KPMG

Budget Brief

Kenya 2016

Consolidating gains for a prosperous Kenya.

Regional Economic Highlights

The world real Gross Domestic Product (GDP) growth rate decelerated to 3.1% in 2015 from 3.4% in 2014. Real GDP in the East African Community (EAC) upended the global trend to grow at 6.1% compared to 5.8% in 2014.

Tanzania experienced a drop in real GDP to 6.9% compared to 7.2% in 2014 while in Uganda real GDP dropped to 5.2% compared to 5.9% in 2014 which is attributable to uncertainty arising from general elections.

Burundi's economy contracted by 7.2% due to political instability attributed to the disputed election.

The general decline in global and regional growth was caused by low commodity prices in particular oil prices and increased financial market volatility.

Kenya and Rwanda experienced growth in real GDP with Rwanda growing from 6.0% to 6.5% and Kenya from 5.3% to 5.6%, largely underpinned by a stable macroeconomic environment and improved output in the agricultural and real estate sectors.

Global inflation rate eased from 3.5% in 2014 to 3.3% in 2015 as a result of decline in international oil and other commodity prices. Inflation rate in the EAC eased save for Burundi that experienced a rise in inflation from 7.0% in 2014 to 7.4% in 2015.

Though EAC has projected economic growth, the outlook is as varied as the countries. Tanzania is in the process of implementing its 5 year strategic plan (2016 to 2021) and has a focus on industrialization and infrastructure development.Uganda is working towards its Second National Development Plan with a focus on attaining middle income status. Rwanda is fairly stable with development in industry and Foreign Direct Investments. Whilst Kenya is gearing up for an election next year, economic growth shall ride on the completion of the Standard Gauge Railway and other infrastructure projects.

Indicator	Kenya	Tanzania	Uganda	Rwanda
GDP current prices (USD' Million)	63,398	45,899	22,732	8,109
Real GDP growth rate (%)	5.6	7.1	5.0	6.9
Population (Million)	44.2	54.3	36	11.30
GDP per capita (USD)	1,436	944	737	720
Overall inflation rate (%)	6.3	5.1	5.4	4.5
Treasury bill interest rate (%)	9.81	18.2	16.36	7.1
Budget deficit % of GDP at current prices	9.3	10	7	5.3
Total public debt (USD million)	26,496	19,779	7,600	2527
Trade deficit as % of GDP current prices	16	11	10.9	15.2
Tax revenues (USD million)	13,128	4,667	3,434	1,354

Kenya Budget Highlights

The 2016/17 budget themes was "consolidating gains for a prosperous Kenya." Despite an aggressive increase in revenue targets, the tax increases were nominal. Thus, even as government consolidates and shares the gains, Kenya Revenue Authority's work is cut out – Kenya must work towards expanding the tax base to grow its tax revenues and fund Kenya's largest ever budget of KShs 2.264 trillion.

The budget speech has highlighted the following sector policies and expenditure priorities.

Big brother is watching

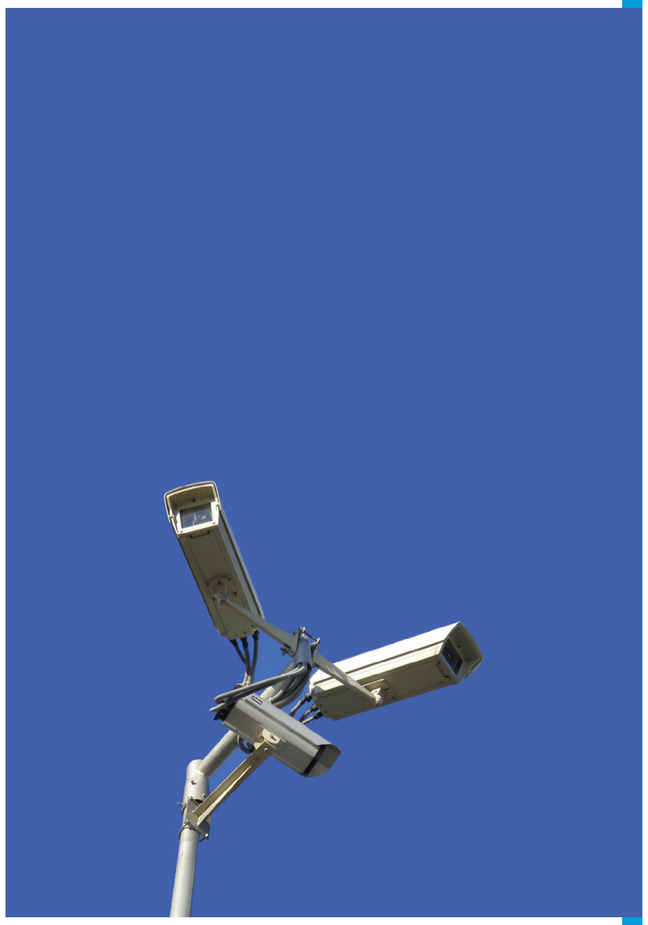
Security is a key component and enabler of macro-economic stability and growth. It is no wonder then that Kenya has invested heavily in security and not just in surveillance cameras but also in a command and control centre, expanded police training facilities and housing, police vehicles and an Integrated Population Registration System to modernize and enhance security.

One beneficiary of this investment is the tourism sector that has been on a recovery path thanks to enhanced security and aggressive marketing campaigns.

Taming or slaying the dragon

Even as government enhances tax administration to shore up revenues, focus is likely to shift to expenditure rationalization and enhancement of governance. The Multi-Agency Team (MAT) which brings together the Kenya Police Service, Directorate of Criminal Investigations, the Ethics and Anti-Corruption Commission (EACC), the Financial Reporting Centre (FRC), the Directorate of Public Prosecutions (OPP), the Kenya Revenue Authority and the Asset Recovery Agency is set to play a leading role in taming the corruption dragon.

The budget has allocated KShs 2.8 billion to EACC, KSh 2. 1 billion to the OPP, and KSh 300 million to FRC for better governance and facilitation of business.



A surveillance camera

Laptops and e-governance: a convergence

The use of ICT for productivity and competitiveness in a knowledge-based economy is critical. By digitalizing land transaction services, e-registry, business registration, motor vehicle and driver licencing and services under the registration of person including passports, work permits and Visa application, government will not only develop a reliable database of taxpayers but also enhance efficient service delivery.

These initiatives align well with the administration's election pledges and continue to focus investment in ICT to drive growth and financial inclusion such as the proposed m-akiba bonds.

Plugging the expenditure leaks

To curb wastage, the government has to improve public finance management and resource management. This is through capacity building and leveraging use of Information Communication and Technology (ICT) in particular e-procurement through IFMIS, gazettment of Public Finance Management Act and directing all public entities to establish Internal Audit Committees with effect from 1 July 2016.

A renewed focus on banks

A stable and efficiently functioning financial system and sector augments economic growth. Drawing on lessons from the recent blips in the financial services sector, the government has moved to boost regulation of the sector including enhanced ICT audits and regulatory oversight capability and focus corporate governance.

Infrastructure development and growth - Tembea Kenya

Transport contributed just under 8% of GDP in 2015, underscoring the important role it plays in bringing different players in the economy together. The government has expressed an intention to continue investing in infrastructure with new roads, expansion of roads in Nairobi and completion of the much talked about standard gauge railway (Phase 1).

A significant portion of these infrastructure projects are debt financed and Kenyans eagerly await information on their return on investment, having sampled the impact of the ring roads around Nairobi and the Thika super highway.

Linking the economics to revenue collection

A KShs 2.26 trillion and an election in the near term, calls for an delicate balancing act by the Cabinet Secretary. The tax to GDP ratio which stands at 20.3% of GDP suggests that Kenya's headroom for new taxes is not huge. With this in mind, the Cabinet Secretary outlined revenue raising measures aligned to the following key development areas:

1. Promoting Growth of Industries and Employment Creation;
2. Facilitating Infrastructure Development;
3. Enhancing Equity and Fairness in the Tax System and Tax Administration;
4. Cushioning Households' Budget to Ease the Cost of Living;
5. Strengthening Financial Sector Stability; and
6. Promoting Private Sector Growth.

Income Tax

Kenya has experienced an increase in the cost of living over the years. However, the graduated tax brackets for Pay As You Earn (PAYE) and the corresponding personal relief have remained constant since the year 2001.

Rate	New Tax Band per annum (KShs)	Old Tax Band per annum (KShs)
10%	134,165	121,968
15%	126,403	114,912
20%	126,403	114,912
25%	126,403	114,912
30%	Over 513,374	Over 466,704

A 15 year wait…a token reprieve

To share the economic gains with the individual taxpayers, the government has proposed to expand individual tax bands by 10% as tabulated above:

In addition, personal relief has been increased by 10% from **KShs 13,944** p.a to **KShs 15,338** p.a

The expansion of tax bands and the increase in personal relief albeit in good faith is expected to marginally lower the PAYE tax burden.

Individuals' tax blanket exemption?

Bonuses, overtime and retirement benefits payable to employees whose income is below the lowest tax bracket of10%, shall be exempt from tax. Is this relief commensurate to the high cost of living and inflation? The jury is still out.

Tax Amnesty – shoring up foreign assets and income

There is reprieve for the taxpayers who own assets and businesses outside Kenya and are willing to repatriate these assets and income to Kenya.

The Cabinet Secretary has offered a tax amnesty for 2016 and prior years for all principal taxes, penalties and interest for those who will repatriate assets and income to Kenya provided that the taxpayers submit their return and accounts for the year of income 2016 between 1 January 2017 and 31 December 2017.

To make this incentive more attractive, the government will not follow up on the sources of such income and assets declared.

Also, clarity on whether the filing due date for the amnesty will change for the qualifying taxpayers from the normal 30 June of the following year will be important.

No letting up on rental income

In the year 2015, the Cabinet Secretary introduced a simplified tax regime for residential rental income at a flat rate of 10% for taxpayers earning less than Ten Million shillings per annum.

The Cabinet Secretary is now proposing to gazette rules for the implementation of the simplified regime on taxable rental income of over **KShs 12,000** per month.

Further, there is a proposal to grant the KRA powers to appoint withholding tax agents for rental income. This move is expected to encourage landlords to make a full disclosure of their rental income. While this is a good proposal to expand the tax base, administratively, we expect roll-out of withholding tax on rental income to be difficult.

A reason to smile for the increased PAYE bands

Corporate Tax

A roof over your head?

In a bid to bridge the housing deficit estimated at 200,000 units a year, the government has proposed to lower the corporate tax rate for developers who construct at least 1,000 units of decent low cost housing units per year in planned development areas from the current 30% to 20%.

Although this is a welcome move for the housing sector, we are keen to see how this will be implemented since construction of houses spans a number years. As such, KRA will need to be clear on whether the reduced corporation tax rate of 20% will be applied over the period of construction or upon completion of construction of the houses.

Keeping the promise!

The Government has followed through on its promise to provide a tax rebate for employers hiring and training graduates or apprentices.

While the proposal was made last year. However, there are no regulations in place to implement it. The Cabinet Secretary has therefore proposed to gazette regulations to facilitate the implementation of these tax breaks.

Employers who engage at least 10 graduate trainees will enjoy 150% deduction of apprentices' emoluments which amounts to a revenue allowance.

Clarity at last!

In the last financial year, the Cabinet Secretary amended the taxation of residential rental income to 10% of the gross rental income for landlords whose income is KShs 10 million or less in a year.

This proposal was intended to ease the compliance burden by eliminating the complexities of ascertaining allowable and disallowed costs when computing tax on rental income.

The Cabinet Secretary has therefore proposed to gazette the regulations to further simplify the taxation on rental income in order to increase compliance and reduce the costs of administration.

WHT on rental income - Change of tact

The Government's effort to rein in errant residential properties landlords has proven futile over the years.

The 2015/16 rental income tax amnesty has not been spectacularly successful. Perhaps this is the reason why the Cabinet Secretary has proposed to gazette rules that will empower the Commissioner of Domestic Taxes to appoint withholding tax agents for rental tax to ensure compliance by the landlords and increase the amount of revenue collected.

The wait continues

The Cabinet Secretary has once again promised to table the long awaited Income Tax Bill in the financial year 2016/2017.

With the promises of a simplified tax regime which will encourage compliance and ease administration, it is about time that the current 1974 Income Tax Act is modernised much like the VAT Act, 2013 and Excise Duty Act, 2015.

Caesar casts the net wider

With the compulsory requirement to file tax returns on the Kenya Revenue Authority (KRA) online iTax platform, the Cabinet Secretary has proposed to amend the Tax Procedures Act to give the KRA powers to collect information in advance from identified individuals for purposes of pre-populating a taxpayer's iTax page.

This amendment is expected to increase compliance as well as cast the net wider on non-compliant individuals by consolidating their information on the iTax platform.

This is an ingenious way of increasing the tax base and using ICT to drive compliance. We however wait to see who these "persons of interest" will be.

Value Added Tax

Made in Kenya…for Kenyans

The government has proposed to exempt from VAT garments and leather footwear procured from the EPZ. This is to protect the EPZs that have faced competition from COMESA imports.

In addition to diversifying market access for EPZs, Kenyans will now have access to locally made high quality clothes and footwear previously exclusively made for the export market.

However, EPZ enterprises have a quota for exports into Kenya and it will be interesting to see how the exemption will be implemented in view of these quotas.

Explore…discover…magical Kenya!

Tourism, once the biggest foreign exchange earner in Kenya, has now ceded ground to horticulture, tea and now diaspora remittances. In a sustained effort to revamp the tourism sector, the government has moved to exempt from VAT, National Park entry fees and the commissions earned by tour operators. Whilst this is a commendable move, exemption from VAT has little impact on cost reduction as suppliers of VAT exempt goods and services cannot claim input VAT.

A shot in the arm for farmers

With a 30% contribution to GDP, the importance of agriculture as a sector cannot be overemphasized. As a follow up to VAT exemption of animal feeds last year, the CS has proposed to exempt raw materials used in manufacturing animal feed.

This will attract more manufacturers to invest in the sector and ultimately increase accessibility to animal feeds at a reasonable cost for food security.

Away with the smoke!

To encourage the use of clean, green energy, the government has moved to exempt liquefied petroleum gas (LPG) from VAT.

This is a welcome relief in a bid to increase access to clean and safe household energy.

VAT on petroleum - a reason to smile

The transition period for the imposition of VAT on petroleum products which was set to expire in September 2016 has been extended by one year, to September 2017, giving consumers a reprieve from petroleum prices increases, especially in the face of global oil price recoveries.

Particulars	New rate	Old rate
Garments and leather footwear procured from the Export Processing Zones	16%	Exempt
National park entry fees	16%	Exempt
Commissions earned by tour operators	16%	Exempt
Raw materials used in manufacture of animal feeds	16%	Exempt
Liquefied Petroleum Gas	16%	Exempt

Customs & Excise

Customs Duty

A reprieve to the iron and steel mills

Importation of cheap iron and steel products have resulted in closure of the local iron and steel mills due to unfair competition from cheaper imported iron and steel products.

In order to promote these ailing industries and create more jobs, the Cabinet Secretary proposes to introduce a specific duty rate of USD 200 per metric ton on imported iron and steel products. However this is likely to increase building cost.

A canny incentive?

With increased consumer demand for food product longevity, most businesses in the food industry opt to package food products in aluminium cans. A good example is the increased uptake of canned fruits and legumes.

However, Kenya does not have aluminium ores from which plates and sheets of aluminium alloys are extracted for manufacture of aluminium cans.

In a bid to attract investors in the can manufacturing business, the Cabinet Secretary has proposed to reduce the import duty on aluminium sheets and plates from 25% to 0%. Conversely, the Cabinet Secretary proposes to increase import duty on aluminium cans from 10% to 25%.

Pharmaceutical wins

The World Health Organisation requires manufacturers of pharmaceutical products to manufacture their products in line with international best practices.

In an effort to comply with manufacturing international best practices, manufacturers of pharmaceutical products expend a substantial amount on specialised air conditioning equipment commonly known as Heating, Ventilation and Air Conditioners (HVACs).

To make HVACs affordable to manufacturers of pharmaceutical products, the Cabinet Secretary has proposed to scrap the 25% duty on the importation of HVACs.

Let's go green

The government, with the aim of environmental conservation, seeks to encourage its citizens to use energy saving stoves.

The Cabinet Secretary has proposed to reduce the import duty on energy saving stoves from 25% to 10%. This proposal aligns the import duty rates already accorded to similar stoves and cookers that use gas, electricity and other fuels.

Proposed amendments to the East Africa Community Customs Management Act, 2004 (EACCMA)

The East Africa Community Finance Heads met and agreed to amend the Common External Tariffs (CETs) in the EACCMA. The amendments to the CETs range from iron products, cement, automotive bolts and nuts, fishing nets and oil and petrol filters, amongst others.

These amendments have not been mentioned in the Kenyan budget statement. However, it is likely that the proposed amendments to the CET will be implemented in Kenya.

Excise Duty

Kerosene prices go up!

Excise duty on kerosene was scrapped in 2011 in a bid to cushion low income earners against high prices for the same, thus improving their standards of living.

However, the resultant low cost of kerosene has been abused by unscrupulous traders who mix kerosene with other fuels especially diesel and then sell the same as pure diesel at the market prices realizing higher margins.

This has resulted in oil marketers having a bad reputation, which has led to loss of Kenyan oil marketer's export business within the East African region.

To curb this malpractice, the Cabinet Secretary has proposed to re-introduce excise duty on kerosene at a rate of KShs 7.205 per litre in a bid to level the prices for the petroleum products thus eliminating the adulteration of petroleum by unscrupulous traders. This move will definitely hurt the low income earners who rely on kerosene.

Cheaper cars? Yes – The government finally listens

Hitherto, excise duty on imported motor vehicles has been KShs 200,000 for vehicles older than three years and KShs 150,000 for vehicles less than three years old from the date of manufacture.

These rates are deemed to be unfair to low income earners who bear a higher excise duty burden for cheaper vehicles compared to their wealthy counterparts, who comparatively pay lower excise duty on more luxurious cars.

To address this plight, the Cabinet Secretary proposes to replace the current specific excise duty rate on imported motor vehicles with *ad valorem* rate of 20% on the value of the vehicle.

The price of beauty

Previously, Excise Duty was levied on beauty and cosmetic products in Kenya. However, the enactment of the Excise Act 2015 exempted cosmetics and beauty products from excise duty.

So as to harmonise excise duty on these beauty products across East Africa and the world, the Cabinet Secretary has proposed to introduce excise duty on cosmetics and beauty products at the rate of 10%.

The Cabinet Secretary proposes to replace the current specific excise duty rate on imported motor vehicles to an ad valorem rate of 20% on the value of the vehicle.

Miscellaneous

Deeping financial inclusion

In its bid to be the leading financial centre in Sub Saharan Africa, Kenya has introduced the following laws:

- The Financial Services Authority Bill. If passed, this law will ensure the creation of a super financial services regulator by combining the IRA, RBA and CMA. With a centralized regulator, this is expected to strengthen the overall regulation and integration of the sector.

- The Nairobi International Financial Centre (NFIC) Bill which has already undergone extensive stakeholder consultation. This law seeks to provide a framework to strengthen Kenya's position as the financial hub through incentives and putting in place the necessary infrastructure and market development.

- The Movable Property Security Rights Bill which seeks to address the high cost of credit and also to expand the access to credit in the economy in line with proposals on credit information sharing to deepen financial inclusion. If passed, this law will ensure that persons be able to use movable assets as collateral for borrowing. The law also seeks to introduce an electronic collateral registry, where lenders will be able to lodge their security rights on specific collateral through an online platform.

Tightening the regulatory grip

The recent headwinds in the banking sector have seen proposals to tighten the financial services regulatory regime. In a bid to tighten the regulatory grip on banks, protect depositor's monies and ultimately restore the Public's confidence in the banks, the Cabinet Secretary has proposed the following measures:

- Re-introduce the proposal to increase the core capital for banks. The proposal in the Finance Bill 2015 was to increase the core capital for banks from 1 Billion Shillings to 5 Billion Shillings by 2018. While this proposal did not go through last year, there is every indication that this will go through this year given the recent developments in the banking sector. This move may precipitate mergers and take-overs in the sector especially for the small players who may not meet the new core capital requirements.

- Increase the penalty for violation of the provisions of the Banking Act or the CBK Prudential Guidelines from 5 Million Shillings to 20 Million Shillings as well as a daily penalty for every day the violation continues.

A better tomorrow

In a clear indication of its commitment to the future welfare of its Citizens, the Government proposes to introduce the following changes to the regulation of Retirement Benefits Schemes:

- Introduction of non-renewable perpetual licenses to retirement benefit schemes. Previously, the licenses were renewable on an annual basis. However, this move will ensure stability for retirement benefit schemes and reduce the administrative burden of having to apply for license renewals year-in year-out.

- Increasing the products in which retirement benefit schemes can invest in. In addition to investing in private equity and venture capital funds which were introduced last year, retirement benefit schemes will now be allowed to invest in exchange-traded derivatives as well as listed Real Estate Investment Trusts (REITS) and other new products approved by the Capital Markets Authority.

- Setting up of separate medical funds into which members can contribute. Medical expenses after retirement is often a challenge. Setting up of medical funds by retirement benefit schemes will ensure that members are able to contribute to the funds during their working days and enjoy the cover upon retirement.

However, questions will linger as to what role NHIF should play for retirees. Employees will also want to understand whether contributions to these medical funds also enjoy a tax deduction much like a pension contribution.

Insurance sector changes

The government introduced risk-based regulation for the insurance sector in the Finance Act 2015. To augment this, the Cabinet Secretary has proposed to expand the allowable forms of capital and reflect the gross premium valuation methodology across the different insurance classes. Currently, equity is the accepted form of capital for insurance companies. This change will make use of other forms of capital such as share premium which were previously unrecognized.

Also, in recognition of the current developments in the insurance industry, the government proposes to properly house Sharia compliant or Takaful insurance products in the Insurance Act.

In a move that favours policy holders, the Cabinet Secretary has reduced the maximum time in which an insurance claim should be settled from 90 days to 30 days.

The Cabinet Secretary also alluded to ensuring local insurance companies provide cover for goods imported on a Cost Insurance Freight (CIF) basis. Should this materialize, it is possible that terms of trade will shift from CIF to Cost and Freight.

Cross border sharing

Despite the apprehension around Credit Reference Bureaus (CRBs), with accusations that they only provide negative information, the Cabinet Secretary has proposed to expand the Credit Information Sharing framework beyond Kenyan borders by fostering cross border information sharing. This therefore means that loan defaulters will be blacklisted no matter where the defaulting occurs.

A host of questions arise including potential breach of data privacy laws and potential misuse of personal data such as under the Consumer Protection Act.

The Competition Authority given teeth!

One of the Competition Authority's (CA) mandate is to conduct market studies and collate the necessary data for various industries. However, over the years, this mandate has been hampered in that the CA has in some instances been unable to collect sufficient data due to lack of co-operation from the relevant industry stakeholders.

In a bid to remedy this, the Cabinet Secretary proposes to impose a legal obligation on industry stakeholders to provide the information requested for by the CA.

International best practices dictates that the maximum financial penalty for engaging in restrictive trade practices is 10% of the gross annual turnover of the company. The CA has continued to follow this practice and now the Government seeks in to entrench the maximum penalty in law for certainty.

Presently, all mergers in Kenya, even where no adverse impact on competition is expected, require approval from the CA. In a bid to relieve this administrative burden and increase efficiency of commerce, the Cabinet Secretary has proposed to exclude from the ambit of the CA, mergers that do not have a significant effect on competition and restrictive trade practices.

SACCOs, exactly what do you do?

The emergence of numerous SACCOs including public service vehicle SACCOs has stirred confusion triggering a move to differentiate between deposit taking and non-deposit taking SACCOs. The proposed requirement will see the deposit taking SACCOs adopt the acronyms SACCO Society (DTS) or DT-SACCO in addition to their registered names.

Devolved funding

Devolution of funds to county governments has meant that the regional governments are able to carry out infrastructure projects within the Counties. However, with the number of projects that can be carried out under the county governments' funding restricted, there is need for county governments to augment funding. Thus, the Cabinet Secretary has proposed to include county governments as contracting parties in a Private Partnership Project.

Sugar, tea and everything sweet!

Once again, the government has demonstrated its commitment to protecting the local sugar and tea industry in Kenya. Currently, a sugar development levy of 7% is levied on ex-factory or CIF prices. In addition, a tea development levy of 1% is levied on the export value of the prices. In the 2016 budget, the Cabinet Secretary proposes to scrap the tea and sugar development levy. This is aimed at improving the earning of the farmers as well as increasing the competitiveness of Kenyan tea in the export market.

Furthermore, the Cabinet Secretary also proposes to scrap various levies in order to reduce the cost of doing business in Kenya. These include levies charged by the National Environmental Management Authority (NEMA) and National Construction Authority (NCA).

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