CAPITAL GAINS TAX (CGT) ON INHERITED PROPERTY IN KENYA. WHAT REALLY HAPPENS WHEN YOU SELL INHERITED PROPERTY?

In Kenya, inherited property is exempt from tax, but Capital Gains Tax (CGT becomes payable once a beneficiary disposes inherited property.

A persistent challenge has been determining the correct "acquisition cost," particularly amid attempts by the Kenya Revenue Authority to treat inherited property as having a zero-cost base.

The Finance Act 2023 introduces the five-year rule, which can expose beneficiaries to tax on historical gains if the property is sold shortly after inheritance.

This article explains when CGT applies, when it does not, how it is computed, and the governing statutory and judicial principles.

CGT as a tax on the transfer of property.

Capital Gains Tax is imposed **under section 3(2)(f) of the Income Tax Act (Cap 470)**, read together with the **Eighth Schedule.** It applies to gains accruing on the **transfer of property situated in Kenya**, including land, buildings, shares, and comparable interests.

Following amendments introduced by the Finance Act, 2023, CGT is charged at **15% of the net gain** and is treated as a **final tax**. The obligation to declare and pay CGT rests on the **transferor**, being the person disposing of the property, and payment is made through the iTax system.

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Is CGT payable at the point of inheritance?

As a general rule, **no CGT is payable merely because property has been inherited.**

Paragraph 6 of the Eighth Schedule exempts:

"the transfer of property by a personal representative to a beneficiary in the course of the administration of the estate of a deceased person."

Accordingly, where executors or administrators transmit property from a deceased person's estate to beneficiaries pursuant to a confirmed grant, **that transfer is not subject to CGT.** The law recognizes that succession is not a commercial transaction intended to generate taxable gains.

However, this exemption applies only to the **succession process itself** and does not permanently remove the property from the CGT regime.

When does CGT arise for inherited property?

CGT arises when a beneficiary later disposes of the inherited property in a taxable transaction, most commonly through an outright sale. At this point, the beneficiary is treated as the transferor and is required to compute CGT on the gain realized.

Under Paragraph 3 of the Eighth Schedule, the gain is computed by comparing:

- **the transfer value or sale price (less incidental transfer costs), and**
- **the adjusted cost of the property.**

Determining the cost of inherited property.

Because beneficiaries typically do not pay a purchase price, determining the acquisition cost of inherited property is a recurring issue in CGT disputes.

Paragraph 9 of the Eighth Schedule provides that where the acquisition cost cannot be ascertained, the cost shall be deemed to be the **market value of the property at the time of acquisition**, or the **value used for stamp duty purposes**, whichever is lower.

This position was affirmed in the case of ***Commissioner of Domestic Taxes v. Shah & 2 Others (2024) (Income Tax Appeal E054 of 2023).*** In this matter, the High Court upheld a previous decision by the **Tax Appeals Tribunal**, rejecting the Kenya Revenue Authority's argument that inherited property should be treated as having a "zero-acquisition cost" simply because the beneficiaries paid nothing to receive it.

The KRA had argued that since the taxpayers inherited the property at no cost, the entire sale price should be subject to CGT. However, the taxpayers contended that the acquisition cost should be "rebased" to the **fair market value** at the time they inherited the property.

The Court ruled in favor of the taxpayers, holding that inherited property must be assigned a **realistic cost base** linked to its value at the time of transmission. This decision was grounded in **Paragraph 9 of the Eighth Schedule** of the Income Tax Act, which specifies that:

- Where property is acquired through a non-arm's length bargain (such as a gift or inheritance), the acquisition cost is deemed to be the market value at the time of acquisition.
- This valuation is subject to the statutory stamp duty cap, ensuring a fair and consistent tax treatment.

The same approach was taken earlier in **Dhanjal Investments Limited v Commissioner of Domestic Taxes** where the High Court held that the Capital Gains Tax regime under the Eighth Schedule must be interpreted in a manner that taxes actual gains and not artificial or notional gains. The Court rejected an interpretation that would ignore an ascertainable cost base and thereby inflate the taxable gain. Dhanjal, therefore, reinforces the principle that CGT is a tax on appreciation in value, not on turnover or receipts.

While the decisions in Shah and Dhanjal remain the guiding judicial authorities on the determination of acquisition cost for CGT purposes, the **Finance Act 2023** introduced a limitation to this rule. To prevent short-term tax maneuvering, the Act now limits the ability to "rebase" inherited property to its market value only for properties that have been held for more than five years prior to their disposal.

The five-year rule explained.

The **Finance Act, 2023** introduced Paragraph 4A to the Eighth Schedule, commonly referred to as the **five-year anti-avoidance rule.**

The rule applies where:

1. property is first transferred in a **CGT-exempt transaction** (such as inheritance); and
2. the same property is later sold or transferred in a **taxable transaction within five years.**

In such cases, the adjusted cost for CGT purposes is traced back to the **original cost of the property before the exempt transfer**, rather than the value at the time of inheritance.

Sale within five years of inheritance.

Where inherited property is sold **within five years of transmission**, the law requires that the **original acquisition cost incurred by the deceased** be used as the reference point for calculating the gain.

In this situation, the **market value of the property at the time of inheritance is ignored** for CGT purposes. As a result, the taxable gain reflects the **entire appreciation in value from the time the deceased originally acquired the property up to the point of sale by the beneficiary.**

This approach significantly increases CGT exposure, particularly where the property was held by the deceased for a long period and appreciated substantially over time.

Sale after five years of inheritance.

If the beneficiary disposes of the property after five years have elapsed from the date of inheritance, the anti-avoidance rule does not apply.

In such cases, the **market value of the property at the time of inheritance becomes the beneficiary's acquisition cost**. This effectively "rebases" the property for CGT purposes, meaning that only the **increase in value occurring after inheritance** is subject to tax.
This treatment substantially reduces CGT liability compared to an early disposal.

The importance of valuation in inherited property transaction.

Although valuation is not the sole determinant of CGT liability, it plays an important supporting role in transactions involving inherited property. A valuation carried out at or around the time of transmission helps establish the deemed acquisition cost under Paragraph 9 of the Eighth Schedule and provides evidentiary support for the cost base used in computing CGT.

In the ***Shah*** decision, the Tribunal's reasoning demonstrates that valuation evidence is relevant in ensuring CGT is imposed on **actual economic gains**, rather than on artificial gains arising from the absence of a recorded purchase price.

When CGT becomes due and payable
Under Paragraph 11 of the Eighth Schedule, CGT becomes due on the **earlier of:**

- receipt of the full purchase price by the transferor; or
- registration of the transfer instrument.

As a result, CGT may become payable before registration if full consideration is received earlier, and proof of payment is typically required before the Lands Registry completes registration.

Conclusion

In Kenya, inheritance itself does not trigger Capital Gains Tax. However, the subsequent sale of inherited property can result in CGT liability, depending on how the gain is computed, the timing of disposal, and the application of the five-year rule. The statutory framework under the Eighth Schedule, together with the ***Shah and Dhanjal decision***, emphasizes that CGT should reflect genuine economic gain.

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