

Highlights of the impact of the Court of Appeal's decision declaring the entire Finance Act 2023 unconstitutional



Background:

On 31 July 2024, the Court of Appeal (the “**Court**”) rendered its judgement in Civil Appeal No. E003 of 2023 (as consolidated with Civil Appeal Nos. E016, E021, E049 and E064 and E080 of 2024) (“the **Appeal**”) in relation to the constitutionality of the Finance Act 2023 (“the **Act**”). The Court of Appeal found that the entire Act was unconstitutional for:

- i. violating Article(s) 220 (1) (a) and 221 of the Constitution as read with sections 37, 39A, and 40 of the Public Finance Management Act which prescribe the budget making process; and
- ii. failure by Parliament to provide reasons for adopting or rejecting any proposals from members of the public during the public participation process.

The Finance Act, 2023 was signed into law to by the President on 26 June 2023. The Act introduced significant and impactful changes to the tax laws including introducing new taxes such as the digital asset tax and the repatriated income tax and increasing the highest personal tax bands to include 32.5% and 35%.

The Government has since appealed to the Supreme Court against this decision. However, as of the time of publication of this alert, no conservatory orders have been issued staying the Court of Appeal's judgement.

This alert summarizes the key amendments introduced by Finance Act 2023 and the implications of the Court of Appeal's decision on their applicability. Please note that these implications are subject to change depending on the outcome of the appeal currently pending determination at the Supreme Court.

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION
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I. INCOME TAX ACT

Employment income tax and individual tax bands	<p>The Finance Act 2023 introduced higher tax rates of 32.5% and 35% on the taxable income of individuals to apply as follows:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr style="background-color: #1a3d4d; color: white;"> <th colspan="2">TAX BANDS</th> <th>RATE</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;"><i>On the first</i></td> <td style="text-align: center;"><i>Kshs 288,000</i></td> <td style="text-align: center;"><i>10%</i></td> </tr> <tr> <td style="text-align: center;"><i>On the next</i></td> <td style="text-align: center;"><i>Kshs 100,000</i></td> <td style="text-align: center;"><i>25%</i></td> </tr> <tr> <td style="text-align: center;"><i>On the next</i></td> <td style="text-align: center;"><i>Kshs 5,612,000</i></td> <td style="text-align: center;"><i>30%</i></td> </tr> <tr> <td style="text-align: center;"><i>On the next</i></td> <td style="text-align: center;"><i>Kshs 3,600,000</i></td> <td style="text-align: center;"><i>32.5%</i></td> </tr> <tr> <td style="text-align: center;"><i>On all income in excess of</i></td> <td style="text-align: center;"><i>Kshs 9,600,000</i></td> <td style="text-align: center;"><i>35%</i></td> </tr> </tbody> </table> <p>The effect of the Court of Appeal's judgement is to reinstate the tax bands that were applicable pre-Finance Act 2023:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr style="background-color: #1a3d4d; color: white;"> <th colspan="2">TAX BANDS</th> <th>RATE</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;"><i>On the first</i></td> <td style="text-align: center;"><i>Kshs 288,000</i></td> <td style="text-align: center;"><i>10%</i></td> </tr> <tr> <td style="text-align: center;"><i>On the next</i></td> <td style="text-align: center;"><i>Kshs 100,000</i></td> <td style="text-align: center;"><i>25%</i></td> </tr> <tr> <td style="text-align: center;"><i>On all income in excess of</i></td> <td style="text-align: center;"><i>Kshs 388,000</i></td> <td style="text-align: center;"><i>30%</i></td> </tr> </tbody> </table> <p>Other significant amendments introduced by the Act, which will no longer be applicable include the following:</p> <ol style="list-style-type: none"> i. the exclusion of travelling allowances calculated using the approved Automobile Association of Kenya standard mileage rate from employment tax; ii. the exclusion of club entrance and subscription fees, which had been taxed from the employer's side, from being taxed as an employment benefit; iii. the Act had also aligned the definition of the market value of shares in employee share options schemes to be the value of the shares when the employee exercises the option and not when the shares were granted; and iv. the Act also provided for taxation of shares issued in lieu of cash for start up companies. 	TAX BANDS		RATE	<i>On the first</i>	<i>Kshs 288,000</i>	<i>10%</i>	<i>On the next</i>	<i>Kshs 100,000</i>	<i>25%</i>	<i>On the next</i>	<i>Kshs 5,612,000</i>	<i>30%</i>	<i>On the next</i>	<i>Kshs 3,600,000</i>	<i>32.5%</i>	<i>On all income in excess of</i>	<i>Kshs 9,600,000</i>	<i>35%</i>	TAX BANDS		RATE	<i>On the first</i>	<i>Kshs 288,000</i>	<i>10%</i>	<i>On the next</i>	<i>Kshs 100,000</i>	<i>25%</i>	<i>On all income in excess of</i>	<i>Kshs 388,000</i>	<i>30%</i>
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Repatriated income tax and taxation of branches of foreign companies registered in Kenya	<p>The Act had amended the tax framework applicable to branch companies with effect from 1 January 2024 to align them to companies incorporated in Kenya. The Act had done this by:</p> <ol style="list-style-type: none"> i. reducing the corporate income tax rate applicable to a branch from 37.5% to 30%; and ii. introducing taxation of repatriated income at 15% of the repatriated income. <p>The effect of the Court of Appeal's decision is that branch companies will revert to the taxation framework applicable prior to the enactment of the Finance Act 2023 where a branch was subject to corporate income tax at 37.5% of taxable profits with no further taxation on repatriation of income.</p>																														

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION
I. INCOME TAX ACT	
Turnover tax	<p>The Act had amended the turnover tax law to:</p> <ul style="list-style-type: none"> i. lower the upper limit for the applicability of turnover tax from 50 million to 25 million; and ii. increase the rate of turnover tax to 3% of the gross receipts of the business from 1%. <p>The effect of the Court of Appeal's decision is that the previous threshold for turnover tax (KSHS1 Million to 50 Million) and the turnover tax rate of 1% will be applicable.</p>
Digital asset tax	<p>The Act had introduced digital asset tax, which was chargeable at 3% of the gross fair market value consideration received or receivable at the point of exchange or transfer of a digital asset. The Act also provided that this tax was to be remitted to KRA within five working days from the date the deduction was made.</p> <p>Following the Court of Appeal's judgement, digital asset tax is no longer applicable.</p>
Deduction of expenses generated from e-TIMS	<p>The Act introduced a rule that for an expense to be tax deductible, the invoices for the transactions, must be generated from by an electronic tax invoice management system (e-TIMS) unless such transactions are exempted.</p> <p>The effect of the Court's decision is that this provision, which became operational on 1 January 2024 is not applicable, and as such, it will not be a requirement for an invoice to be generated on e-TIMS for the expenditure or loss to be tax deductible.</p>
Country by Country reporting	<p>The Act had introduced country-by-country reporting requirements for Multinational Enterprise Groups. This provision applied to groups whose consolidated group turnover is at least KSHS95 billion in the preceding financial year.</p> <p>This amendment was meant to align the Kenya legislation to the OECD Base Erosion and Profit Shifting (BEPS) Action 13.</p> <p>The effect of the Court's finding is that there is no legal basis for ultimate parent entities and/or constituent entities to file a country-by-country report.</p>
Withholding tax on <ul style="list-style-type: none"> i. digital content monetization ii. payments to residents for sales promotion, marketing and advertising services 	<ul style="list-style-type: none"> i. The Act had introduced withholding tax on digital content monetization at the rate(s) of 20% of the gross amount for non-residents and 5% of the gross amount applicable to residents. This is no longer applicable following the Court of Appeal's decision. ii. The Act introduced withholding tax on payments to residents for sales promotion, marketing and advertising services at 5% of the gross amount. This is similarly no longer applicable following the Court's decision.
Taxation of income of companies undertaking the manufacture of human vaccines	<p>The Act deleted the income tax exemption for companies undertaking the manufacture of human vaccines and imposed a corporate income tax rate of 10% on such income.</p> <p>Following the Court's decision, the income of companies undertaking the manufacture of human vaccines is exempt.</p>

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION
I. INCOME TAX ACT	
<p>Incomes no longer exempted from income tax</p>	<p>The following sources of income that had been exempted from income tax by Finance Act, 2023, will no longer be exempt:</p> <ul style="list-style-type: none"> • Royalties paid to a non-resident person by a company undertaking the manufacture of human vaccines. • Interest paid to a resident person or non resident person by a company undertaking the manufacture of human vaccines. • Investment income from a post-retirement medical fund, whether or not the fund is part of a retirement benefits scheme. • Income earned by a non-resident contractor, sub-contractor, consultant or employee involved in the implementation of a project financed through a one hundred percent grant under an agreement between the Government and the development partner, to the extent provided for in the Agreement: Provided that the non-resident is in Kenya solely for the implementation of the project financed by the one hundred percent grant. • Gains on transfer of property within a special economic zone enterprise, developer and operator. • Royalties, interest, management fees, professional fees, training fees, consultancy fee, agency or contractual fees paid by a special economic zone developer, operator or enterprise, in the first ten years of its establishment, to a non-resident person.
<p>Capital gains tax (CGT)</p>	<p>The Act had amended the scope of CGT to include indirect transfers of property within the scope of Kenyan CGT. The Act had also amended the CGT regime as follows:</p> <ol style="list-style-type: none"> i. limiting transfer of exemptions from CGT where property is transferred in a period of less than five years after a transfer in a transaction that is not subject to CGT; ii. introduced a due date for payment of CGT; and iii. inserting a provision to the effect that an internal restructuring for CGT will not qualify for exemption if the group has not existed for at least twenty-four months. <p>The effect of the Court's decision is that the above amendments to CGT will not be applicable.</p>

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION
II. VALUE ADDED TAX (VAT)	
<p>VAT rate on petroleum products and liquified petroleum gas</p>	<p>The Act deleted section 5(2) (aa) of the VAT Act which provided for VAT on petroleum products (excluding Liquid Petroleum Gas) to be chargeable at the rate of eight (8) percent of the taxable value. The effect of this amendment was that petroleum products (excluding Liquid Petroleum Gas) became chargeable to VAT at the standard rate of 16%.</p> <p>Following the judgement, VAT on petroleum products (excluding Liquid Petroleum Gas) will be chargeable at the rate of eight (8) percent.</p>
<p>Refund of VAT on bad debts</p>	<p>The Act extended the time period within which a taxpayer could apply for refund of tax on bad debts from between 3-4 years to 3-10 years.</p> <p>The effect of the Court of Appeal's judgement is that a taxpayer will only be allowed to apply for refund of tax on bad debts 3-4 years from the date of that supply.</p>
<p>Items that had were exempt from VAT and are now standard rated</p>	<p>Following the judgement of the Court of Appeal, the following products which were VAT exempt are now chargeable to VAT at the standard rate of 16%:</p> <ol style="list-style-type: none"> a. aircraft parts of heading 8801; b. taxable goods for the direct and exclusive use in the construction and equipping of specialized hospitals with a minimum bed capacity of one hundred beds, approved by the Cabinet Secretary upon recommendation by the Cabinet Secretary responsible for health who may issue guidelines for determining eligibility for the exemption; c. plant and machinery of chapter 84 and 85 acquired locally by manufacturers of pharmaceutical products or investors in the manufacture of pharmaceutical products upon the recommendation of the Cabinet Secretary responsible for matters relating health; d. taxable goods, inputs and raw materials imported or locally purchased by a company engaged in special operating framework arrangement with the government and is incorporated for purposes of undertaking manufacturing activities including refining; e. taxable supplies made to or by a school feeding programme recognized by the Cabinet Secretary responsible for matters relating to education; f. taxable services imported or locally purchased by a company which— <ol style="list-style-type: none"> i. is engaged in business under a special operating framework arrangement with the Government; and ii. is incorporated for purposes of undertaking the manufacture of human vaccines or other manufacturing activities including refining; and whose capital investment is at least ten billion shillings

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION
II. VALUE ADDED TAX (VAT)	
Zero rated supplies that are now standard rated	<p>Following the judgement of the Court of Appeal, the following products whose VAT status had changed to zero-rated are now chargeable to VAT at the standard rate of 16%:</p> <ol style="list-style-type: none"> a. exported taxable services save for the exportation of taxable services in respect of business process outsourcing; b. inbound international sea freight offered by a registered person; c. all tea and coffee locally purchased for the purpose of value addition before exportation subject to approval by the Commissioner-General; d. the supply of locally assembled and manufactured mobile phones; e. the supply of motorcycles of tariff heading 8711.60.00; f. the supply of electric bicycles; g. the supply of solar and lithium-ion batteries; h. the supply of electric buses of tariff heading 87.02; i. inputs or raw materials locally purchased or imported for the manufacture of animal feeds; and j. Bioethanol vapour (BEV) Stoves classified under HS Code 7321.12.00 (cooking appliances and plate warmers for liquid fuel).
III. EXCISE DUTY ACT	
Adjustment for inflation	<p>The Act, had deleted Section 10 of the Excise Duty Act (EDA) that granted the Commissioner the power to adjust the specific rates of excise duty once a year to take into account inflation.</p> <p>The effect of the Court's decision is that the Commissioner will once again have power to adjust the excise duty rates for inflation annually.</p>
Due date for payment of excise duty to KRA by licensed manufacturers of alcoholic beverages	<p>The Act had amended section 36 of the EDA to require licensed manufacturers of alcoholic beverages to pay excise duty to the Commissioner within 24hrs upon removal of the goods from the stockroom.</p> <p>The effect of the Court's decision is that licensed manufacturers of alcoholic beverages will revert to paying excise duty not later than twentieth day of the succeeding month from the date excisable goods are removed from a manufacturer's factory.</p>
Due date for payment of excise duty on betting and gaming	<p>The Act introduced a requirement for bookmakers to remit excise duty on betting and gaming to the KRA within 24 hours of the closure of daily transactions.</p> <p>The effect of the Court's declaration is that bookmakers will be required to pay excise duty on betting and gaming transactions by the twentieth day of the succeeding month.</p>

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION		
III. EXCISE DUTY ACT			
Items whose excise duty rate had been amended upwards	EXCISABLE GOODS		
	ITEM	EXCISE RATE INTRODUCED BY FINANCE ACT	PRE-FINANCE ACT 2023 RATE (NOW APPLICABLE)
	Imported glass bottles (excluding imported glass bottles for packaging of pharmaceutical products)	35%	25%
	Imported Alkyd	20%	10%
	Imported Unsaturated polyester	20%	10%
	Imported emulsion VAM	20%	10%
	Imported Emulsion – Styrene Acrylic	20%	10%
	Imported Homopolymers	20%	10%
	Imported Emulsion B.A.M	20%	10%
	EXCISABLE SERVICES		
	Telephone and internet data services	15%	20%
	Money transfer services by banks, money transfer agencies and other financial service providers	15%	20%
	Money transfer services by cellular phone service providers	15%	12%
	Betting	12.5%	7.5%
	Gaming	12.5%	7.5%
	Prize competition	12.5%	7.5%
	Lottery (excluding charitable lotteries)	12.5%	7.5%
Fees charged on advertisement on television, print media, Billboards and radio stations on alcoholic beverages, betting, gaming, lotteries and prize competitions	15%	N/A	

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION		
III. EXCISE DUTY ACT			
Items that had been classified as excisable goods and/or services in the Finance Act 2023	ITEM	FINANCE ACT 2023 NEW RATE	REVERSAL TO OLD RATE
	Imported fish	10%	N/A
	Powdered Juice	Kes 25 per kg	N/A
	Imported sugar excluding imported sugar purchased by a registered pharmaceutical manufacturer	Kes 5 per kg	N/A
	Imported cement	10% of the customs value or Kes 1.5 per kg, whichever is higher	N/A
	Imported furniture of tariff heading 9403 excluding furniture originating from East African Community Partner States that meet the East African Community Rules of Origin	30%	N/A
	Imported cellular phones	10%	10%* Chargeable under Part II of the First Schedule to the EDA
	Imported paints, varnishes and lacquers of heading 3208, 3209 and 3210	15%	N/A
	Imported non-virgin test liner of heading 4805.24.00	25%	N/A
	Imported non-virgin fluting medium of heading 4805.19.00	25%	N/A
Imported cartons, boxes and cases of corrugated paper or paper board and imported folding cartons, boxes and case of non-corrugated paper or paper board and imported skillets, free-hinge lid packets of tariff heading 4819.10.00, 4819.20.10 and 4819.20.90	25%	N/A	

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III. EXCISE DUTY ACT			
	Imported plates of plastic of tariff heading 3919.90.90, 3920.10.90, 3920.43.90, 3920.62.90 and 3921.19.90	25%	N/A
	Imported paper or paper board, labels of all kinds whether or not printed of tariff heading 4821.10.00 and 4821.90.00	25%	N/A
	Fees charged on advertisement on television, print media, Billboards and radio stations on alcoholic beverages, betting, gaming, lotteries and prize competitions	15%	N/A
IV. TAX PROCEDURE ACT ("TPA")			
e-TIMS system	<p>The Act introduced Section 23A of the TPA that empowered KRA to establish an electronic tax system for issuing tax invoices and keeping records of stocks. The effect of Finance Act 2023 being declared unconstitutional means that there is no substantive legal framework for the operation of the e-TIMS system. While the Tax Procedures (Electronic Tax Invoice) Regulations, 2023 exist, the Regulations cannot be effected in the absence of the substantive law.</p>		
Mutual administrative assistance in the recovery or collection of tax claims	<p>The Act provided a mechanism to allow the Commissioner to assist aid other revenue authorities in collecting taxes due to them from persons resident in Kenya under various Bilateral Double Tax Agreements and the Convention on Mutual Administrative Assistance in Tax Matters.</p> <p>The judgement by the Court of Appeal means that KRA does not have the power to provide mutual administrative assistance in the recovery or collection of tax claims by other tax authorities.</p>		
Abandonment of taxes	<p>The Act deleted the legal provisions that allowed KRA to recommend abandonment of taxes where it is impossible to recover the unpaid tax; there is undue difficulty or expense in recovery of unpaid tax, or hardship or inequity in relation to recovery of unpaid tax.</p> <p>This provision is effectively in force based on the Court of Appeal's decision.</p>		
Agency notices	<p>The Act had amended Section 42 of the Tax Procedures Act to prevent KRA from issuing agency notices where a taxpayer had appealed to the Courts.</p> <p>A taxpayer appealing to the Courts will now need to seek stay to prevent enforcement of the judgement by KRA.</p>		

AMENDMENT INTRODUCED BY FINANCE ACT, 2023	IMPLICATION
IV. TAX PROCEDURE ACT ("TPA")	
Withholding VAT remittance timelines	The Act required withholding VAT agents to remit withheld VAT within five working from the date the deduction is made. Following the judgement, the previous timeline in the law applies and WHVAT agents will be required to remit withheld VAT by the 20th day of the month following the month in which the taxes were withheld.
Remissions/waiver of penalties and interest	The Act had deleted Section(s) 89 (6,7 and 8) of the TPA that allowed the Commissioner to waive the penalties and interest upon application by a taxpayer. The waiver provisions are effectively in force following the Court's decision.
V. MISCELLANEOUS FEES AND LEVIES ACT	
Change in Railway Development Levy and Import Declaration Fee rates	The Act had amended section 7 and 8 of the Miscellaneous Fees and Levies Act (MFLA) by revising the Import Declaration fee rates from 3.5% to 2.5% and the Railway Development Levy from 2.5% to 1.5%. These amendments have been reversed following the judgement.
Export and investment promotion levy	The Act had introduced an export and investment promotion levy payable by the importer of specified goods at the time of entering the goods into the country for home use. This amendment has been reversed following the judgement.

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