Is it that easy to tax capital gains?

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Since last year's budget speech, we have seen no movement on the reintroduction of the capital gains tax on real estate, marketable securities and other saleable assets.

The Cabinet Secretary for the National Treasury had expressed its intention to clarify their intentions on this issue in his 2014-2015 budget speech, and clarity is precisely what Kenya's investors and the growing middle class require.

Kenya's capital gains tax exists as legislation but it has been suspended since 1985 to encourage investment in properties and securities. If the legislation were in effect, tax would be collected upon the sale or transfer of land, houses, stocks, bonds and similar assets.

If the National Treasury fulfils its intention to reintroduce the capital gains tax, there is little doubt that it will impact Kenya's economy. The tax would affect the property and financial markets most acutely if the exemption on marketable securities (such as shares) is not retained. Kenya's construction and property markets are currently growing at a rapid pace and hence would contribute a large share of capital gains tax revenue.

We should consider whether the sectors impacted by the reintroduction of the capital gains tax are sufficiently mature to make this contribution, without the tax adversely impacting growth. We should also consider whether the proposed tax regime for capital gains tax adequately addresses a number of factors that may not have been prevalent in 1985.

First, does the tax regime provide definitions of terms like disposal, chargeable events, chargeable assets, qualifying assets, qualifying shares etc.? Sales, gifts and exchanges would be instances of natural disposals.

Second, would a transfer between husband and wife be a chargeable transfer? What about disposals of private motor vehicles, tangible moveable property (chattels like household goods and personal effects, worth less than a defined amount) and the receipt of winnings from betting (including pool betting, lotteries or games with prizes)?

Third, would the capital gains tax regime provide relief for first-time homeowners? The purpose of the relief would be to enable a person to replace their existing home with another home of similar value by ensuring that the proceeds of the sale of the old home are not diminished by a capital gains tax. So in most cases the gain arising on the disposal of a person's home would be relieved from capital gains tax. Private residence relief would be available where a gain arises from the disposal of an interest in a dwelling house, or part of a dwelling house, which has at some time been its owners only or main residence.

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Fourth, would the capital gains tax regime provide relief when assets or property are reinvested or reorganised? This type of roll-over relief would enable traders to modernise, expand and relocate without loss of capital to an immediate tax charge.

There could also be roll-over relief for individuals whereby it would allow chargeable gains on qualifying disposals of certain shares to be rolled over where the chargeable gain was reinvested in qualifying shares.

Fifth, we should ask whether the National Treasury or other agencies will use technology to track property and its owners. This property could include financial instruments or physical assets such as land and buildings.

Technology would help Treasury to track assets, which in turn should make it easier for them to collect revenues arising from capital gains. There could also be other benefits such as preventing terrorist financing.

Finally, we should ask whether gains arising due to inflationary pressures will be taxed, and whether an indexing factor will be considered for the valuation of costs of property. The basic principle would be that capital gains tax would be charged on the actual gain from the date of acquisition. It could, however, be argued that capital gains tax is a tax on gains in true money terms.

Therefore the price actually paid by a taxpayer should be reassessed to take into account the fall in value of the shilling. Would the KRA consider introducing tax relief for inflation? In most jurisdictions around the world, there is the concept of 'indexation allowance' in respect of calculating capital gains.

Ideally, the process of reintroducing Kenya's capital gains tax should be consultative and take into account the views of relevant stakeholders.

Tax revenue allows Kenya to achieve many of its development goals but as we craft a more modern tax regime to finance development, we must also consider the impact of tax collection on growth. It is a delicate balancing act, requiring deep and meaningful dialogue. We look forward to this process in the weeks and months ahead.

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