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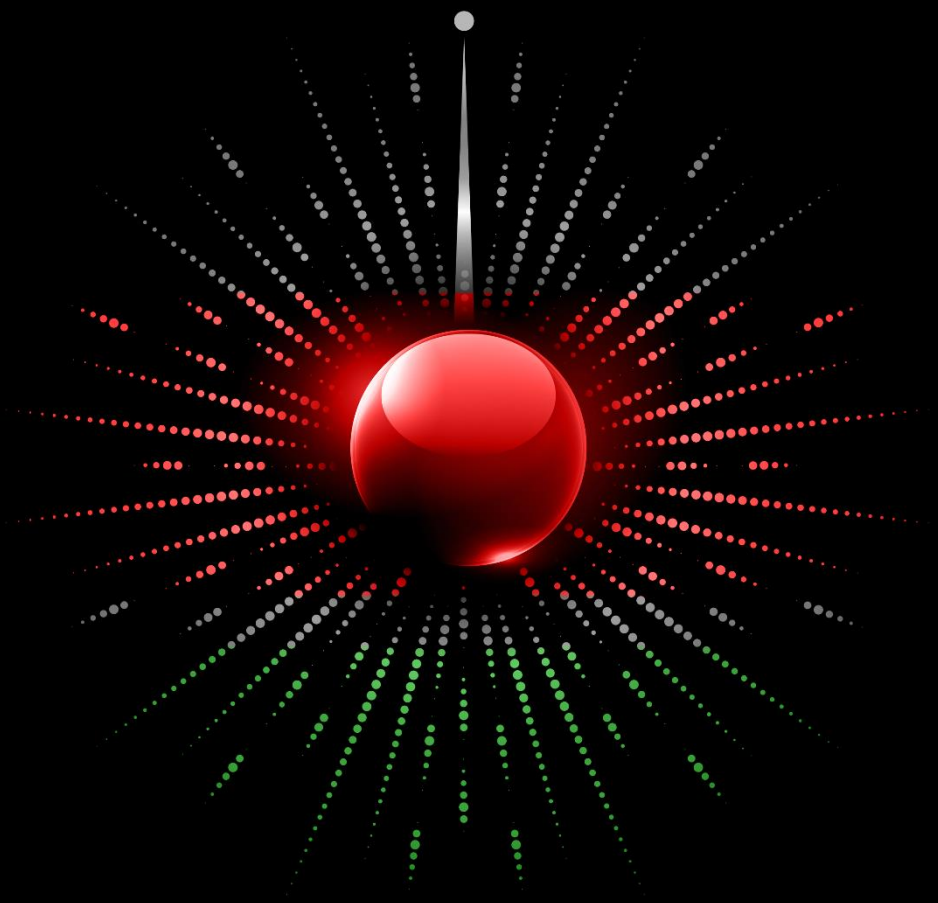


Tax Alert

Court of Appeal declares the Finance Act, 2023 unconstitutional

The Court of Appeal of Kenya ("CoA"), vide its judgment in ***Civil Appeal no. E003 of 2023 – The National Assembly & 1 other v Okiya Omtatah Okoiti & 55 Others [2024] eKLR,*** delivered on 31 July 2024 ("the Judgment"), held that, among other things, the enactment process of the Finance Act, 2023 ("the Act") was fundamentally flawed, rendering it unconstitutional.

The judgement stems from an appeal against the decision of the High Court of Kenya ("the HC") in ***High Court Constitutional Petition No. E181 of 2023 – Okiya Omtata and Others v the Cabinet Secretary for the National Treasury and Planning ("CS") and Others*** wherein the HC, in its judgement of 28 November 2023, upheld the overall constitutionality of the Act whilst declaring certain sections unconstitutional. The amendments declared unconstitutional by the HC then included amendments to the Kenya Roads Board Act, 1999, the Unclaimed Assets Act and the Statutory Instruments Act, and the now moot introduction of the Housing Levy via amendments to the Employment Act.

In this alert, we discuss the key issues identified and addressed by the CoA in the Judgement together with our views on the likely implications of the judgment.

Weighing in on the constitutionality of the Act, the CoA identified nine key issues for determination as argued by the parties to the appeal.

We analyse the key issues addressed in the judgement hereunder.

1. Adherence to the constitutionally and legislatively defined budget-making process

In addressing the issue of whether estimates of revenue and estimates of expenditure were included in the Appropriations Act in accordance with the Constitution of Kenya, 2010 ("the Constitution") and the Public Finance Management Act ("PFMA"), the CoA analysed the budget-making process as contained under Articles 220 and 221 of the Constitution read together with Sections 37, 39, 39A, and 40 of the PFMA.

According to the CoA, adherence to the constitutionally and legislatively defined budget-making process requires that Parliament be presented with, for approval, both estimates of revenue and estimates of expenditure within the Appropriations Bill, prior to its enactment into law. The CoA arrived at the conclusion that:

- Estimates of revenue were **not included** in the Appropriations Bill and the Appropriation Act, 2023.
- The CS presented the Budget proposals after the Finance Bill, 2023 had already been introduced in the National Assembly and was at the Second reading.

The above, per the CoA, flouted the budget-making process, as defined under the Constitution and the PFMA, rendering the Finance Act, 2023, in its entirety, unconstitutional.

2. Obligation to give members of the public reasons for adopting or rejecting their proposals following public participation

On the issue of whether there was sufficient public participation in the Act and whether Parliament is obligated to give reasons for adopting or rejecting views given by members of the public during public participation, the CoA found that the National Assembly had failed to dispense its obligation to inform the public and stakeholders why their views were not considered and why the views of some of the stakeholders were preferred over theirs.

The CoA emphasised that public participation is premised on the principle that those who are affected by a decision have the right to be involved in the decision-making process. Further, the CoA held that the requirement for transparency and accountability from state organs, state officers, and public officers is not a matter of choice but a mandatory constitutional imperative.

In concluding this issue, the CoA found that Parliament after conducting public participation is obligated to give reasons for rejecting or adopting the proposals received. Therefore, failure to adhere to Articles 10 (1) and (2) (c) of the Constitution renders the process leading to the enactment of the Act flawed, rendering the entire Act unconstitutional.

3. Inclusion of new provisions post-public participation

The CoA took issue with 18 amendments that were introduced to the Bill post-public participation, at the Committee stage or at the floor of the House. Per the CoA, the new provisions were substantive and beyond the original scope.

The CoA faulted the HC's reliance on the determination of the Court in ***Pevans East Africa Limited & another vs Chairman, Betting Control & Licensing Board & 7 Others [2018] eKLR*** *("the Pevans case")* to arrive at the conclusion that the National Assembly is not precluded from effecting amendments to a Bill post conclusion of public participation.

Contrasting the facts of the present case against those pled in the Pevans case, the CoA held that the introduction of 18 new provisions, which were neither subjected to public participation nor passed through the First and Second Reading before the National Assembly, was an affront to the legislative process contemplated in the Constitution and Standing Orders. As such, the CoA declared the impugned provisions procedurally and constitutionally deficient and therefore unconstitutional, being the fruit of a flawed process.

Per the judgement, permitting substantively new provisions of a law to be introduced on the floor of the National Assembly is likely to open the door for mischief and defeat the purpose of public participation.

4. Constitutionality of the Housing Levy

With reference to the housing levy and amendments to the Statutory Instruments Act, the CoA took note that the concerns canvassed in the HC decision were addressed vide the enactment of the Affordable Housing Act, 2024 on 19 March 2024 and the Statutory Instrument (Amendment) Bill, 2024.

On this basis, the CoA concluded that there are no live controversies on these issues rendering them moot. To this end, the housing levy remains in force.

5. The scope of money Bills

On whether the Act was a money Bill and whether it contained provisions that ought not to have been included in a money Bill, the CoA found that the inclusion of a non-fiscal matter in a money bill is only sanctioned if it is ancillary to a matter specified in Article 114(3)(a)-(d) and that there must be a clear nexus between the provision and the constitutional clauses. In the present case, the CoA concurred with the HC that amendments to the Kenya Roads Act, 1999, and the Unclaimed Assets Act, 2011 were unconstitutional.

6. Other issues addressed

In addition to the foregoing, the CoA upheld the HC's finding that the concurrence of the two speakers of Parliament is not compulsory in a money bill under Article 114 of the Constitution.

Further, the CoA respectfully concluded that the HC erred in implying that it does not have jurisdiction to intercede in all policy matters, holding the view that the HC has the jurisdiction to determine whether anything, done under the authority of the Constitution, or any other law is inconsistent with the Constitution, including policy matters.

The CoA held the view that there was no value to be derived in determining whether the increased rates of taxation in the impugned Act violated the economic, social, and consumer rights guaranteed by Articles 43 and 46 of the Constitution given its finding on the unconstitutionality of the Act.

Implications of the CoA judgement

The unconstitutionality of the Finance Act, 2023, owing to the CoA's judgment, places Kenya in uncharted waters, particularly considering the context of the rejection of the Finance Bill, 2024. Legally, tax amendments introduced via the Act are no longer in force and their implementation should be halted with effect from 31 July 2024. The legislative framework governing taxation in Kenya ought to be the tax laws in force as of 2022 as amended by the Finance Act, 2022.

The Government has appealed the CoA decision at the Supreme Court and taxpayers should monitor the progress of this appeal. As part of the Prayers, the Government applied for stay orders which were not granted immediately but are still under consideration. If the Supreme Court grants a stay of the CoA decision, the Finance Act, 2023 provisions would continue to apply pending the determination of the appeal. If a stay is not granted then the changes introduced by the Finance Act, 2023 would be inapplicable. The Kenya Revenue Authority (KRA) should expeditiously update the iTax system to avert administrative challenges in complying with the Court ruling.

Some of the key amendments introduced via the Finance Act 2023 include but are not limited to:

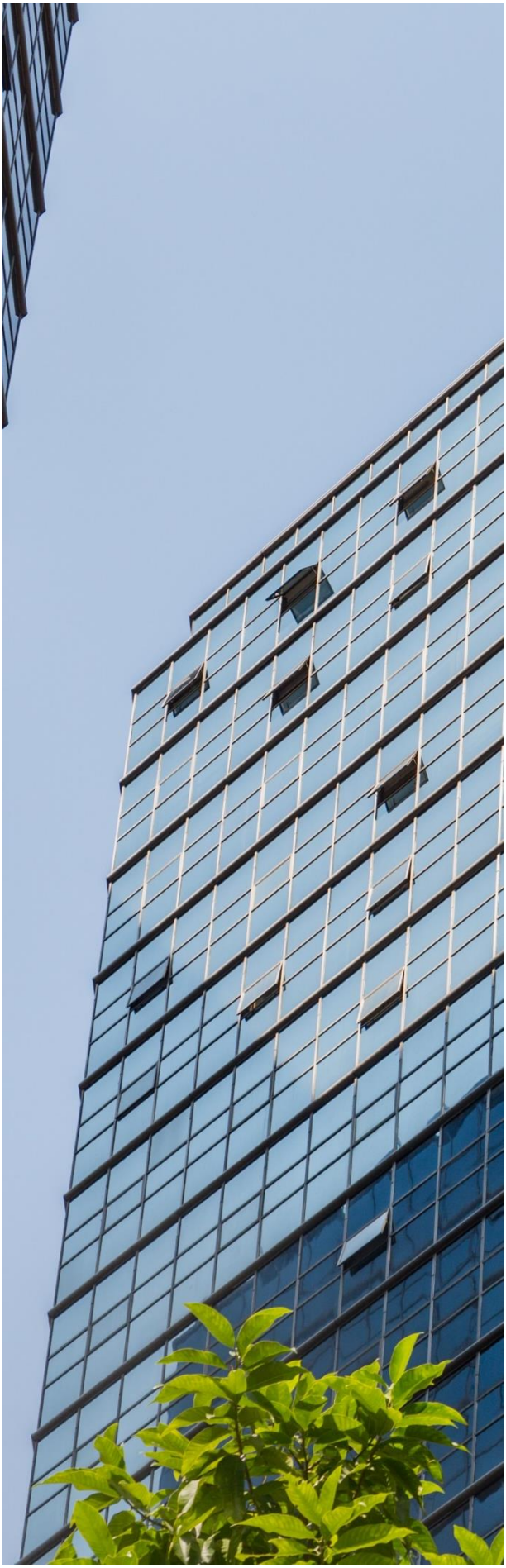
	Issue	Finance Act, 2023 change	Position prior to Finance Act, 2023
1.	VAT on petroleum products and liquified petroleum gas	• VAT on petroleum products increased from 8% to 16% • VAT on liquefied petroleum gas (LPG) reduced from 8% to 0%	• Petroleum products and LPG were taxable at 8%
2.	Exportation of taxable services	• Zero-rating of exportation of taxable services	• Exported services were taxable at standard rate of 16% except for Business Process Outsourcing (BPO) Services
3.	Introduction of two new bands for taxation of personal income	• Introduction of two new tax bands i.e., 32.5% and 35% for income between KES 500,000 and KES 800,000 and over KES 800,000 per month, respectively	• Previously, the highest taxation band for personal taxes was 30%
4.	e-TIMS compliant invoices to support deductibility of expenses for income tax purposes	• Introduction of a provision prohibiting the deductibility of expenditure where invoices relating to the transactions are not generated from an Electronic Tax Invoice Management System ("eTIMS") managed by the KRA	• No requirement for deductible expenses for Income Tax purposes to be supported by an eTIMS invoice
5.	Due date for remittance of Withholding tax (WHT) and withholding VAT (WHVAT)	• The Finance Act reduced the time within which WHT should be remitted to the Commissioner to five working days	• Taxpayers were required to remit WHT and WHVAT on or before the 20th day of the following month
6.	Inflationary adjustment of excise duty rate and due date for excise duty on alcoholic beverages	• Repeal of inflationary adjustment of excise duty rates • Payment of excise duty on alcoholic beverages within 24 hours upon removal of the goods from the stockroom	• The Commissioner General of the KRA was empowered to adjust excise duty rates by taking into account the average inflation of the preceding financial year • Local manufacturers of alcoholic beverages were required to remit excise duty payable before the 20th day of the following month
7.	Changes to the Capital Gains Tax (CGT) regime	• Introduction of CGT on indirect transfer of property • Introduction of a requirement for transferors to notify the Commissioner where there is a change of at least 20% in the underlying ownership of the property. • Clarity that the due date for CGT is the earlier of receipt of full payment of the purchase price or registration of the transfer	• Indirect transfers did not fall within the ambit of the CGT regime • The due date for payment of CGT was on or before the date of application for transfer at the relevant office

Implications of the CoA judgement

	Issue	Finance Act, 2023 change	Position prior to Finance Act, 2023
8.	Interest deductibility rules	• Amendment of the interest limitation rule by limiting the interest restriction to interest payable to non-resident persons only • Allowing taxpayers a deduction of disallowed interest in subsequent three years to the extent that the deduction does not exceed the 30% of Earnings Before Interest Tax Depreciation and Amortization (EBITDA)	• The interest limitation rule applied to all interest (both resident and non-resident persons) and any disallowed interest was not deductible in subsequent years
9.	Taxation of branches	• Reduction of the corporate tax rate for branches of foreign companies from 37.5% to 30% (Effective 1 January 2024). • Introduction of tax on repatriated income of a branch at 15%	• Branches were taxable at 37.5% • No taxation on the repatriated income of a branch
10.	Taxation of the digital economy	• Introduction of withholding tax (WHT) on payments made in respect of digital content monetization at a rate of 5% and 20% for residents and non-residents, respectively • Introduction of digital asset tax on the income derived by a person on transfer or exchange of digital assets at 3%	• Not applicable
11.	Taxation regime for Special Economic Zones (SEZs)	• Introduction of exemption from CGT on transfers within special economic zones • Exemption of payments in respect of royalties, interest, management or professional fees and training fees made by a SEZ enterprise to a non-resident from WHT in the first 10 years	• Transfers within SEZs were subject to CGT • Payment of royalties, interest, management, professional and training fees made by an SEZ were subject to WHT
12.	Reduction of excise duty rate on fees charges for money transfer services	• The Act reduced excise duty on Fees charged for money transfer services by banks, money transfer agencies and other financial service providers from 20% to 15%	• The excise duty rate applicable was 20% for financial service providers and 12.5% for other money transfer agencies
13.	Abolition of waivers of penalties and interest	• The Act repealed provisions that allowed the Commissioner to abandon taxes, with the Cabinet Secretary's approval, where it was impossible to recover unpaid taxes due to undue expense, difficulty or inequity in recovering the tax, or any other reasonable grounds • Abolished waiver of penalties and interest	• The Cabinet Secretary was empowered to abandon tax • Taxpayers could apply for waiver of penalties and interest

For a detailed analysis of the changes that were introduced by the Finance Act, 2023, please see our analysis here.

The above notwithstanding, the CoA has clarified that despite the judgment rendering the Act unconstitutional, taxpayers are not eligible for a refund of taxes collected under the Act. This was on the basis, according to the CoA, that legislative enactments enjoy the benefit of presumption of constitutionality up to the moment they are found to be unconstitutional. Therefore, the changes, including the now-lapsed tax amnesty were constitutional until the CoA decision.



Our view and conclusion

The CoA's landmark judgement declaring the Act unconstitutional will likely have far-reaching implications on Kenya's tax legislative landscape. Some of the key learning points are:

- **Strict adherence to the legislative process** – In light of the CoA ruling, it will be critical to define the legislative path with more precision to pre-empt future faults.
- **Meaningful public participation** – From the judgement, it is clear that state organs have the obligation to inform the general public and stakeholders why their views were not taken into account and why the views of some of the stakeholders were preferred over theirs. Going forward, it will be important for Parliament to meaningfully consider input provided by stakeholders during public participation in respect of the Finance Bill and include reasons and explanations for adopting or not adopting specific input from the public.
- **New substantive provisions should be subjected to fresh public participation** – The CoA faulted the introduction of new provisions to the Bill post conclusion of the first and second readings, without first going through public participation. The pronouncement is a welcome one, as it advocates for public participation even after the introduction of new provisions at the Committee Stage of the legislative process and subverts the 'mischievous sneaking' of amendments into the Act.

It is crucial to note that the National Treasury has proceeded to initiate an appeal before the Supreme Court ("SC") against the CoA's judgement. Upon hearing the appeal, the SC may either uphold, partially uphold, or overturn the findings of the CoA. In the event that the findings of the CoA are overturned, there is a prevailing risk that the KRA may demand tax as though the Act were in operation, inclusive of penalties and interest, unless otherwise guided by the Courts.

Considering the recent frequent changes in tax laws, recent events surrounding the withdrawal of the Finance Bill, 2024, and now, the CoA's decision on the Finance Act, 2023, it means that taxpayers have to contend with further unpredictability. This makes the business environment very unstable, costly for the taxpayers, and defeats the canons of certainty and convenience, which are key to a good tax system. The unpredictability is likely to reduce investor confidence in the Kenyan economy. To enhance predictability, and in line with the National Tax Policy, we recommend moving away from the numerous annual tax changes. Comprehensive review of tax laws could be undertaken every five years to align with Government policies and international best practice. Should the Government adopt this, the Kenyan tax legal framework shall be more predictable, sustainable and improve the ease of doing business.

We shall monitor the progress of the matter and provide updates on the same.

Should you wish to discuss this further, please contact any of the contacts below or your usual Deloitte contact who will be more than glad to offer you guidance and assistance.

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