PARLIAMENTARY SERVICE COMMISSION

PARLIAMENTARY BUDGET OFFICE

ANALYSIS OF THE FINANCE BILL, 2018

August 2018

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Acknowledgements

This analysis of the Finance Bill, 2018 has been prepared by the Parliamentary Budget Office under the overall guidance of the Director, Mrs. Phyllis N. Makau assisted by the Senior Deputy Director, Mr. Martin M. Masinde. The report has been authored by Mr. Robert K. Nyaga, Deputy Director and Mr. Josephat O. Motonu, Fiscal Analyst. Comments from the other members of staff in the Office are also recognized.

1. INTRODUCTION

The total projected expenditure and net lending (excluding debt redemptions) for 2018/19 amounts to KSh. 2.53 trillion. The expenditure will be financed through ordinary revenue (KSh. 1.74 trillion) and Appropriations-in-Aid (KSh. 0.18 trillion). Expected external grants will amount to KSh. 0.05 trillion, bringing the total revenue to KSh. 1.97 trillion. This leaves a fiscal deficit of KSh. 0.56 trillion to be financed through debt. The proportion of revenue estimates to GDP for 2018/19 is 19.6%, which is equivalent to that of the 2017/18 budget.

The revenue estimates comprise of expected growth in tax revenues associated the existing tax laws, tax rates and tax administration and the planned revenue enhancing proposals contained in the Finance Bill and ongoing reforms by the Kenya Revenue Authority. Ongoing tax enhancing reforms include: tax administration reforms through the modernizing of Value Added Tax (VAT) systems, reducing zero rated products through the recently enacted Tax Laws (Amendment) Act, tax base expansion through targeting nil and non-filers, ensuring that all national and county government suppliers are tax compliant, reducing diversion of transit cargo through electronic cargo tracking system, and improved customs systems and border control. Further, the planned repeal of the Income Tax Act is expected to positively influence the collection of income taxes if substantial tax waivers and exemptions are removed.

The projected budget financing estimates of revenue can only be fully met if the revenue enhancing measures are fully implemented. Revenue enhancement measures should however result in net tax yield by curbing the proliferation of tax waiver, remission and exemption schemes. Costly tax waivers and exemptions are sometimes given without adequate scrutiny of their revenue effects, and sometimes without participation of the National Assembly or the public. It is estimated that tax and duty waivers on sugar, maize, milk and fertilizer may have cost at least KSh. 30

billion in forgone revenue in 2017 alone. The solution to this problem lies in closer scrutiny and approval of all proposed waivers and exemptions by the relevant Committees of the National Assembly before their effective date. At the same time an evaluation being made on whether such tax waivers are passed on to the consumer.

This analysis of the Finance Bill, 2018 evaluates the revenue enhancing aspects of the tax related proposals and their likely wider effects on the economy, sectors of the economy, regional economies, and social groups. Tax measures whose projected impact tends to distort existing business activities or is unduly burdensome to tax payers or distortionary to the economy is highlighted and may be considered for review. The analysis in particular isolates several measures which may require greater scrutiny owing to their expected impact on the economy. These include the proposal to introduce a charge on the value of a transfer of money by banks for amounts exceeding Ksh. 500,000 ("Robin Hood" tax (Clause 31(b)) and the proposed removal of the 2016 interest rate regulation (Clause 58).

2. THE MAIN THRUST OF THE FINANCE BILL, 2018

This Finance Bill, 2018 contains various changes to the Income Tax Act, VAT Act, Excise Duty Act, Miscellaneous Fees and Levies Act, Tax Tribunal Act and Tax Procedures Act. Changes on tax rates or tax measures are estimated to yield at least Ksh. 30 billion. The Bill also introduces various tax incentives which are principally meant to spur economic growth as well as support the government's "Big Four" economic plan in the areas of ensuring food security, construction of affordable housing, provision of universal healthcare and increasing the share of manufacturing for value addition and job creation. However, the Bill includes various tax exemptions under the VAT Act which may reduce the net tax increase from the sum of measures contained in the Bill. The Bill contains non-tax miscellaneous proposals comprising of

proposed amendments to several financial sector laws. The primary proposals in the Finance Bill are discussed in the sections below. Some of the proposals have been costed and revenue estimates provided in the brief. Clause-by-Clause account of each provision in the Bill is presented in the appendix.

2.1 Amendments to the Income Tax Act

i) Demurrage Charges: Clause 2 relates to the introduction of demurrage charge paid to non-residents at the rate of 20%. This presents expected additional revenue. The tax rate will likely increase the cost of demurrage if the shipping lines pass on the charge to customers. Since demurrage charges are a penalty for inordinate delays with shipping and transport equipment by traders, it is possible that such charges could encourage efficiency at the port of entry for the greater benefit of the entire importation chain. However, it will potentially increase the cost of imports if prevailing inefficiencies and other factors contributing to delays with transport equipment at the port are not reduced. This could also provide an opportunity for shipping agencies to seek alternative ports.

ii) Charge on insurance premiums paid on imports- Clause 5: The Bill proposes to levy insurance premiums paid by residents on shipping insurance offered by foreign companies at a rate of 5%. Recently, the government allowed local insurance companies to offer maritime insurance. The effect of this measure varies due to the risk complexities of marine insurance. It is estimated that about KSh. 3.8 billion is paid as premiums to foreign marine insurers. Therefore this measure is estimated to raise an additional KSh. 190 million.

iii) Definition of Dividends: The Bill further extends the definition of "dividends" and how profits or gains will be taxed where dividends are distributed without paying full taxes (Clause 3 and 4). The definition of dividend in

terms of taxation will now include any creative arrangements such as any benefit to a shareholder, debt waivers, waivers of obligations measurable in money, among other benefits given by a company to a shareholder, whereby the effect of such benefits is to reduce tax liability.

iv) The Bill further simplifies how a tax shortfall by a domestic company arising from distribution of dividends to shareholders can be recovered (Clause 4). This may apply where a company has not paid corporate income taxes on profit or gains in given income year due to any form of tax waiver, tax incentive, or exemption but goes ahead to pay dividends to shareholders. This tax design which is sometimes referred to as "compensating tax" together with the extended meaning of what a dividend is will ensure that companies do not transfer government tax incentives, which amounts to forgone tax revenue, issued to them to shareholders.

v) Presumptive tax on small businesses – Clause 6: The Bill seeks to replace the Turnover Tax (ToT) which is currently at 3% of gross receipts, with a presumptive tax (PT) at 15% of the amount payable under the business permit or trade license issued. "Turnover Tax" was introduced in 2007 to bring the informal sector whose annual turnover is less than five million Kenya Shillings into the tax bracket. Nonetheless, this tax has posed administrative challenges owing to the difficulty of self-assessment of the small and medium enterprises in the informal sector. The proposal will be easy to implement and could yield an estimated tax of KSh. 625.5 million, slightly higher than the current turnover tax system.

- However, determination of the KSh. 5 million turnover thresholds is still likely to be a challenge for the proposed presumptive tax just like it has been for the turnover tax. The Bill does not state how the tax will be collected given that it is indirectly linked to the business permits and licenses issued by county administrations.

Given that local administrations tend to have better information about local businesses it could be useful for the National Government to explore ways to leverage this capacity in expanding the tax net to the elusive informal sector.

- The proposed tax is based on presumption of income and of profit, but this is unlikely to be a cautious way to tax start-ups, small, and fairly vulnerable businesses. Greater tax payer education and campaigns should be mounted to encourage voluntary self-assessments by the informal sector.

vi) Incentive to manufacturers – Clause 7: The Bill introduces additional allowable deduction of 30% of the electricity bill to manufacturers as an incentive to boost manufacturing, value addition in processing and creation of jobs. The effect of this incentive is to reduce tax payable by such firms due to increased deductible expenditures. The proposal will marginally reduce taxable profit. Recently the government offered lower electricity tariffs to large manufacturers operating during off peak hours. These measures, however, do not address the original matter of why electricity tariffs in Kenya are quite expensive and uncompetitive relative to major economies in Africa

vii) Capital Gains Tax on property transfers by general insurance businesses – Clause 8: A further proposal relates to the introduction of Capital Gains Tax at the rate of 5% on the transfer of property by the general insurance businesses. Purchase and sale of property is emerging as a major area of income insurance companies alongside the usual insurance business. The purpose of the proposal is to ensure gains from property investments by companies in the insurance business do not go un-taxed. This presents a measure to broaden the tax base and yield additional revenue estimated at KSh. 380 million to finance the budget.

2.2 Amendments to the Value Added Tax Act

i) VAT Exemption (Clause 18): The Bill proposes to include a few more items in the VAT exemption list. The new items include: raw materials for animal feeds, wheat & meslin and barley seeds, plant & machinery for manufacture of goods, equipment for wind energy, computers, equipment for hospitals and grain storage facilities in addition to construction materials and also alcoholic and non-alcoholic beverages supplied to the Kenya Defence Forces Canteen and also goods and services supplied for exclusive use under special operating financial arrangements with government.

ii) VAT Exemption (Clause 18): Some of the services included in the VAT exemption regime include postal services and subsidiary services. Postal companies have seen major downturn in business due to internet, digital and e-commerce services. This measure may assist postal services to deal with international postal services and may also enhance their businesses.

iii) Standard rated products (Clause 18): the Bill proposes to exclude some items from the VAT exemption regime. These include: maize (corn) seeds, transportation of cargo outside Kenya as well as garments and footwear manufactured at the Export Processing Zones at the point of importation to the local market. The proposal to place VAT at 16% on items sold to the local market from the Export Processing Zones will ensure some fairness for manufacturers who make similar items in the domestic economy but who do not benefit from the incentives offered to the firms operating in the Export Processing Zones.

iv) Zero-rating (Clause 19): Under the VAT zero rating regime, the Bill seeks to replace the general provision on medicaments containing alkaloids or their derivatives with the specific alkaloids for clarity and ease of administration.

v) Proliferation of tax incentives: Despite the overhaul of the VAT system 2013, which included removal of numerous tax waivers, exemptions and remission, there are concerns that the waivers and exemptions are coming back through the Finance Bill in recent years. The incentive system should be weighed against their efficacy, intended benefits, relative to revenue loss and stability of the tax system.

2.3 Amendments to the Excise Duty Act

i) Inflation Indexing: The Bill seeks to change adjustment for inflation applicable to specific duties under Excise Duty Act from the two year period provided for in the current law to yearly adjustment (Clause 31). The Excise Duty Act, 2015 dropped the *ad valorem* rates for some products in the former excise duty regime. Periodical adjustment for inflation seeks to prevent erosion of taxes caused by rising inflation. Increasing the frequency of inflation indexing will ensure the excise tax yield responds to changes in price of products attributable to inflation in the preceding year. This therefore reduces the lag or delay in changing the tax charge.

However, this mode of inflation indexing may cause persistence of previous year's inflation during the year when the tax charge is applied. Whether the inflation charge causes higher or lower prices of goods targeted will depend on the rate of inflation applied. The likely demerit of this measure is that it may introduce frequent changes in prices of goods and services affected by the inflation charge with possible effects on business planning.

ii) Taxation of Kerosene: the Bill proposes to increase the specific tax rate on illuminating kerosene from the current KSh. 7.205 per litre to KSh. 10.305

per litre. This represents a 43% tax rate increase which is likely to yield about KSh. 1.395 billion. The reason this measure, which is potentially expensive to low income users of kerosene, is that kerosene is used for the adulteration of petrol and therefore an increase in tax will make it unattractive.

Since kerosene is a major source of energy for cooking and lighting by low income citizens, then an alternative energy source such as the planned provision of the subsidized LPG gas to low income households could help offset the tax pain.

iii) Excise duty on mobile money transfer: The Bill proposes to increase the excise duty on mobile money transfer services from the current 10% to 12%. Further, 16% of this tax will be paid into the Sports, Art and Social Development Fund to be applied to support social development initiatives such as universal health care among others.

This measure of deepening the tax base is likely to enhance revenue yield estimated at additional KSh. 1.56 billion and it is also easy to administer. But, the tax measure will lead to a rise in prices of mobile money transfer services. Further, the fairness of the proposal may be assessed in view of the fact that the tax base may be expanded by focusing on new untapped potential areas such as taxation of activities which are operating in the digital platforms.

iv) **Tax on higher value money transfers by banks**: The bill introduces a variant of "**Robin Hood Tax"** at the rate of 0.05% on the money transfer of KSh. 500,000 and above, by banks and other financial service providers. (Clause 32). The proceeds will also be paid into the Sports, Art and Social Development Fund to be applied to support social development initiatives.

It is noted that there is lack of clarity as to what exactly constitutes **a transfer by a bank** or financial service provider. The provision seems to include any movement of bank funds, potentially client funds from one account to another, or from one institution to another within the Kenyan financial system or externally. Typically, some of the transfers should not be subject to taxation. Examples may include interbank transfers for purposes of interbank lending, transfers associated with domestic debt market participation (purchases of government securities) by banks, transfers to the Central Bank during normal banking operations, among others. Additionally, this measure seems to target the core of banking liquidity management operations. This could generate likely negative effects on liquidity distribution in the financial markets and broadly affect financial intermediation.

The current wording of the Bill seems to deviate from common "Robin Hood" variants implemented in developed countries, and therefore out of sync with the international application of "Robin Hood" tax financial sector transactions. Transfer of money by a bank does not constitute a transaction associated with an underlying benefit by a financial institution. Thus, a charge under the class of Robin Hood tax should be attached to the transfer of an underlying asset or on the asset itself. A typical example of Robin Hood tax is, say, a small tax rate on derivative transactions or a tax on certain assets held by banks. The rationale for such a tax ought to be laid out well to fit the purpose of a "Robin Hood" tax, which is to tax the "untaxed" aspects of a highly profitable financial sector and the transfer of such benefits to the less fortunate.

In this respect the proposal in the Bill wrongly assumes the presence of positive externalities or benefit to banks associated with the quantum of money transfer, when in practice the transfer could amount to mere bookkeeping and liquidity management transactions within a bank,

within the financial system, or in case of bank clients, the movement of funds from one account to another for purposes of business and daily trades. Targeting the quantum of transfer with no reference to underlying value creation associated with the transfer drastically deviates from the ordinary taxation principles.

v) Excise duty on high capacity petrol and diesel vehicles: passenger motor vehicles with compression ignition internal combustion piston engine which run on diesel or semi-diesel and others with cylinder capacity exceeding 3000cc and with engine capacity of 2,500 cc for petrol and diesel respectively, will be charged duty at the rate of 30% up from the current 25%.

vi) Duty on sugar confectionary: Sugar confectionery including white chocolate not containing cocoa, chocolate and other food preparation containing cocoa that is either filled or unfilled among will attract duty of KSh. 20 per kilogram as proposed in the Finance Bill.

vii) With regard to the taxable supplies of alcoholic and non-alcoholic beverages to the Kenya Defense Forces Canteen, the Bill proposes to exempt them from excise duty.

2.4 Amendments to the Tax Procedures Act

i) The Bill proposes to allow the Commissioner, on application by a person required to make tax returns, to extend time for filing tax returns by 15 days in case of monthly returns and 30 days for taxpayers for those who submit returns annually,. The Commissioner General is required to notify the applicants 5 days to the deadline day, otherwise the application for extension of time is presumed granted. This will allow additional time for compliance even though there exists no evidence that the current period allowed for filing tax returns is insufficient.

ii) The Bill seeks to clarify some aspects of the amnesty on repatriation of income earned outside Kenya. The Amnesty is applicable to any year of income ending on 31st December 2017. The Bill in particular seeks to prevent the Commissioner from assessing, recovering or placing taxes or penalties, or following up on sources of income where the income was declared for the year 2017 and where the returns and accounts for the year of Amnesty (2017) are submitted by June 30, 2019. This clearly allows beneficiaries of the amnesty to submit returns by June 2019. The income should have been declared in 2017 but funds need to have been transferred during the amnesty period otherwise the Bill allows a further 5 years for remittance subject to a 10% penalty on the remittance.

However, there is a proposed exemption from scrutiny by relevant institutions such as the Financial Reporting Centre, regarding the source of money declared and remitted back into the country, as long as the source is not proceeds of poaching, drug trafficking and terrorism. This proposal may include proceeds from corruption which would naturally fall within the category of illicit financial proceeds.

iii) Late payment of tax: The Bill proposes to place a penalty of 20% of the tax payable and a further 2% interest per month on late payment of tax. This punitive measure is meant to reign on the persons who deduct tax from taxpayers but fail to remit it to the revenue agency in the stipulated timelines.

iv) The late submission of tax returns penalty has been categorized into three. For VAT and Excise Duty it will be the amount higher of either 5% of the tax due or KSh. 10,000. *The penalty for companies will be 5% of the tax due or KSh. 20,000 and individuals will 5% of the tax due or KSh. 2,000*; whichever is higher for all the cases. The current penalty for late submission of tax returns for employment income still remains at 5% or KSh.

10, 000 whichever is higher. The proposal seems to favour the late submission of the nil tax return.

2.5 Amendments to the Miscellaneous Fees and Levies Act

i) Incentives to the SEZs: The Bill proposes to provide export incentives to the nascent Special Economic Zones (SEZ) sector similar to those given to the Export Processing Zones. This is an incentive meant for the licensed Special Economic Zone operators or developers. The primary effect of this proposal is that the SEZs, which operate under a more liberal customs control regime than EPZs, will be allowed to access greater incentives which could pose greater competition with exporters outside either the EPZ or SEZ systems. Though, these incentives can help the country achieve greater export growth, it is critical to equally consider how ordinary exporters can be supported.

ii) Export levy on certain metals: The Bill proposes to impose an export levy on copper waste and scrap at the rate of 20% so as to discourage exportation. This measure is targeted at the retention of the raw materials for the local manufacturers and to discourage the perennial problem of vandalism of public infrastructure.

vi) Exemptions for Special Operating Frameworks: The Bill further proposes a tax exemption of 2% of customs value and 1.5% of customs value in relation to the Import declaration Fees and Railway Development Levy, respectively, for goods imported for exclusive use under special operating framework arrangements with the Government. This further extends the growing tax incentive regime system for infrastructure and other projects where the Government has entered into special arrangements. Even though these incentives may reduce the cost of projects or even improve delivery of public projects, the incentive regime is a major source of revenue underperformance. To mitigate the effect of the incentive

proposal on IDF and RDL revenue yield, the meaning of "special operating framework arrangements" should be exhaustively defined and limited to only deserving cases.

3. MISCELLANEOUS AMENDMENTS TO OTHER STATUTES

3.1 Banking Act: Repeal of the Interest Rate Cap

The Bill proposes to repeal Section 33B of the Banking Act which provides for the enforcement of the interest rate ceiling, effectively removing the interest rate controls introduced in 2016. Interest rate capping was designed to protect borrowers from seemingly exploitative high interest rates while providing savers with minimum interest earnings for their deposits. It was expected that lower interest rates could boost credit to small businesses and individuals. Available evidence shows that the effect of the rate is mixed. Notably, credit to the private has slowed down relative to that to government. Credit to government grew by 27.2% in the first 10 months of 2017/18 financial year relative to credit to the private sector, which grew by only 2.1%. Similarly, credit access appears to be more constrained for predominantly small business sectors such as those in transport, communication.

Additionally, preliminary information indicates that monetary policy flexibility is constrained by the rate cap due to the direct link between the Central Bank Rate (CBR) monetary policy rate with maximum lending rates and deposit rates. The interest rate controls, however, brought the average lending rates from about 16-18% before the cap to maximum 14%, effectively reducing the cost of credit.

A preliminary review of various aspects of the law shows that some of the primary goals of the interest rate controls are yet to be achieved, or may have been achieved at the cost of access to credit and the broader

economic performance. A review of interest rate control regime or its design could therefore help balance the cost of credit, access to credit, protection of borrowers, and sustainability and health of the banking system. **The removal of the interest rate cap, as is proposed in Clause 58 of the Finance Bill, without immediate protection of borrowers is therefore not advised.**

It is clear that protection of the borrower and depositor simultaneously overly constricts bank operations, negatively affecting intermediation of savings to the productive sectors of the economy. The minimum deposit rate tends to increase the cost of bank deposit mobilization, while at the same time removing funds from other investments to the term or fixed deposits. Equally, maximum lending rate tends to curtail overall lending or reduces lending to some sectors. This means that a substantial portion of resources available for lending are not allocated to borrowers for investment or consumption. Thus, the interest rate capping as currently designed is inappropriate for a dynamic and competitive financial sector. Some aspects of the law can be reviewed in the following way.

To solve this problem, a set of interventions can be implemented to see a sustainable growth in affordable credit and sustenance of a healthy, strong and competitive banking system. The review of the interest rate cap should integrate some level of interest rate decontrol with strong aspects of consumer protection. These measures should include delinking the direct determination of lending and deposit rates with the CBR, removing the deposit floor, setting a maximum lending rate (or for various classes of credit) with some flexibility, and regulatory measures to make cost of credit cheaper.

The maximum lending rate can therefore be determined as the maximum rate above a rate equivalent to the Kenya Bankers Reference Rate to be set by the Central Bank of Kenya plus a constant or margin. To anchor the regime of lower interest rates, the constant or margin above the KBRR may not vary per bank or lender as was the case before the interest rate

capping, but can be set by the Central Bank of Kenya as the maximum allowable margin by any Bank (or lender) above the KBRR. Alternatively, the margin can be set in the law. This framework, combined with the removal of the deposit floor, can allow banks to price loans at any point up to the maximum lending rate. The KBRR may be determined regularly taking into account the rates on risk free government securities, CBR, and the prevailing economic expectations.

In sum, a ceiling on lending will protect borrowers from potential explosive interest rates if the cap was removed, while the removal of the deposit floor will give flexibility to banks to price their loans.

3.2 Betting, Lotteries and Gaming Act

The proposed amendment to the Principal Act seeks provide an elaborate criteria for licensing and issuance of permits. It is noted that the marginal note/title of the new provision is about casinos but the body does not mention anything to do with casinos, thus may need to be harmonized. Also the penalty prescribed for falsification of declaration is an amount not exceeding KSh. 5,000 or imprisonment of a term not exceeding 6 months, which appear not sufficiently punitive and may be considered for a review.

The amendment further earmarks the gambling taxes; betting, lotteries, gaming and price competition to be paid into the Sports, Art and Social Development Fund. Earmarking of revenue, alongside earmarking of expenditure, tends to reduce allocative flexibility of the pool of resources available to the government in any financial year. This means that a chunk of revenue will be tied to certain projects, which means that such taxes cannot be reviewed or varied easily without varying the expenditure side. Further, earmarking creates entitlements and may reduce efficiency of resources during times of resource constraints and emergencies.

Further, the Bill seeks to impose a late payment penalty of 20% of the gambling tax which is due and payable as well as the additional interest at 2% per month for the period the tax remains unremitted. This is likely to enhance prompt remittance of tax after deductions have been effected.

It is also worth noting that these four categories of taxes have been effective since January 2018. However, an amendment was effected through the Finance Act of 2017 which excluded them from being paid into the Consolidated Fund. It may therefore be of interest to establish the final destination of the revenue that has been collected thus far.

3.3 Marine Insurance Act

The proposed amendment seeks to harmonize the Marine Insurance Act with the Insurance Act by clarifying that registration of marine cargo insurers is done by the Commissioner of Insurance appointed under the Insurance Act.

3.4 Air Passenger Service Charge Act

The proposed amendment introduces the Tourism Promotion Fund as another beneficiary of the of the passenger service charge in addition to the current two beneficiaries; the Kenya Airport Authority and the Kenya Civil Aviation Authority.

Currently, this charge is about KSh. 5,000 per external and KSh. 600 for local journey tickets which is paid into the Kenya Airports Authority Fund, for the Cabinet Secretary to apportion among the beneficiaries. This charge for Kenya, having been increased in 2016, is among the highest compared to other worthy competitor countries in the aviation industry in Africa such as Ethiopia (about KSh. 3,000 and KSh. 130 for foreign and domestic tickets respectively) and South Africa (KSh. 2,600 and KSh. 900 for foreign and domestic tickets respectively), among others.

Ideally, the air passenger charge, according to the international aeronautical standards, is supposed to be charged and applied in the civil

aviation related activities and relevant supporting operations. Therefore, it may be ascertained whether the proposed inclusion of Tourism Promotion Fund as one of the beneficiaries fits into the auxiliary activities in aviation.

3.5 Stamp Duty Act

Additional tax incentive is proposed by way of exempting licensed operators and developers in the Special Economic Zones from payment of the stamp duty. The other exemption is on an instrument that is executed for collection and recovery of tax. The first proposal is an incentive to support the housing agenda in the "Big Four" economic plan. However, it might be prudent to arrange a specific package with a clear focus rather than the generality.

3.6 Central Bank of Kenya Act

The proposed amendment intends to introduce a mortgage financing business and give the Central Bank the mandate of licensing, regulating and supervising the business. This may be linked with the proposed National Housing Development Fund proposed elsewhere in the Bill.

The other one relates to expanding the latitude of the Central Bank by providing that in addition to making of regulation for the implementation of the Act, it can also issue guidelines, circulars and directives.

3.7 Kenya Revenue Authority Act

The proposed amendment seeks to the inclusion of the Public Finance Management Act, 2012, as among the written laws relating to revenue. The First Schedule of the Act presents several other laws in this category.

3.8 Retirement Benefits Act

The amendment introduces penalties for failure to submit the audited accounts to the Retirement Benefits Authority by:

- Trustee - KSh. 100,000 and KSh. 1,000 every day the records remain un-submitted
- Fund Manager - KSh. 10,000 and KSh. 1,000 every day the records remain un-submitted.
- Fund Administrator - KSh. 10,000 and KSh. 1,000 every day the records remain un-submitted.

There is also an additional penalty for un-remitted contribution at the rate of 5% interest or KSH. 20,000 whichever is higher and the scheme is required to submit to the authority, remedial plans or wind-up the scheme.

3.9 Employment Act

The amendment introduces contribution by both the employers and employees into the National Housing Development Fund as follows:

- Employer – 0.5% of the employees gross pay per month.
- Employee – 0.5% of the earnings deducted from the employee's earnings.

It is estimated that this measure will yield approximately KSh. 19.928 billion annually. But then, it needs to be determined whether employee's housing is really a public good or an externality matter. Ideally, a public good is one whose utilization, enjoyment or consumption is non-rival and non-excludable. Examples include public health, education, security, roads, welfare programmes and research & development.

Externality manifests itself when an action causes an effect to those ones who did not cause it and a corrective measure is required to be effected by the causer and not everyone else. This seems to resonate with the housing phenomenon, thus any participation ought to be voluntary by individual workers as opposed to mandatory contribution.

3.10 Accountants Act

The proposed amendment seeks to harmonize the Principal Act with the Constitution of Kenya, 2010 by redefining the term "minister" and also

referencing the usage of term "company" to the relevant statute, which the Companies Act.

3.11 Proceeds of Crime and Anti-Money Laundering Act

There is a proposed introduction of stringent measures on conducting any business transactions with countries considered risky according to the Financial Action Task Force. In addition, the Sacco's Society Regulatory Authority (SASRA) has been included among the supervisory bodies for the purpose of mutual sharing of information between the Financial Reporting Centre and the supervisory bodies when conducting any investigation or for the enforcement of the law.

Currently, several supervisory bodies in the financial sector are required to receive information from reporting institutions which includes all transactions exceeding USD 10,000 or its equivalent in other currencies, for onward reporting to the Financial Reporting Centre. They are: the Central Bank of Kenya, Insurance Regulatory Authority, Betting and Control Licensing Board, Capital Markets Authority, Retirement Benefits Authority, NGO Coordination Board and Estate Agents Registration Board.

3.12 Tax Appeals Tribunal

The first amendment specifies that the absence of a member of a tax appeals panel will not cause an adjournment since the chairperson has been granted powers to make a replacement. The second one seeks to provide for a mediation window outside the stipulated period for hearing and determination of the tax appeals matters, which is 90 days.

ANNEX 1: DETAILED ANALYSIS OF THE CLAUSES

Clause		Proposal & Implication	PBO Remarks*
PRELIMINARY			
1.	Short title and commencement.	It is worth noting that all the proposed amendments in the Excise Duty, Value Added Tax, Tax Procedures and most of the Income Tax Acts are deemed to be effective from 1st July, 2018, thus, the proposed taxes are already being collected before consideration of the Bill by the Legislature.	The validity of this clause may be assessed on its conformity with Articles 2, 10, 116, 201 and Part 2 of the 6th Schedule of the Constitution in addition to Section 6 of the Public Finance Management Act, 2012.
INCOME TAX ACT			
2.	Amends Section 2 on interpretation	Introduces a new definition of demurrage charges.	It is intended for the new proposed tax on demurrage charges for non-resident persons.
3.	Amends Section 7 which provides for income from dividends.	The proposal extends the coverage of dividend to include any arrangements by companies which may make adjustments on dividends between company and shareholders with the goal of reducing their tax incidence.	The dividends will cover debt settlement even for third parties of shareholders, company expenses to shareholder and transactions that may occasion assets or dividend adjustments. This is likely to deepen the dividends tax base.
4.	Amends Section 7A on dividend tax account.	The proposed amendment seeks to shift taxation of dividends distributed out of untaxed gains from the current compensating tax to corporate income tax.	The proposal is designed to ease how profits or gains are taxed where a corporation pays dividends to shareholders without fully paying corporate taxes on

			the distributed income
5.	Amends Section 10 of the Principal Act on income from management/professional fees, royalties, interest and rents.	Introduces demurrage charges and insurance premium tax at the rates of 20% and 5% respectively, for non-residents, into the tax net.	These measures are intended to expand the tax base and facilitate collection of additional taxes to finance the budget.
6.	Amends Section 12C which established the turnover tax at the rate of 3% of total receipts.	The proposed amendment seeks to replace the current turnover tax with presumptive tax at the rate of 15% of the amount liable for business permits or trade licences.	Turnover tax presented administrative difficulties due to the nature of the taxpayers. So shift to presumptive tax is easy to implement if KSh. 5M threshold is well determined.
7.	Amends Section 15 which provides for the allowable tax deductions	Proposes deduction of 30% of electricity bill from manufacturers' corporation profit for the purpose of tax calculation.	The measure is meant to incentivize manufacturers to support the one of the "Big Four" economic plan.
8.	Amends Section 19 which provides for ascertainment of income from insurance companies.	The proposed amendment introduces capital gains tax at the rate of 5% on transfer of property by insurance companies for general insurance business.	This will broaden the tax base, thereby enhancing revenue yield.
9.	Amends Section 34 which provides for the rates of taxes.	Introduces demurrage charges and insurance premium tax for non-residents into the tax bracket.	This clause may be considered for review to correct inaccurate referencing.
10.	Amends Section 35 which provides for deduction of tax from certain income.	The amendment provides for collection of demurrage charges and insurance premium for non-residents and also specifies that tax on winnings is to be paid into the	It is noted that proposed amendment on the payment of tax on winnings into the Sports, Arts and Social Development Fund seems to reference the Tax

		Sports, Arts and Social Development Fund.	Laws (Amendment) Bill, 2018 as though is already enacted.
11.	Proposes to amend the Third Schedule which provides for tax rates and reliefs.	Stipulates the tax rates for demurrage to be 20%, insurance premium at 5% and presumptive tax at 15%.	Introduces new a new tax on demurrage charges, shipping insurance premiums, and presumptive tax to replace turnover tax for small businesses. These measures are likely to improve revenue, but could raise cost of doing business and cost of living.
VALUE ADDED TAX (VAT) ACT			
12.	Amends Section 2 of the Principal Act on interpretations.	It proposes the deletion of the "electronic notice system" from the definition.	The definition makes reference to Section 39 that was deleted by Tax Procedures Act, 2015.
13.	Amends Section 13 of the Act which provides for taxable value of supply.	The proposed deletion refers to Excise Duty Act which is limited since it only covers mobile money transfer services.	This is a clean-up to ensure conformity and harmony in the taxation system.
14.	Amends Section 16 which provides for debit and credit note.	The amendment seeks to simplify the current provision by removing general prescription of serialization of credit note and provide for case by case prescription.	The measure intends to simplify tax administration and application of the statute.
15.	Amends by repealing Section 40.	Provides for unauthorized access and interference with tax computerized system.	All these provisions are transferred to the tax procedures Act so that they apply to the entire tax system and not Value Added Tax statute only.
16.	Amends by repealing Sections41		
17.	Amends by	Section 44 provides for	

	repealing Section 44 (2) to (5)	submission of returns.	
18.	Amends the First Schedule on tax exemptions	The proposed VAT exemption are: raw materials for animal feeds, wheat & meslin and barley seeds, plant & machinery for manufacture of goods, equipment for wind energy just like solar, computers, equipping hospitals and grain storage facilities in addition to construction materials and also alcoholic and non-alcoholic beverages supplied to the Kenya Defence Forces Canteen and also goods supplied for exclusive use under special arrangements for government projects and also postal services, among others.	The tax exemption list seems to expand every year since the overhaul of the Value Added Tax Act in 2013, whose cardinal goal was to simplify tax administration for ease to enforce and streamlining of revenue collection. There is need for predictable policies on tax incentives with a clear purpose and specific timelines for each.
19.	Amends the Second Schedule which provides for Zero Rating.	Amended to replace the general provision of medicaments containing alkaloids or their derivatives with the specific alkaloids.	The proposed amendment is for clarity and ease of administration
TAX APPEALS TRIBUNAL			
20.	Amends Section 10 of the Act on the constitution of the tax appeals panel.	It specifies that the absence of a member of a tax appeals panel will not cause an adjournment since the chairperson will replace	This ensures that there are no unprecedented delays in hearing and determination of tax appeal cases on account of absence of a panel member.
21.	Amends Section 13 on the procedure of appeal.	Relates to time spent on mediation outside the 90 days for hearing and determination	This will ensure that the period allocated for appeal is not used up by an

		of the tax appeals is treated in the appeals procedure.	alternative dispute resolution mechanism.
EXCISE DUTY ACT			
22.	Proposes to amend Section 6 which provides for timing of liability of excise duty.	The amendment seeks to correct an existing wrong referencing to Section 34 on record keeping to the right one, Section 36 on payment of excise duty.	Correct referencing for clarity.
23.	Amends Section 7 which provides for goods and services not liable for excise duty.	Corrects a wrong referencing which is Section 7 (1) (a) which is the second Schedule on exemption and 7 (1) (b and c) on custom services and exported services.	Correct referencing for clarity.
24.	Proposes amendment to Section 10 which provides for adjustment for inflation.	The excise duty specific duty adjustment for inflation once after every two years is proposed to be changed to annual adjustment.	This introduces a mechanism for the excise tax charge on the applicable goods to be reviewed every year based on the previous year's inflation. The proposal could carry forward inflationary effects of the previous years to the current of future years.
25.	Amends Section 20 on suspension of licence.	The amendment intends to remove the referencing suspension of license by the Commissioner to the notification of the status of licence processing.	This provides seamless performance of functions of the Commissioner General since all the procedures are governed by the Tax Procedures Act.
26.	Amends Section 21 which provides for the cancellation of licence under the	The proposed amendment deletes the provision that allows the commissioner to reject an appeal on an	This removes discretion by the Commissioner General and ensures the statutory procedures prevail on

	Act.	application for licensing.	matters of licensing and appeal mechanisms.
27.	Amends Section 23 on the requirement of the Commissioner to give notification before suspension of licence.	The entire section is refined and it makes it punitive for licensees of excisable goods who may engage in tax fraud and counterfeiting.	This measure enhances the fight on dealing with the counterfeit products in the market.
28.	Amends Section 36 on payment of excise duty.	Earmarks two streams of revenue into the Sports, Arts and Social Development Fund. They are: 16% of the excise duty on mobile money transfer and the entire Robin Hood Tax of 0.05% of banks and financial institutions transfer of amount of KSh. 500,000 and above.	The proposed increase of excise duty on mobile money transfer services from the current 10% to 12% may be reviewed in view of fairness and the proposal is inconsistent with international application of Robin Hood Tax, which is often applied on financial transactions or the underlying financial assets such as derivatives. The proposal should be dropped or redesigned.
29.	Amends Section 38 which provides for penalties.	The amendment introduces enhanced penalty for anyone found with excisable goods without being licensed.	This fortifies the fight against counterfeiting.
30.	Amends Section 39 on offenses relating to licensing and excise control.	It proposes forfeiture to the Commissioner, of excisable goods improperly possessed.	
31.	Amends the First Schedule which provides for the rates of excise duty.	Proposes to increase excise duty on illuminating kerosene from the current KSh. 7.202 per litre to KSh. 10.305 per litre;	The appropriateness, economy, efficiency and fairness of some of these measures need to be

		sugar confectionery at KSh. 20 per kilogram; tax on private passenger motor vehicles from 25 to 30%; increasing excise duty on mobile money transfer services from the current 10% to 12% and introduction of Robin Hood Tax at 0.05% on transfer of KSh. 500,000 and above by bank and financial service providers.	ascertained. Notably, the tax on value of money transferred is quite unusual and could cause distortions in the financial sector, or hinder commerce. Other more innovative ways of expanding revenue may include taxation of the activities in the digital platforms.
32.	Amends the Second Schedule on excise duty exemption.	Exempts from taxation, beverages (alcoholic and non-alcoholic) supplied to the military canteen as well as taxable goods supplied under special framework for government projects.	This is a tax expenditure that is aimed at providing seamless tax administration and implementation of government projects.
TAX PROCEDURES ACT			
33.	Proposes to amend Section 3 of the Act on interpretation.	Correction of referencing error where the definition of prescribed form refers to Section 70 on official language instead of Section 71 which is about the prescribed form.	Correction of referencing error.
34.	Amends Section 12 which provides for issuance of Personal Identification Number (PIN)	Correction of repetition	Removal of typographical error.
35.	Amends Section 16 on the liabilities and obligations of the tax representatives.	The proposed amendment apportions the responsibilities of tax agents to obligations relevant to respective appointment.	Clarification that the tax agents are only responsible for tax obligations for which they are appointed.
36.	Amends by	Introduction of timelines for	There seems not to be any

	replacing Section 25 which provides for extension of time to submit tax returns.	extension of submitting tax returns as 15 days and 30days for monthly and annual returns respectively.	evidence that the time allowed is insufficient for submitting tax returns.
37.	Amends Section 31 which provides for amendment of tax assessment.	Clarification that the Commissioner should give a reason for rejecting to grant an amendment for self-assessment.	This to enhance transparency and accountability in public affairs.
38.	Proposes amendment to Section 37B which provides for amnesty on declaration and transfer of income derived outside Kenya.	There is a further one year extension for transfer of income derived outside the country under the current amnesty exemption of such transfer of funds from the scrutiny regarding the source, by relevant institutions such as the Financial Reporting Centre among others.	The exemption excludes proceeds of poaching, drug trafficking and terrorism. The difficulty could be the mechanism that will be used to identify the three exclusions given that the Bill does not outline how or at what point the relevant authorities will interrogate the source of such income. The proposal excludes proceeds from corruption.
39.	Amends Section 38 which provides for late payment interest.	The interest for the late payment to be enhanced from 1% to 2% per month.	The increased penalty seeks to improve compliance.
40.	Amends Section 42 on the power to collect tax from persons owing money to a taxpayer.	Clarification that the Section should refer to a tax agent and not a taxpayer.	Clarity of the provision.
41.	Amends Section 51 which provides for objection to tax	The proposed amendment links the requirement of objecting a tax decision with the one of	Clarifies that one objects to tax decision after paying the undisputed tax or there has

	decision.	extension of time.	been an application for extension of time.
42.	Proposes to amend Section 62 on binding public rulings.	Clears wrong referencing to Section 62 on binding public ruling to the correct one, Section 63 on making public ruling.	Correct referencing.
43.	Amends Section 80 on general provisions, penalties and offenses.	Corrects erroneous referencing to Section 48 on erroneous refund of tax to the right one, Section 47 on refund of overpaid tax.	Correct referencing.
44.	Amends Section 83 which provides for late submission penalty.	The penalty has been categorized as: VAT and Excise Duty is 5% of the tax due or KSh. 10,000; companies will be 5% of the tax due or KSh. 20,000 and individuals will 5% of the tax due or KSh. 2,000; whichever is higher for all the cases.	The proposed amendment seems to favour the late submission of the nil tax return since the current penalty for late submission of tax returns for employment income still remains at 5% or KSh. 10, 000 whichever is higher.
45.	Introduces a new provision to on late payment penalty.	Late payment penalty has been prescribed at 20% of the tax due and payable.	This measure is targeting persons who deduct tax but fail to remit to the collector in time. Likely to enhance compliance.
46.	Amends Section 89 which provides for general provisions relating to penalty.	First, the Commissioner General is obligated to determine penalty applies in case of multiple penalties for similar offense. Secondly, the Cabinet Secretary will only approve remission of penalty or interest of above KSh. 1.5 million under conditions of hardship, equity or difficulty on tax recovery.	This implies that minor cases of penalty or interest remission of amounts bellow KSh. 1.5 million are addressed by the Commissioner General, and the Cabinet Secretary to only approve cases of higher amounts. This will streamline administration for efficiency.

		Otherwise, the Commissioner General (CG) will approve and submit quarterly reports.	
47.	New provision to address unauthorized access or improper use of computerized tax system.	There are proposed penalties of jail term of 2 years or KSh. 400,000 fine for individuals and KSh. 1 million for corporate bodies for unlawful access and 3 years term or KSh. 800,000 fine for interference with the tax system.	This provision has been shifted from the Income Tax Act to the Tax Procedures Act so that it can be applicable in the entire tax system. However, the penalties may be considered for review to make them punitive enough.
48.	Amends Section 104 which provides for sanctions for offenses.	A clarification that it is jail term or fine.	Clarification.
MISCELLANEAOUS FEES AND LEVIES ACT			
49.	Amends Section 2 on interpretation.	Proposes an inclusion of the Special Economic Zones in the consideration of exportation.	The incentive is targeting Special Economic Zone operators or developers but it is likely to cause revenue loss.
50.	Amends the First Schedule on goods subject to export levy.	Imposes export levy on copper waste and scrap at the rate of 20%.	The measure is aimed at retaining raw materials for local manufacturing and also discouraging vandalism. But then, it is difficult to ascertain the source of such raw materials.
51.	Amends the Second Schedule on exemption from import declaration fees.	Introduces exemption of Import declaration Fees and Railway Development Levy for goods imported for exclusive use under special arrangements for government projects	This is tax expenditure which ensures seamless implementation of government projects.

<table>
<tr><td colspan="4"><u>MISCELLANEOUS</u>
1. BETTING, LOTTERIES AND GAMING ACT</td></tr>
<tr><td>52.</td><td>Amends Section 5 on application for licence and permits</td><td>The marginal note of the new provision is about casinos but the body does not mention casinos, therefore, it may need to be reviewed.</td><td rowspan="2">The penalty prescribed for false declaration is an amount not exceeding KSh. 5,000 or imprisonment of a term not exceeding 6 months, which appear not sufficiently punitive and may be considered for a review</td></tr>
<tr><td>53.</td><td>Amends Section 69 on gambling taxes to be paid into the Consolidated Fund</td><td>Betting, lotteries, gaming and price competition taxes to be paid into the Sports, Art and Social Development Fund. Also late payment penalty of 20% of the tax due and payable and additional interest at 2% per month</td></tr>
<tr><td colspan="4">2. MARINE INSURANCE ACT</td></tr>
<tr><td>54.</td><td>Amends Section 2 on interpretation</td><td rowspan="2">References that the Commissioner in the Marine Insurance Act is that one established in the Insurance Act</td><td rowspan="2">Harmonization of the Marine Insurance Act with the Insurance Act by clarifying that registration of marine cargo insurers is done by the Commissioner of Insurance appointed under the Insurance Act.</td></tr>
<tr><td>55.</td><td>Amends Section 16A on insurable interest in marine cargo</td></tr>
<tr><td colspan="4">3. AIR PASSENGER CHARGE</td></tr>
<tr><td>56.</td><td>Amends Section 3 on imposition of air passenger service charge</td><td>Introduction of the Tourism Promotion Fund as another beneficiary of the of the passenger service charge in addition to the current two beneficiaries; the Kenya Airport Authority and the Kenya Civil Aviation Authority</td><td>Currently, this charge is about 50 USD per external and KSh. 600 for local journey tickets. The Cabinet Secretary has already apportioned the share among the now 3 beneficiaries.</td></tr>
<tr><td colspan="4">4. STAMP DUTY ACT</td></tr>
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<tr><td>57.</td><td>Amends Section 117 on exemption from stamp duty.</td><td>The first is the exemption of licensed operators and developers in the Special Economic Zones from payment of the stamp duty. The other exemption is on an instrument that is executed for collection and recovery of tax</td><td>The first one seems to be targeting the housing agenda. But then, a more targeted package may be designed specifically for the “Big Four” agenda.</td></tr>
<tr><td colspan="4">5. BANKING ACT</td></tr>
<tr><td>58.</td><td>Repeals Section 33B on the power of Central Bank to enforce interest rate ceiling.</td><td>Repeals Section 33B on the capping of bank interest rates.</td><td>The proposed removal of the interest rate controls needs greater scrutiny so as to ensure borrowers are protected and that the banking system remains a viable area of investment. A proposal on how this can be done is provided.</td></tr>
<tr><td colspan="4">6. COOPERATIVE SOCIETIES ACT</td></tr>
<tr><td>59.</td><td>Amends Section 62 on cancellation of registration.</td><td>It provides that a cooperative society to lose registration once the deposit taking licence has been revoked.</td><td>This is a measure to ensure the Cooperative societies adhere to prudential guidelines.</td></tr>
<tr><td colspan="4">7. CENTRAL BANK OF KENYA ACT</td></tr>
<tr><td>60.</td><td>Amends Section 2 on interpretation to introduce 3 new definitions.</td><td>Introduces mortgage refinance business, company and specified mortgage refinance company</td><td rowspan="3">This proposal is linked with the proposed National Housing Development Fund proposed in clause 68. However, it is not clear what will be the role of the existing framework such the National Housing Corporation, among others.</td></tr>
<tr><td>61.</td><td>Amends Section 4A on other objects of the Central Bank.</td><td>Additional role to licence and supervise mortgage refine companies.</td></tr>
<tr><td>62.</td><td>New provision on mortgage financing company.</td><td>Introduces the mandate of licensing, regulating and supervising the mortgage financing companies.</td></tr>
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63.	Amends Section 43 on information to be furnished by specified banks and other institutions.	The specified mortgage financing companies will be required to furnish the Central Bank with any needed information just like other financial institutions.	This is a consequential amendment due to the proposed establishment of the mortgage financing business.
64.	Amends Section 57 on making of regulations by the Central Bank	Expands the function of the Central Bank to encompass issuance of guidelines, circulars and directives in the performance of its functions, in addition making regulations.	This is likely to give the Central Bank enhanced impetus in the performance of its functions.
8. KENYA REVENUE AUTHORITY ACT			
65.	Amends the First Schedule on written laws relating to revenue	Inclusion of the Public Finance Management Act, 2012 in the list of the laws relating to revenue.	The Public Finance Management Act governs budget and finance including revenue issues.
9. RETIREMENT BENEFITS AUTHORITY ACT			
66.	Amends Section 4C on annual reports and accounts	Penalties for failure to submit the audited accounts to the Retirement Benefits Authority by the trustee - KSh. 100,000 and KSh. 1,000 every day the records remain un-submitted, Fund Administrator and fund manager - KSh. 10,000 and KSh. 1,000 every day the records remain un-submitted	This proposed amendment seeks to empower the Retirement Benefits Authority to intervene when employers fail to remit the pension contributions to the scheme and ensure enforcement of compliance.
67.	Amends Section 53 on general penalties.	Imposes a penalty of 5% interest or KSh. 20,000 whichever is higher, for non-remittance.	
10. EMPLOYMENT ACT			
68.	Amends Section 31 which provides for housing/house	It imposes a 0.5% to an employer on employee's gross pay and another 0.5%	Staff housing seems to be an externality as opposed to a public good, whose

	allowance for staff.	deduction from employee's earning to be paid into the National Housing Dev. Fund.	utilization, enjoyment or consumption is non-rival and non-excludable.
11. ACCOUNTANTS ACT			
69.	Amends Section 2 on interpretation.	harmonizing the Principal Act with the Constitution of Kenya, 2010 by redefining the term "minister" and also referencing the usage of term "company" to the Companies Act	This is a clean-up for conformity with the Constitution of Kenya, 2010 and the Companies Act, 2015.
12. PROCEEDS OF CRIME AND ANTI-MONEY LAUNDERING ACT			
70.	Inserts a new provision after Section 45 under obligation to verify customer information.	Introduction of stringent measures on conducting any business transactions with countries considered risky according to the Financial Action Task Force	This measure is likely to improve the anti-money laundering initiative in line with the international best practice.
71.	Amends the First Schedule of the act on Supervisory bodies.	Inclusion of the Saccos Societies Regulatory Authority (SASRA) among the supervisory bodies the Financial Reporting Centre may avail information.	SASRA is another key player in the financial sector and the proposed inclusion will ensure any relevant information is availed for use in enforcement of the law.

**PBO: Parliamentary budget Office*