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LEGAL ALERT

# Analysis of the Tax Changes Proposed by the Finance Bill, 2025

May 2025

## Introduction

The Finance Bill, 2025 (the Bill) was tabled before the National Assembly on 30 April 2025 and is expected to undergo the legislative process for the next two months. The Bill sets out a wide range of proposed changes to Kenya's tax laws, including the Income Tax Act (Chapter 470, Laws of Kenya), the Value Added Tax Act, 2013, the Tax Procedures Act, 2015, the Miscellaneous Fees and Levies Act, 2016 and the Excise Duty Act, 2015.

All provisions in the Bill are set to come into effect on **1 July 2025**, except for the new provisions introducing Advance Pricing Agreements into the transfer pricing regime, and the provision granting the Cabinet Secretary for the National Treasury and Planning the authority to waive penalties and interest in certain cases. These two new provisions will take effect on **1 January 2026**.

It was expected that going forward, tax changes would be in line with the Government's Medium Term Revenue Strategy for FY 2024/25 to 2026/27 published by the National Treasury and Economic Planning in September 2023 (the MTRS). Key amongst these proposals were the intended reduction of the corporate tax rate from 30% to 25% and alignment of the non-resident withholding tax rates with the corporate tax rate.

While the Bill reflects some alignment with the Government's MTRS, including a push for base broadening, rationalisation of exemptions, and greater administrative efficiency. The Bill does not however adopt key headline measures previously signalled under the MTRS such as the proposed reduction in corporate tax rates highlighted above.

Furthermore, while the government has recently indicated that the Finance Bill, 2025 does not introduce any tax measures that would increase the burden on taxpayers, a closer review of the proposed amendments reveals otherwise. The Bill contains several provisions that are likely to have a material financial impact on businesses and individuals. These include the **repeal of investment deduction incentives**, **restriction of tax loss carry-forward to five years**, **elimination of rebates for affordable housing developers and motor vehicle assemblers**, and the **broadening of the Significant Economic Presence Tax (SEPT)** to cover all non-residents regardless of turnover. Although there are some welcome relief measures, such as the **reduction of the digital asset tax rate**, **exemption of gratuity payments**, and **VAT exemptions on tea and coffee packaging,** these are outweighed by proposals that expand the tax base and remove existing incentives, effectively **increasing the tax liability for many taxpayers**. It is therefore important for stakeholders to critically assess the cumulative effect of these proposed changes during the public participation process leading up to the enactment of the Bill.

We have set out below an analysis of the key proposals in the Bill and their potential impact on taxpayers and businesses operating in Kenya.

## A. PROPOSED AMENDMENTS TO THE INCOME TAX ACT

The Bill has proposed various changes under the Income Tax Act (the ITA) which are intended to promote investments, expand the tax base, harmonise the existing provisions and reduce the incentives that are currently available in the income tax regime.

We have highlighted the key income tax proposals below:

### *a) Restriction on Carry-Forward of Tax Losses*

*Proposed Effective Date: 1 July 2025*

Currently, taxpayers are allowed to carry forward tax losses indefinitely and can utilise the tax losses in succeeding years of income. The Bill proposes to restrict the carry-forward period for tax losses to the succeeding five (5) years, limiting taxpayers' ability to utilise their losses in future years of income.

If enacted as proposed, taxpayers with tax losses older than five years from the effective date may lose the ability to utilise those losses against future taxable income. Businesses, particularly those in industries with long recovery periods (e.g., startups, manufacturing, or capital-intensive sectors), may face increased financial strain due to the inability to carry forward losses as has been the case.

Unless a grandfathering provision is introduced for existing tax losses, taxpayers with losses accumulated over many years could face an immediate write-off of those losses, effectively reducing their tax shields and increasing their tax liability.

It should be noted that this provision has been the subject of several changes in the last few years. Prior to 1st January 2016, the carry-forward of losses was restricted to the succeeding four (4) years of income. This was subsequently amended by the Finance Act, 2015 to nine (9) years, before the deletion of the provision by the Finance Act, 2021, which allowed the losses to be carried forward indefinitely.

### *b) Introduction of Advance Pricing Agreements in the Transfer Pricing Regime*

*Proposed Effective Date: 1 January 2026*

The Bill proposes to introduce Advance Pricing Agreements (APA) which would empower the Commissioner to enter into APAs with taxpayers on how transfer pricing regulations should apply to their related party transactions. The APAs entered with the Commissioner shall be valid for a period of five years. However, they may be voided if the Commissioner establishes that the taxpayer misrepresented facts at the time of entry into the APA with the Commissioner.

This is positive move towards establishing a business-friendly environment as it will provide the much-needed clarity and certainty as to how the related party transactions would be treated from a tax perspective and potentially reduce transfer pricing tax disputes. The proposed introduction of APAs also aligns with global standards, as well as other EAC countries such as Rwanda, Uganda and Tanzania which have introduced APAs in their domestic tax legislation.

The Bill also allows the Cabinet Secretary to make regulations for better implementation of the APAs. In the past, capacity constraints have hampered tax authorities in the region from implementing the APAs. We hope that once this proposal is passed into law, the Cabinet Secretary will soon thereafter issue guidelines to assist the Kenya Revenue Authority (KRA) in fast tracking the roll out of the APAs.

***c) Broadening the Scope of SEPT Regime - Two Steps Forward, One Step Backwards***

*Proposed Effective Date: 1 July 2025*

The Tax Laws (Amendment) Act, 2024 introduced Significant Economic Presence Tax (SEPT) with effect from 27 December 2024, which is currently applicable to non-resident persons deriving income from the provision of services in Kenya through a business carried out over a digital marketplace. The Bill clarifies that SEPT shall also be applicable on businesses carried out over the internet or an electronic network, in addition to businesses carried out through a digital marketplace.

The Tax Laws (Amendment) Act, 2024 had excluded non-resident persons with an annual turnover of less than KES 5 million from SEPT. The Bill proposes to delete this provision, such that SEPT shall apply to all non-resident persons who derive income from Kenya through a business carried out over the internet, electronic network or a digital marketplace regardless of their annual turnover.

We are of the view that the proposed amendment, if enacted, will beat the purpose of a selective approach of identifying "significant economic presence" by non-residents. The essence of SEPT is to only subject this tax to non-residents who have a "significant economic presence" in Kenya. In Nigeria, for example, which is the only other African country with a SEPT regime, non-residents are subject to SEPT only if they derive income of approximately USD 65,000 in a year from the relevant activities conducted in Nigeria.

It is also our view that the effort that will be required to monitor implementation of SEPT without a turnover threshold will make it difficult for the KRA to effectively administer the application of SEPT in Kenya.

It is also expected that regulations which will provide further guidance on the operationalisation of the SEPT regime will be issued by the Cabinet Secretary for the National Treasury as contemplated in the existing provisions of the ITA which were introduced by the Tax Laws (Amendment) Act, 2024.

### *d) Preferential Tax Regime for Investors in the Nairobi International Financial Centre*

*Proposed Effective Date: 1 July 2025*

The government has in the recent past introduced various changes intended to provide a preferential tax regime to investors certified by the Nairobi International Financial Centre Authority (NIFCA) to promote and encourage investments under the NIFCA regime. The Tax Laws (Amendment) Act, 2024, introduced a preferential capital gains tax rate of 5% for entities certified by NIFCA.

The Bill further proposes to introduce a preferential corporate tax rate of 15% for the first ten years from the year of commencement of its operations and 20% for the subsequent ten years of its operation provided the following conditions are met:

a) the company invests at least KES 3 billion in Kenya in the first three years of operation;
b) where the company is a holding company, at least 70% of its employees in senior management are citizens of Kenya; and
c) where the regional headquarters of the company is in Kenya, at least 60% of its employees in senior management are citizens of Kenya.

In the case of a start-up certified by NIFCA, the Bill has proposed a corporate tax rate of 15% for the first three years and 20% for the succeeding four years.

Additionally, the Bill proposes to grant a withholding tax exemption on dividends paid by a company certified by NIFCA where the company reinvests at least KES 250 million in Kenya in that year of income.

The proposed preferential corporate tax rates and withholding tax exemption on dividends are intended to encourage the uptake of the NIFCA regime by investors and promote investments in the country.

It has been the case that there has been little uptake in the past of NIFCA by foreign investors, in comparison with other regimes such as special economic zones (SEZ). It is noted that the special economic zones regime does not have financial investment thresholds in order to enjoy tax benefits, as have been now proposed for NIFCA. It remains our view that further alignment will be required in the coming years in order to further enhance NIFCA as a suitable investment destination for foreigners.

### *e) New CGT Exemption on Transfer of Property to a Company Held by an Individual*

*Proposed Effective Date: 1 July 2025*

The Bill proposes to amend the Eighth Schedule to the ITA to introduce a CGT exemption on transfer of assets to a company where an individual holds 100% shareholding in the company. Currently, transfer of assets to a company would be exempt from CGT where 100% of the shareholding of the company is held by spouses or a spouse and their child or children. The proposed amendment is a welcome move as it will enable individuals who, for personal or estate planning purposes wish to hold their assets through a company, to do so without triggering CGT.

It should be noted that while the proposal seeks to exempt such transfers from CGT, there is no corresponding exemption from stamp duty that presently exists. Therefore, any transfers by an individual to a company wholly owned by them would still trigger stamp duty, which will range from 1% to 4% of the value of the property, depending on the type of property.

### *f) Blow to Investors Within SEZs and Outside Nairobi City and Mombasa Counties*

*Proposed Effective Date: 1 July 2025*

Since July 2022, a person who makes significant capital investments outside of Nairobi City County and Mombasa County subject to meeting certain conditions or makes an investment in a Special Economic Zone, is eligible for an investment deduction of 100% of the capital expenditure incurred. The practical implication was that an investor received a tax shield on the capital invested, and therefore did not need to pay corporation taxes until the investment deduction had been exhausted.

The Bill proposes to do away with the investment deduction regime in its entirety. If the Bill is passed in its current form, it is our view that an investor will need to contend with the possibility of paying taxes in the first year of operation. This proposal could therefore make Kenya less attractive, as compared to her neighbours, for investors who may be considering other jurisdictions within the region for purposes of establishment of a regional business.

The impact of this proposal, if enacted, is that businesses that would have qualified for the 100% investment allowance would now only be eligible for the standard investment allowances outlined in the ITA. These rates are significantly lower (ranging from 10% to 50% depending on the asset type) leading to a higher taxable income and increased tax liability for investors in the earlier years of operation.

### *g) Clarity on the Tax Exemption for Transfer of Property within SEZs*

*Proposed Effective Date: 1 July 2025*

Currently, the ITA provides for exemption from tax on the gains from transfer of property "*within a special economic zone enterprise, developer and operator*". Since its introduction, this provision has been subject to varying interpretations and uncertainty noting the ambiguity in the wording.

The Bill proposes to delete and replace the provision with a new provision which provides for an exemption on gains on transfer of property within an SEZ by a licensed SEZ developer, enterprise or operator. This therefore means that the exemption would only apply to gains from transfer of property within a special economic zone such as immovable property or shares of a licensed SEZ entity held by another licensed SEZ entity.

The proposed amendment will provide the much-needed clarity on the application of the exemption.

### h) *Scrapping of Rebates Granted to Housing Developers and Local Motor Vehicle Assemblers*

*Proposed Effective Date: 1 July 2025*

The Bill has proposed to delete the 15% income tax rebate available to companies who construct at least one hundred residential units annually, which had been introduced on 1 January 2017, with the intention to encourage developers to construct affordable housing under the previous government's Big Four Agenda.

The proposed scrapping of the preferential tax rate of 15% appears to be in line with the MTRS which proposed to phase out preferential corporate tax rates in the FY 2024/25. This is also in line with the shift in the implementation of the affordable housing programme which is now under the Affordable Housing Fund managed by the Affordable Housing Board established under the Affordable Housing Act, 2024. However, due to the significant housing deficit in Kenya (estimated at an annual deficit of approximately 200,000 units), and inability of the government to meet the housing demand through the Affordable Housing Scheme, the government should consider retaining the preferential 15% income tax rebate to incentivise real estate developers to continue investing in this sector to meet the housing deficit and deliver affordable housing to Kenyans.

The Bill has further proposed to delete the preferential corporate tax rate of 15% available to local assemblers of motor vehicles in their first 5 years of operations, which can be extended for a further 5 years if the assemblers achieve a local content equivalent to 50% of the ex-factory value of the motor vehicles. This means that local motor vehicle assemblers will be subjected to standard rates of corporate tax if the proposal in the Bill is passed into law. This proposal may be a set-back for the local motor vehicle assembly industry that is still in its early stages of development. It is our expectation that this will be a provision which will need further consideration by Parliament prior to enactment of the Bill.

### i) *Clean Up on Taxation of Pensions and Gratuity*

*Proposed Effective Date: 1 July 2025*

The MTRS provides for review of the taxation of pension as one of the tax policy reforms to be implemented gradually within the period FY 2024/25 to FY 2026/27. The pension tax structure was therefore intended to be reviewed from '*exempt-exempt-tax'* model which means that contributions to pension funds are exempt from tax, investment income of a pension fund is exempt from tax but the pension income withdrawn by members is subject to tax, to an '*exempt-exempt-exempt'* model where pension contributions, investment income of pension funds and the withdrawal of pension income, are all exempt from tax.

The Tax Laws (Amendment) Act, 2024 introduced an exemption on withdrawal of pension benefits from registered pension funds, registered provident funds, registered individual retirement funds, public pension schemes or the National Social Security Fund. The exemption was however limited to withdrawals by persons who have been members of a fund for at least 20 years.

In a clean-up exercise, the Bill proposes to delete Section 8 (4) of the ITA which limited the exemption on pension income / withdrawals to the first KES 300,000 of the total pensions and retirement annuities received by a resident individual from a registered fund or the National Social Security Fund in a year of income. This means that in line with the MTRS strategic policy, withdrawal of income from pensions for persons who have been members of a fund for at least 20 years would be exempt from tax.

The Bill has further proposed to exempt gratuity payments from tax. Currently, only gratuity paid under a public pension scheme is exempt from tax.

***j) Expanded Definition of Royalties***

*Proposed Effective Date: 1 July 2025*

The definition of the term "royalty" was recently expanded through the Tax Laws (Amendment) Act, 2024, and currently includes payments made as a consideration for the use or right to use any software, proprietary or off-the-shelf, whether in the form of licence, development, training, maintenance, or support fees.

The Bill proposes to further expand the provision to include the distribution of the software where regular payments are made for the use of the software through the distributor. We note that a similar amendment was proposed in the Finance Bill, 2024.

We point out that the proposed amendments would not only contradict the current jurisprudence established by Kenyan courts but would also go against international best practice, including guidance from the Organisation for Economic Co-operation and Development (OECD), which provides that the distribution of software is not equivalent to exploitation of the software.

***k) Expanded Definition of "Related Person''***

*Proposed Effective Date: 1 July 2025*

The term "related person" is defined in Section 2 of the ITA to mean (in the case of two persons), a person who participates directly or indirectly in the management, control or capital of the business of the other person. However, a more expansive definition exists under Section 18 of the ITA but which is presently applicable to the transfer pricing regime.

The Bill proposes to delete both definitions and replace them with a broader definition in Section 2 which includes cases where a third party participates, directly or indirectly, in the management, control, or capital of both businesses, and, in the case of an individual:

(a) participates directly or indirectly in the management, control or capital of the business of the two persons;

(b) is associated with the two persons by marriage, consanguinity or affinity; and

(c) the two persons participate in the management, control or capital of the business of the individual.

The practical implication of this is that the expanded definition of "related party" will now apply to all provisions in the ITA.

***I) Other Noteworthy Income Tax Proposals***

*Proposed Effective Date: 1 July 2025*

a) *Clarity on Due Date for Minimum Top-Up Tax* – The Minimum Top-Up Tax provisions were introduced by the Tax Laws (Amendment) Act, 2024, but without guidance on the due date for the same. The Bill proposes to offer clarity to taxpayers on what is a relatively new tax that if enacted, the due date shall be the end of the fourth month after the end of the relevant year of income.

b) *Proposed Reduction in the Digital Asset Tax Rate* – The Bill proposes to reduce the tax rate in respect of digital assets tax from 3% of the transfer or exchange value of the digital asset to 1.5% in what appears to be a move to encourage increased market activity in the digital asset market sector.

c) *Application of Reliefs in Computation of Employment Taxes* – The Bill has proposed to introduce a provision requiring employers to apply all applicable deductions, reliefs and exemptions provided under the ITA before computing tax due on their employees' income. This is a move to ensure that employees take advantage of all the reliefs and deductions available for employment income taxes.

d) *Increased Threshold for Taxable Per Diem Amounts* – Currently, the non-taxable threshold for reimbursements to employees for purposes of subsistence, travelling, entertainment and other allowances (per diems) is KES. 2,000 per day, and the Bill proposes to revise this threshold to KES 10,000, which is a welcome proposal.

e) *Extended Period for Issuing Tax Exemption Certificates to Charitable Organisations* – the Bill proposes to extend the period in which the Commissioner may issue a tax exemption certificate upon lodging an application for tax exemption under the ITA from sixty to ninety days. This is to allow the Commissioner adequate time to review the application and make an appropriate determination.

## B. AMENDMENTS TO THE TAX PROCEDURES ACT

*Proposed Effective Date: 1 July 2025*

### *a) Agency Notices: A Threat to Taxpayers' Constitutional Right to Access Justice*

The Bill proposes to delete the provision which prohibits the Commissioner from issuing agency notices where a taxpayer has lodged an appeal before the Tax Appeals Tribunal or the High Court.

The proposed repeal would empower the Commissioner to issue agency notices in respect of taxpayer immediately upon rendering an objection decision, effectively treating the disputed tax as immediately due and payable. This proposal if enacted would, in substance, amount to a "pay now argue later" policy, by vesting the Commissioner with the power to collect taxes notwithstanding an ongoing appeal by the taxpayer.

Consequently, this proposal poses a significant risk of infringing the taxpayers' constitutional right of access to justice as guaranteed under Article 48 of the Constitution of Kenya, 2010 and has the potential of imposing undue financial hardship on taxpayers by creating cash flow constraints, particularly where taxpayers are required to settle disputed assessments in full prior to the conclusion of appellate proceedings.

The risk is further compounded by the fact that a refund, if the taxpayer is successful on an appeal, will be likely delayed or conditioned.

The Bill further proposes to broaden the powers of the Commissioner to cover non-resident persons who are liable to pay taxes in Kenya. This means the Commissioner may now direct a third party / agent to pay to the KRA any money due to the non-resident, to settle tax debts owing from the non-resident person.

This may provide a mechanism for the Commissioner to enforce the collection of taxes on non-residents who are subject to tax in Kenya through various regimes, including the Significant Economic Presence Tax and Value Added Tax (Digital Marketplace Supply) regimes.

### *b) Delicate Balance Between Accountability and Taxpayers' Rights to Data Protection*

Pursuant to the amendments introduced last year through the Tax Procedures (Amendment) Act, 2024, the Commissioner is empowered to require any person to integrate their electronic tax system with KRA's data management and reporting system, and to submit their data to the KRA on a contemporaneous basis. The Tax Laws (Amendment) Act, 2024 however clarified that the Commissioner could not require the sharing of data relating to trade secrets, or private or personal data held on behalf of customers, or data collected in the course of conducting business from the customers.

The Bill now proposes to delete the provision which currently prohibits the Commissioner from requiring taxpayers to share or integrate data relating to trade secrets or private, or personal data held on behalf of customers or collected during business. This deletion significantly broadens the Commissioner's power to access taxpayers' data.

While the proposed amendment may enhance tax transparency and improve audit capability, it raises serious concerns around data privacy, data confidentiality, and the risk of abuse of this information once remitted to the Commissioner. It is unclear what safeguards within the KRA will be in place, to ensure that such data will not be accessible by potentially the thousands of KRA employees, and the risks that such data may be leaked to competitors and others. Without strong data protection safeguards, this proposed change may expose businesses and their clients to competition, legal and reputational risks.

***c) Express Requirement for the Commissioner to Provide Reasons when Amending Assessments***

The Bill proposes a new requirement for the Commissioner to include reasons when issuing amended tax assessments in their notice of amendment. Currently, whenever a dispute arises between taxpayers and the KRA has not provided reasons for their amended assessments, taxpayers have been able to have the decision set-aside for failure to provide reasons for their decisions.

This proposal is therefore a welcome move because it codifies this obligation on KRA's part and hence enhances transparency and accountability on the part of the Commissioner.

***d) Disposal of Property for Settlement of Unpaid Tax to be Exempt from Stamp Duty***

The Bill proposes to introduce a new provision that seeks to exempt the transfer of property for purposes of tax recovery from the payment of stamp duty. Given that stamp duty is ordinarily borne by a purchaser, the proposed amendment is intended to make it easier and faster for the Commissioner to undertake a forced sale and attractive to purchasers to acquire a distrained property since the transfer of the property would be exempt from stamp duty.

***e) Timelines for Tax Refund Decisions***

The Bill proposes to revise the period to be granted to the Commissioner to respond to taxpayers on various aspects, that is:

a. the Bill proposes to extend the period within which the Commissioner shall be required to ascertain an offset or refund application to one hundred and twenty days from the current ninety days; and
b. in the event the Commissioner subjects the application to an audit, the Bill proposes to extend the period within which the Commissioner must ascertain an offset or refund application from one hundred and twenty days to one hundred and eighty days.

While the intention behind extending the prescribed timelines may be to accommodate the increasing volume of refund applications processed by the Commissioner, the proposed amendments are likely to have the unintended consequence of slowing down the refund and offset process. This may, in turn, adversely affect taxpayers' cash flow.

### *f) Reversal on the Calculation of Timelines for Submissions to the Tax Tribunal and Courts*

The Tax Procedures (Amendment) Act, 2024, introduced a provision which provides for exclusion of weekends and public holidays when computing timelines for filing appeals to the Tax Appeals Tribunal, the High Court, and the Court of Appeal. The provision aligns with existing provisions of the Interpretation and General Provisions Act, Cap. 2 of the Laws of Kenya on computation of time.

The Bill proposes to delete the provision. This means that taxpayers would fall back to the previous position under Section 77(1)(c) of the TPA, which provides that where a statutory deadline falls on a weekend or public holiday, the relevant filing or action must be taken on the preceding working day. Consequently, the repeal may place taxpayers at a procedural disadvantage by requiring compliance within shorter timeframes.

It is also the case that an amendment to this provision raises the question on why a provision should only have been introduced in Kenya's tax laws for a period of six (6) months prior to its reversal, noting that the Tax Procedures (Amendment) Act 2024 came into force in December 2024. This impinges on the overall policy of providing tax certainty to taxpayers.

### *g) Cabinet Secretary's Power to Waive Penalties and Interest due to System Errors*

*Proposed Effective Date: 1 January 2026*

The Bill introduces a new provision, empowering the Cabinet Secretary to waive penalties or interest, upon recommendation by the Commissioner, where:

a) an error is generated by an electronic tax system;
b) a delay in the updating of the electronic tax system;
c) a duplication of penalty or interest due to a malfunction of an electronic tax system; or
d) the incorrect registration of the tax obligations of the taxpayer.

This is a welcome relief provision that recognises the practical challenges posed by system-driven errors, often arising with no fault of a taxpayer. It provides a legal mechanism for redress in cases where taxpayers are unfairly penalised due to system failures, helping restore fairness and trust in digital tax administration.

## C. PROPOSED AMENDMENTS TO THE VALUE ADDED TAX ACT

*Proposed Effective Date: 1 July 2025*

The Bill proposes to make various changes to the Value Added Tax Act, 2013 (the VAT Act) aimed at enhancing efficiency in revenue administration. We have highlighted the proposed changes below.

### *a) VAT Adjustment on Misuse of Exempt or Zero-Rated Supplies*

The Bill proposes to introduce a new provision requiring taxpayers to account for VAT where goods or services acquired under exempt or zero-rated status are subsequently used in a manner inconsistent with the purpose for which that VAT treatment was granted. In such cases, the person must pay VAT at the applicable rate at the time of disposal or alternative use.

This proposed amendment is aimed at closing tax loopholes and preventing abuse of VAT exemptions and zero-rating provisions. This aligns with international best practice and is aimed at enhancing compliance and discourages misuse of incentives. We expect guidelines to be issued in due course to provide guidance on the implementation of the provision.

### *b) Restrictions on Offsets and Refund Claims Arising Out of Tax Withheld by Appointed Tax Withholding Agents*

The Bill proposes to delete paragraph 17(5)(c) of the VAT Act, which currently allows a registered person to apply excess input tax arising specifically from VAT withheld by appointed tax withholding agents, against any tax payable under the VAT Act or other tax laws, or to claim it as a refund under section 47(4) of the Tax Procedures Act. This provision has been instrumental in enabling taxpayers to efficiently utilise withholding VAT credits, either through offsets across various tax heads or by accessing refunds, thereby easing off cash flow constraints.

The proposed deletion is intended to limit the use of VAT withholding credits to input tax deductions under the VAT Act, rather than allowing their offset against other tax obligations. While this proposal may be aimed at tightening control over the use of tax credits and reducing exposure to revenue leakage, the change is likely to have an adverse impact on taxpayers. The proposal removes a clear statutory basis for offsetting excess withheld VAT beyond the VAT regime or claiming a refund and may delay recoveries.

### *c) Offset Option for VAT Refunds Arising from Bad Debts*

The Bill further proposes to introduce a new option allowing taxpayers to offset VAT refunds arising from bad debts against other VAT liabilities upon the approval by the Commissioner. The proposed amendment is a welcome move for compliant taxpayers, particularly those facing cash flow challenges, as it offers an alternative mechanism to utilise bad debt VAT credits.

### *d) Reduction of Timelines for Lodging a Tax Refund Claim*

The Bill proposes to reduce the statutory period for lodging a claim for refund of excess tax from the current 24 months to 12 months from the date the tax becomes due and payable. While the move may be intended to encourage timely reconciliation and improve administrative efficiency, it is likely to have a negative impact on taxpayers, as the amendments will significantly limit the window within which taxpayers can recover VAT. Taxpayers would therefore need to be vigilant to ensure that they are not time-barred form lodging a refund claim.

Additionally, the Bill proposes to reduce the waiting period before a taxpayer can apply for a VAT refund on bad debts from the current 3 years to 2 years after the date of the supply. The proposed amendment would mean that taxpayers would be able to initiate refund claims for VAT on unpaid supplies more promptly. Notably, the deadline for lodging such a refund claim is 10 years.

#### *e) Changes to VAT Treatment of Certain Goods*

The Bill proposes to move a number of taxable supplies from the Second Schedule (relating to zero-rated supplies) to the First Schedule (relating to exempt supplies). The key implication of this change will be that the supplies of the exempt supplies would not be allowed to claim input VAT. This may give rise to a restriction on a suppliers ability to claim input VAT, noting that the higher the exempt supplies are as a proportion of their total supplies, the less input VAT a supplier can claim. Consequently, suppliers will likely bear additional tax costs on their inputs, and which amount will likely be passed on to final consumers.

The Bill also proposes to delete certain taxable supplies currently listed in the First Schedule thereby making these items subject to VAT at the standard rate of 16%. The proposed amendments will impact various industries such as the medical and pharmaceutical industries, the transportation sector, manufacturers and the agricultural industry.

Click here to download a summary of the proposed VAT amendments per sector.

## D. PROPOSED AMENDMENTS TO THE EXCISE DUTY ACT

#### *a) Alignment of Tariff Classification under the Excise Duty Act with the EAC Common External Tariff*

*Proposed Effective Date: 1 July 2025*

The Bill proposes to introduce a new provision requiring goods listed in the Excise Duty Act, 2015 (EDA) to be classified in accordance with the tariff codes set out in Annex 1 to the Protocol on the Establishment of the East African Community Customs Union (the EAC Common External Tariff). The proposed provision further provides that the general rules of interpretation contained in the EAC Common External Tariff will apply when interpreting the classification of goods under the EDA.

This amendment is a welcome development as it provides clarity on how goods are to be classified under the EDA. Whilst this has been the practice, it was not explicitly provided for in the law. By expressly referencing the EAC Common External Tariff and its general rules of interpretation, the amendment codifies existing practice and enhances legal certainty for taxpayers and administrators alike.

#### *b) Expansion of the Definition of "Digital Lenders"*

The Bill has proposed to amend the definition of the term "digital lender" to mean *"a person extending credit through an electronic medium but does not include a bank licensed under the Banking Act, a Sacco society registered under the Co-operative Societies Act, or a microfinance institution licensed under the Microfinance Act."* This amendment further amends the definition that was introduced in the EDA by the Tax Laws (Amendment Act), 2024, which took effect on 27 December 2024 which defined "digital lender" as *"a person holding a valid digital credit provider's license issued by the Central Bank of Kenya."*

The proposed amendment broadens the scope of persons considered to be "digital lenders" for excise duty purposes by shifting from a regulatory-based definition to a functional one. By focusing on the function of the "digital lenders" i.e., provision of credit through an electronic medium, the proposed amendment would be interpreted to include unregulated lenders who were previously outside the scope of the definition due to the lack of licensing by the Central Bank of Kenya.

The proposed amendment further clarifies that digital lenders do not include traditional financial institutions such as banks licensed under the Banking Act, Sacco societies registered under the Cooperative Societies Act or microfinance institutions licensed under the Microfinance Act. However, we note that there is an error in the amendment by referencing that Saccos are registered under the Cooperative Societies Act as opposed to the Sacco's Societies Act, 2008 and therefore a clean-up is required. Further, it is not clear from the current drafting of the Bill, whether Co-operative Societies registered under the Co-operative Societies Act (CAP 490) are to be excluded from this definition and this issue therefore needs to be clarified before the Bill is passed into law.

***c) Expansion of the Scope of Excisable Services Offered Through Digital Platforms by Non-Residents***

The Tax Laws (Amendment Act), 2024 amended the EDA to impose excise duty on excisable services offered in Kenya by a non-resident person through a digital platform effective 27 December 2024.

The Bill seeks to amend the EDA to replace the phrase *"through a digital platform"* with *"over the internet, an electronic network or through a digital marketplace."* The import of this amendment is to capture a wide range of digital transactions into the taxing net. This is on the basis that the term *"over the internet, an electronic network or through a digital marketplace"* ensures that any digital service accessed or delivered online regardless of the infrastructure or medium used, falls within the scope.

***d) Timelines for Issuance of Excise Duty Licences***

The Bill proposes to introduce a 14-day timeline within which the Commissioner must issue a decision on applications for excise duty licences, from the date of receipt of the required documents. This amendment is welcome and is aimed at enhancing administrative efficiency and providing certainty to businesses seeking to operate within the excise duty regime.

***e) Excise Duty Changes for Various Items***

The Bill proposes to make a raft of changes to the First Schedule to the EDA as set out below.

***i. Exclusion of specific goods from the purview of excise duty***

The Bill proposes to delete the following items from the First Schedule of the EDA, along with their corresponding rates. The import of these amendments is that the deleted items will no longer be subject to excise duty. This is a welcome move, as it means that these goods will cease being excisable and would be expected to become more affordable for consumers.

| Product | Current Excise Duty Rate |
|---|---|
| Imported eggs of tariff heading 04.07. | 25% |
| Imported onions of tariff heading 07.03. | 25% |
| Imported potatoes, potato crisps and potato chips of tariff heading 07.01. | 25% |
| Printed paper or paperboard of tariff heading 4811.41.90 or 4811.49.00 but excluding those originating from East African Community Partner States that meet the East African Community Rules of Origin. | 25% or KES 200 per kg, whichever is higher |
| Printed paper or paperboard of tariff heading 4811.41.90 or 4811.49.00 but excluding those originating from East African Community Partner States that meet the East African Community Rules of Origin. | 25% or KES 150 per kg, whichever is higher |

### *ii. Increase in Excise Duty on Certain Imported Plastic Products*

The Bill proposes to increase the excise duty on certain imported plastic products (i.e. self-adhesive plates, sheets, film, foil, tape, strip and other flat shapes, of plastics, excluding those originating from the EAC) from the current rate of 25% or KES 75 per kilogram, whichever is higher, to a significantly higher rate of 25% of the excisable value or KES 200 per kilogram, whichever is higher. The effect of the proposed change is that importers and manufacturers relying on these plastic inputs, particularly those not originating from EAC Partner States, will face higher import costs, which would likely be passed on to consumers.

### *iii. Introduction of excise duty to specific imported products and spirits of undenatured extra neutral alcohol*

The Bill proposes to subject various items to excise duty including spirits of undenatured extra neutral alcohol of alcoholic strength exceeding 90% purchased by licensed manufacturers of spirituous beverages.

Click here to download a summary of the products proposed to be subject to excise duty and the applicable rates.

## E. AMENDMENTS TO THE MISCELLANEOUS FEES AND LEVIES ACT

*Proposed Effective Date: 1 July 2025*

### *a) Narrowing of Exemptions for Aircraft and Related Goods*

The Bill proposes to restrict the current exemption from the Import Declaration Fee and Railway Development Levy for goods classified under Chapter 88 of the EAC Common External Tariff, which includes aircraft, spacecraft, and related parts.

Under the proposed changes, the exemption would be limited to select goods, specifically, parts of Chapter 88 and items under tariff codes 8802.30.00 and 8802.40.00. These cover aeroplanes and other aircraft with an unladen weight exceeding 2,000 kg but not exceeding 15,000 kg, and those exceeding 15,000 kg, respectively. This narrowing of scope may increase the cost of acquiring a broader range of aircraft and related goods, potentially impacting the aviation sector and related industries.

### *b) Reduction of the Export Promotion Levy on Certain Items*

The Bill proposes to amend the Third Schedule of the Miscellaneous Fees and Levies Act, 2015, to reduce the Investment Promotion Levy on various goods from 17.5% to 5%. The goods include semi-finished products of iron or non-alloy steel and bars and rods of iron or non-alloy steel. This reduction is intended to promote investment and enhance the competitiveness of locally manufactured products in export markets.

## Contact Us

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*The content of this alert is intended to be of general use only and should not be relied upon without seeking specific legal advice on any matter.*