KEEPING UP WITH THE CHANGING LANDSCAPE OF CAPITAL GAINS TAX

INTRODUCTION

A big part of our private wealth services is tax planning. Optimizing tax efficiencies within a portfolio will ultimately positively impact the portfolio and result in tax savings. With the re-introduction of Capital Gains Tax (CGT) in 2015 and subsequent review of the applicable rate on CGT under the Finance Act 2023, families or individuals with asset-heavy portfolios must re-look at how their wealth is held and structured if they are to avoid onerous tax burdens.

This week, our ***Private Wealth*** and ***Tax*** Business Units collaborate to re-look the current tax legal framework with a keen focus on CGT and exemptions applicable whilst structuring private portfolios.

CGT is a tax that is imposed on the gain which accrues when an individual or entity transfers, sells or disposes of property (i.e. land, interest in land and shares) in Kenya. It is declared and paid as a final tax by the transferor or seller at the rate of 15% of the net gain.

The net gain is calculated by ***deducting*** the ***cost of selling the property*** and ***adjusted costs from*** the ***sale proceeds***.
The adjusted costs include the following: -

(a) Cost of buying the property
This is the purchase price of the property that was paid by the seller when they acquired the property.

(b) Incidental costs while buying the property

These are the legal fees, valuation fees, survey costs, registration fees and any other costs incurred by the seller when they acquired the property.

(c) Costs for enhancing the property
This is the amount of money spent by the seller over the years making improvements to the property from the time of purchase to the time of sale and includes costs for preserving the title for the property.

Essentially, CGT is determined based on the profit made from selling property.

CGT EXEMPTION FOR REGISTERED FAMILY TRUSTS:

On 23rd December 2021, the Trustees (Perpetual Succession) and Amendment Act, 2021 took effect, introducing the incorporation of family trust essentially allowing a family trust to operate as a body corporate. Previously family trusts could only operate as unincorporated entities.

A family trust is a legal arrangement that is created by a founder or settlor to hold property for the benefit of the beneficiaries of the trust. The property that is transferred or settled in the trust is managed by the trustees of the trust who have a fiduciary duty to act in the best interest of the beneficiaries.

The Finance Act 2021 introduced the following CGT exemptions to promote the transfer of property to a registered family trust: -

(i) The transfer of immovable property to a family trust is CGT-exempt. Examples of immovable property are parcels of land, permanent improvements on land, buildings and apartments.

(ii) Property, including investment shares, which is transferred or sold to transfer the title or the proceeds of the sale into a registered family trust is CGT- exempt. The term '*property*' used in this section includes both movable and immovable property.

It is important to note that these CGT incentives are still applicable as of the date of this alert and were not affected by the coming into force of the Finance Act, 2023.

Additionally, property that is transferred to a registered family trust is also exempt from stamp duty under the Stamp Duty Act. These CGT and stamp duty tax exemptions have managed to save families from tax obligations of 15% (CGT) and between 2-4% (*in the case of stamp duty and depending on the type of property referenced*). These exemptions therefore make it very tax efficient for family members to transfer, accumulate and grow family wealth for the benefit of multiple generations.

CGT EXEMPTIONS AVAILABLE FOR FAMILIES:

Family members stand to enjoy a number of CGT exemptions when transferring property amongst themselves. These tax exemptions are accorded to transactions involving immediate family members i.e. spouses (husband and wife), former spouses and children of the spouses and former spouses. They include:

The transfer of assets: -

(i) between spouses;

(ii) between former spouses as part of a divorce settlement or a separation agreement made in good faith

(iii) to immediate family;

(iv) to immediate family as part of a divorce or a separation agreement made in good faith; or

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

KEY CHANGES IN THE FINANCE ACT 2023 AFFECTING CGT

1. Due date for payment of CGT:

Before the coming into force of the Finance Act, 2023, the due date for declaring and settling CGT was on or before the date of application for transfer of the property at the relevant Lands Office, but not later than the 20th day after the transfer.

Currently, CGT is required to be settled on the date the seller receives the full purchase price or the date of registration of the transfer, whichever is earlier. This simply means that if the seller receives the purchase price before the registration process of the transfer is complete, he or she is required to declare and settle the CGT through their I-tax portal.

2. Exemption for a transfer of assets following internal restructuring within a group

Where the transfer of assets was by a company to a related company wherein evidence is adduced to prove that a transfer was a result of an internal restructuring within a group (associated companies) and did not involve a third-party transfer, CGT exemption on the transfer was automatically approved.

The Finance Act 2023 has introduced a qualifier through an amendment and

paragraph 13(c) of the 8th Schedule of the Income Tax Act now provides that CGT shall not be paid on a transfer of property in a transaction involving the restructuring of a corporate entity, where such transfer is:

> ***"an internal restructuring which does not involve a transfer of property to a third party within a group which has existed for at least twenty-four months".***

This simply means that for the transferring entity to enjoy the exemption: -

(i) The company to which the transfer is being made should have been in existence for at least 24 months; or

(ii) The transferring company should have been in existence for at least 24 months.

Kenya Revenue Authority has yet to give clear guidelines on the new qualifier for this particular exemption.

3. New Anti-Abuse Provision

The Finance Act 2023 had added a new sub-paragraph 4A in Paragraph 8 of the 8th Schedule of the Income Tax Act which provides that: -

> ***"Where property is transferred in a transaction that is not subject to capital gains tax, and the property is subsequently transferred in a taxable transaction within a period of less than five years, then the adjusted cost in the subsequent transfer shall be based on the original adjusted cost as determined in the first transfer."***

The effect of the above provision is that: -

(i) A subsequent transfer done less than 5 years following approval of CGT exemption shall be subjected to CGT, irrespective of it being a qualifying transaction.

(ii) The adjusted cost to be applied in calculating CGT for a transfer contemplated under (1) above shall be that which was determined during the initial transfer.

EFFECT OF THE ABOVE ON WEALTH STRUCTURING

We expect that this tax framework will fortify the use of Family Trusts as a wealth management tool as well as a succession tool. The flexibility offered by the said provisions will allow families to optimize tax savings and encourage the accumulation and growth of multi-generational wealth.

HOW CAN WE HELP?

At CM Advocates LLP, we pride ourselves in having a wide variety of resources, skills, and experience on matters of estate planning, tax planning, wealth management, and trust administration spanning across the East African Region. We offer an edge to our clients based on our legacy of having structured, re-structured, amended, and incorporated several forms of trusts and therefore well capable of guiding you through the process of creating a valid trust.

Should you have any questions regarding the subject of establishing a trust, or a related topic, please do not hesitate to contact us at ***law@cmadvocates.com*** or ***privatewealth-lawyers@cmadvocates.com***

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