Tax alert: Corporation tax on sale of land

Background

This alert brings to your attention the Tax Appeals Tribunal's (TAT) decision in the case of ***Ruaraka Diversified Investments Limited (Appellant) vs. Commissioner of Domestic Taxes (Respondent), Tax Appeal No. 86 of 2019.***

The Appellant had moved to the TAT seeking to overturn the Respondent's corporation income tax (CIT) assessment amounting to **KES 672,150,686** on sale of land for the period 2013 – 2015.

The Appellant was registered in Kenya in April 2012 as a branch of a Mauritius company to invest in real estate. Prior to registration of the Kenyan branch, the Mauritius company had undergone multiple changes in its name.

The Appellant bought 13.01 hectares (equivalent to 34.14 acres) of land for **KES 1.2 Billion** for development of the Garden City project. Between 2013 and 2015, the Appellant subdivided and sold 29.5 acres to three entities (two of which are related entities) at **KES 2.7 Billion**.

The Appellant (Using the name Actis Properties East Africa Limited) sought for a private ruling from the Respondent on applicability of Capital Gain Tax (CGT) on the above sale. The Respondent confirmed that the sale was subject to CGT and the Appellant paid **KES 43.9 Million** as CGT.

In 2018 the Respondent revoked its private ruling citing substantive misrepresentations by the Appellant and assessed corporation tax of **KES 672.2 Million** on the sale of the land. The Appellant lodged an appeal at the TAT against the Respondent's decision in 2019.

The Appellant's grounds of appeal at the TAT

The Appellant challenged the Respondent's decision on the grounds that the Respondent erred:-

a. In finding that the Appellant's principal business activity is that of land development and sale;

b. In assessing CIT on the proceeds of the sale of land rather than CGT;

c. In assessing CIT on the land outside the five-year statute of limitation provided for under the Tax Procedures Act (TPA), 2015; and

d. In finding that the Appellant misrepresented the transaction when seeking the private ruling.

The Respondent's submissions

In rebutting the Appellant's arguments at the TAT, the Respondent stated that:

e. The Appellant was incorporated in 2010 and purchased 34.14 acres of land in 2011 at KES 1.2 Billion. They improved and subsequently sold the land making a profit of KES 1.5Billion on which they accounted for CGT.

f. The Appellant is not an Investment Holding Company as demonstrated by the description of its core activities in the company's financial statements.

g. The Respondent was not barred from amending the Appellant's returns that were filed in 2015 and 2016 as this was within the statutory time limit of 5 years.

h. The application for a private ruling was done by Actis Properties East Africa Ltd (Actis), a non-resident company which claimed that they had received an offer to sell land but did not disclose that the land in question was owned by the Appellant. In addition, the application did not disclose the Appellant's core business.

i. The Respondent relied on incomplete and inaccurate information hence the reason for revoking the private ruling.

Issues for determination

The issues for determination were whether the:

i. (i) Respondent's decision was a private ruling within the provisions of the Tax Procedures Act, Act No.29 of 2015 (TPA);

i. Respondent's private ruling gave legitimate expectation to the Appellant on the treatment of the gains as capital gains;

i. Appellant made substantive misrepresentation when it sought a private ruling; and

i. Income realised by the Appellant from the land transactions was business income or capital gains.

The TAT finding

The TAT dismissed the Appellant's case, holding as follows:

a. Section 65 of the TPA requires the TAT to test whether the Appellant included all relevant details and documents, specified the question to the Respondent for interpretation and made complete and accurate disclosure about the sale of land. The TAT agreed with the Respondent that the Appellant made the following substantive misrepresentation of facts:

- The private ruling application stated that the entity involved in the transaction was Actis and not the Appellant; and
- The application portrayed it as a one-off, unanticipated transaction rather than within the nature of the Appellant's business of land development and sale.

The TAT concluded that the Respondent in the circumstances did not issue a private ruling within the context of Section 65 of the TPA.

b. The Respondent's private ruling did not give rise to legitimate expectation because the Appellant made substantive misrepresentation when it sought a private ruling.

c. The Appellant's transactions were in the nature of trade and not investment. The TAT applied the badges of trade concept as follows to reach its decision:

i. Profit motive: The Appellant's objective was to acquire the land and sell it at a profit without any intention of holding it as an investment;

ii. Modification of an asset in order to make it more saleable: The Appellant made improvements such as infrastructure to increase the value of the land; and

iii. Length of ownership: The Appellant sold the land within 3 years. It bought the land in 2011, improved it in 2012, sold the first property in 2013 and the other two in 2015. According to the TAT, the Appellant intended to sell the land shortly after purchase.

d. The TAT upheld the Respondent's assessment of CIT on the transaction.

Our opinion on the judgment

This judgment brings a couple of important issues into focus. The first relates to private rulings issued by the Kenya Revenue Authority (KRA). Based on the Tribunal's judgment, taxpayers cannot rely on private rulings if they did not make complete and accurate disclosure and provide all relevant details and documents when applying to the KRA. Material non-disclosure and substantive misrepresentation will render the private ruling void meaning KRA can issue assessments retrospectively.

The second salient issue brought out by the judgment relates to the distinction between business profits and capital gains. This is particularly significant for players in the real estate sector. The Tribunal distinguished between investment holding and trading activities using the badges of trade concept to determine the nature of the Appellant's income.

This case shows that it is important for taxpayers to be consistent in describing their principal activities. In this case, the Appellant's business activities in the financial statements were consistently described as that of land development and sale, which undermined their claim that the land was held for investment.

KPMG is happy to assist on any issues arising from this decision.

Contacts

Clive Akora
Partner/Director
Tax and Regulatory Services
KPMG Advisory Services Limited
E: cakora@kpmg.co.ke

Stephen Waweru
Senior Manager
Tax and Regulatory Services
KPMG Advisory Services Limited
E: swaweru@kpmg.co.ke

Alex Kanyi
Regulatory Lead
Tax and Regulatory Services
KPMG Advisory Services Limited
E: akanyi@kpmg.co.ke

home.kpmg/ke/en/home