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Advisory Note:

Kenya Budget Insights 2020/2021

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Introduction

The theme for this year's budget "Stimulating the Economy to Safeguard Livelihoods, Jobs, Businesses and Industrial recovery" sums up the intention and guiding steps for the statement delivered to the National Assembly by Hon. Ukur Yatani when highlighting the budget policy and revenue raising measures for fiscal year 2020/21 budget.

It comes with no surprise that COVID 19 pandemic brought with it the need to re-strategize the economic and financial affairs of our country. The economy was projected to grow by 6.1 percent in 2020 which was an improvement from 5.4 percent in 2019. However, owing to the added blows of the COVID 19 pandemic, locust invasion and flooding witnessed in better parts of the country, there were drastic measures that had to be taken to urgently to ensure the well-being of our people. This of course came at the expense of our economic position.

An adjustment in our monetary policy, increased tax incentives and settlement of pending Government bills were some of the measures taken to curb the adverse effects of these calamities. These measures have translated into abridged revenue collections while at the same time, management of these catastrophes caused an upsurge in public expenditure.

To this end, the Cabinet Secretary has now put forward for assent, several tax measures to assist in reducing the deficit. Most of the tax measures were tabled earlier in May 2020 through the Finance Bill 2020. We hereby provide an overview of the same. The budget allocations are directed towards recovery, sustainability and growth of the economy. We highlight some of the key areas and the proposed allocations below.

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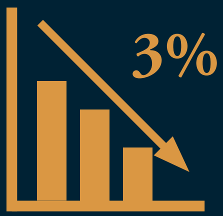


Owing to the COVID 19 pandemic, International Monetary Fund projects world economy to experience negative growth rate of 3% in 2020 but projected to rebound to 5.8% in 2021.

2.5%
Economic growth rate

The Cabinet Secretary projects growth of the Kenyan economy at a lower rate of 2.5% in 2020 down from the 5.4% growth recorded in 2019.

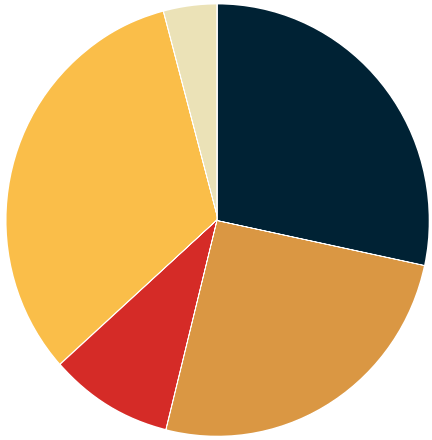
6.5%
2024 growth rate

5.8%
2021 growth rate

Rapid Economic Stimulus Programme and "Post COVID 19 Economic Recovery Strategy" to aid growth of 5.8% in 2021 and 6.5% by 2024

Strategies Geared Towards a Sustainable Economic Growth Trajectory

- Economic Stimulus Programme
- Maintaining Macroeconomic stability
- Growth of Micro, Small and Medium Enterprises
- Keep driving the "Big Four" Agenda
- Development of critical infrastructure
- Empowerment of our youth, women and persons with disability
- Build stronger education and healthcare systems
- Enhanced service delivery through County Governments
- Efficient public service delivery



- Ksh 2.1 billion – construction of additional classrooms in secondary schools
- Ksh 1.9 billion – 250,000 locally fabricated desks for secondary and primary schools
- Ksh 0.7 billion – infrastructure in low cost boarding schools in Arid and Semi-Arid Lands (ASAL)
- Ksh 2.4 billion – recruitment of 10,000 intern teachers
- Ksh 0.3 billion – recruitment of 1,000 ICT intern

8 Point Economic Stimulus Programme

This Programme targets to cushion vulnerable citizens and businesses, particularly those affected by the COVID 19 pandemic. The focus is on maintaining the food supply chains and enforce "Buy Kenya Build Kenya" initiatives in a bid to create opportunities for sustainability for the common mwananchi.

These allocations are done as follows:

i. Infrastructure

Ksh 5.0 billion allocated to rehabilitation of the damaged access roads and foot bridges. Implementation is expected to capitalize on use of local labour and materials rendering short term employment opportunities for our youth. To further supplement this initiative, a further Ksh 10.0 billion has been allocated under the ***"Kazi Mtaani Programme"***. This programme targets unemployed youth in the major cities and urban settlements of Nairobi, Mombasa, Kisumu, Eldoret, Nakuru and other major towns across the country. The youth will be engaged in various tasks to improve the road networks thereby giving them a source of income and at the same time improving our infrastructure.

ii. Improving Education Outcomes

Ksh 7.4 billion allocated to mobilize internship opportunities for unemployed teachers and support local artisans and builders' business.

iii. Enhancing Liquidity to Businesses

Ksh 3.0 billion seed capital set aside to operationalize the Credit Guarantee Scheme with an aim to de-risk lending to the Micro, Small Medium Enterprises.

Furthermore, there is a proposal to fast track payment of outstanding verified VAT refund claims and pending bills to improve cash inflows for these businesses. The supplementary budget had initially allocated Ksh 23.1 billion in respect of this earlier in April 2020 and the Cabinet Secretary has now allocated a further Ksh 10.0 billion to further enhance payment of these Government obligations that can significantly boost cash flows for these businesses

iv. Improving Health Outcomes

Ksh 1.2 billion proposed for recruitment of 5,000 healthcare workers to support local health staff for a period of one year considering the current teams are over stretched by the demands of COVID 19.

Ksh 0.5 billion allocated to supply 20,000 locally made beds and beddings to public hospitals; Ksh .25 billion to support establishment of 50 modern walkthrough sanitizers at our border points and main hospitals across the country.

v. Tourism Promotion

To help the sector recover from the ravaging effects of the COVID-19 pandemic the Government is planning to institute the following measures:

- Temporary lift of ban to hold meetings in private hotels by Government Agencies
- Waiver of landing and parking fees at our airports
- Aggressive post COVID 19 tourism marketing
- Provide support for hotel refurbishment through soft loans to be channeled through the Tourism Finance Corporation
- Ksh 3.0 billion has been set aside specifically for assisting industry players with renovation of their facilities and restructuring of their business operations
- Ksh 2.0 billion set aside to assist with provision of grants to 160 Community Conservancies and support Kenya Wildlife Services to engage 5,500 community scouts for a period of one year

vi. Improving Environment, Water and Sanitation Facilities

To this end, Ksh 1.0 billion has been allocated to support flood control, Ksh 0.85 billion to cater for rehabilitation of wells, water pans and underground tanks in ASAL areas and Ksh 0.54 billion to enhance tree planting programme across the country using locally sourced seedlings.

vii. Manufacturing

Promotion of "Buy Kenya Build Kenya Policy" through:

- Ksh 0.6 billion allocated to purchase of locally assembled motor vehicles
- Ksh 0.712 allocated to provide credit targeted to Micro, Small and Medium Enterprises in the manufacturing sector

viii. Agriculture & Food Security

Ksh 3.0 Billion
subsidize the supply of farm inputs through the e-voucher systems targeted at 200,000 small scale farmers

Ksh 3.4 Billion
expanded community household irrigation

Ksh 1.5 Billion
Flower and horticultural farmers

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Sectoral Analysis

Fiscal Framework for FY 2020/21 Budget

- The Covid-19 Pandemic has not only worsened revenue performance in 2019/20, but will affect revenue in 2020/21 budget.
- Import related taxes such as import duty, VAT on imports, import declaration fees and railway development levy have been negatively affected due to lower imports and reduction of trade among countries.
- Other domestic taxes have been severely affected by declining incomes and depressed consumption.
- In order to cushion Kenyans against the adverse impact of the Pandemic and to further increase liquidity in the economy, the Government lowered tax rates for corporate and personal incomes, turnover tax, value added tax and provided tax relief to low income earners and employees.
- These measures are estimated to cost the exchequer **Ksh 172.0 billion** in revenue foregone by the Government in one financial year.
- The budget proposes to lower the level of tax exemptions. While these tax incentives are well intended, they have limited the capacity of Government to fund critical expenditures.
- A critical review of the incentives shows that consumers have not benefitted through commensurate reduction in the cost of goods and services.
- Some of these incentives have given undue advantage to some sector players over others thus entrenching unfairness and stifling competition.
- In view of the above the budget has proposed further removal of some existing tax exemptions through the **Finance Bill, 2020** with a view to minimizing distortions and providing a level playing ground for all taxpayers.

Fiscal Projections for the FY 2020/21 Budget

- The fiscal framework for 2020/21 budget and the medium term has been revised to take into account the adverse impact of the Pandemic on revenue performance.
- In this respect the 2020/21 budget targets:
  - Revenue collection including Appropriations-in-Aid (AIA) of **Ksh 1.89 trillion**, equivalent to **16.8 percent of GDP**.
  - A stagnation from the estimated revenues of **Ksh 1.89 trillion**, equivalent to **18.6 percent of GDP** in the financial year 2019/20.
  - Ordinary revenues in the financial year 2020/21 are projected at **Ksh 1.63 trillion**, equivalent to **14.5 percent of GDP**.
  - Total expenditures in the financial year 2020/21 are projected at **Ksh 2.79 trillion or 24.7 percent of GDP** from the estimated level of **Ksh 2.77 trillion or 27.2 percent of GDP** in 2019/20.
  - The recurrent expenditures in the financial year FY 2020/21 will amount to **Ksh 1.82 trillion or 16.2 percent of GDP**.
  - Ministerial development expenditures that include foreign financed projects, allocation to contingencies fund and conditional capital transfers to the County Governments are projected at **Ksh 633.1 billion** in 2020/21.
  - The fiscal deficit, including grants is projected to decline to **Ksh 840.6 billion or 7.5 percent of GDP** from **Ksh 842.7 billion or 8.3 percent of GDP** in the financial year 2019/20.
  - The fiscal deficit of Ksh 840.6 billion will be financed through net external financing of **Ksh 347.0 billion, or 3.1 percent of GDP**; net domestic financing of **Ksh 493.4 billion, or 4.4 percent of GDP** and other net domestic repayments of Ksh 627 million.

- To achieve these targets, the National Treasury will continue to contain growth in **non-core recurrent spending** and enhance our efforts in **revenue mobilization**.
- This shall entail closely monitoring the economic impact of Covid-19 and once the economy recovers, review of the fiscal plan including tax measures to strengthen public finances to sustainably fund our development agenda.

External Resource Mobilization

The Government is concerned about perennial low absorption of donor funds that has denied Kenyans the full benefit of these financing.

In view of this the Government proposes to:

- Put in place appropriate policies and administrative measures to remove impediments in project implementation, and scale-up absorption of donor funds.
- This may involve re-allocation of funds from slow-moving projects or non-starter projects to other priority projects and programmes to minimize payment of unnecessary fees and charges.

Stabilizing Growth in Public Debt

- The debt burden is projected to decline over the medium term in line with the fiscal consolidation plan under implementation.
- The Government is committed to implement the 2020 Medium Term Debt Strategy which recommends a shift towards concessional external borrowing and lengthening of maturity structure of the domestic debt.
- The Debt and Borrowing Policy approved in early 2020 will guide management of public debt.

Public Private Partnerships Framework

The Government shall revitalize the Public Private Partnership framework as an alternative source of finance to fund public projects.

In this respect the reforms in this area will include:

- Amending the **PPP Act** to remove unnecessary approvals and redundant processes.
- Restructuring and strengthening institutions responsible for implementing such projects.
- Streamlining and standardizing the appropriate credit enhancement tool including the Government Letter of Support, Partial Risk Guarantees and Indemnity Guarantees.
- Viability gap funding where necessary, to enhance bankability of projects.

Spending Priorities

The total programmed spending for the FY 2020/21 excluding redemptions amounts to Ksh 2.79 trillion.

- **Fulfilling the "Big Four" Agenda**
  The budget has set aside Ksh 128.3 billion for the "Big Four" Agenda drivers and enablers. The targeted expenditures prioritize:
  - employment
  - creation
  - youth empowerment
  - supporting
  - manufacturing activities
  - enhancing health coverage
  - improving food security and living conditions through affordable housing.
- **Universal Health Coverage**
  The Government has made the following allocations towards improvement of health outcomes achievement of the Universal Health Coverage to all the counties:
  - **Ksh 111.7 billion** to the health sector;
  - **Ksh 50.3 billion** to activities and programmes for the attainment of Universal Health Coverage by the Driver and Enablers;
  - **Ksh 19.2 billion** to address and lower cases of HIV, Malaria and tuberculosis in the country;
  - **Ksh 6.2 billion** for the managed equipment services;

- **Ksh 5.3 billion** to transform the health care systems for Universal Health Coverage;
- **Ksh 4.1 billion** to cater for free maternity health care; and
- **Ksh 1.8 billion** to provide medical cover for the elderly and severely disabled in our society.

Allocations to various referral and county hospitals to improve health service delivery:

- **Ksh 15.0 billion** for Kenyatta National Hospital;
- **Ksh 10.0 billion** for Moi Teaching and Referral Hospital;
- **Ksh 7.2 billion** for Kenya Medical Training Centres;
- **Ksh 2.5 billion** for Kenya Medical Research Institute;
- **Ksh 1.2 billion** to Mathari Hospital; and
- **Ksh 4.3 billion** as a conditional grant to level 5 Hospitals in the Counties.

Affordable Housing

To ensure the success of Affordable Housing Programme the Government has proposed the following allocations:

- **Ksh 15.5 billion** to the housing, urban development and public works sector;
- **Ksh 6.9 billion** will cater for the Affordable Housing Programme;
- **Ksh 7.5 billion** for the Kenya Urban Programme; and
- **Ksh 1.1 billion** for the ongoing construction of Gikomba, Githurai, Chaka, Kamukunji and Dagoretti markets.

Manufacturing

To promote investments in the manufacturing sector to support, protect and promote local industries, the Government has made the following allocations:

- **Ksh 18.3 billion** for this sector;
- **Ksh 1.4 billion** for the Kenya Industry and Entrepreneurship Project;
- **Ksh 3.6 billion** for the development of Special Economic Zones in Naivasha, Kenanie and Athi River;
- **Ksh 843 million** to support the modernization of RIVATEX;
- **Ksh 800 million** for the development of various MSMEs;
- **Ksh 715 million** for the Kenya Youth Empowerment and Opportunities Project;
- **Ksh500 million** to support dairy processing; and
- **Ksh 3 billion** for the Dongo Kundu Special Economic Zone.

Food and Nutrition Security

The Government will continue to expand irrigation schemes, support large-scale production of staples, increase access to agricultural inputs, implement programmes to support smallholder farmers and promote the use of appropriate farming techniques.

To support these initiatives, the Government has set aside Ksh 52.8 billion for Food and Nutrition Security. Out of this:

- **Ksh 10.6 billion** has been proposed for the Kenya Climate Smart Agricultural Project;
- **Ksh 5.5 billion** for the National Agricultural and Rural Inclusivity Project;
- **Ksh 4.1 billion** for the Kenya Cereal Enhancement Programme;
- **Ksh 730 million** for the Food Security and Crop Diversification Project;
- **Ksh 10.0 billion** for irrigation land reclamation;
- **Ksh 1.8 billion** to enhance aquaculture business development project;
- **Ksh 1.4 billion** to support small scale irrigation and value addition;
- **Ksh 1.3 billion** to enhance resilience of pastoral communities;
- **Ksh 1.1 billion** to enhance drought resilience and sustainable livelihood;

- **Ksh 1.6 billion** to support processing and registration of title deeds; and
- **Ksh 500 million** to advance agricultural loans through the Agricultural Finance Corporation.

- **Infrastructure**
  To enable Kenyans, enjoy the benefits of expanded infrastructure assets and improve our competitiveness, the Government has made the following allocations towards infrastructure:
  - **Ksh 172.4 billion** to improve and expand the existing infrastructure;
  - **Ksh 18.1 billion** towards SGR Phase II (Nairobi to Naivasha);
  - **Ksh 6 billion** for the LAPSSET Project;
  - **Ksh 5 billion** for the Mombasa Port Development Project; and
  - **Ksh 328 million** for insurance of ferries for the Likoni channel.
- **Energy**
  To support generation of adequate and affordable energy, the Government has allocated:
  - **Ksh 63.3 billion** to the sector;
  - Out of this, **Ksh 50.8 billio**n will cater for transmission and distribution of power;
  - **Ksh 9.3 billion** for development of geothermal energy;
  - **Ksh 6.8 billion** for electrification of public institutions; and
  - **Ksh 900 million** for provision of transformers in constituencies, development of nuclear energy, and exploration and mining of coal.
- **Security**
  The Government has made the following allocations in order to strengthen security agencies:
  - **Ksh 167.9 billion** has been allocated to security agencies; Defence, and National Intelligence Service; leasing of police motor vehicles; National Communication and Surveillance System; police modernization, and the equipping of the National Forensic Laboratory;
  - Ksh 3.4 billion for medical insurance;
  - Ksh 2.2 billion for group personal insurance for the National Police and Prisons services; and
  - Ksh 1.0 billion for the National Integrated Identity Management System (NIIMS).
- **Education**
  The Government has made the following allocations towards the education sector in order to enhance access to quality basic and higher education:
  - **Ksh 497.7 billion** to fund programmes in this sector;
  - **Ksh 59.4 billion** to cater for Free Day Secondary Education Programme (including NHIF for students);
  - **Ksh 2.0 billion** for the recruitment of 5,000 teachers;
  - **Ksh 1.8 billion** for the school feeding Programme;
  - **Ksh 6.3 billion** for the construction and equipping of technical institutions and vocational training centers;
  - **Ksh 4.0 billion** for examinations fee waiver for all class eight and form four candidates;
  - **Ksh 800 million** for the digital literacy Programme and competency based curriculum;
  - **Ksh 323 million** for National Research Fund;
  - **Ksh 94.9 billion** to support University Education; and
  - **Ksh 16.8 billion** to the Higher Education Loans Board.
- **Protecting the Vulnerable Members of our Society**
  The Government has proposed the following allocations towards its most vulnerable members of society:
  - **Ksh 17.6 billion** for cash transfers to the elderly persons;
  - **Ksh 7.9 billion** for orphans and vulnerable children (OVC);

- **Ksh 1.1 billion** for cash transfers to persons with severe disabilities;
- **Ksh 4.3 billion** for the Kenya Hunger Safety Net Programme;
- **Ksh 2.5 billion** for the Kenya Social and Economic Inclusion Project;
- **Ksh 3.5 billion** for Kenya Development Response to the Displacement Impact Project;
- **Ksh 400 million** for the National Development Fund for Persons with Disabilities (PWDs); and
- **Ksh 720 million** for purchase of a building for these vulnerable members of our society.

Equity, Poverty Reduction, Women and Youth Empowerment
To enhance equity and reduce poverty, the Government has proposed:

- Ksh 41.7 billion for the National Government Constituency Development Fund;
- Ksh 2.1 billion for National Government Affirmative Action Fund to promote regional equity and for social development; and
- Ksh 6.8 billion for the Equalization Fund to finance programmes in marginalized areas.

To address the challenges faced by the youth, women and persons living with disabilities (PWDs), the Government has allocated:

- **Ksh 10.2 billion** to the National Youth Service (NYS);
- **Ksh 2.1 billion** for the Kenya Youth Empowerment Project;
- **Ksh 359 million** to the Youth Enterprise Development Fund;
- **Ksh 82 million** to the Youth Employment and Enterprise (Uwezo Fund) and
- **Ksh 150 million** to the Women Enterprise Fund.

Sports, Culture, Recreation and Tourism
To support these sectors, the Government has proposed an allocation of:

- **Ksh 14.0 billion** to the Sports, Arts and Social Development Fund;
- **Ksh 2.5 billion** for the Tourism Promotion Fund (TPF); and
- **Ksh 3.8 billion** for the Tourism Fund.

Environmental Protection, Water and Natural Resources
Some of the key allocations towards this sector include:

- **Ksh 82.7 billion** to support environment and water conservation;
- **Ksh 42.6 billion** for development of water and sewerage infrastructure;
- **Ksh 10.9 billion** for management of water resources;
- **Ksh 8.6 billion** for water storage and flood control;
- **Ksh 1.3 billion** for water harvesting and storage for irrigation.
- **Ksh 10.9 billion** to support conservation of forests and water towers;
- **Ksh 10 billion** for irrigation and land reclamation;
- **Ksh 10.8 billion** for wildlife conservation and management;
- **Ksh 2.7 billion** for environmental management and protection; and
- **Ksh 1.6 billion** for the meteorological service.

Income Tax

MONTHLY RENTAL INCOME

The amount of rental income subject to residential monthly rental income tax has been increased from Ksh 10 million to Ksh 15 million. Residential rental income tax is at the rate of 10% on the gross rental income received by a resident person from residential property. The tax is payable on or before the twentieth day of every month.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

This is a welcome move. This income is earned by both resident individuals and companies and will work to increase their disposable income. The resultant tax benefit is expected to enhance tax compliance.

MINIMUM TAX

This is a new tax which shall be chargeable at the rate of 1% of the gross turnover. The tax will be payable by a person if:

a) that person's income is not exempt under the Income Tax Act;

b) the person's income is not chargeable to tax under employment income, rental income from residential property, turnover tax, capital gains and income from the extractive industry; and

c) the instalment tax payable by that person is higher than the minimum tax.

The minimum tax shall be payable in instalments which shall be due on the twentieth day of each period ending on the fourth, sixth, ninth and twelfth months of the year of income.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

The introduction of the alternative minimum tax is not in line with basic principles of Section 3 of Income Tax Act in which gains or profits are deemed taxable. This will be payable whether or not a person has made any gains/profits. The provision requires payment even where the instalment taxes are higher than the minimum tax paid. We are of the opinion that the word 'higher' used in the Finance Bill 2020 should have read 'lower' and that this was a drafting error. It is also not clear whether the minimum tax paid in a year of income will be final or the credit will be carried forward to be offset against future tax liabilities.

The principal of alternative minimum tax is based on levying taxes on persons with perpetual tax losses which was not addressed by the Finance Bill 2020. Other countries with this legislation, charge this tax only on businesses that remain in losses for a number of years and the tax rates prescribed tax rates are usually lower.

The imposition of this tax in addition to the amendments to the Second Schedule in the recent Tax Laws (Amendment) Act, 2020 (reducing tax incentives on capital investments) does not promote Kenya as an investment destination. The 1% rate is high and punitive for persons with high turnovers and in financial distress. No exemptions have also been provided to critical sectors such as aviation, agriculture, hospitality, health and education that have been hardest hit with the effects of COVID-19 pandemic.

DIGITAL SERVICE TAX

Taxation of income from the digital market place at the rate of 1.5% of the gross transaction value has been introduced as follows:

- Digital service tax (DST) shall be payable by a person whose income from services is derived from or accrues in Kenya through a digital market place.
- A resident person or non-resident person with a permanent establishment in Kenya shall offset the DST paid against the tax payable for that year of income.
- The tax shall be due at the time of the transfer of the payment for the service to the service provider.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

DST has stirred significant debate in the past few days after the release of the Value Added Tax (VAT) (Digital Marketplace Supply) Regulations, 2020 providing more guidance on this tax. DST was first introduced through the Finance Act 2019 and further amendments introduced through the Finance Bill 2020 and subsequently through the aforementioned Regulations.

While these regulations now provide more details on how the tax will be imposed and ascertained, the payment and administration mechanisms, these regulations are only limited to VAT. The Income Tax and Excise Duty areas therefore still remain grey areas.

In our view therefore, it would be suitable to issue unified digital service tax regulations under the Tax Procedures Act as this will ensure that the relevant guidance on applicability of these taxes is available under a uniform legal framework across the four statutes.

We also highlight below other prominent issues that arise from a review of the provisions introduced in the various pieces of legislation mentioned above:

- The Regulations require that any person supplying services through a digital marketplace shall register for VAT. It is clear from the foregoing that the Regulations disregard the five million threshold set under the main Act. It is imperative to note that the Regulations serve as a subsidiary legislation and therefore cannot overrule a main law. There is need for clarity as to whether the threshold set out in the VAT Act shall also apply in the regulations in order to eliminate the discrepancy occasioned by the Regulations.
- The Regulations require that a digital marketplace supplier from an export country shall, for every tax period, submit to the Commissioner, a record of all the supplies made in Kenya indicating the value of the supplies and VAT deducted. The higher the administrative burden, the higher the demotivation to comply. It is key that the Commissioner invests in mediums to collate as much data as necessary to avoid pushing responsibility to taxpayers.
- The Commissioner should institute compliance requirements that are designed to minimize the costs associated with building new systems and identifying the location of a sale or customer.
- There is need for further consultation on the practicability of adding some of the essential services of public interest that are being specified to fall in the scope of taxable supplies e.g. supply of distance teaching via pre-recorded medium or e-learning for instance. This acts in contravention of previous tax incentives introduced recently in aid of supporting Kenyans amid COVID 19.

- The DST regime should be geared towards minimizing complexity and avoid differential treatment between residents and non-residents or between varying sectors.

Owing to the technical nature of this area, we foresee a need for budgetary allocation to empower the Commissioner to invest in the proper human capital and appropriate equipping of these resources to achieve a well-structured tax system in respect of digital services. In the absence of a clear legal frame work to operationalize this provision it will be a fertile ground for tax disputes.

EXEMPT INCOME NOW SUBJECT TO TAX

The following previously exempt income under the First Schedule of the Income Tax Act will now be subject to tax:

i. The income of a registered Home Ownership Savings Plan (HOSP).

ii. Income of the National Social Security Fund (NSSF).

iii. Monthly or lump sum pension granted to a person who is sixty-five year of age or more.

iv. Income from employment paid in the form of bonuses, overtime and retirement benefits to employees whose income is below the lowest tax bracket.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

The effect of these four proposals is to increase the tax base as follows:

- Taxing income earned by financial institutions, fund managers, investment banks and building societies who manage HOSP deposits will reduce the income available for distribution to depositors as interest, and thus income available to purchase homes.
- The income of NSSF will now be taxable and will reduce the net amount available for distribution to retirees which contradicts the principle of not taxing income of registered pensions schemes.
- Taxing the pension income of senior citizens above age of sixty-five years will reduce their net receipts and disposable income. Considering that most old people spend much of their pension income on medicine, this will negatively affect the senior citizens.
- The proposal to tax bonus, overtime and retirement benefits for low income earners will reduce disposable income available to them especially in the current difficult economic time and in future. This is against the presidential recommendations that resorted to exemption of this income in 2016 Finance Act. Considering the effects of the Covid19 pandemic, it would be prudent to retain the tax exemptions on bonuses and overtime benefits to low income earners.

All the above changes had been introduced through the Tax Laws (Amendment) Bill, 2020 and were rejected by parliament.

LISTED COMPANIES AT THE NAIROBI STOCK EXCHANGE

The Bill proposes to disallow for tax purposes the following expenses incurred by listed entities and companies looking to list at the Nairobi Stock Exchange:

i. Expenditure of a capital nature incurred in that year of income by a person on legal costs and other incidental expenses relating to the authorization and issue of shares, debentures or similar securities offered for purchase by the general public.

ii. Expenditure of a capital nature incurred in that year of income by a person, on legal costs and other incidental expenses, for the purposes of listing on any securities exchange operating in Kenya, without raising additional capital.

iii. Expenditure of a capital nature incurred in that year of income by a person on rating for the purposes of listing on any securities exchange operating in Kenya.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

This proposal removes the incentives made earlier in encouraging investments in the stock market.

ALLOWABLE DEDUCTIONS NOW SUBJECT TO TAX

The Bill also proposes to disallow the following expenses which were previously allowable expenses:

i. Annual subscriptions and entrance fees made to trade associations which have made an election for their income to be treated as taxable.

ii. Club subscriptions paid by an employer on behalf of an employee.

iii. Expenditure with the prior approval of the Minister on the construction of a public school, hospital, road or any similar kind of social infrastructure.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

- The taxation of annual subscriptions, entrance fees and club subscription affect several companies. It may not be significant but may discourage employers from extending these benefits to employees.
- The deletion of expenditure on the construction of public schools, hospitals and similar social infrastructure will impact negatively on communities that benefit from such amenities as donors will be dissuaded from investing in such projects.

REMOVAL OF THE HOUSE OWNERSHIP SAVING PLAN TAX RELIEF

The Bill proposes to remove the tax relief available to individual who are saving to own a house under a House Ownership Saving Scheme (HOSP).

Effective Date

This measure will come into effect from 1 January 2021.

Our View

The Bill proposes to delete tax deduction of HOSP contributions up to a limit of Ksh 96,000 per year and interest income earned by a depositor on such deposits up to a maximum of Ksh 3,000,000 which were previously exempted under section 22C of Income Tax Act. This goes against the Big Four Agenda of encouraging home ownership in Kenya by the Government as it will discourage savings and buying of houses through this schemes and interested buyers may resort to seek other available sources of financing e.g. bank loans and mortgages.

It is worth noting that this proposal had earlier in the year been rejected by parliament under the Tax Laws (Amendment) Bill, 2020 as it discourages savings and investing in the housing sector.

Value Added Tax

DEDUCTION OF INPUT TAX

The Bill proposes to introduce an additional condition under which deduction of input tax shall not be allowed where the supplier has not declared the sales invoice in a return.

Previously the only condition was that for deduction of input tax to be allowable, the person had to hold the necessary documentation required under the provision.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This proposal negates the principal of VAT of input tax claim and creates grounds for tax disputes.

The business persons claiming input tax do not have the capacity and any legal backing or obligation to enable them enforce compliance of declaration of sales by their suppliers. Its KRA's Mandate to enforce compliance on declaration of correct sale which is now here being shifted to the purchasers (customers) of goods and services.

In a similar related case at the tax tribunal, the members of the tribunal observed that KRA erred in disallowing input VAT claimed by the Appellant for purchases from registered VAT suppliers given that the Appellant did not have the capacity, duty or knowledge to enforce declaration of output tax by its suppliers.

OTHER NOTABLE CHANGES UNDER THE FIRST SCHEDULE OF THE VAT ACT

a) Zero rated supplies to Standard rated supplies

Supplies	New Rate	Old Rate
The supply of liquefied petroleum gas including propane.	14%	0%
Inputs or raw materials for electric accumulators and separators including lead battery separator rolls whether or not rectangular or square supplied to manufacturers of automotive and solar batteries in Kenya	14%	0%

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This will make LPG Expensive as the extra cost will be passed on to the consumer and may result to use of alternative sources of energy such as kerosene, charcoal and firewood. This change had also been proposed in the Tax Amendment Bill 2020 but was rejected by Parliament based on the adverse effect of usage of the alternative sources and uptake of LPG as source of clean energy.

EXEMPT SUPPLIES TO STANDARD RATED SUPPLIES

Supplies	New Rate	Old Rate
8802.11.00 Helicopters of an unladen weight not exceeding 2,000 kg.	14%	Exempt
8802.12.00 Helicopters of an unladen weight exceeding 2,000 kg.	14%	Exempt
8802.20.00 Aeroplanes and other aircraft, of unladen weight not exceeding 2,000 kg.	14%	Exempt
8803.30.00 Other parts of aeroplanes and helicopters.	14%	Exempt
8805.10.00 Aircraft launching gear and parts thereof; deck-arrestor or similar gear and parts thereof	14%	Exempt
8805.21.00 Air combat simulators and parts thereof.	14%	Exempt
8805.29.00 Other ground flying trainers and parts thereof.	14%	Exempt
Materials, waste, residues and by-products, whether or not in the form of pellets, and preparations of a kind used in animal feeding of tariff numbers 1213.00.00, 1214.10.00, 2308.00.00, 2309.10.00, 2309.90.10, 2309.90.90, 2302.10.00, 2302.30.00, 2303.20.00, 2303.30.00, 2304.00.00, 2306.10.00, 2306.20.00, 2306.30.00, 2306.41.00, 2306.49.00, 2306.50.00, 2306.60.00, 2306.90.00, 2835.25.00 and 2835.26.00.	14%	Exempt
Specialized equipment for the development and generation of solar and wind energy, including deep cycle batteries which use or store solar power upon the recommendation of the Cabinet Secretary responsible for matters relating to energy.	14%	Exempt
Tractors other than road tractors for semitrailers.	14%	Exempt
Goods of tariff No. 4011.30.00.	14%	Exempt
Taxable goods locally purchased or imported by manufacturers or importers of clean cooking stoves for direct and exclusive use in the assembly, manufacture or repair of clean cook stoves approved by the Cabinet Secretary upon recommendation by the Cabinet Secretary for the time being responsible for matters relating to energy.	14%	Exempt
Stoves, ranges, grates, cookers (including those with subsidiary boilers for central heating) barbeques, braziers, gas-rings, plate warmers and similar non-electric domestic appliances, and parts thereof, or iron or steel of tariff numbers 7321.11.00, 7321.12.00, 7321.19.00, 7321.81.00, 7321.82.00, 7321.83.00 and 7321.90.00.	14%	Exempt
One personal motor vehicle, excluding buses and minibuses of seating capacity of more than eight seats, imported by a public officer returning from a posting in a Kenyan mission abroad and another motor vehicle by his spouse and which is not exempted from Value Added Tax under the First Schedule.	14%	Exempt
Plant, machinery and equipment used in the construction of a plastics recycling plant.	14%	Exempt
Hiring, leasing and chartering of helicopters of tariff numbers 8802.11.00 and 8802.12.00.	14%	Exempt

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The proposal to make certain aircrafts and aircraft parts chargeable will have a negative impact in the aviation industry in light of the COVID19 pandemic which has had adverse effects on the travel industry. The potential risk is that Kenya might lose its competitiveness as an aviation hub in the region.

The imposition of tax on materials and by-products used in the manufacture of animal feeds, and the imposition of tax on tractors will have adverse effects on agriculture and livestock production which is the bedrock of the Kenyan economy.

The imposition of VAT on specialized equipment on solar and wind energy will make investment on solar energy expensive and goes against the Government agenda in promoting the use of clean energy especially to low income households. The net effect of this amendment is that rural households will result to use of alternative sources of energy e.g. kerosene, firewood and charcoal. The same effect will be on clean cooking stoves.

The Bill proposes to introduce on VAT on plant, machinery and equipment used in the construction of a plastics recycling plant. This will contradict the government efforts of environmental conservation as this will discourage investments in this sector. These changes had been proposed in the Tax Laws (Amendment) Bill, 2020 but were rejected by parliament. The law was introduced in the Finance Act 2019 and therefore should be given an opportunity to be fully operationalized and the impact assessed before it can be amended.

OTHER CHANGES IN VAT

a) The Bill proposes to introduce Maize (corn) seeds of tariff no. 1005.10.00. under the first schedule as exempt goods.

b) The Bill proposes to introduce under part II of the First Schedule of the VAT Act, exempt services 'ambulance' as part of Medical, veterinary, dental and nursing services.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The inclusion of ambulance services as an exempt service is a welcome move in light of the COVID19 Pandemic.

Excise Duty

LICENSES

The Bill seeks to expand the definition of license by including 'a license required in the carrying out of any other activity in Kenya for which the Commissioner, by notice in the Gazette, may impose a requirement for a license.'

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This will bring more clarity on excise license in respect of excisable goods and services.

ALCOHOLIC STRENGTH OF BEER AND SPIRITS

The Bill proposes to reduce the percentage of alcoholic strength from 10% to 8 % for Beers and spirits. As a result, the revised description will be as follows:

Particulars	Rate
Beer, Cider, Perry, Mead, Opaque beer and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages of alcoholic strength not exceeding 8%	Ksh 110.62 per litre
Spirits of undenatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength exceeding 8%	Ksh 253.00 per litre

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The effect of this is to levy Excise duty on beer and spirituous beverages with lower alcoholic strength. We opine that there is need to include:

a) Beer, Cider, Perry, Mead, Opaque beer and mixtures of fermented beverages with non-alcoholic beverages and spirituous beverages of alcoholic strength exceeding 8%. This will bring Excise Duty to imported Spirituous fermented beverages that are covered under HS Code 2203,2205 and 2206.

b) "Spirits of un denatured ethyl alcohol; spirits liqueurs and other spirituous beverages of alcoholic strength not exceeding 8%. This will bring this beverage covered under HS Code 2207 and 2208 within the realm of Excise Duty.

This in effect will protect local manufacturers from unfair competition from imported spirituous beverages.

Tax Procedures Act

VOLUNTARY TAX DISCLOSURE PROGRAM

The Bill seeks to introduce a Voluntary Tax Disclosure program which shall be for a period of three years with effect from the 1st January, 2021.

Voluntary tax disclosure program means a program where a taxpayer discloses the taxpayer's tax liabilities to the Commissioner for the purpose of being granted a relief of penalties and interest on the tax disclosed.

A person with a tax liability may apply to the Commissioner for relief in the prescribed form with respect to tax liabilities that accrued within a period of five years prior to the 1st July, 2020. The application shall be voluntary and disclose all material facts.

Where the Commissioner is satisfied with the facts disclosed in the application, the Commissioner shall grant the relief provided that the relief shall not result in the payment of a refund to the taxpayer.

If a tax payer is granted relief under the program, they shall not be prosecuted with respect to the tax liability disclosed and shall be granted a remission of the interest and penalty due on the tax liability as follows:

- where the disclosure is made and tax liability paid in the first year of the program, a full remission of the interest and penalty.
- where the disclosure is made and tax liability paid in the second year of the program, remission of fifty per cent of the interest and penalty.
- where the disclosure is made and tax liability paid final year of the program, remission of twenty-five per cent of the interest and penalty.

Where the Commissioner has granted the relief, the Commissioner shall enter into an agreement with the taxpayer setting out the terms of payment of the tax liability and the period within which the payment shall be made which shall not exceed one year from the date of the agreement.

Where a taxpayer fails to disclose all the material facts they shall be liable to pay the full interest and penalty that had been remitted under the agreement.

A taxpayer granted relief under the program shall not seek any other remedy including the right to appeal with respect to the taxes, penalties and interest remitted by the Commissioner.

Where, before the expiry of the agreement between the Commissioner and the taxpayer, the Commissioner establishes that the taxpayer failed to disclose a material fact in respect of the relief granted under this section, the Commissioner may:

- withdraw any relief granted.
- assess and collect any balance of the tax liability.
- commence prosecution.

A taxpayer may appeal against a decision of the Commissioner.

The Voluntary Tax Disclosure program shall not apply to a taxpayer if the taxpayer:

- is under audit, investigation or is a party to ongoing litigation in respect of the tax liability or any matter relating to the tax liability.
- has been notified of a pending audit or investigation by the Commissioner.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

This tax amnesty opens a window for persons who may not have been compliant and are willing to comply but feel that the penalties and interest are punitive.

It also offers a helping hand to KRA especially because it does not have the resources to do compliance checks on all taxpayers to establish any amounts not declared.

APPOINTMENT OF DIGITAL SERVICE TAX AGENT

The Bill seeks to introduce a provision whereby the Commissioner may appoint an agent for the purpose of collection and remittance of digital service tax to the Commissioner.

The provision also grants the commissioner the power to revoke an appointment.

Effective Date

This measure will come into effect from 1 January 2021.

Our View

Due to complexity and technicality of E-commerce transactions, the commissioner is being enabled to appoint agents to collect and remit the taxes on his behalf. There is need to amend this further to provide the same appointment for VAT, Excise and other taxes arising from E-Commerce transactions.

Miscellaneous Fees & Levies Act

IMPORT DECLARATION FEE (IDF)

Description	Current Rate	Proposed Rate
Goods imported under the East African Community Duty Remission Scheme	Ksh 10,000	1.5% of the customs value
Additional import duty payable in respect of goods entered for home use from an export processing zones enterprises	N/A	2.5% of the customs value
Aircraft of unladen weight not exceeding 2,000 kg and Helicopters of Heading 8802.11.00 and 8802.12.00	Exempt	3.5%
Any other goods as the Cabinet Secretary may determine are in public interest, or to promote investments which value shall not be less than two hundred million shillings	Exempt	3.5%
Goods imported for implementation of projects under special operating framework arrangement with the Government	Exempt	3.5%
Goods including materials supplies, equipment, machinery and motor vehicles for the official use by the Kenya Defense Forces and National Police.	3.5%	Exempt

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The amendment on IDF for goods imported under the East African Community Duty Remission scheme creates consistency and equity among all manufacturers.

The proposal to levy additional duty for home use goods from EPZ is to discourage EPZ goods from accessing the local market and ensuring that they exported as required.

The proposed changes in respect of aircrafts affects the aviation industry that is already ailing considering the COVID 19 pandemic. The change is counterproductive and will affect Kenya as an aviation hub in the region. Further, the changes create an ambiguity as aircrafts and helicopters have been classified together and will be subject to different interpretations and thus grounds for disputes.

The deletion of the powers of the minister to exempt IDF in public interest is not progressive considering that there are situations like COVID 19 and the Locust crisis that may require discretionary exemption powers of the minister.

RAILWAY DEVELOPMENT LEVY (RDL)

Description	Current Rate	Old Rate
Currency notes and coins imported by the Central Bank of Kenya	3.5%	Exempt
Goods, including materials supplies, equipment, machinery and motor vehicles for the	3.5%	Exempt
Goods as the Cabinet Secretary may determine are in public interest, or to promote investments whose value exceeds Ksh 200 million	Exempt	3.5%

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The deletion of the powers of the minister to exempt RDL in public interest is not progressive considering that there are situations like COVID 19 and the locust crisis that may require discretionary exemption powers of the minister.

Tax Appeals Tribunal Act 2013

PROCEDURE FOR AN APPEAL

The Bill proposes to amend tax appeals tribunal Act to allow the appellant to rely on the grounds stated in the documents to which the decision relates. Previously it only allowed the appellant to be limited to the grounds stated in the appeal to which the decision relates.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This is for clarity and to avoid ambiguity. This may however prevent an appellant from introducing other grounds of appeal and documents after the appeal has been filed.

The Roads Tolls Act (Cap. 407)

The Bill introduces the definition of a toll collector to include private or public toll collectors. It also includes transit toll stations under the first schedule of this Act. It removes further the requirements for the approval by the National Assembly of agreements entered into by the minister with qualified persons to plan design or manage a public road.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The effect of this proposal is to allow privatization of roads Tolls.

The Capital Markets Act (Cap. 485A)

The Bill seeks to amend section 11 (3) of the Act to bring private equity and venture capital firms that access public funds (pensions scheme funds) under the regulatory oversight of the Capital Markets Authority in line with the Cabinet Secretary's policy pronouncement and intention in the financial year 2015/16 budget speech. The Bill further seeks to amend section 18 of the Act to remove the function of payment of beneficiaries from collected unclaimed dividends when the resurface since this is a function currently domiciled under the Unclaimed Financial Assets Authority.

It also seeks to expand the application of the Investor Compensation Fund (ICF) to activities such as whistle blowing, forensic audits and other related activities that are proactive in nature as far as protection is concerned.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This is a welcome move since the unclaimed dividends are paid out to the Unclaimed Assets Authority which has the responsibility and resources of tracing beneficiaries of unclaimed assets.

The Standards Act (Cap. 496)

The Bill proposes to amend the definition of "consolidator" in Section 2 of the Act to facilitate visibility of individual consignees for the purpose of customs declaration.

"Consolidator" means a firm that is licensed to consolidate goods belonging to different consignees at the country of export, which shall be under one Master Bill of Lading or Master Airway Bill, and breaks the consignment into smaller consignments at the port of destination for the different consignees for the purpose of individual customs declaration.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This definition of consolidator amends the earlier definition of the standards Act which was in the Finance Act of 2019 to give more clarity on what a consolidator entails.

The Kenya Revenue Authority Act (No. 2 of 1995)

The Bill seeks to amend the Act to provide for a legal framework for the establishment of an institution to offer capacity building and training on tax, customs and revenue administration.

The Bill further proposes to amend the Act to include commissions earned by the Kenya Revenue Authority on collections made on behalf of government agencies or county governments as a source of funding for the Authority capped at 2% of the revenue collected.

The Bill also seeks to amend the Act by providing for specific timelines within which the Authority can be sued to enable the Authority to effectively manage its disputes.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

This amendment is meant to give legal status to Kenya school of revenue Administration. (KESRA).

The limitations of actions against KRA is in line with the section 3 of the Public Authorities Limitations Act cap 389 laws of Kenya. However, tax disputes are catered for under specific tax statutes including Tax Procedures Act and Tax Appeal Tribunals Act.

The Retirement Benefits Act, 1997(No. 3 of 1997)

The Bill seeks to amend the Retirement Benefits Act, 1997 to enhance supervisory role of the Authority on pension schemes by providing powers to charge a penalty of Ksh 100,000 for failure to submit actuarial valuation reports within the period specified in the Regulations and a further penalty for Kenya shillings 1000 each day the report remains outstanding.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The effect of this amendment is to enhance supervisory role of the Retirements Benefit Authority. The amendments will increase compliance by the retirement benefit schemes due to the new penalties for non-compliance.

The Insolvency Act (No. 18 of 2015)

The Bill proposes to amend the Second Schedule to the Act to reduce the risk exposure on the tax revenues held by commercial banks before transfer to Central Bank by declaring them preferential claims in the order of priority in the event of insolvency.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The effect of this proposal is to place taxes collected on behalf of KRA to rank in the second priority claims with the first priority claims being those of secured creditors where the collecting tax agent is placed under receivership or liquidation.

Insurance Act (Cap 487)

The Bill proposes a 30-day timeline for an aggrieved party to file an appeal with the insurance tribunal on the decision of the commissioner of insurance in a dispute.

Effective Date

This measure will come into effect on the date of assent of the Finance Bill 2020.

Our View

The introduction of time limit within which to lodge disputes to the tribunal will ensure that the disputes are filed in time to enable commencement of dispute resolution process without unnecessary delay. An appeal may be dismissed for being filed out of time.

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