Snapshot of Kenya’s Commercial Laws

REDD+ Law Project - Briefing Paper

July 2014

Dr Sophie Chapman
Research Associate, Cambridge Centre for Climate Change Mitigation Research

Mona Doshi
Partner
Anjarwalla & Khanna (Africa Legal Network), Mombasa office.

The REDD+ Law Project is led by Baker & McKenzie and the Cambridge Centre for Climate Change Mitigation Research (University of Cambridge), working with international and local advisers/institutions to assist countries in the development and implementation of their national REDD+ legal frameworks.

More information regarding this initiative is available at http://www.4cmr.group.cam.ac.uk/research/projects/reddpluslawproject
ABOUT THIS BRIEF

The finance required to halve emissions from the forest sector to 2030 is expected to be substantial, with a role for both the public and private sectors. Early involvement by the private sector has largely been in the role as offset buyers in the voluntary market for forest carbon credits. However, with no certainty that a future REDD+ market will be established, alternative ways for the private sector to participate in REDD+ are being contemplated. Given that REDD+ is increasingly being framed as a sustainable development opportunity that supports ‘green growth,’ the role of the private sector in the REDD+ value chain and ‘green economy’ are being explored at a high level in many countries, including Kenya.

Any commercial activities undertaken as part of REDD+ implementation or, more broadly, as part of ‘green growth’ initiatives in Kenya, will need to operate within the frameworks of existing commercial laws. This Brief provides an overview of the investment climate in Kenya and an introduction to the key commercial laws of Kenya.
1. INVESTMENT CLIMATE IN KENYA

The capacity of any country to attract foreign investment will rely in part on its investment climate. A general overview of Kenya’s investment climate is given below.

Kenya has a liberalized economy, with no foreign exchange and price controls. The private sector has been described as ‘vibrant and market-driven,’¹ with the Government aiming to have ‘minimal interference in business’ and adopting ‘the role of regulator rather than an active participant.’² The United Nations Conference on Trade and Development (UNCTAD) states that “by East African standards, Kenya has a very substantial private sector, including a significant number of foreign investors.”³ Groups representing the private sector include the⁴:

- Kenya Private Sector Alliance (KEPSA);
- Federation of Kenya Employers (FKE);
- Kenya Association of Manufacturers (KAM);
- Eastern Africa Association (EAA);
- Kenya Flower Council (KFC); and
- Fresh Produce Exporters Association of Kenya (FPEAK).

It has been noted that there are limited foreign investment incentives available in Kenya.⁵ Poor infrastructure and complex administrative procedures have been identified as major barriers for foreign investors.⁶ The World Trade Organisation reports that Australia, China, Germany, India and the United Kingdom are the main sources of foreign direct investment (FDI) for Kenya.⁷ The Foreign Investments Protection Act (Cap 158) provides for certain approved investments and incidental matters.

---

Kenya is a member of the East African Community (EAC) together with Burundi, Rwanda, Tanzania and Uganda. Kenya is also a member of the Common Market for East and Central African States (COMESA).

Kenya’s financial and capital markets have been described as ‘among the most sophisticated in the East African region.’\textsuperscript{8} The Central Bank of Kenya, in conjunction with the Treasury, is responsible for Kenya’s financial and banking system\textsuperscript{9}; the banking industry in Kenya has been described as ‘extensive.’\textsuperscript{10} There are more than 40 licensed banks and numerous other financial institutions such as building societies, foreign exchange bureaus and credit reference agencies in Kenya, and banking supervision is described as ‘a high standard.’\textsuperscript{11}

The capital markets (including the Nairobi Stock Exchange) are regulated and supervised by the Capital Markets Authority.\textsuperscript{12} Corporate bonds have been issued by institutions such as the East African Development Bank, local financial institutions and other companies working in different sectors of the economy.\textsuperscript{13}

There are over 40 licensed insurance companies in Kenya (with 2 reinsurance companies); the governing law is the Insurance Act and the regulatory authority is the Insurance Regulatory Authority.\textsuperscript{14}

Kenya is a member of the Multilateral Investment Guarantee Agency (MIGA); the Africa Trade Insurance Agency (ATIA), which insures investors against non-commercial risks; and the International Centre for Settlement of Investment Disputes (ICSID).\textsuperscript{15}

\textsuperscript{8} Kaplan and Stratton (Advocates), Kenyan Business Environment, \url{http://www.kaplanstratton.com/resources/} (last accessed June 14 2013).

\textsuperscript{9} Ibid.

\textsuperscript{10} United Nations Conference on Trade and Development (UNCTAD), An investment guide to Kenya: Opportunities and Conditions (2012); p.18, paragraph 9.

\textsuperscript{11} Kaplan and Stratton (Advocates), Kenyan Business Environment, \url{http://www.kaplanstratton.com/resources/} (last accessed June 14 2013).

\textsuperscript{12} Ibid.

\textsuperscript{13} Ibid.

\textsuperscript{14} United Nations Conference on Trade and Development (UNCTAD), An investment guide to Kenya: Opportunities and Conditions (2012); p.19, paragraph 3-4.

The Export Processing Zones Act (Chapter 517) can provide incentives to certain types of businesses. For example, the Ecofactory at Rukinga Ranch (part of Wildlife Works' Kasigau Corridor REDD Project) is situated within an Export Processing Zone (EPZ).

In 2014, security concerns have prompted travel warnings and affected the level of tourism. It is unclear how security concerns have affected or will affect foreign investment in Kenya's natural resource sectors (such as forestry).
2. COMMERCIAL LAWS IN KENYA

Both REDD+ projects and investments along the REDD+ value chain will be regulated by various laws related to commerce. Key Kenyan laws and provisions are identified below.

2.1 Business structures

The type of business structure used for a REDD+ project or activity will depend on the purpose for which it is to be used, and the number of stakeholders involved. Both not-for-profit and profit-making structures can be formed in Kenya. A summary of the various forms of association are set out in the table below\(^{16}\) (and further details regarding business structures, including joint ventures, are given in Annex 6).

<table>
<thead>
<tr>
<th>Not-for-Profit Associations</th>
<th>Profit-making Associations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Law Trust</td>
<td>Common Law Trust</td>
</tr>
<tr>
<td>Corporate Trust</td>
<td>Corporate Trust</td>
</tr>
<tr>
<td>Company Limited by Guarantee</td>
<td>Company Limited by Guarantee</td>
</tr>
<tr>
<td>Non Governmental Organization (NGO)</td>
<td>Partnership</td>
</tr>
<tr>
<td>Public Benefits Organization (PBO)</td>
<td>Limited Liability Partnership</td>
</tr>
<tr>
<td></td>
<td>Sole Proprietorship</td>
</tr>
<tr>
<td></td>
<td>Company Limited by Shares</td>
</tr>
</tbody>
</table>

\(^{16}\) Before forming a company, a lawyer will seek the following information:
- The intended name of the entity. In the case of a company, three names are ordinarily requested. This is especially important for association where organization’s name requires prior approval;
- The nature of the activities that the intended association is intended to undertake. In the case of a corporate trust these activities must relate to advancement of religion, advancement of education or the alleviation of poverty only. The nature of activities is a critical matter that needs to be well captured so as to avoid challenges on the basis of “ultra vires” i.e. that the entity is not entitled to engage in certain activities since they are not stated;
- If the intended association is a company, the lawyer will need to know whether such a company will be limited by shares or guarantee. The guarantee company is the not-for-profit while the company limited by shares is for-profit association; and
- The full names of the founding members together with their addresses, nationalities and occupations should be provided.
2.2 Taxation

Income tax applies to gains or income received from investments (including projects) in Kenya. There are taxes applying to income generated from land and property ownership activities in Kenya. The Income Tax Act in section 3 provides that all income derived and accrued from Kenya is subject to tax in Kenya.\(^{17}\)

The tax rates depend on whether the foreigners have incorporated a company or whether they are operating through a branch of a foreign company. The rate of tax is 30% in the case of a resident company and 37.5% in the case of a branch, having deducted all expenses incurred wholly and exclusively in the generation of that income.

Value-added Tax (VAT) of 16% of purchase price/value has been introduced on the sale of immoveable property, exempting the sale of residential properties and (arguably) vacant undeveloped land.\(^{18}\)

There are no taxes applicable on the capital amount invested at the inception stage of the project.

Stamp duty applies on purchase of land at the rate of 2% in non-municipal areas and 4% in all other areas.

Currently, there are no export taxes applicable to goods leaving Kenya. VAT is zero-rated in respect of goods manufactured and exported out of Kenya. Similarly, VAT is zero-rated in respect of services exported out of Kenya. However, the income generated from all activities (whether carried on fully in Kenya or partly in Kenya and partly outside of Kenya) will give rise to income tax in the hands of the entity in Kenya.

Currently, the sale of shares on the stock exchange is exempted from transfer taxes. Kenya does not yet have a commodities exchange on which carbon credits are transferred and therefore would not be within the scope of the exemption granted to shares transferred on the stock exchange. That said, the Kenyan stamp duty legislation has not developed to a stage where the sale of a carbon credit is deemed subject of stamp duty. Notwithstanding these points, a carbon credit which is generated in Kenya if sold would give rise to a profit in the hands of the seller of the carbon credit. Accordingly,

\(^{17}\) Accordingly, rental income is subject to tax in Kenya. In the case of a non-resident owner of rental property, the tax applicable is 30% on the gross amount of the rent receivable by the non-resident owner.

\(^{18}\) Opinion of Kenyan advisors.
such a seller would be considered to have made a “gain” which is subject to tax in Kenya, in the same way as a seller of other goods would be subject to income taxes on income generated in Kenya.

2.3 Employment

REDD+ projects or other related activities could require staff, and labour laws will apply. The rights and responsibilities of employees and employers in Kenya is governed by:

- Employment Act 2007;
- Occupational Safety and Health Act 2007;
- Work Injury Benefits Act 2007;
- Labour Relations Act 2007; and

5.4 Insurance

REDD+ projects or other related activities might use insurance to reduce possible liabilities. Commercial insurance is governed by the Insurance Act (Chapter 487). As noted above, there are over 40 licensed insurance companies in Kenya (with 2 reinsurance companies); the regulatory authority is the Insurance Regulatory Authority.19

5.5 Contract

The Law of Contracts Act (Chapter 28) is the law governing contracts in Kenya.

5.5.1 Enforceability

Although legal contracts are enforceable in Kenya, Kenyan courts have significant delays in the hearing and determination of suits.

5.5.2 Capacity to contract

For public owners: Pursuant to the Constitution, government forests, government game reserves, national parks, government animal sanctuaries and any land not classified as private or community land shall vest in and be held by the national government in trust for the people of Kenya and shall be

---

administered on their behalf by the National Land Commission. As the land laws enacted pursuant to the Constitution are relatively new and the National Land Commission has only recently been constituted, it is difficult to determine who would enter the contract on behalf of the Government and who would receive money from a transaction. One option would be for the National Land Commission to enter into the contract on behalf of the Government, or another option would be that the National Land Commission manages the land but directs the Cabinet Secretary responsible for land matters to execute the contract. Subsidiary legislation or guidelines could have a role in regulating these issues.

For community owners: There are two types of community land:

- **Unregistered community land:** The National Land Commission is mandated under Section 5 of the National Land Commission Act to manage and administer all unregistered community land on behalf of the County Government.

- **Registered community land:** Registered community land is elaborately provided for under the Land (Group Representatives) Act. This Act derives its definition of “group” from the Land Adjudication Act: “a tribe, a clan, section, family or other group of persons, whose land under recognized customary law belongs communally to the persons who are for the time being members of the group, together with any person of whose land the group is determined to be the owner.”

  The Land (Group Representatives) Act provides for incorporation of Group Representatives in a procedure in which an identified group elects not more than ten and not less than three persons to be group representatives of the Group. The said Group representatives are incorporated, they have perpetual succession with power to sue and be sued in their corporate name and to acquire, hold, charge and dispose of the group’s property. Any money that needs to be distributed to the group members would need to be paid to the group representatives who would then distribute it to the group members.

Group representatives can enter into a transaction/contract subject to the provisions of their constitutional document. The constitution of the group would provide how the corporate body would execute documents, but execution would be under common seal in the presence of a minimum of three officers. The group representatives would manage the division of revenues amongst the group members.

---

20 S. 8 Land (Group Representatives) Act.
According to section 46(1) of the **Forests Act**, a member of a forest community may together with other members or persons resident in the same area register a Community Forest Association under the **Societies Act** (Chapter 108). Therefore, a CFA is a society, and has the capacity to contract. The rules of any registered society would set out how the society could enter into a contract and who could execute the contract on its behalf. It is a requirement under section 19 of the **Societies Act** (Cap 108) that the constitution of every society should set out the matters specified in the Schedule to the Act which include the trustees of the society, the custody and investment of funds of the society, the property of the society, and the designation of persons responsible for it.

*For private owners:* For private owners, the governing law is the **Law of Contract Act** (Cap. 23).