



Tax & Exchange Control

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KENYA

- Deductibility of written off loan principal as bad debt for tax purposes



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Deductibility of written off loan principal as bad debt for tax purposes

A recent decision by the Tax Appeals Tribunal (Tribunal) in *Premier Credit Limited v Commissioner of Domestic Taxes* [2026] KETAT 23 (KLR) has caused jaws to drop at the apparent departure from the norm that a written off principal loan amount constitutes a bad debt deductible for tax purposes in Kenya. The Tribunal, in a contentious judgment, was of the view that bad debts arising out of the principal element of a loan are not allowable expenses for tax purposes.

Brief facts of the case

The appellant, Premier Credit Limited (taxpayer), is a credit-only microfinance company. The respondent, the Commissioner of Domestic Taxes (Kenya Revenue Authority (KRA)) (Commissioner), conducted an audit which led to a dispute of principal taxes of KES 30,132,515.10 arising from the treatment of bad debts which was referred to the Tribunal for determination. The taxpayer maintained that the bad debts claimed were incurred in the production of income and had become uncollectable hence allowable deduction as per section 15(2)(a) Income Tax Act (ITA) and Guidelines on Allowability of Bad Debts, Legal Notice No. 37 of 2011 (Guidelines). The KRA, on the other hand, argued that the principal component of the loans was capital in nature and therefore not an allowable deduction.

Section 15(2)(a) of the ITA provides for the deduction of bad debts incurred in the production of income when computing the gains or profits of a business. These debts must be estimated to the Commissioner's satisfaction as uncollectable. Further, pursuant to this section the Commissioner developed the Guidelines which provide that a bad debt is deductible only where it is proven to the Commissioner to be irrecoverable after reasonable recovery efforts, arises wholly and exclusively in the ordinary course of business, and is not of a capital nature.

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Tribunal findings

The Tribunal agreed with the KRA. It made a distinction between the principal loan amount and interest amount, holding that the principal amount of a loan is of a capital nature. Furthermore, the Tribunal noted that the taxpayer complied with International Financial Reporting Standards (IFRS) 9 where it recognised the principal amount of the loans as a financial asset and the interest as revenue/income. In this regard, the Tribunal found that bad debts arising out of the principal element of loans are not allowable expenses for tax purposes.

Comment

Section 15(2)(a) of the ITA allows a deduction for bad debts incurred in the production of income, with the key test being whether the debt is income generating and has become irrecoverable. The Tribunal's holding in this case, treats the principal component of a loan as capital and therefore non-deductible. It introduces a distinction that is not grounded in the statute. The provision does not differentiate between principal and interest but rather focuses on the nexus between the debt and the generation of taxable income.

Previously, the Tribunal's decisions have pointed to a commercially sound approach. In the *Fourth Generation Capital Limited v Kenya Revenue Authority* (Tax Appeal No. E1253 of 2024), the Tribunal held that loan principal constitutes stock-in-trade and that losses arising from default are therefore deductible.

Similarly, in *Branch International Limited v Commissioner of Domestic Taxes* [2025] KETAT 191 (KLR), the Tribunal accepted that bad debts are a normal incident of a lending business, with the dispute turning purely on evidentiary support rather than the nature of the loan principal.

In our view, the Tribunal's reasoning in the present case is difficult to reconcile with both the statutory framework, its previous rulings and established commercial practice. It places undue reliance on accounting classifications and leads to a wrong outcome where lenders are taxed on income without recognition of the corresponding cost of generating that income. The correct view, consistent with both the statute and commercial reality, is that in a lending business, written off loan principal qualifies as a deductible bad debt where the conditions under section 15(2)(a) and the Guidelines are met.

For now, taxpayers may rely on the Tribunal's earlier decision, in *Fourth Generation Capital Ltd* case, where the Tribunal treated the principal loan amount as stock-in-trade deployed in the ordinary course of business to generate income and, therefore, as deductible as a bad debt when written off for tax purposes.

The appellant retains a right of appeal to the High Court, which may provide much needed certainty on the deductibility of written off loan principal as bad debt.

Alex Kanyi and Charity Muindi

OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa, Kenya and Namibia, please contact:



Emil Brincker

Practice Head & Director:
Tax & Exchange Control
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com



Patrick Kauta

Managing Partner | Namibia
T +264 833 730 100
M +264 811 447 777
E patrick.kauta@cdhlegal.com



Gerhard Badenhorst

Director:
Tax & Exchange Control
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com



Jerome Brink

Director:
Tax & Exchange Control
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com



Petr Erasmus

Director:
Tax & Exchange Control
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com



Dries Hoek

Director:
Tax & Exchange Control
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com



Alex Kanyi

Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E alex.kanyi@cdhlegal.com



Heinrich Louw

Director:
Tax & Exchange Control
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com



Howmera Parak

Director:
Tax & Exchange Control
T +27 (0)11 562 1467
E howmera.parak@cdhlegal.com



Stephan Spamer

Director:
Tax & Exchange Control
T +27 (0)11 562 1294
E stephan.spamer@cdhlegal.com



Tersia van Schalkwyk

Tax Consultant:
Tax & Exchange Control
T +27 (0)21 481 6404
E tersia.vanschalkwyk@cdhlegal.com



Nicholas Carroll

Senior Associate:
Tax & Exchange Control
T +27 (0)21 481 6433
E nicholas.carroll@cdhlegal.com



Varusha Moodaley

Senior Associate:
Tax & Exchange Control
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com



Mariska Delpoort

Associate:
Tax & Exchange Control
T +27 (0)11 562 1574
E mariska.delpoort@cdhlegal.com



Denis Maina

Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E denis.maina@cdhlegal.com



Puleng Mothabeng

Associate:
Tax & Exchange Control
T +27 (0)11 562 1355
E puleng.mothabeng@cdhlegal.com



Charity Muindi

Associate | Kenya
T +254 731 086 649
+254 708 562 546
+254 710 560 114
E charity.muindi@cdhlegal.com



Savera Singh

Associate:
Tax & Exchange Control
T +27 (0)11 562 1575
E savera.singh@cdhlegal.com

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JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI

Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

ONGWEDIVA

Shop No A7, Oshana Regional Mall, Ongwediva, Namibia.
T +264 (0) 81 287 8330 E cdhnamibia@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

WINDHOEK

2nd Floor, 4@Steps - East Tower, Hilltop Estate, Kleine Kuppe, Windhoek.
PO Box 97115, Maerua Mall, Windhoek, Namibia, 10020
T +264 833 730 100 E cdhnamibia@cdhlegal.com

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