

LEGAL ALERT

Tax & Commercial

KN

— LAW LLP —

FINANCE Act, 2026

What it means for Businesses in Kenya

Overview

Executive summary

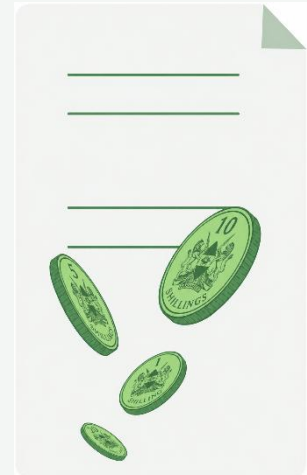
The Finance Act, 2026 (the Act) was passed by the National Assembly on 18th June 2026 and has been assented to by the President. Following our earlier alert on the Finance Bill, 2026 (the Bill), this follow-up sets out what changed between the Bill and the enacted law, the implications for businesses, and the significant new measures that were introduced before assent and did not feature in our previous alert.

Commencement. Most provisions take effect on 01 July 2026. The shortened income tax return deadlines and the non-resident repatriation rates (sections 17, 18 and 24) take effect on 01 January 2027, and the new export declaration regime (section 43) takes effect on 01 September 2026.

A number of the Bill's proposals were dropped, including the deemed dividend on undistributed profits, activation-based excise on mobile phones, the removal of EAC excise preferences, and the one-month nil-return rule. At the same time, the Act introduces new compliance machinery that was absent from the Bill, most notably a mandatory export declaration regime for all importers, a VAT recharacterization of outsourcing and staffing costs, and a power for the Kenya Revenue Authority (KRA) to recover non-tax fees and levies as if they were tax.

Five key provisions that businesses should note are:

1. Importers must obtain and retain export declarations from the country of export for all imported goods from 01 September 2026, failing which KRA may reject customs declarations, reassess taxes and impose penalties.
2. Employee-related costs incurred under labour supply, outsourcing and staffing arrangements are now deemed to be disbursements made on behalf of the client, changing the VAT treatment of these services.
3. KRA may now recover certain statutory fees, levies and charges as if they were unpaid taxes, significantly expanding its enforcement powers beyond tax liabilities.
4. Individuals must file income tax returns within four months of year-end, while companies still have six months to file income tax returns.
5. The Act introduces targeted investment incentives, including enhanced bad debt deductions for qualifying lenders, a 100% first-year investment deduction for investments exceeding KES 10 billion and new VAT exemptions for qualifying infrastructure projects.



A. Bill proposals that were dropped

1. Deemed dividend on undistributed profits abandoned

The Bill would have allowed the Commissioner to treat at least 60% of a private company's after-tax profits as distributed where no dividend was declared within 12 months of year-end, triggering dividend Withholding Tax (WHT). This proposal was not enacted.

Implication: Private companies and family and holding structures are not required to restructure dividend policy on this account.

2. Activation-based excise on mobile phones abandoned

The Bill proposal of taxing mobile phones Excise Duty at 25% on activation, and the removal of the import declaration fee and railway development levy exemptions for phones were dropped. Mobile phones remain on their existing tax regime.

Implication: Phone importers, distributors and telcos can maintain their existing operations.

3. EAC excise withdrawal abandoned

The Bill's deletion of the EAC rules-of-origin excise preference across a long list of goods such as furniture, paper and paperboard, plastics, printing ink, paper labels, kraft paper, safety glass and insulating glass units were dropped. The Act maintained only float glass of tariff 7005.

Implication: Manufacturers and converters sourcing inputs from EAC countries retain preferential excise treatment for those inputs, with float glass the sole exception

4. VAT zero-rating preserved

The Bill's wide withdrawal of zero-rated supplies was largely reversed. The Act deletes only paragraphs 11 (pharmaceutical inputs) and 35 (BEV stoves) of the zero-rating schedule. Bicycles and batteries were not deleted but narrowed to specific tariff headings, 8712.00.00 and 8507.60.00 respectively, confining their zero-rating to those lines.

Implication: Suppliers previously concerned about losing zero-rating and refund positions are largely unaffected, save for the two deleted paragraphs.

5. VAT exemptions dropped

Several VAT exemptions promised by the Bill were dropped from the Act: inputs for the manufacture of animal feeds; electric buses, motorcycles and bicycles; solar and lithium-ion batteries; telephones for

cellular and wireless networks; and worn clothing (mitumba). The Act retains exemptions for pharmaceutical inputs, bioethanol vapour (BEV) stoves and PPP infrastructure, and adds new exemptions (see Section E).

Implication: Businesses that built pricing around these proposed exemptions should maintain current systems, as the anticipated VAT relief did not materialise.

B. Proposals carried into the Act but in modified form

1. Royalty and WHT base narrowed

The broad definition of royalty proposed in the Bill is maintained, but the Bill's software-distribution inclusion in the definition was dropped. Software licence, development, maintenance and support fees remain royalties subject to WHT.

Implication: For banks, fintechs and payment service providers. card payment-network access fees and software fees are now within the WHT net.

2. Electronic tax system invoice penalty materially reduced

The Bill's penalty of two times the tax due for failure to use electronic tax systems was replaced with five per cent of the tax due, subject to a minimum of KES 100,000 for a company and KES 10,000 for an individual.

Implication: Exposure for eTIMS, e-filing and payment lapses is significantly lower than the Bill indicated, though the above minimum thresholds still apply.

3. Gratuity exemption recalibrated

The exemption for employer gratuity contributions is retained, but the cap is now 31% of the employee's emoluments earned over the contract period (the Bill measured it against basic salary), and it applies to a contract of service of at least 3 years, or the renewal or extension of such a contract beyond 3 years. The Bill's exclusion of employees already receiving pension-contribution relief was dropped.

Implication: Employers should re-test gratuity scheme rules and payroll treatment against the emoluments-based cap and the contract-term condition.

C. Major new provisions not in the Bill

1. Export declaration required for all imported goods (new s.23B of the Tax Procedures Act)

Effective 1st September 2026, every importer must obtain and retain, for 5 years, an export declaration or equivalent customs document from the country of export, with prescribed particulars. Where an importer cannot produce it, KRA may reject claims as to value, origin, cost or ownership, redetermine the customs value and tax liability, and impose administrative penalties.

Implication: This is a significant new compliance burden across all import supply chains. Importers should engage overseas suppliers now to secure compliant export documentation and update record-keeping systems ahead of the commencement.

2. VAT on outsourcing and staffing recharged costs (amended s.13 of the Value Added Tax Act)

Where a supplier of labour, outsourcing or employee-placement services incurs employee-related costs such as salaries, wages, statutory deductions and similar costs, those costs are deemed to be non-taxable disbursements made on behalf of the client.

Implication: BPO, staffing, payroll outsourcing and labour-supply providers should review their contracts and invoicing to confirm the VAT treatment of recharged employee costs.

3. KRA recovery of non-tax fees and levies (new s.39B of the Tax Procedures Act)

Where KRA is the collector of a fee, levy or charge under any other written law, it may recover any unpaid amount as if it were unpaid tax, with amounts up to KES 100,000 recoverable summarily.

Implication: KRA's enforcement reach now extends beyond tax to a range of statutory fees and levies it administers.

4. New financial-sector and investment reliefs

Bad-debt deduction – banks, microfinance institutions and money-lenders may deduct the principal, interest and other amounts of a debt that has gone bad in line with the Commissioner's guidelines.

Large-investor deficit – a person who invested at least KES 10 billion before 01 July 2025 may carry a deficit ascertained before that date into the 2025 year of income until it is extinguished.

100% first-year deduction – investments above KES 10 billion qualify for a full first-year capital deduction, against the 10-year equal-installment rule that applies to others.

5. Other notable additions

VAT input recovery – input tax on exempt supplies to the Kenya Defence Forces, National Intelligence Service and National Police Service is now recoverable, and duty-paid inputs used in exempt excisable goods may be offset.

New VAT exemptions – National Infrastructure Fund goods, plant and machinery for projects above KES 3 billion, LPG storage-tank goods and services, and the granting of credit and realisation of collateral as exempt financial services.

Conclusion

The Finance Act, 2026 introduces a number of changes to the proposals contained in the Finance Bill, 2026. While certain measures proposed in the Bill were not enacted, the Act retains key provisions and introduces additional obligations, including the export declaration requirements scheduled to take effect on 01 September 2026.

Businesses should review the enacted provisions to assess their impact on existing operations, tax positions, and compliance frameworks. Particular attention should be given to the provisions that differ from the Bill, the removal of proposed VAT exemptions, and the forthcoming export declaration and outsourcing VAT requirements to ensure readiness ahead of their respective commencement dates.

ABOUT KN

KN Law LLP is a boutique corporate and commercial law firm operating from Nairobi, Kenya, with a regional reach across multiple jurisdictions and with a liaison office in London. We have selected the very top lawyers in their respective fields, each with unique experience and demonstrated expertise, to make up a well-rounded team that works together and with our clients. Our proven experience and proficiency in providing legal advisory to local and multi-national corporations and high-net worth individuals is the core of our practice. We offer innovative, efficient and practical legal solutions through our team of highly trained, skilled and expert lawyers. Our brief is simple: to ensure that our service offering not only meets clients' expectations, but continually surpasses them.

We are a member of Legus International, a top-ranked global network of law firms that provides our clients with access to over 2,500 lawyers in over 60 jurisdictions

CONTRIBUTORS:



EMMANUEL MUEKE
Managing Partner



IMMANUEL NZAKU
Partner



CYD SHIKANGA
Associate



5th Floor, The Pavilion, Westlands Lower Kabete
Road, Nairobi
(+254) 20 386 1306 (+254) 729 891 421 / 738 891
421
P.O. Box 27547-00100, Nairobi

Berkeley Suite, 35 Berkeley Square, Mayfair,
London, W1J 5BF
(+44) 20 7692 1873