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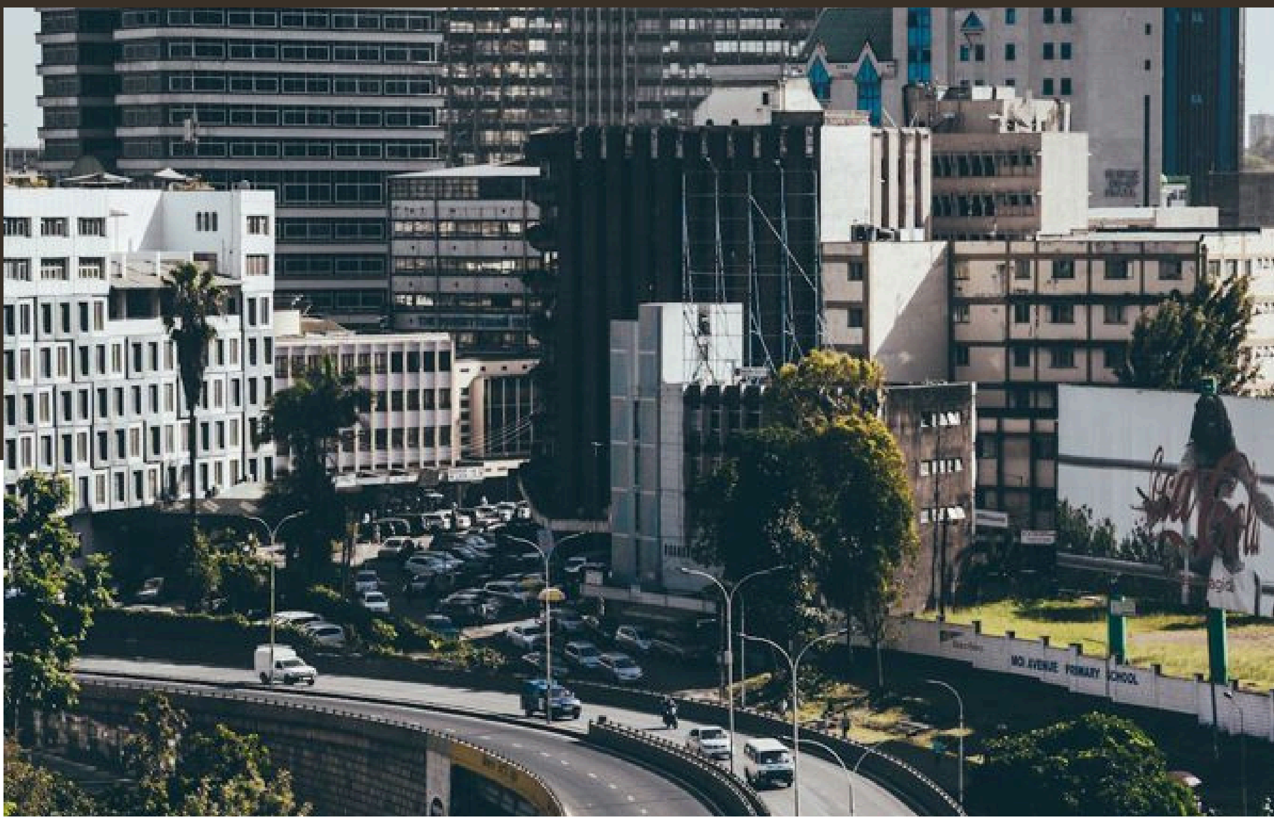
JULY 2025

FINANCE ACT 2025

AMENDMENTS TO THE INCOME TAX ACT.



The Finance Act, 2025 was assented to by the President on 26th June 2025 and is now in force. The Act introduces a wide array of tax measures through amendments to several key pieces of legislation, including the Income Tax Act (Cap. 470), Value Added Tax Act, 2013, Excise Duty Act, 2015, Tax Procedures Act, 2015, and the Miscellaneous Fees and Levies Act (Cap. 469C).

These changes are part of the Government's broader strategy to align Kenya's tax framework with current economic realities and evolving policy priorities. While most of the provisions take effect from 1st July 2025, a few notable measures are scheduled to come into operation on 1st January 2026.

This newsletter provides a breakdown of the key provisions of the Act and what they mean for you and your business.

Debentures

The Finance Act 2025 has amended the Income Tax Act by deleting the definition of "debenture" that previously included loans and loan stock for purposes of applying deemed interest provisions.

This amendment stands to benefit companies with intra-group or cross-border unsecured loans, as it reduces the likelihood of being taxed on deemed interest where no actual interest is charged.

This amendment took effect on the 1st July 2025.

Venture Companies

Section 2 has also been amended to delete the definition of Venture Company.

This is unlikely to affect most businesses directly. However, it may be a sign that the government is doing away with specific tax incentives that were previously available to venture capital-backed businesses or startups.

This amendment took effect on the 1st July 2025.

Winnings and Withdrawals

The Finance Act has deleted the definition of the term 'winnings' and introduced a definition for the term 'withdrawal'.

This amendment indicates a shift in the tax point from when winnings occur to when funds are withdrawn from the wallets.

Although this may 'delay' when income from betting and gaming is taxed, it stands to capture actual cash-out values.

Related Persons

Section 2 of the Income Tax Act has been amended to broaden and clarify the definition of related party relationships.

The revised definition expands the scope of relationships subject to transfer pricing and anti-avoidance rules by including connections through marriage, affinity, and indirect control. This change may increase compliance complexity for family-owned businesses, joint ventures, and informal arrangements.

The amendment came into effect on 1st July 2025.

Employee Allowances

Section 5 of the Income Tax Act has been amended to increase the tax-free daily subsistence allowance for employees.

Previously, only up to KES 2,000 per day paid to an employee as a per diem was exempt from tax. This limit has now been raised to KES 10,000 per day.

Employers can now pay up to KES 10,000 per day in allowances without attracting PAYE tax on that amount.

This amendment took effect on the 1st July 2025.

Income deemed to be from Kenya

Section 10 has been amended to introduce Two (2) more categories of income deemed to arise in Kenya:

- Supply of goods to a public entity
- Making or facilitating payments over a digital marketplace.

This means that if a non-resident person supplies goods to a Kenyan government or public entity or if a non-resident facilitates or processes payments on a digital platform (like a global payment processor or e-commerce intermediary), that income is now within Kenya's tax scope.

Employment Income Provisions

Section 8 of the Income Tax Act has been amended as follows:

- The term "husband" has been replaced with "spouse." The law is now more inclusive and recognizes that either partner can be the relevant party for tax purposes in employment-related provisions.
- Deletion of multiple subsections (4, 6, 7, 9, and 9A). These deletions simplify the tax treatment of employment income, especially for married couples and special employment categories. It also signals a shift towards individual taxation, where each person is taxed separately, regardless of marital status or employment type.

Minimum Tax

Section 12D, which previously dealt with minimum tax, has been fully repealed.

The repealed minimum tax, required businesses to pay tax even when they were making losses.

This eliminates the burden of paying tax when no actual profit is made.

Turnover Tax

Several changes have been made to the application of Turnover Tax. This includes:

- Expanding the scope to include businesses conducted over the internet or electronic networks eg, online shops.
- Introduced a six-month grace period for businesses to comply with the Turnover Tax requirements from the 1st July 2025.

Digital Service Tax (DST)

Section 12F, which introduced Digital Service Tax, has been repealed.

Non-resident digital businesses (like global streaming platforms or online marketplaces) will no longer be subject to DST under Kenyan law.

This reflects Kenya's commitment to align with international tax agreements under the OECD's global tax framework.

Restriction on Deductibility of Certain Expenses

The provision granting the commissioner the power to limit interest deductions on certain loans from non-residents has been removed.

The removal of this provision stands to simplify the treatment of interest on foreign loans.

Deductions Allowed for Tax Purposes

Section 15 of the Income Tax Act sets out the types of expenses that a business can deduct from its income when calculating taxable profit. The Finance Act, 2025 introduces several changes.

- Depreciation of Small Tools & Utensils

Businesses can now deduct 100% of the cost of tools, utensils, or similar items (that are not classified as machinery or plant) in the same year they are purchased.

- Removal of deductions for certain types of contributions.

Taxpayers can no longer claim deductions from contributions made to Clubs and Trade Associations, Scholarships or training and Contributions to certain public projects or charities.

- Claims arising from money spent on building sports facilities.

Taxpayers can now claim a tax deduction for money spent building sports facilities on public grounds.

- Housing for employees

Tax deductions are allowed for costs incurred in constructing housing units for employees.

- Removal of the provision on Treatment of Capital Losses from Investment Assets.

The deleted provision previously allowed taxpayers to deduct capital losses (i.e., losses made when selling investment assets like shares or property) from capital gains that are chargeable to tax under section 3(2)(f), but only within that year or in subsequent years if not fully utilized.

By removing this provision, taxpayers may no longer claim capital losses to offset capital gains for tax purposes.

This change increases the tax burden on investors, especially those who trade in securities, real estate, or other capital assets.

If you sell an asset at a loss, you can no longer carry that loss forward to reduce future taxable capital gains.

In effect, only gains will be taxed, while losses cannot be used to cushion tax liability.

Deductions Allowed for Tax Purposes-Continued

- Reduced Carry-Forward Period for Deductions

This amendment shortens the timeframe for carrying forward certain tax deductions to offset future taxable income.

If your business incurs a deductible expense (like development costs or certain capital expenditures) that you can't fully use in the year it's incurred, you now have only five years to apply the remaining balance.

To illustrate this amendment, suppose you incurred KES 10 million in qualifying expenses in 2025 but only had enough profit to deduct KES 2 million per year:

- Under the old law (10 years): You had until 2035 to finish claiming the deduction.
- Under the new law (5 years): You must now finish by 2030, or lose any unused portion.

Special Provisions for Non-Resident Companies

Section 18 has been amended be deleting subsection 6, provided a definition of "related parties" for the purposes of enforcing arm's length pricing rules in transactions between a non-resident and a related resident person (as described in Section 18(3)).

This definition was important in determining when KRA could adjust profits where a Kenyan company (or branch) was not earning ordinary profits due to dealings with a related non-resident person.

Set off of Taxes

Section 39 has been amended to restrict the automatic set-off of tax withheld under Section 17A (digital services) by companies.

This set-off will now only apply to individuals, potentially impacting corporate digital service providers.

Special Provisions for Non-Resident Companies- Continued

The amendment aligns Section 18(6) with the revised definition of "related person" under Section 2, which now covers direct or indirect control, family ties (including marriage and affinity), and shared involvement in management, control, or capital.

This harmonisation eliminates duplication and broadens the scope of relationships subject to related-party rules, particularly informal or family-based arrangements.

For instance, two siblings managing separate companies that transact with each other may now fall within the scope of related-party scrutiny, even without a direct ownership link.

Non-resident companies and local entities transacting with foreign affiliates must now adhere to stricter arm's length standards and maintain detailed transfer pricing documentation aligned with the expanded definition of "related person."

Inadequate documentation increases the risk of KRA recharacterising transactions or adjusting taxable income.

Transfer Pricing

The Finance Act, 2025 has revised the country-by-country (CbC) reporting requirements for multinational enterprises. Kenyan subsidiaries are now required to either file the CbC report locally or formally notify the Kenya Revenue Authority (KRA) about their group's CbC reporting arrangements, even if the report is submitted in another country.

Additionally, the previous concept of a "surrogate parent entity" has been removed and replaced with a more direct obligation for local entities to ensure compliance. As a result, multinational groups with operations in Kenya should review their internal compliance processes and confirm that KRA is properly informed of how and where their CbC reports are being submitted.

Advance Pricing Agreements

The Act introduces a new provision allowing companies to enter into Advance Pricing Agreements (APAs) with KRA.

These agreements enable businesses to pre-agree with the tax authority on how to price transactions with related parties, offering up to five years of certainty and protection from future transfer pricing disputes.

This is a welcome development for multinationals and large local groups seeking clarity and audit protection in their intercompany dealings.

Companies are encouraged to assess their readiness and consider applying once regulations are published.

Insurance Companies

Section 19 of the Income Tax Act has been amended to refine the terminology used in the taxation of insurance companies by replacing the term “life fund” with “life insurance fund”

While this amendment does not change how taxes are computed, it aligns the law with sector-specific language and improves clarity in the treatment of income from long-term insurance business.

Insurers should ensure that their reporting continues to clearly distinguish between life, annuity, and pension-related business lines in line with this clarification.

Members Clubs and Trade Associations

Members' clubs and trade associations may face uncertainty after the removal of the definition for "gross investment receipts," which previously clarified taxable passive income, such as rent and interest.

Previously, the definition clarified that income from dividends, interest, royalties, rents, etc., was taxable for members' clubs and trade associations.

Clubs or associations that earn significant investment income should review how they report such income in future and watch out for updated guidelines from KRA.

Change of Accounting Periods

The amendment to Section 27 (1C) introduces a clear approval timeline for taxpayers wishing to change their accounting period.

For businesses requesting to change their accounting period, KRA is now required to respond within three months, down from six.

If no response is issued, the application is automatically approved. This enhances efficiency and gives taxpayers greater certainty when aligning reporting timelines.

Withholding Tax on Payments

Section 35 of the act has been amended to reflect the following:

- Payments by Kenya Airways to non-residents for highly specialised services will be exempt from withholding tax, provided the service isn't available locally or the provider is internationally certified.
- Withholding tax shall be applied to betting income, particularly on withdrawals, not winnings.
- Profits from shipping businesses earned by non-residents will now be subject to withholding tax.

Deduction of Tax from Emoluments (PAYE)

Employers are now legally required to apply all applicable tax reliefs and exemptions when calculating Pay As You Earn (PAYE) for their employees. This includes personal relief, insurance relief, and deductible pension contributions. These must be factored in before PAYE is deducted, ensuring that employees are not overtaxed.

In addition, two procedural changes have been introduced:

- Employers are no longer required to submit PAYE certificates to KRA, likely due to improved integration with digital tax systems.
- PAYE disputes will no longer follow a separate objection process and will now be handled under the general tax dispute resolution framework in the Tax Procedures Act.

As a result, businesses should review and update their payroll systems to ensure all employee tax benefits are correctly applied and that their processes align with the new legal requirements.

Tax on Dividends from untaxed Profits.

An amendment has been made to Section 52B to emphasise that dividends from untaxed profits will be treated as part of the company's self-assessment obligation, removing the standalone surcharge approach.

Companies are now expected to declare and pay tax on such dividends within the same timeline as their usual income tax.

Penalty for Negligence of Authorized Tax Agents

Section 72B of the Income Tax Act previously imposed penalties on authorised tax agents whose negligence or disregard of the law caused a taxpayer to be assessed additional tax.

The penalty was ½ of the additional tax (minimum KES 1,000, maximum KES 50,000 per return or document).

This section has been repealed and as such, authorized tax agents will no longer be personally penalized under this specific section for errors leading to additional assessments on their clients.

Penalty on Underpayment of Instalment Tax

Section 72C imposed a 20% penalty on the difference between:

- The actual instalment tax paid and
- 110% of the correct instalment tax payable for the year.

It also allowed for remission (waiver) of penalties by the Commissioner, within set limits, and with reporting to the Cabinet Secretary.

This section has been repealed.

Collection of Taxes from Ship Owners

Section 104 of the Income Tax Act has been streamlined to make it easier for KRA to restrict ship or aircraft clearance where tax debts are owed, without having to follow the process in section 101.

This provision previously allowed the Commissioner to stop the clearance of a ship or aircraft by notifying Customs if the operator had outstanding tax debts recoverable under section 101.

As such, the Commissioner may still issue stop-clearance orders for outstanding tax, but now without having to link it strictly to section 101 recovery procedures.

Exemption from Stamp Duty

Section 131 previously provided a blanket exemption from stamp duty on:

- All securities (of any kind) over movable or immovable property, and
- All transfers of such property made in favour of or by the Commissioner (i.e. the Kenya Revenue Authority, KRA).

This section has been repealed.

Going forward, such securities and transfers will no longer be automatically exempt from stamp duty.

This could include:

- Charges or mortgages over property in favor of KRA; or,
- Property transfers made to or by KRA in enforcement of tax obligations (e.g. recoveries or settlements).

Tax Rates and Withholding Taxes

The third schedule has been amended as follows:

- Income tax rates now explicitly exclude fringe benefits and qualifying interest from the total income used to compute tax bands.
- New tax incentives for Nairobi International Financial Centre-certified companies:
    - 15% tax for first 10 years, 20% for next 10 years, if:
    - Kshs. 3B is invested in 3 years,
    - At least 70% (or 60% for HQs) of senior management are Kenyans.
    - Startups under Nairobi International Financial Centre: 15% tax for 3 years, then 20% for 4 years.

- Withholding Tax Adjustments
    - Withdrawals by punters: Withholding tax set at 5% (previously higher).

- Final Tax Clarifications:
    - Certain taxes (e.g., on winnings, digital monetisation) are now explicitly stated to be final, no further tax payable on this income.

- Fringe Benefits:
    - Set at the resident corporate tax rate (generally 30%), which aligns taxation of employee perks with corporate income tax treatment.

Income Exempt from Tax

The Finance Act 2025 has amended the first schedule as follows:

- Repatriation Timeline Extended:
  - Income of tax-exempt bodies may now be repatriated within 90 days providing more flexibility for planning.
- Social Health Insurance Fund:
  - Contributions into and out of SHIF are fully exempt from income tax.
- Pension and Gratuity Clarification:
  - Gratuity and other allowances paid under a registered pension scheme are now explicitly exempt from tax.
- Special Economic Zones (SEZs):
  - Gains from intra-SEZ property transfers by licensed developers, enterprises, or operators are tax exempt.
- New Exemptions Introduced:
  - Capital gains from transfer of securities listed on licensed securities exchanges are not chargeable to tax.
  - Dividends from companies certified under the Nairobi International Financial Centre are exempt if the company reinvests at least Kshs 250 million in Kenya during the same year.

Capital Deductions

The Second Schedule has been amended to expand the Telecom Sector Deductions as follows:

- Inclusion of indefeasible rights to use (IRU) fibre optic cable or spectrum licences as qualifying capital expenditure.
- Spectrum licences acquired before 1st July 2025 will be amortised over the remaining useful life only, clarifying treatment of past acquisitions.

Capital Gains Tax

The eighth Schedule has been amended to:

- Expand the definition of company to include members' clubs and trade associations deemed to be carrying on business (as per section 21). This brings more entities into the CGT net.
- Widen the Group Reorganisation Relief to include individuals, thereby offering broader relief during restructures.

Whether you're unsure how the new exemptions affect your tax planning, need help applying the new corporate rates, or want guidance on NIFC certification and investment thresholds—contact us. We're here to help you adapt smoothly and stay compliant.

CONNECT WITH US!

Phone

+254 790 723 263
+254 722 720 147
+254 758 860 047

Mail

info@uhy-ke.com
tax@uhy-ke.com
mmbuthia@uhy-ke.com

Address

Rainbow Towers, 6th Floor,
Muthithi Road Westlands
Nairobi.

Westlands Square Offices, 2nd
Floor, Ring Road Westlands
Nairobi.

Website

www.uhy.ke.com