MGI ADAM & ASSOCIATES

Certified Public Accountants

Finance Act 2025 Highlights

Client Brief – August 2025

OVERVIEW

The Finance Act, 2025 was signed into law on 26 June 2025, with most provisions effective from 1 July 2025. Some specific provisions (e.g., on Advance Pricing Agreements and Import Declaration Fees) will take effect from 1 January 2026.

The Finance Act 2025 introduces modern tax policies to expand the digital tax net, simplify compliance, attract investment through Nairobi International Financial Centre (NIFC) incentives, and tighten enforcement—while protecting small businesses from tax burden escalation.

Key objectives of the Act:

a. Broaden the tax base
b. Promote tax compliance
c. Stimulate growth in the digital and financial sectors
d. Support small businesses and the NIFC

1. INCOME TAX ACT (ITA) CHANGES

A. Significant Economic Presence (SEP)

Replaces the Digital Services Tax (DST) effective December 27, 2024.

SEP applies to non-resident persons who derive or accrue income from services provided to users in Kenya, provided those services are delivered via a digital marketplace, internet, or electronic network.

Tax Rate: 10% of deemed profit (which is 30% of gross turnover) = Effective 3% of gross turnover

Filing Deadline: 20th of the following month

B. Minimum Top-Up Tax (QDMTT)

- Kenya's domestic Qualified Domestic Minimum Top-Up Tax (QDMTT) - Ensures Multinational Enterprises (MNEs) pay a minimum 15% effective tax on Kenyan-sourced profits
- Due Date: 4 months after end of accounting period (e.g., 30 April for 31 Dec year-end).

C. Expansion of Withholding Tax

Public entities now required to withhold tax on:

- Supply of goods
- Sale of scrap material

D. Limitation on Loss Carry Forward

Losses can only be carried forward for 5 years unless specific exemptions apply (e.g., infrastructure projects). This restriction applies to both operating losses and capital losses. Additionally, any provision allowing the deduction of capital losses against future capital gains has been deleted.

E. Gratuity Payments Now Fully Tax-Exempt

Withdrawals from pension funds now fully tax-exempt if they meet retirement qualifications. As of 1 July 2025, all gratuity payments—whether from public or private schemes—are fully exempt from income tax under Section 28(c) of the Income Tax Act. Previously, only gratuity from public pension schemes was exempt.

2. CORPORATE & INVESTMENT TAXES

A. Repeal of Investment Deductions

- 100% and 150% deductions for investments in underdeveloped areas are abolished.
- Standard capital deduction rates (50%/25%) remain.

B. Royalties Expanded

- Now includes recurring software license payments, streaming, and other digital rights
- Increases withholding tax exposure

C. Advance Pricing Agreements (APAs)

- Introduced to offer transfer-pricing certainty to MNEs
- New APA regime for related-party transactions aims to reduce transfer-pricing disputes and give investors certainty. APA is valid for up to five consecutive years, after which renewal is needed.

D. Country-by-Country Reporting (CbCR)

- Mandatory for MNEs with consolidated turnover above Kshs. 95 billion (EUR 750M
- Applies regardless of treaty presence

3. EMPLOYMENT TAX CHANGES

A. Increased Per Diem Threshold

Tax-free per diem raised from Kshs. 2,000 to Kshs. 10,000/day

B. Mortgage Interest Deduction Extended

- Now includes construction of residential homes
- Annual cap: Kshs. 360,000

C. PAYE Relief Clarification

- Employers must apply tax reliefs prior to PAYE calculation

D. Pension Tax Changes

- Tax exemption only applies upon retirement at legal age, or 20+ years in a registered pension scheme.

4. DIGITAL & FINANCIAL SERVICES TAXATION

A. 20% Excise Duty on Digital Services

- Applies to digital lenders, e-payment platforms, cloud services, and foreign fintechs
- Exempt: Licensed banks, SACCOs, MFIs

B. Virtual Assets & Crypto

- 3% Digital Asset Tax repealed
- Replaced with 10% excise duty on platform service fees

5. VAT CHANGES

A. Financial Services Now Taxable

- Credit/debit card issuance, FX, cheque processing, and commissions now attract 16% VAT

B. VAT Threshold Raised

- Mandatory registration threshold increased from Kshs. 5M to Kshs. 8M

C. Shortened Refund Timelines

- General VAT refunds claimable within 12 months
- Bad debts: 2 years

D. Use-Based VAT Apportionment

- Mixed-use input VAT must be apportioned based on actual use

E. Misuse of Zero-Rated/Exempt Supplies

- VAT becomes payable if supplies are used outside intended exempt/zero-rated scope

F. ETIMS Compliance

- Electronic Tax Invoices are recognized for compliance and VAT reporting

6. EXCISE DUTY UPDATES

A. 20% Excise on Non-Resident Digital Services

- Applies to unlicensed digital lenders, Fintechs, cloud, etc.

B. 5% Excise on Betting Wallet Deposits

Replaces previous 15% on wagers

C. Other Key Adjustments

- Excise on imported plastic, float glass, and coal
- Farmers using local spirits may qualify for reduced excise

7. NAIROBI INTERNATIONAL FINANCIAL CENTRE (NIFC) TAX INCENTIVES

A. For Startups & Certified Entities:

- 15% Corporate Income Tax (CIT) for first 3 years; 20% for next 4 years
- Dividend tax exemption with minimum Kshs. 250M reinvestment
- Stamp duty relief on internal restructurings

B. For Large Investors:

- 15% CIT for 10 years; 20% for next 10
- Must invest Kshs. 3B+ within 3 years
- Meet senior management localization thresholds - localize senior management (60–70%)

8. ADMINISTRATIVE & ENFORCEMENT CHANGES

- Tax Amnesty Extended to 30 June 2025 (only penalties & interest)
- Objection & Alternative Dispute Resolution (ADR) timelines extended to 120 days from 90 days
- Penalties for e-filing/e-invoicing non-compliance set at: Kshs. 100,000/month or two times of the tax due
- Waiver of penalties/interest no longer allowed
- Failure to remit WHT = 10% penalty
- New penalties for impersonation and statutory instrument breaches: Up to Kshs. 1M fine or 3–5 years imprisonment