Tax Principles in Kenya

JOHN MUIRURI
MUIRURI TAX ASSOCIATES
What is Taxation?

- A **tax** is a financial charge or other levy **imposed** upon a taxpayer (an individual or legal entity) by a **state** or the functional **equivalent** of a state to fund various public expenditures.

- A failure to pay, or evasion of or resistance to taxation, is usually punishable by law.
**Why Tax?**

- The main purpose of taxation is to accumulate funds for running governments world over.

- Administrative systems and development agendas require funds.

- Taxation is the main system of generating these funds.
The Four R’s of Taxation.
Taxation has four main purposes or effects

1. **Revenue** – to spend on services
   
2. **Redistribution** – transferring wealth from rich to the poor
   
3. **Repricing** – encourages/discourages consumption
   
4. **Representation** – rulers tax citizens, who then demand accountability
The purpose of Taxation
Basic Concepts of Taxation

**Tax Base**

- The tax base is the measure or value upon which a tax is levied.
Proportional Tax

- A proportional tax is a tax whose burden is the same proportion of income for all households.

Progressive Tax

- A progressive tax is a tax whose burden, expressed as a percentage of income, increases as income increases.
Regressive Tax

- A regressive tax is a tax whose burden, expressed as a percentage of income, falls as income increases.

- Excise taxes (taxes on specific commodities) are regressive. The VAT is also regressive.
Marginal versus Average Tax Rates

- The **average** tax rate is the total amount of tax you pay divided by your total income.

- The **marginal** tax rate is the tax rate you pay on any additional income you earn.
Classification of Taxes

The most common and traditional classification of taxes is as follows:

- **Direct tax**

  This is a tax whose burden is borne by the person on whom it is levied.

  - **Examples**
    - PAYE, corporation tax, capital gains tax, wealth tax etc.

  - **Considered to be progressive**
Indirect tax

Indirect taxes are those paid by consumers when they buy goods and services.

- May result with higher retail price
- Levied equally irrespective of income

Examples
- VAT, excise tax, customs duty

Considered to be regressive

However its good to note that some taxes exhibit both characteristics
Canons of Taxation

- **Equality** This states that persons should be taxed according to their ability to pay taxes.

- **Certainty** The time of payment, the manner of payment and the amount to be paid should be clear to every tax payer and not arbitrary.
Canons of Taxation

- **Convenience** the mode and timings of tax payment should be convenient to the tax payer. It means that the taxes should be imposed in such a manner and at the time which is most convenient for the tax payer.

- **Economy / efficiency** Every tax has a cost of collection. The canon of economy implies that the cost of tax collection should be minimum.
History of Taxation

- The First known system of taxation was in **Ancient Egypt** around 3000BC – 2800 BC

- In **Biblical** times, tax is already prevalent. According to Genesis 47:24:

  “But when the crop comes in, give a fifth of it to pharaoh. The other four-fifths you may keep ….”
History of Taxation in Kenya

- **Tribute** was the residence tax during the Spanish times

- **Portuguese** in 1502 charged Sultan Ibrahim Malindi an annual tribute (tax) of 1,500 meticals of gold

- The **British** introduced
  - Hut and Poll Tax in 1901,
  - land tax 1908,
  - Graduated personal tax 1933
The main taxes in Kenya are:

<table>
<thead>
<tr>
<th>National Government taxes</th>
<th>County Government taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Income tax</td>
<td>• Property tax</td>
</tr>
<tr>
<td>• Value added tax (VAT)</td>
<td>• Entertainment tax</td>
</tr>
<tr>
<td>• Excise tax</td>
<td>• Other taxes</td>
</tr>
<tr>
<td>• Custom duty/import duty</td>
<td></td>
</tr>
</tbody>
</table>

Source: RoK, Constitution of Kenya 2010
**Article 209** of the Constitution of Kenya 2010 outlines powers to impose taxes or raise revenue for both

- the national government and
- the county government.

- GOK solely be to impose **income tax**, **VAT**, **custom duties** and **excise taxes**.

- GOK needs to retain the ability to **redistribute** national resources and **stabilize** the economy as the key objectives of the tax systems.
Tax Avoidance & Tax Evasion

Common practices to saving taxes:

- **Tax Evasion;**
  Reducing tax liability by *deliberately* manipulating income or expenditure.

- **Tax Avoidance;**
  Taking full advantage of *loopholes* to attract least incidence of tax. May be illegal.

- **Tax Planning.**
  - *Making use* of all beneficial provisions mentioned in the law.
Tax Crimes

- Failure to file **tax returns**
- Filing **false** tax returns
- **Conspiracy** to impede/defeat the collection of tax
- Keeping **two sets** of books
- Claiming **false** deductions
- **Deliberate** underreporting/omitting of income.
cont...

- **Hiding** or transferring assets or income.

- **Inflated** personal/business expenses.

- Transferring **unreported** income to tax havens.

- Using business funds for **personal expenses**.

- Paying employees **in cash** and not remitting statutory deductions.
## Dispute Resolutions & Tax Assessments

### Pending litigation – Sample

<table>
<thead>
<tr>
<th>No.</th>
<th>TAX PAYER</th>
<th>YEAR FILLED</th>
<th>CURRENT STATUS</th>
<th>AMOUNT (KES)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
<td>2007</td>
<td>Pending Appeal</td>
<td>1,377,505,229.00</td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td>2006</td>
<td>Pending Appeal</td>
<td>1,010,000,000.00</td>
</tr>
<tr>
<td>3.</td>
<td></td>
<td>2002</td>
<td>Pending Appeal</td>
<td>117,000,000.00</td>
</tr>
<tr>
<td>4.</td>
<td></td>
<td>2005</td>
<td>Pending Hearing</td>
<td>2,574,747,385.00</td>
</tr>
<tr>
<td>5.</td>
<td></td>
<td>2008</td>
<td>Pending Appeal</td>
<td>442,205,324.00</td>
</tr>
<tr>
<td>6.</td>
<td></td>
<td>2003</td>
<td>Pending appeal</td>
<td>364,054,006.00</td>
</tr>
<tr>
<td>7.</td>
<td></td>
<td>2005</td>
<td>Pending hearing</td>
<td>206,000,000.00</td>
</tr>
<tr>
<td>8.</td>
<td></td>
<td>2011</td>
<td>Pending Appeal</td>
<td>5,620,730,161.00</td>
</tr>
<tr>
<td>9.</td>
<td></td>
<td>2007</td>
<td>Pending hearing</td>
<td>124,720,037.00</td>
</tr>
<tr>
<td>10.</td>
<td></td>
<td>2007</td>
<td>Concluded. Cannot collect (company went under).</td>
<td>906,656,082.00</td>
</tr>
<tr>
<td>11.</td>
<td></td>
<td>2009</td>
<td>Under Receivership</td>
<td>1,514,489,931.00</td>
</tr>
<tr>
<td>12.</td>
<td></td>
<td>2011</td>
<td>Pending Hearing</td>
<td>529,333,839.00</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>14,787,441,994.00</strong></td>
</tr>
</tbody>
</table>
Example: South Africa Revenue Services (SARS)
## Assessments to Litigation Process

### COST EFFECTIVENESS OF ADR

<table>
<thead>
<tr>
<th>ITEM</th>
<th>Estimated Settlement Costs (ADR Unit)</th>
<th>Estimated Litigation Costs (SARS In-House Lawyers &amp; Counsel)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Salary Cost plus Counsel fees</td>
<td>R11,178,800 (27%)</td>
<td>R41,303,855</td>
</tr>
<tr>
<td>Total cases finalised by ADR/Litigation</td>
<td>357 (155%)</td>
<td>230</td>
</tr>
<tr>
<td>Average cost per finalized case</td>
<td>R31,313 (17%)</td>
<td>R179,582</td>
</tr>
</tbody>
</table>
It is recommended that 80% Tax Disputes should be under ADR

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>ADR %</th>
</tr>
</thead>
<tbody>
<tr>
<td>*Canada</td>
<td>95%</td>
</tr>
<tr>
<td>*Australia</td>
<td>85%</td>
</tr>
<tr>
<td>*Brazil</td>
<td>75%</td>
</tr>
<tr>
<td>South Africa</td>
<td>66%</td>
</tr>
<tr>
<td>Kenya</td>
<td>36%</td>
</tr>
</tbody>
</table>

*Source - USAID’s Leadership in Public Financial Management (detailed guidelines for improved Tax Administration in Latin America and the Caribbean – 2013)*
Questions
The END

info@muirurimacharia.com