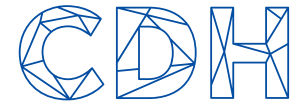


Tax & Exchange Control

ALERT | 3 April 2025



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Court of Appeal clarifies sale of commercial buildings is subject to VAT, defying land and attachment principle

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Court of Appeal clarifies sale of commercial buildings is subject to VAT, defying land and attachment principle

In a landmark decision in *Kenya Revenue Authority v Ndegwa* [2025] KECA 510 (KLR) (*David Ndegwa Case*) the Court of Appeal has clarified the application of value-added tax (VAT) to commercial property transactions.

Section 5 and Paragraph 8 of Part II of the First Schedule of the VAT Act (VAT Act) exempt the sale, rental, hiring or leasing of land and residential premises from VAT (save for hotels and holiday accommodations). In this case, David Mwangi Ndegwa (the taxpayer) bought land valued at KES 70,000,050 with commercial buildings erected on it from Standard Chartered Bank Kenya Ltd. The Kenya Revenue Authority (KRA) demanded VAT of KES 11,200,080 (16% of the total value), which the taxpayer paid under protest and filed a suit for a refund of the same.

Background

The High Court was tasked with considering the definition of "land" referred to under Paragraph 8 of the First Schedule to the VAT Act. On **29 November 2018** the High Court held that the transaction was VAT exempt since "land" means what is on the surface of the earth and the subsurface rock and the air space above the surface.

In the separate case of *National Bank of Kenya Ltd v Commissioner of Domestic Taxes* [2022] KEHC 10549 eKLR, the High Court held on **26 May 2022** that Parliament in its wisdom knew that "land" includes the fixtures erected thereon, which may be residential or commercial, yet it proceeded to define residential premises and exempted the same under Paragraph 8. In this case the High Court held that whatever is not expressly included is deemed to be expressly excluded. It held that land and commercial

buildings are inseparable and that the KRA could charge 16% VAT on the total value (land and buildings), not just on the buildings.

So, on the one hand, the High Court implied that residential premises could be treated separately from the land it sat on, but on the other hand it held that commercial premises could not be treated separately from the land they sat on for tax purposes. This was part of the conundrum in the Court of Appeal in the case of *Kenya Revenue Authority v Ndegwa* [2025] KECA 510 (KLR) that was decided on **21 March 2025**.

Court determination

In *David Ndegwa Case*, the High Court initially held that the meaning of land in the VAT Act was ambiguous and ruled that VAT didn't apply to the sale of land and buildings. It interpreted "land" to include everything above and below the surface. Thus, commercial buildings were exempt pursuant to Paragraph 8 of Part II of the First Schedule of the VAT Act. However, the Court of Appeal overturned this. It ruled that only land and residential premises are VAT exempt, not commercial buildings.

The Court of Appeal's position is that the definition of "land" provided under Article 260 of the Constitution of Kenya, 2010 allows the meaning of land to vary depending on the context. This means that for tax purposes, buildings on land could be treated independently and subjected to tax separately, such that sale of commercial buildings are subject to VAT regardless of the fact that sale of land is exempt from VAT. The court found that there was no ambiguity in Paragraph 8 of Part II of the First Schedule to the VAT Act on the basis of perceived unclarity regarding, for example, mixed-use premises.

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Comment

The Court of Appeal set aside the High Court's judgment in its entirety, implying that VAT applies to the total value of land and commercial buildings. Notably, it did not address whether VAT should apply solely to the value of the buildings or to the combined value of both land and buildings. The Court of Appeal also did not clarify whether for mixed-use properties the taxable value should be apportioned so that VAT would only be payable on the value of the commercial portion.

It's probable that the KRA will evaluate sales/leases of commercial properties transacted over the last five years for which no VAT was remitted and issue assessments on the same.

This ruling brings much-needed clarity to the real estate sector and highlights the growing importance of understanding VAT in property transactions. However, for buyers this will likely raise the cost of buying or renting commercial properties.

The taxpayer still has the right to appeal to the Supreme Court.

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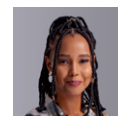
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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