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# Kenya VII: Results

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# 1 Revenue collection related results

## 1.1 Context

Prime goal of the Tax Justice & Poverty research project was the question, whether and inasmuch a more just taxation is suitable to reduce inequality and poverty (Tax Justice & Poverty, 2013). There is widespread agreement, that taxation is a complex process which cannot be evaluated in isolation, but by also taking into account the following dimensions:<sup>1</sup>

1. It shall provide revenue which pays for public services
2. It shall redistribute wealth and income
3. It shall regulate/stimulate economic activities and advance jobs
4. It shall put a price on harmful activities, e.g. regarding public health or the exploitation of resources and the global commons.

This complex approach is also taken by the Kenyan government in the context of its Vision 2030, which determines ongoing government policy in many relevant areas.

Kenya, like many other developing countries, seeks to apply the tax weapon so as to meet her objectives of raising enough revenue and ensuring that revenue is raised in ways that are equitable and that minimize the disincentive effects of taxation. The tax system in the country has concentrated on taxing individual income (Personal Income Tax-PIT), profits (Corporate Income Tax-CIT) and goods and services (VAT, excise duties). However, for purposes of administrative feasibility as well as for political economy reasons, a tax on land has not yet been well developed in Kenya (Ronge, Eliud Moyi & Eric, 2006). The main challenges facing the taxation of factors of production in a low income country like Kenya includes: (i) Structure of the economy: This makes it difficult to impose some taxes. The larger the size of the informal economy, the more challenging taxation becomes. (ii) Administration: Limited capacity in tax administration. (iii) Tax data: Poor quality of basic data to estimate optimal taxation, forecast revenues adequately, undertake micro-simulations and tax modeling; and (iv) Politics: An unfriendly political economy that is not amenable to rational tax policy may prevent significant tax reforms (ibid.). The political elite, who posses high personal income, wealth and property, may use their political influence to oppose the imposition of wealth and

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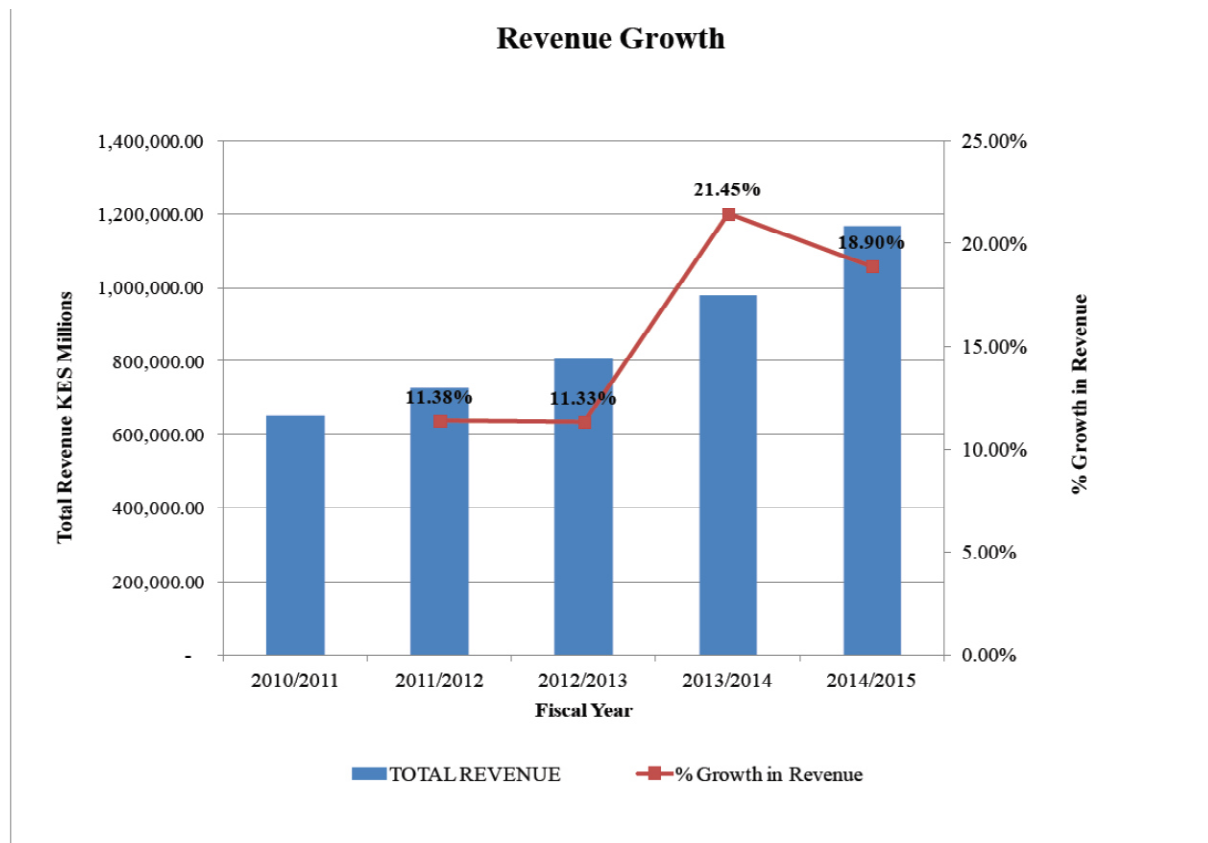
<sup>1</sup> See, e.g., (Institute of Economic Affairs, 2012, p. 8), (ICPAK, 2016), (Rotich, 2017),

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property taxes. The above challenges prevent the setting up of an efficient and effective tax system.

## 1.2 Tax Revenue and trends

Graphic 1 Revenue trend 2010-2015



Source 1 (ICPAK, 2016, p. 18)

ICPAK comments: Between 2010 and 2015, revenue grew 44% in just 5 years, 21.45% in 2013/2014 alone. All this confirms earlier observations that increases were (1) during tax reforms increasing compliance, for example in 2004 with a tax amnesty waiving interests on tax arrears and the (2) principle of self-assessment (ICPAK, 2016, p. 18). → what's the point of the latter?

## 1.3 Revenue from tax categories

→ New and updated diagram from current figures in EXCEL from KRA

Table 1 Revenue collected 2013-2016

REVENUE COLLECTED IN THE PERIOD 2013/14-2015/2016-KSHS MILLION

ITEM	2013/14		2014/15		2015/16	
	Actual	Target	Actual	Target	Actual	Target
<b>CUSTOMS SERVICES</b>						
<i>Exchequer</i>						
Gross Import Duty	66,896	68,560	74,033	77,048	81,266	83,928
Refunds	300	300	300	300	300	300

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<b>Net Import Duty</b>	<b>66,596</b>	<b>68,260</b>	<b>73,733</b>	<b>76,748</b>	<b>80,966</b>	<b>83,628</b>
Import Duty-Ordinary	65,580	67,249	72,346	75,708	79,372	81,957
Import Duty-Oil	1,016	1,010	1,387	1,040	1,595	1,671
<b>Gross Excise Duty</b>	<b>53,968</b>	<b>51,554</b>	<b>60,262</b>	<b>57,782</b>	<b>72,108</b>	<b>69,947</b>
<b>Refunds</b>	2,400	2,400	2,400	2,400	2,400	2,400
<b>Net Excise Duty</b>	<b>51,568</b>	<b>49,154</b>	<b>57,862</b>	<b>55,382</b>	<b>69,708</b>	<b>67,547</b>
Excise Duty-Domestic						
Excise Duty- Imports	13,151	13,732	15,175	15,999	18,096	16,937
Excise Duty-Oil	38,416	35,422	42,687	39,383	51,611	50,609
<b>VAT Imports</b>	<b>125,177</b>	<b>121,756</b>	<b>135,637</b>	<b>143,286</b>	<b>131,473</b>	<b>134,267</b>
VAT-Ordinary Imports	114,556	112,505	127,744	134,038	125,105	127,459
VAT-Oil Imports	10,621	9,251	7,894	9,247	6,368	6,808
Import Declaration Fees	26,627	27,219	27,119	27,640	25,851	26,141
Railway Development Levy	19,721	20,146	18,940	22,922	17,273	17,951
<b>Sub-Total Exchequer</b>	<b>289,689</b>	<b>286,535</b>	<b>313,291</b>	<b>325,977</b>	<b>325,272</b>	<b>329,533</b>
<b>Agency</b>						
Aiport Revenue	6,837	7,287	6,619	7,665	6,570	8,986
Aviation Revenue	3,468	4,164	3,565	3,595	4,122	4,111
Petroleum Development Levy FMV	1,794	1,519	1,817	1,238	1,974	1,395
Road Maintenance Levy	28,163	24,724	30,890	20,684	45,407	26,229
K.A.A Concession Fees	106	111	113	112	114	122
Road Transit Toll	495	550	562	442	674	550
Sugar Levy	114	278	295	104	288	264
Petroleum Regulatory Levy	158	152	301	167	485	301
Merchant Superintendent Shipping Levy	757	855	820	1,018	934	2,001
Railway Development Levy						
KEBS Petroleum Inspection Fess						
Revenue Stamps						
Miscellaneous	250	-	150	-	161	-
<b>Sub-Total Agency</b>	<b>42,142</b>	<b>39,641</b>	<b>45,132</b>	<b>35,026</b>	<b>60,731</b>	<b>43,959</b>
<b>TOTAL</b>	<b>331,831</b>	<b>326,176</b>	<b>358,424</b>	<b>361,003</b>	<b>386,002</b>	<b>373,493</b>
<b>DOMESTIC TAXES</b>						

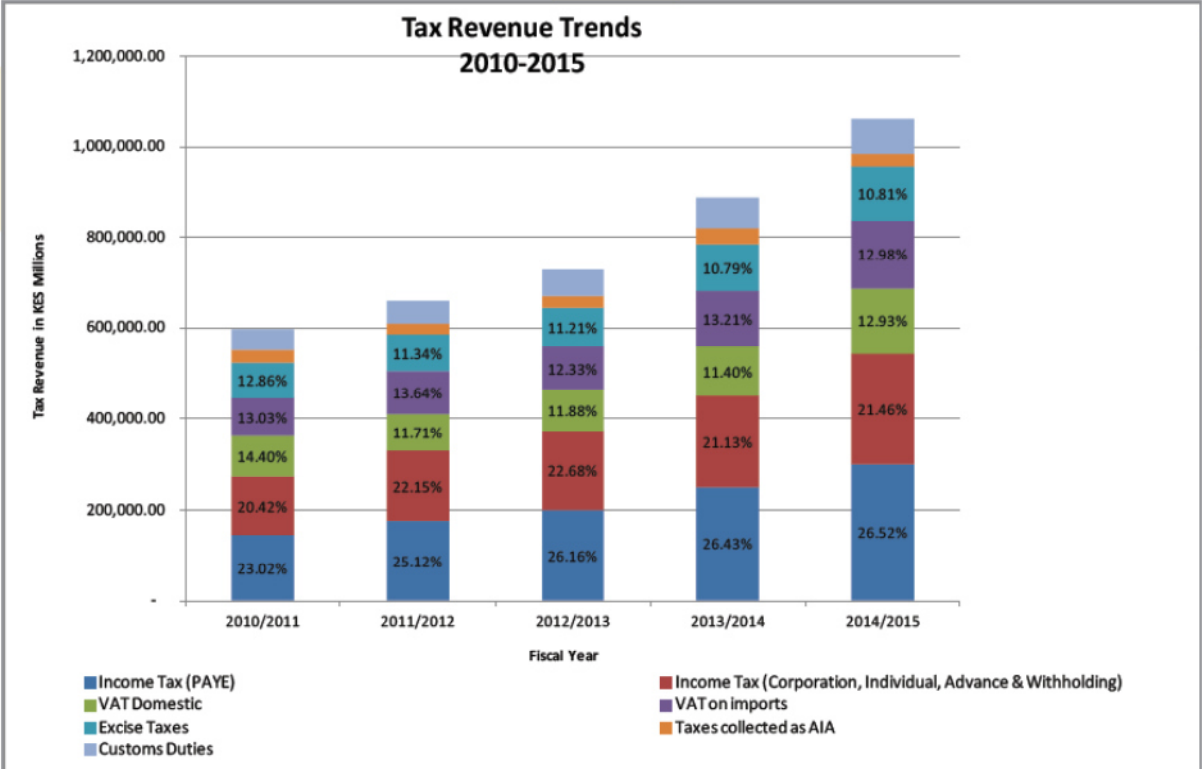
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<i>Exchequer</i>						
PAYE						
WCP						
<b>Total PAYE</b>	<b>252,974</b>	<b>258,011</b>	<b>277,068</b>	<b>284,461</b>	<b>312,032</b>	<b>309,189</b>
Individual	6,033	5,378	7,154	7,458	8,821	9,706
Corporation Tax	135,971	127,523	126,541	164,970	152,407	164,916
Other Taxes						
Advance tax	1,725	1,624	2,064	2,012	2,653	3,294
Withholding Tax	56,816	62,514	92,678	73,301	82,690	90,374
Capital Gains			636	200	3,811	5,240
Rental Income					2,033	
Turnover Tax	166	204	630	198	385	508
<b>Sub-Total Other Taxes</b>	<b>200,710</b>	<b>197,243</b>	<b>229,702</b>	<b>248,138</b>	<b>252,799</b>	<b>274,037</b>
VAT-Gross	123,068	123,895	143,922	141,454	174,051	180,439
<i>o/w Withholding VAT</i>			6,890		34,355	40,476
Refunds	14,688	14,688	14,688	14,688	14,681	14,681
VAT-Net	<b>108,380</b>	<b>109,207</b>	<b>129,234</b>	<b>126,766</b>	<b>159,370</b>	<b>165,758</b>
Excise Duty-Domestic	35,855	35,837	38,246	45,392	48,986	46,724
Excise on Airtime	12,302	12,658	13,122	13,808	14,884	15,076
Excise on Financial Services	4,973	6,356	5,722	4,977	9,013	7,828
Stamp Duty	10,069	10,368	11,579	13,811	10,417	11,570
Land Rent	1,071	1,484	1,045	1,408	1,201	1,923
<b>Sub-Total Exchequer</b>	<b>626,335</b>	<b>631,163</b>	<b>705,718</b>	<b>738,762</b>	<b>808,702</b>	<b>832,105</b>
<i>Agency</i>						
KEBS	496	536	475	561	475	511
Sugar Levy	1,471	1,500	1,034	1,690	1,069	1,700
Land Rates						
<b>Sub-Total Agency</b>	<b>1,966</b>	<b>2,036</b>	<b>1,508</b>	<b>2,251</b>	<b>1,543</b>	<b>2,211</b>
Gross Receipts	638,016	641,531	716,192	750,724	815,913	841,169
<b>TOTAL</b>	<b>628,301</b>	<b>633,199</b>	<b>707,227</b>	<b>741,012</b>	<b>810,245</b>	<b>834,315</b>
<b>ROAD TRANSPORT</b>						
Exchequer	2,959	3,598	2,964	3,010	2,859	3,751
Agency	732	767	982	863	1,052	1,060

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<b>TOTAL</b>	<b>3,691</b>	<b>4,365</b>	<b>3,947</b>	<b>3,874</b>	<b>3,911</b>	<b>4,812</b>
<b>GRAND TOTAL</b>	<b>963,823</b>	<b>963,740</b>	<b>1,069,597</b>	<b>1,105,889</b>	<b>1,200,159</b>	<b>1,212,620</b>

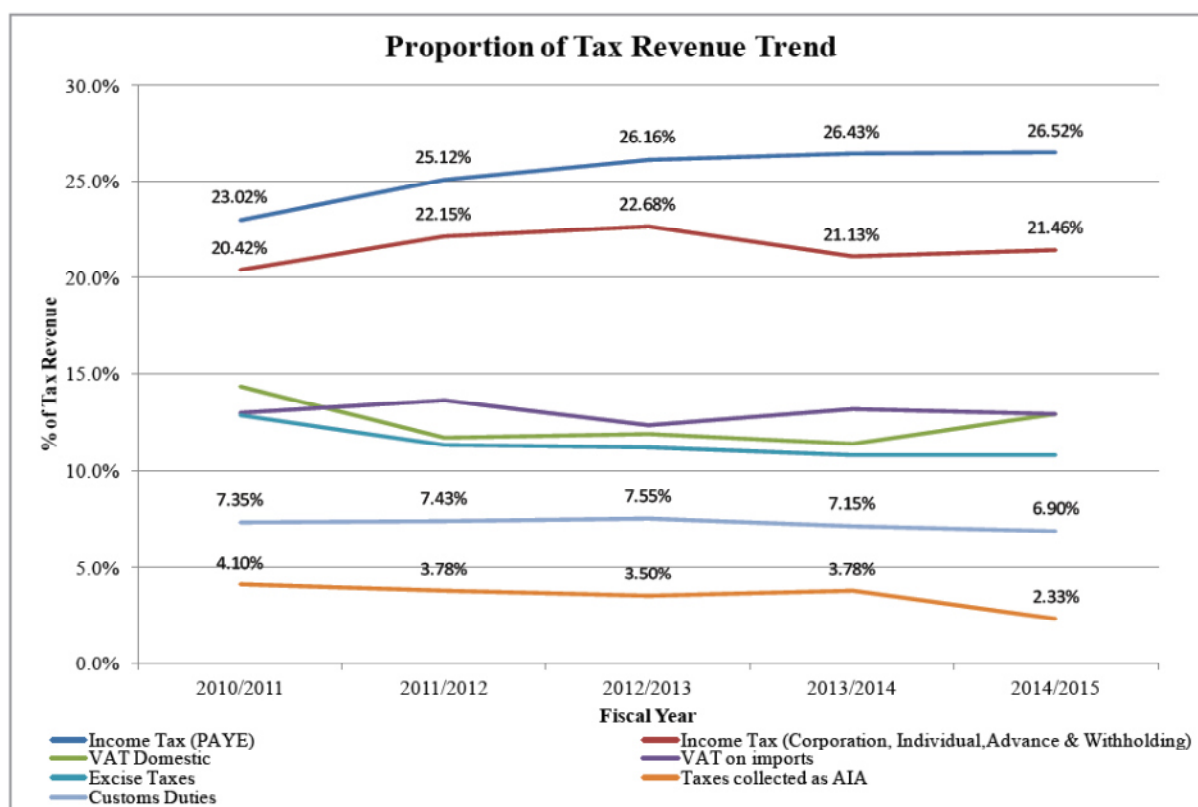
Graphic 2 Trend in tax revenue overall, and within single tax categories 2010-2015



Source 2 (ICPAK, 2016, p. 21)

- ➔ Appropriations in Aid (ICPAK p. 26)? Why is this included with taxes? Seems not to be international standard and rather an Kenyan speciality? Are not in KRAs list
- ➔ The Excise Duty on financial services introduced 2013 made excise revenue rise sharply from 8.5% to 19.1% in 2012/2013 (Institute of Economic Affairs, 2012). ➔ This is not reflected in the above statistics? What to make of the figures in KRAs table on financial services and airtime, if compared with CGT, Rental income, Withholding Tax and CIT, which are also on the increase. Is this still a good argument beyond that fact that indirect taxes hit the poor?

Graphic 3 Trend within individual revenue categories



Source 3 (ICPAK, 2016, p. 23)

### 1.3.1 Tax revenue for counties

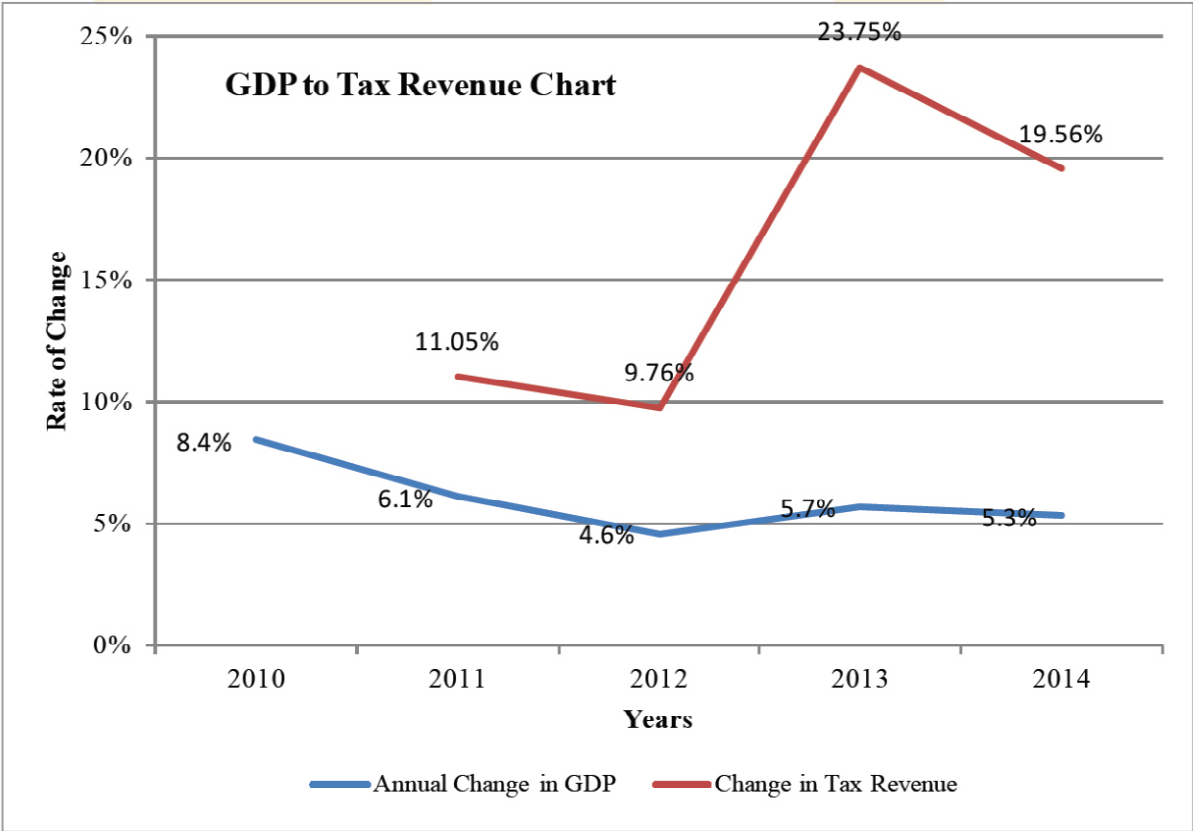
Property taxes (known as Rates) provide an average of 20 percent of the total recurrent revenues for local authorities and represent 1 percent of total government tax revenue and 0.25 percent of GDP. Property Rates in 2000/2001 provided Ksh 1.5 billion (US\$19.2 million)—broken down as follows: Ksh 1.4 billion and Ksh 83 million to the Municipal Councils and to Town, Urban and County Councils, respectively.<sup>2</sup>

### 1.4 Tax revenue in relation to GDP

A widely acknowledged indicator of the quality of a taxation system is the development of tax revenue in relationship with the GDP. In a graphic, ICPAK presents the following development of both GDP and tax revenue, illustrating that there is a link between economic growth and revenue growth:

<sup>2</sup> These figures come from FY 2000-2001 collections as recorded through the Local Authorities Transfer Fund (LATF) financial submissions (Ministry of Local Government). These figures are consistent with those issued annually by the Central Bureau of Statistics Annual Economic Survey—for which the latest figures, issued in 2001, are for FY 1998/99.

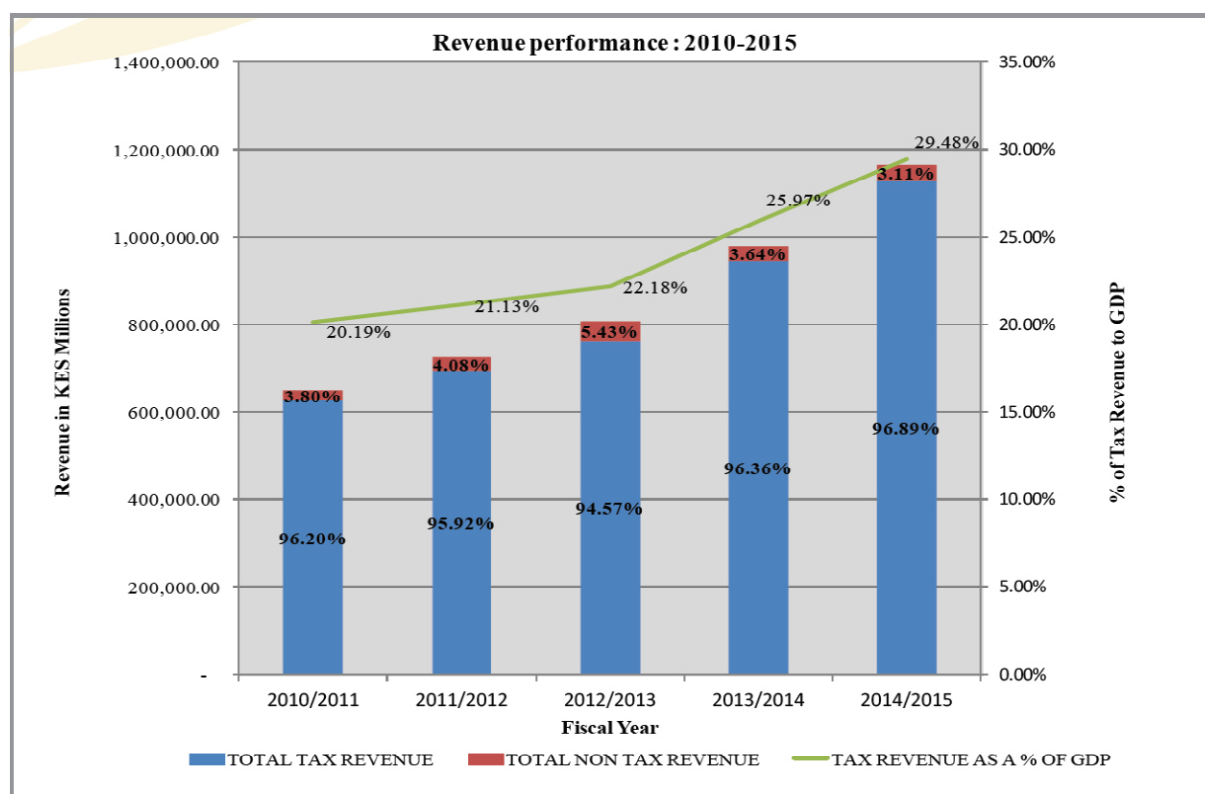
Graphic 4 Development of the GDP to Revenue indicator 2010-2014



Source 4 (ICPAK, 2016, p. 16)

While total tax revenue as percentage of Gross Domestic Product averaged 19.7% in the 1980s, the current average is at 24% (Institute of Economic Affairs, 2012), which is rising in tendency, namely 9% between 2010 and 2015, which makes Kenya look good when comparing with other Low Middle Income country, whose ratio ranks between 11-15% (ICPAK, 2016, p. 19):

Graphic 5 Revenue development, both in absolute terms and as % of GDP 2010-2015



Source 5 (ICPAK, 2016, p. 17)

There is equally an upwards trend in the growth of tax revenue and a declining of non-tax revenue.

## 1.5 Observations

Looking at the development of revenue and certain indicators with which the development of revenue collection commonly is judged, there are encouraging news regarding Kenya:

- Tax revenue from income taxes, especially PAYE, is unchanged the largest share of revenue.
- PIT slow revenue and slow increase,
- CIT has ups and downs and is beneath the target
- Rental income is listed for the first time, but very low
- Withholding and CGT rising

Does all this mean that Kenya is more or less on the right track and things should just continue the way they are taking?

## 2 Preliminary evaluation of the Kenyan tax system

### 2.1 Value dependent conclusions

Ronald Dworkin in his paper, “What is Equality: Equality of Welfare?” explained justice in terms of equality of welfare and emphasised that it entails in making available the resources necessary for development of a person’s physical, mental, educational and material wellbeing.

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(Dworkin, 1985). Hence, to be realised, individuals must be equal in the designated resources, which government should distribute in a manner that leave them as equal as possible in their quality of life. The principle of horizontal and vertical equity need to be respected: The comparable needs to be taxed comparably, the not-comparable needs to be taxed differently. While horizontal equity requires individuals who are similarly placed to be taxed similarly, vertical tax justice aims for the Principle of Ability to Pay. That is, those who are poor, need to be given tax credits, those with equal ability to pay owe equal amount of taxes to the state and those with a higher ability to pay need to pay a higher share (Ochieng, 2012). True: Taxation is never merely about economics and laws, it is also about justice.

At the same time: While everybody would agree to this statement, every political party, business group or civil rights association has different ways and views upon how to achieve those goals and, of course, has particular interests and stake in taxation. This impacts on tax policy and instruments (see V/#) but also regarding the evaluation of results.

One instance for a business friendly vantage point is a joint study by the World Bank (WB) Group and PricewaterhouseCoopers (PwC) provide a platform for governments and businesses to engage in constructive discussion around tax reforms across a broader range of issues. Over ten years of the study, almost 80% of the 189 economies covered in the report made significant changes to their tax regimes at least once. All three sub-indicators – the time to comply, number of tax payments and the total tax rate – have fallen consistently over the period of the study reflecting the reforms that governments have implemented making paying taxes easier for businesses and governments. This report also shows that corporate income tax is only part of the picture when looking at the contribution made by a business to public finances (PWC, 2016). On average around the world corporate income tax (and other profit taxes) accounts in 2014 for only 40% of the total tax rate, 13% of payments and 26% of time.<sup>3</sup>

The Tax Justice & Poverty projects in general, and JHCs focus in particular, are broader than PwC by taking also tax revenue and tax expenditure for the common good into focus. We do not only adhere to the generally established principles of equal and fair taxation (Kabinga, Alt, & al., 2016), but also to values, principles and norms of Catholic social teaching.

One has to be aware that those value dependent starting points also inform the choice of criteria, prioritization and evaluation of a given system.

### **2.1.1 Excursus: Established tax principles**

Over time scholars have attempted to devise and regulate the complexity of taxation by creating rules and principles through retrospective analysis of the application of taxation. Due to their value orientation, they have a strong element to it (see (Kabinga, Alt, & al., 2016).

There are as a result five important considerations in analysing any tax system (Waris, 2007). Firstly, to consider tax system in isolation from other items of public revenue or expenditure is an incomplete and unrealistic attempt. Taxation is only one part of the total budget of the government. Other forms of revenues include charges, fees, licences and government business

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<sup>3</sup> Paying Taxes 2016: The Global Picture. World Bank Group and PwC, Nov 2015.

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holdings. Secondly, a tax system has many dimensions. This includes volume, composition, rates, coverage, and timings of collection, mode of collection among other things in order to grasp its effects in totality. Thirdly, it is nearly impossible to choose theoretically the best taxation system. Government has to conceptualize the various problems while working out the best possible system and will generally settle for a compromise between conflicting considerations and therefore in the end settles for a sub-optimum tax system. Fourthly, is the taxpayer's attitude; normally each taxpayer desires to be freed from the tax burden and does not mind if it is borne by the others. It is essential that a good tax system should be equitable to all taxpayers. Attitude is also influenced by other factors like the political situation, natural calamities and the economic situation. Finally, changes in the tax system itself can be brought about only slowly and in stages. A sudden disruption is impossible and the effects of a sudden overhaul in a tax system can result in collapse of an economy. According to Waris (Waris, 2007) the tax system in order to achieve certain objectives chooses and adheres to certain principles, which are, termed its characteristics. A good tax system, therefore, is one designed on the basis of an agreed appropriate set of principles. However, tax objectives conflict with each other and there is usually a need for compromise usually at the political level. Indeed these principles are very realistic in any democratic state which cares for its citizen and the development of the state in general.

We want to reinstate that for us the "Principle of Enforceability" is key, because the best laws are worth nothing if they cannot be implemented due to the lack of resources or international complexities.

Regarding JHCs convictions and criteria regarding to values, principles and norms of Catholic social teaching see below, 4#

## **2.2 Tax buoyancy and Tax elasticity**

Two widespread criteria with which to assess the efficiency of a tax system are tax buoyancy and tax elasticity and there are quite a number of papers examining this for Kenya.<sup>4</sup> Tax "elasticity" refers to revenue growth in the absence of any tax policy changes, while tax "buoyancy" refers to growth including the effects of such changes. In principle, elasticity is seen to be a better measure of the growth potential of the tax structure. The problem is, that there are many changes with tax law and administration, which is why results of older studies might be outdated. This is why only the latest study known to the authors has been considered for this chapter. In more detail:

Tax buoyancy explains this relationship between the changes in government's tax revenue growth and changes in GDP and income. It shows the association between economy's performance and revenue, it indicates the high sensitiveness of tax revenue realisation to GDP growth. It is a crude measure and does not distinguish between discretionary and automatic

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<sup>4</sup> 2012: [http://pakacademicsearch.com/pdf-files/ech/519/116-125%20Vol%203,%20No%205%20\(2012\).pdf](http://pakacademicsearch.com/pdf-files/ech/519/116-125%20Vol%203,%20No%205%20(2012).pdf)  
2014, examining data from 1963-2010:

<http://www.ku.ac.ke/schools/economics/images/stories/docs/Journalarticles2017/EffectsofTaxReformsonBuoyancy.pdf>

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growth of revenue and a tax is said to be buoyant if the tax revenues increase more than proportionately in response to a rise in national income, GDP and/or output (ICPAK, 2016, p. 13).

There are different ways to define tax elasticity:

Elasticity of the tax system measures instead the responsiveness of tax revenue to changes in national income keeping all other parameters (including tax legislation) constant. When the elasticity of major revenue sources is low (for example, owing to the rigidity of the tax base or the presence of tax evasion and/or avoidance), governments raise additional resources through discretionary measures. In this case, the growth of tax revenue comes through high buoyancy rather than high elasticity. In some sense, elasticity is more appropriately used to estimate the impact on revenues from, say, an unexpected decline in the tax base (owing, for example, to a natural disaster), or the increase in, say, personal income tax revenues over time if other provisions (income brackets, deductions, and allowances) remain the same. Buoyancy on the other hand, more appropriately measures past revenue developments or the combined effects of a package of reforms.<sup>5</sup>

This is in line with the definition by ICPAK, saying that “tax elasticity measures the built-in response of revenues to change in income, while tax buoyancy quantifies the total change in revenue accompanying changes in income” (p.6). If there is no change in tax policy during a period of reference, buoyancy and elasticity are the same.<sup>6</sup> “In a tax environment like Kenya, which has experienced many changes in tax policies, it may be difficult to identify and separate all discretionary tax policies that have been undertaken in the country”, which is why tax buoyancy may be the “alternative approach to tax elasticity in evaluating tax revenue performance” (ICPAK, 2016, p. 12).

On that background, findings are as follows, The “Buoyancy Coefficient” column telling what percentage of change occurred as a result of both automatic changes and discretionary policy for every 1% change in GDP, the  $R^2$  column, being the coefficient of determination, telling, what percentage of change in this particular tax can be explained by the variation of GDP. For example: The tax system yielded a 93% change in tax revenue for every 1% change of GDP, 84% of this variation can be explained by the variation in GDP, the rest by other factors and influences:

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<sup>5</sup> <https://www.imf.org/~media/Files/Publications/WP/wp1704.ashx>

<sup>6</sup> See (ICPAK, 2016, p. 6)

**Table 2 Tax Buoyancy Table Regression Result**

Revenue Classification	Buoyancy Coefficient	R <sup>2</sup>
PAYE	0.93	0.84
Other Income	0.85	0.50
VAT	0.66	0.76
Excise	0.35	0.67
Customs	0.66	0.76
Overall Tax Revenue	0.73	0.78

Source 6 (ICPAK, 2016, p. 27)

ICPAK concludes: „It is apparent that PAYE registers the highest coefficient of buoyancy, however, still below the coefficient necessary for taxes to be considered buoyant. The performance of various taxes aligns with the findings the buoyancy and reflects the effectiveness of the tax system in responding to changes in national income.” (p.30). This implies that at first sight, the tax system of Kenya is improving continuously, but a lot is still to be done to improve, especially regarding the categories “Other Income” and “VAT”, whereas Customs and Excise gradually moves away from national sovereignty into the network of international cooperation.

### **2.3 Tax capacity, tax effort, tax gap**

While the previous criteria rather attempt to describe an almost “automatic” corresponding relationship between changing socio-demographic-economic environment, tax policy and tax revenue collection, another set of criteria might be more illustrative to point towards the effort a state has to put into not only legislative instruments regarding tax base and rates, but also an effective tax administration: Tax(able) capacity and tax effort.

According to a World Bank study, both terms are defined as follows:

Taxable capacity refers to the predicted tax-to-gross domestic product ratio that can be estimated empirically, taking into account a country's specific macroeconomic, demographic, and institutional features, which all change through time. Tax effort is defined as an index of the ratio between the share of the actual tax collection in gross domestic product and taxable capacity.<sup>7</sup>

Regarding Kenya, these indicators have been selected by Attiya Waris in her country portrait of Kenya for the Tax Justice Network Africa. In her paper, based on statistics from the first half of the 2000s and extrapolated for the 2007/2008 budget, she observes that the highest proportion of taxes collected is the beer tax with 85%, i.e. an indirect, sales based tax. It is followed by PAYE with 65% and the Personal Income Tax with 67%. The lowest effort in collecting taxes she states for the Corporate Income Tax, rated at 35% only. Overall, there are large losses in revenue, namely

<sup>7</sup> <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-6252>

**Table 3 Kenya's Revenue Capacity and Tax Effort**

Type of tax	Year	Revenue Tax Capacity Ksh Million	Tax Effort/Ksh Million	Compliance Percentage (est.)	Loss
Personal income taxes	2007/08	113,584	89,368	66.9%	24,216
Excise tax	2007/08	47,689	34,050	71.4%	13,639
Import Duty	2008/08	66,406	32,539	49.0%	33,867
Corporate tax	2007/08	163,164	57,434	35.2%	105,730
VAT	2007/08	198,228	111,008	56.0%	87,220

Source: Karingi and Nyamunga et al. 2004, extrapolated to fiscal year 2007/2008 figures

Source 7 (Waris & al., 2009, p. 16)

All that results for Kenya into a Tax Gap<sup>8</sup> between capacity and effort of 55.1%; which leaves a lot of room for improvement if voluntary or enforced tax compliance would be higher. Waris comes to the conclusion that, obviously, most could be gained in the corporate sector and that also attention should be given to the tax evasive potential of the “underground” economy, which in her understanding combines legal and illegal/criminal aspects. From our point of view, also private wealth holder are a promising area to spend efforts into a higher compliance, since the lack of transparency and the considerable potential for avoiding and evading taxes here, too, holds promises for more revenue.

## **2.4 Experiences with the devolved system**

Local governments raise whatever taxes they are capable of raising, often without worrying excessively about the economic distortions and distribution effects that these taxes may create. Furthermore, there are often large variations on the tax rates imposed by councils/local governments on similar revenue bases, for instance on agricultural products. This has led to extensive ‘smuggling’ of agricultural goods across council boundaries.

Moreover, many local taxes have a distorting effect on resource allocation decisions, and an inhibiting effect on the start-up of new enterprises and the achievement of economic growth. These effects occur when effective tax rates vary greatly between different goods that are traded, or when license fees are set too high for start-up small- scale enterprises to survive. In addition, the levels and types of local taxes can by themselves result in the tax burden falling more on the poor than on the relatively better off in local communities. This is mainly due to the basic design of the tax system. But again Lack of co-ordination between the central and local levels has led to duplication of taxes and inconsistencies between taxes imposed by local authorities and the national government’s development policies. All this, however, is known to the government and about to be addressed (see V/2.2).

## **2.5 Continuing need for other sources of financing**

Kenyas revenue collection improved over the year and with that declined the dependency from foreign aid and borrowing. Kenya needs external support for about 11% of the total

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<sup>8</sup> Tax Gap: The difference between the amount of tax collection that the tax authority should have collected against what is actually collected.

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budget, which compares favourably to the 30-40% of other states of the Eastern African Community (Institute of Economic Affairs, 2012, p. 8+15).

At the same time, and given all tax presents and spending plans, the fiscal deficit for the Financial Year of 2017/2018 lies at 524.6 billion KSh, equivalent to 6.0 percent of GDP. Plans are to cover this by borrowing. Borrowing from external sources will be at 256 billion KSh (2.9 percent GDP), mostly on concessional terms. Domestic financing of the budget will be at 268.6 billion KSh (3.1 percent of GDP borrowing) (Rotich, 2017, p. 36).

## **2.6 Dependence on external financing?**

At the outset of this research, state dependency on external financing was seen to be a problem for developing countries. And, as defined in chapter I/IV/3.1 we distinguished external financing from other forms of credit and loan financing.

Regarding Kenya, and as already indicated in chapter IV/3# of this report, dependency on external financing poses, provided, the global financial and macroeconomic conditions do not change, no major problem: The debt situation of Kenya is sustainable. Admittedly, Kenya as a state still has the need to add external financing on top of its own revenue collection. And, admittedly, there is a number of loans which are directly and indirectly concessional: Problematic are in this context less those loans with clear and publicly know conditions, but those, who have indirect conditions attached – which applies even to the “no strings attached” policy of China, whose unwavering condition is to win an ally in boycotting Taiwan. All in all, “external finance” does not pose insurmountable problems, since it is complemented by domestic debt and, most importantly, will decline further, if more domestic revenue mobilization is possible. Whether and how this is possible, has been outlined in this research report.

As indicated in chapter IV/3#, Kenya has options for domestic borrowing and uses it. For example the M-Akiba bond, as a way to give ordinary Kenyan’s access to the country’s capital markets. Hence investors can buy say an incremental as small as 3000 shillings( about \$30), compared to the minimum of 50,000 shillings would spend previously to buy government bonds.<sup>9</sup> The bond isn’t just about offering encouraging Kenyans to save. The Kenyan government needs a [new pool of cheap money](#) to finance large infrastructure projects and other developmental needs

But here, too, applies that the need for domestic borrowing and debt will decrease to the extent that Domestic Resource Mobilization will improve.

## **2.7 Government spending/insights**

Even though government spending was not planned to be part of this research in the original planning (Tax Justice & Poverty, 2013), some thoughts seem justified. For example, whether the deficit could be removed by spending less? There is certainly a lot which could be saved by cutting expenditures and redundancies, but this is not too easy: Some structures are

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<sup>9</sup> M-AKIBA;Kenya is launching the world’s first mobile-only government bond

<https://qz.com/938054/kenyas-mobile-only-government-bond-m-akiba-builds-on-the-mpesa-platform/>

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historically grown claims of people and groups, other spending will be defended by lobbyists (e.g. tax incentives), other spending is simply necessary (food aid, education...).

### **2.7.1 Lack of transparency, corruption and spending on tax exemptions**

It is widely acknowledged that the willingness of taxpayers to be compliant is related to their feeling that government makes good use of their money.

Especially in Kenya the Controller of the Budget and Auditor General cast a negative image on the expenditure management. Without an expenditure management that does reflect prudence and accountability, also revenue collection will suffer. “The utilization of revenue generated to deliver public services will inevitably raise the tax compliance rate” (ICPAK, 2016, p. 35).

It is widely acknowledged that the lack of transparency and never ending stories of corruption and bribery provide adequate excuses for everybody refusing to pay what is his/her due.

There is the need to incorporate tax exemptions, customs remissions and tax waivers in expenditure budget processes to enhance controls over revenue forgone. All discretionary and formally agreed tax exemptions should be clearly listed, and made public as tax exemptions are a matter of budgeting rather than trade secrets. It is also necessary that more transparent expenditure management systems be instituted.” (Waris & al., 2009, p. +49f.).

### **2.7.2 Ring-fencing and earmarking**

The previous is linked to institutional lack of transparency: in Kenya there are ca. 100 Ministries, departments and agencies were operating with own bank accounts. This lacked transparency and nurtured corruption.

There is a positive intention behind it: Waris argues that Kenya, as other African states, try to re-legitimize their tax collection by ring-fencing or earmarking revenue collected from taxation and levies for specific purposes, e.g. education, infrastructure, electrification, sports etc. This process is ongoing as the attempt undertaken in the 2017/2018 budget illustrates to dedicate revenue raised via the 50% Gambling Tax towards a newly and specifically created National Sports, Culture and Arts Funds. While this process of decentralization may increase representation, participation and transparency, this is far from assured since it also just increases the number of budgets and accounts and those who have access to it. Accordingly, there are many reports of misallocation and corruption, e.g. regarding the Constituency Development Fund (CDF), which received 30.9 billion KSh in the 2017/2018 budget. This fund, because it is linked to the unit of political representation, is known for many cases of cronyism and malpractice.<sup>10</sup>

We also follow Waris in two more observations: First, “it diverts the attention from the harder to tax aspects of the economy, for instance corporate and personal income taxes.” And it favours “more visible aspects of expenditure, such as roads and primary education, while neglecting invisible areas such as maternal care and public security” (Waris & al., 2009, p.

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<sup>10</sup> [https://en.wikipedia.org/wiki/Constituency\\_Development\\_Fund](https://en.wikipedia.org/wiki/Constituency_Development_Fund)

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28). Or, we might add, the investment of resources in enforcement of tax laws and combating IFF related crime.

The issue of ring fencing is supposed to obtain more transparency with the operation of the Single Account System by July 2017.<sup>11</sup>

### 2.7.3 The problem of remuneration of civil servants and politicians

Speaking in his annual state of the nation speech 2017, Kenya's president, Uhuru Kenyatta, was complaining that civil servants are paid too much and eat up too much of the country's tax revenue which, he said, might be better spent elsewhere. He said that Kenya's 700,000 public servants, who represent less than 2% of the country's 46 million citizens, were paid 627bn Kenyan shillings (\$6bn; £4.9bn) in 2015/16, a figure also cited by the Salary and Remuneration Commission which oversees public sector pay. Kenya's tax revenue for that year was Ksh1.3tn (\$12bn, £10bn) according to Kenya's Treasury department which provides Kenyatta with his 50% figure, (although the accurate figure is 48%). By comparison, the average proportion of tax revenue spent on public sector wages in sub-Saharan Africa was 29% in 2012, according to a World Bank analysis. That is nearly twice that paid by OECD countries where the average is 15%. In the UK, public sector staff costs make up 18% of tax revenue, including national insurance, according to the Office of National Statistics.<sup>12</sup>

➔ The question is whether we talk about ordinary civil servants such as nurses or teachers or tax officials... Or whether we talk about politicians with their open and hidden income, their perks of office, pension plans, continuation of salary payment even when out of office...! Kenya has the largest numbers of government ministers worldwide, a large number of MPs ....

In a rare move of transparency, the government of Kenya published on 7 July 2017 salaries and remuneration of top state officials, the president included.

Table 4 Remuneration for State Officer in the Executive

State Officer	Current Monthly Gross Remuneration Package	Reviewed Monthly Gross Remuneration Package (Kshs.)
President of the Republic of Kenya	1,650,000	1,443,750

<sup>11</sup> "the National Treasury is now in a position to operationalize the Treasury Single Account starting July this year" (2017). (Rotich, 2017, p. 13)

<sup>12</sup> <http://www.bbc.com/news/world-africa-39328166> Accessed 201 Mach 2017. Further reading on the collaborative work by KIPPRA, Policy Paper No. 5 and SRC (Salaries and Remuneration Commission) Report for 2013, "A comparative study on public-private sector wage differentials in Kenya".

<http://kippra.or.ke/downloads/Public%20Private%20Wage%20Differentials%20in%20Kenya.pdf>.

Deputy President	1,402,500	1,227,188
Cabinet Secretary Secretary to the Cabinet Attorney General Chief of Defence Forces	1,056,000	924,000
Principal Secretary Vice Chief of Defence Forces Commander of Kenya Army Director General, National Intelligence Service Inspector General, National Police Service	874,500	765,188
Commander Kenya Airforce Commander Kenya Navy	854,241	747,461
Deputy Inspector General Kenya Police Service Deputy Inspector General Administration Police Service	710,000	621,250

Source 8 The Kenya Gazette, 7. July 2017, p.1

The disclosure includes other remuneration packages and is revealed also for other public servants in the national and county governments. The reform also abolishes a number of other perks of office, e.g. sitting allowances for plenary sessions or “Special Responsibility Allowances”. All this is a good move and with cuts only for senior government people government saved more than 8 billion KSh. But:

- ➔ The question is whether publications of MPs and politicians involves only published and regular salaries and whether there is also hidden income which continues unslashed. But this brings us back to the question of transparency (see below#)
- ➔ How much is this in relative terms: If the nurses and teachers lost – say – 20% of their salary, do the cuts for MPs and ministers amount to the same?
- ➔ Government employees up to the president are being taxed as PAYE, there is transparency. But: There is an open secret that senior government officials have additional earnings which are not captured that way.

The overall goal is to bring eventually the wage bill, which currently stands at 52%, to sustainable levels of below 35% of the domestic revenue.

#### **2.7.4 “A better life for all Kenyans”**

The 2017/2018 Budget (Rotich, 2017) was both the last in the present government’s term and the last ahead of national elections. This coloured the framing, presentation and content of it. Under the theme “Creating jobs, delivering a better life for all Kenyans” the Treasury Secretary put an emphasis on creating more quality jobs for the growing workforce.

Basically, the entire Budget Speech has tax relevant implications, by adjusting Income Tax as a measure against inequality, by reducing tax revenue via tax incentives or spending plans on food supply.

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The focus is, in line with the Vision 2030, on FDI and the creation of jobs. Major instruments to achieve that is a mix of tax incentives for investment, subsidies for certain industries as well as public investment in infrastructure, public services (police, water, sewage), into education and the improvement of healthcare.

The government tries to make good use of his big spending power by securing a fair share of local businesses in major infrastructural projects via the “40% local content requirement”. Equally, the Preference and reservations Clauses attempt to secure participation of normally disadvantaged groups to participate in public procurement (KPMG, 2017, p. 12)

Rather contested plans are further announced reduction (and subsequent savings) on salaries and allowances for public sector officers and the gambling tax which has already been scrapped.

## **2.8 Conclusion**

Looking at tax relevant legal and administrative reforms in Kenya it is can be said, that reference to established tax and justice principles is being done. One indicator of success, namely the increase of revenue, must not blind to the fact that much more could be done.

Due to the fact that revenue is increasing, enables this research to conclude already on one of the major questions stated in the project proposal, i.e. “governmental dependence from external financing”: The overarching goal of achieving revenue independence by 2018 (VI/1.2#) seems to be hard to achieve, because there is continuing need for other sources of financing (above 2.5+6). At the same time, there seems to be no need for major dependence on external financing, provided the situation remains as it is and improves further. In that case Kenya can cover deficits by domestic borrowing.

But, at the same time, we have the feeling that the revenue collection situation in Kenya can be improved greatly, if the potential inherent in private, corporate and criminal wealth as well as the informal economy can be tapped more fairly and efficiently. And this is the second research interest, namely “understanding and narrowing the wealth gap.”

As we observed above (1.5) revenue from wealth relevant taxes (CGT, Withholding tax) has increased, so there are some indications the vertical and horizontal justice and the Principle of Ability to Pay is having a greater importance for the Kenyan government.

As we want to indicate in our next chapter, we feel that on a justice background there is plenty more to achieve.

The discussion above also highlights the need of a balanced approach to legal and administrative reforms, increasing tax buoyancy and elasticity by adjusting laws to socio-economic changes, and increasing tax capacity and narrowing the tax gap, by employing an adequate number of professional personnel.

The goal to create a “better life for all Kenyans” needs, in the end, a comprehensive analysis of public policies, seeking to reconcile the creation of jobs as well as the right of the state to collect revenue in order to finance public goods and services.

### **3 Discussion of justice relevant issues**

Some aspects within Kenyas effort to create a tax system seem to be within a global trend, for example the shifts from direct tax to indirect tax, the emphasis on improvements in ICT, a third areas are attempts to keep resource drainage by private and corporate wealth holder at bay (ICPAK, 2016, p. 7).

In this sub-chapter justice-relevant implications are discussed, e.g. in reference to established principles of taxation<sup>13</sup>, but also on the background of CST and our understanding of social justice.

#### **3.1 General**

##### **3.1.1 A gap between declaration and practice nationally**

There are many improvements regarding citizens rights or consequences to taxation on paper due to the constitution, but many loopholes exist in implementation. And many promises are being made during election campaigns. For example:

- Legal loopholes regarding the CGT, where legal uncertainties impede its collection, or withholding taxes, where there are many exemptions (see V/# & VI#)
- There are many loopholes in the POCAMLA 2009 legislation, suggesting that Kenya is not serious in curbing IFFs (V/#).
- Government does not provide money needed for adequate staffing (see VI#)

##### **3.1.2 Transparency & right to information**

A deficit throughout this country report is the lack of transparency and knowledge about asset ownership of private, corporate and criminal wealth holder.

Government is dragging its feet for two reasons:

On the one hand, there is a large overlap between the wealthy and politically powerful, which joins them in hiding assets and be not too eager in advancing transparency. Or: there are those who want to reform the tax burden to make it more just who do not have adequate information on the kind and distribution of income and wealth assets, thus being incapable to develop the adequate tax instruments and/or to decide about the best way to enforce that law.

Problem for administration

If there is no “right to know” even for tax administration (where the knowledge should be protected by tax secrecy from misuse), tax administration does not know where to collect what revenue and to enforce what laws. While the “corporate veil” protects the interests of corporations, there is nothing protecting the interests of the state, creating deficits for taxation (see below#)

This causes problems for administration

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<sup>13</sup> For established Principles of Taxation see paper I/V of this research (Kabinga, Alt, & al., 2016) and the relevant chapters on ethics on the Project Website.

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Transparency, accountability and the availability of information are precondition for equal, just and fair taxation (tax categories, tax bands and rates and administration and enforcement) and for generating interest and participation in the population in tax policy related discussions. Due to the new constitution and the expanded Bill of Rights, also the rights of Access to Information (Art. 35) is accessible to the citizens. But, as indicated in the case of the Kenya/Mauritius DTA this is needed to be implemented step by step with the help of courts.

- ➔ The problem above with civil servants indicates that there are two yardsticks regarding the taxation of income: Part is PAYE, part for the wealthy is intransparent income and needs to be taxed via PIT. Equal transparency is also required because of the principle of equal treatment: We want to have equal transparency for all sorts of income, not only income from labour.
- ➔ Transparency will be easy to install and extend if privacy issues which rightly merit to be protected are effectively protected under tax secrecy provisions. Are there adequate tax secrecy obligations for KRA in place?

### **3.1.3 Participation & Lobbyism**

As outlined already in chapter V/1.4 and regarding the making of laws there is an imbalance between the democratic sovereign (the electorate/people) and influential lobbyists.

The latter have all the knowledge they need to mislead policy maker in creating effective taxation means and/or to advocate for useful loopholes, the former have no education into the problem, into their rights, into alternatives, into campaigning...

### **3.1.4 Entanglement**

People formerly employed at agencies combating IFFs (“revolving door”), as the former Head of the Anti-Corruption Commission, change sides and go into business, business people go into parliament and influence policy and legislation

The refusal of PEPS (publicly exposed people) to publish their information without fear of being investigated.

Kenyatta: As Donald Trump, he refused to put his assets into an independent foundation in order to avoid conflicts of interest, but left it with family members which, of course, will communicate and safeguard family interests.

Chase Banker recently arrested because of money laundering, paid bail was released and escaped. Under normal circumstances such a person would not have been granted bail, but in this case this person had many influential friends.

### **3.1.5 Buying of influence by politicians**

Direct and indirect influence

Direct: Handout of cash during election-campaigns

Indirect: Making basic food cheaper ahead of elections: Before the reform, certain agricultural products were tax exempt or with a reduced rate in order to make them more affordable to

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poor people. At the same time, if needs arise, adjustments are being taken: When maize prices soared in the first part of 2017, the government Zero Rated ordinary bread and maize once more in the attempt to lower prizes and make it more affordable for the poorer segments of the population. Even outside consultant wondered, however, whether this move was due to the ongoing draught or imminent elections.<sup>14</sup>

### **3.1.6 Threats and dangers**

Killing of KRA lawyer, threats and violence against activists and journalists

## **3.2 Tax burden and potential for correction**

### **3.2.1 Tax burden on PAYE and the formal sector**

#### **3.2.1.1 PAYE**

1.3 above indicates that PAYE revenue has a high share in the revenue collection because of existing transparency and because it is easy to collect. This needs re-emphasizing that only 20% of Kenyas workforce bear a heavy burden.

#### **3.2.1.2 Number of taxpayers**

There are contradicting information about the number of registered taxpayer: “It is also important to point out that since the total number of employees in the formal sector paid wage or salary has not been increasing much as by 2010 it was 2.06 million out of a total labour force (15-64 years) of slightly over 10 million (Statistical Abstract, 2011). Elsewhere it says: “Kenya has only registered 1.6 million taxpayers. This implies that out of a population of 43 million, under 5% of the population contribute to income tax.” (ICPAK, 2016, p. 22) . The latter figures concurs to that of KRA (Kenya Revenue Authority, 2015, p. 46) In all cases, however, the implications are the same, namely, that a small proportion of the population, about 20% is bearing the burden of paying PAYE and this raise tax equity concerns.” (Institute of Economic Affairs, 2012, p. 24). This is why one of KRAs strategic goals is to rope 400.000 new taxpayers into the net every year (Kenya Revenue Authority, 2015, p. 46).

#### **3.2.1.3 SMEs in the formal sector**

The other side of the coin for the collection of PAYE are those businesses operating in the formal sector because they have to withhold PAYE and mandatory contribution and forward it to the relevant collecting agencies. I.e. they have higher compliance costs which SMEs in the informal sector, because they are simply not known to KRA, do not have.

At the same time: While TNCs have a lot of options to “optimize” their end-of-year taxbill, SMEs in the formal sector do not have those options.

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<sup>14</sup> “The clearest sign that this is a pre-election budget is perhaps the zero rating of ordinary bread and maize flour in what is seen as a move to cushion the electorate against the rise in the cost of living.” (KPMG, 2017, p. 8)

### 3.2.1.4 Inflation

Personal income tax compounds the effects of inflation on disposable income. An interviewee working a national NGO further added that, “assuming that over time their salary grows at the same rate as the prevailing rate of inflation, means that the person may find themselves paying income tax at a higher rate because the rise in salary may push them partly or fully into the second bracket of Ksh. 10,164 -19,740 to pay tax at a rate of 15% or even to the third bracket, giving an illusion that they are richer and hence paying at a higher rate yet in real terms they are not.” This is a “bracket creep” and is often addressed by indexing or adjusting tax brackets for inflation so that if salaries rise at the same rate as inflation, then the person still pays their income tax at the same marginal tax rate, which is the level of tax threshold that reduces the tax burdens of the poor (Institute of Economic Affairs, 2012, p. 26). Similarly an interviewee added that, “Taxation discourages citizens from earning more, because the more a person earns, the more s/he is taxed.” This is certainly more strongly felt until income rises so much that the top rate of 30% income tax is losing importance.

One also needs to take into account that tax rates do not take inflation into account. It can well be that a worker earns more which pushes him into the higher tax bracket, even so his “purchasing power” in the real world has not increased due to inflation. The “bracket creep” thus punishes him twofold: The worker does not only have lower ability to purchase higher goods, but also has to pay higher taxes, but that having again lower ability to purchase goods. As a consequence, government announced the double-expansion of tax brackets 2017/2018 as a measure to reduce income inequality (Rotich, 2017, p. 38). However: the lack of adjustments for 12 years up to 2016 raises concerns whether the two adjustments taking effect 1<sup>st</sup> January 2017 and 2018 are at all adequate to make up for lost purchasing power in the past and whether they indeed implement the Principle of Ability to pay.<sup>15</sup>

ICPAK points out that real average wage earnings went down between 2007-2014, probably due to inflation, here, counter measures are in place to prevent of wage earner to lose income both to tax and inflation. They also recommend changes to the income brackets especially in view of high income, so that top tax brackets will again “reflect the economic realities of personal income in Kenya.” (p.33)

- ➔ This problem is widely known, discussed and addressed in other countries, i.e. there should also be material for Kenya to learn from that

### 3.2.2 Shift to indirect tax

As could be seen above at the revenue collection trend, VAT and other indirect taxes, levies and excises are in parts solidly increasing as well.

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<sup>15</sup> See also “The current marginal tax rate of 30% for tax band of over Ksh. 38,892 per month is a low progressivity tax system. It seems unfair to charge someone earning over Ksh. 1,000,000 per month at the same rates of 30% marginal tax rate with someone earning Ksh. 38,892” (Yusuf, 2013, p. 13).

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### *3.2.2.1 General pros and cons regarding the shift to indirect taxation*

In principle and theory: there are pros and cons regarding a relief of direct taxation and an increase of indirect taxation:

#### Pros

1. The changing patterns of demand - indirect taxes provide a way of altering the pattern of consumer demand by varying relative prices and thereby affecting our spending decisions. For example higher duties on fuel or air passenger taxes might affect demand for different modes of transport.
2. Linked to the previous point, indirect taxes are often used and justified as an instrument in correcting for externalities and associated market failures – indirect taxes can be used as a means of making the polluter pay and “internalizing the external costs” of production and consumption.
3. Because taxes are levied on spending, indirect taxes are less likely to distort the choices that people have to between work and leisure and therefore have less of a negative effect on work incentives. If people keep more of what they earn, they may be more likely to work extra hours and this can have a positive effect on the supply-side of the economy. Indirect taxes leave people free to make a choice whereas direct taxes leave people with less of their gross income in their pockets.
4. All tax systems are often to avoidance and evasion but perhaps spending taxes are less easy to avoid; often people are unaware of how much in duty and other spending taxes they are paying. And indirect taxes provide an incentive to save.

#### Cons

1. Many indirect taxes make the distribution of income more unequal because indirect taxes are more regressive than direct taxes. Good examples include the excise duties on cigarettes and energy together with the tax on national lottery tickets.
2. Higher indirect taxes can cause cost-push inflation which can lead to a rise in inflation expectations. Much depends on whether suppliers choose to pass on some or all of any increase in tax e.g. higher VAT.
3. If indirect taxes are too high – this creates an incentive to avoid taxes through “boot-legging” – e.g. the booze cruises to France where duty on alcohol and cigarettes is much lower.
4. Revenue from indirect taxes can be uncertain particularly when inflation is low (perhaps even a period of price deflation) or there is a recession causing a fall in consumer spending

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5. From a microeconomics viewpoint, both specific and ad valorem taxes can lead to a loss of welfare e.g. loss of producer & consumer surplus. And higher indirect taxes affect households on lower incomes who are least able to save

6. Many people are unaware of how much they are paying in indirect taxes – they may be taxed by stealth – this goes against one of the basic principles of a tax system – that taxes should be transparent.

### ***3.2.2.2 Reasons behind the Kenyan shift towards indirect taxation***

“Tax policy in Kenya has changed over time towards relying more on indirect taxes as a major source of finance for development budget as a deliberate move intended to reduce the burden on income taxation so that savings and investments could be promoted.” (Institute of Economic Affairs, 2012, p. 14).

ICPAK recommends to move away from direct taxes to indirect taxes which, they think, “might exert a beneficial effect on employment levels and GDP” (ICPAK, 2016, p. 33)

As mentioned already in V/2.3.2, the shift was motivated by the argument that VAT (relative to sales tax) had a higher revenue potential, does not interfere with investment and spending decisions, and that its collection and administration were more economic, efficient and expedient. It was also meant to put away pressure from direct income tax by spreading the tax burden more fairly also among households earning money in the informal economy (Institute of Economic Affairs, 2012a, p. 28). The question is, which of those hopes came true.

This question is even more important since KRA Commissioner General John Njiraini explained that the main intent behind the 2012/2013 reform was NOT to collect more revenue, but to improve compliance for businesses, thus improving Kenyas position upon the Doing Business Ranking of the World Bank, where, up to this reform, the VAT compliance problems were listed to be a major obstacle. (Tax Justice Network Africa; Christian Aid, 2014, p. 64).

### ***3.2.2.3 Consequences of this shift?***

#### **For businesses**

➔ Did the hopes of policy maker regarding improvement in business compliance come true? Does business profit from reforms? Where does it, where does it not?

#### **For poor and low income households**

It is undisputable that value added tax has made the cost of living high by pushing the cost of basic needs out of reach of the poor. This is worsened by the fact that there are already huge inequalities in income as well as expenditure patterns particularly across different regions of Kenya. It is common sense that inhabitants in poor counties with low incomes and therefore low expenditure are the worst hit by value added tax.

When the VAT reform tax has been proposed first in 2012, it aimed for a considerable reduction of exempted and zero rated products, even those essential for poor households. After vigorous campaigning parliament rejected the draft and an amended proposal had to be worked out. The passed law in 2013 still reduced zero rated and exempted products from

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formerly 400 to roughly 100 and still a number of goods important for the consumption also of poor households were no longer privileged, such as all processed milk products, cooking gas or electricity. All this will burden poor households more than wealthy ones.

Given the present economic crisis in Kenya, government in its 2017/2018 Budget Zero Rated a number of essential goods.

A regressive tax in nature is also the Excise Duty on financial service transactions, which works like a VAT when using service provider such as the mobile phone based money transfer system like MPesa and hits poor people dependent on this payment modus rather than wealthy capital owner, for whose capital transfers exist a number of exemptions regarding taxation (Tax Justice Network Africa; Christian Aid, 2014, p. 63).

There is also another possible burden on the rural poor from county taxation. For example, rural farmers travelling through different counties from far-flung farms to market places like Nairobi end up paying the same tax several times as they cross different county jurisdictions. This duplication of taxes places a further burden on poor farmers or traders from rural areas. In this case the problem is also as a result of county governments' regionalization of taxation as opposed to coordination on taxes that potentially affect traders.

### **3.2.3 Conclusion**

Taxation of labour dominates over the taxation of income from other sources, most importantly "unearned" income from capital and land (Tax Justice Network Africa; Christian Aid, 2014, p. 62).

The trend from direct to indirect taxation is international. Besides hope for more business there is certainly also the reason that indirect taxation is very convenient since the tax base cannot be relocated out of the country. And: It is cheap to be collected.

One has to acknowledge that there is more justice in the Kenyan system due to the higher tax relief for lower income households due to changes done in the last two budgets. Deficit: Taxation at the top.

Deficits remain within the area of Principe of Ability to Pay a.k.a taxation of Supersalaries, high profits and all other forms of wealth.

The decision about which types of tax to use as a way of raising revenue raise questions about the roles and relative merits of the different tax regimes or administration. Should Kenya move further towards relying on indirect taxes or are direct taxes the best way of generating enough revenue to fund government spending and cutting the fiscal deficit is an issue the legislative Assembly needs to debate.

## **3.3 Deficits arising in tax categories**

### **3.3.1 Context**

From the discussion in V and VI as well as from above, Kenya and KRA have done some progress with Withholding Taxes, the taxation of capital, especially the CGT and the taxation of property, especially real estate and property. At the same time, when looking at the trends

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and issues presented in chapter VI, we wonder: Are those efforts enough and adequate, and if not, in what direction could more be done?

There are deficits and weaknesses in the ways, those taxes are defined and designed and how they fit into the overall composition of the Kenyan tax system. Relevant issues addressed in the previous chapter were, for example, the following:

- Legal Loopholes in national law, see sub-chapter in V/#
- Conflict between national tax law and national tax privileges and exemptions, see V/#
- Conflict between national law and tax treaties (V/#Withholding Tax Rates)
- Conflict between national law and the lack of administrative resources (VI/#1)

Following we want to just pick up some important issues which we think are specifically justice relevant:

### **3.3.2 Income from labour and profits**

#### **3.3.2.1 Tax rates**

##### **PAYE/PIT**

PAYE and PIT have same progressive tax rates, even though here the question is whether the 30% rate captures the reality of Supersalaries.

##### **CIT**

Regarding corporations, the issue is that corporate income taxes (CIT) were lowered from 45% in 1989/90 period to the current 30% in order to compete favorably with other countries for investment funds. But even if CIT rates were lowered to make it equal to the top marginal personal income tax rate (30%) for purposes of horizontal equity (Institute of Economic Affairs, 2012a, p. 26), the problem is that it violates the principle of equity since the rate payable is fixed and not progressive. The fact, that it is a Flat Tax also indicates that it is a decreasing progressive burden when compared to tax on income from labour.

This Flat rate also seems unfair when it comes to comparing TNCs with SMEs, e.g. since TNCs have more options to lower their profits and tax base.

#### **3.3.2.2 Declaration, Collection, transparency...**

PAYE collected via Withholding tax, easy to check with ICT. Regarding PIT and CIT, we state a number of deficits regarding tax honesty:

PIT and CIT is done via self-assessment and self-declaration, and after submission KRA sets the tax. But, for example, what are the options for private wealth holder to also lower their tax bill? For example, that they hide part of their private income in businesses which they own? Of course, it may be required to have a private/external auditor checking the books, but if the tax auditor is at the same time a tax consultant, as it is the case with the Big Four? And: Who makes sure that the auditor is doing a honest job and not being bribed (who audits the auditor?)

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The German Constitutional Court, for example, ruled in 1991 that in the case of self-assessment and self-declaration this needs to be complemented by robust checks and control in order to secure compliance and tax honesty.

In Kenya, this does not seem to be (adequately) the case:

- ➔ Are there audits of private wealthholder by KRA?
- ➔ What mechanisms are in place to ensure that private wealthholders Supersalaries and other incomes are declared in a correct manner?

Corporations are even more protected regarding the verification of their income, assets and CIT, especially by the Corporate Veil, i.e. high threshold for KRA to move in with auditors in the first place ➔ Something useful from Simpasa/ZAM Report?

Therefore: Here not only the question of a higher tax rate, but also the question whether self-assessment and self-declaration is comprehensive and whether more audits and controls would be in order.

### **3.3.3 Taxation of real estate and property**

#### ***3.3.3.1 Registration precedes taxation***

See V/4.4.3 on the Problem of ownership, valuation and registration

See VI/4.3.4 on efforts of KRA to speed up registration.

- ➔ Registration needs to be speeded up. At the same time the problem remains how it is ascertained that the final beneficial ownership is established. As is indicated in V/6.2.1.1 it seems to be still very easy to establish even within Kenya vehicles with which to hide beneficial ownership, e.g. trusts or shell companies with fake directors.

#### ***3.3.3.2 Taxing land and improvements done to it***

In V/4.4.4 it is unclear to what extent (state and/or counties) tax real estate and improvements made to the estate and what laws definitely apply since those quoted are pretty old.

In VI/4.3.2 KRA is quoted that it tries to improve on real property taxation.

- ➔ How far is this process developed? Because clearly the value of land rises with the improvements and additions done to it like fencing and draining it.

#### ***3.3.3.3 REITS and ABS***

In the 2017/2018 Budget Speech Rotich provided REITs and ABS with tax privileges for transactions<sup>16</sup>. Those instruments are used to advance real estate development. At the same time, they were instrumental in critical developments in the real property sector in Germany

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<sup>16</sup> “I propose therefore to amend the VAT Act to exempt from VAT the transactions related to transfer of assets into Real Estate Investment Trusts (REITs) and Asset Backed Securities (ABS).” (Rotich, 2017, p. 42)

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and speculation based upon them were co-responsible for the 2007 crash, which is why they were prohibited afterwards in many countries.<sup>17</sup>

- ➔ The question is whether the advancing of risky financing instruments can be justified against inherent risks, i.e. short term benefit may in the end the contribution to a more lasting damage for the many for the profit of the few.

#### **3.3.3.4 The number of exemptions**

- ➔ Is it made sure that the exemptions from paying taxes upon real estate and real property are justified, i.e. the amount of institutions, foundations, trusts ..... which are exempted and any verification effort to see whether the money of those institutions is indeed spent on charitably purposes and that those institutions do not just hide ownership or even launder money?

### **3.3.4 Taxation on Capital**

As long as capital is seen as a tool for investment and the creation of jobs as it is outlined in the Vision 2030, the taxation especially of capital is not the top priority for any government, the Kenyan included: Capital .

#### **3.3.4.1 Capital Gains Tax**

A good tax addressing income and wealth inequality is the Capital Gains Tax, and revenue here is rising

However, there are many loopholes are apparent, for example, it can be avoided by paying rather a property transfer tax (seeV/4.3.3), and there are many legal issues regarding how and when to tax proceeds.

Another dubious issue is that the CGT was re-introduced at the same time, when an avenue was opened to avoid its payment: It is striking that Kenya only re-introduced the Capital Gains Tax when, at the same time, it concluded the Tax Treaty with Mauritius which is known to provide vehicles with which Capital Gains Tax can be avoided.

Despite the anti-avoidance rule in Article 13(4) of the OECD (Multi Tax Convention), which gives the right to tax shares to the source state, the Kenya/Mauritius DTA provides that capital gains on the disposal of shares by a Mauritius resident are only taxed in the residence state (Mauritius). In effect Kenya has given away the right to tax capital gains from stock sales of Kenyan companies to Mauritius, which does not levy CGT. (Oguttu, 2017), also (Hearson, 2015, p. 23)

#### **3.3.4.2 Financial Transaction Tax**

And: A Financial Transaction Tax regarding cross-border transfers has been touched upon in the Budget 2017/2018 speech, but whether it is tackled seriously remains to be seen.

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<sup>17</sup> REITS: <http://www.gbv.de/dms/zbw/791579670.pdf> <http://www.manager-magazin.de/finanzen/boerse/a-744824.html> <http://www.zeit.de/wirtschaft/2013-11/usa-immobilien-reit-krise> ABS: <http://www.zeit.de/2011/16/Journalismus-Finanzkrise> <http://www.faz.net/aktuell/wirtschaft/ausloeser-der-finanzkrise-was-sind-abs-papiere-13150186.html>

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### **3.3.5 Withholding taxes**

There are two kinds of Withholding-Tax collection:

#### **Via computerized deduction and transferral**

Here quite a lot of transparency, but what about trader who hide behind Shell companies where beneficial owner is unknown? Who will be billed eventually? And: Be mindful of the many exemptions (see V/4.3.2) which make it difficult in the end to see who has to pay and who not – given the fact that those obliged to pay try to pay as little as possible until KRA or someone else orders them to do so.

#### **Via collection by agents**

Rental income, a withholding tax rate of 10% (since 1<sup>st</sup> January 2017, reduced from 12%) of gross proceeds has been introduced, but this tax will be withheld by agents appointed by government.

→ Problem: Are there enough agents and are they well trained and supervised against bribery?

### **3.4 Conclusion**

Kenya has a number of options in place which would need to be improved, such as getting the CGT and Withholding Tax streamlined and with less exemptions. Very important in our view is also a new tax rate for those earning Super-Salaries. Those, however, need first to be discovered since as the presentation in IV/2 has indicated there are many more HNWI's in Kenya than there are known to KRA.

To uncover malpractice here, national transparency regulation and the (automatic) international exchange of information would be as important as increased international cooperation between tax administrations.

Equally important would be an internationally coordinate positioning against tax havens and secrecy jurisdictions. Here, however, a number of deficits remain, with developing countries being always in the weaker position (see below#).

### **3.5 Deficits in taxing private Supersalaries and Wealth**

Having indicated weaknesses in the design and definition of wealth taxes within the Kenyan tax system, we now to put those provisions in contrast to the developments of private, corporate and criminal wealth, as has been, for example, outlined in chapter IV/2.

#### **3.5.1 Tax on private income**

There are, of course, high salaries which are taxed via PAYE. At the same time, many self-employed people, especially business people, pay their taxes self-assessed and self-declared, i.e. they submit their financial and tax relevant information to KRA and receive their tax-bill in return.

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Before 1983, Kenya had 8 income tax brackets and high marginal tax rates, the highest being 65%.

Revenue arising from PIT is not really remarkable, even though it is here where the more wealthy individuals and business people would be – which in turn asks whether they indeed submit all relevant information and are taxed to their ability to pay.

There are concerns regarding tax rates for top income earners. One such concern is that, “The current marginal tax rate of 30% for tax band of over Ksh. 38,892 per month is a low progressivity tax system. It seems unfair to charge someone earning over Ksh. 1,000,000 per month at the same rates of 30% marginal tax rate with someone earning Ksh. 38,892” (Yusuf, 2013, p. 13)

Equally Institute of Economic Affairs: It seems unfair that someone earning 1 million KSh per month pays as much tax as a citizen with 513,373 KSh. Here, a higher rate for top-income earner/Supersalaries is more than justified (Institute of Economic Affairs, 2012, p. 26)

### **3.5.2 Income from labour, income from wealth**

One of the key trends underlying this huge concentration of wealth and incomes is the increasing return from capital versus income from labour. In almost all rich countries and in most developing countries, the share of national income going to workers has been falling. This means workers are capturing less and less of the gains from growth. In contrast, the owners of capital have seen their capital consistently grow (through interest payments, dividends, or retained profits) faster than the rate the economy has been growing. Tax avoidance by the owners of capital, and governments reducing taxes on capital gains have further added to these returns. As Warren Buffett famously said, he pays a lower rate of tax than anyone in his office—including his cleaner and his secretary. It is the wealthiest individuals and companies –those who should be paying the most tax –who can afford to use these services and this global architecture to avoid paying what they owe. It also indirectly leads to governments outside tax havens lowering taxes on businesses and on the rich themselves in a relentless ‘race to the bottom’

This problem is also discussed under the heading “earned income” and “unearned income”

### **3.5.3 Wealth taxation and Wealth Transfer Tax**

Regarding the taxation of wealth relevant assets via PIT, Withholding Tax and Capital Gains Tax deficits apply which have been outlined above.

In addition, and regarding private wealth holder, a Wealth Transfer Tax should be considered for Kenya:

- ➔ What is known about the importance of inheritances and consolidation of income-inequality

Justified, but not yet existing (Mutuma)

## **3.6 Deficits in taxing corporate wealth**

As outlined in the Vision 2030, the Kenyan government does a lot to facilitate investment and attract FDI with the intention to create jobs. Kenya wants to be “globally competitive”, and

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therefore, it seems, taxation takes the back seat as far as it is seen to be an obstacle to investment. This has not changed up to the present day.

### 3.6.1 Status

According to the World Banks Data Base “Doing business”, which, when following the Kenyan Treasurers Budgetary Speech 2017/2018, is an important yardstick for assessing development in Kenya (see V/1.3Policy#), the Corporate Taxation situation for Kenya is as follows in comparison with other countries:

**Table 5 Country Comparison For Corporate Taxation<sup>18</sup>**

	Kenya	Sub-Saharan Africa	United States	Germany
Number of Payments of Taxes per Year	31.0	38.8	10.6	9.0
Time Taken For Administrative Formalities (Hours)	195.5	304.2	175.0	218.0
Total Share of Taxes (% of Profit)	37.4	47.0	44.0	48.9

The low share of taxes (% of profit) has also to do with the wide range of tax incentives:

### 3.6.2 The costs of tax incentives

#### 3.6.2.1 Direct costs

Around 2010, there were 42 EPZs in Kenya, employing around 30,000 people in quality jobs. This brings PAYE taxes (Silva, 2016, p. 63).

“A Parliamentary Budget Office (2010) study indicated that, over the period 2003/04 - 2005/06 the total amount of revenue forgone over the three-year period was Ksh.109.2 billion, of which investment-related incentives accounted for 84% while export related incentives accounted for 16%. On average, Ksh.30.4 billion was forgone annually in the three-year period. Trade-related incentives accounted for Ksh.18 billion forgone. In this category, Tax Remissions Export Office TREO-related exemptions accounted for 53%

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<sup>18</sup> Taken from the respective side “Paying Taxes”, for Kenya  
<http://www.doingbusiness.org/data/exploreeconomies/kenya/paying-taxes>

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followed by Export Processing Zones Authority EPZA, which accounted for 40%, and Manufacture Under Bond (MUB) 7%.” (Institute of Economic Affairs, 2012, p. 43)

In a 2012 study by Action Aid/Tax Justice Network,<sup>19</sup> a number of revenue losses were listed:

- Kenya lost over Sh200 billion in the five years between June 2003 and June 2008 through numerous tax incentives to manufacturers.
- According to a study carried out by non-governmental organisations ActionAid and Tax Justice Network Africa (TJN-A), the biggest loss of Sh73.1 billion was incurred through incentives to replace wear and tear of plant and machinery.
- The second largest loss came from investment deductions through which companies first subtract their spending on new investments before calculating their tax obligations – which minimizes the expenditure.
- On trade-related incentives, the biggest loss— amounting to Sh19.6 billion — occurred due to the Tax Remission for Exports Office (TREO), a scheme that encourages local manufacturers to export their products by reimbursing the duty and VAT paid on raw materials.

This was not really disputed by government and the figure of 1.1 billion revenue losses per year is repeatedly quoted ever afterwards. In 2012 a Letter of Intent was written to the IMF, announcing that government will look into expenditures. As a new report details, not much has happened since. Also the Budget 2017/2018 continues with many concessions towards the private sector and investors. This contradicts the content of a new Letter of Intent written in 2016. It contained the following passage, where the government promises once more to

complete by end-September 2016 a study on tax expenditures, in order to identify their size, type (e.g., tax exemptions, reduced tax rates), their evolution over time, and the category of taxation to which they apply (structural benchmark). Based on the results of this study, we will devise measures to reduce tax expenditures.” (Tax Justice Network; Action Aid, 2016, p. 14)

Also KRA wants to go against the present system of tax incentives:

Studies have shown that Kenya foregoes about Kshs. 100 billion annually in tax expenditures, primarily as a result of tax exemptions and investment incentives. Currently, tax expenditures in Kenya stand at 3.5% of GDP compared to an estimated 1.4% in Mauritius. Reducing tax expenditure to Mauritian levels will realise additional revenues of at least Kshs 75.2 billion per annum. To achieve this, KRA will review and propose appropriate tax policy amendments as the Income Tax Act is reviewed. (Kenya Revenue Authority, 2015, p. 50).

It remains to be seen what will happen.

### **3.6.2.2 Indirect costs**

Tax incentives make the tax system less transparent and therefore, also for potential investors, less predictable. It also has to be seen that tax incentives for foreign capital owner (a.) disadvantage domestic businesses which do not receive similar concession and (b.) shift the

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<sup>19</sup> Irungu, G. (2012, June 6) Tax incentives to industries cost Kenya Sh200bn. In: Business Daily. Retrieved from <http://www.businessdailyafrica.com/news/Tax-incentives-to-industries-cost-Kenya-Sh200bn-539546-1422110-877d9s/index.html>

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tax burden from capital owner to immobile factor of production, i.e. labor, and indirect taxes on consumption.

Next, the Kenyan policy it puts domestic and foreign capital into different positions, and for obvious reasons domestic capital should be far more interested in remaining in Kenya and upholding its investment than all EPZ and SEZ investment together. In her analysis, Waris is very sceptical whether export-promotion improves the countries overall competitive advantage in the medium and long run, because this money leaves once provisions expire while investment with customers tend to hang on (Waris & al., 2009, p. 24).

The loss of revenue here restricts spending options of the government, e.g. on infrastructure, security, education etc., goods, from which all benefit – even TNCs: taxation is never the single most important and single most decisive criterion for or against an investment (see below, 3.6.4).

### **3.6.3 Legal, illicit and illegal commercial tax dodging**

Regarding Kenya, as other developing countries, transfer-mispricing and trade-mispricing in all its form is a serious problem. In terms of definition, transfer mispricing denotes the practices of internal book-keeping, underpricing or overpricing of cross-border trade between subsidiaries of the same TNC.

Thin borderline: As Luxemburg Leaks revealed, global auditing companies consider tax saving schemes to be legal if they are with 50% on the legal side.<sup>20</sup> To determine, however, whether this is (still) the case needs a tedious case to case determination – this strains resources of wealthy countries, but even more of poor countries. ‘Tax authorities in poor countries, like Kenya, have often found it difficult to win such disputes against multinational firms under OECD guidelines.’<sup>21</sup>

Transfer Pricing: Kenyan law requires arms-length pricing between related enterprises alongside regulation of OECD guidelines (Deloitte, 2017). Compared with Uganda and Tanzania, Kenya has a more stringent law to prevent transfer pricing. ‘the Kenyan income tax contains a provision which requires transactions between resident companies and their related non-residents to be at arm’s length, with rules on transfer pricing which are largely based on the OECD guidelines.’ (Waris & al., 2009, p. 25)

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<sup>20</sup> Instructive are documents arising from a questioning of the Heads of Tax Departments of the “Big 4” at the British Parliament in 2012: Even though they emphasized that they no longer sell aggressive tax avoidance models as in past years the admitted that their tax saving models presently are considered to be legit even if there is only a 50:50 chance that the proposed construction is legal when challenged at court. Doing that, they are well aware that resources of tax administration are such that they are forced to avoid protracted legal proceedings wherever possible. This is easy to calculate: While the British tax administration has 65 experts on transfer pricing, those “Big 4” employ 250 of them. Even better: If their proposed scheme does not live up to judicial review, ‘there are no consequences for the firms.’ (Committee on Public Accounts, 2013, p. 9).

<sup>21</sup> Michira, M. (2015, July 17) Rich nations reject inclusive tax rules body. In: Standard Digital, retrieved 20 July 2015 from [http://www.standardmedia.co.ke/m/?articleID=2000169548&story\\_title=rich-nations-reject-inclusive-tax-rules-body](http://www.standardmedia.co.ke/m/?articleID=2000169548&story_title=rich-nations-reject-inclusive-tax-rules-body)

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But: Even though Kenya has OECD standards regarding transfer pricing, it does not mean as such that misuse for the purpose of aggressive tax avoidance and tax evasion is excluded, as the KRA informant in VI/4.1# indicates.

The fact that tax havens and secrecy jurisdiction exist, which provide ample opportunity for base erosion and profit shifting practices, and the fact that DTAs do not contain adequate information exchange and tax administration cooperation regulation, it can safely be assumed that Kenya does, as other developing countries do, lose a lot of potential revenue via illicit or illegal practices. Waris refers to a study conducted by Simon Pak,<sup>22</sup> according to which Kenya lost between 2005 and 2007 an average of 17.60 million USD due to bilateral trade mispricing

### **3.6.4 Conclusion**

The lowering of CIT from 45% to the current 30% in 1989/1990 comes in addition with the low collection success rate of even tax revenue from this reduced rate (see above#) and the costs for tax incentives (see above#), resulting in losses of around 264 billion KSh/3.5 billion USD per year.<sup>23</sup>

The system of tax incentives should be reviewed even more, since expert institutions (Institute of Economic Affairs, 2012b) and surveys such as the Global Competitive Business survey indicates that taxes are ranking rather low when compared with other factors influencing investment decisions such as infrastructure, social stability, rule of law, efficient administration, educated work force etc., all/a lot of which can only be provided if adequate public resources are at hand.

ICPAK observes that the tax system in Kenya is designed to place a higher burden upon high private and corporate income, in accordance with the Principle of Ability to Pay, while giving low-income people tax reliefs, such lowering the burden. Given the findings of their studies, ICPAK recommends the implementation of “policies that enhance the contribution of corporation tax”, especially reviewing tax incentives, which decreases the burden upon large corporations rather than small and medium enterprises. A proposed instrument could be that KRA “enhances its use of tax incidence analysis”, which will allow to advise the Treasury on the “appropriate means tested tax policy initiative that utilize the ‘ability to pay principle’, foster the growth of domestic industries, cushion the vulnerable and ensure maximum revenue yield from the economy.”(p. 31)

Kenyan government promises towards IMF in letter to intent to check on its tax incentive system. But in actual policy, they continue this intransparent system

As has been shown, tax incentives eat away a lot of that which potentially might be contributed in revenue by the corporate sector. Furthermore: Whatever criterion you apply:

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<sup>22</sup> <https://www.christianaid.org.uk/Images/false-profits.pdf>

<sup>23</sup> (Tax Justice Network Africa; Christian Aid, 2014, p. 63). However, it is not entirely clear what share of this figure is due to tax avoidance and evasion also in the informal sector or whether this is primarily due to tax dodging of large TNCs – the latter is, at any rate, substantial.

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Both Waris and ICPAK come to the conclusion that tax raised from corporations leave a lot to be desired and improved (see above#).

Waris recommends a panel of experts which should establish malpractice, extend of damage and develop proposals to improve the situation. Likewise, reforms in the reporting and accounting practice should be introduced in order to capture better what profit has been generated where and when. Here, Kenya should also join more groups active in combating IFFs in the commercial and criminal area (Waris & al., 2009, p. 51), see also below OECD/UN.

### **3.7 Deficits in capturing criminal wealth**

- ➔ This entire chapter needs to be written once the research regarding IFFs has been concluded. So far, looking at what we have in IV, V and VI, it is safe to say that there is not enough qualified staff and that the legal foundation has as many loopholes as a Swiss cheese.
- ➔ At least it would be easy to put a good law into place, here is enough experience in other states to learn what such a law would need to include. But not even such a good and convincing law is in place.
- ➔ This forces to draw the conclusion that Kenya is unwilling to put an effective system in place

### **3.8 Dependency on other states, deficits in international cooperation...**

Only some selected issues:

#### **3.8.1 Financially**

International development assistance, i.e. from government to government, can be healthy as far as it helps to bridge funding gaps or relieves a country of debt if the country is unable to repay. That way, It goes into supporting a range of development activities that pave the way toward equality, economic growth, job creation, higher incomes, and better living conditions in health, business agriculture, business improvement , roads network and other reforms.

However, the argument is that much as it provides stable substantial funding, that funds can lead to countries overly reliance on external funding for their development priorities that leads to over dependency and debt sustainability instability.

Another problem is if the loan has concessions and obligations which force a country to repay interest and debt rather than covering current expenses in, say, education or health care or even forcing to raise more debt in order to repay debt. That way, it can squeeze a countries fiscal room to maneuver. It makes the borrower stay in debt distress through and through.

The insidious aid leaves a country more debt-laden, more inflation-prone, more vulnerable to the vagaries of the currency markets and more unattractive to higher-quality investment.

At that stage, we agree that financial or assistance in kind which, for the donor country, has a cost factor to it, is still needed. Be it state-backed guarantees for trade, be it supply of equipment for road improvement, hospitals or tax administrations be it the supply of experts for training government civil servants (see, e.g., below 3.8.3 for examples on the assistance from Germany, Sweden and Denmark)

### 3.8.2 Legally

#### 3.8.2.1 Potential implication of the Kenya-Mauritius DTA

Tax Justice Network has the opinion, that the Kenya-Mauritius DTAA is not the only loophole-ridden agreement and that rather those with the UAE and Qatar also fall into this category.

This view is shared by global legal corporations which, in the end, re-emphasize the double edged purpose of DTAs which leaves the developing country, i.e. the weaker partner, in the position to choose between pest and cholera:

The divergent views on the shifting of profits from developing countries through DTAs and treaty shopping are endless. The issue, therefore, concerns the compromise that developing countries such as Kenya have to make, on the one hand to foster economic growth by creating a favourable tax environment to attract FDIs and on the other to comply with the supreme law of the land.<sup>24</sup>

Obviously, the outcome of this court suit will be manifold. First, it will tell the Kenyan government how to handle similar cases. Second, it will impact not only on this individual treaty and not only on Kenya, but also other developing countries since, for example, an entire range of DTAs with Mauritius could be challenged

**Table 6 High-risk provisions in sub-Saharan countries’ treaties with Mauritius, signed after 2000**

Country	Rwanda	Senegal	Uganda	Zambia	Kenya	Rwanda
Year	2001	2002	2003	2011	2012	2013
<b>Construction PE (months, lower is better)</b>	12	9	6	9	12	6
<b>Supervisory activities included</b>	Yes	Yes	Yes	Yes	Yes	Yes
<b>Services PE (months, lower is better)</b>	12	9	4	No	6	6
<b>Max dividend WHT</b>	Exempt	Exempt	10	5	5	10
<b>Max interest WHT</b>	Exempt	Exempt	10	10	10	10
<b>Max royalties WHT</b>	Exempt	Exempt	10	5	10	10
<b>Max management fees WHT</b>	Exempt	Exempt	10	Exempt	Exempt	12
<b>Capital gains: property rich companies provision</b>	No	No	No	NA	No	No
<b>Capital gains on sales of ordinary shares</b>	No	No	No	NA	No	No

Source 9 (Hearson, 2015)

<sup>24</sup> Dentons (2016, November 29) "Double Trouble": The Kenyan Constitution and DTAs. Retrieved on 21 June 2017 from <http://www.lexology.com/library/detail.aspx?g=b0913c97-1d4d-4e49-9b1e-4e6d96193ccf>

### 3.8.2.2 UN or OECD Framework?

The UN and OECD framework have some legal model conventions in place, also some guidelines and handbooks on how to deal with transfer pricing. The UN process is in the weaker position since it is supported by the G77, while the OECD is supported by the G7/G20. Admittedly, there are a number of good declarations by the G7 or G20 regarding support of developing countries, for example For example:

The G20 recognises that developing economies need regular, proactive engagement in the G20/OECD BEPS process, particularly for those countries that may be harder to reach due to geography, capacity, size, or other reasons that may impact upon their ability to effectively implement and benefit from the outcomes of the BEPS Action Plan (G20 2014)<sup>25</sup>. Such countries may require tailored approaches to implement the outcomes of the BEPS Action Plan, without undermining the integrity of the international tax system. African countries in which the G20 reported activity are: Tanzania, Kenya, Uganda, Rwanda and Ethiopia.<sup>26</sup>

The question is: How much assistance does Kenya get from OECD defacto?

The tension and conflict between the UN and OECD framework became public during the FFD3 conference in Addis Ababa in July 2015, when the G77 made an effort to strengthen the the UN framework as a Model within which to establish global tax legal and administrative governance (see GER/W/II).

However, experts also point to the fact that the UN Committee of Experts, in charge of supervising and updating the UN Model Convention, lacks active participation of African states, whereas the OECD context at least offers broader options for participation to a larger number of states, e.g. in the Annual OECD Tax Treaties Meeting. It is true, of course, that developing countries are excluded from participating in decisions taking place in meetings of “Working Party 1 on Tax Conventions and Related Questions” (South Africa, of course, excluded). At the other hand, African states do not adequately make use of rights which they have in principle, e.g. entering formal observations on the OECD model treaty, its application and commentary. As an example he offers the OECDs shifting the balance away from the operating countries of TNCs to their head office countries. Here, South Africa was the only country entering an objection to this change. If those options were used more extensively.

Hearson argues, perhaps changes in the wake of the BEPS initiative or AEOI framework can be moved more towards a benefit for developing countries – in particular now since BEPS and AEOI agreements are in the process of being implemented into the existing bilateral treaties via opt-in and opt-out clauses.<sup>27</sup>

Hearson is of the opinion that African states should in any case carefully examine existing legislation first before entering in negotiating a DTA. If it is unavoidable, there are

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<sup>25</sup> G20 response to 2014 reports on BEPS and AEOI for developing economies, <http://www.g20.utoronto.ca/2014/16%20G20%20response%20to%202014%20reports%20on%20BEPS%20and%20AEOI%20for%20developing%20economies.pdf>

<sup>26</sup> <http://www.ictd.ac/publication/2-working-papers/127-tax-base-erosion-and-profit-shifting-in-africa-part-1-africa-s-response-to-the-oecd-beps-action-plan>

<sup>27</sup> See (Hearson, 2015, p. 32f.) and

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advantages and disadvantages in every Model Convention and states should try to combine whatever available in their favour.

### *3.8.2.3 Any need for DTAs?*

As has been illustrated in chapter V/2.5.2+3, provisions of tax treaties are used to undermine a states ability to tax private and corporate wealth holder. A question asked is, whether and why DTAs are needed in the first place, i.e. whether they answer to a real problem, whether their existence is of eminent importance for investment decisions taken by foreign investors at all and whether there are no alternatives to those comprehensive frameworks. As it seems, gains for developing countries are at best short time, whereas treaty shopping and the exploitation of tax gains are not of primary importance, but, similar as tax incentives, a welcome addition to business decision (Hearson, 2015, p. 14f.).

Disadvantages arising from DTAs more often than not cannot be offset by domestic legislation. Which is why it is so important that Anti-Abuse Clauses enter into DTAs if they cannot be replaced or avoided. The BEPS process also impacts on the OECD Model Convention from where it could enter into existing or new DTAs based upon this Model Convention. So far, however, there is only evidence that those regulations are not been taken up, as a study in the case of Zambia and Uganda examined (Hearson, 2015, p. 24).

The question is whether there need to be tax treaties in the first place

A number of countries continue to trade and invest with other countries without a tax treaty in place. Even without a tax treaty between them, Brazil and the US enjoy a significant trade and investment relationship. In 2014, there was US\$112 billion worth of US investment in Brazil, making the US the second biggest investor in Brazil. Brazil also does not have a tax treaty in place with Germany, Switzerland or the UK, each of which still has billions of dollars invested in Brazil. (Action Aid, 2016a, p. 13)

Others are in favour of re-negotiating unfavourable tax treaties. But: a re-negotiated treaty must not be better than the one before. : See, for example, the DTA revision of Germany with the Philippines, which contains tax breaks and other investor friendly concessions at the cost of the tax administration – as PriceWaterhouseCooper rejoices.<sup>28</sup>

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<sup>28</sup> ‘Salient features of the modified tax treaties include significant tax breaks as well as tightening of certain thresholds that would constitute a taxable presence in either country (or what is technically called a permanent establishment [PE]). Some of these amendments are provided below....Under the Renogiated Philippines-Germany Tax Treaty:

- The 10% withholding tax rate on dividends was lowered to 5% if paid to a company which owns directly at least 70% (formerly 25%) of the capital of the company paying the dividends.
- Unless otherwise exempted, all interest shall now be taxed at a uniform withholding tax rate of 10% (formerly 15%) of the gross amount of interest received. Financing charges in connection with sale on credit shall not be subject to withholding tax, but shall only be taxable in the country of the seller.
- Royalties are now to be taxed at a uniform rate of 10% of the gross amount received regardless of the nature of the royalty payments.

... With more friendly tax rates accorded to foreign investors, we can expect a better churning machinery to generate needed investments for the economy.’

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#### **3.8.2.4 Other frameworks of cooperation**

Beyond that, FATF and AML are separate bodies and membership needs to be continued and intensified. When this report was written, Kenya was not yet member in the EITI initiative, even though committing to implementing its standards.<sup>29</sup>

#### **3.8.2.5 Conclusion**

Waris (2009, p. 51) recommends to “apply the OECD’s Article 26 in its tax information exchange treaties, which reduces the burden of proof for asking information from foreign counterparts. Also the government should attempt to update its double-taxation treaties to provide better avenues for addressing trade mispricing.” → Is this still relevant or has it been superseded by BEPS?

If this still needs to be done, there are always two partners to a treaty and it can be doubted that the rich state will concede to the desire of the poorer partner.

### **3.8.3 Administratively**

As has been indicated in chapter VI, there are a number of issues where developing countries such as Kenya are disadvantaged when it comes to tax administration, for example:

- KRAs operation and conflict resolution depends on the formulation of DTAs
- Kenya does not have the resources for reciprocity in the exchange of information

In chapter VI there were also examples where KRA receives assistance from developed states, e.g. GIZ for training (VI/5.2.2.7), Sweden and Denmark for establishing its ICT operations (VI/11.3).

Whatever is helpful to advance the efficiency of tax administration, e.g. support by training and coaching, support by ICT... should be stronger considered as being Help to Self-Help and steps on the way to financial independence.

### **3.8.4 Declaration and practice, open and hidden interests**

Above (3.8.2.2) we illustrated the gap between political declaration and realization regarding the UN and OECD framework, which are a “crossover” between political declaration and some legal Model conventions in place. The gap between declaration and realization is even worse in discussion frameworks without such basic legal instruments in place, e.g. the FFD3 and SDG process or the G20

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Tsang, J. (2013, September 19) More treats from the treaty front. In: PriceWaterhouseCooper. Retrieved from <http://www.pwc.com/ph/en/taxwise-or-otherwise/2013/more-treats-from-the-treaty-front.html>

<sup>29</sup> Kenya commits to implementing EITI. (2015, August 6). Retrieved from <http://kcspong.org/kenya-commits-to-implementing-eiti/>

### 3.8.4.1 AAAA and SDG

Arising from the process aiming for the replacement of the Millennium Development Goals by the Sustainable Development Goals, there were some nice declarations along the way. For example the Addis Ababa Action Agenda, and there Nr. 22+23

22. We recognize that significant additional domestic public resources, supplemented by international assistance as appropriate, will be critical to realizing sustainable development and achieving the sustainable development goals. We commit to enhancing revenue administration through modernized, progressive tax systems, improved tax policy and more efficient tax collection. We will work to improve the fairness, transparency, efficiency and effectiveness of our tax systems, including by broadening the tax base and continuing efforts to integrate the informal sector into the formal economy in line with country circumstances. In this regard, we will strengthen international cooperation to support efforts to build capacity in developing countries, including through enhanced official development assistance (ODA). We welcome efforts by countries to set nationally defined domestic targets and timelines for enhancing domestic revenue as part of their national sustainable development strategies and will support developing countries in need in reaching these targets.

23. We will redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation. We will also reduce opportunities for tax avoidance and consider inserting anti-abuse clauses in all tax treaties. We will enhance disclosure practices and transparency in both source and destination countries, including by seeking to ensure transparency in all financial transactions between Governments and companies to relevant tax authorities. We will make sure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies.

But: There is little which made its way from Addis to be entered in the end into the decisive document declaring the Sustainable Development Goals,<sup>30</sup> i.e. the framework replacing the Millennium Development Goals, outlining the marching order of nations up to 2030. Only three passages are of interest, namely 12c, 16.4 and 17.1:

Goal 12.c Rationalize inefficient fossil fuel subsidies that encourage wasteful consumption by removing market distortions, in accordance with national circumstances, including by restructuring taxation and phasing out those harmful subsidies, where they exist, to reflect their environmental impacts, taking fully into account the specific needs and conditions of developing countries and minimizing the possible adverse impacts on their development in a manner that protects the poor and the affected communities

Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels. ...

16.4 By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime.

Goal 17. Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development. 17.1 Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.

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<sup>30</sup> <https://sustainabledevelopment.un.org/post2015/transformingourworld/publication>

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But here, too, the declarations are nice, while clear and verifiable criteria to measure progress or failure are as rare as are commitments of governments around the globe how exactly this cooperation should be implemented.

Here, the UN Statistics Office was in charge to develop indicators, criteria and methods of measurements with which to measure that progress. In their preliminary progress paper published in March 2016<sup>31</sup> the situation is best regarding Target 12.1: As indicator they propose ‘Amount of fossil-fuel subsidies, per unit of GDP (production and consumption) and as a proportion of total national expenditure on fossil fuels.’, the proposed custodian agency is the UNEP, there is a suggested methodology (which has not been tested yet) and beyond that ‘UNEP can support the World Bank with the definitions around this indicator.’ (p.45)

The situation is much worse in the two other areas: As an indicator capturing illicit financial flows they proposed in 16.4.1 “Total value of inward and outward illicit financial flows (in current United States dollars)”, as Custodian Agencies the proposed the IMF and UNODC, but regarding everything else they had to admit regarding Target 16.4:

There is no methodology for this indicator and work is ongoing towards the development of an international standard. The concept of illicit financial flows has not been explicitly defined in the international normative framework dealing with crime, corruption, transnational organized crime, money laundering and financing of terrorism. UNODC is currently working, together with other international agencies, towards the formulation of an agreed definition that can be used for international monitoring purposes. The methodological approach to measure IFF will make use of a number of tools, including those recently developed to measure illegal economy. (p. 53)

Regarding Target 17.1. they propose as indicators (1) ‘Total government revenue as a proportion of GDP, by source’ with the correlated Custodian Agency World Bank, and (2) ‘Proportion of domestic budget funded by domestic taxes’, with the Custodian Agency IMF. Regarding a more detailed information, e.g. as to methods of measurement or data availability the paper simply states “No information provided”.

While improvement on target 17.1 can be expected, the research has a skeptical view regarding any sensible progress on Target 16.4.

Of course, from an NGO point of view it makes sense to go back to the FFD3/AAAA paper, namely Nr. 22+23 with all those issues that have been cut out in the SDG paper. Here, more indicators and criteria could be developed and implemented, if acceptable. For example, the promises to

- Improve fairness in existing regimes (waiting time of taxpayers for service, dealing with arrears)
- Increase assistance of poor countries (share of ODA devoted to tax matters)

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<sup>31</sup> <http://unstats.un.org/sdgs/files/meetings/iaeg-sdgs-meeting-03/Provisional-Proposed-Tiers-for-SDG-Indicators-24-03-16.pdf>

Draft version, not yet officially authorized for quoting.

- Increase transparency and exchange of information especially in view of Beneficial Ownership (progress on negotiations involving public registers of BO, automatic exchange of information)<sup>32</sup>

At the time when work to this book stopped, there were no binding agreements both on content and ways/extent of support for poor countries on part of the developed countries within a binding UN framework.

#### *3.8.4.2 G20, Compact with Africa, Marshall Plan with Africa...*

A report preparing the Germany-headed 2017 G20 Finance Ministers and Central Bank Governors meeting in Baden-Baden did not mention Illicit Financial Flows at all. Regarding taxation, two passages were contained in the main report on pages 10 and 12:

The development of strong tax systems, and the importance of external support in building them, is a central plank of the Addis Ababa Action Agenda. Specifically, it recognizes that “significant additional domestic public resources, supplemented by international assistance as appropriate, will be critical to realizing sustainable development and achieve the Sustainable Development Goals”. An important instance of implementing this Agenda is the Addis Tax Initiative, which aims to raise domestic public revenue, improve fairness, transparency, efficiency and effectiveness of tax systems. Launched in July 2015, participating providers of international support in this initiative committed to doubling their technical cooperation in taxation by 2020, and partner countries restated their commitment to strengthen revenue mobilization so as to achieve the Sustainable Development Goals and ensure inclusive development....

International cooperation is needed to avoid adverse cross-border spillover effects and fragmentation of external support efforts and aid flows. The G-20-supported base erosion and profit shifting (BEPS) project enhances the predictability of tax systems of participating countries by implementing internationally agreed taxation rules. To ensure steady and consistent implementation of agreed measures, along with providing support for newly joined developing countries to keep pace with monitoring and implementation, the Inclusive Framework on BEPS was established. The number of participating countries in the Inclusive Framework increased to more than 90 countries, including many developing countries in Africa, some of which are participating as members of its steering group along with OECD member countries.<sup>33</sup>

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<sup>32</sup> Mothe Karoubi, E./Espey, J. (2016, February) Indicators and a Monitoring Framework for the FFD. In: Sustainable Development Solutions Network. Retrieved from <http://unsdsn.org/wp-content/uploads/2016/03/Final-FfD-Follow-up-and-review-paper.pdf>

<sup>33</sup> The G20 Compact with Africa. (2017) A Joint AfDB, IMW and WBR Report for the G20 Finance Ministers and Central Bank Governors Meeting in Baden-Baden, March 2017. Retrieved from [http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Schlaglichter/G20-2016/2017-03-30-g20-compact-with-africa-report.pdf;jsessionid=2897084425A40124B9CC1C5494C1E38E?\\_\\_blob=publicationFile&v=3](http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Schlaglichter/G20-2016/2017-03-30-g20-compact-with-africa-report.pdf;jsessionid=2897084425A40124B9CC1C5494C1E38E?__blob=publicationFile&v=3)

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And a Box dealing with Domestic Resource Mobilization quotes from a submitted joint report by AfDB, ADB, EBRD, EIB, IaDB, IMF and the World Bank (2015), *From Billions to Trillions: Transforming Development Finance*:<sup>34</sup>

A strategy to strengthen domestic revenue mobilization should focus on mutually reinforcing core-elements: stronger administrations, simpler revenue systems, and collective action to address international tax issues, evasion and avoidance more widely. Noting and responding to significant differences among developing countries, key elements of this strategy would include (with accompanying spending measures as needed, for example to protect the poorest when the VAT base is expanded):

- The critical work of building effective and trusted tax administrations;
- Eliminating exemptions and incentives that forego revenue to little useful end;
- Implementing broad - based and simple VATs, complemented with excises on a limited number of items to address other policy priorities such as public health and environmental protection ;
- Building a broad - based and fair Personal Income Tax (PIT);
- Establishing a broad - based Corporate Income Tax (CIT , at rates competitive by international standards;
- Implementing simplified tax regimes for micro and small enterprises;
- Designing and implementing international tax rules, in relation to both the Base Erosion and Profit Shifting (BEPS) project and Exchange of Information (EOI) for tax purposes, that are sensitive to the circumstances and capacities of developing countries and supported by coordinated international action; and
- Establishing fiscal regimes for extractive industries that provide investors with confidence while ensuring that revenue collections respond appropriately to changing circumstances.

When looking at the context of this report and the G20 as a whole one realizes immediately that tax related topics stood not in the focus of the “Compact with Africa” meeting between African Leaders and the German G20 Presidency meeting in June 2017.<sup>35</sup> The “Leaders Declaration” of the Head of States of July 2017 re-emphasizes the partnership with Africa and the intention to combat root causes of poverty and inequality, but does not link this to taxation and Domestic Resource Mobilization.<sup>36</sup> In the centre stands an “Investment Compact” and the promise to “support developing countries and the provision of public goods”. The focus is, however, on trade and/or the facilitation of “private investment”. That given, taxation is, of course, rather seen to be an obstacle of lower importance and the fact that the above mentioned report was “warmly received by the G20 finance ministers and central bank governors at their recent meeting in Baden-Baden” will nevertheless put Domestic Resource Mobilization or the fight against IFFs on the backburner.

The same applies for bilateral initiatives in the context of the 2017 G20, namely the German Marshall Plan with Africa.<sup>37</sup> In his response to a letter of the Tax Justice & Poverty Research

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<sup>34</sup> [http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23659446/DC2015-0002\(E\)FinancingforDevelopment.pdf](http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23659446/DC2015-0002(E)FinancingforDevelopment.pdf)

<sup>35</sup> <http://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Featured/G20/2017-03-30-g20-compact-with-africa.html#collapse40863>

<sup>36</sup> <https://www.g20.org/gipfeldokumente/G20-leaders-declaration.pdf>

<sup>37</sup> [https://www.bmz.de/en/countries\\_regions/marshall\\_plan\\_with\\_africa/index.html](https://www.bmz.de/en/countries_regions/marshall_plan_with_africa/index.html)

Draft version, not yet officially authorized for quoting.

Team, Minister Müller did not comment on any issues raised by the Heads of Institutions regarding taxation and domestic resource mobilization.

At the same time: If the global legal and cooperative framework remains as it is, developing countries will never be able to stop the financial haemorrhaging.

### **3.8.4.3 Conclusion**

Not surprising, therefore, that there is ongoing dragging of feet.

1. No concessions on part of the wealthy states regarding the exchange of tax relevant information without poor states being able to reciprocate right away
2. Protection of own interests, especially own industries, investors and tax revenue (see also below 3.8.6)
3. No adequate willingness to consider the training and assistance of tax administration as part of developmental aid, among other reasons, because
4. there is no partner at eye level to cooperate with us and because“ in Africa everybody is corrupt anyhow.”

That way, the vicious circle turns once and starts again at 1., without developing states being able to advance from there.

Why, therefore, exists this gap between declaration and realization? Because in the end, politics is about interests and, most of all, the own advantage:

### **3.8.5 Benefits for developing countries are losses for developed countries**

One reason why there is not more progress is that benefits for developing countries are losses for developed countries:

#### **3.8.5.1 IFFs**

As indicated in I/IV/6.5, IFFs from developing countries are going to developed countries and are invested there. This applies not only for the City of London, but also the construction sector in London. Germany still privileges foreign assets on German bank accounts by exempting them from the Flat Tax on Capital income and interest.

#### **3.8.5.2 TNC taxation**

Germany is playing an ambiguous role in the EU efforts to improve on tax avoidance measures. It is one of the few states objecting public registers of beneficial ownership and is also less than enthusiastic about a reform of TNC taxation, e.g. via a common consolidated corporate tax base (CCCTB). Germany would be hard hit by that effect.<sup>38</sup>

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<sup>38</sup> „Die Europäische Kommission versucht es deshalb gerade mit einem anderen Ansatz: Verrechnungspreise wären nicht mehr so wichtig. Stattdessen müssten Konzerne für die Finanzämter in der ganzen EU eine gemeinsame Bilanz vorlegen, als wäre die EU ein Land. Dann dürfte sich jeder Mitgliedstaat einen Anteil vom Gewinn nehmen und den besteuern. Welchen Anteil jeder Staat bekommt, das würde nach mehreren Kriterien

### 3.8.6 Conclusion for developed countries

Rich countries need to think more complex that short term benefits may result in middle and long term harm and that some risks are borderless (climate change, migration...)

### 3.8.7 Conclusion for developing countries

More national transparency regulations, reductions upon tax incentives etc. cannot resolve the DMR problem, but they make life easier for tax administrations, also, by providing them insight into the magnitude of the problem which makes it easier for them to increase moral leverage when it comes to re-negotiating DTAs or transforming political declarations into positive laws and practical cooperation..

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festgelegt – auch nach Umsatz. Steuer-Kritiker wie Sven Giegold gehen in ihren Forderungen darüber hinaus: Sie wollen, dass die Konzerne öffentlich machen, wo sie wie viele Steuern zahlen.

Deutschland hätte in beiden Fällen aber einiges zu verlieren. Die Steuern seiner eigenen Konzerne zum Beispiel. Die versteuern ja bisher auch nach dem Wertschöpfungs-Prinzip – entsprechend landen große Teile ihrer Steuern im deutschen Staatshaushalt. Volkswagen zum Beispiel nimmt nur 20 Prozent seines Geldes in Deutschland ein, zahlt aber nach eigenen Angaben mehr als 60 Prozent seiner Steuern hier. Außerhalb der EU gibt es schon Begehrlichkeiten: China findet, sein Markt sei so groß, allein für den Zugang dazu müsse VW doch Steuern in China zahlen. Tatsächlich muss Deutschland aufpassen, dass es im internationalen Steuergezerre nicht allzu viele Steuern der heimischen Konzerne verliert.

Auch aus den Steueroasen gibt es Widerstand gegen die EU-Initiative. Irland, Malta, Luxemburg – sie sehen sich in ihrer Souveränität beeinträchtigt. Die Kommission schreibt zum Beispiel vor, dass Forschung und Entwicklung einheitlich steuerbegünstigt sein sollen. Was, wenn da nicht jeder Staat mitmachen will? Oder was, wenn ein Staat andere Subventionen vergeben will? Das deutsche Finanzministerium gibt sich zurückhaltend. „Besteuerungslücken könnten geschlossen werden“, heißt es aus dem Ministerium, aber: Die Verhandlungen über den Vorschlag seien noch nicht abgeschlossen. ...

Dafür gibt es noch eine andere Erklärung, eine grundsätzlichere. Sie stammt von Charles Blankart, der an der Berliner Humboldt-Universität seit Jahren Steuern und die Europäische Union erforscht. Er sagt: Die Staaten bilden mit ihren Steuerforderungen ein Kartell, das aber instabil geworden ist. Denn Blankart überlegt: Wozu werden Konzerne überhaupt extra besteuert, wenn man den Gewinn doch auch viel einfacher als Einkommensteuer bei den Anteilseignern besteuern könnte? Klassischerweise heißt es: Der Staat erhebt die Steuern, weil die Unternehmen Kosten verursachen: Straßen, Wasserleitungen, Entsorgung etwa. Diese Kosten sind aber schnell abgegolten, vor allem bei Digitalunternehmen wie Apple. Jetzt würden die Staaten die Konzerne gerne zusätzlich belasten, um ihre anderen Ausgaben mit zu finanzieren: den Steuerzuschuss für die Rente zum Beispiel, der den größten Teil des Bundshaushaltes ausmacht. Oder die Kreditzinsen. Schon wird es für andere Staaten attraktiv, das Unternehmen mit niedrigeren Steuern abzuwerben. Immer wieder versuchen die Regierungen, sich auf hohe Steuern zu verpflichten, immer wieder erfinden sie neue Regeln – und immer wieder scheren einzelne aus. „Es entsteht eine Interventionsspirale ohne Endpunkt“, sagt Blankart.“ Bernau, P. (2017, June 28) Warum zahlt Apple so wenig Steuern. In: FAZ. Retrieved from [http://www.faz.net/aktuell/wirtschaft/recht-steuern/technologiekonzern-warum-zahlt-apple-so-wenig-steuern-15063714.html?printPagedArticle=true#pageIndex\\_2](http://www.faz.net/aktuell/wirtschaft/recht-steuern/technologiekonzern-warum-zahlt-apple-so-wenig-steuern-15063714.html?printPagedArticle=true#pageIndex_2)

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African states could also consider a stronger cooperation among each other, as the EU member states did with the European Savings Directive. For example: On a corporate level, the Common Market for Eastern and Southern Africa (COMESA) area allows businesses to operate from the country with the lowest tax base and move profits around through transfer pricing. It does affect taxation system in the respective country.

Regarding Joint Audits, for example, the ATAF Agreement on Mutual Assistance in Tax Matters, signed by 22 African states, is the best framework. But: it has not yet been used in practice.

### **3.8.8 Common conclusions**

Not to forget that there are causes to problems which are common to both developed and developing countries, e.g. the mobility of capital and the absence of regulation of capital flows, which in turn gives undue power to those holding capital over governments and parliaments.

Another common problem are features of the present rent-seeking offshore-capitalism. Instead of opening yet another “International Financial Center”, as Kenya attempts to do, it would be important to push back the options of those secrecy jurisdiction by joining hands on a common policy to end this institutionalized malpractice whether it is the Cayman Islands, ongoing options by Switzerland and the UK or tax presents from Germany such as the non-taxation of financial deposits from non-Germans.

Also tax competition should be finished since in the end, the only ones benefitting are private and corporate wealth holder while states are less and less capable to finance public goods and services (below#Ethics).

From a world, where financial markets are less volatile, where developing countries stabilize because governments have adequate resources to care for its people and where there is less inequality, migration and better controlled consequences of climate change is a world which benefits all.

## **3.9 Taxation and Gender**

→ That “poverty has a female face” is widely known. It is unclear how this spells out in Kenya

Direct taxation impacts on income redistribution, and hence gender inequality (B. Wanjala, J. Kiringai and N. Mathenge, 2006). The relationship between gender and taxation still remains unexplored for most economies. PIT and VAT are the most important sources of government revenues given their shares in total revenue. In some cases the PIT has been used to rationalize on redistribution objectives. For individual filing, explicit biases might exist whereby exemptions are differentiated on the basis of gender and also marital status.

## **3.10 Poverty reduction, Social Protection, Insurance deficits**

### **3.10.1 Cash transfer programs**

Besides tax exemption and zero rating of basic food items with the attempt to make it more affordable for the poorest unconditional cash transfer programs have to be mentioned. In the

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Budget 2017/2018, the Cabinet Secretary mentions cash transfers to the vulnerable, children, persons with disabilities and elderly through the National Safety Net Programs and National Development Programs (Rotich, 2017). One problem is to determine the border between those being entitled and those no-longer being entitled, which requires eventually some bureaucratic screening and the fear of intrusion into privacy and confidentiality (Waris & al., 2009, p. 32). This is where a new development comes in, namely, that Kenya is among those countries which, by now, experiment with the Unconditional Basic Income Grant, even though this experiment largely relies on external funding.<sup>39</sup>

### 3.10.2 State-County solidarity mechanism

Since devolution started, counties contributed an increasing share to Government revenue, rising from 400 million KSh to 1.4 billion KSh and KRA is hoping for more (Kenya Revenue Authority, 2015, p. 52)

→ I think for the reader outside Kenya it might be interesting how the solidarity mechanism here is organized, i.e. how central government and wealthy parts of the country support the poorer regions (?? In Zambia the Local Government Equalization Fund, in Germany the Financial Equalization Mechanism).

### 3.10.3 Levels of and Trends in Social Protection Spending

Overall spending on social protection as a percentage of GDP has been largely steady over the past five years, although there have been notable annual fluctuations. These fluctuations have been driven by different spending patterns between safety nets, contributory programmes, and the civil service pension. Levels of spending<sup>40</sup> on social protection increased between 2005 and 2010, although this general trend masks significant variations among the sub-sectors (Kenya Vision 2030, 2012, pp. 14-15).

Table 7 Spending on social protection programmes 2005-2010 (% of GDP)

Spending on social protection programmes 2005-2010 ( % of GDP)						
Sector	2005	2006	2007	2008`	2009	2010
Safety nets	0.78	0.65	.058	0.40	.082	0.80
Contributory Schemes	0.56	0.54	0.59	0.51	0.48	0.48
Civil Service Pension	1.0	1.10	1.30	1.20	1.20	1.00
<b>Total</b>	<b>2.34</b>	<b>2.29</b>	<b>2.47</b>	<b>2.11</b>	<b>2.50</b>	<b>2.28</b>

Source Authors (2011). (Kenya Vision 2030, 2012, p. 15)

<sup>39</sup> <http://basicincome.org/news/2016/11/kenya-unconditional-cash-transfers-towards-unconditional-basic-income-randomized-controlled-trial-come/>

<sup>40</sup> In this section, spending is equated with the actual expenditure recorded by the social protection programmes

### **3.10.4 Programme Sustainability**

Sustainable financing for the social protection sector remains a challenge, particularly in the context of high poverty incidence and fiscal constraints. As existing social protection programmes are extended, the question of how to finance these initiatives over the long run becomes increasingly important. For instance the NHIF depends on investments and member contributions for its financing. As it stands now, the Fund's "financial position is currently characterized by rising payout caused by significant increases in informal sector membership, unchanging contribution levels, and increasing expectations from members....Its current asset base consists largely of fixed assets which cannot be easily liquidated."<sup>41</sup> Notably, contributions from informal members are set at 50 percent of those for formal sector workers. Yet, informal sector workers draw on NHIF benefits more often than those from the formal sector: This has resulted in major challenges to ensure the financial sustainability of the NHIF. (Kenya Vision 2030, 2012).

In order to strengthen the NSSF's investment portfolio, and to make it compliant with RBA regulations, six leading asset managers have been employed, and two custodians have been employed to oversee the Fund's assets.

To achieve the constitutional mandate, as stipulated in the 2010 Bill of Rights, to provide social security to Kenya's poor and vulnerable citizens, spending on safety nets will need to increase. While at the same time acknowledging the competing priorities for government revenue, as a point of comparison for public financing. The Kenya's Vision 2030 recognises the importance of developing sustainable government financing mechanisms to meet the social protection needs of vulnerable groups. In its social pillar, Vision 2030 envisages the establishment of a "consolidated Social Protection Fund" as a vehicle for allocating government resources to protect orphans and vulnerable children (OVC) and older people. The vast majority of government spending on social protection was allocated to the civil service pension. These points to an important need to consider the fiscal sustainability of the civil service pension.

Finally, when safety nets and contributory programmes complement each other, this has implications in the long term for the financial sustainability of the social protection sector. Safety nets can enable households to invest in productive activities and in human capital development that will increase their productivity and income. By increasing the employability of the poor and vulnerable and enabling them to obtain better and more productive work, safety nets promote participation in the labour market. Thus, beneficiaries become more self-reliant, rise out of poverty, and reduce their dependence on government-funded non-contributory safety nets. As the once-poor and vulnerable participate in the labour market, they can access and invest in contributory schemes (Kenya Vision 2030, 2012, pp. 19-23). By becoming members of contributory schemes, new entrants into the labour market reduce the cost of their social protection by sharing it with their employer. They are also more likely, depending on their place within the labour market, to be able to afford to participate in voluntary personal contributions to a pension. In this way over the long term, the cost to the government of providing safety nets will diminish as the beneficiaries of safety nets graduate to contributory schemes. However, this requires contributory schemes to be well designed and efficient with broad coverage and is likely to materialise only over the long run.

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<sup>41</sup> Estimates suggest that the cost of medical care has increased by nearly 35 percent in the past year. In response, private insurers have increased premiums by between 10 and 20 percent, whereas the NHIF contributions have not risen at all.

### **3.10.5 Informal sector deficits**

Since informal sector is largely unregistered, it goes without saying that there are very few informal sector employees who contribute to social insurance through mandatory social security contributions. This implies that this category of employees is not only vulnerable to a lack of decent living (since they earn low wages) but will also be worse-off once they are no longer in employment since there is no social insurance. Thus majority of those in the informal sector lack accessibility to mandatory social security schemes since by definition, they are not registered.

### **3.10.6 NHIF**

#### ***3.10.6.1 Insurance deficits***

The poorest sections of society are unable to access the NHIF, as they cannot afford the full cost of insurance and the government has insufficient resources to subsidize the cost. Critically, the large informal sector is untouched by the NHIF, due to a lack of systematic methods to reach informal workers. Currently, contributions to NHIF are mandatory for all salaries employees in Kenya.

Although it reaches about 7 million beneficiaries, the NHIF only covers the 'hotel' part of inpatient healthcare costs (World Health Organisation, 2006). That is, insured NHIF members still need to pay out-of-pocket fees for treatment, diagnosis and pharmaceuticals. It can therefore be understood that financial protection by the NHIF is quite weak. However, currently, there is great debate whether the coverage of outpatient expenses would lead to an increase in fraud within the Fund.

One however, has to take into consideration the domination of formal (contributory) safety net measures in the coverage of mostly formal sector workers. About 20% of workers are in the formal sector meaning that both social insurance and social security are dominated by formal sector employees who constitute a minority of workers. Only about 20% of Kenyans for instance are covered by social insurance schemes, this number could be lower given the fact that formal sector workers tend to be the same individuals covered under private schemes therefore enjoying parallel coverage again leaving out the majority; informal sector workers (HakiJamii, 2014, p. 20).

#### ***3.10.6.2 Governance and reform issues***

The suspicion of fraud lead to a number of reform discussion regarding NHIF governance: Various new departments have also been proposed. First, in addition to an Audit panel reporting to the CEO, a new Fraud and Investigation department is suggested, which will check the NSHIF's financial activities. It will report directly to the Board of Trustees, and should be established as an independent entity, so that oversight of the Board of Trustees is strengthened, and transparency and accountability of the NSHIF is ensured. Secondly, a new Controlling department should complement the present Finance department. Whilst the Finance department will continue to develop the annual budget, the Controlling department intends to focus on implementing procedures to check the budget allocation within the various NSHIF departments, and thus help change the NSHIF into an organisation managed by objectives. Thirdly, a new Information Technology department is proposed, since greater computerization of the NSHIF is an essential task not only for operations but also for contracting and quality assessment. Fourthly, a new Marketing department is recommended to develop and implement the communications strategy of the NSHIF. Fifthly, a department of

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Benefits and Quality will define : (i) the standards of the services available for NSHIF members at the various levels of care; and (ii) the criteria for assessing the quality of health service delivery at individual health facilities. Finally, a Contracting department has been suggested, crucial in negotiations on provider payment methods and levels. (World Health Organisation, 2006).

### **3.10.6.3 Further discussion**

Furthermore, the distribution of claims by the NHIF is unevenly skewed towards private hospitals and nursing homes, as opposed to government and mission facilities, where most people access their health services. The NHIF also does not provide coverage for preventive health care services, which are critical to improving health outcomes in Kenya.

NHIF does not provide for reimbursement of contributions to its members, which means that the excess of funds collected vs. claims paid is not returned to contributors. The utilization of these excess funds is another subject of debate; many feel that these excess funds should be invested in Corporate Social Responsibility initiatives (CSR), while others believe they should be invested in profit-making endeavors that will increase returns to the Fund's contributors. It is important to note that the current levels of contribution are capped at a very low rate, and do not reflect the earnings of persons. However, many argue that before contributions are increased in any way, management and governance issues within the Fund must be adequately addressed.

There is much debate as to whether voluntary and discretionary contributions would increase access to and efficiency of the Fund by encouraging competition. Other questions are: should contributions to the NHIF be capped, or based on level of income? Would a more graduated scale increase the cost of doing business in Kenya? How should surpluses within the fund be utilized? Should they be invested and returned to contributors, or used within Corporate Social Responsibility (CSR) schemes?

### **3.10.7 Conclusion**

Regarding tax funded Social Protection Programmes: A valid point remains how those cash transfer programs are being financed. In 2009 already, Waris details how such transfer programs should be financed via tax funded redistribution from those who benefitted most from the economic development, e.g. by raising the income tax rate for top earner up to 40% (Waris & al., 2009, p. 32).

Mandatory SSCs make labour expensive and business out of work. At the same time the need and justification for it is easy to communicate since people will get something re reciprocity to what they are paying.

## **3.11 Informal Sector Economy**

### **3.11.1 Issues at stake**

80% of employment is here, the tax revenue is carried by formal employees only.

And: Not everybody is poor in the informal economy, e.g. home owner renting out property in slums like Kibera.

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At the same time: The blunt imposition of a tax burden on subsistence farmer and small(est) business people may endanger their existence. It needs to be considered that this sector keeps many people alive. The problem therefore is: How to identify those who could be taxed?

### **3.11.2 The link between jobs and taxes**

If you overtax SMEs in the informal sector, people might lose their living. This must not happen. At the same time there are wealthy entrepreneurs who could well afford to be taxed.

For developing countries such as Kenya it is difficult to move towards a more even balance of direct and indirect taxation for a number of reasons. The first and most significant problem is the large informal sector. Essentially, if the government does not know about the income received by farmers and farm workers, and other sectors of the economy it can have no hope of taxing it. However, the lack of information and data on the part of the government in this sector makes it difficult to make direct taxation of individuals. According to an interview with former officer Customs income within the informal sector is not monitored yet it is lucrative and if tapped well, shall go into a long way filling the revenue gaps. An oversight to this is the under-declaration of income, posing loopholes within the tax administration system to maximize on taxation.

### **3.11.3 Block Management Approach?**

Many African states have some form of Block Management Approach for dealing with the informal economy, e.g. Tanzania or Zambia, as shown in the *Zambian Country Report Z/VI/4.4*). Regarding KRA, the intention, to introduce this approach has been mentioned in the 4<sup>th</sup> Corporate plan as follows: “In the Fourth Corporate Plan, KRA will revamp the operations of TOT by adopting block management, review the laws governing TOT and enhance recruitment and monitoring of filing and payment.” (Kenya Revenue Authority, 2009, p. 59). It does not reappear in the 6<sup>th</sup> Corporate Plan

→ Is it at least tested somewhere?

### **3.11.4 Approach to formalize the informal**

No ‘law enforcement approach’ here, but

provide shelter to these activities by extending business counselling services to them, studying the revenue potential in the sector and then taxing them fairly in exchange of a legal status. Indeed, as many ‘Jua Kali’ operators would not even reach the minimum tax threshold of PAYE, PIT or in some cases the VAT, they would only be liable to registration, licence fees and regulation. However, as the informal sector also includes many large operators, regulating the sector through tax registration would spot such large transactions. Other aspects of the informal economy relate to farming or pastoral activities, where the structures of the formal economy are too hard to access, even when the scale is there. The solution here would be to bring the state closer to the people, instead of forcing the contrary. Taxation at community level has been a source of contention in many countries including Uganda. It is often viewed as a double taxation and an over burdening of already ‘overtaxed’ poor. Thus, the Government should provide incentives like credit facilities to small entrepreneurs, with the possibility of selling goods and services to government through micro-enterprise procurement to encourage formalisation. (Waris & al., 2009, p. 39f.)

The first step towards designing effective interventions to facilitate transitions to formality is to recognize the heterogeneity of the informal economy, the many different categories of work involved and the various drivers that are leading it (ILO, 2008). It is

important to distinguish between, on the one hand, recent in-formalization processes linked to trends in the global economy or to past structural adjustment policies and, on the other, the resilience of informal petty production of goods and services for local markets, which is still an important feature of everyday life for a large number of people.

According to Komollo Ouma's paper on regularization of the informal sector, his argument is policy focus in the formal economy has over-shadowed the informal sector. The absence of clear policies has relegated the informal sector to fragile working environments. Informal trading activities in the city of Nairobi have not been incorporated adequately in the land use framework of the city (Komollo, 2010). One other problem associated with informal activities is the conflict of use, between these activities and designated uses, which largely results from lack of regulation. The resultant developments reflect a state of fear to these people as to when, not if, they will be evicted (Komollo, 2010). Despite the constant neglect of the informal economic sector, its contribution to development is fast increasing.

**Lack of access to policy updates:** - Policies regarding the informal sector are poorly coordinated and disseminated within five different government ministries namely finance, trade, industrialization, local government and labour. This confusion often puts the sector operators without access to policy updates in collision with enforcement authorities, not because they want to do so, but because they lack the information (Ogutu, 2013).

**Lack of opportunity to grow and adapt good culture of corporate governance:** - The informal sector has limited access to training and professional services that would enable them adapt better culture of corporate governance. Majority of the sector operators receive cash on daily basis and do not keep records for their transactions. Without business records and legal structure, they cannot enter into legal contracts with government and formal private sector including access to financial and other professional services necessary for their growth.

**Lack of participation in reform processes:** - The current policy reforms regarding business regulations and taxation laws and systems have been formulated with little participation of the informal sector. As a result, many workers and businesses entrepreneurs in the informal sector feel that they have not benefited enough from such democratic reforms and therefore oppose further reform initiatives.

**Bureaucratic licensing procedures:** - Dedicated entrepreneurs who want to register and operate formal businesses often get discouraged by administrative barriers:

- Bureaucratic registration procedures and costly and time-consuming taxation procedures.
- Delays and unnecessary requirements in obtaining business licenses arise from inefficient coordination among the different government agencies.
- The sector operators producing quality products or with potential to enter into legal contracts with the government or private sector for supply of goods choose to operate informally

**Mistrust and weak structural dialogue between informal sector and government:** - There is a general mistrust between tax agents and taxpayers, with agents perceiving the informal sector as criminals unwilling to pay their taxes, and operators wary of government agencies' high-handedness in collection of taxes. There is lack of structured dialogue between the informal sector and the government and other law enforcing authorities. This has led to mistrust and prevents the sector from engaging constructively with the government in reform processes (Ogutu, 2013).

**Corruption/ Embezzlement and Governance-**

Corruption has a direct impact on the size of the informal economy. It increases the cost of creating new businesses and staying in business within the formal economy - unofficial payments and unpredictability of their size and frequency drive the costs and risks so high that the entrepreneurs prefer to move their businesses underground to avoid bribes that they have to pay for services such as registration licensing, permits. Corruption in social services makes them less affordable and leads to creation of alternative services in the informal sector. Corruption at high levels of government such as capture of the state by vested interests has even a more profound impact on the degree of informality in the economies: it forms barriers to entry by creating a less competitive business environment and adds to business risks by increasing the level of unpredictability of government policies that are captured. Weaknesses in governance – governance being defined as the way in which public institutions perform their functions in a country – are strongly correlated with deficiencies in development. Bad governance is associated with corruption, distortion of government budgets, inequitable growth, social exclusion, lack of trust in authorities. Inefficiency of formal governance institutions leads to creation of informal institutions that substitute for the functions that the formal ones are unable to perform.

### **3.11.5 Conclusion**

It is to be borne in mind that the true measure of tax burden is the change in people's economic situations as a result of the taxation. The changes should be measured as the effects on everyone's net-of-tax income after all economic adjustments have run their courses. The burden measure should include not only changes in people's after-tax incomes in a single year, but the lifetime consequences of the tax change as well. Unfortunately, policymakers are not presented with this type of comprehensive information on the true burden of taxation and must make policy judgments based on incomplete and misleading statistics. Hence, if any taxation is attempted here, the legislation should be preceded by careful impact assessment, i.e. the effort to establish how the legislation will affect the livelihood of the poor.

- ➔ Regarding the move from the informal to the formal sector: Would it be helpful to start with mandatory SSCs first, since everybody sees a point in that, and taxation will come later? Once a business registers for SSCs he is recorded and can be nudged further into the formal economy.

### **3.12 Taxing the bads/market failure/Green Taxes**

Indirect taxes are often used and justified as an instrument in correcting for externalities and associated market failures – indirect taxes can be used as a means of making the polluter pay and “internalizing the external costs” of production and consumption. Here, by now, are enough proposals to tax Carbondioxid, by paying attention that poor households are not unduly burdenend, and even support poor households directly from revenue thus collected in order to lower costs on labour and/or facilitate “green consumption” and production.<sup>42</sup>

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<sup>42</sup> (Randers & Maxton, 2016) and Recommendation Nr. 9 of the T20 Thinktank ahead of the G20 in Germany “Promote the coherent management of the distributional effects of climate policy • Monitor systematically the regressive impact of climate policies. • Translate the “carbon dividend” (public revenues generated by carbon pricing) into reduced labor taxes for low-income households. • Adopt active labor market policies to avoid

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Or a levy whose revenue can, different from tax revenue, directly be dedicated to an appropriate purpose such as the Renewable Energy Levy in Germany taxes the use of energy for the subsidizing of renewable energies. The disadvantage of that specific tax is that they burden low income households...

Withholding Taxes here are useful to achieve several ends: First, to collect revenue. Second, to discourage TNCs to shift profits out of the country (or, at least, tax a bit of it away), or, third, to even be an incentive for TNCs to keep money in the country and re-invest it (Hearson, 2015, p. 27)

As has been illustrated in chapter V#, KEN does not have to start from Zero: there are already taxes on socially undesirable behaviour (tobacco, alcohol), and there was even some sort of “Green Tax” on the use of plastic bags before they were banned from use beginning September 2017.

## **4 Ethical considerations**

What are the ethical criteria which are, for us, important for judging the status of the Kenyan tax system. Here, we want to provide only some aspects and refer to the more extensive presentation and discussion available on the project website [www.taxjustice-and-povert.org](http://www.taxjustice-and-povert.org)

### **4.1 Global and local common good**

Borderless risks link nations with each other such as capital, climate and migration, which is why the local common good is affected by events far away and needs to take into account the effects of its own deeds or omission upon areas far away. Global financial system as enabler of IFFs.

Privileging capital over labour is (ideally) meant to develop into capital stock which then will be invested to created jobs in an (ideally) social and ecologically adequate manner.

Fact is that often capital gains and money is transferred out of the country where it is generated. This would still be acceptable somehow if it is elsewhere invested to created jobs in an (ideally) social and ecologically adequate manner, because then it would at least improve the Global Common good. The fact, however, that wealth inequality between private, corporate and criminal wealth holder and poor people is growing that fast and much indicates that something is going wrong. Here, taxation could recoup at least some of that money both for redistribution purposes and for public investment.

Funding of Social Security Systems: Investment in real property and global markets with the hope to reap dividends<sup>43</sup> rather than having a system of revolving solidarity where that, which is needed by the sick and old is financed by the younger generation.

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negative employment effects due to decarbonization and improve skill transferability in other sectors.

“[http://www.t20germany.org/wp-content/uploads/2017/07/20\\_Solutions\\_for-the\\_G20.pdf](http://www.t20germany.org/wp-content/uploads/2017/07/20_Solutions_for-the_G20.pdf)”

<sup>43</sup> The current National Social Security Fund investment portfolio include fixed income (This include Short term and Long term bonds. As at 31 December 2010, the investment in Long term bonds was KSH 24.64 Billion), and Equities( Private Equities - The main private equity held by NSSF is 11.2% of the issues share capital of the

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For Africa, there is current dependence but also dependence regarding that which might be possible or not, i.e. there is no quick fix to many problems as long as the global financial system remains as it is and one repeats or keeps mistakes alive (e.g. REITS or ABSs).

## **4.2 The problem of competition**

As the Institute of Economic Affairs rightly observes, the wealth in tax concessions for Foreign Direct Investment, TNCs and other outside influence arises due to the competition of states for those sources of finance of which is hoped that they will create jobs which in turn will increase revenue from PAYE and consumption tax. Here, also the Kenyan government perceives tax incentives to be an adequate options rather than direct expenditure (Institute of Economic Affairs, 2012a, p. 42). To a similar conclusion comes the study by (Tax Justice Network; Action Aid, 2016). It is our conviction, too, that this school of thought needs to be challenged in order to stop the ongoing “race to the bottom” of which only top private and corporate wealth holder profit in the middle and long run at the expense of middle and low income households and the poor.

## **4.3 Simple law, complex law**

Can tax law be simple? Then it would not be fair, i.e. doing justice to the situation of an individual person or business. In addition there are international complexities. In addition is the right to legal redress if somebody feels treated unfairly and the obligation of the legislator to adjust laws if ordered so by the court. I.e. a simple tax law will never exist

“The detail and complexity of a tax law is required to define a comprehensive tax base and deal with all the exceptional circumstances and cases.” (Waris & al., 2009, p. 50).

## **4.4 Costs of collection**

Yes, auditing, investigation and prosecution costs money and makes tax administration expensive. But: Low-cost alternatives (PAYE, VAT) are having its own disadvantages by placing the burden on the formal worker and poor households. Hence: Justice has its price and therefore costs for enforcing direct taxes on PIT and CIT and tax evaders etc. are justified.

## **4.5 Wealth taxation**

Justification of wealth taxation and wealth transfer taxation

- ➔ Wealth Tax because of the contribution of the community
- ➔ Wealth transfer Tax because of equality of opportunities.

## **4.6 The special case of land**

Should land be privately possessed at all?

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#### **4.7 Democracy, “the markets” and capital owner**

Who is ruling the world with its many problems? The invisible hand of “the market” was long thought to be the best solution for the problems. This is disproven since 2007/2008.

In Africa, economical and political elites are even more “connected” as in Europe. This impacts on the media, since the ownership of media with their power of agenda setting, i.e. permitting some topics to emerge and others to be suppressed.

In Africa intimidation of journalists, activists and other persons and organizations courageous enough to uncover problems → they risk damage to life and property or arrest.

### **5 Alternative ways to reduce poverty**

The goal of the Tax Justice & Poverty project is combating poverty and inequality. There may be better ways to do that than taxation. Only some comments from our more extensive discussion available on the project website [www.taxjustice-and-povert.org](http://www.taxjustice-and-povert.org)

#### **5.1 Trade**

- The critical question is: Advocates of free trade argue that developing countries would gain most from abolishing customs and tariffs, perhaps not in tax, but in jobs, salaries and consumption. Is that so?

Regarding external trade it has been indicated in chapter V/2.5.7# of this report, that the EPA agreement with the EU is burdened with difficulties for Kenya.

Right now, trade and trade policy is rather organized to benefit the (foreign) investor and even developmental policy engagement is oriented towards attracting and protecting the private investor (above#Marshallplan).

#### **5.2 Investment**

There is a lot of talk about “Development Investment”, “Social Entrepreneurship”, a “more inclusive growth” etc. Often, interests of capital owner are hidden behind that and a case to case investment is needed to judge whether it is really beneficial to the common good.

If investment were fair and would also take into account social and ecological concerns it would be a good thing: It would lower profits and, with that, CIT – but much more and sustainable good could be done in a subsidiary way.

#### **5.3 CSR/CC**

CSR came up in VI/4.1 under the suspicion that this instrument is misused for lowering tax obligation. Is it a better way to reduce poverty?

Regarding Corporate Social Responsibility or Corporate Citizenship, it remains our conviction that paying fair and adequate taxes is the first responsible of any business (Eichinger, 2016b). If they choose to do anything beyond paying taxes and additional regarding CSR – fine.

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## **5.4 Foundations, Donations**

→ Foundations in Kenya? Can possibly also treated under the chapter of Exemption from Real Estate

Experience with Germany are bad.

Donations by wealthy people? They are tax deductible in Kenya (see VI/3.3) and if wealthy people donate this is fine. But do they donate as much as they would have to pay taxes?

## **5.5 Assessment of Vision 2030 strategy**

As mentioned in V/1.1, the development policy of Kenya is placed upon the attraction of FDI, which is (to a large extent), private sector and export driven. Here now is the place to briefly evaluate its usefulness to eradicate poverty in the medium and long term. There are a number of problems here:

First, potential revenue gains by FDI investment is more often than not eaten away by the granting of tax incentives, even though a thorough analysis of the link between tax incentives, medium and long term investment and tax revenue still remains to be done. As has been shown above (#), the tax gap for corporate sector is still the widest and as shown in (#), tax incentives eat away a lot of that which corporate taxation should contribute to the treasury.

Next, the Kenyan policy it puts domestic and foreign capital into different positions, and for obvious reasons domestic capital should be far more interested in remaining in Kenya and upholding its investment than all EPZ and SEZ investment together. In her analysis, Waris is very sceptical whether export-promotion improves the countries overall competitive advantage in the medium and long run (Waris & al., 2009, p. 24)

Finally, one should distinguish between the attraction of FDI for local markets and consumer and FDI merely for export assigned production. The first binds the investor to the place of investment and makes him engaged in the market and devoted to the consumer in the medium and long term, the second makes him move on for greener pastures once incentives and concessions are expired or when other states offer better incentives. It is the latter, which poses a considerable problem for Kenya if, for example, Uganda and Tanzania, also members of the EAC, offer more favourable incentives and conditions than Kenya. Here, the following table is illustrative, even though slightly outdated, given the many changes which have happened since 2009

Table 8 Perception about business environment, firms evaluating some constraints

Indicator	Kenya	Tanzania	Uganda
Corruption	73.8%	51.0%	38.2%
Cost of Finance	73.3%	57.8%	60.3%
Crime, theft and disorder	69.8%	25.4%	26.8%
Tax rates	68.2%	73.4%	48.3%
Tax administration	50.9%	55.7%	36.1%
Customs administration	39.9%	31.4%	27.4%
Telecommunications	44.1%	11.8%	5.2%

Source: Ngugi and Nyang'oro 2005

Source 10 (Waris & al., 2009, p. 25)

We are following those who argue that there are many more factors informing deliberations of foreign investors whether to move into a country or not than tax incentives. Good governance and the absence of corruption, working institutions and infrastructure, social security and stability, a trained workforce etc. are of equal, if not higher interest in those calculations, if one follows, for example, the annual Global Competitiveness Report and its Index.<sup>44</sup>

## 5.6 Conclusion

Here are a number of good theories and ideas, but, when looking closer, there are deficits.

Deficits in Vision 2030, more taxation for domestic public investment justified, especially to improve poverty reduction, social protection, social mobility

## 6 Recommendations

### 6.1 General

#### 6.1.1 Fair trade and regional integration

Hafsat Abiola, Cabinet Member of Ogun State (Nigeria) and in charge of trade and commerce, emphasized the link between outmigration and fair trade.<sup>45</sup> Europe, she argued, could resolve the refugee easily. But not with developmental aid, combating traffickers and supporting failed states and refugee camps, but by negotiating fair trade agreements which do not provide short term benefit to EU TNCs and African Elites, but small and medium businesses and African workers who, by earning money, could then buy goods from European companies. But exactly this, she argues, is not that which the EU EPAs will effect in Africa which is why three states of ECOWAS are vetoing the draft on the table. This, of course,

<sup>44</sup> <https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1>

<sup>45</sup> Abiola-Costello, H. (2016, August 1) Europa erzeugt die Flüchtlinge selbst. In: Die Zeit. Retrieved from <http://www.zeit.de/kultur/2016-07/westafrika-freihandelsabkommen-eu-fluechtlinge-hafsat-abiola/komplettansicht>

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would also apply to other EPAs which the EU negotiated with the EAC (of which Kenya is member) and SADEC (including Zambia, the third partner of the Tax Justice research). By pointing to Malaysia she argues that Malaysia was successful because they did not follow conventional “Washington Consensus” wisdom, but focussed on the protective emergence of an own national and regional industrial infrastructure first, because they entered global trade. This, she argued, could also be the way forward for a continent with endemic failure, because it (better: its elite) is always repeating the same mistakes. This insights are gaining supporters, since it is obvious that the “Asian Tigers”, China included, gained a lot by not following neoliberal recommendations, hence those positions are also gaining ground in Africa e.g. by the Kenyan economist James Shikwati<sup>46</sup> or the Zambian economist Dambisa Moyo (2009).

On that background, Kenya should consider inner-African options or, even better, options within the EAC and TFTA in creating a regional market and, by that, learning from other states: A number of agencies in addition to the tax administration, such as social security administration and the customs administration are often involved in revenue administration. Likewise, the success story of the “Asian Tigers” is linked to a period of “seclusion” in which the established and secured their own manufacturing base, before opening up to and participating in the world market and “free trade”.

A functioning regional market would perhaps generate less revenue from Customs and Excise (because of absent or preferential rates within the EAC countries), but has potentially more revenue gains in PIT and CIT due to growth in production and services as well as consumption. In both areas, Kenya seems to be placed well, gaining more independence from exporting raw materials and agricultural goods to Asia, Northern America and Europe and from offering too many tax incentives to export processing businesses in Special Economic Zones.

Kenya has been relatively successful in diversifying its exports and building up a strong manufacturing base. As the most sophisticated economy in East Africa, it stands to gain considerably from deeper regional economic integration, benefiting from strong economic growth in regional peers, exporting both goods and services to these economies. [East African Community \(EAC\)](#) members accounted for around a fifth of total Kenyan exports during 2016. Uganda was Kenya’s largest single export destination, accounting for around 11% of total exports during the year. Overall, the African continent accounted for around 41% of Kenya’s exports during the period, and Kenya’s trade with partners on the continent will continue to grow as demand increases and trade links improve. Europe and Asia each accounted for around a quarter of total exports during 2016. The majority of Kenyan exports are raw agricultural products, particularly tea and flowers, and the country’s comparative advantage in value addition remains largely limited to regional African peers. Receipts from these commodities are largely determined by factors such as global commodity prices and domestic weather conditions (affecting production), and not necessarily the state of world

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<sup>46</sup> Pennekamp, J. (2014, February, 13) Entwicklungshilfe: Nein Danke. In: FAZ. Retrieved from <http://www.faz.net/aktuell/wirtschaft/menschen-wirtschaft/internationale-unterstuetzung-in-afrika-entwicklungshilfe-nein-danke-12800821.html>

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trade. That said, Kenya does stand to benefit from stronger growth in the East Africa region, as it is positioned to take advantage of rising demand for manufactured goods, while the country's location and relatively developed transport infrastructure will allow Kenya to act as the gateway into the East Africa region. ... The EAC is considered the most progressive trade bloc in Africa. Collaboration on regional infrastructure has reached a level rarely seen on the continent.... Furthermore, its Single Customs Territory (SCT) system will take effect across the EAC from July 31, which could, if implemented successfully, the SCT could significantly stimulate trade in the region by reducing the cost of doing business.<sup>47</sup>

Another development to be explored is the Tripartite Free Trade Agreement (TFTA), which looks to unite the EAC, the Southern African Development Community, and the Common Market for Eastern and Southern Africa (COMESA) into one unified region and has been signed in 2015:

Kenya's trade balance is expected to see substantial gains from the agreement. According to a recent analysis by the Ugandan Ministry of EAC Affairs, Kenya is expected to be one of only five countries in the bloc to see exports increase by more than \$100m following full implementation of the TFTA. Moreover, with 41% of Kenya's exports destined for TFTA member states in 2011, compared to the 13% share of imports from TFTA participants, Kenya enters the bloc from a position of relative strength.<sup>48</sup>

At the same time: A adequate fair trade framework needs therefore to be coupled with transparent taxation which soon would lead to financial independence of African states. And, if this research proves anything then this: There is more than enough money in Africa and African states could indeed be independent if they were able to collect it.

### **6.1.2 Setting a good example**

An issue of major importance is the example given by the political elite and class, especially in government and parliament, not just by not being corrupt, but by being obviously transparent and accountable.

This would require an review of bodies which invite malpractice and corruption, such as the Constituency Development Fund, and replace it by something more transparent and participative.

The Leadership and Integrity Act as well as the Public Officer Ethics Act and respective subsidiary legislation<sup>49</sup> requires a high amount of transparency and publication from Civil

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<sup>47</sup> Oxford Economics' report to ICAEW's (the Institute of Chartered Accountants in England and Wales) on the perspective of the Kenyan and EAC in Economic Insight: Africa Q2 2017. Retrieved from <http://www.icaew.com/en/technical/economy/economic-insight/economic-insight-africa>

<sup>48</sup> Kenya increasing integration of East African states to enhance growth. Retrieved on 19 July 2017 from <https://www.oxfordbusinessgroup.com/analysis/common-goals-increasing-regional-integration-eac-member-states-and-beyond-should-help-enhance-growth>

<sup>49</sup> Leadership and Integrity Act 2012:

<http://kenyalaw.org/lex/rest/db/kenyalaw/Kenya/Legislation/English/Acts%20and%20Regulations/L/Leadership>

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Servants and holder of Public Office. It would send out a powerful signal if those requirements would also accepted and adhered to by politicians and MPs.

### **6.1.3 Transparency**

Transparency will be easy to install and extend if privacy issues which rightly merit to be protected are effectively protected under tax secrecy provisions.

- Follow up whether the Single Account procedures really increases transparency and reduces corruption in the government sector.<sup>50</sup>

### **6.1.4 Education, information, participation**

5 Rs of the Tax Justice Network. Paying taxes (revenue) will increase representation and engagement of the population.

## **6.2 Informal Sector**

- Follow the Zambian analysis and recommendations!

## **6.3 Tax Law**

### **6.3.1 Income Tax**

Tax rate for Supersalaries. Waris proposes 40% (2009, p. 32).

### **6.3.2 Indirect tax**

NGOs argue that, whenever legal reforms like that are undertaken, also an impact analysis should be conducted to estimate more clearly in advance how the law impacts upon the poor directly and indirectly in the attempt to avoid that something good is aimed for, while collateral damage, though unintended, creates unsought for hardships (Tax Justice Network Africa; Christian Aid, 2014, p. 64).

### **6.3.3 VAT**

ICPAK starts observing that VAT has the lowest buoyancy and burdens the poor, even though the taxes are designed to exclude the poor from the tax net by excluding basic necessities. Furthermore, ICPAK argues, to exempt goods is inferior to zero rating them: "When a

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[%20and%20Integrity%20Act%20Cap.%20182%20-%20No.%2019%20of%202012/subsidiary%20legislation/docs/LeadershipandIntegrityAct19of2012\\_subsidiary.pdf](#). Public Office Ethics Act 2009:  
[http://publicofficialsfinancialdisclosure.worldbank.org/sites/fdl/files/assets/law-library-files/Kenya\\_Public%20Officer%20Ethics%20Act\\_2003\\_revised%202009\\_EN.pdf](http://publicofficialsfinancialdisclosure.worldbank.org/sites/fdl/files/assets/law-library-files/Kenya_Public%20Officer%20Ethics%20Act_2003_revised%202009_EN.pdf) and 2016:  
[http://kenyalaw.org/kl/fileadmin/pdfdownloads/LegalNotices/2016/54-Public\\_Officers\\_Ethics\\_Act\\_Public\\_Service\\_Code\\_of\\_Conduct\\_and\\_Ethics\\_\\_2016.pdf](http://kenyalaw.org/kl/fileadmin/pdfdownloads/LegalNotices/2016/54-Public_Officers_Ethics_Act_Public_Service_Code_of_Conduct_and_Ethics__2016.pdf)

<sup>50</sup> "the National Treasury is now in a position to operationalize the Treasury Single Account starting July this year" (2017). (Rotich, 2017, p. 13)

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commodity is exempt from VAT, it implies that the manufacturer incurs VAT on the raw materials, however they are unable to recover this amount from VAT on the sales. The manufacturer is therefore forced to adjust prices on the commodities as a means of compensation, increasing the price of basic commodities.” More appropriate would be Zero Rating. ). ICPAK also recommends a more progressive VAT with a Standard Rate, a reduced rate of 30% of the Standard Rate and a luxury rate of 130% of the Standards Rate) (P. 33f.)

### **6.3.4 Wealth transfer tax?**

In a paper available via the World Bank (Mutuma), the author examines the justification and possibility of a Wealth Transfer Tax for Kenya, taxing inheritances and gifts. Starting from the experience of Japan he concludes that a Wealth Transfer Tax would be legally possible (i.e. fit into the present legal framework), administrable by KRA and, balancing pros and cons, overall beneficial and doable for Kenya.

## **6.4 Tax administration**

### **6.4.1 Mixed approach**

Whistleblower, ICT AND personnel

### **6.4.2 Regarding staff**

#### **6.4.2.1 More personnel**

How to fill gap between that which has been approved and that which can be filled? And: Hiring external personnel for compliance (“withholding agents” for rent...): They are certainly cheaper to pay than civil servants At the same time: how qualified is external personnel, how is it with tax secrecy and professionalism? Are the liable to bribes? A good insurance against corruption is the fear of losing not only payment but welfare and retirement packages.

#### **6.4.2.2 Attractive remuneration**

Payment, promotion, welfare pack

#### **6.4.2.3 HNWI unit**

As Uganda: Spurred by the results of the study mentioned above, the Uganda Revenue Authority established a high-net-worth individual unit in September. The new unit has been a significant success, raising an impressive [\\$3.3 million](#) in revenue by February.<sup>51</sup>

### **6.4.3 Regarding ICT**

We refer back to the Discussion on ICT we had in VI/3/10#.

Computers are good insofar they

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<sup>51</sup> <http://www.ictd.ac/blogs/entry/why-african-govs-should-tax-the-rich>

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- make life easier for taxpayers and tax administration by making procedures simpler
- can be used to monitor staff performance
- are a good supporting tool for KRA staffers, e.g. in assisting in complex computing and analytical operations.

At the same time, we believe that there are limits to computerization. Computers are as good as

- People programming and operating them
- Data is complete and we doubt that the data of private and corporate wealth holder is complete and free of manipulation
- They are protected against manipulation and hacking from outside
- A verification and control mechanism is in place to verify the completeness and accuracy of submitted data, e.g. chance checks by tax auditors and fraud investigators
- Legal provisions are preventing the legal or illicit transferring and hiding of assets
- Investigative forces exist who monitor and check on illicit, illegal and criminal tax evasion and fraud.

Before committing to become a “single and fully automated tax collecting agency”, a step to step approach is needed, evaluating and securing gains upon each steps, so that from deficits and shortcomings can be learned, gaps be mended so that a balanced a beneficial “mixed approach” can be established, bringing together legal and administrative reforms, ICT technology and adequate staffing resources.

#### **6.4.4 Reform focus**

Large Taxpayers rather than informal economy, and a strong focus on urban areas, especially Nairobi (see VI/CollectingTaxrealestate#).

Fight crime

#### **6.4.5 Review and reform bodies which are known for deficits**

Constituency Development Fund (see aboveEarmark#)

### **6.5 International cooperation**

Review international trade and taxation regimes. Yes, developed countries will lose under it. But they will also gain, for example, by reducing migration.

Get assistance for tax administrations to be an accepted and integral part of developmental aid and cooperation

### **6.6 Social protection, NHIF**

General

- The government and its development partners can make significant progress in reducing vulnerability and lifting people out of poverty by changing how they allocate their expenditure to social protection programmes.
- Investments in safety nets should increase over time in line with the constitutional obligation for the government to extend social security to all. Financing for the safety

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net subsector should be guided by a framework that considers all sources of funding with a view to ensuring the fiscal sustainability of safety net programmes in the long term.

- The reforms being proposed to the contributory schemes, which include measures to extend coverage to the informal sector, should be implemented urgently and comprehensively. This will not only ensure more equitable social protection coverage but will also yield additional financial resources as a result of the increase in members' contributions. Coupled with rigorous collection of contributions, better investment strategies, and the currently pursued governance arrangements, a more robust financial base for contributory programme will materialize.

NHIF

- Revise individual contributions to reflect income level;
- Increase penalties for NHIF fraud;
- Improve guidelines for the timely management of claims and appeals; and
- Include coverage of preventive health care services within the benefits package
- Address the role of the NHIF within the broader health care financing system, including the drafting and implementation of legislation that would regulate both the public and private sectors within the insurance industry;
- De-link health insurance from the broader Insurance Act, acknowledging that health insurance must have separate regulations from other insurance services;

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