SPECIAL ECONOMIC ZONES
WHAT YOU NEED TO KNOW

Alert

Algeria
Botswana
Ethiopia
Guinea
Kenya
Madagascar
Malawi
Mauritius
Morocco
Mozambique
Nigeria
Rwanda
Sudan
Tanzania
Uganda
Zambia

Regional Office: UAE
Associate Firm: South Africa
INTRODUCTION

In Kenya, an SEZ is a designated geographical area where business-enabling policies are implemented and sector-appropriate on-site and off-site infrastructure and utilities are provided for by the Kenyan Government.

An SEZ has the potential to be developed, whether on a public, private or public-private partnership basis. SEZs are considered to be outside the customs territory of Kenya, and therefore operate in a jurisdictional bubble that shields them from taxes and other regulatory bureaucracy.

The Special Economic Zones Act, 2015 (the “Act”) that establishes SEZs came into force on 15 December 2015. In this alert, we discuss the key provisions of the Act, its legal implications and the key incentives of having a business in an SEZ. The Finance Act, 2017 which was assented to on 21 June 2017 and whose provisions come into force on various dates, introduced various changes to the SEZ regime.

Further, we delve into some commercial and practical considerations that potential investors need to consider when investing in an SEZ enterprise.

To date, the Cabinet Secretary for Industry, Trade and Co-operatives has declared the following parcels of land as SEZs:

- May 2017: Tatu City property: L.R. No 28867 (2,462.7 acres) and L.R. 7192, 7386, 110/2, 111/1, 113/1, 113/2 (2,271 acres) within Kiambu County.
- April 2017: L.R. No. 6170/58 and 59 (700 acres), L.R. No. Eldoret Municipality Block 15/19-132 and 15/151-126 (67 acres) in Kipkenya, Uasin Gishu;
- April 2017: L.R. No. Kiplombe/Kuinet/10 (Shirika)/187 (1,000 acres), Uasin Gishu.
COMMERCIAL CONSIDERATIONS UNDER THE SEZ REGIME

So far, SEZs have been gazetted in Uasin Gishu and Kiambu counties though the Ministry of Industrialisation proposes setting up SEZs in Kisumu, Mombasa and Lamu – areas with fairly well developed transport infrastructure, youthful and educated populations and in need of industrialisation. Naivasha has also been proposed as a potential fourth zone owing to its proximity to cheap geothermal power from Olkaria.

According to the Ministry, it is the Government’s intention to freeze new investment in Export Processing Zones (EPZs) in favour of the more beneficial SEZ regime, with the option to convert from an EPZ to an SEZ.

SETTING UP AND SEZ ENTERPRISE

A company can be registered as a developer, operator, or an enterprise of an SEZ. The following criteria must be met prior to registration:

▷ be a company incorporated in Kenya, for the purpose of undertaking special economic zone activities regardless of whether fully or partly owned by Kenyan citizens. Read together with the Companies Act, 2015, an SEZ can be owned by a single foreign shareholder, as there are no local ownership requirements;

▷ have financial capacity and technical expertise to carry out the SEZ proposed operations;

▷ own or lease land or premise within an SEZ;

▷ engage in any activity eligible to be undertaken by an SEZ; and

▷ not have a negative impact on the environment or engage in activities that are a threat to national security.

BENEFITS OF OPERATING AN SEZ ENTERPRISE

A major benefit of SEZs is the tax shields available to investors as they directly impact return on investment.

These tax shields mean that from a tax perspective, SEZs in Kenya are tax neutral and therefore compete on other efficiencies such as affordable labour with sophisticated skill sets, physical infrastructure, access to land and sea ports.

All goods manufactured in and specified services provided from an SEZ are exempt from most of Kenyan taxes and duties or are subjected to preferential rates.

Particularly, all licenced SEZ enterprises, developers and operators are granted an exemption from excise duty, customs duty, VAT and stamp duty. They are also exempted from acquiring certain licences specific to their businesses. These tax benefits make SEZ goods destined for non-EAC countries competitive on account of the tax exemptions.

In addition, up to 20% of their full time employees can be foreigners. This specific exemption allows SEZ enterprises to profit from skilled foreign staff, making them globally competitive.
COMPARISON OF THE SEZ WITH THE EXPORT PROCESSING ZONES (EPZs)

Export Processing Zones (EPZs) have been in existence in Kenya since 1990. They are governed by the Export Processing Zones Act, 1990.

While SEZs apply to both manufacturers and service providers, EPZs only apply to manufacturers. In this way, SEZs are a much wider incentive regime.

## Comparison of the tax incentives between EPZs and SEZs

<table>
<thead>
<tr>
<th>Tax Aspect</th>
<th>EPZ</th>
<th>SEZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value Added Tax (VAT) – 16%</td>
<td>EPZ enterprises are exempt from VAT registration.</td>
<td>The supply of taxable goods and services to SEZs is zero rated from VAT.</td>
</tr>
<tr>
<td></td>
<td>The supply of taxable goods and services to EPZs is zero rated from VAT.</td>
<td></td>
</tr>
<tr>
<td>Excise Duty – varying rates</td>
<td>Importation of goods and services exempt from excise duty.</td>
<td>Importation of goods and services exempt from excise duty.</td>
</tr>
<tr>
<td>Income Tax – 30%</td>
<td>Exempt for the first 10 years from the date of first sale and at a rate of 25% for the next 10 years thereafter. 30% rate from the 21st year.</td>
<td>10% for the first 10 years of operation, and thereafter 15% subsequent years.</td>
</tr>
<tr>
<td>Withholding Tax – 5% to 20%</td>
<td>Dividends and other payments to non-residents during the 10 year tax holiday.</td>
<td>Payments to non-residents: Interest: 5% Dividend: 0% Management &amp; Professional Fees: 5% Royalties: 5%*</td>
</tr>
<tr>
<td></td>
<td>Subsequently, withholding tax for non-residents applies as follows: Interest: 15% Dividend: 10% Management &amp; Professional Fees: 20% Royalties: 20%</td>
<td></td>
</tr>
</tbody>
</table>
### Tax Aspect

<table>
<thead>
<tr>
<th>EPZ</th>
<th>SEZ</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment Deductions</strong></td>
<td>100% of the capital expenditure on building and machinery in the first year of use.</td>
</tr>
<tr>
<td><strong>Import Declaration Fee – 2%</strong></td>
<td>Goods destined to EPZs are exempt from Import Declaration Fees</td>
</tr>
<tr>
<td><strong>Stamp Duty – Nominal to 4%</strong></td>
<td>Execution of any instrument relating to the EPZ business.</td>
</tr>
<tr>
<td><strong>Railway Development Levy – 1.5%</strong></td>
<td>Applicable on importation</td>
</tr>
<tr>
<td><strong>Export Levy – ad valorem</strong></td>
<td>Exports to EPZs are exempt from Export Levy</td>
</tr>
</tbody>
</table>

SEZ regime also provides for a broader array of incentives (tax and non-tax) as compared to EPZ, particularly, the recognition of service industries as having the same status as mainstay manufacturing and processing concerns. As the definition of “services” under the Act is broad, it would cover a wide array of activities except “government services”. The policy intention of including the service industry into the SEZ regime is to leverage Kenya’s young and educated demographic in industries such as business process outsourcing.

To further enhance the attractiveness of SEZs, the Government should consider abolishing compensating tax (which would be applicable at a rate of up to 42.86%) and thin capitalization restrictions for SEZ operators, developers and enterprises.
THE SEZ AUTHORITY (THE “AUTHORITY”)

The Authority is the regulator of all SEZs. It will be responsible for designing, approving, establishing, developing, operating, promoting and regulating an SEZ. It also issues licences and implements Government policies and programmes. Further, the Authority is in charge of determining the investment criteria and investment thresholds for the businesses in the zone and maintains records of the enterprises and residents operating in each zone.

The Cabinet Secretary for the Ministry of Industry, Trade and Co-operatives (the Ministry) on the recommendation of the Authority is empowered to declare an area as an SEZ and may include:

- Free Trade Zones;
- Industrial Parks;
- Free Ports;
- Information Communication and Technology Parks (ICT Parks);
- Science and Technology Parks;
- Agricultural Zones;
- Tourist and Recreational Zones;
- Business Service Parks; and
- Convention and conference facilities.

TRANSFER PRICING ON DOMESTIC TRANSACTIONS

Currently, transactions between resident related entities are not subject to the Income Tax (Transfer Pricing Rules) 2006 (the TP Rules). However, the Finance Act, 2017 provides that when a resident company under a preferential tax regime transacts with a related resident company not under a preferential tax regime, the TP Rules will apply.

The term “preferential tax regime” refers to the applicability of a preferential rate of taxation including reduction in the tax rate or tax base, such as SEZs or EPZs.

This policy decision points to the Government ringing fencing the numerous tax benefits given to the SEZ sector and could be seen as guarding against abuse and possible revenue leakage.

FREEPORT ZONE AND FREE TRADE ZONE

SEZs are allowed to introduce goods into a Freeport zone, being a designated area generally regarded as being outside the Kenyan customs territory. Further, within a free trade zone, SEZ goods can be offloaded for transshipment, storage, repacking and bulk breaking, all under customs control.

The introduction of a Freeport zone and a free trade zone at the pilot SEZ zone in Mombasa and Lamu will enhance both importation of raw materials and inputs for manufacture and subsequent export of finished goods.
CONCLUSION

The generous tax and regulatory benefits offered under the SEZ regime underpins the Government’s commitment to the economic pillar of Vision 2030, of which attracting foreign direct investment is an integral part.

SEZs need not be viewed merely as an avenue through which global players can invest into Kenya, but also a channel through which local manufacturing and processing entities can enter the global market, by utilizing the SEZ incentives as an incubator.

Businesses in an SEZ are poised to be more competitive in the local and global market thanks to the incentives that are currently being offered.
Daniel Ngumy
Partner
T: +254 (0) 20 364 0267
E: dng@africalegalnetwork.com

Daniel is a Partner at A&K and heads the firm’s Tax Department, specialising in regional and international tax law. He has experience in corporate mergers and acquisitions, private equity, corporate and commercial legal work. He provides ongoing tax advice on matters affecting clients across various industries, including in the banking, insurance, finance, agricultural, power and infrastructure industries.

Daniel was ranked by Chambers Global 2017 in Corporate and Commercial and has over ten years’ experience working for PricewaterhouseCoopers, KPMG and A&K. Daniel is an Advocate of the High Court of Kenya, a Certified Public Accountant and a Certified Public Secretary.

Kenneth Njuguna
Senior Associate
T: +254 (0) 20 364 0312
E: kkn@africalegalnetwork.com

Kenneth is a Senior Associate with A&K with significant experience on Kenyan and cross border taxation. He routinely advises clients on all tax aspects of mergers and acquisitions, joint ventures and corporate restructurings, and regularly handles cross-border transactions. Kenneth also assists clients in complex tax audits and disputes with the Kenya Revenue Authority. He has considerable experience working with a wide variety of multinational clients in corporate matters and has advised on a variety of commercial transactions.

Before joining A&K, Kenneth worked in the tax practice at PricewaterhouseCoopers in Kenya and the United Kingdom. Kenneth is an Advocate of the High Court of Kenya, a Certified Public Accountant and a Certified Public Secretary.