REPUBLIC OF KENYA

THE NATIONAL TREASURY AND ECONOMIC PLANNING

2022 TAX EXPENDITURE REPORT

NOVEMBER 2022

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Foreword

The 2022 Tax Expenditure report, which is the second report to be prepared by the National Treasury, provides information for tracking and evaluating tax expenditure and increases the transparency and accessibility of data on national tax expenditure. The report comes at a time when the Government is implementing the Bottom-up Economic Transformation Agenda which targets to re-position the economy on a steady, inclusive and sustainable growth trajectory. Special focus will be placed on bringing down the cost of living, creating jobs, more equitable distribution of income, eradicating poverty while also expanding the tax revenue base, and increased foreign exchange earnings.

As part of the economic turnaround plan, the Government will scale up revenue collection efforts by the Kenya Revenue Authority (KRA) to Ksh 3.0 trillion in the FY 2023/24 and Ksh 4.0 trillion over the medium term. In order to achieve this, the Government will undertake a combination of both tax administrative and tax policy reforms. Under the tax administrative reforms, the Government targets to reduce tax exemptions through elimination of unproductive tax incentives.

A review carried out by the World Bank in 2015 on the tax incentives concluded that many had not delivered the expected impact such as lower prices for consumers or increased supply of specific products. Moreover, increase in tax incentives has made our tax system less efficient and difficult to administer, further augmenting the challenges encountered in revenue collection. As a result, several incentives were eliminated through the Tax Laws Amendment Act, 2020, the Finance Act, 2020 and the Finance Act, 2021.

In the 2021 Tax Expenditure Report, we noted a significant decline in the level of tax expenditure from 5.15 percent of GDP in 2017 to 2.96 percent as a percent of GDP in 2020. This 2022 Tax Expenditure Report shows a further reduction of the tax expenditures to 2.61 percent of GDP in 2021 with the domestic Value Added Tax accounting for most of the total tax expenditure followed by VAT on imported fuel. Tax expenditure on domestic VAT are spread across a range of sectors such as Agriculture, Manufacturing and Transport. The bulk of tax expenditure related to corporate income tax are allowances and deductions designed to encourage investment in plant and machinery.

To ensure sustainability and value for money from the resources foregone through tax expenditure, the Government will continue to upscale efforts to rationalize and harmonize the tax expenditure with the aim of removing redundant tax expenditure and enhancing those intended to promote investments and for social protection. In addition, there is need to have an elaborate framework for monitoring and evaluating the impact of tax expenditure in the economy.

PROF. NJUGUNA S. NDUNG'U, CBS
CABINET SECRETARY.
NATIONAL TREASURY AND ECONOMIC PLANNING

Preface

The 2022 Tax Expenditure Report enhances fiscal transparency by providing tax expenditure by tax heads. This information also enhances monitoring of the tax incentives to safeguard the tax base.

This is the second report. The first report was prepared in the year 2021. It forms part of the structural benchmarks of IMF program geared towards enhancing revenue collection through rationalizing tax expenditure and retaining those whose intention is to promote investments and for social protection.

Article 201 of the Constitution requires transparency and public participation in financial matters. In this respect, the 2022 Tax Expenditure Report has been prepared in adherence to the constitutional requirement of fostering government budgetary and fiscal transparency. This Report has also been done in conformity to international best practices where expenditure reporting is a key indicator of openness in budgeting.

The preparation of this Report was a collaborative effort among key stakeholders from both the public and private sectors. We are grateful for the timely provision of useful data and information. In particular, we recognize and appreciate the technical committee comprising of officers from the National Treasury and Kenya Revenue Authority who worked tirelessly to ensure that the Report was prepared within the stipulated timeframe. I also acknowledge the support received from the Public Financial Management Reform Secretariat who facilitated meetings and workshops for the technical committee to develop and publish this report.

Finally, allow me to thank the public for the useful comments and inputs. We always value the inputs received from public participation in the formulation of tax policies as we seek to progressively improve transparency and accountability in our tax system.

DR. CHRIS KIPTOO, CBS
PRINCIPAL SECRETARY/THE NATIONAL TREASURY

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Abbreviations and Acronyms

BTS	Benchmark Tax System
CIF	Cost Insurance and Freight
CIT	Corporate Income Tax
COMESA	Common Market for Eastern and Southern Africa
DEFCO	Defence Forces Canteen Organization
EAC	East African Community
EACCMA	East African Community Customs Management Act
EAC CET	East Africa Community Common External Tariffs
GDP	Gross Domestic Product
HOSP	Home Ownership Savings Plan
IDF	Import Declaration Fee
PAYE	Pay As You Earn
PIT	Personal Income Tax
PWD	Persons With Disability
RDL	Railway Development Levy
SEZ	Special Economic Zone
VAT	Value Added Tax

Definition of Terms

Benchmark tax system: Means a baseline against which a tax expenditure is recognized as a standard tax treatment at international standard or in Kenya and not conferring preferential treatment to particular group of taxpayers. However, preferential treatment could be conferred to taxpayers or goods and services due to regional or international commitments or tax design.

Destination principle: This is a concept which provides that value added taxes should be charged by the country where the taxable supplies is consumed.

Digital marketplace: Means an online or electronic platform which enables users to sell or provide services, goods, or other property to other users.

Investment allowance: Means expenditure in respect of investments for the business that taxpayer is allowed to deduct against his taxable income

Tax Expenditure: Means tax foregone due to explicit concession that departs from what is considered as a generally applicable tax provision under the existing tax law and is meant to achieve a specific socio-economic outcome.

Natural resource income: An amount including a premium or such other like amount paid as consideration for the right to take minerals or a living or nonliving resource from land or sea; or (ii) an amount calculated in whole or in part by reference to the quantity or value of minerals or a living or non-living resource taken from land or sea.

Executive Summary

Kenya's tax system provides for preferential tax rates whose objectives is to achieve targeted policy intervention. These rates help the government to leverage on tax system to achieve specific public policy objectives.

The Report reveals that total tax expenditure in 2021 was Ksh 316.0 billion (2.61 percent of GDP) as compared to Ksh 267.1 billion recorded in 2020 (2.49 percent of GDP), an increase of 18.3 percent. Domestic Value Added Tax accounts for most of the total tax expenditure followed by VAT on imported fuel. The total tax expenditure for Kenya is comparable to those of other countries such as 1.38% in Burkina Faso, 4.69% in Poland and 6.13% in Ghana according to Taxation, International Cooperation and the 2030 Sustainable Development Agenda; and United Nations University Series on Regionalism 19. However, it should be noted that comparisons of tax expenditure between countries is delicate as the Benchmark Tax Systems used as reference vary substantially.

Between 2020 and 2021, domestic VAT exemptions increased by Ksh 38.6 billion, while VAT on imported fuel increased by about Ksh 11.2 billion which represent an increase of 22.4 percent and 66.8 percent respectively. On the other hand, Excise duty (domestic) registered the highest decrease between year 2020 and 2021 of Ksh 5.8 billion followed by at Corporation Income Tax at Ksh 920 million.

Tax expenditure on domestic VAT are spread across a range of sectors such as Agriculture, Manufacturing and Transport. The bulk of tax expenditures related to corporate income tax are allowances and deductions designed to encourage investment in plant and machinery.

To ensure sustainability and value for money from the resources foregone through tax expenditure, the Government will continue to upscale efforts to rationalize and harmonize the tax expenditures with the aim of removing redundant tax expenditures and enhancing those intended to promote investments. In addition, there is need to have an elaborate framework for monitoring and evaluating the impact of tax expenditure in the economy

CHAPTER ONE: INTRODUCTION

1.1 Background

The fundamental function of taxation is to collect revenue to finance Government operations and provide public goods and services. A tax system can be used to finance development of public infrastructure and socio-economic projects, as well as facilitating conducive business environment to support growth of economic activities in the country.

In addition to public expenditure as presented in the National Budget, the Government of Kenya also spends through the tax system in the form of tax reliefs. The value of revenue foregone from these reliefs is described as 'Tax Expenditure'. Tax Expenditure are used to achieve specific public policy objectives through targeted preferential tax measures aimed at benefiting specific sectors or categories of taxpayers to achieve a given policy goal. These policy objectives could reduce cost of capital and encourage investment, support development expenditure, ease the cost of living for the vulnerable in society, among others.

The key objective of tax expenditure reporting is to improve transparency of tax expenditure and highlight their scope relative to other forms of government expenditure. The report is also useful in assisting the government to assess the effectiveness and efficiency of the tax reliefs provided and use such information to make more informed policy choices.

While there is no legal requirement to produce tax expenditure report, Articles 201, 210 and 220 of the Constitution of Kenya requires maintenance of a public record of tax waivers and adherence to the principles and framework of public finance in Public Finance Management Act, 2012. Additionally, tax expenditure reporting is considered as an international best practice to foster government budgetary and fiscal transparency. In this regard, the Tax Expenditure report will be published annually to enhance transparency and accessibility of information on national tax expenditure.

The approach taken to estimate tax expenditure in this report is the "Revenue Foregone" approach. This involves estimating the direct revenue loss associated with the provision under consideration, relative to the benchmark system. It does not take into account any behavioral changes by taxpayers and businesses due to the presence or removal of tax reliefs. Revenue foregone is therefore not equivalent to revenue gain that may be achieved from removing tax reliefs.

1.2 Benchmark Tax System

In order to ascertain the amount that the Government foregoes in form of tax expenditures, determination of the standard treatment or benchmark is the first step. This necessitate definition of a baseline against which a tax concession is recognized as either part of the 'normal' tax structure or as a departure from the norm and thus a tax expenditure.

This Report follows the legal approach in defining the benchmark tax system where the existing tax law form the basis for defining the benchmark and identifying differential and preferential treatment. The tax categories considered under this report include: the income tax imposed under the Income Tax Act; the VAT imposed under the Value Added Tax Act, 2013; the Excise duty imposed under the Excise Duty Act, 2015; Import declaration Fees and Railway Development Levy imposed under the Miscellaneous Fees and Levies Act, 2016; and the Import Duties imposed under the East Africa Community Common External Tariff (EAC CET) and East Africa Community Customs Management Act,2004 (EACCMA).

Only the major structural elements of each tax category are considered as part of the benchmark tax system. Therefore, the benchmark tax system is defined on the basis of the following criteria:

i. The general tax regime as defined in the various tax laws, but with emphasis on the scope, the definition of the taxable base, tax unit, the tax rate(s) and tax period;

ii. The national tax policy choices that consider some relief measures as normal, for example, a particular sector of the economy such as health, basic agriculture or education;

iii. Some provisions in bilateral agreements, including the tax treatment of projects financed by development partners, which may be considered part of the benchmark, while others may be considered tax expenditure. In principle, these provisions are intended to prevent the double taxation of income. If the rate provided for is that of the ordinary legal regime, there is no deviation from the benchmark tax system. However, if two countries agree on a preferential tax relative to the general regime, the reduction in some tax rates can be identified as a tax expenditure since any bilateral agreement can be renegotiated;

iv. Regional agreements and directives that necessitate the evaluation of tax expenditures not just against a national norm but also against a community norm. This is the case in a customs union, where the common external tariff is the norm for customs duties; and

v. International agreements have been considered since exemptions can be decided at the international level. According to the hierarchy of norms, international law takes precedence over regional and national law. These measures have therefore been considered in the tax norms and included in the benchmark tax system.

1.3 Objectives of the Report

The overall objective of this report is to estimate the national tax expenditure for 2021. The specific objectives of the report are:

i. Estimate tax expenditure for various tax heads;
ii. Provide statistics on tax expenditure;
iii. Enhance transparency and accessibility of information on national tax expenditures; and
iv. Facilitate monitoring and review of tax expenditure.

1.4 Scope of the Report

The report presents analysis of the tax expenditure under domestic Value Added Tax (VAT), Income Tax (Personal Income Tax and Corporate Income Tax), Import duty, Excise duty, Import VAT and Fees and Levies for the year 2021. For each tax head, the report provides a description of the benchmark tax system, list of tax expenditures and estimates on the value of tax expenditure. Regarding tax heads for which no tax expenditure is identified, the report only provides a description of the benchmark tax system.

This introductory chapter provides the background to this report. The subsequent chapters are organized as follows: Chapter II, III, IV and V analyse tax expenditure under the Income Tax, Value Added Tax, Excise Duty (domestic) and Taxes on Imports, respectively; and Chapter VI presents the conclusion and policy recommendations.

CHAPTER TWO: INCOME TAX

2.1 Overview

Income tax in Kenya is imposed on different categories or sources of income. It is charged for each year of income, upon all the income of a person whether resident or non-resident, which is accrued in or derived from Kenya.

The benchmark for income tax is based on the taxable income of legal persons and individuals who are subject to taxation regardless of their economic activity or their region of operation. A person's taxable income is the difference between the person's total income and the sum of the taxpayer's total allowable deductions.

Under the Kenyan tax system, the categories of income are:

i. Gains or profits from a business, employment or services rendered and a right granted to another person for use or occupation of property;

ii. Dividends or interest;

iii. Income accruing through a digital marketplace;

iv. An amount deemed to be the income of a person under the Act or by rules made under the Act;

v. Any gain as determined under the Act, which accrues to a company or an individual on the transfer of property situated in Kenya;

vi. The net gain derived on the disposal of an interest of a person that derives 20% or more of its value, directly or indirectly, from immovable property in Kenya; and

vii. A natural resource income.

Individuals and corporate bodies are the primary units of income taxation, which is a direct tax. Individuals are taxed on their income through graduated rate while companies are taxed at a general rate of 30.0 percent for residents and 37.5 percent for non-residents.

2.2 Personal Income Tax

Personal Income Tax is charged for each year of income on all the income of a person, whether resident or non-resident, which accrues or was derived from Kenya. Tax on personal income is on graduated scale known as Pay As You Earn (PAYE) and is applicable to all persons at the time of employment and to non-resident persons employed by an employer who is resident in Kenya.

The base of taxation of personal income tax includes wages, casual wages, salary, leave pay, sick pay, payment in lieu of leave, fees, commission, bonus,

gratuity, and allowances such as subsistence, travelling, and entertainment which are received in respect of employment or services rendered.
Taxation of PIT is progressive because the percentage of income that individuals pay in tax tends to increase with increase in income; and those with higher incomes pay higher tax rate. The personal income tax rate includes a personal relief (tax-free) threshold and a graduated personal income tax rate as shown in **Table 1.**

Table 1:PIT Bands and Rates

Tax Band	Applicable Tax Rate
On the first Ksh 24,000 per month or Ksh 288,000 p.a	10%
On the next Ksh 8,333 per month or Ksh 100,000 p.a	25%
On all income amount in excess of Ksh 32,333 per month or Ksh 388,000 p.a	30%

Pension income is subject to PIT but features different tax specific bands as depicted in **Table 2.**

Table 2:Pension Tax Bands

Bands	Annual Tax Rates
On the first lump sum Ksh 600, 000	Tax free
On the next 400,000	10%
On next 400,000	15%
On next 400,000	20%
On next 400,000	25%
On any amount in excess of Kshs 1,600,000	30%

2.2.1 PIT Benchmark

The tax base for taxation is the remuneration paid to an employee or an individual. In this report, the following are considered benchmarks:

i. Contributions to pension scheme and social security fund;
ii. Tax reliefs; and
iii. Income paid to diplomats and privileged persons.

2.2.2 PIT Expenditure

Given the benchmark regime described, the tax expenditure takes the form of reliefs to taxpayers to encourage savings, home ownership and reduce tax burden, among other reasons. These reliefs include; insurance relief, relief related to persons with disability (PWD) and mortgage relief among others**.**

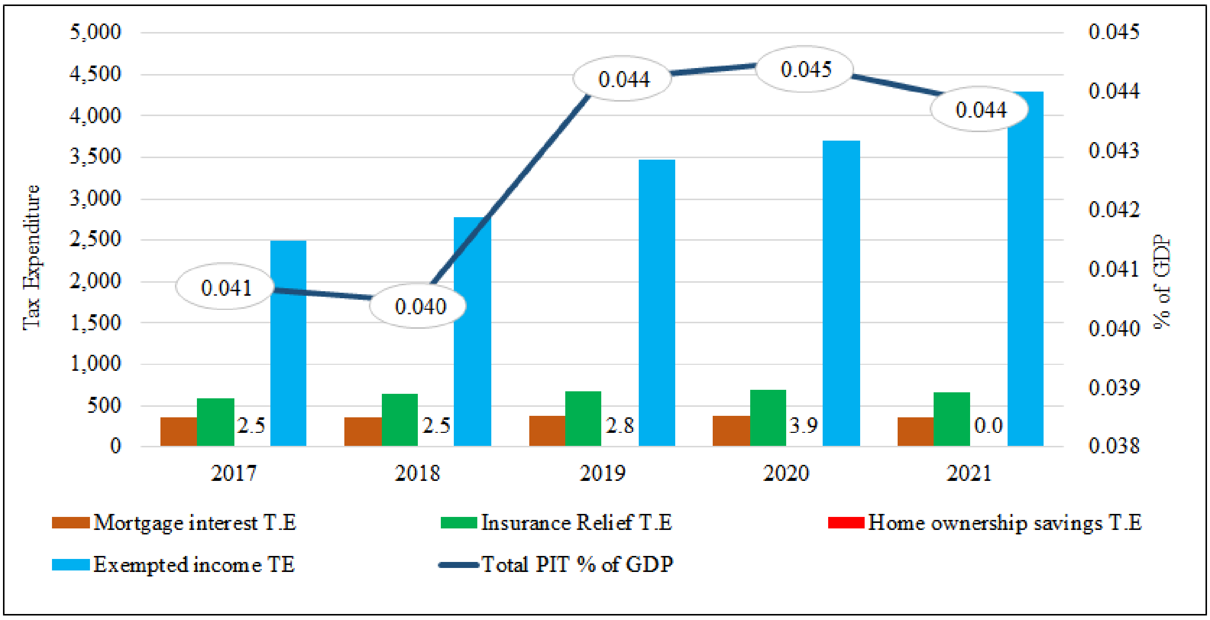
Tax expenditure related to personal income tax stood at Ksh 5.31 billion in 2021, an increase from Ksh 4.77 billion in 2020 **(Table 3).**

Table 3:PIT Tax Expenditure Estimates

Years / PIT Categories					Ksh Million
	2017	2018	2019	2020	2021
Mortgage interest T.E	360.78	365.51	376.47	380.74	366.35
Insurance Relief T.E	588.00	638.00	675.22	689.28	652.75
Home ownership savings '	2.45	2.52	2.81	3.85	*
Exempted income TE	2,502.93	2,773.35	3,470.76	3,695.64	4,287.39
Total PIT TE	3,454.16	3,779.38	4,525.26	4,769.51	5,306.49
Nominal GDP	8,483,396.00	9,340,307.00	10,237,727.00	10,716,034.00	12,098,200.00
Total PIT % of GDP	0.041	0.040	0.044	0.045	0.044

Personal income tax expenditure as a percent of GDP has been increasing at a minimal rate for the period 2017 to 2020. However, for the period 2021, it declined to 0.044. In 2021 Tax Expenditure related to Home Ownership Savings was zero. This is attributed to the change of policy which removed the tax relief on contribution of Home Ownership Savings Plan (HOSP) through the Finance Act, 2020. Ideally, due to the change in policy that removed the HOSP, no tax expenditure should have been incurred in 2021.

Figure 1:PIT Expenditure



2.3 Corporate Income Tax

Corporate Income Tax (CIT) is a tax levied on corporate bodies such as limited liability companies, Co-operatives, among others on their annual income that is derived in Kenya. The base unit of taxation for corporate income tax is the corporate body.

2.3.1 CIT Benchmark

The benchmark for corporate income tax is the statutory standard or general corporate income tax rate in effect at any given time (currently 30% for Kenyan incorporated entities, and 37.5% for non-resident corporate bodies). The taxation system for corporate entity includes preferential tax regimes, which are considered as part of the benchmark for this report and will therefore not count as tax expenditure. These specific regimes include:

i. Companies located in Export Processing Zones, for which the corporate income tax rate is 0% for the first ten years and 25% for the next ten years after which 30% rate applies.

ii. Companies located in Special Economic Zones (SEZ), for which the corporate income tax rate is 10% for the first 10 years of operation and 15% for the next 10 years after which 30% rate applies.

iii. Companies newly listed on any approved securities exchange are subject to a reduced tax rate of 25% for 5 years following the listing. The reduced rate is only applicable to companies listing at least 30% of their issued share capital.

For this Report, 10% investment deduction is considered as benchmark while any deduction more than this is regarded as a tax expenditure. This is on grounds that investment deductions are endemic to all tax systems as international best practice and a standard accounting principle.

In addition to these specific regimes, business losses are carried forward indefinitely to allow companies offset the losses with future profits. This in turn reduces future corporate income tax payments.

2.3.2 CIT Expenditure

Given the benchmark tax regime described in section 3.3.1, Corporate Income Tax expenditure take the form of deductions such as farm work deductions, plant and machinery investment deductions, building investment deductions and wear and tear. These deductions are designed to encourage companies to invest in productive fixed assets. The rate of these deductions varies depending on the type of asset **(Table 4).**

Table 4:Rates of Investment Allowances

Capital expenditure incurred	Rate of Investment Allowance
(a) Buildings	
(i) Hotel building	50% in the first year of use
(ii) Building used for manufacture	50% in the first year of use
(iii) Hospital buildings	50% in the first year of use

(iv) Petroleum or gas storage facilities	50% in the first year of use
(v) Residual value to item (a)(i) to (a)(iv)	25% per year, in equal instalments
(vi) Educational buildings including student hostels	10% per year, in equal instalments
(vii) Commercial building	10% per year, in equal instalments
(b) Machinery	
(i) Machinery used for manufacture	50% in the first year of use
(ii) Hospital equipment	50% in the first year of use
(iii) Ships or aircrafts	50% in the first year of use
(iv) Residual value items (b)(i) to (b)(iii)	25% per year, in equal instalments
(v) Motor vehicles and heavy earth moving equipment	25% per year, in equal instalments
(vi) Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines	25% per year, in equal instalments
(vii) Furniture and fittings	10% per year, in equal instalments
(viii) Telecommunications equipment	10% per year, in equal instalments
(ix) Filming equipment by a local film producer licensed by the Cabinet Secretary responsible for filming	25% per year, in equal instalments
(x) Machinery used to undertake operations under a prospecting right	50% in the first year of use and 25% per year, in equal instalments
(xi) Machinery used to undertake exploration operations	50% in the first year of use and 25% per year, in equal instalments
(xii) Other machinery	10% per year, in equal instalments
(c) Purchase or an acquisition of an indefeasible right to use fibre optic cable by a telecommunication operator	10% per year, in equal instalments
(d) Farm works	50% in the first year of use and 25% per year, in equal instalments

Total CIT expenditure stood at Ksh 21.6 billion in 2021, a decline from Ksh 22.6 billion in 2020. However, total CIT expenditure increased from Ksh 17.1 billion in 2017 to Ksh 22.3 billion in 2018. (**Table 5).**

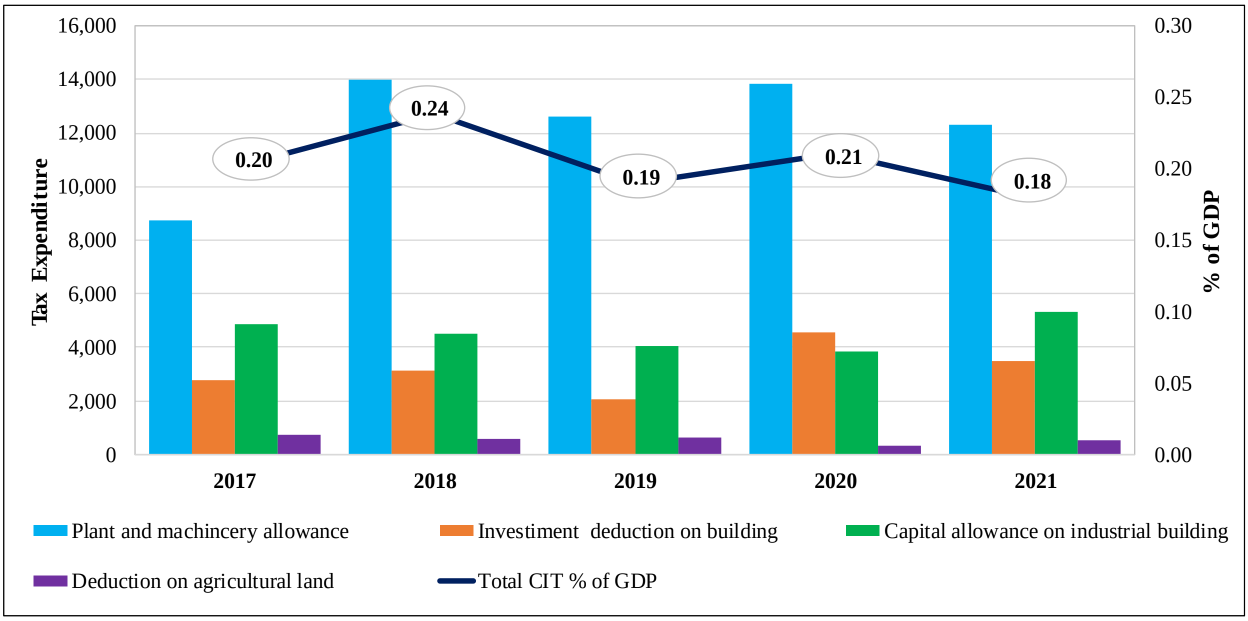
Table 5:Corporate Income Tax Expenditure

					Ksh Million
	2017	2018	2019	2020	2021
Plant and machinery allowance	8,721.57	14,002.18	12,594.46	13,820.49	12,284.68
Investiment deduction on building	2,755.10	3,153.29	2,072.21	4,559.22	3,489.20
Capital allowance on industrial building	4,870.88	4,532.80	4,073.78	3,839.97	5,346.56
Deduction on agricultural land	737.77	598.80	639.41	345.09	516.38
Total CIT Expenditures	17,085.32	22,287.07	19,379.86	22,564.77	21,636.81
Nominal GDP	8,483,396.00	9,340,307.00	10,237,727.00	10,716,034.00	12,098,200.00
Total CIT % of GDP	0.20	0.24	0.19	0.21	0.18

Note: During the estimation of tax expenditure on investment allowances in 2021 Tax Expenditure report, 30% of the value of investment allowances was considered as tax expenditure. However, it was noted that Investment allowances are considered international best practice and therefore, only a percentage of deduction should be considered as tax expenditure. Therefore, in 2022 Tax Expenditure Report, 10% rate of deduction was considered as the benchmark and since most of the investment deductions have a deduction rate of 25% after the first year of use, the difference between 25% and 10% i.e 15% was considered as tax expenditure and was used to revise the tax expenditure in the previous years.

Corporate tax expenditure as a percent of GDP has been on a fluctuating trend since 2017. In 2021, the expenditure reduced to Ksh. 21.6 billion (0.18 percent of GDP) from Ksh. 22.6 billion (0.21 percent of GDP) in 2020. This represents a decline of 0.03 percent **(Figure 2).**

Figure 2:CIT Expenditure



CHAPTER THREE: VALUE-ADDED TAX

3.1 Overview

Value Added Tax is a consumption tax levied on taxable goods and services made or provided in Kenya and supplied or imported into Kenya. The tax is levied at every stage in the supply chain where value is added. Any person, individual, company, or partnership that has supplied or is expected to supply taxable goods worth Ksh 5 million is required to register and charge VAT. Nonetheless, a trader with a turnover of less than Ksh 5 million is allowed to register for VAT on voluntary basis.

3.2 VAT Benchmark

There are three types of VAT rates: the general rate of 16.0 percent on goods and services, 8.0 percent on petroleum products and 0.0 percent on zero rated supplies. The benchmark tax system for domestic VAT is the standard rate of either 16.0 percent or 0.0 percent predominantly on exports. The benchmark unit of taxation is the final consumer of taxable goods and services. However, there are exempt goods and services contained in the First Schedule and zero-rated goods and services in the Second Schedule of the VAT Act, 2013 that are considered benchmark but not as tax expenditure (list in Annex I).

3.3 VAT Expenditure

The VAT Act, 2013 provides legal provisions against which tax expenditure in regard to Value Added Tax are affected. These are:

a) **Exempt supplies**: This involves remission or waiver of VAT where suppliers of goods or services that are exempt can neither charge output VAT nor claim input VAT. Thus, no VAT is chargeable on the supply of exempt goods or services.

b) **Zero-rated supplies**: Here, no VAT is charged on goods and services mainly due to their societal importance or promotion of exports. Thus, no VAT is payable on the supply. The suppliers of zero-rated goods or services claim input VAT.

Tax expenditure in respect of VAT, therefore, is the revenue foregone due to tax exemptions and zero-rating of certain goods and services that are for domestic consumption. Zero rating of exported goods and services is not considered as tax expenditure in this report following its destination principal. Given this, tax expenditure in relation to domestic VAT increased to Ksh 211.09 billion (1.74 percent of GDP) in 2021 from Ksh 172.54 billion (1.61 percent of GDP) in 2020 **(Table 6 and Figure 3).**

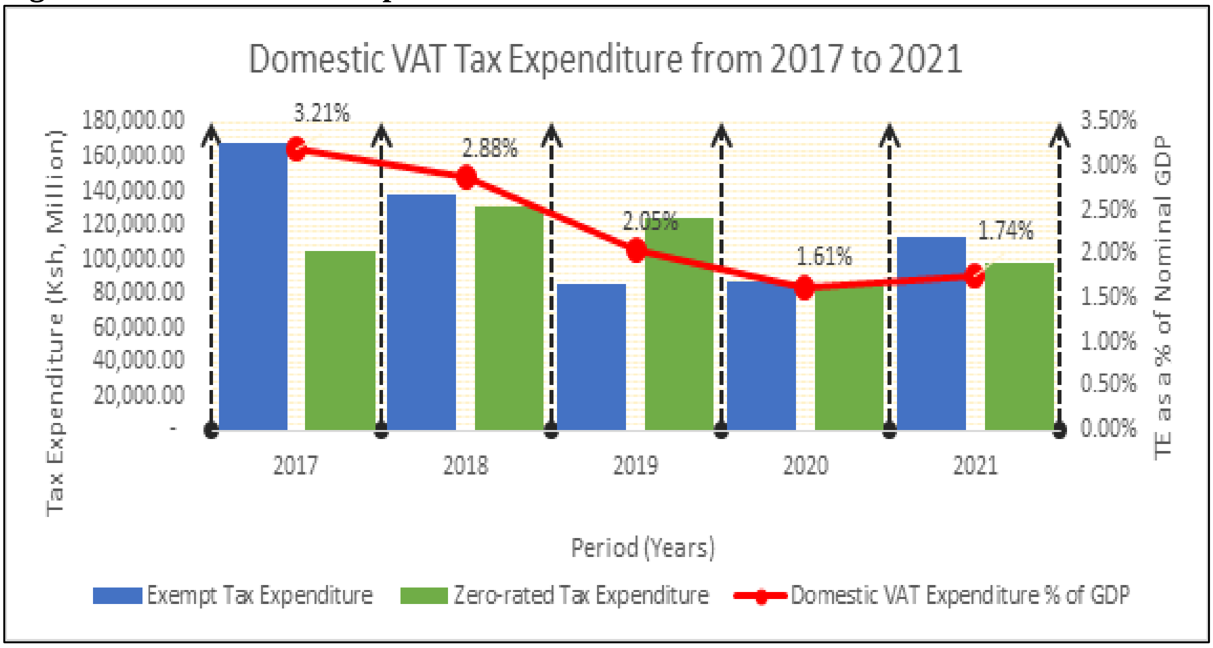
Table 6: VAT Expenditure

Description \ Years	Ksh, million				
	2017	2018	2019	2020	2021
Exempt items	167,600.14	138,446.13	85,822.33	86,820.54	112,677.38
Zero-rated items	104,817.79	130,912.71	123,579.98	85,724.43	98,412.82
Total VAT Expenditure	272,417.93	269,358.84	209,402.31	172,544.97	211,090.20
Nominal GDP	8,483,396.00	9,340,307.00	10,237,727.00	10,716,034.00	12,098,200.00
Total VAT % of GDP	3.21%	2.88%	2.05%	1.61%	1.74%

Note: In computing the zero-rated domestic VAT expenditure for the 2022 report, only zero-rated supplies for local consumption were considered as tax expenditure while exports were considered as benchmark unlike in the 2021 report where both zero-rated supplies for local consumption and export were considered as a tax expenditure. For this reason, the tax expenditure under VAT zero rated was revised downwards for the previous years (2017-2020).

VAT expenditure as a percentage of GDP has been on a downward trend from 2017 to 2020, however, the expenditure marginally increased in 2021. The tax expenditure increased from 1.61 percent of GDP in 2020 to 1.74 percent of GDP in 2021, representing an increase of 0.13 percent **(Figure 3).**

Figure 3: Trend on VAT Expenditure



The report further analyzed the top ten sectors that greatly contributed to domestic VAT expenditure for both VAT zero rated and exempt supplies. For the 2021 exempt supplies, the sectors that are deemed to have contributed largely to the growth of domestic VAT expenditure are: Financial and Insurance activities which contributed 33.8 percent to the total tax expenditure and registered a growth of 60 percent. This was followed by the Information and Communication sector which contributed 15.5 percent to the total VAT expenditure and grew by 31 percent. In addition, Manufacturing sector contributed 10.3 percent to VAT exempt expenditure and grew by 27 percent. Wholesale and Retail Trade sector contributed 8.5 percent and contracted by 15 percent **(Table 7).**

Table 7: Sectoral VAT Expenditure Contribution (Exempt Supplies)

Main Sectors Exempt from Domestic VAT	2020 TE (Million)	2021 TE (Million)	2020 Proportion	2021 proportion	2021 growth
Financial and Insurance Activities	23,769	38,072	27.4%	33.8%	60%
Information and Communication	13,291	17,423	15.3%	15.5%	31%
Manufacturing	9,123	11,579	10.5%	10.3%	27%
Wholesale and Retail Trade	11,186	9,532	12.9%	8.5%	-15%
Agriculture, Forestry, and Fishing	6,024	7,013	6.9%	6.2%	16%
Transportation and Storage	5,039	6,146	5.8%	5.5%	22%
Construction	4,401	5,614	5.1%	5.0%	28%
Human Health and Social Work Activities	2,535	3,355	2.9%	3.0%	32%
Professional, Scientific, and Technical Activities	1,514	3,151	1.7%	2.8%	108%
Administrative and Support Service Activities	1,411	3,080	1.6%	2.7%	118%

Similarly, analysis of the top ten sectors that significantly impacted the 2021 zero-rated VAT expenditure reveals that; the Transportation and Storage sector contributed the largest share of revenue foregone at 35.7 percent and a growth of 26 percent, the Manufacturing sector contributed 27.3 percent to the total domestic zero-rated VAT expenditure and registered a growth of 20 percent. In addition, Electricity, Oil, Gas, Steam, and Air Conditioning Supply contributed 19.3 percent to the tax expenditure under this category and contracted by 8% **(Table 8).**

Table 8: Sectoral Zero-Rated VAT Expenditure Contribution (Zero Rated Supplies)

Main Sectors zero-rated from Domestic VAT	2020 TE (Million)	2021 TE (Million)	2020 Proportion	2021 Proportion	2021 growth
Transportation and Storage	27,850	35,160	32.5%	35.7%	26%
Manufacturing	22,300	26,871	26.0%	27.3%	20%
Electricity, Oil, Gas, Steam, and Air Conditioning Supply	20,650	18,953	24.1%	19.3%	-8%
Construction	1,582	3,021	1.8%	3.1%	91%
Information and Communication	3,223	2,393	3.8%	2.4%	-26%
Professional, Scientific, and Technical Activities	2,121	2,282	2.5%	2.3%	8%
Agriculture, Forestry, and Fishing	1,100	1,854	1.3%	1.9%	69%

Administrative and Support Service Activities	1,194	1,709	1.4%	1.7%	43%
Service Activities	1,013	1,416	1.2%	1.4%	40%
Wholesale and Retail Trade	2,293	1,304	2.7%	1.3%	-43%

Note: 2020 was characterized by constrained economic activities due to lockdowns and restricted domestic and international movements as containment measures of the COVID-19 pandemic. However, in 2021 restrictions were lifted which led to a gradual economic rebound. The easing of the COVID-19 restrictions led to the expansion of the domestic VAT tax base, especially for the sectors that were adversely affected by the pandemic. These sectors include but are not limited to; Transportation & Storage, Manufacturing, Financial & Insurance Activities, and Construction Sectors. This mainly explains the 0.13 percent increase in the domestic VAT expenditure.

CHAPTER FOUR: EXCISE DUTY

4.1 Overview

Excise Duty is levied on excisable goods manufactured in Kenya by a licensed manufacturer, excisable services provided in Kenya by a registered person and on excisable imported goods. Rules governing the imposition of excise duty are contained in the Excise Duty Act, 2015. The duty is mostly levied on goods that the Government may want to discourage their use or consumption and luxury goods and services. The First Schedule to the Excise Duty Act, 2015 provides lists of excisable goods and services which is the scope of excise duty in Kenya. The major excisable items include; petroleum products, alcoholic products, cigarettes, tobacco, soft drinks, airtimes, financial transactions, and automobiles.

Conventionally, the duty is levied to address the negative externalities that some goods/services tend to have. The tax is also used by the Government to meet revenue requirements.

4.2 Excise Duty Benchmark

The list of all excisable goods and services is provided under the First Schedule to the Excise Duty Act, 2015. This is the baseline for determination of the benchmark.

There also some goods and services falling under the second Schedule that are considered to constitute the excise duty benchmark hence excluded in the calculation of excise tax expenditure. These include among others:

i. Goods and services supplied to diplomatic institutions or institutions with privileges and immunities under the Privileges and Immunities Act.
ii. Supplies for official use in Official Aid Funded Projects; and
iii. Excisable goods and services purchased by returning residents subject to conditions placed under East African Community Customs Management Act, 2004.

A comprehensive list of items considered as part of excise duty benchmark is provided under **Annex II.**

4.3 Excise Duty (Domestic) Tax Expenditure

For the case of excise duty, tax expenditure is ideally any goods and services listed under the Second Schedule to the Excise Duty Act, 2015 which provides exemption in respect of excisable products with the exception of those listed above that are regarded as benchmark.

In addition, exemption from Excise duty granted pursuant to Section 7 (2) of Excise Duty Act is also considered as tax expenditure.

However, there are some items provided in the First Schedule as exclusions that are regarded as tax expenditure on grounds of deviating from the standard treatment.

in view of the above, this Report has considered the following items as domestic Excise duty tax expenditure:

i. Exemption of alcoholic and non-alcoholic beverages supplied to Kenya Defence Forces Canteen Organization (DEFCO);

ii. Excise duty remission in respect of beer or wine made from sorghum, millet or cassava or any other agricultural products, (excluding barley), grown in Kenya; and

iii. Exemption of locally assembled motor vehicles and motorcycles.

4.4 Estimation of Tax Expenditure

In this report, computation of tax expenditure for domestic excise tax has included exemption of alcoholic and non-alcoholic beverages supplied to DEFCO and exemption of locally assembled motor vehicles and motorcycles.

From the analysis, tax expenditure in respect of Excise Duty (Domestic) decreased from Ksh 48.4 billion in 2017 to Ksh 31 billion in 2021 **(Table 9).** The downward trend is attributed to decline in tax expenditure in respect of excise duty remission on Keg beer which takes the largest share of the total domestic excise duty expenditure. The largest drop in tax expenditure on Keg beer was realized between 2019 and 2020, this can be attributed to the outbreak of COVID-19 Pandemic that caused economic slowdown as a result of containment measures.

Tax expenditure with respect to local assembly of motor vehicles and motorcycles has, however, been increasing since 2017. This shows that the government tax incentive to promote local assembly industry has resulted to growth in the industry.

Table 9: Excise Duty (Domestic) Tax Expenditure

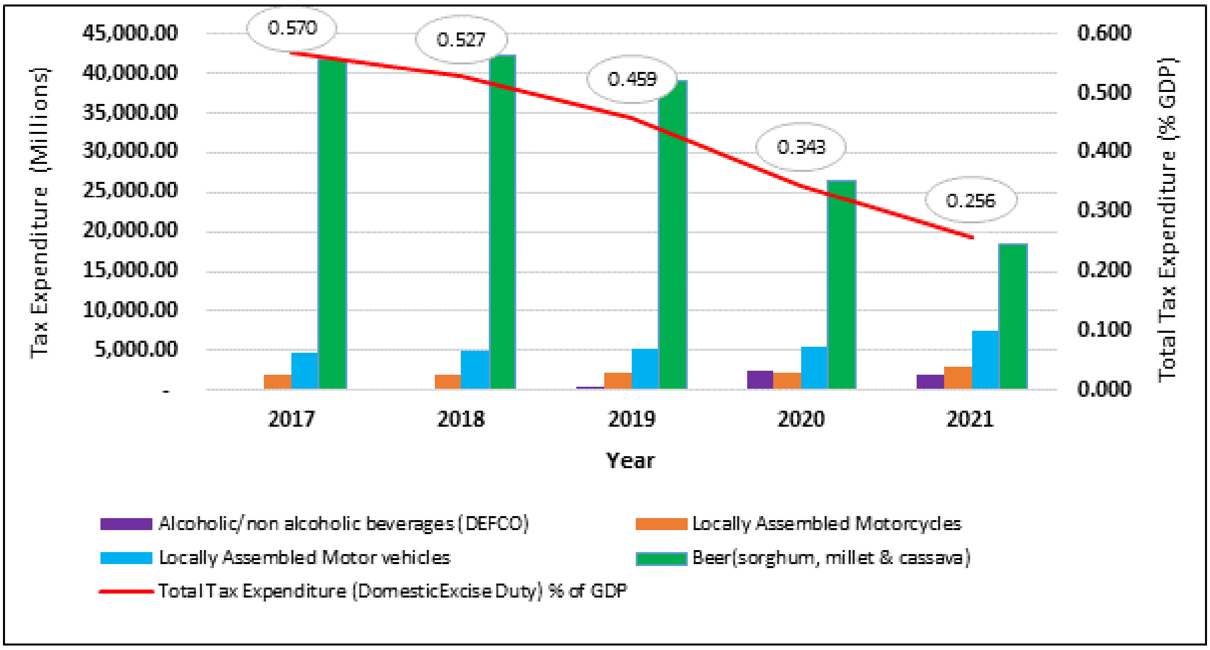
YEARS / DESCRIPTION					Ksh Million
	2017	2018	2019	2020	2021
Alcoholic/non alcoholic beverages (DEFCO)		158.09	417.11	2,482.79	1,985.11
Locally Assembled Motorcycles	1,915.50	1,964.90	2,172.40	2,312.70	3,018.60
Locally Assembled Motor vehicles	4,596.40	4,964.20	5,298.50	5,551.70	7,583.20
Beer(sorghum, millet & cassava)	41,866.21	42,163.36	39,065.84	26,454.59	18,382.65
Total Expenditure (DomesticExcise Duty)	48,378.11	49,250.56	46,953.84	36,801.78	30,969.56
Nominal GDP	8,483,396.00	9,340,307.00	10,237,727.00	10,716,034.00	12,098,200.00
Total Expenditure (DomesticExcise Duty	0.570	0.527	0.459	0.343	0.256

Excise Duty (Domestic) tax expenditure as percentage of Nominal GDP has steadily been decreasing over the period under consideration. The total expenditure as a percentage of GDP dropped from 0.57 in 2017 to 0.256 in 2021 **(Figure 4).**

Exemption for alcoholic and non-alcoholic beverages supplied to DEFCO was introduced in 2018. In this regard tax expenditure analysis for this category is based on 2018 to 2021 period.

Tax expenditure on Keg beer contributed the largest share to the total tax expenditure followed by locally assembled motor vehicles, locally assembled motorcycles and alcohol and non-alcoholic beverages supplied to DEFCO.

Figure 4: Trend on Excise Duty (Domestic) Tax Expenditure



CHAPTER FIVE: TAXES ON IMPORTS

5.1 Overview

Import duty in the East African Community (EAC) is governed by the East African Community Customs Management Act (EACCMA), 2004 and the East African Community Customs Management Regulations, 2010. Kenya as member of the EAC Community applies the duty rates as provided in the East Africa Community Common External Tariffs (EAC CET). The primary basis of determination of customs duty liability is the Cost, Insurance and Freight (CIF) value of imported goods.

Import excise duty is levied on excisable goods imported by licensed importer and excisable services imported by a registered person. Laws and regulations governing the imposition of excise duty are contained in the Excise Duty Act, 2015.

Import VAT is charged on imported goods and services. Application and imposition on Value Added Tax (VAT) is governed by VAT Act, 2013. Imported goods and services are taxed on the same rates as domestic supplies. The goods and services exempted from VAT are specified in the First and Second schedule of the VAT Act, 2013. The standard rate of VAT is 16% of the taxable value, however, oils and zero-rated supplies attract a lower rate of 8% and 0% respectively.

5.2 Benchmark System for Taxes on Imports

a) Import duties

Import duties were levied at the rates of zero (0) percent, ten (10) percent and twenty (25) percent depending on classification in the Harmonized System Nomenclature and East African Community (EAC) Common External Tariff (CET), 2017. Some sensitive goods attract import duty at a rate above 25% while goods emanating from EAC region, COMESA countries and goods traded under other trade agreements are accorded preferential import duty rates if they meet the criteria set of in the agreements and rules of origin.

Part A of the Fifth Schedule to the East African Community Customs Management Act (EACCMA), 2004, provides for specific exemption from import duty. This category includes goods imported for direct and exclusive use in Official Aid Funded Projects, privileged persons and institutions as specified under the Privileges and Immunity Act, Common Wealth Governments, Donor Agencies with bilateral and multilateral agreements, International and Regional Organizations, goods for use by Presidents of the Partner States and the Partner States Armed Forces and Police.

Part B of the Schedule provides for general exemptions. Further, the EACCMA 2004 provides for exemption of goods imported for Manufacturing Under Bond (MUB), Export Processing Zones or Free Zones and inward processing. Additionally, the Act provides for Duty Remission on inputs imported by approved manufacturers for production of goods for export and other essential goods e.g text and exercise books.

b) Excise Duty on Imports

The benchmark excise duty tax base is the consumption or demand of inelastic goods or services and the consumption of luxury goods while the benchmark unit of taxation is the final consumer of the taxed goods or services. The benchmark excise duty rate is either specific or ad valorem.

The Second Schedule to the Excise Duty Act, 2015 lists goods and services that are exempt from excise duty. Most of the goods listed in this Schedule that are imported by the benchmark units form part of the Benchmark Tax System (BTS) for Excise duty.

c) VAT on Imports

The Second Schedule Part B to the VAT Act, 2013 lists goods and services, which are exempt from VAT. The following goods listed in this Schedule form part of the Benchmark Tax System:

- i Supply to Commonwealth and other governments;
- ii Supply to Diplomat or First Arrival persons;
- iii Supply to donor agencies with bilateral or multilateral agreements;
- iv Supply to regional and international organizations;
- v Supply to National Red Cross Society and St. John Ambulance;
- vi Ship store supplied to international sea or air carriers on international voyage or flight;
- vii Transportation of passengers by air carriers on international flight;
- viii The supply of taxable supplies to international sea or air carriers on international voyage or flight;
- ix Goods purchased from duty free shops by passengers departing to places outside Kenya; and
- x Personal effects and motor vehicle imported by returning resident subject to limitations provided for under the Fifth Schedule to the East African Community Management Act.

5.3 Tax Expenditure Related to Taxes on Imports

Import duties in Kenya are based on regional agreements which are ratified and harmonized in the EACCMA, 2004, the EAC CET 2017 and other international agreements. Therefore, expenditure emanating from these agreements do not constitute tax expenditure for purposes of this report. However, preferential treatment of import duty in form of yearly stay of applications occasions the deviations from the applicable rates and therefore constitutes tax expenditure. Supplies that enjoy yearly stay of applications include; rice, worn items of clothing, timber of heading 44.07, poly vinyl alcohol, copolymers and steel coils. Import excise duty tax expenditure include exemption on beers and spirits, and exemptions on oils.

Import VAT tax expenditure arise from exemptions and zero-ratings on imported goods excluding the exempt supplies listed as benchmarks above. The standard rate of VAT in Kenya is 16 percent. The rate is applied on the taxable value as provided for under Section 14 of the VAT Act, 2013. The difference between the standard rate and a lower rate imposed on supplies that are not listed as benchmarks constitute tax expenditure.

In 2021, total tax expenditure related to taxes on imports (Excise duty, import duty and VAT on imports) was Ksh 41.5 billion (0.34 percent of GDP). The amount of tax expenditure on imports increased from Ksh 16.5 billion (0.19 percent of GDP) in 2017 to Ksh 41.5 billion (0.34 percent of GDP) in 2021. The amount of tax expenditure increased to Ksh 41.5 billion in 2021 compared to Ksh 28.4 billion registered in 2020. This represents a 46.0 percent increase **(Table 10).**

Table 10: Tax Expenditure on Imports

					Ksh Million
	2017	2018	2019	2020	2021
Import duty*	11,607.34	11,787.52	9,965.63	11,487.26	13,348.30
Import VAT	4,879.68	1.53	1.37	1.30	1.92
Import excise duty	-	41.69	132.41	127.08	119.55
Import VAT Oils	-	-	9,087.00	16,788.96	28,008.93
Total Tax Expenditure	**16,487.02**	**11,830.74**	**19,186.41**	**28,404.59**	**41,478.70**
Nominal GDP	8,483,396.00	9,340,307.00	10,237,727.00	10,716,034.00	12,098,200.00
Total Taxes on Import as % of GDP	**0.19**	**0.13**	**0.19**	**0.27**	**0.34**

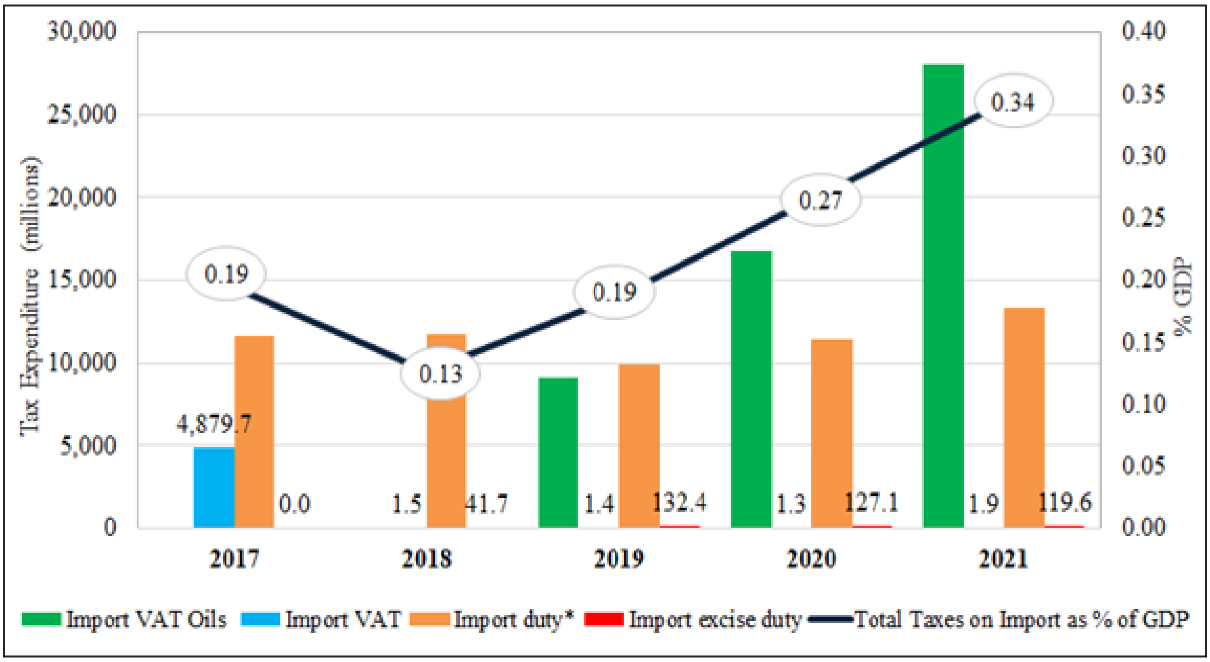
** Import duty on Stay of application*
NB: 8% VAT on fuel was introduced in 2018 and the implementation of the same began in 2019 July.

Tax Expenditure on Imports as a percent of GDP has been on an upward trend from 2017 to 2021. In 2021, the tax expenditure increased to 0.34 percent of GDP from 0.27 percent of GDP in 2020, mainly attributed to the increase in import VAT on oils and import duty **(Figure 5).** Tax expenditure on Import VAT on oils increased to Ksh 28.0 billion in 2021 from Ksh 16.8 billion in 2020. The increase was attributed to the increase in volumes of oil imports in the country and increase in fuel prices towards the end of 2021 in the global market.

Tax expenditure on import VAT increased to Ksh 1.9 million in 2021 from 1.3 billion in 2020 mainly due to the increase of the volume of inputs for the manufacture of pharmaceutical products and due to removal of Government incentives that were put in place in 2020 to mitigate the effects of COVID-19 pandemic. However, tax expenditure on import excise duty decreased from Ksh 127.08 million in 2020 to Ksh

119.55 million in 2021 largely attributed to decreased volumes of imported alcoholic drinks and beverages by DEFCO.

Figure 5: Taxes on imports expenditure



5.4 Fees and Levies on Imports

a) Import Declaration Fee and Railway Development Levy

The imposition of IDF and RDL is anchored in the Miscellaneous Fees and Levies Act, 2016. The standard rate for IDF is 3.5 percent of Custom value and RDL is 2.0 percent of Custom value. The Fee and Levy are charged on goods imported or purchased before clearance through Customs.

Part A and B of the Second Schedule to the Miscellaneous Fees and Levies Act, 2016 lists the goods that are exempt from IDF and RDL respectively. The benchmark tax system for IDF and RDL include:

- i Goods destined for approved duty-free shops;
- ii Ammunition, weapons or implements of war imported by the Government;
- iii Gifts and supplies for diplomatic and consular missions and to the United Nations Missions;
- iv Goods for use by the United Nations or its Agencies;
- v Goods from the East African Community Partner States that meets the East African Community Rules of origin;
- vi Goods destined for official aid-funded projects;
- vii Gifts by foreign Governments or international organizations to charities

and foundations;

viii Aircraft catering stores for use in an aircraft owned and operated by a designated airline;

ix Ships weighing 250 tonnes or more; and

x Equipment, machinery and motor vehicles for the official use by the Kenya Defence Forces and National Police Service.

5.5 Tax Expenditure on IDF and RDL

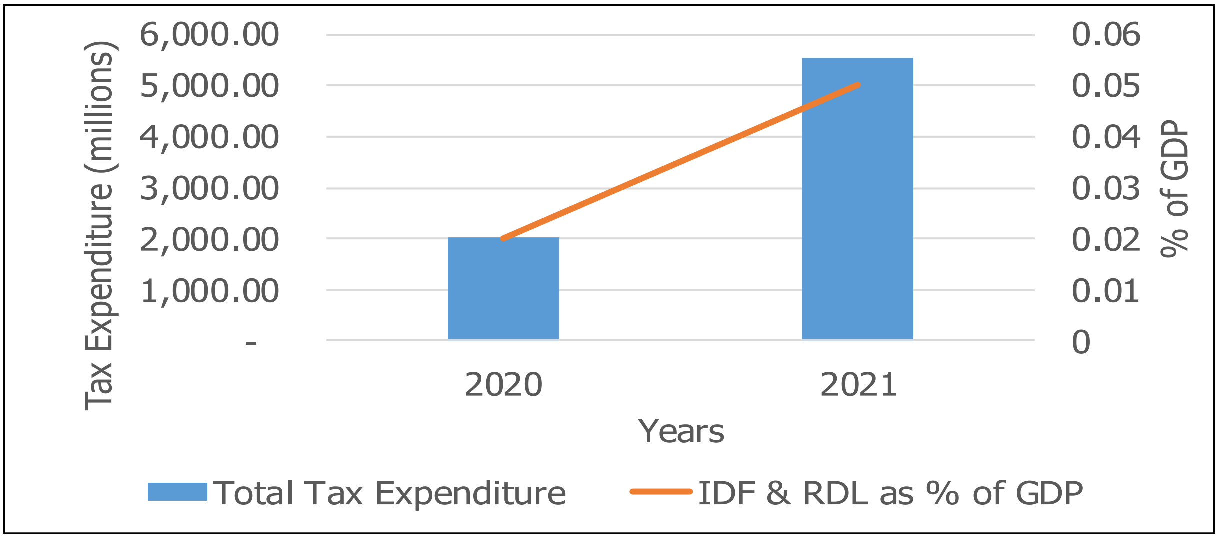
Exemption of fees and levies to any sector or categories of taxpayer constitute tax expenditure. Raw materials and intermediate products imported by approved manufacturers and inputs imported by persons engaged in affordable housing enjoy a preferential rate of 1.5 percent of custom value on RDL and IDF respectively. The difference between the standard rate and the preferential rate for both IDF and RDL constitute the tax expenditure.

Tax Expenditure on IDF increased from Ksh 1.6 billion in 2020 to Ksh 4.5 billion in 2021 (as shown in Table 11). This represents an increase of 175 percent and is attributed to an increase in the value of imports by a similar percent. The value for Tax Expenditure on RDL also increased from Ksh 401.9 million in 2020 to Ksh 1.1 billion in 2021. This represents an increase of 173 percent attributed to an increase in the value of imports by a similar percent. The Tax Total Expenditure for both IDF and RDL increased from Ksh 2.0 billion (0.02 percent of GDP) in 2020 to Ksh 5.6 billion (0.05 percent of GDP) in 2021 (Figure 6). This increase is attributed to the increased volume and value of goods that enjoyed preferential IDF and RDL rates during the years 2020 to 2021.

Table 11: Tax Expenditure on IDF and RDL

Years / Tax Head		Ksh Millions
	2020	2021
IDF	1,622.16	4,454.50
RDL	401.93	1,099.01
Total Tax Expenditure	2,024.09	5,553.52
Nominal GDP	10,716,034.00	12,098,200.00
IDF & RDL as % of GDI	0.02	0.05

Figure 6: Tax Expenditure on IDF and RDL



CHAPTER SIX: CONCLUSION AND POLICY RECOMMENDATIONS

6.1 Key Findings

The analysis of tax expenditure on each tax head shows that the expenditure has been on a downward trend over the last five years. In 2020, total tax expenditure amounted to Ksh 267.1 billion compared to Ksh 357.8 billion in 2017, Ksh 356.5 billion in 2018, Ksh 299.5 billion in 2019. However, in 2021, it was Ksh 316.0 billion which translate to an increase of Ksh 48.9 billion from 2020 **(as shown in Table 12).** It should be noted that, in this Report, total tax expenditure as a percent GDP has been revised for the period 2017-2020. The revision has been occasioned by a change in computation of the tax expenditure in regard to investment deductions that constitute tax expenditure for Corporate Income Tax.

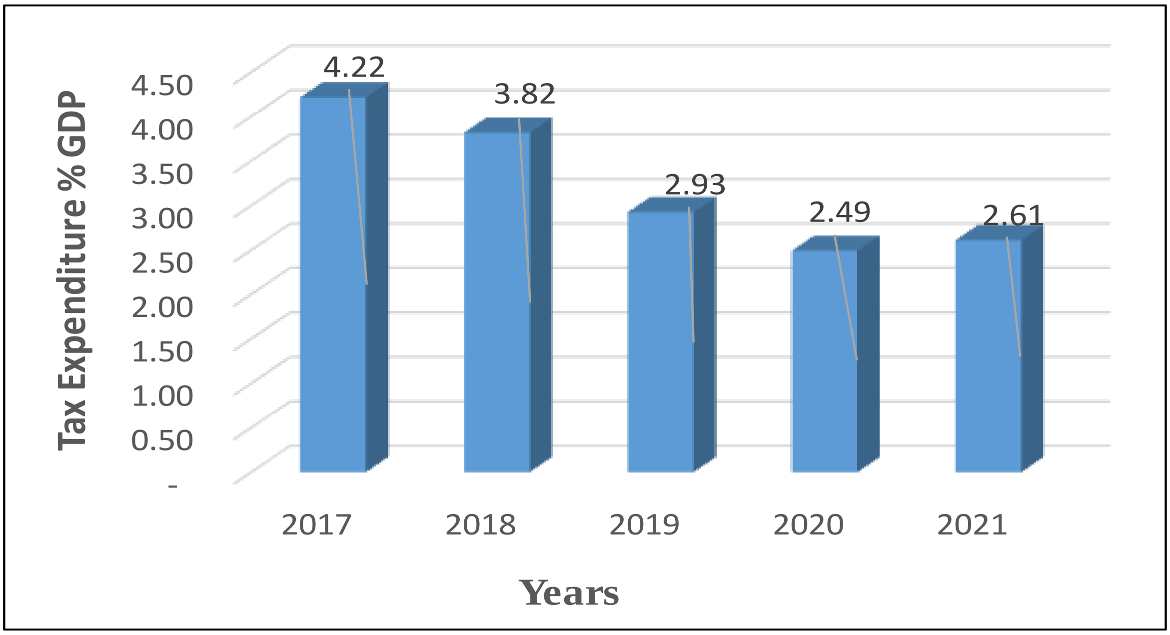
In the period 2017-2020, 30% of the total value of the investment deductions, under the corporate income tax, was considered to be tax expenditure. However, in this year`s Report, 10% rate has been pegged as the benchmark rate. The difference between the applicable rate and the benchmark rate has been used to compute the value of tax expenditure for all the investment deductions that make up tax expenditure on Corporate Income Tax.

Table 12: Tax Expenditure

Tax Head / Years					Ksh Billion
	2017	2018	2019	2020	2021
Personal Income Tax	3.45	3.78	4.53	4.77	5.31
Corporation Inocme Tax	17.09	22.29	19.38	22.56	21.64
VAT Domestic	272.42	269.36	209.4	172.54	211.09
Excise duty on imports	0	0.041	0.132	0.127	0.12
Excise duty(Domestic)	48.38	49.25	46.95	36.8	30.97
VAT on imports	4.88	0.002	0.001	0.001	0.002
VAT on imports(Fuel)	0	0	9.09	16.79	28.01
Import duty	11.61	11.79	9.97	11.49	13.35
Fees and Levies				2.02	5.55
Total Tax Expenditure	357.83	356.513	299.453	267.098	316.042
Nominal GDP	8,483.40	9,340.30	10,237.70	10,716.00	12,098.20
Tax Expenditure % GDP	4.22	3.82	2.93	2.49	2.61

Total tax expenditure as a percent of GDP declined from 4.22 percent in 2017, percent to 2.49 percent in 2020. However, total tax expenditure as a percent of GDP increased to 2.61 percent in 2021 **(as shown in Figure 7)**

Figure 7: Tax Expenditure



In 2021, Value Added Tax (domestic) accounted for most of the tax expenditure/revenue forgone followed by Excise duty (domestic). Excise duty on import contributed the least to the total tax expenditure. Tax expenditure on domestic VAT exemptions accounted 66.79 percent of the total tax expenditure in 2021 followed by tax expenditure on Excise duty (domestic) at 9.80 percent. Income tax expenditure (both personal and corporate income tax) accounted for about 8.53 percent of the total tax expenditure in 2021. VAT on imports account for the least at 0.001 percent **(Table 13).**

Table 13: Tax Expenditure by Tax Head

	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
Tax Heads	Ksh Billion					Share of Total Tax Expenditure				
Personal Income Tax	3.45	3.78	4.53	4.77	5.31	0.964	1.012	1.513	1.786	1.680
Corporation Inocme Tax	17.09	39.29	19.38	22.56	21.64	4.776	10.519	6.472	8.446	5.707
VAT Domestic	272.42	269.36	209.40	172.54	211.09	76.131	72.115	69.928	64.598	67.609
Excise duty on imports	-	0.04	0.13	0.13	0.12	-	0.011	0.044	0.048	0.038
Excise duty(Domestic)	48.38	49.25	46.95	36.80	30.97	13.520	13.186	15.679	13.778	9.919
VAT on imports	4.880	0.002	0.001	0.001	0.002	1.364	0.001	0.000	0.000	0.001
VAT on imports(Fuel)	-	-	9.09	16.79	28.01	-	-	3.036	6.286	8.971
Import duty	11.61	11.79	9.97	11.49	13.35	3.245	3.157	3.329	4.302	4.276
Fees and Levies	-	-	-	2.02	5.55	-	-	-	0.756	1.778
Total Tax Expenditure	357.83	373.51	299.45	267.10	316.04	100	100	100	100	100

Domestic VAT tax expenditure account for the highest increase in total tax expenditure over the period 2020/2021 followed by expenditure related to VAT on fuel. Between 2020 and 2021 domestic VAT expenditure increased by Ksh 38.55 billion (78.76 percentage of the total change) while expenditure related on VAT on fuel increased by Ksh 11.22 billion (22.92 percent of the total change). The tax expenditure on fuel is as a result of reduction in VAT on fuel from 16% to 8% through the Finance Bill

2018. The reduced rate was introduced in 2018 and its implementation stated in 2019. Expenditure on VAT on imports increased by Ksh 1 million, fees and levies increased by Ksh 3.5 billion while tax expenditure on import duty increase by Ksh 1.86 billion between 2020 and 2021. However, tax expenditure on excise duty (domestic), Excise duty on imports and corporation tax decreased by Ksh 5.83 billion, Ksh 10 million and Ksh 920 million respectively **(Table 14)**.

Table 14: Change in Total Tax Expenditure

	2020	2021	Absolute change btn 2020 and 2021(Ksh Bn	Contribution to the change(%)
Personal Income Tax	4.77	5.31	0.54	1.10
Corporation Inocme Tax	22.56	21.64	(0.92)	(1.88)
VAT Domestic	172.54	211.09	38.55	78.76
Excise duty on imports	0.127	0.12	(0.01)	(0.01)
Excise duty(Domestic)	36.8	30.97	(5.83)	(11.91)
VAT on imports	0.001	0.002	0.001	0.00
VAT on imports(Fuel)	16.79	28.01	11.22	22.92
Import duty	11.49	13.35	1.86	3.80
Fees and Levies	2.02	5.55	3.53	7.21
Total Change			**48.944**	**100**

6.2 Comparison of Kenya's Tax Expenditure with other Jurisdictions

Comparisons of tax expenditures between countries is always tricky as the Benchmark Tax Systems used as a reference vary substantially. That notwithstanding, the total tax expenditure for Kenya is comparable to those of other countries such as 1.38% in Burkina Faso, 4.69% in Poland and 6.13% in Ghana according to Taxation, International Cooperation and the 2030 Sustainable Development Agenda; United Nations University Series on Regionalism 19.

6.3 Conclusion

Total tax expenditure has been on a declining trend over the period of 2017 to 2020. The downward trend can be attributed to decline in absolute values across the various tax heads with the values being lowest in 2020. Changes in tax expenditure from one year to another is as a result of changes in tax laws including phase outs of tax expenditure provisions that alter income tax structure such as the tax rate schedule and allowable deductions.

However, total tax expenditure increased slightly from Ksh. 267.10 billion in 2020 to Ksh. 316.04 billion in 2021. The increase is a result of inclusion of IDF, RDL and Excise Duty (Domestic) tax heads that were not considered in 2021 Tax Expenditure Report such as VAT on fuel, import duty and Fees and Levies.

Total tax expenditure as a percent of GDP declined from 4.22 percent in 2017 to 2.49 percent in 2020. However, total tax expenditure as a percent of GDP increased by 0.13 percent between 2020 and 2021.

Whereas the total tax expenditure for Kenya is comparable to those of other countries it should be noted that Benchmark Tax Systems used as a reference vary substantially across countries, hence Kenya should progressively formulate Tax Expenditure policies taking into consideration its unique circumstances.

6.4 Policy Recommendation

To ensure sustainability and value for money from the resources foregone through tax expenditure, the Government will continue to upscale efforts to rationalize and harmonize the tax expenditures with the aim of removing redundant tax expenditure and enhancing those intended to promote investments. In addition, there is need to have an elaborate framework for monitoring and evaluating the impact of tax expenditure in the economy.

APPENDICES

Annex I: List of goods and services contained in tax exemption and zero-rating categories in the First and Second Schedules of the VAT Act, 2013 that are considered benchmark but not as tax expenditure

Domestic supply of listed agricultural inputs, including fertilizers;

1. Domestic supply of unprocessed agricultural products;
2. Specified financial & insurance services;
3. Education services as defined;
4. Agricultural, animal husbandry and horticultural services.
5. Sale, renting, leasing, hiring, letting of land or residential premises as defined;
6. Medical, veterinary, dental, ambulance and nursing services;
7. Listed medical materials, articles and equipment, including articles of apparel, clothing accessories and equipment specially designed for safety or protective purposes for use in registered hospitals and clinics or by County government or local authorities in firefighting;
8. Personal protective equipment, including facemasks, for use by medical personnel in registered hospitals and clinics, or by members of the public in the case of a pandemic or a notifiable infectious disease;
9. Materials, articles, equipment and motor vehicles specially designed for the sole use by disabled and physically handicapped persons;
10. Materials, articles and equipment (excluding motor vehicles) intended for educational, scientific or cultural advancement of the disabled;
11. Medicaments;
12. Mosquito nets;
13. Burial and cremation services;
14. Community, social and welfare services provided by National Government, County Government or any political subdivision, charitable organizations;
15. Services rendered by educational, political, religious, welfare and other philanthropic associations to their members;
16. Entertainment services conducted by educational institutions as part of learning; sports, games or cultural performances conducted under the auspices of the responsible Ministry;
17. Accommodation and restaurant services operated by approved educational training institutions and medical institutions for the use of the staff, students

and patients of that institution;

18. Canteens and cafeterias operated by an employer for the benefit of his employees;
19. Betting, gaming and lotteries services;
20. Hiring, leasing and chartering of aircrafts, aeroplanes, and space crafts, excluding helicopters;
21. Supply of domestic passenger transportation services by road, rail and water, except where the means of conveyance is hired or chartered;
22. Materials, waste, residues and by-products, whether or not in the form of pellets, and preparations of a kind used in animal feeding;
23. Postal services provided through the supply of postage stamps, including rental of post boxes or mailbags and any subsidiary services thereto.
24. Transfer of a business as a going concern by a registered person to another registered person.
25. Goods imported by passengers arriving from places outside Kenya, subject to specified limitations and conditions.
26. Taxable goods for emergency relief purposes for use in specific areas and within a specified period, supplied to or imported by the Government or its approved agent, a nongovernmental organization or a relief agency authorized by the Cabinet Secretary responsible for disaster management.
27. Hearing aids, excluding parts and accessories, of tariff No.9021.40.00.
28. Car park services provided by National Government, County Government, any political subdivision by an employer to his employees on the premises of the employer.
29. The supply of airtime by any person other than by a provider of cellular
30. Mobile telephone services or wireless telephone services.

Further, the following zero-rated supplies are treated as part of the benchmark and therefore not part of tax expenditure: They include

1. Goods consigned to officers or men on board a naval vessel belonging to another Commonwealth Government for their personal use or for consumption on board such Vessel; and Goods for the use of any of the Armed Forces of any allied power;
2. Specified supplies to Diplomats or First Arrivals Persons;
3. Specified supplies to donor agencies with bilateral or multilateral agreements;
4. Goods and equipment imported by or supplied to donor agencies, international

and regional organizations with Diplomatic accreditation or bilateral or multilateral agreements with Kenya for their official use;

5. Supply to the War Graves Commission;
6. Supply to National Red Cross Society and St. John Ambulance;
7. Supply of protective apparel, clothing accessories and equipment; specially designed for safety or protective purposes for use in registered hospitals and clinics or by county government or local authorities in firefighting
8. The supply of coffee and tea for export to coffee or tea auction centres;
9. The supply of taxable services to international sea or air carriers on international voyage or Flight;
10. The Supply of taxable services in respect of goods in transit;
11. The exportation of goods or taxable services;
12. Ship stores supplied to international sea or air carriers on international voyage or flight;
13. Transportation of passengers by air carriers on international flight; and
14. Goods purchased from duty free shops by passengers departing to places

ANNEX II: List of goods and services contained in the Excise Duty Act that are considered benchmark but not as tax expenditure

i. Excisable goods that are bona fide stores for a ship or aircraft, being goods for use or consumption by passengers or crew of the ship or aircraft while on board and while the ship is in international traffic and is such quantities as approved by the Commissioner;

ii. Excisable goods imported into Kenya by a diplomatic or consular mission, or by a diplomat or consul, or a member of the diplomat or consul's family forming part of the diplomat or consul's household in Kenya to the extent provided for under the Privileges and Immunities Act, (Cap.179);

iii. Excisable goods imported into Kenya by a foreign government, international organization, or aid agency to the extent provided for under an international agreement or the Privileges and Immunities Act, 1970.

iv. Excisable goods imported by the Kenya Red Cross or St John Ambulance for official use in the provision of relief services in Kenya.

v. Excisable goods imported by a person changing residence or a returning resident subject to limitations provided for under the Fifth Schedule to the East African Community Management Act.;

vi. Excisable goods imported by, and in the possession of a passenger subject to limitations provided for under the Fifth Schedule to the East African Community Management Act.

vii. One motor vehicle previously owned and used by a deceased person outside Kenya subject to the conditions as the Commissioner may specify;

viii. Excisable goods imported for direct and exclusive use in the implementation of an official Aid-Funded Project, to the extent provided for under the Financing Agreement;

ix. Excisable services supplied in Kenya to a diplomatic or consular mission or to a diplomat or consul, or a member of the diplomat or consul's family forming part of the diplomat or consul's household in Kenya to the extent provided for under the Privileges and Immunities Act (Cap. 179);

x. Excisable services supplied in Kenya to a foreign government, international organization, or aid agency to the extent provided for under an international agreement or the Privileges and Immunities Act (Cap. 179).

Annex III: Methodology

Data sources

The data for the report is from Kenya Revenue Authority.

Estimation of the cost of tax expenditures

The estimation of the tax expenditure is based on the revenue-forgone approach[1]. In this approach, the cost of tax expenditures is calculated as the difference between the tax actually payable and the tax foregone assuming full compliance with the benchmark tax system (BTS).

In this regard, one specific aspect of this methodology worth noting for the interpretation of the estimations in this report is that estimations do not include dynamic effects. Our methodology assumes that no change in behavior following the theoretical removal of a tax expenditure. Depending on each tax expenditure, the actual effect of its removal on the budget might differ in case of behavioral responses by taxpayers.

In practice, the exact formula for the calculation of the theoretical tax varies depending on tax specificities. It also depends a lot on data availability and sometimes require simplifying assumptions.

The methodology for each tax is described below.

a) Personal income tax (PIT)

The methodology for the cost estimation of tax expenditures on personal income tax differs depending on the considered tax relief.

The situation for the General Personal Relief and the Insurance Relief is simple. They are fixed deduction that can be directly obtained and aggregated from the KRA database on PIT.

The situation is more complex for the Mortgage Interest deductions, the Homeowner saving plan and for exempted incomes. For these reliefs, there is need for detailed individual data to be able to simulate the theoretical revenue when applying the progressive tax rates on taxpayers without relief.

The development of a microsimulation framework might be considered in the future but for this second tax expenditure report, an approximate method was used to be able to evaluate those tax expenditures.

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[1] See IMF, Tax Expenditure Reporting and Its Use in Fiscal Management: A Guide for Developing Economies,
March 27, 2019.

Therefore, the cost of the tax expenditure can be estimated as the loss of taxable income due to the relief multiplied by the effective tax rate observed for PAYE:

Tax Expenditure PIT = Tax base loss x Effective tax rate

b) Domestic VAT

In this report, tax expenditure regarding VAT are exemptions and zero-rated supplies that deviates from its international practice. Consequently, the estimation of the tax expenditure consists of estimating the tax base loss for each category of good and service and to apply the rate from the BTS (usually the normal rate of 16 %).

Tax Expenditure Dom. VAT = ∑exemption (Tax base loss x BTS rate) + ∑zero rate (Tax base loss x BTS rate)

c) Taxation of imports

Tax expenditure on imports consists of exemptions from Import Duty, VAT or Excise Duty. In this case, the tax expenditure is estimated by estimating the tax base loss for each item category and apply the normal rate from the BTS (Common External Tariffs for Import Duty, BTS VAT rate and Excise rates).

Tax Expenditure Import Duty = ∑exemption (Tax base loss x BTS rate)

Tax Expenditure Import VAT = ∑exemption (Tax base loss x BTS rate)

Tax Expenditure Import Excise = ∑exemption (Tax base loss x BTS rate)

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