CAPITAL GAINS TAX

(re-introduced through Finance Act,2014)

The Law

- Section 3(2)(f) of the Income Tax Act
- 15(3)(f)
- Section 34(1)(j)
- Eighth Schedule to the Income Tax Act
- Paragraph 36 of 1st Schedule

Introduction

- Reason for suspension in 1985 – to allow for the growth of property market (including Investment Shares)
- CGT has therefore been under suspension for almost 30 years, there was an attempt to introduce it in 2006, which didn't succeed
- Reintroduction of CGT – guided by principles of "***Equity*** and ***Fairness***" in Kenya tax system – Kenyan Constitution 2010 – Article 210, bearing in mind the growth of the property and equity market in the past decade

Scope

- Effective 1st January 2015
- What is taxable

  "- the whole of a gain which accrues to a company or an individual on or after 1st January, 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1st January, 2015".
- Transfer of property by a "***person***" – resident in Kenya and property located in Kenya.
- **Property** is defined and includes ***land***, ***buildings*** and ***investment shares***.
- Plant, Machinery and Motor Vehicles are not taxed

Tax Point

- As with other taxes charged under Income Tax Act, KRA is the collection agent for capital gains tax
- Due date is ***20th day*** following the month of transfer of property or shares
- Taxpayer do self-assessment to determine the ***gain*** upon which tax is computed
- Computations are subject to Commissioner's confirmation of **costs**, **adjustments** and **sales value**.
- Transactions commenced prior to 1/1/2015, tax point is the **date of transfer of title-**as may determined on case by case basis.

Returns/Declaration

- Documentation – ***Form CGT1 and CGT2*** to enable taxpayers assess and declare CGT
- Details; PIN of both buyer and seller, sale value, costs, gain, tax thereon are minimum disclosure requirements.
- Transferor/transferee must be registered ***in iTax***.
- Final tax, disclosure in self assessment return for infomation purposes only

Indexation/inflationary adjustments

- Not provided for in the law.
- Expenses “wholly and exclusively” incurred are allowed in determining the gain.
- Tax rate of 5% is considered nominal compared to 30% and compared to rates in other jurisdictions in EAC or developed tax jurisdictions.

Tax Rates

- 5% on the gain of Capital upon transfer of property. ***It is not a withholding Tax***
- Tax is final and no offset allowed against Corporate Tax.
- Does not apply to Extractive Industry Taxpayers regime as provided for under 9th schedule (Gas &Oil Exploration)
- Lowest rate in the EAC region.

Exemptions

- Income taxed elsewhere as in the case of property dealers (ordinary business income).
- Issuance by a company of its own shares and debentures.
- Transfer of machinery including motor vehicles.
- Disposal of property for purpose of administering the estate of a deceased person.

Exemptions…

- Vesting of property in the hands of a liquidator or receiver.
- Transfer of individual residence occupied by the transferor **for at least three** years before the transfer.
- Compensation by Government for property acquired for infrastructure development.
- Transfer of assets between spouses as part of divorce settlement.
- Sale of land by an individual where the proceeds are less than **Kshs.30,000/-.**

Exemptions…

- Sale of agricultural land by individual outside gazetted townships where the property is **less than 100 acres**.
- Transfer of shares by a body exempted under paragraph 10 of 1st schedule (charities).
- Transfer of shares by retirement benefit scheme registered/exempted with Commissioner

Exemptions…

Exchange of property necessitated by

i. incorporation
ii. recapitalization
iii. acquisition
iv. amalgamation
v. separation
vi. dissolution or similar restructuring involving one or more companies which is done in the public interest

Eighth Schedule to the Income Tax Act

Documentation/Records

- For purposes of compliance/audit checks.
- Sales Agreement.
- Title Deed and documents in support of costs.
- Copy of Share certificate/ CDS Certificates
- PIN of parties involved in the transfer.
- Returns, records and declaration of stamp duty payments may be required for reconciliation purposes.

Non Arms Length Transactions

- Sales or transfers between related parties.
- Sales price may have been understated to depress the tax base.
- Commissioner may make necessary adjustments and/or revaluation to determine the market price.
- Other similar instances requiring Commissioner's valuation includes
  - ✓Transfer by way of a gift in whole or in part.
  - ✓Transfer for a consideration that cannot be valued in monetary terms.

Computations

Example 1 –computation of gain

	Kshs.
Transfer value (say)	2,000,000
Adjusted costs	1,500,000
Taxable value (gain)	500,000
Tax @ 5% (CGT)	**25,000**

Note:-

- Transfer value is determined in accordance with Para 7 of the 8th Schedule.
- Adjusted cost is determined in accordance with Para 8 of 8th schedule.
- In case of capital loss no tax is applicable nor can the loss be offset against other gains from separate source income streams.

Example 2 – computation of transfer value

If the incidental costs were: legal-Ksh. 100000; advertisement-Ksh 50000;agent's commission –Ksh 200000; valuation –Ksh. 150000

		Kshs.
Sales Proceeds		2,000,000
Less: incidental costs		
Legal Fees	100,000	
Advertisements	50,000	
Agent's Commission	200,000	
Valuation fees	150,000	500,000
Transfer value		*1,500,000*

Example 3 –computation of adjusted cost

From the case scenario above say: Legal cost on acquisition was ksh 60000; Valuation ksh 70000; Costs to change the roof of property ksh 130000; Legal cost to defend title ksh 50000; IBD had been allowed totaling ksh 450000 over the years.

Adjusted cost computation		
Cost of acquisition		*ksh 1500000*
Add:		
legal cost on acquisition	*ksh 60000*	
Changing roof	*ksh 130000*	
Valuation	*ksh 70000*	
Defending title	*ksh 50000*	*ksh 310000*
		1810000
Less: IBD		*450000*
Adjusted cost		***ksh 1360000***

adjusted cost… note

1. *For the purpose of computing the adjusted cost of property, an amount computed shall be reduced by such amounts as have been allowed as deduction under section 15(2).*

2. *Where there is a part transfer of property the adjusted cost of the property shall be allocated to the part transferred in accordance with a method approved by the Commissioner.*

Calculation of CGT

- The net gain i.e. the excess of the **transfer value** over the **adjusted cost** will then be subjected to CGT at the rate of 5% .

- In our example above then it will be

Ksh 1500000 less 1360000 = 140000

CGT @ 5% of 140000 is ksh 7000

Managing public enquiries

- Public notices were issued in November and Dec 2014 as well as press releases
- Dedicated contacts MST, LTO and MTO.
- Structured stakeholder engagements

  ICPAK/KAM/LSK/KBA/CMA.

  FAQs – maintain a register.
- Rulings issued by Commissioner to enquirying taxpayers- ordinary and e-mail.

Future legislative changes

- Enhancing the CGT law to bring clarity and encourage compliance
- On exemptions.
    - Lower threshold of Ksh. 30,000
    - Exemption of agricultural land less than 100 acres
- Indexation
- Harmonize rates in EAC Region.
- Feed back from stakeholders (FAQs and Staff submissions).

END OF PRESENTATION

THANK YOU