Kenya 2023/24 budget brief

Theme: Bottom-up Economic Transformation and Climate Change Mitigation/Adaptation for Improved Livelihoods of Kenyans.

June 2023

www.kpmg.com/eastafrica

Economic Highlights

Economic Highlights

Global Highlights

- The Global economy had previously experienced a recession as a result of the ravaging effects of the COVID-19 pandemic. The subsequent vaccination of the world population resulted in the re-opening of the global economy, which translated to a 6% growth in the global economy in 2021.
- In 2022, the global real Gross Domestic Product (GDP) growth witnessed a notable deceleration, dropping to 3.4 percent. The subdued real GDP growth was primarily influenced by issues such as the tightening of monetary policies in many regions following the post-COVID-19 period, the resurgence of COVID-19 cases in China, and the ongoing conflict between Russia and Ukraine, which resulted in significant increases in energy and food prices.
- Further, the sanctions placed against Russia resulted in a halt in the supply of gas to European countries, hampering growth in the advanced economies. The increase in energy prices and supply chain disruptions caused by the Russia-Ukraine war, coupled with other issues, resulted in a global surge in inflation from 4.7 percent in 2021 to 8.7 percent in 2022.
- The inflationary pressures experienced across the world were further compounded by the rapidly depreciating local currencies against the US Dollar, which is the key trading currency in the world.

Africa Highlights

- The African Development Bank anticipates the African economy will grow by 4 percent in 2023 and by 4.3 percent in 2024.
- In 2022, the real GDP grew by 3.9 percent, which is indicative of a slow growth of the economy primarily attributable to tightening global financial position, high inflation and the appreciation of the US Dollar against local African currencies, which impacted African countries' due to their borrowing in foreign currency to finance projects.
- Nigeria and South Africa are the biggest drivers of economic growth in Sub-Saharan Africa. In 2022, the Nigerian economy performed poorly due to lower oil production, uncertainty caused by the 2023 presidential elections and high inflation rates of 14.5 percent in 2022, compared to 11 percent in 2021. This is part of what contributed to a slower GDP growth in 2022.
- Closer home, the East African Community's real GDP grew by 4.9 percent in 2022, compared to 6.7 percent in 2021. Since countries in the East African Community import most of their items from the global market, this led to widening of the current account deficit, as a percentage of GDP from 5.6 percent in 2021 to 6.3 percent in 2022.

Kenya Highlights

- In the last two years, the Kenyan economy has experienced a rebound following the opening of the economy post the debilitating COVID-19 pandemic. The country's real GDP in 2021 grew by 7.6 percent, following a contraction of the real GDP by 0.3 percent in 2020. The real GDP growth in 2021 was attributable to the rebounding of the hospitality sector and the reopening of schools.
- The drought experienced by Kenya, the Russia-Ukraine war and the tightening of the global financial market conditions contributed to the slower growth in real GDP of 4.4 percent in 2022. Drought, combined with the rising fuel prices and the depreciation of the Kenyan shilling against world major currencies contributed to rising food insecurity and increased cost of living. These challenges contributed to inflation of 7.7 percent in 2022, up from 6.1 percent in 2021.
- The agricultural sector, which is the backbone to the Kenyan economy grew by 1.6 percent in 2022. To rejuvenate the agricultural sector, the government has pursued a production biased subsidy program, as a means of addressing the rising food prices. The government has pursued this through the subsidization of fertilizer and waiving of duty on the importation of key food products such as white maize, rice, yellow maize, soya beans, among others.
- In an attempt to tame inflationary pressures, the Central Bank of Kenya (CBK) increased the Central Bank Rate three times in 2022 from 7 percent to 7.5 percent in June 2022, to 8.25 percent in October 2022 and 8.75 percent in December 2022. As of March 2023, the rate was raised once again to 9.5 percent.
- Kenya is a net importer. The increase of interest rates by the USA resulted in scarcity of the US Dollar, therefore resulting in the depreciation of the local currency. This coupled with reduced agricultural input resulted in reduced dollar inflows, impacting Kenya's balance of payment.
- The Kenyan government financed most of the infrastructure projects using foreign currency. Kenya's debt ceiling is KES 10 trillion. As of December 2022, Kenya's total debt was KES 9.1 trillion, which represented 60% of GDP. Of the total debt, KES 4.7 trillion related to external debt while KES 4.4 trillion related to domestic debt.
- Some of the debt matured in 2023 and due to the depreciating currency, the debt repayments increased in Kenya shilling terms putting pressure on government to raise additional revenue to plug in the deficit occasioned by the currency depreciation. This has had a knock on effect on the government's ability to settle recurrent expenditure, therefore having an impact on items such as pending bills, decreased expenditure towards development, among others.
- Furthermore, most investors in domestic debt have either requested for a higher interest rate on bonds or shifted investments towards shorter term debt such as treasury bills. It is against the backdrop of the current economic environment that the Kenyan government has proposed a budget that is focused on increasing tax revenues while at the same time reduce borrowing.

"The agricultural sector, which is the backbone to the Kenyan economy grew by 1.6 percent in 2022.

Budget Overview

Budget Overview

- On 15 June 2023, the Cabinet Secretary (CS) for the National Treasury & Economic Planning, presented the 2023/2024 budget under the theme: ***"Bottom-up Economic Transformation and Climate Change Mitigation/Adaptation for Improved Livelihoods of Kenyans."***

- In his budget statement, the CS indicated that the government's expected expenditure for FY2023/24 is projected at **KES 3.7 trillion**. Out of this, recurrent expenditures will amount to **KES 2.53 trillion** while development expenditures including allocations to Foreign Financed Projects, Contingency Fund and conditional transfers to County Governments will be **KES 743.5 billion**. Equitable share to County Governments is projected at **KES 385.4 billion**. The budget excludes KES 850 in principal loan repayments which the government is likely to refinance resulting in a higher budget deficit than communicated.

- This proposed expenditure will be financed through projected revenue, including Appropriation-in-Aid and grants for the FY 20223/24 budget of **KES 2.96 trillion**. Of this, ordinary revenue is projected at **KES 2.57 trillion**, Ministerial Appropriation-In-Aid is projected at **KES 348.7 billion** and grants projected at **KES 42.2 billion**. The government will finance the balance through debts of **KES 718 billion** split between domestic and foreign debt of **KES 586.5billion** and **KES 131.5 billion** respectively.

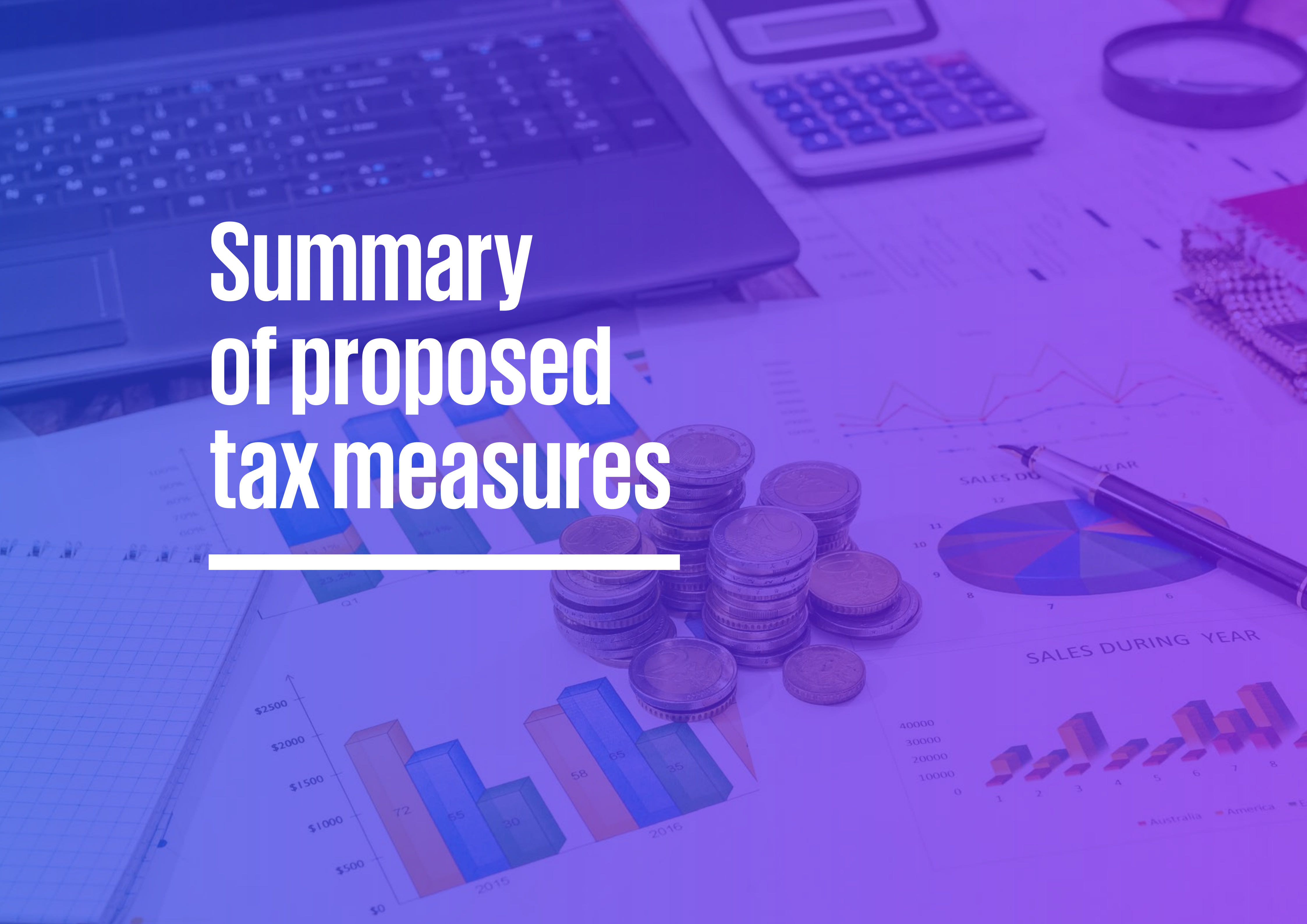
- In terms of allocation, the budget exemplified the government's aim to increase its investment in 5 strategic sectors as follows:
  - Agricultural transformation;
  - Micro, Small and Medium Enterprises (MSMEs);
  - Housing and settlement;
  - Healthcare; and
  - Digital superhighway and creative industry.

- A total of **KES 278.7 billion** has been allocated to the 5 strategic sectors in the FY 2023/24 as follows:

Strategic Area	Proposed Allocation
Agricultural transformation	KES 49.9 billion
Transforming MSMEs	KES 10.7 billion
Housing programme	KES 35.3 billion
Affordable healthcare	KES 141.2 billion
Digital superhighway and creative economy	KES 15.1 billion

- Other key allocations to thematic areas include:
  - National Security - KES 338.2 billion;
  - Manufacturing sector - KES 26.9 billion;
  - Infrastructure development - KES 244.9 billion;
  - Social services - KES 628.6 billion; and
  - County governments - KES 442.1 billion

Summary of proposed tax measures



Summary of proposed tax measures

Income Tax – Corporation Tax

Reduction of corporate tax for non-residents to the rate of 30% from the current 37.5%

This proposal is aimed at promoting equality among resident and resident companies.

Tax on repatriated profits by branches to be at a rate of 15%. The proposed rate of 15% is equivalent to the current withholding tax rate on dividends paid to non-residents.

Introduction of 5% withholding tax on the gross payment in respect to digital content monetization.

The proposal intends to bring into the tax net, digital content creators or influencers in the wake of their mushrooming lucrative digital content business.

The rate proposed is in line with the current withholding tax rate on management and professional fees paid to residents.

Reduction of the rate of Residential Rental Income tax from 10% to 7.5 % to promote compliance.

This proposal is to encourage tax compliance of property owners and boost the government's revenue collection.

Turnover tax rate increased from 1% to 3%, upper threshold lowered to KES 25M.

This proposal aims to bring to tax informal businesses while pushing larger businesses to the mainstream tax regime.

The proposed widening of the threshold contradicts the government's agenda of promoting business.

Introduction of digital asset tax (DAT) at 3% on the value of digital asset transferred or exchanged.

Under the proposed change, the owners of digital assets transfer platforms will be required to deduct and remit the DAT at a proposed rate of 3% of the transfer or exchange value of the digital asset.

"The proposal intends to bring into the tax net, digital content creators or influencers in the wake of their mushrooming lucrative digital content business.

Income Tax – PAYE

Additional individual income tax rates of 32.5 percent for income between KES 500,000 and KES 800,000 per month and 35% for income above KES 800,000 per month

The objective of the proposed change is to shore up the tax revenue by increasing tax on employees earning more than **KES 500,000** per month. However, the anticipated increase in revenue may be negligible given that majority of employees in Kenya earn below **KES 100,000 per month.**

Value Added Tax

Zero rating of Liquefied Petroleum Gas (LPG)

The CS in his statement has indicated that LPG will be zero-rated. The Finance Bill,2023 has proposed to exempt LPG from a VAT rate of 8%. If this amendment is approved by Parliament, it will lead to the reduction in price of LPG as the dealers will now be able to claim input VAT.

Removal of VAT for aircraft, parts and engine to support aviation sector

The proposed amendment widens the scope of exemption of not only aircrafts but space crafts and attendant parts.

Increase VAT rate of petroleum products from 8% to 16%. The differentiated VAT rates have created a loophole for the sector players to inflate their input VAT claims.

The VAT rate of 8% on petroleum products was introduced in the year 2018. This was after the transition clause which provided for an exemption of the VAT on such products for a period of two years expired.

This proposal is likely to impact the prices of transport and production of goods increasing the inflationary pressure in the economy.

Exemption of machinery and equipment used in the manufacture of pharmaceuticals extended to locally purchased products

The proposed amendment exempts plants and machinery acquired locally by manufacturers of pharmaceutical products or investors in the manufacture of pharmaceutical products from VAT upon the recommendation of the Cabinet Secretary responsible for matters relating health.

These products are currently standard rated.

Customs

Customs

Stay of application

- The CS indicated that Kenya will be granted stay of application and remission on various items, inputs and raw materials aimed at spurring the manufacturing sector, creating employment and protecting the local industries from unfair competition by East Africa Community (EAC).
- In order to meet the local demand for rice, Kenya will be granted a stay of application at 35% instead of 75% or USD 345/Metric Tonne. Further, the country will be granted duty remission for wheat at 10% instead of 50% to meet the local demand.
- This proposal is aimed at mitigating drought effects that have been brought about by the adverse climate changes leading to low harvest of these commodities.
- We await to see whether these proposals will be contained in the EAC Gazette notice which to be released on 30 June 2023.

Excise Duty

Excise Duty

The CS in the budget statement highlighted several changes to the Excise Duty regime, some of which are in alignment with the Finance Bill 2023 proposals. The Finance Bill 2023, has proposed to reduce the rate of excise duty on telephone, internet and fees charged on money transfer services by banks, money transfer agencies and other financial services from 20% to 15%.

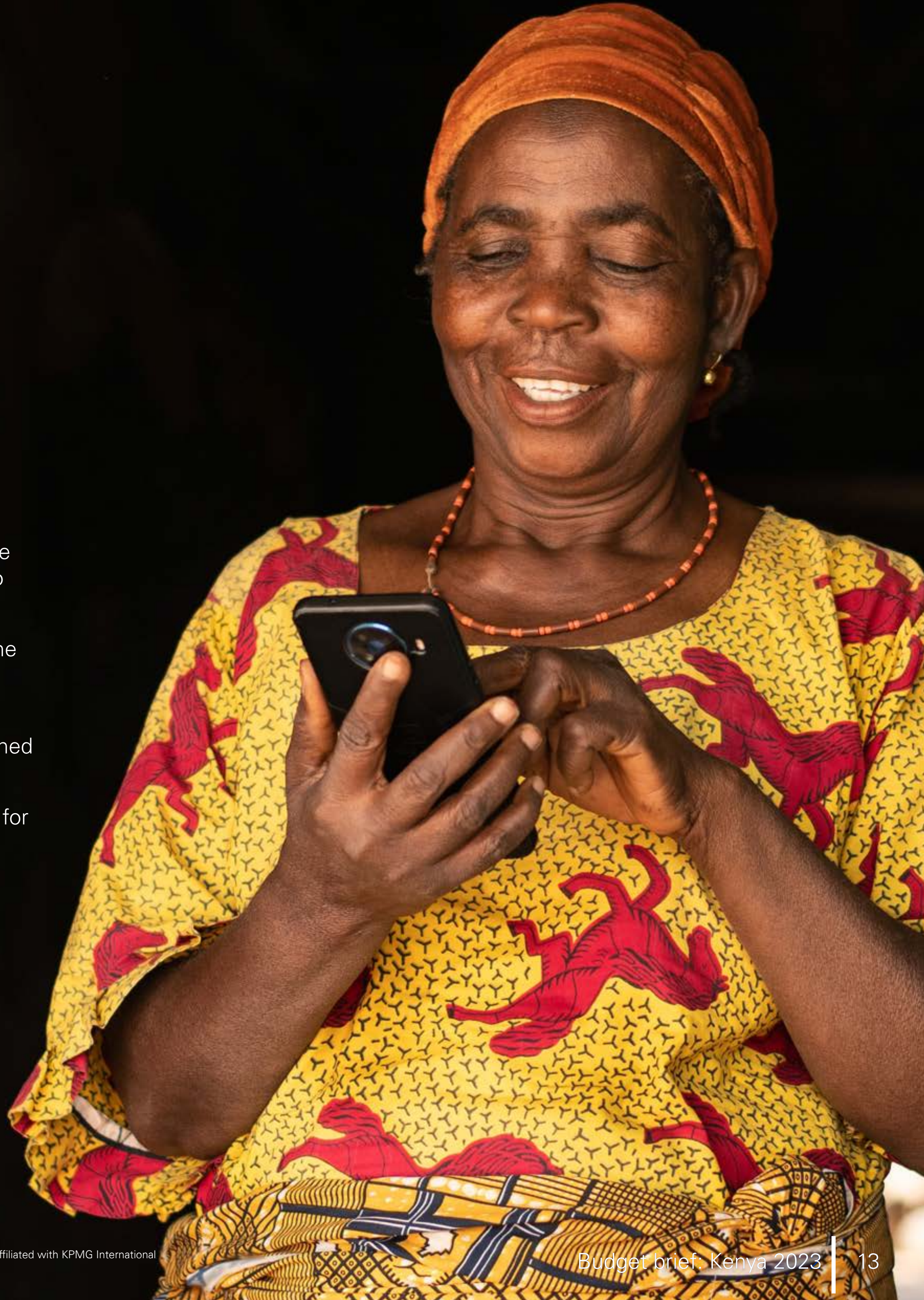
It is interesting to note that while the Finance Bill has proposed to increase the rate of excise duty on fees charged for transfer services by cellular phone from 12 % to 15%, the CS has indicated that this will be amended from 12% to 10%.

These two proposals if passed by the National Assembly may see an increase in the number of transactions effectively increasing the revenue base.

The CS also mentioned that to promote the "jua kali" industry, there will be an introduction of excise duty at a rate of 30%. This is in line with the proposal contained in the Finance Bill, 2023.

Just like the proposal for stay of application on import duty rate from 35% to 45% for customs, this proposal may spur the demand of locally manufactured furniture.

"It is interesting to note that while the Finance Bill has proposed to increase the rate of excise duty on fees charged for transfer services by cellular phone from 12 % to 15%, the CS has indicated that this will be amended from 12% to 10%.



Miscellaneous Fees and Levies Act

	Proposed rate	Current rate
Import Declaration Fee (IDF)	2.5%	3.5%
Railway Development Levy (RDL)	1.5%	2%

Introduction of a Housing Levy of 1.5% of the employee's gross salary to support the affordable housing program

This proposal is aimed at achieving the government's commitment to access to affordable housing under the Big Four agenda. The imposition of a mandatory contribution is unlikely to go down well for most Kenyans especially in the current economic environment.

This proposal was initially in the Finance Bill, 2023 as a proposed change to the Employment Act as a mandatory contribution for both the employer and employee to the National Housing Development Fund at a rate of 3% of the employees' basic salary provided that the sum of the employer and employee contributions do not exceed five thousand shillings a month, capped at KES 5,000 per month.

Tax Procedures Act

Amnesty on outstanding tax penalties and interest on principal taxes fully settled by 30 June 2024

The proposed change if passed into law, will assure tax payers of 100% waiver of penalties and interests on principal taxes relating to past periods up to 31 December 2022 and settled before 30 June 2024.

For more information, please contact:

Peter Kinuthia
Partner, and Head of Tax
and Regulatory Services
KPMG East Africa
T: +254 709 576 215
E: pkinuthia@kpmg.co.ke

Clive Akora
Partner, Tax and
Regulatory Services
KPMG East Africa
T: +254 720 068 088 **E:**
cakora@kpmg.co.ke

Stephen Ng'ang'a
Partner, and Head of Tax and
Regulatory Services KPMG
East Africa
T: +254 709 576 259
E: swnganga@kpmg.co.ke

kpmg.com/socialmedia

The budget proposals included in this Budget Brief may be amended significantly before enactment of the Finance Act. Please note that our interpretation of tax legislation may differ from that of the Kenya Revenue Authority. Similarly, the content of this Budget Brief is intended to provide a general guide and should not be regarded as a basis for ascertaining tax liability or as a substitute for professional advice. If you would like specific advice on the contents of this publication, please get in touch with your regular contact at KPMG

Disclaimer

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.