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# REPUBLIC OF KENYA
# KENYA NATIONAL ASSEMBLY
# NINTH PARLIAMENT – THIRD SESSION

# REPORT

## OF THE
## DEPARTMENTAL COMMITTEE
## ON
## FINANCE, TRADE, TOURISM & PLANNING

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## ON

## THE FINANCE BILL, 2004

**NOVEMBER, 2004**

# 1.0 INTRODUCTION

Mr. Speaker Sir, on behalf of the Members of the Departmental Committee No. F on Finance, Trade Tourism & Planning and pursuant to the provisions of Standing Order No. 162, I would like to take this opportunity to present to the House, the Report on the Finance Bill, 2004.

The membership of the Committee comprise of the following:

The Hon. Mutahi Kagwe, MP **(Chairman)**
The Hon. (Dr.) Oburu Oginga, MP **(Vice Chairman)**
The Hon. Chrysanthus Okemo, MP
The Hon. (Dr.) Adhu Awiti, MP
The Hon. John Mutinda Mutiso, MP
The Hon. Abdi Tari Sasura, M.P.
The Hon. Jakoyo W. Midiwo, MP
The Hon. Nyaga Wambora, MP
The Hon. Wycliffe A. Oparanya, MP
The Hon. S. K. Kanyingi, MP
The Hon. Joel Onyancha, MP

**The functions of this Departmental Committee as established under Standing Order No. 151 are *inter alia:-***

***(i)*** ***to study and review all legislation after First Reading subject to the exemptions under Standing Order No. 101 A (4)***

***(ii)*** ***to make reports and recommendations to the House as often as possible including recommendations of proposed legislation.***

The Finance Bill, 2004 was referred to the Departmental Committee on Finance, Planning and Trade upon a motion moved by the Minister for Finance pursuant to the provisions of Standing Order No. 101(1). The Committee held a consultative post budget workshop in conjunction with the Ministry of Finance and the Finance Bill, 2004 was among the bills discussed during the Workshop.

## 2.0 DELIBERATION ON THE FINANCE BILL, 2004

**PART 1 - PRELIMINARY**

The part indicates the commencement dates of the various amendments under different tax laws.

**PART 11 - CUSTOMS AND EXCISE**

The Part contains amendments relating to various sections under the Customs & Excise Act Cap. 472. The amendments relating to non tariff schedules are contained under this part and these includes:-

(i) Licensing of bonded warehouse aimed at streamlining the procedures for licensing the same.

(ii) Licensing of excise factories aimed at restricting excise factories in designated areas.

(iii) Restriction on packaging of alcoholic beverage in two hundred or less millitres containers aimed at making it unaffordable especially for the youth.

(iv) Empowering the commissioner to assess duty aimed at importers who fail to produce records or documents in respect of goods.

**PART 111** - **VALUE ADDED TAX (VAT)**

The part contains amendments relating to tariff numbers under the VAT Act and these includes:-

(i) Empowering the Commissioner to appoint a withholding VAT agent in order to streamline agent procedures.

(ii) Imposing penalties of Kshs. 400,000.00 aimed at penalizing offenders who make false declarations.

**PART 1V -** **INCOME TAX**

The part contains amendments to Income Tax law and these includes:-

(i) Increasing the tax free annual pension from Kshs. 150,000.00 (Kshs. 12,500.00 per month) to Kshs. 180,000.00 (Kshs. 15,000.00 monthly). This is aimed at giving tax relief to pensioners.

(ii) Widening of the tax bands for individual by 50% aimed at giving tax relief to the employed persons.

**PART V -** **MISCELLANEOUS**

The part contains amendments impinging on revenue but not under the revenue laws. For instance, the Penal Code, Civil Aviation Act, Air Passenger Service Charge Act, Capital Markets Authority Act, Kenya Revenue Authority Act etc.

The amendments includes:-

(i) Criminalizing of cheques aimed at discouraging the practice of issuing bouncing cheques with a view to bringing confidence to the national payment system.

(ii) Amending the Kenya Revenue Authority Act aimed at restructuring the Authority to further improve its performance in revenue collection.

**SCHEDULES**

The schedules to the Finance Bill are intended to amend various rates of duty, excise duty, tariff numbers, tariff splits and general nomenclature as classified under the Customs & Excise Act. These schedules are similarly used to make amendments to exempt, designate and zero-rate goods under the VAT Act.

The Committee deliberated on the Bill as follows:-

| | | |
|---|---|---|
| Clauses 1 - 6 | - | Agreed to |
| Clause 7 | - | Amendment proposed |
| Clauses 7-26 | - | Agreed to |
| Clause 27 | - | Amendment proposed |
| Clauses 28-39 | - | Agreed to |
| Clause 40 | - | Amendment proposed |

| | | |
|---|---|---|
| Clauses 41- 85 | - | Agreed to |
| Schedules (First – Third) | - | Agreed to |
| Fourth Schedule | - | Amendment proposed |
| Fifth Schedule | - | Agreed to |

## 3.0 COMMENTS BY THE MINISTRY OF FINANCE

- The government fiscal policy is long term and dynamic under the medium term expenditure policy framework (MTEF). Annual changes to the fiscal and to some extent monetary policy and general tax measures are given a legal framework under the Finance Bill.

- In preparing the Finance Bill, the Ministry makes the following assumptions:-
  - (i) The Bill can influence the general change in price level and hence in turn change tax rates affecting commodities and services.

  - (ii) The Bill will provide a basis to realize revenue according to given annual estimates and economic forecasts.

  - (iii) The Bill can shape and nature a sound macro-economic environment conducive in supporting efficient production thereby attracting both foreign and domestic investment and thus enhancing economic performance.

(iv) The Bill is a tool for intervention in the consumption of goods and services to realize desired goals. The Bill is also a tool for influencing International Trade and other dealings through varying the level of indirect taxes such as import duty, suspended duty etc.

- The Ministry of Finance aims at achieving the following policy targets through the Finance Bill.
  - (i) Raise additional revenue to realize both the development and recurrent expenditures.
  - (ii) Harmonize both the fiscal and monetary policies to attain stability in the general price level.
  - (iii) Improve the macro-economic performance through enhanced growth in all the key sectors of the economy.
  - (iv) Poverty reduction in the country
  - (v) Achieve a balanced budget.

## 4.0 COMMITTEE'S OBSERVATIONS ON THE BILL

(i) Kenya's budget making process is still stuck in the secrecy culture and the technocrats/bureaucrats make the final decisions while the stakeholders consultative process is more "tolerated" than fully embraced.

(ii) The language of the budget is archaic and the intended audience is no longer clear while the length and jargon appear to be the main criteria. The purpose and relevance of the budget themes is also no longer clear when none have been achieved in the past.

(iii) The government is still using static analysis to score tax rate changes. This assumes little change in behavior in response to tax changes hence almost no overall economic impact of new tax laws. As a result of static scoring, pro-growth tax initiatives will be torpedoed by faulty computer models.

(iv) The legal aspect of the retrospective application of the Finance Bill published on 10th June, 2004 is of concern. Constitutionally, all the amendments to the existing legislation should be effective from the date of publication onwards. However, the VAT Act is amended in Clause 37 with effect from 1st October, 2003 under Clause 1(b) of the Bill. Similarly, the 8th schedule of the VAT Act is amended in Clause 44(a) effective from 31st January, 2003 under Clause 1(a). The cumulative piece-meal amendments of revenue laws are also cumbersome. The Income Tax Act was last overhauled in 1973 and the Government Printer has not printed updates since 1976.

(v) Kenya Revenue Authority commissioners have limited discretionary powers to remit penalties and interest. The Commissioner of Income Tax now requires the Minister's prior authority to abandon collection of tax in cases of uncertainty, hardship and inequity. Penalties and interest cannot be waived also in cases of fraud or gross neglect by either Commissioner or Minister.

(vi) Increase in fees for bonded warehouses from Kshs. 100,000.00 to Kshs. 200,000.00 and the requirement that monthly output in duties and taxes exceed Kshs. 10 million is hurting private bonded warehouses hence discouraging private warehousing. It might be difficult for the private bonded warehouse to achieve this level of output and revoking the license granted will increase the financial costs to manufacturers who normally warehouse their inputs. In some cases, manufacturers cannot predict the orders they will receive from their various customers at any given time. It is therefore vital for them to hold stock of inputs in the private bonded warehouse so as to remain competitive in the region.

(vii) Payment of excise duty in advance in case of spirits affects compounders and rectifiers who are not distillers. Payment of duty on spirits up-front is also hurting Agro-Chemical Company yet it is the only spirits distiller in Kenya.

(viii) Requirements that exporters pay excise duty on exports up-front and claim rebates later adversely affects manufacturers as rebates takes a long time like three months or more. Reduction of period allowable before goods enter a customs bonded warehouse from twenty-one to seven days is also not conducive to up-country industries.

(ix) Currently imported white refined industrial sugar attracts payment 7% of Sugar Development Levy. The sugar is a vital ingredient in the manufacture of infant foods, beverage, soft drinks, confectioneries & sweets, packed juices & fruits and in pharmaceuticals. The product is essential raw material not produced locally but the levy imposed is causing a lot of problems in terms of competitiveness.

(x) The Pre-shipment inspection (PSI) companies fee is very high. There is insufficient raw material in the country yet intermediate goods are currently subjected to 2.75% to Import Declaration fee (IDF) compared to 1.2% and 0.8% in Tanzania and Uganda respectively. This increases the production costs to manufacturers and makes Kenyan goods less competitive in the domestic market with goods from COMESA Free Trade Area.

Further, the imported capital goods also attract IDF fee of 2.75%. which is very high considering that the Kenya desperately require investments which is expected to stimulate economic growth to reduce unemployment.

## 5.0 COMMITTEE'S RECOMMENDATIONS ON THE BILL

(i) Most industries in Kenya are keen on competitiveness in East African Community, COMESA, and beyond. Therefore, the government should not put hurdles via administrative changes such as those in the Finance Bill. Although Kenya adopted the principle of Asymmetry, duty free applies to Tanzania and Uganda while Kenyan goods still have some restrictions. The bottom line is that the government should reduce the cost of doing business in Kenya in order to enhance competitiveness. Kenya is the only East African country without a formal investment policy or code despite having a draft since 1997.

(ii) Parliament should engage the budget process at the expenditure and macro-level and develop key performance indicators or scorecards. There is also need for public sector reform to re-define the role of the government as a facilitator, regulator and enforce of law and order.

(iii) There is need to institutionalize amnesties in the revenue laws for future voluntary disclosures. Penalties, interest and self assessment guidelines should be included if full waiver is not possible in order to limit executive discretion.

(iv) Regulation on bonded warehouse should not be limited to those with monthly turnover of more than Kshs. ten million in duties and taxes. This penalizes manufacturers with private bonded warehouses who have to stock raw materials so as to service orders. Therefore, the regulation on monthly output should not apply to private bonded warehouses.

(v) Imposition of 2.5% duty surcharge on Export Processing Zones exports to Kenya should be removed from goods attracting zero percent import duty already.

(vi) Reduction of excise duty on juices and beverages from 10% should be eventually phased out to zero percent next year.

(vii) The exempt status of VAT products should be removed and replaced with zero-rating status on all goods manufactured locally to enable local manufacturers to claim duty on inputs. The result of this, is that the disallowed VAT is factored in the selling price and hence inflating the prices of goods.

(viii) The warehouse rent should be applicable on arrival of cargo and container at the Port of discharge and not effective on arrival of the vessel at the Port of Mombasa. Reason being that, containers being railed to inland ports or Inland Container Depots like Embakasi, Kisumu takes about two to four months in Mombasa before being railed. This situation is beyond is beyond the control of importers and manufacturers who are penalized for delays in transporting their containers to their destinations.

(ix) The current corporate tax of 30% should be reduced to 25% during this fiscal year in order to increase the domestic savings and also encourage industrial expansion to attract new investors.

## 6.0 PROPOSED AMENDMENTS TO THE BILL

1. **CLAUSE 7**

**THAT**, Section 37 of the customs & Excise Act be amended in subsection (4) by deleting the words "***seven days***" and substituting therefor the words ***"twenty-one days".***

***Rationale***

***The proposed reduction period from twenty one to seven days is short especially for the upcountry industries given that the following***

***procedures takes place from the date goods arrive:-***

***(i) Preparation of Customs entry***

***(ii) Verification of goods***

***(iii) Payment of duty and port charges***

***(iv) The containers have to be lifted from the Port to the Bonded Warehouse.***

***Complaints have been received to the effect that the seven days are not adequate for all these procedures to be carried in an orderly manner and hence the need to revert to the current twenty one days.***

2. **CLAUSE 27**

**THAT,** the Fifth Schedule to the Customs & Excise Act be amended as follows in the Fourth Schedule of the Bill.

(i) The rate of duty for locally produced juice, beverage and carbonated drinks be 5% in 2004 and 0 % in 2005. The rate of duty for locally produced drinking bottled water be 0% in 2004

***Rationale***

***Juice and soft drinks are food items that should not be taxed as these are essential***

***products for the common man. Excise duty on soft drinks discriminates against low-income consumers by placing products out of their price range.***

***Further, more drinking clean water is important from a medical view point and therefore bottled water can not be said to be a luxury.***

(ii) Deleting the following requirements:-

- Payment of excise duty upfront on spirit by Rectified and Neutral spirit manufacturers.
- Payment of excise duty upfront on spirit used by manufacturers to make products for export.
- Payment of excise duty upfront on spirit used by pharmaceutical manufacturers.

***Rationale***

***Currently, the Agro-Chemical & Food Company is the only one compounder/rectifier in the country. Payment of excise duty on spirit upfront will make our manufactured spirit more expensive hence not competitive. This issue has also affected Pharmaceutical***

***manufacturers who source spirit from Agro-Chemical & Food Ltd. for production of medicines. Other compounders/rectifiers like KWAL and UDV get spirit for their manufacture of portable spirit from Agro-Chemical & Food Ltd. It is therefore not possible to install rectifying/compounding distillers at the Port or premises of the two manufacturers.***

(ii) Reducing the rate of excise duty on industrial fuel oil

***Rationale***

***The current excise duty on fuel oil tariff Nos. 2710.19.34; 2710.19.35; 2710.19.36; and 2710.19.37 are at Kshs. 600 per 1000L @20 degC. Fuel oil is used by most of the industries and the indication from these industries is that the removal of excise duty from fuel oil will greatly assist in bringing down the cost of production. The high excise duty on fuel oil increases the cost of production for industries and for the power generation in Kenya. Therefore, the reduction of duty will assist in lowering down the prices of commodities.***

3. **CLAUSE 40**

**THAT**, Clause 40 be amended by including the following items in the Fifth Schedule of the VAT Zero rated goods - Part B instead of the Exempt goods – Part 1.

**4818.40.11 Sanitary towels & tampons**
**5601.10.10 Sanitary towels & tampons**

***Rationale***

***The proposal for exempting sanitary towels for VAT purpose has greatly disadvantaged local manufacturers in favour of importers because they have to pay VAT on raw materials and other inputs which go into making of finished sanitary towels. However, due to exempt status, manufacturers cannot be able to claim back input tax on their industrial inputs.***

***Therefore, the exemption of sanitary towels favours importers but adversely affect the local manufacturers, as they have to bear the additional tax burden on taxable industrial inputs that go into making their final product. The dilemma facing the manufacturers currently is that they are expected to absorb***

***this extra cost and at the same time they are expected to lower their prices to the consumers. The way out of this problem is zero-rating of sanitary towels for VAT purpose, which will allow local manufacturers to claim their input tax.***

4. **FOURTH SCHEDULE**

**THAT,** the Fourth Schedule be amended by reducing the new rate of duty as follows:-

(i) By deleting **"10%"** and inserting in place thereof **"5%"** under **Tariff No. 2106.90.70** on concentrated beverages rendered ready for consumption by simple dilution with water (e.g. syrups, cordials, squashes etc).

(ii) By deleting **"10%"** and inserting in place thereof **"0%"** under **Tariff No. 2202.10.00** on water, including mineral waters, aerated waters containing added sugar or other sweetening matter of flavoured.

***Rationale***

***Juice and soft drinks are food items that should not be taxed as these are essential***

***products for the common man. Excise duty on soft drinks discriminates against low-income consumers by placing products out of their price range.***

***Further, more drinking clean water is important from a medical view point and therefore bottled water can not be said to be a luxury.***

## 7.0 CONCLUSION

The Committee recommends that the House adopts its Report on the Finance Bill, 2004. Mr. Speaker Sir, may I take this opportunity to thank Members of the Committee for their input and valuable contributions during the deliberations on the Bill.

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**Hon. Mutahi Kagwe, MP**
**Chairman**
**Departmental Committee on**
**Finance, Trade, Tourism and Planning**

**Date** 1-12-04.