

# KEPSA WEEKLY LEGISLATIVE BULLETIN

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## Railway levy becomes Kenya's development dilemma

The recent decision of the EAC Council of Ministers directing Kenya to abolish the special 1.5 per cent levy on the customs value of all imports has shown the dilemma that arises when innovative development financing mechanisms run counter to fulfilling regional trade obligations. As things stand, Kenya has ran into heavy head winds with its EAC Partner States over this levy, commonly known as the railway levy.

Following the election of the new government in March 2013, the construction of a standard gauge railway was flagged out as a priority having been a key promise under the Jubilee manifesto. To raise funds for the project, the Kenya Finance Act 2013 proposed a new 1.5 per cent levy on the customs value of all imports to be used in meeting the cost of constructing a standard gauge railway from Mombasa to Malaba in its first phase. The construction of the railway is seen as an important plank in easing the movement of goods from the Port of Mombasa to the other EAC countries.

While external funding has been sourced and guarantees secured from the China Exim Bank, the government of Kenya was required and expected to meet part of the cost of constructing the railway. Among the options that had been suggested to raise funds for the construction was that of floating a bond but this option was not taken up by the government.

Instead, the customs tax regime was seen as offering a more certain and predictable stream of funding which eventually led to the proposal for a 1.5 per cent railway levy. The levy was imposed through an amended Section 117A in the Finance Bill 2013 which introduced the



railway development levy on imports at the rate of 1.5 per cent of Customs Value.

Since the government began levying this tax, there has been concern that the levy, being an extra tax burden, would increase costs for local manufacturers and lead to higher prices for imports and locally manufactured goods dependent on imported raw materials. This would in turn make such goods and products uncompetitive in the local, regional and international markets. But it is the question on whether the railway levy violates Kenya's obligations under the EAC Treaty, and in particular the EAC Customs Union Protocol, that has ignited much attention.

## Tax harmonization

The EAC Partner States are bound by the EAC Treaty and the relevant Protocols as ratified by the Heads of State Summit on taxation. The basic premise is that the Partner States must move towards tax harmonization which is seen as a progressive target and objective to facilitate the free movement of goods.

Indeed, harmonization of taxation to deepen trade and support regional integration is a requirement under Article 75 of the Customs Union Protocol and Article 76 of the Common Market Protocol. Article 83 (2) (e) of the EAC Treaty obligates Partner States to harmonize tax policies while Article 80 (1) (f) seeks measures that avoid double taxation.

In addition, Article 32 of the Common Market Protocol requires EAC Partner States to align their taxes to avoid creating an uneven tax regime which may not be enabling for business enterprise.

Because taxation is the most assured means of raising revenue for the government, taxation is reviewed from time to time through the budget-making process to advance national



developmental objectives. The construction of the standard gauge railway is one such example. Such measures may however have a negative and adverse impact on business as has been the



drive behind the petition by importers presented before the EAC Council of Ministers in respect of the 1.5 per cent railway levy.

While harmonization of taxes is a progressive target and objective which may, therefore, not bar Partner State from imposing any taxation measure, the test will always be whether any such measure(s) undermines the implementation of the EAC Treaty and specific Protocol such as the Customs Union that currently subsists between the EAC Partner States.

By its very definition, a Customs Union is an agreement “between two or more (usually neighboring) countries to remove trade barriers and reduce or eliminate customs duty on mutual trade. A customs union generally imposes a common external-tariff (CTF) on imports from non-member countries”

The issue in dispute pitting Kenya against the EAC Council of Ministers boils down to whether the 1.5 per cent railway levy, though not a permanent tax measure, confirms to the stipulation of having a common external tariff. On a strict construction of the obligation imposed on EAC Partner States by the Common Market Protocol and the Customs Union Protocol, Kenya could be held to be in contravention. It will be interesting to see how this knot is untied.

### **EALA seeks to tighten regulation of Cooperative Societies**

The East African Legislative Assembly (EALA) has developed three Bills to regulate cooperative societies, civic education on the integration process and legal practice in the five Partner States. The three Bills which are currently being reviewed by the relevant departmental committees of national parliament in the Partner States before the commencement of debate at EALA include the EAC Cross Border Legal Practice Bill, 2014; the EAC Integration (Education) Bill, 2014; and, the EAC Cooperative Societies Bill, 2014.

KEPSA has already presented its views and recommendations on the three Bills to Kenya’s National Assembly through the Parliamentary Committee on Regional Integration.

In its submissions, KEPSA welcomed the East African Community Cooperative Societies Bill, 2014 as one which will help create a regional framework to regulate cooperative societies as an important vehicle in mobilizing savings through collective initiative and pulling together across the EAC region. It would also strengthen accountability by cooperatives to their members while allowing members to hold directors to account through various mechanisms like the General Assembly.



The Bill would further leverage the role of the Private Sector in encouraging a culture of saving and investment and support the expansion of national economies across the partner States. KEPSA noted that this Bill had comprehensively addressed a broad range of issues including governance within the Cooperative societies to enhance effective

management of resources and safeguard the rights of the investing public.

Once enacted, the East African Community Cooperative Societies Bill, 2014 will supersede existing national laws governing the co-operative movement in areas of conflict between these two sets of laws.

Among the draconian provisions contained in the Bill is the power proposed for the Authority responsible for regulating cooperatives to suspend the operations of any Cooperative Society found to be operating outside its objects. KEPSA has recommended that before exercising its power to suspend the society from operating, the “authority should notify the concerned Society on the areas of breach and provide a specific time period within which to remedy the breach and be in compliance or face suspension in default”

To strengthen internal audit oversight, KEPSA wants a more explicit role on the mandate of Control Committees whose primary objective is to act on behalf of members to audit the management of finances by directors.

KEPSA has proposed the following provision: “the control committee shall play an independent oversight role over the board of directors in managing and running the affairs of the society”.

In cases where an audit report is submitted by an inspector at the request of members, KEPSA seeks a greater role for members in interrogating the inspection report by requiring its submission to the members at a General Assembly. The EALA Bill had proposed submission of the inspection report to the directors.



Once the Bill is reviewed by the National Assemblies of the five EAC Partner States, it will be tabled for debate before EALA and once passed becomes a new law binding the EAC partner States in accordance with the Treaty establishing the East African Community.

*Next week we shall review the EAC Cross Border Legal Practice Bill, 2014 and the EAC Integration (Education) Bill, 2014*