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# Mobile telephony and taxation in Kenya

## Executive summary

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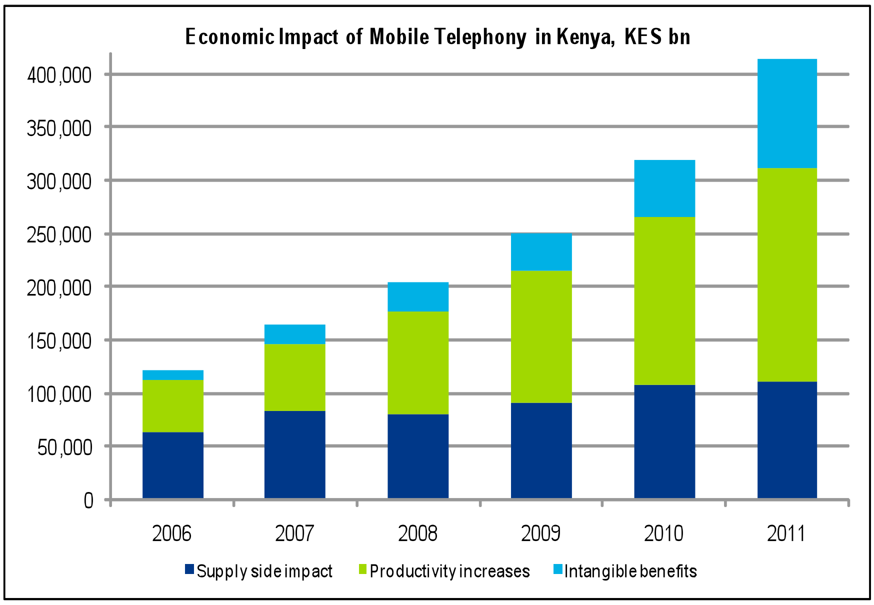
Kenya's mobile market has grown significantly over the last few years. Competition has increased with the introduction of two additional Mobile Network Operators ("MNOs"), and this has contributed to a price drop of over 70% in the last four years. Mobile coverage has increased to 96% of the population, and there are now over 3,500 3G sites in the country. As a result, in Kenya, consumers, businesses and government continue to benefit from the positive developments in the mobile sector.

> "The contribution of the mobile sector to the Kenyan economy represents over 5.6% of GDP, and up to a further a 1.9% from intangibles."

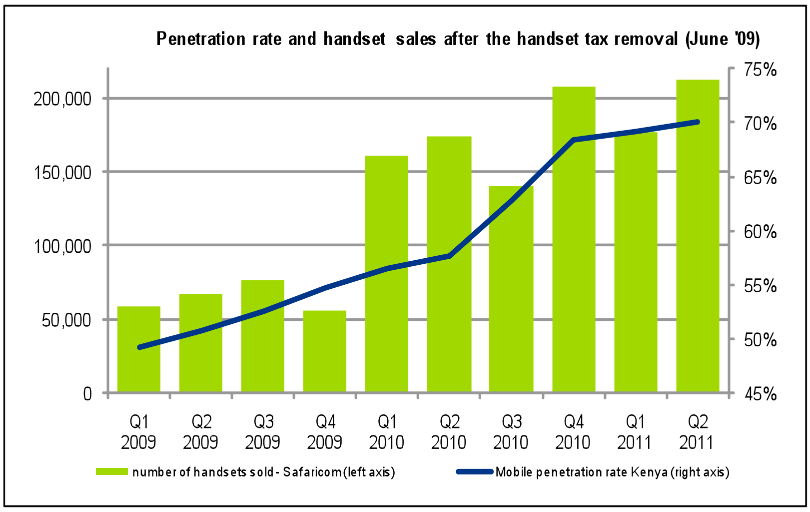
In 2011 the mobile communications industry contributes over KES 300bn and up to a further KES 100bn from intangible benefits to consumers. Additionally, these estimates indicate that in 2011 the mobile communication industry as a whole employs almost 250,000 people in Kenya.

Over the last five years, the contribution of mobile telephony to the Kenyan economy has grown by almost 250%, while mobile-related employment has increased by 67%. As a result of improved coverage, quality of service and affordability, the productivity impact of mobile telephony on the Kenyan economy is estimated to have increased by a similar scale.




This also highlights the importance of the mobile sector to the productivity of the economy as a whole. MNOs contribute to such increases by providing services such as Mobile banking, M-agriculture and M-education, and contributed to a number of social projects in Kenya's rural areas. Here, mobile network installation often leads the developments of roads and electricity provision, and these installation costs are sustained directly by the MNOs.

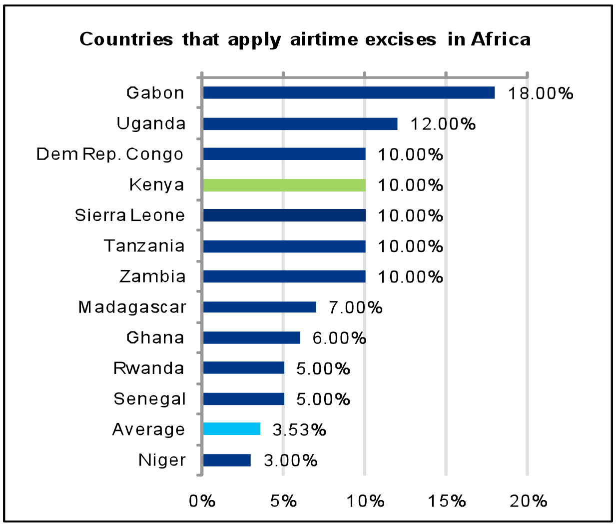
"The experience of the Kenyan government's removal of taxation on handsets indicates there could be significant benefits for consumers from the removal of mobile specific taxes."




In June 2009 the Kenyan government, recognising the importance of enhancing access to mobile telephony, decided to exempt mobile handsets from VAT. This has generated significant benefits for many Kenyans. Handset purchases have increased by more than 200% since the removal of VAT and penetration rates have increased substantially, from 50% to 70%. This successful policy confirms that consumption taxes can have a significant impact on consumer behaviour in Kenya.

"When compared to the Kenyan income per capita, mobile telephony costs, including Kenya's airtime tax, still represent a significant proportion (7.5%) of income, and may not be affordable to the poorer sectors of the population."

Mobile consumers in Kenya are still impacted by a specific tax on airtime. This tax is levied at 10% and is additional to VAT. This is amongst the highest in Africa, and contributes to raise consumer tax as a proportion of the total cost of mobile ownership in Kenya to 21%, well over both the African and the global average. This tax is regressive in nature and may signal the government's intention to discourage consumption of mobile services. This mobile-specific taxation contributes to raising the total cost of mobile ownership in Kenya to $58 per year per user.



"Market, regulatory and taxation pressures represent a significant challenge for MNOs in Kenya and potentially constrain network and service investment."

MNOs in Kenya operate in a challenging investment environment and are subject to a number of market and regulatory pressures. Falling prices have led to decreasing ARPU levels for MNOs, and three out of four MNOs are receiving negative returns. Additional pressures on investment and profitability that MNOs are facing include the high civil works costs sustained by MNOs to set up sites in rural areas, unequal treatment compared to other industries with regards to input costs such as fuel, regulatory decisions affecting retail prices, as well as a high corporation tax and a range of additional taxes on their revenues, turnover and inputs, including a new tax for a Universal Service Fund ("USF").

"In 2011, MNOs in Kenya will pay approximately KES 41 billion to the government in taxes, regulatory and spectrum fees. This represents an increase of 33% compared to 2008."

Of particular concern to MNOs' investment in the country's network are custom duties applying to the network inputs required for the operation of mobile network, and spectrum fees. These are set in a way that may discourage investment, as fees increase with the number of sites set up by MNOs. Also of concern to MNOs is a recent government's decision to create a USF for the promotion of next generation networks in Kenya. Despite MNOs contributing 0.5% of their turnover to the fund, they have reported a lack of transparency on the fund management and on the fund's investment decisions, which has generated significant uncertainty for their investment.

The Kenyan government has successfully implemented a taxation policy that has promoted the benefits of the mobile telephony on the economy and on consumers. To ensure that benefits continue to be delivered to consumers and to businesses, the government could consider the potential benefits from a revised approach to mobile-specific taxation and regulatory policy.

MNOs make a significant contribution to the government's tax receipts despite the current difficult economic climate and the challenging cost conditions and uncertainty under which they operate in Kenya. Any further increases in this tax burden could have negative impacts on investment, product development, the financial contribution made by MNOs to community projects and on the ability of MNOs to retain current levels of employment.

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