Kenya Budget Review

2021/2022

PKF

CONTENTS

Global Expertise • Local Knowledge

Cautionary statement: The taxation and miscellaneous proposals set-out in this document are based on the Budget Statement presented by the Cabinet Secretary and the Finance Bill, 2021. The changes proposed in the Finance Bill, 2021 are subject to parliamentary debate and ascent in the form of the Finance Act, 2021.

THE FINANCE BILL, 2021

General comments on proposed changes

The proposed changes in the Finance Bill, 2021 (Bill) indicate a clear intent by the government to align its tax legislation with international best practice as it seeks to shore-up its tax revenues. The proposals are heavily borrowed from the recent changes and developments by the Organisation for Economic Co-operation and Development (OECD) relating to tax and the prevention of profit shifting to low tax jurisdictions. The proposals also demonstrate the Government's plan to adopt and implement certain action points of the Base Erosion and Profit Shifting (BEPS) project by the OECD that aim at protecting its taxing rights on income derived or accrued in Kenya. Whilst a number of the changes had been proposed in the draft Income Tax Bill, 2018, which to date has never been tabled in Parliament, the introduction of these changes in this Bill indicate the Government's renewed effort to align itself with the recent changes and developments in taxation especially on the ever emerging business models and advancements in technology.

Income Tax Act

Expanded definition of 'Control'

The Bill proposes to expand the definition of 'control' and instances that give rise to control. Currently, control entails ownership by one person of at least 25% of the shares or voting rights in a separate entity or another person but the Bill seeks to reduce this to 20%. Additionally, the Bill proposes to include the following scenarios as instances that result in control:

- Where loans advanced by a person to another person constitute at least 70% of the book value of the total assets excluding loans from financial institutions not associated with the person advancing the loan;
- Where guarantees by the person for any form of indebtedness of another person constitute at least 70% of the total indebtedness of the other person excluding guarantees from financial institutions not associated with the guarantor;
- Where the person appoints more than half of the board of directors of another person or at least one director or executive member of the governing board of that person;
- Where the manufacture or processing of goods or articles or business carried on by one person is dependent on the use of know-how, patent, copy right, trade mark, license, franchise or any other business or commercial right of a similar nature, which the other person has exclusive rights to;
- Where a person or a person designated by that person supplies at least 90% of the purchases of another person;
- Where a person purchases or designates a person to purchase at least 90% of the sales of another person; and
- Where the Commissioner is of the opinion that the relationship, dealing or practice with another person influences pricing or constitutes control.

The above proposals will have significant impact on Transfer Pricing (TP) arrangements. The expanded scope of control from a TP perspective provides a catch-all rule for all cases where the facts and circumstances of a transaction evidence that a person effectively exercises control over the business decisions of the other person even where there is no actual shareholding or voting rights. The proposal, if assented into law will significantly change the TP landscape in Kenya and will greatly impact on the choice of comparables for TP benchmarking analysis since transactions that are currently deemed to be at arm's length will fall under the scope of controlled transactions between related or associated entities.

Proposed Effective Date: 1 July 2021

Expanded definition of a 'Permanent Establishment'

The Bill proposes to expand the definition of a Permanent Establishment (PE) to cover the following additional scenarios:

- A warehouse in relation to a person whose business is providing storage facilities to others;
- A farm or plantation for agricultural activities;
- A building or construction site or project installation that has existed for:
  - (a) a period of 183 days; or
  - (b) an aggregate of between 30 to 183 days when carried on in one or more periods of time; or
  - (c) for more than 30 days if carried on by a related enterprise;

- Provision of consultancy services within Kenya for a period exceeding an aggregate of 91 days in a year;
- An installation or structure used in the exploration of natural resources where the exploration continues for a period of more than 91 days;
- A dependent agent of a person who acts on their behalf in Kenya including the negotiation and conclusion of contracts, except where the activities are preparatory or auxiliary in nature.

This proposed amendment on characterisation of a PE in Kenya is in line with the international best practice on expanded definition of PEs by Article 5 of the OECD Model Tax Convention to bring to tax business models that were hitherto not under the ambit of income tax.

Further, the proposed amendment in the Bill is in line with Action 7 of the BEPS Action points that brought changes to the definition of a PE to counter strategies used by persons to avoid a taxable presence in a jurisdiction and ultimately lead to the shifting of profits. In line with Action 7 of the BEPS report, the proposed amendments would cure this deficiency through:

- Ensuring that where there are activities of an intermediary nature in Kenya that are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, the enterprise will be considered to have a taxable presence in Kenya;
- Restricting entities from fragmenting business operations into several small operations to take advantage of exceptions to the definition of a PE; and
- Preventing entities that have been taking advantage of the exceptions applicable to construction sites through splitting up contracts between closely related enterprises.

This proposed amendment by the Bill also indicates the intent by the Government to expand the scope of a PE because of numerous disputes that have arisen on the interpretation of certain Double Tax Avoidance Agreements (DTAAs) between Kenya and other states e.g. DTAAs between Kenya and South Africa, France and the United Arab Emirates. This is because the aforesaid DTAAs give Kenya the taxing rights to income that has been earned in Kenya by entities of those states only when those entities have a PE in Kenya.

Proposed Effective Date: 1 July 2021

Clarification on Digital Service Tax

Digital Service Tax (DST) was introduced by the Finance Act, 2020. It is applicable on income derived from or accrued in Kenya from provision of services through a digital marketplace. The Bill proposes to clarify that the scope of DST covers all income accrued from business activities made over the internet or an electronic network including through a digital marketplace. The Bill further emphasizes that a digital marketplace is an online platform, which enables users to sell or provide services, goods or other property to other users.

In addition, the Bill proposes to restrict the imposition of DST only to non-resident persons whose income is derived from or accrued in Kenya from the provision of services through a digital marketplace. The proposed amendment brings much clarity on the imposition of DST while the exemption of resident persons from DST is a welcome move because resident persons are already under the ambit of income tax.

The proposal is also in consensus with the international best practice of developing tax laws that cover economic activities beyond the "brick and mortar" economic environment. The emergence of intangible value drivers has revolutionized business models leading to emergence of new business models that do not rely on physical presence, which has created uncertainties from a tax perspective. At the centre of it has been the need to achieve an effective nexus between profit allocation and distribution of taxing rights of income generated from other jurisdictions.

To cure this, there has been the need by digital businesses to pay income taxes where their consumers or users are located. This approach has majorly been adopted in the European Union and has resulted in significant tax collections, which Kenya aims at replicating. Therefore, the proposed amendment by the Bill is in line with the international best practice and seeks to provide clarity on some of the uncertainties that have clouded the taxation of the digital economy.

The Bill also proposes that a non-resident person subject to DST should submit a return and pay DST on or before the 20th day of the month following the end of the month in which the digital service was offered, which is still the case currently.

There is also an amendment in the Bill to clarify that DST is not applicable to income subject to Withholding Tax (WHT) and telecommunications income taxed under Section 9(2) of the Income Tax Act, CAP 470 (ITA). These exemptions had already been gazetted through the DST regulations, 2020 - Legal Notice No. 207.

Proposed Effective Date: 1 July 2021

Removal of capping of carry forward of tax losses

The Bill proposes to re-introduce the indefinite carry forward of tax losses. This was the position until 2010 when carry forward of tax losses was capped to five years and later in 2015 when it was capped to 10 years. Currently, taxpayers seeking to carry forward any tax losses beyond 10 years have to make an application to the Cabinet Secretary (CS) National Treasury upon recommendation by the Commissioner providing evidence of the inability to extinguish the losses within the 10-year period.

This proposal will be advantageous especially to taxpayers with large capital investments that attract investment deductions that result in huge tax losses that cannot be utilized within the 10-year period.

However, this proposed amendment seems to be motivated by the introduction of minimum tax that is also applicable to persons with tax losses. The intended carry forward of tax losses indefinitely is thus a mute proposal if minimum tax is upheld. It should be noted that the High Court has recently suspended implementation of minimum tax pending full hearing of its constitutionality.

Proposed Effective Date: 1 July 2021

Overhaul of thin capitalization provisions

The Bill proposes to completely overhaul thin capitalization provisions by repealing the current provisions where interest payments in a year of income by a foreign controlled entity are not either partly or fully tax deductible depending on the ratio of debt to equity which is 3:1 respectively.

The Bill proposes to introduce restriction on tax deductibility of interest expense on any gross interest amounts exceeding 30% of Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). This proposed provision shall apply to all entities including those in the extractive sector and shall be applicable to interest on all loans, payments that are economically equivalent to interest and expenses incurred in connection with raising the finance. The deferment of realized foreign exchange losses for thinly capitalized companies until they cease to be thinly capitalized, however, remains which we believe could be a drafting error given the proposed overhaul of thin capitalization provisions. From the current drafting of the Bill, the interest restriction appears to be applicable not only to foreign controlled companies but to local companies as well.

This proposal is retrogressive in the sense that it will discourage investments that are highly geared by restricting the amounts of interest claimable even on local loans particularly during earlier periods of such investments when returns are naturally expected to be low. The proposal is also detrimental to loss making entities because they will not claim any interest expense. Further, the proposal is punitive for companies in the extractive industry whose operations are highly geared with no immediate revenues.

Whilst the proposed amendment on restriction of claiming interest expenses is retrogressive to many taxpayers, the proposal is in tandem with Action 4 of the BEPS project. Action 4 aims at limiting base erosion through the use of tax deductible interest deductions and other financial payments. Action 4 recommends the restriction of an entity's net interest deductions to its level of economic activity, which is measured using EBITDA. The proposal has also been adopted by European Union member states who apply an interest cap that restricts taxpayer's deductible interest expenses to 30% of EBITDA.

Proposed Effective Date: 1 January 2022

	Impact of proposal on entities that are not thinly capitalized		Impact of proposal on entities that are thinly capitalized	
Details	Current Thin Cap Provisions (3:1 Debt to Equity ratio)	Proposed interest restriction by FB 2021	Current Thin Cap Provisions (3:1 Debt to Equity ratio)	Proposed interest restriction by FB 2021
Debt: Equity ratio	3:1	N/A	4:1	N/A
EBITDA (KShs)	300	300	300	300
Finance costs - interest (KShs)	(200)	(200)	(200)	(200)
Interest expense claimable (KShs)	200	90	150	90
Disallowed Interest	Nil	110	50	110
Tax on disallowed interest-30%	Nil	33	15	33

Notes : Under the proposed regime, it is evident that all companies will suffer incremental taxes as a result of the proposed change, whether thinly capitalized or not or whether foreign controlled or not. The EBITDA method will clearly yield undesired effects on many businesses whilst yielding additional taxes for government. Furthermore, the option to use various frameworks for Generally Accepted Accounting Practices can affect the calculation of EBITDA.

Introduction of Country-by-Country reports for ultimate parent entities of Multi-National Enterprises resident in Kenya

The Bill proposes to introduce Country-by-Country ("CbC") reporting requirements for ultimate parent entities of multinational enterprises (MNEs) which are:
(a) tax resident in Kenya; (b) not controlled by another entity; and (c) own or control a MNE group. The ultimate parent entity of the MNE shall submit to the Commissioner a return describing the group's financial activities in Kenya and in all other jurisdictions where the group has taxable presence. The return shall be submitted not later than 12 months after the last day of the reporting financial year of the group.

Further, the return shall contain information on the group's aggregate information on revenue, profit and loss before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees and tangible assets with regard to each jurisdiction in which the group operates.

The proposal is in line with KRA's continued scrutiny on MNEs to ensure they pay their fair share of taxes in Kenya. It is imperative to note that the Bill has not prescribed the threshold of gross turnover of the MNEs to qualify for the CbC reporting and we anticipate further guidance on this.

Further, this proposal highlights Kenya's efforts to implement the OECD BEPS Action 13 on CbC reports. Action 13 seeks to provide revenue authorities with a high-level overview of the operations and tax risk profiles of MNE groups. By submitting to the revenue authorities' information on the MNE and all the constituent group entities on an annual basis, revenue authorities are able to assess on a high level any inherent TP risks.

Additionally, this proposal is a further indication that Kenya is stepping up its efforts to join other nations on exchange of information for tax purposes. This is as per the guidance contained in the Common Reporting Standards (CRS) developed by the OECD. CRS calls on nations to obtain tax and financial related information from taxpayers and automatically exchange that information with other nations that have signed to the CRS on an annual basis. Kenya ratified to the Convention on Mutual Administrative Assistance in Tax matters in December 2019. Subsequently, in July 2020, Kenya deposited its instruments of ratification for the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("The Convention") with the OECD.

The ratification means that Kenya can now automatically share tax related information with over 137 jurisdictions that have ratified the Convention. Consequently, Kenya can also undertake simultaneous tax audits with other jurisdictions and the proposed amendment by the Bill, if assented into law, will be a boost to these efforts.

There is a proposal in the Bill to introduce CRS requirements through the Tax Procedures Act, 2015.

Proposed Effective Date: 1 January 2022

Insurance Relief on NHIF Contributions

The Bill proposes to allow individual taxpayers claim insurance relief on contributions made to the National Hospital Insurance Fund ("NHIF") in a year of income.

The proposed amendment is a welcome move as it provides relief to employees on NHIF contributions from taxation.

Proposed Effective Date: 1 January 2022

Expansion of scope of tax rebate scheme for apprenticeship program

The Bill proposes to expand the tax rebate scheme to employers who engage graduates from Technical and Vocational Education and Training ("TVET") for a period of 6 to 12 months. The tax rebate scheme has only been available to employers who engage 10 university graduates as apprentices for a period of 6 to 12 months.

The proposal is a welcome move as it will benefit both employers and TVET graduates as it gives incentives to the employers while enabling TVET graduates acquire more experience.

Proposed Effective Date: 1 January 2022

Amendment of the limitation of benefits clause

The Bill proposes to widen the scope of persons who can access the benefits of the DTAAs that Kenya has signed with other countries. Access to DTA benefits in Kenya is currently restricted to companies which have at least 50% of the underlying ownership held by individuals who are residents of the other contracting state. The Bill proposes to expand this scope to include companies that have at least 50% of the underlying ownership held by persons who are residents of the other contracting state.

Proposed Effective Date: 1 July 2021

Clarification on what constitutes an infrastructure bond

The Bill also proposes to define an infrastructure bond to mean a bond issued by the Government for the financing of a strategic public infrastructure facility including a road, hospital, port, sporting facility, water and sewerage system, or a communication network. This makes it clear for persons who want to invest in infrastructure bonds due to the associated income tax exemptions as a result.

Proposed Effective Date: 1 July 2021

Amendment to investment allowances deduction method

The Bill proposes to amend the investment allowances available on capital expenditure deduction criteria under the Second Schedule of Income Tax Act that is currently on a reducing balance basis to a basis of equal instalments. If this proposal is enacted into law, the new capital deduction rates will be as follows:

Item	Current	Proposed
Hotel buildings, buildings used for manufacture, hospital buildings and petroleum or gas storage facilities	50% in the first year and 25% on the residual value per year on reducing balance basis	50% in the first year and 25% on the residual value per year on equal instalments
Commercial and educational buildings including student hostels	10% per year on reducing balance basis	10% per year on equal instalments
Machinery used for manufacture, hospital equipment, ships and air crafts	50% in the first year and 25% on the residual value per year on reducing balance basis	50% in the first year and 25% on the residual value per year on equal instalments
Motor vehicles and heavy earth moving equipment	25% per year on reducing balance basis	25% per year on equal instalments
Computer and peripheral, computer hardware, computer software, calculators, copiers and duplicating machines	25% per year on reducing balance basis	25% per year on equal instalments
Furniture and fittings and telecommunication equipment	10% per year on reducing balance basis	10% per year on equal instalments
Filming equipment	25% per year on reducing balance basis	25% per year on equal instalments
Machinery used to undertake operations under prospecting right and machinery used to undertake exploration operations under a mining right	50% in the first year and 25% on the residual value per year on reducing balance basis	50% in the first year and 25% on the residual value per year on equal instalments
Other machinery	10% per year on reducing balance basis	10% per year on equal instalments
Fibre optic cable	10% per year on reducing balance basis	10% per year on equal instalments
Farm works	50% in the first year and 25% on the residual value per year on reducing balance basis	50% in the first year and 25% on the residual value per year on equal instalments

The proposed change of capital deduction criteria from reducing balance to equal instalments will see taxpayers equally spread the capital deductions over the life of the asset depending on the applicable investment allowance rate. The result of this change is that taxpayers will claim investment allowances in shorter periods.

Additionally, the Bill has clarified that machinery used in the generation of electricity for own consumption or for distribution to other persons without necessarily being through the National Grid is subject to capital deductions.

The Bill further proposes to clarify on what constitutes civil works to include roads and parking areas, railway lines and related structures, water, industrial effluent and sewerage works, communications and electrical posts and pylons and other electrical supply works and security walls and fencing.

Proposed Effective Date: 1 January 2022

Amendments to the Ninth Schedule (Taxation of Extractive Industries) to the ITA

The Bill proposes to align the capital deductions criteria for machinery used to undertake operations in extractive industry under a prospecting right to equal instalments from a reducing balance basis as per the Second Schedule.

Proposed Effective Date: 1 January 2022

The Bill also proposes to increase the withholding tax rate for service fees paid by a contractor or a licensee to 10% from 5.625%. Further, the Bill proposes to reduce the withholding tax to be deducted by a contractor in the case of management, training or professional fees to 10% from 12.5%.

Proposed Effective Date: 1 July 2021

Interest restriction in the Ninth Schedule to the ITA is also proposed to be aligned to 30% of EBITDA.

Proposed Effective Date: 1 January 2022

Whereas the reduced withholding tax rate for management services is a welcome move, the increased withholding tax rates by contractors and licensees and the restriction of claiming of interest expenses will discourage investments in the mining and petroleum operations.

Tax Procedures Act

The Bill has proposed several changes to the Tax Procedures Act, 2015, (TPA) as highlighted below:

Broadening the scope of tax laws governed under the TPA

The Bill proposes an amendment on the definition of the term "Tax law" under the TPA to include the Miscellaneous Fees and Levies Act, 2016.

This effectively encompasses The Miscellaneous Fees and Levies Act, 2016 as part of statutes for administration under the provisions of the TPA.

Proposed Effective Date: 1 July 2021

Recognition of International Tax Agreements

The Bill proposes to recognise multilateral agreements and treaties entered into or on behalf of the Government of Kenya relating to international tax, compliance and prevention of evasion of tax or exchange of information on tax matters. Such agreements will have an effect as stipulated therein. Whilst these agreements have always had effect in Kenya through provision of Section 41 of ITA, the proposed amendment seeks to anchor them in the TPA for purposes of encompassing the same application in all tax laws.

Proposed Effective Date: 1 July 2021

Confidentiality in administration of Tax Law

The confidentiality scope on information disclosure as stipulated under the TPA is proposed to be expanded to include conditions specified in Multilateral Agreements and Treaties relating to the exchange of information on tax matters. The issues handled under such arrangements shall be guided by the Agreements and Treaties between the two Contracting states.

Proposed Effective Date: 1 July 2021

Common Reporting Standards

The Bill proposes to introduce and define principles that will govern the application of CRS in Kenya as follows:

Common Reporting Standard: this is defined to mean reporting and due diligence standard for the automatic exchange of financial account information.

Financial Institution: means a custodial institution, a depository institution, an investment entity or a specified insurance company.

Kenyan Financial Institution: means any financial institution that is resident in Kenya and does not include any branch of that financial institution that is located outside Kenya or any branch of a financial institution that is not resident in Kenya if that branch is located in Kenya.

The above financial institutions are expected to abide by the CRS Regulations which are yet to be issued. These institutions will be required to share, with the Commissioner an information return on reportable accounts held, managed or administered by the financial institution, in the manner prescribed under Section 6 of the TPA.

If no account is held, a nil return would be considered a reportable account. If a transaction is entered into an arrangement whose purpose is with intention to avoid the CRS and sharing of information, then the proposed amendment empowers the Cabinet Secretary to recommend the Reporting Procedures.

Proposed Effective Date: 1 July 2021

Record keeping requirements for tax purposes

The Bill proposes to have the new record keeping period revised from five years to seven years. This is to align it with the Kenyan Companies Act, 2015 which requires a Company to keep records for a period of seven years.

This implies that taxpayers would be required to produce records for a longer period in the event of a KRA audit if this proposal is enacted.

Proposed Effective Date: 1 July 2021

Abandonment of tax

The Bill proposes that the Commissioner will be required to file a detailed report with the National Treasury for all the abandoned taxes on 30 June and 31 December of every year.

The Bill has further enhanced the basis upon which the Commissioner may propose abandonment of tax to the CS.

Proposed Effective Date: 1 July 2021

PKF

Digital transactions

The Bill proposes that non-resident persons whose businesses operate through a digital marketplace can report their transactions in the respective foreign currency as may be approved by the Commissioner. However, this provision excludes non-resident persons who file their returns via a tax representative.

The Bill proposes to empower the Commissioner to seek intervention from relevant Tax Authorities in the collection of tax from businesses operating via the internet, electronic network or digital service marketplace.

Proposed Effective Date: 1 July 2021

Amendment of assessments

The Bill proposes to increase the period within which the Commissioner can amend assessments from five to seven years.

Additionally, the Bill proposes to align the Commissioner's powers of amending returns to the period proposed for carrying out audits and maintaining records.

Proposed Effective Date: 1 July 2021

Exemption from VAT Withholding in certain circumstances scrapped

The Bill proposes to scrap the powers the Commissioner currently exercises in exempting suppliers from the withholding VAT provisions. There is no clarity on what will happen to already approved exemptions, which in the past were granted for a period of up to 24 months. Businesses that are perpetually in refund position will be pushed into further refunds.

Proposed Effective Date: 1 July 2021

Tax refunds

The Bill proposes that in cases where the Commissioner ascertains and notifies a taxpayer of a tax refund and the refund due is utilized to offset other outstanding taxes, the interest and penalties of the taxes due will no longer accrue from the date the Commissioner informs the taxpayer.

Effective Date: 1 January 2022

Due date for submissions and payments

The Bill proposes that should the due date for submission and payment of taxes due fall on a weekend or a public holiday, the due date is deemed to be the previous working day excluding those submitting a notice of objection, tax return or a tax payment electronically. The due dates will remain as stipulated in law for any electronic tax filings and payments.

Penalties for non-compliance with Common Reporting Standards

The Bill proposes to introduce various penalties for non-compliance with Common Reporting Standards as follows:

i) KShs 100,000 for each false statement or omission, to imprisonment for a term not exceeding 3 years or to both.

ii) KShs 1,000,000 for each failure to file an information return or nil return by a Reporting Financial Institution.

iii) KShs 20,000 for failure to comply with a duty of obligation where no other penalty is prescribed and KShs 20,000 for each day during which non-compliance continues for a period not exceeding 60 days.

Proposed Effective Date: 1 July 2021

Miscellaneous Fees and Levies Act

Refunds for overpaid fees and levies

The Bill proposes to introduce a provision to allow for refund of any overpaid fees and levies under this Act in line with the refund of overpaid tax provisions under Section 47 of the Tax Procedures Act, 2015. The Commissioner will also have powers to determine the resultant penalties and interest if the levies and fees remain unpaid.

This is a welcome proposal since there was no law allowing for refund of any overpaid fees and levies under this Act.

Proposed Effective Date: 1 January 2022

Import Declaration Fee and Railway Development Levy exemption

The Bill proposes to exempt from Import Declaration Fee (IDF) and Railway Development Levy (RDL) goods that the CS in charge of the National Treasury may determine to be in public interest or promote investment and whose value exceeds KShs 5 billion.

This is a welcome incentive that will encourage investments into the country due to huge cost savings on IDF and RDL charges.

Proposed Effective Date: 1 July 2021

Value Added Tax Changes

Clean up of reverse charge VAT applicability

The Bill proposes to clarify the applicability of reverse VAT for:
i) persons who are not registered for VAT;
ii) persons registered for VAT but not entitled to claim input VAT.

This proposal is not a major change in the Bill, just a clean-up of the reverse charge VAT provisions which are applicable to all persons i.e. both VAT registered and non-VAT registered persons. For VAT registered persons, reverse charge VAT on imported services is only applicable if the registered person is not entitled to claim in full input tax payable in that tax period when they import a service.

Proposed Effective Date: 1 July 2021

Clarity on applicability of VAT on online transactions

The Bill clarifies that VAT is applicable on all online vatable transactions that are conducted over the internet or on an electronic network. The Bill further emphasizes that a digital marketplace is an online platform, which enables users to sell or provide services, goods or other property to other users. Any persons doing online business be it sale of goods or provision of services are required to register and charge their customers VAT if their taxable sales exceed the set threshold of KShs 5 million annually.

Proposed Effective Date: 1 July 2021

Restriction of input VAT on hiring and leasing costs for automobiles

The Bill proposes to restrict registered persons from deducting input VAT incurred on leasing and hiring of passenger cars or mini-buses and their repair and maintenance thereof including spare parts.

Proposed Effective Date: 1 July 2021

Group VAT registration NO MORE

The Bill proposes to revoke group registration as one registered person for VAT purposes. Since enactment of the VAT Act in 2013, the law required the CS National Treasury to provide Regulations to guide on group registrations. The draft group VAT Registration Guidelines were later published for public participation sometimes back but these have never been gazetted to date.

Proposed Effective Date: 1 July 2021

VAT Regulations proposed to be at the whimsical mercy of CS National Treasury

The Bill proposes to give the CS National Treasury wide latitude of powers in gazetting VAT Regulations without seeking the approval of the National Assembly. Currently, the CS is required to seek the approval of the National Assembly before gazetting any VAT Regulations.

The proposed change is retrogressive in the sense that it leaves a wide un-checked latitude of powers to the Executive, which can be exercised whimsically and insensitively. The principle of separation of powers will be negated if this provision is passed, leaving taxpayers at the mercy of the Executive. There is no rationale or justification why the Government would want to avoid approval by the National Assembly for such important Regulations which could have far- reaching implications to the business community and consumers generally. This is bad law and should not be allowed to pass.

Proposed Effective Date: 1 July 2021

Proposed reclassification of goods from VAT exempt status to standard-rated

If this proposal is enacted, the following goods and services would be subject to VAT at the standard rate of 16%:

Item
Disposable plastic syringes of tariff number 9018.31.10
Other syringes with or without needles of tariff number 9018.31.90
0402.99.10 Milk, specifically prepared for infants
0402.91.10 Other not containing added sugar or other sweetening matters specially prepared for infants
Airlid paper without super absorbent polymer 180gsm/67 of tariff number 4803.00.0
Airlid paper without super absorbent polymer 80gsm/67 of tariff number 4803.00.0
Plain polythene film/PE of tariff number 3920.10.10
PE white 25-40gsm/release paper of tariff number 4810.99.00
12-16 gsm spun bound piyropo nonwoven cover stock/15gsm spun bound PP non-woven SSMMS hydrophobic leg cuffs of tariff number 5603.1190

Standard rating the above items will automatically lead to an increase in their prices to the end consumers. For example, why would Government make it expensive to buy syringes at a time when millions of these are required to vaccinate millions of Kenyans in the coming months?

Proposed Effective Date: 1 July 2021

Proposed reclassification of goods from standard rate of VAT to VAT exempt status

If this proposal is enacted, the following goods would be VAT exempt:

No.	Item
1	2106.10.00 Protein concentrates and textured protein substances
2	2106.90.10 Food preparations specially prepared for infants
3	2106.90.99 Other – Food preparations not elsewhere specified or included
4	2936.27.00 Vitamin C and its derivatives
5	3002.11.00 Malaria diagnostic test kits
6	3002.13.00 Immunological products unmixed, not put up in measured doses or in forms or packings for retail sale
7	3002.14.00 Immunological products mixed, not put up in measured doses or in forms or packings for retail sale
8	3002.15.00 Immunological products put up in measured doses or in forms or packings for retail sale
9	3004.43.00 Other medicaments, containing alkaloids or derivatives containing norephedrine or its salts
10	3004.60.00 Other, containing antimalarial active principles described in Subheading Note 2 to this chapter
11	2106.90.91 Food supplements
12	0402.21.00 Milk in powder, granules or other solid forms, of a fat content, by weight, exceeding 1.5% not containing added sugar or other sweetening matter
13	0402.91.00 Other not containing added sugar or other sweetening matter
14	0402.99.00 Other milk
15	9021.10.00 Orthopaedic or fracture appliances
16	9021.50.00 Other artificial parts of the body: Pacemakers for stimulating heart muscles, excluding parts and accessories
17	9025.19.00 Hydrometers and similar floating instruments, thermometers, pyrometers, barometers, hygrometers and psychrometers, recording or not, and any combination of these instruments, thermometers and pyrometers, not combined with other instruments - Other
18	9019.20.00 Airway Guedel and Ambu bags
19	9018.90.00 Blood giving set and infusion sets
20	Medical ventilators and the inputs for the manufacture of medical ventilators
21	Physiotherapy accessories, treadmills for cardiology therapy and treatment of tariff number 9506.91.00 for use by licensed hospitals
22	Dexpanthenol of tariff number 3304.99.00 used for medical nappy rash treatment by licensed hospitals

No.	Item
23	Medicaments of tariff numbers 3003.41.00, 3003.42.00, 3003.43.00,3003.49.00,3303.60.00 (excluding goods of heading 30.02,30.05 or 30.06) consisting of two or more constituents which have been mixed together for therapeutic or prophylactic uses
24	Diagnostic or laboratory reagents, of tariff number 3822.00.00 on a backing, prepared diagnostic or laboratory reagents whether or not on a backing, other than those of heading 30.02 or 30.06, certified reference materials
25	Electro-diagnostic apparatus, of tariff numbers 9018.11.00, 9018.12.00,9018.13.00,9018.14.00,9018.19.00,9018.20.00,9018.90.00
26	Other instruments and appliances, of tariff number 9018.41.00, used in dental sciences, dental drill engines, whether or not combined on a single base with other dental drill engines whether or not combined on a single base with other dental equipment
27	Other instruments and appliances, including surgical blades, of tariff number 9018.49.00, 9018.50.00,9018.90.00 used in dental sciences
28	Ozone therapy, oxygen therapy, aerosol therapy, artificial respiration or other therapeutic respiration apparatus
29	Other breathing appliances and gas masks, excluding protective masks having neither mechanical parts nor replaceable filters
30	Artificial teeth and dental fittings of tariff numbers 9021.21.00, 9021.29.00 and artificial parts of the body of tariff numbers 9021.31.00, 9021.39.00,9021.50.00 and 9021.90.00
31	Apparatus based on the use of x-rays, whether or not for medical, surgical or dental of tariff numbers 9022.12.00, 9022.13.00, 9022.14.00 and 9022.19.00
32	Apparatus based on the use of alpha, beta or gramma radiations, whether or not for medical, surgical or dental of tariff numbers 9022.21.00, 9022.29.00, 9022.30.00 and 9022.90.00
33	Discs, tapes, solid-state non-volatile storage devices, “smart cards” and other media for the recording of sound or other phenomena, whether or not recorded of tariff number 8523.80.10, including matrices and masters for the production of discs
34	Weighing machinery (excluding balances of a sensitivity of 5 cg or better) of tariff number 8423.31.00 including weight operated counting or checking machines; weighing machine weights of all kinds
35	Fetal Doppler-Pocket (wgd-002) and pulse oximeter finger held (Gima brand) Pc of tariff number 9018.19.00
36	Sterilizer Dry Heat (Wdg-001-Grx-05A) Pc, autoclave steam table tops of tariff number 8419.20.00
37	Needle holders and urine bags of tariff heading 3926
39	Tourniquets of tariff number 3926.90.99 for use by licensed hospitals
40	Taxable goods, excluding motor vehicles, imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration by a company granted a prospecting or exploration license in accordance with the Energy Act, 2019, production sharing contracts in accordance with the Mining Act, 2016, upon recommendation by the Cabinet Secretary responsible for matters relating to mining, as the case may be
41	Specialized equipment for the development and generation of solar and wind energy, including photovoltaic modules, direct current charge controllers, direct current inverters and deep cycle batteries that use or store solar power, upon recommendation to the Commissioner by the Cabinet Secretary responsible for matters relating to energy.

*The proposed exemption on medical items (serialized 20 to 39 above) shall be granted upon recommendation of the CS responsible for health.

The change in categorisation from standard rated to exempt status of the above items will lead to a marginal to average decrease in their prices. This is because there will be no associated input VAT on their purchase but at the same time, those supplying the above items will not be in a position to claim input VAT incurred on other business aspects such as transportation, storage, electricity etc. hence this has to be absorbed in the pricing mechanism for these items. Nevertheless, this is a welcome move as it will lower the cost of these items which largely comprise of medical equipment.

Proposed Effective Date: 1 July 2021

Proposed reclassification of goods from zero rated status to standard rated

The Bill proposes to subject ordinary bread to VAT at the standard rate of 16% from the current rate of 0%. This will result in price increase of ordinary bread.

Proposed Effective Date: 1 July 2021

Proposed reclassification of export services from zero-rated status to exempt status

The proposal through the Bill to exempt exported taxable services from VAT is ill motivated and aimed at limiting VAT refund claims by taxpayers providing services to non-resident persons. The issue of exported services has always been a thorn in the flesh for KRA due to the contentious issue of determining the place of use and consumption of the services.

On several occasions, KRA has lost various cases at the Tax Appeals Tribunal and at the Courts, which determined that despite the performance of the services being in Kenya, the ultimate determinant of whether services are exported out of Kenya should be the jurisdiction in which the services were used and consumed (destination principle). Additionally, exempting taxable services from VAT would be against the canon of equity given that goods exported out of Kenya are zero-rated whilst importation of taxable services attracts reverse charge VAT in certain circumstances.

Proposed Effective Date: 1 July 2021

Extension of special VAT exemptions

The Bill proposes that any person who had supplied taxable goods to persons that had an agreement or contract with the Government prior to 25 April 2020, which provided for VAT exemption will continue enjoying the exemptions for the unexpired period of the agreement or contract. However, extension of the VAT exemptions will be subject to recommendation by the CS responsible for Energy.

This is a welcome proposal since it will ensure that the initially negotiated project costs are maintained avoiding any contract price escalations that affect funding for the Government Projects.

Proposed Effective Date: 1 July 2021

Proposed VAT exemption for transactions under Real Estate Investment Trusts

The Bill proposes to exempt from VAT transfer of assets and other transactions related to the transfer of assets into real estate investment trusts and asset- backed securities. Currently, this is standard rated. This is aimed at making it cheaper for persons to establish Real Estate Investment Trusts (REITs) hence spurring growth in the real estate sector.

Proposed Effective Date: 1 July 2021

Correction of erroneous tariff codes for VAT exempt goods

The Bill proposes to correct the erroneous tariff codes for the goods stated below. Notably, the goods are currently VAT exempt but bear the wrong tariff codes. Therefore, this amendment is seeking to align the VAT exempt products with their correct tariff codes:

Item	HS Code in VAT Act	Correct HS code
Other – Heparin and its salts	3001.90.10	3001.90.00
Other human or animal substance prepared for therapeutic or prophylactic uses, not elsewhere specified or included	3001.90.90	3001.90.00
Antisera and other blood fractions and modified immunological products whether or not obtained by means of biotechnological processes	3002.10.00	3002.12.00 & 3002.19.00
Other milk in powder, granules, or other solid forms, of a fat content, by weight, exceeding 1.5%	0402.29.10	0402.29.00
Super absorbent polymner (SAP)	3906.90.0	3906.90.00
IP super soft fluff pulp – for – fluff 310 treated pulp 488*125mm (cellulose)	4703.21.0	4703.21.00
Perforated PE film 15-22 gsm	3921.190.0	3921.90.00
Spun bound non-woven 15-25 gsm	56.03.1190.8	5603.11.00
Airlid paper with super absorbent polymer 180gsm/67	48.03.00.0	4803.00.00
Airlid paper with super absorbent polymer 80gsm/67	48.03.00.0	4803.00.00

Item	HS Code in VAT Act	Correct HS code
Pressure sensitive adhesive	3506.91.90	3506.91.00
Palin polythene film/LPDE	39.21.190.0	3921.19.10
Palin polythene film/PE	39.21.190.0	3921.19.10
PE white 25-40 gsm/release paper	48.44.51.10.0	4811.49.00
ADL 25-40 gsm of tariff number	56.03.1190.8	5603.11.00
Elasticized side tape	5402.44.10	5402.44.00
12-16 gsm spun bound piyropo nonwoven cover stock/12 gsm spun bound pp non-wovenn SMS hydrophobic leg cuffs	56.03.1190.8	5603.11.00
Polymetric elastic 2/3 strands	3919.90.90.10	3919.90.10

Proposed Effective Date: 1 July 2021

Items subject to VAT w.e.f 1 July 2021 as per Finance Act, 2020

Effective 1 July 2021, the following items will be subject to VAT at the standard rate of 16%. This is in line with the effective date set out in the Finance Act, 2020.

Item	Current VAT Treatment	New Rate Effective 01/07/2021
The supply of liquefied petroleum gas	Zero Rated	16%
8802.11.00 Helicopters of an unladen weight not exceeding 2,000 kgs	Exempt	16%
8802.12.00 Helicopters of an unladen weight exceeding 2,000 kgs	Exempt	16%
8802.20.00 Aeroplanes and other aircraft, of unladen weight not exceeding 2000 kgs	Exempt	16%
8803.30.00 Other parts of aeroplanes or helicopters	Exempt	16%
8805.21.00 Air combat simulators and parts thereof	Exempt	16%
8805.10.00 Aircraft launching gear and parts thereof; deck arrestor or similar gear and parts thereof	Exempt	16%
8805.29.00 Other ground flying trainers and parts thereof	Exempt	16%
8309.90.90 Aluminium pilfer proof caps with EPE liner	Exempt	16%
Other aircraft (for example, helicopters, aeroplanes); spacecraft (including satellites) and suborbital and spacecraft launch vehicles - • Of an unladen weight not exceeding 2,000 kgs • Of an unladen weight exceeding 2,000 kgs	Exempt	16%

Excise Duty

Excise duty offset for internet service providers

The Bill proposes to amend the Excise Duty Act, 2015 to enable licensed internet service providers (ISPs), who purchase data in bulk for resale, to offset the Excise Duty payable on internet supplied to the final customer against excise duty already paid.

Excise duty on telephone and internet data services was introduced in the Finance Act, 2018. However, there was no corresponding provision, other than in the case of a licensed manufacturer, for ISPs to offset excise duty paid against amounts payable on supply to the final customer.

This is a welcome move as it provides clarity to licensed ISPs that Excise Duty incurred on the purchase of data for resale can now be offset against the Excise Duty payable on internet supplied to final customers.

Proposed Effective Date: 1 July 2021

Local sugar confectionery and chocolate products

The Bill proposes to expand the application of excise duty to include local sugar confectionery and chocolate products as follows:

- Sugar confectionery of tariff 17.04 at the rate of KShs 20 per kg; and
- White chocolate in blocs, slabs or bars of tariff 1806.31.00, 1806.32.00, 1806.90.00 at KShs 200 per kg.

Previously, excise duty was only applicable to imported sugar confectionery and chocolate products. If adopted, this will affect the competitiveness of local sugar confectionery and chocolate products in the market while at the same time, increase tax revenues.

Proposed Effective Date: 1 July 2021

Relief for glass bottle importers

The Bill proposes to scrap the current excise duty of 25% on imported glass bottles that had previously been introduced through the Business Laws (Amendment) Act, 2020 to encourage local industries to venture into production of glass bottles. However, this decision was suspended by the East African Court of Justice (EACJ) following an application by a Tanzanian bottle manufacturer who claimed this amendment was discriminatory as it did not provide an exemption for goods imported from the East African Community (EAC) member states.

The above amendment is a welcome move for local bottlers who currently rely largely on imported glass bottles.

Proposed Effective Date: 1 July 2021

Change of Excise Duty basis on motor cycles

There is a proposal to change the basis upon which Excise Duty on motor cycles of tariff 87.11 other than motor cycle ambulances and locally assembled motor cycles is calculated from a fixed rate to an ad valorem rate of 15%. Previously, motorcycles were excisable at a specific rate of KShs 11,608.23 per unit.

This amendment is aimed at enhancing revenue collection for the KRA as higher value motor cycles will attract more tax on ad valorem basis.

Proposed Effective Date: 1 July 2021

Casting the net wider for luxurious products: Jewellery

There is a proposal to introduce excise duty of 10% on articles of jewellery and imitation jewellery of tariff headings 7113 (articles of jewellery and parts thereof, of precious metal or of metal clad with precious metal) and 7117 (imitation jewellery) respectively.

This proposal is intended to increase revenue collection.

Proposed Effective Date: 1 July 2021

Cashing in on sin taxes: Nicotine

The Bill proposes to introduce Excise Duty of KShs 5,000 per kg on nicotine or nicotine substitutes intended for inhalation without combustion or oral application. However, medical products approved by the CS for Health will be excluded from this.

The government has in the recent past targeted substances such as alcohol and cigarettes as quick sources of incremental tax revenue. The introduction of nicotine substitutes in the market such as nicotine patches have however been a subject of debate between the government and nicotine companies.

The introduction of excise duty on nicotine or nicotine substitutes will thus create an additional revenue stream for the KRA.

Proposed Effective Date: 1 July 2021

Re-introduction of excise duty on betting

The Bill proposes to re-introduce excise duty on betting at a rate of 20% on the amount wagered or staked. This was first introduced through the Finance Act, 2019 and abolished by the Finance Act, 2020 after an outcry by the industry players.

The tax is intended to discourage the negative impact of betting on youth as the government also seeks to cash in on the rapid growth witnessed in this industry in recent years.

Proposed Effective Date: 1 July 2021

Amendment of definitions

The Bill proposes to include and amend the following definitions:

i. The term "Compound" to be included in the Excise Duty Act as assigned to it according to Section 2 the Compounding of Potable Spirits Act as follows:

   "to communicate any flavour to, or to mix any ingredient or material with, spirits, but not so as to denature the spirits"

   The above amendment seeks to align the definition of compounding in line with the Compounding of Potable Spirits Act.

ii. The term "Possession" to be included in the Excise Duty Act and defined as follows:

   "possession means having, owning or controlling any excisable goods including:

a) having in one's possession any excisable goods;

b) knowingly having any excisable goods in the actual possession or custody of any other person;

c) having any excisable goods in any place, whether belonging to or occupied by oneself or not, for the use of benefit of oneself; or

d) having an excisable goods for the use or benefit of another person".

Where two or more persons, and any of them with the knowledge or consent of the others has excisable goods in his custody or possession, such goods shall be deemed to be in the custody and possession of all of them."

The above amendment seeks to clarify who would be considered an importer for purposes of applying Excise Duty.

iii The term "Other fees" to be amended by deleting the term "or fees or commissions earned in respect of a loan".

This proposed amendment seeks to introduce Excise Duty at the rate of 10% on fees or commissions earned in respect of a loan by a financial institution. This will in turn increase tax revenue for the KRA

Proposed Effective Date: 1 July 2021

Customs Duties

The following are the customs measures that have been agreed upon by the East African Community (EAC) Partner States. These measures will become effective from 1 July 2021 through the EAC Gazette Notice.

Items	Old Rate	New Rate	Impact
Inputs for manufacture of masks sanitizers, ventilators and personal protective equipment	0%	0%	Duty remission extended for another 1 year to ensure these items are affordable to the public in a bid to fight the COVID-19 pandemic
Iron and steel products	25%	25%	Duty rate extended for a further 1 year to protect the local sector from cheap imports
Vegetable products (potatoes, peas, tomatoes etc)	25%	30%	The duty rate has been increased to cushion farmers further from cheap imports
Raw materials for manufacturing baby diapers	0%	0%	Duty remission extended for another 1 year to cushion the industry and create jobs
Raw materials for manufacturing leather and footwear products	25%	25%	Duty rate extended for a further 1 year to protect the local sector from cheap imports
Furniture	35%	35%	Duty rate extended for a further 1year to protect the local sector from cheap imports
Raw materials for manufacturing roofing tiles	0%	0%	Duty remission extended to promote the affordable housing program

Miscellaneous Proposals

Capital Markets Act

The Bill proposed to amend the above in a manner that the Capital Markets Tribunal shall hear and determine an appeal within 90 days from the date of filing of the appeal. This provision did not exist previously.

The above amendment is intended to improve efficiency in the capital markets and ensure fair administrative action by the authority, including quick resolutions of disputes.

Insurance Act

The definition of a 'Broker' has been expanded and now includes an intermediary involved with the placing of insurance business with an insurer or reinsurer for or in expectation of payment by way of brokerage commission and includes a medical insurance provider.

The above amendment seeks to provide for the regulation of foreign reinsurance brokers in accordance with the current practice and enable regulation of the brokers by IRA.
The Bill also seeks to provide for an annual fee payable by all persons and entities regulated under the Insurance Act.
The Bill provides clarifications on the definition of a closed fund business (an insurance fund that issues no new policies and runs off its portfolio of insurance liabilities) and that a company may continue to operate an insurance business with a closed fund, provided that permission on the same has been issued by IRA and that the Company that has the closed fund does not need to wind up its business due to other reasons. No assets of the closed fund may be disposed without the prior approval of IRA.
The Bill also proposes to impose a fine not exceeding KShs 200,000 and KShs 10,000 for each day that an insurance company fails to honour its obligations to policyholders.
The above amendment is to further protect the interests of policy holders in the event a company operates a closed fund.

The Bill proposes an amendment to remove the previous regulation that reinsurance contracts must be certified by the Kenya Reinsurance Corporation. This has most likely been brought about fairness that a reinsurance contract need be regulated by IRA rather than an industry player.

The Retirement Benefits Act

The Bill seeks to amend the Act so that Corporate Trustees of a pension fund's authority, powers, duties and functions be regulated under this Act.

The above amendment now brings regulation over Corporate Trustees and their role in managing the funds of the assets of a pension scheme that was previously not the case.

The Bill also proposes to allow Corporate Trustees to apply to RBA for an extension on the submission of the audited financial statements (for a maximum of an additional 90 days) and the Authority may grant the extension if it is justified. The current submission deadline is 90 days after the reporting date of the pension scheme.

The Bill proposes to amend the Act so as to provide for a post-retirement medical fund which will be within a pension scheme from which the costs of medical benefits can be paid in accordance with the scheme rules.

The above amendment will assist the pensioners to access medical facilities after retirement.

Kenya Revenue Authority Act, 1995

The amendment seeks to increase the maximum reward to informers who provide information provided that leads to identification and recovery of unassessed taxes in order to enhance tax compliance.

In the event that information is provided to the identification of unassessed taxes or duties, 1% of the duties or taxes identified or KShs 500,000, whichever is less. This was previously capped at KShs 100,000.

In the event that information is provided to the recovery of unassessed taxes or duties, 5% of the duties or taxes recovered or KShs 5,000,000, whichever is less. This was previously capped at KShs 2,000,000.

Central Depositories Act, 2000

The Bill seeks to introduce the concept of beneficial and legal owner in the capital markets, with a view to enhance the regulation of investors. In addition to this, the Bill also proposes to allow the opening of an omnibus account (defined as 'an account held by an authorised nominee on behalf of 2 or more beneficial/legal owners') by a person making an investment on behalf of others. The above amendment seeks to enhance KYC procedures and is aligned to the recent changes under the Kenyan Companies Act, 2015 which requires companies to maintain details of beneficial owners.

Other provisions in the speech

- A meat processing plant will be set up in Lamu to provide a ready market for livestock with a view to increase income to farmers and enhance the meat value chain. The Liwatoni Fishing complex will also be refurbished and new fish processing plants will be set up in Lamu to promote exports and increase income for local fishermen.
- Full operationalisation of Special Economic Zones in Dongo Kundu, Naivasha and Kisumu to support local industrial activities and employment opportunities.
- A review of the Government procurement consolidation policy has been undertaken on ICT equipment and related services to be decentralised to various Ministries, Departments and Agencies with effect from 1 July 2021.
- Government procurement systems to be fully electronic by 31 December 2021.
- Construction contracts to be now awarded to multiple bidders to support local firms and accelerate delivery of service.

- The Ministry of Education will engage various stakeholders to address the matter on inadequate loans that have been issued in the past to university students and as a result students have not been able to complete their studies.
- All Government Ministries, Departments, Agencies and County Governments have been directed to clear all pending bills by 30 June 2021.
- Nairobi International Financial Centre Authority to publish before the end of 31 December 2021, a framework for attracting investments and innovative financial services into the economy and the region.
- Kenya Mortgage Refinance Company scheduled to issue an infrastructure bond by October 2021 to raise additional funding for its affordable housing finance objectives. Subsequently, the company will also issue Green Bonds to finance climate friendly housing projects.
- The Government through the Central Bank of Kenya Bill, 2021 proposes to licence all digital credit service providers.
- An electronic Over-The-Counter secondary market platform for Government Securities is to be established with a view to improve pricing efficiency, transparency thereby lowering yields and cost of credit in the economy.
- The necessary instruments to operationalise the National Informal Sector Pension Scheme with a sustainable model that combines long-term savings with short term needs of workers in the informal sector, have been prepared and will be rolled out in the next financial year.
- 40% or a maximum of KShs 7 million can be used by retirement benefit scheme members to purchase a house under a tenant purchase scheme.
- Amendment to Insurance Regulations to provide for maximum permitted expenditure for each category of business underwritten, by insurance companies.
- The Government has developed and approved the Sovereign Green Bond Framework to raise capital to finance green projects under the economic recovery strategy.

Overall budgeted revenue and expenditure

Revenue generation	KShs Billion
Income Tax	834.50
Value Added Tax	472.90
Import Duty	119.00
Excise Duty	241.00
Appropriations in Aid	232.40
Railway Development Levy	30.60
Others	108.20
Total revenue	2,038.60

Overall budget and deficit funding	KShs Billion	KShs Billion
Revenue		2,038.60
Total Payments	(3,639.20)	
Redemption of debt	608.90	
Expenditure		(3,030.30)
Fiscal Deficit		(991.70)
Financed by:		
Grants		62.00
Foreign Financing		271.20
Net Domestic Borrowings		658.50
Financing Gap		-

What next?

Discussions by the Finance and Planning Committee of the National Assembly as well as Public Participation have been conducted.The National Assembly will now approve the Bill and forward for assent by the President by 30 June 2021.

ECONOMIC REVIEW & OUTLOOK 2021

Global GDP performance

The health and economic crisis brought about by Covid-19 subdued and recessed the global economy with the contraction estimated to be at 4.3% down from a growth of 2.9% in 2019. This was as a result of the collapse in global trade which was occasioned by border closures and supply disruptions. The pandemic has exacerbated the risks associated with a decade-long wave of global debt accumulation highly impacting Low Income Countries (LICs). It is also likely to steepen the long-expected slowdown in potential growth over the next decade [i]. Despite the expected recovery due to the invention and supply of the Covid-19 vaccines, it is expected that the economic performance will remain below the pre-pandemic trends for a prolonged period with a projected growth of 4% in 2021. However, the projected economic growth still remains embedded on the measures put forth by various countries in the fight against Covid-19 including but not limited to; proper pandemic management and effective vaccination limiting the community spread of Covid-19, the policies formulated to insulate businesses (macro-economic stabilization), continued monetary policy accommodation accompanied by diminishing fiscal support, relief measures aimed at vulnerable populations and global cooperation in the fight against Covid-19.

Whilst the goods sector improved as a result of lifting of strict lockdown measures and demand, the services sector remains depressed with the tourism sector taking a huge blow. Poor performance in the services sector is expected to persist until countries relax international travel restrictions. Further, the pandemic plunged the per capita incomes of more than ninety percent of Emerging Markets Developing Economies (EMDEs) to poverty erasing per capita income gains earned over the last ten years, resultantly impeding future prospects for poverty reduction by adversely affecting longer-term productivity growth. In addition, the deterioration in confidence has dampened investments and the loss in learning-adjusted school years and prolonged spells of unemployment have eroded earlier gains in human capital in the EMDEs.

The uncertainty in trade policies remained above historic norms in 2020 due to the renewed trade tensions between major economies and the Brexit deal between the United Kingdom and the European Union. Further, global trade is expected to have contracted by 9.5% in 2020 comparable to the decline during the 2009 global recession but affecting a markedly larger share of economies before growing by an estimated average of 5.1% in 2021/22.

By 2019, the global debt had reached a record high of 230% of GDP leaving borrowers vulnerable to a sudden change in investor risk appetite and banks under pressure due to falling profitability and asset quality deterioration as a result of a reduction in the capital buffers. Nevertheless, the intervention (low borrowing costs and credit issuance) taken by central banks across the globe kept the global financial system afloat.

The oil demand/supply mismatch in 2020 was exacerbated by industrial slowdowns and travel restrictions caused by the negative effects of Covid-19. In 2020, oil demand plunged by 9% as a result of pandemic-control efforts, the largest one-year reduction on record. Notably, the current oil prices averaging at $60 surpasses earlier anticipations of $50 per barrel by 2022.

Even once the pandemic has subsided, the global economic landscape is unlikely to return to its previous state quickly. The pandemic will leave lasting scars on productivity, including its effect on the accumulation of physical and human capital, which will exacerbate the downward trend in potential growth.

Sub Saharan Africa GDP Performance

The sub-Saharan Africa region has not been left out of the ravage left behind by Covid-19 registering a contraction of 3.7% in 2020. Nevertheless, it is forecasted that the growth will resume at a moderate average rate of 3%. A study conducted by the World bank in January 2021 (Global Economics Prospects) notes that countries which are highly reliant on tourism and oil sectors were hardest hit by the Covid-19 pandemic. Countries which highly rely on agriculture experienced relatively fewer negative impacts with some countries avoiding recessions. Inadvertently, the exchange rates across the region depreciated by 5% compared to the levels prior to the pandemic whilst the foreign direct investments and diaspora remittance inflows collapsed by an estimated average of 35% and 9% respectively. The region's indebtedness rose to an average of 8% which saw some cash strapped countries such as Zambia and Angola restructure their public debt.

[i] https://www.worldbank.org/en/news/press-release/2021/01/05/global-economy-to-expand-by-4-percent-in-2021-vaccine-deployment-and-investment-key-to-sustaining-the-recovery

According to World Bank, the pandemic caused an estimated fall in per capita income by 6.1% in the sub-Saharan region and is expected to further decline by 0.2% in 2021 before recovery in 2022. Resultantly, the per capita forecast will reverse hard-won gains of a quarter of sub-Saharan African economies living standards by a decade or more with more severe setbacks in Nigeria and South Africa.

Whilst its feared that the economic recovery will be slow in the sub-Saharan region due to less developed health care systems, limited capacity for remote work and virtual education, and constrained fiscal space accompanied by lack of capacity to implement large-scale vaccination programs, and outdated or insufficient cold storage systems to preserve vaccines, it remains probable for the Sub-Saharan region to perform better than predicted owing to the lesser impacts of Covid-19 to date as compared to other developed countries.

East African Community (EAC) GDP Performance

Whereas other regions have been hard hit by the Covid-19 pandemic, the East Africa region seems to be more resilient due to the less reliance on primary commodities and greater diversification recording an estimated growth of 0.7% in 2020 against a growth of 5.3% in 2019. The growth in the region is highly attributable to the positive growth registered by Kenya, Tanzania and Rwanda against a contraction in economic activities reported by Uganda and Burundi. Notably, prior to the pandemic the East Africa region was expected to grow by 5.1%. Nevertheless, it is expected that the East Africa region will bounce back and recover to its pre-pandemic status by 2022 [ii].

Research conducted by the African Development Bank (East Africa Economic Outlook in 2020) indicated the inflation rate in East Africa is set to remain at its highest (14.2%) slightly above the 2019 rate of 13.5%. On average, total debt stock in East Africa (domestic and external) stands at 62% of the region's GDP. This has been driven by attempts to grow the economies through borrowed funds spent mainly on recurrent expenditures and infrastructural development amid low tax revenue collections. The high debt levels saw an increase in non-performing loans mostly in Kenya, Tanzania, and Uganda, posing a huge macro financial risk that could, in turn, derail the expected recovery [iii]. The region's fiscal deficit is expected to remain relatively stable, from a deficit of 4.9% of GDP in 2019 to 4.7% in 2020, but with the outbreak of Covid-19, fiscal deficit beyond 2021 is likely to be wider than previously anticipated and public debt will increase at a faster rate.

With reduced foreign direct investments in the East African region emanating from the pandemic coupled up together with limited resources to procure the Covid-19 vaccines and vaccinate massively, the economic outlook of the block hangs in the balance and remains at the mercy of developed economies and the outturn of the pandemic. In the same breadth, if the resilience continues, the East Africa region could be as well be marching towards greatness if all resources are well managed and harnessed with the right policies.

Kenya

Prior to the pandemic, Kenya's economic growth averaged at 5.9% in 2019 despite the challenging environment prevalent at the time. As many other countries, Kenya too was adversely affected by the Covid-19 pandemic registering an average growth of 0.6% in 2020. The slowed growth was largely attributed to the contraction experienced in the services sector (with the tourism sector almost coming to a standstill) against an improved performance in the Agriculture, Forestry and Fishing activities, Health Services and Quarrying activities. Nevertheless, the future looks bright as the economy is projected to recover and grow by above 6% over the medium term.

Notably, according to the Central Bank of Kenya (Quarterly Economic Review, October - December 2020), Kenya's current account deficit is estimated to have narrowed to USD 1,356 million in the fourth quarter of 2020 from USD 1,675 million in the fourth quarter of 2019, reflecting a decline in imports and an improvement in earnings from exports of goods despite lower trade receipts from exports of services [iv]. In addition, Kenya recorded an inflation rate of 5.4% in 2020 up from 5.2% in 2019 mainly on account of increasing food inflation and elevated fuel inflation.

As countries across the globe look forward to dusting off the adverse effects of the pandemic, looking forward, Kenya aims to put in measures aimed at stimulating growth, promoting job creation, reducing poverty and protecting vulnerable groups and businesses. Some of the measures include but not limited to:

- Roll out of the Post Covid-19 Economic Recovery Strategy;
- Implementing the "Big Four" Agenda for job creation;
- Maintaining macroeconomic stability, enhancing security, and improving business relations;

[ii] https://www.statista.com/statistics/1133921/impact-of-covid-19-on-projected-gdp-growth-in-east-africa/

[iii] https://www.afdb.org/en/documents/east-africa-economic-outlook-2020-coping-covid-19-pandemic

[iv] https://www.centralbank.go.ke/uploads/quarterly_economic_review/1321177989_QER%20October-%20December%202020.pdf

- Transform economic sectors for broad based sustainable economic growth; and
- Improve access to education, strengthen health care systems and enhance cash transfers to support the vulnerable members of the society.

Kenya Sectoral Contribution to GDP

A review of the sectoral performance over the last three years' points at an improvement in the agricultural sector which defied all odds in the midst of a pandemic to emerge as the most improved sector in Kenya closely followed by the health sector. Below is a tabulation of how the various sectors in Kenya contributed to Kenya's GDP growth over the last three years:

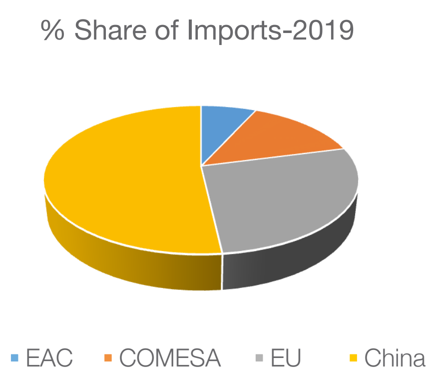
Sector	Sector Growth (%)		
	2018	2019	2020
Agriculture, Forestry and Fishing	5.8	3.7	6.5
Mining and Quarrying	2.8	2.5	12.6
Manufacturing	4.3	3.2	(1.4)
Electricity and Water supply	8	7	3.5
Construction	6.8	6.4	8.5
Wholesale and Retail trade	6.8	6.7	(1.0)
Accommodation and Restaurant	16.4	10.5	(50.1)
Transport and Storage	8.4	7.7	(0.8)
Information and Communication	11.3	8.7	7.2
Financial and Insurance	5.3	6.6	5.2
Public Administration	6.7	8.1	7.3
Real Estate	4.2	5.3	4
Education	5.8	5.5	(30.9)
Health	4.3	5.8	7.2

Table 1 * 2020 estimates only include Q1 to Q3

International Trade Statistics & Balance of Trade

The negative effects of Covid-19 have exacerbated the unpredictable pattern seen over the last decade. Despite having a target of 25% in 2020, the ratio of international trade to world output has been on a downward trend over the past decade. It is probable that international trade growth may surpass global output growth in 2021 and beyond, causing this ratio to rise. However, given the combination of Covid-19's disruption of global value chains and unresolved trade difficulties among some of the world's largest economies, the magnitude of a return is uncertain.

In Kenya, the balance of trade in goods and services is estimated to have improved by 9% from a deficit of USD 2,532 million in the fourth quarter of 2019 to a deficit of USD 2,307 million in the fourth quarter of 2020, mainly attributed to improved earnings from exports and a lower import bill which more than offset lower earnings from services. The figures below illustrate the percentage share of imports for the years 2019 and 2020 respectively.



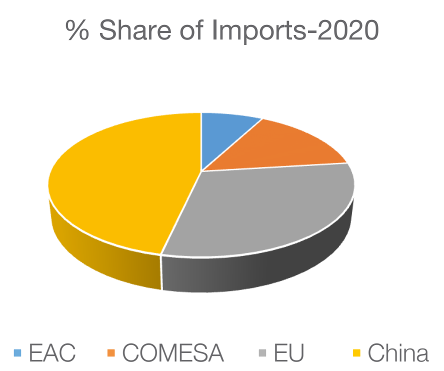


Fig 1.1 % Share of Imports

Interest rates

With low and steady interest rates and a competitive currency rate that encourages exports, the economy has continued to show macroeconomic stability. Further, following the implementation of monetary policies to weather the economic and financial crisis caused by the global health epidemic, the central bank rate has stayed steady at 7% following the decrease of the Central Bank Rate (CBR) & Cash Reserve Ratio (CRR), leading to improved market liquidity. Interest rates on government securities have also fallen as a result of better monetary policy coordination and more liquidity in the government security market. The economic prognosis is uncertain, with recovery contingent on the success of vaccination rollouts and the implementation of measures to halt the spread of Covid-19.

Notably, in the midst of the pandemic's economic upheaval, historically low global interest rates may mask solvency issues that will appear with the next round of financial stress or capital outflows. The average lending rates by commercial banks in 2020 declined to 11.9 % from 12.4 % in 2019. The lowering has a significant influence on the accommodative monetary policies that have been implemented.

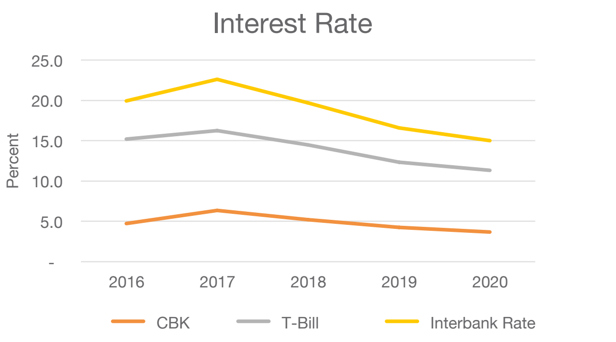


Fig 1.2 Interest Rate

Exchange rates

The impact of the Covid-19 on major international and regional currencies has resulted in volatility against the US dollar. In January 2021, the Kenya Shilling to USD exchange rate was KShs 109.8, up from KShs 101.1 in January 2020. Following global financial conditions caused by the Covid-19 pandemic, the Kenya Shilling exchange rate depreciated against international currencies, but less so than other African currencies. The Kenyan Shilling's relative stability was aided by the resiliency of the country's foreign sector. The growth in remittances in the foreign exchange reserves also contributed to the stability.

During the pandemic, foreign remittances continued to perform extraordinarily well. The country received an estimate of KShs 299.3 billion in April 2021, up from KShs 208.2 billion in April 2020. Foreign remittances are important because they act as a buffer for foreign exchange reserves, which is beneficial to the economy. Conversely, in the face of uncertainty, foreign direct investments have been low, with concerns expressed about the chances of economic recovery and governmental debt levels, both of which have stifled exchange rate reserves. The graph below shows exchange rate versus the Kenya Shilling for a five-year period.

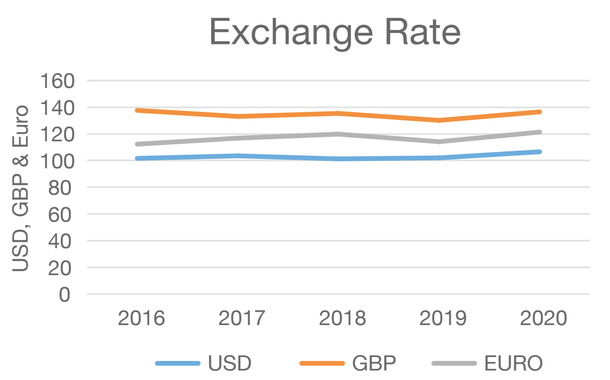


Fig 1.3 Exchange rate

Employment Rates

Unemployment in the third quarter of 2020 was at a high of 7.2%, up from 5.3% in the same quarter of 2019, showing that it has not yet fully recovered to pre-pandemic levels. The unemployment rate is an indicator of a sluggish labor recovery, particularly in the economy's most afflicted sectors of the economy. As a result, it predicts a significant slowdown in private sector consumption, which impacts on growth and human capital development. Notably the longer unemployment continues high, the more severe the human capital losses will be.

Public Debt

Public debt has grown by 6% compared to the period 2019/2020 with an estimated value of KShs 7.7 trillion by June 2021 (Fig. 1.4) and is expected to grow even higher. The major reason for the influx is the continuous growth in population and high cost of infrastructure development as well as recurrent expenditure which translates to increase in resource allocation to different sectors of the Kenyan economy. The effects of the pandemic on the economy

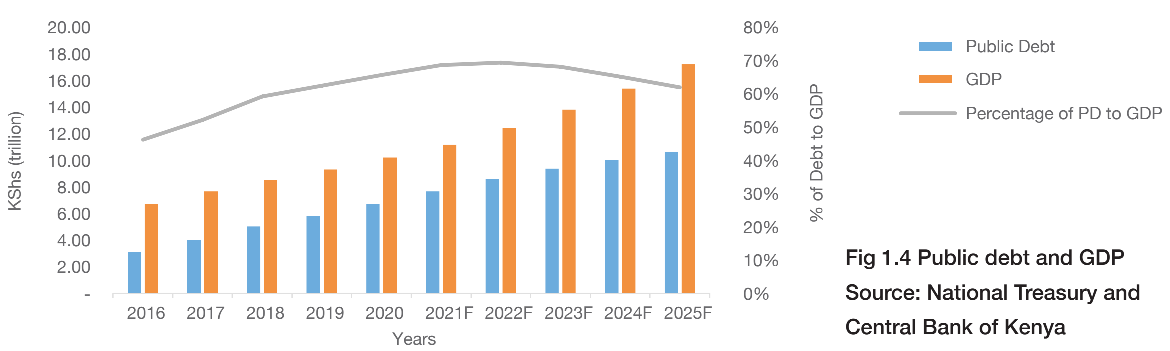


Fig 1.4 Public debt and GDP
Source: National Treasury and Central Bank of Kenya

prompted a reduction in paying public debt from KShs 850 billion in 2019 to KShs 651 billion in 2020.

There has been a drop in export activity and an overall slowdown in economic activity. Conversely, the Gross Domestic Product continues to experience growth over the years with the numbers from 2016 to 2021 being KShs 6.7 trillion , KShs 7.7 trillion, KShs 8.5 trillion, KShs 9.3 trillion, KShs 10.2 trillion and KShs 11.2 trillion (projected) respectively (Fig. 1.4). In the second half of 2020/2021, development spending is expected to fall short of expectations as a result of the adverse effects of the pandemic which have depressed business operations. As a result of the global financial crisis, disbursements to foreign-financed programs decreased by KShs 48.8 billion.

According to the 2021 Budget Policy Statement, private sector lending is increasing as the government's borrowing needs increase. By lowering the risk of default, the credit guarantee plan is projected to improve SMEs' capacity to get capital. Public debt as a percentage of the GDP is experiencing the same upwards trend as shown above in figure 1.4 above.

The government should review the sustainability of public debt to ensure the ability to satisfy debt obligations without jeopardizing development goals.

Ease of Doing Business

Kenya is considered an investment hub in the East Africa region and the ease of doing business in Kenya provides an objective of ensuring that regulations and requirements are fair both to the investors and the Government. The Government continues to adopt appropriate fiscal and monetary policies, which have resulted to macroeconomic stability. In line with this, interest rates, inflation rates and foreign exchange rates have remained relatively stable.

In the year 2020, the Kenyan economy was adversely affected by the outbreak of the Covid-19 pandemic, which has had adverse effects on many businesses. Consequently, the Government has adopted measures to cushion businesses and the economy at large from the shocks of the Covid-19 pandemic.

Some of the measures that had been enacted to improve ease of doing business in Kenya include but not limited to:

a) Reduction of the headline rate of income tax from 30% to 25%;
b) Reduction of the standard rate of VAT from 16% to 14%;
c) Expedition of VAT refunds;
d) Maintaining of the CBR and CRR rates;
e) Loan moratoriums;
f) Incentives i.e. funds released to tourism sector;
g) Money transfer reduction charges;
h) Development of critical infrastructure and implementing various structural reforms; and
i) Implementing major structural reforms and developing vital infrastructure.

The taxation measures above were temporary and have been since reversed with effect from 1 January 2021.

Overall Budget Allocations 2021/2022

The sectoral budget allocation for the financial year 2021/2022 is as shown below in Table 2:

Sector	Approved Budget Estimate KShs millions	% allocation
Agriculture, Rural & Urban Development	63,236	3%
Energy, Infrastructure & ICT	362,769	19%
General Economic And Commercial Affairs (GECA)	27,906	2%
Health	111,703	6%
Education	505,589	27%
Governance, Justice, Law And Order (GJLO)	197,795	10%
Public Administration And International Relations (PAIR)	289,313	15%
National Security	154,533	8%
Social Protection, Culture And Recreation	70,090	4%
Environment Protection Water And Natural Resources	105,217	6%
Total	**1,888,150**	

Table 2 – Budget allocations

Overall Budget Financing

Total expenditure and net loans are expected to rise by 5% to KShs 3,010 billion in the fiscal year 2021/2022, compared to KShs 2,864.5 billion in the same time in 2020. The "Big Four" Agenda and the Post-Covid-19 Economic Recovery Strategy are expected to be the focus of government spending in 2021/2022.

Government Expenditure

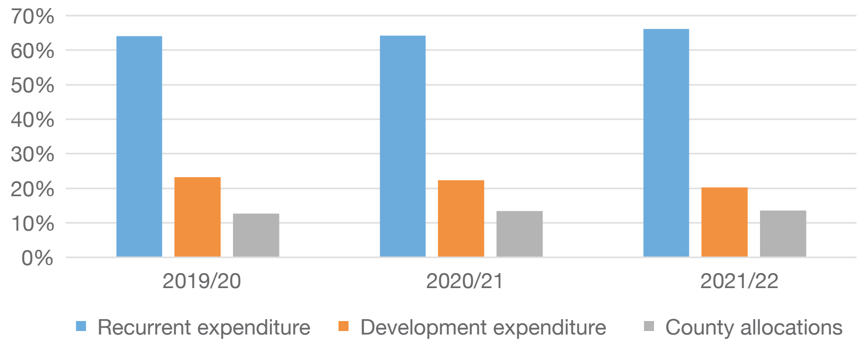


Fig 1.5 Government spending

How will the 2021/22 budget be financed?

Tax revenue is estimated to support 60% of the budget for fiscal year 2021/2022. This is a minor improvement over the budget for 2020/2021, and it is bolstered by a predicted 10% increase in regular revenue. However, there are still concerns about the Covid-19 pandemic's negative impact on tax collection efforts.

Domestic borrowing which is expected to fund 22% of the 2021/22 budget will likely crowd-out the private sector from accessing credit from the domestic market to fund their operations.

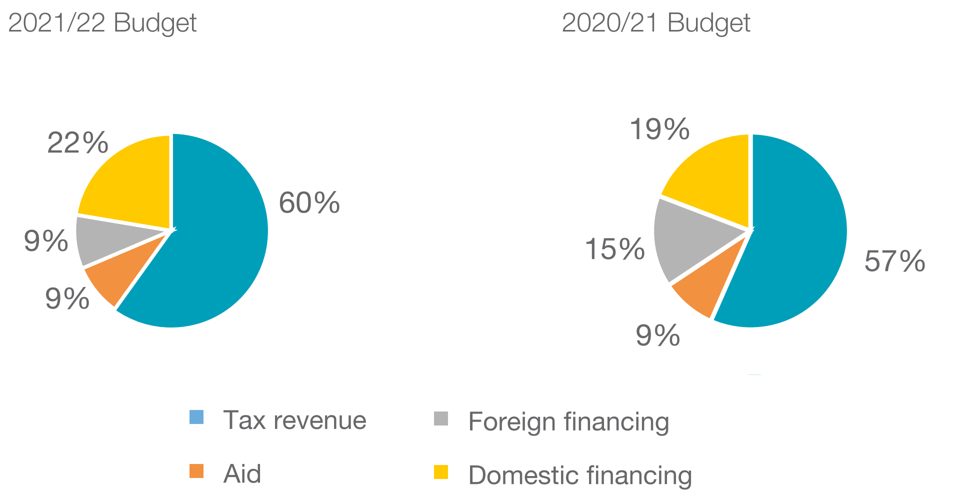


Fig 1.6 Budget 2021/2022

Fig. 1.7 Budget 2020/2021

The Impact of Covid-19 on Businesses

Further to our survey that was conducted when the pandemic first affected Kenya in early 2020, we conducted a further survey in March 2021 on the continuing impact of Covid-19 on the Kenyan economy by sector and noted that different sectors of the economy were affected in different ways with some feeling more impact of the virus than others. We aggregate our findings as below.

From the samples collected, 69% of the respondents reported that they experienced employee layoffs in order to survive during the hard economic times caused by the pandemic, only 31% reported business continuity without having to cut down on the number of employees (Fig. 1.8). 63% of the respondents to our survey were forced to revise their employees' remuneration downwards as their businesses were not able to raise sufficient revenues to pay salaries as they did during pre-Covid times (Fig. 1.9). Many were optimistic that once the economy resumes to normal they will afford to pay normal remuneration. See below the graphical representation for this.

Further, from our survey, we noted that only 31% of respondents were able to maintain the same or slightly higher revenues in 2021, 14% experienced a drop in revenue by up to 10%, 25% of the respondents experienced a drop in ranges of between 11% to 30% while 16% experienced a 31% to 50% drop in revenue (Fig. 1.10). A number of respondents also reported that they were forced to revise their forecasts downwards. Whilst 53% retained the forecasts, 15% had to reduce the numbers by up to 10%, 20% dropped the forecasts by between 11% to 30% while 6% dropped the forecasts by between 31% to 50% (Fig. 1.11)

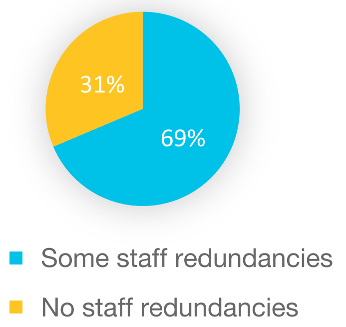


Fig 1.8 Employee layoffs

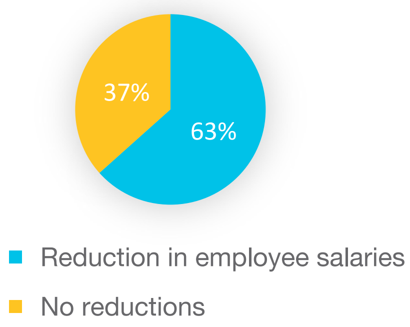


Fig. 1.9 Downward remuneration adjustment

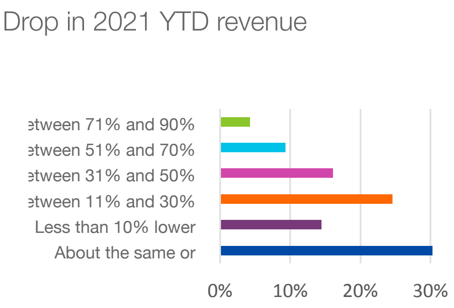


Fig. 1.10 Drop in 2020/2021 YTD revenue

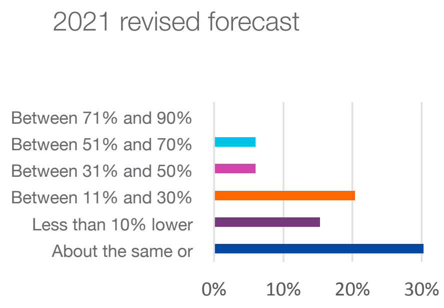


Fig. 1.11 2021 revised forecast

14% of the respondents admitted that the government played a major role in restoring their operations through its interventions, 52% reported that they experienced some relief as a result of government intervention although not sufficient to cushion them against the pandemic while a significant 34% did not feel any impact of the government intervention (Fig. 1.12). On availability of liquidity, 42% of respondents indicated that the available cash flows would only sustain them for 3 months while 25% had access to funds for up to 6 months (Fig 1.13).

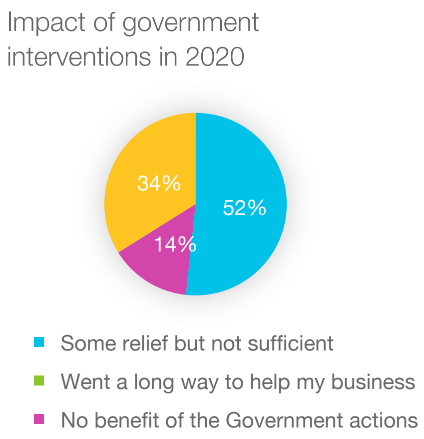


Fig. 1.12 Impact of government interventions

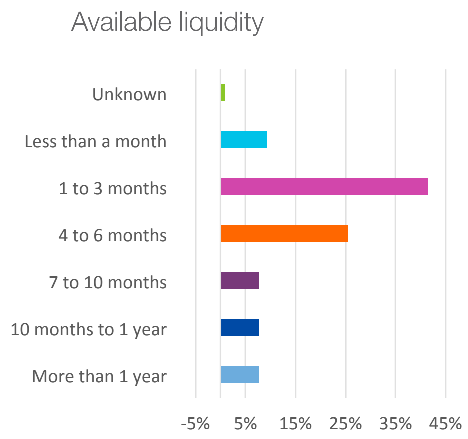
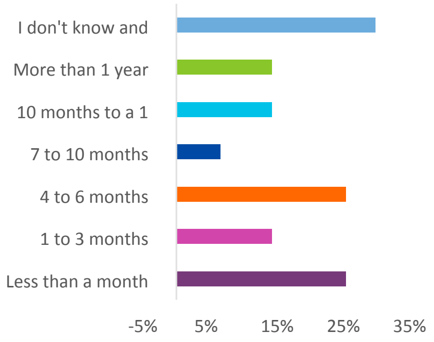


Fig. 1.13 Available liquidity

When we asked about the projected periods to return to normalcy, 25% indicated that they needed only a month to resume full operations as per pre-Covid time, 14% needed 1 to 3 months while 25% required 4 to 6 months, 30% of the respondents were uncertain about when their businesses will stabilize and were not in a position to project due to how hard they have been hit a majority being from tourism sector (Fig. 1.14). On improvements in technology, we noted that 23% of our respondents reported an increase in technological use mostly characterized by online transfer of funds and mobile banking (Fig. 1.15).



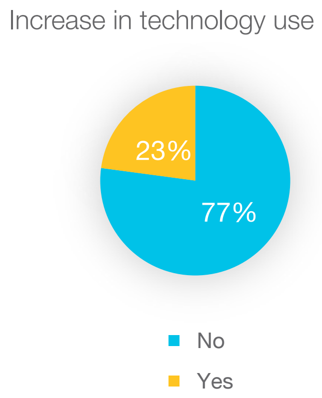
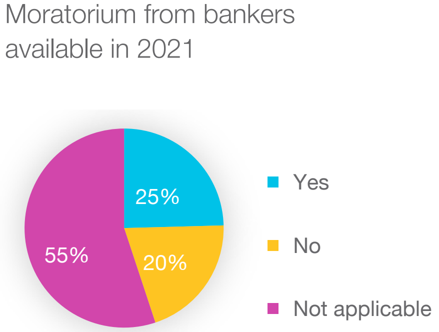


Fig. 1.14 Post restriction period for return to normalcy

Fig. 1.15 Increase in technology use

We also researched on the moratorium periods issued by banks and noted that 25% of the respondents were issued a moratorium on their loans, 20% did not receive any grace period while 55% did not have loans (Fig. 1.16). Our research on businesses that had resumed to normal revealed that 24% had actually resumed while 35% had not and 42% had most of their parts restored to normal (Fig. 1.17). From our research on whether businesses were prepared to cope with higher taxes in 2021, 45% of the correspondents actually indicated their readiness while 55% were not ready (Fig. 1.18).



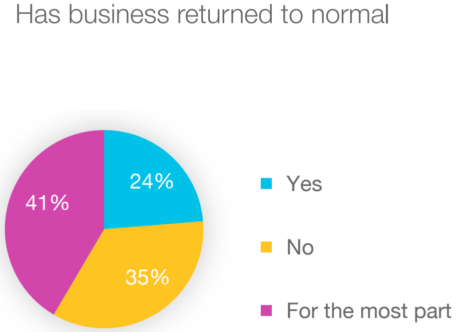


Fig. 1.16 Moratorium from bankers in 2021

Fig. 1.17 Business resumption to normal

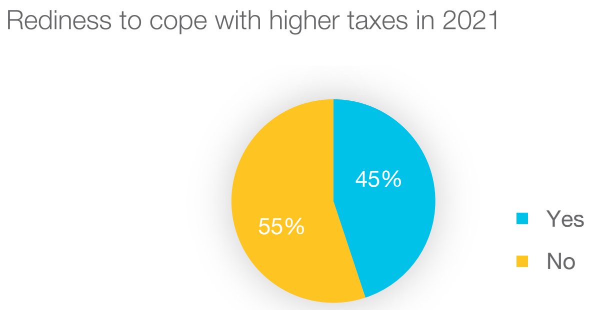


Fig. 1.18 Readiness to cope with higher taxes in 2021

PKF

right people
right size
right solutions

KENYA

Nairobi
Kalamu House, Grevillea Grove
Off Brookside Drive
P. O. Box 14077 - 00800
Nairobi
Tel: (+254 20) 4270000
Cell: (+254) 732 144000

E-mail: pkfnbi@ke.pkfea.com

Mombasa
1st Floor, Pereira Building
Pramukh Swami Maharaj Road
P. O. Box 90553 - 80100
Mombasa
Tel: (+254 41) 2226422/3
(+254 41) 2315846/97
Cell: (+254) 724 563668

E-mail: pkfmsa@ke.pkfea.com

Malindi
Malindi Complex
Lamu Road
P. O. Box 5572 - 80200
Malindi
Tel: (+254 42) 2120701
(+254 42) 2130862
Cell: (+254) 722 209620

E-mail: pkfmld@ke.pkfea.com

Kisumu
Jubilee House, 3rd Floor
Angawa Avenue and
Oginga Odinga Street Junction
P. O. Box 187 - 40100
Kisumu
Tel: (+254 57) 2505787
Cell: (+254) 726 793 355
(+254) 736 221 122
E-mail: pkfksm@ke.pkfea.com

Nakuru
Fourth floor, Office Block
Westside Mall, Junction of
Kenyatta Avenue and West Road
P. O. Box 1236 - 20100
Nakuru
Tel: (+254 51) 2211906
Cell: (+254) 796 015656
E-mail: pkfnku@ke.pkfea.com

UGANDA

Kampala
Kalamu House
Plot 1B
Kira Road
P. O. Box 24544
Kampala
Tel: (+256 312) 305800

E-mail: pkfkam@ug.pkfea.com

TANZANIA

Dar es Salaam
1st Floor, Tower B
Girl Guides Building, Plot No. 1088
Kibasila Street, Upanga
P. O. Box 7323
Dar es Salaam
Tel: (+255 22) 2152501/3/4
Cell: (+255) 784 520097
E-mail: info@tz.pkfea.com

RWANDA

Kigali
KG 5 Avenue 44, Kacyiru
P. O. Box 341
Kigali
Tel: (+250) 255 104514
Cell: (+250) 788 454746
(+250) 788 386565
(+250) 738 386565
E-mail: pkfkgl@rw.pkfea.com

Michael Mburugu
mmburugu@ke.pkfea.com

James Mulili
jmulili@ke.pkfea.com

Ritesh Mirchandani
rmirchandani@ke.pkfea.com

Darshan Shah
dshah@ke.pkfea.com