TAX HIGHLIGHT BULLETIN

2018 BUDGET STATEMENT

The Cabinet Secretary to the National Treasury, Mr. Henry Rotich (**"CS"**) presented the budget statement for the fiscal year 2018/2019 on 14 June, 2018 which focused on the four key strategic areas known as the "The Big Four Plan". Under the Big Four Plan, the Government targets to boost manufacturing activities, enhance food and nutrition security, achieve universal health coverage and support the construction of at least 500,000 affordable houses by 2022.

In the budget statement the CS proposed a number of taxation measures to be introduced through the Finance Bill 2018 that are intended to realize these objectives. What is clear however is that the proposed tax measures are mainly geared towards generating revenue to fund the Big Four Plan and taxpayers will inevitably feel the pinch.

One of the key non-tax amendments that the CS proposed is the repeal of section 33B of the Banking Act which capped interest rates on loans issued by banks and also imposed a minimum rate of interest on interest earning deposit accounts. The reasons given by the CS for repealing section 33B is that financial access and economic growth have been adversely impacted.

We now provide an analysis of the key amendments highlighted in the Budget Statement. The proposals made in the budget speech may be varied by Finance Bill 2018 and we shall provide a further update on any changes made by the Finance Bill once it has been published.

INCOME TAX

The CS stated that the draft Income Tax Bill ("Draft Bill") had undergone public participation and was being finalized with the aim of being tabled in Parliament by the end of July 2018. He announced that following concerns raised by members of the public, the higher tax band of 35% on employment income above Kshs.750,000 per month and the increase of capital gains tax from 5% to 20% that had been proposed in the Draft Bill would be excluded from the Bill to be submitted to parliament. This would obviously be a welcome relief for taxpayers unless parliament, in its own wisdom, decides to reinstate it.

The Draft Bill proposes a raft of changes to the Income Tax regime many of which will have significant implications for taxpayers and the economy. It also presents an opportunity to remedy problems that exist within the current Income Tax Act. We therefore hope that Parliament will allocate sufficient time to interrogate the Bill and seek to understand the implications of every provision, listen to stakeholder concerns and proposals and proceed soberly before passing the Bill. The devil is in the detail and should parliament hurriedly pass the Bill, it is more than likely that we will end up with unintended and unwanted consequences that may end up being punitive to the taxpayer and therefore counterproductive to the overall desired objective.

The following are the key proposed amendments to the Income Tax Act, whose date of effect will be communicated in Finance Bill 2018, once published:

- a presumptive income tax for SMEs to replace Turnover Tax regime. The applicable tax rate will be 15% of the business permit or trading license fees payable;
- manufacturers shall be allowed a further tax deduction of 30% of their electricity bills, subject to conditions to be set by the Ministry of Energy. This will correspondingly enhance returns for eligible manufacturing entities;
- withholding tax at the rate of 20% on demurrage paid to non-resident shipping lines;
- general insurance businesses to pay capital gains tax on transfer of property;
- 5% withholding tax to apply on insurance premium paid to non-resident persons, save for premium paid for insurance of aircraft.

CUSTOMS DUTY

The CS stated that in the East Africa Community ("**EAC**") pre-budget consultations, it was agreed that customs duties aimed at promoting industrialization, encouraging local investments and creating incentives in the local agricultural and manufacturing sectors would be adopted. The agreed measures which will be communicated through the EAC gazette and implemented as from 1st July 2018 (**"Effective Date"**), will also make products produced within the EAC more competitive while at the same time protecting local industries from unfair competition.

The CS indicated that the EAC Common External Tariff and the EAC Customs Management Act, 2004 were undergoing review with a view to achieving these objectives and to enhance efficiency in customs administration. The key proposed changes include the following:

- import duty on a wide range of iron ore and steel products to be increased to 35%;
- import duty on some paper and paper board to be increased to 35%;
- import duty on textiles and footwear to be charged at the rate of USD 5 per unit or 35% of the import value whichever is higher;

- import duty on timber will from the Effective Date be charged on the higher of 35% of the import value or;
    - USD110 per MT for particle board;
    - USD 120 per MT for medium density fibre board;
    - USD 230 per M^3 for plywood; and
    - USD 200 per MT for block boards.

- import duty on vegetable oil shall be charged at USD 500 per MT or 35% of import value whichever is higher;

- raw materials and input for manufacture of pesticides shall enjoy remission under the import duty remission scheme. This will make the price of pesticides manufactured in Kenya more competitive;

- import duty exemption shall be introduced for sightseeing buses and overland trucks imported by licensed tour operators; and

- 100% duty remission shall apply for inputs and raw materials for use in assembly of clean energy cooking stoves.

VALUE ADDED TAX

The CS proposed to exempt certain inputs used in the assembly, manufacture or construction of certain products. The proposed changes highlighted, whose date of effect will be communicated in the Finance Bill 2018, once published, are as follows:

- exemption from VAT on parts imported or sourced locally for assembly of computers;
- exemption from VAT on raw materials for manufacture of animal feeds; and
- exemption from VAT on equipment used in construction of food storage facilities.

There is, however, a significant issue for VAT that did not come up in the CS' budget statement. This is the introduction of VAT on fuel products with effect from 2 September 2018. This amendment was introduced in 2013 when the VAT Act, 2013 was enacted. It contained a provision that fuel products which were exempt would remain exempt but only for three years after which they would be subject to VAT at the standard rate of 16%. The three years was to lapse in September 2016 but by an amendment introduced by Finance Act 2016, the exempt status was extended for a further period until 1st September 2018.

Consequently, on 2nd September this year, fuel will be subject to 16% VAT which will significantly increase the price at the pump with consequential multiplier effects including increase in transport costs. The CS budget statement presented the last opportunity, other than an intervention by Parliament, for fuel products to remain exempt.

EXCISE DUTY

The following are the key changes proposed to be made to the Excise Duty Act:

- increase of excise duty rate on private passenger motor vehicles whose engine capacity exceeds 2500cc for diesel powered vehicles and 3000cc for petrol powered vehicles from 20% to 30%;
- increase of excise duty on illuminating kerosene from Kshs. 7,205 to Kshs. 10,305 per 1,000 litres to curb instances of fuel adulteration;
- robin-hood tax of 0.05% for transfer of funds above Kshs. 500,000 by financial institutions;
- excise duty on mobile money transfer service to be increased from 10% to 12%.

The extra revenue realized from charging excise duty on money transfer services is to be used to fund Universal Health Care which is one of the pillars of the Big Four Plan.

TAX PROCEDURES ACT

The following are the key amendments proposed to be made to the Tax Procedures Act:

- the deadline for declaring taxable income relating to foreign sources and repatriating the same back to Kenya in order to enjoy tax amnesty shall be extended from 30th June 2018 to 30th June 2019. Further, the amnesty period shall be extended to cover up to December 2017. To encourage uptake of the amnesty provisions, funds repatriated shall be exempt from the provisions of the Proceeds of Crime and Anti-money Laundering Act or any other Act relating to reporting and investigation of financial transactions. This exemption, however, will not extend to proceeds from terrorism, poaching or drug trafficking. This is a curious proposed legislative intervention and policy shift by Government as it has the effect of sanitizing proceeds of crimes apart from the 3 excluded crimes. Arguably therefore, if this proposal is adopted, it would be possible to repatriate back proceeds of corruption under the amnesty framework. It would be interesting to watch how development partners including DFIs who typically adopt a very strict attitude towards proceeds of crimes would respond to this intervention;

- late payment interest under the Tax Procedures Act shall be increased from 1% to 2%. A late payment penalty of 20% shall also be introduced in the Act. The penalty chargeable for late filing of individual tax returns shall be reduced from Kshs. 20,000 to Kshs. 2,000; and

- the Tax Procedures Act shall be amended to provide the timelines for application for extension of filing of returns and amendment of self-assessment returns.

MISCELLANEOUS

The following amendments to other statutes have been proposed:

- amendment to repeal Section 33B of the Banking Act to remove the capping of interest rates on loans to enhance access to credit and strengthen financial access and monetary policy effectiveness;

- amendment to the Employment Act to provide for both the employer and employee to each contribute 0.5% of the employee's gross monthly pay, subject to a maximum of Kshs 5,000, to the National Housing Development Fund;

- amendment to the Betting, Lotteries and Gaming Act to introduce 20% penalty and 2% per month interest on late payment of tax under the Act; and

- amendment to the Miscellaneous Fees and Levies Act to introduce export levy of 20% on export of copper waste and scrap.