Kenya reintroduces capital gains tax

Executive summary

The capital gains tax (CGT) has been reintroduced in Kenya following an amendment in the 2014 Finance Act which was assented to by the President on 14 September 2014. The CGT had been suspended in Kenya since 1985 to encourage investment in the real estate sector as well as spur growth in the stock market.

There have been previous attempts by the Kenyan Government to reintroduce the CGT but with no success. One of the main reasons cited by various stakeholders as to the current reintroduction of CGT is the need for the Government to balance an ever increasing financial budget. In light of the enormous growth being experienced in the real estate as well as a robust stock market, the CGT will help the Government meet its revenue targets.

The CGT will be applicable on the gains which accrue to a company or an individual on or after 1 January 2015 on property situated in Kenya, whether or not the property was acquired before 1 January 2015. The rate for CGT on transfer of property is 5%.

Detailed discussion

Overview

The CGT will be applicable on gains realized by companies and individuals on the transfer of property situated in Kenya on or after 1 January 2015. This in essence brings to tax any capital gains accumulated from the time of suspension of the CGT. The general tax rate applicable will be 5%.

The gains shall be determined by the amount by which the transfer value exceeds the adjusted cost of the property. Adjusted cost refers to cost of acquisition of the property and other costs incurred subsequently to enhance or preserve the property, provided that such costs had not been previously deductible for tax purposes.
The Finance Act does not specifically provide guidelines on how the CGT relating to the transfer of property shall be paid. It is expected that the CGT will be payable in the same manner as the stamp duty such that, evidence of payment of CGT may be required for the transfer of property to be registered. However, CGT due on the transfer of shares listed in the NSE (Nairobi Stock Exchange) by an individual is payable by the stock broker who conducts the transfer.

The Finance Act does not provide for taxation of indirect transfers of property in Kenya. Such transactions should therefore not be subject to CGT.

**Determination of taxable gain**

Capital gain shall be the amount by which the transfer value of the property exceeds the adjusted cost of that property. The adjusted cost of property refers to all costs incurred with respect to the property, whether at the date of acquisition or costs incurred after the acquisition to enhance the property. All costs incurred by the transferor in the process of transferring the property e.g., professional fees, advertisement, etc., will be deductible against the income realized. No cost will however be deductible when computing the capital gains if such costs had previously been deducted for tax.

Transfer value shall be the value of consideration and in cases where there is no consideration given, or the value of consideration cannot be determined or in cases where the parties to the transfer are related parties, the commissioner may determine the market value of the property.

**Transfer for CGT purposes**

Transfer of property for purposes of CGT includes:

- Where property is sold, exchanged, conveyed or otherwise disposed of in any manner whatever (including by way of gift), whether or not for consideration.
- On the occasion of the loss, destruction or extinction of property whether or not a sum by way of compensation or otherwise, or under a policy of insurance, is received in respect of the loss, unless that sum is utilized to reinstate the property in essentially the same form and in the same place.
- On the abandonment surrender, cancellation or forfeiture of, or the expiration of substantially all rights to, property, including the surrender of shares or debentures on the dissolution of a company.

A Transfer shall not include:

- Transfer of property for the purpose only of securing a debt or a loan, or on a transfer by a creditor for the purpose only of returning property used as a security for a debt or a loan.
- Issuance by a company of its own shares or debentures.
- Vesting of property of a deceased person to personal representative.
- Transfer by a personal representative of property to a person as legatee in the course of the administration of the estate of a deceased person.
- Vesting in the liquidator, official receiver or other trustee by an order of a court of the property of a company.
- Transfer by a trustee of property, which is shown to the satisfaction of the Commissioner to be subject to a trust, to a beneficiary on his becoming absolutely entitled thereto.
- Compensation for property acquired by the government for infrastructure development.

**Capital gains tax for companies**

Companies will be required to pay CGT on gains realized from transfer of property situated in Kenya. The definition of property has been derived from the Interpretation and General Provisions Act, and includes property acquired or held for investment purposes, excluding road vehicles. This wide definition brings most investments held by a company into the ambit of CGT.

However, gains realized by companies on the transfer of assets which had qualified for the wear & tear deduction as well as on the transfer of property in exchange of other property pursuant to a business restructuring or re-organization found by the minister to be in public interest are exempt from capital gains tax.
Whereas the Eighth Schedule does not specifically provide for taxation of listed marketable securities for a company as is the case for individuals, the broad definition of the term property may be interpreted to mean that CGT will be applicable on gains from transfer of listed securities by companies.

**Capital gains tax for individuals**

Individuals will be required to pay CGT on gains realized from the transfer of land or any interest in land situated in Kenya as well as on marketable securities, whether or not they are listed in the stock exchange.

Taxation of gains realized by an individual from the transfer of property and marketable securities excluding listed shares shall be taxed in the same way as a company.

With regard to listed shares, the gain on shares shall be the amount by which the transfer value of the listed shares exceeds the adjusted cost of such shares. The stockbroker who conducts the transfer of the listed shares shall be responsible for collecting and remitting the tax.

Previously, the CGT rate applicable on gains realized on the transfer of listed shares by an individual was 7.5% as specified in the Eighth Schedule. Following an amendment to the Income Tax Act (ITA) through the 2014 Finance Act, these gains will now be subject to tax at 5%. An amendment to the ITA is however necessary to rationalize this position.

Transfer of an asset between spouses or former spouses as part of a divorce settlement or bona-fide separation agreement shall not be treated as a transfer for purposes of CGT.

Capital gains realized by individuals from under the following instances are exempt from CGT:

- Shares in the stock or funds of the Government, the High Commission or the Authority established under the Organization or the Community
- Shares of a local authority
- Transfer of private residence occupied continuously for a period of three years or more prior to the transfer
- Transfer of land whose value does not exceed KES30,000
- Transfer of agricultural property of less than 100 acres situated outside an area specified to be an urban area
- Transfer of land adjudicated under the registered Lands Act for the first time
- Transfer of property including listed shares for purpose of administering the estate of a deceased person

**Impact**

Taxpayers should review transactions involving the transfer of property where the transaction is expected to take place on or after 1 January 2015.

**Endnotes**

1. Under the Interpretation and General Provisions Act, property is defined to include money, goods, choses in action, land and every description of property, whether movable or immovable; and also obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, arising out of or incident to property as herein defined.

2. Adjusted costs in the case of shares means: (i) the market price at which the shares could have been purchased at arm's length for shares acquired before 13 June 1975; and (ii) the amount or value of consideration for the shares for shares acquired on or after 13 June 1975.
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