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# Assessment of tax incentives for contractors in Kenya's upstream oil and gas legislative framework.

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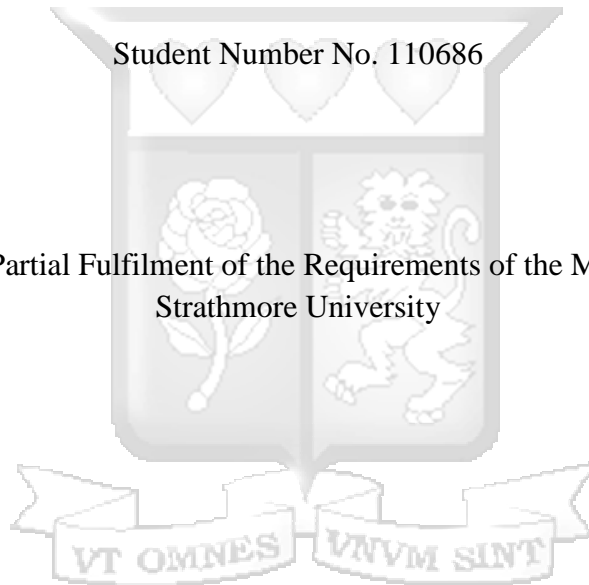
**Assessment of Tax Incentives for Contractors in Kenya's Upstream Oil and Gas  
Legislative Framework**

**By**

Mohamed Bulle Ahmed

Student Number No. 110686

A Thesis Submitted in Partial Fulfilment of the Requirements of the Master of Laws Degree at  
Strathmore University



**Master of Laws  
Strathmore Law School  
Strathmore University  
December, 2021**

## Declaration

I Mohamed Bulle Ahmed declare that this thesis which I submit for the degree of Master of Laws at Strathmore University Law School is my original work and has not previously been submitted for a degree at another University.

Signature.....



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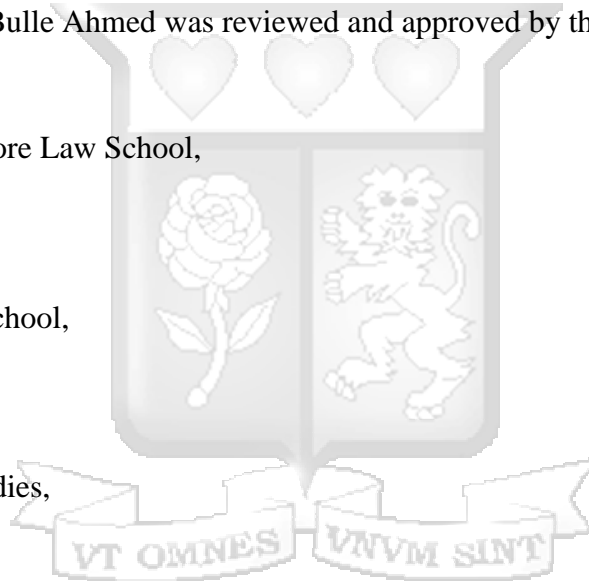
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## Dedication

I dedicate this dissertation work to my loving family who have been very supportive and a source of strength the entire time.

A special feeling of gratitude to my loving father and siblings for being there for me and praying for me.

I also wish to give special thanks to my friends for cheering me on and encouraging me to pursue my dream and complete this dissertation.



## Acknowledgment

Foremost, I would like to express my sincere gratitude to my Supervisor Dr Miyawa Maxwel for the continuous guidance throughout the study and research of this dissertation and for his patience and immense knowledge.

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Lastly but not least I want to thank the almighty God for his faithfulness, providence and for sustaining me this entire time.



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## Abbreviations and Acronyms

<b>BBRs</b>	Balanced Budget Requirements
<b>CIAT</b>	Inter American Centre of Tax Administrations
<b>CMA</b>	Capital Markets Authority
<b>EPZ</b>	Export Processing Zone
<b>FDI</b>	Foreign Direct Investment
<b>FOC</b>	Foreign Oil Company
<b>GDP</b>	Gross Domestic Product
<b>GRIPS</b>	Graduate Institute for Policy Studies
<b>IBD</b>	Industrial Building Deduction
<b>IEA</b>	Institute of Economic Affairs
<b>IMF</b>	International Monetary Fund
<b>IOC</b>	International Oil Company
<b>ITA</b>	Income Tax Act
<b>KMPA</b>	Kenya Model Form Petroleum Agreement
<b>KRA</b>	Kenya Revenue Authority
<b>MENA</b>	Middle East and North Africa
<b>MTP</b>	Medium Term Plan
<b>MUB</b>	Manufacture under Bond
<b>NOC</b>	National Oil Company
<b>NOC-K</b>	National Oil Company of Kenya
<b>OECD</b>	Organization for Economic Cooperation and Development

<b>PSA</b>	Production Sharing Agreement
<b>R &amp; D</b>	Research and Development
<b>SEZs</b>	Special Economic Zones
<b>TJN</b>	Tax Justice Network
<b>TREO</b>	Tax Remission and Exemption Office
<b>UNCTAD</b>	United Nations Conference on Trade and Development



## **List of Constitutions**

Constitution of Kenya, 2010.

Constitution of the Federal Republic of Nigeria, 1994

Constitution of the Republic of Ghana, 1992



## **List of Kenyan Statutes**

Energy Act, 2019

Energy Act No. 12 of 2006

Finance Act, 2014

Petroleum Act, 2019

Petroleum (Exploration and Production) Act, CAP 308, Laws of Kenya.

Income Tax Act, CAP 470, (Schedule IX) Laws of Kenya.

Model Petroleum Production Sharing Agreement (KMPA)

The Natural Resources (Classes of Certain Transactions Subject to Ratification) Act, 2016.

Community Land Act, 2016

Land Laws (Amendment) Act, 2016

Natural Resources (Classes of Transactions Subject to Ratification) Act, 2016

The Mining Act No 12 of 2016

Petroleum (Exploration and Production) Act, PEPA Cap 308, Laws of Kenya

Natural Resources (Classes of Transactions Subject To Ratification) Act No. 41 of 2016

Geothermal Resources Act No. 12 of 1982

The County Allocation of Revenue Act, 2016

The Public Finance Management Act No. 18 Of 2012

Environmental Management and Co-ordination (No.8 of 1998)

## **List of Kenyan Rules and Regulations**

Petroleum (Exploration and Production) Regulations, 1984, L/N 193/1984.

Energy (Petroleum Strategic Stock) Regulations, 2008

Energy (Minimum Operational Stock) Regulations, 2008

Energy (Importation of Petroleum Products) (Quota Allocation) Regulations 2010

Energy (Petroleum Pricing) Regulations, 2010

Energy (Complaints and Disputes Resolution) Regulations, 2012

Energy (Energy Management) Regulations, 2012

Energy (Petroleum Information and Statistics) Regulations, 2013

Energy (Energy Regulatory Commission Petroleum Levy) Order, 2014



## **List of Foreign Legislation (Statutes, Rules and Regulations)**

Petroleum (Exploration and Production) Act, 1984 (PNDCL 84) (Ghana)

Petroleum Profit Tax Act Cap 13 LFN 2004 (Nigeria)

Customs, Excise Tariff (Consolidation) Act 2004 (Nigeria)

Value Added Tax Act 2004 (Nigeria)



## Abstract

Tax and tax related incentives applicable in Kenya's upstream oil and gas sector are defined in two main statutes: The Income Tax Act and the Petroleum Act, 2019. Since 2010, Kenya's taxation regime has undergone numerous developments and of key relevance to this study is the introduction of a separate schedule to the Income Tax Act on taxation of the extractive industry in 2014. The Ninth Schedule separates the taxation treatment of mining and petroleum operations from other sectors of the economy. The incentives provided for under the Ninth Schedule to ITA can be placed into three categories namely: income tax deductions; custom duty exemptions; and value added tax exemptions.

This thesis critically analyses the tax incentives available for international oil companies in the Kenyan law. It identifies the gaps and inconsistencies in the provisions for tax incentives under the Ninth Schedule to the Income Tax Act and the model Production Sharing Contract (PSC) under the Petroleum Act, 2019.

The research methodology used is qualitative research design, utilizing primary and secondary sources of data. It involves review of the legal framework for taxation in the oil and gas sector. Literature materials reviewed included books, journal articles, theses, online sources; as well as statutes, rules and regulations governing taxation in the oil and gas sector. Literature materials analyzed apply to the Kenyan context as well as other jurisdictions such as Ghana and Nigeria. Kenyan literature especially touching on or analyzing the incentives under the fairly recent laws was found to be scanty as few authors have written about them.

The findings of the research are that there are inconsistencies, overlaps and gaps in the Ninth Schedule to the Kenya Income Tax Act (KITA) and the model Production Sharing Contract (PSC) relating to tax and tax-related incentives in the upstream oil and gas sector. The

inconsistencies, overlaps and lack of clarity in effect tend to blur the incentives intended to attract International Oil Companies (IOCs). Ghana and Nigeria have made commendable efforts to establish and impendent tax incentives for IOCs in their oil and gas sector, and few lessons can be drawn from them. The study makes appropriate recommendations on how Kenya can address the challenges identified.



## Chapter One

### Introduction to the Study

#### 1.1 Background to the Study

This thesis critically analyses the tax incentives available for international oil companies in the Kenyan law. It identifies the gaps and inconsistencies in the provisions for tax incentives under the Ninth Schedule to the Income Tax Act and the model Production Sharing Contract (PSC) under the Petroleum Act, 2019.

The extractives industry in Kenya was not robust up until the end of the 20<sup>th</sup> Century.<sup>1</sup> Many areas and aspects in the industry were not adequately regulated by the existing laws of the country. What informed the new additions that were made to the prior regime that regulated the extractives industry was the current exploration and exploitation of minerals that has necessitated the need for a review of the previous laws regulating the mining and energy sectors. The sudden significance of the extractives industry led to the need for a comprehensive policy and legal framework.<sup>2</sup>

The petroleum industry in Kenya broadly falls under three segments: upstream, midstream, and downstream.<sup>3</sup> The processes that take place in the upstream segment are oil and gas exploration, development, and production. As there is no production in Kenya today, this segment is primarily involved in exploration.<sup>4</sup> The midstream segment involves the process

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<sup>1</sup> American Bar Association, available at <[https://www.americanbar.org/content/dam/aba/events/international\\_law/2015/06/Africa%20Forum/Extractive2.pdf](https://www.americanbar.org/content/dam/aba/events/international_law/2015/06/Africa%20Forum/Extractive2.pdf)> ON 18 December, 2018.

<sup>2</sup> American Bar Association.

<sup>3</sup> American Bar Association.

<sup>4</sup> American Bar Association.

around storage, refining and transportation of the crude oil into consumable oil and gas products.<sup>5</sup>

The process at the downstream segment is about the supply and distribution of refined products for instance in the industries and petrol stations so as to reach the consumers. Related studies suggest that there is a fairly well-developed network of transport pipelines storage and retail outlets in Kenya today with a multiplicity of players.<sup>6</sup>

The quest for oil exploration in Kenya began in the 1950s with the first well being drilled in 1960.<sup>7</sup> In 1986, the petroleum exploration and production legislation in Kenya was revised to provide suitable incentives and flexibility to attract international exploration interest in the country hence the Petroleum (Exploration and Production) Act, which commenced on 16<sup>th</sup> November 1986. Despite the results of dry wells, oil exploration works continued because of the indications of oil and gas. In 1991 an in-house study of the Lamu Basin was conducted by the National Oil.<sup>8</sup> The study sought to re-evaluate the existing geological, geophysical and geochemical data relating to the sedimentary basins in Kenya as part of the long-term strategy. Kenya then subdivided the Lamu onshore and offshore into ten exploration blocks. Two or more exploration blocks have been created since 2001.<sup>9</sup>

The recent discovery of more oil and gas in Kenya has sparked interest and discussions on the economic prospects as well as the consequent challenges and reforms in its legal

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<sup>5</sup> American Bar Association. There is only one refinery in Kenya today which is Kenya Petroleum Refineries Limited in Mombasa.

<sup>6</sup> Rift Energy, "Overview of Upstream Oil and Gas Industry in Kenya" pg.1 available at [www.riftenergycorp.com](http://www.riftenergycorp.com) (accessed 14/4/2020).

<sup>7</sup> Mutuma, K, "Kenya's Petroleum Exploration And Production Law: Challenges For Investors, The Government And Local Communities" Master Thesis, (2012) University of Nairobi, available at [http://erepository.uonbi.ac.ke/bitstream/handle/11295/15686/Mutuma\\_Kenya's%20petroleum%20exploration%20and%20production%20law?sequence=1](http://erepository.uonbi.ac.ke/bitstream/handle/11295/15686/Mutuma_Kenya's%20petroleum%20exploration%20and%20production%20law?sequence=1) (last accessed 17/4/2021).

<sup>8</sup> Mutuma, K, "Kenya's Petroleum Exploration And Production Law: Challenges For Investors, The Government And Local Communities" (2012)

<sup>9</sup> Mutuma, K, 'Kenya's Petroleum Exploration and Production Law: Challenges For Investors, The Government And Local Communities' (2012).

framework.<sup>10</sup> The oil and gas industry is an important element of Kenya's development blueprint, the vision 2030. It is an equally significant component needed in the quest for the realization of the big four agenda, the 2017-2022 development blueprint by President Uhuru Kenyatta.<sup>11</sup>

The discovery of oil and gas in Turkana in 2012 by Tullow Oil has arguably provided a great opportunity for Kenya to reposition itself as an economic hub.<sup>12</sup> However, many challenges still lie in the way of the Kenya's bid to successfully realize a developed oil and gas industry. According to Sikwati, the oil and gas discovery in Kenya should be celebrated as a catalyst to transform Kenya into an investment destination and a source of additional revenue to the country.<sup>13</sup> Sikwati observes that if Kenya stays the course to fully implement its new constitutional order, she is likely to escape the 'resource curse.'<sup>14</sup> Studies indicate that many countries have experienced "resource curse" as a result of oil and gas discoveries due to poor management strategies.<sup>15</sup>

The discovery of oil in 2010 has put Kenya on the map of oil producing countries, albeit with minimal oil reserves and a slow pace of production activities.

The Constitution of Kenya 2010 is the overarching law that governs natural resources exploitation and exploration in Kenya. Under Article 69, the state has the responsibility to ensure that the exploitation, utilization, management, and conservation of natural resources is done in a

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<sup>10</sup> Vasquez, P. 'Kenya at a Crossroads: Hopes and Fears Concerning the Development of Oil and Gas Reserves,' *Open Journals Edition*, 2013, <https://journals.openedition.org/poldev/1646> on 27 May 2021.

<sup>11</sup> The big four are: manufacturing, affordable housing, universal health coverage, and food security. See <http://www.big4.president.go.ke/> (last accessed 17/4/2021).

<sup>12</sup> Vasquez, P. „Four Policy Actions to Improve Local Governance of the Oil and Gas Sector“, (2016) 7(1) *International Development Policy*, <<https://journals.openedition.org/poldev/2227?lang=de>> on 01 October 2021.

<sup>13</sup> James Shikwati, 'Oil and Gas: Kenya's Eight Challenges' (Modern Ghana News 24 July 2013).

<sup>14</sup> James Shikwati, 'Oil and Gas: Kenya's Eight Challenges' (Modern Ghana News 24 July 2013).

<sup>15</sup> Johannes E., Zulu L, and Kalipeni E, "Oil discovery in Turkana County, Kenya: A source of conflict or development?" (2014) 34(2) *African Geographical Review*, <[https://www.researchgate.net/publication/261797966\\_Oil\\_discovery\\_in\\_Turkana\\_County\\_Kenya\\_A\\_source\\_of\\_conflict\\_or\\_development](https://www.researchgate.net/publication/261797966_Oil_discovery_in_Turkana_County_Kenya_A_source_of_conflict_or_development)> on 01 October, 2021.

sustainable manner. The state is to also ensure equitable sharing of the accruing benefits. Further, Article 63(3) vests all natural resources including those in the extractive sector to the National Government, to be held in trust for the people of Kenya. In addition, Article 62(f) considers any land containing mineral and mineral oil as public land.

Kenya's Vision 2030 has included oil, gas and other mineral resources as the seventh priority sector with a high potential for spurring the country's economic growth and development. Progress has been made in the review of the legal and regulatory frameworks and institutional restructuring in the extractive sector such as enactment of the Mining Act 2016, Mining and Minerals Policy 2016 and drafting of the Energy Bill and Energy and Petroleum Policy that propose several institutions for the management of oil and gas. However, there is need for an overarching extractive policy that brings the entire sector together in the fiscal management of extractives.

Functioning governance structures, legal and policy instruments as well as institutional capacity for implementation and enforcement are a prerequisite for effective management of the extractive and petroleum industry. It is important to recognize existing institutional and legal frameworks and consider ways and means by which coordination and cooperation can be enhanced through good governance.

It is expected that once these natural resources are exploited the extractive sector will contribute more than ten per cent to GDP by 2030.<sup>16</sup> In addition, the sector will accelerate industrial growth, increase trade and investment thus earn foreign exchange and spur economic growth through infrastructural development. All this could lead to employment creation and

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<sup>16</sup> Hamilton, P. 'Tullow oil reports discovery in northern Kenya,' *The Irish Times*, 17 May 2017, <<https://www.irishtimes.com/business/markets/tullow-oil-reports-discovery-in-northern-kenya-1.3086060>> on 19 April, 2018.

sustainable economic growth and development. However, there are underlying challenges in the legal framework governing the tax incentives in the oil and gas sector.

This study is a critical examination and commentary on the adequacy, or inadequacy, of the taxation regime currently implemented in Kenya to enable the country to attract investors in the oil and gas sector and optimise on the revenue collected from its resources. The revenue may encompass levies, taxes, royalties, profits and rents. The taxation of production on which the Government depends for its revenue was historically determined by the companies on a volume of production and cost recoverable basis.

The regime that governs taxation is the Kenya Income Tax Act (KITA).<sup>17</sup> It sets out the rules that generally apply to tax administration on oil and gas companies in Kenya. KITA defines the rules to be applied in the upstream oil and gas sector under its Ninth Schedule. Where relevant, the oil and gas sector is governed by the general rules in KITA and where there is conflict between the provisions of KITA and the Ninth Schedule, the rules under the Ninth Schedule prevail.

The standard contractual regime in Kenya's upstream oil and gas sector is in the form of the Model Production Sharing Contract (PSC),<sup>18</sup> contained in the Petroleum Act, 2019. Prior to the enactment of the Petroleum Act, 2019, the same were contained in the Petroleum (Exploration and Production) Regulations (the PEPA Regulations), 2012. Pursuant to the standard provisions of PCS, the Ninth Schedule to KITA provides that all income that a

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<sup>17</sup> Chapter 470, *Laws of Kenya*.

<sup>18</sup> The Petroleum Act, 2019 defines a "production sharing contract" to mean a petroleum agreement entered between the Government and the contractor, which enables the contractor to explore, develop and produce petroleum within a contract area. As an illustration, see the PSC signed between the Government and Camac Energy Kenya Limited in 2012, at [https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=2ahUKEwjN\\_o6h2IbfAhVICMAKHwt\\_AmoQFjACegQICBAC&url=https%3A%2F%2Fwww.resourcecontracts.org%2Fcontract%2Focds-591adf-5507758701%2Fdownload%2Fpdf&usg=AOvVaw0CcYYQchyiA95IMFIUhDdt](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=2ahUKEwjN_o6h2IbfAhVICMAKHwt_AmoQFjACegQICBAC&url=https%3A%2F%2Fwww.resourcecontracts.org%2Fcontract%2Focds-591adf-5507758701%2Fdownload%2Fpdf&usg=AOvVaw0CcYYQchyiA95IMFIUhDdt), on December 2018.

contractor is liable to pay to the Government will be deemed to have been paid as a portion of the Government's profit oil.<sup>19</sup> But where a gain is made after an interest under a PSC is disposed, or where there is a tax that the contractor is supposed to deduct from a payment they have made, taxes that are due in that respect do not form part of the tax that is deemed to have been made under this rule.<sup>20</sup>

As such, the net gain from a farm-out transaction (exiting of a contractor from the venture) is aggregated into the transferor's taxable income and taxed at the relevant corporation rate.<sup>21</sup>

Kenya's upstream petroleum regime embodies taxes paid under PSCs. The contractor's share of profit oil under a PSC is received net of income taxes. It is from the state's share of production that the income tax resulting from the petroleum operations by a contractor under a PSC are carved out. This is done through gross-up calculation, although there is no detailed prescription of this methodology.<sup>22</sup>

The PSC does not provide for bonus payments or royalties. These could be essential features to provide tax incentives, which should be detailed under the PSC to enhance investment.

Finally, the model PSC is subordinate to the national statutes applicable to in Kenya. Where changes are made to statutes and such changes affect the economic benefits of a contractor who is a party to a PSC, such In the event that the laws or regulations that impacts the

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<sup>19</sup> Section 5 of the Ninth Schedule to the Income Tax Act.

<sup>20</sup> Section 7 of the Ninth Schedule.

<sup>21</sup> See Anjarwalla & Khanna, 'Oil and gas sector: Kenya guide,' 2016, <<https://www.africalegalnetwork.com/wp-content/uploads/sites/22/2016/08/AK-Oil-Gas-Sector-Kenya-Guide.pdf>> on 17 June 2018.

<sup>22</sup> See Deloitte, 'Oil and gas taxation in Kenya', 2016, at <[https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjN78bn5NzbAhXJthQKHepBDJgQFgglMAA&url=https%3A%2F%2Fwww2.deloitte.com%2Fcontent%2Fdam%2FDeloitte%2Fglobal%2FDocuments%2FEnergy-and-Resources%2Fgx-er-oil-and-gas-taxguide-kenya.pdf&usg=AOvVaw0ja2WS8n\\_GgZDKhuIPgWnb](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjN78bn5NzbAhXJthQKHepBDJgQFgglMAA&url=https%3A%2F%2Fwww2.deloitte.com%2Fcontent%2Fdam%2FDeloitte%2Fglobal%2FDocuments%2FEnergy-and-Resources%2Fgx-er-oil-and-gas-taxguide-kenya.pdf&usg=AOvVaw0ja2WS8n_GgZDKhuIPgWnb)>, on 17 June, 2018.

economic benefits of a party to a PSC are changed, it becomes necessary for the contractor and the government to make relevant contractual adjustments so as to restore the status quo.<sup>23</sup>

From a Host Government (HG) perspective, income tax can be associated with many disadvantages; one of them being the fact that income tax may not be payable during the early stages of production as International Oil Companies (IOCs) are ordinarily allowed to deduct expenses and amortise capital costs early in the life of a project, which is likely to result in IOCs having no, or very little taxable income.<sup>24</sup>

For a country whose extractive industry is as nascent as Kenya, there is on the one side the temptation to try to collect income tax from the IOCs even at the earliest stages of production, while on the other hand, the country seeks to try not to discourage, but rather incentivize investment by ensuring that such tax is not payable until a portion of the capital investment has been recovered. This dilemma is particularly unique to the petroleum sector because initial exploration activities often commence without a guarantee of discoveries and actual return on investment.

The question on whether to maximize taxation and fiscal gains; or permit a delay in taxation until capital investments are recovered is also complex for local communities who expect to gain from the expected resources to understand.

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<sup>23</sup> See Deloitte, 'Oil and gas taxation in Kenya', 2016, <[https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjN78bn5NzbAhXJthQKHepBDJgQFggI1MAA&url=https%3A%2F%2Fwww2.deloitte.com%2Fcontent%2Fdam%2FDeloitte%2Fglobal%2FDocuments%2FEnergy-and-Resources%2Fgx-er-oil-and-gas-taxguide-kenya.pdf&usg=AOvVaw0ja2WS8n\\_GgZDKhuIPgWnb](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjN78bn5NzbAhXJthQKHepBDJgQFggI1MAA&url=https%3A%2F%2Fwww2.deloitte.com%2Fcontent%2Fdam%2FDeloitte%2Fglobal%2FDocuments%2FEnergy-and-Resources%2Fgx-er-oil-and-gas-taxguide-kenya.pdf&usg=AOvVaw0ja2WS8n_GgZDKhuIPgWnb)>, on 17 June 2018.

<sup>24</sup>Claude Duval,Honore Le Leuch,Andre Pertuzio and Jacqueline Lang Weavwer,International Petroleum Exploration and Exploitation Agreements:Legal,Economic and Policy Aspects,2<sup>nd</sup> Edition,New York ;Barrows Company Inc (2009), page 231.

## 1.2 Statement of the Problem

The provisions of the Ninth Schedule to the KITA and the PSC, both relevant to the taxation of the oil and gas sector in Kenya, are not in strict alignment with regard to tax incentives applicable to the upstream oil and gas sector. While the PSC provides for a tax paid regime, the tax paid regime under the Ninth Schedule contains further qualifications, seemingly onerous to contractors' intent on farming out.

Particularly, the net gain from a farm-out transaction (exiting of a contractor from the venture) is aggregated into the taxable income of the company transferring interest and the same is taxed at the rates applicable to all corporations.<sup>25</sup> This may have the undesired effect of disincetivising investors due to the threat of limited gains from a farm-out transaction as a result of onerous taxation. While the PSC would form the substance of the agreement, the applicability of the Act, which contains the mentioned provision may not be totally out of the picture. Additionally, there is no clear structure regarding payable royalties or bonus payments, both of which may be considered key elements of a robust tax incentive regime.

There is consequently a need to consider the overlaps and gaps within the Ninth Schedule and PSC to develop a coherent and appropriate tax incentive structure for both contractors entering into the PSC and transferors or licensees farming-out.

Further, income tax represents a variable cost for IOCs because it is assessed on the basis of profits. While comparatively, it has less distortive effects on investment decisions than do royalties, it may still have a distortive effect because taxation may actually exceed the IOC's

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<sup>25</sup> See Anjarwalla & Khanna, 'Oil and gas sector Kenya guide', 2016, at <https://www.africalegalnetwork.com/wp-content/uploads/sites/22/2016/08/AK-Oil-Gas-Sector-Kenya-Guide.pdf>, on 17 June 2018.

capital, especially at early stages, since cost of capital will generally exceed deductible expenses.<sup>26</sup>

Essentially, this gap between net taxable income and cost of capital means that IOCs will generally be required to pay tax prior to recovering their cost of capital in full.<sup>27</sup> The upshot of it being the consequential discouraging of contractors and investors. This effect is generally magnified in the petroleum industry as compared to other industries due to the higher levels of aggregate taxation. Left unmitigated by the existing fiscal regimes, there might be little or no incentive at all to invest in the petroleum industry.

Moreover, the Kenyan position on royalties is not clearly defined. Kenya Model Production Sharing Agreement under the Petroleum Act, 2019 (MPSA) does not provide for royalties. Royalties are calculated and assessed at a flat rate ranging from 0% to 20%.<sup>28</sup> Such flat rates do not in any way take into consideration the levels and costs of production and hence act as one of the biggest disincentives to produce marginal fields. There is not only a pressing need to re-define the place of royalties in the Kenyan fiscal regime but also to ensure that the assessment of royalties is done using a scale that is equitable for different production levels. If anything, the lack of definitive clarity as regards to Kenya's position on royalties and tax holidays, especially during periods of low oil prices, may disincentivise investors.

### **1.3 Justification of the Study**

Natural resources are one of the four factors of economic growth.<sup>29</sup> There is an obvious need, therefore, to ensure that the applicable regulatory framework is clearly defined and robust.

These attributes serve all the relevant stakeholders, and with a particular emphasis, investors in

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<sup>26</sup> Kemp and Stephen, "Financial Liability for Decommissioning in the UKCS: the Comparative Effects of LOCs, Surety Bonds, and Trust Funds," North Sea Study Occasional Paper No, 103 ,October 2006, p 2.

<sup>27</sup>*Ibid.*

<sup>28</sup> Deloitte, 'Oil and gas taxation in Kenya', 2016.

<sup>29</sup> Kurecic C and Seba S, 'The resource curse in Sub-Saharan Africa: A reality corroborated by the empirical evidence', 1.

the upstream sector. Presumably, a key element valued by investors is the presence of clear incentives, as well as the advantages and disadvantages of a prospective venture. Clearly defined policies and incentives lead to the notions of stability and transparency, factors that are highly valued by investors.

The role of government in establishing a framework to manage and invest revenues derived from oil, gas, and mining projects is crucial to ensure that the sector contributes positively to sustainable development.<sup>30</sup> Particularly, in view of this study, the important input by government would be the harmonisation of the applicable statutory provisions and the PSCs negotiated with foreign contractors. The specific area of focus should be the clarification of various incentives available to such contractors in respect of taxation.

The prevailing taxation framework in Kenya is in need of reassessment to align the incentives under the Ninth Schedule to the KITA and the provisions under the PSC. The results of the research will be useful to the Kenyan government, policy makers, as well as regulatory bodies such as the Kenya Revenue Authority in improving the particular taxation systems and, ultimately, tax and fiscal policies in Kenya generally.

#### **1.4 Objectives of the Study**

This study aims to achieve the following objectives:

- (i) To review and analyse the tax and tax-related incentives in the prevailing legislative and policy framework in Kenya.

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<sup>30</sup> See Muigua K, 'Reflections on managing natural resources and equitable benefit sharing in Kenya', 2016, <<http://www.kmco.co.ke/attachments/article/176/Reflections%20on%20Managing%20Natural%20resources%20and%20Equitable%20Benefit%20Sharing%20in%20Kenya-17th%20November%202017,%20Kariuki%20Muigua.pdf>> on 17 June 2018.

- (ii) To assess and determine whether there are overlaps and gaps in and between the Ninth Schedule to the Kenya Income Tax Act (KITA) and the model Production Sharing Contract (PSC) relating to tax and tax-related incentives in the upstream oil and gas sector.
- (iii) To propose a uniform and clear regime on taxation and tax-related incentives for contractors in the upstream oil and gas industry.

### **1.5 Hypothesis**

This study proceeds on the hypothesis that there are inconsistencies and inadequate integration between the provisions of the Ninth Schedule to the KITA and the model Petroleum Sharing Contract (PSC) under the Petroleum Act, 2019. These two instruments define the tax incentives applicable to companies that deal in the oil and gas sector and the inconsistencies therein tend to dilute the intended purpose of these laws.

### **1.6 Research Questions**

The study aims to answer the following questions:

- (i) What is the legislative position regarding tax and tax-related incentives in the upstream oil and gas sector in Kenya?
- (ii) Are there are overlaps and gaps within the Ninth Schedule to the Kenya Income Tax Act (KITA) and the model PSC with regard to tax and tax-related incentives for contractors in the upstream oil and gas sector.
- (iii) What is the appropriate tax and larger incentive structure to maximise investment in the upstream oil and gas sector?

### **1.7 Conceptual Framework**

#### **1.7.1 Integration as a Principle of Tax Law Design and Drafting**

Integration is a key principle of tax laws, and it is to the effect that a new tax law should be fully integrated into the rest of the legal system. The principle is about ensuring that the legal system and the drafting style of a given jurisdiction is consistent.<sup>31</sup> Not only does the drafter need to be aware of the obvious issues of possible unconstitutionality, but also more subtle questions of conformity with local drafting style and language as well as the legal system in general. This enhances acceptability, understandability, and the effectiveness of the law.<sup>32</sup>

This idea, as a well-settled principle of tax legislation, implies that there should be an internal coherence between pieces of law applying to the taxation regime in a particular sector. This study hypothesises that there is inadequate integration between the Ninth Schedule to the Kenya Income Tax Act (KITA) and the model Production Sharing Contract (PSC), both of which are the operative laws regulating taxation in the upstream oil and gas sector. This is both on a general level and, specifically on the rules around tax incentives.

Tax incentives should be efficient and effective to attract investment for development.<sup>33</sup> According to Moolman and Zwan, a meaningful tax incentive should have at least five features: The tax incentives should be anchored on clear objectives; they should be effective; they should be flexible but stable at the same time; they should be transparent and based on an accountable framework; and lastly, the effectiveness of the tax incentives should be regularly monitored.<sup>34</sup> Coherence and harmony among the applicable laws is therefore a precursor to a meaningful tax incentive.

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<sup>31</sup> International Monetary Fund and Organization for Economic Cooperation and Development “Tax Certainty,” IMF/OECD Report for the G20 Finance Ministers March 2017,” <<https://www.oecd.org/tax/tax-policy/tax-certainty-report-oecd-imf-report-g20-finance-ministers-march-2017.pdf>> (accessed 29 June 2021).

<sup>32</sup> See Thuronyi V, ‘Drafting tax legislation’, in Thuronyi V (Ed), *Tax law design and drafting*, Volume 2, International Monetary Fund, 1998, 99.

<sup>33</sup> Ordu, L.,E. *Tax Incentives in Developing Countries. A Reading on Taxation in Developing Countries*. 3rd Edition. London: Chassel Press. 2016.

<sup>34</sup> Moolman, A & Zwan, P. “An Evaluation of Income Tax Incentives Available to the South African Oil and Gas Industry,” 15(5) *International Business & Economic Research Journal* (2016), <<https://clutejournals.com/index.php/IBER/article/view/9781/9944>> (accessed 23 June 2021).

## 1.7.2 Tax and tax-related Incentives as a Driver of Foreign Direct Investment

Many developing countries offer income tax incentives for investment. These are most often for direct investors as opposed to portfolio investors. The incentives are concerned with real investment in production activities, as opposed to investment in financial assets. Because the domestic capital is not adequate enough to ensure the realization of a country's economic goals, such incentives are often directed towards foreign investment companies. Foreign international companies are often well equipped in terms of the needed modern technology and systems of managing such huge projects.<sup>35</sup>

Tax incentives may impose serious costs on developing and transitioning countries that need to be considered relative to any modest benefits that they have conveyed. More importantly, tax incentives introduce complexity into the tax system, because the rules themselves are complex and because tax authorities react to the tax planning that inevitably results from the introduction of these incentives by putting measures to combat avoidance into place. This complexity imposes costs on administrators and taxpayers, thereby amplifying the uncertainty of tax results.<sup>36</sup> Particularly, the revenue cost is wasted because the investments could go to investments that would have been made in any case.

Considering both the drawbacks and benefits of tax incentives, it becomes the onus of the host government to calibrate if and when tax incentives are required to promote investment, and order the legal regime around this effectively and clearly. It will be proposed by this study that there are specific avenues that can be used to calibrate the tax incentives system in Kenya's upstream oil and gas sector. Similarly, it has been noted that in many countries, the principal

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<sup>35</sup> Holland D and Vann R, 'Income tax incentives for investment', in Thuronyi V (Ed), *Tax law design and drafting*, Volume 2, International Monetary Fund, 1998, 953.

<sup>36</sup> Holland D and Vann R, 1998, 958.

justification for an incentive is to help create a basic amount of market-oriented activity. As the market develops and foreign firms become familiar with a country, the rationale for an incentive reduces.<sup>37</sup>

### **1.8 Research Methodology**

This study uses both primary and secondary sources of data. The method used to acquire information for this research is mainly be qualitative analysis. Fundamentally, the research involves an in-depth review of the relevant tax codes within Kenya’s legislative framework that are relevant to the upstream oil and gas sector. This will be the first part of information-gathering for the study.

The study focuses on secondary sources of information based on library and internet searches including books, book chapters, academic journals, government development blueprints, and internet search engines targeting both published and unpublished materials. This method of research seeks to analyze existing laws, policies and institutional reports in the oil and gas industry.

The objective will be the review of the current situation to identify the specific gaps and their consequences.

The study will pursue a comparative study between Kenya and two jurisdictions, Ghana, and Nigeria that have embraced fairly attractive tax incentives for the upstream oil and gas sector. The oil and gas sectors in Nigeria and Ghana have contributed significantly to their economic growth. This comparative study will constitute the second part of information-gathering. The objective will be to collect unique elements of legally-centred and tax-related incentives incorporated in these countries’ oil, gas and mining sectors.

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<sup>37</sup> Holland D and Vann R, 1998, 965.

The aim of this approach will be to develop a mechanism that will be appropriate for the Kenyan oil and gas industry in ensuring sustainable revenue collection without unduly burdening and thus discouraging the investor.

### **1.9 Limitations of the Study**

The limitations of this study are that first, the Kenyan literature on the subject is quite thin, hence challenges in getting detailed information to support and guide the study. Second, the material relied on in the conduct of comparative study of other countries in Chapter four is secondary data, mainly literature by foreign scholars none of whom has attempted a comparison with other jurisdictions.

### **1.10 Chapter Breakdown**

#### **Chapter One: Introduction**

This is an introductory and explanatory chapter; it has as its central constituents the following; an introduction, statement of the problem, research questions, significance of the study, research methodology, and the literature review. This Proposal will therefore constitute Chapter 1 of the Dissertation.

#### **Chapter Two: The Existing Legal and Institutional Framework for Taxation in the Oil and Gas sector in Kenya.**

This Chapter analyses the available literature on the tax incentives for international oil companies in Kenya and other countries. It involves review of materials such as books, book chapters, journal articles, papers, reports, theses and dissertations, newspaper and magazine articles, and other internet/online sources on the theme.

#### **Chapter Three: Tax Incentives under the Ninth Schedule to the KITA and the Model PSC**

This Chapter looks into the practice in Kenya in respect to taxation and the fiscal management of the petroleum and mining industries. The chapter will identify, discuss

and analyze the existing legal, policy and institutional framework in the petroleum and mining sectors in Kenya.

It points out the various taxes levied on the mining and extractive sectors with a view to identifying the existing gaps therein. Moreover, this Chapter looks into the various tax arrangements that the country has with different investors in the petroleum industry and seeks to analyze the usefulness or lack thereof of such arrangements. It is also in this Chapter that the study considers the practice of fiscal management of the petroleum industry with a view to pointing out the strengths and weaknesses of such arrangements and outlining the opportunities to improve.

#### **Chapter Four: Comparative Study**

This chapter will seek to analyze best practices from other oil producing countries that offer Kenya an opportunity to borrow a leaf. This chapter shall seek to discuss the various models of taxation and fiscal management and how countries like Ghana and Nigeria have to a good extent, benefited from the discovery of oil within their jurisdictions.

#### **Chapter Five: Conclusions and Recommendations**

This being the final chapter of the paper, it will, following from the preceding chapters, conclude and give plausible recommendations on how Kenya can implement a system of taxation and fiscal management for the hydrocarbon sector that considers the interests of the local community, the country as a whole and investors. Moreover, this Chapter makes proposals on how economically sustainable investment policies can be put in place and implemented by the country to facilitate development of the upstream oil and gas sector.

## Chapter Two

### Literature Review on Regulation of Tax Incentives in the Oil and Gas Sector

#### 2.1 Introduction

This Chapter analyses the available literature on the tax incentives for international oil companies in Kenya and other countries. It involves review of materials such as books, book chapters, journal articles, papers, reports, theses and dissertations, newspaper and magazine articles, and other internet/online sources on the theme. The literature is reviewed in a four pronged thematic area informed by the research objectives and the nature of the available literature on the subject: First, review of literature on the tax regime for Kenya's oil and gas sector. Second, review of literature on the general design for tax incentives in the oil and gas sector. Third, review of literature on the role of government in the upstream oil and gas sector. Fourth, review of literature on Nigeria and Ghana's models of tax incentives in their oil and gas sectors.

#### 2.2 The Tax Regime for Kenya's Oil and Gas Sector

In her research reviewing the fiscal regime and tax compliance in the oil and gas industry in Kenya,<sup>38</sup> Chakava finds that Kenya's fiscal regime is robust enough to facilitate collection of taxes from transfer of interests and signature bonus from oil and gas. The main gap noted by Chakava is that in the event of disputes, there is no provision in the fiscal regime for staying proceedings so as to pursue arbitration as provided under the Production Sharing Contract.<sup>39</sup> This implies that there is possibility that revenue can be lost in the parallel processes for dispute

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<sup>38</sup> Chakava, A. L. (2019) 'A Review of the fiscal regime and tax compliance in the oil and gas industry in Kenya,' (Thesis). Strathmore University. <https://suplus.strathmore.edu/handle/11071/6770> on 29 September 2021.

<sup>39</sup> *Ibid.*

resolution.<sup>40</sup> On the flipside, this can also be seen as an advantage in the sense that the tax payer in the sector has various options in dispute resolution. However, Chakava's work does not delve into the tax incentives for upstream oil and gas companies in Kenya.

In another study, Wanyagathi has analyzed the tax regime for the oil and gas sector from an international tax perspective.<sup>41</sup> In the paper, the author offers a critical analysis of the tax incentives applicable to the oil and gas sector and goes further to assess whether or not the incentives are harmful in light of the OECD BEPS Action 5. OECD BEPS Action 5 focuses on countering harmful tax practices, to ensure a leveled playing field for countries.<sup>42</sup> The author also analyses the tax risk areas at the international level, noting that Kenya's current framework addresses most of the international tax risk areas.

Key to this study is the analysis of the relevant provisions of the Income Tax Act where the author notes that the ITA embodies transfer pricing rules, ring fencing rules, thin capitalization, among others. According to Wanyagathi, there is inadequate capacity to audit costs under Kenya's framework. Some of the proposals made in the paper include the need for tax incentives to apply for a limited period of time, to have little room for personal discretion, and to be reviewed so as to enhance effectiveness and efficiency. The author also calls for capacity building and review of legislation to enhance cooperation among government agencies in the oil and gas sector. Wanyagathi's work does not consider the inconsistencies between the provisions for tax incentives under ITA and the model PSC in Kenya. This is the gap that this study seeks to fill.

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<sup>40</sup> *Ibid.*

<sup>41</sup> Wanyagathi Maina, Anne, "The Kenyan Tax Regime for the Oil and Gas Sector: An International Tax Perspective to Policy and Practical Challenges," May 8, 2019), available at SSRN: <https://ssrn.com/abstract=3385060>

<sup>42</sup> *Ibid.*

In a working paper analysing Kenya's oil governance regime, Mwabu has reviewed the applicable policies, identified challenges and made policy proposals.<sup>43</sup> According to Mwabu, governance regimes in the oil sector determine the welfare outcomes and the economy-wide effects of the oil sector.<sup>44</sup> The design and implementation of the governance structures in the extractive industry have a bearing on whether the immediate population needs can get satisfied, and whether such benefits can be sustained for future generations as the livelihood of the local communities is improved.

Mwabu seeks to establish how governance structures can be designed to avoid oil curse and enhance economic and social benefits linked to the discovery of oil in Kenya. The author in discussing the anticipated challenges looks at the adequacy of the legal and regulatory framework in curbing rent seeking and preventing ethnic conflicts often brought about by disagreements in sharing of oil benefits.<sup>45</sup> Although Mwabu's work contributes useful literature on the general aspects of governance of the oil and gas sector in Kenya, it does not discuss tax related incentives in the sector and the gaps and/or inconsistencies with Kenya's model PSC.

In a thesis on the effects of tax incentives on the performance of export processing zone (EPZ) firms in Kenya, Kuria sought to establish the influence of tax incentives in Kenya on the performance of EPZ firms. The author attempted to find out what influence the corporate income tax, capital allowance tax incentive, the VAT incentive, excise duty tax incentive and custom duty incentive has on how EPZ firms perform in Kenya.<sup>46</sup> The author underscores the need for

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<sup>43</sup> Mwabu, G., "Kenya's oil governance regime: Challenges and policies," Centre for Research on Peace and Development (CRPD) Working Paper No. 71, 2018, available at <https://soc.kuleuven.be/crpd/files/working-papers/crpd-no-71-mwabu-full.pdf> (accessed 29 September, 2021).

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid.*

<sup>46</sup> Kuria, J.K., 'Effects of Tax Incentives on the Performance of Export Processing Zone (EPZ) firms in Kenya,' A Dissertation Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Award of the Degree of Doctor of Business Administration (DBA) (2016),

the stakeholders to be aware of the role of tax incentives in investments as well as the need to understand the importance of these tax incentives. One of the findings of the study is that corporate income tax incentive had a positive and significant relationship with performance of EPZ firms.

The study concluded that tax incentives are valuable in attracting EPZ firms, although the survival of these firms also depends on factors other than tax incentives. The study concluded that the government should continue to offer tax exemptions for it to attract and maintain foreign investors in the country.<sup>47</sup>

This was largely an empirical study that adopted both qualitative and quantitative methods of data collection. The study did not review the existing laws and policies to establish their effectiveness. It also focused on EPX firms in general, as opposed to oil and gas companies that this research centers on.

In a related study, Mahero has analysed the influence of government regulatory and fiscal policy requirements on foreign direct investment in the oil and gas sector Kenya.<sup>48</sup> The study notes that despite efforts by the Government to promote the oil and gas sector through different ways including provision of incentives to IOCs, attraction of FDI in the sector has slowed down. This, according to the study, is demonstrated by the low uptake of new oil blocks and low-key work programmes.<sup>49</sup> Critically, one of the challenges facing the sector according to Mahero's findings is that incentives under PSCs were not being honored by the Government at the national

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<<http://erepo.usiu.ac.ke/bitstream/handle/11732/3650/JOHN%20NJOROGI%20KURIA%20DBA%202017.pdf?sequence=1&isAllowed=y>> on 01 October 2021.

<sup>47</sup> *Ibid.*

<sup>48</sup> Mahero, A., 'Influence of Government Regulatory and Fiscal Policy Requirements on Foreign Direct Investment in the Oil and Gas Sector Kenya,' Masters Thesis, University of Nairobi, (2018), <<http://erepository.uonbi.ac.ke/bitstream/handle/11295/106388/Mahero%20Arnold.pdf?sequence=1>> on 01 October, 2021.

<sup>49</sup> *Ibid.*

and county government levels.<sup>50</sup> One of his other relevant findings is that the policy incentives targeting the sector such as exemptions on import and export related taxes have increased availability of capital for IOCs only to a low extent.

Mahero also found that there is a positive relationship between government regulatory and fiscal policy requirements in the oil and gas sector and FDI. He makes recommendations for a balanced policy review geared towards spurring FDIs and ensuring fair revenue collection and adequate control by the Government. Significantly, he also calls for the review of the fiscal policy requirements to ensure they do not water down the incentives under the respective PSCs.<sup>51</sup>

Mahero's study does not dig deep into the nature of tax incentives provided by the government in the oil and gas sector, hence leaving a gap for this research to fill. He does not analyze the specific laws and policies establishing the incentives, but rather generalizes them as fiscal policies.

Wasuna and Ombaki working under the auspices of the Extractives Policy Working Group have published a paper on revenue sharing and management in Kenya's petroleum sector.<sup>52</sup> The paper highlights the dialogues on local content sharing in Kenya in the wake of the recent oil discoveries and increased activities in the extractive industry. According to the paper, one of the challenges facing Kenya's oil and gas sector is the lack of specialized or technical skills and poor infrastructure. These hamper the efforts for Kenya to reap the greatest benefits from the sector. The paper explores the concept of local content in Kenya's petroleum sector that was and is still evolving in the context of new oil discoveries and the controversies that emerged

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<sup>50</sup> *Ibid*, p 31.

<sup>51</sup> *Ibid*, p 44.

<sup>52</sup> Wasunna M.K. and James K. Ombaki J.K, 'Kenya Extractives Policy Dialogues Paper No. 2: Developing a Sustainable In-Country Value Addition Strategy: Real-Time Policy Options for Kenya's Petroleum Sector,' Extractives Baraza – Strathmore University, <<https://www.opml.co.uk/files/Publications/a0648-kenya-extractives-programme/extractives-policy-working-group-epwg-paper-2.pdf?noredirect=1>> on 29 September 2021.

from different interest groups. According to the paper, the term “Local Content” is defined as “the added value brought to the Kenyan economy from extractive industry through systematic development of national capacity and capabilities and investment in developing and procuring locally available work force, services and supplies, for the sharing of accruing benefits.”

Although the paper gives premium to the local agenda and explains the ways in which locals can maximize their benefits from the oil and gas sector, it acknowledges the need for the government to provide fiscal incentives to IOCs as this is an important factor in elevating and building local enterprises to make them internationally competitive.<sup>53</sup>

Relatedly, a 2014 study on Kenya’s predicted that there would be political, social and security risks that would impact Kenya’s oil and gas sector.<sup>54</sup> Patey remarks that during the exploration phase, that is, the initial efforts to discover oil, the oil and gas industry is relatively free from regulatory constraints and political interference. However, this scenario changes when it comes to the development and production stages and the industry cannot be insulated from the attendant risks completely. Patey notes that as at 2014, Kenya’s regulatory environment for the oil industry was still in flux. At that moment, Kenya was still debating various bills touching on the sector, most of which were later reviewed and passed into legislation in 2019.<sup>55</sup>

The author opined that there were fears the government could exploit new rules and regulations to advance political and economic goals that would impact negatively in the sector.<sup>56</sup> Patey also argues that the Constitution of Kenya 2010 that introduced the devolved system of government was a major factor as developments in the oil sector would also be depended on

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<sup>53</sup> *Ibid*, p 21-22.

<sup>54</sup> Patey, L., ‘Kenya: An African oil upstart in transition,’ (2014), *Oxford Institute for Energy Studies* Paper 53, <<https://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/10/WPM-53.pdf>> on 01 October, 2021.

<sup>55</sup> These include the National Energy Bill of 2014.

<sup>56</sup> *Ibid*.

whether devolution would be implemented or not.<sup>57</sup> He further highlights the tensions between local communities who feel entitled to the benefits of oil discovers and the IOCs and national government on the other hand.

Another paper on oil and gas taxation in Kenya has not only provided a general review of taxation of the sector, it has also described the available incentives to companies involved.<sup>58</sup> The paper by Deloitte sums up the incentives under the Ninth Schedule to KITA which provides for specific deductions made in determining taxable income. These include exploration costs, development expenditure, and operating costs.<sup>59</sup> It also points out the other tax incentives apart from income tax deductions, such as custom duty exemptions and VAT exemptions. The paper is however merely descriptive and does not deeply analyze the said incentives in light of the legal framework that governs them and how they are applied in the context of the model PSC.

### **2.3 The General Design for Tax Incentives in the Oil and Gas Sector**

An OECD study report has also analysed the options for low income countries' effective and efficient use of tax incentives for investment.<sup>60</sup> The report calls for a careful design of tax incentives so as to ensure effectiveness and efficiency.<sup>61</sup> According to the report, tax incentives that target sectors that produce for domestic markets or extractive industries have little impact in general. On the other hand, those that are aimed at export oriented sectors and mobile capital are seen to be relatively effective. To ensure effectiveness, the report states that there is need for enabling conditions such as good infrastructure, economic stability, rule of law, among others.

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<sup>57</sup> *Ibid.*

<sup>58</sup> Deloitte, 'Oil and gas taxation in Kenya', at <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Energy-and-Resources/gx-er-oil-and-gas-taxguide-kenya.pdf>, on 17 June, 2018.

<sup>59</sup> *Ibid.*, p 6.

<sup>60</sup> OECD, "Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment," A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank (2015), available at <https://www.oecd.org/tax/tax-global/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.pdf> (accessed 29 September, 2021).

<sup>61</sup> *Ibid.*

The report also calls for good governance of the incentives as this entails a critical aspect for effectiveness and efficiency. Another crucial enable condition is transparency as this facilitates accountability and reduces chances of corruption and rent seeking.<sup>62</sup>

Remarkably, the OECD report also advocates for the consolidation of tax incentives under the prevailing tax laws in the concerned countries. It also recommends the review of the fiscal costs annually as part of a tax-expenditure review. The report also finds that there are numerous countries which have reformed their tax incentive regimes effectively even though there are political obstacles. Grant of tax incentives should ordinarily be based on rules, not discretion.

To facilitate informed decision making, there is need for more systematic evaluations. The OECD report notes that effectiveness and efficiency of tax incentives in low income countries cannot be assessed because of lack of data, the necessary analytical tools, and skills. The report attempts to address this by providing a guide on how to develop data and tools of systematic analysis, and recommends collective action by all stakeholders.<sup>63</sup>

The OECD report gives insights on tax incentives in general, but fails to address Kenya's situation in particular and the issue of inconsistencies in the legal framework governing tax incentives in the oil and gas sector.

The *United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries*<sup>64</sup> highlights key points of considering in designing a tax framework for the extractive industry in countries such as Kenya. The handbook highlights some of the issues that developing countries should bear in mind when designing tax policies and

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<sup>62</sup> *Ibid.*

<sup>63</sup> *Ibid.*

<sup>64</sup> United Nations, *United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries*, (2017) <[https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook\\_2017.pdf](https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook_2017.pdf)> on 01 October, 2021.

when negotiating new contracts for the exploration and exploitation of oil and gas in their jurisdictions.

Notably, the handbook proposes a tax policy legislative design that speaks to, among others, where the income tax provisions for the sector should be located. In that regard, the handbook proposes four options for location of income tax provisions for the sector. First, it proposes that there can be a separate omnibus law that is applicable to extractive industries which cover both tax and non-tax subjects. Second, there can be established a chapter or part in the corporate income tax legislation that covers the extractive sector and includes decommissioning related provisions. Third, the handbook proposes that the sector law, that is, the oil and gas law or mining law as the case may be can have a tax chapter. The fourth option proposed under the handbook is that there can be a contractual obligation between the government and the licensee.<sup>65</sup>

The UN handbook goes ahead to give insights on the key considerations in the location of any legislation. Duplication should be avoided and to the largest extent possible, definitions should be harmonized especially in instances where a country opts to place tax rules in a special tax legislation and the general decommissioning requirements in the sector legislation. The handbook emphasizes the need to ensure that the tax law follows the definitions and tests used in the sector legislation, and that the tax law “does not seek to duplicate or create alternative tests for tax purposes, whether by statute or by regulations.”<sup>66</sup> This literature material is particularly relevant to the study of Kenya’s legislation governing taxation in the oil and gas industry where focus is on inconsistencies between the main tax legislation and the model PSC. It informs the

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<sup>65</sup> *Ibid*, p 322

<sup>66</sup> *Ibid*.

key recommendations in this study on the need for review of the tax legislation to conform with the sector law.

## 2.4 General Role of Government in the Upstream Oil and Gas Sector

What is the role of the state in the upstream oil and gas sector? Host governments, in seeking economic rent on their natural resources do so through enactment of a hydrocarbon law that enshrines legal and fiscal regimes governing the grant of exploration, development and production rights.<sup>67</sup> Such rights, as discussed by Johnson, include production rights in particular areas by means and methods such as concessions or contracts.<sup>68</sup> These fiscal regimes, Tordo opines, are crucial due to the fact that they outline and embolden the obligations and rights of the host government on the one hand and the international oil company (IOC) on the other.<sup>69</sup> Further, according to Johnson, it is essential to classify these fiscal regimes as either contractual base systems or concessionary based systems.<sup>70</sup>

As mentioned earlier, the role of government in establishing a framework to manage and invest revenues derived from oil, gas, and mining projects is crucial to ensure that the sector contributes positively to sustainable development.<sup>71</sup>

While some countries nationalize their extractive industry resources, others tighten control over privately owned firms.<sup>72</sup> Orazgaliyev in his paper has attempted to explain why countries opt for state-owned enterprises and why states that are rich in energy choose to

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<sup>67</sup> See Tordo. S, *Fiscal systems for hydrocarbons- Design issues*, World Bank Working Paper No 123, August 2007.

<sup>68</sup> See Johnson. D, *International Fiscal Systems and Production Sharing Contracts*, PennWell:Oklahoma, 1994.

<sup>69</sup> See Tordo. S, *Fiscal systems for hydrocarbons- Design issues*.

<sup>70</sup> See Johnson. D, 1994.

<sup>71</sup> See Muigua K, 'Reflections on managing natural resources and equitable benefit sharing in Kenya', 2016, at <<http://www.kmco.co.ke/attachments/article/176/Reflections%20on%20Managing%20Natural%20resources%20and%20Equitable%20Benefit%20Sharing%20in%20Kenya-17th%20November%202017,%20Kariuki%20Muigua.pdf>> on 17 June 2018.

<sup>72</sup> Serik Orazgaliyev, "State Ownership and Nationalization in Energy Sector: The Case of Kazakhstan's Oil Industry," ADBI Working Paper Series, <https://www.adb.org/sites/default/files/publication/541026/adbi-wp1042.pdf>

nationalize their oil and gas industries.<sup>73</sup> Orazgaliyev finds that although state owned enterprises have been declining since 1970s, the case is different for the oil and gas sector where state owned national oil companies have continued to be embraced and elevated.<sup>74</sup> It is believed that by states entrenching their participation in the extractive industry, they actually seek to declare sovereignty over the possession of national wealth. Hence the concentration of energy resources in the hands of national oil companies by many states since the 1970s.

According to Rossiaud, the functional effectiveness of an oil governance structure depends on the consistency between the role of the NOC in this structure and the state's capacity to ensure effective regulation through contracts.<sup>75</sup>

## **2.5 Literature Review on the Tax Incentives for Nigeria and Ghana's Oil and Gas Sector**

Ghana and Nigeria are oil producing countries in Kenya and they have been chosen for this study's comparative analysis in Chapter 4. There is a significant volume of literature on the tax incentives in Nigeria and Ghana's oil and gas sector from different angles. This section will only highlight a few.

Kyar has analyzed the impact of petroleum tax incentives on Foreign Direct Investment (FDI) in flow in Nigeria.<sup>76</sup> In this work, the author attempts to find out the extent to which the petroleum tax incentives in Nigeria are appropriate in attracting FDI. Among his findings, the author concludes that the tax incentives in Nigeria's petroleum sector are "sufficient in number and appropriate in mix" in attracting FDI, hence the tax incentive package is suitable for the

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<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

<sup>75</sup> Rossiaud S., 'Opening the upstream oil industry to private companies: An analysis based on transaction cost economics,' (2014), <[https://halshs.archives-ouvertes.fr/halshs-00960681/file/CR2-2014\\_Rossiaud\\_Opening-the-upstream.pdf](https://halshs.archives-ouvertes.fr/halshs-00960681/file/CR2-2014_Rossiaud_Opening-the-upstream.pdf)> on 29 September 2021.

<sup>76</sup> Kyari, A.K., "The Impact of Petroleum Tax Incentives on Foreign Direct Investment Inflow: Evidence from Nigeria," , 2020, 10(4), *International Journal of Energy Economics and Policy*, 516-524.

purpose of attracting FDI in the oil and gas sector.<sup>77</sup> The work gives insights to this research in the comparative study of Nigeria.

A related journal paper has also considered the effect of tax incentives on foreign direct investment in the petroleum industry in Nigeria.<sup>78</sup> Incentives for oil and gas companies in Nigeria are in the nature of allowable deductions, capital allowance, credit allowance, and petroleum investment tax allowance.<sup>79</sup> The paper which sought to, *inter alia*, examine the effect tax incentives such as the investment tax allowance on foreign direct investments found that they indeed have significant effect on FDI. The paper concludes that tax incentives enable companies enjoying them to create employment opportunities in highlight taxed regions hence impacting positively on the living standards of the people. It makes recommendation for elimination of double taxation and the effective implementation of tax incentives to ensure companies actually benefit. Although the focus of the paper is on general tax incentives with no analysis of Nigeria's production sharing contracts, it provides relevant insights to this study's comparative analysis.

Ocran *et al* have evaluated the boundary applicability of the Ghana's oil block fiscal regimes following the commercial discoveries of hydrocarbons in Deepwater Tano-Cape Three Point, the Jubilee field.<sup>80</sup> The authors assess the applicability of Ghana's fiscal regime at varying boundary conditions of oil price and field reserves. It is their finding that Ghana's Jubilee field fiscal regime is fairly attractive and flexible and ensures stable shares of economic rents between the State and the contractor as the profitability of the field increases.

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<sup>77</sup> *Ibid.*

<sup>78</sup> Arzizeh T. Tapang, Benjamin E. Onodi & Akachukwu H. Amarihu, "Effect of Tax Incentives on Foreign Direct Investment in the Petroleum Industry in Nigeria," (2018) 4(7), *IIARD International Journal of Economics and Business Management*.

<sup>79</sup> *Ibid*, p 34.

<sup>80</sup> Ocran, D., Broni-Bediako, E and Ofori-Sarpong, G. (2019), "Boundary Applicability of the Ghana's Oil Block Fiscal Regimes," (2019) 19(2), *Ghana Mining Journal*, 70-76.

In another study, Kankan and Ackah have evaluated Ghana's upstream petroleum fiscal regime, including state and investor shares and attempted to compare it with petroleum fiscal regimes of some six other oil producing African countries.<sup>81</sup> In their qualitative assessment, the authors compared the regimes on general taxation and petroleum taxation in particular. Out of the seven regimes used in the quantitative analysis, the study found that the Ghanaian regime ranks sixth in terms of government take. The authors conclude that though the Ghanaian fiscal regime appears to be progressive; thin capitalisation, royalty rate, and cost recovery limits withholding taxes on interest. The paper recommends the tying of additional oil entitlements to profits in future reviews of the Ghanaian fiscal regime.

In another work, Abudu and Sai have examined the challenges and prospects of the petroleum industry in Ghana.<sup>82</sup> The authors adopted what they term as "innovative and transparent systematic literature review technique."<sup>83</sup> The study appraises the selected literature where scholars evaluated previous studies into qualitative and quantitative literature. The authors analyze and synthesize the literature with both narrative and triangulation techniques. Their conclusion is that Ghana's previous literature on the subject is disjointed and mainly focus on two topics; descriptive content petroleum policy and on descriptive petroleum statistics.<sup>84</sup>

## **2.6 Conclusion**

The literature reviewed indicates that tremendous effort has been by researchers to conceptualize and problematize tax incentives in the oil and gas sector. Focus of the available Kenyan literature is however on general aspects of governance of the oil and gas activities. Kenyan literature especially touching on or analyzing the incentives under the fairly recent laws

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<sup>81</sup> Kankam D and Ackah I, "The Optimal Petroleum Fiscal Regime for Ghana: An Analysis of Available Alternatives," (2014) 4(3) *International Journal of Energy Economics and Policy*, 400-410.

<sup>82</sup> Abudu H. and Sai R, "Examining prospects and challenges of Ghana's petroleum industry: A systematic review," (2020) 6, *Energy Reports*, 841-858.

<sup>83</sup> *Ibid.*

<sup>84</sup> *Ibid.*

was found to be scanty as few authors have written about them. There is therefore need for research to fill the gap on the legal framework on tax incentives for IOCs in the context of Kenya's oil and gas sector.



## Chapter Three

### Tax Incentives Under the Ninth Schedule to the Income Tax Act and the Model Production Sharing Contract

#### 3.1 Introduction

The government of Kenya has acknowledged the importance of oil and other mineral resources to facilitate the economic growth of Kenya. This has further led to the sector of oil and other mineral resources being identified and prioritized under the Economic Pillar of Kenya Vision 2030.<sup>85</sup> Generally, Kenya's tax regime offers incentives to attract foreign investment, which include Special Economic Zones (SEZ), Export Processing Zones (EPZ), enhanced capital allowances, and exemption from import duty and value added tax (VAT).<sup>86</sup>

The practice of oil and gas in Kenya is subject to the provisions of the Ninth Schedule which provides for its application to a licensee (a person who is granted a mining right); Contractor (a person with the government has concluded a petroleum agreement); and Subcontractor (a person supplying services as an employee to a licensee in respect of mining operations that is undertaken by the licensee or a contractor in respect of petroleum operations undertaken by the contractor).

This Chapter looks into the practice in Kenya as regards taxation and the fiscal management of the oil and gas industry. It points out the various taxes levied on the mining and extractive sector with a view to pointing out the existing gaps therein. Moreover, this Chapter looks into the various tax arrangements that the country has with various investors in the petroleum industry and seeks to analyze the usefulness or lack thereof of such arrangements. It is

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<sup>85</sup> See Kenya Vision 2013, < <https://www.sidint.net/files/docs/Kenya%20Vision%202030%20Complete.pdf> > on 28 May 2021.

<sup>86</sup> Maina, A.N, "The Kenyan tax regime for the Oil and Gas Sector: An International Tax Perspective to Policy and Practical Challenges," p 207-219.

also in this Chapter that the study considers the practice of fiscal management of the petroleum industry with a view to pointing out the strengths and weaknesses of such arrangements and outlining the opportunities to improve.

The Ninth Schedule of the Income Tax Act is instructive on the taxation of the various contractors involved in petroleum extraction in Kenya. The Act provides that for resident and non-resident companies, a rate of thirty percent (30%) and thirty seven and a half percent (37.5%) is the respective applicable income tax.

Strikingly, Section 8 of the Ninth Schedule of the Income Tax Act tends to proffer certain advantages to contractors such as the fact that if a contractor incurs losses in a particular contract area during an income year, such an amount of loss shall be carried forward and allowed as a deduction against income in the petroleum operations in the next year of income of the contractor.<sup>87</sup> Oil and gas companies in Kenya are allowed to carry forward losses incurred in their operations indefinitely. The companies are also permitted to carry back losses arising in the final year of production for up to three years. However, it is notable that no carry back is allowed under general tax rules.<sup>88</sup> Moreover, under to paragraph five of Section 8 of the Ninth Schedule of the Income Tax Act, a contractor who has stopped conducting petroleum operations under a contract in a given year of income and who has incurred losses from the said petroleum operations has the option of treating that loss as a loss that relates to petroleum operations conducted in the previous year of income. Such a contractor is obliged to notify the commissioner if they so elect to have the loss treated as such.

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<sup>87</sup> Income Tax Act, 2014 Ninth Schedule Part III, S.7(3)

<sup>88</sup> See Deloitte, 'Oil and gas taxation in Kenya', at <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Energy-and-Resources/gx-er-oil-and-gas-taxguide-kenya.pdf>, on 17 June, 2018.

At the core of this study's objectives lies the analysis of the divergent and practical analogies around the taxation and fiscal management of the petroleum extraction industry to establish a clear legal and institutional framework for Kenya. It analyses the pros and cons that are evident in the legal regime and assesses appropriate methods for strengthening it, not only for the maximization of revenue, but also to establish a system that is investor friendly. Particular focus, as earlier stated, will be on the alignment of the Ninth Schedule to the KITA and the model PSC for Kenya.

The chapter identifies and analyzes the existing legal, policy and institutional framework in the oil and gas sector. This analysis is aimed at examining the adequacy and efficiency of the law in regards to taxation and fiscal management as well as highlighting any loopholes that need to be sealed. This chapter also considers the various legislations and their potential to fill the relevant gaps.

### **3.2 Legal Framework Governing the Oil and Gas Sector in Kenya**

Following the promulgation of the Constitution of Kenya, 2010; the adoption of the Kenya Vision 2030 and subsequently the Energy and Petroleum Policy, 2015, put in place were provisions providing incentives for local and international investments in the energy and petroleum sector to foster international co-operation in energy and petroleum trade, investments and development.

Currently, the legal framework for taxation in the Oil and Gas sector in Kenya includes the Constitution of Kenya 2010 and three key legislations, namely the Petroleum Act, 2019 and the Energy Act, 2019 that were signed into law in March 2019, and the Ninth Schedule to the

KITA.<sup>89</sup> The Energy and Petroleum Policy, 2015 is also part of the legal framework on taxation in the oil and gas sector in Kenya. Prior to the enactment of the Petroleum Act 2019 and the Energy Act 2019, the sector was mainly governed by the following: Petroleum (Exploration and Production) Act (PEPA);<sup>90</sup> the Energy Act;<sup>91</sup> the Geothermal Resources Act;<sup>92</sup> Petroleum (Exploration and Production) Regulations, (PEPA Regulations);<sup>93</sup> Petroleum (Exploration and Production) (Training Fund) Regulations;<sup>94</sup> and Sessional Paper No. 4 of 2004 (policy). Just like in the current Petroleum Act, 2019, the model for petroleum sharing contract (PSC) was contained in the PEPA Regulations and it entailed the framework for negotiation and engagement between the Government of Kenya and oil and gas companies.

In addition, on 1<sup>st</sup> January 2015, the Finance Act, 2014 became effective and it introduced a new taxation regime for the extractive industry. There was an attempt to enact a Petroleum (Exploration, Development and Production) Bill in 2015 that was also meant to repeal PEPA. The Petroleum Act, 2019 was instead introduced covering a wider range of the areas of concern and it is now the substantive law relating to upstream oil and gas.

The energy and petroleum policy also acknowledged the need to align and review the energy and petroleum sector policy, legal and regulatory framework with the provisions, spirit and aspirations of the Constitution. Additionally, the African development Bank and the African

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<sup>89</sup> Petroleum Act, No.2 of 2019, Energy Act, No. 1 of 2019, the Income Tax Act Cap 470 Laws of Kenya. Article 71 (1) of the Constitution of Kenya provides that a transaction is subject to ratification by Parliament if it involves the grant of a right or concession by or on behalf of any person, including the national government, to another person for the exploitation of any natural resource of Kenya.

<sup>90</sup> Petroleum (Exploration and Production) Act (PEPA) Chapter 308 of the Laws of Kenya.

<sup>91</sup> Energy Act No.12 of 2006.

<sup>92</sup> Geothermal Resources Act No. 12 of 1982.

<sup>93</sup> Petroleum (Exploration and Production) Regulations, (PEPA Regulations), 1984.

<sup>94</sup> Petroleum (Exploration and Production) (Training Fund) Regulations, 2006.

Union in its supplement to the African Development report have recognized the inadequacy of policies and legal frameworks in the management of oil and gas resources.<sup>95</sup>

The Constitution of Kenya provides for equitable distribution of natural resources and utilization of natural resources for the benefit of the people.<sup>96</sup> It vests the administration of minerals and mineral oils in the National Land Commission.<sup>97</sup> Patey in his analysis of the Kenya's oil discoveries post 2010 and the transitional issues has argued that the Constitution of Kenya 2010 offered potential economic and social development benefits that could help reverse the inequalities experienced before.<sup>98</sup> On the flipside, the process of implementing the Constitution could still present challenges in the oil industry because political players and communities in oil regions would grapple with increased political power through the devolved system of government on the one hand and the convergence of new economic resources on the other. Failure to implement devolution under the 2010 Constitution could, according to Patey, be more damaging to the timely development of the oil industry. The author predicted the anticipated contestation of oil resources by counties and the communities resident within counties and the national government and IOCs. Such conflicts could be mitigated through the implementation of the devolved system of government that sought to take political power and resources from the central government to the people at the counties. Indeed, conflicts emerged between the national government and Tullow oil and Turkana County Government over the oil resources discovered in the region.<sup>99</sup> Part of the efforts to resolve this was the enactment of the

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<sup>95</sup>Mutuma, K, "Kenya's Petroleum Exploration and Production Law: Challenges For Investors, The Government And Local Communities" (2012).

<sup>96</sup> Article

<sup>97</sup> See Chapter Five, CoK 2010.

<sup>98</sup> Luke Patey, 'Kenya: An African oil upstart in transition,' Oxford Institute for Energy Studies (2014), <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/10/WPM-53.pdf>

<sup>99</sup> Kennedy Mkutu Agade, Oil And Emerging Conflict Dynamics In The Ateker Cluster: The Case Of Turkana, Kenya, *Nomadic Peoples*, 21(1), 34–62. <http://www.jstor.org/stable/44652672>;

Petroleum Act, 2019 that provides that county government should receive 20% and the local communities 5% of the national government's share of the profit oil.

### 3.2.1 The Petroleum Act, 2019

The Petroleum Act, 2019 *inter alia*, provides a framework for contracting, exploring, developing and producing petroleum. The law is also expected to guide in the formulation of a national petroleum policy. It is further meant to guide in the establishment of petroleum institutions. The Act repeals previous statutes including Petroleum (Exploration and Production) Act.<sup>100</sup>

Under the Petroleum Act, 2019, no person is to engage in upstream petroleum operations without entering into a petroleum agreement in compliance with the Act.<sup>101</sup> Where a financial and petroleum agreement is entered into by the national government, there is an obligation for the government to do so fairly, equitably, transparently, competitively and cost effectively.<sup>102</sup> Transparency and accountability is to be realized partly through the requirement that the Cabinet Secretary (CS) in charge of the petroleum industry establishes a framework for publishing all petroleum agreements, records, annual accounts and reports of revenues, fees, royalties, taxes and other charges.<sup>103</sup>

Concerns have been raised before over the decision of the Kenyan Government to keep most of the PCSs signed with various companies private.<sup>104</sup> This is despite an earlier indication by the President of Kenya in 2015 that the Government of Kenya would embrace the Extractives

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<sup>100</sup> Cap 308 Laws of Kenya.

<sup>101</sup> Petroleum Act, 2019, Section 16(i).

<sup>102</sup> Petroleum Act, 2019, Section 17.

<sup>103</sup> *Ibid.*

<sup>104</sup> Business Daily, 'Kenya: Govt. opts to keep oil revenue sharing agreements confidential; Tullow Oil says it is open to disclosure available,' at <https://www.business-humanrights.org/en/latest-news/kenya-govt-opts-to-keep-oil-revenue-sharing-agreements-confidential-tullow-oil-says-it-is-open-to-disclosure/> (accessed 1/5/2021).

Industries Transparency Initiative (EITI).<sup>105</sup> EITI is a global standard for the good governance of oil, gas and mineral resources.<sup>106</sup> According to comments previously made by a Kenyan Government official, confidentiality about PSCs in Kenya is upheld because Kenya does not have a uniform agreement for the various exploration companies it has dealt with.<sup>107</sup>

It is however critical that the national government compliance with the Petroleum Act on requirements for publication of such information to ensure transparency and accountability. This is also in line with the constitutional right to access of information under Article 35 and under the Access to Information Act, 2016.

The Petroleum Act further provides for the sharing of profits between Government and the contractor in accordance with the production sharing contract where such profits are derived from upstream petroleum activities.<sup>108</sup> The contractor is also obligated to pay signature bonus as prescribed in the PSC before the petroleum agreement is awarded. The term “signature bonus” as used in the Act refers to “a single, non-recoverable lump sum payment by the contractor to the National Government upon execution of the petroleum agreement.”<sup>109</sup>

The contractor is mandated to pay all taxes, relevant fees and levies to the National Government in the manner prescribed by the PSC and under any other relevant laws. Further, the taxes, profit petroleum and royalties from upstream petroleum operations are to be collected pursuant to the applicable tax laws and accounts provided to the organ responsible for tax collection, that is, the Kenya Revenue Authority (KRA).<sup>110</sup> The applicable laws in this regard include the Income Tax Act and the Value Added Tax Act. Notably, the Petroleum Act prevails

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<sup>105</sup> See Oil Kenya, <<https://oilkenya.wordpress.com/contracts-pscs/>> accessed 01 May 2021.

<sup>106</sup> Extractives Industries Transparency Initiative <<https://eiti.org/>> accessed 01 October 2021

<sup>107</sup> Business Daily, ‘Kenya: Govt. opts to keep oil revenue sharing agreements confidential; Tullow Oil says it is open to disclosure available,’

<sup>108</sup> Petroleum Act, 2019, Section 57 (1).

<sup>109</sup> Petroleum Act, 2019, Section 55. (1) and (2).

<sup>110</sup> Petroleum Act, 2019, Section 53.

in cases where there is a conflict between its provisions and those of another Act in as far as the oil and gas operations in the upstream, midstream, and downstream segments are concerned.<sup>111</sup>

The Cabinet Secretary is mandated to develop and publish a national policy on petroleum operations, and the policy is to be reviewed at least once in every five years.<sup>112</sup> In doing so, he is to ensure effective stakeholder participation. The Cabinet Secretary is mandated to develop, publish and review a national petroleum strategic plan that is consistent with and factors in the national petroleum policy.<sup>113</sup> In essence, the strategic plan developed by the Cabinet Secretary is expected to guide the implementation of the national policy on petroleum operations.<sup>114</sup>

The Act further provides for permits and licences that must be obtained by contractors under the PSC, including, *inter alia*, operational permits for drilling, operating underground injection wells, building crude oil facilities, and plugging or abandoning a well.<sup>115</sup> Operational permits are to be issued in respect of each well, a provision that is deemed to be a point of concern for contractors, especially in relation to the costs and possible delays in the issuance of permits.<sup>116</sup>

Concerns have been raised about the provision in the Act giving discretionary powers to the licensing authorities to determine the duration of licenses relating to midstream and downstream oil and gas operations by contractors.<sup>117</sup> The Energy Act of 2006 provided for a standard licensing period. According to analysts, this change can undermine the predictability

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<sup>111</sup> Petroleum Act, 2019, Section 4.

<sup>112</sup> Petroleum Act, 2019, Section 5.

<sup>113</sup> Petroleum Act, 2019, Section 6.

<sup>114</sup> Petroleum Act, 2019, Section 6.

<sup>115</sup> Petroleum Act, 2019, Section 7.

<sup>116</sup> Shah, P. "Petroleum Act, 2019 is Now In Force," Bowmans, available at <https://www.bowmanslaw.com/insights/oil-gas/petroleum-act-2019-is-now-in-force/> (accessed 22/4/2021).

<sup>117</sup> Shah, P. "Petroleum Act, 2019 is Now In Force," Bowmans,

and stability of the sector.<sup>118</sup> There is need for a consistent licensing period for the sector to guarantee stability and consistency.

Remarkably, the Petroleum Act establishes a model Production Sharing Agreement as well as a model Participation Agreement. Clause 41 of the model PSA give the Government the discretion of choosing to participate in any development area and acquiring participation interest of a particular percentage of the total interest in such a development area. Such participation by the Government may either be direct or through a National Oil Company. The model Participation Agreement defines the scope and nature of such participation.

### **3.2.2 Salient Features of the Model PSC under the Petroleum Act, 2019**

There is established a model production sharing contract (PSC) under the schedule to the Petroleum Act, 2019. Under the model PSC, a production sharing contract is defined as a petroleum agreement between the Government of the Republic of Kenya and a contractor that enables the contractor to explore, develop and produce petroleum within a contract area.<sup>119</sup> This definition mirrors the previous definition under the repealed law.

Clause 39 of the model PSC mandates a contractor under the PSC to comply with the requirements of tax laws applicable in Kenya. Further, the model PSC provides that a contractor who assigns or transfers a participation interests must comply with the income tax laws that impose taxes on capital gains.

For the portion of each category of profit petroleum that the Government is entitled to take and receive for a particular financial year, the model PSC provides that such portion shall exclude all taxes payable by contractor and the contractor has to make a commitment to pay and discharge such taxes when they become due. The contractor is required to prepare and file tax

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<sup>118</sup> Shah, P. 'Petroleum Act, 2019 is Now In Force,' *Bowmans*,

<sup>119</sup> Clause 2 on Interpretation.

returns as provided for in the tax laws. While at it, receipts are to be issued by the duly constituted authority for collection of taxes, that is, the Kenya Revenue Authority.

In cases where a contractor under the PSC is comprised of more than one legal entity, each of the entities bears their individual tax liabilities under clause 39, and clause 39 requirements apply *mutatis mutandis* to each one of them. This includes in filing an individual tax return or complying with any tax liabilities in respect of an assignment of an interest in the contract by a person.

### **3.2.3 The Income Tax Act, Cap 470**

The gains and profits of petroleum companies are subject to tax in Kenya. Under the United Nations recommended tax design discussed in Chapter Two,<sup>120</sup> a country may opt to have tax laws that apply to all sectors of the economy in one act. The other available alternatives include the inclusion of the relevant tax laws in the specific sectoral law such as the Petroleum Act, or the inclusion of the same policies in the specific PSCs. In Kenya, the Income Tax Act applies to all sectors including the oil and gas industry.

The Income Tax Act makes provision for the charge, assessment and collection of income tax, the ascertainment of the income to be charged; and related areas. The Ninth Schedule of the Income Tax Act enshrines provisions on taxation of petroleum companies. For instance, under paragraph two, the taxable income is equated to the value of the production to which a petroleum company is entitled under a petroleum agreement in a given year of income.

The Act needs to be amended so as to align some provisions with the new Energy Act, 2019 and Petroleum Act, 2019. In analyzing the tax incentives for the oil and gas sector, the

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<sup>120</sup> United Nations, *United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries*, (2017) <[https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook\\_2017.pdf](https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook_2017.pdf)> on 01 October, 2021.

author focuses on the Ninth Schedule of the Income Tax Act and the Model PSC as provided for in the Petroleum Act, 2019.<sup>121</sup> As analysed in the ensuing sections, these two legal instruments have provisions that are not in strict alignment. In part 3.6 below, the author attempts to illustrate the inconsistencies that could result in underdevelopment of the oil and gas sector.

### **3.3 Institutional Framework for the Oil and Gas Sector in Kenya**

Before the enactment of the Energy Act of 2019 and the Petroleum Act of 2019, the key institutions that defined the institutional framework for the oil and gas sector in Kenya included the National Oil Corporation of Kenya (NOCK) and the Ministry of Energy. The Ministry of Energy in Kenya is in charge of oil and gas explorations in the country. This is so because the relevant statutes have empowered the Cabinet Secretary with major powers relating to the upstream activities in Kenya.<sup>122</sup> Thus, the Ministry is in charge of overseeing the delivery of services by Government owned companies such as National Oil Corporation, Kenya Pipelines Company Limited and Kenya Petroleum Refineries Limited.

Following the promulgation of the Constitution of Kenya, 2010, the National Land Commission (NLC) was established with one of its mandates being the ratification of grants of rights or concessions concerning the exploitation of natural resources by parliament.<sup>123</sup> NLC is therefore one of the major institutions that control the mining and exploration sector in Kenya.

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<sup>121</sup> Anjarwalla & Khanna, 'Oil and Gas Sector: Kenya Guide,' *Africa Legal Network*, <<https://www.africalegalnetwork.com/wp-content/uploads/sites/22/2016/08/AK-Oil-Gas-Sector-Kenya-Guide.pdf>> on 27 May 2021.

<sup>122</sup> See the Energy Act, 2019 and the Petroleum Act, 2019.

<sup>123</sup> Article 67 of the Constitution, 2010; Section 14 of the National Land Commission Act, No 5 of 2012. See also Kaplan & Stratton "Kenya Oil Gas Review," available at <http://www.kaplanstratton.com/wp-content/uploads/2017/04/Kenya-Oil-Gas-Review.pdf> (accessed 15/4/2021).

The Energy Act 2019 establishes three key national energy entities tasked to manage and regulate energy resources in the country.<sup>124</sup> It establishes the Rural Electrification and Renewable Energy Corporation (REREC), the Energy Petroleum Regulatory Authority (EPRA), and the Nuclear Power and Energy Agency.<sup>125</sup> EPRA is in charge of regulating the generation, importation, exportation, transmission, distribution, supply and usage of electrical energy with the exception of licensing of nuclear facilities.<sup>126</sup> The other key functions of EPRA are, among others; to conduct regulation, monitoring and supervision of the upstream petroleum operations in Kenya as provided for by the laws and regulations governing the petroleum sector; to provide the Cabinet Secretary in charge of matters relating to petroleum with information and statistics relating to upstream operations in Kenya from time to time; and to collect, maintain and manage upstream petroleum data.

EPRA is also mandated to promote well planned, executed and cost-efficient operations. The above functions therefore undergird the critical role that EPRA plays in the regulations of upstream operations in Kenya. Significantly, EPRA is also given the power to issue, renew, modify, suspend or revoke licenses and permits for all undertakings and activities in the energy sector.

The Nuclear Power and Energy Agency created under the Energy Act, 2019 is mandated to propose policies and legislation necessary for the successful implementation of a nuclear power programme.<sup>127</sup> The Agency is also required to undertake extensive public education and awareness on Kenya's nuclear power programme.

Key to this study, one of the functions of the Energy and Petroleum Regulatory Authority established under section 9 of the Energy Act is to “provide information to the relevant authority

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<sup>124</sup> Energy Act, 2019, Part III.

<sup>125</sup> Energy Act, 2019, Part III.

<sup>126</sup> Energy Act, 2019, Section 10.

<sup>127</sup> Energy Act, 2019, Section 56.

for the collection of taxes and fees from upstream petroleum operations.” The relevant authority in this context is the Kenya Revenue Authority (KRA).

The Petroleum Act establishes various institutions which serve under the auspices of the Cabinet Secretary. One of them is the National Upstream Petroleum Advisory Committee established under section 12. The advisory committee has four main functions: To generally advise the Cabinet Secretary on upstream petroleum operations; to advise the Cabinet Secretary during the negotiation of and entering into of petroleum agreements; upon the recommendation of the Authority, to advise the Cabinet Secretary on the suspension, revocation or termination of a petroleum agreement or the recall of a security given under the terms and conditions of a petroleum agreement; and to assist the Cabinet Secretary to develop criteria for the negotiation of petroleum agreements between the Cabinet Secretary and a contractor.<sup>128</sup>

### **3.4 Taxes Levied in the Extractive Sector and the Existing Gaps as Regards to the Ninth Schedule**

As opined by analysts, it is in the interest of any IOC seeking to sign a Production Sharing Agreement with the Kenyan Government to ascertain the taxes applicable during the exploration and production phase before making the contractual commitment.<sup>129</sup> This will help the company make a rational and informed decision in signing such a contract.

The tax regime regulating the extractive sector involves levies on corporate income tax, other corporate income tax, tax incentives, indirect taxes, withholding taxes and payments to related parties.<sup>130</sup> The institution tasked with administering taxes in Kenya is the Kenya Revenue Authority (KRA). The tax year is the calendar year for natural persons. The Income Tax Act sets out the rules applicable to the upstream oil and gas sector. The general provision of the Act apply

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<sup>128</sup> Energy Act, 2019, Section 13.

<sup>129</sup> Muchiri, G. (2018) ‘Taxation in the Upstream Oil and Gas Sector,’ available at <https://www.oraro.co.ke/2018/09/14/taxation-in-the-upstream-oil-and-gas-sector/> (accessed 15/4/2021).

<sup>130</sup> Deloitte, ‘Oil and gas taxation in Kenya’, 2016.

to the oil and gas sector where as long as they are not inconsistent with the ninth schedule of the same Act. This same schedule also provides for rules pertaining to imposition of tax in the mining sector.

Direct and indirect taxes can be imposed on an income base or consumption base. WTO defines these aforementioned terminologies <sup>131</sup>starting with direct taxes to denote to ‘taxes on wages, profits, interests, rents, royalties and all other forms of income and taxes on the ownership of real property’ while indirect taxes are defined as ‘sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, boarder taxes and all taxes other than direct taxes and import charges.’<sup>132</sup>

Essentially, direct tax is one that is assessed upon the property, business or income of the individual who is to pay tax.<sup>133</sup> A case in point of a direct tax is corporate income tax which involves the contractor’s share of profit oil that is received net of income taxes. In practice, Companies residing in Kenya are taxed on the income they gain from worldwide trade while branches of foreign legal entities are taxed on all income accruing in or derived from Kenya. Income that is subject to tax comprises of gross income, less deductions as provided for in the Act. The Act also stipulates the rules applicable in deducting expenses incurred in the exploration, development and production phases. Special deductions are also available for oil and gas companies. These deductions are provided for in the Act as regards to the taxable

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<sup>131</sup> The mining sector in Kenya is now regulated by the Mining Act, 2016.

<sup>132</sup> Schenk A, *Value added tax A comparative approach*, 5.

<sup>133</sup> Schenk A, *Value added tax A comparative approach*, 5.

income. The specific deductions include, exploration costs,<sup>134</sup> development expenditure<sup>135</sup> and operating costs.<sup>136</sup>

Other tax levies imposed on the upstream oil and gas sector is on the additional profit taxes under the PSCs. Ideally, an increase in the crude oil price per barrel exceeding a defined threshold attracts an imposition of a share on the profits of the oil by the government. Indirect taxes are defined as ‘taxes that are levied upon commodities before they reach the consumer who ultimately pays the taxes as part of the market price of the commodity.’<sup>137</sup> Employment taxes are also imposed on the income. It is collected via withholding at source under Pay as You Earn (PAYE) at a marginal rate of 30%.<sup>138</sup> Statutory contributions for social security and health such as the National Social Security Fund (NSSF) and the National Hospital Insurance Fund (NHIF) are also requirements that employees are required to collect. An exemption in such a case is only permitted where the employee can prove that they are making contributions in form of payments to pension schemes to their host countries.<sup>139</sup>

In the mining sector, the tax regime present in Kenya is similar to what is in the oil and gas sector. Just like the oil and gas sector, the mining sector is not taxed on goods upon entry. This means no VAT is levied on the purchase of shares. However, stamp duty is payable at a minimal amount. As regards to prospecting expenditure, one hundred percent capital allowance is imposed on the year which the expenditure was incurred. Additionally, capital expenditure

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<sup>134</sup> This type of cost includes capital expenditure incurred during exploration operations. They are deductible for tax purposes in the year which they were incurred.

<sup>135</sup> This type of cost is depreciated at a rate of 20% per annum starting the year after the asset is brought into use and year which production begins. It excludes plant and machinery and social infrastructure.

<sup>136</sup> This cost included geological and geophysical and intangible drilling costs that is fully deductible in the year incurred.

<sup>137</sup> Schenk A, Thuronyi V and Cui W, *Value added tax A comparative approach*, 2<sup>nd</sup> ed, Cambridge University Press, New York, 2007, 5.

<sup>138</sup> Deloitte, ‘Oil and gas taxation in Kenya,’ January 2016.

<sup>139</sup> Deloitte, ‘Oil and gas taxation in Kenya,’ January 2016.

incurred on operations is deductible upon commencement of production at a rate of twenty percent over a five-year period.<sup>140</sup>

In matters to do with finance, fifteen percent is payable on interest of withholding tax and interest is restricted where debt equity ratio exceeds 2:1. A fifteen percent withholding tax is imposed on deemed interest on related party interest.<sup>141</sup> When withholding tax on payments to non-residents, 5.625% withholding tax is inflicted on payments to a non-resident sub-contractor without a permanent establishment in respect of service fees for mining operations.<sup>142</sup> 20% withholding tax on payments to a non-resident person for management or professional or training fee is payable.<sup>143</sup> This is the final tax for both the former and latter. Withholding tax on payments to residents ranges from three percent to five percent subject to imposition of more tax.<sup>144</sup>

Value added tax (VAT) is a type of multistage sales tax imposed on goods and services that is collected in chunks at each stage of production and distribution of goods or the rendition of services in proportion to the value added by each taxpaying firm.<sup>145</sup> In the mining sector, domestic sales of minerals are subject to sixteen percent VAT and zero percent for export. Corporation tax rate on the other hand is taxed at thirty percent for a subsidiary and 37.5% for a branch. Royalties are also payable to the government on sale of minerals on an upward trajectory. The rates range between one percent and twelve percent. One percent is for industrial minerals such as gypsum and limestone, ten percent for coal titanium ores, niobium and rare-earth elements and twelve percent for diamonds.<sup>146</sup>

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<sup>140</sup> Section 10 of the Finance Act, 2014. See also Anjarwalla & Khanna, 'Oil and Gas Sector: Kenya Guide,' *Africa Legal Network*, p 4..

<sup>141</sup> Section 16(b) of the Finance Act, 2016.

<sup>142</sup> Section 15(2)(b) of the Finance Act.

<sup>143</sup> Section 15(2)(b)

<sup>144</sup> Anjarwalla & Khanna, 'Oil and Gas Sector: Kenya Guide,' *Africa Legal Network*, p 4.

<sup>145</sup> Schenk A, *Value added tax A comparative approach*, 17.

<sup>146</sup> Anjarwalla & Khanna, 'Oil and Gas Sector: Kenya Guide,' *Africa Legal Network*,

Pomp and Oldman have described the purpose of VAT as a tax system that is intended to tax personal consumption comprehensively, neutrally and efficiently.<sup>147</sup> This is not evident in the mining sector given the provisions of the Ninth Schedule which are not comprehensive and detailed as to the rates that are meant to be applicable in the mining sector. For instance, Section 3(2) provides for the amount of losses to be carried forward and allowed as a deduction against the income of the licensee derived from mining operations in the licensed area in the following year of income of the licensee. This is arguably not efficient given that there is no limit in place as to the number of times in which the losses can be carried forward. Section 3(4) appears to try to solve this gap however, it lacks clarity on whether the other years that the loss was carried forward will be eligible for deduction.

### **3.5 Tax Incentives in the Upstream Oil and Gas Sector in Kenya**

A tax incentive is a government measure that is intended to encourage individuals and businesses to spend money or to save money by reducing the amount they have to pay.<sup>148</sup> The Constitution of Kenya 2010 is the supreme law of the Republic which binds all state organs and persons. It envisages the imposition of tax in Article 210 where it stipulates that no tax or licensing fee may be imposed, waived or varied except as provided by legislation.<sup>149</sup> Since 2010, Kenya's taxation regime has undergone numerous developments and of key relevance to this study is the introduction of a separate schedule to the Income Tax Act on taxation of the extractive industry in 2014. The Ninth Schedule separates the taxation treatment of mining and petroleum operations from other sectors of the economy.<sup>150</sup>

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<sup>147</sup> Pomp R, Oldman O, State and Local Taxation, 4<sup>th</sup> ed, Hartford, 2001, 40.

<sup>148</sup> Cambridge Dictionary, <<https://dictionary.cambridge.org/dictionary/english/tax-incentive>> (accessed 28 May 2021.)

<sup>149</sup> Constitution of Kenya (2010).

<sup>150</sup> (Chapter 470, Laws of Kenya).

Some of the incentives provided for under the Ninth Schedule include the provision that a contractor can recover costs incurred in upstream petroleum operations (known as cost oil); provision for recovery of costs of abandonment. Another incentive is the provision that a contractor can claim capital allowance within five years from the date of production. There is also provision for claim of tax-deductible expenses from the profit for the period. The Ninth Schedule also makes importation of machinery and equipment needed by the contractors for upstream operations duty free.<sup>151</sup>

These incentives can be placed into three categories namely: income tax deductions; custom duty exemptions; and value added tax exemptions.<sup>152</sup>

### **3.5.1 Income Tax Deductions**

Income tax deductions involve particular deductions against oil and gas income in determining the taxable income. The specific deductions are on the cost incurred in oil and gas exploration operations like capital expenditure.<sup>153</sup> For tax purposes, these costs are deducted in full with respect to the period or years they are incurred. Development expenditure is also depreciated using the straight-line method for tax purposes at a rate of 20% per annum beginning the year after the asset is brought into use and the year in which production commences.<sup>154</sup> This depreciated development expenditure does not include plant machinery and social infrastructure. Operating costs are also fully deductible in the year they are incurred. They include geological and geophysical and intangible drilling costs.<sup>155</sup>

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<sup>151</sup>(Chapter 470, Laws of Kenya)

<sup>152</sup> Deloitte, 'Oil and gas taxation in Kenya', 2016.

<sup>153</sup>Income Tax Act, Cap 470, Section 5 of the Ninth Schedule.

<sup>154</sup> Income Tax Act Section 5 of the Ninth Schedule.

<sup>155</sup> Ninth Schedule to the Income Tax Act, Section 5 (2)(b).

### **3.5.2 Custom Duty Exemptions**

An additional incentive is custom duty exemptions on all items except motor vehicles imported by oil and gas companies for direct use in oil and gas exploration and development.<sup>156</sup> The exemption from customs duty is subject to limitations and conditions set out in East African Customs Management Act, 2004, the Customs & Excise Act and the Value Added Tax Act.<sup>157</sup> Under the model PSC, the contractor and its sub-contractors engaged in carrying out upstream petroleum operations are permitted to import into Kenya all materials, equipment, and supplies to be used solely in carrying out upstream petroleum operations as defined in the contract, and they include machinery, vehicles, consumable items, movable property, and any other articles. However, the contractor and its sub-contractors are expected to give preference to Kenyan goods and services.<sup>158</sup>

### **3.5.3 Value Added Tax Exemptions**

Value added tax exemptions is also another incentive in Kenya's VAT regime. It caters for both remission and exemption from VAT with respect to services and goods procured by oil and gas companies for their exploration activities in Kenya. In this context, there is VAT exemption for goods, including motor vehicles and aircraft, and taxable services imported or purchased by any company which has been granted an oil exploration or oil prospecting licence in accordance with a production sharing contract with the Government of Kenya and in accordance with the provisions of the Petroleum Act.<sup>159</sup>

In addition to the above tax incentives envisioned under KITA, the model PSC does not provide for payment of royalties, a position that IOCs prefer and hence an additional incentive. On the flipside, some have argued that non-payment of royalties has the effect of denying the

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<sup>156</sup> Model Production Sharing Contract under the Petroleum Act, 2019, Section 44.

<sup>157</sup> MPSC, Section 44 (2)

<sup>158</sup> MPSC, Section 44 (2).

<sup>159</sup> Value Added Tax Act, Cap 476 Laws of Kenya, Section 23(3)(c).

government the first tranche payments that would help meet citizenry demands of an overly expectant population and this can in turn result in significant political pressure on the ruling government.<sup>160</sup>

However, the tax incentives mentioned above are not adequate to facilitate a comprehensive tax regime in the oil and gas sector to accelerate the economic growth of Kenya.

### **3.6 Overlaps and Gaps Within the Ninth Schedule of the KITA and the Model PSC With Regard to Tax Incentives**

As discussed earlier, a model production sharing contract (PSC) is scheduled to regulations made under the Petroleum Act, 2019.<sup>161</sup> The Petroleum Act establishes certain obligations to the contractor that are implied into any PSC but dealt with in detail in the model PSC.<sup>162</sup> Some of these obligations include the duty to maintain financial, technical and professional capacity throughout the length of the contract; and to ensure that any subcontractor or agent of a contractor acting on behalf of the contractor possesses the necessary skills and qualifications to meet the obligations of the contractor as stipulated in the petroleum agreement or as required under the Act.<sup>163</sup>

Contractors are bound to follow and go by the requirements of the applicable income tax laws as envisaged in the PSC and established comprehensively under the Ninth Schedule to the Income Tax Act.<sup>164</sup> The model PSC proffers detailed provisions governing capital allowances and deductions and additional provisions concerning recoverability of expenses from cost oil.<sup>165</sup> Taxation and regulation of the oil and gas sector faces challenges due to the fragmented rules

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<sup>160</sup> Deloitte, 'Oil and gas taxation in Kenya', 2016.

<sup>161</sup> Petroleum Act, 2019, Section 17.

<sup>162</sup> See the Model PSC in the Schedule to the Petroleum Act, 2021.

<sup>163</sup> Petroleum Act, 2019, Section 17 (2) and (3).

<sup>164</sup> Petroleum Act, 2019, Section 53. See also Article 26, Model PSC

<sup>165</sup> Part VII of the model PSC under the Petroleum Act, 2019..

contained in the various tax legislations and the production sharing contracts. The standard PSC applied in Kenya establishes how income tax will be imposed on a contractor. However, it does not stipulate rules for calculating the implied gross-up or the way forward in the event that a firm has many production sharing agreements.<sup>166</sup> There is therefore need to harmonize the tax legislation and the PSCs to make it less burdensome and less expensive for the companies to comply.

The taxation regime has faced a lot of opposition from industry players who claim that no gains are made during farm outs but reimbursement of costs on past expenditure.<sup>167</sup> This therefore negates the need to tax because of the absence of gains due to the future commitments between parties on future sales. Ideally, tax income should be charged only after a discovery is made.

Furthermore, Article 6 of the Model PSC under the Petroleum Act, 2019 provides for the requirement of the contractor to pay a signature bonus and surface fees. The difference between these two is that the signature bonus is a one-time payment that is usually spread over the life of the contract.<sup>168</sup> On the other hand, surface fees are payable on an annual basis per square kilometer of the relevant block during exploration and production. As much as the signature bonus and surface fees are not tax incentives, the noted concern here is that they are not provided for in the Income Tax Act.<sup>169</sup> This leaves behind some confusion on whether they form part of the tax payable by contractors and should therefore be governed under the tax laws or whether they are simply additional payable fees that are not taxes per se.

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<sup>166</sup>See the Model PSC under the Petroleum Act, 2019.

<sup>167</sup> Kaplan & Stratton "Kenya Oil Gas Review," (2017).

<sup>168</sup> Section 55(1) defines "signature bonus" to mean a single, non-recoverable lump sum payment by the contractor to the National Government upon execution of the petroleum agreement.

<sup>169</sup>(Chapter 470, Laws of Kenya).

A look at the provisions regarding withholding taxes depicts that the Income Tax Act requires oil and gas companies to withhold tax at a rate of 10% on dividends paid while the PSC provides that all income taxes including that on dividends are carved out of the government's share of production.<sup>170</sup> Looking at matters pertaining to assignment of petroleum interests, on 1 January 2015, Kenya introduced new rules under the Finance Act, 2014 that govern the taxation of gains on the direct and indirect disposal of petroleum license interests. These new rules under the Finance Act, 2014 sought tax gains on the disposal of shares in offshore entities where at least 20% of the underlying value is derived from the PSC interest in Kenya.<sup>171</sup> However, it is not clear in the Income Tax Act what tax rate would apply for the disposal of shares in offshore entities.<sup>172</sup>

Section 14(1) of the Ninth schedule provides for indirect transfers of interest. It states mandates contractors and licensees to notify the commissioner in writing immediately there is a 10% or more change in the underlying ownership of said contractors of licensees. Sub section 2 goes further to state if the person disposing of the interest referred to in subsection 1 above is a non-resident, the licensee or contractor takes liability for any taxes payable by such non-resident as their agent.'

The PSC on the other hand stipulates in Article 39(2) that following the assignment or transfer as per the income tax laws in force which impose taxes on capital gains. A literal form of interpreting these two provisions does not depict any provision of taxing the capital gains after transferring interest in the Income Tax Act. The PSC also doesn't state that there needs to be consent sought from the Minister of Energy for transfer to an intra-group especially if the

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<sup>170</sup> Kaplan & Stratton "Kenya Oil Gas Review," (2017) available at <http://www.kaplanstratton.com/wp-content/uploads/2017/04/Kenya-Oil-Gas-Review.pdf> (accessed 15/4/2021).

<sup>171</sup> Section 3 of the Finance Act, 2014 amending section 3 of the Income Tax Act.

<sup>172</sup> Deloitte, 'Oil and gas taxation in Kenya', 2016.

transfer results in the transferor and the transferee retaining joint and several liability for the obligations of the transferor under the PSC.<sup>173</sup>

Over and above that, the terms of the Model Form PSC place a duty on the contractor to report any material changes in the corporate structure, ownership, and financial position of the contractor and its parent company. But no consent is required from the Minister of Energy on a change of control.<sup>174</sup> The amendments to the Income Tax Act under the Finance Act 2014 affected the oil companies, prospective mining companies and mining companies where a ten percent tax on their capital gains following the disposal of shares and assets will be imposed on the companies. Essentially, this implies that a disposal of a right under a PSC will yield a taxable charge on the gains. This is not in strict alignment with the Ninth Schedule of the Income Tax Act where the consideration received following the transfer of an interest under a PSC is treated as income by the disposing company and is not subject to taxation. In addition, these new provisions conflict with the general position under the PSC regarding all tax on income and profits being a part of the government's share of profit oil.<sup>175</sup>

Besides that, the Finance Act 2014 also puts Kenyan companies in a position where they are liable to compensating tax on the distribution of capital gains tax. This means that companies that may have been entitled to certain tax incentives using their tax holiday to distribute dividends to their shareholders instead of reinvesting the profits in the business will be barred from engaging in such practices. For instance, if a Kenyan company sold the share of a Kenyan entity that has an interest in the PSC, the proceeds that are in the hands of the seller will not be termed as income and therefore not subject to tax but any distribution will be caught by the

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<sup>173</sup> Kaplan & Stratton 'Kenya Oil Gas Review,' (2017) available at <http://www.kaplanstratton.com/wp-content/uploads/2017/04/Kenya-Oil-Gas-Review.pdf> (accessed 15/4/2021).

<sup>174</sup> Kaplan & Stratton 'Kenya Oil Gas Review,'.

<sup>175</sup> Kaplan & Stratton.

compensating tax regime.<sup>176</sup> The provisions of the Finance Act are therefore not clear especially once there is an interaction with the compensating tax provisions and the Income tax all together.<sup>177</sup>

Moreover, there exists a gap in the PSC where the model does not provide for farm out or farm in transactions which the Act explicitly does. Article 39 of the PSC states that a portion of each category of the Profit Petroleum which the Government is entitled to take and receive for a given fiscal year, and which is calculated under clause 37 shall be exclusive of all taxes payable by the contractor. Unfortunately, this form of tax incentive is not founded in the Ninth Schedule of the Income Tax Act.<sup>178</sup>

Other tax incentives stipulated in the Ninth Schedule of the Act<sup>179</sup> include, Section 8 which extends the tax incentives to the contractors through limiting deductions relating to petroleum operations; Section 11(3) states that a deduction shall not be allowed for expenditure incurred in the abandonment and decommissioning of petroleum operations in a contract area if the expenditure is paid for, directly or indirectly from money made available out of the escrow account established under the decommissioning plan for the contract area to finance such expenditure. Sub section (4) envisages that an amount accumulated in an escrow account, or an amount withdrawn from an escrow account to meet expenditure under an approved decommissioning plan for a contract area, shall be exempt from tax.<sup>180</sup>

Section 12 (2) (a) and (b) also exempts the contractor from any taxes payable on any gains made by the contractor. These exemptions are not evident in the provisions of the Model

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<sup>176</sup>Kaplan & Stratton.

<sup>177</sup>Kaplan & Stratton.

<sup>178</sup>(Chapter 470, Laws of Kenya).

<sup>179</sup>(Chapter 470, Laws of Kenya).

<sup>180</sup>(Chapter 470, Laws of Kenya).

PSC and further make it a challenge for contractors in the oil and gas sector given the uncertainty and confusion on the terms agreed upon vis a vis the provisions of the law.

Maina has summed up other related challenges of taxation in the oil and gas sector as follows:<sup>181</sup> First, that there is inadequate capacity of the regulators to audit exploration and development cost. Second, that there are challenges with application of transfer pricing rules such as lack of quality comparable data. Third, that there is lack of information on indirect transfer happening overseas.<sup>182</sup>

### **3.7 Tax Arrangements With Various Investors in the Petroleum Industry**

As noted earlier, under production sharing, the state vouches for and engages international oil companies (IOCs) to conduct exploration and extraction activities in return for a share in production. Under such arrangements, the IOC having invested in the project is given the advantage of recovering costs incurred in exploration, development and production activities before the remaining portion is shared with the Government which is the owner of the natural resources.<sup>183</sup>

Kenya has entered into a number of arrangements with companies exploring oil in Kenya using Production sharing Contracts. PSC's have proved to be very attractive to developing countries such as Kenya and particularly economies that are in transition. This is because they

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<sup>181</sup> Maina, A.W, 'The Kenyan tax regime for the Oil and Gas Sector: An International Tax Perspective to Policy and Practical Challenges,' p207-219

<sup>182</sup> Maina, A.W, 'The Kenyan tax regime for the Oil and Gas Sector: An International Tax Perspective to Policy and Practical Challenges,' p207-219

<sup>183</sup>Deloitte, "Kenya's petroleum fiscal regime: Expansive coverage," 2014, available at [https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/tax\\_Kenya\\_petroleum\\_fiscal\\_regime\\_2014.pdf](https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/tax_Kenya_petroleum_fiscal_regime_2014.pdf) (accessed 11//2021).

act as a form of cooperation between the investor and the state in the process of the use of the subsoil.<sup>184</sup>

PSC's came into prominence in the 1970's in countries such as Indonesia, Syria, Egypt, Nigeria and Peru. Over time, they have matured and evolved where even methods of calculating the government revenue changed. For instance, revenues based on an agreed share of the actual production so that the share increases as the production also increases; or at times, they were based on the company's return on investment- a proportion of the yield as a percentage of the capital employed.

Some have argued that in as much as Kenya's extractive industry is likely to generate the much needed resource revenue for development, the domination of the sector by IOCs exposes the industry to challenges of international taxation.<sup>185</sup> Simultaneously, the tax incentives in the industry erode the country's tax base, thus threatening the much needed tax revenue for a country like Kenya struggling to stabilize its economy.<sup>186</sup>

### **3.8 Conclusion**

This Chapter has analyzed the legal and institutional framework governing the oil and gas sector in Kenya. The Kenyan petroleum fiscal regime blends legal and contractual instruments that set out the framework for carrying out petroleum operations. These are mainly captured in the model PSC under the Petroleum Act, 2019 and in the Ninth Schedule to the KITA. The fiscal

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<sup>184</sup> Alramahi M, *Oil and Gas law in the0. UK*, Bloomsbury Professional Ltd, West Sussex, 2013, 1.55-1.59.

<sup>185</sup> Maina, "The Kenyan tax regime for the Oil and Gas Sector: An International Tax Perspective to Policy and Practical Challenges,"

<sup>186</sup> *Ibid*, p 207.

regime also encompasses taxes and related financial approaches of allocating economic rent arising from petroleum operations between the government and the IOCs.<sup>187</sup>

The Chapter has also discussed the specific tax incentives and the inconsistencies in the legal framework. This Chapter concludes that the legal framework governing taxation in the oil and gas sector faces challenges due to, *inter alia* the fragmented rules contained in PSCs and the applicable tax laws. Further, there are glaring inconsistencies between the provisions of ITA (ninth schedule) and the model PSCs in Kenya. This is despite the enactment of the Petroleum Act, 2019 which essentially reproduced the model PCS under the repealed law (Petroleum (Exploration and Production) Act, Chapter 308 of the Laws of Kenya).

The Petroleum Act, 2019 and the Energy Act, 2019 comprehensively address the emerging issues of concern in the oil and gas sector since 2012. These include issues on institutional frameworks, sharing of natural resources among communities, county governments and the national government. However, the laws, as read with the relevant tax laws such as the Income Tax Act are not adequate and effective enough to address the gaps on taxation and tax incentives in the oil and gas sector.

In summary, this Chapter finds that the taxation regime for the oil and gas sector is not coherent as it fails to align with some of the principles identified in Chapter one. These inconsistencies, overlaps and lack of clarity in effect tend to blur the incentives intended to attract IOCs.

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<sup>187</sup> Deloitte, “Kenya’s petroleum fiscal regime: Expansive coverage,” 2014, available at [https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/tax\\_Kenya\\_petroleum\\_fiscal\\_regime\\_2014.pdf](https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/tax_Kenya_petroleum_fiscal_regime_2014.pdf) (accessed 11//2021).

## Chapter Four

### Comparative Study on Tax Incentives for the Oil and Gas Sector

#### 4.1 Introduction

There are countries which have adopted appropriate incentives meant to attract investors in the oil and gas sector that Kenya can learn from. This chapter attempts to analyze the trends and practice of oil taxation in Ghana and Nigeria, with particular focus on how their systems for tax incentives are structured. The focus is on how the two countries have design their laws governing tax incentives in the oil and gas sector and whether this has contributed to progress in the sector.

It is common ground that countries that are rich in natural resources depend on International Oil Companies endowed with the needed technical and financial strength to conduct exploration and petroleum efficiently. In return, these countries use taxation and other fiscal tools such as royalties to tap the economic benefits that accrue.<sup>188</sup> Notably, incentives that are operationalized under the framework of a country's taxation system are seen to boost investment in the upstream segment as they attract IOCs.<sup>189</sup>

Concession contracts used to be the most popular contract type used internationally.<sup>190</sup> Concession contracts were first developed during the American Oil Boom in the 18<sup>th</sup> century. The contracts were based on land ownership and governments would grant concessions (ownership) to tracts of land and resources that would be found below the said tracts of land

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<sup>188</sup> Kyari, A 'The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 10(4), *International Journal of Energy, Economics and Politics*, 2020, 516-524.

<sup>189</sup> Odunta, M.O "The Role Of Taxation In Nigeria's Oil And Gas Sector Reforms – Learning From The Canadian Experience," LLM Thesis, College of Law University of Saskatchewan Saskatoon, <<https://harvest.usask.ca/bitstream/handle/10388/ETD-2015-11-2282/ODUNTAN-THESIS.pdf?sequence=4&isAllowed=y>> (accessed 20 April 2021).

<sup>190</sup> Fouad, M "Production Sharing Agreements: Overview," *Egypt Oil and Gas Newspaper*, 9 March 2015, <<https://egyptoil-gas.com/features/production-sharing-agreements-overview/>> (accessed 30 June 2021).

would be property of the concession holder.<sup>191</sup> According to Fouad, this type of contract was basically attractive for its simplicity, but while the terms are being agreed on, the actual reserves present are generally unknown. The impact of this is that IOCs would be more cautious in bidding for exploration blocks and the government would in the end lower chances of earning revenue from the sector.

Service contracts and participation contracts are also used instead of PSAs. Service contracts are designed such that the oil company does not own the resources it is extracting, rather, the company is paid a fee by the government for the exploration work. Participation contracts are utilized when the state and an IOC develop the resources together and the advantage of this is that both share the risks involved in exploration and production processes. The flipside of this is that both parties will have to contend with the challenge of having to agree on all aspects of the exploration and production process and this can cause delays in the event one of the parties differs on one or more terms and conditions with the other.

Both international oil companies and states have different interests when making PSAs. While states are keen on maximizing production and revenue, IOCs want increased profitability. Both parties have to therefore negotiate and strike a balance of their competing interests as they both need each other. As Fouad puts, the state needs the technical expertise and capital of possessed by the companies, and on the other hand, the companies need access to the natural resources for it to trade and make profit.

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<sup>191</sup> Fouad, M “Production Sharing Agreements: Overview,”

## 4.2 The Case of Ghana

Ghana joined the league of oil producing countries in December 2010.<sup>192</sup> Commercial oil production begun in this period in the Jubilee Field, a status that catapulted economic growth in the country.<sup>193</sup> Ghana is therefore an appropriate comparator for Kenya which is at its infant stages of oil production. Kenya discovered oil in 2012 in Turkana County and started production and exportation in 2019.<sup>194</sup> However, as at this writing, there were concerns that no physical activity was taking place at Kenya's oilfields.<sup>195</sup>

Ghana enacted the Income Tax Act in 2016 that covers taxation of all industries including the upstream oil and gas sector. Prior to the enactment of the Income Tax Act in 2016, taxation in Ghana's upstream oil and gas sector was governed by the Petroleum Income Tax Law (PITL) and Petroleum Agreements (PAs) signed by Government with oil companies. PITL provided the framework for determining chargeable income from oil and gas operations for tax purposes. On the other hand, PAs provide specific fiscal considerations applicable to each of the oil companies.

As noted by Ankomah, ITA only replaced PITL as the primary income tax legislation for upstream oil and gas in general.<sup>196</sup> It is generally agreed that PITL does not affect PAs which have fiscal stability provisions.<sup>197</sup> Petroleum Agreements do not tax branch remittances.

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<sup>192</sup> Ackah I, 'The Optimal Petroleum Fiscal Regime for Ghana: An Analysis of Available Alternatives,' 4 (3), *International Journal of Energy Economics and Policy*, 2014, 13; Ankomah, G. 'Ghana: Recent Tax Developments in the upstream petroleum sector,' *Global Oil and Gas Tax Newsletter*, p 13-15. <<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Energy-and-Resources/gx-er-oil-gas-tax-newsletter-sept2016.pdf>> on 20 April 2021.

<sup>193</sup> Ankomah, G. 'Ghana: Recent Tax Developments in the upstream petroleum sector,' p 13.

<sup>194</sup> Akwiri, J "Kenya's first crude oil export sparks demands over revenue sharing," Reuters, 26 August, 2019 <<https://www.reuters.com/article/us-kenya-oil-idUSKCN1VG1FQ>> on 01 October, 2021.

<sup>195</sup> Wachira, G. "Why Kenya is running out of options on Turkana oil," Business Daily, 28 April, 2021, <<https://www.businessdailyafrica.com/bd/opinion-analysis/ideas-debate/why-kenya-is-running-out-of-options-on-turkana-oil-3378772>> on 01 October, 2021.

<sup>196</sup> Ankomah, G. 'Ghana: Recent Tax Developments in the upstream petroleum sector' 14.

<sup>197</sup> Ackah I, 'The Optimal Petroleum Fiscal Regime for Ghana: An Analysis of Available Alternatives,' 4 (3), *International Journal of Energy Economics and Policy*, 2014, 13.

However, Ghana's Income Tax imposes a tax on branch profit remittances at 8% on other entities that do not deal with upstream petroleum activities. Ghana's model petroleum agreement provides that no tax, duty or other impost is to be imposed by the Government or any political subdivision on the contractor, its subcontractors, or its affiliates with respect to petroleum operations and related activities and to sales and export of petroleum other than as provided for under the petroleum agreement.

However, non-resident sub-contractors under the Petroleum Agreement are subject to a final withholding tax of 15% on gross payments received from the contractor who is a party to a Petroleum Agreement.<sup>198</sup> Resident subcontractors on the other hand are subject to a withholding tax at the rate of 7.5% although a lower rate of 5% is applicable where petroleum agreements provide for such rates.<sup>199</sup>

Companies that are registered in Ghana are required to file annual returns with the Ghana Revenue Authority. On the other hand, nonresident companies do not need to file returns. Ghana's ITA provides that a nonresident person who derives income in Ghana and whose income is not subject to a final withholding tax is required to file tax returns in Ghana.<sup>200</sup>

Just like Kenya, Ghana exempts goods imported for upstream petroleum operations from import duties. In addition, sale of an exempt item by a contractor to another petroleum contractor is also exempt. On the other hand, sale of an exempt item by a contractor to a non-petroleum contractor attracts a duty if the item is ordinarily dutiable.

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<sup>198</sup> The term "contractor" is construed to mean any person who is a party to a petroleum agreement with the Government of Ghana or with the GNPC. A "subcontractor" refers to any person who enters into a contract with contractor for supply of work or services in connection with a petroleum agreement.

<sup>199</sup> Ankomah, G. 'Ghana: Recent Tax Developments in the upstream petroleum sector' 14

<sup>200</sup> Income Tax Act, section 35; See Samanyi, F, & Samanyia S. 'Fiscal Regime Of Ghana's Oil And Gas Industry: A Pre – Commercial Production Review' 4(9) *European Journal of Business, Economics and Accountancy*, 2016, 77. <<https://www.idpublications.org/wp-content/uploads/2016/10/Full-Paper-FISCAL-REGIME-OF-GHANA%E2%80%99S-OIL-AND-GAS-INDUSTRY-A-PRE-%E2%80%93-COMMERCIAL-PRODUCTION.pdf>> on 28 May 2021.

PAs in Ghana exempt upstream petroleum activities from VAT. Otherwise, VAT applies to all transactions conducted in Ghana except those which are exempt. Goods and services supplied to companies that undertake petroleum activities are subject to VAT. VAT exemption is effected through the issuance of a VAT Relief Purchase Order (VRPO) by the Ghana Revenue Authority to a petroleum company whose activities are VAT exempt. The company is then able to “pay” for any VAT assessed on goods and services using the VRPO. This essentially means that although the company is charged VAT on supplies, it uses VRPO instead of cash to pay the VAT element.<sup>201</sup>

Export of goods and services is zero rated for VAT. Also exempt from VAT is sale of equipment and vessels designed for use in the industry, as well as sale of crude oil and hydrocarbon products.<sup>202</sup>

To encourage exports, no export duties are applicable to export of upstream petroleum products.<sup>203</sup> Similarly, Ghana’s MPA exempts upstream petroleum companies from payment of stamp duties.

The Government of Ghana has put in place a prescription for royalties from all petroleum and gas companies (5-12.5% for petroleum production and 3% for gas production).<sup>204</sup> As discussed in Chapter 3 of this study, royalties are calculated and assessed at a flat rate ranging from 0% to 20% in practice, and the law is not elaborate on this. In Ghana, the Government has two options: either to take a cash settlement for its 5% to 12.5% and 3% royalties, or to have it settled with the supply of crude petroleum and gas, respectively.<sup>205</sup>

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<sup>201</sup>Ankomah, G. ‘Ghana: Recent Tax Developments in the upstream petroleum sector’ p. 14.

<sup>202</sup>Samanyi, F, & Samanyia S. ‘Fiscal Regime Of Ghana’s Oil And Gas Industry: A Pre – Commercial Production Review’, 4(9) *European Journal of Business, Economics and Accountancy*,2016,78.

<sup>203</sup> Article 12.4 of Ghana’s Model Production Agreement (MPA).

<sup>204</sup> Petroleum (Exploration and Production) Act, 1984 (PNDCL 84), sec 15.

<sup>205</sup> Petroleum (Exploration and Production) Act, 1984 (PNDCL 84), sec 15; Ankomah, G. ‘Ghana: Recent Tax Developments in the upstream petroleum sector’ 15.

The corporate income tax rate applicable to upstream petroleum operations is 35% under Ghana's ITA, a reduction from an initial 50%.<sup>206</sup> Significantly, it is reported that as at the enactment of this legislation, almost all existing PAs already had provisions prescribing 35% corporate income tax rate for oil companies despite PITL providing for a higher rate of 50%. The rate under ITA therefore serves to align the legislative rate to what had already become the standard corporate income tax rate.<sup>207</sup>

ITA also introduced clear ring-fencing rules to apply to oil and gas operations apart from those already covered by pre-existing PAs. Ring fencing provisions were not explicitly provided for under PITL.<sup>208</sup> Lack of clear rules on ring fencing left ambiguities around its application leading to frequent disputes between oil companies and tax authorities. It also created what was perceived to be a risk of loss of tax revenues for Government.<sup>209</sup> For instance, under the Jubilee Field project, there was no ring fence so cost incurred on a block could be offset by revenue from another block. This, according to Samanyia, reduced the profit of the project, but encouraged reinvestment and attracted new investors.<sup>210</sup>

In Ghana, exploration costs incurred before drilling operations start are capitalized. In the first five years of commercial operations, an equal capital allowance is claimed.<sup>211</sup> On the same breadth, costs of exploration incurred after the start of drilling operations may be capitalized and a capital allowance claimed equally over a period of five years.

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<sup>206</sup> Section 5 of the First Schedule to Ghana's Income Tax Act, 2015 (Act 896).

<sup>207</sup> Ankomah, 'Ghana: Recent Tax Developments in the upstream petroleum sector' 15.

<sup>208</sup> Samanyia, F., & Samanyia S. 'Fiscal Regime Of Ghana's Oil And Gas Industry: A Pre – Commercial Production Review' 4(9) *European Journal of Business, Economics and Accountancy*, 2016, 77

<sup>209</sup> Samanyia, F., & Samanyia S. 'Fiscal Regime Of Ghana's Oil And Gas Industry: A Pre – Commercial Production Review' 77.

<sup>210</sup> Samanyia, F., & Samanyia S. 'Fiscal Regime Of Ghana's Oil And Gas Industry: A Pre – Commercial Production Review' 78.

<sup>211</sup> Samanyia, F., & Samanyia S. 'Fiscal Regime Of Ghana's Oil And Gas Industry: A Pre – Commercial Production Review' 4(9) 77.

Significantly, tax losses incurred in any year of assessment can be deducted from the subsequent year's profit. Such loss can be carried forward for five years. Because ring fencing applies, it follows that losses from operations in respect of a petroleum agreement cannot be used to offset profits from another petroleum agreement. Notably, research and development expenses are not tax-deductible.<sup>212</sup>

In summary, Ghana's fiscal regime for the upstream oil and gas industry is deemed analysts as investor attractive and<sup>213</sup> Kenya can borrow from Ghana's framework for attracting IOCs.

#### 4.3 The Case of Nigeria

Petroleum is considered to be the mainstay of Nigerian economy and the taxation regime for the upstream activities is well crafted.<sup>214</sup> Studies show that the petroleum industry accounts for approximately 75% of the total government revenue and to about 90% of the country's total earning.<sup>215</sup> This makes Nigeria an appropriate choice for comparative study on the tax incentives applied in the oil and gas sector.

Petroleum is considered a national asset in Nigeria, with ownership vested with the Federal Government. There are at least five pieces of legislation that govern the oil industry in

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<sup>212</sup>Ankomah, 'Ghana: Recent Tax Developments in the upstream petroleum sector' 15.

<sup>213</sup> Samanyia, F., & Samanyia S. 'Fiscal Regime Of Ghana's Oil And Gas Industry: A Pre – Commercial Production Review' 4(9) *European Journal of Business, Economics and Accountancy*, 2016, 77

<sup>214</sup> Idubor, R. *et al*, 'Appraising Taxation And The Nigerian Oil Industry,' 37(1) *Journal of Law, Policy and Globalization*, 2015, 188; Mondaq, "Nigeria: Oil And Gas Taxation In Nigeria," available at <https://www.mondaq.com/nigeria/sales-taxes-vat-gst/1004132/oil-and-gas-taxation-in-nigeria-> (accessed 25 April 2021).

<sup>215</sup> Tapang A.T and Onodi B.E 'Effect of Tax Incentives on Foreign Direct Investment in the Petroleum Industry in Nigeria.' 33.

Nigeria: These include: the Petroleum Profit Tax Act;<sup>216</sup> Companies Income tax Act;<sup>217</sup> Personal Income Tax Act;<sup>218</sup> Education Tax Act and the Value Added Tax Act.<sup>219</sup>

Under section 8 of the Petroleum Profit Tax Act, a tax to be charged at a prescribed rate applies to the profits of each accounting period of any company engaged in petroleum operations during that period. Companies that handle petroleum operations are deemed to be in the upstream regime and are taxed under the PPTA.<sup>220</sup>

Other companies involved in transporting, marketing and servicing companies are taxed under the Companies Income Tax (CITA) regime.<sup>221</sup>

Petroleum operations in Nigeria are carried out under both a licensing and a contractual regime.<sup>222</sup> The licensing regime embodies arrangements such as joint ventures between the Federal Government of Nigeria and either IOCs or Sole Risk Operators (SROs). On the other hand, Risk Service Contracts (RSCs) and PSCs are involved in the contractual regime.<sup>223</sup>

Out of the arrangements referred to above, those involving RSCs are placed under performance schemes with the Federal Government where they get remunerated as service

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<sup>216</sup> Petroleum Profit Tax Act Cap p 13 LFN 2004

<sup>217</sup> Petroleum Profit Tax Act LFN 2004.

<sup>218</sup> Petroleum Profit Tax Act LFN 2004.

<sup>219</sup> Petroleum Profit Tax Act LFN 2004. See Idubor, R. *et al*, 'Appraising Taxation And The Nigerian Oil Industry,' 192

<sup>220</sup> Kyari, A 'The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 10(4), *International Journal of Energy, Economics and Politics*, 2020, 516-524.

<sup>221</sup> Gumo, C., S. *Income Tax for Corporate and un-Incorporated Bodies in Nigeria*. Ibadan: Heineman Educational Books Nigeria Limited, 2013, 3..

<sup>222</sup> Tapang, A.T, Onodi, B. and Amaraihu, A, 'The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 4(7) *IIARD International Journal of Economics and Business Management*, 2018,

<sup>223</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. 'The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,' 2(9), *European Journal of Commerce and Management Research*, 2013, 191-196.

providers. They are not deemed to be carrying on petroleum operations. These companies are taxed under the Companies Income Tax Act (as opposed to the PPTA) at a far lower rate.<sup>224</sup>

Profits for any accounting period for companies involved in upstream crude oil operations comprises include proceeds from sales of all chargeable oil sold by the company in that period and all income of the company during that period that arises from the company's petroleum operations. Taxable profits of the company are arrived at under section 10 of PPTA. This section of the law provides for deductible expenses to include expenses "wholly, exclusively and necessarily" incurred in obtaining the profits.

Remarkably, PPTA allows all un-recouped losses suffered by the company during any previous accounting periods to be deducted from its adjusted profits in order to determine the assessable profits of an oil producing company from its adjusted profits. PPTA allows the unrelieved losses to be carried forward to succeeding accounting periods if all the loses cannot be relived from the adjusted profits in any accounting period, for instance because there is insufficient profit from which such loses can be offset.<sup>225</sup>

Production sharing contracts (PSCs) in Nigeria are also used in participating in the exploration of petroleum resources particularly for offshore acreages and inland basins. Like in Kenya, the contractor under a PSC caters for exploration and production activities and recovers the cost of winning crude oil. In the event that no oil is found, the company does not receive compensation.<sup>226</sup>

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<sup>224</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. 'The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,' 195.

<sup>225</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. 'The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,' 195.

<sup>226</sup> Tapang, A.T, Onodi, B. and Amaraihu, A, 'The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 4(7) *IIARD International Journal of Economics and Business Management*, 2018, 35.

A contractor under Nigeria's PSC has the full right to cost oil and profit oil. The contractor is subject to a petroleum profits tax at 50% of the chargeable profit. Further, the contractor can dispose of tax oil to defray tax and royalty obligations. The balance of the oil (if any) is shared between the parties.

There are tax incentives for companies which invest in natural gas liquid extraction equipment and facilities.<sup>227</sup> For all the capital investments that relate to gas to liquid facilities, there is a framework for handling them as a chargeable capital allowance where they are recovered against crude oil income. 0% tax and royalty is incurred for gas transferred from a natural gas liquid facility to the gas to liquids facilities. Because of these incentives, gas producing companies have a wider latitude on expenditures where they can claim capital allowance relief.<sup>228</sup>

Withholding tax is applicable to certain income such as rent, interest, dividends, fees, commissions as well as other payments in respect of contracts.

There are specific countries which a reduced WHT of 7.5% is applicable on account of the treaty agreements they have with Nigeria. They include Belgium, Canada, China, France, the Netherlands, Pakistan, Philippines, Romania, South Africa, the Kingdom of Spain and the United Kingdom.<sup>229</sup> Reportedly, Singapore has also ratified a double tax agreement (DTA) that is based on based on the OECD Model Tax Convention with Nigeria.<sup>230</sup>

Another significant incentive in Nigerian law is the exemption from custom duties on importation of provision, machinery and equipment by companies involved in exploration,

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<sup>227</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. 'The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,' 195.

<sup>228</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. 'The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,' 195.

<sup>229</sup> The generally applicable WHT rates are as follows: • Interest — 10% • Royalties — 10% • Technical services — 10% • Management services — 10% • Consultancy services — 10% • Other contracts for supply of goods and services — 5% • Branch remittance tax — not applicable.

<sup>230</sup> It entered into force in Singapore on 1 November 2018 with an effective date of 1 January 2019.

processing, or power generation through use of oil and gas in Nigeria.<sup>231</sup> Unlike the case of VAT exemptions, a company engaged in the upstream and downstream sector of the oil industry may claim custom duty relief. Save for supply of goods and services specifically exempted under the Act, VAT in Nigeria is VAT is imposed at the rate of 5% on the supply of all other goods and services used in the sector.<sup>232</sup>

In summary, certain tax allowance and incentives have been put in place in Nigeria to cushion IOCs and attract investment in the sector. These incentives are two pronged: First, there are allowable deductions. Second, there is the Petroleum Investment Tax Allowance/Tax Credit Allowance.<sup>233</sup> The chargeable tax is the amount of tax paid after deduction of allowable deductions made.<sup>234</sup> Allowable deductions comprise the following, *inter alia*: rent incurred by the IOC for the period in respect of land or buildings occupied under an oil prospecting license or an oil mining lease for disturbance of surface rights; all royalties, the liability for which was incurred by the company during that period in respect of natural gas sold; all royalties, the liability for which was incurred by the company during that period in respect of crude oil or of casing head petroleum spirit won in Nigeria; and any expenses incurred for repair of premises, plant, machinery, or fixtures employed for the purpose of carrying on petroleum operations.

Capital allowances also comprise a significant incentive to IOC in Nigeria. Capital allowances are granted the IOC pursuant to the second schedule of the PPTA and section 20 of PPTA. The position is that the amount of assessable profit after deduction of any amount allowed under the PPTA as capital allowance entails the chargeable profit.

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<sup>231</sup> See the Customs, Excise Tariff (Consolidation) Act 2004.

<sup>232</sup> Value Added Tax Act 2004.

<sup>233</sup> Idubor, R. Asada, D. and Adef, M. "Appraising Taxation and the Nigerian Oil Industry,"

<sup>234</sup> This is pursuant to the provisions of section 10 of PPTA.

Investment Tax Allowance or Tax Credit is available where a crude oil producing company executes PCS with the NNPC and is claimed as a tax offset.<sup>235</sup> Nigeria has also created what is referred to as the Oil and Gas Free Zone (“OGFZ”)<sup>236</sup>, an entity that is managed by the Oil and Gas Free Zone Authority (the “OGFZA”).<sup>237</sup> Oil and gas companies that operate within the OGFZ, including those that provide services and supply equipment to such companies enjoy certain incentives under the OGFZ Act. OGFZ is specifically created for oil and gas business, unlike other general EPZs and the operational guidelines applicable in OGFZs are similar to those under other EPZs. The OGFZ offer numerous benefits including easier and faster registration process, seamless processing of work permits and residence for expatriates, efficient procedures for customs and clearing of cargoes by shippers and operators at regular ports.

Companies operating within the OGFZ are exempt from payment of custom duty on goods exported from and consumed within the zone. Investors within OGFZ are also exempt from the requirement for import and export licenses. Within the OGFZ, foreign exchange regulations are relaxed and there is the Central Bank of Nigeria has made provision for foreign exchange transactions that are efficient and seamless in the export processing zones.<sup>238</sup>

In addition, companies conducting petroleum operations under PSCs with the Nigerian National Petroleum Corporation in deep offshore and inland basin terrains enjoy a reduced tax rate of 50% instead of the normal rate, 85% while <sup>239</sup>a tax reduced rate of 55% is applicable to marginal field operators. No further tax is applicable to income that has been subject to tax under Nigeria’s PPTA and this means that withholding tax is not applied to dividends earned by

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<sup>235</sup> Tapang, A.T, Onodi, B. and Amaraihu, A, ‘The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,’ 4(7) *IIARD International Journal of Economics and Business Management*, 2018, 37.

<sup>236</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. ‘The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,’ 195.

<sup>237</sup> This was created by the Oil and Gas Export Free Zone Act (“OGFZ Act”), 1996 (Cap O5, LFN 2004).

<sup>238</sup> Guidelines for Banking Operations in the Free Trade Zones in Nigeria, 2015.

<sup>239</sup> See the Deep Offshore and Inland Basin Production Sharing Contracts Act (“DOIBPSCA”).

investors. In the case of deep offshore operations, royalties are graduated from 12% to 0% depending on the depth of the water. A flat rate royalty of 10% is charged for inland basin PSCs.<sup>240</sup>

According to Tapang, Onodi, and Amarahiu, Nigeria's tax incentives positively influences the living standards and per capital income, and expand variety of goods available to consumers.<sup>241</sup> They recommend, *inter alia*, that tax incentives should be effectively implemented and efforts should be made by relevant tax authority to ensure that firms benefit from these incentives in Nigeria.<sup>242</sup>

#### **4.7 Lessons for Kenya on the Appropriate Tax Incentive Structure to Maximize Investment in the Upstream Oil and Gas Sector**

Tax and tax related incentives in the five countries studied above are diverse in detail but largely related in their general designs. The two study countries have or rather attempted to use tax incentives to attract investors in the oil and gas sector.

In order to solve the challenges of Kenya's framework as seen in Chapter Three, the government should consider the following tax initiatives to contribute to the growth of the oil and gas sector.

First, in the cases of Nigeria and Ghana studied above, laws providing for tax incentives in the oil and gas sector are harmonized and do not embody the kind of inconsistencies seen in

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<sup>240</sup> Tapang, A.T, Onodi, B. and Amarahiu, A, 'The Impact of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 4(7) *IIARD International Journal of Economics and Business Management*, 2018, 34; UNCTAD, "Tax Incentives and Foreign Direct Investment A Global Survey," available at [https://unctad.org/system/files/official-document/iteipcmisc3\\_en.pdf](https://unctad.org/system/files/official-document/iteipcmisc3_en.pdf) on 14 May 2021.

<sup>241</sup> Tapang, A.T, Onodi, B. and Amarahiu, A, 'The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 37.

<sup>242</sup> Tapang, A.T, Onodi, B. and Amarahiu, A, 'The Impact Of Petroleum Tax Incentives On Foreign Direct Investment Inflow: Evidence From Nigeria,' 37.

Kenya's framework. Kenya should consider harmonizing laws on taxation in the oil and gas sector and consolidating them in one major statute, such as the Petroleum Act.

Second, there is need for the Government to consider incentives which can ultimately promote research and development in the sector. This can be in form of deductions of research expenses and in the long run, small Kenyan companies that seek to take part in the industry can enjoy tax benefits.<sup>243</sup> In Ghana, research and development expenses are not tax-deductible.

Third, Nigeria's treaty arrangements with the specific countries listed above has provided an incentive for companies from those countries to invest in Nigeria's oil sector. Trade arrangements between Kenya and other countries should also focus on attracting IOCs to the country for mutual benefits.

Fourth, to secure the interests of Kenya in the extractive industry, best practice advocates for incentives that are cost-based as opposed to profit based.<sup>244</sup> Incentives should be for a limited time period and should leave little room for personal discretion. They should also be reviewed regularly.

Fifth, countries such as Nigeria have created free trading zones specifically for oil and gas companies and this has reduced licensing bureaucracy and increased efficiency in operations.<sup>245</sup> Kenya can consider such an arrangement in view of the increasing upstream oil and gas sector activities. Within the oil and gas free trading zone, countries like Nigeria have also scrapped of withholding taxes for storage facilities and services.<sup>246</sup> Creation of free trading

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<sup>243</sup> Maina, 'Kenya needs new law for taxation of petroleum sector,'

<sup>244</sup> Maina, op.cit.

<sup>245</sup>Maina, "Kenya needs new law for taxation of petroleum sector," *Business Daily*, 11/7/2012, <<https://www.businessdailyafrica.com/analysis/539548-1451670-155pekuz/index.html>> (accessed 15/5/2021)

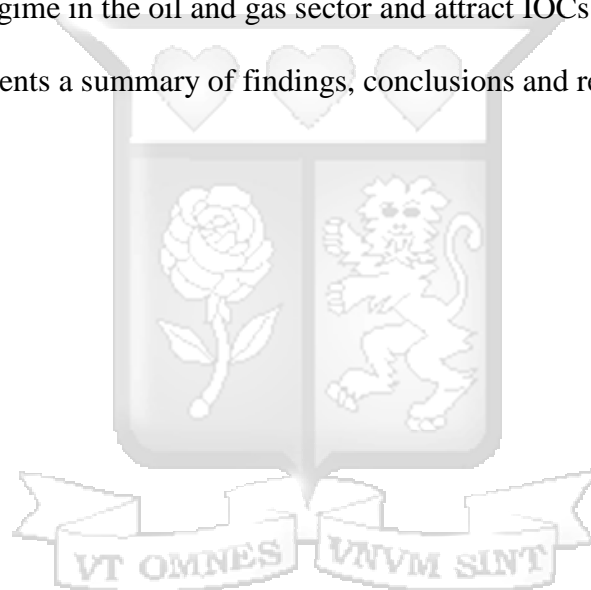
<sup>246</sup> Effiok, S.O., Tapang, A. T. & Eton, O.E. 'The Impact of Tax Policy and Incentives on Foreign Direct Investment (FDI) and Economic Growth: Evident from Export Processing Zones (EPZs) in Nigeria,' 194.f

zone for oil and gas companies in Kenya will be more desirable as oil production increases and it will offer investors with incentives similar to those enjoyed in Nigeria.

#### **4.8 Conclusion**

This Chapter has analysed the applicable taxes in the oil and gas upstream sector in Ghana and Nigeria and the incentives adopted. Although the countries under study do not represent a precise perfect model, there are key lessons which Kenya can draw from them in the quest to align its fiscal regime in the oil and gas sector and attract IOCs.

Chapter Five presents a summary of findings, conclusions and recommendations.



## Chapter Five

### Summary of Findings, Conclusions and Recommendations

#### 5.1 Introduction

From the onset, this study sought to address three research objectives: First, to clarify the position of tax and tax-related incentives in the prevailing legislative and policy framework in Kenya. Second, to address overlaps between, and gaps in, the Ninth Schedule to the Kenya Income Tax Act and the model Production Sharing Contract (PSC) under the Petroleum Act, 2019 relating to tax and tax-related incentives in the upstream oil and gas sector. Third, to propose a uniform and clear regime on taxation and tax-related incentives for contractors in the upstream oil and gas industry.

It proceeded on the hypothesis that there is inadequate integration between the Ninth Schedule to the KITA and the model PSC, both of which are the operative laws regulating taxation in the upstream oil and gas sector. The inadequacy is both on a general level and, specifically on the rules around tax incentives.

The study analysed the existing literature, law and policy governing taxation in the oil and gas sector, and the incentives meant to attract IOCs. The study used primary and secondary sources of data. It applied qualitative research design in acquiring information and data. A comparative study of the tax incentives in jurisdictions such as Ghana, Nigeria has also been conducted.

#### 5.2 Summary of Findings

The general finding of this study is that Kenya has a robust legal and institutional framework governing the oil and gas sector. The legal framework for taxation in the Oil and Gas sector in Kenya includes the Constitution of Kenya 2010 and three key legislations, namely the

Petroleum Act, 2019 and the Energy Act, 2019 that were signed into law in March 2019, and the Ninth Schedule to the Income Tax Act (Chapter 470, Laws of Kenya).

Following the promulgation of the Constitution, 2010, efforts have been made to review and update legislation touching on the oil and gas sector, with the latest enactments being the Petroleum Act, 2019 and the Energy Act, 2019. These laws have attempted to address institutional challenges by establishing new institutions and/or restructuring the previous ones. The laws have also made provisions seeking to fix the recent challenges relating to division of revenue especially following the discovery of oil in Turkana and the ensuing tussles among community members, county government, and the National Government.

However, this study has analysed the above legislation in Chapter 3 and found that it is still inadequate and ineffective in addressing the gaps and inconsistencies on the intended tax incentives in the oil and gas sector.

Tax incentives in the oil and gas sector are provided for under the Income Tax Act, Cap 470 and the model PSC that is a schedule to the Petroleum Act, 2019. The study found that these incentives can be placed into three broad categories namely: income tax deductions; custom duty exemptions; and value added tax exemptions. Income tax deductions include specific deductions on exploration costs like capital expenditure incurred in undertaking exploration operations and they are fully deductible for tax purposes in the year in which they were incurred. Custom duty exemptions are all items except motor vehicles imported by oil and gas companies for direct use in oil and gas exploration and development. The VAT Act, 2012 also caters for both remission and exemption from VAT with respect to services and goods procured by oil and gas companies for their exploration activities in Kenya.

This study has found that the legal framework governing taxation in the oil and gas sector faces challenges due to the fragmented rules contained in PSCs and the applicable tax laws. Further, there are inconsistencies and overlaps between the provisions of the Ninth Schedule to the Kenya Income Tax Act (KITA) and the model Production Sharing Contract (PSC) in Kenya on the incentives that are supposed to attract investors to the sector. These inconsistencies tend to water down the intended purpose of the incentives as IOCs are unable to get clear information. This therefore means the research hypothesis was proved in the affirmative.

A comparative study of Ghana and Nigeria revealed that there are comprehensive frameworks for attracting IOCs including tax incentives. The fiscal regimes for the upstream oil and gas industry in these countries were found to be investor attractive and adequate. In the two countries, laws providing for tax incentives in the oil and gas sector are harmonized and do not reveal inconsistencies like those seen in Kenya's framework. Clear, broad based tax and non-tax related incentives attract more IOCs. However, there is no precise evidence suggesting that more incentives guarantee increased revenue base for the country.

Apart from establishing a policy and legal framework to attract IOCs, Nigeria has also entered treaty arrangements with the specific countries and this has also provided an incentive for companies from those countries to invest in Nigeria's oil sector. As seen in the study on Nigeria has also established the Oil and Gas Free Zone where special incentives are given to IOCs. This is besides the Special Economic Zone that is meant to attract investors in a wide range of industries. Kenya only has a Special Economic Zone.

There are numerous similarities in the frameworks for attracting IOCs in Kenya on the one hand, and in Ghana and Nigeria on the other. In both Ghana and Nigeria, exports of goods and services are zero-rated for VAT, to mean petroleum exports by a contractor attract VAT on

exports at a zero rate. This is the case in Kenya too. The two countries have also enacted laws to exempt import and export duties on items or goods used in the oil and gas industry. In addition, Kenya, Nigeria and Ghana have put in place frameworks for allowable deductions in taxation of petroleum upstream activities.

### **5.3 General Conclusion**

This study concludes that although Kenya has put in place legislation on tax incentives, there are glaring inconsistencies and overlaps between the Ninth Schedule to the Income Tax Act and the model PSC under the Petroleum Act, 2019. The overlaps and inconsistencies tend to obscure the intended benefits of the tax incentives provided for in the laws and in the model PSC. There is need for the Kenyan Government to ensure that the tax incentives are economical and at the same time, that the granting of tax incentives falls within the international standards where laws are consistent.

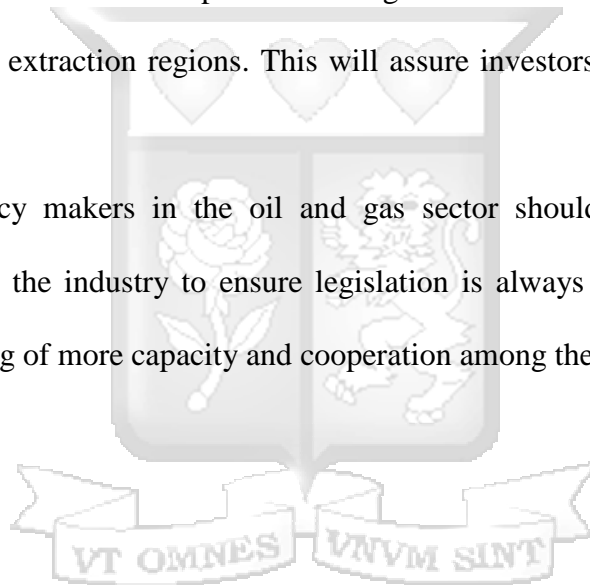
### **5.4 Recommendations**

This thesis makes the following five recommendations:

- a.** There is need to review and harmonize the tax legislation, namely the Ninth Schedule to the Income Tax Act, Cap 470; the Finance Act, 2014; and the model PSC under the Petroleum Act, 2019 to create clarity, consistency, clear overlaps, and make it less burdensome for the companies to comply. The review and amendment should harmonise and bring clarity on the incentives embodied in the said laws. The *United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries* gives a good model in the quest to harmonize provisions that define tax incentives in Kenya's oil and gas sector.
- b.** Kenya should consider making and/or enhancing specific trade treaty arrangements with countries where target major IOCs are domiciled so as to attract those IOCs to the

country for mutual benefits. Policy experts can borrow experiences from Nigeria in that respect.

- c. There is need to undertake an audit and review the legal, policy and administrative framework establishing tax related incentives for International Oil Companies with a view of reducing unnecessary or burdensome incentives and enhancing participation of local companies and benefits for local communities.
- d. The Kenyan Government should undertake measures to guarantee political stability and national security for citizens and potential foreign investors in the oil and gas sector, and specifically in oil extraction regions. This will assure investors of security hence attract them.
- e. Experts and policy makers in the oil and gas sector should constantly monitor the growing needs in the industry to ensure legislation is always adjusted to conform and ensure the building of more capacity and cooperation among the players.



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# Appendices

## Appendix A: Similarity Report



### Document Information

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Submitted	2021-11-15 09:31:00
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Submitter email	mohamed.bulle@strathmore.edu
Similarity	17%
Analysis address	library.strath@analysis.orkund.com

### Sources included in the report

<b>W</b>	URL: <a href="https://su-plus.strathmore.edu/bitstream/handle/11071/8309/Local%20content%20implementation%20strategy%20for%20Kenya%E2%80%99s%20oil%20and%20gas%20industry%20-%20an%20evaluation%20of%20Sections%2050%252C%2051%20and%2052%20of%20the%20Petroleum%20Act%202019.pdf?sequence=3&amp;isAllowed=y">https://su-plus.strathmore.edu/bitstream/handle/11071/8309/Local%20content%20implementation%20strategy%20for%20Kenya%E2%80%99s%20oil%20and%20gas%20industry%20-%20an%20evaluation%20of%20Sections%2050%252C%2051%20and%2052%20of%20the%20Petroleum%20Act%202019.pdf?sequence=3&amp;isAllowed=y</a> Fetched: 2021-11-15 09:34:00	3
<b>W</b>	URL: <a href="https://revistas.uexternado.edu.co/index.php/fiscal/article/download/5946/7657/">https://revistas.uexternado.edu.co/index.php/fiscal/article/download/5946/7657/</a> Fetched: 2021-11-15 09:34:00	16



## Appendix B: Ethical Clearance Confirmation



**Strathmore**  
UNIVERSITY

### Final Decision

This document certifies that the study:

**\\\"ASSESSMENT OF TAX INCENTIVES FOR CONTRACTORS IN KENYA'S UPSTREAM OIL AND GAS LEGISLATIVE FRAMEWORK\\\"**

**Principal Investigator:** Professor MIYAWA, MAXWEL

**Reference number:** SU-IERC1238/21

Was reviewed and received the following status:

**\\\"not-approved\\\"**

**Additional Comments:**

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No Comments from the Reviewers.

Student already graduated, hence negating the need for an ethical review.

13 April 2022 10:13:49