

Tax & Exchange Control

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KENYA

Finally, some white smoke: An analysis of the recent Supreme Court of Kenya's decision on the Finance Act, 2023



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Finally, some white smoke: An analysis of the recent Supreme Court of Kenya's decision on the Finance Act, 2023

Over the last year or so, the Kenyan tax environment has been uncertain, not only because of protests and/or demonstrations that resulted in the withdrawal of the Finance Bill, 2024, but a myriad of court cases challenging the constitutionality of the Finance Act, 2023.

On 29 October 2024, the Supreme Court rendered a decision in the appeal case of *The Cabinet Secretary for the National Treasury and Planning and Four Others v Okiya Omtatah Okiiti and 52 Others* (SC Petition Nos. E031, E032 & E033 of 2024). Though the court effectively overturned the Court of Appeal's (CoA) declaration of the entire Finance Act, 2023 (Act) as unconstitutional, the judgment gives a level of certainty and direction as to the applicable law going forward.

In this alert, we highlight the issues for determination by the court and the implication of the judgment for taxpayers going forward.

Background

The Act came into law on 26 June 2023 and proposed amendments to various provisions of different tax laws. Our analysis of the proposed amendments can be accessed [here](#). A number of Kenyans expressed discontent with the legislative process that led to the Act's enactment, resulting in the filing of 11 constitutional petitions in the High Court to challenge its constitutionality. You can find our analysis

of the High Court's decision [here](#). The Government, aggrieved by the High Court's decision, appealed to the CoA, which dismissed the appeal. Details of the CoA's decision can be found in our alert [here](#). Subsequently, three appeals and two cross appeals were filed before the Supreme Court.

Issues before the court

In respect of the appeal and cross appeals, the Supreme Court identified a total of nine issues for determination:

1. Whether it had jurisdiction to hear and determine SC Appeals Nos. E032 and E033 of 2024.
2. Whether the Finance Act, 2023 was subject to the concurrence process under Article 110(3) of the Constitution of Kenya, 2010 (Constitution).
3. Whether fresh public participation should be undertaken when Parliament amends provisions of a bill or introduces new provisions in a bill after initial public participation.
4. Whether Parliament has an obligation, upon conclusion of the public participation exercise, to provide detailed reasons for accepting or rejecting views, and whether failure to give reasons vitiates the legislative process and invalidates the legislation passed.
5. Whether the Appropriation Act, 2023 contained the estimates of revenue.
6. Whether the question of the validity of section 84 of the Finance Act, 2023 (affordable housing levy) was moot.

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7. Whether a court has jurisdiction to test the legality of policy positions taken by the Executive and Parliament in the legislative process; and, if so, whether the impugned sections of the Act relating to various tax legislations are unconstitutional.
8. What considerations should a court take into account in declaring a statute unconstitutional, and what consequential orders ought a court to issue upon declaring a statute, or parts thereof, unconstitutional?
9. What remedies should be issued?

The court's analysis and determination

The court's jurisdiction

The second respondent challenged the jurisdiction of the Supreme Court since the appeals did not specify which limb of the court's jurisdiction they invoked as per Article 163 (4) of the Constitution. The court dismissed the preliminary objection on the basis that the appeals raised vital constitutional questions and that the questions were of grave public interest with far-reaching ramifications under the constitutional framework.

Senate involvement

The court pointed out that the correspondence between the speaker of the National Assembly (NA) and the speaker of the Senate proved that they concurred that the Finance Bill, 2023 (Bill) did not concern the County Government.

Post-public participation amendments

The High Court and the CoA acknowledged the importance of public participation, agreeing that the initial stages of public consultation for the Bill were adequate and aligned with constitutional requirements. However,

they disagreed on the treatment of new amendments introduced after this initial participation. The High Court held that these amendments did not necessitate further public consultation, hence the NA could proceed without additional public input, whereas the CoA contended that all substantive amendments must undergo fresh public participation, regardless of time constraints, to ensure transparency and accountability.

The court ultimately held that when new amendments, even if substantive, are introduced based on feedback gathered during public participation, Parliament is not obligated to undertake fresh public participation. The court arrived at this conclusion by analysing three critical issues:

1. The court examined whether substantive amendments made following public participation, specifically those intended to implement suggestions by members of the public, should be subjected to another round of public consultation. It concluded that if the amendments stem from public input, further public involvement is unnecessary.

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2. It also considered whether the Bill, recognised as time-sensitive legislation, necessitated a fresh round of public participation for amendments reflecting prior public input. The court determined that requiring additional public participation would have been impractical given the Bill's strict legislative timeline of 61 days under the Public Finance Management Act.
3. Lastly, the court argued that no legal requirement existed which mandated that amendments to a bill after the second reading, must be subjected to the first and second reading.

Parliament's duty to give reason for rejecting public views

The court looked at Article 47 of the Constitution, which enshrines the right to be given written reasons for any action to a person who has been or is likely to be adversely affected by an administrative action. It acknowledged that Parliament exercises administrative powers in some of its functions, including investigations, recommendations, and findings by its respective committees or approval of appointments to public office. However, the process of enacting legislation does not amount to administrative action and Article 47(2) of the Constitution cannot be the basis for an obligation on Parliament to provide reasons for accepting or rejecting views gathered during public participation in the lawmaking process.

Moreover, Article 118(1) of the Constitution only imposes a duty to facilitate public participation and involvement in the legislative process and therefore cannot be the basis for the argument that Parliament is under an obligation to provide reasons for accepting or rejecting public views. In addition, the court stated that values and principles of good governance – contrary to the CoA holding that Article 10(2) (c) mandates Parliament to give reasons for accepting or rejecting public views – are optimizing commands that allow duty bearers to come up with suitable measures for fulfilling the obligations that they impose, without dictating definitive or specific actions that they ought to take.

Revenue estimates

The court held that the enactment of an Appropriation Bill was in no way tied to that of a Finance Bill and faulted the CoA for holding that there existed a legal requirement for the estimates of the revenue to be included in the Appropriation Bill or Act. The Supreme Court held that estimates of revenue are to be considered and approved alongside the estimates of expenditure by Parliament, before the Appropriation Bill. Once approved, the Appropriation Bill is prepared and contains estimates of expenditure. Therefore, the NA had followed the prescribed procedure in enacting the Appropriation Act, 2023.

Affordable housing levy

The court held that following the subsequent enactment of the Affordable Housing Act (AHA), the issues in relation to the affordable housing levy were overtaken by events. It further pointed out that the High Court delivered a judgment in respect of the AHA and it would be prudent for it to restrain from discussing the matter since the avenue of lodging an appeal against the High Court's decision is still open to the parties.

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High Court's jurisdiction to test the legality of policy positions taken by the Executive and Parliament in the legislative process

The Supreme Court's position was that courts should restrain themselves from intervening in policy matters. However, the High Court under Article 165 of the Constitution retains residual jurisdiction to test the constitutionality of policy decisions, whether or not translated into laws.

Considerations for the declaration of a statute as unconstitutional

The court stated that the following should be taken into account when determining whether or not to declare a statute unconstitutional.

- There is a general but rebuttable presumption that a statutory provision is consistent with the Constitution.
- The party that alleges inconsistency has the burden of proving such a contention.
- In construing whether statutory provisions or part thereof offend the Constitution, courts must subject the same to an objective inquiry as to whether they conform with the Constitution.
- The court must determine the object and purpose of the impugned statute and consider the mischief which the statute sought to cure and/or arrest.
- The court must clearly set out what provision is unconstitutional by juxtaposing the offending provision against the Constitution.

- A court must clearly and with precision explain the finding of unconstitutionality.
- The court must consider the effect of that declaration and, where necessary, suspend the application of that unconstitutionality for a prescribed amount of time to allow Parliament to change the law by either making it achieve its purpose without being unconstitutional or by removing the unconstitutional provision.

Furthermore, the Supreme Court stated that once a court has declared a statute unconstitutional, the next step ought to be what consequential orders to issue. Noting that a court may wish in certain cases to suspend the declaration of invalidity of the statute, the court provided guidelines to help a court of law determine whether to issue suspension of declaration of invalidity. These include:

- Suspension of invalidity is a remedy that ensures just and equitable relief, while ensuring that there is no disruption to the regulatory aspects of the statutory provision that is invalidated.



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- The declaration of invalidity would result in a legal lacuna that would create uncertainty, administrative confusion or potential hardship.
- Whether more injustice would flow from the legal vacuum created by rendering the statute invalid with immediate effect than would be the case if the measure were kept functional pending rectification.
- Whether there are multiple ways in which the legislature could cure the unconstitutionality of the legislation.
- The right in question will not be undermined by suspending the declaration of invalidity.
- Whether the suspension would be in interests of justice and good government, that is, whether the declaration of invalidity causes more than an inconvenience but does not go so far as to create a threat of the total breakdown of government.
- A court must balance the interests of the successful litigant in obtaining immediate constitutional relief and the potential of disrupting the administration of justice.
- Whether there will be any countervailing considerations of hardship, prejudice or harm that would result from the continued operation of the statutes.
- In determining the period of suspension, the court should consider the following matters:
 - the Government's conduct;
 - whether there is any legislation in the pipeline; and
 - the nature and severity of the continuing infringement.

The court's determination

The Supreme Court dismissed the preliminary objection challenging its jurisdiction and partially allowed the appeal by setting aside the CoA's declaration of the entire Act unconstitutional. The Supreme Court upheld the CoA's holding in respect of the question on the affordable housing levy being moot. Further, sections 76 and 78 of the Act amending section 7 of the Kenya Roads Act, 1999; and section 87 of the Act amending section 28 of the Unclaimed Financial Assets Act, 2011 are unconstitutional as they were neither incidental to nor directly connected to a money bill.

Comment

Following the Supreme Court's orders setting aside the CoA's finding declaring the entire Act unconstitutional, save for sections 76, 78, 84 and 87, amendments introduced by the Act to the various tax statutes are now the applicable laws. Taxpayers will continue to enjoy the favourable amendments introduced by the Act, like the zero-rating of exported services for VAT purposes.

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Below is a summary of the key implications of the judgment:

Income tax

- Expenditure not supported by an electronic tax invoice (eTIMS invoice) will not be allowable for income tax purposes.
- Permanent establishment will pay corporate tax at the rate of 37,5% and subject repatriated profits to 15% income tax.
- Withholding tax (WHT) will be remitted on the twentieth of each month.
- Special economic zone (SEZ) entities will continue to enjoy income tax exemptions on transfer of property and on the payment of management fees, interest and royalties by SEZ entities to non-resident persons.
- Income derived from the transfer or exchange of digital assets will continue to be taxable at the rate of 3% of the transfer or exchange value.
- Capital gains tax on indirect transfers will be applicable.
- Employees earning above KES 500,000 per month will be taxed at the current graduated PAYE scale.
- WHT will be applicable on payments made to residents and non-residents in respect of digital content monetisation.

- Turnover tax shall apply to resident persons earning between KES 1 million and KES 25 million, and at the rate of 3% of gross turnover.
- The residential rental income tax rate will continue to be 7,5%.

Value-added tax

- The applicable value-added tax (VAT) rate for petroleum products will be 16%.
- Liquefied petroleum gas (LPG) will enjoy exemption payment of VAT. Further, LPG will be exempt from import declaration fees and the railway development levy, making the product cheaper.
- Exported services will now be zero-rated. The hard task of proving that exported services fall within the ambit of "*business process outsourcing*" comes to an end.
- It will be mandatory for suppliers to declare sales invoices in their returns before the recipient can claim or deduct input VAT.
- Local manufacturers of phones, as well as players in the e-mobility sector, will enjoy the VAT incentives applicable to their products.

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Excise duty and miscellaneous fees

- The Kenya Revenue Authority Commissioner (Commissioner) will not have the discretion to adjust excise duty rates on an annual basis to account for inflation.
- Betting companies and manufacturers of alcoholic beverages will be required to remit excise duty to the Commissioner within 24 hours from the closure of the day's transactions.
- Services such as betting will be subject to excise duty rate of 12,5%.
- Other services such as money transfers and telephone and internet data services will be subject to an excise duty rate of 15%.
- The export and investment promotion levy on specified imported goods such as cement clinker will apply.
- The rates of import declaration fees and the railway development levy for imported goods will be 2% and 1,5% respectively.

Tax administration

- eTIMS requirements will apply to both VAT-registered persons and a claim for income tax deduction.
- The Commissioner's discretion to grant waivers of penalties and interest will cease.
- The period for tax disputes to be resolved via alternative dispute resolution shall be 120 days.
- The timelines for the remittance of WHT VAT will be every five working days.
- Ascertained refunds of overpaid tax shall be repaid to taxpayers within six months of the refund application.

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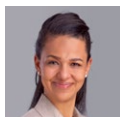
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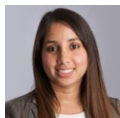
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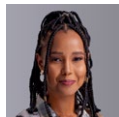
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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