KENYA BUDGET NEWSLETTER

2021 – 2022

THE POWER OF BEING UNDERSTOOD
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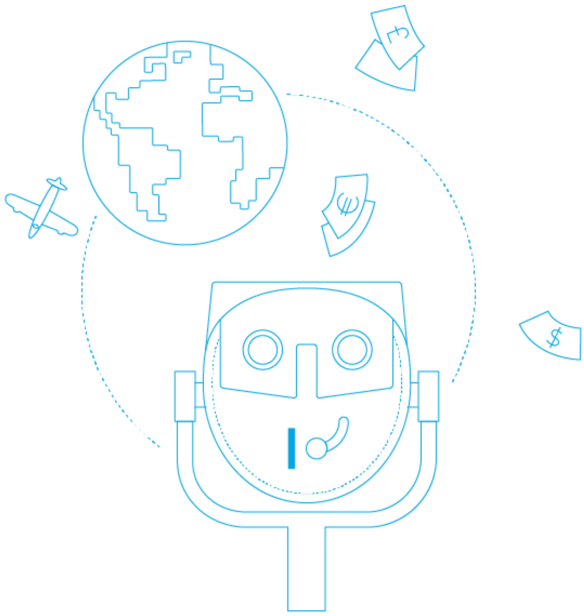
CONTENTS

ECONOMIC PERFORMANCE

GLOBAL ECONOMIC HIGHLIGHTS

- It has been one year since COVID-19 was declared a global pandemic, a year of significant social and economic turmoil. Yet, despite high uncertainty about the path of the pandemic, a way out of this crisis is becoming increasingly visible.
- Multiple vaccines have reduced the risk of the need for critical care, while adaptation to the pandemic life has enabled the global economy to do well despite subdued overall mobility, leading to a stronger-than-anticipated rebound.
- Stronger fiscal support in some advanced economies (especially the United States) has further improved the overall economic outlook.
- The IMF, in estimates released in April 2021, is now projecting a stronger recovery in 2021 and 2022 for the global economy, with growth expected to be 6% in 2021 and 4.4% in 2022 (after an estimated contraction of 3.3% in 2020). Among advanced economies, the United States is expected to surpass its pre-COVID GDP level in 2021 while others will return to pre-COVID levels only in 2022.
- Among emerging markets and developing countries, China had already returned to pre-COVID GDP in 2020, whereas many others are not expected to do so well into 2023.
- Recovery paths among countries remain divergent. Cumulative per capita income losses over 2020-2022, compared to pre-pandemic projections, are equivalent to 20% of 2019 per capita GDP in emerging markets and developing economies (excluding China). This has reversed gains in poverty reduction, with an additional 95 million people expected to have entered the ranks of the extreme poor in 2020, and 80 million more undernourished than before.



- Future economic outlook depends not just on the effect of vaccines on caseloads but also on the effectiveness of economic policies deployed across the globe and the evolution of financial conditions and commodity prices.
- Consistent with the projected global recovery, oil prices are projected to grow 30% in 2021 while metal prices are projected to accelerate strongly in 2021, largely due to the economic rebound in China. Food prices are also expected to pick up this year.

REAL GDP GROWTH (%)	2016	2017	2018	2019	2020*	2021*	2022*
Advanced economies	1.8%	2.5%	2.3%	1.6%	-4.7%	5.1%	3.6%
Japan	0.8%	1.7%	0.6%	0.3%	-4.8%	3.3%	2.5%
UK	1.7%	1.7%	1.3%	1.4%	-9.9%	5.3%	5.1%
USA	1.7%	2.3%	3.0%	2.2%	-3.5%	6.4%	3.5%
Euro Area	1.9%	2.6%	1.9%	1.3%	-6.6%	4.4%	3.8%
Emerging and developing Asia	6.8%	6.6%	6.4%	5.3%	-1.0%	8.6%	6.0%
China	6.9%	6.9%	6.7%	5.8%	2.3%	8.4%	5.6%
India	8.3%	6.8%	6.5%	4.0%	-8.0%	12.5%	6.9%

*Forecast
Source: IMF

SUB-SAHARAN ECONOMIC HIGHLIGHTS

- In the emerging market and developing economies, vaccine procurement data suggests that effective protection will remain unavailable for most of the population in 2021 - which increases the risk of lockdowns and other containment measures in these economies in 2021 and 2022.
- Tourism based countries face particularly difficult prospects considering the expected slow mobilization of cross-border travel over the medium term. Despite the global recovery, global travel remains subdued, and tourist inflows into Africa are not expected to return to pre-pandemic levels until 2023.
- The pandemic continues to have a significant impact on sub-Saharan Africa. Following the largest contraction ever for the region (-1.9% in 2020), growth is expected to rebound to 3.4% in 2021, significantly below pre-pandemic expectations.
- The recovery in advanced economies will be driven in large part by the extraordinary level of policy support, including significant fiscal stimulus and continued accommodation by central banks. For countries in sub-Saharan Africa, this is not generally an option. Most countries within the region entered the second wave with depleted monetary and fiscal buffers.
- Consequently, IMF estimates indicate that sub-Saharan Africa is expected to be the world's slowest growing region in 2021. The region is expected to grow 3.4% in 2021, supported by improved exports and commodity prices, along with a recovery in private consumption and investment. However, per capita output is not expected to return to 2019 levels until after 2022.
- The current outlook is subject to greater-than-usual uncertainty — sub-Saharan Africa could face repeated COVID-19 waves before vaccines become widely available. Other key risks include the availability of external finance, political instability, and the return of climate-related shocks such as floods or droughts.
- Seventeen countries within the region were either in debt distress or at high risk of distress in 2020 (one more than before the crisis). These countries represent about 25% of the region's GDP and 17% of the region's debt stock.

- IMF estimates show that sub-Saharan Africa's low-income countries face additional external funding needs of $245 billion over 2021-2025, to help strengthen the pandemic response.
- Employment within the region fell by about 8.5% in 2020, with more than 32 million people thrown into extreme poverty.
- The second half of 2020 also saw a surge in prices for many staple crops, reversing an earlier decline over the first months of the pandemic, with some regions experiencing food price spikes and increased food insecurity (Burkina Faso, Democratic Republic of the Congo, Mali, Niger, Zimbabwe).

REAL GDP GROWTH (%)	2016	2017	2018	2019	2020*	2021*	2022*
Sub-Saharan Africa	1.5%	3.1%	3.2%	3.2%	-1.9%	3.4%	4.0%
Nigeria	-1.6%	0.8%	1.9%	2.2%	-1.8%	2.5%	2.3%
South Africa	0.4%	1.4%	0.8%	0.2%	-7.0%	3.1%	2.0%
Kenya	5.9%	4.8%	6.3%	5.4%	0.6%	6.6%	5.7%
Tanzania	6.9%	6.8%	7.0%	7.0%	1.0%	2.7%	4.6%
Ethiopia	8.0%	10.2%	7.7%	9.0%	6.1%	2.0%	8.7%
Uganda	0.3%	7.3%	6.0%	8.0%	-2.1%	6.3%	5.0%

*Forecast
Source: IMF

KENYA ECONOMIC HIGHLIGHTS

- The economy began to recover in the second half of 2020, as economic activity picked up following easing of the various containment measures implemented by the Government to curb the spread of COVID-19.
- Real GDP contracted by 1.1% in the third quarter of 2020, compared to a 5.8% growth in the third quarter of 2019. The economy is expected to grow by a modest 0.6% in 2020, before growing at 6.6% in 2021.
- The easing of domestic and international COVID-19 containment measures led to increased activity in sectors such as transport and storage, information and communication and real-estate. However, recovery remained slow in sectors such as accommodation & restaurant, education, and wholesale & retail trade.
- Leading economic indicators for 2021 point to a recovery in industrial activity and continued strong performance of the agriculture sector. However, downside risks to growth remain significant, including protracted waves of infections leading to widespread and prolonged lockdowns, an uneven recovery within the global economy and rising oil prices.
- Overall inflation remains anchored within the Government's target range, supported by lower food prices and muted demand pressures. The 12-month inflation rate was 5.8% in April 2021, up from 4.8% in October 2020. The increase in inflation was largely due to higher fuel prices and the impact of tax relief reversals in January 2021. Non-food, non-fuel inflation remained stable.
- The current account deficit narrowed to 5.2% of GDP in the 12 months to April 2021, down from 5.6% in April 2020, while foreign exchange reserves stood at 4.69 months of import cover at the end of April 2021.

- Estimates included in the Budget Policy Statement, 2021, indicated that Kenya's external debt is expected to increase to KShs. 8.6 trillion in the FY 2021/22 fiscal year (69.3% of nominal GDP). The increase may result in growing fiscal inflexibility while also increasing the risk of a debt default.
- In the last year, approximately 54% of bank loans, equivalent to KShs. 1.7 trillion, were restructured to support borrowers during the pandemic.

Year	2016	2017	2018	2019	2020	2021
Nominal GDP (KES billion)	7,658	8,792	9,303	10,175	11,168	12,393
Average annual inflation (%)	6.35	4.50	4.69	5.20	5.41	5.80
CBR rate (%)	10.00	10.00	9.00	9.00	7.00	7.00
91-Day T-bill rate (%)	8.56	8.01	7.20	7.20	6.93	7.13
Lending rate (%)	13.66	13.64	12.51	12.50	11.98	12.05
Deposit rate (%)	7.33	8.22	7.60	5.16	6.26	6.46
Fiscal Budget deficit (inc grants) (KES billion)	(675)	(597)	(710)	(797)	(967)	(930)
NSE 20 share index (NSE 20)	3,186.21	3,711.94	2,833.84	2,654.39	1,868.39	1,913.13
Nairobi All Share Index (NASI)	133.34	171.20	140.43	166.41	152.11	171.77
USD / KES	102.49	103.23	101.90	101.20	109.15	107.90
Import cover (months)	4.60	4.70	5.25	5.50	4.76	4.69

Source: Central Bank of Kenya, NSE, KNBS, World Bank, IMF, Third Parties

Kenya Fiscal year ends June 30

Notes:

1. Values taken on the last business day of the year except 2021
2. Stock market indices reflect changes in the underlying composition of the market, including additions and rebasing
3. 12-month inflation: normally considered as inflation rate, is defined as the percentage change in the monthly consumer price index (CPI)

BUDGET OVERVIEW

The theme of this year's budget is "Building Back Better: Strategy for Resilient and Sustainable Economic Recovery and Inclusive Growth".

GOVERNMENT REVENUE AND EXPENDITURE

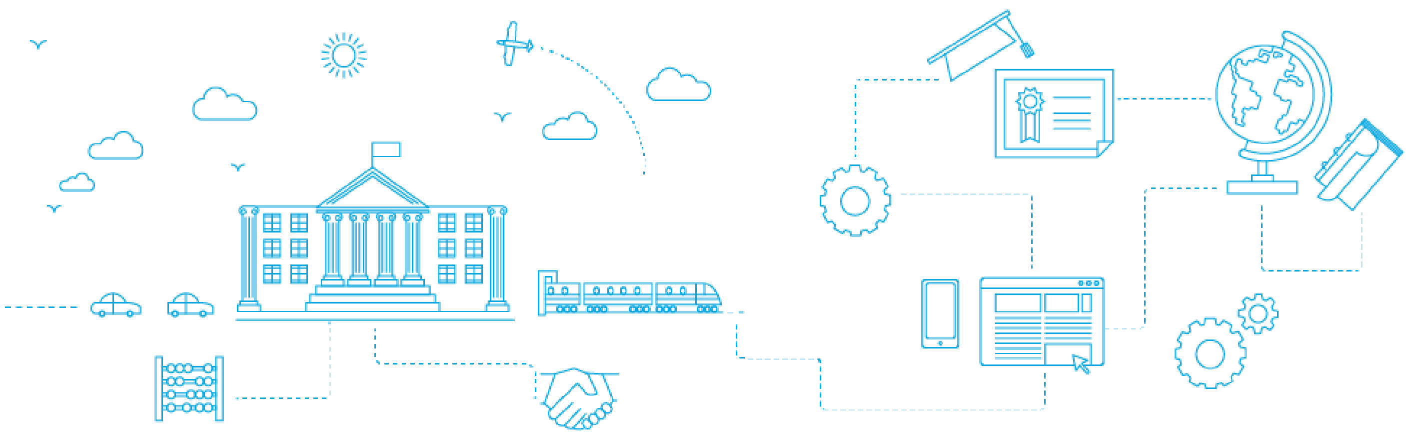
Total revenue (including Appropriations-in-Aid) and grants for the FY 2021/22 budget is projected at KShs. 2.1 trillion, equivalent to 17.0% of GDP. Of this, total revenue is projected at KShs. 2.04 trillion (16.4% of GDP), up from KShs. 1.84 trillion in FY 2020/21. Ordinary revenue is projected at KShs. 1.78 trillion (14.3% of GDP).

Total expenditures in the FY 2021/22 budget are projected at KShs. 3.03 trillion (24.5% of GDP), up from KShs. 2.89 trillion (25.8% of GDP) in the FY 2020/21. Recurrent expenditures are expected to account for KShs. 2.0 trillion (16.2% of GDP).

The fiscal deficit for the FY 2021/22 is projected at KShs. 929.7 billion (7.5% of GDP), which is lower than the fiscal deficit of KShs. 976.2 billion (8.7% of GDP) in the FY 2020/21. The fiscal deficit will be financed through net external financing of KShs. 271.2 billion (2.2% of GDP) and net domestic financing of KShs. 658.5 billion (5.3% of GDP).

FOCUS OF THE FY 2021/2022 BUDGET

1) In the FY 2021/22 budget, KShs. 23.1 billion has been allocated for the Economic Recovery Program aimed at:
    a. Enhancing resource mobilization to ensure sustainable funding of development programs;
    b. Supporting the role of the private sector in economic development by facilitating credit access by Micro, Small & Medium Enterprises through the Credit Guarantee Scheme;
    c. Upscaling investment in ICT and digital infrastructure to facilitate e-commerce and efficient delivery of public services; and
    d. Promoting local production processes and domestic supply value chains.
2) Reduce the level of fiscal deficit from 8.7% of GDP in the current budget to 7.5% of GDP in the FY 2021/22 and 3.6% in the FY 2024/25.
3) Scale up development of critical infrastructure in the country such as roads, rail, energy and water to reduce the cost of doing business and ease movement of people and goods.
4) Enhance investment in key economic sectors for broad based sustainable recovery by promoting agricultural transformation, growth in manufacturing, environmental conservation, and stimulating tourism recovery.
5) Expand access to quality social services in health, education and appropriate social safety nets for the vulnerable population.
6) Support county governments through transfer of shareable revenues to strengthen their systems and capacity in service delivery.



KEY ANNOUNCEMENTS

1) Procurement of ICT equipment and related services will be decentralized to various ministries, departments and agencies with effect from 1st July 2021.
2) Rolling out of the government procurement system and discontinuation of manual procurement processes by 31st December 2021.
3) Changes to the contracting framework through the Public Procurement and Asset Disposal (Amendment) Bill, 2020 to award infrastructural contracts to multiple bidders.
4) Government ministries, departments and agencies, and county governments to clear all pending bills by 30th June 2021.
5) The Kenya Mortgage Refinance Company is expected to issue an infrastructure bond by October 2021 to raise additional financing for its affordable housing initiatives.
6) Proposed amendment of the Central Depositories Act, to allow opening of omnibus investment accounts by persons investing on behalf of others in the securities market.
7) Proposed amendment of the Capital Markets Act to enable the Capital Markets Tribunal to hear and determine any appeal within 90 days.
8) Proposed amendment of the Retirement Benefits Act to provide for the registration and regulation of corporate trustees that provide services to pension schemes.
9) Proposed amendment of the Retirement Benefits Act to provide regulation of post-retirement medical funds.
10) Proposed amendment of mortgage regulations to allow members of a pension scheme to utilize up to 40% of their accrued benefits (up to a maximum of KShs. 7.0 million) to purchase a house on a tenant purchase basis.
11) Proposed amendment of the Insurance Act to provide for the regulation of foreign insurance brokers.
12) Proposed amendment of the Insurance Regulations to provide for the maximum permitted management expenditure for each category.
13) Implementation of the proposed "Financing Locally Led Climate Action Program" to strengthen National and County Governments' capacities to manage climate risk.

MAJOR FY 2021/2022 BUDGET ALLOCATIONS

Economic recovery strategy (KShs. 23.1 billion) • KShs. 2.6 billion to enhance liquidity to business; • KShs. 6.4 billion for improving education outcome; • KShs. 6.9 billion for improving environment, water and sanitation facilities; • KShs. 1.97 billion for improving agriculture and food security; • KShs. 1.2 billion for the recruitment of health care interns; • KShs. 1.0 billion for the Kenya Wildlife Services to engage community scouts; and • KShs. 3.0 billion for the youth empowerment and employment creation under Kazi Mtaani Programme.	Supporting growth of manufacturing (KShs. 20.5 billion) • KShs. 1.4 billion to the Kenya Industry and Entrepreneurship Project; • KShs. 0.5 billion for development of various SMEs; • KShs. 0.8 billion for Kenya Youth Empowerment and Opportunities Project; • KShs. 2.0 billion additional for Credit Guarantee Scheme to enhance access to affordable credit by MSMEs ; and • KShs. 8.3 billion for Dongo Kundu Special Economic Zone.
Affordable housing (KShs. 13.9 billion) • KShs. 3.5 billion to operationalize the Kenya Mortgage and Refinance Company (KMRC); • KShs. 7.0 billion to the Kenya Affordable Housing Project; • KShs. 3.5 billion to the Kenya Informal Settlement Improvement Project – Phase II; • KShs. 750.0 million for the housing units for National Police and Kenya Prisons; and • KShs. 1.0 billion for construction of markets. Universal healthcare coverage (KShs. 47.7 billion) • KShs. 7.2 billion for managed equipment services; • KShs. 4.1 billion for free maternity health care; • KShs. 1.9 billion to provide medical cover for the elderly and severely disabled in our society; • KShs. 8.8 billion for the Kenya COVID-19 Emergency and Response Project; • KShs. 15.3 billion to Kenyatta National Hospital; • KShs. 11.4 billion to Moi Teaching & Referral Hospital; • KShs. 7.3 billion to Kenya Medical Training Centres; • KShs. 2.8 billion to Kenya Medical Research Institute; • KShs. 1.3 billion for the construction of Kenya National Hospital Burns and Paediatrics Centre; and • KShs. 5.8 billion for addressing and lowering cases of HIV, malaria and Tuberculosis.	Enhancing food nutrition and security (KShs. 60.0 billion) • KShs. 7.0 billion National Agricultural and Rural Inclusivity Project; • KShs. 1.5 billion Small Scale Irrigation and Value Addition Project; • KShs. 2.7 billion to Kenya Cereal Enhancement Programme; • KShs. 1.8 billion for the Emergency Locusts Response; • KShs. 1.5 billion for the National Value Chain Support Project; • KShs. 3.1 billion for free disease holding ground in Lamu; • KShs. 10.7 billion to increasing agricultural productivity and enhance resilience to climate change risks in targeted smallholder farming and pastoral communities; • KShs. 529.5 million for an Insurance Scheme for livestock and crops; • KShs. 3.2 billion for the Aquaculture Business Development Project; • KShs. 3.4 billion for the Kenya Marine Fisheries and Socio-Economic Development Project; and • KShs. 2.1 billion for the construction of Liwatoni Fishing Complex.

GOVERNMENT FISCAL OPERATIONS

ESTIMATES OF GOVERNMENT FISCAL OPERATIONS (KSHS. BILLION)	ESTIMATES 2018 / 2019	ESTIMATES 2019 / 2020	ESTIMATES 2020 / 2021	ESTIMATES 2021 / 2022	ESTIMATES 2022 / 2023
Ordinary revenue	1,499.80	1,573.40	1,594.00	1,775.60	2,141.60
Ministerial appropriation in aid	204.60	163.60	255.20	258.30	238.10
	1,704.40	**1,737.00**	**1,849.20**	**2,033.90**	**2,379.70**
Recurrent expenditure					
Interest payments	375.70	437.20	458.70	560.60	644.00
Pensions and other CFS	70.80	89.60	115.30	137.00	152.90
Net issues/net expenditure	936.80	1,011.50	1,082.60	1,093.60	1,152.90
Development and net lending	541.90	594.90	638.50	609.10	670.00
County transfers	360.70	325.30	383.00	409.80	406.50
Others	147.80	106.90	186.40	199.90	175.70
	2,433.70	**2,565.40**	**2,864.50**	**3,010.00**	**3,202.00**
Fiscal balance (commitment basis excl. grants)	**(729.30)**	**(828.40)**	**(1,015.30)**	**(976.10)**	**(822.30)**
Grants	19.70	19.80	48.70	46.10	46.90
Adjustment to cash basis	–	11.80	–	–	–
Fiscal balance (cash basis incl. grants)	**(709.60)**	**(796.80)**	**(966.60)**	**(930.00)**	**(775.40)**
Financing					
Net foreign financing	414.50	340.40	426.50	267.30	263.10
Net domestic financing	306.50	450.40	540.10	662.80	512.20
Total financing	**721.00**	**790.80**	**966.60**	**930.10**	**775.30**
Memo items (Appendix)					
Gross debt (stock)	**5,808.60**	**6,693.30**	**7,659.90**	**8,590.00**	**9,365.30**
External debt	3,023.10	3,515.80	3,942.30	4,209.60	4,472.70
Domestic debt (gross)	2,785.50	3,177.50	3,717.60	4,380.40	4,892.60
Nominal GDP	9,303.10	10,175.20	11,168.50	12,393.10	13,759.90
Gross debt as a % of nominal GDP	62.44%	65.78%	68.58%	69.31%	68.06%
Source: BPS 2021 (February 2021) (some numbers may be different from those announced today)					

INTRODUCTION

The Finance Bill, 2021 was published on 5th May 2021 and the proposed changes were covered in our **Finance Bill, 2021 Newsletter** (https://www.rsm.global/kenya/insights/tax-insights/overview-finance-bill-2021).

THE INCOME TAX ACT

EXPANDED DEFINITION OF CONTROL (EFFECTIVE 1ST JULY 2021)

- Previously, the definition of **control** was in the Second Schedule of the ITA. This was deleted (inadvertently, we believe) when the Second Schedule was repealed and replaced by the Tax Laws (Amendment) Act, 2020, which left a lacuna in our legislature.
- The Bill now seeks to re-introduce a new definition of **control** which is much more comprehensive and which seeks to extend the definition of control to beyond the ability to influence the financial and operating policies of an entity. Control, in relation to a person, now includes:
    - i) A person holding at least 20% voting rights in a company, directly or indirectly;
    - ii) A loan advanced constituting at least 70% of the book value of the total assets of the entity, excluding a loan from a financial institution not associated with the person advancing the loan;
    - iii) A guarantee by a person for any form of indebtedness constituting at least 70% of the total indebtedness of the entity, excluding a guarantee from a financial institution not associated with that guarantor;
    - iv) The power to appoint more than half of the board of directors of the entity, or at least one director or executive member of the governing board of that entity;
    - v) A person who has exclusive rights over the know-how (includes patent, copyright, trademark, license, franchise, and any other business or commercial right) on which the entity is wholly dependent for the manufacture or processing of goods or articles or business carried on by the other person;
    - vi) The person or another person designated by him supplies at least 90% of the purchases of the entity; or in the opinion of the Commissioner, influences the price or other conditions relating to the supply of the purchases of the entity;
    - vii) The person or another person designated by him purchases 90% of the sales of the entity; or in the opinion of the Commissioner, influences the price or any other conditions of sales of the entity; or
    - viii) Any other relationship, dealing or practice that the Commissioner may deem to constitute control.

- This will have an impact on the determination of the residency status of a corporate body, evaluation of whether a Kenyan entity is an ultimate parent company, and also have an impact on the transfer pricing provisions.

DEFINITION OF PERMANENT ESTABLISHMENT EXTENDED (EFFECTIVE 1ST JULY 2021)

- The definition of a **permanent establishment** has been deleted and substituted to include:
  - i) A fixed place of business through which business is wholly or partly carried on and includes:
    - A place of management, a branch, an office, a factory, a workshop and a sales outlet;
    - A mine, an oil or gas well, a quarry, or any other place of extraction or exploitation of natural resources;
    - A warehouse in relation to a person whose business is providing storage facilities to others; or
    - A farm, plantation or other place where agricultural, forestry plantation or related activities are carried out;
  - ii) A building site, construction, assembly or installation project, or any supervisory activity connected to a site or project if it continues for a period of more than 183 days, provided that:
    - Where a person carries on activities at a place that constitutes a building site or construction or installation project and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days but do not exceed 183 days; and
    - Connected activities are carried on at the same building site or construction or installation project during different periods of time, each exceeding thirty days, by one or more enterprises closely related to the first-mentioned enterprise; the different periods of time shall be added to the aggregate period of time during which the first-mentioned enterprise has carried on activities at that building site or construction or installation project;
  - iii) The provision of services including consultancy services provided by a person through employees or other personnel engaged for that purposes if the period exceeds the aggregate 91 days in any 12-month period commencing or ending the year of income concerned;
  - iv) An installation or structure used in the exploration of natural resources provided the exploration continues for a period equal to 91 days or more; or
  - v) A dependent agent of a person who habitually concludes, contracts or plays the principal role leading to the conclusion of contracts without material modification by the person, excluding the activities that are of a preparatory or auxiliary character such as:
    - The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
    - The maintenance of stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display, for the purpose of processing by another enterprise; or
    - The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or collecting information for the enterprise, for the purpose of carrying on any other activity or combination of activities.

- This new definition is much wider than the deleted definition in the ITA as it now provides various scenarios as to when a permanent establishment is deemed to be created in Kenya. Similarly, the new definition has also provided some clarity in the scenarios that do not result in a permanent establishment.
- The above definition to a large extent aligns to the definition provided for in the OECD guidelines.

DIGITAL MARKETPLACE – ADDITIONAL PROVISIONS (EFFECTIVE 1ST JULY 2021)

- The Finance Bill, 2021 has deleted the definition of a digital marketplace and substituted it with the following new definition:
  - *"An online platform which enables users to sell or provide services, goods or other property to other users".*
- Further, the taxation of digital services has been expanded and now includes:
  - *"income accruing from a business carried out over the internet or an electronic network, including through a digital marketplace."*
- We believe this seeks to widen the scope as to who is liable for digital service tax, as property owners who rent their properties via online platforms will be caught by this.

PERSONS LIABLE TO DIGITAL SERVICE TAX (EFFECTIVE 1ST JULY 2021)

- Effective 1st July 2021, only non-resident persons will be subject to digital service tax ("DST").
- Additionally, if the non-residents' income is subject to withholding tax or where the non-resident person is in the business of transmitting messages via radio, cable, optical fiber, television broadcasting, internet, satellite or VSAT, the provisions of DST shall not apply. This amendment is in line with the requirements in the Income Tax (Digital Service Tax) Regulations, 2020.
- The due date for payment of DST has been amended from the time of supply to the 20th of the month following the end of the month when the digital service was offered. This aligns the Regulations to the ITA provisions.
- With regards to collection of taxes, the Tax Procedures Act, 2015 ("TPA") now allows the Commissioner to seek the intervention of relevant authorities in the collection of tax where a person provides services over the internet or through the digital marketplace and has not fulfilled their tax obligations.
- The TPA has also been amended to require a PIN for persons selling goods and services over a digital marketplace.

REMOVAL OF TIME LIMIT TO CARRY FORWARD LOSSES (EFFECTIVE 1ST JULY 2021)

- The provision restricting the carry forward of losses beyond the nine-year period has been deleted. This means that tax losses can be carried forward indefinitely. The intention of this amendment could be to counteract the imposition of minimum tax in the loss making years.
- The original provision, which previously allowed a husband to utilize the losses brought forward by his wife prior to the marriage when submitting a joint return, has now been deleted, hence, it is worth noting that a couple can no longer claim any brought forward losses prior to marriage.
- It is worth noting that the provision relating to the application to the Commissioner of extension of tax losses has not been deleted, despite the proposal for non-expiry of losses.

THIN CAPITALISATION PROVISIONS MORE RESTRICTIVE (EFFECTIVE 1ST JANUARY 2022)

- The thin capitalisation provisions have been amended to restrict the total interest claimable in a year of income to 30% of earnings before interest, taxes, depreciation and amortization ("EBITDA"); provided in the calculation of EBITDA, any income that is exempt from tax, is to be excluded. This is applicable both to locally and foreign controlled companies.
- The interest restriction will apply to:
  - interest on all loans;
  - payments that are economically equivalent to interest; and
  - expenses incurred in connection with raising of finance.
- The move from a debt: equity ratio to interest servicing capacity, extending this to all entities (whether locally or foreign controlled) and also including this to payments that are economically equivalent to interest (unwinding of interest under IFRS) will pose a huge challenge, and if adopted, will have a significant impact on how companies will be capitalized and also on local borrowing. Moreover, financial institutions, which were previously exempt, are now also caught under this change.
- The imposition of deemed interest on interest free loans by entities controlled by a non-resident alone or together with not more than four other persons (excluding a licensed bank or a financial institution) still applies. However, the clarification that loans advanced to the company by a non-resident associate of the non-resident company controlling the resident company has been deleted.
- The exemption granted from this provision for a company implementing a project under the affordable housing scheme upon the recommendation of the CS responsible for housing has also been deleted.

REQUIREMENT FOR SUBMISSION OF GROUP RETURN FOR MULTINATIONAL ENTERPRISE GROUPS (EFFECTIVE 1ST JANUARY 2022)

- The Bill proposes to introduce the requirement for multinational enterprise groups to submit returns giving information on their activities in other jurisdictions.
- The Bill defines a multinational enterprise group ("MEG") to mean:
    - *"A group that includes two or more enterprises which are resident in different jurisdictions including an enterprise that carries on business through a permanent establishment or through any other entity in another jurisdiction."*
- Further, an Ultimate Parent Entity ("UPE") has been defined to mean:
    - *"An entity that is a resident in Kenya for tax purposes; is not controlled by another entity; and owns or controls a multinational enterprise group."*
- An UPE of a MEG will be required to submit to the Commissioner a return describing the group's financial activities in Kenya, where its gross turnover exceeds the prescribed threshold, and in all other jurisdictions where the group has taxable presence, not later than 12 months after the last day of the reporting financial year of the group.
- The Bill however does not provide clarity on the prescribed gross turnover threshold.
- The information required in the group return in relation to each jurisdiction in which the group operates shall consist the group's aggregate information relating to:
    - revenue;
    - profit or loss before income tax;
    - income tax paid;
    - income tax accrued;
    - stated capital;
    - accumulated earnings;
    - number of employees; and
    - tangible assets other than cash or cash equivalents.

- The group reporting has been necessitated by limitations of law to enable the Commissioner to get information from offshore entities for multinational entities whose ultimate parent entities are resident in Kenya.

INTRODUCTION OF NHIF RELIEF (EFFECTIVE 1ST JANUARY 2022)

- The Bill proposes to introduce relief on payments made by resident individuals to the National Hospital Insurance Fund ("NHIF") as an insurance relief.
- This relief will be equivalent to 15% of the amounts paid toward NHIF and other insurance premiums, not exceeding KShs. 60,000 per annum.

INVESTMENT ALLOWANCE (EFFECTIVE 1ST JANUARY 2022)

- The Bill proposes to change investment allowance to be deductible on a straight-line basis instead of a reducing balance basis.
- Additionally, the definition of *manufacturing* has been expanded to allow persons involved in the generation of electrical energy and transformation and distribution to claim investment deduction irrespective of whether the distribution is done through the National Grid or not. Previously, the allowance was only claimable if the distribution was made through the National Grid.
- The Bill has also re-introduced of the definition of "civil works" captured under the terms *building used for manufacture and commercial building* to include:
    - roads and parking areas;
    - railway lines and related structure;
    - water, industrial effluent and sewerage works;
    - communications and electrical posts and pylons and other electrical supply works; and
    - security walls and fencing.
- We believe that this re-introduction of the constituents of civil works provides clarity on additional works that qualify for investment allowance.

TAXATION OF EXTRACTIVE INDUSTRIES

- The Ninth Schedule has now been amended as follows:
  - The rate of depreciation for machinery first used to undertake operations under the prospecting right has been reduced from 100% to 50% in the first year of use, and 25% per year on the residual value in equal instalments, effective 1st January 2022.
  - The rate of depreciation for machinery first used to undertake exploration operations has been reduced from 100% to 50% in the first year of use, and 25% per year on the residual value in equal instalments, effective 1st January 2022.
  - The rate of withholding tax for provision of services to a licensee or contractor in respect of mining or petroleum operations has been increased to 10%, up from 5.65%, effective 1st July 2021.
  - The rate of withholding tax to be withheld by the contractor on management, training and professional fees has been decreased from 12.5% to 10%. This amendment will become effective 1st July 2021.
- The Bill has also introduced interest restriction where interest expense is greater than 30% of EBITDA for contractors and licensees, effective 1st January 2022. This move may be quite unfavorable as it will hugely impact capital intensive projects that rely on debt as its major source of funding, which is the case for the mining and petroleum sectors.

THE VALUE ADDED TAX ACT, 2013

AMENDMENT TO THE DEFINITION OF IMPORTED SERVICES (EFFECTIVE 1ST JULY 2021)

- The Bill proposes to amend part of the definition of the term **supply of imported services** as follows:
- ~~*"(c) the registered person would not have been entitled to a credit for the full amount of input tax payable if the services had been acquired by the person in a taxable supply;"*~~
- *"(c) in the case of a registered person, the person would not have been entitled to a full amount of input tax payable if the services had been acquired by that person in a taxable supply."*
- This means where a supply is made to any person who would not be entitled to claim the full amount of reverse VAT paid as input tax, the VAT on the imported supply has to be accounted for by the person importing the service irrespective of whether the person is registered or not.

TREATMENT OF IMPORTED SERVICES (EFFECTIVE 1ST JULY 2021)

- The VAT Act, 2013 in relation to the treatment of imported services has been amended to state that any person in Kenya, registered or not, on importing a taxable service, shall be deemed to make a taxable supply to himself.
- A person who is not able to claim the full credit for any reverse VAT paid on imported supply as input tax shall have to pay the required reverse VAT at the time of supply in proportion to the amount that would not be eligible for claim as input tax.
- The amended section now reads as follows:

  "(1) If a supply of imported taxable services is made to any person, the ~~registered~~ person shall be deemed to have made a taxable supply to himself. "

  "(2) If ~~a registered person referred to in subsection (1)~~ the person referred to in subsection (1) is a registered person and is entitled to –

  (a) a credit for part of the amount of input tax payable, the value of the taxable supply under subsection (1) shall be reduced by an amount equal to the supply that is entitled for the input tax credit; or

  (b) a full input tax credit payable on the imported taxable services under subsection (1), the value of the taxable services shall be reduced to zero."

  "(3) The output tax in respect of a deemed taxable supply under subsection (1) shall be payable ~~by any person~~ at the time of the supply."

RESTRICTION ON DEDUCTION OF INPUT TAX – LEASING AND HIRING OF PASSENGER CARS AND MINIBUSES (EFFECTIVE 1ST JULY 2021)

- Input VAT on leasing or hiring costs on passenger cars or minibuses will not be claimable as input VAT, unless these costs are incurred exclusively for making taxable supplies of that automobile in the ordinary course of a continuous and regular business of selling or dealing in, or hiring of passenger cars or minibuses.
- The amended section now reads as:
  - *"A registered person shall not deduct input tax under this Act if the tax relates to the acquisition, leasing or hiring of...."*
- This change confirms that prior to this amendment, the lease and hire costs were actually claimable as input VAT before 1st July 2021.

TAX IS DUE BY BOTH REGISTERED AND UNREGISTERED PERSONS (EFFECTIVE 1ST JULY 2021)

- The proposal seeks to ensure that both registered and unregistered persons can have a tax obligation and allows the person to defer the payment of tax to a date not later than the 20th day of the month succeeding the date when the tax became due.
- The amended section now reads as:
  - *"Notwithstanding the provision of subsection (1), a ~~registered~~ person may defer payment of tax due to a date not later than the twentieth day of the month succeeding that in which the tax became due."*

AMENDMENTS TO THE FIRST SCHEDULE AND SECOND SCHEDULE OF THE VAT ACT, 2013

Supplies	New rate	Old rate
The supply of ordinary bread	16%. Indication that this will be exempt	0%
The exportation of taxable services	Exempt	0%
The transfer of assets and other transactions related to the transfer of assets into real estate investment trusts and asset-backed securities (**this was previously exempt and subsequently made vatable by the Tax Laws (Amendment) Act, 2020**)	Exempt	16%

- The movement of the exportation of taxable services, and the transfer of assets and other transactions related to the transfer of assets into REITs and ABS as exempt supplies will affect the deductibility of input VAT relating to those supplies.
- It is our considered view that the move to make the exportation of taxable services as an exempt supply is off the back of continuous disputes between taxpayers and the Kenya Revenue Authority on the issue of where final consumption lies with respect to the provision of taxable services. This amendment will ensure that there are no refunds due from the KRA if consumption is deemed to be in a foreign jurisdiction.
- The supply of ordinary bread may become exempt as indicated in the Budget Highlights "The Mwananchi Guide FY2021/2022 Budget".

THE EXCISE DUTY ACT, 2015

OFFSET OF EXCISE DUTY INCURRED AGAINST EXCISE DUTY PAYABLE (EFFECTIVE 1ST JULY 2021)

- Excise duty paid in respect of internet data services provided by a licensed person who purchases the data in bulk for resale can now be offset against the excise duty payable by that person on internet data services supplied to the final consumer.

AMENDMENTS TO PART I OF THE FIRST SCHEDULE (EFFECTIVE 1ST JULY 2021)

- Sugar confectionary of tariff heading 17.04 now attracts excise duty of KShs. 20 per kg. Previously, excise duty was only payable on imported sugar confectionary.
- White chocolate, chocolate in blocs, slabs or bars of tariff Nos. 1806.31.00, 1806.32.00 and 1806.90.00 to attract excise duty of KShs. 200 per kg. Previously, excise duty was only payable on importation.
- Excise duty of 25% on imported glass bottles (excluding imported glass bottles for packaging of pharmaceutical products) has been removed, meaning glass bottles can now be imported without attracting any excise duty.
- Motorcycles of tariff 87.11, other than motorcycles, ambulances and locally assembled motorcycles will now attract duty excise duty at the rate of 15% of the excisable value instead of the initial flat rate of KShs. 11,608.23 per unit.
- Jewellery of tariff heading 7113 and imported jewellery of tariff heading 7117 will now attract excise duty of 10%.
- Products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application, but excluding medicinal products approved by the Cabinet Secretary responsible for matters relating to health and other manufactured tobacco and manufactured tobacco substitutes that have been homogenized and reconstituted tobacco, tobacco extracts and essences will now attract excise duty of KShs. 5,000 per kg.
- Excise duty has been re-introduced on betting at 20% on the amount wagered or staked. This duty was initially introduced by the Finance Act, 2019, but later deleted by the Finance Act, 2020.
- In addition to interest on loans, fees or commissions earned in respect to those loans shall now not attract excise duty.

THE TAX PROCEDURES ACT, 2015

VALIDITY AND ENFORCEMENT OF INTERNATIONAL TAX AGREEMENTS (EFFECTIVE 1ST JULY 2021)

- The proposed change gives validity to multilateral agreements and treaties that have been entered into by or on behalf of the Government of Kenya relating to international tax compliance and prevention of evasion of tax or exchange of information on tax matters to take effect in the manner stipulated in such agreements or treaties.
- Information obtained pursuant to agreements shall not be disclosed except in accordance with the conditions specified in the agreements.
- This amendment is a stepping stone into Kenya entering into common reporting standards regime, pursuant to the signing and depositing the required instruments under the Multilateral Convention on Mutual Administrative Assistance.

COMMON REPORTING STANDARDS PROVISIONS (EFFECTIVE 1ST JULY 2021)

- The Bill also introduces due diligence procedures and record keeping requirements as set out in the common reporting standards ("CRS") regulation to be developed by the CS Treasury to:
    - Any financial institution that is resident in Kenya (excluding any branch located outside Kenya); or
    - A branch of a foreign financial institution located in Kenya.
- The CRS is a global initiative developed by the Organization for Economic Co-operation and Development ("OECD"). Its objective is to enable tax authorities to obtain more information about their residents' tax affairs.
- The reporting requirements under CRS include furnishing the Commissioner with all reportable accounts held, managed or administered by the reporting institution; or nil accounts if no account is held by a date to be set out under the regulations.
- It also prescribes anti-avoidance provisions to circumvent reporting.
- The penalty for non-compliance with the CRS obligations are as follows;
    - Making a false statement or omission of any information required – KShs. 100,000 for each false statement or omission, an imprisonment for a term not exceeding 3 years or both (unless reasonable effort was made to obtain information);
    - Failure to file an information return or nil return by a financial institution – KShs. 1 million for each failure;
    - Failure to comply with a duty or obligation, where no other penalty is prescribed – penalty of KShs. 20,000; and KShs. 20,000 per day for each day of non-compliance, however, not exceeding 60 days.

RECORD KEEPING AND ASSESSMENTS (EFFECTIVE 1ST JULY 2021)

- The Bill proposes to amend the requirement for record keeping from 5 years to 7 years. Also, where a proceeding has commenced before the end of the 7 years, the person is required to retain the document until all proceedings have been completed.
- A change is also proposed to allow the Commissioner to issue assessments within a period of 7 years as opposed to the current period of 5 years, including making any amendments to the tax returns filed. This time limit does not apply in the case of gross or willful neglect, evasion, or fraud by, or on behalf of, the taxpayer.
- In respect to a digital marketplace, a non-resident can maintain the books of accounts, records, paper registers, tax returns or tax invoices in a convertible foreign currency as approved by the Commissioner. However, this provision does not apply to a non-resident person who files returns and makes payments through a resident tax representative or a non-resident person with a permanent establishment in Kenya.

REMOVAL OF WITHHOLDING VAT EXEMPTIONS (EFFECTIVE 1ST JULY 2021)

- The Bill proposes to repeal the provision exempting taxpayers from withholding VAT if they could prove that due to the nature of their business, they would be in a continuous credit position for a period of not less than twenty-four months.

PENALTIES AND INTEREST ON APPROVED REFUNDS (EFFECTIVE 1ST JANUARY 2022)

- The Bill proposes to introduce new sections cushioning taxpayers from being charged interest and/or penalties on any outstanding tax liabilities that can be offset with an approved tax refund amount. The penalties/interest will cease to accrue from the date of notification after the refund has been ascertained.
- Any tax liability that remains unpaid or outstanding after the Commissioner has applied the refund amount towards payment of an outstanding tax shall continue accruing interest and penalties in accordance to the provision of the TPA.

INCLUSION OF NOTICE OF OBJECTION TO ELECTRONIC DUE DATES (EFFECTIVE 1ST JULY 2021)

- The Bill clarifies that where a notice of objection is in electronic form, the due date shall remain the date specified under the relevant tax law.

OTHER INDIRECT TAXES

MISCELLANEOUS FEES & LEVIES ACT, 2016

GOODS EXEMPT FROM IMPORT DECLARATION FEE (EFFECTIVE 1ST JULY 2021)

- The Cabinet Secretary has been empowered to exempt goods from IDF, where such goods are for public interest or meant to promote investments, the value of which shall not be less than KShs. 5 billion.

GOODS EXEMPT FROM RAILWAY DEVELOPMENT LEVY (EFFECTIVE 1ST JULY 2021)

- The Cabinet Secretary has also been empowered to exempt goods from RDL where such goods are in the public interest or are meant to promote investments, the value of which shall not be less than KShs. 5 billion.

MISCELLANEOUS AMENDMENTS

CAPITAL MARKETS AUTHORITY ACT

APPEALS BEFORE THE TRIBUNAL (EFFECTIVE 1ST JULY 2021)

- The Bill seeks to delete and substitute Section 35A (17) by requiring the Tribunal to hear and determine an appeal within 90 days from the date of filing any Appeal. This is intended to improve efficiency in the capital markets and ensure fair administrative action by the Authority.

INSURANCE ACT

CLOSED FUND BUSINESS (EFFECTIVE 1ST JULY 2021)

- The Bill seeks to introduce a new Section 21A on closed fund business. A closed fund business means the continuance of insurance business for the purpose of maintaining, without renewal, any policy or contract of insurance issued before the appointed date.

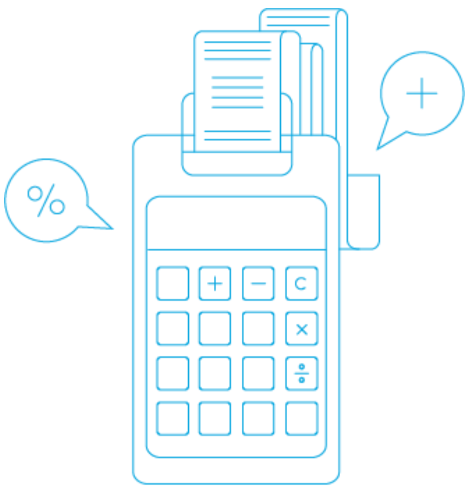
ANNUAL FEES PAYABLE BY LICENCED INSURERS (EFFECTIVE 1ST JANUARY 2022)

- The Bill seeks to introduce an annual fee payable by an insurer issued with a license under the Act. This is through an amendment of Section 31 by introduction of subsection 3.

KENYA REVENUE AUTHORITY ACT

REWARD FOR INFORMATION LEADING TO IDENTIFICATION AND COLLECTION OF DUTIES OR TAXES (EFFECTIVE 1ST JULY 2021)

- The Bill seeks to increase rewards for information leading to identification of unassessed taxes or duties from KShs. 100,000 to KShs. 500,000 or 1% of duties or taxes identified, whichever is lower. Additionally, in a case of information leading to recovery of unassessed duties and taxes, the reward has been increased from KShs. 2 million to KShs. 5 million or 5% of taxes or duties so recovered, whichever is lower.



RETIREMENT BENEFITS ACT

POST RETIREMENT MEDICAL SCHEME (EFFECTIVE 1ST JANUARY 2022)

- The Bill seeks to include post-retirement medical cover to be included as one of the post retirement settlements. This has been done through expanding the definition of a retirement benefits scheme under Section 2 of the Act.
- Additionally, the Bill inserts the definition of post-retirement medical fund, which was only previously included in The Retirement Benefits (Post-Retirement Medical Funds) Guidelines, 2018. This is defined as a fund established within a scheme into which contributions are made and from which the costs of the medical benefits can be met as may be determined in accordance with the medical fund rules.

CORPORATE TRUSTEES (EFFECTIVE 1ST JULY 2021)

- The Bill seeks to empower limited liability companies incorporated under The Companies Act, 2015 to act as corporate trustees.
- The requirements for registration as corporate trustees under Section 25C of the Act are as follows:
  - Minimum paid up share capital as may be prescribed by the Retirements Benefits Authority;
  - Capable of meeting the obligations of members and sponsors as specified in the scheme rules;
  - Has the professional and technical capacity and adequate operational systems to perform its functions;
  - Has never been a corporate trustee of any scheme fund which has been deregistered, wound up or placed under an interim administrator due to any fault, either fully or partially, of the corporate trustee;
  - Has never been involved in the management or administration of a scheme which was deregistered for any failure on the part of management or the administration thereof;
  - Has in its board of directors and senior management such number of persons as may be prescribed who are academically and professionally qualified in matters relating to administration of schemes, insurance, law, accounting, actuarial science, economics, banking, finance or investment of scheme funds; and
  - Meets such additional requirements as may be prescribed by the Authority.

SUBMISSION OF ANNUAL REPORT (EFECTIVE 1ST JULY 2021)

- Trustees can now apply for a further three months' extension to submit a copy of audited accounts of the scheme, if justified.
- Where an extension of time has been granted, the penalty for late submission for the extended period shall not apply.

CENTRAL DEPOSITORIES ACT, 2000 ACT

SECURITY ACCOUNTS AND RECORDS (EFFECTIVE 1ST JANUARY 2022)

- Section 2 of the Act has been amended to insert new definitions as follows:
  - "authorized nominee" means a person appointed in writing by a beneficial owner or legal owner to open a securities account and transact on behalf of such beneficial owner or legal owner;
  - "beneficial owner" has the meaning assigned to it under the Companies Act, 2015;
  - "legal owner" means a person who holds the titles to securities or assets on behalf of a beneficial owner; and
  - "omnibus account" means an account held by an authorized nominee on behalf of two or more beneficial owners or legal owners.
- Section 30(3) introduces the requirement that a securities account opened with the Central Depository shall be in the name of beneficial owner, legal owner or authorized nominee.
- Additionally, Section 30(4) requires a declaration to be made on whether the person is the beneficial owner of the deposited securities or the legal owner.
- Section 30A has been introduced to empower a beneficial owner to appoint in writing a person to be the authorized nominee for the purpose of opening a securities account or in the case of more than one beneficial owner, an omnibus account in the name of the beneficial or legal owner(s).

- A person who contravenes the above requirements will be liable to a fine not exceeding KShs. 10 million or imprisonment for a term not exceeding 10 years, or both.

RECORD KEEPING (EFFECTIVE 1ST JANUARY 2022)

- Section 32 of the Act has been amended to include a new paragraph (e) that requires the Central Depository to keep records of all purchases and sales of deposited securities and other dealings, including the charges and credits arising, the identity of the buyer and seller of each of those deposited securities or, in the case of other dealings, the identity of the persons executing such dealings and the persons in whose favour the dealings are executed.

CUSTOMS

The decision will be published in the EAC Gazette Notice and will become effective from 1st July 2021.

DUTY REMISSION

The Council of Ministers by exercising the powers conferred upon Section 140 of the East African Community Customs Management Act 2004, has approved a remission of duty for a further 1 year on the following:

- Raw materials for manufacture of masks, sanitizers, ventilators and personal protective equipment will be imported duty free.
- Baby diapers – all inputs for the manufacture of baby diapers will be imported duty free.
- Affordable Housing Programme – inputs for the manufacture of roofing tiles will be imported duty free.

STAY OF APPLICATION OF CET RATES

Kenya has been granted a stay application of the EAC rate on the following items effective from 1st July 2021:

- Imported iron and steel products – will now attract CET rate of 25% with the corresponding specific rates for a further period of one year.
- Leather and footwear sector– Retained at the CET rate of 25% and introduction of a further specific duty rate for period of one year.
- Vegetable products including potatoes, peas, tomatoes among others – will attract a CET rate of 30% for a period of one year.
- Furniture industry – imported furniture products will attract a CET rate of 35% for a further period of one year.

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