TAX & EXCHANGE CONTROL
ALERT

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CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

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Ready for take off: Kenya introduces a tax incentive for carbon trading

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This incentive is reflected in the Finance Act's amendment of the Third Schedule of the Income Tax Act Cap 470 of the Laws of Kenya. The amendment sets the tax rate for a company operating a carbon market exchange or emission trading system, that is certified by the Nairobi International Financial Centre Authority, at 15% for the first 10 years from the year of commencement of its operations.

The new tax rate, which comes into operation on 1 July 2022, is significantly lower than the ordinary corporate tax rate of 30% currently applied in Kenya.

CARBON MARKET EXCHANGES AND EMISSIONS TRADING SYSTEMS

Carbon exchanges and emission trading systems are part of carbon emission reduction mechanisms which seek to reduce the greenhouse gas emissions resulting from activities that have adverse effects on the environment.

One carbon credit is equal to one tonne of carbon dioxide or the equivalent in other greenhouse gases, and a carbon exchange often utilises traditional trading architecture to provide a central marketplace for buyers and sellers of this intangible product. There are also now exchange initiatives using distributed ledger technology to securitise carbon credits into digital tokens.

Carbon trading operates in both compliance and voluntary markets. In compliance markets, emission targets are legislated and regulated by a central authority that places and enforces an emission limit on regulated entities. Entities that exceed their allowable emissions may purchase carbon credits in accordance with the rules of the emissions trading system.

Voluntary markets, on the other hand, do not have a mandatory enforcement framework for emission reduction. Entities voluntarily offset their emissions based on ethical concerns, corporate social responsibility, or supply chain risk considerations by purchasing carbon credits through forward contracts or in carbon exchanges.

THE ROLE OF THE NAIROBI INTERNATIONAL FINANCIAL CENTRE

The tax incentive for companies operating a carbon market exchange or emission trading system is subject to the company being certified by the Nairobi International Financial Centre (NIFC) Authority.

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The NIFC was established under the NIFC Act Number 25 of 2017. Part of its main objectives are to:

- develop and recommend strategies and incentive structures in collaboration with relevant agencies in order to attract firms to be NIFC firms; and
- review and recommend developments to the legal and regulatory framework in order to develop Kenya as an internationally competitive financial centre.

To realise these objectives, the NIFC Authority has the power to certify firms to conduct activities under the NIFC. Certified firms enjoy the incentive structures laid out to attract responsible, ambitious businesses to Nairobi, and provide them with the conditions to flourish in Kenya and in the region.

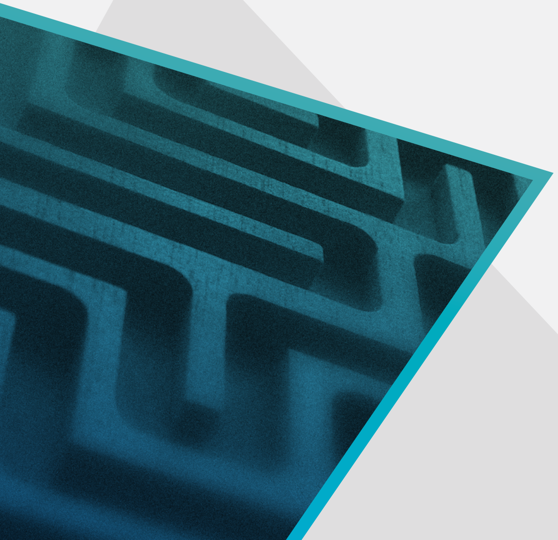
The NIFC officially launches today, 4 July 2022, as a flagship initiative under the economic pillar of Kenya's Vision 2030. The consideration of carbon trading is amongst its inaugural incentive initiatives and is tied to the NIFC's mandate to initially focus on certifying firms that conduct qualified activities, aligned with its four target sectors. Green finance is one of these sectors. At the launch, a collaboration agreement between the NIFC, AirCarbon Exchange and the Nairobi Securities Exchange (NSE) was announced to establish the first carbon exchange in the region.

IMPLICATIONS OF THE NEW INCENTIVE

In May 2021, the Cabinet Secretary in charge of the Ministry of Finance announced that there are plans to set up an emissions trading system in Kenya. Following the introduction of a carbon trading tax incentive, it is evident that the plans continue in earnest. It will therefore be important to keep abreast of any further policy decisions Kenya will take in this regard.

Additionally, for the new tax incentive to foster investment in clean and sustainable business, it will require significant support at both the national and international level.

Kenya first established a carbon exchange in March 2011, through a private sector initiative that saw the launch of the Africa Carbon Exchange (ACX). The ACX aimed to increase Africa's participation in carbon markets through the set-up of a local exchange. This laudable initiative, however, did not take off due to a variety of factors, including the fact that market conditions at the time were not conducive given the rapid fall of carbon credit prices resulting from limited demand and significant oversupply.



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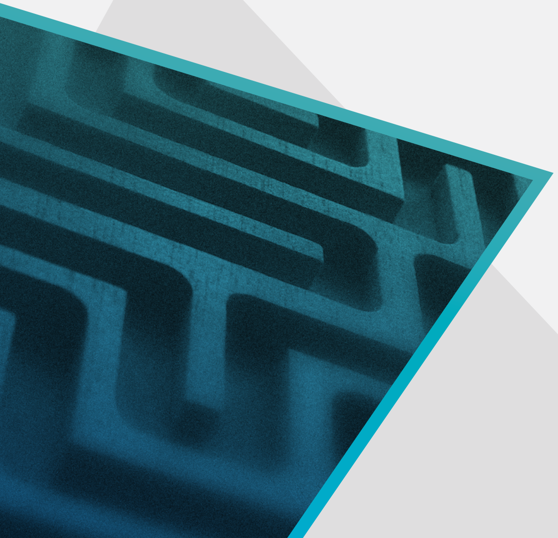
While the current global outlook for carbon markets is positive, with high demand for carbon credits due to a rise in ambition, net zero goals and regulatory compliance requirements, these factors will need to be maintained to sustain a carbon exchange or emission trading system over the long term. On the supply side, increased support for project development will be necessary to ensure a good pipeline of high quality carbon credits that offer significant sustainable development benefits.

With the potential that the new tax incentive holds, it is a welcome addition to Kenya's toolbox for low carbon development. It is likely to be of significant interest to many companies that are keen to benefit from the opportunities it presents.

The collaboration agreement between the NIFC, NSE and AirCarbon Exchange places Kenya on the carbon market runway, ready for take off.

CLARICE WAMBUA AND
ROBERT GITONGA



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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

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