9 August 2019

The Clerk, Kenya National Assembly
Parliament Buildings
P.O. Box 41842-00100
Nairobi Kenya
Email : clerk@parliament.go.ke

Dear Sir,

RE: SUBMISSIONS ON NATIONAL GOVERNMENT FINANCE BILL FOR FY 2019

Members of non-state organisations listed below deliberated and conducted analysis to add value to the 2019/2020 Finance Bill and prepared this joint memorandum for the National Assembly's Budget and Appropriation Committee.

This Memorandum was prepared by the following organizations: Development Initiatives; East Africa Tax and Governance Network; Institute for Public Finance Kenya; International Budget Partnership Kenya; National Taxpayers Association and Oxfam.

The memorandum highlights the observations and recommendations based on the analysis of various proposals outlined in the Finance Bill 2019. We assessed past performance in revenue collection; equitability of proposed tax measures; and the implications of Finance Bill 2019 from gender, small businesses and low-income earners' perspectives. Each sector identified in this submission, including agriculture, manufacturing and housing sectors contains tax proposals, our comments and recommendations for your consideration.

Summary

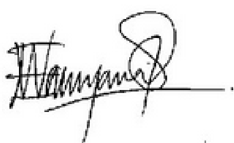
1. *The poor affected adversely*: The principle of equity is not considered in some of the proposed tax measures. The poor, therefore, are likely to be disproportionately affected by the tax measures.
2. *The wealthy favoured*: Tax incentives/exceptions have been provided for corporations without adequate justification in some cases. This may deprive the country of the revenue needed to provide services to the citizenry.
3. *Limited information*: Neither the Finance Bill nor the budget statement which introduced the tax measures to Parliament gives an indication of what impact the proposed measures will have to different sections of the society. Furthermore, the Bill does not provide a breakdown of the revenue that is to be raised by each of the proposed tax measures. Such information should be provided to facilitate analysis of how realistic the revenue targets are.
4. *General lack of evidence*: There is no evidence provided to indicate tax plans and introduced changes are as a result of studies on fiscal multipliers, impact on labour supply, investment, capital stock, total factor productivity or changes in consumer demand.

Thank you for your consideration,

Yours sincerely

Leonard Wanyama, Coordinator,

The East Africa Tax and Governance Network (EATGN), Email: lwanyama@taxjusticeafrica.net



Date: 9 August 2019

Background

The Finance Bill 2019/20 sets out the main tax measures that the national government intent to implement to raise revenue to finance the 2019/20 budget. The Bill proposes various changes to the legislation relating to taxes and duties. These include the Income Tax Act, Value Added Tax, Excise Duty Act, Tax Procedures Act, and Miscellaneous Fees and Levies Act. The proposed changes to tax rates that are expected to increase revenue mobilization in the coming financial year. In addition, the Bill outlines several tax incentives to support achievement of the government's Big Four Development agenda that includes construction of 500,000 affordable housing units, ensuring food security, providing universal health coverage and increasing the share of manufacturing in the gross domestic product (GDP) to 15% by 2022. In the subsequent sections of this analysis, we provide a detailed discussion and recommendations in relation to some of the tax measures proposed in the Finance Bill, as well as past performance in revenue collection.

Key revenue raising proposals for the 2019/20 fiscal year

The finance bill and the budget statement that highlights the proposed revenue measures should clearly give a summary of all the changes either per tax law or per sector. In addition, the amount of extra revenue that is expected to be raised from the proposed measures should be indicated and clearly justified. It is only from this kind of information that one can start analysing how realistic the targets are or not.

The finance bill and related documents should also provide details on whether the proposed revenue raising measures are new or they are revised versions of existing revenue streams. In cases where the revenue streams are not new, the previous rates should be provided for comparison.

The Cabinet Secretary, National Treasury in his budget statement to parliament indicated that the tax measures in the Finance Bill 2019/20 would raise additional KES 37 billion. While, the budget statement goes ahead to provide the measures under different tax streams it does not provide a breakdown of how much will be generated from each of them. Table 1 highlights some of the main tax proposals in the Finance Bill 2019/20.

Table 1: Key tax proposals in the Finance Bill 2019/20

Tax	Proposal
Capital gains tax	Capital gains tax to be increased from 5% to 12.5%.
Withholding Tax	Additional services that are to be subjected to withholding tax include security, cleaning and fumigation, catering services offered outside hotel premises, transportation of goods excluding air transport, sales promotion and marketing and advertising.
Value Added Tax (VAT)	Locally manufactured motherboards and all inputs used in their manufacture to be exempted from VAT.
	All services offered to plastic recycling plants and supply of machinery and equipment used in construction of these plants to be exempted from VAT.
Corporation tax	Corporation tax to be reduced to 15% for the first five years for any investor operating a plastic recycling plant.
Import duty	Import duty on raw timber to be reduced from 10% to 0%.
Excise duty	Excise duty of 10% of the amount staked is to be charged on betting activities.
	The excise duty on motor vehicles that are fully powered by electricity to be reduced to 10%.
	The rates of excise duty on cigarettes, wines and spirit to be increased by 15%
Miscellaneous, fees and levies	Manufacturers of paint and resin to get refund on the anti-adulteration levy charged on illuminating kerosene.

Import declaration fee (IDF)	IDF paid by manufacturers on intermediate goods and raw materials to be reduced from 2% to 1.5% while the rate on finished goods to be increased from 2% to 3.5%.
Railway Development Leavy (RDL)	RDL for finished products is to be increased from 1.5% to 2%.
Export levy	An export levy of 10% is to be imposed on tanned and crust hides and skins

Equitability of the proposed tax measures (International Budget Partnership-Kenya)

The Finance Bill and related documents should provide information that show who are the main beneficiaries of proposed tax measures. The PFM Act, section 40(5) and section 132(3) provides that revenue raising mechanisms should take into consideration principles of equity. Finance bills should also clearly highlight how the measures are distributed equitably. This kind of information should also come with some explanation on the potential impact of the bill on the economy. For example, if the law proposes to increase taxes on certain forms of petroleum products how will that affect different cadres of the population especially the poor?

Neither the Finance Bill nor the budget statement which introduced the tax measures to Parliament gives an indication of what impact the proposed measures will have to different sections of the society. The National Treasury should provide details of who the taxes or levies will mostly affect and whether that is progressive or counterproductive in the long run. This should also be a point of evaluation for the National Assembly before approving any tax measures whether new or just amended. Table 2 provides analysis of the equitability of the tax proposals.

Table 2: Analysis of the equitability of proposed tax measures

Clause	Tax	Proposal	Equity evaluation
9	Capital gains tax	Transfer of property that is necessitated by a transaction involving the incorporation, recapitalization, acquisition, amalgamation, separation, dissolution or similar restructuring of a corporate entity to be exempted from capital gains tax.	Issuing tax breaks to big corporates seems to go against the principle of equity where those who make more should pay more. The Bill does not make any argument on how the corporations would be negatively affected if they pay the required taxes.
12	Personal income tax	Ajira Digital Programme members will be exempt from regular taxation and will only pay a one-off registration cost of KES 10,000 each year	While the proposals will be good for the small-scale entrepreneurs, should the exemptions be extended to other startups at the same level as those who will be under Ajira?
7	Turnover tax	The turnover tax shall be payable by any person whose turnover from business does not exceed or is not expected to exceed five million shillings during any year of income. This should be read together with the presumptive tax that had been introduced by the Finance Act 2018.	This is a more flexible approach compared to the fixed presumptive tax that had been introduced in the Finance Act 2018. However, the administrative cost of filling these taxes should be evaluated before it is implemented.
23	Excise duties	Full electric cars will attract a tax of 10% down from 20%. Meanwhile, vehicles with an engine capacity of 1500 cc and above will attract a tax of 25%.	This seems to be an unequal taxation approach. Electric cars are very expensive and therefore bought by the wealthy in the society. However, the lower capacity vehicles that are mostly imported as second-hand goods are mostly bought by the middle class and small business owners such as taxis. It is, therefore, not fair to give tax breaks for goods bought by the rich and taxing more the goods bought by the poor and middle class.
	Miscellaneous, fees and levies	Tax on imported finished goods to increase from 2% to 3.5%	Kenya is a net importer of many manufactured goods including crucial ones such as medicines. While the objective might be to spur local manufacturing, it may also affect access to essential goods among the poor.

Analysis of past performance in revenue collection (Institute of Public Finance-Kenya)

Article 209 (1) allows the National Government to impose income tax, value added tax, excise duty and customs duties and other duties on imports and exports. Although revenue collection increased in the past fiscal years, the set targets were not achieved (Table 3). The shortfalls in revenue collection means that inadequate resources are available for service provision at the national and county governments. According to the Budget Policy Statement (BPS) 2019, the cumulative revenue shortfalls between 2015/16 and 2018/19 was nearly KES 400 billion with the largest deficit being KSh195 billion experienced in 2017/18 fiscal year.

In 2016/17 fiscal year, actual revenue collection was KES 1.4 trillion against a target of KES 1.46 trillion. The deficit of KES 54.8 billion was attributed to the poor performance in the collection of appropriation in aid (A-I-A) and excise duty. The revenue collected in the 2017/18 fiscal year was KES 1.49 trillion against a target of KES 1.66 trillion. The deficit of KES 172.3 billion was attributed mainly to the shortfalls in the collection of income tax and A-I-A. In the 2018/19 fiscal year, the revenue collection target in the first nine months was KES 1.18 trillion – KES 109.6 billion less than the target of KES 1.29 trillion. Consistent failure to achieve revenue collection targets leads to budget deficits that necessitates borrowing.

In order to improve revenue collection, the National Treasury will implement the Revenue Enhancement Initiatives (REI) being put in place by the Kenya Revenue Authority. These include (1) Regional Electronic Cargo Tracking System (RECTS) to ensure all goods reach the desired destinations; (2) enhanced scanning to detect concealment; (3) increase efficiency in cargo clearing through procurement of additional scanners and full integration of all scanners.

Recommendations

- Revenue projections should be made based on evaluation and analysis of the sources and its potential to meet the set targets. Shortfalls in revenue collection hamper implementation of government programmes.
- In order to boost revenue collection, the government should put measures in place to increase the tax base while providing a friendly business environment.
- There is need to consider alternative sources of resources, especially for the provision of service to citizens. This can be done through issuing of social impact bonds and green bonds.
- The National Treasury should plan for public expenditure based on revenue generation capabilities. This will ensure that the revenue targets for each financial year are realistic.

Table 3: Revenue collection between 2016/17 and 2018/19 fiscal years

	Revenue Targets FY2016/17 (Amounts in millions)	Actual FY2016/17	Revenue Targets FY2017/18 (Amounts in millions)	Actual FY2017/18	Revenue Targets FY2018/19 (Amounts in millions)	Actual FY2018/19 (As at 31st March, 2019)
Ordinary Revenue	1,311,323	1,305,794	1,489,633	1,365,063	1,160,332	1,064,313
Import Duty	89,220	89,943	103,391	99,215	88,268	78,822
Excise Duty	170,258	165,474	179,413	162,484	151,832	142,759
PAYE	318,047	305,164	379,851	350,631	294,581	281,718
Other Income Tax	305,825	319,886	329,418	289,962	234,155	188,379
VAT Local	194,185	194,234	218,596	206,257	174,959	168,606
VAT Imports	143,385	144,800	159,435	150,599	140,915	131,540
Investment Revenue	28,322	28,524	31,561	24,123	19,554	24,571
Traffic Revenue	2,873	2,755	3,146	3,077	2,575	2,919
Taxes on Intl. Trade & Trans.(IDF Fee)	24,669	22,947	26,199	23,782	21,681	17,650
others	34,538	32,067	58,624	54,934	31,812	27,349
Appropriation in Aid (A-I-A) /2	144,067	94,784	169,977	122,164	129,502	115,872
o/w Railway Development Levy	18,530	18,903	21,169	20,773	18,327	15,787
Total Revenue	1,455,390	1,400,578	1,659,611	1,487,227	1,289,834	1,180,186
External Grants	58,784	26,312	42,953	27,600	37,155	16,834
Total Revenue and External Grants	1,514,174	1,426,891	1,702,564	1,514,827	1,326,989	1,197,020

Source: Quarterly Economic and Budgetary Review FY2016/17 to FY2018/19

Sector specific analyses and recommendations

Agriculture sector, Ajira Programme and petroleum (Development Initiatives)

Table 4: Analysis of proposals applicable to agriculture, Ajira Programme and inflationary adjustment of excise duty

Clause.	Subject	Tax proposal	Comments	Recommendations
18	Value added tax	Agricultural pest control products are to be exempted from value added tax	This proposal is expected to improve access to pest control products to enhance agricultural production for food security and raw materials for agro-processing.	Agricultural pest control products should be zero-rated rather than exempted from value added tax. Unlike exemption, zero-rating will allow producers of pest control products to claim input VAT credits, thereby making the products cheaper.
12	Exempting from taxation, the income earned by individuals under the Ajira Digital Programme.	Ajira Digital Programme beneficiaries (individuals) to pay an annual registration fee of KSh 10,000 for the next three years in lieu of tax.	While the exemption is meant to promote youth employment, pegging it (the exemption) on an annual registration fee of KSh 10,000 does not consider ability to pay/fairness. Some individuals are bound to earn high income from digital freelance work while others may not earn much in a year. Thus, requiring everyone to pay the same	Drop the registration fee as a condition for qualifying for the exemption. A system for taxing high income earners (a threshold should be determined through a study of earning patterns) from digital freelance work should be established. The exemption should be maintained for low income earners.

			fee in order to benefit from the exemption is not fair.	
23	Inflationary adjustment of the rate of excise duty	The Bill proposes a change in the effective date of the inflationary adjustment from July to October. Currently, in line with the Excise Duty Act, 2015, the Commissioner General of Kenya Revenue Authority through Legal Notice 109 of 9th July has already adjusted the rates of excise duty applicable to various products including petroleum by 5.2% to cater for inflation.	The proposed change in effective data is expected to align new rates to the effective date of the Finance Act. However, the Bill should also consider the potential impact of the new rate that come into effect in July. In particular, the adjustment has had an immediate impact on fuel (petrol, diesel and kerosene) prices through higher excise duty. For instance, the price of petrol has increased by a shilling per litre (KSh1.02) since 1st of July 2019. The adjustment could affect the cost of living since majority of Kenyans depend on petroleum fuels for lighting, cooking and transportation. Also, the prices of various products are likely to rise due to the use of petroleum fuels for industrial production.	To avoid overburdening citizens, the 2018/19 exemption of petroleum products from the inflationary adjustment should be extended to the 2019/20 financial year. Since a VAT of 8% has recently (in 2018/19) been imposed on petroleum products, the government should consider alternative ways of maximizing revenue collection.

Manufacturing (National Taxpayers Association)

Table 5: Analysis of proposals that affect the manufacturing sector

Clause	Subject	Tax proposal	Comments	Recommendations
13	Reduced corporate tax rate for plastic recycling plants	The Bill proposes to introduce a reduced corporate tax rate of 15% for companies operating plastics recycling plants. The rate will be applicable for the first five years from the year of commencement of the company's operations	Over the recent past, the government has increased measures that are geared towards discouraging the use of plastics in a bid to reduce pollution. This move will incentivize companies to setup plastic recycling plants which is in line with the government's clean environment agenda.	The government should ensure that apart from recycling plastics the companies should be able to create job opportunities for youth, women and persons living with disabilities in order to qualify for the exemption.
27	Reduction of the withholding VAT rate from 6% to 2%	The Bill proposes to amend the Tax Procedures Act (TPA) by reducing the withholding VAT rate from 6% to 2%.	While the TPA allows for application for exemption from withholding VAT, some taxpayers have continued to be in perpetual tax overpayment position as a result of withholding VAT and	At present whenever a manufacturer pays 16% upon the importation of raw materials, the effective rate becomes 22% when they supply and 6% is withheld by creditors. This lowers their creditworthiness with financiers. The proposed review to reduce VAT Withholding Tax to 2%,

			thus have their cash flow negatively affected. It is hoped that this measure will reduce the pile up of VAT credits arising from withholding VAT and free up cash flow for crucial business needs.	will improve liquidity for many manufacturers and improve cash flow to ensure high productivity in their supply and value chains.
23	Increase of excise duty on cigarettes, spirits and wines	The Finance Bill 2019 has proposed to increase excise duty on tobacco and tobacco products, cigarettes, spirits and wines by 15%.	The move by the government to increase excise duty on tobacco and its products is good move to control the consumption of tobacco. However, the 15% increment is still below the WHO recommended tax rate of 70% to discourage the consumption of tobacco as contained in the WHO FCTC which Kenya is a signatory	The tax on tobacco should be increased further by 12% to attain the WHO recommended rate of 70%. The government should introduce a uniform tax rate that gradually moves Kenya to achieve the 70per cent share of tax in the total retail price of cigarettes. The simulation results indicate that the uniform tax rate of KES 2500 per mille performs better than the current two-tier tax.

Housing (National Taxpayers Association)

Table 6: Analysis of proposals that affect the housing sector

Clause	Subject	Tax proposal	Comments	Recommendations
9	Capital gains tax rate to be increased from 5% to 12.5%	The Bill seeks to increase the Capital Gains Tax (CGT) rate from the current 5% to 12.5%	The proposed increment is a welcome move to increase revenue which can be directed towards provision of public goods.	Clear implementation plan should be put in place to determine the true value of properties in order to curb tax avoidance. The problem of undervaluation should be addressed.
8	Tax exemption extended to investee companies of Real Estates Investment Trusts (REITs)	The Bill seeks to expand the scope of income tax exemption to include the income of companies through which REITs hold property (investee companies)	Currently, the ITA only exempts REITs from income tax. As such, the income of investee companies owned by a REIT is subject to tax.	The exemption of investee companies is a move that may deprive the country from attaining maximum revenue collection. Therefore, the proposal should be reversed to the old regime.
12	Income of National Housing Development Fund (NHDF) exempted from tax	The Bill proposes to exempt the income of the National Housing Development Fund from income tax by inclusion in the First Schedule to the ITA.	The proposal by the government to exempt income earned by the Fund is a good move as this will ensure that the Fund's income is fully utilized to enable it to undertake its objectives of delivering affordable housing. This is in line with the government's Big Four Agenda	
13	Change of base for the affordable housing relief	The Bill proposes to amend the affordable housing relief under the ITA to be computed at 15% of the employee's contribution and not the gross emoluments as is currently provided.	This measure is a move to correct the current provision which based the relief on gross emoluments and would have led to a situation where the relief exceeds the affordable housing contribution.	

Gender (Oxfam)

Table 7: Analysis of proposals from a gender perspective

Clause	Subject	Tax proposal	Comments	Recommendations
7	Turnover and presumptive tax	In the Finance Bill 2019, paragraph 7 refers to Section 12C of the income Tax Act, turnover tax and presumptive tax. A tax to be known as turnover tax shall be payable by any resident person whose turnover from business does not exceed or is not expected to exceed five million shillings during any year of income.	The remittance of the presumptive tax and turnover tax puts a double burden to small businesses often employing and run by women. This eats into man hours and potential revenue of these small businesses.	The Finance Bill 2019 should simplify the filing of taxes by small businesses especially the presumptive tax without adding an undue burden on small businesses.
36	Anti-adulteration levy charged on kerosene	Paragraph 35, that makes reference to Section 8 of the Miscellaneous, Fees and Levies Act, 2016, provides for a refund of levy on kerosene used for manufacture of paint, resign or shoe polish.	The levy impacts on low-income households who rely on kerosene for cooking and lighting. The exemption to manufacturers is blind to the impact on households which put a strain on disposable income. Often because cooking falls within the ambit of unpaid care work done by women, this cost is often borne directly by women rather than men within the household.	The Finance Bill 2019 should apply an equal consideration to households using kerosene for domestic consumption.

Tax Amnesty (East Africa Tax and Governance Network)

Table 8: Proposal to delete section 37B (4) of the Tax Procedures Act, 2015

Clause	Subject	Tax proposal	Comments	Recommendations
PART V - Tax Procedures	Tax Amnesty - Exemption of remittances from provisions of The Proceeds of Crime and Anti-Money Laundering Act, introduced by the Finance Act 2018	Remove a pre-existing tax amnesty for money transfers repatriated from incomes or investments held in foreign countries by one year. The amnesty is intended to encourage remittances of funds held outside Kenya into the country to boost the economy	The Proceeds of Crime and Anti-Money Laundering Act, 2009 is intended to safeguard against entry of suspect money that could be proceeds of crime and which could also be used to fund crimes such as terrorism. While the proposed S. 37 B (4) of the Tax Procedures Act 2015 excludes funds derived from proceeds of *terrorism, poaching and drug-trafficking*, this is not helpful, because money does not come with labels. It is only upon inquiry as provided for in the Proceeds of Crime and Anti-Money	Include a clause in the Finance Bill 2019 to delete section 37B (4) of the Tax Procedures Act, 2015 seeking to exempt remittances from the provisions of Proceeds of Crime and Anti-Money Laundering Act, 2009 and other regulations relating to reporting and investigation of financial transactions. Suggested Clause (to be inserted between the current Clause 24 and 25 of the Finance Bill, 2019)

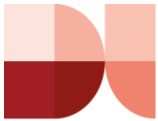
Laundering Act, 2009 and Central Bank Prudential Guidelines that the suspect origin of funds can be discerned.

Retaining this proposed exemption poses many risks:

(a) Security threats: this blanket exemption will weaken the current know-your-customer rules and disclosure procedures under the Proceeds of Crime and Anti-Money Laundering Act and Central Bank Prudential Guidelines. This will in turn open ways for entry of suspect funds that could fund terrorism and similar organized crimes.
(b) Economic distortion. The blanket amnesty threatens safeguards against money laundering which will in turn open the Kenyan economy to the risks of money laundering including economic and political instability.
(c) The exemption is also inconsistent with Kenya's international legal obligations relating to controlling transnational and international money laundering and terrorism financing, for example, under the United Nations Convention against Corruption to which the country is party.

"The Tax Procedures Act, 2015 is amended at section 37 B by deleting paragraph 4 "

About the contributors



Development Initiatives (DI) is an independent international development organisation working on the use of data to drive poverty eradication and sustainable development. Our vision is a world without poverty that invests in human security and where everyone shares the benefits of opportunity and growth. We work to ensure that decisions about the allocation of finance and resources result in an end to poverty, increase the resilience of the world’s most vulnerable people, and ensure no one is left behind.

The **East Africa Tax and Governance Network (EATGN)** is a collaborative initiative of various East African civil society organisations with diverse interests on tax issues within the region. EATGN stands for a just, transparent, accountable and citizen driven tax system in East Africa, and it aims to mobilise citizens to advocate for equitable tax policies and practices through capacity building, research and campaigning. This is due to recognising a conscious need for a greater understanding of taxation, tax justice and public financial management issues within the East African Community.

The **Institute of Public Finance (IPF)- Kenya** is an independent, non-political and non-religious entity established to champion for open public finance management systems. Through research, trainings and capacity strengthening, IPF-Kenya promotes public participation in policy reviews; strengthens the capacity all public finance stakeholders; and generates new knowledge to respond effectively and timely on issues relating to management of public finance.

The **International Budget (IBP)**: For over 20 years, IBP has been working to make public finance systems more transparent and accountable. IBP focuses on government budgets as they are the core of development. Its four interlinked areas of work include: *building organisations* by developing the skills and relationships needed to improve budget processes; *opening budgets* through building an evidence base to promote greater openness; *establishing global norms*; and *learning what works* to inform more strategic and effective practices.

The **National Taxpayers Association (NTA)** is a civil society organization promoting accountable, effective and efficient collection and utilisation of public resources. NTA strives to achieve its mission by demanding accountability from government and public institutions regarding the delivery of essential services and the management of devolved funds; demanding accountability from citizens with regard to their obligations under the Kenya Revenue Authority Taxpayer's Charter; providing information to citizens in response to their information needs; and compiling and submitting Citizen Report Cards to government on the management of devolved funds and provision of sub-county level services.

Oxfam in Kenya is a development, humanitarian, and campaigning organisation that works with others to alleviate poverty and inequality. Since 1963, Oxfam in Kenya has worked with partners in long-term development programmes, humanitarian assistance, peace and conflict resolution programmes and actively engaged in campaigning for better governance and equitable access to services. Oxfam in Kenya works on the premise that poverty and powerlessness are avoidable and can be eliminated by human action and political will. Oxfam in Kenya believes every Kenyan has a right to make free and informed choices to build sustainable livelihoods and resilience to external shocks.