

Beyond the Power Bill: The Tax Economics of Solar Investment in Kenya

Kenya's solar energy sector continues to attract interest from businesses and investors seeking to take advantage of the country's abundant solar resources and growing demand for reliable, sustainable energy. Opportunities exist across the value chain, including the manufacture, importation and distribution of solar equipment, as well as the development of solar power projects for domestic, commercial and industrial use.

As investment in the sector grows, the tax implications become an important consideration. The availability of VAT exemptions and the income tax treatment of qualifying investments can influence both the initial cost of a project and its long-term financial returns. It is therefore important for businesses entering the solar market to understand the relevant tax provisions and the conditions attached to the incentives available.



1 VAT Considerations

One of the VAT incentives available to the solar industry is the exemption of approved inputs and raw materials supplied to manufacturers of solar equipment and qualifying deep-cycle sealed batteries that exclusively use or store solar power. This provision benefits manufacturers by reducing the VAT cost of acquiring qualifying production inputs, subject to approval by the Cabinet Secretary responsible for the National Treasury upon recommendation by the Cabinet Secretary responsible for energy and petroleum.

The manufacturer initiates the application for the VAT exemption, while the approval is granted to the supplier of the qualifying inputs or raw materials. Accordingly, suppliers should ensure that the requisite approval has been obtained before making the supply for the exemption to apply.

The VAT Act also provides for an exemption for specialised equipment used in the development and generation of solar energy, including photovoltaic modules, direct current charge controllers, direct current inverters and qualifying deep-cycle batteries. The exemption is subject to a recommendation to the Commissioner by the Cabinet Secretary responsible for energy. Importers of qualifying equipment should establish the applicable requirements before shipment and allow sufficient time for any necessary recommendation and approval.



2 Income Tax Incentives for Solar Investments

Beyond VAT, the income tax treatment of capital expenditure can influence decisions on whether, where and how to invest in solar-related activities.

01

For income tax purposes, solar power generation equipment used in the manufacturing of goods qualifies for an investment allowance of 50% in the first year of use, with the residual value deductible at 25% per year in equal instalments over the following years.

02

Where investment in solar power generation equipment exceeds KES 250 million in a year of income and is made outside Nairobi City County and Mombasa County, a 100% investment deduction will apply.

03

Investments in solar power generation equipment made within Special Economic Zones (SEZs) will similarly qualify for a 100% investment deduction.

04

For businesses investing in solar equipment outside manufacturing, a capital allowance deduction at a rate of 10% per year in equal instalments may apply, depending on the classification and use of the assets.

Businesses should therefore consider the use of their solar power investments when determining the capital allowances to be deducted in any year of income. The applicable treatment will depend on the nature of the investment and the relevant provisions of the Income Tax Act.



3 Tax Implications of Third-Party Financed Solar Installations

The tax treatment of solar installations financed by third parties will depend on the nature and substance of the financing arrangement. Under a Power Purchase Agreement (PPA), payments for electricity consumed will generally be deductible for income tax purposes, while the user of the equipment will not claim capital allowances on assets owned by the provider. Where the arrangement takes the form of a loan, withholding tax may apply to interest payments, while the borrower may claim capital allowances on qualifying solar equipment owned by the business, subject to the applicable tax rules. In a leasing arrangement, lease payments may be deductible in determining taxable income, while the lessor retains ownership of the equipment and claims the relevant capital deductions in accordance with the Income Tax (Leasing) Rules, 2026. Where ownership transfers to the lessee at the end of the lease term, the tax deductions previously claimed must be reviewed and adjusted as required under the applicable rules, with capital allowances determined in accordance with the relevant provisions. Businesses should therefore engage a tax consultant to review their solar financing agreements and establish the appropriate tax treatment before entering into the arrangement.

As Kenya's solar industry develops, a clear understanding of these tax considerations can help businesses plan their investments, manage compliance obligations and make informed commercial decisions.



For any queries, clarifications or assistance on the tax implications discussed in this article, please contact us:



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