Court Rules Simultaneous Payment of CGT and Stamp Duty by Chargees on Charged Property Unfair and Unreasonable

Tax Alert 02-2020

In a ruling delivered by Justice Ouko (p), Justice Okwengu and Justice Sichale in **Civil Appeal No. 13 of 2018** ***Kenya Revenue Authority V. Kenya Bankers Association,*** the court ruled that banks in their capacity as chargees of land **should not** be required to pay capital gains tax simultaneously with stamp duty while transferring property under their statutory power of sale.

In the Court's words, the unilateral decision made by KRA of twining the payment of CGT and Stamp Duty and as a result requiring banks, in exercising their statutory power of sale, to collect CGT from their borrowers was unfair and irregular.

Key definition

A charge is an instrument that facilitates transfer of a chargor's property upon default of loan repayment.

It is worth noting that when banks give loans with security, a charge over the security is created where the bank is the chargee and the borrower is the chargor of the property. In case of payment default the bank take possession of the property and has statutory power to sell the property to recover the unpaid loan sum.

Background

On 4 October 2016, KRA issued a public notice in the Daily Newspaper introducing the simultaneous payment of CGT and Stamp duty during the transfer of land. In 2017, the KRA implemented this action by twinning CGT with stamp duty in the iTax system, which made it mandatory for transacting parties to declare CGT before paying stamp duty. The move was intended to ensure compliance with CGT payment by proprietors of land.

Issue at hand

Banks, being the main lenders, were adversely affected by this action as its effect was to transfer the burden of assessing and payment of CGT on the chargee and third party purchasing the property, which is ordinarily the obligation of the proprietor/owner/defaulter. In the event that they exercised their statutory power of sale, they would be required to self-assess and pay CGT before paying Stamp Duty on iTax.

Legal redress

Aggrieved, the Kenya Bankers Association (KBA) instituted a Judicial Review Application to challenge the implementation of the administrative action. On 13 March 2018, a ruling was issued in favour of KBA citing the action as unreasonable, unfair and influence by an error of law.

Dissatisfied with the first ruling, the KRA filed the Appeal forming the subject matter on 2 July 2018, relying on the following grounds;

- That the court of first instance erred in fact and law by finding that the chargee does not acquire the proprietary rights of the chargor in exercising its statutory power of sale
- That the court erred in fact and law by finding that the chargee had proprietary rights on the charge and not the charged land
- That the chargee indeed is in a position to calculate CGT when exercising their statutory power of sale

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- That the court of first instance, in delivering the ruling ignored the provisions of the Income Tax Act and the Land Act, 2012 obligating the chargee to pay CGT.

In their submissions/response, the Kenya Bankers Association contended that;

- Being chargees, they do not have proprietary rights over the charged land under Section 80 (1) of the Land Act, 2012 and Paragraph 5 (2) of the Eighth Schedule to the Income Tax Act. They were only nominees of the property.
- Monies received from disposal of a charged property is used to settle the defaulted loan.
- CGT is tax imposed on income and not on land and therefore should not be paid before the transfer is complete and money received.
- Requiring simultaneous filing of CGT without ascertaining whether there is a gain is unreasonable and unfair.
- Article 47 of the Constitution of Kenya and 4(2) of the Fair Administration Act, 2015 were ignored when the notice was made thus infringing on the respondents rights.

The Court of Appeal sided with the respondents by dismissing the appeal giving the following reasons;

1. The power given to a chargee of the property of a loan defaulter is that of statutory sale and not that of the proprietor of the property.
2. Under Paragraph 5(2) of the Eight Schedule to the Income Tax Act quoted by both parties, the chargee is considered by law to be the nominee of the proprietor during the sale and not the proprietor. Stating otherwise would place the chargee and the chargor on equal footing thus thining the distinction between the chargor and the chargee.
3. CGT should indeed be paid on the income gained from disposal of the property and therefore should not be paid before the money is received.
4. That indeed Article 47 of the Constitution of Kenya and 4(2) of the Fair Administration Act, 2015 which provides that if a right or freedom of a person is likely to be adversely affected by an administrative action, they have the right to be given written reasons. The action by KRA was unilateral and without consultation of stakeholders.

Our take.

The main intention of the KRA was to increase revenue. This intention was indeed achieved as CGT revenues grew from Sh635 million in 2015 when the tax was reintroduced to an average of Sh3 billion in the recent financial years.

However, while this is a plus for the KRA, care has to be taken to avoid interference with the tax incidence regulations. CGT should be paid by proprietors, having ownership of property and not persons having possession. The aim of a charge is to secure settlement of a loan and not to make profit. Of course, what happens in actual practice may be different but the law has to be upheld.

This ruling was a welcome relief to banks who stood to lose millions if they were forced to pay CGT on property belonging to tax defaulters, most especially if the value of the property was lower than the loan sum advanced plus interest.

Our Value Addition.

Should you seek further information on the topic or need assistance in filing CGT and/or Stamp Duty, you are welcome to contact us through our contacts below;

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