FOREIGN DIRECT INVESTMENT AND THE QUESTION OF TAXATION IN KENYA

BY

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DECLARATION

I declare this is my original work and has not been submitted for examination in any other University.

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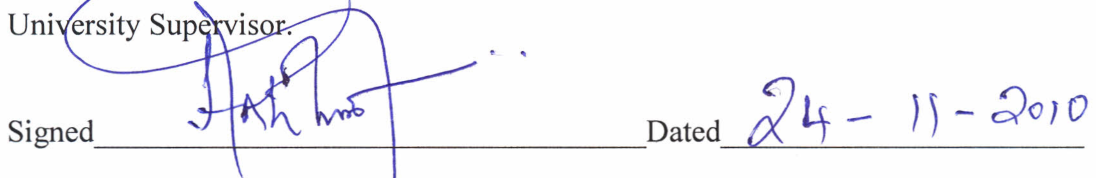
This research report has been submitted for examination with my approval as the University Supervisor.



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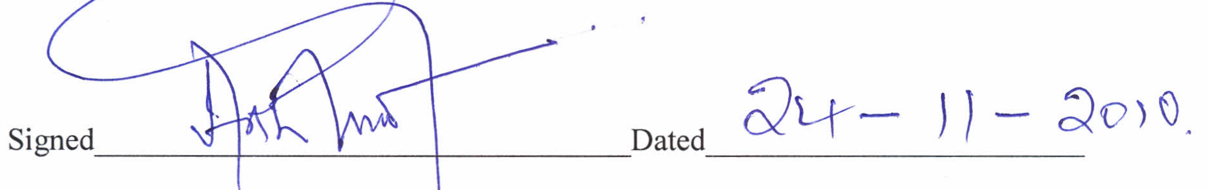

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DEDICATION

In memory of my late father **ABRAHAMS I. GUSERWA** who died on 16th February, 1996.

TABLE OF CONTENTS

DECLARATION i
ACKNOWLEDGEMENT ii
DEDICATION iii
LIST OF FIGURES 7
LIST OF TABLES 7
TABLE OF ABBREVIATIONS/ACRONYMS 8
LIST OF TREATIES 10
LIST OF STATUTES 10
INTRODUCTION 1

CHAPTER 1 4
INTRODUCTION TO TAX INCENTIVES ON FDI 4
1.1 INTRODUCTION 4
1.2 BACKGROUND 6
1.3 STATEMENT OF THE PROBLEM 11
1.4 OBJECTIVES OF THE STUDY 12
1.5 SPECIFIC RESEARCH QUESTIONS 12
1.6 SIGNIFICANCE OF THE STUDY 12

CHAPTER 2 14
TAX INCENTIVES – THE KENYAN LEGAL POSITION 14
2.1 INTRODUCTION 14
2.2 FDI INVESTMENT 15
2.2.1 FDI IN KENYA 16
2.3 THE FORMS OF FDI TAX INCENTIVES 19
2.3.1 General Tax Reduction 20
2.3.2 Non Income Tax Incentives 20
2.4 TAXATION 20
2.4.1 Objectives and Types of Tax Incentives Offered In Kenya 21
2.5 INCENTIVES IN GENERAL 21
2.5.1 Tax Incentives 22
2.6 LEGAL SYSTEM 24

2.6.1 The Trade Licensing Act Cap 497 26
2.6.2 Investment Promotion Act No. 6 of 2004 27
2.7 THE KENYA TAX SYSTEM 30
2.7.1 The Value Added Tax Cap 417 31
2.7.2 Corporate Income Tax 33

CHAPTER 3 41
IMPLEMENTATION OF TAX INCENTIVES IN KENYA 41
3.1 INTRODUCTION 41
3.1.1 Eligibility Criteria for Tax Incentives 41
3.1.2 Target Population 42
3.1.3 Sample Size 42
3.2 QUALIFYING FOR TAX INCENTIVES IN KENYA 43
3.2.1 Who should not qualify? 43
3.2.2 Who should qualify? 45
3.3 ECONOMIC EFFECTS OF TAX INCENTIVES 47
3.4 DISINCENTIVES 47
3.5 BARRIERS TO FDI 48

CHAPTER 4 51
ASSESSING THE IMPACT OF FDI IN KENYA VIS A VIS TAX INCENTIVES 51
4.1 DATA ANALYSIS 51
4.2 EXPORT PROCESSING ZONES (EPZ) 53
4.3 EFFECT OF KENYA TAX REGIME ON FDI 55
4.4 ADVANTAGES AND DISADVANTAGES OF TAX INCENTIVES 57
4.4.1 Advantages 57
4.4.2 Disadvantages 57

CHAPTER 5 58
CONCLUSIONS AND SUGGESTIONS 58
5.1 CONCLUSION 58
5.2 SUGGESTIONS 63
5.2.1 International Taxation 64
5.2.2 The Way Forward 66
5.2.3 Limitations of the Study 67

REFERENCES 68
APPENDIX – TAX RATES..72
KENYA: CAPITAL ALLOWANCES ON INVESTMENTS 72
CORPORATE INCOME TAX RATES..73
WITHHOLDING TAX RATES...74

LIST OF FIGURES

FIGURE 1 - FDI Inflows to Kenya 6
FIGURE 2 - Sectorial breakdown of FDI projects registered by IPC 8
FIGURE 3 - Regional distribution of FDI registered projects 52

LIST OF TABLES

TABLE 1- FDI in Export processing Zones...... 10
TABLE 2 - Government revenue (excluding grants).......................... 30
TABLE 3 - Withholding Tax rates under general regime and DTT's 34
TABLE 4 - Target population 42
TABLE 5 - Sample size of the population 43
TABLE 6 - Investments in EPZ's by sectors 54

TABLE OF ABBREVIATIONS/ACRONYMS

AG	-	Attorney General
AGOA	-	African Growth and Opportunity Act
ATC	-	Agreement on Textiles and Clothing
CBK	-	Central Bank of Kenya
COMESA	-	Common Market for Eastern and Southern Africa
DPP	-	Director of Public Prosecutions
DTT	-	Double taxation treaty
EAC	-	East African Community
EPZ	-	Export processing zone
EPZA	-	Export Processing Zone Authority
EU	-	European Union
FDI	-	Foreign Direct Investment
FIAS	-	Foreign Investment Advisory Services
FIPA	-	Foreign Investments Promotion Act.
GATT	-	General Agreement on Tariffs and Trade
GDP	-	Gross domestic product
GOK	-	Government of Kenya.
HCDA	-	Horticulture Crops Development Agency
IMF	-	International Monetary Fund
IPC	-	Investment Promotion Centre
KACC	-	Kenya Anti-Corruption Commission
KIA	-	Kenya Investment Authority
KIPO	-	Kenya Industrial Property Office.
KRA	-	Kenya Revenue Authority
M&A	-	Merger and Acquisition
MNO	-	Multinational Corporations
MUB	-	Manufacturing Under Bond.
NEMA	-	National Environment Management Authority
NIC	-	National Investment Council

OECD	-	Organization of Economic Co-operation and
SADC	-	South African Development Community
TNC	-	Transnational Corporations
TRIPS	-	Trade-Related Aspects of Intellectual Property Rights
UNCTAD	-	United nations Conference on Trade and Development
UNDP	-	United nations Development Programme
VAT	-	Value added tax
WTO	-	World Trade Organization

LIST OF TREATIES

1. The East African Community Treaty
2. The Cotonou Agreement – Treaty between the European Union and the African, Caribbean and Pacific Group of States (ACP Countries).
3. African Growth and Opportunity Act (AGOA).
4. Generalized System of Preferences (GSP) – The EU's Generalised System of Preferences is a trade arrangement through which the EU provides preferential access to the EU market to 176 developing countries and territories, in the form of reduced tariffs for their goods when entering the EU market.
5. Investment Protection Guarantee
6. Kenya has signed bilateral trade Agreements with more than 20 countries around the world including Argentina, China, India, Egypt, the Netherlands, Poland, Thailand, Tanzania, South Korea and Pakistan

LIST OF STATUTES

1. The Customs and Excise Act, Cap 472 of the Laws of Kenya.
2. The Companies Act, Cap 486 of the Laws of Kenya
3. The Export Processing Zones Act, Cap 514 of the Laws of Kenya.
4. The Foreign Investment Protection Act, Cap 518 of the Laws of Kenya.
5. The Investment Promotion Act, Act No. 6 of 2004.
6. The Finance Act No. 5 of 2004.
7. The Immigration Act, Cap 172 of the Laws of Kenya.
8. The Income Tax Act, Cap 470 of the Laws of Kenya.
9. The Value Added Tax Act, Cap 417, Laws of Kenya.
10. The Trade Licencing Act , Cap 497, Laws of Kenya

INTRODUCTION

Foreign Direct Investment is an integrate part of an open and effective international economic system and a major catalyst to development. Foreign Direct Investment is looked at as the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestments of earnings, other long term capital and short term capital as shown in the balance of payments.

A Foreign Direct Investor, according to the OECD benchmark definition (1996) is in an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises which has a direct investment enterprise – that is, a subsidiary, associate or branch – opening in a country other than the country or countries of residence of the foreign direct investor or investors[1]. The use of tax policy as a tool for economic development is not new. For many years, national governments have deployed tariffs to provide protective advantage for local enterprises. When deciding if tax policy should be used as an incentive to promote an industry, it is important to discern between cases where economically inefficient investments are undertaken purely for tax reasons and the situation where tax incentives provide important encouragement to economically worthwhile investments.

Foreign Direct Investments are an important feature of an increasingly globalized economic system. It also refers to the movement of capital across national frontiers in a manner that grants the investor control over the acquired asset. Firms that use FDI are known as Multinational Enterprises (MNE's)[2]. Production in the foreign country is

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[1] The OECD benchmark definition provides guidance on how FDI data should be compiled to meet internationally agreed standards. This definition was first published in 1983 base report done by the OECD group of financial institutions statisticians.
[2] Legally, MNE's are part of a firm whose agents are linked to it through an employment contract; hence sub contractors, long term suppliers, franchises and licences, are not part of the firm who contracts them.

largely financed by the multinational. Profits accrued to the multinational through sales made by the foreign affiliate. This paper aims to look at the different aspects of FDI in Kenya.

Different countries in the world including Kenya have been taking various approaches to attract foreign direct investment due to the assumed roles of the FDI in the countries. The said roles include but are not limited to: possibility for increased government revenue mainly through taxation, employment creation; improved balance of payment by increased exports and/or reducing imports, technology transfer, improved managerial and entrepreneurial skills, increased competitiveness in the market and linkage with the rest of the economy.

Among the approaches taken by countries to attract more FDI include a general improvement in the investment environments in these countries like the improvement of infrastructure, liberalization of the economy and granting of various incentives among them. It is important for Kenya to attract foreign direct investors to the country through taxation incentives thereby enhancing possibilities of bringing into the country the much needed foreign exchange growth and development for foreign investors to invest in Kenya. Clear and effective laws and regulations are vital for ensuring best results for host economies, their citizens and investors.

This paper will endeavour to consider the offer of tax incentives in the FDI Sector. The paper is organized as follows: Chapter one looks at why Foreign Direct Investments are taxed and the research questions. Chapter two will deal with the case for and against tax incentives, focusing on various tax incentives available for foreign direct investments (FDI) in Kenya, trade agreements and trade zones. Chapter three defines the research methodology and implementation strategies. Finally this study will also seek to find out how effecting of the tax regime is applied to the Foreign Direct Investment Sector in Kenya and how it affects the country's economic development as envisaged by the Investment Promotion Act 2004.

CHAPTER 1

INTRODUCTION TO TAX INCENTIVES ON FDI

1.1 INTRODUCTION

This chapter discusses the effect of taxation on foreign direct investment in Kenya. For foreign direct investors in Kenya the tax incentives are quite an attraction. Foreign direct investment is critical for a countries development especially in time of economic crisis. It brings new and more committed capital new technologies and management styles, helps create jobs, stimulates competition to bring down local prices and improve peoples' access to goods and services (Devan, 2001)[3].

Devan (2001) goes on to add that tax incentives benefit levels in the foreign direct Investments sector could be as a result of the need to attract foreign currency and technology amongst other factors. According to Devan (2001) tax incentives can be a strategic attraction of foreign investors if properly applied within an effective framework with checks and controls. In a study by Oderthai (2001) tax incentives amongst others are considered or identified as one of the major to attraction to foreign direct investment. It is against this background that the purpose of this study is to find out the factors influencing taxation of Foreign Direct Investment in Kenya.

The study seeks to answer the following four questions. First, what are the taxation objectives on foreign Direct Investments in Kenya and what should Kenya Tax and not tax with respect to Foreign Investments? Secondly what are the applicable Tax Laws and Policies on the FDI, how does Kenya implement these laws and policies, as well as benefits derived from the taxation of the sector? Thirdly, what is the reality of taxation in the EPZ area and the tax roadmap for the FDI?

---

[3] Janamitra Devan (2001): Investing Across Borders

Finally is there room for improvement? If so, what suggestions can be made for the way forward? In this project an attempt is made to answer those research questions.

In an effort to attract Foreign Direct Investment, Kenya promulgated the Investment Promotion Act, No. 6 of 2004 aimed at creating an investor friendly business environment. However, this has not been very successful given the case of some of the Foreign Direct Investments in areas like EPZ's. For decades, Kenya had one of the most successful regimes for FDI in Africa. Some of the principal restrictions on FDI are contained in the Trade Licensing Act Cap 418 of the Laws of Kenya which relate to various licences that investors should obtain before starting operations in Kenya. Apart from this Act, another formal limitation on foreign ownership is to be found in the telecommunications and insurance sector in which foreign ownership is limited to 70% and 77 % respectively. As for companies listed on the Nairobi Stock Exchange, foreign ownership is capped at 75%.

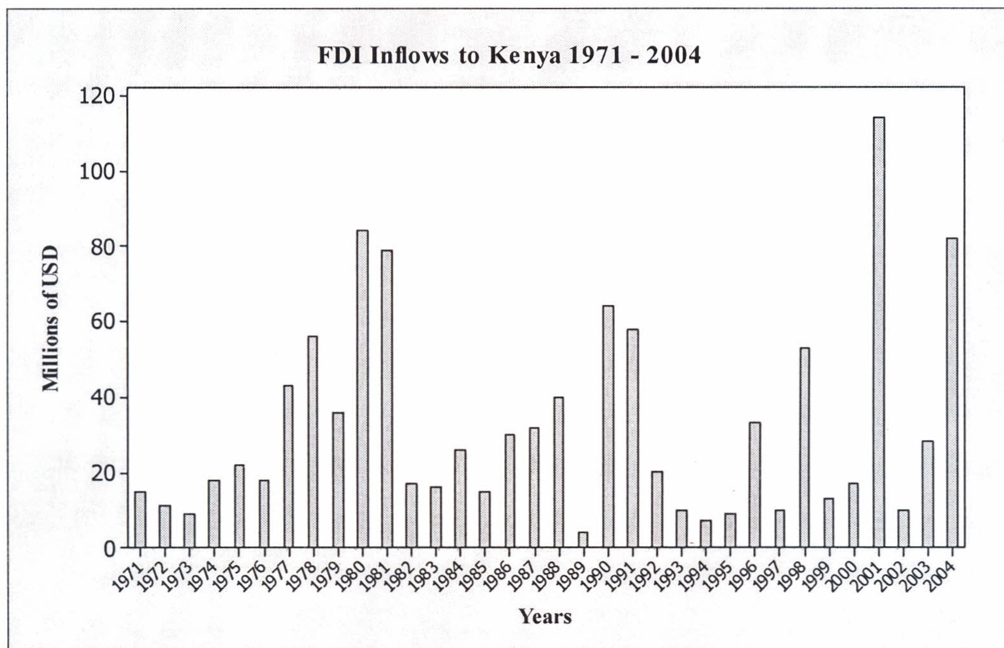
Kenya is one of the economic leaders in the sub-Saharan Africa. Like many African countries, it is dependent on Foreign Direct Investment (FDI) for capital and employment. Remittances are Kenya's single largest source of foreign exchange. According to the Central Bank of Kenya annual report (2008), remittances from FDI totalled USD 611.2 billion in the year 2008. Kenya is also a destination of choice for FDI as it has a well-developed port system with cold storage facilities, computerized port procedures reasonably cheap labour force, international banking and modern telecommunication facilities and forward tax incentives which are amongst the factors that attract FDI. Foreign investment is not routinely screened. Nevertheless, investors may choose to take advantage of the one-stop office of the Investment Promotion Centre, created in 1982 under the Ministry of Finance, and an independent agency since 1986. In the context of this study Kenya has a number of tax laws policies treaties and investment promotion and protection Agreements to encourage FDI. Exporters enjoy perforators' access to world markets under a number of special access and duty reduction programs that will be considered later in this study.

1.2 BACKGROUND

Taxation of Investments in Kenya by international investors has been effected since independence over a long period of time spanning 50 years. The Taxation was initially effected under the provisions of the Income Tax Act, Cap 470. FDI grew steadily through the 1970's as Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa. The Government of Kenya encourages Foreign Direct Investment and this has enabled many Multinational companies to invest in Kenya in the Industrial and Agricultural sectors. This has been made possible due to economic liberalization and privatization of public sector enterprises.

The relatively high level of development, good infrastructure, market size, growth and openness to FDI at a time when other countries in the region had relatively closed regimes all contributed to TNCs choosing Kenya as their regional hub. FDI started at a low of around $10 million a year in the early 1970s before peaking at 80 million in 1979-1980.

Figure 1



Source *Researcher (2010)*

The figure above shows how FDI in Kenya started at a low pace of around USD 10million per annum in the early 1970's before peaking to USD 220 million in the year 2004.

The deterioration in economic performance highlighted above, together with growing problems of corruption and bad governance, inconsistency in economic policies and structural reforms, and the deterioration of public services and infrastructure, generated a long period of low FDI that started in the early 1980s and continues to date. Inflows of FDI in the period 1981-1999 averaged only $22 million a year[4]. Although the sale of mobile phone licences to Kenyan-foreign joint ventures pushed FDI to over $100 million in 2000, inflows fell again to around their average of the 1980s and 1990's, before rising again in 2003 on the back of textile investments in Export Processing Zones (EPZ's) that may not prove sustainable.

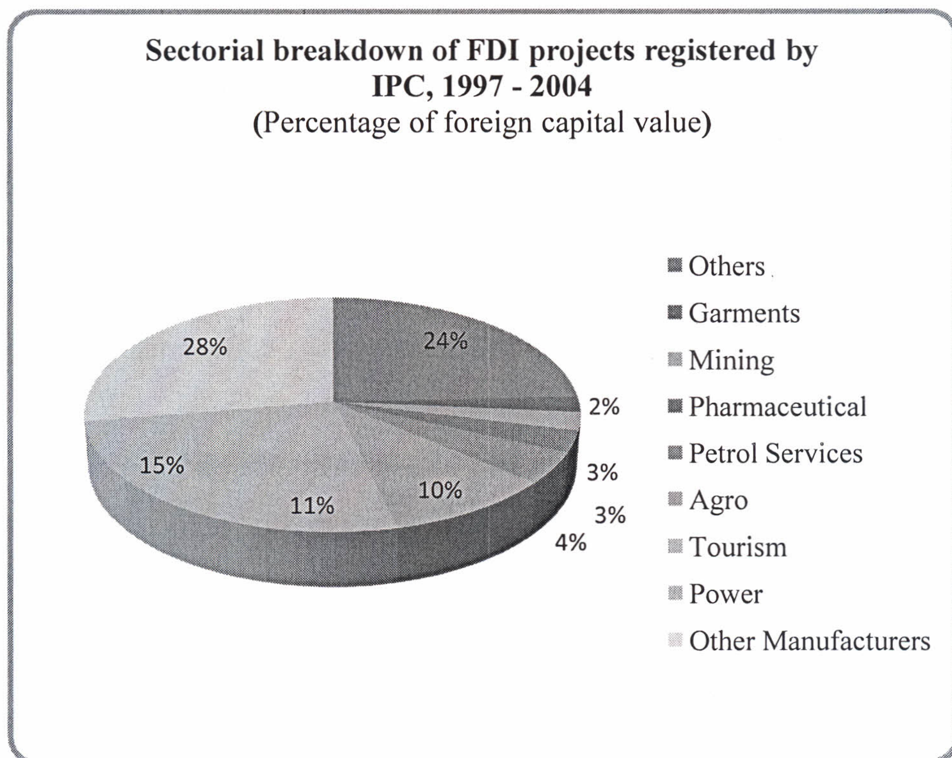
Although Kenya was the lead destination of FDI in the East African Community (EAC) region in the 1970s and 1980s, the relative level of inflows was never high by developing countries' standards' as illustrated by the stock of FDI, which was only 7.5 % of GDP in 2003, compared with 25.3 % for Africa as a whole and 31.5 % for developing countries.[5] Kenya regional leadership in attracting FDI also disappeared as soon as the United Republic of Tanzania and Uganda started reforming their economies and opening up to foreign investors in the early 1990s, at a time when Kenya itself was suffering from economic stagnation. The end of apartheid in South Africa in 1994 also increased competition in the attraction of large TNCs seeking a single production or headquarters centre in English-speaking Africa.

Although it would not change the overall assessment of underperformance in FDI attraction, poor data collection is likely to somewhat underestimate actual inflows of FDI. There is no clear mandate by any agency to collect data on FDI and the Central Bank of Kenya, the Investment Promotion Centre and the Central Bureau of Statistics all collect

[4] The Kenya Economic Survey Report of 2004
[5] The Kenya Economic Survey Report of 2004

only partial information on either balance-of-payments flows or investment projects. Data collection was also made more complicated after the full liberalization of the exchange rate regime in 1994.

Figure 2



Source *Researcher (2010)*

Figure 2 above, gives the distribution of FDI investments within various sectors in Kenya, during the period 1997 to 2004.

The initial development and growth in horticulture were favoured by spill-overs from the tourism sector. Frequent passenger air connections with Europe provided the essential cargo space for transporting fresh produce from Kenya at a time when volume would not justify the use of dedicated cargo planes. Rapidly growing export volumes subsequently

made the use and development of cargo facilities economical, but the initial spill-over from tourism was essential. The growing use of high-quality fruit and vegetables by local hotels and restaurants also gave farmers more experience in horticulture and an outlet for produce not meeting export standards.

Kenya's success in growing vegetables is also related to the growth of the Asian community in the United Kingdom and the expertise and knowledge brought by Asians who were expelled from Uganda and had good knowledge of and close links with Kenya. This increased the demand for Asian vegetables, for which Kenya has an added advantage in production as they can be grown throughout the year. The presence of the Asian community in Kenya means that there are many family ties with traders in London, reducing transaction costs. The involvement of smallholders has also been important in the growth of the sectors. They entered production because of low prices for coffee and tea in the 1970s. Most exporters have contracts with large UK and European retailers. They have processing factories near Nairobi airport where vegetables grown in rural areas are prepared for delivery. In the early 1990's smallholders represented the majority of vegetable production for export, although by the end of the decade they had been superseded by large commercial farms and exporters' own farms.[6]

Manufacturing FDI has concentrated on consumer goods sectors, such as the food and beverage industry. This has changed in recent years, however, with the growth of the garments sector because of AGOA. Out of thirty four companies producing garments for the US market, twenty eight are fully foreign-owned. GOA-related investments in the past couple of years have represented around 80% of FDI, even though these investments have increased.

[6] Investment Promotion Centre Report of 2006.

Table 1

FDI in Export Processing Zones, 1997-2005

(Millions of USD)

Sector	Number of firms	Total investments
Garments	30	111.0
Currency & Security documents	1	47.7
Spinning	1	5.3
Chemicals	4	4.0
Pharmaceuticals	3	2.4
Services	8	1.3
Agro processing	2	1.0
Electronics	2	1.0
Others	4	2.5
Total	**55**	**176.2**

Source *Researcher (2010)*

The table above shows the distribution of FDI investments within various sectors in Kenya, during the period 1997 to 2004.

In the year 2004, the Kenya Government enacted the Investments Promotion Act No. 6 of 2004 which was intended to streamline investments in Kenya by foreign investors. It was also intended to attract foreign investment and facilitate the issue of licenses and permits for foreign investors through the issue of investment certificates by the Kenya Investment Authority.

The Investment Promotion Centre which was created in 1982 under the Ministry of Finance has been engaged in the administration of the investments by foreigners. The centre sets out minimal environmental, health and security requirements for its projects and has put in place an Investment Code since 1994 which sets out guidelines on investment, deals with various investment incentives and required government approvals. Despite the enactment of the new legislation, the tax regime in the Investment sector continues to be wanting in its management and hence the need to look at the weaknesses

of the Investment Promotion Act and other ways and means of improving effective implementation of the tax regime in the sector. There are limited foreign investment incentives available in Kenya. The main area of growth has been in light assembly and manufacturing in the Export Processing Zones (EPZ), where ten years tax holidays amongst other incentives, are available to approved enterprises.[7]

1.3 STATEMENT OF THE PROBLEM

For foreign direct investors the issue of taxation is very important to enable them make a decision of whether or not to invest in Kenya. Foreign Direct Investment (FDI) is a key component of national development strategies for almost all the countries over the globe. This study seeks to increase knowledge in tax incentives to FDI with specific reference to Kenya. Tax Incentives are but one strand of the woven matrix of legal and economic strategies implemented to attract FDI. In examining the role of tax incentives as one of the factors that attract FDI, this research paper analyses the benefits and demerits of this tool and considers ways in which policy objectives delivery by tax incentives, may be improved. This is done through learning various lessons from intra-country and international comparisons as well as suggesting alternative legal and policy means that may better achieve the policy ends of FDI.

As more and more governments have tried to attract multinational companies and enhance the associated technology spill-over, fiscal incentives have become a global phenomenon from tax holidays and import duty exemptions to investments allowances and accelerated depreciation. The effectiveness of tax incentives is likely to vary depending on a firm's activity and its motivations for investing abroad. The debate about the impact of tax incentives on foreign direct investment is far from over. So far the benefits appear uncertain, while the costs are large old questions will lead to new answers and new questions will arise.

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[7] The Export Processing Zone Act Cap 517 of the Laws of Kenya.

1.4 OBJECTIVES OF THE STUDY

The main objectives of this study include:-

i. Taking stock of the taxation regime that has been implemented on foreign investments in Kenya and to assess the challenges thereto and the way forward as well as examining factors affecting the taxation of foreign direct investments in Kenya.

ii. Determining the extent to which taxation is effected on foreign direct investment.

1.5 SPECIFIC RESEARCH QUESTIONS

The study will seek to answer the following questions:

i. What is the relationship between tax incentives and the Foreign Direct Investments?

ii. Can taxation be used as an incentive in the Foreign Direct Investment sector?

1.6 SIGNIFICANCE OF THE STUDY

Kenya is one of the economic leaders in sub-Sahara Africa. Like many African Countries, it is dependent on Foreign Direct Investment (FDI) for capital and employment. Foreign Direct Investment is critical for a country's development especially in times of economic crisis. If handled and/or managed effectively by the state. In some cases, tax instruments such as tax incentives are used to attract foreign investors where the government relies on a targeted approach. If handled and/or managed effectively by the state in some cases, the use of tax instruments to attract foreign investors many governments rely on a targeted approach. The Ministry of Trade, Promotion of Investment Centre and Ministry of Finance benefited from the findings of this study on the application and management of tax incentives to the Foreign Direct Investments in various areas.

The Investment Promotion Act No. 6 of 2004, the Income Tax Act, Cap 470, the Customs & Excise Duty Act Cap 472 and the Value Added Tax Act Cap 476, have also been examined with relation to their application to FDI in Kenya. The outlook of the World Investment Reports 2008/9 and other publications postulate that Foreign Direct Investment injects financial resources into a host country but this requires appropriate regulatory structures.

The recent trends seen in the EPZ sector where most textiles companies like Mirage Co. Ltd and Rolex company have closed shop in the last 6 months after enjoying tax incentives (tax holidays for the last 10 years) without the government ensuring that they have cleared all their debts with the labour force and suppliers confirm that we have weak legislation in following and implementing the application of tax incentives. This move has also been observed in investors who were trading at the Nairobi Stock Exchange who pulled out in the last 2 years leaving the stock market to suffer instability.

CHAPTER 2

TAX INCENTIVES – THE KENYAN LEGAL POSITION

2.1 INTRODUCTION

For decades, Kenya had one of the most successful regimes for FDI in East Africa. The principal restrictions to the FDI investments were contained in the Trade Licensing Act Cap 497 of the Laws of Kenya, with subsequent amendments thereto. These restrictions are highlighted at a later stage in this chapter. Apart from this Act, the only formal limits on foreign ownership of investments in Kenya were restricted to telecommunication at 70% and insurance at 77% respectively. For companies listed at the Nairobi Stock Exchange, at least 25% national ownership is required while 75% ownership is open to foreign investment.[8] In an effort to attract foreign direct investments Kenya has enacted the Foreign Investment Protection Act Cap 518 and the Investment Promotion Act No. 6 of 2004. The aim of enacting this legislation was to create an investor friendly business environment through legal framework. However, this has not been very successful, given the case of some of the foreign direct investments in areas like the EPZ.

Kenya is also a destination of choice for FDI as it has a well-developed port system with computerised facilities, three international airports, a reasonably cheap labour force, international banking and modern telecommunication facilities and forward tax incentives which are among the factors that attract FDI. In the context of this study, Kenya has a number of Tax laws, policies and bilateral treaties with some of its trading partners and protection agreements that encourage and attract FDI to the country.

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[8] Companies Act (Cap 486) Laws of Kenya

2.2 FDI INVESTMENT

FDI is normally undertaken by Multinational Enterprises (MNE's)[9] which invest their capital in different nations. Such investment is undertaken when the MNE's are looking for market efficiency or a good resource/asset investment climate. They take either the form of new investments also known as green fields' investments or the form of acquisition of existing projects through Mergers and Acquisitions (M & A's). They can be market seeking efficiency or resource/asset seeking.

Firms are motivated by various aspects to choose FDI as a mode of entry into foreign markets. These aspects are partly described in the much referred to Dunning's OIL theory. According to Dunning (1993), there are three conditions that motivate firms to choose FDI as a mode of entry to foreign markets. These are ownership advantages, location advantages and internationalisation advantages.[10] FDI inflows to our country like to any other developing country depend largely on the presence in the country of a certain critical minimum of FDI determinants. The determinants are among the factors that give MNE's the confidence and interest to invest their massive and expensive capital in foreign markets.

Among the FDI determinants that MNE's look for are the presence of economic, political and social stability and rules regulating entry and operations of businesses others are standards of treatment of foreign affiliates, business facilitation (including, inter-alia investment incentives and thereby tax incentives, market size, growth structure and accessibility, raw materials low cost but efficient labour force and physical infrastructures in form of pots, roads power and telecommunication.

[9] Hence the transaction cost theory of the MNE is a general theory of economic institutions which is applicable to domestic institutions as well. The only difference is that MNE's face the additional difficulty of having to manage across political and cultural barriers.

[10] Dunning, J. H (1993); Multinational Enterprises and Global Economy

2.2.1 FDI IN KENYA

The government of Kenya encourages foreign direct investment and in this respect multinational companies make up a large percentage of Kenya's industrial sector. In the past, government support for foreign investment was often implicitly conditioned on some form of joint venture whereby a related parastatal or a politically well-connected individual became the local partner. This practice is becoming less common with economic liberalization and privatization of public sector enterprises. Particularly since 1994, the Government of Kenya has sought out foreign investment through investment conferences and foreign trips by the Head of state or some key Ministers in the government.

The IPC sets minimal environmental health and security requirements for its projects. An investment code has been in the works since 1994. The code has set forth guidelines on investment, enumerate the various investment incentives and mandate that all new projects obtain IPC approval. Efforts are under way to harmonize investment regimes in Kenya, Uganda, Tanzania, Rwanda, Burundi, Southern Sudan and DRC Congo and eventually to remove all tariff barriers between the said Eastern African Countries.[11] In addition, the Investment Authorities are working towards harmonizing the investment incentives in the region.

It is a Government of Kenya policy to encourage investment that will produce foreign exchange, provide employment, promote backward and forward linkages and transfer technology. The only significant sectors in which investment (foreign and domestic) is constrained are those where state corporations still enjoy a statutory or de facto monopoly. These are restricted almost entirely to infrastructure (e.g. power, telecommunications, ports and the media). Even in these sectors, ongoing commercialisation and economic reform is expanding the room for private business. Two foreign private sector power producers sell more than 85MW of electricity to the

[11] The East African Community Treaty

national grid. Purchase agreements with two other independent power producers (IPP's) were put in place in 1999.

In July 1999, Kenya Posts and Telecommunications Corporation was split into Telkom Kenya (a telecommunication corporation) and Postal Corporation of Kenya (a postal services corporation). The Communications Commission of Kenya (CCK) was also established to regulate those sectors. The Government subsequently sold off approximately 49 percent of Telkom Kenya to a strategic partner before an initial public offer was made on the Nairobi Stock Exchange in the year 2008. With the right competitive environment, the potential for private sector investments in Telecommunications is enormous.

Branches of foreign companies pay higher income tax rates than local companies and locally incorporated subsidiaries of foreign companies (Refer to table3). This can be seen in the application of withholding tax rates that applies to such companies as set out in the Income Tax Act, Cap 470. The Finance Act No. 5 of 2004 reduced these rates to 40% for foreign companies and 32.5% for local firms. There is no discrimination against foreign investors in the access to government-financed research in Kenya. Expatriates face difficulties in obtaining work permits, but the requirements are not onerous.

The Investment Promotion Centre is quite flexible in terms of setting the minimum of FDI at approximately Kshs. 2 million (approximately $28,000). However, some exceptions have been made with regard to engagement of foreign employees in senior managerial posts who are required to have special skills (not available locally) yet it is an open secret that most of the managerial staff in the EPZ's are foreigners and do not have any special skills when compared to the locals[12]. Foreign employees are expected to be key senior managers or to have special skills not available locally, yet it is an open secret that most of the managerial staff in the EPZ are foreigners and do not have any special skills when compared to the locals.

[12] Export Processing Zone Authority annual report, 2004.

Private investment in Kenya was previously governed by Kenya's Foreign Investment Protection Act (FIPA), Cap 518, which has since been reviewed in the light of liberalization of foreign exchange and import controls. Further, the Investment Promotion Act No. 6 of 2004 was enacted to put in place proper investment requirements by all investors in the country. For example, the previous requirement that foreign investors apply for a certificate of approved enterprises from the Treasury that allowed them to repatriate capital and profits has been removed. There are no formal requirements on minimum local participation in either equity or management under FIPA[13].

Foreign investors are required to sign an agreement with the Government stating training arrangement for phasing out expatriates. Expatriate work permits are increasingly difficult to renew or acquire. Government approval for ventures in Agriculture, distributive trade and small-scale enterprises has become more difficult to get as the Government seeks to localize these sectors. There are no special requirements imposed on foreign investors. All investors (foreign and local) receive the same treatment in the initial screening process. The Government screens each private sector project to determine its viability and implications for the development aspirations of the country. For example, a rural agro-based enterprise, with many forward and backward linkages, is likely to receive licensing fairly quickly. However, new foreign investment in Kenya has in the past been constrained by a time-consuming and highly discretionary approval and a long licensing system that has been vulnerable to corrupt practices. To counter this, the government amended the Investment Promotion Centre Act in September 1992 to require the Centre, through its "one-stop-office", to process applications for foreign investors within one month[14].

Special incentives exist for qualified investors under the Manufacturing Under Bond (MUB) program and the export processing zones (EPZ) authority. MUB investors receive duty and value added tax exemption on imported plant, equipment, raw materials

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[13] Foreign Investment Protection Act, Cap 518

[14] Mugo, J. M. (2007) : The Development Impact of Investments in EPZ's; Identifying Appropriate Measures

and intermediate inputs. They are also entitled to an investment allowance of 100 percent on immovable fixed assets. Investors in the EPZs enjoy duty and VAT exemption on imported machinery and raw material inputs, a ten-year corporate tax holiday, exemption from withholding tax (on dividends payable to non-resident shareholders) and stamp duty, exemption from certain industrial regulations and single licensing. Most new investors prefer the EPZ because they also receive adequate power and water supplies as well as support services.

With the exception of the insurance and telecommunications sectors and other infrastructure and media companies discussed earlier, Kenya does not require that its nationals own a percentage of a company. For insurance companies, at least one-third of the controlling interest, whether in terms of paid-up share capital or voting rights, must be held by citizens of Kenya. In the telecommunications sector, at least 60 % equity must be owned by Kenyan nationals.

2.3 THE FORMS OF FDI TAX INCENTIVES

One of the most important determinants of foreign direct investment is the size as well as the growth prospects of the economy of the country where the foreign direct investment is being made. It is normally assumed that if the country has a big market, it can grow quickly from an economic point of view and it is concluded that the investors would be able to make the most of their investments in that country.

Foreign investors will always compare the taxation of one country with that of another to be able to make a decision as to where to invest. Taxation is crucial because it gives them a critical overview of the operations and expected returns. It is also noteworthy to state that in Kenya there are no restrictions on the type of investment by foreigners in private companies and foreigners can be directors of companies.

2.3.1 General Tax Reduction

The tax liability of a firm is not entirely eliminated as opposed to tax holidays but the benefit is extended beyond new enterprises to include income from existing operations and the benefit is not time limited. When designing this type of incentive one is likely to be faced with the problem of identifying qualifying/threshold income.

2.3.2 Non Income Tax Incentives

These include taxes on business inputs such as custom duties, turn over taxes on imported capital equipment and social security taxes on expatriate wages and salaries. When investors enjoy these facilities, they are attracted to invest more in the country.

2.4 TAXATION

Taxation in Kenya is effected through legislation like the Income Tax Act, the Value Added Tax (VAT) Act and other relevant Acts of parliament and is considered relatively high by both Kenyan citizens as well as foreigners. Investors are repulsed by the hidden costs and hindrances such as non-transparency, non-accountability, red tape and inefficient tax systems. Some of the hidden costs are even difficult to quantify and this makes decision making by the would be investors all the more precarious.

The corporate income and branch tax rates are 32.5% and 40%, respectively and there is no Capital Gains Tax. The withholding tax on dividends is 10%, unless the dividends are paid to a resident, in which case the tax is 5%. The withholding tax on interest is 12.5% for non-residents and 15% for resident, except interest on bearer instruments, to which a 20% tax applies.
Kenya Revenue Authority is responsible for most revenue collection and management of the tax system. Kenya has double taxation treaties which can in certain circumstances mitigate the tax charge. DTA exist between Kenya, Canada, Denmark, Norway, Sweden,

India, Zambia, United Kingdom and Germany. However, countries like the United States of America and South Africa do not have the double taxation treaties with Kenya[15].

2.4.1 Objectives and Types of Tax Incentives Offered In Kenya

Kenya offers a variety of incentives according to the Kenya Investment Promotion Centre, the incentives have been devised to compensate and reward investors for their entrepreneurship, to watch the changing needs of the country, to channel investments in the direction most needed for economic development and to ensure growth with Social equity. The sectors in which Kenya Government offers incentives include and cover the agricultural sector, air aviation, commercial building, commercial development microfinance banks and export oriented projects – (EPZ Zones). Others include geographical special development area – titanium mining in Kilifi area of the Coastal Province, human resource development manufacturing, natural resource, rehabilitation and expansion of infrastructure tourism and tour operations transport and media industry enjoy 0% tax rate on sales tax on capital goods and withholding tax on interest[16].

2.5 INCENTIVES IN GENERAL

The Kenya Investment Promotion Act of 2004 refers to incentives as:-

> **"Tax relief and concessional tax rates which may be accessed by an investor under the Income Tax Act, Cap 470.........and any other"**

There is a wide spectrum of FDI incentives which include:

i. Tax Incentives
ii. Guarantee against arbitrary treatment in case of nationalization
iii. Government provision of such utilities as power, water and communication at subsidized prices or free cost
iv. Tariffs or Quotas set for competing imports

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[15] Investment Promotion Centre Annual Report, 2004
[16] Income Tax Act, Cap 470

v. Reduction/elimination of Import duties on inputs
vi. Interest rate subsidies
vii. Guarantee for loans and coverage for exchange rate risks
viii. Wage subsidies
ix. Training grants
x. Relax legal obligations towards employees' i.e. exempt application of minimum statutory terms and conditions of employment.
xi. Export Processing Zone Regime
xii. Manufacture Under Bond.

Incentives provided to manufacturers in the export processing zones include:

- A ten-year corporate tax holiday as opposed to the normal rate of 37.5% and 25% tax rate thereafter.
- A ten-year withholding tax holiday on dividend remittance
- Duty and VAT exemption on all inputs except motor vehicles
- Stamp duty exemption on legal instruments
- Exemption from Industrial Registration Act Cap 118, Factories Act Cap 514, Statistics Act of 2006 and the Trade Licensing Act 497.
- Exemption from pre-shipment inspection, on site customs inspection, and work permits for senior expatriate staff.

2.5.1 Tax Incentives

Tax Incentives can mean many things. It can mean tax reduction intended to encourage business operations, FDI being one of them. There are special provisions intended to encourage certain kinds of behaviours in response to tax benefits. It can also mean any tax provision which induces certain behaviours because objectively and irrespective of the original rationale of the provisions this behaviour has more favourable tax consequences than the alternative forms of conduct. Tax Incentives are of many types some of which are now presented here below:-

2.5.1.1 Tax Holidays

Probably the most known and widespread tax incentive is tax holidays. These are mainly targeted to new firms and may not be available to basting operations. They are more linked to the establishment of enterprises than to the level of investment. New firms are allowed a period of time after some initial point when they are relieved from the burden of income taxation. The period can be extended to a subsequent period of taxation at a reduced rate of tax with cumulative profit on its operations. For large projection with huge start up costs, tax holidays which start, when production occurs may actually increase the tax paid over the life of the project. This therefore became a disincentive to invest. If loses are experienced in the holiday period they may not be allowed to be carried forward out of the holiday period. Therefore in Kenya tax holidays may be applied where no taxes would have been paid in any event and such taxes would be increased following the tax holiday.

2.5.1.2 Investment Allowances and Tax Credits

This is a tax relief based upon the value of expenditure on qualifying investments. They provide tax benefits that are over and above the depreciation allowed for the asset. A tax allowance is used to reduce the taxable income of the firm. A tax credit is used to reduce directly the amount of taxes to be paid.

This type of tax incentive presents some problems. It is difficult to define the eligible expenditure and to choose the rate of allowance of credit. It is also a problem to set a restriction on their use. This is of little benefits for the quick profit types of firms, which can take best advantage on tax holidays. Tax allowances are of great benefit to firms with income from existing operations[17]. Firms with low income or start-up firms cannot be seen to take advantage of the incentive until such income is earned. Investment allowance is usually made in the year of acquisition or the first year of use of an asset. It

[17] Income Tax Act, Cap 470

does not reduce the basis for write off in later years. It is common in connection with different kinds of capital expenditure, particularly in respect to industrial undertakings. It reduces the taxable income.

Investment credit is tied directly to fixed investment. A calculation of a percentage of investment expenditure is made and this is credited against tax. This type of tax incentive has a similar revenue impact as tax holiday.

2.5.1.3 Capital Deduction

Mining is one of the sectors that enjoy 60% capital deductions for companies seeking specified minerals including titanium, gold, bentonite, platinum, coal lime and zink amongst others qualifying activities include prospecting and testing deposits, purchasing the rights to mining and general administration and management prior to production. Tourism receives a capital deduction of 60% on hotels and installed machinery, as well as a 60% deduction allowed for buildings which are used as hotels.

2.6 LEGAL SYSTEM

FDI operations in Kenya are enshrined in the Investment Promotion Act No. 6 Of 2004 and the Foreign Investment Protection Act Cap 518 of the Laws of Kenya amongst other legal regimes. In general, foreign investors receive almost similar treatment if not better than domestic investors once established in Kenya. The main deviation from national treatment (aside from those related to trade licences described above) is in terms of access to agricultural land.

Kenya's tax law system is derived from the general principles of English Tax Law. It is based mostly on sound principles of law, although in some areas it does not reflect modern approaches to regulating investment and commercial transactions. The authorities have nevertheless made good progress in modernizing the legal regime in

certain key areas over the past decade, including telecommunications, electricity and intellectual property. In this regard, Parliament enacted the Investment Promotion Act No. 6 of 2004 and the Privatization Act of 2005.

The Investment Promotion Act (2004), which the President ratified on 31 December, 2004, introduces a mandatory investment threshold and restrictive screening procedure for all foreign investments. These are set to become a significant impediment to FDI inflows. The Act makes a formal distinction between domestic and foreign investors and requires the latter to apply to the newly established Kenya Investment Authority (KIA) for an Investment Certificate[18] that "a foreign investor shall not invest in Kenya unless (it) has been issued with an investment certificate".

The conditions under which KIA is allowed to issue an Investment Certificate to a foreign investor are restrictive and include the following requirements:

- The amount invested must be at least USD 500,000 or the equivalent in any other convertible currency.
- The investment must be deemed by KIA to be of benefit of Kenya, including at least as a result of: (1) the creation of employment for Kenyans; (2) the acquisition of new skills or technology by Kenyans and: (3) the contribution to tax revenues or other government revenues. Other factors such as the contribution to foreign exchange earnings or utilization of domestic inputs are to be taken into account as well but are not part of the requirements unlike the three items listed above. These form the requirements of Section 4(2) of the Investment Promotion Act 2004.

In contrast, domestic investors are not required to obtain Investment Certificate, but those that do not seek them are nevertheless required to register their investment with KIA. The minimum capital investment for domestic investors seeking an Investment Certificate is set at a lower rate of Kshs.5 million (USD 65,000), but they must fulfil the same requirements to be deemed "beneficial to Kenya".

[18] Section 4 of the Investment Promotion Act No 6 of 2004.

2.6.1 The Trade Licensing Act Cap 497

Under this Act, all businesses are required to operate under a licence that is issued by the appropriate trade ministry/ body. The licence enables the government to keep a record of authorised businesses that are listed for taxation purposes where appropriate, amongst others. The Trade Licensing Act Cap 497 defines broad categories of "businesses", which include trade in a wide range of goods (including sale by a manufacturer of his own goods), imports and exports, and any occupation as decided by the Minister of Trade and Industry. A licence is required from both citizens and non-citizens to conduct a "business". In addition, the Act specifies that non-citizens shall not conduct a "business" outside a "general business area", defined in the law to include parts of Nairobi, Mombasa, Nakuru, Kisumu, Eldoret and Thika, unless specifically authorized to do so in the licence. The Act also lists a range of about 70 "specified goods" (from foodstuffs to consumer and other manufactured goods) in which non-citizens are banned from conducting a business, whether within or outside "general business areas", unless specifically authorized to do so in a licence. In practice, trade licences are obtained at a minimal fee from the Ministry of Trade and Industry and foreigners are allowed to operate in most sectors throughout the country. Licences are normally valid for varying periods of one to three years[19].

The Ministry does not allocate resources to enforce compliance with the licensing requirements and it estimates that only about 50 % of businesses abide by them. This ratio is likely to be higher among foreign investors, however, particularly if they operate outside "general business areas" or in "specified goods" as this requires a special authorization, even though it is granted automatically. In essence, the trade licences system, which was devised to allow protection of small domestic businesses under the mixed-economy regime of the 1980s, has ceased to serve any purpose, as it is no longer used to restrict entry of foreign investors, generates a net cost to the Government (licences are free) and has little use in data collection given the law compliance rate.

[19] Trading Licencing Act Cap 497, Laws of Kenya

2.6.2 Investment Promotion Act No. 6 of 2004

This Act introduced mandatory Investment Certificates and minimum capital requirements for foreign investors for several reasons: (1) to maximize beneficial FDI and minimize its potential negative effects; (2) to give priority to national private sector development and to protect small national businesses in certain sensitive areas and ; (3) to ensure that the entitlement to work permits for foreigners granted as an incentive to holders of Investment Certificates is not abused to illegitimately bring in foreign workers[20]. There are methods provided for in the aforementioned Act to address these concerns, however, are set to have detrimental side effects on legitimate and beneficial FDI. The legitimate concerns, in turn, can and should be addressed in more targeted ways that do not negatively impact on FDI attraction. Investment Certificates would be optional in the sectors open to FDI, but would remain a condition for obtaining special incentives.

Information collected by the Investment Promotion Centre (IPC) in 2000-2004 shows that 74% of all projects, representing 21% of foreign investment, were accounted for by investments of less than USD 500,000. Under the Investment Promotion Act, these projects would not be legally allowed. Pioneering small foreign investments that have led to the emergence of a world-class floriculture and horticulture sector, and have generated significant benefits through job creation, rural development, transfers of skills, access to markets and generation of export earnings, would not have been allowed had the current Act been in place in the 1980's to 1990's. Homegrown, which employs over 6,000 people directly and accounts for about 10 % of Kenya's floriculture and horticulture exports started with an initial investment well below USD 100,000 in 1982[21]. The USD 500,000 requirement is most likely to negatively affect FDI in non-capital intensive projects in the services sector, which, as explained in chapter III, should be a strategic focus for Kenya's attraction of FDI. It will almost certainly also stimulate the practice whereby smaller foreign investors will engage citizens to "front" for them as

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[20] Investment Promotion Act No. 6 of 2004
[21] Investment Promotion Centre Annual Report (2004)

owners of businesses. This could add to corrupting pressures on officials. The requirement to screen all FDI proposals is a measure that is better applied to determine the eligibility for incentives (for qualifying investors) rather than to decide on the entry of FDI. It is not advisable in a market economy for a Government to prevent an investment because it does not create "sufficient" jobs or exports in the Government's opinion. It is a different matter to encourage investments that do have such positive impacts.

The other feature of the Investment Promotion Act is its incentive provisions, which are obtained through the granting of an Investment Certificate by KIA. These are twofold: (1) the granting of temporary business licences and; (2) the entitlement to six work permits for expatriates.

Under the Act, an Investment Certificate entitles the holder to the "deemed" issuance of a wide range of licences, as specified in the certificate, for an initial period not to exceed twelve months. Further, the certificate purports to entitle the holder to obtain actual licences within twelve months. The entitlement to licences is for the initial issuance only after which the laws under which the licences are normally issued apply as usual, including as far as renewals and revocations are concerned.

Although it is aimed at facilitating investment, this approach is unlikely to achieve the Government's objectives and may create certain risks to Kenya. It is unlikely that investors will take the risk of investing until they have more certainty that the competent authorities will actually grant the licences within the 12-month period. More importantly, the issuance of certain preliminary licences without a full assessment may also be dangerous to Kenya in the sense that important matters of public interest can be involved in areas covered by licensing. This is partially recognized by the Act as it prevents KIA from including a licence in the Investment Certificate if the licensing raises environmental, health or security issues that are beyond its competence.

The second incentive granted to holders of Investment Certificates is the entitlement to some work permits for certain expatriates who qualify for their issuance. This is

worthwhile and it follows practices adopted elsewhere. It is unfortunate that it has become linked to mandatory restrictions on all FDI, however. If there are concerns about illegitimate foreign workers entry through "convenience FDI", these can be addressed by granting the incentives to screened investors only without the need to enforce screening and compulsory requirements on all investors, including those that would want to invest without benefiting from or qualifying for the incentives. This is elaborated upon in section 4 of the Investment Promotion Act No. 6 of 2004. In addition to this, the Investment Promotion Act transformed the IPC into the Kenya Investment Authority. It also established an advisory body known as National Investment Council (NIC) as an advisory body. The objectives of the NIC include:-

- Identifying areas of impediment to economic development and investment
- Reviewing the economic environment and proposing incentives for investment
- Monitoring industrial development
- Promoting cooperation between the public and the private sectors in the formulation and implementation of economic policy.

Kenya has negotiated Bilateral Investment Treaties (BITs) only with Germany, Italy, the Netherlands and the United Kingdom. Of these, only the latter two have been ratified and come into force. In contrast, Uganda has 11 BITs ratified or under negotiation, the United Republic of Tanzania 10 and Egypt 88[22]. The provisions in the BITs are standard in that they provide for national treatment as regards management, maintenance, use, enjoyment or disposal of investment, most-favoured status and compensation for war, national emergency and other related losses. They also guarantee transfer rights and provide protection against arbitrary expropriation and prompt, adequate and effective compensation in the event of expropriation. The BITs usually bind the States to consent to international arbitration to ICSID if the investor requests it and if local remedies have been ineffective after a set period of time (typically a few months). As of the end of 2004, only one case had been filed to ICSID by the World Duty Free Company Ltd, relative to issues of bribery in connection with the Goldenberg case.

[22] The US department of commerce report, 2004.

2.7 THE KENYA TAX SYSTEM

Kenya's tax system is relatively straightforward and is not widely used to provide targeted sectorial incentives. The administration of the system is efficient and fair relative to other developing countries. Kenya compares favourably with other countries in the region and elsewhere in terms of revenue collection as a percentage of GDP, which averaged 212 % between 2000 and 2003. The Kenya tax system relies heavily on customs and excise duties, which represent close to 50 % of total revenue, which is also the case among comparable neighbouring countries[23]. This is shown in table 2 below which shows the tax regime effect on FDI investors' decisions.

Table 2

Government revenue (excluding grants) expressed as a percentage of GDP (millions of USD)

	2003	2004	2005	2006	2007
Kenya	19.2	17.2	15.1	14.6	13.2
Colombia	15.8	13.1	11.9	10.5	8.5
South Africa	24.4	22.1	19.1	17.1	15.5
Sri Lanka	24.4	22.1	19.1	17.1	15.5
Tanzania	24.4	22.2	19.1	17.1	15.5
Uganda	24.4	22.2	19.1	17.1	15.5

Source *Researcher, 2010*

Investors' concerns about the tax regime are focused less on the structure of the system itself or the level of taxation, and more on what they perceive as a rather "aggressive" attitude of the Kenya Revenue Authority (KRA) with respect to compliant tax payers, and the "punitive" levels of penalties in the event of delay in payments or minor mistakes in reporting. They often perceive KRA as expending too much effort on chasing existing taxpayers at the expense of its efforts to widen the tax base. They also raise concerns about delays in reimbursements of excess VAT payments, duty drawbacks and the

[23] Customs and Excise Duty Act, CAP 472 of the Laws of Kenya.

administration of customs duty. The overall efficiency and competence of the KRA must be commended; however, as efficient tax collection is essential to the functioning of the economy.

2.7.1 The Value Added Tax Cap 417

Value-added tax was introduced in 1990 under the Value Added Tax Act, Cap 417 to replace the sales tax. This law reflects modern principles of VAT structure and administration. Its main structural weakness which had been in the regulations on transfer pricing has since been addressed by KRA through guidelines. The VAT Act, Cap 417 at section 9 stipulates that the taxable value of goods traded among affiliated companies should be "the price at which the price at which the supply would have been provided in the ordinary course of business to a person independent of the registered person". The Income Tax Act, Cap 470 at section 9, in turn seeks to prevent tax evasion by stipulating that "the gains or profits of that resident person from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent peons dealing at arm's length". The KRA has put in place clear guidelines on the issue of transfer which have been adopted the OECD principles. VAT is levied on both goods and services whether they are produced domestically or imported, while exports are zero-rated. Certain goods, mostly basic foodstuff and machinery, are exempt. Goods and services subject to VAT are taxed at 0 % (foodstuffs, medicine and agricultural inputs), 14 % (hotels and restaurants) or 16%.[24]

Businesses are required to register under the VAT Act if their sales of taxable goods exceed KSh.3,000,000 (USD 40,000) per year, or if they deal in a list of prescribed goods or services. The administration of the VAT system follows standard international practice, which requires businesses to charge their customers VAT and allows them to deduct input taxes from output taxes in calculating their monthly returns. Refunds are granted only to businesses that provide zero-rated supplies or those that have incurred

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[24] The VAT Act Cap 417 of the Laws of Kenya

physical capital investment whose input tax exceeds KSh.1,000,000 (USD13,000). This includes exporters, who are the major claimants of VAT refunds. Other businesses recoup the excess payment from their subsequent returns[25].

The KRA has been allocated KSh.480 million (USD 630,000) per month for VAT refunds over the past couple of years. This has been insufficient to clear the backlog of refunds, even though administrative problems also play a role in delaying refunds as the annual appropriations for refunds were not fully disbursed over the past two fiscal years. The KRA reports that it takes on average between three and six months to process refund claims. This delay is one of the major grievances raised by investors about the administration of the VAT system. The monthly amount allocated for refunds has been on an upward increase trend ranging from KSh.700 million (USD 920,000) in the 2004, to 2008 towards the VAT refund payment. however, and the KRA streamlined the refund payment system so that claims are queued and payments made on a first-in first- out basis.

Investors are also concerned by what they perceive as punitive penalties on delays on their part. The VAT Act imposes penalties of 2% p er month compounded on late payments. The Act also allows the VAT Commissioner to recover unpaid tax liabilities by seizing assets instead of suing the taxable person. The structure of corporate income taxes is straightforward and in line with standard international principles in terms of reporting of income, deduction of expenses and investment allowances. The authorities have used the corporate income tax regime and investment allowances sparingly to provide targeted incentives to priority sectors. The framework for income tax (both personal and corporate) is set in the Income Tax Act Cap 470.

Resident companies are taxed at a rate of 30 % of earnings, regardless of sector of operation and ownership, while local branches of non-resident companies are taxed at a rate of 37.5 % as set out under section this of the Income Tax Act. The only concessions on the corporate income tax rate are granted to companies operating in Export Processing

[25] The VAT Act Cap 417 of the Laws of Kenya

Zones and to companies newly listed on the Nairobi Stock Exchange, which are taxed at either 25% or 27% for five years from the year of listing if they float a minimum of 30 % and 20% of their capital, respectively. Service providers are also subject to a 5 % withholding tax on agency or consultancy fees when the transaction involves two resident entities. Although this is an advance tax as the withholding is credited when income tax returns are filed at the end of the year, it significantly affects the cash flow of the service provider[26].

2.7.2 Corporate Income Tax

Notably, the corporate income tax base is assessed on the basis of deductions of "all expenditure incurred in that year of income which is expenditure wholly and exclusively incurred by the investor in the production of that income". Following international standards and practice, deductions are allowed for bad debts, depreciation of capital or contributions to a national provident fund on behalf of employees, amongst others.

The allowance for depreciation on capital is fairly standard across all sectors, with some variations for mining and farming sectors. Manufacturing and hotels also benefit from accelerated depreciation rates[27]. The standard regime for investment allowance as set out in the Income Tax Act Cap 470 is as follows:

- The cost of buildings or supplemental work on building (roads, water or communication facilities) can be depreciated on a straight-line basis at the rate of 2.5% per annum. Hotels qualify for an accelerated rate of 4% per annum.
- Most machinery qualifies for depreciation at a rate of 37.5% per annum on a declining balance basis.
- IT equipment qualifies for depreciation at a rate of 30 per annum on a declining balance basis.

[26] Income Tax Act Cap 470, of the Laws of Kenya
[27] Income Tax Act Cap 470, of the Laws of Kenya

- Vehicles and aircraft qualify for depreciation at a rate of 25 % per annum on a declining balance basis.
- Other office equipment and furniture and ships qualify for depreciation at a rate of 12.5 % per annum on a declining balance basis.

Other provisions in the income tax law are relatively favourable to investors: loss carry forward is not bounded in time and the capital gain tax has been suspended since 1985. The withholding tax on dividends is 10 % for dividends paid to non-residents and 5 % for dividends paid to residents. Agency or management fees (business or professional services), in turn, are subject to a withholding tax of 20 % for non-residents. The figures in table 3 below reflect the withholding tax rates applicable in various FDI countries.

Table 3
Withholding Tax rates under general regime and DTT's
(Percentage)

	Dividends Individual Companies	Dividends qualifying companies	Interest	Royalties	Professional Fees
General	10	10	15/25	20	20
DTT's					
Kenya	22	10	15	15	25
Canada	25	15	15	15	-
Denmark	30	20	20	20	-
EAC	15	15	20	20	20
Germany	15	15	15	15	15
India	15	15	15	20	17
Norway	25	15	20	20	-
Sweden	25	15	15	20	-
United Kingdom	15	15	15	15	125
Zambia	exempt	exempt	exempt	exempt	exempt

Source *Researcher(2010)*

Kenya has signed eight Double Taxation Agreements (DTT's) with major source countries of FDI such as the United Kingdom, Germany, Canada and Zambia[28]. The treaties allow for the taxation of dividends, royalties, interest rates and management fees in both contracting States but set limits on the withholding rate allowed in the country where the income arises. These limits are typically higher than what Kenya applies in its general regime, except for management fees. ALL DTT's allow for tax credits for tax paid in the partner country.

Negotiations for DTT's with Italy, the United Republic of Tanzania and Uganda were initiated over a decade ago, but have not been concluded. Investors based in Kenya and wish subsidiaries or sources of income in the United Republic of Tanzania, Uganda or any other neighbouring country thus face double taxation, which can raise the effective tax burden up to 51% (e.g. 30% corporate income tax rate in the United Republic of Tanzania or Uganda and another 30% in Kenya). Kenya does not offer unilateral foreign tax credit to companies with taxable income in countries with which it does not have DTT's. The absence of DTT's with neighbouring countries thus constitutes a significant impediment to business expansion in the region. A trilateral tax treaty with the United Republic of Tanzania and Uganda to avoid double taxation was signed 1997, but it has not entered into force as it has been ratified by Kenya and the United Republic of Tanzania, but not Uganda. Additional negotiations are under way with South Africa, Nigeria, Mauritius and France.

A comparative assessment of the burden of direct and indirect taxes is carried out by measuring the discounted present value of taxes paid as a percentage of pre-tax cash flow assuming hypothetical investments with a 10year lifeline in various sectors. Although the tax regime is generally appropriate and competitive, both within the region and globally, a few issues raise significant concern for investors and are impediments to the use of Kenya as a business platform for the region. The main concerns that need to be addressed include:

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[28] Trips Agreement which came into effect on the 1st of January 1995 and the WTO Agreements which are the Final Act of the 1986 – 1994 Uruguay Round of trade negotiations.

- Double taxation on profits or income from operations within the region. The absence of unilateral tax credit and DTT's with partners in the region is a major impediment to the development of Kenya as regional hub. Ratification of the EAC treaty and the conclusion of DTT's with other countries in the region are essential in order to realize Kenya's ambition to become a regional hub for manufacturing and services activities. Until the EAC treaty is ratified and additional DTT's are negotiated with countries in the region, the authorities would be well advised to allow unilateral foreign tax credits to the extent of the amount of foreign tax paid on the income derived from foreign operations.

- The imposition of a 5% withholding tax on agency and consultancy fees between two resident entities is another impediment to the development of a regional services hub, in particular when potential refunds following income tax return are processed slowly. The withholding tax generates a heavy burden on the cash flow of nascent services companies that may not generate significant profits and hence qualify for refunds once income tax returns are filed. A less detrimental way to ensure tax compliance would be to impose a relatively small nominal withholding tax on agency and consultancy fees, not to exceed a specified percentage of 1 to 2 % of the amount, whichever is lower.

Special incentives are provided to enterprises operating in Export Processing Zones under the Export Processing Zones Act Cap 414. These include:-

- Exemption from "all existing and future taxes and duties payable under the Customs and Excise Act and Value Added Tax Act on all export processing zone imports for use in the eligible business activities of the EPZ enterprise"

- Exemption from registration under the VAT Act.

- Exemption from the payment of income tax for the first 10years from the date of first sale, followed by a rate of 25 % for the subsequent 10 years and the standard rate thereafter.

- Exemption from the payment of withholding tax on dividends and other payments made to non-residents for the first 10 years.

- Exemption from stamp duty.

- Exemption from quotas or other restrictions or prohibitions on imports or exports with the exception of trade in firearms, military equipment or other illegal goods.

In addition to procedural incentives (exemption from certain licences, facilitation services by the Export Processing Zones authority) and the higher quality of infrastructure, the following fiscal incentives are granted to companies operating in EPZs

EPZs are considered "extra territorial" in the sense that goods and services purchase from Kenya are treated as Kenyan exports, hence payable in convertible currency. The EPZ Act allows goods produced in EPZs to be sold in Kenya, but they are then created as imports from a third country and hence subject to usual customs procedures and payments of VAT and duties at most favoured-nation (MFN) rates. At the moment, EPZA's policy is to approve projects for setting up in EPZs if a minimum of 80% of output is to be sold outside Kenya.[29] The percentage of output that can be sold domestically is typically specified in each enterprise's licence.

The 2004 Finance Act (fiscal year July 2004-June 2005) imposed an additional 2.5% charge on sales from EPZ enterprises to the Kenyan market, on top of the MFN duties. It also proposes that the EPZ Act be amended to require ministerial approval for sales of goods to Kenya from a zone, a provision that already applies to services.[30]

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[29] The Export processing Zones Act Cap 417 of the Laws of Kenya
[30] The Finance Act 2004

Exports of EPZ companies outside Kenya are treated in a standard way despite the EPZs' extra territorial status. This allows exports to EAC and COMES at preferential rates, as if the goods were originating from Kenya, subject to rules of origin. The same treatment applies to other trade zones or countries, which give EPZ companies Kenyan status and subject their goods to rules of origin to determine the applicable tariff rates.

Imports were subject to seven tariff bands ranging from 0 % to 35 % until the end of 2004, with a weighted average MFN tariff of 13.3 % in 2001. However, under the protocol establishing the East African Community (EAC) Customs Union signed in March 2004, Kenya, the United Republic of Tanzania and Uganda adopted a common external tariff starting on 1 January, 2005. Raw materials and capital goods are now subject to a tariff of 0 %, with intermediate goods and final consumer goods taxed at 10 % and 25 % respectively.

As for VAT and Income Tax, investors raised the concern that KRA's focus on revenue collection is at the expense of other services/functions it should serve. In particular, the customs administration plays a crucial role beyond raising revenue, as it is crucial to facilitating trade and ensuring the enforcement of quality standards on imported goods. While organizational performance is regularly and comprehensively assessed on the basis of revenue targets, the customs department does not systematically benchmark its performance on clearance time or keep track of compliance by traders, which prevents it from carrying differentiated physical inspections based on track records.

The KRA nevertheless carried out a clearance-time study in late 2004, as part of its Customs Reform and Modernisation project and wish technical support from the World Customs Organization. The study showed average times from arrival to removal of 10 days in Mombasa and 5 days at Jomo Kenyatta Airport. Pre-lodgements of documentation with the authorities, however, halved these clearance times. The study identified the main causes of delay as the large number of agencies involved in clearance procedures, computer breakdowns, cargo scanning or misdeclaration by importers. It initiated a review of procedures with a view to automating them and recommended

introducing risk management methods (differentiated physical inspections) and post-clearance audits.

A customs duty drawback scheme is available to exporters. It allows domestic producers to claim exemptions (subject to a bond) on the payment of customs duties on their imported operating inputs. The scheme also allows domestic providers of inputs to direct exporters to claim exemptions on their own imported inputs, in order to encourage linkage between direct exporters and local suppliers. Exemptions for domestic suppliers of inputs to direct exporters can go back two stages of production, i.e. transactions either directly from a local supplier to a direct exporter or from a local supplier to another local supplier providing input to a direct exporter.

The Government no longer steers investment to specific geographic locations. Local content rules are applied but only for purposes of determining whether goods qualify for preferential duty rates under the Common Market for East and Southern Africa. Kenya has replaced its old policy of import substitution with one of export promotion. Employment of Kenyan Nationals is strongly encouraged. In fact, the Immigration Department requires that a minimum of Kshs. 3 million (approximately USD 42,000) be invested before it authorises work permits for foreigners.

Income from foreign investment through acquisitions, mergers or takeovers is governed by the Restrictive Trade Practices, Monopolies and Price Control Act, Cap 504 of 1990, Laws of Kenya, which prohibits restrictive and predatory practices that prevent the establishment of competitive markets. The legislation is also aimed at reducing the concentration of economic power by controlling monopolies, mergers and takeovers of enterprises. Mergers and takeovers are subject to the Companies Act, the Insurance Act (in case of insurance firms) or the Banking Act (in the case of financial institutions). The Government of Kenya launched a privatization program in 1991, in which 207 enterprises were targeted for privatization. As of September 2007, the government of Kenya had divested from 215 public enterprises[31]. Plans to privatize two large sugar

[31] The Kenya Economic Survey Report of 2008

companies and the Kenya Reinsurance Company are currently in the works. Senior officials-both Government and non-government – have repeatedly stated that Kenyans should be given higher priority in the privatization exercise. Divestiture through public share issues provides little opportunity to corporate investors. In past divestitures, the Capital Markets Authority has seen to it that shares are thinly spread over many applicants thereby ruling out the possibility of a foreign investor acquiring a big stake in a company.

Under a World Bank export development program, the Government of Kenya has abolished, except for a few categories, export-licensing requirements and initiated three export incentive schemes for both local and foreign investors. It provides import duty/value added tax remission to importers of raw material inputs used for manufacture of exports. In addition, the government of Kenya has an Export Assistance Scheme and an Export Development support project, both of which provide grants for export promotion including export market studies and seminars. Manufacturing bond facilities and export processing zones also exist.

In the year 2007, the Government of Kenya has strengthened the law on health and safety through the enactment of the Occupational Health and Safety Act No. 15 of 2007. The revised Act authorizes the Labour Minister to undertake formal investigations of occupational accidents and disease. Factories that employ over 20 employees are required to have a safety and Health committee. The Government of Kenya has also established a National Advisory Committee on Occupational Health and Safety as well as a fund for Occupational Health and Safety[32].

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[32] The Occupational Health and Safety Act No. 15 of 2007

CHAPTER 3

IMPLEMENTATION OF TAX INCENTIVES IN KENYA

3.1 INTRODUCTION

This chapter has examined the extent to which tax incentives are applied to Foreign Direct Investments in Kenya. However in general, the incentives depend on the type of investment a country wishes to attract, history, politics and the general competitiveness of the country as a potential destination for FDI. A country with a lot of attractions for investors need not employ as many incentives to attract and/or retain investors as compared to one without.

Tax Incentives may be crucial in attracting high-technology industries and research and development activities. These are likely to lead to technology transfer in the country. Investment that are dependent on tax incentives to do so, should qualify for them. High technology industries and knowledge-creating activities like research and development in Kenya are of vital importance for development in this era of science and technology.

3.1.1 Eligibility Criteria for Tax Incentives

Eligibility Criteria for Tax Incentives differs from country to country. The possible eligibility criteria include the size, nature and importance of the investment, conformity to a country's development plans, employment effects, use of domestic inputs also known as local content requirement and export performance of the investment location of investment in designated geographical areas.

Tax Incentives in Kenya are granted to holders of Certificate of Investments issued by the Investment Promotion Centre. Other approved investors are also eligible. The qualifying threshold for foreign investors is USD 100,000 while local investors face a threshold of

Kshs, 1,000,000. Investment in rehabilitation requires a maximum of USD 500,000 for foreign investors and joint ventures[33].

3.1.2 Target Population

This study used a sample of 30% of the accessible population which it considered as reasonable representation based on the sample size in Mugenda & Mugenda (2003). The target population was the staff Kenya Revenue Authority of EPZ – Athi River a sample of 50 employees was drawn from 500 employees of Kenya Revenue authority and 50 employees from staff of 500 of EPZ. The study was limited to employees who are engaged in taxation matters in general.

Table 4

Target Population

Department	Staff Population
Kenya Revenue Authority	41
EPZ	50
Investment Promotions	5
Kenya Bureau of Statistics	2
Treasury	2
Total	**100**

Source *Researcher, 2010*

3.1.3 Sample Size

According to Mugenda and Mugenda (2003), a sample size is the number of items selected from a sample frame or accessible population for observation. Mugenda asserts that a sample of 30% of the accessible population is quite representative. The sample

[33] Investment Promotion Act No. 6 of 2004

selected is composed of (100) employees from a total staff of (500). The distribution was as follows; KRA (41), EPZ (50), I.PC (5), KBS (2), Treasury (2)

Table 5

Sample size of the population

Department	Staff population	Sample ratio	Sample size
KRA	150	0.27	**29**
EPZ	200	0.37	**60**
IPC	50	0.24	**7**
KBS	50	0.06	**2**
Treasury	50	0.06	**2**
Total	**500**	**1**	**100**

Source *Researcher (2010)*

3.2 QUALIFYING FOR TAX INCENTIVES IN KENYA

It is a well-known fact that tax incentives directly reduce revenue to the Treasury. These incentives therefore are a cost to the government. The need to constantly increas e government revenues mainly through taxation is nowhere more important than in the developing countries like Kenya. Tax incentives for FDI therefore may only be justified if the returns from these investments to the host country generate more revenue than the tax revenue lost in form of granted tax incentives. Hence, the need to identify who may qualify for the tax incentives. Such an identification especially of the later can help the government to avoid losing the much needed tax revenues unnecessarily.

3.2.1 Who should not qualify?

Foreign investors who may qualify for tax incentives are:-

a) Those that enjoy a 10 year corporate income tax holiday and a 25% tax rate for a further 10 years thereafter (except for EPZ commercial enterprises)

b) 10 year withholding tax holiday on dividends and other remittances to non-resident parties (except for EPZ commercial license enterprises).

c) Perpetual exemption from VAT and customs import duty on inputs-raw materials, machinery, office equipment, certain petroleum fuel for boilers and generators, building materials, other supplies. VAT exemption also applies on local purchase of goods and services supplied by companies in the Kenyan customs territory or domestic market. Motor vehicles which do not remain within the zone are not eligible for tax exemption.

d) Perpetual exemption from payment of stamp duty on legal instruments – 100% investment deduction on new investment in EPZ buildings and machinery, applicable over 20 years.

e) The current qualifying threshold for tax incentives in Kenya is not clearly set out generally save for different rates applicable in different sectors like the EPZ – where 10 years, it is the interpretation of the author that any FDI of this size qualifies for the incentives. This work recommends that some investments should not qualify even if they meet the threshold. The threshold alone does not guarantee that such FDI will at least move that offset the costs of tax incentives.

In view of the above considerations, some of the investments that should not qualify are presented hereunder:-

- Given the fact that tax incentives are costs to the government due to the lost revenue, one could suggest that all tax incentives be abolished. In essence, the main of taxation all over the world as fiscal policy instrument is to collect revenue for the government Taxation's main goal is not to attract FDI although as a policy instrument may have multiple purposes. But due to some factors like pressure from MNE's and tax competition with other countries competing for FDI, granting of tax incentives becomes inevitable. Tax revenue could be used to provide services and improvement.

- Another type of investment that should not qualify for tax incentives are low cost assembly plants that are highly mobile. These can be mostly affected by tax holidays. They are likely to move to new jurisdictions to take the advantage of tax holidays there where these expire on the former location. Here it may be observed that the factor that made the investment responsive to the incentive also acted to limit the benefit to the country from the investment.

- Fixture FDI should not qualify for tax incentives. These are FDI created to carry on what is in fact a domestically owned business. This can happen by transferring funds from domestic enterprise to a company incorporate offshore which in turn re-invests in the country as if it were foreign owed company. It starts to enjoy incentives like tax holidays, investments allowances and accelerated deduction that are mainly associated with.new investments.

3.2.2 Who should qualify?

The current qualifying criterion for tax incentives in Kenya is based on nothing but the size of the investment. The qualifying threshold for FDI is currently USD 100,000 and is the only qualifying criteria for tax incentives in Kenya[34]. The above qualifying criteria for tax incentives in Kenya are not adequate. Some investments that do not meet the threshold may be of more importance to the nation than those that meet the qualifying criteria and hence the need to go beyond the pecuniary size of the investment. In general terms investments that would come to Kenya without the tax incentives should qualify for investment while those that require attraction through tax incentives should qualify on condition that they compensate the costs equivalent to the tax incentives. Some of these are set out here below:-

[34] Investment Promotion Act Cap 472 of the Laws of Kenya

a) Conditions required for efficient market have not yet been developed in Kenya. There is still state control of firms, rudimentary capital markets imperfect basic information on market possibilities and undeveloped commercial and legal infrastructure. In these conditions, some FDI have the potential of creating and training domestic agents on how to operate in the market. Investments that are likely to lead towards this end should qualify for the incentives. These are there one that inter-alia are willing to participate in empowering the local population through training and retraining. Benefits from such investment to the nation are likely to be above and beyond the private returns.

b) Investments that are likely to contribute towards some special national interests should qualify for incentives. These may be particularly desirable activities or projects that would not have occurred without the incentives. Some investment may potentially develop low growth areas in the Country. These are designated regions. They are usually more remote; economically less developed and may have lower employment rates than the rest of the country. Investments that are likely to locate in these areas when incentives are linked to these regions should qualify. These investments are expected to generate more activities in such regions if they are granted special tax incentives. (The flower farms in Naivasha such as Sher Karuturi and Rose Farm and those in Athi River Region such as Carnation Plants and Ostrich Farm, are good examples in this regard).

c) However, some investors may be willing to locate in neighbouring countries where the labour costs and other conditions are favourable. Some Investments are likely to contribute towards employment creation and should therefore qualify for incentives for job creation. These incentives may be linked with regional policies seeking to attract FDI in areas of high unemployment. In this category of investment one can include those that promote establishment of Labour intensive industries or employment of particular categories of workers such as young persons, the disabled or the long-term unemployed. The importance of employing young people especially cannot be overemphasized.

The FDI sector in the case of Kenya have proved elusive as the investors have not been able to effectively transfer any known technologies or know how to the locals.

3.3 ECONOMIC EFFECTS OF TAX INCENTIVES

a) While incentives may contribute towards an increased inflow of FDI into the country, some specific types of investments are recommended as appropriate qualifiers for incentives and some as not. Therefore, it is important for a host country to evaluate the type of investments that are beneficial to its needs.

b) Given the appropriate host country policies and a basic level of development, a preponderance of studies shows that FDI with tax incentives trigger technology spill overs, assists human capital formation contributes to international trade integration helps create a more competitive business environment and enhanced enterprise development.

c) On the contrary there are potential draw backs which include a deterioration of the balance of payment as profits are repatriated, a lack of positive linkages with local communities, the potentially harmful environmental impact of FDI in the heavy industries Panafrican paper mills at Webuye, social disruptions of accelerated commercialization in less developed countries and the effects on competition in national markets.

3.4 DISINCENTIVES

It is argued that most countries finance public expenditure largely through taxation, hence investors are not necessarily repulsed by the level of taxation but by the existence of hidden costs and hindrances. Examples include non-transparent, non-accountable, bureaucratic and inefficient tax systems[35]. The target system used by KRA has apparently made the officers give refunds claims processing a low priority as they divert

[35] PWC 2003: East African Tax reference guide

most attention to collection. This has led to delays in processing refunds. Initially KRA assured taxpayers that where refunds are audited by external auditors, they should be paid without KRA audit and paid within two to three weeks. The actual position on the ground is that these refunds are paid after three months at the earliest. This delay makes the taxpayers incur additional costs by way of finance costs.

Where the investment funds have been borrowed from lenders, it affects the opportunity cost of the delayed refunds as well as time spent on their management. This must be considered in the decision made by an investor when considering investing in Kenya. To a taxpayer delayed refunds means unavailability of the needed funds for the next few months and is additional taxation which is deterrent to investments.

3.5 BARRIERS TO FDI

The Investment Promotion Act No. 6 of 2004 introduced a critical barrier to FDI that the Government may consider lifting while ensuring at the same time that it has appropriate tools at its disposal to address its legitimate concerns about national private sector development. Beyond amending the Investment Promotion Act and although many of the laws that determine the investment framework would benefit from being modernised, the weaknesses that must be addressed most urgently relate more to matters of implementation. Significant modernisation work can and may be done on the laws themselves, but this is likely to be a lengthy process. In the meantime, priority may be given to make the current body of law work better, which is a challenge within reach as the principles laid out in the legal system are in many cases sound.

The Kenya Revenue Authority admits Transfer pricing as a challenge to revenue collection from investors. According to them, taxation of multinational corporations is difficult. Due to their size, they are able to adopt transfer pricing mechanisms to reduce their tax liabilities and shift profits to countries with lower tax burdens. Many laws grant or leave the door open to significant discretionary powers to their administrators. Such discretionary powers, which sometimes run counter to the spirit of the law, have

significantly increased the degree of uncertainty faced by businesses in their dealings with the administration and are a major contributor to corruption, which is consistently identified by investors as a major impediment to business.

In this regard, the Government of Kenya has published legislation and guidelines governing the following:-

- The granting of Presidential exemptions on the allocation of agricultural land to foreign investors[36].
- The allocation of government land until a more efficient and transparent system of auctions can be re-established.
- The granting of foreigners' work permits.
- The treatment of transfer pricing by the KRA.
- Amend the Investment Promotion Act as suggested above and implement a sliding scale system for entitlements to foreigners' work permits.
- Replace the labour-market testing procedure with an Australian-type approach of pre-determined skills actively sought. Favour in particular the development of skill-intensive but low capital foreign investments in the services sector that require expatriate workers.
- Replace the rigid understudy programme with more flexible requirements for training schemes for local employees.

Infrastructure is both an impediment to and potential magnet for FDI. While the regulatory framework needs further improvements, key actions can and may be implemented within the following parameters:-

- Proceed faster and more forcefully with private sector involvement in the ICT sector.
- Implement fully the Privatization Act and accompanying regulations to ensure transparency and initiate the privatization of assets in infrastructure and banking.

[36] The Government Lands Act Cap 300 of the Laws of Kenya

- Establish and enforce clear performance contracts that include international benchmarking and short- and medium-term targets for public sector companies that cannot be privatized rapidly, including for airports, ports, railways and utilities.
- Lobby the East African Community member countries to ratify the tripartite tax legislations and enact unilateral foreign tax relief for cases where DTT relief is not available.
- Enforce clear performance benchmarks for the KRA and customs services in terms of VAT refunds, duty drawbacks and customs clearance times.

Private sector involvement in the infrastructure sector and the chances of success of the privatization programme would greatly benefit from a strengthened Commission of Monopolies and Prices legislative amendments should:

- Turn the Commission into an independent body with its own enforcement powers.
- Allow the Commission to investigate practices across all sectors including electricity and telecommunication and harmonize competition and sectorial laws. The Commission should work in consultation with the regulatory bodies but its mandate should be wide enough to investigate anti-competitive practices in those sectors.
- Grant more flexibility to the Commission in regulating and approving Mergers & Acquisitions particularly through a threshold rule.

CHAPTER 4

ASSESSING THE IMPACT OF FDI IN KENYA VIS A VIS TAX INCENTIVES

4.1 DATA ANALYSIS

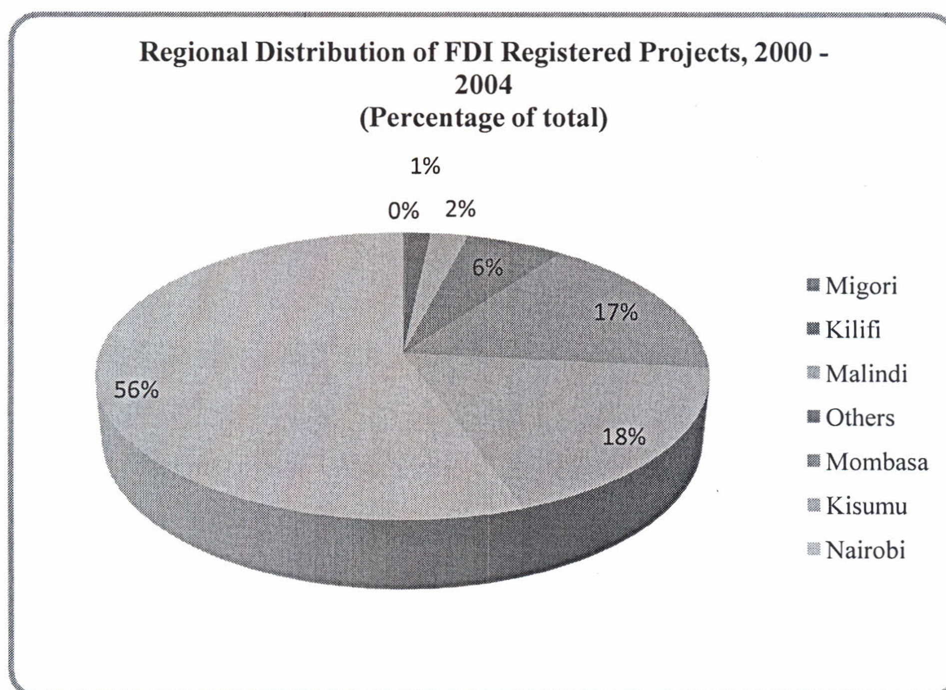
This chapter presents the findings of the limited research undertaken on FDI vis a vis tax incentives in Kenya. From the target population of 100 respondents, 80 of them responded and returned the questionnaire comprising 80% response rate. From the study, the respondents were in various sectors which included the Kenya Revenue Authority offices, the Export Processing Zone Companies at Athi River, the staff at the Investment Promotion Centre, the Kenya Bureau of Statistics and Treasury while their designations included principal taxation officers, investment officers, chief statistical officers, administration and investment secretary, their assistants and planners. FDI projects are mainly concentrated in the Nairobi and Mombasa areas, which accounted for 56% and 17% of the value of IPC-registered projects in 2000-2004.[37]

Although the level of FDI has been low in absolute and in relative terms over the past decades, its impact on the economy should not be underestimated. Foreign investors in Kenya have sometimes tended to make small investments, spread over a wide variety of sectors. However, foreign investors have significantly invested in more dynamic sectors of the economy, including horticulture, floriculture, and telecommunication to export diversification.

The figure below reflects the distribution of the FDI registered projects in Kenya. Nairobi and Mombasa accounted for 78% and 11% of the number of registered projects in the same period.

[37] The Kenya Economic Survey Report of 2004

Figure 3



Source *Researcher (2010)*

Private and public domestic investments have suffered in the past decades from a combination of poor investment climate, high external indebtedness, low domestic savings and the need for fiscal consolidation. These factors and policies have generated a sharp contraction in public investment in infrastructure and social services, reduced the availability of funds for private investment and increased their cost. Gross domestic investment was 13.1% of GDP in 2002, with gross domestic savings at 10.4% of GDP.[38]

Persistent government budget deficits have also contributed to the scarcity and high cost of funds for domestic private investors. In such a context, FDI could play a significant role in providing extra sources of capital and investment and help close the expansion and could further attract foreign investment. Additional FDI could also be attracted in other agri-business sectors, including processed fruit and other food products.

[38] The Kenya Bureau of Statistics – statistical abstract of 2003

4.2 EXPORT PROCESSING ZONES (EPZ)

Investment in the EPZ is mostly governed by the provisions of the Export Processing Zone Act Cap 517. Export processing zones were created in 1990 in order to attract outward-oriented investment, both domestic and foreign. A total of 36 EPZ's were established or in progress as at 2008, the majority of which are centred in Nairobi (Ruaraka, Athi-River within Mavoko Municipality) and Mombasa (Kilifi area). Of all these EPZ zones, Athi-river is the single largest zone that h as been developed and managed by the Government. This zone has adequate infrastructure services, in terms of water supply, electricity and access roads.

Although investment in EPZ's was relatively modest in the 1990's, the introduction of AGOA and the granting of special preferences for apparel, including fabric sourcing requirements, generated a burst of FDI, particularly by Asian-based garment companies seeking quota access to the US market.[39] As of 2008, there were 70 companies operating in EPZs representing a total investment of about $220 million and employing around 40,000 people or 19 % of private formal sector manufacturing employment. Of these companies, 40 operated in the textiles and garments industry and accounted for close to 60 % of total investment, about 95 % of employment and over 70 % of exports.

This study has established that most of Kenya's textiles and garments exports are targeted towards the United States of America, under AGOA agreement. Under AGOA current rules, the United States of America grants Kenya and other sub-Saharan African countries quota-free and duty-free access for its apparel output. This study has noted that preferential access is normally subject to rules of origin that require that fabrics be sourced either in the United States of America or in other AGOA countries. Kenya (along with many other African countries) was granted an exception until the year 2012 that would allow it to source fabrics from anywhere, including Asia.

[39] US Department of Commerce annual report of 2004

Table 6 below reflects the distribution of investment in various sectors in the EPZ zones in Kenya.

Table 6

INVESTMENTS IN EPZ's BY SECTORS

(Percentage Share)

	No. of firms	Employment	Investments	Exports
Textiles/garments	31	95.8	54.3	73.8
Chemicals/oils	5	0.4	9.9	5.9
Computer/electrical	3	0.2	0.5	0.2
Agro processing	3	1.9	1.4	5.7
Printing	2	0.8	26.6	10.2
Pharmaceuticals	3	0.3	1.5	1.9
Services	6	0.2	3.0	1.9
Gemstones	1	0.3	3.0	0.3

Source *Researcher (2010)*

While the European Union also allows limited access to some preferential countries including Kenya it does not grant exemptions on sourcing requirements and rules of origin. As a result, textile and garments exports to the European Union have been virtually non-existent but in contrast, exports to the United States of America amounted to USD 280 million by the year 2008, seven times as high as the pre-AGOA level in 2000.[40] Essentially all of Kenya's exports to the United States of America consist of apparel and clothing accessories.

Although the provision of financial services is not currently allowed in EPZs, the Government should explore whether it has the potential to build upon its well-regarded financial regulatory structure (Central Bank of Kenya and Capital markets Authority), the presence of first-tier foreign banks (Barclays, Citibank, Standard Chartered) and recognized local skills to build a regional offshore financial services centre. This would require market research to establish whether Kenya possesses special competitive

[40] The Kenya Economic Survey of 2008

advantages either in sources of hard currency funding, or favourable tax treaty arrangements that could generate sizeable offshore deposits by non-residents.

The strength of Kenya's national private sector relative to its neighbouring countries is an asset the Government should build upon to attract foreign investors in search of efficient local suppliers i n comparison with the attraction of foreign investors by use of tax incentives. The objectives of fostering a strong national private sector, increasing the level of FDI and generating maximal linkages and knowledge spill overs are complementary rather than contradictory. In most sectors, the Government should seek to optimize the complementarily between foreign investment and national investment through enterprise development and linkages programmes.

4.3 EFFECT OF KENYA TAX REGIME ON FDI

Although Kenya's tax regime does not put domestic producers at a particular disadvantage with respect to competitors in the region, and particularly South Africa, shifting from a neutral to a proactive tax stance could enhance the country's attractiveness to foreign investors seeking a manufacturing basis in East Africa. The Government may also consider being proactive in securing market access to its key neighbours under terms at least as favourable as other competitor countries. Given Kenya's competitive position, regional trade agreements such as the EAC treaty, COMESA treaty and SADC treaty, are set to be more important to its manufacturing sector than market access to the larger industrialized countries under AGOA agreement, ACP agreement or the WTO agreements.[41]

The lack of parallelism between the development of regional trade agreements and the harmonization of tax policies also implies that countries in the region are increasingly against each other to serve as regional platforms for TNCs to serve the regional market. Preferential or free-trade area enhances the relevance of tariff barriers as factors in the

[41] OECD report (2003): African Economic Outlook

location decision of market-seeking FDI, which makes production costs and tax regimes all the more important in determining TNCs' decisions to locate their production facilities. As a result, Kenya has taken steps to maintain tax and market access competitiveness relative to other countries in the region by:

- Implementing a lower tax rate on foreign source income of Kenyan companies. Further research is still being carried out to determine the appropriate levels of application of appropriate tax rates, in the EPZ's in line with regional competitors.
- It has advocated for the enlargement of the free-trade COMESA-11 area to other members of COMESA in the region.

Kenya's tax system is generally well organized and tax incentives are predominantly focused on the export oriented manufacturing textile and agro-allied sectors. Kenya has been at the forefront in the effort to synchronise tax and fiscal policies with the East African Community Customs Union. Several lessons for regional cohesion elsewhere have been learned from the harmonisation use of EPZ's and other tax incentives within the context of growing convergence of investment incentive policy in addition to regional economic bourses. Moreover, the most common and popular tax incentives may not be achieving their intended goals. Fiscal reforms often ignore the small and medium-sized enterprises which are likely to be the most responsive to tax incentives.[42] This study has established that policy-makers have taken into account the objectives and effects of tax incentives in the designing of their investment promotion strategies in order for fiscal incentives to achieve their intended maximum impact.

Investments in the natural extraction sector which involves mineral mining, oil and gas exploration among others do not need to be attracted by tax incentives. The government of Kenya has created a reasonable tax environment and therefore investments in natural extraction should not qualify for tax incentives.

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[42] Guisinger, S.E. (1986). Do performance requirements and investment incentives work?

4.4 ADVANTAGES AND DISADVANTAGES OF TAX INCENTIVES

Some of the notable advantages are as set out below: -

4.4.1 Advantages

a) Attract investment – Tax incentives have been known to attract FDI investments generally in most countries where they are offered.
b) Tax incentives promote expeditious private decision making in comparison with lengthy bureaucratic government decision making process, which can negatively affect investments.
c) Promote creativity in the targeted industry and provide a wider investment base

While carrying out this study it was noted that some of the disadvantages of FDI are:-

4.4.2 Disadvantages

a) Tax incentives are regressive by nature.
b) Tax incentives create windfalls.
c) Tax incentives are more difficult to develop and control
d) Tax incentives distort the choice of the market place and keep tax rates high.

CHAPTER 5

CONCLUSIONS AND SUGGESTIONS

5.1 CONCLUSION

The findings of this study have shown that although Kenya's relative level of development and industrialization remains higher than in most other countries in the region, its economic leadership has eroded significantly over the past couple of decades. In particular, Kenya has been left behind in the global surge in FDI flows that started in the mid and late 1990's and benefited its neighbours in the East African Community as well as much of Africa and the developing world. While Kenya was well positioned to attract regionally-oriented FDI in the 1960's and 1970's as a result of its economic leadership in East Africa at the time, poor and inconsistent economic policies, deteriorating infrastructure, poor growth performance, increasing corruption and insecurity led to a decline in the number of foreign investment throughout the 1980's to 2000's.

Despite Kenya offering foreign investors a wide range of tax incentives as discussed in earlier chapters of this paper, some of the investors have since consolidated out of Kenya over the past few years, notably in the EPZ areas and the remaining few do not seem to have significant plans for expansion. In this regard, foreign investors in the textile industry in the EPZ areas such as Rolex Company Limited, Mirage Company Limited and Fashion Wear Limited have closed shop, and relocated to other areas in Ethiopia because of cheap labour.[43] Kenya's standing as East Africa's most attractive destination to foreign investment has come under serious threat from neighbouring states, who are cashing in on the country's lengthy licensing procedures and sluggish commercial dispute settlement to sharpen their competitiveness.

[43] The Kenya Investment promotion Centre annual report of 2009

This study has highlighted the various benefits of tax incentives as demonstrated through FDI stimulation of domestic investment, promotion of economic growth, creation of employment opportunities and promotion of transfer of new technology. Various studies have been carried out to examine the determinants of FDI in African Countries, but unfortunately, in the course of my research on this paper, I did not come across any studies carried out specifically for Kenya. The studies that have been so far conducted were cross-country studies, usually employing comparative analysis using some of the African/or developing countries including Kenya. Hence, it became necessary to carry out an empirical investigation to find out the factors that influence FDI decisions in Kenya.

The main policy conclusion that can be ventured is that the economic benefits of FDI are real but they do not accrue automatically. To reap the maximum benefits from foreign corporate presence a healthy enabling environment is paramount to encourage domestic as well as foreign investment, provide incentives for innovation and improvement of skills and contribute to a competitive corporate climate. Some of the factors holding back the full benefits of FDI in some developing countries include the level of general education and health, th e technological level of host-country enterprises, insufficient openness to trade, weak competition and inadequate regulatory frameworks.

It has been argued in this study that by easing financial restraint, FDI enables host countries to achieve the highest growth rates that generally emanate from a faster pace of gross fixed capital formation. The eventual economic effect of FDI on economies with recourse to finance depends crucially on the policies pursued by host country authorities. The sectorial composition of an economy can also make a difference. While the services sectors of many developing countries may be underdeveloped and hence unable to attract large inflows of FDI, extractive industries in countries with abundant natural resources can be developed beneficially with the aid of foreign investors.

The study has also found that FDI does not automatically translate to net foreign exchange inflows. To start with, many multinational and transnational "investors' borrow money locally at favourable interest rates and thus finance their projects. This may lead to unfair competition with local firms and crowds the domestic private sector out of the credit markets, displacing its investments in the process. Many transnational corporations are net consumers of savings, draining the local pool and leaving other entrepreneurs side-lined.[44] In some developing countries, profits repatriated by multinationals exceed total FDI. This untoward outcome is exacerbated by principal and interest repayment where investments are financed with debt and by the outflow of royalties, dividends and fees. This is not to mention the sucking sound produced by quasi-legal and outright illegal practices such as transfer pricing and other mutations of creative accounting.[45]

The study has further revealed that FDI does not foster growth and stability, it follows both. Foreign investors are attracted to success stories; they are drawn to countries already growing politically stable and with a stable purchasing power. Foreign investors in most sectors jump ship at the first sight of possible problems, political unrest and declining fortunes which is currently the case in Kenya. In this respect, FDI and portfolio investment are equally unreliable. Previous studies such as those carried out by Mwega and Ngugi (2005), Bergsman (1999) and Ndii (2000) have demonstrated how multinationals hurry to repatriate earnings and repay inter-firm loans with the early harbingers of trouble. FDI is therefore partly pro-cyclical. This study questions the employment "argument" on FDI: "Is FDI the panacea it is made out to be?"

This study also found out that foreign owned projects are capital intensive and labour efficient. They invest in machinery and intellectual property but not in fair wages. It is further noted that skilled workers get well paid in comparison to unskilled labour. The locals rarely benefit from most of the FDI investments and when they do find employment it is short-term poor paying.

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[44] Bjarvatn, Kjetil (2004): Economic integration and the profitability of cross border mergers and acquisitions

[45] Foreign direct investment in developing countries, occasional paper 33, IMF Washington Dc 2006

Lack of public investment and/or poor policies have led to the neglect of infrastructure and failure to ensure that backbone services such as utilities, telecommunications and transport are provided on a competitive basis. The resurgence of Kenya Airways following its privatization is an indication of the opportunities that have been gained from engaging FDI in upgrading Kenya's competitiveness. It has also been noted that FDI in export manufacturing and lately in specialized international services is increasingly won by the efficiency gains that host countries can offer foreign investors. Kenya tried to modernise various legislation such as the Investment Promotion Act No. 6 of 2004 and the Privatisation Act of 2005 to enable key services to benefit from competitive private investment.

This study has also noted that currently Kenya does not seem to have a genuine strategy to harness FDI to aid national development. On the contrary, the Investment Promotion Act of 2004 imposes unnecessary new barriers to FDI that will more than offset the possible gains of new incentives offered under the Act. If Kenya is to succeed in attracting as much FDI per unit of GDP as developing countries on average in 2000 to 2009, inflows would be sustained at USD 600 million a year, over ten times the average in 1984 to 2000. It should engage a strategy to attract such types and levels of FDI inflows and maximize their developmental benefits by considering the following important elements:-

- Improving the dynamic determinants of FDI;
- Providing a competitive and efficient investment framework.;
- Targeting high potential investment opportunities for special regulatory attention and investor promotion;
- Gearing government agencies for effective investment promotion

This study concludes that Kenya has a mixed record in FDI determinants. It takes pride in its long-standing attention to general education and the development of human capital. The "quality of people" has been a bedrock of the competitiveness of export floriculture and horticulture. It has enhanced national benefits by enabling foreign investors to

partner local producers and export of human development seems set to continue, subsequently underpinning efficiency seeking FDI.

Unfortunately, these qualities have not been translated into continuous modernisation of competence in manufacturing. The conditions have not encouraged sustained private investment and these are currently causing a crisis in basic manufacturing. The situation warrants government support for a manufacturing competence, building programmes to help local companies and improving the sector's profile for future FDI. On the positive side, it has been noted that the Government has been active in regional and other trade agreements which enhance market site for investors locating in Kenya. However, work still needs to be done on ancillary arrangements in trade, tax and services – within the East African Community and with other neighbouring countries.

This study has revealed that taxation affects the cost of investment, its profitability and the return on investment. This impact is not just a question of looking at the headline rate of tax on profits. The tax burden on the investor depends on a number of factors and their interaction, including expenses allowed rates of capital allowances (tax depreciation), the availability of tax credits, investment allowances and tax holidays, the loss-carry forward provisions and the taxation of dividends among other things. The fiscal regime in K enya and the chosen comparative c ountries such as South Africa, Uganda, Tanzania and Rwanda, for each sector is applied to the standard business model for over 10 years beginning with the initial investment.

In this paper, it has been argued that Kenya grants a relatively generous package of tax incentives foreign investors. The effectiveness of the incentives is in doubt while it is a naked truth that the incentives are a cost to the government. They represent lost government revenues and therefore this calls for a need to re-consider which ones should qualify for the incentives and which should not. Kenya may consider developing new qualifying criteria for its tax incentives for FDI. The criteria should go beyond the monetary size of the Investment. Broader non-monetary criteria should also be used in determining who should qualify for the tax incentives. Basing the qualifying criteria for

tax incentives on the monetary value of the FDI only puts the country at a great risk of losing more tax revenues.

Foot-loose short term investment should not qualify for the tax incentives generally and tax holidays in particular. Such investment includes the quick-profit business such as in the trade sector, restaurants and construction. These investments are very dynamic. If affected by any disturbance at all, they may move to another location. Alternatively, they may form a new company after the holiday expires because tax holidays reward formation of new companies. Foot-loose short term investments are likely to come in the country irrespectively of tax incentives. Short term profits associated with them should be enough to attract the investment to the country.

5.2 SUGGESTIONS

Upon conclusion of this study, it is suggested that urgent, decisive and sustained policy action is required in order to move economic growth through both domestic and foreign investment. The bright spots in areas such as horticulture, the airline industry and telecommunication services have generated significant success in recent years and have demonstrated that FDI can play a major role in Kenya's economic development and wealth creation. They also show that Kenya has the potential, given appropriate policies and strategies, to attract significantly higher inflows of FDI and to turn itself again into a regional power house in certain key sectors.

The Government's policy focus on manufacturing means that domestic taxation is biased against the services sector[46]. This should be eliminated by:-

- Extending the "investment deduction" available on fixed assets employed in manufacturing (and in tourism) to services, including business and professional services. This means allowing immediate expensing of commercial buildings and

[46] Jaffe, S. (2003): From Opportunity to challenge, transforming Kenya's fresh vegetable trade in the context of emerging markets.

other capital investments (computers, office furniture and others), as opposed to the current depreciation rates of 2.5% per annum (buildings) and 30% per annum (computers)[47]. Future policy changes on investment deductions should apply equally to manufacturing and services investments.

- The 5% w ithholding tax on agency fees should be reduced to a lower of a moderate flat fee of 1 or 2 % of the invoice value. This would strengthen the cash flows of business and professional service frontiers without the compliance value of the arrangement being lost.

5.2.1 International Taxation

The study has established that international taxation affects taxation of FDI's in Kenya and to this extent the following are noted:

- A 15% rat e should be considered as rates in EPZs and in less tax-sensitive offshore services in Africa are coalescing around this level. This would provide a competitive tax environment and would likely be acceptable to the OECD under its tax initiative.

- The small number of DTT's and the absence of treaties with neighbouring countries apart from Zambia) are key impediments to the growth of the service sector and the promotion of Kenya as a regional hub as they generate a heavy tax business that amounts to about 50% on foreign source income.

- Efforts to negotiate and ratify a wide network of DTT's with countries in the region and major source of countries of FDI should thus be intensified.

[47] Investment Promotion Centre annual report, 2008

- The need to rapidly develop Kenya as a regional services hub and gain a leadership position to build upon calls for unilateral foreign tax credit to be provided.

It is further suggested that the Government should consider partially funding benchmarking initiatives on a sector-wide area so as to allow the various sectors to assess their performance with respect to regional and global competitors.
It is also proposed that the following steps could serve as the basis for a strategy of attraction of efficiency-seeking FDI services:

- Implementation of an investor-targeting exercise aimed at raising awareness among global services providers of the fiscal incentives, human resources and other strengths available through EPZ's and other investment sectors in Kenya.
- The EPZ should specifically target call centre operators to explore the possibility of setting up more investment areas in Kenya in order to benefit from a large pool of English-speaking and educated people, within a favourable time-zone.
- Support measures may be explored for pioneers inefficiency-seeking services FDI, particularly so as to lower the set-up cost of modern telecommunications infrastructure in an EPZ. In cases where interests arise from services providers needing initial investments in ICT, the Government should consider being expeditious in providing the necessary licences to operate, including for setting up private international gateways.
- Actively promote the development of a cluster of services providers in one EPZ area where efficient telecommunications facilities (voice and broadband data) can be established so as to reap economies of scale.

Although the provision of financial services is not currently allowed in EPZs, the Government may consider exploring whether it has the potential to build upon its well-regarded financial regulatory structure (Central Bank of Kenya and Capital markets Authority), the presence of first-tier foreign banks (Barclays Bank, Citi Bank, Standard Chartered Bank) and recognise local skills to build a regional offshore financial services

centre. This would require market research to establish whether Kenya possesses special competitive advantages either in sources of hard currency funding, or favourable tax treaty arrangements that could generate sizeable offshore deposits by non-residents.

The strength of Kenya's national private sector relative to its neighbouring countries is an asset the Government should build upon to attract foreign investors in search of efficient local suppliers. The objectives of fostering a strong national private sector, increasing the level of FDI and generating maximal linkages and knowledge spillovers are complementary rather than contradictory. In the few sensitive sectors where crowding out of local investors by foreign investors may be an issue, the findings of this study suggest a negative list approach to restricting FDI entry be availed implementation. In all other sectors, the Government should seek to optimize the complementary between foreign investment and national investment through enterprise development and linkages programmes.

5.2.2 The Way Forward

1. Kenya should concentrate on removing aspects of the tax system which constitute impediments to FDI rather than try to develop and design tax incentives to attract it. These aspects would include the overall tax law, level of tax burden, transparency of the tax system, statutory tax rates, the tax base and non-income taxes that are payable even if a company is not making profit.

2. If Tax Incentives do not attract additional investments, they represent nothing but a revenue loss to the government. The Investments therefore should not qualify for the incentives and vice versa. A move to tax credit incentive would assist in reducing abuse and promote long term investment in commercially viable productions.

3. Investments that aim at selling in Kenya's domestic market need not qualify for tax incentives. If the investors are to be located within Kenya for the aim of supplying to the market there, tax incentives for them would be a direct loss to the

Treasury. It may be difficult to identify such investments but among the ways to solve this problem would be a requirement for the investors applying to relocate to Kenya to state their intended market.

4. Special purpose incentives should not be given to some investments. For example incentives to employment creation or regional development or special activities like transfer of technology for that matter that would have occurred in any event should not be granted.

5. Finally, although tax incentives are a cost to the Government, due to factors like competition between countries, pressure from MNE's and the possibility that the incentives may attract more FDI leaves Kenya with very little option than granting some tax incentives.

5.2.3 Limitations of the Study

1. Restrictions on access to information and some of the respondents: - The employees of KRA and EPZ had to continually be reminded to fill in the questionnaires; some took too long and others asked for favours so as to complete the questionnaires. However the researcher visited them from time to time, encouraging them to complete the questionnaires which came to fruition. The employees were unwilling to give their views for fear of victimization. However I explained to them that their views would be treated with utmost confidentiality and that the information would be used solely for academic purposes.

2. Time and cost constraints: - Given the limited time allocated for the research it was not possible to gather to enough data which also limited the researcher's ability to work as intended.

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APPENDIX – TAX RATES

Under the Income Tax Act Cap 470, the VAT Act Cap 417 and Customs and Excise Act Cap 472

KENYA: CAPITAL ALLOWANCES ON INVESTMENTS

- Wear and tear allowances (calculated on cost, net of any investment deduction allowance) on a reducing basis

    - Tractors, lorries ≥ 3 tonnes and similar heavy self propelled vehicles @ **37.5%**
    - **Computer hardware, calculators, copiers and duplicating machines @ 30%**
    - Aircraft @ **25%**
    - Motor vehicles (if not commercial, limited to notional cost of Kshs. 1,000,000) @ **25%**
    - Ships @ **12.5%**
    - Plant and machinery, furniture and fittings and other equipment @ **12.5%**

- Industrial building allowance (calculated on cost, net of any investment deduction allowances on straight line method)
    - Industrial buildings @ **2.5%**
    - Hotels @ **4%**

- Farm works allowance (on costs, straight line method)
    - structures (excluding machinery) necessary for proper operations of a farm @ **33.3%**

- Investment deduction allowance (on cost of buildings and machinery used for manufacturing purposes, on hotel buildings and electricity generation for national grid)

- all eligible assets (dingle allowance) for 2004 to 2008 @ **100%**

- Manufacturing under Bond and EPZ enterprises @ **100%**
- Shipping investment deduction @ **40%**

- Mining allowance (on capital expenditure incurred in mining specified materials)

  - Year 1 @ **40%**
  - Years 2-7 @ **10%**

CORPORATE INCOME TAX RATES

Resident company @ **30%**
Non-resident company (branches) @ **37.5%**
Newly listed company (NLC) @ **27% & 25%**

- **27%** for listed after 1 January 2002 for 3 years following the year of listed and 25% for those listed after 1 January 2003 for five years following the year of listing

EPZ enterprises:

- first ten years – nil
- next ten years – 25%

WITHHOLDING TAX RATES

	Resident payee	Non-resident
Management fee	n/a	20%
Royalties	5%	20%
Leasing equipment	n/a	15%
Dividend < 12.5% voting power	5%	10%
>12.5% voting power	exempt	10%
Interest from financial institutions And government 2 year bearer bonds	15%	15%
Housing bond interest	10%	15%
Rents – immovable property	n/a	30%
Pension and taxable w/drawals from Pension/provident funds	10%-30%	5%
Insurance commissions	10%	20%
Contractual fees	3%	20%
Consultancy and agency fees	5%	20%
Consultancy fee to E.A.. countries	n/a	15%
Surplus pension fund withdrawals	30%	30%
Shipping business	n/a	2.5%