

Foreign Exchange Losses on Debt-to-Equity Conversions are Tax Deductible

7th July 2026

In a judgment delivered on 12 June 2026, the Court of Appeal answered a question that had long unsettled corporate taxpayers in Kenya: where a foreign currency loan is repaid through shares rather than cash, can the resulting foreign exchange loss be deducted for income tax purposes? The Court's response to this was in the affirmative, dismissing the Commissioner of Domestic Taxes' appeal in **Civil Appeal No. E174 of 2022, Commissioner of Domestic Taxes v Delmonte Kenya Limited.**

Background

From 2001, Delmonte Kenya Limited ("DKL") borrowed money from its parent company in US dollars and Pounds Sterling. The funds were used for everyday business needs; paying suppliers, buying raw materials, and meeting payroll demands. As the Kenya shilling weakened against both currencies over the years, the loans became more expensive to

repay in Kenya shillings, generating significant foreign exchange losses. Since the loans were never actually repaid during that period, however, the losses remained unrealised and were not claimed as tax deductions.

In 2009, DKL settled the outstanding loans, by then amounting to USD 28,255,616 and GBP 1,464,272, primarily through the issuance of shares in itself to the lender. This settlement crystallised the accumulated losses into a realised foreign exchange loss of KES 401,261,996, which DKL claimed as a deduction under Section 4A of the Income Tax Act.

The Commissioner disallowed the deduction, arguing that because the loan was repaid with shares, a capital transaction, the resulting loss was capital in nature and therefore not deductible. This position led to additional tax demands totalling KES 270,661,566. The Tax Appeals Tribunal partially

upheld the Commissioner's decision prompting an appeal to the High Court by DKL.

On appeal, the High Court set aside the Tribunal's decision and allowed the deduction. Dissatisfied with the decision from the High Court, the Commissioner lodged an appeal to the Court of Appeal.

What the Appellate Court decided

The Court of Appeal upheld the High Court's decision and dismissed the Commissioner's appeal on three main grounds.

First, the Court held that the character of a foreign exchange loss follows the purpose of the loan, not the way it is repaid. Because the loans were used to fund day-to-day operations, not to acquire assets or make investments, the losses were revenue in nature. The fact that DKL happened to settle the debt by issuing shares did not change that. The shares were simply the method of payment; the loss itself had been building up over years of currency movement and was tied to the loan, not to the share issuance.

Second, the Court found that Section 4A of the Income Tax Act is clear on its face. It provides that a foreign exchange loss "realised in a business carried on in Kenya" shall be taken into account as a deductible expense. The provision makes no distinction between losses realised through cash payments and those realised through other means. The Commissioner's attempt to read in such a restriction was rejected since courts cannot add

words to a tax statute that Parliament chose not to include.

Third, the Court confirmed that Section 4A overrides the general disallowance of capital expenditure under Section 16(1)(b) of the Act. Section 16(1) itself states that its restrictions apply "save as otherwise expressly provided." Since Section 4A expressly provides for the deductibility of realised foreign exchange losses, it takes precedence.

Key Takeaways

This judgment is significant for any business that holds foreign currency intragroup loans. Where such loans were used for operational purposes and are subsequently settled by converting them into shares, the foreign exchange losses that arise are deductible under Section 4A. The mode of settlement such as cash, shares, or set-off does not affect this.

The decision also serves as a reminder that the Revenue Authority cannot restrict tax deductions beyond what the law expressly provides. Where a statute is clear, it must be applied as written.

Businesses that have had similar deductions disallowed, or those planning to restructure foreign currency intragroup loans, should review their positions in light of this ruling. Applicable time limits under the Tax Procedures Act will need to be considered.

For specific advice on your tax position, please reach out to the OKC Advocates Tax Advisory team

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