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Understanding Kenya's 2014/2015 National Budget

Budget Bulletin

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Budgeted development expenditure must be fully implemented to spur economic growth to enhance productivity.

Transformational efficiencies and effectiveness in service delivery

Execution of budget vital for economic stimulation

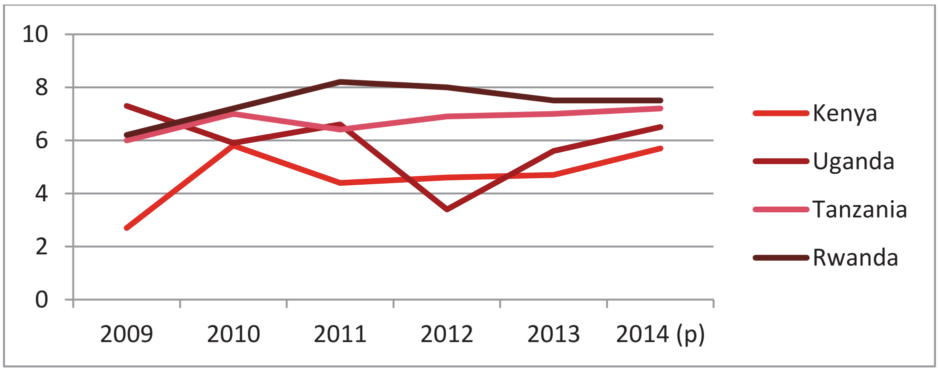
Economic growth modest but not enough

The government's development agenda is founded on 'Economic Transformation for Shared Prosperity' which is the cornerstone of the administration's fiscal strategy. The budgeted expenditure proposal of KES 1.77 trillion in 2014/15, representing an increase of 11% on the 2013/14 budget of KES 1.6 trillion, is geared at stimulating growth through investment in infrastructure and social services. For this to be achieved the government must address challenges in absorbing development expenditure.

According to the Economic Survey 2013, the Kenyan economy grew by 4.7% and is projected to grow 5.7% in 2014. The growth was achieved against a backdrop of a stable macroeconomic environment, characterized by low inflation of 5.8% and a relatively stable exchange rate. Nonetheless, insecurity increased and is adversely affecting the tourism sector. Additionally poor rains could increase inflation and erode the aggregate demand for goods and services.

Our neighbours are growing fast and so should we by doing more business with them.

Fig 1: Kenya and its neighbours economic growth trend (2009 – 2013)



Data Source: World Bank

Agricultural productivity and value addition needs to be accelerated.

Kenya continues to benefit from fast growing neighbouring economies, which provide markets for exports for manufactured products and human capital. Continued ease of trade in the region will enhance productivity and economic development.

Domestically, growth has largely been driven by significant increase in domestic household consumption and investment. The financial intermediation and communication sectors which grew by 7.2% and 6.0% respectively were some of the major contributors to the GDP growth. Inadequate rainfall and significant fall in global prices of coffee and tea led to a depressed growth of 2.9% in the agricultural sector compared to 4.2% the previous year.

Table 1: GDP Composition and Sectoral Growth

	2012	2013	2012	2013
Agriculture & Forestry	24.6	25.3	4.2	2.9
Wholesale and Retail Trade	10.5	10.2	9.0	7.5
Transport & Communication	9.6	9.1	4.7	6.0
Manufacturing	9.5	8.9	3.2	4.8
Financial Intermediation	5.2	4.8	6.5	7.2
Construction	4.2	4.4	4.8	5.5
Utilities (Electricity and Water)			10.3	5.9

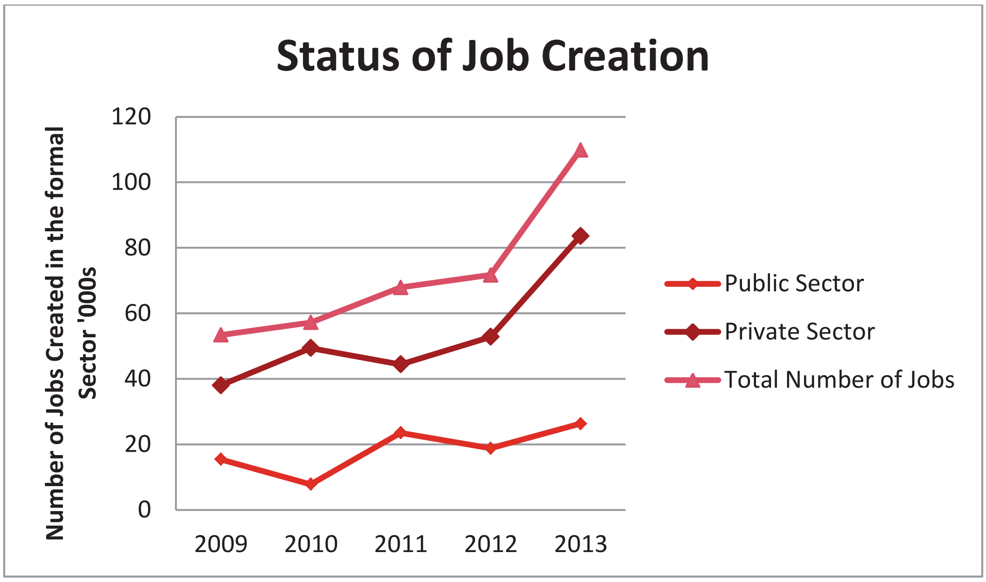
Structural shift to enhance job creation

To facilitate economic transformation, there is a need for structural shift of resources such as labour from the less productive economic activities to manufacturing and the service industries. The presence of large productivity gaps between the manufacturing and service sectors on the one hand and the agricultural sector on the other indicates that there is significant potential for growth. However, fulfilling this potential requires increased diversification and a move away from the production of primary products to value added products as outlined in the budget.

Unemployment remains one of the major challenges in the country. The economy added slightly over 116,800 formal jobs. A solid path out of poverty is through increasing formal employment (including formal self-employment) which in turn will enhance productivity and significantly raise household incomes. Job-skill mismatch is a challenge the government is addressing by investing KES 6 billion for expansion and equipping technical training institutes which will lead to employable skills.

Predictable, consistent and stable economic policies maintained

Fig 2: Formal job creation trends



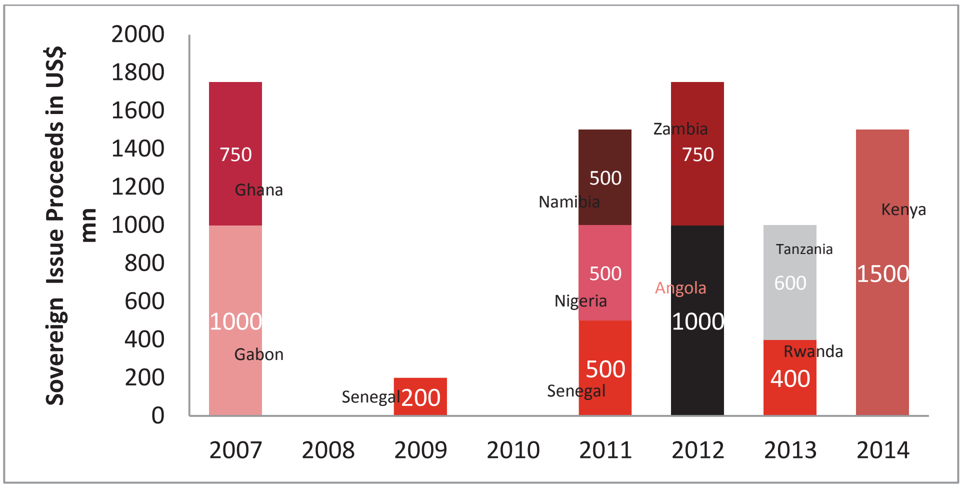
Macro-Economic Environment

Annual inflation rates declined from 9.4% in 2012 to 5.7% in 2013 thereby increasing real average wage per employee by 7.7% in 2013 compared to a 3.1% decline in 2012. There was an increase in nominal average earnings per person in the formal sector largely attributed to a rise in the minimum wage by 14% and the increase in salaries of unionisable employees by 18.2%.

Inflation is projected to remain within the upper limit of 7.5% in 2014 while the budget deficit is projected to be 4.1% of GDP for the financial year 2014/2015. The deficit will be financed by domestic borrowing but will have minimal effects on the cost of credit. Revenue collection efficiencies and prudent management are key to managing the budget deficit through automation of tax collection as well as rationalization of recurrent government expenditure.

The government aims to avoid crowding out the private sector in the capital markets by partly financing the budget deficit through raising debt in the international market. The issuing of foreign currency bonds in the international market is expected to be successful based on the success of other African Countries namely Ghana, Angola and Rwanda. However, we expect the Kenyan bonds to attract a relatively higher interest cost which may set the indicative benchmark rate for private sector loans in the country.

Fig 3: Annual Issuance of Sovereign Bonds by Sub-Saharan Africa



Source: Standard & Poor's

Although there was reduced forex earnings from tea, coffee and tourism, foreign exchange stability was supported by stable crude oil prices, forex inflows through diaspora remittances and increased purchase of equity by foreigners. This stability is expected to continue.

Devolution and the Economy

Low absorption rate of the total annual development budget by county governments is a source of concern. Midway through 2013/2014 counties had only used 4.3% (KES 4.8 billion) of the total annual development budget against a target of 50%. Having developed robust plans for increased development spending and productivity, it is expected that economic activities will be enhanced. Ensuring efficient and effective management practices will enhance service provision and accelerated development and attract more investments to the counties.

Business Outlook

There were no shifts in the government's policy direction. This is important for businesses to continue operating within a predictable, consistent and stable policy environment.

The government's capacity to spend, improved security and social services, equitable distribution of resources through devolution, fast tracked infrastructural development and government rationalization of recurrent expenditure will be critical to the success of the budget execution.

On the other hand, businesses have to be smart. Many have succeeded and in this environment through prudent investments, robust cost control measures and application of modern management and technological innovations to improve efficiency and increase productivity.

Conclusion

This is a fair budget focused on efficiency and prudent use of resources. It has good intentions, accommodating diverse interests but needs continues review during the year to ensure the desired results are achieved. Its full execution will be the shot in the arm the economy requires.

Devolution: Are we making progress?

The first year of Kenya's devolution process was characterised by intense bargaining between organs of the county and the national governments. The most significant outcome of this process was acceleration of the transfer of functional responsibilities to counties, and growing calls for counties to be given more resources.

In the 2014/15 budget the allocation to counties is KES. 226.7 billion which constitutes 12.8% of the budget and 33% of the last (2011/12) audited revenues.

Kenya's first county assemblies, governors and senators were elected on March 4 2013. In the fifteen months that have followed, most county governments have appointed executive committees, passed their first budgets and adopted their first Integrated Development Plans, and have begun recruiting their own staff. The first full year revenue sharing process was completed and the second post-election budget cycle under the government has just been concluded.

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The significance of the administrative changes brought about by devolution should not be underestimated. There are major institutional capacity challenges; counties are requesting assistance in the areas of planning, budgeting, human resources (HR), revenue enhancement and citizen outreach. Addressing these challenges will assist the counties to achieve the 80% absorption target set for the capital budget and to improve implementation.

1. Funding Devolution

Despite the fact that the funding criteria for devolution are clearly stipulated in the constitution, the debate about whether or not the funding is sufficient is still ongoing.

Key points to note:

- In the 2014/15 budget the allocation to counties is KES 226.7 billion which constitutes 12.8% of the budget and 33% of the last (2011/12) audited revenues. The currently allocated budget is in our view not enough and too late for the devolved function. The costing of the devolved functions and the basis for the division of revenues needs to be reviewed.

- Most of the counties have struggled in their efforts to raise internally generated revenues. Most counties still depend heavily on allocations from the National Government. Is this sustainable? Shouldn't counties be focusing on internal revenue enhancement strategies that do not necessarily lead to overtaxing of their citizens? Overtaxing of citizens is becoming a risk to the sustainability of county governments;

- There is a need for the standardisation and synchronisation of the county prioritisation process and needs. We have seen diverse strategies and application for funds in counties with similar demographics and profiles;

- The debate as to who is ultimately responsible for the utilisation of county funds rages on, a year later. Accountability and transparency must follow funding!

- Counties are now expected to spend at least 80% of the development budget while curbing waste and ensuring value for money.

2. Emerging challenges hampering devolution

Managing expectations has been a big challenge because devolution is no silver bullet. It has taken time to balance resource allocations, let alone improve equity of access to services. Many citizens believed that devolution would bring about dramatic change overnight such as upgraded infrastructure, more jobs and opportunities and better services. The reality has been very different, however. Key challenges in implementing devolution have included the following:

- Confusion with regard to the interpretation of various pieces of legislation in dealing with devolution. This has slowed down implementation and created mistrust between the various levels of government and institutions;

- The lack of capacity and ability of county governments to absorb the allocated funds in terms of the development agenda;

- An inadequate capacity and human resources skill mix to deliver the required quality of services to citizens;

- Bureaucratic processes arising from existing legislation in public procurement and financial management laws and regulations.

3. Are we reaping the benefits of devolution yet?

Citizens expected quicker benefits but there has some marginal improvement in delivery of services to Kenyans:

- **Increased public participation process** in the budget preparation and governance process;

- **Devolved development across the country:** Economically, enterprises and employment tended to concentrate in Nairobi and led to migration from rural to urban areas. There has been gradual change with opportunities for business and enterprise now emerging in the counties and attracting business people, workers and professionals back to their counties.

- **Improved absorption capacity:** The level of bureaucracy that was characteristic of the centralised system has reduced (though not to desired levels) and should result in better absorption and consequently more implementation of budgeted activities.

- **Improved local resource mobilisation:** there is better targeting and mobilization of local revenues but counties must guard against over-taxation.

4. Devolution ... the way forward

The challenges ailing devolution cannot be resolved overnight. However, a number of actions can be implemented to move the devolution agenda forward:

- **Division of revenue:** There is a need to review and rethink the criteria for division of revenue between the national government and county governments;

- **Budget process:** There is a need to review the budget process with a view of coming up with more realistic timelines to enable counties to plan and implement better.

- **Legislation:** There is a need to strengthen the legislative framework at both the county and national levels.

- **Capacity building:** There is a need to invest in capacity building programmes at the county level to improve efficiency and value for money.

- **Revenue Mobilization:** Counties should have a balanced approach between revenue enhancement and economic growth through the creation of conducive business environments.

This year KES 255.9bn has been allocated for energy, infrastructure and ICT; which accounts for 14.5% of the Consolidated National Government Budget.

Time for Implementation; Towards Vision 2030

It is time to lay the foundation for future economic sustainable development to transform Kenya from a developing into a middle income economy.

Vision 2030 emphasises the development of key infrastructure sectors including energy and roads.

Implementation of flagship projects in the year is likely to result in the achievement of the targeted absorption rate of 80%

Compared to other forms of government spending, infrastructure projects result in the highest multiplier effect in the economy. This is because it lays the foundation and framework for all other sectors of the economy to thrive. In order to enjoy the benefits, implementation should be expedited.

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Focus on Flagship Projects

The Government has allocated the following:

- **Roads**

On-going roads, maintenance, roads connecting borders, decongestion and new roads amount to KES 116.7bn. The roads sector received the lion's share of the total infrastructure budget both recurrent and development. This is in line with the government initiative of rehabilitating and expanding the existing roads, opening new roads especially along the northern corridor, and maintaining the already developed roads in good standard.

- **Energy**

The government continues to pursue the 5000MW programme and has allocated KES 10bn to geothermal project development. Power transmission and rural electrification account for KES 33.6bn of the budget.

- **Railways**

The Government has allocated KES 22.9bn towards the Standard Gauge Railway (SGR) which will be raised through the Railway Development Levy (RDL) to supplement the other external funding sources. The funding arrangements for the proposed extension of the SGR from Nairobi to Kisumu via Malaba have not been disclosed. There are also modalities of financing the JKIA commuter rail to increase accessibility to and from the airport.

- **Airports and Ports**

KES 1.65 billion has been allocated to upgrading Kisumu and Isiolo and constructing three new airports in Mandera, Malindi and Suneka. The country and the region are set to benefit from the expansion of the Jomo Kenyatta International Airport (JKIA) which has been operating beyond the intended capacity. The completion of terminal 4 and the start of the construction of the green-field terminal will ease the pressure on travellers and contribute to making Nairobi a regional hub.

The upgrade of Kisumu International and Isiolo Airports along with the construction of three new airports in the country will facilitate trade and travel in various parts of the country. This is in line with the strategy to develop a first class transport and logistics network.

- **LAPSSET**

Funding for the transport components of the LAPSSET corridor project will be done under Public Private Partnership (PPP) framework. The upstream oil pipeline to be built, within a PPP structure as part of the LAPSSET programme, reiterates the commitment of the government to the oil industry, and the potential to exploit the found oil reserves into a commercially viable project, with a massive potential income generation capacity. This will require time and close collaboration with the stakeholders involved in the programme.

Critical Success Factors

- The major risks inherent in these projects relate to time and cost overruns, which will require a significant upgrade in technical, legal and institutional frameworks to manage and control the delivery of the investments. This will require project management and independent monitoring that provides assurance and facilitates timely completion.

- Harmonisation of projects requires a pragmatic approach on how the government funds national development. Indeed, it is now recognised that the current development funding gap can only be plugged by bringing together capital and know-how from the public and private sectors. It is for this reason that private sector involvement has been entrenched as a central and prominent feature of national development planning in Kenya.

- The large infrastructure projects that the government is undertaking will have an implementation period of more than one year thus requiring innovative financing approaches. The focus on the international capital markets for financing through the Eurobond opens up possibilities for accessing reliable funding sources for these projects. However, money received from such sources of financing bear a risk of not being utilised while attracting a fixed interest. We therefore need to pursue such funding when projects' feasibility has been assured and the relevant political goodwill garnered.

- The procurement processes in capital and infrastructure projects continue to cause major delays in implementation. There is an urgent need to look at the procurement processes to facilitate speedy, transparent and value for money based procurement of goods, works and services pertaining to the implementation of capital and infrastructure projects. To this effect, the Budget speech for FY 2014/15 has recommended certain measures to improve procurement processes. Some of the recommendations include:

    - New Procurement law,
    - E-procurement systems,
    - Strengthening of the PPOA, EACC, Auditor General's office and the Office of the Public Prosecutor.

- It is hoped that they will improve the procurement process and thereby fast track the implementation of the capital and infrastructure projects.

Digitising government

The 2014/2015 budgetary allocation to ICT is aligned to priorities identified in the government's long term strategy.

Alignment to Vision 2030

Vision 2030 identifies ICT as a key enabler of our country's economic development. Similarly, the government seeks to leverage on ICT to improve citizens' lives. The 2014/2015 budgetary allocation to ICT is aligned to ICT priorities identified in the government's policy statements. Specifically, the Cabinet Secretary seeks to allocate KES 2.5bn to three e-government projects: the Kenya National Electronic Window System, IFMIS (Integrated Financial Management Information System) rollout and national digital services.

Automating revenue collection & financial management

The National Electronic Window system was allocated KES 1.1bn and seeks to modernise the current manual customs clearing processes. It is envisaged that the system will automate the clearing process resulting in reduced turnaround times, lower revenue leakage and streamlined cross border trade in the East African Community. Successful rollout of the National Electronic Window and i-Tax systems is key to achieving the increased efficiency required to meet KRA's higher revenue collection targets.

IFMIS was initiated ten years ago to improve transparency and accountability in government finances by automating budget formulation, government accounting, public procurement and revenue management. The system has gone through several upgrades over the years. The Cabinet Secretary seeks to allocate KES 0.8bn for further system enhancements and roll-out to the counties to support transformation of our public financial management systems given the needs of a devolved system of government. The enhancements are also required to enable the shift to e-procurement.

IT-driven service delivery

The Cabinet Secretary seeks to allocate KES 21.99bn to enhancing internal security with a sizable portion of this amount funding ICT projects including deployment of CCTV surveillance systems and set up of a command and control centre. Additionally, the government plans to implement a national digital registry to consolidate all citizen information and provide a central data repository to support the roll-out of 3rd generation identity cards. A secure integrated citizen registry will form the foundation for other initiatives such as tracking of individuals' financial history to control tax evasion and corruption.

The KES 17.4bn proposed for deployment of laptops and computer laboratories to schools constitutes the largest ICT investment in the current budget. Challenges faced with implementation of the free laptop programme for Standard one pupils have forced the government to change tack. The modified approach seeks to set up a computer laboratory for class 4 to class 8 pupils in schools across the country, the development of digital content and training teachers on IT. Delivery of the project will require innovative solutions to key infrastructure challenges such as the lack of connectivity, electricity and capacity to support the computer equipment in remote areas.

Implementation challenges

- **Public procurement processes**
  Experience shows that large scale ICT projects have either failed or experienced significant delays as a result of inflexible procurement guidelines.

- **Network infrastructure**
  The country does not have a reliable and scalable country wide network infrastructure to support the roll out of nationwide e-government initiatives.

- **Capacity**
  Given the current low level of IT adoption in key government agencies such as the police, successful implementation and subsequent use of envisaged systems will be a challenge.

- **Change Management**
  Adoption of ICT based systems will constitute a significant change to current ways of working. A comprehensive, all inclusive change management programme is an effective way of securing their buy-in and in doing so, transforming them to agents of change.

- **Inter-agency collaboration**
  Duplicated efforts will not only increase the cost of implementation, but also compromise delivery of expected benefits. E-Government initiatives are underpinned by setting up a centralised data repository and shared service delivery centres. This can best be achieved through collaborative efforts.

Possible solutions

We must learn from previous experiences and adopt new ways of doing things, such as:

- **Leadership and stakeholder engagement** through an all-inclusive and collaborative process which includes all key stakeholders;

- **Leveraging existing network infrastructure** by establishing strategic partnerships with both public and private sector entities who have already invested in nationwide network infrastructures and

- **Focusing on benefits** by enhancing awareness of e-governance benefits. People will embrace what benefits them.

Responding to the push to lower interest rates

Structural reforms to improve financial stability

Focus on Transformation Agenda set to continue

Nairobi to be a leading finance hub in Africa

In line with the government's Vision2030 Transformation Agenda, there will be a renewed focus to operationalise the "Nairobi International Financial Centre". This plan, to make Nairobi a leading finance hub for Eastern and Southern Africa, was first mooted in 2010, with the concept model developed in 2011.

The benefits are expected to spread beyond Kenya to other East African countries by encouraging Foreign Direct Investment into the wider region.

Kenya's financial services sector currently accounts for nearly 6% of the country's GDP and has the potential to expand this contribution to GDP even higher.

Greater transparency for borrowers

Greater transparency in the determination of interest rates is expected with the proposal to introduce the Kenya Bank Reference Rate (KBRR).

KBRR will work in a similar manner to other benchmark rates such as the LIBOR. Banks will be expected to adopt the KBRR as their base lending rate.

Other initiatives include the requirement for financial institutions to disclose their Annual Percentage Rate (APR) payable on loan facilities.

It is hoped that, with these initiatives and others proposed by the Committee on Interest Rates, borrowers will have a better platform to compare interest rates between financial institutions. In the long run, this should help drive down interest rates as well as adding greater transparency by disclosing the 'true' cost of borrowing.

Demutualisation of the Nairobi Stock Exchange… finally!

The demutualisation of the Nairobi Securities Exchange (NSE) is expected to be completed in the coming months. The purpose is to separate ownership from trading rights.

The Cabinet Secretary proposes to amend the law to set the minimum shareholding by the Government and Investor Compensation Fund at 5% respectively. This amendment will formalise the current shareholding whereby the two institutions above already hold 5% each.

One benefit that will be derived from the demutualisation is the opportunity for the public to own shares in the NSE.

A two stop shop regulatory environment

Key policy recommendations have been proposed to consolidate the existing regulatory agencies. This is in keeping with the theme to enhance efficiency and effectiveness of regulation and the supervision of the financial sector.

Regulation and supervision of Banks, Insurers, Asset Managers, Pension Schemes and SACCOs is currently undertaken by separate regulators. The Cabinet Secretary proposes to table the Financial Services Act which will establish the Financial Services Authority (FSA). The FSA will take over the regulatory functions which are currently carried out by the Retirement Benefits Authority (RBA), Capital Markets Authority (CMA), Insurance Regulatory Authority and Sacco Societies Regulatory Authority (SASRA). However, the Central Bank of Kenya will retain its current regulatory and supervisory authority.

A consolidated regulatory regime, if properly implemented, would provide a single view on risks affecting regulated entities. This would also reduce the cost of regulatory compliance and minimise duplication of roles.

In formulating the FSA framework, consideration should be given to:

- interactions between CBK and FSA on areas of mutual interest, for example, bancassurance;
- liaison with other regulators in the East African Community; and
- a seamless integration of the existing regulators with the aim of avoiding unnecessary bureaucracy.

The Cabinet Secretary has committed to tabling a number of other bills including the CBK Bill and the Insurance Bill.

Insurance sector – no joy yet on excise duty

The Cabinet Secretary has proposed to separate the Policyholder Compensation Fund between life and general insurance businesses. Each fund will have different contribution rates to reflect the varying levels of risk.

The 2014/2015 budget has however failed to address the contentious issue of excise duty on fees charged by insurance companies. The Finance Act 2013 stipulates that 10% excise duty will be applied to such fees. It is uncertain whether insurance premiums should be subject to excise duty.

Direct Taxes

We would also expect the new Ninth Schedule to consolidate the taxation of the extractive sector to include mining companies.

Review of tax provisions governing the extractive sector

In 2013, the Income Tax Act introduced a withholding tax on proceeds arising from the sale of property and shares by oil companies, mineral companies and mineral prospecting companies. The withholding tax was a punitive tax measure as it taxed the consideration without giving any allowance for costs incurred by the seller. This amendment indeed dampened the spirit of stakeholders in this sector.

In the budget statement, the Cabinet Secretary proposed significant changes in the taxation of the extractive sector. To begin with the Cabinet Secretary proposed to tax petroleum and mining companies on the net gain from farm-in transactions. This is in line with the existing international best practice and has come about after concerted efforts by the stakeholders. This reflects the appreciation by Government of the significant investment in the extractive industry, and will go a long way in spurring growth in this sector.

Government has made its intention known that the current taxation of the extractive sector needs to be updated. While the proposed amendments are yet to be published, we expect that the government will align the provisions of the Production Sharing Contracts (PSC) with the Income Tax Act.

In this regard, there is an expectation that a revamped Ninth Schedule will be introduced soon to replace the current version which has been in existence since 1986. Some of the expected changes in the revamped Ninth Schedule include:

- Taxation of farm-out transactions including indirect transfers,
- Ring fencing of blocks,
- Possible introduction of a royalty regime,
- Certainty of the payor of the taxes on production,
- Changes on withholding tax regime on payments to non-residents,
- Tax implications on funding and
- Issues relating to taxation of subcontractors.

We would also expect the new Ninth Schedule to consolidate the taxation of the extractive sector to include mining companies. It also would be critical to ensure that the provisions of the Production Sharing Contract are aligned with the tax legislation.

As we expect that the legislative changes relating to the extractive sector will be extensive, we intend to issue a more detailed bulletin once the Finance Bill 2014 has been published.

New Income Tax Act on the way

For the second year running, the Cabinet Secretary proposed to review the Income Tax Act by introducing a new bill from July this year. The current law was enacted in 1973 following the breakup of the East African Community leading to each country introducing its own act. Since then, some our partners in the East African Community, Uganda and Tanzania, have introduced new acts in 1997 and 2004 respectively, while Kenya has maintained its 1973 legislation albeit with numerous amendments.

The Cabinet Secretary in his budget statement indicated that the proposed act is meant to adopt international best practice, simplify the tax code and improve revenue collection. What lessons are there to be learnt as we embark on writing a new income tax act? The International Monetary Fund model Income Tax Act advocates for a complete and comprehensive legislation with a broad tax base and limited exemptions. It must be noted that the Uganda and Tanzania acts align taxable profits with the accounting profits in order to minimize tax adjustments and we hope that Treasury will take note. Furthermore, the process should seek to have wider participation of stakeholders. In this regard, we welcome the commitment to consider contributions from bodies like the Institute of Public Accountants of Kenya, other tax experts, submissions from various stakeholders and the attempt to benchmark the new Bill to international best practices.

Taxpayers should actively engage with Treasury in order to shape the new act and ensure that the envisaged law is consistent with modern thinking and practices.

Cabinet Secretary also introduced the Tax Procedures Bill that will contain uniform procedures across the three tax legislations, namely VAT, Excise duty and Income Tax. This is in line with changes introduced last year regarding tax appeals procedures of consolidating procedures previously residing in various acts.

Special Economic Zones - a regime to anchor regional hub ambitions

The Cabinet Secretary has allocated KES 600m for the establishment of Special Economic Zones (SEZ). This budgetary allocation is in our view an indication of the government's commitment to have the SEZ legislation which has been the subject of debate since 2009.

SEZs are selected geographic areas with highly developed infrastructure and which have the potential to be developed into agro-industrial, industrial, tourist/recreational, commercial, finance and technology centres.

SEZs provide numerous investment incentives (both tax and non-tax incentives) through policy and regulatory flexibility for a wide range of economic activities. Such incentives include tax holidays/exemptions, reduced tax rates and relaxed administrative procedures.

Establishment of SEZs is therefore expected to generate greater economic activity and employment thereby hastening industrialization in line with the Vision 2030. SEZs are designed to address the challenges presented by the Export Processing Zones which is biased towards manufacturing for export oriented businesses and to create competitiveness.

There is a global shift from EPZs to SEZs with countries such as China, India and Philippines deriving immense benefits. This is therefore a step in the right direction and will promote Kenya as a desired destination for Foreign Direct Investment (FDI) and setting up of regional headquarter offices as well as establishment of other business activities not covered under the EPZ.

The SEZ Bill, 2014 needs to be harmonized with the Constitution and other tax legislation. In addition, rules and guidelines need to be put in place.

Enhancing transparency and tax compliance

Currently companies are required to only disclose information on name and address of related/ associated enterprises outside Kenya in the self-assessment return. However, companies will now be required to furnish KRA with records and information on any change of corporate structure and business lines. This move aims at aligning the compliance requirements to sharing information on taxpayers and will facilitate identifying companies engaging in cross border investment and trade.

The KRA seeks to have a global view on cross border transactions as an attempt to widen its tax net as it seeks to meet its revenue collection targets. By introducing the proposed change the regulator fails to take cognisance of the additional compliance burden on companies.

What are some of the current challenges?

Tax losses time limits

The Income Tax Act restricts the carrying forward of tax losses to a maximum of four years after the year in which the tax losses arose. The four year period may not be sufficient especially where the tax losses arise from the accelerated capital allowances. The impact is to negate the benefit due to the time restriction. There are provisions for a taxpayer to apply to the Commissioner to use discretionary powers and extend the limit but there is no guidance on criteria to be used.

Investors require certainty to guide the investment decisions and urge the government to issue guidelines with respect to the applications for extension when writing the new Income Tax Act that would take into account the reasons for the tax losses e.g. whether it is from capital allowances or merely operating losses. This would then impact the decision on the extension of limit request.

KRA should immediately introduce guidelines on the criteria they will use to approve the applications and also consider increasing the time limit from four to say seven years.

Deemed interest

In the budget speech for 2011, the Minister deemed an interest rate on interest-free loans provided by a non-resident to a thinly capitalised related Kenyan resident. The deemed interest rate is pegged to the average 91 day Treasury Bill rate.

An attempt was made in 2012 by prescribing rules on calculating deemed interest and amending the enabling withholding tax provisions. The impact of the above amendments has seen the resident taxpayer bear the withholding tax cost.

Our view is that the provision should be abolished in line with international best practice.

Thin capitalisation

The current tax law contains thin capitalization rules that seek to penalize a taxpayer whose ratio of debt to equity exceeds 3:1 by disallowing a portion of the interest cost.

This ratio is suited to more developed countries. We believe that in order for Kenya to continue to attract foreign direct investment FDI, the ratio should be significantly increased to perhaps 6:1 to make it less punitive and easier for businesses that seek funding.

Is interest income a specified source?

The current tax law ring fences income and expenditure on specified sources such as farming, employment and rent of property.

However, the law is not explicit with regard to interest income which has led to the KRA taking an aggressive interpretation. This has been reinforced by recent court rulings, which in our view is not based on the correct reading of the law.

Most interest income is earned as a consequence of the company managing its funds on a short term basis as they wait to embark on major projects.

Our view is that interest income should be treated as business income and not reinforced.

Individual Tax Changes

Tax free vacations for employees within Kenya for the next 12 months

Tax free vacations for employees

The recent security concerns in Kenya have presented challenges to the tourism sector. In order to stimulate recovery of this sector, the government has proposed to exempt from tax employee vacation trips paid for by employers within Kenya. This is a twofold exemption as neither is the employee charged tax on the vacation expense as a benefit, nor is the amount disallowed for tax purposes.

This exemption is effective immediately (from 13 June 2014) for the next 12 months.

We know from the statement issued by the President earlier in May that the targeted group for this benefit was Kenyan citizens. The Budget Statement makes it clear that this benefit can also be enjoyed by expatriates working in Kenya. This provides a tax planning opportunity for expatriates entitled to home leave, as they may now benefit from local trips as well.

Harmonisation of NSSF Act 2013

In order to fully realise the government's objective of promoting tourism, we also expect a reduction in Kenyan vacation package costs to generate volumes.
However, it is unlikely that additional implementation details will be provided by the government. Employers will most likely have to enact individual vacation policies.

Alignment of NSSF Act 2013 with Retirement Benefit Act

The Cabinet Secretary has proposed to amend the NSSF Act 2013 (which came into effect from 1 June 2014) to align it to the Retirement Benefit Act.

The proposed amendment is to restrict the power to prescribe the qualifications of an actuary and make regulations on the payment of benefits to the Retirement Benefits Authority.

In addition, the preparation of the NSSF Fund Accounts will also be aligned with the provisions under the Retirement Benefit Act (i.e., from six months to three months).

Harmonisation of employee statutory payments

Under the government's objective to reduce costs of doing business for employers and ease the administrative burden, the Cabinet Secretary has proposed to harmonise the payment date for NSSF with PAYE and NHIF (from 30 to 10 days).

This is an indication of the government's intention to consolidate all the employee statutory payments under KRA.

We expect the harmonisation process will go further to include compliance review and an enabling IT platform in order to achieve the desired objective.

Transfer Pricing

Payments by a permanent establishment to its head office are now subject to withholding tax

Increased scrutiny on cross border transactions

Permanent establishments now subject to transfer pricing provisions

As foreign direct investment in Kenya increases, the Kenya Revenue Authority continues to grapple with cross border tax issues. The definition of a Permanent Establishment (PE) is to be expanded to include a place of management, branch or office. We wait to see whether the updated definition will include a dependent agent PE. Inclusion of a dependent agent PE would significantly broaden the PE definition.

PEs and branches are also now specifically covered under the arm's length section of the Income Tax Act (ITA). Previously, the section only applied to transactions between resident persons i.e. companies incorporated in Kenya and their related non-resident persons and required such transactions to be conducted at arm's length. There was ambiguity as to whether PEs and branches were covered under the arm's length section of the ITA.

The Cabinet Secretary has resolved this issue by amending the arm's length section of the ITA to include PEs and branches.

In Kenya, PEs and branches are common in the banking, oil & gas and construction industries. Previously, their transactions with their head office were not strictly subject to the arm's length requirements. It is now clear that PEs and branches will be required to comply with the arm's length principle.

Payments by permanent establishments to head office now subject to withholding tax

The Cabinet Secretary appears to have introduced withholding tax on certain payments e.g. management fees, interest and royalties made by PEs to their head office. Further, other proposed amendments to the Income Tax Act appear to clarify that management fees, interest and royalties paid by a PE to its head office are not deductible for tax purposes.

Previously, such payments were not subject to withholding tax. The proposed amendments appear to be punitive as they impose withholding tax on payments from a PE to its head office and still restrict their deductibility.

The proposed amendments are likely to significantly increase the effective tax rate of PEs.

Commissioner seeks powers over DTAs

Clash between tax treaties and domestic laws

There appears to be an intention to amend the provisions of the Income Tax Act that relate to relief from double taxation i.e. Double Tax Agreements (DTA). There are proposals to restrict the benefits arising from the DTA where the entity is owned by individual(s) who are not resident in the contracting state to the extent of 50% or more. The intention of the amendment is to prevent abuse of DTA through what is commonly known as treaty shopping.

In principle, where there are conflicts between the DTA and local tax legislation, the DTA will override the local tax legislation. It appears that the proposed amendment seeks to empower the Commissioner to override the provisions of the DTA.

It is unclear why the KRA has selected this route to prevent treaty shopping. DTAs already have provisions relating to beneficial ownership to counter this type of abuse.

Proposal to deal with the historic VAT refund burden

Challenges faced under the VAT Act, 2013 hopefully will be dealt with by the yet to be published VAT Regulations

Consumption taxes

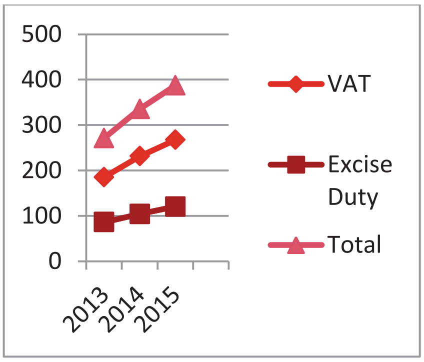
Value Added Tax and Excise Duty

Introduction

Consumption taxes such as Value Added Tax (VAT) and Excise Duty contribute significantly to government revenue.

These taxes have been on an increasing trend with VAT recording actual revenues of KES. 185B in 2013, 231B estimated to be generated in 2014 and projected revenue of 267 in 2015.

On the other hand, actual revenue generated from excise duty in 2013 was KES. 86B, 104B expected to be generated in 2014 and projected revenues in 2015 are estimated to be KES. 120B.



Summary of consumption taxes

Budget Proposals

From the Cabinet Secretary's Budget Statement, there was little mention about specific changes for VAT and Excise Duty; however, we await the publication of the Finance Bill to see what changes could have been made for VAT and Excise Duty – the devil is always in the detail!

In the statement, the Cabinet Secretary stated that the new VAT Act has not only made it easier for taxpayers to comply and but also eased the VAT refund burden. He has promised to reform the Excise Duty regime with the introduction in the coming year of a new Excise Duty Bill which will be simple and modern. So there is little to write about VAT and Excise Duty changes. Perhaps this could be due to the recent enactment of the VAT Amendment Act, 2014.

From hereon we comment on how the government is likely to deal with the historic VAT refund burden, whether the new VAT Act has helped and how the Government can use the opportunity under the new Excise Duty Bill to transform the taxation of consumption.

Excise Duty Reform – an opportunity to transform taxation of consumption

VAT refunds backlog

The Cabinet Secretary acknowledged the existence of a huge VAT refund backlog and the Government's intention to develop a long lasting solution.

In our view, the government is likely to address the backlog by issuing debt instruments to the taxpayers whose refunds are due.

VAT Act, 2013

Generally, the New VAT Act has made it easier for taxpayers to comply with the VAT legislation. However, there are a number of challenges that remain unresolved after the enactment of the new Act.

First, the KRA has not reformed their administration, procedures and returns in line with the new VAT Act for example the collection of VAT on electronic services imported by consumers and the interpretation on which items of plant and machinery are exempt.

Secondly, the administrative difficulties on the accounting for VAT when taxable supplies are subsequently approved for qualifying businesses as exempt supplies.

However, the Cabinet Secretary promised that the VAT regulations will be released soon.

We hope that regulations will be innovative and creative such that they can ease the burden of compliance in the modern digital age.

The jury is out as to whether the regulations will address such areas as export of services, tax representatives, consideration of a valid tax invoice in a digital environment, and VAT status of services provided with respect to goods in transit.

Excise Duty Reform – an opportunity to transform taxation of consumption

A draft Excise Duty Bill is to be tabled in Parliament after going through public participation.

The intention to table a new Excise Duty Bill is in line with the efforts being witnessed in the other Partner States. These efforts present an opportunity for the countries to pull together and come out with either one EAC Excise Management Act or a model Excise Duty Act to be used by the Partner States.

While the drafting and planning around the proposed excise bill goes on, there is need for the government to seize the opportunity to transform the taxation on consumption by being innovative in using both Excise Duty and VAT systems to tax consumption of goods and services.

As an example, excisable products could be restricted to products where tax forms a significant portion of the price paid by consumers and other products and services could be taxed under the VAT regime.

East Africa at a glance

Resilient performance

Focus on tackling insecurity and infrastructure investment

Kenya

The Kenyan economy is projected to grow by 5.8% in FY2013/14 compared to 4.7% in FY 2012/13. These results have been achieved despite the uncertainties related to the general elections, change to devolved governance and insecurity. Improved growth was recorded in the following sectors of the economy:

- The financial services sector grew by 7.2% compared to 6.5% in FY 2012/13 thanks to growth in services to SMEs and previously unbanked populations;
- Transport and communication grew by 6.0% compared to 4.7% in FY 2012/13 attributed to infrastructure development;
- Building and construction grew by 5.5% compared to 4.8% in FY 2012/13 due to increased investment in the sector by both government and the private sector; and
- Manufacturing sector recorded a higher growth of 4.8% in the year compared to 3.2% in FY 2012/13 due to increased household consumption.

Inadequate rainfall and significant fall in global prices of coffee and tea led to a reduced growth of 2.9% in agricultural sector compared to 4.2% in the previous year.

Tourism earnings declined by 2.1% impacted mainly by insecurity.

In addition, inflation eased from an annual average of 7.5% in FY 2012/13 to 5.7% in FY 2013/14 due to the tightening of monetary policies.

The priority areas highlighted in the FY 2013/14 budget include the following:

- Tackling insecurity to attract and retain foreign investment;
- Increased infrastructure investment in the transport network;
- Expanding agro-processing to foster export growth;
- Enhancing quality and accessibility of healthcare and education services;
- Providing affordable credit to encourage entrepreneurship;
- Strengthening devolution to improve delivery of services; and
- Extension of the tax base and tax reforms to reduce revenue leakage.

Tanzania

Tanzania's GDP grew by 7.0% in FY 2013/14 compared to 6.9% in FY 2012/13. This increase is mainly attributed to a 22.8% growth in the communications sector, 12.2% growth in the financial services sector, 8.6% growth in construction, 8.3% growth in wholesale and retail trade, and 6.3% growth in hotel and restaurants services.

The priority areas for FY 2014/15 budget include:

- Infrastructure: transportation (roads, railway, airports and marine transport). Investment is aimed at reducing congestion in urban areas, costs of transport and transportation of goods and services and therefore curbing inflation;
- Energy and Minerals: power generation, gas;
- Agriculture: including food and cash crops, irrigation, industrial raw materials, livestock, fisheries and forestry. The measures will enhance production of crops, food security and ensure availability of reliable markets;
- Education: infrastructure, study equipment; and
- Health: water and good governance.

Macro-economic objectives highlighted in the budget include the following:

- 7.2% GDP growth of in 2014 and 7.4% in 2015;
- Increase domestic revenue ratio to GDP to reach 18.8% by 2014/15;
- Continue to control inflation at a single digit level and eventually to 5.0% by June 2015; and
- Maintain a stable level of exchange rate.

Uganda

The Ugandan economy grew by 6.0% in FY2013/14 compared to 5.1% in FY2012/13 and 3.4% in FY 2011/12. The growth is attributed to improved agricultural production, stronger industrial performance, increase in wholesale and retail trade activities, and improved performance in transport and telecommunications.

Uganda's inflation increased from 3.6% in May 2013 to 5.4% in May 2014.

The priority areas in the FY 2014/15 budget are:

- Undertaking key economic infrastructure investments, while maintaining peace, security and macro-economic stability;
- Government investment in agribusiness, tourism and services such as ICT;
- Provision of quality education, health and water services; and
- Strengthening institutional governance, accountability and transparency.

Other objectives highlighted in the budget include the following:

- Achieving a real economic growth rate of at least 7% per annum;
- Keeping annual consumer price inflation within a single digit level;
- Positioning Uganda in the context of EAC integration to ensure competitiveness;
- Maintaining a prudent level of foreign exchange reserves of at least 5 months import cover to provide a buffer against external shocks; and
- Maintaining a competitive real exchange rate to support the growth of exports.

Rwanda

Rwanda's real GDP growth rate slowed down to 4.6% in 2013/2014 as compared to 8% achieved in 2012/13. Performance highlights include 4% services sector growth and 11% industry sector growth driven by an 11% increase in the construction and agricultural production sub sectors.

Rwanda continued to achieve moderate inflation, with a general inflation rise of 3.7% driven by price rises in food and utilities including electricity.

Exports grew by 19% in FY 2013/14 while imports did not change significantly.

The allocation of resources in the 2014/15 fiscal year has been made taking into account the Economic Development and Poverty Reduction Strategy (EDPRS2) priorities. The main areas of focus under the EDPRS2 are:

- The economic transformation which has been allocated 25 % of the total budget. This includes; construction of power stations, electricity roll out, roads rehabilitation, industrial parks and ICT sector development;

- Rural development has been allocated 14% of the total budget. This constitutes land husbandry, food production, watershed management, sanitation and livestock infrastructure;

- Productivity and youth employment has been allocated 10% of the total budget; and

- Accountable governance which has been allocated 3% of the total budget.

- ## *Key highlights from the Kenya, Tanzania, Uganda and Rwanda*

	Kenya	**Tanzania**	**Uganda**	**Rwanda**
Real GDP growth	5.8% (4.7%)	7.0% (6.9%)	6.0 (5.1%)	4.6% (8%)
Overall inflation	5.7% (7.5%)	6.3% (16%)	5.4 (3.6%)	3.7% (3.3%)
91 day TB rates	9.2% (6.7%)	12.47% (11.91%)	9.97 (9.1 %)	5.325% (11.95%)
	KShs	*TShs*	*UShs*	*RwF*
Exchange rate to the dollar (Local currency = US$1)	86.40 (85.24)	1,609 (1,587)	2,500 (2,575)	680 (641)
Budgeted spend (billions)	1,757 (1,641)	19,853 (18,248)	15,054 (13,169)	1,753 (1,653)
Recurring (billions)	1,248 (1,166)	13,408 (12,574)	*(8,958.6)	865 (736)
Development (billions)	509 (475)	6,445 (5,674)	*(4,210.4)	784 (803)

**The breakdown of recurring and development expenditure is not available as the Background to the FY2014/15 Budget was not released.*

Customs and Excise duty

Kenya

Customs Duty

- Protection of the local steel industry by cushioning local manufacturers against cheap imports through an increase in duty rate on iron and steel products available locally from 0% and 10% to 25%.
- Reduction of administrative barriers in industry by abolishing the requirement for Customs security bonds on importation of industrial sugar and wheat.
- Removal of import duty on machinery, spares and inputs for direct and exclusive use in the development and generation of Solar and Wind energy to support the use of cheaper, cleaner, alternative sources of energy.
- Exemption from import duties inputs used in the processing and preservation of seeds for planting is one of the measures to address food security challenges.
- There are plans to re-organise the revenue authority to enhance the capacity for collection. The Cabinet Secretary will therefore submit to the house for discussion the Draft Inland Revenue Agency Bill and Customs and Border Services Bill.

Excise duty

The new Excise Bill to be tabled in Parliament after going through public participation. The intention to table a new Excise Management Bill is in line with the efforts being witnessed in the other Partner States. This could be an opportunity for the Partner States to formulate an EAC Excise Management Act or a model Excise Duty Act to be used by the Partner States. This could also be an opportunity to realign the excisable products in the EAC.

Tanzania

Customs Duty

- Reduction of import duty, from 25% to 10%, on buses for transportation of more than 25 passengers for a period of one year.
- Extension of stay of an import duty rate of 10% on wheat grain.
- Charge duty at 0% for manufacturers using LABSA as a raw material for soap manufacture.
- Increase the duty rate on chemical based petroleum aerosol spray from 10% to 25%.
- Reduce the duty rate from 25% to 10% on specific paper imports.
- Import duty exemption on Electronic Fiscal devices (EFD).
- Removal of import duty exemption on splints used in the manufacture of matches.
- Extension of exemption from import duty provided to the Armed Forces Canteen Organisation for a period of one year.
- Amendment of the 5th Schedule to the East Africa Community Customs Management Act (EACCMA) to provide import duty exemption to inputs for the manufacture of gas cylinders.
- Amendment of the 5th Schedule to the EACCMA to provide import duty exemption to inputs used for the development and generation of wind and solar energy.

Excise duty

- Excise duty rate of 15% on money transfers reduced to 10% to be levied by banks and telecommunication companies and various agencies for the fees and levy they collect on money transfer services;
- Remove powers of the Minister of Finance to grant exemption on

excise duty on petroleum products.

- To change the threshold on the age of non-utility motor vehicles that are currently being charged an excise duty of 25% from the current ten years to eight years.

- Impose excise duty rate of 15% on imported furniture under Harmonised System (HS) Code 94.01.

- Adjust by 10% the specific rates of excise duty on non-petroleum products; these products include soft drinks, alcohol, spirits etc.

- Increase in excise duty rates on specific cigarettes by 25% while excise duty in cigars remains at 30%.

Uganda

Customs Duty

- Introduction of a 1.5% infrastructure levy on selected imports into the EAC to finance railway infrastructure development.

- Introduction of a single entry East African Tourist Visa.

- Elimination of transit bonds on goods and introduction of a common payment system aimed at enhancing regional integration.

Excise Duty

- As was the case in FY2013/14, excise duty on petrol and diesel will again increase by UShs 50 per litre from UShs 900 and UShs 580 per litre respectively.

- Reinstatement of Excise duty of UShs 200 per litre on kerosene which had been scrapped in FY2011/12. The attempt to re-introduce the duty in FY2013/14 failed.

- Increase in excise duty on sugar by 100% from UShs 25 to UShs 50. The duty on sugar was reduced three years ago when the country was facing a sugar shortage.

- Introduction of 10% excise duty on mobile money withdrawal fees. A similar 10% excise duty rate was introduced in FY2013/14 on mobile money transfer fees.

- Introduction of 10% excise duty on bank charges and money transfer fees.

Rwanda

Customs Duty

Import duty rates have been reduced as follows:

- From 25% to 0% on wheat;

- From 75% to 45% or USD 200 per tonne on rice in husks;

- To 25% on imported cement;

- To 0% on importation of road trucks/semi-trailers;

- From 25% to 10% on motor vehicles weighing between 5 to 20 tonnes and 0% on those weighing more than 20 tonnes;

- To 0% on motor vehicles carrying 25 passengers or more;

- From 25% to 10% on motor vehicles carrying 25 passengers or less;

- A duty rate of 0% to apply on importation of sugar. However, the Council of Ministers to determine the quota of sugar to be imported;

- From 25% to 0% on telecommunication equipment;

Excise Duty

The excise duty on air time has been increased from 8% to 10%.

Direct and indirect taxes

Kenya

Income Tax

- Draft Income Tax Bill will be presented to Parliament for discussion. It is envisaged that the new act will simplify the administration of Income Tax.
- Withholding tax on the consideration from assignment of rights in the oil, gas and mineral exploration has been abolished. Instead, income tax will be applied on the net gain.
- Transactions between a branch and a non-resident parent will now be required to be at arm's length. These transactions may therefore be subject to Transfer pricing adjustments. There will be a need for these local establishments to have transfer pricing document to support the pricing of the related party transactions.
- A budgetary allocation of KES 600m has been made for the establishment of Special Economic Zones (SEZ). This is an indication of the government's commitment to have the SEZ legislation which has been the subject of debate since 2009 enacted. However, the SEZ Bill, 2014 in its current state presents some challenges which need to be addressed before it is enacted into law.
- To enhance transparency and tax compliance, taxpayers will be required to provide the Commissioner with information on the changes in business and corporate structure. This may increase the cost and time for compliance.
- The government has proposed to exempt from tax employee vacation trips paid for by employers within Kenya.

NSSF, PAYE & RBA harmonization

- There is a proposal to amend the NSSF Act 2013 (which came into effect from 1 June 2014) to align it to the Retirement Benefits Authority (RBA) Act.
- The proposed amendment is to restrict the power to prescribe the qualifications of an actuary and make regulations on the payment of benefits to the RBA Act.
- Remittance dates for NSSF and NHIF will be harmonized with PAYE (from 30 to 10 days).

Value Added Tax

- The Cabinet Secretary acknowledged the existence of a huge VAT refund backlog and the Government's intention to develop a long lasting solution. In our view, this could be through issuing debt instrument to the taxpayers whose refunds are due.
- The Cabinet Secretary promised that the VAT regulations will be released soon. We hope that regulations will be innovative and creative such that they can ease the burden of compliance in the modern digital age.

Tanzania

Income Tax

Proposed amendments to the Income Tax Act include:

- Incomes and gains arising from bonds that will be issued by the African Development Bank in Tanzania domestic capital market will be exempt from tax;
- Withholding tax of 15% will be imposed on board of directors' fees. This will be final tax;
- Tax exemption on income derived from gaming is to be removed.

- Withholding tax exemption on rental charges on aircraft lease paid to a non-resident by a person engaged in air transportation business has also been removed. Thus, withholding tax at rate of 15% will apply;
- The powers of the Minister for Finance to grant exemptions for projects relating to expansion and rehabilitation undertaken by investors to be removed. This exemption was being granted to investors who own TIC certificates.
- PAYE threshold to be adjusted from 13% to 12% to provide relief of tax burden to employees.
- Presumptive tax rate to be increased from 2% to 4% for annual turnover of TShs 4 million but not exceeding 7.5 million for those who keep records. The current tax rate will increase from TShs 100,000 to TShs 200,000 for those who don't keep records.

Value Added Tax

- Reducing tax exemptions though a re-enactment of the VAT Act

Uganda

Income Tax

- Termination of initial allowance deductions of 50% and 75% on newly acquired items of eligible plant and machinery.
- Increase in the presumptive tax rate from 1% to 3% of gross turnover, for small business businesses with a turnover less than UShs 50 million.
- Introduction of a 15% withholding tax on sports and pool betting winnings and designation of gambling houses as agents to withhold the 15% tax.
- Termination of the exemption on interest income on agricultural loans advanced by banks.
- Introduction of a 30% capital gains tax on the sale of commercial property (outside of business income).
- Revision of the thin capitalisation rules to restrict the deduction of interest paid to non- associated persons to 50% of EBITDA. This is in line with the Government's tax policy reforms following the OECD's initiative on Base Erosion and Profit Shifting.
- Termination of the tax exemption on income derived by a person from managing or running an educational institution for commercial gain.
- Restriction of the existing start-up costs deduction to non-recurring preliminary costs associated with starting up a business.

Value Added Tax

VAT exemptions on the following supplies have been terminated:

- New computers, desktop printers, computer parts and accessories and computer software licenses;
- Hotel accommodation in tourist lodges and hotels outside Kampala District;
- Liquefied Petroleum Gas;
- Feed for poultry and livestock;
- Agriculture and dairy machinery;
- Packaging materials to the diary and milling industries;
- Salt;
- Insurance services (except medical and life);
- Specialized vehicles, plant and machinery services and civil works related to roads and bridges construction, agriculture, water,

education and health sectors.

The zero-rating of the following supplies has been terminated:-

- Printing services for educational materials;
- Cereals, grown, milled or produced in Uganda;
- Processed milk and milk products;
- Machinery and tools for agriculture;
- Seeds, fertilizers, pesticides and hoes.

Rwanda

Rwanda is undergoing comprehensive tax reforms hence no changes were announced in this budget.

Miscellaneous

Kenya

- Tax Procedures Bill will be presented to Parliament for debate. Once passed, the procedures will be general and applicable on all taxes.

Areas requiring further clarity:

- Carry forward of tax losses: there are no guidelines provided to govern the discretion of the Commissioner to allow for the time extension beyond four years, hence the uncertainty for investors.
- Deemed interest provision continues to be a challenge for foreign controlled entities that receive interest free loans.

Tanzania

Others taxes and levies

Export Levy

Reduction of export levy on raw hides and skins from 90% or TZS 900 per kilogram to 60% or TZS 600 per kilogram whichever is higher.

Business Licensing

Proposal to impose various rates of business licence fees proposed by the Ministry of Industries and Trade. The rates are yet to be published.

Fuel Levy

Removal of Finance Minister's powers to grant fuel tax exemption except in instances of contractual commitment between the government and development partners

Legislative amendments

The Minister stated that minor amendments to various tax laws and other laws will also be made so as to ensure their smooth and effective implementation.

Uganda

- All outstanding taxes excluding PAYE, WHT and any other taxes withheld at source owed to the Uganda Revenue Authority by Central and Local Governments have been written off.
- There are several bills that have been tabled before Parliament, including new Excise Duty and Stamps Bills; a Lotteries and Gaming bill, the Investment Code (Amendment) bill, the Public Private Partnerships Bill and the Tax Procedures Code Bill.
- The Anti-Money Laundering Act was enacted in FY2013/14 and a Financial Intelligence Authority, which will conduct financial sector surveillance to ensure compliance with the AML Act will be operationalized in FY 2014/15.
- Government has suspended negotiations on Double Taxation Agreements, as one of the measures aimed at preventing treaty abuse.
- 37 investment licences will be abolished in FY2014/15 and amendments to laws affecting 307 licences will be completed.
- The gross tax payment system managed under the Ministry of Finance will cease in FY2014/15. All goods and services procured by the Government of Uganda, directly or with donor support, will be tax inclusive, with additional funds allocated to the relevant sectors accordingly.

Tax Administration

- A list of key performance indicators has been developed by both the Ministry of Finance and URA to monitor efficiency gains by the tax administration and ensure that the URA can deliver set targets.