REITS ASSOCIATION OF KENYA (RAK)

NEWSLETTER

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EXPLORING TAXATION AND REITS IN AFFORDABLE HOUSING

CONTENT

Welcome Note from the **RAK Chairman**

A warm welcome to the 12th edition of the RAK Newsletter, where we embark on a journey to explore and unlock the immense potential of Real Estate Investment Trusts (REITs) in Kenya and the wider East African region.

I am pleased to share some exciting developments in the Kenyan REITs market.

The REIT Toolkit and Incubator Program has made significant progress, with the Toolkit in its final stages and a highly successful inaugural workshop held on July 5th, 2023. This event featured engaging panel discussions and insightful presentations, sparking great interest, and leading to ongoing discussions with potential REIT issuers.

Looking ahead to the RAK Conference 2023, attendees can anticipate the formal launch of the REIT Incubator Program, toolkit documentation training sessions, and collaborative pitch sessions for investment opportunities. The conference is set to bring together a diverse array of renowned international experts, policymakers, investors, and real estate professionals featuring keynote speeches, panels, and plenary sessions. These sessions are meticulously designed to delve into the sector dynamics, enhance awareness about REITs as vital catalysts for economic growth, pinpoint critical policy reforms, explore lucrative investment avenues, and disseminate insights from triumphs in the realm of REIT projects. I encourage each of you to attend, seize the networking opportunities, and leverage this exceptional platform to its fullest potential.

The RAK Tax Working Group continues its efforts to advocate for the reinstatement of various tax incentives benefiting REITs, with a specific emphasis on stamp duty. These discussions have been integrated into a comprehensive policy document submitted to relevant authorities, including the Capital Market Authority and national treasury for evaluation and consideration.

RAK is currently in discussions with the African Securities Exchanges Association (ASEA) to explore the creation of a Pan-African REIT platform. Additionally, ILAM Fahari I-REIT strategically transitioned to a Restricted I-REIT, endorsing a redemption offer covering 36,585,134 units from Non-Professional Investors. This transformation addresses evolving market dynamics and investor needs, empowering ILAM Fahari I-REIT to seize specific opportunities and foster sustained growth for professionals and non-professionals alike.

In our commitment to fostering growth, RAK has formed strategic partnerships, including two Memorandums of Understanding (MOUs) signed with Strathmore University to collaborate on research and allied endeavours promoting REIT growth in Kenya and Women in Real Estate to advance gender inclusion within the Real Estate Sector.

Our membership base is expanding, with the recent addition of esteemed organizations and professionals, including the Association of Pension Trustees &Administrators of Kenya (APTAK), The Kenya Development Corporation (KDC), Konza Technopolis Authority (KOTDA), Catalyst Principal Partners (Construct Africa LLC), Dowgate Properties Limited, Sameer Africa PLC, Zima Homes, Crispus Kamau, Samantha Muna, Sarah Wairimu Gitau, and Freda Rutere.

I invite you to join RAK's membership to access diverse opportunities within both the real estate and capital markets industries.

Enjoy the Read!

Kenneth Masika
RAK CHAIRMAN

Harnessing Real Estate Investment Trusts (REITs) to Accelerate Affordable Housing Development in Kenya by TripleOKLaw Firm

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Introduction:

Housing affordability is a perennial agenda item for successive governments. This enduring challenge arises from demographic shifts, urbanization trends, and economic dynamics. The persistent need for affordable housing solutions underscores the gravity of the issue, requiring governments to develop strategies that are not only responsive but also forward-thinking and adaptable. Real Estate Investment Trusts (REITs) offer a compelling solution that aligns with the government's development strategy while providing a robust platform to catalyze the creation of affordable housing units.

Affordable housing REITs are not a new phenomenon in the real estate market globally, and they have demonstrated success rates in various markets. REITs have a long history of participation in the construction and management of affordable housing units in the United States tracing back to the 1950s. The Community Development Trust (CDT) was the first REIT to be established in 1989, and it is one of the largest REITs in the US that focuses on investing in affordable housing. The growth of the CDT has been largely attributable to the government programs that run in parallel to enable the private sector to participate in the affordable housing sector.

Bringing the focus closer home, Ghana is among the African nations that have embraced REITs as a solution to the growing demand for affordable housing. In 2015, the government introduced the National Housing Policy, paving the way for the establishment of the National Homeownership Fund, NHF (formerly, National Housing and Mortgage Fund, NHMF) in partnership with GCB Securities. [1]This collaboration led to

1 National Homeownership Fund (2023) Available at: https://www.nhf.gov.gh/background (Accessed on 15 September 2023).

the creation of an Affordable Housing Real Estate Investment Trust (REIT) aimed at offering rental homes to public sector employees.

The scheme operates on a rent-to-own model, allowing public sector workers to access decent and reasonably priced homes for a duration of 15 to 20 years, with the option to own the property by paying a residual value. This ownership opportunity comes with lower interest rates ranging from 11.9 to 12.5 percent, in contrast to the typical minimum rate of 24 percent for mortgages denominated in the local currency.[2] While the scheme in Ghana is still in the process of being fully operationalized, its successful initial implementation serves as a positive indicator for a developing country.

In view of the growing demand in Kenya for affordable housing due to population growth, urbanization, and economic factors, this demand provides a stable tenant base for affordable housing REITs. This article delves into the transformative potential of REITs and their capacity to assist the Kenyan government in realizing its ambitious affordable housing programs, all while fostering capital market investments and economic growth.

The Role of REITs in Affordable Housing:

REITs are poised to play a pivotal role in reshaping Kenya's affordable housing landscape due to their distinct characteristics. As investment vehicles specifically designed for real estate, REITs provide a unique mechanism for both retail and institutional investors to participate in the real estate market. By pooling resources, investors gain access to a diversified portfolio of real estate assets, minimizing risk and enhancing the attractiveness of real estate investments. Their comparatively low correlation with other assets makes them an excellent portfolio diversifier that can help reduce overall portfolio risk and increase returns.

1. **Access to Capital:** REITs act as conduits that enable both local and foreign investors to pool resources. This collective capital facilitates the financing of large-scale real estate projects, offering the potential to accelerate the construction of housing units designed to cater to the diverse needs of various income segments. The government's support for the issuance of state-backed REITs provides a crucial avenue for individuals to participate in these investments, thereby democratizing access to the benefits of real estate ownership.

2. **Risk Mitigation:** The unique structure of REITs allows for risk diversification across multiple projects. This strategy effectively mitigates the risk associated with individual undertakings, making REITs an attractive avenue for risk-conscious investors. For affordable housing initiatives, risk diversification ensures the sustained development of housing units tailored to different economic groups. The Capital Markets Authority (CMA), in collaboration with various industry playershas been working towards the creation of a Kenya National REIT (KNR). As the government promotes the establishment of the KNR, the potential to harness the power of REITs to address housing challenges is further amplified.

3. **Tax exemptions:** In the case of REITs in Kenya, various exemptions have been implemented towards REITs as one of the tax neutrality measures with the aim of promoting effective roll out of new capital markets products and services. The exemptions are major incentives designed to encourage the growth of REIT funds which allow the public to invest in the property market without requiring large cash investments.

4. **Preservation of Existing Affordable Housing:** REITs may acquire existing affordable housing properties to prevent their conversion into market-rate housing or to renovate and preserve the affordability of these units, thereby generating the much-needed capital to developers to continue constructing additional units.

5. **Stable income stream for investors:** REITs generate a recurring stream of income since they (especially Income REITs) are legally required to distribute at least 80% of their

2 Affordable housing in Ghana: Market shaping indicators, Centre for Affordable Housing Finance in Africa (2020)

net after tax income to unitholders. REIT products have room for 'growth potential', which means that investors have the chance to receive higher returns over time. This is because the underlying assets of a REIT's portfolio contain real estate, which has the nature of unearned increment in the long run.

The Government's Forward-Thinking Approach and Incentives:

The Kenyan government's proactive engagement with REITs as a catalyst for affordable housing is evident through its multifaceted efforts and policy initiatives. The issuance of state-backed REITs through capital markets not only provides potential investors with tangible pathways to homeownership but also demonstrates the government's commitment to fostering private sector involvement in affordable housing solutions. Moreover, the anticipated establishment of the KNR showcases the government's strategic alignment with the Economic Transformation Agenda, affirming the substantial role REITs play in addressing affordable housing challenges.

The amendment of sectoral laws and regulations to facilitate investment in affordable housing REITs would also be a welcome initiative. For instance, inclusion of affordable housing schemes as an investment class under the Insurance (Investment Management) Guidelines, 2017. However, as highlighted above, the success of affordable housing schemes globally is largely credited to government programs and incentives that ensure returns from the scheme are comparable to other investment portfolios.

Taxes are a key policy tool in the achievement of most government initiatives. It bears noting that the government has provided an array of tax incentives to individuals and developers to encourage home ownership. For developers, in the case of a company that has constructed at least 100 residential units annually they are entitled to a reduced corporate income tax rate of 15 percent for that year of income, subject to approval by Cabinet Secretary responsible for housing.

To encourage private sector participation, the government is embracing a strategy that fosters experimentation with affordable housing-tailored REITs. This forward-thinking approach seeks to optimize the effectiveness of such REITs while concurrently stimulating investments within capital markets. The synergy between REITs and the government's developmental objectives underscores a collaborative partnership where private sector growth advances the government's commitment to affordable housing.

REITs as Catalysts for Affordable Housing Development:

The government's proactive stance on REITs carries numerous benefits that extend beyond housing development. By embracing REITs as a mechanism to address affordable housing, the government stands to gain in several critical areas:

1. **Public-Private Partnership:** REITs provide a fertile ground for public and private sector collaboration. Through partnerships with real estate developers and investors, the government can harness private sector expertise, capital, and innovation to expedite the creation of affordable housing units. This synergy ensures that development targets are met efficiently and effectively, translating into tangible benefits for citizens.

2. **Access to Capital through Capital Markets:** By leveraging REITs, developers gain access to capital through the Capital Markets. This strategic channel ensures the availability of funds necessary to meet the growing demand for purpose-built real estate solutions. These solutions cater to diverse economic segments, including individuals at the bottom of the economic pyramid, making homeownership a reality for a wider spectrum of Kenyan citizens.

3. **Broadening and deepening Capital Markets:** The government's commitment to expanding REITs' influence within African states contributes to the broader development of capital markets. The ripple effect is the empowerment of these markets to raise capital dedicated to funding affordable housing projects. As a result, a sustained flow of resources is channelled into the affordable housing sector, fostering resilience and sustainability.

Conclusion:

The Kenyan government's proactive utilization of REITs underscores its visionary approach in tackling the affordable housing challenge. Initiatives such as state-backed REITs and the anticipated KNR epitomize the government's dedication to fostering private sector engagement, innovative financing, and robust public-private partnerships. REITs hold the potential to reshape the affordable housing landscape, ensuring equitable access to secure and affordable homes. Simultaneously, they invigorate capital markets and facilitate sustainable economic growth. As Kenya embarks on a transformative journey towards affordable housing, REITs stand as a beacon of progress, offering tangible solutions that align with the nation's aspirations for a brighter, inclusive future. Through these concerted efforts, the government's vision for accessible housing for all citizens inches closer to becoming a reality, ushering in an era of improved living standards and national development.

Impact of Taxation on Affordable Housing by Viva Africa Consulting LLP

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Introduction

Access to adequate and affordable housing is a paramount need that ensures a dignified existence for all humankind. For this reason, the right to adequate and affordable housing has been recognized as a fundamental human right in the Universal Declaration of Human Rights, as well as in multiple international legal instruments. In Kenya, the right to adequate housing has been entrenched under Article 43 of the Constitution of Kenya (2010) as an economic and social right.

According to the United Nations Human Settlements Programme (UN-Habitat), a house cannot be considered adequate or accessible if its cost threatens or compromises the occupier's enjoyment of basic human rights. The World Bank and the UN-Habitat have collectively calculated unaffordability as a net monthly expenditure on housing cost (including mortgage repayments, rent payments, and direct operational expenses such as taxes, insurance, and service charges) that exceeds 30% of the total monthly income of the household.

According to estimates from the Centre for Affordable Housing Finance in Africa (CAHF), Kenya has a cumulative housing deficit of 2 million units, growing by approximately 200,000 units per annum against an overwhelmed supply, lagging at 50,000 units yearly.

To curb the significant housing deficit in the country, the Government of Kenya rolled out the Affordable Housing Programme/Scheme (AHP) in December 2017. The AHP is a priority Government initiative which is geared towards facilitating the production of decent, safe, and affordable housing for citizens of Kenya, and remains one of the Government's four pillars of strategic growth and development- popularly dubbed "the Big Four Agenda".

Complimentary to this initiative, the incumbent Government

introduced several tax incentives geared towards increasing the uptake of the affordable housing plan in Kenya.

Several years after the inauguration of the AHP, we can now embark on an analysis of the affordable housing framework in Kenya from a tax and fiscal policy perspective, as a means of gauging the impact of these policies on the uptake and performance of affordable housing in the country.

Observably, the construction and delivery of affordable housing units in Kenya has been designed as public private partnerships between the Government on one hand and either developers, private investors, or contractors on the other hand. Based on this arrangement, the tax incentives introduced in the affordable housing sector have not been structured as "umbrella" incentives which would have clustered the diverse interests of different participants in the AHP value chain. Instead, the tax incentives are tailored to cater to the needs of specific stakeholder groups in the affordable housing sector, depending on whether they participate in either the supply-side or demand-side of the affordable housing segment.

We analyse the impact of taxation on affordable housing in Kenya from both the demand-side (focusing on homebuyers) and the supply-side of the affordable housing market in Kenya.

Demand-side: Homebuyers

At present, first-time homebuyers under the AHP in Kenya can benefit from two main tax incentives: -

i. Exemption from Stamp Duty; and
ii. Affordable Housing Relief on voluntary contributions made towards the purchase of a housing unit.

i. Exemption from Stamp Duty

The Tax Laws (Amendment) Act, 2018 introduced an exemption from Stamp Duty for first-time homebuyers under an approved Affordable Housing Scheme upon the purchase of the unit.

Typically, the purchase of a property or housing unit attracts Stamp Duty which is payable by the transferee (purchaser), at a rate of 2% on the property's value for property situated outside a municipality (rural areas), and 4% on the value of the property for property situated within a municipality (in urbanised areas), respectively.

Therefore, the exemption from Stamp Duty on the acquisition of houses purchased under an approved AHP significantly reduces the cost of acquiring affordable housing, in accordance with the overarching objectives of the AHP. It is worth noting that from a practical perspective, this incentive can only be enjoyed once a clear criterion under AHP qualification and verification has been effected.

ii. Affordable Housing Relief

The Income Tax Act guarantees qualified individuals an Affordable Housing Relief of up to 15% of the individual's contribution towards the purchase of their first home under an Affordable Housing Scheme, provided that the Affordable Housing Relief does not exceed the statutory limit of KShs.108,000 per year.

The Affordable Housing Relief was designed by legislators to attract interest from prospective homebuyers under the AHP, noting that participation in an Affordable Housing Scheme was voluntary at the time.

The voluntary participation originally anticipated under the Affordable Housing Scheme essentially involves the remittance of regular contributions to the National Housing Development Fund (NHDF) by an adult Kenyan citizen, subject to a minimum monthly contribution of Two Hundred Kenyan Shillings (KShs.200).

The Affordable Housing Relief incentivises first-time homebuyers under an AHP by enabling them to recoup a fraction of the contributions they have expended towards the acquisition of their affordable housing unit.

To be deemed eligible for the Affordable Housing Relief, a resident individual ought to: -

i. Be eligible to make an application under an Affordable Housing Scheme. Kenyan citizens over 18 years of age, with a Kenyan Identification Card are eligible to participate in the AHP.
ii. Have applied and is currently awaiting the allocation of a house under an Affordable Housing Plan.
iii. Be saving for a purchase under an Affordable Housing Scheme approved by the Cabinet Secretary (CS) for Lands, Public Works, Housing and Urban Development.

This tax relief enhanced the attractiveness of voluntary participation in the affordable housing landscape in Kenya. Notwithstanding this, the relevance and applicability of the Affordable Housing Relief is expected to diminish in the upcoming period following the enactment of the Finance Act, 2023.

New Developments impacting the Demand-side: The Affordable Housing Levy

The Finance Act, 2023 introduced an Affordable Housing Levy (AHL) which is structured as a mandatory contribution by both employers and employees, with each remitting 1.5% of an employee's gross pay, to finance the National Housing Development Fund.

To streamline the remittance and collection of the AHL with other taxes and levies, the Office of the CS for Lands, Public Works, Housing and Urban Development appointed the Kenya Revenue Authority (KRA) as the collecting agent of the AHL through a Public Notice issued on 3 August 2023.

It could be argued that the introduction of the Affordable Housing Levy is likely to curtail the relevance, applicability, and impact of the Affordable Housing Relief. Considering that the Affordable Housing Relief was formulated to reduce the tax burden for voluntary participants in the Affordable Housing Scheme, the Affordable Housing Relief cannot be utilised to offset a taxpayer's mandatory contribution to the Affordable Housing Levy in its current structure and model.

Owing to the high volume of taxpayers that will be obligated to remit the mandatory Affordable Housing Levy monthly, it is conceivable that voluntary participation in the affordable housing segment is likely to decrease, and this could in turn decrease the relevance and applicability of the Affordable Housing Relief.

Noting that the Affordable Housing Levy still a novel idea, it is difficult to gauge the impact of the Levy on the affordable housing landscape in Kenya.

Supply-side: Developers, Contractors, and Private Investors

The construction and delivery of affordable housing units is attributable to the efforts of supply-side stakeholders such as developers, contractors, and private investors.

These stakeholders can reap the benefits of the tax incentives instated for utilisation by supply-side industry players in the affordable housing value chain in Kenya. Currently, these stakeholders can benefit from two main tax incentives: -

i. Preferential rate of Corporation Tax for qualified companies that are involved in the construction of residential units under the AHP; and
ii. Exemption from Value Added Tax (VAT) for goods to be used in the construction of houses under the AHP.

i. Preferential Corporation Income Tax Rate

Under the Income Tax Act, companies involved in the construction of at least 100 residential units annually are subjected to a preferential Corporation Income Tax rate of 15% of the taxable income, as opposed to the standard rate of 30%. However, in addition to meeting the 100-residential units' minimum threshold per annum, such companies must also obtain the approval of the CS for Lands, Public Works, Housing, and Urban Development.

It is worth noting that whilst this provision does not expressly refer to the incentive being exclusively applicable to AHP, the implementation thereof has been tailored to benefit players focused on the affordable housing sector.

Where such companies engage in several commercial activities, they can benefit from this preferential Corporation Income Tax incentive by applying the Corporation Tax rate of 15% proportionately to the extent of their taxable income which is attributable to the affordable housing activity.

This tax concession has not yet had a positive impact on the affordable housing sector in the country despite it being rolled out in 2017 by virtue of the regulations that are to govern implementation not being published. Where this challenge is addressed with a view of offering certainty and clarity, this incentive is likely to catalyse supply-side parties to participate in the construction of affordable housing units, thus stimulating adequate supply of housing projects for uptake under the affordable housing plan in Kenya.

ii. Exemption from VAT

The Value Added Tax Act exempts goods (both imported and locally manufactured) intended for direct and exclusive use in the construction of housing units under an Affordable Housing Scheme from VAT.

In order to qualify for the VAT exemption, the goods must be intended for use in an Affordable Housing Scheme that has been approved by the CS for the National Treasury and Economic Planning, upon the recommendation of the CS for Lands, Public Works, Housing, and Urban Development.

This VAT exemption has a direct and positive impact in reducing the cost of purchasing goods for construction of affordable housing units, in accordance with the overarching objectives of the AHP.

New Developments impacting the Supply-side: Deletion of Preferential Miscellaneous Fees

The Finance Act, 2023 also introduced some amendments that have a bearing on the supply-side of the Affordable Housing Plan in Kenya.

Prior to the Finance Act, 2023, all goods imported for domestic use were charged an Import Declaration Fee (IDF) at a rate of 3.5% of the customs value of the imports, while goods imported for use in the construction of housing units under an approved AHP were charged IDF at a preferential rate of 1.5%. However, the Finance Act, 2023 abolished the preferential rate and introduced a harmonised rate of IDF at 2.5% of the customs value of all imports.

Similarly, prior to the Finance Act, 2023, Railway Development Levy (RDL) was charged on all imports meant for domestic use at a rate of 2% of the customs value of the goods, while imports meant for use in the construction of housing units under an approved AHP enjoyed a preferential rate of 1.5%. The Finance Act, 2023 harmonised the rate of RDL on all imports for domestic use to 1.5%, equivalent to the rate levied upon imports for construction use in an approved affordable housing scheme, thus negating the effect of the preferential rate.

It may be argued that the rationale behind the removal of the preferential rates of IDF and RDL for imports meant for construction use under approved Affordable Housing Plans is premised upon the Government's prevailing policy to promote the local manufacture of these wares.

Given the recent introduction of these amendments by the Finance Act, 2023, it may be premature to assess the real impact of these legislative changes on the affordable housing landscape in Kenya.

Conclusion

Laudably, the Government of Kenya appears to be keenly supportive of the affordable housing initiative, as a means to combat the housing deficit in the nation.

Despite the plethora of tax concessions in the form of direct and indirect tax incentives, the Affordable Housing Programme has not garnered widespread interest from majority of the Kenyan population on both the demand side and supply side. This is by virtue of the lack of clarity and certainty that shrouds the utilization of these incentives.

For the REITs sector, it remains to be seen whether the Government's intention to use REITs for its affordable housing projects will materialize. If it does, we will be monitoring how the tax incentives highlighted in this article will integrate with the existing REIT incentives.

Property Taxation with a Focus on REITs by University of Nairobi

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This article provides a broad review of property taxes in Kenya with a focus on Real Estate Investment Trusts (REITS). It further highlights the applicable legislation for property tax and examines the effect of the taxes on the real estate market in Kenya.

1. Overview of Property Taxation in Kenya

Real Estate in Kenya is subject to a variety of taxes including property rates, land rent, stamp duty, income tax, value-added tax (VAT) and capital gains tax (CGT). The taxes are applicable on the various types of real estate which include, agricultural, residential, commercial, industrial, and leisure properties.

1.1. Property rates

Property rates are levied by county governments based on the unimproved site value (USV) of land as contained in a valuation roll. The valuation roll captures the details of all properties within the county's urban centres including the plot numbers, names of property owners, their addresses, sizes of plots and value. However, not all county governments have prepared valuation rolls, and in such cases, the property rates are based on property schedules prepared and updated by the county department of lands. The applicable property rate is an administrative rate decided by the county government and is subject to revision from time to time. Property rates are charged on both leasehold and freehold land as long as the property falls within the designated urban area. Rates form an important revenue source for the county governments to offer essential services such as education, infrastructure, sanitation, and health. The administration of property rates in Kenya is under several legislation including the County Government Act, the Urban Areas and Cities Act, Valuation for Rating Act and the Rating Act.

1.2. Land rent

Land rent is paid to the national government and is charged only on leasehold land. Land rent is determined either at the point of land allocation, renewal and extension of land lease, change of user on land or upon subdivision of land. Just like property rates, land rent is based on the unimproved land value, and the applicable rate is decided by the ministry responsible for lands, and ranges between 0.5% for agricultural land to 5% for urban land which include residential, commercial, industrial and leisure properties. Land rent is assessed at the Ministry of Lands but paid directly to the Kenya Revenue Authority (KRA) through respective KRA accounts at National Bank of Kenya and Kenya Commercial Bank. With technology, however, one can pay land rent online through the Ardhisasa platform. Land rent is an important revenue source for the National Government and is provided for under the land Act 2012.

1.3. Stamp Duty

Stamp duty is charged on the transfer of immovable property such as land and buildings. The tax is based on the declared purchase price or government valuation whichever is higher. Stamp duty for transfer of real estate is currently 2% for agricultural land and rural properties and 4% for urban land. The tax is assessed at the Ministry of Lands and paid by the purchaser of the property directly to KRA via the Ardhisasa online platform. Overall administration of the stamp duty tax is under the Stamp duty Act, and the Land Registration Act.2012

1.4. Income Tax

Income tax is charged either on income received from rented properties, or from the net profit/gain made from sale of real estate, referred to as capital gains tax (CGT). Income tax on residential rental income (also known as Monthly Rental Income –MRI) is currently at 10% and is payable on gross rent received per month by the land lord. This tax applies to individuals and corporates with residential property only and became effective on 1st January 2016. The tax is paid and filed via the KRA online platform iTax, on or before the 20th day of the following month. Failure to pay the tax within the stipulated period, attracts penalties calculated by KRA. A landlord is required to file nil returns when the premises are unoccupied/vacant. Exemptions from the MRI tax are non-residents and landlords earning over Kshs10 million per annum, who remain under the annual income tax regime. However, according to KRA, any residential property owner who falls within the MRI category can apply to the authority (KRA) requesting to remain in the annual income tax regime. Income tax from rented commercial properties (retail, offices, leisure, industrial and warehouses) is assessed annually and is payable at a rate of 30% for companies and a graduated scale for individuals who own commercial properties (https://www.kra.go.ke/individual/filing-paying/types-of-taxes/residential-rental-income)

1.5. Capital Gains Tax

Capital Gains Tax (CGT) is a form of income tax and is levied on transfer of property. It refers to the tax on the net gain or profit realized from the sale of property. The tax is levied on the difference between the sale price and the property's cost at the initial acquisition of the subject property. In simpler terms, it is the tax on the profit you make (the selling price less the purchase price and the costs incurred up to the time of the sale). The tax is declared and paid by the transferor (seller) of the property. While most property transactions are subject to capital gains tax, there are exemptions to the tax such as transfer of property for the purpose of securing a debt or a loan and transfer of assets between spouses, among others. In Kenya, CGT was first introduced in the year 1975 but later suspended in the year 1985. The objective for the suspension was to spur investment in real estate as well as in the securities market. CGT was however, reintroduced on 19th September 2014 with an applicable rate of 5% of the net gain and became effective on 1st January 2015 (www.kenyalaw.org). In June 2022, the Finance Act of 2022 amended the

Income Tax Act (ITA) by raising the capital gains tax (CGT) rate from 5% to 15%. The enhanced rate became effective on January 2, 2023.

1.6. Withholding Tax

Withholding Tax (WHT) on rental income became effective on 1st January 2017 under section 35(3) (j) of the Income Tax Act (ITA) and applies to rent payable to both residential and commercial property. Under section 35(3) (a) of the ITA, KRA is mandated to appoint rent withholding agents to deduct and remit the tax on rent paid to resident landlords. The agents withhold tax at a flat rate of 10% of gross rent paid to resident landlords, excluding VAT where applicable, and for non-residents, the tax is withheld at a rate of 30% of the gross rent. Payment of WHT is made via iTax to KRA by the 20th day of the month following rent payment (www.kra.go.ke/news-center/blog/984-withholding-tax-on-rental-income).

1.7. Value Added Tax

Value -added tax (VAT) is a consumption tax that is levied on a product repeatedly at every point of sale at which value has been added. The standard rate of taxing VAT for goods and services in Kenya is 16%. While real estate in Kenya is not heavily subjected to VAT, it is important to note that rent on commercial buildings is subjected to VAT at the rate of 16%, and this is in accordance to sections 5(a) and 6 of the Value Added Tax Act. Chapter 476 of the laws of Kenya.

2. Taxation of Real Estate Investment Trusts (REITs) in Kenya

A Real Estate Investment Trust (REIT) is a collective investment scheme that owns, operates, or finances income-generating real estate and allows investors to pool their resources in exchange for ownership units in the REIT. REITs can focus on various types of real estate, such as commercial properties like office buildings, shopping malls, and hotels or residential and industrial income generating properties., REITs allow individual and corporate investors to buy stakes or units in the REIT, and therefore give such investors the opportunity to enjoy regular income in the form of dividends and capital appreciation from real estate without having to directly buy, manage, or finance the properties themselves.

REITs in Kenya were introduced in 2013 under the Capital

Markets (Real Estate Investment Trusts) (Collective Investment Schemes, Regulations 2013) see file:///c:/users/user/desktop/mega%20folder%208/cgt%20notes/reits%20law%20in%20kenya%20act%20of%20parliament.pdf, and allow REITs to be listed at the Nairobi Securities Exchange (NSE).

Unlike, any other forms of real estate in Kenya, REITs which are registered with Kenya Revenue Authority enjoy various tax benefits including income tax.

This special tax treatment provides a conduit for earnings to be taxed at the investor level and not at the entity level. In Kenya, the biggest advantage attached to qualifying REITs is that they enjoy highly favourable tax benefits in the form of exemptions under the Income Tax Act, Capital Gains Tax exemptions, exemptions under the VAT Act, and Stamp duty Tax exemptions- for more insights on the tax regime and exemptions for REITs in Kenya see the article at https://tripleoklaw.com/the-tax-regime-for-reits-in-kenya/

3. Effect of property taxes on the Real Estate Market

While an important source of revenue for County and National government, real estate taxes may have profound effect on the property market. Land based taxes may depress property demand and value as investors shy away from buying properties in neighborhoods with high taxes. Property taxes may erode investor confidence in the real estate market and affect a local economy. The performance of businesses can also be adversely affected by taxes like property rates and land rent. Stamp duty tax and Capital Gains Tax have potential to lower transaction activity in the property market. According to a report on real estate prices by Macharia, (2018) prime residential prices reduced by 1 percent in 2016 while residential rents in Nairobi declined by 3.2 percent in 2016 and 2.8 percent in 2017, following the reintroduction of capital gains tax. Muli and Ombati (2020) investigated the effect of capital gains tax on performance of real estate businesses in Mavoko municipality in Kenya. The research findings show significant relationship between Capital Gains Tax and performance of real estate businesses. CGT can depress demand because investors may opt for other investment options like securities and stocks which have lower taxes. There are also potential implications of CGT on Sectional Titles. The Sectional Properties Act (Amended 2021) aims to divide buildings into units to be owned by individual proprietors. This enables real estate investors to sell units with their own titles and profit from the sale of each unit. Because each sectional unit must have its own title, investors will be taxed 15% on the profits from the sale of each sectional unit. The increase in CGT has the potential to drive up the prices of sectional units sold to buyers, as each investor may want to ensure a profit margin on each unit sold. As a result, buyers of sectional units may be forced to pay more to meet the prices of units sold by the developer. This potentially may impact home ownership affordability hence defeat the government's affordable housing programme.

Conclusion

We conclude that real estate in Kenya is subject to a variety of taxes which include property rates, land rent, stamp duty, income taxes, Value Added tax and Capital Gians Tax. The property taxes put a heavy burden on buyers and sellers, investors and affect the property market, businesses and the local economy. However, REITs although are subject to taxation, enjoy special tax treatment. In Kenya, REITS enjoy highly favorable tax benefits in the form of exemptions under the various tax laws. To stimulate the property sector and REITs market in particular, government should consider more tax incentives and create more awareness on existing tax benefits.

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Secretariat Report

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