Capital gains tax is complex and calls for careful administration

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Major tax hike

The government, through the Finance Act 2022, amended the capital gains tax as provided for in the Income Tax Act from 5% to 15%. This is good for government, which seeks to seize any opportunity to enhance the revenue basket. However, the tripling of the tax shocked those targeted, and could beget the taxman mixed results.

Tax applicable to land and buildings

Capital gains tax is chargeable on gains or profits made on the transfer of land, buildings or market securities. The tax is payable by the transferor, or the person transferring. Where property is involved, the tax is calculated from the gain between the cost of acquiring a property and the cost of selling it, taking into account any input costs such as value enhancement and professional fees.

Capital gains tax isn't well understood in our jurisdiction, and often leaves ordinary investors on land and property a little perplexed. It's therefore prone to evasion, an issue that Treasury should keep its eyes on even as it seeks to draw more from this stream. . In some jurisdictions, the tax is levied to curb speculation, especially in real estate. One wonders whether this may have motivated Kenya's application of this tax and its subsequent hike, or that Treasury is merely doing its usual thing of widening and deepening the tax basket.

Justification

Some proponents have justified the tax by arguing that gains or profits made as a result of environmental factors attributable to the government or the abutting community, without any actions by the owner, should be taxable. This may for instance be the construction of a road, power infrastructure, school or University. It could be a dam such as Thiba in Kirinyaga County, or an Investment Park such as Konza in Machakos County, all which catalyse value increases of surrounding properties. In all the cases, the corresponding property value gains are independent of owner actions or inputs. It has also been argued that capital gains enhance a person's taxable capacity, and should therefore be taxed to ensure equity in tax administration.

Inadequate technical capacity and cadastre gaps

But taxing capital gains can be subtle, and, ironically, could end up promoting inequity. For instance, owing to the inadequate capacity to value specific properties at the time of sale, value generalizations or projections may be done, which could occasion the understatement of sale prices. In other cases, proprietors may not remember the costs of property acquisition. Others deliberately conceal the acquisition and/or sale values in order to minimize the taxable gains, or evade tax. In the vast areas home to community land in Kenya, land hasn't been brought under the cadastre and is therefore "invisible" to the taxman. Yet informal and profitable property transactions continuously happen. Similarly, transfers of unregistered properties happening in our urban areas evade this tax.

Inflation distorts gains

Furthermore, due to inflation, increase in property values may not always be directly attributable to corresponding increases in real values. Such disparity calls for adjustments for inflation, which isn't done. This hurts such investments and ways should be sought to factor in appropriate corrections and minimize loss.

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