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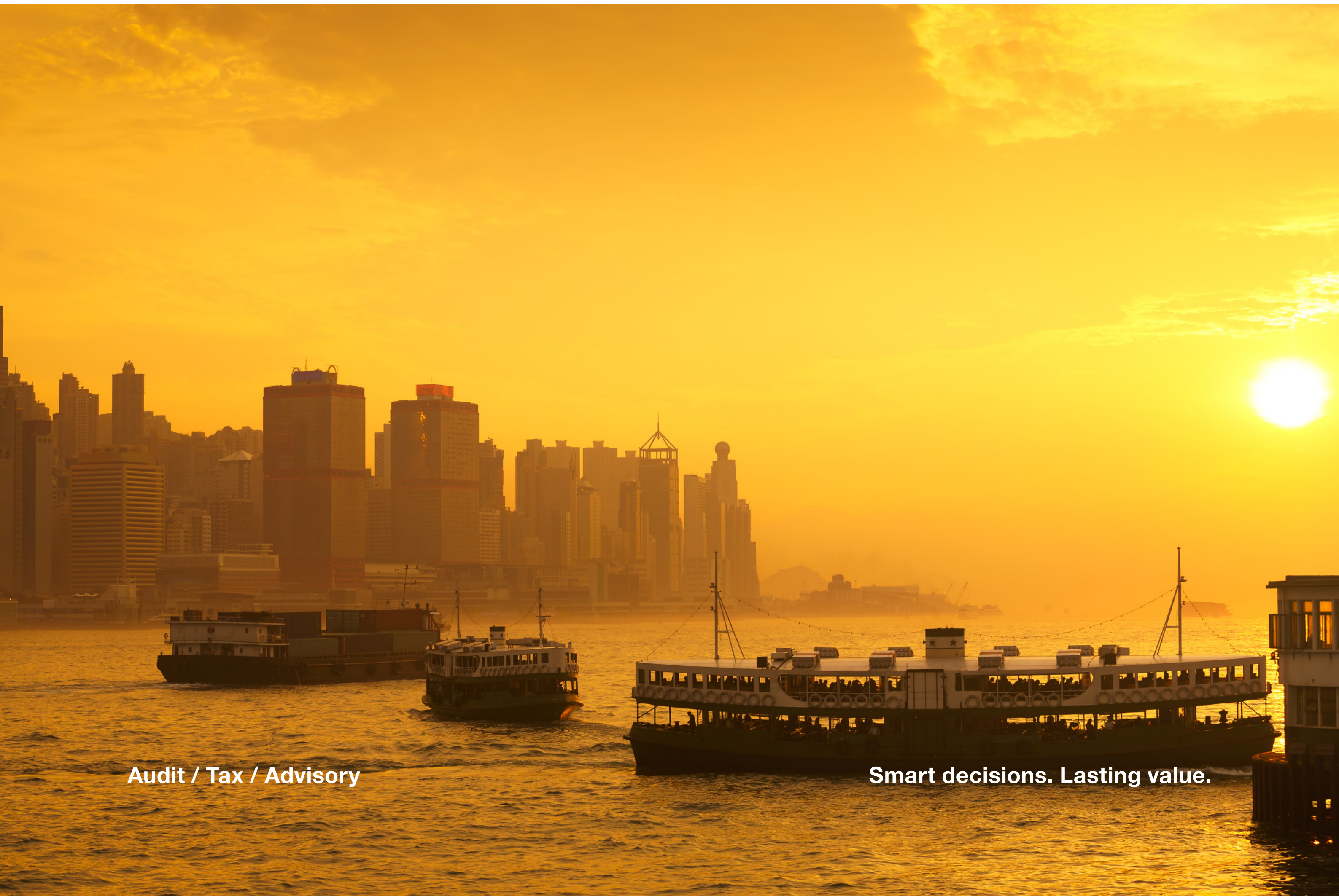
Effects of Increased Capital Gain Tax Rate In Kenya:

Assesing Challenges and Exploring Solutions



Capital Gain Tax (CGT) In Kenya

What is CGT rate?

Capital Gain Tax (CGT) is imposed on profits obtained from the sale or transfer of property within Kenya, acquired on or after January 2015. A transfer of property is said to have occurred if property is sold, exchanged, conveyed, or otherwise disposed of in any manner (including by way of gift), whether or not for consideration. Further, a transfer occurs on destruction, abandonment, surrender, cancellation, or forfeiture of property. The tax liability falls on the transferor of the property, who is responsible for both the declaration and payment of CGT.

Increase in CGT rate.

The amendment to the Income Tax Act, effective from January 1st, 2023, through the Finance Act of 2022, has resulted in an increase in the Capital Gains Tax (CGT) rate in Kenya; previously set at 5%, the amended rate now stands at 15%. Among the reasons for the increase includes the comparatively higher CGT rates in other East African countries such as Uganda at 30%, Tanzania (10% for residents) and Rwanda's rates of 30%; Kenya's CGT rate of 5% was relatively low.

During the assessment of the Finance Bill 2022 (before it was enacted to law) by the Departmental Committee on Finance and National Planning, a significant number of stakeholders put forth a suggestion to reconsider the Capital Gains Tax (CGT) rate of 15% and instead lower it to 10%. Their argument was based on the absence of a mechanism in Kenya to address inflation adjustment in relation to the increased CGT rate. Additionally, these stakeholders expressed concerns that the higher CGT rate would negatively affect Kenya's competitiveness as an economic hub and as a desirable investment destination.

Despite these proposals, the committee rejected the stakeholder recommendation to reduce the CGT rate to 7.5%, citing potential adverse effects on revenue allocation. Nevertheless, the committee did agree and propose a revision of the CGT rate from 15% to 10%. However, despite these recommendations from both the committee and stakeholders, the Finance Act 2022 ultimately adopted the CGT rate of 15% as the committee cited that it would lead to increased revenue collection for the government. The key reason the government sought to raise CGT was increased pressure to meet tax revenue targets due to the rising public debt.

Impact of increased CGT rate

Thus far, there has been a negative impact because of the increased rate, coupled with rising inflation, a depreciating currency, and rising interest rates, which has dampen the appetite for investment in property.

Official data reveals that despite the tripling of the capital gains tax (CGT) rate, taxes collected from financial transactions related to the transfer of real estate and shares in privately held firms experienced a double-digit decline in the third quarter of the current financial year.

Provisional revenue statistics from the National Treasury indicate that tax receipts from real estate and private share transactions amounted to KES 3.28 billion in the January to March 2023 period, compared to KES 3.76 billion in the same period the previous year. This represents a decrease of 12.92% and may suggest a reduction in property deals during the review period following the increase in the CGT rate.

However, the data also shows a significant year-on-year increase of 64.27% in collections, amounting to KES 7.27 Billion in the quarter preceding the CGT rate hike. This contributed to a 13.78% year-on-year jump in CGT receipts for the nine-month period through March, totalling KES 14.26 Billion.

Potential solutions

Some potential solutions that could be considered by the Kenyan government to address the objective of increasing revenue through the increased capital gains tax (CGT) rate:

- **Review the impact of the rate increase:** The government should conduct a comprehensive analysis of the impact of the increased CGT rate to understand the reasons behind the decline in tax collections during the review period. This analysis can help identify specific areas or factors contributing to the drop in transactions and revenue.
- **Evaluate the real estate sector:** Given the sustained downturn in the real estate sector, it would be beneficial for the government to assess the challenges faced by developers and investors. Understanding the specific issues hampering growth in the sector can help in formulating targeted policies or incentives to stimulate investment and transactions.
- **Engage stakeholders for feedback**: The government should actively seek feedback from stakeholders, including tax experts, business associations, and professional bodies, on the impact of the increased CGT rate. This feedback can provide valuable insights and suggestions for potential adjustments or revisions to the tax policy.
- **Consider inflation adjustment:** As suggested by some experts, introducing inflation adjustment to the CGT calculation could be beneficial. This would account for the effects of inflation on the taxable capital gains and help maintain a fair and balanced approach to taxation.
- **Promote ease of doing business:** The government should focus on improving the ease of doing business in Kenya to attract investors and stimulate economic growth. Streamlining bureaucratic processes, reducing red tape, and providing a conducive business environment can encourage investment and lead to increased transactions subject to CGT.
- **Monitor and evaluate the impact:** It is crucial for the government to monitor the impact of the increased CGT rate on revenue collections and overall economic growth. Regular evaluations can help determine the effectiveness of the policy and enable adjustments if needed.

The real estate industry has faced challenges in recent years, with developers struggling to repay loans on properties, leading to banks resorting to auctions to recover debts. Overall, the data suggests that despite the increase in the CGT rate, tax collections from real estate and private share transactions experienced a decline, highlighting potential implications for the sector and overall investment activities.

Maureen Ngetich

Legal & Secretarial

Contact Information
Crowe COR LLP
Symbion House, 2nd Floor
Africa Reit Lane, Off Dagoretti
Road, Karen
Nairobi, Kenya
contactus@crowe.co.ke

P.O. Box 583-00502
Nairobi, Kenya
L.:+ 254 020 388 2073
C: + 254 722 342 259

Cephas Osoro
Managing Partner
+254 (0)722 2342 259
cephas.osoro@crowe.co.ke

For more information,
scan QR
code below:

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