Finance Bill 2025 Note

On 30th April 2025, the Cabinet Secretary for the National Treasury and Economic Planning presented the Finance Bill 2025 to the National Assembly for approval. Rather than introducing aggressive tax hikes, the Bill focused on plugging revenue leakages, a more reserved approach following the widespread anti-finance bill protests that occurred in June and July 2024, following the Finance Bill 2024;

The raft of tax changes in the Finance Bill 2025 are geared towards expanding the tax base and increasing revenues through sealing revenue leakages to meet the government's budget for the fiscal year 2025/2026 of Kshs 4.2 tn, as well as reduce the budget deficit and borrowing. The government's projects to increase revenues to Kshs 3.3 tn in FY'2025/2026, an 8.1% increase from the projected Kshs 3.1 tn in the FY'2024/25 Supplementary Budget II. Additionally, from the FY'2025/26 budget estimates, the fiscal deficit is projected to narrow by 0.5% points 4.6% of GDP, from the 5.1% of GDP in the FY'2024/25 Supplementary Estimates II. According to the CBK Kenya's total public debt to GDP ratio stood at 66.6% as of September 2024 and estimated at 68.6% currently which is higher than the 55.0% preferred by the World Bank and the International Monetary Fund (IMF). This necessitates the urgent need for fiscal consolidation and debt reduction, and as such total borrowing is projected to decline by 16.2% to Kshs 805.6 bn in FY'2025/26 down from the projected borrowing of Kshs 961.2 bn in the FY'2024/25 Supplementary Budget II.

Below is a summary of the major changes as per the updated BPS 2025 from the expected FY'2025/2026 budget performance:

Cytonn Report: Comparison of 2024/25 and 2025/26 Fiscal Year Budgets as per the updated 2025 Budget Policy Statement				
	FY'2023/2024 Budget Outturn (Kshs bn)	FY'2024/2025 Revised Estimates II (Kshs bn)	FY'2025/2026 Budget Estimates (Kshs bn)	% change 2024/25 to 2025/26
Total revenue	2,702.7	3,067.7	3,316.9	8.1%
External grants	22.0	52.6	45.9	(12.7%)
Total revenue & external grants	**2,724.7**	**3,120.3**	**3,362.8**	**7.8%**
Recurrent expenditure	2,678.4	2,948.4	3,119.2	5.8%
Development expenditure & Net Lending	546.4	613.5	643.9	5.0%
County governments + contingencies	380.4	445.6	476.9	7.0%
Total expenditure	3,605.2	4,007.5	4,240.0	5.8%
Fiscal deficit including grants	**880.5**	**887.2**	**877.2**	**(1.1%)**
Deficit as % of GDP (Including grants)	5.6%	5.1%	4.6%	(0.5%)
Net foreign borrowing	222.7	355.5	213.7	(39.9%)
Net domestic borrowing	595.6	605.7	591.9	(2.3%)
Total borrowing	818.3	961.2	805.6	(16.2%)
GDP Estimate	15,826.4	17,434.5	19,272.8	10.5%

Source: National Treasury

Key take-outs from the table include:

i. Total revenue inclusive of Ministerial Appropriation in Aid is projected to increase by 8.1% to Kshs 3.3 tn from Kshs 3.1 tn as per FY'2024/25 revised budget estimates II, with proposals such as expanding the tax base and improving tax compliance already in place to work towards increasing the amount of revenue collected in the next fiscal year,

ii. The updated 2025 BPS points to a 5.8% increase of the total expenditure, to Kshs 4.2 tn from Kshs 4.0 tn in the FY' 2024/25 revised budget estimates,

iii. Development expenditure is set to increase at a lower rate than recurrent expenditure; with development expenditure increasing by 5.0% to Kshs 643.9 bn from Kshs 613.5 bn as per the supplementary budget II, while recurrent expenditure is projected to increase by 5.8% to Kshs 3.1 tn from Kshs 2.9 tn as per the FY'2024/25 supplementary budget II, reflecting the rising debt servicing pressure and the reduced fiscal space for capital projects. Consequently, the recurrent expenditure will still constitute the largest allocation of 73.6% while development will be allocated 15.2%

iv. The budget deficit is projected to decline by 1.1% to Kshs 877.2 bn (4.6% of GDP) in FY'2025/2026, from the projected Kshs 887.2 bn (5.1% of GDP) in the FY'2024/25 revised budget II. The decline is in line with the International Monetary Fund's (IMF's) recommendation for fiscal consolidation, as the country seeks to reduce Kenya's public debt requirements,

v. The total borrowing requirement is expected to decline by 16.2% to Kshs 805.6 bn from Kshs 961.2 bn as per the FY'2024/25 revised budget II, in a bid to reduce Kenya's public debt burden, and,

vi. Debt financing for FY'2025/26 budget is estimated to consist of 26.5% foreign debt and 73.5% domestic debt, pointing towards increased domestic borrowing. Additionally, the projected foreign debt to domestic debt ratio decreased from 37:63, attributable to the faster 39.9% decline in the projected net foreign borrowing compared to the 2.3% decline in the projected net domestic borrowing.

Against this backdrop of fiscal consolidation and cautious borrowing, the Finance Bill 2025 introduces a series of targeted measures that aim to broaden the tax base, seal revenue leakages, and support the government's drive toward a more sustainable fiscal framework. Below we highlight some of the key proposed tax changes, effective from 1st July 2025 contained in the Finance Bill 2025 and the implications:

a) Under the Income Tax Act, the Bill proposes to:

1. Restrict carryover of tax losses to a maximum of 5 years, which could hurt long-term, capital-intensive projects that take over 5 years to become profitable hence possibility of discouraging both foreign and local investment.
2. Eliminate the ability to deduct past capital losses from future capital gains meaning taxpayers may be taxed on gains even when they've recently suffered related losses, increasing tax burden unfairly.
3. Scrap the exemption that prevents income already taxed under another law from being taxed again as a capital gain, increasing the effective tax rate for investors.
4. Exempt gains from transferring securities traded on any Capital Markets Authority-licensed exchange from tax, encouraging foreign investment in securities by removing tax on transfers, boosting market activity.
5. Exempt dividends from tax for companies certified by the Nairobi International Financial Centre Authority (NIFCA) with a minimum reinvestment of Kshs 250.0 mn annually. This will therefore incentivize companies to reinvest significant amounts, balancing tax incentives with economic growth.
6. Lower corporate income tax to 15.0% for the first 10 years for NIFCA-certified companies, then 20.0% thereafter, if they invest Kshs 3.0 bn in the first three years, are holding companies, employ 70.0% Kenyan senior management, and have 60.0% Kenyan employees in senior roles with headquarters in Kenya. For start-ups, 15.0% for the first three years, then 20.0% for the next four years. This promotes investment and job creation in Kenya by offering tax relief, encouraging foreign direct investment and supporting start-ups while ensuring local employment.

7. Decrease the digital asset tax rate to 1.5% from 3.0% on transfer or exchange value, lowering the tax burden on digital asset transactions, therefore fostering higher trading volumes and stimulating Kenya's digital market.
8. Require only one designated entity in Kenya to file Country-by-Country Reporting (CbCR) when multiple entities of a multinational group are resident in Kenya, bringing clarity to the filing obligations of multinational entities, reducing uncertainty.
9. Remove exemption from Country-by-Country Reporting (CbCR) filing for resident surrogate parent entities, aligning Kenya's tax laws with international standards, BEPS Action 13, promoting global tax transparency.
10. Allow taxpayers to agree in advance, Advance Pricing Agreements (APA) with the KRA on transfer pricing for up to 5 years, easing tax compliance for related-party transactions by reducing disputes and audit risks through pre-agreed pricing, effective from 1st January 2026.
11. Introduce a withholding tax on profits or gains from non-resident ship owners or charterers, excluding transhipment activities, expanding the tax base to include income from non-residents, potentially increasing government revenue but raising shipping business costs and possibly redirecting shipping routes.
12. Extend the definition of royalty to include recurring software-related payments made through distributors. This change could expand tax liability for software distributors, increasing compliance obligations and possibly reducing economic returns.
13. Set the payment deadline for minimum top-up tax to the end of the fourth month after the financial year, to enhance clarity and consistency in payment timelines, aligning with amendments from the Tax Laws Amendment Act 2024.
14. Raise the per diem cash benefit ceiling to Kshs 10,000.0 from Kshs 2,000.0 for employees as reimbursement for work-related duties. This increase offers financial relief to employees, to reflect the current economic conditions and the prevailing cost of living
15. Grant tax exemptions, reliefs, and deductions under the Income Tax Act on employee income before applying PAYE, increasing the disposable income
16. Apply the corporate income tax rate to fringe benefits, simplifying the tax calculation process for fringe benefits, reducing the administrative burden on businesses.
17. Mandate that companies report dividends distributed from untaxed gains in their annual tax returns.
18. Include payments for the sale of scrap and supply of goods to a public entity under the ambit of withholding tax.
19. Broaden the Significant Economic Presence Tax to cover businesses operating over the internet or through digital marketplaces.
20. Remove the Kshs 5.0 mn annual turnover threshold for non-residents to be liable for the Significant Economic Presence Tax.

b) Under the Excise Duty Act, the Bill proposes to:

1. Remove excise duty on imported eggs, onions, potatoes, potato crisps, and chips self-adhesive plates, sheets, films, foils, tapes, and flat shapes and printed paper or paperboard, except for items from East African Community (EAC) Partner States meeting EAC Rules of Origin, potentially lowering consumer pricesfor goods from the EAC region through increased competition and boosting regional economic activity.
2. Introduce a 14-day deadline within which the Kenya Revenue Authority (KRA) must either approve or reject applications for licenses concerning the manufacture or importation of excisable goods and services. This time-bound framework aims to increase certainty and speed in the licensing process.
3. Redefine a digital lender as someone who provides credit via electronic means, excluding banks under the Banking Act, Sacco societies under the Co-operative Societies Act, or microfinance

institutions under the Microfinance Act offering relief to financial institutions already subject to excise duties, reducing double taxation and enhancing clarity in the regulatory framework.

4. Describe a digital marketplace as any electronic or online platform that enables users to buy or access goods, services, or property. This updated definition ensures harmonization with existing tax laws, including the Income Tax Act, VAT Act, and Excise Duty Act, thereby promoting consistent tax treatment.
5. Broaden the reach of excise duty to include digital services provided by non-residents over the internet, electronic networks, or digital marketplaces, defining a non-resident as a person outside Kenya.

c) Under the Value Added Tax (VAT) Act, the Bill proposes to:

1. Add Section 66A, which imposes VAT liability if exempt or zero-rated goods/services are used or disposed of in a way that contradicts their original exempted purpose implying that taxpayers must now ensure strict adherence to the intended use of exempt or zero-rated items.
2. Reduce the allowed period for businesses to apply for VAT refunds to 12 months from 24 months after the tax becomes due, meaning businesses will face tighter deadlines to claim VAT refunds, potentially increasing compliance pressure.
3. Cut the refund claim period for VAT on unpaid debts to 2 years from 3 years after supply and permits KRA, upon approval, to apply any refunded VAT to offset other VAT debts.
4. Introduces a formal definition of Tax Invoice including mandatory electronic issuance under Section 23A of the Tax Procedure Act and expand VAT-registered businesses' obligation to issue tax invoices to cover exempt supplies, removing the term "taxable" from existing provisions.
5. Subject fuels, lubricants, and tires used in vehicles for official aid projects to a 16.0% VAT. Even though other goods for aid-funded projects will remain VAT-exempt, these specific vehicle-related items will now attract VAT.
6. Apply 16.0% VAT to goods used exclusively in building tourism infrastructure like hotels, parks (minimum 50 acres), and conference venues, if approved by the Cabinet Secretary, locally assembled vehicles purchased before customs clearance by tour operators for tourist transportation, subject to certain conditions. Key to note, previous VAT exemptions for such developments remain until 30th June 2026. This proposal had been included in the 2024 Finance Bill but was not enacted at that time.
7. Apply 16.0% VAT to construction goods under the Affordable Housing Programme, if approved by the Cabinet Secretary. Key to note, previous VAT exemptions for such developments remain until 30th June 2026.
8. Change the VAT status of locally assembled mobile phones from zero-rated to exempt.
9. The bill proposes to reclassify certain goods and services from zero-rated or standard-rated VAT status to exempt status, including inputs or raw materials for manufacturing pharmaceuticals and animal feeds, transport services for sugarcane from farms to factories, and packaging materials for tea and coffee. This reclassification means these items will no longer qualify for input VAT refunds.

The Finance Bill 2025 reflects a cautious approach, with the government opting for tax administration reforms over new tax burdens. This move is clearly informed by the lessons of 2024, where unpopular tax hikes triggered widespread protests and public discontent. By focusing on broadening the tax base, improving compliance, and sealing revenue leakages, the government seeks to achieve its fiscal objectives while maintaining economic and social stability. The updated budget estimates for FY'2025/26 underscore this approach, with a reduced projected fiscal deficit target of 4.6% of GDP, down from the 5.1% in FY'2024/25. Notably, inflation has remained relatively stable, remaining within the CBK's target range of 2.5%-7.5%, although the risk of inflationary pressures still remains majorly as a result of the easing monetary policy. Additionally, and the Kenyan shilling has stabilized against major currencies, supporting the overall economic performance. Lending rates have started to ease following the continued easing of the monetary policy stance, with the weighted average lending rate for commercial banks standing at 15.8% as of March 2025, 0.6% points down from 16.4% in February 2025, as such this will create a more favorable environment for credit growth to the private sector, which had previously been constrained by high borrowing costs. With GDP growth expected to rebound from 4.7% in 2024 to an estimated 5.3% in 2025, the stage is set for renewed economic momentum, provided the right mix of fiscal discipline and policy support is maintained and stimulation of the business environment to encourage investment. As Kenya navigates the challenges of high public debt, constrained fiscal space, and growing public expectations, the success of this budget cycle will depend on transparency, accountability, and effective implementation. The Finance Bill 2025 marks a step in the right direction, but sustained commitment will be essential to realize its promise.