BUDGET 2008/09

e-brief – June 2008

DCDM

GITHONGO

Since 1969

BUDGET BRIEF 2008/09

Our Esteemed Business Partners, Associates, Colleagues and Friends,

Kenya faces a challenging task in the forthcoming year of genuine national reconciliation to realise our collective vision of a competitive and prosperous Nation. Amidst the unfortunate and painful events of the post-election period, it is heartening that Kenyans in their diversity remained resilient and unwavering in their demand for a return to peace and stability.

DCDM Kenya and Githongo & Co present the key policies, fiscal and monetary changes featured in this year's Budget Speech delivered by the Finance Minister, Hon. Amos Kimunya, on June 12th, 2008, in the attached e-brief. We also take this opportunity to highlight some key economic indicators in our e-brief.

The Budget proposals are subject to amendments during the parliamentary debates on their adoption and there may also be finer points that will require detailed comments once they are incorporated within the Finance Act 2008. We recommend that you seek specific advice on matters concerning your industry.

My colleagues and I are available to provide clarifications should you have any questions on the Budget. Kindly email your queries to admin@dcdmkenya.com and we will revert with our responses as soon as possible.

We trust this brief will be important to you in assessing the likely impact of the Budget measures on the economy and on your business in particular.

Assuring you of our best attention at all times.

Deepa Doshi
Country Managing Partner – DCDM Kenya
Budget Night
12th June, 2008

The 2008/09 Balancing Act

Against a backdrop of an unexpectedly difficult election and post election crisis, the task of formulating a budget for 2008/09 is not an enviable one. This task has not been made any easier with global crises such as soaring food prices, escalating international oil prices and the credit crunch debilitating financial markets in the USA, UK and Europe.

Whilst the formation of the Grand Coalition has set in motion the resolution of the post election political crisis, economic revival will take much longer.

The Minister of Finance has had to execute a fine balancing act between boosting revenues and the economy in the short term while keeping the country on track towards achieving the medium term targets and the National Vision 2030.

In this scenario, the Minister has aptly chosen the Budget theme:

"Working Together to Build a Cohesive, Equitable and Prosperous Kenya".

The Budget focuses on the following four priority development areas of the Grand Coalition Government:

- Restoring the economy to a higher broad-based long-term growth path with expanded opportunities for all Kenyans;
- Creating employment opportunities for the Youth for a more stable and cohesive society;
- Reducing poverty and inequality through accelerated regional development; and
- Deepening our human development efforts for higher productivity and economic prosperity.

Within the context of this Budget Theme, the Minister proposes several laudable initiatives in his Budget Speech touching upon:

- ✓ Significant financial sector reforms to strengthen the financial sector to facilitate investments.
- ✓ Expanding Infrastructure Capacity to facilitate Investment and Faster Growth (roads, ports, railways, energy, water).
- ✓ Incentives for farmers, especially through deeper and wider outreach of funding programs.
- ✓ Improving food security for Kenyans.
- ✓ Special focus on uplifting the living standards of the People of Northern Kenya.
- ✓ Environmental Conservation for Sustainable Development
- ✓ Improving quality and access to education.

The 2008/09 Balancing Act Contd.

Summary fiscal initiatives: In a bid to increase revenues, the Minister has proposed increased excise duties on cigarettes and alcohol; low-income employees and pensioners have some breaks. Bread and rice VAT Zero rating is with the aim of reducing the cost of foodstuffs. The fiscal proposals were a balance between supporting growth and improvement while maintaining the desired stream of revenues.

Kenya registered a relatively high GDP growth rate of 7% in 2007, from a growth rate of 0.5% in 2002, a growth that was attributable to the successful implementation of sound fiscal and monetary policies, the deepening of structural reforms as well as targeted and progressive investments in pro-poor programs under the Economic Recovery Strategy.

The post-election crisis has set Kenya back and economic growth for 2008 is projected at 4.5% amidst severe challenges, both domestically and globally. Indicators in the first quarter of 2008 show escalation of inflation to levels only witnessed a decade ago. The country needs to recover from the loss of capital, damage on the country's image abroad and business uncertainty that emanated from the post-election violence.

Critical factors that will enable our recovery include harmony within the Grand Coalition, the on-going rehabilitation and construction of infrastructure, the integration of the East African Community and COMESA economic blocs. The timing of the Safaricom IPO gave the economy a much needed boost and signalled a return of confidence to the country. The ongoing tourism marketing effort is expected to boost the country's image abroad.

It is the hope of the wanainchi that the various initiatives and reforms proposed in the Budget Speech are not unduly delayed as has happened too often in the past. Kenya and Kenyans cannot afford any such delays. **Our National Vision 2030 remains paramount.**

Economic Indicators

1. **Real GDP growth rate** increases to 7% in 2007 from 0.5% in 2002.
   (*This is the longest continuous growth registered in Kenya over the last 30 years).*
   In 2008, GDP is expected to record a growth of between 4.5% and 6.0%.

2. **GDP Per Capita (PPP)** increases to US$ 1,600 in 2007 (est.) from US$ 1,200 in 2006.

3. **Poverty Incidence** reduced to 40% in 2006 from 57% in 2000.

4. **Inflation** reduces to 9.8% in 2007 from 14.5% in 2006.

5. **Gross Savings to GDP** declined to 12.7% in 2007 from 14.8% in 2006.

6. **Budget Deficit** for 2008/09 projected at Kshs. 127Bn. *(Deficit to be bridged through net external financing of Kshs. 25.2 Bn, privatisation proceeds Kshs. 8 Bn, issuance of infrastructure bonds Kshs. 52.1 Bn, net domestic borrowing Kshs. 36 Bn).*

7. **Revenue** forecast at Kshs. 512.8 Bn (2007/08: Kshs. 448.8 Bn)

8. **Recurrent expenditure** budgeted at Kshs. 563.6 Bn (2007/08: Kshs. 512 Bn)

9. **Development expenditure** budgeted at Kshs.196.2 Bn (2007/08: Kshs. 209.2 Bn)

Sectoral Highlights

Sector (or Sub-sector)	2007/08	2006/07
Agriculture & forestry Sector Growth	2.3%	4.4%
Marketed cereals	Kshs. 14.7 Bn	Kshs. 13.1 Bn
Horticultural produce	Kshs. 65.2 Bn	Kshs. 43.1 Bn.
Coffee production	53,400 tonnes	48,300 tonnes
Tea exports	345,000 tonnes, valued at Kshs. 43.14 Bn.	313,000 tonnes, valued at Kshs. 47.29 Bn.
Dairy produce	Kshs. 8.5 Bn	Kshs. 6.5 Bn
Fishing	167,221 tonnes	158,670 tonnes
Manufacturing Sector Growth	6.2%	6.3%
Electricity & Water Sector Growth	9.2%	(1.4%)
Building & Construction Sector Growth	6.9%	6.3%
Transport & Communication Sector Growth	14.9%	11.4%
Hotels & Restaurants Sector Growth	16.3%	14.9%
Financial Intermediation Sector Growth	6.5%	5.5%
Mining & Quarrying Sector Growth	12.9%	4.1%

SALIENT FEATURES

- **Companies Act – Proposed Amendments:** Notice of AGM, summary of Annual Statement and Auditors Report may be published in at least 2 of the local dailies on at least 2 days. Publication and circulation of information may be done in electronic form when calling for AGMs.

- **Financial Sector:** Reforms covering areas of Microfinance, Insurance, Banking and the Capital Markets. Microfinance Act now operational. Regulatory role of the Capital Markets Authority (CMA) to be strengthened and weaknesses in its regulatory framework to be addressed including introduction of Risk Based Capital Adequacy for the capital markets. Restructuring of 5 Development Finance Institutions. Critical reforms include:
  - ✓ Central Bank of Kenya to issue bank bills and take time deposit placements from commercial banks.
  - ✓ Minimum core capital requirement for banks and mortgage financial institutions to be raised from the current Kshs. 250 million and Kshs. 200 million respectively to Kshs. 1 billion over a period of two years.
  - ✓ Individual retirement benefit schemes will now have a paid up Share Capital of Kshs 10 million inclusive of unimpaired reserves as is the case for fund managers and administrators.
  - ✓ Any person who controls directly or indirectly 25% or more of issued share capital among other things are barred from holding a management position in stock brokers, investment banks and fund managers .
  - ✓ 25% maximum cap shareholding and control of the specified licensed persons with a three (3) year transition period for existing licensees to comply has been introduced.
  - ✓ The paid up Share Capital for stock brokers and investment banks has been increased from Kshs 5 million and Kshs 30 million to Kshs 50 million and Kshs 250 million within three years respectively.

- **Agriculture:** Key reforms include:
  - ✓ Provision of affordable credit to farmers. During 2007, 25,000 farmers awarded loans totaling Kshs. 3Bn under the seasonal credit loans scheme. A further Kshs. 2 Bn disbursed under the Enterprise Loans Scheme.
  - ✓ National Accelerated Agricultural Input Program (NAAFAP) to be expanded to target 65,000 farmers from 35,000 farmers reached in 2007, for provision of fertiliser and seeds, which resulted in maize productivity increasing seven fold from 4 bags per acre to 30 bags per acre.
  - ✓ Kshs. 744 Mn allocated for agricultural extension services and research.
  - ✓ Expansion of wholesale fresh produce marketing infrastructure in Nairobi, Mombasa, Kisumu and Nakuru and other major urban centres.

SALIENT FEATURES Contd/2.

- **Public Private Partnerships (PPPs):** Government to set up an institutional framework for coordinating and managing PPPs.

- **Expanding Infrastructure Capacity:** Plan to issue Kshs. 52Bn in infrastructure bonds comprising Kshs. 33Bn through a debut international sovereign bond and Kshs 18Bn from issuance of long term domestic bonds to finance rehabilitation and expansion of road networks, enhancement of energy and water supply capacities and further rolling out of the ICT infrastructure.

- **Road network:** Kshs. 65Bn allocated to finance new construction, rehabilitation and routine maintenance of various roads earmarked countrywide. Kshs 4Bn allocated to expand and make motorable rural road networks.

- **Railway system and ports:** Significant expansion in our railway infrastructure. Through the support of the government of Japan, Kshs 20Bn allocated over the medium term towards the modernisation of the Port of Mombasa. Kshs. 430M allocated to start the project. Port of Mombasa to be positioned as the regional services hub and should generate increases in trade and employment. Free Port at Dongo Kundu in Mombasa to be established.

- **Energy:** Step up reforms to improve efficiency, reliability and quality of electricity supply. Stabilise oil price through investment N-O-C-K capacity and National Oils Reserves.

- **Water:** Kshs 1Bn allocated for development of multi-purpose dams. Government is committed to lifting water off women's backs and into the pipes of countrywide to facilitate access to clean drinking water.

- **Food security:** Kshs. 4 Bn set aside for Civil Contingency Fund, drought relief and budget reserve to be used in case of emergencies.

SALIENT FEATURES Contd/3.

- **Nairobi metropolis:** Objective - development of the Nairobi Metropolitan Area as a services hub for financial, health, education, agro-processing and business process outsource sectors which will require a drastic improvement in infrastructure services, improved provision of water and security services, construction of by-passes and modern interchanges to solve traffic congestion.

- **Northern Kenya:** To improve living standards of the People of Northern Kenya, Kshs. 2.4 Bn allocated for rehabilitation & construction of roads, expanding supplies of clean drinking water, school feeding programs, rural electrification and livestock support. Kshs 900M allocated to construct Garrisa-Garsen-Hola road. Kshs 200M allocated for improvement of Marsabit and Maralal water supply

- **Employment opportunities for Youth:** Armed Forces Act to be amended to enable youth trained in National Youth Service to be absorbed in the Armed Forces. Creation of a National Youth Council. Youth Enterprise Fund increased by Kshs. 500M. Further Kshs 250M allocated towards youth empowerment centres. Kshs. 465M allocated to cater for free tuition in accredited technical training and vocational colleges. Through sports youth mobilised for environmental conservation and other income generating activities.

- **Education:** Following success of Free Primary Education program, government has introduced Free Secondary Education program. Kshs 280M allocated to build and equip new secondary schools countrywide. Kshs 1.56Bn allocated towards recruitment of teachers for both primary and secondary schools.

- **Governance:** Critical for consolidating gains registered and enabling private sector to play a leading role towards achieving Vision 2030 objectives. Important targets set in the annual Governance Action Plan.

- **SMEs:** Will act as catalysts for economic transformation and industrialisation. Kshs. 300M allocated towards industrial innovation and piloting program covering key regional industries.

FISCAL PROPOSALS

PERSONAL, EMPLOYMENT & PENSION INCOME TAX

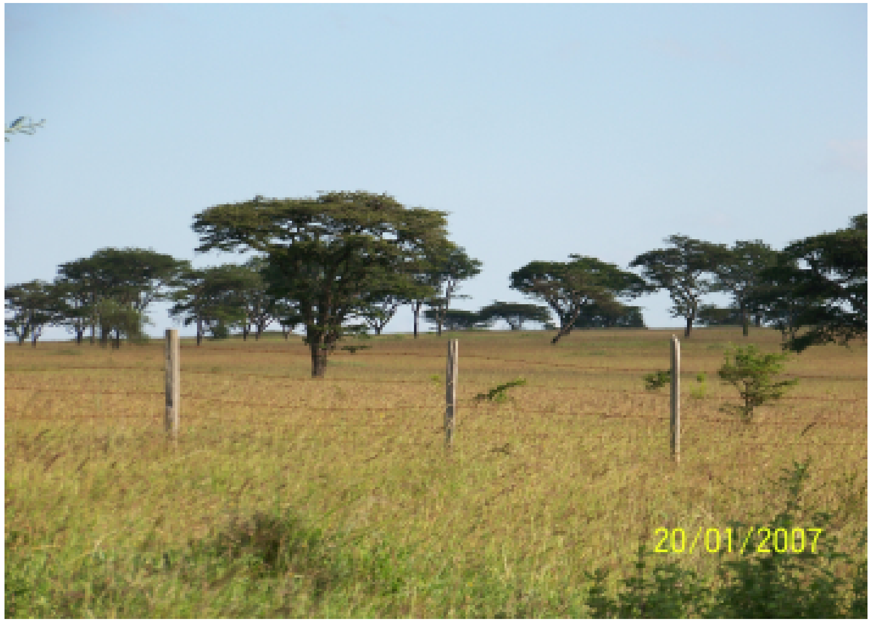
- **School fees** benefit for staff of educational institutions no longer taxable on low income employees – on employee or employer.
- **Low income employees** for the purposes of the above school fees and also canteen meals tax-free benefits are defined to be those employees whose pay tax rate is not more than 20%. Currently employees earning taxable pay of up to Kshs. 29,300 per month fall under this bracket.
- **Pension lump sum payments** to retirees over sixty-five years of age to be tax free
- **Proposal** to be made to tax allowances paid to parliamentarians and holders of constitutional offices
- **Existing mortgage relief** to be extended to mortgage loans obtained from the National Housing Corporation
- **Married ladies** income that can be declared separately extended to include rent and interest income
- **Foreign tax set-off** to be allowed on Kenyan artistes and sportsmen income so as to avoid double taxation

FISCAL PROPOSALS

CORPORATE INCOME TAX AND OTHER DIRECT TAX CHANGES

- **Financial institutions dividend income** that has hitherto been tax exempt will now be taxable – effective 13 June 2008
- **Life insurance taxable income ascertainment rules** revised. Taxable income will be the sum of the following: recommended transferable actuarial surplus; other transfers from life fund for shareholders benefit; and 30% of expenses – effective 01 January 2009
- **Turn-over tax exclusions**: rent, management, training and professional services; incorporated businesses and investment income where withheld tax is final tax – effective 01 January 2009
- **Withholding tax** introduced on business training services fees, at 5% - effective 13 June 2008
- **Appeals** may now be made on disputed Pay as you earn (PAYE) tax. Previously appeals only covered penalty charges with no recourse at the appeal stage for the disputed principal tax amount
- **In-duplum rule** introduced for tax fines and penalties. Tax fines will now be limited to not more than 100% of the principal tax in question

FISCAL PROPOSALS contd.



LAND TRANSFER TAX

- No stamp duty will be payable on land transfers to listed property investment companies

TRAFFIC ACT

- Vehicles to be registered prior to removal from the entry port
- Commercial vehicles to be registered within fourteen days of inspection

Fiscal Proposal

CUSTOMS AND EXCISE DUTIES

Tariff is removed or reduced on the following:
(effective 13 June 2008)

Construction hot rolled steel sections	Import duty removed – previously at 10%
Easy opening can ends – for food cans	Import duty reduced to 10% - previously at 25%
Cement	Import duty reduced to 25% - previously at 40%
Computer printers	Import duty removed
Telecommunication equipment	Import duty removed
Garbage collection trucks	Import duty removed
Hotel gymnasium equipment	Import duty removed

Fiscal Proposal contd.

CUSTOMS AND EXCISE DUTIES

Tariff is removed or reduced on the following: (effective 13 June 2008)

Wheat grain	Import duty reduced to the higher of 10% or US$ 50 per tonne – previously at 35% (applicable for a period of one year)
Insulated milk conveyance tankers	Import duty removed
Barley	Plans underway to reduce import duty

Tariffs added on the following: (effective 13 June 2008)

Sodium Sulphate, Aluminium Sulphate, Epoxide resins	Import duty rate of 10% imposed

FISCAL PROPOSALS

Excise duty tariffs added on the following:
(effective 13 June 2008)

Imported cigarettes excise valuation	To propose a hybrid between the retail selling system and the characteristic based system
Cigarettes – categories A, B, C and D	Excise duty up by Shs. 7 per packet: •Category A: shs. 700 per mille •Category B: shs. 1,200 per mille •Category C: shs. 1,500 per mille •Category D: shs. 2,500 per mille
Malt beer	Excise duty increased to shs. 54 per litre – up from shs 50 per litre
Non-malt beer	Excise duty increased to shs. 36 per litre – up from shs. 26 per litre
Portable wines and spirits	To introduce an Excise duty regime based on alcohol strength by volume (ABV) – currently shs. 7 per 1% alcohol per litre
Plastic paper packaging	Proposal to be made to be made to allow for the refund of excise duty payments on plastic packaging

FISCAL PROPOSALS

VALUE ADDED TAX PROPOSALS – effective 13 June 2008

- **Previously exempt hotels** brought into Vat net: hotels operated by charitable and religious organisations. These organisations will now be required to register for and charge Vat
- **Transport of tourists now taxable**. Previously this was an exempt supply for Vat purposes
- **Postal services** have been classified as taxable except those provided by the Postal Corporation of Kenya
- **Airtime supplies** by a company besides mobile phone and wireless companies are VAT exempt
- **The limit for claiming input and withholding tax** is one year. Claims will require to be supported by tax invoices and withholding tax certificates. In case of a hire purchase or lease financing, the deadline is twelve months after issuance of a letter of undertaking or a clearance certificate
- **VAT on commercial rent extended.** Residential property let out commercially will now attract Vat. Vat exemption will only apply to buildings and premises used to accommodate persons for residential purposes. Previously Vat exemption was extended to residential buildings irrespective, it appeared, of the purpose they were put to

FISCAL PROPOSALS

VALUE ADDED TAX CHANGES – effective 01 July 2008

The following have been zero rated:

Bread	The effect of zero-rating is that input Vat paid on purchases can now be recovered hence lowering the costs of production. A vital aspect here is the speed of Vat refunds.
Rice	
International air travel services	
Motor cycles of up to 250cc	
Printers, facsimiles, copiers	

FISCAL PROPOSALS

Late Tax Penalties – effective 13 June 2008

- **In duplum rule on tax late tax interest**: interest charged on outstanding taxes shall not exceed 100 % of the tax originally due
- **The tax Commissioner's fines remission powers expanded:** The Commissioner may grant remission of the whole or part of interest upon application where the interest due does not exceed 1.5 million. Over this amount the remission shall be subject to the Finance Minister's approval

Tax Information Rewards – effective 01 January 2008

- **Whistle blowers rewards** for providing information leading to tax recovery is hiked - to lower of 5% or two million of the tax recoverable. (Previously, these rates were 3% and One million respectively)

CONTACTS

Please do not hesitate to contact any of the partners, directors and managers listed below for any assistance you may require.

Deepa Doshi	deepa.doshi@dcdmkenya.com
Jharna Kamdar	jharna.kamdar@dcdmkenya.com
Peter Githongo	peter.githongo@dcdmkenya.com
Charles Muchuha	charles.muchuha@dcdmkenya.com
Sayyida Nusrath	sayyida.nusrath@dcdmkenya.com
Zachary Okungu	zachary.okungu@dcdmkenya.com
Neemita Dubal	neemita.dubal@dcdmkenya.com
Anne Waithera	ann.waithera@dcdmkenya.com

DCDM Offices
12th Floor, Loita House, Loita Street
P.O. Box 10032 – 00100, Nairobi
Tel: +254 – 20 – 246314 / 246341 / 246422 / 248381 / 248384
Fax: +254 – 20 - 246345