KENYA 2019/ 2020 BUDGET

MANUFACTURING SECTOR NEWSLETTER

KENYA ASSOCIATION OF MANUFACTURERS
Driving Global Competitiveness
60 YEARS OF ADDING VALUE

EY
Building a better working world

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Foreword

Globally, the manufacturing sector has been the bedrock for economic growth and development. Countries that have realized rapid growth and economic transformation are those with large manufacturing sectors. Examples include early industrializers such as Great Britain, Germany, USA and other Western Europe countries and late industrializer including South Korea, Singapore, Taiwan, Hong kong, Malaysia and China. The newly industrialized countries managed to maintain an annual average growth rate of 5.5% from 1960-1990 because of a vibrant manufacturing sector. This has to be the case for Kenya if industrialization is to materialize.

The Government is aware of the critical role that the manufacturing sector can play in Kenya's economic transformation as evidenced by critical policy documents such as Vision 2030, the Kenya Industrial Transformation Programme (KITP) and most recently the Big 4 Agenda. Under the Big 4 Agenda, the manufacturing sector is expected to contribute 15% of GDP by 2022. However, the sector contributed 7.7% to GDP in 2018. It is time we developed measures to bridge the gap of 7.3%.

For manufacturing sector to survive in a globalized economy, competitiveness is a must. The 2019/2020 Budget Statement enumerated policy and tax measures that will enhance competitiveness of manufacturers in Kenya includingthe finalization of the framework for dediction of 30% of total electricity for manufacturers as a rebate, amendment of the VAT refund formula and reduction of withholding VAT from 6% to 2% to forestall accumulation of VAT credits, commitment by the National Treasury to clear VAT credits from zero-rate supplies, public procurement of locally manufactured goods and reduction of import declaration fee Import Declaration Fee (IDF) from 2% to 1.5% for imported industrial inputs.

Apart from competitiveness, there are other key ingredients to a flourishing manufacturing industry in Kenya. First, the fight against illicit trade, Illicit Trade denies manufacturers legitimate market share and has adverse effects on manufacturers' reputation, citizens' health, and the loss of government revenue. Second, market access particular for exports because of small domestic market and the need for building Kenya's forex. Third, predictable and stable policy environment due to the nature of production that requires long term planning. And finally, a stable macroeconomic environment particularly through the containment of fiscal deficit and stock of debt, stable exchange and inflation rates.

KAM will continue to partner with Government and other like-minded institutions to ensure no one is left behind from the benefits accruing out of the manufacturing sector.

Phyllis Wakiaga
CEO, Kenya Association of Manufacturers

Statement from EY

We reckon that the manufacturing sector plays a critical role in spearheading our economic growth as emphasized in the government's Big Four Agenda which is expected to grow the sector to 15% of GDP by 2022. On this backdrop, EY is greatly honored to partner with Kenya Association of Manufacturers (KAM) in the release of its first edition of Budget Highlights Newsletter publication titled "2019/2020 Budget Newsletter". This initiative is in line with EY's continuous effort of "Building a Better Working World".

EY is a global leader in Assurance, Advisory, Tax and Transaction Advisory Services (TAS). We have people and operations in more than 150 countries organized into four areas and 28 regions. At EY we are committed to doing our part in building a better working world. The insights and services we deliver help to build trust and confidence in the capital markets and in economies the world over.

As KAM service members, under the service sector, we are proud to have contributed to this insightful newsletter which focuses on the economic outlook and how the National Budget proposals are expected to impact the manufacturing sector.

All said and done, a better working world starts with the world that matters most to you.

Mr. Francis Kamau,
EY Tax Leader & Partner, East Africa

1.1 Global Economic Outlook

Global output is estimated to slow down to 3.5 percent in 2019 from an initial projected growth forecast of 3.9 percent over the same period occasioned by weaker economic activities. Downgraded growth from estimated expansion of 3.7 percent in 2018 is expected to recover in 2020.

The overall global inflation rose to 3.6 per cent compared to a revised rate of 3.2 per cent in 2017.

- According to IMF, the weakening global growth is due to the negative effects of tariff increases on imports from the USA and from China.

- From the Europe, Germany's new automobile fuel emission standards are likely to weigh on economic growth. A no brexit will adversely affect prices for goods, and tariffs will increase the cost of imported price of goods for businesses, which will slow down growth.

- China's economy is expected to slow down due to the combined influence of needed financial regulatory tightening and trade tensions with the US.

- Japan's economy is set to grow by 1.1 percent in 2019 supported by implemented fiscal measures to mitigate the effects of the planned consumption tax rate increases.

Global merchandize trade volume growth is expected to fall to 2.6% in 2019 – down from 3.0% in 2018.

1.2 African Economic Outlook

Despite the downward revision of the global growth forecast, Sub-Saharan Africa's economic growth is expected to record stronger growth of 3.5% in 2019, having improved from 2.6 % in 2017 to 2.9% in 2018 (against a target growth of 3.4% in 2018). The growth was supported by a favourable external environment, adjustment of domestic policies and higher commodity prices.

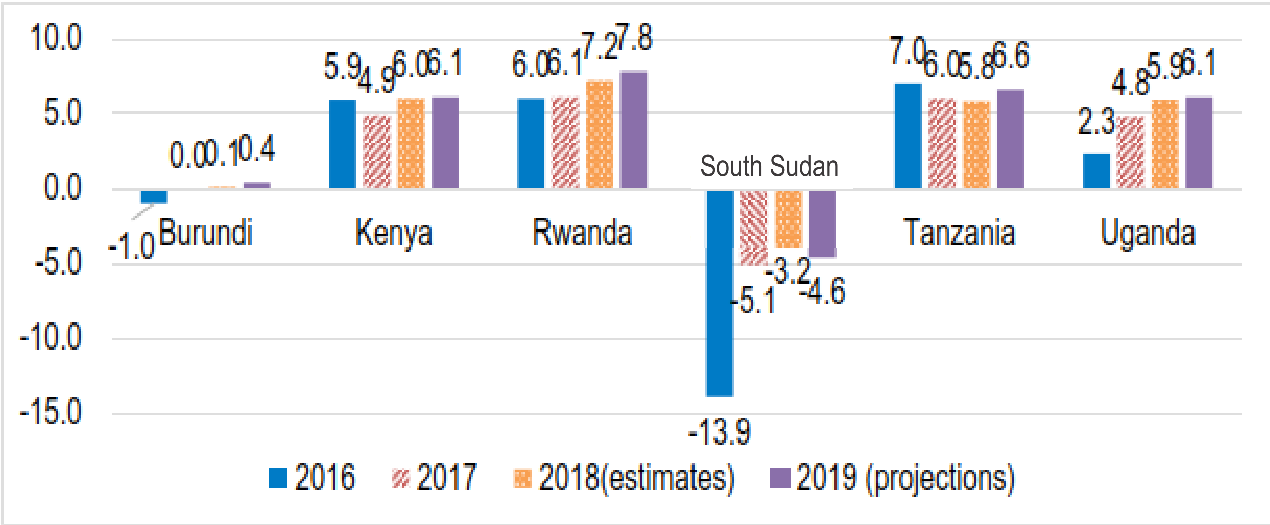
In addition, increased agricultural activity in the wake of easing drought conditions impacted positively on the region's economic performance. Inflationary pressures eased to 8.5 per cent in 2018 from 11.0 per cent in 2017 mainly due to low food prices and tight monetary stance. Current account deficit as a percentage of GDP widened to 2.6 per cent during the review period compared to 2.1 per cent in 2017.

1.3 EAC Economic Outlook

In 2018, real GDP in the East African Community (EAC) grew by 5.9 per cent compared to a 5.3 per cent growth in 2017. It is expected the region's economy will grow at 6.3 per cent in 2019.

The region's economic growth is estimated to have remained unchanged buoyed by Rwanda and a recovering South Sudan.

EAC economies 2016 - 2019 growth trends is summarised as in the bar chart below:
East Africa Community economic growth trends



Source: IMF World Economic Outlook

Lower cost of food and non-alcoholic beverages resulted in a decrease in inflation rate from 4.8 per cent in 2017 to 1.4 per cent in 2018.

1.4 Kenyan Economic Outlook

Economic growth in Kenya has remained stable but below the targeted 10 percent annual growth envisaged in Vision 2030.

The economy is projected to expand by 6.1 percent in 2019/20 on account of implementation of policies and strategies outlined in "The Big Four" plan as prioritized in the Third Medium Term Plan (2018-2022) of Vision 2030.

Kenya's 2018 Macroeconomic Statistics

Indicator	2014	2015	2016	2017	2018
Population (Mns)	43.0	44.2	45.4	46.6	47.8
GDP growth at constant prices (%)	5.4	5.7	5.9	4.9	6.3
Current A/C Balance (Ksh Mn)	(560)	(421)	(343)	(503)	(441)
Inflation (%)	6.9	6.6	6.3	8.0	4.7

Sources: Economic Survey 2019

This growth will be supported by a rebound in agricultural and manufacturing activities underpinned by improved weather conditions, strong service sector, stable macroeconomic environment, ongoing public infrastructural investments and sustained business and consumer confidence.
Measures being undertaken by the Government under "The Big Four" Plan to boost the manufacturing sector; enhance food security and nutrition; build affordable housing; and achieve Universal Health Coverage are expected to enhance growth, create jobs and promote inclusive growth.

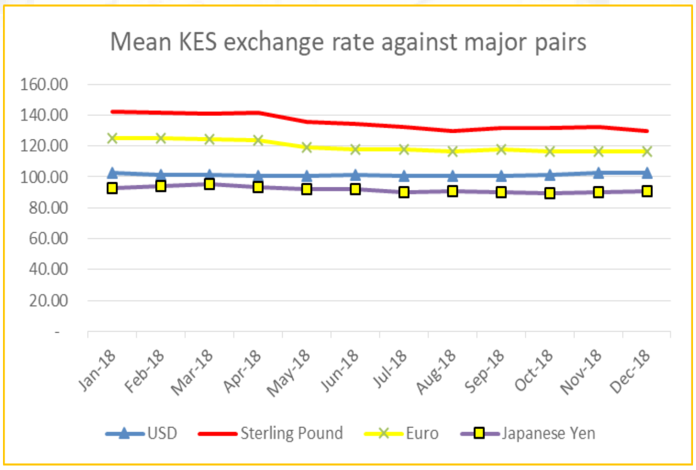
The current account deficit is estimated at 5.2 percent of GDP in 2018, and is expected to narrow to 5.1 percent in 2019. The overall fiscal deficit inclusive of grants, is projected at Ksh 578.3 billion (5.1 percent of GDP) and remains outside the target limit of the EAC convergence ceiling of 3.0 percent of GDP.

During the year, key macroeconomic indicators remained relatively stable and supportive of the growth during the year under review. The shilling recorded mixed but less volatile performance against its major trading currencies.

1.4.1 Selected Macroeconomic Indicators

Inflation: Average overall annual inflation remained stable within CBK's target inflation rate of between 2.5% and 7.5% having recorded a rate of 4.7% in 2018 compared to 8.0 percent in 2017

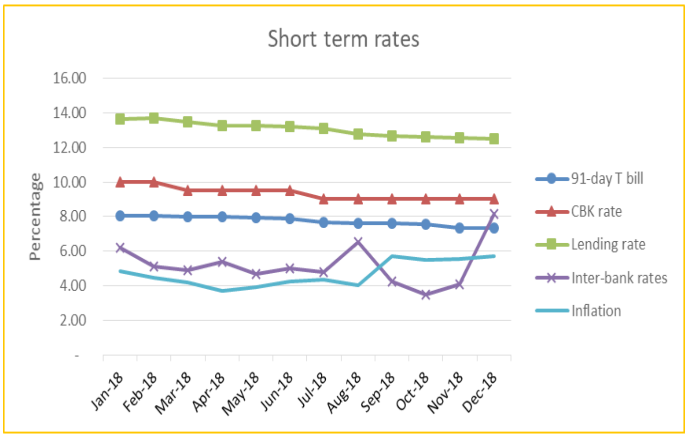
Exchange Rate: The Kenyan Shilling has continued to display less volatility compared to major currency peers. The Shilling strengthened against the Sterling Pound and Euro jolted by the uncertainty about Brexit but weakened against the US Dollar over the period. In the EAC region, the Kenyan Shilling gained against the Uganda Shilling, Rwandese Franc and Tanzanian Shilling.



Interest Rate: Short term interest rates remained low in 2018 due to the capping of interest rates pegged on the Central Bank Rate (CBR), which was gradually decreased from 10% in January, 9.5% in March and 9.0% in July onwards.

The interbank rate also fluctuated for most part of the year until Nov-Dec period when the rate drastically ended in a year-high of 8.5% while the 91-day Treasury bill rate marginally declined over the year.

The monthly trend of average lending, inflation and 91-day Treasury Bill rates, interbank and central bank rate in 2018 is detailed in the graph below:



Source: Central Bank of Kenya

Capital Market Activities: In the securities market, the value of bonds traded rose to KSh 558 billion in 2018 from KSh 429 billion in 2017. The total number of shares traded dropped from KSh 7.1 billion in 2017 to KSh 6.3 billion in 2018. The Nairobi Securities Exchange (NSE) 20-Share index dropped by 23.7 percent to 2,834 points in December 2018.

1 Sectoral Analysis

Real GDP is estimated to have expanded by 6.3 percent in 2018 from 4.9 per cent in 2017. according to the Kenya National Bureau of Statistics

The table below reports Sectors' percentage contribution to the Gross Domestic Product (GDP):

Industry	Percentage Contribution to GDP	
	2017	2018
Agriculture, forestry and fishing	34.8	34.2
Mining and quarrying	0.8	0.8
Manufacturing	8	7.7
Electricity supply	1.8	1.8
Water supply; sewerage, waste management	0.7	0.7
Construction	5.6	5.4
Wholesale and retail trade; repairs	7.4	7.4
Transportation and storage	7.5	8
Accommodation and food service activities	0.7	0.7
Information and communication	1.3	1.3
Financial and insurance activities	6.1	6
Real estate	7.1	7
Professional, scientific and technical activities	0.8	0.8
Administrative and support service activities	0.9	0.9
Public administration and defence	3.6	3.5
Education	4	4.3
Human health and social work activities	1.5	1.5
Arts, entertainment and recreation	0.1	0.1
Other service activities	0.6	0.6
Activities of households as employers	0.4	0.4
Financial Intermediation Services Indirectly Measured (FISIM)	-2.0	-1.9

Source: Economic Survey, 2019

Agriculture, Forestry and Fishing: The sectors performance is widely considered to have rebounded in 2018 despite its contribution to GDP marginally declining in nominal terms compared to 2017. This was mainly driven by marked improvement in crops and animal production that benefited significantly from the sufficient rains during the period under review. The dairy sector also rebounded from the contraction registered in 2017 on account of available fodder.

Manufacturing: The sector's contribution to the GDP declined from 8.4% in 2017 to 7.7% in 2018 on account of faster growth by other sectors. However, the sector's contribution was expected to improve towards 15% target contribution by 2030. In 2018, strong performance was recorded within the sector in agro-processing, manufacture of pharmaceutical, but there was a decline in cement production over the period.

Wholesale and retail trade: The sector posted marginal growth having maintained its contribution to GDP at 7.4 percent following significant growth in the prior years.

Transport and Storage: The sector expanded in 2018 compared to a similar period in 2017. The growth was supported by increased activity in rail transport through the Standard Gauge Railway (SGR).

Economic Outlook for 2019

The performance of Kenya's economy in 2018 is expected to be resilient and grow from 6.0 percent in 2018 to 6.2 percent in 2019.

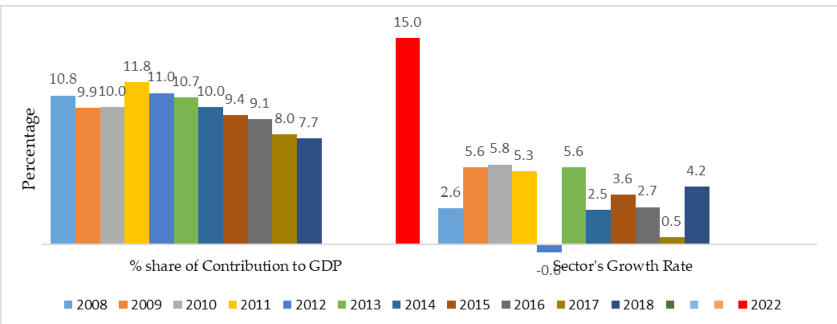
The impetus on "the Big 4" policy by government to increase the share of manufacturing in the economy, deliver affordable housing, roll-out universal health coverage, and improve food security is expected to lead to broad based economic recovery.

The effectiveness of policy options targeting below par growth in the manufacturing sector and lesser dynamism in the housing construction sector under the big four remains to be seen. This will be supplemented by expected agricultural output increase following long rains and rollout of universal healthcare programs.

According to the Big 4 Agenda, the manufacturing sector should contribute 15% of GDP by 2022. However, the sector's contribution has been on a declining trend; reducing from 11.8% in 2011 to 7.7% in 2018. Therefore, instead of industrializing, the Kenya is actually is de-industrializing. Even though the share of the manufacturing sector to the economy has been declining, the sector recorded a robust growth, increasing from 0.5% in 2017 to 4.2% in 2018.

Manufacturing sector contribution to the GDP and Growth Rate, 2008-2018

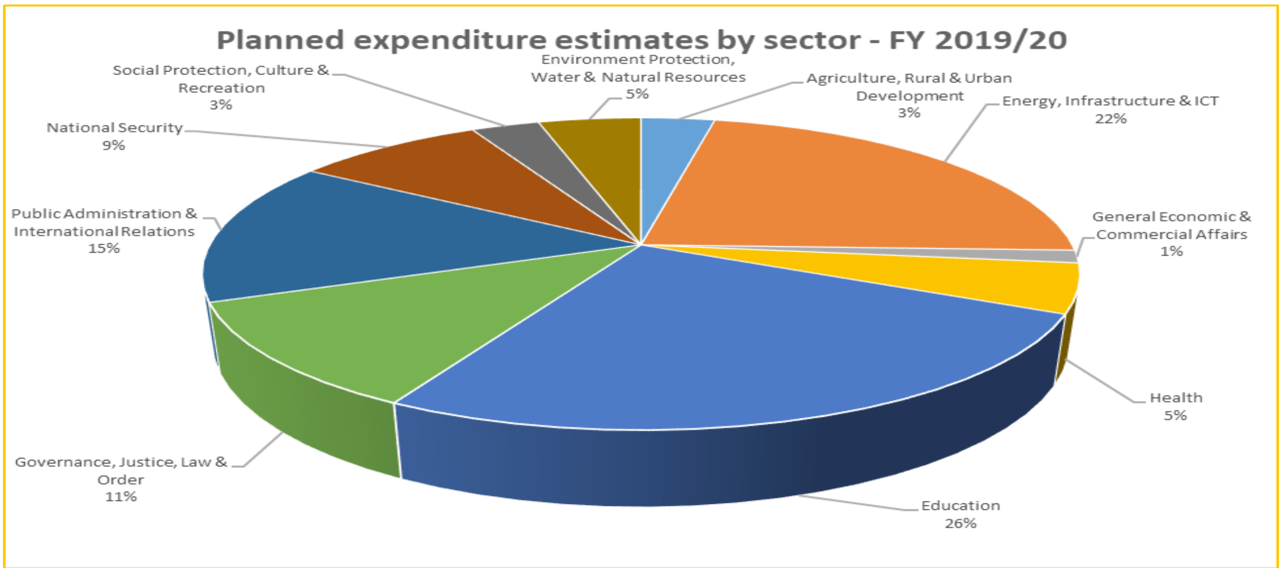
Data source: KNBS Economic survey (various)



2.1 Proposed Expenditure 2019/2020

The total proposed expenditure in 2019/20 is estimated at KSh 2,710 billion. It comprises of KSh 1,663 billion for recurrent expenditure with a ceiling of KSh 670 billion for development expenditure. Additionally, Ksh 372 billion will be transferred to counties.

Planned expenditure is summarised in the chart below:



Source: The National Treasury, Budget Policy Statement 2019-20

2.2 Direct budgetary allocations to the manufacturing sector

The National Government started making budgetary allocations to the Manufacturing Sector consistent with the Big 4 Agenda in the 2018/2019 budget. The table below provides a detailed breakdown of allocations made to the manufacturing sector in both the 2018/2019 and 2019/2020 budgets.

Budgetary allocations to the manufacturing sector: 2018/2019-2019/2020

2018/2019		2019/2020	
Budgetary item	Allocation (Ksh. million)	Budgetary item	Allocation (Ksh. million)
Kenani Leather Industrial Park	400	Development of the textile and leather industrial park, Naivasha Industrial Park and Cotton Development Subsidy	1,100
Textile development of EPZ hub	400	Growth of SMEs	1,700

Modernize RIVATEX	1,430	Constituency Industrial Development Centers	400
Modernize New KCC	200	Modernization of Kenya Industrial Research and Development Institute (KIRDI)	1,000
Total	**2,430**		**** 4,200**
% of the budgeted amount	**10**		**15**

Data source: Budget statements for 2018/2019 and 2019/2020

** Budgetary allocation increased from Ksh. 2.43 billion in the 2018/2019 financial year (FY) to Ksh. 4.2 billion in the 2019/2020 FY.

2.3 Proposed Expenditure Financing

For the 2019/20 fiscal year, the government projects total domestic revenue amounting to KShs. 2.08 trillion (which represents 18.3 percent of GDP). Of the projected total revenue per the budget policy statement, KShs 1.877 trillion will be generated from ordinary revenue (representing about 16.5 percent of GDP) and AIA of KShs 203 billion.

KRA's 7th Corporate Plan noted a consistent decline in revenue collection against set targets over the period 2015/16 to 2017/18. In half year 2018/2019 to December 2018, the Authority recorded a collection of Ksh 794.7 billion against a target of Ksh 855.7 billion revenue. Revenue performance fell short of approved targets on account of depressed Corporation Tax (CT) collections. However, this is expected to recover following completion of the roll-out of Revenue Enhancement Initiatives (REI) implemented by the Kenya Revenue Authority (KRA) such as taxation of the digital economy and the implementation of presumptive tax regime.

In FY 2018/2019, the government registered a shortfall of Ksh 61.0 billion as at December 2018 by Ksh 52.7 billion and Appropriation-in-Aid. A amounting to Ksh 8.3 billion on account of underperformance in all taxes except VAT.

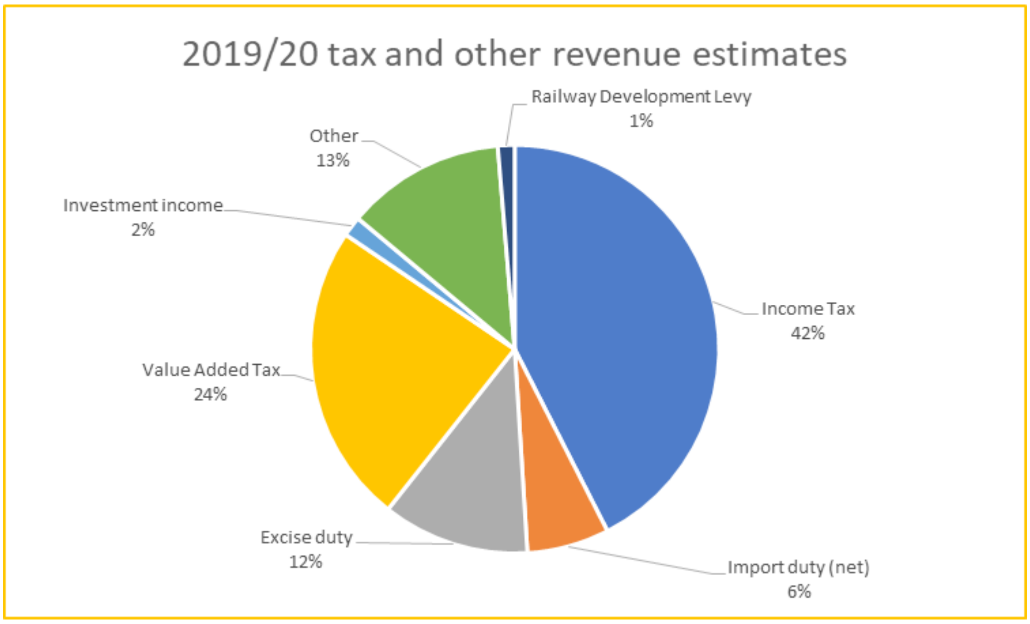
The government registered a shortfall in FY 2018/2019 of Ksh 61.0 billion as at December 2018 by Ksh 52.7 billion and A.i.A amounting to Ksh 8.3 billion on account of underperformance in all taxes except VAT.

Current year estimates have factored in projected underperformance in ordinary revenue with individual tax heads being closely monitored. The government anticipates to collect an additional ksh. 53 billion as a result of deliberate revenue enhancement efforts.

KRA's underperformance is widely expected to narrow following increased budgetary allocation to the agency to boost its collection efforts together with the following efforts:

1. Enhanced scanning and non-intrusive detection;
2. Utilization of Regional Electronic Cargo Tracking System (RECTS) to track transit and export cargo;
3. Utilization of third-party information to identify non-compliant taxpayers;
4. Detection of non-compliance through i-Tax data matching; and
5. Ongoing crackdown on illicit goods through the multi-agency team (MAT).

The figure below presents revised revenue estimates for FY 2019/20.



Source: BPS 2019 (final)

Policy interventions to benefit manufacturing sector as contained in 2019/20 Budget Statement

The 2019/20 Budget statement spelt various policies that are geared to reignite the manufacturing sector's growth and development. Majority of these policy directions are consistent with KAM's advocacy priorities, which are documented in the Association's Manufacturing Priority Agenda (MPA). The theme for the 2019 MPA is "Closing the manufacturing gap through the Big 4 Agenda for shared prosperity". The MPA highlights areas of urgent action for a dynamic manufacturing sector in Kenya so as to achieve the intended government goals. For example, under the Big Four Agenda in which the manufacturing sector is expected to contribute 15% of GDP by 2022.

The table below provides a highlight of some policy pronouncements by the Government which are consistent with MPA 2019.

Policy intervention as contained in 2019/20 Budget statement

	Policy issue	Brief description	Outcome from the 2019/20 budget statement	Implication
1.	High cost of Electricity	■ Electricity is one of the main inputs in the manufacturing process. Some sectors such as Metal and cement, electricity accounts for 40-50% of total conversion cost (KAM, 2018). ■ In 2018 Income Tax Act was amended to provide for a deduction of 30% of the total electricity by manufacturers as rebate subject to the conditions t by the Ministry of Energy. The framework has been developed. However, KAM is advocating for Ksh 9/ kWh.	■ The Ministry of Energy in consultation with relevant ministries and stakeholders have developed the framework that will be used so that manufacturers can enjoy rebate programme effective 2019/20 FY	■ The rebate programme is expected reduce the cost of electricity to manufacturers by about 20%, hence improve competitiveness of manufacturers.
2.	Purchase of locally assembled vehicles	■ Kenya Motor vehicle assemblers are operating at about 30% of the installed capacity.	■ Effective 1st July 2019, all Public Entities are required to give exclusive preference in procurement of motor vehicles and motor cycles from firms that have assembly plants in Kenya.	■ This will enhance capacity utilisation, create employment opportunities to the youth and increase revenue to the government
3.	Delayed payment of supplies	■ There has been an increase in the number of cases of delayed payment by both National and County Government to numerous businesses countrywide. ■ This is also widespread in the Private sector. Delayed payment impedes effective circulation of money in the local economy and denies manufacturers cash flow.	■ Proposal to amend the Competition Act to empower the Competition Authority to deal with abuse of buyer power and ensure prompt payment to suppliers. ■ The Government will endeavour to ensure that payments to suppliers of goods and services are made within a maximum of 60 days	■ The overall impact on this will be increased circulation of money in the economy and availability of working capital to business including manufacturers.
4.	Illicit Trade and Counterfeit	■ Illicit trade undermines the concept of a free and open market place, which is fundamental to improving competitiveness, increasing investment and creating jobs. The vice leads to loss of revenue by Government and denies genuine manufacturers their fair share of market. ■ In 2018, the President formed a Multi-Agency Team lead by Deputy Head of Public Service, Mr Wanyama Musiambo to re-ignite the fight against illicit trade.	■ Commitment to sustain the fight against illicit and counterfeit trade that was launched in 2018.	■ Increased revenue to both the government and businesses and enhanced market share to genuine manufacturers.

	Policy issue	Brief description	Outcome from the 2019/20 budget statement	Implication
5.	Local Content	■ There has been preference by Public Institutions to imported goods over those manufactured locally.	■ Development of a catalogue of items that are locally manufactured, assembled, mined or grown in Kenya and which will be given priority in public procurement consistent with the “Buy Kenya Build Kenya” initiative. ■ Further, no tax exemptions will be provided for any items on the catalogue.	■ This will enhance capacity utilisation, create employment opportunities to the youth and increase revenue to the government
6.	High cost of transport and logistics	■ The cost of Transport and logistics in Kenya has increased owing to inefficiencies at the Mombasa Port and Inland Container Depot in Nairobi (ICDN). ■ For instance, the cost of moving cargo from Mombasa to Nairobi has increased by 118% and 149% for 20ft and 40ft containers respectively (KAM, 2019). ■ This has been largely attributed to poor coordination of Government Agencies that intervene during clearance of cargo. This is compounded by huge payments of storage charges and Demurrages.	■ Unless there is prior intelligence on non-compliance, there shall be no further local inspection of cargo with a Pre-Verification of Conformity (PVOC) certificate at the point of export.	■ There is likely to be a reduction in the number of inspections thus significantly reducing time taken to clear cargo at the Port and ICDN and ultimately reduce amount of storage charges and demurrage cost.
7.	Plastic waste Management	■ In August 2017, the Government banned the use and importation of single use plastic carrier bags. Whilst industrial (primary) packaging are exempt from the ban, manufacturers are required to demonstrate the existence of a take back mechanism for the plastic packaging. ■ In January 2018, the National Environment Management Authority (NEMA) expressed its intent to ban Polyethylene Terephthalate (PET) bottles due to its negative impact to the environment resulting from poor and inefficient post-consumer waste disposal methods. ■ For years, the government has had no clear incentive structure to investors eyeing to invest in the recycling plants in support of circular economy.	■ Exemption from VAT for all services offered to plastic recycling plants and supply of machinery and equipment used in the construction of these plants. ■ Reduction of corporation tax from 30% to 15% for the first five years for any investor operating a plastic recycling plant. ■ Deletion of the provision for charging Excise Duty on plastic shopping bags to align it with the Environmental Management and Co-ordination Act which banned them from use	■ Encourage new investment in plastic recycling plants ■ Create jobs ■ Support environmental conservation as aspired under the Sustainable Development Goal (SDG) No 12 “Ensure sustainable consumption and production patterns”

	Policy issue	Brief description	Outcome from the 2019/20 budget statement	Implication
8.	SME Support	■ Access to affordable credit is one the many challenges that impede growth and development of Kenyan SME sub-sector. ■ In 2019 CBK launched mobile based credit scheme (Stawi loan) that brings 5 banks together to offer unsecured loans to SMEs ranging from 30k to 250k with repayment profiles of 1-12 months at 9% annually.	■ Introduction of an amnesty on the tax penalties and interests on any outstanding tax to enable SMEs to enlist in the Growth and Enterprise Market Segment (GEMS) segment of the Nairobi Securities Exchange Market (NSE) ■ Launch of SME Credit Guarantee Scheme to overcome limitation associated with lack of a collateral.	■ Enhance credit access to SMEs and therefore reduce attrition rate.
9.	Long Term finance	■ Currently there is no funding mechanism by either the Private or Public sector financial institutions that suits the unique funding requirements by manufacturers.	■ Merging of the Tourism Finance Corporation, IDB Capital and the Industrial & Commercial Development Corporation (ICDC) to form the Kenya Development Bank with a capacity to provide long term Industrial Finance.	■ Availability of a financing system that suits the nature of manufacturing business.

KAM tax proposals wins

KAM consulted members for tax proposals and engaged the necessary legislative authorities to lobby for a better manufacturing environment. The below are the tax proposals that were adopted. Other tax proposals will be discussed below this.

		Brief description	KAM proposal	Budget Statement outcome	Implications
1.	VAT Refund formula	■ The VAT Regulations 8(2), 2017 introduced a formula to determine the amount due as a refund to a registered person who makes taxable supplies at both the general rate and zero rate. ■ VAT Act 2013 is meant to cater for cases where a taxpayer can get full refund of excess input tax over output tax related to zero rated supplies. ■ The concern is the interpretation and application of the formula in actual fact which restricts the amount of refund rightly claimable by a person making zero rated sales. ■ The new formula restricts VAT refund amount by calculating refund using net position for the month and allowing percentage of export sales to total sales as refund amount.	■ Revert to the previous system of VAT refunds based on the difference of input and output VAT tax. ■ Introduce a domestic tax remission scheme (like previous TREO) which will allow VAT free imports for export purposes. ■ Amend the formula by replacing, currently the difference between input/ output VAT (e) with i = input tax.	■ The Cabinet Secretary proposed adjustment of the VAT refund formula in order to ensure full recovery of the portion of input tax relating to zero-rated supplies.	■ The proposed measure will incentivize Kenya's exports ■ It will also improve liquidity for manufacturers
2.	Withholding VAT (WHVAT)	■ The Withholding VAT system was re-introduced in 2014. Appointed WHVAT agents are required to withhold 6% of the tax payable at the time of paying for the supplies and remit the same directly to KRA. ■ The Tax Procedures Act allows suppliers to apply for Exemption Certificates, however this is only applicable after 24 months of continuous refund.	■ Reduce the WHVAT rate from the current 6% to 2%. ■ To reduce the effective period for the WHVAT exemptions from the current 24 month to 3 months.	The Cabinet Secretary proposed reduction of the withholding VAT rate from 6% to 2%.	■ The proposed measure will improve liquidity for manufacturers and open up cash flow triggering high productivity in their supply and value chains.

		Brief description	KAM proposal	Budget Statement outcome	Implications
3.	VAT credit amounts arising from the refund formula and WHVAT	■ Accumulation of VAT credit arising from the refund formula and WHVAT has caused huge financing gaps and liquidity constraints. To address this challenge, companies are forced to finance their operations from market-rate loans at 14%. This is an additional cost loaded onto the final unit cost of production, making the product uncompetitive especially in the export market. ■ There is currently no legal mechanism under which VAT credit amounts arising from the refund formula and WHVAT will be refunded to manufacturers.	Amendment of Section 17 of VAT Act 2013 to allow: ■ Refunds on excess credits as a result of the working of the refund formula and WHVAT ■ VAT refunds to be off-set automatically against other taxes payable.	■ The Cabinet Secretary for The National Treasury will constitute a team to quickly validate and clear outstanding refunds in the next 2 months.	■ Validation and subsequent clearance of VAT credits will address liquidity constraints by manufacturers.
4.	Anti-adulteration levy	■ The Finance Act, 2018 introduced an anti-adulteration levy of KES18 per liter to be levied at the point of importation to curb adulteration of diesel fuel by unscrupulous traders. ■ However, kerosene is an important raw material in the manufacture of paints and resins, shoe polish etc. ■ Introduction of this levy increased the cost of production very significantly making the products uncompetitive against imports from Egypt and other countries.	■ Conversion of the anti-adulteration levy into an excise tax to enable refunds for all manufacturers who use kerosene as an input.	■ Proposed introduction of a provision, under the Miscellaneous, Fees and Levies Act, 2016 to allow manufacturers of paint and resin to get refund on the levy paid.	■ Will reduce cost of production for paint and resin manufacturers translating to lower prices for final consumers. ■ It will also improve competitiveness for paint and resin manufacturers against imports.
5.	Import Declaration Fee (IDF)	■ IDF is charged on all goods imported into the country for domestic use including basic and intermediate raw materials at a rate of 2% of the customs value of the goods ■ It increases the cost of imported raw materials and thus increasing the unit cost of production and ultimately the prices at which the consumers get the products.	■ Remove IDF from all industrial inputs (basic raw materials and intermediate inputs).	■ Reduction of IDF on raw materials and intermediate goods from 2% to 1.5%.	■ This proposal will reduce the cost of imported raw materials and thus improve competitiveness of local manufacturers against finished imports.
6.	Railway Development Levy (RDL)	■ RDL is charged on all goods imported into the country for domestic use including basic and intermediate raw materials at a rate of 1.5% of the customs value of the goods. ■ It increases the cost of imported raw materials and other industrial inputs and thus increases the unit cost of production and ultimately the prices at which the consumers get the products.	■ Remove RDL from all industrial inputs (basic raw materials and intermediate inputs).	■ Increment of RDL for finished products from 1.5% to 2%.	■ To further increase competitiveness of manufacturing sector in Kenya, RDL on imported industrial inputs should be removed

4. Other tax proposals and miscellaneous provisions

4.1 Business tax

- Increase of Capital Gain Tax (CGT) from 5% to 12.5%. This will impact different companies net gains from disposals of different assets.
- Corporate internal legal restructures will be exempted from CGT. This will be based on some guidelines that have been proposed for any Person to qualify for the exemption.
- List of services subject to withholding tax expanded to include security, cleaning & fumigation, outside catering, ground and water transportation of goods and advertisement services.
- Proposal to bring e-commerce platforms (digital market place) into taxation.
  - Digital market place has been defined to mean a platform that enables, by electronic means, direct interaction between buyers and sellers of goods and services.
- Liabilities arising from non-deliberate or unintentional acts of omissions or commissions not subject to tax shortfall penalty.
- Income Tax Bill, 2019 at an advanced stage of legal drafting awaiting tabling in front of National Assembly.

4.2 Personal tax

- Affordable housing relief to be calculated on 15% of employee's contribution rather than gross emolument up to a maximum of KES 108k per annum.

4.3 Value Added Tax (VAT)

- Definition of "supply of imported services" will been expanded to include non-registered persons.
- The time and supply of imported goods has been expanded to include the time the goods are removed from the Special Economic Zone.
- Exemptions
  - Locally manufactured motherboard and inputs used in their manufacture to transform Kenya into a major manufacturer and supplier of electronics and computers in the East Africa Community
  - Plant, machinery and equipment used in construction of plastic recycling plants with the aim of reducing pollution from the unbanned plastic waste
  - Agricultural pest control products
  - Input or raw materials for electric accumulators and separators including lead battery separator rolls supplied to manufacturers of automotive and solar batteries
- Taxable (16%)
  - Road tractors for semi-trailers (Tractors used for agriculture will retain the VAT exempt status)
- Zero Rated
  - Denatured Bioethanol

4.4 Customs and international trade

The proposed measures are intended to make Kenyan products more competitive while at the same time protecting local industries from unfair competition. These measures are expected to boost the manufacturing sector under the Big Four plan which is expected to grow to 15% of GDP by 2022 namely:

- Metal and Allied sector which continues to face stiff competition from imported cheap and subsidized iron and steel products.
- Paper and paper board sector which has sufficient capacity to produce hence the need to protect these industries
- Government banned the logging of trees to stop deforestation. However, manufacturers who use raw timber to manufacture furniture and other products are affected by this measure as they now lack adequate supply of raw timber - To address their plight and at the same time protect our forests, there is a proposal proposed to reduce import duty on raw timber

The customs duty measures are as follows:

- Duty remission for key items i.e. wheat grain, motor cycle kits, industrial sugar, roofing tiles coated with acrylic paint
- Lower CET rates
  - Reduced import duty rate on raw timber from 10% to 0%
  - Reduced import duty rate from 10% to 0% on polymers of vinyl acetate
  - Lower import duty rate of higher of 35% or USD 0.2/Kg on worn clothing instead of higher of 35% or USD 0.2/Kg
- Higher CET rates
  - Maintained higher import duty rates applicable on selected imported iron and steel products
  - Minimum specific rate of USD 500/MT on refined edible oil
  - Increased duty rate on prefabricated buildings from 25% to 35% or USD 250/MT
  - Increased duty on liquid petroleum gas (LPG) cylinders from 0% to 25%
  - Increased duty on paper and paperboard instead from 10% to 25% rate
  - Miscellaneous fees and levies proposals
  - Increase of Railway Development Levy on finished products from 1.5% to 2.0% except for raw materials and intermediate goods imported by approved manufacturers who will be charged 1.5%.
  - Increase import declaration fee on finished goods from 2% to 3.5%. Raw materials and intermediate goods that are for manufacture to be remitted to 1.5%
  - Impose 10% export levy on wet-blue and crust hides and skins exported outside East Africa Community (EAC)
  - Introduced a standardized prescribed import declaration form
  - Refund of anti-adulteration levy paid on illuminating kerosene for manufacturers of paint

4.5 Excise duty

- Decrease of duty of all motor vehicles that are fully powered by electricity from 20% to 10%.
- Increase of specific rates of duty of spirits, wine and cigarettes by 15%.
- Introduction of a general penalty of a fine not exceeding KES 2m or imprisonment for a term not exceeding 2 years or both to cover offences under the Act or regulations without penalties.

4.6 Financial sector highlights

- The Capital Markets Act to empower the Authority to enforce penalties and interest as well as sanctions on market players who violate laid down rules and procedures.
- Introduction of the National Electronic Single Window Bill, 2019 to establish the legal framework for the operation of the National Electronic Single Window System and re-establishment of the Kenya Trade Network Agency as well as formalize the issuance of electronic certificates/permits.
- Repeal of the interest rate capping regulations

4.7 Other key highlights

- The National Government, in collaboration with the County Government are in the process of enacting the County Governments' Revenue Raising Process Bill (2018) aimed at regulating the introduction of levies by county governments to enhance a conducive business environment across counties.
- The Government has finalized the revival of RIVATEX, and has allocated resources for development of textile and leather industrial park, Naivasha industrial park, and cotton development subsidy which will play a great role in job creation.
- The Government is keen on partnering with the private sector to augment the funding of infrastructure development.
- The Kenya Sovereign Wealth Fund Bill, whose aim is to guide the investment of revenues from oil, gas and mineral resources is undergoing legal drafting before submission to parliament for approval

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CLP04

About KAM

KAM is a Business Member Organization representing value-add companies and associate services in Kenya. Its members' significant contribution to the economy is estimated at a quarter of the country's Gross Domestic Product. The Association provides an essential link for co-operation, dialogue and understanding with the Government and other key stakeholders by representing its members' views and concerns through fact-based policy advocacy.

KAM promotes trade and investment, upholds standards, encourages the formulation, enactment and administration of sound policies that facilitate a competitive business environment and reduce the cost of doing business.

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