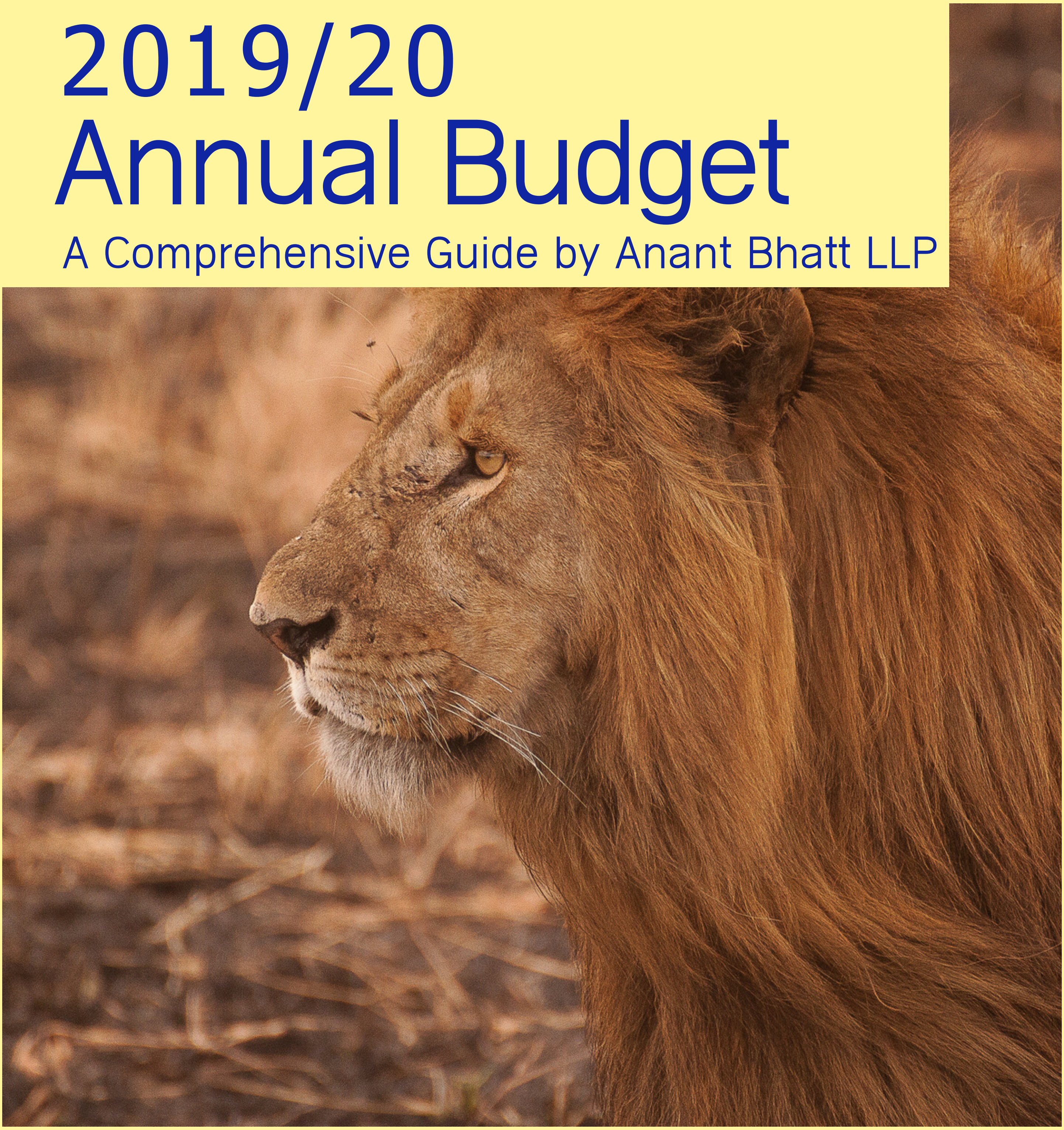
2019/20 Annual Budget

A Comprehensive Guide by Anant Bhatt LLP



CELEBRATING 70 YEARS OF PROFESSIONAL PRACTICE

ANANT BHATT LLP

CERTIFIED PUBLIC ACCOUNTANTS

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WHO ARE WE?

Anant Bhatt LLP, was founded by Anant S. Bhatt in 1949 - Mombasa, Kenya.
CPA Kamal Anantroy Bhatt runs and leads the firm as its Managing Partner. He is an astute professional who has garnered well over 30 years of industry experience, and a member of the professional body ICPAK.
Mr. Bhatt is also seated on the boards of several institutions.
The firm provides a great number of services to an impressively diverse and satisfied set of clientele.
Anant Bhatt LLP and its trusted team of staff are always striving to provide the highest quality of services needed by the client - whilst offering immense personal guidance and attention to detail. Industry experts from across the nation work in conjunction with us as part of our consultants team, allowing us to provide top notch broad level and industry specific services across the entire country. The firm conducts its self by adopting a rigorously market proven, and performance driven approach to all the services provided.

The firm in 2019, is now celebrating its 70th anniversary, marking it as one of the oldest standing and experienced audit practice in the East African region.

SERVICES WE OFFER:

COMPANY SECRETARIES	ACCOUNTS PREPARATION	PAYROLL MANAGEMENT
AUDIT & ASSURANCE	TAXATION SERVICES	ADVISORY SERVICES
MANAGEMENT REPORTING	MANAGEMENT CONSULTANCY	INTERNAL AUDITS & RISK MANAGEMENT
FAMILY OWNED BUSINESSES SERVICES	SUCCESSION PLANNING SERVICES	CORPORATE FINANCE SERVICES
BUSINESS & FINANCIAL PLANNING	BUSINESS RESTRUCTURING & TURNAROUNDS	INSOLVENCY SERVICES

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KENYA OVERVIEW

Kenya has been experiencing a higher level of growth than previously expected. in 2017, the economic growth stood at 4.9%, and rose to 6.3% in 2018. Some of the biggest reasons for this is the tremendous growth in Manufacturing sector, Agricultural sector, Transportation and Services sector.

The overall level of inflation stood at 4.8% in 2018, compared to the level of 8% in 2017. One of the largest reasons for the decline is that fall in the price of food.The current trend shows that 2019 will show similar growth in the economy, as it did in 2018.

The economy of Kenya experienced a number of driving forces:

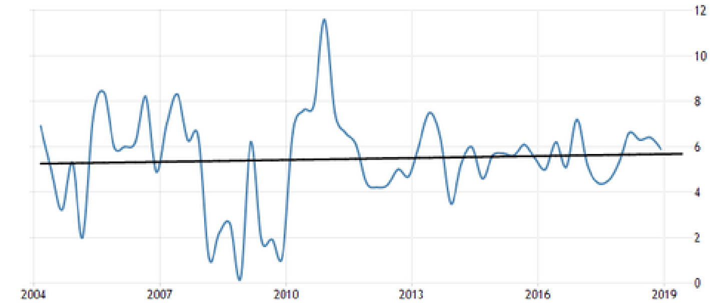
1. Livestock and crop production saw gains with the favorable rainfall and weather conditions in the region.
2. A lower level of political driven sluggish markets, resulting in the lifting of travel advisories from several international communities. This led to higher security confidence.
3. Tax amnesty that was available on income tax saw a substantial rise in remittances into Kenya.

The government continues to prioritise its funding for the Big Four agenda. The Big Four agenda stands on the pillars of: Manufacturing, Affordable Housing, Universal Health Coverage, and Food Security.

To help grow the initiative, the government has decided to focus on

- Improving the debt levels of Kenya.
- Creating more changes to give a chance for greater efficiency of local resources.
- Using a greater number of local resources to fund the prioritized programs/projects already in place.
- Focusing on overall improved business environment, and attracting investors.

Kenya has seen a relatively stable currency valuation in the past year. A high level of sales of Coffee and Tea, coupled with growth from infrastructure projects have played a pivotal role in this. We can observe that this has boosted GDP, as from this trend line of GDP growth:



SOURCE: KENYA NATIONAL BUREAU OF STATISTICS I GDP GROWTH TREND LINE

On a quarterly basis, the GDP grew 1.5%, compared to a 1.4% rise in Q3 2018. The high growth is mainly driven by agriculture (6.4%), manufacturing (4.2%) and transportation (8.8%). It marks the fastest growth since 2010 when the country's growth was 8.4%.

The Nairobi Stock Exchange continues to prove a disappointment well into Q1 of 2019, as it did throughout of 2018. Public data shows that:

SOURCE: KENYA NATIONAL BUREAU OF STATISTICS I NSE VALUATION IN KSH

the NSE 20 decreased 116 points or 4.11% since the beginning of 2019, according to trading on a contract for difference (CFD) that tracks this benchmark index in Kenya. Historically, the NSE reached an all time high of Ksh 5499.64, and the all time low was in May 2019 at Ksh 2636.47 .

KENYA OVERVIEW

Although the stock market is nonperforming, the Treasury Bill market is and was a relatively safer option for conservative investors, compared to the NSE. The year 2018 saw the inter-market liquidity boosted after the inter-market rate dropped down to 3.5%, a 2.7% drop from 2018.

SOURCE: KENYA NATIONAL BUREAU OF STATISTICS I 10 YEAR T-BILL RETURNS IN %

Treasury Bills are government issued bonds. The yield required by investors to loan funds to governments reflects inflation expectations and the likelihood that the debt will be repaid.

Kenya 10Y bonds are approximately yielding 12%, this has decreased 0.61% since the beginning of 2019. Historically, the Kenya Government Bond 10y reached an all time high of 17.35% in October of 2011 and a record low of 5.64% in July of 2010.

The public of Kenya however. feels that the cost of living has exponentially continued to rise. This is backed by data: there has been a decrease in growth of formal employment from 107,500 to only 65,600 formal jobs in the past year alone. These are very worrying statistics.

Kenyan government has focused to build up the Micro Small Medium Enterprises, to tackle this. The proposal in the budget explains that SMEs will be granted access to unsecured loans through a mobile phone loan service called Stawi loans, and be backed with a proposed Credit Guarantee Scheme.
The government also intends to get households more employment by doing two further things:

Firstly, taking a page out of India's playbook, Kenya intends to introduce the Ajira Digital Program. In this project, the users are engaged as freelance (self-employed) workers to earn income from online work and access relevant training and valuable mentorship. Ajira Digital program works on the ethos of:

1. Private sector first.
2. Sustainability.
3. Eliminate brokers.
4. Promote the domestic economy.

The main objectives are to raise the profile of digital work, provide Kenyans with access to digital work. This year's budget will allocate Ksh 1 Billion to the program.

Secondly, the government intends to pay Ksh 10.9 Billion that haven't yet been paid to the most vulnerable groups in the country, thus increasing the chances of groups such as the differently abled to be able to find work.
It is hopeful that this years's budget will further improve the already improving rank in the Ease of Doing Business quotient. Kenya has risen from rank 136 in 2014, to rank 61 in 2019.

Although there is a significant improvement in ease of doing business, the private sector is facing major disappointments such as long waiting in payment of suppliers by the government and lengthy port clearance processes.
Interest rate caps and the government's increased rates for commercial loans have also significantly discouraged the private sector from accessing credit loans for the past year.

In addition to this, the proposed budget suggests that the Corporation Taxes are due to rise from its current level of 30% to 35% for business earning Ksh 500m or more. If this is true, some businesses will likely prefer to move, or convert or try to, into a SEZ/EPZ to save on duty.

BUDGET ALLOCATION

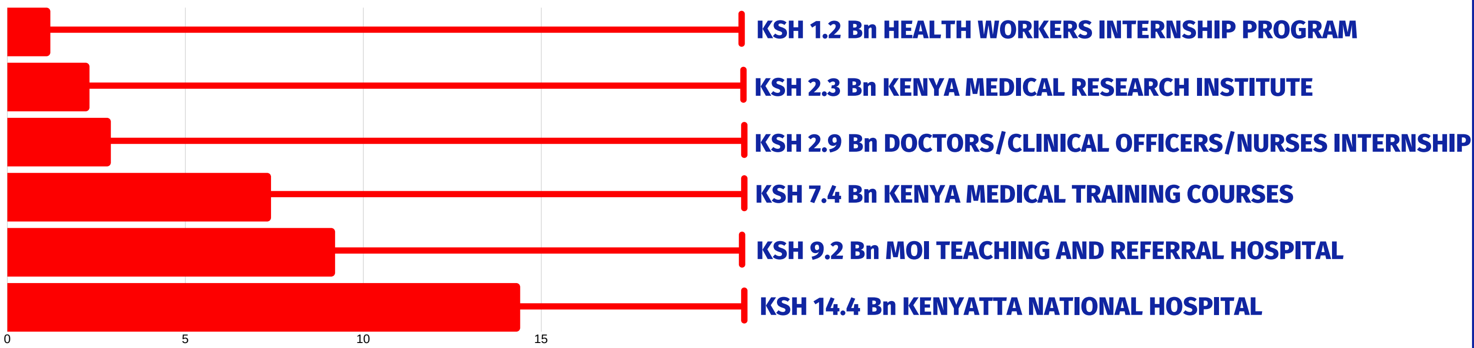
TOTAL EXPENDITURE & NET LENDING (2019/20) = Ksh 2.762 Trn

TOTAL FISCAL DEFICIT = Ksh 607.8 Bn
(of which externally financed = 324.3 Bn)

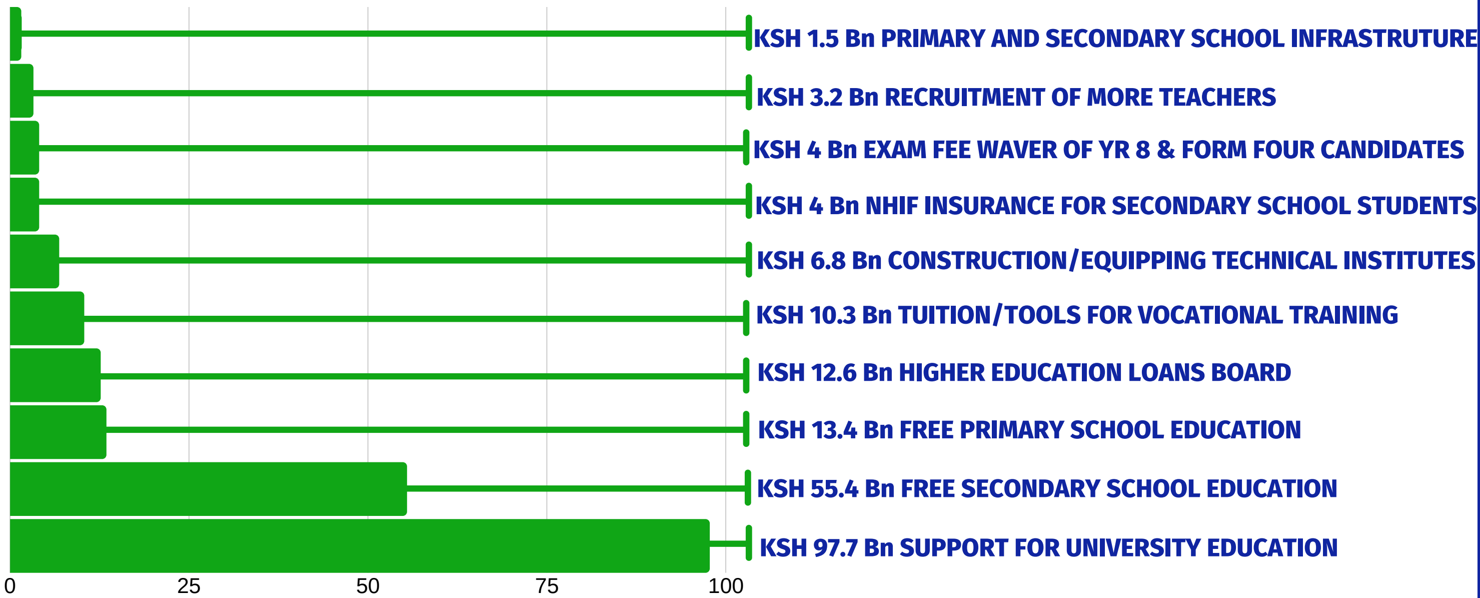
BIG FOUR AGENDA - ALLOCATION = Ksh 450.9 Bn

Kenya recorded a Government Budget deficit equal to 6.70 % of the country's Gross Domestic Product in 2018.

HEALTHCARE

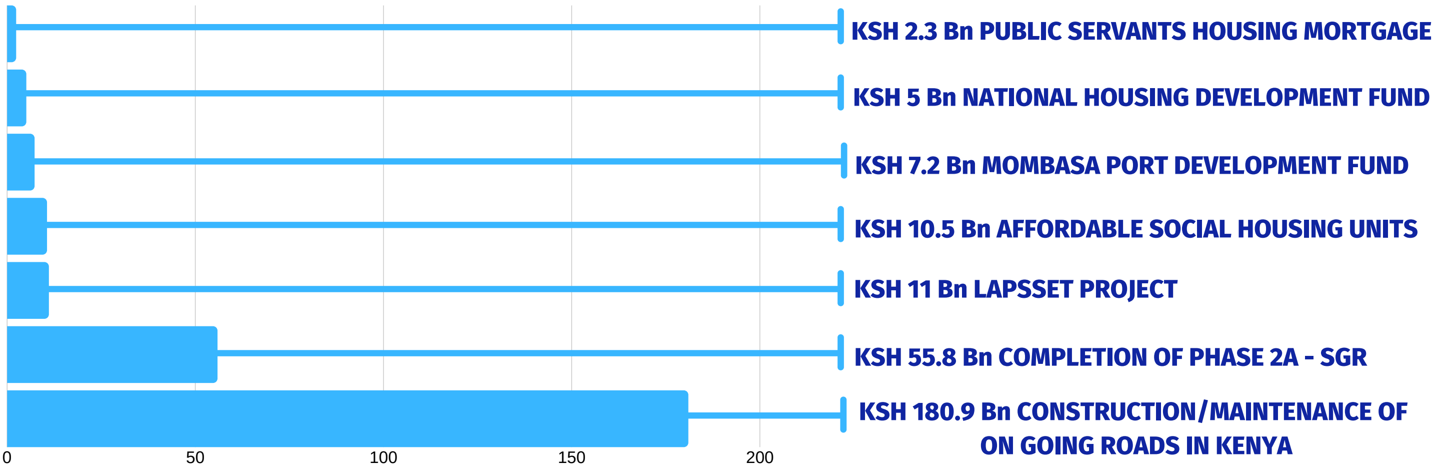


EDUCATION



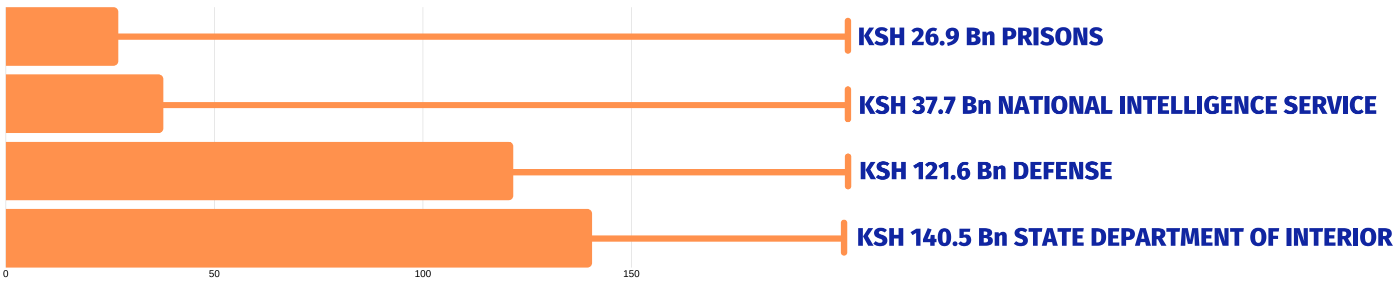
BUDGET ALLOCATION

INFRASTRUCTURE

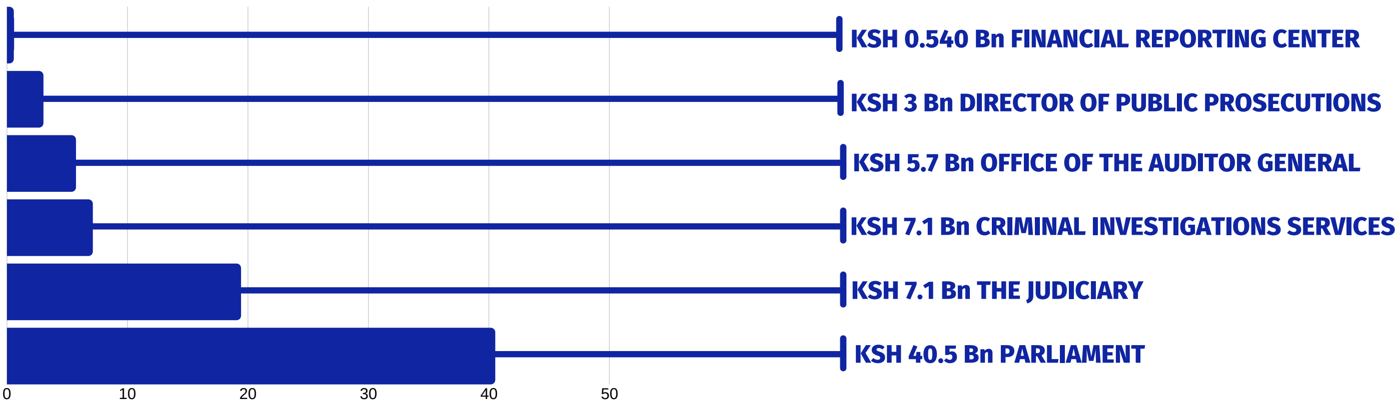


ENERGY

NATIONAL SECURITY



PUBLIC INSTITUTIONS



BUDGET KEY HIGHLIGHTS

From now on, all importer and exporters will be subject to even more intense vetting, and registration processes before being able to carry out business at the ports.

A more efficient process for pre-verification at the port has been suggested to reduce demurrage costs . The PVOC (Pre-Verification of Conformity) once approved, the same goods will not be checked again for inspection by Kenya Port Authority unless they have a non-compliance history, or suspected to become non-compliant .

A better Revenue Enhancement Initative to aid in Improved container scanning at airports and ports thus minimizing illegal concealment. Also, Improved tracking systems that minimize transit diversions.

The government has decided to bulk up manufacturing industries by empowering the 'Buy Kenya Build Kenya' initiative. Products of Kenya will be given the first priority in public procurement systems.

One of the largest industries that the 'Buy Kenya Build Kenya' initiative will impact is the automobile industry. GoK has gazetted all ministries, counties and MPs will give preference to companies with plants in Kenya. Analysts predict that one of the companies most likely setting a plant is Mahindra Group (India) - Although this is still unconfirmed.

Public officers will now be given a pre-loaded card with the official allowance applicable to them while they are on duty - within the domestic domain, or internationally. This aim's to curb corruption, as the card will be valid only for approved eligible expenses.

An effort will be made to now severely restrict the number of applications made by civil servants who are 60 years of age and over, when applying for an 'Extension of Service'.

The government has vowed to implement a policy of 'No New Projects', for the current term. This will ensure that Kenya first complete its already large number of ongoing projects, and that no large amounts of additional debt is incurred. This seems like a good idea, as Kenya has already weakened its Debt-GDP ratio from previous unfinished projects.

The Treasury has begun a large scale process of deploying a multi-agency team to investigate current, analyse for new and implement additional revenue management systems across all the counties.
Key counties will remain: Nairobi, Mombasa, Kisumu, and Eldoret.

A Zero-Based budgeting model will now be implemented across the country, with one view in mind: Severely cut out unnecessary expenses, and promote the strength of the Kenyan currency.

Restructure the externally obtained sources of finance of the country, and invest them in the 'Big-Four' project, in order to facilitate economic growth in Kenya.

CORPORATE INCOME TAX

The base rate of Corporate Tax in Kenya stands at 30%. Non-Resident companies are charged 37.5%

Capital Gains Tax (CGT)

INFORMATION

- CGT is tax that is levied on transfer of property situated in Kenya. It is supposed to be declared and paid by the transferor of the property.
- It is a final tax i.e. the Capital Gain is not subject to further taxation after payment of the 12.5% rate of tax.CGT is payable on the gains arising from sale of property.
- Net Gain is Sales Proceeds minus the Acquisition and Incidental cost.

CHANGES

- The CS has declared that the CGT will now rise from 5% to 12.5%
- The new rate will help bring fairness in the East African community members, who have rates higher than 20%.
- New finance bill states that there will be an exemption of CGT, for transactions that occur from acquisitions, separations, restructuring, or recapitalization of corporate entities. PROVIDED: 1) It is in public interest. 2) A compulsory acquisition ordered by the government of Kenya. 3) An internal restructuring that does not involve transfer to a 3rd party.

Withholding Tax (WHT)

INFORMATION

- Withholding tax is a tax that is deducted at the source of payments, minimum value being Ksh 24,000. Prices vary for residents and non residents of Kenya.
- A person making the payment of income is obligated to the WHT, and must deduct the tax at its relevant date. End of year for WHT is 28th February, the following year.
- Late payment will result in a penalty of 10% - Max Ksh 1m. Also, interest of 1%/month on tax until it is paid. Kenya has a number of double tax treaties with many countries.

CHANGES

- A few more services will be subject to WHT this year: security services, marketing services, advertising services, goods transport services - except by air.
- Demurrage charges that were introduced in the Finance Act 2018 has been proposed for repeal this year. It is suggested that the tax be transferred to the shipping lines as part of their income.
- Reinsurance premiums that are paid to non-residents of Kenya will now be subject to a 5% WHT.

CORPORATE TAXATION

REITS: REAL ESTATE INVESTMENT TRUSTS

The government has now mandated that a Tax Exemption will be granted to all REITs. Before the finance bill was updated, only the REIT that was registered was tax exempt, meaning the company that actually held the Asset in its financial statements was subject to tax. However, now even the investee corporations will be exempt from tax.
This being said, the individuals who hold the investee companies will have to pay 5% tax.

TAX AMNESTY FOR SME

Kenya's government, in a further bid to aid growth of Small to Medium enterprises has introduced a new tax incentive. After the Capital Markets Authority introduced a 'Growth and Enterprise Markets Segment - GEMS' on the Nairobi Stock Exchange, the hope was that smaller business would grow capital by investing in the NSE.

However, this did not go to plan. Thus, a 2 year tax amnesty on the outstanding taxes (not the principal) , interest and penalties has been introduced, so that business still give the GEMS a fair try.

DIGITAL ECONOMY TAX

Kenya's government has now begun to really capitalize on its booming online economy. Ever since with, first, creation of Mpesa, and then the introduction of online stores such as Jumia - the economy has seen a significant rise in the digital world. Thus, taxation is about to begin for online markets from now on. It is unclear what the rates will be, but one hopes it isn't high enough to drive out the new entrants in the market.

PLASTIC RECYCLING COMPANIES

Kenya has taken a tough, but excellent stance against the use of plastic. Banning the use of plastic bags will make a difference for the future of our planet. To further give incentives to the private sector, the government has proposed a corporation tax of 15%, for plastic recycling companies - for the first 5 years.
This is a major opportunity for large scale manufacturing industries.

TURNOVER TAX

Last year's Finance Act saw the introduction of the 'Presumptive Tax' - to persons who are issued by a single business permit by a County Government, applicable at 15% of the single business permit fee. However, the new bill will most likely re-introduce 'Turnover Tax', at 3% of gross turnover, for businesses whose turnover doesn't exceed Ksh 5m. Turnover Tax will be payable by 20th of the month.

VAT & EXCISE DUTY

VAT:
Value Added Tax is a charge on the supply of taxable goods or services made or being provided in Kenya, and on the importation of taxable goods or services into the country of Kenya.

The most significant development this year is the proposed change of the Withholding VAT rate from the current 6% to 2%.

Another bill being presented before the parliament is a bill that allows the tax refunds of previously accumulated VAT credits derived from the WH VAT system.

Moreover, the Finance Bill has now introduced a fixed definition of 'Concessional Loans' - It has now to be known as any loans that include AT LEAST 25% grant element in them.

A further amendment to the First schedule of the VAT Act on goods and supplies that are exempt from VAT, to include the following items:

- Locally manufactured computer motherboards, and inputs for its manufacturing.

- Green Energy equipment

- PPE that is used in the construction of a plastics recycling plant.

- Securities brokerage services.

- Agricultural pest control products.

- Inputs for electric accumulators and separators, including its lead batteries.

EXCISE DUTY:
Excise tax is any duty on manufactured goods which is payable at the moment of manufacture, rather than on the moment of its sale.

One of the most significant propositions is the introduction of excise duty on betting activities - the rate will be 10% of the amount staked. This is a positive move for the people of Kenya, as it discourages people from engaging in betting activities.

Electric powered motor vehicles will now be imported at an excise duty rate of 10%, down from its previous rate of 20%. This again plays in line with the government's aim at promoting the green initiative.

Insurance based commissions, and any other premium based commission as specified within the Insurance Act will now be exempt from excise duty. Admin fees and other related charges are still obligated.

Goods that have been imported, or purchased locally that are exicisable goods, that are being used directly for 'official aid funded projects' are exempt from excise duty.

A general penalty has been introduced. This will attract a fine not exceeding Ksh 2m, or imprisonment not exceeding 2 years, or both.

PROPOSED INCOME TAX BILL CHANGES

INDIVIDUALS

Individuals earning over Ksh 9 Million will most likely be taxed at 35%.

CORPORATIONS

Profit of Ksh 500M and over will likely be taxed at 35%. Shareholder dividends for resident to rise from 33.5% to 38.5%. Non-Residents will face a rise from 37% to 41.5%.

DIVIDENDS

The tax exempt threshold for dividends will increase from a 12.5% holding to 25% holding.

INVESTMENT DEDUCTIONS

Investments in machinery and buildings outside of Nairobi, Mombasa & Kisumu will face a removal of deductibles amounting to 150%.

LANDLORDS

Structural repairs will be disallowed to maintain existing rent in personal property. Commercially a capital allowance compensation can be made.

Rent payments maybe subject to 10% WHT.

TENANTS

Legal costs and Stamp duty that relates to acquisitions of leases that are less than 99 years, will not be allowed to be classified as 'Expenditures'

AGRICULTURE

Stock now may be tax payable, including the biological assets. Accounting professionals may refer to IAS 41 in tandem to the actual Income Tax Bill. Furthermore, a 20% WHT on auction commission is being discussed.

LIFE INSURANCE

A new CGT on the transfer of property from non-life to life business. non-life insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event.

TAX LOSSES

Government now plans to restrict business from carrying forward their tax losses occurring from business transfers and business activity changes.

TAX PROCEDURES ACT CHANGES

REMOVAL OF PIN REQUIREMENT?:

The power to waive the requirement of a 'Personal Identification Number' - PIN has now been removed as a requirement for opening a bank account, for a limited group of people, namely:

1) Visiting Foreigners
2) Privileged Personnel

Foreigners found the process of opening a new bank account quite difficult due to the PIN requirement, and thus in a bid to grow FDI, the government has chosen to comply with them.

TAX MISTAKES MADE? :

Currently, if a tax payer unknowingly makes a mistake in calculating their required amount of tax payable, the penalty arising on the shortfall is 20%.
However, the CS now wants to pass that this penalty be abolished and taxpayers be given the benefit of doubt. Most likely this will create trouble in the level of tax collections

EXTENSION TO PAY TAX :

A tax payer may apply in writing to the commissioner for an extension of time to pay their obligations - When reasonable cause for the extension is correctly identified, commissioner:
a) A time extension may be granted
b) Taxpayer may be required to pay obligation in installments as determined by KRA.

Tax obligations outstanding in a return would already include a portion of 'Tax already paid', The new proposal will now clearly indicate that penalties computed will be on Tax Payable less Tax already paid (including withholding tax credits).

TAX REPRESENTATIVES:

Kenya has cracked down on Non-Residents of Kenya trying to travel from the country - without fulfilling their tax obligations.
The DPO - Departure Prohibition Order has been now made to include tax representatives: including CEOs, MDs, Corporate Secretaries, Trustees etc.

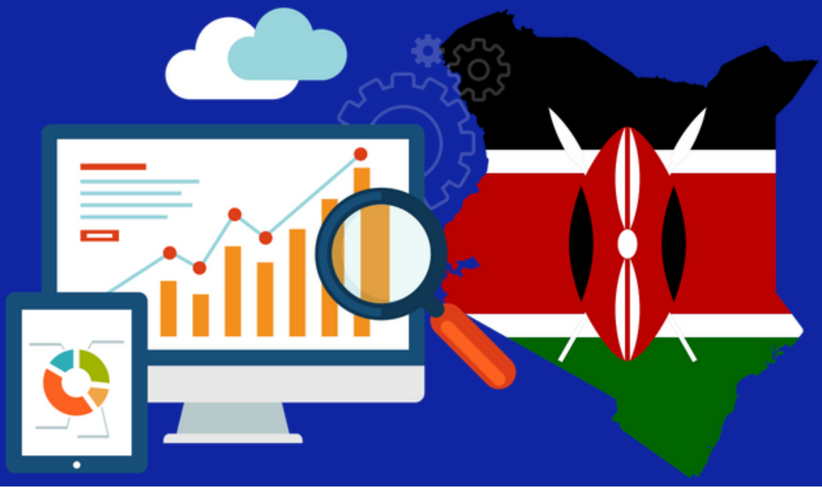
TAX DISPUTES TIMING CHANGES :

The decision made on an objection is currently within 60 days from the start of the dispute claim. However, the CS is requesting the Commissioner to extend this time frame.
KRA is wishing to reduce the intense escalations that occur due to the limited time frames.

PIN REQUIRED! :

The new proposal will see even more transactions requiring a PIN, thus allowing KRA to collect more taxes. Registering for pay bills, and till numbers along with Licencing & Professional bodies within Kenya will now require PINs.

INDUSTRY ANALYSIS



FINANCE & INSURANCE INDUSTRY

The performance of the finance and insurance industry improved in 2018 since 2017 due to interest rate capping that took place. The sector expanded by 5.6% in 2018 compared to 2.8% in 2017. Credit to the private sector expanded by 1.9% in 2018 compared to 4.1% in 2017. Interest earned by commercial banks rose from Ksh 368.2 Bn in 2017 to Ksh 379.6 Bn. This growth was driven mainly by investment in government security. Insurance activities dropped to 5.2% growth in 2018 from 6.5% in 2017. This was clear in the slowdown in the growth of gross premium income from 13.6% in 2017 to 5.3% in 2018

Given that T-bills are average for now, 2019 growth levels should be similar to that of 2018.

CONSTRUCTION INDUSTRY

There was a drop in the rate of growth in the construction industry. Growth was 8.5% in 2017, and dropped to 6.6% in 2018. The largest proportion of the growth was attributed to the SGR. The growth was shown in the increase in consumption of cement from 5856.6 million tonnes in 2017 to 5948.7 million tonnes during 2018.

Growth in the length of roads constructed slowed to 9.5% in 2018 compared to 30.6% in 2017. Currently the position of the Port of Lamu is sill unclear for many, however if successfully implemented into the economy, the construction industry can boom in its presence.

MANUFACTURING INDUSTRY

The growth in 2018 has been tremendous as compared to 2017, with the rate booming from 0.5% to 4.2%. The largest reasons being: efficient agro-processing activities & production of beverages. Sugar, liquid milk, black tea, beer and bread were the top winners of 2018, and are most likely going to be for 2019 as well - depending on weather conditions across the country.

Manufacture of cement and that of clinker declined by an average of 2.5%.

Levels of credit being given to the manufacturing sector rose from Ksh 315.5Bn in 2017, to Ksh 336Bn in 2018.

TRANSPORTATION INDUSTRY

The performance of the transport industry is highly correlated with economic activity in goods related to sectors with high turnover. Growth in 2018 was 8.8% compared to 7.2% in 2017. Creation of the SGR has severely dampened the businesses which locally transport people and goods - Although the general public is much better of. In addition to this, the sector's growth was driven by higher levels of water transport activities. Total throughput handled at the Mombasa Port increased by 2.2% from 30.3 million tonnes in 2017 to 30.9 million tonnes in 2018. Completion of Phase 2A of the SGR, and better efficiency at the ports will see even more growth in 2019/20.

TELECOMMUNICATION INDUSTRY

In 2018, data shows that mobile cellular penetration was 103.45 per 100 inhabitants. - This doesn't mean everyone in the country is connected, but that many people have more than one subscription to enjoy more offers from the companies. Safaricom (SCOM) is currently the most valuable company in Kenya, with a net valuation of >$11Bn. Most revenues are generated from M-Pesa and its cellular services. 4G connection grew from 3873 transceivers in 2017 to 7469 in 2018. Tata group, is beginning to show its true strength in Kenya, after fully updating the KRA filling systems, and it has the potential to fully expand into telcoms if it wishes.

ELECTRICITY INDUSTRY

Kenya has continued to take a steps in the right direction here. The growth of renewable energy sources pumping power into the national grid has continued to grow - a rise from 75.5% in 2017 to 86% in 2018. The rise was partly attributed to the heavy rains in 2018, and caused hydroelectricity generation to boom. A huge rise in hydro, solar, and wind caused a drop in the use of thermal sources.

KPLC remains the largest provider of energy across the nation.

Celebrating 70 Years of Professional Practice

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ANANT BHATT LLP CAVEAT

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