

SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FOR THE PERIOD SEPTEMBER – OCTOBER 2024

HIGHLIGHTS

- The Supreme Court has restored the Finance Act 2023 by finding that the Act was properly passed by the National Assembly, adequate public participation was held and save for two specified provisions, the Act is otherwise constitutional
- Employment Court finds Conflict of Interest, lack of integrity and accountability as good grounds of termination of bank employees, more particularly branch managers and senior bank officials
- The employment court further finds that in investigating an employee's conduct, an employer must not violate an employee's right to privacy and should therefore ensure investigators do not overstep legally acceptable methods of collecting information.
- The High Court has declared the Income Tax (Financial Derivatives) Regulations, 2023, unconstitutional, effectively quashing the Regulations enacted for the purposes regulating financial derivatives by the Cabinet Secretary for Finance
- Proposed amendments to the KRA Act, particularly Section 42A, allowing the Authority to appoint agents for transferring funds from individuals in tax default. Agents failing to comply will face a penalty of 10% of the untransferred revenue.

RECENT DECISIONS

1. **Mwangi v ABSA Bank Kenya PLC (Cause E065 of 2023) [2024] KEELRC 2399 (KLR) (1 October 2024) (Judgment)**

Facts

In the instant case, the Claimant was a Branch Manager of the Bank at the Nkurumah Branch in Mombasa. In the course of his employment, he undertook irregular transactions with two bank clients.

There was an investigation undertaken by the Bank which found that there were irregular and unauthorized overdraft facilities advanced to bank customers under his leadership. On several occasions, he had violated the bank policies and procedures by engaging in irregular lending for two separate customers; INO Safinah Petroleum and DM Kanyi.

Decision/Analysis

- The court established that the claimant had

indeed breached bank policies and procedures, particularly regarding the management of customer accounts and hence, arose conflict of interest.

- The Court further held that the Claimant could not extricate himself from responsibility and the fiduciary duty held as the branch manager for the respondent. Such conduct exposed the Bank.
- The Court held that the termination was lawful and fair highlighting that the bank had followed due process in dismissing the claimant from employment.
- The court acknowledged that the claimant's conduct as a senior officer required a high degree of integrity and accountability, which he failed to uphold.
- On the question of the Bank hiring a Private Investigator to probe the Claimant's conduct with clients in social places, the Court held that it contravened the Claimant's right to privacy and as such could not be justified and hence awarded damages worth of Kes. 5 million.

Implications

a) Bank Branch Managers and Senior Bank Officials are placed at a higher professional duty, a higher calling of integrity, a higher financial probity, great responsibility and accountability. The standard for determining liability for actions and/or omissions of such bank officials is set at a lower threshold as compared to other staffs;

b) Conflict of Interest, lack of integrity and accountability have now been set by precedence as grounds of termination of bank employees, more particularly branch managers and senior bank official; and

c) This decision is an invitation to employers to safeguard the privacy of their employees. Employees should be cognizant of the fact that, while there may exist valid grounds for termination, the methods employed in conducting investigation must not encroach upon the employee's privacy.

2. HCJRMISC/E043/2023 Kenya Bankers Association Vs State Law and Kenya Revenue Authority And 2 Others

Facts

The High Court declared the Income Tax (Financial Derivatives) Regulations, 2023, unconstitutional, effectively quashing the Regulations enacted for the purposes regulating financial derivatives by the Cabinet Secretary for Finance.

These regulations, implemented in January 2023, aimed to impose a 15% withholding tax on financial derivative transactions with non-residents, asserting that residents' losses were directly linked to non-residents' gains. The Applicants in the JR Proceedings argued that the Regulations was not supported by the provisions of the Income Tax Act and an affront to the Constitution. The Authority and the AG argued otherwise.

Decision/Analysis

The Court in its findings held as follows-

- The ambiguity surrounding the calculation of gains for non-residents for purposes of taxation made the Regulations unreasonable and oppressive.

- The Cabinet Secretary's failure to comply with statutory and constitutional standards in developing the Regulations infringed on the Kenya Bankers Association's rights to fair administrative action under Article 47 of the CoK 2010;
- The Court issued an order preventing the Kenya Revenue Authority, along with its agents and employees, from taking any actions to impose or collect taxes from the ex parte Applicant involved in transactions related to financial derivatives, as well as from enforcing the Income Tax (Financial Derivatives) Regulations, 2023.

Implications

- The decision by the Court provides a relief to financial derivatives transactions by financial institutions, such as banks and other entities engaging in derivative transactions. Additionally, the quashing of the proposed withholding tax is a relief and ensures that the existing tax regime is maintained. As a result, financial institutions can continue their operations without the fear and burden of the proposed withholding tax, which could have adversely impacted their profitability and competitiveness.

3. The Cabinet Secretary for the National Treasury and Planning and 4 Others v Okiya Omtatah Okiiti and 52 Others (SC Petition Nos. E031, E032 & E033 of 2024)

Decision

- The Supreme Court of Kenya has overturned the decision of the Court of Appeal holding that there was adequate public participation

undertaken in enacting the Finance Act 2023, therefore restoring it as the applicable law.

- The court held that substantive amendments based on public participation do not require further public consultation, especially given the Bill's strict 61-day legislative timeline. It also clarified that there is no legal obligation for amendments made after the second reading to undergo 1st and 2nd reading again.
- The court highlighted that Article 47 of the Constitution, which requires written reasons for administrative actions, does not apply to Parliament's legislative process, as enacting laws is not considered administrative action. It also clarified that Article 118(1) only mandates facilitating public participation, without imposing an obligation on Parliament to provide reasons for accepting or rejecting public input.
- The Supreme Court highlighted that the Appropriation Bill's enactment is independent of the Finance Bill, clarifying that revenue estimates are approved alongside expenditure estimates before preparing the Appropriation Bill, which the National Assembly correctly followed in enacting the Appropriation Act, 2023.

Implications

- The Finance Act, 2023 shall remain in operation, considering that the Finance Bill, 2024 failed enactment.
- Taxpayers will continue to benefit from the favorable changes brought about by the Act, including the zero-rating of exported services for VAT.

- Entities in special economic zones (SEZ) will maintain their income tax exemptions on property transfers and on payments of management fees, interest, and royalties to non-resident individuals.
- Capital gains tax will apply to indirect transfers. Employees earning over KES 500,000 per month will be taxed according to the current PAYE scale.

Recent Legislations, Bills and Policies/Regulatory Instruments

Legislation , Bills and Regulatory Instruments

1. The Kenya Revenue Authority (Amendment) (No. 2) Bill, 2024

Brief facts/Analysis

The Bill proposes amendments to the KRA Act, particularly Section 42A, allowing the Authority to appoint agents for transferring funds from individuals in tax default. Agents failing to comply will face a penalty of 10% of the untransferred revenue.

The Bill introduces provisions to exempt banks from penalties under certain circumstances, including system downtime, lack of negligence, receivership, force majeure events, or any justifiable reason deemed appropriate by the Cabinet Secretary.

Implications

(a) Banks that fail to comply with the requirements of the KRA may face penalties of 2% of the untransferred revenue. This could expose banks to significant financial risks.

(b) The provision for exemptions from penalties allows banks to mitigate risks associated with non-compliance.

(c) Businesses in default of tax obligations may face increased scrutiny and pressure to settle their dues promptly to avoid penalties.

Legislation , Bills and Regulatory Instruments

2. The Tax Procedures (Amendment) Bill, 2024

Decision

The Supreme Court of Kenya has overturned the decision of the Court of Appeal holding that there was adequate public participation undertaken in enacting the Finance Act 2023, therefore restoring it as the applicable law.

The court held that substantive amendments based on public participation do not require further public consultation, especially given the Bill's strict 61-day legislative timeline. It also clarified that there is no legal obligation for amendments made after the second reading to undergo 1st and 2nd reading again.

Implications

(a) Taxpayers facing genuine difficulties in paying their taxes can apply for relief, reducing the financial burden on them.

(b) By easing the tax burden on struggling taxpayers, this amendment could help businesses recover and contribute to economic stability.

Disclaimer: Some of the decisions presented may be subject of appeal in Court and as such should not be relied upon as the sole basis for any actions.

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