

Tax Alert

Kenyan Court of Appeal declares Finance Act, 2023 unconstitutional – Appeal pending Supreme Court determination



Summary

This alert brings to your attention the Court of Appeal's ("Court") judgement dated 31 July 2024 in the case of **National Assembly & Another v Okiya Omtatah Okoiti & 55 Others** ("Judgement").

In summary, the Court declared the whole Finance Act 2023 unconstitutional due to non-adherence to prescribed legislative procedures. The Court's justification was that, among other reasons, the National Assembly:

- Did not provide reasons for either adopting or rejecting public proposals received during the public participation process for the Finance Bill, 2023.
- Omitted revenue estimates in both the Appropriation Bill, 2023, and the Appropriation Act, 2023; and
- Disregarded set procedures in the Public Finance Management Act, 2012 and the Constitution.

Background

The current appeal arose from the decision of the High Court delivered on 28 November 2023. The High Court, in its judgement, declared some sections of the Finance Act 2023 unconstitutional while dismissing the issues raised by the petitioners on lack of public participation and omissions in the budget making process.



The specific omissions highlighted relate to failure to follow due process in approving the revenue estimates in the Appropriation Bill/Act, thus affecting the legality of the resultant Finance Act 2023.

This decision prompted 7 appeals and 3 cross-appeals, each focusing on specific aspects of the judgment.

Appellants' argument.

In this case there were several appellants, including the National Assembly, KRA and other state agencies. The Appellants' raised various grounds of appeal including the argument that the Finance Bill, 2023, was correctly categorized as a money Bill, and therefore did not necessitate Senate involvement as per the Constitution.

The Appellants further defended the adequacy of public participation, stating that the National Assembly had sufficiently conducted the participatory process. They argued that amendments made during the legislative debate did not require a separate public participation process, as this would curtail the legislative mandate of the National Assembly.

Respondent's arguments/Cross Appeal

The Respondents contended that the High Court erred in determining that the National Assembly's change of provisions in the Finance Bill without providing any reasons, was proper.

They also asserted that since the Finance Bill, 2023, was classified as a bill concerning county governments, it should have involved the Senate. Excluding the Senate was unconstitutional.

Additionally, in opposition to the Appellant faulting the High Court for concluding that there was inadequate public participation in the legislative process, the Respondents contended that the new clauses added to the Bill were not subjected to public participation, thus violating constitutional requirements.

The Respondents also argued that the High Court overlooked binding precedents set by the Supreme Court, which mandate Senate involvement in matters affecting county governments. The lack of Senate involvement, they argued, compromised the legislative process.

Issues For Determination

In summary, court identified the following issues for determination:

- a. Whether the grounds raised in relation to Affordable Housing and amendments to the Statutory Instruments Act had been caught up by the doctrine of mootness, and, if the answer is in the affirmative, whether the said issue falls within the exceptions to the said doctrine.
- b. Whether the Finance Act was a money Bill and whether it contained provisions which ought not to have been included in a money Bill contrary to Article 114 (3) (4).
- c. Whether the Act included provisions which were not in the Finance Bill, 2023, which was subjected to public participation.
- d. Whether the Senate ought to have been involved in the enactment of the Act.
- e. Whether there was sufficient public participation in the enactment of the Act and whether Parliament is obligated to give reasons for adopting and rejecting views given by members of the public during public participation.
- f. Whether the trial court erred in upholding the constitutionality of sections 30 of 38 of the Act relating to the VAT Act, 2013.
- g. Whether the trial court erred in failing to strike out the entire Act after it held that it contained non-money matters.
- h. Whether the trial court abdicated its jurisdiction by holding that it cannot intervene in policy decisions.
- i. Whether the increased rates of taxation in the Act violated the economic, social and consumer rights guaranteed by Articles 43 and 46.

Court's Determination

The Court held that the entire Finance Act was unconstitutional for the following reasons:

- i. **Public Participation:** The National Assembly failed to provide reasons for either rejecting or adopting public proposals received during the public participation process.
- ii. **The Revenue Estimates:** The required revenue estimates were not included in the Appropriation Bill, 2023, and the Appropriation Act, 2023, violating the constitutional requirement that these estimates be included in the Appropriation Bill that is to be presented to the National Assembly at least two months before the end of each financial year. The estimates of appropriation reflect the revenue generated vide the Finance Act provisions relied upon in the Budget. The Court nullified the Appropriation Act for being considered prior to the Budget Proposals.
- iii. **Affordable Housing Levy:** The Court ruled the issue of the affordable housing levy moot, as the government had already enacted the Affordable Housing Act, 2024, which repealed the levy provisions in the Finance Act and established a new legislative framework in compliance with the High Court's decision.
- iv. **Statutory Instruments Act:** The Court also found the issue of the amendments to the Statutory Instruments Act moot, as the government had introduced the Statutory Instruments (Amendments) Bill, 2024 to address the concerns raised by the High Court.
- v. **Unrelated Amendments:** Amendments to the Unclaimed Assets Act, 2011, and the Kenya Roads Board Act, 1999, introduced through the Finance Act, were deemed unconstitutional because they involved matters unrelated to a money bill.
- vi. **Money Bill:** The Court of Appeal clarified that the Finance Bill, being a money bill with taxes as its dominant feature, falls under the exclusive competence of the National Assembly, and Senate concurrence is not required. Additionally, the Court of Appeal confirmed that the High Court has jurisdiction to test the constitutionality of policy matters, contrary to the High Court's blanket statement that courts should not intervene in policy matters.
- vii. **Refund of Taxes:** The Court denied the request for a refund of taxes collected under the unconstitutional sections of the Finance Act, noting that the issue was not pleaded in the constitutional petition, and legislative provisions are presumed constitutional until a court declares otherwise.



Our opinion on the Judgment

The Court of Appeal's decision generated a lot of debate due to the uncertainty on its implications, especially on the government fiscal position and the measures that needed to be undertaken to unwind its impact.

The Government, concerned about the impact of the judgment on revenues coming so soon after the withdrawal of the Finance Bill, 2024 appealed to the Supreme Court for a stay order.

On 20 August 2024, the Supreme Court issued a stay of execution suspending the orders of the Court of Appeal pending the hearing and determination of the substantive appeal.

Below we outline some key changes introduced by the Finance Act, 2023 which will remain in force pending the Supreme Court's ruling:

- a. Capital Gains Tax (CGT) on indirect transfer:** Introduction of provisions allowing for taxation of gains arising from indirect transfer of property.
- b. Withholding Tax on Digital Content Monetization:** Withholding tax of 5% for residents and 20% for non-residents for digital content monetization, effective from 1 July 2023.
- c. Due dates for payment of WHT, WHVAT and Excise Duty:** The Finance Act, 2023 provided that payment of withholding tax (WHT) and withholding VAT (WHVAT) is to be remitted within five (5) working days of the deduction being made. Further, Excise Duty is to be paid within twenty-four (24) hours by licensed manufacturers of alcoholic beverages as well as betting and gaming operators.
- d. Allowability of Expenses:** Expenses not supported by eTIMS-compliant invoices will not be deductible for Corporate Income Tax (CIT) purposes, except where an exemption has been granted under the Tax Procedures Act.
- e. Taxation of Branches:** The reduction of the corporate tax rate for branches from 37.5% to 30%.
- f. Employment Tax (PAYE):** Introduction of new income tax bands at rates of 32.5% and 35% for employment income exceeding KES 500,000 and KES 800,000, respectively.
- g. Digital Asset Tax:** 3% Digital Asset Tax (DAT) on income derived from the transfer or exchange of digital assets.
- h. Monthly Rental Income (MRI):** The Finance Act, 2023 reduced the applicable tax rate on MRI to 7.5% from 10%.
- i. VAT on exported services:** The Finance Act, 2023 zero-rated exported taxable services.
- j. VAT on Fuel:** The VAT rate on petroleum products (excluding Liquid Petroleum Gas) was increased from 8% to 16%.
- k. Excise duty on Telephone and internet data services:** The Finance Act, 2023 reduced the excise duty payable from 20% to 15%.

With the Supreme Court granting the stay of execution orders, the provisions of the Finance Act, 2023 will continue to apply pending the hearing and determination of the appeal.

The Supreme Court has indicated that hearing of the appeal shall be expedited and concluded in September 2024, with judgment expected by the end of the year.

Consequently, taxpayers should adhere to the provisions of the Finance Act 2023 pending the Supreme Court's decision.

If you have any questions, do not hesitate to reach out to us on taxandregulatory@kpmg.co.ke

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