

Sagamore Hill. TAX NEWSLETTER.



"Navigating Capital Gains: Your Comprehensive Guide to Tax Efficiency "

Page 2

Background of
the case

Page 3-4

Issues of determination.
Further discussion

Page 5-8

Capital gain Tax: transfers,
costs, valuation and
exemptions

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In our aim to keep you updated and knowledgeable to matters of tax, every month we do an analysis of the most downloaded tax case law from our [data base](#).

This month's newsletter, we delve into an interesting case that involved capital gains tax.



The case involved an internal restructuring at equity bank and a subsequent assessment by Kenya Revenue Authority.

The case revolved around the nature and time of transfer in what turned out to be very interesting turn of events.

Following the completion of the restructuring, Kenya Revenue authority conducted a review of the restructuring and determined that Capital gain tax was due, consequently giving an assessment arising from the transfer of Assets from the Equity Bank Limited to Equity Group amounting to Ksh 330M including penalties and interest on 10th Oct 2016.

The appellant sought to resolve the matter by meeting with the respondent but this proved to be unfruitful and on 9th Nov 2016, the appellant filed a notice of objection.

The respondent reviewing the objection, raised the demand to Ksh 820M vide a letter dated 9th January 2017 being the objection decision.

The grounds for the appeal were as follows

1. The objection decision issued was invalid as it was not made and communicated within the 60 days timeline that a valid objection should be lodged as per the Tax Procedure Act.
2. The objection decision being invalidly lodged and not communicated within the 60 days allowed by the law, resulted to the appellant objection being allowed.
3. The respondent erred in law in finding that the appellant made a gain in the transfer of banking net assets to EBK and the appellant being liable to pay capital gains.
4. The respondent failed to take into account all the documents in determining the applicability of capital gain tax to the transaction and therefore arrived into an assessment that had no basis and was otherwise ill-conceived, unreasonable and flawed.

In response, the respondent prayed that the objection be upheld on the following grounds.

That the objection was communicated within the required days according to the law and was not time barred. Indeed, the objection was delivered on 9th January and a copy delivered the appellant tax consultant on the same day, 9th January 2017.

That the actual transfer of the assets occurred on 14th January 2015 when the Statement of Nominal capital was duly registered at the registrar of companies.

This therefore means that the appellant was supposed to pay Capital Gain Tax on the transfer under the provision of the Income Tax Act Section 3(2)(f).

The respondent relied on the formulas contained in the Business Transfer Agreement which outlined how to calculate the book value of the transfer

In light of the forgoing the issues of determinations were narrowed down to three.

1. Whether the objection Decision dated 9th January was within the time prescribed by the Tax Procedures Act
2. When the transfer of the assets from EBL to EBKL was completed.
3. Whether the appellant reorganisation transaction attracted Capital Gain Tax.

On whether the Objection decision dated 9th January.

The appellant argued that Section 5(11) of the tax producers Act required the respondent to provide the appellant with an objection decision within 60 days failure to which the appellant objection would automatically be allowed.

The appellant further clarified that they filled their notice of objection was lodged on 9th Nov 2016 and therefore the objection decision should have been issued on or before Sunday of 8th January 2017 since section 77 of the Tax Procedures Act required that if a day falls on a Sunday, Saturday or a public holiday, the due date shall be the previous working day and therefore, the objection decision should have been issued on Friday 7th January 2017. Therefore, the Objection decision being communicated on 9th January was in complete disregard of the TPA section 77 and 55(11).

The appellant relied on two caselaws to further buttress his stand, that of *Ceanest Air vs Kenya Shell limited 2002* and where the court held that any an objection decision issued after the 60 days as provided by the law was invalid and did not have any effect.



The other case law the appellant relied on was that of *Republic Vs Commissioner of Customs Service Ex-parte Unliver Kenya Limited 2012* where the court held that if the commissioner of customs does not respond within the allowed days, then the respondent shall be deemed to have made a decision to allows the appellants application.

In response, the respondent argued that the court adopts a purposive interpretation of the provision and dispense justice on the matter, rather than dwelling on the technicalities to dispense the matter.

That the court looks into the merits in the dispute and administer justice without undue regard to procedural technicality.

As to when the transfer of the assets took place.

The appellant argued that the transfer was completed on 31st Dec 2014 and the following events do indeed support this stand.

- EBKL processed customer deposits from 1st January 2015 which could not be possible had the banking assets such as soft wares, equipment and customer deposits were transferred.
- A public pronouncement was done on 1st January 2015 pursuant to CMA regulations on Public offers, Listing and Disclosures, the appellant disclosed that

it had transferred its assets and liabilities to EBKL and that the transfer was effected on 31st Dec 2014 2359Hrs.

- The appellants licence was withdrawn with effect from 1st Jan 2015 and was subsequently prohibited from accepting customer deposits by the Banking Act

The appellant further argued that the respondent failed to distinguish the point and date of transfer to assets from the date of the payment of the consideration by way of issuing of shares. The appellant made reference to the Sale of Goods Act section 19 and 20 which provides that the terms of the contract, the conduct of the parties and the circumstances of the case dictate when the transfer occurred. Section 20 in specific states that the date of delivery, the date of payment or both are immaterial as to the determination of the time of the transfer.



In response, the respondent stand was that... The statement of increase of nominal capital and special resolution dated 2nd January 2015 was endorsed by the registrar on 14th January 2015 and that this provided evidence that the whole restructuring has not been completed by December 31st 2014.

That the appellant was required to comply with other statutory regulations and laws so as to effect the transfer of all assets and liabilities

which had not been done by 31st December 2015 as provided by the Banking Act.

Even though the date of the transfer is provided in the transfer Agreement, some assets had to undergo separate registration process at either the office of the registrar of Lands or Registrar of companies and these assets included investment properties, and properties and equipments which must all be transferred at their own account.

The above reinstated the respondents' argument that until the transfer of all assets had been done, and compliance with all laws fulfilled, the transaction was not complete and this is where the tax point lies.

On whether the appellant's reorganisation transaction attracted capital gain tax, the appellant argued that no gain was realised in the transfer of assets from EBL to EBKL with the respondents arguing that it relied on the formulas provided by the appellant on determining whether there were gains on the transfer.

The Courts analysis and findings were as follows.

1. As to whether the objection decision was time barred,

The court held that in light of the constitution of Kenya, Article 159, in order not to shut out the respondent on a technical ground and admitted the objection decision.

The tribunal also held that the delay on the side of the respondent was not inordinate as to conclude that the appellant would have suffered great prejudice.

2. As to when the transfer of the banking assets was done,

The court ruled that the appropriate legal provision applicable in the following case was the Banking Act and not the Companies Act as the respondent argued, or the Sales of Goods Act as the appellant argued.

The Banking Act was the only act that determined when the transfer of a financial institution occurred in section 9(1).

Sec 9(1) states that the Cabinet Secretary of Treasury has to give an approval for the transfer and until this is done, no change in the transfer of assets shall be effective...

No amalgamation or arrangement which involves an institution as one of the principal parties to the relevant transaction, and no arrangement for the transfer of all or any part of the assets and liabilities of an institution to another person, shall have legal force except with the prior written approval of the Cabinet Secretary.

Section 9(8), as relied on by the respondents only acts as an endorsement of the change of status. It states,
The Registrar of Companies and the Registrar of Titles, and every officer or person in charge of a deed registry or any other relevant office shall, if in his office or in any register under his control—

- (a) there is registered any title to property belonging to, or any bond or other right in favour of, or any appointment of or by; or*
- (b) there is registered any share, stock, debenture or other marketable security in favour of; or*
- (c) there has been issued any licence to or in favour of, any amalgamating or transferor institution, and if satisfied—*
 - (i) that the Cabinet Secretary has approved the amalgamation or transfer pursuant to subsection (1); and*
 - (ii) that such amalgamation or transfer has been duly effected,*

On this matter, the tribunal was not shown any approval from the CS effecting the transfer even

though this happened after December 31st 2014.

3. On whether the appellant

reorganisation attracted capital gains,

it was established that this was not the case as there was no transfer of the assets to a third party. The operative of capital gain is such that the tax payable is a percentage of the difference in value of transfer and acquisition costs.

In this case, such an increase in the value of liabilities and net assets would be reflected in a gain in the shareholders' wealth, in this case the share premium account.

An increase in the share premium account would have signified an increase in value which for the purpose of this case, that did not happen.

- ❖ In light of the above foregoing, the appeal was allowed.

Far and above this, we will, for the sake of this newsletter delve further into the issue of capital gain tax as envisioned in the Income Tax Act.

As a brief history, capital Gain tax was re-introduced in Kenya in 2015 at the rate of 5% after being suspended in 1985. The rate has since changed vide finance act 2022 to 15%. Capital Gain Tax is a type of tax that is levied on gains made from the transfer of property situated in Kenya whether or not the property was acquired before 1st January 2015 (When the capital gain tax was re-introduced).

The income tax Act provides in a comprehensive manner, does have provisions that the tax payer is required to adhere to, in determining the amount due for tax, where applicable.



The 8th Schedule of the Income Tax Act, section 6(2), there are various types of inter party transfers that would not constitute a transfer that would attract capital gain tax. These transfers include;

1. Transfer of a property for the purpose of securing a debt or a loan, or a transfer by a creditor of a property that had been used as a security for a debt.
2. Issuance of shares or debentures by a company.
3. Transfer by a personal representative of any property to a person as beneficiary in the course of the administration of the estate of a deceased person.
4. transfer by a trustee of property, which is shown to the satisfaction of the Commissioner to be subject to a trust, to a beneficiary on his becoming absolutely entitled.
5. Transfer of property between spouses.
6. Transfer of property between former spouses as part of a divorce settlement.
7. Transfer of property to an immediate family
8. Transfer of property to an immediate family member as part of divorce settlement.
9. Transfer to of assets to a company where spouses or a spouse and immediate family have a 100% shareholding.

Further, there are several transactions that are exempt for Capital Gain Tax as envisioned in the

first schedule. These are incomes from;

1. Transfer of a private residence if the individual owner has occupied the residence continuously for the three-year period immediately prior to the transfer concerned in determining the transfer in the above, the following is to be put into consideration,
 - a. Any period that they were temporarily absent from the residence shall be ignored.
 - b. Surrounding land utilised for personal purposes shall be included and any part of the residence and land utilised for business shall not be included.
 - c. One cannot claim to have more than one residence.
 - d. No individual shall claim or be taken to have used a residence as a residence at any time when he was a dependant of either or both of his parents
 - e. Where a residence is used in part for business purposes, or is transferred in a single transaction together with land and other property used for the production of income, the taxable value of such property used for residential purposes shall be separately determined from that used for business purposes or for the production of income.
2. Land transferred by an individual and has a value of less than Ksh 3 Million shilling is exempt from capital gain tax.
3. Agricultural land transferred that has an area of less than 50 acres and situated outside a municipality, a township, or an urban area as may be declared by the minister by a notice in a gazette.

4. Property (including investment shares) which is transferred or sold for the purpose of administering the estate of a deceased person where the transfer or sale is completed within two years of the death of the deceased
5. Property, including investment shares, which is transferred or sold for the purpose of transferring the title or the proceeds into a registered family trust.



In our discussion, elsewhere in this newsletter, we have seen that the transferor will pay Capital Gain Tax on the net gains accruing on a transfer of the said property. This, therefore, would mean that a tax payer has provisions to deduct some qualifying costs as we shall discuss them.

The net gain subject to the provided percentage of capital gain tax is computed as follows,

Net Gain = (Transfer value – Incidental Costs on Transfer) – Adjusted Cost (Acquisition Cost + Incidental Costs on Acquisition + enhancement if any Cost)

For the purposes of ascertainment of the value of property in question, the transfer value will be considered to be any or combination of the following,

1. Value of the consideration paid.
2. Sums received for abandonment, forfeiture or Surrender of the property.

3. Sums received for compensation of damage or injury to the property or loss of a property.
4. Sums received under an insurance policy for loss, damage or destruction of the property.
5. Where no amount is ascertained, the transfer value shall be the market value of the property.

The adjusted costs include.

1. The cost of acquisition or construction of the property.
2. The cost of enhancing or preserving the value of the property at the time of transfer.
3. Amounts incurred after acquisition in establishing, preserving or defending the title to, or a right over, the property; and
4. Incidental costs to the transferor of acquiring the property.

The incidental costs include such costs as

- A. Fees, commission or remuneration paid for the professional services of any surveyor, valuer, accountant, agent or legal adviser;
- B. Costs of transfer (including stamp duty);
- C. In the case of an acquisition, the cost of acquisition (including mortgage costs) and the cost of **advertising** to find a seller, and costs reasonably incurred in **making** any valuation or in **ascertaining** market value;
- D. In the case of a transfer, the cost of advertising to find a buyer and costs reasonably incurred in making any valuation or in ascertaining market value;
- E. Any other costs which the Commissioner may allow as being just and reasonable.



It is important to note that, the following pointers while including the amounts that qualify as deductions while arriving at the net gain;

- The costs that have been allowed for deduction in an income chargeable to tax under Section 3(2)(a) of the Income Tax Act shall not be allowed for deduction. This would mean that the costs the tax payers incurred, have not been claimed elsewhere as to reduce the tax payable. This is only right and justifiable as claiming expenses more than once would put the tax payer at an advantaged position, and yet, this is not the practice.
- Any incidental costs deducted by the transferor while making the transfer shall not be included. This buttresses the point discusses above. This again would mean claiming of expenses more than once.

In closing, section 8 of the eight schedule further exempts a transfer that is necessitated by a transaction involving the incorporation, recapitalization, acquisition, amalgamation, separation, dissolution or similar restructuring of a corporate entity, where such transfer is -;

- (i) A legal or regulatory requirement;
- (ii) As a result of a directive or compulsory acquisition by the government.
- (iii) An internal restructuring within a group which does not involve transfer of property to a third party; or
- (iv) In the public interest and approved by the Cabinet Secretary.

If you wish to deepen your understanding of taxation, reading tax case laws is the most useful way.

Tax planning, to a great extent, is understanding a tax payer's obligations, while making use of all the provisions that has been provided in the law so that the tax payer only pays what is rightfully due to the taxman.

In our discussion above, tax payers are encouraged to make use of the legal provisions in the various tax acts to enhance compliance on their side.

At [Sagamore Hill](#) we have case laws classified in the tax categories that they fall in for ease of your perusal.

Do not hesitate to talk to us via info@sagamorehill.co.ke