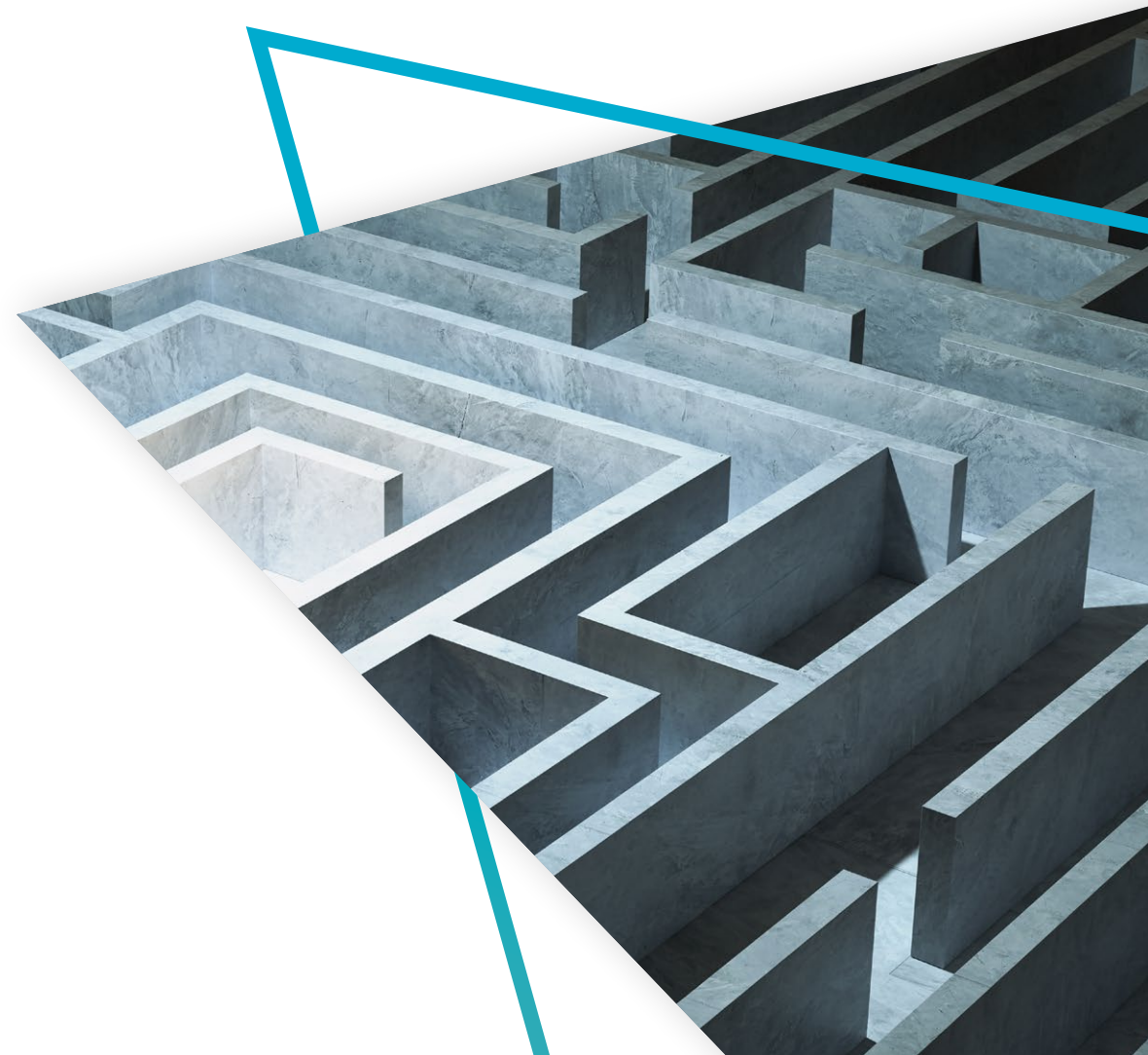


# Tax & Exchange Control

ALERT | 1 August 2024



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### KENYA

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## Public participation is the fulcrum upon which the constitutionality of legislation rests: An analysis of the recent Court of Appeal decision nullifying the Finance Act, 2023

The Court of Appeal of Kenya (CoA), through its judgment issued on 31 July 2024, declared the entire Finance Act, 2023 (Act) unconstitutional. Details of what was contained in the Act are provided in our analysis [here](#).

In this alert, we discuss the key findings of the court in the judgment and analyse what they mean for the Government and taxpayers in Kenya.

### Background

The Act, which was signed into law on 26 June 2023, amended various tax laws to introduce revenue raising measures for the fiscal year 2023/24 and going forward. Aggrieved by the legislative process leading to its enactment, 11 constitutional petitions were filed in the High Court challenging the Act's constitutionality. This culminated in a judgment delivered by the High Court on 28 November 2023. Details on the High Court's decision can be found in our alert [here](#).

Aggrieved by the High Court's decision, the Government made an appeal to the CoA. In dismissing the appeal and declaring the entire Act to be unconstitutional, the CoA found as follows:

- **Post-public participation amendments:** In what is perhaps the most significant finding, the CoA determined that the inclusion of 18 new provisions in the Finance Bill, 2023 after the conclusion of the public participation process, without submitting

the provisions to the public for comments, was unconstitutional. The 18 new provisions included the imposition of withholding tax (WHT) on digital content monetisation, the granting of income tax incentives to special economic zone (SEZ) enterprises, and the introduction of value-added tax (VAT) incentives for the e-mobility sector.

- **Public participation:** In yet another landmark finding, the CoA held that the constitutional principles of accountability and transparency mandated the National Assembly to give reasons to the public as to why their views were not incorporated into the Act. As these reasons were not provided, the process leading to the Act's enactment was constitutionally infirm.
- **Judicial discretion:** The CoA further held that the High Court has the jurisdiction to determine the constitutionality of policy matters, even where such matters are within the exclusive domain of other arms of government, such as the legislature.
- **Budget making process:** As per Articles 220 and 221 of the Constitution, the budgets of the national and county Governments should contain estimates of both revenue and expenditure. Consequently, the CoA held that the Appropriation Act, 2023 was unconstitutional since it only contained expenditure estimates and did not contain estimates of revenue. In this regard, we note that the Appropriation Act, 2024 also did not contain revenue estimates, and its legality could be challenged on this basis.

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- **Affordable housing levy:** The CoA held that the question as to the constitutionality of the affordable housing levy introduced by the Act was now moot, since the National Assembly has taken measures to address the legal defects identified by the High Court by passing the Affordable Housing Act, 2024 (Affordable Housing Act). In effect, therefore, the affordable housing levy is constitutional, and the Government can continue collecting the levy, notwithstanding the CoA's finding that the Finance Act, 2023 was unconstitutional. We are, however, aware that there is a separate ongoing court matter challenging the housing levy as per the Affordable Housing Act.
- **Money bill:** In upholding the High Court's finding, the CoA held that the Finance Act, 2023 was a money bill, and therefore, its provisions amending laws such as the Kenya Roads Board Act were unconstitutional as they do not relate to taxes, public money or debt.
- **Involvement of the Senate:** The CoA concurred with the High Court in holding that the Finance Bill, 2023 was a money bill that can only be considered by the National Assembly. The concurrence of the Speaker of the Senate was therefore not required.
- **Refund of taxes paid under the Act:** The CoA declined to order the refund of taxes collected under the Act as it was not initially pleaded before the High Court, and legislation is presumed to be constitutional until it is determined to be unconstitutional by a competent court.

## Comment

Following the CoA's judgment, all amendments introduced to various tax laws by the Act are unconstitutional. However, this position may change should the Government successfully appeal the CoA's judgment to the Supreme Court, which we expect to be filed given the far-reaching implications of the judgment.

While the CoA's judgment may be lauded by taxpayers and the public, its declaration of the Act's unconstitutionality means that some of the more favourable amendments, such as the express zero-rating of exported services for VAT purposes, are now unconstitutional. Below is a summary of the key implications of the judgment:

## Income tax

- Expenditure not supported by an electronic tax invoice (eTIMS invoice) will be allowable for income tax purposes. The Act had disallowed all expenditure not supported by an eTIMS invoice.
- Income tax on repatriated profits for permanent establishments at the rate of 15% will not apply. The corporate tax rate for permanent establishments will also revert to 37.5%.

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- The timelines for the remittance of WHT will revert to the twentieth of each month. The Act had reduced this to every five working days.
- SEZ entities will not 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 not be taxable at the rate of 3% of the transfer or exchange value.
- Capital gains tax on indirect transfers will not be applicable.
- Employees earning above KES 500,000 per month will be taxed at the prior graduated PAYE scale, whose highest tax rate was 30%.
- WHT will not be applicable on payments made to residents and non-residents in respect of digital content monetisation.
- Turnover tax shall only apply to resident persons earning between KES 1 million and KES 50 million, and at the rate of 1% of gross turnover. The Act had changed the range to between KES 1 million and KES 25 million and increased the rate to 3%.
- The residential rental income tax rate will be 10%, up from the 7,5% rate provided by the Act.

### VAT

- The applicable VAT rate for petroleum products will be 8%, down from the current 16%.
- Liquefied petroleum gas (LPG) will now be subject to VAT at the rate of 8%. The exemption of LPG from import declaration fees and the railway development levy will also cease to apply, making the product more costly.
- Exported services will be standard rated, save for those in respect of business process outsourcing, which will be zero-rated.
- The mandatory requirement for suppliers to declare sales invoices in their returns before the recipient can claim or deduct input VAT will not apply.
- Local manufacturers of phones, as well as players in the e-mobility sector, will not enjoy the VAT incentives applicable to their products.



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## Excise duty and miscellaneous fees

- The Kenya Revenue Authority (KRA) Commissioner (Commissioner) will regain their 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 on the twentieth of each month. The Act had changed this period to every 24 hours.
- Services such as betting will be subject to a lower excise duty rate of 7,5%, down from the Act's rate of 12,5%.
- Other services such as money transfers and telephone and internet data services will be subject to a higher excise duty rate of 20% than the prevailing rate of 15%.
- The export and investment promotion levy on specified imported goods such as cement clinker will cease to apply.
- The rates of import declaration fees and the railway development levy for imported goods will be 3,5% and 2,5% respectively, up from 2% and 1,5% as provided for in the Act.

## Tax administration

- Electronic tax invoice (eTIMS) requirements will only apply to VAT-registered persons.
- The Commissioner's discretion to grant waivers of penalties and interest has been restored.
- The period for tax disputes to be resolved via alternative dispute resolution shall be 90 days. The Act had increased the period to 120 days.
- The timelines for the remittance of withholding VAT will revert to the twentieth of each month. The Act had reduced this to every five working days.
- Ascertained refunds of overpaid tax shall be repaid to taxpayers within two years of the refund application. The Act had shortened this period to six months, although in practice it takes longer.

## Conclusion and way forward

With the Finance Act, 2023 being declared unconstitutional and with the withdrawal of the Finance Bill, 2024, the tax laws as amended by the Finance Act, 2022 are now the operational statutes for tax collection and administration purposes. As such, some of the positive measures for taxpayers introduced by the Act and summarised above are no longer applicable.

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The judgment also sends a strong message to the National Assembly and policymakers in general regarding the place of public participation in the legislative process. Going forward, these bodies should not only give written reasons for not considering the public's views, but also resubmit any new amendments to bills for public comments and participation. While this will inevitably protract the law-making process, it buttresses the centrality of public participation, accountability and transparency in the post-2010 constitutional era. Furthermore, the ongoing protests led by the Gen Z prove that public participation should be beyond the submission of comments in parliamentary committee sessions.

That said, the CoA's hesitation to grant an order for the refund of taxes paid under the Act is problematic. It remains to be seen whether the KRA will adopt the same restraint when collecting taxes that ought to have been paid under the Act, a crucial example being VAT on exported services. In addition, we will have to wait and see if the revenue authority will change the affected tax rates on iTax.

The Government is also unlikely to meet its revenue targets this year due to the withdrawal of the Finance Bill, 2024 and the declaration of the Act as unconstitutional. The two laws had expanded the tax base to increase revenue collection and their withdrawal may result in more borrowing and less money for development. Going forward, it is likely that National Treasury will reintroduce most of changes brought by the Act in a tax law amendment bill. It is noteworthy that the current regime has not had its way in matters of revenue generation since its election in 2022.

The Act remains unconstitutional, subject to a successful appeal of the judgment to the Supreme Court. We understand that the Government intends to file an appeal before the Supreme Court. It is also expected that the Government will seek a stay of the CoA's orders, pending the determination of the appeal by the Supreme Court.

We are monitoring the progress of the appeal.

**Alex Kanyi, Lena Onyango, Nicholas Gathecha and Charity Muindi**

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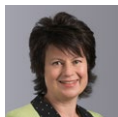
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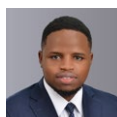
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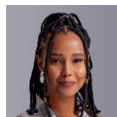
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