Paper laid by the Hon Benjamin Lang'at, MP in the House on 25/7/2013

REPUBLIC OF KENYA

KENYA NATIONAL ASSEMBLY

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ELEVENTH PARLIAMENT – FIRST SESSION

PARLIAMENT OF KENYA LIBRARY

THE DEPARTMENTAL COMMITTEE
ON
FINANCE PLANNING & TRADE

REPORT ON THE VALUE ADDED TAX BILL, 2013

PARLIAMENT BUILDINGS
NAIROBI

JULY, 2013

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1.0 INTRODUCTION

1. The Departmental Committee on Finance, Planning and Trade is established pursuant to the provisions of Standing Order No. 216(5) of the Kenya National Assembly and in line with Article 124 of the Constitution (2010) which provides for the establishment of the Committees by Parliament. The mandate and functions of the Committee is to:-

   i) *Investigate, inquire into, and report on all matters relating to the mandate, management, activities, administration, operations and estimates of the assigned Ministries and departments;*
   ii) *Study the programme and policy objectives of the Ministries and departments and the effectiveness of the implementation;*
   iii) *Study and review all legislation referred to it;*
   iv) *Study, assess and analyse the relative success of the Ministries and departments as measured by the results obtained as compared with its stated objectives;*
   v) *Investigate and inquire into all matters relating to the assigned Ministries and departments as they may deem necessary, and as may be referred to them by the House;*
   vi) *Vet and report on all appointments where the constitution or any law requires the National Assembly to approve, except those under Standing Order 204; and*
   vii) *Make reports and recommendations to the House as often as possible, including recommendation of proposed legislation.*

2. The subject matter of the Departmental Committee on Finance, Planning and Trade are stated in the Second Schedule of the Standing Order 216 as follows: Public Finance, Monetary policies, Public debt, Financial institutions, Investment and divestiture policies, Pricing policies, Banking, Insurance, Population, Revenue policies, Planning, National development, Trade tourism promotion and management, Commerce and Industry.

3. The Committee comprises:-

   1. Hon. Benjamin Langat, MP **(Chairperson)**
   2. Hon. Nelson Gaichuhie, MP **(Vice Chairperson)**
   3. Hon. Shakeel Shabbir Ahmed, MP
   4. Hon. Jones M Mlolwa, MP
   5. Hon. Anyanga, Andrew Toboso, MP
   6. Hon. Timothy M .E. Bosire, MP
   7. Hon. Joash Olum, MP
   8. Hon. Dr. Oburu Oginga, MP

9. Hon. Patrick Makau King'ola, MP
10. Hon. Abdullswamad Sheriff, MP
11. Hon. Sumra Irshadali, MP
12. Hon. Ogendo Rose Nyamunga, MP
13. Hon. Iringo Cyprian Kubai, MP
14. Hon. Dennis Waweru, MP
15. Hon. Ronald Tonui, MP
16. Hon. Tiras N Ngahu, MP
17. Hon. Sakaja Johnson, MP
18. Hon. Jimmy Nuru Angwenyi, MP
19. Hon. Sammy Koech, MP
20. Hon. Mary Emase, MP
21. Hon. Joseph Limo, MP
22. Hon. Lati Lelelit, MP
23. Hon. Kirwa Stephen Bitok, MP
24. Hon. Sammy Mwaita, MP
25. Hon. Daniel E. Nanok, MP
26. Hon. Eng. Shadrack Manga, MP
27. Hon. Abdul Rahim Dawood, MP
28. Hon. Sakwa John Bunyasi, MP
29. Hon. Alfred W. Sambu, MP

4. On Tuesday, 2nd July 2013, the VAT Bill was first read and referred to the Departmental Committee for consideration pursuant to the provisions of Standing Order No. 127(1) of the Kenya National Assembly.

5. According to the National Treasury, the process of reforming the VAT regime in Kenya gathered momentum in 2010/11. The then Minister of Finance, Hon. Uhuru Kenyatta in his Budget speech alluded to that by saying **"Mr. Speaker, I intend to overhaul VAT, to come up with modern tax legislation in line with best practice".** According to the National Treasury, the comprehensive review of the VAT Act was inevitable because of the challenges facing the administration of the VAT tax. More specifically, complexities had emerged with regards to the VAT refund system. This has resulted in huge backlog, thereby affecting the cost of firm operations. In addition, businesses continue to spend up to 243 hours in a year complying with VAT tax obligations according to a recent study by PwC on doing business. During the 2013/14 Budget Statement, the Cabinet Secretary to the National Treasury reinstated the government's commitment to simplify and make it easy to administer VAT by reintroducing the VAT Bill before the National Assembly.

6. The VAT Bill 2013 seeks to replace the existing VAT Act with its administration challenges and therefore the review of the Act was informed by the following four important reasons:

   i) **First, the enactment of the Constitution of Kenya, 2010** required that the existing VAT Act to be amended in line with the provisions therein.

   ii) **Second, unpaid VAT refunds;** Given the complexity of the VAT law, KRA is faced with a huge VAT refund problem where up to Kshs 29Billion is owed to the private sector. This has denied the sector the much needed funds for investment, stifled growth in the sector and thereby compromised job creation

   iii) **Third, Low compliance;** recent studies show that VAT compliance rate stands at about 55 percent with studies on *Paying Taxes 2013:The Global Picture* rating Kenya on overall paying taxes ranking at position 164 out of 185 globally. The poor show in the ranking is due to distortions and tax leakages resulting from leakages associated with exemptions and zero-rating. Studies have indicated that VAT compliance accounts for approximately 70 percent of the total time spent on compliance related issues making it difficult for Kenya to sell itself as a preferred destination for investment.

   iv) **Fourth, Enhance revenue collection;** The complexity of the Act created loopholes resulting in significant revenue leakages. Given the increasing demand in service provision, among them free primary and subsidized secondary education, free maternal health services, the review of the Act is therefore a matter of urgency.

7. The impact of the VAT Bill 2013 to the economy therefore include:
   i. Increase revenue: The Bill will enhance revenue collection given its proposals on limiting the number of supplies of both the exempt and zero rated items
   ii. Compliance time will reduce with indirect effect expected to enhance Kenya's outlook in attracting investors
   iii. Addressing the VAT refund problem in the long-term thereby releasing to the private sector the much needed resources for investment

2.0 THE OBJECTS OF THE VAT BILL

8. The Bill has been simplified to enable tax payers to comply with ease while leveraging on information Technology in its administration. To address the Administrative hiccups of the current Act, the Bill proposes to introduce public and private rulings by the Commissioner while time required for tax refund claims is reduced to within three months down from

twelve months. Provisions for tax appeal have been moved to a new Bill (Tax appeals Tribunal Bill, 2013) also before Parliament and its provision made more succinct.

9. The Bill further provides 16% standard rate, tax exempt and zero rated categories and as such abolishes the 12% rate on some residual fuel products e.g. marine, furnace, industrial heavy diesel oils and electrical energy.

10. Arising out of the complexity of the current VAT law, the Kenya Revenue Authority is faced with a huge VAT refund problem occasioned by zero rated supplies. For a long time this Country has witnessed a trend where exempt and zero rating list of items has expanded exponentially to an all time high of over 700 as is provided in the current Act. KRA estimates that the Problem of VAT refunds rises by approximately Kshs 1.5 billion every month. This, in a country hoping to be developed by 2030 is not feasible. The Bill therefore reverses multiple exemptions and zero rating of a large class of supplies introduced in previous Finance Acts. A status quo remains for a few items in the proposed Bill *[See Schedules to the Bill]*.

11. Some of the products proposed for exemption include fertilizers, plants and machinery including agricultural machinery (ploughs etc), live animals, various seeds, pyrethrum flower, edible vegetables and root tubers, unprocessed milk, fish, certain cereal such as maize, rice, sorghum and millet, a large array of fruits, petroleum products such as aviation spirit and motor spirit, financial services among others.

12. The Bill proposes to zero rate the following supplies exportation of goods and services, supplies to export processing zones, air travel, supplies and purchases for oil and gas exploration services, un-bottled water and select supplies to public and diplomatic institutions

13. The rationale for an expanded list of exempt and zero rated good in the current Act was to cushion the low income earners against sky rocketing prices of basic consumer goods such as milk, bread, maize flour, wheat kerosene among others. However, such intended benefits have never been passed on the consumers with the ever increasing prices of even the very basic of household commodities

14. Under a liberalized economy, taxation is a weak instrument of targeting the poor and as such the Bill intends to shift policy from targeting the poor through taxation to targeting them through targeted expenditure. On the expanded list of the zero-rated and exempted items therefore, reviews provided the following critical conclusions:

i) Zero rating consumer goods to cushion the poor does not confer the benefits to the target group under a liberalized economy unlike in the price control regime
ii) Zero rating only passes benefits to suppliers of consumer goods and erodes the VAT base making the tax non –productive
iii) Zero rating should only be restricted to exports
iv) Exemptions of intermediate goods distorts VAT system thereby exposing it to indirect tax leakages since they do not carry input tax hence reducing incentives to keep books
v) Exemptions of fuels, oil and gas distorts the supply chain as supplier are stuck with input tax paid on other components and input into production
vi) Exemptions of imported consumer goods also distorts the domestic supplies crating incentives to but imported goods and services
vii) Exemptions be limited only to unprocessed goods used by low income earners

15. The Bill therefore seeks to reduce refunds and reign on tax refund fraud menace. To ensure the any future tax law is in line with the Constitutional provisions, the bill seeks to ensure that no person is exempted from tax obligations on the basis of the office they hold. Consequently the Bill has dropped zero-rating and exemption privileges on supplies to certain officer including supplies to the Presidency, the security forces among others.

3.0 DELIBERATIONS ON THE VAT BILL, 2013

16. On Thursday, 18th July, 2013, Monday, 22nd July 2013 and Tuesday, 23rd July, 2013, the Committee held sittings to deliberate on the contents of the Bill and to make recommendations.

17. Earlier on Tuesday, 9th July, 2013; Thursday, 11th July 2013; and Tuesday, 16th July, 2013; the Committee met with the following stakeholders: PriceWaterHouse Coopers, ICPAK, Kenya Airways and the Consumer Federation of Kenya (COFEK). During the meetings, the Committee received submissions in respect of the VAT Bill, 2013 which in the opinion of all the stakeholders, the Bill is timely, urgent and an improvement of the current VAT Act but were in consensus that it required further amendment on certain provisions.

18. To clearly understand the underpinning policy behind the proposed VAT Bill, the Committee also held a one-day workshop with the National treasury at the Boma Hotel Nairobi.

19. This Report therefore contains the summary of the deliberations that ensued and the recommendations on the Bill. In making its recommendations, the Committee examined the

Bill clause by clause. Where objections were registered with respect to a particular clause in the Bill, the Committee proposed Amendments.

20. Following the subsequent discussions which proceeded between the Committee and the Stakeholders, the Committee was in agreement that the VAT Bill, 2013 had indeed many positives as compared to the current VAT Act, among them, speeding up any adjudication on VAT matters by allowing for both public and private hearings; harness Government revenue by increasing the tax base; and simplified VAT administrative procedures on exported and imported services. Further that the number of zero rated and exempted goods and services has been reduced significantly to levels that are feasible. Bill.

21. The submissions presented by Institute of Public Accountant of Kenya (ICPAK), Consumer Federation of Kenya (COFEK) and PricewaterHouse Coopers (PwC) with regards to the treatment of basic commodities where the stakeholders noted that the Bill did not seem to take cognizance of the potential impacts of the standard rating of all supplies including basic commodities. That upon enactment, the Bill would cause an increment in basic commodities such as maize flour, milk, bread among others that have been otherwise zero rated. It was felt that the Bill should provide a middle ground in the treatment of basic commodities and even attempt to **define basic commodities for clarity purposes as "essential goods that support life"**. These defined basic commodities would then be zero rated.

22. While acknowledging the impact of standard rating some basic commodities, the National Treasury was emphatic to add that zero rating of consumer goods to cushion the poor does not in most cases confer the benefits to the target group under a liberalized economy since this was only possible in economies where prices are controlled. The Committee was nevertheless concerned as to how the National treasury intends to intervene to cushion the poor so as to reduce the cost of living. The National treasury assured the Committee that targeting the poor through expenditure (Budgetary provisions) where investment is redirected to key service delivery like the free quality health care system, quality education, food security, efficient and cheaper transport and affordable energy and water, and improved business environment for expanded economic activities is the only targeted modality and the way to go.

23. The Committee was in agreement that it was essential to reduce commodities that were either zero rated or exempt from the current number of over 700 to a modest number that can easily be managed. The Committee was also in agreement that there was need for the Government to address revenue leakages by overhauling the VAT system in the country to guarantee increased revenues and bearing in mind the increased expenditure demands for services. Nevertheless, the Committee was in consensus that basic commodities likely to be used by the low income earners in the county and on a daily basis be either exempted from tax or zero rated. The Committee therefore proposed some amendments to the Bill to reflect these thinking.

24. The concerns raised before the Committee about sensitive sectors of the economy could not go unnoticed. The following sectors were identified as sensitive and which must be cushioned against incursion from cheap imports: the extractive industry- specifically mining, geothermal and energy and the Diary industry. The Aviation industry was also added to the list of the most critical sectors that required reprieve from the Bill. According to the stakeholders, the extractive industries are significantly high risk investments and hence VAT on inputs for the mining industry was likely to increase the cost of investment thereby discouraging critical investment in the county.

25. The Committee also heard that proposed VAT changes affecting the aviation industry, some of which include standard taxation on purchasing and hiring of aircrafts, standard taxation on purchase, leasing of aircraft operations goods, exempting kerosene and aviation spirit and applying standard tax on landing and parking services. The Bill therefore excluded from the list of exemptions and zero rating the various inputs and outputs in the aviation sector, a situation the Kenya Airways felt it will negatively impact on local training of workforce for the industry and even introduce operational inefficiencies. Other fears were that such changes will result in a shift of aircraft maintenance business from the country resulting in loss of job opportunities and further cause safety concerns in the local aviation sector. The Committee while acknowledging aviation sector contributions to Kenya's GDP, among them the support of up to 46,000 jobs in Kenya and its contribution to the public finance through taxes of up to ten Billion shillings, it was concerned about the ambitious investment plans by the Airline and its impact on its profits. The Committee however agreed on some amendments as regards the sensitive sectors.

26. The issue of transition clauses on remissions and outstanding refund claims granted by the current Act was brought up during the deliberations. The stakeholders acknowledged that the VAT remissions under the VAT Act have been grossly abused, but felt that this was not a sufficient reason to scrap it given the potential impact on productivity and the effect on it is likely to have on future public –private partnerships. The Committee was informed that system of VAT remissions is a mechanism for granting favorable tax treatment to facilitate investment and that several investors had committed to invest in the productive sectors of the economy on the strength of remissions. The Committee was therefore urged to reconsider this policy shift as it is likely to send the wrong message to potential investors.

27. In a similar context, it was felt that the Kenya Revenue Authority institute some drastic reforms in Tax management.

28. Arising from the Committee's interaction with the stakeholders, the Committee is considering the following amendments for possible presentation to the House during the Committee Stage of the Whole House :-

NO.	Clause	Issue	Proposed Amendment
1.	4	Authorized officers in the Bill have been given so much powers	- For further consideration
2	6 (1)	The Cabinet Secretary may amend the rate or tax	- For further consideration
3.	7	Introduce a sub clause 3 to read:	- The Cabinet secretary with approval of the National Assembly shall prescribe the inclusion of the items that qualify for inclusion in the Second Schedule
4	12	The Issue of time of supply of goods and services	- For further consideration
5	13	The word "or" needs to be inserted between 13(3)(a) and (b) to avoid ambiguity	- Insert the word 'or' after sub-clause 13(3)(a)
6	17	Sub-clause 2 limits the period within which the taxpayer would be expected to deduct input tax from 12 months to 3months. Amend to read 6 months	- Delete the word 'three" in sub-clause 17(2) immediately after within and replace it with "six".
7	24	Collection of tax by distrait. Does the clause contradict the Bill of Rights	- For further consideration
8	30	Refund of tax paid in error, the	- Delete the word " three" in clause

		refund period to be extended to 12 months from three months	30 and replace it with "twelve"
9	36	Amend to 30 days within which application for cancellation be done from 7 days	- Delete the word "seven" in clause 36 and replace it with "thirty".
10	49	Sub-clause1 as to whether to have power of inspection without warrant	- For further consideration
11	49	Provide for additional sub-clause 11(a)(b) and (c)	- 49(11)(a)Any audit or examination of tax payer records shall be finalized within six months from the date it commenced - (b)In the event that the audit is not completed within six months, the authorized officers shall seek authority to extend the audit and which shall be made available to the tax payer - (C) Subject to (b) above, the tax payer shall if required, be issued with an interim certificate for the progress made.
12	63	Amend clause to provide for the following: Timelines within which the regulations should be harmonized with the principle Act be within 6months on enactment. Regulations should be subject to National Assembly Approval	
13	64	Amend the transitional and saving clauses to provide for: (i)Transition arrangement for VAT remissions granted under the repealed VAT Act. (ii)Insert section to provide for transitional arrangement for refund of outstanding claims	- Introduce sub-clause 4(e) to read " where remission of tax was granted under the repealed ACT the Cabinet Secretary on any taxable goods or services, such remissions shall continue to remain in force for a period of five years from the commencement of

		Propose a period (e.g. three months) within which any outstanding claims after the prescribed period should attract a penalty (e.g. two and half percent) for every additional months that is outstanding Provision for frivolous claims	consideration) - Introduce sub-clause 4(f) to read "where a refund of VAT was due to be paid or refunded under the repealed Act whether before or after the commencement of this Act and was not paid or refunded, it shall be paid or refunded as though it were a sum due under this Act" - For further consideration - For further consideration
14	1st Schedule	Delete unprocessed milk from the list of exempt supplies since it is against the Dairy Act to hawk milk. Retain the essential goods in the Fifth schedule in the Act as exempt Exempt Aircrafts including spare parts and accessories Retain the current Third Schedule	- Delete paragraph 21 - Amend the 1st Schedule, Part 1 Section A: to include the following: medical equipment, medicine, medicaments, medical laboratory, consumables, farm inputs including seeds, pesticides, animal feeds, Jet fuel, Kerosene and aviation spirit, deceased persons effects, life saving apparatus, passage baggage ships and other marine vessels, rewards earned by sportsmen, capital equipment for generation of electricity, electric energy imported in the Country. - Reinstate the following Tariffs codes as exempt (Chapter 88) 8802.11.00; 8802.12.00; 8802.20.00;

			8802.30.00; 8802.40.00; 8802.60.00; 8805.10.00; 8805.21.00; 8805.29.00 - Amend Part 2: to include Ambulance services(including air ambulance), landing, parking and navigation services for aircrafts , transportation of tourists by any means of conveyance - Amend Part 2: By adding to paragraph 10 the following: tour operators, travel agents, flower actions(just like tea/ coffee)
15	2nd Schedule	Item 14 in the Current Act be Zero rated Re-instate AFCO in line with similar provisions for supplied to Armed Forces for the Commonwealth and Other Government	- Amend Part A to include purchase of kerosene, jet fuel and aviation spirit - Amend Part A Paragraph 5 to include cargo - Amend Part B to reinstate zero – rating of goods used in air-crafts operations, goods leased or imported or purchased for use by an approved ground handler or caterer - Insert a new paragraph 10 under Part A to read: 'Inputs to critical but sensitive sectors of the economy as the Cabinet Secretary may prescribe in accordance with the adopted development policies - Insert a new paragraph 11 under Part A to read:"Taxable supplies imported or purchased by any company which has been granted a geothermal resources license in accordance with a production sharing contract with the Government of Kenya in accordance with the provisions of

			the Geothermal Resources Act, 19982" - Insert a new paragraph 12 under Part A to read: "Taxable supplies imported or purchased by any company in the construction of power generating plans used to supply electricity to the national grid" - Insert a new paragraph 13 under Part A to read: " The Supply of farm inputs , dairy machinery, processing equipment and such other dairy equipment, dairy trucks and insulated milk tankers supplied to or purchased by dairy farmers, processors and traders who are registered as such with the Kenya Dairy Board" - Insert a new paragraph 14 under Part A to read: "The supply of taxable services in respect of goods in transit" - The Following basic food commodities should be zero rated: maize(corn)seed, rice, maize flour, wheat flour, ordinary bread, gluten bread and unleavened bread, infant milk and food preparations for infants - Medicaments, Exercise Books and other printed books, sanitary towels and tampons, mosquito nets, newspapers, journals and periodicals.(See attached

			schedule)

4.0 CONCLUSION

29. Pursuant to the Standing Order 127, the Committee therefore presents its report on the deliberations on the VAT Bill, 2013 to the National Assembly for information.

Thank You

SIGNED ....

CHAIRPERSON
(HON.BENJAMIN LANGAT, MP)

DATE......25-07-2013..