REPUBLIC OF KENYA

THE NATIONAL TREASURY AND ECONOMIC PLANNING

2023 TAX EXPENDITURE REPORT

OCTOBER 2023

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FOREWORD

The 2023 Tax Expenditure Report provides information for tracking and evaluating tax expenditure thereby increasing the transparency and accessibility of data on national tax expenditure. The report has been prepared at a time when the Government is implementing priority programmes, policies and reforms under the Bottom-Up Economic Transformation Agenda (BETA) outlined in the 2023 Budget Policy Statement geared towards economic turnaround and inclusive growth. The priority programmes and policies under BETA are detailed in the Fourth Medium-Term Plan for the period 2023-2027 which is anchored on Kenya Vision 2030.

The Government aims to support the priority programmes under BETA through a growth friendly fiscal consolidation plan designed to slow down the annual growth in public debt and implement an effective liability management strategy, without compromising service delivery to citizens. This is expected to boost the country's debt sustainability position and ensure that Kenya's development agenda honors the principle of inter-generational equity. Towards this end, emphasis is placed on aggressive revenue mobilization through a combination of tax administrative and tax policy reforms. One of the measures aimed at protecting our tax base is reduction of tax expenditure through the elimination of unproductive tax incentives.

Tax expenditures are used instead of direct spending to deliver a Government subsidy to a class of taxpayers or encourage a desired activity. They can take many forms, including tax exemptions; zero rating (Value Added Tax); tax deductions; tax offsets (or credits); and concessional tax rates or timing rules, such as accelerated depreciation of capital assets, that either reduce or defer a taxpayer's tax liability. In this regard, this report enables the Government to account for tax expenditures and use that information in fiscal management.

The 2023 Tax Expenditure Report indicates that in 2022, total tax expenditure increased to Ksh 393.6 billion (2.94 percent of GDP), from Ksh 292.9 billion (2.44 percent of GDP) in 2021. VAT Domestic contributed the highest to the tax expenditures (36.94 percent) followed by Corporate Income Tax (19.87 percent) and VAT on fuel (16.38 percent). Excise duty contributed the least at less than 0.55 percent.

To ensure sustainability and value for money from the resources foregone through tax expenditure, the Government will continue to rationalize and harmonize the tax expenditures with the aim of removing redundant tax expenditures while enhancing those intended to promote investments. Further, the National Treasury is in the process of automating tax exemption processes which will create efficiency in terms of time taken to process the exemption.

NJUGUNA S. NDUNG'U, CBS
Cabinet Secretary, National Treasury and Economic Planning.

PREFACE

Tax expenditure is defined as a government's estimated revenue forgone as a result of giving tax concessions or preferences to a particular class of taxpayer or activity. The revenue foregone, or "expenditure," is calculated as the difference between whatever tax would have been paid under a defined benchmark tax law (the ideal tax structure that should apply to all taxpayers) and the amount that was actually paid after the tax incentive.

The 2023 Tax Expenditure Report is prepared at a time when the Government is operating under a limited fiscal space thereby necessitating fiscal prudence. As such, this report enhances fiscal transparency of tax expenditure and highlights 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. The Report also 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.

The Report has been prepared in adherence to Articles 201, 210, and 220 of the Constitution that 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, this Report has been done in conformity to international best practices where expenditure reporting is a key indicator of openness in budgeting.

Preparation of this report was through a collaborative effort among key stakeholders from the public sector. 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 finalize this Report.

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 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

The approach taken to estimate tax expenditure in the 2023 Tax Expenditure Report is the "Revenue Foregone" approach. This involves estimating the direct revenue loss associated with the provision under consideration, relative to the benchmark system. The approach 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 incentives.

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 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.

This 2023 Tax Expenditure Report indicates that in 2022, total tax expenditure increased to Ksh 393.6 billion (2.94 percent of GDP), from Ksh 292.9 billion (2.44 percent of GDP) in 2021 with the domestic Value Added Tax (VAT) accounting for most of the total tax expenditure. The tax expenditure on domestic VAT increased from Ksh 211.1 billion (2.061 percent of GDP) in 2021 to Ksh 248.3 billion (2.319 percent of GDP) in 2022.

Income tax expenditures are the second largest contributors of tax expenditures at Ksh. 46.9 billon. Tax expenditure related to personal income tax stood at Ksh 5.2 billion in 2022, a decrease from Ksh 5.31 billion in 2021. However, Corporate tax expenditure increased to Ksh 41.6 billion in 2022 from Ksh 21.6 billion in 2021. The bulk of tax expenditure related to corporate income tax are investment allowances in plant and machinery.

In 2022, total tax expenditure on Import Duty stood at Ksh 13.6 billion in 2022, increasing from Ksh 4.8 billion in 2021. Excise Duty on imports increased from Ksh. 92.84 million to Ksh. 438.7 million in 2021 and 2022 respectively. Tax expenditure in respect of Excise Duty (Domestic) increased from Ksh 7.6 billion in 2021 to Ksh 8.0 billion in 2022. The upward trend in the country's tax expenditure is attributed to, among others, the increase in tax incentives aimed at promoting the local assembly of Motor vehicles industry. The Total Tax Expenditure for both Import Declaration Fee (IDF) and Railway Development Levy (RDL) increased from Ksh 5.6 billion in 2021 to Ksh 14.7 billion in 2022. This is attributed to the increased volume and value of goods that enjoyed preferential IDF and RDL rates during the period.

VAT Domestic contributed the highest to the total tax expenditures by 63.08 percent followed by VAT on imports (Fuel) at 11.31 percent and Corporate Income Tax at 10.58 percent. Excise Duty on imports contributed the least to the total tax expenditure at 0.11 percent.

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 is a source of funds 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 Expenditures are used to achieve specific public policy objectives through targeted preferential tax measures aimed at benefiting specific sectors or categories of taxpayers for a given policy goal. These policy objectives could be geared to: 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 the 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 the 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 EAC customs union, where the Common External Tariff (EAC CET) 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 2022. 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 2022. 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 charged on different sources of income. It is charged upon all the income of a person for each year of income whether resident or non-resident, which is accrued in or derived from Kenya.

Under the Kenyan tax system, the sources 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.

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

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 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 a 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 graduated based on the income of an individual's pay. The personal income tax comprises of a tax band and the respective rate as shown in **Table 1.**

Table 1: PIT Bands and Rates

PIT Band	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

Pension Tax Band	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%

Each taxpayer is entitled to a tax relief of Ksh 2,400 per month translating to Ksh 28,800 per annum.

2.2.1 PIT Benchmark

The PIT base is the remuneration of an employee or an individual. The items that are considered as benchmark in this report in respect to PIT are contained in **Annex I.**

2.2.2 PIT Expenditure

The PIT tax expenditure comprises 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 5.2 billion in 2022, a decrease from Ksh 5.3 billion in 2021 **(See Table 3).**

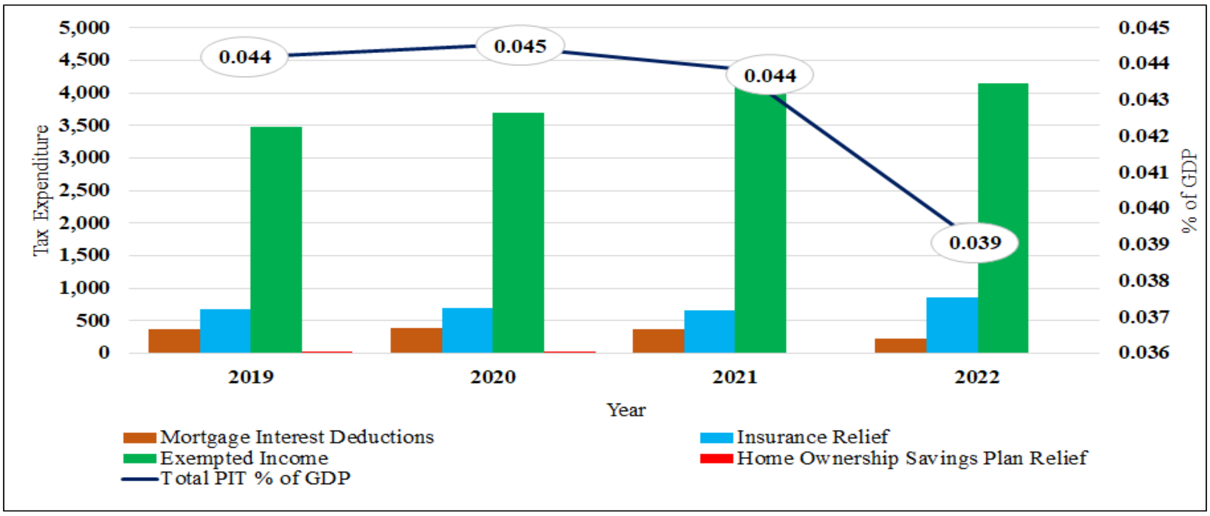
Table 3: PIT Tax Expenditure Estimates

PIT Categories / Years	2019*	2020*	2021*	2022
Mortgage Interest Deductions	376.47	380.74	366.35	224.38
Insurance Relief	675.22	689.28	652.75	856.17
Home Ownership Savings Plan Relief	2.81	3.85	-	-
Exempted Income	3,470.76	3,695.64	4,287.39	4,141.89
Total PIT Expenditure	**4,525.26**	**4,769.51**	**5,306.49**	**5,222.43**
Nominal GDP	10,237,727.0	10,716,034.0	12,098,200.0	13,368,340.0
Total PIT % of GDP	**0.044**	**0.045**	**0.044**	**0.039**

Source: Kenya Revenue Authority, 2023;
**Revised*

Despite the decline in PIT Expenditure, it is observed that Insurance relief increased significantly by 31.1 percent in 2022 as compared to 2021. The increase is attributed to introduction of relief on National Hospital Insurance Fund (NHIF) contributions through the Finance Act, 2021, that amended Section 31 (1) of the Income Tax Act to allow for relief on contributions to NHIF effective from 1st January, 2022.

Figure 1: PIT Expenditure



Further, Personal income tax expenditure as a percentage of GDP has been almost constant for the period 2019 to 2021 varying from 0.044 in 2019, 0.045 in 2020, and 0.044 in 2021. However, for the period 2022, it declined by 0.005 percent to 0.039 percent. The reduction in PIT Expenditure as a percentage of GDP in 2022 can be attributed to the decline in PIT expenditure by 2 percent and a GDP growth rate of 10 percent in the same period.

2.3 Corporate Income Tax

Corporate Income Tax (CIT) is a tax charged on corporate entities such as limited liability companies and Cooperative societies among others on their annual income that is derived in Kenya. The base unit of taxation for corporate income tax is the corporate entity.

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 entities). The taxation regime for corporate entities includes preferential tax regimes, which are considered as part of the benchmark for this report and will therefore not count as tax expenditure. These regimes are contained in **Annex II.**

For this Report, a 10% investment deduction is considered a benchmark while any deduction more than this is regarded as a tax expenditure. This is on the 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 to 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 2.3.1, Corporate Income Tax expenditure takes 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) Farmworks	50% in the first year of use and 25% per year, in equal instalments

Total CIT expenditure stood at Ksh 41.6 billion in 2022, an increase from Ksh 21.6 billion in 2021 (**Table 5).**

Table 5: Corporate Income Tax Expenditure

				Ksh, million
	2019	**2020**	**2021**	**2022**
plant and machinery allowance	12,594.46	13,820.49	12,284.68	32,179.55
investment deduction on building	2,072.21	4,559.22	3,489.20	4,745.70
capital allowance on industrial building	4,073.78	3,839.97	5,346.56	4,035.07
Deduction on agricultural land	639.41	345.09	516.38	681.70
Total	**19,379.86**	**22,564.77**	**21,636.81**	**41,642.02**
Nominal GDP	10,237,727.00	10,716,034.00	12,098,200.00	13,368,340.00
Total CIT % of GDP	**0.19**	**0.21**	**0.18**	**0.31**

Source: Kenya Revenue Authority, 2023

Note: In this Tax Expenditure Report, a 10 percent rate of deduction was considered as the benchmark and since most of the investment deductions have a deduction rate of 25 percent after the first year of use, the difference between 25 percent and 10 percent; that is, 15 percent was considered as tax expenditure.

Corporate tax expenditure as a percentage of GDP has been on a fluctuating trend since 2019. In 2022, the expenditure increased to Ksh 41.6 billion (0.31 percent of GDP) from Ksh. 21.6 billion (0.18 percent of GDP) in 2021. This represents an increase of 0.13 percent **(Figure 2).**

The data indicates that investment in plant and machinery increased significantly in 2022 compared to 2021 from Ksh 118 billion to Ksh 206 billion. Out of these new investments 99 percent were in the manufacturing sector. **Some of these new investments in the manufacturing sector were allowed deductions of 150**

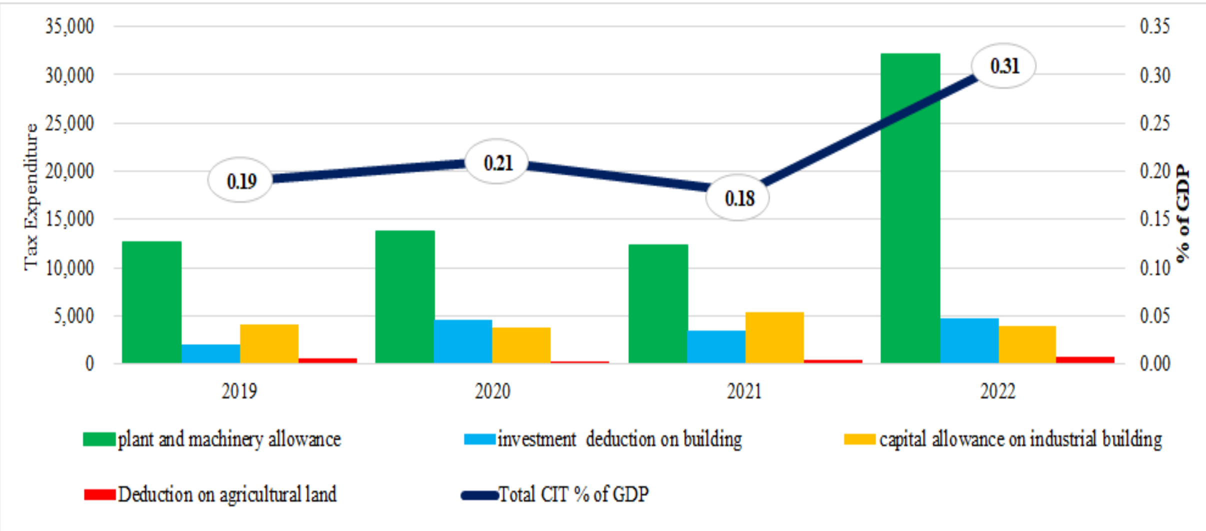
percent which has significantly contributed to the increase in plant and machinery expenditure.

In 2022 compared to 2021, five companies out of more than 127,000 CIT-obligated companies made considerable investment in plant and machinery, accounting for 45 percent of the total investments.

Further, the increase in CIT expenditure can be partly attributed to the amendments contained in the Finance Act, 2021 which:

i. Changed the method of deduction from reducing balance to equal installments which accelerates the deductions;
ii. Removed restrictions for allowable deductions for power generation to only those distributed to the national grid; and
iii. Allowed deductions for expenditure on; roads and parking areas; railway lines and related structures; water, industrial effluent and sewerage works; communications and electrical posts and pylons and other electrical supply works; and security walls and fencing.

Figure 2: CIT Expenditure



CHAPTER THREE: VALUE ADDED TAX

3.1 Overview

Value Added Tax (VAT) is a consumption tax charged on taxable goods and services made or provided in Kenya and supplied or imported into Kenya. The tax is charged at designated stages in the supply chain where value is added. Any individual, company or partnership supplying or who expects to supply taxable goods worth Ksh 5.0 million or more in a year is required to register for VAT. Nonetheless, a trader whose annual turnover is less than Ksh 5.0 million is allowed to register for VAT on voluntary basis.

3.2 VAT Benchmark

There are three types of VAT rates, for the period under review:

i) the general rate of 16.0 percent on goods and services;
ii) 8.0 percent on petroleum products; and
iii) 0.0 percent on some supplies.

The benchmark tax system for domestic VAT is the standard rate of either 16.0 percent or 0.0 percent. The benchmark unit of taxation is on the final consumer of taxable goods and services. However, goods and services that are considered as benchmark in this report in respect to VAT are contained in **Annex III.**

3.3 VAT Expenditure

The VAT Act, 2013 provides for exemption and zero rating on taxable supplies.

a) **VAT exemption:** This involves remission or waiver of VAT on vatable supplies of goods and services.

b) **Zero rating:** This involves charging vatable supplies at the rate of zero per cent. Thus, no VAT is payable on vatable supply. The suppliers of vatable supplies that are zero-rated 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. VAT on exported goods and services are not considered to be tax expenditure as they conform to international best practice.

In 2022, the overall tax expenditure in relation to domestic VAT increased to Kshs 248.29 billion from Ksh 211.09 billion in 2021 **(See Table 6).** Tax expenditure on exempt items increased from Ksh 112.7 billion in 2021 to Ksh 128.3 billion in 2022. Similarly, tax expenditure on zero-rated goods and services increased from Ksh 98.4 billion in 2021 to Ksh 119.9 billion in 2022. The increase in the overall tax expenditure relates to the overall growth of the economy as reflected in the nominal GDP growth, expansion in the VAT base and introduction of tax measures through Finance Acts of 2021 and 2022. These measures are contained in **Annex IV.**

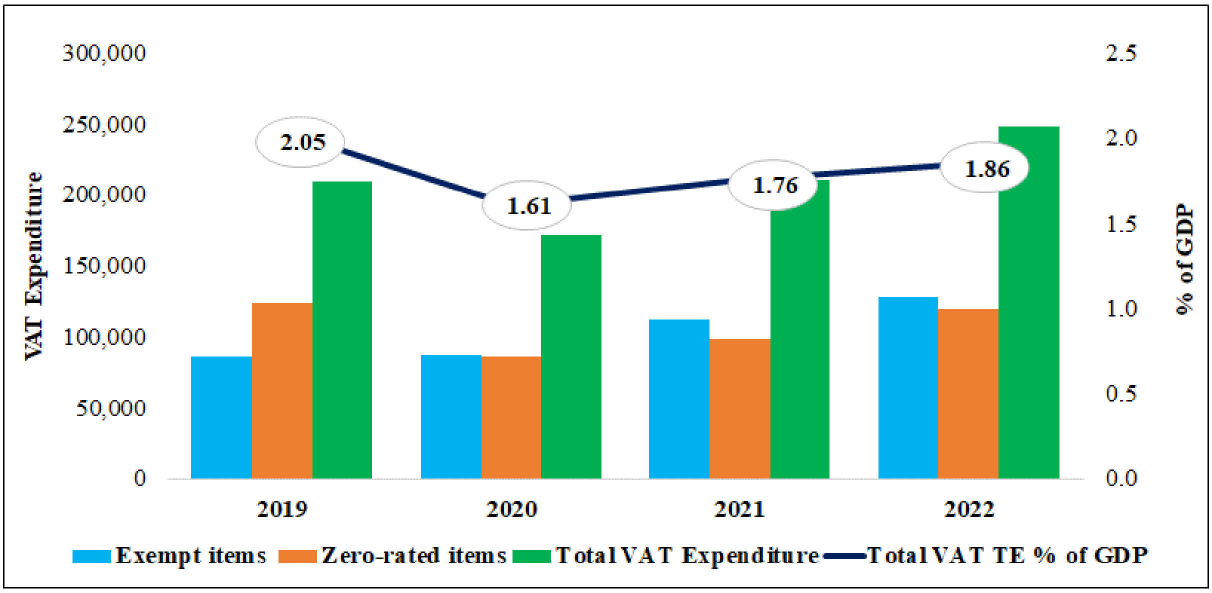
Table 6: VAT Expenditure, Ksh Million

	2019	2020	2021	2022
Exempt items	85,822.33	86,820.54	112,677.38	128,318.31
Zero-rated items	123,579.98	85,724.43	98,412.82	119,975.27
Total VAT Expenditure	209,402.31	172,544.97	211,090.20	248,293.58
Nominal GDP	10,237,727.30	10,715,070.00	12,027,661.50	13,368,340.00
Total VAT TE % of GDP	2.05	1.61	1.76	1.86

Source: Kenya Revenue Authority, 2023

VAT expenditure as a percentage of GDP declined from 2.05 percent in 2019 to 1.61 percent 2020. However, there was an upward trend of the domestic VAT expenditure from 2020 to 2022, increasing from 1.61 percent in 2020 to 1.76 percent in 2021 and 1.86 percent in 2022 (**Figure 3).**

Figure 3: Trend on VAT Expenditure



Source: Kenya Revenue Authority, 2023

3.3.1 Tax Expenditure on VAT Exemption

In 2022, tax expenditure in relation to exempt supplies was Ksh 128.32 billion representing a Ksh 15.6 billion increase from 2021. The main contributors to the total VAT expenditure were financial and insurance activities accounting for 27.67 percent, electricity, oil, gas, steam and air conditioning supply at 25.35 percent, information and communication at 16.75 percent, transportation and storage at 7.96 percent, and supplies related to agriculture, forestry and fishing accounting for 5.16 percent (**see Table 7).** The growth in tax expenditures in these sectors was mainly attributed to an expansion in the vatable base for the various sectors of the economy and introduction of new exempt supplies in the VAT Act, 2013 through Finance Acts of 2021 and 2022 **(See Annex IV).**

Economic Survey, 2023 indicates that sectors illustrated in Table 7 recorded improved economic activities that partly explain the increase in the tax expenditures for the period under review. For instance, information and communication sector recorded an overall growth of 9.9 percent in 2022 compared to 6.1 percent in 2021. The growth of the base in this sector was mainly supported by increase of bandwidth capacity and international telephone traffic.

Table 7: Sectoral VAT Expenditure Contribution (Exempt Supplies)

Main Sectors Exempt from Domestic VAT	2021 Exempt TE (Million)	2022 Exempt TE (Million)	2021 Percent Contribution (%)	2022 Percent Contribution (%)	2021-2022 Change (%)
Financial and Insurance Activities	38,072	35,507	33.79	27.67	-6.74
Electricity, Oil, Gas, Steam and Air Conditioning Supply	-	32,534.00	-	25.35	-
Information and Communication	17,423	21,488	15.46	16.75	23.33
Transportation and Storage	6,146	10,210	5.45	7.96	66.12
Agriculture, Forestry and Fishing	7,013	6,615	6.22	5.16	-5.68
Human Health and Social Work Activities	3,355	6,491	2.98	5.06	93.47
Administrative and Support Service Activities	3,080	5,940	2.73	4.63	92.86
Construction	5,614	5,195	4.98	4.05	-7.46
Professional, Scientific and Technical Activities	3,151	3,629	2.80	2.83	15.17
Other Sectors	28,823	708	25.58	0.55	-97.54
Total	**112,677**	**128,317**	**100.00**	**100.00**	

Source: Kenya Revenue Authority, 2023

Similarly, tax expenditure for transportation and storage sector expanded by 66.13 per cent over the review period. This growth is partly attributed to the positive economic growth of the sector by 5.6 percent in 2022. The growth of the VAT base was main in the volume of freight transported by standard gauge railway which expanded by 12.6 percent as well as passenger traffic by air that grew by 52.2 percent.

Construction sector recorded a tax expenditure growth of 4.05 percent in 2022 compared to 4.98 percent in 2021. This represents a decrease of 0.93 percent. Although the sector had a positive economic growth over the period under review, the decrease in tax expenditure was mainly due to decline in the volume of vatable purchased construction materials, quantity of cement clinkers, iron and steel, and non-ferrous. Finally, tax expenditure under Electricity, Oil, Gas, Steam and Air Conditioning Supply grew significantly in 2022. This was due to introduction of new exempt supplies through the Finance Act, 2021.

3.3.2 Tax Expenditure on Zero Rated VAT

VAT expenditure for zero rated supplies stood at Kshs 119.98 billion in 2022 compared to Kshs 98.41 billion in 2021, representing a 22 percent increase over the review period. Table 8 presents sectoral growth of the tax expenditure over the review period.

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

Main Sectors Zero rated from Domestic VAT	2021 Zero Rate TE (Million)	2022 Zero Rate TE (Million)	2021 Percent Contribution (%)	2022 Percent Contribution (%)	2021-2022 Change (%)
Manufacturing	26,871	46,330	27.30	38.62	72.42
Transportation and Storage	35,160	44,804	35.73	37.34	27.43
Electricity, Oil, Gas, Steam and Air Conditioning Supply	18,953	12,384	19.26	10.32	-34.66
Administrative and Support Service Activities	1,709	6,568	1.74	5.47	284.32
Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles	1,304	2,827	1.33	2.36	116.79
Professional, Scientific and Technical Activities	2,282	2,542	2.32	2.12	11.39
Human Health and Social Work Activities	987	1,400	1.00	1.17	41.84
Accommodation and Food Service Activities	943	1,198	0.96	1.00	27.04
Other Sectors	10,203	1,923	10.37	1.60	-81.15
Total	**98,412.33**	**119,976.00**	**100.00**	**100.00**	

Source: Kenya Revenue Authority, 2023

Analysis of the top sectors that significantly impacted VAT expenditure reveals that Manufacturing was the main contributor at 38.62 percent, followed by Transportation and Storage at 37.34 percent, and Electricity, Oil, Gas, Steam and Air Conditioning Supply at 10.32 percent. Generally, the tax expenditure in respect of zero-rated supplies increased in 2022 compared to 2021, majorly due to general expansion of the economic activity, increase in the VAT base in the key contributing sectors and introduction of new zero-rated supplies through the Finance Acts of 2021 and 2022.

Moreover, the Economic Survey, 2023 shows that growth of tax expenditure in the manufacturing sector is attributed to increase in the Gross Value Addition in the manufacturing sector caused by the increase in manufacture of food and non-food products (motor vehicles, trailers, semi-trailers, and basic and structural metal products) and activities in 2022 compared to 2021.

Similarly, economic activities on transport and storage sector increased by 18.82 percent mainly in land transport, air travel including support services, as well as other transport including courier activities. The increase in volume of the vatable products in the sector partly explains the increase in tax expenditure from 35.73 percent in 2021 to 37.34 percent in 2022.

Table 9: 2021 and 2022 Tax Expenditure Sectoral Comparison

SECTOR	Exempt TE		Zero rated TE		Total TE		2022 Total TE Growth
	2021	2022	2021	2022	2021	2022	
Transportation and Storage	6,146	10,210	35,160	44,804	41,306	55,014	33.19
Manufacturing	11,579	-	26,871	46,330	38,450	45,604	18.61
Electricity, Oil, Gas, Steam and Air Conditioning Supply	-	32534	18953	12384	18953	44917	136.99
Financial and Insurance Activities	38,072	35,507	344	410	38,416	35,917	-6.51
Information and Communication	17,423	21,488	2,393	-	19,816	21,488	8.44
Administrative and Support Service Activities	3,080	5,940	1,709	6,568	4,789	12,508	161.18
Human Health and Social Work Activities	3,355	6,491	987	1,400	4,342	7,891	81.74
Agriculture, Forestry And Fishing	7,013	6,615	1,854	-	8,867	6,615	-25.40
Professional, Scientific and Technical Activities	3,151	3,629	2,282	2,542	5,433	6,171	13.58
Construction	5,614	5,195	3,021	-	8,635	5,195	-39.84
Other Sectors	17,245	708	4,840	5,478	22,085	6,913	-68.70
Total	**112,678**	**128,317**	**98,414**	**119,916**	**211,092**	**248,233**	

Source: Kenya Revenue Authority, 2023

For ease of comparison, the zero rated and exempt tax expenditures per sector are presented. In addition, the total tax expenditures under domestic VAT at sector level is presented where, transport and storage sector has the highest total (both exempt and zero-rated) tax expenditures at Ksh 55,014 million. Manufacturing sector is the second highest contribution to the total domestic VAT at Ksh 45,604 million as per **Table 9.** Sector wise contribution and the total Tax Expenditure growth is analyzed where Administrative and Support Service Activities Sector grew by the largest margin at 161 percent while the expenditure under the Construction sector declined the largest at 40 percent. Important to note is that, the sectors that contributed tax expenditures of less than Ksh 5 billion were grouped under Others and combined they contributed a total of Ksh 6,913 million and collectively had the expenditure under them declined by 69 percent.

3.3.3 Overall VAT Base Analysis

Zero rated: Zero rated sales proportion to the total sales increased from 11.8 percent in 2021 to 18.4 percent in 2022 which partly explains the increase in zero rated tax expenditures. In addition, zero rated supplies proportion to the final private consumption increased to 18.1 percent from 10.5 percent in 2021. This category contributed 11 percent of the 24 percent growth in sales. This is based on returns data. Final private consumption data is obtained from Economic survey of 2023.

Exempt supplies: The exempt sales as a proportion to the total sales marginally increased to 18.1 percent in 2022 from 16.6 percent in 2021. In respect to the final private consumption, exempt sales proportion to the consumption increased to 17.8

percent in 2022 from 14.7 percent in 2021. This contributed 6 percent to the total growth in sales in VAT returns for 2022.

Note: Total sales captured in VAT return (which includes sales at general rate of 16 percent exempt sales and zero-rated sales) grew by 24.2 percent in 2022 indicating growth in the VAT base in 2022. Also, private consumption grew by 12 percent in 2022 compared to 2021.

Table 10: VAT Base Analysis

Description	Ksh Million		Proportion to Total		Contribution to Growth
	2021	2022	2021 Proportion	2022 Proportion	
Zero rated supplies	948,365	1,831,385	12%	18%	11%
Exempt supplies	1,327,376	1,800,556	17%	18%	6%
General supplies at 16%	5,729,135	6,313,033	72%	64%	7%
Total supplies	8,004,875	9,944,974	100%	100%	24%

Source: Kenya National Bureau of Statistics, 2023

Table 11: Private Consumption/Sales Analysis Across Different VAT Categories

Description	Ksh Million		Proportion to Final Consumption	
	2021	2022	2021	2022
Zero rated supplies	948,365	1,831,385	10.50%	18.10%
Exempt supplies	1,327,376	1,800,556	14.70%	17.80%
General supplies at 16%	5,729,135	6,313,033	63.50%	62.50%
Private consumption	9,023,553	10,107,170	100.00%	100.00%

Source: Kenya National Bureau of Statistics, 2023

CHAPTER FOUR: EXCISE DUTY

4.1 Overview

Excise Duty is a tax charged on locally manufactured and imported goods or supply of certain services. Major excisable goods include: beer, wines and spirits, other alcoholic beverages, bottled water, fruit juices, filtered and non-filtered cigarettes, cosmetics, fuels, motor vehicles, other manufactured tobacco and its substitutes. Excisable services include telephone and internet data services, fees charged for money transfer services, other fees charged by financial institutions, gaming and lottery. Rules governing imposition of excise duty are confined in the Excise Duty Act, 2015 and its Regulations. Excise Duty is imposed by the Government to discourage consumption of goods and services that have negative externalities as well as to raise revenue to finance government priorities.

4.2 Excise Duty Benchmark

Excisable goods and services are contained in the First Schedule of the Excise Duty Act, 2015 while the exempt goods and services are in the Second Schedule of the Excise Duty Act, 2015.The same schedules represent the benchmarks with exceptions of items which are considered as tax expenditures. The list of goods and services that are considered as benchmarks are shown in **Annex V.**

4.3 Tax Expenditure on Excise Duty (Domestic)

Tax Expenditure in respect of Excise Duty (Domestic) is considered as exemption on goods and services listed under the Second Schedule to the Excise Duty Act, 2015 with the exception of those listed above that are regarded as benchmark.

In addition, exemption from Excise Duty granted to beer or wine made from sorghum, cassava, millet or any other agricultural products (excluding barley) grown in Kenya 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 exemptions granted to 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); and
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.

4.4 Estimation of Tax Expenditure

In this report, computation of Tax Expenditure for Domestic Excise Tax considered exemption of Keg beer (Sorghum, Millet, and Cassava) and Alcoholic and Non-alcoholic Beverages supplied to DEFCO.

From the analysis, Tax Expenditure in respect of Excise Duty (Domestic) increased from Ksh 6.82 billion in 2019 to Ksh 8.04 billion in 2022 **(Table 12).** The upward trend in Tax Expenditure is attributed to an increase in consumption of Keg beer.

The Report also noted that there was a major decline in Tax Expenditure on Keg beer in the year 2020. This could be credited to Covid-19 restrictions on opening of Bars and Restaurants. However, in the year 2021, the restrictions were lifted, leading to a sharp increase in consumption of Keg beer and a subsequent rise in Tax Expenditure. Additionally, Tax Expenditure on Keg beer increased from Ksh 6.24 billion in 2021 to Ksh 7.30 billion in 2022. The increase could be accredited to a rise in Excise Duty charged on Beer in the year 2022 which led to an increase in beer prices, thereby, shifting consumption from bottled beer to Keg beer. It was noted that, through the Finance Act, 2022, Excise Duty on bottled beer not exceeding an alcoholic strength of 6 percent rose up to Ksh 134 per litre in 2022 from Ksh 121.85 per litre in 2021 while the rate of Excise Duty on wines shot up from Kshs 208 per litre in 2021 to Ksh 229 per litre in 2022. Similarly, Excise Duty on spirits exceeding 6 percent alcohol strength rose from Ksh 278.70 per litre in 2021 to Ksh 335.30 per litre in 2022.

In relation to Alcoholic and non-alcoholic beverages supplied to DEFCO, there was a sharp decline in Tax Expenditure from Ksh 1.39 billion in 2021 to Ksh 737.93 million in 2022. This could be as a result of decline in supply for Alcoholic beverages from the major companies (Kenya Breweries Limited and Keroche Breweries Limited) which reduced from 8.72 million litres in 2021 to 5.22 million litres in 2022. In addition, the importation of alcoholic beverages increased by 8 percent which could have reduced the local supply. However, the supply of non-alcoholic beverages increased from Ksh 4.23 million in 2021 to Ksh 5.34 million in 2022.

Table 12: Tax Expenditure on Excise Duty (Domestic)

Description / Year	Kshs Million			
	2019*	**2020***	**2021***	**2022**
Alcoholic/Non-Alcoholic Beverages (DEFCO)	598.58	2,953.98	1,391.22	737.93
Keg beer (sorghum, millet and cassava)	6,219.37	4,165.96	6,244.72	7,297.65
Total Expenditure	6,817.95	7,119.94	7,635.94	8,035.58
Nominal GDP	10,237,727	10,715,070	12,027,662	13,368,340
Total Expenditure (Domestic Excise Duty % nominal GDP)	**0.067**	**0.066**	**0.063**	**0.0601**

Source: Kenya Revenue Authority, 2023

* *Revised*

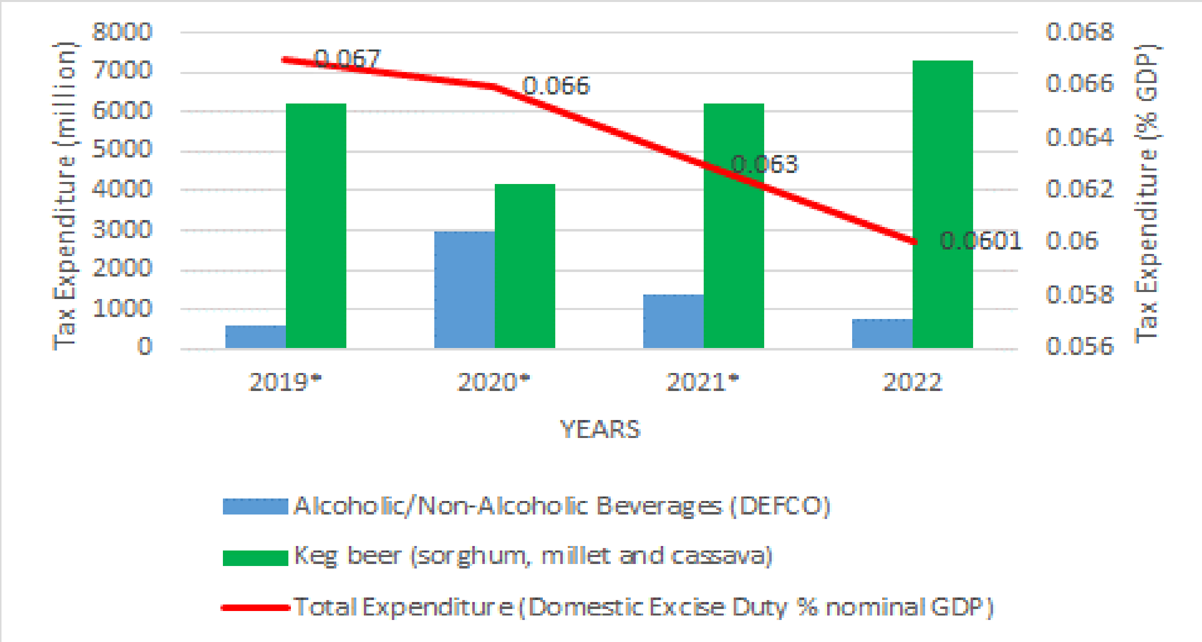
Note: The total tax expenditure in respect of domestic excise duty shows a different trend between the 2022 and 2023 Tax Expenditure Reports. This is mainly attributed to:

a) ***The 2022 report used financial year data while the 2023 report used calendar year data.***

b) ***Exemptions of locally assembled motor vehicles and motor vehicle ambulances and locally assembled motorcycles and motorcycle ambulances which formed part of the 2022 Report has been excluded in the estimation of Tax Expenditure in this chapter and considered under Chapter five on excise duty on import.***

Excise Duty (Domestic) tax expenditure as percentage of Nominal GDP has steadily been decreasing from 0.067 percent in 2019 to 0.063 percent in 2021. However, the 0.004 percent decline in tax expenditure as a percentage of GDP realized in 2022 from 2021 was as a result of the new tax measures that were introduced in the Finance Act, 2022.

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



**Revised*

CHAPTER FIVE: TAXES ON IMPORTS

5.1 Overview

The East African Community has achieved full implementation of the Customs Union Protocol and currently operates as a single customs territory. The East African Community Customs Management Act (EACCMA), 2004, the East African Community Customs Management Regulations, 2010, and the East Africa Community Customs Union Protocol govern charging of import duty in the East African Community (EAC). The primary basis of determination of the taxable customs value for purposes of levying ad valorem tax is the Cost, Insurance and Freight (CIF) value of imported goods.

Import Excise Duty is levied on excisable goods imported into the country. Laws and Regulations governing the imposition of Excise Duty are contained in the Excise Duty Act, 2015. The excisable taxable value for charging Excise Duty on imported products is the CIF value plus the applicable Import Duty.

Import VAT is charged on imported goods. The VAT Act, 2013, governs application and imposition of Value Added Tax (VAT). Imported goods are taxed at the same rates as domestic supplies. All imported goods are vatable unless exempted or zero rated under the VAT Act, 2013.

5.2 Tax Expenditures/Benchmark for Taxes on Imports

a) Import Duties

Import duties are charged at the rates of zero (0) percent, ten (10) percent, twenty-five (25) percent and thirty-five percent (35) depending on the level of processing and regional policy. The rates applicable are specified in the East African Community (EAC) Common External Tariff (CET), 2022. Due to the need to protect local industries across the EAC Region, some goods are classified as sensitive and attract import duty at rates above 35 percent while goods emanating from the EAC region, COMESA countries and goods traded under other trade agreements meeting the criteria set out in the agreements and rules of origin are accorded preferential Import Duty rates.

Part A of the Fifth Schedule to the East African Community Customs Management Act (EACCMA), 2004, provides specific exemptions 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 Immunities and Privileges 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 same 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.

Additionally, the Act provides for Duty Remission on inputs imported by approved manufacturers for production of goods for export and other essential goods, for example, exercise books.

The goods that are exempt under the Fifth Schedule of the EAC Customs Management Act, 2004 are considered part of the benchmark tax regime and have therefore been excluded in the calculation of the tax expenditure in this Report.

Kenya is also a party to other international and regional agreements such as COMESA and AGOA among others that determine Import Duty of goods coming into the country. 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.

Any deviation from the regionally agreed rates of Import Duty in form of duty remission exemption/reduced rates (stay of application of EAC CET) is considered as tax expenditure. Supplies that enjoy yearly stays of applications include; rice, worn items of clothing, timber of heading 44.07, poly vinyl alcohol, copolymers and steel coils, among others.

b) Excise Duty on Imports

Excisable goods are contained in the First Schedule of the Excise Duty Act, 2015 while the exempt goods are in the Second Schedule of the Excise Duty Act, 2015. The same Schedules represent the benchmarks with exceptions of items which are considered as tax expenditures. The list of goods that are considered as benchmarks are illustrated in **Annex V.** Import excise duty tax expenditure includes all exemptions on excisable goods such as beers and spirits, oils among others.

c) VAT on Imports

All goods consumed in Kenya are subject to VAT unless exempt under the First Schedule or zero rated under the Second Schedule of the VAT Act, 2013. Therefore, unless listed under the First and Second Schedule, exemptions granted to all vatable goods imported into the country at reduced rates are considered Tax Expenditures. For purposes of this report, the benchmarks in respect to import VAT include goods listed in **Annex VI.**

5.3 Tax Expenditure on Imports

Tax Expenditure on imports as a percent of GDP has been on an upward trajectory from 2019 to 2022. In 2022, total tax expenditure related to taxes on imports (Excise Duty, Import Duty, Import VAT on Oils and VAT on imports) was Ksh 75.7 billion (0.57 percent of GDP) compared to Ksh 20.6 billion (0.20 percent of GDP) in 2019. Similarly, in 2021, the amount of tax expenditure increased to Ksh 41.7 billion from Ksh 29.6 billion in 2020. This represents an increase of 0.35 and 0.28 percent of the GDP respectively; **See Table 14.**

Similarly, tax expenditure on Import VAT increased from Ksh 8.8 billion in 2021 to Ksh 17.2 billion in 2022. This increase is mainly attributed to the increase in the import VAT on oils. The shift in rates brought by the new EAC CET and increased importation of duty-free maize, sorghum, rice, vegetables, raw materials for the manufacture of animal feeds and other foodstuff products also contributed largely to this spike **(See Table 13).**

Table 13: Importation of Duty-Free Agricultural Products

Year	Commodity	CIF Value of Imports (In Kshs)	Exchange Rate
2021	Vegetables	6,694,433.23	113.14
	Wheat	10,685,713,893.41	
	Maize	1,100,240.95	
	Rice	11,256,753,245.44	
	Sorghum	39.42	
	Edible oils	56,111,075.52	
	Animal feeds	2,189,635.44	
2022	Vegetables	5,298,455.01	123.37
	Wheat	60,921,219,635.06	
	Maize	3,013,604.32	
	Rice	6,595,013,402.05	
	Sorghum	255,530,320.06	
	Edible oils	140,463,719.16	
	Animal feeds	144,347,535.42	

Source: Kenya Revenue Authority, 2023

Further, the rise in tax expenditure in regard to VAT on oils was as a result of an increase in international prices of petroleum products amid the weakening of the Kenyan shilling against the US dollar.

Other reasons attributable to this increase include:

i. The general increase in the number of exemptions in 2022 compared to 2021 as a result of increase in economic activities;
ii. The general growth of imports post Covid period;
iii. Increase in imports of petroleum products (especially diesel) and industrial machinery;
iv. Inclusion of the Treasury undertakings as part of tax expenditures; and
v. Extensive capital expenditure by various companies in the year 2022.

Table 14: Tax Expenditure on Imports

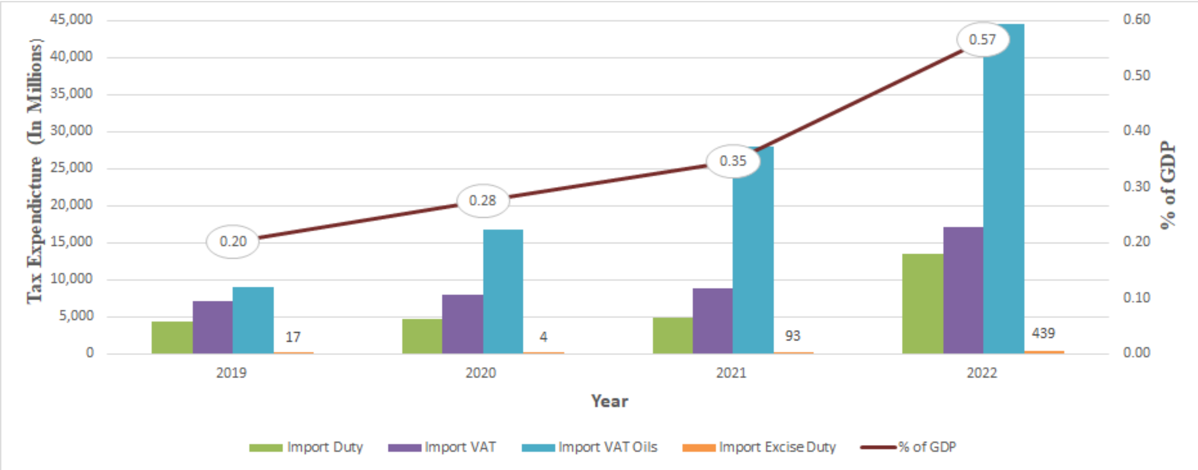
Tax Head / Year	Kshs in Millions			
	2019*	2020*	2021*	2022
Import Duty	4,332.42	4,705.32	4,825.30	13,589.36
Import Excise Duty	17.33	3.62	92.84	438.75
Import VAT Oils	9,087.00	16,788.96	28,008.93	44,501.00
Import VAT	7,169.12	8,058.07	8,772.47	17,169.54
Total Expenditure	**20,605.87**	**29,555.98**	**41,699.54**	**75,698.65**
Nominal GDP	10,237,727.00	10,715,070.00	12,027,662.00	13,368,340.00
Total Taxes on Import as % of GDP	**0.20**	**0.28**	**0.35**	**0.57**

*Source: Kenya Revenue Authority, 2023; * Revised*

Note: 8 percent VAT on fuel was introduced in 2018 and implemented as from July 2019 while Treasury undertakings is a commitment by the Government to pay taxes on behalf of select taxpayers.

Tax expenditure on import duty increased from Ksh 4.8 billion in 2021 to Ksh 13.6 billion in 2022 mainly due to the high importation of exempt foodstuff such as maize, sorghum among others. Equally, there was an increase in volume of inputs for the manufacture of pharmaceutical products that were granted tax exemption and re-introduction of tax incentives that had been removed in 2020 through the Finance Act, 2021 and Finance Act, 2022. In addition, tax expenditure on import Excise Duty increased from Ksh 92.8 million in 2021 to Ksh 438.7 million in 2022 largely ascribed to increased volumes of imported alcoholic drinks and beverages by DEFCO.

Figure 5: Tax Expenditure on Imports



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 and RDL during the period under review was 3.5 percent and 2.0 percent of the Custom value respectively. They 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 is contained in **Annex VII.**

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 Customs 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.

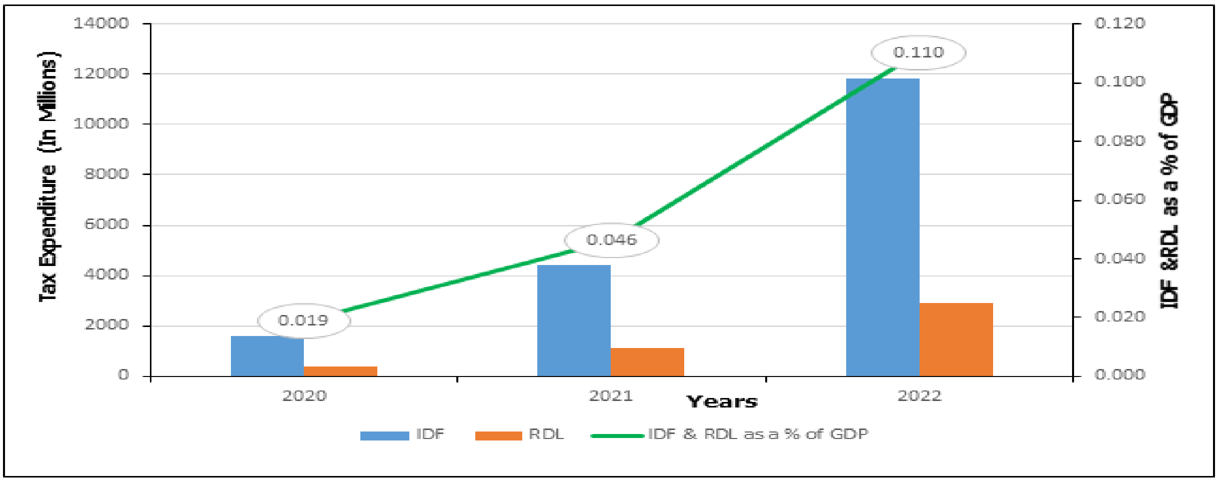
Tax Expenditure on IDF increased from Ksh 1.6 billion in 2020 to Ksh 11.8 billion in 2022 **(See Table 15).** This represents an increase from 0.02 percent of GDP in 2020 to 0.11 percent of GDP in 2022. The value for tax expenditure on RDL also increased from Ksh 401.9 million in 2020 to Ksh 2.9 billion in 2022 representing a 622 percent increase. This sharp increase is attributed to the increase in the value of imports in the same period. The total Tax Expenditure for both IDF and RDL increased from Ksh 2.0 billion (0.02 percent of GDP) in 2020 to Ksh 14.7 billion (0.11 percent of GDP) in 2023 (**Figure 5**). This increase is due to the increased volume and value of goods that enjoyed preferential IDF and RDL rates during the years 2020 to 2022.

Table 15: Tax Expenditure on IDF and RDL

Tax Head / Year	Ksh in Millions		
	2020	2021	2022
IDF	1,622.16	4,454.50	11,831.85
RDL	401.93	1,099.01	2,900.60
Total Tax Expenditure	2,024.09	5,553.51	14,732.45
Nominal GDP	10,715,070.00*	12,027,662.00*	13,368,340.00
IDF & RDL as a % of GDP	0.02	0.05	0.11

Source: Kenya Revenue Authority, 2023
* *Revised*

Figure 6: Tax Expenditure on IDF and RDL

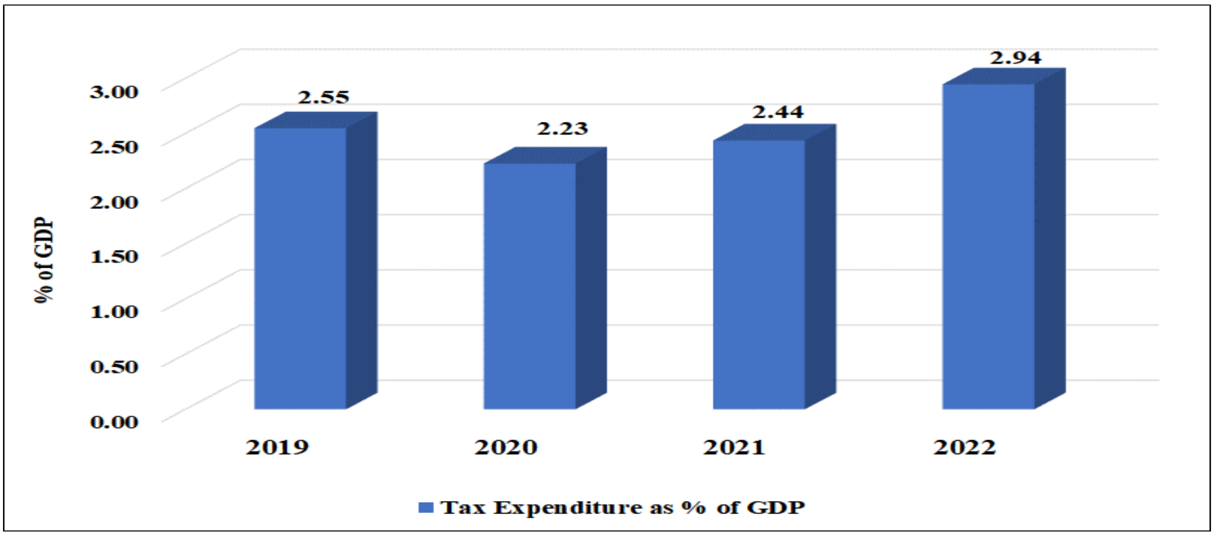


CHAPTER SIX: CONCLUSION AND POLICY RECOMMENDATIONS

6.1 Key Findings

Tax expenditure to GDP ratio has been on an upward trend since 2020, increasing to 2.94 percent in 2022 from 2.44 percent in 2021 and 2.23 percent in 2020 **(Figure 6)**.

Figure 7: Tax Expenditure as a Percent of GDP



In 2022, total tax expenditure increased by Ksh 100,600.06 million to Ksh 393,522.55 million from Ksh 292,922.49 million in 2021. Tax expenditure on all tax heads increased in 2022 except Personal Income Tax which had a marginal drop of Ksh 84.06 million. VAT domestic increased by Ksh 37,203.38 million to Ksh 248,293.58 million in 2022 from Ksh 211,090.20 million in 2021, contributing 36.94 percent of the total increase in the 2022 tax expenditure. Over the same period CIT increased by Ksh 20,005.21 million, VAT on Imports (Fuel) by Ksh 16,492.07 million, Fees and Levies by Ksh 9,178.94 million, Import duty by Ksh 8,764.06 million, and VAT imports by Ksh 8,397.07 million. Excise Duty on imports and Excise Duty (domestic) had the least contribution to the total increase in the 2022 tax expenditure by 0.34 percent and 0.4 percent respectively **(Table 16).**

Table 16: Summary of Tax Expenditure per Tax Head

Tax Head	2019	2020	2021	2022	Change (2021-2022)	Contribution to the Total Change (%)
	Ksh Millions					
Personal income tax	4,525.26	4,769.51	5,306.49	5,222.43	-84.06	-0.08
Corporate Income Tax	19,379.86	22,564.77	21,636.81	41,642.02	20,005.21	19.87
VAT domestic	209,402.31	172,544.97	211,090.20	248,293.58	37,203.38	36.94
Excise Duty on imports	17.33	3.62	92.84	438.75	345.91	0.34
Excise Duty (Domestic)	6,817.95	7,119.94	7,635.94	8,035.58	399.64	0.4
VAT on Imports	7,169.12	8,058.07	8,772.47	17,169.54	8,397.07	8.34
VAT on Imports (Fuel)	9,087.00	16,788.96	28,008.93	44,501.00	16,492.07	16.38
Import Duty	4,332.42	4,705.32	4,825.30	13,589.36	8,764.06	8.7
Fees and Levies	-	2,024.09	5,553.51	14,732.45	9,178.94	9.11
Total Tax Expenditure	260,731.25	238,579.25	292,922.49	393,624.71	100,702.22	100
Nominal GDP	10,237,727.30	10,715,070.00	12,027,661.50	13,368,340.00		
Tax Expenditure as % of GDI	2.55	2.23	2.44	2.94		

The total tax expenditure to GDP ratio increased to 2.94 percent in 2022 from 2.44 percent in 2021. VAT expenditure as a percentage of GDP increased from 2.06 percent in 2021 to 2.32 percent in 2022. Similarly, Income Tax expenditure, Import Duty expenditures and expenditures from Fees and Levies to GDP ratio increased in 2022. The increase in the tax expenditures reflects the recovery of economic activities in the country after the Covid-19 pandemic and the introduction of tax incentive measures through Finance Acts 2021 and 2022 to promote investment in certain sectors of the economy **(Table 17)**.

Table 17: Tax Expenditure to GDP Ratio

Tax Head	2019	2020	2021	2022	2019	2020	2021	2022
	Ksh Million				Expenditure to GDP ratio			
Income Tax	23,905.12	27,334.28	26,943.30	46,864.45	0.234	0.255	0.224	0.351
VAT	225,658.43	197,392.00	247,871.60	309,964.12	2.204	1.842	2.061	2.319
Excise Duty	6,835.28	7,123.56	7,728.78	8,474.33	0.067	0.066	0.064	0.063
Import Duty	4,332.42	4,705.32	4,825.30	13,589.36	0.042	0.044	0.040	0.102
Fees and Levies	-	2,024.09	5,553.51	14,732.45	-	0.019	0.046	0.110
Total Tax Expenditure	260,731.25	238,579.25	292,922.49	393,624.71	2.55	2.23	2.44	2.94
Nominal GDP	10,237,727.30	10,715,070.00	12,027,661.50	13,368,340.00				

6.2 Contribution to the Total Tax Expenditure by Tax Head

In 2022, Value Added Tax (domestic) accounted for most of the tax expenditure by 63.1 percent, followed by VAT on imports (Fuel) and CIT by 11.3 percent and 10.9 percent, respectively. Despite being the highest contributor to tax expenditure, VAT domestic contribution has been on a downward trend since 2019, declining from 80.3 percent to 63.1 percent in 2022. VAT on imports (Fuel) and Fees and levies have been on an upward trend, while the other tax heads have been fluctuating over the period **(Table 18)**.

Table 18: Tax Expenditure by Tax Head

Tax Head	2019	2020	2021	2022	2019	2020	2021	2022
	Ksh Million				Share of Total Tax Expenditure			
Personal income tax	4,525.26	4,769.51	5,306.49	5,222.43	1.74	2.00	1.81	1.33
Corporate Income Tax	19,379.86	22,564.77	21,636.81	41,642.02	7.43	9.46	7.39	10.58
VAT domestic	209,402.31	172,544.97	211,090.20	248,293.58	80.31	72.32	72.06	63.08
Excise Duty on imports	17.33	3.62	92.84	438.75	0.01	0.00	0.03	0.11
Excise Duty (Domestic)	6,817.95	7,119.94	7,635.94	8,035.58	2.61	2.98	2.61	2.04
VAT on Imports	7,169.12	8,058.07	8,772.47	17,169.54	2.75	3.38	2.99	4.36
VAT on Imports (Fuel)	9,087.00	16,788.96	28,008.93	44,501.00	3.49	7.04	9.56	11.31
Import Duty	4,332.42	4,705.32	4,825.30	13,589.36	1.66	1.97	1.65	3.45
Fees and Levies	-	2,024.09	5,553.51	14,732.45	-	0.85	1.90	3.74
Total Tax Expenditure	260,731.25	238,579.25	292,922.49	393,624.71	100.00	100.00	100.00	100.00

6.3 Comparison of Kenya's Tax Expenditure with other Jurisdictions

Comparisons of tax expenditures between countries has been always difficult as the Benchmark Tax Systems used as a reference vary substantially. In addition, most countries do not publish tax expenditure reports. That notwithstanding, the trend of total tax expenditure for Kenya is comparable to those of other countries that report on the same. The tax expenditure for Ghana increased from 0.13 percent in 2020 to 1.68 percent while for Mauritius increased from 2.16 percent in 2020 to 2.69 percent in 2021. Similarly, South Africa's tax expenditure increased from 1.88 percent in 2020 to 2.14 percent in 2021 while that of Uganda increased from 2.71 percent in 2020 to 2.84 percent in 2021.

The world average tax expenditure declined from 2.29 percent in 2020 to 2.16 percent in 2021. Despite Kenya's tax expenditure being above the world average, it is within the range of the neighbouring countries and exhibits a similar upward trend (*Source of the statistics: The Global Tax Expenditures Database (GTED), 2022*).

6.4 Conclusion

The upward trend on total tax expenditure from 2020 to 2022, is attributed to increasing expenditures across the various tax heads as a result of increase in economic activities. The review of various tax laws to achieve specific Government objectives has resulted to introduction of several tax incentives thus contributing to the increase in tax expenditures. In particular, Government provided Import Duty exemption to allow importation of food items into country to cushion Kenyans from high cost of food as a result of drought and high commodity prices; introduction of 150 percent in capital allowance to promote investment; and introduction of insurance relief for contribution of NHIF, among others.

6.5 Way Forward

The Government will continue to review and rationalize the tax incentives in order to ensure that the expenditures are sustainable and provide value for money foregone and ensure that the incentives achieve the intended purpose.

APPENDICES

Annex I: PIT Benchmarks

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

Annex II: CIT Benchmarks

i The Export Processing Zones regimes whereby entities are exempt for the first ten years and taxed at the rate of 25% for the next ten years and 30% for the subsequent years;

ii The Special Economic Zones (SEZ) regimes, 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 a 30% rate applies;

iii The newly listed entities 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;

iv Contributions to pension schemes and social security funds;

v Personal reliefs; and

vi Income paid to diplomats and privileged persons.

Annex III: 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;

i Domestic supply of unprocessed agricultural products;
ii Specified financial & insurance services;
iii Education services as defined;
iv Agricultural, animal husbandry and horticultural services.
v Sale, renting, leasing, hiring, letting of land or residential premises as defined;
vi Medical, veterinary, dental, ambulance and nursing services;
vii 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;

viii 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;

ix Materials, articles, equipment and motor vehicles specially designed for the sole use by disabled and physically handicapped persons;

x Materials, articles and equipment (excluding motor vehicles) intended for educational, scientific or cultural advancement of the disabled;

xi Medicaments;

xii Mosquito nets;

xiii Burial and cremation services;

xiv Community, social and welfare services provided by National Government, County Government or any political subdivision, charitable organizations;

xv Services rendered by educational, political, religious, welfare and other philanthropic associations to their members;

xvi Entertainment services conducted by educational institutions as part of learning; sports, games or cultural performances conducted under the auspices of the responsible Ministry;

xvii 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;

xviii Canteens and cafeterias operated by an employer for the benefit of his employees;

xix Betting, gaming and lotteries services;

xx Hiring, leasing and chartering of aircrafts, aeroplanes, and space crafts, excluding helicopters;

xxi Supply of domestic passenger transportation services by road, rail and water, except where the means of conveyance is hired or chartered;

xxii Materials, waste, residues and by-products, whether or not in the form of pellets, and preparations of a kind used in animal feeding;

xxiii Postal services provided through the supply of postage stamps, including rental of post boxes or mailbags and any subsidiary services thereto.

xxiv Transfer of a business as a going concern by a registered person to another registered person.

xxv Goods imported by passengers arriving from places outside Kenya, subject to specified limitations and conditions.

xxvi 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.

xxvii Hearing aids, excluding parts and accessories, of tariff No.9021.40.00.

xxviii Car park services provided by National Government, County Government, any political subdivision by an employer to his employees on the premises of the employer.

xxix The supply of airtime by any person other than by a provider of cellular

xxx 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:

i 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;

ii Specified supplies to Diplomats or First Arrivals Persons;

iii Specified supplies to donor agencies with bilateral or multilateral agreements;

iv 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;

v Supply to the War Graves Commission;

vi Supply to National Red Cross Society and St. John Ambulance;

vii 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

viii The supply of coffee and tea for export to coffee or tea auction centres;

ix The supply of taxable services to international sea or air carriers on international voyage or Flight;

x The Supply of taxable services in respect of goods in transit;

xi The exportation of goods or taxable services;

xii Ship stores supplied to international sea or air carriers on international voyage or flight;

xiii Transportation of passengers by air carriers on international flight; and

xiv Goods purchased from duty free shops by passengers departing to places

Annex IV: New tax measures introduced in the First Schedule and Second Schedule of the VAT Act, 2013 through Finance Acts of 2021 and 2022:

Exempt Supplies

i Paragraph 112: Taxable goods, excluding motor vehicles, imported or purchased for direct and exclusive use in geothermal, oil or mining prospecting or exploration by a company granted a prospecting or exploration license in accordance with the Energy Act, 2019, production sharing contracts in accordance with the Petroleum Act, 2019, or a mining license in accordance with the Mining Act, 2016, upon recommendation by the Cabinet Secretary responsible for matters relating to energy, the Cabinet Secretary responsible for matters relating to petroleum, or the Cabinet Secretary responsible for matters relating to mining, as the case may be.

ii Paragraph 113: Specialized equipment for the development and generation of solar and wind energy, including photovoltaic modules, direct current charge controllers, direct current inverters and deep cycle batteries that use or store solar power, upon recommendation to the Commissioner by the Cabinet Secretary responsible for matters relating to energy.

iii Paragraph 116: Physiotherapy accessories, treadmills for cardiology therapy and treatment of tariff number 9506.91.00 for use by licensed hospitals upon approval by the Cabinet Secretary responsible for matters relating to health.

iv Paragraph 134: Taxable supplies including fish feeding and handling, water operations, cold storage, fish cages, pond construction and maintenance, and fish processing and handling, imported or purchased for direct and exclusive use on the recommendation of the relevant state department;

v Paragraph 135: Pre-fabricated biogas digesters.

vi Paragraph 136: Biogas

vii Paragraph 139: Tractors other than road tractors for semitrailers.

viii Paragraph 143: Inputs and raw materials used in the manufacture of passenger motor vehicles.

Zero-rated Supplies

i Paragraph 20: The transportation of goods originating from Kenya to a place outside Kenya.

ii Transportation of sugarcane from farms to milling factories.

iii The supply of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than ten percent in weight.

iv Inputs or raw materials locally purchased or imported by manufacturers of fertilizer as approved from time to time by the Cabinet Secretary responsible for Agriculture.

Annex V: Excise Duty (Domestic) Benchmark

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 in such quantities as approved by the Commissioner;

ii Excisable goods imported into Kenya or purchased in 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;

iii Excisable goods purchased in Kenya by a foreign government, international organisation, or aid agency;

iv One motor vehicle for use by persons with disability;

v Excisable Goods purchased locally by the Kenya Red Cross or St John Ambulance for official use in the provision of relief services in Kenya;

vi Excisable goods imported by a person changing residence or a returning resident subject to limitations;

vii 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;

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

ix Excisable goods imported or purchased locally for direct and exclusive use in the implementation of an Official Aid-Funded Project;

x Excisable goods imported or purchased locally for direct use in the manufacture of sanitary towels;

xi All goods including materials supplies, equipment, machinery and motor vehicles for the official use by the Kenya Defence Forces and the National Police Service;

xii Goods and services that are supplied to diplomatic institutions or institutions with privileges and immunities;

xiii Excisable goods exported under customs control, including as stores;

xiv Excisable services exported from Kenya;

xv Excisable goods that the manufacturer has destroyed, with the prior written permission of the Commissioner, under the supervision of an authorized officer prior to their removal from the factory in which they were manufactured;

xvi Denatured spirits for use in the manufacture of gasohol or as a heating fuel;

xvii Excisable goods that have been lost or destroyed by accident or other unavoidable cause:

a) In the course of removal of the goods by the manufacturer from the manufacturer's factory including when loading or unloading the goods;

b) In the factory of the manufacturer in which the goods were manufactured before removal from the factory; or

c) On board an aircraft or vessel prior to importation into Kenya.

Annex VI: List of goods and services contained in the Excise Duty Act, 2015 that are considered benchmark but not as tax expenditure:

i Excisable goods contained in the First Schedule; and

ii Exempt goods contained in the Second Schedule which include:

a) Goods that are supplied to diplomatic institutions or institutions with privileges and immunities;
b) Supplies for Official Aid Funded Projects;
c) Excisable goods purchased by returning residents; One motor vehicle for use by persons with disability; and
d) Excisable Goods imported or purchased locally by the Kenya Red Cross or St John Ambulance for official use in the provision of relief services in Kenya.

Annex VII: Benchmarks of Import VAT on Goods:

i Supply to the Commonwealth and other governments;

ii Supply to Diplomats or First Arrival persons;

iii Supply to donor agencies with bilateral or multilateral agreements;

iv Supply to regional and international organizations;

v Supply to the National Red Cross Society and St. John Ambulance;

vi Ship stores 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 vehicles imported by returning residents subject to limitations provided for under the Fifth Schedule to the East African Community Management Act.

Annex VIII: Benchmark Tax System for IDF and RDL

These include:

i Goods destined to 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 meet 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.

Annex IX: Methodology

Data sources

The data employed in the preparation of this 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

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

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.

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)