



Budget Brief

Kenya 2017



Economic Overview

The global economy is projected to grow at 3.4% amid concerns of the impact of certain events e.g. Brexit, US elections and China industrial transformation.

The global economy is projected to grow at 3.4% in 2017, an increase from the 3.1% growth achieved in 2016. However, a number of recent global events have cast a shadow on future growth prospects. The major changes that will impact global trade and economic growth include the election of a new government in the United States of America (USA) whose policies are inward looking. Some of the policies that the new administration is advocating include renegotiation of trade agreements deemed to be detrimental to the USA, imposition of punitive tariffs on imports from certain countries, and overhaul of climate and immigration laws. Another force that is likely to impact trade is Brexit – the decision by the United Kingdom to leave the European Union (EU). The discussions on the terms of Brexit will continue for the next two years, but its implication will cast a shadow on the EU for many years to come. The changes in the UK and the USA point to the rise of anti-globalisation and anti-immigration movements in a number of countries, a possible consequence of inequalities in the distribution of the globalisation dividend.

Other factors such as changes in China as it moves to higher value industrial production will impact global supply chains. The stagnation of primary product prices remains a major factor in subdued growth in Sub-Saharan Africa, which is projected to grow at a rate of 2.8%, a marginal increase from 1.6% in 2016. The main drivers of growth in Africa over the last decade have been the mineral and petroleum exporting countries such as Nigeria, Angola, Ethiopia and South Africa. Economic growth in these countries has been subdued following the dramatic decline in petroleum prices, dwindling mineral prices and lower than expected prices for exports of agricultural products.

The Kenya government expects the economy to grow at a rate of 5.9% in 2017. The growth is driven by massive public infrastructure projects such as the Standard Gauge Railway (SGR), expansion of the road network, investments in electricity generation and transmission projects. Other significant contributors to growth include a resurgent tourism industry and growth in transport and telecommunication. Agriculture remains a major contributor to Kenya's economy, with a share of approximately 25% of

the country's gross domestic product (GDP). However, this sector has been affected adversely by drought which is likely to negatively impact overall GDP growth. The slow-down in private sector credit which, though attributed to the capping of interest rates, started well before the interest caps took effect and is a pointer to general deterioration of the business environment.





Kenyan environment

Kenya normally presents the budget to the National Assembly in the second week of June in tandem with the other East African countries. The government presented this year's budget in March due to the expected dissolution of parliament in preparation for the general elections in August. The theme for the 2017/18 budget is **“Creating jobs, delivering a better life for all Kenyans”** perhaps in response to concerns that many of the country's citizens have not shared in the country's economic growth and prosperity.

The 2017/18 budget is the last one in the first term of the current administration. The Cabinet Secretary took time to present a scorecard of the administration's achievements, possibly with an eye on the upcoming elections. Achievements highlighted include improvement in the business climate, investment in infrastructure, rebound in tourism, increase in electricity connections and equipping of hospitals with specialised medical equipment.

In an apparent tribute to the budget theme, the Cabinet Secretary proposed tax incentives to:

- Support growth and domestic production;
- Reduce income inequality;
- Promote job creation;
- Improve tax administration and compliance; and
- Enhance social security and welfare.

Below are some of the highlights from the budget statement:

Biashara chap chap

The government is keen to build on the gains made in enhancing the ease of doing business. Over the last three years, Kenya's ranking in the World Bank's Ease of Doing Business index has improved by 44 places and in 2016 Kenya was among the best reformers globally. The rise in ranking is attributable to reforms that ease access to credit, making it easy to start businesses and introduction of e-government services all of which have reduced costs and increased accessibility.

In an effort to sustain the successes achieved, the government plans to introduce a one stop centre (OSC) for investors while creating an investor friendly website with details of regulations and available investment opportunities.

Moving around gets faster

One of the current government's major achievement has been infrastructural development. This financial year, the government will complete Phase 1 of the SGR and commence Phase II, which will connect the seaport of Mombasa to the proposed inland container depot and industrial park at Naivasha. Other major projects include expansion of roads within Nairobi to ease traffic congestion, investment in the LAPSSET Project and upgrading of airstrips in different parts of the country. However, significant cost overruns occasioned by delays in project

completion remain a major point of concern.

Utumishi kwa Wote, enabling police to serve

The government has made significant investments in the security sector with the number of policemen increasing by 20,000 to 98,732 over three years to reach a ratio of 1 policeman to 400 citizens. This is better than the United Nations recommended ratio of 1 policeman to 450 citizens. Investments have included acquisition of 3,208 police service vehicles under a vehicle leasing scheme, investments in medical insurance schemes and acquisition of modern equipment for the forces.

Further investments in the year will go towards the construction of a National Forensic Laboratory, construction of a fence on the border with Somalia and additional houses for the police.



Living within our means

A significant portion of the government budget is allocated to recurrent expenditure with salaries and allowances taking a lion's share. The Salaries and Remuneration Commission has completed a job evaluation survey which will form the basis for the harmonization of public sector salaries. The government has indicated that it will implement salary reductions for state officers effective 1 July 2017. It will be interesting to see how this proposal pans out given the recent rise in industrial action by workers from different sectors seeking improvements in their terms of service.

Creating jobs for a farming nation

One proposal for creation of jobs is the promotion of industries that have the highest capacity to create employment. The government has identified the leather and textile sectors as the priority areas for investment. Another proposal includes increased incentives for investors in the Special Economic Zones (SEZs) as well as the automotive assembly.

The government, appreciating that agriculture accounts for almost 25% of the country's GDP, will invest more in the national irrigation schemes, provide subsidised fertilizer and seeds to farmers, fund livestock insurance schemes, digitize land registries and mechanise agriculture.

A better life

In a bid to reduce poor drainage and environmental degradation caused by improper disposal of plastic bags, Kenya has banned the use, manufacture or importation of all plastic bags for commercial and household packaging beginning September 2017.

With a promise to unveil a comprehensive housing package, the government hopes to encourage the private sector to invest in low cost housing. Kenya Police and Prisons staff will have an additional 1,500 housing units constructed.

Water scarcity continues to bite. With an allocation of KES 36.7 billion for water resource management, water and sewerage infrastructure development, dam construction, national water harvesting and ground water exploitation, water provision is expected to be brought under control.

Financial services, an industry in flux

The financial services sector plays an important role in the economy, with over 75.3% of the population now having access to financial services. In the past, the sector has faced turbulence resulting in some banks going under statutory management while others have merged with larger rivals to survive. One of the biggest challenges facing the industry is the introduction of legislation capping interest rates, a move that is now associated with the reduction in credit to the private sector. Other initiatives include legislative provisions to position Nairobi as a financial hub in the region and promotion of Islamic financial products as an alternative source of funding.

Investing in Mwananchi

The government is speeding up the implementation of the Education Information Management System to ensure education data in the country is accurate, up to date and available. The government has also increased budgetary allocation for hiring additional teachers, provision of sanitary towels, waiver of fees for day primary and secondary schools and the school feeding programme.

The government seeks to improve health service delivery in government hospitals through provision of specialized equipment and manpower. In addition, the cash transfer programme has been enhanced to fully cover persons above the age of 70 years. Senior citizens will now receive a monthly stipend and NHIF cover paid for by the government.



Income Tax

After a long wait for changes in PAYE bands the government has for the second year in a row, proposed to expand the band by a further 10%

On a roll...A smile for the employees!

For the second year in a row, the Cabinet Secretary has proposed to expand PAYE bands by a further 10%. This follows an expansion of the bands by a similar margin in the last budget with an effective date of 1 January 2017. This is a welcome move especially given that it had previously taken 12 years since the bands were last expanded.

Hopefully, this trend will continue as we play catch-up with the annual rate of inflation.

With effect from 1 January 2018, the new PAYE bands will be as follows:

New Tax Band (KES)	Old Tax Band (KES)	Rate
First 147,580	First 134,165	10%
Next 139,043	Next 126,403	15%
Next 139,043	Next 126,403	20%
Next 139,043	Next 126,403	25%
Over 564,710	Over 513,374	30%

Similarly, the personal relief has also been increased by a 10% from KES 15,360 p.a. to KES 16,896 p.a.

Following from these proposed changes, the lowest taxable income will increase from KES 12,260 p.m. to KES 13,486 p.m.

The expansion of tax bands and increase in personal relief, albeit modest, will marginally lower the PAYE tax burden and increase the take home income for employees. This may marginally improve their purchasing power.

Last call to bring foreign earned income back home!

During the previous budget, the Cabinet Secretary provided a tax amnesty for 2016 and prior years of income on principal taxes, penalties and interest for those who would repatriate assets and income to Kenya provided that the taxpayers submit their returns and accounts for the year of income 2016 by 31 December 2017.

The taxpayers willing to take advantage of the amnesty should now exercise their right by 30 June 2018.

The Cabinet Secretary mentioned that the Kenya Revenue Authority (KRA) is expected to issue guidelines to operationalise the tax amnesty. However, the KRA has since issued tax amnesty guidelines on foreign income which came into force on 1 January 2017.



Aging gracefully

The Cabinet Secretary has proposed to enhance National Safety Net Programme through the cash transfer programme to incorporate National Hospital Insurance Fund (NHIF) cover for senior citizens aged 70 years and above. This is a welcome move as it will go a long way in cushioning them against their ever escalating health bills and hopefully free funds to improve their quality of life.

Meanwhile, the existing programme for old persons over 65 years and people with disability will continue.

“The taxpayers willing to take advantage of the amnesty should now exercise their right by 30 June 2018.”

Corporate Tax

There is a deliberate effort to develop marine fishing, motor vehicle assembly and special economic zones.

The ocean... an economic force to reckon with!

The Blue economy, which involves the exploitation of the sea resources for sustainable economic development, has been termed as Kenya's next frontier.

As an incentive to boost this sector which covers marine, fisheries and fish processing, the government proposes to provide investment deduction at 150% on capital expenditure incurred by investors. Previously, items such as boats and ships would obtain a wear and tear deduction at the rate of 12.5% while ships of above 125 tons and machinery for the processing would get investment deduction at 100%.

In addition to reviewing of the National Oceans and Fisheries and National Aquaculture policies, this government incentive will go a long way in strengthening the maritime sector.



Special Economic Zones – It just got better!

The government proposes to provide SEZ enterprises with investment deduction at 100% on buildings and machinery within the first year of utilisation.

This will go a long way in meeting the SEZ objectives to attract investment and a departure from the emphasis in previous years on the promotion of manufacturing as the sole engine of growth.

The SEZ regime seeks to promote retail and wholesale trade, back office services, tourism and ICT, together with manufacturing as the engines of growth into the future. This proposition will see investors in the SEZ obtain investment deduction at 100% on buildings which ordinarily would attract industrial building allowance of 10%.



New life line for the motor assemblers

New motor vehicle assemblers in Kenya will now enjoy a reduced corporation tax rate of 15% down from the standard rate of 30% for the first five years of operation.

This is a welcome move, especially with the recent motor vehicle assemblers coming into Kenya. The reduced corporation tax rate of 15% is expected to enhance investor returns and increase job opportunities for Kenyans. Although the Cabinet Secretary spoke of 'new motor vehicle assemblers' it will be interesting to see if the existing motor vehicle assemblers will enjoy this incentive.

Kenya is open for investment

The Special Economic Zone (SEZ) Act came into operation on 14 December 2015. The regime provides incentives touching on ease of setting up, investment and investor protection, simplified tax regime, and favourable labour regulations among others.

To promote the uptake of investment in this sector particularly by non-resident persons, the CS has proposed additional tax incentives.

Specifically, dividends payable to non-residents by SEZ enterprises will be exempt from withholding tax currently chargeable at 10%. Further, withholding tax on interest payable to non-residents by SEZ enterprises will be reduced from 15% to 5%.

The primary objective of the proposed tax incentives is to attract foreign direct investment into the SEZs, expand the local economy and increase employment opportunities.

End of an Era?

The on-going tax reforms and modernization of the tax laws have led to the introduction of new Tax Acts or overhaul of existing ones. The current Income Tax Act which was enacted in 1974 has undergone various amendments over the years. To reap the full benefits from these initiatives, the CS has also proposed to roll out the revised Income Tax Bill which will be aligned to international best practice. It will also be aimed at expanding the tax base, reduce the cost of tax compliance and ensure certainty.

The amendment Tax Bill will reflect contributions by the various stakeholders in line with the Constitutional requirement for public participation.

We anticipate that the review will have proposals addressing various income tax issues such as capital gains tax and compensating tax. The proposed Act may also deal with the taxation of pensions, extractive industries and cross-border transactions.

Charity begins in Kenya

Kenyans are generally a generous lot and readily donate especially where disasters are concerned. The government encourages such donations by allowing them for tax purposes upon meeting specified criteria.

Encouraged by this spirit especially during the ongoing drought, the CS declared donations to alleviate distress during national disasters declared by the President, will be tax allowable. These donations will however need to be channelled through the Kenya Red Cross, the County government or any other institutions responsible for managing national disasters.



The proposed Act may also deal with the taxation of pensions, extractive industries and cross-border transactions.

Value Added Tax



A fickle smile?

The clearest sign that this is a pre-election budget is perhaps the zero rating of ordinary bread and maize flour in what is seen as a move to cushion the electorate against the rise in the cost of living.

The exemption was first introduced in 2014 and the government has finally gone the full cycle on what is arguably the most effective way of reducing the cost of production. It remains to be seen whether the manufacturers of these products will pass on this benefit to consumers through reduction of the cost of these commodities.

Relentless efforts to revive the tourism industry

The CS has proposed to exempt from VAT locally assembled tourist vehicles as an incentive to promote the tourism sector. The gains from this proposal are two-fold: encouraging local assembly industry and boosting the tourism sector.

It is expected that this move will eventually yield more jobs in the motor vehicle and tourist sector.

Saying no to weevils

Food security is the backbone of any stable economy. There have been instances of destruction of harvested products by pests.

To alleviate this problem and in a bid to boost food security, the government has proposed to exempt from VAT all inputs used in the manufacture of pesticides.

Healthcare upgrade ... reloaded

In 2016, the CS exempted from VAT taxable goods used for construction of specialized hospitals with accommodation facilities. To encourage continued investment, the CS has proposed to extend the VAT exemption to medical equipment and apparatus used in specialized hospitals.

We hope this incentives will translate to quality health care to the ordinary Kenyan.

Encouraging REITS

The transfer of assets into Real Estate Investment Trusts (REITs) and Asset Backed Securities (ABS) is now exempt from VAT.

The incentive aims at revolutionizing the capital markets as well as the property market through creation of attractive investment environment. Hopefully, this will encourage an investment culture by the ordinary citizen.

The wait continues, three years and counting...

The VAT Act, 2013 has partly been operationalised by the regulations under the repealed VAT Act on a transition basis.

This long wait may soon be over with the CS promising to release the VAT Regulations to VAT Act, 2013 in the near future. Hopefully, this will not be another long wait.

Blue economy

In an effort to revamp the marine and fish processing industry, the CS has proposed to exempt from VAT packaging materials and other inputs intended to support primary, secondary and ancillary marine fisheries and fish processing.

The proposal, if adopted, will definitely boost the fish processing industry in Kenya in general and specifically along the country's coast line which is endowed with expansive fishing resources.



Custom & Excise Tax

Kenya is part of the EAC that uses the Common External Tariff. We expect these changes will be determined by the East African Community Ministers of Finance in May 2017.

Customs duties

Feeding the masses

The price of basic commodities including food stuff has in the last few months increased to unprecedented high levels. This has largely been attributed to the current drought in the Country. The CS has proposed to cushion an import duty break on imported maize.

To our Muslim brothers and sisters, import of dates during the Holy month of Ramadhan will also enjoy an import duty break.

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Excise duties

A fresh coat of paint!

Registered manufacturers of paints and resins have a reason to smile.

The CS to the National Treasury has proposed to amend the Excise Duty Act to permit refunds on excise duty paid on Illuminating Kerosene, a key ingredient in paints and resins.

We expect these changes to make Kenya's construction paints industry more competitive.

County governments will also have another reason to enforce a requirement that building owners give their buildings a new coat of paint every so often!

Excise duty stamps – spot the difference

Currently, excise duty stamps cost KES 1.50 irrespective of the final cost of the excisable product. In order to eliminate the inherent inequity in this pricing, the CS proposes to gazette rates between KES 0.50 and KES 2.50 that will be aligned to the cost of the product.

Although the operationalisation of this proposal is not clear yet, we expect that the excise stamps will adopt bands based on the prices of the products.

Boozers...losers...and the mixed bag of fortunes

Beer manufactured from cassava, millet or sorghum previously enjoyed excise duty remissions but these were repealed in 2016, thereby negatively impacting affordability of drinks perceived to be within the reach of common man. The 80% excise duty remission proposal on these beers will no doubt see the ordinary mwananchi enjoying his tippie once again.

Effective 1 July 2017, the CS has also proposed a 15% increase in excise duty rates on spirits, from KES 175 to KES 200 per litre.

The CS also indicated that KRA would soon publish inflation adjusted excise duty rates and hence the joy expressed by consumers of beers will be short-lived come July 2017.

A cigarette break

Equity was a prevalent theme in the 2017/18 budget – from excise duty stamps to tax breaks.

In a move to enhance equity, the CS has proposed to introduce a two tier tax system that will see a decrease in the excise tax for cigarettes without filters from KES 2,500 to 1,800 per mille.

Thus, smokers can puff a little more for a little less.

In addition, this reduction will act as a minor reprieve to the embattled tobacco industry.

Key changes in customs and excise rates:

	New	Old
Illuminating Kerosene for use in paints and resin manufacture	Refund of Excise Duty of KES 7,205 per 1000L@20°C	KES 7,205 per 1000L@20 °C non refundable
Beer manufactured from local raw materials (excluding barley)	80 % remission of Excise Duty of KES 100 per Litre	KES 100 per Litre
Spirits	KES 200 Per Litre	KES 175 per Litre
Cigarettes without a filter	KES 1800 Per Mille (Plain Cigarette	KES 2,500 per Mille
White maize	25% duty suspended for four months	25%
Dates	25% duty suspended during Ramadhan	25%



Miscellaneous

Huduma Centre for investors

Building on the e-governance momentum and in a move to spur investment in Kenya, the government will establish online platforms such as e-opportunities and e-regulation to provide information for investors seeking investment opportunities in Kenya.

In addition, the government will set up a One Stop Centre (OSC) by April 2017 to provide services to investors under one roof, significantly reducing the hurdles that investors face when setting up businesses.



County finance – a road map at last!

While devolution has opened opportunities across the country it has brought with it a number of challenges such as the introduction of numerous levies and regulations which are making it difficult for businesses to operate. The CS has pledged to put in place legislative provisions to guide County governments in their revenue raising initiatives.

Article 209 of the Constitution of Kenya limits the sources of revenues for county governments to property rates, entertainment taxes and charges for services. It will therefore be interesting to see what proposals the CS comes up with to drive higher revenue collections in counties.

Who's holding the purse strings?

Prudent resource and expenditure management has been a real challenge given the more than 100 ministries, departments and agencies (MDAs) with each operating its own bank account. To address this and optimize funding priorities, the government intends to operationalize the Treasury Single Account (TSA) starting July 2017. This now means that all government expenditure will be controlled from a single account, with sub-accounts for the different MDAs

Once operational, we expect that MDAs that had term deposits with financial institutions will reduce these holdings, perhaps with a knock on effect on the cost of funds for the banks. In addition to curbing corruption and wastage, the TSA will enhance value for money and efficiency in government expenditure.

Regulation keeping pace with commerce in insurance

Recent changes in the insurance industry, particularly with demerger of composite insurers, enhanced capital requirements and the uptake of bancassurance, have forced insurance sector players to merge into groups. In a clear example of regulation trailing commerce, the CS has proposed to amend the Insurance Act to introduce regulations for the proper supervision of insurance groups.

Following the perpetual licensing of banks in 2015 and institutions licensed under the Retirement Benefits Authority in 2016, the government has roped in insurers who will now also enjoy perpetual licenses. Insurance intermediaries including insurance brokers and loss assessors will however not enjoy this perpetual license.

We expect these changes to complement the risk-based supervision model, encourage further consolidation of the sector and enhance efficiencies whose benefits should trickle down to the common man.

Toe the line

The Public Procurement and Asset Disposal Act, 2015 (PPADA), which came into force in January, 2016 has not been successful as expected in fighting corruption in public procurement. Effective this year, private sector suppliers dealing with National and County governments have obligations to give effect to the key principles of integrity, transparency and accountability required of government officials.



This proposal is complemented by the Treasury Single Account, and if well implemented will drive efficiencies in procurement and value for money.

Interest caps, a case of unintended consequences?

The capping of credit was intended to stimulate expansion of cheap credit to the private sector as one way of spurring economic growth. However, the latest statistics point to a slowdown in private sector credit.

The government has proposed to engage stakeholders to assess the impact of the interest-rate capping law. This assessment will inform any intervention measures that may need to be taken to ensure that credit expansion continues in order to spur economic growth.

Credit on the move

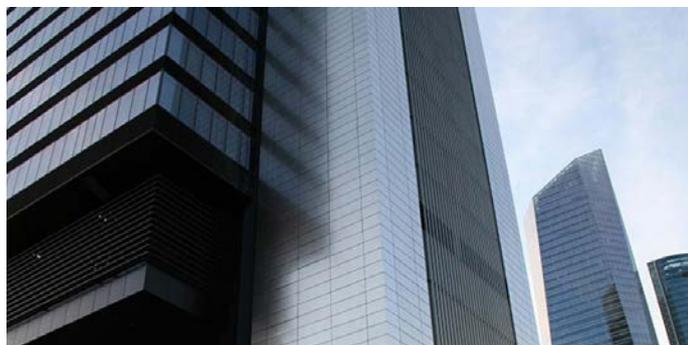
Prior to the interest rate caps, the risks in unsecured lending were mitigated through high interest pricing. However, under the interest rate cap regime, unsecured lending has become unattractive for most lenders. In a bid to address this gap and expand access to credit, the government has proposed to finalise the Movable Property Security Rights Bill, 2016.

Once passed by parliament, the Act will facilitate borrowing using movable assets as securities. This should drive credit expansion and support economic growth. Taking lessons from the Limited Partnership Act, which did not have supporting administrative framework such as the Registry, it will be important for the necessary infrastructure to be put in place in order to reap the benefits early.

Islamic financing now mainstreamed

Islamic financing is a major and attractive source of development expenditure funding. In order to facilitate access to Shariah financing, government has proposed to amend the Capital Markets Act, the Cooperatives Societies Act and SACCO Societies Act.

These changes speak to an evolving and increasing competitive financial market in which innovation will be key to survival.



Levelling the ground

In an economy where the biggest spender is government, if one is not doing business with government, then one is not in business. Recognizing the competitive nature of public procurement, the public procurement policies provide for Preference and Reservations Clauses that offer disadvantaged groups opportunities to participate in public

procurement without discrimination.

This was aimed at promoting the local industries and enhancing participation by disadvantaged groups in public procurement.

In order to further enhance this access, the government proposes to establish the Preference and Reservation Secretariat to advance the interests of youth, women, people with disabilities and other disadvantaged groups in public procurement. This proposal resonates with the 2017/18 budget theme of **“creating jobs, delivering a better life for all Kenyans.”**

Mkenya daima

Kenya has registered impressive economic growth rates of more than 5%, outperforming Sub-Saharan Africa by a factor of 3. A significant driver of Kenya’s economic growth has been the massive investments in infrastructure projects including the Standard Gauge Railway and port expansion.

By proposing a 40% local content requirement for supplies used in these projects, the government is facilitating broad participation. This incentive is designed to spur SME participation and drive employment, living up to the mantra Buy Kenya, Build Kenya.

Chasing the investment dollars

The government has proposed to amend the Miscellaneous Fees and Levies Act to exempt Special Economic Zones Enterprises from export duty and Import Declaration Fees.

While these measures are meant to reduce the cost of doing business, attract foreign direct investment, position Kenya as a premier business hub and increase employment opportunities, they may be a duplication as SEZs already enjoy these tax incentives.

Heads or tails?

With jackpot prizes of more than KES 100 million, the gaming industry has burst into the limelight. The government is certainly not snoozing! The general perception is that betting and gaming have become widespread in an environment that is inadequately regulated.

Although not employing the traditional sin tax, the government proposes to raise taxes for betting, lottery, gaming and competition from the current rates of 7.5%, 5%, 12% and 15% to a uniform tax rate of 50%. The gaming tax proceeds will be put into the newly created National Sports, Culture and Arts Fund to support development of sports, culture and arts in Kenya.

Whilst the increase is steep and the detail will be in the Finance Bill, an immediate question that arises is whether this 50% tax will be in addition to the normal corporation tax. Whichever way this goes, it will be interesting to see the reaction of the sector players.

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