

Finance Bill 2024 Policy and Legal Analysis

Policy Impacts of the Finance Act 2024

Introduction

There are many legal briefs available online that outline the raft of revenue raising measures in the Finance Bill, 2024. I will therefore steer clear from providing a popular summary of the Finance Bill 2024. The material available online is sufficient for that purpose. I will however review the Finance Bill based on the following parameters:

- Constitutionality of taxation: whether the taxes proposed
- Policy Objectives: whether the policy objectives revealed by the
- Clarity of the Bill: whether the bill as drafted can pass the test of efficiency, and the impact this might have on the quality of Public Participation.

Constitutionality of Taxation

The Constitution of Kenya has well defined parameters that should guide taxation in Kenya. Breach of these principles has led to taxation provisions in previous Finance Acts being declared unconstitutional.¹The principals of taxations laid out in Article 209 of the Constitution of Kenya must therefore be carefully examined when analysing proposed tax provisions. Taxation also affects other Constitutional provisions such as Public Participation and the right to Property. Unfortunately the Finance Bill 2024 has provisions that are likely to face a constitutional challenge on various grounds of constitutionality including:

- The right to property
- Public Participation
- Consumer rights

¹ See the following cases: *Finance Act 2023*: Constitution Petition No. E181 of 2023 Consolidated with E211 of 2023, E217 of 2023, E219 of 2023, E221 of 2023, E227 of 2023, E228 of 2023, E232 of 2023, E234 of 2023, E237 of 2023 and E254 of 2023 Hereinafter referred to as the Housing Levy Case and *Finance Act 2020*: Kenya Revenue Authority v Waweru & 3 others; Institute of Certified Public Accountants & 2 others (Interested Parties) (Civil Appeal E591 of 2021) [2022] KECA 1306 (KLR) (2 December 2022) Hereinafter referred to as the Minimum Tax Case.

The Right to Property

The Finance Act proposes taxation of travel allowances given to employees who are on work travel. The nature of work travel is that it is an activity undertaken in course of duty by an employee, and in the interest of the employer. This is clearly not an income to the employee. When travel allowances are subjected to taxation, this treats them as an income, and therefore the employee is taxed for an income not earned. This results to taxing the employees personal resources (read capital) which have already been taxed, therefore subjecting such employees to double taxation. This is the same reason that savings are never subjected to tax. The Minimum Tax case sufficiently adjudicated this matter.

Public Participation

Public Participation is a national value, sated in Article 10 (2) (a) of the constitution of Kenya. The question of quality of public participation and the role of government in. Facilitating public participation was addressed in the case of **Robert N. Gakuru & Others v Governor Kiambu County & 3 others [2014] eKLR**. The Income Tax Act version available in the Kenya Law Reports Website was last updated in 2022. This is a factual issue that shows how compromised the process of public participation is. Citizens will be left confused when they try to trace the section being amended and they are unable to find it, because sections are scattered across various Finance Acts and subsequent Miscellaneous Amendment Bill. This will compromise the quality of information relied on to make decisions. I have addressed this issue in detail later in this document.

Consumer Rights

Consumer rights are provided for in Article 46 of the Constitution of Kenya, with Article 46 (a) requiring that goods and service is in the market should be or reasonable quality. There are a raft of taxes that will affect consumer products in the market due to raising costs of production and importation in the midst of economic hardship. One of the predictable consequence will be an increase in consumption of substandard products. There is recent evidence seen from what is happening to alcohol consumption, with a affordability being a major drive towards illicit brews. Increasing taxes on consumable will have the effect of promoting the growth of the black market and compromising consumer protection. This is an evidence based elements, but it not hard to demonstrate that the general state of the economy in Kenya and recent natural calamities have reduced people's disposable income. Raising taxes on consumable therefore bears the risk of compromising the quality of goods and services offered in the market, and therefore compromising

consumer rights. Oates and Wallace (2015) provide a compelling argument on how burdensome taxation distorts behaviour.²

Questionable Policy objectives of the proposed revenue raising measures

There should be a clear difference between taxation and monopolistic extortion. In essence, the government is a monopoly when it comes to collecting taxes - no other entity is allowed to collect taxes. However, governments have in the past been known to create absurd taxes with disastrous results all in the name of addressing revenue shortfalls. One example is the Window Tax, introduced in England to finance the Great Recoinage of 1696 other expenses caused by the Revolution³. People were taxed based on the number of windows in their houses. As expected, people bricked up their windows and this had dire health effects including outbreaks of epidemics such as epidemics typhus, smallpox and cholera.⁴ To avoid such scenarios, it is important that taxation measures be backed by sound policy apart from merely raising revenue. This is particularly true because tax is a legal creation, and like any other law will inspire behaviour change. There are a few incentives in this bill like increase the limits for deductions made for pension schemes and raising the turnover entry point for mandatory registration of VAT agents. However, the bill is awash with all manner of taxes, or increased tax obligations without an identifiable policy objective. It is almost impossible to draw a clear line of sight between the Fourth Medium Term Plan (which implements the Vision 2030) and the Finance Bill 2024. Some of the questionable policy objectives that emerge include:

- (a) **Multiple taxes for digital market place services:** the definition of digital market place has been broadened to include any internet based service provided. It is clear that non - resident companies are being targeted, through residents are not much exempted. At present such services are liable for pay Value Added tax. The Bill proposes an addition of a Significant Economic Presence Tax at a rate of 20% and imposition an excise tax. What will this do the cost of cloud hosting services, and what is the ripple effect of this increase in cost on the ICT based start ups in Kenya ? What will be the impact to fintech? It is worth considering that ICT innovation is led by the youth, who are typically incapable of managing capital intensive projects. Low

² Oates, Wallace E., and Robert M. Schwab. 2015. "The Window Tax: A Case Study in Excess Burden." *Journal of Economic Perspectives*, 29 (1): 163-80. DOI: 10.1257/jep.29.1.163

³ Id, Oates and Wallace

⁴ UK Parliament. Window Tax. Available at <https://www.parliament.uk/about/living-heritage/transformingsociety/towncountry/towns/tyne-and-wear-case-study/about-the-group/housing/window-tax/#:~:text=This tax was first imposed,exempt from the window tax.>

costs offered by non - resident cloud service providers enable young people to affordably incubate ideas which can later be scaled once there is a proof of concept. The Medium Term Plan IV states seek to position Kenya as a knowledge-based economy and preferred Science, Technology and Innovation destination⁵. Is the taxation policy of digital market services in line with this policy objective?

- (b) **Imposition of Value Added Tax (VAT) for financial services:** financial services have in the recent past been exempt from VAT. The reason behind this is clear: financial inclusion is a critical factor for economic growth. Increasing the costs for financial services in a country where the informal sector accounts for over 80% of the economy is a disastrous approach. Already, the increase in M-PESA tariffs, due to taxation, led to a drop in the use of M-PESA merchant services such as Lipa na Mpesa and Paybill. There are a number of vendors who instead prefer to deal with cash and will therefore prefer that their clients withdraw money and pay. This stifled mobile money innovation and clawed back on progress made. A similar impact will be witnessed with banking services, which are already not performing well in providing financial inclusion. The question is therefore whether this aligns with Kenya's policy objectives on financial inclusion.
- (c) **Taxing travel allowances for employees:** movement and logistics is an integral aspect of employment, and critically supports domestic tourism. One of the lessons learnt from the Third Medium Term Plan is that: *Domestic tourism holds great potential in cushioning the economy against uncertainties in the tourism sector related with travel advisories and related emergencies.*⁶ Taxing employees for travel expenses would therefore disincentivize domestic tourism. Anecdotal evidence suggests that domestic tourism across Kenya, is largely facilitated by workshops which involve employees getting travel allowances. The other challenge will be employers who will have an onerous task of convincing employees to travel to destinations where formal service providers do not exist. This will mean that the employee will be forced to finance their employer since they will be taxed for an employment related cost. The question again is, has the impact of this tax been envisioned?
- (d) **Imposition of the eco - levy on locally manufactured goods :** This levy is being imposed supposedly as a climate change mitigation measure. However, Kenya is a relatively low emitter of greenhouse gases (GHGs) generating less than 0.1% of global GHG emissions although its emissions have more than doubled since 1995.⁷ In any case, Kenya is a victim of Climate Change and a recipient of Climate Adaptation

⁵ Government of Kenya. Fourth Medium Term Plan 2023 – 2027: “Bottom-Up Economic Transformation Agenda for Inclusive Growth”. Pp13 (MTPIV)

⁶ Id, MTPIV, Pp 55

⁷ World Bank. Climate Action Key to Kenya's Upper-Middle-Income Country Aspirations. November 16, 2023. Available at <https://www.worldbank.org/en/news/press-release/2023/11/16/climate-action-key-to-kenya-s-upper-middle-income-economy-1123-country-aspirations>

funding. Why then would we punish our local producers by imposing the eco - levy for goods manufactured in Kenya. Why would manufacturers in Kenya be punished for the climate errors of the global north, when our impact in terms of green house gas emissions is dismal?

- (e) **Compulsion of integrating electronic tax systems:** Decriminalization of MSMEs in the informal sector is one of the enablers for production stated in MTPIV.⁸ Integrating electronic tax systems is a costly affair and one that cannot be forced on businesses. This provision, which has a hefty penalty, goes against the grain of this policy objective.
- (f) **Opening up affordable housing to market forces:** the bill proposes a removal of the restriction imposed on the transfer of affordable housing. The restriction in section 54 of the Affordable Housing Act would have assisted to ensure that the affordable houses, which are procured at below market rates due to government intervention, are availed to deserving beneficiaries. This would also ensure minimal disruption of the existing private sector development space. Removing this clause would compromise the sanctity of the Affordable Housing Act as a whole, as well as the policy initiative. The affordable houses would be mopped up by the rich and resold at market rates. The beneficiaries of affordable houses would become proxies for rich people who see an opportunity to acquire cheap houses at scale. This would result in affordable houses being constructed and still not being available for use. There is enough evidence with what happened in slum upgrading projects, where beneficiaries chose to rent out the units and return to the slum.

Clarity and impact on Public Participation

Clarity is a parameter that is used to measure the effectiveness of legislation.⁹ One of the key challenges with the Finance Bill 2024, is that it amends provisions that are yet to be revised by the National Council for Law Reporting (NCLR). NCLR updates the Kenya Law Reports website which is the most authoritative and popular source of legal texts online. Unfortunately the version of the Income Tax (Chapter 470 of the Laws of Kenya) has only been updated up to 2022. Amendments introduced by the Finance Act 2023 do not reflect in the online version. This will significantly affect the quality of public participation, since persons in the general public will likely not realise this error in versions. Some examples are the amendments in clause 2 of the bill which amend terms like 'digital market place' and 'related persons'. Another example is clause 11 of the Finance Bill that makes reference to a Section 15 (2) (ga) that does not exist in the Income Tax Act as published in

⁸ Supra, Pp 128

⁹ H. Xanthaki, Drafting Legislation: Art and Technology of Rules for Regulation. Hart Publishing (2014)

the Kenya Law Reports Website and is also missing in the Finance Act 2023. These definitions are not available in the online version of the act published in the Kenya Law Reports website. It is therefore impossible to achieve quality Public Participation when the available information is scattered across various finance acts and miscellaneous amendments.

Conclusion

The government pays the most attention to constitutionality, when it comes to enacting Finance Bills. This is because of the precedent set by courts, of expunging unconstitutional provisions. There are risks of unconstitutionality in this bill. Some like the presumed infringement on the right to property by taxing travel allowances may be easy to deal with. The other two on Public Participation and Consumer Protection may need a radical surgery of the bill. I would however lay greater emphasis on the policy objectives, and therefore the policy impact of the bill. While constitutionality can eventually be resolved, it would be a great disservice if we harm our economy in attempt to gather revenue through unbridled imagination.

Table 1: Taxation Target and Impact

Finance Act Section	Issue	Persons Targeted	Anticipated Impact	Revenue Target??
2	The target is vague. It seems aimed at targeting income from monetisation of digital content that may have been excluded in the existing definition.	Monetisation of digital services		
	Broaden the definition of related persons to capture income earned by persons with a controlling interest or power over a business	Related person is not a terminology that is used anywhere in the income tax act. The only existing mention was in Section 16 paragraph (j) and this was deleted by the Finance Act 2023.		
	Royalty is defined in its various formations as an intellectual property			
	Donation is defined	Contributions made for causes such as harambees		
3	Definition of digital marketplace is broadened to include mobile phone app based services	Mobile phone App based services, hosted services (server services)		
5	There presumption of income for person who supply goods and services to the government	Service Providers to government	This section seems misplaced. It is misaligned with the general subject of the section	
6	Amounts given to employees as travel expenses	Employees whose work involves travel	Any amount given to an employee as a travel expense shall be deemed as income and is taxable	
7	Income from non-resident digital marketplace service providers	Income from Non - resident subscription based service providers like Netflix, Google, Facebook		
8	Replace Digital Service Tax with Significant Economic Presence Tax	Non - resident digital market place service providers like server hosting and other hosted services?	Foreign based hosted services will have a 20% increase in cost to cover the final tax imposed on turnover	

Finance Act Section	Issue	Persons Targeted	Anticipated Impact	Revenue Target??
9	Introduce a minimum top up tax	Multinational entities?		
10	Motor Vehicle Tax	Motor Vehicles Owners	Increase in the cost of insurance premium for motor vehicles	
34	Banking transactions and instruments are being made VAT chargeable	Financial services	Increased cost of financial services	
37	Imposition of excise duty on non-resident digital services	Non - resident digital market place service providers	Increased costs for non - resident digital market services	
44	Increasing the import declaration fee from 3% to 4%	Consumers	Increased costs for imported consumable products	
57	Compel an integrated tax system	General traders	Forcing expenditure on business people	
61	Remove the transfer of affordable house	Affordable houses beneficiaries	Disrupt the real estate sector and compromise the affordable housing policy	