FACTORS INFLUENCING CAPITAL GAINS TAX PERFORMANCE IN THIKA DISTRICT REAL ESTATE

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A RESEARCH PROJECT SUBMITED TO THE DEPARTMENT OF ECONOMICS,ACCOUNTING AND FINANCE, SCHOOL OF BUSINESS IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF POSTGRADUATE DIPLOMA IN TAX ADMINISTRATION AT JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY.

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DECLARATION

This research project report is my original work and has not been submitted to any other university.

…… **Date……**

Jewel Wambui Gathuri

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This research project report has been submitted for examination with my approval as the university supervisor.

…… **Date…….**

Dr. Bruce Ogaga

DEDICATION

This research project is dedicated to my mother Jayne Gathuri and fiancée Robert Kibet. Thank you for the encouragement and above all to the Almighty God.

ACKNOWLEDGEMENT

I acknowledge my supervisor, Dr. Bruce Ogaga. You are a great mentor and a guide. Learning under your instruction is a great gain. God bless you. To all those who have contributed to the actualization of this output, Thank you.

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ABBREVIATIONS AND ACRONYMS

CGT	Capital Gains Tax
DTD	Domestic Taxpayers Department
KRA	Kenya Revenue Authority
TEU	Taxpayers Education Unit
VAT	Value Added Tax

DEFINITION OF TERMS

Costs Allers (1994,) defines administrative costs as "costs incurred by(mainly) public sector agents in order to administer the tax-benefit system" Tax compliance costs are those costs "incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax" (Sandford, Godwin and Hard- wick, 1989)

Capital Gains Tax According to Stuart (2008) CGT is a tax on the increase in the value of an asset between its acquisition and its disposal.

Lock in Effect According to Kovenock & Rothschild (1985) as compared to taxation on an accrual basis, the capital gains tax discourages sales of appreciated assets hence the lock in effect.

ABSTRACT

Capital gains tax is a tax imposed on the increase in value of marketable assets between the date of their acquisition or some fixed date and the time of disposal, when the tax becomes payable. Policy analysts have had diverging views of the effects of Capital Gains Tax on any given economy. Capital gains tax (CGT) has been reintroduced in Kenya as part of the government's efforts to increase revenue and plug the budget deficit following an amendment in the 2014 Finance Act. This study therefore aimed at establishing the factors influencing the performance of CGT in Thika District Real Estate namely: lock in effect, costs and level of income. Stakeholders have raised a number of concerns on the reintroduction of this tax, whereas it is not in doubt that CGT is an important aspect of Kenyan economy, concerns have arisen on a number of issues especially since the revenue from CGT collection has faced a downward trend. Agency theory states that an agency problem occurs in such a relationship when asymmetric information is available to either party. Prospect theory states that people value gains and losses differently and as such will base decisions on perceive gains rather than losses To achieve fulfilling results for this study, the study adopted the use of the questionnaires as well as reports from KRA on remittance of the CGT and 3 top developers of real estate in Thika comprised the study's target population of 50 respondents from which a sample size of 40% was used. The study adopted regression analysis using SPSS to establish the relationship between the dependent and the independent variables. The study findings show that Capital gains tax discouraged sales of appreciated assets because assets subject to capital gains taxation are generally held for a longer time by investors who hold assets, which have increased in value thus impacting Capital Gains Tax negatively.It was also found that the use of agents and brokers lead to high compliance costs for the tax payer and would at times lead to tax irregularities. The study also found that embracing technology would suffice in minimizing this loophole as well as ensure efficiency of tax collection. The findings revealed that 46 percent of the changes in tax performance in real estate are as a result of the factors identified in the research while 54 percent are others that are not included in this particular research. The study therefore recommends that,more variables should be used to widen the scope hence more comparisons. Kenya Revenue Authority take it upon themselves being the Tax Administration Authority to employ more technical staff and train them in interpreting the tax laws.The policy makers should introduce stringent measures in form of tax penalties and fines on the real estate firms and tax payers who violate and act as an obstacle in the administration of this tax

CHAPTER ONE

INTRODUCTION AND BACKGROUND

1.0 Introduction

This chapter shall draw out the outline from the background of the study which shall project to the problem statement from which the objectives of the study shall be deducted. Also herein, are the research questions and value of the study.

1.1 Background of Study

According to Atika (2012), electronic tax system forms part of the revenue collection reforms by Kenya Revenue Authority whose main motive is enhancing tax collections and tax efficiency and thus, tax revenues have been increasing rapidly due to the country's rapid economic development accelerated by the new systems In this regard, the planning and formulation phase of an elaborate electronic system strategy was done in the KRA Corporate plan of 2003 and was implemented in the fourth corporate plan of 2009. KRA has a centralized Information Communication Technology (ICT) department that provides support services in terms of electronic systems to the entire organization all these to try and achieve its goals for achieving increased tax collection and facilitating voluntary compliance by taxpayers. Rukungu (2015), states that compliance costs and knowledge on capital gains tax have a significant role to play in asset allocation decisions by investment groups.

According to Stuart (2008) CGT is a tax on the increase in the value of an asset between its acquisition and its disposal. Broadly speaking, this means its sale price minus its purchase price, though assets that are acquired or disposed of in other ways. Capital gains

arise from the sale of capital assets sold by individuals and trustees; gains made by companies are included in profits and subject to corporation tax (Stuart, 2008). Capital assets include investment assets, such as stocks and bonds; assets (including land) held for long-term investment rather than commercial purposes and self-created patents goodwill and going-concern value created by a firm. In addition to the sale of capital assets, capital gains can arise from the sale of real or depreciable property under some circumstances (Desai & Gentry, 2003).

Proponents of CGT argue that capital gains tax is most often justified on fiscal equity grounds and excluding capital gains from the income tax base is an important structural weakness in the income tax system, which leads to tax avoidance and the misallocation of productive investment resources. The opponents of CGT argue that if capital gains go untaxed, individuals are encouraged by the tax system to invest their savings in assets that provide returns in the form of capital gains from property rather than income producing assets like equipment and machinery.

However, Stuart (2008) argues that higher CGT rates might discourage saving, investment and entrepreneurship, but these could be encouraged in better-targeted ways. On the other hand, low rates of capital gains tax are essential to reward difficult and risky entrepreneurial activity. Hungerford (2010) posits that capital gains tax reductions are often proposed as a policy that will increase saving and investment, provide a short-term economic stimulus, and boost long-term economic growth. Since CGT is charged only when an asset is sold, a straightforward way to avoid it is to not sell assets. This observation raises the possibility of a Laffer effect: by discouraging asset sales, increases in CGT rates may actually reduce revenue. Among economists, this is referred to as a

“lock-in effect” and the argument is as follows. An individual holding an asset may believe that another asset offers him a higher rate of return. The efficient outcome would be for the individual to sell the first asset and buy the second. However, if the CGT rate is sufficiently high, he may find that the tax liability he faces upon selling the first asset outweighs the higher rate of return he could obtain by buying the second. In this case the individual will choose not to trade.

The lock-in effect caused by high rates of CGT does not just have implications for revenue:it can also discourage entrepreneurship and, in particular, serial entrepreneurship. By taxing the proceeds from selling a successful start-up, CGT incentives entrepreneurs to continue managing their businesses once they become established rather than selling them and moving on to the next project. This could have negative implications for economic dynamism as natural risk-takers become locked into an existing business when the overall economy would be better off if they became serial entrepreneurs. In addition, the fact that they will be liable to pay CGT if they sell off a successful business means that higher rates of CGT will reduce the number of start-ups happening in the first place.

(Chari, golosov, & tsyvinski, 2005) attempted to quantify these effects. By studying a model economy in which individuals can be better suited to either entrepreneurship or management they showed how this effect can have important implications for the optimal level of CGT: they find that cutting CGT from 20% to 0% increases national welfare even when the tax cut directly benefits only the top 1% of the most successful entrepreneurs. This is because it encourages a larger number of individuals to start new businesses with positive implications for the wider economy. The authors also find that the revenue raised by CGT quickly declines as soon as the rate exceeds 15%,.

1.1.1 Factors Influencing Capital Gains Tax

Last but not least, the authors also discuss the impact of capital gains taxation on compliance costs, administrative costs, and tax avoidance. Unfortunately, no studies have yet managed to successfully quantify these psychological costs, although research in this area is now taking place. Research being undertaken in Australia by Woellner et.al (2001) uses a combination of approaches to quantify the psychological costs of the tax system, including adaptation of health studies work and analysis of legal “pain and suffering” compensation cases. According to Kovenock & Rothschild (1985) as compared to taxation on an accrual basis, the capital gains tax discourages sales of appreciated assets hence the lock in effect. This is because assets subject to capital gains taxation are generally held for a longer time by investors who hold assets, which have increased in value. In as much as taxes improve the government's revenue, it also reduces the disposable income available to households for consumption.

1.1.2 Capital Gains Tax

Capital gains tax is a tax imposed on the increase in value of marketable assets between the date of their acquisition or some fixed date and the time of disposal, when the tax becomes payable. Policy analysts have had diverging views of the effects of Capital Gains Tax on any given economy. Most critics of CGT argue that a tax on capital hurts the economy by reducing the incentive to save and invest. They pose the following reasons to back-up the argument: Capital Gains Tax is complicated and costly to administer for practical and political reasons are perpetually riddled with exemptions and exceptions making them complicated to administer and to comply with. The big complication is determining the true capital gain net of inflation after netting out the

purchase price and the cost of maintenance and investment in the asset over the years; Capital gains tax is easy to avoid as decision to pay a capital gains tax is entirely up to the taxpayer. It's the easiest tax to avoid because you just don't sell your asset; Capital gains tax chokes the economy, the heart of a vibrant, prospering society is wealth-creating trades that shift productive resources to ever higher valued uses. A capital gains tax chokes those trades and the economy at large. Imagine you can increase the value of a productive asset by ten percent. That's a big gain that the economy can ill-afford to miss out on. In the absence of a capital gains tax you would easily make an offer to the present owner in which both of you are better off through the trade and the economy gets a ten percent gain. That gain won't happen with a capital gains tax, (ICPAK, 2014).

1.1.3 Capital Gains Tax on Revenue Collection

The Kenya's tax system has undergone more or less continual reform over the last twenty years. On the policy side, rate schedules have been rationalized and simplified, a new value-added tax introduced, and external tariffs brought in line with those of neighboring countries in East Africa. At the same time, administrative and institutional reforms have taken place. Most remarkable is the creation of the semi-autonomous Kenya Revenue Authority (KRA) in 1995, which centralized the administration of tax collection (Muriithi, 2003). KRA has been able to collect and grow taxes efficiency, effectiveness and progressively (KRA Annual Report, 2013/2014). The capital gains tax (CGT) has been reintroduced in Kenya as part of the government's efforts to increase revenue and plug the budget deficit following an amendment in the 2014 Finance Act to encourage investment in the real estate sector as well as spur growth in the stock market (PWC, 2014). The result that tax revenue tends to increase following a reduction in the tax rate

may seem counterintuitive; however, there are many offsetting factors which must be considered. In the static analysis, tax revenue inevitably falls because the same level of realizations is being taxed at a lower rate. In addition, tax receipts may fall if taxpayers reclassify regular income as capital gains in order to take advantage of the lower rate. On the other hand, a reduction in the capital gains tax rate creates three effects which tend to increase tax revenue. The first is the unlocking effect, which expands the tax base because realizations increase in response to the lower tax rate. The magnitude of the unlocking effect is quite controversial and will be discussed in greater detail in the next section. The second is the dynamic effect, which measures the increase in tax revenue generated from the impact of lower tax rates on economic growth. The third effect measures the increased tax revenue resulting from an increase in the value of existing assets. When capital gains tax rates are lowered, the value of existing assets necessarily increases. Tax revenue rises as owners of stock pay taxes on the higher value of their assets when realized. The impact on tax revenue depends on the relative magnitude of each of these offsetting factors. In general, more comprehensive studies find that a reduction in the capital gains tax rate will be revenue neutral, and may even generate small revenue gains.

1.1.4 Real Estate in Kenya

CGT was first incorporated within the Kenyan income tax legislation in 1975, as entrenched in the Eighth Schedule to the ITA. In 1985, the tax was suspended so as to encourage growth in the real estate sector. Since 1985, Kenya has witnessed tremendous economic growth, in particular, in recent years, the boom in the Kenyan property development and real estate sector has seen Kenya ranked in first place (in 2011 and 2012) representing the world's fastest growing property market as measured by rise in

property prices by Knights Frank's Prime International Residential Index. The notion that the big winners in the real estate market go untaxed therefore has not augured well with the principle of equity, in taxation. Further, the numerous infrastructural flagship project under Vision 2030 all aim to elevate Kenya from a low income to middle income economy by the year 2030. One of the core pillars entrenched within Vision 2030 is to enhance prosperity of the populace through economic development. Additionally, one of the Jubilee Government main campaign promises contained in its pre-election manifesto is to attain an average economic growth rate of 7-10% and reduce the public debt. In order to finance all these initiatives, it is clear that the government needs additional revenues raised through taxation and other means. Therefore, with a growing economy and increased interest in the extractive sector, re-introduction of CGT was long overdue. The CS for Treasury therefore amended the Eighth Schedule to the ITA through the Finance Act 2014 by providing for tax at 5% on gains accruing to a company or an individual upon the transfer of property in Kenya on or after January 1, 2015.

Whereas as all stakeholders represented by ICPAK welcome the re-introduction of CGT, many have raised concern relating to the implementation of the 1975 law in this current economy. This paper therefore consolidates the general concern expressed by various industries in Kenya and provides the recommendations and proposed changes to the CGT legislation so as to enhance its implementation and administration. Capital Gains in relation to real estate are the profits which accrue upon the transfer of land to a company or an individual. Capital Gains Tax (CGT) is charged on this profit. CGT is computed on the amount by which the transfer value of the real estate property exceeds the value of the consideration for the acquisition or construction of the property that is the cost of the

property borne by the seller in acquiring the property. Real property was defined as all the interests, benefits, rights and encumbrances inherent in ownership of physical real estate, where real estate is land together with all improvements that are permanently affixed to it and all appetences associated thereto (Gerald,et.al,1996). The number of properties in comparison to the demand in the country is not at all equal to the supply of such properties due to the fact that the growth rate of demand outweighs the supply. This was an opportunity that many investors have taken up in the real estate sector properties in Kenya. The real estate period of boom in which it was performing at its peak survived the 2007 Post Election Violence and global economic downturn that crippled other sectors such as tourism and agriculture which showed that this sector was very strong in the country and was very profitable. The construction sector is approximated to have created 82,000 private sector jobs in 2010 , (Kibiru.C, 2014) .

In the period for 2011 and part of 2012 the real estate sector growth had a server negative effect this was due to the high interest rates that were experienced during the period. This lead to a lot of construction of properties been postponed and left hanging for some time due to the mortgage interests at the time going to as high as 30%. However, with the fall of interest rates the sector picked up and the growth rate increased. This was from a study carried out by knight Frank for the 3rd quarter for the year ended 2012. The Kenyan real estate market has been experiencing a boom in the past ten years and the latest findings have shown that the trend will continue into the foreseeable future, order (Knight Frank & Citi Private Bank, 2012). Statistics indicate that the demand for housing, which has possibly led to increase in house prices, has been on the rise at a faster rate than the number of houses available or under construction (National Housing Corporation, 2010).

The estimate number of houses constructed annually is about 30,000 whereas the demand is estimate at 150,000 (National Housing Survey, 2010). It is no secret that every informed person wants a piece of Thika Town. They branded it 'The Birmingham of Kenya due to its strategic location on the Kenyan map. Thika serves as the epi-centre of Nairobi, Muranga, Ukambani area, Garissa and even Nakuru, making it the market of choice for most residents of those counties. Another factor that has made Thika an attractive investment destination is its proximity to Nairobi City.

1.2 Statement of the Problem

According to Professor Martin Feldstein et.al (2008) study which was one of first to provide an empirical analysis of the effect of taxation on tax compliance costs are incurred when fulfilling the recording and filing requirements associated with paying a tax. These costs include such expenses as bookkeeping, reporting, calculating, and remitting tax payments. Blumenthal & Slemrod (1992) found that American taxpayers who received capital gains income incurred higher compliance costs than those who did not gain. Vaillancourt (1989) examined compliance and administrative costs for personal income taxes in Canada. Since capital gains are taxed through the income-tax system in Canada, this study provides some useful insights into the compliance costs for capital gains taxes. A study in the American Economic Review was a path breaking work in measuring the relationship between capital gains taxes and tax evasion (Poterba, 1987). He found that capital gains taxes have a significant impact on tax evasion on the realization of capital gains sale of corporate stocks at a profit. Kasingiu, (2012) whose paper focused on the effect of capital gains tax on total revenue in Kenya using secondary time series data collected from 1965 to 1994. The study concluded that CGT would have a negative and insignificant contribution to total tax revenue. However, CGT has not lived up to expectations going by its reducing trend in revenue collected from CGT, 3.3 billion in 2015 and 1.3 billion in 2016. It targeted investors selling property such as land, shares, government securities and private equity. Since 1985, Kenya has witnessed tremendous economic growth, in particular. The notion that the big winners in the real estate market go untaxed therefore has not augured well with the principle of equity, in taxation. The Law Society of Kenya (LSK) filed a constitutional petition (No. 39 of 2017)

to challenge that requirement by KRA. The court eventually ruled that paragraph 11A is unconstitutional inasmuch as it limits the right to freely transfer property, (LSK versus KRA 2017). Stakeholders have raised a number of concerns on the reintroduction of this tax, whereas it is not in doubt that CGT is an important aspect of Kenyan economy, concerns have arisen on a number of issues. Stock brokers filed a case challenging its implementation since they felt that the KRA was passing on to them responsibilities which were not in the Act. The Act states, they are to collect and remit the tax, but KRA was adding the responsibility by requiring them to calculate the investors liability, (George, 2015). The lock-in of capital prevents the development of some new, potentially profitable, businesses that are engines of productivity, employment, and wealth creation. Numerous academic studies have investigated the lock-in effect. However, pursuing a policy of zero capital gains tax may go against the main canon of equity in taxation. Due to the major boom for commercial and residential development, facilitated by the infrastructural development as well as land availability; a rare asset that Thika takes pride in, this study therefore sought to establish what factors influence capital gains tax performance in Thika real estate?

1.3 Research Objectives

The general objective of the study was to establish the factors that influence the performance of capital gains tax in Thika's real estate-

1.3.1Specific Objectives

The specific objectives were to

i. Establish the influence of lock in effect on the of CGT performance in Thika Real Estate
ii. Determine the influence of costs on the of CGT performance in Thika Real Estate
iii. Determine the influence of the level of income on the CGT performance in Thika Real Estate

1.4 Research Questions

i. What is the influence of the lock in effect on the performance CGT in Thika Real Estate?
ii. How do costs influence the performance of CGT in Thika Real Estate?
iii. What is the influence of the level of income on performance of CGT in Thika Real Estate?

1.5 Value of the Study

The study will be of significance to future researchers and scholars since it will add on to existing literature. The study will also increase the knowledge base, and thus enable future researchers to build upon the concepts resolute by this study. The study will also be valuable to research institutions, students and other researchers.

The study will also be of great benefit to policy makers like the government, the Kenya revenue authority, Capital markets authority and the Treasury; they may use the study findings to formulate policies that will enhance revenue collection and budget formulation in the country. Findings from the study shall be of great benefit to the management of real estate firms. This is because they shall have a reference of what is required and how to ensure full compliance in terms of Capital Gains Tax.

1.6 Scope of the Study

This study focused on the Kenya Revenue Authority as an establishment since it is the revenue collection body in Kenya as per the law. It also targeted 3 main real estate developers within Thika District as they are targeted by the Capital Gains Tax Re-introduction.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

The chapter contains relevant theories and a review of literature on the variables of study, which form the themes of the study. It further gives various studies and contributions that have relevance to the study. It reviews the literature that has been generated on capital gains tax and the effects they project on revenue collection.

2.1 Theoretical Review

2.1.1 Agency Theory

An agency relationship occurs where one party principal engages another party the agent to perform a task on their behalf. In the real estate market, the principal is the seller or buyer of the house and the agent is the real estate broker (Rottke, 2001). An agency problem occurs in such a relationship when asymmetric information is available to either party. The different types of asymmetric information that come into play in these relationships include hidden characteristics, hidden information, hidden action and hidden intentions. All these happen in the time between when the investor realizes he has a problem needing a solution and when the action is executed. This asymmetry affects the pricing of residential real estate because either party may overprice as they speculate the intentions of the other party. The threats can be countered by solution approaches which incorporate management and financial elements into an incentive compatible investment model (Rottke, 2001). This theory is thus relevant in our study as it relates to the lock in effect as the broker may advise the buyer based on the information they have on whether to purchase, dispose or withhold the property.

2.1.2 Prospect Theory

The prospect theory states that people value gains and losses differently and as such will base decisions on perceive gains rather than losses. Value is assigned to gains and losses rather than to final assets and probabilities are replaced by decision weights. In particular, people underweight outcomes that is merely probable in comparison with outcomes that are obtained with certainty. In addition, the value function is normally concave for gains, convex for losses depicting diminishing marginal value and is generally steeper for losses than for gains. Decision weights are generally lower than the corresponding probabilities for events which are most probable but higher for those that are less probable (Kahneman & Tversky, 1979). Prospect theory is a well-established descriptive theory of human behavior under risk. The idea that people care about changes in financial wealth and that they are loss averse over these changes is a central feature of the prospect theory of (Kahneman & Tversky 1979). Accordingly, investors derive direct utility not only from consumption but also from fluctuations in the value of their financial wealth. They are loss averse over these fluctuations, and the degree of loss aversion depends on their prior investment performance(Barberis, 2001). Thus, average decision-makers are not economic automatons; instead, from time to time they are affected by emotions and cognitive hindrances in making rational decisions. The relevance of this theory in relation to the study resonates with the level of income objective since any investor wants gains from any venture they undertake. The costs have relevance since decision weights are on probabilities as well as cognitive hindrances such that where costs outweigh the returns the human behavior shall be influenced negatively.

2.2 Empirical Review

2.2.1 Lock In Effect

The prior studies indicated that the lock-in effect from taxing capital gains for securities can be viewed as the impact of a tax burden on investment decisions. Investors' preferring to avoid such tax burdens tend to reduce their participation in stock-investing activities or even discontinue investing in stocks in order to invest on low tax or tax-free investment commodity. This change in investor behavior would reduce or stagnate the stock market trading volumes, affecting the liquidity of stock market trading and often intensifying price fluctuations. Somers (1948) documented that taxes on capital gains for securities typically cause a lock-in effect in stock markets, primarily because investors become less willing to invest or they wish to avoid taxation. Stiglitz (1983) also indicated that capital gains tax for securities are detrimental to the development of securities markets, arguing that levying taxes on capital gains increases asset transfer costs and reduces transaction efficiency, causing a lock-in effect on trading volume. Dai et al. (2006) demonstrated that the equilibrium impact of capital gains taxes reflects both the capitalization effect that is, capital gains taxes decrease demand and the lock-in effect that is, capital gains taxes decrease supply. Sahm (2008) has found taxation of capital gains upon realization instead of accrual provides incentives to hold winners as long as possible and sell losers immediately. The lock-in effect possibly distorts the liquidation and investment decision. Such market inefficiency increases stock market volatility, further reducing the willingness of investors to trade and intensifying the lock-in effect. According to Kovenock & Rothschild (1985) as compared to taxation on an accrual basis, the capital gains tax discourages sales of appreciated assets hence the lock in effect. This is because

assets subject to capital gains taxation are generally held for a longer time by investors who hold assets, which have increased in value. Kovenock & Rothschild (1985) since capital gains tax is a transactions tax, it diminishes trading and that in the United States, the sale of an asset can be put off until death, to avoid paying capital gains taxes

2.2.2 Level of Income

Capital gains are taxed on a realization basis. This means that the tax is only imposed when an investor opts to withdraw his or her investment from the market and realize the capital gain. One of the most significant economic effects is the incentive this creates for owners of capital to retain their current investments even if more profitable and productive opportunities are available. Capital gains taxes make capital investments more expensive and therefore less investment occurs. Several studies have investigated the link between the supply and cost of venture capital financing and capital gains taxation, and found theoretical and empirical evidence suggesting a direct causality between a lower tax rate and a greater supply of venture capital. Kevin & Gilbert, (2001) sought to estimate the sensitivity of investment to changes in the user cost of capital and found that decreasing capital gains taxes by 4.0 percentage points leads to a 1.0 to 2.0 percent increase in investment. Next, they investigate the impact on entrepreneurship. Capital gains taxes reduce the return that entrepreneurs and investors receive from the sale of a business. This diminishes the reward for entrepreneurial risk-taking and reduces the number of entrepreneurs and the investors that support them. The result is lower levels of economic growth and job creation. Analysing the stock of venture capital and tax rates on capital gains from 1972 to 1994, Gompers & Lerner (2003) found that a one percentage

point increase in the rate of the capital gains tax was associated with a 3.8 percent reduction in venture capital funding. Last but not least, the authors also discuss the impact of capital gains taxation on compliance costs, administrative costs, and tax avoidance. They also look at the marginal efficiency cost of capital gains taxation and report on some of the research in that area. Dale Jorgensen & Kun-Young Yun (1991) estimate the marginal efficiency costs of select US taxes and find that capital-based taxes (such as capital gains taxes) impose a marginal cost of $0.92 for one additional dollar of revenue compared to $0.26 for consumption taxes. Baylor & Beausejour (2004) find that a $1 decrease in personal income taxes on capital (such as capital gains, dividends, and interest income) increases society's well-being by $1.30; by comparison, a similar decrease in consumption taxes only produces a $0.10 benefit the Quebec government's Ministry of Finance found that a reduction in capital gains taxes yields more economic benefits than a reduction in other types of taxes such as sales taxes. Reducing the capital gains tax by $1 would yield a $1.21 increase in the GDP.

Taxes are the major means by which the government finances its activities. Therefore introduction of new taxes will surely increase the government revenue. However, one question that one has to ask is whether the taxes will be good for the economy as a whole. In as much as taxes improve the government's revenue, it also reduces the disposable income available to households for consumption. Consumption is the biggest component of the GDP and therefore a reduction in consumption is likely to slow down economic growth. Taxes, as mentioned earlier, reduce the disposable income of consumers. Disposable income is the income that households are left with after deducting taxes. Households have two uses for their disposable income, that is, consumption and saving.

When their disposable income is reduced, both consumption and savings are automatically reduced. In the national income determination, consumption by households represents the biggest component of the GDP. This implies that a reduction in consumption is likely to slow down economic growth. Savings on the other hand supply the funds which are loaned to firms for investment. As mentioned earlier, taxes reduce the amounts available for saving. Hence, the funds available for loaning to firms are limited or are obtained at high costs which tend to discourage investors. Investment is another component of the GDP. Reduction in investment means that the economic growth of a country is likely to be slowed down is whether imposition of extra taxes is good for the economy or not? This brings to mind the concept of the multiplier effect. An analysis of the impact of taxes on the economy requires the use of the tax multiplier. The effect of taxes on consumption is that it reduces consumption by the amount of taxes multiplied by the marginal propensity to consume (the amount consumed by the households per unit shilling). It also reduces investment by the amount of taxes imposed multiplied by the marginal propensity to save (amount saved per unit shilling). However, government expenditure increase by the amount of taxes levied. The overall effect is that consumption and investments reduces more than government spending increases. This implies a decrease in the national income. The net decrease in national income may be gotten by obtaining the tax multiplier and the multiplying it by the amount of taxes levied. In conclusion, imposition of extra taxes has negative impact on the economy. However, if the government expenditure multiplier effect exceeds the tax effect on consumption and investment, then it can simulate economic growth. A detailed analysis of the effect of

taxation on the economy therefore has to be done before the government imposes new taxes on the economy.

2.2.3 Costs

Allers (1994,) defines administrative costs as “costs incurred by mainly public sector agents in order to administer the tax-benefit system”. He then goes on to note that “it is not obvious, exactly, which activities should be attributed to the operation of the system. For example, should the costs of the legislation itself or the costs of legal disputes, be included within the measure of administrative costs? And how are the costs of some very other obvious elements (such as the depreciation of buildings and other physical infrastructure) to be measured? Administrative costs clearly include the costs of running and maintaining revenue agencies, including salaries of staff, pensions relating to those staff, together with accommodation and office expenses for revenue department staff. Less obviously, administrative costs can also include the costs of legislative enactment relating to the tax system, from initial policy formulation through to statutory or other rule enactment. They can also include the judicial costs of administration of the tax dispute system, which may involve local and national tribunals and at the extreme the courts themselves. There is also uncertainty about what should be included in the measurement of tax compliance costs.

Tax compliance costs are those costs “incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax” (Sandford, et.al.,1989); bookkeeping, agency fees as well as advertising costs. Whilst this is an area in which there will always be debate, it is possible to identify a “hard core” of costs that are indisputably part of the costs of complying with

tax requirements. Compliance costs associated with a tax system may have a different nature and origin.It may involve the “classic“ compliance costs (costs of employees, time, premises and external supplies of goods and services), cash-flow costs, psychological costs. In addition to this generally accepted hard core of compliance costs, there are a number of other costs that need to be considered. For example, there is little doubt that there will always be a measure of psychological cost that is induced by the operation of the tax system. Taxpayers suffer stress, anxiety and frustration as a result of attempting to comply with their tax obligations. Unfortunately, no studies have yet managed to successfully quantify these psychological costs, although research in this area is now taking place. Research being undertaken in Australia by Woellner, et.al (2001) uses a combination of approaches to quantify the psychological costs of the tax system, including adaptation of health studies work and analysis of legal “pain and suffering” compensation cases. There is also contention over other aspects of the precise boundaries of compliance costs. For example, compliance costs are sometimes divided into computational (unavoidable or involuntary) and tax planning (avoidable or voluntary) costs.

2.3 Critique of the Literature

The study reviewed theories and empirical literature relevant to the variables under research. Somers(1948) stated in their findings that taxes on capital gains on securities prompt investors to become less willing to invest as well as avoid tax which is incontrast to (Stiglitz,1983) whose findings emphasized that the capital gains tax on securities led to increased transfer costs thus prompting the lock in effect. The two scholars findings are concurement with the prospect theory which propels the aspect of investors regarding

their decisions on gains rather than losses. However, findings by (Sahm,2008) state that taxation of capital gains upon realization provide an incentive to hold winners and sell losers immediately which is in contrast with the prospect theory where they costs of disposing the losers overweigh the return but the investors still make that decision.

Kevin&Gilbert (2001) stated in their research that a decrease in cost of capital on capital gains led to increase in investment which contrasts with (Baylor&Beausejour,2004) whose findings reveal that decrease in personal income tax increases society's well being. The two scholars findings concur with the agency theory as through the various real estate brokers, their decisions would be informed depending on their respective level of income as well as the potential of the various investment opportunities.

Woellner, et.al (2001) in their findings stated that the tax system has psychological costs incurred in compliance which cannot be recouped regardless of the returns, This is contrary with the prospect theory which states that where the costs outweigh the returns, the decision is not considered due to the negative result.

2.4 Capital Gains Tax Performance

Capital gains taxation further effects economic and employment growth through its impact on entrepreneurial activity and business creation. Entrepreneurship is the driving force of a market economy. It is crucial to job creation, innovation, and productivity. Entrepreneurship is affected by, among other things, the strength of the incentives that motivate entrepreneurs to undertake innovative projects and the ability of the entrepreneur to raise enough capital to finance projects. The taxation of capital gains discourages innovation, risk-taking, and capital investment, thus diminishing entrepreneurial activity in the economy.

Opponents of a capital gains tax reduction argue that capital gains are already subject to preferential treatment, and a further rate reduction would only motivate many taxpayers to reclassify regular income as capital gains in order to take advantage of lower tax rates. However, there are many provisions in the tax code which discriminate against saving and investment and outweigh the preferential treatment of capital gains, (Robert.J et.al., 2005).

According to Kasingiu, (2012), taxation is the single largest source of government budgetary resources. The current tax structure comprises of two main direct taxes: Individual Income Tax and Corporate Tax, and three main indirect taxes: Value Added Tax (VAT,Excise Tax, and Customs Duties. Capital gains tax (a direct tax) was introduced in Kenya in 1975 and suspended in year 1985. The effect of suspending CGT in 1985 has never before been quantitatively analysed. The study found that while average GDP and inflation were significant determinants of total tax revenue, CGT, agricultural, manufacturing and external sectors were insignificant determinants. The study concluded that CGT would have a negative and insignificant contribution to total tax revenue. However, pursuing a policy of zero capital gains tax may go against the main canon of equity in taxation.

2.5 Conceptual Framework

Capital gains tax reintroduction was to prompt more development in the real estate sector as well as the securities market. Despite the various objectives and projected benefits of this source of revenue, there are certain consequences that sprung out from the CGT. It is from the empirical literature that the various variables have been exhaustively reviewed and hence the conceptual framework, aims at portraying the relationship between them for a better understanding of the study.

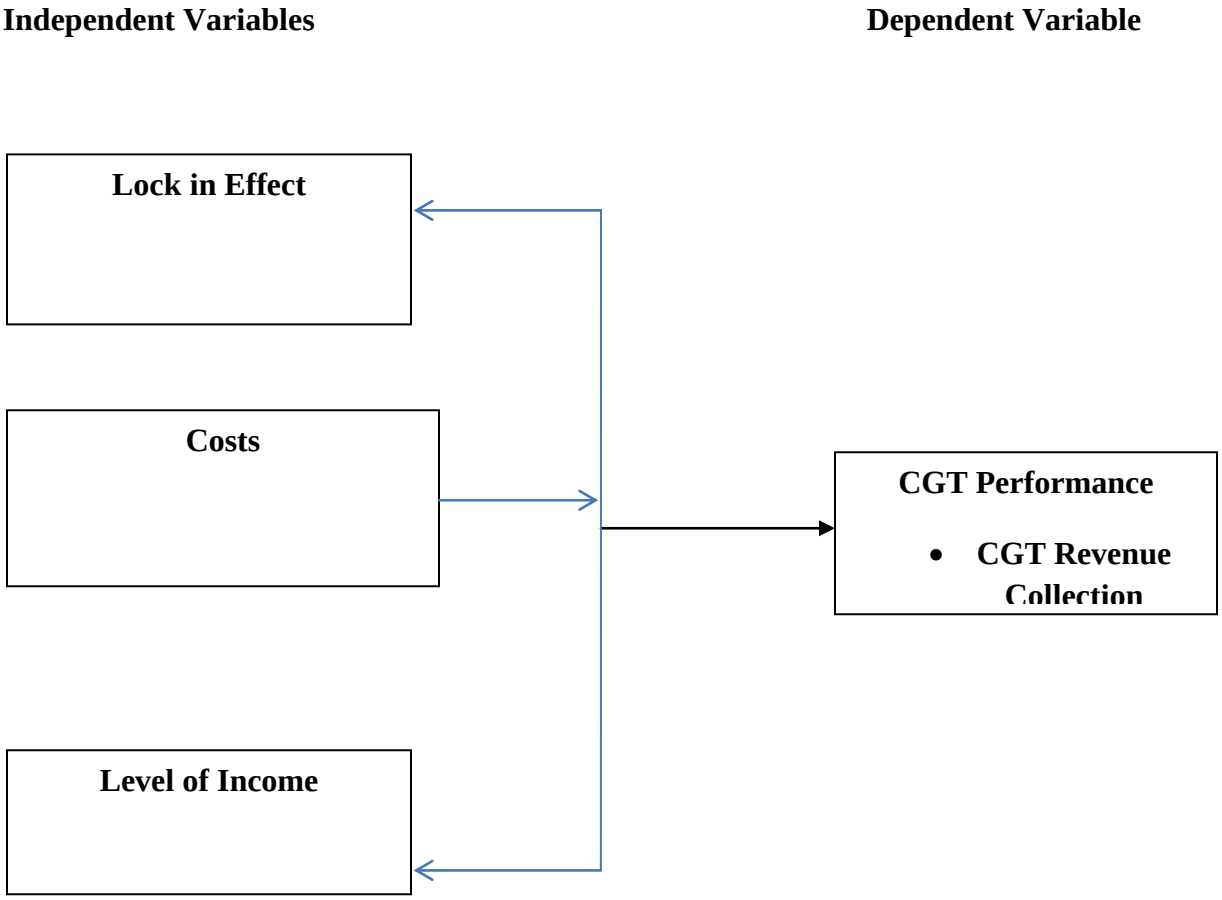


Figure 2.1 Conceptual Framework

Table 2.1 Summary of Previous Studies and Knowledge Gaps

Author	Title	Findings	Current Study	Gaps
Kasingiu, (2012)	Effect of Capital Gains Tax on Total Revenue in Kenya	CGT has a negative and insignificant contribution to total tax	CGT performance from real estate	Contextual gap exists owing to the fact that CGT had been suspended until just recently in 2014.
E.N. Karinga,(2015)	The Announcement Effect of Capital Gains Tax on Stock Performance at NSE	Positive effect on performance of stocks due resistance to the announcement	Reintroduction Effect on CGT performance by the Real Estate	Contextual gap due to the difference in the dependent variable
Poterba, (1987)	Relationship between Capital Gains Taxes and Tax Evasion in USA.	Capital gains taxes have a significant impact on tax evasion on the realization of capital gains sale of corporate stocks at a profit.	Factors influencing CGT performance	Methodological gap since in the prior study used panel data. This study embraced time series

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research design and procedures that were used to select the sample elements. It covers the research instruments and the procedure for collecting the research data and defines the methods were used by the researcher to analyze it.

3.2 Research Design

The research design constitutes the blueprint for the collection, measurement and analysis of data (Cooper & Schinder, 2007). The study employed a descriptive also referred to as diagnostic research design which is considered with describing characteristics of a particular individual or groups of individuals, (Kothari, 2005). According to Cooper & Schindler (2003), the descriptive study tries to answer the, who, what, when, where and sometimes how questions.

This particular study aimed at establishing what the factors influencing performance of capital gains tax a case of Thika Real Estate. To achieve fulfilling results for this study, the researcher adopted the use of structured instruments like the questionnaires which involved questions that were developed using the Likert scale as well as reports from KRA on remittance of the CGT

3.3 Target Population

The researcher targeted to collect views in relation to the real estate sector within Thika and the factors influencing performance of Capital Gains Tax as the 3 top developers of real estate in Thika comprised the researcher's target population of 50 respondents.

3.4 Sample Size

The study applied stratified random sampling method to select a sample because the population does not form a homogenous group. Sample size was selected on the basis of proportionate representation of each strum in the population.

Table 3.1 Sample size

TARGET POPULATION	RESPONDENTS	SAMPLE SIZE (40%)
Angaza Real Estate	15	10
Gakuyo Real Estate	15	10
Uriithi Housing	20	8
TOTAL	**50**	**20**

3.5 Data Collection

The study collected both secondary and primary data. Secondary data from KRA reports on the trend of revenue collection from capital gains tax since its re-introduction with keen focus on Thika's real estate contribution. Primary data was collected by aid of structured questionnaires from the 3 real estate companies within Thika district.

3.6 Pilot Test

The study carried out a pilot test to pretest the validity and reliability of data collected using the questionnaire. A pilot group of 5 individuals was selected from the target population to test the reliability of the research instruments. Pilot data was not included in the actual study.

3.7 Reliability Test

Reliability is increased by including many similar items on a measure, by testing a diverse sample of individuals and by using uniform testing procedures. In order to test the reliability of the instruments, internal consistency techniques were applied using Cronbach's Alpha. The alpha value ranges between 0 and 1 with reliability increasing with the increase in value. According to (Mugenda, 2003), a coefficient of 0.6-0.7 is a commonly accepted rule of thumb that indicates acceptable reliability and 0.8 or higher indicated good reliability.

3.8 Validity Test

According to Gall et al. (2003), validity is the degree by which the sample of test items represents the content of test is designed to measure. Content validity which was employed by this study was a measure of the degree to which data collected using a particular instrument represents a specific domain or content of a particular concept. Mugenda & Mugenda (1999) contend that the usual procedure in assessing the content validity of measure is to use a professional or expert in a particular field.

3.9 Data Analysis and Presentation

Anderson & Poole (1998), postulate that once data has been collected, the researcher must be able to interpret it's reliably. The process involves summarizing and categorizing the data to a temporary manageable length, identify themes, analyze and assess. It is from this point that the researcher will look for meaning within the data and often relate findings to previous studies to see if these support existing research. The researcher analyzed data using descriptive statistics. Data presentation was by use of cross tabulation charts and graphs, tables, percentages and frequencies to display a visual presentation of the data, for ease of understanding and analysis.

The analysis was done by application of the statistical package for social sciences (SPSS) software, IMB 2015 version. The study also adopted regression analysis to establish the relationship between the dependent and the independent variables.

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta 3 X_3 + \varepsilon$

Where:

Y = Tax Performance

β_0 = Constant Term

β_1 = Beta coefficients

X_1 = Lock in Effect

X_2 =Costs

X_3 = Level of Income

ε = Error term

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter explains the results of the findings. The research sought to establish the factors that influence performance of capital gains tax in Thika district real estate. The data collected from the respondents has been analyzed and presented in tables and pie charts which are accompanied by discussions. The chapter is structured according to results of the findings on the objectives of the study.

4.2 Demographic Information

4.2.1 Organization Related Information

The study sought to establish the respondent's current position in that organization and finally how long they have been in that level within the institution. The findings also indicated that 35% of the respondents were from the top level of management within the organization while the 45% were at the middle level of management in their respective institutions and the remaining 20% represented the low level of management.

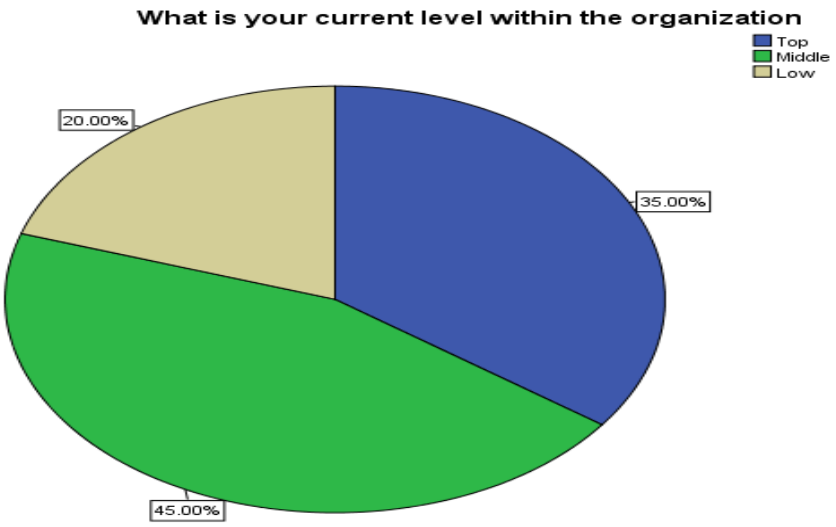


Figure 4.1 current levels in organization

The other important question the respondents were asked was how long they have held the position they have within that organization. The findings thus revealed that, 25% of the respondents have been with the organization at the same position for a period of 1-3 years, 55% have held the position for a period of 4-6 and the remaining 20% have been at the current level of management for over 7 years, this demographic findings validate that the respondents have exposure that ascertains the variables of the study.

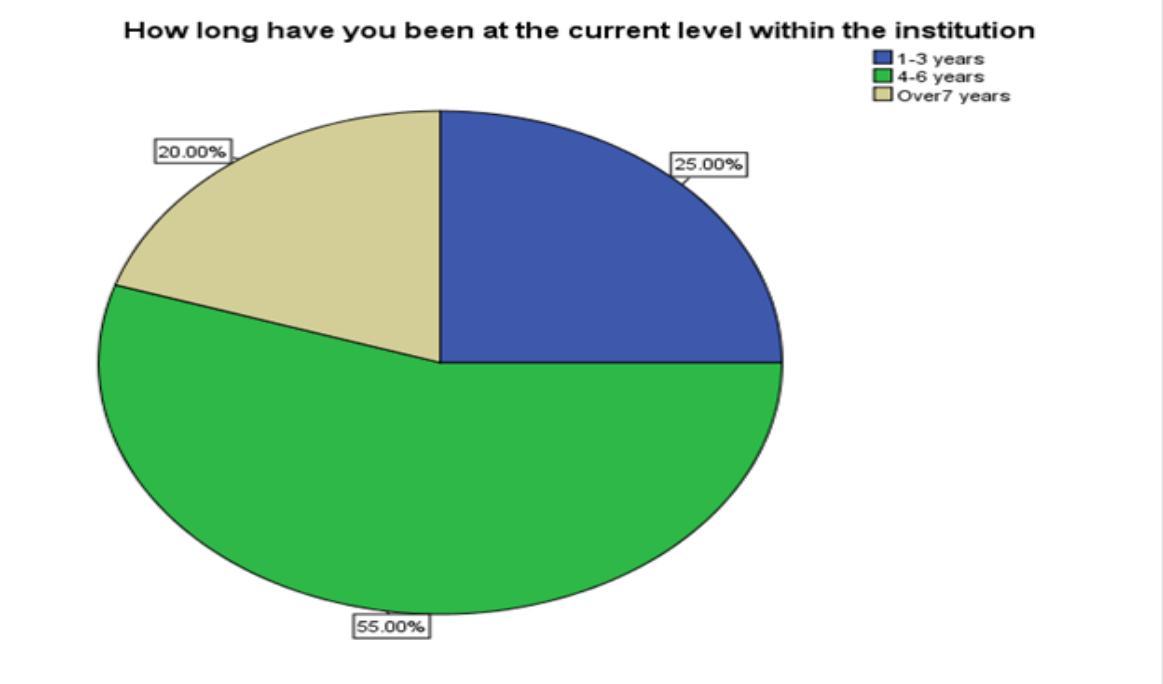


Figure 4.2 Period of years at current level

4.2.2 Capital Gains Tax Familiarity

The research also sought to gauge the familiarity and exposure of the respondents with regards to their knowledge on Capital Gains Tax. Findings showed that 100% of the respondents are aware of the CGT concept which supports the researcher's choice on the target population. The research findings also sought to shed light with regards to what experience the respondents have had as well as the impact they have noted or witnessed through the reintroduction of CGT. The table below shows a collection of the views from the respondents that shall expound the questions raised.

Table 4.1 Experience of Respondents with Capital Gains Tax

Statement	Frequency	Percent
Tedious	4	20.0
Costly	7	35.0
A deterrent measure	4	20.0
Necessary measure	5	25.0
Total	**20**	**100.0**

Table 4.2 Impact of Reintroduction of Capital Gains Tax on the Real Estate Sector

Statement	Frequency	Percent
Discouraged Investments	7	35.0
Increased cases of tax evasion	4	20.0
Lead to an increase in the cases of agency costs that ensure compliance by the tax payers	5	25.0
Capital Gains Tax reintroduction has resulted in the streamlining of the real estate sector by improving the accountability	4	20.0
Total	**20**	**100.0**

From the tables above the respondents were asked to state their experience with the Capital Gains Tax. Majority felt that it is a costly tax for them to comply with while the others view it a necessary measure to ensure that people just do not accumulate wealth without proper remittance of the taxes due.

4.3 Lock in Effect

	Mean	Standard Deviation
Taxes on capital gains for securities typically cause a lock-in effect in stock markets, primarily because investors become less willing to invest or they wish to avoid taxation	**1.80**	**.696**
Capital gains tax discourages sales of appreciated assets because assets subject to capital gains taxation are generally held for a longer time by investors who hold assets, which have increased in value	**1.70**	**.657**
The lock-in effect possibly distorts the liquidation and investment decision.	**2.00**	**.562**

The study sought to establish the effect of lock in effect on Capital gain tax performance. From the statements the respondents were requested to give the opinion by choosing from the likert scale. It was found that majority of the respondents strongly agreed as clearly illustrated by the mean value on the table above of 2.00 on the statement implying how investors in this case; Real Estate Investors opt to hold on to appreciate land rather than dispose it so as to avoid the burden of getting the taxation on its appreciated value.

4.4 Costs

	Mean	Standard Deviation
Tax compliance costs are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax	**1.50**	**.513**
Administrative costs clearly include the costs of running and maintaining revenue agencies	**1.95**	**.686**
Administrative costs can also include the costs of legislative enactment relating to the tax system, from initial policy formulation through to statutory or other rule enactment	**2.20**	**.616**

Capital Gains Tax is complicated and costly to administer for practical and political reasons are perpetually riddled with exemptions and exceptions making them complicated to administer and to comply with. Findings from the study with a supportive mean of 1.95 also show that technology needs to make it easier for taxpayers to comply with their tax obligations if it increases the accessibility level as well as the amount of information available, widening the range of payment modalities, reducing the need for taxpayers to visit the office and shortening waiting times for those taxpayers who need help. Advanced internet options, payment via electronic banking services as well as virtual telephones have been developed to achieve these aims. The tax administration agency needs to see the taxpayer as a customer, not as someone who owes money to the Administration.

4.5 Level of Income

	Mean	Standard Deviation
Capital gains taxes reduce the return that entrepreneurs and investors receive from the sale of a business. This diminishes the reward for entrepreneurial risk-taking and reduces the number of entrepreneurs and the investors that support them	**1.90**	**.553**
Capital gains tax is easy to avoid as decision to pay a capital gains tax is entirely up to the taxpayer. It's the easiest tax to avoid because you just don't sell your asset;	**1.40**	**.503**
Disposable income is the income that households are left with after deducting taxes. Taxes reduce the amounts available for saving. Hence, the funds available for loaning to firms are limited or are obtained at high costs which tend to discourage investors.	**1.95**	**.605**

From the table above, it is evident that the respondents are clearly in strong agreement according to the mean of 1.90, 1.40 and 1.95 with the research questions posed to them which proves that effect of taxes on consumption is that it reduces consumption by the amount of taxes multiplied by the marginal propensity to consume (the amount consumed by the households per unit shilling). It also reduces investment by the amount of taxes imposed multiplied by the marginal propensity to save (amount saved per unit shilling).

4.6 Tax Performance

	Mean	Standard Deviation
The capital gains tax (CGT) has been reintroduced in Kenya as part of the government's efforts to increase revenue	**1.50**	**.513**
Capital gains tax reintroduction has been met with resistance hence suffering from poor return filling	**1.95**	**.605**
Tax performance is determined by the voluntary compliance of the parties involved hence the revenue collected depends on the awareness of this new tax	**2.35**	**.489**

The research also sought to explain how the dependent variable has a relationship with the other three independent factors of the study. Tax stands as a major source of government revenue not only for developed countries but also for developing countries. As a way of raising revenue which services the Government's budget, CGT was reintroduced and as the mean of 1.5 supports this. Capital gains tax is easy to avoid as decision to pay a capital gains tax is entirely up to the taxpayer. The research concurs with this through the mean of 1.95 of the respondents who strongly agree with Capital gains tax reintroduction has been met with resistance hence suffering from poor return filling

Correlations

		Lock_in_effect_1	Cost_1	Level_of_income_1
Lock_in_effect_1	Pearson Correlation	1	.396	-.025
	Sig. (2-tailed)		.054	.417
	N	20	20	20
Cost_1	Pearson Correlation	.396	1	.103
	Sig. (2-tailed)	.044		.667
	N	20	20	20
Level_of_income_1	Pearson Correlation	-.025	.103	1
	Sig. (2-tailed)	.037	.667	
	N	20	20	20
Tax_performance_1	Pearson Correlation	.369	.410	-.518*
	Sig. (2-tailed)	.049	.053	.079
	N	20	20	20

The table above illustrates the variables and the correlation between each of them. From it correlation is seen to either be positive or negative.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics	
					R Square Change	F Change
1	.681[a]	.464	.364	.519	.464	4.625

a. Predictors: (Constant), Level_of_income_1, Lock_in_effect_1, Cost_1

b. Dependent Variable: Tax_performance_1

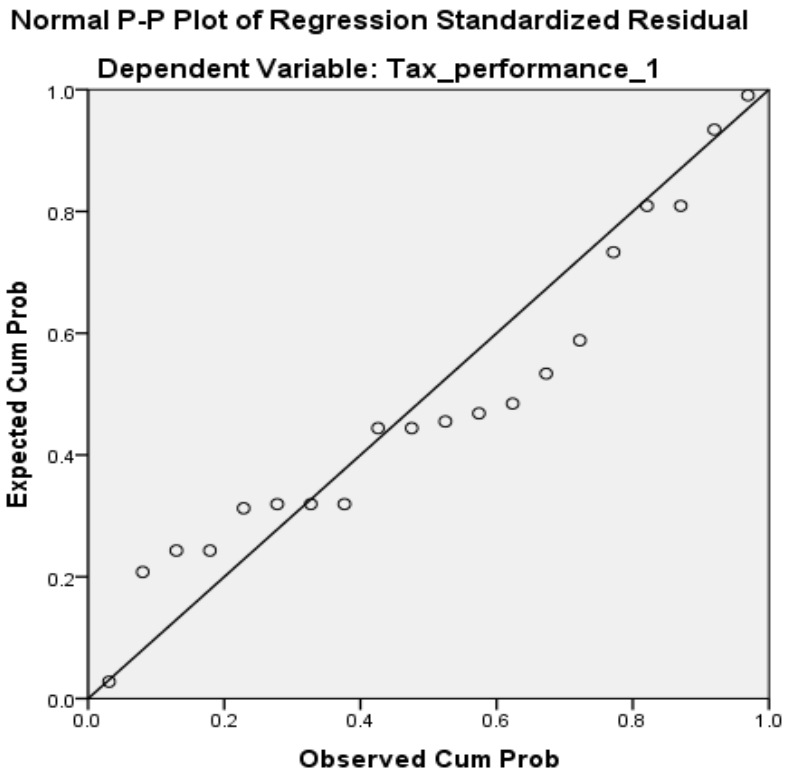
Model Summary shows that there is 68% positive correlations between the variables that were involved in the research. The R Square can be interpreted to show that 46 % of the changes in tax performance in real estate are as a result of the factors identified in the research while 54 percent are others that are not included in this particular research. The multiple regression analysis also revealed that with 19+1 parameters, the predictor variables resulted in a significant value of 0.016 meaning that the prediction model was a good one.

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	3.733	3	1.244	4.625	.016[b]
	Residual	4.305	16	.269		
	Total	8.038	19			

a. Dependent Variable: Tax_performance_1

b. Predictors: (Constant), Level_of_income_1, Lock_in_effect_1, Cost_1



The regression model used in analysis of the data resulted in the coefficients in the table above. The lock in effect (b=0.566, p=0.038) is significant and since the coefficients is positive, it indicates that lock in effect influences Capital Gains Tax performance. Next, the influence of costs (b=0.471, p=0.043) is significant and having a positive coefficient means that the costs incurred in compliance and facilitation of Capital Gains Tax have a positive influence on its performance. Finally, level of income (b=1.211, p=0.75) is insignificant, since it falls on a point beyond the acceptance region.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-2.253	1.152		-1.955	.068
	Lock_in_effect_1	.566	.398	.284	1.421	.038
	Cost_1	.471	.385	.246	1.225	.043
	Level_of_income_1	1.211	.447	.500	2.711	.075

4.7 Discussion of the Results

The first objective of the study was to establish the influence of lock in effect on CGT performance; findings reveal that real estate investors opt to hold on to appreciated land rather than dispose it so as to avoid the burden of getting the taxation on its appreciated value. The findings concur with those of (Sahm 2008) which show that taxation of capital gains upon realization instead of accrual provided incentives to hold winners as long as possible and sell losers immediately. Somers (1948), also documented that taxes on capital gains for securities typically cause a lock-in effect in stock markets, primarily because investors become less willing to invest or they wish to avoid taxation.

The second objective of the study was to determine the influence of costs on CGT performance, findings reveal that costs incurred by the tax payer may limit their willingness to comply with Capital Gains Tax. The greater inefficiencies are more likely to be driven by transactions costs — the costs incurred by people, in the form of professional fees. The findings concur with (Bittker 1975), high tax rates on real estate cause transaction costs to increase in equal measure: a tax averse rich person would pay a lot to avoid more than half of his estate being turned over to the government on his death, Bittker's study concluded that tax evasion is as a result of the high cost in complying with the capital gains tax. However they contrast with (Poterba 1987) which state Capital gains taxes have a significant impact on tax evasion on the realization of capital gains sale of corporate stocks at a profit

The third objective of the study was to determine the influence of the level of income on CGT performance; findings reveal a negative impact on CGT performance as there is an effect of taxes on consumption and it reduces consumption by the amount of taxes multiplied by the marginal propensity to consume (the amount consumed by the households per unit shilling). The findings contrast with (Baylor 2008), government expenditure increase by the amount of taxes levied and the overall effect is that consumption and investments reduces more than government spending increases: since the level of income determines the tax rate its subjected to, that is the higher the income the more taxes levied.On the other hand the same level of income determines how much one can invest from the disposable income, that is the more the income the higher the purchasing power.This leads to a negative effect translated to the capital gains performance as both are scrambling for the same income.

According to the study, while still being a recently re-introduced tax it has recorded a a slight positive effect since there is evidence of revenue collected from CGT. Findings from Kasingiu (2012), revealed the overall insight that CGT introduction led to loss of buoyancy of the tax system and concluded that CGT would have a negative and insignificant contribution to total tax revenue. These findings are contrary to the current study's since it is evident from the secondary data that the revenue has been remitted from the capital gains tax and it shows there is potential in growth since the real estate is a vast growing sector.

CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

The study sought to establish the Factors Influencing Capital Gains Tax Performance of Thika District Real Estate, it therefore sought to establish how selected factors: lock in effect, costs and level of income affect tax performance of Capital Gains Tax.

5.1.1 Lock In Effect

The study found that there was a slight positive correlation of 0.396 between this variable and the costs while there was a negative relationship of -0.025 between level of income. The study also found that Capital gains tax discouraged sales of appreciated assets because assets subject to capital gains taxation are generally held for a longer time by investors who hold assets, which have increased in value and that lock-in effect distorts the investment decision which in return impacts the revenue collected form the Capital Gains Tax.

5.1.2 Costs

The study found that there is a positive correlation between the variables involved in the research. The common costs that the respondents were most conversant with were found to be; book keeping, calculation and tax remittance costs. It was also found that the use of agents and brokers lead to high compliance costs for the tax payer and would at times lead to tax irregularities. The study also found that embracing technology would suffice in minimizing this loophole as well as ensure efficiency of tax administration.

5.1.3 Level of Income

The study's findings revealed that there is a negative correlation between the level of income and the dependent variable. It was also revealed that, disposable income is the income that households are left with after deducting taxes. Taxes reduce the amounts available for saving. Hence, the funds available for loaning to firms are limited or are obtained at high costs which tend to discourage investors. It was also seen that the high resultant costs end up as a discouragement to the entrepreneurial culture in the potential investors.

5.1.4 Tax Performance

The study found that this dependent variable had a positive correlation with the variables; lock in effect and costs, while there was a negative correlation between the level of income. It was also found that the re-introduction of the capital gains tax was aimed at increasing the tax revenue base as well as encourages investment within the real estate sector. Findings also show that the performance of tax is highly reliant on the compliance of the investors which puts the projected revenue from this CGT base at a risk, since the investors can easily comply and still avoid the tax by withholding their property despite any increase in value.

5.2 Conclusions

The study therefore concludes that capital gains tax is not a new concept despite its recent re-introduction going by the findings and familiarity with respondents. It thus can be concluded that the parties that are involved in transactions that attract this tax are well conversant with its working. The study also concludes that the aim of the tax re introduction has resulted in a great discouragement of transfer of land and other real

estate assets as the sellers try to avoid paying up the CGT, which in turn reduces the tax performance by the KRA revenue collection.

The study also concludes that the costs that are a resultant factor of the Capital Gains Tax impact the performance of the tax. This is so since some of the administrative costs that are mostly to be borne by the tax administration agency if not well distributed contribute to the failure while on the same hand the compliance costs that are borne by the tax payer may be too much of an expense that may in turn encourage tax avoidance or evasion . Finally, the study concludes that despite the level of income being a determinant on how the investors spend and invest it does not affect the tax performance since each investor has a different risk attitude and portfolio.

5.3 Limitations of the Study

The research encountered few challenges. First the resources were limited especially due to paucity of documented information on the capital gains tax subject especially in Kenya. largely attributed to the fact that this is a totally new area of Study with limited publications in the country owing to it being recently re-introduced.This was mitigated by working with the available information from the few sources as well as the primary data from the field. Another resource limitation was the expense incurred during the entire research period since most required finance to ensure efficiency.

Second challenge was the response rate by the target repondents making data from the targeted Real Estate District in Kenya insufficient to be used to answer some of the research objectives sufficiently and also since availability of all the respondents posed a challenge.

Final limitation to the study was the aspect of time, thus limiting the scope and depth of the research study owing to the fact that it was time bound with deadlines that required a balance stricken between work and conducting the study,

5.4 Recommendations

From the study's findings the following are recommendations;

That for a different research, more variables should be used as well as widening of the scope, which would help for comparison with the current study's findings.

For managerial purpose, the study recommends that Kenya Revenue Authority being the Tax Administration Authority should employ more technical staff and train them in interpreting the law which shall ensure that proper sensitization of this Capital Gains Tax is done to the tax payers.

Policy makers should introduce stringent measures with respect to tax penalties and fines on the real estate firms and tax payers who violate and act as an obstacle in the administration of this tax.

5.5 Suggestions For Further Research

Further research can be done by expanding the scope of coverage to a different sector of from the country's economy other than the real estate. This would serve further to explain the different demands and unique needs attached to the sectors with regards to Capital Gains Tax.Capital Gains Tax on shares in Kenya was suspended and hence very little research has been done,hence further research should be done with regards to international stock market trading and its influence on tax performance.Research could

also be done on this particular sector with the aim of establishing which other factor(s) constitute the 54% the analysis of this study's findings was referring to.

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APPENDICES

APPENDIX A: LETTER OF INTRODUCTION

Dear Sir/Madam

I am a Post Graduate Diploma student in Tax Administration at KESRA. As a key requirement for the fulfillment of my course I am required to carry out a research project. This questionnaire seeks to assess the Factors Influencing Performance of Capital Gains Tax in Thika District. The information collected through this questionnaire shall be treated with confidentiality and it is for academic research purpose only. Your help will be very much appreciated.

Yours Faithfully,

Jewel Gathuri

APPENDIX B: QUESTIONNAIRE

This questionnaire is divided into five parts. You are requested to the read the questions in each part carefully.

You can tick as applicable

PART 1: DEMOGRAPHICS OF THE RESPONDENT

1. What is your current level within the organization

   Top ☐ Middle ☐ Low ☐

2. How long have you been at the current level within the institution

   1-3 years ☐ 4-6 years ☐ Over7 years ☐

3. Are you familiar with the concept of Capital Gains Tax? If yes, give brief description of your experience with it

   ……

   ……

   ……

   ……

   ……

4. Kindly state how you view the impact of reintroducing the capital gains tax on the real estate sector

   ……

   ……

   ……

PART 2: OBJECTIVES OF THE STUDY

a) Lock in Effect

Using the following scale, state your opinion by ticking on the space

1- Strongly Agree 2- Agree 3- Neutral 4- disagree 5- Strongly Disagree

Effects of Capital Gains Tax	**1**	**2**	**3**	**4**	**5**
Taxes on capital gains for securities typically cause a lock-in effect in stock markets, primarily because investors become less willing to invest or they wish to avoid taxation.					
Capital gains tax discourages sales of appreciated assets because assets subject to capital gains taxation are generally held for a longer time by investors who hold assets, which have increased in value					
The lock-in effect possibly distorts the liquidation and investment decision.					

b) Costs

Using the following scale, state your opinion by ticking on the space

1- Strongly Agree 2- Agree 3- Neutral 4- disagree 5- Strongly Disagree

Effects of Capital Gains Tax	**1**	**2**	**3**	**4**	**5**
Tax compliance costs are those costs "incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax					
Administrative costs clearly include the costs of running and maintaining revenue agencies					
administrative costs can also include the costs of legislative enactment relating to the tax system, from initial policy formulation through to statutory or other rule enactment					

From your understanding and experience, what are some of the administrative and compliance costs incurred in relation to Capital Gains Tax…….

……

……

c) Level of Income

Using the following scale, state your opinion by ticking on the space

1- Strongly Agree 2- Agree 3- Neutral 4- disagree 5- Strongly Disagree

Effects of Capital Gains Tax	**1**	**2**	**3**	**4**	**5**
Capital gains taxes reduce the return that entrepreneurs and investors receive from the sale of a business. This diminishes the reward for entrepreneurial risk-taking and reduces the number of entrepreneurs and the investors that support them					
Capital gains tax is easy to avoid as decision to pay a capital gains tax is entirely up to the taxpayer. It's the easiest tax to avoid because you just don't sell your asset;					
Disposable income is the income that households are left with after deducting taxes.					
Taxes reduce the amounts available for saving. Hence, the funds available for loaning to firms are limited or are obtained at high costs which tend to discourage investors.					

d) Tax Performance

Using the following scale, state your opinion by ticking on the space

1- Strongly Agree 2- Agree 3- Neutral 4- disagree 5- Strongly Disagree

Statements on Tax Performance	**1**	**2**	**3**	**4**	**5**
The capital gains tax (CGT) has been reintroduced in Kenya as part of the government's efforts to increase revenue					
Capital gains tax reintroduction has been met with resistance hence suffering from poor return filling					
Tax performance is determined by the voluntary compliance of the parties involved hence the revenue collected depends on the awareness of this new tax					

As an individual who has interacted with the newly re-introduced capital gains tax, suggest ways by which the revenue collection can be improved within the booming real estate sector

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APPENDIX C: CAPITAL GAINS TAX TREND

	STAMP DUTY COLLECTED IN 2015	STAMP DUTY COLLECTED IN 2016	COLLECTION FROM SHARES TRADED AT NSE 2015	CGT COLLECTION LESS SHARES TRADED AT NSE 2015	CGT COLLECTION 2015	CGT COLLECTION 2016	Percentage Growth in CGT (2015-2016)
Jan	563,259,316.25	594,926,210.35	0.00	0.00	0.00	156,016,838.15	N/A
Feb	677,920,170.70	805,214,817.80	12,341,036.25	89,016,080.00	101,357,116.25	301,793,032.00	239.03
Mar	780,718,531.75	771,696,819.25	1,845,600.30	5,814,321.10	7,659,921.40	131,368,119.70	2,159.39
Apr	743,094,693.75	719,367,141.70	1,265,983.00	271,119,130.25	272,385,113.25	119,990,373.00	-55.74
May	756,026,851.40	756,026,851.00	17,983,995.25	27,701,009.15	45,685,004.40	225,749,457.00	714.95
Jun	657,143,463.92	811,253,687.00	38,257,471.35	170,461,887.35	208,719,358.70	144,782,300.00	-15.06
Jul	998,341,994.00	627,916,331.00	16,891,641.05	521,061,317.10	537,952,958.15	199,903,436.00	-61.64
Aug	1,175,387,452.90	745,928,523.55	14,566,669.80	134,950,338.30	149,517,008.10	107,107,522.25	-20.63
Sep	967,334,804.40		12,658,489.15		328,566,423.30		
Oct	743,879,942.06		34,110,176.30		1,478,277,630.25		
Nov	872,455,624.70		6,355,235.10		55,994,818.30		
Dec	1,231,690,190.90		1,418,462.30		176,415,632.45		
	10,167,253,036.73	5,832,330,381.65	157,694,759.85	1,220,124,083.25	3,362,530,984.55	1,386,711,078.10	