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KENYA NATIONAL BUDGET OVERVIEW 2022/2023

KENYAN NATIONAL BUDGET

Anant Bhatt LLP has prepared a brief analysis for clients and external parties on the recently published Kenyan National Budget, by the Government of Kenya.

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1 INTRODUCTION

The FY 22/23 Budget will be implemented during an electioneering year and at a time when the economy continues to recover from the adverse effects of the COVID-19 pandemic. This year's budget is a tough juggle for the Government as it tries to balance stakeholders' expectation amid internal and external uncertainties.

The Government has projected a growth of 6% for FY 2022/2023. This is against a backdrop of an economy recovering from the COVID-19 pandemic, rising costs of debt, projected drought, rising cost of goods, elections, among other factors. The total expenditure is set to increase from KES 3.2 trillion in FY 21/22 to KES 3.34 trillion in FY 22/23 with a projected ordinary revenue increase from KES 1.81 trillion to KES 2.14 trillion.

The Government has projected the fiscal deficit to fall from the current KES 1.02 trillion (about 8.2% to the GDP) to KES 862 million (6% to the GDP) in FY 2022/23. It is imperative to note that the third medium-term plan had projected the deficit to fall from 7.54% to GDP in 2016/2017 to 3.8% to GDP in 2021/2022. This was not achieved.

In FY 2013/2014, the first budget for the current Government budget stood at KES 1.32 trillion, rising to KES 3.34 trillion in FY 2022/2023. Ordinary revenue on the other hand for the same period has increased from KES 920 billion to KES 2.14 trillion. Faster growth in expenditure in comparison to revenue is the reason for the expanding fiscal deficit.

Payments for debt are increasingly taking a significant share of the revenues. The total debt service as a percentage of ordinary revenue has increased from 38% in FY 2014/15 to a projected 50% in FY 2022/2023. This is a worrying statistic for both, the current and incoming government this August.

The Government continues on its quest to achieve its Big Four agenda as indicated by various budgetary allocations. Supporting manufacturing for job creation (KES 10.1 Billion); Food and nutrition security (KES 46.8 billion); Universal Health Coverage (KES 62.3 billion) and provision of affordable and decent housing for all Kenyans (KES 27.7 billion).

2 KENYAN ECONOMY

INFLATION RATES

The country recorded a 6.1% increase in inflation in 2021 owing to the increase in the cost of food and fuel primarily driven by:

- Reversal of the COVID-19 relief measures in January 2021 previously implemented by the Government;

- Depreciation of the KES against the USD to 109.6 driven by a wider current account deficit, a downward drift in foreign exchange reserves since mid-2021 and a stronger USD; and

- Poor weather conditions that resulted in a 1.2% contraction in the agriculture sector.

Despite increased fuel subsidies from the Government, inflation is projected at 6.0% in 2022 driven by the increase in commodity prices and rising global oil prices as well as the forecasted depreciation of the KES against major currencies.

SECTORAL GROWTH

The agricultural sector is estimated to have contracted by 1.2% in 2021, due to adverse weather conditions. Despite the expected poor weather outlook, uncertainty linked to the general election in August and global supply chain disruptions due to the Russia-Ukraine war, agriculture is expected to grow by 4.6% in 2022 driven by government subsidies on fertilisers and strengthening external demand.

The services sector was the most adversely affected by the COVID-19 Pandemic, recording a 2.0% contraction in 2020. The sector bounced back with an 8.8% growth in 2021 driven by the easing of the COVID-19 restrictions and increased private consumption.

The industry sector registered a strong growth of 5.6% in 2021, driven by the resumption of the construction of major infrastructure projects and implementation of investment policies such as facilitation of public private partnerships.

GOVERNMENT EXPENDITURE

Government expenditure as a % of GDP is projected to decline from 25.0% in 2021/2023 to 23.9% in 2022/2023 owing to efforts by the Government to rationalise recurrent expenditure through implementation of cost-cutting measures including parastatal reforms

Development expenditure as a % of total expenditure in 2022/2023 is expected to increase to 36% primarily driven by enactment of the law requiring that development expenditure constitutes a minimum of 30% of total expenditure and restriction of the use of borrowings for development expenditure.

Fiscal deficit, inclusive of grants, is projected to decline to KES 862.5bn (6.2% of GDP) from KES 1024.3bn (8.1% of GDP) in FY 2021/2022.This is driven by the rationalisation of government expenditure by developing policies geared towards economic recovery.

Interest payment of debts have been estimated at 869 billion in FY 2022/23 against an expected ordinary tax collection of KES 2.14 trillion. It should be noted that the Government might have to borrow to fund recurrent expenditure given a deficit of KES 862 billion and development expenditure of at least KES 715 billion.

Recurrent expenditure continues to take the largest share of the budget at 67%, with development expenditure and county allocation taking a minority share of 22% and 11%, respectively

DEBT SERVICING OBLIGATIONS

The heavy reliance on debt facilities to finance the Government of Kenya's expenditure priorities has resulted in increased pressures on the exchequer in meeting Kenya's debt servicing obligations.

As a whole, it is imperative that the Government of Kenya balances its debt appetite as debt servicing obligations have gradually led to a reduction in the fiscal space to finance recurrent and developmental expenditure.

While it is expected that expansion of the tax base and promotion of increased tax compliance, would lead to increased tax revenues and ease the pressure on the treasury, this has to be balanced with managing growth in expenditure.

TAX REVENUE

There is an upward trend in the revenue collections over the last five years from KES 1.3 Trillion in the financial year 2017/18 to projected revenue collections of KES 2.4 Trillion in FY 22/23. The FY 22/23 budgeted revenue of KES 2.4 Trillion represents anticipated growth in revenue collections of 17% compared to FY 21/22 projected revenue collections of KES 2.1 Trillion.

Income tax continues to be the main revenue generator with a projection of KES 997 Billion in FY 22/23, accounting for approximately 49% of the total projected tax revenue. However, from a tax revenue growth perspective, VAT is projected to achieve the highest growth in revenues at 23%, followed by Excise duty at 21%, with import duty trailing at 14%.

The projected increase in tax revenues can be attributed to the expected economic recovery post COVID-19 which is expected to spur economic growth as well as the Kenya Revenue Authority's intensified compliance and enforcement efforts.

Other ongoing measures include fast-tracking dispute resolution, Voluntary Tax Disclosure Programme (VTDP), continued automation of processes in tax administration, etc.

GEOPOLITICAL INSTABILITY

According to McKinsey's March 2022 Economic conditions outlook, geopolitical instability is one of top risks to global and domestic economies. The Russia-Ukraine conflict, and the resultant sanctions imposed on the Russian economy, has caused a surge in the global prices particularly in relation to fossil fuels, fertilizer and wheat. An increase in fossil fuel prices is bound to impact Kenyans through a corresponding increase in cost of living, occasioned by surges in transport and production costs.

2022 GENERAL ELECTIONS

Kenya is entering into an election season culminating in the August 2022 General Elections. Election periods in Kenya are typically characterized by intense political campaigns often leading to high political temperatures that cause uncertainty. These uncertainties may result to a slump in economic activity and investments as investors conserve financial reserves awaiting the outcome of the elections and resumption of 'business as usual'. Consequently, election years tend to witness reduced growth in GDP as compared to non-election years.

COVID-19

The COVID-19 pandemic adversely affected growth globally, regionally, and ultimately in Kenya through adverse impacts on international trade flows, restrictions on international travel, work patterns, public health, education, consumer spending patterns and the production of goods and services. We are now entering into a post-pandemic era in which restrictions on movement have been lifted in many jurisdictions with measures instituted to encourage a return to normalcy. However, the risk of the possibility of emergence of new covid-19 variants cannot be ignored.

CLIMATE CHANGE

Climate change is a major concern to the extent that it induces uncertainty in weather patterns, influencing regional crop growing conditions and pest incidence. Adverse weather conditions are expected to potentially reduce the annual crop yields and as such exposing the economy to negative shocks which will certainly impact on economic growth and by extension tax revenues.

3 BUDGET OVERVIEW - SECTOR BY SECTOR ANALYSIS

FINANCIAL SERVICES

RESILIENCE AND RECOVERY OF THE BANKING SECTOR

The Cabinet Secretary noted that the banking sector remains stable and resilient, and has registered strong recovery from the adverse effects of the COVID-19 pandemic, as evidenced by the strong capital and liquidity buffers.

ENHANCING ACCESS TO AFFORDABLE CREDIT

The Cabinet Secretary noted that the credit guarantee scheme had surpassed KES 2.2 billion in advances to Micro, Small and Medium Enterprises (MSMEs). There was no direct budgetary allocation included in the budget.

In 2021, KES 2 billion was allocated to the scheme. However, the Cabinet Secretary announced that the Government will seek the support of development partners to increase the scheme's capital from the current KES 4 billion to KES 10 billion over the medium term.

ENHANCING ACCESS TO AFFORDABLE HOUSING

The Cabinet Secretary noted that the Kenya Mortgage Refinancing Company (KMRC), which was established to offer long term loans at concessionary rates to mortgage lenders, had disbursed loans amounting to KES 2.2 billion to 7 primary mortgage lenders for onward lending, with an additional KES 7 billion currently being processed.

To expand its funding base, KMRC recently issued a KES 10.5 billion Medium Term Note (MTN), of which KES 1.4 billion has already been drawn down.

INSURANCE

The cabinet secretary weighed in on the ongoing proposed reforms to the motorcycles transport sector. Acknowledging the increased use of the motorcycles “boda boda” and three wheelers “tuk tuk” in the commercial fare paying passenger business, accompanied by the increased accident rates in this business, he proposed a change in Insurance Regulations to require motorcycles and three wheelers used by fare paying passengers to take out insurance for their passengers. This will cater to the treatment of injuries or compensation in case of death or accidental damages.

PENSION REFORMS

The Cabinet Secretary acknowledged that there is need to improve the pensions policy framework and the Government, through the National Treasury will develop a National Pensions Policy that will set out the guiding principles for application on the structure and management of retirement benefits for public servants.

The Cabinet Secretary widened the scope of the areas where pension funds can invest through his proposal to amend the Retirement Benefits Investment Guidelines to include the unlisted Real Estates Investment Trusts incorporated in Kenya that are approved by the Capital Markets Authority. The limit for this asset class under the investment guidelines will remain at 30%.

PROPOSED CHANGES TO THE UNCLAIMED FINANCIAL ASSETS ACT (UFA ACT)

In a bid to boost the reporting and recovery of the unclaimed financial assets, the Cabinet Secretary proposed the following amendments to the UFA Act, 2011:

- Introduction of a 12-month voluntary disclosure program to grant relief of penalties and interest on unclaimed financial assets declared and submitted to the authority in the next twelve months;
- Waiver of the penalties, fines and audit fees charged to holders of unclaimed financial assets where there are valid circumstances;
- Introduction of a cap on penalties and interest payable to the value of the unclaimed asset.

PROPOSED CHANGES TO THE CAPITAL MARKETS ACT

The Cabinet Secretary proposed an amendment to the Capital Markets Act to expand the category of persons that may be licensed as investment advisors.

PROPOSED CHANGES TO THE CAPITAL MARKETS ACT

The Cabinet Secretary proposed:

- An amendment to the Income Tax Act to exclude microfinance institutions licensed under the Microfinance Act from interest deductibility restrictions;
- To tax gains accruing from trading in financial derivatives by non-residents.

AGRICULTURE

OVERVIEW

The agricultural sector remains the cornerstone of the Kenyan economy with a significant contribution to GDP and employment. Agriculture contributes 26% directly to Gross Domestic Product (GDP), and up to 27% indirectly through linkages with other sectors. 40% of Kenyan citizens are gainfully employed in this sector. This makes the industry is an important pillar in both the Economic Recovery Strategy (ERS) and the Big Four Agenda.

BUDGETARY ALLOCATION

The FY 2022/23 agricultural sector allocation of KES 63.9 billion represents a decline of 16% compared to the prior year of KES 75.7 billion (including supplementary allocation). The proposed allocations intended to spur economic productivity and accelerate labor participation.

To boost agricultural produce, it will be key for the Government to increase investment in key programmes and projects that will lead to higher yield, notably provision of subsidised fertlizers, quality and certified seeds and mechanisation, all aimed at ensuring that we produce enough food to feed ourselves as a nation. There may be a need to implement reforms that ensure sustainable farming practices

The budgeted Government contribution for the above interventions mirror prior year allocations. From the final printed budget estimates, the additional resources mobilized for this sector from other sources including donors was approximately KES 15 billion.

Other achievements include streamlined and improved operations in the tea sector owing to the restructuring of the Kenya Tea Development Agency (KTDA); and

KEY PRODUCTIVE AND STRATEGIC INTERVENTIONS

County governments need to play their role to create a conducive environment for agriculture to thrive.

The proposed allocation for National Agricultural and Rural Inclusivity project of KES 4.2B, Small Scale Irrigation and Value Addition Project of KES 1.5B, National Value Chain Support Project of KES 1.6B, Fertilizer subsidies of KES 2.7B and Kenya Climate-Smart Agriculture Project of KES 7B will enhance productivity.

MANUFACTURING

CONTINUED INVESTMENT INTO SPECIAL ECONOMIC ZONES

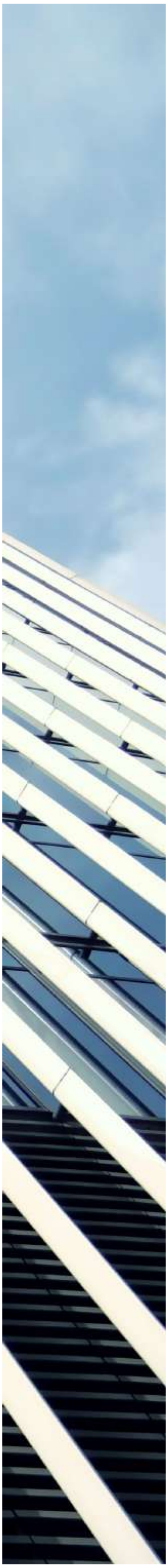
The Cabinet Secretary indicated the government will support the industry with an allocation of KES 10.1 billion, a 50% decline from the 2021/22 budget allocation of KES 20.5 billion, under various implementing Ministries, Departments and Agencies.

An additional KES 3 billion has been allocated to support access to finance and enterprise recovery.

Investment in the manufacturing pillar will enable the Kenyan youth to acquire skills necessary for industrial growth, job creation and improved living conditions.

The government will continue focusing on special economic zones with these proposed cash injections:

- KES 2.6 billion for Dongo Kundu Special Economic Zone;
- KES 295 million for the development of the Special Economic Zone Textile Park in Naivasha, Kinanie Leather Industrial Park and Athi River Textile Hub;
- KES 50 million for the Freeport and Industrial Park Special Economic Zone in Mombasa;
- KES 410.4 million for the modernization of RIVATEX.



TOURISM AND HOSPITALITY SECTOR

TOURISM RECOVERY

International tourism receipts posted a 19.0% growth in 2021 driven by the vaccine rollout and easing of the COVID-19 restrictions.

The tourism sector has a positive outlook for 2022 following the easing of COVID-19 Pandemic restrictions including travel restrictions and night curfews.

International arrivals grew by 53.3% in 2021, a rebound from the decline noted in 2020 reflecting a steadily growing trust for Kenya as a tourist destination owing to diverse marketing efforts by the Kenya Tourism Board and regained consumer confidence. The growth was also driven by innovative products offered by both international and domestic players in the sector.

TOURISM INDUSTRY

- KES 3.2 billion to the Tourism Fund
- KES 1.8 billion to the Tourism Promotion Fund
- KES 125 million towards refurbishment of the regional stadia
- KES 15.8 billion towards the Sports, Arts and Social Development Fund

HEALTHCARE

THE BIG 4 AGENDA

The ‘Big Four Agenda’ is the current administration’s legacy project which directly relate to Kenya’s Vision 2030. Under the Big Four Agenda, the government aimed to ensure:

- 100% universal health coverage;
- 100% national food and nutrition security;
- 500,000 new houses for Kenyan families; and
- Manufacturing sector to contribute 15% to GDP.

While the government has achieved some milestones with respect to implementation of this agenda, there remain gaps in meeting the set-out goals under the respective initiatives.

UNIVERSAL HEALTH COVERAGE

The provision of quality healthcare is important in order to sustainably drive the development agenda. Consequently, the government targeted 100% universal health coverage by 2022 through expanding the number of health facilities and provision of specialized medical equipment.

Government expenditure on affordable healthcare at both national and county government levels has significantly increased over the years, from combined expenditure of KES 118 Billion in 2016/17 to KES 233 Billion in 2020/21. Moreover, membership of NHIF also increased in the period from 13 Million to 22 Million members. KNBS further estimates the government expenditure on COVID-19 support to counties at KES 7.7 Billion.

AFFORDABLE HOUSING

The government intended to provide 500,000 affordable new houses across the 47 counties for Kenyan families by 2022.

The government completed construction of 2,235 affordable housing as at the end of September 2021. Further, the government has been able to support this agenda through construction of 1,370 affordable housing units, 462 social housing units, 540 National Police and Prisons Services housing units and 670 civil servants' houses.

However, despite not meeting the targeted 500,000 houses, government expenditure on housing declined from KES 27 Billion in 2019/20 to 18 Billion in 2020/21.

FOOD SECURITY

The government aimed to achieve 100% food and nutrition security by 2022 through supporting large scale production of staple food, increasing access to agricultural inputs, expansion of irrigation schemes and implementing smallholder farmer support programs.

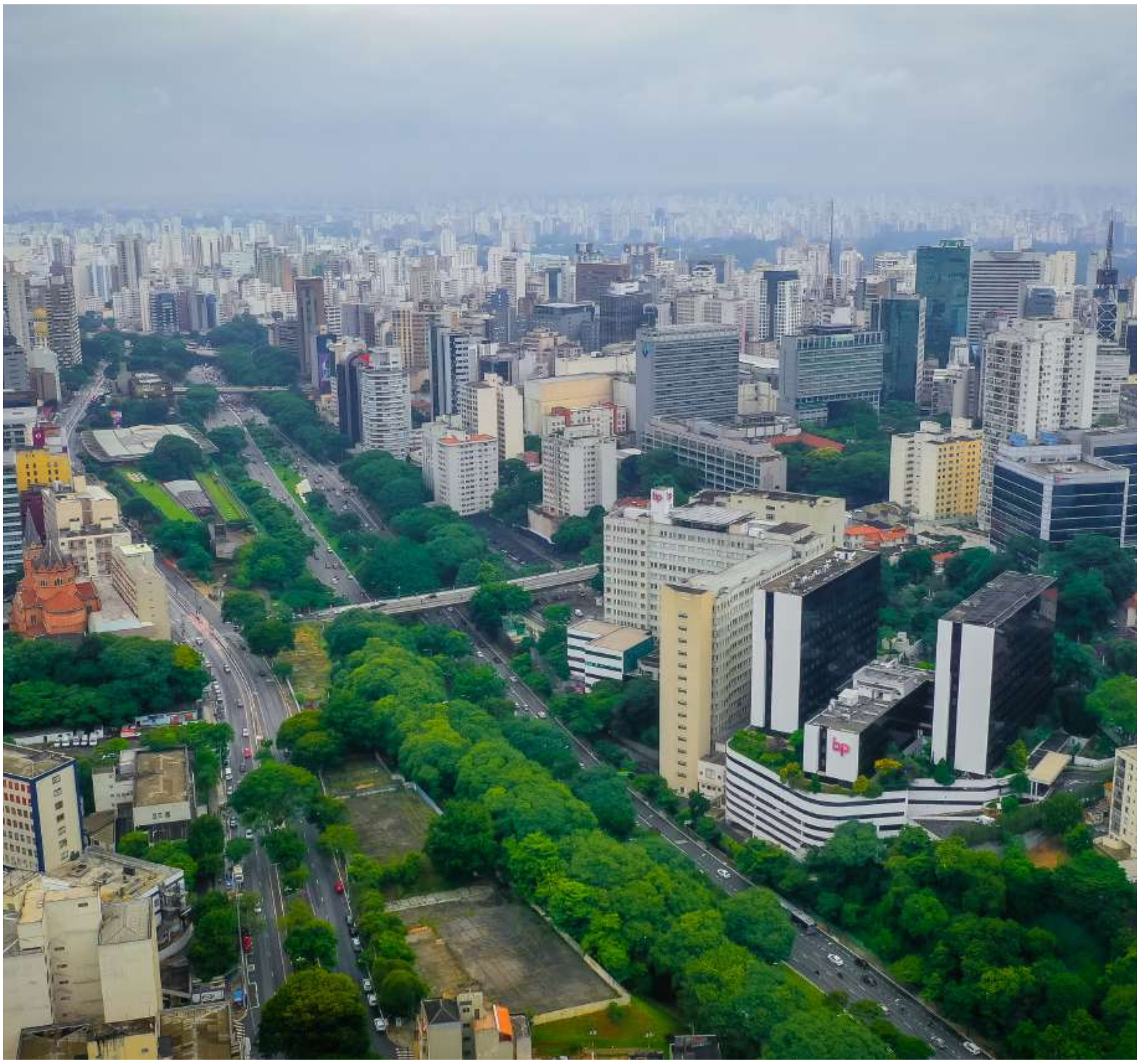
The real agricultural growth rate increased from 2.96% in 2019 to 5.39% in 2020 in line with the increase in agricultural production. Moreover, the agricultural sector's share of GDP has increased from 21% in 2019 to 23% in 2020.

HOUSING, URBAN DEVELOPMENT AND PUBLIC WORKS

The Government aims to digitalize the economy, in recognition of the opportunities that digital technologies offer in various sectors.

KEY ALLOCATIONS

- KES 4.6 billion to Kenya Mortgage Refinance Company for enhancement of the Company;
- KES 8.7 billion for construction of affordable housing units;
- KES 1.2 billion for construction of social housing units;
- KES 200 million towards the Nairobi Metropolitan Services Improvement Project; and
- KES 118.7 million for construction of foot bridges



SECURITY

The government has set aside KES 317.8 billion to support operations of the National Police Service, National Defence Forces, and the National Intelligence Service.

KEY ALLOCATIONS

- KES 128.4 billion to the Kenya Defence Forces;
- KES 46.1 billion to the National Intelligence Service;
- KES 122.2 billion to cater for Police and Prisons Services;
- KES 10.7 billion towards leasing of police motor vehicles;
- KES 1.0 billion towards the Police Modernization Programme;
- KES 1.0 billion towards the National Communication and Surveillance System;
- KES 335 million for the equipment of the National Forensic Laboratory;
- KES 4.8 billion towards medical insurance for the National Police Service and Prisons;
- KES 2.3 billion towards the group personal insurance for the National Police Service and Prisons; and
- KES 1 billion towards the National Integrated Identity Management System

ENERGY & INFRASTRUCTURE

The government has specifically identified the development of critical infrastructure in roads, rail, energy and water sectors as one of the key focus areas to accelerate economic recovery and improve livelihoods under the Economic Recovery Programme.

- KES 212.5 billion to expand, rehabilitate and maintain critical infrastructure in roads, rails, air, and seaports;
- KES 18.5 billion for development of the Standard Gauge Railway (“SGR”); • KES 1.1 billion for Railways Metro Lines;
- KES 439 million for rehabilitation of locomotives;
- KES 264 million for development of an ERP system for the SGR; and
- KES 91.5 billion to support the production of reliable and affordable energy, out of which KES 62.9 billion will cater for transmission and distribution of power; KES 18.5 billion for development of geothermal energy; KES 9.3 billion for electrification of public facilities and KES 2 billion for development of nuclear energy and the exploration and mining of coal.

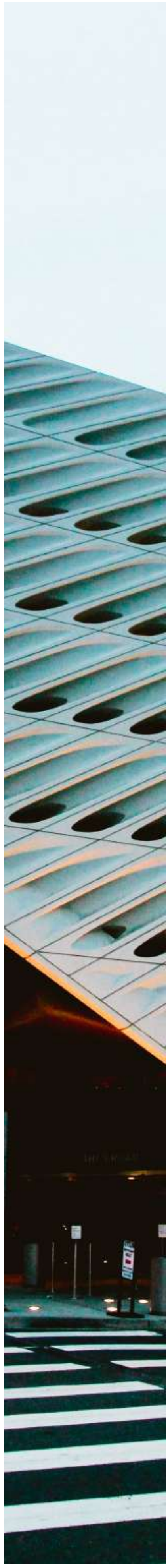
The Government took a step in the right direction, with the Public Private Partnership Act, 2021 coming into effect in December 2021, setting fit for purpose laws for the participation of the private sector in development projects. The re-prioritised Public Private Partnership (“PPP”) pipeline targets to unlock an estimated KES 350bn in new development capital for priority projects in 2022.

The Government floated a 19-year KES 75bn infrastructure bond in February-22 for funding of infrastructure projects in the 2021/2022 budget estimates, with the CBK taking up KES 98.6bn at an average rate of 12.965%. This performance underlines the massive advantage drawn by infrastructure bonds from their high return and tax-free status.

ICT

The Government aims to digitalize the economy, in recognition of the opportunities that digital technologies offer in various sectors.

- KES 15.6 billion to fund initiatives in the Information, Communication and Technology (“ICT”) sector;
- KES 9 billion to fast-track the development of the Konza Technopolis City;
- KES 2.7 billion for the Last Mile Connectivity Network; and
- KES 1.2 billion for maintaining and rehabilitating the National Optic Fibre Backbone Phase II Expansion Cable



EDUCATION

The government has set aside KES 5.8 billion for implementation of certain activities towards improvement of environment, water, and sanitation facilities. Key allocations are as follows:

- KES 12 billion for free primary education;
- KES 2.5 billion for recruitment of teachers;
- KES 64.4 billion for free day secondary education, including NHIF insurance for secondary school students;
- KES 5 billion for exam fees waiver for grade 6, class 8 and form 4 candidates;
- KES 1.96 billion for the school feeding programme;
- KES 1.2 billion for training of teachers on the Competency Based Curriculum (CBC);
- KES 4 billion for the construction of classrooms;
- KES 2.8 billion for primary and secondary schools’ infrastructure;
- Kes 1.8 billion for construction and equipping of Technical Training Institutes and Vocational Training Centres;
- KES 1.1 billion to enhance access to Technical and Vocational Education and Training (“TVET”) programmes.
- KES 294.7 billion to the Teachers Service Commission;
- KES 91.2 billion for university education;
- KES 15.8 billion for the Higher Education Loans Board;

ENVIRONMENTAL, WATER AND NATURAL RESOURCES

The government is committed to expand clean and adequate water for domestic and agricultural use. Key allocations are:

- KES 45.9 billion to water and sewerage infrastructure development to facilitate wide access to clean and adequate water for domestic and agricultural use;
- KES 16.0 billion to water resources management;
- KES 9.8 billion for water storage and flood control;
- KES 8.5 billion for irrigation and land reclamation and KES 2.1 billion for water harvesting and storage for irrigation;
- KES 10.2 billion for forests and water towers conservation;
- KES 3.1 billion for environment management and protection;
- KES 1.5 billion for the Meteorological Service Department; and
- KES 7.0 billion towards wildlife conservation and management.

4 INCOME TAX

EXEMPTION OF MICROFINANCE INSTITUTIONS FROM THE INTEREST LIMITATION RULE

The Finance Act 2021 replaced the thin capitalisation interest limitation rule with an Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)-based interest limitation rule with effect from 1 January 2022.

In the repealed thin capitalisation interest limitation rule, foreign controlled entities, except banks and financial institutions licensed under the Banking Act, were not allowed to claim a deduction in respect of interest that corresponds to excess debt. Presently, only SMEs registered under the Micro and Small Enterprises Act, 2012 and banks or financial institutions licensed under the Banking Act are exempted from the EBITDA-based interest limitation rule.

The CS in his statement has now indicated that the Income Tax Act will be amended to also exclude microfinance institutions (MFIs) licensed under the Microfinance Act from the EBITDA-based interest limitation rule.

In the EBITDA-based interest limitation rule, only interest up to 30% of the EBITDA is allowed as a deduction. Any amount above 30% of EBITDA is not deductible.

CASH DONATIONS TO ANY CHARITABLE ORGANISATION TO BE DEDUCTIBLE

The Income Tax Act will be amended to allow entities to claim deductions in respect of cash donations to any charitable organization.

Currently only donations to charitable organisations that are registered under either the Societies Act or the Non-Governmental Organisations Coordination Act are allowable.

The proposal to have donations as an allowable expense will encourage entities to continue engaging in charitable acts in their local communities.

COUNTRY BY COUNTRY REPORTING

In a bid to broaden the application of the existing country by country reporting provisions, the CS National Treasury has proposed to amend the country by country reporting provisions to further align them with the global provisions on the same. The previous proposal had appeared to restrict their applicability to multinational entities headquartered in Kenya.

GAINS BY NON RESIDENTS FROM FINANCIAL DERIVATIVES

The CS, National Treasury has proposed amendments to the ITA to subject to tax gains made by non-residents from trading in financial derivatives. The enforcement of this proposal on non residents may give rise to complexities. In addition, further guidelines may be required to determine whether such gains are capital or revenue in nature.

PERSONAL TAXES

The CS National Treasury did not propose any changes on employment taxes. This is not surprising given that there have been considerable adjustments to employment taxes in the last two years.

PAYMENT OF DISPUTED TAXES

The CS National Treasury has proposed to amend the Tax Appeals Tribunal Act, 2013 to introduce a requirement for a payment of 50%of the tax in dispute to be paid to an account at the Central Bank of Kenya. This will be applicable where a taxpayer appeals to the High Court, a Tax Appeals Tribunal ruling that is in favour of the KRA.

In the event of a favourable ruling to the taxpayer at the final end of the litigation process, the 50% deposit will be refunded to the taxpayer within 30 days. This proposal raises serious concerns, notably, the limitation of taxpayers' access to justice and their right of appeal. It creates a significant barrier for the taxpayer to appeal to the High Court and appears to usurp the powers of the High Court to make decisions in relation to the treatment of sums in disputes.

Given that tax disputes can take several years to be resolved, the provision is likely to significantly affect the cash flows of taxpayers.

It is noted that the provision may create certain disincentives in the dispute resolution process. It may incentivise the KRA to raise exaggerated assessments with the view of collecting 50% of such assessments where it wins such a case at the Tax Appeals Tribunal.

It also provides the KRA with a powerful bargaining position in an alternative dispute resolution process as taxpayers may be intimidated to settle cases rather than pursue the litigation process.

Finally, the provision also raises issues of fairness as it is not clear whether the 50% deposit will accrue interest at market rates that will be payable to the taxpayer in the event of a successful appeal.

OBJECTION DECISION TO BE CONFIRMED WITHIN 60 DAYS

The CS National Treasury has also proposed to amend the Tax Procedures Act, 2015 ("TPA") to reduce the amount of time it takes the Commissioner to issue a decision on a taxpayer's objection against a tax assessment.

Currently, the Commissioner can request for documents from the taxpayer which extends the 60-day limit within which they are required to issue an objection decision. In this proposal, the Commissioner will be required to issue an objection decision within one cycle of 60 days of receiving a valid objection.

The proposal will go a long way in ensuring efficiency in dispute resolution. The Commissioner will no longer be able to make several requests for documents to prolong the time within which they are required to make a decision on an objection.

NAME CHANGE TO KENYA REVENUE SERVICE

In a move to change the perception of KRA's public image from an enforcement agency to a service oriented institution that is focused on taxpayer needs, the CS National Treasury has proposed to amend the Kenya Revenue Authority Act to change the name of the KRA from the "Kenya Revenue Authority" to the "Kenya Revenue Service"

EXEMPTIONS TO THE STATUTORY INSTRUMENTS ACT

In a proposed amendment to the Statutory Instruments Act, the CS National Treasury has excluded tax related regulations from the expiration limit of ten (10) years from the date of publication. This will go a long way in creating a predictable tax environment.

SECURITY FOR TAXES

The CS National Treasury made a proposal to broaden the assets available to KRA that can be used as security for unpaid taxes to include ships, aircrafts, motor vehicles and any other properties that may be used as security for unpaid taxes.

5 VALUE ADDED TAX (VAT)

EXEMPTION OF PLANT AND MACHINERY USED IN MANUFACTURING OF PHARMACEUTICAL PRODUCTS

The CS proposes to exempt the acquisition of plant and machinery for use by manufacturers of pharmaceutical products from VAT.

This proposal will assist in reducing the cost of production which in turn will make the pharmaceutical products more affordable and further encourage additional investments by the players in the health sector.

An example of this is the recent memorandum of understanding signed between Kenya and Moderna to establish the first mRNA manufacturing facility in Africa.

EXEMPTIONS OF LOCALLY MANUFACTURED PASSENGER MOTOR VEHICLES

VAT exemption is to be introduced on the following:

- The purchase or importation of inputs and raw materials by manufacturers for use in the manufacture of passenger motor vehicles; and
- The purchase of locally manufactured passenger motor vehicles

The government has progressively initiated various tax incentive schemes to promote the local assembly and manufacture of motor vehicles. These measures are aimed at reducing the importation of used motor vehicles and to boost the local manufacturing sector.

The exemption of inputs used in local manufacturing of passenger vehicles from VAT will reduce the cost of local assembly as envisioned by the continuous efforts made by the Government to promote this sector.

Thus, the exemption from VAT of locally manufactured passenger vehicles will further make the vehicles cheaper and more competitive compared to the imported vehicles.

CUSTOMS

The Cabinet Secretary indicated in his speech that Kenya will submit its proposals with respect to Customs to the East African Community (EAC) for consideration during the EAC pre-budget consultations.

The adopted Customs changes will be communicated through the EAC Gazette before 1st July 2022

6 EXCISE DUTY

EXCLUSION OF CERTAIN PRODUCTS FROM INFLATIONARY ADJUSTMENT BY THE COMMISSIONER GENERAL

The CS has proposed to empower the Commissioner General of the KRA to exclude some products from inflation adjustment based on consideration of prevailing economic and social environment facing the products.

The proposal to allow the Commissioner General the discretion to exclude certain products from inflationary adjustment is welcome, as the Commissioner General will be expected to protect certain industries from negative economic impacts arising from increased costs of the excisable products.

EXCISE DUTY ON FEES CHARGED TO ADVERTISE ALCOHOLIC BEVERAGES, BETTING, AND GAMING ACTIVITIES

The CS has proposed to introduce excise duty at 15% on fees charged by all television stations, print media, billboards, and radio stations for advertisement of alcoholic beverages, betting and gaming.

The proposal to introduce excise duty on advertisement of the foregoing activities is aimed at increasing the cost of these activities to further protect the population from the associated negative social and health effects. It is also aimed at generating additional revenue from these activities.

AMENDMENT OF EXCISE DUTY REGIME ON LIQUID NICOTINE

The CS has proposed to amend the excise duty regime on liquid nicotine from shillings per unit to KES. 70 per millilitre. Since the Excise Duty Act only covers electronic cigarettes, the CS will be expected to provide further details on other liquid nicotine products that will be subjected to excise duty in the Finance Bill 2022.

The Excise Duty Act provides for excise duty on electronic cigarettes at KES 3,787 per unit. This measure is aimed at bringing into the ambit of excise duty, other liquid nicotine products that have been introduced into the Kenyan market.

This measure is therefore geared towards discouraging consumption of these products to protect the population from the associated health effects.

CHANGE OF EXCISE DUTY BASIS ON MOTOR CYCLES

The CS has proposed to exempt the following products from excise duty:

- Eggs for hatching imported by licensed hatcheries upon recommendation by the responsible Cabinet Secretary;
- Neutral spirit used by registered pharmaceutical manufacturers upon approval by the Commissioner General; and
- Locally manufactured passenger motor vehicles.

The proposal to exempt imported eggs for hatching is aimed at promoting the hatching business that was adversely affected by the introduction of the excise duty, particularly considering that Kenya lacks sufficient capacity to meet local demand for eggs.

The Excise Duty Act provides for refund of excise duty on spirits used for manufacture of unexcisable goods. The CS has proposed to exempt neutral spirits used by pharmaceutical manufacturers to address cash flow challenges faced by these manufacturers because of the lengthy process of claiming refund of excise duty paid on the neutral spirits.

The Excise Duty Act currently excludes locally assembled motor vehicles from excise duty. As per our understanding this exemption covers all locally assembled motor vehicles including locally assembled passenger motor vehicles. However, in his speech, the CS seems to differentiate between locally assembled motor vehicles and locally manufactured passenger motor vehicles.

INCREASE OF EXCISE DUTY ON CERTAIN PRODUCTS

The CS has proposed to increase excise duty on certain products with specific rates by 10%

The CS did not clarify which products will be affected by the proposed increase in excise duty. Petroleum products will be excluded from the excise duty increase.

In our view, this measure is primarily geared towards generating additional revenue for the Government. It is expected that the Commissioner General will adjust excise duty rates for inflation on the same products later this year.

7 MISCELLANEOUS FEES AND LEVIES ACT (MFLA)

EXEMPTION OF IDF AND RDL ON INPUTS USED FOR MANUFACTURE OF PHARMACEUTICAL PRODUCTS

» The CS has proposed to exempt inputs and raw materials imported by manufacturers of pharmaceutical products from import declaration fee (IDF) and Railway Development Levy (RDL).

This is a welcome proposal that if adopted will promote local manufacturing of pharmaceutical products and also encourage local investment in the industry.

REDUCTION OF EXPORT LEVY ON RAW HIDES AND SKINS FROM 80% OR USD 0.52 PER KG TO 50% OR USD 0.32 PER KG.

The CS has proposed to reduce the export levy on raw hides and skins from 80% or USD 0.52 per Kg to 50% or USD 0.32 per Kg.

Based on the CS` s proposal, it seems that there is insufficient local demand for raw hides and skins which has negatively affected the raw hides and skin business by local pastoralists.

This proposal is therefore geared towards reducing the cost of exporting raw hides and skins in a bid to increase the profitability of exportation of raw hides and skins

8 OTHER LEGISLATIVE UPDATES

PROPOSED LEGISLATIVE REFORMS

- Public Procurement and Asset Disposal (Amendment) Bill, 2021 proposes to allow contracts to be awarded to multiple bidders to support better service delivery and participation by local firms;

- National Rating Bill to replace the outdated Rating Act and the Valuation for Rating Act;

- County Governments (Revenue Raising Process) Bill to regulate the manner in which County Governments introduce fees and charges. These bills are in support of County Governments Own -Source Revenue Policy;

- An amendment to the Capital Markets Act to expand the category of persons that may be licensed as investment advisors to include single -director companies and partnerships to enable more investment advisors offer their services;

- An amendment to the Unclaimed Financial Assets Act to allow for a waiver of penalties, fines and audit fees charged on collection of unclaimed financial assets in justifiable circumstances;

- It has further been proposed that a cap on such charges be introduced, limiting them to the value of the asset, and that a 12 -month Voluntary Declaration Programme be created to grant a relief from penalties and interest on financial assets delivered to UFAA within the next 12 months;

- An amendment to the Retirement Benefits Investment Guidelines to allow pension schemes to invest in unlisted REITs. The move is aimed at widening the scope of investment where Pension Schemes can invest their funds;

- An amendment to the Insurance Regulations to require public transport motorcycles and three wheelers to take out insurance for their passengers. This will cater for the treatment costs in case of injury and compensation for death or damages occasioned by motorcycle related accidents. This is a welcome move. However, it may have been prudent to expand the scope to include private motorcyclists.

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