



Tax Alert

The Court of Appeal (“CoA”) on 31 July 2024 delivered a Judgment in Civil Appeal No. E003 of 2023, in an appeal before it to determine whether the Finance Act, 2023 met the relevant constitutional thresholds required under the law. The Judgment nullified the entire Finance Act, 2023 (“FA, 2023”, “the Act”), finding that it was unconstitutional and void ab initio as the process leading to its enactment was fundamentally flawed and in violation of the Constitution of Kenya, 2010 (“the Constitution”).

The Judgment went further to expressly specify why various sections of the Act were also found to be unconstitutional.

The Appellants in the referenced case were the National Assembly (“NA”) and the Speaker of the NA, represented by the Attorney General. There were fifty-six (56) Respondents, being individuals and entities who had earlier filed various petitions at the High Court (“HC”) seeking to invalidate the Act.

The present CoA Judgment is the result of an Appeal against the HC Judgment rendered on 28 November 2023, whereby the HC declared various sections of the FA, 2023 as unconstitutional.

Background

The FA, 2023, was assented to law on 26 June 2023 eliciting 11 consolidated constitutional petitions filed at the HC’s Constitutional and Human Rights Division in Nairobi.

The 11 Petitions sought to have the FA, 2023 declared unconstitutional arguing broadly among other grounds, that for FA, 2023 to be passed it required the concurrence of

the Senate and involvement of the public regarding the amendments passed on the floor of ‘the House’.

Further, the Petitioners at the HC argued that the proper legislative process including public participation was not followed while enacting the FA, 2023. At the center of the petitions was the issue of whether the Affordable Housing Levy (AHL) was constitutionally introduced through the FA, 2023.

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After the hearing of the matter by a three Judge Bench, the HC through a Judgement delivered on 28 November 2023 declared certain provisions of the FA, 2023 to be unconstitutional and in particular, Section 84 of the FA, 2023 that had sought to introduce the AHL. Save for the specific sections of the law that were declared unconstitutional, the rest of the FA, 2023 remained valid.

Being dissatisfied with part of the HC judgment, the NA and the Speaker of the NA appealed to the CoA. The dispute before the CoA elicited 6 appeals and 3 cross appeals from the partially dissatisfied Respondents. In reaching its verdict, the CoA consolidated the various appeals and considered several issues for determination as discussed below:

- a. Whether the appeals challenging the AHL and the Statutory Instruments Act, fall within the doctrine of mootness;
- b. Whether the Act was a money bill and if non money bill provisions in it violate the Constitution;
- c. Whether the Act included provisions which were not in the Finance Bill, 2023, and which were not duly subjected to public participation;
- d. Whether the Senate ought to have been involved in the enactment of the FA, 2023;
- e. Whether the HC erred in upholding the constitutionality of sections 30 to 38 of the FA, 2023; and
- f. 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.

Summary of the CoA's determination and findings

a. Affordable Housing and Statutory Instruments Act

The CoA was called on to determine whether the appeals challenging AHL and the Statutory Instruments Act, fall within the doctrine of mootness.

On the prayers challenging the unconstitutionality of the provisions touching on AHL and the Statutory Instruments Act the CoA deemed these issues as moot, since the NA had already enacted an AHL Act, 2024 and introduced to the NA a Statutory Instruments Bill, after addressing the lacunas in the law observed in the Judgement of the HC. The CoA held that the issues now on appeal, presented no live controversies. The enactment of the AHL Aact provided a supervening event, such that the CoA found that making a further declaration would not be practical but only academic.

b. Whether the FA, 2023 is a Money Bill that requires the Senate's involvement in its enactment

The CoA was called upon to determine whether the FA was a 'Money Bill' as defined under Article 114 (3) of the Constitution. It affirmed the HC's finding on this, that the Finance Act is a Money Bill.

Having found so, it also found that it was unconstitutional and extraneous to have introduced non-Money Bill amendments to various legislation that were not strictly Money Bill related, i.e. amending the Roads Act, which altered the composition of the Kenya Roads Board and amending the Unclaimed Financial Assets Act in relation to payment to a designated proxy out of the Unclaimed Assets Trust Fund.

Once it was affirmed that the Finance Act is a Money Bill, the CoA concluded that the bill did not require a concurrence process from the county governments.

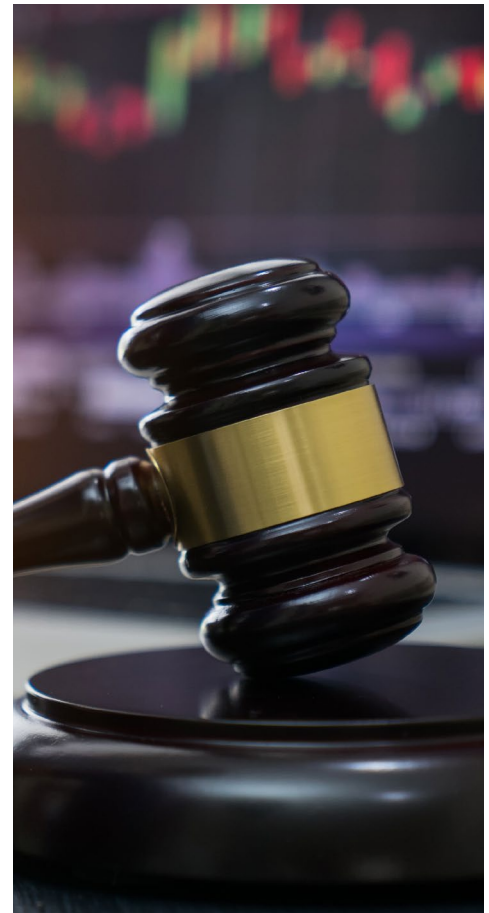
c. Public participation

- i. Introduction of new amendments on floor of the House

On whether the Act included provisions which were not in the Finance Bill, 2023, and which were not duly subjected to public participation, the CoA observed

that there were 18 amendments that were introduced in the NA that were not subjected to public participation. The National Treasury and National Assembly argued that they are not precluded from introducing new amendments without fresh public participation. In turn, the Respondents argued that to permit completely new provisions of the law to be introduced on the floor of the house defeated the purpose of public participation.

The CoA observed that the substantive sections of the FA, 2023 included at later stages of enactment - after the 1st and 2nd Reading in the NA were unconstitutional for not undergoing public participation and for violating the constitutionally mandated legislative process.



ii. Reasons for rejection of public participation proposals

The CoA also found that to ensure that public participation is not a mere formality and complies with the provisions of Article 10 of the Constitution on transparency and accountability, the NA must provide reasons for adopting or rejecting public proposals during the public participation process and that failure to do so rendered the entire process flawed. It found that to vest in the NA arbitrary power to reject or ignore contributions would undermine participation.

d. Compliance with the provisions of the Public Finance Management Act

On whether the FA, 2023 complied with the provisions of the Public Finance Management Act (PFMA), the Court held that the FA, 2023 enacted did not comply with the laid-out budget-making process, as contained under Article 221 of the Constitution, the PFMA and the Supreme Court Advisory on the subject. In particular, the CoA found issue with the fact that the Finance Bill, 2023 was introduced in the NA prior to the Cabinet Secretary National Treasury (“CS Treasury”) presenting the budget statement, and the estimates of revenue were not included in the Appropriations Act. It is on this basis that the CoA rendered the entire FA, 2023 unconstitutional and null and void ab initio.

e. Whether courts can intervene in government policy decisions.

The CoA held that the courts would be abdicating their jurisdiction if they failed to test the constitutionality of policy that may infringe the constitution.

f. Whether the HC erred in upholding the constitutionality of various specified amendments to the VAT Act, Amendments to the Tax Procedures Act, Income tax Act, Excise Act.

The FA, 2023 sought to Amend 12 Statutes. On this the CoA held that having reached the conclusion that the legislative process leading to the enactment of the Act was fundamentally flawed and in violation of the Constitution, it did not add value to determine each of the impugned provisions as they each stood equally vitiated. This also determined the issue of whether the increase in taxes violated the economic, social and consumer rights of the public.

Impact of the Judgement on taxpayers:

Having declared the FA, 2023 as unconstitutional the resultant effect is a reversal of several changes introduced through the FA, 2023. For detailed analysis of all the changes introduced by the FA,2023 you may access our previous alert on this via this [link](#). This said, we have set out below some highlights of the impact of resulting from the CoA Judgement:

i. Refund of taxes and retrospective application of the law

It is important to note that acts done in compliance with the FA, 2023 prior to the Judgement being

delivered on 31 July 2024 by the CoA remain lawful. For instance, taxes waived pursuant to the tax amnesty program introduced by the FA, 2023 are safeguarded.

On whether to order KRA to refund taxes collected under the unconstitutional sections of the FA, 2023, the CoA declined to grant this order on account of two grounds; firstly, because this prayer had not been pleaded in the original petition before the HC. Additionally, the court directed that **“legislative enactments enjoy presumption of constitutionality up to the moment that they are found to be unconstitutional”**.

ii. With the enactment of FA, 2023 (effective 01 July 2023), VAT on petroleum products and liquified petroleum gas (LPG) rose from 8% to 16%. The CoA judgement has therefore reversed this rate back to 8%. Some notable additional VAT amendments that have been reversed include introduction of VAT on compensation for the loss of taxable supplies and the zero rating of exported taxable services.

iii. With the FA, 2023 now nullified, exported taxable services will now be subject to VAT at the standard rate of 16% except those that relate to Business Process Outsourcing (BPO) which are zero-rated.

iv. For employment taxes, the FA, 2023 introduced revised Pay as You Earn (“PAYE”) tax bands, establishing a 32.5% tax rate for monthly taxable income between



KES 500,000 and KES 800,000 and 35% for income above KES 800,000. With FA, 2023 now nullified, PAYE rates shall revert to those of the fiscal year 2022/2023, where the highest rate was 30%.

- v. FA, 2023 had effected the payment of withholding tax and withholding VAT within five (5) working days of the deduction being made. This is no longer applicable as the same revert to the payment on or before the twentieth day following the end of the month of the payment or accrual.
- vi. Certain taxpayers have also had challenges complying with the e-Tims regulations which were introduced through the FA, 2023. The invalidation of FA, 2023 will therefore be a reprieve for such taxpayers.
- vii. The Judgement equally affects the treatment and the restriction of interest, which was introduced by the FA, 2023, wherein the FA, 2023 only restricted interest emanating from loans advanced by non-resident entities compared to the law prior thereto, which restricted all interest from all loans irrespective of the residency thereof. The judgement may therefore negatively impact taxpayers.
- viii. The FA, 2023 had repealed the requirement for annual inflation adjustment under the Excise Duty Act, a move that was welcomed by affected taxpayers. With the

Judgement of the CoA, the same has now been reversed and the KRA now has powers to exercise these powers annually.

- ix. Payment of Excise Duty within twenty-four (24) hours by licensed manufacturers of alcoholic beverages and payment within twenty-four hours on betting and gaming transactions have also been caught in the radar and are reversed to payment being due on or before 20th of the following month after the supply.
- x. It is noteworthy to mention that AHL is still applicable and payable. It should be recalled that after the HC declared the AHL as unconstitutional on 28 November 2023, the NA proceeded to enact the AHL Act, 2024 which remains valid as the same has not been declared otherwise by a court of law. Employers should therefore continue deducting and remitting AHL.

What is next in the corridors of justice?

Stay execution application

On 2 August 2024, The CS Treasury filed an application at the Supreme Court seeking stay orders to suspend the Judgement of the CoA. The Supreme Court on 2 August 2024 certified the matter as urgent, admitting it for hearing and directed parties to file their responses and submissions by 5 August 2024. The Supreme Court also directed that the matter would be heard by way of submissions and a ruling on

the question of stay would be issued on notice.

In the intervening period, in absence of a stay of execution, the Judgment of the CoA has the full force of law and accordingly, the the government has to revert to the pre-FA 2023 for revenue collection.

Substantive hearing

We note that the CS Treasury has filed a Petition of Appeal before the Supreme Court, challenging the CoA Judgement. Upon hearing the appeal by the Supreme Court, the Judges have powers to either vary, set aside or uphold the Judgement of the CoA. The Supreme Court decision shall finally settle the matter being the highest Court in the land.

