CRITICAL TAX & BUSINESS LAW CHANGES TAKING EFFECT JANUARY 2026

As we approach the close of 2025, it's a time for reflection, celebration of your achievements, and strategic preparation for the year ahead.

The journey of building and growing a business in Kenya's dynamic economy requires not only vision and resilience but also an awareness of the evolving regulatory landscape that shapes how we operate.

Starting January 1st, 2026, significant amendments in various key laws will come into effect, introducing new compliance requirements, opportunities, and operational considerations for businesses across all sectors.

This newsletter is your practical guide to understanding what these changes mean for your business.

Whether you're a sole proprietor, running an SME, or managing a larger enterprise, these amendments will touch various aspects of your operations. From tax compliance and transfer pricing to corporate governance and digital reporting, the changes demand attention and proactive planning.

Our goal is to help you transition smoothly into 2026, turning regulatory compliance into a strategic advantage for your business.

Changes from the Finance Act 2025

Advance Pricing Agreements (APAs)

The Finance Act 2025 introduces a formal Advance Pricing Agreement framework under Section 18G of the Income Tax Act. This is a game-changing tool for businesses engaged in transactions with related parties, whether locally or internationally.

An APA is a **pre-negotiated agreement with the Kenya Revenue Authority (KRA) that establishes the transfer pricing methodology for your related-party transactions**. Instead of waiting for a tax audit to determine whether your pricing was appropriate, you can now get advance certainty.

These Advance Pricing Agreements:

- Are valid for up to five consecutive years;
- Cover transactions with related resident persons or persons in preferential tax regimes; and,
- Provides tax certainty and reduces the risk of transfer pricing disputes.

These arrangements are particularly valuable for:

- Companies with foreign subsidiaries or parent companies;
- Businesses engaged in cross-border transactions with related entities;
- Enterprises dealing with affiliated companies in special economic zones; and,
- Family businesses with multiple related corporate structures.

Businesses falling into these categories should conduct internal reviews now to ensure their transfer pricing policies and documentation are robust before the 2026 implementation deadline.

The Commissioner's Enhanced Powers to issue Penalty Waivers

The second amendment effective January 1st, 2026, grants the KRA Commissioner expanded authority to waive penalties and interest that arise from errors in electronic tax systems in situations clearly beyond a taxpayer's control.

What does this mean for businesses?

- If KRA's i-Tax system malfunctions and causes late filing or payment errors, you can now request a waiver;
- System-generated penalties from technical glitches can be challenged; and,
- Greater fairness in cases where compliance failure wasn't your fault

This amendment provides welcome relief for businesses affected by persistent i-Tax system errors.

For the first time, you have a formal pathway to challenge penalties arising from technical glitches beyond your control, reducing the financial impact of system malfunctions on your tax liabilities.

KRA Directives effective 1st January 2026

Validation of Income & Expenses:

KRA will validate declared income and expense claims in tax returns (for both individuals and non-individuals) using TIMS/eTIMS, gross withholding tax data, and import records.

Only transactions backed by valid electronic tax invoices, properly transmitted with the buyer's PIN (where required), will be accepted.

Expense deductions may be disallowed if the invoice is not e-tax compliant or not linked to the correct buyer PIN.

Turnover Tax (TOT) Clarification:

KRA's "Unpacking Turnover Tax" guide indicates TOT applies for businesses with gross turnover between KSh 1,000,000 and KSh 25,000,000, at 1.5% on gross sales.

Businesses in this bracket should reassess their TOT exposure, particularly for the Financial Year 2026.

Minimum Top- Up Tax

KRA has proposed a Minimum Top-Up Tax to ensure companies pay at least a basic level of tax.

For 2026, the draft rules provide that KRA will use 9.4% of your employee costs and 7.4% of your asset values to estimate this minimum tax.

If your normal tax (based on profits) is lower than this minimum, you may have to top up the difference. Businesses with high assets or many staff but low taxable profits should check if they fall into this category.

It's wise to estimate your 2026 exposure now so you're not surprised by a top-up tax bill when the rules take effect.

Other Changes introduced by the Finance Act that took effect in July 2025

While not commencing in January 2026, it's important to note several Finance Act 2025 provisions already in effect that continue to impact your 2026 operations:

Transfer Pricing & Related Party Definitions: The definition of *"related person"* has been significantly expanded to include relationships by marriage, blood, or affinity, not just corporate shareholding. This means more transactions will fall under transfer pricing scrutiny.

Tax Loss Limitations: Tax losses can now only be carried forward for five years (with possible extension by the Cabinet Secretary). This requires more strategic tax planning to ensure you utilize losses before they expire.

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Digital Economy Taxation: A 10% excise duty now applies to fees charged on virtual asset transactions, affecting fintech platforms and cryptocurrency exchanges.

Employee Benefits: The tax-free per diem allowance has increased from KES 2,000 to KES 10,000 per day, reducing the tax burden on employees who travel for work.

VAT Refund Timelines: VAT refund processing time increased from 90 to 120 days without audit, or 180 days with audit, impacting working capital planning.

Strategies for Compliance and Alignment: Preparing Your Business for 2026

Navigating these changes successfully requires a strategic, proactive approach. Here are practical steps you can take now to ensure compliance and position your business advantageously:

Conduct a Comprehensive Compliance Audit:

Before January 1st, 2026,

- Map all related-party transactions and assess whether they meet arm's length standards;
- Review your transfer pricing documentation and evaluate whether it is current, comprehensive, and defensible;
- Identify any carried-forward tax losses and create a strategy to utilize them within the five-year window; and,

We acknowledge that this can be a highly technical process requiring specialized expertise. We recommend engaging a tax professional to conduct a pre-compliance review before KRA does.

Cash Flow Planning for Extended Refund Timelines

With VAT refund processing now taking 120-180 days, Build larger working capital reserves to absorb refund delays;

- Consider alternative financing arrangements to bridge refund periods;
- Negotiate payment terms with suppliers that account for longer cash cycles; and,
- Monitor refund applications closely and follow up proactively with KRA.

Evaluate Your APA Eligibility and Strategic Value.

Not every business needs an APA, but for those with significant related-party transactions, it's a powerful tool:

When to consider an APA:

- Annual related-party transaction values exceed KES 50 million
- You operate in multiple jurisdictions with complex transfer pricing issues
- You're establishing new related-party arrangements with novel pricing structures
- Historical audits have resulted in transfer pricing adjustments

The APA application process shall be detailed in the Income Tax (Advance Pricing Agreement) Regulations, which are yet to be published. In anticipation for the same, we recommend that you:

- Prepare comprehensive documentation of your proposed methodology;
- Demonstrate in your application that your pricing approach aligns with OECD guidelines;
- Are ready for thorough KRA review and potential negotiation; and,
- Budget for professional advisory costs as APAs require robust technical support.

Update your Transfer Pricing Documentation.

Even if you don't pursue an APA, robust transfer pricing documentation essential for our business.

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