KEPSA PROPOSALS TO FINANCE BILL 2025

No.	ISSUE	WHAT NEEDS TO BE DONE	JUSTIFICATION
1.	Misalignment of the Value Added Tax (VAT) and the Turn Over Tax (TOT) regime creating increased administrative burden and non-compliance of MSEs.	• To increase compliance, align the TOT limit (between KES. 1,000,000 to KES. 25 Million) with the VAT registration threshold of 5 Million to 15 million for the first year then KES 20 Million in Year 2 and KES 25Million in Year 3.	• The purpose of TOT is to have a simplified tax regime for the MSMEs where such sectors are not required to maintain complex records but only maintain turnover record. • Basic Micro, Small and Medium Enterprises (MSMEs) make a gross profit margin of 10%. The VAT on this is 1.6% (10%*16% VAT). Further, such businesses only make a net profit margin of approximately 5%. The income tax on this is equivalent to 1.5% (5%*30%) resulting to a total tax is approximately 3%. • To maintain the TOT effective tax rate at 1.5%, it is crucial to align the VAT threshold with the TOT. This will simplify the tax system for small businesses and encourage compliance by making the process easier for them
2.	Increase of costs of raw materials and intermediary materials by the increase of the IDF rate of from 1.5% to 2.5% by the Finance Act 2023 Section 68 (b)	• Revert the raw materials and intermediate goods that were under section 7 (2A) of the Miscellaneous Fees and Levies Act to 1.5% IDF	• Higher manufacturing costs translate into higher prices for consumers, leading to reduced purchasing power and potential declines in consumer demand.

			• Applying a rate of 2.5% to locally manufactured products increases the cost of locally produced items vs imports.
3.	Exemption of Taxpayers in perennial VAT refunds from Withholding VAT (WHVAT). A case for the petroleum industry is given, Since the provision for exemption was removed from the TPA Section 42, 4a, the industry has no solution to untie cash flow (working capital) held as a result of this tax administration provision. This has rendered business untenable for players which has seen 50% of the resellers close shop.	• Introduce the provisions exempting Taxpayers in perennial VAT refunds from Withholding VAT. The Taxpayers should demonstrate that due to the nature of their business, and due to the application of this section, they are going to be in a continuous credit position for a period not less than twenty-four months	• WHVAT is symbiotic with VAT and aims to benefit the traders. VAT is a margin tax, which means it is taxed on profits made by the business. • A case is given for the petroleum sector, the profits are less than the withholding tax which is at 2% of the taxable value of supplies. This was the reason players used to apply for exemption certificates on WHVAT.
4.	Reforms to enhance tax administration and compliance so as to ensure each taxpayer pays the rightful share of tax through reducing tax evasion and avoidance.	• Adoption of a five-year excise duty schedule/calendar to enhance stability in the excise duty and tax environment. • We propose excise increases of 1.5%, 3%, 3%, 3%, 3% for Financial Years 2025/2026 to 2029/2030 respectively, for cigarettes; products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application.	• This proposal promotes certainty and predictability of tax rates in line with the National Tax Policy, further allowing cigarette consumers to switch to better alternatives. It also aids in the fight against illicit trade where there is proliferation of tax evaded oral nicotine pouches. Cigarettes: • Apart from the financial year 2023-2024, excise duty has been adjusted, both by the Cabinet Secretary

			through the budget cycle and by the Kenya Revenue Authority, Commissioner General through the annual inflationary adjustment, resulting in a 51.3% cumulative excise increase from FY2018-2019 to FY2022-2023. During this five-year period, we have observed a decline in legitimate volumes and excise revenue collection. In particular, • In the financial year 2019-2020, when the excise rate was raised by 19%, the excise revenue collection for that year dropped by 3%; However, when there was no excise rate increase in the financial year 2023-2024, the excise revenue collection grew by 7% in the same period. • Therefore, an increase in excise does not necessarily translate to increase in revenue collection. Products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application (oral nicotine pouches)

			The tobacco harm reduction value of such nicotine products such as oral nicotine pouches and vapour products/electronic cigarettes, results from two widely acknowledged factors: ○ Based on the weight of evidence, products that contain nicotine are less risky than cigarettes; and are associated with reductions in smoking prevalence. ○ The combination of these two factors means that, if properly regulated and taxed, these nicotine products have the potential to significantly reduce the projected impacts of smoking related illness. • Given Kenya's progressive approach and position as a leader in the region, our Government has a real chance to lead in reducing tobacco-related harm, by enacting and implementing balanced and evidence based fiscal policies that consider the

			relative risk profile of less risky products in the country. • Further, the current tax structure that recognises the relative risk profile of nicotine products such as oral nicotine pouches should be retained due to the potential net public health benefit of those wishing to switch to less risk products. • The 5-year tax calendar for oral nicotine pouches. It will also encourage investment in these products, which will result in a net positive public health outcome, and generate government revenue.
5.	Inflation adjustment Formula	• Deletion of paragraph 2 of Part 1 of Schedule 1 (Rates of Excise Duty) on the adjustment of specific rate for inflation at the beginning of each financial year, in accordance with the formula specified therein,	• This will be in line with the Finance Act 2023 that removed the annual increases of the inflationary adjustments on specific products.
6.	Credit adjustment vouchers (CAVs)-Credit for input tax against output tax • Outstanding Refunds arising from zero rated supplies adjusted/ assessed using the	• Introduce provisions to allow for refund of excess tax arising from zero rated supplies adjusted/ assessed using the formula before 17th June 2019 under Legal Notice No. 86 published in the Kenya Gazette Supplement No. 84 dated 17th June 2019.	To address outstanding Refunds Arising from the previous VAT Formula under Regulation 8 (2) of the Value Added Tax Regulations, 2017 • In 2019, the National Treasury changed the VAT Formula to address the concerns arising from

	formula before 17th June 2019 under Legal Notice No. 86 published in the Kenya Gazette Supplement No. 84 dated 17th June 2019.	• The amendments should read as follows: Amend Section 17 (5) to introduce new sub-section (e) and provision to read as follows: (f) such excess arose from the formula before 17th June 2019 under Regulation 8 (2) of the Value Added Tax Regulations, 2017 and. (g) such excess arose from the formula before 17th June 2019 under Regulation 8 (2) of the Value Added Tax Regulations, 2017 may be applied against any tax payable under this Act or any other written law, or is due for refund pursuant to section 47(4) of the Tax Procedures Act, 2015; and "Provided further that, notwithstanding Section 17(5)(f), a registered person who prior to the commencement of Section 17(5) (e) and (f), has a credit arising from the formula under Regulation 8 (2) of the Value Added Tax Regulations, 2017, may make an application for a refund of the excess tax from the commencement date of the Regulations.	the Formula that disadvantaged exporters of taxable goods since they could not recover their input VAT and led to perpetual refund position by export manufacturers. • The change was made by replacing the Formula that determines the amount due as a refund to a registered person who makes taxable supplies at both the general rate and zero rate under Regulation 8 of the Value Added Tax Regulations, 2017. The new Formula has addressed the refund concerns. • However, the refunds arising from the old formula have not been addressed and have led to outstanding refunds. • After deducting VAT Refund, persons are still in refund position. When applying under the Itax System, capital expenditure, - Tax headings not

			there that is why they concentrate on export. This proposal seeks to: I. create a legal mechanism to facilitate payment of such outstanding refunds owed to manufacturers. II. Seek to have in place provisions recognizing refunds that can arise from the old Formula. III. Include retrospective provisions allowing for payments of prior claims from the date of the commencement of the application of the formula under the Value Added Tax Regulations, 2017 to the date of the new Formula which commenced in June 2019. IV. Provide for off set of refunds from the VAT Act and any other tax law. To address refund for excess input credit after VAT refunds are paid under the VAT Formula

			• There still exist outstanding refunds after Formula is utilized. • The refunds are attributable to capital expenditure such as machinery or spares. This is especially after VAT on machinery was introduced in April 2020 under the Tax Laws (Amendment) Act, 2020. • The ITAX system of KRA includes the requirement to upload capital expenditure items such as machinery and spare parts together with other manufacturing inputs. • There are three (3) possible solutions to address this challenge: i. Introduce legal amendments with provisions recognizing refunds arising after the VAT Formula is applied; or ii. Separate the capital expenditure items captured on the KRA Itax system which causes an increase in credit refunds; or Exemption of VAT on Machinery to ensure it is not captured under the ITax

			system as capital expenditure input items. The removal of VAT on machinery has benefits to the manufacturing sector such as promoting long term investments.
7.	High costs of aircraft maintenance in Kenya leading to the loss of jobs to our regional EAC neighbours as these services end up being outsourced by local airlines.	• Reinstate the zero-rated status of Direction-finding compasses, instruments and appliances for aircraft. • Reinstate the exempt status of aircraft spare parts imported by aircraft operators or persons engaged in the business of aircraft maintenance upon recommendation by the competent authority responsible for civil aviation.	• Introduction of 16% VAT on Direction-finding compasses, instruments and appliances for aircraft will result in higher cost for aircraft maintenance, which has a safety implication as the costs will be extremely high. • This will have a negative impact to local aircraft maintenance organizations since it will be cheaper to outsource maintenance activities in other countries within the region thereby making Kenya uncompetitive. This will result in the loss of jobs. • Increased costs will also discourage investors from registering aircraft in the Kenyan registry, which will impact revenue generated by the Kenya

			Airports Authority and Kenya Civil Aviation Authority in the form of fees and charges.
8.	• Amendments to the VAT Act 2013 through the Statute Law (Miscellaneous Amendments) Act, 2024 subjected the supply of denatured ethanol of tariff number 2207.20.00 to 16% VAT effective 25th April 2024. This has been very detrimental to the growth of the Ethanol Cooking Fuel industry by rendering it unaffordable to households. • Currently, there is a limited supply of bioethanol due to low investment in ethanol production, mechanization, low adoption of high-yield cane varieties, and insufficient areas under cane to support an increase in production.	• We propose to amend Part 1, Section A to the First Schedule of the VAT Act 2013 by inserting: “The supply of denatured ethanol of tariff number 2207.20.00”	• The supply of bioethanol was VAT-exempt from the Finance Act 2021, which enabled fast uptake of the KOKO Fuel solution amongst Kenyan households to where 1.3 Million households cook with KOKO Fuel. • The VAT exemption would directly result in lower consumer prices, which would enable significant demand growth and accelerated expansion into more urban areas and eventually into rural areas. • The growth of the local Ethanol industry will support the projected fuel demand which is projected to grow to 192 million litres per year by 2028, reducing the the current reliance on imports and improving income

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<tr><td></td><td></td><td></td><td>earnings for sugarcane farmers and the Sugarcane industry.</td></tr>
<tr><td>9.</td><td>The First Schedule to the Excise Duty Act is
(a) in Part I
Increase in the excise of cigarettes

<table>
<tr><td>Cigarettes</td><td>Current Rates (per mille)</td><td>Proposed Rates (per mille)</td></tr>
<tr><td>With filters (hinge lid and soft cap)</td><td>KSh. 4,067.03</td><td>KSh.4,100</td></tr>
<tr><td>Without filters (plain cigarettes)</td><td>KSh. 2,926.41</td><td>KSh.4,100</td></tr>
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Enhance predictability in tax increment and changes through adoption of a five year excise duty schedule/ calendar for cigarettes. We propose excise increases of 1.5%, 3%, 3%, 3%, 3% for Financial Years 2025/2026 to 2029/2030.
Urgently address the exponential growth of illicit trade currently (2024) at 37% (third party research) through targeted tax policy measures to seal tax revenue leakages in excise loss of KSh.7.5 Billion annually (at 37% illicit incidence) and a cumulative loss of KSh. 29 Billion in the last five years (FY2019/20 to FY2023/24).

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The Industry recommendation will ensure:
a) Predictability in the tax system;
b) Stability in government revenues;
c) Curb the rising illicit trade;
d) Safeguard the competitiveness of the Nairobi hub manufacturing facility; and
e) Aligned to the National Tax Policy developed in 2023 that entrenches predictability in tax legislations.
The impact of the proposed excise increase in the Bill will:
a) render tobacco manufacturing operations in Kenya uncompetitive;
b) jeopardize employment opportunities for 437 direct employees, 50 interns and more than 15,000 indirect jobs;
c) threaten the livelihood of approximately 1700 farmers; and
d) put at risk the $100 million annual foreign currency

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			generated by the industry for the country. • The proposed excise increase in the Bill will result in a 40% excise duty increase for cigarettes without filter. • We have observed that when there was no excise rate increase in the financial year 2023/24, the excise revenue collection by Government grew by 7% in the same period. However, when the excise rate was raised by 19% in the financial year 2019/20, the excise revenue collection dropped by 3%. Therefore, an increase in excise does not necessarily translate to increase in revenue collection. • Harmonizing the two tiers - while we recognize that that the Government is trying to enhance simplicity in taxation by harmonizing the two tiers and providing for one single rate for cigarettes, we note that this proposals comes at a time when there is exponential growth in illicit trade. Illicit trade in tax-evaded cigarettes:

			a) Has grown from 27% in June 2023 to 37% in June 2024 (third party research) with an estimated 1 in every 3 cigarettes smoked in Kenya being illicit and tax evaded; b) Resulting in a shrinkage of the legitimate cigarette market in Kenya; c) Further annual loss of excise revenue by Government of KSh.7.5 Billion (at 37% illicit incidence) and a cumulative loss of KSh.29 Billion in the last five years (FY2019/2020 to FY2023/2024); and d) Are primarily smuggled from Uganda where excise duty rates are almost half that of Kenya. • The sustainability of the legitimate industry is in a dire situation as a result of the impact of historical aggressive increases in excise duty coupled with enforcement efforts not resulting in significant change. • We believe that the Government needs to urgently address combatting illicit trade in tax-evaded cigarettes through decisive and novel

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(a) in Part I

• Products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application but excluding medicinal products approved by the Cabinet Secretary responsible for matters relating to health and other manufactured tobacco and manufactured tobacco substitutes that have been homogenized and reconstituted tobacco, tobacco extracts and essences from KSh. 1,595.00 per kg to KSh. 2000 per kg. (Also known as ‘oral nicotine pouches’).</td><td>• Enhance predictability in tax increment and changes through adoption of a five-year excise duty schedule/ calendar for products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application.

• We propose excise increases of 1.5%, 3%, 3%, 3%, 3% for Financial Years 2025/2026 to 2029/2030 for products containing nicotine or nicotine substitutes intended for inhalation without combustion or oral application.

<table>
<tr><td rowspan="2">Oral nicotine pouches:

Current Rates (per kg)

2024</td><td colspan="5">Proposed Rates per kg</td></tr>
<tr><td>FY 2025 - 2026

@1.5%</td><td>FY 2026 - 2027

@3%</td><td>FY 2027 - 2028

@3%</td><td>FY 2028 - 2029

@3%</td><td>FY 2029 - 2030

@3%</td></tr>
<tr><td>KSh. 1595</td><td>KSh. 1618</td><td>KSh. 1667</td><td>KSh. 1717</td><td>KSh. 1769</td><td>KSh. 1822</td></tr>
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</td><td>• The industry recommendation will:
a) promote certainty and predictability of tax rates in line with the National Tax Policy;
b) further allowing cigarette consumers to switch to better alternatives;
c) encourage investment in nicotine products, which will result in a net positive public health outcome, and generate government revenue; and
d) aids in the fight against illicit trade where there is proliferation of tax evaded oral nicotine pouches.
• The proposed change in excise increase in the Bill will result in a 25% excise duty increase in oral nicotine pouches.

• The tobacco harm reduction value of such nicotine products such as oral nicotine pouches and vapour products/electronic cigarettes,</td></tr>
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			results from two widely acknowledged factors: a) based on the weight of evidence, products that contain nicotine are less risky than cigarettes; and b) are associated with reductions in smoking prevalence. • The combination of these two factors means that, if properly regulated and taxed, these nicotine products have the potential to significantly reduce the projected impacts of smoking related illness. • Given Kenya's progressive approach and position as a leader in the region, our Government has a real chance to lead in reducing tobacco-related harm, by enacting and implementing balanced and evidence based fiscal policies that consider the relative risk profile of less risky products*[1] in the country. • Further, the current tax structure that recognises the relative risk profile of

			nicotine products such as oral nicotine pouches should be retained due to the potential net public health benefit of those wishing to switch to less risk products.
11.	Without the amendment of Section 14 of the Excise Duty Act; excise duty is effectively charged multiple times during the production process—once on the packaging materials and again on the finished goods. This double taxation inflates production costs, ultimately increasing the final price to consumers and compounding the tax burden.	• Amend the clause 14.(1) Where excise duty has been paid in respect of excisable goods imported into or manufactured in Kenya by a licensed manufacturer and which have been used as raw materials (including packaging materials) in the manufacture of other excisable goods (hereinafter referred to as "finished goods"), the excise duty paid on the raw materials shall be offset against the excise duty payable on the finished goods.	• The proposal to include packaging materials in Section 14 to offset excise duty on raw materials aligned with both economic principles and international best practices, ensuring a more equitable tax regime. • Globally, excise duty is regarded as a consumption tax intended to be borne by the final consumer. Allowing an offset for packaging materials ensures alignment with international best practices by preventing intermediate producers from bearing undue tax burdens. • The ability to offset excise duty on packaging materials will lower manufacturing costs, enabling producers to price their goods more competitively, particularly in

			domestic and international market. • Allowing the offset enables manufacturers to claim input excise tax, alleviating cash flow constraints and thereby strengthening their financial stability and operational efficiency.
12.	*New Clause* *Amend First Schedule of the Excise Duty Act under part I by deleting the paragraph (together with the corresponding rate) that reads: -* *Imported Glass Bottles (excluding imported glass bottles for packaging of pharmaceutical products) provided that it shall not apply to glass bottles imported from any of the countries within the East African Community- Rate of excise duty 35%.*	• Amend Paragraph 1 of Part I of the First Schedule to the Excise Duty Act, 2015 to delete the following item — Description Rate Imported Glass 35% bottles (excluding imported glass bottles for packaging of pharmaceutical products) • To safeguard local glass manufacturers, define a quota uptake of locally manufactured glass bottles before importation.	• Imposing excise tax on glass is in violation of COMESA Treaty provisions on most favoured nation treatment and provisions that prohibits Member States from enacting legislation or applying administrative measures which directly or indirectly discriminate against the same or like products of other Member States • Kenya has only two glass manufacturers with a total installed production capacity of 90,425 tonnes/annum against a higher demand by glass users in

			Kenya, necessitating the need to import. • Finished goods coming in glass packaging is more affordable that those manufactured in Kenya due to this tax, making locally produced goods uncompetitive. • Local glass industry is currently uncompetitive compared to other glass manufacturers in Africa mainly due to factors outside the industry control such as high cost of power. The challenge is compounded by the lack of adequate local capacity to provide high quality affordable glass bottles efficiently and reliably. In fact, one of the local glass manufacturers is importing glass bottles from Egypt to supplement local capacity and is affected by the increased taxation. • The tax was introduced to resolve the challenge of undervaluation of imported glass leading to loss in

			government revenue. However, it has increased the cost of raw materials for compliant importers without guaranteeing that the right taxes are paid on imported glass. • Glass packaging is now more highly taxed than the least environmentally friendly plastic packaging (at 10% excise). If Kenya can reduce excise duty on imported glass it will be able to promote sustainable and environmentally friendly forms of packaging, prevent import substitution effect and switching to plastic packaging.