CAPITAL GAINS TAX

Presentation ICPAK by
Policy & Advisory Unit

12th April, 2018
Background

- Capital Gains tax is not a new tax - it was first introduced in 1975
- Suspended in 1985 to attract investment in both real estate and the stock market and consequently facilitate growth in property market
- There was a proposal to introduce it in 2006 did not go through.
What is Capital Gains Tax (CGT)?

- Tax chargeable on 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**.
- **Property** includes land, buildings and marketable securities.
Why reintroduction of CGT?

- The **preamble to the constitution** recognizes the aspirations of all Kenyans for a government based on **essential values of equality, social justice and the rule of law**.

- **Article 10** provides for the **national values** and principles of governance which includes among others:
  
  - *Patriotism*
  
  - *Equity, social justice, inclusiveness, equality and non-discrimination.*
Every person should therefore participate in the development of our country through payment of taxes

- Articles 209 and 210 empowers the government to impose taxes through legislation.
In view of the constitutional provisions, CGT was reintroduced through the Finance Act, 2014 for the following reasons:

(i) **promote horizontal and vertical equity** in taxation by ensuring fair sharing of tax burden

(ii) **Enhance market efficiency** by minimizing speculation

(iii) **Minimise tax avoidance and evasion** because CGT eliminates tax advantage from those who may shift from other income generating investments to property expecting untaxed gains on transfer

(iv) **Internationally**, including all other EAC countries, CGT has generally been embraced.
• The reintroduction came through amendments to Income Tax Act:
  
i. **Section 34(1)** of the by insertion of a new paragraph(j) which introduced a rate of 5% on capital gains; and

  
  ii. **paragraph 2 of the 8th Schedule** to the Act (on taxation of gain) **as read together with Section 3(2)(f) of the Act.**
Challenges

i. Records on acquisition costs and other allowable expenses on properties subject to CGT were not preserved to enable taxpayers support their claims.

ii. The re-introduction after 30 years required a lot of time to sensitize stakeholders.

iii. Relevant Sections and Schedules of the Income Tax Act required amendments in order to be in harmony with the changes which have taken place since 1985.
Amendments

First Schedule:

In paragraph 36 (2015 FA)

i. Exempt transfer value of property by an individual enhanced from Ksh \textbf{30 thousand} to \textbf{3m}

ii. Exempt acreage of agricultural land reduced from \textbf{100} to \textbf{50} acres.

iii. Where there is a court case, \textbf{period of transfer} or sale of property for purposes of administering the estate of the deceased person increased from 2 years from date of death to 2 years from date of finalization of such a court case.
Eighth Schedule

Paragraph 6(2) (2016 FA)

No transfer of assets-

i) between spouses;

ii) between former spouses as part of a divorce settlement or a *bona fide* separation agreement;

iii) to immediate family-(i.e children of the spouses or former spouses);

iv) to immediate family as part of a divorce or *bona fide* separation agreement; or

v) to a company where spouses or a spouse and immediate family hold 100% shareholding.
Court Rulings

Kenya Association of Stock Brokers and Investment Banks vs

The Attorney General and Kenya Revenue Authority

The petitioners went to court on three issues-

i. Whether re-introduction of CGT was unconstitutional because it was passed without public participation as required under Article 201 of the constitution.

Ruling

No violation since the Finance Bill which re-introduced it was in the standing orders of the National assembly.
ii. Whether introduction of CGT providing for a rate of 5% while paragraph 16 of the 8th schedule provides for 7% is inconsistent with Article 10 of the constitution which requires transparency and clarity

Ruling
The effect of the re-introduction at 5% was to impliedly repeal the provisions of paragraph 16 of the 8th schedule and therefore not unconstitutional
iii. Whether charging CGT on sale of properties acquired before 1st June, 2005 contravenes Article 40 as it has a retroactive effect, thus infringing on property rights protected in the constitution.

Ruling

The provisions re-introducing CGT are not retrospective in effect and do not, therefore, violate and threaten the right to property under article 40.
The applicant based the application on unfair administrative action.

i. That it was unreasonable for the respondent to require simultaneous payment of Stamp Duty and Capital Gains Tax on sale of land by chargee pursuant and chargees power of sale

**Ruling**

Prayer granted BUT respondents in the process of filing an appeal
Kenya Bankers Association Vs KRA

ii. That it is unreasonable, unfair and an error in law for the respondent to require payment of CGT by chargee or purchaser on the sale of land by chargee in pursuant to chargee’s power of sale without first ascertaining whether there is capital gain.

Ruling
Prayer granted BUT respondents are in the process of filing an appeal.
iii. A declaration that on sale of land by a chargee pursuant to chargees power of sale, CGT is payable upon registration of the transfer by the chargor of the land per paragraph 5 (2) of the 5th schedule to ITA and not by the chargee or purchaser.

Ruling

CGT is payable upon registration of the transfer by the chargee of the land and not by the chargee or purchaser unless there is a surplus from the proceeds of sale as to constitute the change a trustee of the charger
iv. An order be given to allow payment of Stamp Duty on instrument of transfer following the sale of land by a chargee pursuant to charges power of sale, without requiring payment of Capital Gains Tax.

Ruling

Prayer granted BUT respondent in the process of filing an appeal.
Law society of Kenya Vs KRA (petition no. 39 of 2017)

That paragraph 11A of the 8th schedule to ITA (providing for capital gains tax point as on or before the date of application for transfer of property is made at lands office) is inconsistent with paragraph 2 of the schedule (on charge of CGT on transfer of property) as read together with paragraph 6(i) of the schedule and violates Article 10(1), (2), 40 (2) (a) and 20 1(b)(i) hence unconstitutional

Ruling

Prayer granted but the respondents have appealed.
What constitutes a transfer?- para 6 (1) of 8\textsuperscript{th} Sch

(a) where a property is sold, exchanged, conveyed or disposed of in any manner (including by way of a gift whether or not for consideration); or

(b) on the occasion of loss, destruction or extinction of property whether or not compensation is received or not; or

(c) on the abandonment, surrender, cancellation or forfeiture of, or the expiration of rights to property.

Para 6 (2) outlines situations that do not constitute a transfer for CGT purposes:

(a) transfer only as security to secure a debt or a loan; or

(b) Issuance by a company of its own shares or debentures; or
What does not constitutes a transfer?- para 6 (2) of 8th Sch continued

(c) vesting of property of a deceased person in the personal representative by operation of law; or

(d) transfer of property by a personal representative to a person as a legatee in the course of the administration of the estate of a deceased person; or

(e) vesting in the liquidator by an order of a court of the property of a company under section 240 of the Companies Act; or

(f) vesting in the official receiver or other trustee in a bankruptcy of a bankrupt under section 57 of the Bankruptcy Act; or
(g) transfer by a trustee of property, to a beneficiary on his becoming absolutely entitled thereto; or

(h) refer to 2016 FA amendments to paragraph 6 as discussed above. On transfer between spouses and immediate family members
**Implementation**

**What is the rate of tax?**

- Section 34(1)(j) - 5% of the net gain, which is a final tax;
- Kenya compared to some selected African Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>40.00%</td>
</tr>
<tr>
<td>Uganda</td>
<td>33.00%</td>
</tr>
<tr>
<td>Botswana</td>
<td>25.00%</td>
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<tr>
<td>Tanzania</td>
<td>20.00%</td>
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<tr>
<td>Senegal</td>
<td>15.00%</td>
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<tr>
<td>Ghana</td>
<td>10.00%</td>
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<tr>
<td>Country</td>
<td>Percentage</td>
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<tr>
<td>Nigeria</td>
<td>10.00%</td>
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<tr>
<td>Kenya</td>
<td>5.00%</td>
</tr>
<tr>
<td>Mauritius</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

*Source: Global Property Guide, 2014*
**Determination of Net gain**

- The net gain is the excess of the *transfer value* (*Para 7*) over the *adjusted cost* (*Para 8*) of the property that has been transferred. It is this excess that is subjected to tax at 5%.
Transfer Value (Para 7)
• Computed in reference to amounts outlined inPara 7 depending on the manner of transfer.
• Incidental costs to the transferor in making the transfer shall be deducted when computing the transfer value.
• Where no amount is ascertainable as the transfer value, the transfer value shall be the market value as determined by the Commissioner.

Adjusted Cost (Para 8)
• Constitutes the amounts listed in Para 8.
• The adjusted cost computed shall be reduced by amounts allowed as deductions under Section 15(2)
Transfer value; Adjusted Cost & Incidental Costs....

**Incidental Costs (Para 10)**

- Constitutes expenditure wholly & exclusively incurred by the person acquiring the property or the transferor for purposes of the acquisition or transfer.
- Para 11 – Costs already allowed as deductions in determination of other incomes, are not allowable for CGT.
- Proof of the incidental costs must be provided.

**Capital Loss**

- If the adjusted cost exceeds the transfer value, a capital loss is incurred. This loss can only be offset against a gain from a similar source i.e, another capital gain – Section 15(3)(f).
Market Value (Para 9)...

- Where property is acquired or transferred -
  - not at arms length or
  - by way of a gift in whole or in part or
  - for a consideration that cannot be valued or
  - as a result of a transaction between persons who are related, then: -

  - consideration for the transfer = the market value of the property at the time of the transfer
  - consideration for the acquisition = market value of the property at the time of the acquisition or to the amount of consideration used in computing stamp duty payable on the transfer by which the property was acquired, whichever is the lesser.
Due date, Declaration & Payment...

• Due date for tax payable upon disposal of property under Part 1 of the 8th Schedule= on or before the date of application for transfer of the property is made at Lands Office (par 11(A) of the 8th Schedule but currently under dispute) wef 1st January, 2016

• Taxpayer to do a self-assessment to determine the gain upon which tax is computed.

• For investment shares, stockbrokers are required to collect and account on behalf of individual investors (Par.18 of 8th Sch). Note: This paragraph is also applicable to shares transferred under Part 1 of the 8th Schedules).

• Upon transfer of property the transferor shall complete the relevant CGT declaration form and compute and pay the tax thereon.
CGT Declaration Forms

- **CGT 1** – Transfer of land and buildings by individuals & corporate bodies
- **CGT1P** – Transfer of land and buildings by partnerships
- **CGT2** – Transfer of marketable securities by individuals & corporate bodies
- **CGT2P** – Transfer of marketable securities by partnerships
- **CGT3** – Declaration for transactions that are exempt from CGT

NB: Can be downloaded from the KRA website
**Exclusions**

Income that is taxed elsewhere as in the case of property dealers-Para 3 (3) of 8\textsuperscript{th} She;

- gain on transfer of machinery including motor vehicles - para 3 (2);

**Exemptions**

- disposal of property for purpose of administering the estate of a deceased person – para 36 (f) of 1\textsuperscript{st} Schedule
- transfer of individual residence occupied by the transferor for at least three years before the transfer - para 36 (c) 1\textsuperscript{st} Sch;
Exemptions...

- sale of land by an individual where the transfer value is not more than Kshs. 3m;
- sale of agricultural land by individuals outside a municipality, gazetted townships of less than 50 acres
- exchange of property necessitated by: incorporation, recapitalization, acquisition, amalgamation, separation, dissolution or similar restructuring involving one or more corporate companies which is certified by the Cabinet Secretary to have been done in the public interest
- transfer of investment shares by a body exempted under Paragraph 10 of the St Schedule – para 21 (1) of 8th Sch.
- transfer of investment shares by retirement benefits scheme registered with Commissioner (excluding foreign schemes)
## Worked Example...

**Transfer Value Computation**

- Assume that the sale proceed was Kshs. 2,000,000 and the incidental costs were: Legal fees - Kshs. 100,000; Advertisement – Kshs. 50,000; Agent’s commission – Kshs. 200,000 and Valuation fees – Kshs. 150,000.

<table>
<thead>
<tr>
<th>Sales proceeds</th>
<th>Kshs. 2,000,000</th>
</tr>
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<tbody>
<tr>
<td><strong>Less Incidental Costs:</strong></td>
<td></td>
</tr>
<tr>
<td>legal fees</td>
<td>Kshs. 100,000</td>
</tr>
<tr>
<td>Advertisement</td>
<td>Kshs. 50,000</td>
</tr>
<tr>
<td>Agents commission</td>
<td>Kshs. 200,000</td>
</tr>
<tr>
<td>Valuation fees</td>
<td>Kshs. 150,000</td>
</tr>
<tr>
<td><strong>Transfer Value</strong></td>
<td>Kshs. 1,500,000</td>
</tr>
</tbody>
</table>
Worked Example...

Adjusted Cost computation

• Assume the cost of acquisition/construction was Kshs. 1,500,000 and the other relevant/incidental costs were as follows: legal cost on acquisition - kshs. 60,000; valuation – kshs. 70,000; costs to change the roof of property – kshs. 130,000; legal cost to defend title kshs. 50,000; IBD had been allowed totaling kshs. 450,000 over the years.

Cost of acquisition

Add:

legal cost on acquisition Kshs. 60,000
Changing roof Kshs. 130,000
Valuation Kshs. 70,000
Defending title Kshs. 50,000

• Less: IBD

• Adjusted cost

Kshs. 1,360,000
Worked Example...

Computation of Gain & Tax thereon:
Transfer Value less Adjusted Cost (Kshs. 1,500,000 – Kshs. 1,360,000)

= Kshs. 140,000

Tax at 5% of Gain (5% x Kshs. 140,000) = **Kshs. 7,000**
END OF PRESENTATION

THANK YOU