GUIDE

KENYA

Regulatory Framework and Taxation Guide for Captive Projects

C&I Renewable Energy Projects in Kenya

giz Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

This guide was commissioned by the German Energy Solutions Initiative of the German Federal Ministry for Economic Affairs and Climate Action (BMWK)

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Currency units

KES	Kenyan Shilling
EUR	Euro
USD	United States Dollar

Conversion rate as of 12.12.2023
(for three-month moving average)

KES 1 = EUR 0.00636
USD 1 = EUR 0.9374
EUR 1 = USD 1.0668

Source: https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-usd.en.html

Technical units

kW	Kilowatt
kWh	Kilowatt hour
MW	Megawatt
MWp	Megawatt peak
W	Watt

Abbreviations/acronyms

BOOT	Build, Own, Operate & Transfer
C&I	Commercial and Industrial
CBK	Central Bank of Kenya
CHP	Combined Heat and Power
CIT	Corporate Income Tax
EACCMA	East Africa Community Customs Management Act
EPRA	Energy and Petroleum Regulatory Authority
EPZ	Export Processing Zone
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH
ICPAK	Institute of Certified Public Accountants of Kenya
IFRS	International Financial Reporting Standards
ITA	Income Tax Act
KPLC	Kenya Power and Lighting Company
KRA	Kenya Revenue Authority
MFLA	Miscellaneous Fees and Levies Act
NHIF	National Health Insurance Fund
NSSF	National Social Security Fund
PPA	Power Purchase Agreement
PV	Photovoltaic
RE	Renewable Energy
REIT	Real Estate Investment Trusts
SDA	Stamp Duty Act
SEZ	Special Economic Zone
SPV	Special Purpose Vehicle
TPA	Tax Procedures Act
TPO	Third-Party Ownership
WHT	Withholding Tax
VAT	Value Added Tax

ENERGY SOLUTIONS – MADE IN GERMANY

The German Energy Solutions Initiative

The German Energy Solutions Initiative, coordinated and financed by the German Federal Ministry for Economic Affairs and Climate Action (BMWK), aims to globalise German and European technologies and expertise in climate-friendly energy solutions.

Years of promoting smart and sustainable energy solutions in Germany have led to a thriving industry known for world-class technologies. Thousands of specialised small and medium-sized enterprises (SMEs) focus on developing renewable energy systems, energy efficiency solutions, smart grids and storage technologies. Cutting-edge energy solutions are also built on emerging technologies like Power-to-Gas, fuel cells and green hydrogen. The initiative's strategy is shaped around ongoing collaboration with the German business community.

THE PROJECT DEVELOPMENT PROGRAMME (PDP)

Implemented by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, the Project Development Programme (PDP) is an integral part of the German Energy Solutions Initiative. The PDP combines development cooperation with private-sector engagement to promote climate-friendly energy solutions and facilitate market access for German and European small businesses in selected developing and emerging countries. This fosters economic growth and international cooperation, and contributes to climate change mitigation. The PDP works closely with the German Chambers of Commerce Abroad (AHK) to implement tailor made local solutions.

The PDP team keeps a constant eye on key market sectors in the target countries for providers of climate-friendly energy solutions. Using these insights, they generate sector analyses for areas where renewable energies or energy efficiency measures can compete effectively without extra subsidies.

PROJECT OPPORTUNITIES IN DEVELOPING AND EMERGING COUNTRIES

The markets in developing countries and emerging economies are promising, but also pose challenges for international business partners. The PDP team provides free and impartial advice to local companies, in particular, and puts them in contact with German or European business partners.

The team collects data from the energy consumer and evaluates it from a technical and economic perspective, thus developing financially viable projects focused on renewable energies and energy efficiency with local companies. It also offers business initiation opportunities with German or European small and mid-sized companies.

At the same time, the project provides training courses, analyses and studies on the risks and potential of renewable energies to help support market development. Visiting reference projects within the countries also promotes the creation of private-sector business partnerships.

In addition to commerce and industry, operators of refugee camps are a further target group for the transition to renewable energies as many still use diesel generators to supply energy or water.

The focus of activities currently lies in 15 countries across Southeast Asia, South Asia, Sub-Saharan Africa, and the Middle East.

Executive summary

KENYA'S LEGAL FRAMEWORK FOR RENEWABLE ENERGY

Kenya's legal framework for renewable energy is established through the 2010 Constitution. It assigns the key function of formulating guidelines for the energy sector to the National Government. The sector is overseen by the Ministry of Energy and Petroleum (MoEP), which sets guidelines, and the Energy and Petroleum Regulatory Authority (EPRA), acting as the sector's regulatory body. The sector's guidelines are determined by the National Energy Policy of 2018 and the Energy Act of 2019. A primary goal of this policy is to promote electricity generation from renewable sources, with solar energy identified as a particularly significant renewable energy source. This was clearly reflected in the recent review period of the 2021 Economic Survey report, where an astonishing 89.6% of Kenya's grid electricity came from renewable sources.

Zusammenfassung

KENIAS RECHTSRAHMEN FÜR ERNEUERBARE ENERGIEN

Kenia legt seinen rechtlichen Rahmen im Bereich erneuerbarer Energien durch die Verfassung von 2010 fest. Sie weist der Nationalregierung die Schlüsselfunktion der Richtlinienformulierung für den Energiesektor zu. Überwacht wird dieser Sektor vom Ministerium für Energie und Erdöl (MoEP), welche Richtlinien festlegt, sowie von der Energy and Petroleum Regulatory Authority (EPRA), die als Sektorregulierungsbehörde fungiert. Die Leitlinien des Sektors werden durch die National Energy Policy von 2018 und das spezifische Energiegesetz Energy Act 2019 bestimmt. Eine vorrangige Zielsetzung dieser Politik ist die Förderung der Stromerzeugung aus erneuerbaren Quellen, wobei Solarenergie als besonders bedeutende erneuerbare Energiequelle identifiziert wird. Dies spiegelte sich deutlich im jüngsten Betrachtungszeitraum des Wirtschaftsberichts von 2021 wider, in der erstaunliche 89,6 % des Netzstroms in Kenia aus erneuerbaren Quellen stammten.

RISING TRENDS IN DECENTRALISED SOLAR PV SYSTEMS FOR COMMERCIAL AND INDUSTRIAL CONSUMERS

Since 2021, large and medium-sized commercial and industrial consumers have accounted for the majority of domestic electricity demand, at 49.4%. In this dynamic context, decentralised solar PV systems have emerged as a crucial complement to grid power. These systems not only provide a reliable energy source but also contribute to reducing energy costs for commercial and industrial businesses in Kenya. The EPRA reports that over 30 MW of embedded solar generation plants have been installed in the country. Both local and international project developers play a crucial role, delivering solar generation plants to commercial and industrial consumers through engineering, procurement and construction (EPC) contracts, as well as third-party ownership (TPO) contracts.

TAILORED GUIDE TO ACCOUNTING AND TAX FRAMEWORKS FOR RENEWABLE ENERGY IN KENYA

To support both new market entrants and existing players, this guide offers a comprehensive overview of the accounting and taxation framework for EPC and TPO contracts in Kenya. It provides detailed information on how to handle depreciation, taxes and profits from a regulatory and reporting perspective. The focus goes beyond analysing various tax mechanisms for different contracts on a commercial and industrial scale of renewable energy, starting from the import of materials, project execution, to the transfer of profits from Kenya. The applicable taxes within Kenya for such proceeds and revenues are also covered.

DEZENTRALE SOLAR-PV-SYSTEME FÜR GEWERBLICHE UND INDUSTRIELLE VERBRAUCHER IM AUFSCHWUNG

Seit 2021 machen große und mittelständische gewerbliche sowie industrielle Verbraucher mit 49,4 % den Großteil der Inlandsstromnachfrage aus. In diesem dynamischen Kontext haben sich dezentrale Solar-PV-Systeme als entscheidende Ergänzung zum Netzstrom etabliert. Diese Systeme sind nicht nur eine zuverlässige Energiequelle, sondern tragen auch dazu bei, die Energiekosten für gewerbliche und industrielle Unternehmen in Kenia zu reduzieren. Die Energy and Petroleum Regulatory Authority (EPRA) gibt an, dass im Land bereits über 30 MW an eingebetteten Solaranlagen installiert wurden. Dabei spielen sowohl lokale als auch internationale Projektentwickler für Gewerbe und Industrie eine entscheidende Rolle, indem sie Solaranlagen durch Engineering, Procurement and Construction (EPC)-Verträge sowie Third-Party Ownership (TPO) Verträge an gewerbliche und industrielle Verbraucher liefern.

MASSGESCHNEIDERTER LEITFADEN ZU BUCHHALTUNGS- UND STEUERRAHMEN FÜR ERNEUERBARE ENERGIEN IN KENIA

Um sowohl neue Marktteilnehmer als auch bestehenden Akteure zu unterstützen, bietet dieser Leitfaden einen umfassenden Überblick über den Rechnungslegungs- und Steuerrahmen für EPC- und TPO-Verträge in Kenia. Er enthält detaillierte Informationen zur Behandlung von Abschreibungen, Steuern und Gewinnen aus regulatorischer und berichterstattender Sicht. Der Fokus liegt nicht nur auf der Analyse unterschiedlicher Steuermechanismen im Bereich erneuerbare Energien im gewerblichen und industriellen Maßstab, beginnend mit dem Import von Materialien, der Projektdurchführung bis zur Übertragung von Gewinnen aus Kenia. Darüber hinaus werden die anwendbaren Steuern innerhalb Kenias für entsprechende Erlöse und Einnahmen behandelt.

This guide provides an easy entry point for German and European companies looking to engage in the Kenyan market but seeking assistance with the applicable accounting and tax regulations for various contract types. Additionally, the guide offers insights for local offtakers regarding applicable regulations on how to treat renewable energy systems in their financial statements for different contract models.

The structure allows readers to jump directly to the relevant contract model to review the applicable regulations, making the guide more accessible and reducing complexity. Diagrams and tables in the text support the understanding of processes and provide a clear view of default tax rates under different categories. The guide is suitable for both a quick overview and a detailed understanding of the relevant accounting and tax regulations in Kenya.

Dieser Leitfaden bietet einen einfachen Einstieg für deutsche und europäische Unternehmen, die sich im kenianischen Markt engagieren möchten und dabei Unterstützung bei den geltenden Buchführungs- und Steuervorschriften für verschiedene Vertragstypen suchen. Zusätzlich liefert der Leitfaden einen Einblick für lokale Abnehmer, wie erneuerbare Energiesysteme in ihren Finanzberichten für unterschiedliche Vertragsmodelle behandelt werden sollten.

Die Struktur ermöglicht es Lesern, direkt zum relevanten Vertragsmodell zu springen, um die jeweiligen Vorschriften zu überprüfen. Dies macht den Leitfaden zugänglicher und reduziert die Komplexität. Diagramme und Tabellen im Text unterstützen die Verständlichkeit der Prozesse und bieten einen klaren Blick auf Standardsteuersätze in verschiedenen Kategorien. Der Leitfaden eignet sich sowohl für einen schnellen Überblick als auch für ein detailliertes Verständnis der relevanten Buchhaltungs- und Steuervorschriften in Kenia.

1

Background

1.1 Commercial and industrial power consumer projects

Falling system prices for renewable energy (RE) systems, a challenging environment for the development of large-scale utility projects and rising power prices for commercial and industrial power consumers (C&I consumers) have led RE project developers to increase their focus on the development of distributed renewable energy systems with C&I consumers as direct counterparts (C&I projects).

With the C&I market segment gaining traction in various jurisdictions and increasingly threatening the traditional business model of electricity utilities, the segment is also attracting increased attention from regulators.

Delivery models in the C&I segment can generally be differentiated between:

- "EPC model", where the C&I consumer is self-financing the RE project; and
- "third-party ownership models", where investment and, most often, the operational risks are borne by the RE service provider.

Under third-party ownership (TPO) models, RE system services are provided to C&I consumers through a variety of contractual structures such as power purchase agreements (PPAs) or lease agreements, with possible transfer of system ownership to the C&I consumer at some point during the project lifetime.

The concrete contract design of these delivery models not only raises various regulatory concerns for developers and beneficiaries, but also has implications on accounting/financial reporting and tax treatment, which need to be particularly well considered by the C&I consumer.

With the aim of a functional and efficient market for C&I projects, the guide intends to mitigate existing information asymmetries, leading to high transaction costs and risks, by providing market information knowledge products for RE project developers as well as C&I consumers. In this study, the information needs of Germany-based RE developers, in particular, are considered.

This study focuses on the tax and corporate aspects to be considered for the three dominant delivery models within the C&I segment: EPC model, PPA model and leasing model. Similar studies have been carried out by GIZ for other countries in sub-Saharan Africa and Asia.

1.1.1 Solar or hybrid power generation systems

This study looks at C&I projects where power generation equipment is deployed "on-site", meaning on the premises of a C&I consumer.

In this context, power generation equipment can consist of:

- photovoltaic (PV) and storage systems,
- PV and diesel generator systems, or
- PV and natural-gas hybrid systems.

A combination of these systems is also possible. This study focuses on on-site power generation systems with an installed capacity between 50 kW and 20 MW (the RE/hybrid system).

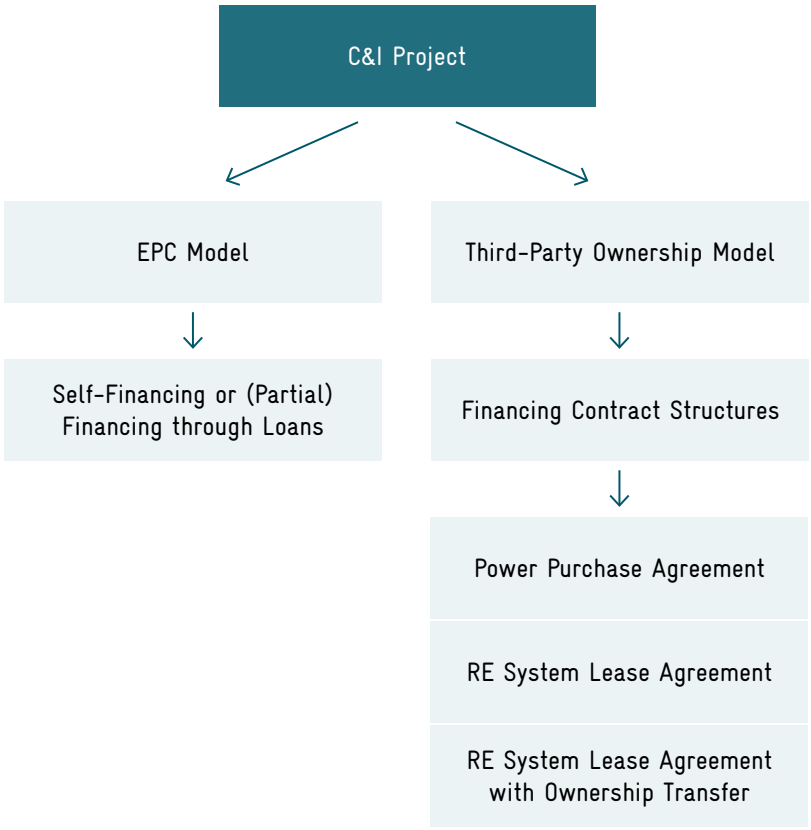
The C&I consumer can be either off-grid or on-grid. The RE/hybrid system may be grid-tied or function as an "islanding system" that is only connected to the on-site distribution grid. The RE/hybrid systems are specifically designed by the RE service provider to adapt the power supply to the needs (e. g. load profile, existing net metering) of the C&I consumer.

This study does not take into account systems reliant on wheeling[1], i.e. offsite PPA or virtual PPA and/or open access, etc.

1.1.2 Delivery models in C&I projects

The delivery models in C&I projects can be represented as follows:

FIGURE 1. Delivery models in C&I projects



Source: Own illustration (BBH, 2023)

1 Wheeling is the transportation of electric energy from within an electrical grid to an electrical load outside the grid boundaries.

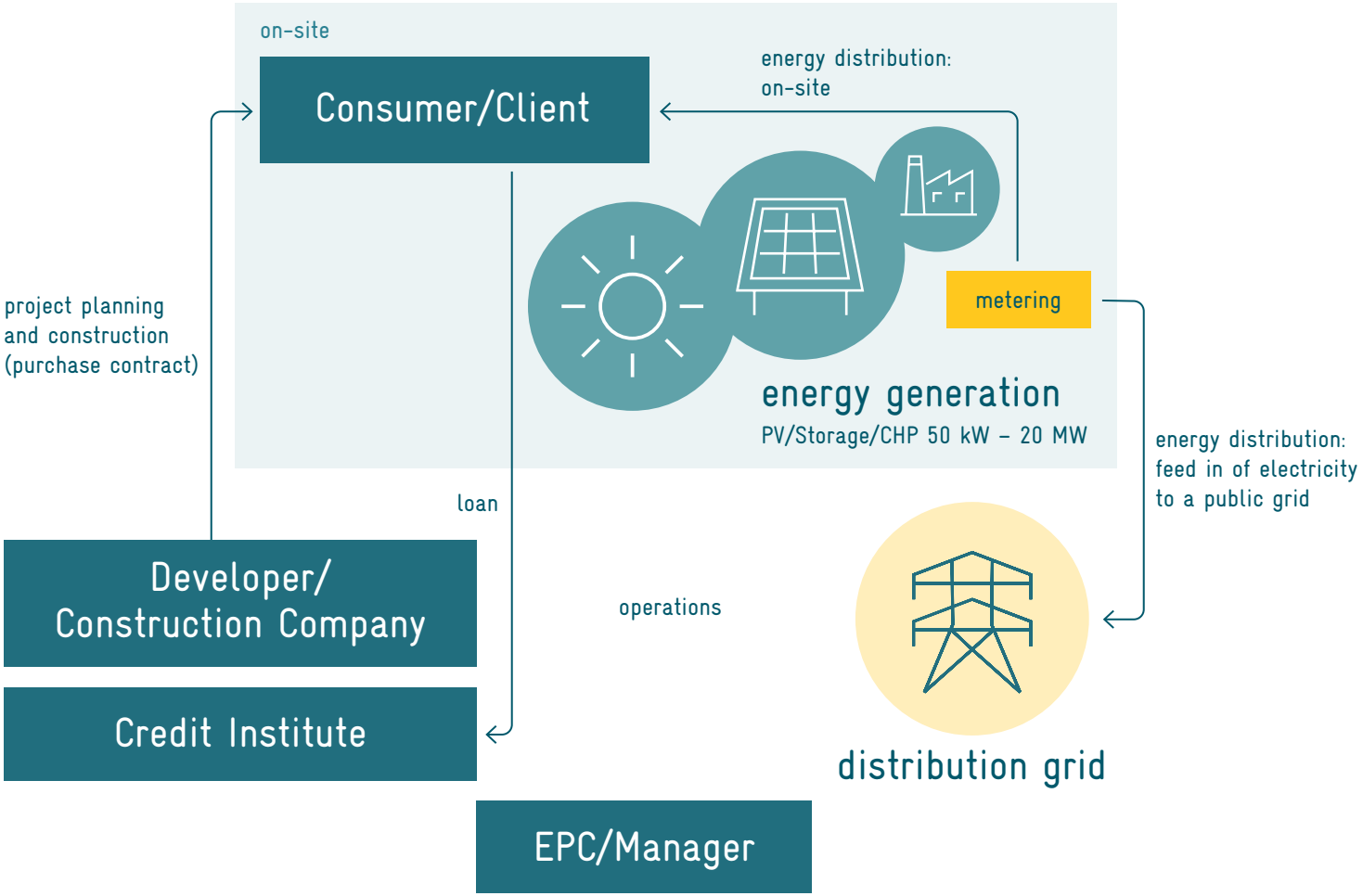
Upfront purchase model (EPC model)

EPC stands for engineering, procurement and construction.

In this delivery model, the EPC Contractor provides a detailed engineering design of the RE/hybrid system according to the C&I Consumer's needs. The EPC contractor will than procure equipment and parts required for the RE/hybrid system from manufacturers and construct the system on the C&I consumer's site. In this model, the consumer is the offtaker as well as the RE service provider in the same entity.

Under the EPC model, the C&I consumer must finance the RE/hybrid system themselves (self-financing). The C&I consumer may avail loans to partially finance the system. This delivery model impacts the C&I consumer's capital expenditures (CapEx).

FIGURE 2. Upfront purchase model/EPC model



Source: Own illustration (BBH, 2023)

Leasing model with ownership transfer

A lease is "an agreement between two parties whereby one party allows the other to use his/her property for a certain period of time in exchange for a periodic fee."

In the context of third-party ownership models, the lease structure means that the RE service provider leases a RE/hybrid system to the C&I consumer. The RE service provider installs a RE/hybrid system on the C&I consumer's site and retains ownership.

The C&I consumer is legally the operator of the RE/hybrid system and generates electricity to cover its needs in exchange for rent. However, the C&I consumer can hire an RE service provider for operation and maintenance (O&M) services.

Lease structures within the C&I segment usually have:

- contract periods from 5 to 15 years,
- transfer-of-ownership clause at the end of the contract term,
- options to purchase early,
- down payments,
- fixed payment rates (independent of the energy output),
- O&M guarantee, and
- payment clause in local or foreign currency.

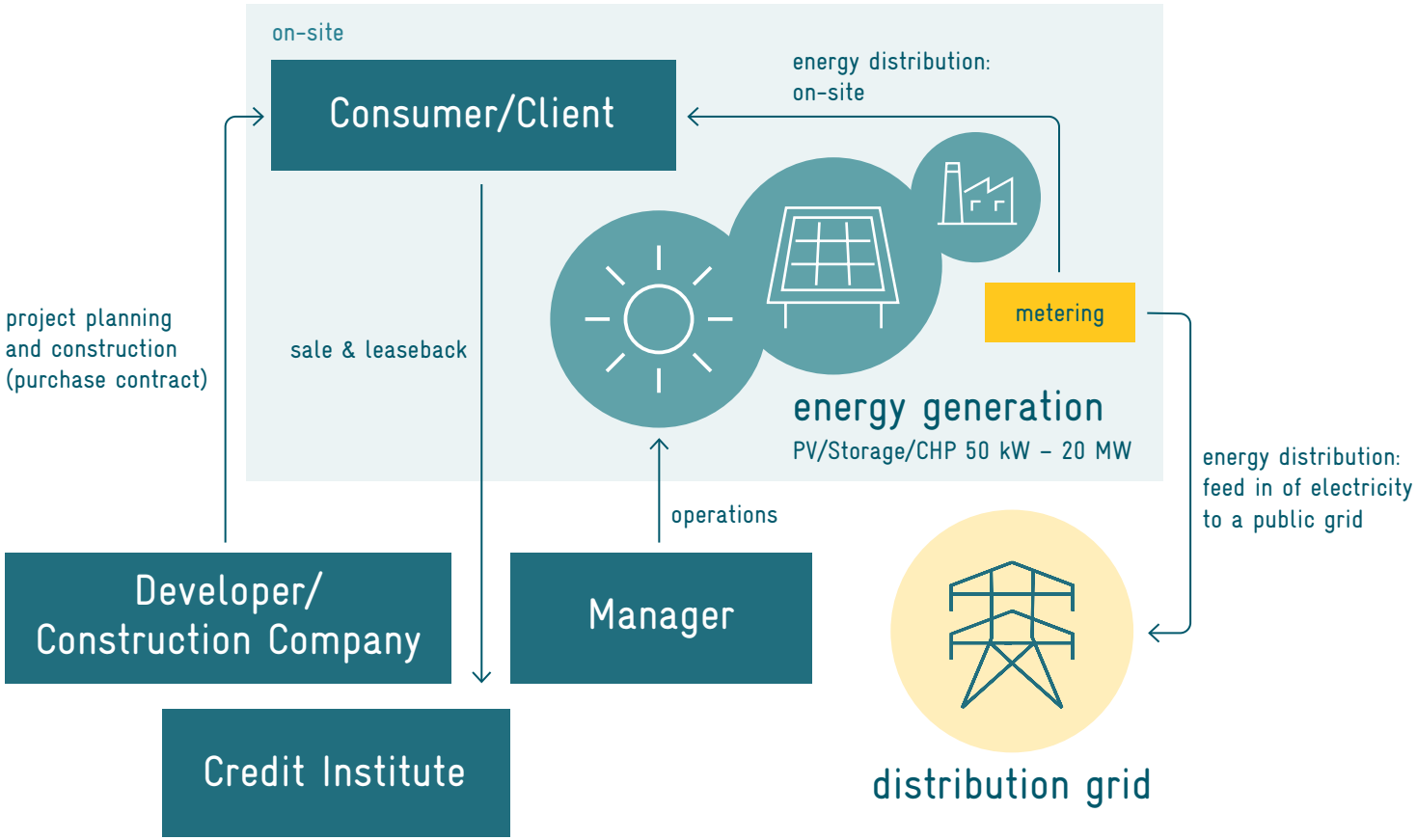
Nevertheless, leases do in fact include a wide variety of contract features, some additional or even contrary to those mentioned above.

Legally, leases are classified into different categories with distinct legal regimes (e.g. equipment lease, finance lease, etc.) according to the country.

In Kenya, there are certain contractual obligations and performance guarantees that both parties typically agree upon. These obligations and guarantees help ensure the smooth operation of the leasing arrangement and protect the interests of both parties:

- Performance guarantees – the constructor may provide performance guarantees to the consumer to ensure that the energy system meets specified performance criteria. These guarantees encompass factors such as energy generation capacity, efficiency levels, uptime and maintenance requirements. The purpose of these guarantees is to ensure that the energy system operates as intended and delivers the promised benefits.
- Contractual obligations – the leasing agreement establishes the specific obligations of both parties. The lessor (constructor) is responsible for tasks related to the installation, operation, maintenance and repair of the energy system. The lessee, on the other hand, is obliged to adhere to usage and maintenance guidelines and make timely payments for the lease. Clear delineation of responsibilities ensures the smooth functioning of the energy system during the lease period.
- Ownership transfer – the leasing model with ownership transfer entails the transfer of ownership from the lessor to the lessee upon completion of the agreed lease term. The leasing agreement explicitly details the terms and conditions governing this ownership transfer, including any associated costs or procedural requirements. Once the transfer is complete, the lessee assumes full ownership and all accompanying responsibilities for the energy system.
- Contractual termination – the leasing agreement outlines the conditions and procedures for terminating the contract. Such circumstances may include breach of contract, non-payment of rent or any other conditions mutually agreed upon. The agreement specifies the rights and obligations of both parties in the event of contractual termination, including any applicable penalties or compensation.

FIGURE 3. Leasing model with ownership transfer



Source: Own illustration (BBH, 2023)

Renting model with ownership transfer

A rent is "a regular, usually monthly, payment that a person makes in exchange for the use of an asset he/she does not own. That is, rent is the payment on a lease."[2] The term is most often used to refer to payments on a leased dwelling or other piece of real estate.

In the context of third-party ownership models, the rent structure means that the RE service provider rents a RE/hybrid system to the C&I consumer. The RE service provider installs a RE/hybrid system on the C&I consumer's site and sells ownership to the credit institution for a finance lease contract between the consumer and the credit institution.

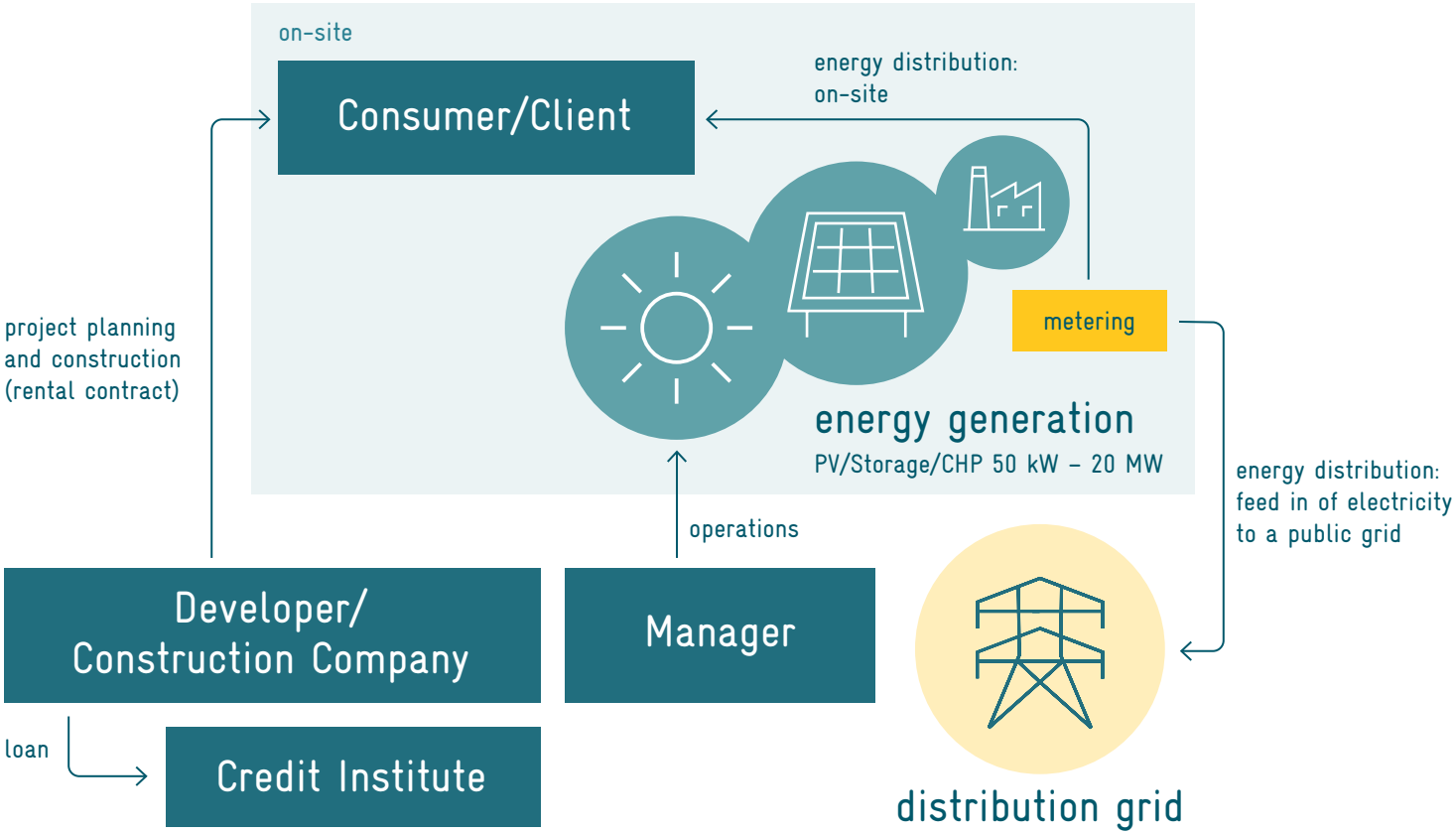
The C&I consumer is legally the operator of the RE/hybrid system and generates electricity to cover its needs in exchange for rent. However, the C&I consumer can hire an RE service provider for operation and maintenance (O&M) services. In general, the C&I consumer is the offtaker in this model, whereas the developer is the RE service provider.

Rent structures in the C&I segment usually have:

- contract periods from 5 to 15 years,
- transfer-of-ownership clause at the end of the contract term,
- options to purchase early,
- down payments,
- fixed payment rates (independent of the energy output),
- O&M guarantee, and
- payment clause in local or foreign currency.

Nevertheless, rents do in fact include a wide variety of contract features, some additional or even contrary to those mentioned above.

FIGURE 4. Renting model with ownership transfer



Source: Own illustration (BBH, 2023)

2 Farlex Financial Dictionary (2009): Financial definition of renting (thefreedictionary.com) (accessed on 28.01.2023).

1.1.3 Build-own-operate-transfer (BOOT) model and power purchase agreement (PPA)

Build, own, operate & transfer (BOOT)

The build-own-operate-transfer model is a widely used framework in infrastructure projects, including renewable energy endeavours such as power generation facilities. The following provides a formal description of how this model typically functions:

- Build – within the BOOT model, a private entity (referred to as the developer or construction company) assumes responsibility for financing, designing and constructing the power generation facility. This encompasses various types of renewable energy projects, such as solar, wind or other renewable sources.
- Own – once the facility is completed, the developer assumes ownership and operation of the power generation facility. They undertake the maintenance, operation and management of the facility for a specified duration, usually ranging from 15 to 25 years.
- Operate – during the operational phase, the developer sells the electricity generated by the facility to an offtaker, typically a utility company or a large energy consumer, through a long-term PPA. The PPA establishes the terms and conditions of the electricity sale, including pricing structures and the duration of the agreement.
- Transfer – on conclusion of the agreed period (typically aligned with the duration of the PPA), ownership of the power generation facility is transferred to the offtaker or another designated entity. This transfer may involve a nominal or predetermined price, contingent on the terms outlined in the agreement.

In this model, the C&I consumer is the offtaker, whereas the developer is the RE service provider.

POWER PURCHASE AGREEMENT STRUCTURE

A PPA is a contract between two parties, one which generates electricity (the seller) and one looking to purchase electricity (the buyer).

The PPA defines all commercial terms for the sale of electricity between the two parties, including when the project will begin commercial operation, the schedule for delivery of electricity, penalties for under-delivery, payment terms and termination.

The PPA fixes the price for the electricity provided by the seller (here, the RE service provider) to the offtaker (here, the C&I consumer) over a fixed period.

At the end of the PPA, there are several options:

- reconditioning – signing of a new PPA and updating the entire RE/hybrid system with the latest technology;
- contract extension – extending the contract duration for a fixed period;
- decommissioning – removing the RE/hybrid system; and
- transfer – transferring the RE/hybrid system to the C&I consumer.

There are two types of PPAs: physical and virtual (or synthetic/structured). Whilst physical PPAs are characterised by a "physical" delivery of the produced energy to the offtaker, virtual PPAs are financially settled arrangements between the two contractual parties who do not need to be in the same grid region.

Only physical PPAs are considered in the context of this study.

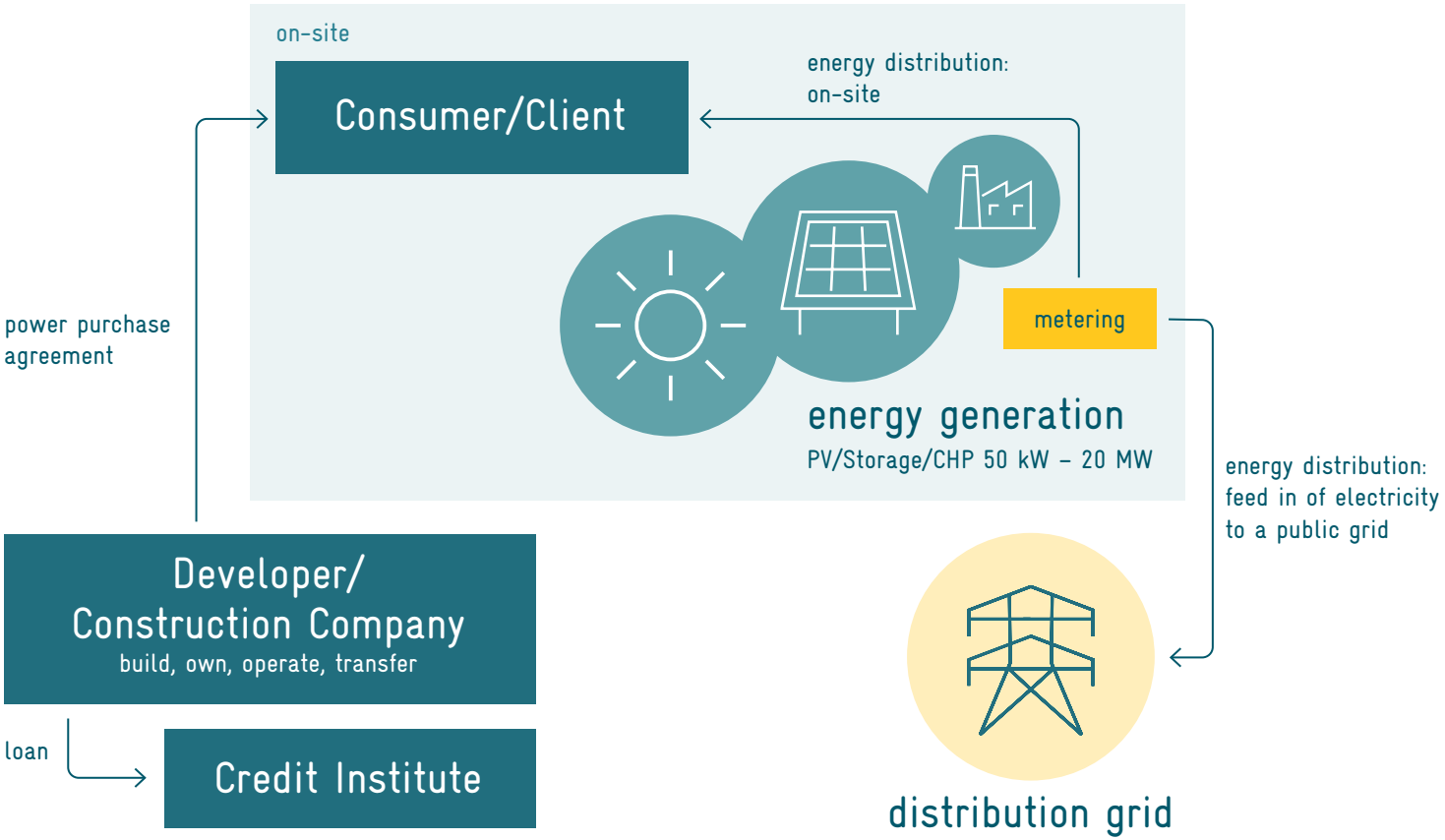
These PPAs often have the following characteristics in the C&I segment:

- long-term contract periods,
- options to transfer ownership of the RE/hybrid system,
- variable payment rates (dependent on the energy output),
- performance guarantee, and
- payment in local or foreign currency.

Nevertheless, PPAs do in fact include a wide variety of contract features, some additional to or even contrary to those mentioned above.

The BOOT model with PPA offers numerous advantages for both developers and offtakers. Developers can secure long-term revenue through the PPA, ensuring a stable and predictable income stream. Offtakers benefit from a reliable supply of electricity over an extended period at predetermined prices, supporting energy security and renewable energy objectives.

FIGURE 5. Build-own-operate-transfer (BOOT) model and PPA



Source: Own illustration (BBH, 2023)

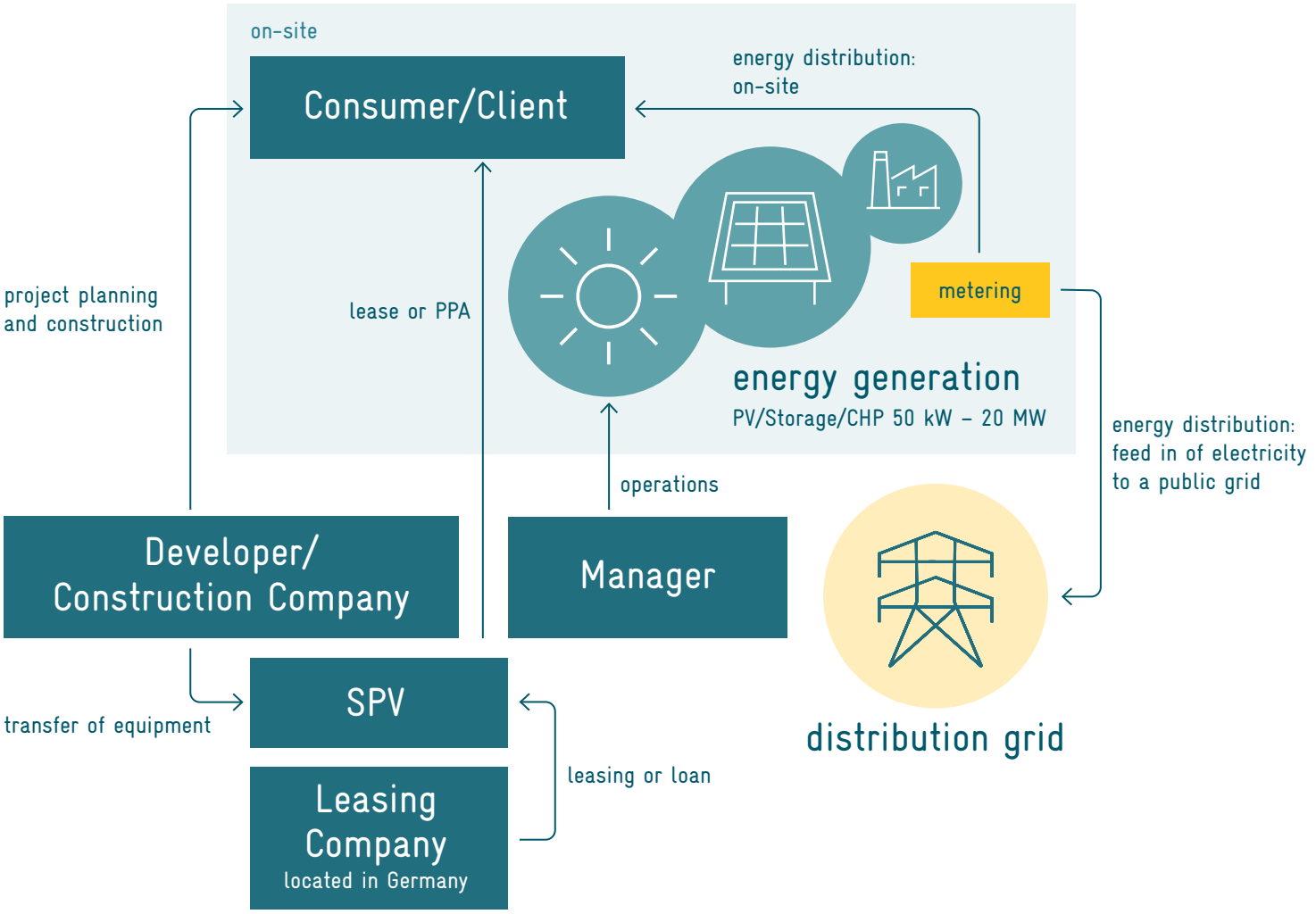
Third-party ownership model

The third-party ownership (TPO) model is a financing solution for C&I consumers to obtain the benefits of having a RE/hybrid system on their site without the upfront costs of purchasing the system.

The RE service provider owns and maintains the RE/hybrid system while the C&I consumer can use said system to produce electricity or directly use the electricity generated. For the C&I consumer, the TPO model provides the advantage of being relieved from the upfront costs (CapEx). By shifting the CapEx to the third-party entity, the consumer can conserve their own financial resources and avoid the need for significant upfront capital investment.

The main contractual structures involved in the third-party ownership model are PPAs as well as lease or rental agreements.

FIGURE 6. Third-party ownership (TPO) model



Source: Own illustration (BBH, 2023)

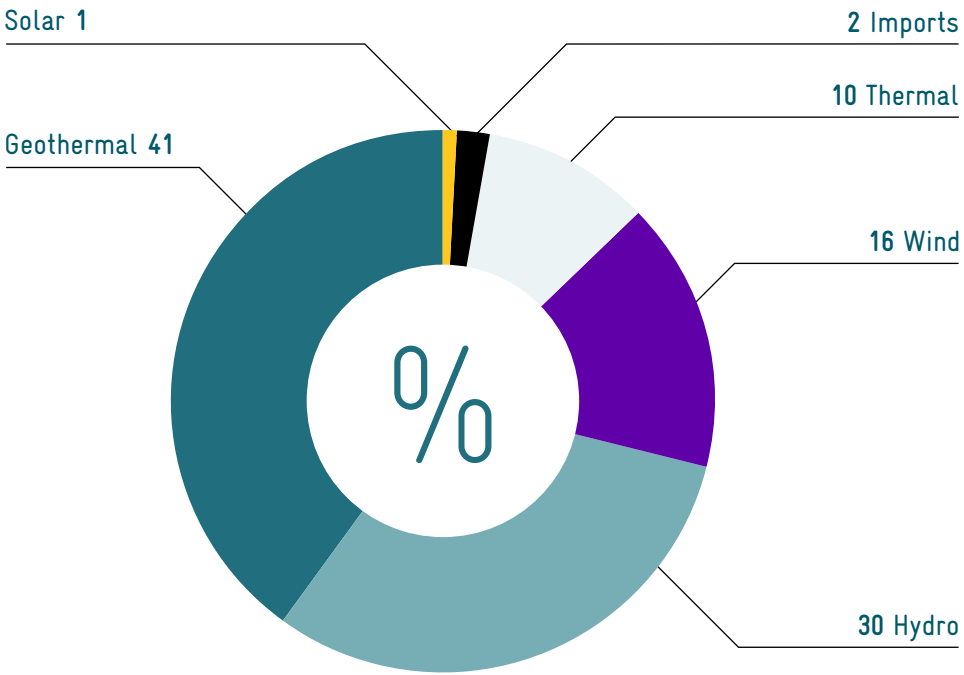
1.2 Market snapshot – Kenya

This study looks at the taxation framework(s) and the financial requirements in Kenya for developing commercial and industrial (C&I) projects.

1.2.1 Overview of the electricity market in Kenya

The overarching law in Kenya is the Constitution of Kenya, 2010, which assigns the function of formulating policy for the energy sector to the National Government. The sector is overseen by the Ministry of Energy and Petroleum (MoEP), which provides policy direction, and the Energy and Petroleum Regulatory Authority (EPRA), acting as the sector regulator. The current policy guiding the sector is the National Energy Policy of 2018, and the specific law governing the sector is the Energy Act, 2019. One of the objectives of the policy is to encourage the generation of electricity from renewable sources and it identifies solar energy as a renewable source that the country should harness. During the review period of the latest annual Economic Survey report, 89.6% of grid electricity in Kenya in 2021 was generated from renewable sources.

FIGURE 7. Proportion of electricity generation by source, 2021[3]



Source: Own illustration (BBH, 2023)

3 Source: International Trade Administration (2023) Kenya - Energy-Electrical Power Systems (trade.gov)

The Kenya Power and Lighting Company (KPLC) is the system operator and the main offtaker in the power market, buying bulk power from all power generators based on negotiated power purchase agreements (PPAs) for onward supply to consumers. It also owns and operates part of the existing transmission infrastructure and most of the interconnected distribution network.

As of 2021, large and medium category consumers account for the highest percentage of total domestic demand for electricity, at 49.4%. Decentralised solar PV systems have emerged as a viable source of power to complement grid power and reduce energy costs for C&I entities in Kenya. According to the EPRA, more than 30 MW of embedded solar generation plants have been installed in the country. There are several local and international C&I project developers operating in the country that provide the solar generation plants to C&I consumers through both engineering, procurement and construction (EPC) contracts and third-party ownership (TPO) contracts.

The Energy Act, 2019 permits a consumer who owns an electric power generator of a capacity not exceeding 1 MW to enter into a net-metering-system agreement to operate a net-metering system with a distribution licensee or retailer. The detailed legal provisions on how net metering is to be operationalised are to be contained within specific regulations. Draft Energy (Net-Metering) Regulations have been developed and are at an advanced stage of development. However, net metering is not currently permitted in the C&I sector.

Kenya's rapid economic growth is challenged by high energy costs, high levels of government debt, including in the energy sector, low-level access to credit, high borrowing costs[4] and regional trade barriers. Higher growth has also led to an increase in electricity demand, which requires a surge in installed generation capacity and power generation.

4 Source: Business Daily (2023) Kenya Power seeks increase of electricity prices by up to 78pc - Business Daily (businessdailyafrica.com)

2

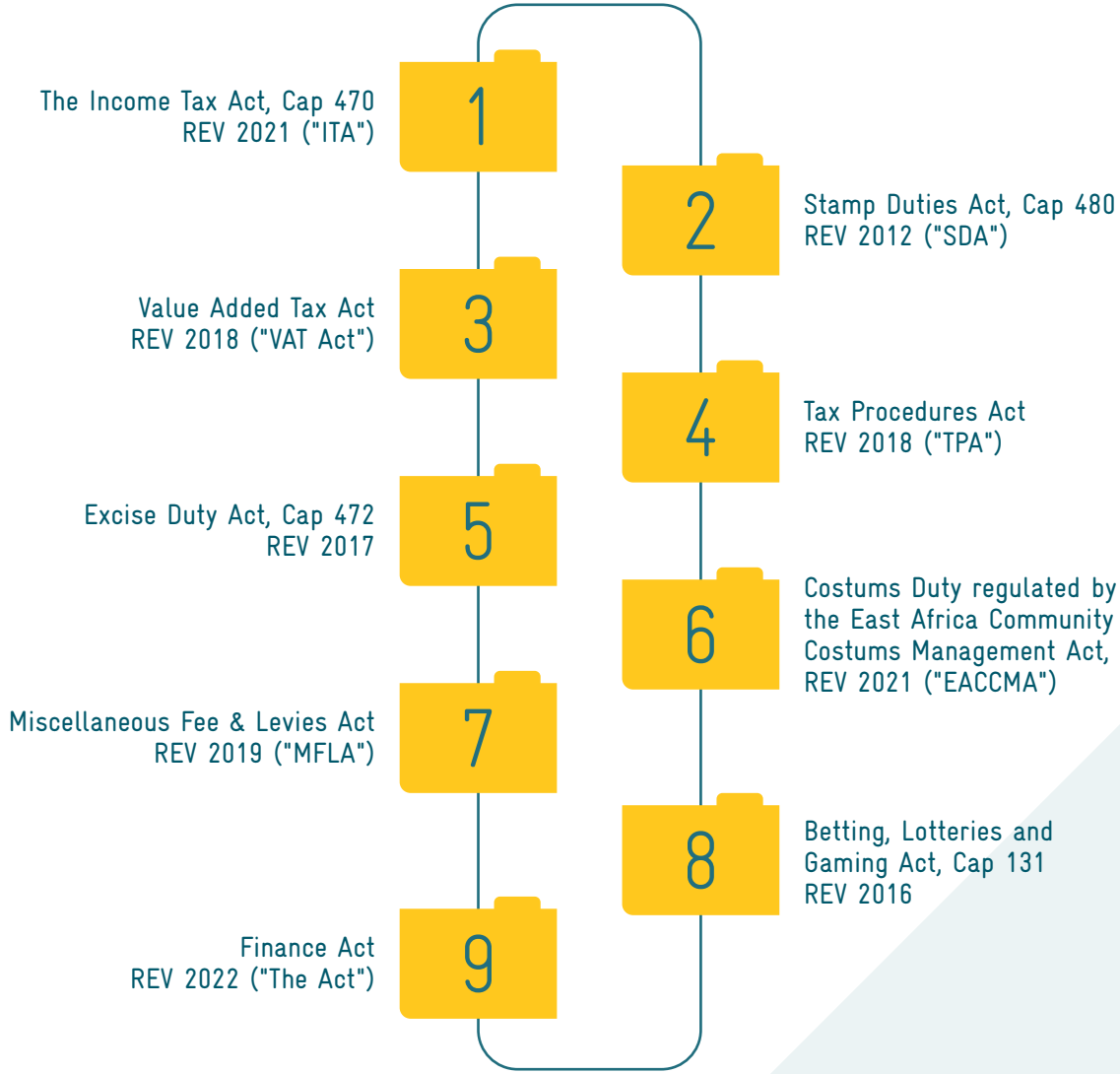
Foundations

2.1 Taxation regulations

Relevant tax and tax depreciation regulations

The main law governing the income tax system in Kenya is the Income Tax Act (ITA), Cap 470 of the Laws of Kenya. However, in 2022, Kenya assented into law the Finance Act. The Act has amended various tax laws including the Income Tax Act, the Value Added Tax Act, the Excise Duty Act., the Tax Procedures Act and the Miscellaneous Fees and Levies Act. The bases for opinions for the taxation regulations can be found in the following figure:

FIGURE 8. Bases for opinion



Source: BBH, 2023

Taxes payable in Kenya

There are two categories of taxpayers in Kenya which are subject to different types of taxes. Taxpayers are categorised as either individual or corporate taxpayers. Generally, Kenyan companies are liable to tax in Kenya on their worldwide income regardless of where the income is generated or whether the income is received or brought into Kenya. The different types of taxes payable per category in Kenya include the following:

TABLE 1. Legal forms and applicable taxes with rates

INDIVIDUAL TAXPAYERS AND RATE [%]	CORPORATE TAXPAYERS AND RATE [%]
Income Tax, 10–30%	Corporate Income Tax, 30% or 37.5%
Value Added Tax, 16%	Value Added Tax, 16%
Excise Duties, varying rates	Excise Duties, varying rates
Withholding Tax, 0–30%	Withholding Tax, 0–30%
Capital Gains Tax, 5–20%	Capital Gains Tax, 5–20%
–	Pay As You Earn (PAYE), 0–25%
–	Turnover Tax, 0–3%
–	Other forms include the NHIF, NSSF, Skills Development Levy, etc.

Source: Own illustration (BBH, 2023)

Case law

Kenya's legal system follows a common-law approach, where court decisions play a pivotal role in the development of legal principles. The Supreme Court of Kenya is the highest judicial authority in the country, with the responsibility to interpret the Constitution and make final legal determinations.

The hierarchy of courts in Kenya ensures that lower-level courts must adhere to the rulings of higher-level courts. Thus, the decisions of the Supreme Court carry authoritative weight over all other courts in Kenya, while the Court of Appeal's decisions are binding on both the High Court and subordinate courts.

Kenyan courts also consider persuasive precedents from foreign jurisdictions and other Commonwealth nations. Additionally, the principles of justice, equity and good conscience may override legal precedent in certain cases.

Tax clearance certificates

The Kenya Revenue Authority (KRA) shall issue a tax clearance certificate to the taxpayer for a specific or general purpose, as applicable. This confirms that a person or entity has fulfilled their tax obligations for a specific period.

A tax clearance certificate is usually required for various purposes, including:

- the clearance of goods in commercial quantities from any customs port or factory in Kenya;
- Kenyan banks' requirement for customers to provide a tax clearance certificate before opening an account;
- an application for a work permit by a non-resident in Kenya;
- the registration of any document conferring title to land;
- the departure of a foreigner who has resided and earned in Kenya; and
- the tendering of projects or contracts awarded by public institutions, agencies, corporations and bodies in Kenya.

To obtain a tax clearance certificate in Kenya, an individual or entity must have filed their tax returns and paid any outstanding tax liabilities. The KRA may conduct a tax audit to verify the accuracy of the information provided and confirm that the taxes have been paid.

The tax clearance certificate is valid for one year from the date of issue, after which the holder must apply for a new certificate, if required. The KRA has an online platform where individuals and entities can apply for tax clearance certificates, which has streamlined the process and reduced the processing time.

Taxation of companies (legal forms)

Companies in Kenya are subject to various taxes, including corporate income tax, withholding tax, value added tax, excise duty and other fees and levies.

Companies in Kenya are required to pay corporate income tax (CIT) on their taxable profits. The current standard CIT rate in Kenya is 30%, but certain industries such as mining, oil and gas and insurance may have different rates. Tax is assessed on the company's net profit, which is calculated by subtracting allowable deductions from the company's gross income.

Withholding tax (WHT) is a tax deducted at the source from payments made to non-residents. The standard WHT rate in Kenya is 20%, but it may be lower or exempt under certain circumstances. WHT applies to payments such as dividends, royalties, interest and management fees made to non-residents.

Value added tax (VAT) is a tax on the value added to goods and services at each stage of production and distribution. Companies in Kenya are required to charge and remit VAT on their taxable supplies. The current standard VAT rate in Kenya is 16%.

Excise duty is a tax on specific goods such as tobacco, alcohol and petroleum products. Companies that manufacture, import or sell excisable goods in Kenya are required to pay excise duty on those goods.

It is important to note that companies in Kenya are required to comply with various tax regulations, including filing regular tax returns, maintaining proper records and submitting to tax audits. Failure to comply with these regulations can result in penalties and fines.

Kenyan company tax distinguishes between tax-resident and non-resident companies when determining the tax rate.

RESIDENCY

A company is considered tax-resident in Kenya if it is incorporated or effectively managed in Kenya.

Under Kenyan tax law, a company is considered incorporated in Kenya if it is registered under the Companies Act or if its central management and control is exercised in Kenya. A company is considered effectively managed in Kenya if its board of directors meets in Kenya, and the decisions made by the board are regularly implemented in Kenya. In addition, a company is resident in Kenya if the body has been declared by the Minister, by notice in the Gazette, to be resident in Kenya for any year of income.

A company that is resident in Kenya is subject to tax on its worldwide income, meaning that it must pay tax on income earned both within Kenya and outside of the country. Non-resident companies are only subject to tax on their Kenyan-source income. Tax residency is confirmed by the Cabinet Secretary responsible for the Ministry of Finance.

Companies who do not meet the above requirements shall be deemed to be non-resident companies.

ASSESSMENT PERIOD

The assessment period for a company in Kenya is the period for which the company's tax liability is calculated and assessed by the KRA.

In Kenya, the standard assessment period for companies is 12 months, and it typically runs from 1 January to 31 December of each year. During this period, the company is required to keep accurate and up-to-date accounting records, prepare financial statements and file a tax return with the KRA. However, a company is free to choose its financial year. Once a particular financial year has been chosen, it cannot be changed unless prior written approval has been obtained from the KRA Commissioner General.

The tax return for a company in Kenya must be filed within six months of the end of the assessment period. For example, if the assessment period ends on 31 December, the tax return must be filed by 30 June of the following year.

After the tax return is filed, the KRA will review the return and assess the company's tax liability. The KRA may conduct an audit or request additional information to verify the accuracy of the return. Once the KRA completes its assessment, it will issue a tax assessment notice to the company, indicating the amount of tax due and the deadline for payment.

ACCOUNTING AND VALUATION METHODS

In Kenya, accounting and valuation methods are regulated by the Institute of Certified Public Accountants of Kenya (ICPAK) and the International Financial Reporting Standards (IFRS). The IFRS is the globally recognised standard for financial reporting, and it sets out guidelines and principles for the preparation and presentation of financial statements.

The most frequently used accounting and valuation methods in Kenya include:

- Accrual accounting – this method recognises revenue and expenses when they are earned or incurred, regardless of when payment is received or made. It provides a more accurate picture of a company's financial performance than cash accounting.
- Cash accounting – this method records transactions only when cash is received or paid out. It is simpler and easier to implement than accrual accounting but may not provide an accurate reflection of a company's financial performance.
- Market valuation – this method determines the value of an asset based on its current market price. It is commonly used for valuing stocks, bonds and other securities.

- Cost-based valuation – this method calculates the value of an asset based on its historical cost, adjusted for depreciation and other factors. It is commonly used for valuing fixed assets as buildings and machinery.

Value added tax (VAT)

VAT is a tax on the value added to goods and services at each stage of production and distribution. In Kenya, VAT is governed by the Value Added Tax Act of 2013, which replaced the previous VAT Act of 1989. The general regulations for VAT can also be found in the VAT Regulations of 2017 as well as the VAT (Electronic Tax Invoice) Regulations of 2020.

VAT is levied at each stage of production/distribution when goods or services change hands. It is charged by the company at the relevant stage and is borne by the final consumer. Apart from exempt goods and services, VAT is to be charged on the following supplies:

- any supply of goods and services manufactured in Kenya;
- any importation of goods; and
- the supply of any imported service.

Liability for the tax is borne in the case of:

- a taxable supply – the taxable person making the supply; or receives the supply;
- imported goods – the importer; and
- imported services – the recipient of the service.

Apart from exempt goods and services, VAT is 16%, 8% for petroleum products and 0.0% for companies in special economic zones and export processing zones (EPZs).

It is important to note that certain goods and services are exempt from VAT or subject to reduced rates. For example, agricultural inputs, medical supplies and certain types of education and training are exempt from VAT. Additionally, some goods and services such as electricity and telecommunications are subject to specific VAT rates or levies.

Registration is compulsory if the annual taxable supply is/is expected to be KES 5 million or more. A non-resident who is required to register for VAT is required to appoint a tax representative who is a resident of Kenya. If this is not done, a tax representative will be appointed.

Registered businesses in Kenya are required to charge VAT on their taxable supplies, and they can claim back the VAT they have paid on their purchases and expenses. However, businesses must keep proper records of their VAT transactions and submit regular VAT returns to the KRA. The KRA also conducts regular VAT audits to ensure compliance with VAT regulations and to identify any cases of tax fraud or evasion.

TAX BASE

The tax base for VAT is the sum of:

- the amount of money paid or payable, directly or indirectly, by any person for the supply; or
- the open market value at the time of the supply of an amount in kind paid or payable, directly or indirectly, by any person for the supply; and
- any taxes, duties, levies, fees and charges (other than VAT) paid or payable on, or by reason of, the supply less any discounts or rebates allowed and accounted for at the time of the supply.

INPUT VAT

When a business purchases goods or services, it pays VAT on the purchase price. This VAT is called input VAT, and it can be recovered by the business when it files its VAT return. The amount of input VAT that a business can recover depends on the use of the goods or services. If the goods or services are used for making taxable supplies, the business can recover the full amount of input VAT paid. If the goods or services are used for making exempt supplies, the business cannot recover any input VAT paid.

Input VAT can be claimed in the VAT return that a business files with the KRA. The input VAT claimed is offset against the output VAT charged by the business on its taxable supplies. If the input VAT exceeds the output VAT, the business is entitled to a VAT refund. If the output VAT exceeds the input VAT, the business must pay the difference to the KRA.

VAT ON THE PURCHASE OF ASSET

The VAT paid on the purchase of an asset is treated as input VAT, which can be recovered by the business when it files its VAT return. However, the input VAT on the purchase of an asset cannot be fully claimed in the same period that the asset is acquired. Instead, the input VAT can be claimed over several years, based on the asset's useful life.

Corporate income tax

CIT stands for corporate income tax, which is a tax on the profits earned by companies and other business entities in Kenya. It is governed by the Income Tax Act, which provides the legal framework for the taxation of corporate income in Kenya.

In Kenya, companies are required to pay CIT on their worldwide income, which includes income earned from both domestic and foreign sources. The CIT rate for resident companies is currently 30%, while the rate for non-resident companies is 37.5%. Resident companies are those that are incorporated or managed and controlled in Kenya, while non-resident companies are those that are incorporated or managed and controlled outside Kenya.

CIT is assessed on the net income of a company, which is calculated by deducting allowable expenses from the company's gross income. Allowable expenses include expenses that are incurred in the production of income, such as wages, rent and raw materials. Non-allowable expenses, such as fines and penalties, are not deductible for tax purposes.

CIT is typically paid in four quarterly instalments, with the final instalment due by the end of the fiscal year. Companies are required to file their tax returns by the 20th day of the sixth month after the end of their fiscal year. Failure to pay CIT or file tax returns on time can result in penalties and interest charges.

The possible exemptions from CIT are:

- Newly incorporated companies – companies that have been incorporated in Kenya and are not carrying on business for more than 12 months are exempt from paying CIT for the first year of operation.
- Companies engaged in EPZs – companies that are located within an EPZ and are engaged in manufacturing or other export-oriented activities are exempt from paying CIT for a period of 10 years from the date of commencement of operations.
- Agricultural companies – companies engaged in agriculture, including farming, livestock breeding and horticulture, are eligible for a 100% investment deduction on the cost of machinery, plant or equipment used for the purpose of the business.
- Companies investing in renewable energy – companies that invest in renewable energy projects, such as wind and solar power, are eligible for a 50% investment deduction on the cost of machinery, plant or equipment used for the project.

- Companies investing in affordable housing – companies that invest in affordable housing projects are eligible for a 150% investment deduction on the cost of machinery, plant or equipment used for the project.

It is important for companies to understand the eligibility criteria for these exemptions and to apply for them in a timely manner.

When a company operates within a special economic zone (SEZ) in Kenya, it may be eligible for certain tax incentives, including exemptions from CIT.

Companies that operate in SEZs in Kenya are eligible for a CIT tax holiday for the first 10 years of operation. This means that they are exempt from paying CIT for a period of 10 years from the date of commencement of operations within the SEZ.

After the 10-year tax holiday period, companies operating within SEZs will be subject to the normal CIT rate of 30% for resident companies.

MINIMUM TAX

The minimum tax was introduced in the Finance Act, 2020 and is applicable to all companies that make losses or earn profits below a certain threshold.

The minimum tax is calculated at 1% of the gross turnover of the company, less any VAT paid or payable. However, the minimum tax payable cannot be less than 0.5% of the gross turnover or less than the amount of the instalment tax payable in that year.

Companies that are newly incorporated or are engaged in agricultural activities or renewable energy projects are exempt from the minimum tax for the first three years of operation.

It is important to note that the minimum tax is a separate tax from CIT. While CIT is calculated on the net profit of the company, the minimum tax is calculated based on the company's gross turnover. Companies that are subject to the minimum tax are required to pay the higher of the minimum tax or the instalment tax, which is a provisional tax payment made in four equal instalments throughout the year.

Taxes on interest

In Kenya, interest income is subject to tax as part of the individual's or company's overall income tax liability. The tax treatment of interest income may vary depending on the type of interest income earned, the residency status of the taxpayer and the purpose of the interest income.

For individuals, interest income earned from bank deposits, bonds and other investments is subject to a withholding tax rate of 15%. Non-residents who earn interest income in Kenya are subject to a withholding tax rate of 20%. However, if a tax treaty exists between Kenya and the country of residence of the non-resident taxpayer, the withholding tax rate may be reduced or eliminated.

For companies, interest income received is generally considered part of their taxable income and is subject to the normal CIT rate of 30%. However, certain exemptions and deductions may be available, such as the interest paid on borrowings used for the purposes of earning taxable income.

Taxes on dividends

In Kenya, dividends are subject to WHT at a rate of 5%. The tax is withheld at source by the company paying the dividends and is paid to the KRA on behalf of the recipient. Dividend taxation applies to any distribution by a company to its shareholders with respect to their equity interest in the company.

The WHT on dividends applies to both resident and non-resident shareholders, although non-resident shareholders may be eligible for a reduced rate under a tax treaty between Kenya and their country

of residence. Dividends paid to citizens of the East African Community Partner States are taxed at the rate of 5%, whereas dividends paid to non-residents are taxed at the rate of 15%.

It is important to note that dividends received by companies from other companies in which they own at least 12.5% of the share capital are exempt from WHT. Another exemption applies to dividends paid by companies operating within an EPZ.

Additionally, dividends paid to investors in real estate investment trusts (REIT) are exempt from WHT, provided that the REIT distributes at least 90% of its income to investors.

In Kenya, an amount is deemed to be a dividend distributed by a company to a shareholder, when:

- any cash or asset is distributed or transferred by that company to or for the benefit of that shareholder or any person related to that shareholder; or
- the shareholder or any person related to that shareholder is discharged from any obligation measurable in money which is owed to that company by that shareholder or related person; or
- the amount is used by that company in any other manner for the benefit of the shareholder or any person related to that shareholder; or
- any debt owed by the shareholder, or any person related to that shareholder to any third party, is paid or settled by that company; or
- the amount represents additional taxable income or reduced assessed loss of that company by virtue of any transaction with the shareholder or related person to such shareholder, resulting from an adjustment.

Any amount withheld should be remitted on or before the 20th day of the following month.

Finally, it is important to note that WHT on dividends is a final tax, meaning that income is not subject to further tax in the hands of the recipient. However, if the recipient is a non-resident and the income is not effectively connected to a permanent establishment in Kenya, it may still be subject to tax in the recipient's home country.

Income from operating sites

Income from operating sites, such as rental income, licence fees and franchise fees, is generally subject to tax under the corporate income tax (CIT) regime in Kenya. The tax treatment of this income depends on several factors, including the nature of the income, the legal form of the entity and the applicable tax laws and regulations. Operating sites would be considered taxable entities in Kenya if they exist for longer than 183 days. Income attributable to the functions carried out by the resources/employees within the operating sites shall be considered to have accrued and derived from Kenya and shall therefore be taxable. In the case of related party transactions, transfer pricing regulations must be observed.

When calculating the tax liability on income from operating sites, the tax base is typically the gross revenue earned from these activities, less any allowable deductions, such as operating expenses, depreciation and interest expense. The applicable tax rate for income from operating sites depends on the legal form of the entity, with companies generally subject to CIT at a rate of 30%, while individuals and partnerships are taxed at a lower rate of 10% on rental income.

In addition to CIT, income from operating sites may also be subject to value added tax (VAT) or withholding tax (WHT). For example, rental income is generally subject to VAT at a rate of 16%, while licence fees and franchise fees may be subject to WHT at a rate of 20%.

It is important for companies earning income from operating sites to accurately report their income and expenses, comply with all applicable tax laws and regulations and take advantage of any available

deductions or exemptions. Failure to do so could result in penalties and interest charges, as well as damage to the company's reputation and business operations.

Withholding tax

Withholding tax (WHT) is a tax system whereby a person or entity making a payment (known as the payer) is required to withhold a certain percentage of the payment and remit it to the tax authorities on behalf of the recipient of the payment (known as the payee). In Kenya, WHT is typically applied to certain types of income, such as royalties, management and technical fees, interest and dividends, earned by non-residents or residents.

The WHT rate varies depending on the type of income, and the payee's residency status. For example, the WHT rate for interest earned by non-residents is 15%, while the WHT rate for management and technical fees earned by non-residents is 20%. Resident individuals and companies are not generally subject to WHT on their income but may be subject to WHT on certain types of payments, such as interest earned on deposits.

The payer is responsible for withholding the applicable WHT amount from the payment and remitting it to the Kenya Revenue Authority (KRA) within the prescribed timeframe. Failure to do so may result in penalties and interest charges.

In some cases, the recipient of the payment may be entitled to a reduced WHT rate or exemption from WHT, depending on the tax laws of the country in which they are resident, and any relevant double taxation treaties between that country and Kenya.

Payments to residents:

- 5% advisory and management services,
- 5% dividends (Kenyan companies with more than 12.5% company shares are exempt from tax),
- 5% licences,
- 15–25% interest.

Payments to non-residents:

- 20% for consultancy and management services,
- 10% for dividends,
- 20% for licences,
- 15% for interest.

No withholding tax is levied on payments to non-residents for services under a PPA. In addition, interest paid to non-residents investing in the energy sector is also exempt from tax in Kenya.

Kenya has a double taxation treaty with Germany, as mentioned in the section “Taxation of foreign income in Germany and double taxation agreement”. The various withholding tax rates applicable to payments to non-residents under Kenya's tax laws and double taxation treaties apply.

Investment allowances

In Kenya, an investment allowance is a tax incentive that is available to businesses that invest in qualifying capital assets. The allowance is designed to encourage businesses to invest in new or improved capital assets, which can help to stimulate economic growth and development. Investment allowances are accounted for as per the Second Schedule to the Income Tax Act (ITA), as follows.

Under Kenyan tax law, businesses can claim an investment allowance of up to 150% of the cost of qualifying capital assets in the year of acquisition or construction. This means that businesses can deduct up to 150% of the cost of qualifying assets from their taxable income in the year that the assets are acquired or constructed.

Qualifying capital assets may include:

- machinery and equipment used for manufacturing or processing,

- commercial buildings used for manufacturing, processing or warehousing,
- computer hardware and software used for business purposes,
- renewable energy equipment,
- farm buildings and farm machinery used in farming operations, and
- commercial vehicles.

It is important to note that the investment allowance is subject to certain conditions and limitations. For example, the assets must be used in the taxpayer's business for at least three years after the investment allowance is claimed. Additionally, the investment allowance cannot be claimed on assets that are used for personal purposes.

Businesses that wish to claim the investment allowance must apply to the KRA and provide detailed information about the assets that they wish to claim the allowance on.

In the event that a person incurs capital expenditure in respect of an item listed in the first column of the table below, an investment allowance may be deducted when computing the gains or profits of that person at the corresponding rate specified in the second column, for each year of income.

TABLE 2. Investment allowance rates for each year of income

CAPITAL EXPENDITURE INCURRED	INVESTMENT ALLOWANCE RATE
(a) Buildings	-
(i) Hotel building	50% in the first year of use
(ii) Building used for manufacture	50% in the first year of use
(iii) Hospital buildings	50% in the first year of use
(iv) Petroleum or gas storage facilities	50% in the first year of use
(v) Residual value items (a)(i) to (a)(iv)	25% per year, in equal instalments
(vi) Educational buildings including student hostels	10% per year, in equal instalments
(vii) Commercial buildings	10% per year, in equal instalments
(b) Machinery	-
(i) Machinery used for manufacture	50% in the first year of use
(ii) Hospital equipment	50% in the first year of use
(iii) Ships or aircraft	50% in the first year of use
(iv) Residual value items (b)(i) to (b)(iii)	25% per year, in equal instalments
(v) Motor vehicles and heavy earth-moving equipment	25% per year, in equal instalments
(vi) Computer and peripheral computer hardware and software, calculators, copiers and duplicating machines	25% per year, in equal instalments

CAPITAL EXPENDITURE INCURRED	INVESTMENT ALLOWANCE RATE
(vii) Furniture and fittings	10% per year, in equal instalments
(viii) Telecommunications equipment	10% per year, in equal instalments
(ix) Filming equipment used by a local film producer licensed by the Cabinet Secretary responsible for filming	25% per year, in equal instalments
(x) Machinery used to undertake operations under a prospecting right	50% in the first year of use and 25% per year, in equal instalments
(xi) Machinery used to undertake exploration operations	50% in the first year of use and 25% per year, in equal instalments
(xii) Other machinery	10% per year, in equal instalments
(c) Purchase or an acquisition of an indefeasible right to use of fibre-optic cable by a telecommunications operator	10% per year, in equal instalments
(d) Farmwork	50% in the first year of use and 25% per year, in equal instalments

Source: Own illustration (BBH, 2023)

The applicable investment allowance rate for PV and solar equipment usually falls under "Machinery and Equipment", mentioned, in particular, in Class 43A of the Second Schedule of the Income Tax Act. The rate of allowance for PV and solar equipment assets is currently set at 50% of the cost of the asset in the first year, with the remaining 50% being depreciated over the useful life of the asset.

Balancing allowances and charges

Balancing allowances and charges are a tax concept used in Kenya and many other countries to calculate the tax deductions for the disposal of a fixed asset. When a company sells or disposes of a fixed asset, it may need to adjust its accounting records to reflect the asset's reduced value or disposal.

A balancing allowance arises when the disposal proceeds of an asset are less than its tax written down value. In such a case, the difference between the disposal proceeds and the tax written down value of the asset is treated as a loss, and the company is allowed to deduct the loss from its taxable income for the year of disposal.

On the other hand, a balancing charge arises when the disposal proceeds of an asset are more than its tax written down value. In this case, the amount in excess of the tax written down value is treated as a profit, and the company is required to add it to its taxable income for the year of disposal.

The tax written down value is the cost of the asset less any capital allowances claimed on the asset. Capital allowances are tax deductions that a company can claim on its capital assets, such as plant and machinery, furniture and buildings.

In summary, a balancing allowance is a tax relief that reduces a company's taxable income, while a balancing charge is a tax charge that increases the taxable income. These concepts are essential in determining a company's tax liability and in tax planning.

Applicable depreciation type and rate

Capital expenses such as depreciation and amortisation are not deductible for tax purposes. The Income Tax Act Chapter 470 (ITA), however, provides for investment and wear and tear allowances as a deduction for the purpose of computing the taxable income.

There are different depreciation methods that can be used for tax purposes in Kenya. The most common methods are the straight-line method and the reducing balance method.

The straight-line method is a method of depreciation where the cost of an asset is spread evenly over its useful life. The annual depreciation charge is calculated by dividing the cost of the asset by the number of years of its useful life.

The reducing balance method is a method of depreciation where the cost of an asset is written off by a fixed percentage each year. The depreciation charge is calculated by multiplying the remaining balance of the asset by the percentage rate of depreciation.

It is important to note that the depreciation method chosen can have a significant impact on the amount of taxable income and tax liability of a company. Taxpayers are required to follow the tax law requirements in calculating their taxable income and maintaining accurate records of their assets and the related depreciation calculations for tax purposes.

Capital gains taxes

In Kenya, capital gains tax (CGT) is a tax levied on the profit made from the sale of a capital asset. The tax applies to both individuals and companies and is calculated on the gain realised on the sale of an asset after deducting the cost of acquisition and any allowable expenses.

The current rate of CGT in Kenya is 15% as of January 2023 for both resident and non-resident individuals and companies.

Some capital assets are exempt from CGT, including personal effects, government securities and property transferred as part of a restructuring or merger. Transfer for CGT purposes occurs when:

- the property is sold, exchanged, conveyed or otherwise disposed of in any manner (including by way of a gift), whether for consideration or otherwise; or

- on the loss, destruction or extinction of property, whether or not a sum by way of compensation is received in respect of the loss, destruction or extinction unless that sum is utilised to reinstate the property in essentially the same form and in the same place within one year or within a longer period of the time approved by the Commissioner; or
- on the abandonment, surrender, cancellation or forfeiture of, or the expiration of substantially all rights to property, including the surrender of shares or debentures on the dissolution of a company.

Possible exemptions from the payment of CGT include:

- income that is taxed elsewhere with regard to the property dealers;
- issuance by a company of its own shares and debentures;
- transfer of property for the sole purpose of securing a debt or a loan;
- transfer by a creditor for the sole purpose of returning property used as security for a debt or a loan;
- transfer by a personal representative of any property to a person as beneficiary in the course of the administration of the estate of a deceased person;
- transfer of assets between spouses;
- transfer of assets between former spouses as part of a divorce settlement or a bona fide separation agreement;
- a company where spouses or a spouse and immediate family holding 100% shares;
- a private residence if the individual owner has occupied the residence continuously for the three-year period immediately prior to the transfer concerned.

CGT is due on or before the 20th day of the following month after the transfer of property. Some allowable expenses for the purposes of CGT include:

- loan/mortgage interest,
- cost of advertising to find a buyer,
- costs incurred in valuation of the property,
- legal fees, and
- costs of enhancements.

It is important to note that CGT is a self-assessed tax, meaning that taxpayers are responsible for calculating and paying the tax themselves. However, the KRA may conduct audits or investigations to ensure that taxpayers are complying with their obligations.

Stamp duty

Stamp duty is a tax imposed on certain documents and transactions in Kenya. It is governed by the Stamp Duty Act, which provides for the types of documents and transactions that are subject to stamp duty and the applicable rates.

Some of the documents and transactions subject to stamp duty include:

- Transfer of immovable property – when a property is sold or transferred, stamp duty is payable on the sale agreement or transfer document. The rate of stamp duty is based on the value of the property.
- Shares and other securities – when shares or other securities are transferred, stamp duty is payable on the transfer document. The stamp duty rate is 1% of the value of the securities being transferred.
- Leases – when a lease agreement is entered into, stamp duty is payable on the lease document. The stamp duty rate is based on the rent payable over the term of the lease.
- Powers of attorney – when a power of attorney is granted, stamp duty is payable on the power of attorney document. The stamp duty rate is based on the value of the transaction that the power of attorney relates to.

- Debentures – when a company issues debentures, stamp duty is payable on the debenture document. The stamp duty rate is 0.1% of the value of the debentures issued.

Stamp duty is usually paid by purchasing adhesive stamps from the KRA and affixing them to the relevant documents. Some documents, such as electronic documents, can be stamped using an electronic stamping system provided by the KRA.

Customs duties and excise taxes

Kenya has adopted the Harmonised System and Customs Tariff Schedule 2012 (HS code) which sets out the various customs duties and administrative charges for imports, exports and local manufacturing (i.e. excise duties).

IMPORT DUTY

Import duties are taxes levied on goods that are imported into a country. In Kenya, import duties are regulated by the East African Community (EAC) Customs Management Act, 2004 and the East African Community Common External Tariff. Import duties are payable to the KRA.

The rate of import duty varies depending on the nature of the goods being imported. Some goods are exempt from import duties, while others may attract a duty of up to 25% of their value. The duty rates are determined based on the Harmonised System (HS) code, which is an international classification system used to categorise traded goods.

Import duties are designed to protect domestic industries from foreign competition and to raise revenue for the government. They can be a significant source of revenue for a country, particularly if it has a large volume of imports.

In addition to import duties, importers may also be required to pay other taxes and fees, such VAT, excise duty and an environmental levy. These taxes and fees can significantly increase the cost of imported goods.

ADMINISTRATIVE FEES

Statutory administrative fees on imported goods are fees that are charged by the government of Kenya as a form of administrative cost for processing import-related documents and facilitating the clearance of goods at the border. These fees are usually separate from the customs duties and taxes that are charged on imported goods.

The amount of administrative fees charged by the Kenyan government varies depending on the type and value of the imported goods, as well as the mode of transportation used to bring the goods into the country. The fees may be charged as a percentage of the value of the goods being imported, or as a flat-rate fee.

In Kenya, the KRA is responsible for administering and collecting all taxes and fees relating to imports. The KRA publishes a schedule of administrative fees and other charges on its website, which importers can use to estimate the total cost of importing goods into Kenya.

EXPORT DUTY

There are currently no export duties imposed on goods exported from Kenya. However, exports of certain goods may be subject to other taxes or levies, such as excise duty, value added tax or withholding tax on payments made to non-residents. Additionally, some goods may require export permits or licences, which may involve fees or other charges.

EXCISE TAX

Excise tax is a tax levied on specific goods or services that are deemed to be harmful to public health or the environment. In Kenya, excise tax is mainly levied on three categories of products:

- Alcohol – excise tax is imposed on beer, spirits, wines and other alcoholic beverages at varying rates depending on the type and strength of the beverage.
- Tobacco – excise tax is imposed on cigarettes, cigars and other tobacco products at a specific rate per stick or weight of tobacco.
- Petroleum products – excise tax is imposed on various petroleum products such as petrol, diesel, kerosene and lubricants. The tax is calculated based on the volume or weight of the product.

The excise tax rates vary depending on the type of product and its value. The tax may be ad valorem, which is a percentage of the value of the product, or specific, which is a fixed amount per unit of product. Excise tax is typically included in the price of the product, and the seller is responsible for collecting and remitting the tax to the government.

Excise tax is a form of indirect tax, meaning that it is ultimately paid by the consumer of the product. However, the tax burden may be shared between producers, distributors and consumers depending on the elasticity of demand for the product. Excise tax is an important source of revenue for the Kenyan government and is used to fund various public services and programmes.

Ability and methods to carry forward losses

In Kenya, a company can carry forward tax losses incurred in a particular year and use them to offset taxable profits in subsequent years. Tax losses can be carried forward for 10 years. There are specific rules for determining the amount of tax losses that can be carried forward, depending on the type of loss. For example, capital losses can only be offset against capital gains, and only 50% of the net capital loss can be carried forward.

The loss carry-forward rules apply to both corporate income tax and individual income tax. In the case of individuals, losses incurred from employment income can be offset against future employment income, subject to certain restrictions.

It is important to note that the carrying forward of losses is subject to certain conditions, such as maintaining the same business activity that gave rise to the losses and ensuring that the company's ownership does not change substantially. Failure to meet these conditions may result in the forfeiture of the loss carry-forward entitlements.

Loss carry-forward provisions are designed to provide tax relief to companies that experience temporary setbacks, allowing them to offset losses against future profits and reduce their tax liability. This can help companies to remain viable and continue to contribute to the economy even during difficult times.

Taxation of the transfer of funds and equipment

The transfer of funds is not subject to any further tax when corporate tax has been paid on such funds. However, with respect to the transfer of equipment, any allowances claimed on the disposed asset are not allowed for tax purposes while the balancing deductions are tax deductible.

Taxation of foreign income in Germany and double taxation agreement

Kenya has Double Tax Avoidance Agreements (DTAAs) with many countries. The provisions of the DTAAs (including nil or lower tax rates) prevail over the provisions of the Income Tax Ordinance, 1979 (ITO). If a foreign company is a resident of a country with which Kenya has a DTAA in place, it may be entitled to certain tax benefits. However, to enjoy the tax benefits provided in the DTAA, a separate certification is required from the tax authorities.

The main benefits provided by the DTAA between the Federal Republic of Germany and the Republic of Kenya are highlighted below:

- **Article 7** - Business Profits. The profit of an enterprise of a Contracting State will be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State, but only so much of them as is attributable to that permanent establishment.

  No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

- **Article 10** – Dividends. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State, unless the dividends are excluded from the basis upon which German tax is imposed according to paragraph 1(a) or Article 23.

  However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but the tax so charged shall not exceed 15 per cent of the gross amount of the dividends.

- **Article 11** – Interest. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

  However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but the tax so charged shall not exceed 15 per cent of the gross amount of the interest.

- **Article 12** – Royalties. Royalties arising in a Contracting State and paid to a resident of the other contracting state may be taxed in that other State.

  However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but the tax so charged shall not exceed 15 per cent of the gross amount of payments.

2.2 Financing and transfer of funds and equipment

2.2.1 Relevant tax and tax depreciation regulations

Kenya has various methods of financing and transferring funds and equipment. Some of the commonly used methods include:

- Bank transfers – this is a widely used method for transferring funds between individuals, companies and organisations in Kenya. Most banks in Kenya offer various types of bank transfer, including electronic funds transfer, real-time gross settlement (RTGS) and Swift transfers.
- Mobile money transfers – mobile money transfer services are very popular in Kenya. The most common mobile money transfer services in Kenya are M-Pesa, Airtel Money and T-Kash. These services allow users to send and receive money using their mobile phones.
- Online payment systems – there are various online payment systems available in Kenya, such as PayPal, Skill and Payoneer. These systems allow businesses and individuals to receive payments from customers globally.
- Asset financing – this involves obtaining financing for the purchase of assets such as machinery, equipment and vehicles. Banks, microfinance institutions and leasing companies offer asset financing in Kenya.
- Trade financing – this is a type of financing that helps businesses to finance their trade transactions. Trade financing includes import and export financing, letters of credit and guarantees.
- Equity financing – this involves capital by selling shares in a company to investors. Equity financing can be done through initial public offerings, private placements or venture capital funding.
- Grants and donations – companies and organisations can also receive funds through grants and donations from government agencies, non-governmental organisations and international development partners.

Overall, Kenya has a well-developed financial system that offers various financing and transfer options to businesses and individuals. However, financing and the transfer of funds and equipment are subject to various regulations and taxes, such as:

- Foreign exchange regulations – all foreign exchange transactions in Kenya are regulated by the Central Bank of Kenya (CBK). Individuals and companies must comply with the exchange control regulations when making transactions involving foreign currency.
- Capital gains tax – if a company transfers or sells its assets, it may be liable to pay capital gains tax on the gain made from the transfer or sale. The tax rate for capital gains is currently 5%.
- Stamp duty – stamp duty is payable on documents such as agreements, contracts and deeds. The rate of stamp duty varies depending on the nature of the transaction.
- Value added tax (VAT) – if a company purchases goods or services, it may be liable to pay VAT on the transaction. The current VAT rate in Kenya is 16%.
- Withholding tax – if a company makes payments to non-residents for services or royalties, it may be required to deduct withholding tax from the payments. The rate of withholding tax varies depending on the nature of the payment.

- Transfer pricing – if a company is part of a group of companies and engages in cross-border transactions with its related companies, it must comply with transfer pricing regulations. The transfer pricing regulations aim to ensure that prices charged in cross-border transactions are arm's length and reflect market prices.
- Export processing zones – companies operating within export processing zones may be entitled to various tax incentives, including exemptions from VAT and customs duties.

Transfer of funds out of the country

In Kenya, the transfer of funds out of the country is regulated by the CBK through various laws and regulations.

Individuals and companies can transfer funds out of Kenya subject to compliance with certain rules and regulations. For instance, individuals and companies are required to obtain approval from the CBK for any transfers above a certain threshold. The threshold amount for individuals is KES 500,000 per transaction, while for companies the threshold is KES 5,000,000 per transaction.

The approval process for transfers above the threshold involves the submission of various documents, including a tax compliance certificate, invoices and relevant contracts. The CBK reviews the documents and approves the transfer if it deems the transaction to be legitimate and in compliance with all regulations.

Additionally, individuals and companies are required to submit certain reports to the CBK, such as monthly returns of foreign exchange transactions and quarterly reports on the foreign currency accounts held with local banks. Failure to comply with these reporting requirements can result in penalties and fines.

It is also worth noting that the Kenyan government imposes restrictions on the transfer of funds related to certain activities, such as money laundering, terrorism financing and corruption. Any funds suspected to be involved in such activities are subject to seizure by the government.

REMITTANCE OF PROFITS

When a company earns profits in Kenya, it can remit those profits to a foreign country subject to certain conditions and regulations. The CBK regulates the remittance of profits by foreign investors, and there are specific procedures that must be followed.

The remittance of profits is subject to taxes in Kenya. The tax rate is currently set at 20% of the gross amount remitted. Companies that remit profits are required to file a tax return with the Kenya Revenue Authority and pay the tax due within 15 days of making the remittance.

Companies that have invested in Kenya through a branch or subsidiary may also be subject to additional taxes and regulations on the remittance of profits. For example, companies operating in certain sectors, such as the oil and gas industry, may be subject to specific regulations and taxes on the repatriation of profits.

REMITTANCE OF DIVIDENDS

The remittance of dividends refers to the transfer of profits earned by a company to its shareholders who are residents outside the country. When a company makes a profit, it can distribute the earnings to its shareholders in the form of dividends. However, when the shareholders are residents outside the country, the remittance of dividends involves transferring the funds to the shareholders' bank accounts in their respective countries.

In Kenya, the remittance of dividends is subject to certain regulations, including the approval of the CBK. Companies are required to seek approval from the CBK before remitting dividends to non-resident shareholders. The approval process involves submitting relevant documents to the CBK, including the audited financial statements, tax returns and board resolutions approving the distribution of dividends.

Additionally, the remittance of dividends may be subject to withholding tax. The withholding tax rate for the remittance of dividends to non-resident shareholders is currently set at 10%. This means that a company is required to deduct 10% of the total dividend amount as withholding tax and remit the amount to the KRA before transferring the remaining amount to the non-resident shareholder.

It is also important to note that the remittance of dividends is subject to foreign exchange controls. The CBK may require the company to provide supporting documentation, including a copy of the contract for the purchase of shares, before approving the remittance of dividends. The CBK may also impose restrictions on the amount of funds that can be remitted out of the country, depending on the prevailing foreign exchange regulations.

REPATRIATION OF SALES PROCEEDS

Repatriation of sales proceeds refers to the transfer of funds from the sale of assets or investment returns to the investor's home country. In Kenya, there are no restrictions on the repatriation of sales proceeds, subject to the requirements of the foreign exchange regulations.

Under the foreign exchange regulations, residents and non-residents are allowed to freely transfer their funds into and out of the country. However, certain transactions require prior approval from the CBK and documentation to prove the legitimacy of the transaction.

For instance, if the sales proceeds are from the disposal of an asset in Kenya, such as shares in a Kenyan company or property, the transaction must be reported to the CBK within 14 days of the transfer. The transfer must also be made through a licensed foreign exchange dealer or a commercial bank and supporting documentation must be provided to show the source of the funds and the legitimacy of the transaction.

Furthermore, non-residents are required to obtain a tax clearance certificate from the KRA before repatriating sales proceeds to their home country. The tax clearance certificate is issued to confirm that all tax obligations have been met, and the certificate must be obtained within six months from the end of the financial year in which the proceeds were earned.

REMITTANCE OF SALARIES AND SAVINGS BY EXPATRIATES

The remittance of salaries and savings by expatriates refers to the transfer of funds by foreign workers who are employed in Kenya to their home countries or to other countries for personal use. This type of transfer is subject to foreign exchange regulations and may be subject to taxation.

In Kenya, non-residents are required to pay tax on any income earned within the country. However, if a double taxation treaty exists between Kenya and the foreign worker's home country, they may be able to claim tax relief in one of the countries.

To remit salaries and savings, the foreign worker must first convert their earnings from Kenyan shillings into the desired currency through a licensed commercial bank or authorised foreign exchange bureau. The foreign exchange regulations may limit the amount that can be transferred or the frequency of transfers, and proof of the source of the funds may be required.

In addition to foreign exchange regulations, the transfer of funds may also be subject to other regulations or restrictions, such as anti-money laundering laws.

REMITTANCE OF ROYALTY AND TECHNICAL KNOW-HOW FEES

When a Kenyan company pays royalties or technical know-how fees to a non-resident person or entity, there is a requirement to withhold tax at a rate of 20% on the gross payment. This withholding tax is considered final tax on the royalty or technical know-how fees paid, and the non-resident recipient of the payment is not required to file a tax return in Kenya.

However, if there is a double taxation agreement between Kenya and the country in which the non-resident recipient is based, the withholding tax rate may be reduced to the rate specified in the double taxation agreement. In addition, the non-resident recipient may be eligible for relief from Kenyan tax under the DTAA.

When the non-resident recipient wishes to remit the royalty or technical know-how fees received from the Kenyan company out of the country, they may do so after paying the applicable WHT. The remittance may be subject to further foreign exchange control regulations and may require approval from the CBK.

REMITTANCE ON ACCOUNT OF TRAINING AND CONSULTANCY

When it comes to the remittance of funds for training and consultancy services, the Kenyan government may require withholding tax to be deducted from the amount being remitted. The WHT rate for these types of services is typically 20%.

The remittance may also be subject to VAT if the training or consultancy services were received within Kenya. In such cases, the VAT rate is currently 16%.

It is important to note that companies may be required to obtain a tax compliance certificate from the KRA before they can remit funds out of the country.

Interest and loan repayments and dividends

When it comes to financing and the transfer of funds and equipment, there are several aspects related to interest, loan repayments and dividends that may be relevant. The key points are listed as follows:

- Interest – interest paid on loans or other types of borrowing is generally tax-deductible in Kenya, which can reduce the taxable income of the borrower.
- Loan repayments – loan repayments made to lenders outside of Kenya are subject to WHT, which is currently set at a rate of 15%. However, there are some exemptions and reduced rates that may apply depending on the type of loan and the country in which the lender is located.
- Dividends – dividends paid by Kenyan companies to non-residents are also subject to WHT at a rate of 10%. However, this rate may be reduced if Kenya has a tax treaty with the country in which the recipient is located.
- Transfer pricing – Kenya has transfer pricing rules that apply to cross-border transactions between related parties. These rules aim to ensure that the prices charged in these transactions are arm's length and reflect the market value of the foods or services being transferred. Failure to comply with these rules can result in penalties and additional tax liabilities.

Payment of insurance premiums or payments for other services

When it comes to financing and the transfer of funds and equipment, payment of insurance premiums or payments for other services may also be subject to taxation. In Kenya, for instance, the payment of insurance premiums is subject to WHT at a rate of 5% for life insurance and 10% for all other types of insurance.

Similarly, payments for certain services such as management, technical and professional services are also subject to WHT in Kenya. The WHT rate varies depending on the service, but generally ranges from 5–20%.

2.2.2 Further restrictions regarding currency conversion and loans

In Kenya, there are certain restrictions on currency conversion and loans when it comes to financing and the transfer of funds and equipment. The CBK regulates foreign currency transactions, including the conversion of Kenyan shillings into foreign currency and vice versa. The CBK requires that all foreign currency transactions be conducted through authorised banks or bureaux de change.

Additionally, there are restrictions on the amount of foreign currency that can be converted and transferred out of the country. These restrictions may vary depending on the purpose of the transaction and the country of destination.

With regards to loans, the Kenyan government regulates the terms and conditions of all foreign loans to ensure that they are in the best interest of the country. The government may require that certain conditions be met before approving a loan, such as the provision of collateral or the repayment of the loan in a specific currency.

Moreover, there are certain restrictions on the transfer of loan funds outside the country, which are aimed at ensuring that the funds are used for their intended purpose. The transfer of loan funds outside the country may require the approval of the CBK.

In addition, there are restrictions on the repayment of loans in foreign currency. The Kenyan government may require that loans be repaid in Kenyan shillings to avoid exposure to currency exchange risks. However, if the loan was obtained for a specific project or investment that generates foreign currency earnings, repayment may be allowed in the foreign currency earned from the project or investment.

2.3 Accounting regulations

2.3.1 Accounting principles

The accounting principles in Kenya are similar to the International Financial Reporting Standards (IFRS) and are governed by the Institute of Certified Public Accountants of Kenya (ICPAK). The principles aim to ensure that financial statements are accurate, reliable and useful for stakeholders – such as investors, lenders and regulators – to make informed decisions. Some of the key accounting principles in Kenya include:

- Accrual accounting – this principle requires that revenues and expenses are recognised when earned and incurred, respectively, regardless of when cash is received or paid out.
- Going concern – this principle assumes that the entity will continue to operate in the foreseeable future and financial statements should therefore be prepared on that basis.
- Consistency – this principle requires that an entity uses the same accounting methods and practices from one period to the next, ensuring the comparability of financial statements.
- Materiality – this principle requires that significant transactions and events should be disclosed in financial statements to provide a true and fair view of an entity's financial position.
- Prudence – this principle requires that financial statements should reflect the economic substance of transactions rather than their mere legal form.
- Dual aspect – this principle requires that every transaction has two aspects (a debit and a credit) which should be recorded in the accounting records to ensure that the accounting equation balances (assets = liabilities + equity).

Adherence to these accounting principles is essential to maintain the integrity and accuracy of financial statements and ensure that they are useful for decision-making purposes.

In Kenya, companies are classified into three categories based on their annual turnover.

TABLE 3. Size classes of companies in Kenya

	ANNUAL TURNOVER	TOTAL ASSETS
Micro Enterprises	Less than KES 1 million	Less than KES 500,00
Small Enterprises	Between KES 1 million and KES 200 million	Between KES 500,001 and KES 50 million
Medium Enterprises	Between KES 200 million and KES 1 billion	Between KES 50 million and KES 250 million
Large Enterprises	More than KES 1 billion	More than KES 250 million

Source: Own illustration (BBH, 2023)

2.3.2 Depreciation types and rates

Companies in Kenya are required to follow the depreciation rates and methods prescribed by the Kenyan accounting standards, which are based on IFRS. However, companies may have some flexibility in choosing the specific method within the prescribed guidelines. The Companies Act, 2015 requires companies to use the straight-line method of depreciation for buildings and structures, and either the straight-line method or the reducing balance method for other assets. The depreciation rates are also prescribed by law, and they vary depending on the type of asset. There are various depreciation methods that companies can use for accounting purposes.

Straight-line depreciation

Straight-line depreciation is a commonly used method for calculating depreciation. It is a simple method that spreads the cost of the asset evenly over its estimated useful life.

Under the straight-line method, the cost of the asset (less its residual value) is divided by its estimated useful life, resulting in an annual depreciation expense that is the same for each year of the asset's life.

The straight-line method is commonly used for assets that have a predictable and consistent pattern of wear and tear, such as buildings, vehicles and office equipment. It is also a useful method for companies that want to simplify their accounting process and minimise the risk of error or inconsistency in depreciation calculations.

However, the straight-line method may not always accurately reflect the actual pattern of an asset's usage or wear and tear. In such cases, other depreciation methods, such as units of production or diminishing balance, may be more appropriate.

Reducing balance method

The reducing balance method is a type of depreciation method used in accounting to allocate the cost of an asset over its useful life. Under this method, the depreciation expense charged to the income statement decreases over time as the book value of the asset declines.

In Kenya, the reducing balance method is one of the most commonly used depreciation methods. It involves applying a fixed percentage rate of depreciation to the book value of the asset at the beginning of each accounting period. The percentage rate is usually higher in the early years of the asset's life and reduces as the asset gets older.

The reducing balance method is often used for assets that have a high rate of obsolescence or technological change, such as computers or software. It allows companies to reflect the declining value of the asset as it becomes less useful over time.

Units of production depreciation

Units of production depreciation is a method for calculating depreciation that is based on the actual usage of an asset rather than its age or life. Under this method, depreciation is charged based on the number of units produced, hours used or any other measure of actual usage of the asset.

The key factor in this method is the estimation of total estimated production or usage, which is used to calculate the depreciation charge per unit of production of usage.

Units of production depreciation is commonly used for assets that are directly related to production, such as manufacturing equipment and assets that are subject to heavy usage, such as vehicles or aeroplanes. It is also useful for companies that wish to allocate the depreciation expense more accurately based on the actual usage of the asset, rather than a pre-determined rate or period. However, it can be difficult to accurately estimate the total production or usage of an asset, which can make this method less reliable for certain assets.

Sum-of-the-years' digits depreciation

The sum-of-the-years' digits depreciation is a method for calculating depreciation that considers the useful life of an asset. It is also known as the "accelerated depreciation" method because it results in higher de-

preciation charges in the early years of an asset's life, compared to the straight-line method.

Under this method, the total number of years of the asset's useful life are added up, and each year's depreciation expense is calculated as a fraction of the total. The numerator of the fraction is the remaining years of useful life, and the denominator is the sum of the years of useful life.

The sum-of-the-years' digits depreciation method is often used for assets that have a higher rate of depreciation in the early years of their life, such as vehicles or machinery. It allows companies to allocate more of the asset's cost to the earlier years when it is likely to be generating more revenue. However, this method can result in higher depreciation charges in the early years which can impact a company's financial statements and tax liability.

2.3.3 Accounting treatments of RE service providers and C&I consumers

RE service providers and C&I consumers have different accounting treatments depending on the type of renewable energy arrangement they have.

In a power purchase agreement (PPA) model, where the RE service provider generates and supplies electricity to the C&I consumer, the RE service provider recognises revenue based on the terms of the PPA, which could be fixed or variable. The C&I consumer, on the other hand, recognises the electricity purchased as an expense on their income statement.

In a build-own-operate-transfer (BOOT) model, where the RE service provider builds and operates the renewable energy project on behalf of the C&I consumer, the RE service provider capitalises the project cost as a fixed asset and recognises revenue from the C&I consumer based on the terms of the arrangement. The C&I consumer recognises the project cost as a liability and depreciates it over the useful life of the project.

In both cases, any payments made by the C&I consumer to the RE service provider are treated as operating expenses, and any financing costs associated with the project are treated as interest expense. The RE service provider may also be required to recognise intangible assets, such as renewable energy credits or carbon offsets, if applicable.

It is important to note that accounting treatments may vary depending on the specific terms of the renewable energy arrangement, as well as the accounting standards and regulations applicable in the country in which the parties are located.

2.3.4 Ability and methods to carry forward losses

In Kenya, in terms of accounting treatment, losses can also be carried forward in the financial statements. The IFRS allow for the recognition of deferred tax assets (DTAs) on tax losses carried forward, where it is probable that future taxable profits will be available against which the DTA can be utilised.

The carrying amount of DTAs should be reviewed on each balance sheet date and adjusted to reflect any changes in the likelihood of future taxable profits. If the carrying amount of the DTA exceeds the expected future taxable profits, the excess should be written off on the income statement as an impairment loss.

It is important to note that the rules governing the carry-forward of losses in tax and accounting may differ, and companies need to carefully consider both when planning their tax and financial strategies.

2.3.5 Possible legal forms

There is one legal form applicable to C&I projects and RE service providers which is the LLC.

Limited liability company (LLC)

An LLC describes a business structure that provides limited liability protection to its owners while allowing them to retain flexibility in management and ownership.

An LLC is a legal entity separate from its owners, which means that it can enter into contracts, own assets and conduct business operations in its own name. The owners of an LLC are referred to as members, and their ownership interests are represented by membership units, which can be assigned and transferred among members.

One of the main benefits of an LLC is limited liability protection for its members. Therefore, the personal assets of the members are generally protected from the debts and obligations of the LLC. However, members may still be personally liable for their own wrongful acts or negligence.

Another advantage of an LLC is that it offers pass-through taxation, which means that the company itself is not taxed on its income. Instead, the profits and losses of the LLC are passed through to its members and taxed at their individual rates.

3

Framework for C&I projects in Kenya

3.1 Specific requirements for the upfront purchase model

3.1.1 Description of the upfront purchase model

The upfront purchase model

In general, the upfront purchase model is a business model commonly used in the sale of goods or services. In this model, a customer pays a lump sum upfront for the right to use or access a product or service over a specified period, rather than paying for it on a recurring basis.

This model can be beneficial to both the customer and the business. For the customer, it can provide a sense of ownership and flexibility when using the product or service, without the worry of recurring payments. For the business, it can provide a steady stream of revenue upfront, as well as potentially reducing administrative costs associated with recurring billing.

However, this model also carries some risks to the business, such as the possibility of overestimating the revenue that will be generated from the upfront payment and the potential for customers to feel locked into a product or service they no longer want or need.

In accounting, revenue from an upfront purchase is generally recognised as deferred revenue and recognised over the period during which the customer is entitled to use the product or service. This occurs through the process of amortisation, which gradually reduces the deferred revenue balance and increases revenue recognised on the income statement.

In this study, the consumer will purchase the RE system through the execution of a purchase contract with the constructor who is outside Kenya. The consumer can make an upfront purchase, that is, pay the constructor ahead of the delivery of the system; this could either be achieved by the consumer taking out a loan from a credit institution or by self-financing the purchase of the system. Upon purchasing the system, the consumer contracts the services of a manager who oversees the system's operations. The consumer generates electricity from the RE system for its own use while the excess is sold to the public grid.

Relevant contractual relationships

In the upfront purchase model, the relevant contractual relationships between the offtaker and the RE service provider are the following:

- purchase contract between the engineering, procure and construction (EPC)/RE service company of the energy generation system and the consumer whereby the constructor is in charge of project planning and construction;
- loan agreement between the consumer and the credit institution, provided that the financing is not from equity;
- service contract between the contractor and the consumer, whereby the manager is responsible for the operational activity of the energy generation system; and
- contract for feeding surplus energy into the public grid.

3.1.2 Analysis of the offtaker's accounting and tax implications

Accounting implications

In the upfront purchase model, the C&I consumer who purchases the renewable energy system incurs a significant initial cost. This cost is recorded as a fixed asset on the balance sheet of the C&I consumer, reflecting the amount paid for the renewable energy system. The asset is then depreciated over its useful life, and the depreciation expense is recognised as an operating expense on the income statement.

The C&I consumer may also incur additional costs relating to installation and maintenance of the renewable energy system, which are recognised as operating expenses on the income statement as incurred.

In terms of the accounting treatment of any financing arrangements, the C&I customer would record any financing obtained for the purchase of the renewable energy system as a liability on the balance sheet, with interest expense recognised on the income statement over the term of the financing arrangement.

Further accounting implications are described below.

PURCHASE OF THE RE SYSTEM

The consumer shall capitalise the RE system as a fixed asset on the balance sheet. Depreciation of the asset would be realised using an appropriate depreciation method.

IMPORTATION OF COMPONENTS

Import duties are to be capitalised along with the cost of the asset.

FINANCING AGREEMENT

The consumer may recognise loan liabilities in line with IFRS 9. Interest expense paid or payable by the consumer is to be debited to the income statement. Interest accrued up to the date of commissioning of the RE system is to be capitalised.

SALE OF EXCESS POWER TO THE PUBLIC GRID

The consumer may recognise income from the sale of excess power on the credit income statement. Credit VAT-payable account with VAT on the sale of excess power.

COST OF OPERATING THE RE SYSTEM (THROUGH A MANAGER OR SELF)

The consumer may recognise the costs of operating the RE system itself or through a manager as debit on the income statement.

STAMP DUTY

Stamp duty paid by the consumer in respect of the financing arrangement is to be expensed on the income statement.

Taxation implications

In the upfront purchase model, the C&I consumer typically owns the renewable energy system and is responsible for its maintenance and operation. As such, the consumer may be eligible for certain tax incentives, such as investment tax credits and accelerated depreciation, which can help reduce the cost of the system.

The main tax incentive for the C&I consumer is the investment deduction allowance (IDA). The IDA allows businesses to claim a deduction of 150% of the qualifying capital expenditure in the year in which it is incurred. This means that a business that invests KES 1 million in a renewable energy system can claim a tax deduction of KES 1.5 million.

Another tax incentive available in Kenya is the accelerated depreciation allowance (ADA). This allows businesses to claim depreciation of 50% in the first year of purchase and 25% for the next three years on qualifying capital expenditure.

FINANCING AGREEMENT

The following tax implications may arise in case of financing agreements to purchase the upfront purchase model:

- VAT at a rate of 16% payable on non-interest fees.
- 15% WHT to be deducted from fees and interest payable to the credit institution.
- There is no capital gains tax (CGT) to be considered.
- Stamp duties may be payable at a rate of 0.1% of the loan amount.
- There are no import duties to be considered.
- For CIT, interest is deductible subject to prescribed restrictions, applicable when the consumer is linked to a foreign credit institution. VAT paid on loan charges is also deductible. The C&I consumer may be eligible to claim capital allowances on the renewable energy system if they meet certain conditions. The amount of capital allowances that can be claimed depends on the type of asset and the depreciation rate used.

UPFRONT PURCHASE AGREEMENT

The following tax implications may arise in the case of the purchase agreement:

- VAT at a rate of 16% payable on the earlier of payment or delivery.
- There is no WHT to be considered if the constructor is a Kenyan resident. However, if the constructor is a non-resident person or entity, the consumer must consider WHT at a rate of 20%.
- There is no CGT to be considered.
- There is nominal stamp duty on the agreement.
- There are no import duties to be considered.
- For CIT, capital allowance claimable on the system is 50% and 25% as initial and annual rates, respectively.

OPERATION OF THE RE SYSTEM

A manager may be hired for the operation of the RE system. This may trigger the following tax implications:

- The fees to the manager will include VAT at a rate of 16% if the manager is a registered VAT entity. The reimbursement of expenses will not attract any additional VAT if the manager is already paid with VAT.
- There is no WHT to be considered if the manager is a resident entity. If the latter is a non-resident entity, the consumer may be required to apply WHT. The rate is dependent on the country of residence of the manager and any applicable tax treaty.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of appointment of a manager.
- There are no import duties to be considered.
- For CIT, annual fees and VAT paid to the manager are deductible for tax purposes.

SALE OF SURPLUS ENERGY TO THE PUBLIC GRID

The following tax implications may arise in the sale of surplus energy to the public grid:

- There is VAT at a rate of 16% to be included in the invoice issued to the grid operators. However, if the consumer is a small supplier (annual turnover not more than KES 5 million), they may be exempt from VAT. Failure to charge VAT will result in the consumer bearing the VAT cost.
- The payment from the grid operators is to attract WHT at a rate of 5% for resident suppliers and 20% for non-resident suppliers. However, if the consumer is a small supplier, they may be exempt from WHT. This is to be used to offset future income tax liabilities.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of supply to the grid.
- There are no import duties to be considered.
- For CIT, the profit generated from supply is subject to CIT at a rate of either 30% for resident companies or 37.5% for non-resident companies.

3.1.3 Analysis of the RE service provider's accounting and tax implications

Accounting implications

In the upfront purchase model, the RE service provider receives payment for the renewable energy system upfront and transfers ownership of the system to the consumer. As a result, the RE service provider will recognise the entire revenue at the time of sale.

However, the RE service provider may also incur significant costs associated with the installation of the renewable energy system, including equipment, labour and other related expenses. These costs will be recognised as expenses as incurred.

Additionally, the RE service provider may need to recognise a provision for warranty costs, which represents the estimated cost or replacing any defects in the system during the warranty period.

From an accounting perspective, the upfront purchase model may result in significant revenue recognition in the short term, but the associated expenses and warranty costs will be recognised over a longer period. It is important for the RE service provider to accurately estimate and recognise these costs to ensure that the financial statements reflect the true financial position and performance of the company.

Taxation implicatons

TRANSFER OF THE RE SYSTEM TO THE CONSUMER

The following tax implications may arise in the transfer of the RE system to the consumer:

- The sale of the RE system will attract VAT at a standard rate of 16%.
- The payment to the constructor will attract 5% WHT to be deducted by the consumer on every milestone payment.
- There is no CGT to be considered.
- There is a nominal stamp duty of 1%.
- There are no import duties to be considered.
- For CIT, the payment received from the consumer will be subject to income tax in Kenya, with the WHT deducted by the consumer recognised as an advance payment.

IMPORTATION OF COMPONENTS

The following tax implications may arise in the case of the importation of components:

- Most components for RE equipment are exempt from VAT.
- The RE service provider may be subject to WHT for payments made to foreign suppliers for the imported components. The rate depends on the type of payment being made and the country of origin of the supplier.
- There is no CGT to be considered.
- There is no stamp duty to be considered.
- Import duties are payable at specific rates.
- For CIT, the cost is to be deducted from the purchase price to determine the taxable profit.

The VAT Act exempts certain renewable energy equipment from VAT. This includes:

- wind-powered generators;
- solar-powered generators;
- solar cells, whether or not in models or made up into panels;
- other photosensitive semiconductor devices;
- solar DC generators of an output not exceeding 750 W; and
- solar DC generators of an output exceeding 750 W but not exceeding 75 kW.

The RE service provider will be exempt from VAT when equipment is used for the construction of solar, wind or geothermal projects. An approval must be issued by the Cabinet Secretary of Energy and Petroleum.

The Fifth Schedule of the EACCMA specifies the goods that are exempt from import duty subject to certain conditions being met. Import duty is not charged on the goods specified in said Fifth Schedule.

Notwithstanding the exemption conferred on the components above, there is no express exemption for the sale of the energy generation system. Therefore, the eventual transfer of the system from the constructor to the consumer will attract VAT at 16% to be paid by the consumer.

Interest taxation under this model is as discussed above. That is, when the consumer obtains a loan from a foreign related party, the total interest expense deductible is restricted to 30% of EBITDA, the excess of which may be carried forward for a maximum period of five years. Therefore, interest expense can be made fully deductible if the loan is from a Kenyan entity or from a foreign unrelated lender, but partially deductible if the loan is from a foreign related party.

Meanwhile, although the consumer is entitled to claim both capital and investment allowances on the RE system, note that the investment allowance will be withdrawn if the RE requirement is sold within five years of purchase.

3.2 Specific requirements for the leasing model with ownership transfer

3.2.1 Description of the leasing model with ownership transfer

The leasing model with ownership transfer

In the leasing model with ownership transfer for C&I projects, the RE service provider retains ownership of the renewable energy system and leases it to the C&I consumer. The lease agreement typically includes an option for the C&I consumer to purchase the system at the end of the lease term at a pre-agreed price, which is often lower than the fair market value of the system.

The constructor may sell the RE system to either the consumer or the credit institution. When the consumer is the purchaser, the consumer would sell the RE system to the credit institution and lease the system back from the credit institution for the generation of electricity for the use of the consumer. On the other hand, when the sale is to the credit institution, the consumer simply leases the RE system from the purchaser. In either case, the consumer uses the system to generate electricity for itself and sells any surplus to the public grid, whilst the consumer appoints a manager to oversee the operations of the system.

From an accounting perspective, the RE service provider records the renewable energy system as a fixed asset on their balance sheet and depreciates it over its useful life. The lease payments received from the C&I consumer are recognised as revenue over the term of the lease, and any profit or loss on the sale of the system to the C&I consumer at the end of the lease term is recorded accordingly.

For the C&I consumer, the lease payments are typically treated as operating expenses and deducted from their taxable income, while the option to purchase the system at the end of the lease term may be recorded as a contingent liability until exercised.

From a taxation perspective, the lease payments are subject to VAT and WHT, while the sale of the system to the C&I consumer at the end of the lease term may be subject to CGT. The tax treatment may vary depending on the specific details of the lease agreement and the applicable tax laws and regulations.

Further tax implications considered in this model are based on the following assumptions:

- The ownership of the asset will revert to the consumer at the end of the lease term.
- The consumer has control over the asset, evidenced by the obligation to appoint a manager.
- The consumer is the sole user of the asset.
- The asset is located on the consumer's premises.

Relevant contractual relationships

In the leasing model with ownership transfer, the relevant contractual relationships between the offtaker and the RE service provider are the following:

- purchase contract between the constructor of the energy generation system and the consumer whereby the constructor is in charge of project planning and construction;
- sale-and-leaseback agreement between the consumer and the credit institution;
- service contract between the manager and the consumer, whereby the manager is responsible for the operational activity of the energy generation system; and
- contract for feeding surplus energy into the public grid.

3.2.2 Analysis of the offtaker's accounting and tax implications

Accounting implications

In the leasing model with ownership transfer for C&I projects, the accounting implications for the consumer depend on whether the lease arrangement is classified as a finance lease or an operating lease.

If the lease is classified as a finance lease, the consumer is deemed to have acquired the asset, and the asset should be recognised as an asset on the consumer's balance sheet. The consumer should also recognise a liability equal to the present value of lease payments. The asset should be depreciated over its useful life, and interest expense should be recognised on the lease liability.

If the lease is classified as an operating lease, the asset should not be recognised on the consumer's balance sheet. Instead, lease payments should be recognised as an expense on the consumer's income statement over the lease term on a straight-line basis or using another systematic method.

In either case, any upfront payments made by the consumer to the lessor should be treated as a repayment or asset and recognised as an expense over the lease term. Additionally, any potential residual value guarantees or obligations should be recognised on the consumer's balance sheet as a liability.

It is important for the consumer to carefully evaluate the lease terms and classifications, as they can have significant implications on the financial statements and related key ratios, such as leverage ratios and return on assets.

Further accounting implications are described below.

PURCHASE OF THE RE SYSTEM

The consumer shall capitalise the RE system as property, plant and equipment (PPE) in line with IAS 16. The depreciation of assets would be realised in line with IAS 16. Ownership and control are deemed to remain with the consumer irrespective of the lease agreement.

LEASEBACK OF RE SYSTEM

Leaseback of the RE system will be accounted for in line with IFRS 16, as follows:

In the books of the consumer (on initial recognition): debit right-of-use asset a/c; credit lease liability a/c with the present value of the minimum lease payment.

On subsequent recognition, amortisation of the right-of-use asset: debit depreciation expense a/c; credit right-of-use asset a/c.

In the books of the credit institution: debit lease interest receivable a/c; credit lease interest income a/c.

SALE OF EXCESS POWER TO THE PUBLIC GRID

The consumer may recognise income from the sale of excess power on the credit income statement. Credit VAT-payable account with VAT on the sale of excess power.

COST OF OPERATING THE RE SYSTEM (THROUGH A MANAGER OR SELF)

The consumer may recognise the costs of operating the RE system itself or through a manager as debit on the income statement.

STAMP DUTY

Stamp duty paid by the consumer in respect of the financing arrangement is to be expensed on the income statement.

Taxation implications

PURCHASE OF THE ENERGY GENERATING SYSTEM FROM THE CONSTRUCTOR

The following tax implications may arise in the case of the purchase of the energy generating system from the constructor:

- VAT at a rate of 16% payable on the earlier of payment of delivery.
- In the event of the constructor being non-resident, WHT at a rate of 20% of the purchase price is to be deducted on every milestone payment. If the constructor is a resident, there is no WHT to be considered.
- There is no CGT to be considered.
- There is nominal stamp duty of 1% of the purchase price on the agreement.
- There are no import duties to be considered.
- There is no CIT to be considered.

SALE OF THE ENERGY GENERATING SYSTEM TO THE CREDIT INSTITUTION BY THE CONSUMER

This contractual relationship is typically viewed as a financing arrangement that does not equate to the outright sale of the equipment. There are no tax implications that may arise.

LEASEBACK/LEASE OF THE ENERGY GENERATING SYSTEM FROM THE CREDIT INSTITUTION

The following tax implications may arise in the case of a leaseback of the energy generating system from the credit institution:

- In general, lease payments are subject to VAT. The consumer may be required to pay VAT on the lease payment at the standard rate of 16%.
- WHT will be due at the point the consumer settles interest expense on the lease. At this point, the consumer is required to withhold a certain percentage of the amount and remit it to the KRA. However, an operating lease will attract withholding tax at 15% if the lessor is a non-resident. If resident, WHT will not apply.
- A finance lease will attract WHT at 15%, where it is paid to both a resident or a non-resident.
- There is no CGT to be considered.
- As per the Stamp Duty Act, stamp duty is payable on a lease at the rate of 1% of the annual rent for a period of 3 years and below, and 2% for lease periods greater than 3 years.
- For CIT, the capital allowance claimable on the system is 50% and 25% as initial and annual rates, respectively. However, the actual amount of capital allowance that can be claimed will depend on the actual cost of the system, as well as any other factors that may affect the calculation of capital allowance, such as the method of depreciation used.

However, as per Paragraph 113 of the First Schedule of the VAT Act, there is an exemption insofar as equipment being transferred is for the development and generation of solar and wind energy: specialised equipment for the development and generation of solar and wind energy.

There is no express provision providing for the applicability of VAT on sale-and-leaseback transactions. The lease payments may be considered as financial payments made by the C&I consumer to the credit institution and, subsequently, VAT exempt.

Interest expenses are deductible, but not fully, and are subject to the 30% EBITDA fixed ratio rule. The enactment of the Finance Act, 2021 saw the replacement of the thin capitalisation provision with a provision that the deduction of interest paid or payable to related and third parties of more than 30% of EBITDA be disallowed when ascertaining taxable income.

Interest expense is fully deductible when the lessee receives funding from foreign sources.

OPERATION OF THE RE SYSTEM

A manager may be hired for the operation of the RE system. This may trigger the following tax implications:

- The fees to the manager will include VAT at a rate of 16% if the manager is a registered VAT entity. The reimbursement of expenses will not attract any additional VAT if the manager is already paid with VAT.
- There is no WHT to be considered if the manager is a resident entity. If it is a non-resident entity, the consumer may be required to apply WHT. The rate is dependent on the country of residence of the manager and any applicable tax treaty.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of appointment of a manager.
- There are no import duties to be considered.
- For CIT, annual fees and VAT paid to the manager are deductible for tax purposes.

SALE OF SURPLUS ENERGY TO THE PUBLIC GRID

The following tax implications may arise in the event of the sale of surplus energy to the public grid:

- There is VAT at a rate of 16% to be included in the invoice issued to the grid operators. However, if the consumer is a small supplier, they may be exempt from VAT. Failure to charge VAT will result in the consumer bearing the VAT cost.
- The payment from the grid operators is to attract WHT at rate of 5% for resident suppliers and 20% for non-resident suppliers. However, if the consumer is a small supplier, they may be exempt from WHT. This is to be used to offset future income tax liabilities.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of supply to the grid.
- There are no import duties to be considered.
- For CIT, the profit generated from supply is subject to CIT at a rate of either 30% for resident companies or 37.5% for non-resident companies.

3.2.3 Analysis of the RE service provider's accounting and tax implications

Accounting implications

In the leasing model with ownership transfer, the RE service provider would construct the C&I project for the needs of the consumer. The constructor may sell the RE system to either the consumer or the credit institution. As a result, the RE service provider will recognise the entire revenue at the time of sale.

However, the RE service provider may also incur significant costs associated with the installation of the renewable energy system, including equipment, labour and other related expenses. These costs will be recognised as expenses as incurred.

Additionally, the RE service provider may need to recognise a provision for warranty costs, which represents the estimated cost or replacing any defects in the system during the warranty period.

From an accounting perspective, the leasing model with ownership transfer may result in significant revenue recognition in the short term, but the associated expenses and warranty costs will be recognised over a longer period. It is important for the RE service provider to accurately estimate and recognise these costs to ensure that the financial statements reflect the true financial position and performance of the company.

Further accounting implications are described below.

IMPORTATION OF COMPONENTS

Import duties are to be capitalised along with the cost of the asset.

Taxation implicatons

SALE OF THE RE SYSTEM TO THE CONSUMER OR CREDIT INSTUTE

The following tax implications are triggered in the event of transfer of the RE system to the consumer or the credit institution:

- There is no VAT to be applied. However, the constructor will act as an agent for the collection of 16% VAT if the constructor is a Kenyan company.
- The payment to the constructor will attract 15% WHT to be deducted by the consumer on every milestone payment.
- There is no CGT to be considered.
- The sale of the RE system may be subject to stamp duty, which is levied on the transfer of immovable property. The rate varies depending on the location of the property and the value of the transaction.
- There are no import duties to be considered.
- For CIT, the payment received from the consumer will be subject to income tax in Kenya, with the WHT deducted by the consumer recognised as an advance payment.

IMPORTATION OF COMPONENTS

The following tax implications may arise in the event of the importation of components:

- Most components for RE equipment are exempt from VAT.
- The RE service provider may be subject to WHT for payments made to foreign suppliers for the imported components. The rate depends on the type of payment being made and the country of origin of the supplier.
- There is no CGT to be considered.
- There is no stamp duty to be considered.
- Import duties are payable at specific rates.
- For CIT, the cost is to be deducted from the purchase price to determine the taxable profit.

The VAT Act exempts certain renewable energy equipment from VAT. This includes:

- wind-powered generators;
- solar-powered generators;
- solar cells, whether or not in models or made up into panels;
- other photosensitive semiconductor devices;
- solar DC generators of an output not exceeding 750 W; and
- solar DC generators of an output exceeding 750 W but not exceeding 75 kW.

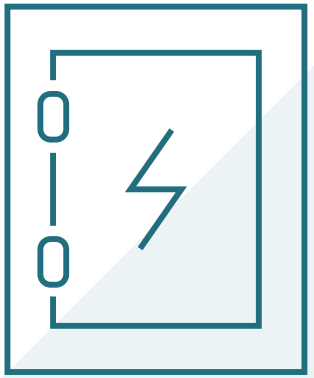
The RE service provider will be exempt from VAT when equipment is used for the construction of solar, wind or geothermal projects. An approval must be issued by the Cabinet Secretary of Energy and Petroleum.

The Fifth Schedule of the EACCMA specifies the goods that are exempt from import duty subject to certain conditions being met. Import duty is not charged on the goods specified in said Fifth Schedule.

Notwithstanding the exemption conferred on the components above, there is no express exemption for the sale of the energy generation system. Therefore, the eventual transfer of the system from the constructor to the consumer will attract VAT at 16% to be paid by the consumer.

Interest taxation under this model is as discussed above. That is, when the consumer obtains a loan from a foreign related party, the total interest expense deductible is restricted to 30% of EBITDA, the excess of which may be carried forward for a maximum period of five years. Therefore, interest expense can be made fully deductible if the loan is from a Kenyan entity or from a foreign unrelated lender, but partially deductible if the loan is from a foreign related party.

Meanwhile, although the consumer is entitled to claim both capital and investment allowances on the RE system, note that the investment allowance will be withdrawn if the RE requirement is sold within five years of purchase.



3.3 Specific requirements for the renting model with ownership transfer

3.3.1 Description of the renting model with ownership transfer

The renting model with ownership transfer

In the renting model with ownership transfer for C&I projects, the RE service provider (lessor) retains ownership of the renewable energy system and leases it to the C&I consumer (lessee) for a fixed term. At the end of the lease term, ownership of the renewable energy system is transferred to the lessee. The lease payments cover the financing costs and depreciation of the renewable energy system. The rental payments are often structured to be lower than the energy savings achieved, allowing the lessee to generate cost savings towards the later periods of the contract, especially when the contract durations are shorter.

The accounting treatment of the renting model with ownership transfer for C&I projects involves recognising the lease payment as income for the RE service provider over the term of the lease. The lease payments are also recognised as an expense for the C&I consumer. The renewable energy system is recorded as an asset on the lessor's balance sheet and is depreciated over its useful life, while the lessee records the rental payments as an operating expense and the renewable energy system as a leased asset on their balance sheet.

When ownership of the renewable energy system is transferred to the lessee at the end of the lease term, the lessor recognises the transfer as a sale and records a gain or loss on the sale. The lessee records the renewable energy system as a purchased asset on their balance sheet, and the cost of the system is recognised as capital expenditure.

Overall, the renting model with ownership transfer allows the C&I consumer to access renewable energy technology without incurring upfront costs or taking on debt, while the RE service provider generates a steady stream of income from the lease payments and retains ownership of the renewable energy system until the end of the lease term.

Relevant contractual relationships

In the renting model with ownership transfer, the relevant contractual relationships between the offtaker and the RE service provider are the following:

- rental contract between the constructor of the energy generation system and the consumer, whereby the constructor is in charge of project planning and construction;
- loan agreement between the constructor and the credit institution, provided that the financing is not from equity;
- service contract between the manager and the consumer, whereby the manager is responsible for the operational activity of the energy generation system; and
- contract for feeding surplus energy into the public grid.

3.3.2 Analysis of the offtaker's accounting and tax implications

Accounting implications

In the renting model with ownership transfer for C&I projects, the consumer is essentially leasing the renewable energy system for a set period with the option to eventually own it.

From an accounting perspective, the consumer would record the periodic lease payments as an operating expense on their income statement. If the lease agreement includes a bargain purchase option, the consumer may also record an asset on their balance sheet for the estimated value of the renewable energy system at the end of the lease term.

If the consumer chooses to exercise the ownership transfer option, the asset would be transferred to their balance sheet and the lease payments would be discontinued. The transfer would be recorded at the fair market value of the system at the time of the transfer and any difference between the fair market value and the carrying value of the asset on the lessor's balance sheet would be recognised as a gain or loss on their income statement.

It is important to note that the specific accounting treatment may vary depending on the lease agreement and applicable accounting standards.

Further accounting implications are described below.

PURCHASE OF THE RE SYSTEM

The consumer shall capitalise the asset upon eventual transfer from the constructor at the transfer value in line with IAS 16. Depreciation of the asset would be realised by the party capitalising at each stage in line with IAS 16.

RENTAL OF THE RE SYSTEM

The lease rental expense is to be debited to the income statement of the consumer.

SALE OF EXCESS POWER TO THE PUBLIC GRID

The consumer may recognise income from the sale of excess power on the credit income statement. Credit VAT-payable account with VAT on the sale of excess power.

COST OF OPERATING THE RE SYSTEM (THROUGH A MANAGER OR SELF)

The consumer may recognise the costs of operating the RE system itself or through a manager as debit on the income statement.

STAMP DUTY

Stamp duty paid by the consumer in respect of the financing arrangement is to be expensed on the income statement.

Taxation implications

RENTAL OF THE ENERGY GENERATING SYSTEM FROM THE CONSTRUCTOR

The following tax implications may arise in the event of rental of the energy generating system from the constructor:

- VAT at a rate of 16% payable on the lease rental.
- In the event of the constructor being non-resident, WHT at a rate of 20% of the purchase price is to be deducted on every milestone payment. If the constructor is a resident, there is no WHT to be considered.
- There is no CGT to be considered.
- There is stamp duty at a rate of 2% on the transfer of ownership agreement to be considered.
- There are no import duties to be considered.
- For CIT, there is no capital allowance claimable. All rentals may be considered as instalment sales.

SALE OF SURPLUS ENERGY TO THE PUBLIC GRID

The following tax implications may arise in the event of the sale of surplus energy to the public grid:

- There is VAT at a rate of 16% to be included in the invoice issued to the grid operators. However, if the consumer is a small supplier, they may be exempt from VAT. Failure to charge VAT will result in the consumer bearing the VAT cost.
- The payment from the grid operators is to attract WHT at rate of 5% for resident suppliers and 20% for non-resident suppliers. However, if the consumer is a small supplier, they may be exempt from WHT. This is to be used to offset future income tax liabilities.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of supply to the grid.
- There are no import duties to be considered.
- For CIT, the profit generated from supply is subject to CIT at a rate of either 30% for resident companies or 37.5% for non-resident companies.

EVENTUAL PURCHASE OF THE RE SYSTEM

The following tax implications may arise in the event of the eventual purchase of the RE system:

- There is no express provision on the applicability of VAT on rent-to-own transactions. Therefore, the rent payments may be considered as instalments made by the consumer to the constructor for acquisition of the energy generating equipment. When the equipment is used for the generation of energy from solar, wind or geothermal sources, VAT shall not apply upon approval of exemptions.
- WHT at a rate of 15% may apply if the constructor is a non-resident. However, if the constructor is a resident of Kenya, then WHT may not apply to the purchase price.
- There is no CGT to be considered.
- There is stamp duty at a rate of 2% on the transfer of ownership agreement to be considered.
- There are no import duties to be considered.
- For CIT, capital allowance claimable on the system is 50% and 25% as initial and annual rates, respectively.

3.3.3 Analysis of the RE service provider's accounting and tax implications

Accounting implications

In the renting model with ownership transfer, the RE service provider retains ownership of the renewable energy system and leases it to the C&I consumer. The rental payments made by the C&I consumer typically include a portion that goes towards the purchase of the system over the lease term, after which ownership is transferred to the C&I consumer.

From an accounting perspective, the RE service provider initially records the renewable energy system as a fixed asset on their balance sheet. As rental payments are received, a portion of these payments is recognised as revenue, and the portion allocated to the purchase of the system is recorded as a reduction in the asset value of the system on the RE service provider's balance sheet.

The C&I consumer records the rental payments as operating expenses on their income statement. As the payments are made, the C&I consumer also records a liability on their balance sheet, representing the outstanding amount owed to the RE service provider for the purchase of the system.

Once the ownership transfer occurs, the RE service provider records a gain or loss on the sale of the system, based on the difference between the net book value of the system and the purchase price paid by the C&I consumer. The C&I consumer records the system as a fixed asset on their balance sheet at the purchase price paid.

Overall, the accounting treatment for the renting model with ownership transfer is similar to that of the leasing model with ownership transfer, with the main difference being that the C&I consumer's payments are classified as operating expenses rather than lease payments.

Further accounting implications are described below.

PURCHASE OF THE RE SYSTEM

The constructor shall capitalise the RE system as PPE during the rental period in line with IAS 16. Depreciation of the asset would be realised by the party capitalising at each stage in line with IAS 16.

IMPORTATION OF COMPONENTS

Import duties are to be capitalised along with the cost of the asset.

RENTAL OF THE RE SYSTEM

The lease rental income is to be credited to the income statement of the constructor.

FINANCING ARRANGEMENT WITH A CREDIT INSTITUTION

The constructor shall recognise loan liability in line with IFRS 9. Interest expense paid or payable by the constructor is to be debited on the income statement. Interest accrued up to the date of commissioning of the RE system is to be capitalised.

Taxation implications

FINANCING ARRANGEMENT

The following tax implications may arise in the case of the financing arrangement:

- VAT will be applied, save for renewable energy specifically exempted. Where VAT at a rate of 16% would apply, the tax base will be the lease payments.
- WHT will be due at the point the tenant settles rent payments. The tenant is required to withhold 15% of the rental payments to the non-resident owner and remit it to the KRA. If the owner is a resident, WHT will not apply.
- There is no CGT to be considered.

- As per the Stamp Duty Act, stamp duty is payable on a lease at the rate of 1% of the annual rent for a period of 3 years and below, and 2% for lease period greater than 3 years.
- There are no import duties to be considered.
- For CIT, the interest is deductible subject to prescribed restrictions, applicable when the consumer is related to a foreign credit institution. VAT paid on loan charges is also deductible.

IMPORTATION OF COMPONENTS

The following tax implications may arise in the event of the importation of components:

- Most components for RE equipment are exempt from VAT.
- The RE service provider may be subject to WHT for payments made to foreign suppliers for the imported components. The rate depends on the type of payment being made and the country of origin of the supplier.
- There is no CGT to be considered.
- There is no stamp duty to be considered.
- Import duties are payable at specific rates.
- For CIT, the cost is to be deducted from the purchase price to determine the taxable profit.

The VAT Act exempts certain renewable energy equipment from VAT. This includes:

- wind-powered generators;
- solar-powered generators;
- solar cells, whether or not in models or made up into panels;
- other photosensitive semiconductor devices;
- solar DC generators of an output not exceeding 750 W;
- solar DC generators of an output exceeding 750 W but not exceeding 75 kW.

The RE service provider will be exempt from VAT when equipment is used for the construction of solar, wind or geothermal projects. An approval must be issued by the Cabinet Secretary of Energy and Petroleum.

The Fifth Schedule of the EACCMA specifies the goods that are exempt from import duty subject to certain conditions being met. Import duty is not charged on the goods specified in said Fifth Schedule.

Notwithstanding the exemption conferred on the components above, there is no express exemption for the sale of the energy generation system. Therefore, the eventual transfer of the system from the constructor to the consumer will attract VAT at 16% to be paid by the consumer.

Interest taxation under this model is as discussed above. That is, when the consumer obtains a loan from a foreign related party, the total interest expense deductible is restricted to 30% of EBITDA, the excess of which may be carried forward for a maximum period of five years. Therefore, interest expense can be made fully deductible if the loan is from a Kenyan entity or from a foreign unrelated lender, but partially deductible if the loan is from a foreign related party.

Meanwhile, although the consumer is entitled to claim both capital and investment allowances on the RE system, note that the investment allowance will be withdrawn if the RE requirement is sold within five years of purchase.

RENTAL OF THE ENERGY GENERATION SYSTEM TO THE CONSUMER

The following tax implications may arise when renting the energy system to the C&I consumer:

- There is no VAT to be applied. However, the constructor will act as an agent for the collection of 16% VAT if the constructor is a Kenyan company.
- WHT will be due at the point the tenant settles rent payments. The tenant is required to withhold 15% of the rental payments to the non-resident owner and remit it to the KRA. If the owner is a resident, WHT will not apply.
- There is no CGT to be considered.
- There is no stamp duty to be considered.
- Import duties according to the East African Community Common External Tariff (EAC-CET) is to be applied by the constructor.
- For CIT, rental agreements may be subject to income tax on the rental income earned. The income tax would be based on the gross rental income earned.

OPERATION OF THE RE SYSTEM

A manager may be hired for the operation of the RE system. This may trigger the following tax implications:

- The fees to the manager will include VAT at a rate of 16% if the manager is a registered VAT entity. The reimbursement of expenses will not attract any additional VAT if the manager is already paid with VAT.
- There is no WHT to be considered if the manager is a resident entity. If it is a non-resident entity, the consumer may be required to apply WHT. The rate is dependent on the country of residence of the manager and any applicable tax treaty.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of appointment of a manager.
- There are no import duties to be considered.
- For CIT, annual fees and VAT paid to the manager are deductible for tax purposes.

EVENTUAL SALE OF THE RE SYSTEM TO THE CONSUMER

The following tax implications may arise in the event of transfer of the RE system to the consumer:

- There is no VAT to be applied. However, the constructor will act as an agent for the collection of 16% VAT if the constructor is a Kenyan company.
- There is no WHT to be considered if the constructor is a resident. Otherwise, WHT at a rate of 15% will be applied. However, if there is a tax treaty between Kenya and the constructor's home country, the WHT rate may be reduced.
- Gains from the sale of the RE system to the consumer will attract CGT at a rate of 5% for residents and 20% for non-residents.
- There is no stamp duty to be considered.
- There are no import duties to be considered.
- For CIT, the income generated from the sale of the energy system to the consumer is subject to CIT at a rate of 30%.

Please note that an RE system generation capacity of more than 1000 kW will require approval and licensing by the EPRA to own the RE system in Kenya.

3.4 Specific requirements for the build-own-operate-transfer (BOOT) model and PPA

3.4.1 Description of the BOOT model and PPA

The BOOT model and PPA

The BOOT model and PPA are two common models used for C&I renewable energy projects.

Under the BOOT model, the developer or service provider designs, finances, builds and operates the renewable energy project for a defined period. The developer owns and operates the project during this period and recovers the investment costs through the sale of energy generated by the project. At the end of the agreed period, ownership of the project is transferred to the C&I consumer.

On the other hand, a PPA is an agreement between the C&I consumer and the developer or service provider where the developer agrees to design, finance, build and operate the renewable energy project for the C&I consumer, who agrees to purchase the energy generated by the project for a fixed period at an agreed price.

From an accounting perspective, in the BOOT model, the developer or service provider records the investment costs, depreciation and operating expenses during the project's operating period. The developer also records the energy sales revenue. On the other hand, the C&I consumer records the energy purchases as expenses on their income statement.

In the PPA model, the developer or service provider records the investment costs, depreciation and operating expenses of the renewable energy project. The revenue recorded will be the energy sales revenue received from the C&I consumer. The C&I consumer records the energy purchases as expenses on their income statement.

In both models, the transfer of ownership of the renewable energy project to the C&I consumer may result in additional accounting and tax implications, which need to be carefully considered and addressed.

In this study, we look at the following case: the constructor builds, owns and operates the RE system with a loan facility from the credit institution. The constructor executes a PPA thereafter, through which it sells power to the consumer. The consumer will use the power purchased from the constructor and may sell the excess power generated to the public grid.

Relevant contractual relationships

In the BOOT model with PPA, the relevant contractual relationships between the offtaker and the RE service provider are the following:

- loan agreement between the constructor and the credit institution, provided that the financing is not from equity;
- service contract between the manager and the consumer, whereby the manager is responsible for the operational activity of the energy generation system;
- contract for feeding surplus energy into the public grid.

3.4.2 Analysis of the offtaker's accounting and tax implications

Accounting implications

In the BOOT model with PPA for C&I projects, the consumer does not have any ownership rights to the system. The RE service provider or developer retains ownership of the system throughout the BOOT period, which is typically 10–15 years.

As the consumer does not have any ownership rights to the system, they do not have any assets or liabilities to record on their balance sheet. Instead, the consumer enters into a long-term contract with the RE service provider for the purchase of electricity generated by the system at a fixed price per unit for the duration of the PPA.

Under the PPA, the consumer agrees to purchase all, or a portion, of the electricity generated by the system from the RE service provider at a pre-determined price. This price is typically lower than the prevailing electricity rates, providing the consumer with cost savings on their electricity bills.

From an accounting perspective, the consumer records the payments made to the RE service provider for electricity as an expense on their income statement. As the payments are fixed for the duration of the PPA, the consumer can accurately forecast their electricity costs for the term of the agreement.

It is important for the consumer to ensure that the terms of the PPA are in line with their long-term business objectives, as any changes to the agreement may result in significant financial implications. The consumer should also ensure that the PPA includes provisions for regular maintenance and repair of the system, to ensure optimal performance and to minimise downtime.

Overall, the BOOT model with PPA provides the consumer with a cost-effective and reliable source of electricity without the need for significant upfront capital investment.

Further accounting implications are described below.

PURCHASE OF THE RE SYSTEM

The consumer shall capitalise the asset after eventual transfer from the constructor in line with IAS 16. Depreciation of the asset would be realised by the party capitalising at each stage in line with IAS 16.

SALE AND PPA

The cost of power purchase is to be debited to the income statement of the consumer.

SALE OF EXCESS POWER TO THE PUBLIC GRID

The consumer may recognise income from the sale of excess power on the credit income statement. Credit VAT-payable account with VAT on the sale of excess power.

COST OF OPERATING THE RE SYSTEM (THROUGH A MANAGER OR SELF)

The consumer may recognise the costs of operating the RE system itself or through a manager as debit on the income statement.

STAMP DUTY

Stamp duty paid by the consumer in respect of the financing arrangement is to be expensed on the income statement.

Taxation implications

PURCHASE OF POWER FROM THE CONSTRUCTOR

When purchasing power from the constructor, the following tax implications may arise:

- VAT at a rate of 16% is applied to the purchase price payable by the consumer. VAT paid is recoverable from output VAT generated from sales.
- There is no WHT to be considered.

- There is no CGT to be considered.
- There is nominal stamp duty payable on the power purchase agreement.
- There are no import duties to be considered.
- For CIT, the power purchase cost is deductible from the taxable profit.

SALE OF SURPLUS ENERGY TO THE PUBLIC GRID

For the sale of surplus energy to the public grid, the following tax implications may arise:

- There is VAT at a rate of 16% to be included in the invoice issued to the grid operators. However, if the consumer is a small supplier, they may be exempt from VAT. Failure to charge VAT will result in the consumer bearing the VAT cost.
- The payment from the grid operators is to attract WHT at rate of 5% for resident suppliers and 20% for non-resident suppliers. However, if the consumer is a small supplier, they may be exempt from WHT. This is to be used to offset future income tax liabilities.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on contract of supply to the grid.
- There are no import duties to be considered.
- For CIT, the profit generated from supply is subject to CIT at a rate of either 30% for resident companies or 37.5% for non-resident companies.

EVENTUAL PURCHASE OF THE RE SYSTEM

the following tax implications may arise in the event of the eventual purchase of the RE system:

- There is no express provision on the applicability of VAT on rent-to-own transactions. Therefore, the rent payments may be considered as instalments made by the consumer to the constructor for the acquisition of the energy generating equipment. When the equipment is used for the generation of energy from solar, wind or geothermal sources, VAT shall not apply upon approval of exemptions.
- WHT at a rate of 15% may apply if the constructor is a non-resident. However, if the constructor is a resident of Kenya, then WHT may not apply to the purchase price.
- There is no CGT to be considered.
- There is stamp duty at a rate of 2% on the transfer of ownership agreement to be considered.
- There are no import duties to be considered.
- For CIT, capital allowance claimable on the system is 50% and 25% as initial and annual rates, respectively.

3.4.3 Analysis of the RE service provider's accounting and tax implications

Accounting implications

In the BOOT model with PPA for C&I projects, the constructor is responsible for designing, building and owning the renewable energy project until the end of the PPA term. During this time, the constructor is also responsible for operating and maintaining the project.

From an accounting perspective, the constructor will need to recognise the construction costs as an asset on their balance sheet, which will be depreciated over the useful life of the project. They will also need to recognise the revenue from the PPA as income over the term of the agreement.

Additionally, the constructor may need to account for any financing arrangements that they enter into to fund the construction of the project. If they take on debt or other financing, they will need to recognise this as liability on their balance sheet and make interest payments over the life of the financing.

Overall, the accounting implications for the constructor in the BOOT model with PPA for C&I projects will involve recognising the costs of construction, accounting for any financing arrangements and recognising revenue over the term of the PPA.

Further accounting implications are described below.

PURCHASE OF THE RE SYSTEM

The constructor shall capitalise the RE system as an asset at build-own-operate stage in line with IAS 16. Depreciation of the asset would be realised by the party capitalising at each stage in line with IAS 16.

IMPORTATION OF COMPONENTS

Import duties are to be capitalised along with the cost of the asset.

FINANCING ARRANGEMENT WITH THE CREDIT INSTITUTION

The constructor shall recognise loan liability in line with IFRS 9. Interest expense paid or payable by the constructor is to be debited on the income statement. Interest accrued up to the date of commissioning of the RE system is to be capitalised.

SALE AND PPA

Income from the sale of power is to be credited to the income statement of the constructor.

Taxation implications

FINANCING ARRANGEMENT

The following tax implications may arise in the case of the financing arrangement:

- VAT at a rate of 16% payable on non-interest fees.
- There is 15% WHT to be deducted from fees and interest payable to the credit institution. However, there is a tax exemption for interest paid on a loan from foreign sources for the purpose of investing in the energy sectors, courtesy of Legal Notice No. 91 of 2015.
- There is no CGT to be considered.
- There is nominal stamp duty to be considered.
- There are no import duties to be considered.
- For CIT, the interest is deductible subject to prescribed restrictions, applicable when the consumer is related to a foreign credit institution. VAT paid on loan charges is also deductible.

IMPORTATION OF COMPONENTS

The following tax implications may arise in the event of the importation of components:

- Most components for RE equipment are exempt from VAT.
- The RE service provider may be subject to WHT for payments made to foreign suppliers for the imported components. The rate depends on the type of payment being made and the country of origin of the supplier.
- There is no CGT to be considered.
- There is no stamp duty to be considered.
- Import duties are payable at specific rates.
- For CIT, the cost is to be deducted from the purchase price to determine the taxable profit.

The VAT Act exempts certain renewable energy equipment from VAT. This includes:

- wind-powered generators;
- solar-powered generators;
- solar cells, whether or not in models or made up into panels;
- other photosensitive semiconductor devices;
- solar DC generators of an output not exceeding 750 W; and
- solar DC generators of an output exceeding 750 W but not exceeding 75 kW.

The RE service provider will be exempt from VAT when equipment is used for the construction of solar, wind or geothermal projects. An approval must be issued by the Cabinet Secretary of Energy and Petroleum.

The Fifth Schedule of the EACCMA specifies the goods that are exempt from import duty subject to certain conditions being met. Import duty is not charged on the goods specified in said Fifth Schedule.

Notwithstanding the exemption conferred on the components above, there is no express exemption for the sale of the energy generation system. Therefore, the eventual transfer of the system from the constructor to the consumer will attract VAT at 16% to be paid by the consumer.

Interest taxation under this model is as discussed above. That is, when the consumer obtains a loan from a foreign related party, the total interest expense deductible is restricted to 30% of EBITDA, the excess of which may be carried forward for a maximum period of five years. Therefore, interest expense can be made fully deductible if the loan is from a Kenyan entity or from a foreign unrelated lender, but partially deductible if the loan is from a foreign related party.

Meanwhile, although the consumer is entitled to claim both capital and investment allowances on the RE system, note that the investment allowance will be withdrawn if the RE requirement is sold within five years of purchase.

SALE OF POWER TO THE CONSUMER

The following tax implications may arise when selling power to the consumer:

- There is no VAT to be applied. However, the constructor will act as an agent for the collection of 16% VAT if the constructor is a Kenyan company.
- The RE service provider may contract consultants, who meet the ambit of professional services as per the ITA, laws of Kenya, in its day-to-day operations as regards generating electricity.
- There is no CGT to be considered.
- There is nominal stamp duty to be considered.
- There are no import duties to be considered.
- For CIT, the income generated from the PPA is subject to CIT at 30%. The investment allowance claimable on the system is 25% for Class 1 assets and 10% for Class 2 assets. Furthermore, machinery used to undertake operations under a prospecting right is granted an investment allowance of 50% in the first year and 25% as initial and annual rates, respectively.

OPERATION OF THE RE SYSTEM

A manager may be hired for the operation of the RE system. This may trigger the following tax implications:

- The fees to the manager will include VAT at a rate of 16% if the manager is a registered VAT entity. The reimbursement of expenses will not attract any additional VAT if the manager is already paid with VAT.
- There is no WHT to be considered if the manager is a resident entity. If it is a non-resident entity, the consumer may be required to apply WHT. The rate is dependent on the country of residence of the manager and any applicable tax treaty.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of appointment of a manager.
- There are no import duties to be considered.
- For CIT, annual fees and VAT paid to the manager are deductible for tax purposes.

EVENTUAL SALE OF THE RE SYSTEM TO THE CONSUMER

The following tax implications may arise in the event of transfer of the RE system to the consumer:

- There is no VAT to be applied. However, the constructor will act as an agent for the collection of 16% VAT if the constructor is a Kenyan company.
- There is no WHT to be considered if the constructor is a resident. Otherwise, WHT at a rate of 15% will be applied. However, if there is a tax treaty between Kenya and the constructor's home country, the WHT rate may be reduced.
- Gains from the sale of the RE system to the consumer will attract CGT at a rate of 5% for residents and 20% for non-residents.
- There is no stamp duty to be considered.
- There are no import duties to be considered.
- For CIT, the income generated from the sale of the energy system to the consumer is subject to CIT at a rate of 30%.

Please note that an RE system generation capacity of more than 1,000 kW will require approval and licensing by the EPRA to own the RE system in Kenya.

3.5 Specific requirements for the third-party ownership (TPO) model

3.5.1 Description of the TPO model

The TPO model with ownership transfer

The TPO model is a financing arrangement in which a third party, such as a developer or investor, owns and operates a renewable energy system on a customer's property. In this model, the customer enters into a PPA with the third-party owner to purchase the energy generated by the system at an agreed rate for a set period.

In this study, the constructor transfers the RE system to the special purpose vehicle (SPV), who in turn either leases the system to the consumer or sells power to the consumer upon execution of a PPA, whilst remaining the manager of RE system operations. The consumer either leases the system or purchases power for its use while the excess of electricity generated is sold to the public grid. Furthermore, upon expiration of the PPA, the SPV can either sell the RE system to the consumer or renew the PPA arrangement.

The accounting implications for the customer in the TPO model with PPA depend on the specific terms of the agreement, but, generally, the customer is treated as a purchaser of energy under the PPA. The customer may also be required to make an upfront payment or agree to a minimum purchase amount over the term of the agreement.

From an accounting perspective, the customer would record the energy purchased under the PPA as an expense on their income statement, and any upfront payment or deposits as an asset on their balance sheet. The customer would not record the renewable energy system as an asset or liability, as they do not own or operate the system.

The accounting implications for the third-party owner in the TPO model with PPA for C&I projects involve recording the renewable energy system as an asset and any financing or lease payments made by the customer as revenue on their income statement. The third-party owner may also be eligible for tax credits or other incentives related to the installation and operation of the renewable energy system.

It is important to note that the accounting treatment of the TPO model may vary depending on the specific accounting standards and regulations applicable to the jurisdiction in which the project is located.

Relevant contractual relationships

In the TPO model, the relevant contractual relationships between the offtaker and the RE service provider are the following:

- agreement on the transfer of equipment between the constructor and the SPV;
- loan agreement between the SPV and the leasing company located in Germany;
- lease agreement or PPA between the SPV and the consumer;

3.5.2 Analysis of the offtaker's accounting and tax implications

Accounting implications

In the TPO model, the SPV owns and operates the renewable energy system and sells the electricity generated to the C&I consumer under a PPA.

From an accounting perspective, the C&I consumer typically treats the payments made to the SPV as operating expenses, and the payments made under the PPA as a reduction in electricity expenses. The C&I consumer does not recognise any assets or liabilities related to the renewable energy system.

The C&I consumer also needs to consider the potential impact of changes in the PPA terms on its financial statements. For example, changes to the pricing or quantity of electricity sold under the PPA could result in increases or decreases in operating expenses. Similarly, changes to the renewable energy system's capacity or expected useful life could impact depreciation expenses.

Overall, the TPO model offers the C&I consumer the benefits of accessing renewable energy without incurring the upfront costs of purchasing and installing the system. However, the C&I consumer should carefully consider the terms of the PPA and the financial implications of the agreement before entering into the arrangement.

Further accounting implications are described below.

RENTAL OF THE RE SYSTEM

The lease rental income is to be credited to the income statement of the consumer.

SALE AND PPA

The consumer may recognise the costs of power purchase as debit to the income statement.

SALE OF EXCESS POWER TO THE PUBLIC GRID

The consumer may recognise income from the sale of excess power on the credit income statement. Credit VAT-payable account with VAT on the sale of excess power.

COST OF OPERATING THE RE SYSTEM (THROUGH A MANAGER OR SELF)

The consumer may recognise the costs of operating the RE system itself or through a manager as debit on the income statement.

STAMP DUTY

Stamp duty paid by the consumer in respect of the financing arrangement is to be expensed on the income statement.

Taxation implications

PROJECT PLANNING AND CONSTRUCTION

There are no tax implications for project planning and construction in this model.

LEASE OF THE ENERGY GENERATING SYSTEM FROM THE SPV

The following tax implications may arise in the event of leasing the energy generating system from the SPV:

- VAT is payable at a rate of 16% on the lease rental.
- The payment of rental attracts a WHT deduction of 5%.
- There is no CGT to be considered.
- There is nominal stamp duty on the agreement.
- There are no import duties to be considered.
- For CIT, profit generated from supply is subject to CIT at a rate of 30%.

PURCHASE OF POWER UNDER THE PPA

The following tax implications may arise when purchasing power from the SPV under the PPA:

- VAT at a rate of 16% is applied to the purchase price payable by the consumer. VAT paid is recoverable from output VAT generated from sales.
- There is no WHT to be considered.
- There is no CGT to be considered.
- There is nominal stamp duty payable on the power purchase agreement.
- There are no import duties to be considered.
- For CIT, the power purchase cost is deductible from the taxable profit.

SALE OF SURPLUS ENERGY TO THE PUBLIC GRID

The following tax implications may arise in the event of the sale of surplus energy to the public grid:

- There is VAT at a rate of 16% to be included in the invoice issued to the grid operators. However, if the consumer is a small supplier, they may be exempt from VAT. Failure to charge VAT will result in the consumer bearing the VAT cost.
- The payment from the grid operators is to attract WHT at rate of 5% for resident suppliers and 20% for non-resident suppliers. However, if the consumer is a small supplier, they may be exempt from WHT. This is to be used to offset future income tax liabilities.
- There is no CGT to be considered.
- There is nominal stamp duty to be paid on the contract of supply to the grid.
- There are no import duties to be considered.
- For CIT, the profit generated from supply is subject to CIT at a rate of either 30% for resident companies or 37.5% for non-resident companies.

3.5.3 Analysis of the RE service provider's accounting and tax implications

Accounting implications

In the TPO model including PPA, the RE service provider typically owns and operates the renewable energy system on the consumer's property and sells the generated electricity to the consumer under a PPA. However, in this case the RE service provider sells the energy system to the SPV. The accounting implications for the RE service provider in this model are similar to those in the upfront purchase model.

The RE service provider recognises revenue from the sale of electricity under the PPA over the contract term, usually on a straight-line basis. The service provider also records the capital cost of the renewable energy system as a fixed asset on their balance sheet and depreciates it over its useful life.

Additionally, the RE service provider may also incur ongoing operating and maintenance expenses for the renewable energy system, which are expensed as incurred. These expenses include costs such as insurance, repairs and maintenance, monitoring and reporting and administrative costs related to managing the PPA.

It is important for the RE service provider to properly account for revenue recognition and expenses related to the renewable energy system to ensure accurate financial reporting and compliance with accounting standards.

Further accounting implications are described below.

IMPORTATION OF COMPONENTS

Import duties are to be capitalised along with the cost of the asset.

Taxation implications

TRANSFER OF THE RE SYSTEM TO THE SPV

The following tax implications may arise in the event of transfer of the equipment to the SPV:

- The sale of the energy generating system may be subject to VAT at a rate of 16%.
- The payment to the constructor will attract 5% WHT to be deducted by the consumer on every milestone payment.
- There is no CGT to be considered.
- There is no stamp duty to be considered.
- There are no import duties to be considered.
- Payments received from the SPV will be subject to income tax in Kenya, with the WHT deducted by the SPV recognised as an advance payment.

3.5.4 Specific requirements for in-country establishment

Establishing a German entity in Kenya for the purpose of providing renewable energy services in a TPO model would require compliance with certain legal and regulatory requirements in both Germany and Kenya. Some specific requirements for in-country establishment of a German entity in Kenya include:

- Company registration – the German entity would need to be registered as a foreign company in Kenya with the Registrar of Companies. This involves submitting various documents such as the company's certificates of incorporation, memorandum and articles of association, and details of its directors and shareholders.
- Tax registration – the German entity would need to register for taxes with the KRA and obtain a tax identification number (TIN).
- Work permit – non-Kenyan employees of the German entity would need to obtain work permits from the Directorate of Immigration Services in Kenya.
- Compliance with local laws and regulations – the German entity would need to comply with all applicable laws and regulations in Kenya, including labour laws, environmental regulations and licensing requirements for renewable energy service providers.
- Corporate governance – the German entity would need to comply with corporate governance requirements in Kenya, including having a registered office in Kenya, appointing local directors and holding regular board meetings.

3.6 Reality check and recommendation

In Kenya, the C&I segment is increasingly investing in solar PV systems to reduce the cost of electricity supply to their business. Solar PV has become a cost-effective energy source. The Kenyan government has also been actively promoting the use of renewable energy in the country, with various incentives and policies aimed at promoting the uptake of renewable energy technologies.

The main challenge facing the C&I segment in Kenya is access to financing for renewable energy projects. Most commercial banks are reluctant to lend to this sector due to a perceived high risk and lack of expertise in renewable energy financing. However, there has been an increase in the number of specialised renewable energy financing institutions and initiatives aimed at addressing this gap, such as the Kenya Climate Innovation Center.

Despite these challenges, the C&I segment in Kenya is expected to continue growing in coming years, driven by increasing awareness of the benefits of renewable energy, rising energy costs and government policies aimed at promoting renewable energy investment.

Setting up a subsidiary in Kenya would ensure a reduced corporate tax rate of 30%. A permanent entity may crystalise by virtue of the construction work or site being in existence for a period exceeding 183 days. Corporation tax will apply at 37.5% in such an instance.

Regarding the different business models, the following factors need to be considered when evaluating the right model for Kenya.

UPFRONT PURCHASE MODEL

The upfront purchase model can be expensive, as it requires a large initial investment to buy and install the RE system. Businesses need to consider whether they have the necessary funds or access to financing to make this investment.

The upfront purchase model may be suitable for businesses with high energy consumption, as they can potentially save money in the long run by generating their own energy rather than purchasing it from the grid.

Businesses also need to consider the maintenance costs of the RE system, such as repairs or replacements of components, and factor these into their decision.

For incorporation, a private limited company shall be recommended as it is taxable in Kenya at 30%, compared to a branch which shall be taxed at 37.5%.

A manager hired to operate the generation system must be licensed by the EPRA pursuant to Sections 148 and 151 of the Energy Act, 2019. All licensed technicians, electrical workers and contractors are required to adhere to the terms and conditions of the licences issued to them by the EPRA.

Similarly, owners or occupiers of any premises must ensure that electrical installations are carried out by authorised electricians and technicians. The C&I consumer is tasked with ensuring that installations are periodically inspected, and any defects remedied.

The Energy Act imposes a fine of not less than KES 1 million and a prison term of not less than one year, or both, if a person is convicted and found guilty of carrying out substandard works or works that are not within the scope of their licence.

The EPRA maintains a register of active licensed technicians and consultants. We recommend that the C&I consumer selects a manager from the list of licensed technicians and consultants.

LEASING AND RENTING MODEL WITH OWNERSHIP TRANSFER

The leasing model with ownership transfer represents reduced upfront costs since the company does not have to make an upfront payment to purchase the RE system. Leasing with ownership transfer can help to reduce initial capital expenditure. While the upfront costs may be reduced, leasing with ownership transfer

can be more expensive over the long term than an upfront purchase model.

The company can benefit from predictable and stable lease payments over the life of the agreement, which can help with budgeting and cash flow management. However, depending on the creditworthiness of the leasing company, there may be some risk of default or non-payment.

Since ownership of the RE system transfers to the company at the end of the lease term, the company can choose to upgrade the system or replace it with newer technology. However, the company may have less control over the RE system during the lease term and may be subject to certain restrictions or requirements under the lease agreement.

BOOT MODEL AND PPA

Based on the market conditions and legal framework in Kenya, the BOOT model with PPA could be a suitable option for C&I consumers who are interested in implementing renewable energy solutions. In this model, a renewable energy service provider would design, construct, operate and maintain the renewable energy system, while the C&I consumer would provide the site for the installation and purchase the energy generated through a PPA. However, the provision of the site for installation could limit the feasibility of this model for some businesses.

The benefits of this model for the C&I consumer include the fact that no upfront capital investment is required. This allows the customer to preserve cash flow and invest in core business operations. Energy costs are typically fixed or predictable over the long term, providing greater budget certainty and reducing exposure to volatile energy prices. However, the C&I consumer may be locked into a long-term contract and could face penalties for early termination.

The RE service provider is responsible for the operation and maintenance of the system, ensuring optimal performance and minimising downtime. However, this could result in limited control over energy output or maintenance schedules.

TPO MODEL

In the TPO model, as previously illustrated, it is important to ensure that the transaction of equipment complies with the relevant laws and regulations in Kenya and Germany.

It is also important to carefully consider the financing structure of the SPV to ensure that the project is bankable. The creditworthiness of the consumer needs to be assessed to ensure that they can meet their obligations under the lease and PPA agreements.

In addition, the responsibility for equipment maintenance needs to be clearly defined in the lease agreement.

The most optimal structure would be to set up a limited liability company, as opposed to setting up a branch where the company would simply act as an extension of the company in Germany. Additionally, setting up as a subsidiary would see the German company attract a corporate rate of 30% as opposed to 37.5% due to a branch.

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