

## Legal Alert – Capital Gains Tax Increase

The Finance Act 2022 (the “**Finance Act**”) amended the Income Tax Act to increase the Capital Gains Tax (the “**CGT**”) payable from 5% to 15% which became effective on 1<sup>st</sup> January 2023. CGT is a tax charged on profits or gains accrued from transfer of property i.e. buildings, land or unlisted shares in Kenya. CGT is payable by the transferor upon registration of the transfer instrument in favour of the transferee. For purposes of CGT, a transfer occurs when property is sold, exchanged, conveyed or disposed of in any manner

(including by way of a gift), whether or not for consideration.

Some property transactions are exempt from CGT including the transfer of property for securing a debt, transfer of listed shares and income that is taxed elsewhere as is the case for property developers. The disposal of property for purposes of administering the estate of a deceased person, the transfer of assets between spouses, or former spouses as part of a divorce settlement, to a company where spouses or a spouse and immediate family members hold 100% shareholding and transfers to immediate family members are also exempt from CGT.

### What the CGT increase means for you

The increase in capital gains tax from 5% to 15% is a major blow to tax payers who will pay higher taxes upon the sale of properties. The higher CGT rate may lower the return on investment, thus increasing the cost of capital and depress overall investment in the economy. This is likely to have an impact in sectors such as real estate as well as for sellers in mergers and acquisitions transactions as the transfer of shares in private companies and assets such as land and buildings will be subjected to the higher rate from 1<sup>st</sup> January 2023.

The increase in CGT was partly aimed at aligning the Kenyan CGT rates with other countries in the region, which have higher rates. For instance:

- Capital gains in Uganda is taxed as part of business income at 30%;
- Ethiopia has a CGT rate of 30% for share disposals and 15% for transfer of immovable property; and

- Rwanda has a CGT rate of 5% for share transfers and 30% on the transfer of commercial immovable property.

It may appear that the Kenyan CGT rate is now aligned or even lower than some countries in the East African region. However, the Finance Act ought to have factored a corresponding inflation adjustment (indexation) as has been done in other countries. Indexation is the adjustment of the value of an asset to eliminate the effect of inflation using a Consumer Price Index. Indexation is vital because a good proportion of the increase in the value of property over time is attributable to a general increase in prices caused by inflation. It is notable that nations such as Uganda factor an indexation allowance in the payment of CGT, while Ethiopia provides for the same in respect of immovable property. Despite Rwanda not providing for indexation, capital gains is exempt for corporate restructuring, which includes mergers and acquisitions. This indexation and exemption is beneficial for investors in these countries.

Despite key stakeholders and the Departmental Committee on Finance and National Planning, in their Report on the Finance Bill 2022, proposing a lower CGT rate in Kenya, in the absence of indexation, neither a lower rate nor indexation was introduced in the Finance Act 2022. The introduction of indexation when increasing the CGT rate would have been a welcome move by increasing tax revenues while equally encouraging investments.

On a more positive note, the Finance Act has provided for an exemption from the higher CGT rate for entities that are certified by the Nairobi International Financial Center Authority with investments of KES 5 billion (approximately USD 40 million) or more in Kenya. The certified firms shall be permitted to pay the prevailing CGT rate of 5% where the investment is made prior to 31<sup>st</sup> December 2021 and the transfer is made after five (5) years have lapsed following

the investment. The Nairobi International Financial Centre (the “NIFC”) was established by the Nairobi International Financial Centre Act 2017 as a flagship initiative under the economic pillar of Kenya’s vision 2030.

NIFC is designed to attract increased finance, investments and to support green growth and innovation. This is by providing certified firms with the conditions necessary to flourish in Kenya and in the region. The NIFC currently prioritizes firms within the sectors of green finance, fintech, investment funds as well as holding companies and multinational headquarters, when granting the certification. In addition, reputable market and consumer data platform, Statista, currently ranks Kenya fourth in Africa for ease of doing business. Kenya therefore continues to be a relatively safe investment destination.

Noting that the Kenya Revenue Authority was set to increase the CGT rate to 15% on the iTax system on 1<sup>st</sup> January 2023, it would be in your best interests to note that any pending transactions shall now be subject to the higher CGT rate.

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