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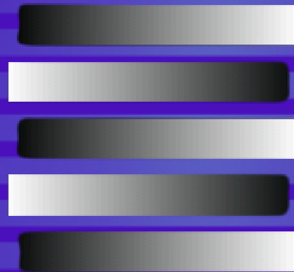

ANALYSIS OF THE PROPOSED FINANCE BILL, 2026

Tax Policy, Compliance and Business Impact Review

Eliacc Consulting 2026

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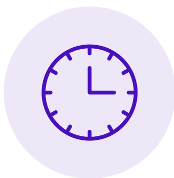
DISCLAIMER
This publication is intended for general informational purposes only and does not constitute legal, tax or financial advice. Businesses and taxpayers are encouraged to seek professional advisory support before acting on any proposals contained within the Finance Bill, 2026.

Introduction

Kenya's proposed Finance Bill, 2026 represents a significant shift in the country's fiscal and tax administration framework, reflecting the Government's transition toward a technology-driven, enforcement-oriented and data-centric revenue system aimed at expanding the tax base, enhancing compliance and increasing transparency across both the physical and digital economy. While the proposals introduce targeted incentives for sectors such as manufacturing, renewable energy and agriculture, they also impose stricter compliance obligations that are likely to increase operational and administrative pressure on businesses, particularly SMEs that remain semi-formal or technologically underdeveloped. This analysis by Eliacc Consulting critically examines the key proposals contained in the Bill, their legal and commercial implications and the anticipated impact on businesses operating within Kenya.

Proposal Objectives:



To transition toward a fully digital tax ecosystem by integrating eTIMS, enabling prepopulated returns, improving real-time transaction monitoring, and leveraging third-party data for enforcement.

To progressively formalize informal economic activity while aligning Kenya's tax framework with international standards, including OECD principles on transparency, cross-border taxation, and anti-tax avoidance frameworks.

To increase domestic revenue collection by widening the tax net to include digital platforms, informal businesses, offshore income streams, and emerging economic sectors, thereby reducing reliance on external borrowing.

To improve compliance through stricter enforcement mechanisms such as expanded withholding tax regimes, enhanced audit powers, reduced deductibility of non-compliant expenses, and stronger anti-avoidance provisions.

Background and Policy Context

The Finance Bill, 2026 was tabled before the National Assembly as part of the Government's broader Medium-Term Revenue Strategy (MTRS) aimed at increasing domestic revenue mobilization and reducing dependency on external borrowing. The Bill emerges against a backdrop of increasing fiscal deficits, pressure from international lenders, rising public debt servicing obligations and growing demands for social and infrastructure financing.

Over the last five years, Kenya's tax policy direction has increasingly shifted toward digitization, real-time reporting and aggressive enforcement. The introduction of eTIMS, electronic invoicing systems, digital service taxation and expanded withholding tax regimes reflects a long-term structural transition toward automated tax administration. The Finance Bill, 2026 appears to consolidate these earlier reforms while introducing more sophisticated enforcement mechanisms.

The Bill also reflects Kenya's growing alignment with international tax standards, particularly OECD-driven initiatives such as Pillar Two minimum taxation, transfer pricing transparency and cross-border reporting obligations.

A notable trend within the Bill is the legislative response to adverse court decisions previously issued against the KRA, indicating increasing legislative override of judicial interpretation.

1. PROPOSED AMENDMENTS TO THE INCOME TAX ACT (CAP. 470)

1.1 Expansion of Withholding Tax on Digital Payment Ecosystems

One of the most commercially significant proposals within the Finance Bill, 2026 is the expansion of withholding tax obligations to cover interchange fees, merchant service fees, card network access fees and payment processing systems. The amendment effectively reverses the legal position established by the Supreme Court in the Absa Bank Kenya PLC case where such payments had previously been found not to constitute royalties or management fees.

The proposed definition of royalty is now significantly broader and includes proprietary digital platforms, payment networks, switching systems, settlement systems and access rights connected to card payment infrastructure. Parliament appears to have intentionally drafted the provision to override judicial interpretation and eliminate taxpayer reliance on the contractual characterization of payment arrangements.

The commercial implications are substantial. Banks, payment service providers, fintech companies, digital marketplaces and merchants relying on card infrastructure are likely to experience significantly higher operational costs due to increased withholding tax exposure. International payment systems may pass these additional costs directly to local consumers and merchants, thereby increasing transaction costs across Kenya's digital economy.

For SMEs increasingly reliant on digital payment systems, the proposal risks undermining financial inclusion efforts by increasing the cost of accepting digital payments. This may particularly affect small retailers, online merchants and emerging fintech startups whose margins remain relatively thin.
Eliacc's view is that while the Government's intention to broaden the tax base is understandable, the proposed provisions may inadvertently slow digital adoption within the SME sector and increase the cost of formal financial participation. Consideration should therefore be given to introducing lower withholding rates for SMEs or creating specific exemptions for small-value transactions.

1.2 Expansion of Royalty Definition to Include Software Distribution

The Bill further proposes to expand the definition of royalty to include payments arising from software distribution arrangements where regular payments are made through distributors. This proposal has appeared repeatedly in previous Finance Bills and signals continued determination by Treasury to bring software distribution structures within the withholding tax framework.
The amendment directly targets software resellers, sub-licensors and technology distributors who historically relied on judicial decisions holding that distribution payments did not constitute royalties under Kenyan law.

If enacted, the amendment will significantly affect Kenya's growing technology ecosystem. Many SMEs rely heavily on imported software subscriptions, cloud-based systems, ERP solutions, accounting systems and digital business tools. The imposition of withholding tax on software distribution payments may increase software procurement costs, licensing expenses and overall operational expenditure for businesses already facing high compliance costs.

There is also significant ambiguity surrounding the phrase "regular payments," which remains undefined. This creates potential for interpretive disputes regarding annual licenses, one-off subscriptions, hybrid payment structures and milestone-based contracts.

From a policy perspective, Eliacc believes the proposal risks creating double taxation exposure, particularly where the same software may already be taxed in foreign jurisdictions. There is also concern that the proposal may discourage technology investment and increase barriers to digital transformation among SMEs.

We recommend that Parliament provide clearer legislative distinctions between software licensing, software distribution and pure resale transactions to avoid unintended taxation of ordinary commercial arrangements.

1.3 Introduction of Non-Resident Rental Income Tax

The proposed introduction of Non-Resident Rental Income Tax (NRRT) represents a major expansion of Kenya's source-based taxation regime. The proposed framework seeks to impose tax obligations directly on non-resident persons earning rental income from property situated in Kenya.

The measure reflects Government concern regarding tax leakage within Kenya's growing real estate sector, particularly where foreign property owners earn rental income without meaningful domestic tax compliance.

Unlike the residential rental income tax framework, the proposed NRRT applies broadly to both residential and commercial property without turnover thresholds. This significantly widens the tax base and may increase compliance requirements for foreign investors with Kenyan property interests.

The proposed regime aligns with global trends toward taxing income derived from immovable property based on source jurisdiction principles. However, implementation may prove challenging where property ownership structures involve layered offshore entities or nominee arrangements.

For Kenya's real estate market, the proposal may increase compliance costs for foreign investors and potentially reduce attractiveness of Kenyan property investments if not accompanied by administrative clarity and efficient registration mechanisms.

1.4 Expansion of Offshore Capital Gains Tax

The Bill proposes a dramatic expansion of Kenya's offshore capital gains tax framework by extending taxation to virtually all offshore share transfers connected to Kenyan economic interests.

The proposed language is extremely broad and removes existing thresholds that previously limited exposure to transactions involving substantial Kenyan nexus. Under the new proposal, any transaction resulting in changes to ownership structures connected to Kenyan property or Kenyan-resident companies may trigger tax exposure.

This amendment significantly increases tax uncertainty for multinational groups, investors, private equity funds and cross-border transaction advisors. Internal group reorganizations, offshore mergers and foreign holding company transactions may now fall within Kenyan tax jurisdiction.

The absence of clear valuation rules, nexus thresholds or apportionment mechanisms creates substantial legal uncertainty and increases the likelihood of disputes between taxpayers and the KRA.

Eliacc's assessment is that while Kenya is justified in seeking to tax value derived from Kenyan assets, the breadth of the proposal may discourage foreign investment and increase transaction risk. More precise drafting and clearer thresholds would improve predictability and investor confidence.

2. PROPOSED AMENDMENTS TO THE VALUE ADDED TAX ACT, 2013

2.1 Rationalization of VAT Exemptions and Reclassification of Supplies

The Finance Bill, 2026 continues the Government's ongoing policy of rationalizing VAT exemptions and reclassifying goods from zero-rated to exempt status. Although this appears fiscally neutral from a revenue perspective, the practical impact on businesses is substantial.

Businesses supplying exempt goods lose the ability to recover input VAT incurred during production and procurement. Consequently, production costs increase and these additional costs are often transferred to consumers through higher prices.

For SMEs operating in manufacturing, agriculture, retail and distribution sectors, this proposal may significantly affect working capital and profitability. Businesses with long inventory cycles may face increased tax adjustments where previously taxable goods subsequently become exempt before sale.

The proposed introduction of Section 17A requiring reversal of previously claimed input VAT further compounds the issue by creating retroactive tax adjustments linked to inventory classification changes.

Eliacc's position is that excessive migration of goods from zero-rated to exempt status may undermine local manufacturing competitiveness and increase inflationary pressure within supply chains.

2.2 Mandatory Tax Invoice Issuance by Small Traders

The Bill proposes to broaden the obligation to issue tax invoices beyond VAT-registered persons to effectively include all traders.

This proposal reflects Treasury's intention to formalize the informal economy and improve transaction visibility through digital invoicing systems. However, the practical implications for micro and small enterprises are substantial.

Many SMEs currently operate without sophisticated accounting systems, formal bookkeeping structures or tax-trained personnel. Requiring widespread invoice issuance may increase compliance costs, expose businesses to penalties and accelerate forced formalization without sufficient transition support.

While the proposal may improve transparency and reduce tax evasion, implementation should ideally be phased and accompanied by taxpayer education, simplified compliance tools and exemptions for low-turnover enterprises.

3. PROPOSED AMENDMENTS TO THE TAX PROCEDURES ACT, 2015

3.1 Mandatory eTIMS Integration and Deductibility Restrictions

Among the most consequential proposals for SMEs is the linkage between deductibility of business expenses and electronic invoicing compliance through eTIMS.

Under the proposal, expenses unsupported by valid eTIMS-generated invoices may become non-deductible for income tax purposes. This represents a significant policy shift from substantive verification toward system-based deductibility.

For SMEs, the proposal introduces serious operational challenges. Businesses dealing with informal suppliers, rural supply chains or cash-based procurement structures may struggle to obtain compliant invoices despite legitimate business expenditure.

The measure will likely accelerate accounting formalization and increase adoption of digital bookkeeping systems. However, the transitional burden may disproportionately affect smaller enterprises lacking financial and technological capacity.

Eliacc strongly recommends phased implementation for SMEs with turnover below specified thresholds and greater administrative flexibility during the transition period.

3.2 Introduction of Prepopulated Returns

The proposal allowing KRA to generate prepopulated tax returns represents a major evolution in Kenyan tax administration.

Using data gathered through eTIMS, banking systems, withholding records and third-party reporting, the KRA may increasingly shift taxpayers into verification roles rather than self-assessment roles.

While this may simplify compliance for some taxpayers, it also creates significant risk where system-generated information is inaccurate, incomplete or inconsistent with commercial realities.

Businesses will need stronger internal reconciliation systems and continuous monitoring of tax data appearing within KRA systems.

3.3 Expanded Anti-Avoidance Framework

The introduction of a consolidated General Anti-Avoidance Rule (GAAR) under the Tax Procedures Act significantly expands the Commissioner's powers to challenge tax planning arrangements.

The proposed framework applies broadly across all tax heads and adopts extremely wide definitions of "scheme" and "tax benefit." This substantially increases the KRA's discretion to disregard transactions deemed tax-motivated.

The risk for businesses is increased uncertainty regarding legitimate commercial structuring, investment arrangements and operational planning.

Eliacc believes clearer safeguards and objective thresholds should accompany the GAAR provisions to reduce arbitrary enforcement risk and protect legitimate commercial transactions.

4. PROPOSED AMENDMENTS TO THE EXCISE DUTY ACT

4.1 Expansion of Betting and Gambling Taxation

The Bill significantly broadens taxation of betting and gambling transactions by expanding the definition of “amount deposited” to include all forms of value made available for gambling purposes.

The proposal appears designed to prevent avoidance through promotional credits, tokenized betting systems and virtual asset-based gambling mechanisms.

The inclusion of virtual assets and digital gambling instruments signals increasing regulatory concern regarding cryptocurrency-linked gaming ecosystems.

Businesses operating in gaming, fintech and digital entertainment sectors should anticipate increased reporting obligations and enhanced transaction monitoring requirements.

4.2 Activation-Based Taxation of Mobile Phones

The proposed activation-based excise framework for mobile devices represents a fundamental departure from importation-based taxation.

While intended to reduce tax leakage and improve traceability, the proposal introduces substantial implementation uncertainty regarding activation triggers, compliance obligations and cross-border device usage.

There is risk that increased excise burdens on mobile devices may undermine affordability and digital inclusion objectives, particularly among lower-income consumers and SMEs dependent on mobile connectivity.

5. SME IMPACT ANALYSIS

The Finance Bill, 2026 is likely to have its most significant economic impact on SMEs. While large corporates may possess internal tax departments, advanced accounting infrastructure and legal advisory support, many SMEs remain vulnerable to abrupt compliance changes.

The mandatory digitization of invoicing, increased withholding obligations and accelerated filing deadlines may create significant transitional pressure for businesses already facing inflation, reduced consumer spending and constrained access to credit.

The proposals effectively push SMEs toward deeper formalization. While this may improve transparency and expand access to financing in the long term, the short-term burden may increase business failure risk among smaller enterprises unable to absorb compliance costs.

Technology-dependent SMEs may experience rising software costs due to expanded royalty definitions. Retailers and digital merchants may face higher payment processing costs due to withholding tax on card infrastructure. Manufacturers may encounter reduced VAT recoverability. Businesses operating with informal supply chains may lose deductibility for otherwise legitimate expenses.

At the same time, sectors aligned with manufacturing, renewable energy, agriculture and infrastructure may benefit from targeted exemptions and incentives embedded within the Bill.

Ultimately, the Bill rewards businesses that are digitally compliant, formally structured and administratively organized. Businesses that remain informal or manually operated face increasing tax exposure.

6. ELIACC'S PROPOSALS AND RECOMMENDATIONS

Eliacc Consulting recommends phased implementation of the eTIMS deductibility framework for SMEs below specified turnover thresholds. A gradual transition period supported by taxpayer training and simplified onboarding tools would reduce compliance disruption.

The proposed definition of software royalties should be narrowed to exclude pure resale arrangements involving standard off-the-shelf software. Failure to clarify this distinction risks excessive taxation and increased technology costs for SMEs.

The proposed reduction of filing timelines should be reconsidered, particularly for SMEs requiring additional time for year-end reconciliation and audit preparation. Retaining exclusion of weekends and public holidays within objection timelines would also preserve procedural fairness within tax dispute processes.

The offshore capital gains tax provisions require clearer nexus thresholds, valuation methodologies, and carve-outs for internal group reorganizations. Excessively broad drafting may discourage investment and increase transaction uncertainty.

The proposed anti-avoidance framework should incorporate objective safeguards and clearer definitions to protect legitimate commercial arrangements from arbitrary reinterpretation.

Finally, Eliacc recommends establishment of dedicated SME transition support programs focusing on digital compliance training, bookkeeping formalization and affordable access to tax technology systems.

7.ANNEXTURES

I: KEY THEMATIC SHIFTS UNDER THE FINANCE BILL, 2026

THEME	POLICY DIRECTION	ANTICIPATED IMPACT
Digital Tax Enforcement	Increased eTIMS integration and automated reporting	Greater transaction visibility and compliance burden
Expansion of Source-Based Taxation	Broader taxation of non-resident income and offshore gains	Increased exposure for multinational and cross-border structures
Formalization of Informal Economy	Mandatory invoicing and electronic tracking	Accelerated SME formalization
Digital Economy Taxation	Taxation of software, virtual assets and payment systems	Higher compliance costs for technology sectors
Anti-Avoidance Enforcement	Expanded GAAR powers	Increased scrutiny of tax planning arrangements

II: SECTORAL IMPACT OVERVIEW

SECTOR	MAJOR PROPOSAL	ELIACC ASSESSMENT
SMEs	eTIMS deductibility rules	High transitional burden
Fintech	WHT on payment infrastructure	Increased operational costs
Technology	Software royalty expansion	Increased licensing expense
Manufacturing	VAT reclassification	Reduced input recoverability
Renewable Energy	VAT incentives	Positive long-term growth opportunity
Real Estate	NRRT and offshore CGT	Increased investor compliance burden
Gambling & Digital Assets	Expanded reporting obligations	Higher regulatory scrutiny

8.Conclusion

The Finance Bill, 2026 represents a defining moment in Kenya's evolving tax landscape. The Bill signals the Government's intention to create a highly digitized, enforcement-oriented and globally integrated tax administration framework.

The proposals collectively indicate a future where tax compliance becomes increasingly real-time, automated and data-driven. Businesses operating in Kenya must therefore prepare for heightened transparency, reduced administrative flexibility and significantly expanded reporting obligations.

For SMEs, the transition may be difficult but ultimately unavoidable. Businesses that invest early in proper accounting systems, digital compliance infrastructure and proactive tax planning will likely emerge more resilient and competitive within the evolving economic environment.

At the same time, policymakers must carefully balance revenue objectives with economic sustainability. Overly aggressive enforcement without sufficient transition support risks stifling entrepreneurship, increasing informality and slowing private sector growth.

The success of the Finance Bill, 2026 will therefore depend not only on the strength of its enforcement mechanisms, but also on the Government's ability to implement reforms in a manner that preserves business confidence, encourages investment and supports long-term economic development.

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