance food security. However, the extension of the stay brings to question the efficacy of methods adopted by the Government to increase food production.

Road Tractors & Semitrailers

There is a proposal to increase the import duty rate on tractors and semi-trailers from the current rate of 10% to 25%. This move could be aimed at encouraging the local manufacture of the above. This is a welcome move as it seeks to encourage local assembly of these units.

Safety Matches

There is a proposal for a stay of application of the current 25% import duty on safety matches. If the proposal is passed, an import duty rate of the higher of 25% or USD 1.35/kg for the next financial year will be applicable.

The use of alternative rates could be a means to prevent undervaluation of imports as a means of tax evasion.

Conclusion

The proposed changes focus on enhancement of the local manufacturing sector as evidenced by the numerous proposed incentives towards local manufacturers. The CS has anchored the proposals on the government's Big Four agenda.

Further, the CS has embraced a protectionism approach with regard to imports by increasing tariffs on importation of finished goods. It is our view that the successful implementation of the budget proposals will spur growth in the local manufacturing sector.

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Other taxes: New tax legislation /tax reform agenda

Tax reforms

Over the last five years, the government has made moves to modernise and simplify the tax legislation. The CS proposes to undertake a comprehensive review of the Income Tax Act, the East African Community Customs Management Act, 2004 and the East African Community Common External Tariffs with the Income Tax Bill set to be tabled before Parliament in July 2018. These are some of the last pieces of tax legislations to be reviewed.

The overhaul of the legislations is expected to incorporate new developments, create a conducive business environment as well as address challenges in the implementation of the existing laws.

Fiscal policy and reforms

Strengthening revenues through tax policy is at the core of achieving fiscal targets. The government has highlighted a combination of policy and administrative reforms targeted at boosting domestic revenue mobilization. The Government aims to reduce the fiscal deficit through these measures. Some of the suggested reforms in the Budget Policy Statement, 2018 include:

- Roll out of the Integrated Customs Management System (ICMS) to seal loop holes at Customs;
- Implementation of the Regional Electronic Cargo Tracking (RECTS) to tackle transit diversion;

- Enhanced scanning activities to detect concealment;
- Scaling-up on-going and routine activities such as Pre-Verification of Conformity (PVOC), benchmarking and auctions;
- Data matching and use of third party data to enhance compliance through integration of iTax with IFMIS;
- Expansion of tax base by targeting the informal sector, pursue non-filers and increase the focus on taxation of international transactions and transfer pricing; and
- Enhance investigations, intelligence capacity and Kenya Revenue Authority (KRA) capacity to support revenue collection.

The budget fails to address the reforms comprehensively and focuses on the expansion of the tax base and pursuing non-filers.

Tightening compliance

The government has been working towards enhancing compliance with the tax laws. Some of the proposals made by the CS include:

- The increase of the late payment interest from 1% to 2%;
- Introduction of a penalty of 20% for late payment of taxes;
- Amendment of the Tax Procedure Act, to provide for time limits in the application and extension of time to file a return as well as allow taxpayers to amend self-assessment returns;
- Imposing a penalty of 20% and interest of 2% on late payment of tax in the Betting, Lotteries and Gaming Act; and
- Empowering the KRA to collect the surplus from the regulatory authorities and remit to the Consolidated Fund. The Regulatory Authorities have been inconsistent in remitting surpluses to the Consolidated fund despite being exempt to corporate tax.

The measures are aimed at mobilising revenue collection to avail the funds for supporting the government's Big Four agenda.

Encouraging investments

The Government proposes to develop a framework to introduce special incentives in the VAT Act, Excise Duty Act, and Miscellaneous Fees and Levies Act, and provide a preferential tax rate under the Income Tax Act. This is aimed at encouraging investments. We await further guidelines to be provided on the implementation of this proposal.

Other levies

Export levy on copper waste and scrap metal

A new export levy of 20% on copper waste and scrap metal is set to be introduced in order to protect local manufacturers and stem the tide against vandalism of public infrastructure. This measure is expected to discourage the export of these materials and enhance the regulation of dealings in scrap metal which is provided for under the Scrap Metal Act.

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Other legislative reforms

The Budget proposes a range of reforms to legislation beyond tax laws, some of which are set out below:

The SACCO Societies (Amendment) Bill, 2018

The Government proposes to amend the SACCO Societies Act to allow the usage of ICT in the submission of statutory reports to the SACCO Regulatory Authority on a monthly and quarterly basis.

The Capital Markets (Amendment) Bill, 2018

The Government proposes to amend the Capital Markets Act to introduce enhanced financial controls to provide for investor confidence in this area.

Retirements Benefits Act

The Government proposes to amend this Act to enable the Retirement Benefits Authority to intervene against any employers who fail to remit contributions to their respective retirement benefit scheme.

Retirement Benefits Regulations

The Government proposes to amend the benefit scheme regulations to enable members who are unable to build up medical funds while in employment to use a portion of their retirement benefits for post-retirement medical cover.

The Insurance (Amendment) Bill, 2018

The Government propose to amend the Insurance Act to introduce index-based insurance on crop and livestock insurance which will enable companies to pay out claims based on certain environmental conditions and not the quantum of loss suffered, which can take a long time to prove.

Employment Act 2012

The Government intends to amend the Employment Act to provide that an employer shall contribute 0.5% of the employee's gross monthly emolument subject to a maximum of KES 5000 to the National Housing Development Fund. An employee will match this and contribute 0.5% of their gross monthly earnings to the Fund. It is not clear whether the employee contribution will also be subject to KES 5000 maximum. The stated purpose of this amendment to the Act is the promotion of low-cost housing for Kenyans. A pertinent question will be whether persons ineligible for housing under the Government's program (e.g., those earning more than KES 100,000 or more) will be required to contribute (and have their employers contribute), thus subsidizing those that would generally be eligible. What is also not clear is how this contribution scheme will apply to those in self-employment and casual/temporary employees.

The Proceeds of Crime and Anti-Money Laundering Act, 2009

The Government proposes to amend this Act to include the SACCO Societies Regulatory Authority as a supervisory body with the authority to monitor transactions of deposit taking SACCOS.

Financial Markets Conduct Bill 2018

The Government proposes to enact this Bill into law in order to remedy inadequacies in consumer protection and unregulated lending.

The Public Procurement and Disposal Act 2015

Public Procurement and Asset Disposal Act (PPAD) regulations will be submitted to parliament shortly. These regulations seek to improve efficiency and effectiveness, accountability and transparency in the procurement processes.

The Betting, Lotteries and Gaming Act

The Government will be introducing a framework to cover the issuance of the casino licenses to ensure that individuals are vetted in an act to reduce money laundering. The Betting, Control and Licensing Board will be required take into account a wider criterion while undertaking the fit and proper test.

Public Private Partnership Act 2013

The Government proposes to amend this Act to focus on project land acquisition and reduce the bureaucracy associated with PPP project development. The Government will undertake administrative actions aimed at speeding up project turnaround times.

The Banking Act

The Government intends to repeal section 33B of the Banking Act to remove the capping of interest rates to ensure access to credit facilities across the economy. The amendment will also remove the requirement for a minimum rate on deposits.

Economy

The Big Four – Big hopes?

Kenya has successfully come out of prolonged electioneering cycle and with political truce, there is a semblance of stability. The macro-economic environment has remained stable and this is good for business predictability.

This year's budget is anchored on the government's focus to stimulate economic growth, create jobs and increase the well being of Kenyans under the Big Four plan – Manufacturing, Food and Nutrition Security, Health and Housing.

The Cabinet Secretary has allocated KES 460 billion towards this plan. It is a good beginning with very ambitious targets.

To achieve its targets, the government has committed to building strong macroeconomic fundamentals by pursuing prudent monetary and fiscal policies to maintain stability in macroeconomic fundamentals, enhance security, support technology innovation and deal decisively with corruption.

Implementation will require a different approach and commitment including an improved and targeted regulatory and legal environment, increased public sector efficiency and productivity as well as well as the adoption of modern business procedures.

Modest GDP growth … with the usual cyclic reasons

The economy slowed down in 2017 from 5.9% growth in 2016 to 4.9% in 2017. This as a result of the long electioneering period and poor weather. Key sectors of the economy such as Agriculture and Manufacturing recorded significant deceleration in 2017 while the service oriented sectors grew. In addition, the effect of the interest rate caps affected the uptake of credit by the private sector.

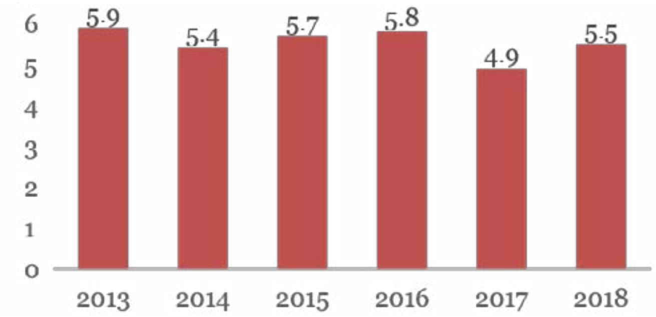
In 2018, GDP is projected to expand by 5.5%, being driven by the Big Four. The budget has allocated KES 43.1 billion for Food and Nutrition Security, KES 44.6 billion in Universal Health Coverage, KES 6.5 billion for provision of affordable housing and KES 10.5 billion for manufacturing .

Rate capping curtailed growth…

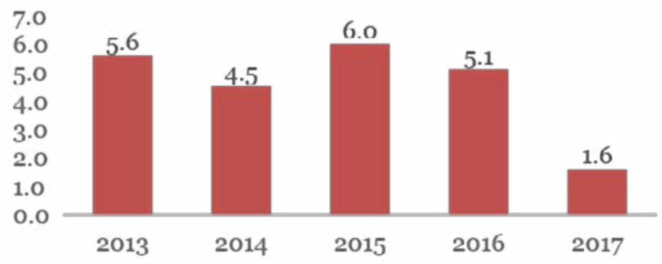
The performance of the economy in 2017 was adversely affected by the capping of interest rates that started in September 2016 to not more than 4% above the CBR. Monetary policy adjustments of the CBR rate to 9.5% has not produced the desired effects either. Slow uptake of credit facilities by the private sector from commercial banks has thinned investments.

In his speech, the Cabinet Secretary referred to this and proposed reforms, including repealing section 33B of the Banking (Amendment) Act, 2016, to optimise lending to

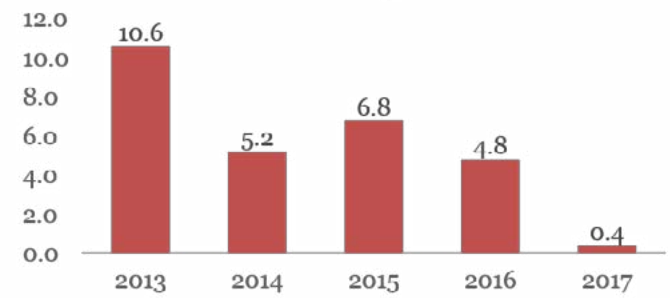
Annual GDP Growth



Agriculture

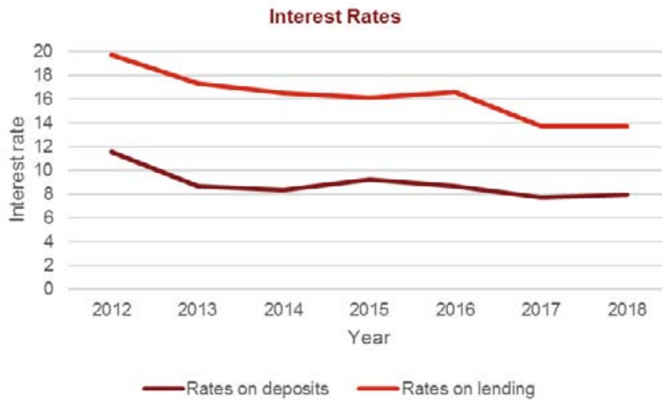


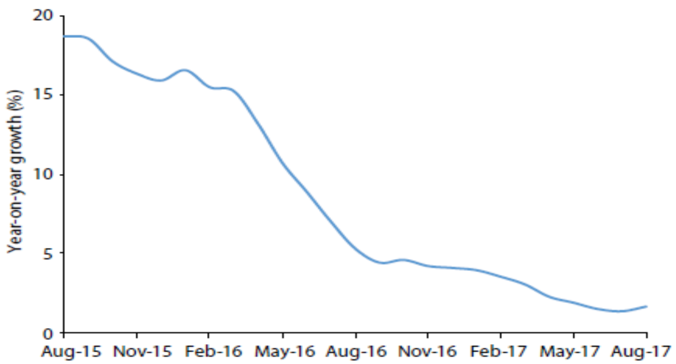
Manufacturing sector



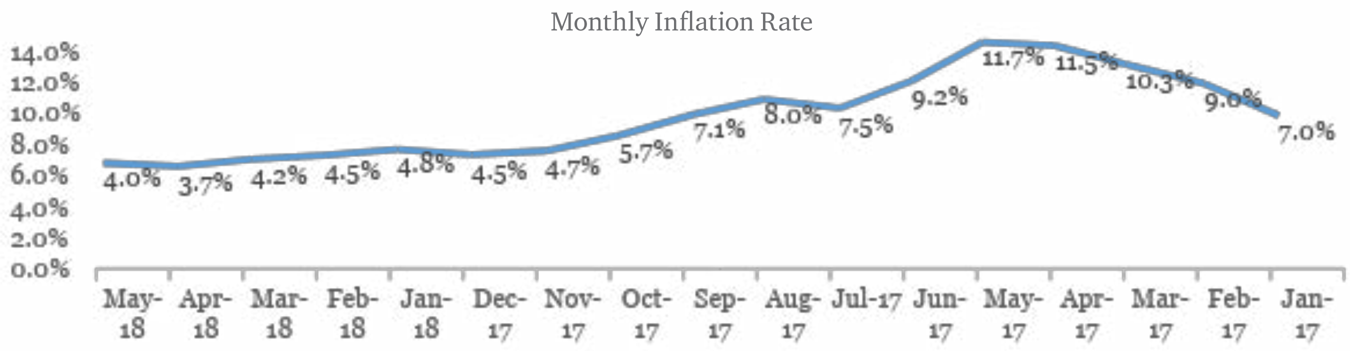
the private sector while encouraging innovation in the financial sector. This should be done sooner to maximise the improving economic environment.

Inflation has been curiously low and this has helped to stabilise the macro economic fundamentals especially with the budget deficit and debt levels. Government is looking at reducing the budget deficit to 5.7% in 2018/19 (7.2% in 2017/18). This should manage the crowding out effect of the private sector.





Deceleration of private sector credit demand (World Bank Kenya Economic Update)

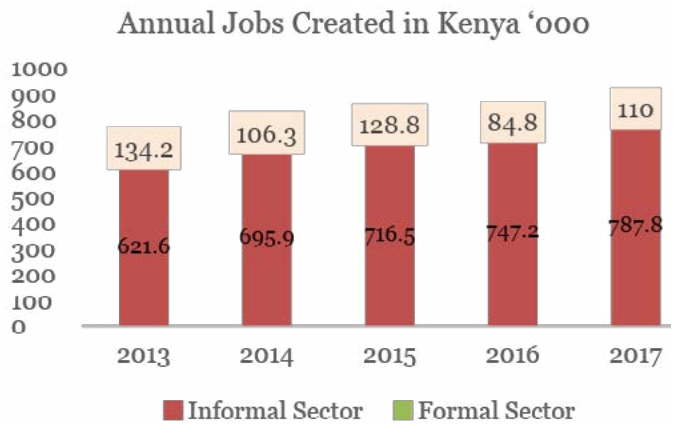


Absorption Capacity and Economic Growth

Two of the challenges the government has faced over the years with respect to budget execution are the delays and slow absorption capacity of development expenditure. The Cabinet Secretary mentioned the establishment of a Public Investment and Management Unit to improve the management and budgeting of public development projects. It remains to be seen how this effort will address a perennial problem.

The economy generated 897,800 jobs in 2017, with 12% of these jobs in the formal sector. The largest employers were education, agriculture, fisheries and manufacturing.

The government has envisioned further policy reforms and investments in agriculture, fisheries and manufacturing. However there is a need to ensure that the jobs created in the informal sector offer meaningful incomes to support aggregate demand for goods and services.



It can work

The 2018/19 budget broadly gives a picture of a government focused on investments that will stimulate economic growth, create jobs, transform lives and reduce poverty and inequality.

The focus on the Big Four plan creates a roadmap for Kenya's social and economic transformation as embedded in Vision 2030 and the Medium Term Plan III.

While KES 460 billion has been allocated to the Big Four, a further KES 992 billion has been set aside for enablers like security, infrastructure and education. Even so, more needs to be done.

There should be a stronger focus on building collaborations between national and county governments, increasing public private partnerships (PPP) to accelerate investments leading to the creation of jobs, increasing food security, achieving universal health care and growing a more robust manufacturing sector.

To promote macroeconomic stability, the government will need to intervene effectively and rapidly to influence labour productivity, manufacturing and the production of agricultural products. A lot of focus is needed on increasing resource mobilization at the county level, promoting the growth of local industries, dropping of regulations that handicap local industries, promoting the adoption of low-cost technologies especially in the housing and agricultural sectors and collaborating with regional partners to remove interstate barriers.

What does this mean for business

There have been no shifts in the government's policy direction, just the focus on the Big Four. This is important for businesses to continue operating within a predictable, consistent and stable policy environment.

The government's absorptive capacity of development expenditure, timely and active support to counties, increased public sector efficiency and productivity as well as the adoption of modern business procedures and an increased focus on regional trade will be critical to the success of the budget's execution.

In addition, it will be critical to ensure that standards are maintained and properly monitored to protect businesses. It is not enough to fight corruption; clear evidence of preventing corruption will need to be demonstrated.

Businesses have to be smart and innovative. Prudent investments, robust cost control measures including a review and streamlining of business process, and distribution and customer engagement channels using technology will be important for benefits to be realised and to actualise the theme of "Creating jobs, Transforming Lives and Sharing Prosperity".

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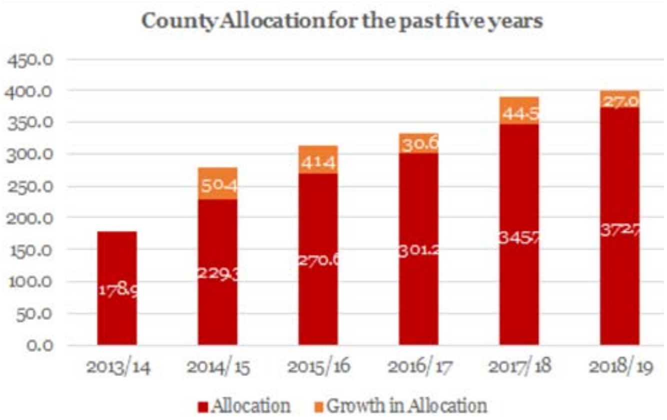
Counties and the Big 4 Agenda

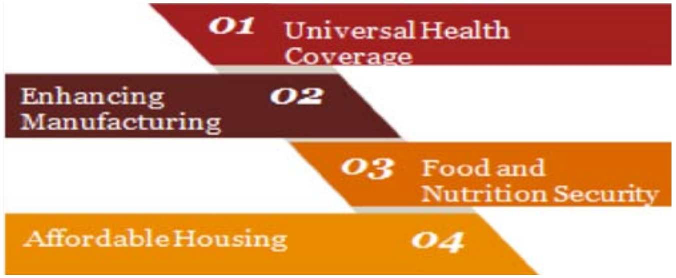
The devolution journey

Introduction

Five years later, counties are making good progress as they continue to navigate the complexities of setting up a devolved government structure. According to the Controller of Budget reports, revenue share (including conditional grants) has grown year on year and currently totals KES 1.7 trillion since 2013.



Implementation of projects in counties is guided by County Integrated Development Plans (CIDPs) which set out midterm priorities for county governments and guide in planning and budgeting. As per the PFM Act, no public funds can be expended outside the long term plans. County governments are a fundamental vehicle for development.



The functions allocated to Counties under Schedule Four of the Constitution largely mirror the priority areas of the Big Four Agenda.

> It is with this backdrop that we set out below some of the key considerations for counties as they integrate their plans with the Big Four Agenda.

Are Counties ready to implement the Big Four Agenda?

Implementation of the Big Four Agenda calls for partnerships and collaboration between the two levels of Government. In developing the 2018-2022 County Integrated Development Plans (CIDPs), counties should identify projects that are aligned to the aspirations of the Big Four Agenda. They should allocate a substantive amount of money to provision of Universal Health Care, promotion of Food and Nutrition Security, provision of Affordable Housing and Creation of Industries to generate employment.

KES 372 billion

allocated to counties in 2018/19 Budget

In the 2018/19 Budget, county governments have been allocated KES 372 billion (Equitable Share and Conditional Grants), an 8% increase from 2017/18. Counties allocation remains above the 15% threshold, however far more funding is required to realise the objectives of the Big Four Agenda at the county level.

Do they have the human capital with requisite skills to deliver the Big Four Agenda?

Counties should assess critical skills needed and engage development partners and private sector players with the capacity to grow human capital and accelerate development through skills transfer.

Some of the projects under the Big Four will be implemented across counties. Counties in close proximity should consider coming together to form regional economic blocs, create shared centres of excellence and thereby develop a more readily available and better skilled combined pool of human capital.

If well managed and anchored on a strong legal and institutional framework, these bodies can generate immense economic and social benefits to individual counties due to economies of scale.

Do they have the institutional frameworks to engage with the National Government and Private Sector?

The National Government should empower counties with tools and policy reforms to work seamlessly with private institutions.

These will improve macroeconomic fundamentals, increase investments in manufacturing and agriculture, create jobs and increase consumers' purchasing power at the county level. Some projects will require intensive capital investment which is beyond the revenue basket.

Counties will therefore be required to explore alternative revenue mobilization strategies. This will call for policies and legislation to support local revenue mobilization, land reforms, advancing manufacturing at the county level and agricultural production.

With allocation of funds at County level to be in line with the Big Four priorities and a strong human capital pool with the critical skills, the expected value of this Agenda is an achievable dream.

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Financial services sector

Increasing access to affordable credit and facilitating credit growth

Repeal of interest rate capping

The Cabinet Secretary began by acknowledging that the introduction of rate capping in September 2016 had resulted in a slowdown of lending to the Private and micro, small & medium enterprises (MSMEs).

Credit growth in the private sector has slowed down significantly to 2.4% from double digit growth in the prior year. The Government fears that this trend could adversely affect economic growth.

The CS proposed repeal of Section 33B of the Banking (amendment) Act, 2016 which brought into effect interest rate capping in September 2016.

It remains to be seen whether Parliament will support the intended repeal given that the CS has not proposed an alternative framework. It is likely that Parliamentarians will not accept a return to the previous unregulated regime where they felt banks were profiteering at the expense of customers.

Other measures:

Other reforms aimed at expanding access to credit and enhancing the return on savings included:

- the introduction of a National Credit Guarantee Scheme as a policy tool to increase access to credit by MSMEs and start-ups;
- the establishment of the Kenya Development Bank and the Biashara Kenya Fund to provide long term credit to MSMEs.

The Kenya Development Bank will be formed by merging the Industrial and Commercial Development Corporation (ICDC), the Industrial Development Bank (IDB) and the Tourism Finance Corporation (TFC) while the Biashara Kenya Fund will be formed by merging the Uwezo Fund, the Youth Enterprise Development Fund and the Women Enterprise Development Fund.

The consolidated entities will provide:

- the larger scale required for greater investment in technology and increases in efficiency;
- the digitization of land titling processes and a functional collateral registry; and
- implementation of the Treasury Mobile Direct and M-Akiba to enhance return on investments by the public.

The Financial Markets Conduct Bill

The Financial Markets Conduct Bill, 2018 is currently undergoing stakeholder consultations before Cabinet consideration. It is aimed at creating effective financial consumer protection, making credit more accessible, supporting competition and harmonizing the conduct of financial service providers.

The Bill creates four new institutions: the Financial Markets Conduct Authority, the Financial Sector Ombudsman, the Conduct Compensation Fund Board and the Financial Services Tribunal.

There has been some concern by the Central Bank of Kenya that some of its roles would be duplicated.

Insurance sector

Introduction of index-based agriculture insurance

In an effort to increase agricultural production by small scale farmers, the Government aims to make crop and livestock insurance readily available.

To increase the uptake of agricultural insurance, the CS proposes to amend the Insurance Act to introduce index-based insurance whose payouts are driven by certain environmental and agricultural conditions/indices.

The current conventional agricultural insurance relies on direct measurement of the loss or damage suffered by the farmer whose assessment is normally costly or infeasible.

This reform will require the development of consistent and relevant agricultural indices. There is also a lack of historical data to determine the design and pricing of these products. In addition, whether the cost of agricultural insurance is within the reach of the targeted small scale farmers remains a concern.

Insured to directly remit premiums

The CS also proposes to amend the Insurance Act to require the insured to make payments in respect of premiums direct to the insurer. Currently, a significant proportion of insurance premiums is paid through intermediaries who sometimes delay or fail to remit the premiums to insurers.

The amendment is aimed at prompt coverage of the insured risks and thereby enhanced consumer protection.

Fraud in the insurance sector

The insurance industry has long been impacted by insurance fraud that is hard to investigate or punish and leaves insurers with unwarranted losses. The CS proposes to amend the Insurance Act to introduce provisions to criminalize insurance fraud and protect the insured.

Retirement Benefits

The CS proposes to amend the Retirement Benefits Act to enable the Retirement Benefits Authority take action against any employers who fail to remit pension contributions to the appointed schemes.

The Government also proposes to introduce amendments to the Retirement Regulations to allow members who are unable to build medical funds during employment to utilize a portion of their retirement benefits for post-retirement medical cover. This medical fund set up in 2016 would be exempted from the retirement benefit levy to boost members' contributions.

Capital Markets

The government proposes to amend the CM Act to introduce enhanced financial controls and provide investor protection.

Taxes

The Cabinet Secretary for Treasury has proposed a number of tax measures affecting the financial services sector as outlined below:

- Introduction of excise duty ('Robin Hood' tax) of 0.05% on transfer of amounts more than KES 500,000 through banks and other financial institutions. The proposed change is meant generate more revenues to finance critical Government programs;
- Increase excise duty on fees charged on money transfer services by cellular phone service providers from 10% to 12%. The proposed change is purely driven by revenue considerations for the Exchequer and will further drive up the cost of mobile money transfers;
- Introduction of 5% withholding tax on insurance premiums paid to non-resident insurance companies. This could adversely affect the sector by increasing the cost of re-insurance with non-residents companies; and
- Clarification that gains arising from transfer of property under the general insurance business will be taxed as capital gains, currently at the rate of 5%. The proposed amendment has further clarified that life insurance business in not subject to capital gains.

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Food and Nutrition Security

Introduction

Enhancing food and nutrition security to all Kenyans by 2022 is one of the big four priorities of the national government.

Although the agricultural sector contributes approximately 30% of Gross Domestic Product (GDP) annually, and employs over 70% of the labour force, Kenya is still categorised as a food deficit country.

Boosting agricultural output

The largest share of the agriculture budget (KES 8.5 b) was allocated to ongoing irrigation projects as the government aims to encourage large-scale food production. The budget also proposes to increase food production by cultivating cereals on an additional 700,000 acres through PPPs.

Following the adverse effects of climate change and the increased prevalence of pests and diseases, the CS considered enhancing the Crop Insurance Scheme (CIS) and Fall Army Worm mitigation by allocating each KES 0.3 billion. These allocations reflect the Government's assessment and management of disaster risk and its impact on the farmers.

These allocations will enable the government to achieve its goal to cushion farmers against the related risks while enabling them to enhance agricultural productivity.

The proposed budget has also considered measures to reduce the cost of food production by reducing the high cost of farm inputs by allocating KES 4.3 billion for fertilizer subsidies and exempting Value Added Tax (VAT) on raw materials used in the production of animal feeds.

Other measures aimed at supporting safe food storage and sustain food security include exemption of VAT on equipment used in the construction of grain storage facilities.

More action required to reform the sector

Crop diversification and mechanisation of agriculture are fundamental initiatives to achieve food security. The CS allocated KES 1.9 billion and KES 0.5 billion to crop diversification and mechanisation of agriculture respectively.

The government has not provided an appraisal of past investments in mechanising agriculture given that the majority of agriculture in the country is carried out on a subsistence basis.

The feasibility of achieving effective mechanisation remains in doubt given the reduced allocation in the current budget.

In addition, the CS could have proposed measures to specifically address post harvest losses arising from poor market distribution infrastructure, high energy costs and lack of use of technology.

Food security in the ASAL regions should mainly focus on the management of livestock. The budget did not set out a clear strategy to mitigate loss of livestock especially during extreme weather conditions.

There is also a need for proactive initiatives to reform key institutions in the sector to prevent post-harvest losses and budget leakages.

It also remains unclear how the proposed initiatives will cascade down to the counties given that agriculture is a devolved function.

Overall, the less than 2% allocation may be seen to be inadequate for various reasons:-

- Agriculture contributes significantly to the GDP (30% directly and roughly another 20% indirectly);
- It is a significant initiative under Big Four agenda for the government;
- The sector offers employment to about 70% of the population and
- The proposed allocation falls below the 10% public expenditure allocation required as per the *'African Union (AU) Malabo Declaration on Agriculture and Postharvest Losses'.*

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Catalysing achievement of Universal Health Coverage (UHC)

Universal health coverage (UHC) is part of Kenya's goal to attain the highest standard of healthcare as elaborated in the Kenya Health Policy as well as to achieve economic growth as enshrined in Kenya Vision 2030. There is political goodwill and infrastructure to catapult achievement of this desire hence UHC has been included as one of the Big Four pillars.

The National Health Insurance Fund (NHIF) is a major catalyst towards achievement of UHC. The proposal by the Cabinet Secretary in the 2018-19 budget statement to reconfigure the NHIF model will accelerate the projected NHIF enrolment from the current 16.5 million to 25 million Kenyans which represents a 52% increase by the end of 2018.

By 2022, NHIF insurance coverage is expected to increase from the current 36% to 100% with a unified progressive benefit package that covers essential interventions.

In our view, the reconfiguration of the NHIF should be geared towards strengthening NHIF systems and capacity, especially in the areas of costing benefit packages and provider payment mechanisms, and to address outstanding issues regarding the flow of funds to counties and public facilities. This is fundamental to ensuring that the investments in NHIF yield the expected results.

Currently, health insurance coverage is concentrated among formal sector workers (public and private sector), for which employee income-related contributions are automatically deducted from salaries. This population group, along with their dependents, accounts for around 18% of the population.

To enhance wider coverage by the private sector, the CS's proposal to reform the governance of private insurance companies to align them to universal health coverage is vital. The Government should also consider incentivising private sector insurance companies and also subsidising the cost of insurance to increase coverage.

Free primary health care has been allocated KES 4.3 billion which is similar to the prior year's allocation. We would have expected an increase in investment in this area as free primary health care is a key ingredient towards achievement of UHC and reducing under-five mortality rates, particularly among the poor.

However, we note that there have been challenges in rolling out free primary health care at the county level and we hope that the lessons learnt in prior years will be taken into account.

Quality of care is paramount and to achieve this, the CS has proposed an investment in the following areas:

- KES 9.4 billion for leasing of medical equipment, an increase from KES 5 billion allocated in the prior year;
- KES 4.7 billion for Kenya Medical Training centers, an increase from KES 3.9 billion;
- KES 11.7 billion for Kenyatta National Hospital, an increase from KES 9 billion;
- KES 7.7 billion for Moi Teaching and Referral Hospital, an increase from KES 6.2 billion;
- KES 1.7 billion for Kenya Medical Research Institute which is a slight reduction from KES 2 billion allocated last year;

- KES 2.9 billion for Doctors, Clinical officers, Nurses internship which is a slight increase from KES 2.7 billion in last year's allocation and
- KES 7.0 billion for CT (Computed Tomography) scanners used in screening for diseases such as cancer which is a significant increase from KES 0.7 billion allocated last year.

From our analysis, generally there is an increase in funding for inputs to achieve quality of care which includes capacity building of health workers, infrastructure and medical equipment. Funding for cancer screening has received a 900% increase in investment.

We observe that this is in tandem with the government's increased attention to cancer treatment. In the recent past, there has been increased scale up in establishment of cancer centres.

The pilot roll out of UHC in four counties is very welcome and is a progressive move towards achievement of UHC by 2022. The government's allocation of KES 2.5 billion, an increase from KES 1.1 billion from last year, shows real commitment.

However, the government needs to set the stage if the roll out of UHC is to be a success. The Government should prioritise the finalisation of the UHC roadmap and development of the Health Financing Strategy to achieve UHC. There is also a need for collaboration between development partners and other key stakeholders in the health sector.

Although the fiscal plan is well set out, the Government needs to ensure that there is good ownership and coordination with the County Governments in order to achieve UHC.

As per the Kenyan Constitution, the role of the National Government is policy development and strategic guidance, while the actual delivery of services is a function of country governments.

Though clearly defined in the constitution, there continues to be confusion. For example, the plan to integrate community health strategy is not clear and we observe that in the 2018-19 budget estimate, there is an intention to enlist Community Health Volunteers to help provide healthcare services at the grassroots level. However, there are no funds allocated in the 2018/2019 budget.

In the past, there has been a low level of coordination and ownership by County governments and this has led to challenges such as health workers' strikes, inadequate health budget allocations at the County level, slow responses to disease outbreaks among other incidents.

There is a need for improved coordination and governance even as we increase fiscal allocations. The national government should develop clear strategies on how to work with the county governments to ensure that UHC becomes a reality.

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Energy

Rise in the cost of Kerosene to hurt 'Wanjiku'

Efforts towards limiting the adulteration of diesel have been enhanced by the matching of the excise duty rate charged on kerosene to that of diesel fuel. This is good news for owners and operators of vehicles and equipment/machinery who have historically suffered higher maintenance costs as a result.

However, these actions will increase the cost of living for low income households who still rely on kerosene for lighting, cooking and heating, following on from the rise in the cost of charcoal and firewood after the recent logging ban. In the long run, the use of alternative fuel such as LPG, will reduce poor health resulting from exposure to dirty domestic fuels.

Progress towards oil production

This year's budgetary allocation for oil and gas is similar to last year's, focusing on exploration and distribution. To this extent the government has set aside KES 4.8 billion. It is expected that part of this allocation will go towards the Early Oil Pilot Scheme which has now taken off with the objective of early monetization of Kenya's crude. The allocation may also fund some of the preliminary studies for the anticipated crude oil pipeline.

The Cabinet Minister was, however, silent on continued interventions to promote the use of LPG as a domestic fuel, whose uptake has been considerably slow. National Oil Corporation of Kenya has also faced challenges in implementation of its subsidized cylinder plan.

Reserving extractive wealth for future generations

Learning from the experience of many mature oil and gas producing nations that have been inspired to preserve their extractives wealth for future generations, legislation resulting in the creation of a Sovereign Wealth Fund ("SWF") will soon be tabled in Parliament. This is expected to put in place a legal framework to guide the investment and management of the proceeds from the sale of oil and gas and other minerals. The efficacy of SWFs is typically enhanced when legislation is in place before commercial production.

Power for growth

With an all-time peak demand of 1,802MW experienced in June 2018, investment in generation of additional power looks plausible.

In a bid to support the generation of affordable energy, the government has allocated KES 12.7 billion in 2018/2019 for geothermal, wind and solar energy resources. Although this represents a reduction of 22% from the allocation in 2017/2018, it will enhance generation of adequate and affordable electricity to power the growing economy and support the manufacturing pillar of the Big Four Agenda.

The halving of tariffs during off-peak hours will further contribute to this initiative.

Power for all

In recent years, the Government has made significant strides in expanding the national electricity grid for both high and low voltage transmission network. As at June 2017, 6.1 million Kenyans were connected to electricity compared to 2.2 million Kenyans in 2013, with current annual demand growth at 4.4 %.

The Government will set aside KES 5.9 billion for rural electrification and connection of public facilities. The Last Mile Connectivity Project will be supported with KES 6.7 billion while KES 1 billion will go towards the national street lightning programme.

To facilitate cheap power from Ethiopia, KES 5.5 billion has been allocated for the Ethiopia - Kenya Interconnector. KES 1 billion will go towards extending the connection subsidy for Kenyans living within 600 meters of a transformer. The delayed transmission line for the Lake Turkana Wind Project has been allocated KES 12.6 billion.

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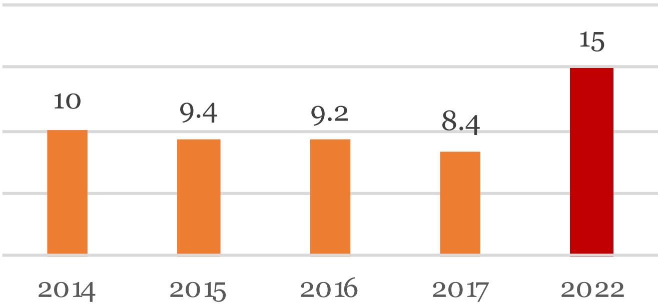
Manufacturing Sector

In line with the economic aspirations under Vision 2030, the government has declared the manufacturing sector as one of the areas of focus for the next five years under the Big Four Agenda.

Manufacturing sector contribution to GDP (%)



Source: KNBS

The government seeks to increase the contribution of the manufacturing sector to Gross Domestic Product (GDP) to 15% by 2022. This is expected to increase jobs in this sector by more than 800,000, accelerate economic growth and reduce poverty.

Bold intentions to expand the manufacturing sector going forward

The government has spelt out specific measures to support the expansion of the manufacturing sector, revolving around four pillars:

Direct support of specific industries to drive growth

The government intends to provide direct financial support to promote the growth of specific industries within the sector.

For instance, it has allocated KES 400 Million for the continued development of the leather industrial park, KES 400 Million for textile development in the EPZ hub, and KES 1.43 Billion for modernization of Rivatex East Africa Limited and KES 200 Million for the modernisation of New KCC.

Protection and promotion of local manufacturing

The government has proposed tax incentives to protect and promote local manufacturers in sub-sectors such as textile and apparels, vegetable oils, construction materials, timber, and assembly of computers and laptops.

To expand demand for locally manufactured products, government institutions will be required to only procure items manufactured locally.

Efforts to lower cost of production

For many years, Kenyan manufacturers have remained uncompetitive due to high cost of production driven by high energy costs, inefficient supply chains due to inadequate infrastructure development and general labor costs.

In an effort to reduce the cost of production, there is a proposal to cut the cost of off-peak power by half and plans to implement measures to bring down the cost of energy for selected investors.

The government also intends to accelerate infrastructure growth and improve land access to investors in this sector. This will be partly achieved through the roll-out of additional Special Economic Zones (SEZs) in the counties.

Counterfeit and illicit products

Manufacturers and the government have been losing significant revenues due to the proliferation of counterfeit and illicit products in the market.

To clamp down on such products, a multi-agency team has been formed comprising of Kenya Revenue Authority (KRA), Kenya Bureau of Statistics (KEBS) and the Anti-Counterfeit Agency.

So, is the future of the manufacturing sector secured?

On paper, the government's intentions are admirable and if well implemented can result in substantial transformation of the manufacturing sector.

However, there are wider macro economic dynamics which could weigh down the achievement of the vision. In an increasingly competitive world, it is becoming more difficult to implement effective market protection measures due to competing multilateral relationships.

In addition, there are several variables impacting the general cost of manufacturing in the country such as our energy production costs, the cost of infrastructure development, the cost of corruption and the ability to attract large scale foreign investors.

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Affordable Housing

The Cabinet Secretary highlighted that Kenya's urban centres face a shortage of 200,000 housing units annually and this is expected to rise to 300,000 units by 2020 based on the current policies and the current construction rate of only 50,000 new units a year.

Under the Affordable Housing pillar of the Big Four Agenda, the Government's objective is to provide 500,000 housing units by 2022, primarily for citizens earning less than KES 100,000 per month.

This will be achieved by partnering with the private sector to develop homes on serviced land belonging to the National and County Governments.

Current challenges

Affordable Housing remains inaccessible to most Kenyans as a result of:

- high financing and mortgage costs which are out of the reach of low income earners;
- lack of long term funds by financial institutions;
- high land and construction costs;
- insufficient serviced land;
- a complex and inefficient legal and policy framework to deal with large scale land projects; and
- low cost building techniques and construction materials that have not been widely researched and deployed in Kenya.

500,000

homes by 2022

Key allocations

- KES 1.0 billion for construction of affordable housing;
- KES 2.0 billion for construction of social housing units;
- KES 1.5 billion for construction of housing of Police and Kenya Prison;
- KES 1.5 billion for Civil Servant Housing Scheme;
- KES 2.5 billion for the Kisumu Urban programme;
- KES 4.3 billion for the Nairobi Metropolitan Services; and
- KES 11.7 billion for the Kenya Urban Programme.

Tax relief for developers

The Cabinet Secretary announced that the Government has developed a comprehensive housing package that will incentivize the private sector in the construction of low cost housing.

This package includes a corporate income tax rate of 15% for developers who construct at least 100 units a year; this was already included in the Finance Act, 2017 and hence there has not been any change in the status quo.

Facilitating mortgage growth

The Government established the Kenya Mortgage Refinance Company (KMRC) in 2018. The KMRC will be jointly owned by the Government, the private sector and select development partners to create long term liquid funds in the mortgage market.

Through the KMRC, banks will be able to access financing for loans issued, with the aim of lowering the cost of mortgage financing to buyers.

The Government will establish a National Housing Development Fund to contract with Developers to acquire all units once developed.

In addition, the Government will strengthen the National Housing Corporation (NHC) to take up more strategic roles in the mobilization and management of Tenant Purchase Schemes and provide alternate financing strategies for the purchase of low cost housing.

Creation of the National Social Housing Development Fund

A National Social Housing Development Fund (NSHDF/ the "Fund") will be created to guarantee the purchase of housing units from the developers.

The Government seeks to amend the Employment Act to provide that employers will contribute 0.5% of an employee's gross monthly emoluments subject to a maximum of KES 5,000 to the Fund. The employee will make a matching contribution. The Budget speech contradicts Section 68 of the Finance Bill, 2018 which states that the employer and employee will make matching contributions of 1% of the employee's monthly gross emoluments capped at KES 5,000 to the Fund. It is presumed that the contributions as stated in the Bill will apply.

This proposal will place the NSHDF at par with the NSSF and NHIF as a statutory fund which will further reduce the "take home" salaries of employees.

Technology and innovation

The government intends to invest in low cost building technology. The projects are envisaged to be "smart" – broadband enabled and using renewable energy sources (e.g. solar panels) and green technology such as for waste management.

The role of PPPs

The Private sector continues to play a key role in enabling the fruition of projects spearheaded by the Government.

The proposal by the Government is to engage developers to construct homes on serviced lands where social and physical infrastructure will be provided. There may be a role for the private sector in undertaking the servicing of land in exchange for tax subsidies from the Government.

Further legislative changes needed

A number of legislative changes were expected for the Government to be able to effectively deliver on Affordable Housing.

However, none of these were covered in the budget speech. These would have included (amongst others):

- An amendment to the Stamp Duty Act to exempt first time home owners from Stamp Duty;
- An amendment to the Sectional Properties Act to facilitate registration of units; and
- A review of the National Construction Authority Act and the Built Environment Bill to ensure that they address matters on sustainable building standards and design procedures.

Conclusion

Whereas the measures announced by the Cabinet Secretary are encouraging, it remains to be seen if the Housing Database will be credible and provide verifiable baseline data on the success of these initiatives.

What gets measured gets done. Additionally, will these measures undertaken only in urban towns be replicated in the rural towns to uplift the living standards of rural and informal dwellers?

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Information, Communication and Technology Sector

The ICT sector in Kenya has continued posting positive growth. In 2017, the sector expanded by 11% compared to 9.7% in 2016. This growth was principally driven by improved performance in the telecommunication sub-sector, which rose by 12.7% in 2017.

Over the years, the local ICT sector has made a positive contribution to the GDP. According to the 2017 Economic Survey, the sector's contribution to the GDP increased to 8.6% in 2017 from 6.1% in 2016, buoyed by expansion in the digital economy through mobile telephony and e-commerce.

In December 2017, the current Administration announced the 'Big Four' agenda, which will guide the country's development plans in the period 2018-2022. ICT will be integrated in the implementation of the Big Four agenda to facilitate efficient and effective processes and data sharing to achieve the program objectives.

Further, in February 2018, the government constituted a taskforce aimed at providing guidance on how it can leverage on emerging technologies such as blockchain and Artificial Intelligence. Specifically, the taskforce will provide a roadmap on how the government can leverage on digital ledgers to centralise government data access. This move demonstrates the need for ICT integration in the implementation of the government's Big Four agenda.

Key 2018/19 Budget Highlights – ICT Allocations

In this Financial-Year 2018/19 National Budget, resources have been allocated to key government flagship projects and devolved units of government to drive the Big Four agenda. A total of KES 21.61 billion has been allocated for Information, Communication and Technology projects in this budget.

We present key highlights of Information, Communication and Technology allocation in the Financial-Year 2018/19 National Budget mapped to the Big Four agenda below:

- KES 11.9 billion for Digital Literacy Programme
- KES 8.3 billion for ongoing development at Konza Technopolis
- KES 100 million for Presidential Digital Talent Program
- KES 310 million for Digital Migration for the Kenya Broadcasting Corporation (KBC)
- KES 300 million for Single Window Support Project
- KES 700 million for roll out of IFMIS

FY 2018/19 Budget Allocations

Digital literacy

The government has been running the Digital Literacy Program (DLP) whose aim is to advance education through e-Teaching and e-Learning. As of May 2017, over 14,300 primary schools in the country had benefited from this program through the installation of digital learning devices, and over 95,000 had been trained to deliver digital based learning.

This program has received an allocation of KES 11.9 billion which is a decrease from the KES 13.4 billion allocated in the Financial-Year 2017/18 budget. These funds will allow the government to enhance further ICT integration in education and the promote science, technology and innovation in our schools.

In its plan to increase manufacturing to 15% of GDP by 2022, the government has envisaged the local assembly of laptops. This will stimulate further development of this local industry that has often suffered against competition from similar imported goods. We expect that the Digital Literacy Program will benefit further from this, through the supply of the locally assembled computer devices.

Enhancing Service delivery – to all parts of the country

The government is committed towards the use of ICT as a means of reducing the cost of doing business and enhancing efficiency in service delivery. One of the initiatives includes the deployment of terrestrial fibre optic connectivity to the 47 county headquarters through the National Optic Fibre Backbone Infrastructure (NOFBI).

This initiative is geared towards ensuring that the country leverages on the current 850,000Mbps high-speed international bandwidth capacity.

To further avail government services to citizens through ICT, KES 300 million has been allocated for the Single Window Support Project.

This platform allows one to lodge all customs documents and submit online payments, eliminating the bureaucracy associated with clearing goods at sea ports and border points. This will reduce cargo dwell time at the ports and border points, maintain requisite controls, and enhance collection of applicable levies, taxes, and duties.

Over the years, the local ICT sector has made a positive contribution to the GDP.

Additionally, the National Treasury has allocated KES 700 million which will facilitate the rollout of IFMIS to the counties. This will continue to support the deepening of public financial management reforms and enhance the automation of public payments. Further, the government has plans to finalize the integration of IFMIS with the electronic Project Monitoring Information System (e-ProMIS), KRA (iTax) and the CBK systems.

Delivering on job creation

In delivering on its promise on job creation, the government is supporting the Presidential Digital Talent Programme. Through this programme, some university graduates have benefited through ICT trainings that have enhanced their ICT skills, thereby increasing their employability. The National Treasury has allocated KES 100 million, which will support this program further, allowing the recruitment and training of more graduates.

The National Treasury has allocated KES 8.3 billion towards the development of Konza Technopolis City which is a significant increase from the KES 600 million allocated in the Financial-Year 2017/18 budget.

These funds will go towards the completion of the first phase of Konza Technopolis City, which is expected to create at least 17,000 high skilled jobs. Konza is expected to grow into a smart city, with an integrated urban information and communication technology (ICT) network that supports the delivery of connected urban services and allows for the efficient management of those services on a large scale.

Embracing digitisation

The government is keen on embracing a digital economy, which is a key input in propelling economic growth and has been proven to create employment and improve income levels.

Towards this, the government has allocated KES 300 million for digital migration for the Kenya Broadcasting Corporation. Further, this will ensure easier access to information and promote economic growth.

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East Africa at a glance

We present below a summary of the key economic and tax highlights based on the FY 18/19 budget speeches by the Ministers of the 4 EAC partner states.

The common theme running through the budget speeches are spending on infrastructure, promoting local manufactures and creating employment opportunities.

The table below summarizes the key economic indicators for the 4 countries:

Indicator	Kenya	Tanzania	Uganda	Rwanda
Real GDP growth	4.9% (5.8%)	7.2%(7.1%)	5.8% (3.9%)	6.1% (5.9%)
Overall inflation	7.9% (6.3%)	5.32%(5%)	3.6% (5.7%)	4.9% (5.7%)
Country currency	**KES**	**TSHS**	**UGX**	**RWF**
Exchange rate to the dollar (Local currency = US$1)	103	2281	3,800	859
Real GDP FY17/18 (billions)	9,721 (USD 94.4)	132,629 (USD 58.0)	101,800 (USD 26.8)	6,692 (USD 7.8)
Recurrent budget (billions)	1,550 (1,347)	20,469 (19,712)	13,392 (11,902)	1,266 (1,131)
Development budget (billions)	625 (640)	12,007(11,999)	12,975 (11,349)	937 (783)
Total budget FY 18/19 (billions)	2,557 (2643)	32,476 (31,712)	32,702 (29,008)	2,444 (2,115)
Projected tax revenue	1,998 (1,705)	18,000 (17,106)	16,359 (15,062)	1,353 (1,200)
Other budget funding sources	559 (524)	14,475(14,606)	16,343 (15,578)	158 (138)
% of tax revenue to CY Budget	78% (64%)	55% (46%)	50% (52%)	55% (57%)
Tax revenue as a % of GDP	21%	14%	16%	20%

East Africa highlights

Kenya economy

Summary

Kenya's economic growth has remained steady in the past five years maintaining an average of 5.6% per year. This has been achieved through an Economic Transformation Plan whose main focus has been infrastructure development.

The growth is expected be 5.8% in 2018 against 4.9% in 2017. Kenya maintained macroeconomic stability with inflation, interest rates and exchange rates remaining stable throughout 2017.

Economic drivers in prior year, 2017

The key drivers of the economy in 2017 included:

- Food security through expanded irrigation schemes, increased access to agricultural inputs and supported large-scale production of staples;
- Increased health facilities, equipped hospitals with specialized medical equipment and expanded NHIF coverage;
- Increased access to electricity with over 6.7 million Kenyans connected;
- Improved infrastructure with completion of phase 1 of the SGR and commencement of phase 2;
- Enhanced service delivery through devolution and expanded fibre optic infrastructure to the counties leading to e-governance and innovation;
- Improved macroeconomic stability and improved security aimed at creating a conducive environment and
- Improved education sector through the free education plan;

Subdued growth in 2017

In 2017 Kenya experienced a GDP growth of 4.9% down from 5.8% in 2016. In 2017, Kenyan economic prospects were dampened by a prolonged electioneering period and adverse weather conditions.

While service-oriented sectors grew, agriculture and manufacturing sectors underperformed.

Government priorities for the year/ long term

The government has set out four priority areas (the Big Four plan) and allocated KES 460 billion in expenditure.

The key pillars of the big four plan include:

- Manufacturing: the government aims to raise manufacturing's contribution to GDP to 15% by 2022;
- Universal healthcare coverage (UHC): to guarantee access to quality and affordable healthcare, the government has focused to provide UHC to all households by 2022;
- Provision of affordable and decent housing for all Kenyans: the government is aiming to deliver 500,000 housing units by 2022 and at the same time provide incentives to private developers; and
- Enhancing food and nutrition security for all Kenyans: the government will focus on enhancing large-scale production, boosting smallholder productivity and reducing the cost of food.

Kenya tax highlights

Customs

- Import duty on iron and steel products and on paper and paper board increased from 25% to 35%;
- Introduction of import duty of USD5 per unit or 35%, whichever is higher, on textile and footwear;
- Introduction of a specific rate duty of USD 110/MT on particle board, USD 120/MT on medium density fiber board, USD 230/M3 on plywood and USD 200/MT on block boards, or 35% whichever is higher;
- Introduction of a specific rate of USD 500/MT or 35% whichever is higher on vegetable oils;
- Remission of duty on inputs and raw materials for the manufacture of pesticides and acaricides
- Remission of import duty on importation of sightseeing buses and overland trucks imported by licensed tour operators; and
- Remission of duty on taxable inputs and raw materials for assembly of clean energy cooking stoves imported by local manufacturers.

Excise

- Excise duty of KES 20 per Kg on sugar confectionaries and chocolates;
- Increase of excise duty on mobile money transfer fees from 10% to 12%;
- Increase of excise duty from 20% to 30% on private passenger motor vehicles exceeding 2500cc (diesel) and 3000cc (petrol);
- Introduction of excise duty on transfer of KES 500,000 or more by banks/ financial providers at 0.05%; and
- Introduction of an export levy of 20% on copper waste and scrap. There is need for clarity on the desired outcome of this change.

VAT

There has been VAT exemption introduced on the following:

- Importation or local purchase of parts for computer assembly;
- Purchase of equipment for construction of grain storage facilities; and
- Purchase of raw materials for animal feeds production.

Income Tax

- Introduction of presumptive income tax based on the business permit or trading license fees at 15% to replace turnover tax;
- Withholding tax on payments for demurrage charges made to non-resident persons at 20%;
- Introduction of capital gains tax on sale of property by general insurance companies at 5%;
- Withholding tax of 5% on insurance premiums paid to non-residents excluding insurance for aircrafts;
- Tax amnesty for foreign income declaration extended to 30 June 2019 and exempted from proceeds of the Crime Act, subject to exemptions;
- 30% rebate on the total electricity bill incurred by manufacturers;
- 20% penalty and 2% interest on late payment of tax on betting, gaming and lotteries;
- Late payment interest increased from 1% to 2% and reintroduction of 20% penalty on late payment of income tax; and
- A limit has been set for application for and extension of time for filing tax returns and to also allow taxpayers to amend filed returns. The time limits are yet to be made available.

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Tanzania economy

Summary

The economy of Tanzania has continued to register high economic growth with an average real GDP growth rate in 2017 of 7.1%, compared to 7.0% in 2016 with economic activities recording mixed results. In 2017, the inflation trend was relatively stable, averaging 5.3% compared to 5.2% in 2016. The stability is largely attributed to improved availability of food and stable energy prices especially for fuel.

Economic drivers in prior year

SECTOR	ACTUAL	BUDGET	MOVEMENT
Agriculture	2.1%	2.9%	↓
Trade and Maintenance	6.7%	7.8%	↓
Food and Accommodation	3.7%	8.0%	↓
Administrative services	2.1%	6.3%	↓
Information and Technology	13.0%	12.1%	↑
Transportation and Storage	11.8%	8.0%	↑
Mining and Quarrying	11.5%	9.2%	↑
Manufacturing	7.8%	6.7%	↑

Total resources mobilized during the period between July 2017 and April 2018 amounted to Tzs 21.89 trillion, equivalent to 69.0% of the annual target of Tzs 31.71 trillion.

Government priorities for the year/long term

The priorities for 2018/19 will be on flagship infrastructure projects and in creating a conducive environment for investment and business.

The focus will be on the following priority areas:

Agriculture: improving irrigation infrastructure, warehouses and markets, supply of inputs, dissemination of findings and development of livestock and fisheries sub sectors.

- **Industries:** implementing the recently developed blueprint for regulatory reform to improve the business environment.
- **Social services:** clean water, free basic education, improved health facilities and supplies.
- **Supportive infrastructure:** electricity generation, construction of a standard gauge railway, improving regional and rural road connectivity, air and marine transport
- **Others:** land acquisition and ownership, communication services, finance, tourism, defence and security, good governance and justice.

The Government is committed to increase and strengthen domestic revenue collections by pursuing the following policies:

- Continue to widen the tax base including formalisation of the informal sector and improving the investment environment to foster new sources of revenue;
- Enable conducive environment (supportive infrastructure, tax incentives, consistent and predictable policy, land accessibility, legal and regulatory frameworks) to attract business and investment;
- Implement the “Blueprint for Regulatory Reform to Improve Business Environment for Tanzania” for simplification of payment of taxes and elimination of bureaucracies; and
- Improve relationship between TRA and taxpayers based on trust.

Tanzania tax highlights

Tax amnesty

A tax amnesty will run for a six month period from July to December 2018. Taxes declared under the amnesty will have full remission of interest and penalties.

Excise

The fixed tariffs on locally produced non-petroleum excisable products including alcohol, soft drinks and tobacco have not been changed but excise duty rates relating to imported non petroleum products will increase by 5%.

An Electronic Tax Stamp will replace the Paper Tax Stamp with effect from 1 September 2018. This is to enable the Government to obtain production data from the manufacturers in real time.

Local Taxes (agriculture)

The Minister is also proposing to amend the Local Government Finance Act, to require any corporate entity which produces agricultural crops without processing them for the purpose of adding value to pay Produce Cess.

Customs

To assist local industries, duties have been decreased/ remitted on the following products:

- Paper used to manufacture exercise books, text books and gypsum boards,
- Self adhesive labels,
- Printed aluminium barrier laminates,
- Polyvinyl alcohol,
- Inputs used to manufacture pesticides, fungicides, insecticides and caricides and
- RBD palm stearin.

To protect local industries, duties have been increased on the following imported products:

- Crude, semi refined and double refined edible oil and crude palm oil;
- Potatoes, chewing gum, sweets, chocolates, biscuits, tomato sauce, water, meat and edible offal and sausages and
- Increased duty of 35% on imported sugar.

Value Added Tax

Exemption from VAT proposed on:

- Packaging material used by local manufacturer of pharmaceutical products,
- Imported animal and poultry feed additives and
- Sanitary pads.

Additional powers are given to the Minister to exempt imports by a government entity or supply to a government entity of goods or services to be used solely for the implementation of government projects funded by a non-concessional loans.

Income tax

- Reduction of the CIT rate for new investors in the pharmaceutical and leather industries from 30% to 20% for 5 years from 2018/19 to 2022/23. However, it is unclear whether the intention is to apply a reduced rate for a period of 5 years to 2022/23 or apply the reduced rate for new entrants investing between 2018/19 and 2022/23 for an indefinite period.
- Withholding tax exemption to apply to interest on Government borrowings from non-resident financial institutions.

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Uganda economy

Summary

The economy is projected to grow by 5.8% in FY17/18, with year-on-year growth of 1.9%, bouncing from the low growth of 3.9% in FY16/17. Uganda's GDP growth is higher than that of the Sub Saharan region, which is expected to average 3.4% in FY17/18.

According to the Monetary Policy issued in June 2018 by the Bank of Uganda, the economy has a positive outlook driven by growth across all sectors, in particular:

- manufacturing (4.4%),
- the industrial sector (6.2%),
- construction (5.7%) and
- agricultural sector (3.2%), mainly due to good weather throughout the year.

Inflation has remained stable in FY2017/18 at single digit through the year, with annual headline inflation at 3.6%, mainly due to the increased agricultural output. Inflation is projected to fluctuate at an average of 5% in FY18/19.

With respect to the exchange rate, the Uganda shilling depreciated by an average of 3% year-on-year, with a significant drop in May 2018 when the exchange rate reached Ushs 3,800 against the US dollar.

The depreciation of the shilling is attributed to increased demand for oil especially in the manufacturing and telecom sectors.

Uganda has a positive economic outlook in FY18/19, with GDP projected to grow to 6% and is projected to continue to grow to an average of 7% per annum by 2020.

Government priorities

The priority areas highlighted in the FY2018/2019 budget in line with the National Development Plan (Phase II) are:

- Increased agricultural production and agro processing,
- Transforming Uganda's tourism potential,
- Development of oil gas infrastructure,
- Human capital and skills development and
- Effective development and maintenance of infrastructure.

Economic drivers

The main drivers for revenue in FY 2018/19 are based on the following assumptions :

- A GDP growth of 6%,
- Stable inflation of single digit,
- A stable exchange rate and
- Enhanced tax compliance.

In terms of revenue performance, total tax collections in FY 2018/19 are projected at Ushs 16,359 billion up from Ushs 15,939 billion in FY 2017/18, representing 14.6% of tax revenue to GDP ratio.

We expect to see an increased focus on strengthening tax administration and compliance, curbing of VAT fraud and improvement of PAYE compliance by Government institutions.

Uganda tax highlights

Excise Duty

Proposed telecommunication services amendments include:

- Increase of excise duty on landlines by 700 percentage points from 5% to 12%. Harmonise excise duty on all telecommunication services;
- Introduction of excise duty of Ushs 200 per user per day for the use of Voice Over the Internet Protocol (VOIP);
- In addition to excise duty on mobile money services a levy of 1% on transaction value of withdrawals, payments and receiving money and
- Increase excise duty on mobile money and bank charges from 10% to 15%.

Additional proposed amendments include the introduction of excise duty on:

- Opaque beer (kibuku) at 30% or Ushs 230 per litre, whichever is higher,
- Powder for juice (excluding pulp) at 15% of the value,
- Cooking oil at Ushs 200 per litre and
- Motorcycles at first registration – Ushs 200,000.

Time of supply rules are to be introduced for excise duty.

There is a proposal of remission of excise duty on export of excisable goods.

Value Added Tax

- Introduction of Withholding of 50% of VAT charged on taxable supplies by appointed withholding VAT agents.
- Interest on overpayments and late refunds by the URA is to be capped to the principal tax.
- Clarity on the obligation of foreign based remote service providers to account for VAT in Uganda
- Legislation is to be introduced in FY19 to provide for the tax treatment of Islamic financial transactions.
- Introduction of VAT exemption on construction materials, services and equipment for developers of industrial parks or free zones, supplies to hotel or tourism facilities and to hospital facility developers; subject to certain criteria.

Income tax

- Thin capitalization rules are to be repealed. Instead, deductibility of interest on debts owed by a taxpayer who is a member of a group is to be limited to 30% of Earnings before interest, tax, depreciation and amortization (EBITDA). This is in line with BEPS agenda.
- A tax of 0.5% of gross revenue to be imposed on a taxpayer who makes tax losses for seven consecutive years.
- Interest incurred by individuals on mortgages obtained from financial institutions to be tax deductible. This is in addition to 20% expense allowed to deriving chargeable rental income.
- Clarity on taxation of offshore indirect transfers of interest by imposing tax on a direct or indirect sale of an asset connected to Uganda by a non-resident.
- Introduction of 10% final withholding tax on commissions by telecommunication companies to mobile money and airtime agents as a final tax.
- Planned introduction of regulations pertaining to Islamic financial transactions.
- Reduction of withholding tax on payments for agricultural supplies from 6% to 1%.
- Exemption of the income of a developer or operator of an industrial park or free zone from income tax subject to certain criteria.

Stamp duty

- Proposed amendment to increase stamp duty on dutiable instruments previously at Ushs 10,000 to Ushs 15,000.
- Exemption from stamp duty on strategic projects for developers in industrial parks, operators in free zones, hotels or tourism facilities, and hospital facilities, subject to meeting certain criteria.

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Rwanda economy

Summary

Rwanda's economy grew by 6.1% in FY 2017/18 from 5.9% in 2016/17. This was driven by the service sector (+8%), the agricultural sector (+7%), and the industry sector (+4%). The economy is projected to grow by 7.2% and 7.8% in the FY 2018/19 and 2019/20 respectively. The growth performance is expected to be driven by the agriculture and industry sector.

The agriculture sector is expected to grow moderately at 5.6% in 2018/19 and 4.5% in FY 2019/20 due to low performance in forestry and poor weather conditions in some parts of the country.

The industrial sector is expected to contribute 8.3% in FY 2018/19 and 13.5% in 2019/20 from 4% in 2017/18. This will mainly be boosted by mining and construction.

The ongoing improvement in international mineral prices as well as planned investments in the mining sector are expected to support domestic production while the construction sector is expected to pick up and grow at 5.2% in FY 2018/19 mainly due to the construction of Bugesera Airport and other private sector projects.

The services sector is expected to remain strong, growing at 7.6 % in FY 2018/19 and 7.8% in 2019/20.

55%

Percentage tax revenue to finance budget

The forex market is expected to stabilise due to an expected increase in export receipts and a moderate increase in imports.

This situation will reduce inflationary pressures whilst allowing the central bank to continue to support the foreign exchange market.

Government priorities for the year/ long term

Rwanda has developed the National Strategy for Transformation (NST1) as an implementation instrument for the remainder of Vision 2020 and for the first four years of the Vision 2050.

The allocation of resources in FY 2018/19 has been made taking into account the NST1 as follows:

- Economic transformation – 57%
- Social transformation – 27%
- Transformational governance – 16%

Rwanda tax highlights

The following highlights are based on the 2017/2018 budget statement read by the Finance Minister.

Tax reforms

There has been a deliberate move over the last five years to modernise the major tax laws in Rwanda. These include the following new laws: VAT law, Investment Promotion and Facilitation law, Mineral Tax law, Gaming law and Income Tax law which was recently gazetted on 16 April 2018.

Tax changes

The minister announced the amendment, during the year, of other tax laws governing tax procedures, use of electronic billing machines, property taxes and consumption/excise duty taxes.

Corporate taxes

- Reduction of the taxing threshold for small businesses from Rwf50 million to Rwf20 million.
- Tightening of restrictions on expense deduction for the determination of taxable income e.g. management, technical and royalty fees are now capped to 2% of the company's turnover.
- Broadening of the provision that deems income to be derived in Rwanda by non-resident e.g. the direct and indirect sale of shares in a Rwandan company is now considered to be income sourced from Rwanda, and services performed abroad by a non-resident for the benefit of a Rwandan company is also now considered to be income sourced from Rwanda.
- Exclusion of liberal professionals (professionals with special skills, working in an independent manner) from the lump sum/flat tax regime.

Customs Duty

Transportation sector

- Import duty rate of 0% instead of 10% or 25% for road tractors for semi trailers, motor vehicles for transport of goods with gross weight exceeding 20 tons and buses for transportation of 50 persons and above.
- Import duty of 10% instead of 25% for motor vehicles for transport of goods with gross weight exceeding 5 tons but not exceeding 20 tons.
- Import duty of 10% instead of 25% on buses for transportation of more than 25 persons.

Promotion of "Made in Rwanda" initiative

- All capital machinery used in textile and leather industry will continue attracting import duty of 0% instead of 25%.
- Certain raw materials used in industry will continue to be taxed at a rate of 0% instead of 10% or 25%.
- Import duty rates of US$ 4/Kg for second hand clothes and US $5/kg for second hand shoes.

Information Technology

- Telecommunication equipment will continue to attract import duty at a rate of 0% instead of 25%.

Financial sector

- As a support towards a cashless economy, electronic transaction devices (smart cards, ATM cards, Point of sale cards and their operating machines) will attract import duty at 0% instead of 25%.

Basic goods

- Rice will continue to be taxed at the rate of 45% or US$ 345/MT instead of 75% or US$ 345/MT.
- Sugar will continue to be taxed at a rate of 25% instead of 100% or US$460/MT whichever is higher.
- Goods imported for use by Armed Forces Shop (AFOS) will continue to attract duty at 0% instead of 10% and 25%.

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