Capital Gains Tax Updates

Introduction

CGT was first suspended in 1985 and was re-introduced with effect from 1st January 2015.

The current rate is at five percent (5%) of the net gains; which is the excess of the transfer value and the adjusted cost of the property. This is a final tax and does not offset any other income taxes. The transferor accounts for this tax.

Although there have been various challenges faced in rolling out the CGT regime, various strides have been taken to address these challenges.

In this article we address some key updates in the CGT regime, including the most recent requirement by the Kenya Revenue Authority (KRA) to review CGT exempt transactions before accounting for the tax.

Challenges in implementing CGT regime

One major challenge in CGT regime was the administration and accounting for CGT on securities transactions. This posed various challenges as outlined below;

- The cost of tax collection was higher than the amount of tax collected from the transaction this negated the canon of economy.
- Because of the re-introduction of CGT, there was a huge backlog in capturing the numerous share transactions and this rendered the automated system of the NSE inoperable.
- There were some difficulties in computing gains as individuals or companies would invest in the same company at different dates and different prices so it would be difficult to get the exact adjusted cost.

This led to CGT on listed securities suspended in the Finance Act 2015. However, CGT still applies on the unlisted securities at 5% of the gain on transfer.

In 2017, KRA further twined CGT with Stamp Duty in the system, which made it mandatory for transacting parties to declare CGT before paying Stamp Duty. This was to ensure payment of CGT, which would significantly boost collections.

A challenge that stemmed from this was that the CGT tax point was when the transfer was made. However, stamp duty had to be levied before CGT for the transfer to be finalized which meant that it was unreasonable to demand CGT before stamp duty. A ruling was made putting a stay on the application of CGT before stamp duty. The case was *The Law Society of Kenya versus the KRA & the Honorable Attorney General*. The petitioner was not opposed to payment of the tax, but the petitioner challenged paragraph 11A of the Eight Schedule of the Income Tax Act which makes the due tax payable "*on or before the date of application for transfer of the property is made at the relevant Lands Office*" as opposed to upon successful transfer of the property.

According to the Section 37 of the Land Registration Act, real property is deemed to have passed once the following conditions are met:

i. Filing the instrument (transfer forms); and
ii. Registration of the Transferee as proprietor of the land

Paragraph 2 of the Eighth Schedule clearly provides that CGT can only accrue once the transferee has been registered as the proprietor of the land and not earlier as provided in the challenged provision. The court eventually ruled that paragraph 11A as null and void.

Another grey area had been accounting for CGT on CGT exempt transactions. Previously a taxpayer could simply declare the transaction as exempt and account for it on Itax. KRA however has proposed the introduction of measures to verify such transactions to gauge if they qualify as being exempt from CGT, in order to ensure compliance.

Measures introduced to verify CGT exempt transactions

Considering various procedural challenges in implementing CGT, KRA has done a system enhancement, which requires the physical verification and approval of CGT exempt transactions before finalization on Itax.

This verification will be applicable on the following exempt transactions;

- Where the transfer value of the property is not more than three million shillings;
- Agricultural property having an area of less than fifty acres; and
- Transfer of property from the estate of a deceased person.

The taxpayer will be required to initiate the verification by registering the transaction on Itax before seeking subsequent approval from KRA.

The taxpayer will then be required to visit the KRA offices with the requested documentation for a physical verification and approval which includes;

- the transferor's national identity card or passport number;
- the transfer or sale agreement;
- the valuation document; and
- The utility bills and tenant rental agreement (if in existence).

After the verification process, the normal registration process at the Ministry of Lands will follow suit and Stamp Duty is then payable where applicable. The transfer is then finalized on Itax. The verification process is proposed to take three days. The move is set to ensure compliance with CGT and prevent evasion of CGT taxes. There are however various areas of concern such as;

- The transferor will not be able to finalize the transaction if there are any instances of non-compliance. These would have to be finalized before KRA authorizes the transaction.
- If the transaction is ruled as not being exempt, CGT will become due and payable by the 20th day following the month of transfer. Failure to remit CGT on time attracts a penalty of 5% of the tax due and interest at 1% per month for the period that the tax remains unpaid. This may pose a challenge especially where verification takes longer than envisaged.

Although the verification is a good move to ensure compliance, the administrative element and verification of other non-related non-compliance issues may create a back log and delay many transfers making it difficult for many transactions.

Other proposed measures under CGT regime

Proposed measures highlighted under the Finance Bill 2019 are;

- The proposed increase in the CGT rate from 5% to 12.5% was rejected by the National Assembly's Finance and National Planning Committee (the Finance Committee. The Finance Bill 2019 is now before the President for assent.

- The Finance Bill 2019 proposes to exempt from CGT, the transfer of property necessitated by restructuring of corporate entities where such transfer is, a legal or regulatory requirement, as a result of directive or compulsory acquisition by the government, an internal restructuring within a group which does not involve transfer of property to a third party, or in public interest and approved by the cabinet secretary.

Conclusion

It would be interesting to see how effective the verification procedures will be and if it will pose a challenge or help streamline the CGT regime.

Let's talk

For further information on how the proposed tax provisions will affect your business or assistance on any other matter kindly contact your regular Taxwise Africa Analyst or the contacts below.

020 2025230
cngetich@taxwise-consulting.com
Info@taxwise-consulting.com
https://taxwise-consulting.com