# Tax Principles in Kenya

## JOHN MUIRURI MUIRURI TAX ASSOCIATES



## **Taxation Concepts**



### 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.



## **Taxation Concepts**



## 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 purpose of Taxation



#### 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









#### 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



## Classification of Taxes



#### 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
- ExamplesVAT, excise tax, customs duty
- Considered to be regressive
- However its good to note that some taxes exhibit MuiruriTax both characteristics

#### Canons of Taxation



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



## History of Taxation in Kenya



## The main taxes in Kenya are:

National Government taxes	County Government taxes	
• Income tax	<ul> <li>Property tax</li> </ul>	
Value added tax (VAT)	• Entertainment tax	
• Excise tax	• Other taxes	
Custom duty/import duty		

Source: RoK, Constitution of Kenya 2010



## Tax Structure in Kenya



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.





#### 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

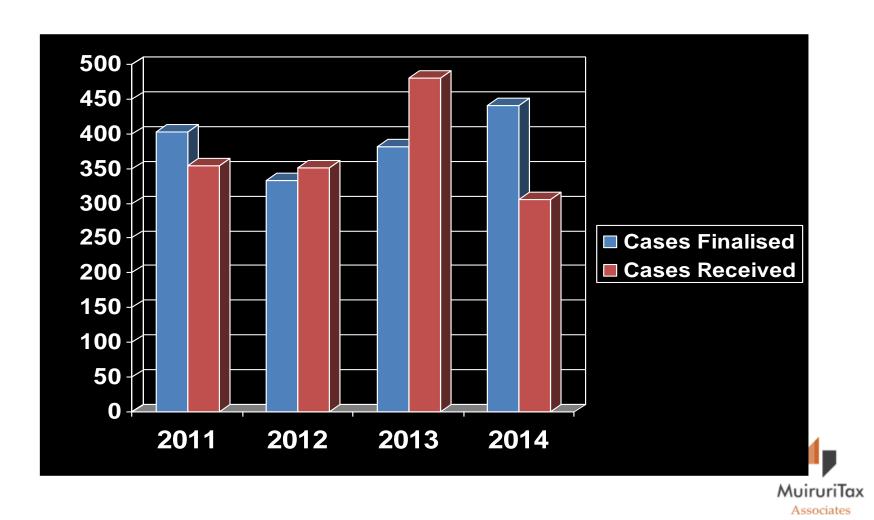
No.	TAX PAYER	YEAR FILLED	CURRENT STATUS	AMOUNT (KES)
1.		2007	Pending Appeal	1,377,505,229.00
2.		2006	Pending Appeal	1,010,000,000.00
3.		2002	Pending Appeal	117,000,000.00
4.		2005	Pending Hearing	2,574,747,385.00
5.		2008	Pending Appeal	442,205,324.00
6.		2003	Pending appeal	364,054,006.00
7.		2005	Pending hearing	206,000,000.00
8.		2011	Pending Appeal	5,620,730,161.00
9.		2007	Pending hearing	124,720,037.00
10.		2007	Concluded. Cannot collect (company went under).	906,656,082.00
11.		2009	Under Receivership	1,514,489,931.00
12.		2011	Pending Hearing	529,333,839.00
	TOTAL			14,787,441,994.00



## Dispute Resolutions & Tax Assessments



## Example: South Africa Revenue Services (SARS)



## Assessments to Litigation Process



#### **COST EFFECTIVENESS OF ADR**

ITEM	Estimated Settlement Costs (ADR Unit)	Estimated Litigation Costs (SARS In-House Lawyers & Counsel)
Total Salary Cost plus Counsel fees	R11,178,800 (27%)	R41,303,855
Total cases finalised by ADR/Litigation	357 (155%)	230
Average cost per finalized case	R31, 313 (17%)	R179,582



## Dispute Resolutions & Tax Assessments



It is recommended that 80 % Tax Disputes should be under ADR

COUNTRY ADR %

\*Canada 95%

\*Australia 85%

\*Brazil 75%

South Africa 66%

Kenya 36%



<sup>\*</sup>Source - USAID's Leadership in Public Financial Management (detailed guidelines for improved Tax Administration in Latin America and the Caribean – 2013)



## Questions







# The END

info@muirurimacharia.com



